The 10th Tokyo Fiscal Forum

Fiscal Reforms & Sustainability in Korea:
Achievements and Challenges

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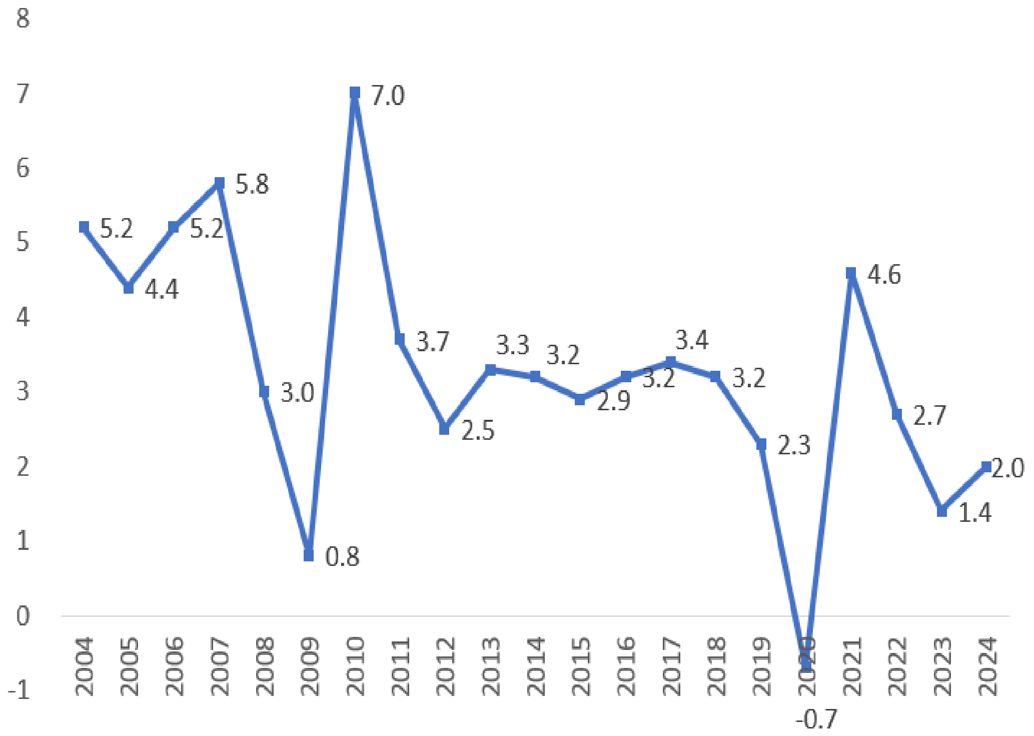
Contents

