

Performance Budgeting in Korea

by

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Korea is in the initial stages of implementing performance-based budgeting. The system was introduced as part of a comprehensive fiscal reform package in the late 1990s. This article discusses the background, framework and implementation of performance budgeting and its impact in the budget process.

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1. Description of the performance system

1.1. Background and context

Korea has recently launched a reform to introduce performance-based budgeting into government. What makes the Korean case particularly interesting is the speed with which the government has ushered in a performance management system, and the fact that other budgetary reforms of similar magnitude are being pursued concurrently with equal zeal as part of a comprehensive fiscal reform package known as the Four Major Fiscal Reforms. One advantage of such a multi-pronged effort is that, if co-ordinated properly, it ensures that an exceptionally favourable background is set for building up an effective performance management system. The downside to such an approach is that it demands a level of commitment in terms of both political willpower and material resources that may not be readily feasible in many countries.

The Korean government's Four Major Fiscal Reforms are: 1) to establish a medium-term expenditure framework (National Fiscal Management Plan); 2) to introduce top-down budgeting; 3) to establish a performance management system; and 4) to build a digital budget information system (the latter includes a transition from the existing line-item structure to a programme budget structure). The scope and pace of this reform package are quite exceptional. If successful, the Korean budget system will be completely retooled within the space of a few years into one that incorporates virtually all of the best practices.

These ambitious reforms were motivated by the deteriorating fiscal situation of the Korean government. After the Asian financial crisis in the late 1990s, public debt increased dramatically. The growing debt was partly driven by rapid rises in public expenditures to strengthen the social safety net and so assuage widening income disparities resulting from the economy-wide restructuring. Looking ahead, population ageing in Korea is progressing at a pace that is unprecedented among countries, generating additional pressure on public finances.

The medium-term fiscal plan puts government spending decisions in a five-year framework. Based on prudent economic growth projections, the plan determines the annual overall expenditure levels over the medium term, allocated among the 14 major sectors of government spending. Consistency between such medium-term resource allocation decisions and annual budget appropriations is enforced through the top-down system. This system assigns

firm spending ceilings to line ministries according to the medium-term fiscal plan, but delegates lower-level budgeting decisions to ministries, provided that the latter's aggregate expenditures remain within their assigned ceilings. The greater autonomy given to line ministries in turn requires greater accountability on their part. This is ensured through the performance management system, which was introduced to examine the performance of spending programmes and thus strengthen the link between budgeting and performance. The digital budget information system will allow the budget office to monitor ministries' spending in real time. The task force charged with developing this information system was also asked to overhaul the budget classification structure. Accordingly, a new programme budget and cost accounting system was developed in 2005, to be fully implemented by 2007.

1.2. Content and approaches

Performance-based budgeting was introduced in Korea in three phases. The first was an experimental pilot project carried out during 2000-02. Entitled "Performance Budgeting", the performance-based system was based on the model of the United States GPRA (Government Performance and Results Act), with some modifications. Divisions in 22 ministries and agencies that participated in this project were asked to develop annual performance plans. This first initiative ended with the change of the incumbent administration.

Building on that experience, the second initiative began as one component of the Four Major Fiscal Reforms of 2003. Twenty-two ministries and agencies were selected and asked to submit their annual performance plans to the Ministry of Planning and Budget along with their annual budget requests. This second initiative was also inspired by the GPRA but implemented only a limited subset of GPRA features. While the GPRA requires each agency to submit strategic plans, annual performance plans and annual performance reports for every single programme, the Korean version requires performance plans and reports only for major budgetary programmes over USD 1 million in size. This second initiative, entitled "Performance Management System of the Budgetary Programme", was expanded to cover 26 ministries/agencies in 2005.

A third initiative, the "Self-Assessment of the Budgetary Programme" (SABP), was introduced in 2005. This system was based on the "Program Assessment Rating Tool" (PART) of the United States, with some modifications. Under the SABP, 555 programmes (about a third of all government programmes) were reviewed in 2005, a pace which would allow the Ministry of Planning and Budget to review every major budgetary programme over a three-year cycle. Similarly to PART, the self-assessments were done according to a checklist developed by the Ministry that lists questions on planning, management and results.

1.3. Legal and institutional framework

The Korean performance system was implemented as an initiative of the Ministry of Planning and Budgeting, and is not as yet defined in any law. The Ministry's role has been to design performance programmes and implement them by giving directives and guidelines to line ministries/agencies on how the latter should adopt and operate a performance management system. However, an umbrella bill, intended to supersede the outdated Budget and Accounts Act, was submitted to the National Assembly (the legislature). This bill includes a comprehensive, updated definition of the budget system, including performance management. Meanwhile, a new law was enacted in 2005 that gives the Office for Government Policy Co-ordination the authority to supervise and co-ordinate the various existing performance evaluation systems within the government.

