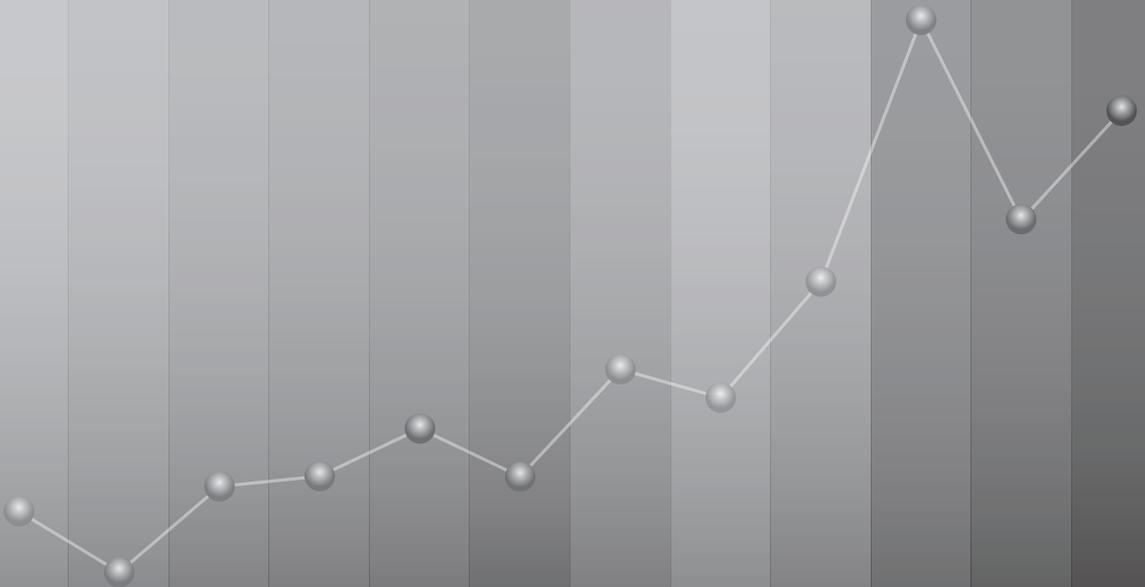


Fiscal Institutions and Fiscal Management in Korea:

Evaluation and Improvement of Recent Changes

December 2012

*Hyung-soo Park, Deockhyun Ryu, Nowook Park,
Ehung Gi Baek, Seung Hyun Hong*



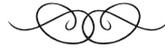
Korea Institute of Public Finance

28, Songpa-daero 28-gil, Songpa-gu, Seoul 138-774, Korea

Tel: 82-2-2186-2114 Fax: 82-2-2186-2179

URL: www.kipf.re.kr

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Hyung-soo Park

Deockhyun Ryu

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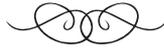
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I

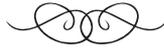
Introduction

Recently, increasing demands have been voiced both at home and abroad for the reform of fiscal controls and fiscal operating systems. In the wake of the most recent global financial crisis, a number of developed countries are now introducing improved fiscal controls or overhauling their fiscal operating systems, and South Korea as well is highly likely to embark on reforms to its fiscal controls and fiscal operating systems in conjunction with the launch of a new administration in 2013. As detailed in the following, South Korea has in the past reformed its fiscal controls and fiscal operating systems with the inauguration of new administrations.

After the establishment of the Fifth Republic, South Korea conducted several fiscal reforms as part of economic stabilization policies, such as introducing a zero-based budgeting system (ZBBS) to ensure fiscal prudence and adopting the principle of revenue budgeting (budget preparation within the range of tax revenues). In the current Sixth Republic, the government established multiple special accounts, including special accounts for treasury loans, and the Roh administration instigated the four major fiscal innovations which serve as the main subjects of this study: formulating national fiscal management plans (medium-term expenditure frameworks), introducing a top-down budgetary system, operating a budgetary performance management system, and establishing a digital budgeting and accounting system. Developed countries such as the

United States, France, United Kingdom, Australia and New Zealand have also reformed their fiscal controls and fiscal operating systems when new administrations assumed office.

Against this backdrop, this study aims to assess current fiscal controls and fiscal operating systems and propose detailed policy alternatives for adoption by the incoming administration. For the purpose of analysis, fiscal controls and fiscal operating systems are divided into four broad areas: fiscal management in the medium and long term; procedures and decision-making for budget preparation; assessment of and feedback on budgetary programs; and management and disclosure of fiscal data. Section II analyzes the issues surrounding fiscal management within the mid- and long-term timeframe based on national fiscal management plans. In line with the national fiscal management plans discussed in Section II, Section III will analyze top-down budgeting, in which decisions for budget determination are made in a phased and top-down manner, together with additional budget-preparation issues including both decision-making regarding large-scale national projects and welfare efforts and budget deliberation by the National Assembly. Section IV examines issues related to budgetary performance management and execution management institutionally responding to problems arising in budget preparation and in the process of executing budgets. Lastly, Section V explores the major issues concerning the management and disclosure of fiscal data, which is the infrastructure for fiscal controls and fiscal operating systems.



II

Improvement of Formulation of Mid- and Long-term Fiscal Management Strategies

Background

The two distinct financial crises occurring since the mid-1990s have brought home to South Korea the critical importance of finances. During the foreign exchange crisis that occurred toward the end of the 1990s, the South Korean government led the restructuring of financial institutions and corporations by raising public funds. It focused on stabilizing employment by preparing and executing job-related stimulus budgets in the wake of the 2008 global financial crisis. As evidenced by these examples, finances have played a critical role in overcoming crises, but the government debt that was amassed in the process must be contained within a manageable level in order to fulfill the original function of finances—allocation of financial resources, income distribution, and economic growth and stabilization—without compromising fiscal soundness.

South Korea formulated its first medium-term expenditure framework (MTEF) more than 30 years ago, but the current more-advanced form of national fiscal management plan (NFMP) was introduced in 2004. The first MTEF was designed in conjunction with the preparation of the 5th five-year economic development plan in 1982. MTEFs were afterwards only used as a reference for budget authorities until the reformation of the concept by the Roh administration to establish

MTEFs with a focus on strategic allocation of financial resources within a medium-term timeframe. Although the MTEF has assumed certain roles as an MTEF over the past nine years, it is difficult to state that it has fully achieved its original goals of maintaining fiscal soundness and more strategically allocating financial resources. There have been mixed evaluations of the system not only in South Korea, but also in a number of the developed and developing countries that have adopted it. Since issues regarding the strategic allocation of financial resources will be discussed in detail in the following section based on the top-down budgetary system, this section will focus upon the NFMP and examine measures to improve the system.

Brief History

Medium-term planning by the South Korean government is considered to date back to the five-year economic development plans first launched in 1962. These development plans took the form of indicative plans rather than forcible controls, under which the state first sets certain goals and then induces their fulfillment through the provision to the public sector of subsidies, financial support or tax reductions/exemptions. Due to their nature, economic development plans are meant to incorporate certain features of an MTEF within a broad framework. Financial support was one of the primary facets of economic development policy in the initial stages of the plans, but the importance of the fiscal sector in the five-year plans gradually declined during the period of breakneck growth in the 1970s. The budget authorities, however, still required medium-term fiscal plans as a means to offer adequate financial support to policies included in the five-year plans and maintain fiscal soundness in the mid- and long-term.

The 1982-1986 MTEF, considered the first of its type, was formulated against this backdrop. Following a large-scale personnel realignment between budgeting and planning departments in the early 1980s, a consensus was reached within the Budget Office on the necessity of medium-term perspectives in regard to the allocation of financial resources. The initial MTEFs launched to suit such needs were formulated mainly for

internal reference within the Budget Office as a technique to predict fiscal deficits or determine plans for scaling down deficits, remaining outside the interest of many. Still, unlike the previous economic development plans, the medium-term plans related to fiscal matters were prepared from the start as rolling plans. Due to the nature of rolling plans, MTEFs had to be updated annually by the responsible parties, but they were not published as official reports. They were prepared only as reports for internal use on three occasions between 1982 and the onset of the 1997 foreign exchange crisis.

For the first time among its internal-use MTEFs, budget authorities published in booklet form the 1993-1997 MTEF that corresponded to the period of a new five-year economic development plan. The year 1993 witnessed dramatic changes in the fragmentary character of MTEFs. Under the leadership of Budget Director Lee Suk-chae, who maintained a strong drive in support of planning, the 1993-1997 MTEF was prepared after undergoing detailed and in-depth deliberations conducted for the general budgeting process. This MTEF served as a concrete plan for outlining the new government's fiscal policies, but has since reverted to the nature of an unofficial MTEF for internal reference by budget authorities. As government debt increased in the wake of the foreign exchange crisis of 1997, corralling the growth of government debt and restoring fiscal soundness became important issues in fiscal management. In an effort to conduct fiscal management that would reduce debt in the medium term and concretize related plans, the 1999-2002 MTEF was formulated and presented to the National Assembly. Although this medium-term plan was a major step forward from its counterparts formulated in the 1980s, it remained far from a full-scale MTEF.

Such a full-scale MTEF was eventually created during the Roh administration, which was characterized from the beginning by its strong initiatives to expand welfare and reinforce decentralization. In order to improve the existing system of allocating financial resources and address the additional fiscal demands expected to increase dramatically as a result of such initiatives, the Roh administration introduced NFMPs, a top-down budgeting system, and performance management, all as a single package.

3 Issues with National Fiscal Management Plans

Over the past ten-years of the process of operating NFMPs together in combination with a top-down budgeting system and performance management system, South Korea has established advanced fiscal operating systems that well match those of many developed countries from an institutional point of view, but issues have also surfaced within the new systems. This section will examine problems pointed out in the existing literature regarding NFMPs.

A. Setting Mid- and Long-term Goals

The main significance of the preparation of NFMPs lies in strategically allocating financial resources from a mid- and long-term perspective as opposed to the single-year timeframe taken in budgeting. Setting mid- and long-term goals for fiscal management is important in order to establish a mid- and long-term perspective. It has been pointed out that indicators for the mid- and long-term goals of NFMPs need to be further clarified and that fiscal management strategies and detailed plans to attain the determined goal indicators are not firmly established.

B. Readjusting Outlooks and Goals

The second issue is the frequent readjustment of outlooks and goals. Outlooks on an uncertain future are fundamentally understood to be destined to prove inaccurate. However, if forecasted figures are mistaken for goals to be attained, there inevitably follows an attempt to alter detailed plans in order to achieve the “goals” when a situation develops in a direction divergent from the one expected at the point of formulating plans, countering the intent of introducing medium-term plans. Assuming that outlooks based on future uncertainty are bound to prove inaccurate, the government must avoid employing far-fetched measures to fulfill forecasts generated in the past. Instead, it should implement proper policy measures that suit the emerging conditions and then later explain the errors in the forecasts, the necessity to alter future forecasts, and possible

policy shifts to follow, in order to satisfy the purposes of MTEFs.

C. Reliability in Mid- and Long-term Outlooks

Thirdly, issues regarding the reliability of outlooks are most commonly identified, both domestically and internationally, in relation to MTEFs. In formulating MTEFs, financial resources to be allocated are often overestimated based on an overly-optimistic growth outlook, resulting in increased pressure on public expenditures. However, considering that MTEFs reflect, by their nature, not outlooks but policy drives, it is inappropriate to fault the enthusiastic fiscal outlooks themselves. Instead, it is necessary to consider how the plans will reflect the government's drive for policy efforts to improve fiscal outlooks. Problems arise when the government depends heavily on a rosy business outlook without resorting to controllable measures. More fundamentally, it is essential to ensure reliability through a transparent process of formulating the plans and adequate, *ex post* error-cause analysis

D. Linkage to Annual Allocation of Financial Resources

How the direction of financial-resource allocation reflected in NFMPs is directly linked to budgeting, a form of single-year allocation of financial resources, is closely related to the effectiveness of NFMPs from a mid- and long-term perspective—that is, the extent to which an NFMP is able to guide the allocation of financial resources over the years beyond the immediate budget year in which the plan is formulated. Under the current system in place in South Korea, it is acknowledged that NFMPs are reflected to a certain extent in the formulation of the mid-term project plans of individual ministries. It is also true that NFMPs play a role in the single-year allocation of financial resources, since each ministry's budget request is proposed in consideration of such medium-term business plans. However, the uses of NFMPs are too limited to hold significance for specific individual projects beyond suggesting a broad direction to pursue. There is a need to encourage individual ministries to take more explicit procedures in considering the direction from NFMPs when planning their projects.

Assessment of National Fiscal Management Plans

This section aims to compare NFMPs from EU member nations, which have long operated MTEFs, with those of South Korea by using *ex post* data. Every member of the European Union is required to submit to the EU its plan for the medium term, and the plans are divided into stability programs or convergence programs depending on their use of the euro currency.

By revising the Stability and Growth Pact in 2005, the EU unified the forms for stability programs and convergence programs submitted by member states and reinforced their function as MTEFs. *Public Finance in EMU 2007* analyzed the stability and convergence programs of EU member nations and summarized their characteristics as MTEFs. First, a majority of member states showed a tendency to plan for the constant improvement of their fiscal situations. In particular, countries with a high level of debt or deficit at the initial stage proposed a higher level of improvement in their medium-term plans. The second common characteristic is the composition of their adjustment plans. The majority of member countries intended to improve fiscal conditions by minimizing expenditures, and only 15 percent of members planned for an increase in revenues. The final highlighted point is related to macro-views. In general, EU countries tended to suggest outlooks slightly improved over their previous growth rates, indicating that they projected their current situations into the future and leaned toward optimism in that the positive situation at that time would continue into the future.

