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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT  
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OF

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## VI. PUBLIC FINANCE

### I. OUTLINE OF PUBLIC SECTOR FINANCES

1. In the Republic of Korea, public sector consists of the Central Government, the Local Governments at province, city and county (gun) levels, and the Public Corporations. With the help of data processed by Bank of Korea it was possible to construct a series of consolidated public sector accounts from 1958 to 1965 which include the Central Government and Local Government budgets. Lack of systematic data precluded the inclusion of Public Corporations. The finances of these institutions are reflected in the consolidated tables only to the extent they pay dividends to the Government (only some of them do) and to the extent they receive capital transfers from the Government. What is not possible to detect over a period of time is the investment expenditures of these firms out of their surpluses or through borrowing. Therefore, in the following discussion public sector will mean Central Government and Local Governments only, leaving Public Corporations for separate discussion.

2. For analytical purposes, the budget transactions of the Central Government are classified into "general government" and "enterprise" categories. The former refers to the transactions of the Government departments that perform the traditional public sector functions on the basis of providing free services and financing through compulsory levies. The latter refers, in accordance with standard U.N. definitions, to the transactions of the public agencies involved in producing and selling goods and services on a commercial basis, covering most of their costs by the prices they charge. The five accounts included in this category of enterprises are railways, communications, tobacco and ginseng monopoly, grain management and office supplies. Being operations of a commercial nature, the revenues and expenditures of these enterprises are included in our public sector accounts on a net basis. This means, the revenues and expenditures taken into the consolidation are mainly the surpluses and the investments of these institutions rather than the total of their sales proceeds or their costs of production.

3. The Local Government accounts are the consolidated totals of the budgets of provinces, cities and counties. There is a complicated line of transfers going from the Central Government to local governments at various levels. Parts of these are earmarked revenues from certain taxes, the rest are subsidies. In the following discussion, Local Government sector is taken as a consolidated unit. Only the transfers from the Central Government to the Local Government are shown.

#### Recent Trends

4. The general aggregates in the public sector accounts as defined above are shown in Table 1 and diagram for the years 1958-1965. The values are given as ratios to the GNP in order to eliminate the effect of price changes.

Table 1: PUBLIC REVENUES AND EXPENDITURE AS % OF GNP

	<u>1958</u>	<u>1959</u>	<u>1960</u>	<u>1961</u>	<u>1962</u>	<u>1963</u>	<u>1964</u>	<u>1965 /2</u>
GNP (billion won current prices)	<u>211</u>	<u>228</u>	<u>243</u>	<u>293</u>	<u>339</u>	<u>472</u>	<u>667</u>	<u>779</u> /1
Public Revenue	<u>9.8</u>	<u>12.0</u>	<u>14.0</u>	<u>13.0</u>	<u>14.3</u>	<u>12.1</u>	<u>10.2</u>	<u>11.3</u>
Tax	<u>7.9</u>	<u>10.4</u>	<u>11.1</u>	<u>8.8</u>	<u>9.9</u>	<u>8.1</u>	<u>6.9</u>	<u>8.2</u>
Monopoly	<u>1.0</u>	<u>1.0</u>	<u>1.1</u>	<u>0.9</u>	<u>1.2</u>	<u>1.0</u>	<u>0.7</u>	<u>0.5</u>
Non-Tax	<u>0.9</u>	<u>0.6</u>	<u>1.8</u>	<u>3.3</u>	<u>3.2</u>	<u>3.0</u>	<u>2.7</u>	<u>2.6</u>
Current Expenditure	<u>13.6</u>	<u>14.0</u>	<u>15.1</u>	<u>15.1</u>	<u>16.4</u>	<u>12.6</u>	<u>10.2</u>	<u>9.9</u>
Civil Administration (Wages & Salaries)	<u>7.5</u>	<u>7.9</u>	<u>9.0</u>	<u>9.6</u>	<u>10.4</u>	<u>8.3</u>	<u>6.5</u>	<u>6.2</u>
(Goods & Services)	n.a.	n.a.	n.a.	(4.4)	(5.0)	(4.2)	(3.3)	(3.1)
(Interest Payments)	n.a.	n.a.	n.a.	(2.7)	(2.9)	(2.4)	(1.8)	(1.9)
(Transfers)	n.a.	n.a.	n.a.	(0.2)	(0.2)	(0.2)	(0.1)	(0.2)
Defense	<u>6.1</u>	<u>6.1</u>	<u>6.1</u>	<u>5.5</u>	<u>6.0</u>	<u>4.3</u>	<u>3.7</u>	<u>3.7</u>
Savings on Current Account	<u>-3.8</u>	<u>-2.0</u>	<u>-1.1</u>	<u>-2.1</u>	<u>-2.0</u>	<u>-0.5</u>	<u>0.1</u>	<u>1.4</u>
Counterpart Funds	<u>8.2</u>	<u>5.4</u>	<u>5.5</u>	<u>6.9</u>	<u>7.5</u>	<u>5.1</u>	<u>4.0</u>	<u>3.6</u>
Utilization of Loans (Net) /3	<u>0.5</u>	<u>-3.0</u>	<u>2.6</u>	<u>2.1</u>	<u>0.1</u>	<u>1.1</u>	<u>0.8</u>	<u>-0.3</u>
Other Capital Resources	<u>2.1</u>	<u>4.6</u>	<u>-1.9</u>	<u>1.1</u>	<u>4.2</u>	<u>0.4</u>	-	<u>-0.3</u>
Capital Expenditures	<u>7.0</u>	<u>5.0</u>	<u>5.0</u>	<u>8.1</u>	<u>9.7</u>	<u>6.0</u>	<u>4.8</u>	<u>4.5</u>
Gross Capital Formation	<u>2.8</u>	<u>2.9</u>	<u>3.4</u>	<u>4.4</u>	<u>5.7</u>	<u>3.7</u>	<u>3.6</u>	<u>3.3</u>
Subscriptions	<u>0.1</u>	-	-	<u>0.2</u>	<u>0.8</u>	<u>0.8</u>	<u>0.3</u>	<u>0.5</u>
Loans	<u>3.0</u>	<u>1.2</u>	<u>1.0</u>	<u>2.7</u>	<u>2.9</u>	<u>1.2</u>	<u>0.8</u>	<u>0.6</u>
Transfers (Grants)	<u>1.1</u>	<u>0.9</u>	<u>0.6</u>	<u>0.8</u>	<u>0.4</u>	<u>0.3</u>	<u>0.2</u>	<u>0.2</u>

/1 Preliminary

/2 Based on third supplementary budget of central government presented in November 1965; reflects actuals for most of the year. For Local Government figures represent budget estimates.

/3 Includes domestic and foreign borrowing.

Source: Appendix Table 33

5. The most striking fact in the overall trend of public sector finances in Korea in recent years is the sharp decline in the relative size of public sector transactions. During 1958-1961 the level of total public expenditures (current and capital, direct and indirect) had fluctuated between 19 and 23 percent of GNP. In 1962, they reached a peak equal to 26.1 percent of GNP. In 1963, the second year of the Five Year Plan, the relative level of public expenditures started to decline sharply and continuously bringing the ratio down to 14.4 percent in 1965. In other words, within the last three years, the size of public sector activities was reduced by as much as one-third.

6. This deterioration in the size of the public sector, relative to GNP, was caused by both a relative fall in current revenues and a relative fall in foreign budget support. Current revenues fell from 14.3 percent of GNP in 1962 to 10.2 percent in 1964. The fall, in relative terms, of the value of counterpart funds which correspond to the foreign budget support was even sharper, declining from a level equal to 7.5 percent of GNP in 1962 to 4.0 percent in 1964. In 1965, there was a recovery in the tax ratio, but the relative share of counterpart funds continued to decline.

7. The figures shown as net borrowing by the public sector in the consolidated accounts conceal the actual cash deficits of the Government as it is distributed over the years, and hence the impact on monetary phenomena of deficit financing. This is due to the difference between accounts prepared on accrual basis and the treasury cash positions. This difference is aggravated in Korea by substantial carry-overs from one year to the next. The impact of public sector deficits on liquidity and prices will be discussed in Chapter IV. It may be in order to mention three points. First, after having a cash surplus in 1960, the Government had significant cash deficits in 1961 and 1962, was in balance in 1963 and 1964 and there was again a cash deficit in 1965. Secondly, although the cash deficits of the public sector were not large compared to GNP, because of an unusually high velocity (low ratio of money to GNP), the impact of these deficits on aggregate demand was significant. Finally, the lending by the Government to the private sector exceeded the cash deficits of the public sector, showing that, in the ultimate analysis, the Government acted as an intermediary for inflationary financing of the private sector.

#### Sources of Funds for Public Expenditure

8. In 1965, about 57 percent of total public expenditures was financed by tax revenues, about 25 percent by counterpart funds and the rest by non-tax income. Less than one-third of the tax revenue is from income taxes. The rest is distributed among a number of indirect taxes, levied at the Central Government or local levels, and the yields of customs duties. (See Table 2)

9. Counterpart funds are grants received out of the sales proceeds of imports under U.S. aid programs. The total won value of supporting assistance and approximately 80 percent of the won value of agricultural

# KOREA: PUBLIC REVENUES AND EXPENDITURES, 1958-1965

(AS % OF GNP)

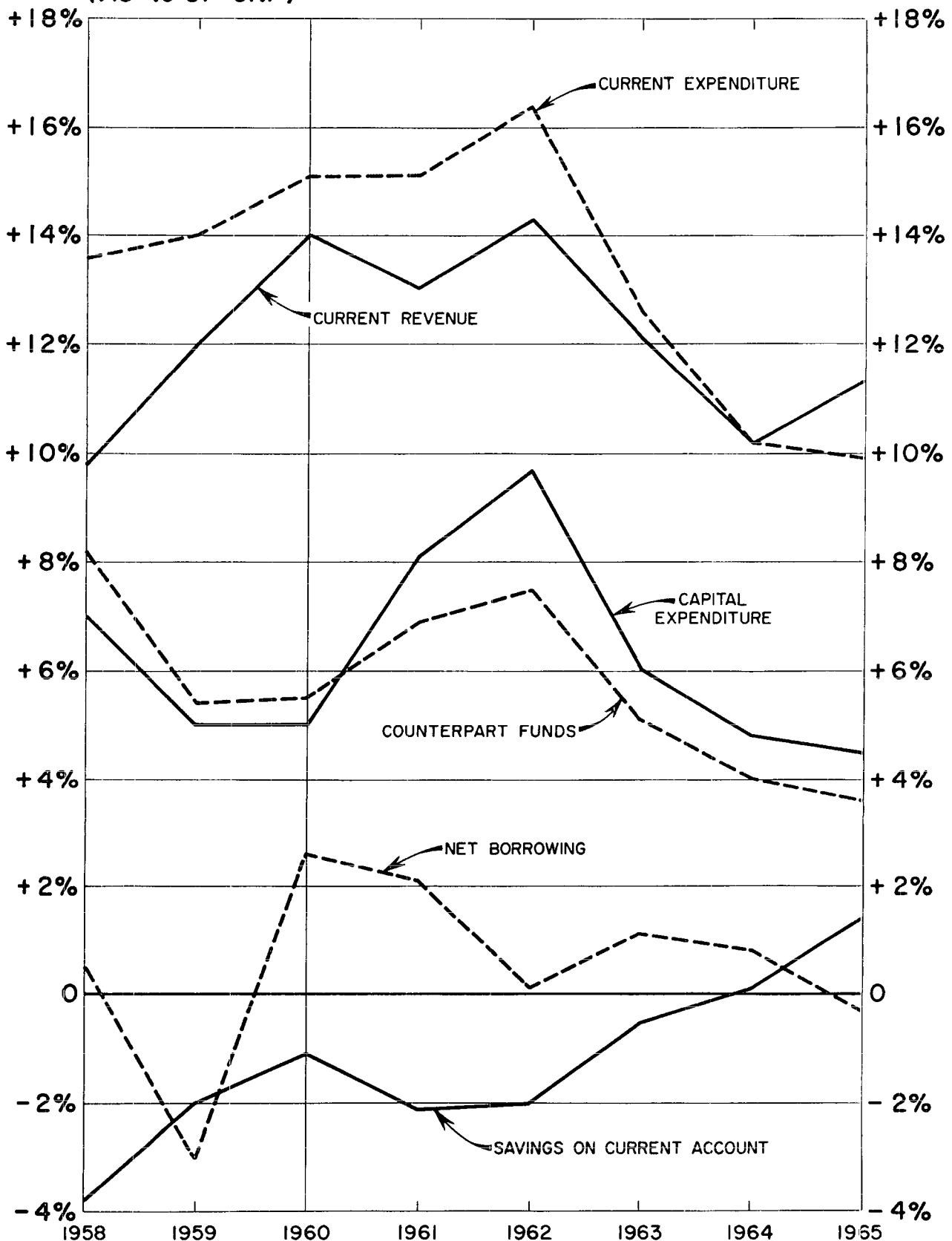


Table 2: CONSOLIDATED TAX REVENUES IN 1965 /2

	(billion won)	(% of total)
<u>Direct Taxes</u>	<u>18.1</u>	<u>28.3</u>
Personal Income	11.4	17.8
Corporate Income	5.4	8.5
Registration	1.1	1.7
Others	0.2	0.3
<u>Indirect Taxes</u>	<u>35.4</u>	<u>55.4</u>
Commodity	7.0	11.0
Petroleum Products	3.2	5.0
Business Activity	4.1	6.4
Liquor	3.6	5.6
Travel	1.4	2.2
Customs	12.4	19.4
Others	3.7	5.8
<u>Local Taxes</u>	<u>10.4</u>	<u>16.3</u>
Land Tax /1	4.0	6.3
Property Tax	0.8	1.3
Surtaxes /1	3.0	4.7
Others	2.6	4.0
<u>TOTAL TAX REVENUE</u>	<u>63.9</u>	<u>100.0</u>

/1 A portion of land tax and a portion of surtaxes can be considered direct taxes. See Chapter II.

/2 Based on third supplementary budget of Central Government reflecting actuals for most of the year; data for Local Governments are budget estimates.

Source: Appendix Table 34

surplus imports under PL 480 Title I agreement are donated to the Korean Government as budget support. The dollar value of imports financed by U.S. aid, and the counterpart funds allocated to the budget are shown in Table 3.