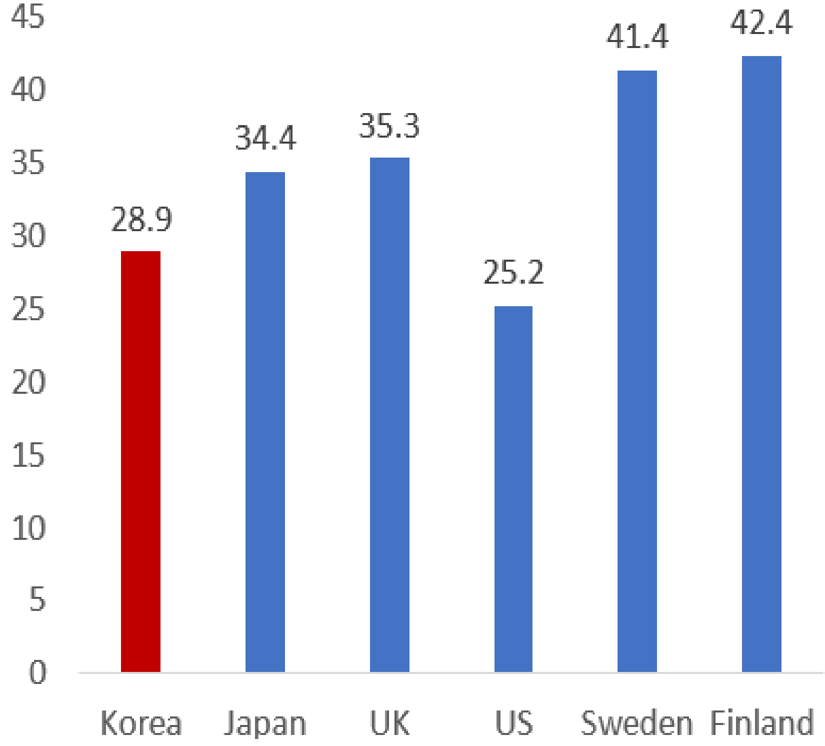
1. Economy and public finance in Korea

◆ Growth rates of GDP, 2004-2024



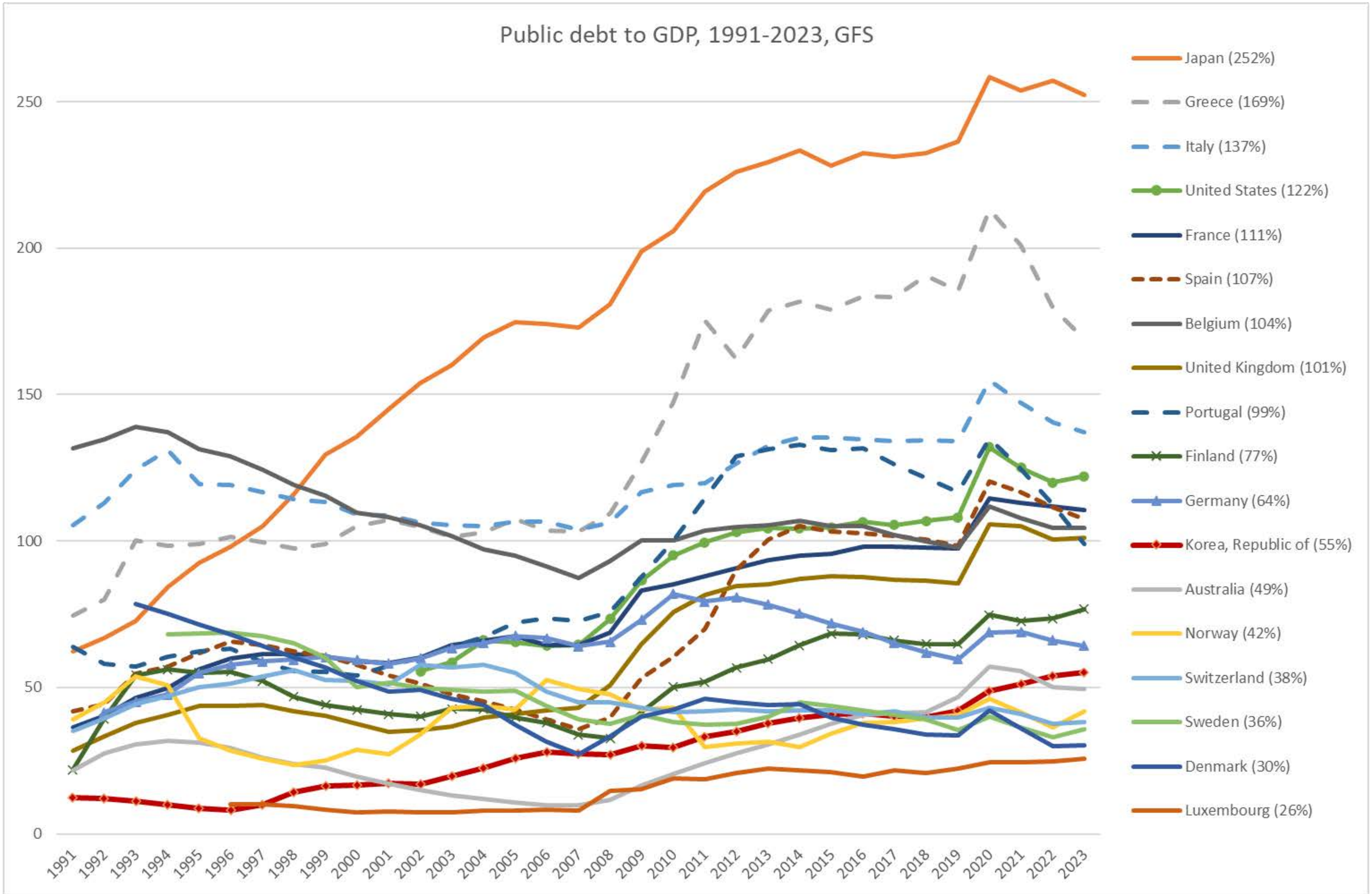
Source: BOK, National Accounts

◆ Tax burden, % of GDP, 2023



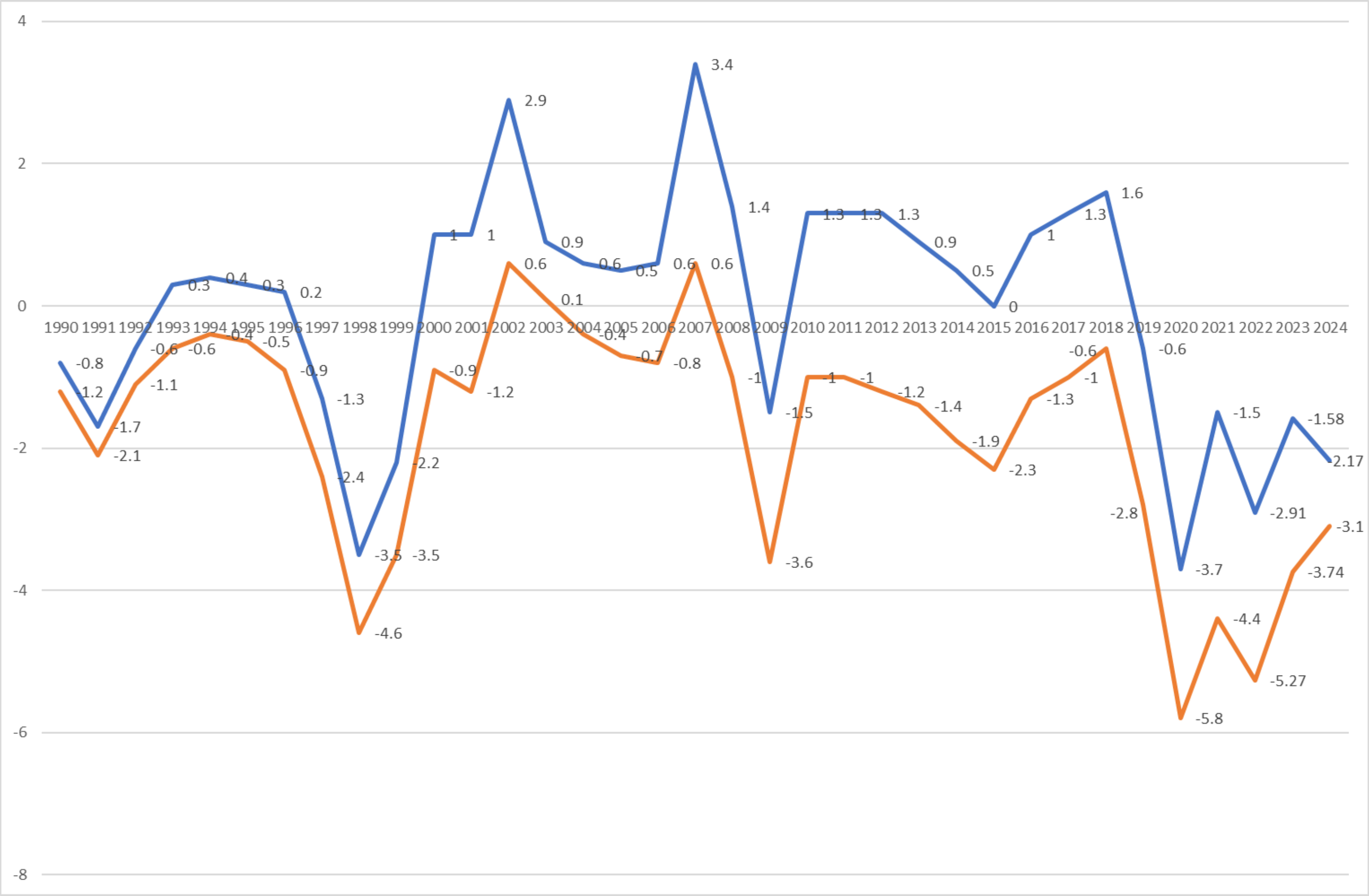
Source: OECD, Revenue Statistics (2024)

1. Economy and public finance in Korea – Public debt, % of GDP, GFS



Source: IMF GFS

1. Economy and public finance in Korea – Surplus/Deficit, % of GDP, KOSIS



- (blue line) Consolidated budget surplus/deficit including social insurance
- (orange line) Consolidated budget surplus/deficit excluding social insurance

Source: KOSIS

2. performance budgeting - History of budget management system

- **Monitoring system has been in place since 1961**
  - Corresponding to the 5-year economic development plans
  - Focused on input and process monitoring

- Monitoring focus has moved from **process** to **output/outcome** over time, reflecting **evolution of government roles** from economic growth and to social changes.

- M&E has been reinforced by **the public financial management reforms in mid 2000s**
  - Explicit introduction of outcome-oriented M&E
  - Explicit Integration into budget process
  - The Asian financial crisis in 1997/1998, aging population, and a political need provided a momentum for the reform.

2. performance budgeting - Four layers of M&E System

1. Annual Monitoring	
Annual Performance Plan & Report	Performance Indicators & Targets

2. Self-Assessment of Budgetary Programs	
Line Ministries' Self-Assessment	Checklist-Based Assessment

3. Year-Round Performance Management	
Focus on 12 high priority programs	Year-Round Monitoring + Annual Assessment

4. In-depth Evaluation	
Focus on Crosscutting Programs	Program Evaluation

2. performance budgeting - PFM System within the Administration

Corresponding to each stage of budget process, PFM systems have been established and are in operation.

