

Local Public Finance and Intergovernmental Transfers in the ROK (Summary)

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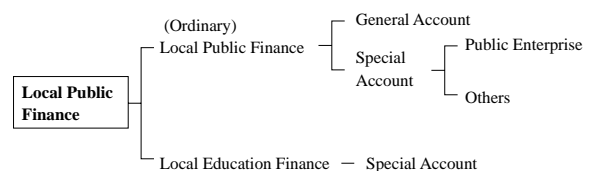
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1. The Characteristics of Local Public Accounts

Local public accounts in the ROK consist of one general account (GA) and two special accounts (SA), the latter being a special account for local public enterprises and another special account. Let us call the sum of these three accounts 'ordinary' local public finance, which is ultimately controlled by the Ministry of Government Administration and Home Affairs (MGAHA). However, local education finance is dealt with separately from 'ordinary' local public finance, in the form of a special account for local education under the control of the Ministry of Education. This separation of the administration of 'ordinary' local public finance and local education finance is a characteristic of local public finance in the ROK. Figure 1 expresses the situation in the form of a diagram.

Figure 1 Types of Account in Local Public Finance



2. Intergovernmental Transfers

Almost all central government revenues derive from national taxes, which consist of such internal taxes as individual income tax, corporate income tax, and valued-added tax. The combined revenue from three earmarked taxes - transportation tax, education tax, and special tax for rural development - accounted for 17.2% of national tax revenues in 2000. General and earmarked taxes are a major

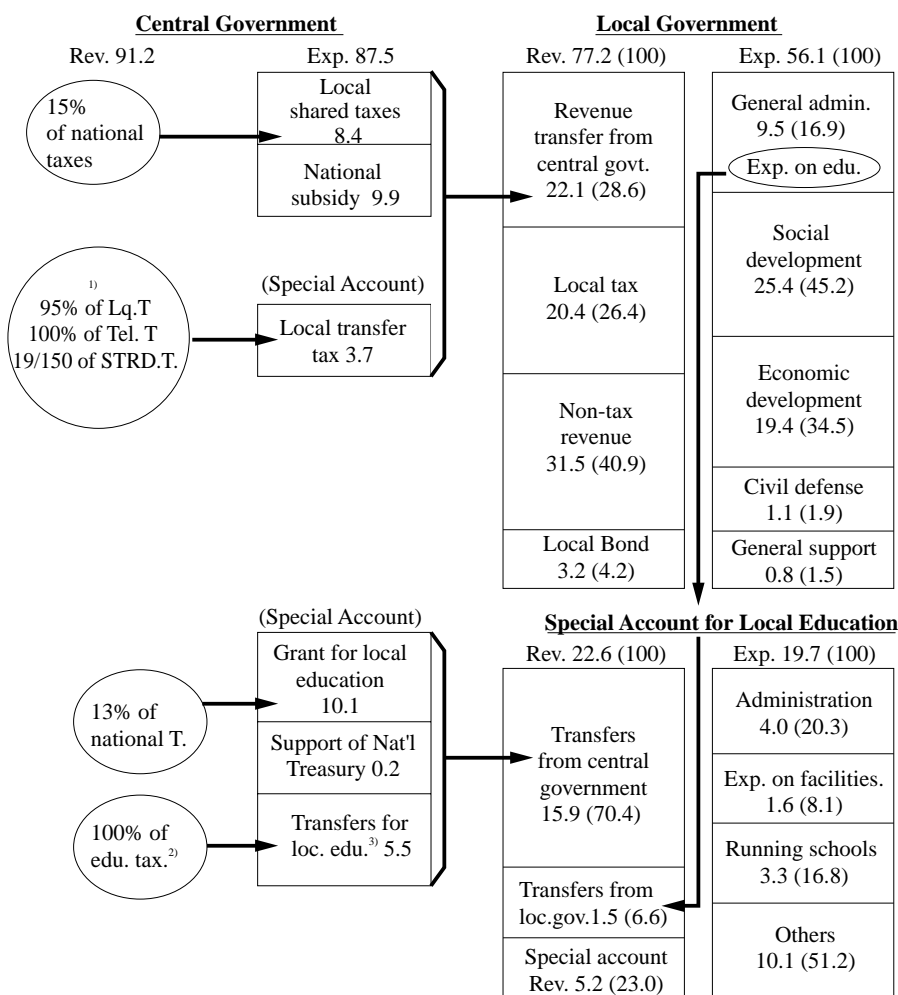
source of revenue for transfers to local governments.

There are three types of transfer from the central government to local governments: local shared tax, local transfer tax and national subsidies. Local shared tax is an unconditional grant while local transfer tax and national subsidies are conditional grants. There are also three types

of transfer in local education finance: financial grants for local education, transfers for local education, and national treasury support. These three types of transfer correspond to local shared tax, local transfer tax, and local subsidy, respectively. Figure 2 outlines the allocation criteria for transfers in greater detail.

