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Achieving Medium Term Expenditure Framework Reform

A Case Study of Korea

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Abstract

A medium-term expenditure framework is considered an essential element of public financial management reform, and this framework has been adopted in many countries. However, in terms of implementation in those countries, the medium-term expenditure framework continues to present a significant challenge within the budget process. This case study provides an inside story of medium-term expenditure framework reform in the Republic of Korea and offers some suggestive evidence about the impact of the reform. Drawing on theories of change management, the study explores how actors within the Korean government created acceptance of reform needs among relevant stakeholders, how they handled various challenges throughout the reform, how they built capacity among stakeholders, and how they institutionalized the reform measures that were consistent with stakeholder incentives. The case highlights the following implications: (1) having strong support from top decision makers is essential to successful medium-term expenditure framework reform; (2) finding ways of integrating a medium-term expenditure framework into the budget process is critical; and (3) making the framework stable and sustainable requires both capacity building of relevant stakeholders and significant organizational restructuring.

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Achieving Medium Term Expenditure Framework Reform: A Case Study of Korea

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I. Introduction

Public financial management (PFM) reform affects all countries around the globe. It is a constant issue in advanced economies, where economic and political environments change continually. At the same time, under pressure from the public or from donor institutions, many emerging and developing countries are also instituting PFM reforms in attempts to establish sound financial management systems. However, despite their importance and prevalence, effective PFM reforms are not easy to design and implement.

As pointed out by Odugbemi and Jacobson (2008), "in the real world, reforms will not succeed, and they will certainly not be sustained, without the correct alignment of citizens, stakeholders, and voice." Although "the toolbox is overflowing" and "best practice manuals in various areas of interest tumble out of seminars and workshops," "difficulties arise when attempts are made to apply what are often excellent technical solutions under real-world conditions" (p. 1). In other words, even in the best conditions, implementing successful reform is difficult. Thus, multilateral-development banks and other research institutions have made continuous attempts to fill in the gap between the real world and technical tools.

Among efforts to identify and understand crucial factors affecting the reform process, research on change management in particular has gained some visibility. This line of research emphasizes that common factors affect the reform process, regardless of the particular reform program. Kotter (1996) suggests that change can be managed successfully by using the following steps: create a sense of urgency; create a guiding coalition; develop a vision and strategy to direct change; communicate the vision and strategy; empower stakeholders for broad-based action; generate a series of quick wins; consolidate your gains, and scale up as quickly as possible; and anchor your message of change within the existing culture and performance approaches. Andrews (2011) proposes that creating a space of acceptance, authority, and ability is important for successful reform. Contributors to a World Bank symposium (2008) suggest six key challenges for governance reformers: (1) uncovering the challenges inherent in building support for governance reform through political analysis; (2) securing political will and the best methods for reaching out to political leaders, policy makers, and legislators; (3) gaining the support of public sector middle managers, often the strongest opponents of change; (4) building broad coalitions of pro-change and dealing with powerful vested interests; (5) transforming indifferent or hostile public opinion into support for reform objectives; and (6) encouraging citizen demand for accountability to sustain governance reform.

Building on change management literature, this study analyzes PFM reform during the last decade in the Republic of Korea, a free market democracy (sometimes called South Korea). The initial attempt to introduce modern PFM measures occurred in response to the 1997 Asian financial crisis, but the real reform was achieved in 2003. Among other reform measures, including performance budgeting, program structure, cost accounting, and an integrated financial information system, the study will focus on medium term expenditure framework (MTEF) from the viewpoint of change management: How did the Korean government create acceptance of reform needs among relevant stakeholders? How did it build capacity among these stakeholders? And, finally, how did government actors institutionalize reform measures that were consistent with stakeholder incentives?

Policy Implications

This study provides valuable policy implications from the following perspectives. First, the Korean case gives an inside look into a PFM reform process that took place within a short time span and entailed a comprehensive reform package. The advantages and disadvantages of this approach may be instructive for countries trying to adopt a PFM reform package in a short timeframe. Experts debate whether a comprehensive reform package with a big bang approach is better than reform with limited scope and a gradual approach. On the one hand, the comprehensive reform may overburden the capacity of the public sector and may end up achieving little while incurring many costs. On the other hand, the comprehensive reform with a big bang approach may optimize on a window of opportunity and may create an environment of reform irreversibility, leading to lasting change. The Korean case showcases the positives and the negatives a big bang approach produced.

Second, an insider reform champion played a key role in initiating the Korean reform. While macro and contextual factors may provide a momentum for PFM reform, effective implementation is not easy to come by. Having an insider reform champion gives a great boost to the early stage of reform implementation, because the insider champion knows the informal mechanisms of the extant public financial management system and the incentives of public officials. Additionally, insiders often have the advantage of better credibility with public officials. The Korean reform story shows how the insider reform champion managed internal challenges to the reform.

Third, the Korean case shows how MTEF reform can evolve through interactions with other stakeholders. The reforms started as an internal management tool of the executive branch, but as the legislature became engaged in the new fiscal process, the nature of the MTEF system changed. Through demands from the legislature, the system gained more rigor and formality. The Korean case also demonstrates that without sustained demand for reform, sustaining reform efforts is harder than initiating reform. Sustained demand for reform can come from civil society organizations, from pressure to meet the global financial standard, or from other sources. In Korea, the legislature provided impetus to sustain reform efforts.

Fourth, the Korean case provides practical policy implications for integrating MTEF reform into the regular budget process. Because integration is difficult to achieve, MTEF reform ends up being a standalone process or document in some countries—which decreases its efficacy. The Korean government worked against the same challenge but succeeded in institutionalizing MTEF into the budget process. As witnessed by the recent effort of restoring fiscal sustainability in Korea after the global financial crisis in 2008, MTEF turns out to be a useful tool in setting fiscal policy goals and explaining them to other stakeholders. The institutionalization process of MTEF reform in Korea may provide useful policy guidance to other countries.

This paper is divided into five parts. Following this introduction, the second section presents a brief overview of MTEF in Korea. The third section discusses why the first attempts for MTEF, in the late 1990s, failed. The fourth section analyzes the change management process used in the second MTEF attempt. The fifth section discusses recent

developments in Korea's MTEF processes. The final section examines the impact of MTEF and identifies some policy implications.

Study Focus and Methodology

This study examines possible issues according to the sequence of reforms. It examines each stage of reform in sequence: the recognition of need for the reforms and then the planning of the reform program, the implementation process, coping with issues rising from implementation, and the institutionalization process. Along this sequence of reforms, typical issues related to change management are discussed, including creating acceptance of the need for reform, building capacity, and establishing relevant incentive and accountability schemes. In addition, specific issues related to MTEF are analyzed as they arise along the sequence of the reforms.

At the initial stage of reforms, the acceptance of the necessity of reform itself can be an issue. In particular, it is challenging to convince stakeholders of the need for reform if there is no fiscal crisis or imminent threat. In this regard, the Korean case is interesting because there were no imminent serious fiscal issues or any strong outside pressure to embark on the reforms. Instead, the Ministry of Planning and Budget initiated the MTEF reform to make the best use of two windows of opportunity: i) there was a huge demand for new PFM reform agenda during periods of transition to a new administration, ii) there was widespread perception in academicians, experts, civil society organizations, and public officials within the Ministry of Planning and Budget of the need for PFM reform. Thus the Korean experience offers an interesting case in which PFM reforms occurred as a preemptive measure without external crisis or pressure. This study examines how the desire for reform was shared among key stakeholders and how it spread to other stakeholders.

A carefully designed reform program allows reformers to gain legitimacy and buy-in from relevant stakeholders. The planning phase includes the formation of a core reform team that should come up with a customized MTEF reform program and change management strategy. In the Korean case, forming the core reform team itself presented a challenge because senior officials in the Ministry of Planning and Budget were not willing to risk participation. The difficulty of forming a core reform team makes clear that the most important challenge to overcome is not outside but inside stakeholders. The Korean story offers an opportunity to observe how reform initiators managed resistance from public officials within the central budget office[1], who were accustomed to the traditional budget system. At this phase of reform design, internal personnel took charge of the job and customized an ideal MTEF model, fitted to institutional settings of Korea. This provides a lesson on how important it is to have knowledge about local institutional settings and to customize reform programs accordingly.