<Table II-1> shows the forecasts for changes in fiscal balances proposed each year by major countries throughout the period covered by their MTEFs. As seen in the table, most countries tended to prefer optimistic outlooks (expressed in positive numbers) in the later stage of the forecast period. Although most countries briefly shifted to worsened outlooks around the time of the global financial crisis, they suggested rather higher outlooks for rebounds in the wake of the crisis. The performance of 11 countries excluding South Korea shows that the average outlook for fiscal balance remained at approximately 1.0 percentage point, while the average outlook for the three years following 2009 recorded a notably

higher figure of 2.7 percentage points.

**<Table II-1> Changes in Fiscal-balance Forecasts
(Difference Between Previous Year and Initial Year)**

	2003	2004	2005	2006	2007	2008	2009	2011 ¹⁾	2012 ¹⁾
Belgium	-0.10	-0.10	0.50	0.60	0.40	-3.20	-1.80	3.30	3.70
Denmark	0.20	0.50	0.40	-2.20	-3.40	-4.20	-6.60	1.70	0.20
Germany	<i>2.50</i>	<i>2.25</i>	<i>1.80</i>	<i>1.60</i>	<i>0.50</i>	-2.50	0.20	2.00	1.00
Spain	0.10	0.00	0.70	-0.20	-0.60	-6.10	-1.20	7.10	7.40
France	3.30	2.70	2.00	2.70	1.80	1.80	4.90	5.70	4.40
Italy	1.60	1.00	<i>1.10</i>	<i>2.60</i>	<i>3.70</i>	-1.30	0.00	4.40	3.90
Austria	0.90	1.30	1.90	1.50	0.70	-4.30	0.80	3.90	3.00
Portugal	<i>1.80</i>	<i>0.10</i>	<i>4.50</i>	<i>4.20</i>	<i>2.80</i>	<i>2.20</i>	<i>6.50</i>	-	<i>4.00</i>
Finland	-0.10	0.00	-0.30	-0.50	-2.10	-3.50	0.30	0.00	1.50
Sweden	0.50	0.40	0.10	0.10	1.10	-1.00	-3.60	3.90	2.70
U.K.	0.00	1.50	<i>1.80</i>	<i>1.50</i>	<i>1.00</i>	-0.30	2.30	9.80	8.20
(average)	1.0	0.9	1.3	1.1	0.5	-2.0	0.2	4.2	3.6
South Korea ²⁾	-	0.9	0.6	0.9	1.0	1.1	2.9	2.7	-

Note: Italicized numbers indicate programs submitted by EU countries during the excessive deficit procedure (EDP) period.

1) Due to the introduction of the European Semester, EU countries formulated no medium-term plans in 2010, and submitted medium-term plans at the beginning of 2011 and 2012.

2) The operational budget balance included in South Korea's NFMPs.

Source: Stability and convergence programs of each country, calculated by the author

<Table II-2> Changes in Structure of NFMPs During Government Transition Period

Major Content	Roh Administration		Lee Administration	
	2006-2010	2007-2011	2008-2012	2009-2013
Mid- and long-term strategic goals and outlooks		Part I. Long-term Vision for National Development	Part I. National Administration Vision of the Lee Administration: Building Advanced First-tier Nation Part II. Fiscal Strategies for Building an Advanced First-tier Nation	
Overall introduction for NFMPs	Part I. Overview of NFMPs	Part II. Overview of NFMPs		Part I. Overview of NFMPs
Trends in major fiscal indicators and assessment on previous fiscal management	Part II. Current Status and Assessment of Fiscal Management	Part III. Current Status and Assessment of Fiscal Management		Part II. Global Economic Crisis and the South Korean Situation Part III. 2009-2013 Fiscal Management Conditions
Outlook for major economic indicators and fiscal-operation goals	Part III. 2006-2010 NFMPs Part III. 2006-2010 NFMPs	Part IV. Direction for 2007-2011 Medium-term Fiscal Management	Part III. Summary of Medium-term Fiscal Management	Part IV. Direction for 2009-2013 Fiscal Management
Allocation of financial resources for each sector and major policies		Part V. Policy Direction and Investment Plans by Sector	Part IV. Fiscal Investment Plans by Sector	Part V. Policy Direction and Fiscal Investment Plans by Sector
Matters for improvement in the system	Part IV. Innovation of Fiscal Operating System	Part VI. Innovation of Fiscal Operating System	Part V. Improvement of Fiscal Management System	Part VI. Improvement of Fiscal Management System

It is also worth examining the influence of changes in presidential administration on NFMPs. The past nine years witnessed a change of administration at the turn of the year 2007 as the Roh administration transitioned to the presidency of Lee Myung-bak. Previously pointed out in this paper were the structural issues arising from a five-year single-term presidency and five-year rolling plans, and these problems can also be found within the organization of NFMPs. In <Table II-2>, similar NFMP contents are grouped together. As seen in this table, the Roh administration's plan for the year 2006, one of the middle years of the presidency, and the Lee administration's plan for the year 2009, its second year in power, were structured to embody similar contents. On the other hand, the Roh administration's plan for its final year, 2007, and the Lee administration's plan for its inaugural year of 2008 featured slightly different organizational structures than did other NFMPs. In the 2007-2011 NFMP, the Roh administration established a five-year medium-term plan for the succeeding administration and suggested long-term initiatives, while the Lee administration proposed the plans and strategies it aimed to achieve over its presidential term in the 2008-2012 NFMP.

Meanwhile, the contents of each sector reveal the differences between the plans of the Roh administration, which adopted the NFMP system, and those of the following administration. <Table II-3> compares the details in education policy found in the last two NFMPs of the outgoing administration with the first two of the incoming administration. The most striking difference seen in the changes is that the Lee administration's plans bore less concrete investment plans for respective sectors. This shift in detail is also reflected in the plans for allocating financial resources. <Table II-4> shows a significant discrepancy in the classification of items in the five-year plans for allocating financial resources.

<Table II-3> Changes in Sectoral Plans (Education Sector)

Roh Administration		Lee Administration	
2006-2010	2007-2011	2008-2012	2009-2013
1. Analysis of previous fiscal investment - Current state of the education sector - Trends in fiscal investment - Performance assessment	1. Performance of fiscal management for the past five years		1. Major points in previous fiscal investment
2. Directions for policy and fiscal investment - Blueprint for the education sector in five years	2. Future directions for policy and fiscal investment 3. Major points in fiscal investment in the 2007-2011 period	1. Policy directions and major points for fiscal investment	2. Policy directions and major points for fiscal investment
3. Investment plans by sector and project - Overall fiscal investment plans - Higher education sector - Early childhood, elementary and secondary education sector - Lifelong and vocational education sector	4. Plans for allocating financial resources		
		2. Major projects and tasks for system improvement	3. Major projects and tasks for system improvement

<Table II-4> Changes in Sectoral Resource Allocation Classification (Education Sector)

	2006-2010	2009-2012
Classification financial resources allocation	Higher education - Supporting the operation of national universities - Diversifying specializations of universities - Reinforcing capacities for academic research - Expanding welfare support for university students - Supporting the informatization of knowledge	Higher education
	Childhood, elementary and secondary education - Reinforcing in-school education - Local education subsidies - Invigorating e-learning	Childhood, elementary and secondary education
	Lifelong and vocational education - Strengthening the policy foundation for human resources - Establishing systems for lifelong learning and vocational education - Promoting cooperation in international education - Promoting international education	Lifelong and vocational education
		Education in general
	Education budget - Local education subsidies - Budget - Funds	Education in general - Local education subsidies

5 Direction-setting for Improvement of National Fiscal Management Plans

Against this backdrop, this study aims to define matters requiring institutional improvement from both short-term and mid- and long-term perspectives in order to hone the effectiveness of NFMPs.

The initial short-term task is to clearly define the nature of NFMPs. In order to address the structural challenge of NFMPs as rolling plans being interconnected with presidential terms, it is necessary to divide the

nature of NFMPs between political cycles: NFMPs need to be considered as goals that reflect policy drives during the period overlapping with the term of the sitting president's, while they need to be defined as simple baseline projections exclusive of policy considerations in terms of the period following the end of the current presidential term. The strategic allocation of financial resources will then coincide with the presidential term, and the baseline projections can ensure consideration of fiscal soundness for the remainder of the period. In this way, the NFMP formulated in the first year of a presidency will serve as a plan for allocating financial resources reflecting policy priorities, and that formulated in the final year will provide baseline projections for the upcoming four-year period, allowing an entering administration to introduce new budgetary programs in the following year's NFMP with added policy effectiveness on the basis of such baseline projections.

Secondly, there is a need to clarify the target variables for management through NFMPs. From the perspective of fiscal soundness, it is desirable to define target variables regarding fiscal balance and governmental debt. In the case of fiscal balance, it is recommended to use structural fiscal balance in consideration of business fluctuations, but it is difficult for the general public to fully grasp the concept because it must first be adjusted for business cycles. Furthermore, ensuring reliability becomes a significant issue, since arbitrary decisions such as the estimation of potential GDP may be involved. In this vein, in order to enhance reliability it becomes necessary to introduce institutional tools such as the independent fiscal agencies recently created in major countries, together with target and controlling variables. Government debt can also be defined through a variety of different concepts based on the extent of inclusion, but it is recommended to set the determinable debt for which the government directly bears the obligation to repay principal and interest as the sole target variable and set other indicators as reference indicators.

Thirdly, explicit fiscal guidelines must be legislated. South Korea introduced temporary rules as fiscal soundness eroded in the wake of the global financial crisis, but it is expected to undergo fiscal deterioration as its aging population will inevitably increase mandatory expenditures over an extended period. Given this situation, more so than temporary fiscal

rules, South Korea desperately requires explicit fiscal guidelines established through the legal process. In terms of the specific forms for the rules to take, it is recommended to establish goals by period to allow the average of the structural fiscal balance between the year immediately preceding the formulation of a plan (t-1) and the third year from its formulation (t+3) to maintain a balance, as well as to set the ratio of government debt to GDP to fall below 25 percent after 2020. In order to alleviate the question of rigidity resulting from legislative action, laws regarding target debt levels, the most fundamental indicator of fiscal soundness, and balance-related rules must undergo separate legislation such a way as to enable flexible operation. This differentiated legislation will at the same time ensure the fiscal flexibility required to respond to cyclical fluctuations and fiscal soundness.

In order to achieve a balance between structural fiscal balance in different cycles of business fluctuations and the overall target of a government debt to GDP ratio set at 25 percent or lower, it is necessary to emplace strictly binding fiscal rules with regard to mandatory and discretionary expenditures. Furthermore, since the aging population is expected to significantly increase mandatory expenditures in the social welfare fields, a legalized pay-go principle must be emplaced for mandatory expenditures. In addition to these measures, there is a need to establish a system that will, *ex ante*, increase the accuracy of cost estimation on the bills and will, *ex post*, forcibly adjust (relevant) expenditures if the fiscal deficit climbs as a result of underestimation.

Fourthly, in order to enhance the effectiveness of NFMPs, the allocation of financial resources delineated in NFMPs and that for single-year budget proposals must be aligned in a more robust manner. Although NFMPs are not multiple-year budget proposals, they should be linked to single-year allocations of financial resources proposed by budget measures, since these consider the strategic allocation of financial resources. NFMPs aim to enhance efficiency in terms of allocation and technicalities of financial resources over the medium term, and therefore the single-year assignment of financial resources must be understood within the context of medium-term plans. Consequently, a new government should propose in the NFMP it formulates in its first year a fundamental framework for the strategic allocation of financial resources over the next five years,

and the financial-resource allocation in single-year budget proposals should be prepared within this framework. It is important to discourage administrations from engaging in the unhindered modification or discarding of the fundamental framework for allocating financial resources proposed in NFMPs, even as fiscal conditions change.

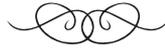
Mid- and long-term tasks address more fundamental structural problems. First, it is necessary to conduct performance assessments of government debt management plans on the basis of NFMPs and, as *ex post* measures, ensure the proper observance of the ratio for government debt to GDP based on the NFMPs.

Second, the objectivity of projections must be ensured through the improvement of macro- and budgetary projection systems. Although the government does provide estimated economic growth rates at the point of formulating NFMPs, the economic growth rate must not be considered targets, but rather objective projections intended to support the accurate economic forecasting of gross income and other related variables. As found in the example of Canada, the South Korean government needs to consider receiving projections for economic growth rates from institutions such as the Korea Development Institute, Bank of Korea or Korea Institute of Public Finance and take an average of such data in objectively forecasting an economic outlook.

Third, at the end of each presidential term the government should submit to the National Assembly reports on the outcomes of executing NFMPs as a measure to heighten the effectiveness of NFMPs. The outcomes of budget operations can be verified and examined *ex post facto* through the settlement of accounts. However, *ex post* verification procedures do not exist for NFMPs, despite the plans being an important design to ensure fiscal soundness from a medium-term perspective and implement the strategic allocation of financial resources. Therefore, obliging an incoming administration to submit to the National Assembly *ex post* assessment reports on the NFMPs formulated and implemented by the preceding administration will enhance the plans' effectiveness. The details to be included in such reports, however, will require additional in-depth research.

There are also several additional tasks regarding the system of formulating NFMPs, such as increasing the transparency of the formulation

system, vitalizing communications, expanding the participation of the National Assembly, and improving the operation of working groups in each sector.



