

Implementation of Program Budgeting in Korea

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I . Background of introducing a new budget system

1. Merits and demerits of the control-centered budget system

For the last five decades, control-centered budget formulation and execution management by detailed subprogram and line-item had a positive effect on restraining wasteful expenditures in budget. The government formulated budget as in standard of input-oriented line-items and unit costs by detailed subprogram and managed budget execution and balanced budget account settlement as line item-centered. As line ministries lack of accountability, this control-centered budget operation contributed to reducing misuse and misappropriation of tax revenues.

However, there is a limitation in the control-centered system as the Korean budget system has adopted the mid to long term strategic resource allocation and is strengthening a Performance Management System in accordance to the international trend. The fiscal authority is putting an excessive amount of time and efforts in inspection of detailed subprograms (currently over 6,000 subprograms; Sesehang) while there is a lack of efforts in strategic resource allocation to link the mid to long term policy with budget. The budget system which enables the performance management by programs is absent as budget is operated as input-centered by line-items (currently 49 divisions/101 subdivisions) such as personnel cost and goods expense.

In short, the budget system as control-centered by detailed subprograms and line-items is a paradigm that basically cannot correspond to fiscal reform directions of the current Participatory Government, which aims at autonomy and decentralization and accountability and performance.

2. Limitations of the recent fiscal reform measures

The Korean government is implementing the medium-term expenditure framework(MTEF), efficient budget formulation, and fiscal reform measures to strengthen the linkage between budget and performance. A National Fiscal Management Plan, a Top-down Budgeting System and a Performance

Management System are included in those fiscal reform initiatives.

However, the traditional input-oriented budget structure and management, which is fundamental infrastructure of fiscal reform measures, acts as an obstacle as it is maintained as before.

Regarding the National Fiscal Management Plan and Top-down Budgeting System, it is difficult to ensure the linkage between the medium term fiscal plan and annual budget as functional classification of the National Fiscal Management Plan and annual budget is different. Moreover, strategic resource allocation is difficult to carry out as there is no program level, between about 500 items and 6,000 sub-subitems in budget classification, that links policy with budget. Sub items of about 1,400 are classified by organization such as Offices and Bureaus. According to Dr. Allen Schick, sub-subitems in Korea are inappropriate for the unit of strategic resource allocation. In the process of top-down budgeting, the program level, which each ministry can consult with the fiscal authority in depth, is absent in the case of deciding sectoral and ministerial ceilings. Actually, each ministry is having difficulties in realizing purpose of introducing the Top-down Budgeting System in Korea as sub-subitem is the basis in deciding ceilings and it is making it difficult for the fiscal authority to transfer its role to policy review-centered.

Meanwhile, regarding the Performance Management System, program level which is appropriate for performance management is absent in the Korean budget structure. The budget structure does not indicate unit costs by programs as personnel costs and operation expenses are not allocated by programs of Offices and Bureaus. Additionally, there is no change in line-item centered approach in the process of budget execution management and budget account settlement.

3. Directions of the new budgeting system

The budgeting system should be transferred from control-centered by detailed subprograms and line-items to program budgeting structure as policy and performance-centered. The government will set up a new functional classification system which accords the National Fiscal Management Plan with annual budget. The fundamental factors will be prepared in order to support

strategic resource allocation and performance management by setting up program level in budget classification system. Linking relevant detailed activities and/or projects under each program, we will establish program budget structure. Personnel costs and operation expenses are allocated by programs in order to present program unit costs in the budget. Dr. Schick commented that one of the problems in Korean budget structure is that personnel and operational costs are not allocated by programs.

In addition to that, the budget operation method will be reformed in the way that each ministry can ensure its autonomy and accountability in the process of budget formulation, execution, evaluation and budget account settlement. The fiscal authority will inspect and adjust as program unit-centered during the decision process of establishment of the National Fiscal Management Plan and sectoral and ministerial ceilings. Each ministry will autonomously formulate budgets for activities and/or projects within the program ceilings in principle. Line-items will be reduced or reformed in the direction of uplifting each ministry's autonomy. The budget execution and the budget account settlement system will be reformed from line-items centered to program performance centered.

