

## A Study on the Estimation Method for the Subsidy Rate for National Subsidies in Social Welfare

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### Summary

A national subsidy measurement standard should reflect the changes in local finances and the demand for welfare.

### 1. Introduction

**Considering Korea's demographics, there is no doubt that the government spending on social and public welfare will continue to rise unabated.**

Issues related to the state welfare programs such as the Basic Pension Program and the Free Education Scheme are widely discussed in Korean society today. It has aroused much controversy among politicians including the members of the National Assembly. Nevertheless, it is the plain truth that the state expenditure on public and social welfare will keep going up. It is the inevitable owing to the country's demographics and welfare policy directions.

With continuous increase in the national government's welfare expenditure, local authorities' welfare spending has been on the rise, too. In general, the National Subsidy Program is based on the Matching Fund Method - that is, both the nation and local governments defray the cost of investment in public welfare. Korea's National Welfare Subsidy Program is consisted of the five core programs: the Basic Pension Program, the Disability Pension Program, the Infant and Child Care Grant Program, the Child Home Care Allowance Program, and the National Basic Livelihood Security System. As prescribed by the law, the nation is obligated to carry out all these welfare programs. In turn, local governments are bound to pay their shares in welfare spending. Given that, the expansion of the National Subsidy

Program serves as the main culprit of decrease in discretionary spending of local governments. It also increases their dependency on the nation.

## 2. Main Findings

This paper examines the present status and problems of the National Welfare Subsidy Program. It also analyzes factors that may improve the national subsidy measurement method.

### **Spike in spending on social welfare and public health has imposed financial pressures on local governments**

As of 2014, the total expenditure of local governments in Korea has increased by on average 4.6 percent each year. Meanwhile, spending on social welfare and public health has soared by on average 10.3 percent a year. This is true of most local authorities. In particular, Seoul and other municipalities are witnessing abrupt increases in their spending on the two aforesaid areas.

[Table 1] Expenditure of Seoul, Metropolitan Cities, and Province

(Unit : trillion won, %)

Category	2008	2009	2010	2011	2012	2013	2014	Annual increase rate
Provinces								
Total expenditure	125.0 (100.0)	137.5 (100.0)	139.9 (100.0)	141.0 (100.0)	151.1 (100.0)	156.8 (100.0)	163.6 (100.0)	4.6%
Social welfare:public health spending	23.6 (18.9)	26.1 (18.4)	28.8 (20.6)	30.4 (21.6)	33.0 (21.8)	37.3 (23.8)	42.5 (26.0)	10.3%
Seoul								
Total expenditure	21.1 (100.0)	22.7 (100.0)	22.9 (100.0)	22.7 (100.0)	23.7 (100.0)	23.5 (100.0)	24.5 (100.0)	2.5%
Social welfare:public health spending	4.5 (21.4)	4.7 (20.8)	5.1 (22.3)	5.3 (23.5)	6.1 (25.6)	6.9 (29.3)	7.6 (30.9)	9.0%
Metropolitan Cities								
Total expenditure	4.1 (100.0)	4.6 (100.0)	4.9 (100.0)	4.9 (100.0)	5.3 (100.0)	5.5 (100.0)	5.8 (100.0)	5.7%
Social welfare:public health spending	0.9 (21.3)	1.0 (21.2)	1.1 (22.9)	1.2 (25.0)	1.3 (25.3)	1.5 (27.1)	1.7 (29.6)	11.6%

Source: The Current Status of Local Finances, Local Finance Integrated Open System

**For the National Welfare Subsidy Program, local governments must bear a certain cost prescribed in the law. It hurts their autonomy to manage their own finances**

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Local governments can plan and control, to a certain extent, their spending on the National Subsidy Program for areas besides welfare (e.g. roads, transportation, and other infrastructures). Thus, they are able to manage financial risk involved in such investment. Unfortunately, this is not the case with the National Welfare Subsidy Program. The law clearly stipulates that local governments are obligated to bear a certain portion of cost required for the program. This renders the risk management rather impossible. With the expansion of the National Welfare Subsidy Program, local governments become financially less able to run their own projects. Hence, a decrease in the size and number of autonomous programs executed at the local government level.

