

# Central Control of Local Finance in South Korea

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## 1. Introduction

In an analysis of central government control over South Korean local government, nothing provides a clearer picture than the status of local government finance. It is precise, quantitative, and convincing. The evidence that the central authority holds a tight grip on the local government in this regard is abundant.

The spheres of central control are wide and the results are successful. In almost every aspect of local government finance, there is evidence of central control. The essential areas of local finance controlled by the central authority are as follows:

- Local taxation
- central grants and subsidies
- Local budgetary process
- Auditing and inspection

Thus, local finance in the Republic of Korea is characterized by two interdependent phenomena: central domination and local dependence.

To provide an over-all picture, a brief introduction to the Korean economy is in order.

The Gross National Product (GNP) in South Korea amounted to 695 billion *won* (equivalent to approximately 2.5 billion) in 1965, an increase of 99 billion *won* over 1964. During the fiscal year 1965, government expenditures at all levels reached an all-time high of 227 billion *won* (0.8 billion), which was approximately 32 per cent of GNP. Thus both the size and the proportion of the governmental sector in the South Korean economy is large. It is not only large, but it is also pervasive in that governmental expenditures affect almost every aspect of economic life, ranging from grain operation to the

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\* Sections of this essay are drawn by the author from his "System of Local Government in South Korea as Affected by Patterns of Centralized Control" (Doctoral Dissertation, The George Washington University, 1968)

ownership of various public corporations.<sup>(1)</sup>

While government expenditures amounted to 32 per cent of the GNP, only 48 billion *won* out of the total of 227 billion *won* spent by all governmental units in fiscal year 1965 represented local government expenditures, comprising barely 21 per cent of the total government spending in that period. As Table I shows, the percentage of local government spending has declined rather increased for the preceding three-year period.

The picture of central domination over the local government finance can be further sharpened by a separation of the general account expenditures (shown in Table II) from the special account expenditures which are financed primarily by other than the ordinary revenues of the local governments. The special accounts system is widely used in South Korea in government accounting for such special activities or projects as operation of public schools, utilities, etc.<sup>(2)</sup>

TABLE I  
TRENDS OF EXPENDITURES BY NATIONAL AND  
LOCAL GOVERNMENTS: 1963-1965  
(in millions of *won*)

Item	1963	1964	1965
A. National Government	125,271	139,610	178,983
General Account	59,959	62,907	83,534
Special Account	65,312	76,703	96,449
B. Local Government	39,696	44,451	48,570
General Account	17,530	19,927	20,823
Special Account	22,166	24,524	27,747
C. Total	164,967	184,061	227,553
D. Local expenditures as a percentage of Total	24%	24%	21%

Source: *Korea Statistical Yearbook*, 1966, pp. 278, 284, and 310.

TABLE II  
GROWTH OF GENERAL ACCOUNT EXPENDITURES BY  
NATIONAL AND LOCAL GOVERNMENTS: 1961-1965  
(in million of *won*)

Year	National Government	Per Cent	Local Government	Per Cent	Total
1961	50,902	82%	13,663	18%	74,565
1962	73,256	86	12,657	14	85,913

(1) *Korea Statistical Yearbook*, 1966. Seoul: Economic Planning Board, 1966.

(2) *Ibid.*, p. 311.

1963	59,959	79	17,330	21	77,489
1964	62,907	76	19,927	24	82,834
1965	82,534	80	20,823	20	103,357

Source: *Korea Statistical Yearbook*, 1966, pp.278, 310.

For fiscal year 1965, the general account portion of local government spending amounted to more than 20 billion *won* which was approximately 40 per cent of the total amount spent by the local government. As Table II indicates, the general account expenditures of the local government, until 1963, had been under the 20 per cent level as a portion of total government expenditures.<sup>(3)</sup>

The second major characteristic of South Korea local government finance is the local dependence upon central government grants and subsidies, stemming from the weakness of the local government's financial resources. The lack of such resources has forced the local government to seek such help.

During fiscal year 1964, the local government received 42.8 per cent of its total revenues from the central government's grants and subsidies. The local government, was able to raise only 57.2 per cent total revenues from its own sources. During the same year, local taxes constituted only 40.8 per cent of total revenues. The local tax collection, although reflecting improvements made in the preceding years, was nevertheless far from the major revenue source for the local government needs. Thus, the local government finance, no matter how small

its share of the total government spending, still needs a large proportion of central grants and subsidies to survive.

Table III indicates the total amounts of local government spending by the local governments at the principal levels, as well as the percentages of the totals for each category shown. The principal local autonomous entities are the provincial, city, and county governments. The table shows that the three principal local governments during the four years 1962-1965 experienced changes in their shares of the total amounts. It also shows how these principal local autonomous entities spent their funds on each of the major accounts education, general, and other as well as their total spending.

During fiscal year 1965, 60.5 per cent of the total of all local government budgets was allocated for the eleven provincial-level governments, leaving the remainder (39.5 per cent) to the numerous cities and counties. The governments of cities and counties, which numbered 169 in 1965, were forced to survive on only 39.5 per cent of the local expenditures. It is well known that the governments of cities and counties, as the principal municipal service providers, are not adequately financed to carry out their assign-

(3) ChuyoHaengjong T'onggye P'yonjip Wiwonhoe(Compiling Committee for Important Statistics on Public Administration), *Chuyo haengjongt'onggye chosa chonghap pogo* (Consolidated Research Report on Important Statistics of Public Administration) (Seoul: Chuyo Haengjong T'onggye Pyonjip Wiwonhoe, 1966), pp. 88-89.

