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Report No. EAP-12a

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

ECONOMIC POSITION AND PROSPECTS OF THE REPUBLIC OF KOREA

(in three volumes)

VOLUME I

MAIN REPORT

March 16, 1970

East Asia and Pacific Department

CURRENCY EQUIVALENTS

U.S. $1.00	=	Won 305
Won 1,000	=	U.S. $3.28
Won 1,000,000	=	U.S. $3,279

PLAN PERIOD

First Five-Year Plan	-	1962-1966
Second Five-Year Plan	-	1967-1971
Third Five-Year Plan	-	1972-1976

This report is based on the findings of an Economic Mission which visited the Republic of Korea in September - October, 1969. The Mission was composed of the following members:

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VOLUME I

MAIN REPORT

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BASIC DATA

Area	98,438 sq. kms
Population	
Total (mid-1969)	31.14 million
Growth rate (1969)	2.2 percent
Density (per sq. km)	315
Gross National Product	
Total (1969)	2,030 billion won
Per capita (1969)	$190 equivalent
Growth rate (1969 at constant prices)	15.5 percent
Growth rate of real GNP (1962-69)	10.8 percent
Industrial Origin of real GNP (1969)	100 percent
Agriculture, forestry and fisheries	28 percent
Mining and manufacturing	26 percent
Economic overhead and construction	13 percent
Other services	33 percent

Gross Domestic Expenditure (current prices; as percent of GDP)

	1965	1968	1969
Consumption	94	88	85
Private	84	77	74
Public	10	11	11
Gross Capital Formation	15	27	30
Current Deficit and Statistical Discrepancies	-9	-15	-15

Financing of Investment

As Percentage of GDP	1965	1968	1969
Gross Domestic Saving:	7.3	13.7	17.3
Public	(1.4)	(6.0)	(6.1)
Private	(5.9)	(7.7)	(11.2)
"Foreign Savings"	7.5	13.4	12.6
As a Percentage of Gross Capital Formation:			
Gross National Saving:	49	51	58
Public	(9)	(22)	(21)
Private	(40)	(29)	(37)
"Foreign Savings"	51	49	42

Public Finance (current prices, in billion won)	1965	1968	1969
Current Revenue	91	285	363
Current Expenditure	81	191	241
Surplus	10	94	122
Capital Expenditure	41	149	233
Counterpart funds finance	33	34	36

Money, Credit and Prices (annual rate of change in percent):

	1965	1968	1969	(Sept. 1968 (Sept. 1969)
Money Supply	33	25	37	
Time and Savings Deposits	94	99	94	
Total Bank Credit Outstanding:	42	74	69	
To Private Sector	32	81	80	
Price Indices:				
Consumer Prices (Seoul)	13.6	11.1	12.0	
Wholesale Prices	10.0	8.1	7.5	

Balance of Payments (in million US$)

	1965	1968	Jan. - Sept. 1968	Jan. - Sept. 1969
Merchandise Exports (f.o.b.)	175	486	336	461
Merchandise Imports (f.o.b.)	-416	-1,322	-945	-1,182
Deficit	-241	-836	-609	-721
Receipts from Military Expenditures	74	217	154	190
Other Services, net	- 28	- 47	- 40	- 46
Balance on Goods and Services Account	-194	-666	-496	-577

International Liquidity (in million US$)

	1965	1968	Nov. 1969
Gross Foreign Exchange Reserves	146	409	527
Months' Imports of Goods & Services	4	3	
IMF Quota	18.8	50	50
IMF Drawings (outstanding)	-	12.5	12.5

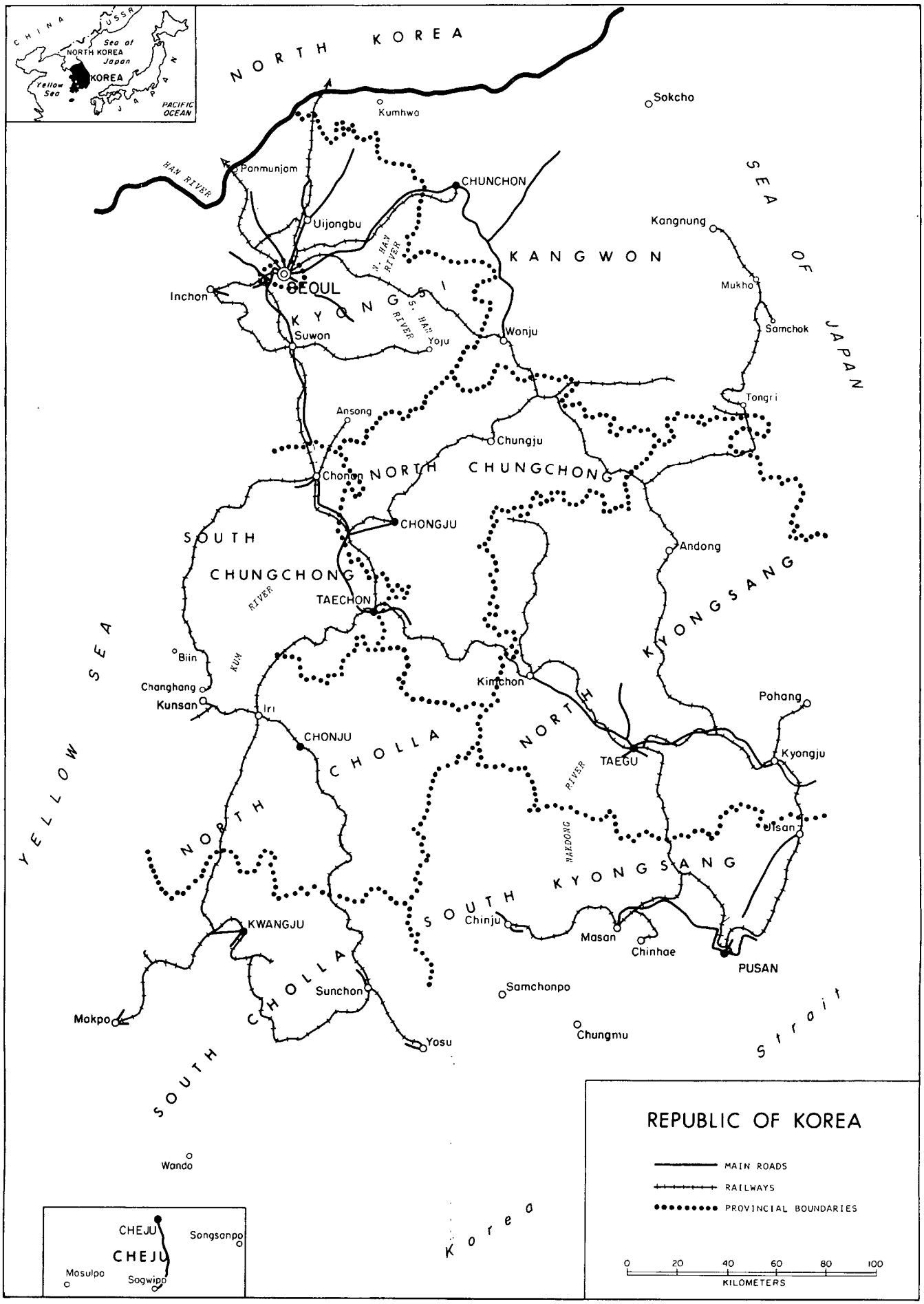
Net Inflow of Foreign Capital (in million US$)

	1965	1968	Jan. - Sept. 1968	Jan. - Sept. 1969
Grants	203	226	144	163
Loans	- 2	421	326	463
Direct Investment	- 3	20	16	12
Total	201	667	486	638

External Debt

Total outstanding external debt, with maturity of over 3 years (including commercial banks guaranteed and those without guarantees) on November 30, 1969, $2,166 million
of which undisbursed: $ 799 million

Total outstanding debt, with maturity of 1-3 years on September 30, 1969: $ 261 million



DECEMBER 1967

IBRD-1762R1

SUMMARY AND CONCLUSIONS

A. Factors of Accelerated Growth

1. Korea entered the final two years of the Second Five-Year Plan (1967-71) with a booming economy. All the major Plan targets for 1971, except in agriculture, were exceeded by 1969. Despite severe droughts, real GNP grew in 1968 by 13 percent, due mainly to the rapid expansion of manufacturing; it probably increased by over 15 percent in 1969 when agricultural production rebounded. With population growth declining, aided by the official family planning program, per capita GNP has risen noticeably in recent years, reaching about $190 in 1969.

2. The basis for Korea's fast economic progress has been the relatively stable political environment and the Government's firm commitment to economic development under the strong leadership of President Park. His victory in the recent referendum on a constitutional amendment will permit him to run for re-election for a third term in 1971.

3. The most important growth stimuli have been investment and exports. The investment rate in terms of constant prices reached 29 percent of GNP in 1968 and almost 32 percent in 1969, while exports increased by over 40 percent in 1967 and 1968, and by 33 percent in 1969. The rapid growth in exports has been particularly important in stimulating expansion in the manufacturing sector.

4. The very fast expansion of investment included intensified Government investment in power, transport and agriculture and private investment in manufacturing. These investments, while adding valuable productive capacity to the economy, had a multiplier effect on demand. Prices and real wages have risen and the trade gap has widened. Realizing the dangers of an overheated economy, the Government attempted to slow down investments in 1969. Curbs were put on private foreign borrowing and on private investments in construction and equipment. Gross fixed capital formation in 1969 increased by 27 percent as compared with 40 percent in 1968.

B. Development of Economic Sectors

5. After two consecutive drought years in 1967 and 1968, Korea enjoyed a bumper crop in 1969, with good weather and improvements in cultivation methods. The Government increased considerably the irrigation facilities under the "all-weather farming program". It increased its rice procurement price in 1968 and 1969 by a total of 40 percent, to stimulate production and increase the farmers' purchasing power. Progress in land consolidation and slopeland development was still relatively slow. Livestock development made good progress, but fisheries development was below expectations.

6. Manufacturing continued to be the leading economic sector with an average annual growth rate of 22 percent since 1965. Its share in GNP is now 25 percent as compared to 16 percent in 1965. Although still producing largely consumer goods, intermediate and capital goods production has speeded up. Progress has been particularly rapid in developing such intermediate goods industries as fertilizer, petrochemicals and petroleum refining. The Government has also undertaken measures to develop a local machinery industry. It has recently decided to build an integrated iron and steel mill with an initial capacity of 1,032,000 tons of crude steel.

7. The Government has overcome the power shortage, a major problem in 1967 and 1968, with a crash investment program in generating plant. There is, however, still a serious shortage in transmission and distribution facilities. Transportation continues to be a bottleneck but the situation has been improving with the expanding capacities of railways, roads and ports. The Government puts top priority on the construction of the national expressway system. The Seoul-Inchon expressway was completed by the end of 1968, and the 430 km Seoul-Pusan expressway is to be finished by mid-1970.

C. The Trade Gap

8. From 1964 to 1968 merchandise exports grew at the phenomenal average rate of 40 percent a year, with a sharp increase of 45 percent in 1968. During the first nine months of 1969 merchandise exports reached $460 million, 37 percent over the corresponding period in 1968. The slower growth in 1969 was due mainly to stagnation of textile exports, shortfall of plywood exports because of the decline in construction activity in the United States, flood damage to export industries, and the temporary suspension of fish exports to Japan. Diversification of export commodities has increased; three-fourths of them are manufactured goods. Over 50 percent of Korean exports now are purchased by the U.S., while exports to Japan have declined.

9. Despite rapid export expansion, Korea's merchandise trade deficit has increased in absolute terms. The main reasons for the import expansion were the high level of investment and the availability of and receptivity for foreign loans. Other factors were large grain imports because of the droughts and the easing of import restrictions since mid-1967. In 1969, because of some cooling off of the investment boom and measures to contain import expansion adopted by the Government (including higher advance deposit requirements and tighter import controls) merchandise imports are estimated to have increased by only 25 percent, as compared with 45 percent in 1968.

10. The large merchandise trade deficit was partly offset by a surplus in the services account resulting from the receipts from the UN forces in Korea and from the Korean soldiers and technicians in Vietnam. Receipts from Vietnam, including merchandise sales to the military forces, amounted to about $150 million in 1968, or 17 percent of total Korean export earnings. All told, the deficit on the goods and services account was $666 million in 1968 (60 percent increase over 1967) and $577 million in the first nine months of 1969 (16 percent over the corresponding period of 1968). For the whole of 1969 it is likely to be around $800 million.

D. Development Finance

11. During 1967-68, about one-half of the gross capital formation was financed by domestic savings, the other half by foreign savings. The share of domestic savings in gross capital formation increased appreciably to 58 percent in 1969. In that year, because of the higher GDP growth rate and increased agricultural income, the marginal savings rate rose to 26 percent from 23 percent in 1968. The average savings rate has increased steadily from 7 percent of GDP in 1964-65 to 17.3 percent in 1969.

12. As a result of tax reform and improvement in tax administration, public savings as a percent of GDP rose sharply from 1965 to 1968, when it levelled off. In 1969, public savings amounted to 6 percent of GDP. In contrast, private savings rose from 7.7 percent in 1968 to over 11 percent in 1969, largely in the form of increased stocks resulting from the good crops.

13. One of the most striking features in Korea's past economic growth has been the great surge in foreign loans extended to Korean private enterprises. Net foreign loans received the private sector rose by leaps and bounds from $16 million in 1965 to almost $400 million in 1968. The inflow of official grants has increased only slightly during the period, with the decline of U.S. grants compensated by the appearance of the Japanese grants. It amounted to $226 million in 1968. Foreign loans received by the Government and foreign direct investment have been rather small.

14. Since 1965, the large influx of foreign capital has been more than sufficient to cover the trade gap and foreign exchange reserves have grown. Net foreign exchange reserves, estimated at about $400 million at the end of September 1969, were equivalent to about 3 months' imports of goods and services.

15. The last economic report expressed apprehension about Korea's rapidly increasing external debt. In 1969, the Government tried to contain foreign borrowing. It stopped guaranteeing private loans, and limited the amount of private loans with a comparatively short period of maturity. As a result, loans with maturity of over 3 years contracted from foreign private sources increased by about 40 percent in 1969, as compared with over 200 percent increase in 1968. However, the rate of increase is still higher than should be sustained over any substantial period.

16. Total contracted external debt outstanding at the end of November 1969 was $2,427 million, including $261 million of loans with maturity of 1-3 years. Debt service, estimated at $67 million for 1968, amounted to 7.6 percent of export earnings. However, because of the large amount of commercial debt contracted in recent years, the debt service ratio is expected to increase sharply in 1970 or 1971, possibly approaching 20 percent.

17. One encouraging sign in external borrowing in 1969 was the sharp increase in loans from official sources. The amount rose from $83 million in 1968 to more than $220 million in 1969, thanks to the large loans from the U.S. ($120 million, largely for financing foodgrain imports) and from the Bank Group ($80 million, for financing irrigation, technical education and the Korea Development Finance Company). In spite of this increase, external official loans outstanding at the end of November 1969 still accounted for only 34 percent of total external debt contracted.

E. Problems and Prospects

18. The major problems facing Korea at the present stage of development are continuing inflation, a large trade gap and rapidly mounting external debt service. The root of these problems is over-investment. The long-term prospects for growth appear bright. At this juncture, however, curbs to temporarily reduce the rate of investment below the absorptive capacity of the country are required to achieve greater stability and improve long range prospects. The Mission therefore suggests that the Government should continue to exercise constraints on investment.

19. Government investments in recent years have been directed at correcting the imbalance between sectors, as evidenced by the step-up in investments in agriculture, power and transportation. The Mission expects in the coming years that the imbalance among sectors will continue to be reduced. But more attention should be given to the balance of investment within each broad sector. For instance, judging from the latest trend in demand for power and the existing investment program, there appears no need for new investments in generating capacity up to the mid-1970's. But investment in transmission and distribution is lagging. Because of

the declining world market price of rice, investment in large irrigation projects should be carefully considered. Improvements to the existing roads are probably more urgently needed than expressways, and this need should be reflected in the investment program.

20. Since it is necessary to keep the size of total investment within a certain limit in order to maintain economic and financial viability, a commitment of one project will necessarily preclude the inclusion of some other project(s). This is particularly true for large projects such as the integrated steel mill. In this connection, the Mission reiterates the general suggestion of the last mission, it is now time to be less "target minded" and more "cost conscious", and that great caution should be exercised in project selection and in the phasing of investments, based on benefit-cost evaluation.

F. External Financing Requirements

21. After careful examination of possibilities of future export growth, the Mission projects that merchandise exports can be expected to increase from $664 million in 1969 to $2,830 million in 1976, provided that the exchange rate will float as it is supposed to in accordance with future price changes.

22. The Mission has also made two sets of projections of the components of GNP, one based on a GDP growth rate of 9 percent, and the other 8 percent. The results show that with a 9 percent GDP growth rate the trade gap will be about $660 million in 1976. The Mission projects that net external loan capital requirements will be $530 million in 1976, and that to meet these requirements Korea will have to have $1,400 million gross inflow of external loans.

23. Based on the assumption that 20 percent of future net loan capital requirements will come on concessional terms, 25 percent on conventional terms, and 55 percent on commercial terms, the debt service ratio will reach 28 percent of export earnings in 1976. However, on the assumption of an 8 percent growth rate with the same export projections, the trade gap will be reduced to about $430 million and the net loan capital requirement will be about $275 million in 1976. The debt service ratio will be between 24 and 25 percent in 1976 and will reach a peak of 27 percent in 1980. The debt service ratio for debt of maturity over 3 years will be around 16 percent in 1976 and slightly higher in the peak year of 1980.

24. If a restrictive monetary policy is to be applied, or if the currency is devalued in the immediate future to offset the existing overvaluation and exemptions of import duties are substantially reduced, exports may be higher and imports may be lower than what we have projected. Also, if the amount of external official loans can be increased and that of commercial loans reduced with improved terms over what we have assumed, the debt service ratio can be further lowered to close to the 15 percent which the Korean authorities committed at the last Consultative Group Meeting. For controlling foreign borrowing, the Mission has also suggested the imposition of interest equalization tax.

25. In view of the good economic performance, large resource gap and the need to prevent debt service from mounting, Korea, with a restrained investment program and foreign commercial borrowing, should receive increased amounts of foreign capital from official sources. Conventional loans should be provided with a long grace period. In addition, because of its still low per capita GNP and the large resource gap, Korea should also receive a reasonable amount of official loans on concessional terms.

I

BACKGROUND

1. In 1969, the third year of the Second Five-Year Plan, except in agriculture, Korea has already exceeded all the major Plan targets for 1971. The GNP in real terms was 13 percent over the Plan's 1971 target. Because of a more rapid decline in the population growth than expected in the Plan, per capita in 1969 was 16 percent over, amounting to US$190 equivalent. Exports and domestic savings also exceeded their respective targets by a considerable amount. This remarkable performance has given the Korean Government and people great confidence in their ability to manage successfully their own economic affairs. Many foreign countries have provided finance for her development. Indeed, the total amount of foreign capital made available to Korea in 1969 was more than two and a half times that which the Second Plan had envisaged for 1971.

2. A basic factor in Korea's unprecedented rapid economic advance is her relative political stability and the Government's commitment to economic development, under the strong leadership of President Park Chung Hee. Mr. Park was re-elected in 1967 for a second four-year term, which coincided with the initiation of the Second Plan. He has been in firm control of the Government, with his ruling party holding a comfortable majority in the National Assembly. In October 1969, a national referendum was held on a constitutional amendment which permits an incumbent president to run for a third consecutive term. Opposition members boycotted the National Assembly when the proposal for the referendum was approved. As a result of the referendum which approved the amendment, Mr. Park is able to run for another term in 1971. The economic achievements under the Park administration and the fear of internal turmoil and economic decline if Mr. Park resigns (as he indicated he would) in the event that the amendment was rejected, appeared to have been the voters' most important considerations in endorsing the change.

3. Most likely the Government will continue to emphasize economic development. The prevailing political thinking in Korea is that strong and continuous political leadership is good for a developing country, and that the best way to compete with North Korea is by rapid economic development and improvement of people's living standards. The Government has already begun to prepare the Third Five-Year Plan. In spite of some short-term problems, the general political framework is undoubtedly conducive to economic growth. Moreover, Korea now has a young, dynamic and devoted corps of civil servants. The present arrangements of placing both the budget and the planning functions in the Economic Planning Board and of using the annual plan (Overall Resources Budget, ORB) to coordinate the plan implementation with the budget and to meet changing conditions continue to provide flexible planning machinery.

4. Rapid industrialization has brought about social changes, but the Koreans seem to adapt themselves fairly easily. For instance, the Government's family planning program has been gradually accepted by the people. Technical and vocational education has been speeded up, and the high literacy rate is beneficial to industry in obtaining trainable workers. However, the traditional emphasis on liberal arts in the whole educational system and in the attitudes of the parents has not shown much change. The rapid inflow of population to urban areas has intensified the housing shortage in the cities and, along with the rising cost of living, the labor movement has become more active, as evidenced by recent strikes in the textile and shipbuilding industries. The gap between urban and rural income, caused by a lag in agricultural development, has been partly corrected by the Government's price policy, but more fundemental improvement has to come from increasing agricultural productivity.

5. The last Economic Mission report commented upon the over-investment situation, the excessive external borrowing and the need for improving the balance of payments, and suggested more careful financial and investment management. The statistics for the full year of 1968 now show that 1968 indeed turned out to be a year of unusual expansion. During 1969 the Government has tried to reduce the overheating of the economy, but the twin problems of inflation and rapidly mounting external debt still persist. This points to the need for continuous efforts to control spending and foreign borrowing. We believe that with a determined effort the Korean Government can cope with these problems, provided that over-ambitious endeavours can be avoided.

Table 1

COMPARISON OF PLAN AND PERFORMANCE
(In billion won at 1965 prices)

	SFYP Plan for 1971	Performance in 1969 a/	Percent of Fulfilment	Adjusted (in 1969) Plan for 1971
GNP	1,170	1,302	113	1,508
Agricultural sector	397	366	92	424
Mining and manufacturing	314	339	108	455
Social overhead and other services	458	597	130	630
Consumption	1,002	1,090	109	1,232
Investment	233	447	192	387
Exports ($ million)	719	1,115	155	1,500
Imports ($ million)	962	1,954	203	1,861
Domestic savings	168	224	133	276
Foreign savings ($ million)	243	839	345	419
Per capita GNP (in thousand won)	36.1	41.8	116	46.5

a/ Preliminary; exports and imports are estimates of the Mission

Source: The Second Five-Year Economic Development Plan, 1967-71; Bank of Korea (BOK) national income statistics

II

THE GROWTH RECORD

A. The Over-all Picture

6. Korean economic growth has accelerated since the launching of the Second Five-Year Plan in 1967. The First Five-Year Plan recorded an average growth rate for GNP in real terms of 8.3 percent a year, thanks particularly to rapid industrialization after the monetary stabilization and the devaluation in 1964. The momentum of growth has accelerated since 1967, even with the setback to the agricultural sector by two consecutive years of drought. In 1969, with the increase of agricultural production by almost 11 percent, real GNP growth rate is estimated at 15.5 percent, as compared to 13.3 percent in 1968. Per capita real GNP has risen by about 6 percent annually on the average since 1962, reaching about US$190 1/ in 1969. Most of the targets of the Second Plan have already been reached. However, the high growth rate has created some imbalances and considerable strains in the economy.

7. The population growth rate, aided by the official family planning program, declined from 2.3 percent in 1968 to 2.2 percent in 1969. By the end of July 1969, about 1.1 million couples, which accounted for 28 percent of the women aged 20-44, participated in some phase of the program 2/.

8. Investment and exports continued to be the major factors in the rapid growth of the economy. The 40 percent increase in gross fixed capital formation, which brought the rate of fixed investment to GNP up from 23 percent in 1967 to 29 percent in 1968, was the main factor in the process of economic expansion. To overcome bottlenecks in the infrastructural services, investments in power and transportation continued to rise fast. Investments in irrigation (to redress the drought) and in manufacturing were also stepped up substantially. In 1969, with the Government's attempts to cool off the economy, fixed capital investment expanded at a more sustainable rate of 27 percent, with some levelling off of private building construction and equipment investment. Government investment, however, continued to expand rapidly, especially in highways, harbors and industrial

1/ Per capita GNP at current prices converted at a parity exchange rate.
2/ For details, see Appendix I.

estates. The rate of fixed investment at constant prices reached almost 32 percent of GNP. While the expansion in investment added considerable productive capacity to the economy, it also injected additional income into the demand stream. As a result, total public and private consumption, which increased by 9 percent in 1967, rose by 11 percent annually in 1968 and 1969. National savings, now at 16-17 percent of GNP, leaves a large resource gap to be financed by foreign capital.

9. Imports increased by over 40 percent in 1967 and 1968, and by 33 percent in 1969, thereby providing a stimulus to output, particularly in the industrial sector. However, over the three year period imports have also risen rapidly. In fact, the deficit in the current account of the balance of payments has widened. This reflects the high rate of domestic capital formation and the eagerness of foreign suppliers to sell in Korea. It accounts for the deterioration in the external debt position.

10. The heavy investment and rapid economic growth have led to considerable increases in price and wage levels. During 1967-69, the consumer price index rose by almost 11 percent a year, and the money wage of manufacturing workers at 23 percent a year.

11. The expansion of all economic activities has brought about an annual rate of employment increase from below 3 percent during 1962-66 to almost 4 percent in 1968 and perhaps the same rate in 1969. The ratio of unemployed to the labor force fell from 7.6 percent in 1962-66 to slightly above 5 percent in 1968. Rapid urbanization has begun to reduce the farm labor force, and a farm labor shortage at peak agricultural seasons has emerged. Also, while there is still some unemployment and underemployment within the unskilled labor force, the shortage of skilled labor has become more acute. This labor shortage and the rising cost-of-living explain most of the recent sharp rise in money wages.

12. The rapid industrialization has, in a short span of five years, led to a significant transformation in the economic structure of Korea. In terms of output, the share of the agricultural sector fell from 42 percent in 1964 to 28 percent in 1969, while that of manufacturing increased from 16 percent to 25 percent. In terms of employment, the share of the agricultural sector decreased from 62 percent to 53 percent, and that of manufacturing increased from 8 percent to 13 percent. This basic trend is likely to continue.

Table 2

GROWTH OF AGGREGATE EXPENDITURES, OUTPUT, CAPITAL AND EMPLOYMENT
(Annual rate of growth in percent at 1965 market prices)

	1962-66	1967-69	1967	1968	1969 a/
GNP	8.3	12.5	8.9	13.3	15.5
Consumption	6.1	10.8	9.4	11.2	11.2
Gross fixed capital formation	23.9	29.5	21.7	40.3	27.1
Exports of goods and services	26.2	36.8	41.4	41.6	33.3
Imports of goods and services	17.5	35.1	34.8	45.9	25.2
Gross fixed capital formation as percent of GNP	15.5	28.4	23.3	28.9	31.8
Ratio of gross fixed capital formation to GNP increase (ICOR)	2.0	2.5	2.8	2.5	2.4
Employment growth rate	2.9 b/	3.4 c/	3.0	3.9	
Unemployment as percent of economic active population	7.6 b/	5.6 c/	6.2	5.1	

a/ Preliminary
b/ 1963-66 only
c/ 1967-68 only

Sources: Bank of Korea (BOK), Economic Statistics Yearbook, 1969; Planning Board (EPB), Korea Statistical Yearbook, 1969.

