Economic Democratization and Tax Reform
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1. The Importance of Economic Democratization

What are Koreans living on today? Yuna Kim gave people a brief taste of joy and foreigners singing the Korean national anthem in Korean moved the country during the past days of economic downturn. Yet that only lasted a moment. Even with the launch of a new administration, the public feel anxious due to the unpredictable direction the society is heading and the presidential approval rating is taking a sudden turn. The atmosphere is different from where the high uncertainty before the elections is resolved after the events.

Why is this? People are nervous whether President Park Geun-hye will give hope like Yuna Kim by performing impeccably or disappoint like Asada Mao by stubbornly pursuing the overwhelming triple axel. Even though President Park has strong support which includes the conservative press that try hard to cover her mistakes, maintaining her headstrong inflexibility while making errors makes it difficult to shut their eyes to her shortcomings.

On the other hand, the ruling party and the opposition were both well-aware of the fact that economic democratization is essential in solving Korea’s socio-economic problems during the presidential election. Hopes are high for the transition the country will go through with the new government, even though discrepancy exists between the two sides regarding the application of economic democratization. However, the dispute is never-ending because of the difference from its concept to application.

What is economic democratization? Most discussions start by citing the regulation from Article 119 of the Constitution. Article 119 states, 1) the economic order of the Republic of Korea shall be based on a respect for the freedom and creative initiative of enterprises and individuals in economic affairs; 2) the State may regulate and coordinate economic affairs in order to maintain the balanced growth and stability of the national economy, to ensure
proper distribution of income, to prevent the domination of the market and the abuse of economic power, and to democratize the economy though harmony among the economic agents.

The Federation of the Korean Industries, a gathering of conglomerates, and neo-liberalists argue the free market order of Clause 1) is the priority, while chaebol reformers stress the importance of income distribution, economic power abuse prevention, and economic regulation of Clause 2). It is absolutely meaningless and biased to claim one precedes the other in significance. In any case, free market order is the basic foundation, if capitalistic market economy is the economic system of Korea. However, the market economy of capitalism is commonly acknowledged as an imperfect system with numerous deficiencies due to anarchism, and the inevitable conclusion is that the government must manage and adjust for market order to function properly.

Then what meaning does economic democratization embody realistically? Economic democratization consists of three components. First is equal opportunity when starting economic activity; next is fairness in procedure in the progress of economic activity; and lastly, equity in distribution which is the result of economic activity.

Article 1 of the Constitution prescribes that 1) the Republic of Korea shall be a democratic republic; and 2) the sovereignty of the Republic of Korea shall reside in the people, and all state authority emanate from the people. This confirms that the people together are the main agent whether it concerns politics, the economy or society. Furthermore, Articles 10 to 39 define the rights and duties of citizens as the right to pursue happiness and live a dignified life and how it is the duty of the State to confirm and assure these rights. All citizens shall be equal in front of economic opportunity and enjoy liberty; however, each type of freedom, including economic freedom, will be followed by responsibility. Thus, economic democratization means that everyone is entitled to equal opportunity, procedure, and result as a Korean citizen, and the State has the duty to realize this. Hence, regulation and adjustment of the State is mandatory.
Yet, economic democratization in its true form, apart from perfunctory democratization of legal regulation including the Constitution, needs to be understood with the prerequisite of recognizing society as the entire system configuration. This is because all aspects – politics, economy, society, culture – compose a person's life. In addition, the subsystems (political, economic and social system) of these aspects have different regulations and conduct codes. For example, capitalist market economy accepts the "one-group-one-vote" principle and works based on competition to solve scarcity effectively. But the political system in a modern civil state is democracy of "one person, one vote" with the root principle that all people are equal. Moreover, the social system that directly manages our lives is founded by the community, formed of families and local neighbors, where everyone is an equal member. Here, the fundamental is co-existence and cooperation. As a result, interpreting the concept of democratization from one aspect will only hinder us in solving the problems we face in reality.

Capitalist market economy is established on free competition to achieve effective economic behaviors of production, distribution, and consumption of life's necessities. The one with market power should not be able to act as the price maker whether it is the factor market that deals with labor and natural resources or the product market that trade in produced goods. In other words, the government has the duty to monitor and regulate the market for fair competition to take place. Theoretically, market order consists of a causal process of market structure, market behavior and market performance. Structural competition must occur to eliminate behavioral contest and that will lead to desirable performance.

