Reallocation of National Tax Resources among the Central and Local Government: With Special Emphasis on "Local Transfer Tax"

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I. Introduction

Korea is ready to introduce local autonomy as a result of political compromise between the ruling and opposition party. With the introduction of local autonomy in Korea, changes in the local financial system are expected. For example, the local government is expected to raise its own tax efforts as well as share more portion of total internal tax revenue.

Therefore, the redesign of local tax system with additional transfer of the national tax base to the local government is one of the major tax policy issues in Korea. For strengthening local tax capability, the central government has transfered most of tobacco profits of the public enterprise to local government in a form of Tobacco Consumption Tax. In spite of the introduction of Tobacco Consumption Tax to local tax system which contributes to improvement of financial situation of local government, other national taxes (example, Telephone Tax, Inheritance Tax, Liquor Tax) are also under consideration, as adequate targets for local transfer.

II. An Outline of the Local Finance and Tax Allocation Between Central & Local Government

1. Expenditure Size of Local Government

Table 1. shows a trend of expenditure size of government sector in Korea. According to the table, the expenditure size of local government has significantly grown during the last decade: the ratio of gross expenditure to GNP was only 4.2% in 1965, but it amounted to 9% in 1980s. The growth rate of local govern-

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Table 1. Annual Trend for Expenditure Size of Government

Unit: % to GNP

Year	Central		Local			Ratio of Local Expenditure to Total Gov't Expenditure	
	General Account (A)	Gross Expenditure (B)	General Account (C)	Special Account (D)	Gross Expenditure (E)	General Account $\frac{C}{A+C}$	Gross Expenditure $\frac{E}{B+E}$
1965	11.6	19.1	3.5	0.7	4.2	23	18
1970	15.6	21.9	4.9	1.7	6.6	24	23
1975	15.2	21.0	4.7	1.4	6.1	24	23
1980	17.7	23.6	6.0	1.9	7.9	25	25
1985	17.0	20.6	6.4	2.9	9.3	27	31
1986	17.2	21.5	6.4	3.6	9.9	27	31
1987	17.6	22.0	6.4	3.2	9.6	27	30

Note: Settled Account (1965-1986)
Initial Budget(1987)
Source: EPB, Ministry of Finance

ment size is far higher than that of central government(in case of the central government, the ratio of gross expenditure size to GNP was 19.1% in 1965, but 22.0% in 1987).

It is noteworthy that the local government activities based on Special Account and local public enterprises have been activated during the last 20 years. Actually, the considerable expansion of local gross expenditure, particularly compared with that of central government, is due to higher growth rate of local expenditure in a field of Special Account.

The table also indicates a trend of comparative portion of local expenditure in a total government sector. It is convenient to distinguish general account expenditure from gross expenditure in analyzing how financial resources were allocated between the central and local government. In terms of general account expenditure, a comparative portion of local expenditure has been gradually increased, from 23% in 1965 to 27% in 1987. Such a trend is clearer with respect to the size of gross expenditure: the local government shared only 18% of the total government sector, but the ratio exceeded 30% in mid-1980s.

The trend of government size of expenditure demonstrates that a comparative weight of local finance in the government sector has been growing for last 20 years. Especially, an expansion of local expenditure was remarkable in non-General Account sector. The relative increase of local finance implies that the role of the local government has been relatively expanding in a total public sector.

2. An Outline of the Current Tax System

As shown in Table. 2, the Korean tax system is composed of fifteen national taxes and fourteen local taxes. Though the numbers are similar, the amounts of revenue raised by each government are extremely skewed. The national government collects almost 82 per cent of total tax revenue. The major revenue sources for the central government are consumption and income taxes, and those of local governments are property-related taxes and Tobacco Tax. The property-related taxes such as Property.(Building) Tax, General Land Tax, Acquisition Tax and the like account for approximately 50% of the total local tax revenue while the Tobacco Tax, newly incorporated into the local tax system, sharing 28% of the tax revenues as of 1990, has the highest revenue for any single local tax.

The distinction between central and local government has relatively little meaning in Korea. Because local autonomy has not been in effect so far. At present local governments in Korea have acted merely as agents carrying out the decisions of the central government. They have neither their own kinds of tax nor the power to change tax rates in response to the needs of local residents.

