

Fiscal Sustainability for the Republic of Korea: Long-Term Fiscal Headway under Demographic Pressure

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Executive Summary

The Republic of Korea enters the coming demographic transition from a position of relative fiscal strength. Public debt remains moderate compared with many advanced economies, fiscal institutions retain credibility, and the government still has policy space that many older welfare states no longer possess ([International Monetary Fund, 2025](#)). The challenge is that Korea is now entering one of the most compressed demographic transitions in history. The same forces that will raise pension, healthcare, and long-term care spending will also weaken the labor-income and contribution bases that have historically supported public finances ([OECD, 2025a](#); [De Biase et al., 2022](#)).

The central argument of this report is that Korea needs fiscal headway: a credible medium-term framework that preserves policy capacity and smooths burdens across cohorts while deeper reforms address low fertility, housing pressure, labor-market dualism, productivity slowdown, and the political economy of aging. Fiscal policy cannot by itself solve Korea's demographic problem. But VAT reform, excise indexation, pension reform, Basic Pension retargeting, health-payment reform, and longer working lives can make adjustment earlier, smoother, and fairer. In a rapidly aging society, time and credibility are policy assets.

Korea's strategy should draw selectively from international experience while remaining grounded in domestic constraints. Europe offers fiscal instruments, especially in consumption taxation, medium-term revenue planning, and social-insurance financing, although several European states now carry alarming public debt. Japan shows how delayed adjustment can narrow future policy choices. Korea's own starting point is distinctive: moderate public debt, high household leverage, severe housing burdens, high elderly poverty, and unusually compressed aging ([International Monetary Fund, 2025](#); [Kim, 2025](#); [OECD, 2025a](#)).

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These features point toward a Korea-specific strategy that preserves fiscal room while smoothing adjustment across cohorts.

Korean institutions have already produced serious proposals. KDI work on National Pension restructuring, Basic Pension targeting, healthcare expenditure growth, and household debt provides a strong starting point (Korea Development Institute, 2024; Kim and Lee, 2025; Kwon, 2025; Kim, 2025). This report integrates those domestic proposals with OECD and IMF benchmarks to recommend a Korea-specific framework for fiscal headway and intergenerational burden smoothing.

Six linked reforms are recommended. First, Korea should adopt a medium-term revenue strategy that emphasizes predictability, gradualism, and diversification away from a shrinking labor base. Second, VAT and excise reforms should be gradual, pre-announced, and visibly compensated for vulnerable households; their role is to create fiscal headway, not to solve the demographic problem. Third, pension reform should distinguish legacy liabilities from future accrual rules, rather than relying indefinitely on contribution increases imposed on a smaller younger workforce. Fourth, the Basic Pension should move from a mechanically expanding cohort-share rule toward a more explicit old-age poverty instrument. Fifth, healthcare, long-term care, and retirement-age reform should be linked to payment incentives, provider-price discipline, and labor-market reform rather than treated as narrow demographic arithmetic. Sixth, major fiscal reforms should be accompanied by cohort-impact analysis and a Demographic Fiscal Headway Account that makes intergenerational burdens transparent.

The value of these measures lies in preserving Korea's room for maneuver. They will not solve low fertility, housing affordability, labor-market dualism, productivity slowdown, or elderly poverty on their own. They can keep the public balance sheet strong enough, and the social contract credible enough, for Korea to confront those deeper problems without sudden austerity or sharper generational conflict.

1 Introduction

The Republic of Korea is undergoing one of the most rapid demographic transitions among advanced economies. Persistently low fertility, rising longevity, and a rapidly increasing old-age dependency ratio are reshaping the country's economic and fiscal landscape (OECD, 2024b; Statistics Korea, 2025). Even if demographic trends were to suddenly reverse today, the next several decades are set: the working-age population will contract while the population over 65 grows as a share of the total (OECD, 2025a).

These demographic pressures affect the budget on both sides. On the expenditure side, pension, healthcare, and long-term care obligations will rise as the National Pension System matures and as older cohorts become a larger share of the population (Korea Development Institute, 2024; De Biase et al., 2022). On the revenue side, the labor-income tax base and social-contribution base will come under pressure as the working-age population shrinks. Slower

potential growth would further weaken fiscal space, especially if productivity improvements and labor-force participation gains do not offset the demographic drag (OECD, 2024b).

Korea begins from a stronger public-debt position than many older welfare states. The IMF's 2025 Article IV consultation notes that central government debt was below 50 percent of GDP at end-2024, giving Korea near-term room to respond to age-related spending needs (International Monetary Fund, 2025). But the challenge is dynamic: a manageable position can deteriorate if age-related commitments mature before revenue, pension, healthcare, and labor-market institutions adapt.

The policy task is to turn this fiscal advantage into durable headway: a medium-term strategy that draws on Korean institutional work, uses international evidence selectively, and preserves room for adjustment before demographic costs become harder to manage.

This report frames Korea's fiscal challenge as one of fiscal headway and intergenerational burden smoothing. Fiscal headway means creating enough room, early enough, to avoid abrupt adjustment later. Burden smoothing means distributing the costs of demographic change across cohorts and instruments rather than loading them onto younger workers, elderly poor households, or future taxpayers. The objective is to prevent fiscal drift from making housing, labor-market, productivity, childcare, and migration reforms harder and more politically divisive.

The analysis proceeds as follows. Section 2 reviews Korea's demographic transition and uses Europe and Japan as selective reference points. Section 3 evaluates Korea's current fiscal position. Section 4 identifies structural vulnerabilities that make annual budgeting inadequate for the aging transition. Section 5 develops a medium-term revenue strategy, with VAT and excise reforms placed in a supporting role. Section 6 discusses pension reform and intergenerational equity. Section 7 examines healthcare and social spending efficiency. Section 8 proposes a Korea-specific fiscal governance package. Section 9 summarizes policy recommendations.

