Budgetary responses to COVID-19: the case of South Korea

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Abstract

Purpose – This paper presents the details, circumstances and issues relating to Korea’s budgetary responses to COVID-19.

Design/methodology/approach – The author analyzes the details and consequences of budget responses to COVID-19 of Korea.

Findings – Korea has implemented two supplementary budgets, worth 50 tn KRW, which were approved by the National Parliament within an average of 13 days. This was an exceptionally quick approval by the Parliament. While these prompt actions help the government provide necessary measures to combat the pandemic, hasty decisions may have long-term consequences on fiscal soundness. Effective handling of COVID-19 in Korea increased the approval rating for the current administration.

Originality/value – This is consistent with the argument by Bartels (2013) who states that ordinary citizens assess politicians and policies primarily on the basis of visible evidence of success or failure. Because evaluations on government projects other than handling crisis is out of people’s interests during pandemic, inefficient projects tend to be maintained. For future, it is desirable to have a fiscal rule beforehand to address a crisis.

Keywords Budget, Crisis, Fiscal soundness

Paper type Research paper

Introduction

The first confirmed case of COVID-19 in South Korea was reported on January 20, 2020, and since then new cases have continued to emerge. After Korea’s 31st patient was reported in Daegu on February 18, the number of cases increased exponentially. The Korean government actively tested and monitored patients as well as those who had contact with them. With the efforts of the government and individual citizens, the situation has been contained and new confirmed cases per day have decreased significantly since May 2020.

As is the case for all other countries affected by the virus, the health crisis brought on by COVID-19 has evolved into an economic crisis in Korea. In response to this, the Korean government has utilized reserve funds and supplementary budgets, totaling over 50 tn KRW, to enact emergency economic policies.

The supplementary budgets were approved by the Parliament with an exceptionally quick review. The prompt use of supplementary budgets, however, aroused questions about the costs of the timely response to the crisis. With two supplementary budgets that have already been approved, the debt-to-GDP ratio is expected to increase to over 43% by the end of 2020 – the highest ever recorded. This paper presents the details, circumstances and issues relating to Korea’s budgetary responses to COVID-19.

Budgetary response to crisis

Several studies have investigated emergency government expenditures in Asia. Jha et al. (2014) examined ten emerging Asian countries to assess whether countercyclical fiscal policy can support future growth in a given region. They found that tax cuts have a greater countercyclical impact on output than government spending. Kalinowski (2015) found that East Asian fiscal stimulus packages were more supply-oriented compared to their
Western counterparts. He also found that East Asian countries reinforced industrial policies and supported investment and international competitiveness. Similarly, the Korean government has previously implemented supplementary budgets focusing on industrial policies as a response to crises. However, it has also overused supplementary budgets to achieve political goals. Hence, the National Finance Act (hereafter the Act) was enacted to define the condition for supplementary budgets [1]. Article 89 of the Act states that the government may formulate any supplementary revised budget bill if one of the following events occurs: a war or large-scale disaster; a significant change in circumstances at home or abroad, such as an economic recession, mass unemployment, or change in inter-Korean relations; an occurrence or increase of expenditure the state is obligated to pay pursuant to statutes. In addition, the government shall not allocate or execute the supplementary revised budget before the budget bill is approved by the National Parliament. Hence, even in an emergency, budget expenditure is only possible upon Parliament approval.

The Parliament approved the government’s supplementary budget proposal of 11.7 tn KRW (10.0 bn USD) on March 17, 2020 to combat the impact of COVID-19 on public health and the national economy. The funds is supposed to be used to prevent and treat COVID-19, support affected businesses through loans and guarantees, and assist affected households. At the time, this supplementary budget was the largest in Korean history. Funding will also support local economies, including that of Daegu city where confirmed cases are most highly concentrated. The details of the supplementary budget are as follows: 4.1 tn KRW (3.5 bn USD) to support microbusinesses and small-medium enterprises, 3.5 tn KRW (3.0 bn USD) to stabilize employment and individual livelihoods, 2.1 tn KRW (1.8 bn USD) to strengthen quarantine and disease control systems, 1.2 tn KRW (1.0 bn USD) to revitalize local economies and businesses, and 1.7 tn KRW (1.5 bn USD) to help Daegu and its neighboring provinces.

Right after the historic first supplementary budget, the 2nd supplementary budget worth 12.2 tn KRW was passed at the National Parliament on April 30, 2020. The supplementary budget was meant to finance the household emergency relief program of up to 1 m KRW per household. A total of 14.3 tn KRW, which includes local government funds totaling 1.2 tn KRW, will be spent on the relief program.

