

The List of 2006~2008 Publications

2009



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(2006~2008)

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THE LIST OF PUBLICATIONS (2006~2008)

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Preface

The Korea Institute of Public Finance(KIPF) was established in July 1992 for the purpose of conducting policy-oriented research and analyses on all aspects of taxation and public finance, thereby assisting in the formation of public tax policies and contributing to the national economy.

Since its inception, KIPF has played a critical role in the development of tax and budget policies and in the advancement of tax administration. KIPF conducts extensive research and provides recommendations on alternative tax and fiscal policies.

The changing economic environment under a globalized and open economy gives importance to tax and fiscal policies as a basis for making sound economic decisions. The importance of in-depth research and the influence of suggestions on various policy alternatives are greater than ever before.

This publication provides studies and research conducted by KIPF in the areas of fiscal policy and taxation, which serve as the backbone of the nation's economy.

I sincerely hope this book, a product of hard work by our staff, will be beneficial to the government, various enterprises, citizens and researchers of this field.

President Yun-Hi Won

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The List of Publications(2006~2008)

Research Papers

The Redistributive Effect of Government Social Expenditures, Including Indirect Taxes and In-kind Benefits

Ki-baeg Park, Myung Jae Sung, John M. Kim and Jin Kim

We examine the redistributive effects of government taxes and expenditures on the household income distribution, which has shown a deteriorating trend since the mid-1990s, notably after the financial crisis of 1997. Focusing on expenditures for social programs, we measure their effects on household income and also discuss policy suggestions based on policy simulation analyses. Specifically, we use survey data to estimate the incidence of cash benefits and the tax burden of direct and indirect taxes. We also attempt a simulated reconstruction of in-kind benefits for health-care and education, etc., using information such as age, gender, and number of children in households.

The redistributive effect of direct taxes such as income tax and of income transfers, as measured by their impact on the Gini coefficient, is estimated to be 10.5 percent as of 2005. Excluding private transfers, public-sector redistribution came to about 6.6 percent. If we include indirect taxes, which are somewhat regressive, public-sector redistribution was 6.1 percent. The redistributive effects of in-kind benefits (as of 2005) were estimated to be 2.75, 2.6, and 0.17 percent for health insurance, education, and child-care, respectively. Housing was not found to have a significant impact for redistribution, as subsidies were mainly small-scale and skewed toward

high-income households.

Looking at private income (defined as market income plus private transfers), when we excluded taxes and social contributions and added cash and in-kind benefits, final income was higher than private income for the first to fifth deciles, and vice versa for the higher deciles. From this result, we conclude that the public sector—through taxes, contributions to social insurances, cash transfers and benefits in kind—effectively does redistribute household income.

Both increasing government spending and government revenues to finance such spending will have impacts on income redistribution. Therefore decisions to expand welfare programs to benefit low-income households or to counter widening income gaps, the positive effect of additional spending on the household income distribution must be larger than any negative effect of tax increases. The results of policy simulations to analyze the effects of revenue increases to finance additional spending and of increasing welfare program spending are as follows.

Consider the case of raising taxes by 1 trillion won to finance an increase of the same amount in welfare spending. We estimate that if the additional tax revenues come wholly from income taxes, the after-tax Gini coefficient will fall by 0.00018 to 0.00069, improving the household income distribution. In contrast, excise taxes will result in a very miniscule increase (0.00003) in the Gini index, which has practically no impact on the income distribution. Surcharges on tobacco are strongly regressive and will hence have a rather strong negative impact on the Gini (increase of 0.00015).

Expanding welfare spending will positively affect the household income distribution. Education, basic income guarantee, child-care programs will reduce the after-tax Gini coefficient by 0.00028, 0.00211 and 0.00136, respectively.

06-02

Estimation of Joint Distribution of Income and Real Assets, and Related Tax Burdens

Sung, Myung Jae and Hyunsook Kim

This report aims to estimate the joint distribution of income and real assets and, furthermore, their related tax burdens, using raw data of property and land tax returns and household income survey data for the year 2003. However, a part (12.7%) of land asset raw data is not matched to income data due to the lack of necessary information.

The shares of land assets (excluding housing appended land) and housing assets (including housing appended land) are estimated to be 28.9% and 60.8%, respectively. The shares of households which own their housing and land assets are estimated to be 70% and 30%, at most, respectively. The Gini coefficients for land and housing assets are 0.95 or higher, and 0.7~0.8, respectively. The Gini coefficient of joint ownership of land and housing assets is estimated to be 0.765.

The housing ownership seems to be positively correlated with income. However, it is unlikely to expect similar correlation between land assets and income. Since the relative ranks are different between income and real asset distributions, the owners of housing and land assets are not necessarily concentrated on high income groups. Bequests, retirement, and other reasons might account mostly for the relatively huge discrepancies between income and real asset distributions.

The comprehensive income can be derived by adding up the imputed

income from real assets into the gross income. The Gini for comprehensive income is estimated to decrease, when changes in rank orders are not allowed. However, it seems to increase, when rank changes are allowed.

Income tax, taxes on capital gains, and property tax on housing turn out to have positive redistributive effects on relative income distribution. However, the redistributive effects of property tax on housing seem relatively small, compared to those of other taxes.

It is well known that the ownership tax burden on real assets increased tremendously in a couple of recent years. The recent sharp increases in tax burdens on real assets surely had strong impacts on income distribution. Therefore, this calls for additional basic research for thorough evaluation of recent government interventions and, also, for more detailed policy suggestions.

06-03

Fiscal Policies for the Accumulation of Human Capital in Korea: An Economic Analysis on Fertility

Kim, Hyunsook, Ryu, Deockhyun and Min, Heechul

This report, which is the first volume of the two-year research project on the accumulation of human capital, analyzes the economic factors driving a sharp decrease in the fertility rate, including household income or male income, female education, female participation in the labor market, female wage, marriage age, etc. Previous studies on fertility in Korea did not pay enough attention to economic variables, mainly due to lack of appropriate data and also because previous works on fertility in Korea were produced largely in the other social science disciplines than economics. Adopting rigorous empirical models and focusing on economic reasons for women to have less children recently, we believe this study makes its own contribution to the fertility literature in Korea, distinct from previous studies.

Chapter II reports a recent trend of fertility in Korea and OECD members and discuss underlying causes. The total fertility rate of Korea, which was as high as 6.0 in year 1960, recently dropped sharply to the world lowest 1.08 in year 2005. Statistics and the experience of OECD countries seem to suggest that the drop in the fertility rate results from various factors such as the government policy to curb population growth which lasted too long till the mid 1990s, advances in health care, growing preference for a small number of children, but most importantly from female participation in the labor market and rising cost of child care and education.

In Chapter IV, we present an empirical analysis of fertility on a micro-economic level using a household survey data (Survey on the National Fertility, Family Health and Welfare). First, in order to identify factors affecting birth spacing, we use a survival analysis method and find that increase in female wage significantly delays both first and second birth, and raises the probability of women to stop giving birth. The effect of male income, on the other hand, does not come out statistically significant in most specifications that we consider. The next set of results is based on a count model where we test the impact on the number of children of household income, women's wage and education, and women's job market participation. We find that household income significantly increases the number of children, and also have shown that the education level of a woman over 40 years old has a negative effect on the number of children. In addition, the empirical model suggests that a woman having a job tend to have fewer children for a group 40 years old and over, while more children for below 40 years old.

Chapter V includes a macro-economic analysis on the relationship among the aggregate data on fertility rate, male/female income, and male/female wage. We empirically test the hypothesis of new home economics and find that the effect of female wage is stronger for younger cohorts and the effect of male income is more apparent for older cohorts. In an additional test of the relative income hypothesis, the relative income gap between old and new generations is found to have a larger effect on fertility for younger cohorts.

The last two chapters provides an overall summary of the micro-analysis and the macro-analysis and discuss policy implications. We suggest that the decline of fertility, if not followed by technological advance or productivity growth, would harm the growth of potential GDP in the long run. It is also argued that the policy toward the lower fertility in Korea should encourage women participation in the labor market so that women can balance work and family without much difficulty. We have not provided in this report a detailed analysis on specific policy tools, which we plan to do in the second year project.

06-04

A Study on the taxation for the Mergers and Acquisition

Jin Soo Kim and June-Q Lee

As a result of the 1998 tax reform, the provisions for the increased capitalization for merger, liquidation income, and goodwill were amended. In other words, the tax exemption system for merger was introduced in the corporate income tax law by prescribing the merger and division. However, the current law seems incomplete and insufficient to apply to merger. Either the corporate income tax does not have the provisions for overall acquisition, and especially for hostile M&A in spite of the increasing social concern.

Under this background, this report seeks to ways to improve the taxation for merger. First, since the necessary conditions of the tax exemption for merger are far from the economic substances and it is easy to satisfy the conditions of the tax exemption even for mergers with the aim of tax evasion, the conditions of the tax exemption should be amended. Second, the current tax exemption system for merger should be transferred to tax free merger system. Third, the difference between consideration given and net worth received should not be taxed, but should be taxed when the assets are sold. Fourth, the restriction on the deduction of losses carried forward for reverse merger should not apply to incomes after merger which are generated from the business operated by the merging corporation before merger, but not apply to incomes after

merger which are generated from the business operated by the merged corporation before merger. Fifth, the tax exemption system must be applied to the triangular merger which includes the corporation that pays the consideration for merger besides the merging corporation and the merged corporation.

This report seeks to ways to improve the taxation for acquisition. First, if the acquiring company pays by stocks instead of by cashes and continues the business after acquisition, the tax exemption system must be applied to the acquisition. Second, the acquisition tax should not be levied on the dominant stockholder who acquired the stocks or shares from shareholders. The acquisition tax should not be levied on the dominant stockholder who acquired the stocks or shares from shareholders in the cases of Listed companies and Kosdaq listed companies. Third, if there is a great numerical difference of the trading profits of each other country's stocks between our country and some country, we need to come to an agreement to revise the tax treaty with the country. Fourth, the taxation for greenmail should be equipped. If we levy on the receipt of greenmail, the tax rate could be between 20% and 30%. Fifth, the ceiling on inclusion of loss for retirement allowance for executive is necessary regardless of articles of association. Sixth, in the short run, we do not need to restrict on the original issue discount of high yield discount obligation, and, in the long run, we do not need to permit the expense deduction on the original issue discount of high yield discount obligation.

06-05

Reform Proposal on Korean Capital Gains Taxation on Housing

Ro, Younghoon

Korea has more than 30-years long history of maintaining the scheduler system of taxation on the capital gains from the dwelling houses, separate from other ordinary income. Even if the 'Capital Gains Tax' - translated in Korean as 'the tax on the income from alienation (of asset)' - has been imposed upon the seller's total annual net gains from the disposals of chargeable capital assets, it has not been developed as a special form of personal income tax in terms of source, characteristics, and timing of income. Very specific assets like the real estate and the right to real estate has been subject to taxation, and hence it has been used as a fiscal tool by the central government to stabilize the local housing market boom and bust cycles. So Korean capital gains tax on housing has very unique features like differential tax treatment toward multi house owners, exemption of capital gains from the sale by the single house owner without strict residence requirement, etc.

This study examined the economic inefficiency and equity aspects of the current Korean capital gains tax on housing. We found that the effectiveness of conventional government's employment of capital gains tax policy for the housing market stabilization purposes declines as the investment motive and feature of housing capital becomes more important than the role of consuming housing services from the housing capital. Also, it is noted that the Korean tradition of taxing housing capital appreciation separate from other ordinary income has not always resulted in the heavy tax burden compared with other sourced of income when we chronologically followed

the tax rate schedule changes of both personal income tax and capital gains tax. Another peculiar feature like heavy capital gains tax treatment toward high-priced houses deserves our research attention on the possible lock-in and economic inefficiency effect on the local high-end housing market resulting more volatile transaction volume.

Finally, we examined the equity aspects of current capital gains tax structure of schedular system - same tax treatment of chargeable capital gains amount without taking into account of the seller's other income and economic position - by empirically analyzing the housing wealth and housing appreciation distribution of families belonging to each sample income decile. The relationship between household income and housing wealth was not a strong one.

We recommend that the current Korean capital gains taxation on housing needs total overhaul to become a normal capital gains tax. First, rather than making its tax complex to differentiate the tax burden on the specific housing market and the targeted multi house ownership, it needs to be incorporated as a source of income into the comprehensive personal income tax system. Second, the current tax relief measure taking the form of exemption provided toward 'only one house ownership per one family' should require more strict residency test, and the partial exclusion into the taxable income.

06-06

Income Tax Policy to Enhance Married Women's Labor Force Participation in Korea : Introduction of Child Tax Credit

Kim, Hyunsook and Sung, Myung Jae

The trend toward very rapidly fallen total fertility rates and population ageing causes high share of elderly and low share of young and labor active population in Korea. It may imply the slow or negative economic growth in the economy due to the shortage of labor force in the future.

