Strategies for Implementing Intergovernmental Transfers to Foster Local Development in Korea

Yunwon Hwang*

Abstract: This study proposes policy implementation strategies of intergovernmental transfers for local development in Korea. Based on the previous empirical research findings, the study assumes a positive relationship between fiscal decentralization and local economic growth. Once a positive relationship is assumed, the study goes on to analyze the utilities and strategies of intergovernmental transfers for local economic development in Korea. Before getting into a discussion of the Korean intergovernmental transfers system, the study briefly reviews the theoretical basis of intergovernmental transfers. Followed by is the analysis of the current system of intergovernmental transfers in Korea. Implementation strategies for local development will be proposed in the last section of the paper as the major thrust of the study. Research results suggest that the following policy measures should be considered: (1) restructuring the local tax system along with the intergovernmental transfers system; (2) adopting grants-centered intergovernmental transfers system; (3) establishing capital-focused grants system ; (4) restructuring balanced national development special account grants; (5) combining the local education shared tax with the general local shared tax: (6) encouraging proactive local borrowings; (7) deregulating local transfer funds management; (8) institutionalizing effective monitoring mechanism in local transfers distribution; and (9) adopting quality assurance evaluation system.

Keywords: Intergovernmental transfers, local development, Implementing strategies, local shared tax/revenue, grants, subsidy

INTRODUCTION

Intergovernmental transfers are the dominant source of revenues for local governments in most countries. The issue of financing local development projects through

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* Yunwon Hwang is a professor in the Department of Public Administration, Chung-Ang University, 221 Heukseok-dong, Dongjak-gu, Seoul, 156-756, Korea. Telephone 02-820-5900, 010-8939-6000; e-mail: ywhwang@cau.ac.kr.

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intergovernmental transfers contains several preconditions which must be resolved before a discussion of institutional arrangements and implementing strategies of intergovernmental transfers can be undertaken. The most critical theoretical question is whether intergovernmental transfers play a key role in promoting local economic development[1] or not. As the following discussion will show, this study assumes a positive relationship between intergovernmental transfers and local and regional economic development. Once accepting this hypothesis, the study discusses the theoretical backgrounds of intergovernmental transfers. Followed by is the description of intergovernmental transfers system in Korea. Like in other countries, intergovernmental transfers are the dominant source of revenues for local governments. Fiscal decentralization in Korea started to change dramatically after the introduction of the local autonomy system in 1991. Because of a strong centralization tradition derived from a long history of dynastic governance, Korea's fiscal decentralization system has evolved in a unique way to make localities heavily dependent upon the central government. In this study, the outline and types of intergovernmental transfers in Korea will be discussed as well to explore desirable policy alternatives for better implementation of intergovernmental transferring fund distribution.

In the final section of the paper, the implementing strategies will be proposed. With the low level of financial self-reliance, Korean local governments are struggling for finding better implementing measures to improve their financial health condition. One survey shows that 79.4% of Korean local officials are dissatisfied with the current intergovernmental transfer system (Seo 2008). The issue of the relationship between local economic development and intergovernmental transfers is tricky in Korea because the small size and number of localities may discourage competition among regions, as suggested by Tiebout (1956). Some critics may insist that a strong unitary fiscal system, like that of Korea, can boost the local economy because of the relatively small size of the territory, the homogeneity of the people, and the strong centralization tradition and culture. Thus the need for intergovernmental transfers lies more in fiscal equalization among regions to promote democracy than in the pursuit of economic growth (Oates 1972). For these reasons, it is utmost important for Korea to develop more sophisticated policy measures for better implementation of intergovernmental transfers. This study examines various policy measures such as restructuring a whole intergovernmental transfers system, grants system reform, specific block grant system change, monitoring and evaluating system reform, and institutionalizing proactive local borrowing scheme.

1. In this paper, those words of 'local economic growth,' 'local economic development' and 'local development' are used interchangeably.

