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The Tax-Expenditure Linkage in Korea¹

(Summary)

The tax structure in Korea does not much resemble those found in developed countries: the personal income tax is of relatively minor importance (14.1 percent of total tax revenue in 2003; the share for corporate taxes was 17.3); the corporate taxes are paid primarily by large manufacturing companies; and the use of revenue earmarking is extensive (the revenue from earmarked taxes amounted to 3.5 percent of GDP or 17.2 percent of total taxes; taking into account earmarked grants to localities, almost 35 percent of total tax revenue was earmarked in 2003).

These phenomena are possibly related to *tax enforcement* problems faced in Korea: due to the lack of reliable tax information on the self-employed and small firms, the bases of income and value added taxes are narrow. Earmarked taxes, the revenue from which normally flows into a special account or fund, have appeared to be an attractive source of financing various public services without much resistance from the taxpayers (the special accounts and public funds together accounted for about 45 percent of the consolidated central government expenditure, leaving barely over half of central government activities for the general account).

¹ Prepared for IPD Tax Task Force meeting, New York, March 30, 2005. Not to be cited or quoted.

This note presents an analysis of the link between major earmarked taxes (the transportation, the rural development, the education, and the liquor tax, etc.) and their corresponding accounts (transportation facilities, rural development, environment, education, transfers-to-localities, etc.): The major findings are: (1) the link between any specific source and expenditure does not appear to be tight (“*weak*” earmarking), suggesting that the marginal expenditure decision remain in the hands of the budgetary authorities, not taxpayers; (2) the tax-expenditure linkage does not reflect a *benefit-tax principle* in most cases (especially when taxes are imposed in surcharges; when a fixed ratio of general revenue is earmarked); most likely, earmarking in Korea was motivated by *revenue collecting purposes*.

The Tax-Expenditure Linkage in Korea

Description of the system

As Table 1 shows, the tax burden in Korea in 2003 was 20.5 percent of GDP. The value added tax, the corporate and the personal income taxes accounted for more than half of the total tax revenues or about 70 percent of national taxes collected. In addition, a group of ‘officially’ earmarked taxes comprising transportation tax, education tax and special tax for rural development provided 10.6 percent of total and 13.6 percent of national taxes. Note also that about 80 percent of total taxes were collected at the national level, implying a significant portion of local expenditures being financed through grants and transfers from the central government. At the local level, acquisition and registration taxes, imposed mostly on motor vehicles and real estate transactions, represented about 40 percent of local taxes collected.²

The tax structure in Korea does not much resemble those found in developed countries: notably, the personal income tax is of relatively minor importance, accounting for 14.1 percent of total tax revenue while the share for corporate taxes reached 17.3 in 2003; and the use of revenue earmarking is quite extensive for a wide variety of expenditure items. These phenomena are possibly related to tax enforcement problems faced in Korea. The income tax base in Korea is very narrow due to the lack of reliable tax information on the self-employed and small firms as well as to lenient deduction

² In addition, customs duties collected 4.6 percent of total revenues.

policies toward low-income households.³ In addition, small firms can easily avoid corporate taxes by relying on cash transactions: so, the corporate taxes in Korea are paid largely by large manufacturing companies which are less prone to evading taxes. The lack of tax information on the self-employed and small firms is also responsible for the erosion of the base for value added taxes.⁴ In the face of such narrow tax bases, the Korean tax authorities might well have found earmarked taxes, to be an attractive and feasible source of financing various public services without much resistance from the taxpayers.⁵

Table 2 depicts the level and nature of earmarked taxes in more detail. At the national level, the special excise tax on automobile sales and the liquor tax can properly be added to the official list of earmarked taxes -- the transportation tax, the special tax for rural development and the education tax – increasing the importance of earmarked revenues in 2003 to 18.3 percent of national taxes or 14.2 percent of total tax revenues. At the local level, we count only the local education tax as a ‘true’ earmarked tax although there are several other items which are officially classified as such.⁶ In addition, 45 percent of

³ The low compliance of the self-employed is, by invoking the sense of “horizontal equity”, partly responsible for the generous allowances to wages and salary earners. Owners of small firms may take their compensation in a form of corporate income.

⁴ Sales are likely to be understated and accordingly, their incomes as well.

⁵ Many of Korean earmarked taxes are imposed in the form of surcharges on the tax receipts from other sources. The revenue from an earmarked tax typically flows into a special account(s) or public fund(s).

⁶ These include the community facilities tax, the regional development tax, the urban planning tax and the business place tax. In reality, however, revenues from these taxes cannot be distinguished from general tax funds.

revenues from the tobacco tax are earmarked to finance local education.⁷ Revenues from these two sources accounted for 3.0 percent of total tax revenues in 2003. All together, the total revenue from earmarked taxes amounted to 3.5 percent of GDP or 17.2 percent of total taxes collected, or about as much as the corporate income tax. In addition to these earmarked taxes, a fixed proportion of internal tax revenue is earmarked to central government grants: 15 percent for local expenditure and 13% for local education.⁸ If these grants are taken into account, almost 35 percent of total tax revenue was earmarked in 2003.⁹

Table 2 also shows the bases and uses of the main earmarked taxes. While the transportation tax and excise taxes are based on the sales of relevant products, the other taxes take the form of surcharges on other taxes. Typically, the revenue of an earmarked tax is funneled into a special account of a specific expenditure purpose. In certain cases, the revenue is divided among multiple destinations: for example, 85.8 percent of the proceeds from the transportation tax go to the transportation facilities account, and the remaining 14.2 percent is earmarked to an account for transfers to localities.¹⁰ Earmarked

⁷ More accurately, earmarking is 45% for revenue collected by metropolitan cities and 50% for that collected by the remaining provinces.