2 Demographic Context and Fiscal Implications

2.1 The fertility crisis

Korea's fertility decline is exceptional in both level and persistence. The total fertility rate fell from around six births per woman in the 1960s to below replacement in the early 1980s, and then continued downward over subsequent decades, reaching 0.72 in 2023 before recovering modestly to 0.75 in 2024. The number of live births rose to 238,300 in 2024 but remained far below the 1,024,773 recorded in 1971 (Statistics Korea, 2025). The recent uptick is welcome, but it should not be overinterpreted: fertility remains far below replacement and far below the OECD average (OECD, 2024b).

The causes are structural rather than merely cyclical. Housing affordability, delayed marriage, labor-market insecurity, long working hours, high private education costs, weak work-family compatibility, and unequal household labor burdens all shape fertility decisions (OECD, 2024b).

These factors also interact with expectations. If young households believe that family formation requires unaffordable housing, intensive private education spending, and career penalties for women, small marginal subsidies will have limited effect.

The fiscal implication is direct. Low fertility reduces the future working-age population, weakens the long-run contribution base for social insurance, and makes pay-as-you-go promises harder to sustain. Fiscal policy cannot solve the fertility crisis, but it can reduce the risk that future governments face demographic pressure with too little room to respond.

This distinction matters in Korea, where fertility policy has already involved substantial public effort (OECD, 2024b). Housing, education, labor-market expectations, gender norms, and urban concentration jointly shape household decisions. Better fiscal arithmetic preserves policy capacity while those deeper reforms are pursued.

2.2 Aging, dependency ratios, and growth

Korea's aging process is unusually compressed. OECD's 2025 Korea pension note reports that the old-age to working-age ratio rose from 11 people aged 65 and over per 100 people aged 20-64 in 2000 to 31 in 2025, and is projected to reach 80 by 2050. By that measure, Korea would become the oldest OECD country, slightly ahead of Japan. The same OECD note projects that the population aged 20-64 will halve by 2064 (OECD, 2025a).

This transition has three macro-fiscal consequences. First, age-related expenditures rise mechanically as more people receive pensions, healthcare, and long-term care (De Biase et al., 2022). Second, the revenue base weakens if labor-force contraction is not offset by productivity, employment, participation, or migration. Third, political conflict over intergenerational burden sharing becomes more acute because smaller younger cohorts are asked to finance promises made under very different demographic conditions.

For that reason, the relevant fiscal question is whether Korea can combine several imperfect reforms early enough that no single cohort or instrument is asked to carry the whole adjustment.

The growth channel deserves emphasis. A fiscal projection that simply adds pension and health spending to today's GDP path understates the problem if aging also reduces potential output (OECD, 2024b). Policies that raise productivity, female employment, older-worker employment, and high-skilled migration can ease the fiscal problem indirectly. Fiscal reform is a bridge to structural adaptation, not a substitute for it.

2.3 Korea, Japan, and Europe

Korea should use international comparisons selectively, starting from its own fiscal and social constraints. Japan illustrates how delayed adjustment under low fertility and population aging can narrow future policy choices. Korea's starting point is stronger in public-debt terms, but more constrained in private balance-sheet terms: higher household leverage and acute housing-

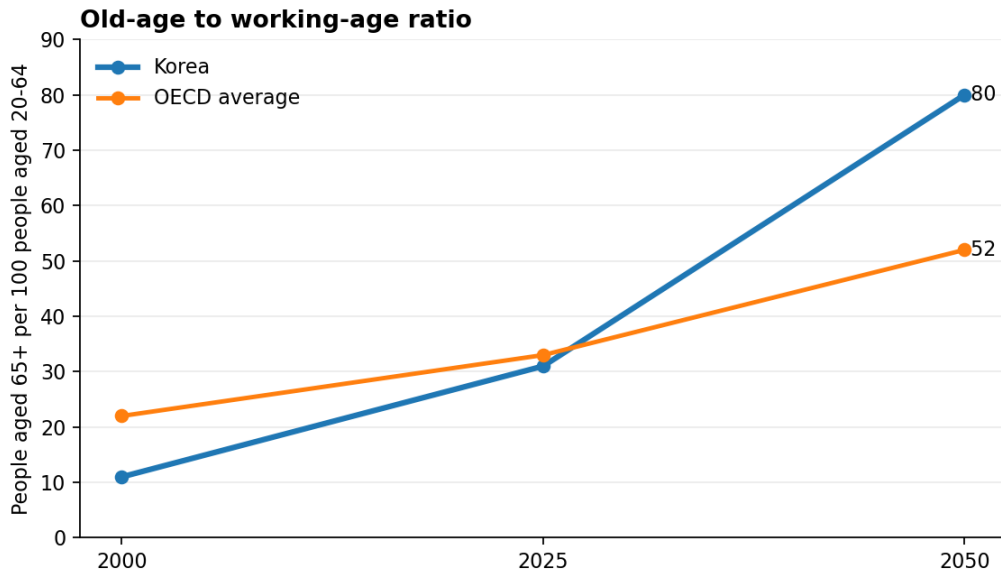


Figure 1: Demographic Compression and Fiscal Starting Point

Old-age to working-age ratio, Korea and OECD average

Source: (OECD, 2025a). Note: old-age to working-age ratio is people aged 65 and over per 100 people aged 20-64.

related pressure on younger cohorts change the political economy of adjustment (International Monetary Fund, 2025; Kim, 2025).