3. The Characteristics of Tax Revenue Allocation

The major characteristics for allocation system of tax resources among the central and local government may be described as follows.

Basically, the Korean tax system is heavily reliant upon national taxes, which account for 81% of the total tax revenue: it means that the central government still plays a key role in resources allocation, and the function of government is highly centrallized. On the other hand, the local government shares only 19% of the total tax revenue, which is estimated to be so low, in terms of functions imposed on local government, that the local government cannot carry out it's functions effectively. In addition the local government is not in position to maintain an adequate level of financial autonomy. Under such a situation the local government heavily depends upon intergovernmental transfer payment by the central government. The higher dependence of the local government upon the intergovermental financial transfer from the upper-level government naturally leads to the heavier control of local government activities by the upper-level government.

There is little overlap in the tax bases for national and local taxes. In other words, each tax system has different tax base with few exceptions. Therefore, there is a basic difference in revenue raising ability of each tax system. Table. 3 shows that the major revenue sources for the central government are consumption and income taxes which are income elastic as well as rapidly growing while that of local government is property-related taxes which are less income elastic than

Table 2. The Tax Structure in Korea(1990)

Unit: million won, %

Classification	Amount	Composition(%)
National Taxes		
1. Domestic Taxes		
Personal Income Tax	3,250,654	12.0
Corporation Tax	3,361,584	12.4
Inheritance Tax	149,971	0.6
Asset Revaluation Tax	49,685	0.2
Excess Profit Tax	1	0.0
Value Added Tax	5,734,508	21.2
Special Consumption	1,348,716	5.0
Liquor Tax	902,961	3.3
Security Transaction Tax	529,194	2.0
Telephone Tax	234,413	0.9
Stamp Tax	174,968	0.6
2. Customs Duties	2,043,080	7.5
3. Surcharges		
Defense Tax	3,581,926	13.2
Education Tax	478,249	1.8
4. Revenue From Previous Year	84,323	0.3
Sub-total	21,081,823	81.0
Local Taxes		
1. Ordinary Taxes		
Acquisition Tax	709,231	2.6
Registration Tax	960,963	3.5
License Tax	46,665	0.2
Inhabitant Tax	505,980	1.9
Property Tax	215,182	0.8
Automobile Tax	378,949	1.4
Farmlamd Income Tax	6,767	0.03
Butchery Tax	18,443	0.1
Horse Race Tax	39,100	0.1
Tobacco Tax	1,443,080	5.3
General Land Tax	350,637	1.3
2. Earmarked Taxes		
City Planning Tax	215,231	0.8
Fire Service Facilities Tax	79,944	0.3
Business Firm Tax	144,018	0.5
3. Revenue From Previous Year	43,400	0.2
Sub-total	5,157,590	19.0
Total	27,081,823	100.0

Note: Initial Budget(1990)
Source: Economic Planning Board

Table 3. Structure of National and Local Tax System(1988)

Unit: hundred million won, %

Classification	National Tax	Local Tax
Income & Profits Taxes	53,468(32.2)	2,855(12.1)
Consumption & Sales Taxes	76,947(46.4)	5,917(25.1)
Property Taxes	2,188 (1.3)	14,508(61.6)
Customs Duties	27,107(16.3)	–
Other Taxes	6,247 (3.8)	283 (1.2)
Total	165,957(100.0)	23,563(100.0)

Note: Initial Budget(1988)
Source: Ministry of Finance

consumption or income taxes.

Thus, the fact that the local tax system is dependent upon a variety of property related taxes implies that the local government has a limited revenue capacity compared with the central government, and is faced with some types of tax resistence because of the non-income-elastic nature of proerty-based taxes especially when the local government tries to raise.

4. Trend of Tax Revenue Allocation

Let us take a look at a trend of an annual ratio of national and local tax burden to GNP. According to the Table. 4, the ratio of total tax burden to GNP, by and large, has been growing since 1965: the ratio was 8.6% in 1965 while it was approximately 19% in 1980s. The fact clearly indicates that the Korean government has increasingly raised its tax efforts for economic development during the last decade.