**Timeliness and frequency of supplementary budgets during COVID-19**

As stated by the Act, the government had to get the supplementary budgets approved before it could financially respond to COVID-19. In general, getting supplementary budgets approved is a long and tiring process for the government. It takes a long time for the government and the ruling party to persuade opposition parties to agree on the proposed supplementary budget. However, supplementary budgets for COVID-19 were different. The average time necessary to pass supplementary budget in the Parliament has been 48 days for the past 10 years. However, with the COVID-19 outbreak and the economic crisis that followed, opposition parties had few grounds on which to deny the supplementary budget proposals. Therefore, the supplementary budgets for COVID-19 response were approved by the Parliament in a much shorter period of time. As shown in Table 1, the two supplementary budgets in 2020 were passed after 12 and 14 days, respectively. This is in contrast to previous supplementary budgets, some of which took over 90 days to get approved.

There are several reasons for this timely passage of supplementary budgets. First, the pandemic was far-reaching and the people affected required a timely response. The demand for a supplementary budget was greater because COVID-19 is a potentially life-threatening health disease. Second, the approval ratings for the ruling party was high, which served as an impetus for the Parliament to pass the budget. Many studies have investigated state or municipal
responses to economic downturns or recessions (Darvas, 2010; Sacco and Buscheé, 2013; Campbell and Sances, 2013; Cary and Bush, 2018). Poterba (1994) demonstrated that, facing economic downturn and fiscal crises, state fiscal institutions adjust to address budget deficits. He also showed that adjustment is more rapid when a single party controls the state house. This suggests that a government with higher approval ratings will have a quicker fiscal adjustment. President Moon Jae-in’s approval ratings were as high as 57% when the supplementary budgets were passed. Third, budget responses from other countries also affected the passage of the budgets in Korea. The budget responses of the US and Europe spurred the Korean government and Parliament to implement supplementary budgets in a timely manner. Thanks to the Internet, Korean citizens and the members of Parliament were instantly informed of the actions of foreign countries, which affected COVID-19 policies in Korea.

The frequency of supplementary budget approval during COVID-19 is also unique. There have been several cases in Korea of two supplementary budgets being approved in a given year. However, the interval between the two COVID-19 supplementary budgets, 44 days, is still considered to be extremely short. The first supplementary budget was for policies which both the ruling party and opposition parties agreed upon, and the second supplementary budget was for policies the two disagreed upon. This helped the government implement urgent policies to address pandemic without delay. Later, the government included less urgent policies in the second supplementary budget proposal. This two-track approach was possible because the government was confident that the opposition party had no choice but to agree on the second budget request due to the urgency of the crisis. In fact, the government has since then prepared a third supplementary budget bill of approximately 36 tn KRW. If realized, it will be the first time since 1972 that Korea has had three supplementary budgets approved in a single year [2]. With the two extra budget bills, the government deficit is already expected to increase to 89.4 tn KRW in 2020. The third supplementary budget will make the deficit even worse, possibly over 112 tn KRW, which is 5.8% of Korea’s GDP.

Considerations of fiscal soundness in the fiscal response to pandemic
In the past, one of the most important considerations in determining supplementary budgets was fiscal soundness. Recently, Korea’s national debt has increased rapidly, inviting debate on whether it is necessary to set a limit on the permissible amount of national debt. A 40% debt-to-GDP ratio has been the implicit limit. However, this unprecedented crisis has made this 40% rule irrelevant. Traditionally, the Ministry of Economy and Finance (MOEF), Korea’s budgeting agency, functioned as a gatekeeper in maintaining fiscal soundness. In the
early discussion on supplementary budgets for COVID-19, MOEF tried to lower the size of deficit by minimizing spending. The minister originally planned to provide emergency relief handouts to households that rank in the bottom 70% of gross income but changed the plan to provide the handouts to every household [3]. This change was due to pressure from both from the ruling party and the opposition parties. Opposition parties rarely request higher expenditures because a high expenditure is seen as beneficial to the ruling party and the government. However, with the COVID-19 outbreak, rival parties pledged to give relief handouts to all citizens. To finance the relief handout fund, all parties agreed to allow the government to issue deficit-covering bonds worth 3.4 tn KRW. Speedy budgetary response comes at a price. Hasty decisions on budgets without necessary deliberations produced an unprecedented number of projects being included in the supplementary budgets without the proper removal of unnecessary projects, which led to an inefficient use of funds [4]. During crises, such as the Great Recession, the needs of the poor increased at the same time that the ability and willingness to pay for entitlement spending deteriorated (Rubin, 2014). This phenomenon is expected to occur in Korea as well. Korea has maintained fiscal soundness so far, but it seems inevitable that fiscal soundness will deteriorate at a much higher speed as the pandemic continues.

