



# Public Expenditure Reforms in Korea: Restoring fiscal sustainability and preparing for looming risks

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# Challenges



# Challenges of PFM in the Post Covid-19 Era

## Fiscal Sustainability

- Higher level of debt: need for retrenchment but politically hard
- Hard to reverse fiscal policy direction: fiscal policy under low interest rates → fiscal policy under high interest rates

## Looming Risks

- Ageing → higher spending on pension and healthcare
- Climate Change → higher spending on decarbonization and prevention of natural disaster
- Geopolitical Risk → higher spending on defense and economic security

## Building Trust

- Political polarization hinders government from gaining trust from citizens
- To overcome fiscal challenges in the Post Covid-19 Era, citizens' trust in government is essential.

# Fiscal sustainability is under threat

Need for social insurance reforms + Accumulation of government debt

(NABO 2022 long-term fiscal projection)

Social insurance funds

- fiscal balance will turn to negative from 2039
- baseline projection presents non-sustainability

General government debt

- Managed fiscal deficit : 127.0 trillion KRW in 2022 → 249.6 trillion KRW in 2070
- Government debt: 49.2% of GDP in 2022 → 192.6% in 2070

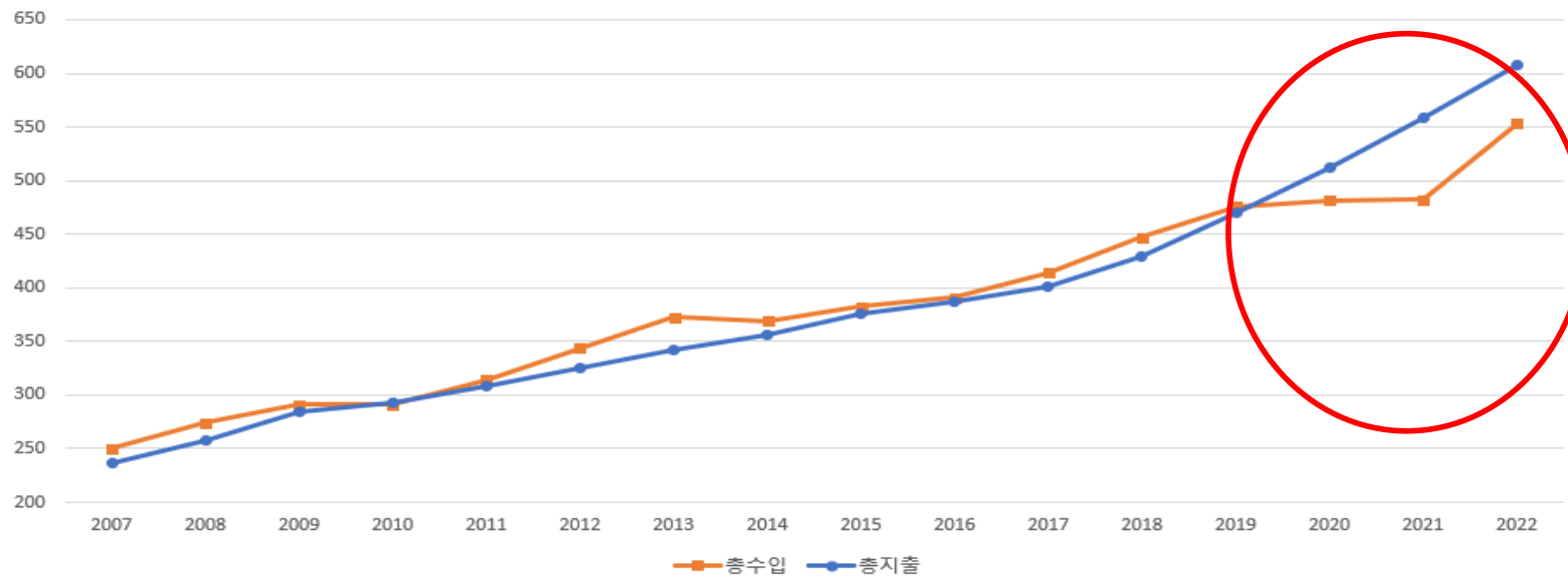
Government debt and managed fiscal balance (MFB) trends

(unit: trillion KRW)

	2017	2018	2019	2020	2021	2022
MFB	-18.5	-10.6	-54.4	-112.0	-126.6	-117.0
Gov Debt	660.2	680.5	723.2	846.6	965.3	1,075.7

# Trend of total revenue and expenditure

Recent 5-year avg growth rate of total expenditure (9.10%) exceeds that of total revenue (5.48%).