The tax revenue of central government drastically increased between 1965 and 1970, during which the Office of National Tax Administration was established in an effort to strengthen mobilization of domestic tax resources. Since then, the national tax revenue has been mildly growing.

Now, let us turn to a trend of local tax burden to GNP. In contrast to the national tax burden, the local tax burden to GNP remained not to be significantly changed until 1975 while it increased to a considerable level (more than 2%) in 1980s.

A trend of allocation of tax revenues among the central and local government is as follows. According to the Table. 5, the portion of local tax revenue has been consistently increasing since 1968 : as of 1990, the portion amounted to 19%.

Table 4. Annual Trend of Tax Burden to GNP

Unit: %

Year	Internal Tax	National Tax	Local Tax	Total
1965	5.2	7.2	1.4	8.6
1970	10.4	13.3	1.3	14.6
1975	10.0	13.8	1.6	15.4
1980	9.9	15.6	2.1	17.7
1983	10.0	16.3	2.3	18.6
1985	9.6	15.2	2.1	17.3
1987	9.5	15.5	2.1	17.6
1989	11.1	15.5	3.6	19.1
1990	10.4	14.4	3.4	17.8

Note: Settled Account (1965-1989)
Initial Budget (1990)
Source: Ministry of Finance

Table 5. Allocation of Tax Revenues among Central & Local Government

Unit: hundred million won, %

By year	National Tax	Local Tax	Total
1968	1,943(91.0)	193(9.0)	2,136(100.0)
1972	4,334(90.3)	466(9.7)	4,800(100.0)
1976	19,147(89.4)	2,270(10.6)	21,417(100.0)
1980	52,977(87.3)	7,678(12.7)	60,655(100.0)
1984	96,938(86.5)	15,084(13.5)	112,022(100.0)
1988	194,842(86.3)	31,000(13.7)	225,842(100.0)
1989	212,341(81.1)	49,480(18.9)	261,821(100.0)
1990	219,242(81.0)	51,575(19.0)	270,817(100.0)

Note: Settled Revenue (1968-1989)
Initial Budget(1990)
Source: Ministry of Finance

Such a considerable increase was due to not only the aggressive revenue raising effort at the local level but also additional transfer of national tax base for strengthening local tax revenue. Especially, it is with the incorporation of Tobacco Tax into the local tax system that the portion of local tax revenue in the total tax system increased.

It is necessary to observe the tax revenues expended by the central and local government in order to estimate the actual allocation of tax resources between different level of government. Table. 6 reveals that the ratio of tax revenues

Table 6. Allocation of Tax Revenues among Central & Local Government

Unit: hundred million won, %

Year	Tax Revenues			Transfer			Tax Revenues Expended by	
	National Tax	Local Tax	Total	General Grants	Specific Grants	Total	Central	Local
1965	583	114	697	–	–	81	501	195
	(84)	(16)	(100)				(72)	(28)
1970	3,469	332	3,981	511	207	718	2,931	1,050
	(92)	(8)	(100)				(74)	(26)
1975	13,910	1,588	15,498	1,178	822	2,000	11,910	3,588
	(90)	(10)	(100)				(77)	(23)
1980	58,077	7,677	65,754	4,100	3,269	7,369	50,708	15,046
	(88)	(12)	(100)				(77)	(23)
1983	100,507	13,972	114,479	8,588	3,769	12,291	88,216	26,263
	(88)	(12)	(100)				(77)	(23)
1985	118,765	16,546	135,310	10,061	4,217	14,278	104,486	30,824
	(88)	(12)	(100)				(77)	(23)
1987	163,437	21,924	168,402	16,097	9,815	25,912	137,525	47,836
	(88.2)	(11.8)	(100)				(74.2)	(25.8)
1989	192,284	39,458	231,742	16,811	13,079	29,890	162,394	69,348
	(82.9)	(17.1)	(100)				(70.1)	(29.9)

Note: Settled Account (1965-1987)
Initial Budget (1989)
Source: EPB, Ministry of Finance

expended by local government decreased until 1975 but it fluctuated around 23% since then.

5. Base of Local Tax: Separation or Overlapping?

Generally, there are two approaches in allocating the total tax base among central and local government: one is the "separation method" which is designed to have each level of government tax its own revenue base separately, and the other is the "overlapping method" which makes it possible for each level of government to share tax bases simultaneously.

