

Introduction of the "Real-Name Financial Dealing System": Its Effects and Promotion

SUNG, BAIK-KWAN

Vice President, Korean French Banking Corp.

I. Situational Changes and Incidental Problems

With the aims of normalizing financial transactions, establishing a fair economic system by raising equity of tax burdens as well as contributing to a balanced development of economic community, the government on July 1989, decided to carry out preparations for the implementation of a real-name financial dealing system and a global taxation system for incomes from financial assets, effective 1, 1991.

The Ministry of Finance, in a statement setting forth the basic direction of the future tax system management, harshly criticized the growth-oriented economic policy of the past by saying, "economic policy is losing fairness through the proliferation of unearned incomes and special favors, and as a result, public confidence about the legitimacy of wealth is declining." The tax system had been managed heavily in favor of supporting economic growth and development rather than realizing the equity of tax burdens, by increasing the tax reduction and exemption ranges in the strategic growth sector and by imposing preferential levies on income from properties designed to mobilize investment sources.

Making the matter worse is the existence of uninscribed and pseudonymous deposits. Under the circumstances, financial institutions are forced to protect their secrets in order to meet the nation's need to secure financial resources for economic development. In other words, financial institutions have been performing the negative function of rationalizing underground economy. These pseudonymous deposits have become breeding grounds for high interest curb loan sources, and irregular inheritances and gifts. Such practices naturally further deepen financial distortion.

As a result, the need for a large-scale revamping of the tax system has come to be raised. Namely, the government has come to conceive a reformist thinking,

calling for the revising of the tax system in line with the advent of the era of democratization.

Legislation concerning a real-name financial dealing system (Law 3609) was promulgated on December 31, 1982. But it was decided that supplementary provisions would be implemented at a date to be fixed by a presidential order after January 1, 1986, taking into consideration the progress of their administrative preparations including computerization, and economic circumstances.

Entering 1989, however, the Korean economy began to show signs of difficulty. Under the circumstances, the introduction of a real-name financial dealing system was thought to entail enormous adverse effects. Therefore, the government finally decided to shelve the 1989 decision to introduce a real name financial system. In fact, the suspension was regarded as part of a plan to revitalize the economy.

Progress is possible when a society fosters self-transaction capability through the improvement of its leadership. If the government lacks the will to actively seek solution of the problems in spite of the fact that there are structural difficulties, the government will lose confidence of the general public. The frequent changes of government policy gave the people psychological instability and no vision for the future.

It is a widely known fact that under the current system, differentiated tax rates are applied to interest incomes accrued from real-name and pseudonymous deposits. As far as the interest incomes resulting from real-name deposits are concerned, the government withholding rate comes to 52.0% (from January 1, 1989).

Pseudonymous depositors pay a penalty-like tax of a high 31.25%, compared with real-name deposits. But the essence of the problem is to understand why they are willing to risk such a heavy penalty.

Classification of pseudonymous deposits by their specific characters

It is money whose use and whereabouts are secret. It is presumed that such fund is usually used for real estate speculations, political funds, lobbying efforts, bribing or high-interest private loaning, irregular inheritance and gift sources etc. If the real identities of depositors of such unethical money are made known, and sources of deposit money are tracked down, the depositors involved may face a danger of being subjected to investigations for possible tax evasions or criminal charges. It is, therefore, important that identities of depositors must be kept secret, so that their recipients can also be protected and feel safe.

During the authoritarian regimes in the past, pseudonymous deposit accounts were "legally recognized" on the pretext of maximizing domestic capital formation by increasing savings. This is why up until today a real-name dealing system is being resisted.

At any rate, the reality is that the attempt to initiate a real-name dealing system has been suspended and is disappearing into a swamp of oblivion. But in view of the importance of the issue, the need for, and the inevitability of, the introduction of the system should not, but be discussed. In analyzing the negative as well as positive aspects of the system, we will attempt here to suggest ways of promoting the system.

II. Needs for the Active introduction of a Real-Name Financial Dealing system

Let's then review the needs for active introduction of a real-name dealing system from the perspectives of a rational system of taxation needed in the process of economic development.

1. Inequality of income distribution as a factor hampering economic development

a) Traditional Views

There were claims in the past that inequality of income distribution was absolutely needed for sustained economic development. The claims were based on the theory that incomes of the high income bracket usually go for savings, that will lead to reinvestment, while those of the low-income bracket are usually earmarked for spending. Hence, the greater the income gap becomes, the higher the savings go up, stimulating the growth rate, the theory goes. As a consequence, the inequality of income distribution will increase national income or per capita income, and this increased incomes in turn, by way of taxation or transfer expenditures, will be ultimately redistributed more equitably. Until then, any artificial efforts aimed at income redistribution would only harm economic growth.

b) Perceptual Changes

In recent day, however, there emerge views disputing such claims on the ground that the above-mentioned arguments are far from the reality prevailing in developing countries. These views hold that an equitable income distribution is a prerequisite for sustained economic growth.

Increased incomes and improved welfare for the people of the low-income class are important elements boosting a nation's productivity and growth rates. These elements also stimulate domestic demands, bring about increased employment and investment, and make the people of the low-income class active participants in the process of economic development.

2. Rational Taxation System as means of Promoting Economic Growth

a) Problems of income tax system related to current financial assets

On the basis of the 1988 budget, the share of income taxes was about 12% in the total taxes of 18,429.1 billion won. The value of income taxes amounted to 2,217.2 billion won, large in size after value-added taxes and defense taxes.

The actual tax collection record shows that the amount of income taxes collected came to 2,964.1 billion won, of which the share of withholding taxes was 1,979.9 billion won or 66.8%, while that of the tax returns filed came to 984.2 billion won. This means that income taxes were excessively collected by 30.5% or 629.9 billion won over the planned collection target.

Taxes can be levied only on those items enumerated. And all incomes (interest, dividends, real estates, business, wages, forest, others) must all be added up, and their global tax amounts calculated. This method, however, exists only as a principle. In actual practices, not only interest incomes and parts of dividend incomes, but also incomes from daily labor are subjected to schedular levies in accordance with special tax rates. Thus, by adopting the schedular income tax system, Korea withholds 66.8% of income taxes, amounting to about two trillion won in value. Korea's tax system, devoid of the benefits of a global income tax system, thus can be called a "limping tax system."

The absence of a global income tax system prevents Korea from promoting the principle of equity, a core task of income taxes.

The schedular income tax system in theory has an advantage of applying different taxation methods in accordance with the nature of incomes. For example, a low tax rate can be applied to wage incomes, while a high rate can be applied to incomes from financial assets, such as interest, dividends, rents, etc. In practice, however, the schedular tax system is not managed that way. Capital gains from stock transactions are also exempt from income tax levies, because they are not listed as a tax item. This is a serious shortcoming, which the tax item enumerating system has.

b) Inevitability of tax system reform

As stated before, Korea's personal income tax is centered on wage income tax in terms of structure. As a result, wage incomes are subjected to a high progressive rate of the global tax. Wage earners, therefore, have to assume heavier tax burdens, compared with earners of financial assets profits. The income tax system, therefore, is horizontally inequitable, while the capital earnings tax is vertically inequitable, as capital earnings mostly belong to high income earners.