III

Improvement of the Budget Preparation Procedures and Decision-making Process

1 Introduction of Top-down Budgeting

In order to reinforce the strategic allocation of financial resources and enhance the autonomy of individual ministries, the Ministry of Planning and Budget determined in 2004 to introduce a top-down budgetary system for application to budget preparation for fiscal year 2005. Under this method, fiscal authorities would formulate a five-year plan for financial-resource allocation (NFMP) according to related priorities and the Open Forum of Cabinet Members (National Forum on Financial-resource Allocation) would determine, in advance, sectoral and ministerial expenditure limits based on the NFMP. Each ministry would then in turn request a budget within the pertinent expenditure limits determined through this process, and the fiscal authorities must undertake a final examination and supplementation before completing a governmental proposal.

Since budgetary preparation is a process of allocating limited fiscal resources in a manner that addresses multiple policy goals, budgets cannot be prepared based entirely on either top-down or bottom-up techniques. The abundant information possessed by each recipient ministry must be reflected in the decisions taken regarding the directions of budget preparation and specific projects, while the process of budget preparation

must also be considered from the perspective of overall governmental administration so as to establish a keynote of fiscal policy and policy directions and establish priorities among different projects in line with national agendas. As a result, in actuality both top-down and bottom-up approaches must be taken together. In this sense, the fiscal reforms of 2004 that introduced a top-down budget preparation system may be interpreted as a move to further bulwark the top-down approach. This reform measure ensured a phased decision-making process through which the aggregate volume of public finance is first decided as part of the process of budget preparation, sectoral expenditure limits are determined based on such decisions, and then budgets for specific projects are outlined in consideration of these prior decisions.

In the 1990s, some major countries also adopted a top-down budgetary system in an attempt to respond to a call for fiscal soundness prompted by fiscal deterioration, as well as to carry out reforms on budgetary systems within the framework of comprehensive governmental reforms. In the Netherlands and Sweden, nations with traditions of forming coalition cabinets, expenditure limits are strictly observed and the autonomy of budget-executing ministries is guaranteed on a foundation of practical negotiation and decision-making among cabinet members with regard to sectoral and ministerial expenditure limits. In these countries, as well as in others such as the United Kingdom that have adopted a top-down budgetary system, the ruling parties organize a coalition under the parliamentary government political system and assume full responsibility for fiscal management and leading the decision making in their parliament, leaving the body to deliberate budgets prepared by the executive branch as a mere formality. In contrast, South Korea features a presidential system under which cabinet members are appointed by the president. In such a system, it is often difficult to reach agreement among cabinet members as to expenditure limits, and since the country's constitution grants the National Assembly the right to deliberate on and finalize budgets, the sectoral and ministerial expenditure limits determined by the administration are often compromised.

In that case, what prompted the government to emphasize the top-down approach in 2004? The existing literature published by the Ministry of

Planning and Budget (2007) and other agencies, as well as a focused group interview (FGI) with former and incumbent public officials and finance scholars, generally suggest three purposes: budgets needed to be prepared in a more efficient manner by bulwarking the principle of decentralization of power or division of labor in budget preparation; the nation's financial resources required allocation in a more strategic manner in accordance with administration philosophy; and the fiscal authorities were required to share with cabinet members and recipient ministries information on, for example, restrictions on the aggregate volume of public finance during the process of budget preparation in an effort to forge a government-wide consensus on the necessity to maintain fiscal soundness. In particular, the government introduced its Cabinet Meeting for Financial-resource Allocation by benchmarking the Swedish system, based on the notion that fiscal plans are an important framework for governmental administration and therefore all cabinet members must participate in allocating financial resources based on joint decision-making.

<Table III-1> Comparison Between Budget Cycles Before and After the Reform

Bottom-up Method (Budget and Accounts Act)		Top-down Method (National Finance Act)
<ul style="list-style-type: none"> • Submission of plans for new/major continued projects (end of February) (Individual ministries → Ministry of Planning and Budget) • Notification of guidelines for preparing budget proposals (end of March) (Ministry of Planning and Budget → individual ministries) 	January	<ul style="list-style-type: none"> • Submit medium-term project plans (end of January) (Individual ministries → Ministry of Strategy and Finance) - Projections on new/major continued/medium-term expenditures
	February	<ul style="list-style-type: none"> • Preliminary preparation by budget authorities - Analysis of macro-projections and outcomes of performance assessment

the system through questionnaires, concluding that the system received the overall least favorable evaluation among the four major fiscal reforms. Other studies have analyzed the effects of the introduction of the top-down budgetary system through empirical analysis.

In order to verify whether establishing expenditure limits affects the budget fluctuations of a specific project unit, Ham, Lee and Yang (2009) expanded the analysis target to project units, specifically budgets for education sector between 2001 and 2010. Using the concept of “incrementalism” of Bailey and O’Connor (1975) and Wildavsky (1984), they found that the introduction of the top-down budgetary system demonstrated the expected effect to a certain extent in that since the introduction of the system in 2005 there has been an overall improvement in the practices of incremental budget preparation for education-sector projects under the Ministry of Education, Science and Technology.

Ljungman (2009) of the International Monetary Fund examined selected previous empirical analyses of the effect of top-down budgetary system. In an empirical study conducted by von Hagen (1992), who initiated empirical analysis of the relations between fiscal controls and fiscal performance, whether to adopt a top-down budgeting system in the preparation of governmental budget bills and deliberation procedures at the legislature was included as one of the factors that constitute fiscal controls, and it was a meaningful relationship was revealed between fiscal deficits and the scale of government debt. The same conclusion was repeatedly confirmed in subsequent empirical analyses by de Haan and Sturm (1994), Woo (2003) including nine East Asian countries into the subject group, and Gleich (2003) and Ylaoutinen (2004), in which Central and Eastern European countries were examined as well. Meanwhile, Perotti and Kontopoulos (2002) concluded that, although budgeting based on stronger top-down methods did result in reduced fiscal deficits, fiscal expenditures and fiscal revenues, the correlation appeared rather weak.

However, since these studies all integrated multiple aspects of fiscal controls into a single comprehensive index by taking into account whether to adopt top-down budgeting, it is difficult to conclude that the observed fiscal improvement was purely the result of top-down budgeting. It is also necessary to remain cautious in interpreting the study outcomes, due to

the difficulty of accurately defining top-down or bottom-up budgetary systems and, in some sense, the actual practice of budget preparation takes precedence over the legislated practice outlined in statutes.

Preliminary documentary investigation and focus group interviews with former and incumbent public officials and fiscal experts have revealed issues arising over the course of operating the top-down budgetary system during the past decade. First, the Cabinet Meeting for Financial-resource Allocation (later renamed the Cabinet Meeting for Fiscal Strategies) under the presidential system exposed numerous limitations, such as its failure to play a role as a decision-making body that arranges gross expenditures as well as sectoral and ministerial expenditure limits. Consequently, it was rare for due consideration to be paid to executive-branch decisions regarding the allocation of financial resources during the course of budget deliberations by the National Assembly. Moreover, since more than 200 expenditure limits were determined in a bottom-up fashion, there has been a persistent problem with the sectoral and ministerial expenditure limits already determined not being meticulously observed by the budget-executing ministries and being routinely modified in the National Assembly—a practice rare to find in a country with a well-established top-down budgetary system.

3 Improvement of Operation of Cabinet Meeting for Fiscal Strategies

A. Operational Trends and Challenges

In a press release dated February 25, 2004, the Ministry of Planning and Budget announced that South Korea had elected to introduce a meeting on national financial-resource allocation presided over by the President (currently Cabinet Meeting for Fiscal Strategies) in consideration of the examples provided by Sweden and the Netherlands. The meeting is a conference body made up of the President and cabinet members and is intended to determine the direction of the following year's financial-resource allocation and sectoral and ministerial expenditure limits in

line with the introduction of a top-down budgetary system. Although no separate legal basis had been prepared to operate such an organization, the meeting was scheduled to be held from 2004 when the top-down budgetary system was introduced.

However, as an impeachment bill was passed in the National Assembly on March 12, 2004, and the President was accordingly suspended from office, it was impossible to hold the Cabinet Meeting for Financial-resource Allocation as planned. As a result, the Ministry of Planning and Budget decided to follow an alternative budget preparation method and notified each ministry of its respective expenditure guidelines in the form of tentative expenditure limits rather than official ones. In June, when a meeting on national financial-resources allocation was held to ratify such tentative expenditure limits, the Ministry of Planning and Budget designed an all-day discussion by preparing policy debate materials touching on over 100 policy issues spanning 14 expenditure areas. The meeting was actually completed within the morning session, however. Thus, the actual first meeting on national financial-resources allocation was the one held at the Central Officials Training Institute in 2005 (April 30-May 1).

The Cabinet Meeting for Financial-resource Allocation has since been held on an annual basis and was renamed Cabinet Meeting for Fiscal Strategies in 2008 with the introduction of the Lee administration. As hinted at in the revision of the title, while the previous meeting had been focused on decentralization and joint allocation of financial resources through discussion among cabinet members, the reformed meeting was more centered on establishing broad directions and strategies for fiscal management and discussing issues arising within individual ministries. Generally, fiscal authorities discuss at these meetings the aggregate volume of public finance in the morning session, along with the directions for fiscal policy and tax revenues and expenditures, while the afternoon session is dedicated to debate on sectoral and ministerial issues. It is found that Cabinet Meetings for Financial-resource Allocation or Cabinet Meetings for Fiscal Strategies presided over by the President of South Korea focus more on debate over the aggregate volume of public finance and key projects within individual ministries than on a final agreement regarding expenditure limits as is the case in the developed countries South Korea

initially benchmarked.

B. Issue 1: Limitations and Significance of Cabinet Meetings for Financial-resource Allocation under the Presidential System

Why has South Korea been unable to develop a system in which cabinet members are able to discuss and determine expenditure limits, as takes place in Sweden and in the Netherlands? To begin with, South Korea's system for organizing a cabinet, including the authority to appoint cabinet members, differs from that of Western countries, resulting in a unique method of allocating financial resources. In the Netherlands and Sweden, where it is conventional to organize a coalition cabinet in the course of allocating national financial resources for each sector and ministry, cabinet members participate in actual negotiations and transactions regarding sectoral and ministerial expenditure limits. In South Korea, however, the head of fiscal authorities is simply one among multiple cabinet members, making it difficult for cabinet members to reach a joint decision on financial-resource allocation. Furthermore, since presidential authority is limited by the decision-making process taking place in the legislative branch on the basis of the principle of separation of powers, and because there is no preliminary stage for discussing the issue of financial-resource allocation with the National Assembly prior to budget preparation, it is difficult for the executive branch's decisions on financial-resource allocation to receive full consideration during the deliberative process within the National Assembly.

Despite these variations in political systems or methods of governmental administration, the current discussion centered on the aggregate volume of public finance and controversial or pending issues must be further expanded to include cabinet discussion on more fundamental issues such as sectoral expenditure limits and financial-resource allocation. Even if this type of discussion fails to come to an agreement, the process itself will sustain the intended purpose of top-down budgeting by ensuring staged decision-making during the budget preparation process, including the determination of the aggregate volume of public finance followed by the establishment of sectoral expenditure

limits and specific projects. In addition, in order to ensure that cabinet members reach an accord on expenditure limits, the status of fiscal authorities under a presidential system must be further heightened, just as is done in countries with a parliamentary government. Fiscal officials granted increased authority must cooperate with budget-executing ministries assuming reinforced fiscal responsibilities in order to bolster the principle of top-down budgeting under which fiscal authorities take the lead in determining the aggregate volume of public finance and sectoral expenditure limits and verifying fiscal management, while budget-executing ministries assume responsibility for preparing and executing budgets for specific projects.

In order to more completely achieve the purposes of top-down budgeting, the National Assembly should also endeavor to introduce a two-step budget deliberation system as has been done in some developed countries and thereby ensure that preliminary decisions on financial-resource allocation are observed throughout the process of deliberating budgets for specific projects by reviewing the decisions of the executive branch regarding fiscal expenditure limits and other issues. To this end, the status of the fiscal authorities must be raised within the executive branch, as must the status and roles of the Special Committee on Budget and Accounts within the National Assembly. Currently, although the preliminary examination by the standing committees of the National Assembly and the overall examination by the Special Committee on Budget and Accounts can be said to constitute a two-track examination system, both focus on microscopic budget examination mainly regarding specific projects, and therefore the examination function from aggregate and macro-perspectives to determine broader directions for fiscal management remains feeble. Just as the executive branch introduced a top-down budgetary system through fiscal reforms, the National Assembly must also reinforce the top-down nature of the budget deliberation process.

<Table III-2> Examples of Top-down Budget Deliberation by Legislative Branches in Developed Countries

Classification	United States	France	Sweden
Macro-deliberation of the aggregate volume of public finance	Budget resolution by the Legislative Budget Committees	Comprehensive reporting to the Committee on Finance, General Economy and Planning (first-step deliberation)	Comprehensive examination by the Finance Committee
Micro-deliberation	Examination of the authorization act and appropriation act by standing committees	Special reporting to the Committee on Finance, General Economy and Planning (second-step deliberation)	Examination by standing committees

C. Issue 2: Measures to Reinforce Cabinet Meeting for Fiscal Strategies

In order to further reinforce South Korea’s Cabinet Meeting for Fiscal Strategies, improvements can be made to areas such as agenda-setting, scope of participants, and the planning and analysis capacities of budget-executing ministries and the presidential office with regard to strategic allocation of financial resources. The fiscal authorities and the presidential office must set agendas that exclude topics related to specific projects or pending policy issues to allow tentative conclusions to be drawn after detailed deliberation over agendas related to the establishment of fiscal strategies and allocation of financial resources. The scope of the participants involved must also be modified. Currently, the representatives present include experts from the private sector and the chairpersons of committees under the jurisdiction of the President. However, while expert opinion on the issues examined may indeed support discussion on controversial issues, this practice is highly likely to compromise the meeting’s original purpose of allowing cabinet members with authority over budget execution to participate in intensive discussions on the allocation of financial resources.

