

# Pension Reform Options in Korea

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## I . Introduction

Although public pension was introduced in Korea relatively late, it has grown quite rapidly over the past 50 years. Starting from the civil servant pension in 1960, the military personnel pension was separated from the civil servant pension scheme in 1963. The private school teachers' pension was introduced in 1975. However, since its introduction in 1988, the national pension became Korea's major public pension scheme and the key social insurance program, currently covering almost entire labor force, at least in principle. Meanwhile, the introduction of individual pension scheme in 1994 and retirement pension scheme for private sector employees in 2005 has established a multi-pillar income security system.

The rapid and compact growth of income security systems in Korea resembles its economic growth. However, though the overall frame of the multiple income security system has been completed in very short period of time, its contents need further improvement to tackle various challenges. The extension of coverage of each pension scheme is one of the most urgent issues. This is essential for the national pension to enhance its role of providing income security. Although it has comprehensive coverage by law, in reality, it still excludes a large number of vulnerable groups from its application.

Because world-wide zeal for pension reform had just begun in the end of 1980s, as soon as it was initiated, the national pension was confronted with strong forces to push its reform for the long term sustainability. As a result, the national pension scheme was reformed at the end of 1998 to reduce its benefit level from 70% as of earnings replacement ratio to 60% and raise pensionable age from 60 to 65. It also introduced a financial review system every five year. This reform improved the financial robustness of the national pension scheme. However, its first financial review in 2003 concluded that the scheme required another reform. The proposal for the second national reform was suggested in the late 2003, but compared to the first reform there was greater struggle to pass the reform act. The second reform act was finally enacted in July 2007.

In the process of pursuing the second national pension reform, the poverty of the elderly was rising as a big issue, resulting in the introduction of the basic old age pension in 2007 through tough political negotiations between the political parties. The basic old age pension scheme is tax-based non-contributory benefit, which covers 70% of the elderly aged 65 and over. In spite of its large coverage, its low level of benefit may be insufficient to eliminate the poverty of the elderly (Yoon, 2012).

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Overall, Korea's public pensions systems have confronted difficult challenges to extend coverage of income security systems on one hand, and to alleviate poverty of the current and future elderly people on the other, while improving its overall long term solvency. Considering the limited resources, it is extremely difficult to simultaneously resolve the conflicting challenges. A wise social consensus is necessary to push ahead the tasks successfully.

This paper looks into the evolution of the national pension system in Korea and examines the possible changes for the future. The organization of this paper is as follows. The first section will provide an overview of current public pension systems in Korea. Next a brief history of national pension reforms in Korea will be examined. Finally, the necessity of another national pension reform and some pension reform options will be reviewed and followed by summary and conclusion.

## **II. Overview of Current Public Pension Systems in Korea**

Korea's income security system is composed of multi-pillars. The national pension scheme is by far the largest covering 19.89 million insured persons as of Dec. 2011. The number of affiliated persons under the public occupational pension schemes for civil servants, private school teachers and military personnel only covers 1.39 million. The size of insured persons under private pension schemes – retirement pension and individual pension – is also still quite small. Meanwhile, the basic old age pension enforced since 2008, which is a means tested benefit, covers 70% of the elderly. The national basic livelihood security scheme acts as the last resort of the safety net and a social assistance program. The scheme was transformed from a livelihood care scheme of a very residual program introduced in 1960 to a top-up benefit program in 2001.

**Table 1: Overview of Current Income Security Systems in Korea**

3 <sup>rd</sup> pillar	Individual pension(1.62 million insured persons, Dec. 2009)		
2 <sup>nd</sup> pillar	Retirement Pension (3.49 million insured persons, Feb. 2012)	Public Occupational Pensions (1.39 million insured persons, Dec. 2010)	
1 <sup>st</sup> pillar	<b>National Pension</b> (19.89 million insured persons, Dec. 2011)		
0 pillar	Basic Old Age Pension(Tax-based and means tested, 70% of the elderly aged 65 and over, 3.80 million beneficiaries, Dec. 2011)		
	National Basic Livelihood Security (1.47 million beneficiaries, Dec. 2011): poverty households		
Covered Groups	Employees	Self-employed	Others Civil servants, Private school teachers and Military personnel

Sources: collected from statistics of each scheme

In Korea, as both public and private pension schemes – national pension, retirement pension and individual pension - have all been introduced within 20 years, they have competed extensively to increase applicants. However, with the advent homo hundred period and people’s better acknowledgement on importance of advance preparation for their old age, the national pension has confirmed its strong position as the most basic provision.