Table 3

GROWTH AND STRUCTURE OF MAJOR PRODUCTION SECTORS
(At 1965 Prices)

	Annual Rate of Growth (%)						Composition (%)	
	1965	1966	1967	1968	1969 a/	1965-69 b/	1964	1969 b/
Output (Gross value added)								
Gross National Product	7.4	13.4	8.9	13.3	15.5	11.7	100.0	100.0
Agriculture	-0.9	11.0	- 5.5	1.2	10.7	3.1	41.9	28.1
Manufacturing	22.3	16.1	23.9	28.1	22.5	22.0	15.6	24.7
Electricity, gas and water supply	21.1	19.3	28.8	22.5	27.5	24.0	1.1	1.9
Transportation, storage and communication	18.4	17.2	21.0	24.7	21.0	20.0	3.6	5.3
Education	7.1	8.5	4.9	6.7	6.3	6.7	2.0	1.6
Capital Investment (Gross fixed capital formation)								
Total	26.0	62.0	21.7	40.3	27.1	35.0	100.0	100.0
Agriculture	28.2	69.4	-16.9	23.8	- 4.2	16.5	11.4	5.5
Manufacturing	36.2	102.6	4.1	24.1	18.8	33.5	24.0	22.8
Electricity, gas and water supply	-4.1	34.5	100.3	80.5	36.4	44.6	7.9	11.4
Transportation, storage and communication	22.9	95.2	44.1	32.2	41.4	45.2	21.0	30.6
Employment, total	3.8	1.6	2.9	3.9	n.a.	2.8	100.0	100.0
Agriculture	-1.7	0.3	- 1.8	- 1.2	n.a.	- .9	61.9	52.5
Manufacturing	19.6	7.0	21.7	13.2	n.a.	13.8	8.2	12.8
Economic overheads	27.2	-11.3	16.6	18.6	n.a.	7.0	4.5	6.2
Other services	6.9	5.4	3.4	6.8	n.a.	5.2	24.8	27.3

a/ Preliminary
b/ 1969 employment figures are not available, 1968 figures are used instead.

Source: BOK, Statistical Yearbook, 1969, and national income data

B. Agriculture[1/]

13. After two consecutive drought years, Korea enjoyed a record crop in 1969. While good weather was undoubtedly the major cause, an increase in planted area and improvements in cultivating methods were also contributing factors. Cereal production rose by 20 percent over 1968, and by 9 percent over the last record crop in 1966. Production of most other crops also increased.

14. Alarmed by the setback in agricultural production in 1967 and 1968 and the growing urban rural income gap resulting mainly from rapid industrialization, the Government hastened to take two major steps in agricultural development: the strengthening of the "all-weather farming program" and the increase of its rice procurement price. In 1969, the Central Government made a record budget appropriation for expenditure in the agricultural sector, totalling 48.3 billion won (not including the third supplementary budget)[2/], which was a 70 percent increase over 1968. The major item was capital expenditure, largely for investment in irrigation and land improvement to reduce the influence of weather on farm production.

15. Judging by the increase in planted area, the improvement in irrigation facilities under the all-weather farming program, and the increased use of chemical fertilizers, lime, pesticides, farm machinery, etc., performance in agricultural development has generally improved in 1969. However, consolidation progress has been somewhat below expectations and slopeland development, although considerably improved, has not regained the pre-drought (1966) level.

16. To stimulate production and to increase the farmer's purchasing power, the Government raised its rice procurement price by 17 percent for the harvest season in late 1968, and by a further 22.6 percent in 1969. Obviously, the rice price increases also raised the urban cost of living and contributed to the rise in the wages. Now that the rice price is substantially above the world level and the all-weather farming program is well under way, the direction in which future agricultural development strategy should move is an urgent decision to be made, particularly in connection with the recently introduced Ten-Year (1970-79) Rural Modernization Plan and with the Third Five-Year Plan. This question will be discussed in Chapter VI.

1/ For details see Volume II, Annex I

2/ The Third Supplementary Budget consists of only one item, i.e. 18.8 billion won of additional appropriation for purchases of grains under the Grain Management Account. See P.45.

17. Livestock, although its share in total agricultural production is still small, has progressed well in 1968 and 1969. Output of meat, poultry and dairy products in value-added terms increased by 11 percent in 1968 and 23 percent in 1969, reflecting a significant change in the Koreans' diet in favor of protein food. Pork, chicken and egg production has increased particularly rapidly. The development of beef cattle and the dairy industry is just beginning, and appears promising. The shortage of farm labor during peak agricultural seasons and soaring prices of cattle have stimulated the expansion of farm mechanization. The trend appears to be for power tillers to replace draft cattle and save farm labor for raising dairy cows on small farms. Mechanization will also shift feed sources from supplying draft cattle to supplying dairy cows. The development of the whole complex of the livestock industry is likely to have a significant impact on the future agricultural development.

18. Coastal and inshore fisheries suffered a setback in 1969 because of a cold tide, typhoon damages and a cholera epidemic. Laver production, mainly for export to Japan, was poor in 1969. Moreover, Japan has imposed import restrictions on Korean laver because 30 percent of Japan's coastal fishermen are harvesting laver. Korea has built and imported many tuna boats in 1969, and tuna production increased accordingly. However, the Korean tuna industry is now facing various problems, such as declined catch rate, shortage of qualified crews, and the rise in bait price. In addition, fishing companies are suffering from the high cost of boat construction and high debts to foreign tuna packing and trading firms. As a whole, fishery production in 1969 increased by less than 2 percent in value-added terms, as compared with an average of 14 percent during 1966-68.

C. Manufacturing 1/

19. Since 1965, value added at constant prices in the manufacturing industry has grown at a very fast rate of 22 percent annually, which is twice as fast as the GNP growth rate. With the associated similar rapid expansion in construction, power and transportation, it has played a leading role in Korea's phenomenal rate of industrialization and economic growth. In 1969, the manufacturing output growth slowed down from the exceptionally high rate in 1968, but it still maintained the average growth rate of the past five years.

1/ For details, see Volume II, Annex II

20. The manufacturing industry produces largely consumer goods, although their share in the total output has declined gradually from 63 percent in 1965 to 58 percent in 1968. In the consumer goods field, Korea had already achieved a high degree of import substitution in the First Plan period; therefore very little progress has been made in this regard since then. The fairly rapid growth of consumer goods production (23 percent annually during 1965-69) has been due to the expanding export market as well as the rising domestic demand. About 75 percent of Korea's exports are manufactured goods, of which 60 percent are consumer goods. The rising standard of living of the Korean people has increased private consumption of manufactured goods[1/] by as much as 16 percent yearly, as compared with a 9 percent increase for all private consumption.

21. The growth rate of intermediate and capital goods production has been even faster than consumer goods in the last 5 or 6 years (about 30 percent annually for 1965-69). This growth can be explained both by the rising domestic demand and import-substitution. The rapidly rising demand for capital and producer's goods is indicative of the tremendous expansion of domestic fixed capital formation since 1965. However, Korea has depended heavily on foreign sources for capital goods. At present, imported capital goods account for three-fourths of the capital goods supplied to the domestic market. The dependence has been encouraged by tax and credit concessions, and the availability of suppliers' credit on favorable terms (as compared with domestic borrowing). The domestic capital goods industry is rudimentary and in quality, price and speed of delivery domestically produced capital goods are less attractive than imported ones to Korean investors. The Government and the industry itself should examine the prospects carefully to determine what the most profitable investment opportunities are in the production of producer's goods. In the examination, the economic costs involved in saving foreign exchange by import-substitution, and the comparison of these costs among the various branches of the industry, should be studied.

22. Since the last Economic Mission suggested the possibility of developing the machinery industry, the Korean Government has implemented measures to encourage some machine-making branches by providing credit on reasonable terms, and protection through import restrictions. A thorough pre-investment study of future possibilities in this area is needed.

1/ Including beverages, clothing and other personal effects, furniture furnishings and household equipment.

23. Korean manufacturing industry also depends greatly on imported materials and intermediate goods. The proportion of value-added is small. There are good prospects for developing backward linkages and, in fact, Korea has made progress in this direction, particularly in the fields of chemicals, fertilizers, and refined petroleum. However, in the production of many intermediate goods, an economical operation would require a scale exceeding the size of Korea's domestic market. In a number of recently constructed industrial plants in the field of plastics, synthetic fibers, etc. (and also passenger car assembly), the scale was below optimum and the production costs are much higher than the international level. To overcome this limitation in the petro-chemical industry, Korea has entered into a market sharing agreement with the Republic of China, under which China will import Korean caprolactam and Korea will import China's DMT.

24. In line with the suggestions made at the last meeting of the Consultative Group, the Government dropped the original plan for a 600,000 ton steel plant and produced plans for an integrated mill with an initial capacity of 1,032,000 tons of crude steel and provision for expansion to 2 million tons and ultimately to 5 million tons. The total financial cost of the project (excluding infrastructure costs and including interest during construction on foreign funds) comes to about $251 million, of which the foreign cost component is about $156 million. We understand that the Japanese Government has agreed to provide $123.7 million for the foreign cost, of which $73.7 million will be on concessional terms and $50 million from the Japanese Export-Import Bank on commercial terms. This would leave a gap of about $32 million in foreign requirements to be met from other sources. A Bank steel mission reviewed the proposal and concluded that the economic rate of return on the investment in Stage I of the project would be inadequate; it would improve substantially if Stage II were implemented in response to an increase in demand for the company's products[1/].

1/ IBRD, Industrial Projects Department, Pohang Iron and Steel Company Limited: Project Evaluation, December 29, 1969. This report has been circulated to members of the Consultative Group on Korea.

D. Infrastructure

25. The rapid increase in the power and transportation sectors has supported the growth in production. Such infrastructure industries with high capital-output ratios require heavy investment. While the value-added for public utilities and transportation services rose by over 20 percent annually from 1965 to 1968, the fixed capital investment in these two sectors rose by over 45 percent a year. Typically, these infrastructure industries account for a large portion of total investment (48 percent of total fixed capital formation in 1968), but contribute directly only a very small portion to GNP (7 percent in 1968). This is very important to make correct projections of the future needs for infrastructural services, so as to avoid bottlenecks on the one hand and over-investment on the other.

Electricity 1/

26. Electricity consumption has increased at over 20 percent a year in the past decade. The power shortage experienced in 1967 and 1968 prompted the Government to step up investment in generating capacity and as a result fixed capital investment in the power sector doubled in 1967 and rose by 80 percent in 1968. Meanwhile, several Government agencies were asked to make forecasts, several projecting a higher demand than the pre-drought forecasts made by the Korean Electricity Company (KECO). Recent developments, however, indicate that the lower projections may be adequate.

27. If the lower forecast is correct, then under the present Government's power investment program more than sufficient generating plant is now in the "pipeline" to meet power demands up to 1976-77 and no further generating plant need be planned until 1973-74 for commercial operation in 1977-78.

28. By mid-1969 the country had a total generating capacity of about 1,900 MW, of which the predominantly Government-owned Korean Electricity Co. (KECO) had 1,629 MW (which supplied over 80 percent of electricity). The planned generating program was to increase the installed capacity to 6,633 MW in 1974 and 9,433 MW in 1976 (excluding captive plant). Based on the forecasts considered by the Mission to be realistic, the amount of generating capacity to which the Government is committed, and which is now expected to be commissioned by 1974 to bring the total installed capacity up to about 6,430 MW, could be sufficient to meet the most likely peak demand for 1976 with a spare capacity margin of about 34 percent. Thus, some

1/ For details, see Volume II, Annex III

postponement of investment in the KECO generating program and in private generating stations should be considered.

29. On the other hand, however, there is a great shortage in transmission and distribution facilities which prevents the full utilization of electricity generated. Investment in this field should be carried out as planned by KECO.

Transportation

30. Domestic passenger and freight traffic increased at a rate of 15.5 percent a year between 1965 and 1968. In passenger transportation, motor vehicles have taken over the lead from the railroads since 1965, whose share in total passenger/kilometers fell to 42 percent in 1968. In freight transportation, the railroads have continued to play the major role, expanding in terms of ton/kilometers at 11 percent a year in the last 4 or 5 years. In 1968, the railroads transported almost three-quarters of the total freight in ton/kilometers. Although the freight volume carried by motor vehicles increased by about 20 percent annually, it still accounts for only about one-tenth of the total freight traffic. Motor freight transport is used mostly for short hauls. Coastal shipping is taking an increasing portion of bulk freight traffic; in 1968 it accounted for 15 percent of domestic freight traffic, as compared to only 4 percent in 1964.

31. Highway construction was given low priority in the First Plan. In line with the recommendations of a Bank-financed Transportation Survey, the Government greatly increased the allocations for highway construction in the implementation of the Second Plan. However, most of these funds were allocated to the construction of the Seoul-Inchon and the Seoul-Pusan four-lane toll expressways, rather than to improvements on the existing network, of which less than 10 percent is paved. The 30 km Seoul-Inchon expressway, partially financed by a $6.8 million ADB loan, was opened to traffic in December 1968. The Seoul-Pusan expressway (total length 430km) is to be completed by mid-1970.

32. The number of registered automobiles more than doubled between 1965 and mid-1969, with cars and buses increasing faster than trucks. The establishment of local assembly plants, import liberalization for

parts, and the Government's permission for installment purchases of cars have been the major factors in the rapid increase in automobiles. However, with an average highway length of 360 meters (including unpaved) per square km of land area and 300 persons per automobile[1/], road transport is still inadequate.

33. Korean National Railroads have lengthened their track from 4,780 km in 1964 to 5,360 km in mid-1969 by expanding the connections with the North-East coastal area where the bulk of the mining industry is located and by building a double-track on the crucial Seoul-Pusan line. Dieselization of locomotives and the expansion and modernization of rolling stock have progressed well, with external financial assistance from the Japanese Property and Claim Funds, USAID, and IDA. In the last five years, the number of diesel engines more than doubled and the freight car rolling stock increased by over one-third, although the number of passenger cars increased only slightly. Due to persistant strains on the railway capacity, the Government has continued to apply a priority system and has prohibited freight traffic by rail over distances of less than 50 km, except for coal.

34. Along with the increased foreign trade and maritime traffic, Korea's ocean going fleet has been expanded from 117,000 GT in 1964 to 633,000 GT in mid-1969, of which 385,000 GT are cargo vessels and 248,000 GT oil tankers. Coastal vessels now total about 1,800, with a gross tonnage of 156,000, as compared with over 1,400 vessels with a 70,000 GT in 1964. Coastal shipping is handicapped by the poor port facilities and the small size and obsolescence of most vessels. At present, freight rates appear to favor the railroads, although bulk freight traffic is a major bottleneck in rail transport and some of it could be shifted to coastal shipping.

35. Passenger air traffic has expanded very rapidly in the last 2 or 3 years, particularly on domestic lines. The Government-owned Korea Airlines (KAL) was sold to private interests in late 1968. Its domestic network is being serviced more frequently and its international operations now extend beyond Japan to South-East Asia.

1/ In 1966, Thailand and the Philippines had 114 and 107 persons respectively per automobile. The Philippines had an average length of highway of 191 meters per square km of land area.

III

EXTERNAL TRADE

A. Recent Performance

Export Expansion

36. Export expansion has been a major factor in Korea's rapid economic growth. During 1964-68, merchandise exports increased at an average rate of 40 percent a year, with 45 percent in 1968. In the first nine months of 1969 the rate of expansion of merchandise exports slowed down to a 37 percent increase over the same period in 1968.

37. The buoyant exports in 1968 were mainly due to the booming U.S. market; to meet the rising demand there, Korea's exports of wigs, clothing, electrical and electronic appliances and plywood rose sharply. Total exports to the United States increased by over 70 percent in 1968. Also, the scheme of bonded processing for exports has become increasingly important for promoting exports. In 1968, almost 20 percent of the total export value came from the bonded area, as compared with less than 10 percent in 1965. Bonded processing is predominant in electrical and electronic appliances with foreign (largely US) investment, but is also considerable in clothing and the still minor non-electrical machinery exports.

38. In the first nine months of 1969 the major disappointment was the performance of textile exports; although exports of woven cotton fabrics rose moderately, other textile exports declined, with the result that this major export category barely maintained its level of the corresponding period a year ago. With a total of only $46 million of textiles exported by the end of September, it is unlikely that the $111 million target set for the whole year would have been met. Also, exports of food items slowed down, partly because Japan, the major customer, suspended fish imports following a cholera epidemic in Korea and partly because of stagnant exports of fruits and vegetables. Other major exports - clothing (now the largest export item), plywood, electrical and electronic appliances, and some minor items such as tobacco and metal manufactures - still increased during the first nine months of 1969 at high rates ranging

from 45-100 percent over the same period in 1968, but all were slower than the rates of increase in 1968 over 1967. Exports of miscellaneous manufactures (largely wigs) accelerated. Sales to military forces in Vietnam lagged behind last year's level. Several unfavorable factors also became evident late in 1969. The slump in U.S. construction activity following the tight money policy began to affect Korea's plywood exports which, for 1969 as a whole, may fall short by 20 percent of the $100 million target. Korean raw silk exports felt the pressure of heavy cheap exports from mainland China. The autumn floods caused extensive damage to the bonded factories in the Pusan-Ulsan area.

39. While flood damage and the cholera epidemic are only temporary impediments, other factors tend to have some lasting effects. The rate of growth of those exports which already account for a large share of imports into the United States may be adversely affected by any slowdown in the growth rate of the U.S. economy. In this regard, the growth in raw silk exports (which account for about 40 percent of U.S. raw silk imports), plywood (20 percent), human hair products (5 percent) and electric lamps and bulbs (5 percent) could be reduced by a fall in the growth of U.S. demands. The importance of trends in the U.S. economy is heightened by the fact that several of the commodities that go to the U.S. market account for a very large share in total exports of Korea. Approximately 90 percent of the human hair and wigs, the plywood and the footwear exports, 70 percent of the electrical machinery exports and 60 percent of the clothing exports from Korea are sold in the United States. Any decline in the U.S. demand for these commodities can have considerable effects on Korea's total export earnings. Until the U.S. economy resumes a reasonable rate of growth, Korea may find it difficult to maintain the high export growth rate experienced in the recent past. This points once again to the need for market diversification, for in constrast to the successful commodity diversification, Korea's exports have become increasingly concentrated on the U.S. market which purchased over one-half of her total exports in 1968, as compared with over one-third in 1965.

40. A natural market for Korean exports would be the nearby largest industrial country - Japan. However, Korea's exports to Japan, as a share of total Korean exports, have declined from 25 percent in 1965 to about 20 percent during the first nine months of 1969. This intensified Korea's serious problem of trade imbalance with Japan which reached an alarming amount of over $500 million in 1968 in favor of Japan (larger than Korea's total exports in 1968). Recently, the Japanese Government has made some attempts to liberalize its import trade on a multilateral basis,

and Korea is expected to benefit. Furthermore, following basically a Korean proposal, Japan has selected eleven import items on which the Japanese import duty is not levied on the value of the goods but rather on the added value. This regulation became effective on April 1, 1969 and applies to those items for which the raw materials and intermediates have been imported from Japan and processed in a foreign country under a consignment sale contract. The list includes electronic parts, refrigerator parts, etc. Although this arrangement is extended to all countries, the main beneficiaries will be Korea and the Republic of China. Among primary exports, there appear to be possibilities for Korea to export some food items with large labor content and high income elasticities to Japan, such as meat and marine products, vegetables and fruits.

41. The depressed textile exports will have additional difficulties if further restrictions are applied by the major importing countries, particularly the United States. Even a recovery of the U.S. economy may not provide a solution to the problem that is satisfactory to Korea.

Import Trends

42. Since 1964, when the Korean economy began to surge ahead, merchandise imports have increased as rapidly as merchandise exports. This is because Korea has a rather poor resource base and a high import content in its manufacturing industry. The 47 percent increase in imports in 1968 was particularly steep. It is true that the droughts in 1967 and 1968 necessitated larger grain imports, but the increase in grain imports accounted for only 8 percent of the total import increase of $667 million. It is also true that since July 1967, import restrictions had been gradually liberalized, particularly for consumer goods, but the increase of non-grain consumer goods imports in 1968 was only 5 percent of the total import increase.

43. The main reasons for the 1968 import boost is clearly the high level of investment and the liberal amount of foreign loans. Imports of machinery and other capital goods continued their sharply rising trend and increased by 72 percent in 1968; their increase accounted for one-third of the total import expansion. Their share in gross domestic fixed capital formation increased continuously from 17 percent in 1965 to 37 percent in 1968, reflecting both the substantial expansion in domestic investment (especially in manufacturing, power and transportation), and Korea's heavy reliance on foreign capital goods and foreign finance.

44. Imports of raw material and intermediate goods, the largest commodity group on Korea's import bill, have been rising constantly with growing industrialization, but their share in total imports declined from over two-thirds in 1965 to one-half in 1968. The absolute amount of the

Table 4

CHANGES IN EXPORTS AND IMPORTS

Commodity Group	Growth Rate (%) Annual Average 1964-68	Growth Rate (%) Jan-Aug 1969 over Jan-Aug 1968	Composition (%) 1964	Composition (%) 1968 a/	Amount (in million US $) 1964	Amount (in million US $) 1968	Amount (in million US $) Jan.-Sept. 1969
Exports (f.o.b.)							
Food	14.0	9.9	22.2	9.8	26.4	44.5	35.6
Raw materials	17.1	18.5	28.5	14.0	34.0	63.9	51.3
Manufactures	55.0	40.8	49.0	74.3	58.3	338.2	334.3
Others	22.0	68.3	0.3	1.9	0.4	8.8	10.6
Total	40.0	35.2	100.0	100.0	119.1	455.4	431.8
Imports (c.i.f.)							
Consumer goods	29.0	57.5	18.5	14.3	75.0	208.3	236.0
(Grains)	(21.0)	(54.9)	(15.0)	(8.8)	(60.8)	(129.3)	(157.5)
Raw materials and intermediate goods	29.0	33.6	64.3	49.3	259.9	721.6	626.1
Machinery and equipment	67.0	17.1	17.2	36.4	69.5	533.0	447.2
Total	38.0	30.8	100.0	100.0	404.4	1,462.9	1,309.3

a/ Excluding sales of military goods to Vietnam

Source: See Tables 3.2 and 3.5 of the Statistical Appendix

Groupings: Exports: Food, SITC 0; Raw materials SITC 2-4; Manufactures SITC 5-8 Others SITC 1, 9
Imports: Consumer goods SITC 0, 1, 8 9; Raw materials SITC 2-6; Machinery and transport equipment SITC 7; Grains SITC 04

increase in 1968 was also considerably smaller than that of capital goods. In this group, imports of wood and lumber for plywood production, of synthetic fibers, regenerated fibers and wool for clothing and sweater manufacturing, all mainly for the export market, increased most sharply. Crude oil imports also rose rapidly, owing to the expansion of domestic oil refining capacity and the Government's fuel policy of shifting from coal to oil. Fertilizer imports, however, declined drastically with growing domestic production.

45. Only a modest portion of the imports of raw materials and intermediate goods have been used for making export commodities. In 1968, out of $722 million of these imports, only about $212 million (or 28 percent of the total) were used for making exports; the rest was used directly or indirectly for domestic consumption, except a small portion (10-15 percent) for investment. A recent Korean study shows that total imported inputs (excluding capital cost) accounted for one-third of total merchandise exports in 1966[1/]

46. Realizing the over-investment and over-import situation, the Government decided to slow both down in 1969. In the ORB, merchandise imports were planned to increase by 13 percent in 1969 up to $1,450 million (estimated on c.i.f. base). However, for the first nine months of 1969, actual imports showed a 31 percent increase over the comparable period of 1968. This still represents a noticeable slowdown in import expansion as compared with the same period in 1968.

47. A major factor in the import slowdown during 1969 has been a sharp decline in the rate of expansion of capital goods imports, which increased by only 15 percent during the first nine months of 1969 over the same period in 1968. To a large extent, this reflects the Government's efforts in slowing down investment and in restricting private suppliers' credits. On the other hand, imports of raw materials and intermediate goods increased by 35 percent, and consumer goods imports by 48 percent. Consumer goods imports were also the largest in absolute terms, due mainly to substantial foodgrain imports to make up for the poor crop in 1968, the bulk of which was available for consumption in 1969.

48. Japan has become Korea's largest supplier in recent years, following the normalization of relations with Korea and the subsequent considerable expansion of Japanese loans to Korea. Imports from Japan in the first nine months of 1969 accounted for 46 percent of the total, as

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1/ Korea Trade Research Center, Review on Measures to Increase Net Foreign Exchange Earning from Export

compared with 36 percent in 1965. In addition to large purchases of capital goods and transport equipment, imports from Japan of raw materials, especially synthetic fibers, have also risen considerably. The United States, Korea's main supplier in the early 1960's, now ranks second with around 30 percent of total imports. Imports from other countries are still relatively minor. However, there has been a sharp rise of imports from the Federal Republic of Germany lately.

The Trade Gap

49. During 1966-68, imports increased as rapidly as exports, and exports as a percentage of imports has hardly improved. During the first nine months of 1969, the ratio of exports to imports improved moderately to 39 percent, as compared with 36 percent in the corresponding period of 1968. Since imports are much larger than exports, the merchandise trade gap in absolute terms has widened continuously.

50. The large merchandise trade deficit has been offset to some extent by U.N. military expenditures in Korea, which have increased quite rapidly during the past 4 or 5 years. The balance of other services, however, has shown small deficits. All counted, the deficit on the goods and services account in 1968 increased alarmingly by 60 percent to $666 million. During the first nine months of 1969, the situation improved somewhat. The deficit increased only by 16 percent, and the percentage of the total receipts to total payments of goods and services rose moderately to 59 percent. However, as Table 6 shows, this ratio has been very stable at about 60 percent over the last 5 years.

51. It is clear that, whilst Korean exports have performed remarkably well, it will take a fairly long time for the economy to achieve a viable balance in the goods and services account. This is particularly so because after the partition of the country the development of the Korean economy started with a large trade deficit and poor resource base. Owing to the dependence on imports, export performance should not be viewed in isolation in terms of its own rate of increase, but should be considered together with imports. Table 6 gives the growth rates for both exports and imports of goods and services and the ratio between these two rates. To improve the balance of payments, it is important to maintain this ratio as much as over 1; to increase exports alone is not sufficient.

Table 5

BALANCE OF PAYMENTS: GOODS AND SERVICES ACCOUNT
(In million US dollars)

	1964	1965	1966	1967	1968	Jan.-September 1968	Jan.-September 1969
Receipts	211	290	455	643	880	612	812
Goods (f.o.b.)	119[a]	175[a]	250[a]	335	486	336	461
Military expenditures	64	74	101	163	217	154	190
Other services	28	41	104	145	177	122	161
Payments	-432	-484	-778	-1,060	-1,547	-1,107	-1,389
Goods (f.o.b.)	-365	-416	-680	- 909	-1,322	- 945	-1,182
Services	- 67	- 68	- 98	- 151	- 225	- 162	- 207
Trade Gap	-221	-194	-323	- 417	- 666	- 496	- 577
Goods	-246	-240	-430	- 574	- 836	- 610	- 721
Military expenditures	64	74	101	163	217	154	190
Other services	- 39	- 27	6	- 6	- 48	- 40	- 46
Receipts as % of payments	48.8%	59.9%	58.5%	60.7%	56.9%	55.3%	58.5%
Goods only	32.6%	42.1%	36.8%	36.9%	36.8%	35.6%	39.0%

a/ Exports to military forces in Vietnam are excluded; they are, however, included in "services".

Source: Statistical Appendix Table 3.8

Table 6

EXTERNAL TRADE PERFORMANCE

	1965	1966	1967	1968	Jan.-Sept. 1969 over Jan.-Sept. 1968
A. Growth rate of receipts from exports of goods and services (%)	37.4	56.9	41.3	36.8	32.7
B. Growth rate of payments for imports of goods and services (%)	12.0	60.7	36.2	45.9	25.5
C. Comparative growth of exports and imports (= A ÷ B)	3.11	0.94	1.14	0.80	1.28
D. Percentage of receipts to payments for goods and services (%)	59.9	58.5	60.7	56.9	58.5

Source: Mission calculation, based on data in Table 5.

52. In this connection, greater importance must be attached to slowing down the import growth rate. This is particularly necessary if receipts from Vietnam are going to decline substantially. These receipts, including sales of goods and services offered, remittances from Korean forces and civilians stationed in Vietnam and non-merchandise insurance, amounted to about $153 million in 1968 (or 17 percent of total export earnings), which is a less than 10 percent increase over 1967.

B. Trade Policy Problems

53. Whether the balance of payments will be improved quickly depends very much on the Government's trade policy. The Korean Government is following the strategy of "export first" in its development planning, and it will continue to do so in the Third Plan. The Government has also been encouraging import-substituting industries. The question, however, is whether all the policy measures adopted, taken together, are really operating efficiently to achieve the policy target. Indeed, since the devaluation and the adoption of the floating exchange rate system, further monetary and trade developments have accumulated to a point where a re-examination of the trade policy measures is needed.

