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November 20, 1967

To: Members of the Executive Board
From: The Secretary
Subject: Korea - 1967 Article XIV Consultation

Attached for consideration by the Executive Directors is the staff report on the 1967 Article XIV consultation with Korea. The decision proposed by the staff appears on pages 16 and 17 of Part I. Background information on the economy and restrictive system of Korea is contained in Part II of the memorandum.

This subject will be brought to the agenda for discussion on a date to be announced.

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INTERNATIONAL MONETARY FUND

REPUBLIC OF KOREA

PART I

Staff Report and Proposed Decision - 1967 Article XIV Consultation

Prepared by Staff Representatives for the
1967 Article XIV Consultation with Korea

(Reviewed by the Committee on Article XIV Consultations)

Approved by Tun Thin and Timothy Sweeney

November 15, 1967

I. Introduction

The Article XIV Consultation discussions with Korea were held in Seoul from August 7 to 19, 1967. The representatives of Korea included officials of the Economic Planning Board, the Ministries of Finance, Commerce and Industry, and Agriculture, and the Bank of Korea. The staff team also had discussions with the Deputy Prime Minister, the Minister of Finance, the Minister of Commerce and Industry, the Governor of the Bank of Korea, the Governor of the Korean Reconstruction Bank and the President of the Foreign Exchange Bank. The staff team consisted of Messrs. Joachim Ahrensdorf, S. Kanasa-Thasan, H.C. Kim, and P. Valabregue. Mr. Beue Tann, Executive Director for Korea, attended some of the meetings. Mr. Pandit, IMF resident advisor, attended the discussions as an observer.

II. Report on Discussions

1. The economy in 1966-67

Gross national product at constant prices increased by 13.4 per cent in 1966, helped by an unusually large increase of 11 per cent in primary production partly due to favorable weather conditions. Manufacturing output rose by 16 per cent. There was a very substantial increase in capital formation and in saving. The ratio of gross investment to GNP rose from 14.7 per cent in 1965 to 22.7 per cent in 1966 and the ratios of domestic and foreign saving (the current account deficit in the balance of payments) to GNP (at constant prices) rose from 8.2 per cent and 6.5 per cent in 1965 to 13.2 per cent and 9.5 per cent, respectively, in 1966.

The money supply rose by 22 per cent in 1966 following an increase of 31 per cent in 1965. Wholesale prices rose by 8 per cent in 1966, or somewhat more than in the previous year, while the implicit GNP deflator rose by nearly 13 per cent as against less than 7 per cent in 1965. The principal factors in the monetary expansion in 1966 were accumulation of foreign exchange reserves and credit to the private sector. Fiscal operations yielded a cash surplus and the growth in quasi-monetary deposits, in response to the interest rate reform of September 1965, was substantially larger than the credit expansion to the private sector. Gold and foreign exchange reserves rose by \$98 million in 1966 as the combined receipts from exports, net invisibles and private transfers and net capital inflow exceeded disbursements for imports which rose by 62 per cent.

GNP at constant prices was estimated to rise in 1967 by 10.5 per cent, and a growth rate of 10 per cent was projected for 1968. In view of the high growth rates in GNP and in saving and investment attained in recent years, the Government expected to achieve an annual growth rate of 10 per cent in the next few years and to reach some of the major targets of the Second Five-Year Plan within three and a half years.

In implementing its current financial stabilization program the Government's main concern has been the deployment of policies directed toward minimizing the expansion in domestic liquidity caused by the continuing balance of payments surplus. However, during the first half of 1967 political pressures connected with the general elections contributed to a large temporary fiscal deficit. The money supply increased by 12 per cent, nearly twice the rate in the first half of 1966. By mid-year the fiscal deficit was eliminated and the growth in the money supply was relatively small during July and August. Bank credit to the private sector, mainly to the growing industrial sector and for financing exports, continued to rise sharply but was more than matched by the growth in time and savings deposits. Wholesale prices in August were 6 per cent higher than in December 1966 and consumer prices were almost 7 per cent higher.

The balance of payments position remained strong in 1967 with exports, net private transfers and net capital receipts continuing to increase more than imports. The growth rate of exports in the first eight months of 1967 was considerably lower than in the corresponding period of 1966. Gold and foreign exchange reserves rose by about \$70 million in the first five months of 1967 to \$309 million and changed little in the following three months. Progress was made in the liberalization of trade and payments.