Pre-Budget Stage

- Pre-Feasibility Studies on new large programs by the central budget authority
- Assessment of PPP proposal
- Spending Reviews

Budget Formulation

- MTEF
- Annual performance plan by line ministries
- Reexamination of large programs experiencing cost overruns

Budget Execution

- On-site examination of programs suffering from budget execution problem
- Quarterly monitoring of selected programs
- Budget Waste Center

Post Budget Execution

- Annual performance report
- Self-Assessment of Budgetary Programs
- In-depth evaluation
- Other focused assessment

History of PB in Korea

2000 ~ 2002

performance budgeting (Pilot Project)
- Developed Strategic Objectives, Performance Goals
- Performance Indicators

2003 ~

Performance Goal Management System (PGMS)
- Expanded to all ministries and agencies
- Annual performance plan and report are required

2005 ~

Self-Assessment of Budgetary Programs
- 1/3 of major budgetary activities are evaluated every year
- Designed after the US PART(Program Assessment Rating Tool)

2005

In-Depth Evaluation
- Selected activities are subject to evaluation
- About 5 sets of activities selected every year

2018

- Year-Round Performance Management of Major Programs
- Quarterly monitoring & Annual Assessment of 80 programs

2. performance budgeting (1) Annual Monitoring

Performance Goal Management System (PGMS)

Every line ministry submits the annual performance plan along with budget request and the annual performance report with annual financial report.

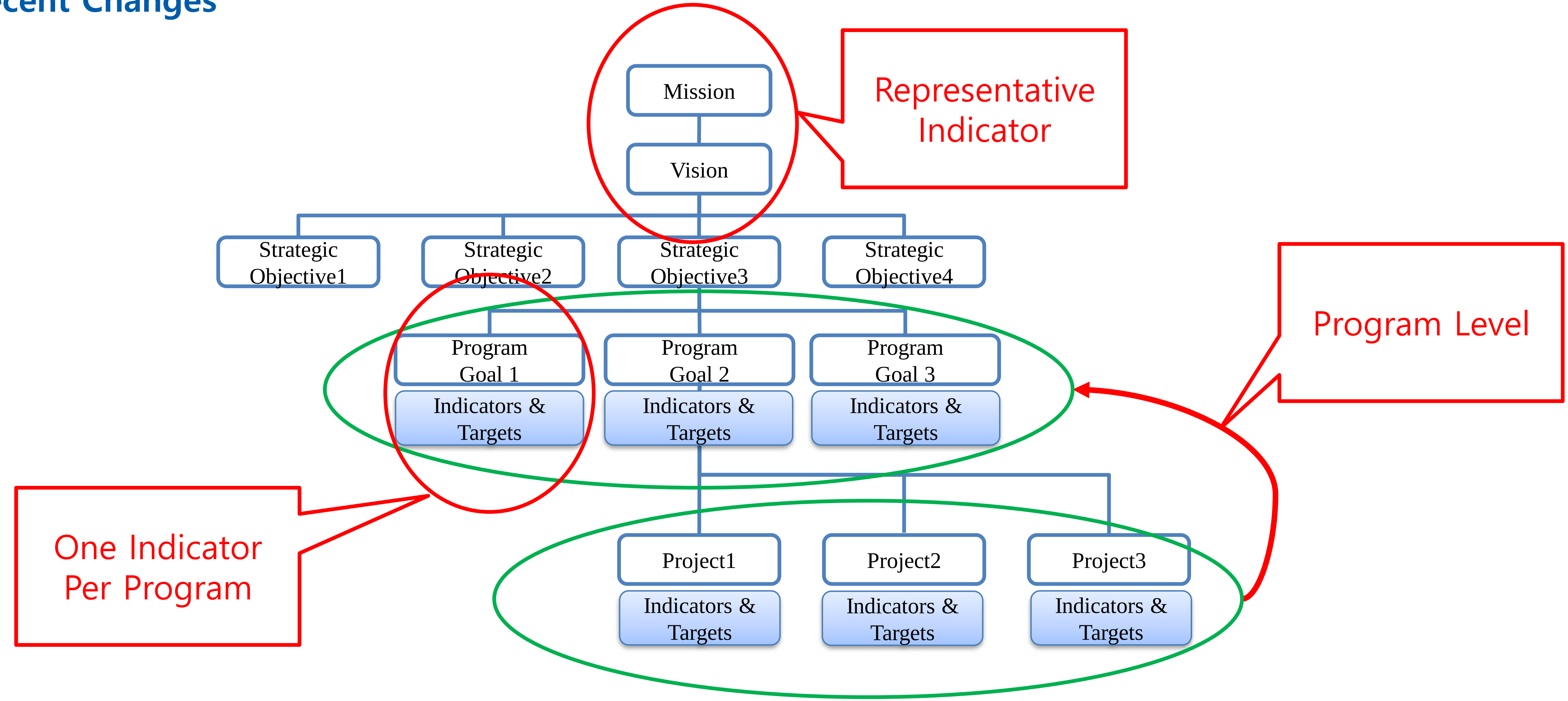
Year t-1	Year t	Year t+1
Establish Performance plan	Managing Finance (Fiscal Year)	Report Performance

▶ Annual performance plan : Ministries establish objectives, performance indicators, and targets of their projects.

