Income Security Systems in the Republic of Korea – Directions for Development

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based on the work of Seong Sook Kim, National Pension Research Institute, National Pension Service, Rep. of Korea

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I. Introduction
I. Introduction

1. Brief History

Introduction of the Income Security Schemes

- Public Old Age Income Security Schemes
  - Social Insurance Pension Schemes
    - National Pension Scheme (1988)
    - Government Employees (1961), Military Personnel (1963), Private School Teachers & Officials (1975)
  - Social Assistance Schemes
    - Basic Old Age Pension Scheme (2008)
    - Basic Livelihood Protection Scheme (1961 → 2000)

- Private Old Age Income Security Schemes
  - Private Occupational Pension Scheme: (2005 ← Severance Allowance)
  - Individual Pension Scheme (1994)
I. Introduction

2. Main Issues of Income Security Schemes

- Main Issues of Income Security Schemes in Korea
  - Improving the coverage of the national pension scheme
  - Securing adequate benefit level of public pension schemes
  - Restructuring the public income security systems
  - Making the public pension schemes financially more stable in the long run
  - Further developing multi pillar systems

- The reform issue here to be focused on restructuring the public pension schemes
Ⅱ. Current Income Security Systems
## II. Current Income Security Systems

### 1. Income Security Schemes as a Whole

#### Structure of Income Security Systems

<Old Age Income Security systems in Korea>

<table>
<thead>
<tr>
<th>0 Pillar</th>
<th>1st Pillar</th>
<th>2nd Pillar</th>
<th>3rd Pillar</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>National Basic Livelihood Protection Scheme (Social Assistance)</td>
<td>National Pension (Social Insurance)</td>
<td>Private Occupational Pension</td>
</tr>
<tr>
<td></td>
<td>Basic Old Age Pension (Social Assistance)</td>
<td>Private Pension, Private Saving</td>
<td></td>
</tr>
<tr>
<td>Workers</td>
<td>Self-Employed</td>
<td>Non-Work Force</td>
<td></td>
</tr>
</tbody>
</table>
## II. Current Income Security Systems

### 1. Income Security Schemes as a Whole

#### Coverage

- **The Insured of Public Pension Schemes (Dec. 2009)**

<table>
<thead>
<tr>
<th>Workforce (20~59)</th>
<th>The affiliated of public pension schemes</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total</td>
<td>National Pension</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>20.1 million (93.7%)</td>
<td>18.6 million (87.0%)</td>
<td>1.45 million (6.8%)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>The Contributors of public pension schemes</th>
<th>Total</th>
<th>National Pension</th>
<th>Public Occupational Pension</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>13.15 million (61.5%)</td>
<td>11.7 million</td>
<td>1.45 million</td>
<td></td>
</tr>
<tr>
<td>(the insured 18.6 m – the insured exempted from paying contributions 5.1 m – the insured in arrears more than 4 months 1.8 m)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

- **The Insured of Private Retirement Pension (Dec. 2009); 2.45 Million**
### Current Income Security Systems

## 1. Income Security Schemes as a Whole

### Coverage

- **Beneficiaries of Public Income Security for the Elderly (Dec. 2009)**

<table>
<thead>
<tr>
<th>Total Population Aged 65 and over</th>
<th>Basic Old Age Pension (BOAP) Recipients</th>
<th>Recipients of National Pension (NP) and/or Public Occupational Pensions (POP)</th>
<th>Non-beneficiaries</th>
</tr>
</thead>
<tbody>
<tr>
<td>5,268 (100.0%)</td>
<td>3,610 (68.5%)</td>
<td>1,429 (27.1%)</td>
<td>946 (18.0%)</td>
</tr>
<tr>
<td></td>
<td>Only BOAP 2,893 (54.9%), NP+BOAP 717 (13.6%), Only NP or POPs 712 (13.5%)</td>
<td>(NP 1,246+POP 183)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>&lt;Total=4,322, 82.0%&gt;</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Sources:** National Pension and Basic Old Age Pension Data Base (as of the end of 2009); Government employees Pension Scheme (Dec. 2008); Private School Pension Scheme (June 2008), Military Personnel Pension Scheme (Dec. 2006).
II. Current Income Security Systems