So far there is no legal requirement to present performance information in the annual budget proposal or supporting documents. Nevertheless, the Ministry of Planning and Budget provided the National Assembly with the SABP evaluation results. There are legal requirements (stipulated in the new law enacted last year) for line ministries/agencies to submit strategic plans, annual performance plans and performance reports to the Office for Government Policy Co-ordination. There is no legal requirement regarding programme evaluation, but a question in the SABP asks whether a particular programme is evaluated by an independent organisation, which encourages line ministries to conduct evaluation.

The Ministry of Planning and Budget has been the key actor in developing and implementing performance-based budgeting in Korea. Its roles include oversight of performance budgeting programmes, issuing guidelines to line ministries/agencies, and evaluating the latter's performance information. The Ministry has relied heavily on advice and assistance from the Korea Institute of Public Finance, a public think tank, which has been instrumental in developing manuals and running training programmes on performance budgeting for line ministry/agency staff. In order to get the attention of line ministries/agencies, the Ministry of Planning and Budget encourages them to use performance evaluation results in preparing their budget requests. Upon receiving the budget requests, the Ministry also incorporates the ministries' performance information into its decisions during budget formulation.

In 2005, the Ministry of Planning and Budget signalled its intention to further strengthen performance budgeting by creating a bureau that specialises in performance issues. This newly created bureau is fully in charge of both policy decisions and programme implementation in performance budgeting.

1.4. Scope and coverage

So far, performance budgeting in Korea has taken a partial approach: it mainly covers major budgetary programmes, defined as those either with

budgets over USD 1 million or whose nature merits special attention (e.g. programmes over which the legislature or the National Audit Office has taken issue). More specifically, 22 out of 39 ministries/agencies have developed performance measures for 100% of their major budgetary programmes. Performance measures have been developed for some of the other smaller programmes as well. Starting in 2006, the performance system is being expanded comprehensively, requiring performance information to be developed for every programme.

Regarding efforts by ministries/agencies to implement performance management, none has yet set up special units solely or mainly for conducting evaluations. That task usually falls to budget departments within most ministries/agencies. Overall, ministries/agencies do not have much experience with evaluations at this point. The situation is expected to improve rapidly, as the SABP encourages doing evaluations on a regular basis.

2. Measurement and assessment of results

2.1. Setting goals

Decision makers in ministries/agencies have not been actively involved in developing strategic goals/objectives. The usual practice is for the budget department to develop them with the help of outside professionals. Nor have politicians been actively involved so far in setting goals, which is done on an organisational basis. Strategic plans were developed in 2006 and will be updated every three years.

2.2. Performance measures: outputs, outcomes and measurement issues

Korea's performance system is oriented toward outcomes, but outputs are used when it is difficult to define or develop appropriate outcome measures. The system started with outcome-oriented performance information; it took the United States system as the benchmark model.

Developing outcome measures is indeed a difficult task for ministries/agencies. Since these measures are often too broad, there has been some resistance from ministries/agencies. In particular, policy-oriented ministries, whose outcomes are heavily affected by external factors, have found it very difficult to develop meaningful outcome measures. Allowances are made for such external factors in assessing performance information, but there is as yet no systematic approach to incorporating them into the evaluations.

2.3. Setting targets

Performance targets, which are included in performance plans, are set by ministries/agencies. The plans and targets, however, reflect significant input

from the Ministry of Planning and Budget as to whether they are appropriate. In making such judgments, the Ministry uses time-series data and benchmarking against similar cases.

Following an initial self-assessment by ministries/agencies, the Ministry of Planning and Budget makes the final assessment of performance. Throughout the entire process, assessments rely entirely on performance information produced by the ministries/agencies themselves. Lacking a formal process for independent verification, the Ministry tries to ensure the reliability of performance data by penalising wrong or misleading information.

3. Integrating performance information in the budget process

The Ministry of Planning and Budget uses annual performance reports and the SABP in its negotiations with line ministries during the annual budget process. This practice has also encouraged ministries/agencies to use performance information in formulating their budget requests.

The results from the 2005 SABP show a strong correlation with budget requests from ministries/agencies. This means that final budget allocation decisions by the Ministry of Planning and Budget tend to favour programmes with strong performance results. It thus appears that the Ministry's emphasis on performance assessments has resulted in positive feedback between performance information and budget allocation.

So far in the Korean case, the use of performance information in budget decisions has focused on identifying possible savings in order to finance higher priority spending. Specifically, increasing expenditures for welfare programmes has required savings/freezes in other sectors, and the Ministry of Planning and Budget asked ministries/agencies to find room for new or higher priority programmes through savings and reallocations totalling up to 10% of their budgets. Ministries/agencies used performance information heavily in their budget restructuring efforts.

