

## Medium-Term Fiscal Strategy: Korea

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### Executive Summary

The medium-term expenditure framework (MTEF) was introduced in Korea during the presidency of Roh Moo-hyun (February 2003–February 2008) for strategic and efficient resource allocation over a medium-term time horizon. The National Fiscal Management Plan is the core part of the MTEF. It contains directions for the fiscal policy including 5-year projections of key fiscal aggregate variables: revenue, expenditure, fiscal balance, resource allocation by sector, and public debt. NFMP provides details on fund allocation for the current year (year  $t$ ), forecast for the following year (year  $t+1$ ), and forecast for the following three years (years  $t+2$ ,  $t+3$ ,  $t+4$ ). In addition to the resource allocation planning, MTEF contains the evaluation of government-funded programs and reforms/improvements of the fiscal management system.

In response to COVID-19's impact on the economy, the government prepared four additional supplementary budgets in 2020 and two additional supplementary budgets in 2021. The supplementary budgets focused on the emergency quarantine support package including COVID-19 vaccine procurement and support for unemployed vulnerable groups and small business owners. Additionally, cash assistance subsidy was paid to each household in 2020 and again paid to 80% of the citizens in 2021. The Korean government's response to COVID-19 using a medium-term fiscal strategy is shown in the change of expenditures of NFMP 2020–2024 and 2021–2025 because the NFMP 2021–2025 was formulated to actively react to the negative impact of COVID-19 on the economy. To overcome the COVID-19 crisis, the government decided to significantly increase discretionary expenditure in 2021, and then significantly reduce it in 2022 to curb the medium-term expenditure growth rate for fiscal sustainability. Controlling discretionary expenditure will be a key to the success of the NFMP 2021–2025. More fundamentally, an important and immediate task is to institutionally establish a fiscal rule that can induce the recovery of fiscal soundness for the medium term, while considering the expansionary fiscal policy if necessary. It is exceedingly difficult, but an essential task in MTEF that fiscal authorities must resolve.

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I. Overview of Korean Medium-Term Expenditure Framework

1. Background to Introduce MTEF

Before the Asian financial crisis of 1997, the Korean economy had never been worried about a fiscal deficit, at least in the budget planning as a developing country. This was because Korea’s budgetary authority had always adhered to a fiscal rule called “expenditure-within-revenue.”

The expenditure-within-revenue rule required the government to formulate the budget within the expected revenue. Therefore, the Korean government had never considered an expansionary fiscal policy to borrow resources by issuing government bonds. However, after the 1997 financial crisis, the government had no choice but to develop a financial market that would allow them to borrow resources when needed. To accommodate these changes, the government needed a more efficient method of allocating public resources over a longer time horizon. As a result, the government introduced the medium-term expenditure framework (MTEF).

The idea behind MTEF was to allocate funds that would be available beyond the standard one-year budget period. A multi-year plan that allowed adjustments in fiscal priorities, when required, was considered. It was also expected that a medium-term fiscal management strategy would provide better control of ad hoc fiscal expenditures that could occur due to changes in the economic environment. Finally, an MTEF was designed with the intention to increase fiscal accountability and transparency and to strengthen the fiscal authority by enacting the ‘National Fiscal Act.’

2. Objectives and institutional process of National Fiscal Management Plan

The MTEF was introduced in Korea during the presidency of Roh Moo-hyun (February 2003–February 2008). A National Fiscal Management Plan that is the core of MTEF, was established based on the Article 7 of the National Fiscal Act. The newly introduced National Fiscal Management Plan contains the projections of key aggregate fiscal variables. Specifically, the most important part of the National Fiscal Management Plan is

to present the direction of the fiscal policy and sectoral resource allocation plan, including 5-year projections of key fiscal variables: revenue, expenditure, fiscal balance, resource allocation by sector, and public debt. It also contains details about the strategic allocation of public resources by sector for the same period. Moreover, it takes care of reforms and improvements of the fiscal management system.

