OECD

2015 Pension Policy Notes

KOREA

- **Increase contributions to public and private pensions to promote long-term sustainability and adequate pensions.**
- **Eliminate the possibility for companies to set retirement ages below the NPS age.**

The pension system has still to reach full maturity. The new basic old-age pension was introduced in July 2014. This guarantees a minimum monthly pension of KRW 100,000 (or about USD 100), with a full pension of twice that amount, representing 5% and 10%, respectively, of the average income of the earnings-related contributors. This new basic old-age pension is still targeted at the poorest 70% of the elderly population. The earnings-related component, operated by the National Pension Service (NPS), is a public mandatory partially funded defined-benefit scheme with limited scope as the targeted gross replacement rate for a 40-year career has decreased from an initial promise of 70% in 1988 to 47% in 2014 and 40% by 2028. Overall, this has the potential to generate long-term replacement rates around 70% of the OECD average rate for low earners, but only 30% for high earners. Promoting better coverage of private pensions would be an advantageous way to improve the adequacy of total retirement savings. The relative average income of people aged over 65 (versus that of the whole population) is currently the lowest within the OECD. The old-age poverty rate is the highest in the OECD, and three times the poverty rate for the total population, reflecting the recent creation of the earnings-related pension in 1988.

Key indicators: Korea and OECD average

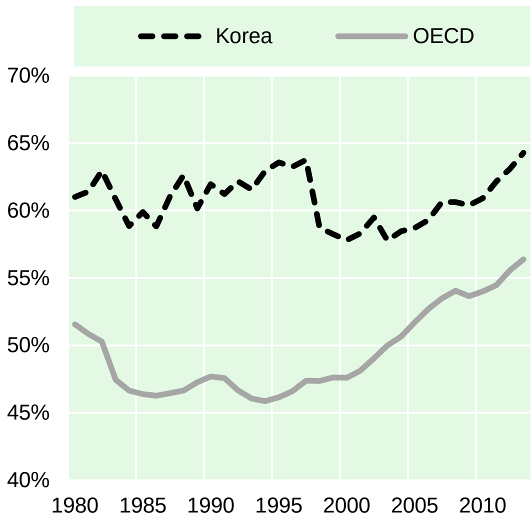
	Mid-1980s	Mid-1990s	Mid-2000s	latest available	latest OECD	long-term	long-term OECD
Pensionable age for a full-time career starting at the age of 20		60.0	60.0	60.0		65.0	
Retirement age		60.0	60.0	60.0	62.9 (61.8)	65.0	64.6 (64.4)
Net replacement rate, avg earner						45.0	63.2 (62.7)
Total mandatory contribution rate		6.0	9.0	9.0	19.1		
Total pension spending, % of GDP		1.5	2.0	3.4	10.3		
Public pension spending, % of GDP		1.3	1.7	2.4	8.4		
Public debt, % of GDP	..	..	24	35	115		
Employment rate 55-64, %	75.7 (47.1)	78.7 (50.2)	72.2 (45.7)	79.6 (52.0)	66.1 (49.1)		
Labour-market exit age	66.4 (63.6)	70.6 (66.8)	70.2 (67.7)	72.9 (70.6)	64.6 (63.1)		
Old-age poverty rate, %			44.6	49.6	12.6		
Life expectancy at 65, years	11.9 (16.0)	13.8 (17.6)	16.6 (20.7)	18.4 (22.7)	18.4 (21.5)	23.1 (28.1)	22.9 (25.9)
Old-age dependency ratio	0.08	0.09	0.14	0.20	0.28	0.79	0.57
Fertility rate	1.6	1.5	1.2	1.3	1.7	1.7	1.8

Note. The figures for women appear in parenthesis where they differ from those for men.
Long-term: Around 2060 based on all legislated reforms up to mid-2015.

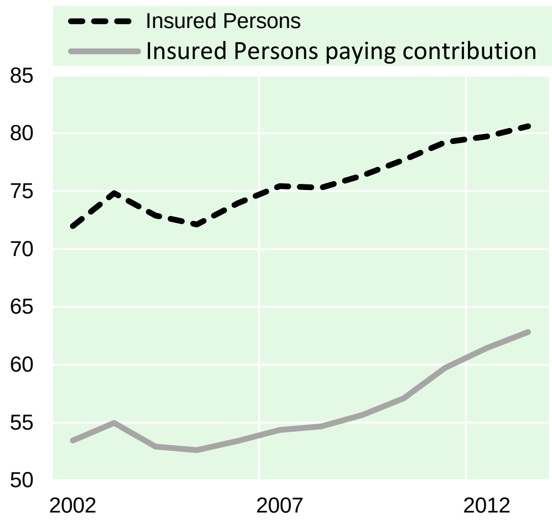
Increasing the number of contributors will help to lower poverty levels. The coverage of the NPS pension system has been extended over time and current plans are to include more vulnerable groups, in particular those working in small workplaces. Along with the targeted pension, this will contribute to protecting future retirees from poverty, especially if the safety-net pension is redesigned to better include the most vulnerable or is increased to a significantly higher level. Also many older workers are required in many cases to leave their primary occupation well before age 65, because of company specific retirement rules. Many fail to gain subsequent employment or make voluntary contributions when self-employed and aged over 60, leading to low benefits.

While fiscal sustainability is not a risk in the short-term the NPS cannot continue without reform. Despite future pension promises having been gradually reduced from an initial 70% replacement rate for a 40-year career to 40% currently, the NPS projects deficits from 2044 and funds depletion by 2060. With Korea facing the fastest population ageing among OECD countries, being second oldest to Japan by the middle of this century, action needs to be taken quickly.

Employment rate for those aged 55-64



Pension coverage, % economically active



Sources: OECD Employment Outlook; National Pension Statistics facts book

Pension contributions will need to be increased to ensure future pension adequacy and sustainability. Contributions to the scheme are currently 9% of earnings, split equally between workers and employers. This is about half the level of contributions on average in OECD countries. Despite the pension system still needing to mature reforms will be required in the coming years to ensure that it is financially sustainable. Increasing the contribution levels from both employees and employers would increase the revenues available to the NPS, prolonging its sustainability. Beyond improving sustainability, any increase in contributions to both the public and private pensions could also be used to increase future benefits. The long-term retirement age, of 65 by 2033, is low in comparison to many OECD countries where the majority have legislated increases to 67 and beyond. Korea should at least link retirement age to increases in life expectancy to help with sustainability. Currently companies can enforce early retirement from age 55 and as such many private pensions can also be retrieved from this age. This threshold is expected to increase to age 60 by 2016 for large companies, with smaller employers following in 2017. However, early retirement could still be enforced prior to the NPS retirement age. Legislation banning companies from enforcing early retirement would increase total contributions. Additional labour market reforms would be required though. For example, seniority wage setting would have to be reassessed as retaining older workers has currently a considerable cost to employers. Whilst the introduction of the targeted pension is welcome, more needs to be done to tackle the high levels of poverty that exist amongst the elderly. The benefit level should be increased considerably and then better targeted. This will add extra cost to the government initially, but over time as the NPS matures fewer workers will require any additional top-up.

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