⁸ The ratio for revenue sharing will be increased from 15 to 18.3 percent in 2005.

⁹ Customs duties imposed on railroad-related imports are also earmarked to an account for railroad facilities. In addition to taxes, numerous fees, charges and levies are earmarked to various government activities, many of which are operated through on- or off-budget funds.

¹⁰ From 2005, this portion of the transportation tax will be earmarked to financing environment-related expenditures.

taxes for education are collected both at the national and the local level. In some instance, the earmarked ratios may vary between localities (e.g., tobacco taxes) and years (e.g., special excise on automobiles).

As Figure 1 shows, earmarking has been important in Korea for many years. Except for a few years in the early 1990s, earmarked taxes have been an important source of revenue throughout the period shown.¹¹ Figure 2 depicts the same trends as in Figure 1 as a share of GDP rather than of total taxes and shows that revenue from earmarked sources amounts to about 3 percent of GDP in recent years, a level close to that for the corporate income or the personal income tax. Figure 2 depicts the trends of the same sources as percentage of GDP. Revenue from earmarked sources has amounted to about 3 percent of GDP in recent years, a level close to those for the corporate income and the personal income taxes.

The breakdown of earmarked taxes presented in Figure 3 shows that there was a major shift in their mix in the early 1990s. During the 1980s the defense tax was the most

¹¹ The earmarked taxes shown here do not include the special excise tax on automobiles or the cigarette tax, since data for these were not readily available for the whole sample period. Up until the early 2000s, the personal income tax was a more important revenue source than the corporate tax. Jun (2004) reported that the expansion of exemptions and deductions at the individual level, combined with reduced interest expenses at the corporate level, all in the wake of the financial crisis in 1997-98, contributed to reversal of the relative importance between these two sources. The value added tax, on the other hand, has been a steady source of revenue, financing about 20-25 percent of total revenue for most years. The share of local taxes increased significantly during the 1980s, and then showed a declining trend during the 1990s. Although their share has begun to rise again in recent years, it still represents a minor portion of total revenue.

significant example of earmarking, with revenue up to about 2 percent of GDP. When this tax was repealed in 1991, the government initially had to struggle to make up the lost revenue. It did so essentially by introducing new earmarked taxes. The transportation tax and the special tax for rural development were introduced in 1994, and the bases of the education tax were broadened. As a result, the revenue from the earmarked taxes came back to the level experienced in the 1980s. Despite a modestly declining trend, the steady share of liquor tax revenue (as a percent of GDP) over the past two decades is notable.

The Tax-Expenditure Linkage

Table 3 reveals the extent to which Korean government depends on special accounts and public funds to finance a specific set of public activities. In 2003, there were 17 non-enterprise special accounts, 61 public funds¹², and 5 public enterprise special accounts in addition to the general account. The special accounts and public funds together accounted for about 45 percent of the consolidated central government in terms of expenditure, leaving barely over half of central government activities for the general account. Figure 4 shows that the general account and the special accounts have been following different directions. The share of general account spending even fell below 50 percent in the late 1990s when earmarked government activities expanded. In part perhaps because not all of these accounts and funds were established on the basis of any

¹² 47 funds are included in the consolidated budget. The remaining 14 funds are off-budgetary. Although efforts have been made in recent years to close unnecessary funds and merge redundant one, 57 funds remain as of 2005.

clear benefit rationale linking specific taxes and expenditures, the government has been under steady pressure to reduce the extent of budgetary fragmentation. Since 1999, the trends have been reversed to some extent, and general account activities have again become more important.

Among various types of special accounts¹³, those financed by earmarked taxes are of particular interest in the present context. Revenues from each major earmarked tax (the transportation tax, the special tax for rural development, the national and the local education tax, special excise tax on automobiles, and liquor tax) flow into one or two specific accounts: accounts for transportation facilities, rural development, environmental improvement, transfers-to-localities, transfers-to-local education, etc.¹⁴

Table 4 presents a detailed breakdown of revenue sources for the account for transportation facilities. As noted in Table 2, revenue from the transportation tax is split into financing two specific but independent sets of activities: 85.8 percent of revenue is earmarked to the 'Transportation facilities account' and the remaining 14.2 percent to the 'Transfers-to-localities account.' Revenue from the transportation tax was a primary source of funding for this account, accounting for 64.9 percent of its total budget in 2003.

¹³ Besides special accounts housing earmarked revenues, other non-enterprise special accounts include those for fiscal financing, post-office insurance, national property management, patent management, registration, prison management, environmental improvement, energy and resources management, agriculture and fishery infrastructure, etc.

¹⁴ In 2005, special accounts for transfers-to-localities and transfers-to-local education will be repealed. The revenues earmarked for these funds will be redirected into relevant grants.

Other earmarked sources -- the special excise tax on automobiles, tariff on railroad-related imports, and fees charged on the use of transportation facilities -- made up another 16.5 percent. All of these earmarked sources combined accounted for 81.5 percent of total revenue, with the balance financed mainly by transfers from the general account.

