

THE REINSTATEMENT OF LOCAL FISCAL AUTONOMY IN THE REPUBLIC OF KOREA

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INTRODUCTION

Two elections for local representative assemblies were held in the Republic of Korea in 1991, the first such elections in thirty years since the last ones that took place in 1960. Next are to be elections for the mayor of Seoul Special City as well as governors of provinces and heads of other local autonomous governments. These elections are the start of a process to revive local autonomy which had flourished for over ten years following Korea's independence in 1948. The thirty years between 1961 and 1991 were a period of economic development carried out under the authority of the central government. These years were also a period of regional development carried out through a policy of priority given to heavy industries. This policy succeeded in efficiently allocating resources, and during these thirty years the Korean economy achieved high rates of growth; however another outcome of the policy has been the rise of numerous economic and social imbalances.

Korea is now plagued by imbalances among economic sectors and within and between social classes, but the most serious imbalance at present is that between regions. For Korea to continue on its successful path of development, these imbalances will have to be corrected. Politically this means that the participation of local citizens and the establishment of local autonomy will be essential, and economically it means that the basis of local finances will have to be established. Local self-supporting economies make possible local development that moves in the direction anticipated by the local citizens. This study examines conditions and issues of present local finances in Korea which economically support local autonomy. Section I looks at the characteristics of Korean public finances in general; Section II looks at the characteristics and problems of local finances; Section III takes up issues to be solved in local finances; and finally Section IV sets forth this study's conclusions.

I. THE CENTRAL GOVERNMENT FINANCIAL SYSTEM

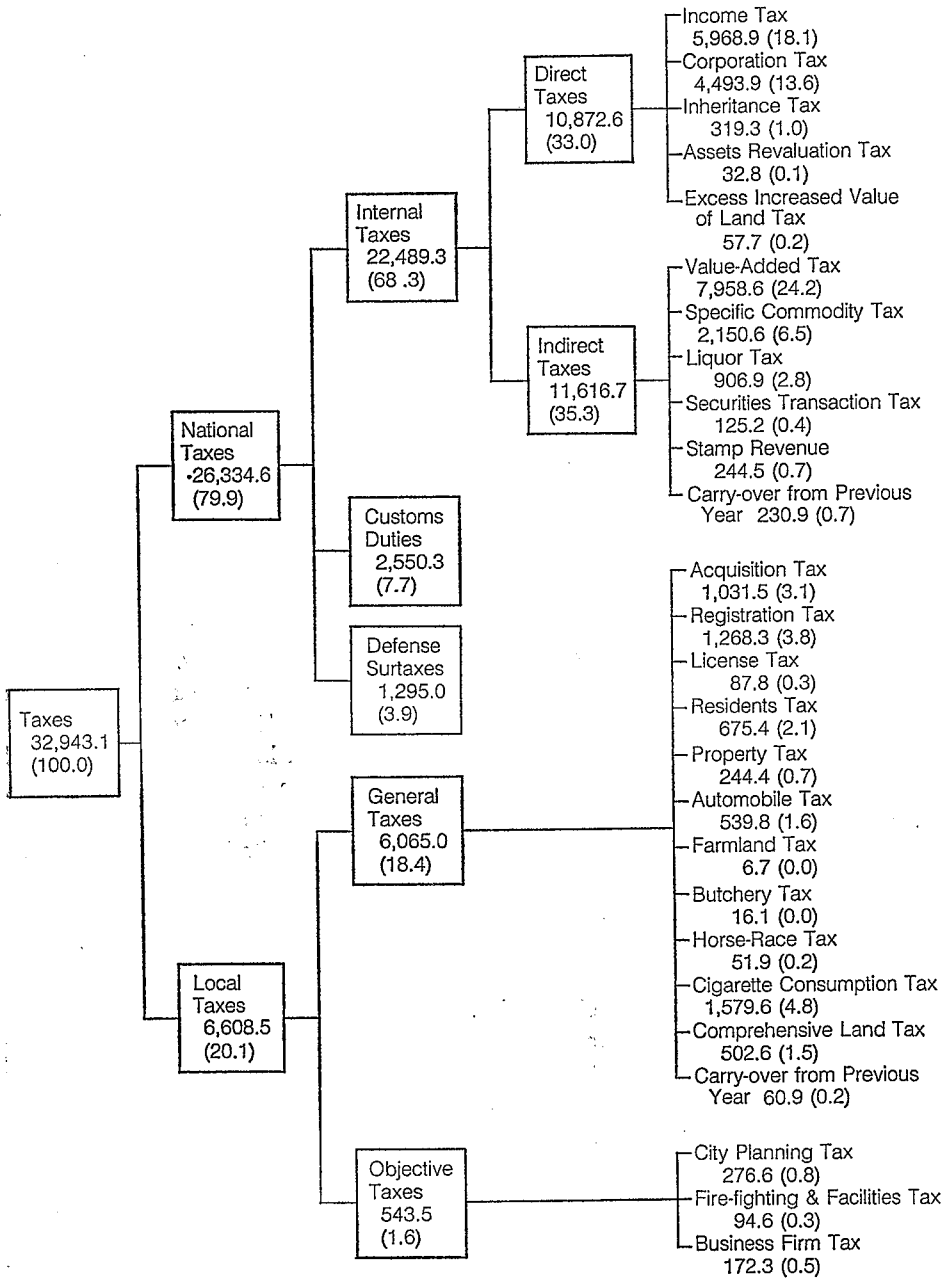
The single most important characteristic of Korea's central finances during the past thirty years has been their employment to support economic development. Ever since the first five-year plan, which went into effect in 1962, the tax system and government expenditures have all been directed toward promoting economic development.

The central government is headed by the president under whom is the prime minister who presides over the cabinet. The Economic Planning Board (EPB), which is in charge of the government budget and economic planning, was set up in 1961 by the military government. Under the chairmanship of the deputy prime minister, the EPB is an essential administrative organization having supervision over economic-related ministries. The administrative offices of the government include the Ministry of Finance, the Ministry of Trade and Industry, the Ministry of Construction, the Ministry of Agriculture, Forestry and Fisheries, the Ministry of Transportation, the Ministry of Energy and Resources, the Ministry of Communications, the Ministry of National Defense, the Ministry of Labor, the Ministry of Education, the Ministry of Health and Social Affairs, the Ministry of Foreign Affairs, and the Ministry of Home Affairs. This last office is responsible for local administration and finances and for internal security.

Looking first at the tax system, in 1965 when the United States changed its policies on economic assistance to Korea, the government used the opportunity to set up a National Tax Administration and reorganize its tax administration structure. This reorganization was directed toward increasing domestic tax revenues, stimulating domestic savings as well as providing a variety of measures for promoting exports in order to acquire foreign exchange. The most prominent features in these moves were the measures allowing for the reduction and exemption of customs duties. Such reduction and exemption were allowed for imports of capital goods and intermediate goods needed to produce goods for exports as well as capital goods that improved the country's industrial structure and strengthened its international competitiveness. The ratio of reductions and exemptions to total customs duties collected rose during the second half of the 1960s, peaked in 1973, thereafter gradually declined, and has now stabilized at a lower level. Compared with other developing countries where customs duties are employed as a means for procuring revenues, Korea has regarded customs duties as a means for fostering industries. Reductions and exemptions have not been limited to customs duties however; they have also been applied to corporation and income taxes as incentives for promoting industrialization. Tax reductions and exemptions on income from exports and on corporate income for setting up heavy industries have been extensively provided along with preferential financing to individual industries notably those in machinery and electronics.

