

## **Track 2: Social Security and Social Protection: Developing Discourses**

### **THE RECENT REFORM OF THE PUBLIC PENSION SYSTEM IN KOREA**

**By LEE Kwang-Taek**

Professor Emeritus, College of Law, Kookmin University,  
Seoul, Korea

Director, Korea Institute of Industrial Society

Vice President, International Society for Labour and Social  
Security Law

*E-mail: sansayon@kookmin.ac.kr*

# I . Introduction

Two criteria of public pension programs:

- **National Pension Scheme(NPS)**

  - initiated 1988, universal since 1999

  - for private employees, self-employed and local residents

- **Special Occupational Pension plans(SOP)**

  - for Government Employees Pension Scheme(GEPS) since 1960

  - Military Personnel Pension Scheme(MPPS) since 1960

  - Private School Personnel Pension Scheme(PSPPS) since 1975

# I . Introduction

- Korea has drastic political, economic, social, cultural and demographic changes.
- The rapid economic development
  - > The rise in the standard of living resulted
  - > The increase of the average life span of Koreans by 30 years in about 40 years/  
decrease of fertility rate at 1.19(2013)
  - > Striking decrease of economically active population.

# I . Introduction

- The NPS was already reformed in the late 1998 to secure financial stability.
- **The necessity to reform the GEPS**
  - <- The retired civil servants receive 2.4 times what they pay in premiums, compared with 1.7 times for other pensioners
  - <- The deficit has reached 9.8 trillion won(\$8.4 billion), with 2.5 trillion won(\$2.1 billion) in taxes to be used in 2014.  
(\$1=1,100 Korean won as of end May, 2015)

# I . Introduction

- **The Civil Service Pension Reform Bill** passed the National Assembly on May 29, 2015 <- seven months of boisterous debate and turbulent negotiations
- Various surveys: The changes to the civil service pension save 333 trillion won (\$303 billion) over the next 70 years.
- The reform will
  - raise the contribution rate from 7 % to 9 % in 5 years,
  - reduce entitlements from 1.9 % to 1.7 % in stages over 20 years,
  - push back the retirement age from the 60 to 65.

## II. Demographic Change and Income Security in Korea

- **Four 'tiger' states** Korea, Taiwan, Hongkong and Singapore, poses the Confucian values of the societies, the particular role of the state, and the unique economic conditions, including the impact of productivist or developmental social contexts (Klassen & Yang 2010).
- Even among the four Asian tigers, Korea is appraised as extraordinary. Along with its economic progress, from an impoverished and devastated country in the 1960s, Korea's effort to become an emerging welfare state is significant.