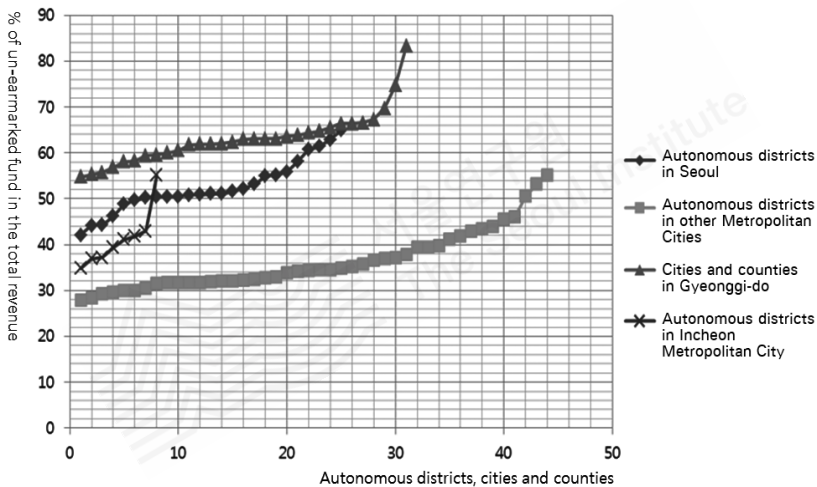
Oftentimes, local governments are asked to consume more of their financial resources, supporting the policy demand from the nation. This hinders their operation and management. As previously explained, the expansion of the National Subsidy Program increases the financial dependency of local governments on the nation. This could be criticized as a “new kind of financial control by the nation government.”

**Changes in the demand for welfare are not reflected in the current subsidy rate. As a result, a financial gap between localities is widening**

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The amount of subsidy can be adjusted based on the law. The proportion of un-earmarked fund in total revenue of local government is used as the standard subsidy rate. In the case of Seoul, the un-earmarked fund constitutes the city’s local tax revenue combined with non-tax receipts. Since it accounts for large sum of total revenue, local governments in Seoul are eligible for only a small amount of national subsidy. Other cities, in contrast, are paid a considerably greater subsidies.

However, it does not necessarily imply that every autonomous district (Gu) government within Seoul is better off than ones in other areas. In fact, autonomous districts in Gyeonggi-Do (i.e. Gyeonggi province) and Incheon Metropolitan City are found to have larger financial resources. As seen in [Figure 1] below, financially weak districts in Seoul are receiving less subsidy than the wealthy districts in the two aforesaid localities. The former are in need for greater support, yet being provided little help just because they are “Seoul districts“. This disparity in the size of subsidies between Seoul and other regions raises a question about the fairness of the system.



[Figure 1] Proportion of Un-earmarked Fund Owned by Autonomous Districts in Seoul, Incheon and other Metropolitan Cities & Cities and Counties in Gyeonggi-Do (as of 2015)

[Table 2] below shows differentiated subsidy rates of the Infant and Child Care Grant Program applied to Seoul and other localities: Seoul is subsidized at the rate of 25 percent, for the un-earmarked fund takes more than 85 percent of the total revenue. A much higher rate of 65 percent or 75 percent is applied to other cities and regions. Like this, the subsidy rate of the National Subsidy Program is measured based on the proportion of un-earmarked fund in a local government’s total revenue.

Continuous expansion of the National Subsidy Program has culminated in some

changes in its beneficiary pool. Recently, the number of beneficiaries for the National Basic Livelihood Security System has been on the rise in Seoul. Most other cities and regions have been experiencing the opposite. The fixed subsidy measurement method of today does not reflect changing localities and people in need for welfare support. As a result, the unrealistically measured national subsidy is now further widening a gap in welfare finance among localities.

### **The basic subsidy rate for the National Subsidy Program is measured amid a lack of reasonable principles and transparency**

[Table 2] Law related to Subsidy Rate and Programs Eligible for Basic Subsidy Rate

[Enforcement Decree of the Subsidy Management Act]

Article 4 (Scope of Programs Eligible for Subsidies and Basic Subsidy Rate) (1) The scope of local government's program eligible for subsidies under subparagraph 1 of Article 9 of the Act and the basic subsidy rate under subparagraph of the same Article (hereinafter referred to as "basic subsidy rate") shall be as set forth in attached Table 1: Provided that a local government's programs set forth in attached Table 2 shall be excluded from the eligibility.