We need to devise policy tools to increase fertility rates to cope with shortage of labor supply in the long run. At the same time, we need to induce inactive labor force into participating in labor market in the short term and the main force for inactive labor is married women in Korea.

It is well-known that there may be a trade-off between fertility rates and women's labor force participation and recently this relationship is changed to positive relationship in a few countries due to strong family friendly government policies.

Thus we need to consider how to get high fertility rates as well as high married or coupled women's labor force participation rates in designing a family friendly government policy. One of policy tools is to help women with children under age 5 to reconcile work and child rearing, i.e., child care policy.

Our research agenda is to lessen households' child care expense within income tax scheme using child tax credit and to see how much it can

impact on women's labor force participation rates and working hours.

First, we construct married women's labor supply function under CES(constant elasticity of substitution) utility function assumption with the budget constraints incorporating child care expense and hour allocation (working-leisure) constraint. We estimate compensated and uncompensated wage elasticity for married women using year 2004 Korean Labor and Income Panel Study and get the compensated elasticity ranged from 0.23 to 0.26.

We waive child care expense via child tax credit and increase women's effective hourly wage to see child care cost impact on labor force participation and working hours of married women with children under age 5.

We simulate three different child tax credit scheme to compare effects of different schemes. First, we give child tax credit for only low income women workers with children under age 5 without tax burden in current income tax regime. We design increasing-constant-decreasing tax credit bracket based on the income size as Earned Income Tax Credit system does. The size of child tax credit is 30% of income under wage 5 million won, 1,500 thousand won for income 5~7 million won of income range and 50% of the difference between income and 7 million won for income 7~10 million won.

This scheme creates 19.6% increase of new labor force participation and 9.5% increase of working hours. It also creates extra income four times higher compare to tax revenue loss for child tax credit implementation.

Second scheme is to give lump-sum tax credit, 600 thousand won for middle income class and has no effect on married women's labor activity. Third scheme is a proportional tax credit with tax burden under the current income tax regime and has only a small positive effect on working hours.

We found that negative income tax credit for low income earners has large effect on women's labor market activity whereas child tax credit policy for middle class and highly educated women has little effect.

However, we can not conclude child tax credit for highly educated women has no effect based on this result only. Our income elasticity of married women is relative low and more diverse and sophisticated child tax credit design is needed to examine child tax credit effect on women's labor force participation as well as working hours for the further elaborated study.

06-07

The Elasticity of Taxable Income: Personal income tax

Jeon Byung Mok

This study estimates taxable personal income elasticity with respect to tax rate change. Estimation process covers both cross section data approach and time series approach. Cross section data is used to estimate taxable income elasticity around 2002 when personal income tax rate is lowered by 10%. The estimates are not statistically significant with the tax cut. However, time series approach suggests that the estimates are statistically significant for top 10% class. The estimates are 0.79 and 0.99 for top 10% and top 5%, respectively. These are higher than the United States case which is 0.62 for top 1%(Saez, 2004). This implies that excess burden of income taxation in Korea is much higher than that of the United States. The result shows that we need to be cautious in increasing top income tax rate.

06-08

The Effect of the DDA Negotiations on Korean Tariff Structure and Economy

Jaeho Cheung, Soon-Chan Park

This paper analyzes the impact of tariff reduction modality mentioned in Doha Development Agenda(DDA) negotiations on the tariff structure of Korea and some major countries.

Applying the simple non-linear Swiss Formula on a line-by-line basis reduces or eliminates tariff peak, high tariff and tariff escalation. The size of reducing tariff variation depends on the level of coefficient for the tariff reduction formula.

If Korean government intends to use its statutory tariff rates as a tool of industry policy, it will announce the new level of main tariff rate on most of final product (currently 8%) as soon as possible and consider the length of the full implementation periods for tariff reduction.

With new tariff structures after DDA, this paper examines the possible economic effects of the DDA negotiations on GDP, welfare, trade and industrial production of Korea by using a computable general equilibrium model.

The result suggests that the amount of welfare gain of Korea from the DDA negotiations is relatively greater than that of other countries. Finally, we find that the effects of the DDA negotiations can be further increased in a long-term period if each country makes great efforts to realize increasing return to scale and boost capital accumulation to improve its industrial structure.

06-09

A Study on the Efficiency of Education Expenditure

Jongseok An, No Wook Park, Jaeho Cheung and Jin-Yeong Kim

The purpose of this research is to investigate the characteristic features of the budget for education, evaluate the efficiency of education expenditure, and derive the way to improve its efficiency. "Efficiency" means to raise funds with minimum distortion of resource allocation or to maximize the outcome out of given funds. We are also interested in analyzing whether an increase in education expenditure could improve the national welfare in Korea.

We focus on the following three issues among other things.

First, we examine the allocation of funds to improve diversity and efficiency in the primary and the secondary education. For this purpose, we perform case studies of other countries, examine the theoretical reasons why the government provide education funds, and evaluate the current system in Korea.

Second, we study the relationship of changes in population and budget for education. In Korea, the number of students in the primary and the secondary education is expected to decrease by 30 percent in 20 years. This change seems to have a great impact on education budget. Thus, we investigate the impact of the change in population on education budget and analyze the possible responses of the government to this change.

Lastly, we study the efficiency of the tertiary education in Korea. Through comparing with other countries, examining the private and social rate of return on tertiary education, and also considering the change in population, we evaluate the current level of expenditure for tertiary education in Korea. We also analyze the respective roles of public and private sectors in tertiary education. The methods to allocate education funds to educational institutions and students are also examined.

06-10

Equivalence Scale and its Application to Economic Policy on Household Income

Woochul Kim, Heechul Min, Sangwon Park

In this study, we provide household equivalence scales based on alternative methods and investigate the implication on the minimum cost of living, the income tax system, and household income inequality. The report includes four main chapters. Chapter II reviews the previous literature, discusses the definition of equivalence scales, and presents a summary of various estimation methods available so far. Chapter III, using the Household Income and Expenditure Survey, estimates and compares alternative equivalence scales according to the expenditure ratio approach, the Engel approach, and the demand function approach, etc. In chapter IV, we compare the average effective (income) tax rates for each household type in light of equivalence scales. Chapter V examines the Gini coefficients of household incomes adjusted for equivalences scales.

In Chapter III, we first compare the expenditure level or ratio of hypothetical households whose income rankings within each household type are similar. The incremental expenditure turns out to decrease as an additional kid is added to the household while the incremental expenditure rises with more adults. We also find that according to the Engel approach and the demand function approach, the square-root N-rule - the simplest form of equivalence scales - underestimates the economy of scale coming from additional children, because the square

root N-rule assumes a wrong scales elasticity ignoring the differences between adults and children. The equivalence scale currently used in the national basic livelihood security system also has a similar problem. We expect the adoption of an Modified OECD scale, which sets the additional cost of a kid to be 60% of an additional adult's, to improve on the current income security system.

Chapter IV examines the ratios of before-tax incomes, at which the average effective tax rates are the same across household types. We suggest that the ratios can be interpreted as equivalence scales implied by the income tax system. We find that the income-tax-system-implied equivalence scales are generally much closer to 1 than the other scales, meaning the necessary expenditure does not change much for different household types under the income-tax-system-implied scales. Since the income tax system is not solely responsible for adjusting welfare levels across households, it would be desirable to examine whether the income tax system is consistent with the other redistribution policies rather than to evaluate the absolute level of exemption. The second finding is, the income tax system favors a household with more children than a household with more adults, while the opposite is the case with the other equivalence scales. Finally, we analyze various scenarios allowing different exemption rules.

Chapter V analyzes the effect of the tax and the government transfer on the income inequality among working households using alternative equivalence scales. The impact of the tax and the government transfer is not found to vary much with the choice of equivalence scales. However, equivalence scales have significant consequences for the relative ranks of households. In addition, we decompose the Gini coefficients into the one between household types and the one within household types, and find that the within-group inequality is much more important than the between-group inequality, which sheds light on the effectiveness of the between-group redistribution policies.

06-11

A study on anti-treaty abuse measures

Jongseok An and Beom-Gyo Hong

This study reviews the characteristics of treaty abuse and analyses its economic impacts. Then it provides policy suggestions to prevent treaty abuse.

The Korean tax authority did not pay much attention to treaty abuse before 1999. Since the IMF crisis, foreign capital flow into Korea has increased greatly for the restructuring of financial sectors and industrial sectors. After the crisis is over, those foreign capital has reaped a great amount of profits. But those big profits were repatriated without paying any taxes to the Korean government, because they took advantage of tax treaties. That aroused social attention to treaty abuse and it became one of the big economic issues in international taxation in Korea.

This study is composed of two parts. First, we have analysed the impacts of treaty abuse as well as policy impacts to prevent it. Second, we looked into the institutional aspects of tax policy of other countries to prevent treaty abuse. We reviewed the historic policy development processes as well as the pros and cons of different policies of different countries. Based on these analyses, we provided policy suggestions for the Korean tax authority as follows.

First, to revise the tax treaty itself is the best way to solve any problems stemming from treaty abuse. By that way, we can maintain the principle of the precedence of international law over domestic law. As a small open economy, we also have to consider any probable negative impact of strict prevention of treaty abuse on capital inflows.

Second, we need to consider the revision of pre-approval conditions for withholding tax at the source for non-residents. Because there are some overlapping and conflicting aspects between conditions.

Third, the tax authority have to continue its efforts in revising tax treaties over the principle of substance over form. They are already recognizing the problems and have been trying to correct them. The limitation on benefits clause should be included in the tax treaties, because it is reflected in the corresponding domestic laws. At the same time, we have to consider more comprehensive and flexible provisions in tax treaties.

06-12

A Long Term Fiscal Model

Hyungsoo Park and Deockhyun Ryu

This study develops a long-term fiscal model to project central government's revenue and expenditure in the long run with the changes of demographic and macroeconomic sectors.

We make a long-term projection of central government's public finance up to the year of 2050 based on the following macroeconomic and demographic assumptions; to the year of 2010, we use the assumptions of 'mid-term fiscal framework of 2006~2010', and through the year of 2050, we forecast population by sex and age, the potential growth rate, the rate of employment by sex and age, the age-related expenditures - such as health, primary and secondary education, child care, national basic livelihood, public pension - fiscal deficit, debt to GDP ratio, etc., using this long-term fiscal model.

We also did a sensitivity analysis and a policy simulation to look into the difference between baseline estimates and simulated estimates by changing a total fertility rate(TFR), a mortality rate, a employment rate by sex and age, child care subsidy policy, and public pension reform, etc.

A Study on Fiscal Rules in Korea

Hyung-soo Park and Deockhyun Ryu

This study investigates fiscal rules, which focus on fiscal consolidation by way of permanently constraining aggregate fiscal targets. Well-known candidates of aggregate fiscal targets are fiscal deficits, a growth rate of expenditure, and government debt. A rule-based fiscal policy is useful to strengthen fiscal discipline, though it temporarily limits government fiscal policy tools to face business cycle. It may be questionable to introduce a rule-based fiscal policy to Korea now since the fiscal sector is sounder than any other economic sector. If we consider several factors threatening fiscal sector soundness, for example, ageing and low fertility problem, it is relevant to study a rule-based fiscal policy now.

The composition of this study is as follows; the chapter 2 summarizes a theoretical aspects of fiscal rules, such as, definitions, usefulness, macroeconomic effects, and an empirical literature review. The chapter 3 covers an extensive survey advanced countries' experiences about fiscal rules. The chapter 4 considers an application of fiscal policy rules in Korea. We evaluate a balanced budgeting principle, mid-term expenditure framework, and issues of fiscal rules in case of introduction of fiscal policy rules into Korea. The final chapter closes the report with concluding policy remarks.

06-14

An Analysis on the Fiscal Sustainability and the Granger Causality between Tax and Spending in Korea

Ki-Baek Park and Woocheol Kim

This paper provides three different analyses on the Korean fiscal policy from the perspective of fiscal stability. The first part of the paper concerns Bohn(1998)'s test of the fiscal sustainability in Korea. After pointing out that sustainability can be spuriously rejected owing to the fiscal consolidation policy pursued by the Korean government in the mid 1980's, we suggest to modify the original Bohn's test to encompass the structural changes in the operation of fiscal policies.

While Bohn's test focuses on the fiscal stability from the long-run perspective, the second part of the paper puts an emphasis on the short-run adjustment of the primary budget surplus in a response to changes in government debt. To capture the short-run dynamic relationship between the debt and the primary surplus, we use a structural VAR model whose identification is given by exploiting the period-by-period budget equation. A basic impulse-response analysis then can show how Korean government reacts to an increase of debt.