However these measures have brought about a reduction in tax revenues, and the government has had to look for new sources of income. This need was the primary reason for the introduction of a value-added tax in 1977. This tax continues to be the government's single largest source of income in a tax system that has continued to rely predominantly on indirect taxation. However since the latter half of the 1980s with the rise in wages and salaries, the share from direct taxes has been increasing, and while indirect taxes still provide the larger share of tax revenues, since 1989 Korea has come to have an essentially balanced tax revenue structure. In 1990 indirect taxes provided 51.7 per cent and direct taxes 48.3 per cent of government tax revenues.

Fig. 1. The Present Tax System: 1991 Budget (in Billion Won and %)



Source: [8, p. 31].

TABLE I
THE COMPOSITION OF CENTRAL GOVERNMENT REVENUES

	(%)				
	1987	1988	1989	1990	1991
	(Actual)	(Actual)	(Actual)	(Budget)	(Budget)
1. National taxes	86.3	84.1	83.0	87.7	96.9
a. Internal taxes	56.0	56.9	59.4	61.6	82.6
b. Customs duties	15.0	11.7	8.3	9.6	9.5
c. Defense surtaxes	13.0	13.2	13.6	14.8	4.8
d. Education surtaxes	2.3	2.3	1.7	1.7	—
2. Monopoly profits	5.1	4.3	0.0	—	—
3. Other non-tax revenues	3.1	3.0	3.1	2.6	2.9
4. Loans	0.5	0.2	0.1	0.2	0.2
5. Carry-over from previous year	5.0	8.4	13.8	9.5	—
6. Total	100.0	100.0	100.0	100.0	100.0

Source: [1, p. 81].

TABLE II
THE COMPOSITION OF CENTRAL GOVERNMENT EXPENDITURES

	(%)				
	1987	1988	1989	1990	1991
	(Actual)	(Actual)	(Actual)	(Budget)	(Budget)
1. National defense	30.4	30.7	28.3	25.1	28.7
2. Education	19.8	20.5	19.7	20.3	19.1
3. Social development	8.2	7.8	8.8	8.9	11.0
4. Economic development	19.4	14.6	15.3	13.0	15.9
5. General administration	9.9	9.9	10.1	10.2	12.4
6. Local finance subsidies	10.2	9.6	9.9	10.1	11.0
7. Debt reimbursement, etc.	1.1	1.0	1.7	2.0	1.6
8. Reinvestments and financing cost	1.0	5.9	6.2	10.4	0.3
9. Total	100.0	100.0	100.0	100.0	100.0

Source: [1, p. 69].

As can be seen from Table I, the central government gets 97 per cent of its income from tax revenues in 1991, and only an insignificant amount from national bonds. It is clear from this that the government depends almost entirely on taxation for its revenues.

Turning next to government expenditures, until around 1980, expenditures on economic development along with those for national defense were the two largest outlays, indicating that until that time economic development was a major target for the employment of government finances. However with the 1980s, expenditures on social development gradually increased. As the importance of social development has increased, there has been a change in the target for government finances (see Table II). Until the time of the third five-year plan (1972-76), education

expenditure accounted for two-thirds of the expenditures on social development,¹ or about 20 per cent of total expenditures, and expenditures on social security, health, housing, and the like did not even reach 10 per cent of total expenditures. Not until the budget for 1991 did the expenditures for these latter finally go over 11 per cent. Thus Korea shows a marked contrast from the advanced nations of Europe and the United States where social security expenditures account for over 40 per cent of government expenditures. One important reason for Korea's low expenditures on social security is the low portion of the population that is sixty-five years and older when compared with the advanced countries, but another cause is the underdeveloped state of the public pension program, unemployment insurance, and other facilities of Korea's social security system.

Before examining the conditions of local finances, we will look at Korea's system of local government (Figure 2). The principal units of local government are divided into two groups. The first group includes autonomous local governments with large areas such as Seoul Special City under the direct supervision of the prime minister, five direct jurisdiction cities under the control of the minister of home affairs, and nine provinces. Under the jurisdiction of the provinces are the second group or basic autonomous local governments consisting of cities and counties. Added to these, in the second group there are wards which are divided into: (1) autonomous wards under the jurisdiction of Seoul Special City and the direct jurisdiction cities and which have autonomous authority, and (2) wards under cities with a population of over 500,000 people and which do not have autonomous authority. Under the counties are towns (*eub*) and townships (*myeon*); under the cities and wards (including the autonomous wards) are urban neighborhoods (*dong*), and under the towns and townships are rural neighborhoods (*ri*). Urban areas with a population of over 50,000 are classified as cities, and those with a population over 20,000 are towns.

This study will examine the finances of Seoul Special City; the nine provinces of Gyeonggi, Gangweon, Chungcheongbug, Chungcheongnam, Jeonlabug, Jeonlanam, Gyeongsangbug, Gyeongsangnam, and Jeju; the five direct jurisdiction cities of Incheon, Daejeon, Daegu, Gwangju, and Busan; as well as the finances of the other cities, counties, and the autonomous wards under Seoul Special City and the five direct jurisdiction cities (Figure 3).

II. LOCAL FINANCES AND THEIR PROBLEMS

The primary characteristic of central government finances has been the clear priority given to the development of the Korean economy. From the standpoint of local finances however, the central government's policy of promoting selected strategic industrial regions has brought about striking disparities among the different regions and between urban and rural areas. As will be pointed out below, although

¹ Until 1981, education expenditure was calculated as part of social development expenditures. To get a more accurate view of social development expenditures, education expenditure has been removed from the social development expenditures and treated as an independent item throughout this paper.