REVIEW OF RELATED RESEARCHES AND RATIONALE OF STUDY

Do intergovernmental transfers boost local economic development? More fundamentally, does fiscal decentralization have a direct impact on local economic growth? Most economists raise these two basic questions on whether or not fiscal decentralization boosts local economy. A typical example comes from the 'Oates Theorem' hypothesizing that fiscal decentralization may be conducive to local economic growth (Oates 1972). Oates continues to stress that if few public goods entail nationwide externalities, sub-national governments[2] are likely to be more efficient in the production and delivery of public goods. Another assertion is that decision-making on expenditures at the lower levels of government is more responsive to local preferences and needs and, therefore, more conducive to allocation efficiency (Tiebout 1956). Having been inspired by these widely recognized assertions by Tiebout and Oates, researchers have been searching for a direct relationship between fiscal decentralization and economic growth, and a positive correlation between them. More recent studies have engaged themselves in this normative and theoretical discussion of the impact of fiscal decentralization on local economic growth in the allocation of resources, horizontal fiscal imbalances, and economic stabilization (Martinez-Vazquez and McNab 2003; Fukasaku and de Mello 1998; Treisman 2000; Lee 2003; Lim 2008). Still, other studies argue that the traditional theory and practice of fiscal decentralization gives little attention to the objective of local economic growth (Prud'homme 1995; Tanzi 1996; Ter-Minassian 2000). Therefore, the question of whether fiscal decentralization has contributed to local economic growth is open to debate.

Interestingly, this question was tested in China, where researchers presumed a positive relationship given the country's rapid local economic growth through a policy of fiscal decentralization. But empirical studies have shown two opposite results. Some argue that fiscal decentralization has been fundamental to China's economic success (Lin and Liu 2000), while others assert that fiscal decentralization fragmented the national market, thereby negatively affecting the economic growth (Zhang and Zou 1998).

However, in the case of Korea, most of researchers agreed upon the positive relationship between intergovernmental transfers and local economic growth. Moon and Jeong's study (2000, 97) shows that fiscal decentralization through intergovernmental transfers promotes the regional economic growth. They conclude the total multiplier from fiscal decentralization to regional economic growth to be positive and suggest

2. In this paper, the term "sub-national governments" covers all sorts of governments below the national level and is used interchangeably with the term "local governments" or "localities."

that the fiscal decentralization may be profitable for regional growth. In the analysis of functional relations between regional economic growth and fiscal decentralization, Lim (2008, 73) also finds the causalities between fiscal decentralization and regional growth in Korea. There found many other empirical studies to prove the positive relationship between fiscal decentralization and local economic growth (Choi and Chung 2000; Kim 2005; Kim 2007; Lee 2003; Lee 2009).[3] Of particular note is the most recent empirical study between fiscal decentralization and economic growth in Korea by Lim (2008), which showed a positive relationship at the local level, but not at the national level. He utilized five years panel data from 2002 to 2006 for 16 upper-level local governments, and concluded that, along with local tax system reform, efforts to improve the intergovernmental transfers system could accelerate the local economy.

Based on these empirical testing, the study presupposes a positive impact of fiscal transfers on local governments in Korea first. However, in the field of implementing strategy studies, there found only few previous researches, which is based on the idea that the developing implementing strategy should be the job of local administration rather than theoretical or empirical analysis. Due to the characteristics of policy implementation strategy development in intergovernmental transfers, the study simply borrows the empirical bases studied previously by others, instead of empirical testing per se.

Therefore, the examination of the relationship between fiscal decentralization and local economic growth is set aside in the study and calls for a future examination.. The study also assumes a positive relationship between fiscal decentralization and local economic growth in order to develop better policy implementation tools for promoting local economy through intergovernmental transfers in Korea.

INTERGOVERNMENTAL TRANSFERS IN THEORY

The Purpose of Intergovernmental Transfers

In theory, intergovernmental transfers have three purposes. The first is to finance the difference between local government expenditure and revenue-raising responsibilities. Intergovernmental transfers address the structural imbalance between revenues available to localities and the expenditure responsibilities assigned to them. The second is to utilize equalizing intergovernmental resources to compensate for differences

3. However, Choi and Chung (2001) insisted that fiscal decentralization and local economic development do not show a positive relationship because *de facto* fiscal decentralization has not been accomplished in Korea during the last 20 years of local autonomy.

in local fiscal capacities that arise from the decentralization of fiscal responsibilities—specifically, providing universal and sustainable access to services. The third is to allow the federal or central government to exercise influence or oversight over the design of local programs in order to establish incentives for good overall governance. In practice, intergovernmental transfers are made through a range of mechanisms and instruments. Since the circumstances and objectives of each country differ, no simple, uniform pattern of transfers is universally appropriate.