Table III

## Trends of Budgets by Local Government: Fiscal Year 1962-1965

(in million of won)

Governments Accounts	FY 1962		FY 1963		FY 1964		FY 1965	
	Amount Per Cent		Amount Per Cent		Amount Per Cent		Amount Per Cent	
Provinces	General	7,970 58.2%	10,650 55.0%	11,257 52.2%	11,496 55.2%			
(11)	Education	11,899 61.6	12,260 61.9	13,270 60.6	13,655 62.9			
	Others	1,635 58.3	1,910 59.4	2,262 61.9	4,243 70.2			
	Total	21,494 60.0%	24,820 58.6%	26,719 56.9%	29,394 60.5%			
Cities	General	1,505 11.0%	2,026 10.5%	2,323 10.8%	2,190 10.5%			
(30)	Education	1,150 6.0	1,256 6.4	1,305 5.0	1,206 5.6			
	Others	704 25.1	846 26.3	959 26.2	1,229 20.3			
	Total	3,359 9.4%	4,128 9.7%	4,587 9.7%	4,625 9.5%			
Counties	General	4,225 30.8%	6,680 34.5%	7,971 37.0%	7,136 34.3%			
(139)	Education	6,260 32.4	6,273 31.7	7,216 34.4	6,841 31.5			
	Others	465 16.6	461 14.3	432 11.9	569 9.5			
	Total	10,940 30.6%	13,414 31.7%	15,619 33.4%	14,546 30.0%			
Total	General	13,700 100%	19,356 100%	21,551 100%	20,822 100%			
Governments	Education	19,309 100	19,809 100	21,791 100	21,702 100			
(180)	Others	2,804 100	3,217 100	3,653 100	6,041 100			
	Total	35,813 100%	42,382 100%	46,995 100%	48,565 100%			

Source: Naemubu, *Chibang chach'i tanch'e kyolsan kaeyo* (An Outline of the Closing Accounts for Local *Autonomous* Entities),

1965, pp.19-19.

ments of responsibility.

Out of the 39.5 percent of total local finance allocated for the city and county governments during fiscal year 1965, 30 cities shared 9.5 percent while the 139 counties consumed the remainder (30 percent). In general, the "rural" county government received a smaller proportionate share of the total local budget than its urban counterpart, the city government.

It is therefore concluded that the provincial-level governments, as the higher although least numerous entities, enjoy the greatest share of the local finance, the "urban" city governments come next, and the poorer county governments are given the smallest portion of the local finance.<sup>(4)</sup>

## II. Local Taxation

Taxation, however unsatisfactory it may be, remains the principal local element of finance for South Korean local governments. The "unsatisfactory" status of local government finance can be said to be, in part, a result of the local taxation system. The question arises: how are local taxes determined, and who control their rates?

In general, local taxes have been traditionally determined by the central authority. The local government, even when it was allowed a "fulfilled" autonomy (by Korean standards) during 1960-1961, has never enjoyed this fundamental governing authority. The central government determines by central legislation not only what kinds of taxes shall

be levied but also how much to levy. Setting the kinds and rates of local taxes is solely the function of the National Assembly, and its enactments in this field apply uniformly throughout the country. The Local Autonomy Law itself concedes that while the local autonomous entities may levy taxes upon their residents, the kinds, of and rates for local taxes shall be determined by law.

Before 1961, there were several individual legislative measures regarding local taxes, such as the farm land tax law, the property tax law, and so on. Although these measures dealt with only one kind of local tax in each instance, the legislation still covered all local governments uniformly. In other words, no local differences in tax rates or kinds of tax were allowed. These separate local tax measures were incorporated into a single tax law in 1961, soon after the military revolution. The Local Tax Law, thus, is the single legislative enactment currently in force dealing with the local taxes of more than 180 local autonomous entities (provinces, cities, and counties).

Before 1961, the governments of towns and villages were also allowed to levy local taxes upon their residents, a privilege which the new Local Tax Law denied them. The local taxes formerly collected by the towns and villages were transferred to the county governments which now supervise them. Thus, the governments of the 1,467 South Korean towns and villages now exist without authority to tax.

At present, the local autonomous entities

(4) Han'guk Unhaeng Chosabu (Research Department, Bank of Korea), *Kyongje t'onggye yonbo*, 1966 (Economic Statistics Yearbook, 1966) (Seoul: Han'guk Unhaeng Chosabu, 1966), pp. 162-163.

which have power to tax their local inhabitants are the 139 counties, 30 regular cities, nine provinces, and the two uniquely classified cities, Seoul and Pusan. To regulate the taxes levied by the 180 local governments, the Local Tax Law provides only two levels of local tax schedules: local taxes for the provincial-level governments and local taxes for governments at the city-county level.<sup>(5)</sup>

For each of these levels of the local autonomous entities, local taxes are enumerated and standard rates are specified.

