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PROBLEMS OF ECONOMIC DEVELOPMENT AND FOREIGN EXCHANGE CONTROL IN KOREA

by

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PREFACE

One of the most striking characteristics of the developing underdeveloped countries of today may be found in the fact that those countries are suffering from balance of payments difficulties. Korea is by no means an exceptional case. Rather, the balance of payments problems in Korea are more acute than those in other countries in the corresponding stage of economic development. It should be, however, noted that the balance of payments difficulties are nothing but reflections of various obstacles confronted by each country in the course of economic development. Accordingly, the analysis of the factors responsible for the balance of payments difficulties should be the precondition for the exploration of possible ways to mitigate or overcome the difficulties and thereby to contribute to the economic development.

The objective of this thesis is to determine the extent to which foreign exchange control policies have contributed and will be able to contribute to the mitigation of the balance of payments difficulties and therefore to the economic development in Korea. For this purpose, this thesis tries to answer the two broad questions, namely, (a) what are the major factors impeding the economic development of Korea and responsible for the fundamental disequilibrium in her balance of payments? and (b) what sorts of foreign exchange control policies have been adopted by the Korean government to combat the particular problems reflected in the

balance of payments and how such policies contributed to the solution of the problem; particularly during the period 1953 - 1958?

Economic development is a complicated process. The factors that affect the economic development of Korea are numerous ranging from social, political, historical, cultural and even religious factors to the purely economic factors. Nevertheless, (a) capital deficiency, (b) population pressures, (c) shortage of natural resources, (d) chronic inflationary pressures and (e) inadequate governmental economic development policies stand out as the most serious and closely related factors to the economic development and to the balance of payments problems in Korea. The first four chapters are devoted to the discussions of these problems.

Against these backgrounds discussed in Chapter I through Chapter IV, discussions proceed to the analysis of overall foreign exchange control policies adopted by the Korean government to combat the particular problems of the Korean economy. Four chapters are devoted for these discussions, namely, Chapter V explores the role of foreign exchange control in general in the economic development of underdeveloped countries, Chapter VI discusses the origin of and the development in the foreign exchange control system in Korea before 1953, and Chapters VII and VIII discuss the central theme of this thesis: to what extent the Korean foreign exchange control contributed to the economic development?

Chapter IX concludes the study with the following major findings: (a) foreign exchange control devices are necessary and effective measures to mitigate the balance of payments difficulties in Korea, and, hence,

to eliminate the obstacles to the economic development of Korea to a certain degree; (b) foreign exchange control is, however, subject to serious limitations in its role to stimulate economic development, particularly in its role to encourage exports and to prevent capital flight; and (c) foreign exchange control, unless it is handled with the utmost care, may prove to be too costly to bring about any net benefit to the economy.

To the best of my knowledge, this thesis is the first attempt to analyse this area of Korean economic problems. Therefore, there has been no single source which has been exclusively helpful for this study. This study is to a large extent based upon the analyses of statistical data and various laws and regulations governing the problems related to this thesis and partly upon my personal experiences in the practice of foreign exchange control in Korea during my three years' employment at the Bank of Korea.

The most helpful data have been the Bank of Korea's Annual Economic Reviews covering the period 1950 to 1958, which contain the most reliable statistical data on the Korean economy and various laws and regulations concerning the problem discussed herein. Various publications by the Ministry of Reconstruction of the Korean government and by the United Nations have been also extremely valuable. (See bibliography.)

Finally, I wish to take this opportunity to express my sincerest appreciation to Professor Robert L. Allen for his constructive criticisms, understanding, patience and guidance.

H. Y. Kim

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CHAPTER I

SOURCES OF CAPITAL FOR THE ECONOMIC DEVELOPMENT OF KOREA

For the underdeveloped countries which are in the pre-take-off stage, rapid rate of real capital formation represents a major condition for their economic development, even if it may not represent the sufficient condition therefore as well.[1] Doubtlessly, the problem of capital formation lies at the center of the problem of developing economically less developed countries of today. If a successful economic development means the attainment of a level of economic performance which makes, in W. W. Rostow's word, "self-sustained growth"[2] possible and practicable, the constant accumulation of real capital at a rapid rate is the essential condition for the successful economic development. According to Rostow, it is an essential condition for the underdeveloped countries to reach to the stage of take-off, i.e., the stage where self-sustained growth becomes possible and practicable, that the proportion of net capital

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[1] In this connection, Ragnar Nurkse's words may be worth citing: "This (capital formation) is by no means the whole story. Economic development has much to do with human endowments, social attitude, political conditions and historical accidents. Capital is necessary but not a sufficient condition of progress." Ragner Nurkse, Problems of Capital Formation in Underdeveloped Countries (Oxford: Basil Blackwell, 1958), p. 1.

[2] W. W. Rostow, "The Take-off into Self-sustained Growth", The Economic Journal LXVI (March, 1956)

formation to national income should rise to over 10 per cent, definitely outstripping the likely population pressure.[1]

Needless to say capital formation requires not only an adequate supply of capital but also an adequate demand for capital. As Nurkse points out, capital formation is "not entirely a problem of capital supply."[2] Capital formation is hindered not only by capital deficiency but also by the weakness of inducement to investment chiefly because of limited markets in underdeveloped countries of today. Despite this, there is no doubt that capital deficiency represents the major part of the problem. The present underdeveloped countries are suffering from extremely low level of income because of the fact that they are under-equipped with capital in relation to their population and other resources. The inadequate demand for capital can not be considered as the cause of underdevelopment but as the result thereof. As the direction of "the vicious circle of poverty" which proceeds from capital deficiency to low productivity to low real income to low saving to low rates of capital formation to a continuation of capital deficiency indicates, the adequate supply of capital is the major condition for overcoming the underdevelopment.

The capital for financing the economic development may be derived

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[1] Rostow defines take-off as "the interval during which the rate of investment increases in such a way that real output per capita rises and this initial increase carries with it radical change in production technique and the disposition of income flows which perpetuate the new scale of investment and perpetuate thereby the rising trend in per capita output." Ibid., pp. 29-30.

[2] Nurkse, op. cit. p. 10.

from various sources, which, however, can be broadly divided into domestic and foreign sources. Unfortunately, the domestic sources that are represented by either voluntary or compulsory domestic savings are extremely limited in underdeveloped countries of today, but the domestic capital supply, however small it may be, should be considered as bearing the vital importance in the light of the fact that a country must reach to the position where the capital requirements of the country are met by its own domestic capital sources, sooner or later, before the country attains the self-sustained economy.

For this reason, the problems related with the domestic capital sources in Korea are discussed in the first place even though they make relatively small contribution to the capital formation at the present stage compared with the foreign sources. As the propensity to save is extremely weak and the private savings, if any, are not likely to contribute much to the real capital formation,[1] the compulsory savings assume more significances than the voluntary saving in the financing of economic development in Korea as in the cases of other less developed countries.

In the case of Korea, foreign sources of capital are represented chiefly by unilateral transfers of capital including intergovernmental grants-in-aid, private donations, inter-governmental loans. Private

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[1] In this connection, Meier & Baldwin point out that savings in underdeveloped countries tend to be invested in more land, real estate speculation, capital flights, or inventory accumulation rather than long-term industrial investments or public utilities. G. M. Meier & R. E. Baldwin, Economic Development (New York: John Wily & Sons, Inc., 1957), p. 307.

foreign capital which played an essential role in the development of the less developed countries in the 19th century and is still available to some underdeveloped countries of today has been beyond the distance Korea could reach.

A. DOMESTIC PRIVATE SAVINGS

Various data on the private saving in Korea reveal that the private saving that can be available for capital formation is extremely low. The percentages of private consumption expenditures to the gross national product in 1956 and 1957 were as high as 96 per cent and 85 per cent, respectively. Even if government consumptions and import surpluses are disregarded, savings were less than 15 per cent of the GNP. The high ratio of private consumption to GNP, i.e., the low level of private saving in Korea becomes more evident when they are compared with the corresponding figures in other countries.

Table 1

Percentage of Private Consumption Expenditures to Gross National Products in Selected Countries in 1957

Korea	Japan	U.S.A.	Ceylan	Panama	Peru	Ghana	Finland
85	58	65	77	68	68	76	67

Source: UN, Statistical Year Book: 1959 (New York: 1959), pp. 456-57.

The absolute size of the private saving is, however, not so significant for the economic development. In order to be meaningful,

the private saving should be available for capital formation in one way or another. Domestic savings available for loans through the banks other than the central bank in Korea represented roughly 5-7 per cent of the gross national product over the 1955-58 period.

Table 2

Money Supply, GNP, Savings Deposits in Korea 1955-1958

	Money Supply (In Million hwan)	GNP (A) (In Billion hwan)[a]	Savings Deposits In All Banks (B) (In Million hwan)[b]	B/A x 100 (%)
1955	93,523	943.9	45,283	5
1956	120,925	1,192.0	72,032	6
1957	145,186	1,606.5	80,776	5
1958	192,553	1,656.3	115,068	6

a. At current market prices.
b. Excludes savings deposits in the Bank of Korea.

Source: Compiled from, The Bank of Korea, Annual Economic Review: 1959 (Seoul: 1959), pp. III-9, III-17.

Savings deposited at the financial institutions are, of course, not necessarily utilized for productive purposes which will contribute to economic development. Another factor that should be taken into consideration in this connection is the ratio of loanable portion to total deposit. The loanable amount represents only a portion of the total deposit because of the reserve requirements. The average ratio of loans to deposits during the 1956-57 period in Korea was, according

to a report of the Bank of Korea, roughly 60 per cent.[1] Considering these facts, the real amount of private savings that can contribute to the financing of capital formation in Korea should be extremely small -- 1-2 per cent of the GNP.

Even though data are not officially available, it can be supposed that a larger portion of the private savings is concealed in such forms as the purchase of precious goods, capital flights, private lending for higher interests, speculative investments for windfall gains and so on.

How the level of private savings in Korea is low can be demonstrated by another datum by the Bank of Korea. Surveys undertaken by the Bank of Korea on the average family income and expenditures in Seoul area show that, out of the total monthly income of 100,531 hwan in 1958, only 1,122 hwan or 1.1 per cent of the total was deposited in banks for saving and 495 hwan or 0.5 per cent was lent and 112 hwan or 0.1 per cent was allocated for the purchase of national bonds. The total amount of expenditures for the savings purpose, therefore, does not exceed 2 per cent of their total income. It should be noted that living conditions of the farming families in Korea, which represent more than 60 per cent of the total population, are generally lower than those of the urban population.

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[1] The Bank of Korea, Annual Economic Review: 1959 (Seoul: 1959), p. III-71.

Table 3

Average Monthly Family Income and Expenditures in Seoul Area

	1956	1957	1958
Number of Families Surveyed[a]	159	140	130
Average Size of Family	5.05	4.91	5.02
Total Income (In Hwan)	76,210	88,573	100,531
Savings in Banks	462	782	1,122
Purchase of Bonds	6	101	122
Lending	424	726	595
Total Saving	852	1,609	1,839

a. Purposive sampling method is used.

Source: Compiled from the Bank of Korea, Annual Economic Review: 1959, p. III-264.

B. NON-VOLUNTARY DOMESTIC SAVINGS

As shown in the preceding section, the rate of private savings is extremely low relative to the national income in Korea. It is, however, expected that there are considerable disparities in the income levels among various income recipients. Some groups receive real incomes high enough for a substantial saving. According to the estimation of the Reconstruction Bank of Korea,[1] approximately 40-50 per cent of the

[1] The Reconstruction Bank of Korea, Proposals for Economic Policy (Seoul: 1956), p. 116.

total national income in 1956 was distributed to the middle or upper income brackets whose incomes are considered to be large enough for setting aside substantial portion of income for saving. It is supposed that such savings are often directed to non-developmental investments, such as short term private loans to consumers, farmers, and traders for a high rate of interest, or other speculative investments. Mobilization of such potential savings for productive investments is of vital importance in the light of the extreme scarcity of domestic source of capital in Korea. Under the present circumstances the mobilization seems to be feasible almost solely through the enforcement by the government. In this section two ways of enforced saving, taxation and public borrowing, are discussed.

Taxation

Despite the war destroyed economic condition and the absolutely low level of income, the Korean government has been able to raise relatively large revenue from taxation since the outbreak of the Korean War in 1950. This is best expressed in the following words of the Nathan report:[1]

> The performance of the revenue system of the Republic of Korea since 1950 has been above what could normally have been expected. Between the fiscal years 1949-50 and 1952-53, total national tax revenue increased by more than twice the rise in retail price and by two and three-quarters times the increase in wholesale prices. This is an impressive result for a period which saw extensive destruction and dislocation of industry and the uprooting of as much as one fourth of the total population.

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[1] Robert R. Nathan Associates, Inc., An Economic Programme for Korean Reconstruction (New York: 1954), p. 162.

Such high level of tax revenue has, of course, been possible through maintaining a relatively high tax burden. The ratio of the national tax burden to the gross national income in 1958 was 9.3 in Korea. This ratio is fairly high one compared with those in other countries in the corresponding stage of economic development.

Table 4

The Ratio of Tax Burden to National Income in Korea and Selected Countries

	National Income(A)	Tax Burden(B)	B/A
Korea (Billion Hwan)	1,483.5	145.8	9.3
U.S.A. (Billion Dollars)	366.2	65.9	18.0
Japan (Billion Yen)	8,287.7	1,249.0	14.9
India (Billion Rupee)	113.6	9.2	8.1
Philippine (Million Peso)	9,232.0	812.0	8.8
Pakistan (Million Kyat)	20,839.0	1,554.0	7.3
Burma (Million Kyat)	4,344.0	227.2	5.2

Source: United Nations, Statistical Yearbook: 1959 (New York: 1959).

Neverless, the present level of tax yields in Korea is by no means adequate and sufficient to meet even the general expenditure requirements of the government. This is chiefly because of the abnormally heavy expenditures on national defense. Since the outbreak of the Korean War almost 50 per cent of the total government revenues or approximately 7 per cent of the gross national products have been spent on nonproductive national defense. This is the highest rate in the free world excepting that of the United States.

Table 5

Ratios of Defense Expenditure to GNP and General Government Expenditures in Korea

	GNP (A) (In Billion Hwan)	General Government Expenditure (B)	Defense Exp. (C) (In million Hwan)	C/A	C/B
1953	482	57,674	32,605	6.7	56.5
1957	1,634	248,777	114,071	7.0	45.9
1958	1,837	262,438	124,165	6.8	47.3

Source: The Bank of Korea, Annual Economic Review: 1958 (Seoul: 1958), p. I-17.

As a consequence, the general government revenue which includes tax revenues has been far short of the general government expenditures each year and the deficits have been mainly covered by the counterpart fund. In 1958, 48,370 million hwan was transfered from the counterpart fund to offset the budget deficit. In short, the present level of taxation in Korea is far from such level as can provide funds for financing economic development. Considering the extremely low level of private savings in Korea which, if left alone, would not suffice even the minimum capital requirements for the private investment which would provide the minimum living facilities for the growing population, further increase in the tax yield along with the reduction in the defense expenditures seem highly important for the economic development in Korea.

how?

Table 6

General Government Revenues and Expenditures in Korea
(At Current Market Prices)

(In Billion Hwan)

	1955	1956	1957	1958
Current Revenues	85.5	107.7	159.0	205.9
Revenue from Taxes	75.2	95.8	150.1	194.1
Public Debt (Less interest)	1.1	1.2	4.7	4.1
Income from Property and Enterprises	8.5	9.3	7.2	7.4
Other Current Transfers from the Public	2.9	3.8	6.4	8.5
Current Expenditures	99.7	134.1	215.6	260.0
Consumption	94.9	127.7	207.5	249.1
Civil	40.0	62.5	100.2	127.3
Defense	54.9	65.2	107.3	121.8
Subsidies	0.5	0.4	1.5	1.9
Other Transfers to the Public	4.3	6.0	6.6	9.0
Deficit	14.2	26.4	56.6	54.1

Source: Compiled from The Bank of Korea, Annual Economic Review: 1959, p. III-17.

Public Borrowing

Government borrowings mainly through the issuance of the national bond has been playing an important role in mobilizing the private savings and directing them to the financing of long range economic development program in Korea. By the end of 1958 the total outstanding

amount the national bond issued including the Industrial Reconstruction Bond accounted for 99.4 billion hwan. Of this total amount, 53,066 million hwan was the balance on the Industrial Reconstruction Bond and the remaining 46,320 million hwan was the balance on the National Bond. The National Bond has been issued in order to supplement the tax revenue in the general government budget since 1949 when the Republic of Korea was born. In the meantime, the Industrial Reconstruction Bond was newly introduced in 1953 with a view to raising funds particularly for the long term industrial reconstruction. This bond, therefore, bears more direct importance in the financing of economic development than the other.

Data on the ownership of the national bonds in Korea reveal that more than half of the total outstanding national bonds are owned by the central bank and about four fifths, by the general public at the end of 1958. The ratio of the amount of national bonds owned by the central bank to that by the public has been increasing since 1950 as the government borrowing increased. Needless to say, the more borrowing from the central bank by the government, the more inflationary the result will be and the more adverse the effects will be upon the economic development, as will be discussed later.

It is, however, worth while to note that the steady increase in the absolute amount of national bonds sold to the general public shows the potentiality of the public to absorb further government bonds, provided that more adequate attractive measures along with a stronger enforcement measure to purchase them will be adopted.

Table 7

National Bonds by Distribution in Korea
1950-1958

(In Million Hwan)

At the End of	1950	1953	1954	1957	1958
Financial Institutions					
The Bank of Korea	34	5,124	9,848	59,351	53,066
Other Banks	59	763	1,324	4,940	4,797
Total	93	5,887	11,172	64,291	57,863
Private					
Insurance Co.	--	1	3	249	573
Other General Public	6	2,566	5,137	26,077	40,949
Total	6	2,567	5,140	26,326	41,522
Total Outstanding Amount					
The National Bond	100	3,429	6,588	31,267	46,320
The Industrial Reconstruction Bond	--	5,000	17,564	59,350	53,066
Total	100	8,429	24,152	90,617	99,386

Source: The Bank of Korea, Annual Economic Review: 1959, pp. III-140-142.

C. FOREIGN SOURCES

Foreign sources of capital, mainly U.S. economic aid have been playing an essential role in the achievement of economic growth in Korea. As will be shown in detail in the following chapter, South Korea lost her essential natural resources including coals and iron and hydro-electric resources which are vital for the economic development, when Korea was divided into two parts, south and north, in August 1945. Moreover, the outbreak of the Korean War compelled the Korean economy

to go from bad to worse. When the war ceased in 1953, Korea was faced with the problem of economic rehabilitation from the war destroyed economy in addition to the task of developing the economy toward self-sustained level. These extremely unfavorable situations made Korean economy heavily dependent upon foreign aid. Indeed, it has been almost hopeless for the Korean economy to achieve any sizable economic growth but for the vast sum of foreign economic aids extended to Korea by the friendly nations, especially by the United States.

Past history shows that private foreign capital played an important role in the development of some of the currently developed countries, such as the United States and Germany in the 19th century. To the Korean economy, however, almost no private foreign capital has been available so far. This may be no wonder when we consider the generally unfavorable climates for inducing interest-oriented private foreign capital to Korea. Economic instability chiefly due to the chronic inflation, low rate of return to the capital invested -- because large portion of capital needed is for the development of social and economic overhead capital -- , political instability, limited markets, and so on, would be sufficient for the explanation of the absence of foreign private capital. In reality, no private foreign investment has been recorded in Korea by the end of 1958. Consequently, the foreign sources of capital have been almost entirely confined to foreign economic aids, mainly those from the United States. However, considering the fact that the amount of US economic aid has been decreasing year by year since 1958 and that there is no guarantee that the economic aid will

continue until Korea attains self-sustained economy, the importance of the private foreign capital in the future can not be overemphasized.[1] underestimated?

During the period from September 1945 to the end of 1958 a total amount of 2,468 million dollars or an annual average amount of 190 million dollars has been received by Korea as foreign economic aids. The breakdown of the foreign economic aids is shown in table 8.

The importance of the economic aid can be shown in the percentage of the aid to GNP. In the recent years, the percentage has been almost 15 per cent. In 1958, the total economic aid amounted to 321 million dollars and GNP was estimated at 1,111 billion hwan or 2,220 million dollars converting at the official exchange rate of US $1 = Hwan 500. The percentage of foreign economic aid to GNP was, therefore, 14.4 per cent even if highly overvalued official exchange rate is applied to the calculation.

The amount provided directly by the United States accounted for 1,891 million dollars, representing 77 per cent of the total and the remaining 23 per cent, 577 million dollars, came from the United Nations during the 1945-58 period. Considering the fact that the United States has been the largest contributor to this United Nations' economic aids, the United States' share in the economic aid to Korea should be far above 80 per cent of the total.

The U.S. economic aid to Korea can be classified into three categories: project assistance; non-project assistance and technical

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[1] According to Dong A Il Bo (A leading Korean newspaper) the US economic aid will be reduced by 5 million dollars in 1961 from the amount in 1960. Dong A Il Bo (Seoul) September 17, 1960, p. 1.

Table 8

Summary of Foreign Economic Aid & Relief Goods
Received by Korea
1945 - 1958

(In Thousand US Dollars)

Year	Total	U. S. A.				CRIK	UNKRA
		GARIOA	ECA & SEC	PL 480[a]	ICA		
1945	4,934	4,934	—	—	—	—	—
1946	49,496	49,496	—	—	—	—	—
1947	175,371	175,371	—	—	—	—	—
1948	179,593	179,593	—	—	—	—	—
1949	116,509	92,703	23,806	—	—	—	—
1950	58,706	—	49,330	—	—	9,376	—
1951	106,542	—	31,972	—	—	74,448	122
1952	161,327	—	3,823	—	—	155,534	1,969
1953	194,170	—	232	—	5,571	158,787	29,580
1954	153,925	—	—	—	82,437	50,191	21,297
1955	236,707	—	—	—	205,815	8,711	22,181
1956	326,705	—	—	32,955	271,049	331	23,370
1957	382,892	—	—	45,522	323,267	—	14,103
1958	321,316	—	—	47,890	265,629	—	7,797

a. A portion of proceeds from sales of surplus agricultural commodities imported under the US Public Law 480 is used by the US Government. Therefore, this portion can not be regarded as foreign aid received. However, it is included in this table to show the total imports under the same law for convenience sake.

The abbreviations used on this table stand for as follows:

GARIOA: Government Appropriation for Relief in Occupied Area
ECA: Economic Cooperation Administration
SEC: Supplies, Economic Cooperation
CRIK: Civil Relief in Korea
UNKRA: United Nations Korean Reconstruction Agency

Source: The Bank of Korea, Annual Economic Review: 1959, p. III-222.

cooperation. Project assistance refers to the financing of specific projects, particularly such social overhead investments as the development of agricultural and natural resources, industries and mining, transportation, education facilities and dwellings. This assistance, therefore, is the real portion of the economic aid which directly contributes to the capital formation in Korea. Non-project assistance refers to the financing of commodities either for consumption or for reproduction to meet final consumption needs. The total amount of 1,399 million dollars received through ICA, UNKRA and agricultural surplus commodities disposal program under the US Public Law 480 since 1950 can be broken down into 418 million dollars for project assistance, 965.5 million dollars for non-project assistance and 16 million dollars for technical assistance, each, therefore, representing 29.9 per cent, 69.0 per cent and 1.1 per cent of the total respectively.[1]

From above it can be seen that the share of the project assistance which directly contributes to the economic development has been relatively small compared with the non-project assistance. A drastic increase in the share of the former assistance seems highly desirable for the real economic development of Korea. It is, however, worthy to note that an enormous amount of counterpart funds has been collected from the sales of goods and services imported under the non-project assistance. By the end of 1958 a total of 362 billion hwan was collected for counterpart funds.[2] This fund has been used for various purposes, mainly for

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[1] Ministry of Reconstruction, The Republic of Korea, Economic Survey: 1959 (Seoul: 1959), p. 154.

[2] Ibid., p. 160.

covering the deficit in the government's general budget and the entire expenditures of the government on the economic rehabilitation program, and for making loans to the public. In 1958, 48,370 million hwan was transfered from the counterpart fund to the general budget to cover the deficit therein and 74,331 million hwan was transfered to the special budget for economic rehabilitation to cover the entire revenue.[1] By the end of 1958, a total amount of 214,041 million hwan has been approved for the counterpart fund loans and 172,905 million hwan has been loaned out of the fund for the development of various sectors of the economy. The breakdown of the loans are shown in table 9.

Table 9

Counterpart Fund Loans by Field

(In Million Hwan)

	Approvals	Loans	%
Agriculture and Natural Resources	67,964.7	63,475.0	36.7
Industry and Mining	32,138.3	30,368.8	17.6
Transportation	51,908.9	50,479.9	29.2
Health and Sanitation	13,581.0	13,333.4	7.6
Education	3,160.6	2,891.2	1.6
Public Administration	253.0	247.3	0.5
Community Development - social welfare and housing	7,816.4	7,302.9	4.2
General and Miscel.	5,705.4	4,716.5	2.6
Totals	214,041.5	172,905.0	100.0

Source: Ministry of Reconstruction, the Republic of Korea, Economic Survey: 1959, p. 216.

[1] The Bank of Korea, Annual Economic Review: 1959, p. III-123.

CHAPTER II

HUMAN AND NATURAL RESOURCES

A. HUMAN RESOURCES

Unlike natural resources, human resources can be assets and, at the same time, debts to the economy. As long as a large scale unemployed or underemployed population exists, a part of the human resources is evidently a burden to the economy, for a country would have a larger output per capita with a smaller population in this case. In the dynamic case, population can also be a burden to the economy, for the rate of population growth directly affects the real rate of economic growth. It is self-evident that the growth in real income per capita is the function of the rate of change in total output and the rate of change in population. This relation is best demonstrated in the Harrod-Domar type of growth model.[1] According to the model, the rate of growth in per capita income is directly affected by the rate of population growth. If the rate of growth in the total output can not outstrip the rate of

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[1] In the simplest form, the model can be illustrated as $dY = \frac{s}{K} - dL$, where dY is the rate of change in per capita national income, K is the capital output ratio, s is the rate of saving or investment out of national income and dL is the rate of change in population. C. P. Kindleberger, Economic Development (New York: The McGraw-Hill Co., 1958), p. 39.

change in population, economic growth can not be achieved whatever the absolute rate of capital formation may be.

For the Korean economy, population seems to be more burden than asset or contributor to the economic development. Korea is not only suffering from "overpopulation"[1] but also from a rapid rate of population growth. Particularly, a chronic and large scale underemployment or "disguised unemployment"[2] in the agricultural sector is conspicuous in Korea.

Since the partition of Korea in 1945, the population of South Korea has been increasing to an abnormal size. During the period of 1945-50, the population of South Korea inflated by 25 per cent, increasing from approximately 16 million to more than 20 million. This was mainly due to the enormous inflow of refugees from North Korea and repatriates

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[1] W. A. Lewis classifies the cases of "overpopulation" in the following four categories: (a) a population which is so large that a country would have a larger output per head with a smaller population, (b) a population which is larger than can be fed without importing food, (c) a population which is so large relatively to its resources that a change in population would have no effect on total output, and (d) a population that is large enough to compel a country to use up irreplaceable resources at an excessive rate. W. A. Lewis, The Theory of Economic Growth (Homewood, Ill: Richard D. Irwin, Inc., 1955), p. 320. The "overpopulation" in Korea seems to fall in any of the four categories.

[2] Ragner Nurkse uses this term particularly for the underemployment in the agricultural sector in the sense that, even with unchanged technique of agriculture, a large part of the population engaged in agriculture could be removed without reducing agricultural output. Nurkse, op. cit., p. 32.

from Japan and other parts of the world rather than due to the natural increase even if the rate was also considerably high. According to Nathan Report,[1] the number of the refugees amounted to as many as 2.5 million and another 1.5 million fled North Korea after 1950 to South Korea. The total population of Korea as of the end of 1957 was estimated at 21,321,136. As this figure excludes armed forces, national police, prisoners and ship crews, the real population should be well above 22 million. As the present land area of South Korea is 97 thousand square kilometer, population density accounts for 230 people per square kilometer or about 600 people per square mile. This is in the neighborhood of the population density of Japan whose degree of industrialization is incomparable with that of Korea, or 6-7 times those of Thailand and Burma. Excepting Japan and Taiwan, Korea is the most densely populated country in Asia, indicating a more difficult basic population problem than any other country in the area.

Except those years during the Korean War, the rate of population increase has ranged from 1.5 per cent to 2.2 per cent. Considering the possible further decline in the death rate[2] in the future due to the better medical care and nutrition, it is hard to expect any decline in the rate of population growth from the present level of approximately 1.7 per cent per annum. Assuming 2 per cent a year as an average annual

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[1] Nathan Associates, Inc., op. cit., p. 23.