In most countries, the main revenues are collected by the central government, while significant responsibilities are assigned to local governments. Statistics show that local revenues are normally small as a percentage of total national revenue: 9 percent in developing countries and 19 percent in developed countries in the 1990s. Meanwhile, local government spending is much higher than income: 14 percent higher in developing countries and 32 percent higher in developed countries. The difference is normally covered by intergovernmental transfers (Devas 2002). As such, intergovernmental transfers are common policy measures for local government operations in relation to the central government. This is the case for Korea as well.

Rationale for Intergovernmental Transfers

Most researchers agree on the utility of intergovernmental transfers on three grounds: correction of vertical and horizontal fiscal imbalances, national minimum service provision, and beneficial spillover effects.

In most countries, central government taxes—such as the value-added tax and income tax—are the most productive sources of revenue, which leaves local governments with a much smaller tax base. At the same time, local governments have more responsibilities for providing public services as a result of decentralization. Transfers from central to local governments are designed to cure the problem of fiscal imbalances among the different levels of governments, as well as differences in revenue-generating capacity and expenditure responsibility across regions. Some localities have more resources to tax, and some regions have more spending responsibilities due to demographic and economic differences.

Central governments are better positioned to assume a distributive role for resources and ensure that services reach all people at a similar quality level—particularly for merit goods, those goods that an individual or society should have based on need rather than on ability and willingness to pay (Musgrave 1959).[4] Therefore, the

4. Examples of merit goods include food stamps, health services, subsidized housing, and education, all of which generate positive externalities. An opposite concept is de-merit

central government needs to subsidize local governments with a minimum level of resources to finance the provision of those merit goods and meet minimum standards of service nationwide.

The interjurisdictional spillover effect is another rationale for intergovernmental transfers. Without subsidies from the central government, local governments would likely underfinance some services that cover a wide area, or could even prohibit people from outside the region from consuming services. This would create unnecessary transaction costs and could raise ethical or moral dilemmas.

Taxonomy of Intergovernmental Transfers

The design of the intergovernmental transfers system is of critical importance for efficiency and equity of local service provision and fiscal health of local governments. To design the most appropriate system for each country is consequential to accomplish the goal of intergovernmental transfers without decreasing efficiency. Each country operates its own system that fits best with its decentralization history and culture. Hence, it is important at least to examine theoretically the common, if not universally accepted, characteristics of intergovernmental transfer schemes. Intergovernmental transfers can be categorized in terms of what conditions are placed on the funds by the central government: matching transfer and non-matching transfer. Matching transfers is selective, conditional, and cost-sharing subsidy, whereas non-matching transfers is general, unconditional, and non cost-sharing subsidy. Based on this taxonomical nature of intergovernmental transfers, most countries develop their unique form in sharing intergovernmental financial resources. Among many, the most common forms can be divided into two types: tax/revenue sharing and grants. Tax/revenue sharing is practiced on the basis of origin, but due to the difficulty of origin identification, many countries make use of the formula constructed on the bases of administrative needs. Grants are funds dispersed by central government to localities with or without spending conditions, thus decided by the central government's willingness.

Critics of Intergovernmental Transfers

Despite the rationale for intergovernmental transfers stated above, some still criticize them. Most critics charge that intergovernmental transfers make local governments less accountable for their fiscal decisions by enabling them to increase spending without increasing taxes or finding other means of generating revenues. As a result,

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goods—for example, alcohol, cigarettes, and drugs.

intergovernmental transfers play a disincentive role for local governments to improve administrative efficiency and develop innovative methods of service delivery (Bahl and Linn1992; Devas 1997). In order to enhance localities to generate more sources of revenues for local development project implementation independently, more discretionary financial resources should be expanded.

INTERGOVERNMENTAL TRANSFER SYSTEM IN KOREA

Korean Government Revenue Structure

The ratio of national tax to local tax has not changed much during the last seven years, as seen in table 1: 79.2:20.8 in 2003 and 79.5:20.5 in 2008. Therefore, without the Korean central government's willingness to reform the tax structure from a center-focused system to a local-focused system, local governments are destined to depend upon the central government financially.