The individual income tax system can be revamped by broadening the tax base inclusive of various taxable incomes and by reducing nominal tax rates at the same time.

By abolishing various non-taxable items currently in existence, the tax base can be broadened, and thus, at the same time, the taxation system can be simplified. A high nominal tax rate is undesirable, because it becomes an important factor causing the so-called "erosion of taxation" which gradually reduce the tax assessment base through multiplication of tax reductions and exemptions. Hence, the personal income tax system should be revised to be a global system based on a progressive rate so that it can be adequate to secure a horizontal and vertical equity of taxation and satisfy the anticipated expansion of fiscal demands for social welfare.

III. Negative Effect of the Real-Name Dealing System

1. Current Status of The Real-Name Dealing System

As of the end of December, 1988, the share of money transacted under real names in the balance of total deposits of 98,709.2 billion won registered with financial institutions across the nation was 97.44% or 96,186.3 billion won while that of the money transacted under pseudonymous names recorded 2.56% or 2,522.9 billion won (the balance excluded insurance, pension, bonds, etc.).

Statistics published by Korea Investment Financial Association (Short-term Financing Cys + merchant banks) shows that as of the end of June, 1989, the share of the money transacted under real-names in its total receipts of 18,403.4 billion won was 98.54%, while that of the money dealt under pseudonymous names recorded 1.46% or 268.66 billion won.

Considering that the share of deposits made under real names in total deposits was more than 97%, it is inconceivable that depositors put their money into their bank accounts without knowing at all the moves to impose a global tax on incomes from interest. The high ratio of real-name deposits must, therefore, be attributed to perceptual changes regarding the real-name financial dealing system.

2. Analysis of Negative Effects of a Real-Name Dealing System

Those who oppose the real-name dealing system generally base their argument on the grounds that this system distorts the flow of money and damages the desire for investment

a) A real-name dealing system Evading funds escaping into Underground Economy

The expansion of a hidden, organized markets called the underground economy, which fraudulently obtain high earnings by evading taxes, is one of the worries afflicting today's capitalist countries. Underground economy, in the cases

of the United States, Italy and India, accounts for 10 to 33.5% of the GNP, 30% and about 50%, respectively, while in the case of Korea, it is supposed to be 20 to 30% of the GNP (according to daily Chosun Ilbo survey).

Estimating that it is 20% of the GNP, its monetary values amount to 24,715.8 billion won at 1988 prices. This is an enormous scale. But no country will know the exact scale of underground economy, because its monetary figures escape taxation. Hence, we can only guess. It is illogical to say that taxation on real-name deposits will help create an exodus of the money from financial institutions.

Considering that curb market volume reached 25% of the average amount of currency in circulation on the basis of adjusted curb loan of 350 billion won reported on August 3, 1972, we may assume the volume of curb market to be about 11,930 billion won as of the end of 1988 when the average balance of currency in circulation amounted to 47,720.7 billion won (although the circumstances of then and now are different). Knowing the nature of high-risk curb market, how many good-willed real name depositors are willing to risk their fortunes by venturing into the market, just to avoid tax burdens? Hence, to assume that taxation on real-name deposits will cause the depositors to withdraw their money from financial institutions and indulge them with curb market is simply groundless fears.

The way to stem the flourishing of the underground market is to institutionalize real-name deposit system in order to expose sources of unethically acquired money.

Besides, the assertion that taxation on real-name deposits will drain institutional deposits and cause the flight of money into underground economy is illogical because even the money illicitly transacted can not be kept to circulate in cash wholly without going through financial institutions, due to high risks.

b) The funds tend to turn into speculative ventures such as real-estate speculation

A study of the recent skyrocketing prices of real estate from the perspectives of the money flow reveals the following points:

(a) Construction Companies spent over two trillion won to purchase land in Poondang and about 850 billion won in Ilsan to build the areas into Seoul's new satellite cities. The citizens there, who had received compensation, in turn sought to purchase real estates in other places to replace their lost lands. In the process, their rush to secure real estate pushed up its prices.

(b) During the previous year when the economy was in trouble, 30 business conglomerates received permissions from their banks to purchase five trillion won worth of real estates for the ostensible purposes of building housing projects and securing plant sites. They have so far purchased 3,800 billion won worth of real estates in book values. But the actual values of the real estates they have bought

would be much higher, considering the real estates they acquired without permissions from the authorities.

(c) In December 1989, the Bank of Korea extended about three trillion won to three big investment trust companies to help them buy stocks, as part of a plan to galvanize the shrinking stock market. Three firms spent the money to help boost the stock prices. Investors, taking advantage of the situation, promptly disposed of their stocks on time and left the market for good. They instead spent the money in real estate speculation, pushing up realty prices.

The money accrued from general real estate transactions tend to be reinvested in purchasing yet another real estates, because they are the most valuable assets ensuring attractive returns. Naturally, real estate prices are bound to go up. Ordinary real-estate owners, fearing the rising realty prices, tend to hold back their assets. This situation creates a shortage of real estate supply. Taking advantage of the supply shortage, real-estate brokers induce prospective buyers to offer higher prices yet. This sort of vicious practices naturally result in high real estate prices.

Also serious is the fact that today's land prices are jumping up, and rents surging up, in the wake of rising real estate prices, despite the numerous attempts to curb such speculations.

Because of the rising rents, many poor people have committed suicide (already 15 persons died), who were unable to meet rising lease-hold deposit. This tragedy represents nothing but the deep conflicts between the haves and the have-nots which rend our society.

According to recent government statistics, far more than 80,000 Seoul citizens own more than two units of various kinds of dwelling including apartments, independent houses and duplexes. Of the figure, 2,000 person own more than five houses of various kinds. This means that the number of multiple house owners account for 3% of Seoul's total households, owing 12.5% of the total housing units in Seoul. Considering that the housing supply rate in the Seoul area is about 60%, only the 3% of the small fraction of the Seoul population own houses, that should be owned by 120,000 households corresponding to 40% of Seoul residents. In short, the oligarchic moneyed class can easily hike rents, which are their attractive income sources.

Considering the above-mentioned background and the actual conditions of soaring prices of real estate, the view that the introduction of a real-name dealing system would bring about the outflows of capital to the real estate side is disputable.

c) The Possibility of financial assets making flight abroad.

Korea's membership in the International Monetary Fund makes it easier for Koreans to spend money overseas within certain limits than before. The spend-

ings include remittances abroad, overseas travel expenses, investments by export firms. But since Korea has not implemented a policy of complete liberalization of capital transactions, which permit free capital moves between Korea and foreign nations, outflow of Korean capital is not considered to be completely free institutionally. (Foreign Exchange Control Act is still in force).

When Korea initiate a capital market liberalization policy in 1992 as scheduled, Koreans may be able to make investment in foreign assets freely. And financial assets most likely to be sent abroad illegally will be the money deposited under pseudonyms.