The exchange rate and export incentives

54. A fresh look at the monetary and trade picture may conveniently begin with the relationship between costs and prices in the export and domestic (including import-substituting) sectors, and the exchange rate. When the floating exchange rate system was introduced, the underlying idea was to let the exchange rate adjust itself to the changing monetary and trade position, thus bringing about a better balance in the international accounts. However, since 1965 consumer prices and wholesale prices of consumer goods in Korea rose by 23 to 38 percent (up to September 1969) more than those in the United States and Japan, whereas the exchange rate depreciated by only 6 percent. The rise in Korean general wholesale price index in relation to those of the U.S. and Japan was much lower than other price indices. But this was due mainly to the influence on the wholesale price index of imports of producer goods and therefore is not appropriate for this comparison. Comparing the absolute prices of 34 international

Table 7

INDICATORS OF PRICE-COST STRUCTURE
(Indices: 1965=100)

		1966	1967	1968	Sept. 1969
	A. Price and wage indices in Korea				
Wholesale Prices:	All commodities	109	116	125	125
	Producer goods	108	111	117	121
	Consumer goods	109	119	131	144
Import Prices:	Wholesale	102	104	103	109
	Unit value of imports	98	99	98	96 a/
Export Prices:	Unit value of exports	109	114	118	113 a/
Wages:	Monthly earnings	117	144	177	199 b/
All urban consumer prices		111	123	137	152
Exchange rate (won per $1)		100	101	104	106
	B. Price and wage indices in USA and Japan				
USA:	Wholesale prices	104	104	106	111
	Consumer prices	103	106	111	117
	Wages: hourly earnings	105	108	115	120 b/
Japan:	Wholesale prices	102	104	105	109
	Consumer prices	104	109	115	124
	Wages: monthly earnings	111	122	138	148
	C. Relative movements				
Relative change in wholesale prices:					
	Korea over USA	105	112	118	113
	Korea over Japan	107	112	119	115
Relative changes in consumer prices:					
	Korea over USA	106	112	118	130
	Korea over Japan	107	113	119	123
Relative changes in wage rates:					
	Korea over USA	111	133	159	166
	Korea over Japan	105	118	128	134
Korean wholesale prices of consumer goods:					
	over USA wholesale prices	105	114	124	130
	over Japan wholesale prices	107	114	125	133
Korean over world market prices of 34 internationally traded commodities (simple arithmetic average)		n.a.	n.a.	146	n.a.

a/ August
b/ January-March

Source: BOK, Monthly Economic Statistics; IMF, International Financial Statistics and Statistical Appendix Table 9.2

traded commodities in Korea and in the world markets, the Korean prices on the average were 46 percent higher in 1968. Since 1965, the rise in the Korean money wage rate was 34 percent greater than in Japan and 66 percent greater than in the U.S. Thus, if the exchange rate had been allowed to reflect this changing international price relationship (resulting mainly from inflation in Korea) the exchange rate in September 1969 probably would have been somewhere between 330 to 390 won per dollar. However, the exchange rate then was only about 290 won per dollar.

55. The over-valuation of the currency has exerted pressure on the profitability of export, particularly because the money wage rate has doubled since 1965, while the unit value of exports in terms of dollars has risen by only 13 percent, or, given the 6 percent currency depreciation, the unit value in terms of won has risen by 19 percent. Despite this unfavorable price-cost relation, exports have increased rapidly during the interval. This increase is due mainly to the array of incentives offered to the export sector. As analyzed in the last economic mission report, the most important export promotion measures have been tax and credit concessions[1/]. The sum of these concessions, as estimated by the last economic mission, amounted to 38 won per one dollar of exports in 1965, and 62 won in 1967. Subsequently, a similar Korean estimate came out with almost the same results, with the figure of 82 won per dollar for 1968. Adding this to the prevailing exchange rate in 1968, we get an effective exchange rate for exports at about 360 won per dollar. Thus, by offering all these fiscal and credit concessions, Korea has been able to maintain the competitive position of its exports.

56. But how long can the increase in concessions continue? In past years, the Government was able to raise these concessions to offset the increasing erosion of the exchange value of the currency by (a) a gradual extension in the scope and amounts of the concessions, and (b) general increases in domestic taxes and customs duties which made stronger tax concessions to the exporters. It seems now that the concessions

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1/ The concessions include (a) exemptions of business tax, commodity tax and customs duties on imported raw materials, and (b) reduction by one-half of income and corporate taxes. Credit incentives include (a) cheap credits for export production and importation of raw materials for export production at 6 percent interest rates as against the market interest rate of 24-26 percent, and (b) cheap medium- and long-term credits for financing machinery and equipment imports for export production at 6.5-7.5 percent interest rates.

offered have already approached the maximum limit, and any further concessions will have to go into the negative zone of subsidies. Complaints are often heard that exports give very small, if any, profit margins which have to be compensated by high profit margins from sales to the domestic market. After the Mission left, the monetary authorities devalued the won by 4.5 percent from 292 won per dollar to 305 won per dollar in November. This appears insufficient, but the mechanism of the flexible exchange rate system provides ample room for the Government to take further action.

Import-substitution

57. The picture of production for the domestic market is much less clear and more complicated. In general, one can observe that the production of consumer goods appears much more profitable than the production of producer goods. The relative profitability of these industries is closely related to the trade policy. From 1965 to September 1969, while wholesale prices of consumer goods rose by 44 percent, those of producer's goods rose only by 21 percent, largely because imports of consumption goods have been restricted and imports of producer goods encouraged. In fact, wholesale prices of imported goods during this period rose only by 9 percent, and prices of many raw materials did not rise at all. This was due to the fact that world market prices of such raw materials (largely processed) have been stable (as indicated by the unit value index of Korean imports) and the exchange rate has changed very little. Furthermore, tariffs have been exempted for a large part of raw materials imports. Of course, the privilege of tariff exemptions applies in principle only to materials imported for export goods production. But it appears that there is a shift of these imports into the production of goods for the domestic market. First of all, the standard coefficients used in calculating the needs of imported materials for making export goods, have been quite liberal; moreover, the actual coefficients applied appear to allow further margins of wastage. Furthermore, it appears that producers (or importers) try to import the largest possible amount of goods entitled to duty exemptions, even if they do not actually use these goods for making exports.

58. To the extent that they can manage to use such duty - free imported materials for making goods for sale on the domestic market they can obtain a very high profit margin. If the producer is supplying both export and domestic markets, the high profits derived from domestic sales can offset the low profits from export sales. This distorted price relation gives a strong incentive for businessmen to try to import as much foreign material and intermediate goods as possible and obtain as much duty exemption as possible, at the expense of using scarce

foreign exchange and reducing Government revenue. Thus, while custom exemptions play a powerful role in promoting exports, they are also very costly to the economy. This may be one of the reasons why Korea's balance of payments structure is still not improving very much despite the high export growth rate. 1/

59. The cost of export promotion does not end here. The resulting comparatively low prices of raw materials and intermediate goods and to a lesser extent, capital goods, have greatly discouraged the development of import-substituting industries in these categories. The burden of protecting such industries has fallen almost entirely on quantitative import restrictions. But usually such protection is only applied to new and large industries, such as fertilizer, petrochemicals and automobiles. Only recently has it been used for the machinery industry. Restrictions have been applied in a piecemeal manner, thereby adding to the complexity of the whole control-incentive system. Also, they are not like a change in the exchange rate which provides general encouragement to all industries with a potential for import-substitution.

Import Policy

60. Since 1965, quantitative restrictions were relaxed gradually until mid-1968. Alarmed by the rapid expansion in imports, the Government began to tighten import controls in mid-1968. The number of restricted items has been substantially raised, while the number of items that are automatically approved has been reduced. By August 1969, out of the 1,312 SITC items, 525 were on the restricted list (386 in December 1967) and 713 on the automatic approval list (810 in December 1967). Items on the restricted list consist largely of consumer goods which can be produced locally, but the list also includes meat and dairy products and some special metal goods. In the import plan for the second half of 1969, three basic automatic approval items, namely crude petroleum, partly refined petroleum, and regenerated fiber yarn were placed on the restricted list while some inorganic chemicals were placed on the prohibited list. In addition, some machinery including textile machines and wood working machine tools, stainless scrap and sheets, and musical instruments, were put on the restricted list. Among automatic approval items, some

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1/ Furthermore, the granting of the privileges to the exporters to import some prohibited or restricted imports adds indirectly to a high foreign exchange content of exports.

are now subject to the Government's prior approval for special reasons. The number of these items was increased in December 1968, to include commodities imported from countries whose trade balance with Korea have been excessively unfavorable. Imports of certain kinds of machinery, transport equipment and miscellaneous manufactured articles are affected by this restriction. This new measure was also designed to protect Korea's lagging domestic machinery industry.

61. In addition to quantitative import restrictions, the Korean Government raised the advance deposit requirements in mid-1968 to contain import expansion. These have been applied chiefly to imports bearing custom duties over 30 percent. Most of these requirements were raised again in early 1969, with more restrictive requirements on imports from "Specified Regions"[1/].

1/ In July 1968, the Government raised the advance deposit requirement ratio from 100 percent to 150 percent on import items currently subject to custom duties of over 50 percent. This affected 48 luxury goods items and 202 items of raw materials and equipment goods. The ratio for import items with a duty of 30-40 percent remained at 100 percent, and items with a lower duty are exempt. Imports from "Specified Regions" have become subject, effective January 9, 1969, to substantially higher advance deposit requirement rates, while the deposit requirement rates for imports from all other countries remained unchanged. "Specified Regions" are defined as those countries of origin within a distance of 10 nautical days from Korea and whose exports to Korea are more than twice that of Korean exports to that country. These measures mainly affect imports from Japan, the Philippines and the Republic of China. Since May 1969, the Ministry of Commerce and Industry has been able to use its discretion in imposing higher deposit ratios of up to 200 percent on imports from areas outside the 10 nautical days' distance.

Advance Deposit Requirements for Imports

	Prior to July 9, 1968	Since July 9, 1968	Since January 9, 1969 Specified Regions	Since January 9, 1969 Other areas
	%	%	%	%
Letters of Credit, at sight				
(Tariff: 30-40%)	100	100	100	100
(Tariff: over 50%)	100	150	200	150
Documents against acceptance[a/]	0	10	30	10
Usance credits (L/Cs on term)	30	30	30	30
Documents against payment[b/]	0	5	50	5

a/ Documents against acceptance (D/A) refer to imports on deferred-payments in a private credit arrangement between importer and foreign supplier not using L/C's.

b/ Documents against payments (D/P) refer to imports for which the importer pays immediately when receiving document of shipment (bill of lading).

62. With a rather inflexible exchange rate policy, quantative and financial restrictions continue to be major instruments of import policy, evidenced particularly by the renewed tightening of controls. There have been no significant changes in tariffs since the 1967 Tariff Reform. However, a revision of the rates in the light of recent experience regarding imports is planned for early 1970. A major factor blunting the effectiveness of tariff policy has been the large scope of tariff exemptions. In 1968, total duty exemptions amounted to 66.8 billion won, which are 1.8 times total duties received (36.9 billion won).

Cost-Price Realignment

63. Apparently the whole complex of the foreign trade and exchange policy measures have piled up to a point where further improvement of the balance of payments cannot be optimistically expected without a major realignment of the cost-price relation. The central issue is the exchange rate. While Korea attempts to shift more resources from the domestic sector to the export sector to sustain a satisfactory growth rate without causing excessive external difficulties, inflation and the over-valued exchange rate operate in the opposite direction. This has necessitated the application of a number of complicated strong export promotion measures. However, these measures have only succeeded in off-setting the adverse effects of currency over-valuation. Moreover, they have induced excessively large imports and are very costly to the economy. If the exchange rate is allowed to be really flexible to reflect the basic monetary and trade position, the task of export promotion and import containment will be much easier. Tax and credit concessions to exporters could then be selectively removed. The net position of the exporters would remain the same or even improve (assuming no further inflation) and the Government could collect a large amount of additional customs revenues and reduce some of the interest subsidies. Meanwhile, imports would be more expensive, thereby reducing import expansion. Since prices of imported producers goods would rise, producers would be provided with a strong incentive to economize on the use of imported materials and to develop local import-substituting industries. There would also be less need for quantitative restrictions to protect domestic industries. Imports for domestic consumption could even be made more expensive by imposing selective higher import duties. Such major realignments in exchange and trade policies deserve the Government's urgent attention.

IV

FOREIGN CAPITAL

A. Trends and Patterns

64. One of the most striking features in Korea's rapid economic growth has been the great surge in foreign loans extended to Korean private enterprises. Net foreign loans received by the private sector rose by leaps and bounds from $16 million in 1965 to almost $400 million in 1968. External loans received by the Government have been much smaller in comparison ($15 million net in 1968). Furthermore, the Government has obtained its foreign resources largely in the form of grants. In recent years, U.S. Government grants have declined appreciably from $135 million in 1965 to $88 million in 1968. To some extent, this decline has been offset by the Japanese Government grants under the Property and Claims (PAC) Funds which started in 1966, following the normalization of relations between the two countries. The annual disbursement of the grants was agreed at $30 million for a period of 10 years.

65. In addition to official grants and foreign loans, Korea has also received sizeable amounts of private donations, particularly from Koreans residing abroad, mainly in Japan. These have been rising steadily, and passed the $100 million mark in 1968. Foreign direct investment in Korea is rather small ($ 20 million in 1968) and comes largely from U.S. business firms (about 70 percent of the cumulative total), followed by Japan (about 20 percent of the cumulative total). Most direct investments have been in the fields of fertilizer, electrical and electronic and petro-chemical industries, and petroleum refining.

66. The decline in foreign official grants and the rise in private borrowing has had a significant impact on the composition of Korea's external finance. In 1968 the shares of grants and loans in the total net inflow of external capital were 34 and 63 percent respectively (direct investment, 3 percent), as compared with 89 and 11 percent in 1964 (no direct investment). In 1969, the trend continued but with a slower increase in private external borrowing and a faster increase in official loans than in 1968. The net capital inflow during the first nine months of 1969 totalled $638 million, an increase of 31 percent over the corresponding period of 1968, as compared with 60 percent increase in 1968 over 1967.

67. Since 1965, the large influx of foreign capital has been more than sufficient to cover the trade gap. The extra funds were used to build up the foreign exchange reserves. This has been necessary because

the exchange reserves were low before 1965 and import expansion has been very rapid since then. Even with the sharp increase in monetary assets to enhance the international liquidity, gross official foreign exchange reserves have seldom exceeded four months' imports. Official exchange reserves increased from $410 million at the end of 1968 to $526 million at the end of October 1969; the latter figure being equivalent to 3.6 months' imports of goods and services at the 1969 level.

68. The international reserves have been bolstered with borrowings by Korean monetary authorities from foreign commercial banks. In 1968, the authorities borrowed a total of $40 million from two U.S. commercial banks and in 1969, $25 million from a consortium of eight U.S. and two Canadian banks. If one deducts public and private short-term foreign liabilities with less than one year maturity (breakdowns for public and private sectors are not available), the net foreign exchange reserves would be somewhere around $400 million at the end of September 1969, or slightly below 3 months' imports of goods and services at 1969 level.

B. External Debt

Medium and Long-Term Debt

69. The last economic mission's report expressed some apprehension about Korea's rapidly rising external debt. Indeed, 1968 proved to be a year of extraordinary expansion. Gross fixed capital formation increased by as much as 40 percent, and external medium and long-term (with original maturity over 3 years) debt disbursement increased by 47 percent. External medium and long-term debt contracted surged by 137 percent. The sharpest increase occurred in loans from foreign private lenders without Korean Government's guarantee, which rose from $118 million in 1967 to $442 million in 1968.

70. External borrowing continued to rise in 1969, although at a slower pace, with some marginal improvement in the structure. During the first 11 months of 1969, public and private medium and long-term loans contracted totalled $731 million, or about $785 million on an annual basis - a 44 percent increase over 1968. The disbursement of these loans during the first ten months was $474 million, or about $570 million on an annual basis - a 40 percent increase over 1968. These rates of increase are still very high and certainly will substantially increase the future debt burden.

Table 8

EXTERNAL TRANSFERS AND CAPITAL INFLOWS
(In million US $)

		1964	1965	1966	1967	1968	Jan. - Sept. 1968	Jan. - Sept. 1969
1.	Grants, net	194.9	203.3	219.6	225.2	226.1	144.4	163.0
	(U.S. Government)	(139.7)	(134.8)	(94.2)	(95.8)	(87.9)	(75.1)	(75.4)
	(Japanese Government)	(-)	(-)	(29.3)	(37.4)	(30.0)	(n.a.)	(n.a.)
2.	Loans, net	24.4	- 2.5	208.0	280.6	420.7	326.1	463.2
	Loans to the private sector	8.1	16.3	170.2	267.3	395.1	n.a.	n.a.
	(Long and Medium Term)	(12.5)	(39.4)	(163.8)	(224.6)	381.9	n.a.	n.a.
	(Short Term)	(-4.4)	(-23.1)	(6.4)	(42.7)	(13.2)	(14.4)	(31.3)
	Loans to the Government sector	16.3	- 18.8	37.8	13.3	25.6	n.a.	n.a.
3.	Direct Investment	- 0.8	0.3	13.4	11.3	19.9	15.5	11.6
4.	Total Net Capital Inflow (1 to 3)	218.5	201.1	440.8	517.1	666.7	486.0	632.8
5.	Use of Monetary Assets[a]	3.6	- 4.9	-117.6	-111.1	- 4.4	22.0	- 54.7
6.	Errors and Omissions	- 1.1	- 2.0	- 0.2	11.1	4.1	- 12.1	- 6.6
7.	Total Transfers and Capital Account (4 to 6)	221.0	194.2	323.0	417.1	666.4	495.9	576.5

a/ (-) indicates increase

Source: IMF, balance of payments statistics

71. One striking change in the external debt situation in 1969 is the sharp increase of loans from official sources. The contracted amount rose from $83 million in 1968 to $222 million during the first 11 months of 1969. The largest portion, totalling about $120 million, came from the United States, which includes $95 million in loans on concessional terms for financing the imports of rice, wheat and barley to meet the foodgrain shortage. Such large emergency borrowing would not recur under normal weather and agricultural conditions. The next largest portion of the new official loans, totalling $80 million, was from the World Bank Group, which includes a $45 million IBRD loan for the All-Weather Farming Project in the Pyongtaek-Kumgang area, a $14.8 million IDA credit for financing technical and vocational schools, and a $20 million IBRD loan to the Korean Development Finance Company.

72. During the first 11 months of 1969, the newly contracted external private loans amounted to about $510 million, and for the whole year would have reached $625 million. This would be a 34 percent increase over 1968, as compared to a 224 percent increase in 1968, and is an indication of the Government's efforts to slow down borrowing from external private sources. In 1969, no Governmental guarantees were granted to Korean private enterprises for the contraction of external private loans.

73. In spite of the sharp rise in official loans and the relatively slow increase in commercial loans, the share of official loans in the total loans committed decreased from 36 percent at the end of 1968 to 34 percent at the end of November, 1969.
To improve the external debt situation, Korea has to continue to slow down the total amount of external borrowing and, in particular, bring about a more rapid reduction in borrowing from private sources. The total committed medium and long-term external loans as of November 30, 1969 already passed the $2 billion mark ($2,166 million), and total disbursements of these loans about $1.4 billion. Of these totals, private loans contracted amounted to about $1.4 billion and private loans disbursed amounted to $0.9 billion.

74. Out of the total commercial loans contracted during the first 11 months of 1969, the U.S. had the largest share with $212 million. These were mainly to the Korean fertilizer, chemical and oil refining industries. Commercial loans from Western European countries surged ahead to $260 million during the same period. In the last two years or so, the Korean Government has emphasized external borrowing for financing the development of infrastructure, particularly power. Thus, loans disbursed to the infrastructural service sector during the first 10 months of 1969 totalled $300 million, an amount almost equivalent to the total borrowing for this sector during the previous 10 years. Of this

amount, $116 million was disbursed to the power sector (with $251 million in the pipeline) and $62 million to the transportation sector (with $60 million in the pipeline). External loans disbursed to the manufacturing sector totalled $169 million during the first 10 months of 1969 (compared to $206 million in 1968), while disbursements to the agricultural sector amounted to $14 million (compared to $4 million in 1968).

75. Another recent change in external borrowing has been the big increase in cash loans. Cash loans have been incurred not because of the need to pay for imported materials or equipment, but because of the shortage of local currency working capital. Because of the shortage and the high interest cost of loan funds from local banks many enterprises have tried to secure foreign cash loans which carry much lower interest. During the first nine months of 1969, external medium and long-term cash loans actually remitted amounted to $75 million, as compared to $29 million in 1968. The use of external cash loans, besides adding to the country's external debt burden, has expanded domestic liquidity since they coincided with a build-up of reserves.

Short-Term Credit

76. There was no large net increase in the amount of short-term credit during the first nine months of 1969. The amount of short-term credit with original maturity of 1-3 years outstanding at the end of September 1969 was $261 million, $33 million above that at the end of 1968. External short-term credit increased by $75 million in 1968. These credits were for imports of raw cotton and grains from the United States.

Debt Servicing

77. During 1969 there were no significant changes in terms and conditions of official loans. Regarding commercial loans, Korea has contracted proportionately less on loans with an original maturity of less than 10 years, but more on loans with maturity of over 10 years. In compliance with the standby agreement with the IMF, newly contracted commercial loans with maturity of 3-10 years have been kept within the ceiling of $295 million for 1969. Loans in this category accounted for 47 percent of total new medium and long-term commercial loans contracted during 1969, compared with over 60 percent in 1968. There has, however, been some hardening in the interest rate on commercial loans, reflecting the trend in the international financial markets.

78. Total debt service (principal repayments and interest payments) for external debt with maturity of over 3 years was $52.3 million for 1968. Repayments of external debt with maturity of 1-3 years were officially calculated at only $7.1 million for 1968. The reason given for the small amount of servicing was that there were large amounts of deferred repayments caused by delays in shipping. However, assuming 5 percent interest on the average outstanding amount of debt ($152 million at the end of 1967, and $228 million at the end of 1968) for 1968, interest payments alone would have been $9.5 million. The Bank's External Debt Statistics Division calculated Korea's total amortization and interest payments for external debt (with maturity of over one year) in 1968 at $67.1 million. If we take the latter figure, the ratio of debt service to exports of goods and services for 1968 would be 7.6 percent.

Table 9

INFLOW OF EXTERNAL MEDIUM AND LONG-TERM LOANS[a]
(In million US $)

	1959-64	1965	1966	1967	1968	Cumulative Total by the end of 1968	Jan.-Nov. 1969	Cumulative Total by the end of November 1969
				A. Committments[b]				
Official Loans[c]	120.1	76.3	152.9	87.9	82.6	519.8	222.2	742.0
Private Loans[c]	123.8	78.2	104.4	143.5	465.6	915.5	508.8	1,424.3
(a) Government guaranteed	116.7	74.9	93.7	25.9	23.5	334.7	-	334.7
(b) Commercial Banks guaranteed	2.3	-	9.0	99.6	384.6	495.5	437.5	933.0
(c) Without guarantee	4.8	3.3	1.7	18.0	57.5	85.3	71.3	156.6
Total	243.9	154.5	257.3	231.4	548.2	1,435.3	731.0	2,166.3
				B. Arrivals (disbursed)			Jan.-Oct. 1969	(by the end of October 1969)
Official Loans[c]	62.4	5.6	72.9	109.7	70.2	320.8	151.4	472.2
Private Loans[c]	37.6	36.1	110.1	119.9	268.1	571.8	322.9	894.7
(a) Government guaranteed	35.2	34.3	101.8	62.3	66.2	299.8	23.0	322.8
(b) Commercial Banks guaranteed	-	-	5.2	39.0	161.7	205.9	284.6	490.5
(c) Without guarantee	2.4	1.8	3.1	18.7	40.1	66.1	15.2	81.3
Total,	100.0	41.7	183.0	229.6	338.3	892.6	474.3	1,366.9
(of which, cash loans, all private)	(-)	(-)	(10.6)	(23.0)	(28.8)		(75.0)[d]	(119.4)

a/ Including loans with original maturity of over 3 years
b/ Based on loan agreements signed for official loans and the opening of letters of credit or letters of guarantee for private loans
c/ Based on the status of the lender
d/ January - September

Source: EPB

V

DOMESTIC FINANCE

A. National Savings

79. During 1967-68, about one-half of the gross capital formation was financed by domestic savings, the other half by foreign savings. The share of domestic savings in gross capital formation rose from 51 percent in 1968 to 58 percent in 1969. The marginal savings rate, which dropped to a very low level in the drought year of 1967, increased to 23 percent (calculated on the basis of current prices) in 1968, even though it was another drought year. The increase was due to the higher GDP growth rate and the fact that the drought was less serious. In 1969, the GDP growth rate accelerated again with good crops, and the marginal savings rate rose to 26 percent, almost the same as in 1966 - the previous bumper crop year. The average savings rate has increased rather steadily from about 7 percent of GDP in 1964-65 to 17.3 percent of GDP in 1969.

80. Public savings as a percent of GDP rose sharply during 1965-68, but increased only slightly to over 6 percent in 1969. The slowdown can be explained by the fact that the improvement of tax administration and tax collection has more or less reached a maximum and the effects of these changes, together with those of the 1967 tax reform, have begun to level off. In contrast, private savings which, as a percent of GDP were stagnant at over 7 percent for two years, rose considerably in 1969 to over 11 percent of GDP. This is due largely to the increase of stocks resulting from the good crops, rather than to any behavioral change in the saving propensities of the private sector.

Table 10

ORIGIN AND COMPOSITION OF SAVINGS
(at current market prices)

	1965	1966	1967	1968	1969 a/
	Amount (In billion won)				
GDP	798	1,019	1,220	1,552	2,006
Gross domestic capital formation	118	223	272	421	600
Minus: Foreign saving b/	60	101	135	208	253
Equals: Gross domestic saving , of which:	58	122	137	213	347
(public sector) c/	(11)	(25)	(47)	(94)	(122)
(private sector)	(47)	(97)	(90)	(119)	(212)
Add: Net factor income	8	13	22	24	24
Equals: Gross national saving	66	135	159	237	371
	As Percent of GDP				
Gross domestic capital formation	14.8	21.0	22.3	27.1	29.9
Foreign savings	7.5	9.9	11.1	13.4	12.6
Gross domestic saving :	7.3	12.0	11.2	13.7	17.3
(public sector)	(1.4)	(2.5)	(3.8)	(6.0)	(6.1)
(private sector)	(5.9)	(9.5)	(7.4)	(7.7)	(11.2)
	As Percent of Gross Domestic Capital Formation				
Foreign saving	50.8	45.3	49.6	49.4	42.2
Gross domestic saving:	49.2	54.7	50.4	50.6	57.8
(public sector)	(9.3)	(11.2)	(17.3)	(22.3)	(20.5)
(private sector)	(39.9)	(43.5)	(33.1)	(28.3)	(37.3)
	Marginal Savings Rate (%)				
Gross domestic saving	10.4	28.3	7.3	22.9	26.4

a/ Preliminary
b/ Deficit of the nation on goods and non-factor services account
c/ Public sector savings are from Table 11 on public revenue and expenditure

Source: BOK, National income data

B. Public Finance

Over-all performance

81. The overall performance of public finance, especially the increase in Government savings, has been remarkable in recent years. To some extent it reflects the rapid growth of the economy, but credit has to be given to the Government's determined policy of raising public revenue. There has been a substantial improvement in tax administration and collection, and a comprehensive tax and tariff reform was introduced in 1967, the details of which have been analyzed in the reports of the two previous economic missions. Actual current revenue of the consolidated public sector increased by 50 percent in 1968, and the budget estimate[1/] of current revenue for 1969 is expected to increase by 27 percent. The proportion of current revenue to GDP at current prices rose from 11 percent in 1965 to 18 percent in 1968 and will be around that in 1969. With current expenditure of the consolidated public sector rising at a slower rate, public saving at current prices increased substantially from only 11 billion won in 1965 (1.4 percent of GDP) to 94 billion won in 1968 (6.0 percent) and a budgeted 122 billion won in 1969 (6.1 percent of GDP).

Current Revenue and Tax Changes

82. Tax revenue accounts for around three-quarters of Government revenue, with monolopy surpluses, net profits of Government enterprises and other non-tax revenues making up the balance. Although relatively small, monopoly surpluses transferred to the Central Government have risen from only 3.6 billion won in 1965 to 24.3 billion won in the 1969 budget.

83. Tax revenue of Central and Local Governments more than tripled between 1965 and 1968, with another 33 percent increase budgeted for 1969. As a proportion of money GDP, tax revenue is likely to rise to 14 percent in 1969 from 8 percent in 1965. If the monopoly surpluses, which have the characteristics of indirect taxes, are included, the over-all "tax" ratio to GDP would be 15 percent in 1969.