A considerable portion of the local tax revenue in Korea was overlapped with that of central government until 1976 tax reform in which such a double tax-base method was abolished in an effort to rationalize the local tax system. A major form of the overlapping tax-base method used in Korea was the so-called "surcharge method" which used national taxes themselves as local tax base.

The surcharge method has some weaknesses. First, the local government is not in a position to adjust its tax revenues depending upon change in local financial demand because the local tax assessment totally relies upon the national tax revenue itself. Second, the surcharge method tends to discourage the local government from improving its own tax effort. On the other hand, it has some strong points, because it can not only save tax collection costs and compliance costs but also contribute to facilitating tax increase without extra revenue-raising effort of local government, particularly when the local government surcharges certain taxes, for example, income tax and VAT of which revenues are more income-elastic.

Presently, "the separation principle" is basically applied in allocating tax resources among the central and local government while "the overlapping method" is also exceptionally used, in case for the income-type Inhabitant Tax(Inhabitant Tax is composed of major Income-type which is surcharged on the National Income Tax and Corporate Income Tax, and minor Household-type respectively).

Tobacco Sales Tax which was replaced by Tobacco Consumption Tax is also one of examples for "the overlapping method." The tax was imposed on profits of tobacco sales which was run by the public enterprise (The National Monopoly Corporation). It is noticeable that the Tobacco Sales Tax was introduced in 1985 as a result of reallocation of domestic tax revenues. The tax with differentiated tax rate depending upon level of local jurisdiction was designed to alleviate fiscal inequalities among local governments, in a form of intergovernmental fiscal coordination.

It must be noted that limited financial capability of local governments may be partly due to strict application of "the separation method" in allocating domestic tax bases between the central and local governments, because income-elastic and fast-growing revenues such as consumption and income taxes are concentrated on the national tax system while less-elastic taxes like property-related taxes are dominant in local tax system. With the introduction of local autonomy, it is suggested for the local government to expand the "overlapping method" to some extent, to enable local government to have an access to the fast-growing revenue of the central government.

6. The Role of Intergovernmental Transfer

As shown in Table.7, the central government's intergovernmental transfer payment, which is composed of the unconditional general grants (similar to revenue sharing) and specific grants (similar to conditional categorical grants), plays an important role in the local finance in Korea. As of 1990 fiscal year, the uncon-

Table 7. Local Revenue Structure (1990)

Unit: hundred million won,%

Revenue	Amount(%)
Local Taxes	51,576(38.7)
Non-Tax Revenue	18,938(14.2)
General Grants	20,613(15.5)
Adjustment General Grants	6,160 (4.6)
Specific Grants	33,904(25.4)
Local Bonds	2,186 (1.6)
Total	133,377(100.0)

Note: Initial Budget based on General Account
Source: Ministry of Home Affairs

ditional general grants and specific grants respectively account for 20.1% and 25.4% of the total local revenue. Thus, the local government, as a whole, is heavily dependent upon the intergovernmental transfer mechanism: the nation-wide self-reliance ratio of local finance to the total revenue is merely 53.5%. The role of intergovernmental transfer is getting more important at the level of Province and County. As shown in the Table.8, the intergovernmental transfer payment accounts for approximately 67.9% of the total revenue for Province, and 72.9% for County while the largest cities like Seoul and Pusan are scarcely dependent upon the financial transfer from the central government.

There are two devices in determining a size of unconditional general grants: one is the "fixed method" which determines a certain portion of revenue in advance, by law, and the other one is the "budget allocation method" which determines the size of general grants as a result of central budget allocation for local government.

The size of unconditional general grants has been determined as annual budget policy by the central budget authorities until 1982. Though the budget allocation method had some strong points in terms of efficient resources allocation and effective economic policy from the viewpoint of the central government, it has several weak points.

First, the central government tended to increase its control over local activities, damaging autonomous operation of local finance.

Second, it was difficult for the local government to predict the amount of general grant to be received.

Third, the size of general grant was actually decreased, due to the centralized economic policy of the central government.