## **II. Demographic Change and Income Security in Korea**

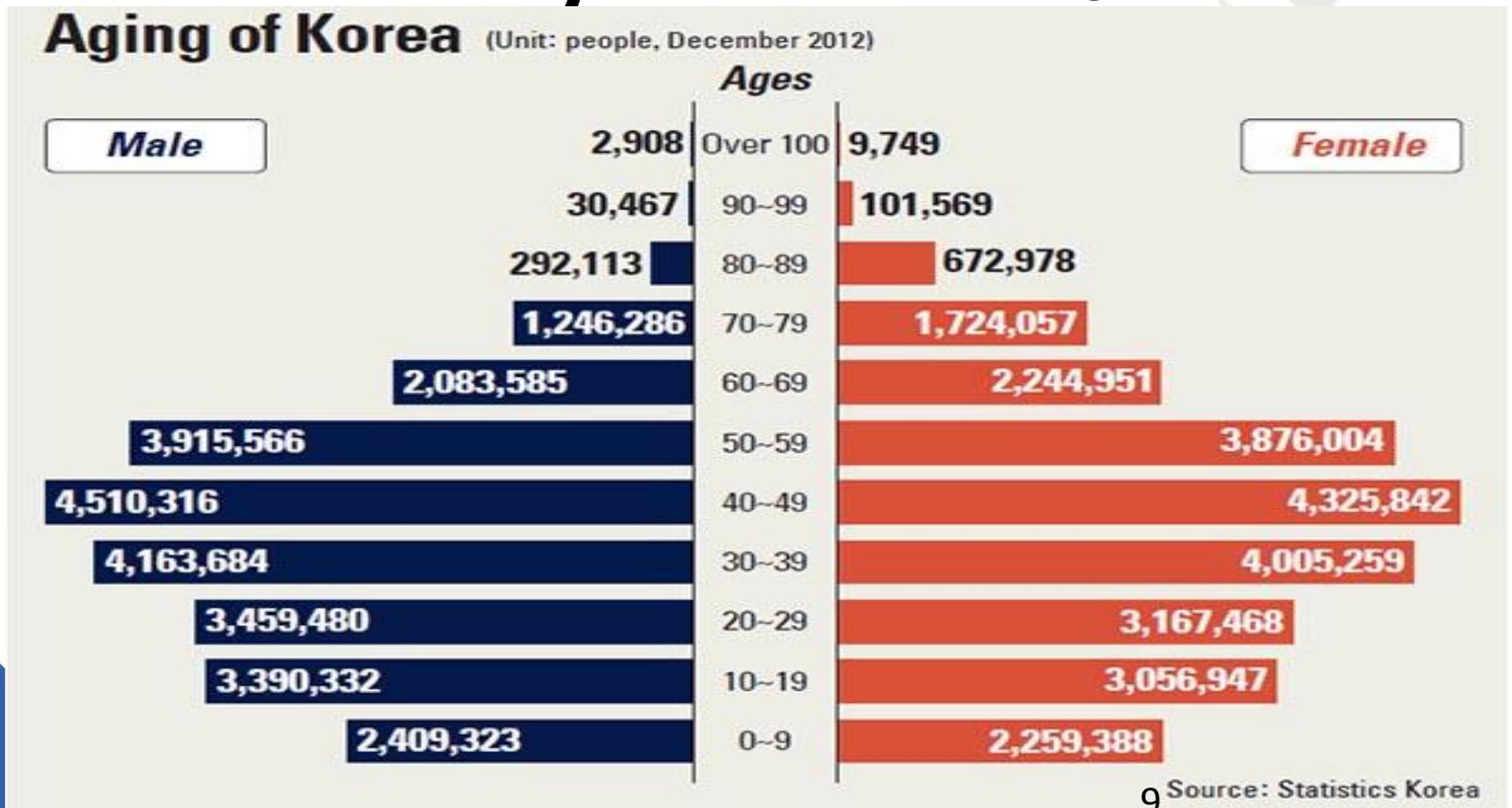
- Korea now, however, faces a population that is ageing at an unprecedented rate.
- As the pressures from an ageing population mount, the traditional old-age income support system, partially built upon inter-family transfers, is proving inadequate (Chung, Yun, Park, Na, & Hong 2000: 87-88).

## II. Demographic Change and Income Security in Korea

- The speed of population ageing in Korea:
  - a population profile of a **pyramid** (1990)
  - the profile of a **diamond** (2010 – 2030)
  - the shape of an **inverse pyramid** by 2050 with relatively few individuals under the age of 50.

# II. Demographic Change and Income Security in Korea

<Figure 1>



## **II. Demographic Change and Income Security in Korea**

- This demographic trend in Korea <- increases in life expectancy, a steep decline in fertility rates (from around 6.0 in 1960 to 1.1-1.2 in the past decade)  
<- economic growth and improving health conditions, family planning programmes, the changing role of women in the labour market.
- By 2050, the median age of the population of Korea to be 54 years, making it the most elderly population in the world. (United Nations 2007: 66).

## II. Demographic Change and Income Security in Korea

- The first state-mandated pension in Korea began in 1960 for government employees, including the military personnel.
- A separate plan for those serving in the military was carved out in 1963-> GEPS + MPPS.
  - These were designed to secure the loyalty of state workers, especially to the authoritarian governments of the 1960s and 1970s.
- Private school teachers were covered under the PSPPS in 1975.