3.1. Budget negotiations: linkage of performance information to budgeting decisions

Performance information is discussed as part of the budget negotiations between the Ministry of Planning and Budget and the spending ministries. These negotiations include discussions on a spending ministry's performance for the previous year; however, targets for the next year are not discussed. The Ministry also encourages ministries to use performance information as they formulate their budget requests, and for restructuring their budget allocations.

As a mechanism for linking performance information to resource allocation, the programme ratings produced by the SABP are used by the Ministry of Planning and Budget to reduce the budgets of ineffective programmes. The budget cut announced by the Ministry was 10%.

On the part of spending ministries, performance information is used to reshuffle budget allocations within ministries/agencies and to justify existing appropriations. Ministries often use performance information to obtain more money, and they also find it to be an effective tool for preventing cuts by the Ministry of Planning and Budget.

Disagreement between the Ministry and ministries/agencies frequently occurs, and the Ministry of Planning and Budget has the final authority in settling differences. In this process, past performance information is the most frequently used rationale for performance targets. Sometimes the performance of another comparable organisation is cited as a benchmark reference.

The budget departments of ministries/agencies use performance information in preparing their budget requests, but it is too early to tell whether the use of the information has had any significant impact on their management system.

In order to help line ministries/agencies develop effective performance information systems and monitor performance, the Ministry of Planning and Budget offers training courses and provides manuals with the help of its research affiliate, the Korea Institute of Public Finance. Korea's performance system has not developed to the stage where recommendations from evaluations go beyond budget allocation to programme management. The Ministry plans to expand the scope of its evaluations to include such recommendations.

3.2. Incentives

The primary mechanism at the disposal of the Ministry of Planning and Budget to encourage ministries/agencies to improve performance is to cut the budgets of ineffective programmes. There are also incentives targeted to individuals, such as staff performance evaluations; promotions are often affected by such evaluations.

While spending ministries often attempt to use performance results to justify the resource level for existing programmes, the Ministry of Planning and Budget mainly considers these results before determining the resource level for a programme. In 2005 for example, the Ministry made significant use of the programme review results (SABP) in resource allocation decisions.

If an agency/ministry does not meet its performance target or receives a poor evaluation, it may be penalised with a budget cut. Apart from budget cuts, there is no penalty on an organisational level, nor are there explicit penalties or incentives that affect senior civil servants directly, despite the fact that they are required to sign performance agreements. However, senior civil servants are quite aware that organisational performance will probably have an impact on their own career prospects.

Not much change has taken place regarding a reduction of input control following the introduction of performance-based budgeting. Because top-down budgeting and performance management were introduced at the same time, in theory this should have significantly reduced input control and delegated more authority to line ministries. However, with top-down and performance budgeting barely out of the inception stages, the Ministry of Planning and Budget still closely supervises budgeting decisions by line ministries. Overall it is still too early to judge the pros and cons of relaxed input control which is being implemented as a feature of top-down budgeting, introduced only in 2005.

So far there is no clear evidence of distorted behaviour resulting from perverse incentives that may arise inadvertently from the new performance system. However, it has been noted that ministries/agencies behave strategically to protect important programmes. For example, they tend to give lower ratings to less important programmes and better ratings to those that they consider important within their programme portfolio.

There is some gaming, goal distortion and presentation of misleading information. For example, ministries/agencies have been known to select performance indicators not because they are good indicators but because they improve the odds of earning a good rating. In an attempt to prevent such behaviour, the Ministry of Planning and Budget issued a warning that in the 2006 SABP, misleading information may result in a major budgetary penalty for the offending ministry. To check the accuracy of performance information, the Ministry will use information from the National Audit Office and the National Assembly.

4. Reporting of performance information

Availability of information about performance is still somewhat limited. For example, the results of the 2005 SABP were provided to the National Assembly as separate supplementary material to the budget documents. Thus the Ministry of Planning and Budget, the ministries/agencies and the legislature use performance information during budget formulation and deliberation. However, such performance information is not yet available to the public. Nor are ministries' performance plans and reports made public.

It is too early to tell how politicians are using performance information, because systematic information was first provided only in 2005. Although the National Audit Office produces information that may, in theory, be used to cross-check the information generated by spending ministries, there is no formal process yet for auditing performance information.

5. Key challenges

The problems encountered so far are predominantly of a technical nature, because Korea is still in the early stages of building a performance system. Political and cultural problems are also observed, especially when it comes to using performance information and improving the system.

The limited technical capacity of ministries/agencies impedes efforts to develop useful performance information. Progress is being made through training programmes to augment technical capacity, but deficiencies in data availability also hinder agencies from producing useful information. It appears that considerable time and effort will be needed to develop good performance measures and data.

For example, the Ministry of Construction and Transportation has found it very difficult to come up with reasonable outcome measures, and as a result uses mostly output measures. Policy-oriented ministries are likewise struggling to identify concrete measures/indices that can link their efforts to outcomes.