An even-more important task is encouraging the heads of budget-

executing ministries and presidential aides to focus on macro- and strategic allocation of financial resources and allow them to discuss matters on the same level as fiscal authorities. In the early stages following the introduction of the top-down budgetary system, a number of ministers carefully studied broader finances beyond the budgeting of their respective ministries in order to compete with one another for financial-resource allocation in front of the President, and the capabilities for budget preparation resultantly improved through the efforts of each ministry to organize their own internal examination committees and allocate budgets within the ministry. However, this trend has since declined, transitioning to a greater dependence on the capabilities of individual ministers. In order to prevent fiscal authorities from suggesting policy measures and drawing conclusions solely based upon their own initiative, each participant in the meeting should develop their pertinent ministry's capacity to plan and analyze the strategic allocation of financial resources.

In addition, a specific scope of disclosure must be determined to allow the details of and relevant information from the meeting, if not its entire contents, to be opened to the public, and efforts must be directed at encouraging the National Assembly, media and general public to take a greater interest in macro-budgeting or strategic financial-resource allocation and forge a related national consensus.

Determining Expenditure Limits and Improving Operational Methods

A. Operational Trends and Issues

According to a press release from the Ministry of Planning and Budget issued on February 25, 2004, expenditure limits were to be determined based on aggregate expenditures, including general accounts, special accounts and public funds. Specifically, the following five items were to be determined: (1) sectoral expenditure limits (by using 16 major categories of NFMPs such as social overhead capital, agriculture and fishery, education, environment, and small and medium enterprises), (2)

ministerial expenditure limits, (3) departmental expenditure limits within each ministry (by using 55 mid-level categories of NFMPs), (4) expenditure limits for each account within each ministry, and (5) adjusted financial resources (in preparation for unexpected situations arising after prior allocation of financial resources).

Nevertheless, it is considered that expenditure limits are still determined in a bottom-up manner. The fiscal authorities set expenditure limits for the relevant year in a similar manner as with preparing budgets for specific projects by, for example, allocating to new projects the financial resources obtained from the budget cut in the process of deliberating medium-term budget demands of individual ministries based on the previous year's expenditure limits. While the OECD and other international organizations recommend approximately 30 expenditure limit items as an optimal number, South Korea includes more than 200 expenditure limit items, due largely to the fact that expenditure limits are not determined in a top-down manner and instead the expenditure limits for respective ministries are subdivided between each department and account in order to establish limits and the sum of these limits becomes the ministerial expenditure limit. Thus, fiscal authorities are constantly seeking ways to determine ministerial and sectoral expenditure limits in a more macroscopic manner.

The larger problem is that the determined sectoral and ministerial expenditure limits are not meticulously observed by respective budget-executing ministries. Budget requests submitted by ministries in 2004, when the system was first introduced, demonstrate that 37 out of 48 government agencies observed their expenditure limits. In addition, in a press release announced on June 28, 2006, regarding the "status of request for budget proposals for the year 2007 and fund-operation plans," the Ministry of Planning and Budget related that, out of the 54 government agencies to which expenditure limits had been provided, 38 observed their expenditure limits for the year 2007 (37 government agencies in 2005). The results of a focused group interview indicate that many government agencies continue to demand a budget that exceeds their expenditure limits, while the fiscal authorities attempt to scale it down to meet the limits during the deliberation process. Even if the portion of the budget requested

by ministries exceeding the limit is not remarkable, the simple fact that expenditure limits already agreed upon or discussed in accordance with the principle of top-down budget preparation are not precisely observed and budgets exceeding the predetermined limits are indeed submitted is evidence that government agencies themselves maintain only limited control over their own budget preparations, or that they continue to engage in gamesmanship with the fiscal authorities as before, even if the intensity has significantly diminished. Requesting funding that exceeds expenditure limits is not allowed in countries where a top-down budget preparation system has been successfully settled.

Meanwhile, top-down budget preparation includes the inherent limitation that it may not be granted due respect in the budget deliberation process of the National Assembly since it is a system that applies to the budget preparation process of the executive branch.

B. Issue 1: Reasonable Determination of Expenditure Limits

Determining the expenditure limits is the most important decision in the process of budget preparation. Under the top-down budget preparation system, limits for aggregate expenditure must be first determined prior to setting sectoral and ministerial expenditure limits. In order to satisfy the original purpose of the system of the allocation of national financial resources through top-down budget preparation, the scope of fiscal expenditures for which such limits are to be announced must include not only general accounts, but special accounts and public funds as well.

Aggregate expenditure limits must be decided in the process of formulating medium-term fiscal plans as analyzed in Section II. Philosophically speaking, the determination of the scale of the assorted demands to be properly provided to the general public, such as public goods and welfare services is a highly political process. From another point of view, this is also a technical issue that requires the fiscal authorities to exert considerable professionalism by making decisions regarding economic conditions and projecting tax revenues accordingly, selecting appropriate keynotes for fiscal policy, and analyzing the costs and effects of budget projects.

Determining sectoral expenditure limits is much more complicated than setting aggregate expenditure limits, because the allocation of financial resources for such major areas as welfare, economic growth, education, national defense, public administration and local policy is a process of setting policy priorities, making it difficult to apply a unified standard. It is, in addition, a political process in that these priorities will be discriminately set based on political or philosophical viewpoints. On the other hand, it secures less attention from the media or general public than does determining the scale of aggregate expenditures. The adjustment of financial-resource allocation is mainly concentrated on discretionary spending, since the personnel expenses of public officials and mandatory expenditures cannot be drastically altered.

As seen in <Table III-3>, the rate of increase in the budget requests by ministries, which had surpassed 20 percent, plunged to 5 percent in 2005 with the introduction of the top-down budgetary system, only to climb again thereafter. Since the government does not share ministerial expenditure limits with the public, in order to analyze the degree to which the fiscal authorities reduced budget requests a comparison was made between the budget requests of each ministry and the final governmental budget proposals included in budget summary reports for each fiscal year as released by the government (see <Table III-4>). As a result, the rate of reduction of budget projects for general accounts has recently been again on the increase. In addition, the proportion of ministries without budget cuts made up somewhere between 7 percent and 42 percent, while 15-27 percent of ministries witnessed their budget requests cut by 10 percent or more. This illustrates that budget-executing ministries are not strictly observing expenditure limits and that fiscal authorities are still required to slash a large number of budget requests through deliberation.

<Table III-3> Trend of the Budget Requests Beyond Ceilings

(Unit: %)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Budget Request	25.3	24.5	28.6	24.9	5.0	7.1	7.6	9.6	7.4	4.5	6.9	8.7	8.8
General Accounts	32.2	29.9	25.8	30.8	11.7	9.3	10.0	-	-	-	-	-	-
Special Accounts	16.4	16.8	33.1	15.6	-6.7	1.3	0.9	-	-	-	-	-	-
Public Funds	-	-	-	-	-	6.9	4.7	5.6	7.5	9.5	6.9	5.0	1.2

Source: Ministry of Strategy and Finance, press releases related to budget requests (annual)

<Table III-4> Trends of Ministerial Budget Cuts after Deliberation

(Unit: %)

	FY2005	FY2006	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	
Mean	-4.8	-5.9	1.1	-4.6	-3.7	-7.2	-5.4	-8.9	
Median	-0.8	-1.1	-2.2	-1.9	-3.6	-4.9	-3.9	-5.0	
Max.	20.6	27.2	432.3	15.7	36.0	3.3	13.7	16.2	
Min.	-70.6	-86.1	-48.1	-53.4	-38.3	-27.0	-33.7	-83.7	
Standard Deviation	14.7	16.7	58.5	8.6	12.0	7.3	7.7	14.8	
No. of Government Agencies	52	56	58	58	48	48	47	48	
Sum of General Accounts	-2.1	-2.6	-5.2	-1.9	-2.9	-8.6	-4.1	-6.8	
Reduction Rate	0% or lower	38%	34%	7%	9%	42%	35%	40%	27%
	5% or higher	29%	25%	29%	28%	33%	48%	45%	50%
	10% or higher	15%	20%	19%	16%	15%	27%	17%	23%
	20% or higher	8%	11%	7%	2%	8%	10%	6%	10%

Note: Based on general accounts. (-) indicates reductions.

Source: Ministry of Strategy and Finance, budget summary reports for each fiscal year.

Allocating financial resources by sector is a highly complex process because it is basically aimed at determining policy priorities. In the future, further opinions from respective ministries must be collected and the roles of the Cabinet Meeting for Financial-resource Allocation / Cabinet Meeting for Fiscal Strategies must be enhanced in determining ministerial and sectoral expenditure limits based on the aggregate expenditure limits drawn in the process of formulating MTEFs as a means to allow expenditure limits to be set at a level observable by both the fiscal authorities and budget-executing ministries and then respected by the National Assembly. To this end, aggregate expenditure limits must first be determined in a more top-down manner. With regard to sectoral expenditure limits, the functions of cabinet meetings must be heightened, as must the deliberation process of the fiscal authorities, in order to guarantee faithful observance of expenditure limits through concurrence with budget-executing ministries. This will ensure that budget-executing ministries amend their distorted practices and the National Assembly follows the expenditure limits determined by the executive branch. According to Kim and Park (2006), the eight OECD countries listed in <Table III-5> operate a top-down budgetary system, but determine overall aggregate expenditure limits and individual limits for specific programs by appending bottom-up features as necessary. In particular, greater attention must be focused on the case of Switzerland, which grants expenditure limits on the basis of fixed formulas, and that of Sweden, where the cabinet jointly determines expenditure limits.

<Table III-5> Method of Determining Expenditure Limits

	Top-down Approach		Bottom-up Approach		
	Overall Ceiling	Sectoral Ceiling	Overall Ceiling	Sectoral Ceiling	Program Review
Australia	○	–	–	○	○
Canada	○	–	–	○	○
Chile	○	–	–	○	○
Denmark	○	○	–	△	○
South Korea	○	○	–	△	○
Netherlands	○	○	–	△	○
Sweden	○	○	–	–	△
U.K.	○	○	–	△	○

Note: ○ = actively used; △ = used as reference; – = not used
Source: Kim and Park (2006), Secondary citation from Lee (2006)

C. Issue 2: Balancing Bottom-up and Top-down Budget Preparation

In real-world budget preparation, where top-down and bottom-up approaches may well come together, it is important to strike a balance between the two. If fiscal authorities enjoy exclusive power over budget preparation, budget-executing ministries, without hesitation, request budgets in excess of their need by some dozens or sometimes even hundreds of percent, in order to compensate for feared budget cuts and secure the greatest budget possible. This was the case prior to the top-down budgetary system being introduced in South Korea, when fiscal authorities were required upon deliberation, as revealed in <Table III-6>, to trim budget requests by more than 20 percent. Under such conditions, the extreme distrust existing between fiscal authorities and government agencies forces them to lash out at each other in waging an annual “budget war.”

In order to eliminate the inefficiency of fiscal authorities being required to drastically cut inflated budget requests submitted by government agencies in the budget-preparation process and reduce the costs incurred by unnecessary negotiations between budget authorities and recipient ministries, roles must be assigned based on trust among

government agencies in such a manner that budget-executing ministries can take responsibility for preparing budgets for specific projects within given expenditure limits while the fiscal authorities manage overall financial resources and operate shared standards. As part of this process, fiscal authorities must also grant budget incentives on the basis of restructuring performance so as to induce ministries to initiate autonomous restructuring on tax expenditures.

As found in <Table III-6>, the introduction of the top-down budgetary system seems to have achieved a certain level of improvement in this regard. Citing the examples of South Korea in Kim and Park (2006) and Finland in Blondal et al. (2002), Ljungman (2009) maintained that the fact that the introduction of top-down budgetary system can drastically reduce the increase rate of budget requests made by ministries is the primary merit of top-down budgeting. However, the recent rebound in fiscal authorities' budget reduction rate raises concerns over whether the principle of top-down budgeting is being undermined. Even today, more than 150 public officials in the Budget Office undertake annual budget deliberations at the end of June when budget-executing ministries submit their respective budget requests. They work day and night for roughly three months until the end of September when the government's budget bills are finalized. On the other hand, time is extremely limited for reviewing controversial issues in the MTEFs and thoroughly examining the direction-setting of sectoral budget policy. As a result, budget-executing ministries are not guaranteed sufficient autonomy with regard to budget preparation.

<Table III-6> Line Ministries' Budget Requests and Budget Cuts

(Unit: trillion won, %)

Fiscal Year	Requested Budget	Actual Budget	Reduction Rate	Fiscal Year	Requested Budget	Actual Budget	Reduction Rate
1990	29.6	22.7	-23.4	2005	137.3	134.4	-2.1
1991	32.7	27.0	-17.4	2006	148.7	144.8	-2.6
1992	42.3	33.2	-21.6	2007	165.1	156.5	-5.2
1993	48.1	38.1	-20.9	2008	178.4	175.0	-1.9
1994	49.5	43.3	-12.6	2009	202.8	196.9	-2.9
1995	57.1	50.0	-12.5	2010	220.3	201.3	-8.6
1996	65.4	58.0	-11.4	2011	219.0	209.9	-4.1
1997	78.9	67.6	-14.3	2012	239.4	223.1	-6.8
1998	84.3	70.3	-16.6				
1999	96.4	75.6	-21.6				
2000	107.3	86.5	-19.4				
2001	118.7	94.1	-20.7				
2002	130.0	105.9	-18.6				
2003	132.0	111.5	-15.6				
2004	145.1	118.4	-18.4				

Note: Based on general accounts.