2. Public Income Security Systems

■ National Pension Scheme

1) Applied Population and Coverage

- **Applied Population:** the entire workforce aged 18 to 59 except
  - the insured or pensioners of three public occupational pension schemes
  - spouses with no self earnings and of the insured or pensioners of any public pension scheme
  - students or conscripted military personnel aged 18 to 26
  - beneficiaries of the national basic livelihood security scheme
  - persons who have been missing for one year or more.
II. Current Income Security Systems

2. Public Income Security Systems

- National Pension Scheme
  1) Applied Population and Coverage

  - **Number of the Insured:** 16.3 million as of Dec. 1999 ⇒ 18.6 million as of Dec. 2009
    - Insured persons in workplaces: 32.2% of the whole insured as of Dec. 1999 ⇒ 53.0% as of Dec. 2009
    - Insured persons in regions and individually managed: 66.6%(12. 1999) ⇒ 46.6%(12. 2009)
    - Insured persons voluntarily: 1.2%(12. 1999) ⇒ 0.4%(12. 2009)
II. Current Income Security Systems

2. Public Income Security Systems

- National Pension Scheme

  2) Financing

  - Financial Sources
    - Contributions: 2/3 of total accumulated fund
    - Returns by the fund operation: 1/3
    - National subsidy: very small amount

  - Contribution Rate: 9%
    - 3% to 9% every 5 years for the workers (from 1988 to 1998)
    - 3% to 9% every year for the insured individually managed (from 1999 to 2005)

  - Threshold and Ceiling of Earnings to Contribute
    - Raised every year from 2010 according to the change of A value (= 3-year average earnings of the whole insured of NP)
2. Public Income Security Systems

■ National Pension Scheme

3) Benefits

- ERR of the Old Age Pension
  - 40% of the insured of average earnings with 40 qualifying years
  - ERR originally was 70%, but it was changed to 60% in 1998, then to change gradually to 40% from 2008 to 2028

- Tax Treatment
  - EET from TEE since 2001
2. Public Income Security Systems

- National Pension Scheme

4) Pension Reforms and Financial Status

- Pension reform: as soon as the scheme was introduced, the pension reform was pursued
  - For long term financial stability, the first pension reform was achieved in 1998, and the second pension reform, in 2007
  - 1998 Reform: reduction of benefit level, increase in pensionable age from 60 to 65 gradually by 2033

- Financial Status
  - Size of Fund: KW300 trillion as of Aug. 2010 (4th largest public pension fund in the world)
  - Result of the 2nd financial review in 2008: fund depleted in 2060
2. Public Income Security Systems

- Basic Old Age Pension Scheme
  1) Coverage and Benefit
  - Introduction of the scheme: Apr. 2007
    - by-product of the controversial political struggles for the reform of national pension scheme.
  - Characteristics
    - Means tested and a flat rate benefit
  - Coverage
    - 70% of the elderly aged 65 and over since 2009
  - Benefit
    - 5% of the 3-year average earnings of the insured of the national pension
2. Public Income Security Systems

Basic Old Age Pension Scheme

2) Criteria for Selection of Beneficiaries
- Elderly aged 65 and over residing in Korea
- Below 70% at the ranking of the earnings among the elderly

3) Financing and Administration
- Financing: 60~90% by central government and 10~40% by local government in total expenditure
  - the more aged pension and the less financial autonomy, the local governments can get more subsidy from central government.
- Administration: Ministry of Health and and Welfare, and the local governments
2. Public Income Security Systems

Public Occupational Pension Schemes

1) Coverage
- The affiliated of the 3 public occupational pension schemes: about 7% of the workforce aged 20 to 59.
- More than 2/3 of them are the those of the government employee pension scheme.

2) Contribution and Benefit
- Contribution rate: 14% of total taxable income for three schemes alike
- Benefit: one year accrual rate is 1.9% of average income of total working years
II. Current Income Security Systems