Table 1. Ratio between National Tax and Local Tax in Korea

	2003	2004	2005	2006	2007	2008
National tax	79.8%	79.2%	79.5%	79.3%	79.5%	79.2%
Local tax	20.2%	20.8%	20.5%	20.7%	20.5%	20.8%

Source: Ministry of Public Administration and Safety.

This is also true in examining the revenue structure of localities. Roughly 60 percent of their expenditures can be covered by their own resources; the remaining 40 percent comes from outside, namely the central government. The degree of financial self-sufficiency for local governments in Korea is low—localities were only able to fund 53.9 percent of their expenditures in 2008. Of particular interest, the capital city of Seoul is able to fund 85.7 percent of its expenditures, whereas the poorest localities of Sinan-gun and Wando-gun are only able to fund 6.4 percent of their expenditures. Generally, localities in the Seoul metropolitan area are in a better position to fund their expenditures from their own resources than are grass-roots-level urban city (si), rural county (gun), or urban district (gu) governments.

Outline of Korean Intergovernmental Transfers

Korean intergovernmental transfers reached 29,047,445 million won, 14.8 percent of the total central government budget, in 2009. Most intergovernmental transfers are delivered by the Ministry of Public Administration and Security to the localities. Out of 31,955,028 million won of the ministry's total budget, local revenue sharing makes up 90 percent; the remaining 10 percent covers general administration expenses.

Total intergovernmental transfers include grants to local governments' general accounts and education accounts. Including intergovernmental transfers, the size of the Korean local government budget is 45.5 percent of the total governmental budget in Korea, as shown in table 2. The historical trend shows gradual improvements in the ratio of central government budget to local government budget (as a portion of the total government budget), from 60:40 in 2003 to 55:45 in 2008.

Table 2. Comparison of Central Government and Local Government Budgets

	2003	2004	2005	2006	2007	2008
Central government budget	59.9%	57.8%	57.6%	57.0%	54.8%	54.5%
Local government general budget	30.1%	31.7%	31.8%	32.9%	34.8%	34.9%
Local government education budget	10.0%	10.5%	10.6%	10.1%	10.4%	10.6%

Source: Ministry of Public Administration and Safety.

Types of Intergovernmental Transfers in Korea

Intergovernmental transfers in Korea occupy 38.3% of total local government revenue as shown in Table 3. Out of 124,966 billion won in total local government revenue, intergovernmental transfers from the central government constitute 47,819 billion won. Two major resources are local shared taxes and national subsidies at 24,129

Table 3. Local Government Revenue by Source (2008)

Source	Amount (billion won)	Percent
Total	124,966	100.0
Own source	77,147	61.7
Local tax	43,550	34.8
Non-tax	30,100	24.2
Local debt	3,497	2.7
Dependent source	47,819	38.3
Local Shared taxes	24,129	19.3
National subsidies	23,690	19.0

Source: Ministry of Public Administration and Safety.

billion won (19.3% of local revenue) and 23,690 billion won (19%), respectively.

Intergovernmental transfers consist of two major categories: local shared taxes and national subsidies (grants). Local shared taxes are provided as unconditional grants, whereas national subsidies are provided as conditional grants.

Local Shared Taxes

The Local Shared Tax Law requires that 19.24 percent of national taxes be shared with localities. Local shared taxes can be divided into four categories: general, special, decentralization, and real estate.

General local shared taxes make up 95 percent of the total. These taxes are not earmarked for specific expenditure, so they are unconditional sharing funds. They go to localities in order to cover the difference between expenses for providing standard services and the revenue collected by each locality.

Special local shared taxes make up only 4 percent of the local shared taxes; these funds go to localities upon request in response to local needs for pending projects or disaster relief. They are specially allocated when general local shared taxes do not cover local expenses. They are project-based with a strict screening test for feasibility by the relevant ministry. Although it is considered to be a general expense of the locality and is legally independent from the central government, still it is practiced for specified local projects within certain limits and under certain conditions.

Decentralization shared taxes have made up 1 percent of the local shared taxes during the last five years. These taxes were instituted in order to promote decentralization as a supplementary instrument to general local shared taxes. They were introduced during the participatory government of Rho Mu Hyun, which was regarded as a decentralization-focused regime. They are an independent resource for localities, similar to the general local shared taxes. These taxes will be included in the general local shared taxes beginning in 2010.