Europe is useful in a different way. European welfare states show how broader consumption taxes, social contributions, and mature social spending systems can finance aging societies. Several European countries now carry much higher public debt burdens than Korea and aged over a longer institutional adjustment period (International Monetary Fund, 2025; OECD, 2024a). The relevant lesson is selective adaptation, not mechanical convergence to European tax levels.

The right comparison strategy is therefore selective. Europe provides an instrument menu. Japan shows the cost of delay. Korean institutional work provides the foundation for implementation. Korea's task is to preserve its comparatively favorable public-debt position while adapting institutions quickly enough for a demographic transition that leaves little margin for drift.

3 Korea's Current Fiscal Position

3.1 Revenue structure

Korea's revenue system is relatively lean by OECD standards. OECD Revenue Statistics in Asia and the Pacific 2025 reports Korea's tax-to-GDP ratio at 28.8 percent in 2023, below the OECD average of 33.9 percent. Korea is not a high-tax welfare state, and this gives it more room for gradual revenue planning than many older European states. It also has a distinctive revenue structure: personal income taxation is comparatively limited, corporate income taxation

is important but cyclical, VAT is broad and efficiently collected but has a low statutory rate, and social contributions face long-run demographic pressure (OECD, 2025b).

The VAT comparison matters. Korea's standard VAT rate is 10 percent, unchanged since its introduction in 1977, compared with an OECD average standard rate of 19.3 percent as of end-2024. Korea's VAT Revenue Ratio was 0.73 in 2022, above the OECD average of 0.58, suggesting strong collection performance for the existing rate and base. This combination of a low rate and strong administration creates room for gradual consumption-tax reform (OECD, 2024a).

This room should be used carefully. Korea's household sector is already strained by high debt and housing costs (Kim, 2025). A VAT increase that looks efficient on average can be politically and distributionally difficult when young households face high housing and childcare costs and elderly households face high poverty (OECD, 2025a). Korea therefore has a credible instrument for fiscal headway, but only if reform is gradual, transparent, and compensated.

Corporate income taxation adds another vulnerability. Korea's corporate tax base is concentrated among large export-oriented firms, making receipts sensitive to global cycles, semiconductor earnings, and exchange-rate and trade conditions (Ministry of Economy and Finance, 2025). This volatility reinforces the case for a broader medium-term revenue strategy rather than repeated annual adjustments.

3.2 Expenditure trends

Korea's social spending remains below many mature welfare states, but its growth trajectory is steep (OECD, 2024b). Pension spending is still relatively moderate because the National Pension System is still maturing, but this will change as more cohorts retire with longer contribution histories and as the population ages (Korea Development Institute, 2024). Healthcare spending has grown quickly, and long-term care pressures will rise as the very old population expands (De Biase et al., 2022).

Korea still spends less than many older welfare states, but expenditure commitments may rise faster than institutions adapt. A country can move from fiscal strength to fiscal constraint not because of one crisis, but because predictable commitments accumulate while reform remains incremental. That is the fiscal version of Korea's broader demographic problem: the risks are visible well in advance, but delayed action makes every later option harsher.

3.3 Private balance sheets as fiscal constraints

Korea's fiscal debate should treat household balance sheets as a constraint on public finance. KDI's 2025 study on demographic change and household debt estimates that key variables account for the 33.8 percentage-point rise in Korea's household debt-to-GDP ratio between 2003 and 2023, with 28.6 percentage points explained by rising life expectancy and 4.0 percentage

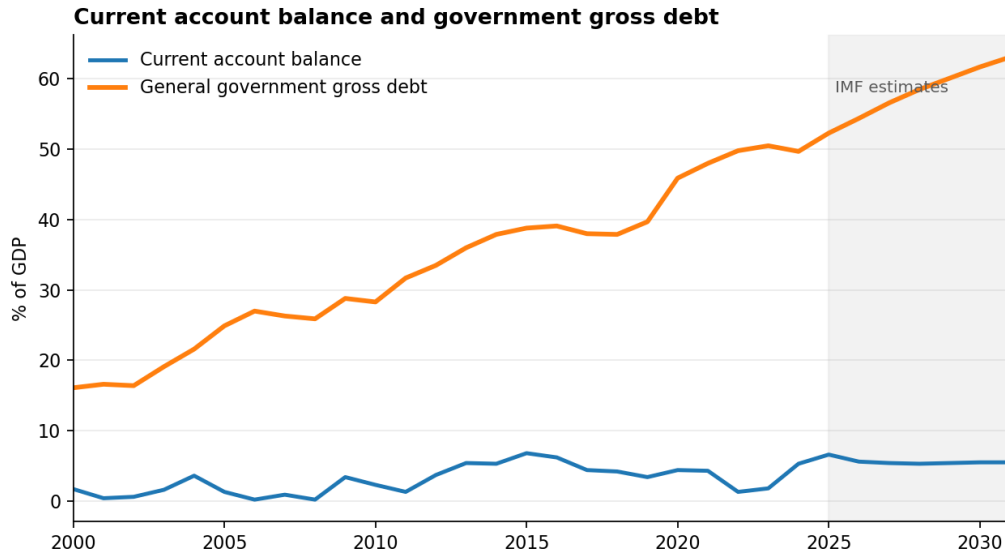


Figure 2: Current Account Balance and Government Gross Debt Trajectory

Current account balance and government gross debt trajectory

Source: (*International Monetary Fund, 2026*), using the *v1* workbook data. Note: shaded years are IMF estimates.

points by shifts in age distribution (Kim, 2025). This means demographic change is already visible in private borrowing and saving behavior, not only in future public pension projections.