The provincial-level governments consist of the nine provinces, one Direct Control City (Pusan) and one Special City (Seoul). The nine provincial governments have three national tax surcharges and six independent taxes, while the Direct Control City and the Special City are given three national tax surcharges, eight independent taxes, and two special purpose taxes. A list of local taxes permitted these governments follows.<sup>(6)</sup>

#### I. ordinary taxes

##### A. surtaxes

1. Income tax surtax
2. Corporation tax surtax
3. Enterprise tax surtax

##### B. Independent taxes

1. Acquisition tax
2. Motor vehicle tax
3. pleasure and restaurant tax
4. Butchery tax
5. Parimutuel tax

##### 6. License tax

#### C. Independent taxes (Seoul and Pusan only)

1. Property tax
2. Farm land tax

#### II. Special purpose taxes (Seoul and Pusan only)

1. Urban planning tax
2. Public facility tax

The 139 county and 30 city governments have eight surtaxes on national and provincial taxes and two taxes in each of two categories-independent taxes and special purpose taxes. Following is a list of taxes allowed to the city-county level governments:<sup>(7)</sup>

#### I. Ordinary taxes

##### A. Surtaxes

1. National tax surtax
  - a. Income tax surtax
  - b. Corporation tax surtax
  - c. Enterprise tax surtax
2. Provincial tax surtaxes
  - a. Acquisition tax surtax
  - b. Motor vehicle tax surtax
  - c. Pleasure and restaurant tax surtax
  - d. Butchery tax surtax
  - e. License tax surtax

##### B. Independent taxes

1. Property tax
2. Farm land tax

#### II. Special purpose taxes

- A. Urban planning tax
- B. Public facility tax

(5) Haengjong Yon'gam P'yongch'an Wiwonhoe (Compiling Committee for Yearbook of Public Administration, (*Haengjong Yon'gam*, 1966 (Yearbook of Public Administration, 1966) (Seoul: Haengjong Yon'gam P'yongch'an Wiwonhoe, 1966), pp. 406-407.

(6) Article 5, Local Tax Law.

(7) Article 6, Local Tax Law.

Except for the two special purpose taxes permitted to Seoul and Pusan, the local taxes for each level of the local government are uniformly regulated and, therefore, leave little room for local adjustments which the differences in economy and function in each locality realistically demand.

Central determination of the kinds and rates of local taxes for the diverse local entities naturally leads to a situation where one locality lacks certain tax resources while others have an excess of them. Unrealistic assessment of the financial needs of local governments tends to be created on the one hand, and irresponsible management of these financial resources on the other.

The gaps created from one locality to another in applying the nationally standardized local tax system have inevitably charged the central government with the further role of equalizing the financial position of local governments by collecting more taxes for the central government (which means lessened local tax resources) and distributing them to the local governments according to their needs. This provides another example of self-perpetuating central government control over local government finance.

As Table IV show, the largest single local tax is the Farm Land Tax, which made up 34.2 per cent of the total local taxes levied during fiscal year 1964. Because the Republic of Korea is primarily an agricultural nation, South Korean local government depends heavily on this farm land product tax, with some exceptions. Thus, the county government, containing the greater part of the rural farm land, derives the highest portion

of its tax revenue (80.1 per cent) from the Farm Land Tax, while the two urban provinces receive only 1.35 per cent of their of their tax revenue from the same tax.

The second most important tax among local taxes in South Korea is the Property Tax, which represented 12.6 per cent of the total local taxes collected during fiscal year 1964. The Property Tax is levied on the ownership of land, buildings, mines, and boats. It is the largest tax revenue source for the regular classification of cities (25.0 per cent), and for the Special City (18.3 per cent) and the Direct Control City (14.3 per cent). The Property Tax is also significant in the county government as the second largest single tax revenue source, ranking second to the Farm Land Tax.

The third most important tax in the local tax schedule is the Income Tax surcharge, which all levels of local government are allowed to levy. However, it represented only 10.2 per cent of the total tax revenue for fiscal year 1964. While the provincial governments enjoy the highest income tax surcharge revenue (21.7 per cent of the total provincial tax collection), the rural county governments rely on this tax for only 2.9 per cent of the total county tax collection.

There remains another question: what portion of the local revenues do the local taxes yield?

During fiscal year 1964, as Table V shows, local government taxes yielded an average of 40.8 per cent of the revenues of the local governments at various levels. The portions yielded by the local taxes ranged widely, however, from only 13.8 per cent of the

Table IV

## Local Tax Composition: Fiscal Year 1962

(in million of won)

Tax	Seoul	Per Cent	Pusan	Per Cent	Provinces	Per Cent	Cities	Per Cent	Counties	Per Cent	Total	Per Cent
Income tax surtax	225	13.4%	56	13.6%	134	21.7%	70	13.5%	65	2.9%	551	10.2%
Corporation tax surtax	191	11.4	43	10.4	16	2.7	14	2.8	2	0.1	266	4.9
Business tax surtax	210	12.5	95	22.7	95	15.4	60	11.7	34	1.6	494	9.1
Acquisition tax surtax	143	8.5	22	5.5	57	9.2	21	4.1	35	1.6	278	5.2
Motor Vehicle tax	277	16.5	58	14.0	142	22.9	52	11.0	27	1.3	556	10.4
Restaurant tax surtax	159	9.4	27	6.6	40	6.5	27	5.3	12	0.6	265	4.9
Butchery tax surtax	41	2.5	12	2.9	37	6.0	15	3.0	21	1.0	126	2.4
Parimutuel tax	2	0.2									2	
Licence tax surtax	104	6.2	35	8.4	96	15.6	46	8.9	50	2.3	331	6.1
Farm Land tax	18	1.1	6	1.6			76	14.7	1,762	80.1	1,862	34.2
Property tax	307	18.3	60	14.3	130	25.0			188	8.5	685	12.6
Total	1,677	31.0%	414	7.7%	617	11.4%	511	9.4%	2,195	40.5%	5,414	100.0%

Source: Mun-hi Nam, "Chibang chaejong ui silt'ae wa munjeom" (Status and Problems in Local Finance), *Chibang Haengjong*, July, 1964, p. 25.