Note: Initial budget basis

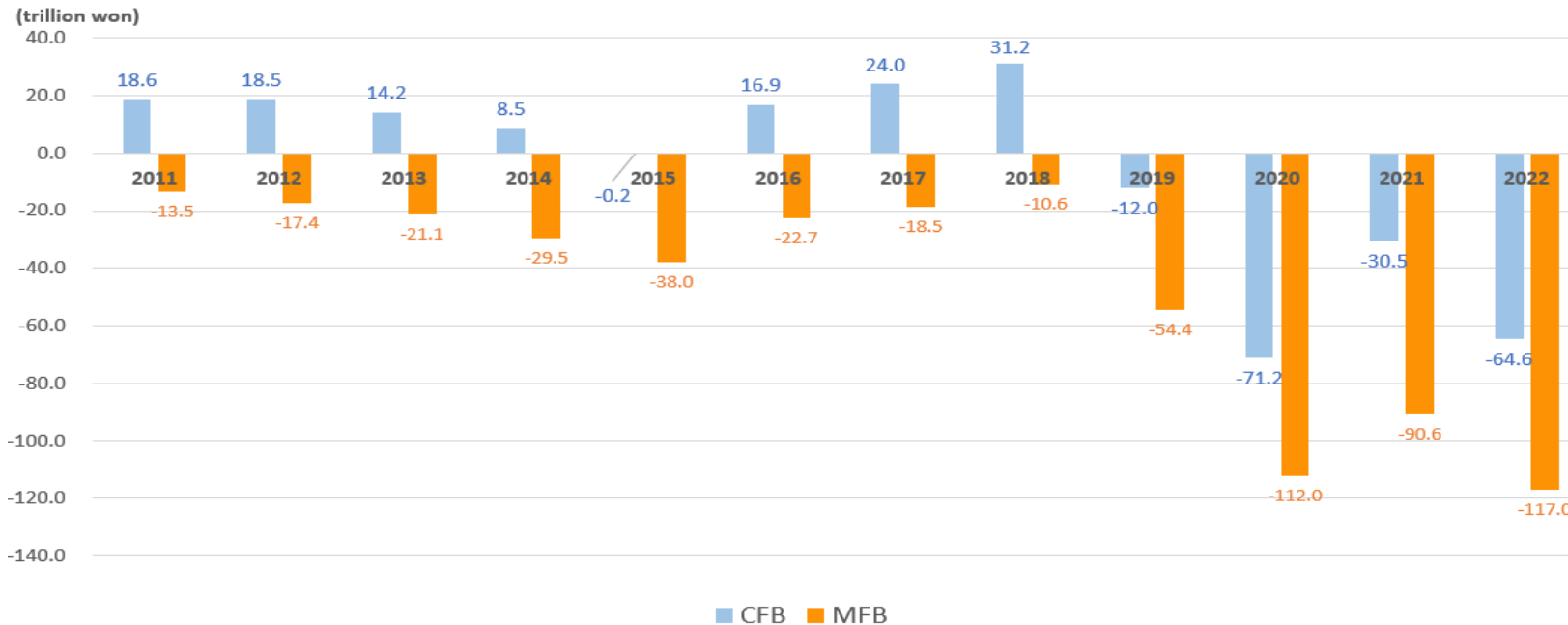
Source: Open Public Finance,

<https://www.openfiscaldata.go.kr/op/ko/sm/UOPKOSMA04?acctYrFr=2007&acctYrTo=2022&langCd=ko>,

accessed on 8. 30. 2022.

# Trend of Managed FB and Consolidated FB

The consolidated fiscal balance has turned negative since 2019. MFB is 117 trillion won (-5.4% of GDP), and CFB is -64.6 trillion won (-3.0% of GDP) in 2022.



[https://www.index.go.kr/unity/potal/main/EachDtIPageDetail.do?idx\\_cd=1104](https://www.index.go.kr/unity/potal/main/EachDtIPageDetail.do?idx_cd=1104), Accessed on 8.29.2023