This matters for fiscal design. Consumption-tax increases without compensation could worsen pressure on liquidity-constrained households. Payroll-heavy pension reform could intensify burdens on younger workers already facing housing and family-formation constraints. Healthcare cost-shifting could worsen elderly poverty. Korea’s public-debt position gives it room to move gradually, but household fragility limits how abrupt that movement can be.

4 Structural Fiscal Vulnerabilities

4.1 Annual budgeting is poorly matched to demographic aging

Korea has managed cyclical shocks relatively well, but demographic aging is not a business-cycle event. It is a multi-decade structural process. Annual budgeting and discretionary tax changes are poorly suited to a problem whose costs are predictable but politically easy to postpone. The key institutional vulnerability is not a lack of awareness. It is the absence of a sufficiently binding medium-term framework that connects long-run expenditure commitments to revenue planning and distributional choices (OECD, 2024b; International Monetary Fund, 2017).

4.2 Fiscal rules need demographic content

Fiscal rules focused only on annual deficits or headline debt ratios can miss implicit age-related liabilities and cohort distribution. A debt ceiling may discipline aggregate borrowing, but it does

not answer whether younger cohorts are being asked to finance legacy promises, whether elderly poverty is being reduced efficiently, or whether healthcare cost growth reflects value or price drift.

Korea therefore needs fiscal governance that includes demographic stress tests and cohort incidence. This does not mean abandoning aggregate fiscal discipline. It means complementing aggregate rules with tools suited to an aging society.

4.3 Pension promises contain intergenerational imbalance

The National Pension System was designed under more favorable demographic conditions. Earlier cohorts benefited from parameters that cannot be replicated indefinitely under very low fertility and rising longevity. The 2025 reform, raising the contribution rate from 9 percent to 13 percent and the future target replacement rate from 40 percent to 43 percent, is significant. OECD reports that it delays the projected annual deficit and fund depletion by several years, but also emphasizes that further reform is needed for adequacy and sustainability (OECD, 2025a; Reuters, 2025).

The political difficulty is obvious: older cohorts face real income insecurity and Korea has the highest old-age poverty rate in the OECD (OECD, 2025a). But ignoring the intergenerational structure of pension promises is not progressive. It simply transfers the adjustment problem to younger and future cohorts with less political voice.

4.4 Healthcare spending is not aging alone

Healthcare expenditure will rise with aging, but Korean evidence suggests that aging is not the dominant proximate driver. KDI's 2025 analysis identifies price increases as the dominant factor in health-insurance expenditure growth (Kwon, 2025). That creates a practical reform agenda: if price dynamics, fee updates, provider incentives, and payment structures drive spending growth, payment reform can improve value before demographic pressure peaks.

5 Medium-Term Revenue Strategy: Useful Headway, Not a Demographic Solution

5.1 Why Korea needs a medium-term revenue strategy

A medium-term revenue strategy is a government-led, multi-year plan linking tax policy, administration, and legal reform. The IMF has promoted MTRS frameworks as a way to move beyond short-term discretionary tax measures (Gaspar, 2019; International Monetary Fund, 2017). Korea's demographic challenge is a natural case because the expenditure pressure is

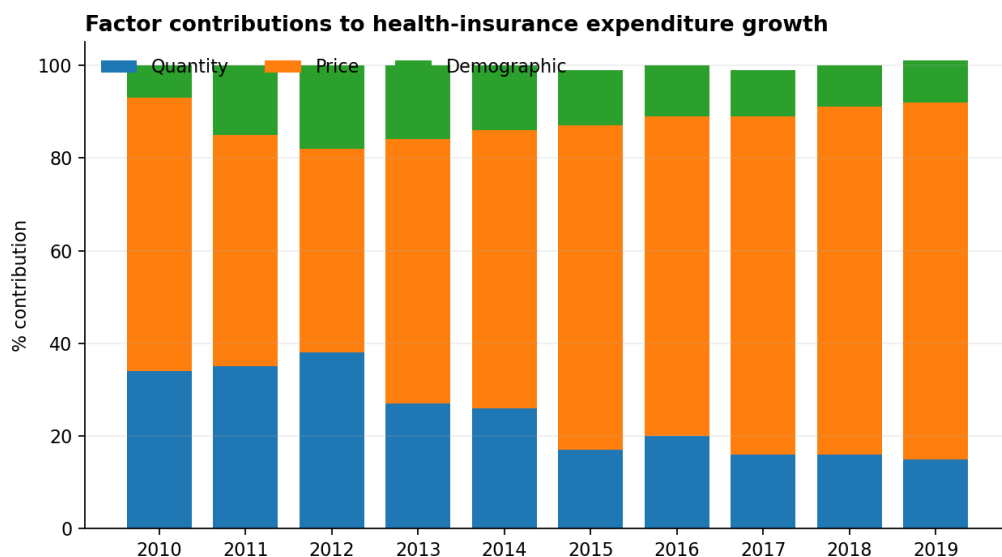


Figure 3: Factor Contributions to Health-Insurance Expenditure Growth

Factor contributions to health-insurance expenditure growth

Source: (Kwon, 2025), using the v1 workbook data. Note: healthcare spending growth is not explained by aging alone.

foreseeable and long-horizon. The point is not to announce a single tax increase, but to create a path that households, firms, and public institutions can understand, contest, and plan around.

For Korea, the revenue strategy should have three objectives. First, diversify away from tax bases that are vulnerable to aging or corporate cycles. Second, improve predictability so fiscal adjustment does not arrive as repeated ad hoc shocks. Third, build trust that additional revenues are creating demographic headway rather than financing open-ended commitments.