Table 8. Revenue Structure by Each Local Government (1989)

Unit: hundred million won,(%)

	Seoul	Direct Jurisdiction City	Province	City	County	Autonomous District
Local Tax	12,660 (82.5)	8,195 (67.2)	4,838 (19.4)	6,576 (44.7)	4,101 (16.1)	3,088 (26.4)
Non-Tax Revenues	2,754 (15.6)	2,748 (22.5)	3,160 (12.7)	3,478 (23.6)	2,758 (10.9)	1,746 (14.9)
General Grants	— —	395 (3.2)	5,420 (21.7)	1,935 (13.1)	9,016 (35.9)	— —
Specific Grants	299 (1.9)	866 (7.1)	11,505 (46.2)	2,729 (18.6)	9,333 (37.0)	2,416 (20.6)
Adjustment Grants						4,461 (38.1)
Total	15,349	12,204	24,923	14,718	25,253	11,711

Note: Initial Budget(1989)
Source: Ministry of Home Affairs

In an effort to reduce such problems of general grant system, the budget allocation method was replaced by the fixed method in 1983. Since then, amount of the general grants has been determined on the basis of 13.27% of internal taxes. The new method seems to contribute to more autonomous operation of local finance, expansion of local expenditure, and more reliable forecasting of local revenue.

Table. 9 shows a trend of the general grants since 1970. According to the table, the ratio of the general grants with respect to the internal taxes became higher since the reform of the grant system in 1983. Though the unconditional general grant plays a remarkable role in financing local government, it is observed that its ratio in the total local revenue structure has been decreased since 1970. The decrease is thought to be due to the fact that the growth rate of its own revenues including local taxes and nontax revenues exceeded that of general grants during the period. In other words, the local goverment has gradually improved its revenue raising efforts in the field of tax and nontax revenue.

The conditional specific grants (or subsidies) of the central government are one of important channels of intergovernmental financial relations. It is distinguished from the general grant system in that the conditional special grants are limited to special purposes or specific expenditures of local government. Therefore, it is

Table 9. Annual Trend of General Grants

Unit: million won, %

Year	Interal Tax (A)	Local Revenue (general Account) (B)	General Grants (C)	C/A	C/B
1970	2,838	1,223	541	19.1	44.2
1975	10,123	3,449	1,177	11.6	34.1
1980	36,758	19,076	4,100	11.2	21.5
1981	45,958	23,397	5,200	11.3	22.2
1982	52,507	29,640	7,009	13.3	23.6
1983	61,884	40,147	8,588	13.9	21.4
1984	66,974	47,595	10,200	15.2	21.4
1985	74,969	49,531	10,061	13.4	20.3
1986	81,194	51,272	12,489	15.4	24.4
1987	100,120	60,421	16,097	16.1	26.6
1988	125,402	99,331	17,208	13.7	17.3
1989	152,084	134,798	21,869	14.4	16.2
1990	158,210	133,377	26,613	16.8	20.0

Note: Settled Account (1970-1989)
Initial Budget (1990)
Source: EPB, Ministry of Home Affairs

widely utilized by the central government, for letting local government achieve policy objectives of the central government at the implementation stage.

As indicated Table. 10 the ratio of the conditional specific grants in the local revenue structure has fluctuated year by year because the specific grants are determined by policy objectives and financial situation of the central government. As of 1990, the specific grants transferred by the central government share 25.4% of the total local revenue (based on General Account).

III. Evaluation of the Localized Tobacco Tax

1. The Background of Tobacco Consumption Tax

When it comes to the reallocation of domestic tax resources, the first priority is to reallocate selective consumption taxes (some part of Liquor Tax, Telephone Tax, profits of monopoly enterprise and so forth) from national to local taxes, on the ground that they have relative advantages over other taxes in meeting the criteria for local tax such as relatively even regional distribution of tax base, benefit principle and administrative efficiency, etc.

Table 10. Annual Trend of Specific Grants (Subsidies)
Unit: million won, %

Year	Local Revenue (General Account) (A)	Specific Grants (B)	B/A
1974	344,946	81,942	23.8
1979	1,907,616	381,804	20.0
1983	4,014,779	570,812	14.2
1985	4,953,065	798,837	16.1
1987	7,571,673	1,761,939	23.3
1989	13,479,768	2,839,445	21.1
1990	13,337,655	2,844,889	21.3

Note: Settled Account (1974-1989)
Initial Budget (1990)
Source: Ministry of Home Affairs

Among these selective consumption taxes, tobacco sales have been preferred as local tax base for it has shown a relatively even regional distribution.