At the stage of reform implementation, crucial factors to success include providing proper incentives and an accountability scheme to stakeholders, building the capacity of stakeholders, and establishing communication channels with stakeholders. For MTEF reform, incentive

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[1] Regarding organizational structure of ministry in the Korean government, 'office' is hierarchically higher than 'bureau'. The head of the former is deputy minister and that of the latter is director general. From now on 'budget office' refers to the central budget office in the Ministry of Planning and Budget, unless it is defined differently.

issues are important for almost every stakeholder. The central budget office may be afraid of losing control due to medium-term financial commitment in advance under the MTEF arrangement and may need capacity building in the area of policy analysis and program evaluation in the medium term. The line ministries (government departments responsible for specific areas, such as education, health, or agriculture) may need to develop competency in policy analysis and performance management. In particular, because line ministries know MTEF reform may add to their administrative burden, they need to understand the expected benefits of MTEF reform. Thus, the provision of proper incentives and support for capacity building is important. Outside of the executive branch, politicians and civil society organizations should readily see the benefits of the reforms, such as more information and more channels to participate in the budget process. The Korean case demonstrates how incentive issues were raised and handled among various groups.

Like other reforms, MTEF reform can evolve as environments change over time. In the Korean context, the MTEF reforms started as an internal reform measure within the executive branch. Therefore, the institutional design was customized to meet the needs of the Ministry of Planning and Budget. Initially, neither civil society organizations nor the National Assembly (a 299-member unicameral legislature) were actively involved in the reform. Through the legislation process, however, the National Assembly had the opportunity to express its interests in the MTEF reforms. The National Assembly pointed out weakness in the reformed MTEF system and revised the National Finance Act to correct some issues. Legislators also tried to have a stronger voice in the MTEF system by requiring the Ministry of Planning and Budget to report information from MTEF to them. These interventions by the National Assembly strengthened the MTEF system and increased its rigor. This study discusses how these changing environments affected the reformed MTEF system, and the policy implications that can be derived.

The institutionalization of the reforms itself deserves separate attention because, in many cases, MTEF reform merely affects the de jure process of PFM without changing the de facto decision-making process; that is, the reform may exist in law but not in practice. By contrast, MTEF reform in Korea affected the de facto decision-making process through top-down budgeting and organizational restructuring to integrate MTEF within the budget process. This study offers useful policy implications for institutional design of MTEF reforms, including limitations and factors that contribute to success.

To get the inside story of the MTEF reform, the authors surveyed relevant literature and conducted interviews with stakeholders. Few studies analyze the Korean MTEF reform from the perspective of change management. Still, existing literature and conference presentation materials provide useful information on MTEF and its impact on budgetary processes. Interviews added insider views from former reform team members, experts at the public research institutes, former and current policy makers at the Ministry of Planning and Budget, and a representative from a civil society organization.

II. An Overview of MTEF in Korea

MTEF was introduced as a part of a PFM reform package in Korea in 2004. The reform package consisted of MTEF, top-down budgeting, performance-oriented budgeting, and an integrated financial management information system. Considering the other PFM reform initiatives, Korea's current MTEF can be classified as the highest level of MTEF, Medium Term Performance Framework (MTPF), according to the World Bank classification.[2] In Korea, the MTEF was named the "National Fiscal Management Plan," or "Gukga Jaejung Woonyong Gyeheok". Specifics of the plan are outlined below.

MTEF was introduced to incorporate longer term perspectives into annual budget process. The looming policy issues, such as increasing government debt, aging population and increasing social welfare spending, required longer term perspectives. Traditional annual budget process could not easily accommodate counter-cyclical government spending. These issues became salient after the late 1990s' Asian financial crisis.

The National Fiscal Management Plan, as it now operates, requires cooperation from many actors. The Ministry of Strategy and Finance[3] forecasts macroeconomic variables for the next four years. Line ministries are responsible to provide cost estimates of their programs and to submit their own medium-term fiscal plans. To help the Ministry of Strategy and Finance determine policies that will be included in the plan, working groups—comprising experts from public institutes, universities, and civil society—identify the major agendas of government and economic sectors. Regional meetings are held to discuss important issues in local governments. Based on the projections of macroeconomic variables, revenues, and program costs, the Ministry of Strategy and Finance develops the first draft of National Fiscal Management Plan, consisting of major policy directions, the fiscal aggregate, and tentative ceilings for line ministries.

With the draft of the National Fiscal Management Plan, the Fiscal Strategy Cabinet Meeting is held to finalize the spending ceilings for line ministries. Based on the finalized spending ceilings, guidelines to budget preparation is issued to line ministries. By following these guidelines, line ministries develop a budget request that is submitted to Ministry of Strategy and Finance. After negotiation between line ministries and Ministry of Strategy and Finance, the National Fiscal Management Plan and budget draft is finalized.

Each National Fiscal Management Plan covers five years; that is, the current year, the budget year, and three out-years. It is a rolling plan, revised every year. It consists of two main parts: macro fiscal policy and sectoral fiscal policy. Macro fiscal policy includes projections on spending, revenue, balance, and debts. Sectoral fiscal policy contains major policy

[2] According to the classification recently developed by the Poverty Reduction and Economic Management, Public Sector Governance Unit of the World Bank (2012), the level of MTEF can be divided into three stages: medium-term fiscal framework (MTFF), medium-term budget framework (MTBF), and medium-term performance framework (MTPF). MTPF requires performance measurement, link budget to result, accrual accounting or modified one, treasury information system and relevant performance indicators with the core requirements of the MTBF.

[3] The former Ministry of Planning and Budget and the former Ministry of Finance and Economy were merged into the Ministry of Strategy and Finance in 2008.

directions and spending allocations on each sector.[4]

After the National Fiscal Management Plan is prepared by Ministry of Strategy and Finance each year, it is submitted to the National Assembly, together with the annual budget draft. Although no votes are taken, the National Assembly members express their opinions, and communications between the administration and the National Assembly occur. Recently, some members of the National Assembly have begun to call for a voice in the National Fiscal Management Plan. Through the revision of the National Finance Act, the Ministry of Strategy and Finance must submit the strategic direction of their fiscal management to the National Assembly before establishing MTEF.

By looking closely at '2011-2015 National Fiscal Management Plan' as an example, the general process of the plan could be understood easily. In December 2010, Ministry of Strategy and Finance disseminated guidelines for National Fiscal Management Plan to line ministries. In accordance with the guidelines, the line ministries had reported its medium term project plans to the Ministry of Strategy and Finance by the end of January 2011. In February 2011, sixteen working groups were comprised of experts from government agencies, public institutes, universities, and civil society, and commenced an analysis on policy directions and major fiscal issues for sixteen sectors. In April 2011, the Fiscal Strategy Cabinet Meeting was held to discuss government fiscal strategy for the next four years both in general and the sixteen sectors and to agree annual spending limit of each line ministry. It was presided by the President, and all the relevant cabinet members attended the meeting. From June 22 to 29 of 2011, Korea Development Institute and the Ministry of Strategy and Finance jointly hosted an open forum for each reported sector to gather the public opinions. In the end of June 2012, the line ministries' requests for budget had been submitted to the Ministry of Strategy and Finance. Based on these requests and all the discussions until then, the Ministry of Strategy and Finance finalized the National Fiscal Management Plan in mid-September after the approval from the cabinet meeting and sent to National Assembly.

Korea's MTEF process facilitates an unusual level of communication among stakeholders. In the planning phase, the expert working groups provide input on the policy directions of each sector. The MTEF has thus been used as a venue to communicate policy directions between the central budget office and other stakeholders, including line ministries, local governments, experts, academics, and civil society organizations. Although there are not always clear links between policy issues discussed in the MTEF working groups and actual resource allocation, the working groups facilitate stakeholder communication, leading to budget buy-in and, ideally, enhanced collective action.

[4] Spending ceilings for line ministries are decided but they are not open to the public. It is viewed as an internal management information rather than agreement with the public.

III. Attempts at MTEF before 2003

Two major attempts at MTEF occurred in Korea before 2003.[5] The first started in response to the 1997 Asian financial crisis. In the aftermath of rescue spending, the medium term fiscal plan was developed to restore fiscal sustainability. The new government, inaugurated just after the financial crisis, needed to prove to the International Monetary Fund (IMF) and domestic stakeholders its will to return Korea to financial soundness. Despite the difficulty of fiscal reform during an economic crisis, it was a matter of national pride to free Korea from IMF's economic interference. For this political reason, the new government leaders needed to develop a medium-term expenditure plan to show how they would achieve fiscal balance. As a result, the focus of this MTEF was macro fiscal balance, and resource allocation was a secondary issue.