Yet, the historical development of capitalism which began with unfair discrimination between the haves and have-nots from the start is already deep in its monopolistic capitalism phase. That is why a structural competition without the one with market power does not exist in reality. As a result, the government's regulation and adjustment of market power abuse or unfair transaction in the process of behavioral competition, as well as the high price and absurdly steep profit rate resulting from monopolization become the subjects of performance-based regulation.
However, the indiscriminate expansion of globalization pressure promotes an early end of nation-states in addition to infinite competition without a regulator. The reality where a world government is absent to set fair rules as an arbitrator let international economic organizations, such as IMF, to play this role. They take sides without hesitation and are busy rationalizing the greedy behavior of speculative international financial capital. It is like watching an endless match for commercial gains with no regard to the different weight class.
2. Economic Democratization and the Role of Government

Then what is the role of government for economic democratization?

First, the government must prevent unfair competition caused by the inheritance of production method from the very beginning to provide equal opportunity. The succession of conglomerate system and rampant illegality and expedients in any of these processes should rightfully be sanctioned. Certain restriction on gift and inheritance is inevitable, excluding the minimal succession for communal livelihood, for not only conglomerates, but also inheritance of any production method. This is the reason why gift and inheritance tax must be in place and be strengthened in part. Furthermore, the use of holding tax for proper amount of wealth and property can be linked to this.

Next is the need of legal foundation and supervisory and regulatory behavior for procedural democratization in market competition process. In simple language, Fair Trade Commission, Financial Services Commission, Korea Communications Commission and other supervisory organizations have an important role concerning information distortion and unjust transaction. Regulating and restricting excessive advertisement expenses, expense deduction of entertainment expenses, monopoly, tyranny against subcontractors, and opportunities to gain profits through speculative activities that are not productive are some examples. Financially, this is why stronger capital gains tax and other taxations are needed for companies with reserves seeking capital appreciation and real estate speculation, respectively.

Lastly, fair distribution/redistribution for democratic results is an integral part of the government’s role. Fair distribution/redistribution can be divided into a way to ease disparity or guarantee livelihood security depending on its character. Gift and inheritance tax is a proactive measure and progressive income tax and property tax would be retroactive measures to narrow the gap. Diverse social security systems including income security, housing security, medical security as well as compulsory education fall under means of guaranteeing livelihood security.
Accordingly, we need to review the recent developments of decentralization for the expansion for grassroots democracy in relation to economic democratization. Especially, if centralism where concentration of wealth corresponds with concentration of power at the stage of monopoly capitalism was a trend, globalization, marketization, low birth rate, aging and other socio-economic changes pressure the governments to move towards decentralism.

Thus, reform of the conglomerate system is unavoidable to establish a market competition system when we breakdown economic democratization into the three aspects of opportunity, procedure, and result. Also, there is the uneasy task of democratically resolving the very tight alliance between politics, administration, economic world and press which is widely internalized in monopoly capitalism. A democratic reorganization will be needed for various social capitals such as legal framework directly related to conglomerates, bureaucracy, political parties and electoral system, financial system, telecommunications system and labor laws. Furthermore, we come to the principal understanding that it is necessary to seek an insightful alternative system that solve the means of livelihood directly connected to people’s lives through a cooperative community, rather than a competitive market system.

In addition, another challenge is to revolutionize election so that the political system is represented by 80% of society, not just 20%. The government building an extensive social safety net will make creative innovation possible in the market while being a prerequisite to trust of economic stabilization in particular. In short, social integration must be the premise for capital accumulation, the ultimate goal of market economy, and the government’s proper regulation and revision mandatory in supplementing the state of anarchy to stabilize cycle of production and consumption.
3. Financial and Tax Reforms for Sustainable Growth

1) Agenda and Direction of Financial and Tax Reforms for Sustainable Growth

“Globalization”, “Informatization”, “Softnomics”, “Localization”, “Population Aging”. These are key words that represent socio-economic changes of the 21st Century. The 1997 Asian financial crisis was a result of failure to respond to the changing world with much-needed flexible reforms, and it ended with restructuring measures imposed by external enforcement for sustainable growth. The 2008 global financial crisis is causing a serious budget crisis in many advanced countries. Coping strategies involving inflation have led many nations to currency wars.

Search for a comprehensive socio-economic reform is essential to overcome the current economic crisis caused by reckless and unilateral globalization. We could fall behind in the dynamic transformation of the world economy. The reform of the fiscal and tax system should also factor in those changes and seek to build a socio-economic structure for sustainable growth.

Functions of a modern state can be summarized as capital accumulation and social integration. Financial system and structure are determined by these functions as well. There are criteria we have to meet in order to reflect the change of the times and create appropriate capital accumulation structure and social integration for sustainable growth.