#### **<Appendix 1> Scope of Programs Eligible for Subsidies and Basic Subsidy Rate (related to section 1 of Article 4)**

Project	Standard Subsidy Rate	Note
1. Issue a general passport	100	
2. Expand 119 rescue facilities	50	
3. Expand facilities and equipment placements for civil defense training	30	
4. Maintain safe conditions in calamity danger districts	50	
5. Maintain small rivers	50	
6-121. (...)		
122. Other programs that the national and local authorities have stakes in, and that require a subsidy	Subsidize at the fixed rate (100%, 80%, 70%, 50%, 40%, 30%, 20%) or pay the fixed amount based on the foundation, legislation, and characteristic of program	The title of eligible program and the basic subsidy rate shall be disclosed in the budget compilation guidance set by the Minister of Strategy and Finance or decided in the budget every year.

The National Subsidy Program prescribed in the law shall have a fairly and transparently measured subsidy rate. Yet it is impossible to ensure that the process follows a set of reasonable principles. It is because the nation does not disclose such principles by which it measures the rate. It merely has enumerated subsidy rate each project like in [Table 2] below. Today, local governments are encumbered with aggravated financial strains due to the enlarged National Subsidy Program. Under such a circumstance, it becomes more essential for the national government to make the subsidy measurement method public and, if necessary, adjust it.

The subsidy rate applied to each city government is determined based on the two values: One is the proportion of un-earmarked fund in total revenue of local government. Another is the value derived from dividing a social welfare budget by an expenditure budget. Neither of them truly mirrors the characteristics of the National Welfare Subsidy Program. For instance, the Infant and Child Care Grant Program is comprised of various sub-programs, which all pay a subsidy. The amount of subsidy for every sub-program is currently measured based on a single standard: the actual expense ratio relative to the size of social welfare budget. This method is simply inappropriate.

### **Various standards should be applied to better distribute the national subsidy**

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The present National Subsidy Program embodies several problems. To name a few, it burdens local governments with the obligation to allocate a certain portion of their financial resources to particular activities. Not only that, the unrealistic subsidy rate is not so much helpful as problematic. As explained earlier, the national government distributes the national subsidy without factoring in the financial conditions of local governments. When the national government first introduced the program, its aim was to efficiently promote welfare in the country by financially supporting local governments' endeavor. The current subsidy apportionment scheme is not conducive to serving this goal.

As mentioned, there are only two subsidy measurement standards that are set differently for each local government: One is the proportion of un-earmarked fund in total revenue of local government. Another is the size of welfare budget actually used. The national government cannot cope with the uniqueness of each city and region if it applies an uniform standard to the subsidy measurement for every local government. In this sense, other factors in addition to the two aforesaid standards should be adjusted to better reflect the reality. They are, for example, the number of beneficiaries of each welfare program, the expenditure budget per capita, and the feasibility of executing social welfare programs solely with the local tax revenue and non-tax receipts.

### **Demand for welfare in each locality is the common key variable for five major welfare subsidy programs**

As shown in [Table 3] below, based on our analysis, factors that influence the amount of national welfare subsidy vary among local governments. However, the demand for welfare is found to be a common key variable. In measuring the amount of subsidies required, Metropolitan Cities and Provinces are more susceptible to factors that are directly related to finances (e.g. the proportion of un-earmarked fund in total revenue and revenue relative to financial demand). To most except for few, expenditure budget per capita is a significant variable affecting the size of national subsidy. If the national government weighs all these variables, it will be able to come up with a more accurate and objective national subsidy measurement model. Meanwhile, the national government needs to bear in mind that the demand for welfare is an important variable to every field of social welfare as well as every type of local authorities. For such a variable, the government therefore should consider the population of eligible beneficiaries rather than social welfare budget.

[Table 3] Factors Affecting the Size of National Welfare Subsidy for each Local Government