Fig. 2. The Structure of Local Governments in Korea

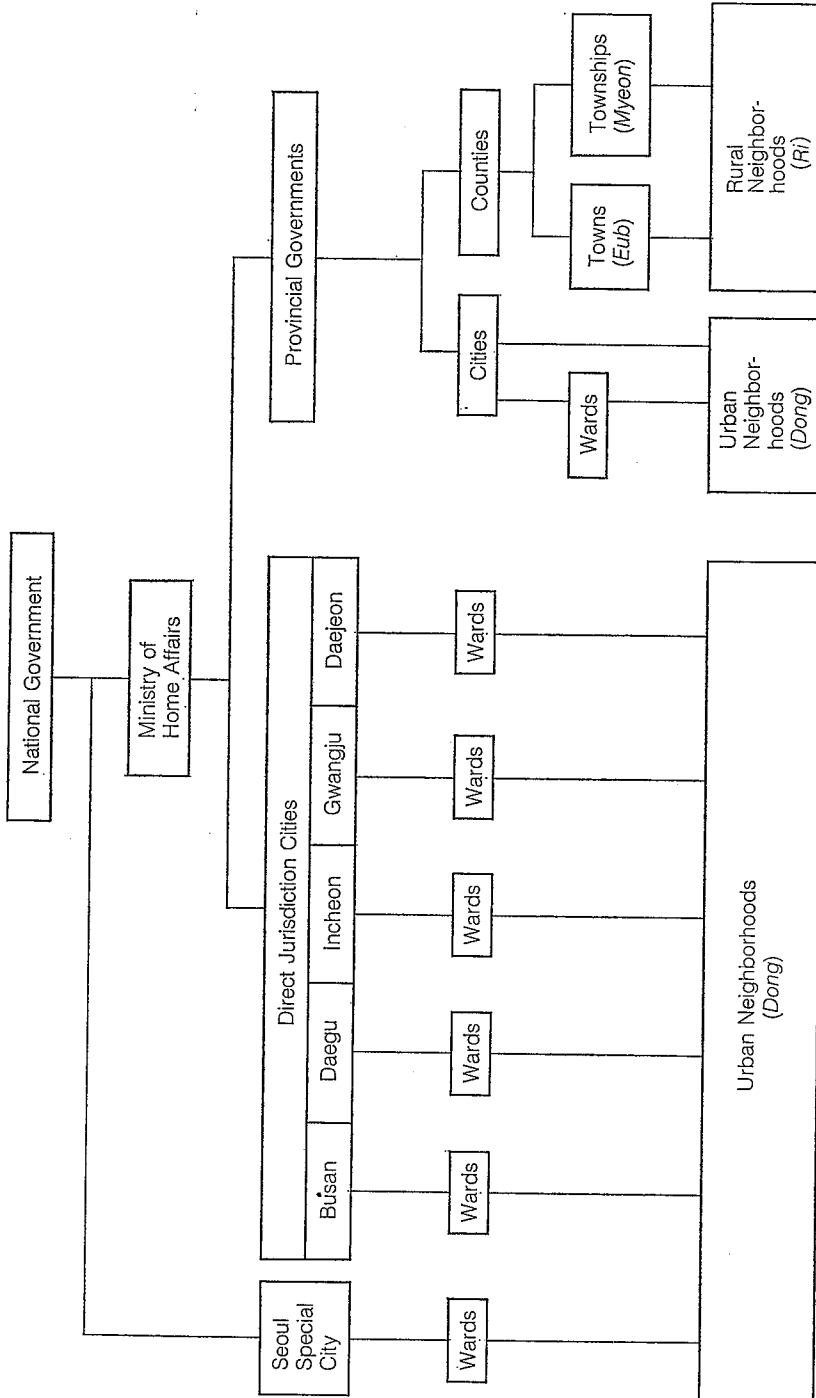
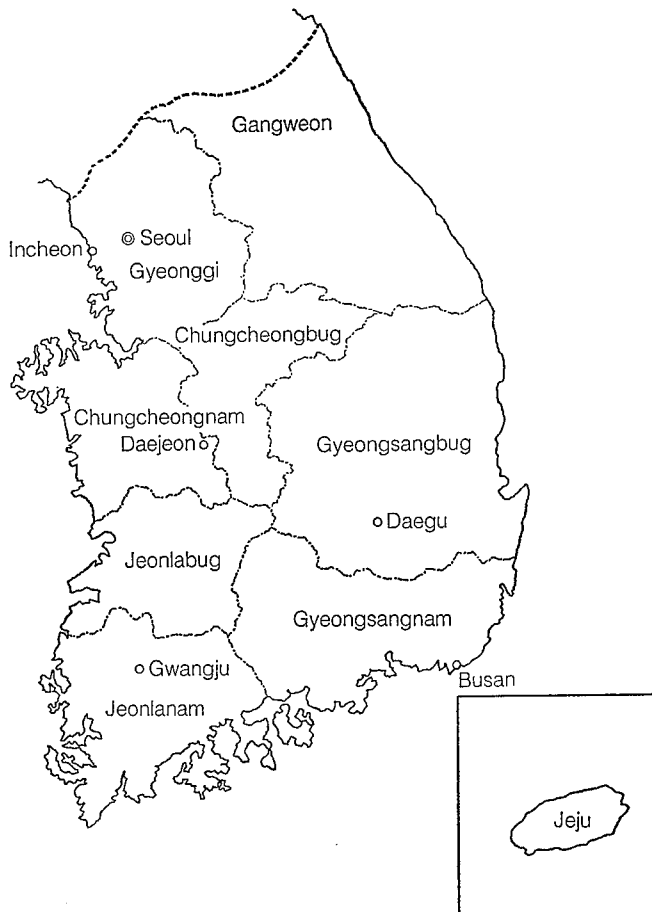


Fig. 3. The Provinces of Korea



the concentration of economic development in the capital city may be a common phenomenon observable worldwide, the fact that most of the heavy industries were constructed in Gyeongsang provinces in the southeastern part of Korea shows the dictatorial development pursued by the Park Chung-hee government that came to power in the coup d'état of 1961. In that year the new military government suspended the autonomy of local governments as part of its program to concentrate authority in the central government. Until that time, local autonomy had been guaranteed by law (Table III), even though it suffered from various weaknesses. But under Park's military government, economic development became centralized under the state, and henceforth economic policy did not pursue the well-balanced development of local economies but concentrated development efforts in a small number of the regions in order to maximize economic growth. Thus Korea's regional disparities are not simply a holdover from the past, rather these were brought

TABLE III
LEGAL REVISIONS AND CHANGES IN THE SYSTEM OF LOCAL AUTONOMY

	The Constitution and Laws		Local Elections	
	The Constitution	Local Autonomy Act	Local Assemblies	Chiefs of Local Government
The First Republic	July 1948: Ordained	July 1949: Promulgated Dec. 1949: 1st amendment	Apr. 5, 1952: Members of provincial, city, <i>eub</i> , and <i>myeon</i> assemblies	
	July 1952: 1st amendment Nov. 1954: 2nd amendment	Feb. 1956: 2nd amendment July 1956: 3rd amendment	Aug. 1956: Members of Seoul, provincial, city, <i>eub</i> , and <i>myeon</i> assemblies	Aug. 1956: Chiefs of cities, <i>eub</i> , and <i>myeon</i>
		Dec. 1958: 4th amendment		
		June 1960: 3rd amendment Nov. 1960: 4th amendment		
The Second Republic		Nov. 1960: 5th amendment	Dec. 1960: Members of Seoul, provincial, city, <i>eub</i> , and <i>myeon</i> assemblies	Dec. 1960: Mayor of Seoul, governors of provinces, chiefs of cities, <i>eub</i> , and <i>myeon</i>
The Third Republic		Sept. 1961: Provisional Act on Local Autonomy promulgated Mar. 1962: 1st amendment	May 1961: Local assemblies dissolved	Sept. 1961: Changed to an appointment system
		Dec. 1962: 5th amendment		
		June 1963: 2nd amendment Dec. 1963: 3rd amendment		
		Oct. 1969: 6th amendment		

TABLE III (Continued)

	The Constitution and Laws		Local Elections	
	The Constitution	Local Autonomy Act	Local Assemblies	Chiefs of Local Government
The Fourth Republic	Dec. 1972: 7th amendment	Mar. 1973: 4th amendment Dec. 1975: 5th amendment		
The Fifth Republic	Oct. 1980: 8th amendment	Apr. 1981: 6th amendment		
The Sixth Republic	Oct. 1987: 9th amendment	Mar. 1988: Complete revision		

Source: [4].