Stability of fiscal policy can also be appraised from analysing the causality between tax and spending. In general, stable operation of fiscal policy is likely to be expected under the spending-tax hypothesis, since deficits in the primary balance from an increase in the spending can soon be covered by the consecutive increase in the tax revenue. Considering

nonstationarity of the relevant fiscal variables, a VECM approach is applied to analyse the Granger causality between tax revenue and government spending. As an auxiliary analysis, we also examine how tax revenue and spending response to changes in the primary surplus in the previous year.

06-15

A Study on the Economic Effect of Inheritance and Gift Taxes

Jin Kim and Jonghak Weon

We examine the effects of inheritance and gift taxes upon the economic behavior of asset transfers among generations, which has recently shown an increasing trend. We introduce a multi-stage decision model of transferring monetary and real assets among generations, formalize the ratio of the effective average gift tax rates over inheritance tax rates as the opportunity cost of inter-vivos gift choice relative to inheritance bequeath choice, and highlight the meaningfulness of tax rate change into gift-inheritance mix in asset transfer decisions.

There are several policy implications of the results. Firstly, because of the inter-temporal structure of asset transfers, we find that the effect of the tax ratio between gift and inheritance tax is meaningful not only in the short run but also in the long run. According to the empirical result from the data in 1975-2005 period, the elasticity of gift tax revenue with respect to gift price is 15.5 in the short run and 5.6 in the long run. Therefore, the market response to the government policy on inter-generation transfers, is high and lasting.

Secondly, tax reduction ratio between gift and inheritance tax is remarkable to explaining the change of asset transfer from inheritance to gift. That is very important to policy makers' designing tax structure of transfer taxes.

Finally, we report that not only micro tax policies but also macro fiscal and monetary policies are important to explaining the recent trend of gift and inheritance taxes revenue.

06-16

A General Equilibrium Model for Tax Policy Evaluation in Korea: Tax Incidence Analysis

Seung-Rae Kim

The purpose of this study is to present a new approach to the quantitative analysis of tax and fiscal policies in Korea. For the analysis of tax incidence, this study uses a new, multi-sector, multi-agent, dynamic life-cycle simulation model to evaluate the economic effects of transitions to fundamental alternatives to current Korean tax system. This approach is based on an integration of econometric modeling and general equilibrium life-cycle analysis, and incorporates disaggregated production technologies, intragenerational and intergenerational heterogeneities, and the Korean tax system. The advantage of this modeling strategy is that it allows multiple households to be categorized, and various tax burdens evaluated according to behavioral responses to tax changes in utility-based measures of well-being. The results show that the lifetime incidence of income and consumption taxes in Korea can be significantly different from their annual incidence and that shifting the current capital income taxation toward consumption-based taxation could yield significant welfare gains in several aspects compared to other reforms.

06-17

**The Reformation Plan of Framework
Act on National Taxes
- Centered on Harmony with Civil Obligatory Right -**

Wan Souk Kim, Sang Kook Han and Hun Park

The tax law is becoming an important standard in not only in the aspect of protecting property rights by the taxpayer in collecting taxes by tax office, but also in reporting and paying taxes by taxpayers on their own. It is necessary to make the tax law which becomes the standard related to taxation by both taxpayer and tax office uniform and easy to understand.

The FRAMEWORK ACT ON NATIONAL TAXES('FANT') having about 86 provisions deal with various issues related to national tax. This thesis presents the reformation plan of FANT as it reexamines the Principle of Preference of National Tax('PPNT'), Secondary Liability for Tax Payment('SLTP'), Joint Liability for Tax Payment('JLTP') on the FANT in the aspect called active exercise of rights by the taxpayer.

First, the forwarding date of tax payment notice among legal deadlines must be changed as payment deadline.

Second, the range of concerned tax must be reduced.

Third, the retroactivity of seizure before confirmation must be restricted.

Fourth, the priority must be improved while transferring the mortgage.

Fifth, it is necessary to newly establish an independent regulation of

JLTP on the tax law by escaping the legal system which uses the method of applying joint obligations on the civil law.

Sixth, it is necessary to unite legal terms on JLTP being applied currently in case of newly establishing the JLTP regulations.

Seventh, the JLTP of inheritance tax and gift tax would have to be operated so that they wouldn't restrict the freedom of disposing individual property rights because of annual installment payment system.

Eighth, the new establishment of regulations on collection priority, distribution of remaining property or improvement of limit by one who has accepted the transfer and deletion of overlapping regulations on individual tax laws, etc can be presented in case of SLTP by liquidator.

Ninth, while it is reasonable to abolish the SLTP system by oligopoly shareholder, the reduction of the one possessing set conditions among oligopoly shareholders, elimination of application on shareholder of KOSDAQ listed corporations and reduction of limits by special participants, etc are necessary in case of maintaining it the same way as the present.

Tenth, the clarification of tax items in national taxes related to business and their scope must be reduced in case of SLTP by business undertaker.

Eleventh, it is ideal to newly establish the SLTP even for tax payment obligations of associations that are not corporations and tax payment obligations of real income earners.

Twelfth, the property of secondary tax payment obligator among seized property must be made so that it cannot be sold before selling the property of original tax payment obligator.

Thirteenth, the regulations on excluded period of imposition rights of SLTP must be clarified.

06-18

Policy Issues on reforming Balanced Development Special Account(BDSA)

Junghun Kim and Hyun-A Kim

The objective of this paper is to analyze and evaluate balanced development special account (BSDA), which was created two years ago as a process of reforming special grants. As a result of the reform, BSDA was created by combining more than 100 specific grants with an objective to make it a kind of block grant. The process is incomplete, however, and BSDA is needed to be modified further to become a block grant in its real sense.

To find a way to improve BSDA, this paper analyzes the statistical characteristics of BSDA, using regional panel data that includes the BSDA data obtained from the Ministry of Planning and Budget. The main objective of the regression analysis in the report is to see whether different categories of BSDA projects have different effects on the local governments' expenditure on economic development, and we confirm the conjecture that the heterogeneity of BSDA projects is statistically significant. This finding suggests that categorizing BSDA projects into several different block grants, which consist of more homogeneous projects, is more consistent with the object of creating BSDA.

06-19

Redistribution Effects of Taxes : Lifetime Tax Approach

Joonook Choi, Woochul Kim and Myungho Park

This study investigates the redistributive effects of income tax in a lifetime context. It identified main factors that make the distribution of lifetime income different from that of annual income, and analyzed how each factor works in making the difference. The empirical analysis and simulations are based on the Labor Panel Data by KLI (Korea Labor Institute). The study also tried to identify possible distortion that progressive income based on annual income taxation can cause in the lifetime context, and included some policy debate on the choice of tax system.

The result of the study shows that the distribution of lifetime income is far less unequal than that of annual income, and the redistributive effects of income tax in the lifetime income is far smaller than that in the annual income. The reason is that the income of a person shows some variation over time. The results of analysis show not only the inverse- U shaped pattern in the age-income profile but also temporary changes in income is an important factor in making the redistributive effects of taxes in the lifetime different from that of annual income.

07-01

A Proposal for the Reform of Korean Tax Audit System

Yoon Oh and Myung-Ho Park

In this report the authors intend to analyze the current legal system and its administration for tax audits in Korea. Through such analyses the authors suggest proposals for increasing the efficiency of tax audits as well as improving taxpayer protection during tax audits.

In terms of increasing the efficiency of tax audits, the following suggestions are made.

First, the audit strategies have to be differentiated according to the types and classes of taxpayers.

Second, a random sampling audit has to be introduced for the development of strategic audit planning.

Third, systems for tax penalty, real name financial transaction system, and broader access to financial transaction data have to be operated in a very solid manner. Then cash basis tax liability system may be introduced in the near future.

Fourth, a detailed report on tax compliance activities including the performance of tax audits has to be made public periodically.

In terms of improving taxpayer protection during tax audits the following suggestions are made.

First, the reduction of compliance cost has to be pursued through the increase in legal certainty.

Second, the tax audit procedure has to be regulated by the law of the

National Assembly rather than internal regulations of the tax authority. For this purpose, some important provisions in the Tax Audit Administration Regulation of the National Tax Service have to be provided for in the law, the Basic Law for National Taxes.

Third, the requirements of criminal tax audits and the punishments of tax crimes have to be changed so as to reflect the current societal environment.

Fourth, the advance audit and the advance ruling are worth being introduced.

Fifth, the audit closing through settlement is worth being introduced, at least in a gradual manner.

Sixth, taxpayers should be required to be present in a pre-assessment hearing.

Seventh, provisions for taxpayer advocate have to be introduced and the advocate should be responsible for the development of strategic plan for taxpayer protection.

Lastly, the legal improvement and its administration should be pursued through an independent committee comprising internal officials and external experts, which has the role of overseeing the NTS in its administration and direction by setting the goals of the NTS's performance indicators such as the national tax gap, the voluntary tax compliance rate, and the compliance cost.

07-02

Political Economic Model and Empirical Study on Earmarked Revenues

Ki-baek Park, Sangwon Park and Wonik Son

In this study we derive a new theoretical interpretation on earmarked revenues and conduct an empirical analysis on the important issues related to earmarked revenues. A policy proposal is recommended based on the outcomes from the theoretical and empirical analyses.

In the theoretical analysis two outcomes are derived; (1) if goods or services provided by the government are private goods which have the characteristics of both exclusion and rival, then an efficiency can be achieved by levying charges or user fees on the private goods, (2) earmarked revenues exist due to the discrepancy between the political support of the public and the priority in the process of budget allocation. Therefore, it could be understood that earmarked revenues are used in the fields where the political support is very strong such as education, environment, and road construction.

In the empirical analysis the following several outcomes are derived; (1) the results of unit root test including trends show that the introduction of earmarked tax may cause the structural changes in the proportion of tax revenues in all cases of education tax, transportation tax, and special tax for rural development, (2) the results of Chow test show that the introduction of earmarked tax may increase the total tax revenues in all cases of education tax, transportation tax, and special tax for rural development, (3) the effect

of earmarked tax on the size of related expenses is not significant in all cases of education tax, transportation tax, and special tax for rural development, (4) the stability of the related expenses is more enhanced in the cases of transportation tax and special tax for rural development compared to the case of education tax. From these outcomes, we may conclude that the role of earmarked taxes discussed in this study is to increase the total tax revenues or to enhance the stability of the related expenses rather than to increase expenses of the related fields.

For non-tax earmarked burden (the earmarked charges), empirical analysis is also conducted and the following outcomes are derived; (1) the effect of earmarked charges on the size of expenses in the related field is positive in both environment field and construction/transportation field, but is not clear in industry/energy field, (2) the earmarked charges do not affect the stability of the related expenses in all fields, (3) the earmarked charges are not used as an easy alternative of raising a fund instead of going through the budget allocation process. However, each field has many earmarked charges so that the results derived in this empirical analysis cannot be generalized for each earmarked charges. Therefore, we also conduct the additional analysis on the characteristics of each earmarked charges.

07-03

The Effects of Pronatal Policies on Fertility, Labor Supply, and Marriage of Korean Women

Suk Jin Woo and Hee Chul Min

This report comes out of the second half of the two-year research project on "Fiscal Policies for the Accumulation of Human capital in Korea: An Economic Analysis on Fertility". This study investigates the effect of pro-natal policies on childbirth, labor supply, marriage, and the accumulation of human capital, based on the first-year report which analyzed the socio-economic factors that determines women's birth and labor supply decisions. We estimated a dynamic structural model of birth, labor supply, and marriage. And the estimated parameters were utilized for counter-factual experiments on various government policies. The empirical result shows that providing leave, whether paid or not, has a limited impact on childbirth decisions while the incentive for women to participate in a labor market becomes weak. Subsidies to childcare are expected to promote both birth and labor supply, but only by a limited degree with relatively large fiscal expenditure. The effect of cash transfers, such as child tax credit, is large compared to other policies, but universal transfer has a shortcoming that it may impede labor supply in the long term. Restricted only to working women, cash transfer encourages the long-term accumulation of human capital, while posing equity concerns. Lastly we evaluated two alternative changes to the current pro-natal policy: (1) expanding graded childcare support, (2) introducing child allowance with the current graded

childcare support. According the result, expanding graded childcare support is more effective.

07-04

A Study on Fiscal Risks in Korea

Hyung-soo Park et al.

The analysis and management of government exposure to fiscal risks have two dimensions : the macro-fiscal context and specific fiscal risks. We apply internationally standard analysis of fiscal risks to Korea.

The macro-fiscal context of government exposure to fiscal risks related to its capacity to absorb financial pressures that it may realize in the future. This study adopts Hemming & Petrie(2000)'s four macro-fiscal aspects of vulnerability - ① incorrect specification of the initial fiscal position, ② sensitivity of short-term fiscal outcomes to risk, ③ threats to longer-term fiscal sustainability, ④ structural or institutional weaknesses affecting the design and implementation of fiscal policy. Chapter 3 analyzes each aspect of these vulnerabilities in Korea.