In view of all these different revenue sources, the link between any specific source and expenditure does not appear to be tight. Although a major portion of transportation tax receipts is earmarked to this account, the marginal source of funds is more likely to be the transfers from the general account. In 2003, for example, the receipts of the transportation tax (10,000 billion won, as shown in Table 1) fell short of the budgeted account expenditures (13,223 billion won). Nonetheless, 14.2 percent of the receipts from transportation tax are earmarked for other purposes, thus intensifying still more the dependence at the margin on general account transfers. The marginal expenditure decision thus appears to remain firmly in the hands of the budgetary authorities, not taxpayers. The trends in revenue sources for the transportation facilities account shown in Table 5 provide further evidence of the extent to which general account funds maintain fund stability. During the sample period, the shares for earmarked revenues and general account transfers moved in opposite directions: In 2002-2003, for example, transfers from the general account dropped significantly, seemingly in response to a sharp increase in earmarked revenues, while the level of expenditure remained pretty stable.

Although the links between earmarked sources and expenditures for the

transportation facilities account thus seem relatively loose, there is nonetheless a benefit rationale for each linkage, although to a varying degree. The special excise tax on automobiles, the tariff on railroad-related imports and user fees are all strong cases of benefit taxation since their receipts are earmarked to an appropriate sub-account for roads, railroads, airports, and so on. In all likelihood, the proceeds from these sources are likely to be used for the benefit of those who use these facilities. Nonetheless, the combined revenue from these sources in 2003 accounted for only 16.5 percent of the fund. The benefit tax rationale is less strong in the case of the transportation tax, however, since although its revenue comes mainly from road users, only 65.5 percent of it is earmarked to the road account with the balance dispersed over various sub-accounts.

In contrast to the transportation facilities account, the linkage between the special tax for rural development and the destination of its revenue appears tight at first sight, since all the tax receipts initially flow into the 'Rural development account' (Table 4). However, about 24 percent of the revenue is redirected to funds and grants for local expenditure, although the funds part is still earmarked for rural development purposes.¹⁵ In addition, this expenditure area is so broad that the level of spending might not be much constrained by the variations in revenue. Moreover, since this tax takes the form of surcharges on the receipts of other taxes, there is clearly no benefit rationale.

¹⁵ About 15.3 percent (23/50) is distributed to the 'Transfers-to-locality account' with specified destinations, and the remaining 8.7 percent to the revenue sharing grant.

Education is another area in which earmarked taxes account for a major portion of financing, as shown in Table 6. Education taxes levied both at the national and the local level amounted to 25.6 percent of total educational financing in 2003.¹⁶ The remaining portion is made up by grants from the central government, the amount of which is determined as a fixed ratio (13 percent) of 'internal taxes,'¹⁷ as well as various other sources including tuition receipts and transfers from localities and central government ministries. In 2003, 66.1 percent of the education budget was financed through earmarked revenue, and the remaining 33.9 percent by more or less discretionary sources. As in the case of the transportation facilities account, these 'other' sources are likely to be the marginal source of funds for education. Like the special tax for rural development, education taxes are collected in the form of surcharges, leaving little room for a benefit rationale.

Revenue sharing to localities is yet another area in which earmarking is utilized in Korea. In addition to specific tax items (the liquor tax, etc.), as shown in Table 7, a fixed share (15 percent) of internal tax revenue is assigned to central government grants to localities.¹⁸ Since the expenditure area is very quite broad and earmarked revenue finances a relatively minor portion of spending (11.5 percent in 2003), the tax-expenditure linkage is very loose and removed from any benefit rationale.

¹⁶ 13.4 percent and 12.2 percent, respectively.

¹⁷ See Table 2 for the major items and the 2003 receipts of the internal taxes.

¹⁸ From 2005, transportation tax revenues will be no longer earmarked to local expenditure. Instead, the proportion of internal tax earmarking will be increased to 18.3 percent.

Table 8 summarizes what we have found so far with respect to earmarking in Korea. We indicate for each earmarked source the specificity of the expenditure designation, the tightness of the revenue-expenditure linkage, and the existence or not of a benefit rationale for the linkage. In most cases, the linkage is loose and does not reflect any benefit tax principle. It appears, therefore, that other explanations must provide the main rationale for earmarking in Korea as in most countries.

Korea's tax system

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1. Tax revenue (Table 1)

- The total tax revenue (general account): 20.5% of GDP (in 2003)
- The expenditure of consolidated central government: 22.7% of GDP
- Social security tax/spending still small, though rapidly expanding
- A relatively small government sector (vs. Latin America, industrial countries)
- Extra-budgetary activities (quasi-taxes/spending)

2. Tax structure (Table 1A, 1B; Table 2)

- The personal income tax is of relatively minor importance (14.1 % of total tax revenue in 2003; corporate taxes 17.3%; import duties 4.6%);
- The CITs paid primarily by large manufacturing firms: 0.1% (147 firms) pays 55.1% of total tax; 0.3%(658 firms)-70.5%; 2.0%(5344 firm)-87.4%
- The use of revenue earmarking is extensive: the revenue from earmarked taxes amounted to 3.5 % of GDP or 17.2 % of total taxes; taking into account earmarked grants to localities, almost 35 % of total tax revenue was earmarked in 2003.

*Incentives to the corporate sector:

- 1960-70s: Tax preferences to offset high corporate tax rates (larger manufacturing)
- 1980s-: From industry specific (targets: heavy-chemical) to a functional approach (investment in technology; SME support, etc.)
- Nontax incentives: directed loans through State-owned/controlled banks

3. Tax enforcement (Table 1C)

- The base for PIT, CIT, VAT is very narrow due to the lack of reliable tax information on the self-employed and small firms.
- VAT: (1) the underreporting of sales by small businesses (hard to identify self-employed income); (2) generous “zero-rate” policies
- PIT: (1) The income of the self-employed are understated as well; (2) Generous allowances: pushed by a sense of “horizontal equity” b/w the self-employed and salary/wage earners.
- CIT: (1) Small firms can easily avoid corporate taxes by relying on cash transactions; (2) Income shifting between PIT and CIT
- EMT(earmarked taxes): could be an attractive/feasible source of financing various public services without much resistance from the taxpayers: many EMTs are imposed in the form of surcharges & designated to noble purposes (defense, education, rural development, transportation, etc.)