Starting with just over 4 million insured workers applied to workplaces with 10 workers or more in 1988, the national pension soon began to rapidly extend its compulsory application. It was compulsorily applied to rural areas in 1995 and also to urban areas in 1999, covering total labor force between the age of 18 and 59. Due to the compulsory application to urban areas, the number of those insured by the national pension made a huge increase to over 16 million at the end of 1999 from less than 7 million in the previous year. Following the 1997 Asian financial crisis, the number of insured dropped temporarily between 1998 and 1999 but since then has continued to grow. Meanwhile, the recent global recession initiated from the collapse of the U.S. housing market in 2007 did not have any negative effect on the increasing trend of the number of insured. Rather the number of insured has been rising more quickly over the recent years due to people’s increasing interests about their old lives.

**Table 2: Number of the insured in the National Pension (at the end of the year)**

(Unit: thousand persons)

1988	1992	1994	1995	1998	1999	2007	2008	2009	2010	2011	09. 2012
4,433	5,021	5,445	7,497	6,580	16,262	18,267	18,335	18,624	19,229	19,886	20,141

Source: Statistical data base, National Pension Service

As of December 2011, the proportion of those insured by public pension schemes was 57.0% for working age group between 15 and 64, and 90.6% for labor force aged from 15 to 64. Meanwhile, for those between 18 and 59 whom the national pension scheme is compulsorily applied, the coverage was higher; 64.7% and 95.7%, for working age group and labor force, respectively. However, the proportions of current contributors are much less than those of the insured. The proportion of current contributors of public pension schemes is 40.4% for working age group between 15 and 64, 64.2% for labor force of same ages, and 45.8% and 67.7% respectively for age group from 18 to 59.

**Table 3: Size of the insured of public pension schemes(As of December 2011)**

(Unit: thousand persons, %)

		working age: 15~64	labor force: age 15~64		working age: 18~59	labor force: age 18~59
<b>Working age 15-64 (A)</b>	<b>37,233</b>			<b>Working age 18~59 (A')</b>	<b>32,793</b>	
<b>Labor force: age 15~64 (B)</b>	<b>23,421</b>			<b>Labor force: age 18~59 (B')</b>	<b>22,182</b>	
<b>Number of the insured of public pensions (C)</b>	<b>21,227</b>	<b>57.01 (C/A)</b>	<b>90.63 (C/B)</b>	<b>Number of the insured of public pensions (C')</b>	<b>21,227</b>	<b>64.73 (C'/A')</b> <b>95.69 (C'/B')</b>
(National pension)	(19,823)			(National pension)	(19,823)	
(Public occupational pensions) <sup>1</sup>	(1,404)			(Public occupational pensions) <sup>1</sup>	(1,404)	
<b>Current contributors of public pensions (D)</b>	<b>15,024</b>	<b>40.35 (D/A)</b>	<b>64.15 (D/B)</b>	<b>Current contributors of public pensions (D')</b>	<b>15,024</b>	<b>45.81 (D'/A')</b> <b>67.73 (D'/B')</b>
(National pension) <sup>2</sup>	(13,620)			(National pension) <sup>2</sup>	(13,620)	
(Public occupational pensions) <sup>1</sup>	(1,404)			(Public occupational pensions) <sup>1</sup>	(1,404)	

Note 1: Public occupational pensions above include schemes for civil servants, private school teachers and military personnel.

2: Subtracted those who are being exempted from contributions payment due to no earnings and those who have reported their earnings but have not paid contributions more than 1 year from the total insured

Source: Statistical Data of National Statistical Office, National Pension Service, Government Employees Pension Service, Korea Teachers Pension and Ministry of National Defense

The proportion of beneficiaries aged 65 or more under public income security systems reached 82.2% of as of the end of 2011. The proportion of pensioners from public insurance pension schemes stood at 31.6% and it is rising every year owing to the increase of pensioners of national pension. However, most beneficiaries of public income security schemes for the elderly come from the basic old age pension which has been stipulated by law to cover 70% of the elderly. Dual beneficiaries from the national pension and the basic old age pension are increasing every year due to the fixed rate of beneficiaries in the basic old age pension and the increase of pensioners in the national pension.

**Table 4: Size of Beneficiaries of Public Income Security for the Elderly**

(Unit: Thousand Persons, %)

Total Population Aged 65 and over	Basic Old Age Pension (BOAP) Recipients	Recipients of National Pension (NP) and/or Public Occupational Pensions (POP)	Non-beneficiaries
<b>5,701</b> <b>(100.0%)</b>	<b>3,796</b> <b>(66.6%)</b>	<b>1,799(31.6%)</b> (NP 1,577+POP222)	<b>1,013 (17.8%)</b>
	Only BOAP <b>2,889 (50.7%)</b> , NP+BOAP <b>907 (15.9%)</b> , Only NP or POPs <b>892(15.7%)</b> <Total= <b>4,688, 82.2%</b> >		

**Sources:** Residents registration statistics, National statistical Office (Dec. 2011); National Pension and Basic Old Age Pension Data base (Dec. 2011); Government employees Pension Scheme (Dec. 2010); Private School Pension Scheme (June 2010); Military Personnel Pension Scheme (Dec. 2011).