Figure 2 Intergovernmental Fiscal Relations (2000)

Trillion Won (%)



1) 95% Lq.T., 100% Tel. T., and 19/150 of STRD refer to 95% of revenue from liquor tax, 100% of that from the telephone tax, and 19/150 of revenue from the special tax for rural development, respectively.

2) The tax bases and tax rates of education tax are described in the section explaining local education finance.

3) Transfers for local education also include 0.6 trillion Won of grants for improving the educational environment.

Sources: Ministry of Government Administration and Home Affairs, *Financial Yearbook of Local Government* 2001.

Ministry of Finance and Economy, *Tax Summary (Josegaeyo)*, 2000, 2001, 2002.

1) Local Shared Tax

The local shared tax promotes fiscal equalization and provides fiscal support for local governments in the form of a general grant. The size of the grant has been increased to 15% of the internal tax revenues of the central government. Ten-elevenths of it is used for ordinary purposes, while one-eleventh is designated as being for special purposes. However, the central government provides additional grants if the 15% is not enough to fulfill the expenditure requirements of local governments.

The term 'local allocation tax' is also used in Moon (1999) and the Statistical Yearbook of Local Government,

instead of local shared tax. Central government distributes the special local shared tax to local governments when the ordinary local shared tax is insufficient to meet the fiscal needs of local governments, or unexpected fiscal needs arise due to disasters.

2) Local Transfer Tax

The local transfer tax was introduced in 1991 to support certain local government projects: road improvements, regional development, water quality improvements, and the education of young people. This transfer tax is financed by 95% of liquor tax revenue, 100%

of telephone tax revenue, and 19/150 of the revenue from the special tax for rural development. The central government adjudicates on whether projects are eligible to receive local transfer tax.

3) National Subsidies

National subsidies are conditional grants transferred to local governments for specific purposes. Laws such as the Local Public Finance Law and the Law on the Budgeting and Management of Subsidies prescribe the specific purposes for which national subsidies may be used. For example, these subsidies are provided when a local government implements some administrative functions on behalf of the central government, needs to promote local business, and carries out a project that is also beneficial to the central government.

4) Local Education Finance

While the MGAHA deals with ordinary finance for all local governments as a whole, the Ministry of Education controls finance for local education (special account for local education). Even so, the transfer system in local education finance follows almost the same pattern as that for ordinary local public finance. Financial grants for local education, transfers for local education, and the support of national treasury correspond to local shared tax, local transfer tax, and local subsidy, respectively. Transfers to local education finance are confined to upper-level local governments, i.e. Seoul special metropolitan city, other metropolitan cities, and provincial governments, in which local education finance is separate from ordinary local public finance. In other words, the decentralization of local education finance is not established in lower-level local government.

Grants for local education take the form of general grants for education, the purpose of which is not specified. 13% of internal taxes are transferred to this special account. As shown in Figure 2, transfers for local education are financed from 100% of education tax revenue for the purpose of improving education and the welfare of teachers.*

In spite of the existence of transfers for education with specific purposes, in practice, the special account for local education operates in such a way that these transfers for a purpose are not distinguished from financial grants for local education.

3. Revenue Structure in Brief

Local governments not only have transfer revenues but also their own revenues. Local governments issue local bonds and manage some local public enterprises as a special account. Let us take a look at the local revenue items. Table 1 presents revenue items which both exclude and include local education finance.

Table 1 Revenue Structure of Local Government (2000)

	Amounts	%
Transfer revenues from central government	28.6	
Local shared tax	10.9	
Local transfer Tax	5.0	
National subsidy	12.8	
Local tax	26.4	
Non-tax revenue	40.9	
Local bond	4.2	
Total	100	

Sources: Ministry of Government Administration and Home Affairs, *Financial Yearbook of Local Government*, 2001.

As shown in Table 1, the shares of 'ordinary' local revenue in 2000 accounted for by transfer revenue, local tax revenue, non-tax revenue, and local bonds were 28.6%, 26.4%, 40.9%, and 4.2%, respectively. Judging from this, one may be tempted to assume that local governments in the ROK have high revenues of their own. One should be cautious, however, with regard to the characteristics of and practices relating to tax and non-tax revenues. Carried-over items in non-tax revenue actually include many transfers, something that will be explained in detail in the next edition of this report. The share of transfer revenue in total revenue is higher because local education finance is more reliant on transfer revenue from the central government than ordinary local public finance. This implies that local governments are more highly dependent on transfers than would seem to be the case from the values shown in Table 1.

* The structure of education tax is very complicated. The tax base and tax rate of education tax consist of various revenues from national and local taxes. Its tax bases (basic tax rate in parenthesis) are gross receipts from banking and insurance businesses (0.5%), plus revenue from the following taxes: liquor tax (10%), special excise tax (30%), resident tax (10%), registration tax (20%), horse race tax (50%), property tax (20%), aggregate land tax (20%), automobile tax (30%), tobacco consumption tax (40%), and transportation tax (15%). Ministry of Finance and Economy, Korean Taxation, 2001.