

## **On the Intergovernmental Fiscal Relations in the ROK (Summary)**

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This paper provides an overview of the intergovernmental fiscal relations, or the local public finance adjustment system, in the ROK, using a model of this system to examine public finance adjustment and the regional equalization effect. The local public finance adjustment system secures funding for local authorities and aims that regions are allocated an standard level of public finance. According to our analysis, the local public finance adjustment system has helped to promote regional equalization to a certain extent, but at the same time, it should be noted that this results in a moral hazard in local public finance. The structure and content of this paper is as follows:

Section 1 provides a simple explanation of the structure of local authorities and the electoral system for local councils and the heads of local authorities. In June 1995, direct elections for regional councils and the heads of regional authorities, and for district councils and the heads of district authorities, thereby introducing citizen autonomy into the electoral system, but the fiscal foundations for local government have yet to be put in place. The question of how local taxation and inter-governmental fiscal adjustment systems will be put in place remains an outstanding issue.

After discussing the revenue of local governments, we illustrate inter-governmental fiscal relationships in Section 2. This is because we believed that we could gain a more systematic understanding of the mechanisms involved in the local public finance adjustment system and local government revenue by examining changes in the latter. Statistics published in the ROK indicate that local non-tax revenue accounts for the largest share of revenue, but it should be noted that this is not actually the case in practice. The reason for this is the fact that the system enables surplus money from the previous fiscal year to be carried over into the following one. The result demonstrates that real non-tax revenue (service charges and usage fees) after adjustment for the total carried-over surplus accounts for just 9.2% (as of 2001) of local government revenue and that reliance on income from transfers has been on the increase of late.

Section 3 describes aspects of the inter-governmental transfer system, including the mechanism used for tax allocations to local government, administrative characteristics of the figures for standard fiscal needs and standard fiscal revenue and problems relating to

the softening of local government budgets. In addition, we explain local government transfers other than tax allocations to local government, government subsidies and the ROK's fiscal adjustment system with regard to the special account for local education, which differs from that in Japan.

Section 4 sets forth a model of the local public finance adjustment system in order to evaluate how adjustments in the ROK's local government finance are carried out. Based on this model, Section 5 examines the inter-regional fiscal equalization effect arising from funds transferred to regional authorities in the ROK. In addition, we discuss the correlation between annual expenditure by local government and relative variables and corroborate the results obtained from the model. Our analysis reveals that there is no correspondence between annual expenditure by local government and regional taxation or income levels: in other words, the benefit principle, which can be described as the principle underlying regional taxation, is not being put into practice. In addition, we assert that putting this principle into practice is an important task for the future in the field of local government finance in the ROK.

Finally, in Section 6, we look at challenges facing the local public finance adjustment system in the ROK, with reference to the analysis and innovative discussion presented in this paper, while also drawing comparisons with Japan. Focusing on local tax allocations in Japan and the ROK, we discuss differences and similarities in terms of the management of accounting procedures and methods of calculating local public finance.