84. The marginal propensity to tax[2/] rose steadily from 18 percent in 1965 to 21 percent in 1968. It has fallen in 1969 because of the very large increase in GDP as a result of the bumper crop and the lack of tax

1/ Budget estimates for 1969 include the Central Government Second Supplementary Budget.

2/ The increase in tax revenue as a percentage of the increase in GNP, both at current prices.

response to income rises in the agricultural sector.

85. Most of the increase in tax revenue has accrued to the Central Government. Local Government revenue has grown relatively slowly and as a result, its share in total tax revenue fell from 17 percent in 1965 to 9 percent in 1968[1/]. The share of direct taxes in the Central Government revenue rose continuously from about 35 percent in 1965 to 40 percent in 1968.

1/ The Central Government transfers a substantial portion of its revenue to the Local Governments. Under the existing provisions, it has to transfer 30.5 percent of its internal tax revenue to the Local Governments: 17.6 percent for financing general local government expenditure and 12.9 percent for the local autonomous school bodies. Such transfers have been more than double the Local Government's own revenue. The Central Government also makes substantial capital transfers to the local levels. These transfers rose from about 6 billion won in 1965 to about 20 billion won in 1968 and 22 billion won in the 1969 second supplementary budget.

Table 11

PUBLIC REVENUE AND EXPENDITURE[a]
(In billion won at current prices)

	1965	1966	1967	1968	1969[b]
		I - Current Account			
1. Current Revenue, of which	91.4	137.6	190.0	284.9	363.0
Direct Taxes[c]	25.0	39.7	56.0	82.9	105.4
Indirect Taxes[c]	40.6	63.1	86.1	129.4	176.1
Monopoly Profits	3.6	7.5	10.0	16.4	24.3
2. Current Expenditure, of which	80.8	112.4	142.9	190.6	240.5
Defense (Central Government)	29.9	40.6	49.5	64.8	82.5
Education (Central Government)	13.5	19.1	24.3	34.8	45.0
Economic Services (Central Government)	3.8	5.7	6.7	10.5	14.8
3. Savings on Current Account (1-2)	10.6	25.2	47.1	94.3	122.5
		II - Capital Account			
3. Savings on Current Account	10.6	25.2	47.1	94.3	122.5
4. Receipts from Counterpart Funds	32.9	35.5	34.1	33.7	35.7
5. Other Capital Receipts	- 0.4	3.6	- 3.2	4.5	57.6
6. Net Borrowing:	- 1.6	10.9	17.1	16.0	17.8
Domestic	(- 1.6)	(5.3)	(11.8)	(12.5)	(7.1)
Foreign	(-)	(5.6)	(5.3)	(3.5)	(10.7)
7. Total Capital Expenditures = Total investment funds available (3+4+5+6)	41.5	75.2	95.1	148.5	233.6
		III - Total			
8. Total Receipts (1+4+5)	123.9	176.7	220.9	323.1	456.3
9. Total Expenditure (2+7)	122.3	187.6	238.0	339.1	474.1
10. Budget Deficit(-) or Surplus (+)(=6)	+ 1.6	-10.9	-17.1	-16.0	-17.8

a/ Figures in this table are consolidated results of Central and Local Governments and Government enterprises account. They are based on fiscal data and consistently slightly smaller than the corresponding national accounts figures.
b/ Estimated by BOK on the basis of the Second Supplementary Budget of the Central Government and the preliminary budgets of the Local Governments.
c/ Totals are slightly lower than in Table 5.3 because of different accounting date
Source: Statistical Appendix Table 5.1

86. Recently the share of direct tax revenue has tended to decline slightly because of changes in the structure of income tax rates. In December 1968, the tax rates for the middle income brackets were reduced. This is estimated to have produced a tax revenue loss of 960 million won in 1969. A more substantial change in the rate structure is to be enacted in 1970. It is proposed that the tax credit system be abolished in favor of a flat earned income allowance of 10,000 won[1].

87. For the promotion of modern corporations and equity financing, the corporation tax preferences for so-called "open" corporations have been further enhanced and, therefore, "closed" corporations further discouraged. Rates for "open" corporations are now 15 to 25 percent of taxable annual income, compared with 25 to 45 percent for "closed" corporations. Lately, the qualifications required for recognition as an "open" corporation have been made stricter[2].

88. To curb consumption in 1970, the Government plans to raise the commodity tax rates and to apply the commodity tax to a number of new items, especially non-essential and luxury durable consumer goods (e.g., TV sets, stereo sets, refrigerators). It is estimated that in 1970 additional revenue of about 10 billion won will be derived from these measures, more or less offsetting the losses expected from the changes in income tax legislation. The increase in commodity tax is also expected to reduce imports of non-essential consumer goods.

89. Among other indirect taxes, liquor tax revenue was boosted by the change from a specific to an ad valorem tax base and by improved collection methods. Effective 1970, liquor tax rates will again be raised. Petroleum tax revenue also rose sharply since 1968, following the imposition of the tax on kerosene at a 30 percent rate and on Bunker C oil at a 5 percent rate.

1/ The present formula introduced in 1967 for calculating tax credit is (W 20,000 - Y) x 2.5%, where Y is income receivable. The tax rates will then range from 7 percent on taxable income below 10,000 won (after the 10,000 won tax-free allowance) up to 50 percent for incomes over 200,000 won (currently over 80,000 won), with additional rate cuts in the low and medium-income brackets.

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Taxable Income	Corporation Tax Rate: "Closed" Corporation	"Open" Corporation: Before Nov. 22 1968	"Open" Corporation: Since Nov. 22 1968
1 million won or less	25%	20%	15%
Over 1 million won up to 5 million won	35%	30%	20%
Over 5 million won	45%	35%	25%

Effective July 31, 1969, the required ratio of the holdings by small stockholders has been raised from 20 to 30 percent and the minimum required number of stockholders from over 30 to over 100 persons. In addition, "open" corporations have to sell their shares through the stock exchange or by public auction by the Government or Korea Development Bank (KDB), with one-tenth or more listed and traded on the exchange and less than 50 percent of the shares held by one company.

Current Expenditure

90. Total current expenditure of the public sector increased by one-third in 1968, following more or less the past trend. For 1969, a growth rate of almost 26 percent was budgeted. Wages and salaries have accounted for around 60 percent of total current public expenditure; its increase, at the same pace as total current expenditure, reflects chiefly the Government's policy to lift the remuneration of public servants up to the level existing in the private sector. During 1966-68, salaries of both military and civilian personnel were raised by 30 percent a year. Another 30 percent boost was enacted in mid-1969, and a further 20 percent rise is budgeted for mid-1970.

91. Defense expenditure continues to rank prominently in the current budget, although its share has been declining because of the rapid expansion of other outlays. In 1968, defense outlays accounted for 35 percent of total Central Government current expenditure, as compared to 42 percent in 1965, which were to fall further to 34 percent in the 1969 budget. Defense spending is now slightly above 4 percent of GDP.

92. The Central Government's current expenditure on economic services, especially in the field of agriculture, has increased rapidly since 1968, reflecting the emphasis on economic development in general and agricultural development in particular.

Public Capital Expenditure

93. Public investment has risen more rapidly than public current expenditure in recent years. Total public capital outlays (including capital transfers to the private sector) as a whole increased by 27 percent in 1967 and 56 percent in 1968. For 1969, another 57 percent increase was budgeted lifting the total to 233 billion won. Out of total public investment, the share of central and local governments' own investments has increased from 62 percent in 1965 to 83 percent in the 1969 final budget. Correspondingly, the share of investments by Government enterprises declined from 38 percent in 1965 to 17 percent in 1969, reflecting the Government's policy of gradually turning some public enterprises over to the private sector.

94. The allocation of Central Government capital expenditure shows clearly the Government's development priorities. Capital outlays for roads and waterways rose from only 1.1 billion won in 1965 to 14.7 billion won (or 12.7 percent of the total) in 1968, and further to 33.3 billion won (or 18 percent of the total) in 1969, because of the construction of the expressways.

Transportation as a whole has, since 1965, continued to account for around 38 percent of total Central Government capital outlays. Priority has also been given to fuel and power, but in 1969, after the acute power shortage was overcome and following the contraction of large foreign loans, Government's investment was somewhat slowed down. For agricultural development, Central Government outlays were boosted by over 80 percent in 1969 (to 22 percent of total capital outlays), after some lapse in the development programs in the two preceeding years. Capital outlays for education have increased fairly rapidly in most recent years: 33 percent in 1968 and 47 percent in 1969.

Sources of Finance for Public Capital Expenditure

95. In 1968 savings on current account contributed almost two-thirds of the funds used for public capital expenditure (including capital transfers to the private sector); it was only one-quarter of the funds in 1965. Counterpart funds used for public investment remained at around 33-36 billion won a year, and their share fell drastically in the last 5 years. The public sector has increased its domestic and foreign loans for financing investments. On the whole, the dependency on foreign financial sources (counterpart funds and foreign loans) had fallen from 80 percent of total public capital expenditure in 1965 to 25 percent in 1968.

96. The very rapid expansion of public capital expenditure in the 1969 budget to a total of 233 billion won caused a change in the financing pattern. Savings on current account, despite a further 30 percent boost, will finance slightly over one-half, and counterpart funds only 15 percent of the total. Domestic and foreign borrowing will finance around 8 percent, and other capital resources 25 percent, which include loan repayments from the private sector, depreciation reserves of the Government enterprises, and other capital transfers.

Budget deficit

97. Total borrowing from both domestic and foreign sources, which reflects the budget deficit, has increased from 16 billion won in 1968 to 17.8 billion won in 1969 (including the Central Government Second Supplementary Budget), largely due to a substantial increase in Government enterprises' borrowing. Government enterprises' foreign borrowing rose from 2.4 billion won to 8.2 billion won equivalent. The Central Government's Third Supplementary Budget for 1969 was passed by the National Assembly in November 1969. It is not reflected in Table 11. The sole purpose of the Budget was to provide 18.8 billion won of additional expenditure for the operations of the Grain Management Account for the purchase of larger quantities of grains than originally anticipated for the Government's buffer stock, because of the bumper crop and higher prices granted by the Government. Since only 6.7 billion won can momentarily be financed from additional current receipts of the Account, the Budget authorized a 12.1 billion won short-term credit from the central bank to finance the balance.

98.. As a percent of total public revenue, the public sector's total budget deficit rose from around 5.6 percent in 1968 to 8 percent in the 1969 budget, including the Third Supplementary budget.

C. Financial Policies and Financial Markets

Interest Rates

99.. Since 1965, interest rates have been used by the Korean authorities as a major financial policy instrument. The high level of market interest rates has been maintained to contain inflation, while differential interest rates have been applied to channel financial resources into priority fields of development. During 1968-69, the level and structure of interest rates were adjusted. These measures were taken to streamline the system, and to lower the general level of the market interest rates which was considered too high.

100. In September 1965, when the high interest rate policy was introduced, some of the interest rates on time and savings deposits were raised above some of the lending rates. Thus, it became profitable for clients to borrow from the banks and deposit their money in time and savings deposit accounts. To some extent, the very rapid increase in both time and savings deposits and bank credit was the result of this kind of manipulation, rather than because of a higher mobilization of domestic savings. The negative interest rate margin also reduced the profitability of the commercial banking operations. Meanwhile, the private sector continued to complain about the high interest rate (generally 26 percent per annum on bank loans) which has kept their cost of operation high and made capacity expansion difficult. As a result, the monetary authorities have made several small readjustments in the interest rates since early 1968.

101. On April 1, 1968, interest rates on time and savings deposits were lowered, except for the 12 month deposit rate (26.4 percent per annum). The interest rates on bank loans were left unchanged and thus, the negative margin between some deposit and bank lending rates was reduced. Apparently this change has not affected the continuous rapid growth of time and savings deposits. On October 1, 1968, all time and savings deposit rates were further reduced (for 12 month deposit the interest rate was reduced to 25.2 percent per annum), thereby completely eliminating the negative interest rate margin and bringing the commercial banks back to normal operation. At the same time, the typical lending rate of the commercial banks was also reduced from 26.0 percent to 25.2 percent per annum[1/]. Again no evidence was found

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1/ However, the interest rate of loans based on commercial bills was raised to encourage the use of this kind of bill.

that the growth of the time and savings deposits was interrupted after the rate reduction, and hence the third interest rate adjustment was made effective as of June 1, 1969. On this occasion the reductions were larger on all but a few minor rates. The interest rate on 12 month time deposits was lowered from 25.2 percent to 22.8 percent, and the interest rate on general purpose loans from 25.2 percent to 24.0 percent. The monetary authorities believe that in the light of continued growth of time and savings deposits, these downward adjustments have brought the interest rates gradually to a more "normal" level, in line with the need by enterprises to maintain sufficient profit margins for operation and expansion[1/].

102. While enterprises obtaining funds from the banks' deposit sources have to bear the high market interest rates, certain industries have access to credit at preferential interest rates, mostly from fiscal funds channelled by the specialized Government financial institutions. In addition, export credit and some agricultural finance, provided at very low interest rates by the financial institutions, have been refinanced by the Bank of Korea at even lower rates. The last economic mission commented on the multiplicity of preferential rates and, in some instances, on their extremely low level. Since then, some realignments have been made to simplify the preferential rate structure.

103. In early 1969, the Korean Development Bank (KDB, formerly Korean Reconstruction Bank) began to lend out its fiscal funds for equipment financing at 12 percent, instead of 10 to 12 percent as before, while the rate for working capital loans and for financing "special funds" industries (including coal, power development, shipbuilding, public utilities and marine transportation) remained at 18 and 7.5 percent respectively. When lending out internal funds, KDB charges "important industries" (that is, coal, power, shipbuilding, iron and steel and other industries so designated by Presidential decree) 12 percent on equipment loans (compared to 10 to 12 percent previously), and 18 percent on working capital loans. For other industries, a new rate stratum was added, with rates of 20 percent on equipment loans and 23 percent on working capital - which were much closer to the market rates than before. Since mid-1969 this new rate stratum has also been applied to Medium Industry Bank's (MIB) loans out of its banking funds (15 percent on equipment loans and 23 percent on working capital previously). The rate structure of National Agricultural Cooperatives Federation (NACF) has not

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1/ For the effects of high interest burden on the manufacturing industry, see Volume II, Annex II on "Manufacturing".

been simplified, except that the rates at the high end of the scale were reduced. The very low rate for long-term irrigation loans still remains at 3.5 percent per annum. Export credit extended by the commercial banks at 6 percent per annum can be refinanced by the Bank of Korea at 3.5 percent, and rice lien loans supplied to the farmers by NACF at 11 percent can be refinanced by the Bank of Korea at 4 percent per annum.

104. At 20-24 percent per annum, the domestic market interest rate on loans for private enterprises is still much higher than that on foreign loans (generally 7 percent). This wide differential provides a strong incentive for private enterprises to borrow from abroad, even if they need only local currency. Foreign cash loans, therefore, have increased sharply in 1969 (see Chapter IV). The increase in these loans is one of the major reasons for the rapid expansion in the money supply. Moreover, unless these cash and equipment loans are used for increasing export earnings, the repayments will lead to a depletion of official foreign exchange reserves in the future (as indicated in Chapter IV). The debt service on these loans is increasing substantially. Unless the gap between the internal and external interest rates is narrowed, it will be very difficult to curb excessive foreign borrowing. But at the present rate of inflation it would not be advisable to lower the domestic interest rate any further. Therefore, the Mission suggests the introduction of an interest equalization tax on foreign loans.

Sources and Uses of Funds 1/

105. The rapid increase in capital formation in recent years has taken place both in the Government and the corporate sectors. In 1968, gross capital formation in the corporate sector (including Government-controlled corporations) accounted for 55 percent of the total, compared with 27 percent in the Government sector (including Government enterprises). Because of the amount of savings from its current account, the Government sector had some surplus for financing corporate investment after financing its own investment. In 1968, the financial surplus of the Government sector totalled 20.4 billion won, which was channelled through the specialized financial institutions to the private business sector. A similar financial surplus was realized by the private non-corporate sector. The corporate sector, however, could only finance slightly over one-fourth of its own investment, and relied heavily on savings from other sectors. On a net basis, the huge financial gap of the corporate sector, which totalled 188 billion won, was filled largely by foreign savings. These amounted to 122 million won equivalent in 1968.

1/ Based on the flow of fund statistics compiled by BOK.

Table 12

SAVINGS AND INVESTMENT BY SECTORS, 1968
(In billion won at current prices)

	Gov't a/	Corps b/	Private Individual	Rest of the World	Total
Gross Savings:	127	67	69	122	393
Current surplus	119	25	21	122	293
Depreciation	8	42	48	-	100
Gross Investment:	-113	-256	-50	-	-421
Fixed capital formation	-110	-220	-64	-	-402
Changes in stocks	- 3	- 36	14	-	- 19
Deficit or surplus	20	-188	20	122	28 c/

a/ Including Government enterprises
b/ Including Government-controlled corporations
c/ Including -1.8 billion won of the financial institutions

Source: BOK, Flow of Fund Statistics

106. The private individual sector prefers to keep its savings predominantely in the form of deposits (particularly time and savings deposits), with very little in securities or direct lendings to the business sector. In 1968, time and savings deposits accounted for almost four-fifths of the private individual sector's total new financial assets acquired, while purchases of securities and private loans amounted to only 15 percent of the total. Correspondingly, the corporate sector relied heavily on finance from domestic banking institutions and foreign sources. In 1968, its borrowings from domestic banking institutions accounted for 43 percent of the total financing of the sector (net of financial transactions within the sector), while foreign borrowings accounted for 41 percent. "Direct finance", including the sale of securities and direct borrowings from private individuals and non-bank financial institutions,

accounted for the remaining 16 percent of the total new financial resources. The high proportion of deposits and loans in the financial structure of Korea highlights the dominant position of the banks in mobilizing domestic savings, and is indicative of the general public's reluctance to diversify their financial assets in the poorly developed capital market.

107. An important implication of the corporations' heavy reliance on bank financing is the generally high debt-equity ratio. The heavy indebtedness has placed the private enterprises in a precarious position where any unfavorable turn in the market can cause considerable financial strains on themselves and, in turn, on the banking system. These financial strains can be particularly severe for the banks which, in addition to their own loans, have also guaranteed large amounts of external loans. Some loan-financed enterprises have reportedly suffered from poor management, a lack of markets and an excessive dependence on loans. The number of such "insolvent" firms was reportedly over 30 around mid-1969, but 20 more have been added since then.[1/] Failures in repayments of loans may necessitate the banking institutions taking over the enterprises. But it would not be a sound principle for the banks to become permanently involved in the direct management of the enterprises. A more basic solution would be to screen the enterprises more carefully when they seek approval for their requests for foreign and domestic loans, and to insist on a minimum proportion of equity capital.

108. The major means of mobilizing domestic resources by the financial institutions has been time and savings deposits. Such deposits have increased at a very rapid rate since 1965 (almost 90 percent per annum during 1965-68) and there have been no clear signs that the rate of increase will slow down significantly in 1970, even with the recent lowering of the interest rates. In 1968, the increase in time and savings deposits in the banking system, totalling about 128 billion won, accounted for one-half of all financial resources mobilized by the organized financial system. The increase in currency, demand deposits and Government and foreign loans received, accounted for almost another quarter. Insurance and trust funds accounted for less than 10 percent. The sum of financial resources mobilized by the financial institutions, in turn, accounted for slightly over one-third of the total additional financial sources of the economy in that year. The financial markets are, indeed, still in their early stages of development.

1/ New York Times, January 19, 1970, page C.59.

109. The sharp increase in time and savings deposits (99 percent in 1968 and 70 percent in the first nine months of 1969) can be explained by a variety of factors: the rapid growth of money GNP, the high interest rates, the inflow of remittances from abroad (particularly Vietnam), the tax concessions (on income from interests), the inflow of foreign cash loans, and the lack of other financial investment opportunities. It is probable that most of the remittances by Korean soldiers and technicians, averaging 20 billion won a year in 1967 and 1968, were deposited in the banks. But this can only explain a small portion of the large increase in time and savings deposits in 1968 and 1969. The 25 percent increase in money GNP in 1968 and the 29 percent in 1969 would explain another portion of the increases. Before June 1969, the negative margin of interest rates between some savings deposits and loans may have encouraged the growth in time and savings deposits. Moreover, the exemption of income tax on interest tends to encourage deposits as against other forms of investment. However, since interest rates have recently been reduced and tax advantages have remained the same, there have been no additional incentives for time and savings deposits, although the level of interest rates is still high. For these reasons, a considerable part of the recent increase in time and savings deposits must be due to the large inflow of foreign loans. By borrowing money from abroad at 7 percent and depositing it in domestic banks at over 24 percent interest, large windfall profits can be made provided the exchange rate does not change much. Even those who are not short of capital would be tempted to borrow from abroad, while placing their own funds in time and savings deposits. Of course, increase in time and savings deposits in this way does not constitute any increase in domestic savings.

110. Bank loans, which account for two-thirds of the total fund sources of the banking institutions, expanded rapidly in 1968 (78 percent) and in the first nine months of 1969 (57 percent). Credit expansion from commercial bank deposits was particularly rapid. The special financial institutions, who account for less than two-fifths of total bank credit, derive part of their funds from the Government budget. It is likely that these institutions will have to obtain funds from other sources to support their operations because such fiscal funds, which have amounted to about 25 billion won a year lately, cannot be increased easily. Time and savings deposits have increased rapidly in recent years, and for those who are not entitled to receive such deposits (e.g. KDB), short-term debentures have been issued at near market interest rates.

111. Since early 1968, the monetary authorities have taken measures to strengthen the banking institutions and to develop the capital market. The details of these developments are given in Appendix II.

D. Money and Prices

Expansion of Money Supply

112. Money supply increased in 1968 by 30 billion won, or 25 percent, after an alarming 43 percent expansion in 1967. In both years the increase in foreign assets had been a major expansionary factor. Credit expansion to the private sector accelerated at a phenomenal rate, but due to the sharp increase in time and savings deposits, its net effect on monetary expansion was relatively small. The public sector had a net contractive effect in 1968.

113. For 1969, the Korean Government had projected an approximate 20 percent increase in money supply, based on an expected GNP growth of 12 percent, a wholesale price increase of 6 percent and a rate of monetization at 4 percent. However, in the first ten months, money supply rose by 34 percent (or by 51 billion won), as compared to a 19 percent increase during the same period in 1968.

114. The main factors in the monetary expansion were the rapid increase in bank credit to the private sector (14 billion won), the liquidity generated by the external sector (31 billion won) as a result of the large inflow of foreign loans, and an expansion of so-called "other assets" (22 billion won). The public sector had a contractive effect, but it was too small (16 billion won) to have an appreciable impact on the expansionary effect of these other sources. With GNP growing at a record 15.5 percent in 1969 after the recent bumper crop, it is doubtful whether the Government was able to curb the monetary expansion significantly during the remainder of 1969, despite attempts to clamp down on further foreign cash loans. In fact, there was further expansion in the money supply, as a result of the increased payments for the Government's rice procurements that were partly financed by central bank advances and by substantial emergency credits for relief to flood stricken areas. The sudden change from contraction to expansion in "other assets" since August 1969 is also noteworthy.

115. In an effort to attain monetary stability, the Korean monetary authorities established, in early 1968, a ceiling on central bank loans to banking institutions, with the monthly ceiling determined by the Governor of the Bank of Korea. However, since export loans and import loans to finance raw materials inputs for use in the export sector are excluded from the ceiling, the measure has not been very successful in containing credit expansion. Moreover, as explained above, central banks' accommodations of the NACF increased substantially because of drought relief and rice purchases.

116. The Stabilization Account introduced by the central bank in 1967, requiring commercial banks to keep a certain amount of deposits with the central bank in addition to the normal reserve requirements, has gradually been losing its importance. The outstanding amount of deposits from commercial banks held in the Account decreased sharply from 9.4 billion won at the end of 1968 to 1.9 billion won at the end of October 1969. There have been legal barriers in paying interest on such deposits by the central bank.

117. Instead, the monetary authorities now appear to emphasize the Monetary Stabilisation Bonds which were introduced at the same time as the Stabilization Account. In early 1969, the maximum discount rate of the bonds was raised from 14.4 percent to 22 percent, while their maturity was adjusted from 91 days to 3 - 12 months. Thus, the bonds have become more acceptable to banking institutions and more suitable for open-market operations. The outstanding amount of these bonds has increased from 5.6 billion won at the end of 1968 to 15.0 billion won at the end of October 1969. The additional bonds were issued to offset the monetary expansion caused by the rise in foreign assets. This is in line with the thinking of the previous and present economic missions. Under its statute, the central bank can issue bonds up to 10 percent of the outstanding money supply. Central banks reserve requirements, simplified and slightly reduced since the beginning of 1968, remained unchanged at 18 percent for time and savings deposits, and 32 percent for demand deposits. For NACF, however, they have been reduced to 15 and 25 percent respectively since September 1968.

Price Movements

118. It was quite an achievement to have brought price inflation (in terms of the consumer price index) down from 28 percent in 1964 to 14 percent in 1965, and further to 11 percent in 1967. However, since 1968 price inflation began to increase again. Strong anti-inflationary measures will have to be applied, otherwise some sort of cost-price spiral could develop. The annual 10 percent increase of prices which has prevailed since 1967 appear to have built up people's expectations.

119. In 1968, the Seoul consumer price index went up by 11.1 percent, as compared to 10.8 percent in 1967. During January-September 1969 it went up by 8 percent, as compared to 5.9 percent in the same period of 1968. The limits on price increases planned by the Government for 1969 (10 percent for consumer and 6 percent for wholesale prices) are likely to be exceeded. Important factors in the price increases have lately been excessive liquidity in the economy, the rise in grain prices (the Government's procurement price for rice increased by 17 percent in Fall 1968 and 23 percent in Fall 1969), and the sharp increase in wages. In addition, there have been rate hikes for several indirect taxes, increases in the Government-administered prices for coal, power, petroleum and fertilizer, and boosts in railway and bus fares. Prices for imported goods remained rather stable in 1968 but rose by 5.6 percent in January-October 1969, due mainly to a more restrictive import policy (e.g. tightening of quantative restrictions, increase in advance import deposit requirements, restrictions on import credits) and additional commodity taxes.

120. The repeated increases in the Government's rice procurement price, designed to compensate the farmers for the losses suffered from continuous inflation, have enhanced their purchasing power. At the same time, the rise in the rice price further increased the cost of living of the urban wage earners. This has contributed to the wage hikes; the money wage rate of the manufacturing workers rose by 26.5 percent in 1968. To the extent that the wage hike goes beyond the increase in productivity, it tends to trigger off further boosts in the general price level. The present situation of price inflation therefore needs to be dealt with urgently and resolutely.

Table 13

MONEY SUPPLY AND PRICE MOVEMENTS
(Rate of Increase in Percent)

	1965	1966	1967	1968	1969	Jan.-Oct. 1968	Jan.-Oct. 1969
Real GNP	7.4	13.4	8.9	13.4	15.5	-	-
Money Supply	33.1	30.1	42.5	24.9	-	19.3	34.1
Time and Savings Deposits	93.5	119.6	51.2	98.9	-	83.4	71.8
Wholesale Price Index (annual average)	10.0	8.8	6.4	8.1	-	6.6	6.2
Consumer Price Index (Seoul) (annual average)	13.6	12.1	10.8	11.1	-	5.9 a/	8.0 a/

a/ January-September period

Source: Bank of Korea, National Accounts Statistics and Monthly Statistical Review

VI

GROWTH PROSPECTS AND FINANCING REQUIREMENTS

A. Growth Prospects

Towards Balanced Growth

121. The Second Five-Year Plan, and the adjusted version published in the 1969 ORB, contain macro-economic targets up to 1971. The draft 1970 ORB[1/], however, only has targets for 1970, with no new projections for 1971. Senior officials in the EPB have stated that 1971 will be a year of adjustments, in preparation for launching the Third Five-Year Plan in 1972. The planning authorities have just begun their work on the Third Plan. Based on discussions with the EPB officials and its own independent judgements, the Mission has prepared rough projections of GNP components for the period 1970-76 that are discussed below and summarized in Appendix IV. These projections are, of course, very tentative because the development objectives for the Third Plan are not yet clear to us and the actual course of development in 1970 and 1971 may necessitate some changes in our assumptions. They are presented merely to indicate some magnitudes of the probable growth path up to the mid-1970's.