5.2 VAT reform

VAT reform belongs in the discussion because Korea’s rate is low, administration is strong, and consumption taxation is less tied to the shrinking number of formal workers than payroll contributions (OECD, 2024a). The point is not convergence with Europe, but the careful use of an existing tax instrument as part of a gradual headway strategy.

A plausible Korean VAT path would be gradual and pre-announced, with periodic review and explicit compensation. For example, a small multi-year increase could be paired with targeted transfers or tax credits for low-income elderly households and liquidity-constrained families with children. The design should minimize the risk that consumption-tax reform worsens fertility constraints or elderly poverty.

The political economy is as important as the arithmetic. VAT reform is most defensible as one instrument for preserving fiscal flexibility under demographic pressure, with visible compensation and transparent use. The fiscal gain is then not just revenue, but a more credible adjustment path.

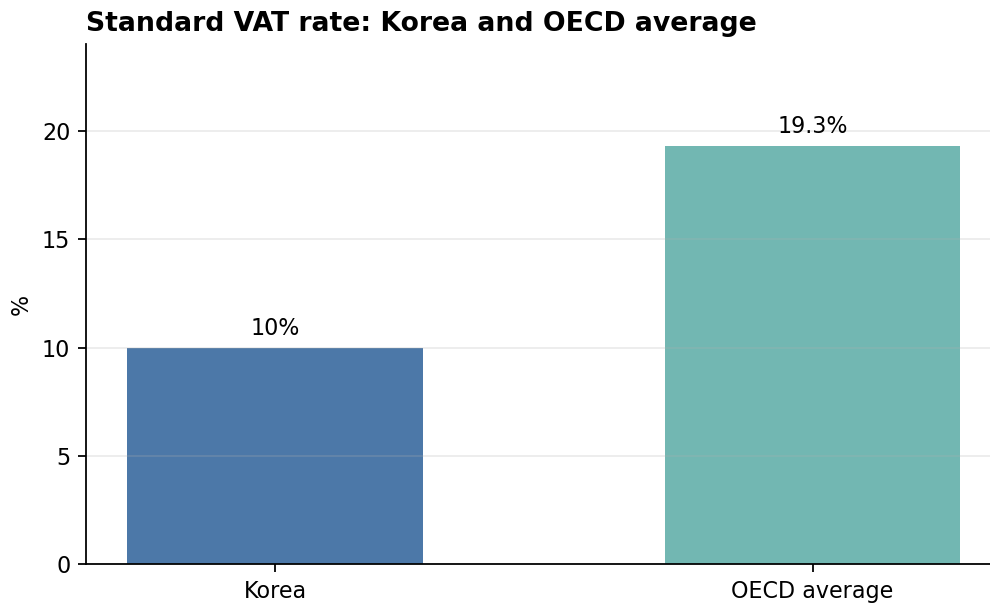


Figure 4: Korea’s VAT Rate Relative to the OECD

Korea’s VAT rate relative to the OECD

Source: (OECD, 2024a). Note: standard VAT rates as of end-2024.

5.3 Excise taxation and indexation

Excise taxes can play a supporting role, especially when indexed to inflation so real revenues do not erode. Taxes on alcohol, tobacco, and sugar-sweetened products can also serve public-health objectives and provide small, predictable revenues for compensation or transition costs (Paraje et al., 2023; Summan et al., 2025).

Korea already has a domestic example. In 2021, the government shifted beer and takju taxation toward a volume-based structure with annual adjustments linked to the consumer price index, partly to address distortions between domestically produced and imported alcoholic beverages (United States Department of Agriculture, Foreign Agricultural Service, 2020). Beer excise revenues, which had been declining before the reform, stabilized and began to recover after the move to a volume-based, CPI-adjusted structure. The case shows that Korea can adapt excise design to reduce revenue erosion without repeated discretionary tax changes.

Holter (2025) emphasizes the value of medium-term tax strategies and inflation-adaptive policies for reducing fiscal volatility, and Korea’s beer-tax reform fits that logic. The next step is to make the approach more explicitly medium-term. CPI indexation smooths cyclical and inflation-driven revenue erosion; it does not by itself align revenues with long-run pension, healthcare, and long-term care commitments. Korea could use the beer-tax precedent as a template for a broader excise framework: pre-announced rate paths, automatic inflation adjustment, periodic distributional review, and transparent assignment of incremental revenue to compensation or demographic fiscal headway.

Excise taxes are quantitatively secondary relative to Korea’s demographic challenge. Beer