4. Earmarking: the tax-expenditure linkage (see the accompanying note for full description).

- The link between any specific source and expenditure does not appear to be tight (“*weak*” earmarking), suggesting that *the marginal expenditure decision* remain in the hands of the budgetary authorities, not taxpayers
- The tax-expenditure linkage does not reflect a *benefit-tax principle* in most cases (especially when taxes are imposed in surcharges; when a fixed ratio of general revenue is earmarked)
- Most likely, earmarking in Korea was motivated by *revenue collecting purposes*.

5. Other issues

- Increased demand for government services: aging-welfare spending, re-unification costs; restructuring costs;
- Revenue/efficiency/equity-enhancing tax reform: widely varying ETRs across uses of commodities and sources of income; capital taxation-low tax rates but too complicated
- Property tax: low holding tax vs. high transactions tax (curbing speculation; lock-in effect)
- Complexity of the system: high administrative/compliance costs (Simplicity vs. Ramsey)
- The link b/w tax and spending: on-budget, off-budget; pros/cons of budget fragmentation
- Local autonomy limited: less incentive to use “flexible rates”; marginal expenditure decision as well as changes in tax statutes to be made by the central government.

6. Data and empirical strategy

- Firm-level data: (1) 1996-2002, 2340 firms; (2) classify by large vs. small/medium; chaebol vs. non-chaebol; listed-main/venture/non-listed; STR-top/bottom; (3) data for CIT-ok, VAT-to-be-estimated, PIT?
- Industry aggregates(published): (1) CIT; (2) VAT data available but tricky (1977-)
- Financial sector (12 subs): (1) banking (1988-), non- (1996-); (2) CIT available...

Table 1. The Tax Structure of Korea, 2003

	billion won	% of GDP	In percent		
Total taxes	147,797	20.5	100.0	-	-
National taxes	114,664	15.9	77.6	100.0	-
1. Internal taxes	92,231	12.8	62.4	80.4	100.0
Personal income tax	20,787	2.9	14.1	18.1	22.5
Corporate income tax	25,633	3.6	17.3	22.4	27.8
Value added tax	33,447	4.6	22.6	29.2	36.3
Special excise tax ³	4,733	0.7	3.2	4.1	5.1
Liquor tax ¹	2,726	0.4	1.8	2.4	3.0
Etc. ²	4,905	0.7	3.3	4.2	5.3
2. Transportation tax ¹	10,000	1.4	6.8	8.7	-
3. Education tax ¹	3,651	0.5	2.5	3.2	-
4. Special tax for rural development ¹	1,932	0.3	1.3	1.7	-
5. Customs duties	6,847	1.0	4.6	6.0	-
Local taxes	33,133	4.6	22.4	100.0	-
1. Ordinary taxes	26,554	3.7	18.0	80.1	-
Acquisition and registration taxes	13,053	1.9	8.8	39.4	-
Resident tax	4,558	0.6	3.1	13.8	-
Tobacco consumption tax ^{1,4}	2,384	0.3	1.6	7.2	-
Etc. ⁵	6,559	0.9	4.5	19.7	-
2. 'Objective' taxes	6,047	0.8	4.1	18.3	-
Local education tax ¹	4,009	0.6	2.7	12.1	-
Etc. ⁶	2,038	0.3	1.4	6.2	-
3. Carry-over from previous year	532	0.1	0.4	1.6	-

Sources: *Statistical Yearbook of National Tax*, National Tax Service and *Financial Yearbook of Local Government*, Bureau of Local Finance and Economy Ministry of Government Administration and Home Affairs; and author's calculation

¹ Earmarked taxes

² Inheritance tax, gift tax, revaluation tax, excess profit tax, excessively increased value of land tax, telephone tax, securities transaction tax, stamp tax, carry-over from previous year, etc..

³ Special excise tax on automobiles earmarked for road facilities.

⁴ Forty five percent of cigarette tax earmarked for local education.

⁵ License tax, property tax, automobile tax, motor fuel tax, agriculture income tax, butchery tax, cigarette tax, aggregate land tax, leisure tax, and farmland tax.

⁶ Includes urban planning tax, community facilities tax, business place tax, and regional development tax.

Table 1A. Tax rates

Personal Income Tax

1989	1994	1996	2002	2005
5%	5%	10%	9%	8%
10	9	20	18	17
15	18	30	27	26
20	27	40	36	35
25	36			
30	45			
40				
50				

Corporate Income Tax

year	Bottom rate	Top rate	Top effective rate ¹
1984	20	30	39.75
1991	20	34	36.55
1994	18	32	36.4
1995	18	30	34.25
1996	16	28	30.8
2002	15	27	29.7
2005	13	25	27.5

¹ Effective rate reflects earmarked surtaxes (defense, residence, and rural development).

*** Value Added Tax rate: 10% (1977-present)**

Zero rate: Goods for exportation; Services rendered outside Korea; Overseas transportation service (by ships and aircraft); Other goods or services to earn foreign exchange.

Exemption: Necessities: health; education; insurance; cultural activities; quasi-labour (composer, actor); public-service related.

