

Financial Challenge of the pension system in the republic of Korea

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Brief History of National Pension Reforms

-First Reform of National Pension

-Background:

- 1) The pension scheme had raised doubts about its long term sustainability since its introduction. The expected financial model of National Pension scheme is PAYG system at the time of its introduction. The imbalance between generous benefits and low contribution rates purposed to raising scheme compliance.
- 2) Scheduled extension of national pension in urban areas in 1998. It had raised the issue of pension compliance with declared income level.
- 3) The main purpose of reform is to resolve the imbalance between benefits and contribution. But, it also purposed to expand pension coverage to urban area without a serious resistance.

-Three Main changes for financial sustainability:

- 1) the replacement rate was reduced from 70%(with average earnings and 40 qualifying years) to 60%
 - 2) the pensionable age was raised from 60 to 65 during 2013–2033, every 5 years
 - 3) 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.
- * Option for raising contribution rate from 9% to 12.65% gradually from 2010 to 2025, did not introduced at that time.

Brief History of National Pension Reforms

-Second Reform of National Pension in 2007

-Background

- 1) The first actuarial projection in 2003 showed that a pension deficit occur by 2036, and the pension fund would be exhausted by 2047(Before the first pension reform, the year of depletion of pension fund is 2031).
- 2) National Pension Development Committee(NPDC) which performed actuarial projection made three reform proposal. All of them included the raising of contribution rate.
- 3) Based on the proposal of NPDC, the government proposed the bill for pension reform. The bill composed an increase of the contribution rate and a reduction of the benefits level.
- 4) Another bill was proposed by opposition party, which made pension scheme to dual tier by introducing basic pension.

-Two Main changes:

- 1) the introduction of basic old age pension scheme with 70% of coverage in 65+ ages and 5% of benefits level(A-value of the national pension)
- 2) the benefits level reduced from 60% to 50% in 2008. Thereafter, replacement rate would drop from 50% to 40% between 2009 and 2028(dropping by 0.5%pt per every year)

Brief History of National Pension Reforms

Year	Replacement rate	Contribution rate	Pension Calculation Formula
1988~1998	70%	Employment_based : 3%(1988~1992) : 6%(1993~1997) : 9%(1998~) Residence_based : 3%(1995~2000.6) : 4~9%(2005.7)	$2.4(A+0.75B)(1+0.05n)$
1999~2007	60%	Employment_based : 9%(1998~) Residence_based : 4~9%(2005.7)	$1.8(A+B)(1+0.05n)$
2008	50%	9%	$1.5(A+B)(1+0.05n)$
2028	40%	9%	$1.2(A+B)(1+0.05n)$