Although Korea’s national debt has increased over the years, the 40% debt-to-GDP ratio was maintained until 2019, as shown in Table 2. The projection for the debt ratio by the end of 2020, which the government had announced before the implementation of supplementary budgets, was 39.8%. However, with the already-approved two supplementary budgets and the expected additional supplementary budget of 35.3 tn KRW, the national debt is expected to increase to 840.2 tn KRW by the end of 2020, which means that the debt-to-GDP ratio will be over 43%. The implicit fiscal rule of 40% debt-to-GDP ratio has collapsed due to the urgent nature of the pandemic. In addition, the highest yearly growth rate of the debt-to-GDP ratio in the last ten years was 6.1%. With two supplementary budgets, the growth rate in 2020 will be 14.2%. Considering the downward rigidity of the budget, fiscal conditions in Korea are expected to worsen in the near future. Even though the budgetary response to the pandemic was necessary to prevent short term economic damage, the current magnitude of fiscal expansion will expedite the deterioration of fiscal soundness of Korea for two reasons. First, the 40% debt-to-GDP rule has been breached, and the growth rate of the debt-to-GDP ratio is unusually high. Prior to the pandemic, the government has maintained a 40% debt-to-GDP ratio, but now there is no ceiling for the debt-to-GDP ratio. Second, universal welfare was adopted in the two supplementary budgets without citizen consensus. The urgency of the supplementary budgets overrode the long debate of universal vs. selective welfare. Hence, it is likely more universal welfare policies will be enacted in the future, which may also exacerbate the fiscal soundness of Korea [5].

Efficient allocation of public funds during the pandemic
The question is whether a budget formulated in a state of crisis is efficient. Timely fiscal response is important in addressing a crisis. However, when the public is overwhelmed by the media, budget distribution is likely to be distorted if it is determined by politicians who are motivated to satisfy the urgent needs of the public. According to Kuran and Sunstein (1998), for resources to be distributed efficiently, it is necessary to adopt a mechanism that isolates decision-makers from public pressure so that fair professionals can make rational budget decisions. Politicians, by nature, cannot ignore the public’s demands. Therefore, it is best to leave the distribution of public resources to unbiased administrators.

Korea’s general election was scheduled to be held on April 15, 2020, at height of the pandemic. The first supplementary budget was passed on March 17, 2020, a month before the general election. Even when it came to this supplementary budget, politicians from both parties tried to allocate resources to their own districts in an attempt to gain votes by
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<td>443.1</td>
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<td>17.0</td>
<td>5.8</td>
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<td>-0.2</td>
<td>16.9</td>
<td>24</td>
<td>31.2</td>
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<td>Consolidated fiscal balance without funds</td>
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<td>-13.5</td>
<td>-17.4</td>
<td>-21.1</td>
<td>-29.5</td>
<td>-38</td>
<td>-22.7</td>
<td>-18.5</td>
<td>-10.6</td>
<td>-54.4</td>
<td>-112.2</td>
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satisfying local demand (Kim, 2019). Without legal support or hard fiscal rules, the Minister of Economy and Finance, who is supposed to ensure long-term fiscal soundness, failed to resist the political pressure.

Fiscal rules need to be established prior to a crisis, so that when a crisis does occur, emergency funds can be distributed rationally, free from public pressure. Kuran and Sunstein (1998) argued that public officials should be protected from the public and have easy access to objective data so that decisions can be made based on objective facts rather than emotions [6].

Fiscal expenditure is expected to increase rapidly due to the growing demand for social security in Korea. In addition, Korea is one of the world’s fastest aging countries. Although debt-to-GDP of Korea is low compared to that of most OECD countries, the average growth rate of national debt in Korea from 2000 to 2015 is 12%, which is higher than the OECD average, which is 7.5%. Hence, it would be desirable to establish a debt rule once fiscal expenditure and structural change of population are stabilized in Korea. However, for the time being, it is more effective to have an expenditure rule or budget balance rule.

**Budget responses from local governments**
In response to the crisis, the speed at which people receive necessary supports becomes an indicator of a politician’s capability. Governors and mayors are participating in this race to prove their capabilities. In the past, local governments have typically waited to see what kinds of supports will be provided to their area by the federal government, simply filling up the gap if necessary. However, in the time of COVID-19, local governments have been proactive in providing financial aids to citizens even before decisions were made by the federal government. The nature of local emergency handouts varied depending on a mayor’s political preferences or a local government’s fiscal situation. Some cities provided handouts to every household while others provided handouts to only the bottom-something percent of citizens.