In addition to the macro-fiscal context, there are various specific fiscal risks such as state guarantees, state insurance schemes, default of a subnational government or public entity on nonguaranteed debt/obligation, implicit liability of social security schemes, future recurrent costs of public investment projects. Chapter 4 to 7 analyze and measure the size of these specific fiscal risks according to the following Polackova(1998)'s fiscal risk matrix.

Coverage according to Polackova(1998)'s Government Fiscal Risk Matrix

| Sources of obligation | Direct liabilities (obligation in any event) | Contingent liabilities (obligation if a particular event occurs) |
|--|---|---|
| Explicit (Government liability as recognized by a law or contract) | <p>< predetermined ></p> <ul style="list-style-type: none"> - Sovereign debt : Ch. III (overall fiscal position), Ch.VI(local government), Ch.VII(government debt) | <ul style="list-style-type: none"> - State guarantees : Ch. V.4 - State insurance schemes : Ch. V.2 - Others : Ch.V.3(public investment project-BTO) |
| | <p>< undetermined ></p> <ul style="list-style-type: none"> - Social security schemes mandated by law : Ch.IV.1 - Others : Ch.V.3(public investment project-BTL) | |
| Implicit (A moral obligation of government that reflects public and interest group pressures) | <ul style="list-style-type: none"> - Social security schemes not mandated by law : Ch.IV.1 | <ul style="list-style-type: none"> - Default of public entities on nonguaranteed debt/obligation: Ch. V.1 - Possibly negative net worth and/or default of central bank : Ch.V.4 (monetary stabilization bond) - Bank failure : Ch. V.3 (deposit insurance & public fund) - Others : Ch.III.4(North Korea & Reunification) |

07-05

Measures against Aggressive Tax Planning

Jongseok An, Ahn Kyung-Bong and Yoon Oh

Aggressive Tax Planning (ATP) is a new concept in Korea. Until recently, tax officials in Korea did not pay much attention to tax avoidance as to tax evasion. Thus, measures against ATP were hardly implemented. However, several big cases regarded as ATP has been revealed in recent few years and ATP became an important social issue in nowadays.

This study discusses on the concept of ATP and the social/economic effects of ATP. Then it investigates the cases of ATP to find out characteristic features of ATP. It also studies the measures taken by other countries against ATP.

Lastly, this study suggests Korean government to implement four measures to prevent or reduce ATP: (1) the general anti-avoidance rule; (2) produce rulings; (3) tax shelter disclosure rule; and (4) the penalty on promoters.

07-06

Family Policies for Coping with Low Fertility and Stimulating Growth : Role of Government in Fiscal, Childcare, Education, Female Labor Policies

Heechul Min, Seokjin Woo, Hyunsook Kim,
Hyewon Kim, Deockhyun Ryu and Wooseok Ok

This study aims to propose desirable family policies by surveying family policies of foreign countries, and by analyzing empirically birth, labor supply, and potential growth. We examine family policies of the Korean government and review their consistency in Chapter III. Chapter IV provides an overview of family policies in OECD members, and presents a brief survey of literature on the effectiveness of pro-natal policies. In Chapter V, we estimate a dynamic structural model for counter-factual experiments on alternative policies, mostly drawn from OECD member countries. Thus, we were able to assess the impact of introducing such policies to Korea. Chapter VI provides several scenarios of population structure, labor market conditions, and labor productivity, and analyzes the consequence for potential growth using a growth accounting equation. According to the analysis, the impact of education investment on per capita GDP growth amounts to 0.39% per annum. Chapter VII considers alternative policy tools, and assess their relative effectiveness when introduced to Korea. The analysis shows that childcare support, especially graded childcare support and child tax credit are preferred in terms of policy outcomes, such as childbirth, labor supply,

and growth. Also, we argue that it is more effective for those on childcare leave to be paid at a proportion of their average earnings, than to be paid at a flat rate.

07-07

The Effect of Expenditure Assignment on Migration into Seoul Capital Region

Jung-Hun Kim and Hyun-A Kim

Decentralization and balanced regional development have been top policy priorities for Noh administration. A main question that arose in the process of pursuing these two policies were whether they are consistent policy goals.

According to other countries' experiences and researches on this issue, decentralization can go either way: it can reduce or worsen regional disparities depending on the economic conditions of a country and the way decentralization is implemented.

In this study, the relationship between expenditure assignment and the population concentration around the Seoul capital region is investigated, and it is shown that the weak congestion effect of the public goods provided by local governments makes a big city like Seoul attract migration into it due to the net fiscal benefit created by the economies of scale effects large cities enjoy.

The policy implication of this finding is the following: if the local public services such as education and police are made to be the responsibilities of local governments, as is the case for most OECD countries, the immigration pressure into Seoul capital region can be significantly reduced, and policy objectives of decentralization and balanced regional development can be made more consistent with each other.

07-08

A Study of the Changes in the Corporate Income Tax Revenue after the Korean Economic Crisis

Woo Cheol Kim

This paper investigates why the Korean corporation tax has recently raised so much revenue. We examine three economic factors that can affect the corporate income tax(CIT) revenue; including the effective tax rate, profitability, and the total number of firms. Also, to understand the how the CIT revenue depends on the asymmetric performance of different firms, we analyse persistence of firms' profitability as well as the performance of the 100 biggest firms.

Our main results show that the increase in the CIT revenue is more closely related to the higher profitability of firms due to the outstanding decreases of firms' debts, rather than the increase in the tax burden of firms(which actually has slightly decreased since the economic crisis). From estimating the transition function of corporate incomes, it turns out that the level(not the relative order) of firms' profitability has become more persistent since the economic crisis. While the tax-payment per firm was stable during the period of 2000 through 2005, the growth rate of the whole CIT revenue(67%) might well be explained by the growth rate of the number of firms(68%), implying the important role of the number of firms in the CIT revenue. However, from the comparison of the increase in the tax payments of the 100 biggest firms(₩8,630bil.) to the increase in the whole CIT revenue(₩8,467bil.), it is inferred that the

higher profitability of the 100 biggest firms explains most of the increase in the whole CIT revenue.

07-09

Real Estate Market and its Tax Policy in Korea

Ro, Younghoon

Recent concerns about speculation in Korean housing market have underscored the fact that housing is not only a consumption good but is also an investment asset with potential to generate capital gains. Housing has the dual role of providing consumption services and being the form of capital asset in which the household put his accumulated wealth. Especially, the investment motive of housing capital demand becomes more important than the housing service consumption feature in Korea during the past 5 years. So, we tried to figure out whether the apartment market in Seoul metropolitan area shows some sign of capital asset efficient market hypothesis. We show that the housing's role as investment asset with its potential for capital gains dominates its role as consumption good at least in the Seoul metropolitan area apartment market by comparing the sales price index with its rental price index from year 1999 to 2007 period. The rental-to-sales price ratio (implying the degree of consumption goods price weight among its capital market value) tends to decline after the October 2001 when the sales price sharply climbed up. It should be noted that the ratio itself was surveyed for each sample apartments independently with the denominator of the ratio, i.e. sales price index.

This study starts from recognizing the important distinction between

'man-made' real estate i.e. property and (vacant) land, and its economic implications in the market as well as tax policy. The market mechanism of housing which is the combination of residential capital and land, differs from that of land in that the supply elasticity of the former with regard to price tends to be higher than that of the latter. Hence, when the substitution elasticity between capital and land in the production of housing can be increased by loosening the strict density regulation in Seoul metropolitan area, supply-side measures can be made best use of in curbing the ever-escalating housing price expectation in the prime Seoul residential area. Korean government's repeated resorts to the tax measures in order to stabilize the housing market price by suppressing the demand proved to be of little success.

Next, we examined the equity aspects of current capital gains tax structure of schedular system - same tax treatment of chargeable capital gains amount which doesn't take into account of the seller's other income and economic position. After analyzing empirically the year 2003 cross-section joint sample distribution of family income and housing wealth, we conclude that the relationship between household income and housing wealth was not a strong one. There were large variations of housing wealth distribution in low income family deciles due to the existence of non-house-owning families, and the average housing wealth amount declined as the family income decile goes up. When we adopted the grouping by the comprehensive family income rather than the reported family income by adding up the imputed rental income for owner occupying households, the relationship became a little stronger.

Hence, we recommend as a policy implication that the current Korean capital gains taxation on housing needs total overhaul to become a part of normal income tax. First, rather than maintaining its current complex tax structure by differentiating the tax burden on the specific housing market and the targeted multi house ownership, it needs to be incorporated into the comprehensive personal income tax system as a

source of income . Second, the current tax relief measure taking the form of exemption provided toward 'only one house ownership per one family' should require more strict residency test, and the partial exclusion into the taxable income.

Finally, we examined the holding-stage tax burden of housing in Korea in comparison with other OECD member countries to check whether the property tax component in the user cost of housing can be critical in affecting the housing inflation rate. We found no evidence of the local and regional effective property tax rate of housing property being correlated with the housing price appreciation. We suggest that the differential housing tax policies targeted for the different regional housing market might be more appropriate for the stabilization purposes as well as the equity and efficiency perspectives rather than the nation- wide wealth tax and capital gains tax.

07-10

Increasing Income Inequality in Korea and Policy Suggestions

Jonghak Weon and Myung Jae Sung

The gini coefficient measuring the relative income inequality in Korea dwindled in 1980s and early 1990s, but started to rise from the mid 1990s. Therefore, the locus of gini coefficients has shown a U-shaped curve during the last two decades. It decreased from 0.287 in 1982 to 0.244 in 1995, and rose to 0.283 in 2000 and, again, to 0.298 in 2006. It turned out that the aging of the population was the most important factor that caused the recent increase in gini coefficient. A study on the demographic characteristics showed that about two thirds of the increase in gini coefficient can attribute to the rapid population aging, and that the rest to the economic factors such as discrepancies in productivity, unemployment rate, wage difference, share of part-time workers and so forth.

The second most important factor causing the increase in the gini coefficient would be the enlarged wage difference. The wage difference began to rise from the mid 1990s. The wage differences between men and women and those among different education groups have more or less decreased since 2000. However, they increased rapidly among age groups and firms by size. The change in wage structure between 1985 and 2005 did not much depend on the demand factors but heavily on the supply factors such as population aging and increasing average

education years.

Most of the old are retired and, so, are not likely to participate in the labor market actively, competing against young labor force. However, it is expected in the medium- and long-term that the effective labor supply will run out. Therefore, it is strongly recommended to utilize more old labor force.

To cope with the increase in the income inequality due to the increasing average education years, we need to enlarge retraining programs and enhance labor market flexibility, especially to the nearly uneducated. However, direct intervention of government on labor market intended to reduce the income inequality is not recommended since the inequality did not stem from market failure and, thus, since it may cause inefficiency rather than reduce inequality.

07-11

Implementation of Dual Income Taxation

Jongseok An and Jeon, Byung Mok

This study explores possible policy options for dual income taxation(DIT) and analyzes the distribution effect of the tax reform. Although current tax system is similar to the DIT system, we can find equity problems in taxation across various capital incomes. We construct 3 DIT scenarios for Korean economy which include variations of repeal of global taxation system for financial incomes, taxation for capital gains of real estate, and allowance for corporate equity. Using household survey of National statistical office(NSO), We find that income distribution can be improved under scenario 2 which includes repeal of global taxation system for financial incomes, tax exemption for various saving types, and decrease of corporate income tax rate by 0.5%p. The reason is that revenue increase from capital incomes allows us to decrease value added tax which is regressive. However, when we include allowance for corporate equity(scenario3), income distribution is worse than before since value added tax rate is increased to recover revenue loss from corporate income taxation. In sum, moving to DIT in Korea does not cause big change in income distribution which suggests that the repeal of global taxation system for financial incomes and various tax exempted saving accounts.

07-12

A Study on the Taxation of Retirement Pension Plan

Jin Soo Kim and Jae-Jin Kim

Upon the introduction of the retirement pension plan in 2005, the multi-pillar arrangement for retirement income provision, in concurrence with the national and personal pension plans, has been formalized. However, for its substantiality, the settlement of retirement pension and its appropriate taxation must be preceded.

The prospect of the settlement and invigoration of the pension plan will be significantly affected by the retirement allowance and its respective taxation, for the primary policy objective of introducing the retirement pension is to divert the internal reserve of retirement allowances to outside the company.

The policy objective of securing retirement income can be achieved when the construction of retirement allowance is followed by the revitalization of external reserves of retirement allowances, hence the most influential tool being appropriate taxation.