*** Special excise tax**

Class	Tax rates	items
1	20%	Slot machines, golf products, etc.
2	20	Jewelry, cameras, watches, carpets and furniture etc.
3	7-14	Automobiles
4	specific	Fuels such as gasoline, diesel, LPG, LNG etc.
Activities	specific	Race parks, golf courses, casino, entertainment taverns, etc.

Table 1B. Taxpayers**Personal Income Tax, 2002**

	Taxpayers (thousand)	(%)	Tax payment (trillion won)	(%)	(%)
Wages and salaries (withholding)	12,017	100.0	6.93	37.4	
Paying taxes	6,187	51.5	6.93		
Under-threshold	5,830	48.5	0	-	
Global income taxes (tax returns)	4,161	100.0	5.75	31.0	
Filing tax returns	2,010	48.3	5.75		100.0
Bookkeeping	919	22.1	4.02		70.0
Estimated income	1,092	26.2	1.72		30.0
Under-threshold (estimated)	2,150	51.7	0	-	
Other income taxes (withholding)	-	-	5.87	31.6	
Total	-	-	18.55	100.0	

Value Added Tax, 2002

	Taxpayers	(%)	Tax payment (billion won)	(%)
General	2,119,560	53.5	32,213	99.7
Corporation	345,292	8.7	26,753	82.8
Individual	1,774,268	44.8	5,460	16.9
Simplified +Exemption	1,843,894	46.5	98	0.3
Total	3,963,454	100.0	32,311	100.0

Corporate Income Tax, 2002

Tax base (million won)	Tax rates	Taxpayers	(%)	Tax payment (billion won)	(%)
Deficit	-	93,970	34.6	72	0.4
0- 10	15	65,580	24.2	62	0.4
10 – 100	15	75,122	27.7	432	2.5
(sub total)		234,672	51.9	566	2.9
100 -1000	27	31,337	11.5	1,602	9.3
1000 -10,000	27	4,686	1.7	2,907	16.9
10, 000-50,000	27	511	0.2	2,656	15.4
50,000 -	27	147	0.1	9,504	55.1
(sub total)		36,681	13.5	16,669	96.7
Total		271,353	100.0	17,235	100.0

Table 1C. Corporate tax payments by industry, 2002 (tentative results)

	CIT share of total(%)	Corporate tax relative to				VAT shares(%) ¹	
		Sales	Asset	Gross profit	Operating surplus	Corp.+ Indiv.	Corp.
Fishing	0.06	0.008	0.007	0.059	0.198		
Mining	0.32	0.034	0.025	0.198	2.247	0.19	0.22
Manufacturing	33.89	0.009	0.010	0.049	0.141	37.40	39.80
Electricity, Gas and Water Supply	7.35	0.026	0.012	0.169	0.227	4.02	5.06
Construction	8.05	0.013	0.015	0.113	0.288	11.05	12.24
Sales	10.32	0.006	0.014	0.045	0.194	30.13	26.40
Restaurants, Hotels	0.52	0.021	0.007	0.054	0.287	2.02	0.80
Transport, Storage and Communications	4.45	0.010	0.007	0.021	0.114	4.38	4.76
Real Estate	1.15	0.085	0.033	0.147	1.288	1.53	0.92
Services	5.50	0.028	0.036	0.079	1.203	9.27	9.78
Health	0.14	-	-	-	-	-	-
Livestocks, Hunting and Forestry	0.02	-	-	-	-	-	-
Finance and Insurance	26.00	-	-	-	-	-	-
Others	2.21	-	-	-	-	0.01	0.01
Total	100.0	0.014	0.016	0.074	0.245	100.0	100.0

¹ VAT shares are based on gross sales(tentative figures).

*** Corporate tax share, 1999-2003**

	1999	2000	2001	2002	2003
Manufacturing	42.7	41.1	44.1	33.9	38.8
Finance and Insurance	21.1	26.4	21.1	26.0	18.9

Table 2. Earmarked Taxes in Korea, 2003

Tax	Base	Destination	billion won	percent of		
				Total taxes	National taxes	GDP
Transportation tax	Gasoline, diesel, and substitute oils	85.8%: Transportation facilities account 14.2%: Transfer-to-localities account ⁴	10,000	6.8	8.7	1.4
Special tax for rural development	Surtax ¹	Rural development account ⁵	1,932	1.3	1.7	0.3
Education tax	Surtax ²	Transfer-to-local-education account	3,651	2.5	3.2	0.5
Special excise tax on automobiles	Automobile sales	72%: Transport. facilities account (road) ⁶ 15%: Grants for revenue sharing ⁷ 13%: Grants for local education	2,675	1.8	2.3	0.4
Liquor tax	Liquor sales	Transfer-to-localities account	2,726	1.8	2.4	0.4
National level			20,984	14.2	18.3	3.0
Local education tax	Surtax ³	Local education account	4,009	2.7	-	0.6
Tobacco tax	Cigarette sales	45%: Transfers for local education ⁸	443	0.3	-	0.1
Local level			4,452	3.0	-	0.6
Total			25,436	17.2	-	3.5
Related items	15% of internal taxes ⁷	Grants for revenue sharing	13,835	9.4	12.1	1.9
	13% of internal taxes	Grants for local education	11,990	8.1	10.5	1.7
	Part of customs duties ⁹	Transportation facilities account (railroad)	n.a	n.a	n.a	n.a

Sources: Author's calculation based on budget sources

¹ Surtax on (1) exemptions of corporation tax, individual income tax, customs duties, acquisition and registration taxes; (2) securities transaction tax, special excise tax, acquisition tax, aggregate land tax, and leisure tax.

² Surtax on special excise tax, transportation tax, liquor tax.