II. Introduction of the program budget in Korea

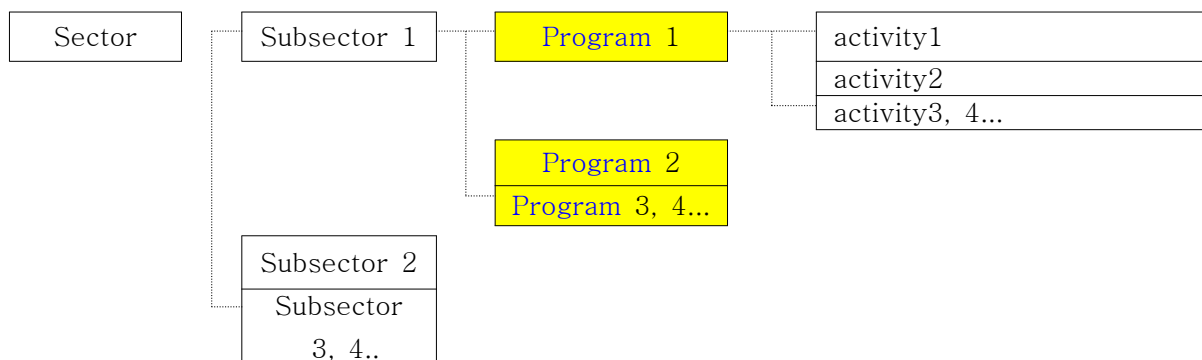
1. Definition of a program

Though there is no unilateral definition of a program, we generally name a program as a group of activities and/or projects to achieve the identical policy objective. International institutions and other countries operate their systems by defining the program budget system in the similar way.

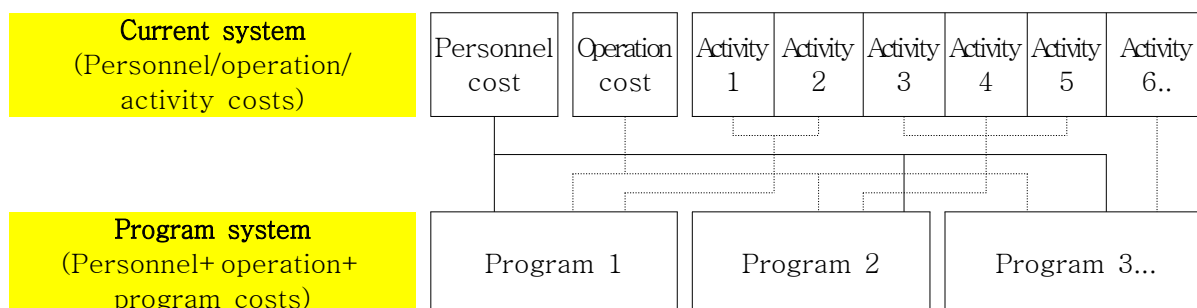
- any suitable and meaningfully integrated group of activities and projects, under a single manager, which consume resources to contribute to a specified policy objective(IMF Working Paper, April, 2003)
- generally defined as an organized set of activities directed toward a common purpose or goal, undertaken or purposed by an agency in order to carry out its responsibilities(USA JFMIP, Joint Financial Management Improvement Program)
- a program consists of a group of government-mandated activities that contribute to a common strategic or operational objective(Australia)

2. Key factors in designing program budget structure

- (1) The current sub-subitem activities will be grouped as program level (the lowest unit of legislative approval) by linking to policies.



- (2) Personnel cost and operation cost will be allocated by programs.



- (3) Ensuring accountability by linking with each ministry (Offices and Bureaus)

- Management of budget execution and performance management by program levels of Offices and Bureaus
- The budget account settlement is also reformed from line-item centered to program centered.

- (4) The activities under programs, in principle, will be managed autonomously by line ministries.

- The ceilings in the mid to long term fiscal management plan will be managed as program level.

3. Detailed approaches to design the program structure

(1) Setting up programs to link budget with policy(function).

Programs will be set up by taking into account the government policies and the current organizations' main functions, and resultantly policy and budget are linked at program level. Firstly, functional classification of expenditure budget will be rearranged by taking into account the international standard and changes of fiscal environment(20 sections 66 subsections → 16 sections 68 subsections). The functional classification of the National Fiscal Management Plan and annual budget will be accorded with each other. Also, activities that are carried out by each organization (central government- Offices and Bureaus, local governments- Division) will be restructured under relevant programs that are linked to policies. Excessively detailed activities will be simplified to the consolidated activity level that links to programs.