Donahue and Joyce (2001) recommend that the federal government should progress from response and recovery to mitigation in emergency management. They argue that response and recovery are within the functional domain of local governments, while the federal government is most effective for mitigation, since it rests heavily on research, development and technical expertise that should be made broadly available. During COVID-19, there were no clear guidelines or rules on how to divide roles between the federal and local governments, which led to overlapping and inefficient budget responses such as emergency handouts.

**Political implications from budget response to pandemic**
During an election year, a supplementary budget is seldom approved by the Parliament because supplementary budgets are believed to benefit the ruling party. COVID-19 caused an exception. Contrary to their prior position on universal provision, the opposition parties were the ones to pledge emergency handouts for everyone rather than the bottom 70%. All parties promised to pass the second supplementary budget during the campaign for the general election, which was held on April 15, 2020.

During a crisis, political judgment tends to be made solely based on how the government handles the crisis [7]. Bartels (2013) argued that ordinary citizens assess politicians and policies primarily based on visible evidence of success or failure [8]. During a pandemic, the most visible evidence of success is the containment of confirmed cases and death toll reduction. The performances of other policies are likely to be ignored. In other words, the pandemic is the public’s highest priority. This phenomenon normally works in favor of the current administration, and thus the ruling party, if the crisis is handled successfully. Indeed, the current administration’s approval rating was falling prior to COVID-19, but the effective handling of the pandemic raised the approval rating, which then led to a landslide win in the general election.
When the first case of COVID-19 was confirmed in the third week of January, the president’s approval rating was 46.3%, while the disapproval rating was 46%. In the fourth week of February, the number of confirmed cases peaked at over 800, and the disapproval rating increased to 51% accordingly. However, by the end of March, the number of confirmed cases dropped below 100, and by April 6 that number had dropped below 50. This dramatic decrease in the number of confirmed cases coincided with the abrupt increase in the approval rating as shown in Figure 1.

The shift of political power in favor of the ruling party in times of crisis has been previously observed in other countries. In times of crisis, people tend to judge politicians based only on emergency response rather than a multi-dimensional evaluation of various policies. This leads to risk management becoming the most important criterion politicians must meet to maintain or be voted into office.

The public tendency to make emotional judgments based on fragmentary data in a crisis, as opposed to rational judgments based on comprehensive data, may harm government efficiency in the long run and support the principle of big rather than small government. In addition, it is possible for political leaders to use this opportunity to directly control the public sector and centralize the decision process, leading to the emergence of an authoritarian government (Peters, 2011).

Conclusions
Fiscal challenges caused by a pandemic, such as that of COVID-19, are unique in the sense that the crisis brought on by a pandemic affects a much wider area and a larger number of people compared to other crises. An effective budget response to a pandemic is critical in two ways. First, urgent public expenditure to enforce quarantine is key to controlling the spread of a pandemic. Second, the economic crisis caused by a pandemic can be overcome by timely government spending. Korea’s fiscal reserve is large enough to increase government expenditure without significantly compromising fiscal soundness. While average general government debt-to-GDP ratio for OECD countries is 109.2% as of 2018, Korea’s debt-to-GDP ratio was 40.1%. There is, however, a growing concern for the future of fiscal soundness in
Korea, especially because of the irreversibility of extraordinary emergency spending due to political reasons and the downward rigidity of public expenditure.

Supplementary budgets are by nature urgently determined. This suggests that deliberations on fiscal soundness and effectiveness may not always be feasible. Korea has handled the COVID-19 pandemic with a relative success. Although the budget responses to the economic crisis incurred by pandemic were timely and historic in size, the long-term consequences of the responses are not clear in terms of fiscal soundness and effectiveness. The Korean government should learn from this pandemic and establish fiscal rules and specific plans to properly address future pandemics.

Notes
2. In 1972, President Park declared the martial law as an attempt to extend his presidency and had three supplementary budgets to boost economy.
3. Besley (1990) illustrates the trade-off from that the fact that means testing is costly to both the government and the claimant in terms of transaction and monitoring costs, while universal provision entails a leakage to the non-poor.
4. A project of KRW 7.7 bn to fix temples is an example of inefficient and unnecessary projects. This project had no relationship with pandemic or an economic crisis but was proposed by a Buddhist congressman to be included in the supplementary budget for COVID-19.
5. Besley (1990) argues that universal welfare might win on efficiency grounds and are more politically popular than means testing.
6. Kuran and Sunstein (1998) also point out that political judgment should be based on both people’s values and facts.

References


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