Table 3: IMPORTS FINANCED BY U.S. ASSISTANCE AND THE GENERATION OF COUNTERPART FUNDS

		<u>1960</u>	<u>1961</u>	<u>1963</u>	<u>1964</u>	<u>Note</u>
Imports (Supporting Assistance) Mil. \$	220	135	114	83	Line 1	
Imports (PL 480 Title I) Million \$	20	45	97	61	Line 2	
Grants to Korean Government (PL 480 Account) Million \$	22	46 <u>/1</u>	77	51	Line 3 <u>/2</u>	
Budget Support (Dollar Equivalent) Million \$	242	181	191	134	Line 4 = 1+3	
Exchange Rate (won per \$) Million \$	65	108.8	130.0	206.9	Line 5	
Budget Support (billion won)	15.7	19.7	24.8	27.7	Line 6 = 4x5	
Counterpart Funds <u>/3</u> (billion won)	13.4	20.2	24.1	28.0	Line 7	

/1 Includes stabilization grant equal to U.S. \$20 million.

/2 Line 3 differs from line 2 owing to changes in the proportions of PL 480 proceeds which are given as grants to R.O.K. These proportions were 88 percent in 1961-63, 85% in 1964, 80% in 1965 and 79% in 1966. Another source of the discrepancy between line 3 and 2 is leads and lags between arrival of shipments and the disposition of funds.

/3 According to public accounts. There are minor discrepancies between lines 6 and 7.

Source: BOK: Economic Statistics Yearbook 1965

IMF: Balance of Payments Yearbook

ECAFE: A Note on the Utilization of U.S. Agricultural Surplus  
in Korea

10. The high level of U.S. budget support has been almost matched by spending on defense. It should be noted that whereas in the past counterpart grants have been equal to or above defense expenditures, in 1966 they are expected to fall significantly below the defense budget. (See Table 4)

Table 4: COMPARISON OF DEFENSE EXPENDITURES AND U.S. BUDGET SUPPORT  
1958 - 1966  
(billion won)

	<u>1958</u>	<u>1959</u>	<u>1960</u>	<u>1961</u>	<u>1962</u>	<u>1963</u>	<u>1964</u>	<u>1965</u> (Estimate)	<u>1966</u> (Budget)
Defense Expenditures	12.8	14.0	14.8	16.7	20.5	20.5	23.9	28.0	36.8
Counterpart Funds	17.2	12.2	13.4	20.2	25.3	24.1	28.0	28.3	30.9

Source: Appendix Tables 33 and 35

11. Non-tax revenue of the public sector can be classified into three categories: income from ownership of property, net profits of Government enterprises and miscellaneous revenues. (See Table 5) Income from the ownership of property includes dividends received by the Government from Public Corporations as well as interest and rent incomes. Net profits of the enterprises are the surpluses of the railway, communications and monopoly administrations.

Table 5: NON-TAX REVENUES IN 1965

	<u>Billion Won</u>
Income from Ownership of Property	3.2
Income from Government Enterprises (of which transfers from Monopolies to General Budget)	13.6 (3.6)
Miscellaneous Incomes	<u>7.5</u>
TOTAL	23.9

Source: BOK Economic Classification of Central and Local Government Transactions

Table 6: FUNCTIONAL DISTRIBUTION OF CENTRAL GOVERNMENT EXPENDITURES IN 1965 /1 (INCLUDING TRANSFERS TO LOCAL GOVERNMENT)

	<u>Billion Won</u>	<u>% of Total</u>
<u>Current Expenditures</u>	<u>68.3</u>	<u>66.9</u>
General Administration	5.3	5.2
Defense	28.9	28.3
Justice and Police	5.9	5.8
Education	12.8	12.5
(Primary)	(9.7)	(9.5)
(Secondary)	(1.0)	(1.0)
(Higher)	(1.0)	(1.0)
(Other)	(1.0)	(1.0)
Health	0.8	0.8
Social Welfare	5.5	5.4
Agriculture and Non-Mineral Resources	2.9	2.8
Other Economic Services	0.7	0.7
Other Current Expenditures	5.3	5.2
<u>Capital Expenditures</u>	<u>33.8</u>	<u>33.1</u>
General Services	0.3	0.3
Community Services	1.1	1.1
Education	1.5	1.5
Other Social Services	0.5	0.5
Agriculture and Non-Mineral Resources	7.6	7.4
Mining, Manufacturing and Construction	5.0	4.9
Electric Power	1.0	1.0
Transport	9.5	9.3
Communications	5.5	5.4
Other Capital Expenditures	1.8	1.8
<b>TOTAL PUBLIC EXPENDITURES</b>	<b><u>102.1</u></b>	<b><u>100.0</u></b>

/1 Third Supplementary budget reflecting actuals for most of the year.

Source: Appendix Table 35

Composition of Public Expenditures

12. A functional classification of expenditures by the total public sector is not available. However, since Central Government accounts for about 84 percent of total expenditures (including transfers to Local Government), a breakdown of Central Government expenditures into functional categories can give an idea about the pattern of public spending. (See Table 6) The implications of the structure and the trends in current expenditures and implications for future policy will be discussed in Chapter III.

13. The capital expenditures of the public sector take place in three ways. First, there are direct Government investments either out of the general budget (economic development account) or from the enterprise accounts (monopoly, railways, communications and state forestry). Another category of spending is Government subscriptions to the share capital of Public Corporations. Thirdly, Government makes funds available out of the loan fund account to financial intermediaries to be lent to the private sector. And finally, minor amounts are given as grants to the private sector. (See Table 7)

Table 7: PUBLIC SECTOR CAPITAL EXPENDITURES  
1958 - 1965  
(in billion won)

	<u>Direct Investments</u>	<u>Subscriptions</u>	<u>Loans</u>	<u>Grants</u>	<u>Total</u>
1958	5.9	0.2	6.3	2.3	14.7
1959	6.6	-	2.7	2.0	11.3
1960	8.2	-	2.5	1.6	12.3
1961	13.0	0.5	8.0	2.2	23.7
1962	19.2	2.6	9.7	1.5	33.0
1963	17.6	3.8	5.9	1.5	28.8
1964	24.1	1.8	5.1	1.0	32.0
1965	25.4	3.6	4.5	1.4	35.0

Source: Appendix Table 33.

14. Comparison of public sector capital expenditures with gross domestic capital formation totals reported in national income accounts involves some conceptual difficulties. Public sector capital expenditures are estimates based on budget classifications which may not be always consistent with national income accounting definitions. Moreover, because of the significant amount of capital loans and grants by the

public sector as shown in Table 7, direct investment by the public sector will be considerably smaller than capital expenditures financed by the public sector. Both totals are compared with gross domestic capital formation in Table 8.

Table 8: SHARE OF PUBLIC SECTOR IN GROSS DOMESTIC CAPITAL FORMATION  
1960 - 1965  
(current prices)

	(1)	(2)		(3)	
	<u>Gross Domestic Capital Formation</u> <u>billion won</u>	<u>Gross Capital Formation</u> <u>by Public Sector</u> <u>billion won</u>	<u>% of total</u>	<u>Total Investments</u> <u>Financed by</u> <u>Public Sector</u> <u>billion won</u>	<u>% of total</u>
1960	25.3	8.2	32.4	12.3	48.6
1961	36.9	13.5	36.6	23.7	64.2
1962	41.9	21.8	52.0	33.0	78.8
1963	85.5	21.4	25.0	28.8	33.7
1964	90.2	25.9	28.7	32.0	35.5
1965	91.1	29.0	31.8	35.0	38.4

Column 1: BOK: 1965 preliminary estimate.

Column 2: Direct Investments plus subscriptions, according to BOK classification corresponding figures shown in national income accounts for fixed investment by general Government and Government enterprises are 8.2, 11.0, 15.4, 18.7, 18.1, and 22.1 billion won from 1960 to 1965.

Column 3: Total Public Sector Capital Expenditure which is Column 2 plus loans and grants.

15. An industry by industry comparison of total and public investments is even more problematic. However, just to illustrate the orders of magnitude, totals of gross domestic fixed capital formation in certain major activities are compared with total capital expenditures (direct + transfers) in these areas by the Central Government. (See Table 9) Throughout the period, Government financing has dominated investments in agriculture, transport and communications and electricity, but public expenditures in manufacturing have not kept up with the rapid increase in total investments in this sector.

Table 9: CENTRAL GOVERNMENT INVESTMENTS COMPARED TO GROSS DOMESTIC FIXED CAPITAL FORMATION IN SELECTED INDUSTRIES, 1960-1965  
(billion won, current prices)

	<u>Agriculture, Forestry, Fishing</u>		<u>Manufacturing, Mining, Construction</u>		<u>Transport Communications</u>		<u>Electricity, Water, Sanitation</u>	
	<u>G.D.F.C.F.</u>	<u>C.G./1</u>	<u>G.D.F.C.F.</u>	<u>C.G./1</u>	<u>G.D.F.C.F.</u>	<u>C.G./1</u>	<u>G.D.F.C.F.</u>	<u>C.G./1</u>
1960	3.5	2.5	5.6	1.8	4.9	2.5	1.1	0.8
1961	4.7	4.8	7.1	3.4	7.5	3.5	2.8	4.5
1962	3.8	7.0	11.0	5.5	10.6	6.6	5.2	3.3
1963	6.5	5.6	16.9	4.7	15.1	9.2	8.6	4.4
1964	5.5	3.6	19.7	3.4	15.4	8.5	6.4	4.4
1965	7.5	7.6	26.4	4.7	20.0	15.0	7.3	2.1

G.D.F.C.F.: Gross Domestic Fixed Capital Formation as reported in BOK,  
National Accounts of Korea.

C.G.: Total Capital Expenditures by Central Government,  
Statistical Appendix.

/1 May include inventory investment.

#### Budgetary System

16. In general, Korea has a rational and systematic budget and public accounting system, which is divided into categories of general budget, enterprise budget and budget of Public Corporations, each regulated by a separate law.

17. The Central Government budget formally consists of one general account and 19 special accounts. Thirteen of these special accounts together with the general account make up the "general government" sector which covers transactions arising from non-commercial exchanges between the Government and individuals - such as taxes and public services. Three of the special accounts are essentially summary accounts:

- (1) Counterpart Special Account, which shows the sources and the uses - including transfers to other accounts - of counterpart funds;

- (2) Economic Development Account, which is essentially the "capital budget" which also includes some minor current expenditures considered to be of developmental importance;
- (3) Government Loan Fund Operation Account, to which the surpluses of other special accounts are trusted (as well as some transfers from the general account) and from which Government loans are made mostly through public financial institutions, such as Korean Reconstruction Bank and National Agricultural Cooperatives Federation. The repayments of loans are also made into this account which functions like a revolving fund. Starting in 1966, a separate special account is established for the regulation of foreign loans.

18. The budgeting and accounting of the general account as well as the 13 special accounts are according to the strict single entry system specified in The Budget and Accounting Act. Legislative decisions are necessary for all amendments except minor transfers between accounts.

19. The other component of the Central Government budget is the "enterprise" sector which covers the market-exchange activities of the Central Government, summarized under the following special accounts:

- (1) Railway Transportation;
- (2) Communication Services;
- (3) Monopoly Enterprise;
- (4) Grain Management;
- (5) Office of Supply.

These "enterprises" of the Central Government which should not be confused with the 25 Public Corporations outside the Central Government budget proper, are subject to The Government Enterprises Budget and Accounting Act. According to this law, enterprises conform to double-entry accounting and have more freedom and flexibility in conducting their affairs.

20. Although accounting methods are somewhat different, both components of the Central Government budget are discussed and approved by the Parliament as a legislative act. This is not the case for the budgets of the Public Corporations which are prepared according to The Budget and Accounting Law Governing Government-invested Corporations and approved by the Cabinet. The Minister of Home Affairs is the final authority in the preparation of local budgets.

21. The budget guidelines for the Central Government budget are prepared by the Economic Planning Board and sent to the related agencies before the end of March each year. According to these guidelines the planning offices in the Ministries prepare annual programs and submit them to the Prime Minister's office which reviews them and sends them back with instructions for modifications. Then the Economic Planning Board receives budget projects from two sources: (1) From Prime Minister's

office - the general program budget; (2) From individual Ministries - the detailed schedules. These drafts have to come to the Economic Planning Board before the end of May and the Economic Planning Board has to submit the budget proposal to the Cabinet before August 15. During the interval from the end of May to the middle of August, reviews, negotiations and discussions take place between the Economic Planning Board and other related Government agencies, which help to put the budget proposal into its final shape. The Cabinet has to submit the budget proposal to the National Assembly 120 days before the new fiscal year, and the Assembly has to pass it 30 days before the relevant fiscal year begins.

22. It can be seen that the responsibility for the budget preparation rests with the Economic Planning Board. In fact, the whole budget bureau is part of the Economic Planning Board, rather than a section of the Ministry of Finance as is usual in other countries. Although this system has helped to bring planning and implementation functions together as far as public expenditures are concerned, it has caused separation of responsibilities for expenditures and revenues - since the Ministry of Finance is still responsible for taxation.

#### Public Corporations

23. Public Corporations are the enterprises in which Government equity ownership amounts to more than half of the total or the enterprises with more than half of the ownership vested in the Government according to the Vested Property Disposal Law. At present, there are twenty-five such enterprises, a list of which is given in the Appendix. Six of these are financial institutions: Bank of Korea, Korean Reconstruction Bank, Medium Industry Bank, National Citizens Bank, Mint Corporation and Reinsurance Corporation. There is one enterprise in fishing (Fishery Development Corporation), one corporation for housing, two corporations in the field of transport and one in tourism. The remaining fourteen are industrial or commercial enterprises. The most important ones in terms of their net worth and investments are Korea Electric Company, two fertilizer plants, Oil Refinery and Coal Corporation. The total paid capital of Public Corporations totaled 42.1 billion won in 1965, of which 37.2 billion or about 90 percent was owned by the Government.

24. According to an estimate provided by the Economic Planning Board annual investments by Public Corporations (excluding financial institutions) amounted to 19 billion won in 1965. (See Table 10) These investments were financed by Government funds - either subscriptions to the share capital of Corporations or loans - the surpluses of these enterprises and by other borrowing including substantial amounts of foreign loans. It was not possible to determine the exact amounts of these finances.

25. The financial management of the Public Corporations is regulated under "The Budget and Accounting Law Governing Government-Invested Corporations." According to this law, the Corporations have to prepare budgets "flexible enough to keep up with increases in demand, changes in

economic conditions and other unforeseen events, as a means of ensuring efficient management of business." These budgets, including profit and loss statements and balance sheets, are submitted by the Governors of the Corporations to the Ministers to whom they are responsible. These budgets are reviewed by the Economic Planning Board and finally approved by the State Council. Any major shifts in programmed expenditures during the year have to be ratified by the responsible Minister who has to notify the Economic Planning Board. Unfortunately most of these provisions which are basically sound, do not seem to be applied fully in practice. In contrast to the abundance of statistical information in Korea, it was not possible to get a systematic account of annual investments and finances of Public Corporations which could be consolidated with other Public Sector accounts.