Source: Ministry of Planning and Budget, budget summary reports for each fiscal year.

In order to pursue measures designed to address these issues, it is advisable to refer to the example of the budget preparation process of the Netherlands where top-down and bottom-up approaches are sufficiently harmonized. Compared to South Korea, the Netherlands features a more practical step-by-step decision-making process that covers aggregate expenditures, departmental and sectoral expenditure limits, and budgets for specific projects, and that binds next-step decision-making, embodying the characteristics of top-down budgeting. This appears to mainly rely upon the unique political environment of the Netherlands, which as a parliamentary government must form a coalition cabinet to assume power and therefore must make essential budget decisions during the process of forming a cabinet. However, South Korea may refer to the practical concurrence of various expenditure limits, as well as the institutional mechanisms and practices that guarantee observance of such concurrence.

In the meantime, two reasons explain why the budget requests of government agencies in South Korea surpass their determined expenditure limits. First, fiscal authorities are granted insufficient means to ensure that ministries submit budget requests at a scale only up to the predetermined expenditure limits. In developed countries, it is difficult to imagine that any government agency would request a budget surpassing the limits determined by fiscal authorities, since such authorities in those countries hold much higher status than do their counterparts in South Korea and limits have been already agreed to by government agencies. Second, ministries maintain insufficient capabilities to autonomously intermediate between interests during the course of budget preparations as a means to curb their expenditures within the expenditure limits. The introduction of a top-down budgetary system has reinforced the status and roles of the Planning and Budget Office of each budget-executing ministries, but it appears that budget-executing ministries still fail to assume the initiative in making the needed decisions to respond to interest intermediation among various departments and demands from special interest groups. Instead, they tend to transfer all such responsibilities to the fiscal authorities as in the bottom-up budgetary system of the past. This is largely because both the fiscal authorities and governmental agencies maintain poor budget-analysis and decision-making capabilities. This can also be attributable to the job rotation system among South Korean public officials, which makes it difficult to develop individual professional expertise and organization-wide trust. As Kim and Park (2006) have pointed out, a top-down budgetary system can succeed only when accompanied by behavioral changes. To this end, the inertia of behavioral changes must be overcome and the agency in charge of budget must strive to reorganize the roles of each government agency.

Lastly, while the National Assembly of South Korea has tended to deliberate budgets by focusing purely on funding for specific projects, it needs to add a bottom-up deliberation process as well. As-is, the process of budget deliberation and finalization in the National Assembly begins with the government's administrative policy speech (falling somewhere between October 2 and mid-October), followed by preliminary examinations by standing committees (between mid-October and early November), overall

examination by the Special Committee on Budget and Accounts (between early November and December 1) and resolution at the Plenary Session (by December 2). Both the preliminary and overall examinations focus largely on the coordination of specific projects. As mentioned earlier, the legislative branch needs to introduce a two-step budget preparation system in the same manner as did the executive. In order for the National Assembly to foster fiscal discipline, it is advised to refer to the example of Norway, which introduced a bottom-up deliberation process to their parliament's budget deliberations in 1997.

5 Strengthening Preliminary Feasibility Study of Large-scale National Projects and Welfare Programs

The management systems for large-scale fiscal investment projects include a total project cost management system, preliminary feasibility studies, feasibility re-verification systems, and a re-verification system for SOC project demand projection. During the period between 1994 and 1998, prior to the introduction of preliminary feasibility studies, the feasibility studies conducted by respective governmental agencies for large-scale budgetary programs concluded that each of the 33 projects examined were feasible, with the sole exception of an effort to construct an airport in Ulleung-do. However, this situation changed remarkably upon preliminary feasibility studies being introduced. The preliminary feasibility studies conducted between 1999 and the end of 2011 on a total of 588 projects (with total project costs of 272 trillion won) resulted in determinations of low feasibility for 220 projects, or 37 percent of the total, with project costs valued at 118 trillion won (43 percent).

Despite these efforts, there remain certain occasions when political or policy decisions require particular projects to be pushed through without a preliminary feasibility study. In addition, despite the introduction of a feasibility re-verification system, demand projection re-verification system, and feasibility verification for welfare programs, suspicions are occasionally raised regarding whether national projects are determined by political or policy considerations due to the unnecessarily broad scope of exemptions

from feasibility study. Other persistent problems include insufficient projection of traffic demand, and the preliminary feasibility study for welfare programs failing to take root due to an excessively broad scope of exemption.

The following may be suggested as measures to address such issues. Firstly, it is necessary to delete or amend the phrase “a project prescribed by the Minister of Strategy and Finance as necessary to promote as a national policy for balanced regional development, response to urgent economic or social conditions, etc.” from among the requirements for exemption allowed in the Enforcement Decree of the National Finance Act. Secondly, requirements for exemptions from preliminary feasibility studies should be tightened by excluding welfare programs simply aimed at income transfer from those subject to exemption and clearly defining the requirements for projects to be conducted in accordance with the related acts or subordinate statutes, as well as conduct simplified preliminary feasibility studies for those projects exempted from a preliminary feasibility study. Lastly, feasibility verification for a budget increase in continuing projects must be also heightened.

**<Table III-7> Projects Exempted from Preliminary Feasibility Study
(Classified by Reasons of Exemption)**

Reasons of Exemption from Preliminary Feasibility Study	No. of Projects	Total Project Costs	Remark
Other Projects with no Actual Benefit Ensuing from a Preliminary Feasibility Study	27	18 trillion and 104.4 billion won	Seoul-Sejong expressway (2008), construction of Songdo Global University Campus (2009), structural improvement of the estuary weir of Yeongsan River (2009), development of a new port in the Saemangeum area (2009), Pohang-Yeongdeok expressway (2009), creation of a theme park for Korean culture (2009)
Projects to Prevent Disasters	13	15 trillion and 561.9 billion won	Four Major Rivers Restoration Project (2009), construction of breakwater at Dadaepo Port (2010), construction of Shinnam breakwater (2nd stage) in Ulsan (2011), construction of Munjeong Flood Control Dam (2011)

<Table III-7> Continue

Reasons of Exemption from Preliminary Feasibility Study	No. of Projects	Total Project Costs	Remark
Projects for National Policies	2	824.2 billion won	Construction of Songdo Global University Campus (2009), marine convergence project of Busan Innovation City (2011)
Facilities Prescribed in Acts and Subordinate Statutes	22	13 trillion and 573.4 billion won	Construction of education research complex for fire prevention (2009), project to utilize national assets (2010), National Medical Center (2010), support project for 2015 Gwangju Summer Universiade (2010), creation of the International Science and Business Belt (2011), construction of facilities for the Pyeongchang Winter Olympics, reinforcement work for national highways
Projects for Simple Income Transfer	3	5 trillion and 364.6 billion won	Support for national pension premiums for self-employed small business owners (2009), project to disburse pension for the seriously disabled (2009), Long-term Care Insurance for the Disabled (2009)
National Defense-related Projects that are Relevant to National Security or Require Security	1	352 billion won	2 nd -stage project for Ulleung (Sadong) Port
Total	68	53 trillion and 919.5 billion won	—

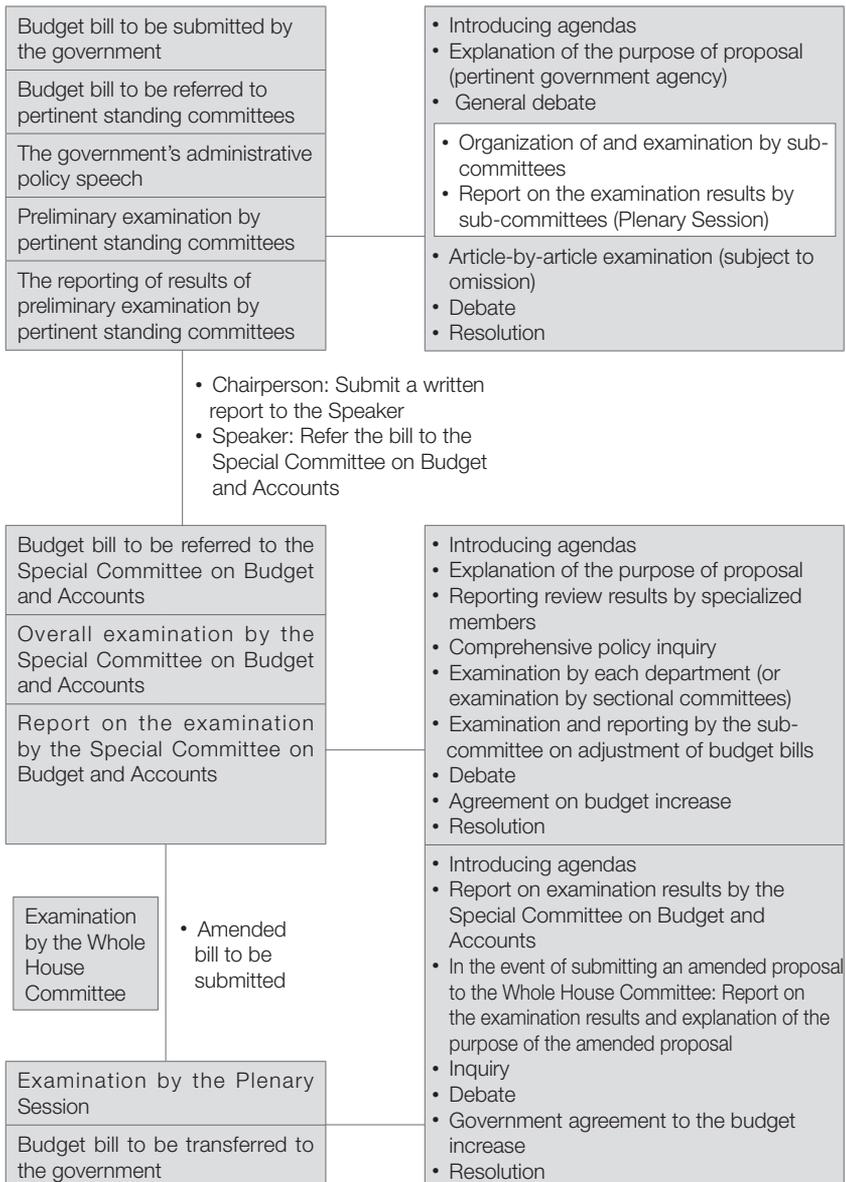
Source: Office of Representative Park (2012)

6 Measures to Improve the National Assembly's Budget Deliberation Process

As shown in [Figure III-1], the process of budget deliberation in the National Assembly begins with the government's administrative policy speech on budget bills, followed by preliminary examination by competent standing committees, overall examination by the Special Committee on Budget and

Accounts, and the examination and resolution in the Plenary Session.

[Figure III-1] Process of National Assembly’s Budget Deliberation



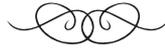
Source: Ministry of Strategy and Finance (2012)

The problems raised in relation to the division of roles on the Special Committee on Budget and Accounts include the excessively political nature of the Special Committee on Budget and Accounts, the one-year term of office of its members, the holding of concurrent memberships on other standing committees, the brief period allowed for the examination of budget bills, the phased examination by standing committees and the Special Committee on Budget and Accounts, and the lack of measures in place to ensure the effectiveness of the results of examinations of settlement of accounts. To address these issues, a number of opinions have been voiced in support of making the Special Committee on Budget and Accounts a standing committee. The Special Committee on the Reformation of National Assembly (2004) summarized, as follows, the advantages and disadvantages of a shift to establishing the Special Committee on Budget and Accounts as a standing committee. First of all, the merits include convenient management of the lifecycle of budgets, suitability in terms of the government's top-down budgetary system, enhanced professionalism and independence in the examination of budget bills and settlement of accounts, and ease of securing the right to examine bills. On the other hand, the Special Committee on Budget and Accounts as a standing committee might allow it excessive power, weaken the utilization of expertise on other standing committees, exacerbate tensions between the right to examine budget bills (National Assembly) and the right to prepare budgets (government), burden the government with an increased workload on behalf of the National Assembly, reduce the number of members assigned to other standing committees, or make it difficult to determine pertinent government agencies.

A further issue is related to the effects of the introduction of a top-down budgetary system to the National Assembly's budget bill examination. In South Korea, the National Assembly examines budget bills not through discussion of the strategic frameworks for financial-resources allocation by sector or ministry, but instead by reviewing and coordinating budget sums for individual project units. However, the full-scale introduction of a top-down budgetary system is likely to limit the scope of budget examination in the National Assembly for making decisions on the allocation of aggregate sums for respective government agencies. Since the top-down budgetary

system requires a determination of the aggregate volume of public finance and the expenditure limits for each government agency, it is presumed to be possible to start discussing the following year's budgets prior to the submission of budget bills to the National Assembly. As a result, a top-down budgetary system is expected to ensure that the process of budget examination by the National Assembly will grow more stable and practical and the National Assembly will come to examine budget bills from the perspective of overall national finances.