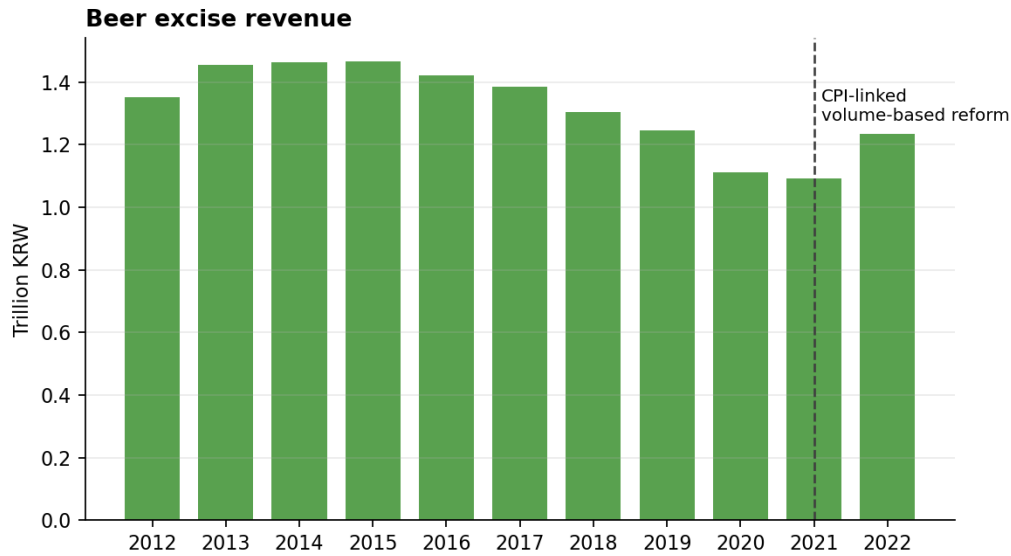


Figure 5: Beer-Tax Revenue

Beer excise revenue

Source: (Korean Statistical Information Service, 2024), using the v1 workbook. Note: the 2021 volume-based, CPI-adjusted reform helped stabilize revenue after a period of decline; it is a useful medium-term revenue-design precedent, not a stand-alone response to demographic aging.

taxes, tobacco taxes, and sugar taxes will not finance pension aging, healthcare growth, or long-term care on their own. Applied properly, however, they can build fiscal headway: they normalize automatic revenue adjustment, reduce erosion, and provide incremental funds within a larger medium-term revenue strategy. They are useful because they are limited, concrete, and easy to explain, not because they are transformative.

5.4 Compensation and trust

Compensation should be built into reform design from the beginning. Korea’s old-age poverty and household-debt burdens make distributional design central (OECD, 2025a; Kim, 2025). A VAT or excise package that leaves vulnerable households worse off would undermine trust and may worsen the structural problems that fiscal reform is supposed to buy time to address.

The key design principle is pre-commitment plus compensation. Pre-commitment makes the fiscal path credible; compensation makes reform politically and socially viable; transparency makes it harder for new revenue to disappear into general spending.

6 Pension Reform and Intergenerational Equity

6.1 National Pension reform: necessary, but not sufficient

Korea’s 2025 pension reform is a significant political achievement. OECD reports that the contribution rate will rise from 9 percent to 13 percent, split between employees and employers,

while the future target replacement rate increases from 40 percent to 43 percent. The reform delays the annual deficit and fund depletion, but does not remove the need for further reform (OECD, 2025a; Reuters, 2025).

The reform is a bridge. It signals political capacity, but under extreme aging, contribution increases alone cannot resolve adequacy, sustainability, and intergenerational fairness.

The scale of the remaining problem is visible in official pension projections. The fifth National Pension financial recalculation projected that, under the pre-reform baseline, reserves would peak at about KRW 1,755 trillion in 2040, begin running annual deficits in 2041, and be depleted by 2055 (Ministry of Health and Welfare, 2023). The 2025 reform improves that path, but it does not remove the underlying intergenerational issue: younger cohorts are being asked to finance promises made under much more favorable demographic assumptions.

KDI's structural pension proposals are valuable because they make the legacy-versus-future distinction explicit (Korea Development Institute, 2024). Earlier promises made under favorable demographics should be recognized transparently rather than loaded silently onto smaller younger cohorts through ever-higher payroll contributions. Korea should explore a clearer separation between legacy obligations and future accrual rules, with broader revenue used only for explicitly redistributive or transition components.

6.2 Contribution rates, retirement age, and payroll limits

Higher contributions are likely unavoidable, but the burden cannot fall only on payroll. Korea's contribution rate remains low by international standards even after the planned increase to 13 percent, but the relevant comparison is not only the OECD average (OECD, 2025a). The relevant Korean constraint is that younger workers face housing costs, weak family formation incentives, and uncertainty about whether future benefits will be credible.

Retirement-age reform is also necessary but must be linked to labor-market reform. OECD notes that Korea allows mandatory retirement at age 60, below the normal pension age, and that extending contributions at least to the normal retirement age would improve entitlements (OECD, 2025a). But simply raising retirement ages without changing seniority wages and firm-level employment practices could intensify conflict between older and younger workers. Longer working lives should be paired with wage-system reform, retraining, and job matching.

6.3 Basic Pension: protect the poor, reduce automatic leakage

Korea's Basic Pension plays an important anti-poverty role. OECD reports that Korea's relative income poverty rate for the 66+ population is around 40 percent, the highest in the OECD (OECD, 2025a). This makes blunt old-age spending cuts both socially undesirable and politically unrealistic.

The issue is targeting. KDI argues that the current Basic Pension eligibility threshold, which covers the bottom 70 percent of older adults by recognized income, increasingly fails to reflect