# Increasing budget rigidity

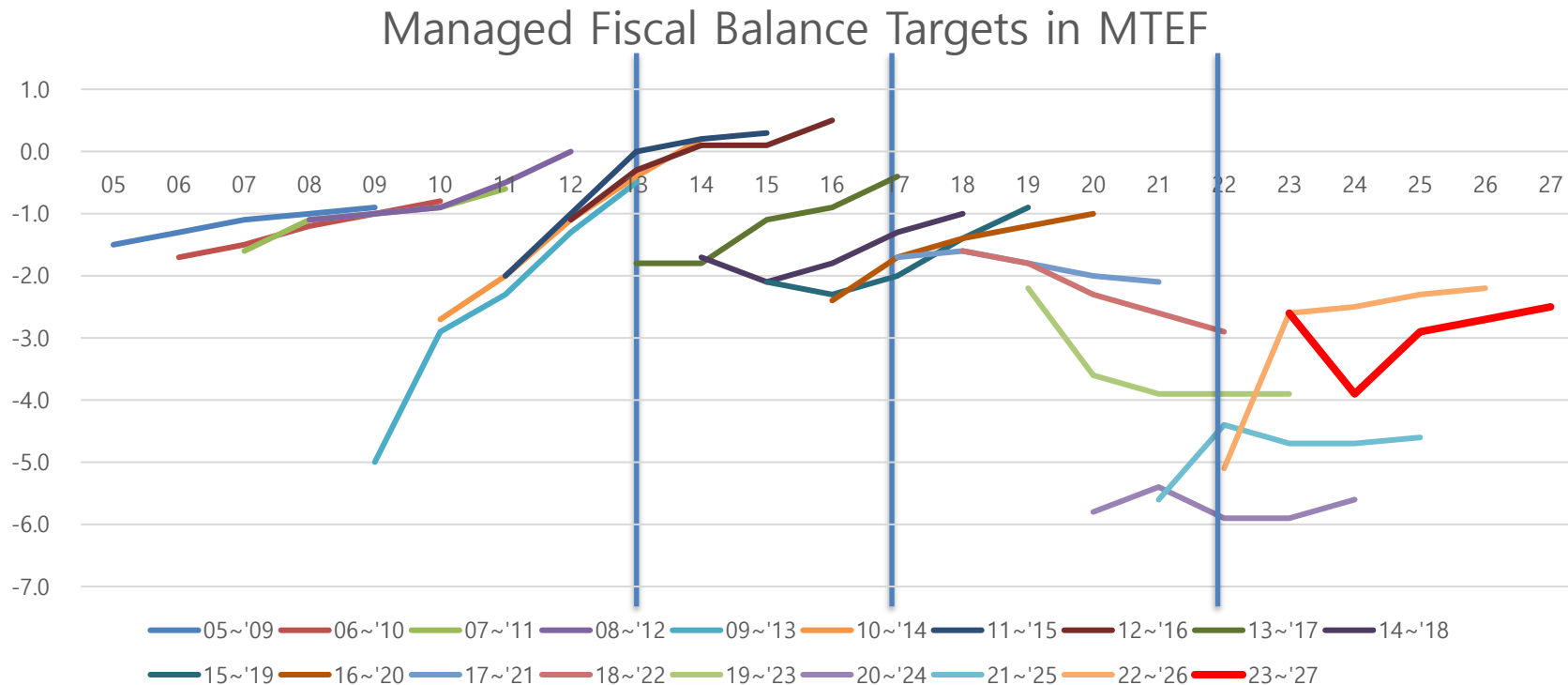
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## Decreasing fiscal room for new policies

- ◆ The share of mandatory spending to the total budget will be 53.0% in 2024 according to FY 2023 MTEF by the MoEF
  - ◆ It will increase to 64.7%~72.1% in 2070 according to the 2022 NABO long-term fiscal projection.
  - ◆ For FY 2024 budget draft, MoEF said discretionary spending is only 120 trillion KRW among 656.9 trillion KRW. →
    - Only 18.3% of budget is amenable to fiscal consolidation in the annual budget formulation.
- Without fundamental fiscal consolidation including mandatory & rigid expenditures, returning to fiscal balance is not possible.