2. Internal economic policy

a. Development and price policies

The Korean representatives expected a lower growth rate of real GNP for 1967 than for the previous year mainly because primary production was estimated to increase by only 3 per cent in the light of the exceptionally

high output in 1966. They felt that the increase might be higher. Manufacturing output was estimated to rise by nearly 19 per cent, partly as new plants came into production, especially in the fertilizer, cement, and synthetic fiber industries.

The staff team asked for elucidation of the Government's intention to implement the Second Five-Year Plan (1967-71) within three and a half years. The Korean representatives stated that the Plan was still the basic frame for development policies in the next few years. The Plan had been formulated in early 1966 and had set annual growth targets of 7 per cent, approximately equal to the average growth rate achieved in the preceding five years. Considering that large industrial investments in 1966 had increased the productive base of the economy more than had been anticipated when the Plan was formulated, the authorities felt that a 10 per cent growth rate in the next few years was feasible and that internal and external saving adequate to support a higher level of capital formation could be generated. The higher growth rate was to be achieved through more rapid expansion of the secondary and tertiary sectors than originally projected. The implementation of the Plan was to be facilitated through annual over-all resources budgets which would help in resetting each year's targets and also in framing appropriate fiscal and other policies for the year. These annual budgets were to be prepared in a rolling manner, with the budget for any one year being formulated in the light of developments in the previous year and the general prospects for the following year. In order to achieve a higher growth rate than originally planned, the Korean authorities raised the projected total investment during the Plan period by 46 per cent, with a substantial part of the increase allocated for power and transportation sectors where bottlenecks were emerging. To match this increase in investment, projections for foreign saving were raised by 11 per cent and for domestic saving by 67 per cent. The over-all resources budget for 1968 envisaged investment/GNP and domestic saving/GNP ratios of 23.7 per cent and 15.4 per cent as compared with 18.5 per cent and 9.9 per cent, respectively, projected for the year in the Plan.

The staff team expressed concern regarding the ability of the Korean economy to absorb such high levels of investment without misallocations, e.g., due to inadequate project preparation, and to generate savings on the scale projected. The Korean representatives stressed that the projected investment and domestic saving ratios were only slightly higher than those achieved in 1966. Korea's ability to install and operate satisfactorily industrial plants and social overhead facilities had been demonstrated in recent years. With the available supply of skilled labor, they were confident that this satisfactory performance could be maintained. As to the savings projector, they said that in 1966 the amount of domestic saving had doubled, raising the domestic saving/GNP ratio from 8 per cent in 1965 to 13 per cent. The doubling had occurred both in public and private sectors' saving--the former as a result of the 60 per cent increase in revenue collections, and the latter reflecting mostly the 116 per cent increase in time and savings deposits. The further modest increases in the saving ratio

projected for 1967 and 1968 were to be achieved primarily through increased public sector saving. The marginal propensity to save in the private sector had, in fact, been estimated to decline from the abnormally high rate achieved in 1966 as an immediate reaction to the interest rate reform of September 1965. The new projections of foreign saving were based on estimated arrivals of goods under foreign loans and grants already committed. The staff team pointed out that the new projections of foreign saving also depended on the new export projections being realized. The revised export estimates for the Plan period projected an annual average growth in exports of 25 per cent which would be difficult to achieve from the increased base of 1966.

Referring to the rising rate of price increases between 1965 and 1966 the staff team noted that this development was particularly dangerous in a country that had experienced years of chronic inflation and was bound to jeopardize the progress made in reversing price expectations and in enhancing the incentive to save. The Korean representatives said that the Government was fully conscious of such risks and, therefore, had announced its intention to limit the increase in wholesale prices to within 7 per cent in 1967 and 5 per cent in 1968, through appropriate financial policies and import liberalization. The Government no longer relied on direct price controls in its price policy. All such controls were eliminated except for flour which however was inoperative because the market price had been lower than the maximum price.