### III. Brief History of National Pension Reforms in Korea

#### 1. Introduction and the First Reform of National Pension

The national pension was enforced in 1988 by the national pension act revised in 1987. The national pension act was actually legislated in 1973 but its enforcement was prolonged indefinitely due to the sudden world economic recession instigated by the first world oil shock. At first, it was applied to workplaces with 10 workers or more but was extended to workplaces with 5 workers or more in 1992. Its application was also extended to rural areas in 1995, where the insured persons were managed individually. As population residing rural areas was small in Korea, the number of the insured increased just around 2 million from 1994 to 1995, (Refer to table 2) and the size of the insured aged from 18 to 59 was only about 1/3 of the total labor force of the corresponding age group at the time.

Prior to the scheduled extension of national pension application in urban areas in 1998, the committee for the national pension reform was established in 1997 as the scheme had raised doubts about its long term sustainability since its introduction. The committee submitted its reform measures to the government at the end of the same year. The majority of the committee members favored the

structural reform of national pension which was to change the existing system into a dual pension system of basic pension and earnings related pension. However, the revised act of the end of 1998 was passed with the contents of parametric reform. Meanwhile, due to outbreak of Asian economic crisis at the end of 1997, the extension of national pension to urban areas was delayed to April 1999. With the 1999's application of national pension to urban areas, most labor force in Korea became covered by the public pension schemes by law.

Before the first reform, the financial state of national pension was good in the short term because the scheme was in its initial stage; the ratio of expenditure to accumulated fund was 20.7 times as at the end of 1998 and the fund was increasing. However, due to unbalanced contribution (9%) and benefit (70%) as well as the trend of rapid ageing in the Korean society, the fund was projected to be depleted by 2031. (NPRI, 1998)

By the 1998's pension reform, the benefit of national pension was reduced from 70% (as of earnings replacement rate of the insured person with average earnings and 40 qualifying years) to 60% from January 1999, while the contribution rate was kept at 9%. The pensionable age was raised 60 to 65 every 5 years from 2013 to 2033. The financial review system was introduced to project the long term finance of the national pension and suggest measures for improving the system every five years. Most people did not recognize the first pension reform during the process because there were only a handful of pensioners at the time and most people did not understand the necessity or meaning of the public pension. Therefore there was almost no resistance against the reform.

## **2. Second Pension Reform in 2007**

In virtue of the successful first reform, the first national pension financial review in 2003 showed that the depletion year of national pension fund would be postponed to 2047 (Committee on the Development of the National Pension, 2003). However, members of the committee evaluated that the financial status of the national pension need further improvement asking for another reform. The government proposed the bill for national pension amendment composed of an increase of the contribution rate and a reduction of the benefit level. However, the bill was not passed. The opposition party at the time proposed another bill at the end of 2004 to change the structure of national pension completely to an earnings related pension, 20% of individual life-long earnings and a universal tax based basic pension, 20% of average earnings of the total insured of the national pension.

The pension reform proposals of the government and the opposition party went through serious controversies for nearly 4 years, finally resulting in the introduction of basic old age pension scheme with 70% of coverage and 5% of average earnings of the national pension in terms of its benefit level. Also, the benefit level was to be reduced from 60% to 40%, starting from 50% in 2008, incrementally dropping by 0.5%pt every year between 2009 and 2028 since then.

As a result of the second reform of the national pension in July 2007, the depletion year of the national pension fund was projected to be extended to 2060. However, as the pension reform was performed without social consensus on the definition of the financial stability or its long term financial goal, it has been ambiguous whether the national pension could be evaluated to have achieved long-run financial solvency. Accordingly, soon after the first reform, some of experts have strongly argued the national pension needs another reform to make it financial solvent in the long term. Meanwhile, some groups of civil rights activists, social welfare experts, and politicians have insisted that solving elderly poverty and securing adequate benefits should be the social priorities of the pension system.

The basic old age pension law stipulated its benefit level to increase from 5% to 10% by 2028 and to establish a special committee in the parliament in order to determine the modes of financing and the schedule of the benefit increase. However, such matters are still pending without making any decision. Accordingly, restructuring of national pension and basic old age pension will be one of the priority issues to be addressed, in relation to the development of Korea's income security system.