Unfortunately, employees are reluctant to convert to the pension plan, which can be explained by the ineffective current tax incentives. The employee is not assured a tax cut by conversion, and the employer has no particular incentive to entrust the retirement reserves in their contractual form to other institutions such as insurers, banks, and trust investment companies.

We suggest providing additional tax incentives to encourage the development of retirement plans. First, by dissolving the inequality of tax burden in retirement pension plan and the retirement allowance, employees will perceive the pension plan more favorable. This can be achieved by increasing the deduction amount, deduction limit, and tax brackets on retirement income. Concurrently, the retirement allowance must be perceived to be less favorable in terms of tax burden through gradual reduction of the deduction rate proportional to both retirement income and service period.

Second, the deduction limit on the retirement allowance reserves must be reduced immediately in order to encourage the retirement pension plan, to be abolished in the long run.

Third, in the case of Defined Benefit retirement pension plan, it will be necessary to set the deduction limitation according to both the non-continuous and continuous standard, allowing the employer to choose the greater deduction of the two. As in the Defined Contribution retirement plan, this will in the long run allow the employers to commit to the deduction limit by entrusting the entire contribution to external financial institutions such as banks, insurers, etc.

Finally, an individual income deduction limit to the employee's portion of contribution must be set up in the Defined Contribution retirement pension plan. However, it will be necessary to increase the deduction limitation in order to encourage additional contributions if we are to maintain the current deduction limitation which sums up both the retirement and the personal pension plans.

07-13

The Marginal Efficiency Cost of Taxation in Korea: An Econometric Approach

Seung-Rae Kim and Woorhul Kim

This study estimates marginal efficiency costs (or marginal excess burdens) of different taxes to the Korean economy, using flexible functional form techniques. The general equilibrium approach here involves a model of consumer behavior, a model of producer behavior, and the marginal efficiency cost model. These models are econometrically estimated for the period 1970-2004 for the Korean economy, based on the latest empirical techniques rather than the guesstimates and restrictive assumptions of typical calibration-based approaches. The efficiency cost of tax increases by major categories in Korea are evaluated using the behavioral elasticities and extensive time-series data over the 35 years in the sample period. In this approach, changes in the size of marginal efficiency costs are attributable to the changes in tax rates, flexibility and responsiveness of the economy and factor mobilities. The results show that the marginal efficiency costs associated with increased taxation on consumption, imports, labor, and capital in Korea grew from 6.4%, 4.4%, 9.9%, and 5.9% in 1970 to 15.5%, 9.6%, 21.2%, and 29.8% in 2004, respectively. On efficiency grounds, it implies that shifting tax burdens from income to consumption in Korea may improve social welfare by reducing excess burdens on the community to finance government expenditures.

07-14

An Economic Analysis of the VAT System in Korea: For a Broad Tax Base

Seung-Rae Kim, Myung-Ho Park and Beom-Gyo Hong

This study examines major policy issues of the VAT system in Korea. Especially the scope of VAT exemptions, the current VAT threshold level, and the statutory value-added ratio applied to traders eligible for simplified taxation are examined.

Firstly, we analyze the effects of reducing the scope of exemptions on the revenue, the price level, and the redistribution of income using the numerical general equilibrium model of Gottfried and Wiegard(1991). Then, in order to determine whether the current VAT threshold level is optimal, we calibrate both Keen and Mintz(2004)'s simple model and Zee(2005)'s model with plausible parameter values. Lastly, we review the validity of the statutory value-added ratio applied to traders eligible for simplified taxation.

If the current exemptions were replaced by full taxation, the general equilibrium calculations show that there are increases in VAT revenues as follows: 1.4 trillion won in the case of unprocessed foodstuffs and agricultural products, 5.6 trillion won in goods and services supplied to all levels of governments, 1.1 trillion won in passenger transportation services, 0.8 trillion won in finance and insurance services, 4.7 trillion won in social welfare services including medical, health and education services. On the contrary, putting goods and services related to culture under full taxation reduces VAT revenues by 5.5 billion won.

Additionally the full taxation brings about only mild increases in price levels except the cases of unprocessed foodstuffs and agricultural products, and goods and services supplied to all levels of governments. And the negative redistribution effects are not serious except the case of basic life necessities and services. Since reducing the scope of exemptions generates large increases in VAT revenues with only small negative effects on price level and income distribution, it is desirable to narrow down the scope of exemptions.

According to the calibration results, the current VAT threshold level seems to be lower than the optimal level. Thus, we expect that increasing the current threshold level may contribute to the improvement of social welfare.

The statutory value-added ratios applied to traders eligible for simplified taxation do not reflect the actual value-added ratios. Thus it is necessary to classify the statutory industry-wide value-added ratios into more detailed level for more equitable taxation.

07-15

A Model of Long-term Healthcare Costs

John M. Kim and Woocheol Kim

We focus on two factors that have not been fully investigated in previous long-term forecasts of the National Health Insurance expenditures: a) the possibility that mortality rates may fall faster than had been previously assumed, hence resulting in different population projections, and b) the possibility that relative age-specific healthcare costs may not be as stable as had been implicitly assumed in many previous studies.

Qualitatively, our new population projection does not differ greatly from the National Statistics Office's(NSO) official projection (2006). Over the long-term, the total population was slightly larger in our study. The peak population was estimated to reach 49.7 million during 2020-2025, which is close to the 49.3 million in 2018 projected by the NSO. Our projection departs more significantly from the NSO's, however, after 2020 and reaches 44 million in 2050, which is 4% larger than the NSO's 42.3 million. We report a larger difference in the elderly ratio among the population; we estimate that the proportion of the population aged 65 and over among the total population will reach 41.16% in 2020, which is almost 8% higher than the 38.15% projected by the NSO.

In addition to investigating the ramifications of different population projection methodologies, we also undertake a systematic review of different approaches to estimating future healthcare costs. We first derive long-term healthcare cost projections using the standard method based primarily on a more or less stable elasticity of healthcare expenditure with respect to per

capita GDP levels. As an new alternative to this standard approach, we then introduce factor analysis as a method for predicting how the population's age-specific healthcare cost curve will change over time. The new approach yields healthcare cost projections that, in the extreme, can reach 13% of GDP as of 2050, which is markedly higher than the 6~7% predicted by GDP-elasticity-based methods.

Although our main results employ much more conservative baseline assumptions than this extreme prediction, our larger and more aged projected population leads to healthcare expenditure predictions that are about 10% higher than previous estimates. Long-term plans will need to take such possibilities into account.

A Study on Tax Compliance Costs in Korea

Hyunjun Kim and Myung-Ho Park

This study examines tax compliance costs in Korea based on a survey conducted by the Korea Institute of Public Policy. The survey attempts to measure the size and composition of compliance costs according to major tax items such as corporate and personal income taxes and a VAT.

First, this study introduces the concept of tax compliance costs and summarizes domestic and foreign literature on this field. Next this study presents estimates of compliance costs by tax items.

According to the results, the value-added tax compliance costs are estimated to be ranged of 0.43% by 29.72% for corporations and 3.61% by 9.19% for self-employees of value-added taxes by the size of turnover of companies. In particular, the ratio of compliance costs to taxes found to be decreasing in the amount of turnover. This implies that the value-added tax compliance costs are regressive. The average estimate of the value-added tax compliance costs per a company is about 22.7 million won for corporations and 6.0 million won for self-employees.

The corporate income tax compliance costs are estimated to be ranged of 0.80% by 42.96% of corporate taxes by the size of turnover of companies. When examined by turnover level, the corporate income tax compliance costs are also founded to be regressive. The average estimate of the corporate income tax compliance costs per a company is about 40.6 million won which is about 21.82% of average corporate taxes per a company.

In the case of the personal income tax, compliance costs are estimated to be ranged of 6.36% by 10.58% of personal income taxes by the size of

turnover of companies. As in VAT and corporate income tax compliance costs, the personal income tax compliance costs are found to be regressive. The average estimate of the personal income tax compliance costs for a company is about 3.1 million won that accounts for 20.17% of personal income taxes for self-employees.

08-01

Poverty Characteristics and Implications on Welfare Expenditure Programs Associated with Labor Supply

Myung Jae Sung, Shin-wook Kang and Chul-in Lee

This report analyzes short-run and long-run poverty characteristics based on life-time income flow, and proposes policy mixes to enhance the efficiency of fiscal welfare expenditure in association with labor supply. Long-run or life-long poor households consist of the households whose heads, as main income earners, are mostly retirees mainly because they are old. It is unlikely for them to increase supply labor to earn income and, so, successfully escape from poverty. It is also unlikely to expect to reduce the welfare expenditure to support the old households. Therefore, the policy targets for enhancing the fiscal efficiency are focused mostly on those who are able to supply labor.

Poor households can be divided into three groups: temporarily, continuously, and repetitively poor households. Based on the KLIPS (Korea Labor and Income Panel Study) data for the most recent eight years, their estimates are 67.0%, 15.5%, and 17.5%, respectively, among the households which experienced at least once for the above mentioned period.

Unconditional pecuniary subsidies more or less discourage labor supply due to moral hazard. We aim to minimize poverty dependence by differentiating poverty subsidizing tools in accordance with poverty characteristics.

Regarding unemployment insurance system, it is desired to reduce the

maximum length of cash benefits provided to the short-run poverty from six to four months, instead with higher benefit levels.

The National Basic Livelihood Security System (NBLSS) is known to discourage labor supply since it is not designed to correlate pecuniary subsidies with labor supply. It is not likely for the beneficiaries to increase labor supply to escape from poverty under the system.

It is recommended to minimize the moral hazard and, so, enhance the fiscal efficiency that the combination of the EITC and the NBLSS is desirable with the exclusion of those who are able to supply labor from the NBLSS, and that the maximum length of cash benefits under the NBLSS needs to be limited to five years during life-time, in principle.

08-02

Introduction of Inflation Indexation into Korean Tax System

Myung Jae Sung and Sangwon Park

This report aims to analyze the effects of inflation indexation on income and consumption taxes with specific components embedded in excise rate structure in Korea.

Simulation results show that inflation indexed income tax system yields a constant real income tax burden, unless the real income or the relative income distribution changes. This is because inflation indexation neutralizes nominal effects. To the contrary, the effective income tax burden under the actual tax laws has changed irregularly mainly due to the fact that recent arbitrary/discretionary income tax reforms have not successfully reflected the inflationary effects to the extent of changes in nominal values. In addition, the share of income tax payers whose income tax burdens are positive dwindles during the couple of decades. This means that income deduction level have increased more sharply than the nominal income increases.

These mean that actual income tax has failed incorporating inflationary effects and results in excessive or insufficient real tax burden. Rather, the discretionary tax reforms incorporate external/political considerations. Therefore, introduction of inflation indexation into income tax system is desirable to cope with the illusion in real income tax burden arising from inflation.

We also focus on tobacco and fuel oil related taxes with specific rate structure. Tobacco and fuel oil related excise duties are regarded as

Pigouvian taxes in economic sense which endogenize negative externalities from consumption. To achieve socially desirable equilibria, the tax amounts should be equated with the marginal social cost of consuming the goods. Since the nominal values of social costs tend to increase along with inflation in general, the desired tax rates should also increase as much as price changes (or inflation rates).

The various taxes on tobacco products increased drastically every four to five years, which distorted market activity and increased speculations about future tax burden. Furthermore, it is argued that the tax rate has not been determined by the economic rational but by the political power or government's financial needs. Thus, we can say that recent changes in excise rates on tobacco products are rather political outcomes and generate distortions on consumer behaviors.

Therefore, inflation indexation is recommended to recover the economic functions of excise duties on tobacco products as Pigouvian taxes. The inflation index can be CPI or nominal GDP growth rate. Both of them have own advantages. Specially, the latter is preferred in order to reflect the income effect in tobacco consumption.

Implementation of inflation indexation on fuel oil excise duties is recommended in the long run primarily due to the following conditions. Firstly, elastic excise rates can be applied within the range of 30% of basic excise rates under the current tax system. Therefore, contemporaneous changes in excise rates can be modified with elastic rates in line with the changes in general price level, especially in the short run. Secondly, desired and/or normative relative tax excise rates among gasoline, diesel and kerosene may change in the future. Thirdly, the international oil price has been volatile recently and, thus, we need to cope with the unusual movements in international oil prices to stabilize domestic oil prices. However, in the long run, the introduction of inflation indexation is desirable in order to keep the real tax burden consistent.

08-03

A Study on the Extent to which the Korean Tax Regime Equalizes Opportunities for Income Acquisition among Citizens

Kim, Woocheol and Lee, Woojin

For the last three decades or so, the economic success stories of Korea, and some other East Asian miracle countries, have been well documented and widely discussed among scholars and policy makers. Not much has been known about the extent to which opportunities for income acquisition are equalized in these countries among their citizens.