The Ministry of Finance and Economy and the Ministry of Planning and Budget had large interests in the plan. The goal was to achieve fiscal balance within five years, which was the end of the incumbent government. Major directions for resource allocation and plans for sectoral resource allocation were developed, as well. However, the plans were not based on the consensus of line ministries, which limited ministry buy-in. After implementation, the MTEF was revised every year, but only the plan on fiscal balance was revised in a meaningful way. Therefore, this plan should be viewed as a five-year plan for the management of fiscal balance rather than a true MTEF. The dedicated unit for MTEF, which was established with the new administration, was abolished in the second year of the new administration, and the task of developing MTEF became part-time job for another unit within the Ministry of Planning and Budget. Although MTEF played a limited role in budget process, it facilitated communication among line ministries and the legislature; in particular, it informed line ministries and the legislature about the total amount of available resources. Fiscal balance was achieved in 2002, one year earlier than planned.

A separate attempt to develop an MTEF began in 2001. Fiscal Planning Bureau in the Ministry of Planning and Budget recognized that (1) the existing MTEF was mainly about the projection of the fiscal balance and not integrated into regular budget process; and (2) the existing, predominantly bottom-up budget process was not equipped with handling medium- and long-term policy issues. With their limited collective influence and their diverse agendas, participants in the bottom-up approach failed to align resources with the policy directions of government.

To tackle with these issues, the director general of the Fiscal Planning Bureau requested technical assistance from IMF. In response, IMF issued a detailed report that included recommendation of MTEF implementation. The director general also sent a research team composed of an official in the Bureau and a researcher from the Korea Institute of Public Finance to Sweden and the United Kingdom to study top-down budgeting in practice.

This separate reform effort did not last. In retrospect, the timing was not good. The orderly restructuring of failing firms and the banking industry overwhelmed the

[5] Based on the World Bank's classification mentioned earlier, Korea had MTFF since 1982, which was included in the 5-Year Economic Development Plan. The two attempts before 2003 were efforts to develop the old MTFF without any relation with the 5-Year Economic Development Plan.

administration, and few resources were available to develop and implement the PFM reform. Additionally, as fiscal balance was achieved, there were fewer environmental demands for reform.

Perhaps more crucial, the director general of Fiscal Planning Bureau, as the head of a particular bureau, never received support from the minister. The budget office, which locates in the same ministry, strongly opposed MTEF with its top-down approach. Since MTEF affects entire organizations within the administration, it cannot be adopted as a new management system without backing from the president and the minister of Planning and Budget. MTEF without institutionalization could not survive when the term of the incumbent government came to an end.

In sum, the first MTEF, which presented the plan for restoring fiscal balance, was somewhat limited in scope, and the subsequent MTEF became meaningless over time. These early attempts, however, can be viewed as partial success in that they became valuable stepping stones for the future reform.

IV. Making MTEF Reform Work: Reform Effort since 2003

This chapter describes the MTEF reform process that started in 2003 and concluded with the enactment of the National Finance Act in 2006. The description and analysis focus on the change management aspect of the reform.

1. New Window of Opportunity

The initial MTEF lost its momentum when the new administration was inaugurated. After the new president was elected in December 2002, he formed a transition team to develop presidential action plans and to identify new policy agenda. During administrative transitions, demand for reform ideas tends to increase, which created a new window of opportunity for MTEF reform.

The environment for this reform differed from that of the previous reform. The economic situation now was not bad, and there was no imminent pressure for fiscal reform. There was, however, a widespread perception among academics that no meaningful PFM reforms had been achieved. The new administration’s transition team recognized this perception and frequently discussed PFM reform agendas.

The Ministry of Planning and Budget faced two options in responding to this domestic pressure. They could halfheartedly implement the reform in a way that would show compliance but would not affect much change. Or, they could take initiative in the reform process and embark on real and drastic change.

Officials in the Ministry of Planning and Budget hotly debated which stance they would take. Initially skeptics dominated the debate, pointing to the failure of the previous reform efforts. They argued that it might be inevitable to start the reform, but the ministry should adopt a

cautious and conservative approach. The other side argued that it would be better for the ministry to lead the reform process than to follow a reform program developed by outsiders. In the end, the ministry adopted the latter stance. Why?

First, the Ministry of Planning and Budget knew the limitations of the existing budget process, which was heavily focused on annual budgeting issues. Without long-term national vision, policies that required long-term commitment or had long-term implications were set aside for imminent issues in resource allocation. In other words, programs designed to cope with imminent political issues received more weight in resource allocation than those intended to address long-term issues. Another budget limitation was the bottom-up approach, which was difficult to facilitate the process to reflect changing future demand.

The Ministry of Planning and Budget also knew that the extant annual budgeting was not good at performing the role of automatic stabilizer. If the time horizon is limited to a year, government spending tends to exhibit a pro-cyclical pattern: When the economy is good, government spending increases, but when the economy is bad, government spending decreases due to reduced tax revenues. This means that the government has little spending power to buoy the economy when that spending is needed the most. In Korea, government spending was counter-cyclical only eight years out of twenty between 1977 and 1996. To facilitate counter-cyclical government spending, medium-term perspectives would need to be built into the budget process.

Another important factor in the ministry's decision to embrace reform was a strong pro-reform political champion. The Planning and Budget vice minister who initiated the reform was exceptionally committed (Kim, 2010). He believed that comprehensive PFM reforms were urgently needed and that the time-consuming, short-sighted budget process must be overhauled. It is him who was the director general who had attempted introduction of MTEF with a top-down approach in 2001. Politically, a comprehensive reform package would come across as an achievement commensurate with his strong reform-mindedness.

Indeed, politics played an important role in promoting the reform. Drastically shifting resources to a new policy priority is not easy—especially in the face of annual incremental budgeting with a bottom-up approach. The reform took place as the new administration sought to change the government's role from leader of economic development to provider of social service. The administration recognized that the top-down approach and medium-term planning included in the reform could be useful tools to reflect new policy priorities in the budget process (Ministry of Planning and Budget, 2007). In the end, the reform did facilitate resource reallocation to social welfare and regional development programs.

The PFM reform package consisted of performance budgeting, top-down budgeting, and program budgeting—all guided from a medium-term expenditure framework. Many officials within the Ministry of Planning and Budget did not embrace the reform idea. In particular, the budget office was not happy about the idea of delegating the formulation of detailed budgets to line ministries with top-down budgeting. Nobody knew what kinds of changes this reform program would bring about. Many officials thought this reform effort would actually change little in practice. However, the reform effort was sustained, and the following three and a half years brought the first dramatic overhaul of Korea's budget process.

2. Securing Political Will

As mentioned above, the vice minister of the Ministry of Planning and Budget worked hard to secure political will for the reform. In Korea, the newly elected president usually enjoys the strongest power in the first year of the term. So the Ministry of Planning and Budget exerted efforts to gather strong political supports for the reform during the first year of the new administration.

In January of 2003, the Ministry of Planning and Budget reported to the Transition Committee for the New President that a fundamental overhaul of existing PFM system was needed: Existing budget processes could not adequately address the issue of significant resource allocation to reflect policy priorities of the new administration. It raised the issues of devolving more autonomy to line ministries and introducing the MTEF and performance-oriented budgeting. In his speech to introduce the "2003 Annual Plan of the Ministry of Planning and Budget," the minister announced that the ministry would embark on the PFM reforms. It was the first official announcement of the change to MTEF, performance-oriented budgeting, and top-down budgeting.

In July 2003, one of the president's advisory committees, the Committee for Government Reforms and Local Decentralization, included the content of the PFM reforms in its "Road Map for Public Finance Reforms."[6] This made it clear that the PFM reforms were not solely the initiative of the Ministry of Planning and Budget, but also that of the president. Although the road map did not detail the PFM reform programs, it strongly signaled that the reforms would not be reversed.

