Current Issues of PFM Reforms in Korea

2017. 05.

Nowook Park
Center for Performance Evaluation & Management (CPEM)
Korea Institute of Public Finance (KIPF)
CONTENTS

01 Overview of Public Finance in Korea

02 PFM Reforms in Korea
Overview of Public Finance in Korea
Trends of Economic Growth

Rapid growth until late 1990s and recent stagnant growth

GDP Growth Rate

(단위: %)
Slowing down population growth

Population is no longer growing.
Fertility rate is 1.14. in 2016.
Dramatic pop aging is going on

Ratio of Pop over 65 years old to Pop under 15 years old.
Trends of Fiscal Balance

Maintained positive fiscal balance except 2009 due to stimulus spending

Consolidated Fiscal Balance to GDP Ratio(%)
Increasing government debt

Unstainable path is expected without reforms

Government debt to GDP Ratio(%)
Dramatic increase in mandatory spending

Mandatory spending will exceed discretionary spending within 2-3 years
Trust in Government

Low in Korea, in particular, among the young people
PFM Mandates in Korea

Institute aggregate fiscal discipline
- MTEF
- Fiscal rules
- Independent fiscal institution

Improve resource allocation
- Periodic review process focused on 1% consolidation
- Institute spending review process focused on sectoral issues

Improve service delivery & productivity
- Make in-year monitoring process problem-solving mechanism
- Institute delivery unit at the center of government
PFM Reforms in Korea
PFM reforms in Korea

- MTEF
- Top-down budgeting
- Performance M&E
- Program budget classification
- IFMIS
- Accrual Accounting
Sequence of PFM reforms

- PB pilot 2000
- Top Down 2004
- Program Budget 2006
- Accrual Accounting 2010

- MTEF & Top Down pilot 2003
- MTEF 2005
- PB 2007
- FMIS 2007
Characteristics of PFM reforms in Korea

Big bang approach

• Introducing all major components of PFM reforms within a single presidential term (5 year)
• All initiatives are pursued in a parallel manner

Practical adjustment of reform programs

• Some delays in program budget classification and accrual accounting

Executive branch initiated reforms

• Almost no engagement of the legislature
Elements of PFM reforms in Korea

Top-Down Budgeting
- Fixed spending envelope for each sector/ministry
- Autonomy for line ministries in own budgets

Medium-Term Expenditure Framework
- National Fiscal Management Plan
- Medium-term fiscal plan for sectors

Performance Budgeting
- Assessing performance of budgetary programs
- Use performance information in budget process

Digital Budget & Accounting System
- Program budgeting
- Accrual Accounting
- Integrated Financial Information Management System (DBrain)
Corresponding to each stage of budget process, PFM systems have been established and are in operation.

**Pre-Budget Stage**
- Feasibility Studies on new large programs by the central budget authority

**Budget Formulation**
- MTEF
- Annual performance plan by line ministries

**Budget Execution**
- On-site examination of programs suffering from budget execution problem
- Reexamination of large programs experiencing cost overruns

**Post Budget Execution**
- Annual performance report
- Self-Assessment of Budgetary Programs
- In-depth evaluation
- Other focused assessment
Budget Formulation Process & PFM Reforms

1. **MTEF**
   - Macroeconomic forecasting & Updated cost estimates for coming years
     (MOSF, Jan-Fed)

2. **Top/Down Budgeting**
   - Draft National Fiscal Management Plan
     (MOSF, Feb-March)

3. **Performance Budgeting**
   - Guide to Budget Preparation
     (MOSF to Agency; end of March)

4. **Cross-cutting: Digital Budget & Accounting System**
   - Cabinet meeting (March)
     • Finalizes the spending ceilings

5. **Performance Budgeting (continued)**
   - Budget requests
     (Agency to MOSF; end of May)

6. **MTEF (continued)**
   - National Fiscal Management Plan, Draft Budget
     (MOSF; June-Aug)

7. **PFM Reforms**
   - Submit to NA (MOSF; Sept 3th)

- Working level review → Government agencies’ meeting
  → Negotiations with polities → Cabinet meeting
Issues in developing program structure

• Existing organizational structure was observed
  – Program corresponds to office/bureau level
  – Sub-program corresponds to team level
  – No crosscutting program was developed
  – Practical approach was adopted to match budget execution unit and budget classification

• No distribution of overhead costs to each program was done
  – Created separate “Administrative support program”
Relation between Annual Performance Plan and Budget Structure

Program Structure

- Field
  - 16
- Sector
  - 69
- Program
  - 639
- Sub-Program
  - 3,018
- Activities
  - 8,304


- Mission
- Vision
- Strategic Objective
  - 189
- Performance Goal
  - 479
- Sub-program
  - 2,163