[2] According to the Bank of Korea's data, the death rate fell from 2.6% in 1950 to 2.0% in 1955, but 2% is still a much higher rate compared with even those of pre-war time. See, The Bank of Korea, Annual Economic Review: 1959, p. III-11.

rate of growth in population in the future, Korea would be one of the fastest growing among the Asian countries except Ceylon and China and this would mean that the total output of Korea should expand by about 2 per cent per year simply to maintain the present level of per capita income.

The occupational structure of the population reveals another underdeveloped characteristic of the Korean economy. According to the statistics of the Bank of Korea,[1] more than 70 per cent of the total active population of Korea has been engaged in agriculture and fisheries, and 63 per cent out of the 70 per cent was in agriculture. As of the end of 1957, out of the total active population of 8,100,790 in Korea, 6,050,323 were engaged in agriculture and fisheries, representing 74 per cent of the total and the remaining 26 per cent was distributed among various fields which can be represented as secondary or tertiary sectors. Despite such high percentage of population in the primary sector, only 40 per cent of the national income was derived therefrom. (See Table 18.) The character of underdevelopment of the population structure of Korea becomes clearer when it is compared with those of other countries. Table 12 shows that Korea is one of the most predominent primary producing countries in the world. Excepting Thailand and Pakistan, the ratio of the population in the primary industries in Korea was the highest one in Asia.

In the light of the predominent agricultural population in the Korean population structure, it seems worth while to pay little more

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[1] The Bank of Korea, op. cit., p. III-14.

attention thereto. Korean agricultural population may be best characterized by comparing it with the size of land. As of 1957, 2,210,914 households or 13,591,637 people, representing 63.74 per cent of the total population were engaged in farming on the total cultivated area of 2,021,961 jungbo.[1] This means an average household of 6.15 people owns 9.15 jungbo of arable land, indicating extremely high ratio of labor to land or existence of a large scale disguised unemployment. In this connection, the following words in the UNKRA's report might be worth citing:[2]

> There may be a small seasonal manpower shortage in isolated areas, i.e., rice area of Cholla Pukto (a province in Korea), but the more general position is a surplus all over the rural areas.

Indeed, by all reasoning, it must be safe to estimate that 30-40 per cent of the rural human resources are underemployed except such busy periods as harvest times or planting period.

Amidst such numerous unfavorable population problems, Korea possesses one strikingly favorable element. The rate of illiteracy is conspicuously low in Korea comparing with other underdeveloped countries. At the end of 1957, the number of illiterate people was 7,185,876, accounting for 34 per cent of the total population, according to the Bank of Korea's estimate.[3] Taking account of the fact that infants are included in the number, the real percentage of illiteracy, i.e.,

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[1] 1 jungbo is equivalent to 2.45 acres.

[2] United Nations Korean Reconstruction Agency, Agriculture, Forestry and Fisheries in South Korea (New York: Columbia Univ. Press, 1954), p. 75.

[3] The Bank of Korea, op. cit., p. III-12.

the illiteracy among the adult would be well below 10 per cent. This strongly indicates the potentiality of the Korean workers to raise productivity if necessary conditions are provided. Nathan report comments on this point as follows:[1]

> Observers familiar with conditions in other former colonial countries recently achieving independence, have been impressed by the relatively greater reservoir of talent and ability possessed by the Koreans . . . . All observers agree on the high aptitude of the Korean people to learn and on their serious and hard working qualities.

Table 10

Population Growth in South Korea
1944-1957

Year	Land Area (Square Km)	Population	Rate of Increase (Per 1,000)
1944	94,299.18	15,879,100	10.5
1946	"	19,369,270	4.2
1947	"	19,886,234	13.1
1948	"	20,027,293	9.3
1949	"	20,188,641	9.6
1951		20,670,848	7.7
1952		21,144,210	22.9
1953		21,440,229	14.0
1954	96,929.21	21,796,137	16.0
1955	"	22,123,079	15.0
1957	"	21,321,136[a]	

a. excludes armed forces, foreigners, police, prisoners, and ship crews.

Source: 1944-49, Ministry of Internal Affairs,
1951-1955, Ministry of Health and Social Affairs
1957, The result of Year-end census.

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[1] Nathan Associate Inc., op. cit., p. 20.

Table 11

Populations and Their Growth in Selected Countries

Country	1953 (In Thousands)	1957 (In Thousands)	Annual Rate of Increase 1953-57(%)	Area (Km^2)	Density-1957 (Per Km^2)
Burma	19,272	20,054	1.0	677,950	30
Ceylon	8,290	9,165	2.5	65,610	140
Taiwan	8,261	9,506	3.6	35,961	264
India	372,623	392,440	1.3	3,281,769	120
Indonesia	79,500	85,100	1.7	1,491,562	57
Japan	86,700	90,900	1.2	369,661	246
Thailand	19,556	21,076	1.9	514,000	41

Source: UN, Demographic Year Book, 1958 (New York: 1958), pp. 95-98.

Table 12

Occupational Distribution of Employment in Selective Countries

Country	Primary %	Secondary %	Tertiary %
Korea (1958)[a]	73.8	2.5	23.7
Ceylon (1946)	59.2	11.6	29.2
Formosa (1957)	57.7	10.7	31.6
India (1951)	70.6	10.6	18.8
Japan (1956)	41.2	23.5	35.3
Pakistan (1951)	79.4	7.6	13.0
Philippine (1948)	71.6	8.9	19.3
Thailand (1947)	85.5	2.4	11.8
Denmark (1953)	25.1	32.7	42.2
France (1954)	27.7	35.6	36.7
Germany (1950)	23.2	41.6	35.2
U.S.A. (1950)	12.2	34.7	53.1

a. Ministry of Reconstruction, The Republic of Korea, Economic Survey: 1959 (Seoul).

Source: UN, Statistical Year Book: 1958 (New York, 1959),

B. NATURAL RESOURCES

Needless to say, it is not the mere size of land or the ratio of population to land but the real productivity of land or other natural resources that affects the potentiality of the economic development of an economy. For this reason, some important natural and economic resources which are likely to affect the direction of economic development in Korea are discussed in this section.

Agricultural Resources

As shown in table 13, the land of Korea is 9,501,128.1 jungbo or about 22 million acres. Because of mountainous character, only 2,021,921 jungbo or 21.2 per cent of the total land is arable land and the rest of the land are either forest or waste land. Out of the total cultivated land, 1,206,686 jungbo or 59 per cent of the total arable land represented rice paddy and 815,275 jungbo or 40 per cent, dry field, as of the end of 1957.

Table 13

Cultivated Area compared with Total Land in Korea

(In Jungbo)

Year	Total Land(A)	Cultivated Area			
		Rice Paddy	Dry Field	Total(B)	B/A
1956	9,501,128.2	1,198,652	809,815	2,008,467	21.14
1957	9,501,128.2	1,206,688	815,275	2,021,961	21.28

Source: The Korean Agricultural Bank, Agricultural Year Book: 1959 (Seoul: 1959), p. II-10.

As the table shows, rice is the main crop, accounting for more than 60 per cent of the total agricultural products. Barley follows rice in importance, accounting for about 10 per cent of the total agricultural product. According to the Korean Agricultural Bank's report,[1] out of the total annual average income of a farming household of 429 thousand hwan in 1958, income from rice production was 215 thousand hwan, accounting for more than 50 per cent of the total income and that from barley was 58 thousand hwan or 11 per cent, indicating the heavy concentration of Korean agriculture on grain farming, especially on rice production. In the dry field are planted potatoes, corns and other commercial crops, besides barley and wheat.

The chief agricultural raw material is cotton although the production has been remarkably shrinking since 1952 with the increase in the import of raw cotton. Besides considerable amount of ginseng, tobacco, hemp, ramie and mulberry leaves are produced.

Forest Resources

Forest land covers more than 70 per cent of the total land of Korea, which is almost 3 times the cultivated area. This relatively vast resource, however, does not render any significant contribution to the national income of Korea because of the fact that almost half of the total forest represents the forest without trees. The denudation of the forest has been mainly due to the severe shortage in fuel supply since the partition of Korea in 1945 when the supplies of coal and

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[1] The Korean Agricultural Bank, Agricultural Year Book: 1959 (Seoul: 1959), p. II-179.

electricity from North Korea were interrupted. As shown in table 14, out of the total forest area of 6,709 thousand jungbo, 3,039 thousand jungbo, or 45 per cent was completely denuded area, as of 1957. Such a high ratio of denudation brings about not only the shortage of timber but also the danger of flood to Korea.

Table 14

Forest Area

(In Thousands Jungbo)

Year	Total Area	Well Stocked Forest	Denuded Forest	Other
1956	6,748	3,489	2,963	173
1957	6,709	3,487	3,039	182

Source: The Korean Agricultural Bank, Agricultural Year Book: 1959, p. II-151.

Fisheries Resources

Korea is maritime in character due to the country being a penisula and therefore surrounded by sea on three sides. Not only because of the geographical reason but also because of the shortage of land resources, fisheries resources are deemed to be extremely helpful for the economic development in Korea. An expansion in the fishing industry will contribute to supplementing the shortage of domestic food supply and to the promotion of exports as well.

In spite of such importance and potentiality, the total fishery

production accounted for only 3.2 per cent of the GNP in 1958.[1] The low productivity of fishery industries seems mainly due to the shortage of capital and equipments including vessels, lack of skilled personnels and of storage facilities and processing industries, and limited markets.

The total landings of fishery products were 395 thousand metric tons in 1958 and 403 thousand metric tons in 1957. These amounts are less than as much as half of the highest total landings record of 850 thousand metric tons Korea enjoyed in 1935.[2] It is worthy to note that Korea as a whole was the sixth largest fish exporter in the world in those days.

Table 15

Marine Production in Korea

(In Thousand Metric Tons)

Year	Total	Fish	Shellfish	Seaplants	Other
1957	403.3	279.7	11.5	35.5	76.4
1958	395.1	291.1	15.8	28.7	59.3

Source: The Bank of Korea, Annual Economic Review: 1959, p. III-157.

Mineral Resources

One of the greatest impacts of the partition of Korea on the economy of South Korea was the separation of the vast mineral resources existing

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[1] Ministry of Reconstruction, op. cit., p. 81.

[2] Nathan Associates Inc., op. cit., p. 30.

in the northern part of Korea from South Korea. As table 16 indicates, more than 90 per cent of mineral resources was produced in North Korea before 1945. In 1936, iron ore was entirely produced in North Korea and 98 per cent of total coal was produced in the north. Considering the essential roles these minerals assume in the industrialization of the economy, the partition of Korea was really a fatal blow to South Korea, indeed.

Table 16

Comparison of the Mineral Production in South and North Korea before 1945 (1936)

(In Metric Tons)

	South Korea		North Korea	
	Production	%	Production	%
Gold (In Kg)	3,084	21.0	11,594	79.0
Silver (In Kg)	5,281	9.0	53,539	91.0
Copper	531	14.6	3,103	85.4
Lead	0	0.0	2,738	100.0
Zinc Ore	15	0.3	5,556	99.7
Tungsten Ore	260	15.2	1,447	84.8
Coal	48,082	2.1	2,233,911	97.9
Graphite	19,149	46.8	21,766	53.2
Fluorspar	0	0.0	8,740	100.0
Iron Ore	2	0.0	234,398	100.0
Kaolin	6,480	26.2	18,232	73.8

Source: The Bank of Korea, Monthly Statistical Review, No. 40, (Nov., 1951), Seoul, p. 7.

In spite of these facts, South Korea is fairly well endowed with various mineral resources, which had not been developed by 1945. Besides iron ore and coal which represent the major items, gold, silver, tungsten, amorphous and crystalline graphite, copper, fluorite,

columbite, manganese, molybdenum, monazite, talc, lead ore, zinc ore, bismuth concentrate, kaolin, silica sand, etc. are produced in considerable amounts. These mineral resources are extremely helpful not only for the domestic industrial economic development but also for the expansion of exports. In 1958, mining industries contributed to the GNP only by 1.2 per cent, whereas mineral products represented the major export items, accounting for 63 per cent of the total exports.[1]

Electric power resources

The greatest shortage the partition of Korea brought about to South Korea seems to be electricity. Since the supply of electricity from North Korea was suspended in 1948, Korean economy has been suffering from severe electric power shortage. In 1947, of the total electric power of 829 million Kw hour consumed in South Korea, 522 million KWH, or about two thirds of the total was supplied from North Korea.[2] With these figures in mind, it can not be hard to understand what the impact of the suspension of the electric supply from North Korea was to the South Korean economy.

The electric power generation, however, could be increased remarkably with the aid of foreign aid funds since 1949. By the end of 1958, the total electric power generation could have reached 1,511 million KWH. Despite such remarkable increase, the absolute shortage of electric power is still acute in Korea.[3]

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[1] Ministry of Reconstruction, op. cit., p. 133.

[2] Until 1945, 89 per cent of the total electric power was generated in North Korea.

[3] The Ministry of Commerce and Industry of the Republic of Korea estimated the minimum electric power requirements for the year 1957 at 227 thousand Kw. Taking this as minimum amount required, Korea was short of at least 70 thousand Kw in 1957. Ministry of Reconstruction, The Republic of Korea, Annual Economic Survey: 1958, p. 59.

Table 17

Electric Power Generated in South Korea
in Selected Years

(In Thousand KWH)

Year	Total Power Generated	Average Power (KW)
1946[a]	676,124	77.2
1947[a]	828,760	94.6
1948[a]	693,999	79.2
1950	420,651	48.0
1951	336,629	102.6
1955	879,272	100.4
1956	1,118,308	127.3
1957	1,323,012	150.9
1958	1,511,675	172.5

a. The electric power supplied by the North Korea: 451,098 for 1946, 551,820 for 1947 and 204,044 for 1948 are included.

Source: The Bank of Korea, Annual Economic Review: 1959, p. III-180.

CHAPTER III

SOME OTHER FACTORS AFFECTING ECONOMIC DEVELOPMENT IN KOREA: INFLATION AND GOVERNMENTAL POLICY AND PROGRAMMING FOR ECONOMIC DEVELOPMENT

Although it is impossible to touch upon every factor affecting economic development in Korea in this paper, there are at least two more important factors whose discussions can not be dispensed with for the further development of our discussion: inflation and the government's developmental policies and programs.

A. INFLATION

Inflation, of course, is not necessarily an adverse factor to the economic development of underdeveloped countries. Inflation can be used as a non-voluntary method to raise fund for financing economic development as public borrowing or taxation. Indeed, inflationary method of financing appears to be the simplest way to force people to save for enabling the government to finance economic development. In this instance, inflation, of course, should not be the kind of uncontrollable hyper-inflation. Some writers argue that inflation can provide incentives to encouraging investment. A. O. Hirshman, for instance, argues that "rises in individual prices result from complementarities and shortages and have the function of calling forth investment,

and increased output."[1] In this argument, Hirshman, however, does not presuppose an over-all inflation but a relative price rise or a partial inflation.

Although it may be inadequate to draw a generalized conclusion since the economic, social and political situations differ from country to country, even among the underdeveloped countries of today, observers of this problem generally seem to view that inflationary financing that is likely to bring about over-all inflation is undesirable and disastrous for the underdeveloped countries of today. The United Nation's experts insist that the gains, if any, from inflationary financing seems to be too small compared with the great dangers which are accompanied by the method of financing in underdeveloped countries of today for the following reasons: (a) generally their output is more rigid than that of industrialized countries, and, accordingly, their output is not able to be expanded to meet the pressure of rising money demand; (b) the administrative and economic mechanisms required for keeping inflation in check are less developed and (c) confidence in monetary stability is less firmly established.[2]

Considering this view as valid, inflation must be a more adverse than favorable factor affecting economic development in the underdeveloped countries of today. In reality, the present underdeveloped countries are likely to be subject to inflation not only because of the excessive

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[1] A. O. Hirshman, The Strategy of Economic Development, (New Haven: Yale Univ. Press, 1958), p. 160.

[2] UN, Methods of Financing Economic Development in Underdeveloped Countries (New York: 1949), p. 9.

investment through inflationary financing but also by excessive consumption. The excessive consumption as the cause of inflation may be best explained by Nurkse in his appeal to the "demonstration effect."[1] Nurkse explains the strong tendency toward excessive consumption and, accordingly, toward inflation in terms of the attractive effect of high standard of living of the advanced countries, and of the goods available there upon the consumers of the underdeveloped countries. This effect makes the consumers to desire the fruit of economic progress, but does not prepare them for the sacrifices necessary to obtain them. Situations being as such, there remains less grounds for inflation to exert favorably for, or to contribute to the economic development in underdeveloped countries.

The Korean economy has been plagued by chronic inflation for almost two decades. Before 1945 inflationary pressure was already existing under the Japanese controlled war economy. When World War II was over and Korea was liberated in August 1945, the dormant inflationary pressure turned into open inflation. It was, however, not until the outbreak of the Korean War that the inflation in Korea developed into a hyper-inflation. From the time of the communist invasion in June 1950 to the middle of 1953, the retail price index rose twenty fold. During the period 1947-1957, the whole sale price index of Korea rose more than two hundred times, i.e., Seoul whole sale price index rose from the base of 100 in 1947 to 22,070 in 1957, and Seoul retail price index rose from the base of 100 in 1947 to 25,985 in 1957. Although such a severe inflationary pressure as existed during the war has been suppressed

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[1] Nurkse, op. cit., p. 58.

in recent years, inflation in Korea is still under progress without being completely controlled. Theoretically, inflation occurs when a country's consumption and investment demands outrun the total available products at current prices. But the explanation of inflation in Korea is perhaps not so simple as that. The factors contributed to the inflationary pressure have been numerous and complicated, although the main cause could be attributed to the war and its aftermath. The hyper-inflation began when the shortage of goods and services due to the paralized economy as the war broke out, on the one hand, and tremendous increase in money supply to finance the war, on the other, blew the inflationary flame which had been existing since 1945 as mentioned above. During the period 1950-53, money supply in Korea inflated by more than 10 times, whereas the gross national product decreased by 22 per cent.[1]

Major factors contributed to the enormous expansion of money supply in Korea since 1950 have been the credit expansions by the commercial banks chiefly to cover the deficit of government owned enterprises, increased government borrowings from the central bank to cover the budgetary deficits year after year and the enormous amount of local currency advanced to the United Nations forces in Korea without concurrent payments in foreign currency. During 1950-53, the volume of credits by the commercial banks in Korea expanded from 235 million hwan in 1950 to 11,600 million hwan in 1953, or almost by fifty times.[2]

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[1] According to the Nathan Report's estimation, the GNP in 1950 was 1,769.5 million dollars, whereas the GNP in 1953 was 1,383.9 million dollars. Nathan Associates Inc., op. cit., p. 452.

[2] The Bank of Korea, Annual Economic Review: 1955 (Seoul: 1955), p. 19.

The government's loan from the central bank to cover the deficit in the general budget in 1953 alone accounted for 22,468.1 million hwan or almost 40 per cent of the total revenue.[1] During the period 1950-53 the United Nations forces in Korea borrowed local currency in the amount of 17,739 million hwan from the government without any concurrent payments in any form.[2]

As the pressure of inflation grew sharply against the background mentioned above, the Korean economy was, inevitably, plagued by every bad impact that inflation can bring about. Inflation encouraged hoarding, speculation, capital flights, and flagging morals, and discouraged saving, incentive to work and private foreign investments. Inflation disrupted the price mechanism and foreign trade relations. It also, of course, resulted in serious inequities in the distribution of income and extreme hardships among the general people. Nathan Report's comments on the inflation during the Korean War are as follows:[3]

> It is unnecessary to elaborate in detail on the powerful consequences of the runaway inflation in Korea. Not only has it resulted in a wasteful use of resources and in serious inequities and severe hardships among the people, but it has been particularly costly in that the whole economic system of the country has been invaded with special arrangements and special adjustments in a series of attempts to avoid the inevitable impacts of such an inflation.

Situations having been as such, there has been no room to consider inflation as a method of financing economic development in Korea. On

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[1] Ibid., p. 87.

[2] Ibid., p. 19.

[3] Nathan Associates Inc., op. cit., p. 46.

the contrary, fighting against inflation has been one of the major tasks for the achievement of economic development in Korea. This policy was adopted officially by the Korean government when the "Agreement on the Programs for the Economic Reconstruction and Financial Stability" was signed between the United States and Korean governments in December 1953. In this agreement are stressed particularly the importance of halting inflation in Korea as a condition to achieve economic reconstruction, and both governments agreed upon making every effort to help each other to curb inflation and strengthen the financial stability in Korea in the following sentence.[1]

> The Governments of the Republic of Korea and the United States agree to make every effort to help each other to curb the inflationary pressure in Korea and to establish a stable economy within the Programs for the Economic Reconstruction and Financial Stability.

Since the government of Korea adopted strong anti-inflationary policies, including excessive credit contraction policy, following the line provided in the above agreement in 1953, the inflation in Korea has been halted to a considerable extent. During the period of 1955-1958, both the Seoul wholesale and retail price indices rose only by less than fifty per cent. Whether this is the symptom for a continuing price stability in the future or not is the question time will solve.

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[1] This sentence is the translation of the Korean text by the writer. For the full text of the Agreement, refer to the Bank of Korea, Annual Economic Review: 1955, p. I-572.

Table 18

The Quantity of Money and the Price Level
1947 - 1958

Year	Total Money Supply (In Million Hwan)	Price Indices	
		Seoul Wholesale	Seoul Retail
		1947 = 100	
1947	465	100	100
1948	696	163	154
1949	1,211	223	195
1950	2,831	334	565
1951	7,304	2,194	2,605
1952	14,325	4,751	6,841
1953	30,316	5,951	7,384
1954	58,079	7,629	10,126
1955	93,523	13,816	17,058
1956	120,925	18,623	21,048
1957	145,186	22,070	25,985
1958	192,553	20,619	146.7[a]

a. This is the index number based on 1955 = 100

Source: The Bank of Korea, Annual Economic Review: 1958, p. III-9 and Annual Economic Review: 1959, p. III-9.

B. THE GOVERNMENT'S DEVELOPMENT POLICIES AND PROGRAMS

Governments are playing an important role in accelerating economic development in various ways in the developing underdeveloped countries of today. In some countries, national development plans providing investment and output targets are prepared and adopted by the government as a national objective and the government assumes most of the entrepreneural activities. In some countries, a program of economic development is established by the government just for the guiding policy for the economic development and the government intervenes indirectly into the

economy through using such instruments as monetary, fiscal, credit, trade, foreign exchange, etc., policies.

No matter what the degree of government intervention into the economy may be, at least the preparation of a comprehensive economic development program based on the fundamental development policy should be an essential pre-condition for the successful achievement of economic development in the light of tremendous obstacles to the spontaneous economic growth in those countries.

Until recent years, an integrated comprehensive economic programming for development has been lacking in Korea, except one prepared by the economic commission of Robert Nathan Associates at the request of the United Nations Korean Reconstruction Agency in 1954. This program, "An Economic Programme for Korean Reconstruction," played an important role in rehabilitating the Korean economy from war torn situation during the period 1954-58, although it was not prepared by the Korean government. As this program was the first detailed and exhaustive developmental projection ever prepared for Korea, it seems worth while to take a brief look at it, even though the plans proposed in the program were not successfully implemented mainly due to the lack of satisfactory coordination between the Korean government and the United Nations agencies.

The program set a self-supporting status as the reconstruction goal. For the achievement of this goal the program proposed a five-year reconstruction plan starting from the fiscal year[1] 1953-1954 and ending

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[1] Until 1953 the fiscal year covered the period starting from April to March of the following calendar year. Since 1955, the fiscal year has been the same as the calendar year.

in the fiscal year 1957-1958, assuming the goal would be achieved by the end of the 1957-1958 fiscal year. This "properly ambitious and, at the same time, realistic"[1] goal was supposed to be achieved through various programs including production program, consumption program and investment program. As the self-supporting level specified in the Report is a gross output 40 per cent higher than the level of 1949, the production goal was set at the level of output 80 per cent higher than the level of 1953.[2] This means that the GNP must grow at the average annual rate of 16 per cent.

For the achievement of the production goal, the Report stressed, above all, that agricultural products, which account for nearly half of Korea's output, should be increased by 35 per cent during the five years. In the meantime, the Report projected five-fold increase in mining output, principally to expand exports and to minimize the need for coal imports, and 85 per cent increase in construction and manufacturing output over the pre-war levels, respectively.

The consumption goal to be achieved by the final year of the plan was set at an approximately same level as that of 1949, i.e., $75.50 per capita in 1958 against $70.80 in 1949. The Report called this goal as "the most conservative that can realistically be set."[3]

The total capital requirement for the implementation of this program was estimated at 1.9 billion dollars, which would be provided both from the foreign aid and domestic sources. The rate of capital formation was

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[1] Nathan Associate Inc., op. cit., p. ix.

[2] Because the GNP in 1953 was 40 per cent lower than that of 1949.

[3] Nathan Associates Inc., op. cit., p. xi.

projected at the level of absorbing 18 per cent of the total resources in Korea per annum. The heaviest emphasis was put upon the social investment, which accounts for more than one-quarter of the total investment program. An investment of 447 million dollars was scheduled to be devoted to improving health, education and housing standards.

As indicated above, this program, modest, realistic and comprehensive as it is, could not result in a successful achievement of those goals set. As shown in the following chapter, the actual average annual rate of growth in the gross national product has been less than 6 per cent since 1953 and, accordingly, the proposed self-supporting status was not attained by 1958, still lying in the far distance from the present level.

In 1959, the Korean government established the "Three year economic development Plan"[1] which constitutes the first part of the seven year economic development plan (1960-1966). Considering the fact that this program is the first long range economic development plan that the Korean government has ever established, this plan bears significant importance for the future economic development in Korea.

The plan aims to establish the "groundwork for economic self-sufficiency" in Korea through the efficient utilization of domestic human and physical resources along with foreign economic aid within the framework of a free enterprise system. To achieve this goal, a 5.2 per

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[1] The draft for the Three Year Economic Development Plan was prepared by the Economic Development Council of the Korean government, which was established in March 1958 for the purpose of undertaking analyses and projections of economic development in Korea.

cent growth rate in the GNP is estimated and emphases are placed particularly upon (1) the increase in the productivity of the import competing industries and agriculture, (2) the improvement of balance of trade and (3) the expansion of employment opportunities. Comparing with the program prepared by the Nathan Associates Inc., this program seems too conservative and less ambitious, but more realistic, considering the past records of achievement and decreasing foreign aids.

The production goals for the achievement of annual average growth rate of 5.2 per cent are set as follows: (a) 15.4 per cent increase in the output of agriculture, forestry and fisheries; (b) 145 per cent increase in the output of minerals, chiefly coal and iron ore; (c) 56.5 per cent increase in the manufacturing industries and (d) 25.7 per cent increase in construction industries. The plan states that although these increases will not be able to supply the total domestic demand, "they will not only decrease the import requirements but also improve balance of payments through expanding exports capacity."[1] Thus, the GNP in the target year of 1962 is estimated at 2,038.2 billion hwan, accounting for 22.6 per cent above the base year of 1960.

Assuming the capital output ratio as 3.3, the plan estimated the capital requirement for the achievement of 22.6 per cent increase in GNP at 953.2 billion hwan. Foreign aid contribution to the capital requirement is estimated at 40 per cent of the total in the first year, but is expected to decline to 22 per cent in the target year. The remainder

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[1] Economic Development Council, Ministry of Reconstruction, The Republic of Korea, Draft for the Three Year Economic Development Plan (Seoul: 1959), pp. 71-72.

is, of course, expected to come from domestic sources, on the assumption that the austerity on the part of the government and the public will enable the contribution of the domestic private sources to increase from the level of 40 per cent of the total capital requirements to 51.5 per cent in the target year.

Based on these production and investment programs, the consumption goal is set at the per capita GNP of 82,871 hwan in the target year, accounting for a 12 per cent increase over the base year figure. However, per capita consumption levels are estimated at 65,235 hwan, accounting for only 6.7 per cent increase over the base year level. This discrepancy between the per capita GNP and the per capita consumption is expected to be due to the deliberate increase in the domestic savings as mentioned above.

The plan assumes that these goals are to be achieved within the framework of free enterprise economic system.[1] Accordingly, the main instruments to be used by the government for the implementation of the plan are largely limited to various policies, such as monetary, fiscal, credit, exchange control, export and import policies rather than direct intervention into the economy.

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[1] Ibid., p. 87.

Table 19

Projections of GNP by Industrial Origin under the Nathan Report's Reconstruction Programme (1953 - 1958)

(In Millions of 1952-53 US Dollars)

	1953	1954	1955	1956	1957	1958
Gross National Product	1659	1905	2093	2279	2400	2510
Agriculture	765	869	969	1059	1121	1184
Fisheries	58	60	65	70	76	83
Mining	23	33	45	57	69	81
Manufacturing	189	218	252	304	326	339
Construction	42	120	130	125	115	88
Wholesale & Retail Trade	139	146	154	167	168	175
Services, Foreign trading, Finance	231	248	269	292	318	344
Transportation and Public Utilities	45	51	56	63	65	66
Government	127	130	133	137	142	150
Service to UNC	40	30	20	10	-	-

Source: Nathan Associates, Inc., An Economic Programme for Korean Reconstruction, pp. 452-453.