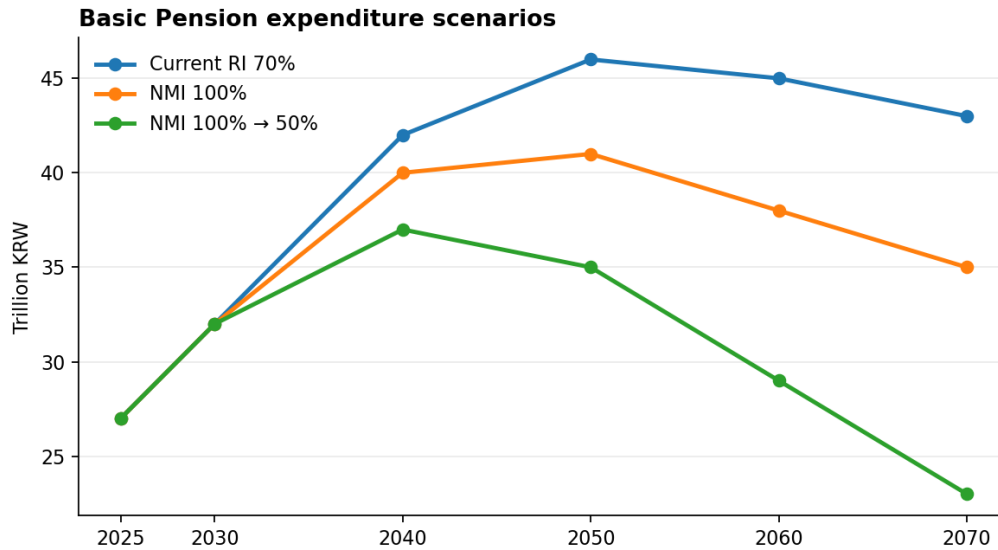


Figure 6: Fiscal Expenditure Estimates of the Basic Pension, 2025-2070

Basic Pension expenditure scenarios

Source: (Kim and Lee, 2025), using the v1 workbook data. Note: scenarios compare the current recognized-income bottom-70-percent rule with national-median-income anchors.

improvements among newer elderly cohorts. The threshold rose from 50 percent of national median income in 2015 to 93 percent in 2025, nearly matching the national median income. As the elderly population grows, a fixed 70 percent cohort rule creates mechanical expenditure expansion even when some beneficiaries are less vulnerable than earlier cohorts (Kim and Lee, 2025).

The fiscal difference is material. Under the current recognized-income bottom-70-percent rule, KDI estimates Basic Pension expenditure rising from KRW 27 trillion in 2025, or 1.09 percent of GDP, to KRW 46 trillion in 2050, or 1.48 percent of GDP. A more targeted national-median-income path would rise less sharply, creating room to strengthen benefits for the elderly poor rather than expanding coverage mechanically (Kim and Lee, 2025).

Korea should move gradually from a cohort-share rule toward a national-median-income anchor and, over time, a more explicit old-age minimum income guarantee. The goal is stronger protection for the elderly poor and less automatic leakage to less vulnerable households. Special care is needed for asset-poor renters and liquidity-constrained homeowners, since income alone may not capture economic vulnerability.

7 Healthcare and Social Spending Efficiency

7.1 Korea's healthcare achievement and fiscal pressure

Korea's National Health Insurance system achieved universal coverage in 1989 and now covers nearly the entire population. It has delivered strong health outcomes at historically moderate

cost; recent estimates place Korea's cost per DALY averted close to Australia and the United Kingdom and far below the Netherlands (Park et al., 2025). Health spending is therefore both a fiscal pressure and a source of real social value.

But expenditure growth is now a central fiscal issue. Health spending rose from USD 45.6 billion in 2011 to USD 76.9 billion in 2020, an average annual growth rate of 5.4 percent, while current health expenditure rose from 5.9 percent of GDP in 2009 to 9.4 percent in 2022 (Yoo et al., 2025; Kwon, 2025). As the population ages and chronic conditions become more common, health and long-term care spending will rise further (De Biase et al., 2022). Heavy reliance on fee-for-service incentives and price increases would amplify that pressure.

7.2 Payment incentives and price effects

KDI's analysis of health-insurance expenditure growth is central Korea-specific evidence. It identifies price increases as the dominant factor, implying that institutional design matters (Kwon, 2025). This shifts the policy discussion from demographic inevitability toward provider payment, price governance, and care coordination.

The institutional detail matters. KDI finds that price effects accounted for 76.7 percent of per-capita health-insurance expenditure growth over 2009-2019, compared with 14.6 percent from service volume and 8.6 percent from demographic change. Primary care clinics accounted for 24.9 percentage points of price-driven growth in 2019, above tertiary hospitals at 17.0 percentage points and general hospitals at 14.6 percentage points; medical service fees at clinics rose 28.4 percent from 2009 to 2019, compared with 18.1 percent at hospital-level institutions (Kwon, 2025). This points directly toward payment reform and fee governance rather than a purely demographic explanation.

Korea should move gradually away from pure fee-for-service where it encourages excessive volume or price-driven expenditure. Options include blended payments in primary care, chronic-disease management bundles, pay-for-performance where outcomes are measurable, and stronger review of fee updates by provider category (Kwon, 2025; Jones, 2024).

7.3 Long-term care and integration

Long-term care will become increasingly important as the population over 80 expands (De Biase et al., 2022). Korea should integrate long-term care projections into the medium-term fiscal framework rather than treating them as a separate social-policy issue. Health, long-term care, family caregiving, and labor-market participation are linked: if care burdens fall heavily on working-age women, fertility and female employment suffer; if public long-term care expands without discipline, fiscal pressure rises.

The goal is to improve spending quality before demographic pressure makes reform harder. Healthcare payment reform preserves access and slows avoidable expenditure drift while Korea works on broader structural adaptation.

8 Korea-Specific Fiscal Governance

8.1 Demographic Fiscal Headway Account

This report's first distinctive proposal is a Demographic Fiscal Headway Account. The account should operate as a transparent reporting device inside the medium-term fiscal framework rather than as a rigid earmarked fund. Rigid hypothecation can reduce fiscal flexibility and create artificial spending silos.

The account would record inflows from incremental VAT revenue, indexed excise revenue, base-broadening measures, verified Basic Pension targeting savings, and verified healthcare-efficiency savings. It would record outflows to pension-transition costs, targeted compensation, old-age poverty protection, healthcare payment-reform transition costs, and long-term care preparation. The purpose is to show whether Korea is creating demographic headway or merely relabeling revenue and spending.