During this process, the Planning and Budget minister and vice minister exhibited a strong will for the reform. The vice minister continued to rise in government position, and he remained an advocate throughout the whole reform process.[7]

It is noteworthy that the legislature was not involved in the reform process. According to the Korean constitution, the authority of budget formulation lies with the administration, and the authority of the legislature in the budget process is limited to budget approval. Since the reform was mostly about changing budget processes within the administration, there was no need to seek the approval from the legislature. In Korea, developing an MTEF does not infringe on the jurisdiction of the legislature. However, there is a risk that, without legislation, the MTEF may become less binding. As the MTEF solidified, the administration tried to give it legal foundation by laying a bill before the legislature.

3. Building a Reform Team in the Face of Internal Resistance

Although the reform directions were decided by the top decision makers, including the president and the Planning and Budget minister and vice minister, developing implementable

[6] The road map advocated reforms in the PFM system, in intergovernmental relations, and in tax structure.
[7] The vice minister was promoted to the minister position in one and a half years and, two years after that, he became the head of policy office in the President's Office. In each of these positions he supported the success of the reform (excerpted from an interview with then-head of the task force team).

reform programs was still a challenge. The vice minister found that assigning the existing divisions to come up with detailed reform programs on MTEF with a top-down budgeting not effective Eventually, he gave up working with existing teams and created a new task force whose job was entirely focused on developing reform programs. For the team's manager he chose a junior official, who was a deputy director at the time. Apparently, senior officials were hesitant to try the new job and the junior official was the only one who was willing to take the risk. The new director thought the task would not be hard—too optimistic an expectation; but as a junior member of the organization he felt he had little to lose.

When the new team succeeded in developing implementable reform programs, the ministry solidified the task force as the vehicle for improving financial resource allocation systems. Thereafter, the team led MTEF and top-down budgeting reforms which might change the conventional budget practice that the budget office wanted to remain with.

During the last four months of 2003 the task force worked intensely and reported directly to the vice minister in daily private meetings. The vice minister reported directly to the presidential office. Throughout the design process, the line of command was simple and clear: the Planning and Budget vice minister, and the head of the task force were the key decision-making figures.

The detailed plan did not meet with universal agreement. A new minister took over at Planning and Budget in January 2004, necessitating another round of consensus building. Debates about the specific measures and tools raged within the ministry, particularly over the devolution of budgetary powers to line ministries. The proposed reform program entailed the transformation of the budget office's role. It implied giving up the power of detailed budget formulation and, instead, shifting its focus on strategic issues of the whole government. The reform program also suggested increased autonomy of line ministries should be matched with increased responsibility. Many senior officials who had been working at the budget office were worried and offended by the reform proposal that appeared to challenge the long standing tradition of the central budget office

4. Failure of the First National Fiscal Management Plan

As the reformers discovered, it is easier to develop MTEF in theory than to make the information public and ensure its use in the decision making process. Despite strong political support from the president and the high ranking officials in the Ministry of Planning and Budget, developing MTEF metrics and putting them to work was not a smooth process. Some trials and errors were inevitable.

The Ministry of Planning and Budget established a Fiscal Planning Office within the ministry to develop the MTEF in early 2003. The office started by defining the coverage of government expenditure to be included in the MTEF and classified it into thirteen sectors. In order to identify major budget related policy issues and projects, the office formed a working group for each sector. The working groups brought together officials from the Ministry of Planning and Budget and relevant line ministries, with relevant experts from public research institutes, universities, and civil society organizations. After receiving the working group

reports, the Fiscal Planning Office held public forums for each sector from May to July, 2003. In addition, regional forums were held to discuss local issues.

Although the working group meetings and forums for sectors and regions, still conducted every year, help officials identify important policy agenda, it remains unclear how this input is used in setting policy priorities and budget allocation. Some critics deem these forums a publicity tool rather than a legitimate source of information used in the decision making process. It is, however, fair to say that they serve as a communication channel between the central budget authority and line ministries, local governments, and the public. According to Planning and Budget officials, the output from the working group meetings and the regional forums is reflected in the policy direction of MTEF, although the connections to the policy direction are not explicit or automatic.[8]

In December 2003, a draft of the MTEF for fiscal years 2004–2008, called the National Fiscal Management Plan, was finalized. However, the Fiscal Planning Office, the central budget office (which handles annual budgeting), and the Public Fund Bureau had not resolved their disagreements over sectoral expenditures in the plan. Also, the ministry believed there had not been enough discussion with line ministries. As a result, this draft of MTEF was not made public.

5. Encountering Implementation Challenges

This failed attempt, due to a lack of communication with the office that handles annual budgeting, convinced the Ministry of Planning and Budget that MTEF development needed to be part of the annual budgeting process. But success did not come soon. Administrative upheaval, including disruption from the president's impeachment proceedings and significant resistance from bureaucrats, stymied the MTEF until 2005.

Integrating MTEF into the Annual Budget Process

After the failed draft in 2003, the ministry sought to integrate MTEF into the annual budgeting process by introducing top-down budgeting. In practice, this top-down budgeting takes the form of annual budget ceilings for line ministries, dictated through the MTEF; line ministries then develop their detailed budgets within the ceilings. Thus, medium-term perspectives are built into the budgeting process. In many cases, there is the danger that MTEF ends up as standalone paper without any link to actual budgeting. In the Korean case, the ministry spending ceilings integrate MTEF into the annual budget process.

To make this change, reformers had to secure active participation from the office that handles annual budgeting, the central budget office. During the previous year's MTEF development, the Fiscal Planning Office had managed the whole process; cooperation with the central budget office was limited and rough. This time, the Fiscal Planning Office coordinated the process, but the central budget office, as a sub-unit, was responsible for identifying policy

[8] This is based on the interviews with former budget officials in the Ministry of Planning and Budget. Recently, there has been an attempt to improve the output from the working groups, which has often lacked fiscal implications for sectoral policy issues. The Ministry of Strategy and Finance is considering a requirement that working groups must project fiscal implicaitons for each sector's policy issues.

agenda for each sector. The macro aggregates developed in the previous year's MTEF were updated to reflect the changing economic and political environment. The sectoral and program cost estimates were developed with close involvement from the central budget office and line ministries. This cooperation allowed for greater buy-in and set a workable pattern, but more difficulty lay ahead.

Unanticipated Interruption and Further Cooperation Challenges

Following the Swedish model, reformers planned that budget ceilings for line ministries would be determined in a cabinet meeting led by the president. However, this plan was interrupted by unanticipated political upheaval. In March 2004, the opposition party initiated an impeachment vote for the president. As a result, the president could not chair the cabinet meeting, called the Financial Resources Allocation Meeting, scheduled for April 2004. This meeting was cancelled, and both the MTEF and the budget ceilings for line ministries were tagged as provisional. After the Constitutional Court ruled against the impeachment, the MTEF and the budget ceilings were approved ex post at a cabinet meeting held in June.[9] Major newspaper headlines about the meeting took on an ominous tone: "Ministers' Survival Game for Their Budget," and "Ministers War with Logic to Secure Their Budget."

Meanwhile, the Fiscal Planning Office and the central budget office continued to oppose each other on the reform. According to their arguments, the Fiscal Planning Office was not good at estimating the cost of budgetary programs, and the central budget office lacked medium-term perspectives. This uneasiness between the two organizations indicated that organizational restructuring would be needed to accommodate the reformed budget process.

Complaints from the Central Budget Office and Line Ministries

Based on the implementation plan developed by the reform task force, the new budget process was implemented in March 2004, amid growing bureaucratic complaints. The central budget office was not happy about increased workload. In the previous system, the beginning of the fiscal year was quiet, and the workload peaked during the second part of the fiscal year, when annual budget formulation was in full swing. In contrast, under the new system, there was no off-season. During the first part of the fiscal year, the budget office was to develop the MTEF with budget ceilings for line ministries and simultaneously review the performance of government spending programs. Because requests for additional government-office employees are rarely approved, officials worried that the MTEF reform would overburden the capacity of the budget office and thus impair the efficacy of employees' work.

In principle, the annual budget formulation process called for in the reform was supposed to be less burdensome to the budget office, because detailed budget formulation was delegated to line ministries and initial reviews of the budget details were conducted in the process of developing the MTEF. In reality, the annual budget formulation process was almost the

[9] Within a few weeks, the petition of impeachment adjudication was rejected by the Constitutional Court, and the president was able to resume his job.

same in terms of workload, but initially there were added burdens associated with implementing the reform programs.

The greatest burden was caused by the budget office's reluctance to integrate the MTEF into their annual budget formulation process. The allocation of human resources within the Ministry of Planning Budget was skewed towards the budget office, with almost half of the ministry's personnel allocated to the task of annual budget formulation. As a result, there were not enough personnel to handle new initiatives without the active participation of the budget office.