³ Surtax on automobile tax, inhabitant tax, property tax, registration tax, leisure tax, and cigarette tax.

⁴ From 2005, this portion of transportation tax will be earmarked for the Environmental improvement account.

⁵ Part of this fund (about 24%) will subsequently be transferred to local-spending accounts and grants

⁶ The earmarked portion varies by year.; ⁷ The ratio will be increased to 18.3% in 2005.; ⁸ 50% for local provinces other than metropolitan cities.; ⁹ Imposed on railroad-related imports.

Figure 1. Trends in Major Taxes (percent of total taxes), 1981-2003

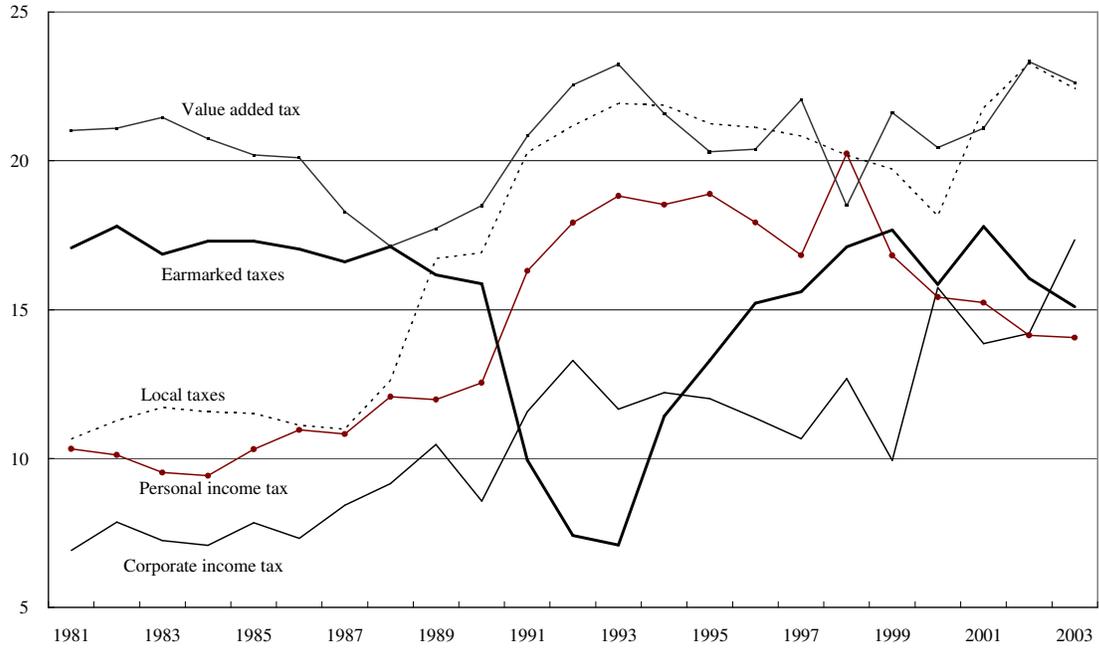


Figure 2. Trends in Major Taxes (percent of GDP), 1981-2003

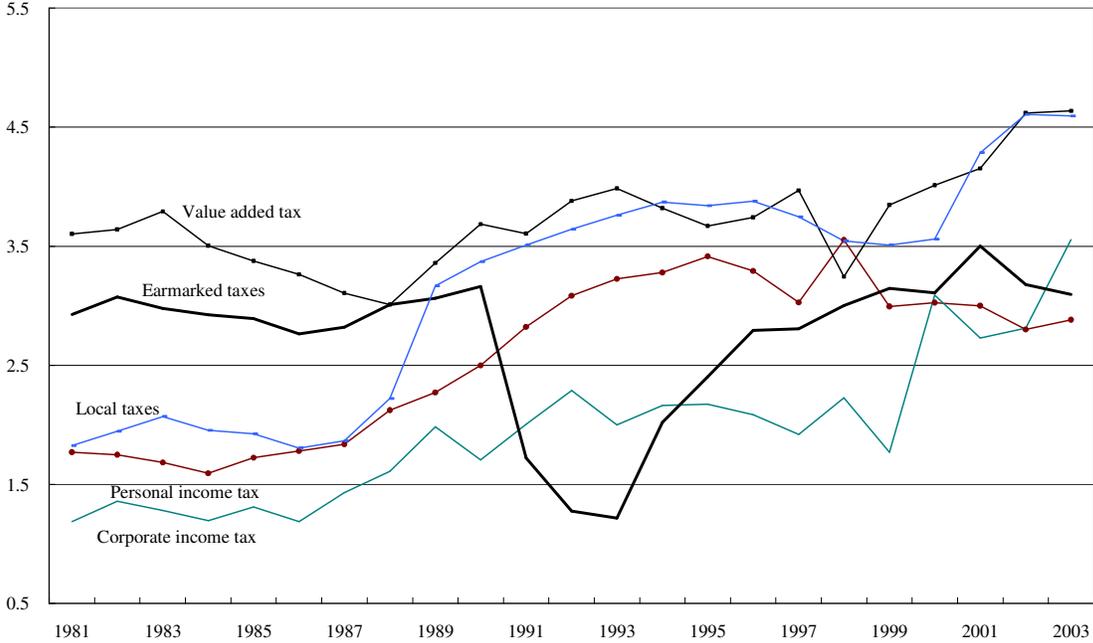


Figure 3. Trends in Earmarked Taxes (percent of GDP), 1981-2003

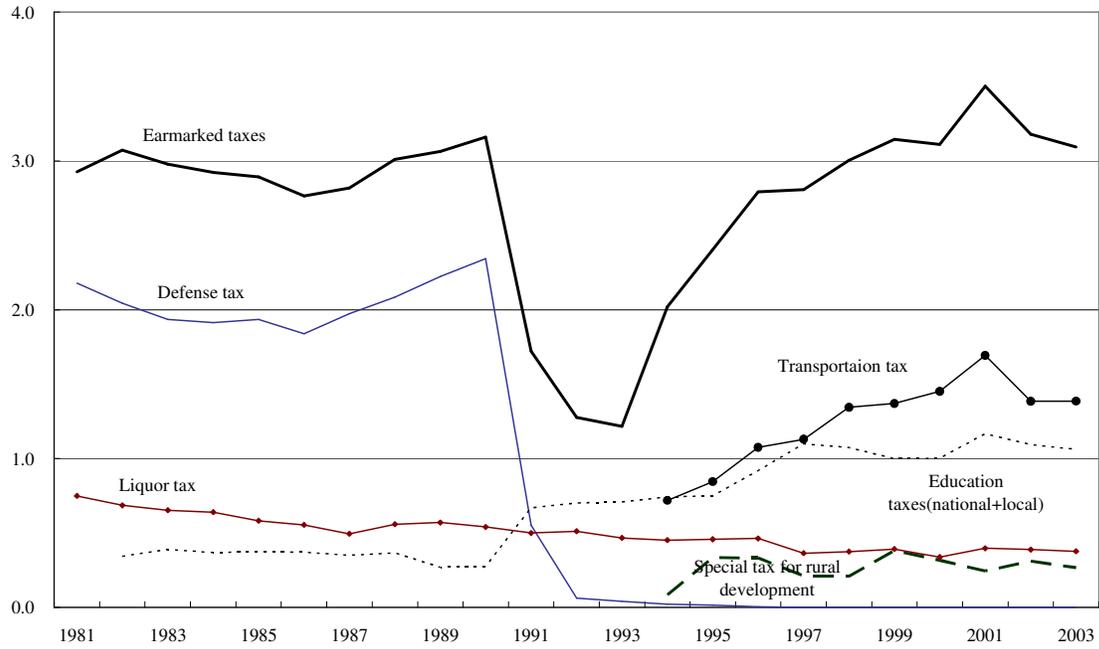


Table 3. Consolidated Central Government, Korea, 2003

	Central Government						Public enterprise special accounts ³	Total ⁴ (C)
	Accounts				Public funds ²	Total (B)		
	General account	Special accounts ¹	Surplus	Total (A)				
Revenue								