In March 1980, when Japan announced the introduction of a Green Card System and the implementation of a global tax system for financial assets, Japanese investors rushed to buy America's Zero Coupon bonds. (the bonds are issued at discounted prices without interest until the repayment period, and the difference between the issued values and the repayment values is interest.)

In January 1986, when Japan reformed its tax law, the enthusiasms for the bonds subsided, for the capital gains accrued from sales of the bonds became subjected to global taxation. Before the tax law was reformed, they had been exempted from taxation.

At any rate, there is a possibility that taxation on real-name deposits tempt depositors to send their money abroad to avoid taxation. Therefore, it is desirable to work out legal and physical means to prevent such possible flights.

d) Low savings rates caused by dampened savings desire.

The difference between the tax amount resulting from schedular and global taxation on interest incomes will be larger or smaller or equal in proportion to the absolute amount of depositors' other incomes, which are combined with interest incomes. In other words, the greater the high-income earners' interest incomes are, the heavier their tax burdens progressively become. The smaller low-income earners' interest incomes are, the lighter their tax burdens become, even smaller than the tax imposed separately.

Considering this, it can be assumed that those big money depositors, who think that they are unfairly given great tax burdens, might feel a temptation to withdraw their deposits to invest them in another high income-generating sources. But assuming that all incomes can be taxed without exceptions—whether it is possible actually or not is another matter—incomes from other sources will be added up and subjected to taxation, as interest incomes.

It would then be impossible for the depositors to evade taxes and their deposit withdrawals in this case is meaningless.

On the other hand, as real interest incomes decrease, the desire for savings will be dampened. Therefore, it can not rule out the possibility of consumption demand being generated. However, if the generated consumption demand imported

goods, such a phenomenon is undesirable, for precious foreign exchange will be wasted. People generally save not exclusively for the purpose of making interest incomes, but for rainy days too. Therefore, giving up savings at once and instead, opting for consumption would be only a temporary phenomenon.

In the case of depositors, whose only income sources are interest, (retirement funds, inheritances, etc.) the depositors will be made to assume far heavier tax burdens, depending on the sizes of their deposits, than the burdens they assumed when they paid separated taxes. Of course, the progressive rate of a global tax system is responsible for this. Hence, the greater a depositors savings earnings are, the smaller his disposable incomes become.

However, if an elastic deduction system, allowing for deductions of fundamental living cost, is realized, then the impact of a progressive rate would significantly be lessened.

f) Shrinking Stock Market

Koreans tend to invest in stock for capital gains rather than dividends. This tendency has nowadays run to an extreme, painting the image of the stock market as a place of speculative binge.

The perception of the stock market as a place to garner capital gains runs counter to the principle of capital market. Of course, it is not to say that the speculative aspect should be expunged altogether from the stock market. Our argument is that since the stock is also an investment asset, incomes arising from stock transactions must also be subjected to taxes. Stock, interest from deposits, and unearned incomes from real estate speculations, are closely interlocked in circulation in money market. Hence, stocks should not be exempted from taxation.

Of course, there is a danger that threat of taxation might shrink the stock market. But here again, since almost all other investment sources are subjected to taxation, it would not be easy for habitual stock investors to give up the stock market entirely.

At present, the stock market, which lost its course, seems to plunge into an extremely bearish situation, causing share prices to plummet in the first half of this year, and bankrupting thousands of small investors. As a result, disappointment-induced stock sales have become widespread, prompting the public to fear that the stock market might lose self-sustaining force.

IV. Positive Effects of a Real-Name Dealing System

In order to discuss the positive effects of a real-name dealing system, the status of financial asset accumulation, which constitutes individual financial assets and income sources, must be understood. And all the effects, which can be

obtained through a global taxation, will be studied in terms of their practical aspects.

1. Financial Assets of the Individual Sector

During 1989, the size of financial assets managed by individuals recorded a growth of 29.9% over the previous year or 30,900 billion won. The size of capital raised from outside increased by 15,400 billion won or a rise of 28.9% over a year ago. As of the end of 1989, the actual balance of the domestic non-financial assets (government sectors + private sectors + individuals) marked 301,875.4 billion won. Among the figure, estimating that the increase rate of financial assets in the individual sector is 54.1%, they came to 162,875.4 billion won. This figure is of a great magnitude, surpassing by 21,809 billion won the 1989 GNP of 141,066 billion won.

Therefore, the importance of managing a rational and fair taxation system for the financial assets of such a great magnitude needs no further emphasis.

2. Effects of Global Taxation on Financial Assets

a) Effects on income Distribution

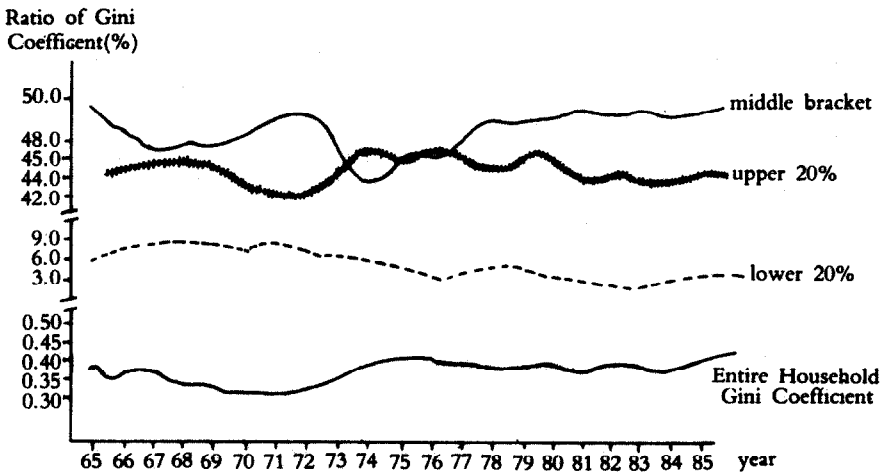
"A Limping" taxation structure, which practically "legalize" pseudonymous deposits and impose separate levies on incomes from financial assets, can hardly be considered as seeking to use the fruits of economic growth for the improvement of the living standards of the general public. A progressive tax rate system is considered as an important method to rectify gradually the problems created by unbridled free market forces, which tend to aggravate economic inequity. In order for the progressive tax rate system to achieve an effective objective, it should not be used to impose heavy levies on individual wage incomes or incomes of enterprises. It should rather be used to impose levies equitably not only on interest earnings and dividend earnings from financial assets, but also on all capital gains accrued from asset transactions. The expanded application of a capital gains accrued from asset transactions. The expanded application of a comprehensive progressive tax rate does not run counter to the principle of equity.

A survey of the status and effects of Korea's income distribution reveals that one of the most urgent problems confronting Korea's economy is the improvement of income distribution. Income distribution in this country has made a meager improvement or rather gotten worse, despite the high economic growth achieved in the past. It is, therefore, true that discontent about unfair income distribution is becoming more widespread as the days go by. In Korea, it is true that there has been economic growth, but no improvement of individual welfare.