In year 2014

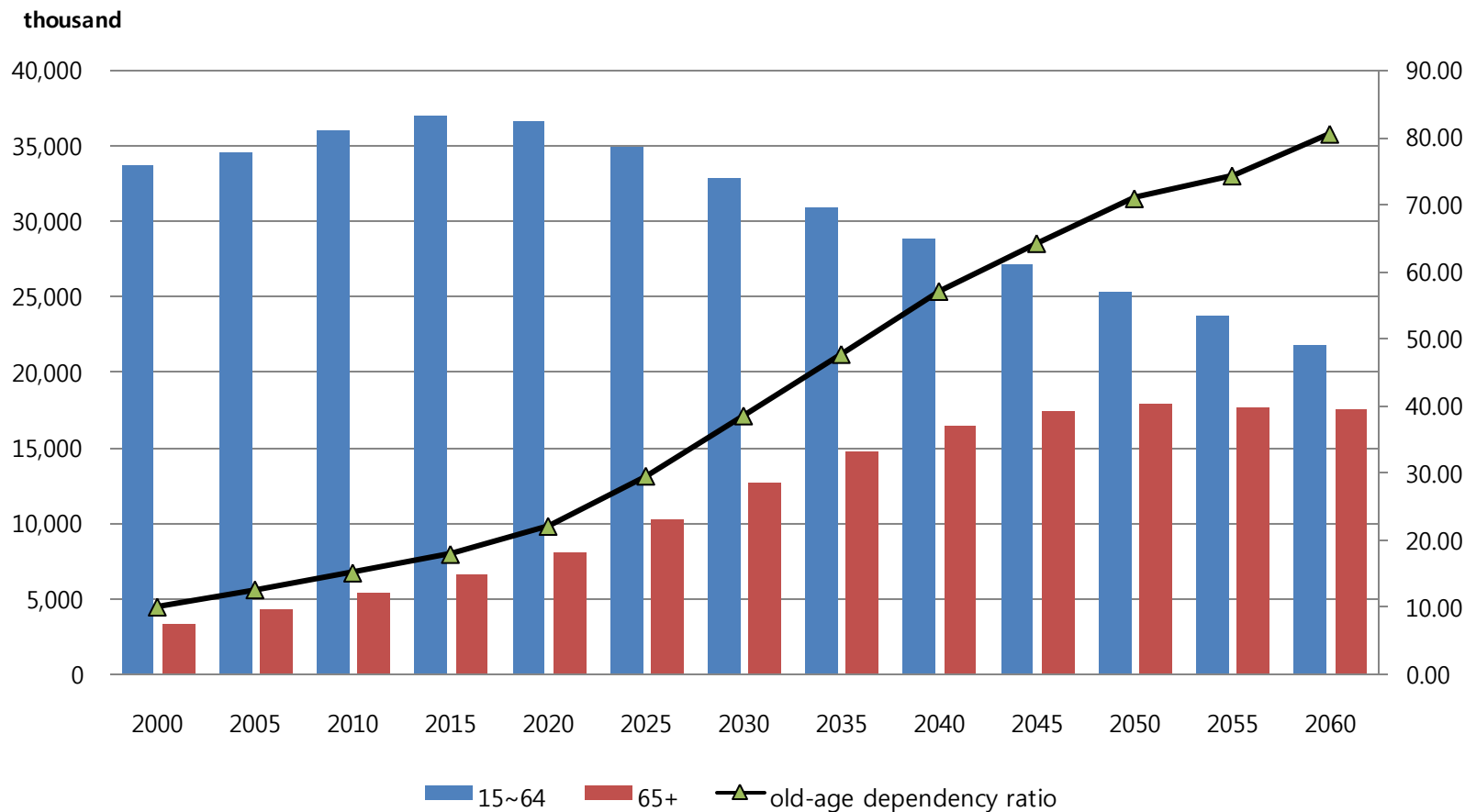
: Replacement rate 47.0%,
: pension formula $1.41(A+B)(1+0.05n)$

- As a result of second pension reform, the depletion year of the national pension fund was extended from 2047 to 2060.
 - The depletion year of pension fund was 2031 before the first pension reform.
 - Although reducing of benefits level from 70% to 40% and extending of pensionable age from 60 to 65, the doubt of long-term financial sustainability of national pension did not diminish.
 - The third actuarial projection results showed that the expenditures will exceed the contribution income starting in 2031, and the expenditure will exceed the total income(contribution income + investment return of pension fund) in 2044, and the pension fund exhaust in 2060.
- All the time of reform, the long-term financial instability is the main issue of reform. As a result, the confidence of pensioners on government was damaged.
- During the two pension reform process, the issue of increasing contribution rate was always brought up. But it did not introduce.
 - Contribution rate required for accomplishing for the financial goals which targeted to 2 funded/expenditure ratio by 2083 is 12.91%(results from 3rd Actuarial projection).