Table V  
Percentages of Revenues of General Accounts  
for Local Autonomous Entities: By Source  
Fiscal Year 1964

Revenue Source	Seoul	Pusan	Povinces	Cities	Counties	Average
Local taxes	68.9%	73.5%	13.8%	33.0%	50.6%	40.8%
Property income	1.7	3.0	1.3	3.7	1.0	1.6
Fees	3.8	5.5	3.0	5.2	2.4	3.2
Carry-over	15.4	8.8	4.5	5.9	11.2	9.1
Donations	—	—	—	0.3	0.1	0.1
Transfers	0.5	0.6	—	0.7	0.1	0.2
Local bond	2.4	0.9	—	1.3	—	0.6
Others	2.3	2.1	2.0	2.5	0.7	1.6
Total-local revenues	95.0%	94.4%	24.6%	52.6%	66.1%	57.2%
Central subsidies	—	—	31.3	29.7	12.9	18.0
grants	5.0	5.6	44.1	17.7	21.0	24.8
Total-grants and subsidies	5.0%	5.6%	75.4%	47.4%	33.9%	42.8%
Grand total	100%	100%	100%	100%	100%	100%

Source: Naemubu, *Chibang chach'i tanch'e kyolsan kaeyo* (An Outline of the Closing Accounts for Local Autonomous Entities), 1965, pp 32-33.

total revenue for the provincial government to 73.5 per cent of the Direct Control City (Pusan) revenue. The local governments, therefore, have to seek other sources in varying degree to fill the deficit created as a result of the insufficient income yielded by local taxes. However, as of fiscal year 1964, the local tax revenue stood as the second largest revenue source in South Korean local government, next to the central government's grants and subsidies. For the past few years, the local tax structure has been under the constant scrutiny of the central

authority in the attempt to strengthen it as a local government resource.

The weak position of local taxes in the local government revenue structure is a reflection of central government domination in the total structure of governmental taxes in South Korea. Table VI shows that although the amount of the local tax collected has increased greatly for the past few years for which records are available, the ratio of local taxes to total taxes has remained the same. The central government, in addition to its internal taxes, has a large source of

revenue in customs duties and domestic monopoly profits (tobacco, salt, and ginseng). These two revenue sources yielded more than the total local taxes collected during fiscal year 1965.

Including customs duties and monopoly profits, total government tax revenues am-

ounted to over 64 billion won in fiscal year 1965. The local government during the same fiscal year collected taxes amounting to approximately 10 billion won, which was only 16 per cent of the total taxes collected in the Republic of Korea, maintaining the ratio of previous years.

Table VI  
Trends of National and Local Tax Burden  
Related to National Income Data and  
Population: 1963--1965

Item			
Population	27,400,000	28,100,000	28,300,000
Gross National Product (in million <i>won</i> )	428,280	596,580	695,000
Total amount of taxes (in million <i>won</i> )	44,040	52,000	64,180
Internal taxes	24,370	28,910	36,870
Custom duties	6,700	8,500	12,390
Monopoly profits	5,610	5,940	4,530
Local taxes	7,350	8,730	10,390
Per capita income( <i>won</i> )	15,587	21,167	24,513
Ratio of taxes to GNP	10.3%	8.7%	9.2%
Ratio of local taxes to total taxes	16.0%	16.0%	16.0%

Source: *Korea Statistical Yearbook*, 1967, p. 302.

If the customs duties and monopoly profits are excluded, the ratio of the local tax collection of national tax collection is 20.9 per cent for fiscal year 1965. This ratio makes for an interesting comparison, shown in Table VII. No country cited in the table has a lower local to national tax ratio than the Republic of Korea. Although each nation has a unique historical and political background which makes a comparison difficult, the ratio of the South Korean local tax to the total government tax represents clearly the

nature of strong central domination in the local tax system.

### III. Central Grants and Subsidies

Second to central control over local taxation, the central government control over local finance through the system of grants and subsidies stands as the most powerful vehicle for central domination over the local autonomous entities in south Korea in financial matters. This power of the central government has been acquired slowly but steadily

Table VII.

## Comparison of National and Local Taxes by Nations

Nation	National Tax	Local Tax	Local Tax as a Percentage of National Tax	Currency Unit	Year
Korea(South)	42,129	8,806	20.9%	million won	1965
Japan	24,991	10,501	42.3	100million yen	1963
China(Taiwan)	3,516	1,856	45.1	million yuan	1962
India	9,280	4,486	48.3	million rupees	1962
West Germany	32,912	24,825	75.4	million marks	1960
United States	94,347	40,501	42.9	million dollars	1962

Source: Song-je Yim, "Chibang sepop ui kaeson panghyang," (A Direction for Local Tax Revision), *Chibang Haengjong*, July, 1965, p. 31.

over the past half century. Because the local governments have never been equipped with the authority to determine the kinds and rates of local taxes to meet their own needs, any unsatisfactory consequences resulting from the arrangements established by the central authority can be resolved only by the central government. The local government's dependence upon the central treasury is clearly seen as the natural consequence of the State's maintenance of control over local taxation.