We have already discussed the current status of income distribution. Although there are many methods to gauge the inequality of income distribution, a tradi-

tionally used method is Lorenz curve. Gini coefficient showing the Lorenz curve as a simple number is generally used. (Diagram 1) shows the status of Korea's income distribution during the past 20 years by Gini coefficient. In relation to all households, the Gini coefficient slowly dropped from 0.3652 in 1965 to 0.3377 in 1971 but with the year 1971 as the lowest point, the Gini coefficient rapidly rose to 0.4084 in 1976. From 1976, it slowly declined 0.3744 in 1981, while in 82, 83, 84, 85, it maintained a relatively high point, 0.4056, respectively, and is on a rising trend.

Diagram: 1 Current status of Korea's income distribution



It is worth noting that Gini coefficient in the '80s was almost similar to that of the mid '70s when the distortion of income distribution was relatively serious and that it reached the highest level in 1985.

The relative composition ratio of lower income 20% maintained a gradually rising trend from 6.81% of 1965 to 8.31% in 1971. From 1971, however, the ratio began to gradually drop, reaching 4.44% in 1985. In contrast to this, the relative composition ratio of the higher income 20% showed a sliding trend, dropping to 42.26% in 1971 from 44.29% of 1965. But after 1971, it rose drastically, reaching the highest level of 47.34%. Since then, it repeated increases and decreases, and then is maintaining a relatively high level of 45% and 46% in the 1980s.

In the case of the middle income bracket, the ratio reached the highest level of 49.3% in 1971 from, 48.9% of 1965, and then, showed a drastic decrease in 1973. Since then, it increased, recording about 50% in the 1980s.

By making a comparative analysis of Gini coefficient and the distribution ratio by classified income brackets, we can discern a changing trend in income dis-

tribution appearing behind Gini coefficient and its relation with income distribution. The above-study can be summarized as follows:

Firstly, Korea's high economic growth has gradually brought about positive impact on the lower income bracket. But the impact was meager, relative to the middle and upper income bracket.

Secondly, the Gini coefficient of the upper and middle brackets have come into conflict with each other as time goes on, i.e., a drop in the Gini coefficient of the upper bracket brought an increase in that of the middle bracket and vice versa.

Thirdly, changes in the Gini coefficient of the upper and middle groups in relation to each other can be noted in three stages. The first stage comprises a drastic rise in the middle bracket and a decline in the upper bracket. The second state consisted of about 46% of the upper and middle brackets repeating rises and declines until 1976. The third stage embraces the period following 1976 in which the middle bracket rose again, while the upper bracket declined.

This simple statistical analysis shows that despite Korea's outward economic expansion, income distribution has improved little.

Table 4 quoted the results of a research on the distribution of financial savings assets holdings by the sizes of savings. In case savings assets are arranged in the order of bigness in size, the upper income 10% occupies 41% of total financial savings assets. And its Gini coefficient is 0.5610, showing that the degree of inequality of financial assets holdings is much higher than the degree of income inequality of the households surveyed (Gini Coefficient: 0.3206).

Table 4. Comparison of Income & Savings Concentration

	Year of Survey	Gini Coefficient	lower 40% occupied upper 20% ratio
Income	1986	0.3567	0.45
Holding of Financial Assets	1988	0.5610	0.13

Data: "the effects of the strategy of Korea's Economic Development on the structure of income distribution by income bracket," PHD dissertation by Kang Bong Kyun in 1989.

As far as the degree of concentration of financial savings assets holdings (all the institutional financial savings including securities plus private financial savings) is concerned, the upper income 20% accounts for 58% of total financial assets, while the lower income 40% occupies a meager 7.9% of total financial savings. (reference: of total financial assets, $7.9/58.6 = 0.13$).

The above analysis conclusively shows that the status of income-distribution, which is the flow concept, as well as the concentration of assets holdings, which is the stock concept, must be studied in order to seek an overall analysis of the distribution of Korea's incomes. Namely, the real picture of the inequality felt by individuals or the seriousness of inequitable income distribution, can not be understood by ignoring the lopsided concentration of assets ownership.

Korea's tax system is oriented toward indirect taxation, which provokes little tax revolt, in order to realize fiscal self-reliance and to secure development resources. This means a relative weakening of the collection mechanism of the income and revenue-sources related tax systems. Therefore' it is desirable for the government to strengthen the function of taxation for income redistribution by reinforcing direct tax systems.

The fact that the share of income and inheritance taxes in national revenue is only 55.8% and that of property taxes 1.3% show the weak base and role of Korea's tax system. The fact that the share of income taxes is relatively low means that Korea's tax system has an inherent limit in attempting to achieve income redistribution. It also means that there is a limit to enhancing equality by means of government welfare expenditures.

The weaknesses of the current income tax system have already been stated. To add to it, another serious problem is the differences, which occur in individuals' actual tax burdens, depending on the types of their incomes. These differences seriously threaten the principle of horizontal equity. Moreover, if taxes are to be imposed rationally on lopsidedly concentrated financial assets incomes, ascertaining identities of the persons handling financial transactions becomes a priority. Hence, the search for a rational system of taxation aimed at financial incomes is an essential task in the process of implementing a real-name dealing system.

Implementation of a real-name dealing system is sorely needed not only to impose taxes on financial assets incomes, but also to secure accurateness in the taxation of items related to the transfer of wealth such as inheritances and gifts, etc.

Classifying Korea's assets liable to inheritance taxation, real estate accounts for 86%, securities 6.8%, and deposits 2.7% etc. The share of taxable financial assets in Korea's total assets is below 10%. In comparison with this, the share of real estate in Japan is 72% and that of financial assets about 20%, while in the United States, the share of financial assets was about 60% in the 60s. As is shown, the share of financial assets in Korea's total assets is lower than that of Japan and the U. S. There may be many reasons for this. Differences in the degree of industrialization may be the one. But allowance of pseudonymous financial transactions is another. It prevents the government from identifying for the purpose of taxation, financial properties which have the nature of inheritance and gift.

As was stated before, most of the incomes from financial assets (interest, &

dividends incomes, etc) are subjected to a 10% schedular taxation. This raises many problems. First of all, the schedular tax system, when applied to high income earners, whose marginal tax rate is higher than the schedular tax rate, will give a regressive effect in terms of the tax rate. Namely the greater the schedular tax-imposed incomes are, the lower the average tax rate becomes.

If we regard the progressive tax rate, which is being applied to composite incomes, as a standard for gauging the vertical equity of tax burdens, the schedular tax system has an effect of lowering the average tax rate, for high income earners, whose marginal tax rate is higher than the schedular rate. On the contrary, the schedular tax system has an effect of raising the average tax rate for the low income bracket, which have a low marginal tax rate. As a result, the system has an effect of weakening the progressive tax structure.

Hence it becomes a factor greatly harming the income redistribution mechanism of taxation. The way to correct this problem is to fully implement a real-name financial dealing system and at the same time institute a global system for taxation on interest and dividend incomes.

b) Effects on interest rates

A downward adjustment of the tax rate will permit a similar adjustment of the financial interest rates. As was stated before, the application of a progressive tax rate will boost the marginal tax rate for high-income earning brackets.