First, Korea needs to build a sound economic structure capable of sustainable growth in the limitless competition of capitalism. While sustainable growth can mean many things, here it means a growth mechanism where division of labor is constructed through growth factors being produced-consumed-reproduced internally, and where mutual dependence leads to advanced external relations. The era of rapid growth from input expansion has ended. As
the key words of change indicate, in today’s world we need to innovate ceaselessly to survive in this knowledge information society. The government’s role is to prepare the foundation for creative reform. We need to shift the focus from material investment to human resource investment. We need to build a secure society where the quality of life is guaranteed for everyone. The role of finance should center on creating a foundation for knowledge industry such as education, environment, and informatization.

Second, we need to alleviate disparities between sectors, regions and classes resulted from anarchic capital accumulation and build a socio-economic structure that provides a basic livelihood for everyone. To secure a healthy and smooth operation of market competition, it is a prerequisite for the government to include those who lag behind into the economic cycle of growth. There should be a social safety net of basic livelihood and consideration for underdeveloped regions which represent uneven regional development. When these issues go unaddressed, the organic cycle of the nation’s economy will fall. A strong solidarity of Korean society is essential to survive in the infinite competition of international market. If the principle of cooperation and co-existence doesn’t work, market competition is impossible. The financial system is the node that connects these principles and the actual social system. The core issues of the society such as education, medical service, housing, transportation, regional imbalance, water and environment require harmonious efforts between economic growth and social integration. Various social demands leading to higher financial demands inevitably cause difficulties in funds supply.

Third, we need to establish sound socio-economic order and practice. As Korea comes out of domestic and international financial crisis, the importance of the economic order and ethics has once again come to the fore. Irregularities and unfair practices which had been connived under the name of fast track to success resulted in lack of substantiality in the process of globalization. In other words, so-called Asian values that were glamorized in the past were shattered by the logic of transnational capital. The fundamental question of
whether such changes are appropriate or not is not attracting much attention. Then what we need is well-organized economic ethics and framework that will enable us to maximize the benefit of Capitalism, that is economic dynamism, which includes the spirit of Capitalism, work ethics, the role of government, and competition order in the market, to name a few.

Unfortunately, however, the government has directed instructions and interventions, overriding the rules of the capital system as Korea was busy to push economic growth. The dogmatic decision making from the state created the tendency among economic players to depend on special favors rather than fair procedures. Common unfair practices in the economy led to failure of justification of wealth, and economic players ended up indulging in speculative profits. And the rich and powerful are now being the barriers against structural reform. As we can see, unfair practices of chaebol system and unproductive interventions of the government were the main culprit of distorted order and framework, using the nation's coffers and finance. Therefore, the direction of financial reform should be restoring and normalizing distorted financial system and structure to make it fair and efficient.

The financial reform to address these challenges should start with establishing the public's financial right through a democratic overhaul of the financial system. The financial right, which is secured in the process of democratization, refers to the right to know about the fiscal status and to involve in the allocation and use of budget. At the core of it, there is the release of a transparent and easy to understand report on the financial decisions and the results of the central and local government. The current financial reports are drawn up from a statistical perspective, and difficult to understand even for experts. When information is monopolized by special interest groups and bureaucrats, it is more likely that decisions on financial spending and tax cuts are influenced. The public will participate more and bear more responsibilities when details of financial decisions are released, such as tax collection, financial investment and loans, government ordering, and the relations between central and
local government. The financial reform should be about rebuilding the right system and practice where democratic financial regulations can function.

Secondly, the centralized financial management methods should be revised to a decentralized one as it was designed under the assumption of a firmly established financial right. Government led economic development plans required strong centralized system. But the rise of globalization and localization caused the nation-state to wane, requiring a new decentralized system of joint participation and shared responsibility. Another global trend is the neoliberal government reform with the catchphrase of “from public to private” and the authority transfer “from central government to local governments” to change non-market service provision system. In particular, the expansion of citizen’s participation and transfer of authority and funds from the central government to local governments based on autonomy, participation and responsibility are the two most significant elements of the reform.

Thirdly, we need to establish democratic regulation measures in the management cycle of budget, which is planning-execution-balancing. Current control-oriented budget management system should shift its focus to performance, and more measures for citizens’ participation should be introduced in order to prevent collusion and irregularities in the national assembly’s review process. The National Assembly Budget Office was created in 2003 with the aim of enhancing the specialty in the assessment and evaluation of the budget, yet the function of checks and balances in budget compilation is insufficient.

Fourthly, along with the democratic reform of the financial system, the revenue and expenditure should be restructured as well. The finance structure should move away from growth-first policy to a sustainable socio-economic structure centered on citizens’ quality of life. The SOC needs to prioritize social safety net and basic livelihood over production, and the public’s contribution, including tax payment and social security fund should be used for income redistribution and equity recovery.
Lastly, the whole process of budget execution and results from tax collection to government expenditure should be released to the public in a transparent and simple manner, so people can engage, bear responsibilities, and guard against possible inefficiency and unfairness.

