

5. Fiscal Decentralization in Korea: Challenges and Policy Implications ¹

Fiscal decentralization in Korea is characterized by independently managed central and local finances that are nonetheless closely interconnected through sizeable intergovernmental transfers. After consolidating these transfers, local governments ultimately execute nearly half of total public spending, making the effectiveness and efficiency of local fiscal management a critical element of overall fiscal performance. This Selected Issue reviews central–local shares in revenue, expenditure, and sectoral allocation; identifies challenges in local fiscal planning and execution; and outlines policy implications to improve the strategic allocation and performance of local public finances.

Relationship Between Central Local Finances

1. In Korea, although central and local government finances are operated independently, they are closely interconnected through intergovernmental transfers (Figure A5.1). Local governments and local education authorities manage their fiscal policies and operations independently under the principle of local autonomy, as stipulated by the Constitution. Intergovernmental transfers—comprising the local allotment tax, local education grant, and national subsidies to local governments—serve as key channels linking central and local finances.² Meanwhile, metropolitan/provincial governments also make transfers to the corresponding provincial/metropolitan education offices within the same jurisdiction.³

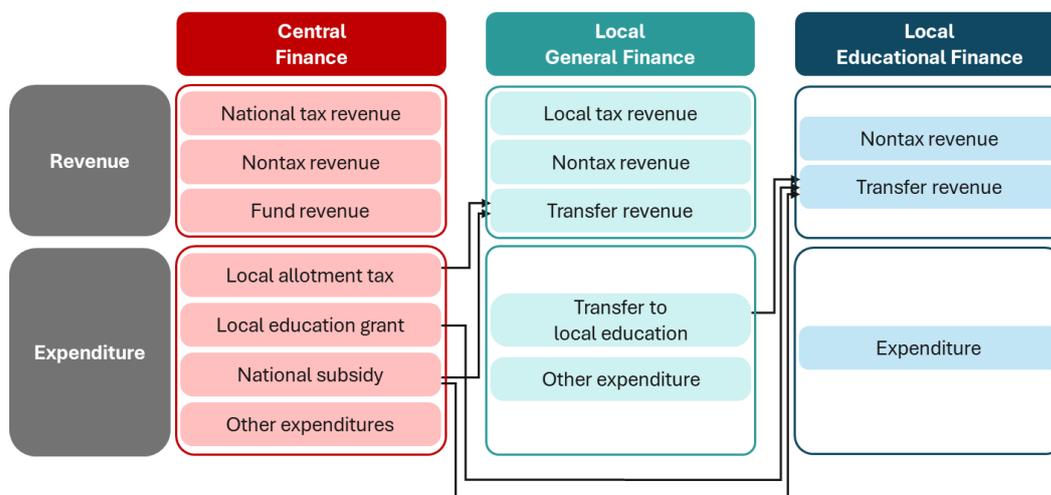
- Local allotment tax is a central government transfer to local governments aimed at guaranteeing local fiscal resources and alleviating fiscal imbalances. It consists of 19.24 percent of the total domestic tax revenue of the corresponding fiscal year, the entire comprehensive real estate tax revenue, and 45 percent of the excise tax levied on tobacco.
- Local education grant is a central government transfer intended to support the establishment and operation of educational institutions and education administrative bodies, promoting balanced educational development across regions. It is funded by 20.79 percent of the total domestic tax revenue and a portion of the education tax.
- National subsidies to local governments are transfers provided to support nationally mandated functions and policy-priority projects or to deliver fiscal assistance. These subsidies are tied to specific purposes and conditions, and must be spent exclusively on predefined projects, generally requiring matching funds from local governments.
- Transfers from local governments to education offices are local statutory and non-statutory contributions intended to partially finance provincial education and academic affairs using resources from the local general account. These transfers are funded by sources such as local education tax, tobacco consumption tax, and other provincial and metropolitan tax revenues.

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² In addition, the Local Extinction Response Fund, which provides support to regions experiencing population decline, was introduced in 2022.

³ Beyond the horizontal transfer from metropolitan/provincial governments to their corresponding education offices, fiscal transfers among local governments include vertical transfers whereby metropolitan/provincial governments support municipal and district governments through adjustment grants and provincial/municipal subsidies. Furthermore, to address horizontal fiscal disparities among local governments at the same administrative tier, the Regional Coexistence and Development Fund was established in 2010.