▶ Annual performance report : Ministries report their actual performance in achieving objectives, measured by performance indicators and their targets.

2. performance budgeting (1) Annual Monitoring

Recent Changes



2. performance budgeting (2) Self-Assessment of Budgetary Programs

Self-Assessment of Budgetary Programs

Checklist-style Review

- Line ministries assess their own programs based on the checklist provided by MOEF and apply the results into budget operation
- Introduced by benchmarking the United States' PART(Program Assessment Rating Tool) system
- Mandatory budget cuts for projects with a 'poor' rating
  - Method: Relative evaluation(good/average/poor)
  - Criteria of checklist: Appropriateness of the plan, Efficiency of execution, Performance achievement, Performance excellence, Effort of improvement
  - If budget cuts are challenging, LM are required to submit a performance improvement plan for each poor project

Recent Changes

- To address the drawbacks of preparing performance plans at the program level, self-assessments are managed at the sub-project level (previously at the project level)

2. performance budgeting (3) Year-Round Performance Management

Performance Management of Core Programs

◆ Background

- Select core programs that reflect the government's national vision and implement close and focused management over five years (from 2023 to 2027) to achieve visible results during the current government's term, introduced in 2023
- Since 2025, existing programs have been monitored using quarterly performance indicators, while four new cross-ministerial initiatives are being evaluated: Strategic ODA, Youth Advancement, SME Innovation, and AI Ecosystem Development.

◆ Purpose

- Inter-ministerial cooperation through the sharing of a national governance vision
- Enhancing performance through intensive and sustained management over five years
- Disclosing the performance of projects to the public

2. performance budgeting (4) In-Depth Evaluation

In-depth Evaluation

- **Ex-post evaluation**
  - Crosscutting issues and projects of systemic issues are subject to in-depth evaluation
  - Analyze the effects of the projects (group) using quantitative and qualitative methods
- **Evaluation target**
  - Usually project "group" that do not follow the program budget system
  - Example: Tourism Infrastructure Support Project Group (ongoing in 2024)

Ministry of Culture, Sports and Tourism	Metropolitan Tourism Development Projects for the Southern Region
	Metropolitan Tourism Development Projects for the Western Region
	Establishing a Foundation for Tourism Resources
	⋮
Ministry of Land, Infrastructure and Transport	Support for Coastal and Inland Development Projects
Ministry of Oceans and Fisheries	Marine Tourism Promotion
⋮	⋮

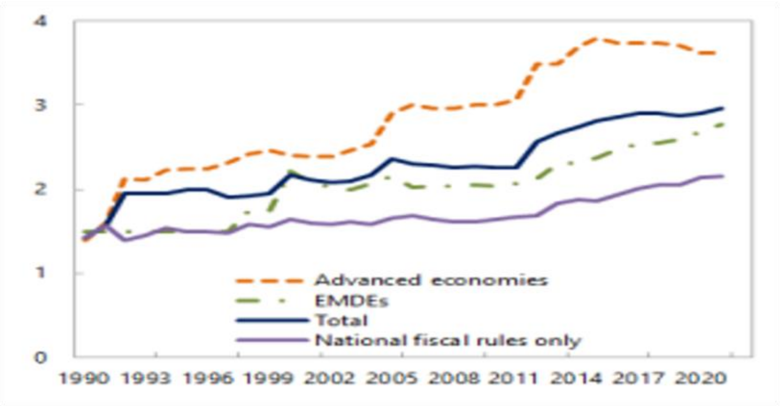
3. Fiscal rules (1) Korea

- **Korea does not have formalized fiscal rules, but operates under informal national guidelines.**
- **Currently, Korea operates under a framework of fiscal discipline and medium-term fiscal management plans**:
  - **Managed Fiscal Balance**: The government targets a managed fiscal deficit within 3% of GDP starting from 2025
  - **Debt Management**: The goal is to keep the government debt-to-GDP ratio around 50% by 2028
  - **Expenditure Growth**: Total government expenditure is set to grow at a moderate pace (3.2% increase in 2025 over the previous year)