2) Direction of Tax Reform for Sustainable Growth

On the premise of democratic financial reform, there are two major discussions regarding the direction of tax policy or tax reform for economic democratization. One is the short term plans to secure the tax revenue, and the other is building a stable and desirable tax system that can withstand and overcome financial crisis. To realize either of the two let alone both, a complete restructuring of the current tax system is necessary.

The primary purpose of the tax reform is to restore the financing ability and fiscal sustainability. After the Asian financial crisis, easier financing measures, including selling public enterprises and issuing national bonds were commonly used which rendered tax revenue less significant in government fund. Add to that, the former president Lee Myung-bak’s large-scale tax cuts and unreasonable state bond issue for reckless construction projects on four rivers significantly damaged the nation’s fiscal stability. Tax revenue elasticity and the fairness in taxation were both seriously hampered.

Efforts to privatize public enterprises haven’t stopped. Apart from the discussion around functions as SOC, selling them merely generates a temporary revenue increase irrelevant to structural stability. Seeking an easy exit from the crisis instead of imposing the burden on the people who made excessive unearned profits in order to win votes is injurious to the principle of finance management. In case of resale of a nationalized company during the crisis, it is only right to use the revenue to reduce the national debt.
Similar cases are found in local governments. There are many pork-barrel projects to win voters' hearts the easy way, such as selling off publicly owned land. However, those financial practices backfire and, after a while, lead to increased spending in the government and growing burden on citizens. On principle, the revenue for current expenditure for both central and local governments should come from tax. Given the aggravating social polarization and division, we much pursuit expansion of universal welfare for social integration and a tax reform for the recovery of financing function is necessary.

The fundamentals we need to discuss for tax reform are principles of the tax system, the level of tax or tax rates, and setting standards for assignment of the tax burden. Based on a review of the current tax system focused on efficiency and equity, the purpose of the reform should be determined whether it is the recovery of financing function or an intended economic effect for a specific policy. In case the former is chosen, the reasonable level of tax rate should be discussed as well. The socio-economic changes that came with the new century call for the balance between efficiency and equity. At the same time, tax related regulatory measures on speculative profits are unavoidable considering the growing criticism on deregulation and tax cuts that went unchecked for greedy financial capital expansion during the globalization process. In particular, from its development phase, Korea's tax system focused more on efficiency and financing function over equity, and the burden of crisis management was distributed unfairly. Therefore, the tax reform should start with efforts to recover the equity in assignment of the tax burden.

To be more specific in tax reform discussion, first, we need a comprehensive review of the current assignment system and tax rate in national tax, local taxes, and social insurance fees. Second, we need an overall review of the distribution system between the national tax and local taxes, and examination of individual items. Third, we need to identify unfair elements in the current system. Fourth, we need to check inefficiency factors caused by the current tax
system. And fifth, we need to produce a reasonable and efficient system and promote tax morale.

Before we move to the concrete tax reform discussion, it needs to be noted that there are too many tax items in today’s system. Currently there are 25 items, 14 types of national tax and 11 types of local taxes. The number has gone down through previous tax reforms, yet surtax is excessively being used for special purpose tax. As such, streamlining the current system is one of the most fundamental and important tasks in tax reform.

With the desirable tax system in mind, let us turn to the major issues in existing tax assignment reform and measures to make the current system more reasonable.

3) Appropriate Tax Burden Ratio and Fiscal Responsibility

Reviewing the adequate level of taxation should precede the discussion on the concrete course of tax reform. A tax burden ratio or national burden ratio indicates citizens’ burden on sovereign activity. The size of citizens’ burden is discussed due to the two following reasons; does the burden of taxpayers correspond to the public service they are provided with; can the current level of burden be sufficient to provide a range of public services in demand and overcome potential financial crisis?

Its adequacy can considerably vary according to value judgments and in reality the standard lies in the global trend. Along the rising tide of neoliberalism since the 1980s, calls were high for no or limited government intervention on market economy. This was a counteraction to Keynesian welfare state that has expanded to overcome the crisis of capitalism since 1930s as well as an ideology for the greater opportunity to accumulate speculative financial assets.

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1 A tax burden ratio equals the total tax including national tax and local tax divided by GDP. A national burden ratio equals the tax and social security contribution divided by GDP. Social security contributions encompass the burden cost in health care, public fund, unemployment insurance, occupational health and safety insurance, etc.
The role of a nation varies in accordance with the changing socio-economic conditions and is not to be evaluated upon cyclical quantitative scales. It is now in transition from the 20th century type to that of the 21st century. Thus, the adequacy issue should be adjusted according to the clearly identified role of a nation that meets the demand of the time. Moreover, measures should be sought not only to tackle economic recession and fiscal crisis at the same time but also to realize economic recovery and reconstruction of public finance.