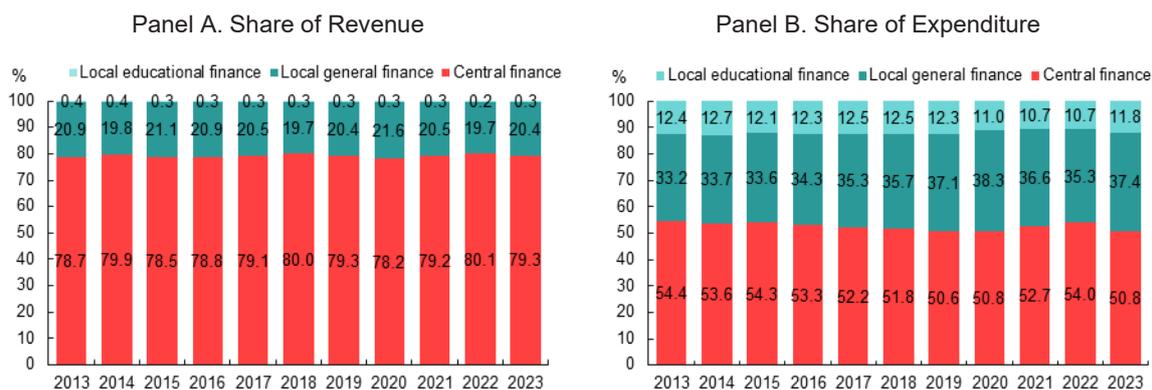
Figure A5.1. Relationship Between Central and Local Finances



Source: Ministry of Economy and Finance; Ministry of Interior and Security; Ministry of Education; AMRO staff illustration

2. Korea’s fiscal revenues rely heavily on the central government, whereas fiscal spending is split more evenly between central and local authorities. Based on the 2023 final settlement, the shares of consolidated fiscal revenue—adjusted for intergovernmental transfers and classified by the authority that actually collects the revenue—stood at central finance : local general finance : local education finance = 79.3: 20.4: 0.3 percent. Meanwhile, the shares of consolidated fiscal expenditure—also adjusted for intergovernmental transfers and classified by the authority that ultimately executes the spending—were 50.8 : 37.4 : 11.8 percent, respectively (Figure A5.2). Given the large share of consolidated expenditure ultimately executed by local governments, it is critical to assess the allocative and technical efficiency of local fiscal spending.

Figure A5.2. Shares of Central and Local Governments in Consolidated Revenue and Expenditure



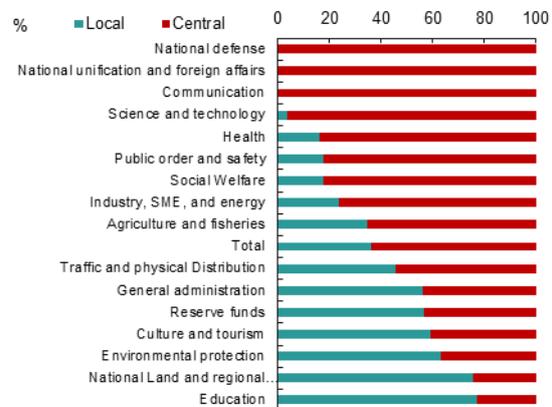
Source: Ministry of Economy and Finance; Ministry of Interior and Security; Ministry of Education; AMRO staff estimates

Note: 1) Data are based on the settlement; 2) Consolidation of central and local government revenue and expenditure follows AMRO staff estimates: (i) Transfers from the central to local governments are excluded from central finance expenditure and local general finance revenue; (ii) Transfers from the central government to local education are excluded from central finance expenditure and local education finance revenue; (iii) Transfers from local general finance to local education finance are excluded from local general finance expenditure and local education finance revenue.

Sectoral Resource Allocation

3. The distribution of consolidated fiscal expenditure across the 16 major functional program areas broadly aligns with Korea’s central–local functional assignment structure (Figure A5.3). Aside from functions that are exclusively national—such as defense, foreign affairs and unification, and communications—most expenditure areas are shared between the central and local governments, with relative shares reflecting the characteristics of each function. Education, regional development, environment, and culture and tourism are primarily delivered by local governments, while science and technology, social welfare, health, public order and safety, and industry, SMEs and energy are largely managed by the central government in line with national priorities. Transport and logistics, agriculture–forestry–fisheries, and general administration are joint responsibilities, financed and implemented by both levels of government.