Table 20

Key Economic Indicators for the Three Year Economic Development Plan
(In 1958 Price)

	Base Year 1958	Target Year 1962	Increment	%
Gross National Product (In Billion Hwan)	1,662.6	2,038.2	375.6	22.6
Gross Capital Formation (In Billion Hwan)	220.7	361.7	141.0	63.9
Private Consumption (In Billion Hwan)	1,375.3	1,617.8	242.5	17.6
Production Index for Mining and Industry	100.0	152.5	52.5	52.5
Production Index for Agriculture, Forestry and Fisheries	100.0	115.4	15.4	15.4
Rice (Thousand Suk)	16,595	18,781	2,186	13.2
Fish (M/T)	291,191	337,400	46,209	15.9
Power Generation (In Million KWH)	1,511	1,808	297	19.7
Balance of Payment (In Thousand US Dollar)				
Receipts (A)	444,657	427,403	-17,254	-3.9
Exports (FOB)	17,094	63,590	46,496	272.0
Invisible	76,019	83,880	7,861	10.3
Grants, Loans, Private Capital	351,544	279,933	-71,611	-20.4
Payments (B)	406,241	381,563	-24,678	-6.1
Imports	376,892	345,521	-31,371	-8.3
Invisible	29,394	36,042	6,693	22.8
Deficit (A-B)	38,416	45,840	7,424	1.9
National Living Standard				
Per Capita GNP (In Hwan)	74,028	82,817	8,789	12
Per Capita National Income (In Hwan)	64,260	69,552	5,292	8.2
Per Capita Private Consumption (In Hwan)	61,142	65,235	4,093	6.7

Table 20 (Continued)

Source: Economic Development Council, Ministry of Reconstruction, The Republic of Korea, Draft for the Three Year Economic Development Plan, pp. 74-76.

CHAPTER IV

THE GROWTH OF NATIONAL PRODUCT AND THE DEVELOPMENT IN BALANCE OF PAYMENTS IN KOREA SINCE 1953

A. THE GROWTH IN NATIONAL PRODUCT[1]

Despite the numerous extremely unfavorable conditions against economic development, e.g., the severe shortage of basic physical resources as well as capital, over-crowded and rapidly growing population, persisting disastrous chronic inflation, huge military expenditures and the disorganized economic structure due to the war, the Korean economy has been growing fairly rapidly since 1953 when the Korean War was ceased. The rate of growth in Gross National Product during the period 1953-1958 recorded approximately as high as 6 per cent per annum, although it is far lower than the rate estimated by the Nathan Report for the achievement of self-supporting level by 1958.

This rate of growth during the six year period in Korea stands out as one of the highest among the most of the underdeveloped countries in

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[1] Until recently Korea could not establish a fully satisfactory statistical base for the estimation of Gross National Product. The first undertaking on GNP estimation was done by R. R. Nathan, Associates Inc., in 1953 in their work, An Economic Programme for Korean Reconstruction, as referred to in the previous chapter. Since then, estimations had been made by various organizations, such as the Bank of Korea, Ministry of Finance, Ministry of Reconstruction and Economic Coordinator's Office, independently, until 1956, when the Bank of Korea was designated as a single official organization responsible for the GNP estimation.

Asia and Latin America as table 21 shows. Absolute figure, however, does not bear any significant meaning in comparison. For this reason, the rate of growth in per capita GNP is also illustrated in the same table. As soon as the comparison is made with these relative figures, Korea drops to a lower ranking, but still maintains a fairly high position.

Table 21

Rates of Growth in Real GNP
in Various Countries
1950-1956

Country	Annual Rate of Growth	
	In per Capita GNP (%)	In Aggregate GNP (%)
West Germany	7.4	8.5
Austria	6.4	6.6
Burma	5.3	6.5
Israel (1950-1958)	5.2	11.4
Puerto Rico	3.7	4.2
Korea (1953-1958)	3.6	6.0
Brazil (1950-1954)	3.2	5.7
U.S.A. (1950-1957)	2.6	4.1
Guatemala	2.0	5.1
Ceylon	0.2	3.0
Chile	-0.2	2.1
Argentina	-0.5	1.6

Source: Korea - Table 23.
Other Countries - UN, Year Book of National Accounts Statistics: 1957 and Statistical Year Book: 1958.

These figures on the rate of growth, however, do not tell whether the economy is growing on a sound basis or not. Table 24 shows that the economic growth during the period has taken place against a background of continuous dependence upon the import surpluses whose ratio

to GNP have been more than 10 per cent each year. These huge amounts of import surpluses are, of course, the obverse side of the large unilateral transfers of various types of capital, mainly represented by U.S. foreign economic aid to Korea.

The rate of growth by industry, however, reveals a sound sign. The relatively high rate of growth in the secondary industries compared with the primary and the tertiary industries[1] has been conspicuous, although it has slowed down in the recent year. During the period 1953-1958 the annual rate of growth in the secondary industries, which constitute the backbone of a country's industrial development, maintained the level of 15 per cent, while primary industries represented largely by agriculture grew at the average annual rate of 3.7 per cent and tertiary industries, which include electricity and transportation, at the average annual rate of 2.9 per cent during the corresponding period.

Table 22

Percentage Increase in GNP
by Industrial Sector
In 1955 Constant Price

	1954	1955	1956	1957	1958
Primary	7.5	2.1	-6.7	11.3	8.1
Secondary	20.1	13.6	12.1	15.6	6.3
Tertiary	0.9	3.6	1.1	6.0	4.8
Total	4.5	2.7	-2.0	7.9	4.7

Source: Computed from table 25.

[1] This classification of industries into three categories is done according to the concept of Colin Clark. See, Colin Clark, The Conditions of Economic Progress (London: 1951), Chap. IX.

It should be, however, noted that the secondary industries constitute extremely small portion of the GNP, although the portion has been increasing steadily. As of 1958, the primary industries shared 40.5 per cent of the GNP and the tertiary industries, 41.6 per cent, whereas the secondary industries shared as low as 18 per cent of the GNP, although it is 5 per cent higher than the ratio in 1953. The major factors contributed to the growth of the secondary industries have been mining industries, one of the most important sources of exports, and the manufacturing industries. Mining industries have grown at the average rate of 21 per cent per annum, accounting for the fastest rate in the whole economy. Manufacturing industries accounted for the second fastest growing industries with the average annual growth rate of 18 per cent during 1953-1958.

As the secondary industries grew at such a relatively fast pace, the relative portion of the primary industries in the GNP has been reduced from 42.0 per cent in 1953 to 40.1 per cent in 1958, although these industries made a fairly steady growth during the period. The decrease in the relative portion of the primary industries should be considered as indicating a gradual transition of the Korean economy from primary producing stage to intermediary stage of economic development.[1] The steady growth in the primary industries has been mainly thanks to the

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[1] In this connection A. W. Zanzi, a member of the Institute of Pacific Relations, comments as follows: "Korea today is at an intermediary stage of economic development. It approximates that stage characterized by Colin Clark as the secondary stage of economic development. Though predominantly agricultural, its industrial capacity has been developed further than that of most Asian countries, except Japan and India." A. W. Zanzi, Economic Reconstruction Problems in South Korea (New York: Institute of Pacific Relations, 1954), p. 5.

continuous bumper crops of grains, particularly that of rice during the period 1953-1958. This was not only a result of favorable weathers but also the result of the improvements in farming technique and irrigation conditions as well as the efficient utilization of fertilizers.

The tertiary industries have been making relatively slow progress. However, the electricity, water and sanitation services, and the transportation and communication sector, which constitute the groundwork for economic development, grew fairly rapidly during 1953-1958 due to the emphasis put on these sectors by the economic aid agencies as mentioned in the preceding chapter. During the period, the electricity output and the value of water service increased by 34 per cent and the transportation and communication increased their values by almost 200 per cent.

The gross domestic capital formation has been growing in parallel with the growth in national product. During the period 1955-1958, the domestic investment grew at the average annual rate of approximately 9 per cent, absorbing about 10 per cent of the GNP each year. This ratio, fairly high as it is, is far below the optimum rate of capital formation in Korea for a substantial progress toward self-sustained growth, considering the fact that many industrially advanced countries invest more than 15 per cent of their annual national incomes although their capital output ratio is much lower than that of underdeveloped countries, and that Korean economy started economic reconstruction and development from an extremely low level of capital accumulation.

The investment rate in the secondary industries has been most conspicuous over the past 5 year period, with the average annual rate

of increase in the value of investment of 16 per cent. In the meantime, investments in the primary and the tertiary industries maintained the average annual increase rate of 14.4 per cent and 13.9 per cent, respectively, during the same period.

Since 1954 a remarkable change took place in the composition of the capital formation in Korea. The proportions of the investments in the primary and the secondary industries to the total domestic capital formation were only 9.8 per cent and 16.0 per cent, respectively in 1954, whereas the proportion of investment in the tertiary industries to the total was an overwhelmingly large ratio of 74.2 per cent in the same year. Since 1955 these proportions have been shifting in the direction of lower proportion in the tertiary and higher proportions in the primary and the secondary industries. In 1958 the proportions of investment in the primary, the secondary and the tertiary industries to the total capital formation accounted for 15.4 per cent, 20.9 per cent and 63.7 per cent, respectively. Taking account of the fact that Korean economy attained recovery from war-destroyed situation, resuming the pre-war level in 1956, such a trend should be considered as a healthy sign.

Table 23
Gross National Product by Industrial Origin (In Billion Hwan)

	1953	%	1954	%	1955	%	1956	%	1957	%	1958	%
A. Primary Industries												
1. Agriculture, Forestry, Fishing	351.5	42.0	373.6	40.6	394.2	41.8	358.1	38.9	414.2	39.6	445.7	40.1
B. Secondary Industries												
2. Mining & Quarrying	7.8	0.8	6.5	0.7	7.7	0.8	9.6	1.0	12.5	1.2	13.5	1.2
3. Manufacturing	76.3	9.1	87.4	9.5	103.0	10.9	113.4	12.3	123.4	11.8	131.8	11.9
4. Construction	23.7	2.9	35.0	3.8	33.2	3.5	31.5	3.4	42.2	4.0	45.7	4.1
C. Tertiary Industries												
5. Electricity, Water & Sanitary Services	2.7	0.3	4.3	0.5	2.9	0.3	1.4	0.2	3.3	0.3	4.1	0.4
6. Transportation, Communication & Storage	13.5	1.6	16.7	1.8	20.1	2.1	27.1	2.9	37.3	3.6	38.7	3.5
7. Wholesale & Retail Trade	150.7	18.0	160.3	17.4	157.6	16.8	157.1	17.1	166.0	15.9	173.6	15.6
8. Banking, Insurance & Real Estate	10.3	1.2	6.6	0.7	7.9	0.8	7.1	0.8	10.6	1.0	12.6	1.1
9. Housing	59.7	7.2	62.0	6.7	64.4	6.8	66.6	7.2	68.9	6.6	69.9	6.3
10. Public Administration & Defense	50.4	6.0	74.2	8.1	58.9	6.2	49.8	5.4	65.6	6.3	67.4	6.1
11. Services	69.5	8.3	79.4	8.6	80.1	8.8	81.8	8.9	88.1	8.4	91.3	8.2
12. Rest of the World	20.2	2.4	14.6	1.6	13.9	1.5	17.5	1.9	13.2	1.3	16.9	1.5
Gross National Product	836.3	100.0	920.6	100.0	943.9	100.0	921.5	100.0	1045.0	100.0	1112.2	100.0
Rate of Growth			10.1		2.5		2.4		13.4		6.3	
Per Capita GNP (In Hwan)[a]					44000		43100		46500		48700	
Index (1955 = 100)	88.6		97.5		100.0		97.6		110.7		117.8	
Rate of Growth Per Capita GNP[a]			4.5		2.7		-2.0		7.9		4.7	

Sources: The Bank of Korea, Annual Economic Review: 1959, p. III-6.
(a) - Ministry of Reconstruction, Economic Survey: 1959, pp. 22-23.

Table 24
Total Resources and Their Disposal (At 1955 Constant Prices)
(In Billion Hwan)

	1955	%	1956	%	1957	%	1958[a]	%
1. Private Consumption	842.8	89.3	1155.2	96.9	1389.5	86.5	1387.2	83.8
2. General Gov't Consumption	94.9	10.0	127.7	10.7	207.5	12.9	249.0	15.0
3. Gross Domestic Fixed Capital Formation	97.4	10.3	112.1	9.4	181.1	11.3	187.8	11.3
4. Change in Inventory	4.4	0.5	-37.8	-3.2	42.0	2.6	10.7	0.7
5. Import Surplus	109.5	11.6	172.7	15.3	226.8	14.1	195.2	11.8
6. Total Use of Domestic Resources	930.0	98.5	1174.5	98.5	1593.3	99.2	1639.5	99.0
7. Net Factor Income from Abroad	13.9	1.5	17.5	1.5	13.2	0.8	16.9	1.0
8. Gross National Product (6 + 7)	943.9	100.0	1192.0	100.0	1606.5	100.0	1656.4	100.0

Source: Compiled from, the Bank of Korea, Annual Economic Review: 1959, p. III-7.
a. Preliminary figures.

Table 25

Composition of Gross Fixed Capital Formation (In 1955 Constant Prices)

	1954		1955		1956		1957		1958	
	% of Change	% of Distribution	% of Change	% of Distribution	% of Change	% of Distribution	% of Change	% of Distribution	% of Change	% of Distribution
A. Primary Industries	-13.6	9.8	16.7	11.0	19.9	13.9	44.4	14.9	4.4	15.4
B. Secondary Industries	18.6	16.0	10.2	17.0	1.6	18.3	15.1	15.5	33.5	20.9
Mining	15.8	2.1	-	2.0	86.4	4.0	4.9	3.1	-25.6	2.3
Manufacturing	19.3	13.7	12.7	14.9	-10.0	14.2	18.1	12.3	51.2	18.5
Construction	-	0.2	-50.0	0.1	-	0.1	-	0.1	-	0.1
C. Tertiary Industries	48.7	74.2	0.9	72.0	-10.9	67.8	38.6	69.6	-7.5	63.7
Electricity, Water & Sanitation	21.9	3.8	156.4	9.3	-27.0	7.2	12.3	6.0	39.0	8.2
Transportation, Storage & Communication	101.0	20.3	10.0	21.5	3.9	23.7	92.5	33.7	-33.0	22.4
Wholesale & Retail Trade	21.9	3.8	-12.8	3.2	-8.8	3.1	-19.4	1.8	8.0	1.9
Other	37.9	46.3	-14.6	38.0	-15.6	33.8	11.8	28.1	12.1	31.2
D. Total	33.8	100.0	4.0	100.0	-5.5	100.0	5.1	100.0	0.9	100.0

Source: Ministry of Reconstruction, Economic Survey: 1959 p. 34.

B. THE DEVELOPMENT IN BALANCE OF PAYMENTS[1]

The Korean balance of payments has been characterized by a persistent heavy import surplus, on the one hand, as briefly indicated in the preceeding section, and a large amount of unilateral capital transfers in the form of economic aid, on the other, offsetting the deficit on the trade accounts. Indeed, no other country comes even close to this degree of dependence on import surpluses and on foreign economic aid. Particularly since the outbreak of Korean hostilities, the value of trade deficits has been increasing and so has been the ratio of import surpluses to national income, as shown in table 24.

The import surpluses have been, of course, due to the heavy demand for goods and services for consumption as well as for investment and also due to the low capacity of exports. It should be noted, however, that in the recent year the increasing tendency in import surplus has been curbed to a large extent. In 1958 the value of import surplus accounted for 195.2 billion hwan as compared with 226.8 billion hwan in 1957. This was, however, not due to the increase in exports but due to the decrease in imports because of the reduced foreign economic aid. This indicates that the volume of import surplus in Korea has been determined not so much by the need on the part of Korean economy as by the size of foreign economic aid.

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[1] The Bank of Korea is the only official organization to prepare the Korean balance of payments, pursuant to Article 36 of the Law Establishing the Bank of Korea. It was not until 1955 when Korea was admitted to the membership of IMF that the Bank of Korea began preparing the balance of payments in the standard form designated by the Fund.

Another striking characteristic of the Korean balance of payments in the past years may be attributable to the complete absence of records on the private foreign capital movements. So far, no private foreign investment has been recorded in the balance of payments. For this reason discussions in this section will be concentrated mainly on the transactions on the current account, i.e., chiefly on the developments in international trade.

Merchandise Exports

The structure of exports in Korea assumes two conspicuous characteristics: absolutely small size of exports and concentration of exports on a few commodities. The first characteristic has been amplified by the fact that the value of exports has been decreasing continuously since 1953. The second characteristic becomes clear when we look at table 23.

During the period from 1946-1950, fishery and agricultural products accounted for more than 80 per cent of the total exports. From 1951 to 1954, tungsten alone accounted for more than 70 per cent of the total exports. After the termination of the US-Korea Tungsten Agreement in 1954,[1] the export value of tungsten declined substantially, but the export of minerals including tungsten ore still represents the major export item, accounting for more than 60 per cent of the total exports.

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[1] This Agreement was concluded between the two governments in March 1952 to sell 15,000 metric tons of tungsten to the United States within 5 years from 1952. The remarkable increase in the production of tungsten, however, enabled the Korean Government to export the designated amount of tungsten within two years. So the Agreement was terminated in 1954. For the text of this Agreement, refer to, Ministry of Reconstruction, Selected Laws and Regulations Pertaining to Foreign Economic Aid for Korea (Seoul: 1959), pp. 47-57.

Needless to say, such a heavy concentration of export on few commodities makes the domestic supply highly inelastic and, accordingly, export proceeds are subject to wide fluctuation according to the world market condition. The seriousness of this problem is shown, for instance, in the fact that the sharp decrease in exports in 1958 (from 21 thousand dollars in 1957 to 16 thousand dollars in 1958) was mainly attributable to the markedly decreased demand of the world market for the Korean minerals.

Table 26

Relative Importance of Exports by Commodity in Percentage

	1946	1950	1953	1954	1955	1956	1957	1958
Food (Fishery and Agricultural Products)	80	82	16	12	5.5	6.1	14.9	14.9
Minerals	20	13	72.8	76	70	79.2	63.1	62.8
Others	-	5	1.2	12	24.5	14.7	22	22.3

Source: Computed from The Bank of Korea, Monthly Statistical Review No. LXXIV, (January 1955), p. 66, and Vol. XIV, No. 1, (January 1960), p. 55.

Lopsided market structure is another characteristic of Korean exports. Export markets are almost confined to Japan, the United States and Hong Kong. Since the shipment of tungsten ore to the United States declined drastically in 1954, Japan has been the largest importer of Korean commodities. In 1958, Japan was the main outlet for Korean export goods, accounting for 59.4 per cent of the total

exports. Next to Japan was the United States with 10.2 per cent of the total exports and Hong Kong followed the United States with 7.7 per cent.

Table 27

Value of Exports by Countries

(In Thousand U.S. Dollars)

	1953	1954	1955	1956	1957	1958
Japan	5,944	7,260	6,994	8,092	9,258	10,741
U.S.A.	30,434	14,143	8,124	10,695	5,292	3,290
Hong Kong	2,715	2,587	1,756	2,368	3,909	1,369
U.K.	204	203	482	1,419	615	547
Others	289	53	247	2,580	2,447	833
Total	39,586	24,246	17,603	25,154	21,521	16,780

Source: The Bank of Korea, Annual Economic Review: 1959 p. III-232.

It is true that the lopsided export market structure is due to the limited number of exportable commodities, which is, in turn, because of the low productivity of the economy in general, but it is also true that the limited market is a major obstacle to developing export production in Korea. Here we can find a "vicious circle of poor trade." Needless to say, a wider and more diversified export market is also an essential condition for the prevention of monopolistic exploitation by the trading partners.

Merchandise Imports

Contrary to the shrinking exports, the volume of imports has been increasing markedly since 1953. The enormous imports against absolutely small and shrinking exports have been, of course, possible by economic

aid. Imports financed by private funds accounted for less than 20 per cent of the total import during the 1953-1958 period. The remaining portion was entirely financed by foreign economic aid funds, and, accordingly, the size of imports has been determined by the size of foreign economic aid to a large extent. For instance, in 1958 the total import of goods decreased by 14 per cent from the level of 1957 and this was due mainly to the reduction in the amount of foreign economic aid, i.e., the import financed by foreign aid funds amounted to 311 million dollars in 1958, whereas it amounted to 374 million dollars in 1957. Indeed, the most striking characteristic of the Korean import lies in the extremely high degree of dependence upon the size of foreign aids.

The high ratio of consumption goods imports including food and various manufactured goods to the total imports has been another characteristic of the Korean import structure. Excluding imports financed by foreign aid funds, the consumption goods accounted for more than 60 per cent of the total imports in recent years and food alone shared more than 15 per cent of the total while raw materials and investment goods altogether accounted for less than 30 per cent of the total imports. Including the imports by aid funds, however, the raw materials and investment goods accounted for a higher ratio than the consumption goods because of the absolutely high percentage of the chemical goods imports. In 1958, the chemicals alone accounted for 26.2 per cent of the total imports. This was due to the large amount of chemical fertilizer imports which alone accounted for 12 per cent of the total imports in the year. Considering that chemicals

Table 28

Imports by Commercial Base and Foreign Aid

(In Thousand U.S. Dollars)

	Commercial		Foreign Aid	Total
	Government	Private		
1953		153,630	191,806	345,436
1954		93,926	149,401	243,327
1955	5,146	103,482	232,787	341,415
1956	6,561	59,605	319,897	386,063
1957	10,972	57,177	374,025	442,174
1958	2,140	65,048	311,020	378,208

Source: The Bank of Korea, Annual Economic Review: 1959 p. III-200.

represent semi-manufactured consumption goods, the ratio of consumption goods to the total imports remains high even if the aid goods are included in the total picture. The reduction of consumption goods imports is urgent not only for directing the essential foreign exchanges toward the import of more vital goods for economic development in Korea but also for encouraging domestic industries competing with imported goods.

During the period 1953-1958, more than one half of the total private imports was transacted with Japan and the United States. Table 30 shows that the volume of imports from the United States has been increasing steadily since 1955 when it jumped to 17 billion hwan from 6 billion hwan in 1954, in spite of the fact that the exports thereto have been decreasing since the same year. This has been due to the political conflict between Japan and Korea. Until 1954 Japan was the largest trade partner of Korea but the worsened political relation of Korea with Japan in 1955 led to a drastic decline in the volume of imports from Japan and to an abrupt increase in the imports

Table 29

Imports by Economic Destinations
1957-1958
(In Thousand U.S. Dollars)

	1957			1958		
	Commercial	Aid	Total	Commercial	Aid	Total
Consumption Goods[a]	46,092	108,473	154,565	41,207	60,556	101,763
Raw Materials[b]	9,682	178,275	187,957	16,025	188,326	204,351
Investment Goods	6,577	15,252	26,729	7,265	16,600	25,463
Miscellaneous	737	72,025	73,239	1,036	46,891	47,927
Total	68,149	374,025	442,174	67,189	322,373	379,562

a. Consumption goods include food, beverage and tobacco, manufactured goods and miscellaneous manufactured goods.

b. Raw materials include inedible crude materials, mineral fuels, animal and vegetable oil and fats, and chemicals.

Source: Ministry of Reconstruction, The Government of Republic of Korea, Economic Survey: 1959 p. 135.

from the United States. In 1953 imports from Japan accounted for 48 per cent of the total private imports, while imports from the United States accounted for only 16 per cent of the total. In 1955, however, the situation was reversed. The volume of imports from Japan dropped from 48 per cent to 19 per cent while the imports from the United States increased from 20 per cent to 34 per cent of the total imports in 1955. As of the end of 1958, this trade pattern was still maintained: the United States still ranked first with 13,897 million hwan or 32 per cent of the total imports and Japan ranked second with 10,335 million

hwan or 23 per cent of the total imports. Considering the relatively cheap prices of Japanese goods in the world market and the low cost of transportation with a short notice of arrival, restoration of the normal trade relation with Japan is highly necessary for the interest of Korea regardless of the Korean people's political prejudice, which is natural considering the past history.

It is worth while to note that imports from European countries, namely, from West Germany, Italy and the Netherlands have been increasing in recent years. Diversified and wider markets are desirable for mitigating the possible adverse terms of trade against Korea. Indeed, the chances are strong in Korea for the adverse terms of trade to jeopardize the balance of payments because of the highly inelastic domestic demand for imports.

Table 30

Geographical Pattern of Imports
1953-1958
(In Million Hwan)

	Total	Japan	U.S.A.	Europe	Asia (Excluding Japan)
1953	22,370	10,666	3,703	896	5,018
1954	27,785	10,612	6,126	4,285	5,174
1955	48,245	7,067	16,853	11,233	10,466
1956	35,436	6,820	11,724	8,159	6,922
1957	37,916	8,529	14,009	5,401	9,543
1958	43,564	10,335	13,897	10,493	6,688

Source: The Bank of Korea, Annual Economic Review: 1959, p. III-212.

Invisible Trade

Invisible trade has been an important source of foreign exchange earnings during the 1953-1958 period. Unlike the deficit merchandise trade account, invisible accounts, comprising those items such as, government transactions, transportation and insurance, investment income and foreign travel have recorded continuous surpluses during the 6-year period. The surplus on these accounts which has been quite helpful for balancing the current account deficits during the period, however, were not derived from such sources as transportation, travel or insurance which are deemed to be the ordinary items of the invisible trade, but largely from the government transactions with the United Nations forces in Korea. Excluding the government transactions and investment incomes of the Bank of Korea, all the invisible trade accounts have been in deficit in the same period. The balance of the invisible trade account has been favorable solely owing to the substantial amount of foreign exchange receipts from the United Nations forces in Korea under the offshore procurement programs.

This program, a part of the indirect economic aid program of the United States, consists of the following four types of procurements by the United Nations forces in Korea: (a) local currency purchase in exchange for foreign currencies, mainly for U.S. dollars, (b) procurement of goods and services from the Korean government for their own uses, (c) procurements of goods and services to supply the Korean military forces as an indirect defense support and (d) utilizations of the public facilities, such as electric power, water service and transportation.

As mentioned in the preceding chapter, the local currency advanced to the United Nations forces without an immediate repayment in foreign currencies was the major factor contributing to the acute inflationary pressure during the Korean War. In August 1955, when the official exchange rate of Hwan to U.S. dollar was devaluated to Hwan 500 = U.S. $1 from Hwan 180 = U.S. $1, the Korean government and the United Nations forces agreed upon changing the method of local currency procurement from the borrowing method to the purchasing method. Since then the adverse effect of local currency procurement to the Korean economy has been eliminated.

The foreign exchange earnings from these sources have been remarkably increasing since 1953, exceeding the foreign exchange proceeds from merchandise exports, as shown in table 31. In 1958 the receipts from these sources amounted to 57,580 thousand dollars, accounting for more than three times the receipts from the merchandise export.

Another important factor which has been contributing to balancing the deficits on the trade account is private donations from abroad, mainly from overseas religious organizations. Excluding the official foreign economic aid, the private donation has been the second largest source of foreign exchange earnings since 1955. Since 1955 the foreign exchange receipts from private organizations or individuals as donations have been exceeding the merchandise export proceeds by considerable margins. In 1958 the private donations amounted to 29 million dollars,

whereas the export proceeds accounted for 17 million dollars. As we will discuss in the following chapters, these foreign exchanges can be used for the import of goods and services and, therefore, bear a significant importance.