The interest rate is a variable, causing increases and decreases of financial assets incomes. Hence, if the interest rate is hiked, incomes will be great in proportion to the size of financial assets. Consequently, tax burdens will increase that much. Hence, disposable incomes among total incomes can be regressively diminished. Assuming such a tax structure takes root, and government revenues become capable of adjusting the tax rates, and assuming again that so long as the prime rate exists and the market interest rate is amenable to adjustment, the government can lower the interest rate by reducing the progressive tax rate to a certain range. It is because the interest rate could be lowered, while the actual level of disposable incomes accrued after global taxation of financial assets, showed little differences with the one existed before and after the lowering of the tax rate. Let us assume that financial assets incomes are fixed, (for the sake of simplification, we exclude here other wage incomes, real estate incomes) and assume again that the progressive tax rate also adopts a fiat rate system.

a) In case of Deposit, (M: Stands for Million & ₩: Stands for won currency)

Principle: 100 million won

Progressive tax rate: 30% of earnings

Interest rate: 10% (per Annum)

The tax is $(100 \text{ million} \times 10\%) \times 30\% = 3 \text{ million won}$.

The disposable income is $10 \text{ million won} - 3 \text{ million won (Tax)} = 7 \text{ million}$

won. Hence, the actual income earnings rate (after tax) is 7.0% against the principle.

b) On the other hand, if the prime rate is reduced to 1% to 9% from 10% while the tax rate is lowered to 23% from 30%.

$$\text{The disposable income is } (100M \times 9\% = 9M\text{₦}) - 2.0M\text{₦} = 7M\text{₦}$$

Hence, the actual earnings rate (after tax) is about 7.0% against the principle. As in the case of (b), if decreasing tax rate and interest rate are applied to (a) formula, depositors consequently can acquire the same disposable incomes. If we change the interest rate and income tax rate as follow, in accordance with the above-cited example, the functional relations between disposable incomes and the principle can be derived.

$$Z = Y \times \frac{r}{100} \left(1 - \frac{T}{100} \right)$$

Y = the principle, T = the progressive tax rate, r = the interest rate,
Z = disposable incomes

(a) With the interest rate fixed, if we change the progressive tax rate, the disposable income changes in inverse proportion against tax rate. For instance, when the yearly interest rate is 10%,

$$Z = Y \times \frac{10}{100} \left(1 - \frac{T}{100} \right)$$

the above-formula is shown in diagram 2

$$\begin{aligned} \text{Consequently, when } T = 23\%, r = 9\%, Z = 7M\text{₦} \\ T = 30\%, r = 10\%, Z = 7M\text{₦} \\ T = 32\%, r = 11\%, Z = 7M\text{₦} \end{aligned}$$

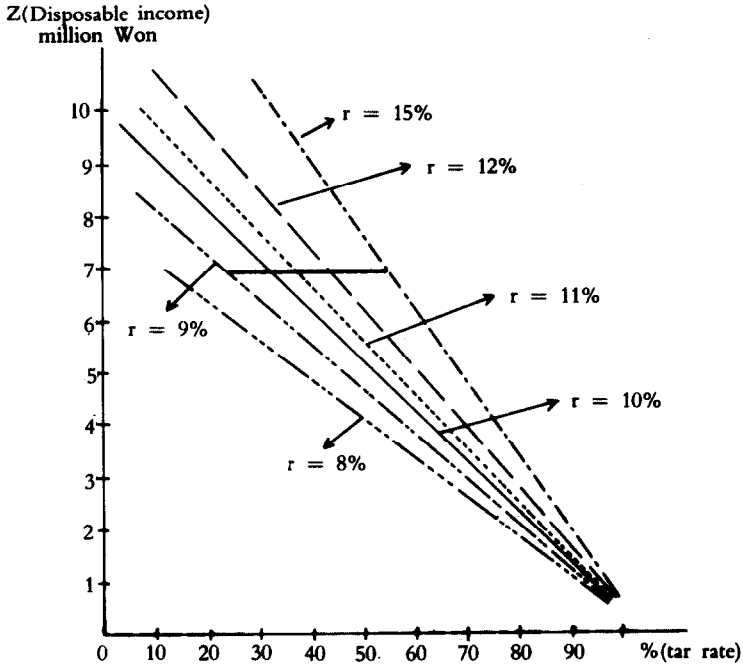
(b) With the progressive tax rate fixed, if we change the interest rate, the disposable income will change in proportion to the interest rate, i.e., when the tax rate is 30%,

$$Z = Y \times \frac{r}{100} \left(1 - \frac{30}{100} \right)$$

$$\begin{aligned} \text{Consequently, when } T = 30\% r = 10\% Z = 7M\text{₦} \\ T = 40\% r = 11.7\% Z = 7M\text{₦} \\ T = 20\% r = 8.75\% Z = 7M\text{₦} \end{aligned}$$

As the above diagram 3 shows, if the interest rates are high, and as a result, incomes increase, then, the tax rate also goes up. The consequence of this is small disposable incomes. If the interest rate is low, then, incomes become smaller. As a result, the tax rate goes down and the disposable incomes acquired after paying taxes are on the same line as the small disposable incomes. Hence, it is under-

Diagram: 2



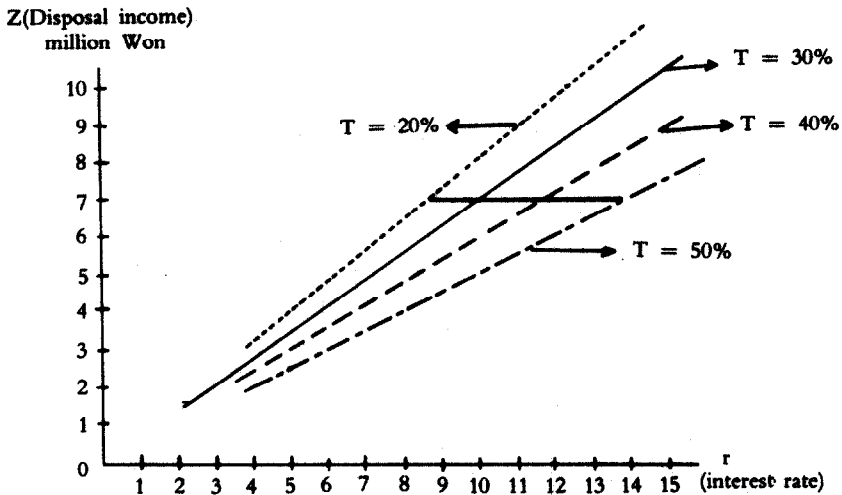
stood that the effects tax and interest rates have on disposable incomes are independent variables, and they at the same time have mutually proportional relations.

Therefore, by utilizing the variables, the tax rate can be adjusted upward and downward in accordance with economic realities without making actual changes in individual disposable incomes. The interest rate can also be subjected to upward and downward adjustments.