122. According to the draft 1970 ORB, the planned rate of growth of real GNP for 1970 (at 1965 constant market prices) is 11 percent. The Mission's projections (at 1965 constant market prices) were prepared on the basis that real GDP would grow at 11 percent in 1970, at 10 percent in 1971 and at 9 percent in each year of the Third Plan period (1972-76). It may, in fact, be desirable to aim at a rate of growth somewhat lower than 9 percent in order to keep foreign debt from rising too rapidly in relation to export earnings. The rate of increase in real GNP is expected to be somewhat lower each year, because of the decline in net factor income from abroad. These increases compare with the actual average increases of slightly over 12.5 percent for real GDP and GNP from 1965 to 1969.

123. The 15.5 percent increase in real GNP in 1969 was rather exceptional, chiefly because of the bumper harvest following the poor crop in the previous year. Assuming normal weather and based on the known Government agricultural policies and programs as well as the potential for growth, the value-added in agriculture, forestry and fisheries is expected to increase at 4.5 percent a year through the Third Plan period, compared with the actual rate of increase of 3.1 percent a year from 1964-66 (taken as a base) to 1968.

1/ The final version of the 1970 ORB came out after the report was completed.

124. Our assumptions of the growth rates of other broad economic sectors up to 1976 are given in Table 14.

125. We expect that during the Third Plan period a better balance between agriculture and industry and between urban and rural incomes will be achieved, because the growth rates in agriculture will be higher and those in industry will be lower than those which occurred in the Second Plan period. We also expect that the supply of power and perhaps, to a lesser extent, the supply of transportation services, will increase sufficiently to match the growing demand from the direct production sectors, and thus maintain a reasonable balance between the growth of infrastructure and direct production. Such balanced growth should, of course, also be reflected in the investment pattern.

126. Based on Government projections, the population growth rate will decline from 2.2 percent in 1969 to 1.7 percent in 1976. Per capita GNP is therefore likely to reach $300 in 1976.

Size and Strategy of Investment

127. According to the Mission projections, gross capital formation (at 1965 constant market prices) is expected to increase at an annual rate of 6.4 percent during the Third Plan period. The average annual rate of increase of 39 percent that prevailed from 1965 to 1969 was exceptionally high. The share of gross capital formation in GNP (at constant prices) is expected to decline from about 30 percent in 1968 to 27 percent in 1976.

128. As mentioned earlier, the high level of investment has been an important factor in explaining the recent rapid economic growth, but it has also brought strains to the balance of payments and to prices. In order to "cool down" the economy and avert further inflation and deterioration in the balance of payments, the Mission believes that the investment rate must be lowered substantially in 1970 and kept at a reasonable level through the Third Plan period. The draft 1970 ORB plans only a 3 percent increase in fixed capital formation for 1970, and the 1970 Central Government budget does not provide for any increase in Government investment. The ability of the Government to hold down gross investment to these projected levels depends upon the extent to which it can exercise control over private borrowings from both external and domestic sources and prevent public capital expenditures from increasing through any supplementary budgets.

Table 14

PROJECTIONS OF INDUSTRIAL ORIGIN OF GROSS NATIONAL PRODUCT
(In billion won at 1965 constant market prices)

	Actual			ORB	Mission Projections				Average Annual Rate of Growth (%)		
	1965	1968	1969 a/	1970	1970	1971	1972	1976	1965 - 69	1969 - 71	1971 - 76
Agriculture, Forestry and Fisheries	312	331	366	389	383	400	418	498	3.1 b/	4.5	4.5
Mining and Manufacturing	157	279	339	415	397	455	521	892	21.3	15.8	14.4
Construction, Power and Transportation c/	72	130	167	202	195	222	244	344	23.4	15.3	9.1
Other Services	265	387	430	434	452	480	503	625	12.9	5.6	5.4
Gross National Product	806	1,127	1,302	1,440	1,427	1,557	1,686	2,359	12.7	9.3	8.6

a/ Preliminary. The 1970 ORB and Mission projections were based on estimates for 1969 that were made before the preliminary national accounts data were available.
b/ Taking the 1964-68 average as base year for calculation.
c/ Including construction, electricity, gas and water; and transportation, storage and communications.

Sources: BOK, national income statistics, EPB, Over-all Resources Budget, and Mission projections

129. According to the Mission's projections, the incremental capital-output ratio (ICOR) for the economy will rise from 2.5 in 1968 to 3 in 1970 and will remain at slightly above 3 for the entire Third Plan period. There are several reasons for the expected rise in the economy-wide ICOR. Perhaps the most important is the anticipated continued impact of large-scale capital-intensive investments[1/] that have been commenced in recent years, together with new projects. Of particular significance are the investments in the Seoul-Pusan expressway, port development (such as Inchon and Pusan), the petro-chemical complex at Ulsan, and the integrated iron and steel project at Pohang. Furthermore, it is expected that there will be some tendency for firms to shift to more capital-intensive techniques as a result of increases in the real cost of labor relative to capital. The impending plans to modernize agriculture are also likely to have a capital-intensifying effect in the economy.

1/ From 1964 to 1968 the average ICOR for the construction, power and transport sector was 4.4

Table 15

PROJECTIONS OF EXPENDITURE ON GNP
(In billion won at 1965 constant market prices)

	Actual			ORB	Mission Projection				Average Annual Growth Rate (%)		
	1965	1968	1969 a/	1970	1970	1971	1972	1976	1965-69	1969-71	1971-76
Consumption	745	980	1,090	1,179	1,207	1,312	1,422	1,935	10.0	9.7	8.1
Private	669	874	972	n.a.	1,072	1,164	1,260	1,707	9.8	9.4	7.9
Public	76	106	118	n.a.	135	148	162	228	11.6	12.0	9.0
Gross Capital Formation	119	345	447	439	447	468	486	637	39.2	2.3	6.4
Fixed Domestic Capital	118	326	414	399	426	445	460	601	36.9	3.7	6.2
Increase in Stocks	1	19	33	40	21	23	26	36	139.6	-19.8	8.7
Gross Domestic Product	798	1,105	1,279	n.a.	1,420	1,562	1,703	2,404	12.6	10.5	9.0
Net Factor Income	8	22	23	n.a.	7	-5	-17	-45	30.2	-	-55.2
Gross National Product	806	1,127	1,302	1,440	1,427	1,557	1,686	2,359	12.7	9.3	8.6

a/ Preliminary. The 1970 ORB and Mission projections were based on estimates for 1969 that were made before the preliminary national accounts data were available.

Sources: BOK, national income statistics, EPB, Over-All Resources Budget, and Mission projections

130. The Mission would like to reiterate the general suggestions of the last mission, that it is now time to be more "cost conscious" and that great caution should be exercised in the selection of projects and in the phasing of investments through time. Since it is necessary to keep the size of total investment within a certain limit in order to maintain economic and financial viability, a committment one project will necessarily preclude the inclusion of some other project or projects in the investment program. This is particularly true for large projects.
For this reason, those projects which are selected should have higher economic returns than those rejected. In this way, the resources will be used in a most economical way and output, consumption and people's living standards can be increased to the maximum extent. Adequate technical and economic data are needed to make a proper evaluation of investment projects. In this connection the Mission feels certain pre-investment studies should be given priority. These are spelled out in Volume II and summarized in Appendix III of the main report. In particular, the Mission feels the following fields of investment require careful consideration:

(1) Large irrigation projects - In view of the prospects for self-sufficiency in rice in the near future (as a result of the various irrigation projects already underway and some modest extension of planting with improved seeds) and the declining world market price of rice, the benefits from new large irrigation projects should be carefully reassessed in comparison with the relatively high investment cost.

(2) Power projects - It is likely that a re-examination by the Government of the power demand forecasts, and consequently the required new projects, will show that the investment to which the Government is already committed will ensure that sufficient generating capacity is commissioned to meet likely peak demands until about 1976 and therefore some investment can be postponed (especially in private generating stations). On the other hand, investment in transmission and distribution should be carried out as planned.

(3) Transport projects - it would be more economical if more funds are allocated for improvements to the existing public road network. These improvements, which are urgently needed because of the rapid growth in traffic on these roads, will give higher economic returns than the four-lane expressways. Port development is urgently needed, but proper priorities have to be established.

131. Of course, this is not an exhaustive list, but it is sufficient to show the importance of making proper economic decisions in formulating the investment program.

Savings

132. With a slower rate of GDP growth assumed for the Third Plan, it is expected that the average annual rate of increase of consumption will also slow down from 10 percent during 1965-68 to 8 percent during the Third Plan period. Thus, the share of consumption in GDP is expected to fall from 89 percent in 1968 to 82 percent in 1976. The share of public consumption in GDP was assumed to remain at the same level as in the recent past, that is, at 9.5 percent of GDP. It was assumed that the recent steady decline in the share of private consumption in GDP would continue and it would fall from 79 percent in 1968 to 71 percent by 1976.

133. Domestic savings are arrived at as a residual between expected gross investment and foreign savings. As will be shown below, the importance of foreign savings (defined as the difference between imports and exports of goods and non-factor services) as a source of finance for the investment program is expected to decline. Its share will decline from 58 percent of gross capital formation in 1968 to about 26 percent by 1976. At an average annual rate of increase of 13.4 percent during the Third Plan period, the share of domestic savings in GDP is expected to rise steadily from 13 percent in 1968 to about 20 percent in 1976. In the Third Plan period the marginal rate of domestic saving is expected to be about 27 percent, compared with the rate of 25 percent which prevailed from 1964 to 1968.1/

134. There are several reasons for being reasonably optimistic about the extent to which national savings can be raised. It is expected that public savings will remain at a fairly high level with the momentum of the recent impressive performance. More importantly, along with the further growth of the industrial sector and commercialization of agriculture, business savings, particularly corporate savings, can be expected to increase substantially.

1/ We have projected factor receipts from and factor payments to the rest of the world to obtain an estimate of net factor income. Details of these items are provided in Appendix IV. It is expected that the substantial inflow of factor income to Korea (largely remittances of wages by Korean military forces and civilian technicians in Vietnam) will decline rapidly from 1970. On the other hand, there will be a sharp increase in factor payments abroad, largely because of the rapid increase in interest payments on the foreign debt. Thus, by 1971 we expect that there will be a net outflow of about 7 billion won. The net outflow is expected to increase to about 45 billion won by 1976. By adding net factor income from abroad to national savings, an estimate of domestic savings is obtained, which of course will grow at a slightly faster rate than national savings.

Table 16

PROJECTIONS OF CAPITAL FORMATION AND SAVINGS

Amount (In billion won at 1965 constant market prices)

	Actual			ORB	Mission Projection			
	1965	1968	1969[a]	1970	1970	1971	1972	1976
GDP	798	1,105	1,279	n.a.	1,420	1,562	1,703	2,404
Gross domestic capital formation	118	345	447	439	447	468	486	637
Foreign saving[b]	60	199	233	n.a.	234	218	205	168
Gross domestic saving	58	146	214	n.a.	213	250	281	469
Net factor income	8	22	23	n.a.	7	-5	-17	-45
Gross national saving	66	166	237	178	220	245	264	424
As Percent of GDP								
Gross domestic capital formation	14.8	31.2	34.9	n.a.	31.5	30.0	28.5	26.5
Foreign saving	7.5	18.0	18.2	n.a.	16.5	14.0	12.0	7.0
Gross domestic saving	7.3	13.2	16.7	n.a.	15.0	16.0	16.5	19.5
As Percent of Gross Domestic Capital Formation								
Foreign saving	50.8	57.7	52.1	n.a.	52.3	46.6	42.2	36.4
Gross domestic saving	49.2	42.3	47.9	n.a.	47.7	53.4	57.8	73.6

a/ Preliminary.
b/ Defined as the trade deficits on the goods and non-factor services account.

Source: BOK, Economic Statistics Yearbook, 1968; EPB, and Mission calculation.

B. Trade Prospects

Export Projections

135. The remarkable export performance led to another upward revision of the export target. The $1 billion merchandise export target for 1971 has now been established for 1970. Since the 1969 exports of merchandise (on an f.o.b. basis) probably increased to $664 million, the attainment of the new 1970 target will require an increase of 51 percent. The draft 1970 ORB has not announced the 1971 target, and the EPB is now working on projections up to 1976 in connection with the preparation of the Third Plan. While it is still too early to firm up the final projections, the EPB has completed some tentative work for the balance of payments projections. The tentative projections envisage that in 1976 merchandise exports will reach $3.6 billion. The EPB's tentative planned rate of export increase for 1971 is 30 percent and thereafter it will gradually fall to 20 percent in 1975 and 1976. We understand that the tentative export projections were based on the expected share of Korean exports in the total world exports.

136. The Mission tried to project Korean exports in a more direct way, as was done by the last mission. We reviewed both the supply capabilities of Korea and the world demand possibilities for each commodity group and for selected major commodities from information available to us. For 1969 we relied mainly on the first nine months' actual export figures and the Ministry of Commerce and Industry (MCI) estimates. For 1970 we referred both to our 1969 estimates and the MCI projections. The Mission believes that in 1970 merchandise exports could rise to about $890 million, an increase of almost 34 percent over our estimated figure for 1969. Our 1970 export projection is lower than the $1,000 million target because we are less optimistic about the prospects of Korean raw silk, chemicals, plywood, textile yarns and fabrics. We have taken a more oprimistic view than the MCI of the 1970 export prospects for clothing and wigs, because of their good performance in 1969. But this does not offset the lower projections for the other items mentioned above.

137. Beyond 1970 we made two separate estimates for exports of fish and fish preparations, textile fibers, textile yarns and fabrics, nonmetallic minerals, transport equipment and clothing. In each case, the lower estimate was based on less optimistic assumptions about the overseas market prospects or about supply conditions in Korea. It took into consideration the possibility of further trade barriers for Korean products in foreign markets and limitations in the absorptive capacity of non-quota markets, which accounted for most of the recent export growth. However, since the Korean Government and the export industry have repeatedly demonstrated their dynamism and ability in achieving higher and higher export targets, we choose the moderately optimistic projections. In these projections

total exports grow to about $2,830 million in 1976, giving an average annual growth rate of 20 percent during 1972-76, as compared to a corresponding rate of 22.6 percent in the EPB tentative projections.

138. One unknown factor in the export projections is the future exchange rate. Our projections have implied that the existing cost-price relation of the export sector will not deteriorate. But, if by future changes of the exchange rate or by other measures, the cost-price relationship becomes more favorable to the export sector, exports could be increased somewhat above our projections. However, we doubt whether the increase will be so large as to reach $3.6 billion because, at that level, with exports amounting to 34 percent of GNP (as compared with 9.7 percent in 1968),[1] the balance between domestic supply and demand may be upset. Even based on our projections, the proportion of exports to GNP will be 27 percent in 1976, which is already high even among the industrialized countries of similar size The details of the Mission's export projections are given in Appendix IV.

139. Receipts from the sale of services other than investment income increased from $110 million in 1965 to $382 million in 1968, an average annual rate of growth of about 52 percent. During 1969, exports of services (net of investment income) probably increased to about $430 million. Receipts from the sale of services related to the Vietnam conflict continue to account for a large share of total invisible receipts, although they declined in absolute and relative importance in 1969.

140. The draft 1970 ORB estimates that receipts from the sale of services (net of investment income) will be $480 million, compared with the Mission's estimate of $414 million. The reasons for the lower estimate by us are less optimistic forecasts of earnings from Vietnam-related services and, to a lesser extent, from freight and insurance receipts. Since the preparation of the draft 1970 ORB, the likelihood of a reduction in the scale of the Vietnam conflict and of further troop withdrawals has increased. In view of these developments, we have projected earnings from Vietnam-related services to fall to about $85 million in 1970, compared with the ORB estimate of $131 million.

141. Receipts from the sale of services other than to Vietnam are projected by us to be about $330 million in 1970, compared with the ORB projection of $349 million. Our lower estimate is due largely to a less optimistic estimate of receipts from transportation and insurance and from travel. We have assumed that in 1970 these items will grow at about the same rate as in 1968 and 1969, which was already high. We have also

1/ Export figures in dollars are converted into won at purchasing power parity rate.

assumed that the past trend in earnings from other services will continue, but that earnings from the sale of services to UN forces in Korea will be stable in 1970.

142. Sales of goods and services to the military forces in Vietnam, remittances from Korean forces and income from non-merchandise insurance in Vietnam are likely to continue to fall rapidly after 1970. Remittances from civil technicians in Vietnam may fall less slowly, assuming the continuation of technical assistance and reconstruction programs. We believe that total exports of services (net of investment income) may grow to about $390 million by 1976, of which services unrelated to Vietnam will be $380 million.

Import Projections

143. The draft 1970 ORB reflects the Government's intention of slowing down the rate of increase of merchandise imports. On the basis of the balance of payments statistics for January - September 1969, it is expected that the f.o.b. value of merchandise imports for 1969 was about $1,680 million, compared with the ORB estimate of $1,700 million. The lower estimate is due largely to smaller grain imports than expected, estimated now at about $210 million (compared with the projected value of $242 million in the draft 1970 ORB). Imports of other consumer goods and intermediate goods probably exceeded the ORB projections by about $50 million, but imports of machinery and transport equipment were likely to be slightly below the planned levels.

144. According to the draft 1970 ORB, the f.o.b. value of merchandise imports will increase to $1,800 million in 1970, compared with the Mission's estimate of $1,826 million. Assuming that the increase in gross capital formation can be held down to 3 or 4 percent in 1969 - 70, and that there are not substantial increases in inventories, it should be possible to hold down imports of capital goods to the projected level of about $680 million. This represents a 9.7 percent increase over the 1969 figure. However, greater difficulty may be experienced in curbing imports of raw materials and imports of other intermediate goods in view of the planned expansion in exports, particularly in those commodities with a high import content. Similarly, under the existing set of controls, the ORB estimate for imports of consumer goods other than grains in 1970 may be too conservative. Even assuming (as we have done) that the rate of increase in consumer goods imports will fall from 33 percent in 1968-69 to about 14 percent in 1969-70 and the rate of increase in imports of intermediate goods from 28 percent to 20 percent, imports of these commodities will exceed the ORB projection by some $20 million.

145. The Mission expects that the f.o.b. value of merchandise imports could increase to $3,375 million by 1976 if merchandise exports will attain $2,830 million. This is very close to the EPB's tentative projection of

$3,558 million. The implied average rate of increase is 11 percent a year during 1972-76. Clearly, the future trend of merchandise imports depends critically on the Government's development strategy and economic policy measures. Trends in imports of capital goods and intermediate goods will depend on the extent to which measures to promote import substituting industries and to lower the import content of domestically produced commodities are successful. As a result of past application of these policies Korea has become largely self-sufficient in the production of fertilizer, cement and textiles. The completion of the petro-chemical complex in 1970 or 1971 and its operation at full capacity by 1974 will result in self-sufficiency in refined petroleum and its derivatives, although Korea will have to continue to import crude oil. Construction of an integrated steel mill in the Third Plan period would further lessen Korean dependence on imports, particularly in the basic metals and capital goods industries. About three-fourths of inputs in the basic metals industry, for example, are currently imported.

146. The import content in such industries as automobiles and electronic equipment is expected to fall considerably during the Third Plan period as a result of discretionary action by the Government with such instruments as import-licensing, requirements of minimum domestic content of manufacturing, and tax and tariff policy. It is anticipated, for example, that the import content of automobiles will fall from the present level of about 60 percent to less than 20 percent by 1974. Successful application of these policy measures is likely to have an important influence on the rate of growth of imports of capital goods and raw materials.

147. Given the assumed rate of growth in gross capital formation in the Mission's projections it is possible that the rate of increase of imports of capital goods can be held down to about 6 percent a year in the Third Plan Period. Thus, the average rate of increase of imports of these commodities from 1968 to 1976 is expected to be 9.5 percent a year. Imports of intermediate goods have been assumed to grow at about 12 percent a year during the Third Plan period to about $2,210 million by 1976.

148. The proposed expansion in rice production is expected to eliminate the need for rice imports by 1971, so that the future growth in grain imports will depend largely on the demand for wheat and coarse grains for stock feed. While imports of coarse grains in 1970 may decrease because of the high levels of domestic production in 1969, it is expected that they will increase steadily in the Third Plan period along with the expansion of the livestock industry. Given that private consumption is expected to grow at about 8 percent a year and that the agriculture sector is expected to expand at between 4 and 5 percent a year in the Third Plan period, a rate of growth in grain imports of 5 percent a year may be reasonable. Thus, the c.i.f. value of grain imports is expected to rise to about $140 million by 1976.

149. Expansion in imports of other consumer goods depends, in part, on plans for import substitution and on the extent to which the Government

is willing and able to discourage imports of luxury consumer goods and domestic production of luxury items with a high import content. Assuming that the Government can successfully hold down the rate of growth of imports of these items in the Third Plan period to about $250 million by 1976, the average rate of increase from 1968 to 1976 will be 15.5 percent a year.

150. The draft 1970 ORB projects imports of services, excluding investment incomes, to rise to $287 million in 1970, whereas we project a slightly lower level of $273 million. We estimate that payments for freight and insurance in 1970 will be higher than that in the 1970 ORB,[1/] which is due in part to our less optimistic assumption about the extent to which Korean shipping capacity can be expanded to reduce payments for freight and insurance. However, our estimate of payments for other service (excluding investment income) is slightly less than the ORB's.

151. We anticipate that by 1976, freight and insurance payments may grow to $326 million and payments for other services (excluding investment income) may increase to about $178 million, which is a substantially slower rate of increase than that which prevailed in the 1960's. Total service payments (excluding investment income) in 1976, therefore, are expected to be slightly over $500 million.

The Overall Picture and the Trade Gap

152. Table 17 gives a summary of the Mission's projections of exports, imports and the trade gap. The Mission projects Korean exports of goods and services (excluding investment income) will be $3,220 million in 1976 and imports of goods and services (excluding payment for investment income) will be $3,880 million, leaving a trade deficit of $660 million. Exports are expected to grow at 17.8 percent a year during 1968-76 and imports at 12.4 percent a year. Thus, the trade deficit will decline gradually from the peak of around $800 million in 1969 to a level of $660 million in 1975-76. If this can be realized, the 1970's will begin with a turning point in Korea's balance of payments, wherein the trade gap will begin to narrow. Exports of goods and services (excluding investment income) as a percentage of imports of goods and services (excluding investment payments) can be expected to increase from 57 percent in 1968 to 83 percent in 1976.

1/ From 1965 to 1968 the total outlay on freight and insurance (the sum of receipts and payments) each year has been stable at about 6 percent of the total f.o.b. value of merchandise traded for the corresponding year.

153. The EPB's tentative projections are more optimistic on exports. With high export projections, the EPB's import projections are also higher than the Mission's, but only by a small margin. The EPB projected export figure for 1976 is $4,160 million and imports $4,190 million. As a result, the trade deficit will virtually disappear by 1976.

Table 17

EXTERNAL TRADE PROJECTIONS
(In million US $)

	Actual		EPB Projections								Growth Rate (%)		
	1965	1968	1969 Estimate	1970 (ORB)	1971	1972	1973	1974	1975	1976	1965-68	1968-71	1971-76
Exports of Goods & Services[a]	286	868	1,162	1,480	1,797	2,163	2,576	3,041	3,552	4,164	44.9	27.5	18.3
Merchandise (f.o.b.)	175	486	700	1,000	1,300	1,650	2,050	2,500	3,000	3,600	40.1	38.8	22.6
Services	111	382	462	480	497	513	526	541	552	546	50.5	9.1	1.9
Imports of Goods & Services[a]	482	1,529	1,963	2,087	2,388	2,646	2,956	3,205	3,689	4,187	46.9	16.1	11.9
Merchandise (f.o.b.)	416	1,322	1,700	1,800	2,050	2,292	2,562	2,870	3,195	3,558	46.9	15.7	11.6
Services	66	207	263	287	338	354	394	435	494	629	46.9	17.8	13.2
External Trade Gap	-196	-661	-801	-607	-591	-483	-380	-164	-137	- 23			
Export as % of Imports	59.3	56.8	59.2	70.9	75.3	81.7	87.1	94.9	96.3	99.4			

	Actual		Mission Projections								Growth Rate (%)		
	1965	1968	1969 Estimate	1970	1971	1972	1973	1974	1975	1976	1965-68	1968-71	1971-76
Exports of Goods & Services[a]	286	868	1,095	1,302	1,543	1,795	2,072	2,408	2,790	3,221	44.9	21.2	15.8
Merchandise (f.o.b.)	175	486	664	888	1,141	1,416	1,701	2,027	2,404	2,832	40.1	32.9	19.9
Services	111	382	431	414	402	379	371	381	386	389	50.5	1.7	-0.7
Imports of Goods & Services[a]	482	1,529	1,917	2,099	2,297	2,520	2,776	3,089	3,448	3,879	46.9	14.6	11.0
Merchandise (f.o.b.)	416	1,322	1,678	1,826	1,998	2,192	2,415	2,678	3,000	3,375	46.9	14.8	11.0
Services	66	207	239	273	299	328	361	402	448	504	46.9	13.1	11.0
External Trade Gap	-196	-661	-822	-796	-754	-725	-704	-681	-658	-658			
Exports as % of Imports	59.3	56.8	57.1	62.0	67.2	71.2	74.6	78.0	80.9	83.0			

a/ Excluding investment income and payments

Source: EPB and Mission projections

C. External Financing Requirements

154. In addition to the foreign exchange required to finance the external trade deficit estimated above, Korea will also have to increase its foreign exchange reserves and service existing and new debts. The magnitude of the debt service depends on the amount, interest and terms of the debt already incurred and that which will be incurred. This will be discussed later. The need for additional foreign exchange reserves will rise, along with the increase in the volume of international transactions. We assume that the level of foreign exchange reserves would be equivalent to about 3 months of imports.

155. Some of the required foreign finance will be met by private transfers, official grants and direct investment. Private transfers have increased steadily from 1965, and we assume that this trend will continue. Transfers from the U.S. Government are expected to decline rapidly in 1970 and 1971, after which a small amount of aid will continue. Official Japanese grants from the Property and Claims Fund (PAC) are expected to remain at $30 million a year until 1975. It is expected that direct foreign investment (net of profit remittances) will continue to grow steadily to about $50 million by 1976, given continued confidence among overseas investors in the growth potential of the Korean economy.

156. After subtracting the above-mentioned items from the foreign exchange required to finance the trade deficit, and adding the need for increasing the reserves, the remainder is the net inflow of external loan capital needed to close the trade gap. After deducting the estimated amount of short-term credits of less than one year, changes in balance of open accounts, etc., the net requirement of medium and long-term capital (that is, loans with a maturity of more than one year) needed to meet Korea's foreign exchange requirements is obtained.

157. The Mission estimates that in 1970 Korea will need a net inflow of medium and long-term loan capital of approximately $600 million, compared with the draft 1970 ORB estimate of $380 million. The higher estimate by the Mission is due largely to the less optimistic forecast of export earnings. Under the various assumptions we have made on the GNP growth rate, export and import trend, etc., the Mission expects that the net requirement for medium and long-term loan capital will decline to about $530 million by 1976.

Table 18

PROJECTIONS OF EXTERNAL FINANCING REQUIREMENTS
(In million US $)

	Actual		Mission Projections							
	1965	1968	1969 (Est)	1970	1971	1972	1973	1974	1975	1976
Net External Capital Requirement a/	195.6	661.0	822	796	755	724	703	681	658	659
Plus Increase in Foreign Reserves	9.4	59.1	97	45	50	56	64	78	90	108
Minus Net Private Transfers	68.7	105.5	120	125	130	135	140	145	150	155
Net Official Transfers	134.6	120.6	119	94	60	45	38	37	37	12
Direct Investment (net of profits)	0.3	19.9	16	19	23	27	32	37	43	50
Minus Short-term Credit b/, open accounts, etc.	-38.9	12.4	10	11	12	13	14	16	18	20
Net Inflow of Medium and Long-Term Loan Capital	40.3	461.7	654	592	580	560	543	524	500	530

a/ Defined as the deficit on the goods and services account net of investment incomes
b/ Less than one year

Source: IMF, Balance of Payments Yearbook, Vols. 19, 20, 21; Mission projections

158. In order to obtain some insight into the likely trends in Korea's foreign exchange requirements beyond 1976, exports of goods and services (net of investment income) were projected from 1976 to 1985 at an average annual growth rate of about 13 percent. The corresponding average annual growth rate for imports was assumed at about 11 percent. Reserve requirements were assumed to remain at 25 percent of imports and the trends in transfers, direct investment and short-term credits were expected to continue. Thus, the net inflow of medium and long-term loan capital in 1984 was projected to be about $80 million, and in 1985 a small surplus appears.