Table 31

Balance of Payments in Korea
1953 - 1958
(In Thousand U.S. Dollars)

	1953		1954		1955		1956		1957		1958	
	Credit	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit	Debit
A. Goods and Services	72,428	351,602	64,581	244,688	71,327	337,264	63,091	393,976	78,677	464,778	93,108	401,515
1. Merchandise	39,586	347,047	24,246	241,179	17,602	326,993	25,154	380,392	19,361	388,336	17,094	344,088
2. Monetary Gold	143	-	892	-	114	-	89	-	127	-	162	-
3. Foreign Travel	61	736	65	1,244	352	1,683	59	3,032	153	2,927	323	3,362
4.5. Transportation and Insurance	375	2,442	618	858	768	428	999	1,139	7,769	57,151	4,607	37,139
6. Investment Income	543	2	1,366	-	1,646	-	1,713	-	2,515	-	2,905	77
7. Government	30,627	-	35,241	403	49,563	6,705	34,893	8,467	48,155	14,953	66,743	13,955
7.1. Receipts from UN Forces	30,627	-	34,378	-	44,040	-	22,566	-	43,477	-	57,580	-
7.2. Others	-	-	863	403	5,253	6,705	11,868	8,467	4,678	14,953	9,163	13,955
8. Miscellaneous	1,093	1,335	2,153	1,004	1,282	1,455	184	946	597	1,411	1,274	2,894
Net Goods and Services	-	279,174	-	180,107	-	265,937	-	330,885	-	386,101	-	308,407
B. Donations	205,072	9,484	155,138	3,865	265,625	9,228	326,482	5,590	387,897	4,373	352,036	6,251
9. Private	9,616	9,484	16,034	3,865	21,203	4,364	26,732	3,926	30,844	1,719	28,645	1,935
10. Official	193,456	-	139,104	-	244,422	4,864	299,750	1,664	357,053	2,654	323,391	4,316
Net Donations	193,588	-	151,273	-	256,397	-	320,829	-	383,524	-	345,785	-
Net Total (1-9)	-	279,042	-	167,938	-	249,098	-	308,079	-	356,976	-	281,697
Net Total (1-10)	-	85,586	-	28,834	-	9,540	-	9,993	-	2,577	37,378	-
C. Capital and Monetary Gold	85,705	-	29,088	-	8,740	-	10,715	-	1,193	-	-	37,885
Private	-	-	-	-	-	-	-	-	-	2,875	6,969	-
11.13. Long Term Capital	-	-	-	-	-	859	-	3,235	-	2,875	6,969	-
12.14. Short Term Capital	-	-	-	-	-	859	-	3,235	-	-	-	-
Official and Banking Institutions	85,705	-	29,088	-	9,599	-	13,950	-	4,068	-	-	44,854
15.17. Long Term Capital	-	-	-	-	-	5,625	-	-	-	-	-	-
16.18. Short Term Capital	85,848		29,980	-	14,137	-	14,039	-	4,195	-	-	44,692
Liabilities to IBRD	-	-	-	-	2,250	-	-	3	-	-	-	-
Korea-Japan Open Account	20,215	-	22,562	-	-	241	-	644	740	-	-	853
Other	65,633	-	7,418	-	12,128	-	14,686	-	3,455	-	-	43,839
19. Monetary Gold	-	143	-	892	1,087	-	-	89	-	127	-	162
Net Errors, Omissions	-	119	-	254	800	-	-	722	1,384	-	507	-

Source: The Bank of Korea, Annual Economic Review: 1959, pp. III-226-227.

CHAPTER V

FOREIGN EXCHANGE CONTROL AND ECONOMIC DEVELOPMENT

Originally, foreign exchange control devices were developed without anything to do with economic development of underdeveloped countries. It is quite obvious when we observe the fact that foreign exchange control systems were first adopted by such highly industrially developed countries as Germany or Great Britain during the depression of the 1930's following the financial crisis of 1931. It was not until after World War II that the device has been widely used as a means of economic development in underdeveloped countries. Causes which led the countries to adopt foreign exchange control measures might be fundamentally the same both in industrially developed countries and in underdeveloped countries: overall shortage of foreign exchange resources and currency inconvertibility.[1] However, the conditions which brought about these two causes can not be the same in both categories of countries and the need for foreign exchange control is, no doubt, more acute in developing underdeveloped countries than in industrialized countries. These facts may be explained from two aspects of foreign exchange situations in underdeveloped countries:

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[1] See, UN, Department of Economic and Social Affairs, The Quest for Freer Trade (New York: 1955), p. 33.

relatively enormous demand for foreign exchange and small and uncertain amount of supply of foreign exchange in underdeveloped countries.

Economic development requires a substantial amount of foreign exchange. Even if we assume that the developing underdeveloped countries are endowed with rich essential natural and human resources, a large demand for imports of investment goods and technical know-hows is inevitably accompanied by an increased rate of capital formation, in view of the low capacity of underdeveloped countries for the production of capital goods. In general cases, the import requirements are, however, not limited to such pure investment goods. As we have seen in chapter IV, the economic development process often requires a substantial amount of consumption goods and raw materials imports in addition to the investment goods imports. In the meantime, there is a strong tendency that higher incomes and urbanization generated by the achievement of economic development along with the possible "demonstration effect" will contribute to the expansion in the demand for imported consumer's goods. Taking into account the likely inflationary pressures in underdeveloped countries not only due to the high propensity to consume but also due to the possible inflationary financing of capital formation, the difficulties in the balance of payments are likely to be greatly intensified. Situations being as such, the necessity to take measures to curtail imports on the part of governments of underdeveloped countries must be acute. Foreign exchange control is, beyond doubt, one of the most certain, rapid and effective measures for this purpose.

The balance of payments difficulties in developing underdeveloped

countries is also attributable to the supply side of foreign exchange. The supply of foreign exchange is limited not only because of the generally low capacity to export which, in turn, is due to the low productivity, but also because of the "disequalizing forces"[1] operating in the world economy, making the gains from trade go mainly to the more developed countries. Although numerous arguments have been presented over this question, the causes for the "disequalizing forces" and, therefore, for greater pressure upon the balance of payments of underdeveloped countries seem to lie in the following two facts: (1) instability in the demand for their exports due to their concentration of production on a few primary commodities, (2) a greater degree of fluctuation in world prices of raw materials compared with the prices of industrial commodities.[2]

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[1] Meier and Baldwin use this term referring to those arguments presented by such writers as Prebish, Singer, Mynt, Lewis and Myrdal on this question. See, Meier and Baldwin, op. cit., p. 326.

[2] These facts have been demonstrated by the United Nations' empirical case study on the 18 important primary commodities which represent the major exports of selected underdeveloped countries over the period 1901-1950. According to this study, there have been marked fluctuations in proceeds from exports as well as in prices of those commodities not only during the fifty year period, but also over the year-to-year period. See, UN, Department of Economic Affairs, Instability in Export Market of Underdeveloped Countries (New York: 1952). Besides these points, Singer and Prebish argue that terms of trade have been deteriorating against underdeveloped countries in the long run. See, H.W. Singer, "Distribution of Gains between Investing and Borrowing Countries", American Economic Review, Papers and Proceedings, XL, No. 2, (May, 1950, pp. 472-492, and R. Prebish, "Commercial Policy in Underdeveloped Countries", American Economic Review, XLIX (May, 1959). These arguments have been, however, subject to severe controversy and attacked by various writers as unrealistic. For instance, Kindleberger argues that the situation has been vice versa, in the following passage: "It may be fair to conclude that there is no long-run tendency for the terms of trade to move against primary products in favor of manufactures. On the contrary, if allowance is made for the unprovable but generally

Under these situations, adoption of measures to secure a more stable level of demand for their export products on the part of underdeveloped countries in the process of economic development seems to be inevitable.

The balance of payments difficulties which accompany economic development programmes are, however, usually too serious to be solved by the mere maintenance of stability in the demand for the exports of the underdeveloped countries. Measures to increase the level of foreign exchange receipts through the expansion of exports and the encouragement of foreign private investment should be vital for alleviating the pressures on a country's international reserve.

Needless to say, foreign exchange control is not the only device to contribute to the solution of the balance of payments difficulties generated in the process of economic development in underdeveloped countries. Various governmental policies including monetary, fiscal and commercial policies and direct trade controls can be alternative measures to foreign exchange control. Moreover, it is hard to expect that foreign exchange control alone can achieve any effective solution. Government policies are by no means mutually exclusive. They should be complemented by each other in the solution of the balance of payments problems. On this point, Professor Mikesell comments as follows:[1]

(Cont'd from previous page.) accepted fact that the improvement in the quality of manufactures over the past eighty years has been greater than that of primary products, the terms of trade may have turned against manufactures and in favor of raw materials . . " C. P. Kindleberger, The Terms of Trade, A European Case Study (New York: The Technological Press of MIT and Wiley & Sons, Inc., 1956), p. 263.

[1] Raymond F. Mikesell, Foreign Exchange in the Post War World (New York: Twentieth Century Fund, 1954), p. 59.

> Exchange control represents only one among many tools in the bureaucratic kit for accomplishing a given purpose, but they are usually combined with other devices for achieving the desired ends. It is frequently difficult to decide, therefore, whether a particular objective is being realized through the use of an exchange restriction or through other type of restriction.

Realities being as such, although our discussion will be chiefly limited to the foreign exchange control problems in terms of the stimulation of economic development in Korea, other restrictive measures which are employed in close conjunction with foreign exchange control and which aim at controlling the international payments or receipts will not be entirely excluded from our discussions in the following chapters.

Foreign exchange control assumes various forms and numerous purposes.[1] The types and purposes of foreign exchange control vary from one country to another and have been undergoing changes as time passes. It is, however, not the aim of this study to go into these discussions. The discussion in this chapter is mainly concentrated on those aspects of foreign exchange control that are closely related with the development of underdeveloped countries, particularly with the discussions in the following chapters.

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[1] In this connection, the classification of the purposes of foreign exchange control by Howard S. Ellis may be worth citing. He classified the purposes into the following seven categories: (1) prevention of unregulated export of capital and depreciation of the currency, (2) temporary insulation to permit adjustment to international equilibrium, (3) increasing the total economic gain from foreign trade, (4) securing cheap foreign exchange for government purposes, (5) retaliation against foreign controls, (6) protection of domestic production and (7) totalitarian economic and political control. Howard S. Ellis, Exchange Control in Central Europe (Cambridge: Harvard Univ. Press, 1941), p. 290.

A. FOREIGN EXCHANGE CONTROL ON IMPORTS

Needless to say, economic development generates a large demand for foreign investment goods. Those countries that are undertaking economic development programs must be underdeveloped countries and, therefore, lack the capacity for capital goods production. In the meantime, as we discussed briefly above, the process of economic development and industrialization is very likely to involve inflationary pressures. This may be due to the generally inevitable adoption of the inflationary financing method on the part of the government, but inflationary pressure may be generated in the absence of such inflationary financing. Kindleberger argues that any investment process is apt to be inflationary if it requires the shifting of any considerable volume of resources, "whether savings are large or small, and whether the project of economic development is limited in amount to the volume of savings known to be available or not."[1] A similar view is expressed also in the following passage from the report of the United Nations on this problem:[2]

> Inflationary pressure is an inevitable result of the accelerated investment required by a development programme in so far as it is not financed from abroad . . . Thus governments of underdeveloped countries are not likely to find it possible to avoid inflationary pressure since this in many cases would mean the abandonment of development itself.

Furthermore, Ragner Nurkse even argues that inflationary pressure is very likely to be generated in the underdeveloped countries by the mere

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[1] Kindleberger, Dollar Shortage (New York: John Wiley and Sons, Inc., 1950), p. 127.

[2] UN, Department of Economic Affairs, Methods of Financing Economic Development in Underdeveloped Countries, p. 19.

contact of the underdeveloped countries with the attractive advanced consumption standard in richer countries because such "contact makes nations feel continually impelled to keep their money incomes and outlays above what is warranted by their own capacityto produce."[1]

Thus, the economic development process involves not only a huge demand for imports of capital goods but also a strong demand for the consumption goods imports due to the likely inflationary pressures. The result is obviously a persistent tendency towards balance of payments disequilibrium. Under these conditions, there can be little doubt that mere adjustment of the exchange rate can not bring the balance of payments into equilibrium any more. Elasticity of demand for imports is too low to let the changes in the exchange rate bring about any improvements in the balance of payments disequilibrium.

Under these situations, it is not hard to find a role of foreign exchange control as a means of stimulating economic development. Foreign exchange control certainly can be used as a means to conserve foreign exchange for essential goods imports for development programmes at the expense of luxury imports. As Nurkse points out, the restriction of luxury or semi-luxury imports will not only suppress the disequilibrium in the balance of payments but also offset the deteriorating effect of attractive high consumption patterns of the rich countries upon domestic capital formation.[2] Indeed, the restriction of luxury imports would

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[1] Nurkse, Some Aspects of Capital Accumulation in Underdeveloped Countries (Cairo: National Bank of Egypt, Fiftieth Anniversary Commemoration Lectures, 1952), p. 45.

[2] Ibid., p. 53.

contribute to the economic development of underdeveloped countries not merely through making more foreign exchange available for the import of essential goods but also through forcing the people to cut their consumption level, i.e., to save.

The selective restriction of imports designed to conserve foreign exchange for essential uses and to enforce domestic saving can, of course, be achieved either by increasing local currency costs through the introduction of multiple exchange rate or by imposing quantitative restrictions on the foreign exchange available for imports, or by the combination of the two. A brief discussion on the merits and demerits of these two types of foreign exchange control in the selective restriction of imports may be valuable for our discussions on the Korean exchange control system.

The advantages and disadvantages of these two types of exchange control have been well described by E. R. Schlesinger.[1] Schlesinger points out two principal advantages of quantitative restrictions as an instrument for limiting foreign exchange disbursements: the comparative certainty of their effects and the relative rapidity with which these can be realized.[2] The certainty and the rapidity can be achieved more efficiently especially when a foreign exchange budget is introduced and strictly followed. The quantitative restrictions can not, however, evade the major difficulties resulting from the complex administrative problems of allocation of foreign exchanges. In Schlesinger's words,

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[1] Eugene Richard Schlesinger, Multiple Exchange Rates and Economic Development (Princeton: Princeton Univ. Press, 1952).

[2] Ibid., p. 8.

"the major difficulties inherent in quantitative restrictions arise because the allocation of exchange among different uses and among the various importers is entirely a function of administrative decision."[1] Because the foreign exchange is distributed according to the views and judgements of the authorities, the chances that this procedure will bring about any beneficial results depend upon the ability and honesty of the administrators to a large extent.

In the meantime, the use of cost restrictions based upon the artificial price or cost differentiations in the foreign exchange market can avoid "many of the difficulties which are created by the existence of windfall profits and the danger of incompetent or dishonest allocation of exchange."[2] But Schlesinger argues that "these advantages are gained at the expense of greater uncertainty and slower appearance of the effects on imports."[3]

The multiple exchange rate system based upon the distrust of the competency and honesty of administrative authorities was predominent among the underdeveloped countries in the post war period. As of 1950, more than one half of the Latin American countries and numerous countries in Asia including Thailand, Indonesia, Taiwan and Korea adopted this system.[4] The multiple rate system has been, however, gradually replaced

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[1] Ibid., p. 8.

[2] Ibid., p. 9.

[3] Ibid., p. 9.

[4] See, International Monetary Fund, First Annual Report on Exchange Restrictions (Washington D.C., 1951).

by a single rate system or relatively simpler rates systems in recent years.[1]

B. FOREIGN EXCHANGE CONTROL ON EXPORTS

In the brief discussion above we have already seen that the balance of payments difficulties during the period of economic development are brought about not only because of the huge demand for foreign exchange to finance economic development but also because of the unstable and low level of foreign exchange receipts. Needless to say, foreign exchange control upon exports is primarily necessary in order to have control over foreign exchange receipts from exports, for, otherwise, allocation of foreign exchange and control of exchange rate is almost impossible. The pressures upon a developing country's international reserves are, however, very likely to require further steps from this level. Not merely foreign exchange receipts must be controlled by the government, but also they must be stabilized and increased deliberately through the foreign exchange control device. A steady investment in development programmes over a period of years would be severely handicaped as long as the foreign exchange receipts from exports remain in an

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[1] This fact is clearly stated in the following passage from the IMF Report on the conditions of world foreign exchange restrictions in 1959: "Considerable progress has again been made during the past twelve months in eliminating and reducing the use of multiple currency practices. In several countries, this has been achieved by replacing complex multiple rate systems with a single; elsewhere, there has been further simplification of the existing multiple rate systems." IMF, Eleventh Annual Report, Exchange Restrictions: 1960 (Washington, D.C.: 1960), pp. 4-5.

unstable situation. This point has been adequately expressed in the following statement of a UN report:[1]

> The instability experienced by underdeveloped countries in their foreign exchange receipts from exports -- particularly if reinforced by similar fluctuations in other credit items in their balance of payments -- imposes severe handicaps in maintaining steady investment in development programmes over a period of years . . . Furthermore, if development projects are expected to result in the production of exportable goods, calculations of cost and income may be completely upset by wide fluctuations in price and demand.

Along with the stabilization of exports, expansion of exports represents another precondition for economic development in view of the huge foreign exchange requirements. Expansion of exports may be achieved in various ways, such as (a) by expanding the production of particular commodities, generally primary commodities, or reducing domestic consumption; (b) by exporting new commodities not previously exported; (c) by increasing the value of exported goods through improving qualities, standardization or further processing and so on and (d) by undertaking services in connection with foreign trade which are presently performed by industrialized countries.[2]

These problems are, however, likely to be seriously difficult to implement in a developing economy, since (1) the goods thus to be exported should be withdrawn from domestic consumption and, accordingly, the inflationary pressures already created by the development process, as we have seen above, are likely to be intensified, (2) export industries

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[1] UN, Instability in Export Markets of Underdeveloped Countries, p. 1.

[2] See, UN, Department of Economic Affairs, Methods of Financing Economic Development in Underdeveloped Countries, p. 20.

may find more certain demand in the domestic markets as the real income rises along with economic development and (3) the unstable foreign demand for and prices of the export commodities are due to the international forces, which are beyond the control of a single nation to a large extent.

It can not be doubted, however, that these difficulties can be mitigated by deliberate government policies to a large extent. Needless to say, foreign exchange control is one of the important and effective government policies for this purpose, although the foreign exchange control on exports seems to be less common than that on imports.

The most widely used foreign exchange control device for this purpose seems to be a multiple exchange rates system. Deliberate differentiation between the exchange rates for exports and imports or even between the exchange rates for various exports must be effective in maintaining a high level of exports or in encouraging particular exports deliberately. Especially for the purpose of encouraging marginal exports that would not be produced or exported in the absence of government protection, the application of favorable exchange rates for such exports seems to be highly effective.[1] Obviously, such favorable rates are a subsidy to the export industries concerned and, therefore, can bring about the same result as is derived from other measures, such as direct subsidy from the government budget.

Multiple exchange rates can also be a measure to protect the export proceeds from a cyclical decline in underdeveloped countries.

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[1] See, E. M. Bernstein, "Some Economic Aspects of Multiple Exchange Rates", International Monetary Fund, Staff Papers Vol. I, No. 2 (September, 1950), p. 233.

As Schlesinger points out, in the case of cyclical decline of exports, it is frequently found that overall exchange depreciation is not desirable in underdeveloped countries because the demand for overall exports could be inelastic.[1] Needless to say, depreciation of foreign exchange rates can influence the foreign exchange receipts from exports favorably only when the demand for the exports is fairly elastic assuming domestic supply of exports is also fairly elastic. The demand for overall exports being inelastic, it is obvious that the result of depreciation would be an overall decline of foreign exchange receipts even if some individual export sectors could result in a substantial increase. Schlesinger argues that under this condition a country can obtain the benefits of depreciation by introducing a policy of "selective depreciation" with respect to exports whose demand elasticities are large enough to result in a substantial increase in the foreign exchange proceeds.[2]

Multiple exchange rates device is, of course, not the only foreign exchange control designed to encourage exports for the purpose of stimulating economic development. Quantitative control devices are also frequently used for the same purpose. The system which permits the exporters to retain all or a portion of their exports proceeds of certain commodities either for the use of imports of certain commodities or for their own use or for sale in the free markets falls under this category.[3]

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[1] Schlesinger, op. cit., p. 45.

[2] Ibid., p. 46.

[3] For instance, this system is adopted by Korea during the Korean War and its aftermath as will be shown in the following chapters.

The multiple exchange rates on exports can also be used as a means to capture a part of any exceptional profits from exports. This, of course, is contrary to those objectives discussed above. This aspect of foreign exchange control, however, can be important since this "penalty export rates" may be useful as a means of raising government revenue for domestic financing of economic development in lieu of ordinary tax under certain conditions. Bernstein explains the reason for imposing the "penalty rates" on certain exports in the following words:[1]

> These penalty export rates are used because the profits of the companies are high and government revenue would be diminished if such exports were placed on the same basis as other exports . . . It is difficult to insist that taxes should not be imposed on some exports when the burden of taxation can be borne without impairing production.

C. FOREIGN EXCHANGE CONTROL ON CAPITAL MOVEMENTS

As the past history shows, the foreign exchange control on capital movements preceded the control on current account transactions. The exchange control in Germany was first adopted in July 15, 1931 to check a capital flight. At the time of adoption it was indicated that the need for exchange control would be eliminated as soon as the panic of capital flight was ceased.[2] The step taken by Great Britain in adopting exchange control in the 1930's was also the same. Now-a-days countries adopting exchange control systems impose restrictions on capital movements almost without any exception.

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[1] Bernstein, op. cit., pp. 232-234.

[2] Frank C. Child, The Theory and Practice of Exchange Control in Germany (Hague: Martinus Nijhoff, 1958), p. 4.

The control of capital outflow is, of course, one of the essential pre-conditions for economic development in underdeveloped countries, for domestic capital must be kept within the countries before they are mobilized for economic development. In view of the high propensity of domestic capital to flow out of the country in underdeveloped countries, the need for the prevention of capital flight can not be overemphasized in those countries.

The control on the capital movements, however, entails a serious dilemma with regard to the problem of inducing private foreign capital, because even if the inflow of capital is not controlled, the private foreign capital will not be induced without the anticipated guarantee that the principal and the earnings of the capital invested can be transferred sooner or later. There is no doubt that such a guarantee is inevitably weakened by the foreign exchange control on capital outflow.

In this connection Prof. Mikesell points out three major obstacles of foreign exchange control to the flow of foreign investment in underdeveloped countries: (1) limitation on the ability to transfer earnings or to repartriate invested capital; (2) unfavorable exchange rates either for remittance or for the purchase of currency for local expenditures; and (3) limitations on the ability to acquire imports of goods and services needed for business operations.[1]

In view of the low capacity to export and unstable proceeds therefrom on the one hand, and huge demand for foreign exchange on the other,

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[1] Mikesell, op. cit., p. 451.

as we have seen above, private foreign capital is an extremely important source of foreign exchange required for the financing of economic development in underdeveloped countries. In the present underdeveloped countries, however, the need for and gains from the imposition of foreign exchange control seem to be greater than the benefits that might be derived from the elimination of foreign exchange control. This may be explained by the fact that there is no assurance that the mere elimination of foreign exchange control would induce sizable private foreign investment. Obstacles to the movement of private foreign capital into underdeveloped countries are numerous, besides foreign exchange control. For instance, a study by the University of Chicago classifies the major obstacles in the following five categories: (1) absolutely smaller amount of private capital than existed before 1914; (2) low rates of return to the capital invested; (3) limited markets; (4) existence of chronic inflation, balance of payments disequilibrium and unstable currency; (5) political and social instability.[1]

Furthermore, there may be some measures which enable capital importing countries to induce private foreign capital without eliminating foreign exchange control. For example, the limitations on the transfer of earnings and principals imposed by the foreign exchange control may be overcome by inter-governmental guarantees, as suggested by a United

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[1] The Research Center in Economic Development and Cultural Change of the University of Chicago, "The Role of Foreign Aid in the Development of other Countries," U.S. Senate, Foreign Aid Program (Washington: Government Printing Office, 1957), pp. 211-214.

Nations' report.[1] Doubtlessly, if governments of capital exporting countries as well as the government of capital importing countries guarantee the future transfers for the private investor, existence of foreign exchange control would not represent a major obstacle to private foreign investment.

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[1] UN, op. cit., pp. 30-34. And for a detailed analysis of the United States investment guarantee program, see Marina von Neumann Whitman, The United States Investment Guarantee Program and Private Foreign Investment (Princeton: Princeton Univ. Press, 1959), pp. 20-45.

CHAPTER VI

DEVELOPMENTS IN THE KOREAN FOREIGN EXCHANGE CONTROL SYSTEM BEFORE 1953

The foundation of the Korean foreign exchange control system was laid down during the period from August 1945, when Korea was liberated from Japanese rule, to the middle of 1953 when the Korean War was ceased. In order to better understand the present foreign exchange control system in Korea, it is important as well as necessary to trace the developments in this field during the period. This period consists of two markedly distinct periods. One is the period during which Korea was under the rule of the U.S. Army Military Government in Korea (USAMGIK) and the other is the period beginning from the establishment of the new government of Korea in August 1948 through the outbreak of the Korean War in 1950 to the ceasefire of the hostilities in July 1953.

A. FOREIGN EXCHANGE CONTROL UNDER THE U.S. ARMY MILITARY GOVERNMENT IN KOREA (SEPTEMBER 1945 - AUGUST 1948)

A strict foreign exchange control was imposed on the Korean economy right after the termination of Japanese rule in Korea by a series of ordinances and proclamations of the U.S. Army Military Government in Korea. Foreign exchange control was first introduced in Korea by Proclamation No. 3 of the Commanding General of U.S. Army Forces,

Pacific, dated 7 September 1945.[1] This Proclamation prohibited any kinds of foreign exchange transactions in the following terms.

> 5. All foreign financial transactions including the export and import of currency, coins and securities are prohibited except as authorized by me.
>
> 7. The delivery or acceptance of any currency other than the supplemental military and regular yen currency now legal tender in Korea is prohibited, except as authorized by me.

It was, however, not until July 4, 1946, when Military Ordinance No. 93 of the USAMGIK was set forth, that a complete form of foreign exchange control was established in Korea. The Military Ordinance No. 93 merits a brief study in view of the fact that this ordinance still remains effective as a part of the legal basis for the present foreign exchange control in Korea. The main provisions of this ordinance are:[2]

(1) Any transactions in Korea, which involve (a) property (or evidence thereof) located abroad, (b) gold, silver, platinum or other precious metals, (c) money other than legal tender in Korea, (d) any kind of foreign exchange instruments, securities, negotiable instruments and so on, are prohibited without license.

(2) It was declared that any person owning, holding or controlling any property described in (1) and any person owing any obligation of payment to any person outside of Korea were required to file with the Bank of Chosun[3] a written declaration of such assets or obligations within 60 days after the effective date of the ordinance.

(3) Transactions prohibited by this ordinance can take place only by acquiring license from the Director of the Department of Finance who is the licensing authority.

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[1] See, Department of Justice, United States Army Military Government in Korea, Selected Legal Opinions of the Department of Justice, United States Army Military Government in Korea (Seoul: 1948), p. 275.

[2] See, the Bank of Korea, Laws and Regulations Governing Foreign Exchange in the Republic of Korea: 1959 (Seoul: 1959), p. 2.

[3] The Bank of Chosun was the former Bank of Korea.

As the provisions mentioned above indicate, this ordinance imposed strict control not only upon the transactions in foreign exchange but also upon any kinds of capital movements. Although the ordinance designated the Bank of Chosun as the only official channel of foreign exchange transactions and the department of Finance as the licensing authority, no specific regulations governing the issuance of licenses for exchange transactions were set forth during the period. Presumably this was due to the fact that there were so few transactions in foreign exchange taken place during the period. It should be, however, admitted that the strict control in turn was a great obstacle to the sound development in foreign exchange transactions.

The official channel of foreign exchange transactions was transferred to the Korean Foreign Exchange Bank on July 16, 1947, when the bank was established by the Military Ordinance No. 145, "Creation of the Foreign Exchange Bank, Ltd."[1] This bank, owned and operated by the Military Government, started to handle drafts, bills and other documents resulting from Korean foreign exchange transactions and to make efforts to insure stability of exports in relationship to import volume. Despite the efforts made by this bank, however, no remarkable progress was made in the development of foreign exchange transactions during the period as shown below.

Indeed, under the strict controls on foreign exchange and capital movements, foreign exchange transactions were almost paralyzed during the period 1945-1948. This fact might be best disclosed by looking into

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[1] See, Department of Justice, United States Army Military Government in Korea, op. cit., p. 367.

the foreign trade situations during the same period.

The foreign trade during the period from August 1945 to August 1948 might be characterized as one "absolutely small in volume and primitive in nature." Foreign trade was not only small in volume as can be seen in table 27, but also was undertaken in the form of primitive barter transactions or compensation trade with a few countries in Asia, mainly with mainland China and Hong Kong. Almost no foreign exchange transaction was involved in foreign trade during the period.

When the occupation of Korea by the U.S. Army began in September 1945, little or no consideration seemed to be given to the foreign trade of Korea in the light of other more urgent problems.[1] In addition, the Korean people were lacking in the knowledge and experiences in the field of international trade due to the fact that foreign trade was entirely monopolized by the Japanese before the liberation. The imposition of strict exchange control on the economy under such conditions made the barter transaction the only possible way to carry on foreign trade.

There was no trade during 1945. The first record of private trade was during January 1946, when 405 thousand hwan worth of commodities were imported into Korea.[2]

In July 1946, the Bureau of Foreign Commerce was established in the Department of Commerce of the USAMGIK "to develop, stimulate, regulate

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[1] See, National Economic Board, U. S. Army Forces in Korea, South Korean Interrim Government Activities No. 34 (July-August, 1948), Seoul, p. 97.

[2] Commander in Chief, U. S. Army Forces, Pacific, Summation of U. S. Army Military Government Activities in Korea No. 6 (February, 1946), Seoul, pp. 12-14.

and control imports and exports by the promulgation of appropriate policies and procedures and the implementation thereof."[1] Shortly after the establishment of the Bureau, Foreign Commerce Regulation No. 1 was published in order to set the initial procedure of granting licenses and permits by the Bureau.[2] This regulation required all exporters and importers to obtain licenses before they engaged in the trade business. In order to either import or export a commodity, it was necessary for the individual or the company to apply for a license authorizing him to engage generally in foreign trade. With this license, the traders could apply individually for a permit for each export or import.