The structure of Korea's public pension system seems to have made considerably changes by the two pension reforms. The national pension reforms were pushed forward with recognition of future threats influenced by reforms in developed countries rather than by the domestically felt needs. Meanwhile, during the process of the reforms, many people did not have good understanding of the meanings of the national pension as an income security program because most of them have been applied to the scheme for only a short period and had not received any benefit.

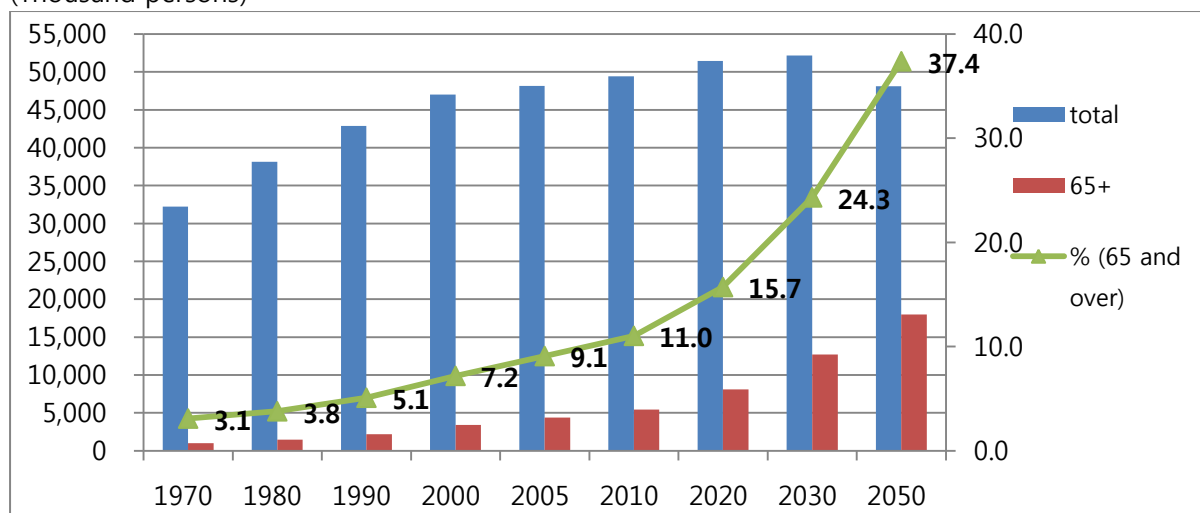
## **IV. Necessity of Another Pension Reform**

### **1. Changes of Population and Family Structure**

Population ageing in Korea is happening in a fast pace. The population aged 65 and over stood at 3.1% in 1970, 5.1% in 1990, and 11.0% in 2010. The size of the elderly doubled within 20 years from 1990 to 2010. The proportion of elderly population will continue to increase rapidly in the future, reaching 37% by 2050.

**Figure 1: Population Ageing in Korea**

(Thousand persons)



Source: National Statistical Office (2011), Long term population projection

Meanwhile, life expectancy which was 61.9 in 1970 has increased to 71.3 in 1990, 76.0 in 2000, and 81.0 in 2010. It is expected to be 84.3 in 2030 and 87.4 in 2050, according to the 2011 population projection. On the other hand, the total fertility rate (TFR) which was 4.53 in 1970, dropped sharply to 1.08 in 2005. It has slightly increased over recent years, reaching 1.23 in 2010. However, the increase of TFR is not much expected in the future. Due to the increase of life expectancy and low fertility rate, elderly dependency ratio was 15% in 2010, but was projected to be 71% in 2050. (National Statistical Office, 2011)

Urbanization and increase of nuclear family has led to a growth of single household. The number of the single elderly household shows an especially significant expansion owing to greater increase of their life expectancy. The proportion of single elderly household was 24.0% in 2000, and 25.4% in 2010, but is expected to be 29.7% in 2020 and 39.8% in 2030. (NSO, 2011) The current elderly has been less supported by their children compared to their parent generations, and thus the increasing future elderly should find means to support themselves.

## 2. Poverty of the Elderly

OECD reported recently that the poverty rate of the elderly aged 65 and over in Korea was 45.1%, the highest among OECD countries. (OECD, 2008) The reason why the elderly in Korea are so poor may be due to a sudden collapse of the traditional family support system as a result of the rapid increase of nuclear families and ageing. Most elderly in Korea did not expect they would live so long,



and thus did not prepare for their later years in advance. In tradition, Korean parents have invested in their children, who they depended upon in their old age. The prevalent poverty among the elderly is natural result of the change in the family structure and the extension of life-span.