Projection of Debt Burden

159. On the basis of information supplied by the Korean authorities, it is estimated that on December 31, 1969 approximately $910 million in medium and long-term loans contracted prior to that date remained to be disbursed. Given the disbursement schedule for this loan capital, new borrowings must be sufficient to meet the remaining net requirements plus the debt servicing obligations associated with existing and new loans.

160. The repayment schedule for the existing debt was derived from the official repayment schedule for the debt existing on June 30, 1969. A separate calculation by the Mission was used to estimate the servicing on debt contracted from July to December 1969.

161. Servicing of the new debt depends on the terms on which the debts are incurred. Four different kinds of loans were distinguished for the purposes of estimating the future debt burden and the implications of each of three different patterns of future debt composition were examined. Variant A assumes that compared with the existing debt composition the future pattern will improve modestly, essentially by having a somewhat larger share of official loans in the total. Variants B and C represent further improvement in the same direction.

	Composition(%) A	B	C	Interest Rate (%)	Terms: Grace Period	Repayment Period **
Concessional	25	20	20	2.8	8	25
Conventional	15	25	30	6.5	5	15
Commercial:						
over 3 years	55	50	45	7.5	1	10
1 to 3 years	5	5	5	7.5	0	2
	100	100	100			

(** Excluding grace period)

162. By the end of August 1969, total external loans contracted (with maturity of over one year) amounted to $2,156 million, of which about one-third were loans from official sources on concessional or conventional terms, the other two-thirds were commercial loans. In the first eight months of 1969, the composition improved, with 40 percent of the external loans contracted from official sources and 60 percent from commercial sources. This trend is likely to continue and the future external debt committment may approximate a composition close to Variant B, or even to Variant C.

Table 19

COMPOSITION OF EXTERNAL LOANS CONTRACTED
(In million US $)

	As of Aug. 31, 1969 Amount	%	January-August 1969 Amount	%
Concessional	605	28.1	142	28.0
Conventional	114	5.3	60	11.8
Commercial (over 3 years)	1,194	55.3	284	56.2
Commercial (1 to 3 years)	243	11.3	20	4.0
	2,156	100.0	506	100.0

Source: EPB and Ministry of Finance

Table 20

PROJECTION OF GROSS REQUIREMENTS FOR MEDIUM AND LONG-TERM LOAN CAPITAL
(In million US $)

	1969	1970	1971	1972	1973	1974	1975	1976	Total 1972-76
Net Inflow of Medium and Long-Term Loan Capital	655	593	579	560	543	525	500	529	2,657
Servicing on Existing Debt a/	123	263	272	295	282	285	178	157	1,197
Servicing on New Debt									
Variant A	-	13	65	144	244	395	571	753	2,107
B	-	13	62	135	230	376	548	726	2,015
C	-	13	61	131	222	362	530	702	1,947
Gross Inflow of Medium and Long-Term Loan Capital									
Variant A	778	869	916	999	1,069	1,205	1,249	1,439	5,961
B	778	869	913	990	1,055	1,186	1,226	1,412	5,896
C	778	869	912	986	1,047	1,172	1,208	1,388	5,801

a/ Projection for 1970 and beyond is servicing on estimated debt at December 31, 1969

Source: Mission projections

Table 21

PROJECTIONS OF DEBT SERVICE RATIOS[a/]

	1969	1970	1971	1972	1973	1974	1975	1976	Average 1972-76
For Loans of 1-3 years maturity	1.8	7.6	5.2	5.2	7.8	9.6	7.7	8.3	7.9
For Loans of greater than 3 years maturity									
Variant A	9.3	13.2	16.3	18.9	17.2	18.2	18.7	19.5	18.6
B	9.3	13.2	16.1	18.4	16.5	17.4	17.9	18.7	17.8
C	9.3	13.2	16.0	18.1	16.1	16.9	17.3	18.0	17.3
All medium and long-term loans									
Variant A	11.1	20.8	21.5	24.1	25.0	27.8	26.4	27.8	26.5
B	11.1	20.8	21.3	23.6	24.3	27.0	25.6	27.0	25.7
C	11.1	20.8	21.2	23.3	23.9	26.5	25.0	26.3	25.2

a/ The debt service ratio is defined to be the sum of amortization and interest payments divided by exports of goods and services (including investment income).

Source: Mission projections

163. Under the assumptions given above, the results of the analysis indicate that if the external debt pattern continues at more or less the present composition (Variant A), debt service payments in 1976 are likely to exceed $900 million. If the external debt pattern improves to that indicated in Variant C, the debt service payments may be $50 million lower. Thus, in order to obtain $530 million net inflow of foreign loan capital in 1976, Korea will have to borrow around $1,400 million (gross inflow).

164. Based on the above calculation, the debt service ratio (debt service payments expressed as a percentage of exports of goods and services) would increase from over 11 percent in 1969 to 26-28 percent in 1976.

165. In external debt management, the Korean Government distinguishes between medium and long-term loans with a maturity of over 3 years and those with a maturity of less than three years. Following the Mission's projections, the debt service ratio on the loans of greater than 3 years maturity will increase from slightly over 9 percent in 1969 to slightly over 13 percent in 1970 and then remain at a level of between about 17 to 19 percent during the Third Plan period.

Alternatives

166. The tentative EPB balance of payments projections, which are based on more optimistic export and import projections than the Mission's, give a trade gap of $102 million in 1976. With a slightly more optimistic future debt composition than the Mission assumed, the EPB projections result in a debt service ratio that reaches a maximum of slightly over 18 percent of export earnings in 1973-74, and a debt service ratio for debt with over 3 years maturity below 15 percent. The latter is in line with what the Korean delegation stated at the 1969 Consultative Group meeting. The projections show that by 1976 Korea will have a small surplus on the current account, because the net transfer receipts will exceed the deficit on the goods and services account.

167. The Mission tried another alternative by reducing the growth rate and, therefore, investment and consumption expenditures and imports. We tried an 8 percent GDP growth model, assuming private consumption will increase at a rate of 7 percent and fixed capital formation at about 4 percent a year during 1972-76. We also assumed that the capital-output ratio

will be slightly higher than in the 9 percent GDP growth model, but exports will remain the same.[1/] The results show that imports will be $3,650 million in 1976 (or 6.3 percent lower than the imports in the 9 percent GDP growth model) and the trade gap will be $430 million, almost one-third smaller than our 9 percent growth rate model. Net foreign loan capital requirements in 1976 will be reduced from $530 million in the earlier model to $275 million in the new model.

168. Given the same composition of future external debt (Variant B) the debt service ratio will on the average be about 24.5 percent during the Third Plan period and will reach a peak of 27 percent in 1980. The debt service ratio for debt with maturities of over 3 years will on the average be about 17 percent during the Third Plan period. The modest improvement in the debt service ratio in the intermediate term is due to the fact that there is still a heavy inflow of loans projected for the remainder of the Second Plan period and the early part of the Third Plan period. The reduction in the growth rate and reduction in loan requirements in the latter part of the Third Plan period, does not have an appreciable impact on the debt servicing obligations of Korea until the 1980's.

169. In the export projections, the Mission assumed that the exchange rate-price relationship will remain unchanged, or at least that in the future the exchange rate will be adjusted to follow the relative price changes between Korea and the United States. However, if the Korean authorities will exercise more restrictive monetary policies in the near future, and devalue the currency to correct the existing over-valuation, the trade gap can be expected to be smaller than what the Mission projected and the debt service ratio will also be brought down. To what extent these improvements can be achieved by a certain degree of devaluation is, of course, difficult to assess.

170. The effective rate of devaluation also depends on the extent to which the Government will at the same time reduce the complicated export incentive measures now offered. If a certain degree of devaluation is combined with a removal or a reduction of import duty exemptions, the total discouraging effects on imports will be larger than otherwise.

171. The debt service ratio in the near term can be further lowered if the repayments of short-term debt can be postponed (as Korea did in recent years) and if Korea can receive more official loans and less commercial loans with better terms than assumed in Variant B.

172. With all the above-mentioned efforts, constraints and the additional favorable factors, Korea can perhaps keep the future debt service ratio below 21 or 22 percent of export earnings and for debt with over 3 years maturity more or less at the level of 15 percent. However, this will not be an easy task.

1/ The results are summarized in Tables 15a, 16a, 17a, 18a and 21a on the following pages. They are all based on the assumption of an 8 percent GDP growth rate p.a. during 1972-76.

Table 15a

PROJECTIONS OF EXPENDITURE ON GNP
(In billion won at 1965 market prices)

(Assuming an 8 percent Annual GNP Growth Rate during 1972-76)

	Actual			ORB	Mission Projection				Average Annual Growth Rate (%)		
	1965	1968	1969a/	1970	1970	1971	1972	1976	1965-69	1969-71	1971-76
Consumption	745	980	1,090	1,179	1,207	1,306	1,405	1,850	10.0	9.4	7.3
Private	669	874	972	n.a.	1,072	1,158	1,245	1,632	9.8	9.1	7.1
Public	76	106	118	n.a.	135	148	160	218	11.6	12.0	8.0
Gross Capital Formation	119	345	447	439	447	460	482	562	39.2	1.5	4.1
Fixed Domestic Capital	118	326	414	399	426	437	447	528	36.9	2.8	3.9
Increase in Stocks	1	19	33	40	21	23	25	34	139.6	-19.8	1.6
Gross Domestic Product	798	1,105	1,279	n.a.	1,420	1,562	1,687	2,295	12.6	10.5	8.0
Net Factor Income	8	22	23	n.a.	7	- 5	-16	-43	30.2	-	-53.8
Gross National Product	806	1,127	1,302	1,440	1,427	1,557	1,671	2,252	12.7	9.3	7.6

a/ See Table 15, footnote a/

Source: Table 15 and Mission projections

Table 16a

PROJECTIONS OF CAPITAL FORMATION AND SAVINGS
(Assuming an 8 percent annual GDP growth rate during 1972-76)

Amount (in billion won at 1965 constant market prices)

	Actual			ORB	Mission Projection			
	1965	1968	1969[a]	1970	1970	1971	1972	1976
GDP	798	1,105	1,279	n.a.	1,420	1,562	1,687	2,295
Gross domestic capital formation	118	345	447	439	447	460	482	562
Foreign saving[b]	60	199	233	n.a.	234	205	190	117
Gross domestic saving	58	146	214	n.a.	213	255	292	445
Net factor income	8	22	23	n.a.	7	-5	-16	-43
Gross national saving	66	168	237	178	220	250	276	402
As Percent of GDP								
Gross domestic capital formation	14.8	31.2	34.9	n.a.	31.5	29.4	28.6	24.5
Foreign saving	7.5	18.0	18.2	n.a.	16.5	13.1	11.3	5.1
Gross domestic saving	7.3	13.2	16.7	n.a.	15.0	16.3	17.3	19.4
As Percent of Gross Domestic Capital Formation								
Foreign saving	50.8	57.7	52.1	n.a.	52.3	44.6	39.4	20.5
Gross domestic saving	49.2	42.3	47.9	n.a.	47.7	55.4	60.6	79.2

a/ Preliminary.
b/ Defined as the trade deficit on the goods and non-factor services account.

Source: BOK, Economic Statistics Yearbook, 1964; EPB, Table 16, and Mission calculations.

Summary of

Tables 17a and 18a

PROJECTIONS OF EXPORTS, IMPORTS AND NET CAPITAL REQUIREMENTS
(Assuming an 8 percent annual GDP growth rate during 1972-76)

	1969	1970	1971	1972	1973	1974	1975	1976	Total 1972-76
Exports of Goods and Services a/	1,095	1,302	1,542	1,795	2,072	2,407	2,790	3,221	
Imports of Goods and Services a/	1,917	2,099	2,245	2,467	2,714	3,008	3,312	3,648	
Net External Capital Requirement	822	796	703	672	642	601	521	427	2,863
Net Inflow of Medium and Long Term Loan Capital	655	593	514	507	480	440	349	274	2,050

a/ Net of investment incomes

Source: Tables 17 and 18 and Mission projections

Table 21a

PROJECTIONS OF DEBT SERVICE RATIOS[a]
(Assuming an 8 percent annual GDP growth rate during 1972-76)

	1969	1970	1971	1972	1973	1974	1975	1976
For loans of 1-3 years maturity	1.8	7.6	5.2	5.1	7.5	9.1	7.1	7.5
For loans of greater than 3 years maturity								
Variant A	9.3	13.2	16.3	18.7	16.8	17.8	18.0	18.5
B	9.3	13.2	16.1	18.3	16.2	17.0	17.3	17.7
C	9.3	13.2	16.0	18.0	15.8	16.5	16.7	17.0
All medium and long-term loans								
Variant A	11.1	20.8	21.5	23.8	24.3	26.9	25.1	26.0
B	11.1	20.8	21.3	23.4	23.7	26.1	24.4	25.2
C	11.1	20.8	21.2	23.1	23.3	25.6	23.8	24.5

a/ See Table 21

Source: Mission projections.

Implications

173. Korea's economic performance has been generally good and growth trends are favorable, but inflation and external debt are mounting. The Government has tried to contain investment and foreign private loans, and in 1969 the increases of both have somewhat slowed down from the extraordinary expansion in 1968. But apparently continuous efforts towards this direction are needed. The investment program should be kept to a reasonable size, with proper selection of projects based on a cost-benefit comparison. The Mission believes that a planned GDP growth rate of 8 percent per annum, with slower growth in investment for the Third Plan period, should help to keep the debt service ratio from rising dangerously. With additional efforts to contain imports and stimulate exports (through proper monetary and foreign exchange policies) and a more substantial increase in the amount of long-term foreign capital from official sources, the debt service ratio can be further improved to a level of 20-21 percent of export earnings in 1975-76, and for debt with more than 3 years maturity, to a level of 15 percent as committed by the Korean Authorities at the last Consultative Group meeting.

174. The Korean Government has made great efforts in mobilizing domestic savings, and the marginal savings rate has been rising. However, since national savings account for only slightly over one-half of capital formation, even with slowed down investment in the future, the resource gap will still be sizeable. The country will continue to rely on foreign capital to support its future growth, particularly because of the expected fall in receipts from Vietnam and of official grants. If Korea continues to rely heavily on supplier's credits, the consequent increase in debt services obligations will be hard to bear. For these reasons, and with restrained future growth and investment, Korea should receive a substantially increased amount of long-term foreign capital from official sources. While a generally good economic performance would enable Korea to increase conventional loans, such loans should be made available with a long grace period in order not to accentuate the expected high plateau of external debt service in the seventies. In addition, in view of its low level of per capita GNP and the large resource gap, Korea should also receive a reasonable amount of official loans on concessional terms.

175. Of course, regardless of Korea's policies and plan objectives, it will be difficult for her to receive the level of gross capital inflow projected at well over $1 billion a year in the second half of the 1970's. Therefore, the supply of foreign capital on acceptable terms is likely to be an increasingly important constraint.

KOREA: PROJECTED EXPORTS, IMPORTS AND TRADE GAP

(OF GOODS AND SERVICES, EXCLUDING INVESTMENT INCOME)

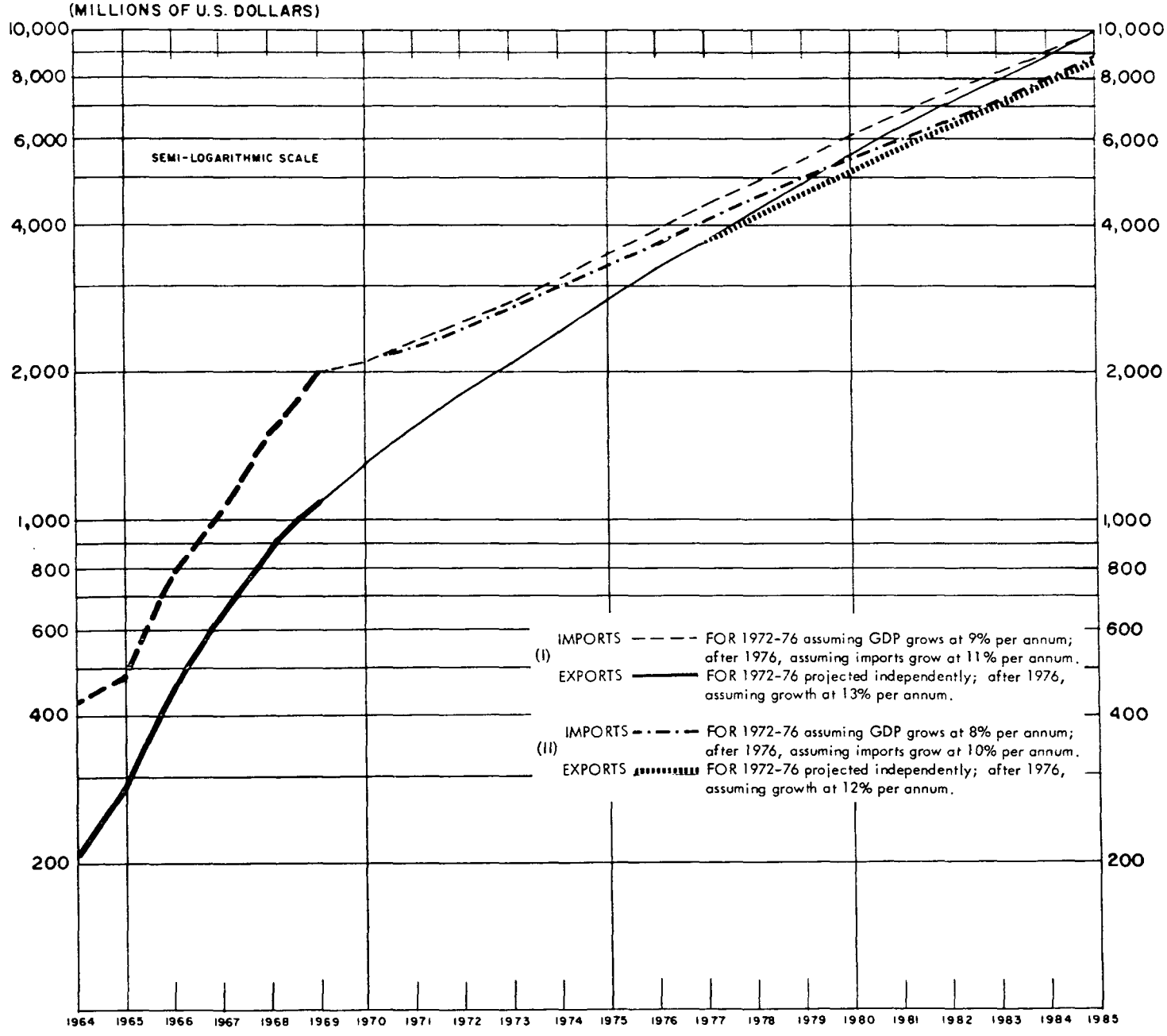


CHART ONE

IBRD - 4790

KOREA: PROJECTED GROSS AND NET INFLOW OF LOAN CAPITAL

(With maturities more than one year)

(MILLIONS OF U.S. DOLLARS)

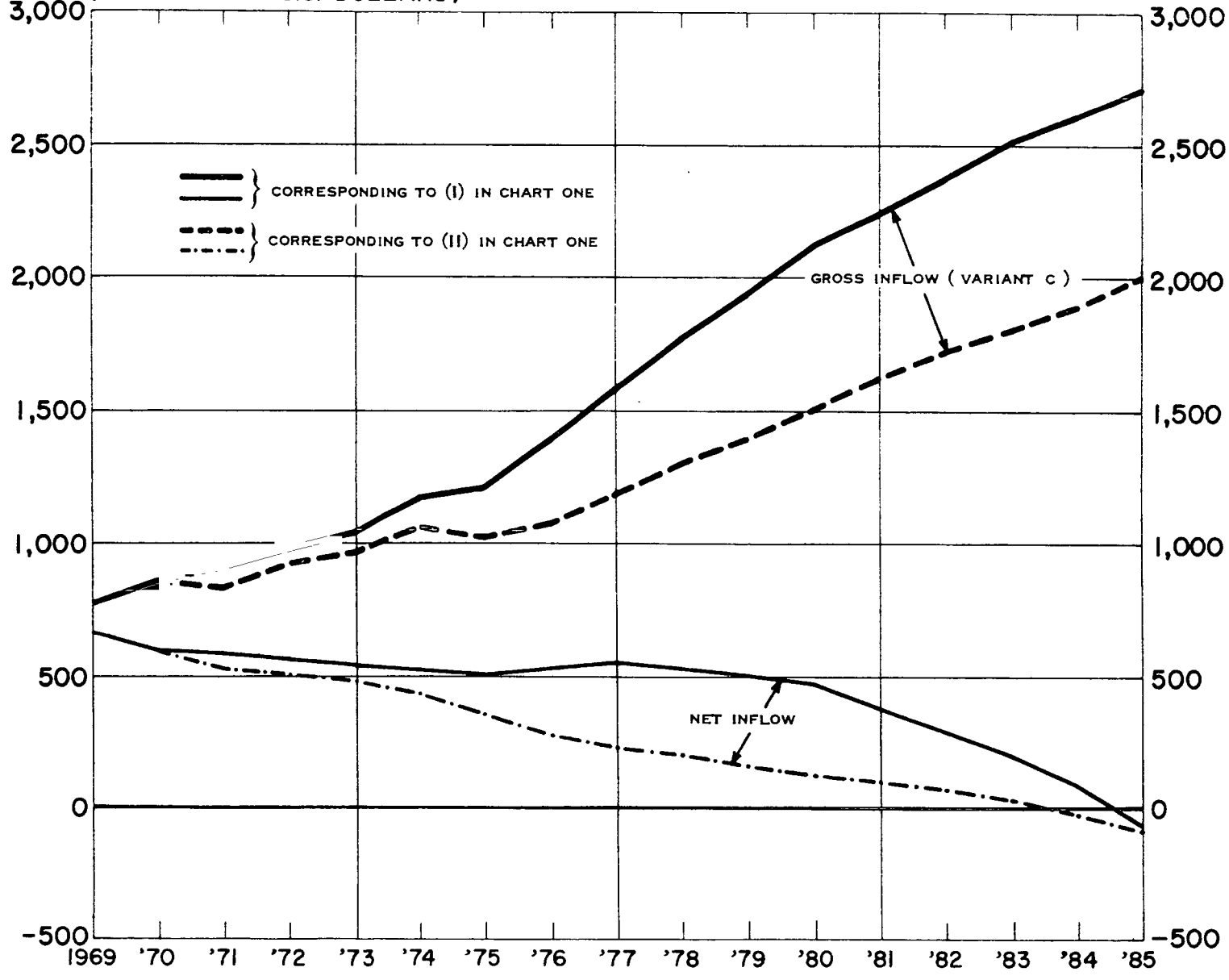
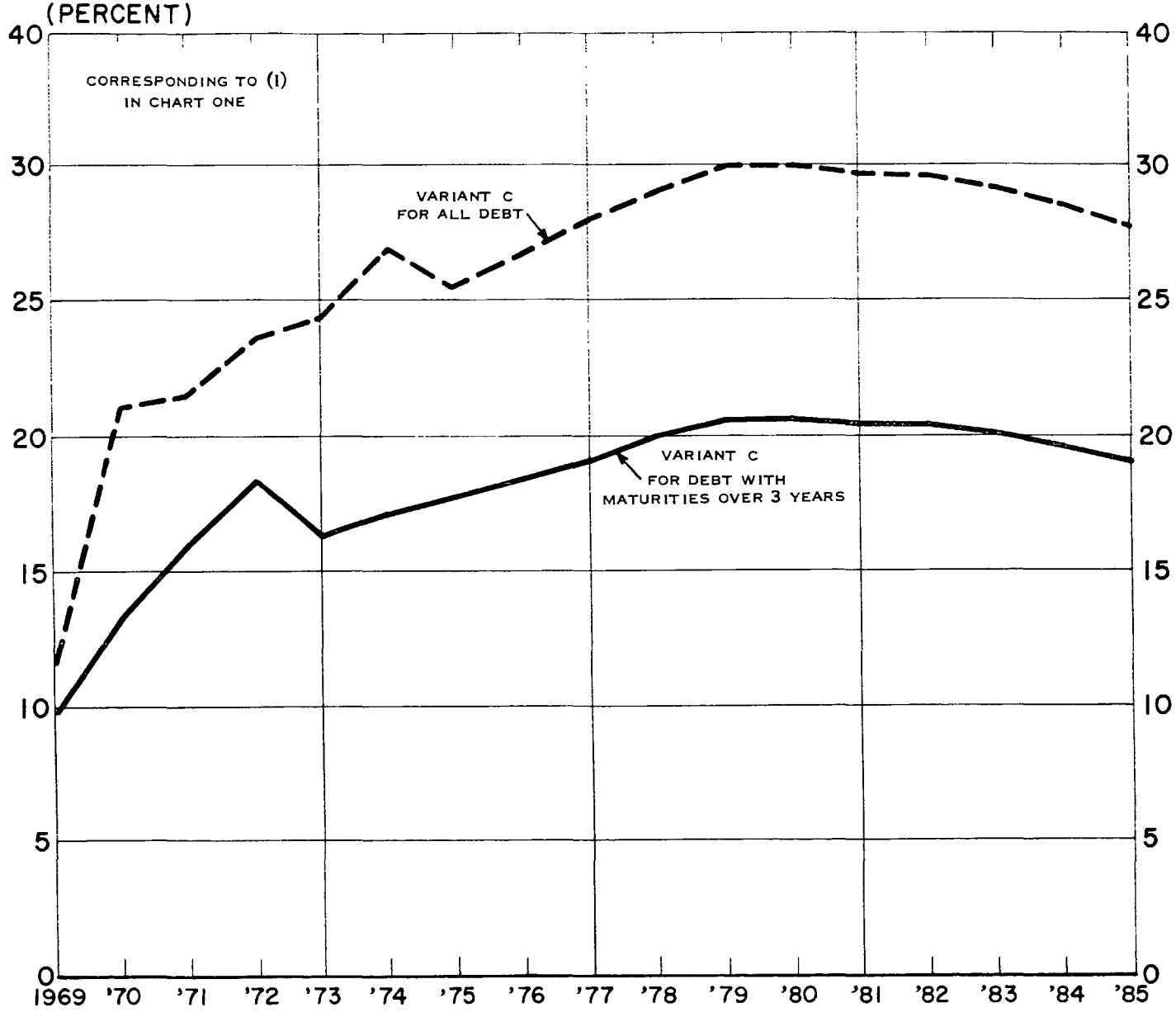


CHART 2

IBRD - 4874

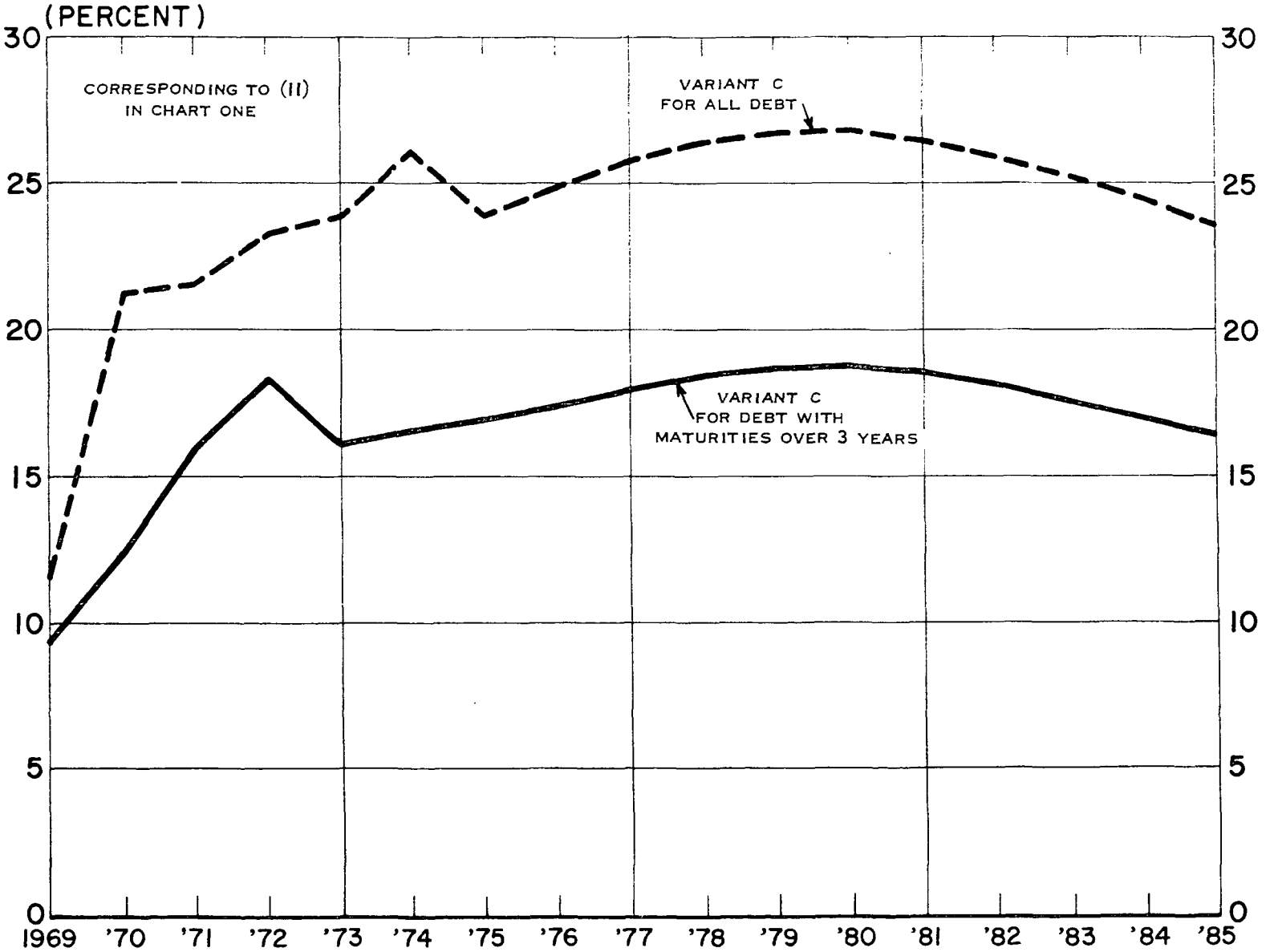
KOREA: PROJECTED RATIO OF DEBT SERVICE TO EXPORTS OF GOODS AND SERVICES (1)



IBRD - 4875

CHART 3

KOREA: PROJECTED RATIO OF DEBT SERVICE TO EXPORTS OF GOODS AND SERVICES (II)



IBRD - 4876

CHART 4

APPENDIX I

POPULATION, FAMILY PLANNING, URBANIZATION AND EMPLOYMENT.