TABLE IV
SHARE OF GROSS PRODUCTION BY REGION

	(%)		
	1975	1980	1985
Seoul	28.1	27.7	28.3
Busan	8.2	9.1	8.8
Incheon & Gyeonggi Province	12.3	14.4	16.1
Gangweon Province	4.1	4.0	3.9
Chungbug Province	4.0	3.2	3.1
Chungnam Province	6.5	6.0	5.8
Jeonbug Province	5.4	4.3	4.2
Jeonnam Province	8.6	8.2	7.2
Daegu & Gyeongbug Province	11.0	11.2	11.4
Gyeongnam Province	10.2	10.8	10.1
Jeju Province	1.1	1.0	1.0
Whole country	100.0	100.0	100.0

Source: [9, p. 132].

Note: Names of the provinces have been shortened. For full terms, see Figure 2.

TABLE V
CHANGE IN THE COMPOSITION OF INDUSTRIES BY REGION

	1974			1983		
	Primary Industry	Secondary Industry	Tertiary Industry	Primary Industry	Secondary Industry	Tertiary Industry
Seoul	2.1	20.4	77.5	0.8	21.0	78.2
Incheon & Gyeonggi	37.5	22.4	40.2	16.2	47.9	35.8
Gangweon	35.1	21.0	43.9	24.2	28.5	47.4
Chungbug	50.7	15.0	34.3	38.3	24.9	36.8
Chungnam	53.8	11.1	35.1	34.0	23.5	42.6
Jeonbug	56.3	9.9	33.8	41.1	16.8	42.1
Jeonnam	55.9	10.9	33.2	31.1	27.6	41.3
Daegu & Gyeongbug	44.8	14.8	40.4	21.7	31.3	47.0
Busan & Gyeongnam	26.9	22.7	50.4	10.5	44.7	44.8
Jeju	48.6	4.2	47.2	44.2	3.1	52.7

Source: [9, p. 134].

Notes: 1. Based on the 1980 constant price.

2. Names of the provinces have been shortened. For full terms, see Figure 2.

about intentionally by government policy. Park and the two presidents who followed him came from Gyeongsang provinces, and their policy of favoring their home provinces for economic development is the direct cause today for the confrontations with Jeolla and other provinces.

Looking first at the economic imbalance among the regions, Tables IV through VI show shares of gross production, the industrial shares, and shares of fund

TABLE VI
THE LEVEL OF FINANCIAL ALLOCATION BY REGION

(%)

	1980			1985		
	Ratio of Lending/Deposit	Lending Ratio	Lending/GRP Ratio	Ratio of Lending/Deposit	Lending Ratio	Lending/GRP Ratio
Seoul	97.5	64.4	27.7	111.9	60.6	28.3
Busan	96.7	8.8	9.1	95.5	7.9	8.8
Incheon & Gyeonggi	76.9	4.9	14.4	88.2	7.9	16.1
Gangweon	82.6	1.5	4.0	83.9	1.5	3.9
Chungbug	115.6	1.4	3.2	118.3	1.5	3.1
Chungnam	102.3	2.7	6.0	103.9	3.0	5.8
Jeonbug	123.1	2.3	4.3	144.0	2.4	4.2
Jeonnam	107.4	1.9	8.2	136.4	2.3	7.2
Daegu & Gyeongbug	108.7	6.6	11.2	110.5	6.8	11.4
Gyeongnam	88.4	4.8	10.8	86.7	5.4	10.1
Jeju	90.9	0.7	1.0	109.4	0.7	1.0

Source: [9, p. 137].

- Notes: 1. Lending ratio = regional lending / total lending \times 100. GRP stands for gross regional product.
2. Names of the provinces have been shortened. For full terms, see Figure 2.

allocation by region. From Table IV it can be seen that gross production for Seoul-Incheon-Gyeonggi Province is over 40 per cent, and with the addition of Busan, Daegu, and Gyeongsang provinces this figure reaches about 75 per cent. This is true for manufacturing, shown in Table V which points out the concentration of this sector in Incheon and Gyeonggi and Gyeongsang provinces, while agriculture is concentrated in the other regions. From Table VI it is clear that lending by financial institutions is highly concentrated in Seoul; that is, these institutions procure funds locally and invest these in major cities and industrial regions.

This regional imbalance has largely split the country into the industrialized zones of the Seoul capital district, Busan, Daegu, and Gyeongsang provinces on the one side and the rest of the country on the other. The former districts suffer from a concentration of population and accompanying urban problems such as housing shortages and traffic congestion as well as the difficulties of acquiring land for factories. At the same time the latter have suffered from economic stagnation and the outflow of population. The development of Jeonla provinces and the western seaboard will be especially important for a more balanced growth of the Korean economy.

This sort of regional economic imbalance has caused regional imbalance in local finances. The Seoul capital district including nearby Incheon and Gyeonggi Province as well as the highly industrialized Gyeongsangnam Province have a high capacity of financial self-support while the other regions (excluding the direct jurisdiction cities) have a low capacity (see Table X). Because Seoul enjoys the

highest capacity of financial self-support, the government allots it very little in the way of local share taxes and national subsidies. In actual fact however, the government helps the capital city by covering some of its major expenditures such as subway construction. Rapid population growth has caused serious traffic congestion and other problems, and overcoming these has posed a heavy financial burden. The size of subway construction costs alone has been comparable to that of the city's general account budget. If these costs are added in, Seoul's capacity for financially supporting itself drops to almost the same level as the other cities.

In fact, when measured per capita, the size of Seoul's finances is not high at all. This indicates that as the population of a region becomes more concentrated, the income of that region rises, but at the same time the demands on local government services and the costs of urbanization also increase. In Gyeongsangnam Province, with its flourishing industrial zones and where urban problems are not as serious as in the Seoul capital district or in the direct jurisdiction cities, the self-supporting financial capacity and the per capita financial burden are higher on average than in other provinces. Nevertheless, when examined excluding the province's industrial zones, the quality of government services in the region cannot be regarded as high.

As can be seen from the country's transportation and communications networks, which are directly connected with the Seoul region, public services have been provided with priority given to industrial use and have not reflected the needs of regional citizens. However, government policy has been to pursue an "era of development," and perhaps no assertion can be made that there was a more effective policy.

The central government policy of promoting selected strategic regions brought about the economic imbalance among the regions. This policy caused on the one hand the concentration of population in the Seoul capital district, the Gyeongsangnam region, and other industrial zones due to industrialization and urbanization, which brought traffic congestion, housing shortages, difficulties in locating factories, and other urban problems. For the neglected regions, however, the policy caused depopulation and economic stagnation. It brought to the developed regions the benefits of accumulation, but pursuing further accumulation has led to the phenomenon of increasing costs, while in the depopulated regions existing equipment has been idled. In effect the policy has brought about the inefficient employment of resources in both regions. Despite such policy efforts as the planning and promotion of the 1982 second comprehensive national land development plan to correct the imbalances, for the past thirty years the concentration of population and industry in the capital district and the other industrialized regions has continued. This has increasingly strengthened the need for establishing economic development policy from a new perspective, and out of the need for economic change arose the demand for a restoration of local autonomy.

