Long-Term Fiscal Projections in Korea

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1. Background

- The demographic and macroeconomic challenges in Korea
1. Background (cont’d)

◆ Korea’s current fiscal condition seems relatively good compared to other major economies.

  General gov’t gross financial liability (2015, as % of GDP):
  ▪ Korea: 43.2%
  ▪ OECD average: 115.5%

◆ However, its long-term fiscal condition is projected to worsen due to rapid demographic changes:

  Major welfare systems such as the national pension scheme will reach the stage of maturity.

  Expenditures associated with population aging, such as those for healthcare, are expected to rise sharply.
1. Background (cont'd)

In order to respond systematically to these long-term fiscal risks and assess fiscal sustainability, the 1st long-term fiscal projections from 2016 to 2060 have been carried out.

- **Legal basis**: National Finance Act ([presidential decree §2](#))
  - Authority in charge: Ministry of Strategy and Finance
  - Time span covered: more than forty years ahead
  - Frequency: at least every five years (in case of doing it)

- **Usage**: a central early-warning instrument
  - Indicates the need for policy reforms
  - Raises awareness for “costs of reform delay”
  - Improves public confidence by increasing transparency
2. Procedures

◆ Step 1: Identify the premises for projections (population, growth rate, etc.)
  - Demographic changes projected by Statistics Korea
    - Productive age group declines since 2016
    - Total population declines since 2030
  - Macroeconomic changes projected by KDI
    - Potential growth rate declines continuously

◆ Step 2: Estimate each of the areas* affected by demographic / macroeconomic changes (mandatory spending, revenues, etc.)
  - No policy change: current institutional frameworks remain
    - Major national tax items projected by KIPF
    - Age-related expenditures projected by governing bodies
  *Areas: 8 social insurances (4 public pensions, health & long-term care, etc.)
2. Procedures (cont’d)

◆ Step 3: Determine the areas at the discretion of the government (discretionary spending)
  - Two baseline scenarios:
    - Scenario 1: A rise in the nominal growth rate
    - Scenario 2: Expenditure restructuring

◆ Step 4: Conduct long-term fiscal projections
  - Estimate fiscal balance and national debt
  - Diagnose fiscal sustainability of each social insurance

◆ Step 5: Conduct sensitivity analysis if there are additional changes in basic scenarios
3. Projection results: Revenue/Expenditure (scenario 1)

**Total Revenue (% of GDP) : 25.6-27.9%**

<table>
<thead>
<tr>
<th></th>
<th>'16</th>
<th>'30</th>
<th>'40</th>
<th>'60</th>
<th>CAGR</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Total Revenue</td>
<td>25.6</td>
<td>27.8</td>
<td>27.9</td>
<td>25.7</td>
<td>3.8</td>
</tr>
<tr>
<td>▪ National Tax</td>
<td>14.6</td>
<td>14.9</td>
<td>15.2</td>
<td>15.6</td>
<td>4.0</td>
</tr>
<tr>
<td>▪ Social Security</td>
<td>6.2</td>
<td>8.6</td>
<td>8.3</td>
<td>5.8</td>
<td>3.7</td>
</tr>
<tr>
<td>▪ Others</td>
<td>4.8</td>
<td>4.3</td>
<td>4.3</td>
<td>4.3</td>
<td>3.6</td>
</tr>
</tbody>
</table>

**Total Expenditure (% of GDP) : 25.3-32.2%**

<table>
<thead>
<tr>
<th></th>
<th>'16</th>
<th>'30</th>
<th>'40</th>
<th>'60</th>
<th>CAGR</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Total Expenditure</td>
<td>25.3</td>
<td>26.3</td>
<td>28.4</td>
<td>32.2</td>
<td>4.4</td>
</tr>
<tr>
<td>▪ Mandatory</td>
<td>12.0</td>
<td>15.4</td>
<td>17.4</td>
<td>21.2</td>
<td>5.2</td>
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<tr>
<td>▪ Discretionary</td>
<td>13.3</td>
<td>10.9</td>
<td>10.9</td>
<td>10.9</td>
<td>3.4</td>
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3. Projection results: National debt ratio

- Baseline scenarios: with/without fiscal consolidation

![Graph showing national debt ratio projections with and without fiscal consolidation from 2016 to 2060. The graph indicates a significant difference between the scenarios, with the without fiscal consolidation scenario reaching a debt ratio of 62.4% by 2060, while the with fiscal consolidation scenario remains below 40% throughout the projection period.]
3. Projection results: National debt ratio

- Sensitivity analyses (when each unfavorable condition is materialized individually)

![Graph showing national debt ratio projections](Image)
3. Projection results: National pension

- The reserve of the national pension fund is projected to dry up in 2060.
3. Projection results: Health and long-term care

- National health insurance and long-term care insurance for the aged are exposed to sustainability risk.

<table>
<thead>
<tr>
<th>National Health Insurance</th>
<th>Long-term Care Insurance for the Aged</th>
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<tbody>
<tr>
<td><img src="image1.png" alt="Graph of National Health Insurance" /></td>
<td><img src="image2.png" alt="Graph of Long-term Care Insurance" /></td>
</tr>
</tbody>
</table>

- **Balance:** balance switching in 2022, deficit increasing continuously
- **Reserve:** reserve depleted in 2025

- **Balance:** balance switching in 2024, deficit increasing continuously
- **Reserve:** reserve depleted in 2028
4. Policy implications

- Systematically control additional financial burden
  - Mandatory expenditure: Pay-as-you-go rule
  - Discretionary expenditure: Fiscal rule

  Work on the passage of the Fiscal Soundness Act by the National Assembly to build a legal foundation for securing mid- to long-term fiscal soundness.
4. Policy implications (cont’d)

- Enhance sustainability of social insurance
  - Reform current generous contribution/benefit structure
  - Build social consensus among stakeholders

- Broaden managerial capacity for fiscal risk monitoring
  - “Integrated fiscal projection committee” was launched in 2016 to introduce preemptive measures to stabilize social insurances’ fiscal balance and monitor the performances periodically.
  - The committee will distribute common guidelines for the 2nd long-term fiscal projections, which is expected to be completed in 2018.
  - Projection timings and premises of 8 social insurances will be unified from this time onwards.
Thank You!