Figure A5.3. Shares of Central and Local Finances in Sectoral Expenditure, 2025 Budget



Source: Ministry of Economy and Finance; Ministry of Interior and Security; Ministry of Education; AMRO staff estimates
 Note: 1) Data are based on the initial budgets; 2) Sectoral classification of expenditure is based on 16 sectors adopted by the Korean authorities; 3) Sectoral expenditures are estimated by AMRO staff: (i) Local allotment tax is excluded from general administration of central finance; (ii) Local education grant is excluded from education of central finance; (iii) Transfers from local general finance to local education finance are excluded to avoid double-counting; (iv) National subsidies are excluded from each sectoral expenditure of local governments, with only the portion funded by local governments included; 4) Estimated shares may be subject to inaccuracies due to discrepancies between central and local initial budgets for the same items.

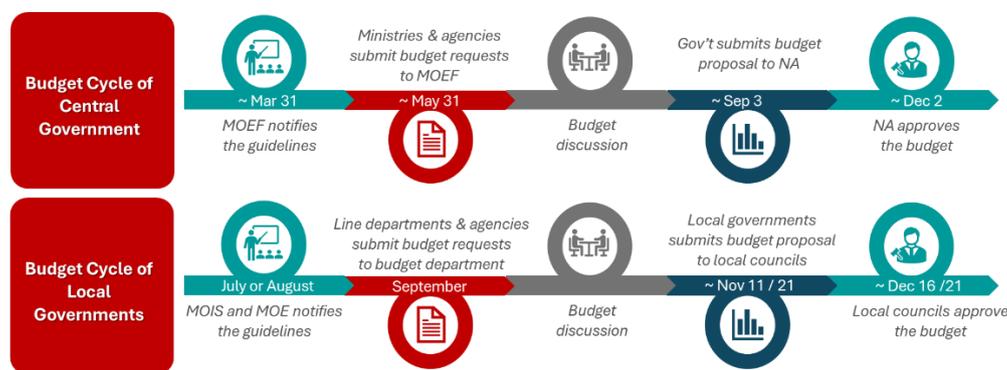
4. The discussion on nation-wide sectoral resource allocation strategy is insufficient, and the matching rates for national subsidy projects remain unclear. The central government’s sectoral resource allocation is generally discussed at the National Fiscal Strategy Meeting chaired by the President, and medium-term strategic priorities and sectoral resource allocation directions are set in the NFMP. Local governments determine their sectoral resource allocation independently through their medium-term local fiscal plans, although national subsidies create a de facto linkage by influencing local spending choices. However, a comprehensive national-level sectoral allocation discussion under a consolidated fiscal framework—integrating central and local fiscal plans—is insufficient. In addition, while national subsidy projects require cost-sharing between the central and local governments, only 121 out of more than 1,300 national subsidy projects have legally mandated standard subsidy rates explicitly defined in legislation. For the remainder, rates are set case-by-case under individual laws or determined during annual budget formulation and parliamentary deliberations, resulting in low transparency and limited ex-ante predictability.

Fiscal Planning of Local Governments

5. The budgeting process of local governments is shorter than the central government and often delayed. The central government budget formulation involves (i) issuance of budget guidelines followed by line ministries/ agencies preparing and submitting budget requests (≈2 months); (ii) budget negotiations and reviews between the budget authority and line ministries/agencies to finalize the government budget proposal (≈3 months);

and (iii) deliberation and approval by the National Assembly (≈3 months). Local governments follow procedurally similar stages with functional counterparts—line departments (equivalent to ministries/agencies), budget departments (equivalent to the central budget authority), and local councils (equivalent to the National Assembly). Yet, local formulation phases are typically compressed to ≈1 month per stage, a period that, even accounting for smaller budget sizes, is often insufficient for comprehensive reviews and deliberation (Figure A5.4). This compression reflects the reality that local budgets remain highly dependent on central transfers, including block grants and national subsidies, forcing local governments to sequentially trail the central schedule. As a result, local budget approvals are often delayed beyond the fiscal year, and local provisional budget mechanisms have been activated repeatedly, unlike at the central level where such arrangements have never been used.