Population

1. By the end of 1969, the population was estimated at 31.5 million. The country is heavily populated, with a density of about 315 inhabitants per square kilometer.

2. In the period 1963-68 the population growth rate declined by about 5 per thousand, to almost 23.0 per thousand in 1968. During this period, the crude birth rate decreased by over 6.5 per thousand. Various factors have contributed to this decline, including urbanization, a higher marriage age and increased use of devices to prevent conception.

3. The age structure of the Korean population is similar to that of the countries of Asia, Africa and Latin America, with the notable exemption of Japan. About 43 percent of the population is less than 15 years of age and only 3 percent is over 65 years. The Mission estimates that by 1976, when the population is expected to be about 36 million, the 0-14 age group will account for about 35 percent of the population and the group over 65 years of age will account for about 4 percent.

Family Planning

4. The official family planning program emphasizes use of the loop. Higher targets for new users have successfully counteracted the large drop-out rate of participants using this method. On July 31, 1969, about 1.1 million couples (or 27.9 percent of the eligible women aged 20-44) were protected through some phase of the program and 1.5 million loop insertions (including 20 percent reinsertions) had been made; over 150,000 couples were receiving condoms monthly; 125,000 vasectories had been performed and over 90,000 women were using oral pills. The pill was initially introduced in the program in 1968.

5. In 1969 expenditure on the Government family planning program (excluding foreign assistance) was 816 million won, or a 29 percent increase over 1968. In 1969 the central government contributed about three-fourths of the total and the local governments the rest.

6. External assistance to the family planning program, both in cash and kind, has been significant. The major cash contributions have come from the U.S. Population Council, the International Planned Parenthood Federation and, lately, from U.S. AID. Such cash assistance amounted to $577,650 in 1968, as compared to $894,800 in 1964; for 1969, $461,600 is estimated. This money has been used mainly to finance training, educational campaigns, program evaluations and related research.

7. The main contributors to assistance in kind have been SIDA (Swedish International Development Association) and also U.S.AID. With the allocation of foreign aid funds for family planning by the U.S. Congress, U.S. assistance in kind increased from $67,000 in 1967 to $1.4 million in 1968. For 1969 it was $1.1 million, and estimates for 1970 and 1971 are $880,000 and $525,000 respectively. This assistance includes programs for participant training, equipment for health facilities, laboratories, equipment for the new Family Planning Center at Seoul, and logistical support for related research by various Governmental agencies and universities. SIDA has recently contributed 36 land rovers for the mobile units of the family planning program, and is committed to supply 7 million cycles of the pill, delivery of which has begun. It is also financing most of the construction costs of the $500,000 Family Planning Center in Seoul, to be completed by the summer of 1970.

8. The target of the Second Five-Year Plan is to reduce the population growth rate to 20.0 per thousand by 1971. Since the impact of self financed family planning is expected to be marginal during the Second Plan period, there is an overwhelming reliance on the public family planning program to achieve the target.

9. The participation in the official family planning program is projected to level off after 1970, but self financed family planning is expected to increase substantially in the Third Plan period. The Korean official estimate is that by 1976 about 35 percent of the births averted through family planning will be from the self financed practice of program participants. The official target of population growth rate in 1976 is 15.0 per thousand, but we feel that the family planning program may not be so effective, and a population growth rate of up to 17.0 per thousand in 1976 is quite likely.

DEMOGRAPHIC CHARACTERISTICS: 1970-76

Year	Crude Birth a/ Rate (per '000)	Crude Death b/ Rate (per '000)	Population (end of year - in million)
1970	29.5	8.0	32.2
1971	28.1	7.7	32.9
1972	27.5	7.4	33.5
1973	27.1	7.2	34.2
1974	26.0	6.8	34.9
1975	24.7	6.6	35.5
1976	23.4	6.3	36.1

a/ Mission's estimates on the basis of crude birth rates provided by the Ministry of Health and Social Affairs.
b/ Ministry of Health and Social Affairs

Sources: As per footnotes

Migration

10. Based on the 1960-66 average annual rate of migration into the urban areas of about 2.7 percent, we estimate that by the end of 1969, 35 percent of the population was residing in the urban sector, as compared to 28 percent in 1960. The provinces of the country have shared unequally in the urbanisation movement. In urban-rural migration within the provinces, the highest net urban gains have occurred in provinces with a relatively higher proportion of population in the rural sector. In inter-provincial rural-urban migration, the net urban gain has almost exclusively been realized by the cities of Seoul and Pusan, particularly Seoul.

11. Migration between the urban sectors of the provinces (including the cities of Seoul and Pusan) is more limited in magnitude. The outstanding characteristic of this type of migration is that the city of Seoul is the main net recipient of the people leaving the urban sectors of the other provinces.

12. The growth of the city of Seoul is striking. The city's population of 4.8 million in 1969 shows an increase of 38 percent since 1965. About 80 percent of this increase is explained by the net in-migration, and the rest by the natural increase of the indigenous population. The characteristics of the migrants into Seoul are generally representative of the migrants at large. A large proportion of the migrants are dependents migrating concurrently with their household heads, or belatedly joining members of their family already settled there. Less than a quarter of the migrants have jobs upon arrival. Unemployment among migrants is very high during the first year (around 40 percent), particularly among women. The expansion of employment demand in recent years, however, has absorbed a substantial portion of the jobless migrants along with the indigenous city manpower. Total unemployment is high, but on a declining trend since an all-time high of 25 percent in 1964.

13. The rapid increase in the population of the cities has been closely related to the rapid growth in employment in manufacturing. However, the experience of the migrants to the city of Seoul suggests that the geographical transfer of the economically active migrants is accompanied by a change in occupation into predominantly tertiary economic activities. This would imply that the absorption of labor by the expanding manufacturing sector is drawn mainly from the indigenous urban population and that the migrants find employment, in large numbers, in the tertiary industries, the growth of which is complementary to that of the secondary industry.

14. The physical reallocation of people within, and among, the provinces' rural and urban sectors imposes many demands for infrastructure investment. The most critical situation arises in housing. Various indicators

of urbanization have been found to be significantly correlated with the shortage of urban housing. While the total deficit of housing units (based on the judgement that each household should have its own quarters and by definition excluding substandard housing) has remained in the magnitude of 25 percent of total required housing since 1965, the situation in the urban sector is more critical. Despite some recent relative improvements in the housing situation in Seoul and Pusan, the deficit ratio in 1968 was 48 percent for the urban sector (51 and 52 percent respectively for Seoul and Pusan).

15. The Second Five-Year Plan calls for the construction of 500,000 housing units, of which 6 percent are to be constructed by the public sector at a total cost of 4,783 million won. The construction of that number of housing units is just sufficient to retain the total housing deficit ratio of 26 percent by 1971. However, there is no assurance that the private sector will meet the Government's expectations by increasing private construction of housing units 20 percent above previous performance levels, considering the high interest rate.

16. We estimate that by 1976 over 43 percent of the population will reside in the urban sector. Our estimates are based on the assumption that the decline in the natural rate of growth of the indigenous urban population will continue to lead the national one, and that the rate of urbanization will remain about the same. The expected total urban growth of about 3.5 million people during 1970-76 will create a new demand for over 700,000 urban housing units in addition to the demands for the related water, electric and sanitary services. If the urban housing deficit ratio is to remain at its 1968 level of 48 percent, there should be an annual construction of over 100,000 housing units in the sector in order to accommodate the new demand on housing plus additional construction, as required, to meet whatever needs arise from replacement of structures due to aging or destruction from natural calamities.

Employment

17. Employment increased by about 2.8 percent annually on the average during 1963-68. The most rapid increase in employment occurred in the secondary industries, followed by the services sector. In agriculture, total farm employment has been maintained, but male employment has declined. This has been compensated by an increase in female farm employment.

18. The ratio of employed to economically active has steadily increased since 1963, with stronger advances registered among the non-farm economically active population. Employment in the non-farm sector rose from 84 percent to 91 percent of the economically active (or labor force) during 1963-68. The share of non-agricultural employment in total employment has increased

from 37 to 48 percent in the same period. Increases in manufacturing employment accounted for 37 percent of this increase; commerce for 29 percent; services for 14 percent, and transportation, storage and communications 8 percent. Non-agricultural male employment increased during the same period by 44 percent, while the non-farm female employment increased by 61 percent. Increases in male employment were spread, more or less, over all economic activities, with the lowest in services. Increases in female employment occurred mostly in manufacturing and services. On the other hand, in 1968 farm (male) employment still accounted for 46 percent of total male employment, and farm female employment 57 percent of total female employment.

19. General changes in employment have been accompanied by a number of healthy signs in other structural characteristics of the labor market. Some other structural changes also occurred during 1963-68. The number of regularly employed in the non-farm sector has increased by over 85 percent, mostly in male workers. In the farm sector, the employment of family workers declined by about 9 percent, indicating out-migration. Self-employment has increased by 10 percent during 1963-68, with those in the non-farm sector increasing by 30 percent.

20. The average number of hours worked has increased slightly from 47.5 hours per week in 1963 to 49.3 in 1968. In non-agricultural employment, those working 40 hours and over increased from 81 percent of the workers in 1963 to 88 percent in 1968. The increases in the average hours worked per week may reflect some of the tightening of the labor market.

21. There exists a great seasonal variation in the employment in the farm sector. In 1968, for example, more than 3 million farm workers, or about twice the total number of workers in the low farm activity season, predominately family workers, joined the labor force only temporarily for the rice planting and harvesting periods in the spring and fall quarters. A scarcity of labor has been observed at the peak of the seasonal demand in spring. This seems to have brought about a very significant increase in the number of hours worked during spring, the average of which was in 1968 25 percent higher than in winter.

Unemployment

22. Since employment growth has outpaced the increase in the economically active population, unemployment has steadily declined from an annual average of 705,000 in 1963 (8 percent) to 496,000 in 1968 (5 percent). Male unemployment declined faster than the female one. In 1968 it stood at 2.1 percent for farm households and at 9.3 percent for non-farm households. The respective unemployment rates for the females in 1968 were 1.6 and 8.1 percent.

23. The highest unemployment rates are among those aged 14-29. The unemployment in the lower age brackets is very high because it includes those seeking employment for the first time. Although male new job seekers outnumber the female ones by a ratio of about 3:2, female unemployment is more than double that of the male in the 14-19 age bracket and about double that of the male in the 20-24 age bracket.

24. A central labor agency has been organized to coordinate and assist the functions of the labor market on the basis of the Amended Employment Security Law of 1967. The Employment Service System started its operations in 1969. It accepts requests for workers, registers and counsels applicants for employment, and researches labor market conditions. In the first six months of 1969, the demand for laborers through the Agency's offices has exceeded the number of applicants in that period by 3:2; placements have been limited only to 1 out of 3 applicants for jobs (5,718). At present, few workers know of the Agency's existence and services. Workers using it have high expectations as to their wage and employment conditions, but the larger establishments (with 100 or more workers) placed 73 percent of the request for manpower with the expectation of hiring cheap labor. The difference between the wage offered by prospective employers and the wage expected by the prospective employees has not, as yet, been successfully negotiated through the services of the Agency.

ECONOMICALLY ACTIVE, EMPLOYED & UNEMPLOYED: 1963-68
(In thousands)

	Agriculture Forestry & Fisheries	Mining & Manufact.	Services	First Job Seekers	Total
1963					
Econ. Active	5,090	760	2,424	379	8,653
Employed	5,021	690	2,236	-	7,947
Unemployed:					
Absolute	69	70	188	379	706
% of Econ. Active	1.4	9.2	7.8	-	8.1
1964					
Econ. Active	5,153	790	2,591	358	8,892
Employed	5,084	725	2,401	-	8,210
Unemployed:					
Absolute	69	65	190	358	682
% of Econ. Active	1.3	8.2	7.3	-	7.7
1965					
Econ. Active	5,056	936	2,808	400	9,200
Employed	5,000	880	2,643	-	8,523
Unemployed:					
Absolute	56	56	165	400	677
% of Econ. Active	1.1	6.0	5.9	-	7.4
1966					
Econ. Active	5,076	985	2,829	435	9,325
Employed	5,013	940	2,706	-	8,659
Unemployed:					
Absolute	63	45	123	435	666
% of Econ. Active	1.2	4.6	4.3	-	7.1
1967					
Econ. Active	4,964	1,197	2,986	355	9,502
Employed	4,924	1,138	2,852	-	8,914
Unemployed:					
Absolute	40	59	134	355	588
% of Econ. Active	0.8	4.9	4.5	-	6.2
1968					
Econ. Active	4,900	1,346	3,218	293	9,757
Employed	4,836	1,295	3,103	-	9,261
Unemployed:					
Absolute	37	51	115	293	496
% of Econ. Active	0.8	3.8	3.6	-	5.1

Source: Economic Planning Board, Annual Report on the Economically Active Population

APPENDIX II

RECENT DEVELOPMENTS IN FINANCIAL INSTITUTIONS AND CAPITAL MARKETS

1. Since early 1968, the monetary authorities have taken measures to strengthen the banking institutions and to promote the development of capital markets. The rapid growth of deposits and loans, and the great expansion of the function of guaranteeing foreign loans, along with inflation, have necessitated the increase in capitalization of the banks. Thus, in August 1868, the monetary authorities approved a 91 percent increase in the total capital of five commercial banks[1/]. The capital of four specialized Government financial institutions has been trebled[2/].

2. To strengthen the banking business, the existing laws have also been amended. In January 1969, the General Banking Act was amended so that every banking institution shall maintain an amount of paid-in capital and surplus equivalent to at least one-fifteenth of its foreign debt repayment guarantees. For specialized banks, the limitations on receiving deposits by both the Medium Industry Bank and the Citizens National Bank (which specializes in consumer's installment credits) were abolished in 1968. The latter was also allowed to issue "national savings debentures" within a limit equivalent to ten times the sum of its paid-in capital and reserves.

3. The most important change was perhaps the great enhancement of the KDB. Along with the increase in total capitalization, the amendments to the KDB Act in September 1968 have also enlarged its capacity in financing industrial development. The limit on the outstanding balance of industrial financial debentures and obligations, resulting from the KDB's underwriting of stock issues and from guaranteeing loan repayments, was raised from the amount equivalent to ten times the Bank's paid-in capital to an amount equivalent to ten times the sum of its paid-in capital and reserves. The upper limit of KDB's equity investment in a given company was increased from 50

1/ Authorized capital increased from 9.4 billion won to 18.0 billion won. All five banks have Government shares. In some cases these shares account for more than 50 percent of the total.

2/ In March 1968, the Medium Industry Bank's capital was raised from 3.0 billion won to 4.0 billion won; in July the Citizens National Banks' capital from 0.5 billion won to 5.0 billion won, and in September the Korean Development Bank's (foremerly Korean Reconstruction Bank) from 20 billion won to 70 billion won, while the Korea Exchange Bank's capital was increased from 10.0 billion won to 30.0 billion won.

percent to 100 percent of the paid-in capital of the company in question. Thus, KDB's function was enlarged to that of a holding company.

4. In July 1969, with the passing of the Korea Development Bank Shareholding Administration Act, KDB became the holding company and central manager for the Government-controlled enterprises, currently numbering about 36 and operating under the supervision of the respective ministries. A Management Committee, chaired by the Deputy Prime Minister with participation of all Ministers and the KDB Governor, has been established to formulate basic guidelines for the enterprises' business projects and annual budgets. To fulfill the additional function, the KDB's authorized capital was further increased from 70 billion won to 150 billion won. Enterprise management funds to be established in KDB are to be derived by borrowing from the Government, from stock sales and dividends received, and are to be operated independently from other KDB accounts. In October 1969, the first six enterprises[1/] were transferred to KDB control.

5. In early 1969, the Korean National Assembly authorized the KDB to issue industrial financial debentures up to a total of 15 billion won. By the end of September 1969, KDB had issued 6.5 billion won of debentures, with a two year maturity at a discount rate of 24 percent per annum, tax free. The new debentures are listed on the stock market and can be used in lieu of cash to meet any guarantee or deposit requirements of the Government and for collateral on loans from banking institutions.

6. Several new financial institutions were also authorized by the Government. In December 1968, a trust bank was established for the sole purpose of handling trust business that was previously handled by the commercial banks. In addition, two more provincial banks were established, increasing the number of local banks to five. In mid-1969, the legal groundwork was laid for the establishment of a Korean Export-Import Bank to take charge (from the Korea Exchange Bank) of medium and long-term export credit. The authorized capital of the Bank will be 30 billion won and will be wholly Government-subscribed. Loans and guarantees generally will be up to 5 years; however, for ships, railway rolling stock and other export goods designated by Presidential decree, the terms can be extended to 10 years.

1/ Korea Oil Corporation; Korea Tungsten Mining Co. Ltd; Chungju Fertilizer Corp; Honam Fertilizer Corp; Korea Salt Co. Ltd; and Daehan Coal Corp.

7. Realizing the excessive dependence of Korean enterprises on loan capital, the drawbacks of the traditional closed family corporations and the need for mobilizing additional domestic resources, the Government has tried to promote equity investment through the organized capital market. Since 1967, it has taken a number of concrete steps in this direction, although not many tangible results have been seen. As mentioned above in connection with the tax reform, the Government has granted preferential corporate income tax treatment to "open" corporations. It has also enacted the Real Estate Investment Supression Law to discourage real estate speculation by heavily taxing capital gains from real estate transactions and thereby attracting funds to the stock market.

8. In late 1968, it promulgated the Capital Market Promotion Law, which incorporates preferential corporate tax rates and special depreciation allowances to "open" corporations, amd exemptions of income tax on dividends from stocks of "open" corporations. More importantly, it authorizes the establishment of the Korea Investment Development Corporation (KIDC) to engage in underwriting and transactions of securities, stock market operations for preventing undue fluctuations in stock prices, loans against securities, and securities investment trusts. KIDC has already started operation and, under its sponsorship, the Consultative Organization for Underwiring of Securities was established in January 1969. The organization consists of KIDC, KDB, KDFC, NACF, the five commercial banks, the Korea Trust Bank, the two insurance associations, and the Korea Stock Brokers Association. It provides a permanent body for consulting on the organization of underwriting or sub-underwriting syndicates for the sales of Government and corporate securities.

9. In addition, the Government also approved the establishment of securities departments in commercial banks to enable the banks to deal on the stock market without the intermediacy of security dealers and also has allowed the banks to extend loans with securities as collateral.

APPENDIX III

PRE-INVESTMENT STUDIES

A. Background

1. Government investment programs and projects in Korea are prepared by the various responsible Ministries or Government agencies, then coordinated with the Economic Planning Board, approved by the Council of Economic Ministers and incorporated in the plan and the annual Overall Resources Budget.

2. Virtually all Ministries and Government agencies have their own planning units which have formulated their own sector development programs, such as the Ten-Year National Construction plan (1967-1976) and the Highway Development Program (1967-1976) prepared by the Ministry of National Construction, the long-range power development program prepared by the Korea Electric Company and more lately, the Ten-Year Rural Modernization Plan (1969-1979) by the Ministry of Agriculture and Forestry, covering irrigation, land development, and farm housing projects. The sector plans usually go beyond the medium-term horizon of the five-year plans. In general, they represent maximal programs for the sector concerned and their size and priorities may have to be altered when being integrated into the macro-economic frame of the Five-Year Plans or the ORB for budget allocation and implementation.

3. Korea has quite a sizeable number of competent technical personnel (e.g., engineers, technicians, administrators, etc.) and several important pre-investment studies were carried out by the Korean themselves with only little or no help from abroad. Notable examples are the studies for the construction of the Seoul-Pusan Expressway, the pre-investment studies for some ports (like the master plan for the expansion of Pusan port, Mukho, and Cheju) and lately the integrated iron and steel mill at Pohang.

4. The Korean Government has been constantly surveying their water and land resources and studying possibilities of project investment. This includes broad surveys of river basins, multi-purpose dam construction, flood control and disaster prevention, and irrigation and land reclamation. The Ministry of Construction has conducted a survey of the Yangsongang River basin and is investigating and designing eight multipurpose dams (Andong, Imha, Hapcheon, Chungju, Hankang, Imkye, Yongdam and Dongbook).

5. In addition, Korea obtained assistance from abroad for important pre-investment studies, especially from UNDP/FAO, the Bank Group, USAID and lately, from Japan. The UNDP has conducted a number of projects for developing Korea's agricultural potential. Surveys on tube-well irrigation, watershed management and slopeland development, initiated as pre-investment studies, have already led to actual investment. A tidal land reclamation survey was terminated in 1967, as it turned out clearly that the costs of tidal land reclamation would be too high as compared with slopeland development. At present, there are two major pre-investment studies being carried out under UNDP in Korea. A pre-investment survey on the Naktong River Basin, to be completed by 1970, aims at formulating long-term integrated plans for the development of the Basin's land and water resources. The forest survey and development program, to be completed by 1973, includes demarcation and mapping of the limits of potential commercially exploitable forests, management planning training, identification of investment opportunities, reforestation and erosion control of the watersheds.

6. In addition to acting as executing agent for most of the above-mentioned UNDP projects, FAO recently has prepared a study of Korea's agricultural credit system under its cooperation program with the IBRD. This study relates to a Korean request for a $10 million agricultural credit loan from IBRD.

7. The UNDP Special Fund is now embarking on a major study to assist the Korean Government in preparing regional physical plans as a component of the Third Five-Year Plan. The study is to establish a set of regional plans which will translate into detailed physical terms. In this context, it will draw up provisional land utilization plans, propose priority programs for the development of national resources, recommend optimal locations for different types of industries and examine current urban growth trends with suggestions to correct present regional imbalances in growth. It will identify resulting infrastructural development needs in such sectors as transportation (mainly intra-city), communication, power, and water. It will also assess the social consequences of the proposals made regarding rural-urban migration, urban living conditions, housing, health, and educational needs, effects on wholesale and retail trade, etc. The team will consist of at least 10 experts, and it is to complete its work before 1972.

8. UNDP has received informal Korean requests for help in conducting oceanographic pre-investment studies including oil and other mineral resources after the U.S. Army has finished air reconnaisance of the shoreline. Gulf Oil has already been prospecting for oil in some coastal areas. At present, UNDP is examining whether studies on mineral resources

should be concentrated on land areas rather than on coastal areas since the new USAID investigations which were more optimistic about mineral deposits in Korea.

9. UNIDO may be asked to prepare a pre-investment study on the establishment of an export processing zone with a free port in Masan.

10. Bank Group assistance for pre-investment studies has so far been confined to the transportation sector. As a result of a technical assistance grant from the Bank, a French-Dutch firm of consultants prepared a comprehensive Transportation Survey for Korea in 1965-66. This study provided the basis for the allocation of the transportation investment in the Second Five-Year Plan. In 1968, IDA made a project preparation credit of $3.5 million to finance consulting services for a highway organization study aimed at making recommendations for appropriate modifications in the present transport policies and the establishment of an organization for transport coordination. The consultants' recommendations are to be discussed between the Government and the Bank group, and the consultants will subsequently assist in implementing the accepted recommendations. In addition, the credit also included funds for feasibility studies and subsequent detailed engineering of selected priority highway projects. IDA has in the past made two credits to Korea National Railroads for the procurement of rolling stock and consulting services for the railroads. The latter included funds to make studies on improvements of KNR facilities including marshalling yards, workshops, and repair facilities. In this context, a study on coal transportation and distribution was made in 1968 in order to promote more efficient utilization of coal cars.

11. In 1968, USAID experts did a study on grain storage, handling, processing and distribution problems and recommended a formal feasibility study. No concrete action has yet been taken. A major project undertaken by USAID has been the comprehensive survey of water resources and land use in the Han River basin. This study is to be completed by 1971. In the past, USAID has given considerable technical assistance to the Korea Electric Company in establishing its pre-investment studies for its power development program. The only power pre-investment study currently under preparation is also sponsored by USAID under its Second Transmission and Distribution Loan. In manufacturing, USAID plans to undertake a study in conjunction with the Korean Government, to investigate whether idle capacity in the existing machine industry is worth utilizing at all and where new investment in this industry should be directed in order to avoid misallocation of resources.

12. Japanese consultants financed by grants under PAC funds are currently conducting a survey on the Kumgang River Basin with the purpose of formulating a long-term plan for the development of its land and water resources. Another group of Japanese consultants financed by PAC funds has just completed a study of possibilities of developing the livestock industry.

B. Future Pre-investment Studies

13. Because of the limited time and resources available, the Mission has not attempted to develop a comprehensive country program for pre-investment studies in selected fields which the Mission feels should have high priority. In some cases, such studies may lead to a reappraisal of projects already under preparation.

Agriculture 1/

14. Water and Land Resources: Part of the seven large-scale irrigation projects to be implemented by the Ministry of Agriculture and Forestry benefitting about 120,000 ha area in lowland and the land conversion projects for more than 400,000 ha of slope areas urgently require pre-investment studies. Some river-basin-wide studies are underway - e.g. those on Naktong and Han rivers. The river basin approach should also be applied to the study of other major river basins, thereby (i) combining water development programs with watershed management, soil conservation and forest management programs, and (ii) assessing total water supply and water demands for irrigation, power, and urban and industrial development, possibly in coordination with the envisaged regional physical plans. In evaluating slopeland conversion, attention should also be paid to marketing and transportation. In carrying out these pre-investment studies, it is important that close inter-agency coordination and cooperation be maintained, particularly in pooling or sharing of all available data, experienced and technical personnel in the various Government agencies concerned. Based on these pre-investment studies, integrated basin wide development programs can be formulated. Such programs will provide an adequate base for the overall planning and budgeting agencies to review and establish proper priorities.

15. Mechanization: Studies should cover types of farm equipment suitable to land use in Korea, with special reference to the experience in Japan. They should also find appropriate systems which provide the machinery at reasonable cost and train farmers in the required operational skills. Studies should relate to land consolidation, group farming, machinery pool and repair services, and possibilities of local manufacturing of farm machinery.