26. It has been Government policy in recent years to transfer some of its share in Public Corporations to private ownership, but no progress has been made until now. According to a list prepared by the Government, the present policy seems to be, in principle, to keep the five financial institutions and Electricity, Coal, Oil Refinery and Airlines Corporations for full or semi-Government ownership, and to transfer the rest to the private sector. However, there are no indications that this transfer can be effected in the near future. This is not only due to hesitancy in Government circles, but also due to the undeveloped state of the capital market and the shortage of savings. It has been pointed out that a large scale sale of stocks owned by the Government could seriously depress stock prices in the very limited market. Some experts have recommended the establishment of a mutual fund to be managed by the Korean Reconstruction Bank where the stocks of Public Corporations would be deposited 1/. The Mission was unable to find any detailed preparation on the question of transferring some Government shares to private ownership.

Table 10: INVESTMENTS BY PUBLIC CORPORATIONS 1965  
(billion won)

	<u>1963</u>	<u>1964</u>	<u>1965</u>
Korea Electric Corporation	5.3	8.5	8.8
Korea Fishery Development Corp.	-	0.6	3.3
Korea Oil Refinery Corp.	2.1	0.4	3.5
Honan Fertilizer Company	-	2.6	0.2
Korea Marine Transportation Corp.	0.7	-	0.7
Korea Coal Corp.	0.6	0.5	0.7
Korea Airline Corp.	0.1	0.4	0.6
Others	0.7	0.9	1.2
	<u>9.5</u>	<u>13.9</u>	<u>19.0</u>

1/ J. Gurley, H. Patrick and E. Shaw, The Financial Structure of Korea

II. STRUCTURE OF PUBLIC REVENUES

Trend of Total Tax Revenues

27. The trend of tax ratios (ratios of national and local taxes - excluding monopoly profits - to GNP) in recent years has followed a hill-shaped curve with two ends in 1957 and 1964 and the peak in 1960. The total tax ratio increased from 6.6 percent in 1957 to 11.1 percent in 1960 and then dropped to 7 percent in 1964. The final estimates for 1965 show a slight recovery which is expected to continue into 1966. (See Table 11)

28. The high tax ratios of 1958, 1959 and 1960 can partly be explained by the Foreign Exchange Tax which was applied in those years yielding high revenues. However, even without this tax which was, in effect, tantamount to a general customs duty, (or a partial devaluation) the tax ratio was 9 percent in 1960 as compared to a ratio of 7 percent in 1964.

29. Three factors at the beginning of 1961 combined to lower the tax ratio to 8.8. First, following the drastic devaluation from 65 to 130 won to one U.S. dollar, the Foreign Exchange Tax was abolished. Secondly, the tariff schedules were revised downwards. And finally, there was a fall in the dollar value of imports. The two last factors, reduction in tariffs and fall in imports, more than compensated for the improvement that would be expected from devaluation.

30. An extensive revision of the tax system was put into effect in 1962. This involved rate increases and administrative improvements. In personal income taxes, the structure was revised into five scheduled income categories ((i) wages and salaries, (ii) profits, (iii) income from real estate, (iv) dividends and interest, (v) other) and the education tax was merged into the income tax. Land tax was transferred to Local Governments. Petroleum products, until then taxed under the commodity tax, were made the subject of a separate tax. The commodity taxes and the business activity taxes were simplified. Some tax rates as well as the specific tax levies on liquors were increased. All these measures were effective in producing a marked improvement in revenues raising the tax rate to 9.7 percent of GNP.

31. In spite of improvements in the tax system in 1962, the tax yields relative to GNP deteriorated sharply during the following two years. The tax ratio fell to 8.1 percent in 1963 and 7 percent in 1964. This was due almost entirely to lagging revenues of commodity taxes and customs duties in relation to the rising GNP. Customs revenues suffered mainly because of pegged exchange rates in the face of rising domestic prices, but also as a result of some revisions in tariffs from 1962 to 1963. The pegged exchange rates and falling customs duties also had repercussions on commodity taxes; almost half of commodity tax revenue is collected from imported goods. The ratio of revenues from taxes based on imports to total tax revenue and the falling trend of this ratio over recent years is shown in Table 12.

Table 11: TAX REVENUES AS PERCENT OF GNP  
1957 - 1966

	1957	1958	1959	1960	1961	1962	1963	1964	1965 /1	1966 /2
GNP (billion won) current prices	199	212	228	243	294	345	472	667	779	(910)
<u>Direct Taxes</u>	1.1	1.4	2.1	2.0	2.1	2.2	2.1	2.1	2.3	2.2
Personal Income	0.7	1.0	1.6	1.5	1.4	1.4	1.3	1.3	1.5	1.2
Corporate Income	0.3	0.2	0.3	0.4	0.6	0.6	0.6	0.6	0.7	0.8
Registration	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2
Others	0.1	0.1	0.0	0.0	0.1	0.1	0.1	0.1	0.0	0.0
<u>Indirect Taxes</u>	3.4	3.9	4.6	5.5	4.9	5.9	4.5	3.5	4.5	5.0
Commodity										
Petroleum Products	1.1	1.2	1.4	1.8	1.7	1.4	0.8	0.5	0.9	0.9
Business Activity	0.4	0.4	0.5	0.4	0.4	0.6	0.5	0.5	0.5	0.6
Liquor	0.4	0.4	0.4	0.5	0.4	0.7	0.6	0.4	0.5	0.6
Travel	0.1	0.1	0.1	0.0	0.1	0.2	0.2	0.1	0.2	0.4
Customs	1.2	1.4	1.6	2.1	1.8	1.9	1.4	1.2	1.6	1.7
Others	0.2	0.4	0.6	0.6	0.5	0.6	0.6	0.4	0.5	0.5
<u>Land Taxes</u>	1.4	0.9	0.8	0.6	0.7	0.7	0.7	0.6	0.5	0.5
<u>Other Local Taxes /3</u>	0.8	0.9	0.7	0.9	0.9	0.9	0.9	0.8	0.8	0.9
<u>Foreign Exchange Tax</u>	---	0.7	2.1	2.1	0.1	---	---	---	---	---
<u>Total Tax</u>	6.6	7.8	10.3	11.1	8.8	9.7	8.1	7.0	8.2	8.7

/1 Preliminary estimate of GNP; tax revenue data from Third Supplementary Budget of Central Government which reflects actuals for most of the year; data for local taxes from the budget.

/2 GNP assumed to be 15% over 1965 expressed in current prices; tax data from budget.

/3 Includes surtaxes on national taxes; business activity, personal income and corporate income.  
Source: Appendix Table 34

Table 12: REVENUE FROM TAXES ON IMPORTS COMPARED TO TOTAL  
TAX REVENUE  
1958 - 1964

Customs Revenue	Foreign Exchange Tax	Commodity Tax on Imports		Total Tax on Imports	Import Taxes as Percent of Total Taxes	Import Tax Revenues per \$ Imports (won)
		B i l l i o n	W o n			
1958	3.0	1.4	0.8	5.2	31	13.7
1959	3.6	4.7	1.1	9.4	40	30.9
1960	5.2	5.1	1.5	11.8	41	34.4
1961	5.3	0.3	3.2	8.8	34	27.8
1962	6.7	0.1	2.3	9.1	27	21.6
1963	6.4	-	2.1	8.5	24	15.2
1964	8.2	-	1.2	9.4	20	23.2

Source: Commodity Tax: Ministry of Finance; others: Appendix Table 34.

32. An extensive administrative campaign combined with adjusted exchange rates, rise in commodity tax rates and inclusion of new items in its coverage resulted in an improvement in tax revenues in 1965 raising the tax rates to 8.2 percent. For 1966, higher tax rates on corporate income, liquor and transportation which have become effective since January 1 are expected to more than compensate for the loss in revenues due to increased personal exemption levels in personal income taxes, and to result in a further improvement of the tax ratio.

#### Personal Income Taxes

33. Personal income taxation in Korea is based on a schedular tax system where different kinds of income are subject to different methods and rates of taxes. Separate categories of incomes earned by an individual are considered separately - not combined for tax purposes. In a way, this is a tax on incomes rather than on income receivers. At present five main categories of incomes are distinguished. These categories and the rates applicable to them are shown in Table 13.

Table 13: INCOME CATEGORIES AND RATES OF PERSONAL INCOME TAX  
Effective from January 1, 1966

1. Wage and Salary Income (Monthly)

Less than 20,000 won	7%
Less than 40,000 won	15%
Less than 60,000 won	25%
More than 60,000 won	35%
If not employed by any definite employer and is paid on daily or hourly basis	7%

2,3. Business and Real Estate Income (6 months)

Less than 100,000 won	15%
Less than 250,000 won	20%
Less than 600,000 won	30%
Less than 2,000,000 won	40%
More than 2,000,000 won	50%

4. Dividend and Interest Income

Dividend and Interest Income from Corporations	12%
Interest Income on Non-Business Loan	10%

5. Other Income

Temporary Wage Income (Same rates as Wage and Salary Income)	
Other Income	15% (flat)

34. In 1963, there were over 700,000 1/ individual income tax payers compared to nearly 3 million people employed in non-agricultural activities. Wage and salary earners constituted about 90% of total taxpayers, but paid only slightly more than half of the total personal income taxes. 90% of the tax paid by wage and salary earners came from the lowest bracket. On the other hand, individuals receiving incomes from unincorporated businesses, whose number constituted only 8 percent of the total, were responsible for about 57 percent of the total revenue from personal income taxes. (See Table 14)

1/ There is some double-counting in this figure to the extent that some people had more than one kind of income, but this is believed to be minor.

Table 14: PERSONAL INCOME TAX BY SIZE OF INCOME BRACKET  
1963

<u>Income Bracket</u>	<u>Number of Taxpayers</u>	<u>Revenue</u> (million won)
<u>1. Wage and Salary Income (monthly) /1</u>		
Less than 20,000 won	636,782	3,243
Less than 40,000 won	5,711	186
Less than 60,000 won	364	31
More than 60,000 won	46	8
Bonus Approved	6,962	47
Others	NA	63
<u>Total</u>	<u>649,865</u>	<u>3,578</u>
<u>2. Business Income (6 months)</u>		
Less than 60,000 won	45,235	594
Less than 180,000 won	8,194	487
Less than 540,000 won	2,277	498
More than 540,000 won	653	940
<u>Total</u>	<u>56,364</u>	<u>2,519</u>
<u>3. Real Estate Income (6 months)</u>		
Less than 60,000 won	5,033	69
Less than 180,000 won	593	32
Less than 540,000 won	46	10
More than 540,000 won	4	2
<u>Total</u>	<u>5,676</u>	<u>113</u>

/1 Does not include taxes paid by employees of foreign missions in Korea which are subject to the same rates but paid every three months. In 1963 there were 5,551 taxpayers under this category who paid a total of 99.7 million in personal income taxes.

Source: R. A. Musgrave, Revenue Policy for Korea's Economic Development

35. The changes in the tax rates since 1961 on wages and salaries and on income from business and real estate are shown in Table 15.

Table 15: CHANGES IN RATES OF PERSONAL INCOME TAX

## 1. Wages and Salaries

## 2. Income from Business and Real Estate

36. The major tax revision which was implemented in 1962 would be expected to result in a significant loss of revenue from personal income taxes since the rates in all brackets were drastically reduced. But in spite of this, the ratio of personal income tax revenues to GNP remained constant at 1.4 percent. Although improvements in the tax administration could be partly responsible for this, the main factor seems to be a faster rise during 1962-65 of non-agricultural income compared to the growth of agricultural incomes, which are not included in the tax base.

In fact, if personal income tax revenue is compared with non-agricultural income, there is a significant fall in the ratio.

37. After 1962, the adjustments in rates were mainly confined to adding new brackets to high incomes without either reducing the low bracket rates or raising the minimum exemptions. With a rapid inflation, this would be expected to increase the tax ratio since a rise in nominal incomes would bring taxpayers into higher tax brackets. This did not happen. On the contrary, there was even a slight fall in the tax ratio in 1963 and 1964. A close examination reveals that this was the outcome of opposing trends in major components of personal income taxes; mainly because of the lag of Government salaries and wages behind price increases, the tax on wage income showed a less than proportional responsiveness to GNP. On the other hand, yields on business taxes had an income elasticity of above unity.

38. For 1966, there is no change in the rate structure of the tax on wages and salaries, but the minimum tax exempt income level is raised from 4,285 won to 5,600 won per month. On the other hand, minimum exemption levels of tax on business and real estate incomes are not changed, but rates are reduced, except in the lowest and the highest brackets. Both of these amendments would be expected to have negative effects on tax yields. However, a rise of 30 percent in Government salaries is bound to increase tax revenues. The net result of these developments plus developments in incomes and prices is estimated by the Korean Government to result in an increase of 6 percent in the yields of personal income taxes. If this is realistic, the tax ratio in 1966 will be around 1.2 of GNP (assuming 15% increase in GNP in current prices). This may be an underestimate but it is very probable that the tax ratio in 1966 will fall short of the 1965 level.

#### Corporate Income Tax

39. From 1961 to 1964, the corporate income tax revenues remain steady at 0.6 percent of GNP. During this period the rates increase from an average of 20 percent in 1961 to 25-30 percent in 1964. (See Table 16) Although this implies a tax structure relatively inelastic to income and price changes, closer examination shows that this can be explained in terms of two developments:

- (1) Agricultural income in current prices, which is scarcely tapped by corporate taxes, has increased faster than non-agricultural income, during 1961-64 1/.
- (2) The number and size of tax exempt industries and tax credits have increased.

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1/ However, during 1962-65 agricultural income rose less rapidly than other incomes. (See para. 36)

Table 16: CHANGES IN CORPORATE TAX RATES

	<u>1961</u>	<u>1962</u>	<u>1963</u>	<u>1964</u>	<u>1965</u>	<u>1966</u>
Non-family Corporations	17)					
Family Corporation	22)	20				
Under 1 million won			20	25	25	20
Over 1 million won			25	30	30	30
Over 5 million won						35

40. The revenue loss from exemption under the corporation tax has been estimated to be about 37 percent of the yield in absence of such exemptions. "Over one-half of the loss results from the exemption of public and semi-public corporations. The remainder is about equally divided between rate reduction for new firms (Articles 21 and 22), profits from expansion (Article 23) and reinvested earnings (Article 24). Partial exemption of export profits (Article 25) is also provided for but not as yet a major revenue loss." 1/

41. A concentrated administrative effort in 1965 was able to raise the corporate tax ratio to GNP from 0.6 to 0.7 percent. For 1966, the major changes are a reduction of the rate on incomes under 1 million won from 25 to 20 percent and addition of a new bracket of 35 percent for incomes over 5 million, and the repeal of the 50 percent tax credit on reinvested incomes. These amendments are expected to cause an increase of one-third in revenues which will raise the tax ratio to 0.8 percent of GNP.