Figure A5.4. Budget Cycles of Central and Local Governments



Source: Ministry of Economy and Finance; Ministry of Interior and Security; Ministry of Education; AMRO staff illustration

6. Supplementary budgets are formulated frequently in local governments. This is partly unavoidable due to misalignment of central and local budgeting cycles. Cycle mismatches produce gaps between the transfer amounts the central government records as expenditure and the transfer revenues local governments record in their budgets, requiring ex-post corrections through supplementary budgeting. In practice, the National Assembly frequently approves the central budget after the statutory deadline, creating significant uncertainty for local budget planning, which depends heavily on intergovernmental transfers. In addressing the cycle mismatches, local block transfers—including the local allotment tax and local education grant—are provisionally disbursed at around 90–95% of expected amounts before central budget approval, with the remainder to be transferred after approval. This sequential settlement mechanism inevitably leads to multiple supplementary budget rounds. Other key reasons for supplementary budgets include (i) realization of net budget surplus, (ii) ex-post settlement of increases in central transfers from the prior year, (iii) unexpected revenue sources, and (iv) in-year program adjustments during execution. While supplementary budgets offer fiscal flexibility, frequent revisions raise concerns over transparency, allocative efficiency, planning credibility, and spending discipline, potentially weakening the consistency and reliability of local fiscal plans.

Budget Execution of Local Governments

7. The budget execution of local governments tends to be weaker than that of the central government. Local governments' execution rates have consistently underperformed those of the central government, with an average gap of around 10 percentage points over

the past decade (Figure A5.5).⁴ The relatively low execution rates reflect larger carry-overs and unused appropriations in both local governments and local education offices (Figure A5.6). Weak disbursement capacity is particularly pronounced among municipal and district governments, as evidenced by excessive carry-overs and unused appropriations, although performance varies widely across entities (Figures A5.7 and A5.8). In 2023, their execution rates ranged from 66.8 to 88.9 percent, while carry-over ratios ranged from 4.0 to 25.7 percent and unused appropriation ratios from 2.2 to 17.2 percent.

Figure A5.5. Budget Execution Rates of Central Local Governments

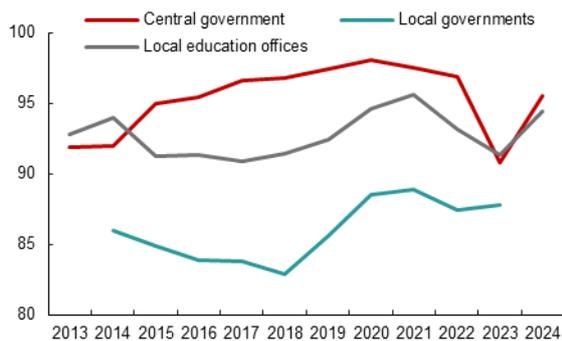
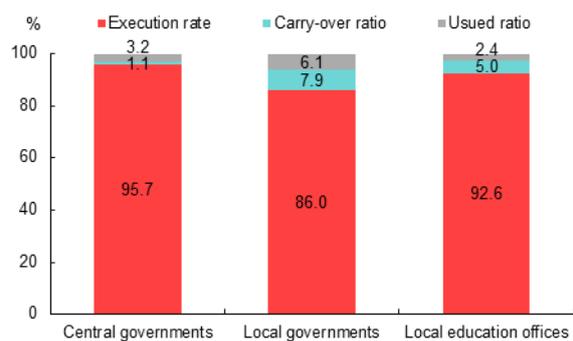


Figure A5.6. Execution Rates, Carry-over Ratios, and Unused Ratios: 2014–2023 Average



Source: Ministry of Economy and Finance; Ministry of Interior and Security; Ministry of Education; AMRO staff estimates

Note: 1) On a gross basis, including all internal transactions; 2) The execution rate is the share of actual disbursement relative to the total authorized budget (the sum of the approved budget and the carry-over from the previous year); 3) The carry-over ratio is the share of the amount carried over to the following year relative to the total authorized budget; 4) The unused ratio is the share of unused appropriations relative to the total authorized budget, where unused appropriations are calculated by subtracting disbursement and the following year's carry-over from the total authorized budget.