Thus, it is suggested that the Special Committee on Budget and Accounts become a standing committee and be divided into a committee on budgets and a second on accounts in order to reinforce its functions. After readjusting the roles of each standing committee, two-step budget deliberation featuring micro- and macro-budget preparation is recommended for introduction to the National Assembly's budget examinations. In addition, it is necessary to reflect the results of performance assessment and the National Assembly's examination of settlement of accounts into the process of budget deliberation by the National Assembly.



IV

Performance Assessment of Budgetary Programs and Improvement of Feedback Process

1 Significance and Issues of Budgetary Performance Management Systems

There is no denying that budgetary performance management systems must be introduced as a means to improve the performance of the government's budgetary programs and enhance the rationality of budget allocation, but it is no simple matter to operate an effective system. The operation of a budgetary performance management system requires the comprehensive engagement of the capabilities, culture and political functions of a country. This section aims to examine and draw implications from international trends with regard to major issues related to the effective operation of a budgetary performance management system. Based on these leading issues, it will also analyze the current status of South Korea's budgetary performance management systems and suggest policy tasks.

The infrastructure for the operation of the budgetary performance management systems is comprised of performance information designed to measure the performance of budgetary programs, cost information that reveals the expenses incurred by budgetary programs, and program budget systems that help select units for performance management in a systematic and comprehensive manner. While this infrastructure assists decision-makers in drawing helpful basic information, the next-most important

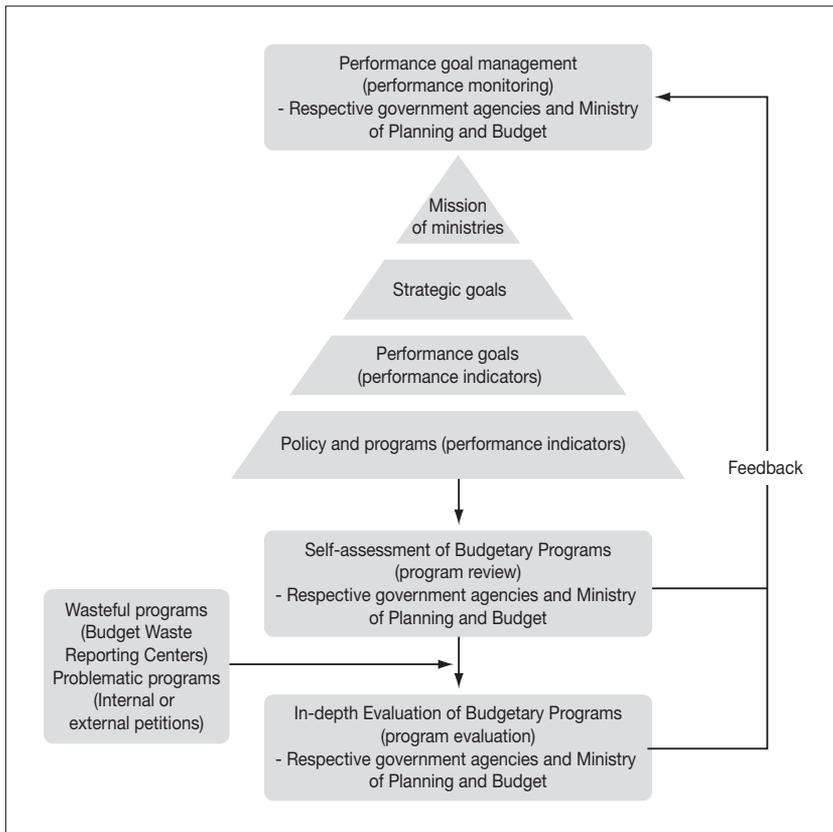
matters are the institutionalization of the performance management and evaluation process, the capabilities of those who operate the system, and the existing environment for the operation of the system. Examples from other countries suggest that they by and large maintain similar infrastructure for their budgetary performance management systems, but specifics related to operating the system vary according to the government structure, culture, and socioeconomic environment of respective countries.

2 Major Issues of South Korea's Budgetary Performance Management Systems and Direction-setting for Improvement

It was in 2003, upon the inauguration of the Roh administration, that a performance management system for budgetary programs was fully supported in South Korea, but pilot projects had already been conducted between 2000 and 2002. South Korea's current framework for budgetary performance management systems are categorized into the following three systems: Performance Goal Management, Self-assessment of Budgetary Programs, and In-depth Evaluation of Budgetary Programs. Performance Goal Management aims to monitor the performance of the budgetary programs of respective government agencies through a focus on a small number of performance indicators on the basis of the structure of strategic goals, performance goals and unit projects. Self-assessment of Budgetary Programs is designed to examine the performance of budgetary programs based on checklists that detail the criteria for evaluating budgetary performance. In-depth Evaluation of Budgetary Programs is conducted with a limited selection of budgetary programs that are discovered to manifest shortcomings during the Self-assessment of Budgetary Programs or other internal or external examination. To complement these systems, the government has established Budget Waste Reporting Centers as a means to respond to internal or external petitions in a timely manner. These performance management systems for budgetary programs first give line ministries autonomy in conducting projects on their own and then in evaluating the results and reflecting them in future budget preparation or program operations. This performance-management system can be

summarized through the following figure.

[Figure IV-1] Budgetary Performance Management System of South Korea



Now that eight years have passed since the 2005 introduction of the budgetary performance management system in South Korea and with a new administration set to be introduced in the coming year, it is imperative to examine the effectiveness of the system and devise measures to fundamentally improve it. This section will identify major issues regarding the budgetary performance management system and discuss measures for its improvement.

A. Improving Information Levels for Performance Management

1) Improving Program Budget Structures

Program budget structures are infrastructure that allows more-systematic and comprehensive performance management. If program budget structures are set inappropriately, failures can emerge from the establishment of performance indicators for performance management. Often, the introduction of program budget structures is connected with a shift in providing program-conducting ministries with autonomy for budget preparation and execution.

Since South Korean program budget structures and the performance goal system for the purposes of performance management were developed in parallel by different organizations, it has often been difficult to identify the relevance between the two systems. In an attempt to address this problem, the National Finance Act was amended in 2010 with an added provision stipulating that the details of performance plans must, in principle, coincide with program budgets. Thanks to efforts by the executive branch, almost all government agencies have now squared their performance plans with program budgets.

What is more important than this exterior matching, however, is whether program budget structures will be harmonized with the performance goal system in a manner that satisfies the purposes of performance management. While traditional program budget structures were established with maximum consideration given to the existing organizational structures, the performance goal system developed a hierarchy that accords more with the purposes of performance management. In addition, program budget structures are operated with a minimum potential for any change in order to maintain the consistency of the budget structure. Therefore, one of the easiest ways to achieve synchronization is to mechanically match the performance goal system with program budget structures, but this may in fact result in a change for the worse.

Generally, the introduction of program budget structures accompanies increased autonomy for government agencies. For example,

budget preparation on the program level requires consultation with central budget authorities, but budget preparation at the lower levels of projects may be conducted by means of the autonomous operations of the agencies responsible for the projects. In South Korea, the introduction of both program budget structures and top-down budgeting has improved ministerial autonomy in budget preparation. However, this does not mean that the roles of central budget authorities and government agencies have expressly been separated. In reality, there is room for central budget authorities to intervene at all levels of budget preparation as deemed necessary. As a result, a government agency that has pushed forward a project after prior consultation with the budget authorities may find it difficult to accept an unexpected business process or being held accountable as a result of *ex post facto* evaluation.

If government organizations are to be revamped upon the inauguration of the new administration, it is necessary to fundamentally examine and reform program budget structures. It will be much easier to produce performance data when both the organizational structure and program budget structures are reformed to conform to the purposes of performance management. It is also imperative to review not only the appropriateness of program budget structures themselves, but also the degree of autonomy that must be granted to respective strata within program budget structures. In order to achieve the purposes of outcome-focused performance management, it is essential to guarantee a certain level of autonomy to government agencies over the course of planning and conducting projects.

2) Improving Performance Indicators and Targets

Performance indicators and targets are fundamental performance data for performance management. The appropriateness of performance indicators and targets as defined in performance plans has improved significantly, but there remains room for improvement. Central budget authorities have endeavored to ensure the appropriateness of performance plans, and the Board of Audit and Inspection of South Korea started examining performance plans in 2010, contributing as well to the

improvement of performance indicators and targets. The National Assembly also publishes annual reports after reviewing government agencies' performance plans and performance reports. Given this involvement of a range of organizations, the binding force of performance indicators and targets has been gradually increased. As a result, performance plans and reports are no longer simply internal administrative tools of the executive branch, but are developing into tools for the Board of Audit and Inspection or the National Assembly to fulfill their responsibility. This wave of change is contributing to ensuring the sustainability of the system and reinforcing its binding nature, but it is also promoting an environment that obstructs the flexible operation of the system. For example, it is impossible to nimbly revise performance targets in reflection of changes in the external environment once targets are submitted to the National Assembly as fixed documents

In order to ensure the appropriateness of performance indicators and targets, it is imperative to require that performance indicators be determined when applying for new projects, since government agencies are frequently more cooperative when applying for new projects. In fact, such a measure has been in place since 2012, but it remains to be seen how much it will contribute to improving performance data. The government must actively communicate with the National Assembly in order to discuss whether to allow the amendment of not only budgets, but also of indicators and targets with changes in situations. Because performance indicators and targets are submitted by individual ministries prior to the finalization of budgets, it is necessary to provide them with an opportunity to adjust their targets at the beginning of each year in consideration of shifts in external factors resulting from finalized budgets and the passage of time. If greater flexibility is allowed in amending performance indicators and targets, government agencies are expected to demonstrate a higher level of acceptance of evaluation results. It is certain that if this form of amendment is to be allowed, it is necessary for government agencies to undergo an approval process for amendment from the Ministry of Strategy and Finance and communicate with the National Assembly.

In addition, there is a need to employ a mid- and long-term perspective when determining performance targets and reviewing the

appropriateness of the level for achievement. Currently, evaluation is conducted based on annual targets, but considering that performance of budgetary programs needs to be analyzed from a medium-term perspective, it is imperative to analyze and evaluate program performance on the basis of trends over a minimum of three years. Existing evaluation is disproportionately based on single-year performance, resulting in limited acceptability and utilization.

It is also possible to operate a separate track for managing government agencies that have failed to adequately set performance indicators and targets. Currently, agencies featuring insufficient performance indicators and targets have tended to receive budget reductions as a disadvantage. It is suggested, however, that more appropriate incentives would be not inducement for project units, but rather incentives provided at the level of organizations and their management.

3) Improving Items Under Self-assessment of Budgetary Programs

It is also essential to improve the examination criteria for the periodic examination of budgetary programs that is conducted every three years. There are concerns surrounding clarifying the related criteria and appropriateness of evaluation items, but more fundamental challenges are related to evaluation capability and the process of operating evaluations.

First, issues arise with the flexibility of evaluation. Self-assessment of Budgetary Programs is conducted after first developing detailed evaluation criteria and then reigning in the discretionary power of reviewers based on these criteria. The practice of conducting a review allowing minimal discretionary power on the part of reviewers is often found in other types of review in South Korea, a method that relies more on evaluation guidelines rather than on the expertise of reviewers. Such a technique maintains evaluation consistency and produces relatively objective outcomes, but it is unable to take into account the myriad situations encountered in practice that are not reflected in the evaluation guidelines. For instance, although whether or not performance targets are achieved may be interpreted through a range of factors, evaluation is usually conducted with high weight placed on the achievement level itself. Even if the same targets are

achieved, the performance could be considered problematic or not after other factors are taken into account. The current guidelines assign points in consideration of external factors, but fundamentally any agency that fails to fulfill its targets must suffer disadvantages. Therefore, it is necessary to examine how much discretionary power should be granted to reviewers during the evaluation process. If reviewers conduct evaluations from a more comprehensive perspective by considering evaluation guidelines and other real-world factors not included in the guidelines, reviewees will prove more willing to accept the results.

Second, in relation to the aforementioned problem of flexibility, attention must also be turned to reviewers' capabilities. When reviewers are equipped with the expertise to successfully examine relevant projects, an evaluation system may be operated in a manner that does not rely on detailed guidelines, but instead utilizes the expertise of reviewers to a maximum degree. However, if reviewers do not bear the capacity for responsible evaluation, it is inevitable to conduct reviews based on evaluation guidelines. Considering the staff rotation system of South Korea's central administrative agencies, it is not far-fetched to conclude that guideline-based evaluation is unavoidable in the case of South Korea. In order to deviate from an evaluation method heavily reliant on evaluation guidelines, it is imperative to secure reviewer expertise.

4) Improving Project Evaluation

Central budget authorities are currently recommending that government agencies conduct regular project evaluation on their own initiative and actively formulate evidence-based policy. In practice, Self-assessment of Budgetary Programs requires utilizing the results of comprehensive project evaluation in combination with performance indicators and targets. Project evaluation is critical because performance indicators and targets are the most basic form of data and additional analysis is required to apply them to practical decision making. To fulfill these needs, Self-assessment of Budgetary Programs includes an item asking whether independent project evaluation has been conducted and requesting details about evaluation results. However, practical difficulties still

remain. Above all, there is resistance in practice to items that recommend commissioning evaluations to external independent institutions in order to ensure independence of evaluation. Government agencies have also voiced the complaint that they have difficulty securing the budget to cover costs incurred in evaluation and that the results of alternative evaluation systems need to be recognized.

In many international cases, project evaluation is conducted mainly by the agencies that carry out the relevant project, and budget authorities produce and manage information to be used for monitoring and for periodic reviews. It appears necessary to enhance the expertise of line ministries in project evaluation and raise awareness regarding periodic project evaluation as an important component of project management on the part of government agencies.