Financial Challenge come with Demographic changes

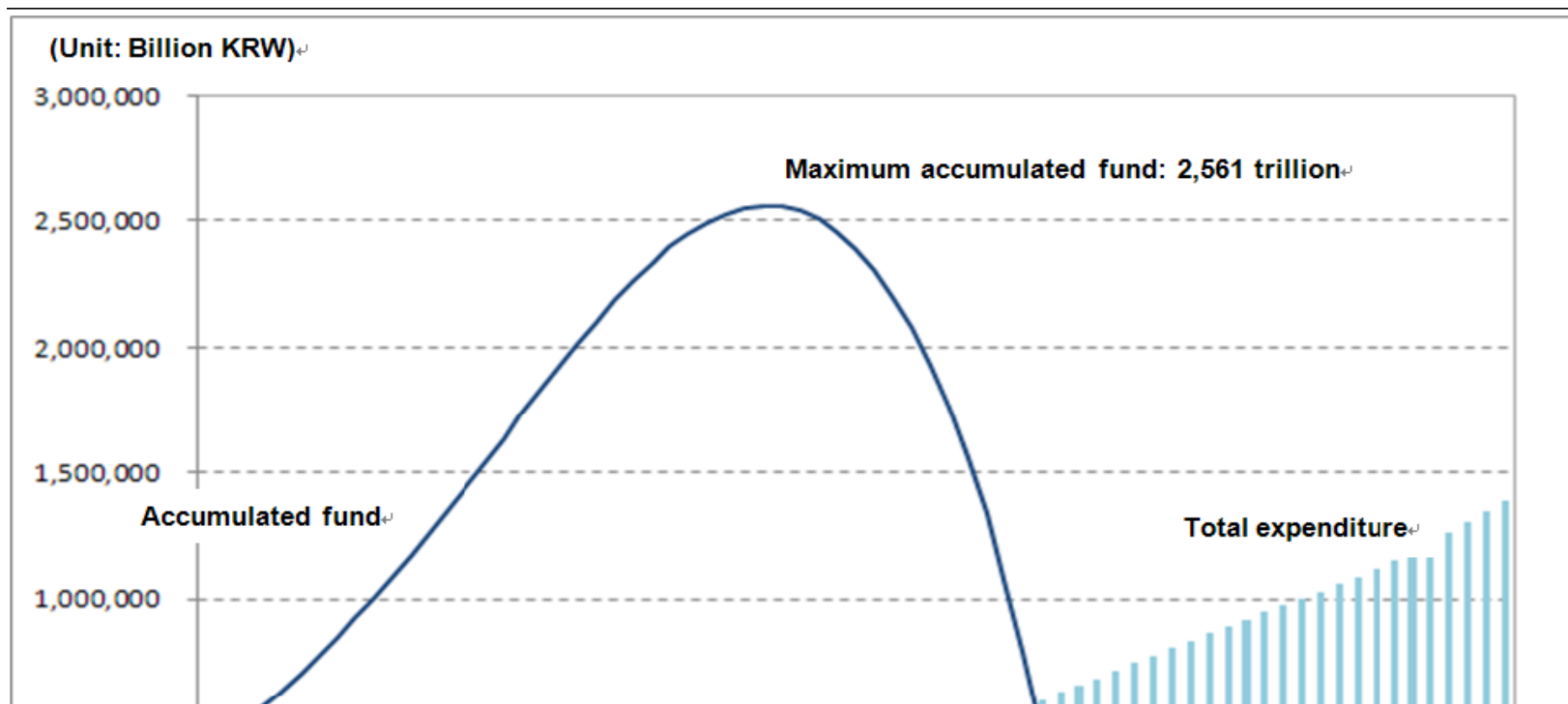
- In Korea, rapid population ageing will make old-age income security more important.
 - People who did not have enough resource to secure old-age life standard was 48.6%(OECD, 2011).
- Population ageing combining with expanding life expectancy and low fertility ratio could undermine the system sustainability.
 - During two times of national pension reform, the huge benefits cuts eventually reduce its role as old age income security.
 - Increasing old-age dependency ratio make difficult to select a option for expanding national pension benefits.
 - The role of Basic Old Age Pension would be more important to people with low(or not having) national pension benefits.

Demographic Change in Korea (Forecasts)



Source: National Statistical Office(2010), Population Projection.

Financial Flows of Pension Fund



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https://www.yunbaogao.cn/report/index/report?reportId=5_5664