The current study aims at filling this gap by carrying out an empirical analysis for one of these miracle countries. Using Korea's micro-survey data, we examine how unequal opportunities are for income acquisition among its citizens, and calculate the extent to which Korea's tax-benefit policies correct those unequal opportunities.

There is a spectrum of views regarding what defines opportunities and what is required for equalizing opportunities. The present study adopts the conception of equal opportunity proposed by Roemer(1993, 1998). In Roemer's definition, equality of opportunity for a certain objective is achieved when the values of the objective equal for all those who exercised a 'comparable' degree of effort, regardless of their circumstances. The aim of Roemer's equal opportunity is not to hold persons accountable for characteristics which are due to their being in a disadvantaged type. Thus a policy equalizes opportunities if it makes the achievement of the objective of individuals be a function only of their efforts, not of their circumstances.

One advantage, among others, of the Roemer's approach is that it is a computable concept of equality of opportunity. Indeed Roemer et al.(2003) empirically examined, for eleven Western countries, the extent to which fiscal policies equalize opportunity for income acquisition among citizens. The present study employs the same method to Korean data and compares the main results with those reported in Roemer et al.(2003).

Inequality in income has many causes, and there is no a priori reason to believe that a country with a relatively low level of inequality of final outcomes will also have a relatively low degree of inequality of opportunities. A society may have a lower level of outcome inequality and a higher level of opportunity inequality than another if the former's reward scheme oppresses the variation in outcomes across effort levels while maintaining (or encouraging) the variation in outcomes due to differential circumstances, such as family backgrounds. In this study, we ask: To what extent does Korea's relatively equal distribution of income has been accompanied by equality of opportunities for incomes among its citizens?

Our empirical analysis uses the Korea Labor and Income Panel Studies(KLIPS), compiled by the Korea Labor Institute, during the period of 2001-2005. Our samples consist of individuals who are male heads of household 35-55 years old. To obtain stable estimates of various statistics, we construct four estimation periods by pooling samples of two consecutive years: 2001/02-2004/2005.

As in Roemer et al.(2003), we use two definitions of income: standard income (ST-income) and equivalence income (EQ-income).

To partition the samples into types based on circumstances, we use two different typologies of individuals: one (EDU typology) characterizes each individual by his parents' level of education (EDU_PA1, EDU_PA2, EDU_PA3) according to the level of education of the more highly educated parent (usually father in Korea) and the second (OCC typology) characterizes the individual by his father's occupation (OCC_PA1, OCC_PA2, OCC_PA3).

In our analysis, EDU_PA1 consists of those individuals whose parent (the more highly educated one) has schooling years less than or equal to 5, EDU_PA2 consists of those whose parent has primary and junior-high school

education (6-9 years of schooling), and EDU_PA3 consists of those whose parent's schooling years are greater than or equal to 10(high school and above). Regarding the occupation typology, OCC_PA1 consists of those individuals whose father is a simple manual worker, OCC_PA2 consists of those whose father is a farmer or a unskilled worker, and OCC_PA3 consists of those whose father is a skilled worker or a professional.

Our main findings are the following.

First, the EOP tax rates in Korea are quite comparable to those of Spain, Italy, the UK, and the US. Out of the eleven countries studied in Roemer et al.(2003), they are the four countries that have the highest EOP tax rates. Our analysis thus indicates that opportunities in Korea are as unequal as those in the four countries.

Second, the observed marginal tax rates in Korea are, however, significantly smaller than those in the four countries. This implies that Korean tax-benefit policies have played almost no role in correcting unequal opportunities for income acquisition among its citizens.

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| 08-04 |
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Government Debt Management in Korea

Korea Institute of Public Finance
Korea Legislation Research Institute
Korea Fixed Income Research Institute
The Korean Association for Governmental Accounting
Korea University, Konkuk University

In the first part, we tried in-depth analysis on various aspects of government debt management policy including policy objectives, coverage, institutional framework, strategy, risk management framework. We surveyed international standard and situation of major industrialized nations and our country, and tried to present policy directions on these issues.

Next, we address government debt level management from the macroscopic(macro) side of government debt management policy. This part covered current situation and problems, target level, mid-long term prospect and sustainability analysis of government debt. Also we set up a DSGE model and analyzed effect of government debt level on national economy.

In the third and final part of the book, we focused on the microscopic(micro) and institutional side of government debt management policy. We develop a stochastic simulation model for risk measurement and risk management of government debt. And we suggested some policy directions for development and maintenance of an efficient market for government securities and for the better legal system of government

debt and its management. Finally, we investigated government debt administration plan which prepares in conversion to accrual basis accounting standard.

08-05

Proposing a New Tax Policy on Collective Investments

Beom-Gyo Hong, Jae-Jin Kim, Jin Soo Kim and Byung Mok Jeon

Collective investments are relatively new type of investments, gaining momentum in recent years in Korea. Many factors such as deregulation and globalization of financial markets, introduction of new financial products including derivatives contributed to the increase of investments in funds. By relying on the expertise of fund managers, general investors can expect higher returns though they have to pay some kinds of fees in return.

Recent global financial crisis made general investors more cautious in their investments in funds. But still the changed financial environment will surely make the collective investments a major form of investments in the future. Korean tax authority have made an announcement to reform the tax system related with collective investments. The Financial Investment Services and Capital Market Act that is to be effective in February 2009 allows many new forms of collective investment vehicles. The proposal to reform the current tax law meets many demands for the changed environments. But it falls short of a complete reform due to the neutrality principle between direct investments and collective investments.

This study intends to make up for the shortfalls and tries to make the reform complete. That is to tax the capital gains from stock trading in collective investments. Because the current system excludes the gains from stock trading from the taxable income, it does not allow loss deduction either. That makes the current system very peculiar in the sense that though

the total return is negative due to the loss from stock trading, the investors have to pay taxes if they have any income in the form of interest or dividends. The distinction between direct investment and collective investment warrants the different tax treatments. If the distinction is not accepted universally, the introduction of capital gains tax in collective investments first can lead to the same tax treatment in direct investment, ultimately restoring the tax neutrality.

08-06

Study on the introduction of interest subsidy in government credit policies for tax-burden relief

Jiyoung Kim and Sangwon Park

In this study we examine the characteristics of direct loan, interest subsidy, on lending, and loan guarantee as government's support through financial market. A theoretical model is developed to analyze how each policy affect the resource allocation. It shows that interest subsidy is the most efficient way by generating bigger social welfare than any other policies. But when financial resources of government are fixed, the range of beneficiaries are the smallest under interest subsidy, which is the considerable shortcoming in terms of government goal. Comparison with respect to fiscal effect is also explored. The current government loan in Korea requires the large initial public resource and operating · managing cost is also relatively big.

We discuss the plausibility of the introduction of interest subsidy as an alternative way to the current governmental credit policies such as direct government loan and on lending. First, we examine government credit policies on housing market, small businesses, livestock industry loans and student loans. Secondly, preconditions for introducing interest subsidy are set down. Finally, we suggest that shift to interest subsidy should follow the next six principles: a phase-in and standardization of the new system, voluntary participation of operating agents, combination with loan guarantee, and establishment of coordinating body, protection of financial institutions' autonomy. Under these principles, it would be reasonable to start interest subsidy from the government programs where a scale is relatively small or

efficiency outweighs equity in the resource allocation.

08-07

A legal and economic study on the tax unit for income taxation

Byung Mok Jeon, Myung-Ho Park and Wan Souk Kim

This study performs a legal and economic analysis of the change in the personal income tax unit from the individual unit system into the marital unit system. It begins by examining the current system in terms of the consistency of the legal system. The individual unit system under the current income tax code is overall in accordance with the Constitution and the civil law. However, the fact that the current civil law does allow the rights of wife to claim on the division of matrimonial property on divorce implies that in the Korean Civil Code, there exists the concept of the community property system. This again implies that the current legal system may not be consistent in dealing with the two, property and income. Therefore, introducing elective marital income splitting may be worth considering as an alternative for improving the consistency of the current legal system.

Permitting married couples to split income for income tax purposes may provoke a variety of economic effects. According to our economic analyses, married women's labor force participation rate is estimated to fall since they will face higher marginal tax rate under the income splitting system. This causes to lower family income level but not substantially. In addition, tax revenue becomes smaller due to the reduction of tax base and the number of taxpayers with positive taxable

income. In order to maintain tax revenue neutral, it is necessary to raise the overall income tax rate. The higher overall tax rate exerts a positive impact on the income distribution, however, the magnitude is not meaningful.

In conclusion, the consistency of the legal system can be improved by adopting elective marital income splitting. However, its positive economic impacts are not substantial. Moreover, the fact that elective marital income splitting have an effect of lowering married women's labor force participation does not coincide with the government's policy goal, such as boosting potential economic growth by inducing higher married women's labor supply. After considering these aspects, we conclude that it is sensible to keep the current individual unit system.

08-08

A Study on Reforming the Direct-Indirect Tax Mix for Korea

Seung-Rae Kim, Hyungjun Kim and Chul-In Lee

Determining the mix of direct and indirect taxes is a fundamental issue in tax policy design. This study provides a new framework for evaluating the direction and magnitude of direct-indirect tax reforms in Korea. In discussing how the tax system affects economic performance, it is important to distinguish the efficiency and equity effects of taxes. Therefore we also focus on the relationship between efficiency and equity arguments for restructuring the Korean tax system.

First, we investigate current patterns of taxation and their recent trends in OECD countries. Then we review the theoretical models and some of empirical evidence regarding the consequences of changing the direct-indirect tax mix. Finally we evaluate various economic effects of changing the mix of direct personal income taxes, corporate income taxes, and consumption taxes in Korea.

The results imply that on efficiency grounds, Korea should rely on lower corporate income taxes and higher consumption taxes for additional revenue, while addressing rising equity concerns via progressive personal income taxes.

08-09

Assessment of Performance-based Budgeting in Korea and Policy Recommendations

No Wook Park et al.

This study is carried out to assess the current status of performance-based budgeting in Korea and to develop policy recommendations. In particular, it addresses the foundation of performance-based budgeting, which are performance information, cost information, and program structure. It examines two pillars of performance-based budgeting in Korea by examining the aforementioned three elements in the two systems: Performance Goal Management System designed for the purpose of monitoring and Self-Assessment of Budgetary Programs designed for periodic review.

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| 08-10 |
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Research on Establishing a Foundation of Gender-Sensitive Budgeting and Taxation in Korea

No Wook Park et al.

This study is carried out to lay out the foundation for gender sensitive budgeting and taxation. It consists of two parts: analysis on the government expenditure and the tax system from gender perspectives. In the part of taxation analysis, it identifies clauses of tax law which contain elements of gender-inequity and estimates the effects of changing them into gender equitable ones. For gender budgeting part, it discusses methodologies of analyzing government expenditure from gender perspectives. As a case study, it analyzes the national pension system from gender perspectives and provides policy recommendations.

08-11

Review and remaining issues of fiscal decentralization in Participatory Administration

Junghun Kim and Hyun-A Kim

There have been many changes in Participatory Administration such as the fiscal size of subcentral government and political & institutional reforms. This paper attempts to review these changes based on theoretical background and empirical findings. From the viewpoint of second generation of fiscal federalism, SCG fiscal expansion through intergovernmental transfer may not be desirable for efficiency and equity ground. Also, this paper provides empirical results that the population of Capital city, Seoul, may be the critical determinant of SCG fiscal expansion. This finding could be interpreted that political demand of Capital city causes fiscal decentralization.

08-12

A Study on Green Tax and Budget Reform in Korea

Seung-Rae Kim, Sangwon Park, and Hyungjun Kim

This study explores how the government should reform the tax and budget system to improve both the environment and economic welfare in Korea. It provides a comprehensive discussion of environmentally-related taxes such as taxes on energy products and motor vehicles in OECD countries and discusses the environmental and economic effects of applying these taxes. In particular, it focuses on how to design efficient tax and fiscal policies for environmentally sustainable development in the presence of other taxes, and on how to recycle the revenues raised by the environmentally-related taxes.

Since the taxation of energy in Korea has been earmarked mostly for transportation infrastructure and still allowed for tax reductions and exemptions for most energy-intensive sectors and industries, it undermines seriously the environmental effectiveness. For this reason, the earmarked "transportation-energy-environment tax" (which is subject to a 2009 clause) would need to be converted a general consumption tax so as to increase the allocative efficiency and the flexibility of government spendings.

Based on experience in OECD countries and the results in this study implies that Korea should shift more some of tax burdens from income to energy, while addressing properly their potential impact on international competitiveness and distributional concerns. To do this, the Korean government needs to consider further the full environmental costs and other

external costs in setting tax rates on energy, phasing out various exemptions and environmentally harmful subsidies, and introduce a carbon tax to curb CO₂ emissions in the near future.