#### Commodity Tax

42. Commodity tax is levied on the sales value of certain commodities classified into 46 categories and collected from the manufacturers or from the importers. The rates vary from 5 to 70 percent. A high portion of the domestic component of the tax is collected from the manufacturers of cotton yarn, semi-finished wool, other threads, cement and paper as is shown in Table 17. According to these figures, the five items listed contribute about 84 percent of the total domestic commodity tax, and cotton yarn by itself is responsible for 42 percent.

43. Almost half of the commodity taxes were collected from the importers in 1963. In the following years this ratio has fallen mainly due to the rapid growth in domestic manufacturing industry and a fall

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1/ See R. Musgrave, op. cit.

in the imports of some commodities such as rubber, vehicles, textile goods and wool. Rapid increase in the exports of plywood and textile products, the inputs of which are exempted from the commodity tax, could also have contributed to the relative fall in the share of the revenues collected from imports.

Table 17: MAJOR COMMODITIES SUBJECT TO COMMODITY TAX

<u>Commodity</u>	<u>Tax Rate</u>	<u>Tax Revenue</u>
Cotton Yarn	10%	809 mil. won
Semi-finished Wool	5	364
Other Threads	15 (average)	243
Cement	5	117
Paper	2	<u>85</u>
		1,618 mil. won
Total commodity tax revenue from domestic manufacturing		1,930 mil. won

44. As mentioned above, there was a very sharp fall in the ratio of commodity tax revenues to GNP in 1963 and 1964. The ratio was about 0.5 percent in 1964 compared to 1.4 percent in 1962. Several factors were responsible for this sharp fall: pegged exchange rates plus downward revisions of some tariff schedules slowed down the increase in the revenue from imports. The lag in the tax yields from domestic manufacturing is attributed to price controls.

45. In 1965, use of a realistic exchange rate, an increase in the coverage and upward revision of some rates have increased the commodity tax ratio to 0.9 percent of GNP. Twenty-one new items - most of them electrical appliances and luxury household goods - were added to the list of taxable items. The rates on these items varied between 5 and 50 percent. At the same time, rates on wool, paper, sugar and a few other items were raised. The expected GNP ratio of commodity tax revenues in 1966 is also around 0.9 percent.

Petroleum Products Tax

46. Petroleum products tax (POL: petroleum, oil, lubricants) was separated from the general commodity tax in 1962 and rates were set as follows:

Gasoline	300%
Kerosene	20
Light Oil	20
Diesel	10
Others	10

In the second half of 1964, following the devaluation of the won, taxes on gasoline were reduced to 100 percent. The tax on other products was abolished. Since the beginning of 1965, rates of 40, 20 and 10 percent are applied on light oil, diesel and other petroleum products respectively. The revision of rates in 1964 plus a fall in petroleum imports caused POL tax ratio to fall from 0.5 percent of GNP to 0.3 percent. In 1965, the increase in rates raised the ratio to 0.4 percent. The 1966 ratio is expected to be the same.

#### Business Activity Tax

47. Business Activity Tax is a sales tax applied at the stages of manufacturing, wholesale and retail of goods, and sales of some services. The ratio of proceeds from this tax to GNP rose to 0.6 percent in 1962 from 0.4 percent in 1961 mainly due to increases in its rates. Since then, it has been around 0.5%.

Manufacturing	
Class A	0.3%
Class B	0.7
Wholesale	
Class A	0.3
Class B	0.7
Retail	
Class A	0.5
Class B	1.0
Specified Activities	0.3-2.0%

In manufacturing, rice-polishing, fertilizer, reeling, cotton processing, oil refinery, spinning and weaving, papermill, briquet and manufacture of rayon are subject to tax rate in Class A, and other to tax rate in Class B, respectively. In wholesale and retail business sales of grain, salt, tobacco, flour, fertilizer, fruits and greens, fresh fish, briquet and rationed items of daily necessities designated by Presidential Decree are subject to tax rate in Class A and the rest to Class B.

48. Both corporations and unincorporated business are subject to these rates. In 1963, the revenues were almost evenly divided between corporations and personal business activity taxes. The highest portion of taxes paid by corporations was on manufacturing activities, whereas the highest portion of taxes paid by unincorporate business was on retail trade. (See Table 18)

Table 18: COMPOSITION OF REVENUE FROM BUSINESS ACTIVITY TAX

<u>Sector</u>	<u>Private Business</u> (percent)	<u>Corporations</u>
Manufacturing	12	38
Wholesale	29	20
Retail	37	10
Construction	1	14
Other Services	21	18
<u>Total</u>	<u>100</u>	<u>100</u>

49. Business tax is not only important in relation to its own revenue yield, but it is the tax base for a 20 percent surtax imposed by local governments. Furthermore, a significant proportion of income tax levies are based on sales estimates underlying the assessment of the business tax.

#### Liquor Tax

50. Liquor tax is the only major tax item in Korea which is specific - levied on quantity rather than value of the product. Because of this, during a period of inflation, the revenue from this tax as percent of GNP has shown a declining trend with periodic jumps occurring in years when the tax rates were adjusted. The ratio has fluctuated between 0.4 and 0.7% of GNP since 1960. The changes in the rates of major items are shown in Table 19.

Table 19: CHANGES IN LIQUOR TAX RATES  
(Won per Suk = 180 Liters)

	<u>1960-61</u>	<u>1962-63</u>	<u>1964-65</u>	<u>1966</u>
Takju (rice wine), unfiltered	40	300	240	265
Takju (rice wine), filtered	750	3,000	3,000	3,600
Beer	3,250	9,750	7,800	14,010
Chungju (top grade)	3,600	10,810	7,540	11,285
Chungju (1st grade)	2,200	3,220		10,535
Alcohol	2,300	5,750	5,750	7,075
Soju (distilled wine)	930	2,325	2,325	3,250
Soju (undistilled)	930	640	640	

51. Although rate adjustments including those in 1966, have, in general, been in line with price increases since 1960, if 1966 rates and prices are compared with 1962 rates and prices, tax rates in value terms have fallen for unfiltered rice wine and alcohol. These two items account for about 40% of the total revenues from liquor taxes. (See Table 20) In 1964, the tax on beer amounted to 72 percent of its price net of tax. Tax rate on filtered rice wine in value terms was 97 percent.

Table 20: COMPOSITION OF REVENUE FROM LIQUOR TAX

<u>Category</u>	<u>Revenue in 1963</u> (million won)	<u>% of Total</u>
Takju, unfiltered	589	21.1
Alcohol	560	20.0
Chungju	415	14.9
Beer	409	14.6
Soju, distilled	371	13.3
Soju, undistilled	213	7.6
Others	237	8.5
<u>Total</u>	<u>2,794</u>	<u>100.0</u>

Travel Tax

52. The base of the travel or transportation tax is the fare paid to various means of transport. It is collected by the provider of the transport service and paid to the Government on a monthly basis. In the last six years, revenue from this tax has been equal to about 0.1-0.2% of GNP. Tax revenues have been affected by the pricing policies applied to public transportation.

53. The rates applied to fares of various means of transport are shown in Table 21.

54. The Government proposal for rate adjustments in 1966 was for a tripling of the first three rates. The Assembly trimmed it down to 20%. But revenue estimates which were based on 30% rates were not adequately adjusted. Since train and taxi and micro bus accounts for over 60 percent of the total revenues (in 1963), it is very probable that revenue expectations from travel tax will not be realized, unless price adjustments make up for the difference.

Table 21: RATE STRUCTURE OF TRAVEL TAX  
(percent)

	<u>1960-61</u>	<u>1962</u>	<u>1964-65</u>	<u>1966</u>
Railway	10	10	10	20
Sleeper or Express	10	10	10	20
Jitney or Taxi (Micro Bus)	15	10	10	20
Bus	5	5	5	5
Steamship	10	5	5	5
Streetcar or Coach	10	5		
City Bus	10	5	5	5
Chartered Bus				10

Customs

55. The import values in dollars and wons and the public revenues accruing from customs duties are shown in Table 22.

Table 22: IMPORTS AND CUSTOMS REVENUES  
1957-1964

<u>Imports</u> (Million \$)	<u>Total</u> <u>Imports</u> (bil. won) (A)	<u>Customs</u> <u>Revenue</u> (bil. won) (B)	<u>Average</u> <u>Tariff</u> <u>Rate</u> (B)/(A) %	<u>General</u> <u>Price</u> <u>Level</u>	<u>Exchange</u> <u>Rate</u> Won per \$
1957 442.2	22.1	2.4	10.9	94.1	50
1958 378.2	18.9	3.0	15.9	88.2	50
1959 303.8	15.2	3.6	23.7	90.3	50
1960 343.5	22.3	5.2	23.3	100.0	65
1961 316.1	41.1	5.3	12.9	113.2	100/130 /2
1962 421.8	54.8	6.7	12.2	123.8	130
1963 560.3	72.8	6.4	8.8	149.3	130
1964 404.4	87.8	8.2	9.3	201.1	130/255 /3

/1 Includes Special Customs Duty

/2 Devaluation, February 1961

/3 Devaluation, May 1964

56. From 1957 to 1960, revenues from customs more than doubled in spite of almost no increase in won import values and an actual fall in dollar import values. This was due to a drastic upward adjustment of tariffs raising the average rate from 11 percent to 23 percent. If the Foreign Exchange Tax applied in 1959 and 1960 are taken into account, the effective average tariffs go much higher to about 48 percent of the import value in 1960.

57. Parallel with the devaluation of 1961 the tariffs were scaled down to an average of about 13 percent. From 1962 to the middle of 1964, there was no increase in the average tariff rates nor an adjustment in the exchange rate in spite of a 70-80 percent rise in the general price level. This pegging of exchange rates and no compensating increases in tariffs was the cause of the deterioration of revenues dependent on import values, discussed at the beginning of this chapter. The devaluation on May 1964 has improved the ratio of customs revenues to GNP.

58. About 12 percent of imports are free from customs duties. Fertilizers and crude oil account for a large portion of these duty-free imports. Nearly half of total imports fall in the 10% tariff category; main items are raw cotton, wheat, aluminum sulfate, chemical wood pulp and natural rubber. This category accounts for 30% customs duties. About 5 percent of total imports with tariffs above 35 percent were responsible for about 20 percent of the total revenue (excluding special customs duties). This category includes items such as clothing, motor vehicles, woven fabrics and powdered milk.

59. In addition to the regular customs duty, there is the so-called "special customs duty" which is an excess profits surtax introduced after the devaluation of 1964. This is applied at the rates of 70 and 90 percent depending on the size of the excess profits, that is the difference between the market price and the total import costs (including a normal profit of 30 percent). In 1965, the revenue from special customs duties was 3.9 billion won as compared to ordinary customs revenue of 8.5 billion.

#### Local Taxes

60. The main categories of local taxes and the revenues collected from these taxes in 1965 are shown in Table 23. The most important single category among local taxes is the land tax which yields about two-fifths of the total local tax revenue. Until 1962, the land tax was collected by the Central Government. "The Law on Adjustment Between National and Local Taxes" transferred the land tax into a county or city tax. Cultivated land is subjected to different rates depending on the crop grown. Class A lands, which are lands producing grains, are taxed on the basis of a "standard output" valued at current grain prices. This makes the tax yield elastic with respect to price. But unless "standard outputs" are revised, tax yield is not elastic with respect to increases in volume of output. However, if the actual crop falls below 80 percent of the standard yield, an adjustment is made in the tax base. The tax rate on the products of Class A lands is 6 percent.

Table 23: LOCAL TAX REVENUES IN 1965

	<u>Million Won</u>	<u>% of Total</u>
<b>I. Independent Taxes</b>		
<u>City and County Level</u>	<u>4,885</u>	<u>47.0</u>
Land Tax	(4,055)	(39.0)
Property Tax	( 830)	( 8.0)
<u>Province Level (Including Seoul and Pusan)</u>	<u>2,523</u>	<u>24.3</u>
License Tax		
Husbandry Tax		
Horserace Tax		
Entertainment Tax		
Automobile Tax		
Acquisition Tax		
<b>II. Surtaxes</b>		
<u>Surtaxes on National Taxes</u>	<u>2,353</u>	<u>22.7</u>
On Business Activity Tax		
On Personal Income Tax		
On Corporation Tax		
<u>Surtaxes on Province Taxes (Cities and Counties)</u>	<u>626</u>	<u>6.0</u>
<b>TOTAL</b>	<b><u>10,387</u></b>	<b><u>100.0</u></b>
Ratio to GNP	1.3%	

61. Class B lands are lands producing special crops like fruits, tobacco, etc. These lands are taxed on the basis of net income. The rates are progressive: the rates range from 10 percent on net income below 60,000 won to 20 percent on net income above 180,000 won.

62. Revenues from agricultural land taxes have averaged 1.8 percent of agricultural income in the first three years of the 1960's, but the ratio had dropped to 1.3 percent in recent years. This fall seems to have been due to the fact that standard yield estimates have not been adjusted since 1959.

63. Yields of other local taxes show a remarkable stability since 1957 staying at 0.8 or 0.9 percent of GNP. These taxes can be classified under three categories. The first category is the property tax. About 78 percent of this tax is collected from buildings and 20 percent from urban land, the rest being taxes in mining properties and fishing boats. The total yield is very minor and has deteriorated in real terms in recent years. There has even been a fall in absolute terms from 1963 to 1964 due to a reduction of tax rate on land from 5 percent to 2 percent in Seoul.

64. The rates of the local surtaxes on Central Government taxes are as follows:

Surtax on Business Activity Tax - 20%  
Surtax on Personal Income Tax - 10%  
Surtax on Corporation Tax - 10%

The revenues from these taxes have followed the revenues of national taxes on which they are based.

#### Non-Tax Revenues

65. The changes in the ratio of the main components of non-tax revenues to GNP are shown in Table 24. Monopoly profits which are essentially from the sale of tobacco and cigarettes - with very minor trade in ginseng - have fallen as a result of rising costs - mainly high prices paid to tobacco growers and lagging cigarette prices. This will be discussed in Chapter IV.