Type	1. Basic Pension Program	2. Disability Pension Program	3. Infant and Child Care Grant Program	4. Child Home Care Allowance Program	5. National Basic Livelihood Security System
Special City	① Proportion of un-earmarked fund in the total revenue		① Proportion of un-earmarked fund in the total revenue	① Proportion of un-earmarked fund in the total revenue	
	② Revenue relative to financial demand				
	③ Demand for welfare	③ Demand for welfare	③ Demand for welfare	③ Demand for welfare	③ Demand for welfare
	④ Budget expenditure per capita	④ Budget expenditure per capita	④ Budget expenditure per capita	④ Budget expenditure per capita	
Metropolitan City	① Proportion of un-earmarked fund in the total revenue	① Proportion of un-earmarked fund in the total revenue	① Proportion of un-earmarked fund in the total revenue	① Proportion of un-earmarked fund in the total revenue	① Proportion of un-earmarked fund in the total revenue
	② Revenue relative to financial demand	② Revenue relative to financial demand	② Revenue relative to financial demand	② Revenue relative to financial demand	② Revenue relative to financial demand
	③ Demand for welfare	③ Demand for welfare	③ Demand for welfare	③ Demand for welfare	③ Demand for welfare
		④ Budget expenditure per capita	④ Budget expenditure per capita	④ Budget expenditure per capita	
Province	① Proportion of un-earmarked fund in the total revenue	① Proportion of un-earmarked fund in the total revenue	① Proportion of un-earmarked fund in the total revenue	① Proportion of un-earmarked fund in the total revenue	① Proportion of un-earmarked fund in the total revenue
	② Revenue relative to financial demand	② Revenue relative to financial demand	② Revenue relative to financial demand	② Revenue relative to financial demand	
	③ Demand for welfare	③ Demand for welfare	③ Demand for welfare	③ Demand for welfare	③ Demand for welfare
	④ Budget expenditure per capita	④ Budget expenditure per capita	④ Budget expenditure per capita	④ Budget expenditure per capita	



**Before all, a study should be conducted to identify the size of actual demand for welfare programs such as the number of beneficiaries from the National Basic Livelihood Security System**

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In general, welfare should be delivered universally to every member of society. In some cases, however, the national government targets a certain group of people in need (e.g. the handicapped, the recipients of living allowance) for selective benefits. The foremost task in the latter case is to find the actual demand for welfare programs. Unfortunately, it is practically impossible to pin down the number of eligible beneficiaries of the National Basic Livelihood Security System: Sometimes, people who are not supposed to receive the benefit do so, while others in dire economic hardship are rejected because they do not meet the eligibility criteria. In other occasions, some miss out on the benefit, for they are not aware of the program. To avoid such cases, research should be conducted so that eligible beneficiaries of welfare programs can be accurately identified.

### 3. Conclusions and Policy Recommendations

This report has discussed problems with the current National Welfare Subsidy Program. It also has identified factors that must be considered for the subsidy measurement based on the analysis of empirical data and regression model. At last, the following conclusions and policy recommendations have been drawn.

**Devise a more reasonable national subsidy distribution method by weighing other types of financial assistance**

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The national government needs better apportion the national welfare subsidy to local governments. In order to do so, it should consider not only the national subsidy, but also other various kinds of finances. The national subsidy measurement factors

in revenue relative to financial demand and the proportion of un-earmarked fund in total revenue. The reason is that other sorts of finances managed by local governments are related to the national subsidy.

The national government considers various demands for social welfare when it pays local governments welfare subsidies that they may use autonomously. Problems occur when the demand that has already been factored in for local subsidy is considered again for the national subsidy. Simply put, demands overlap. Therefore, it is necessary to consider the national subsidy and other welfare subsidies that local governments are allowed to manage autonomously at the same time. Alternatively, the national government can adjust the demand estimate by applying a welfare budget or the number of beneficiaries.

### **Distribute social welfare tasks between the national and local governments for efficient execution of the national subsidy payment**

In order to more reasonably and efficiently carry out the national welfare subsidy payment, the central and local governments should rearrange their roles in welfare services. In other words, projects that the national government takes responsibility in execution to meet national minimum standard<sup>5</sup> need to be distinguished from ones that local governments are in charge. The former is fully funded by the nation. For the latter, the national government subsidizes local governments at a reasonable

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<sup>5</sup> National minimum is an indicator representing the lowest possible level of welfare of the citizenry of a country. It numerically indicates what should be accepted for the “lowest” or “standard” level of nutrition, housing, and living conditions relative to the economy and GNP per capita of a country. It was first introduced by the Sydney department of the UK, and later set forth as a specific policy agenda in the Beveridge Plan in 1942. Some use it as a normative concept, while other use it as a specific policy concept like in the Beveridge Plan. In the latter case, the necessary minimum living cost is instrumented to be determined, yet the value changes with the time.

rate measured by allowing for their financial conditions. Through these efforts, the national government can alleviate the financial burden of local governments, while pursuing welfare policy.