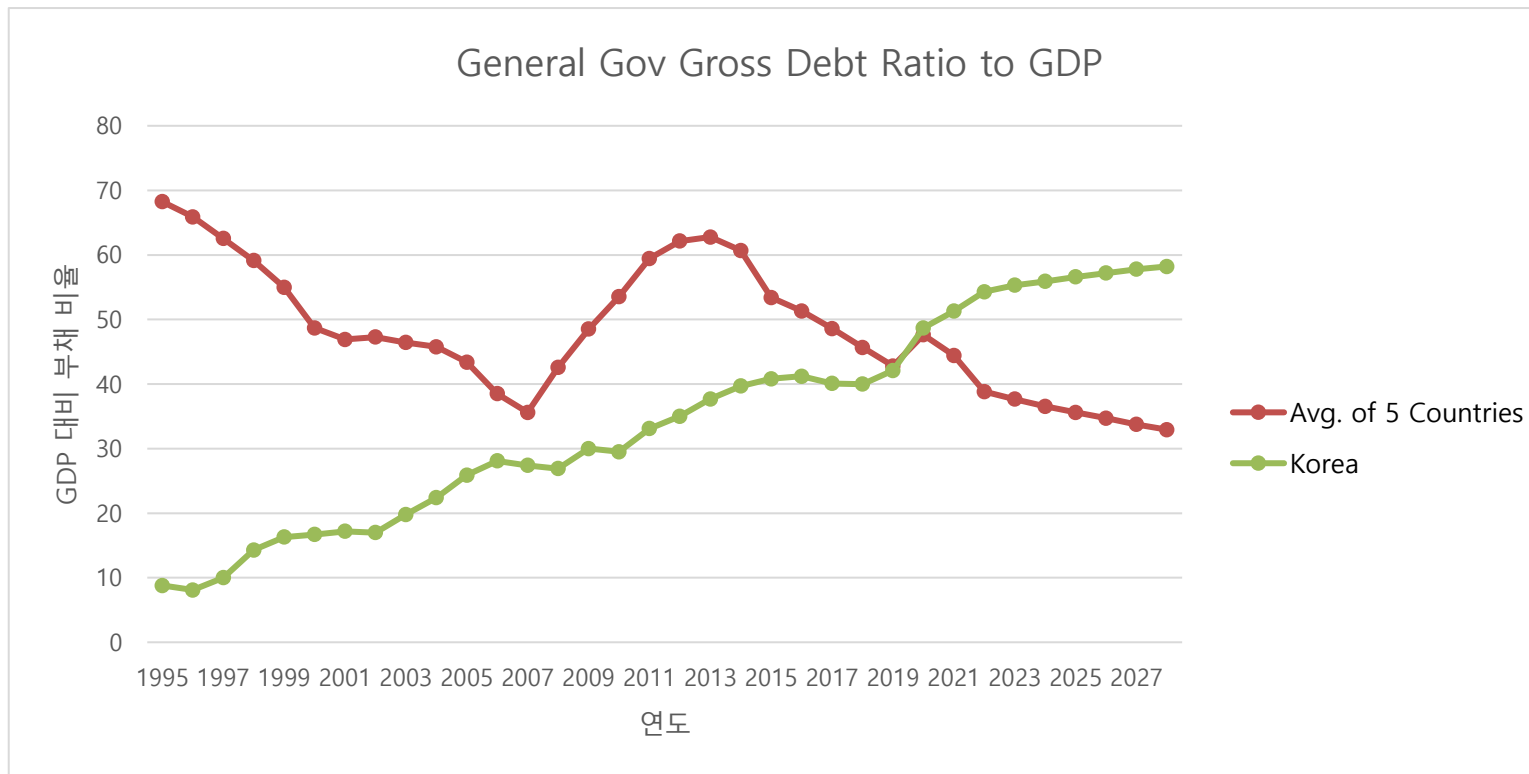
# Trends of fiscal stance since 2005

- 2005~2012: deficit reduction after shocks
- 2013~2016: planed for deficit reduction, but resulted in deficit increase
- 2017~2021: no plan for deficit reduction
- 2022~2023: plan for deficit reduction, but not easy



# Comparison of Gov Debt Trajectories

Benchmarking countries: Denmark, Ireland, Netherlands, Sweden, and Switzerland



# More demand for public spending

ageing + decarbonization + defense → On average, W. European countries need to spend additional 2~3% of GDP annually by 2030.

## ◆ 고령화

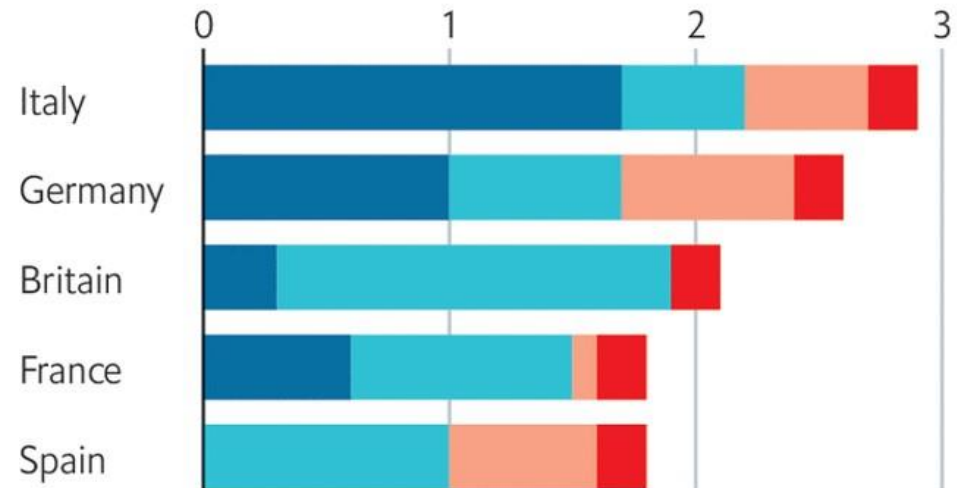
- More spending on pension & healthcare

## ◆ 탄소중립

- According to the median estimates by IMF, on average, annually additional spending amounts to 2% of GDP is required
  - Includes only the investment costs of decarbonization, so assuming that revenues from taxing fossil fuels will be replaced as pollution falls.