In South Korea, In-depth Evaluation of Budgetary Programs is conducted by the budget authorities. In the past, no clear principles for selecting projects subject to this evaluation had been detailed, but in 2010 the evaluation system shifted to distinguishing between individual projects and clusters of projects directed at the same purpose. There was a need for budget authorities' evaluation of project groups involving multiple ministries to be reinforced, but in order to ensure the effectiveness of such evaluation, line ministries must take increased responsibility for data management.

5) Selecting Projects for Evaluation

Proper selection of projects for evaluation is an important starting point for performance management and evaluation. In the past, Self-assessment of Budgetary Programs annually evaluated one-third of all government agencies' unit projects following a selection process featuring no specific criteria. From 2010, however, unit projects sharing the same performance goals are to be examined within the same year as an effort to enhance the effectiveness of performance management. This approach was adopted with the intention of conducting not only micro-evaluation of individual unit projects, but also more-comprehensive evaluation in consideration of the connection with high-priority goals. Nevertheless,

some exceptional cases occasionally occur in practice, and there has been a limitation regarding drawing significant conclusions from the details of evaluation on the status of performance goals. In the future, it will be necessary to refine budget authorities' capabilities and thereby draw further policy implications by analyzing the grades of individual projects and levels of performance goals.

6) Improving Cost Information

Since budgetary performance management systems aim to enhance not only project effectiveness itself, but effectiveness or efficiency relative to cost, it is important to produce and make use of adequate cost information. South Korea's budgetary performance management systems do conduct a brief examination of efficiency, but not on the basis of explicit cost information. Since the introduction of accrual-basis accounting, cost information has been produced on the program level of, but on the unit-project level, the area for performance management, it is not being generated. In addition, overhead costs are distributed on the level of programs only for public funds and special accounts, but not in the case of general accounts.

In the short term, it is necessary to partially introduce efficiency indicators to those projects that will demonstrate the greatest effect from efficiency management, such as projects providing administrative services, and in the longer term it is required to complete the distribution of overhead costs, thereby reinforcing efficiency management. More fundamentally, measures to enhance the flexibility of management by public officials must be also considered as a means to heighten the flexibility of personnel expenses of central government agencies, which constitute a major share of overhead.

B. Connecting Systems and Eliminating Overlaps

1) Strengthening Connectivity Between Budgetary Performance Management Systems

The current South Korean systems of Budgetary Performance Goal Management, Self-assessment of Budgetary Programs, and In-depth Evaluation of Budgetary Programs feature respective purposes of monitoring, periodic review and selective in-depth analysis, and complement one another. The connectedness between the systems has in fact been reinforced, but there remains room for improvement. Performance plans and reports are largely neglected and are not being used for purposes beyond information disclosure. The National Assembly Budget Office regularly publishes analysis reports, but their application by the National Assembly is limited due to the poor quality of performance information.

Self-assessment is undertaken by means of the performance goal systems identified in the performance plans for select projects to be evaluated, but this also calls for refinement. In particular, it is desirable to require unit projects targeting identical performance goals to be evaluated within the same year, but this has not yet been reflected in the actual evaluation process. In-depth evaluation accesses some self-assessment data for the selection of projects to be evaluated, but the interconnectedness requires strengthening. Although some underperforming projects are considered as candidates for in-depth evaluation, it is more necessary to take into account measures to improve connectedness through detailed self-assessment data.

It is also recommended that performance plans and reports be used for monitoring by government agencies. To this end, high-ranking decision makers within the agencies must focus on utilizing performance information. As a support measure, the sufficiency of the establishment and operation of performance management systems must be evaluated, and the results need to be utilized as a means to provide incentives to top leadership. One of such attempts is the Management Accountability Framework of Canada.

In selecting projects to be subjected to in-depth evaluation, the results of self-assessment must be fully utilized to create a synergy effect between the two systems. This necessitates the enhancement of the quality of the self-assessment system. Major issues regarding projects, as well as their evaluation grades, must be identified through the self-assessment process, and in-depth evaluation may be conducted on important matters found among such major issues.

The results of in-depth evaluation may be also used to enrich the performance information contained in performance plans. Since in-depth evaluation may help identify desirable indicators for relevant projects, the results of in-depth evaluation need to be more fully utilized in performance planning.

Performance plans and reports should be continuously utilized by ministries, but it is also necessary to selectively establish a periodic monitoring system for major performance goals and management tasks of government agencies. It is assumed that the introduction of a selective regular monitoring system, combined with the result-centered ex post evaluation system, will greatly enhance the effectiveness of performance management. One example of which to take note is the GPRA Modernization Act put forward by the Obama administration.

2) Overlaps with other Evaluation Systems Segmentation

It is imperative to minimize the burdens of performance management and evaluation and mitigate the segmentation of evaluation by alleviating such segmentation and any overlaps with other evaluation systems within the government that may share similar features. Overlapping systems include evaluations of departmental business, metropolitan special accounts, subsidy retention, and welfare projects using lottery funds.

It may be worth considering establishing a measure to manage such evaluation systems in an integrated manner if they demonstrate similar targets and criteria. The demands for evaluation by the Ministry of Strategy and Finance's Budget Office need to be fulfilled step by step through performance management and evaluation organizations within the ministry. In the meantime, the Office for Government Policy Coordination

must focus on selectively coordinating and monitoring policy from a long-term perspective, while the Ministry of Strategy and Finance assumes the role of taking charge of routine performance management. It is also necessary to construct an integrated management system by abolishing the artificial separation between budget and non-budget projects. More fundamentally, it is advisable to consider measures for integrating the functions within the executive branch of preparing budgets and formulating and managing policies or projects.

C. Improving the Use of Evaluation Results

1) Reforming Practices of Connecting to Budgets

The current practice of linking budgets to the results from Self-assessment of Budgetary Programs must be reformed in a manner that rationally reflects the individual details of project evaluation in the process of budget preparation. The current method of mechanically cutting budgets served effectively as a form of shock therapy in the initial stages of the introduction of the system, but in order to enhance the sustainability and effectiveness of the system, it is necessary to develop an improved linkage method.

At present, if any project is evaluated as falling below the grade of “unsatisfactory” according to the classification of evaluation grades, that project’s budget is automatically reduced. As a result, the system is considered to be subject to abuse in some cases, allowing projects that cannot afford budget cuts to evade a budget reduction by adjusting evaluation grades.

In this vein, there is a need when concluding evaluation results to draw recommendations for budget preparation only after considering both project performance and policy significance. In addition, projects with inadequate performance data need to be managed along a separate track. With regard to such projects, it is better to create incentive systems for enhancing the responsibility of the relevant organization or heads of organizations than it is to reduce the working funds themselves. Additionally, there is also a need for separate measures to manage

mandatory expenditure programs. Since it is impossible to cut the budgets of mandatory expenditure programs without amending the related laws, it is necessary to conduct their performance management via a reinforced track.

2) Reinforcing the Improvement of Business Methods

The purposes of the budgetary performance management system are not limited to reflecting the results of budget preparation; it also aims to improve business methods. There has not been sufficient management with regard to the recommendations for business method improvement drawn from the evaluation outcomes. Above all, it is necessary to draw practical details regarding recommendations for improving business methods to allow each government agency to utilize the recommendation details for improving their respective business. Next, there needs to be a system in place that allows periodic examination and feedback on whether such recommendations are being put into practice. For example, in operating the Program Assessment Rating Tool (PART), the U.S. government examines and opens to the public on a quarterly basis whether or not recommendations have been met. The South Korean government must similarly establish a monitoring system by requiring that recommendations be entered into the budgetary management information system and any changes be noted with regularity.

D. Strengthening Performance Management Capabilities and Restructuring Organizations for the Efficient Operation of Systems

1) Executive Branch

South Korea is currently facing the challenge that while each actor individual displays insufficient performance-management capabilities, a variety of evaluation systems are being operated in an overlapping or segmented manner. It is therefore imperative to merge selected systems within the extent possible or reinforce their interconnectedness. More fundamentally it is necessary to configure an organization within the

executive branch to assume global functions.

Restructuring is also required at the Ministry of Strategy and Finance. Although the Fiscal Policy Bureau is the core of performance management and evaluation functions, the Budget Office operates additional evaluation systems as the need arises. The Fiscal Policy Bureau must absorb the evaluation demands from the Budget Office and increase its own capabilities for independent evaluation. In particular, it is important to heighten the status and capabilities of the organization that takes charge of the tasks of performance management and evaluation in order to promote an environment allowing it to operate as an independent organization in evaluation matters. It is worth taking note of the example of the Obama administration, which appointed the Chief Performance Officer within the White House to preside over meetings on performance attended by undersecretaries or department heads of assorted government agencies. If the South Korean government is to appoint its own Chief Performance Officer, it must first restructure relevant government organizations by merging the global functions held by the presidential aide for governance, the Prime Minister's Office, the Ministry of Strategy and Finance and the Ministry of Public Administration and Security.

2) Line Ministries

Although with the reformation of fiscal controls in the mid-2000s considerable weight has been placed upon the roles of the internal organizations responsible for budgets as well as performance management and evaluation within line ministries, such organizations continue to manifest inadequate capabilities and minimal status within the government agencies to which they belong.

It is essential to heighten the status of performance officers within government agencies, thereby allowing performance-related issues to be discussed effectively within the organizations. These performance officers must be granted a status corresponding to that of department head or higher and be mandated to attend regular meetings presided over by the Chief Performance Officer. In addition, each government agency needs to operate an organization with its own evaluation capabilities in order to

create a system under which monitoring and performance evaluation can be conducted periodically within the agency.

3) Board of Audit and Inspection and the Legislative Branch

Although the Board of Audit and Inspection of South Korea has contributed to improving the quality of performance information by beginning from 2010 to examine performance reports, it has undermined the flexibility of operating the performance management system by making the system itself the subject of audit. The legislative branch has also focused more on verifying the observance of budget reduction guidelines rather than on the constructive use of evaluation outcomes. As a result, the performance management system has emerged not as the government's management system, but as a regulatory tool that focuses on compliance with the system.

To facilitate communication with the Board of Audit and Inspection and the legislative branch, it is vital to share the purposes and intent of the performance management system. The two agencies need to intervene with a focus more on recommending practical monitoring and evaluation activities than on scrutinizing the observance of guidelines. However, it is assumed that, considering their inherent nature, the Board of Audit and Inspection and the legislative branch cannot entirely discard their tendency to emphasize the observance of guidelines.

E. Relieving Burdens on Government Agencies and Providing Incentives to Minimize their Tactical Behavior

1) Selecting and Concentrating on Projects Subject to Management

Through Self-assessment of Budgetary Programs, more than 400 unit projects are examined annually and evaluated according to standardized criteria. Given the current scale of staffing within the government, it is almost impossible to produce in-depth evaluation results within the brief period of only three months. Therefore, it is essential to select target projects and focus on those that will enjoy greater benefits from evaluation.

For instance, it is possible to examine projects not manifesting conspicuous issues by means of simply monitoring them based on previous evaluation outcomes, while operating a separate track for managing projects that face important issues and therefore require more intensive examination.

2) Reinforcing the Roles of Government Agencies During Evaluation Periods

The central budget authorities are presently intervening in a practical manner in the full range of processes of drawing evaluation outcomes, and although self-evaluations are conducted by self-evaluation committees of government ministries, their concrete significance is limited. If it is possible to presume that the information possessed by ministries is superior to that by the central budget authorities, it is imperative to strengthen the roles of government agencies. For example, greater autonomy could be provided to government agencies in their evaluation process on the premise that they observe the evaluation criteria provided by the central budget authorities and conduct normative evaluations. In such case, the criteria for normative evaluation may be required to include the amount or proportion of budget as a specific adjustment target.

Reinforcing Budget Execution Management and Budget Waste Prevention Systems

Over one full year is generally required from the point of budget preparation by the executive branch and examination and resolution by the National Assembly to the settlement of the results of budget-execution plans. Due to this time gap, it is essential to ensure efficient budget execution by strengthening interim and ex post examination of the appropriateness of execution based on these plans. Currently, budget management examination meetings, the budget waste reporting system, and the budget incentive system are serving in their due roles, but it is vital to respond to budget waste in a more systemic manner after categorizing the varied types of budget waste by referring to the Korean Association for

Policy Studies (2006) and Park and Song (2011).

To this end, it is necessary to establish a system for effectively reflecting in budget examinations a range of information such as the results of settlement audits conducted in the immediately preceding year and existing performance management outcomes. It is also required to consider devising measures to strengthen supervision in order to ensure efficient budget execution through increased interest and participation by civic groups and the general public.