< Example of Ministry of Maritime Affairs and Fisheries >

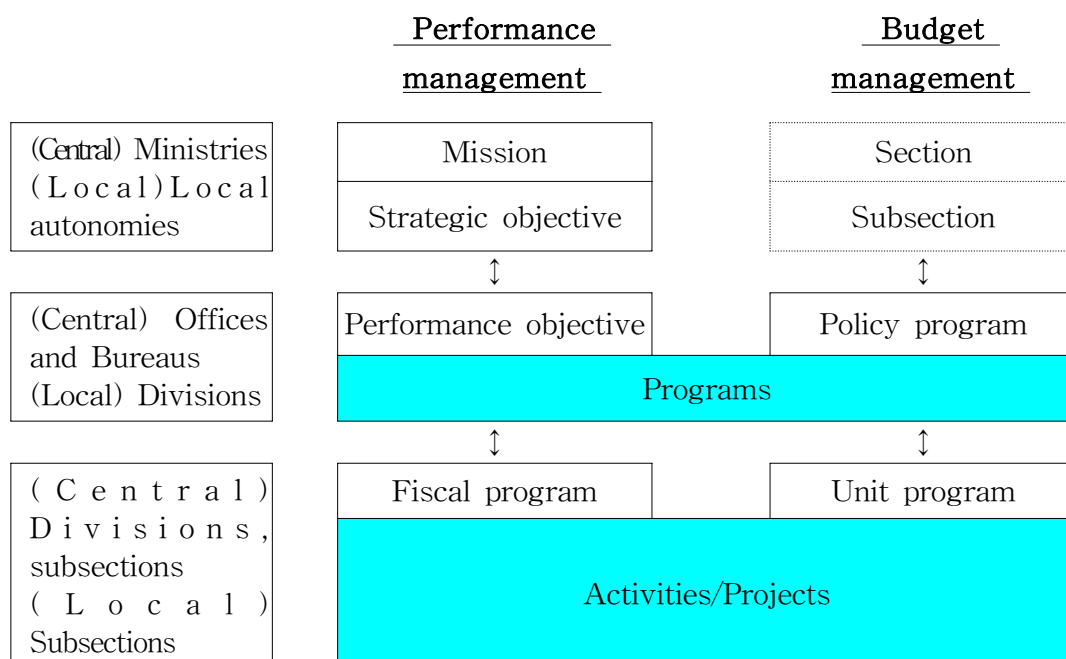
Current system	Program system	
Sub-subitem activity	Consolidated activity	Program
<ul style="list-style-type: none"> • Preparation of statistics of marine products • Supporting self-management marine products department • Assistant to Korea Fishing Port Association • Preparation of fishery production statistics 	<ul style="list-style-type: none"> 1. Construction of fishery production foundation 	Development of fishery villages and fishing ports
<ul style="list-style-type: none"> • Construction of a Fishes Museum • Construction of fishery tourism complex • Fishery Folk Museum 	<ul style="list-style-type: none"> 2. Development of tourism in fishery villages 	
<ul style="list-style-type: none"> • Construction of a National Fishing Port • Supporting feeding facilities • Construction of digitalized fishery villages • Construction of fishery villages and fishing port complex space • Oil storage facility • Construction of local fishing ports 	<ul style="list-style-type: none"> 3. Investment and management of fishery villages and fishing ports 	

(2) Allocation of indirect costs by programs

The method to allocate personnel cost and operation cost by programs will be implemented by stages. In a short term, only personnel cost and operation cost of Offices and Bureaus will be allocated by relevant Offices and Bureaus' programs. In a long term, costs of supporting organizations within a ministry such as Planning and Management Office and Coordination Division will be allocated by relevant Offices and Bureaus' programs. At the beginning stage, supporting organizations' those costs will be managed as consolidated at program level.

(3) Ensuring accountability by linking performance of organizations

The unit of performance management and budget management will be accorded with each other at each stage of program and activities. The performance management unit and budget formulation and execution units will be accorded at each stage of programs and activities that are carried out by each organization.



(4) Enhancement of autonomy in each ministry

Programs will be adjusted through consultations between the fiscal authority and each ministry while activities will be formulated and executed autonomously by each ministry in principle. The fiscal authority consolidates and adjusts a resource allocation policy through macro and performance information analysis of programs. Each line ministry will formulate and execute activities autonomously but guarantee accountability at the same time through uplifting performance of programs. Only, new or large projects over certain size (e.g. construction of Busan Port, Kwangyang Port etc.) will be decided through consultations with the fiscal authority.