During fiscal year 1964, the local governments in South Korea were required to make up an average of 42 per cent of the total local revenue through central government grants and subsidies, inasmuch as the local government's own revenues amounted to only 58 per cent of their total needs.<sup>(8)</sup>

In addition to central over the determination of the kinds and rates of local tax levies, local financial resources other than

taxes have long been regarded as much less productive than central revenue sources. This weakness of local financial resources has forced the local governments to depend further on central grants and subsidies. For the six years from 1960 to 1965, as Table VIII shows, the local governments' financial dependence upon the central treasury increased sharply after the Second Republic (1960-1961) was overthrown and then tended to level off in percentage terms, although some slight reduction in this dependence may be observed.

As the result of actions taken by the central government to strengthen the financial posture of local government, central grants and subsidies have been slightly reduced in the past few years. The significance of the central grants subsidies in the local financial system has not been modified to any great extent, however, and this aid

(8) Naemubu(Ministry of Home Affairs), *Chibang chach'i tanch'e kyolsan kaeyo*, 1965 (Outline of the Closing Accounts for Local Autonomous Entities, 1965) (Seoul: Naemubu, 1965), pp. 32-33.

Table VIII.  
Trends of Local Financial Dependence upon  
The National Treasury;  
1960—1965  
(in million of *won*)

Year	Total	Per Cent	Local revenue				Total	Per Cent	Revenues from National Treasury	Per Cent
			Local Tax	Per Cent	Other Revenues	Per Cent				
1960	13,713	100%	2,124	15.5%	2,438	17.7%	4,562	33.2%	9,151	66.8%
1961	14,481	100	2,170	15.0	2,162	14.9	4,332	29.9	10,149	70.1
1962	13,701	100	5,215	38.0	2,329	17.0	7,544	55.0	6,157	45.0
1963	19,358	100	7,404	38.2	2,840	14.7	10,244	52.9	9,114	47.1
1964	16,710	100	6,567	39.3	2,464	14.7	9,031	54.0	7,670	46.0
1965	20,823	100	8,806	42.3	2,383	11.4	11,189	53.9	9,634	46.3

Source: *Chibang Haengjong*, July, 1965, p. 30.

remains the most crucial and also the most influential avenue through which the policy and politics of the central government are impressed upon the local government system.

The local government's dependence upon financial assistance from the central treasury has been justified by the fact that the local governments in South Korea have been required to execute a great many functions which are legally or administratively the responsibility of the State. A realistic division between the central and local function is difficult to determine under the South Korean system of local government because the Constitution does not provide an enumeration of functions for the purpose of such division. Further, under administrative law and ordinance, and partly as a result of changing conditions in the country, there has been a continual accretion and shifting of governmen-

tal responsibilities. The assignment of local functions thus varies from one political regime to another and also from one level of government to another.

In general, there are two types of central government assistance to local government finance. One is generally known by the designation "grant," and is designed to subsidize a specific project or function assigned to the local government. The other type is termed "subsidy," and is designed to help take care of the general financial deficiencies of the local governments.

The central government's grants and subsidies are both based upon the same general principle of the central government's legitimate interest in the coordination of the local government's financial affairs.<sup>(9)</sup>

A central government grant for a local government project usually requires that

(9) Kyong-gwon Ch'a *Chaejonghak* (Public Finance) (Seoul: Chinmyong Munhwasa, 1963), p. 404.

the grant be matched from a local government project usually requires that the grant be matched from a local fund as a prerequisite for such grant. Certain grants, however, do not require local matching funds. As Table IX indicates for fiscal year 1965, the local governments have rather consistently failed to raise the full amount of the required matching fund, primarily because the local government could not produce the needed amount out of the already shrunken treasury.

Central grants for local government projects have long been recognized as institutions that the central government finds quite convenient for achieving the implementation

of a centrally conceived new program in the localities without being compelled to establish a local office for such programs. The arrangement does not sacrifice central control, for the allotment as well as the disbursement of the grants are subject to scrutiny by the central authorities. How much a grant will be, and sometimes even whether or not there will be such a grant, is a matter of grave concern for the local government officials in case of any particular program, since they are not only responsible for administering the program but also for annual budget-making and auditing with already strained financial resources.

Table IX  
Status of Local Matching Funds for Central Grants  
Fiscal Year 1965  
(in thousands of won)

Sources of Grants	Amount of Grants	Required Local Fund	Per Cent of Grants	Actual Local Fund	Per Cent of Fund Needed
Ministries: Construction	1,337,818	438,490	32.7%	262,656	59.9%
Home Affairs	107,000	—	—	—	—
National Defense	148,744	—	—	—	—
Agriculture & Forestry	1,535,956	377,743	25.0	280,447	74.2
Health & Social Affairs	286,066	244,178	85.3	255,425	104.6
Commerce & Industry	3,533	1,533	60.5	406	26.5
Office of Rural Development	234,009	44,311	18.8	55,900	127.0
Total or Average Percentage	3,653,126	1,105,975	30.3	854,734	77.0

Source: Mun-hi Nam, "Chibang kyobuse chedo" (System for Local Grants), *Chibang Haengjong.*, June, 1965, p.27.