Along with recognizing the need for a policy change, people came to realize the importance of autonomy. In other words, the consciousness of autonomy and capacity for autonomy were strengthened with the rise in income and education level and with the progress of urbanization. Urbanization in particular had a great impact on the political demand for local autonomy. In 1960 there were

twenty-seven cities with a population of 50,000 or over, representing 28 per cent of the total population; by 1970 the number of such cities had risen to thirty-two with 41.2 per cent of the population; by 1980 the figure stood at forty with 57.3 per cent of the population; and by 1986 the number was sixty-one with 65.7 per cent. Urban residents accounted for almost 70 per cent of the country's population. With the rise in their standard of living, people came to demand not only quantitative improvements in government services and social infrastructure but also qualitative improvements. They came to demand services adequate to their own situations and not just standardized services. For example, in the 1960s people called for the installation of roads; in the 1970s they wanted the roads widened; in the 1980s their demand changed again to calls for the roads to be paved [7, p. 437].

In 1987, as it became increasingly evident that Korea needed to reassess its development policy, President Roh Tae-woo (then chairman of the Democratic Justice Party) set out his June 29 declaration on democratization, an eight-point proposal which initiated moves to revive local autonomous government. It is evident from what has already been set forth in this study that Korea is now confronting the limits of its development policy which has concentrated on promoting selected strategic industrial regions. Korea is now at the stage where balanced growth among the different regions will be indispensable if the country is to continue experiencing its high rates of economic growth. The greatest political need now for achieving this objective is the restoration of local autonomy, for it is now recognized that such a restoration will be the means for correcting the country's regional imbalances and for making possible the optimum reallocation of resources for the country as a whole. For this reason a major issue now facing Korea is the need to provide the basis of local finances, for ultimately it is the strength of these finances that will make local autonomy possible. The present reality, however, is that centralized development and finances have existed for the past thirty years, and this fact is sure to put great constraints on efforts to strengthen local finances.

A. *The Size of Local Finances*

The relative size of Korea's local public finances and that of the central government are shown in Table VII. From this table it can be seen that during the 1970s and 1980s the combined ratio of central and local finances to GNP stood in the 20 per cent range, but that in 1990 this rose to the 30 per cent level, indicating the increased importance of public finances. The share of local finances rose at a faster pace than that of the central government. An example indicating this is the growth in the number of government workers. As of June 1989 the number of national government workers was 17.6 per cent higher than in 1980; but the corresponding number for local government workers increased by 66.6 per cent, reflecting the increase in demand for local government services. However, the ratio of Korea's local finances to GNP is still small when compared with that of advanced countries. Table VIII provides a comparison of Korea with several advanced countries whose governments are also not of the federal type. For Korea

TABLE VII
THE TREND OF GROWTH IN THE SIZE OF LOCAL FINANCES

	(Billion won)				
	1970	1975	1980	1985	1990 ^a
Total governmental finances ^b (A)	693.7	2,482.1	10,502.9	20,028.4	51,023.4
Central government ^c (B)	526.5	1,923.6	7,898.7	13,433.8	29,439.2
Local governments (C)	167.2	558.5	2,604.2	6,594.6	21,584.2
GNP	2,776.9	10,064.6	36,672.3	72,849.6	152,630.0 ^d
C/A (%)	24.1	22.5	24.8	32.9	42.3
C/GNP (%)	6.0	5.5	7.1	9.1	14.1
A/GNP (%)	25.0	24.7	28.6	27.5	33.4

Source: [9, p. 24].

^a Budget.

^b Net total of expenditures (general accounts plus special accounts excluding education special account).

^c Transfers to local governments (local share tax and national subsidies) are counted twice.

^d Preliminary.

TABLE VIII
INTERNATIONAL COMPARISON OF KOREAN LOCAL FINANCES (1987)

	(%)			
	Korea	Japan	U.K.	France
Local finance/total finance	42.2	61.5	28.0	15.4
Local finance/GDP	8.6	18.1	13.6	7.4
Total finance/GDP	20.4	29.5	48.4	48.3

Source: [9, p. 25].

Note: Net total of actual expenditures (general accounts plus special accounts).

the share of local finances to total public finances is larger than that for Britain and France, but it is important to note that for both Britain and France total finances to GNP is nearly twice that of Korea. When compared with Japan whose local public finances are very similar to those of Korea, it can be seen more clearly that Korea needs to expand the size of its local finances.

B. Revenues Available to Local Finances

Looking next at revenues for local finances, a notable feature is that local taxes make up an extremely small portion of total taxes. Table IX shows the comparative trend of national taxes and local taxes. It can be seen that the share for local taxes has been trending upward, reaching 19 per cent in 1990, while that for national taxes has been decreasing; nevertheless its 81 per cent share in 1990 still shows the overwhelming dominance of national taxes. The sources of revenue available to local governments and their ratio to total revenues are shown in

TABLE IX
THE COMPARATIVE SIZE OF NATIONAL AND LOCAL TAXES

	National Taxes		Local Taxes		Total	
	Billion Won	(%)	Billion Won	(%)	Billion Won	(%)
1970	364.9	(91.7)	33.2	(8.3)	398.1	(100.0)
1975	1,391.0	(89.8)	158.8	(10.2)	1,549.8	(100.0)
1980	5,807.7	(88.3)	767.7	(11.7)	6,575.4	(100.0)
1981	7,257.9	(88.8)	914.4	(11.2)	8,172.3	(100.0)
1982	8,405.4	(88.2)	1,119.2	(11.8)	9,524.6	(100.0)
1983	10,050.3	(87.8)	1,397.2	(12.2)	11,447.5	(100.0)
1984	10,899.7	(87.9)	1,508.4	(12.1)	12,408.1	(100.0)
1985	11,876.1	(87.8)	1,654.6	(12.2)	13,530.7	(100.0)
1986	13,606.2	(88.2)	1,809.7	(11.8)	15,415.9	(100.0)
1987	14,151.3	(86.6)	2,192.3	(13.4)	16,343.6	(100.0)
1988	19,484.2	(86.3)	3,100.0	(13.7)	22,584.2	(100.0)
1989	18,408.5	(82.3)	3,945.8	(17.7)	22,354.3	(100.0)
1990	21,924.2	(81.0)	5,158.0	(19.0)	27,082.2	(100.0)

Source: [6].

Table X. It can be seen that revenue from taxation provides less than 40 per cent of the total general account revenues in 1990. The remainder is made up largely of non-tax revenues, local share taxes, and national subsidies which altogether provide close to 60 per cent of total local revenues. However these are average nationwide figures. If we look at revenues by local government, we can see from the table that there are very considerable disparities in the shares coming from the different revenue sources. For Seoul, 82.5 per cent of its revenues comes from local taxes and the remainder comes from non-tax revenues. For Busan and the other four direct jurisdiction cities, tax revenues provide about 60 per cent, non-tax revenues 25 per cent, and subsidies from the national government about 14 per cent of their total revenues. But as can be seen from Table X, the portion of revenues coming from taxation declines as one descends from cities, to provinces, to counties, and finally to wards, while that coming from local share taxes and national subsidies rises. This indicates that as urban areas decrease in size and as regions become more rural, their capacity to be financially self-supporting goes down. There are 158 local governments, i.e., 63 per cent of all cities, provinces, counties, and wards in the country, whose revenues from taxes alone are insufficient to cover even their personnel expenses. When revenues from non-tax sources are added, there are still 77 local governments (31 per cent) whose self-supporting revenues are still insufficient to meet their personnel expenses [5, p. 45]. From this it can be seen that the self-supporting financial capacity of Seoul and the five large direct jurisdiction cities is high. Other cities, provinces, counties, and other local administrative units, however, would find it very difficult to supply public services if the central government did not make up for their revenue shortfalls.