Line ministries were also not happy about the reformed budget process. They complained about their lack of power in ministerial budget formulation, because they expected greater autonomy in budget formulation below program level., but also said they were not ready to exercise increased autonomy in their own budget formation due to lack of capacity. Traditionally, the role of budget team in line ministries was limited to collecting budget requests from each department within their ministries.

Another line ministry complaint involved the organizational structure within the Ministry of Planning and Budget. At the time, the ministry was divided into three units: the Fiscal Planning Office, the Budget Office, and the Public Fund Bureau. Medium-term plans were handled by the Fiscal Planning Office, annual budgeting was dealt with by the Budget Office, and budgeting for public funds was done by the Public Fund Bureau, with very little coordination among the units. Therefore, line ministries had to communicate with each unit, repeatedly, about similar issues, to develop coherent MTEF and annual budgets. The budget office and line ministries would need to be brought on board, together, for the reform to work.

Coping with Implementation Challenges

The MTEF process in 2003 and 2004 had been subject to trial and error mostly due to coordination and capacity issues within the extant central budget office and line ministries. Through these two years, it quickly became clear that MTEF would fail unless the budget office took an active role in making it an integral part of the budget process. A shifting of assignments made that active role imperative in 2005.

This time, the Budget Office and the Fiscal Planning Office maintained communication from the beginning, and the main responsibility of MTEF development was assigned to the central budget office. The Fiscal Planning Office still played a coordinating role but in a supporting capacity. In this way, the central budget office was left with no choice but to actively participate in the MTEF process and take responsibility.

Although MTEF was developed in 2003 and 2004, 2005 can be viewed as the first year that the annual budget was actually formulated based on MTEF. Another round of changes resulted in serious efforts toward integrating MTEF into the annual budget process. First, the annual budget process was changed to start in January, four months earlier than the previous budget process, which had started in May with accepting budget request from line ministries. Under the reformed system, line ministries were required to submit their medium-term plan for their programs at the beginning of the year. Based on the medium-

term plans and macro fiscal estimates, the next year's total expenditure and budgeting ceilings for line ministries were developed by April.

Other changes included the request that line ministries prioritize their programs by importance and performance, and use this prioritization in ministerial resource allocation. Line ministries were also asked to consolidate existing programs, particularly programs without further demand or clear policy goals. These consolidation efforts resulted in a reshuffling of 9.3 percent of the total budget.

The MTEF development process changed over time, in response to complaints from line ministries. In the first year of MTEF development, every program was required to develop a medium-term projection to help determine budget ceilings. This new annual budgeting process mostly resembled the previous process, but was more time intensive for ministries. Soon officials deemed it impractical to develop medium-term projections for every program and examine every program in the annual budgeting process. One problem is that it resulted in a huge increase in workload. The more critical issue to Budget Office was how to treat the new program not listed in the MTEF earlier years. Line ministries argued that extra funding is needed on the new program not listed in the previous MTEF because Budget office already reviewed and allocated proper amount of resource on those programs. To this argument, Budget office had not much counter arguments that persuade both the line ministries and itself. To respond to these problems, Budget Office came to classify programs into two categories: (1) programs subject to detailed examination, generally those entailing big changes in spending, large budgets, and policy sensitivity; and (2) programs subject to less scrutiny, which were mostly recurring routine programs. That could lead to less burden of work, more credible budget estimates. This enabled Budget Office to allocate the budget between new budget program and those not listed in the MTEF.

6. Organizational Restructuring and Redefining the Role of the Budget Office

Ultimately, the reluctance of the Budget Office, combined with the mismatch between tasks created by the reforms and existing organizational structure, resulted in a drastic measure: restructuring of the Ministry of Planning and Budget, including the eventual elimination of the Budget Office.

In September 2004, a new task force started to plan for the organizational restructuring. Over the next four months, officials within the ministry passionately debated restructuring's merits and methods. The initial idea was to reduce the hierarchical layers to make the Ministry of Planning and Budget more horizontal and cooperative. This was not possible, given the constraints of government organization law and the ensuing objections from the Ministry of Government Administration and Home Affairs (responsible for managing the government organizational structure).

In January 2005, a compromise plan, called the Fiscal Management Innovation Task Force Structure, was selected for pilot testing. The Ministry of Planning and Budget was restructured into seven coordinating teams and sixteen sectoral teams. Issues including MTEF, annual budgeting, and public fund budgeting were to be handled by every sectoral team.

While implementing the Fiscal Management Innovation Task Force Structure, the ministry also formally adapted its own mission and vision to reflect changing environments and the new tasks assigned by the reforms. The new mission was, "Make a better future." Specifically, the ministry would "contribute to national policy through fiscal policy, a national fiscal management plan, budget execution, performance management, and management of state enterprises and public entities." The new vision was to make the ministry a "strategic planning organization that develops big pictures of national development."

Even with the new vision and mission, organizational restructuring issues soon resurfaced. Officials viewed the temporary task force structure as somewhat unstable, at least for long-term use. In April 2005, the Ministry of Government Administration and Home Affairs delegated to line ministries the authority to decide organizational structure below the departmental level. The new autonomy ignited another round of restructuring discussions.

May 2005 brought the most drastic organizational change, as one of the most powerful and prestigious government organizations disappeared: the central budget office was gone. After the line ministries were informed of their budget ceilings for 2006, the Ministry of Planning and Budget announced the change as a move to achieve a greater fit with the reformed budget process. A secondary rationale was to remedy once and for all the unsatisfying level of cooperation from the central budget office. Now the task of developing the sectoral MTEF and the annual budgeting process would fall to the new Fiscal Management Office—in reality a merger of the former Budget Office and the former Public Fund Bureau.

Removing the name of the Budget Office from the Ministry of Planning and Budget was a shock not only to the inside officials but also to the outside experts.[10] It clearly signaled that the role of the Ministry of Planning and Budget was expanded to include MTEF, performance management, and policy development. By restructuring the organization, the Ministry of Planning and Budget tried to make the MTEF an integral part of the regular budget process.

As part of the restructuring, two major organizational changes occurred. The first entailed a shuffling of personnel and tasks. The second divided the ministry according to responsibility—fiscal planning versus fiscal strategy—under the larger umbrella of matrix management. Both changes are discussed below.

To accommodate the ministry's new direction, the number of staffers working on the job of individual budget formulation was reduced. The extra employees were transferred to work on macro fiscal policy, medium- and long-term planning and resource allocation, and performance management. Another new organization, the Fiscal Strategy Office, was established to develop medium- and long-term fiscal strategy, and the Performance Management Bureau was established to manage performance of government spending programs. While previously 50.4 percent of ministry staff had been engaged in budget

[10] In particular, some retired senior officials were offended because they had been proud of being a part of the central budget office. Throughout the restructuring process, retired senior members' implicit pressure was the most difficult challenge to overcome.

formulation for individual programs, under the new organizational structure, only 39.6 percent of the staff worked on individual program budgets.

To help manage the many new groups, the ministry broke employees into two divisions. One division, the Fiscal Planning Unit, was responsible for the sectoral issues, such as education, defense, local finance, trade, and so on. The Fiscal Planning Unit contained eleven teams—one for each sector of budget preparation—and their tasks were similar to those previously carried out by the central budget office. The other division, responsible for functional issues, comprised three units: (1) The Fiscal Strategy Office developed medium- and long-term fiscal policy, including macro issues in the MTEF; (2) the Fiscal Management Office developed MTEF focusing on sectoral issues and annual budgeting; and (3) the Performance Management Bureau conducted performance evaluation and management. All three units were supposed to work with the Fiscal Planning Unit and its eleven sectoral teams. As long as the cooperation between functional units and sectoral units went smoothly, the matrix structure[11] would make the reforms well-integrated into the budget process.

This matrix structure was also expected to relieve some burdens of the line ministries. Now line ministries could solve all the budget issues by talking to a relevant sectoral team, rather than to three different units, as in the past. The matrix structure was supposed to provide one-stop service to line ministries.