The account should be a credibility device rather than a fiscal straitjacket. Its political value would come from annual transparency: policymakers and the public could see whether reforms are increasing room for demographic adjustment or simply shifting labels inside the budget.

Its value is practical: making fiscal tradeoffs visible, which is a precondition for trust.

8.2 Cohort-impact analysis

This report's second distinctive proposal is cohort-impact analysis for major fiscal reforms. Korea's demographic problem is fundamentally intergenerational, but budget debates often focus on annual deficits or aggregate debt. Cohort-impact analysis would require major tax, pension, healthcare, and retirement-age legislation to report burdens and benefits across birth cohorts.

This would make visible who pays, who benefits, and when. It would also discipline policy rhetoric. A reform that improves the aggregate deficit while imposing excessive costs on younger households may not be politically sustainable. A reform that protects current elderly households while leaving younger cohorts with implicit liabilities may not be fair. Cohort reporting would not eliminate conflict, but it would make the conflict explicit.

8.3 Distributional guardrails

Every major fiscal reform should pass three Korea-specific tests.

1. Does it improve long-run fiscal credibility? A measure that raises revenue but finances new open-ended promises may not create headway.
2. Does it smooth burdens across cohorts? A measure that relies excessively on younger payroll contributors or vulnerable elderly households may be arithmetically convenient but politically fragile.

3. Does it avoid worsening structural constraints? A measure that worsens household-debt stress, housing pressure, fertility constraints, or elderly poverty may weaken the broader adjustment Korea needs.

These guardrails should be embedded in the fiscal framework, not appended as rhetorical caveats.

9 Policy Recommendations

1 Adopt a medium-term revenue strategy focused on fiscal headway

Korea should adopt a medium-term revenue strategy that pre-commits a gradual revenue path over several years. The purpose should be diversification, predictability, and trust, while preserving Korea's stronger fiscal starting point relative to many older welfare states (Gaspar, 2019; International Monetary Fund, 2017). The strategy should include VAT options, excise indexation, base-broadening, and compliance improvements, while stating clearly that fiscal reform buys time for deeper structural reform.

2 Use VAT and excise reforms as auxiliary instruments, with compensation

Korea's low VAT rate and strong VAT administration create room for reform, but any increase should be phased, pre-announced, and paired with targeted compensation (OECD, 2024a). Excise taxes should be indexed where appropriate and framed as health taxes and revenue-stabilization tools (Paraje et al., 2023; Summan et al., 2025). Their contribution is fiscal headway, not demographic financing.

3 Treat pension reform as a legacy-versus-future-rules problem

The 2025 pension reform is a bridge, not the destination. Korea should continue parametric reform while developing a clearer distinction between legacy obligations and future accrual rules (OECD, 2025a; Korea Development Institute, 2024). Payroll contributions cannot be the only adjustment instrument in a society with a shrinking workforce and high household burdens.

4 Retarget the Basic Pension toward poverty reduction

The Basic Pension should evolve from a fixed bottom-70-percent cohort rule toward an income-anchored and eventually more explicit old-age poverty instrument (Kim and Lee, 2025). Savings from reduced leakage should strengthen protection for truly vulnerable elderly households, with careful treatment of housing assets, renters, and liquidity constraints.

5 Link healthcare, long-term care, and working-life reform

Korea should use KDI's evidence on price effects to focus healthcare reform on provider payment, fee updates, and care coordination before demographic pressure peaks (Kwon, 2025). Long-term care projections should be integrated into the medium-term fiscal framework, since care burdens affect family formation, female employment, and old-age poverty. Longer working lives are fiscally important, but retirement-age reform should be linked to wage-system reform, retraining, age-neutral human-resource practices, and support for SMEs so adjustment does not intensify youth-older worker conflict (OECD, 2025a).

6 Create fiscal-governance tools for intergenerational burden smoothing

Korea should create a Demographic Fiscal Headway Account to report whether incremental revenues and expenditure reforms are genuinely creating room against demographic pressures. The account should be a soft reporting framework rather than a rigid fund, preserving flexibility while improving trust. Major pension, tax, healthcare, long-term care, and retirement-age reforms should also include cohort-impact analysis so aggregate fiscal indicators do not hide generational imbalance.

10 Conclusion

Korea's fiscal challenge is best understood as a predictable intergenerational squeeze rather than an immediate debt crisis. The country begins from a comparatively favorable public-debt position, especially relative to many older European welfare states, but the demographic transition is unusually fast and the private-sector constraints are unusually binding. The central risk is that delay could transform a manageable adjustment into a much harsher future settlement.

The policy package proposed here is a headway strategy, not a substitute for Korea's deeper structural reforms. VAT reform will not raise fertility. Excise taxes will not finance aging. Pension reform will not solve housing affordability. Healthcare payment reform will not reverse population decline. A Demographic Fiscal Headway Account will not create political consensus by itself. The value of these reforms is concrete: they reduce fiscal volatility, preserve room for future governments, and distribute burdens more transparently across cohorts.

That realism is a strength. Korea can learn from Europe where European instruments are useful, while recognizing that many European states now face weaker fiscal starting points. It can learn from Japan's delayed adjustment without treating Japan as destiny. The stronger foundation is domestic: Korean institutional work, Korea's current fiscal credibility, and a clear recognition that the window for gradual adjustment will not remain open indefinitely. The best fiscal strategy is early, credible, compensated, and explicitly transitional: not a final answer to Korea's demographic problem, but a way to keep the state capable while Korea confronts harder structural reforms.

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