Under these strict controls on trade in addition to the control on foreign exchange transactions, it was quite natural that foreign trade could not find the way to expand. During 1946, the total exports amounted to only 470 thousand hwan or 940 thousand dollars, while the total imports, to 1,680 thousand hwan or 3,360 thousand dollars.[3]

Keenly feeling the necessity to promote foreign trade, the Military Government promulgated a new procedure governing the foreign trade on August 25, 1947.[4] Under this procedure, foreign trade of Korea still had to be conducted on a barter basis but with less degree of government restrictions or controls. Licenses to engage in the business of foreign trade were no longer required. However, it was still necessary to

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[1] Ibid., No. 10 (July 1946), Seoul, p. 34.

[2] See, National Economic Board, U.S. Army Forces in Korea, op. cit., p. 98.

[3] These figures in U.S. dollars are converted from the figures in local currency figures at the official rate of 0.5 hwan to 1 U.S. dollar, prevailed during the period.

[4] See, Ibid., p. 99.

obtain from the Bureau of Foreign Commerce a license for each import and export transaction.

In the meantime, as mentioned above, the Korean Foreign Exchange Bank, Ltd., was established on July 16, 1947. In view of the lack of knowledge and experiences of Korean people in the foreign exchange transactions and the urgent need for the establishment of normal foreign exchange transactions particularly in foreign trade, the creation of the bank was of great significance for the Korean economy. This bank, in order to handle drafts, bills and other documents resulting from foreign trade, established correspondent banks in the United States, Hawaii, and Hong Kong.[1] In spite of the efforts made by the bank for the establishment of a normal foreign exchange transactions, the primitive foreign trade pattern based upon barter transactions, however, could not be overcome because local currency still had no international exchange rate.

During 1947, however, volumes of foreign trade increased remarkably compared with the level in 1946. Imports were valued at more than 20 million hwan or 41 million dollars and exports, at 11 million hwan or 22 million dollars.

During January 1948, a new plan, called the "Trustee Shipment" plan was established with a view to promoting foreign trade.[2] This plan represented the most advanced form of foreign trade during the period 1945-1948. This plan enabled Korean businessmen to export first by making trustee

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[1] Commander in Chief, Far East, Summation of U.S. Army Military Government Activities in Korea, No. 21, (June 1947), Seoul, p. 55.

[2] National Economic Board, U.S. Army Forces in Korea, op. cit., No. 29, (February 1948), Seoul, p. 89.

shipments through the Korean Foreign Exchange Bank. Under this measure, a Korean exporter could export goods to a foreign port and seek buyers after the cargo arrived there. The trader had to deposit, in local currency, 10 per cent of the estimated value of the goods exported at the bank. Such deposits were refunded upon satisfactory fulfillment of the obligation of this procedure. The exporter was allowed either to get barter goods for his cargo or to get foreign exchange credited to his account in a foreign bank for the purchase of approved cargoes for return to Korea.

Under this plan, volumes of both exports and imports increased sharply in 1948. During the first seven months of 1948, total exports amounted to 27 million hwan and total imports, to 36 million hwan, both exceeding the total volumes of 1947.

Table 32

Exports and Imports: Values and Number of Permits under Private Trade January 1946 - August 1948

	Exports (In Million Hwan)	Imports (In Million Hwan)	Export Permits	Import Permits
1946	0.47	1.68	65	158
1947	11.11	20.88	300	477
1948 (January to July)	27.62	36.43	674	928

Source: National Economic Board, U.S. Army Forces in Korea, South Korean Interrim Government Activities, No. 34, (July-August 1948), Seoul, p. 102.

There were no specific economic development policies or programmes prepared by the Military Government. Accordingly, foreign exchange control policies during the period were set forth without any deliberate consideration of economic development of Korea. Taking account of the social, political and economic situations prevailing during the period, which might be comparable to those under anarchy, and particularly of the acute inflationary pressures inherited from the controlled war economy under Japanese rule, the introduction of the strict foreign exchange control was inevitable. Indeed, foreign exchange control was a product of necessity in Korea.

B. FOREIGN EXCHANGE CONTROL DURING THE PERIOD 1948-1953

In the preceding section we have seen that foreign exchange transactions were almost negligible during the period from the liberation to the eve of the establishment of the new Korean Government. Foreign exchange transactions were not involved even in the foreign trade. Accordingly, the objective of foreign exchange control was mainly centered on the prevention of capital flight.

As the Constitution of the Republic of Korea, promulgated on July 17, 1948, provided that the laws and ordinances set forth during the occupation period shall remain effective to the extent that they do not conflict with the Constitution, foreign exchange control under the new Government had been governed by the same ordinances as existed under the interrim government until a series of new laws were promulgated.[1]

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[1] Article 100. of the Constitution of the Republic of Korea promulgated on July 17, 1948 reads as follows:

"Existing law and ordinances shall be in effect to the extent that they do not conflict with this Constitution."

It was not until the spring of 1950, when a series of laws concerning foreign exchange control were set forth, that the Korean foreign exchange control system was systematically reorganized in such a way as to be able to meet the various tasks including the problem of economic reconstruction faced by the new Government. On April 20, 1950, the Law for the Prevention of Capital Flight, prohibiting the removal of domestic property for the purpose of capital flight, was promulgated, replacing the existing provisions in various ordinances concerning the prevention of capital flight.[1] Under the new Law, any of the following properties are prescribed as falling under the categories of the domestic property subject to prohibition of movements:[2]

(1) Coins, subsidiary and banknotes.

(2) Valuable securities and other loan bonds.

(3) Gold, silver, platinum and other precious metals and jewelry.

(4) Foreign coins, foreign subsidiary coins, foreign paper money, foreign banknotes, foreign securities and other loan bonds.

(5) Other movables and ships.

Article 2 of the Law provides that anyone violating the Law shall be subject to "penal servitude or imprisonment of not more than 10 years." This penalty provision indicates that capital movements were further rigorously restricted under the new government of Korea.

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[1] For the full text of the Law, refer to the Bank of Korea, Laws and Regulations Governing Foreign Exchange in the Republic of Korea (Seoul: 1959), pp. 6-7.

[2] See, Article 1 of "Presidential Decree for the Enforcement of the Law for Preventing Capital Flight," The Bank of Korea, op. cit., p. 7.

A significant achievement in the development of the foreign exchange control system was made when the Bank of Korea was created on June 12, 1950, absorbing the Korean Foreign Exchange Bank. The Bank of Korea was established not only to perform the general functions of a central bank but also to act as the only official channel of foreign exchange transactions in Korea. In addition to this, although Ministry of Finance, the successor to the Department of Finance of the interrim government, still holds the ultimate power of licensing the foreign exchange transactions, the Bank of Korea shares a large part of the responsibilities for the establishment of national foreign exchange policies and for the administration of the nation's international monetary reserves. Article 3 of the Act Establishing the Bank of Korea reads as follows:[1]

> Article 3. The primary purposes of the Bank shall be:
> . . . . .
> (c) To administer the nations international monetary reserves in the interests of achieving and maintaining an orderly pattern of international trade and exchange relationship.

For the purpose stated in Article 3, the Act required all foreign exchange, whether it is owned by the government, natural or juridical persons, or banking institutions, to be sold or credited to the Bank of Korea.[2] In the meantime, any foreign exchange accruing from sales of goods or services, from remittances or from other sources is subject to sale to or deposit at the Bank of Korea, according to the Act.

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[1] For the full text of the Act, refer to the Bank of Korea, Annual Economic Review: 1955, pp. I-411 - I-417.

[2] See, Articles 101, 102, 103 of the Act, the Bank of Korea, Laws and Regulations Governing Foreign Exchange in the Republic of Korea: 1959, p. 4.

For the purpose of implementing this system, various foreign exchange accounts were established at the Bank. The following four categories of foreign exchange accounts were initially established:[1]

(a) Government Account, where all foreign exchange holdings of the Government are deposited.

(b) Export Account, where foreign exchange proceeds from ordinary commercial transactions are deposited.

(c) General Account, where foreign resident individuals and governments represented in Korea deposit their foreign exchange holdings.

(d) Special Account, where all other foreign exchanges, particularly those accrued from transactions with resident foreigners are deposited.

The uses of the foreign exchange deposited in these accounts require prior approval of the authority unless they are approved by respective regulations.

Thus the system of the centralization of foreign exchange was established in Korea. In the meantime, the supreme authority in the determination of foreign exchange policy, along with general monetary and credit policies of the nation was endowed with the Monetary Board of the Bank, which is composed of seven members including the Minister of Finance and the Governor of the Bank; and of seven alternate members including the Vice Minister of Finance and the Deputy Governor of the Bank.[2] It should

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[1] Export Account and General Account were established on July 14, 1950 and Special Account was added to these accounts on November 16, 1950, pursuant to the Monetary Board's decisions. See, "Monetary Board Regulations Governing Deposits and Dispositions of Foreign Exchange Held under Private Foreign Exchange Account" of November 16, 1950, the Bank of Korea, Annual Economic Review: 1955, p. I-619.

[2] Article 8 of the Act Establishing the Bank of Korea.

be noted, however, that although it was the clearcut intention of the Bank of Korea Act that the Monetary Board would be the central supreme authority in determining all matters relating to foreign exchange transactions, the President as well as the Minister of Finance exercised a considerable degree of authority in this field by means of various regulations or orders since the establishment of the Bank.

The Bank of Korea, as the only official channel to "carry out, handle, or supervise" the foreign exchange transactions in Korea, started to operate such foreign exchange transactions as are designated by the Act, actively, pursuant to the regulations of the Monetary Board. The main functions or operations provided by the Act are (a) to open and maintain correspondent relations with foreign banking institutions or to act as correspondent for such institutions; (b) to open or negotiate letters of credit on behalf of the Korean traders; (c) to grant loans to Korean exports against their shipping documents; (d) to supervise government or private foreign exchange accounts in the bank; (e) to sell or purchase foreign exchange pursuant to the governing regulations of the Monetary Board and (f) to accept deposits from foreign and international banking or financial institutions, foreign governments and their instrumentalities and international organizations.[1] As will be discussed in the following chapter, under the active efforts made by the Bank of Korea, the primitive and paralyzed foreign exchange transactions during the occupation period could be normalized to a large extent during the period 1948-1953, inspite of the Korean War.

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[1] See, Article 105 of the Act Establishing the Bank of Korea.

Developments in Exchange Rate System

As the paralyzed foreign exchange transactions during the occupation period resumed normal operation even within the framework of foreign exchange control, with the establishment of the Bank of Korea, the problem of setting exchange rates emerged as one of the central problems of foreign exchange control in Korea. Especially the severe inflation which developed into hyper-inflation after the outbreak of the Korean War caused tremendous difficulty in the establishment of a sound exchange rate system in Korea.

The most striking characteristics of the Korean exchange rate system may be found in the facts that there has been no agreed par value of the local currency and that the official exchange rate has been artificially determined through the negotiations between the Korean government and the U.S. authority since the establishment of the new Korean government.

The official exchange rate in August 1948 when the Korean government was born was 4.5 hwan to 1 U.S. dollar. After undergoing several changes, the official rate was set at 60 hwan to 1 U.S. dollar at the end of 1951 and remained the same until June 1953. (See table 33). Although the official exchange rate underwent frequent changes during the period, the rates were far from being realistic. This becomes clear when we compare the change in the price level with the change in the exchange rate during the same period. The Seoul wholesale price index rose by nearly 30 times, whereas the official exchange rate was raised by less than 13 fold during the period from 1948 to 1952. (See table 18 and table 33.) As a result of the wide disparity between the official rate

and the realistic rate, the government adopted a multiple exchange rate structure.

As of 1952, three kinds of exchange rates were in effect in Korea: (a) the official exchange rate, at which the official channel of foreign exchange transactions, now the Bank of Korea, stands ready to buy dollars and sells to certain authorized purchasers;[1] (b) a set of multiple exchange rates governing the sale of government owned foreign exchange to private importers; (c) fluctuating "transfer rates" at which dollars held by private individuals in accounts at the Bank of Korea were sold to other holders of such accounts.

The multiple exchange rates system was introduced when the Bank of Korea was established. As the Bank can not force the exporters to sell the proceeds from exports at the official rate, foreign exchange proceeds deposited at the Bank could be sold to other exporters or importers at higher rates through unofficial individual bargaining. It was, however, not until March 1951 when the black market dollars were allowed to be deposited in the Special Account at the Bank of Korea and the transfer of the dollar from the Special Account to the Export Account was permitted by a Monetary Board's decision, that the "transfer rates" were officially admitted.[2] In October 1952 the transfer of dollars to the Export Account was further permitted for the dollars remitted from religious organizations

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[1] The "military conversion rate" applied in the repayment by the United Nations Command to the Republic of Korea for their local currency advances from the Korean government and in the sale of local currency to U.N. army personnel, was the official rate until June 1953, when the military conversion rate was raised to $1 = Hwan 180. See, the Bank of Korea, Annual Economic Review: 1955, p. I-153.

[2] Ibid., p. I-152.

abroad to help Korean religious organizations.[1] Needless to say, the "transfer rates" were much higher than the official rate.

Multiple exchange rates for imports were first set when the government introduced the "Special Foreign Exchange Loans" system in December 1952.[2] The foreign exchange fund for this loan was derived from foreign exchange received from United Nations Command as a repayment for the local currency advanced and the proceeds from the export of tungsten. The objective of this loan was to curb inflation by absorbing the inflated local currency and increasing the supply of necessary goods through the stimulation of exports. The loan was divided into two types: type A loans and type B loans. Type A loans were made to importers for the importation of raw materials and some consumption goods. Type B loans were made directly to end-users for the importation of capital goods. The exchange rates applicable to the repayment of the loans were set according to the "Price-Ratio Differential System", which stipulated various exchange rates for each commodity or commodity group. The rates as of December 1952 are shown in table 34.

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[1] Ibid., p. I-152.

[2] For the full text of the regulations governing the Special Foreign Exchange Loans, refer to Ibid., pp. I-644 - I-646.

Table 33

Exchange Rates
1945-1953
(Hwan Per U.S. Dollar)

	Official Rate	Special[a] Rate	Transfer Rates[b] Export	Transfer Rates[b] Other	Counterpart Fund Rate
1945 Oct.	0.5	0.5	-	-	-
1947 July	0.5	0.5	-	-	-
1948 Oct.	4.5	4.5	-	-	4.5
1949 June	9.0	9.0	-	-	4.5
1950 June	16.0	16.0	20	19	14
1950 Oct.	18.0	25	c	c	25
1950 Nov.	25.0	25	c	c	25
1951 March	25.0	60	c	c	40
1951 June	25.0	60	80	77	60
1951 Nov.	60.0	60	c	c	60
1952 June	60.0	60	160	155	60
1953 March	60.0	60	240	220	60
1953 June	60.0	180	290	260	60

a. Exchange rates used by U.N. Finance Office. These rates did not apply to the repayments of local currency advances by the United Nations Command to the Korean government.

b. Monthly average rates.

c. Not available.

Sources: Transfer Rates - Korean Civil Assistance Command, United Nations Command, Civil Assistance and Economic Affairs - Korea (July 1, 1953 - June 30, 1954), Seoul, 1954, p. 69.

Other Rates - The Bank of Korea, Annual Economic Review: 1958, p. III-240.

Table 34

Exchange Rates for Selected Imports under the Special Foreign Exchange Loans During December 1952

(Hwan per U.S. Dollar)

Commodity	Effective Dates	
	December 4, 1952	December 19, 1952
Wheat Flour (Earth Trade Mark)	236	236
Wheat Flour (Green Earth Trade Mark)	235	235
Rayon Yarn	213	213
Dyes	192	127
Oil Penicillin	258	-
Bicarbonate Soda	296	224
Auto Tires and Tubes	-	144
Window Glass	-	235
Printing Paper	216	216

Source: The Bank of Korea, Annual Economic Review: 1955, p. I-154.

Exchange Rates and the Local Currency Advance to the United Nations Command

The major reason for the Korean government's effort to keep the official exchange rate as low as possible was to maximize its dollar receipts from the transactions with the United Nations Command, which represented the largest single source of foreign exchange during the period 1948-1953. Conflict, however, inevitably occurred between the Korean government and the United Nations Command (UNC) over the adjustment of exchange rates as the latter wanted to minimize the dollar costs.

The local currency advance to UNC from the Korean government was started when the "Agreement between the Government of the United States of America and the Government of the Republic of Korea Regarding Expenditures by Forces under Command of the Commanding General, Armed Forces of the Member States of the United Nations" was signed at Taegu, Korea, on July 28, 1950 between the two governments.[1]

Pursuant to this Agreement, UNC borrowed local currency from the Korean government in the amount of 9,773 million hwan during the period from July 1950 to December 1952 without any concurrent repayments for nearly one year and a half. The major factor contributed to the long delay in the repayment was the long unsettled negotiation between the Korean government and UNC on the exchange rate at which the repayment for the local currency disbursed to UNC was to be made. The Korean government wanted to maximize its dollar receipts from this transaction

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[1] For the text of the Agreement, refer to Ministry of Reconstruction, the Republic of Korea, Selected Laws and Regulations Pertaining to Foreign Economic Aid for Korea (Seoul: 1959), pp. 28-31.

by virtue of overvalued exchange rate and UNC wanted to minimize their dollar costs through devaluation of the official rate. Thus the negotiation remained unsettled until October 1951, when the first partial repayment was made in the amount of 12,156 thousand dollars at the rate of 60 hwan to 1 U.S. dollar. The repayment was, however, not smoothly done even after the first repayment was made. The second repayment was delayed until August 1952, when UNC resumed to make some partial repayment.

Needless to say, the impact of such long delay of the repayments on the Korean economy was of great significance. As discussed in chapter III, the local currency advance to UNC was one of the major factors contributed to the hyper-inflation during the Korean War. The negotiation on the repayment being pending, the only way for the Korean government to make local currency advances to UNC was printing money. Indeed, the cost for maintaining the unrealistic overvalued official exchange rate for bargaining purposes with the UNC was too great compared with the gains that the Korean government could have achieved therefrom. It is true that the Korean government received a certain amount of repayments at the discriminated exchange rate as table 35 shows. The gains derived from such partial repayments after a long delay were, however, too small to offset the serious unfavorable results already brought about during the course of delay.

Table 35

Advances of Local Currency to the United Nations Command and Repayments therefor July 1950 - December 1952

Period	Local Currency Advances (In Million Hwan)	Repayments (In Thousand U.S. Dollars)
1950 July-Dec.	609	
1951 Jan.-Dec.	3,655	12,156
1951 Oct.		12,156
1952 Jan-Dec.	5,518	62,035
1952 Sept.		35,495
1952 Nov.		17,988
1952 Dec.		8,552

Source: The Bank of Korea, Annual Economic Review: 1955, p. I-153, p. (107).

The unfavorable results that the maintenance of the overvalued official exchange rate brought about were, of course, not confined to the distortion of price structure. Without doubt, exports were discouraged to a large extent due to the overvalued official exchange rate because the rate also applied to the purchase of export proceeds by the Bank of Korea. As mentioned above, there was no obligation on the part of exporters to sell their foreign exchange earnings to the Bank of Korea. The requirement was that they must deposit the foreign exchange proceeds in their Export Accounts at the Bank. However, it should be noted that if the exporter could not use the foreign exchange deposited at the Bank for importation of goods on the approved list within 45 days, the foreign exchange had to be sold to the Bank at the official rate.[1] This

[1] See, "Monetary Board Regulations Governing Deposits and Dispositions of Foreign Exchange Held Under Private Foreign Exchange Account" of August 16, 1951, The Bank of Korea, Annual Economic Review: 1955, p. I-628.

obviously represented an important factor discouraging exports.

Another important unfavorable impact upon the Korean economy was the expansion of black market transactions not only among Koreans but also among foreigners in Korea, enlarging loopholes for smuggling. In view of the wide disparity between the black market rates for Military Payment Certificates and greenbacks and the official rate, there was a constant incentive for the UN personnel to convert dollars at black markets instead of converting through the official channel when they needed local currency for purchase of goods and services in Korea. Dollars flew into the black markets, and, without doubt, made smuggling of non-essential luxury goods as well as hoarding and capital flights possible.

Table 36

Exchange Rates of Military Payment Certificates and Greenbacks at Seoul Black Markets 1950 - 1952

(Hwan per U.S. Dollar)

Period	Official Rate	MPC	Greenback
1950 June	16	20	22
1951 June	25	60	83
1952 June	60	104	163

Source: Korean Civil Assistance Command, United Nations Command, Civil Assistance and Economic Affairs, Korea (July 1953 - June 1954), p. 69.

It must be, however, admitted that it was extremely difficult for the Korean government to maintain the official rate at the realistic level because, (a) even if the official rate was set at the realistic level, the progressing hyper-inflation during the period would not allow the rate to remain as such for long and (b) there was no easy and single way of calculating a realistic rate under the disorganized economic condition during the period.

CHAPTER VII

FOREIGN EXCHANGE CONTROL AND INTERNATIONAL TRADE IN KOREA SINCE 1953

A. POST-KOREAN WAR FOREIGN EXCHANGE CONTROL ON FOREIGN TRADE: A MEASURE TO COMBAT INFLATION

In July, 1953, more than three years' hostilities in Korea ceased, leaving tremendous economic problems to the country. The war destroyed not only living facilities including houses and buildings but also industrial facilities.[1] Moreover, making the situation worse, the damage was concentrated in industry, as a United Nations' report points out.[2] According to the report, industrial facilities alone were estimated to have been damaged to the extent of 354 million dollars. This includes substantial damage to 43 per cent of all industrial installations, 41 per cent of all power generating facilities and 50 per cent of all coal mining installations. In parallel with such destruction, the war compelled the government to expand expenditures sharply as mentioned in chapter I. The result was, inevitably, the development of a hyper-inflation accompanied by an acute shortage of goods. Indeed, as Nathan

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[1] The estimation of the Korean government on the total property losses during the Korean War is 30 billion dollars. See, Ministry of Reconstruction, the Government of Republic of Korea, Annual Economic Review: 1957, p. 8.

[2] See, UN, Economic Survey of Asia and the Far East: 1955 (Bangkok: February 1956), p. 140.

Report adequately mentions, any description of Korea during the war and its aftermath "would necessarily repeat the word 'shortages' over and over again."[1]

One of the most imminent tasks with which Korea was confronted was to combat the inflation. In the long run, this task could be solved by a long range economic reconstruction programme. The inflation and the shortage of goods in the immediate postwar period were, however, too acute to allow their solutions to rely solely upon the long range economic reconstruction plan. Foreign exchange control policy during the period immediately after the war pursued mainly the objective of counteracting the postwar economic problems in Korea, particularly the inflation, in the short run.

Special Foreign Exchange Loan

As briefly mentioned in the preceding chapter the "Special Foreign Exchange Loans" system was first introduced into the Korean foreign exchange control system at the end of 1952 with a view to reducing the quantity of money in the hands of the public on the one hand and increasing the supply of necessary goods through stimulating imports, on the other. This loan represented the major foreign exchange control device for regulating imports immediately after the war as the fund for the loan increased steadily thanks to the smooth repayments by the United Nations Command for the local currency advanced to them during the war.

The smooth repayments started when the "Agreement on Economic

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[1] Nathan Associates Inc., op. cit., p. 44.

Coordination between the Republic of Korea and the United Nations Command" was signed on May 24, 1952.[1] In this agreement the United States as the representative of the United Nations Command made a commitment to repay a certain amount of dollars regularly every month for local currency they borrowed under the terms of the July 28, 1950. In the same agreement, the Korean government agreed to the United States' proposal that the foreign exchange to be repaid should be used for the purpose of stabilizing the economy of Korea. Under this agreement, UNC made a repayment in the total amount of 237 million dollars to the Korean government by the end of October 1954.[2]

As mentioned in the preceding chapter, the foreign exchange loan was based upon a "Price-Ratio Differential" system. Under the system a competent importer could apply for a foreign exchange loan if he deposited local currency equivalent to his foreign exchange loan computed at the official exchange rate plus the difference between the amount of local currency computed at the official exchange rate and the local currency value of the foreign exchange loan computed at the "price ratio" for the specific commodity. Upon the arrival of goods financed by this loan, the hwan currency deposited at the bank was automatically transferred to the Bank of Korea. Thus, the loan was nothing but the sale of foreign exchange by the government to the importers at multiple exchange rates. The "differential" exchange rates applicable to each commodity were

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[1] For the text of the Agreement, refer to Ministry of Reconstruction, Selected Laws and Regulations Pertaining to Foreign Economic Aid for Korea, p. 41.

[2] The Bank of Korea, Annual Economic Review: 1956, pp. I-141 - I-142.

determined by the Monetary Board of the Bank of Korea from time to time based upon both the international market price and the domestic price of each commodity to be imported.

As the supply of goods increased as a result of the stimulation of imports by the loan, the spread between the highest and the lowest rates was gradually eliminated. Finally, in December, 1953, when the official exchange rate was raised from 60 hwan to 1 U.S. dollar to 180 hwan to 1 U.S. dollar, the Monetary Board decided to apply a uniform exchange rate to each type of foreign exchange loan.[1] To the type A loans, the exchange rate of 200 hwan to 1 U.S. dollar and to the type B loans, the exchange rate of 180 hwan to 1 U.S. dollar were uniformly applied. This was a significant movement not only in view of the fact that the exchange rate structure in the allocation of foreign exchange for imports was in the process of developing into a single exchange rate but also in view of the fact that such movement clearly indicated the normalization of the distorted price structure of Korean economy.

The effort of the government to attain a single exchange rate system, however, could not result in success due to the continuous increase in domestic price level. The Seoul wholesale price index rose by more than 25 per cent during the period 1953-1954. (See table 18.) Such an inflationary spiral inevitably brought about a great disparity between the official exchange rate and the realistic rate. The growing disparity was, without doubt, only favorable for the importers who could acquire the foreign exchange loan at the official rate.

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[1] See, the Monetary Board's resolutions No. 740 of December 30, 1953 and No. 743 of December 30, 1953, compiled in, the Bank of Korea, Annual Economic Review: 1955, p. I-673.

In order to adjust the loan system to the inflationary spiral, a series of efforts was made by the government during the period from May, 1954 to July, 1954, when the system came to an end. In May, 1954, importers were required to make time deposits payable in one year in the amount of 40 hwan per each dollar loaned in addition to the deposit of local currency in the amount equivalent to foreign exchange loans at the stipulated exchange rate.[1] In July, 1954, adjustment was further made in such a way that importers were required to purchase National Bonds in the amount ranging from 10 hwan to 50 hwan per each dollar of loans received, in addition to the above mentioned requirements.[2] The amount of National Bonds to be purchased varied according to the commodities to be imported. Thus the multiple exchange rates system in the allocation of foreign exchange for imports was virtually revived.

The total amount of foreign exchange sold under this loan system during the period from January, 1953 to July, 1954 accounted for 95 million dollars, of which 73 million dollars were allocated for type A loans and 22 million dollars, for type B loans, indicating that almost three quarters of the total foreign exchange were used for the importation of consumption goods.[3] As the total volume of private imports during the same period was 124 million dollars, the foreign exchange loan financed almost 80 per cent of the total private imports during the period.

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[1] This adjustment was made by the Monetary Board's resolution No. 819 of May 6, 1954, the Bank of Korea, op. cit., p. I-689.

[2] See, Monetary Board's resolution No. 861 of July 1, 1954, compiled in the Bank of Korea, Annual Economic Review: 1956, p. II-118.

[3] As mentioned in chapter VI, type A loans were for the importation of consumption goods and type B loans, for the importation of capital goods.

Table 37

Imports by Commodities
Jan. 1953-June 1954

(In Million Dollars)

Item	1953	%	1954 (Jan-June)	%
Food & Beverage	85.3	55.5	8.8	15.0
Textiles	14.5	9.4	14.8	24.6
Timber & Paper	5.5	3.6	5.5	9.1
Chemicals	18.2	11.8	6.3	10.4
Vegetable & Animal Products	3.1	2.0	2.4	4.0
Animal Fat	1.6	1.0	1.0	1.7
Machinery	19.4	12.6	15.4	25.6
Minerals	3.3	2.1	3.6	5.9
Non-ferrous Minerals	1.9	1.2	0.5	0.9
Miscellaneous	0.7	0.5	1.7	2.8
Total[a]	152.1	100.0	62.3	100.0
Total Private Imports	74.0		49.5	
Total Government Imports	78.1		12.9	

a. Because of rounding, detail does not always add to total.

Source: The Bank of Korea, Annual Economic Review: 1955, pp. I-159, I-161.

Considering the extreme shortage of necessary goods and the acute inflationary pressure during this period, the stimulation of imports through the sale of large amounts of foreign exchange by the government was, no doubt, highly desirable. Indeed, excluding the foreign economic aid, the only way to enhance private imports to overcome the shortage of goods in the short run was the allocation of the foreign exchange held by the government to the private sector, in view of the low level of private exports.