When the national pension was introduced in 1988, the proportion of the elderly was only around 5 % and the average life expectancy was 70 years. Thus, people at the time, who were unaware of the fast changing age structure, did not realize the importance of making advance preparation for their old age. As the national pension is a social insurance of which the benefit can be paid only when the insured has fulfilled the qualifying conditions, the elderly without adequate contribution careers cannot receive pension benefits. Meanwhile, young people who think supporting their parent as their obligation have continued to decrease. The proportion of private transfer occupied to total income among the elderly has also been decreasing in Korea from 54.8% in 1990 (Japan Ministry of home affairs, 2002) to 44.7% in 2008 (Ministry of Health and Welfare, 2008).

### **3. Inadequacy of Income Security**

The national pension pays old age pension to the insured person who has fulfilled minimum qualifying years and who becomes 61 years as of 2013. The minimum-qualifying-year is ten but it was exceptionally applied five by March 2009 since its introduction. Therefore, due to the short insurance period, the average amount of the old age pension was only 15.4% of the average earnings of the total insured as of the end of 2011. For the newly awarded, the proportion was higher standing at 20.5%.

Although the national pension is maturing and average contribution years of the insured are increasing, as its benefit level is going down, the average pension amount for future pensioners is not expected to increase much. The fact that the amount of benefit was reduced through the 2007 national pension reform can be interpreted as the acceptance of the multi-pillar system as a form of enhancing income security. To make this proposition true, the multi-pillar system should operate well. However, the current real benefit level of the national pension is low and is anticipated to be kept low in the future, and the private pension system are still in infant stages. The retirement pension introduced in 2005 covers only 9.8% of the total workplaces and 38.3% of the total regular employees as of February 2012. Since the history of this program is very short, the pensioners of retirement pension schemes have not appeared yet. The low coverage and continuous contract rate of individual pension impose many challenges that the future of private pension schemes needs to overcome.

The introduction of the basic old age pension seems to be a good policy for the elderly who never had an opportunity to be covered by public insurance pension schemes. However, despite the 70% coverage, its low benefit level has been assessed to have little impact on ameliorating poverty of the

elderly. Accordingly, many civil activists and law makers have insisted on an immediate increase of the benefit level. However, while greater amount of finance is needed to make the basic old age pension universal and sufficient to alleviate poverty, the source of financing has not yet been discussed.

#### 4. Sustainability of the Pension Schemes

##### A. Financial Stability and Adequate Size of Accumulative Fund

After the two reforms for a long term financial stability, the fund of national pension is projected to exhaust in 2060. Though the ratio of expenditure to assets is decreasing, it is expected to be 5.8 in 2050. While most developed countries reformed their public pension when the fund was nearly exhausted <sup>1</sup>(Kim, 2010, p136), the national pension in Korea was reformed when its fund was still accumulating. However, although the fund will remain for quite a long time, the future of national pension is insecure as there are currently no plan after the fund has depleted.

**Table 5: Long-term Financial Projection of the National Pension 2008**

(Unit: billion won, time, %)

year	Assets(A)	Revenue			Expenditure		Balance	Assets /Expenditure (A/B) <sup>1)</sup>	Contribution Rate	Assets(2005 constant price)
		Total	Contributions	Returns	Total(B)	Benefits				
2008	248,133	41,374	23,808	17,566	6,792	6,373	34,582	31.4	9.00	228,854
2010	325,294	50,851	27,629	23,222	10,328	9,852	40,523	27.6	9.00	282,798
2020	923,985	109,949	53,421	56,528	31,818	31,364	78,131	26.6	9.00	624,472
2030	1,738,946	176,064	87,150	88,913	86,287	85,525	89,777	19.1	9.00	964,123
2040	2,413,567	240,844	127,764	113,080	198,670	197,440	42,174	11.9	9.00	1,097,752
2043	2,464,507	252,055	140,901	111,154	244,861	243,454	7,194	10.0	9.00	1,056,269
2044	2,459,151	257,173	145,974	111,198	262,529	261,057	-5,356	9.4	9.00	1,033,307
2050	2,110,154	278,988	181,417	97,571	377,879	375,952	-98,891	5.8	9.00	787,331
2060	-214,225	231,684	231,684	0	596,793	593,799	-365,108	0.3	9.00	-65,571
2070	-	308,703	308,703	0	843,119	838,471	-534,416	-	9.00	-
2078	-	387,432	387,432	0	1,044,438	1,037,827	-657,006	-	9.00	-

Source: The 2<sup>nd</sup> Financial Review Report (2008), the National Pension Financial Review Committee

Furthermore, the new long term population projection in 2011 showed that Korea's population structure would worsen. According to the 2012 national pension projection by the National Assembly Budget Office, which used the new long term population projection and more parsimonious assumptions on economic variables, the depletion year would be moved forward to 2053. (NSBO, 2012)

The new national pension financial projection by the 3<sup>rd</sup> financial review will be officially

announced by the government at the end of March 2013. Based on the new projection, the reform measures will be discussed by the committee to improve the national pension system. This time, the measures for long term financial stability should be more permanent as frequent reforms and conflicts have created enormous fatigue in the society.