Forecast spending, 2030  
Increase on 2021 as % of GDP

■ Pension ■ Health ■ Defence  
■ Reaching net-zero greenhouse-gas emissions\*



Sources: IMF; SIPRI

\*IMF estimate for G20 countries

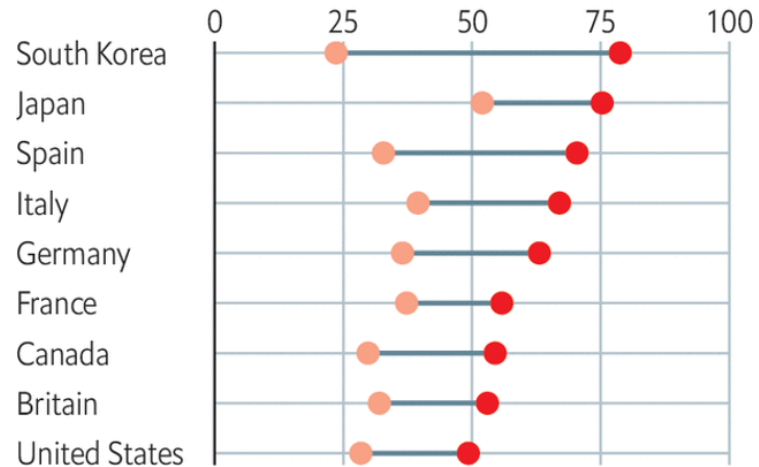
# Ageing

Korea is ageing at the fastest pace, and by 2075, Korea will be the most aged country.

