

## Korean labor law: The Confusing Administrative Interpretation from the Ministry of Employment and Labor on Calculating Severance Pay

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### I. Introduction

The recent administrative interpretation of severance pay calculations by the Ministry of Employment and Labor (MOEL) is causing confusion in many companies.<sup>1</sup> If a worker who receives 2 million won per month in fixed wage has worked for one year and resigns, he must receive 2 million won in severance pay (total wage for 3 months: 6 million won/90 days x 30 days average wage). However, the MOEL guidance says it should be 2,296,650 won and is ordering companies to be punished if they do not pay the additional 296,650 won. In the case of ordinary wages, if the monthly salary, 2 million won, is divided by 209 monthly contractual working hours, the hourly ordinary wage is obtained (2 million won/209 hours). If this hourly ordinary wage is multiplied by 8 hours, which is the contractual working hours in a day, the normal wage for one day is calculated (hourly wage 9,569 won x 8 hours = 76,555 won). Since the daily ordinary wage is higher than the daily average wage, multiplying the daily ordinary wage by 90 days becomes 2,296,650 won (76,555 x 90 days of daily ordinary wage). This recent administrative interpretation states that, citing Article 2 (2) of the Labor Standards Act (LSA), if the hourly average wage of a worker is lower than the hourly ordinary wage, that hourly ordinary wage shall replace the hourly average wage.

However, this administrative interpretation violates the method for calculating severance pay under the current Employee Retirement Benefit Guarantee Act (the ERBG Act) and does not fit the interpretation of the law by the courts. The ERBG Act states that the principle of calculating severance pay is based on the average wage, and in particular, 1/12 of the total wage for the defined contribution (DC) retirement pension is specified. Court rulings also state that, in calculating average wage, the basic principle is to use the ordinary living wage

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<sup>1</sup> Han Kyung-hee, "Is the higher ordinary wage more often used than the average wage in calculating severance pay?" Korea Apartment Daily, Sep. 15, 2020; Goh Hee-kyung, "Disputes in calculating severance pay at an apartment workplace due to ordinary wage being higher than average wage... Why?" Apartment Management Newspaper, July 24, 2020.

of workers.<sup>2</sup>

Hereby, I would like to look at where the contradictions in the MOEL's administrative interpretation occur, and also examine in detail whether it is appropriate to use ordinary wage rather than average wage in the calculation of severance pay.

## **II. Reasons Why Ordinary Wage is Higher than Average Wage**

### **1. Reduction of statutory working hours**

What is at issue here is that Article 2 (2) of the Labor Standards Act states that if the average wage is lower than the ordinary wage, the ordinary wage shall be the average wage. This provision did not change even when, on March 29, 1989, the existing statutory working hours per week were reduced from 48 hours to 44 hours per week. And on September 15, 2003, the statutory working hours per week were reduced to 40 hours, but there was no change to the provision. That is, the contractual monthly working hours are 240 hours in the 48-hour workweek system, 226 hours in the 44-hour week system, and 209 hours in the current 40-hour week system. Therefore, at the present time, contrary to the purpose of this article, the average wage must be lower than ordinary wage.<sup>3</sup> In other words, the average wage obtained by dividing the total wage by 30 days is actually lower than the ordinary wage, as the ordinary wage becomes the amount obtained by dividing the wage for 20 days by 30. On the other hand, since the ordinary wage is 6 days a week including the weekly holiday allowance, the monthly ordinary wage is divided by 25 days. In this way, the ordinary wage is always higher than the average wage.

### **2. Changes in the wage structure**

In December 2013, the Supreme Court ruled on a very important case related to ordinary wage that regular annual bonuses and various monthly allowances were included.<sup>4</sup>

As a result of this ruling, the annual fixed bonus system, which was the basic framework of Korean company wage structures, was abolished in 2014. The ruling simplifies wage structures. In other words, Korea's wage structure has come to consist of basic wages, legal allowances, and incentives since then,

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<sup>2</sup> Supreme Court ruling on Nov. 12, 1999: 98da49357.

<sup>3</sup> Koo Kunseo, "Strange severance pay calculation," Korea Economy Daily, Jan. 16, 2022.

<sup>4</sup> Supreme Court ruling on Dec. 18, 2013: 2012da89399, 2012da94643.

which increased the level of ordinary wages greatly.

### III. Method for Calculating Statutory Severance Pay and Problems with Recent MOEL Guidelines on Calculating Severance Pay

#### 1. How to calculate statutory retirement pay

The ERBG Act stipulates that severance pay is calculated as average wage equivalent to 30 days for each year of the relevant worker's continuous service. In the defined benefit (DB) pension system, an amount calculated as the average wage of 30 days for each year of continuous service is deposited into the retirement pension account. In the defined contribution (DC) retirement pension system, 1/12 of the total annual wage is deposited into the retirement pension account. This is equivalent to 8.3% of the annual salary. Because a defined contribution (DC) retirement pension system pays a fixed amount each year, it cannot be recalculated later because the ordinary wage is higher than the average wage.<sup>5</sup> As such, it can be said that severance pay is clarified by calculating the average wage, which is the total wage, in the ERBG Act.

In this way, severance pay and retirement pension are calculated with the average wage, which is the total wage. The reason for calculating and paying the average wage is to protect the living wage of workers and to match a certain wage level in terms of severance pay or accident compensation. The Labor Standards Act provides three ways to protect the level of average wage. First, if the average wage is lower than the ordinary wage, it is stipulated that the ordinary wage shall be the average wage (Article 2, Paragraph 2). Second, the calculations of average wage exclude the probationary period of workers, periods of absence due to reasons attributable to the employer, periods of maternity leave, periods of recovery from work-related illnesses or accidents, periods of childcare leave, periods of legal industrial action, etc. This is an exception to the calculation of average wage, and is a limited enumeration provision to prevent the average wage from being unreasonably low in special cases for workers.<sup>6</sup> Third, despite the exceptions to the above Enforcement Regulation to the Labor Standards Act, if the average wage fluctuates significantly due to the worker's accidental circumstances, the notice on special cases for calculating the average

<sup>5</sup> Supreme Court ruling on Jan. 14, 2021: 2020da207444.