Real estate shared taxes were introduced in 2005 to equalize the regional imbalance due to the introduction of comprehensive real estate taxes by region.[5] Although they are legally classified as local shared taxes, practically they operate as national subsidies. These taxes are also regarded as an instrument of decentralization policy.

National Subsidies

National subsidies are grants given to localities for implementing the central government's policies. These funds should be defined clearly in the scope of usage, thus

5. The comprehensive real estate tax was introduced in 2005 to stabilize the real estate market nationwide.

they are conditional. The total amount of national subsidies is similar to that of local shared taxes: 24,958 billion won and 25,779,696 million won, respectively. Compared to the total local tax revenue of 43,550 billion won, these two intergovernmental transfers are critical sources of money for localities in Korea. In 2008, 977 projects received subsidies from various central ministries. There are four different types of national subsidies in Korea: national affairs delegation grants, local-initiated project grants, national-encouraged project grants, and balanced national development special-account grants.[6]

National affairs delegation grants are provided to localities to implement national projects. Under these grants, local governments become regional branch offices of a government ministry. In fact, these funds should not be called intergovernmental transfers because central ministries are in effect contracting out their work to the localities.

Local-initiated project grants are delivered to localities to fund local projects that have a spillover effect to other regions. The amount of the subsidy is decided by the degree of responsibility between the locality and national government. To get these funds, a locality must submit a project proposal to a national committee and persuade the panel of the utility of the project.

National-encouraged project grants are delivered to the local governments by the central ministry to encourage localities to undertake projects that would benefit specific regions. They are locally initiated but centrally encouraged and funded project-financing instruments of intergovernmental transfer.

Balanced national development special-account grants, introduced in 2005 as a decentralization policy measure, aim at balancing regional development. The balanced national development special account integrates various local development project-financing instruments into one account in order to promote a more efficient and effective decentralization policy.[7]

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6. Many researchers in Korea insist that balanced national development special-account grants are different from the national subsidies and thus should be classified as a separate type. However, because they are conditional national funds granted to selected localities and distributed by the central government, similar to other grants, they should be considered national subsidies. These particular grants are managed not by the Ministry of Public Administration and Security, but by the Presidential Committee on Balanced National Development, based on the Special Law.
7. The balanced national development special account covers around 100 local projects with a 7,622 billion won budget. It consists of three major accounts: the regional development project account (5,557 billion won), the local innovative project account (1,690 billion won), and the Jeju special autonomy province account (375 billion won).

IMPLEMENTING STRATEGIES FOR LOCAL DEVELOPMENT IN KOREA

Restructuring the Local Tax System Along with the Intergovernmental Transfers System

The local tax system in Korea should be restructured in such a way to promote fiscal decentralization. The local autonomy governance system in Korea has focused on political, rather than fiscal, autonomy. Without a solid self-reliant fiscal base, the local autonomy system itself may not be sustainable, thus leading to a central government-controlled local field office system (Hwang 2000).

In 2008, the ratio between central government tax and local tax as a portion of total tax revenue was 79.5:20.5 (166 trillion won to 43 trillion won out of a total tax revenue of 209 trillion won), whereas the ratio between central government expenditures and local expenditures as a portion of total national expenditures was 54.5:45.5. What these statistics mean is that the difference between revenue and expenditure for localities must come from the central government's pocket. In other words, Korean local governments provide more public services than the central government with less revenue. The difference needs to be covered by intergovernmental transfers, which make localities dependent on the central government.

Therefore, a restructuring of the tax system between central government tax and local tax must be accomplished. Shifting some of the central government taxes to local taxes is one way to do this; examples include transferring a portion (for example 10 percent) of value-added tax to a local tax, and introducing new local taxes such as a local consumption tax and a local income tax (Lim 2008; Lee 2009). Tax autonomy and thus fiscal autonomy for localities can boost the local economy by giving localities the ability to prioritize local development projects. With these new local tax measures in place, localities will be able to rely less on transfers from the central government with their restrictions and conditions.