2. Public Income Security Systems

- Public Occupational Pension Schemes

3) Pension reform in 2009

<table>
<thead>
<tr>
<th></th>
<th>Before Reform</th>
<th>After Reform</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income to impose contribution</td>
<td>Monthly basic salary except bonus and extra allowances (65% of gross income)</td>
<td>Total taxable income</td>
</tr>
<tr>
<td>Income to calculate benefit</td>
<td>Average salary of 3 years before retirement</td>
<td>Average income of total working period</td>
</tr>
<tr>
<td>Pension amount formula</td>
<td>[50%+(total working years – 20 years)*2%]</td>
<td>Average income x working years x 1.9%</td>
</tr>
<tr>
<td></td>
<td>Pension ceiling: 76% for 33 working years</td>
<td></td>
</tr>
<tr>
<td>Pensionable age</td>
<td>60 (for employees employed since 1996)</td>
<td>65(for the newly employed after enforcement of the revised act)</td>
</tr>
<tr>
<td>Contribution rates</td>
<td>17% (11% if calculated to total taxable income)</td>
<td>Gradually increasing to 14% of total taxable income</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- 2010; 12.6%, 2011; 13.4%, 2012~; 14%</td>
</tr>
<tr>
<td>Index of pension</td>
<td>CPI or income within ± 2% difference between two</td>
<td>2010~2014: price or salary within ± 2% difference between two</td>
</tr>
<tr>
<td></td>
<td></td>
<td>2015~: CPI</td>
</tr>
</tbody>
</table>
II. Current Income Security Systems

2. Public Income Security Systems

- Public Occupational Pension Schemes

  4) Financial State

  - Military Personnel Pension: fund exhausted in 1973
  - Government Employer Pension: financial deficit since 1993
    - government subsidy started in 2001
  - Private School Teachers and Officials Pension: still accumulating fund because of its late start in 1975
  - All 3 pension schemes are financially unstable though the government employer pension and the private school teachers pension were reformed in 2009.
Ⅱ. Current Income Security Systems

3. Private Income Security Systems

■ Retirement Pension Scheme

1) Application and Coverage

- Applied to workplaces with 5 employees and over by the retirement pension act in 2005
- Coverage: 32.5% of the whole workers working at workplaces with 5 employees and over as of Dec. 2009
- Nearly 80% of the total affiliated to be joined to the DB schemes.

2) Size of the Assets of Retirement Pension Scheme

- Total assets: KW 13,042 billion as of Dec. 2009
- 65.8% of the assets from the DB schemes
3. Private Income Security Systems

- **Individual Pension Scheme**
  1) **Coverage**
     - Introduced in 1994
     - Since the bailout by the IMF in the end of 1990s, its popularity has withered because of sharply reduced interest rates.
  2) **Size of Assets**
     - Total assets: KW 98,061 billion as of Dec. 2008
     - The commodities by life insurance companies are most popular.
III. Assessment of Pension Arrangements
III. Assessment of Pension Arrangements

1. Coverage

- **National Pension Scheme**
  - It is in theory covering nearly all workforce between 18 and 59.
  - In reality, about 25~27% of the total insured has been those exempted from contribution payment.
  - About a half of the insured individually managed do not pay their contributions in time.
  - Another big coverage gap: housewives who are not working in labor market and are excluded from compulsory application to the scheme.

- **Basic Old Age Pension Scheme**
  - 70% of the elderly as a coverage of basic old age pension is arbitrary.
Ⅲ. Assessment of Pension Arrangements

2. Adequacy

- **National Pension Scheme**
  - Average pension amount of national pension: about 14% of A value (which means 3-year average earnings of the total insured of the national pension)
  - Even in the long run, inadequate level to live only with national pension benefit

- **Basic Old Age Pension Scheme**
  - Too low benefit level to alleviate poverty
  - The benefit level stipulated to be 10% of A value by 2028, but without an acting plan.
### II. Assessment of Pension Arrangements

#### 2. Adequacy

- **Composition of Income sources of the elderly:**
  Aged 60 and over, 2008

<table>
<thead>
<tr>
<th>Source</th>
<th>Wage</th>
<th>Business income</th>
<th>Financial income</th>
<th>Individual pension</th>
<th>Real estate income</th>
<th>Private transfer</th>
<th>Public pension</th>
<th>Other public transfer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>9.6%</td>
<td>13.0%</td>
<td>2.7%</td>
<td>0.3%</td>
<td>4.2%</td>
<td>44.7%</td>
<td>10.5%</td>
<td>15.0%</td>
</tr>
</tbody>
</table>

*Source: the Ministry of Health and Welfare (2008), Survey on the living condition of the elderly, p 258*
3. Equity

- Inter-generational Equity of the National Pension
  - At the initial period of the scheme, as the contribution rate was 9% and the benefit level (ERR) was 70% (for 40 qualifying years), the benefit/cost ratio was high.
  - As the benefit level is reduced gradually to 40% by two previous reforms, the benefit/cost ratio is declining but the inter-generational equity is improving.
Ⅲ. Assessment of Pension Arrangements

3. Equity

- Inter-generational Equity of the National Pension
  - It is not still equitable between generations if the pay-as-you-go rate is considered.