(billion won)	110,828	16,405		127,233	42,377	169,610	2,335	171,945
(% of GDP)	15.36	2.27	-	17.64	5.87	23.51	0.32	23.84
(% of Total)	64.46	9.54		74.00	24.65	98.64	1.36	100.00
Expenditure ⁵								
(billion won)	89,154	22,639	102	111,895	45,133	157,028	7,275	164,303
(% of GDP)	12.36	3.14	0.01	15.51	6.26	21.77	1.01	22.78
(% of Total)	54.26	13.78	0.06	68.10	27.47	95.57	4.43	100.00
Balance								
(billion won)	21,674	-6,233	-102	15,338	-2,756	12,583	-4,940	7,642
(% of GDP)	3.00	-0.86	-0.01	2.13	-0.38	1.74	-0.68	1.06

Source: *Government Finance Statistics in Korea*, Ministry of Finance & Economy; and author's calculation

¹ 17 accounts: Agriculture and fisheries structural adjustment, Energy & resources, Fiscal financing, Management of funds transferred to local education authority, Management of funds transferred to local govt., Rural development tax management, Transportation facilities, etc..

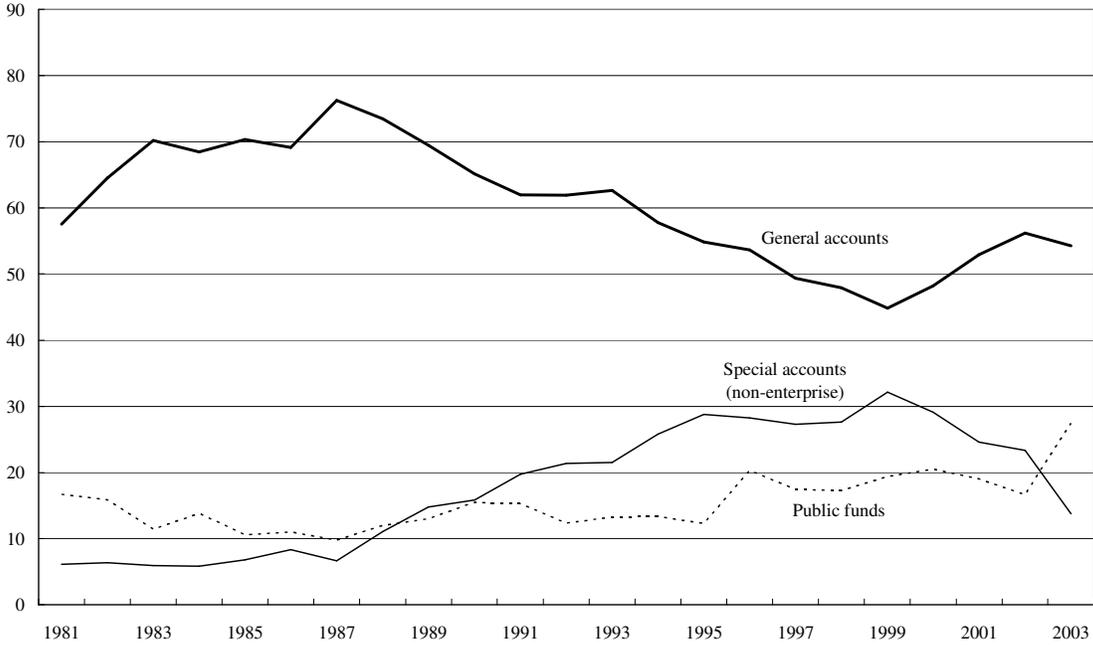
² 47 funds: National housing, National pension, Public management fund, etc. In addition, there are 14 off-budget funds.