Figure A5.7. Execution Rate and Carry-over Ratio of Individual Local Governments, 2023

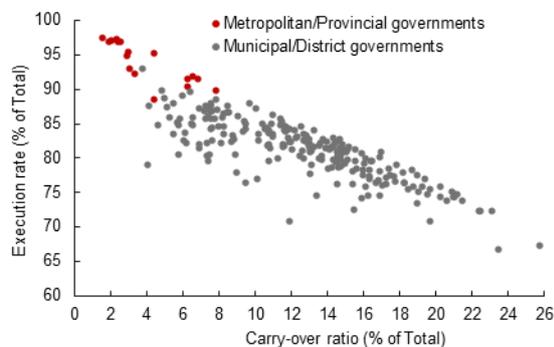
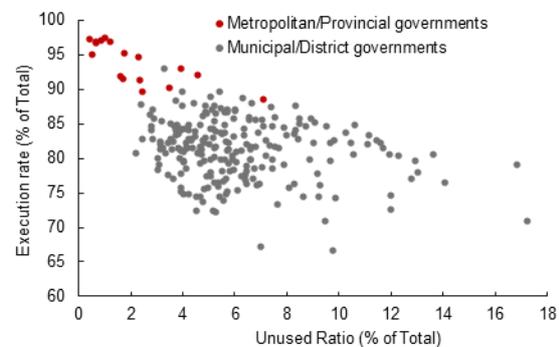


Figure A5.8. Execution Rate and Unused Ratio of Individual Local Governments, 2023



Source: Ministry of Economy and Finance; Ministry of Interior and Security; Ministry of Education; AMRO staff estimates

8. Limited planning and implementation capacity—combined with the frequent use of supplementary budgets—constrains the timely execution of fiscal spending, thereby reducing the effectiveness and efficiency of fiscal policy. Anecdotal evidence also highlights structural weaknesses, including mismatches between budgeting and project readiness and inefficient planning practices. For instance, in national subsidy projects, local governments are sometimes required to appropriate budgets before completing pre-implementation procedures, leading to projects that cannot begin and are automatically carried over. In other cases, although funds should be appropriated in stages, local councils

⁴ Execution rates in 2023 declined markedly as unused appropriations were intentionally increased—including reductions in transfers to local governments and education—in response to sizable revenue shortfalls relative to the budget.

may demand full-amount appropriations upfront, creating misalignment between project execution timelines and budget management.

Policy Discussions

9. Mechanisms to better align local public resource allocation with national priorities should be strengthened. Given the increasingly complex policy environment and the growing role of local governments in executing public spending, a clearer division of responsibilities between the central and local governments is essential. One option is to institutionalize a nationwide strategic resource allocation discussion—covering consolidated expenditure that integrates both central and local finances—within the National Fiscal Strategy Meeting, with the participation of representatives of local governments. Such a platform would help coordinate sectoral priorities, reduce fragmentation, and ensure that local spending decisions reflect national strategies. In parallel, discussions on balanced regional development, taking into account each region’s endowments and strategic direction, could be anchored within a broader national priority-setting framework to enhance policy coherence across levels of government. In addition, presetting cost-sharing ratios (matching rates) for national subsidy projects based on project characteristics would improve accountability, transparency, and predictability in fiscal management at both the central and local levels.⁵

10. The budgeting processes of the central and local governments should be better synchronized to reduce the need for frequent supplementary budgets and to allow sufficient lead time for planning and implementation. Although local budgets inevitably follow the central budget cycle due to their heavy reliance on intergovernmental transfers, there remains room to enhance coordination and predictability. For example, because block grants—the local allotment tax and local education grant—change only marginally during government budget formulation and parliamentary deliberation, the central government could communicate preliminary block grant totals to MOIS and MOE earlier in the budget cycle. These agencies could then begin allocating funds across local governments in advance, with minor adjustments made later once the central budget is finalized. Such an approach would reduce sequential delays, improve planning certainty, and contribute to more efficient and timely local budget formulation.

11. Strengthening the planning and spending capacity of local governments—particularly at the municipal and district levels—is critical for improving fiscal management and timely budget execution. Priority should be placed on enhancing performance management systems, ensuring that evaluations from project implementation and execution outcomes, including execution timeliness, are incorporated systematically into the following year’s budget formulation. Improving the feedback loop between performance results and budget decisions would help reduce structural bottlenecks that contribute to low execution rates, excessive carry-overs, and inefficient project sequencing. Capacity building efforts, supported by the central ministries and specialized institutions in local public finance, can further equip local officials with the skills required for project appraisal, procurement planning, monitoring, and execution management. Strengthening these capabilities would

⁵ For example, preset cost-sharing ratios between the central and local governments for national subsidy projects could broadly reflect the existing central-local expenditure shares by function or sector, as illustrated in Figure A5.3.

enhance the credibility and effectiveness of local fiscal operations and contribute to more efficient service delivery.