## Older but not wiser

Population aged 65 and over as % of population aged 25-64

● 2020 ● 2075 forecast

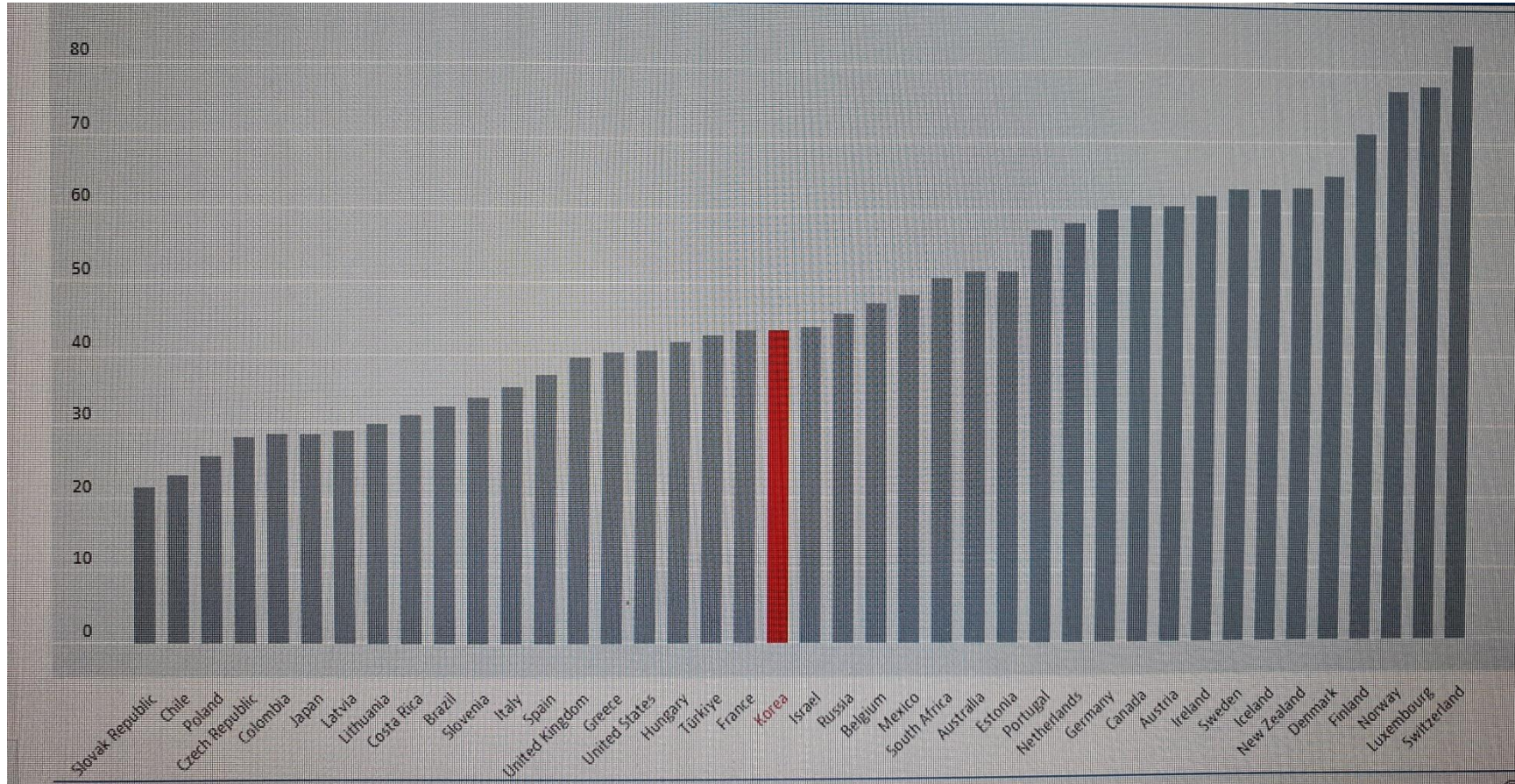


Source: OECD

The Economist

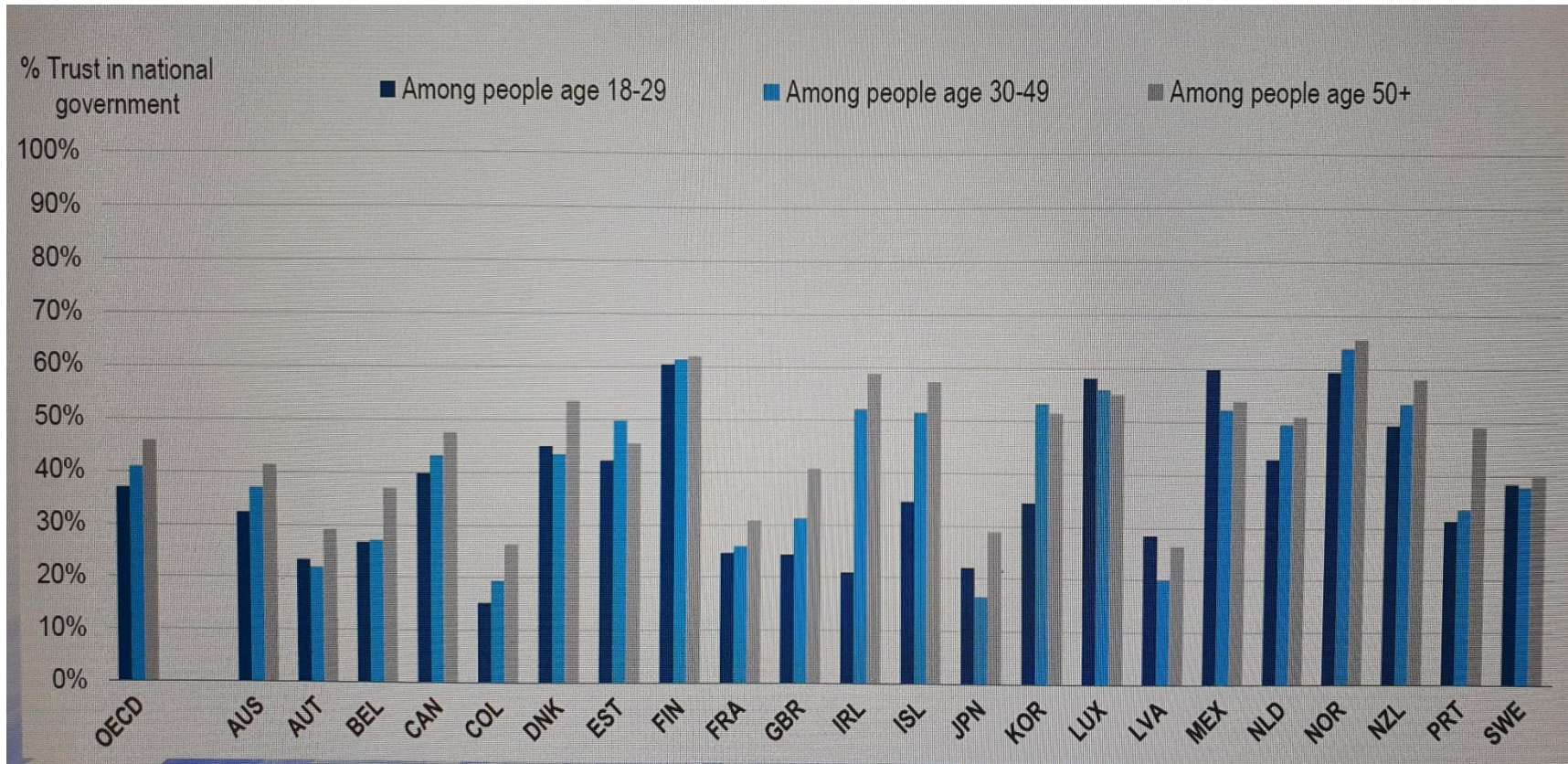
# Trust in Government (OECD, 2022)

Korea has ample room to improve.



# Trust in government: generation gap

Korea has huge generation gap.