³ 5 accounts: Communication service, Government supply, Grain management, Agency, and National railroad account (repealed in 2004), etc..

⁴ While the official budget covers general and special accounts, the budget balance is measured according to this consolidated basis.

⁵ Includes net lending items.

Figure 4. Trends in Expenditure for General Account, Special Account, and Public Funds (percent of consolidated central government), 1981-2003



**Table 4. Special Accounts for Transportation Facilities and Rural Development,
2003 planned budget ¹**

Special accounts	Revenue sources (earmarked portion)	billion won	percent
Transportation facilities account	Earmarked taxes and fees	10,780.2	81.5
	- Transportation tax (85.8%)	8,585.8	64.9
	- Special excise tax on automobiles (72%): earmarked to 'road' part	1,565.8	11.8
	- Tariff on railroad-related imports: earmarked to 'railroad' part	253.8	1.9
	- User fees: respective sub-accounts	374.8	2.8
	Transfer from general account	2,101.3	15.9
	Others	342.0	2.6
	Total	13,223.5	100.0
Rural development account ²	Special tax for rural devp. (100%)	2,079.3	98.0
	Etc.	41.7	2.0
	Total	2,121.0	100.0

Sources: Author's calculation based on budget sources

¹ Since specific breakdown of special account for 2003 was not available when this draft was being written, we used the figures in the planned budget here. Thus, some tax measures deviate from corresponding one in Table 2. We will revise this table as final budget figures are available.

² Technically, about 24% of rural development tax revenue will be transferred to funds and grants for local spending, while they are still earmarked for rural development.

Table 5. Transportation Facilities Account, 1994-2003 (planned budget)

	1994	1996	1998	2000	2002	2003
Earmarked revenue	91.5	85.5	84.3	90.4	72.7	81.4
- Transportation tax	71.1	64.8	69.9	79.7	57.7	64.9
- Special excise on autos.	12.7	13.1	8.1	7.1	10.3	11.8
- Tariff on railroad-related imports	1.7	2.6	2.0	1.1	1.9	1.9
- User fees	6.0	5.0	4.3	2.5	2.8	2.8
Transfers from general account	5.2	12.7	14.4	7.5	25.1	15.9
Others	3.3	1.8	1.4	2.0	2.2	2.6
Total: percent	100.0	100.0	100.0	100.0	100.0	100.0
billion won	4,534.5	6,531.0	10,333.9	12,330.9	13,255.8	13,223.5
(% of GDP)	(1.3)	(1.5)	(2.1)	(2.1)	(1.9)	(1.8)

Sources: *The Korea Transport Institute(2003)* and author's calculation

Table 6. Financing of Local Education, 2003 planned budget

Revenue sources	billion won	percent
Earmarked revenue	20,140.8	66.1
- Earmarked taxes: special accounts	8,301.0	27.3
Education tax (100%)	4,091.0	13.4
Local education tax (100%)	3,720.0	12.2
Tobacco tax (45%)	490.0	1.6
- Internal taxes (13%): grants	11,279.8	37.0
- Province taxes (3.6%)	560.0	1.8
Others ¹	10,319.2	33.9
Total	30,460.0	100.0

Sources: Author's calculation based on budget sources

¹ Various sources including transfers from central government ministries and localities, tuition, etc.

Table 7. Financing of Local Expenditures, 2003

Revenue sources (earmarked portion)	billion won	percent
Earmarked revenue	17,552.8	11.5
- Earmarked taxes: special account	4,155.5	2.7
Liquor (100%)	2,726.1	1.8
Transportation tax (14.2%)	1,418.3	0.9
Etc.	11.1	0.0
- Internal taxes (15%): grants	13,397.3	8.8
Local revenue	98,901.5	64.7
- Local taxes	33,062.0	21.6
- Non- tax revenue	59,337.6	38.8
- Province revenue sharing	2,558.5	1.7
- Borrowing	3,943.4	2.6
Adjustable transfers	36,409.0	23.8
- Subsidies	31,104.0	20.3
- Supplementary local share tax	1,640.4	1.1
- Metropolitan city revenue sharing	3,664.6	2.4
Total	152,863.3	100.0

Sources: Author's calculation based on budget sources

Table 8. Characteristics of Earmarking in Korea

Tax	Expenditure	Linkage	Rationale
Transportation tax (85.8%) (14.2%)	Specific (Road, railroad, port, etc.) Specific (Environment, from 2005)	Loose	Mixed
Rural development tax	Broad (Variety of uses)	Tight?	None
Education taxes	Specific (Education)	Loose	None
Liquor tax	Broad (Local expenditure)	Loose	None
Tobacco tax (45%)	Specific (Education)	Loose	None
Special excise tax on automobiles (72%) (28%)	Specific (Road) Broad (Local expenditure)	Loose	Mixed
Internal taxes (15%) (13%)	Broad (Local expenditure) Specific (Education)	Loose	None