Table XI provides the composition of local government tax revenues. According to the general account, the single largest source of tax revenue comes from the

TABLE X
THE PRINCIPAL CATEGORIES OF LOCAL REVENUES (1990)

	Total Revenues		Local Tax Revenue	Non-tax Revenue ^a	Local Share Tax	National Subsidies	Control Grants	Financial Self-sufficiency Ratio
	Billion Won	%						
Seoul ^b	2,317.5	100.0	82.5	14.4	0.0	3.0	—	97.0
Direct jurisdiction cities	1,728.7	100.0	57.8	25.3	3.0	13.9	—	83.1
Provinces	2,926.9	100.0	23.0	10.6	19.2	47.2	—	33.6
Cities	1,992.5	100.0	43.1	26.0	12.0	18.9	—	69.2
Counties	3,192.1	100.0	16.6	11.9	37.8	33.7	—	28.5
Wards	1,180.0	100.0	15.8	11.1	0.0	20.9	52.2	26.9
Whole country	13,337.7	100.0	38.7	15.8	15.5	25.4	4.6	54.5

Source: [9, p. 34].

Notes: 1. Based on the general account budget total.

2. Financial self-sufficiency ratio is the share of local tax and non-tax revenues to total revenues.

^a Including local loans.

^b Control grants for Seoul Special City is classified under revenues of wards.

TABLE XI
LOCAL TAX REVENUE BY CATEGORY (1991)

	Value (Billion Won)	Percentage
Acquisition tax	1,031.5	16
Registration tax	1,268.3	19
License tax	87.8	1
Horse-race tax	51.9	1
Residents tax	675.4	10
Property tax	244.4	4
Automobile tax	539.8	8
Farmland tax	6.7	—
Butchery tax	16.1	—
Cigarette consumption tax	1,579.6	24
Comprehensive land tax	502.5	8
City planning tax	276.6	4
Fire-fighting & facilities tax	94.6	1
Business firm tax	172.3	3
Carry-over from previous year	60.9	1
Total	6,608.5	100

Source: Ministry of Home Affairs, *Jibang jachiche yesan gaeyo, 1991* [Summary of local government budget, 1991].

cigarette consumption tax introduced in 1989 (called the cigarette sales tax between 1985 and 1988) which provides 24 per cent of total tax revenues. Next is the registration tax providing 19 per cent, then the acquisition tax (paid by those who acquire real estate, motor vehicles, heavy equipment, trees, boats, and aircraft) which provides 16 per cent. These three taxes together provide about 60 per cent of total tax revenues. Only a tiny amount of revenue comes from the highly elastic income-related taxes, while about 60 per cent comes from the inelastic taxes imposed on property. Among the latter group are the property tax and the city planning tax, but as is well known, the assessment of fixed assets does not move closely with market prices, posing problems for increasing local tax revenues.

An extremely important development for local taxes was the introduction of the comprehensive land tax. Under this tax scheme the value of all land owned nationwide by an individual landowner is totaled together, calculated under a progressive tax scale, then the taxes are distributed to the cities, counties, and wards where the land is located. This tax law was passed by the Parliament with the intention of restraining excess land ownership and speculation in property. But for this tax scheme to work, it will be necessary to total up during a set period of time the taxation data for all 260 cities, counties, and wards throughout the country, and for this the government will have to set up a nationwide computer network. This tax scheme will require far more work than any other local tax ever has, nevertheless it was put into effect in 1990. According to Table XI this tax presently provides only 8 per cent of local tax revenue, but as the frame-

work for collecting the tax is put into place, this tax revenue is expected to increase. In 1991 a regional development tax was introduced by provincial governments as one of the objective taxes to be used for specific purposes. This tax is intended to increase local tax revenues and is to be assessed on such things as electric power generation, the use of underground water, and on underground resources [2].

The growing financial self-supporting capability of Seoul and the other large cities has already been noted, and there is a clear imbalance in local tax revenues among the different regions. There is also a striking disparity in the share of tax revenues going to the different administrative units. In 1989 Seoul's share alone was 36.6 per cent while it was 20.8 per cent for the five direct jurisdiction cities together, 16.7 per cent for the other 67 cities, 12.3 per cent for the nine provinces, 10.4 per cent for the 137 counties, and 3.3 per cent for the 34 wards. If the local governments with large areas and the "basic" local governments are to become financially self-supporting and realize local autonomy, then the above inequalities in tax revenues will have to be corrected.

Because of the inability of local governments to financially support themselves, local share taxes from the central government are provided to cover the expenses of general local administrative services. The local share tax system has undergone changes over the years. Until 1973 when promotion of heavy industries began in earnest, the rate of local share tax had been set at 17.6 per cent of internal tax revenues, but in that year the system was revised so that the percentage could be flexibly set at the central government's discretion. This change created uncertainties and instability in local government funding and budgeting, and ultimately these governments had to reduce their budgets. This system continued in effect until 1982 when the relevant share was again set at a fixed portion of internal tax revenues, but the rate of allotment was lowered to 13.27 per cent. The portion of local government revenues coming from local share taxes and national subsidies was 62.4 per cent in 1970; this fell to 39.3 per cent in 1980, but rose to the 40 per cent level thereafter, and was budgeted at 45.5 per cent in 1990. From this it can be seen that local share taxes and national subsidies provide an important share of local government revenues, and are employed as a means for correcting regional imbalances. There are two types of local share taxes: an ordinary share tax and a special share tax. The special share tax is set at one-tenth that of the ordinary share tax. The ordinary share tax is allotted to local governments whose annual revenues do not cover their basic financial requirements. The special share tax is allotted when special financial demands arise or revenues have declined for unusual reasons. National subsidies are different from local share taxes in that the former are provided by the central government to assist with expenditures on projects for specific purposes that are undertaken by local governments. National subsidies and local share taxes provide practically equal amounts of revenue for local governments.

As can be clearly seen from Table X, the share of revenues that provincial, city, and county governments (excluding Seoul, the direct jurisdiction cities, and their wards) receive from local share taxes and national subsidies is extremely high.

TABLE XII
REVENUES OF LOCAL GOVERNMENTS BY SOURCES (1988)

(Billion won; %)

	Population Ratio	Local Tax	Local Tax + Non-tax Revenue	Local Tax + Non-tax Revenue + Local Share Tax	Local Tax + Non-tax Revenue + Subsidies	Local Tax + Non-tax Revenue + Local Share Tax + Subsidies
Seoul	23.8	879.9 (44.0)	1,119.3 (38.2)	1,119.3 (28.4)	1,149.9 (28.3)	1,149.9 (22.6)
Direct jurisdiction cities	19.8	459.8 (23.0)	698.7 (23.9)	733.8 (18.7)	817.5 (20.1)	857.6 (16.9)
Cities	25.5	337.2 (16.9)	572.8 (19.6)	796.4 (20.2)	842.9 (20.7)	1,066.4 (21.0)
Counties	30.9	322.2 (16.1)	538.2 (18.3)	1,288.2 (32.7)	1,259.3 (30.9)	2,009.3 (39.5)
Total	100.0	1,999.1 (100.0)	2,929.0 (100.0)	3,937.7 (100.0)	4,069.6 (100.0)	5,083.2 (100.0)

Source: [10, p. 141].