The National Fiscal Management Plan (NFMP) presents projections of major fiscal variables for five years including the current year. These projections are the indicative targets that the government intends to achieve. NFMP covers the fund allocation details for the current year (year t), the forecast for the following year (year t+1), and the forecast for the next three years (years t+2, t+3, t+4). The forecasts for the current year and following year, which are formulated during the budget drafting process, are reflected in the national fiscal management plan as they are. Therefore, the projections additionally established in the NFMP are projections for the following three years after year t+1. Each year, these forecasts are revised and projected for an additional year in the next NFMP. Budget proposals submitted by the government have to be approved by the National Assembly, but the NFMP does not require their approval. Table 1 presents the key fiscal aggregates in 2021–2025 NFMP.

Table 1. Key Fiscal Aggregates in 2021-2025 NFMP

(Unit: trillion KW, %)	2021		2022	2023	2024	2025	Average growth rate
	Original budget	Supplementary budget					
Revenue	482.6	514.6	548.8	570.2	593.9	618.5	(4.7*)
Tax Revenue	282.7	314.3	338.6	352.9	367.7	383.1	(5.1**)
Expenditure	558.0	604.9	604.4	634.7	663.2	691.1	(5.5)
Fiscal Balance (percentage of GDP, %)	-75.4	-90.3	-55.6	-64.5	-69.4	-72.6	N.A.
	(-3.7)	(-4.4)	(-2.6)	(-2.9)	(-3.0)	(-3.0)	N.A.
Public Debt (percentage of GDP, %)	956.0	965.3	1,068.3	1,175.4	1,291.5	1,408.5	N.A.
	(47.3)	(47.3)	(50.2)	(53.1)	(56.1)	(58.8)	N.A.

\* In case of 2021, it is compared to the supplementary budget. It would be 6.4% if it is compared to the original budget.  
\*\* In case of 2021, it is compared to the supplementary budget. It would be 7.9% if it is compared to the original budget.

Source: Ministry of Economy and Finance (MOEF)

The NFMP also presents the allocation of resources by sectors. According to the 2021–2025 NFMP, the average growth rate of total expenditure over the next five years will be 5.5% as shown in Table 2. The average growth rates of environment (8.2%), health, social welfare, employment (6.7%), R&D (6.6%), industry, SME, energy (6.2%), and education (6.0%) are above average. It implies that a relatively larger percentage of resources will be invested in these sectors compared to other sectors such as agriculture (2.0%), public order and safety (3.0%), and the SOC (3.3%).

Table 2. Allocation of Resources by Sector for 2021–2025

	2021	2022	2023	2024	2025	2021~2025 average growth rate (%)
Total Expenditure	558.0 (8.9)	604.4 (8.3)	634.7 (5.0)	663.2 (4.5)	691.1 (4.2)	(5.5)
1. Health, Social Welfare, Employment	199.7 (10.6)	216.7 (8.5)	232.2 (7.1)	246.1 (6.0)	259.3 (5.3)	(6.7)
2. Education	71.2 (-2.0)	83.2 (16.8)	84.8 (2.0)	87.4 (3.0)	90.0 (3.0)	(6.0)
3. Culture, Sports, Tourism	8.5 (5.8)	8.8 (3.9)	9.1 (3.5)	9.4 (3.5)	9.8 (3.4)	(3.6)
4. Environment	10.6 (17.8)	11.9 (12.4)	12.9 (8.5)	13.7 (6.1)	14.5 (5.9)	(8.2)
5. R&D	27.4 (13.1)	29.8 (8.8)	32.3 (8.5)	34.0 (5.2)	35.4 (5.2)	(6.6)
6. Industry, SME, Energy	28.6 (20.8)	30.4 (6.0)	32.6 (7.5)	35.0 (7.2)	36.4 (4.1)	(6.2)
7. SOC	26.5 (14.1)	27.5 (3.8)	28.7 (4.4)	29.5 (2.5)	30.2 (2.4)	(3.3)
8. Agriculture, Fishery, Food	22.7 (5.3)	23.4 (3.4)	24.0 (2.3)	24.4 (2.0)	24.9 (1.8)	(2.4)
9. Defense	52.8 (5.4)	55.2 (4.5)	57.7 (4.4)	60.3 (4.6)	63.1 (4.5)	(4.5)
10. Diplomacy, Unification	5.7 (3.5)	6.0 (5.7)	6.2 (3.3)	6.4 (3.2)	6.6 (3.2)	(3.8)
11. Public Order, Safety	22.3 (7.0)	22.4 (0.3)	23.4 (4.4)	24.3 (4.1)	25.1 (3.1)	(3.0)
12. General, Local Administration	84.7 (7.2)	96.8 (14.3)	100.4 (3.7)	103.0 (2.6)	105.8 (2.7)	(5.7)