<Table IV-1> Classification of Waste Types by Concepts of Budget Waste

Concept Stage	Narrowest Sense (Illegalities by Individuals)	Narrow Sense (Moral Hazard)	Broad Sense (Limitation of Knowledge)	Broadest Sense (Conflicts of Values)
Planning and Preparation	<ul style="list-style-type: none"> - Continuing projects without undertaking examination or obtaining approval for investments or loans - Politicians' decisions to initiate a project for the benefit of their political financial backers 	<ul style="list-style-type: none"> - Politicians' decision to initiate a project solely for the benefit of particular constituents - Waste resulting from seeking better alternatives - Decisions for overlapping projects - Lenient management of organizations or human resources - Determination to use excessive funds by pursuing upscale, large-scale or state-of-the-art projects 	<ul style="list-style-type: none"> - Insufficient ability to forecast situational changes due to a lack of efforts toward scientific analysis - Lack of analysis of the consequences of budget programs 	<ul style="list-style-type: none"> - Budget-related decisions to pursue equity or further administrative values other than efficiency

<Table IV-1> Continue

Concept Stage	Narrowest Sense (Illegalities by Individuals)	Narrow Sense (Moral Hazard)	Broad Sense (Limitation of Knowledge)	Broadest Sense (Conflicts of Values)
		- Bureaucrats' decision to launch a project that elicits politicians' moral hazard		
Execution	<ul style="list-style-type: none"> - Expenditures in violation of budget plans or legislation - Excessive expenditures caused by corruption - Increased expenditures caused by inappropriate design modifications - Illegal redirection of travel expenses or other expenditure items 	- Year-end expenditures for inessential, not-urgent purposes	<ul style="list-style-type: none"> - Failure to select a competent project operator or calculate accurate unit costs due to asymmetric information - Delay of projects due to opposition from local residents or other causes - Lack of appropriate responses to situational changes 	
Evaluation	(Common) - Where problematic expenditures are repeated due to inadequate performance management			

Source: South Korean Association for Policy Studies (2006)



Production and Disclosure of Fiscal Information and Improvement of Its Use

1 Assessment and Improvement Measures for the Digital Budgeting and Accounting System

In order for the reformation of fiscal controls and fiscal operating systems to more firmly take root, it is essential to establish an integrated fiscal information system able to analyze, process and make use of the needed fiscal information. According to a press release (dated October 18, 2004) issued by the Presidential Committee on Government Innovation and Decentralization and the Ministry of Planning and Budget when it first decided to establish the Digital Budgeting and Accounting System (also known as D-Brain), which was put into practice in January 2007 as South Korea's first "integrated fiscal information system that can be exported to other countries," there were four major tasks in establishing the system: (1) re-determining the scope of the fiscal data to be produced in developing the system, in consideration of international standards; (2) restructuring a program-budget system that supports the betterment of government policies and their performance; (3) efficiently introducing double-entry bookkeeping and an accrual-basis accounting system; and (4) establishing a national integrated fiscal information system. The following will assess how successfully these four tasks have been accomplished.

First, integrated fiscal statistics at that time included general accounts,

special accounts and certain funds of the central government. Only central government debt was considered and managed as national debt, hindering the identification and management of the nation's overall fiscal scale. To address this problem, there was a need to include local governments as well as public institutions under the jurisdiction of central and local governments under the scope of finance, and to develop statistics related to the public sector that included public enterprises. Even in this situation, the government postponed re-assessing the scope of the government on the pretext of an absence of an accrual-basis accounting system. In November 2008, a public-private working group for fiscal statistics reformation was finally embodied. Through a total of 15 task-force meetings, the working group discussed, in a full and open manner, the criteria for calculating debt based on an accrual-basis accounting system and measures to determine the scope of inclusion of government, all based on emerging international standards and the cases of other countries. After two years of discussion, a reform proposal for fiscal data was released in a public hearing on January 26, 2011. The government then collected opinions from the media and the broader political community regarding the reform proposal before finalizing the government proposal. The general government's fiscal data produced on the basis of these new criteria will first be released at the end of 2012. The remaining tasks include producing fiscal statistics about the public sector including all public enterprises under the jurisdiction of the central and local governments, in addition to those related to the general government, and establishing a system for comprehensive management of the public sector's debt that can embark on integrated management of diverse fiscal risks.

Second, despite its 50-year history of fiscal management, South Korea still maintained a control-centered line-item budget structure. It was imperative to restructure the line-item budget system into a program-based one and transform the framework of budget operations in order to link the budget structure to policy and organization and allow the performance management of budgets. Particularly, in order to efficiently operate and settle fiscal innovation systems such as the performance management system and top-down budget preparation system, it was vital to renovate the budget structures and shift to a system able to better manage the full

lifecycle (embarkation, execution, completion and evaluation) of each program. A program-based budget structure was officially applied to the budget proposal prepared in 2006 for fiscal year 2007. As of 2011, the budget structure is composed of 16 sectors, 69 departments, 741 programs and 3,064 unit projects. In the future, there is a need to more actively utilize the program-based budget structure by strengthening the connection to performance management through aligning organizational and budget items and properly allocating shared expenses.

[Figure V-1] Comparison Between Former Budget Structure and Program-based Budget Structure

	Current Structure (Former)	Program-based Structure	
Functional Level	Article	Sector	
	Section	Sub-sector	
	Paragraph		Organization
Program Level	Subparagraph	Program	
	Sub-subparagraph	Activity	
		Task	
Execution Level	Item (49)	Item (23)	
	Sub-item (102)	Sub-item (90)	

Source: Ministry of Planning and Budget, *Korea's Finances: Past, Present and Future* (2007)

Third, since the accrual-basis accounting system requires transactions to be recorded at the point of occurrence, separate from the receipt or payment of cash, it makes it possible to apply the principle of matching revenues and expenses in relation to the government’s activities and indicate the performance over a set period in a more rational manner. This is why most countries have shifted to an accrual-basis accounting system, and the South Korean Ministry of Finance and Economy and the Planning and Budget Commission announced in 1998 and 1999, respectively, that they would introduce double-entry bookkeeping and an accrual-basis

accounting system. Following this extended preparation period, the two systems were introduced to the full range of general accounts, special accounts and public funds in fiscal year 2009. However, their application to submissions to the National Assembly was initiated only with the settlement of the fiscal year 2011 after undergoing verification procedures to ensure reliability. According to the FY2011 National Settlement Report released in late May 2012, the total amount of central government assets reflected in the balance sheet after first conducting due diligence and evaluation of social infrastructure including roads, railways, harbors, dams, airports, waterworks and rivers stood at 1.523 quadrillion won, while the total debt of the central government amounted to 774 trillion won, including 342 trillion won of estimated pension liabilities for government and military employees included to clearly define the government's future burdens for pension funds. This volume of debt is greater than the 420.7 trillion won of national debt at the end of 2011, but the amount excluding the estimated pension liabilities (432 trillion won) is similar to the 2011 debt. Later, it will be necessary to presume estimated liabilities for the teachers' pension in the same manner as the government employees' pension. It will not be necessary to set estimated liabilities for the national pension, since it is not an occupational pension based on employment contracts but rather social insurance for the entire nation, but it is still necessary to presume the future burden of the national pension in a unique manner and open the results to the public separately from the national financial statement. In addition, the recently announced estimated liabilities for pensions should have been calculated based on the projected benefit obligation (PBO), but it was instead calculated according to accumulated benefit obligation (ABO), as there had been insufficient preparation for the introductory year, resulting in a slightly reduced amount of liabilities. This suggests that, despite intensive preparations, even more efforts must be expended for ideal settlement on the basis of the accrual-basis accounting system.

Lastly, at the point when it was decided to establish a digital budgeting and accounting system, fiscal information systems were separately established by various government agencies in satisfaction of their discrete needs, thereby making it impossible to provide the required information and statistics in an integrated manner. Even now, however,

a number of related computer systems are being separately operated for the purposes of different ministries or subjects, such as the Ministry of Strategy and Finance's D-Brain and ALIO systems, the Ministry of Public Administration and Security's e-hojo system (local finance management system) and Clean-Eye system, and the Ministry of Education, Science and Technology's computer system. Although it has been asserted that it would not be difficult to prepare integrated statistics for the general government or the entire public sector in the future since such systems regularly exchange data, it is still true that certain limits exist on ensuring inter-consistency and accuracy of basic data compared to what would be possible with an integrated system. It will be vital to require all government agencies to use shared accounting and settlement functions, as well as routine and shared duties that can be standardized based on the organic systemization of the integrated fiscal information system. Meanwhile, it is necessary for each government agency to operate its own system for supporting decision making in connection with the integrated fiscal information system in order to deal with policy-related duties and atypical information requiring value judgments.

2 Measures to Expand Disclosure of Fiscal Information

There is a further issue regarding insufficient disclosure of information on debts, guaranty debts, liabilities related to private capital investment and fiscal risks of public enterprises.

Public enterprises are using either the ALIO (central government) or Local Public Enterprise Clean-Eye (local government) systems as their management-information portal website, and 39 public enterprises and quasi-governmental institutions falling under the jurisdiction of the central government with at least two trillion won of assets are obliged to submit mid- and long-term financial management plans to the government and National Assembly from 2012. With regard to guaranty debts, in 2010 the government began submitting a five-year national guaranty debt management plan to the National Assembly on an annual basis accompanying its budget proposal, and the amount of guaranty debt of the

central government at the end of 2011 amounted to 34.8 trillion won. The scale of guaranty debt of local governments was 336.2 billion won as of the end of 2009, recording an amount smaller than their debt (25.5 trillion won). Local governments largely remain beyond the reach of management, however, as found in the recent case of the city of Taebaek, which has experienced difficulty in its fiscal management due to payment guarantees provided to 146 billion won of corporate and municipal bonds issued by the Taebaek Tourism Organization (O2 Resort).

With regard to private capital investment, since 2010 the government has been submitting reports to the National Assembly on estimated government payments for BTL (Build-Transfer-Lease) projects. With the changeover in national accounting standards to an accrual-basis accounting system, this payment was included in the government's debt starting from the settlement of fiscal year 2011. However, management is limited for the contingent liabilities resulting from the minimum revenue guarantee (MRG) of BTO (Build-Own-Transfer) projects.

It is vital to expand by stages the disclosure of information on public enterprises' debt, guaranty debt, liabilities related to private capital investment and fiscal risks through the establishment of an integrated debt management system for the public sector.

The International Budget Project under the Center on Budget and Policy Priorities, a budget-monitoring organization, publishes the results of the Open Budget Survey every two years, ranking South Korea 11th among 59 countries with 73 points in 2006, 12th among 85 countries with 66 points in 2008, and 10th among 94 countries with 71 points in 2010. The recommendations accompanying the evaluation of South Korean finances included in the Open Budget Survey report on South Korea in 2010 suggested that South Korea publish an interim report for relevant fiscal years and related policy reports.

In addition, the government needs to actively consider pursuing measures to expand its fiscal reporting, such as pre-presidential election reports and long-term fiscal outlook reports. International organizations including the OECD recommend that governments publish pre-election reports in an effort to accurately inform politicians and the electorate of fiscal conditions and warn against imprudent pledges in advance. In

response to this recommendation, countries including Australia and New Zealand publish pre-election financial reports, while Australia and the Netherlands commission government agencies or government-funded research institutions to objectively estimate the financial impact of the election pledges made by the ruling and opposition parties and publicly announce the results. With regard to the pension and medical fields, which are greatly affected by demographic changes, pertinent institutions have conducted long-term fiscal estimations, but there was a lack of comprehensive reports on long-term fiscal outlooks published by the government. Against this backdrop, measures were enacted in 2011 to provide systemic long-term fiscal projections at the governmental level in order to synchronize premises and methods of sectoral projection and connect them in a comprehensive manner through the work of the Working Group for NFMP Long-term Fiscal Projection led by the South Korea Institute of Public Finance. This group has created a legal basis, organized a conference on long-term fiscal projections and formulated guidelines for long-term fiscal projection, and, in partnership with pertinent ministries, public corporations, and the Center for Long-term Fiscal Projections of the KIPF, is currently conducting projection efforts scheduled to be completed in March 2013. The results of this government-level long-term fiscal projection will be published in the second half of 2013. In conjunction with the long-term demographic estimation to be published every five years, the government must organize a working group partnering with the government and routinize engaging in projecting long-term fiscal trends and publishing reports on the long-term fiscal projection.

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Hyung-soo Park is a senior fellow at the Korea Institute of Public Finance (KIPF). He is now taking a leave of absence to serve as the Commissioner of Statistics Korea. His research interests include fiscal policy, tax revenue forecasting and long-term fiscal projections. Park has a Ph.D. in Economics from UCLA.

Deockhyun Ryu is an associate professor of Economics at Chun-Ang University in Seoul and was a former fellow of Korean Institute of Public Finance (KIPF). He is an expert in public finance, financial and macroeconomic issues. He has published numerous journal articles. He has a Ph.D. in Economics from Rice University.

Nowook Park is the founding director of the Center for Performance Evaluation and Management at the Korea Institute of Public Finance. He has served in many evaluation-related committees in various ministries and public organizations. He has been working as a consultant to international organizations including the World Bank and the World Intellectual Property Office. He has been an active researcher in the field of public financial management and program evaluation, and provided many presentations and training programs to government officials in various countries. He received BA in economics from the Seoul National University and Ph.D. in Economics from the University of Michigan.

Ehung Gi Baek is a professor of economics at Sangmyung University. Since receiving his Ph.D. from University of Wisconsin, he has published many articles in several academic journals including *Review of Economic Studies*, *Defence and Peace Economics*, *Journal of Policy Modeling*, *Statistica Sinica* etc. He has research interest in empirical macroeconomics and public finance. He has served as President of the Association of Korean Economic Studies, Committee Member of Fiscal Management Council of MOSEF, and editors of academic journals including *Journal of Money & Finance*, *Journal of Budget and Policy*, and *Journal of Korean Economic Analysis* etc.

Seung Hyun Hong is currently the head of Center for Fiscal Analysis at the Korea Institute of Public Finance (KIPF). He received his BA in Economics from the Seoul National University and completed a Ph.D. in Economics at Yale University. His research interests include public finance, theoretic/empirical econometrics and macroeconomics. He is currently working on various issues in public financial management system, including PFM reforms, comparative analysis of budgetary institutions etc.