Table 24: NON-TAX REVENUES AS PERCENT OF GNP

	<u>1961</u>	<u>1962</u>	<u>1963</u>	<u>1964</u>	<u>1965</u>
Monopoly Profits /1	0.9	1.9	1.0	0.7	0.5
Income from Government Enterprises	0.8	0.8	0.9	1.1	1.2
Income from Property	0.5	0.8	0.7	0.4	0.5
Miscellaneous Revenues	2.0	1.5	1.4	1.1	1.0
<u>Total Non-Tax Revenue</u>	<u>4.2</u>	<u>4.3</u>	<u>4.0</u>	<u>3.3</u>	<u>3.2</u>

/1 Includes only that portion of surplus in the monopoly which has been transferred to general account, the remaining portion entered in the "Enterprise Profits."

66. Income from Government Enterprises are mainly net surpluses of Railway Transportation Special Account and Communication Services Special Account. In 1965, the net profit of the Communication Services which includes postal exchange and saving service, telegraph and telephone services was estimated to be 2.5 billion won. The net profit of railways was 1.3 billion won.

III. PROJECTION OF CURRENT PUBLIC EXPENDITURES

67. The past trend of the main components of current expenditures by the Central and the Local Government are summarized in Table 25. The level of current expenditures are low compared to other developing countries. The austerity of Korea with respect to current public expenditures becomes more marked if defense expenditures are excluded from the comparison. In 1965 Koreans spent only 6.2 percent of their gross national product on civil public consumption of all kinds compared to military expenditures equaling 3.7 percent of GNP.

Table 25: PUBLIC SECTOR CURRENT EXPENDITURES

	Civil Administration		Education		Defense		Transfers		Total	
	B.Won	% of GNP	B. Won	% of GNP	B.Won	% of GNP	B.Won	% of GNP	B. Won	% of GNP
1961	14.2	4.8	6.7	2.3	16.2	5.5	7.2	2.4	44.4	15.1
1962	17.1	5.0	9.8	3.0	20.5	6.0	8.1	2.4	55.5	16.1
1963	19.9	4.2	11.5	2.4	20.1	4.2	9.6	2.0	60.0	12.6
1964	21.4	3.2	12.5	1.9	24.5	3.7	9.3	1.4	67.7	10.2
1965	25.0	3.2	13.5	1.8	28.6	3.7	9.8	1.3	77.0	9.9

Source: BOK, Economic Classification of Central and Local Government Transactions.

68. Most of the civil administrative expenses are for general administrative services, justice and police. Economic and social services (other than education) account for only a minor proportion. Total current expenditure by the Government on economic services in 1965 is about 0.4 percent of GNP, for health about 0.1 percent and almost nothing for housing. (See Appendix Table )

69. About 40 percent of the current expenditures other than on education and defense are spent by various levels of Local Governments. Defense expenditures are all administered by the Central Government. For education, there is a mixed system. In the final analysis, about 85-90 percent of current public expenditures for education are financed by the Central Government. However, most of these funds are administered by the Provincial Boards of Education which are autonomous bodies at the local government level.

70. All major categories of current public expenditures have lagged behind the growth of GNP since 1961. Ratio of current expenditures on civil administration has fallen from 4.7 percent of GNP in 1961 to 3.2 percent, education from 2.3 to 1.8 and defense from 5.5 percent to 3.7

percent. In terms of their shares in the total current expenditures, civil administration and defense have kept their relative shares, education has achieved a slight gain at the expense of transfers.

71. This sharp fall of current expenditure, relative to GNP, has been necessitated by lagging tax revenues, as discussed above, and has been possible mainly by allowing no rise in the pay to public employees from 1962 to 1965 - a period during which GNP per capita in real terms increased by 18 percent and in current prices by 112 percent. Wages constitute about 60 percent of total current expenditures.

72. Projections of current public expenditures has to depend on assumptions about (1) salary policy, (2) employment policy, and (3) associated expenses on goods and services.

#### Policy Regarding Salaries

73. The last major salary increase was in 1962. Since 1962, there had been only minor adjustments until the recent increases which became effective in January 1966 granting salary increases of 30 percent to civil employees including teachers, 100 percent to enlisted men, and 60 percent to professional military personnel. This increase was long overdue in view of a price increase of about 80 percent since 1962 and a per capita GNP increase of about 112 percent in current prices.

74. Because salaries have suffered severely in the inflation of recent years, there is general agreement that further adjustments are necessary in order to make up for the loss of the last three years. Some studies have come out with recommendation of a 100 percent increase over the 1964 level (Office of Government Administration). The tentative projections of EPB aim at an increase of approximately 90 percent in real terms by 1968 over levels of 1964.

75. An increase of salary levels of this order of magnitude seems to be a definite necessity. The salary level, even in 1962, was very low in absolute terms. Since then inflation has further reduced its real value. A Vice Minister, the senior-most civil servant, draws a salary of about 361,000 won per year in 1965. This is about 15 times the national per capita income level and amounts to the equivalent of US \$1,337 at the present exchange rate. Corresponding salaries in other developing countries at lower levels of per capita income are considerably higher than in Korea. There are indications that the public sector cannot attract qualified personnel at the existing salary levels. The Mission learnt that a number of Government employees switched to the private sector in recent years. Also Korean students abroad frequently fail to return home, partly owing to unattractive working conditions at home. Furthermore, by all indications, Government will need more specialized experts in agriculture, industry, finance and construction, and these may become more and more scarce for the public sector if private sector activity grows at expected rates. The effect of very low salaries on the morale of the public servants must not be minimized either. These considerations lead the Mission to believe that an increase in real salary levels in the order of about 70 percent over 1966 levels would be a desirable goal. Although

this looks like an ambitious target, it should be realized that if this goal is achieved in 1968, then public salaries will be only 13 percent over 1962 in real terms. Meanwhile, real per capita income will have increased by approximately 30 percent in this period.

76. The increase in salary levels must be well planned. In the first place, it is very important that the increase in salaries be coordinated with the tax reform. Indeed, the salary increases have to be contingent upon increases in tax revenues because higher current expenditures are just not possible at the present level of public revenues. Secondly, to maximize the benefits to the public sector, salary increases may be on a selective basis, raising pays for those skills and grades where there is the greatest need and urgency.

Growth in Public Employees

77. The tentative projections of the Economic Planning Board about the future trend of employment in the public sector is based on the assumption of 1.5 percent annual increase in civil administration (including secondary and high education) and no increase in the military <sup>1/</sup>. Estimates of the number of teachers for primary education are based on projections of enrollments in the schools in coming years. The increase is 5.3 percent per year from 1964 to 1967 and then around 3 percent per annum.

78. The average annual rates of increase in various categories of public employees in the past are shown in Table 26. Although the average rate of growth in the Central Government employment excluding teachers was 1.4 percent in the nine years from 1955 to 1964, the rate of increase has gone up in the last four years averaging 3.2 percent per annum after 1960. It should also be noted that employment in Local Governments has grown at an even higher rate.

Table 26: PAST TRENDS IN PUBLIC EMPLOYMENT  
(per annum average rate of increase)

	<u>1955-1964</u>	<u>1960-1964</u>	<u>1962-1964</u>
Teachers	4.3	5.5	8.5
Central Government Employees (excluding teachers)	1.4	3.2	3.3
Total Employees in Central and Local Governments (excluding teachers)	1.8	3.8	3.6
Total Employees in Central and Local Governments	2.5	4.3	5.1

Source: EPB, Korea Statistical Yearbook, 1965

<sup>1/</sup> EPB Aggregate Model, October 1965

79. To project the increase of public employment on the basis of past trends alone would be misleading. As this year's budget shows, considerations of economy in the public sector may keep employment from rising significantly from one year to the next. There is also the question of quantity vs. quality; the increase in salary levels may contribute to productivity in administration. However, in view of the expanding functions of Government and also in view of the increase in the labor force, it may not be possible or desirable to curtail excessively the growth in public employment. These considerations have led the Mission to assume higher rates of increase in the number of public employees, compared to rates assumed by EPB.

80. The probable future trend of employment in the public sector are considered under four categories: primary school teachers, other educational personnel, military personnel, and other public employees. Public employees, other than military personnel and teachers, are expected to increase at 3 percent per annum which is twice the rate assumed by EPE, but nearer to the rate of increase in recent years.

81. The increase in the number of primary school teachers will depend on the number of students that will be enrolled in schools in coming years as well as the desired student-teacher ratio. The rise in enrollment rates from 62.7 percent of the children between ages of 6 and 11 in 1948 to 92.1 percent in 1963 achieved under the Compulsory Education system has been a remarkable accomplishment. This emphasis on quantity may exaggerate the success of the program to the extent that budgetary constraints in recent years may have reduced the quality, as is evidenced by overcrowded classes and double or triple shift systems in some areas. It is therefore desirable that quality as well as quantity be emphasized in future programs for education. However, given the high value Korean's attach to compulsory education, it may not be politically feasible to aim at enrollment rates below their present level.

82. According to the population projections which the Mission regards plausible and has used in the other parts of the Report, the number of children in primary school age is expected to grow by 2.5 percent per year from 1965 to 1971. (See Annex I) If the enrollment ratio remains the same, this will mean an increase of 2.5 percent in primary school students.

83. The present student-teacher ratio is about 62 students per teacher. Although this is a relatively high figure, in view of the high enrollment ratio and the shortage of classrooms, rapid improvement in coming years should not be expected. For illustrative purposes, a projection of the number of students in primary schools, number of teachers and the implied student-teacher ratio is shown in Table 27.

84. The range of choice is much wider in projecting targets for secondary and higher education. The Mission could not go into a detailed analysis of the efforts needed in these fields. However, there seems to be general agreement that "as far as higher education is concerned, emphasis might well be given, not to quantitative development, but to

qualitative development," and that "the present proportion of enrollment and expenditure allocated to secondary education is comparatively low." <sup>1/</sup> The Mission has therefore assumed a higher rate of increase, 5 percent in the number of secondary and higher education personnel. It should be added that only about 56 percent of secondary and high school students attend public schools.

Table 27: A PROJECTION OF NUMBER OF STUDENTS AND TEACHERS IN PRIMARY SCHOOLS

	<u>Number of Students</u> (increase 2.5% per year)	<u>Number of Teachers</u> (increase 3% per year)	<u>Student-Teacher Ratio</u>
	000	000	
1965	4,995	80.7	61.9
1966	5,120	83.1	61.6
1967	5,248	85.6	61.3
1968	5,379	88.2	61.0
1969	5,514	90.8	60.7
1970	5,651	93.6	60.4
1971	5,793	96.4	60.1

85. The tentative EPB assumption is that there will be no increase in the number of military personnel after 1966. This is also the assumption in the Mission projection.

Projection of "Other Expenses"

86. EPB has assumed that the "other expenses," that is, all expenses other than salaries, will increase by 1.1 percent per employee per year in civil administration and education. This coefficient is derived from the past trend. Although the conversion of past data to constant price series creates problems which make such a correlation dubious, it is realistic to expect "other expenses" to increase from year to year and also in relation with growth in employment. In our projections, a coefficient of 3.0 percent per year per employee is used. For the military the tentative assumption of EPB is that the level of other expenses will not change in coming years. This is a desirable target from the economic point of view.

87. A projection of current public expenditures from 1965 to 1971 at 1965 prices is given in Table 28. In addition to the assumptions

<sup>1/</sup> Unesco Regional Advisory Team for Educational Planning in Asia, Long-Term Projections for Education in the Republic of Korea, Preliminary Draft Report, Bangkok, May 1964.

Table 28: A PROJECTION OF CURRENT PUBLIC EXPENDITURES  
1965 - 1971

Billion won at 1965 prices

	Primary Education		Other Education		Civil Adm.		Defense		Transfers		Total		
	Salary	Other	Salary	Other	Salary	Other	Salary	Other	Salaries	Other			
1965	8.0	2.8	3.2	1.8	12.7	9.8	9.9	18.7	9.8	33.8	42.9	76.7	
1966	9.9	3.0	4.0	1.9	15.7	10.4	14.4	18.7	10.0	44.0	44.0	88.0	
1967	13.3	3.2	5.5	2.1	21.0	11.0	18.7	18.7	10.0	58.5	45.0	103.5	
1968	17.8	3.3	7.5	2.3	28.1	11.7	24.3	18.7	10.0	77.7	46.0	123.7	
1969	18.3	3.5	7.8	2.5	28.9	12.4	24.3	18.7	10.0	79.3	47.1	126.4	
1970	18.9	3.8	8.2	2.7	29.8	13.2	24.3	18.7	10.0	81.2	48.4	129.6	
1971	19.5	4.0	8.6	2.9	30.7	14.0	24.3	18.7	10.0	83.1	49.6	132.7	

Note:

1. Assumption about salary rate increase:

1966 over 1965: Military: from the budget.

Others : 20% increase in real salary level.

1967 over 1966: All = 30% increase in real salary level.

1968 over 1967: All = 30% increase in real salary level.

2. Assumptions about increase in employment:

Primary education = 3% per annum.

Other education = 5% per annum.

Civil administration = 3% per annum.

Military = no increase.

3. Assumption about "other current expenditures" = 3% increase per employee per year.

4. Transfers: Assumed at 10 billion won after 1966.

already discussed, for illustration purposes and in line with the revenue targets to be discussed in Chapter IV, it is assumed that the salary increases will take place at the beginning of the Second Five Year Plan - 30 percent in 1967 and 30 percent in 1968 amounting to 69 percent over 1966. According to these estimates and on the assumption that real GNP will grow by 6 percent per annum, the ratio of public current expenditures to GNP will rise from 9.8 percent to 12 percent during 1965-1971.

IV. FUTURE FISCAL EFFORT

Future Capital Needs and the Public Sector

88. The level of public revenues has to increase in coming years for several important reasons. First, as discussed in the last chapter, there is urgent need for elevating the level of current public expenditures from their present depressed state. Secondly, although the planners have not yet come out with any estimate of what the direct capital expenditures of the public sector in coming years will be, indications are that the Second Five Year Plan may necessitate heavy infrastructure expenditures which will have to be undertaken by the Government. Thus an increase in public savings will be imperative to finance public investments and reduce Korea's dependence on foreign aid. And finally, in the present organizational framework where public funds are channeled to the private sector through special banks, the increase in public savings can be looked upon as a vehicle for raising total savings, abstracting from the ultimate use of the funds.

89. There are reasons for expecting that a major public revenue effort can be made. The public sector revenues are low compared to other developing countries. (See Table 29) The figure for Korea is given as stated in the I.M.F. study. It should be noted that due to revisions in GNP since the study was prepared, the tax ratio in 1963 has dropped to 8.1. (See Chapter II) This puts Korea at the very end of the countries listed with respect to the tax revenue ratio.