<table>
<thead>
<tr>
<th>Year</th>
<th>2010</th>
<th>2020</th>
<th>2030</th>
<th>2040</th>
<th>2050</th>
<th>2060</th>
<th>2070</th>
<th>2078</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rate</td>
<td>3.0</td>
<td>4.9</td>
<td>8.2</td>
<td>13.1</td>
<td>17.7</td>
<td>21.9</td>
<td>23.2</td>
<td>22.9</td>
</tr>
</tbody>
</table>
3. Equity

- **Intra Redistribution of the National Pension**
  - By benefit formula of NP, the intra redistribution effect is exerted.
    - The earnings used computing the national pension benefit are an average of A value (3-year average earnings of the total insured) and B value (the insured’s own life-long average earnings).
    - Some distortion has been made because of difficulty of accurate assessment of earnings for the insured individually managed.
Ⅲ. Assessment of Pension Arrangements

3. Equity

- Equity between National Pension Scheme and Public Occupational Pension Schemes
  - Though the public occupational pension schemes were reformed in 2009, they are still relatively more advantageous than the national pension in regard of its accrual rate and pensionable age and so on.
  - As for the public occupational pension schemes, the equity between generations can be problematic.
    - Because the revised act in 2009 will be applied to the new entrants since 2010.
3. Assessment of Pension Arrangements

4. Efficiency

- **Economic efficiency**
  - The income security systems in Korea have been established without a grand blueprint.
    - The benefits of some public income security schemes may be duplicated and the roles of each scheme are not clear.
    - The basic old age pension is not well targeted to the most needy despite being a means-tested program.
III. Assessment of Pension Arrangements

4. Efficiency

- **Administrative efficiency**
  - Weak infra structure to assess earnings accurately
    - The National Tax Office is making efforts for it in various ways and the assessment of earnings is gradually getting better.
  - Consolidation of collection of contributions for four social insurance programs from 2011
    - well for workplaces, but not much expected for the insured individually managed.
### National Pension Scheme

- With longer longevity and low total fertility rate, the elderly dependency ratio is forecast to be continuously higher.

#### Elderly Dependency Ratio and Ageing Index Projected

(Unit: %)

<table>
<thead>
<tr>
<th>Year</th>
<th>Elderly Dependency Ratio</th>
<th>Ageing Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970</td>
<td>5.7</td>
<td>7.2</td>
</tr>
<tr>
<td>1980</td>
<td>6.1</td>
<td>11.2</td>
</tr>
<tr>
<td>1990</td>
<td>7.4</td>
<td>20.0</td>
</tr>
<tr>
<td>2000</td>
<td>10.1</td>
<td>34.3</td>
</tr>
<tr>
<td>2005</td>
<td>12.6</td>
<td>47.3</td>
</tr>
<tr>
<td>2010</td>
<td>15.0</td>
<td>67.7</td>
</tr>
<tr>
<td>2020</td>
<td>21.7</td>
<td>125.9</td>
</tr>
<tr>
<td>2030</td>
<td>37.7</td>
<td>213.8</td>
</tr>
<tr>
<td>2050</td>
<td>72.0</td>
<td>429.3</td>
</tr>
</tbody>
</table>
III. Assessment of Pension Arrangements

5. Sustainability

- National Pension Scheme
  - According to the result of the financial review in 2008, the pension dependency ratio (ratio of old age pensioners to the insured) is forecast to be 119.3% in 2070.
  - It is expected that some measures for long term stability will be discussed in the next financial review, 2013.