- Notes: 1. Based on the general account budget total for 1988.
2. Figures in parentheses are percentages.

Moreover, when allotting local share taxes to the regions, very little goes to Gyeonggi Province, Gyeongsangnam Province, or the other industrially developed regions, while that allotted to the other regions is very large. More specifically, the provinces and counties which respectively account for only 15.2 per cent and 13.7 per cent of total local revenues, are allotted a 30.7 per cent and 51.5 per cent share of the share taxes, indicating that these allocations are indispensable for the financially weak local governments. From the figures in Table XII it can be seen that the local share taxes and national subsidies act as an adjustment mechanism to ameliorate the financial imbalances among the local governments. The figures show that these taxes and subsidies bring about almost equal per capita revenue to the different local governments.²

Non-tax revenues are not regulated by the central government, and local governments can freely turn to these to increase their income. These revenues are the largest source of income for these governments accounting for nearly 50 per cent of the revenues going into their general accounts and special accounts combined (see Table XIII). Non-tax revenues appropriated for the general accounts come from fees charged for government services or for using public facilities and from interest payments; those appropriated for the special accounts

² The provinces have the function of transferring financial resources and also duplicate the population of the other local governments, and for these reasons they have not been included in Table XII.

TABLE XIII
CHANGES IN THE COMPOSITION OF LOCAL REVENUES

	(%)				
	1970	1975	1980	1985	1990*
Local tax	19.9	28.4	29.5	25.1	23.9
Non-tax revenue	36.8	35.8	41.8	51.2	47.4
Local share tax	30.6	21.1	15.7	15.3	9.5
National subsidies	12.8	14.7	13.0	8.5	16.3
Control grants	—	—	—	—	2.9
Self-sufficiency ratio	56.6	64.2	71.2	76.2	71.3
Total revenues					
%	100.0	100.0	100.0	100.0	100.0
(Billion won)	(167.2)	(558.5)	(2,604.2)	(6,594.6)	(21,584.2)

Source: [9, p. 73].

Note: Net total (settled) of general accounts and special accounts (excluding education special account). For self-sufficiency ratio, see note to Table X.

* Budget.

come from income on public services such as water and sewage, housing, land readjustment services, and construction of industrial estates. Although revenues from business activities of public enterprises connected with public works are of central importance for the special accounts, on a nationwide average over 60 per cent of the public works are not run in the form of public enterprises. This is because their personnel, organizational, budgeting, accounting, and other systems are not independent of the local governments, which cause problems that make public works inefficiently run. Moreover, fees that public enterprises can charge are determined by presidential decrees, meaning that such fees are determined by political rather than economic considerations. This has caused numerous problems needing to be rectified, such as fees being kept below the costs of operations, fees inelastic to changing economic conditions, and fees determined uniformly throughout the country regardless of regional differences.

Generally speaking, the issuing of local government bonds is regarded as an effective way of raising funds. In Korea, however, this is not regarded as a normal revenue measure and only for specific cases and under special circumstances are small amount of such bonds issued. Moreover there is no well-established bond market, especially for the local areas. Nevertheless, the percentage of revenue gained through local bond issues rose from 4.0 per cent in 1970 to 10.2 per cent in 1990, more than a twofold increase. The percentage of issue for the direct jurisdiction cities, provinces, and cities in 1990 was 16.1 per cent, 11.8 per cent, and 12.0 per cent respectively. Local government fund-raising is generally divided into three types: bonds, domestic borrowing, and overseas borrowing; in 1988 the first form accounted for 56.6 per cent, the second 31.2 per cent, and the last 12.2 per cent [10].

As a form of policy-oriented taxation to promote or restrict specific sectors or industries, surtaxes, reductions, and exemptions are widely used in the local tax

TABLE XIV
FUNCTIONAL CLASSIFICATION OF LOCAL GOVERNMENT EXPENDITURES

	(%)				
	1971	1975	1980	1985	1989*
General public services	14.8	17.3	16.7	18.2	18.7
Defense	0.0	0.0	0.5	0.6	0.6
Education	35.6	34.5	35.7	35.5	31.2
Social development	16.0	20.9	20.4	18.1	19.5
Health	3.0	2.8	3.6	3.4	3.8
Social security and welfare	1.6	5.5	4.1	3.1	5.1
Housing and community amenities	11.4	12.4	12.6	10.2	10.4
Other community and social services	0.0	0.2	0.1	1.4	0.3
Economic development	32.1	26.6	26.2	26.2	27.0
Others	1.4	0.8	0.5	1.3	2.9
<hr/>					
Total expenditures					
%	100.0	100.0	100.0	100.0	100.0
(Billion won)	(292.4)	(686.1)	(3,272.4)	(7,521.0)	(13,441.0)

Source: [9, p. 41].

Note: See Table XIII.

* Budget.

system. In particular, tax exemptions and reductions for various types of policy objectives are used to encourage local industrial development. But in addition to the local tax laws, there are also legal provisions that allow for local tax reductions and exemptions such as the Local Industrial Development Act, the Industrial Zone Development Promotion Act, the Industrial Location Act, the Foreign Capital Inducement Law, and the Tax Exemption and Reduction Control Law. Moreover, there are also authorizations by the home affairs minister given to specific regions as well as local government ordinances that provide for tax reductions and exemptions. Since 1977 the ratio of reductions and exemptions from local taxes (amount of reductions and exemptions / [amount of tax collected + amount of reductions and exemptions]) has been around 10 per cent. However, in the size of local tax reductions and exemptions per capita, Seoul is by far the highest, along with the direct jurisdiction cities and Gyeonggi Province, which indicates that local tax reduction and exemption provisions have yet succeeded in improving the distribution of industry and the imbalance among the regions.

C. Local Finance Expenditures

Items of local government expenditures are shown in Table XIV. The largest item is education accounting for about 35 per cent of total expenditures. Shares for economic development and social development have changed little over the past twenty years. When expenditures are broken down into economic classifications of capital expenditures, social welfare, current expenditures, and personnel expenses (shown in Table XV), the portions accounting for current expenditures

TABLE XV
THE PRINCIPAL CATEGORIES OF LOCAL GOVERNMENT EXPENDITURES (1985)

	Total Expenditures		Capital Expenditures	Social Welfare	Current Expenditures	Personnel Expenses	Others	Self-sufficiency Ratio
	Billion Won	%						
Seoul	1,649.5	100.0	75.4	5.1	19.2	11.0	0.4	98.8
Direct jurisdiction cities	873.8	100.0	72.2	6.1	21.0	13.9	0.7	92.4
Provinces	737.2	100.0	79.3	3.0	16.6	9.4	1.2	52.1
Cities	1,028.9	100.0	62.9	8.9	28.2	18.8	0.1	84.3
Counties	1,515.5	100.0	52.0	10.1	37.9	25.5	0.0	52.2
Whole country	5,804.9	100.0	67.1	6.9	25.6	16.4	0.4	76.2

Source: [9, p. 36].