A national burden ratio in Korea is not as high as that of developed nations even compared to the days when their income levels were similar. A tax burden ratio in Korea has increased ever since the 1997 Asian financial crisis. The tax burden ratio based on nominal GDP as of 2005 shows an increase from 17% in 1998 to 21% in 2007. This was partly due to the increased tax revenue from economic turnaround. So as to meet the rise in fiscal demand, efforts were made to legalize taxation standards as in the increased use of credit cards and expansion of VAT taxation target. At the same time, strengthening wealth taxation and imposing further indirect tax on transportation, alcohol, etc. have played a role. The Participatory Government that levied additional tax on wealth, e.g., comprehensive real estate holding tax, however, lost public support due to the tenacious attack from conservatives. In response, the following Lee-Myung Bak administration announced tax breaks. While a reserved crisis management was indispensable in the aftermath of global financial crisis, the Lee administration issued government bonds to finance public works while cutting taxes. As a result, a tax burden ratio in 2010 fell to 19.3%.

Still, growing concerns on fiscal soundness and increasing welfare demand inevitably entail a gradual rise in the tax burden ratio to regenerate financing. If the ratio is raised up to 21-22% as in the Participatory Government, social integration cost required at the current level can be sufficiently procured.

At this juncture, a different approach from the original tax burden theory is necessary, i.e., social wage. In other words, unlike in the industrial capitalist era where capitalism was sought after by the private sector, in the stage of monopoly capitalism, the production size expands so rapidly that private recreation alone cannot maintain the social system and
social recreation should play a complementary role. In essence, wage in the private sector can no longer reproduce labor solely by itself but the reproduction cost should rather be complemented by social wage to realize social integration and maintain a smooth capital accumulation.

It is undoubtable that the crucial means to procure social wage is a progressive and distinct direct tax, or income taxation. Korea is witnessing the ever-growing roles of social integration as well as capital accumulation. Here, awareness should be raised on the fact that what Korea needs is not the theory of micro-efficiency and equality but the payment of social wage by raising direct tax for market economy to sustain. It is not the general public who should be liable of adequate tax burden but the high-income earners who have enjoyed tax provisions so far, kept massive capital gains to themselves in the times of crisis, and are now obliged to share the burden.

4) Tax Equality and Reform

(1) Recovery of Fair Income Taxation

Fair taxation – vertically and horizontally – per income type and class should be realized to for an income tax to recover its due role. In Korea, the individual income tax system can be defined as follows; one, asset-type income taxes such as interest dividend income or capital gains from stock, land are co-shared through special deduction or separate taxation; one, the privileged class who exclusively enjoys large income are not thoroughly taxed, e.g., politician, religious believer, doctor, lawyer, tax accountant, patent agent, etc.; one, wage and salary earners are heavily taxed; one, a huge gap exists in locating a source of taxation per different income source; and one, a massive sum of derived income acquired through manipulation as in the case of new financial entities that cannot be easily tracked down. As a result, citizens find the income tax burden unfair and tax administration untrustworthy.

Reforms to the individual income tax code can be approached in mainly two directions. One is an issue of taxation itself that lies in fully realizing composite income taxation which pursues the ideal comprehensive income tax. The other is an issue of practical tax
administration to narrow the gap between the capture rates per income type. The latter includes adopting taxation measures in consideration of different capture rates.

In the process of income taxation, whether to apply differential tax rates on capital income should be reviewed. In globalized world, a small-sized open economy requires a seamless safety net as it can be a focused target of international speculative capital. As such, the issue boils down to whether Korea should adopt the Swedish dual income tax system which is considered a symbol of small-sized open economy. It is to realize progressive taxation centered on earned and business incomes and apply an excess tax rate on capital income. For one of the ten top global economies in terms of size, the fundamental solution would be to enhance the ability to cope with the potential financial manipulation caused by international speculative capital. Applying a marginal tax rate would be an evasive measure.

Dual income tax refers to imposing national tax on local public services and capital income from which one that profits is unclear while levying a local income tax limitedly on earned income, business income and property income that pertain to the local area when designing income taxation of national and local tax. As in Northern Europe, for instance, as for earned and business income, it is a valid reform to levy proportionate basic tax in the form of local income tax and progressive tax rate in national tax for income redistribution. This also serves the purpose of decentralization reform. Especially, by reducing tax deduction and tax rates, low-income individuals can also be allotted with the duty of paying a least amount of tax as a citizen. If every citizen takes an equal tax burden according to the size of income and a local government provides a social safety net to guarantee a dignified life, they would be able to acknowledge the relations between burden and benefit.