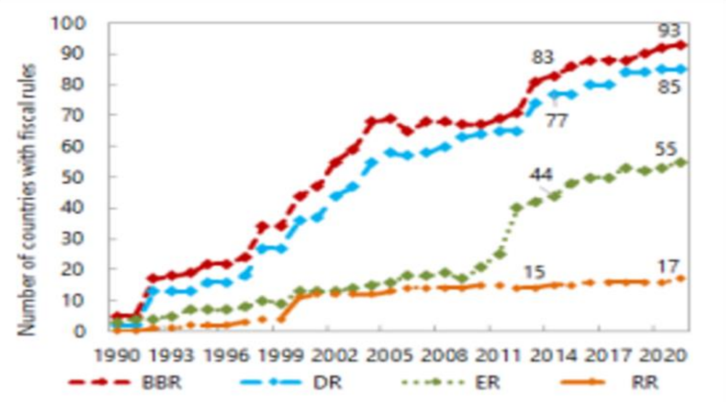
3. Fiscal rules (2) International comparison

◆ 1985-2021 International comparisons by IMF fiscal rules dataset (Davoodi et al., 2022)

Average Number of Rules per Country (number of fiscal rules)



Types of Fiscal Rules (Number of countries with specific type of fiscal rule)



- Sources: IMF Fiscal Rules Dataset: 1985–2021; Davoodi, Elger, Fotiou, Garcia-Macia, Lagerborg, Lam, and Pillai (2022a).
- Note: BBR: Budget balance rule; DR: Debt rule; ER: Expenditure rule; RR: Revenue rule.

Key fiscal discipline tool	Switzerland	Expenditure constraint	Germany	Debt Brakes
	Sweden	Surplus rule, Expenditure cap	United States	Expenditure constraint, PAYGO
	Ireland	Expenditure constraint	Japan	Balanced budget rule
	Netherlands	Long term expenditure plan	United Kingdom	Balanced budget rule, Debt rule

3. Fiscal rules (2) International comparison – US

United States: PAYGO principle

- The Pay-As-You-Go principle requires that any new legislation affecting spending or revenues must not increase the Federal deficit. It must include offsetting measures such as spending cuts or revenue increases.
- Background: Introduced in the 1990s to address rising fiscal and trade deficits.
- Outcome: Contributed to achieving a budget surplus in 1998 for the first time in 30 years and helped reduce deficits.

Type of national rules (Start date)	Monitoring outside government	Formal enforcement procedures	Coverage	Statutory basis	Escape clauses	Investment excluded from rules
Expenditure rule (1990, 2010)	Yes	Yes	Federal government	Yes	No	No
Budget balance (1986)	Yes	Yes	Federal government	Yes	No	No

Source:: Davoodi et al.(2022a), p.126.

3. Fiscal rules (2) International comparison – Japan

Japan : Medium-Term Fiscal Framework

- Japan adopts a medium-term fiscal framework to ensure fiscal sustainability, including expenditure ceilings and long-term planning.
- Background: A response to growing fiscal pressures due to an aging population and slow economic growth.
- Impact: Helped slow the pace of debt accumulation and reduced the fiscal deficit over time.

Type of national rules (Start date)	Monitoring outside government	Formal enforcement procedures	Coverage	Statutory basis	Escape clauses	Investment excluded from rules
Expenditure rule (2006, 2010, 2015, 2018)	No	No	Central government	Political commitment	No	No
Balance budget rule (1947, 1998)	No	No	Central government	Yes	No	Yes

Source:: Davoodi et al.(2022a), p.68.

3. Fiscal rules (2) International comparison – UK

United Kingdom: Fiscal Responsibility Act(FRA)

- The FRA sets legally binding targets for reducing the fiscal deficit and stabilizing public debt.
- Background: Introduced after the 2008 global crisis to restore fiscal discipline.
- Impact : Played a role in deficit reduction and maintaining debt stability.

Type of national rules (Start date)	Monitoring outside government	Formal enforcement procedures	Coverage	Statutory basis	Escape clauses	Investment excluded from rules
Budget balance rule (1997, 2010, 2014, 2015, 2017, 2019, 2021)	Yes	No	Public sector	Yes	Yes	Yes
Debt rule (1986, 2020, 2021)	Yes	No	Public sector	Yes	Yes	No

Source:: Davoodi et al.(2022a), p.123.

4. The division of budgetary powers

- **Current division of budgetary powers between the legislature and the executive branch in Korea's constitution**
  - Article 54
    - (1) The National Assembly shall deliberate and decide upon the national budget bill.
    - (2) The Executive shall formulate the budget bill for each fiscal year and submit it to the National Assembly within ninety days before the beginning of a fiscal year. The National Assembly shall decide upon it within thirty days before the beginning of the fiscal year.
  - Article 57
    - The National Assembly shall, without the consent of the Executive, neither increase the sum of any item of expenditure nor create any new items of expenditure in the budget submitted by the Executive.
  - Article 58
    - When the Executive plans to issue national bonds or to conclude contracts which may incur financial obligations on the State outside the budget, it shall have the prior concurrence of the National Assembly.
  - Article 59
    - Types and rates of taxes shall be determined by Act.