The special foreign exchange loan seemed to have achieved its two major objectives, namely, (a) to increase the supply of goods in order to meet the immediate shortage of goods and (b) to combat inflation, to a large extent. It is, however, very doubtful that the precious foreign exchange was adequately utilized. The suddenly increased importation of consumption goods under this loan was, without doubt, a great blow to the existing import competing domestic industries and particularly to "small and medium" enterprises. From the point of view of the stimulation of domestic industries, the ratio of consumption goods to the investment goods must have been too high.

The "differential" exchange rates which were determined by the subjective judgements of the authority were another major factor contributing to the inefficient utilization of the foreign exchange. Obviously such artificial multiple exchange rates system was a great obstacle to the normalization of the disorganized domestic price mechanism and distorted cost structures. In practice the domestic price level was subject to fluctuation whenever the exchange rate for each commodity was changed.

Dollar Auction System and Imports

In October, 1954, the "special foreign exchange loan" system was replaced by a competitive auction system. The system of competitive bids for the foreign exchange for imports was introduced as a result of an agreement between the United Nations Command and the Korean government on the new method of local currency procurements by UNC. On November 17, 1954, UNC and the Korean government reached an agreement to the effect that UNC could sell U.S. dollars directly to competent Korean

importers to obtain local currency needed for current military expenditures and for sales to UN military and civilian personnel, instead of receiving monthly advances from the Korean government and repaying in U.S. dollars at the official rate.[1]

The main reason for adopting the new system was to eliminate the conflict between UNC and the Korean government over the exchange rate at which repayments for local currency advances were to be made. The direct sale of foreign exchange to importers by UNC solved the problem of repayments which were delayed frequently by the problem of the exchange rate which took place whenever the disparity between the official rate and the real market rate became substantial. Moreover, the new system could simplify the complicated process of the allocation of foreign exchange to the importer in the sense that the Bank of Korea did not have to intervene in the process any more and no setting of artificial exchange rates was necessary.

Under this new system UNC sold a total amount of 39 million dollars to Korean importers during the nine month period from November 1954 to August 1955.[2] The most important impact of the dollar auction upon the Korean economy might lie in the fact that the experiences of the auction provided the ground for undertaking the drastic reform of the foreign exchange control system in 1955. During the nine months there were 21

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[1] See, The Bank of Korea, Five Years' History of the Bank of Korea (Seoul: 1955), pp. 150-151, and "Memorandum on Economic Coordination between the Republic of Korea and the United Nations Command" dated November 17, 1954, compiled in the Bank of Korea, Annual Economic Review: 1956, pp. II-62 - II-63.

[2] Ibid., p. I-145.

UNC dollar sales and all of them proved that the successful exchange rates at which the importers could purchase the dollars were within the range between 400 hwan to 1 U.S. dollar to 500 hwan to 1 U.S. dollar.

Table 38

Amount of Selected UNC Dollar Auctions and Successful Exchange Rates

Date of Auction	Amount Sold (In Thousand Dollars)	Range of Successful Exchange Rates (Hwan per Dollar)
Nov. 29, 1954	2,000	255 - 426
Jan. 10, 1955	2,500	506 - 552
March 14, 1955	2,000	486 - 516
April 25, 1955	1,500	408 - 450
June 27, 1955	1,750	459 - 487
July 11, 1955	1,250	515 - 531

Source: The Bank of Korea, Annual Economic Review: 1956, p. I-142.

These experiences led to the revision of the official exchange rate from 180 hwan to a dollar to 500 hwan to 1 U.S. dollar in August 1955, and to the reform of the overall foreign exchange control system in the direction of a single exchange rate structure in August 1955, following a series of conferences between the United States and the Korean government held in Washington D.C.

Import Quota and Foreign Exchange Control[1]

Practically, foreign exchange control represents a secondary measure for import control in Korea. Imports are, first of all, subject to restriction by quota which the Ministry of Commerce and Industry establishes each year. Until 1954 the quota on imports was established as an annual import programme in the first place. Then, the annual programme was further broken down into a detailed quarterly set of quotas. For the importation of the commodities listed in the quota importers could apply for licenses. There was, however, no assurance that an importer who acquired a license would be able to get foreign exchange to finance the import. Also it was not guaranteed that those with foreign exchange would be able to get import licenses.[2] This problem was solved by the introduction of the special foreign exchange loan system and the UNC dollar auction system, to a large extent, since the loan was made only to the importer who had received import licenses for each commodity, which, in turn, had to be imported by the loan, and the dollars purchased through the auction were automatically assigned for the importation of specified goods designated by the Ministry of Commerce and Industry.

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[1] Tariffs are also an important measure for import control in Korea. At the present, tariffs are levied by ad valorem measures and the rates are differentiated according to the nature of goods. Luxury goods pay the highest rates and industrial materials and equipments, the lowest. See, the Tariff Law of 1949 as amended in 1958, compiled in the Bank of Korea, Annual Economic Review: 1959, pp. II-31 - II-35. In view of the relative irrelevance of tariffs to foreign exchange control, detailed discussions of tariffs are excluded in this study.

[2] These points are well described in Nathan Associates Inc., op. cit., p. 224.

The quarterly quota which required the importer to acquire an import license not only for the quantity but also for the market of each import was, indeed, too restrictive to meet the post-war economic situation. A more efficient coordination between import licensing and foreign exchange allocation along with the mitigation of the import quota was highly necessary for the encouragement of private imports to meet the post-war situation. In 1954, the detailed quarterly set of import quotas was replaced by the "half-yearly general quota", as a first step to eliminate the excessive restrictions on imports. Following this revision, in January 1955, the quota system was further revised in such a way as to abolish the limits to the amount of each importable item and to adopt a "global" quota.[1]

Under the new system, the Ministry of Commerce and Industry established simply the total amount of imports along with the two sets of commodities lists: one for the importable commodities and the other for the commodities that could be imported only by the "preferential foreign exchange." In the meantime, the Ministry set forth a decree concerning the procedures for undertaking foreign trade.[2] This decree stipulated that an importer, in order to apply for an import license, had to submit a certificate of foreign exchange holdings at the Bank of Korea.[3]

In this way the coordination between the import licensing and the

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[1] See, the Bank of Korea, op. cit., p. I-144.

[2] See, "Regulations Governing the Process of Foreign Trade," Ibid., pp. II-53 - II-56.

[3] Article 15 of the Regulation.

allocation of foreign exchange was gradually achieved. Such coordination or the mitigation of import restrictions were, however, by no means the fundamental solution to the expansion of private foreign trade. Rather, the fundamental question lay in the ultimate sources of foreign exchange to finance imports, namely, the expansion of exports.

B. POST-KOREAN WAR FOREIGN EXCHANGE CONTROL ON EXPORTS: EXPORT ENCOURAGEMENT MEASURES

The backbone of the Korean foreign exchange control policy since the establishment of the new Korean government had been, as we have seen in the preceding chapter, the encouragement of exports. This policy was further strengthened after the Korean War even though any sizable result was hard to be expected in the short run. As there was no assurance that foreign economic aid would continue until Korea attained self-sustained economy and, moreover, the size of the foreign economic aid would be large enough to cover the foreign exchange required to finance the importation of necessary goods and services, and in view of the fact that the chances were extremely weak for that any sizable foreign private capital could be induced, the stimulation of exports could not be overemphasized in Korea.

Various foreign exchange control measures to encourage exports were introduced in the post-Korean War period. Our discussions will be, however, concentrated on the following three major systems: (a) favorable treatment of export proceeds; (b) retention quota system and (c) foreign exchange special loan system.

Favorable Treatment of Export Proceeds

As briefly touched upon in the preceding chapter, foreign exchange proceeds accruing from exports are not subject to surrender but to credit to the Bank of Korea, according to the Bank of Korea Act of 1950. This provision was widely used as a means to encourage exports in Korea.

As of July 1953, export proceeds deposited at the Bank of Korea could be disposed of for the following purposes: (a) payment for the importation of goods approved by the government; (b) transfer to other export accounts subject to the prior approval of the Bank of Korea; (c) surrender to the Bank of Korea and (d) payment for such purposes as might be authorized by the government.[1]

These provisions implied various grounds for the favorable treatment of export proceeds. First of all, the provision (b) enabled the exporter to sell his export proceeds deposited at the Bank of Korea to other exporters, who possessed their own export accounts and needed more foreign exchange, at a reasonably high exchange rate through individual bargaining. Thus exporters were implicitly allowed to convert their export proceeds at the rate close to black market rates.[2]

Secondly, the government, furthermore, applied an explicitly favorable measure in the implementation of the provision (a). Foreign exchange acquired through exports was not only allowed to be used for the

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[1] These are stipulated in the "Regulations Governing the Deposits and Dispositions of Foreign Exchange held under Private Foreign Exchange Accounts," the Monetary Board Regulations of Nov. 16, 1950 as amended June 16, 1953, compiled in the Bank of Korea, Annual Economic Review: 1955, pp. I-619, I-661.

[2] Transfer rates were little lower than the black market rates. See table 39.

importation of goods listed in the quota but also was given the exclusive right to import such highly profitable goods as textiles, paper, medicines, chemicals, movies, sugar and so on.[1] This system was, however, abolished as soon as the United Nations Command's dollar auction started in December 1954, because the dollar purchased from UNC had to be subject to the same treatment as that of export proceeds and this made it impossible for the government to treat the export proceeds alone favorably.[2]

The government, however, could not abolish this system entirely for fear that export would be depressed. The government found the way to make up for the abolition of the "favorable treatment" system of export proceeds in the strengthened "retention quota" system.

Retention Quota System

The retention quota system or the "preferential" foreign exchange system was first introduced into the foreign exchange control system of Korea in August 1951, with a view to providing a strong incentive to specific exporters.[3] Under this system, a portion of the proceeds of certain exports was permitted to be retained by exporters for a variety of uses which was, otherwise, strictly restricted, such as imports of semi-luxury goods or goods outside the quota, foreign travel, etc.

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[1] The commodities that could be imported only by export proceeds were listed in each quarterly quota until December 1954.

[2] Article 15 of "Regulations Governing the Sales of U.S. dollars by the United Nations Command" of December 2, 1954, the Monetary Board Regulation No. 926 provides the treatment of UNC dollar as such, compiled in the Bank of Korea, Annual Economic Review: 1956, pp. II-127 - II-128.

[3] In order to introduce this system, the "Regulations Governing the Deposits and Dispositions of Foreign Exchange held under Private Foreign Exchange Accounts" were amended on August 16, 1951. For the amended part of the regulations, refer to Ibid., p. I-628. The privilege of this system was mainly extended to those who exported commodities whose domestic prices were much higher than their international prices.

Exporters could thus be compensated for the loss in their exports by the profits obtainable from importing highly profitable goods or from selling their privileged foreign exchange to other importers.

In practice, for the implementation of this system, the Export Account was divided into four subaccounts: accounts for export earnings from Japan; accounts for export earnings from other countries; accounts for "preferential" earnings from exports to Japan; and accounts for "preferential" earnings from exports to other countries. As a result, many different exchange rates arose, depending upon the degree of restrictions to which each particular type of foreign exchange was subject. The preferential foreign exchange and particularly those permissible for payment of imports from Japan obtained the highest exchange rate because of their relatively high profitability. (See table 39.)

At the end of 1953, there was a total of 66 commodities which could be exported under the retention quota system. The ratio of preferential foreign exchange to the total foreign exchange earnings of each commodity varied, ranging from the lowest rate of 4 per cent to the highest rate of 50 per cent, depending upon the kinds of commodities.[1] For instance, exporters of agar-agar could retain 50 per cent of the total foreign exchange proceeds for "preferential" uses.

This system was further expanded when the UNC auction dollars became subject to the same regulations as those governing the disposition of export proceeds in December 1954. In order to make up for the

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[1] Ibid., p. I-143.

abolition of the favorable treatment of export dollars, the "preferential" foreign exchange system was developed in such a way that most of the export commodities (76 items) could enjoy the preferential treatment.[1]

Under this new scheme, the export commodities were classified into three categories, namely, type A, type B and type C. Commodities falling under the category of type A were given the preferential rate of 50 per cent, those under type B, 40 per cent, and those under type C, 30 per cent. Furthermore, a preferential rate of 80 per cent was permitted to those foreign exchange earnings from the export of an entirely new commodity or from the exports to entirely new markets. This was, indeed, the most drastic measure that the Korean government adopted in the past to encourage exports.

The preferential foreign exchange system remained as the backbone of foreign exchange control policy on exports until August 15, 1955, when this system was entirely repealed with the introduction of the new exchange rate of 500 hwan to 1 U.S. dollar.

It can hardly be denied that these various discriminatory foreign exchange control devices provided the exporters with strong incentives to export. Although it is hard to measure to what extent these devices contributed to the expansion of exports and to the stimulation of export industries, there was no doubt that such measures increased exports to a large extent. It is, however, doubtful if the harmful effects that these discriminatory foreign exchange control devices had brought about to the Korean economy were small enough to be offset by the gains derived from

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[1] Ibid., p. I-144.

the encouragement of marginal exports.

Besides the unfavorable impact of multiple exchange rates in general, namely, the discouragement of sound competition between the favored export industries and the rest of the industries, the special forms of multiple exchange rates system in Korea contained a seriously harmful element which was extremely contradictory to the principal objective of export encouragement. The objective of export encouragement in Korea had to lie in increasing foreign exchange earnings that could be used for the importation of essential goods and services necessary for the economic development. The fact that the system of "favorable treatment of export proceeds" and the "preferential foreign exchange" system allowed exporters to use a part or the whole of the proceeds from exports for the importation of highly profitable goods or even some "semi-luxury" goods was, no doubt, contradictory to the objective mentioned above.

Moreover, the various exchange rates resulted from the highly complicated multiple exchange rates structure were evidently a great obstacle to the development of a sound domestic price structure based on a normal cost structure and to the elimination of price disparities existing between domestic markets and foreign markets.

Table 39

Exchange Rates
Sept. 1954 - June 1955
(Hwan per U.S. Dollar)

Period	Official Rate	UNC[a] Conversion Rate	Unofficial Transfer Rates[b] Preferential Japan	Preferential Other	Non-preferential Japan	Non-preferential Other	Black Market Rate Greenback
1954 Sept.	180	310	—	—	—	852	741
1954 Dec.	180	427	1,180	1,091	793	758	711
1955 Jan.	180	521	1,175	1,141	897	867	771
1955 Feb.	180	511	1,180	1,124	908	597	803
1955 March	180	466	1,279	1,262	885	506	778
1955 April	180	394	1,180	1,151	754	462	749
1955 May	180	462	1,188	1,168	769	521	729
1955 June	180	489	1,391	1,370	796	586	753

a. After December 1954 weighed average rate of dollar auctions during each month indicated.

b. Exchange rates for Japan are those for foreign exchange earned by export to Japan which may be used to import goods from Japan. "Other" refers to foreign exchange earned by export to other areas than Japan which may be used to import goods from areas other than Japan.

Source: Korean Civil Assistance Command, United Nations Command, Civil Assistance and Economic Affairs-Korea, (July 1, 1954-June 30, 1955), Seoul, p. 190.

C. DEVELOPMENTS IN THE FOREIGN TRADE WITH JAPAN: A CASE OF BILATERAL TRADE AND CLEARING AGREEMENT

From every logical point of view, Japan is the most suitable trading partner of Korea. Not only because of the geographical reason but also because of various similarities in taste and culture as well as in industrial structures (e.g., a substantial portion of Korea's industrial equipment is Japanese made), the trade between Korea and Japan must be of vital importance for the development of Korea's foreign trade and of great mutual benefit for both countries. In spite of these logical grounds, the trade with Japan has been by no means smoothly developed, having been confronted with various obstacles, represented mainly by political conflicts.[1] Nevertheless, Japan has been the major trading partner of Korea since the new Korean government was established in 1948.

It was after the "Trade Agreement between the Republic of Korea and Occupied Japan" was signed on June 2, 1950, that Korea's trade with Japan started expanding rapidly.[2] The objective of the treaty was not merely to normalize the trade relation between the two countries but also to expand the trade between the countries to the highest volume possible.

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[1] The major political issues between the Korean and Japanese governments since the liberation have been those related to (1) property claims by citizens of each country on the territory of the other, (2) the Korean claim to sovereignty, and particularly to fishing rights, in waters up to 96 kilometers off the Korean coast line and (3) the status of Korean residents in Japan. See, the Office of Public Information, the Republic of Korea, Korea Report, Vol. IV, (Washington: Korean Pacific Press, 1956), pp. 10-11.

[2] For the text of this agreement, refer to the Ministry of Reconstruction, Selected Laws and Regulations Pertaining to Foreign Economic Aid for Korea, pp. 86-92.

For this purpose, an annual "trade plan" stating both the estimates of purchases by Japan from Korea and those by Korea from Japan was to be established under the agreement. The first annual trade plan was established in April, 1951. The plan covering the period from April 1, 1951 to March 31, 1952 estimated the amount of exports to Japan from Korea at 16 million dollars and the amount of imports to Korea from Japan at 32 million dollars.[1] These figures were then broken down into detailed categories, such as mineral products, agricultural products, minerals, textiles and so on.

Along with this trade agreement, the "Financial Agreement for Trade between the Republic of Korea and Occupied Japan" was concluded concurrently in order to facilitate the financing of the trade.[2] The Financial Agreement established an account designated as "Korea-Japan Open Account" in terms of U.S. dollars at the Bank of Japan in Tokyo so that the value of all export from Korea to Japan may be credited to and the value of all imports to Korea from Japan may be debited to this Account. Other major provisions of the Financial Agreement are as follows:

(a) Payments for the trade between the two countries shall be made of the net balance only under the Open Account. Any excess over a net balance of two million dollars shall be immediately due and payable on demand of the creditor.

(b) Final payment of the net balance of the Account should be

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1 The first "trade plan" was attached to the Financial Agreement mentioned below. See, Ibid., pp. 100-102.

2 The Financial Agreement is compiled in Ibid., pp. 93-95.

made on or before the last day of the fourth calendar month following the effective date on which this Agreement is cancelled or terminated.

(c) Payments must be made either in U.S. dollars or in such currencies as are mutually acceptable.

Thus a bilateral trade quota system accompanied by a bilateral clearing system was established between Korea and Japan. This system, however, could not operate smoothly for long as the Korean War broke out immediately after the agreements entered into force, increasing the Korean demand for imports and decreasing the capacity to export. The increased demand for imports to support the War enabled Japan to enjoy a sizable benefit from the trade agreement. During the 1950-1952 period, more than 50 per cent of the total Korean imports came from Japan. (See table 40.) The increased imports from Japan without concurrent increase in export thereto resulted in a mounting indebtedness in the Open Account. The increasing indebtedness was partly due to the shrunken productivity of Korean export industries and partly due to the Japanese refusal to accept Korean exports in the volume formerly agreed to under the trade agreement.[1] Japanese discriminatory restriction upon the import of Korean commodities, in spite of the enormous Korean demand for Japanese goods during the War, was one of the major factors contributed to worsening the trade relation between the two countries since 1953.

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[1] See, UN, Economic Survey of Asia and the Far East:1955 (Bangkok: February 1956), p. 144.

Table 40

Korean Trade with Japan Compared with the Total Trade During 1950 - 1953

(In Million Hwan)

	1950	1951	1952	1953
Total Exports	325.75	459.14	1,949.64	3,987.20
Exports to Japan	245.73	383.60	1,053.91	1,496.99
Total Imports	52.13[a]	1,218.27	7,044.19	22,370.13
Imports from Japan	36.01[a]	886.42	4,169.27	10,665.60

a. Figures for the goods imported through Inchon (a major port in Korea) during March-June 1950 are not included due to the loss of data.

Source: The Bank of Korea, Annual Economic Review: 1955, p. 170.

Since the break-off of the third Korea-Japan Conference in 1953, the effort to divert the trade with Japan to other areas, i.e., to discourage imports from Japan and to explore new export markets in an area other than Japan, has been one of the major foreign exchange control policies of the Korean government. The following measures were the major foreign exchange control devices adopted for this purpose during the immediate post-Korean War period:[1]

(a) Under the "preferential foreign exchange" system, foreign exchange earnings from exports to areas other than Japan were allowed much higher preferential rates than those from exports to Japan in 1954.[2]

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[1] The Bank of Korea, op. cit., pp. I-144 - I-145.

[2] As of January, 1955, the preferential rates for foreign exchange proceeds from exports to other areas than Japan were higher than those from exports to Japan by 20 per cent.

Moreover, in July, 1955 the preferential treatment of foreign exchange proceeds from exports to Japan was entirely suspended.

(b) In March, 1954, the "foreign exchange special loan" for the importation of Japanese goods was suspended.

(c) In June, 1954, imports from Japan were restricted in such a way that the imports therefrom could only be financed by foreign exchange earned from exports to Japan.

(d) In early 1955, the UNC auction dollars were permitted to be used for import but not for the import from Japan.

Finally, on August 18, 1955, the Korean government suspended all commercial trade with Japan following Japanese reiteration of claims on certain properties in Korea.

D. FOREIGN EXCHANGE CONTROL ON IMPORT UNDER THE SINGLE EXCHANGE RATE SYSTEM

The Foreign Exchange Control Reform of August 1955

The year 1955 was a most significant era for the Korean foreign exchange control system. During the year, Korean economy emerged from the rubble of war destruction, gradually bringing the chronic inflationary spiral under control, while various noteworthy achievements were made in the field of foreign exchange control.

On August 15, 1955, the foreign exchange control system of Korea underwent a drastic reform, following the U.S. - Korea conferences in Washington, D.C. on this matter.[1] The highlights of the foreign

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[1] See, "Amendment of Annex A, Section 1 of Memorendum agreed between governments of the United States and the Republic of Korea on November 17, 1954," the Bank of Korea, op. cit., p. II-30, and International Monetary Fund, Seventh Annual Report on Exchange Restrictions: 1956 (Washington D.C.: 1956), p. 219.

exchange control reform of August, 1955, were (a) to raise the official exchange rate from 180 hwan to a dollar to 500 hwan to a dollar; (b) to abolish the complicated multiple exchange rate structure and apply the new official exchange rate to all foreign exchange transactions in Korea with the temporary exception of the following U.S. aid goods imports: (i) coal of U.S. origin (200 hwan to 1 U.S. dollar until June, 1956); (ii) fertilizer (250 hwan to a dollar until January, 1956); (iii) investment goods for non-revenue-yielding projects; and (iv) relief supplies; and (c) to readjust the official exchange rate whenever the Seoul wholesale price index exceeds the level in September, 1955 by 25 per cent.

As the result, a single exchange rate system was realized in Korea, taking the place of the existing multiple exchange rates structure. The UNC dollar auction, the "preferential" foreign exchange system and the foreign exchange sales by the government on the basis of multiple exchange rates were all replaced by a transaction with the Bank of Korea at the single official rate.

Immediately after the establishment of the new exchange rate, the Korean government undertook a reform in the foreign exchange accounts system in such a way as to meet the exchange rate reform effectively.[1] The existing complicated foreign exchange accounts were integrated into two sorts of accounts: Import Accounts and General Accounts. As of 1956, the major categories of foreign exchange to be credited with Import Accounts were proceeds from (a) exports of goods and services;

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[1] See, "Regulations Governing Deposits and Dispositions of Foreign Exchange Held under Private Foreign Exchange Accounts" of August 24, 1955, compiled in the Bank of Korea, op. cit., p. II-143.

(b) sales of goods to the Republic of Korea Army, where payment therefor was made from U.S. aid funds; (c) sales of goods and services to UNC; (d) purchase of foreign exchange from the Korean government for imports; and (e) sales of gold and silver to the Bank of Korea. Foreign exchange deposited in these accounts could be used to pay for imports and for other incidental costs necessary for the imports or for other purposes approved by the authority. General Accounts were to be credited with the following categories of foreign exchange: (a) proceeds from invisible transactions; (b) foreign exchange received by foreigners from employment in Korea; and (c) foreign exchange reported upon entry to Korea or sent from overseas, and the foreign exchange in this Account was allowed to be used for (a) payments of remuneration to foreign employees for their services rendered and (b) remittance abroad with prior approval of the government. Needless to say, foreign exchange in both Accounts could be surrendered to the Bank of Korea at any time at the official exchange rate.

Another significant event in relation with the Korean foreign exchange control during the same year was the admission of the Korean government to the International Monetary Fund and the International Bank for Reconstruction and Development. Thus the Korean government established the groundwork for developing a normal foreign trade as well as foreign exchange relations within the international framework.[1] As a

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[1] On August 27, 1955 the Korean government paid to IMF 1,202 thousand dollars in gold (34,329 ounces) which was equivalent to 25 per cent of the quota assigned to Korea and became the member of the organization. See, the Bank of Korea, Annual Economic Review: 1957, p. I-126.

member country of these international organizations, Korea's responsibility for maintaining exchange stability increased. Indeed, since August, 1955 the monetary, fiscal and credit policies as well as the foreign exchange control policy of the Korean government have been directly or indirectly concentrated upon the maintenance of the new official exchange rate and, accordingly, upon the stabilization of the price level.

Before proceeding to further discussions, it may be worth while to point out some significant aspects of the foreign exchange control reform of August, 1955.

(1) The reform was the first attempt of the Korean government to establish a single exchange rate system in Korea. Moreover, the new rate of 500 hwan to 1 U.S. dollar was considered as a rate reasonably close to the realistic rate in view of the fact that it was derived from almost one year's experiences in auctions of dollars. (See table 38.)

(2) The extremely disorganized state of price and cost relationships during the War and its aftermath had to be rationalized as early as possible to facilitate sound economic reconstruction and further economic development toward a self-sustained stage. Since the Korean economy was emerging from the dust of war destruction in 1955, a single realistic exchange rate would, without doubt, help rationalize such price and cost structure to a large extent by connecting domestic prices with international price mechanisms.

(3) The single exchange rate system based on the realistic rate would discourage imports and protect domestic import competing industries. In the meantime, exports would be discouraged without such complicated exchange control measures as existed in the past under the new system.

However, some direct subsidies might be necessary for the export industries which had been protected by the government to a considerable degree and would be unable to operate in the absence of the government subsidies even under the new exchange rate system for the time being.

(4) Finally, the single exchange rate system was vital for a smooth coordination between the Korean government and UNC. The smooth coordination was desirable not only to avoid the unfavorable results that would otherwise be brought about to the Korean economy as we have seen in the preceding chapter but also to maintain and control efficiently the largest single foreign exchange earnings in Korea: the earnings from the transactions with UNC.

Developments in the Transactions with the United Nations Command

Under the new foreign exchange control system the transactions with UNC could make steady progress, although there was a sharp decline in the receipts of foreign exchange from UNC during the period immediately following the devaluation. Foreign exchange receipts from the sale of local currency to UNC declined from 33.6 million dollars in the first half of 1955 to as low as 9.1 million dollars in the second half of the same year and remained at the latter level during 1956. (See table 41.) Since 1957, such receipts have been, however, sharply increasing again, as the scope as well as the volume of the transactions with UNC expanded conspicuously.

Since August, 1955 various previous methods of local currency sales to UNC, such as local currency advances and auctions of dollars have been entirely replaced by the direct sale of local currency through the Bank of Korea at the official exchange rate. In the meantime UNC

started two kinds of direct procurements of goods and services from Korea under the U.S. offshore procurement program in 1956. One of them was the direct offshore procurement for UNC and the other was the procurement of supplies by UNC to support the Korean Army under the U.S. indirect defense aid program.[1]

As mentioned above, foreign exchange earned from the sale of goods and services to UNC by private persons or firms in Korea was treated as export proceeds and permitted to be deposited in Import Accounts. This measure has been a great incentive to Korean suppliers to undertake transactions with UNC, although there were some restrictions upon the uses of the foreign exchange for importation.[2]

The foreign exchange proceeds from these sources have been increasing remarkably as shown in table 41, contributing to the increase of the total foreign exchange receipts from UNC. In view of the declining merchandise exports since 1955 as shown in chapter IV above, the foreign exchange proceeds from UNC have been playing a major role in balancing the Korean balance of trade.

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[1] The procurement of supplies for Korean Army support was started after the governments of the United States and the Republic of Korea exchanged the notes under the title of "Agreement between the Government of the United States of America and the Government of the Republic of Korea on the Use of Foreign Exchange Accruing from U.S. Procurement in Korea for Support of Republic of Korea Forces" on February 20, 1956.

[2] Firstly, the uses of foreign exchange proceeds from the transactions with UNC were restricted to the imports of goods falling under the category of "special imports." As of 1956, import quota was divided into two categories: "ordinary imports" and "special imports." Secondly, the foreign exchange was subject to surrender to the Bank of Korea with or without consent of the owner if the foreign exchange was not used for imports within 30 days of its deposit with the Bank of Korea. See Article 2 of the "Regulations Governing the Uses and Sales of Foreign Exchange Accruing from U.S. Procurement in Korea for Support of Republic of Korea Forces," Ibid., p. II-56.