## **II. Demographic Change and Income Security in Korea**

- In 1988 in response to emerging demographic trends and a crisis of legitimacy, the government implemented the NPS for the general public. The NPS was ambitious, permitting eligibility at age 60 for full benefits and providing a replacement rate of 70 % of lifetime income, while keeping the contribution rate at 3%.
- In 1998, it became obvious that the plan would be unsustainable as more workers reached eligibility age, so the age of entitlement was increased to 61 by 2013 and then gradually to 65 by 2033.

## II. Demographic Change and Income Security in Korea

- **The retirement (or severance) allowance system** in Korea was first introduced in 1953 under **the Labour Standards Act** as a way to guarantee income for retired workers voluntarily quitting or dismissed.
- During the industrializing phase of Korea, the allowance served both as unemployment insurance for the jobless and old-age income security for the retired, since neither a **public pension scheme** nor the **unemployment insurance programme** existed until 1988 and 1995, respectively.

## **II. Demographic Change and Income Security in Korea**

- Initially the allowance was only compulsory for larger enterprises with 30 or more workers, but expanded gradually until December 1, 2010, when it applies to all employers, even they employ only one worker.
- The severance allowance, which gives at least 30 days of wage for every year of service at the rate of average wage over the last three months is of a unique character of the Korean labour law

## II. Demographic Change and Income Security in Korea

- The government enacted on December 1, 2005 the new law which enabled the firms to replace the retirement allowance with a more typical **corporate pension plan**.
- Many of the larger enterprises are slowly gravitating towards pensions, while small and medium-size enterprises continue with allowances. At the same time, the government also allowed companies, especially small ones, to create individual retirement accounts for employees.

## **II. Demographic Change and Income Security in Korea**

- The retirement allowance - rather than pensions - has provided retiring workers with an immediate lump-sum cash payment, which has mitigated the economic consequences of mandatory retirement at an early age.
- The retirement allowance has been critical as start-up capital or as an initial financial cushion to temper the short-term household cash flow impacts of the transition from the primary to the, invariably precarious, secondary labour market (Klassen & Yang 2010).

## III. The History of the NPS and Other Old-age Income Security Programmes

- The **National Pension Scheme(NPS)** is the key programme in the entire old-age income support system of Korea. However,
- First, the NPS is not mature, with few retired workers yet eligible to receive payments.
- Second, the NPS has been downsized twice and is still under further reform pressure due to financial instability.

## III. The History of the NPS and Other Old-age Income Security Programmes

- **The generous SOP** comprising the GEPS (1960), the MPPS (1963) and the PSPPS (1975) served as a means to compensate for the relatively lower wages of public sector workers and for the lack of a retirement allowance comparable to private sector workers.

## **III. The History of the NPS and Other Old-age Income Security Programmes**

- It was only in 1988 that the NPS was introduced. Based on the principle of social insurance, the NPS was designed to serve as the sole system providing old-age income for private sector workers.
- The strategy was for the employers' financial responsibility for the retirement allowance to be gradually converted in to contributions to the NPS, although this planned conversion was annulled in 1998.

## **III. The History of the NPS and Other Old-age Income Security Programmes**

- The strategy to integrate the two was clear if one considers that the national pension system was for companies with five or more employees, the same coverage for severance pay since March 1989.
- Labour unions strongly opposed the planned conversion of the retirement allowance system into the NPS, and hence the plan was eliminated in the 1998 pension reform (Kim, Soo Wan 2010).

## **III. The History of the NPS and Other Old-age Income Security Programmes**

- The first systematic review of the relationship between public and private pensions was made by IBRD, when it proposed integrated development and improvement measures for both systems as a condition for the second structural adjustment loan during the 1997-98 financial crisis in Korea (World Bank 1998a & 1998b).
- This led to the establishment of the Commission for Improving the Public and Private Pension Systems, in December 1998.