Meanwhile, as the national pension fund became tremendous in size, adequate operation is becoming a big issue. The size of national pension fund is the 4<sup>th</sup> largest among public pension funds in the world as of the middle of 2012. With its huge growth, the importance of managing the fund is growing along with its influence in markets. The major issues recently raised on the operation of national pension fund includes policy directions of fund operation, adequate assets allocation in domestic and foreign investments and in stocks, bonds and alternative investments, and the types and sizes of the fund. The governance structure is also receiving great attention as well as the issue of offering shareholder's voting rights to the national pension and the validity of making social investment with the fund. The size of fund will become much bigger if the contribution rate of national pension increases for its financial stability. If so, the fund operation would be more of an important issue.

## **B. Fairness**

Due to the scheme's immaturity, the pay-as-you-go rate of national pension stood at only 3.0% in 2010, much lower than the present contribution rate of 9%. However, because speed of ageing in Korea is very fast and the size of pensioners will quickly increase, pay-as-you-go rate will also grow very fast reaching 21.9% in 2060.

**Table 6: Pay-As-You-Go Rate of National Pension (%)**

2010	2020	2030	2040	2050	2060	2070	2078
3.0	4.9	8.2	13.1	17.7	21.9	23.2	22.9

**Source:** Committee of National Pension Financial Review (2008), Report of the 2<sup>nd</sup> National Pension Financial Review

Under the present contribution-benefit structure of national pension, the present generation receives greater benefit compared to their contributions payment. Thus, the future generations have to bear the cost of this gain. The unbearable burden of the future generations can raise conflicts between generations. Young generations may also avoid the scheme.

On the other hand, due to the benefit calculation formula, the fairness of the national pension among different income strata is recognized to be quite good. As the earnings used to compute the national pension benefits are the average of the A value (average earnings of the total insured) and the

B value (the participant's own life-long average earnings), a person whose earned income is less than A value can get greater benefit.

However, many low income earners and the elderly without any contribution career currently cannot access national pension because the scheme requires contributions to receive benefits. As a result, the biggest beneficiaries of the national pension may be those who were first to apply to the scheme and kept their contribution payments. On the other hand, future generations including the present young generation must bear larger burden, while the generations before the introduction of national pension cannot get any benefit from the scheme. Furthermore, those who failed to meet their contribution payments will also be excluded from the scheme. As a result, the public insurance pension may not be able to cover a considerable proportion of population.

Along with the size of the currently poor elderly, easier accessibility to the public insurance pension and less financial burden to the future generations should also be considered. Through adequate measures, it is necessary to enhance fairness between generations and among income strata, while providing better care for the less privileged.

### **C. Compliance with the Pension Schemes**

To sustain pension schemes in the long run, it is essential for people to be supportive, and comply well with the plan. Since the introduction of the national pension system, the government and the National Pension Service have made hard efforts to improve its compliance. Since 2010, when the first generation of baby boomers, born in 1955, retired at the age of 55, the media has highlighted their expected future. The media has also shed light on the homo- hundred-period and the income security of the older people. As people have recently become more interested in their future income security and have realized the high return of rates of the national pension scheme, the size of the insured by the national pension is increasing rapidly, especially in the voluntary affiliation. Over 3 million pensioners who gradually increased also have contributed to the change of recognition and the compliance rate. The compliance with the retirement pension schemes is also improving steadily. Meanwhile, for higher affiliation of private pension schemes, its governance and regulations should be improved.

## **5. Systematic Role Allocation Among Pension Schemes**

The income security system in Korea has become a multi-pillar system over a relatively short period of time. However, it is still immature and inadequate in terms of the benefit levels. Each scheme in the system is trying to improve its quality and quantity as soon as possible. However, in pursuance of such efforts, they have been competitive and conflicting. For example, while the national pension started to give subsidy to contributions of low income workers since 2012, the retirement

pension has also tried to introduce similar program. Meanwhile, the most urgent task to be addressed in the pension schemes may be the positioning of the basic old age pension within the while income security system. Since various public and private pension systems have been introduced almost at once in a short time, they have not yet allocated their proper roles. To develop systematic income security schemes in Korea, it is necessary to draw a blue print for the short and long term income security system and to credibly enforce the plan.