Furthermore, the line-items, which are the main reasons for the limitation in the current budget system, will be reduced and reformed greatly (49 division, 101 subdivision → 7 division, 59 subdivisions). The tentative seven divisions include personnel cost, operation cost, current transfers, interest expenses, capital acquisitions, capital transfers, and other spendings. The compartments between divisions will be minimized while compartments will carry out the role of the cost element as in resource allocation, rather than input control. The standard will be set at IMF or GFS's standards but the standard will be adjusted in accordance to the Korean circumstances. In the government budget(proposal) and budget of the National Assembly review, it will be recorded as division unit. After the review of the National Assembly, it will be put as subdivision (statistic item of expenditure) unit. During the execution stage, sub-subdivision(account items) will be used as budget execution items.

(5) Improvement of budget documents

As the program budget is introduced, we need to uplift range and quality of budget information that is provided to the Congress and the public. The current "Jang(Section), Kwan(Subsection), Hang(Item), Sehang(Subitem), Sesehang(Sub-Subitem), Mok(Division)" system will be changed to "Section, Subsection, Program, Activity, Division" system. The budget and public funds will be prepared as a program budget document through consolidation. Moreover, we will supply budget information by programs with explanations. The budget documents will provide information on management of life cycle of programs (formation, execution,

extinction), which supplies implementation status and performance analysis of programs, such as program contents, past progress and performance, to the National Assembly and citizens.

A budget document system that reflects requirements by users will be introduced. It supplies the information required by users such as by accounts, public funds, programs, regions and etc., as appendix in the budget document or through the information system. Analysis and calculation of preparation of budget document and various fiscal information will be carried out through the fiscal information system, which substantially will alleviate workload burden on each ministry's staffs who are in charge of budget matters.

(6) Improvement of budget account settlement documents

The budget account settlement document of revenue and expenditure budgets that is as cash based will be reformed to the program system like the budget document in order to provide information with consistency. The results of cash-based budget execution will be prepared as program standard from the current division-centered system.

In addition to the cash-based settlement document, the consolidated financial budget account settlement document of accrual account and double entry bookkeeping will be produced as a separate document. This document will include a report on fiscal circumstances such as assets and liabilities of the government, a fiscal operation report by programs, a report on net asset fluctuations etc.

4. Efficient operation of the program budget system

(1) Upright establishment of roles of each ministry and the fiscal authority

There is a requirement of upright establishment of the role of each ministry and fiscal authorities such as Ministry of Planning and Budget, Ministry of Finance and Economy and Board of Audit and Inspection in order to efficiently carry out the program budget system.

	Current	Forward
Line ministries	<ul style="list-style-type: none"> ▪ A lack of efforts to guarantee program performance ▪ Not taking initiative in deciding detailed budget activities and budget size 	<ul style="list-style-type: none"> ▪ Guarantee of accountability in program performance ▪ Higher discretion of detailed budget activities and operational autonomy
Ministry of Planning and Budget	<ul style="list-style-type: none"> ▪ Micro analysis of activities ▪ Input and control-centered resource allocation → controlling each ministry's budget in advance 	<ul style="list-style-type: none"> ▪ Macro analysis of policies and programs ▪ Program performance centered resource allocation → coordination and adjustment of each ministry's policies
Ministry of Finance and Economy	<ul style="list-style-type: none"> ▪ Budget execution management and budget account settlement report as line item-centered 	<ul style="list-style-type: none"> ▪ Supplying budget account settlement information as program centered ▪ A partner of the macro resource allocation policy with the MPB
Board of Audit and Inspection	<ul style="list-style-type: none"> ▪ Account inspection as regulation oriented ▪ Performance auditing of detailed activities 	<ul style="list-style-type: none"> ▪ Program performance-centered auditing ▪ Coordination of performance evaluation system management

Each line ministry will guarantee autonomy in operation of activities under a program while making efforts to guarantee accountability through uplifting performance of the program at the same time. Accountability of program operation will be enhanced through the Performance Management System.