Income taxation is one of the most desirable measures that satisfy both finance and income redistribution. Composite income tax introduced in 1974 ahead of value added tax to relieve inequality in tax burden failed to serve a proper role. Rather, it was a device that allowed justification of taxing citizens for their earned income. That makes reviving comprehensive composite income tax of its function the first task of reform.
To this end, capital gains as well as capital income from assets such as interest, dividend and rent should first be included in the targets of taxation amid the transition from a high-growth flow economy to a low-growth stock economy. Use of credit cards or debit cards should be constantly encouraged to narrow the gap in income capture rate.

Second, it is crucial to secure the efficacy of minimum limit of taxation and progressive tax. Minimum limit is meaningful in that it is equivalent to deduction of necessary expenses in terms of earned income. In Korea, however, it has been expanded as a compensation for disproportionate distribution or increased burden of indirect tax. Expanded tax deduction only increases non-taxable income class and does not have a redistribution effect on the undertaxed class. When an income tax cannibalizes a tax source, the countermeasure to increase indirect tax like alcohol tax or tobacco tax for financing can lead to counter-redistribution.

Administrations following the Asian financial crisis have lowered tax rates. As a result, supposed income distribution via taxation was reduced in its effect while resulting in the lowered tax burden for the high-income individuals. If maximum marginal tax rates fell by 5% from 40% to 35%, one comes to wonder how much less tax has been collected on dividend income of CEOs of conglomerates. Therefore, at a time when recovery of fiscal soundness and new fiscal demand require increased tax revenue, maximum tax rates should be raised for the burden sharing of high-income class.

(2) Increased Wealth Tax

One of the measures that literally bridge the income gap is wealth taxation. It consists of three aspects; gift and inheritance taxes as an institutional filter on wealth inheritance in a capitalist market economy; acquisition/registration tax imposed on the transaction of wealth and asset; and wealth tax on wealth possession.

In regards to gift and inheritance taxes, neoliberals are calling for the repeal, whereas the opposing parties request full comprehension so that wealth inheritance is regulated and opportunities are equally guaranteed.
Arguments that the taxes go against tax legality are raised but this is not about law and regulation but about the nature of regime. That the early progressive (“discriminatory”) tax in developed countries was targeted at inherited income shows the importance of securing a level tax field in a capitalist society.

Since tax revenue raised from gift and inheritance taxes has a minor impact for now, its impact on the economy is often undervalued. Creating a fair ground for income distribution, however, is the basic premise that maintains society-wide cohesion. Moreover, when corrections cannot be made on unfair conditions resulting from competition, inheritance of massive wealth without personal efforts may risk sustainability of capitalism.

Acquisition tax that is classified into wealth tax but often into transaction tax is always an issue regarding the reshuffle of local tax code. Not only neoliberals but also a school of fiscal experts have presented measures to ease acquisition and registration tax while reinforcing wealth tax, calling for less transaction tax and more holding tax to curb speculation in a real estate market. Case in example is a rise in wealth tax and successive introduction of composite real estate tax during the Participatory Government.

This, however, is a completely illogical rhetoric. A problem in real estate speculation lies in those who trade real estate frequently according to the fluctuation in the market, not in property holders for 10 to 20 years. In fact, lowering transaction cost results in reduced transaction cost and instigated speculation. When home prices and the holding tax rise, the tax burden is rather imposed on an unspeculative generation who has lived in one place for a long period of time and has seen it being included in the development area.

Another issue spotlighted in regards to raising wealth tax is the reinforcement of holding tax. This has been raised theoretically and empirically for some time but has not seen a practical effect. In reality, the reason behind a call for increased holding tax is to rein in real estate speculation but a fault lies in the policy means. Speculation should be curtailed not through a holding tax but from taxing capital gains. If capitalism basically acknowledges private ownership, controlling the possession of asset is not the right policy. The first step would be
reexamining the article in which housing is defined as a private possession. Providing public rental housing would be a much more effective policy when low income families are suffering from affording a house. The issue will not surface until the depressed real estate market picks up but speculation is a concern in Seoul, Gyeonggi province, in new cities in a few metropolitan areas or in expensive regions. Therefore, the nationwide increase in holding tax may meet a more direct resistance than that in the progressive income tax.