The function of the tax rates exerts the following impact effects: Firstly, since big depositors are more likely to have other incomes, relative to low income earners, the amount of their high incomes, above and beyond incomes from deposits, to be aggregated for taxation is bound to be large. If a global tax is imposed on such a large sum of incomes, a high interest rate can be heavy tax burdens for the depositors, because it would boost their incomes, and consequently, their tax burdens. Hence, big depositors might wish for a low interest and the resulting lighter tax burdens rather than a high interest rate and the resulting heavier tax burdens.

Such a thinking will provide impetus to the revamping of today's high financial interest structure. On the other hand, low income brackets, which have a low

Diagram: 3



level of interest incomes, will be subjected to a low tax rate and consequently, have its disposable incomes increased. Because the less their other incomes are, the less their tax burdens become.

However, the trouble facing these brackets is that because of their small financial assets,—assuming no other incomes they have—a lowered interest rate will reduce their incomes. This phenomenon is what we call “Elasticity of interest,” and it can not be ignored. But since the interest rate is lowered as the result of a reduction of the tax rate, the effect of the lowered interest rate on disposable incomes remain unchanged as before.

As is shown in the diagram, even if the tax rate is significantly lowered, the interest rate can not be reduced in proportion to the lowered tax rate. Considering this, the government must be willing to risk the danger that a significant lowering of the interest rate would bring about revenue shortfalls.

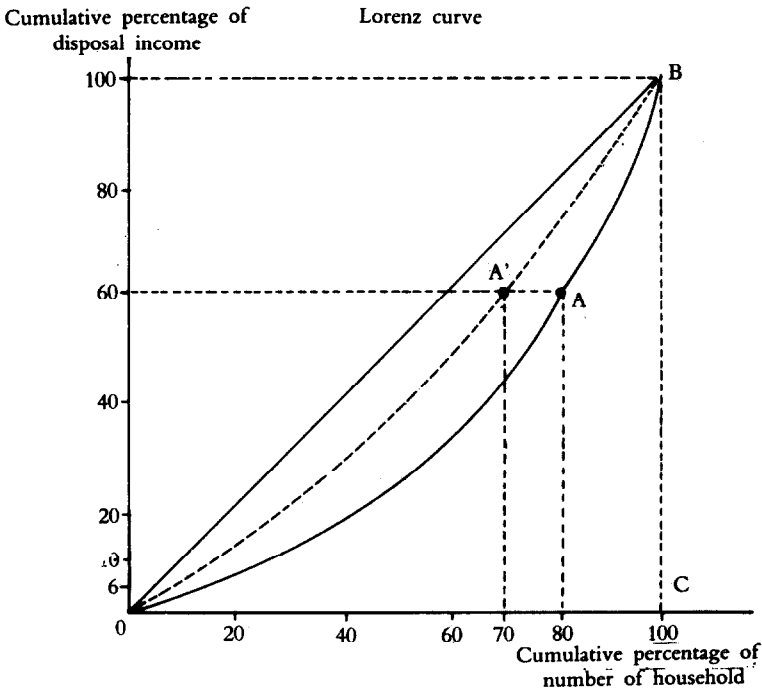
Secondly, floating funds of a great magnitude will be absorbed into a stable interest rate structure. As was stated before, total balance of financial assets reached over 4 times the GNP in 1988. The national savings ratio flowing into the GNP in the form of investment reached 36.3% in 1987 and 37.7% in 1988 from 29.1% in 1985. Unfathomably large floating funds are boosting short-term liquidity and are moving at a rapid speed in search of assets ensuring attractive returns. Hence, if the government seeks ways of imposing taxes on such unmobilizable funds by revamping the taxation system, the funds, which are capable of generating diversity of incomes, will become an ideal object of taxation. Hence, the major objective of the implementation of a real-name dealing system is to

find out the distorted flow of funds and legalize them by a thorough taxation. If we succeed in bringing the floating money to the ground of equitable taxation, it will contribute to the stabilization of the interest rate structure, thereby controlling the factors disturbing the economy.

c) Return Effects of Distribution

One method to measure the tax return categorically is to compare the status of income distribution by class before and after tax by using Lorenz curve. Such a comparison can be shown in the following graph. The vertical axis represents percentile of disposable incomes, and the horizontal axis represents percentile of the number of households by grade rising from low-income to high-income earners. Lorenz curve OAB represents the percentile of the incomes of minimum-income brackets' encompassing 10%, 20% and 30% and so on. In the figure, 10 percentile of minimum income brackets of the households account for 6 percent of the total disposable incomes. And 80 percentile of minimum-income brackets account for 60 percent of the total disposable incomes, and the cumulative disposable incomes of the remaining 40 percentage are represented by 20 percentile of households in the maximum-income brackets. If the incomes are distributed evenly, the OBA curve will overlap the direct line of OB. The ratio of the two spaces, $OABC/DBC$ is equality index of the income distributions.

Diagram: 4



If the incomes are distributed perfectly equally, the value of index is one. The distribution status of disposable incomes under the existing tax system is indicated in curve OAB, and let's assume that the distribution status of the disposable income after the revision of the tax system is shown like OA'B. This means that the income distribution took the form of equality after the revision of the tax system. That is because $OA'BC/OBC > OABC/OBC$.

In this context, the tax reform can be said to be progressive. We should take note of the fact that such a change can be brought forth through two channels. The change may be the result of a shift in the distribution status of the original tax burden. For instance, the change may represent the identification of progressiveness of income tax rate while the total tax revenues remain unchanged. Or it may result from an increased tax revenues while the intensity of tax rate progress remains unchanged. Namely, it may come as a consequence of increasing the tax burden of all taxpayers at equal proportion.

Thus, the overall effect the tax reform has on the distribution of the disposable incomes is determined not only by progressive intensity of specific tax (speed of increase in effective tax rate, total tax revenues/income, in conjunction with the rise in incomes) but also by the level of overall tax burden of incomes. The tax system in which the progressive system is moderate but the overall tax burden rate is high can bear greater impact on the status of income distribution than the tax system in which the progressive system is sharp but the overall tax burden rate is low.

Let's consider our reality by using the Lorenz curve. Price upsurge was periodically triggered by real estate speculation, a situation that is attributable to the lack of an institutional device to funnel the development-based profits into capital and to stem the speculative demand eyeing speculative incomes.

As has been well known, the concentration of real estates in the hands of small groups of high-income brackets worsened the structure of income distribution and also created social problem such as the feeling of relative want toughed off by the speculative incomes. People in the upper 5 percent brackets hold 65.25 percent of the total land, and the people in the upper 10 percent brackets have 76.9 percent of the total land, showing an extreme concentration. Table 5 shows the concentration of land in big cities; people in the upper 10 percent brackets account for 66 to 82 percent of the land. This indicates that the concentration gets more intense where land prices are higher.

Table 6 shows the concentration of land holding as expressed in Gini coefficient on the basis of the Table 5.