The Ministry of Planning and Budget will enhance the role of synthesizing and adjusting each ministry's policies through macro analysis about policies and programs' performance-centered resource allocation. It will outgrow of micro control of detailed activities in advance, but concentrate on strengthening capacity of macro review and adjustment such as implementation directions of policies and programs. For activities management, the Ministry of Planning and Budget will endow autonomy to each ministry but guarantee accountability through the linkage between program performance and resource allocation.

The Ministry of Finance and Economy will strengthen its role from the past line-items centered to the role of supplying budget execution management and budget account settlement information as program and activity centered. In the mean time, during the processes of establishment and adjustment of strategic resource allocation policy as program-centered, the ministry will maintain close cooperation relationship with the budget authority, the MPB.

The Board of Audit and Inspection will be transferred to a management coordination institution of program performance-centered auditing and performance evaluation system. As far as control and regulation oriented auditing is maintained, it will be difficult for the program budget system to be in place during the process of execution of line ministries. Therefore, it needs to be transferred to the performance audit system about the government policies and programs. It is also one of missions of the BAI to establish a reflux system of evaluation results in the national evaluation infrastructure system.

(2) Establishment of the National Fiscal Management Plan and budget formulation process

Innovation is required during the entire fiscal operation process in order to efficiently operate program budget system. Careful review and improvement of the entire process such as budget formulation, execution management and a report on budget account settlement are required. Particularly, establishment of the medium term fiscal plan and the budget formulation process, which are the starting point of fiscal operation cycle, are significant.

The National Fiscal Management Plan should be formulated and updated through strategic resource allocation. The strategic resource allocation plan will be

established on the basis of each ministry's programs. The current sub-subitems are inappropriate as strategic resource allocation unit to determine the size and directions of the mid to long term resource allocation of sections and subsections. There is a requirement of a system which determines each subsection's resource allocation directions through in-depth consultations, about relevant programs between the budget authority and each ministry. Each ministry will consult with the budget authority about the necessity of implementing programs and feasibility of formation of activities within programs. The budget authority will analyze and adjust feasibility of programs and finalize directions and size of resource allocation of relevant subsections. In the process of analyzing programs, it is required to closely collaborate with experts from various national policy research institutes.

The program budget will be formulated through consultations between the budget authority and each ministry while activities within programs will be autonomously formulated by ministries in principle. There is a requirement of upright establishment of the role of budget authority and each ministry in the process of Top-down Budgeting System as in program standard. A system which presents sectoral and ministerial ceilings and allows ministries to formulate all the programs autonomously will be difficult. In other countries, which have implemented the Top-down Budgeting System, there is no case of endowing complete discretion for program budgets to line ministries. In the future, it will be desirable that the budget authority will decide the program budget size through consultations with each ministry to decide sectoral and ministerial ceilings, and then each ministry formulates relevant activity budgets within the fixed program ceilings autonomously.

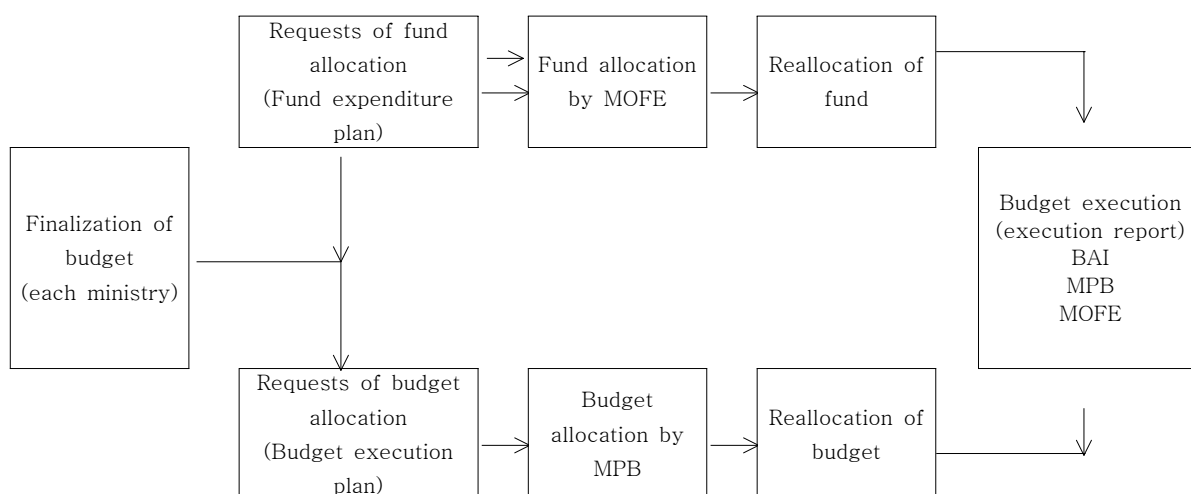
In the case of budget review, objects of resource allocation management and control will be transferred from sub-subitem and detailed line-item unit to program unit. Activities will be autonomously formulated by ministries in principle except special cases such as budget formulation of new program or certain amount of projects. Controlling line items will be minimized in the process of budget formulation due to application of reduced and reformed line-items. In the case of reviewing by divisions after endowing expenditure ceilings, it will be hard for each ministry to realize the purpose of introducing the Top-down Budgeting System.