Table 41

Foreign Exchange Proceeds from UNC
1955 - 1958
(In Thousand U.S. Dollars)

	1955 (Jan.-June)	1955 (July-Dec.)	1956	1957	1958
Direct Local Currency Purchase	-	5,206	11,537	25,127	25,697
Direct Offshore Procurement	-	-	2,674	10,646	21,351
Procurement for Korean Army Support	-	-	4,700	8	-
Utilization of Public Facilities	-	-	-	2,005	17,580
Dollar Auction	33,614	3,905	-	-	-
Total Receipts	33,614	9,111	18,911	41,148	64,636

Source: 1955 - The Bank of Korea, Annual Economic Review: 1957, p. I-138.
1956 - The Bank of Korea, Annual Economic Review: 1958, p. I-91.
1957-1958 - The Bank of Korea, Annual Economic Review: 1959, p. I-115.

Allocation of Foreign Exchange for Imports and Revival of Multiple Exchange Rates

As discussed in chapter IV, the gap between exports and imports has been widening in Korea since 1955 particularly due to the sharp decline in the volume of exports. Termination of the tungsten export to the United States which accounted for almost 70 per cent of the total exports during the period 1951-1954 and the worsened trade relations with Japan have been the major factors contributing to the sharp decline

in the exports, deteriorating the balance of trade since 1955. As the result, the proportion of imports financed by exports to the total imports (inclusive of aid imports) declined from 10 per cent in 1954 to 5.2 per cent in 1955 and remained in the latter level during the following 3 years.

Table 42

Exports as Percentage of Imports
1954 - 1958
(In Million U.S. Dollars)

	Exports	Imports	Exports as % of Imports
1954	24.2	241.2	10.0
1955	17.6	338.8	5.2
1956	25.2	384.3	6.6
1957	19.3	388.3	4.9
1958	17.0	344.0	4.9

Source: Computed from table 31.

In view of the absolutely small capacity of exports to acquire necessary foreign exchange for the importation of essential goods for economic reconstruction and for suppressing inflationary pressures, the Korean government continued to sell a part of its foreign exchange holdings to importers after the exchange control reform of August, 1955.

In order to adjust the foreign exchange sale to the new foreign exchange control system, the Monetary Board of the Bank of Korea established a new regulation concerning the sale on August 24, 1955.[1]

[1] See "Regulations Governing the Sales of Foreign Exchange for Imports" Monetary Board Resolution No. 32 of September 7, 1955, compiled in the Bank of Korea, Annual Economic Review: 1956, p. II-142.

Pursuant to this regulation, a total amount of 24.4 million dollars was sold to importers at the official exchange rate (500 : 1) during the 6 month period from August, 1955 to January, 1956 and the local currency in the amount of 1,400 million hwan was absorbed into the hands of the government from the private sector.[1] The foreign exchange purchased by importers was credited with Import Accounts and used for the importation of "ordinary imports" listed in the import quota established half-yearly by the Ministry of Commerce and Industry.

Since August, 1955, the Korean government could maintain a relatively stable price level so that the new exchange rate could remain unchanged during the three year period from August, 1955 to December, 1958. The black market exchange rates, however, continued to fall during the same period, making it impossible for the government to sell foreign exchange at the official exchange rate. Although the Seoul wholesale price index which was the criterion for the readjustment of the official exchange rate did not rise by more than 25 per cent from the level in August, 1955, the Seoul consumer price index rose by more than 50 per cent during the three years, reflecting a substantial loss of the real value of the local currency. (See table 18.)

As a consequence, the foreign exchange sale by the government was entirely suspended from February, 1956, to the end of 1957. It was after December, 1957, when the government revised the method of selling the foreign exchange for imports in such a way as to allocate the

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[1] The Bank of Korea, Annual Economic Review: 1957, p. I-139.

foreign exchange to bidders in order of those offering to buy the largest amount of National Bonds for each dollar they wished to purchase, that the foreign exchange sale was resumed.[1] In other words, under the amended regulation, the official exchange rate of 500 hwan to 1 U.S. dollar was still applied to the sale of foreign exchange by the government to importers. The government, however, required importers to bid for the purchase of National Bonds in addition to paying hwan at the official rate so that the order of allocation might be determined. Thus, a multiple exchange rates system revived in the Korean foreign exchange control structure in "disguised" form, since the purchase of National Bonds meant nothing but the increased cost of purchasing the foreign exchange.[2]

Under the new system, the government sold 5 million dollars to importers on March 14, 1958. In this sale the weighted average amount of National Bonds purchased by the importer per each dollar was 278 hwan, reflecting a substantial disparity between the official exchange rate and the real exchange rate.[3]

The "disguised" multiple exchange rates system developed into an "open" multiple exchange rates system in August, 1958, when the government promulgated the "Provisional Foreign Exchange Special Tax Law," which replaced the system of tying sales of National Bonds to the sale

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[1] See the "Regulations Governing the Sales of Foreign Exchange for Imports as amended on December 19, 1957," the Bank of Korea, Annual Economic Review: 1958, p. II-65.

[2] The interest rate on National Bonds was 5 per cent per annum, which could not offset even the increase in the general price level.

[3] The Bank of Korea, Annual Economic Review: 1959, p. I-117.

of foreign exchange.[1] The objective of the tax is to increase the government's revenue through imposing the tax on the foreign exchange transactions. The tax rate is 150 hwan flat per one dollar purchased from the government for imports. In the meantime, the competitive bid for National Bonds in the sale of foreign exchange for imports was replaced by a direct auction of foreign exchange. Therefore, an importer had to pay 500 hwan plus 150 hwan per dollar and the difference between the successful bid price and the official exchange rate to the government in order to purchase foreign exchange for imports from the government.

The foreign exchange tax was virtually nothing but a "partial" devaluation of the official exchange rate discriminating against importers and in favor of exporters because the tax was applicable only to the sale of foreign exchange for imports and was not levied on the foreign exchange proceeds from either exports or transactions with UNC.[2]

During December, 1958, two foreign exchange sales for imports were undertaken pursuant to the foreign exchange tax law. One was the sale of 5 million dollars on December 11 and the other was the sale of 3 million dollars on December 27.[3] In these sales the weighted average amount of foreign exchange tax that the successful bidders paid per

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[1] For the text of the Law, refer to the Bank of Korea, Laws and Regulations Governing Foreign Exchange in the Republic of Korea: 1959, pp. 8-13.

[2] These are stipulated in Article I (b) and Article II (b) of the Law. Article II of the Law also stipulates that the governments (including local governments) and foreign diplomatic missions shall be exempted from paying the tax.

[3] The Bank of Korea, op. cit., p. I-117.

each dollar purchased was 311 hwan.

Thus, the original intention of the foreign exchange control reform of August, 1955 -- the establishment of a single exchange rate system -- resulted in failure.

E. INCENTIVE MEASURES TO EXPORTS UNDER THE SINGLE EXCHANGE RATE SYSTEM

As mentioned in the preceding section, various multiple exchange rates devices for export encouragement, such as the retention quota system and the system of favorable treatment of export proceeds were entirely repealed with the introduction of a single exchange rate system in August, 1955. Consequently, the nature of the foreign exchange control for export encouragement underwent a drastic change since August, 1955. The direct subsidy to exporters by the government took the place of the disguised subsidy which was implied in the multiple exchange rates existing before August, 1955. The more important developments with regard to the encouragement of exports during the period 1955-1958 might be attributable to the various efforts of the government to improve the general conditions and circumstances for exports. Along with these trends, the exchange control on exports was shifted from cost to quantitative control.

Although the new foreign exchange control policy was such that any kind of multiple exchange rates devices had to be repealed, this did not imply that the government had to abolish every measure for export encouragement. A foreign exchange control for the encouragement of exports was adopted in conjunction with the reform of the import

licensing system in August, 1955. Until August, 1955, the Ministry of Commerce and Industry established two sets of commodities lists every half year: one for the commodities which could be imported by acquiring licenses from the Ministry and the other for the commodities which could be imported by "preferential foreign exchange." After the foreign exchange control reform of August, 1955, this system was simplified in such a way that the importable commodities were classified into two categories -- "ordinary imports" and "special imports," and no license was required for the import of both items.[1] The only requirement for the importation of goods on the lists was the possession of adequate foreign exchange for each import. For example, commodities listed in "special imports" could be imported with foreign exchange earned from exports or transactions with UNC without a license.

Under this system, the incentive measures to exports were provided in such a way that foreign exchange proceeds from exports could be used for the importation of goods in both categories, while foreign exchange proceeds from other than exports, such as foreign exchange purchased from the government and foreign exchange receipts from UNC could only be used for the importation of goods in one category.[2] Thus a quantitative discrimination of foreign exchange was introduced in favor of exports.

This system, however, could not provide an incentive to a specific

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[1] See, the Bank of Korea, Annual Economic Review: 1957, p. I-139, and IMF, op. cit., p. 219.

[2] Foreign exchange receipts from UNC could be used only for the importation of "special imports" and foreign exchange purchased from the government, only for the importation of "ordinary imports" as of 1956.

export, upon which the government wished to place particular emphasis, and was likely to be a great blow to the marginal export industries which had been heavily subsidized by multiple exchange rates. To meet these problems the government established the "Regulation Governing the Payment of Subsidies for Export Encouragement" on December 17, 1956.[1] This regulation stipulated that direct subsidies would be paid to those (a) who exported goods whose domestic prices were exceedingly high compared with international markets prices; (b) who exported goods for display at an international exhibition and (c) who explored and opened new exports markets abroad.[2] The disguised subsidies under the multiple exchange rates thus developed into an open subsidy.

In the meantime, significant achievements were made in the government's effort to improve the general environment and conditions for exports during the period 1955-1958. On November 7, 1957, the "Treaty of Friendship, Commerce and Navigation between the Republic of Korea and the United States of America" which was signed by the governments of both nations on November 28, 1956, entered into force following the ratifications by the Congresses of both countries.[3] This treaty has significant bearings for the expansion of Korean exports considering the following points:

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[1] For the text of the regulation, refer to the Bank of Korea, op. cit., p. II-16.

[2] See Article I of the regulation.

[3] For the text of the treaty, refer to the Ministry of Reconstruction, op. cit., pp. 65-80.

(a) Article 14 of the treaty stipulates that "each Party shall accord most favored treatment to products of the other Party, from whatever place and by whatever type of carrier arriving, and to products destined for exportation to the territories of such other Party . . . ."[1] By this Clause was established a firm groundwork for the most favored treatment of Korean exports by the United States. Considering the fact that the United States is the largest trading partner of Korea, the establishment of such basis is, without doubt, extremely favorable for the further expansion of Korean exports.

(b) Section 2 of the same Article stipulates that "Neither Party shall impose restrictions or prohibitions . . . on the exportation of any product to the territories of the other Party, unless . . . the exporter of the like product to all third countries is similarly restricted or prohibited."[2] Since the United States is one of the freest trading nations in the world and since Korea does not have to reduce the restrictions upon the import from the United States as long as the restrictions are the same as are imposed on other countries, this Clause must be much more beneficial to Korea than to the United States in expanding exports.

(c) Besides these, various favorable conditions for stimulating the foreign trade between the two countries were established on the basis of the principles of the national treatment and the most favored-

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[1] Ibid., pp. 72-73.

[2] Ibid., p. 73.

nation. Those conditions include (i) the freedom of travel for the promotion of foreign trade and (ii) the freedom of navigation.

On December 13, 1957, the Korean government inaugurated the Trade Law by Law No. 460.[1] In view of the fact that the complicated and changeable and therefore inefficient administration of foreign trade in the past were mainly attributable to the absence of the principal law for the regulation of foreign trade and also in view of the urgent need for the establishment of a long range stable foreign trade policy to facilitate the implementation of the overall economic policy for the development of the national economy, the enactment of the Law was of great significance.

Article I of the Law states the purpose of the Law as follows:

> The purpose of this Law is to encourage exports and adjust imports, and to promote sound foreign transactions, with a view to ensuring the equilibrium of international balance of payments and the growth of the national economy.

As indicated in the Article above, the Law puts primary stress upon the encouragement of exports. The Law further stipulates that the government may grant "export subsidies or take other effective measures for such export pursuant to pertinent Presidential Decree to exporters of those goods."[2] This provision was elaborated by "The Trade Law Enforcement Decree" of March 18, 1958, which was promulgated immediately after the enactment of the Trade Law.[3] The main provisions of this

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[1] For the text of the Law, refer to the Bank of Korea, Laws and Regulations Governing Foreign Trade in the Republic of Korea (Seoul: 1959), pp. 8-12.

[2] Article XI of the Law.

[3] For the text of this Decree, refer to Ibid., pp. 13-24.

Decree concerning export encouragement are as follows:[1]

(a) When a new export market for a certain commodity has been developed by an exporter, the exporter may be allowed to monopolize the export to the area for a certain period of time as may be decided by the government.

(b) In the allocation of foreign exchange held by the government, priority for the purchase of the whole or a part of the foreign exchange may be given to exporters who have export records.

(c) Whole or a part of foreign exchange proceeds from exports or sales of goods to military agencies may be privileged to be used for the importation of designated goods.[2]

Thus, such export encouragement measures as direct export subsidies and quantitative foreign exchange controls in favor of export proceeds became a part of the government's long range foreign trade policy.

In connection with the discussions of foreign exchange control on exports during the period 1955-1958, two more aspects may be worthy of discussion. One is the developments in the trade with Japan and the other is the regulations concerning the kinds of foreign exchange that the Bank of Korea can accept.

As mentioned above, the trade with Japan was absolutely suspended after the foreign exchange control reform of August, 1955. The impact

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[1] See chapter 6 of the Decree.

[2] The military agencies refer to the United Nations Command in Korea and designated goods refer to those commodities whose importations are much more profitable than other goods due to the larger price discrepancies existing between internal prices and foreign prices. The price discrepancies that occur are due mainly to import restrictions and relative costs of transportation. Japanese goods are the most typical case falling within this category.

of such a measure upon the Korean economy was serious. For instance, the volume of exports in 1955 shrunk to the lowest level ever recorded since 1947.[1] In view of the seriousness of the impact, the Korean government reluctantly resumed foreign trade with Japan on January 1, 1956. But the trade was reopened on the condition that imports from Japan would be limited to the amount of foreign exchange accruing from exports to the country.[2] This principle, which was maintained throughout the period 1956-1958, contributed to equilibrating the balance of trade with Japan and might have served as a retaliatory measure against the unwillingness of Japan to settle various political issues outstanding.

Such gains, if any, however, must have been too small to offset the losses that the Korean economy incurred from the restricted trade with Japan. Restriction of imports from Japan up to the level of exports thereto meant that Korea had to import a larger amount of commodities from markets other than Japan, since the reduction of imports from Japan did not change the total imports that Korea had to make. As a consequence, Korea had to divert her large portion of imports from the logical and economical market to inconvenient and expensive markets. Moreover, the drastic reduction of imports from Japan must have been detrimental to the expansion of Korean exports thereto. Table 43 shows that although exports to Japan did not deteriorate since 1955, no marked improvements were made as well.

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[1] Even in 1947 the export was estimated at 22 million dollars in contrast with 17 million dollars in 1955. See chapter VI, A. The sudden decrease in exports was, of course, not entirely due to the worsened trade relation with Japan as mentioned above.

[2] See, the Office of Public Information, op. cit., p. 24.

Table 43

Trade with Japan
1954 - 1958
(In Thousand Dollars)

	Export	Import	Balance
1954	7,258	40,468	-33,205
1955	6,994	8,082	-1,088
1956	8,092	7,486	606
1957	9,258	11,383	-2,125
1958	9,772	14,207	-4,435

Source: 1954-1956 - The Bank of Korea, Annual Economic Review: 1957, p. I-128.
1957-1958 - The Bank of Korea, Annual Economic Review: 1959, p. I-109.

Another noteworthy effort made by the government to facilitate exports during the 3 year period was the addition of Deutsche Mark to the kinds of foreign exchange that the Bank of Korea may accept. Since the establishment of the Bank of Korea, Korean exporters have been required to receive export proceeds only in the currencies designated by the Monetary Board of the Bank. Until March, 1958, the designated currencies were limited to U.S. dollars, British pound sterling, Hong Kong dollars and Japanese yen.[1] On March 27, 1958, the Monetary Board decided to include Deutsche Mark in those currencies with a view to encouraging export to West Germany. By the end of 1958 no private transactions in Deutsche Mark had been recorded. However, considering

[1] See, "Regulations Concerning Types of Foreign Exchange that the Bank of Korea may Purchase," the Monetary Board Regulations of June 14, 1950, as amended on June 4, 1953, compiled in the Bank of Korea, Annual Economic Review: 1955, p. I-660.

the trends that the currency has been firmly stabilized in the recent years and that the volume of Korean trade with West Germany has been increasing, such measures seem to be adequate as well as necessary.

In the discussions above, we have seen that some sound signs have been developing in the foreign exchange control system with regard to export encouragement in Korea. First of all the multiple exchange rates which prevailed during the Korean War and its aftermath were officially repealed and accordingly such unfavorable impacts of the multiple exchange rates upon the economy as discussed in section B of this chapter could have been eliminated to a large extent.

Secondly, the government paved the way for establishing a long range export policy through setting forth the Trade Law and concluding a trade treaty with the United States. The Trade Law was significant for the expansion of exports in the sense that the Law put the major emphasis upon the encouragement of exports and stipulated various measures for the purpose. The "Treaty of Friendship, Commerce and Navigation between the Republic of Korea and the United States" was also of great importance for the promotion of Korean exports, since the treaty paved the way for the further expansion of the trade with the United States, which has been and will be the largest trading partner of Korea.

In spite of these healthy movements, the exports during the three year period revealed a gradually decreasing tendency. (See table 27.) This was by no means a sound or encouraging sign for the prospect of exports. Although the volume of exports in 1956 recovered the level of 1954, increasing from 17 million dollars in 1955 to 25

million dollars in 1956, the following two years reversed the upward trend of 1956 again. This was mainly due to the termination of the tungsten export to the United States and the worsened trade relation with Japan as mentioned in the preceding section. These experiences clearly indicate the limited role of foreign exchange control measures in promoting exports. Lowering the costs of production through increasing productivity, the normalization of the distorted price and cost structure and the diversification of export products seem to be the preconditions for enabling foreign exchange control devices to bring about a sizable expansion of exports.

CHAPTER VIII

FOREIGN EXCHANGE CONTROL AND THE PROBLEM OF PRIVATE FOREIGN INVESTMENT IN KOREA

Until very recently the problem of inducing private foreign capital to Korea has been of little importance for the Korean economy due to the existence of sizable foreign economic aid and to the unfeasibility of the Korean economy to attract private foreign investment. As shown in chapters I and IV above, foreign economic aid mainly from the United States has played an essential role in the reconstruction of the Korean economy from war destruction through providing the means for closing the enormous gaps between the payments and receipts in international transactions. Indeed, it has been owing mainly to the foreign economic aid that Korea could maintain a relatively stable level of foreign exchange holdings against the background of enormous deficits in the visible trade accounts since 1953. (See table 44.) Thus, the foreign economic aid mitigated the necessity of private foreign capital for the rehabilitation of the Korean economy after the Korean War.

In the meantime, private foreign capital has not been able to bear any significance for the Korean economy since such capital has been beyond the reach of the country. As mentioned in chapter I, the social, political and economic conditions in Korea must have been too unfavorable to induce the interest-oriented private foreign capital

Table 44

Gold and Foreign Exchange Holdings
of the Bank of Korea
1953 - 1958
(In Thousand U.S. Dollars)

	Gold[a]	Foreign Exchange			
		U.S. Dollar	Sterling[c]	Others[b]	Total
1953	1,436	107,144	139	29	107,312
1954	2,328	98,465	6,937	53	105,455
1955	1,241	89,932	4,616	291	94,839
1956	1,335	95,319	1,518	400	97,237
1957	1,457	112,628	1,113	367	114,108
1958	1,619	143,240	1,232	391	144,863

a. Calculated from the total weight of the gold holding at US $35.00 per troy ounce.

b. The foreign exchange under this item includes Hong Kong dollar, German mark and Japanese yen.

b.c. The figures shown in these items are converted into U.S. dollars at the following exchange rates:

£1 = US $2.8, H.K. $1 = US $0.175, Mark 4.2 = US $1,
¥360 = US $1.

Source: The Bank of Korea, Annual Economic Review: 1959, p. III-223.

to the country. In Korea, almost every condition necessary for attracting private foreign capital seems to have been lacking. First of all, the prospect for a reasonable rate of profits has been poor because markets are limited both at home and abroad, and because a large portion of capital needed in Korea is for social overhead investment. Secondly, general economic situations have been extremely uncertain in Korea. The hyper-inflation during the Korean War and its aftermath alone might be sufficient to account for the uncertain economic situation of Korea. We have already seen how the inflation disrupted the price

mechanism and distorted the relation between costs and prices in Korea. Political instability mainly due to the threat of communist invasion from the northern part of Korea must represent another impediment to the movement of private foreign capital of Korea. The political instability, while enabling the Korean economy to enjoy a sizable economic aid from the free world, is one of the greatest obstacles to the inducement of private foreign capital. No other factors could have been, however, more directly impeding the flow of private foreign capital into Korea than the excessive foreign exchange control on capital movements without any special measures to immunize such controls on private foreign investments. Moreover, the overvalued and unstable foreign exchange rates made it extremely unfavorable for private foreign investors, if any, to undertake businesses in Korea.

Private foreign investment, while having been insignificant for the Korean economy in the past because of the existence of the sizable foreign economic aid and the generally unfavorable climates for inducing private foreign capital, will be essential for the economic development of Korea in the future considering the following points:

(1) There is no guarantee that foreign economic aid will continue until the Korean economy attains a self-sustained level. In practice, the amount of economic aid has been decreasing since 1958. It is, indeed, not hard to foresee in the near future that the time will come when foreign economic aid is no longer available in significant size.

(2) As we have seen in chapter I, foreign economic aid, while playing an essential role in reconstructing the Korean economy from war destructions in the past years, seems to be not adequate and sufficient

to cover the gap between the capital requirements for undertaking developmental projects to attain the self-sustained level and the private domestic savings, even if assuming that the same level of foreign economic aid as Korea received in the past will be maintained in the future. It was shown in chapter I that the portion of foreign economic aid that really contributed to the real capital formation in Korea in the past was relatively small, accounting for less than 30 per cent of the total foreign economic aid.

(3) The capacity to earn foreign exchange through exports is extremely limited in Korea, as we have seen in chapters IV, VI and VII. It is hard to expect any sizable expansion of exports in the near future. Moreover, domestic savings are, as shown in chapter I, extremely limited as in the case of underdeveloped countries in general. To make matters worse, the heavy expenditures on national defense have been making it impossible even for the government to save domestic capital in significant amounts for economic development. In spite of the relatively high level of tax revenues in Korea, the government revenues have been by no means sufficient to meet even the general government expenditures including national defense expenditures.

A. FOREIGN EXCHANGE CONTROL ON CAPITAL MOVEMENTS IN KOREA SINCE 1953

As discussed in chapter VI, inflow as well as outflow of capital funds in any form has been under strict control in Korea since the liberation of Korea from Japanese rule in August, 1945. The Military Ordinance No. 93 of July, 1946, and the Law for the Prevention of Capital Flight of April, 1950, are the major laws that prohibited the

capital movements in Korea. The strict controls over capital movements remained unmitigated throughout the period from 1953 to 1958. As we have already made ample discussions over controls of capital exports in Korea in the preceding two chapters, discussions in this chapter shall be limited to the aspect of foreign exchange control over capital imports in Korea.

As of 1953, inward movements of capital were controlled in the following ways in Korea.[1]

(1) Foreign exchange imported by foreigners including the diplomatic missions and United Nations organizations in Korea was subject to deposit in a General Account at the Bank of Korea. The foreign exchange under this category included those registered at the customs upon entry, received from abroad through remittances and acquired as remunerations for services rendered in Korea.[2] The dispositions of such foreign exchange were restricted to the following purposes: (a) transfers to other general accounts; (b) payments for goods purchased and services rendered in Korea; and (c) donations to Koreans. Uses of such foreign exchange for other purposes were subject to the prior approval of the Korean government.[3]

(2) Foreign exchange imported by a Korean was subject to deposit in a Special Account at the Bank of Korea and the disposition of such

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[1] See, chapters 2 and 3 of "Regulations Governing Deposits and Dispositions of Foreign Exchange Held under Private Foreign Exchange Accounts," the Monetary Board Regulations No. 51 of November 16, 1950, as amended on February 19, 1953, compiled in the Bank of Korea, Annual Economic Review: 1955, p. I-650.

[2] Section 1, chapter 2 of the regulations.

[3] Section 2, chapter 2 of the regulations.

foreign exchange was much more restricted than that of foreign exchange deposited in General Accounts. The foreign exchange in Special Accounts was either to be surrendered to the Bank of Korea or to be used for such purposes as might be authorized by the government, case by case.[1]

As mentioned in the preceding chapter, these regulations were reformed in August, 1955, in such a way that Special Accounts were integrated into General Accounts and the discrimination against the foreign exchange imported by nationals was eliminated.[2] Under the new regulations foreign exchange moving into Korea either by foreigners or by nationals was subject to the same control, i.e., subject to deposit in General Accounts at the Bank of Korea.[3] The foreign exchange deposited in General Accounts was allowed to be used only for such purposes as surrenders to the Bank of Korea, payments of remunerations to foreign employees for their services rendered in Korea, and remittances abroad with the approval of the government.[4] Uses of the

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[1] Chapter 3 of the regulations.

[2] See, "Regulations Governing Deposits and Dispositions of Foreign Exchange Held under Private Foreign Exchange Accounts," the Monetary Board Regulation No. 33 of August 24, 1955, compiled in the Bank of Korea, Annual Economic Review: 1956, p. II-142.

[3] The importation of foreign exchange could be done through (a) remittances, (b) persons, carrying the foreign exchange into Korea and (c) transmissions by mail. Until August, 1955, there was no regulation governing the control of the importation of foreign exchange by mail. On September 16, 1955, the "Regulations Governing Foreign Exchange Transmitted by Mail" was established by the Ministry of Finance Instruction Cheri No. 5415. Since then, the foreign exchange imported by mail has been subject to the same controls as those upon (a) and (b) above, which were controlled by General Accounts. See, the Bank of Korea, Law and Regulations Governing Foreign Exchange in the Republic of Korea: 1959, pp. 34-35.

[4] Diplomatic missions in Korea, United Nations organizations, ambassadors, ministers or persons of any such diplomatic status were, however, allowed to make remittances abroad freely. See, Article 5, (b) of the regulations.

foreign exchange for other purposes than those prescribed above were only feasible through obtaining prior approvals therefor from the government, case by case.

Considering the fact that these were the only regulations concerning the capital movements into Korea during the period 1955-1958, it is not hard to understand how private foreign investments were discouraged by foreign exchange control in the past. Aside from other unfavorable conditions including the absence of the legal basis for the protection and encouragement of private foreign investments, the strict foreign exchange control alone could account for the nonexistence of private foreign investment in Korea until 1958. First of all, under the regulations described above, there was no assurance that foreign investors would be able to transfer earnings or to repatriate invested capital in the same currency in which the investment was made, since such capital outflows were possible only after acquiring an approval from the government. Unstable and unrealistic foreign exchange rates at which foreign investors had to convert foreign exchange into local currency for local expenditures might have been another serious obstacle to private foreign investment. Thirdly, the precarious and unsettled foreign exchange control system must have been a principal factor which discouraged the inflow of private foreign capital into Korea. Indeed, during the period 1953-1958, it was hard to foresee how the foreign exchange control system would be changed even within a year in Korea.

In reality, no private foreign capital had been available to the Korean economy by the end of 1958, except a certain amount of

loans from the Development Loan Fund. In 1958, DLF approved three loans for the development of Korean industries.[1] They were 1.5 million dollars for the designing and engineering of a hydro-electric power plant, 3.5 million dollars to improve the telecommunication system and 2.14 million dollars for expanding a cement plant. Taking account of the fact, however, that loans from DLF should be considered as indirect economic aid from the United States, it is safe to say that private foreign investment had been nil in Korea by the end of 1958.

B. FOREIGN INVESTMENT ENCOURAGEMENT LAW OF JANUARY 1960

Keenly feeling the growing necessity of inducing private foreign capital into Korea as the amount of foreign economic aid started to decrease, on the one hand, and the need for undertaking developmental projects increased as the Korean economy emerged from the rubble of war destruction, on the other, the Korean government set forth the "Foreign Investment Encouragement Law" by Law No. 532 on January 1, 1960.[2] It might be unlikely that any sizable foreign capital will be induced in the near future by the mere establishment of such law. Nevertheless, the promulgation of such law must be of great significance for the development of the Korean economy in the sense that the law certainly provided the momentum with the Korean government to start pursuing policies which will eventually make it possible to induce private foreign capital to Korea.

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[1] The Bank of Korea, Annual Economic Review: 1959, p. I-127.