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## Efforts to restore fiscal sustainability and create fiscal space



# Fiscal reform initiative of the current administration

Introducing fiscal rules

Strengthening fiscal consolidation efforts

- Targeting mandatory & rigid spending as well as discretionary spending

Reforming the national pension

Improving performance management & evaluation of gov programs

Attracting private capital and expertise

# Instituting fiscal rules

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## Set the managed fiscal balance limit at 3% of GDP

◆ Medium Term debt target is mid 50% of GDP until 2027

### ◆ Correction mechanism

● If debt level goes above 60%, managed fiscal balance limit shall be reduced to 2% of GDP

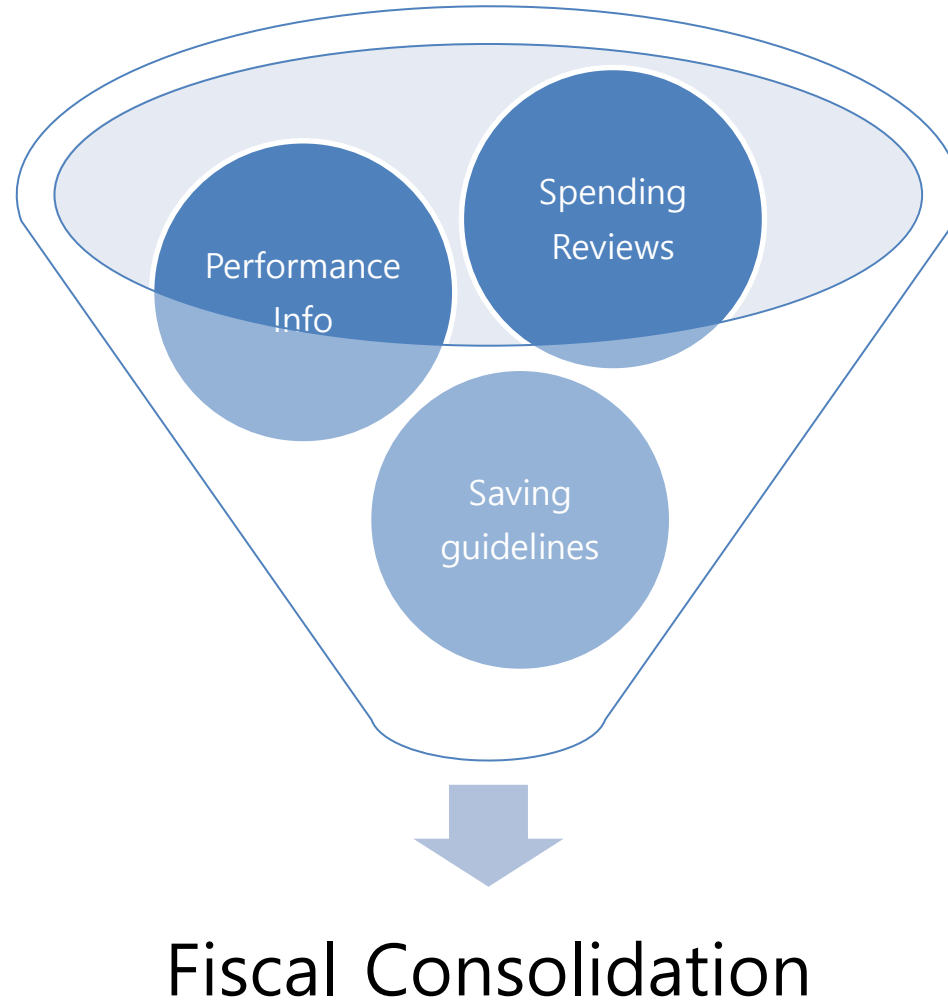
### ◆ Escape clause

● The conditions for suspending the fiscal rules are the same with that of supplementary budget.

● Right after the crisis, the fiscal rules shall be reinstated and the plan for restoring fiscal sustainability shall be developed.

◆ MoEF plans to pass its proposal for the fiscal rules at the National Assembly this year.

## Efforts to create fiscal space



# Fiscal Consolidation Strategy for FY 2023 Budget

Doubling fiscal consolidation amount: 10 trillion KRW → 24 trillion KRW

## Realignment of government & private sector roles

- Reducing budget for temporary public employment
- Shifting financial support programs from policy loans to guarantees
- Reducing direct support to specific industry promotion

## Rationalization

- Reducing budget for the programs lacking demand
- Shifting program's focus reflecting changes of policy environments
- Consolidating service delivery channels

## Fiscal Consolidation Strategy (Cont'd)

### Withdrawal of Covid 19 spending

- Reduce public health spending of Covid 19
- Normalize fiscal support for self-employed, small and medium size business

### Savings from public sector

- Consolidate government committees(abolish 33, consolidate 48)
- Impose salary cap to public employees
  - 10% return of ministers & vice ministers' salary, freezing salary of high ranking officials, and 1.7% salary-increase of low ranking officials

# Performance information for fiscal consolidation

Information from M&E systems has been used for fiscal consolidation.

## Performance M&E systems

- Identification of spending priorities is required by the Program Performance Goal Management System.
- Fiscal consolidation is required based on the annual Self-Assessment results.
- Fiscal consolidation options are identified by the In-depth Evaluation.

## Targeted assessment systems

- Targeted assessment systems have been contributed to budget savings, including subsidy programs, earmarked fund programs, and tax expenditures.

# Efforts to conduct spending reviews

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Spending reviews have been tried to identify strategic saving options.