7. Redefining the Role of Line Ministries

Like the Ministry of Planning and Budget, line ministries also needed some restructuring to help them adapt to their new roles in the reformed budget process. First, the budgeting team inside each ministry was upgraded. In the previous regime, each ministry's budget team collected budget requests from program managers and conveyed those requests to the Ministry of Planning and Budget. Under the reformed PFM system, the line ministries' budget teams set priorities for their programs and mediated among conflicting budget demands within their ministries. In February 2005, the Ministry of Planning and Budget initiated communication with the president's office, prime minister's office, and the Ministry of Government Administration and Home Affairs to enhance the status of the budget teams within line ministries. In April 2005, the name of the office was changed from "Planning and Budget Division or Team" to "Fiscal Planning Bureau (Director General position was added and team level was expanded to division level)," and additional personnel were added. In May 2005, the president and cabinet upped the level of the fiscal planning officers from director to director general.

In addition, the reform gave more budget autonomy and responsibility to line ministries. After budget ceilings were decided within the top-down MTEF approach, line ministries formulated their own budgets. Therefore the role of budget division in the line ministries should be changed to 'real Budget Office' in the ministry because it should prioritize the budget requests and allocate resources according policy priorities.

[11] Ideally, matrix leadership in organizations differs from direct-line command in that authority is more horizontal and cooperative. Within a matrix structure, the same employee might report to multiple supervisors and work with employees from several divisions on specific projects.

Informal incentives rewarded line ministries whose budget drafts stayed within the limits of their annual budget ceilings. Although never explicitly articulating these incentives, the Ministry of Planning and Budget gave preferential treatment to these line ministries, both by quickly approving their basic operating costs and by leaving their budget drafts mostly unchanged. In contrast, if a particular line ministry's annual budget request exceeded its budget ceiling, its budget was inevitably subject to more scrutiny.

Along with greater autonomy in the new process, line ministries gained a voice in the National Assembly. Previously, line ministry officials were not present when the assembly's special committee of budget and settlement met to decide which programs would be subject to cuts in the final budget adjustment. Instead, the Ministry of Planning and Budget delivered line ministries' opinions to the committee. From 2005, however, line ministries were allowed to attend the adjustment meeting and present their cases. This privilege implied that line ministries were still responsible for their budget, even during the assembly's budget approval process. It signaled that line ministries would bear more responsibility in return for their increased autonomy.

8. Laying Legal Foundations for the PFM Reforms

The role of the National Assembly also expanded under the budget changes, as reformers sought the stability that legislation can provide. Because PFM reforms are vulnerable to political regime change, establishing their legal basis is crucial. Codified reforms (that is, reforms written into law through legislation) are less likely to disappear as politicians' interest wanes. Often, a new administration will embark on management reform without actually changing the decision-making process, because elected officials gain more political momentum from starting a new reform program than refining the existing system. Thus bureaucrats sometimes respond to reform initiatives by saying, "They will be gone when the current administration goes." Without proof of reform stability, officials tend to just make a show of compliance, rather than change their behavior and decision making. By contrast, management systems solidified by law tend to last long enough to impact decision making, and they enjoy better chances of continued improvement.

The PFM reforms in Korea gained legal foundations with the enactment of the National Finance Act in October 2006. There had been no major changes to the Budget and Accounting Act of 1961 or the Public Fund Management Act of 1991, although there had been some revisions and revision attempts[12] before the enactment of the National Finance Act. The first overhaul of public finance laws since 1961, the act solidified the PFM reforms of 2003 to 2006 and allowed the legislators to voice their opinions on the reforms.

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[12] In December 2000, the majority and the opposition agreed that the overhaul of the existing Budget and Accounting Act and the Public Fund Management Act, and the enactment of the Restoring Fiscal Soundness Act were warranted to cope with changed policy environments due to the Asian financial crisis. Despite this initial agreement, the legislature could not reach an agreement on the revision of the Budget and Accounting Act or the enactment of the Restoring Fiscal Soundness Act. One problematic issue was the coverage of government debt, and the legislation efforts ended only with the revision of the 1991 Public Fund Management Act. (These efforts did not include clauses on the PFM reforms, because the PFM reforms started in 2003.)

Because the PFM reforms had been introduced and implemented almost solely by the executive branch, the legislature was largely unaware of the reform implications. Legislative attention gave new momentum to budget process development.

Although there were no serious disagreements in the National Assembly regarding PFM systems, disagreement on other issues related to public finance delayed and interrupted the enactment process. The Ministry of Planning and Budget had started to examine the possibility of reorganizing the public finance-related laws in 2003. The ministry prepared the first draft in June 2004, renaming the existing Budget and Accounting Act as the National Finance Act. The act included clauses not only about budgeting and accounting, but also about PFM. After consulting with other stakeholders and making some corrections, the ministry submitted its draft to the National Assembly in October 2004.

In response to the ministry's draft, the opposition party in the National Assembly submitted the National Sound Finance Act in December 2004. This was not just a revised version of the original draft. It included several issues that needed to be reconciled to reach an agreement.

One point of contention was the name for the new framework. The ministry's draft named the MTEF the National Fiscal Management Plan, while the draft from the opposition party named it the Medium-term Fiscal Plan. Since the MTEF had been called the National Fiscal Management Plan for years, that name was selected by consensus. Another issue was time horizon. The ministry's draft specified that each plan should cover three fiscal years, while the opposition party's draft demanded five fiscal years. Legislators eventually agreed that a plan should include five fiscal years, including the current fiscal year. While there were a few differences regarding the actual contents of the National Fiscal Management Plan, the differences were not significant and consensus was easily achieved.[13] The last PFM difference concerned the Ministry of Planning and Budget's reporting obligation. The opposition party's draft included the clause that the Ministry of Planning and Budget should produce a white paper on the previous fiscal year's plan and report on it to the National Assembly. Instead, legislators agreed that each new National Fiscal Management Plan should include an assessment of the previous fiscal year's plan. Interestingly, the biggest debates during enactment were not related to PFM at all, but to the coverage of government debt. One year and eleven months after the initial draft submission, the National Assembly passed the National Fiscal Act with no objections and only one withdrawal.

While there was no serious dissent in the National Assembly over the PFM reforms, the process gave the legislators a sense of ownership. The legislators actually added rigor to the reforms, because the Ministry of Planning and Budget had viewed the reforms as internal management tools and used them with some flexibility, while the National Assembly considered them as tools for enhancing the administration's accountability and wanted them to be formal and binding. These distinct agendas show that administrative viewpoints differ from legislative viewpoints, such that change agents must find ways to maintain balance between two different demands without losing reform efficacy.

[13] Lawmakers agreed that the National Fiscal Management Plan should contain the following: goals and directions for fiscal management, medium-term estimates of fiscal aggregates, sectoral resource allocation plans, calculations of budget growth rate and estimated rate of tax burden, forecasts of aggregated fiscal balance and government debt, and items decided by the president.

9. Working with Public Research Institutes, International Organizations, and Civil Society Organizations

Public research institutes, international organizations, and civil society organizations helped greatly with PFM reform design. Two public research institutes within Korea offered invaluable assistance: The Korea Development Institute provided rationale for the reforms, and the Korea Institute of Public Finance provided case studies on other countries' experiences and other practical support for the reform implementation. Additional research teams were created within the Korea Institute of Public Finance in September 2003 to support the reforms. The institute established the Center for Fiscal Analysis and, later, the Center for Performance Evaluation and Management, to cope with expanding demand for planning, training, and evaluation.

The initial reform team worked very closely with the public research institutes to gain ideas and feedback from experts. During MTEF implementation, the Korea Development Institute organized working groups and regional forums to identify sectoral policy issues and regional concerns. Researchers at the Korea Institute of Public Finance provided advice on revenue estimates and participated in working group meetings.

International organizations played an important role in sharing other countries' experiences and informing policy makers of best practices for PFM reforms. For example, the World Bank hosted many conferences with public research institutes in Korea and with the Ministry of Planning and Budget. Cooperation with international organizations helped to convince stakeholders that the PFM reforms were necessary to move Korea towards the best practices already employed in other countries.

Civil society organizations also played a role in the reform process. When PFM reforms began in 2003, only one civil society organization, the Citizens' Alliance for Economic Justice, expressed interest in public finance issues. This organization supported the reforms and stressed that PFM transparency would require performance-oriented budgeting and accrual accounting. Citizens' Alliance representatives joined academics and experts from the public research institutes in forming policy advisory committees. For the implementation process of MTEF, these representatives attended working group meetings to give input for policy direction.