90. Public sector revenues are low not only compared to other countries, but also compared to levels achieved by Korea in the early 1960's. It is therefore concluded that there is room for improvement in the public revenue ratio. This conclusion is also supported by the examination of individual taxes and other revenue sources as discussed below.

Public Revenue Effort

91. The Mission recommends an increase of 120% in public revenues during 1965-1971; a target which is in line with the tentative thinking of EPB. However, since EPB postulates a growth in GNP of approximately 7% per annum while the Mission's calculations assume 6%, the revenue target suggested by the Mission is somewhat more ambitious in terms of marginal

Table 29: SELECTED DEVELOPING COUNTRIES: TAX REVENUE OF ALL GOVERNMENT ENTITIES AS PERCENT OF GNP

<u>Country</u>	<u>Year</u>	<u>Total Tax as % of GNP</u>
Israel	1960/61	29.0
Uruguay	1963	21.3
United Arab Republic	1963/64	21.2
Greece	1962	20.8
Ceylon	1961/62	19.8
Brazil	1961	19.3
Chile	1963	19.2
Malagasy	1962	19.0
China (Taiwan)	1960/61	18.5
Sudan	1963/64	18.4
Dominican Republic	1962	17.9
Iraq	1962/63	17.7
Argentina	1962/63	16.6
Peru	1963	16.3
Ecuador	1963	16.2
Turkey	1963/64	15.3
South Africa	1962/63	14.7
Panama	1962	13.7
Costa Rica	1962	14.3
Thailand	1962	12.3
Nicaragua	1963/64	12.3
Tanzania	1961/62	11.3
Paraguay	1962	11.1
Colombia	1963	10.9
Korea	1963	10.7 <u>/1</u>
Philippines	1961/62	10.7
India	1960/61	10.4
Mexico	1963	10.2

/1 Mission estimate 8.1%.

Source: Joergen Lotz, Tax Ratios in Developing Countries, (mimeographed), I.M.F., Fiscal Affairs Department, March 4, 1966.

increments. While the Mission proposes that 32% of the increment in GNP during 1965-71 should be channeled into public revenues, the corresponding proportion in EPB projections is 28% <sup>1/</sup>. The ratio of public revenues to GNP, according to the Mission, should rise from 11.3% to 17.5%.

92. In order to accomplish the objectives of the tax reform without letting it degenerate into a struggle of vested interests, the main measures should be taken during a short period rather than be spread over many years. It seems that the first two years of the Second Plan would be the ideal time to implement most of the major changes. This would also enable the Government to make the recommended adjustments in salary levels during these years. Needless to say, the exact timing has to take into consideration many factors outside the scope of this report. However, for purposes of illustration, a timetable for the annual changes in public revenues, current expenditures and public savings is given in Table 30.

Table 30: AN ILLUSTRATIVE PHASING OF PUBLIC REVENUES, CURRENT EXPENDITURES AND PUBLIC SAVINGS FOR 1965-1971

	<u>Public Revenues</u>	<u>Current Expenditure</u>	<u>Public Saving</u>
(percent of GNP)			
1965	11.3	9.8	1.5
1966	12.3	10.7	1.6
1967	14.0	11.8	2.2
1968	16.0	13.3	2.7
1969	16.5	12.9	3.6
1970	17.0	12.4	4.6
1971	17.5	12.0	5.5
(billion won)			
1965	88.0	77.0	11.0
1971	193.5	132.7	60.8
1966-71	905.9	703.9	202.0
1967-71	804.3	615.9	188.4

1/ There are certain technical differences in the concept of current public revenues adopted by EPB and those underlying the Mission's calculations. The Mission's concept is the same as that of BOK in their "Economic Classification of Government Transactions." The implicit marginal public revenue rate of 28%, cited above, is calculated on the basis of EPB data adjusted by the Mission.

93. An increase in total revenues of this magnitude cannot come about automatically. If imports increase at a faster rate than GNP - which is doubtful - some gains in tax revenues may be expected. But even an optimistic guess would put total public revenues at 12% of GNP by 1971 if a major effort is not made. Nor should administrative improvements in tax collection alone be expected to have more than a marginal impact, except in the case of personal income taxes. (See paragraph ) At present some officials tend to exaggerate the potentials of raising revenue in this way. A great portion of the increase must come from increases in tax rates, tax coverage and prices of goods and services produced by Government enterprises.

94. No visiting team from abroad can advise on the precise details of a tax reform in Korea. This is one among many subjects on which the Government will have to formulate their own policy position, after careful study of alternative revenue measures and their implications for resource allocation and equity. Nevertheless, the Mission's judgement is that sharp increments in revenue should be secured through indirect taxes, particularly on petroleum, liquor and travel. Also, there seems to be substantial room for expanding the surpluses of the tobacco monopoly and other Government enterprises. (See Table 31) A few observations on the potentialities of these and other major revenue devices are offered below.

#### Reform of Personal Income Taxes

95. In personal income taxes, the first question is whether the present system of schedular taxation - where incomes are taxed separately according to their kinds at the places they are earned - should be changed into a global tax - where income receivers would be taxed on the total incomes they receive irrespective of the kinds of income. It seems to be generally agreed that from the point of view of equitable distribution of the tax burden by the use of progressive rates, a change towards global taxation is desirable. As can be clearly seen in the case of Korea, progression in taxing of business income and real estate income is more a restriction on the size of the firm or the real estate in one place, than a means of taxing people with higher incomes at a higher rate compared to people with lower incomes. There are several different tax districts even within one city and incomes earned in one of these districts is taxed independently of incomes earned in other tax districts.

96. On the other hand, the present system has one big advantage which is the greater ease of administration. This aspect cannot be ignored. It is believed by some experts in Korea that an immediate change to global income taxation will cause a fall in tax revenues, and this may be a realistic assessment. For this reason, the Mission is in favor of a move towards the adoption of a global tax system in graduated steps. The first step could be the application of the global system to taxpayers with high incomes. Even this will, of course, require large scale administrative preparation and planning.

Table 31: TARGETS FOR PUBLIC REVENUE  
(1965 prices)

<u>Category</u>	<u>1965</u> (Billion Won)	<u>1971</u>	<u>1971</u> (1965=100)	<u>1965</u> (% of GNP)	<u>1971</u>
<u>Total Revenue</u>	<u>88.0</u>	<u>193.5</u>	<u>220</u>	<u>11.3</u>	<u>17.5</u>
<u>Total Taxes</u>	<u>63.9</u>	<u>138.2</u>	<u>216</u>	<u>8.2</u>	<u>12.5</u>
<u>Direct Taxes</u>	<u>18.1</u>	<u>33.2</u>	<u>183</u>	<u>2.3</u>	<u>3.0</u>
Personal Income	11.4	18.8	165	1.5	1.7
Corporation	5.4	12.2	226	0.7	1.1
<u>Indirect Taxes</u>	<u>35.4</u>	<u>82.9</u>	<u>234</u>	<u>4.5</u>	<u>7.5</u>
Commodity	7.0	16.6	237	0.9	1.5
Petroleum	3.2	8.8	275	0.4	0.8
Business Activity	4.1	11.1	271	0.5	1.0
Liquor	3.6	11.1	308	0.5	1.0
Travel	1.4	5.5	393	0.2	0.5
Customs	12.4	22.1	178	1.6	2.0
<u>Local Taxes</u>	<u>10.4</u>	<u>22.1</u>	<u>213</u>	<u>1.3</u>	<u>2.0</u>
Land	4.0	8.8	220	0.5	0.8
<u>Non-Tax Revenue</u>	<u>24.0</u>	<u>55.3</u>	<u>230</u>	<u>3.1</u>	<u>5.0</u>
Monopoly Profit	3.6	16.6	461	0.5	1.5
Other Income	11.5	16.6	144	1.5	1.5
Enterprise Surplus	8.8	22.1	251	1.1	2.0

Source: Mission Estimates

97. A change to a global system will make present differentials in tax rates for different incomes less plausible. Indeed, it can be said that the present rate structure under which business and real estate incomes are taxed at almost double the rates for wages and salary incomes does introduce some progressivity into the system. If incomes above a certain level are going to be unified, the rates applied should be no less than the present rates on business and real estate incomes.

98. Another factor which can increase the progressivity of personal income taxes is the introduction of personal exemptions. Under the present system, there are no such allowances except a total exemption of

wage and salary earners with incomes below 5,600 won per month i.e. less than 50% of average household income. This exemption has its origin in exempting tax revenues not worth collecting, but it has come to be looked upon as an equity measure. The exemption level was recently changed from 4,285 won per month to 5,600 won on grounds of equity. However, in its present form it has the serious defect of making the marginal tax rate extremely high just below this limit. In other words, a taxpayer earning slightly less than 5,600 won per month pays no tax whereas a person earning slightly more is liable to be taxed on his entire income. This system does not have any merit and should be substituted by a system of credit to the tax liability. This can be done before a change to a global tax system. When a global system is devised, it would be desirable to link the size of the tax credit to the marital status and the family size of the taxpayer. However, there should be a limit to the number of eligible dependents - say three. Otherwise the canons of equity will come in conflict with the Government's determined policy to limit family size.

99. According to estimates by Musgrave, probably more than one-half of business and property income escapes income taxation. Although the exact size of this estimate which is based on dubious national income data could be questioned, there seems to be room for increasing the tax yield from these incomes as the high return to extra administrative efforts in 1965 shows. The Mission, therefore, is of the opinion that projected revenues from the personal income tax can be achieved without a major change in tax rates.

#### Potential of the Corporate Income Tax

100. The major problem in the taxation of corporate profits is the question of tax exemptions and tax benefits for certain industries and institutions. The total of these concessions were estimated to amount to 37 percent of the yield of the corporation tax in the absence of such exemptions. The major categories of tax exemptions and their share in the total revenue less are shown in Table 32.

101. An amendment to the corporation tax law (also income tax) which was approved by the Parliament last December to be effective January 1, 1966 deleted the 50% tax credit for retained earnings.

102. Three points can be made about the present pattern of corporate tax exemptions. First, the total exemption of public corporations cannot be looked upon as net loss of savings for the public sector defined in a broad sense. Or looking at the picture from the other side, subjecting these corporations to tax will not increase investible funds for the public sector (including investments of corporations) since 94 percent of the net worth of these corporations are owned by the Government. However, the Mission agrees with the view that it would be desirable to bring these corporations under the corporate tax for better cost accounting, improved pricing policies and for giving the Government greater control over the allocation of funds.

Table 32: COST OF CORPORATE TAX EXEMPTIONS

	Loss of Tax Revenue (million won)	% of Total
1. Exemption of Government Corporations	1,308	58
2. 50% Tax Credit for Retained Earnings	463	21
3. Tax Holidays to New Industries	352	16
4. Exemption of Foreign Route Navigation	62	3
5. 50% Credit for Foreign Exchange Earnings	<u>55</u>	<u>2</u>
<u>Total</u>	<u>2,240</u>	<u>100</u>

103. Secondly, the loss of revenue due to tax holidays granted to new establishments is substantial. These tax holidays, which involve various degrees and periods of exemption, can be justified if it is believed that the beneficiary industries deserve to be encouraged. In any case, the fact that these exemptions are temporary makes them more palatable than indefinite subsidies through tariff protection.

104. Thirdly, the revenue cost of the 50% tax credit on foreign exchange earnings is negligible at the moment. Yet, as exports increase, the significance of this revenue loss may rise rapidly. This tax credit should be evaluated in the context of the general system of export subsidies.

105. Since dividends from corporations are subject to a flat rate tax (12%), there may be some justification in having a progressive tax structure for the corporation tax as the case is in Korea. Starting this year, rates of 20%-30% and 35% are applied depending on the size of corporate incomes. The first bracket which was 25% last year was lowered to 20% at the time when a third bracket of 35% was added. As it is, the progression is very steep and may discourage the formation of large corporations. It is therefore recommended that the first bracket be raised to 25%. This rate increase together with the development of the corporate sector and suggested changes regarding exemptions can be expected to yield the tax revenues projected for the target year.

The Case for Raising Indirect Taxes

106. In Korea, about 70 percent of the tax revenue accrues from indirect taxes (including customs duties). If monopoly profits are considered as a kind of indirect tax, the ratio is even higher. This ratio, according to Mission projections, is not expected to change in favor of direct taxes during the next six years. On the contrary, higher revenue increases are foreseen from indirect rather than from direct taxes. It has to be admitted that greater emphasis on indirect taxes is a necessity from the administrative feasibility point of view rather than a choice based purely on social and economic considerations. However, it is not at all clear that indirect taxes are inferior to other forms of taxation in Korea, on social equity or economic efficiency considerations.

107. Some observers argue that raising indirect taxes will prove inflationary. Of course, if prices are artificially kept below market equilibrium through controls, and if a rise in indirect levies forces upward adjustments in administered prices then indirect taxes may be associated with the price rise. Since Korea has few commodities with controlled prices and since the wage-price spiral is not a political reality, it can safely be assumed that the increase in indirect taxes will have no impact on the general price level, although it may influence relative prices.

108. The indirect taxes are also considered inferior to direct taxes from the viewpoint of efficient allocation of resources because the former taxes distort cost-price relationships. It is possible to minimize the waste by making indirect taxes general and basing them on value added rather than on sale prices. This system is being applied in some countries but its feasibility is doubtful in Korea, owing to the present state of accounting and administration. Short of such a general system which would amount to a tax on expenditures and which would be neutral among economic activities, countries like Korea have to approach the indirect tax problem in a pragmatic way.

109. From the viewpoint of economic efficiency, the business activity tax in Korea, which is a general turnover tax applied at three levels (manufacturing, wholesale and retail), is obviously superior to other excises on particular products. Nevertheless, even this tax introduces some distortions into the cost-price structure. However, even after the inclusion of local surtaxes, the effective rates on commodities are below one percent. It can be said that the negative effect of this levy on the allocation of resources in the Korean economy - where allocation is far from perfect - would be negligible. The rates are low compared to some other countries (an extreme case is Peru where the rate is 5% on every transaction). The Mission, therefore, thinks that the rates of business activity tax on the production and trading of goods should be increased. It is estimated that a 50% increase in rates may achieve the revenue targets.

110. In Korea, the Government gets much lower revenues from tobacco and liquor than in most other countries 1/. Whereas in Taiwan, the liquor taxes and the tobacco monopoly account for about one-fifth of total Government revenues, in Korea the ratio is less than 12 percent of total revenues. Approximately 18% of the retail price of tobacco in Korea represents profits received by the Government as compared to a ratio of 40 to 50 percent in most other countries. The monopoly revenue is not only low compared to other countries, but also compared to revenues in past years in Korea. The decline has been the result of rising costs - prices paid to tobacco growers - and lagging cigarette prices. The demand for cigarettes is quite inelastic with respect to price and there is room for securing higher revenues by charging higher prices as well as through measures to reduce costs.