## **III. The History of the NPS and Other Old-age Income Security Programmes**

- The Tripartite Commission of Korea took up as their agenda the improvement of the severance pay system and the introduction of a retirement pension system, with discussions continuing from July 2001 to July 2003.
- However, no consensus was reached on the specific model and procedure to convert retirement allowance into a retirement pension.

## III. The History of the NPS and Other Old-age Income Security Programmes

- After the Government's Bill passed the National Assembly at the end of 2005, the companies can convert the existing severance pay system to a corporate retirement pension based on the employer's and employees' mutual agreement.
- From this point, it is appraised that a modernized **multi-pillar system** was built in Korea (Kim, Soo Wan 2010).

## IV. Korea's Pension System Overview and Reform Directions

- It was 1988 when the NPS, modeled after the employees' pension of Japan in the 1970s, close in form to the early German pension before its reform in 1957.
- Accordingly, the benefit level was quite high:  
70 % of the earnings replacement rate for a participant with a 40-year contribution period and the life-long average earnings as same the 'A value' (Kim, Seong Sook, 2011).

## **IV. Korea's Pension System Overview and Reform Directions**

- Until 2009, the contribution rate had been kept the same for all three SOPs at 17% of monthly basic salary (excluding bonus and extra allowances). According to the revised law of 2009, it was lowered between 2010 and 2012 to 14% of taxable income. The previous contribution rate was equivalent to 11% of total taxable income.
- The change in the law therefore means an increase in contribution payment of 3% of taxable income in real term. The maximum contribution period has been kept to 33 years from the beginning of the schemes. The minimum contribution period required for all three pensions is 20 years.

## **IV. Korea's Pension System Overview and Reform Directions**

- Any retiree with a 20-year contribution history could claim pension benefits upon retirement. The pensionable age was introduced in 1996 and over time raised to 60. It would further increase to 65 for newly employed officials after the enforcement of the revised law in 2009.
- No specific pensionable age is yet applied to the military personnel pension. The index of benefit is CPI (Kim, Seong Sook, 2011).

## **IV. Korea's Pension System Overview and Reform Directions**

- The SOPs are financed through contributions, returns from its fund operation and government subsidy. As the fund of MPPS was exhausted in 1973, government subsidy has gradually increased. The financial status of the PSPPS is much better than the other two.
- The GEPS began running deficits in 1993, in particular, with a rapid increase in the number of pensioners in 1998 and 1999, deficits also increased abruptly. In 2001, the government started to subsidize the scheme.

# V. The GEPS – History and Reform Efforts

- Like Korea, about half of OECD countries have a separate pension scheme for their civil service (Palacios & Whitehouse 2006).
- In most of these nations, however, the pension benefit gap between the civil service scheme and the national scheme is not so large.
- In contrast, the benefits and eligibility requirements of the GEPS are superior to that of Korea's national pension and resemble the situation in France and Germany, where state workers have more generous income security arrangements (Bae, Jun-Ho 2010).

# V. The GEPS – History and Reform Efforts

- The coverage of the GEPS has been comprehensive since its introduction, including national and local civil servants in general administration, teachers and administrative staff in public education, police and fire services, general and special postal services, as well as judges and prosecutors.
- The Korean system differs from those of the United States or Japan, where the pension scheme for central or federal government employees and that for local government employees are separated.
- It also differs from the pension scheme of Germany that separate state workers into different pension plans depending on job requirements. (Bae, Jun-Ho 2010).

# V. The GEPS – History and Reform Efforts

## <Table 1> Major changes in civil service pension

<u>Year</u>	<u>Summary of the major changes</u>
• 1960	Government Employees Pension Act is enacted
• 1962	Retirement age (60 years of age) is withdrawn
• 1967	Contribution rate hikes to 3.5% from 2.3%
• 1970	Contribution rate hikes to 5.5%; survivor's pension lump sum payment is introduced
• 1975	Benefit cut is introduced; upper limit on vesting period is extended to 30 years
• 1980	Vesting period is extended to 33 years; income replacement rate upper limit is hiked (70%→75%)
• 1982	Government Employees Pension Service established
• 1988	Survivor's pension is increased (from 50% to 70% of retirement pension)