## **V. Pension Reform Options and Assessments**

### **1. Tasks of Pension Reform**

#### **A. Establishment of Minimum and Adequate Standards of Income Security**

The income security systems in Korea have developed in a piecemeal manner adjusting to the short-term circumstances without a systematic plan. Therefore, before pursuing new pension reform, it would be better to make both a long and short term blue print for the income security. Before making the blue print, the minimum and adequate standards for the income security should be clearly defined, although the diverse positions in the society make it extremely difficult to reach a consensus. Referring to the fact that the benefit levels of basic pension in some of OECD countries are 15%~25% of average income, a minimum standard of pension benefit could be determined. There is no common definition of the adequate income level for old age, but 60~70% of income before retirement is mentioned to be adequate for old age life. However, it should be kept in mind that the level will be higher for the low income strata and lower for the high income strata. Accordingly, it is necessary to allow differences in the attainable adequate income level according to the income strata.

#### **B. Arrangements for Adequate Benefits and Extension of Coverage**

Owing to the rapid change in the age structure and the difficulty of making prompt provisions, the poverty of the elderly in Korea became pervasive. Because the national pension scheme is social insurance, the basic old age pension as a social pension could play its role of mitigating the elderly poverty.

At the same time, measures to help the insured acquire longer qualifying years should be made to enhance the adequacy of pension benefits. It will be useful for the vulnerable people who face difficulty of keeping their contributions to receive credits during the periods of raising children or serving the military, while subsidizing their contributions and facilitating voluntary affiliation. In Korea where multi-pillar income security system has been established almost at once, both public and private pension systems should improve simultaneously to secure sufficient income for the old age.

### **C. Enhancing Sustainability**

It is important for public pension schemes to become more sustainable. Although the fund of national pension will be keep accumulating for the next several decades, it will eventually run out. Therefore, it is necessary for the scheme improve its long term financial stability in advance. Meanwhile, the financial states of the public occupational pension schemes in Korea are relatively weak. Thus, the government subsidy for those schemes is increasing rapidly every year, requiring for an urgent reform despite the fact that the last reform was in 2009.

Clarification of the long term financial goal of the pension reform can make its future more predictable. People would have greater trust toward the scheme when they can expect the future of the scheme. The size of total public pension expenditures to GDP in future should be also constantly forecasted and monitored.

### **D. Restructuring Income Security System for Better Harmonization**

The present income security system need restructuring for better efficiency and effectiveness. The basic old age pension has obscure characteristics between social assistance and social allowance. It is not universal but has quite a wide coverage. However, its low benefit level is assessed to be inefficient for ameliorating poverty. Moreover, there is no clear concept on its role for income security of the elderly and has no plan for the future. Due to the ambiguity of the basic old age pension, the position of the national pension is also rather obscure. Positioning of the basic old age pension within income security system will influence the direction of the national pension. Meanwhile, the development of private pension schemes will also contribute to the betterment of the income security.

## **2. Principles of Pension Reform**

### **A. Adequacy of Benefit**

The minimum goal of public pension would be achieving freedom from. Regarding that there are still many people who are not covered by the national pension, the basic old age pension may stay for a long time. If public pension schemes can function better in the future, the role of the basic livelihood security program as a last resort could be weakened. Although the adequacy of income security should be attained together by both public and private pension schemes, it is more fundamental to substantially widen the coverage of the national pension and lengthen the average affiliation years of the insured.

### **B. Adequate Level of Burden and Equity between Generations**

Currently, the burden of the income security in Korea is not large. As of 2011, the expenditure of the national pension to GDP was only 0.8% and that of basic old age pension was 0.3%. However, as

national pension matures, the burden will become bigger with the aging society.. To achieve greater sustainability of public pension schemes, new measures are needed to reduce the burden of future generations.

Enhancing equity between generations is a big task in an ageing society. As the benefit level of the national pension has been reduced considerably while its contribution rate is relatively stayed at a low level, the increase of the contribution rate may seem more feasible to improve equity between generations.

### **C. Consideration on Social Acceptance and Feasibility of Reforms**

As the number of the insured and pensioners of the national pension increased and people became more aware of the importance early preparation for their old age, reforming the pension scheme is likely to be more difficult than the past. The reform should be socially and financially acceptable and feasible to succeed. For example, the increase of pensionable age will require a further consideration on the possibility of lengthening the retirement age and adequacy of total pensionable years. Successful pension reform also needs measures on dealing with shocks coming from differences between the present system and the reformed one. Compensation to the loser of the reform also needs to be thought through in advance. As the size of the national pension fund is expected to grow substantially in several decades to come, the appropriate size of the fund should also be considered, since operation can be more difficult when the fund size becomes larger.