Select

Select
3 Layers of PB system

Monitoring
- Annual performance plan & report
- Performance indicators & targets

Periodic Review
- Assessing sub-programs for fiscal consolidation
- Checklist-based review

In-depth Evaluation
- Evaluating 10 cross-cutting programs
- Data-driven program evaluation
# Program Review Results

(Number of Programs, %)

<table>
<thead>
<tr>
<th>Year</th>
<th>Total</th>
<th>Effective</th>
<th>Adequate</th>
<th>Ineffective</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>384 (100)</td>
<td>55 (14.4)</td>
<td>226 (58.9)</td>
<td>103 (26.8)</td>
</tr>
<tr>
<td>2009</td>
<td>440 (100)</td>
<td>36 (8.2)</td>
<td>311 (70.7)</td>
<td>93 (21.2)</td>
</tr>
<tr>
<td>2010</td>
<td>552 (100)</td>
<td>26 (4.7)</td>
<td>393 (71.2)</td>
<td>133 (24.1)</td>
</tr>
<tr>
<td>2011</td>
<td>482 (100)</td>
<td>33 (6.8)</td>
<td>317 (65.8)</td>
<td>132 (27.4)</td>
</tr>
<tr>
<td>2012</td>
<td>474 (100)</td>
<td>32 (6.8)</td>
<td>330 (69.6)</td>
<td>112 (23.6)</td>
</tr>
<tr>
<td>2013</td>
<td>597 (100)</td>
<td>29 (4.9)</td>
<td>424 (71.0)</td>
<td>114 (24.1)</td>
</tr>
</tbody>
</table>
Current status of Korean PB

Considered one of best practices among OECD countries

OECD average
Use of Performance Information

• Information from monitoring system (performance plan and report) has not been systematically utilized so far.
  – For internal use, they are useful information
  – From the viewpoint of central budget authority, they provide limited information

• Information from review system are actively used in budget negotiation process.
  – Programs rated as ineffective are in danger of suffering budget cut
  – Its use is systematically built into the budget process

• Information from program evaluation is usually useful
  – Their use in budget process depends on the quality of evaluation and the will of central budget authority
  – Recently it gained visibility by formalizing the reporting process.
## Budget Cut for Ineffective Programs

(Billion USD, %)

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of Ineffective Programs</th>
<th>Total Budget in FY (t)</th>
<th>Total Budget for FY (t+1)</th>
<th>Budget cut (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>103</td>
<td>5.7</td>
<td>4.6</td>
<td>-19.3</td>
</tr>
<tr>
<td>2009</td>
<td>93</td>
<td>2.8</td>
<td>2.6</td>
<td>-6.8</td>
</tr>
<tr>
<td>2010</td>
<td>133</td>
<td>3.9</td>
<td>3.4</td>
<td>-12.5</td>
</tr>
<tr>
<td>2011</td>
<td>132</td>
<td>4.3</td>
<td>3.9</td>
<td>-10.0</td>
</tr>
<tr>
<td>2012</td>
<td>112</td>
<td>1.9</td>
<td>1.5</td>
<td>-18.4</td>
</tr>
</tbody>
</table>
329 recommendations are produced from the in-depth evaluation between 2008 and 2012.
- 166 are finished with follow-up actions
- 144 are in progress
- 19 are delayed

Program consolidation, program design and implementation improvement, improvement of performance management

Example: Program for the improvement of energy efficiency

ESCO (Energy Service Company) program
- Government provides subsidy and tax exemption to the company renovating facilities to improve energy efficiency.
- 20% of the expense was exempt from corporate income tax.
- The problem was government subsidy was counted as expense, which means double-counting.

One of the in-depth evaluation’s recommendation was the elimination of the double-counting practice, which was implemented by the Ministry of Strategy and Finance
Cultural changes in line ministries

• Monitoring & evaluation activities become essential elements of program design and management.
  – Many big programs set up M&E system. In particular, subsidy or grant programs are implicitly required to operate M&E system.

• Performance contracts are tried in some programs to improve program performance.
  – The initial evidence shows big improvement of performance.
  – However, contract management capacity is an issue to be addressed.
Further Challenges

Engagement of the legislature

• The National Assembly wants to have more voice in the reformed budget process
• The budget deliberation and approval process within the National Assembly needs to be reformed

Engagement of the National Audit Office

• Adds more rigor the reformed budget process but also brings in the danger of becoming compliance mechanism
Further Improvement

More timely intervention in program management

• Establishing quarterly performance information in FMIS and using it for decision making purposes

Further capacity building among stakeholders

• Fundamental reexamination of HR management in government
• Establishing government-wide evaluation policy

Revisiting the initial spirit of PFM reforms

• Revive top-down budgeting?

Further technical improvement

• Improving cost accounting and refining the scope of government
Thank You!

Nowook Park, PhD
Director
CPEM at KIPF
npark@kipf.re.kr
npark64@gmail.com