Lastly, this study proved that there is potential government incentive to recycle the environmental tax revenue into environmental government expenditure, in order to extend political support without the economic consideration. Therefore, it is suggested the future revenue from environmental-related taxes should be used to enhance social welfare with thorough analysis on dead weight loss of other taxes and marginal benefit of government expenditure.

08-13

Recommendations for Tax and Fiscal Policies for Trade Liberalization

John M. Kim, Seung-Rae Kim, Wonik Son, Hoshin Song and Myunghun Lee

This study aims to provide clear policy directions for tax and fiscal measures that address issues arising from greater trade liberalization, and, in particular, the increasing presence of bilateral free trade agreements, or FTAs. Case studies of domestic and foreign tax and spending measures to ameliorate or compensate for friction or losses from trade liberalization show reveal that such measures can be classified into 3 categories, depending on the beneficiary groups: measures to compensate corporations, workers, or the farming sector.

Case studies of measures adopted by other governments show that compensation schemes that target corporations are actually both quite rare and meager, suggesting that Korea should also approach this category of policy measures with caution. Compensations for workers can possibly expand rapidly depending on later developments and can grow into heavy fiscal burdens. One cannot rule out the possibility that future spending to compensate workers may overrun the combined capacities of existing social security programs and new compensation measures for workers' losses from the expansion of free trade. Therefore the latter measures need to be designed so that their role is clearly differentiated from what social security programs are supposed to accomplish. Among the 3 policy categories, compensation of the farming sector clearly demands the most attention from policymakers. and this report provides estimates of the total size of

compensation to farmers, both at the time of a free trade agreement and for a gradually declining cost profile over the long run.

As for specific method of supporting farmers, case studies of other countries show that most governments have adopted policy measures to stabilize farming income, regardless of whether or not free trade has contributed to income volatility. Accordingly, we recommend that Korea should likewise substitute policies that target farming households for the current measures that compensate losses by farming product. However, it should be noted that such a reorientation can temporarily lead to considerably higher compensation for farming households initially, and therefore policymakers will need to take account of medium to long-term smoothing of fiscal resource allocation.

08-14

Fiscal Impact of Economic Integration of two Koreas

Joonook Choi

This report studies the fiscal impact of economic integration of two Koreas. There are several previous studies dealing with the fiscal issues regarding unification, but they share some common problems. This study tried to overcome the shortcomings of previous studies in two aspects. Instead of estimating unification costs for a relatively short period of time, this study examines how much fiscal policy should be adjusted to maintain fiscal sustainability in the long run. Furthermore, this study carries out a variety of sensitivity analysis, to accommodate big uncertainty in the economic variables and policies in the course of integration.

The type of integration analysed in this study is rapid, in that no artificial restrictions are imposed on labor mobility. However, it is less rapid than in Germany, in that we do not assume rapid integration of social systems. The fiscal outcome under such scenario is not very pessimistic. Fiscal sustainability can be maintained only with a moderate increase in taxes, if the productivity in the North Korean region rises to 80-90% of that in South Korean region in the next 50-60 years after the integration.

Tax and Fiscal Policy and the Labor Supply of the Elderly

Jonghak Weon, John M. Kim, Byung-Hill Jun and Suk Jin Woo

This study analyzes the implications of population aging on the Korean economy. Specifically, we focus on the salient features of population aging, patterns in the labor supply of the elderly, pension reforms and their effect on elderly labor supply, and the effect that changes in elderly labor can have on tax and fiscal policies.

We review the progress of population aging in Korea and policy responses to aging among developed countries. The results can be summarized as follows: a) labor force participation among the elderly is higher in Korea than the OECD average; b) the willingness to work beyond age 60 was high among both genders; and c) OECD countries with more advanced aging than Korea pursue a policy of "active ageing", which aims to stimulate the economic activity of their elderly populations. The high labor force participation among elderly Koreans is explained partially by the fact that a relatively larger proportion were self-employed or were proprietors, plus the fact that social institutions to provide or supplement elderly income, e.g., pensions, are not fully developed as in other developed countries. Nevertheless, we find that elderly labor force participation still remains high even after allowing for such factors.

The third chapter attempts an empirical investigation of how explicit and implicit taxes on private pensions affect the labor supply of the elderly. Our results suggest some implications for tax and fiscal policy as they relate to

pensions. Specifically, we find that one additional year of age among the elderly has the effect of reducing labor force participation by 3.1 to 3.5%. Furthermore, contrary to a priori expectations, household assets did not influence the retirement decisions with any statistical significance. In contrast, public pensions, including the National Pension and Special Occupational Pensions, were found to have a statistically significant strong negative relationship with labor force participation.

The fourth chapter analyzes the tax and fiscal implications of changing elderly labor supply induced by pension reforms. We postulate that there can be large long-term effects on tax revenues and social expenditures, following changes in the income stream of the elderly, which in turn arise from changes in their retirement decisions as a result of pension reform. Our analysis was limited by data availability to changes in tax revenues at a single point in time (2030), rather than the full effect over the remaining lifetime. The specific case we analyzed was a pension reform that would lower the income replacement rate from 60% to 40%, similarly to the reform that was implemented recently. Despite this limitation, we found that the reform could result in a tax revenue increase that amounts to 1.5% of GDP. We conclude that pension reforms need to consider the full effect on areas beyond the sustainability of pensions per se, such as additional significant benefits on income tax revenue and welfare spending.

A Study on Local Share Tax Allocation Method

Jongseok An

This study examines the problems that the allocation method of Local Share Tax (LST) in Korea has and investigates the way to improve it.

LST is a general grant in Korea provided by the central government to local authorities. The central government estimates fiscal need amounts and fiscal resource amounts of local authorities and allocate the LST to local authorities in proportion to the difference between the fiscal need amount and the fiscal resource amount of each local authority. If the fiscal resource amount of a local authority is equal to or greater than the fiscal need amount, the authority wouldn't get LST.

It has been said that the allocation method of LST has several important problems: it is very complicated; fiscal resource amounts are estimated based on real tax and non-tax revenue having negative effects on revenue raising efforts of local authorities; and fiscal need amounts are estimated through unnecessarily complicated procedures.

This study provides several suggestions to improve the allocation method. First, it suggests the separation of LST into three components: a component to correct vertical imbalance of fiscal resources; a component to correct horizontal inequity of fiscal resources; and a component to compensate the cost differences. Second, it also suggests that the fiscal resource amount of each local authority should be estimated by multiplying tax bases of each locality with the representative tax rates. Lastly, it shows the way to simplify, clarify, and rationalize the estimation procedures for fiscal need amounts.

The List of Publications(2006~2008)

Issue Papers

A Study on Sustainability of Government Debt

Seong-Lin Na, Kibaek Park and Hyung-soo Park

The aim of this paper is to find out some reliable empirical evidences for the controversy of the sustainability of government debt. In doing so, we need to reconsider the definition of government debt. This is because most debates on the sustainability of government debt in Korea center around the scope of government debt.

Once we have agreed on the scope of government debt, we then need to find out if it is sustainable. There are various means of testing the sustainability of government debt. This paper uses Bohn's test, Tax Gap test, IGDC(International Government Debt Comparisons) Index. The main result of these tests is that, based on the IMF definition, the government debt in Korea is sustainable in short or medium term, but may not sustainable in the long term.

Proposals for simplifying the tax law

Wan Souk Kim

The current tax law is said to be excessively complicated while being hard to understand. There is a need for the tax law to be simple for taxpayers as well as the Internal Revenue Service. A tax law that is easy to understand guarantees legal stability and predictability in taxpayers' economic activities. Since taxes have a close relationship to people's every economic activity, no decision can be made regarding economic activities without the consideration of the tax effect. Moreover, a comprehensible tax law increases the level of voluntary compliance while clearly decreasing the compliance cost of the taxpayers and the administration cost of the Internal Revenue Service. Therefore, the significance of the tax law rewrite project is indisputable.

The reasons for the difficulty of the tax law may be found in the fact that substantial contents of the tax law are complicated and incomprehensible or in problems related to the form or system of the tax law.

This study aimed at presenting a practical scheme for simplifying the complex and difficult tax law of today. Specifically this study analyzed problems such as the complexity of the legal system, the repetition of the provisions, lack of uniformity of the legal provisions and consistency of legal structure, disorder of tax law establishment, the ambiguity and abstruseness of the legal provisions and the expressions therein, and presented improvement schemes as solutions to the problems.

Nevertheless, the improvement of the form and the system itself has a limitation for improvement into an easier tax law system. Hence, there

should be an effort to simplify the complexity of substantial contents of the tax law within the limit of not causing too much damage to the equality of taxation and the purpose of national policies to be accomplished through the tax law. Moreover, a scheme to unify excessively numerous taxes as well as to absorb taxes for special purpose into general taxes shall be examined together.

In order to revise the tax law to be more comprehensible, a project team to execute the revision of the tax law as well as a consulting committee should be established, and the project team should perform long-term tasks with sufficient financial supports. In other words, since the revision of the tax law is based on the revision of the tax law system and the process of rewriting the tax law, the project team composed of professionals such as policy makers, tax officials, professors in tax law, public finance and accounting specialists, lawyers and certified public accountants, certified tax accountants and other relevant experts shall take charge of the revision.

Policy Directions for Expanding Tax Base

Joosung Jun

This report examines the main characteristics of Korea's tax system and suggests policy directions for expanding the tax base. The optimal size of the government finance is determined by the social benefits and costs of public service. The social costs of public service should include various tax costs in addition to tax payments. Reducing such costs will be the first step in expanding the tax base. Reducing tax evasion and tax resistance is another important task since in Korea, tax information is not adequate, the benefit principle of taxation is weakly implemented, and horizontal tax equity is questionable. Providing better financial service, promoting exchange of tax information among related authorities, and linking tax and spending based on economic rationality are among suggested measures. In the face of increasing capital mobility, more attention should be paid to the inefficiencies of capital taxation. While corporate tax will face downward pressure, the rent-characteristics of corporate profits need to be explored before undertaking a major rate cut for the corporate income tax.

The Effects of Introducing Inflation Indexed Income Tax

An, Chong-Bum and Lee, sang-don

This research attempts to suggest a new income tax system which adjusts the income tax scheme to inflation. Based on the previous studies the effects of inflation indexed tax system and experiences of major countries having the system, we investigate various indexation methods to find the most suitable one for the Korean income tax system.

Using data set of "Urban Household Survey" from 1982 to 2005, we compare the computed results of total tax revenue, social welfare and progressivity according to the various indexation methods. As a result, most indexation methods induce a decrease of the total tax revenue, an increase of the social welfare and a fall of the progressivity. Based on such the results, we suggest a best policy measure for the indexation of income tax of Korea.

A Study on Private Donation of Korea

Wonik Son and Tae-Kyu Park

This study analyzes the motivation of private donation and the effect of tax policy on private donation. It is known that the individual donation is seriously affected by cultural and societal factors of the society. The analysis on the individual donation of Korea shows that the tax policy affects the decision of individual donation. The evidence of the effectiveness of tax policy on individual donation is shown that the total amount of donation has been increased as the tax allowances for donation in social welfare area was increased.

The most important factor to blossom the culture of individual donation is not only the total amount of donation, but also the number of donation for each individual. In other words, how often each individual donates is the key index to measure the level of donation in a society. Another important finding of the previous study is that the experience of volunteer work is deeply related to the number of individual's donation and the amount of donation. The study shows that individuals who have more experiences of volunteer work tend to donate more often and more amounts.

The following policy propositions are made to boost individuals' donation in Korea;

- (1) increase tax incentives for individuals' donation
- (2) enhance the transparency of charitable organizations
- (3) induce more active volunteer work to blossom the culture of individual donation

An empirical study is conducted to examines the results derived from the theoretical analysis. The finding of the analysis is that the tax rate can affect the decision of corporate donation even in the frame of profit-maximizing

model as long as a part of donation is not deducted due to the limit of tax deduction. This finding implies that the motivation of corporate donation changes according to the corporation's situation which is affected by the amount of tax deduction available and the amount of marginal donation. We may derive the following tax policy implications regarding the corporate donation from the findings of the empirical analysis; the expected effects of tax policy changes should be calculated by incorporating the relationship between the amount of the marginal donation and the limit of tax deduction for each individual corporation.

Fiscal Decentralization and the Restructuring of the General Grant System of Korea

Jhungsoo Park

Roh Moo-hyun Government's fiscal decentralization policy has been evaluated as half success in the restricted range of local finance's transparency, autonomy, and soundness perspectives. However, in the efficiency and accountability principle perspectives, it has been evaluated rather that insignificant progress has been achieved, in fact. There were huge gap between original policy orientation and idea in formal stance and the real performance achieved in reality. His government were heading to truly localization in real sense, however, in essence, fundamental accountability problem has not been seriously tackled in the intergovernmental fiscal relations.