## **3. Pension Reform Options and Assessments**

### **A. Parametric Pension Reform Measures and Brief Assessment**

If the national pension goes through another reform to improve its financial stability, its priority policy option can be raising the contribution rate. However, this will not be easy because the insured tend to dislike such a measure. During the prior two reforms, they have shown preference towards reducing the benefit rather than increasing the contribution rate as the effect of benefit reduction is slow and difficult to be recognized in early years of pension scheme while the increase of contribution rate is not. If the increase of contribution rate is chosen, the main issues will be deciding the level and the schedule of the increase.

Another parametric reform option for national pension is to increase the pensionable age. The pensionable age was raised in 1998's reform from 60 to 65, but as the life expectancy in Korea is quickly catching up with the OECD countries, additional raise of pensionable age can be possible. However, considering the current retirement age and inactive labor market for the old age people, it is not an easy policy option.

An introduction of automatic stabilizer can be considered. But regarding that its main purpose is to make a systematic reduction of the benefit, its introduction seems to be rather too early for the national pension with the low average pension amount.

To make another successful parametric reform of the national pension, it is inevitable to make some measures for coverage extension and adequate benefits along with enhancing the financial condition.

## **B. Structural Pension Reform Options and Brief Assessment**

The most frequently suggested structural pension reform option in Korea is a combination of the tax based basic pension scheme and the social insurance earning related pension scheme. However, there are various different combinations in terms of concrete forms and benefit levels of the basic pension and the earnings related pension. The ideas of the structural reform have not been socially accepted mainly because of the large amount of cost from the tax based basic pension for both the present and the future.

Another idea for the structural reform is introducing NDC pension and minimum pension guarantee or minimum income guarantee. The introduction of such systems should result in an increase of contribution rate or a decrease of benefit level of the national pension, and a large amount of public expenditure is needed to maintain the minimum guarantee program. In the near future, such option will be unrealistic in Korea because either a sudden increase of contribution rate or a sudden decrease of benefit level will be socially unacceptable. Also, there will be too many beneficiaries of minimum guarantee program owing to underdeveloped national pension. Some have suggested privatizing the national pension, but this idea is socially unpopular and seems unrealistic.

## **4. Prerequisites for Successful Reform**

The effects of pension reform options can be evaluated through different aspects including alleviation of poverty, extension of coverage, adequacy of benefit, equity between strata and between generations, financial and social sustainability, social acceptance, and financial and managerial feasibility. However, it is too early to assess pension reform measures because there are currently no clear pension reform proposals or pension reform directions in Korea.

Another pension reform proposal should be made considering all the criteria mentioned above. If the pension reform only considers its acceptance and feasibility, the parametric reform would be the best. but the final decision is up to politics.

At the present when the importance of regular paid pension is getting greater recognition, attempting another pension reform is sure to induce strong social resistance. Accordingly, it is almost



certain that the third reform will take more time to reach social consensus than the previous two reforms.

## **VI. Summary and Conclusion**

Korea has experienced a compact growth of income security systems. Although the introduction of the national pension, in 1988, was late compared to other OECD countries, it was compulsorily applied by law to all labor force aged 18 to 59 by 1999. With the introduction of the individual pension in 1994 and the retirement pension for private sector employees in 2005, multi-pillar income security system was established. Two pension reforms for greater financial sustainability were achieved only within 20 years since its implement, considerably changing the frame work of the scheme.

Since its introduction, the most important tasks of the national pension have been extending its coverage and obtaining long term financial sustainability, while the income security of the present elderly has been rather disregarded. The issue on the income security of the present elderly resulted in the introduction of the basic old age pension in 2007. As the basic old age pension has a wide coverage with a low benefit level, its impact on poverty alleviation is assessed to be low. When the basic old age pension was introduced, it was stipulated to increase its benefit to 10% of A value (average earnings of the insured) of national pension by 2028 from the current 5%. A special committee was established in the national assembly in order to determine the schedule of benefit increase and the financing plan. However, neither a schedule nor financing plan has yet been made. Furthermore, it is not clear whether basic old age pension is going to expand or reduce its coverage. Its development in future will influence the future of national pension.

However, even without considering the future of the basic old age pension, the national pension should promote its own development as the main income security system in Korea. Its key tasks remains such as extending the coverage and achieving a long term financial stability. To successfully achieve these tasks, some measures will be suggested through the 3<sup>rd</sup> financial review in 2013.

Korean public pension schemes needs to be developed more systematically with each scheme finding its own adequate position. The various reform options are currently being discussed and hoped to be settled despite the painful and time-consuming process it will need to go through.

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<sup>1</sup>The ratio of expenditure to assets when pension reform for financial solvency was firstly performed was less than 1 in Britain in 1985, 1 in US in 1983, 5.7 in Japan in 1985, 2 in Canada in 1998, and 5 in Sweden in 1998. Germany possessed the fund for expenditure for only 2.7 month in 1992.