4. The division of budgetary powers

Principle and cases of the division of budgetary powers

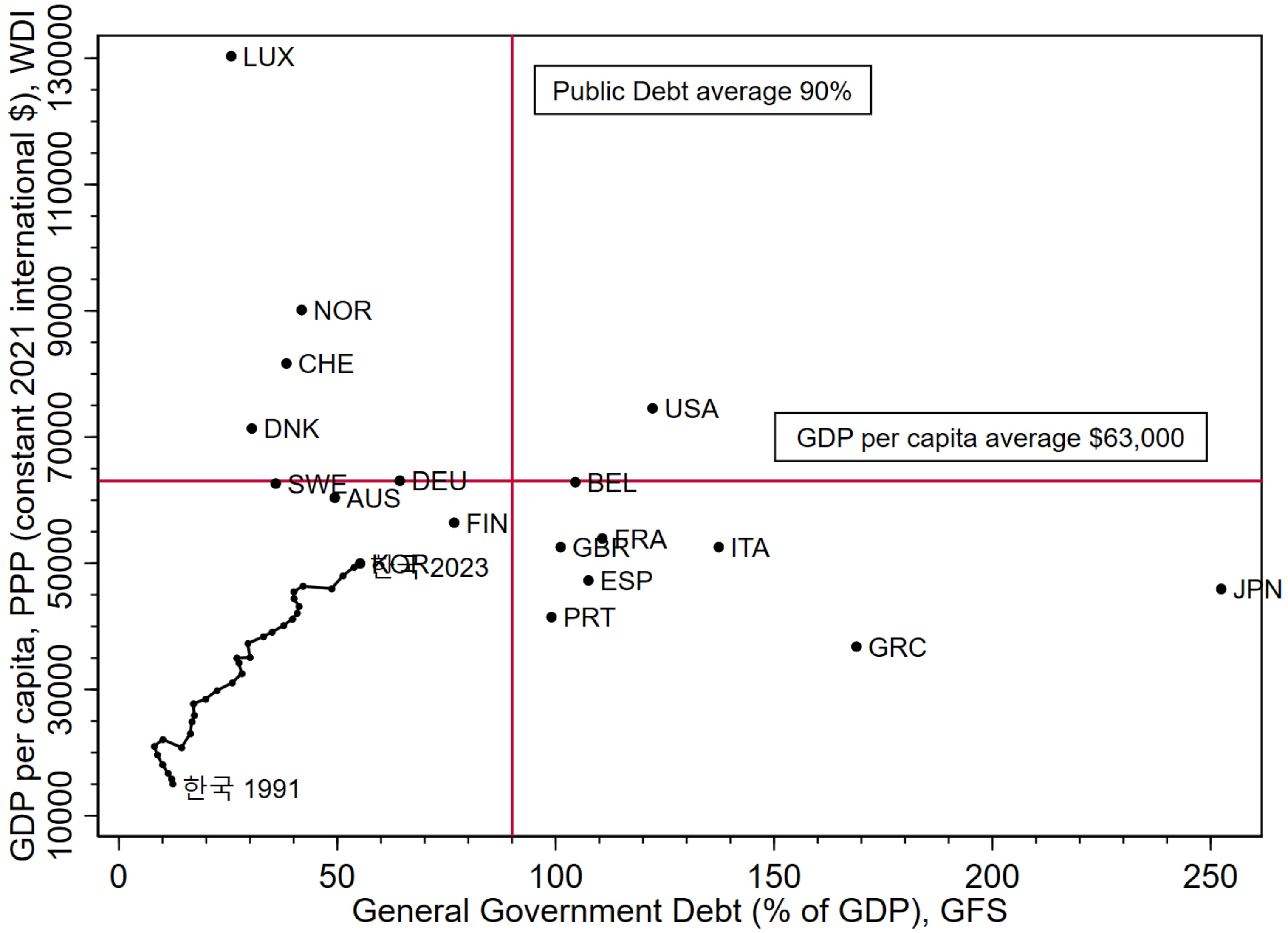
- Core principle of separation of powers between the two are very similar among all countries: Not monopolized by one party but shared by the two (Kim, 2024, OECD Journal on budgeting).
- The **strict division** between the authority of the executive branch to formulate the budget and the authority of the legislature to deliberate and approve it.
- Whether budget is a law or not is not fundamental factor but a rather cosmetic element.
- US is known to have the budget as a law. But this is a cosmetic element. In the US, the right to formulate the budget belongs to the executive branch, OMB.
- If the legislature have both the authority of formulate and the authority to approve it, there are severe problem caused by **the tragedy of the commons**, pork barrel, and log-rolling.