Note: The unit of expenditure is trillion KW. The number in the parenthesis indicates the growth rate compared to the previous year.

The Korean government has established an institutional virtuous cycle of “planning-execution-evaluation-feedback” by evaluation the performance of government budget projects to maximize the effectiveness of government spending, and by reflecting the feedback for the next national fiscal management plan. In-depth evaluations of government funded key projects are carried out under the supervision of the Ministry of Economy and Finance if needed. The legal regulations for performance evaluation are stipulated in Article 8 of the National Finance Act. Accordingly, a 'performance management system for public finance activities' to achieve medium-term, long-term, and annual goals has been built in terms of economic efficiency and effectiveness.

II. The Korean government’s response to COVID-19

1. Response to COVID-19 crisis via fiscal policy

The first confirmed case of COVID-19 in Korea was identified in January 2020. With the rapid spread of COVID-19, the Korean economy was hit hard, particularly in relation to service industries such as travel, accommodation, and wholesale/retail businesses. The self-employed were severely affected by the restrictions placed on their business in accordance with the quarantine guidelines. In response to the COVID-19’s negative impact on the economy, the government prepared four additional supplementary budgets in 2020.

As the supplementary budgets were formulated four times (Table 3), the total revenues were reduced, and the expenditures increased. The magnitude of fiscal policy measures amounted to 2.9/2.6 percent of the GDP when it is measured by the change of consolidated/managed fiscal balance. Therefore, the public debt increased to 43.9 percent of the GDP, from the 39.8 percent of GDP. The allocation of resources by sector for 2020 was also adjusted accordingly (see Table 4). However, the adjusted projection of resource allocation by sector for the medium-term horizon was not officially announced. The supplementary budgets focused on the emergency quarantine support package such as the COVID-19 vaccine procurement, distance learning support for middle school students, support for unemployed vulnerable groups, and support for small business owners. In particular, a cash assistance subsidy was paid to the whole household in the second supplementary budget. Initially, the budget authority planned to distribute cash

assistance subsidy to only 30% of the households, but the National Assembly expanded the target to the whole household.

Table 3. Supplementary Budgets in 2020

(Trillion KW, %)

	2020				
	Original budget	1 <sup>st</sup> supplementary budget	2 <sup>nd</sup> supplementary budget	3 <sup>rd</sup> supplementary budget	4 <sup>th</sup> supplementary budget
◆ Total revenue (growth rate, %)	481.8 (1.2)	481.6 (1.2)	482.2 (1.3)	470.7 (-1.1)	470.7 (-1.1)
◆ Total expenditure (growth rate, %)	512.3 (9.1)	523.1 (11.4)	531.1 (13.1)	546.9 (16.5)	554.7 (18.1)
• Consolidated fiscal balance (percentage of GDP, %)	-30.5 (-1.5)	-41.5 (-2.1)	-48.9 (-2.5)	-76.2 (-3.9)	-84.0 (-4.4)
• Managed fiscal balance (percentage of GDP, %)	-71.5 (-3.5)	-82.0 (-4.1)	-89.4 (-4.5)	-111.5 (-5.8)	-118.6 (-6.1)
• Public debt (percentage of GDP, %)	805.2 (39.8)	815.5 (41.2)	819.0 (41.4)	839.4 (43.5)	846.9 (43.9)

Source: Ministry of Economy and Finance (2020. 9. 22)

Table 4. Adjusted allocation of resources by sector for 2020

(Unit: trillion KW)