Another problem is civil servants' incentives for improving the performance management system. While the motivation for introducing a performance system is often strong, incentives for improving an existing system may be inadequate because the results may not be readily apparent to the public and politicians. In contrast, introducing a new performance system is usually counted as a major achievement.

Cultural challenges are also present. Early on, there was significant resistance/inertia in the civil service which was not accustomed to being evaluated. However, recently it appears that Korean civil servants are coming to accept result-oriented performance management as a normal part of bureaucratic culture.

Korea's civil service also faces institutional challenges. Civil servants rotate through different assignments on a regular basis. This practice allows them to accumulate general knowledge and skills, and also helps to circumvent opportunities for corruption. However, a clear negative consequence is that the practice tends to work against civil servants' gaining expertise in any specialty, including performance management.

Another problem is the existence of too many fragmented evaluation systems. Not counting a myriad of small systems, there are four major evaluation systems, each operated by a different ministry/agency. As a result, line ministries/agencies are voicing complaints about the redundant administrative burden these impose.

6. Solutions

The Ministry of Planning and Budget, with the Korea Institute of Public Finance, has recently set up a task force and established training programmes to address the problems mentioned above. Currently a manual is being compiled on how to develop performance information, which should help disseminate a standardised framework for performance evaluations.

In overcoming the initial bureaucratic resistance, the president's leadership has greatly helped give the necessary impetus to introducing the performance management system. The strong link enforced by the Ministry of Planning and Budget between performance information and budget allocations has also acted as additional motivation for ministries/agencies to invest in improving the quality of their performance information. The concurrent effort by the Ministry to provide workshops and training courses for ministries/agencies helped them build their capacity for defining and producing meaningful performance information.

On the issue of gaming, there is no explicit mechanism for dealing with the problem. How specific instances of gaming are resolved is entirely up to the Ministry of Planning and Budget and the agency budget departments.

7. Lessons learned and impact

At present, Korea is in the initial stages of implementing performance-based budgeting; it is therefore too early to form an assessment. However, it should be noted that having introduced performance-based budgeting as one component within a broader range of comprehensive reforms has helped to lower resistance and resolve institutional problems. At the same time, concerns have been raised that the concurrent implementation of multiple major reforms in itself imposes an inappropriately heavy burden on the government.

Overall, performance information has had a positive impact on the budgeting process. As regards the impact of performance information on ministry/agency performance, it is too early to tell.

Despite Korea's meagre experience time-wise in introducing performance budgeting, some general lessons can be drawn. Reorganising ministries/agencies and the budget structure needs to be done before introducing the performance system. In Korea, performance information is focused on individual programmes/projects, but cost information is not readily available because organisational units, programmes, and the budget structure need to be realigned so that they are consistent with each other. As a result, it has been extremely difficult to develop meaningful outcome measures and efficiency/effectiveness measures.

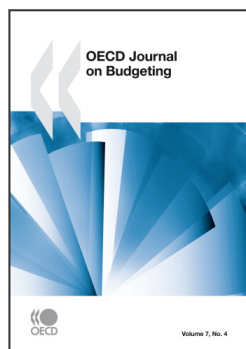
Korea's short experience has also shown that, in introducing the performance system, decision makers should be patient about reaping any benefits. There is a concern that decision makers in Korea may be more interested in introducing the performance system than in monitoring or improving it. If a particular country is accustomed to getting quick returns from the reforms, it will not be easy to develop and improve the system.

The political and administrative culture of Korea poses some idiosyncratic challenges that other countries hopefully need not consider. Regular rotation of assignments in the civil service may work against the capacity development of ministries/agencies. Lack of patience on the part of decision makers may force the Ministry of Planning and Budget to take ill-advised or excessive measures in order to show quick results. It was partly because of this kind of pressure that the Ministry felt forced to quickly implement a 10% budget cut for ineffective programmes.

Korea's experience confirms that a performance system evolves over time and raises different challenges at each stage. At the initial stage, merely developing relevant information is the main challenge. As the performance system evolves, other changes become more important, namely behavioural change, such as how to get various actors to use performance information in the decision-making process, and how to monitor the performance of the performance system itself.

The lessons from the Korean experience can be summed up as follows. Make sure the infrastructure is ready for the reforms. Proper cost accounting and a solid programme budget structure will help greatly to maximise the benefits of the performance system. There should be proper understanding of performance-based budgeting among civil servants. Otherwise, wasteful and distorting behaviour may proliferate.

Looking forward, the major ongoing problem for Korea is the quality of performance information. More training and research is needed, along with a greater commitment to invest in collecting and organising the information. Specifically, the analytical and administrative capacities of the Ministry of Planning and Budget and ministries/agencies need to improve. This may require reinforcement of units specialising in evaluation in both the Ministry and ministries/agencies.



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