Raising a holding tax not as a real estate measure but in regards to the provision of local public services that directly affect real estate prices would be much more valid both theoretically and empirically. Relating to education finances as in the cases of developed nations would be effective but under the separate self-governing education that exists today, linking burden and responsibility is difficult. Because it is a fundamental issue related to reform on decentralization, comprehensive reform measures should ensue to see a valid result.

5) Efficiency and Tax Reform

(1) Investment and Corporate Tax

Three issues are contested regarding corporate tax in a tax reform: whether to continue or discontinue corporate tax, whether to lower a tax rate, and whether to maintain special tax measures.

First, whether the corporate tax should stay or expire will be examined. So far, some neoliberal researchers including The Federation of the Korean Industries have argued for repealing corporate tax, pointing to the theory of double taxation on corporate and dividend incomes. The theoretical aspect on the foundation of corporate taxation and the practical aspect to reduce tax burden of capital are intermingled in the discussion. Surrounding the legal status of a corporation, there has been a prolonged debate over real entity theory and fictional theory. Legal status of corporations varies in a different country. As Korea regards corporate identity a real entity, corporations have the duty to pay tax as
individuals do. Other various economic factors are cited to lift corporate tax but most of them lack in-depth insight.²

Opponents insist that corporate tax be lifted and dividend income tax be raised. However, such an argument is flawed. One problem is capital gains. Corporate profits that are not divided but reserved are reflected in stocks and generate capital gains. Thus, even when capital gains tax is in place, if not absent at all, there are limits to taxation methods. It is natural that capitalists including main stockholders prefer reservation to dividend income tax in pursuit of capital gains. While dividend income tax can be levied in the form of fictitious dividend, taxation on the unrealized income will have a limit in terms of taxation theory and encounter a huge disagreement from the capital side.

Lowering corporate tax rate and implementing special tax measures is the second agenda. As mentioned above, the former is driven by the exterior pressure of globalization. However, it is supposed to be discussed in relation to a competitor as the corporate tax rate in Korea is not high enough to meet the global standard.

Proponents of lower corporate tax raise their voices whenever the economy slows down in the name of economic recovery. Scholars’ opinions vary on the relationship between increased corporate tax and economic recovery. No empirical indicators showing the Lee administration’s tax cut contributed to investment expansion and economic recovery have ever been reported.

A number of theoretical premises are needed to prove validity of the idea. That is, a decisive factor of investment is profit rate and corporate tax strains investigation by reducing after-tax profit rate. This may be valid in the neoclassic investment theory. As Keynes pointed out, however, the investment decision is made on the expected profit rate, which is often an estimate projected by subjective investors. No matter how low interest rate or tax rate may be, investors do not roll a dice when future is highly unpredictable. No matter high a short-term profit may be, companies do not increase investment on facilities when a long-term market prospect is dim. Moreover, factors that affect profit rate are competitiveness and

² Study on Corporate Tax Reform, Lee, Insil et al., Korea Economic Research Institute, 2002.
market conditions, not corporate tax rate in which the burden to bear is decided after profit is generated.

Today, real investment is sluggish in Korea not because of the profit rate but because of market uncertainty. Thus, tax cuts to boost the economy will have a relatively marginal effect in the low-growth economy. Furthermore, a special tax measure is more desirable than a tax cut to spur investment. Partial tax cuts such as temporary investment tax credit lead to increased tax revenue after a certain period of time but general tax cuts such as lowering tax rate does not generate the similar effect. At a time when concerns over fiscal soundness are high due to piled government debt, weakening the natural increase in revenue is simply undesirable.

For instance, despite tax cuts that have been in place since the 1990s, the Japanese economy has been trapped in the vicious cycle of economic depression and accumulated government debt rather than turning around, and Korea has a lesson to learn from Japanese experience. For a country like Japan that is struggling with chronic economic downturn due to its structure, a proactive fiscal policy that nurtures a new growth engine is much more needed than tax cuts. In order to drive technological innovation towards a knowledge-based economy, policies that build social safety net on the production site to attain social cohesion and boost social investment on education and R&D would be far more effective.

Aside from the tax cut debate, many critics point out that the current corporate tax is problematic in terms of economic efficiency. Under the two-tier tax rate regime with a huge gap between the maximum marginal tax rate and low rate, 90% of corporations are applied a low tax rate. What is needed is redesigning the corporate tax rate to address inefficiency of marginal tax rate, not a tax cut based on the international comparison.