The second type of central government direct financial assistance, the so-called entral subsidies, are in the nature of lump sum grants added to the local revenue. They do

not have a particular tag for use on a certain program, but are intedned to supplement the local government's general fund in meeting local deficits. The central subsidy derives

from the idea of financial equalization among the local governments. Consequently, a rich local government gets less than it remits to the central government in national taxes, while a poor local government is likely to be returned more than it pays in national taxes. Thus, the central government determines the subsidy needs for each government having a deficit by subtracting the local tax revenue from the local financial demand, both of which are essentially set by the standardized national scale.

Each local government, therefore, receives a certain amount as its general fund revenue which the locality uses for its general account. The amount of the subsidy is determined by the amount of shortage of funds needed to fulfill the centrally determined "standard financial demand" of each local government. Because the amount of local financial demand is determined not by the local government but by the central authority, the local government is again in a position of submission to central domination and control.<sup>(10)</sup>

The local governments' financial dependence upon central grants and subsidies is by no means the same at all levels (or in all localities). The degree of dependence varies from one government to another. As Table X shows, the provincial governments have the greatest over-all dependence upon the central treasury while Seoul and Pusan enjoy the least dependence. During fiscal year 1964, the nine provincial governments were subsidized to the extent of 80.5 per cent of their combined revenues by central grants

and subsidies, and Seoul and Pusan needed to obtain only 2.3 per cent and 12.4 per cent, respectively, of their revenue from the central treasury. The situation of this provincial government finance reflects the two extremes of urban and provincial government dependence upon the largest of the State. The urban government is least dependent upon central treasury while the rural government is the most dependent.

The pattern of financial dependence upon central grants and subsidies at the city-county level of government provides another picture. Here, the rural governments of counties have lesser financial dependence than their urban counterparts—the cities. During fiscal year 1964, as Table X shows, the city governments were subsidized to the extent of 51.8 per cent of their total financial need by the central treasury, while the county governments relied upon the treasury for a lesser portion (35.8 per cent) of their revenue needs. An explanation is in order for the above reverse pattern of urban-rural dependence, as compared to the provincial-level government situation. The county governments are benefited by large revenues from the farm land tax, which the city government governments largely lack, and they are also benefited by the fact that the county governments in South Korea, being predominately rural, are called upon to satisfy fewer service demands than the urban governments of cities, where the financial resources cannot catch up with spiraling urban service demands. The city governments, therefore, are compelled to

(10) *Ibid.*, pp. 405-409

Table X

## Financial Dependence of Local Autonomous

Entities: Fiscal Year 1964

(in million of won)

Entities	Total Revenues	Local Revenues			Central Treasury Contributions		
		Local Tax	Per Cent	Other	Grants	Subsidies	Per Cent
Seoul	3,419	2,598	76.0%	741	3,339	79	97.7%
Pusan	946	627	66.3	202	829	117	87.6
Provinces	7,131	832	11.7	553	1,384	3,386	19.5
Cities	2,190	746	34.0	310	1,056	413	48.2
Counties	7,137	4,003	56.1	577	4,581	1,698	64.2
Total	20,823	8,806	42.3%	2,383	11,189	5,693	53.7%
						3,941	46.3%

Source: *Chihang Haengjong*, July, 1965, p. 30.

seek central subsidies and grants without which most South Korean city governments could not survive under the present financial structure of government.<sup>(11)</sup>

#### IV. Budgetary processes and Appropriations

The budgetary processes and the appropriations for local governments in South Korea provide the central authority with another vehicle to control local government finance under the existing system. These financial processes are controlled through the hierarchy of local government. Each higher level of government controls the budgets of the lower government in the hierarchy.

The annual budgets of local governments are submitted to their superior governments for approval. The provincial governments and the Direct Control City submit their annual budgets to the Ministry of Home Affairs for final approval, while the more independent Special City submits its budget to the Prime Minister's Office for approval.

In the provinces, the city and county governments formulate and submit their annual budgets to the provincial government which supervises them. Below the county and City level, the town and village governments are not allowed to formulate their own budgets, but operate on funds allotted from the appropriations for the county government under which they exist.

This executive rather than legislative co-

ntrol over the local government budgetary and appropriations processes is at present known as a "temporary measure" in the absence of the constitutionally authorized local assemblies.<sup>(12)</sup> The local assemblies of appropriate levels of local autonomous entities, guaranteed by the Constitution as a measure of local autonomy, are not in existence, because no election for local assemblies under the Constitution of 1962 has been held by the central regime.

Before the 1961 military revolution, the local budget and appropriations were controlled by the appropriate local assemblies. The chief executive officers of the local governments were responsible for the formulation of their annual budgets and submitted them to the local assemblies. The local assemblies, after examining the proposed budgets, signified their approval by passing them. When the budgets passed by the local assemblies were signed by the local chiefs of governments, they became appropriation acts. In other words, the budget in the South Korean governmental system is more than just an estimate, it is a bill. When it passes the assembly, it becomes law, although not so designated by name. Thus, the assembly's approval of the local budget combined with it the legislative function of appropriation. Unlike the budgetary process of the United States, the assembly does not write individual appropriation bills based on the proposed budget. Instead the proposed budget is intro-

(11) *Chibang chach'i tanch'e kyolsan kaeyo*, op. cit., pp. 105-109

(12) To-ch'ang Kim, *Kaego haengjongpop, Ha* (Revised Administrative Law, Vol. II) (Seoul: Pagyongsa, 1962), p. 361.

duced to the assembly as an integrated bill (appropriation) and is treated as a whole.<sup>(13)</sup>

This function of local government appropriation is now in the hands of the executives of the hierarchy of local government. This "temporary measure" has been in effect for more than nine years.