The Tobacco Consumption Tax (TCT) intorduced in 1989 in Korea, marks the turning point of expansion of local tax revenue. The tax has replaced Tobacco Sales Tax (TST), but the former not only includes the latter but also expanded its tax base to tobacco-related surcharges, (i.e. Education Tax, Defense Tax, Tariff, Value-Added Tax, and the profits of the monopoly enterprise). The replacement of TST with TCT enables major cities such as Seoul and "Directly-Governed Cities" (Pusan, Taegu, Inchon and Kwangjoo), that have been unable to have an access TST, to tax the tobacco sales. This arrangement resulted in relative increase of revenue in the big cities where large amount of tobacco are consumed.

2. The Affect of Tobacco Tax on Local Finance

After enforcing TCT, the local govenment can collect another 32% of existing tax revenue as of 1989. And the ratio of allocation between national tax revenue versus local tax revenue strikingly changed from 88:12 to 82:18.

In the view of the level of financial independence, the affect of TCT can be shown as follows. First, Table. 11 shows 11.6% of increase on the average in the ratio of financial independence to total local revenue from 51.9% in 1988 to 63.5% in 1989. While the increase at city level is noticeable that county level ("Kun" in Korea) is not so remarkable. This is due to the fact that Kun has already enjoyed the revenue of TST—when cities had not—and that the marginal increase of TCT is not so substantial.

Table 11. Annual Trend of the Level of Financial Independence

Unit: %

	1986	1987	1988	1989
Seoul	98.1	97.5	97.3	98.0
Direct Jurisdiction City	89.6	84.0	81.9	89.7
Province	40.3	32.7	36.4	32.1
City	61.9	57.6	53.8	68.3
County	30.0	25.9	26.8	27.2
Total(Average)	56.0	52.4	51.9	63.5

Note: Settled Account (1986)
Initial Budget (1987-1989)
Source: Ministry of Home Affairs

It is concluded that the absolute ratio of financial independency was improved throughout all levels of local government after TCT. However, at the level of cities and "Diretly-Governed Cities" the improvement is quite remarkable, while it is not at the level of "Kun".

3. Policy Implications

Even transferring the tobacco-related tax to local government could not ameliorate the regional financial inequalities among local governments owing to the concentration of tax base into Seoul and major cities. This situation implies that the design of transferring some national tax items to local government may improve the average ratio of financial independency of local government, but never can it relieve the regional financial inequalities as far as the target tax resources are concentrated in major cities.

IV. Reallocation of Tax Resources and the Adoptation of Local Transfer Tax

1. Introduction

Assuming that it is necessary to transfer some national tax to local government for balancing regional development, three major points are supposed to be regarded: (1) the size of additional allocation of tax resources to the local government, (2) the form of transferring tax resources, (3) the national tax items that are to be transferred.

The first point is up to the degree of reorganization of governmental function between the national and local government, and the optimal expenditure size of local finance. And about the second point, the reallocation should be made within a framework such as intergovernmental general grants, which consider favorable readjustment of tax revenue for financially weak local jurisdictions.

2. The Criteria and Target Taxes for Reallocation

There can be suggested as a criteria for transfer, like the stability of tax revenue, the ubiquity of tax resources, the benefit principle, connection to local economic activities, and the administrative efficiency.

However it is no exaggeration to say that there is no perfect tax item for these normative criteria. All we can do is to give a priority as to whether an item can relatively satisfy some criteria or not. Under the current tax system, Income Tax, Corporative Income Tax, and Inheritance Tax are not suitable to transfer, because they should be carried out by the central government based on the needs for income redistribution and integration of tax resources. And the Value-Added Tax as a whole is not suitable to transfer because of its nation-wide nature as a general consumer tax. Speical excise tax and earmarked taxes like Defence Tax and Education Tax are not suitable to transfer for several reasons.