The concentration degree of land asset ownership is much larger than that of financial savings assets and income distribution. This fact is illustrated as the Lorenz curve in (Diagram 5)

Table 5. Land ownership concentration Degree

(As of 1988. 6.;%)

	The whole country	Seoul	Pusan	Taegu	Incheon	Kwangju	Taejun	remarks
upper 5%	65.2	57.7	72.3	72.6	64.2	55.7	65.1	
10w 10%	76.9	65.9	81.4	82.4	77.8	69.4	76.4	

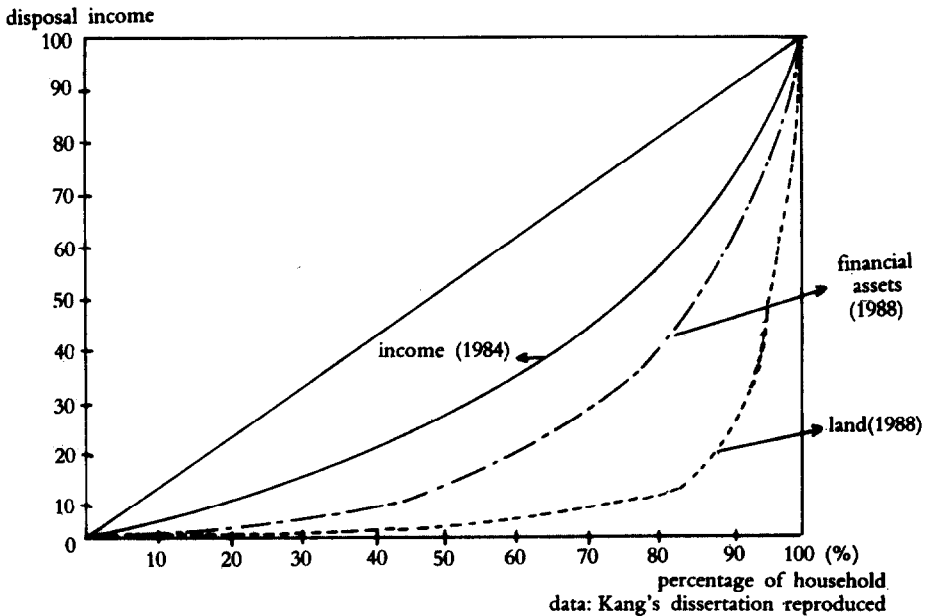
<data; National Land Development Research Institute, Land Public Conception Research Committee, 1989>

Table 6. Land ownership concentration Degree(Gini Coefficient) by household in large city

	Seoul	Pusan	Taegu	Inchon	kwangju
Ratio of land holding household ^(Gini coefficient)	28.1	33.1	38.3	30.1	69.7
Based on entire household	0.911	0.946	0.944	0.937	0.838
Based on land owners	0.709	0.846	0.867	0.812	0.808

<Data: National Land Development Research Institute, Land Public Conception Research Committee 1989>

Diagram: 5 Lorenz curve of income, financial assets, land



V. Promotional Direction of Global Taxation on Financial Incomes

With the full implementation of a real-name financial dealing system, the hitherto limpingly managed global income tax system can be improved in a rational manner. Together with this, related tax systems should be entirely streamlined and supplemented in order to reinforce the inherent function and role of the tax system. This revamping of the tax system is needed to meet the requirements of rapidly changing economic environment. To do so, income from interest and dividend, hitherto levied on separately, should be taxed compositely at their sources. Items which have hitherto been excluded from taxation, such as savings-type insurance, capital gains, interests from savings of the National Saving Association, profit from community trust, etc., must be taxed. At present, income taxes are not levied on capital gains or capital losses accrued from disposal of securities, but those capital gains (i.e.: profit margins) also should be taxed.

The above suggestion can be explained in detail as follows:

(1) After instituting a global tax system, all individual aggregate data be classified by income brackets where a certain tax rate can be applied. From there, extracting various types of similarity, taxational rates and collection methods will be decided.

(2) Global tax system in the first several years will be implemented, centering on high income brackets for the sake of it's smooth administration and then, the items to be subjected to the tax system will be gradually expanded (hence, an implementation schedule should be drawn up).

As an example, based on the statistics of (table 7), the upper 10% income brackets, which accounts for 41% of total financial assets (the size of average savings assets amount to over 20 million won) will be picked up for the implementation of a global tax system. Ways of vastly simplifying the procedures of filing returns for a great majority of financial income earners will be studied.

(3) The tax preferential deposit system currently applying to savings depositors of small amount (5 million won) will be expanded. At the same time, this class of people should be allowed to choose types of a global tax system. Those devises are designed to seek ways of lessening the relatively higher tax burdens low income groups have to assume, due to separately withholding income tax.

(4) Considering the introduction of a real-name financial dealing system and the expiration of defense and education taxes, a review of the global income tax rate is called for. The government, while making a downward adjustment of income brackets from 16 to 8 in 1989, vastly increased assessment base amount which is subjected to the lowest tax rate, and weakened the progressive degree applicable to a class below the middle class.

In advanced countries, the recent tendency is focused on preventing the loss of

Table 7. Distribution of household by size of savings asset holding

by size of savings assets	size of average savings assets (thousand won)	share of each bracket in total assets (%)	share of each bracket in cumulative savings assets(%)
upper 10% I	20,879	41.04	41.04
II	8,953	17.60	58.64
III	6,084	11.96	70.60
IV	4,657	9.15	79.76
V	3,573	7.02	86.78
VI	2,702	5.31	92.09
VII	1,960	3.85	95.94
VIII	1,290	2.54	98.48
IX	699	1.37	99.86
low 10% X	71	1.40	100.00

⟨Data: Bank of Korea, Marketing Survey of savings, 1988.⟩

efficiency in the income tax system caused by a nominally high rate rather than enhancing its function of promoting equity. For this purpose, the government not only decreased the highest income tax rate, but also vastly retrenched income brackets. In this way, the government aims at providing incentives for savings and investments, enhancing the enthusiasm for work and preventing tax omissions and evasions.

(5) Together with the progressive structure of income tax rates, choice of the taxation scope—whether it is individual, household, or family—will affect tax burdens. In accordance with the present taxation system, if a family has income from assets, i.e., interest, dividend incomes, they will be added to incomes of a family member, who earn the highest incomes. The aggregate incomes then are subjected to taxation. The main income earner and other family members whose incomes are to be aggregated, will jointly assume the obligation to pay a combined income tax, in case they have incomes from financial assets. But there is no consistent standards for calculating the amount of joint returns filed. Hence, provisions concerning the choice of a taxation unit and calculation of the amount of joint returns must be studied.

(6) Direction of taxation concerning capital gains from the transfer of securities.

As was stated before, individual profits and losses occurring from the disposal of securities are not subjected to taxation. On the other hand, corporation taxation are imposed on incomes from dividends and interest. Profits and losses from the transfer of securities too, as they are considered as profits and losses in the calculation of taxable incomes, are subjected to corporation taxes. The govern-

ment has hitherto not imposed taxes on capital gains from the transfer of securities in deference to the policy of fostering development of capital market. This, however, has spawned adverse effects harmful to the vertical and horizontal equities of the entire tax system.