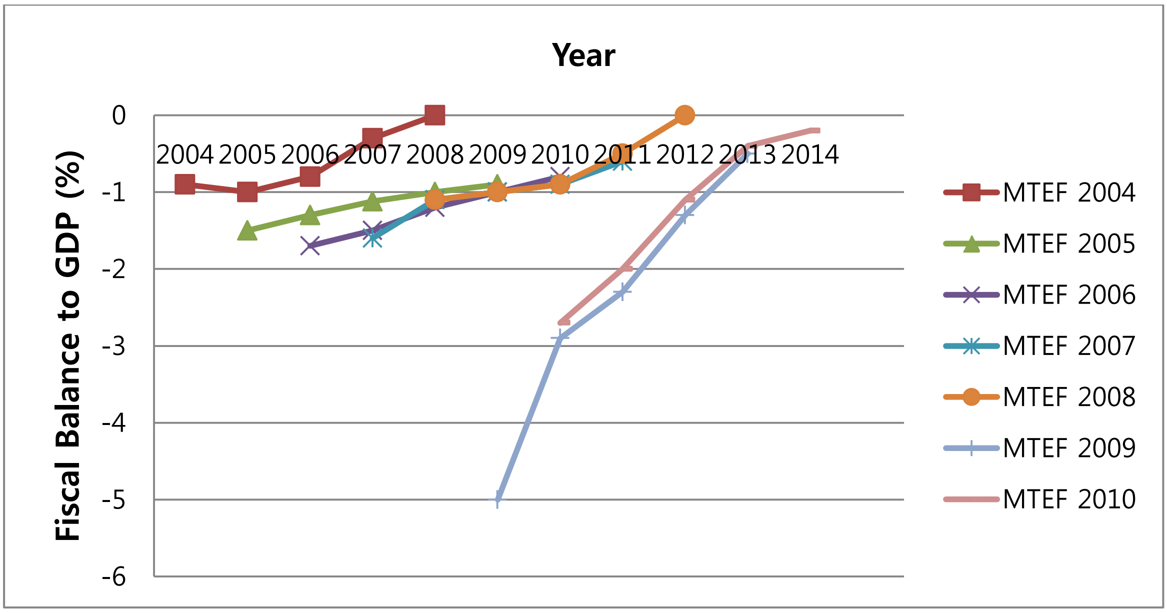
The Ministry of Planning and Budget strategically approached civil society organizations, as well as media and the public, to draw attention to salient issues. The ministry established an avenue for the public to report budget waste, the Center for Budget Waste Prevention, and worked closely with civil society organizations to identify additional budget waste. Media rallied around these efforts, generating public awareness (and pressure for policy makers). This approach successfully helped the public grasp complex financial issues and recognize the need for PFM reform.

V. Sustained MTEF Improvement

Following the 2006 legislation, the MTEF process continued to improve. The new presidential administration, which came to power in 2008, viewed the MTEF process as a useful tool for strengthening fiscal discipline. As the global financial crisis deepened, the president and cabinet used their MTEF meeting, called the Fiscal Strategy Meeting, to discuss issues of fiscal consolidation and sustainability. The 2008 MTEF, the first under the new administration, honored the previous year's MTEF in that the target for fiscal balance (excluding social security funds) was set at 1.0% and -0.9% of gross domestic product (GDP), respectively, for fiscal years 2009 and 2010, which was the level set for those out-years in the 2007 MTEF.

Figure 1 presents the ratio of fiscal balance to GDP for the current fiscal year and the next four fiscal years, as specified in MTEF plans for 2004 to 2010 (including targets through 2014). For example, the MTEF 2004 line shows the ratios of fiscal balance to GDP for fiscal years 2004 to 2008. While the first ratio in the 2004 line represents the projection given in the 2004 MTEF for the current fiscal year (2004), the other ratios are the target numbers specified in 2004's MTEF for the budget year (2005) and three out-years.

[Figure 1] Ratio of Fiscal Balance to GDP, as Targeted in MTEF 2004–2010



Note. The first coordinate of each series represents the MTEF-projected ratio of fiscal balance to GDP for the current year; the next coordinate represents the ratio projection for the upcoming budget year; and the final three coordinates represent projections for the three out-years covered in each MTEF plan.

The first three lines in figure 1, representing MTEF 2004, 2005, and 2006, show that the targets shifted each year rather than staying on a similar path. Considering there was no considerable change in external factors during these years, this pattern hints that policy makers expended little effort to maintain the consistency of MTEF targets, at least initially (Park 2010). However, target consistency improved with MTEF 2007. The fiscal balance targets remained at the path set by MTEF 2006 until MTEF 2008. Fiscal balance targets

shifted in MTEF 2009 due to the global financial crisis, but the MTEF 2010 projection and out-year targets remained consistent with the path set by MTEF 2009. This increasing consistency demonstrates that the fiscal targets set by the MTEF have become binding over time, which implies that MTEF improved fiscal discipline in Korea.

To recover fiscal sustainability in the wake of extended stimulus spending, a new fiscal rule was introduced through MTEF in 2010: The growth rate of spending increase should stay 2–3 percent lower than that of revenue increase. This rule silenced criticisms that MTEF plans lacked explicit fiscal rules. When the rule was broadcast publicly, it gained informal binding power.

Recognizing the agenda-setting power inherent in MTEF, the National Assembly asked to be involved in the MTEF process. Specifically, the legislators requested that budget ceiling proposals be submitted to the National Assembly. They solidified this desire with a revision of the National Finance Act in 2010, which stated that the planning direction of each MTEF should be submitted to the National Assembly prior to MTEF development. However, the Ministry of Strategy and Finance refused to submit budget ceiling proposals to the National Assembly because it held that budget ceilings were only for the purpose of budget formulation within the administration and should be kept confidential to outsiders. Although the legislature's involvement in MTEF is still in flux, this involvement binds MTEF closer to the decision making process and may prevent it from becoming a standalone document.

These continuous efforts to enhance MTEF, along with the sustained evidence of MTEF use for decision-making purposes, demonstrate that MTEF has become an integrated part of the regular budget process. The following section provides evidence that MTEF improved fiscal management, as well.

VI. MTEF Impact and Policy Implications

This section discusses the impact and performance of MTEF in Korea, leading to several policy implications. As mentioned, evidence suggests that MTEF has been well-integrated into regular budget processes. Evidence of MTEF's actual impact on fiscal performance is more difficult to solidify, but Korea's financial standing and financial goal achievement, compared to that of other countries, is increasingly recognized.

Budget-Process Integration

First, the aggregate expenditure ceiling in MTEF has been well observed in the annual budget. The discrepancy between the total expenditure ceiling given in MTEF and the ceiling in the actual annual budget draft was averaged only 1.16 percent during 2006–2011 (see Table 1). This suggests that the total expenditure ceiling developed in MTEF affected Korea's total annual expenditure.

<Table 1> Comparison of Total Expenditure [in Billions of USD] in MTEF and Budget Draft

Year	2006	2007	2008	2009	2010	2011
Total expenditure in plan	220.7	234.8	253.8	274.1	290.9	306.6
Total expenditure in budget draft	221.4	238.5	257.3	283.8	291.8	309.6
Difference (%)	0.3	1.5	1.37	3.5*	0.3	0.97

Note. * The increased discrepancy in 2009 was mainly due to the stimulus spending in response to the global financial crisis in 2008.

Second, the observance of the ministerial ceilings in the annual budget process has improved. Table 2 shows that the compliance rate grew from 72.7 percent in 2009 to 79.5 percent in 2011. The ministerial budget ceilings were introduced as part of MTEF and, in theory, line ministries are supposed to develop their annual budget drafts within the ceilings. Although the data show that ministries fall short of perfect compliance, the compliance rate is improving. This evidence suggests that MTEF affects Korea's annual budgeting through budget ceilings.