- ◆ The plan for spending review introduction was announced in the 2015 cabinet meeting for National Fiscal Strategy.
- ◆ Since 2018, spending review efforts have been exerted, under the name of “Strategic Reviews”, “Comprehensive Sectoral Fiscal Consolidation”, “Spending Efficiency Improvement”, and “Planning for Spending Reviews of Mandatory & Rigid Expenditures”
- ◆ Limitations
  - Limited political support
  - Lack of government-wide governance
  - Lack of medium-term perspectives & explicit saving targets
- ◆ Under the current government, it remains to be seen how spending review efforts will evolve.

# M&E and coordination of social protection programs

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## Social Security Committee is trying to streamline social programs

### ◆ Expert committee of system adjustment

- Adjust duplicative or overlapping social protection programs between central and local governments

### ◆ Expert committee of evaluation

- M&E of the social protection program's implementation
- In-depth evaluation of social protection programs

### ◆ Expert committee of system integration

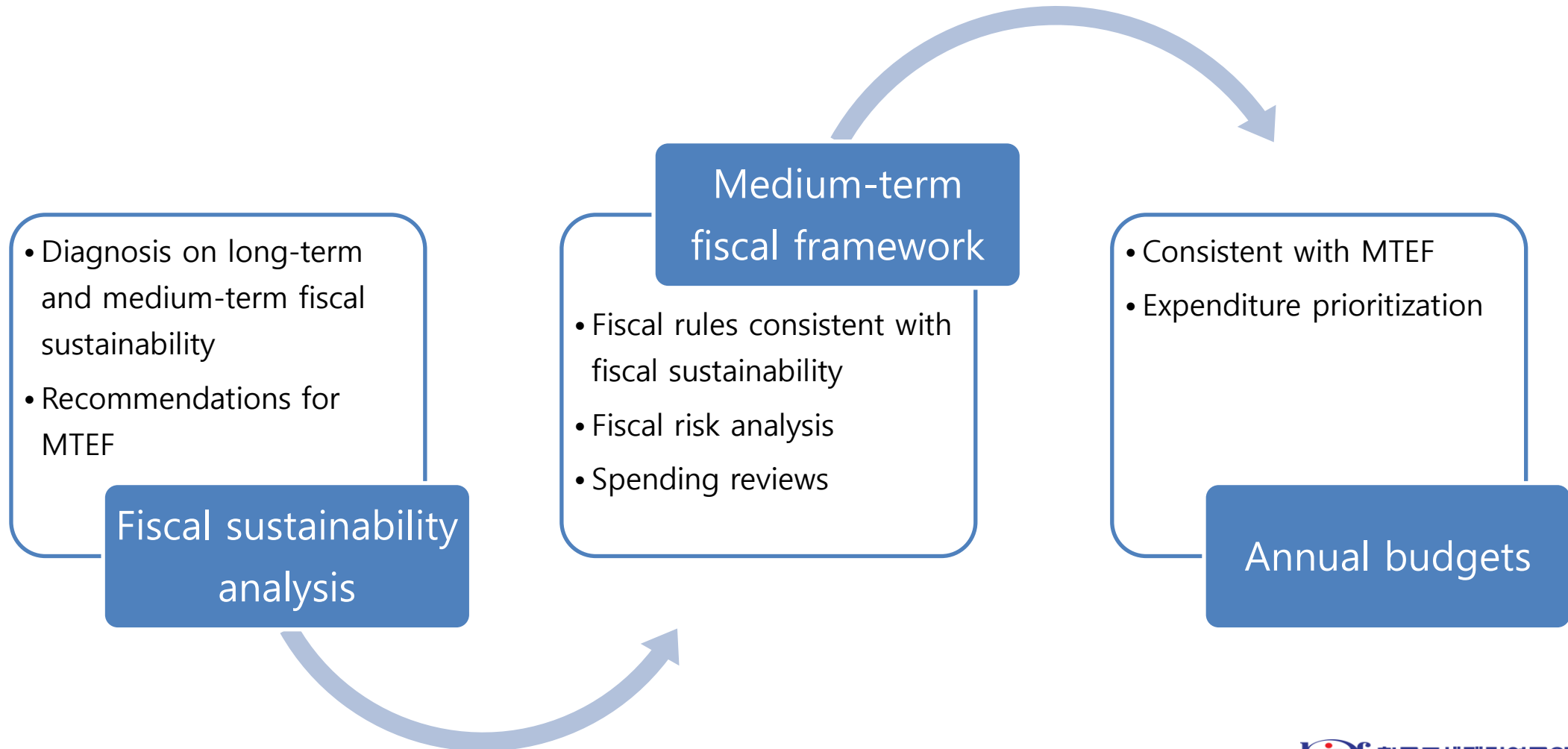
- Promote integrated management of social protection systems by central and local governments

# 3 Future reform agenda



# Move to rule-based fiscal framework

## Rule-based fiscal framework with independent monitoring and evaluation



# Thank you!

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