On the basis of an idea that capital gains from disposal of securities after a certain interval of their purchases represent an increased portion of economic values and that the realized capital gains are not different from ordinary incomes, from the point of view of tax-paying ability, capital gains from the transfer should be subjected to a global progressive taxation. As was stated before, the virtual exemption of capital gains from taxation (only a low proportional rate of securities transaction tax is in force) injures the horizontal equity of taxation. Hence, aggregate taxes should be imposed indiscriminately on capital gains. It will bring about a considerable increase in tax revenues and at the same time, realize a horizontally equitable taxation on the high income brackets, relative to the low income brackets. It will also have an effect of ameliorating the shortcomings, which result from the fact that, the current separate, differentiated, proportional tax system is regressively applied to low income brackets, particularly, those who have only transfer incomes.

(7) Problems to be considered incidental to the implementation of a real-name dealing system including revision of the tax system.

(a) Ways of imposing taxes, in case of the financial assets held in pseudonymous names being transferred and registered in real-names.

(b) Whether or not aggregate incomes be calculated by linking them with changes of inflation index.

(c) Ways of improving tax administrative systems aimed at effectively handling greatly increased volumes of tax returns.

(d) Whether to impose, in the case of long-term bonds held in pseudonymous names, taxes on bond holders by dividing interests classified on the basis of holding periods, or aggregate levies on the final holders.

(e) When a real-name financial dealing system and a global income tax system are implemented, all incomes are to be aggregated. Hence, the tax exemption points, i.e., personal deduction amounts or wage income deductions, must be readjusted.

(f) Since there can be no unscrubbed and pseudonymous financial assets, their actual owners may tempt to borrow names of other persons to evade a global income tax. Hence, the question of whether to punish the actual owners or the name lenders, must be studied. In case of Germany, any person, who uses a borrowed name in transacting assets, is subjected to criminal punishment. This means the importance Germany attaches to personal integrity.

(8) Finally, a major reason why some people oppose or try to evade a real-name dealing system is their fears that the secret of their assets might be exposed and that the process of their assets formation might be investigated or tracked down for tax peralization. Therefore, it is very important that there should be an objective guarantee that the secret of personal assets will be protected and no investigation of the process of accumulation of fortunes will be instituted.

VI. Conclusion

The economic growth and its fruit resulted in deepening income disparities among individuals. The haves, propelled by rising income thrived in stock market and lucrative real estate market. Recently, however, the plunging stock market moved the money game into the real estate market. The real estate as a stable hedge against inflation emerged as the most attractive commodity that assures profitability and guarantees rise in value in the future as well.

The persisting credibility gap about the government, threat of price uncertainty and economic jitters will certainly cause the haves to turn their attention to where their properties are kept intact or their values are allowed to rise. Under such circumstances, idle money is bound to emerge in massive quantity for a haven of profitability. If the flow of such idle money is misdirected, the resulting distortion in the money's flow can hardly be corrected by any regulation or control in the capitalist market mechanism. Like chicken and egg issue, the inability to correctly grapple with the problem ahead is bringing us into depression.

The nature of the money flow into the real estates and the money put into the stock market represent the money flow of the same kind.

In as much as the rising tide of the real estate speculation is the consequence of the stock market bust, the two markets must not be treated as independent variables. In this context, the two-pronged measures against the real estate speculation—the adoption of tax levies based on real names of accounts and the enlarged concept of land—are not the kind of the steps in which one takes precedence over the other, or either may be deferred. Obviously, neither of the steps can work without implementing them altogether leaving no leeway for a choice.

As we have reviewed, the need for an overall reform of our tax system by adopting the real name system in financial accounts in by no means spawned in the mere context of the principle of equality, and elimination of inequality, we should trace the origin of the need back to the necessity that is required of a changing time. If our past economic growth was an extensional growth engineered by the government-led efficient mobilization of idled manpower and material, such an age is already over. Take one example. The technology and capital we had induced by paying high prices have now become a second hand goods, while

high technologies are tied to intellectual property rights; we are thus compelled to step up our endeavors to develop new technologies to stay afloat. With the old and same merchandises, we cannot meet new demand in international markets, and will lose ground in competitiveness.

To keep up with the change, we should set out to reshape the industrial structure, giving priority to the technology. We should establish the industrial policy with emphasis on the creation of new technologies. That requires enormous prices of innovation. We should pay the sum for the technological development on a national dimension, not confining to private enterprises. The scope of the funding will be such that it will be almost impossible to do the task without the fiscal backing. The demand for the huge fiscal funding cannot but be met through the rational overhaul of the tax system. The government should at least provide the basis to enter into the growth on the home front. A shift in our thinking pattern must be sought by bringing ourselves into that turning point and by setting ourselves in motions for self-reform. The path to reform in the spirit of a bold action to address contradiction must take the form of painstaking efforts to keep ourselves from being adrift in the rapid stream of the history; it must be a shortcut to eliminate the deep conflict. Confidence will be built as the reform reveals its true nature after being permeated everywhere. Then we can arrive at the national consensus with which we can endure what ever sacrifice impinging on us, although it may cause the friction of conflicting interest in its course.

References

- Simon Kuznets: *Modern Economic Growth-Rate, Structure and Trade* (Yale University Press 1969) chap. 4
- Tjalling E. Koopmans: *Three Essay on the Economic Science*, chap. 10
- James M. Buchanan: *Public Choice and Fiscal Theory*, Part III
- R. A. Musgrave: *Public Finance in Theory and Practice* 3rd New York Macgraw-Hill 1980 chap. 5, 12, 16, 17.
- John G. Gurley: *Economic Development and Financial Structure*
- Nicholas Kaldor: *Taxation System in Underdeveloped Countries*.
- R. K. Davidson: *Fiscal Problems of Underdeveloped Countries*
- S. Enke: *Contribution of Fiscal Policy for Economic Development*
- Joseph A. Pechman: *Federal Tax policy* 4th, *Studies of Government Finance-the Brookings Institution-Washington DC.:* chap. 4
- W. I. Sinclair, FCA. *Allied Dunbar: "TAX GUIDE" 1989-1990* Published Longman Law Tax and Finance 3. 5. 8. 18.
- Rhee Jin Soon: *Fiscal Theory*, 1990 published by CHOSE TONGRAM CO. Part III chap. 10, 11, 12, 13, 14.
- Rhee Cyul Sung: *Discussion of Korean Fiscal Issues*, 1986 Pakyong Co., chap. 4
- Korea Tax Attorney Association: *U. S. TAX*, 1986, chap.2

Samil Accounting Corp.: U. S. INCOME TAX. 1989.

Bank of Korea: Economic Statistics yearbook. 1989.

Korea Tax Research Institute: Research on Rationalization in Korean Taxation System. p67

Korea Economic Planning Board: An Economic white Paper, 1989.

Korea Tax Affair Association: A Handbook of Korea Tax. 1990.

Ishi Mory Hiroyoshi: Entrance into a Income Tax in Japan. Published by Tax Accounting Asscoiation, 1990.

Shi Mada Jikeng Yoo: All Kind of Taxation, 1990 in Japan Published by Chitsu Kyousi Nihong Sha, 1990.