This research focused on the pivotal role of the general grant system(local transfer tax) in the paradigm shift in local fiscal decentralization. We still have the ratio of local tax and national tax as 2 to 8. And we still have low level of tax autonomy in local government. Therefore the impact of the policy change of the general grant system is quite significant. If we assume the functional distribution between national and local governments is relevant, we can drive the relevant ratio between the self fiscal resources and transfers from the national government. The restructuring of the general grant system for the efficiency purpose and it could link the benefit and cost of the region. The scheme would be changed from filling out the lacking portion(standardized demand - standardized revenue) to guarantee the national minimum cost. Further expenditure for the projects and the investment should be mobilized from the regional residents and industry, such as local tax and non tax revenues. This transformation to the

equalization fund for the national minimum guarantee could neutralize the strategic behavior of local governments and the simple and the expectable from the local governments' view, formula based distribution of the fund would enhance the transparency and efficiency of the intergovernmental fiscal relations in Korea.

Market Economy and Government Budget -Constitutional Discourses-

Kwang Choi

Every country has its Constitution. The Constitution is the supreme law of the nation which entails national identity and principles of government. The Constitution of Korea was promulgated in 1948 and since then amended nine times. The major purpose of this book is to make suggestions for amending economy-related and budget-related articles of the Constitution. Many believe that some of the economy-related articles of Korea's Constitution are anti-market and budget-related articles are more or less procedural in nature rather than substantial.

This book consists of three parts. The first part, which covers Chapters I through IV, is an introduction to fundamental issues necessary for discussing amendment of economy-related and budget-related articles of the Constitution.

Chapter II deals with the issue of why we should pursue big market and small government instead of big government and small market. To begin with, we raise some conceptual questions such as what is government?, why does government exist?, what roles does the government play?, and what are ideological arguments for and against the big government?, and provide answers to the questions raised.

Historical data show that big government is a quiet recent phenomenon. In most advanced countries the government expenditures as a percent of GDP was about 10% in 1870s and reached 20% in 1960s. 1980s and 1990s saw a dramatic increase in the share of government expenditure to 40-50%. The book sides with the big market-small government argument by examining why government fails, why politicians and bureaucrats make

matter worse, and why government continues to grow.

Chapter III and Chapter IV explain the nature of capitalistic free market economy and interactions between market and politics, respectively. Chapter III starts with the discussion of what the capitalistic free market is and thereafter explains some fundamental issues such as importance of private property right and freedom to choose, rules of games, and strength and weakness of the market economy. Furthermore Chapter III discusses current crises of the world and Korean economy. Based on the theory of public choice, Chapter IV discusses the nature of two decision making processes(market and non-market) and interaction of two decision making processes(democracy and market) and shows how non-market[political] decision making process leads to inefficient allocation of resources.

Topics of part two and three of the book are Constitution and the economy and Constitution and national budget(public finance), which are covered in Chapters V and VI, respectively.

In the Constitution of Korea there are nine economy-related articles from Article 119 to Article 127 under the caption of 'Chapter 9 Economy'. Needless to say these nine articles are not all the articles related to the economy. Articles concerning private property right and human right have something to do with the functioning of the economy. The very first draft of the Constitution shows that Korea was oriented more or less toward the socialistic command economy rather than the capitalistic free market. Under the amendment of the Constitution after the Military Revolution in 1962 Korea changed from the command-oriented economy to the free market-oriented economy.

Nevertheless there are still command, regulation, and intervention elements in the economy-related articles of the Constitution. Based on the discussions of Chapters II to IV, Chapter V gives diagnosis of the current Constitution's economy-related articles and suggests how to amend them.

Though there were amendments to the Constitution nine times in Korea since her independence, there were no revisions or changes in budget-related articles. One major failure of Korean Constitution is that Constitutional articles related to government finance have no substance but have only

budgetary procedures in the Constitution. No active discussions and researches were made to fill up the deficiency in fiscal Constitution.

The Chapter VI reviews first historical development of Korean Constitution and major contents of fiscal Constitution of five countries[USA, Germany, France, Switzerland] and then makes suggestions for the future amendments to fiscal clauses of the Constitution. In making suggestions much attention was focused on how to minimize government intervention in activities of the private sector, how to lessen tax and quasi-tax burden, how to maintain check and balance between legislative and administrative bodies, and how to increase fiscal transparency.

Specific suggestions were made with regard to the issues such as adoption of an independent chapter for fiscal Constitution, explicit introduction of consolidated budget in the Constitution, more fiscal transparency and accountability, budget act for expenditures and revenues, establishment of the fiscal-tax court, independence of national audit office, and adoption of overall fiscal rules.

In an appendix the book examines the structural flaws and operational shortcomings of the recently implemented National Finance Act, designed to serve as the foundation for national fiscal management. This book was written with conviction that Korea's economic prosperity can be achieved only by adapting the small government-big market philosophy. The contribution of this book is twofold. First, it provides a fresh and fundamental insight with which to view economic and fiscal policies. Second, the book provides specific suggestions for amending economy-related articles and budget-related articles of the Korean Constitution. The book reexamines the fundamental aspects of major economic and fiscal issues Korea now faces from the historical perspective imbued with small government-big market philosophy. As such, this book will be a valuable reference to those in political, academic, and business arenas interested in economic and fiscal policy issues.

Analysis of Korean Tariff Structure within a Computable General Equilibrium Simulation

Jaeho Cheung

Since 1984, Korea maintains 8% tariff rate on most of its final output. Using Computable General Equilibrium (CGE) model, this study proposes that Korea maintains current tariff structure now and after conclusion of DDA negotiation, even if the rates of tariff are lowered after conclusion of DDA negotiation.

Using CGE model, this study calculates the optimal tariff structures that maximizes the representative consumer's utility under some political constraints. The result of calculation shows that the tariff structure should be significantly changed if Korean government accepts the theoretically optimal tariff structures. However, the gain from such optimization is almost negligible from the practical view. Also, when Korea adopts an uniform tariff rate system, the gain from the uniform tariff rate system is negligible.

It implies that an attempt for major changes in the current tariff structure brings on small welfare gains which could not cover the political and administrative costs.

Tax-benefit Microsimulation Model: KIPFSIM08

Myung Jae Sung, Byung Mok Jeon and Byung-Hill Jun

To achieve policy goals more effectively under rapidly changing economic circumstances, analyzing the effect of tax and fiscal policy becomes more important. Proper analysis improves the effectiveness and efficiency of government policies by examining the economic outcome of a proposed policy in advance. Many countries including Australia, the United Kingdom, and the United States use systematic micro tax-benefit model to meet policy demands. Korea also relies on simple micro and macro analytic tools in evaluating policies but limitations in current approaches make it difficult to satisfy the needs.

We try to establish a microsimulation model to enable more precise policy analysis. To this purpose, this report introduces the first-year microsimulation model, which is named KIPFSIM08, and includes an example for policy analysis using KIPFSIM08. Areas in KIPFSIM08 include income · consumption · property tax, social contributions, and public transfers.

We illustrate the use of KIPFSIM08 to show its practicality and effectiveness by investigating the effect of a hypothetical scenario on households income distributions. Our findings are as follows: firstly, benefit of income tax cut is largely concentrated on high taxpayers so income inequality measured by the Gini coefficient, gets worse; secondly, changes in consumption tax, which involves increase in consumption tax on cars, environment tax, and cigarette tax, do not affect largely the ratio of amount of taxes and income distributions; and, thirdly proportional increase in public income transfers improves income inequality.

KIPFSIM08 is an outcome at the first-year stage of long-term developing process of a microsimulation model, which provides a starting point to

construct foundations for consistent analysis on tax and fiscal policy. KIPFSIM08 has some limitations. KIPFSIM08 does not consider possible behavioral changes of agents when economic environments vary. In this sense, the current model remains at a primitive stage as a tax calculator. Also, KIPFSIM08 has other issues in raw data. Over the next a few years, we plan to develop KIPFSIM by remedying aforementioned shortcomings.

Development of Tax Attitude Index: Public Opinion Survey in Korea

Myung-Ho Park, Bonggeun Kim and Kim, Chung Kweon

There has been widespread concern that the fiscal soundness in Korea may be weakened not only by the growing need for government spending, but also by the reduction in tax revenues due to economic downturn. Facing these difficulties, the Korean government has made efforts towards restructuring existing tax policies in order to secure fiscal soundness and to diversify tax revenue sources.

Given the expectation of unfavorable future fiscal conditions and also the fact that the existing tax system works based on self-reporting, enhancing voluntary compliance by taxpayers seems to become ever more important. The reduction of the gap between potential tax revenues and self-reported tax liabilities through the improvement of tax compliance is the most feasible alternative in solving the ongoing fiscal difficulties.

While it is well known that voluntary tax compliance behaviors are based on taxpayers' tax attitudes, there is not much systematic research on such attitudes. Therefore, instead of simply speculating upon whether or not the Korean population has a desirable tax attitude, there is a clear need to pursue more formal empirical research. As tax attitudes are resistant to improvement in the short run, it is important to continuously and systematically monitor and investigate the changes in tax attitude.

Tax attitude can be defined as the taxpayer's comprehensive awareness of and social values concerning taxation as a whole. The purpose of this report is first to measure the individual index numbers for tax understanding, tax fairness, willingness to comply, and tax compliance behavior, and second to generate a comprehensive tax attitude index

summarizing these indices. The tax understanding index is a combination of the perceived personal understanding of various tax items in addition to the actual understanding of real tax numbers such as value added taxes. The tax fairness index is also a combined index which consists of a self-evaluation of the current tax system in terms of the perceived fairness of one's own tax payment based on personal income level, paired with the fairness of government services in exchange for tax payments. The willingness to comply represents both active compliance in terms of civil responsibility and passive compliance through avoidance of the penalty threat of tax evasion. The tax compliance behavior index consists of the hypothetical tax compliance behavior and the real tax compliance behavior.

In order to systematically measure the tax attitude level of Korean taxpayers, this report has designed the survey questionnaires with four sections, consisting of tax understanding, tax compliance, tax fairness, and demographic variables, each in turn. The survey was conducted in May 2008 from a randomly selected pool of 2,399 taxpayers aged 25 to 64 from sixteen different provinces, using telephone, fax, or e-mail. In order to strengthen the generalizability of the research, different sample numbers were assigned to various subgroups classified by employment status, region, age group, and gender in proportion to their respective population distributions based on the 2005 population census data provided by the National Statistical Office.

Our report focuses on two issues: One is a measurement of the tax attitude index for Korean taxpayers; another issue is the measurement of changes in the tax attitude index triggered by changes in tax policies and tax administration services, as well as changes in other extraneous variables. Using the survey data, the report measures the individual indices for tax understanding, tax fairness, willingness to comply, and tax compliance behavior (both real and hypothetical), and also measures the comprehensive tax attitude index representing other indices. In order to determine the appropriate direction of future tax policy for enhancing tax attitudes and tax compliance behaviors, we also analyze the tax compliance model which considers the casual relation of the real tax compliance behaviors with willingness to comply, tax understanding, perceived fairness, and other

extraneous variables.

According to the data analysis, after having controlled the effects of other extraneous variables such as employment conditions and income levels, a taxpayer's willingness to comply has been found to be the most influential factor upon his/her tax compliance decisions, regardless of whether this willingness is a result of the active acceptance of tax responsibility or the passive avoidance of penalty. The effect of such willingness is relatively larger in hypothetical tax compliance situations (hereafter, hypothetical cases) than in real tax compliance situations (hereafter, real cases). We speculate that the willingness to comply is especially important in the hypothetical case as the effect of willingness can be undermined by other extraneous variables in real cases. On the other hand, in opposition to our prior expectation, tax understanding has a negative effect on compliance in the real case. This result may imply that a better understanding of the tax system induces taxpayers to commit more tax evasion.

The survey data shows that the Korean taxpayers' average tax attitude index is 78.4 points in a 100-point scale, and that income and education level are negatively related to the tax attitude index. The data also shows that the self-employed group tends to show a lower tax attitude index. The value of this report is to provide a long-term basis for evaluating the effect of tax policies on tax compliance as long as future follow-up studies continue to monitor the annual tax attitude indices by adopting the basic research methodology we have already used in this study.

About KIPF

About KIPF

- ① The institute conducting specialized research on all aspects of taxation and public finance.
 - KIPF is a specialized research institute supporting the development and formulation of tax and fiscal systems and policies through systematic research and scientific investigation.

- ② Formulating important policies through our highly capable research staff.
 - Our team of economic experts at KIPF strive to make more effective and responsive tax and fiscal policies.

- ③ Striving to make a better society for everyone.
 - We at KIPF do our best to enhance the equity and efficiency of tax and fiscal systems.
 - We strive to raise living standards and make Korea a better society.

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