[2] The text of the law was published by the Ministry of Finance, the Republic of Korea, by a pamphlet under the title of "Foreign Investment Encouragement Law, Law No. 532, promulgated on January 1, 1960." Seoul, 1960.

The law provides foreign investors with fairly wide areas in which they can make investments and engage themselves. The benefits of the law can, however, be extended only to those foreign investments that are for productive purposes and for such purposes as will contribute to the economic development of Korea. These are clearly stated in the purpose of the law cited below:

> Article 1. (Purpose) The purpose of this Law is to invite, encourage and protect the investment by foreign nationals of new capital seeking to initiate, expand or improve development of industrial, mineral, agricultural, forest or fishing resources, so as to advance the standard of living of the people and to promote the economic stability of the country.

The first step a foreign investor who wishes to engage himself in business in Korea, has to take is to file a detailed listing of the "foreign capital base" with which he is going to start business and to make profits.[1] The "foreign capital base" means the sum of the values of capital in the form of (a) foreign currencies or foreign exchange; (b) intangible rights, such as patent rights and trade marks; (c) capital equipments to start operation during the first six months; (d) expenses for technical assistances in installing equipments and (e) raw materials and spare parts necessary for the operation during the first six months.[2] Accordingly, the "foreign capital base" indicates the total amount of the initial investment as well as to the type of business a foreign investor is going to undertake.

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[1] Article 2 of the law.

[2] Article 12 of the law.

Upon approval of the "foreign capital base" by the Foreign Investment Encouragement Committee,[1] the foreign investor becomes a registered investor and can undertake a business in Korea, enjoying the privileges and protections to be provided by the Korean government as described below.

a. Tax Exemptions - The incomes accruing from investments made by registered foreign investors under this law are exempted from obligations for paying the personal income tax and the corporate income tax for five years from the date of commencement of the business.[2] Moreover, the tax rates in the sixth and seventh years from the date of commencement are one third, and those in the eighth year are two thirds, of the total tax rates stipulated in the personal income tax law and the corporate income tax law respectively.[3] The same principles of tax exemptions and reductions apply to the incomes accruing from technical assistances of foreign nationals, whose contract may be concluded with

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[1] The Foreign Investment Encouragement Committee consists of the Ministers of Finance, Reconstruction, Foreign Affairs, Commerce and Industry, and Agriculture and Forestry, of the Korean government, the governors of the Bank of Korea, the Korean Reconstruction Bank and the Agricultural Bank, and the president of the Chamber of Commerce.

[2] Article 19 of the law.

[3] The present personal income tax law classifies personal incomes into six major categories: real estate income, enterprise income, dividend and interest income, capital gains, wages and salaries, and miscellaneous incomes. These incomes are subject to each prescribed progressive rate of taxation. Real estate income, for instance, is taxed at a progressive rate which ranges from 19 per cent to 57 per cent with 8 brackets. See "The Personal Income Tax Law of 1951, as amended in 1954," compiled in the Bank of Korea, Annual Economic Review: 1956, pp. II-3-8. The corporate income tax rates are 32 per cent flat on normal corporate profits and 27 per cent flat on special corporate profits. See "The Corporate Income Tax Law of 1949 as amended in 1955," compiled in Ibid., pp. II-11-14.

registered foreign investors or Korean nationals.[1] In the meantime, income taxes to be levied upon dividends or surpluses distributed to foreign investors abroad by registered enterprises in Korea are also exempted for the first five years from the date of registration and are reduced to one half of the total tax rates for the following three years from the expiration date of tax exemption.[2] Income taxes to be levied upon remunerations (salaries, bonuses, annuities and so on) to foreign nationals engaged in the operation of enterprises registered under this law are also exempted for the first five years and reduced to one half of the total tax rates for the following five years.[3]

b. Exemptions of Import Duties[4] - Under the law, no import duties are to be levied upon the commodities imported as the "foreign capital base" or for the purpose of rehabilitating or enlarging the existing facilities of the registered enterprise in accordance with the installation plan indicated in the application for the registration of investment. Machineries imported for maintaining the existing facilities are exempted from customs duties for five years from the date of commencement of the business. Customs duties are, however, not exempted for commodities imported for personal consumptions and for such commodities as are produced in Korea in sufficient quantity.

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[1] Articles 16 and 20 of the law.

[2] Article 22 of the law.

[3] Article 23 of the law.

[4] Article 27 of the law.

c. Repatriation of Capital and Transfer of Profits[1] - Under the law, repatriation of capital is permitted after two years from the date of original investment in the same currency in which the original investment was made. The maximum amount of the annual repatriation of capital is 20 per cent of the "foreign capital base." The government may, however, approve shorter terms for the repatriation in cases where enterprises are going into liquidation due to failure. As to the transfer of foreign investment income, the law stipulates that the foreign investor may transfer profits up to a maximum of 20 per cent of the "foreign capital base" per year. In case the profits earned in any year amount to less than 20 per cent of the foreign capital base, transfer of such profits may be reserved for not more than three years and may be transferred together with the profits earned thereafter.

d. Other measures to protect foreign investments - Under the law, the Korean government guarantees protections of foreign investors from (a) compulsory expropriations of their assets or any form of compulsory transfers of ownerships, except appropriations by the government for public purposes and (b) requisitions of their property, except in the event of a state of war or national emergency.[2] In the event of expropriations or requisitions, the Korean government guarantees to pay a fair and just compensation therefor and to enable the foreign investors concerned to remit the compensation in the foreign currency in which the original investment was made.

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[1] The provisions for the repatriation of capital are stipulated in article 28 of the law and those for transfers of profits, in article 29 of the law.

[2] Articles 32 and 33 of the law.

Another significant measure for the protection of foreign investors under the law is the preclusion of competitive businesses operated by the government to exclude unfair competitions.[1] The government guarantees that no government business which will compete with registered foreign investments or enterprises is to be established. In the meantime, foreign investors are treated equally with Korean nationals, except when they are subject to the special treatments or protections under the law.[2]

Thus the Korean government, for the first time, has laid down a legal groundwork for attracting private foreign capital to Korea. Even if it is hard to expect that the law will solve the problems of developing broader markets for Korean products at home or abroad and of improving the prospect for a reasonable rate of profits, the establishment of such law will, without doubt, play an essential role in eliminating such serious obstacles to private foreign investments as fears of foreign investors over the possible excessive controls on or arbitrary treatment of foreign investments, fears of confiscations or requisitions without just compensations, absence of legal basis enabling foreign investors to repatriate their capital or to transfer a reasonable rate of earnings to their own countries, double taxations, and so on. The measures to mitigate these obstacles are extremely essential for inducing private foreign capital to Korea, considering the particularly unstable political situations the Korean economy has to face because of the historical and geographical reasons as long as the east-west political

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[1] Article 40 of the law.

[2] Article 38 of the law.

tension persists. Indeed, the establishment of the law for the encouragement of foreign investment must be highly significant and essential for the development of the Korean economy in the future even only in the sense that the law provided the momentum to the Korean economy to set out positive efforts to improve the general climates for the inducement of foreign capital.

CHAPTER IX

SUMMARY AND CONCLUSIONS

A. SUMMARY

1. In the preceding analysis, efforts have been made to answer the two broad questions: (1) what are the major problems faced by Korea in the course of her economic development, which brought about a fundamental disequilibrium in her balance of payments? and (2) what kinds of foreign exchange control measures were adopted to combat the particular problems reflected in the balance of payments and to what extent such measures contributed to the solution of the problems?

2. Factors impeding the development of the Korean economy, numerous as they are, are mainly represented by (a) insufficient sources of capital, (b) population pressures, (c) limited natural resources, (d) chronic inflationary pressures and (e) inadequate governmental policies for economic development. The seriousness of these basic problems were generated to a large extent and intensified by two factors: the partition of Korea into south and north in 1945 and the Korean War in 1950. Indeed, except the availability of a relatively large amount of foreign economic aid provided by free world nations, especially by the United States and a fairly high standard of education, Korea is short of almost every condition necessary for undertaking economic development.

3. Among other things, capital deficiency stands out as the most fundamental obstacle to the economic development of Korea, particularly in view of the fact that the problem of capital formation lies at the core of the problem of developing the Korean economy. Various data on private savings in Korea reveal an extremely low level of private savings available for capital formation. By all reasoning, the real amount of private savings that can contribute to the financing of economic development in Korea must be no more than 2 per cent of the GNP in the recent years. It is, however, expected that, as there are considerable disparities in the income levels among various income recipients, some groups receive real incomes high enough for a substantial saving. It is supposed, however, that such potential savings are often directed to non-productive investments. Mobilization of such savings for developmental investments is of vital importance. This, under the present circumstances, seems only possible through enforced savings by the government.

In practice, the Korean government has been maintaining a relatively high tax burden which ranks one of the highest imposed by other countries in the same stage of economic development. Nevertheless, the present level of tax yields in Korea is not adequate and sufficient to meet even the general government expenditures chiefly because of the abnormally heavy expenditures on national defense, which account for almost 50 per cent of the total government revenues and 7 per cent of the GNP in the recent years.

Foreign sources of capital, mainly U. S. economic aid have been the essential factor enabling the Korean economy to achieve a sizable

growth in the midst of the extremely low level of domestic capital since 1953. During the period from September, 1945, to the end of 1958, a total amount of 2,468 million dollars has been received by Korea as foreign economic aid. Foreign economic aid, while playing an essential role in assisting Korea to overcome the shortage of consumption goods during the Korean War and its aftermath, seems, however, not sufficient to meet the capital requirements for undertaking developmental projects to attain the self-sustained economy in Korea. The share of foreign economic aid that contributed to the real capital formation in Korea has been less than 30 per cent of the total. Moreover, the volume of foreign economic aid has been declining lately.

4. Human resources are evidently more burden than asset to the Korean economy. Korea is suffering from overpopulation which largely resulted from the vast inflow of refugees, from the northern part of Korea after the partition of Korea in 1945, and during the Korean War, seeking freedom. Indeed, the problem of resettlement of huge numbers of refugees in the totally destroyed economy, which was already suffering from population pressures, was one of the major post-Korean War problems. A total number of 4 million people flowed into South Korea since 1945. As the result, the rate of population increase in Korea accounted for almost 2 per cent per annum. Moreover, the natural rate of population increase since 1953 in the absence of the flow of the refugees has been approximately 1.7 per cent per year. As it is hard to expect that any decline in the rate will occur in the future, the total output of Korea should expand by about 2 per cent per year simply to maintain the present level of per capita income.

Korea, however, possesses one strikingly favorable element with regard to population problems. The rate of illiteracy is conspicuously low in Korea. This strongly indicates the potentiality of the Korean workers to raise productivity if other necessary conditions are present.

5. Without doubt, it is not the mere size of land or the ratio of population to land but the real productivity of the land that determines the potentiality of economic development of an economy. Land for agriculture, supporting more than 60 per cent of the population as it is, represents only 21 per cent of the total land because of mountainous character. Rice is the main crop, accounting for more than 60 per cent of the total agricultural products.

Forest land covers more than 70 per cent of the total land of Korea. This, however, does not render any significant contribution to the national income because of denudation which accounts for 45 per cent of the total forest land as of 1957.

Korea is maritime in character due to the economy being surrounded by sea on three sides. In spite of such potentiality, the productivity of fishery industries in Korea has been low due mainly to the shortage of capital and skills.

One of the greatest blows of the partition of Korea to the Korean economy was the separation of the vast mineral resources as well as the hydro-electric power resources in the northern part of Korea from South Korea. Before the partition, 90 per cent of the total minerals including coal and iron ore and 89 per cent of total electric power were produced in the northern part of Korea. Moreover, making the situation worse, the Korean War destroyed 41 per cent of all power

generating facilities and 50 per cent of all coal mining installations.

6. The Korean economy has been plagued by a chronic inflation for almost two decades. When Korea was liberated in 1945, the dormant inflationary pressure existing under the Japanese controlled economy, turned into open inflation. After the outbreak of the Korean War the inflation developed further into a hyper-inflation. During the period 1947-1957, the price index of Korea jumped more than 200 times. Although such severe inflationary pressure has been suppressed in recent years, a considerable degree of inflation is still under progress without being completely checked.

As the pressure of inflation grew sharply, the Korean economy was plagued by every bad impact that inflation can bring about. Inflation encouraged hoardings, speculation, capital flights and flagging morals, and discouraged the desire to save, incentive to work and private foreign investments. Inflation disrupted the price mechanism and distorted cost-price relations. It also resulted in serious inequities in the distribution of income and extreme hardships among the general people. Certainly, inflation has been one of the major obstacles to the economic development of Korea. These situations, of course, deprived the Korean government of the chance for undertaking deficit financing of economic development, completely.

7. Until recent years, an integrated comprehensive programming for economic development has been lacking in Korea, except one prepared by the United Nations agency in Korea, in spite of the fact that the establishment of the government's development policies and programs is an essential precondition for the achievement of economic development

in the light of tremendous obstacles to the spontaneous economic growth in Korea.

8. Despite these numerous, extremely unfavorable, conditions, the Korean economy has been growing fairly rapidly since 1953. The rate of growth in GNP during the 1953-1958 period recorded approximately as high as 6 per cent per annum. This stands out as one of the highest growth rates in the free world. Behind this is, however, concealed an extremely gloomy aspect of the economy, which is clearly reflected in the balance of payments.

9. The Korean balance of payments, balanced as they are without depleting the foreign exchange reserves, are fundamentally in a serious disequilibrium. The most striking characteristics of the Korean balance of payments have been the persistent enormous import surpluses, on the one hand, and huge amounts of donations, on the other. The enormous imbalances in visible trade accounts have been attributable to (a) the absolutely small size of exports depending upon the limited exports goods and markets and (b) heavy domestic demands for foreign goods for consumption as well as for investment due to the large and persistent imbalance between the domestic capacity to produce and the domestic demand. Indeed, during the period 1953-1958, the proportion of imports financed by exports to the total imports accounted for far below 10 per cent. This in turn indicates that more than 90 per cent of the total imports (inclusive of aid imports) has been import surpluses. To make the situation worse, gaps between visible exports and imports have been widening in Korea since 1953. The only encouraging aspect in the Korean balance of payments during the same period was found in invisible trade

accounts which recorded sizable export surpluses each year. Such surpluses have, however, been derived not from such ordinary items of invisible accounts as transportation, travel or insurance, but from the government transactions with the United Nations forces in Korea.

10. Against these backgrounds discussed above, our discussions proceeded to the analysis of the overall foreign exchange control policies adopted by the Korean government to combat the particular problems of the Korean economy. The foreign exchange control was first introduced in Korea as early as 1945 when she was liberated from Japanese rule. The major purpose of foreign exchange control during the early period covering from September, 1945, to August, 1948, during which Korea was under the rule of U. S. Army Military Government, was the prevention of capital flight rather than the control of foreign trade. This, however, did not imply that foreign exchange control upon foreign trade was milder than that on capital movements. Foreign exchange control during the period was the strictest one that Korea has ever experienced. The Korean foreign trade during the period was absolutely small in size and primitive in nature, and this was the reason why the foreign exchange control on foreign trade was insignificant. It was, however, found that the strict foreign exchange control was in turn a great obstacle to the sound development of foreign trade in Korea.

11. The foundations of the present Korean foreign exchange control system were laid down after the establishment of the new Korean government in August, 1948. Since then, the foreign exchange control policies of the Korean government pursued mainly the following specific purposes: (a) prevention of capital flight; (b) maximization of foreign exchange

receipts chiefly from the United Nations Command in Korea through maintaining an overvalued foreign exchange rate; (c) encouragement of exports through special types of multiple exchange rates; (d) suppression of inflation through the sale of foreign exchange to Korean importers; and (e) political retaliation against Japan.

12. The strict control over capital movements was introduced by the Military Ordinance No. 93 of July, 1946, and the Law for the Prevention of Capital Flight of April, 1950. Under these laws, every outflow of capital funds was subject to prior approval of the authority. Such strict control remained unmitigated and as a major objective of the Korean foreign exchange control throughout the period 1953-1958. Inward movements of capital were also subject to fairly strict controls which enforced such capital to be deposited at the Bank of Korea for restricted uses. These measures, while essential for the preservation of the national foreign exchange reserves, represented one of the major obstacles to the inducement of private foreign capital to the country.

13. No other foreign exchange control policies of the Korean government, however, brought about more serious and controversial issues and unfavorable impacts to the Korean economy than the policy of maintaining overvalued exchange rates particularly with regard to the transactions with the United Nations Command in Korea. In view of the low capacity of the Korean economy to earn foreign exchange through exports and the bottomless requirement of foreign exchange for the economic development, it is quite understandable that the Korean government tried to maximize the foreign exchange receipts from UNC through maintaining exchange rates as high as possible in terms of local

currency, since UNC had to procure a certain amount of goods and services from Korea at any costs. The cost of maintaining an unrealistic official exchange rate was, however, too expensive compared with the gains therefrom. The long delay of repayments by UNC for their local currency borrowings from the Korean government during and immediately after the Korean War due to the unsettled negotiations between the Korean government and UNC over the exchange rate was one of the major factors contributing to the hyper-inflation during the same period. Moreover, the maintenance of the overvalued official exchange rate was the main factor that led the Korean government to adopt various particular multiple exchange rates in the foreign exchange control system. The overvalued official exchange rate also stimulated the development of black market transactions among foreigners as well as Koreans, enlarging the loopholes for smuggling and capital flights.

Finally, the dispute over the foreign exchange rate was settled by the foreign exchange control reform of August, 1955, in which the exchange rate was set at the realistic level of 500 hwan to 1 U.S. dollar. Although the immediate impact of the reform upon the Korean economy was fairly serious due to the drastic reduction of the foreign exchange receipts from UNC, the foreign exchange receipts gradually resumed the pre-reform level as the volume and scope of UNC transactions increased remarkably.

14. The backbone of the Korean foreign exchange control on foreign trade has been the encouragement of exports since the establishment of the new Korean government. In order to implement this policy, while maintaining overvalued official exchange rates, the Korean government introduced various multiple exchange rates devices, such as "favorable

treatment of export proceeds," "retention quota system" and "foreign exchange special loan system." These various schemes, without doubt, provided the exporters with strong incentives to expand exports through enabling them to enjoy special privileges, such as the privilege to import semi-luxury goods or certain highly profitable goods, the privilege to sell the export proceeds to other importers at the black market rates and so on. Aside from the unfavorable impacts of multiple exchange rates in general, the special forms of multiple exchange rates systems in Korea, however, contained a seriously harmful element to the sound economic development of Korea. For instance, the privileges of exporters to use a part of the whole of the export proceeds for the importation of highly profitable goods or "semi-luxury" goods were, without doubt, contradictory to the objective of export encouragement. Moreover, the complicated exchange rates resulting from these schemes were evidently great obstacles to the development of a sound domestic price and cost mechanisms and to the elimination of price disparities existing between domestic and foreign markets.

With the foreign exchange control reform of 1955, the multiple exchange rates devices were repealed and replaced by the system of direct export subsidy. The single exchange rate system, however, could not survive for long due to the continuous loss of the local currency value, although the Korean government did not have to introduce any particular multiple exchange rates devices for export encouragement by the end of 1958.

15. Since the cessation of the hostilities in Korea, foreign exchange control policies in Korea has been mainly pursuing the objective

of counteracting the inflation -- the major post-Korean War economic problem. This policy was first put into practice through providing Korean importers with "special foreign exchange loans," aimed at reducing the quantity of money circulating among the public, on the one hand, and increasing the supply of goods through stimulating imports, on the other. This system was replaced by the dollar auction system in October, 1954, which was again superseded by the foreign exchange sale at the official rate in August, 1955.

The continuously falling value of the local currency, however, made it impossible for the government to continue the foreign exchange sale for long. Eventually, a new form of foreign exchange auction system was introduced with the promulgation of the Provisional Foreign Exchange Special Tax Law in August, 1958. With this new system the original intention of the foreign exchange control reform of 1955 -- the establishment of a single exchange rate system -- resulted in failure, starting to introduce another multiple exchange rates structure in Korea.

These various systems of foreign exchange allocations for imports seem to have achieved their major objectives, namely, the suppression of the inflationary pressures. It is, however, doubtful if the precious foreign exchange was efficiently utilized. Among other things, the suddenly increased supply of consumption goods under these systems was a great blow to the development of import competing domestic industries. Moreover, the artificial exchange rates applied to the sale of foreign exchange were a great obstacle to the normalization of the disorganized domestic price mechanism and distorted cost structures.

16. Foreign exchange control measures have been employed by the

Korean government as a retaliatory measure against the unwillingness of Japan to settle various political issues outstanding since the third Korea-Japan conference was broken off in 1953. Since 1953, one of the major foreign exchange control policies of the Korean government has been directed to discouraging the trade with Japan, namely, to discouraging imports from Japan and to encouraging the exploration of new export markets in other areas than Japan. At the outset, this policy was put into practice through suspending the foreign exchange allocation for import from Japan and depriving the export proceeds from Japan of the various privileges that exporters could, otherwise, enjoy. The most stringent measure was adopted in August, 1955, when Korea absolutely suspended the trade with Japan. In view of the seriousness of the impact of such extreme policy upon the Korean economy, the Korean government reluctantly resumed the foreign trade with Japan in January, 1956. The trade was, however, reopened on the condition that imports from Japan would be limited to the amount of foreign exchange accruing from exports to the country. This principle remained unmitigated throughout the period 1956-1958.

B. CONCLUSIONS

On the basis of the analysis above, it is now possible to draw the following conclusions and some recommendations with regard to the role of foreign exchange control in the course of economic development and to the possible solutions of the particular problems related with the economic development of Korea.

1. Foreign exchange control is an important and effective means to

help the underdeveloped countries to attain their economic development nowadays, chiefly because their processes of economic developments are very likely to be accompanied by balance of payments difficulties. The balance of payments difficulties are attributable to both the demand side and the supply side of foreign exchange in those countries. The demand side is characterized by a huge need for foreign exchange not only for the importation of capital goods but also for that of consumption goods. With the likely inflationary pressures, the demand for consumption goods is likely to be intensified. Foreign exchange control is, without doubt, a most certain, rapid and effective measure to control selectively such unbalanced demand for imports. The supply of foreign exchange is limited in those countries not only because of the generally low capacity to produce exportable goods but also because of the international forces operating unfavorably against the primary products. Foreign exchange control is an essential measure to stimulate economic development in these countries through enabling the government to control the foreign exchange receipts from exports so that the scarce foreign exchange may be most effectively utilized for developmental purposes. Moreover, foreign exchange control is an important measure to maintain and expand the level of exports. Multiple exchange rates seem to be the most effective device for this purpose. Another vital role of foreign exchange control in the development of underdeveloped countries is the control of capital flight. Foreign exchange control for this purpose is of great importance in view of the high propensity of small domestic capital to flow out of the country and in view of the effectiveness of foreign exchange control in checking such capital flows.

These general propositions seem to be applicable to the Korean economy almost without exception even though Korea possesses some peculiar aspects which make it necessary for the Korean government to make some adjustments in the implementation of these propositions.

2. The experiences of the Korean economy in foreign exchange control clearly indicate that foreign exchange control, a necessary means as it is to protect the balance of payments, has serious limitations in its role to facilitate economic development in Korea. The major limitation seems to lie in its role of encouraging exports. Attempting to stimulate exports in the short run, the Korean government adopted both multiple exchange rates and quantitative control devices. The results were almost negligible in both cases. These experiences prove that foreign exchange control measures can expand exports only (a) when the capacity of a country to export is fairly large and stable, i.e., the elasticity of domestic supply for exports is larger than unity and (b) when both the foreign demand for the country's exports and the world prices of the export goods are fairly stable. In Korea, where both of these conditions are absent due to the absolutely low productivity which was further depleted by war destructions and due to the concentration of export goods on a few raw materials such as foodstuffs including rice and some minerals, it is natural that foreign exchange control could not bring about any sizable results in the export encouragements.

Another major limitation was found in the control of capital movements. If the preservation of domestic capital is one of the necessary conditions for a successful economic development, the inducement of private foreign investment represents another indispensable factor for

that. Particularly in Korea, where the need for private foreign capital has been conspicuously growing as the foreign aid fund started to decrease without any new sources of foreign exchange to offset the reduction, the foreign exchange control over capital movements cannot help but to undergo a drastic modification. Furthermore, the simultaneous development of black markets inevitably limited the role of the foreign exchange control in the prevention of domestic capital flight.

3. Moreover, it is very likely that the cost of maintaining foreign exchange control may prove to be greater than the gains that can be derived from foreign exchange control unless it is handled with the utmost care. This may be the most important lesson that the practice of foreign exchange control in Korea in the past years provides. Although it is impossible to calculate exactly the benefits from and the costs of maintaining various foreign exchange control measures in Korea in the past and to compare them precisely to determine which was greater, it is clear that the costs were generally substantial and, in some cases, the cost definitely outstripped the benefit. The attempt to maintain a high overvalued official exchange rate to maximize the foreign exchange receipts from UNC (a), the introduction of the complicated multiple exchange rates structure to encourage exports (b), and the utilization of foreign exchange control policies for the political retaliation against Japan (c) were the cases in which the cost was evidently greater than the benefit.

The direct cost of (a) was its contribution to the hyper-inflation during the Korean War and its aftermath, and its indirect costs were various unfavorable outcomes originating from the maintenance of

overvalued exchange rates, such as the inevitable introduction of the complicated exchange rates structures, which in turn impeded the normalization of the distorted domestic price and cost mechanisms and the elimination of the price disparity between domestic and foreign markets. The benefit derived from (a) was the receipt of a certain amount of foreign exchange from UNC as repayments for local currency advanced to them at the overvalued exchange rate after the more than 3 years delay. The cost of (b) was also high. It not only disturbed the normalization of the disrupted domestic price and cost mechanism but also wasted the precious foreign exchange proceeds from exports and encouraged the black market transactions. Against these unfavorable incidents, the gain was negligible due to the reasons mentioned in the preceding paragraph. No foreign exchange control policies of the Korean government were, however, more costly than (c), since the gain from (c) was nil from the economical point of view, whereas its cost was enormous due to the fact that it enforced the Korean economy to undertake much more expensive import than that Korea, otherwise, would have undertaken. Indeed, without a careful weighing of the advantages to be derived from the adoption of a foreign exchange control policy against the possible disadvantages arising therefrom, it is hard to expect that foreign exchange control will contribute to economic development.

4. These failures of the Korean foreign exchange control policies seem to be mainly attributable to the fact that the foreign exchange control policies have never integrated with a long range national economic developmental policy. This has been partly due to the lack of a definite governmental economic development policy and partly due

to the absence of a stable long run principle for foreign exchange control. The long range national guiding principle for the foreign exchange control being absent, the system of foreign exchange control in Korea could undergo changes any time to meet an immediate short run need or just for convenience sake. The fact that the method of foreign exchange allocation for imports alone underwent fundamental changes 5 times during the period 1953-1958 is a good example.

5. On the basis of the conclusions drawn above, it is now clear that the following measures are highly recommendable for the development of the Korean economy.

(a) The foreign exchange control law based upon the long range national economic development policy should be established as soon as possible.

(b) Foreign exchange rates system should be simplified. The preconditions for this are numerous, but the maintenance of the official exchange rate at the realistic level seems to be the most essential condition. Without doubt, the maintenance of realistic exchange rate can hardly be expected without the stabilized economy, especially the stable price level. This clearly indicates that foreign exchange control policy should be supplemented by other economic policies in order to achieve satisfactory results.

(c) In view of the nature of foreign exchange control and in view of the peculiar economic situations in Korea, the emphasis of foreign exchange control on foreign trade should be placed more on imports than on exports. Introductions of foreign exchange control measures for export encouragement are likely to lead to the waste of foreign exchange

reserves. At the present stage, it is certain that the efficient utilization of the available foreign exchange for imports and the minimization of the demand for imports through increasing the productivity of import competing domestic industries and through enforcing austerities among the people are more effective measures to improve the balance of payments situations than the effort to expand exports.

(d) As to the export expansion, direct subsidies from the government's budget to marginal export industries, economic developmental policies to diversify export industries and to stabilize the export prices and the improvement of the general conditions and circumstances for exports including the active exploration of new markets abroad are preferred to foreign exchange control measures including multiple exchange rates devices.[1]

(e) Private foreign capital should be induced actively. The Korean government should see to it that foreign exchange control will not constitute an obstacle to the capital movement. The first target of this policy might be the capital owned by Koreans abroad, particularly in Japan.

(f) The political animosity and prejudice of Korea toward Japan should not jeopardize the trade relation of Korea with Japan. Until the Korean economy grows strong enough to compete with Japanese

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[1] As discussed in chapter VII, these were the major export encouragement policies followed by the Korean government during the period 1955-1958. The Korean government, however, reintroduced multiple exchange rates devices for export expansion, such as "retention quota" system in 1959. See, IMF, Eleventh Annual Report on Exchange Restrictions (1960), (Washington: 1960), p. 231.

economy, Korea should avail herself of the maximum benefit that can be derived from the trade with Japan. Moreover, the private investment from Japan should be encouraged as well.

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