<Table 2> Line Ministries' compliance with Budget Ceilings

FY	Number of line ministries receiving budget ceilings (A)	Number in compliance with ceilings (B)	Number in non-compliance (A-B)	Compliance rate (B/A, %)
2009	44	32	12	72.7
2010	44	33	11	75.0
2011	44	35	9	79.5

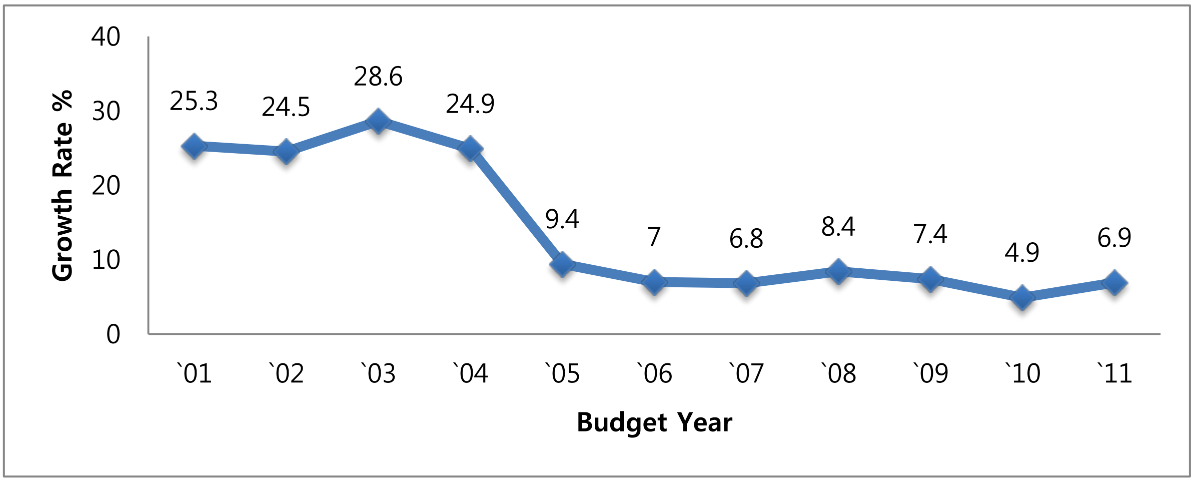
Fiscal Performance

It is not easy to present rigorous evidence of the impact of MTEF on fiscal performance, because many other factors affect fiscal performance as well. Since it is beyond the scope of this paper to pin down MTEF's impact on fiscal performance, only some suggestive evidence is presented.[14]

[14] Grigoli et al. (2011) examined the impact of MTEF by conducting cross-country analysis. Their criteria were fiscal discipline, allocative efficiency, and technical efficiency. The present case study adds some suggestive evidence on fiscal discipline and strategic resource allocation.

As seen in figure 2, the introduction of MTEF preceded a decrease in the growth rate of line ministries' budget requests. Before 2005, line ministries' budget requests grew more than 20 percent annually. However, since 2005, this growth rate has been reduced to single-digit figures. This implies that MTEF may have contributed to restraining budget demands from line ministries.

[Figure 2] Changes to Growth Rate of Budget Requests



So far, the fiscal goals in MTEF have been relatively well-achieved. For example, the projected consolidated fiscal balance in MTEF has been consistently close to actual figures. Table 3 shows that Korea's discrepancies between MTEF targets and actual figures are relatively small, compared to those of fifteen countries in the European Union. This suggests that the projections of fiscal aggregates in Korea's MTEF are relatively accurate and that MTEF plans are relatively well followed.

<Table 3> Discrepancy between Realized Figures and MTEF Target Figures for Consolidated Fiscal Balance, Excluding Social Security Funds

	(t+1)	(t+2)	(t+3)
EU 15 countries* (2004–06)	-0.1%p	-0.5%p	-1.1%p
Korea (2005–07)	0.43%p	0.2%p	0.1%p

Note. These numbers represent differences between the planned and observed change in the budget balance (as % of GDP) for different time horizons. (-) means the budget balance became worse than planned and (+) means the budget balance became better than planned, given as a percent.
* Figures for 15 EU countries are calculated from simple averages of the 15 countries' numbers.
Source: Public Finances in EMU 2007, p. 172, in *European Economy No.3*, Brussels: European Commission, 2007.

The current fiscal condition of Korea is relatively sound compared to that of other advanced countries. Although, of course, multiple factors influence Korea's fiscal situation, we conjecture that the reformed PFM system, including MTEF, may have contributed to sound fiscal management. Table 4 shows how the ratios of fiscal balance to GDP and of government debt to GDP have changed in the process of coping with the global financial crisis that began in 2008. Korea's ratio of fiscal balance to GDP worsened from 0.4 percent in 2007 to -1.7 percent in 2010, while the average of that ratio for the G20 countries changed from -0.9 percent to -6.8 percent. Meanwhile, Korea's ratio of government debt to GDP in increased from 30.7 percent in 2007 to 34.7 percent in 2010, while the average of that ratio for the G20 countries increased from 61.3 percent to 76.1 percent.

<Table 4> Comparisons of Korea's Fiscal Soundness, as Ratio of Fiscal Balance or Government Debt to GDP

Country	Fiscal Balance				Government Debt			
	'07	'08	'09	'10	'07	'08	'09	'10
US	-2.7	-6.7	-12.9	-11.1	62.1	71.1	84.3	92.7
UK	-2.7	-4.9	-10.3	-10.2	43.9	52.1	68.5	76.7
Germany	0.2	0.0	-3.1	-4.5	64.9	66.3	73.5	75.3
France	-2.7	-3.3	-7.6	-8.0	63.8	67.5	78.1	84.2
Japan	-2.4	-4.1	-10.2	-9.6	187.7	194.7	217.6	225.8
KOREA	**0.4**	**-1.5**	**-4.1**	**-1.7**	**30.7**	**30.1**	**33.8**	**34.7**
G20	-0.9	-2.7	-7.6	-6.8	60.8	63.8	72.6	76.1

Note. % of GDP, general gov't (central + local), IMF (Nov. 2010), Korea is based on the consolidated fiscal balance, excluding social security funds

Taken together, all of these data suggest that MTEF reform in Korea has achieved relative success. What can policy makers and reform agents learn from this success? A few ideas are outlined below.

Implications for MTEF Reform

The Korean case provides at least three policy implications for MTEF reform. First, strong support from top decision makers is crucial in drawing attention from stakeholders, such as the central budget office and line ministries. The top decision makers should include those who deal with issues across ministries, such as the president, prime minister, and minister of the Finance and Economy, in order for MTEF to cover the entire government. In the Korean case, the support of top decision makers sustained the second attempt at PFM reform all the way through the institutionalization of MTEF in the National Assembly. By contrast, Korea's first effort towards PFM reform, lacking such endorsement, could not last.

Second, reformers must find ways to integrate MTEF into the budget process.[15] The MTEF should affect the annual budgeting, and the consistency of MTEF needs to be maintained from year to year. In the Korean case, top-down budgeting was the link between MTEF and annual budgeting. Thus, one crucial component of MTEF in Korea was to have the Ministry of Planning and Budget hand down credible spending ceilings, supported through the active involvement of the office responsible for annual budgets, the central budget office. Ideally, the budget office would develop sectoral MTEF and spending ceilings, while the reform team developed macro fiscal aggregates. As Korean reformers soon discovered, if MTEF is developed without the cooperation of the budget office, the MTEF process is unlikely to maintain credible spending ceilings. As a result, MTEF may not affect annual budgeting in practice.

When reformers were unable to secure central budget office cooperation, a whole-scale ministry restructuring ensued. This points again to the importance of support from top decision makers, as the Ministry of Planning and Budget could not have achieved matrix management without strong up-line support. The restructuring redefined the role of budget officials and aligned the ministry's structure with the tasks generated by the reformed PFM system. It also improved cooperation.

Third, enhancing the capacity of each line ministry's budget division was essential to fully realizing the benefits of MTEF. Under the old regime in Korea, the budget teams within the line ministries served only as liaisons between line-ministry program managers and the central budget office; that is, they collected and submitted budget requests. Under the new regime, the line ministry budget divisions needed the capacity to develop ministerial budget drafts—and these budget drafts needed to align with government-wide priorities. To reinforce the ministerial budget divisions, the Ministry of Planning and Budget upgraded the teams' status and added personnel. In addition, the ministry tried to give more jurisdictions to the ministerial budget division. This development reinforces the idea that successful PFM reforms usually require plans for building the capacity of stakeholders who will implement the reforms.

In addition, the Korean experience shows that comprehensive financial reforms enacted within a short time can succeed, even without international pressures, when supported by top national officials and strong inside change agents.

[15] Le Houerou and Taliercio (2002) arrived at the same conclusion from the African context.

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Abbreviations

MTEF	Medium-Term Expenditure Framework
PFM	Public Financial Management
IMF	International Monetary Fund
GDP	Gross Domestic Product