111. Some rate increases are also necessary in liquor taxes. In this connection two points need to be stressed: first, strict measures are necessary to control the leakage of tax free liquor into the market. Second, the present system of specific taxes on liquor - taxes on quantity rather than value - should be changed to an ad valorem tax. There seems to be no administrative advantage in keeping the specific system. As past experience shows, the continuation of the present system will mean that liquor tax revenues will have no elasticity with respect to price changes.

112. Taxes on luxury items have much to recommend them as a way of introducing progressivity into the indirect tax structure. The present business activity tax and some local taxes cover the luxury services, but rates are low. There is room for the inclusion of new items as well as increases in rates.

113. Commodity taxes now include a number of items which would come under the category of luxury products. Since these taxes are imposed on domestically produced goods as well as imports, they are more efficient ways of taxing luxury imports than customs duties which simply give protection to the domestic production of luxury goods. A study is already underway in Korea examining the structure of commodity taxes. The results of this study should identify tax subjects which could be exploited without putting much burden on relatively poor people.

114. The report of the Transport Survey Mission is not finalized yet. However, by all signs, Korea will embark on a substantial public investment program in transportation during the Second Five Year Plan. This will have important implications for the magnitude of user charges. In the case of railways, airlines and shipping, which are Government owned, the question of the travel tax will have to be considered in conjunction with policy regarding transport rates. As far as highway investments and maintenance is concerned, gasoline and diesel tax revenues should be expected to pay part of the costs.

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1/ See Musgrave, ... op. cit.

115. Petroleum products tax revenues are expected by the Mission to increase by 175 percent from 1965 to 1971. This is a higher increase than that projected for petroleum consumption. If these projections for petroleum products are realistic then, without any change in tax rates, the revenue from the petroleum products tax will be about 1.6 billion short of the target as shown in the Mission's projections. A rate increase of 22 percent on the average will be necessary to achieve the target. A comparison of gasoline prices in various countries shows that prices in Korea are about 30 percent lower compared to Japan and about 100 percent lower compared to Western Europe 1/. It is therefore concluded that an increase of 20-25 percent in the tax rates is feasible.

116. There are also a number of excises whose sole attraction is their capacity to earn revenue. This is usually attained at the cost of economic efficiency, but some inefficiency combined with high savings and high capital formation may be preferred to static efficiency. A good part of commodity taxes and customs duties come under this category. In the case of commodity taxes, the Mission recommends the continuation of taxes on basic raw materials like cotton, wool and rubber. With the establishment of the petrochemical complex, tax policy should assist in the process of substituting synthetic materials for primary good imports by levying higher duties on the latter.

117. In the case of customs duties, no significant increase in the present average rate i.e. about 10-12% is expected. Many rates will need revision as Korea dispenses with import prohibitions, but these adjustments should be made in the context of industrial policy rather than with the object of raising revenues.

118. Three kinds of development in the economy may effect the average rate of tariffs. First, if the items which are now prohibited are liberalized but the rate of duty is raised, then even a small quantity of these imports may cause a noticeable increase in the average effective tariff rate. The future import of automobiles is an important example. Imports of some consumer goods may also become important sources of customs revenue. Secondly, the share of capital goods - machinery and equipment in imports is expected to increase and since many industries enjoy exemptions on these items, this development will tend to lower the effective tariff rate. Thirdly, the trend towards establishing domestic industries and exempting the inputs of these industries from customs duties may also cause a substantial loss of customs revenue. Two important examples of this kind of development are the planned petrochemical industry and the assembly plants for automobiles and trucks. In the case of petrochemicals, the customs revenue loss will be more than 100 million won, compared to 1964. In the case of vehicle assembly, there would be a big loss in terms of potential revenue. Finally, the present customs revenue includes the special duties imposed on goods whose market prices are significantly above their import costs. If trade liberalization proceeds, then this revenue will tend to diminish.

119. Naturally, the most important determinant of future customs revenues will be the trend of imports. If the present average tariff rate is maintained, the ratio of customs revenues to GNP will not increase. However, if the average effective tariff rate increases to 12 percent of the import value, compared to 9.3% in 1964, then the Mission projections can be achieved.

120. The urban property tax at the local level needs radical changes. Improvements are necessary on grounds of equity and economic efficiency. The Mission agrees with specific recommendations of Prof. Musgrave that rates should be increased - more for land than for buildings - that property value should be updated and that it may be desirable to transfers the administration of this tax to Central Government authorities 1/. The Government should also reevaluate the merits of the present agricultural tax which exempts lands reclaimed for cultivation for a period of 20 years. The Mission recommends a substantial reduction in this tax holiday. (See Annex II)

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1/ R. Musgrave, ... op. cit.

Table 2.21: PUBLIC REVENUES AND EXPENDITURES  
1958-1965

In billion won	1958 (Actual)					1959 (Actual)					1960 (Actual)					1961 (Actual)				
	Central General	Government Enterprise	Local Government	Consolidated Public Sector		Central General	Government Enterprise	Local Government	Consolidated Public Sector		Central General	Government Enterprise	Local Government	Consolidated Public Sector		Central General	Government Enterprise	Local Government	Consolidated Public Sector	
I. Current Revenue	17.9	0.4	2.4	20.7		25.3	1	2.0	27.4		29.4	4	3.8	34.1		30.7	2.4	4.9	38.0	
Tax Revenue	(16.8)	-	2.0	18.8		21.1	-	3.7	26.0		27.5	-	2.2	29.7		26.8	--	2.6	29.5	
(Direct and Indirect)	14.6	-	(2.0)	16.6		(22.4)	-	(1.6)	(23.6)		(21.9)	-	(2.2)	(27.1)		(23.2)	--	(2.6)	(25.8)	
(Monopoly Profits)	(2.2)	-	-	(2.2)		(2.4)	-	-	(2.4)		(2.6)	-	-	(2.6)		(2.7)	--	-	(2.7)	
Other Income	1.1	.4	.4	1.9		.9	.1	.4	1.4		1.9	.9	1.6	4.4		4.9	2.4	2.3	9.6	
II. Current Expenditure	21.6	-	7.2	28.8		22.9	-	9.1	32.0		25.4	-	11.1	36.8		31.7	--	12.7	44.4	
Public Consumption	17.9	-	---	---		20.1	-	---	---		20.1	-	---	---		29.1	--	11.8	37.2	
(Wages and Salaries)	(11.7)	-	---	---		(11.4)	-	---	---		(14.8)	-	---	---		(17.5)	--	(8.0)	(25.5)	
(Goods and Services)	(6.2)	-	---	---		(6.1)	-	---	---		(7.2)	-	---	---		(7.9)	--	(3.8)	(11.7)	
Interest Payments	.4	-	---	---		.5	-	---	---		2.7	-	---	---		.5	--	-	.5	
Extra-System Transfers	3.3	-	---	---		2.0	-	---	---		.6	-	---	---		5.8	--	.9	6.7	
III. Intra-System Transfers	-5.2	-	+5.2	-		-7.5	-	+7.5	-		-7.5	-	+7.5	-		-8.2	--	+8.2	-	
IV. Savings on Current Account	-8.9	.4	.4	-8.1		-5.1	.1	.1	-11.6		-3.5	.9	-1.1	-2.7		-9.2	2.4	0.4	-6.4	
V. Counterpart Funds	17.2	-	-	17.2		12.2	-	-	12.2		13.4	-	-	13.4		20.2	--	-	20.2	
VI. Utilization of Loans	1.0	-	-	1.0		-6.9	-	-	-6.9		6.3	-	-	6.3		3.1	3.1	-	6.2	
Domestic	1.0	-	-	-		-6.9	-	-	-6.9		6.6	-	-	6.6		3.1	3.0	-	6.1	
Foreign	-	-	-	-		-	-	-	-		-.3	-	-	-.3		-	.1	-	.1	
VII. Other Capital Resources	4.0	.1	.4	4.5		2.3	.6	.7	10.6		-7.0	1.3	1.0	-4.7		2.9	--	0.6	3.5	
Sale of Capital Goods	-	-	-	-		-	-	-	-		-	-	-	-		-	--	-	-	
Loan Repayment Received	-	-	-	-		-	-	-	-		.2	-	.2	.2		0.6	1.4	-	.6	
Depreciation Reserves	-	-	.2	.2		-	-	.3	.3		.2	1.3	-	1.5		-	-1.4	-	2.1	
Use of Cash Balances	2.5	.1	.2	2.8		8.4	.6	.4	9.4		-8.5	-	.6	-7.9		1.4	--	0.1	1.3	
Other Capital Transfers	1.5	-	-	1.5		.9	-	-	.9		1.1	-	.4	1.5		.9	0.5	.9	-	
VIII. Intra-System Capital Transfers	-3.8	+1.1	+2.7	-		-4.0	+1.0	+3.0	-		-3.2	+6	+2.6	-		-5.4	+5	+4.9	-	
IX. Extra-System Capital Transfers	.5	-	1.8	2.3		.3	-	1.7	2.0		.9	-	.7	1.6		.5	--	1.7	2.2	
X. Investments	9.1	1.6	1.7	12.4		5.2	1.7	2.4	9.3		5.1	2.8	2.8	10.7		11.2	6.1	4.2	21.5	
Gross Capital Formation	2.6	1.6	1.7	5.9		2.5	1.7	2.4	6.6		2.6	2.8	2.8	8.2		3.2	5.6	4.2	13.0	
(Fixed Capital Formation)	...	...	...	...		...	...	...	...		...	...	...	...		(3.2)	(3.6)	(4.2)	(11.0)	
(Inventories)	...	...	...	...		...	...	...	...		...	...	...	...		-	(2.0)	-	(2.0)	
Subscription	.2	-	-	.2		-.1	-	-	-		-.1	-	-	-		.5	-	.5	6.0	
Loans	6.3	-	-	6.3		2.7	-	-	2.7		2.5	-	-	2.5		7.5	.5	-	5	

Source: Reclassified from:

1958-1960: B.O.K. Economic Statistics Yearbook, 1961, 1963  
1961-1965: B.O.K. Economic Classification of Government Transactions

Note: Monopoly profits include only portions of surplus in monopoly which have been transferred to the general account; the remaining portion is included in enterprise revenues.

Table 23: PUBLIC REVENUES AND EXPENDITURES  
1959-1965  
(Cont.)

	1962 (Actual)				1963 (Actual)				1964 (Actual)				1965 (Final Budget)			
	Central General	Government Enterprise	Local Government	Consolidated Public Sector	Central General	Government Enterprise	Local Government	Consolidated Public Sector	Central General	Government Enterprise	Local Government	Consolidated Public Sector	Central General	Government Enterprise	Local Government	Consolidated Public Sector
I. Current Revenue	37.9	2.6	8.0	18.5	43.1	4.0	10.4	57.5	48.1	6.6	13.4	68.1	64.0	8.8	15.2	81.0
Tax Revenue	32.9	-	5.3	38.2	35.9	-	7.3	53.2	41.7	-	8.7	50.8	57.1	-	10.6	57.7
(Direct and Indirect)	(28.2)	-	(5.3)	(33.5)	(31.1)	-	(7.3)	(38.4)	(37.2)	-	(8.7)	(46.3)	(53.5)	-	(10.6)	(61.1)
(Monopoly Profits)	(1.2)	-	(4.2)	(4.2)	(1.8)	-	(1.8)	(1.8)	(4.5)	-	(4.5)	(4.5)	(3.6)	-	(3.6)	(3.6)
Other Income	5.5	2.6	2.7	10.8	7.2	4.0	3.1	11.3	6.3	6.6	4.7	10.4	6.9	8.8	4.6	20.3
II. Current Expenditure	39.0	-	16.5	55.5	40.6	-	19.4	60.0	46.2	...	21.5	67.7	52.8	-	24.2	77.0
Public Consumption	31.6	-	15.8	57.1	32.8	-	18.6	51.6	37.6	...	26.8	58.4	43.9	-	23.3	57.2
(Wages and Salaries)	(23.2)	-	(10.9)	(34.1)	(24.0)	-	(12.4)	(36.4)	(28.9)	...	(11.1)	(43.0)	(32.7)	-	(15.5)	(45.2)
(Goods and Services)	(8.4)	-	(4.9)	(13.3)	(8.8)	-	(6.2)	(15.0)	(8.3)	...	(6.7)	(15.5)	(11.2)	-	(7.8)	(19.0)
Interest Payments	.6	-	-	.6	.8	-	.8	.8	.8	...	.8	.8	1.3	-	1.3	8.5
Extra-System Transfers	6.8	-	.7	7.5	7.0	-	.8	7.3	7.8	...	.7	8.5	7.6	-	.9	8.5
III. Intra-System Transfers	-9.6	-	+9.6	-	-11.9	-	+11.9	-	-12.9	-	+12.9	-	-15.4	-	+15.4	-
IV. Savings on Current Account	-10.7	2.6	1.1	-7.0	-9.4	4.0	2.9	-2.5	-11.0	6.6	4.9	-0.5	-4.2	8.8	6.5	11.0
V. Counterpart Funds	25.3	-	-	25.3	24.1	-	-	24.1	26.5	-	-	26.5	28.3	-	-	28.3
VI. Utilization of Loans	.1	.4	-	.5	2.1	3.0	-	5.1	1.0	6.0	-	5.0	-1.5	-0.4	-0.1	-2.0
Domestic	.1	.2	-	.3	2.1	2.2	-	2.3	1.0	5.5	-	5.5	-1.5	-0.1	0.1	-2.6
Foreign	-	.2	-	.2	-	2.8	-	2.8	-	5.5	-	5.5	-	-0.1	.1	-0.1
VII. Other Capital Resources	8.4	4.9	.9	14.2	3.0	-0.7	-3	2.0	0.7	0.6	-1.5	-0.2	-2.4	3.0	-2.6	-2.0
Sale of Capital Goods	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Loan Repayments Received	6.6	-	-	6.6	.7	.2	-	.9	0.7	-	-	0.7	0.2	.3	-	0.5
Depreciation of Reserves	-	2.1	-	2.1	-	2.4	-	2.4	-	2.4	-	2.4	-	2.7	-	2.7
Use of Cash Balances	-2.7	2.3	.4	-	-2.6	-3.8	-6	-5.0	-1.5	-2.7	-1.5	-5.7	-5.5	-1.0	-2.1	-8.6
Other Capital Transfers	4.5	.2	.5	5.2	2.9	.5	.3	3.7	1.5	0.9	-	2.4	2.9	1.0	-0.5	3.4
VIII. Intra-System Capital Transfers	-4.7	+6	+6.1	-	-4.9	+6.7	+1.2	-	-4.5	0.7	2.8	-	-6.2	.5	5.7	0.0
IX. Extra-System Capital Transfers	1.3	-	.2	1.5	.3	-	1.2	1.5	0.4	-	.6	1.0	.8	-	.6	1.4
X. Investments	17.1	8.5	5.9	31.5	14.7	7.0	5.6	27.3	10.4	11.0	6.6	31.0	13.1	11.6	8.9	33.6
Gross Capital Formation	11.8	8.5	5.9	19.2	8.0	7.0	5.6	19.6	3.5	13.9	6.6	21.1	5.2	11.6	8.6	25.4
(Fixed Capital Formation)	(6.8)	(1.7)	(5.9)	(15.1)	(5.0)	(8.1)	(5.6)	(18.7)	-	(7.9)	-	-	(5.2)	(8.2)	-	-
(Inventoryes)	-	(3.8)	-	(3.8)	-	(1.1)	-	(1.1)	-	(6.0)	-	-	(-)	(3.4)	-	-
Subscriptions	2.6	-	-	2.6	3.8	-	-	3.8	1.7	.1	-	1.8	3.6	-	-	3.6
Loans	9.7	-	-	9.7	5.9	-	-	5.9	5.1	-	-	5.1	4.3	-	.2	4.5