	Original budget	1 <sup>st</sup> supplementary budget	2 <sup>nd</sup> supplementary budget	3 <sup>rd</sup> supplementary budget	4 <sup>th</sup> supplementary budget
Total Expenditure	512.3	523.1	531.1	546.9	554.7
1. Health, Social Welfare, Employment	180.5	185.5	185.4	194.4	197.8
2. Education	72.6	72.9	72.8	71.0	71.0
3. Culture, Sports, Tourism	8.0	8.0	8.0	8.1	8.1
4. Environment	9.0	9.0	8.8	9.2	9.2
5. R&D	24.2	24.2	24.2	24.3	24.3
6. Industry, SME, Energy	23.7	27.5	27.3	31.6	35.5
7. SOC	23.2	23.2	22.4	22.9	22.9
8. Agriculture, Fishery, Food	21.5	21.5	21.3	21.4	21.4
9. Defense	50.2	50.2	48.7	48.4	48.4
10. Diplomacy, Unification	5.5	5.5	5.2	5.1	5.1
11. Public Order, Safety	20.8	21.2	20.8	20.7	20.7
12. General, Local Administration	79.0	79.5	91.4	93.6	94.0

Source: Ministry of Economy and Finance (2020. 9. 22)

As COVID-19 became more widespread, the government formulated two additional supplementary budgets in 2021 as well. The magnitude of fiscal policy measures of the year 2021 amounted to 0.7 percent of the GDP when it is measured by the change of consolidated fiscal balance.

The increased expenditure of the 1st supplementary budget was 14.9 trillion KW, most of which was for measures taken to support small business owners negatively affected by the plummeting sales due to decrease in demand for products and services during the quarantine. Additional costs of enforcing quarantine measures and procurement of vaccines was also included in the 1st supplementary budget.

The government formulated the 2nd supplementary budget in June 2021 to overcome the economic difficulty caused by COVID-19. The expenditure increased by 32.0 trillion KW compared to the 1st supplementary budget. Around 17.3 trillion KW was supposed to be spent on overcoming damages incurred by small business owners and as an assistance subsidy to citizens. Particularly, cash assistance subsidies of 11 trillion KW were paid to 80% of the citizens. While the expenditure rapidly increased because of two supplementary budgets, the consolidated fiscal balance improved at the end due to unexpected revenue increase.

Table 5. Supplementary Budgets in 2021

(Unit: trillion KW, %)

	2021		
	Original budget	1 <sup>st</sup> supplementary budget	2 <sup>nd</sup> supplementary budget
◆ Total revenue (growth rate, %)	482.6 (0.2)	483.0 (0.3)	514.6 (6.8)
• Tax revenue (growth rate, %)	282.7 (-3.2)	282.7 (-3.2)	314.3 (7.6)
◆ Total expenditure (growth rate, %)	558.0 (8.9)	572.9 (11.8)	604.9 (18.1)
• Consolidated fiscal balance (percentage of GDP, %)	-75.4 (-3.7)	-89.9 (-4.5)	-90.3 (-4.4)
• Public debt (percentage of GDP, %)	956.0 (47.3)	965.9 (48.2)	963.9 (47.2)

Source: Ministry of Economy and Finance (2021. 7. 24)

The Korean government’s response to COVID-19 using the medium-term fiscal strategy is reflected in the differences in the NFMP 2020–2024 and 2021–2025 because NFMP 2021–2025 was formulated to actively overcome the negative impact of COVID-19 on the economy. It is clearly shown in the expenditure side. The total expenditures in 2021, 2022, 2023, and 2024 for the NFMP 2021–2025 increased compared to those in NFMP 2020–2024 by 49.1, 15.3, 19.0, and 22.9 trillion KW, respectively. In particular, the discretionary expenditure sharply rose in 2021, and it is expected to fall drastically in 2022. This was because, to overcome the COVID-19 crisis, the government had decided to significantly increase the discretionary expenditure in 2021, and then significantly reduce it in 2022 to curb the medium-term expenditure growth rate for fiscal sustainability. Whether or not such a discretionary expenditure plan of 2021 and 2022 can be achieved will be the key to the success or failure of the NFMP 2021–2025. Fortunately, the government had large windfalls in tax revenue side due to the active stock transactions and the sharp rise of house prices in 2021. Therefore, the managed fiscal balances for the NFMP 2021–2025 are expected to improve during the years 2021–2024 compared to NFMP 2020–2024. The public debt projections in NFMP 2021–2025 show similar features for years 2022 to 2024, compared to NFMP 2020–2024.