For the hierarchic approval of the local government budget, the Ministry of Home Affairs issues a nation-wide detailed policy of a basic nature which controls the local government budget formulation.

There is an exception to this hierarchic control over the local government by the Ministry of Home Affairs. The Ministry of Education is charged with the responsibility for hierarchic control over the educational budget of the local educational system.<sup>(14)</sup>

The basic objectives laid down by the Ministry of Home Affairs for the provincial government budget formulation are specific and inclusive, so that the provincial governments, even in the stage of budget formulation, are not allowed to have much leeway for indicating their own policy differences with their superiors in the central government. The budget formulation the provincial level thus has become no more than a clerical tabulation of the policy objectives set by the central authority.

The basic policy objectives issued annually by the Ministry of Home Affairs are usually based on the budget estimates of the preceding fiscal years. Thus, the local formulation of

each government's own annual budget merely provides a strongly flavored continuation of central policy for previous years in terms of the over-all policy objectives of the coming fiscal year for the local government.<sup>(15)</sup>

When the provincial budget is formulated it is submitted the Ministry of Home Affairs for consideration. The Ministry, before it approves the budget, subjects it to two phases of examination.

The first phase of examination of the provincial government budget proposal is mainly taken up by the professional staffs in the Finance Section of the Bureau of Local Government in the Ministry. The Staffs in the Section are interested in pursuing two basic objectives in examining the provincial budget: one is to see if the proposed budget violates the basic guidelines set by the Ministry; the second is to achieve an equilibrium among the provinces.

The first examination of the provincial budget breaks the budget down by expenditures and revenues. The expenditures are arranged by the major categories of functions--General Administration, public works, Social Welfare, etc. The staffs review each category, function by function. They are allowed to reduce the amounts proposed by the provincial government which they regard as excessive or unnecessary in the light of central policy objectives. Only those items on which the staffs fail to reach agreement go to the Chief of the Finance Section, which

(13) *Ibid.*, pp. 334-335.

(14) Article 26, Local Public Finance Law.

(15) Mun-hi Nam, "Chibang yesan kaeyo" (An Outline of the Local Budget) *Chibang Haengjong* (Seoul: Naemubu Chibangguk), January, 1965, pp. 47-49.

is a principal office for local finance (primarily the budget) in the Bureau of Local Government.

The first phase of the central examination of the provincial budgets takes only twenty days and consists of a review of the budgets for all nine provinces and the Direct Control City. An average of two days is allotted for each province. For the fiscal year 1965 budget, this first-phase examination was accomplished between November 26 and December 15, 1964.<sup>(16)</sup>

The second phase of local budget examination is even more hasty. This phase usually takes a total of five days to complete; roughly two provincial budgets are examined each day. The second phase of the examination of provincial budgets for fiscal year 1965 started on December 16 and ended December 20, 1964, while the first phase of the examination is primarily a technical review by the professional budget examiners, the second phase is of a nature more concerned with over-all balance.

For the second phase of the examination, a budget review committee is formed by the Ministry of Home Affairs. The committee is composed of officials from not only the Home Ministry hierarchy but also from the Economic Planning Board, the "superministry" overseeing economic matters. Named to this committee from the Ministry of Home Affairs are the Chief of Planning and Coordination, the Director of the Bureau of Local Government, planning officers, and the chiefs of the following sections: Admin-

istration, planning and Auditing, Training, Local Taxation, and Local Finance. The chiefs of the Sections of General Budget Affairs and Budgetary Administration from the Economic Planning Board also sit on the review committee. The committee conducts the examination of the proposed budget in the presence of the Minister and Vice-Minister of the Ministry of Home Affairs.

The committee first hears the justification of the proposed budget from the lieutenant governor of each provincial government. The next witness on each budget is the Chief of the Local Finance section who previously led the first examination of the proposed budget by his staffs. His reports consist more or less of the results of the first phase of the examination. The committee then has a question-and-answer period on the fundamental policy of the provincial government. It next re-examines the problematic items considered in the first phase. It then allows a final plea from the provincial government. The whole process for all provincial governments is completed in five days.

Consideration of the budgets of nine provinces and the Direct Control City for fiscal year 1965, from submission to final approval, took less than a month.<sup>(17)</sup>

The budget for Seoul, the capital city, is considered by the office of the Prime Minister in a fashion similar to that used by the Ministry of Home Affairs for provincial budgets. The annual budgets of city and county governments in the nine provinces go through an almost identical procedure in the

(16) *Ibid.*, p. 50.

(17) *Ibid.*, p. 51.

provincincial government administration.

Thus, the local government budgets at all levels are carefully controlled either directly by the central government or indirectly through the central authority at the provincial level.

## V. Central Inspection and Audit

The last, but certainly not least powerful, institution to be analyzed in the central government's control over local government finance is found in the central authority to conduct inspections and audits of the local financial administration. The central authority for such function is based on a constitutional provision (Article 94 of the Constitution of 1962) which designates the Board of Inspection and Audit as the sole watchdog agency of the financial administration not only for the central government agencies but for the local governments at every level.

The Board of Inspection and Audit is a product of two previously separated agencies for inspections and audits. At present the Board is one of the most powerful government agencies in South Korea.