The structural problem in tax rate is related to the reckless tax credit policies. So far, the government has pursued growth by setting a high nominal tax rate while relieving the actual tax burden with a variety of special tax provisions. Such measures should be phased out while impractical tax credits should be streamlined in a decisive manner. Then, marginal tax rates should be adjusted with the overall fluctuation of tax revenue in consideration.
(2) Consumption and Value Added Tax

In terms of income redistribution, rational restructuring of value added tax code is intricately connected to strengthening tax base of business income earners. The most important factors discussed in this arena boil down to simplified taxpayers, duty free, and zero tax rate. Special tax treatment that has been an issue is now lifted and was arranged into general taxation and simplified taxation. Still, there is a high rate of simplified taxpayers whose tax due is minimal. While simplified taxation should be slashed in stages with a realistic tax base, it is essential to make tax payment of small-scale business more convenient, e.g., non-collection of small tax amount. Duty free should also be gradually downsized but as specific cases need to be reviewed, it will not be discussed in this paper.

Meanwhile, some fiscal experts are calling for the rise in value added tax rate. Discussions on higher VAT are always available to secure tax revenue in lieu with the increased fiscal demand. However, discussions that should be rendered attention are those at the introduction of VAT. In other words, the claim that composite income tax should be levied two years ahead of VAT adoption to address the fundamental reversibility of burden must apply the same after increasing value added tax rate. The increase that will inevitably follow so as to secure social welfare fund after the functions of income tax are fully recovered – procuring tax revenue and redistributing income – deserves a due consideration. High value added tax being imposed in Sweden and other welfare states is noticeable as well.

In the current tide of tax reform in which capital tax cut is disproportionate to labor tax boost, however, an effortless increase in value added tax is economically and politically not viable. Progressives should weigh the advantages and disadvantages of VAT increase via thorough review for shared growth if inconsistencies of capitalist market economy cannot be fundamentally removed.
4. Long-term Design of Tax Regime

Terms that define the socio-economic changes in the 21st century are said to be globalization, localization, ageing, and information. As the role of a nation is changing, fiscal policies and financing should change accordingly. Fiscal reform in line with the varying role of nation is fiscal democracy. Fiscal democratization refers to a democratic reform of fiscal and tax regimes as well as management and practices of institutions. Its results should be as democratic as the process. In short, the main agents of reform should be citizens.

Democratic fiscal reform should start from changing the frame of nation. Thus, a comprehensive reform of the nation is necessary for the three sub-regimes of society – politics, economy and society – to form organic and complementary relations. Skeptics doubt that a country where democracy is yet to be deeply rooted in the political arena can successfully undergo the democratic reform of government structure. The obsolete political structure undermines the nature of parliamentary democracy and local autonomy. Democracy should settle in politics, economy, and society. To this end, it is urgent to secure separation of power and decentralization so that every agent is allocated responsibility and duty to participate in building a democratic society. Fiscal reform should be directed to devise institutions that enable such allocation.

Reforms on fiscal structure and tax regime, a prerequisite for an open and symbiotic society, do not go hand in hand with the vested interest. Tax should be spent to improve quality of life of citizens and social and economic systems that allow sustainable development should be established. A key to fiscal soundness and economic recovery in the post crisis era is to ask every citizen for burden sharing. The existing structure and regime that ask for the sacrifice of working public require a reform from the very root.

Under chronic deficit due to enlarged welfare spending, Sweden received a bailout from the International Monetary Fund and pushed ahead aggressive fiscal policies to achieve both fiscal soundness and economic recovery. The Swedish government cut welfare benefits, asking for a sacrifice of low-income class and at the same time, saw growing tax revenue from increased maximum income tax. With fiscal capacity, the country concentrated
investment in education, environment and digitization, achieving economic recovery. Since the 1990s, Sweden has succeeded in maintaining fiscal surplus, economic recovery and low unemployment rate while most developed countries were suffering from fiscal deficit and economic recession in the midst of global financial crisis. A lesson from Swedish case is that they put an emphasis on cooperation over competition and has built a sharing, co-prosperous society.

Armed with the theory of global standard, Korea has demolished the base of citizens’ life, patted working public against one another, and rattled trust, inviting the current crisis of social destabilization and capital accumulation. It has been proven that tax cuts fail to contribute to economic recovery. Still, neoliberals including the FKI are holding onto the outdated tax cut theory. The tax reform in demand inevitably requires a larger total tax contribution to meet both ends of recovering fiscal soundness and procuring social integration cost.

Furthermore, reforming the tax code that will pave the way for decentralization reforms will be necessary to establish a democratic supply system of non-market public services. It is high time that the haves who enjoyed vested interest from the existing economic operation and thus are resistant to decentralization go along the tide of change. Koreans’ yearning for the decentralization reform in politics, finance and residential community was expressed ahead of the 2014 local election so that local governments could be endowed with authority, e.g., deterring party nomination for local government elections. The collective will was highly visible in the presidential election as well. The task now is to implement reforms following democratic procedure grounded on the public consensus.