Challenges and Trends in Fiscal Sustainability and Tax in Korea

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Long-term projection based on 2015 system

- Welfare expenditures are expected to increase from 10% of GDP in 2015 to 20% in 2040
  - To 27% in 2060
  - based on 2005 series of GDP

The new government has plans toward a more generous welfare system

- National Health Insurance: wider coverage, lower co-payment
- A new child allowance
- To increase Basic Senior Pension
- To increase EITC
- To increase public support for education
Increasing trend of National Debt

- National Debt Ratio increased from 28.7% in 2007 to 38.3% in 2016
- The ratio is still low, compared to other countries
- But we are worrying about the rapid rate of debt rises
  - The national debt ratio went up by 10% point during the last 10 years
- During the last 10 years, the government announced that they would try to keep the ratio below 40%
- However, the current government (the President Moon) does not say anything on debt issue
National Debt/GDP (%)
In Korean society, preference for income redistribution is very strong
- Compared with other countries, the degree of income inequality in Korea is relatively low
  - Gini coefficient for market income: 0.336 in 2013, the lowest in OECD countries
- The income redistribution function of tax and fiscal expenditures is very weak
  - Gini coefficient of disposable income: 0.302, 17th in OECD countries
- Income inequality has recently been expanded

The new government also shows strong support for income redistribution
- As for tax policy, plans to increase top rates of corporation tax and personal income tax have been proposed
Trends of Gini Coefficients (Sung, 2015)

[Graph showing trends of Gini coefficients for different income categories from 1982 to 2012.]
International competition of businesses

International competition of tax policy
- Lowering corporate tax rates, different from recent trend of Korea

Most of the governments in the world are trying to keep tax base from being eroded due to international tax avoidance or evasion
- BEPS(Base Erosion and Profit Shifting) project of OECD
Need more revenue under certain constraints

- International competition
- Slow economic growth
  - Growth rate of Korean economy: below 3% compared to 10% in 1970’s and 1980’s
- Not much room to raise tax revenue through improvements in tax administration and improvements in tax system

In order to raise sufficient revenue, need to focus on PIT, CT, VAT

- Shares of these taxes in national tax revenue: PIT 24.3%, CT 24.4%, VAT 29.6%
Recent trend of Tax Revenue

Tax/GDP ratio (%)
In order to raise sufficient revenue, need to focus on PIT, CT, VAT

- Shares of these taxes in national tax revenue: PIT 24.3%, CT 24.4%, VAT 29.6%

- Need some big changes
  - depending on autonomous increase followed by economic growth, improvements in tax administration and tax laws might not be enough
Discussions on Tax Policy (3)

◆ (CT and PIT of the highest income class) vs
(VAT and increase in PIT of all income classes)

- The government proposed to raise CT rate for very large corporations
- and to raise PIT rate for the highest income class

◆ Evaluation

- Efficiency: VAT > PIT > CT
- Income redistribution: PIT > VAT
  - CT is irrelevant with income redistribution
  - VAT is evaluated as proportional rather than regressive
  - PIT of the highest income classes may have only a limited effect
- Efficiency of the welfare system : VAT > PIT > CT
Current status of these taxes

- ETRs of PIT are relatively low for all income classes
- VAT rate: 10% - lower than many other countries with VAT
- CT rate: top rate (25% in 2018) is in the middle of top CT rates of OECD countries

Other tax issues

- Tax on capital income
- Tax on property
- Sales tax on fuel
Thank You!