Grants-centered Intergovernmental Transfers System

Tax/revenue sharing transfers are unconditional local funds given to localities by the central government. There exists the inescapable temptation for each local government to spend those funds for political purposes rather than for local economic growth. However, specifically designed grants are less likely to be mismanaged because of the strict conditions. As a result, the central government often prefers to transfer funds through specific grants rather than general tax sharing tools for preventing the local chief from overriding the direction given by the central government (Bird 2000). Out of 47 trillion won in intergovernmental transfers in 2008, its half came from local shared taxes with the other half coming from grants. The 50:50 ratio should be restructured to a 40:60 ratio structure, the grants making up a larger portion, in order to maximize the local economy. Since each locality enjoy very much of limited discretionary budgetary power to boost local economic development, project implementation with the current ratio of half and half between grants and intergovernmental transfers.

Another alternative would be to switch local shared taxes to specific block grants to promote specific local projects (Lim 2008). It is because local governments will be bounded by strict regulations to a specific local project implementation with specific block grants whereas local shared taxes are general purpose expense not to be used for specific projects. In theory, local shared taxes such as tax /revenue sharing transfers are often utilized for equalization among regions, whereas grants are utilized for regional development (Bahl and Linn 1992). Because local shared taxes carries less strict conditions than grants, so that political factors may affect the misuse of transferred funds such as local political events budget and election campaign-related projects. To prevent this from an undesired mismanagement of transferring funds, more strict control and evaluation schemes must be developed and institutionalized into the intergovernmental transfer mechanism in Korea.

Capital-focused Grants System

Currently, the intergovernmental transfers system in Korea is merely based on fund conditionality, not on fund characteristics. This leads to a difficulty of evaluating fund performance and responsibility of whether funds are spent for capital investment or operating expenses. In a longer term perspective, intergovernmental transfers must be classified by investment effects: operating expense transfer account and capital investment account. However, if this solution is too radical, then the current system of tax sharing and grants could be subdivided into: i) operating expense tax sharing, ii) capital tax sharing, iii) operating expense grants, and iv) capital grants. If and when this new classification system comes in use, the capital investment purpose tax sharing and grants would be invested only for local economic development, and, as a consequence, each locality would meet higher responsibility standards, resulting in better performance in the local region. This is because most local development projects are capital projects in nature, whereas operating expenses occur during the capital project implementation process (Lim 2008). Therefore, more restriction measures on performance and responsibility should be set forth for delivering operating budget.

Restructuring Balanced National Development Special-account Grants

The balanced national development special account grants have been criticized as typical pork-barrel spending[8] since their inception in 2005. Despite their goal of providing a balanced national development project financing instrument, these grants have been distributed by influential political and administrative individuals, not as a result of objective and scientific analyses of feasibility among regions (Lim 2008). Therefore, because of their possibility of misuse, these grants should be completely restructured, if not eliminated.

Combining Local Education Shared Taxes with General Local Shared Taxes

Currently in Korea, local education is governed by the local education authority, which receives the local education shared taxes. The education authority is the only autonomous government body in the locality besides the general local government. Since the provision of education is one of local government's responsibilities, along with parks and recreation, water and sewage, and transportation, it needs to be treated equally with those other services. Therefore, in the long run, local education shared taxes and general local shared taxes will need to be consolidated; in the short term, close cooperation and creative planning are recommended (Lim 2008).

Proactive Local Borrowing

To maximize intergovernmental transfers for local economic development, local matching of central government funds ought to be required. Intergovernmental grants to local governments, unless local matching is mandatory, will tend be inefficient (Hwang 2000). Sometimes local officials consider them as "free money" and try to spend them all, or even waste them to keep the same grant level for next year's appropriation. For local matching, local bond[9] issuance is a down-to-earth policy instrument for supporting local project implementation (Hwang and Lynch 1999). Considering the fact that

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8. *Pork-barrel spending* is the use of government money on a local project in order for politicians to win the votes of the people who live in that area, and is called *patronage, election sweetener*, or *tax sweetener*.
9. According to the Ministry of Public Administration and Safety, total local debt reached 29 trillion won for 246 local governments, which is 3.7% out of the total local budget of 794 trillion won at the end of 2006. This debt ratio is far less than in the private sector or in other countries (Lim 2008).

issuing local bonds is strictly restricted to capital investment projects by law, local bonds would become a useful tool for local economic development. The funds from local bonds could have a multiplier effect throughout the region, so that the indirect economic effects would also contribute to the local economy. In 2005, the Korean government reformed the local bond policy by changing the total amount limitation screening system to an individual project screening system in order to expand the localities' autonomy and responsibility. This reform was expected to trigger local bond issues to boost the local economy. However, the Korean culture's reluctance to take on debt deterred local governments from expanding the size of local bond issues due to local resistance (Hwang 2000). Local government administrators were ordered to persuade local residents and stakeholders by giving reasonable explanations on the benefits of local bond issues to the local economy. Despite local resistance, local governments in Korea currently maintain a healthy balanced budget, with debt making up around 3% of the total local budget—quite a low percentage compared to other countries.