Considering these facts, some items of selective consumption tax (e. g. Telephone Tax or Liquor Tax) and some of Value-Added Tax (mainly on entertainment and retail business which was part of local tax system before 1977 tax reform) have their merits for reallocation on the ground of administrative efficiency, benefit principle, and less concentration in cities. It is true that the additional transfer of national tax base to local government is less necessary owing to the Tobacco Consumption Tax which has already enabled the 32% increase of the local tax revenue. But some researchers still insist that Telephone Tax, a part of Liquor Tax, and a part of Value-Added Tax be transfered for the same reasons.

3. "Local Transfer Tax" as a new Reallocation Method

(1) Why the Local Transfer Tax?

Now, with the introduction of local autonomy in 1991, a need for additional transfer of national tax base into local government is obvious.

In the light of reallocation of tax resources for strengthening local financial capability, direct transferring of national tax item in an autonomous local tax into local government has some advantages such as autonomous operation of local finance and administrative simplicity. But it leads to regional revenue inequalities under highly concentrated distribution of existing tax revenues.

In order to overcome such basic shortcomings, it is necessary to utilize the readjustment system which enables financially weak local governments to gain the benefit of higher tax revenue while financially strong local governments receive less benfit. The readjustment mechanism is inevitable, especially when "balanced regional development" is the major goal for public policy.

When a need for readjustment mechanism of tax distribution as well as transferring of national tax revenue to local government because of political demands for local autonomy is taken into consideration, so-called, "Local Transfer Tax" is one of alternatives as result of general compromise "Local Transfer Tax" can be defined as tax that is collected by the central government but automatically transferred for use by the local government.

If reallocation of tax base between the central and local government is made in the form of Transfer Tax, shortcomings arising from the direct localization of existing national tax items can be reduced. Telephone tax, for example, when it is to be operated in the form of transfer tax, can reduce revenue concentration into big cities by the allocation of tax revenues. A part of Value-Added Tax (for example, revenues from amusement, food and drink, retail, lodging, electricity and gas, and water supply) can be a choice for transfer tax with the most of Value-Added Tax as the general sales tax itself integrated nationwide.

Part of Special Excise Tax, which is imposed on consumption of gasoline, can be also included on the Transfer Tax on the ground that the revenue can be used to build local roads. In addition to those taxes, the Liquor Tax can be another alternative for the Transfer Tax. Good examples of the liquor for the Liquor Tax are "tack-joo," "yack-joo," "so-joo"(all of which are Korean traditional liquor), of which revenues are more evenly distributed.

It is necessary to arrange the priority in accordance with the intended amount of tax transfer for local government. But, it still remains subjective, in fact, in which item has priority in making a transfer tax. So the question of giving specific priority is wholly up to policy consideration.

(2) General Purpose or Specific Purpose?

Local Transfer Tax remains intermediate between local tax and General Grants, so it does not have a fixed form. So how to design the transfer tax system and its function depends on the intention of legislature. The characteristics of the Transfer Tax are specified by whether the local use of revenue from the Transfer Tax is limited to special purpose. If the local use of the Transfer Tax is open to general purpose it does not make a significant difference between the Transfer Tax and General Grants.

The choice of specific or general purpose basically depends on the special goal of reallocation of tax resources.

If the basic goal lies in the improvement of financial capability in general of local government, giving them wide discretion, "General Type" Transfer Tax will be preferred.

On the contrary, if the aim of Transfer Tax lies in the improvement of local financial ability to deal with a specific and nationwide strategic project, assisting regional development, the "Specific Type" Transfer Tax will meet this aim more effectively.

Considering the fact that the main purpose of reallocation of tax resources between local and central governments is to concentrate local efforts on strategic field for alleviation of regional imbalance "Specific Type" Transfer Tax has the priority.

Under the current social and economic situation in Korea, it is urgent to make an enormous public expenditure in order to expand social overhand capital including "road and highway" and to improve undeveloped areas for balanced local development. This point makes the "Specific Type" Transfer Tax more preferrable.

It is expected for the Korean Ministry of Finance to submit a legislative bill regarding reallocation of tax revenues among the central and local governments during the regular session of National Assembly beginning October 1990. The legislative bill seems to include the idea of Local Transfer Tax, which is managed and collected in a form of natioal tax by the central government and automatically allocated for local use, benefiting the financially weak local governments more tax revenues.