<table>
<thead>
<tr>
<th>Year</th>
<th>2010</th>
<th>2020</th>
<th>2030</th>
<th>2040</th>
<th>2050</th>
<th>2060</th>
<th>2070</th>
<th>2078</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ratio (%)</td>
<td>11.1</td>
<td>18.3</td>
<td>34.4</td>
<td>61.6</td>
<td>90.1</td>
<td>112.9</td>
<td>119.3</td>
<td>115.4</td>
</tr>
</tbody>
</table>
III. Assessment of Pension Arrangements

5. Sustainability

- Public Occupational Pension Schemes
  - By the 2009 reform, the size of government subsidy for the government employer pension scheme will be less in the long term than before.
  - However, another reform should be pursued some years later to make the scheme financially more stable.
  - As for the military personnel pension scheme, it raised the contribution rate only in 2009 reform.
    - It is not clear if the new reform can be considered in the future.
IV. Reform Options of Income Security Systems
IV. Reform Options of Income Security Systems

1. Principle of Restructuring of Public Pensions

- Sufficiency of Coverage
- Adequacy of Benefits
- Equity between Generations, Income Strata, and Income Security Schemes
- Efficiency
- Affordability
- Sustainability
### 2. Feasible Options for Restructuring Pension Schemes

#### Feasible Options for Public Pension Schemes in Future

<table>
<thead>
<tr>
<th>Future Option 1</th>
<th>Present</th>
<th>Future Option 2</th>
<th>Additional Income Security Schemes</th>
<th>Basic Income Security Schemes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individual Pension</td>
<td>Individual Pension</td>
<td>Individual Pension</td>
<td>▶ National Pension Benefit: 50%→40%</td>
<td>▶ Reduction of NP benefit</td>
</tr>
<tr>
<td>Retirement Pension</td>
<td>Retirement Pension (+Severance allowance)</td>
<td>Retirement Pension</td>
<td>▶ Basic Old Age Pension Benefit: 5%→10%</td>
<td>▶ Strengthening BOAP (Absorption of cash benefits of Basic Livelihood Security benefit into BOAP)</td>
</tr>
<tr>
<td>Same as present NP Benefit</td>
<td>National Pension Benefit</td>
<td>▶ Reduction of NP benefit</td>
<td>▶ Abolition of cash benefit of Basic Livelihood Security</td>
<td></td>
</tr>
<tr>
<td>Reduction of BOAP coverage with higher benefit level</td>
<td>Basic Livelihood Security</td>
<td>▶ Basic Livelihood Security</td>
<td>▶ Abolition of cash benefit of Basic Livelihood Security</td>
<td></td>
</tr>
<tr>
<td>Abolition of cash benefit of Basic Livelihood Security</td>
<td>?</td>
<td>▶ Basic Livelihood Security</td>
<td>▶ Abolition of cash benefit of Basic Livelihood Security</td>
<td></td>
</tr>
</tbody>
</table>

Social Insurance oriented model

Tax financing oriented model

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IV. Reform Options of Income Security Systems

3. Evaluation of Each Option

- **Coverage**
  - Future option 2 is better than option 1 in regard of coverage.
    - In option 2, all of the elderly can be covered by public pension schemes as soon as the universal basic pension scheme is introduced.

- **Equity**
  - In future option 1, to make more equitable between generations, it is necessary to raise the contribution rate of the national pension.
  - If then, the option 1 is more equitable than the option 2 in terms of equity between generations.
3. Evaluation of Each Option

- **Efficiency**
  - Option 2 is better to alleviate poverty.
  - Option 2 can be more efficient to administer the schemes because the schemes can be managed by a centralized manner and the waste by duplication of benefits may be reduced.

- **Adequacy**
  - Though the total benefit level looks better in option 1, it can be in real better in option 2 because the average pension amount of the national pension may be not high enough even in the long term due to its low average qualifying years of the insured.
IV. Reform Options of Income Security Systems

3. Evaluation of Each Option

■ Affordability
  - Option 2 seems to be less affordable.
    - Structural change of the public pension schemes can make people confused and skeptical about public pension schemes.
    - Difficulty to increase tax for the universal basic pension

■ Sustainability
  - If the amount of universal pension is 10% of A value of the national pension, the total expenditure of public pensions will be higher in option 2 than in option 1.
  - If the total expenditure of public pensions to GDP is over 10% in the long run, it can be more or less burdensome for the future generation.
4. Main tasks for Restructuring

- Financing the Public Pension Schemes
  - As even at the present, it is difficult to make budgets for the basic old age pension; if its benefit level increases, its financing will become a more tricky issue.
    - In terms of financing, option 1 seems to be easier.

- Securing Adequacy of Benefits
  - Public pension schemes to fulfill a national minimum
  - Additional income security by private schemes

- Making Consensus Between Various Interests Groups
  - Necessary to adjust the interests between various groups for successful restructuring of the public pension schemes
Thank You