Table 3b: TAX REVENUES  
1957-1966

Billion Won	1957 (Actual)	1958 (Actual)	1959 (Actual)	1960 (Actual)	1961 (Actual)	1962 (Actual)	1963 (Actual)	1964 (Actual)	1965 (Budget)	1966 (Budget)
<u>Central Government</u>										
<u>Direct Taxes</u>	<u>4.9</u>	<u>4.9</u>	<u>6.6</u>	<u>6.1</u>	<u>8.3</u>	<u>7.6</u>	<u>9.9</u>	<u>11.0</u>	<u>18.1</u>	<u>20.1</u>
Personal Income 1/	1.4	2.1	3.6	3.6	4.0	4.9	5.9	6.6	11.4	11.1
Corporate Income	0.5	0.5	0.7	0.9	1.7	2.0	3.0	4.1	5.4	7.6
Registration	0.1	0.2	0.3	0.3	0.3	0.5	0.7	0.9	1.1	1.1
Land Income Tax	2.8	2.0	1.9	1.5	2.1	-	-	-	-	-
Others	0.2	0.1	0.1	0.1	0.2	0.2	0.3	0.4	0.2	0.3
<u>Indirect Taxes</u>	<u>6.8</u>	<u>9.7</u>	<u>15.3</u>	<u>18.5</u>	<u>14.9</u>	<u>20.6</u>	<u>21.1</u>	<u>23.5</u>	<u>35.4</u>	<u>45.8</u>
Commodity	2.1	2.5	3.3	4.3	4.9	4.7	3.8	3.3	7.0	7.9
Petroleum Products									3.2	3.8
Business	0.7	0.9	1.1	1.0	1.1	1.9	2.3	2.0		
Liquor	0.8	0.8	1.0	1.2	1.3	2.5	2.8	3.2	3.6	5.1
Travel	0.2	0.2	0.3	0.3	0.4	0.7	0.9	1.0	1.4	3.4
Customs	2.4	3.0	3.6	5.2	5.3	6.7	6.4	8.2	12.4	15.7
Foreign Exchange	-	1.4	4.7	5.1	0.3	0.1	-	-	-	-
Land Tax	-	-	-	-	-	-	-	-	-	-
Others	0.5	0.9	1.3	1.1	1.6	2.1	2.4	2.9	3.7	4.8
<u>Total Central Government</u>	<u>11.7</u>	<u>14.6</u>	<u>22.0</u>	<u>21.9</u>	<u>23.2</u>	<u>28.2</u>	<u>31.1</u>	<u>37.4</u>	<u>53.5</u>	<u>66.2</u>
<u>Local Government</u>										
<u>Surtaxes on National Taxes</u>							<u>0.9</u>	<u>1.4</u>	<u>1.9</u>	<u>3.0</u>
<u>Independent Provincial Taxes</u>							<u>1.6</u>	<u>2.1</u>	<u>2.5</u>	<u>2.6</u>
<u>Independent City and Kun Taxes</u>							<u>2.9</u>	<u>4.0</u>	<u>4.7</u>	<u>5.9</u>
Agricultural Land Tax							2.3	3.1	3.9	4.0
Non-Agricultural Property Tax							.6	.9	.8	1.0
<u>Special Purpose Taxes</u>							-	-		
<u>Miscellaneous Taxes before Tax Reform of 1962</u>	<u>1.5</u>	<u>2.0</u>	<u>1.6</u>	<u>2.2</u>	<u>2.6</u>					
<u>Total Local Government</u>	<u>1.5</u>	<u>2.0</u>	<u>1.6</u>	<u>2.2</u>	<u>2.6</u>	<u>5.3</u>	<u>7.3</u>	<u>9.1</u> 2/	<u>10.1</u> 3/	<u>12.8</u>
<u>Total Tax Revenue</u>	<u>13.2</u>	<u>16.6</u>	<u>23.6</u>	<u>27.1</u>	<u>25.8</u>	<u>33.5</u>	<u>38.4</u>	<u>46.5</u>	<u>63.9</u>	<u>79.0</u>

Source:

Central Government:

1957-1963: Summary of Budget for Fiscal Year 1965, E.P.B.

1964-1966: E.P.B.

Local Government:

1957-1961: E.P.B.

1962-1964: R.A. Musgrave, Revenue Policy for Korea's Economic Development, 1965

1965-1966: Home Affairs Ministry

Notes:

1/ 1958-1963: Personal Income Tax includes Education Tax.

2/ Musgrave's figures 0.4 billion higher than B.O.K. estimates used in Table

3/ 0.2 billion lower than B.O.K. figure in Table

Table 35: FUNCTIONAL CLASSIFICATION OF CENTRAL GOVERNMENT EXPENDITURES  
1960-1965

(in millions of won)

	1960 (actual)			1961 (actual)			1962 (actual)			1963 (actual)			1964 (actual)			1965 (final budget)		
	Current	Capital	Total	Current	Capital	Total												
<b>General Services</b>	<b>20,172</b>	<b>602</b>	<b>20,774</b>	<b>23,380</b>	<b>552</b>	<b>23,931</b>	<b>28,779</b>	<b>322</b>	<b>29,102</b>	<b>30,215</b>	<b>659</b>	<b>30,874</b>	<b>31,609</b>	<b>180</b>	<b>31,789</b>	<b>40,089</b>	<b>252</b>	<b>40,311</b>
General Administration	2,616	439	3,054	3,118	398	3,516	3,750	218	3,973	4,827	454	5,261	4,920	150	5,304	150	5,454	
Defense	14,764	-	14,764	16,662	-	16,662	20,529	-	20,529	20,581	-	20,481	21,927	-	24,927	28,852	-	26,852
Justice and Police	2,793	183	2,976	3,570	154	3,724	4,496	104	4,600	4,907	205	5,112	4,762	22	4,784	5,933	102	6,035
<b>Community Services</b>	<b>107</b>	<b>502</b>	<b>609</b>	<b>124</b>	<b>353</b>	<b>477</b>	<b>63</b>	<b>714</b>	<b>777</b>	<b>95</b>	<b>794</b>	<b>889</b>	<b>175</b>	<b>868</b>	<b>1,043</b>	<b>139</b>	<b>1,116</b>	<b>1,255</b>
Water Supply, Sewerage	4	385	389	32	324	357	-	632	652	-	726	726	-	537	537	3	901	901
Other Civic Services	103	117	220	92	29	121	63	32	95	95	68	163	175	331	506	136	215	351
<b>Social Services</b>	<b>7,736</b>	<b>1,849</b>	<b>9,585</b>	<b>9,505</b>	<b>1,958</b>	<b>11,465</b>	<b>12,208</b>	<b>3,937</b>	<b>16,114</b>	<b>15,629</b>	<b>1,629</b>	<b>17,258</b>	<b>17,322</b>	<b>1,421</b>	<b>18,743</b>	<b>19,125</b>	<b>1,978</b>	<b>21,103</b>
Education	5,216	1,126	6,342	5,305	1,135	7,740	8,239	2,114	10,392	2,795	2,795	10,719	11,104	1,009	12,113	12,795	1,508	14,303
(primary schools)	(4,389)	(812)	(5,201)	(5,136)	(812)	(5,918)	(6,564)	(1,635)	(8,199)	(7,712)	(586)	(8,328)	(8,357)	(134)	(8,191)	(9,725)	(826)	(10,551)
(secondary schools)	(522)	(79)	(601)	(605)	(175)	(780)	(715)	(204)	(919)	(952)	(214)	(1,166)	(771)	(5)	(776)	(1,008)	(109)	(1,117)
(colleges and universities)	(206)	(189)	(395)	(251)	(314)	(595)	(556)	(195)	(751)	(640)	(110)	(1,750)	(779)	(138)	(917)	(1,031)	(137)	(1,471)
(other education)	(229)	(47)	(275)	(312)	(105)	(417)	(1,01)	(110)	(514)	(61)	(505)	(1,194)	(732)	(1,296)	(1,028)	(136)	(1,164)	
Health	401	139	540	445	113	559	423	293	716	807	49	856	929	88	1,017	818	85	903
(hospitals)	(166)	(100)	(265)	(245)	(195)	(340)	(83)	(176)	(259)	(261)	(19)	(310)	(329)	(28)	(357)	(330)	(44)	(374)
(other health)	(235)	(39)	(275)	(200)	(18)	(219)	(340)	(117)	(457)	(516)	(-)	(516)	(600)	(60)	(660)	(1,08)	(41)	(529)
Social Welfare	1,986	135	2,121	2,753	152	2,906	3,546	334	3,980	5,027	65	5,092	5,289	24	5,313	5,512	25	5,537
Housing	3	449	452	2	258	260	-	1,166	1,166	-	561	561	-	300	-	360	360	
<b>Economic Services</b>	<b>1,387</b>	<b>7,010</b>	<b>8,397</b>	<b>3,398</b>	<b>15,206</b>	<b>19,302</b>	<b>3,985</b>	<b>21,653</b>	<b>25,610</b>	<b>2,611</b>	<b>23,065</b>	<b>25,706</b>	<b>2,139</b>	<b>19,156</b>	<b>22,395</b>	<b>3,607</b>	<b>28,638</b>	<b>32,213</b>
Agriculture and Non-Mineral Resources	893	2,516	3,410	2,950	1,827	7,776	3,423	6,974	10,399	2,101	5,560	7,661	2,439	3,612	6,101	2,925	7,600	10,525
(agriculture)	(333)	(1,714)	(2,078)	(2,209)	(3,909)	(6,118)	(2,789)	(5,915)	(8,704)	(1,349)	(3,259)	(4,608)	(1,422)	(2,440)	(3,862)	(1,211)	(5,531)	(6,742)
(forestry)	(104)	(322)	(426)	(130)	(500)	(630)	(108)	(424)	(532)	(141)	(1,100)	(1,244)	(180)	(698)	(878)	(239)	(714)	(953)
(fishing and hunting)	(78)	(421)	(499)	(112)	(316)	(458)	(45)	(503)	(519)	(21)	(1,194)	(1,215)	(12)	(436)	(148)	(73)	(1,148)	(1,221)
(others)	(378)	(29)	(407)	(499)	(72)	(570)	(481)	(132)	(614)	(587)	(7)	(594)	(875)	(38)	(913)	(1,402)	(207)	(1,609)
Mining, Manufacturing and Construction	153	1,759	1,911	254	3,427	3,681	517	5,519	6,037	536	4,690	5,226	359	3,816	4,175	625	5,019	5,644
(manufacturing)	(36)	(1,543)	(1,578)	(78)	(3,097)	(3,175)	(57)	(1,430)	(1,487)	(40)	(3,388)	(4,428)	(17)	(3,375)	(3,422)	(69)	(4,671)	(4,760)
(others)	(117)	(216)	(333)	(176)	(330)	(506)	(460)	(1,089)	(1,550)	(96)	(302)	(798)	(312)	(411)	(753)	(556)	(318)	(904)
Electric Power	24	276	300	27	1,130	4,157	11	2,552	2,563	34	3,622	3,656	1	3,495	3,496	18	991	1,009
Transport	301	1,963	2,265	167	2,593	2,759	34	5,525	5,558	-30	7,818	7,818	55	5,989	6,044	39	9,524	9,563
(railways)	(-)	(879)	(879)	(-)	(907)	(907)	(-)	(3,118)	(3,118)	(-)	(5,766)	(5,766)	(-)	(3,616)	(3,616)	(7,046)	(7,046)	
(roads)	(21)	(692)	(513)	(12)	(1,225)	(1,237)	(1)	(1,270)	(1,270)	(-)	(1,136)	(6,136)	(1)	(664)	(664)	(1)	(1,024)	(1,025)
(waterways)	(280)	(592)	(873)	(154)	(420)	(574)	(33)	(768)	(806)	(-30)	(910)	(880)	(51)	(1,553)	(1,607)	(38)	(1,208)	(1,216)
(airways)	(-)	(-)	(-)	(1)	(41)	(41)	(-)	(339)	(339)	(-)	(36)	(36)	(-)	(156)	(156)	(-)	(216)	(216)
Communications	16	496	511	-	929	929	-	1,083	1,083	-	1,345	1,345	35	2,544	2,579	-	5,502	5,502
<b>Unallocable and Others</b>	<b>2,557</b>	<b>242</b>	<b>3,749</b>	<b>2,884</b>	<b>166</b>	<b>3,827</b>	<b>2,974</b>	<b>760</b>	<b>4,374</b>	<b>3,089</b>	<b>1,716</b>	<b>5,172</b>	<b>3,271</b>	<b>903</b>	<b>5,007</b>	<b>3,998</b>	<b>1,801</b>	<b>7,140</b>
<b>TOTAL</b>	<b>31,957</b>	<b>10,203</b>	<b>42,711</b>	<b>39,290</b>	<b>19,235</b>	<b>59,002</b>	<b>48,009</b>	<b>27,385</b>	<b>76,032</b>	<b>51,669</b>	<b>27,163</b>	<b>79,899</b>	<b>58,313</b>	<b>22,828</b>	<b>81,974</b>	<b>66,958</b>	<b>33,783</b>	<b>102,082</b>

Source: Bank of Korea, Research Department