(3) Budget execution and evaluation process

As the system will be transferred to the program budget system, budget allocation by divisions with a purpose of control will be executed restrictedly by taking into account autonomy and discretion of budget execution. The budget formulation itself is being carried out from a perspective of unit cost by programs in advance, not a method which sets up limits by divisions, therefore, allocation by unit cost elements will not be significant.

Allocation of budget and fund, reallocation of budget within ministries and reallocation of fund by quarters happen through submission of the annual budget execution plan at ministry unit. In the case of changes in annual budget execution plan due to consolidation, separation and abolition of activities, the modified report of budget execution plan will be submitted. The quarterly results of budget execution will be reported to the Board of Audit and Inspection, Ministry of Planning and Budget and Ministry of Finance and Economy through the budget execution report.

< Flowchart of budget execution >



From the resource management perspective, evaluation of programs by the Ministry of Planning and Budget will be a basic monitoring system that is based on the quarterly budget execution report. The monitoring system monitors

differences between the budget plan and execution by comparing yearly budget execution plan and practical budget execution report. It will also monitor reasons and grounds of consolidation, abolition and changes of programs.

(4) Budget account settlement process

『Budget account settlement』 will be carried out as settling budget execution results as cash based in accordance to the program budget document system. This document describes comprehensive analysis about yearly economic and fiscal management of the government and budget execution results such as performance by functions and programs and details of budget uses. Budget execution results are recorded by functions, programs, activities and divisions like the budget document system. The government will prepare one consolidated budget account settlement document of revenue and expenditure budgets and public funds with details of account settlement by accounts and public funds attached.

For the 『Financial budget account settlement』, a consolidated financial report will be prepared and submitted in accordance to the introduction of accrual accounting. Types and contents of the main financial report documents are:

- Report of financial status : a report on government assets, liabilities and net assets at the time of budget account settlement
- Report of financial management : a report on status of profits and expenses in accordance to management of programs during the fiscal year
- Report of net asset changes : a report on net asset increases or decreases during the fiscal year
- Report of collecting national(customs) taxes : a report on collection activities of National Tax Service and Korean Customs Service

III. Implementation schedule

The first stage(2004): Preparation of introducing the program budget system

- Preparation of guidelines of the program budget system
- Preparation of a reform proposal of the program budget system for pilot ministries* (as in the 2005 budget standard)
 - * 4 ministries : Ministries of Maritime Affairs & Fisheries, Finance & Economy, Environment and Construction & Transportation

The second stage(2005): Application of program budget test non electronically

- Pilot ministries : Preparation of the 2006 program budget(proposal) non electronically
 - Submission to the National Assembly: 1 copy of existing budget proposal + 1 copy of program budget system (as reference)
- Other ministries : preparation of reform proposal of the program budget system (as in the 2005 budget standard)
 - Submission to the National Assembly: 1 copy of existing budget proposal

The third stage(2006): Application of program budget test by Information System

- All the ministries will submit the 2007 budget (proposal) to the National Assembly as in the existing budget proposal system (early October) & prepare the 2007 program budget (proposal) non electronically simultaneously (not submitted to the National Assembly yet)
- After October, when the Integrated Financial Management System is established, the 2007 program budget (proposal) will be produced under the IT foundation → submission to the National Assembly in November(for reference)

The final stage(2007): Operation of the program budget system

- All the ministries will prepare the 2008 program budget (proposal) and submit this to the National Assembly under the foundation of the Integrated Financial Management System.