# V. The GEPS – History and Reform Efforts

- 1991 Retirement allowance is introduced
- 1996 Retirement age (60) is introduced for those employed after 1 January 1996; contribution rate hikes to 6.5%
- 1999 Contribution rate hikes to 7.5%
- 2001 Retirement age comes into effect for those employed after 1995; price indexation is made; pensionable earnings basis is changed from final defined salary to final three years average defined salary; contribution rate hikes to 8.5%, government deficit financing stipulation is established in case of deficit in retirement benefit and survivor's benefit accounts; reserve fund stipulation is established
- 2003 Price indexation and salary indexation are combined; indexing rate is settled to less than 2% points in comparison to salary increase rate (only if salary increase rate is more than 2% points larger in comparison to price increase rate)
- 2005 Benefit cut under income test is enforced; benefit cut is below one-half
- 2008 Government Employees Pension Reform Bill is passed

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Source: Government Employees Pension Service

## **V. The GEPS – History and Reform Efforts**

- <Table 1> shows the major modifications that have occurred in the GEPS since its introduction in 1960. It is to note that the establishment of the Government Employees Pension Service in 1982 to administer the GEPS and its funds.
- The Ministry of Government Administration and Home Affairs (MOGAHA) is responsible for the reform and enforcement of the scheme.

## VI. Recent Development to Reform GEPS

- Retired public employees receive a monthly average of 2.19 million won, compared with 870,000 won for recipients of the NPS. This means retired civil servants receive 2.4 times what they pay in premiums, compared with 1.7 times for other pensioners.
- As such, the deficit was snowballing. The government poured 2 trillion won into the scheme 2014 to make up for the shortfall in the GEPS. If unchecked, the shortfall would increase to 7 trillion won by 2020. The nation could no longer afford to ignore what was shaping up to be a fiscal catastrophe

## **VI. Recent Development to Reform GEPS**

- The reform direction is simple: Pensioners should contribute more and receive less. The Korea Pension Association (KPA)'s suggestion called for increasing premiums from 7 percent of income to 10 percent by 2026, which was a 43 percent rise. In addition, the pension payouts should be cut by 34 percent.
- The plan would also gradually raise the entitlement to 65 by 2033. All the public pensions, including soldiers and teachers, should be unified with the national pension scheme by 2055.

## VI. Recent Development to Reform GEPS

- The reforms to the civil service are aimed at reducing the public debt. Aggregate debt levels of public companies amount to about 520.5 trillion won (\$470 billion) while total government debt stands at about 570 trillion won.
- The gist of the bill is no different from what the ruling Saenuri Party and the main opposition NPAD agreed on in early May, requiring government officials to pay more and receive less.
- Specifically, the overhaul plan obliges them to contribute 9 % of their monthly income to their pension scheme, raising the rate from the current 7 % over the next 5 years, while cutting their pension payment rate to 1.7 % from 1.9 % over the next two decades.

## **VI. Recent Development to Reform GEPS**

- With the passage of the pension reform bill, the government will be able to save about 333 trillion won over the next 70 years. But the overhaul plan faces criticism for being cosmetic because it allows incumbent civil servants to maintain their vested interests.
- In fact, despite the overhaul, the government is supposed to finance more than 1.65 quadrillion won through 2085 to keep the debt-ridden pension system afloat.
- Even so, it carries great significance that the rival parties hammered out a compromise with the participation of all stakeholders. It might be reasonable for them to go for second best when it is impossible to make the best choice.

## **VI. Recent Development to Reform GEPS**

- The main parties agreed to establish a special parliamentary committee and a social consultation body to explore ways to revamp the broader national pension system and help resolve our elderly poverty problem.
- All previous governments since President Kim Dae-jung pushed for pension reform, but to no avail, in the face of resistance from public officials and politicians' irresponsible acts. But failing to overhaul the debt-ridden public servant pension system this time would result in a national disaster.

Thank you!