Deregulation of Local Transfer Funds Management

Intergovernmental transfers have various kinds of restrictions on decisions by local government thanks to the nature of the funds transferred from the upper levels of government. An exemplary case even the general shared tax funds must meet certain administrative conditions highlighted by the central government (Hwang, 2000). When it comes to specified grants, the conditions are even stricter; these conditions relate to the qualification of the receiver of the funds, the amount of the funds allotted, the degree of local economic contribution, etc. Also, there are numerous regulations and red tape, not only during the stage of receiving transfers from the central government, but also of the distribution of funds to the private sector. Deregulating these administrative procedures will greatly enhance the effectiveness of fund transfers. Ad hoc funds and an open-ended funds system may offer alternatives for local government to lessen control by the central government over local transfers to promote local economic growth (Lim, 2008).

Effective Mechanisms for Monitoring Local Transfer Funds Distribution

The management of local government transfer funds is crucial in improving local economic conditions. To maintain a transparent distribution process and to allocate funds efficiently and effectively, objective and rational monitoring mechanisms should be necessary (Hwang, 2000). Grants with specific guidelines can be monitored more easily, than general local shared taxes with their general guidelines. For this reason, particular attention should be paid to the general purpose funds. A systemic and scientific monitoring scheme needs to determine if grants are being properly dispersed.

Quality Assurance System

Both the central government and local governments should be equipped with efficient and effective evaluation systems in funds management. Short-term and long-term effects measurement must be developed to confirm that the goals and objectives of intergovernmental transfers are being met (Hwang and Lynch, 1999). Considering how economic development projects produce long-term economic effects, comprehensive evaluation strategies and techniques to measure long-term effects must be prepared. Developing a quality assurance mechanism for each fund is the precondition for securing a high quality intergovernmental transfers system. Specific grants must be evaluated by using specific measurements to assure that the local economic impact is beneficial the region.

CONCLUSION

The issue of intergovernmental transfers in Korea may be condensed into the question of "Who gets what and how much from whom?" On the question of who, needy localities should get more funds than simply rich localities in terms of local development project implementation capacity. On the question of what, the grants for enhancing local development should be prioritized in funding as an alternative than the general shared taxes based on the uniformed formula of equal distribution regardless of regional needs. However, a careful consideration should also be held in grant distribution in order not to bring about political winners and losers. On the question of how much, there exists no argument especially when the amount is decided by the objective formula, only if little or no political and economic factors beyond formula intervene seriously into the rational decision making processes. The question of from whom is a much more sensitive matter in the sense that the major sources of revenue for intergovernmental transfers are the citizens of the capital or big urban cities, but a large chunk of their tax money goes to local regions. It requires central government to ensure that localities have efficient and transparent fund management in place for lessening political debate between urban region and rural region.

Another factor which has not been fully examined in the study is the basic nature of intergovernmental transfers for equalization vertically and horizontally. Intergovernmental transfer distribution mechanism should guarantee the very basic local service needs without discrimination among regions, and thus any local residents should not be deprived of a minimum level of public services as a result of a locality's limited fiscal capacity due to the excessive investment into the privileged local development project implementation.

Finally, this study assumes a positive relationship between the intergovernmental transfers and local economic development as explained earlier. Based on this assumption, the study proposes several strategies to boost the local economy through intergovernmental transfers. In order to accomplish those proposed policy suggestions, current intergovernmental transfer system should be reformed as early as possible. The current Lee Myung Bak administration seems to change policies gradually to enhance local financial efficiency without radical macroscopic financial system reform, as was done by the previous government. However, for a successful implementation of local economic growth projects via intergovernmental transfers, a holistic local financial system reform policy such as whole tax system reform project may be necessary, at least for some degree.[10]

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