Priority fiscal policies to overcome economic crises such as COVID-19 are usually implemented by supplementary budgets or the regular budget. Although the fiscal authorities' commitments to restore fiscal soundness are reflected in the following NFMP, after the expansionary fiscal policy implementation, they are not binding in the sense that their commitments are subject to another economic urgency.

Table 6. NFMP 2020–2024 and 2021–2025

	2020 - 2024 NFMP					
	2020*	2021	2022	2023	2024	-
Total revenue (unit: trillion KW)	470.7	483.0	505.4	527.8	552.2	-
Total expenditure (unit: trillion KW)	546.9	555.8	589.1	615.7	640.3	-
[Obligatory expenditure]	255.1	267.3	282.5	295.7	314.2	-
[Discretionary expenditure]	291.8	288.5	306.6	320.0	326.1	-
Managed fiscal balance (unit: % of GDP)	-5.8	-5.4	-5.9	-5.9	-5.6	-
Public debt (unit: % of GDP)	43.5	46.7	50.9	54.6	58.3	-
2021 - 2025 NFMP						
2021-2025	-	2021**	2022	2023	2024	2025
Total revenue (unit: trillion KW)	-	514.6	548.8	570.2	593.9	618.5
Total expenditure (unit: trillion KW)	-	604.9	604.4	634.7	663.2	691.1
[Obligatory expenditure]	-	279.1	301.1	311.7	327.0	342.7
[Discretionary expenditure]	-	325.8	303.3	323.0	336.2	348.4
Managed fiscal balance (% of GDP)	-	-4.4	-2.6	-2.9	-3.0	-3.0
Public debt (% of GDP)	-	47.3	50.2	53.1	56.1	58.8

\* 3rd supplementary budget

\*\* 2nd supplementary budget

2. Some ongoing issues

Korea is still in the process of overcoming the COVID-19 economic crisis. In January 2022, the first supplementary budget had already been formulated to support the damages caused by the extension of quarantine measures to self-employed small business owners. The main resource came from the unexpected tax revenue increase, which was mainly due to the increase of residential property tax revenue, comprehensive real estate tax revenue, and stock transaction tax revenue.

The continued fiscal support policy to overcome COVID-19 is raising concerns that the

fiscal soundness of the Korean economy could be weakened. The payouts to the general population, rather than targeted groups in need, raises concerns over fiscal populism as it may politically be difficult to move away from them in future. As new variants of the corona virus emerge, the expansionary fiscal policy stance will likely continue. Considering the large amount of fiscal expenditure made so far to overcome COVID-19, it is very important to restore fiscal soundness in the medium-term expenditure framework. Unfortunately, there is still no binding fiscal rule to restore fiscal soundness in the MTEF. The reality is that the public debt–GDP ratio plans in NFMP have been worsening after active fiscal policies were implemented in response to the economic downturn. Even if an improved debt–GDP plan came out, in most cases, it was just a declaration and slogan, and mostly there was no real possibility. For this reason, it is a very important to institutionally establish fiscal rules that induces the recovery of fiscal soundness in the medium term while considering the expansionary fiscal policy if necessary. Although it is very difficult, it is a task in MTEF that fiscal authorities must resolve.

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## About the Author

Hosin Song joined the Bank of Korea in 2000, after completing his Bachelor's and Master's degrees in Economics from Seoul National University. After working at the Research Department of the Bank of Korea for about 2.5 years, he obtained a Ph.D. in Economics from the Pennsylvania State University. He joined the Korea Institute of Public Finance in 2007, where he participated in research and projects related to fiscal policy. At the Ewha Womans University, which he joined in 2012, he teaches econometrics and conducts research on the field as well as on fiscal policy.