- Notes: 1. Net total of general accounts and special accounts excluding education special account.
2. For self-sufficiency ratio, see note to Table X.
3. Personnel expenses are part of current expenditures.

TABLE XVI
CHANGES IN CENTRAL AND LOCAL GOVERNMENTS EXPENDITURES

(Billion won)

	Central Government			Local Governments		
	1980	1989*	Increase Rate (%)	1980	1989*	Increase Rate (%)
1. General public services	655.5	2,348.4	3.58	547.9	2,510.0	4.58
2. Defense	2,349.1	6,027.2	2.57	16.6	86.5	5.21
3. Education	1,124.4	4,134.8	3.68	1,167.4	4,197.9	3.60
4. Health	78.3	513.8	6.56	117.8	509.7	4.33
5. Social security & welfare	437.9	2,023.4	4.62	135.4	679.5	5.02
6. Housing & community amenities	191.1	1,146.1	6.00	411.5	1,399.4	3.40
7. Other community & social services	53.9	167.3	3.10	2.6	35.3	13.58
8. Economic development	1,996.7	4,011.4	2.01	855.9	3,630.9	4.24
9. Others	795.1	3,247.3	4.08	17.3	391.8	22.65
Total	7,682.0	23,619.8	3.07	3,272.4	13,441.0	4.11

Source: Bank of Korea, *Economic Statistics Yearbook, 1990*.

* Budget.

and personnel expenses are the highest for the counties followed by the cities. The structure of local government expenditures shows that social infrastructure is less sufficient in the local area. As mentioned previously, there are local county and city governments that are unable to cover even their personnel expenses with their own local revenues, showing the need for expanding sources of local expenses finance.

Comparing trends in central and local government expenditures (shown in Table XVI), as already mentioned, the growth in local government expenditures has been faster than that for the central government. When examined by item, it can be seen that expenditures by both levels of government for health, social security and welfare, and for housing and local community amenities have risen. But economic services provided by local governments have registered faster growth than those for the central government, showing that since the 1980s priority has been directed at local government investment to balance regional development [3, p. 6].

III. ISSUES FACING LOCAL FINANCES

As is evident from this study, many problems confront local finances in Korea, and these problems will have to be solved as they are closely related to central

government finances. The strict implementation of local autonomy is indispensable for solving these problems, and the emphasis of policies should be shifted from promoting selective strategic industrial regions to encouraging regional development in accordance with the interests of the people in the regions. Changes now taking place in the development of the Korean economy are pushing forward the need to encourage local areas rather than centralization. In order to achieve balanced regional development, financial autonomy as well as political autonomy are prerequisites. To achieve these the first priority is secure sources of funds. In this regard, Seoul and the five direct jurisdiction cities already enjoy a high degree of financial self-sufficiency, and the situations for these cities will be relatively easy to correct; the real problem lies in the rural area.

Because of the features of local government services, it is generally considered that local taxation should be applied directly to the consumption of the local citizens, the cigarette consumption tax being one example. At present in Korea however, income through property taxes accounts for a large proportion of local revenues. In comparison with other countries, however, even if national taxes are included, the ratio of Korea's property taxes to GNP is low. The comprehensive land tax that was enacted in 1989 and put into effect in 1990 is a step to overcome this situation, and thus far it has been successful. The extreme increases in land values in recent years has made it all the more difficult to keep tax rates in line with the market value of land; however, the strengthening of property taxes is a matter that has to be vigorously pursued when there exists the need to improving income distribution.

The expansion of tax sources for local finances is another pressing issue that has to be dealt with, particularly in relation to national taxes. Compared with other countries, national taxes in Korea totally dominate over local taxes. In 1991 national taxes accounted for 81 per cent of all taxes, local taxes 19 per cent. By comparison, for Japan national taxes were 63.4 per cent, local taxes 36.6 per cent; and for the United States, 56.3 per cent and 43.7 per cent. Because of the dominance of national taxes, Korea's central government can use its financial power to excessively control and interfere with the operations of local governments, making it difficult for these governments to perform the duties expected of them and restricting the growth of local autonomy.

A review of the present sources for national and local taxes and a reexamination of the percentage and method of distributing local share taxes is now being debated. In the area of national taxes, indirect taxes tend to predominate while for local taxes, direct taxation is overwhelmingly predominant (in 1991 76.1 per cent of the taxes were direct, 23.9 per cent indirect). However, taxpayers show strong resistance to direct taxes, and therefore local governments are at a disadvantage in collecting taxes. For this reason it would seem appropriate to allow local governments to impose taxes on such businesses as wholesale and retail sales, the beverage business, and hotel business. Another means for increasing local tax revenues would be to distribute a portion of revenue through a special consumption tax and value-added tax to the local governments. These measures seem highly plausible because these businesses and consumers are spread over the country

relatively evenly and also demand for these services and goods increases as income increases.

As a measure to expand local government revenues through the local share tax system, a new "tax transfer system" was introduced in 1991 which allots a portion of national tax revenues to local government development projects, particularly for road construction. However, even better than share taxes, subsidies, and tax transfers would be a "tax sharing system" which is now beginning to be proposed. This system would be much better for helping local governments stabilize their revenues and manage their budgets.

In addition to tax revenues, local governments also procure revenues from such services as water and sewage, gas, mass transportation, housing, and cultural facilities, but these services operate through the special account and there exist numerous problems related to furnishing and setting fees for these services. It would be good if these services were converted into public enterprises and the costs borne by the recipients. The same should be applied to increasing services arising from urbanization. For such public enterprises, issuing bonds would be a suitable way for raising funds. Also there needs to be a range of choices, such as corporatization through joint investment with private enterprises or the privatization of services. A measure to make it easier for public enterprises to raise funds is the proposal for a "Regional Development Financing Corporation" which follows the example of Japan Finance Corporation for Municipal Enterprises. Also, in the seventh five-year plan it is stated clearly that a "Regional Development Fund" is to be set up. When this has been established, there is no doubt that it will greatly assist the development of local public enterprises.

IV. CONCLUSION

For more than ten years after independence, local governments in Korea enjoyed political autonomy. This was terminated by the military government that came to power in 1961, and for the thirty years since then, the country has pursued the centralization of power and the promotion of selective strategic industries. Under this economic policy Korea achieved rapid development, but critics pointed out the limits that existed in allocating resources under the leadership of the central government. This era of rapid economic growth resulted in serious urban and environmental problems. Added to these came the outbreak of labor unrest following President Roh Tae-woo's 1987 declaration on democratization which restored workers' rights. In the midst of such social, political, and economic change, the 1991 elections for local assemblies took place, and these assemblies have begun to function. However, there are still numerous problems to be overcome such as the location of assemblies, funds for the functioning of their offices, and the preparation of the variety of conditions needed for their smooth operation. Functions which the central government has been performing in a single, unitary manner have to be taken over by local governments in order for them to function autonomously and efficiently. The work of transferring power to local governments has just begun. The strengthening of local government administration and

organization can be seen in the new local finance bureaus that have been established in the provinces and in the large cities with populations of around 500,000.

Thirty years of imbalance in regional development has been a burden weighing heavily on local finances in Korea. It is self-evident that balanced regional development is inseparable from local autonomy, and from now on both will exert a great influence on the continuing development of the Korean economy.

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