1/ For details of explanation, see Volume II, Annex I.

16. Livestock: Lacking livestock tradition, Korea should have a comprehensive livestock development program, with emphasis on cattle. Priority of pre-investment studies should be given to domestic marketing for livestock products, particularly processing, packing, storage and transportation facilities. Then, tracing back to the production structure, the studies should find out how to fit livestock raising in small-holder farms and how to develop slopeland for pasture formation. The studies should also cover the development of a feed industry and veterinary services.

17. Agribusiness: With the livestock program and farm machinery being studied separately, pre-investment studies in the broad agri-business field should be confined to new cash crops, tree-farm produce, coastal and cultural fisheries, and should explore potentials of domestic and foreign markets, ways of encouraging private investment, measures to ensure marketing discipline and credit supply, and training of skilled labor.

Manufacturing 1/

18. Pre-investment studies in the development of mechanical (machinery) industries are urgently needed, as emphasized in the main text. The studies should try to identify those branches of the industries which are technically feasible and economically profitable to develop under Korean conditions. The results should provide guidance to private investment. The studies should cover the problems of standardization, size of the market, technological inputs (particularly blue-prints and designs), arrangements of sub-contractors, availability of production engineers, etc.

Power 1/

19. In the power sector, pre-investment studies will be necessary in the following fields in the order of priority:

Load Forecasting:

(i) To determine the most probable demand for electricity for each year up to 1981 and a spot figure for 1990. Both peak demand (kw) and energy requirements (kwh) should be covered.

(ii) To indicate a reasonable range of alternative forecasts on either side of the most probable demand.

Although many agencies in Korea have experience in making such forecasts, the Mission suggests the hiring of consultants. The work could be sponsored by the Ministry of Technology and Science, to be financed from its own budget or by UNDP.

1/ For details of explanation, see Volume II, Annex III.

System Planning: To determine the overall optimum development of the generation and transmission system in detail up to 1981 and in outline beyond. Finance is likely to be available in the AID Transmission and Distribution Loan No. 2.

Transportation

20. The Mission suggests pre-investment studies to define in the long run the future roles of the various modes of transportation in Korea, not only during the Third Plan period but also beyond. Such studies should cover the relationship between rail and road in passenger and freight traffic and the relationship between coastal shipping and railway traffic for bulk freight traffic. Such studies should fit in with the planned port development program and the development of new industrial centers in the North-East and South-East of the Republic.

21. For highways, careful studies should be made on the appropriate alignment of future portions of the planned national highway system (including possible expressways), taking into account the location of existing and future industries and the envisaged regional physical plans. In the construction of new sections of tje system, studies should be made on the desirable number of lanes, the question of toll versus freeway, the level of the toll rates imposed and, most importantly, the economics of new expressways versus improving existing roads and the optimum timing of such investment, including staged construction where appropriate.

22. In railways, the Mission suggests pre-investment studies on the future expansion of KNR's workshop facilities, especially on the planned establishment of facilities to build completely by KNR not only rolling stock but also diesel locomotives. Such locomotives might be much more costly than imported ones. Also, the question arises whether the Government railroad company should engage in large-scale manufacturing of rolling stock and engines.

23. In port development, the Government plans to expand port facilities in Pusan and Kungsan, and has requested possible financing from the Bank for the projects. For the development of minor ports, pre-investment studies should be made to establish a set of priorities. This is particularly necessary in connection with coastal shipping, which competes with road transport.

Telecommunications

24. The Mission had no chance to look specifically into the needs for pre-investment studies on telecommunications. Since the Bank Group also has

little sector knowledge from operations, and substantial Korean investments go into the sector (14.7 billion won in the 1970 ORB), a review to establish a sectoral pre-investment program seems justified. It would probably have to cover primarily the improvement of Korea's international telecommunications links (e.g. satellite stations, sea cables) and expansion of domestic facilities (e.g. micro-wave circuits, automatic exchanges, better inter-city connections, etc.)

APPENDIX IV

PROJECTIONS OF GNP COMPONENTS

The Mission's detailed projections of the components of GNP by industrial origin, expenditure on GDP and GNP and net factor income are given in the three tables that follow. The assumptions and methods used in making these projections have been explained in Chapter VI.

Table IV.1

PROJECTION OF INDUSTRIAL ORIGIN OF GNP
(In billion won at 1965 constant market prices)

	1969	1970	1971	1972	1973	1974	1975	1976
Agriculture, Forestry and Fishery	366	383	400	418	437	456	477	498
Mining	17	17	18	18	18	19	19	20
Manufacturing	322	380	437	503	578	665	765	872
Construction	74	85	96	105	113	122	132	141
Electricity, Gas and Water	25	28	33	37	43	50	57	65
Transportation, Storage and Communication	69	81	93	102	110	119	128	139
Wholesale and Retail Trade	221	246	268	292	318	344	371	401
Banking, Insurance and Real Estate	20	22	23	25	27	29	31	33
Ownership of Dwellings	33	34	35	36	38	39	41	42
Public Administration and Defense	50	51	53	54	55	57	58	60
Other Services	82	93	106	113	119	123	126	133
Net Factor Income from Rest of the World	23	7	-5	-17	-19	-27	-36	-45
GNP	1,302	1,427	1,557	1,686	1,837	1,997	2,170	2,359

Source: Mission projections

Table IV.2

PROJECTION OF EXPENDITURES ON GNP
(In billion won at 1965 constant market prices)

	1969 a/	1970	1971	1972	1973	1974	1975	1976
Private Consumption Expenditure	971	1,072	1,164	1,260	1,364	1,477	1,588	1,707
General Government Consumption	118	135	148	162	176	192	209	228
Gross Domestic Fixed Capital Formation	414	426	445	460	483	511	551	601
Increase in Stocks	33	21	23	26	28	30	33	36
Exports of Goods and Services	256	315	382	455	531	621	725	837
Less Imports of Goods and Services	501	549	600	660	726	808	901	1,005
Expenditure on GDP	1,279	1,420	1,562	1,703	1,856	2,023	2,205	2,404
Net Factor Income from Rest of the World	23	7	-5	-17	-19	-27	-35	-45
Expenditure on GNP	1,302	1,427	1,557	1,686	1,837	1,997	2,170	2,359

a/ Preliminary estimates of BOK. The export figure in the preliminary national accounts, however, was adjusted downwards to 256 billion won to be consistent with the Mission's estimates of exports and factor receipts for 1969. The statistical discrepancy was reduced from -24 billion won to -16 billion won.

Source: Mission projections.

Table IV.3

PROJECTION OF NET FACTOR INCOME
(In million US $)

	1969	1970	1971	1972	1973	1974	1975	1976
Factor Income Receipts	153	141	127	109	102	103	108	112
Remittances from Vietnam	71	55	39	20	11	6	6	5
Military	32	30	22	10	5	2	2	2
Civilian	34	22	15	8	5	4	4	3
Non-merchandise insurance	5	3	2	2	1	-	-	-
Investment Income	20	24	26	28	32	36	42	48
Other Factor Services	62	62	62	61	59	61	60	60
Factor Income Payments	67	114	146	171	175	203	242	282
Investment Income a/	37	84	114	136	136	160	195	230
Other Factor Services	30	30	32	35	39	43	47	52
Net Factor Income	86	27	-19	-62	-73	-100	-134	-169

a/ Derived from debt service projection using loan composition variant B which is described in Chapter VI

Source: Mission projections

APPENDIX V

PROJECTIONS OF EXPORTS AND IMPORTS

Merchandise Exports

1. The 1970 ORB includes a target of $1,000 million for merchandise exports (f.o.b., and including exports to military forces in Viet-Nam) in 1970, which is a 42.9 percent increase over the target of $700 million for 1969. As already indicated in Chapter III, merchandise exports (f.o.b., and including exports to military forces in Viet-Nam) in 1969, probably increased to about $664 million, an increase of 36.6 percent from 1968. In order to attain the 1970 target figure, therefore, exports must increase by 50.6 percent in 1970.

2. The Mission believes that in 1970, merchandise exports could rise to about $888 million, an increase of 33.7 percent over the estimate of $664 million for 1969. In assessing export prospects beyond 1970, two separate estimates were prepared for exports of fish and fish preparations, textile fibers, textile yarns and fabrics, non-metallic minerals, transport equipment, and clothing. In each case, the lower estimate was based on less optimistic assumptions about overseas market prospects or about supply conditions in Korea. In the higher projection (Projection A), exports grow to $2,831 million in 1976, whereas in Projection B the corresponding total is $2,490 million. The average annual growth rates from 1968 to 1976 for the two projections are 24.7 percent and 22.7 percent respectively.

3. The importance of exports of food and raw materials relative to exports of manufactures is expected to continue to decline, but at a much slower rate than in the past. The share of food exports in total merchandise exports is expected to fall from 9 percent in 1968 to about 8 percent in 1976, while the share of raw materials is expected to decline from 13 percent in 1968 to about 7 percent in 1976. On the other hand, the share of manufactures is expected to rise from 70 percent in 1968 to about 84 percent in 1976. These changes in the structure of Korean exports reflect the continued trend in industrialization and growth in light manufacturing industries that has characterized the recent past, and which is likely to continue during the Third Five-Year Plan period. Some changes in the composition of manufactured exports is anticipated because of changes in market opportunities and domestic supply and demand. Among exports of manufactures, continued rapid expansion of clothing, machinery and transport equipment; plastics and resins, non-metallic minerals, and iron and steel is anticipated, while the overall rate of increase in exports of silk, plywood, textiles and fabrics, footwear and wigs will be somewhat slower than during the period 1965-68.

4. The Ministry of Commerce and Industry (MCI) expects that in 1970 exports of food will increase to $100 million (this figure includes most of the projected $30 million in exports to military forces in Viet-Nam, which are mainly food items). The Mission estimate for food exports in 1970 is $91 million (excluding exports to military forces in Viet-Nam) and over $100 million if exports to military forces in Viet-Nam are included.

5. Exports of food are expected to rise to between $214 million (Projection B) and $225 million (Projection A) by 1976. The average annual rate of growth between 1968 and 1976 is expected to be about 22 percent, which is slightly higher than the 10 percent annual growth rate achieved between 1965 and 1968. The lower level of food exports reflects the possibility of difficulties in expanding tuna fish exports to Japan because of import restrictions. Prospects for continued rapid expansion in exports of fruit and vegetables remain favorable.

6. It was assumed by the Mission that there would not be substantial exports of rice during the Third Plan period. As already indicated, implementation of existing agricultural policy with respect to rice production could lead to a substantial surplus of rice by 1971. However, in view of the likely difficulties in securing export markets for large quantities of rice and the probable loss in foreign exchange from a low export price relative to domestic costs, it was assumed that such surpluses would not emerge.

7. According to MCI projections, exports of raw materials are expected to reach $103.8 million in 1970, compared with the Mission's estimate of $83.2 million. The difference is due largely to a less optimistic view of prospects for textile fiber (mainly raw silk) exports by the Mission. The MCI projection assumes that textile fiber exports will reach $49.2 million in 1970, compared with actual exports of $20.0 million in 1968. The MCI estimate assumes that the rate of growth in silk exports will increase over the past rate, while the Mission projection assumes that the rate of growth will fall. The MCI projection implies an annual average growth rate of 56.9 percent, compared with the growth rate in the Mission's projection of 25.7 percent a year and an actual growth rate of 37.5 percent a year between 1965 and 1968.

8. The Mission expects textile fiber exports to rise to somewhere between $90 million (Projection B) and $116 million (Projection A) by 1976. The higher projection is based on the assumption that the present rate of growth of silk exports will be sustained during the Third Five-Year Plan period. However, the degree to which silk exports can be expanded depends largely on the extent to which demand for Korean silk will grow in the face of possible competition from cheap silk exports from Mainland China,

and on the ability of Korean producers to continue the present rate of expansion in the industry. The lower projection reflects these difficulties.

9. The other important raw material export is metalliferous ores and scrap (mainly tungsten and iron ores). Here the Mission expects a substantial slowdown in the rate of increase of this group, much in line with that anticipated in the MCI projections, because of the rather limited scope for expansion in the industry. A rate of growth of about 2 percent a year is expected to prevail during the Third Five-Year Plan. Thus, the share of raw materials in total exports is expected to decline from 13.1 percent in 1968 to about 6.8 percent in 1976.

10. The Ministry of Commerce and Industry expects exports of manufactures to reach $779 million in 1970, which implies an increase of 51.8 percent per annum over the 1968 level of $338.2 million. On the other hand, the Mission estimates that exports of manufactures will increase to $684 million, which is an average rate of increase of 42.2 percent a year since 1968. By 1976, exports of manufactures are expected to be between $2,380 million (Projection A) and $2,076 million (Projection B). Thus, the share of manufactures in total exports is expected to rise from 70 percent in 1968 to about 84 percent in 1976.

11. While MCI expects exports of chemicals to reach $24.6 million in 1970, the corresponding Mission estimate is $5.7 million. The MCI projection appears somewhat optimistic in view of the performance in 1969 and the present stage of development of the petro-chemical complex. The completion of the petro-chemical complex by 1971 and operation at full capacity by 1974 should lead to a rapid growth in exports of plastics and resins to as much as $40 million by 1976. Expansion of exports beyond this level is unlikely, given the capacity of the plant and expected rapid growth in domestic demand for chemicals.

12. It is assumed by the Mission that there will only be a relatively small expansion in fertilizer exports because of the high cost of production compared to export prices.

13. The Mission expects plywood exports in 1970 to reach $94 million, compared with the MCI estimate of $131 million. The extent to which plywood exports can be increased depends largely on activity in the construction industry in the United States. Given the fact that Korean plywood already occupies a large share in the US market, the rate of growth in plywood exports may be determined largely by the growth in the US construction industry rather than by any further increase in the share of the market held by Korean exporters. During the Third Five-Year Plan, the growth in plywood exports from Korea is assumed to decline from 15 percent

in 1972 to 10 percent in 1976. A higher growth rate may be possible if higher quality plywood can be produced and marketed, or if new markets in Europe can be obtained. However, scope for developing the European market appears to be limited because of the relative unimportance of plywood in the construction industry there.

14. The other major group of manufactures about which the Mission is less optimistic than the MCI is textile yarns and fabrics. Whereas the MCI estimates exports of these items will reach $126 million in 1970, the corresponding Mission estimate is $80 million. The MCI projection implies that the average annual rate of growth in 1968-70 will be 43.7 percent, compared with the actual growth rate of 32.5 percent a year between 1965 and 1968. The Mission estimate implies a growth rate of 14.4 percent a year from 1968 to 1970. Expansion of exports of cotton textiles depends to a large extend on the limitations imposed by quota restrictions by the United States and other importers, and there is growing pressure in the industrialized countries, especially in the U.S., to tighten these restrictions. Also the absorptive capacity of non-quota markets may be limited. While restrictions on woollen and synthetic fabrics appear currently to be less serious, little expansion in exports of woollens is expected because of the relatively low return from these exports. The past rapid growth in exports of synthetics has been due, in part, to the presence of production surplus to domestic needs. As domestic demand expands, the rate of growth in exports of synthetics may fall somewhat. Further quota restrictions on textile exports could result in an average annual rate of increase as low as 13.5 percent a year, to $168 million by 1976. On the other hand, if the present quota restrictions remain in force, exports of these items could reach as much as $314 million by 1976.

15. The rapid increase in exports of non-metallic minerals in 1969 and 1970 is due largely to cement exports. It is unlikely that exports of this product will expand continuously, because of its relatively low return as an export commodity and the likely rapid growth in domestic demand. However, exports of other non-metallic minerals could grow to as much as $104 million by 1976, depending largely on the extent to which exports of tiles and ceramics are increased. Prospects for expanding exports of these commodities continue to be good and sales could be increased considerably if the past difficulties with the quality of the products can be overcome.

16. With the completion of the integrated steel mill during the Third Plan period, some exports of iron and steel products appear likely. It is expected that there may be a surplus of pig iron available for export and that exports of this and other steel products could grow to $53 million by 1976.

17. The Ministry of Commerce and Industry expects exports of machinery and transport equipment to grow to $95.5 million in 1970, an average rate of increase of 93.6 percent a year from 1968. The Mission

estimates exports to reach $83.5 million in 1970, due to a somewhat slower rate of expansion in exports of electrical machinery and transport equipment. The Mission expects that machinery exports will grow to somewhere between $487 million (Projection B) and $510 million (Projection A) by 1976, depending largely on the success with exports of ships. Additional contracts for construction of fishing vessels are expected and the present program to enlarge the capacity of the shipbuilding industry will allow construction of larger vessels. However, the extent to which the industry can expand exports of larger ships will depend on its ability to compete with other exporters, which at this stage is a matter of conjecture, given trends in labor costs and plans for the steel mill.

18. Exports of miscellaneous manufactures (mainly clothing, footwear and wigs) are forecast by the MCI to increase to $363 million in 1970, compared to the Mission's estimate of $383 million. The Mission has taken a somewhat more optimistic view of the 1970 export prospects for clothing and wigs, in view of the 1969 performance. It is expected that exports of miscellaneous manufactures will be somewhere between $1,127 million (Projection A) and $1,036 million (Projection B) by 1976. The more optimistic estimate is based on the assumption that with the penetration of new markets by Korean exporters exports of clothing will grow more rapidly. Prospects for continued growth in exports of wigs and toys appear favorable and sales of these and other miscellaneous items may reach $230 million by 1976.

Other Projections

19. The Mission's detailed projections of exports of services, imports of merchandise by commodity groups and payments for services are given in the attached tables. The assumptions and methods used to make these projections have been explained in Chapter VI.

Table V.1

PROJECTION OF EXPORTS
(In million US $)

	Actual		1970 ORB Projection		Mission Projection			
	1965	1968	1969	1970	1969	1970	1976 Proj. A	1976 Proj. B
Merchandise Exports (f.o.b.)	175.1	486.2	700.0	1,000.0	664.0	888.3	2,831.4	2,490.9
Excluding those to military forces in Viet-Nam	175.1	455.4	670.0	970.0	642.0	875.1	2,828.4	2,487.9
To military forces in Viet-Nam	-	30.8	30.0	30.0	22.0	13.2	3.0	3.0
Services (a)	111.0	381.7	462.4	480.0	431.0	413.9	389.2	389.2
Excluding sales to military forces in Viet-Nam	111.0	259.9	331.4	349.0	320.6	328.9	380.2	380.2
To military forces in Viet-Nam	-	121.8	131.0	131.0	110.4	85.0	9.0	9.0
Total (a)	286.1	867.9	1,162.4	1,480.0	1,095.0	1,302.2	3,220.6	2,880.1
Excluding exports to military forces in Viet-Nam	286.1	715.3	1,001.4	1,319.0	962.6	1,204.0	3,208.6	2,868.1
To military forces in Viet-Nam	-	152.6	161.0	161.0	132.4	98.2	12.0	12.0

(a) Net of investment income.

Sources: IMF, Balance of Payments Yearbook, Vols. 19, 20, 21; EPB; Mission Estimates

Table V.2

PROJECTIONS OF MERCHANDISE EXPORTS (f.o.b.)

	Commodity Group[a]				Exports to Military Forces in Viet-Nam	Total
	Food	Raw Materials	Manufactures	Others		
Amount (in million US$)						
Actual - 1965	28.2	39.0	106.8	1.1	-	175.1
Actual - 1968	44.5	63.9	338.2	8.8	30.8	486.2
MCI[b] Projection - 1969	87.0	78.0	524.2	10.8	(31.0)	700.0
MCI Projection - 1970	100.0	103.8	779.4	16.7	(31.0)	1,000.0
Mission Projection:						
1969	59.8	74.8	495.9	12.3	22.0	664.0
1970	90.6	83.2	683.6	17.4	13.2	888.3
1976 - Proj. A	225.0	191.7	2,379.8	31.9	3.0	2,831.4
1976 - Proj. B	213.9	165.8	2,076.3	31.9	3.0	2,490.9
Average Annual Growth Rate (%)						
Actual - 1965-68	16.4	17.9	47.1	100.0	-	40.6
MCI Projection: 1968-70	50.0	27.5	51.8	37.7	(0.3)	43.4
Mission Projection:						
1968-70	42.7	14.1	42.2	40.5	-18.3	35.2
1976 - Proj. A	22.5	14.8	27.6	17.4	- 0.3	24.7
1976 - Proj. B	21.7	12.7	25.4	17.4	- 0.3	22.7

a/ Food includes SITC Group 0; raw materials SITC Groups 2,3 and 4; manufactures SITC groups 5,6,7 and 8; and others SITC groups 1 and 9.

b/ The Ministry of Commerce and Industry projections allocate merchandise exports to military forces in Viet-Nam among the various commodity groups which are estimated to be $31.0 million in 1969 and again in 1970. The exports consist mainly of food.

Source: EPB, MCI, and Mission estimates.

Table V.3

PROJECTIONS OF MERCHANDISE EXPORTS (f.o.b.)

SITC Code	Commodity Group	Amount (in million US $)								Average Annual Growth Rate (%)				
		Actual		MCI Projection a/		Mission Projection				Actual	MCI Projection	Mission Projection		
								1976				1968 - 76		
		1965	1968	1969	1970	1969	1970	Proj.A	Proj.B	1965-68	1968-70	1968-70	Proj.A	Proj.B
0	Food	28.2	44.5	87.0	100.1	59.8	90.6	225.0	213.9	16.4	50.0	42.7	22.5	21.7
03	Fish and fish preparations	17.8	25.8	48.5	54.0	30.0	50.0	142.0	130.9	13.2	44.6	39.2	23.8	22.6
05	Fruit and vegetables	5.5	15.6	20.8	24.5	20.8	32.6	74.6	74.6	41.6	25.3	44.5	21.6	21.6
1	Beverages and Tobacco	0.9	8.6	10.8	15.8	12.1	17.2	31.5	31.5	112.2	35.5	41.5	17.6	17.6
12	Tobacco	0.9	7.8	10.5	15.5	10.5	15.0	26.0	26.0	105.4	40.9	38.7	16.2	16.2
2	Crude Materials	37.0	61.5	75.6	101.3	72.0	80.3	188.6	162.7	18.5	28.3	14.2	15.0	12.9
26	Textile Fibers	7.7	20.0	29.8	49.2	26.0	31.6	116.2	90.3	37.5	56.9	25.7	24.6	20.7
28	Metalliferous ores and scrap	17.7	25.8	25.5	26.9	26.0	27.0	31.2	31.2	13.3	2.1	2.3	2.4	2.4
5	Chemicals	0.4	3.1	15.9	24.6	5.0	5.7	40.0	40.0	97.9	181.7	35.6	37.7	37.7
58	Plastics and resins	-	0.2	8.0	15.0	0.6	0.8	30.0	30.0	-	766.2	100.0	87.1	87.1
6	Manufactured goods	66.4	143.6	222.6	296.0	180.7	211.7	703.2	513.7	29.3	43.5	21.4	22.0	17.3
63	Wood and cork	18.2	65.9	90.4	130.6	85.0	94.4	193.0	193.0	53.6	40.8	19.7	14.4	14.4
65	Textile yarns, fabrics	26.3	61.2	111.5	126.4	65.0	80.1	313.5	168.8	32.5	43.7	14.4	22.7	13.5
66	Non-metallic minerals, n.e.s.	2.8	0.9	8.2	16.5	5.0	8.0	104.0	59.2	-46.0	328.3	198.2	80.1	68.8
67-68	Iron, steel and non-ferrous metals	15.6	2.7	4.7	8.4	3.8	5.3	52.7	52.7	-79.5	76.4	40.2	45.0	45.0
7	Machinery and Transport equipment	5.5	24.5	64.1	95.5	49.5	83.5	510.0	486.9	64.5	93.6	80.9	46.2	45.3
71	Machinery, non-electrical	2.5	4.2	5.3	7.7	8.0	13.0	60.0	60.0	18.9	35.4	76.0	39.4	39.4
72	Electrical machinery	1.9	18.9	46.8	70.8	34.0	63.0	400.0	400.0	115.1	92.7	82.6	46.4	46.4
73	Transport equipment	1.1	1.4	12.0	17.6	7.5	7.5	50.0	26.9	8.3	293.2	131.5	56.3	44.7
8	Miscellaneous manufactures	34.5	167.0	221.6	363.3	260.7	382.7	1126.6	1035.7	69.1	47.5	51.4	27.0	25.6
84	Clothing	20.7	112.2	156.0	250.0	172.3	258.5	821.4	730.5	75.7	49.3	51.8	28.6	26.4
85	Footwear	4.2	11.0	16.0	28.0	14.0	19.5	65.5	65.5	37.8	59.5	33.1	25.0	25.0
89	Miscellaneous	8.9	40.9	49.6	85.3	67.0	100.5	229.7	229.7	66.3	44.4	56.8	24.1	24.1
3,4,9	Other	2.2	2.6	2.4	3.4	3.0	3.1	3.5	3.5	5.7	14.6	9.1	3.8	3.8
	Sub-Total	175.1	455.4	700.0	1000.0	642.0	875.1	2828.4	2487.9	37.5	43.4	38.7	25.6	23.4
	Exports to military forces in Vietnam	-	30.8	(31.0)	(31.0)	22.0	13.2	3.0	3.0	-	(0.3)	-18.3	- 0.3	- 0.3
	Total	175.1	486.2	700.0	1000.0	664.0	888.3	2831.4	2490.9	40.6	43.4	35.2	24.7	22.7

a/ The Ministry of Commerce and Industry projections allocate merchandise exports to military forces in Vietnam among the various commodity groups which are estimated to be $31. million in 1969 and again in 1970. The exports consist mainly of food.

Source: MCI and Mission calculations

Table V.4

PROJECTIONS OF EXPORTS OF SERVICES
(In million US $)

	Actual		1970 ORB Projection		Mission Projection		
	1965	1968	1969	1970	1969	1970	1976
Non-monetary Gold	0.5	0.1	(a)	(a)	0.1	0.1	0.1
Freight and Insurance	4.5	17.3	26.9	35.5	21.0	25.2	46.0
Other Transportation	3.4	10.3	14.5	15.0	14.5	15.0	30.0
Travel	7.7	16.9	21.0	26.0	17.5	21.0	43.0
Government, n.i.e.	88.1	257.4	310.3	310.5	294.5	279.0	190.0
Military transactions	74.0	216.6	260.9	263.5	249.5	238.0	136.0
Vietnam b/	-	83.4	83.4	83.0	72.0	60.0	6.0
UN Forces in Korea	74.0	133.2	177.5	178.0	177.5	178.0	130.0
Non-military transactions	14.1	40.8	49.4	47.0	45.0	41.0	54.0
Other Services	6.8	79.7	89.7	93.0	83.4	73.6	80.1
Vietnam c/	-	38.4	48.0	48.0	38.4	25.0	3.0
Other	6.8	41.3	41.7	45.0	45.0	48.6	77.1
Total	111.0	381.7	462.4	480.0	431.0	413.9	389.2

a/ No separate estimate available.

b/ Includes construction and service contracts and remittances by military forces in Viet-Nam.

c/ Includes remittances by civilian technicians and remittances of non-merchandise insurance from Vietnam.

Sources: IMF, Balance of Payments Yearbook, Vols. 19,20,21; EPB; Mission Estimates.

Table V.5

PROJECTIONS OF MERCHANDISE IMPORTS (c.i.f.)
(In million US $)

Commodity Group a/	Actual 1965	Actual 1968	1970 ORB Projection 1969	1970 ORB Projection 1970	Mission Projection 1969	Mission Projection 1970	Mission Projection 1976 Proj. A	Mission Projection 1976 Proj. B
Grains	54.4	129.3	242.0	80.0	210.0	100.0	140.0	140.0
Consumer Goods	16.3	78.9)	982.0	1,203.0	105.0	120.0	250.0	250.0
Intermediate Goods	319.6	721.7)			925.0	1,110.0	2,210.0	2,160.0
Capital Goods	73.1	533.0	634.0	684.0	620.0	680.0	1,100.0	1,080.0
Total	463.4	1,462.9	1,858.0	1,967.0	1,860.0	2,010.0	3,700.0	3,630.0

a/ Grains, SITC 04; Consumer Goods SITC 0, 1, 8, 9 (excluding 04); Intermediate Goods SITC 2-6; Capital Goods SITC 7.

Source: Bank of Korea, Economic Statistics Yearbook 1969; EPB; Mission Estimates.