The Board is under the general authority of the President of the Republic but performs its functions independently. The Board is composed of nine Inspectors, including the Comtroller General, who the President appoints with the other inspectors are nominated by the President for a term of four years. They are by law prohibited from participation in either political activities

or private profit-making activities.<sup>(18)</sup>

The Board is empowered to conduct not only audits of revenue and expenditures, but also inspections to see if there is any wrong doing public service employees. This semi independent central agency is thus authorized to perform the functions of auditor, controller, and inspector of the local governments at all levels.

At the local government level, there is no parallel agency, although the Bureau of Local Government in the Home Ministry and the Section of Local Administration in the provincial governments exercise general administrative management control over the lower-level governments. The Bureau of Local Government conducts a periodic audit and inspection for the provincial governments while the Section of Local Administration in the provincial government audits and inspects the city and county governments. The county government performs a similar for the governments of towns and villages.<sup>(19)</sup>

The significant difference between the between the audit and inspection function of the local government hierarchy and the Board of Inspection and Audit lies in the fact that the former is limited to administrative management status while the latter's action is legal in character and of a quasi-judicial and quasi-legislative character. The decisions reached by the Board have a binding power to nullify restore actions previously taken by the local government.

(18) Article 2-9, Board of Inspection and Audit Act.

(19) Article 22, Board of Inspection and Audit Act.

Furthermore, the control of the local government hierarchy over the lower government administration of finance is focused primarily on the technical aspects of the government accounting system and its application, while the Board's interest in local government control is primarily inspection for alleged wrong doing of the local government employees.

In its audit function, the Board review the revenues and expenditures of the local

government and examines the cash, property, and securities in the possession of the local government.<sup>(20)</sup>

In both the audit and inspection aspects of its functions, the Board is empowered to request (or order) the local government to submit for examination the documents, ledgers, and other records the Board deems necessary to determine the adequacy and appropriateness of the financial decisions made by that govern-

Table XI  
Charges of Illegality of Inequity Brought by  
The Board of Inspection and Audit:  
Fiscal Year 1963

Local Government	Charges Brought	Cases Settled	Cases Pending
Seoul	144	125	19
Pusan	58	46	12
Kyonggi-do	20	13	7
Chungchong Pukdo	6	5	1
Chungchong Namdo	13	13	—
Cholla Pukdo	4	4	—
Cholla Namdo	8	8	—
Kyongsang Pukdo	7	5	2
Kyongsang Namdo	12	9	3
Kangwon-do	10	8	2
Cheju-do	1	1	—
Cities and Counties	74	62	12
Total	357	299	58

Source: Kamsawon, *Kyolsan kamsa pogo* (Report on Inspection and Auditing), 1963, p. 458.

ment. The Board can perform its audit either by examining papers submitted by the local governments or by field trips. In the performance of its duties, the Board can request the presence of, and answers to its questions

from, the officials of the local government and is further authorized to seal the safes, warehouses, documents, and articles which are under inspection, if necessary.<sup>(21)</sup>

Table XI indicates the number of indictm-

(20) *Ibid.*

(21) Article 27, Board of Inspection and Audit Act.

entsbrought by the Board and the status of the cases after its audit and inspection of fiscal year 1963. An interesting fact is that the governments in the urban areas produce more indictments than their rural counterparts.

In brief, the powers and functions of the Board of Inspection and Audit in controlling the financial administration of the South Korean local governments are expansive and sweeping, thus placing the Board high on the list of the most powerful bureaucratic establishments.

## VI. Summary

The status of local government finance discussed in the preceding pages provides a clear picture of the extent of this important central control institution--financial control.

The central authority controls all essential areas of local finance, including central legislation on local taxation, central legislation on local taxation, central grants and subsidies, central approval of local budgets, and central audit and inspection. Central control not only places local governments under a system limiting their freedom of financial action but the system operates successfully to produce two interdependent phenomena: central domination of the financial structure and local dependence on the central treasury.

During fiscal year 1965, the local governments at all levels (a total of 1,647) shared only 21 per cent (659 million). The ratio of local government spending to total spending had declined rather than increased for the preceding three-year period, thus indicating

the trend toward increased central control.

The weak status of local finance is a reflection of central domination over local taxation in particular. By a single piece of legislation enacted by the National Assembly, the central government is enabled to determine not only what types of local taxes shall be levied but also how much to levy, without allowance for local differences in the economy or the needs. This central domination over types and rates of local tax levies tends to create an unrealistic assessment of local governments' financial needs on the one hand and unresponsive and irresponsible management of financial resources on the other.

During fiscal year 1965, local taxes constituted only 40.8 per cent of the total revenues of South Korean local governments. This circumstance, recurring each year, forces the local government to seek central treasury assistance to remedy the shortage of local revenue. During the same fiscal year, the local governments received 42.8 per cent of their total revenues in the form of central government grants and subsidies. From 1960 to 1965, the financial dependence of the local governments showed a continuing trend toward increasing reliance on this source of revenue.

This pattern of central aid remains a crucial and influential avenue through which the policy and politics of the central domination over local government finance in the present South Korean system reaches its peak in the method of hierarchical approval of local government budgets. Similarly, in the absence of local assemblies, "temporary" situation

until local elections are held, the function of local government appropriation of funds is now in the hands of the executives of the hierarchy of local government.

Finally, the powerful central Board of Inspection and Audit serves as the sole watchdog agency overseeing the financa

iladministration of the local governments. The Board, acting as a quasi-judicial and quasi-legislative agency, exercises broad powers in controlling actions taken by the local governments. Thus, evidence that the central authority holds at tight grip on the local government is abundant.