5. Conclusion (1) Evaluation

Evaluation on Fiscal Policy in Korea

- Relatively sound macro public finance.
  - South Korea's government debt is approximately 55% of GDP, aligning with the OECD average.
  - South Korea’s budget deficit stands at around -3% except for recession and economic crisis.
- Budget process for performance budgeting is carried out.
- System for mid-term budgeting and digital public budgeting system,

5. Conclusion (2) international comparison



5. Conclusion (2) international comparison

- **GDP per capita and Debt of general government, 2023**
  - A clear negative correlation suggests two equilibria: one good and one bad.
  - Prosperous countries tend to have low public debt, while relatively low-income countries have high public debt.
  - Exceptions include the United States, whose currency serves as the dominant global reserve currency.
  - Korea is now at a crossroads, facing a choice between a good equilibrium and a bad one. Not shown in the figure, most of developing countries also in the third quadrants.

5. (3) Issues and recommendation – performance budgeting

- Need for **impact assessment**
  - Expenditures involving multiple ministries and/or multiple layers of government are common. In-depth evaluation now needs to take a form of impact assessment.
  - Preliminary impact assessment conducted or to be conducted: policy to promote regional balance, policy to address low birth rates, primary and secondary education policy of local government.
- **Specific issues**
  - Annual Monitoring: In a context where budgets are allocated at the sub-project level, program-level performance indicators have limitations in providing meaningful information for MOEF
  - Self-Assessment of Budgetary Programs: Strategic behavior of line ministries caused by mechanical budget cuts
  - Year-Round Performance Management: Hard for MOEF to commit to enhance performance (rather than performance improvement)
  - In-Depth Evaluation: Limitations in deriving recommendations for budget formulation at the project level

5. (3) Issues and recommendation – Fiscal rules

- **Institutions, rules for fiscal soundness**
  - Old implicit system of expenditure within revenue was collapsed since Asian Financial Crisis in 1997
  - New system for fiscal rules: where, in what form,
- **Challenging concerns for introducing fiscal rules in Korea**
  - 1. **Legislative delay**: The amendment of the National finance Act to introduce fiscal rules remains stalled in the National Assembly, delaying legal enforcement.
  - 2. **Political Incentives**: Fiscal spending may be influenced by short-term political motives, especially before elections, undermining the effectiveness of fiscal rules.
  - 3. **Constraints during economic shocks**: Setting the 'escape clauses' in the recession or crises may take time
  - 4. **Difficulty in setting appropriate criteria**: Indicators such as debt-to-GDP deficit ceiling may not be optimal under all economic conditions, and rigid thresholds could lead to suboptimal policy choices.
- **Despite all the challenges, Korea needs to establish formal fiscal rules in law.**

5. (3) Issues and recommendation – Fiscal rules

- **Implementation of legal fiscal rules might affect Korea's market credibility and sustainability**
  - Korea has maintained relatively strict fiscal discipline, keeping the national debt level around 50%.

  However, due to demographic changes such as population aging and low birth rates, as well as declining economic vitality from low growth, the fiscal role of the government is expected to become increasingly important from now on.

- **Implementation strategy and caveat**
  - **Fiscal council's** : The IMF and other institutions recommend that revisions to fiscal rule parameters and oversight be handled by an independent entity, 'fiscal council'. This independent oversight is seen as critical for credibility, transparency, and effective enforcement of fiscal rules.
  - **Political polarization** : We may need to pay socio-economic costs to finalize specific figures for the exception clause agreement caused by political polarization.

5. (3) Issues and recommendation – The division of budgetary powers

- Unfortunately, recently in Korea, strengthening the role of the parliament even including formulating the budget is being discussed.

- We recommend to keep current delicate balance between the legislator and the executive branch to avoid problem from the tragedy of the commons and pork barrel.

5. (3) Issues and recommendation – Revenue and Expenditure

- **Expenditure and revenue of the following need to reform.**
  - National public pension is unsustainable and intergenerationally inequitable.
    - The recent reform increases the rate from 9% to 13%. Need to raise further the rate, say to 16%.
    - Need policy can help to transfer income and asset from the old to the young
  - National health insurance reform. Populist pressures and political demands are pushing for expanded medical benefits. There is a significant risk of moral hazard.
  - Revenue mobilization and restructuring:
    - Need more revenue for social expenditure.
    - VAT rate increase from 10% to 15%.
    - Higher personal income revenue by lowering income threshold for the top rate.