<sup>6</sup> Supreme Court ruling on July 25, 2003: 2001da12669.

wage determined by the MOEL (Article 4 of the Enforcement Decree to the LSA) is applied.<sup>7</sup>

## 2. Problems in using ordinary wage when calculating severance pay

Currently, the MOEL is saying that severance pay should be calculated using ordinary wage when the average wage is lower than ordinary wage.<sup>8</sup> However, in principle, severance pay should be based on calculations using the average wage, and ordinary wage should help to prevent a decrease in severance pay if average wage is lower. Currently, the severance pay and defined benefit (DB) retirement pension plan under the ERBG Act are calculated as the average wage of 30 days for each year of continuous service. One-twelfth of the total annual wage for defined contribution (DC) retirement pension plans is taken as a reserve fund. According to this guideline, all calculations of retirement benefits that currently reflect average wages should be converted to reflect ordinary wages (Article 12 of the ERBG Act). If this happens, the calculation system of the ERPG Act will be broken, resulting in chaos. In other words, the administrative interpretation of the MOEL is not in line with the interpreted purpose of this Act, as it results in the use of the ordinary wage as a supplement to the average wage used in the calculation of severance pay.

## IV. Purpose of Average Wage in Calculating Severance Pay and the Clause to Use Ordinary Wage in Exceptions

### 1. Purpose of using average wage in calculating severance pay

The severance pay system was introduced to ensure that companies can guarantee an income for their workers in their old age when there was no old-age pension in Korea. Therefore, the calculation of severance pay using average wage, which is the total amount of wages, was prepared in consideration of the fact that there is no disadvantage by reflecting the ordinary living wage of workers.<sup>9</sup> Since the total wage is the average wage, it has always been higher than ordinary wage, which reflects only fixed and regular wages. For this reason, Article 46 of the Labor Standards Act

<sup>7</sup> Supreme Court ruling on June 25, 2020: 2018da292418.

<sup>8</sup> MOEL Guidelines: Labor Standards-3405, Aug. 25, 2020.

<sup>9</sup> Supreme Court ruling on April 12, 1994: 92da20309; Supreme Court ruling on Nov. 12, 1999: 98da49357.

stipulates that 70% of the average wage or 100% of the ordinary wage must be paid as leave of absence allowance for periods attributable to the employer. This is because the use of average wages is the basis for severance pay regulations and accident compensation for workers. However, ordinary wage is calculated for the purpose of calculating hourly wage, and so such ordinary wage is used when calculating paid allowances stipulated in the Labor Standards Act, such as overtime pay and unused annual allowance under the Labor Standards Act. Because ordinary wages refer to fixed and pre-promised wages paid for the contractual working hours when a labor contract is drawn up, while the average wage is paid according to the rate of attendance at work, it does not decrease.

## **2. Reasons for placing the clause to use ordinary wage in exceptions when calculating severance pay**

The basic principle of average wage is to calculate the ordinary living wage of workers as a matter of fact. Severance pay is based on the average wage for the same reason.<sup>10</sup> According to Article 2 (2) of the Labor Standards Act, if the total wage decreases due to abnormal work, the average wage will be lower than the normal wage, so then the ordinary wage is used.<sup>11</sup> The precedent also stipulates that if the amount calculated as the average wage is lower than the ordinary wage of the worker concerned, the ordinary wage shall be the average wage in Article 2 Paragraph 2 of the Labor Standards Act. The purpose for this is to guarantee the minimum average wage in case the wage is significantly lower than in normal cases due to reasons attributable to the worker or an inability to work normally due to reasons attributable to the worker during the three months prior to the occurrence of the reason for calculating the average wage.<sup>12</sup> Here, ordinary wages refer to fixed wages in advance that are set to be paid regularly and uniformly regardless of the actual provision of work. For this reason, Article 2 (2) of the Labor Standards Act is used in cases where the average wage falls short of the ordinary wage.<sup>13</sup>

## **V. Conclusion**

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<sup>10</sup> Supreme Court ruling on Nov. 12, 1999: 98da49357.

<sup>11</sup> Gwangju Appellate Court ruling on Dec. 22, 2015: 2004nu1062.

<sup>12</sup> Seoul Administrative Court ruling on July 1, 1999: 98gu19789.

<sup>13</sup> Supreme Court ruling on June 28, 1991: 90daka14758; Supreme Court ruling on Dec. 26, 1990: 90daka12493.

Severance pay is the wage calculated as the average wage of 30 days per year of a worker's continuous service. Here, the average wage falls short of the ordinary wage in situations in which workers are not protected by law, such as for absenteeism or personal leaves. At present, the ordinary wage is often higher than the average wage even in general cases, not just in special cases. This is because the standard calculation formula for ordinary wages is calculated on the basis of 6 days (including weekly holidays) in the 40-hour work week system, while average wage is calculated on the basis of 7 days a week. Accordingly, the provision in Article 2 (2) of the Labor Standards Act shall be added as a supplement when the average wage is lower than the ordinary wage, because the average wage shall be applied in accordance with the purpose of the Act. This is because, as can be seen with the MOEL's recent administrative interpretation, if the formula for calculating severance pay with ordinary wages is established, the severance pay systems in the Retirement Benefit Guarantee Act must be revised completely.