As regards the Agricultural and the General Price Stabilization Funds set up in the 1967 budget to finance with Central Bank overdrafts inventories of agricultural products and other strategic commodities in order to stabilize their prices, the staff team pointed out that while the evening out of temporary price fluctuations was a justifiable objective, the use of Central Bank overdrafts for this purpose could become large and either endanger the stabilization program or reduce credit available for other purposes. There was also the danger that the price stabilization operations could result in hidden consumer subsidies. Moreover, with progressive import liberalization, price fluctuations would be reduced by the changes in the flow of imports. The Korean representatives asserted that the new Funds were to help influence price expectations. A mere announcement of the Government's intention to use these Funds served to deter speculative activity. So far in 1967 the General Price Stabilization Fund had drawn only W 1 billion from the Central Bank. The Agricultural Price Stabilization Fund had so far not used the overdraft facility but might draw W 2 billion to finance the purchase of barley during the harvest season. It was the Government's policy to operate these Funds without a loss. They agreed that as import liberalization was widened the need for special efforts by the Government to stabilize prices would diminish.

The staff team referred to the practice in recent years of raising steadily official purchase prices for grains. This practice could result in a misallocation of resources and indirectly could affect adversely Korea's export industries by raising wage costs. The reply was that the procurement prices were raised more or less in step with the increase in the general price

level. The Government's policy was to eventually make domestic grain prices broadly equal to international prices by raising agricultural productivity and by limiting general price increases. Agricultural productivity was being improved by wider use of small-sized mechanized tillers and pesticides and the encouragement of double cropping. Early in 1967, the Government had reduced the price of chemical fertilizers following the opening of three new fertilizer plants. The agricultural development program incorporated into the Second Five-Year Plan projected an annual growth of 5 per cent in primary production during 1967-71. Self-sufficiency in foodgrains was projected for 1971, implying no net imports of foodgrains thereafter.

In view of the importance of exports of manufactured goods in Korea's economic growth and the faster increase in wages than in labor productivity in the manufacturing sector in the past two or three years, the staff team inquired about Korea's competitiveness in international markets and the outlook for the expansion of exports of manufactured goods. The Korean representatives stated that wages had risen more rapidly in the new import-substituting industries such as fertilizer and cement than in export industries, which were still largely labor-intensive. Although no accurate data were available, levels of wages in Korea were believed to be still lower than in competing countries. In addition, wage increases would be offset by cost-reducing factors such as more efficient management and economies of scale in production.

b. Financial policies

The central problem in the implementation of the current stabilization program was the large expansionary impact of the balance of payments surplus. In the first eight months of 1967, net foreign assets of the Central Bank increased by W 9.4 billion, as compared with a projected increase in total net domestic and net foreign assets of W 11 billion during the year. During the first half of the year, the authorities were hampered in taking adequate offsetting action due to political pressures associated with the elections. While a substantial amount of commercial bank liquidity was absorbed in the newly created special deposit account with the Central Bank^{1/} and through the issue of Central Bank bonds, the Government had a large cash deficit. By June, the fiscal cash deficit was eliminated and the accumulation of external reserves had leveled off. Between June and August the authorities by and large continued to implement an offsetting policy. Even so by the end of August the money supply was about W 10 billion or nearly 15 per cent higher than at the end of 1966. As important planks in its stabilization policies, the Government further liberalized restrictions on trade and payments and also took some steps to restrict the rapid growth of foreign short-term import credits. It also provided foreign currency loans for the import of capital goods.^{2/}

^{1/} See Part II, p. 39.

^{2/} See Part II, pp. 56-57.

(1) Budgetary policy

The cash surpluses achieved annually since 1964, largely through rapid increases in tax revenue, were an important factor in the stabilization policies. Tax revenue more than doubled between 1964 and 1966, mainly as a result of intensified tax collections backed by the strong support of the President. In 1966 the cash budget surplus amounted to W 6.4 billion, helped to some extent by a larger carryover of expenditure from 1966 into 1967 than at the previous turn of the year. As regards the tendency in recent years to enlarge the amount of carryover of expenditure from one fiscal year to the next, the staff team stressed the difficulties for proper financial management which this practice entailed and urged an early reduction in the level of such expenditure carryovers.

The staff team inquired about the measures which the Government would take to avoid a cash deficit considering the potential deficit elements in the current year's budget, in particular in the Grain Management Account and the two Price Stabilization Funds. The Korean representatives said that whatever deficits occurred in these accounts would be covered by revenue collections in excess of the budget estimates. For this purpose, they intended to keep to a minimum new expenditures to be included in the second supplementary budget for this year. They were confident of achieving over-all balance in the budget and were hopeful of even attaining a cash surplus.

The Government secured authorization in February 1967 to issue Treasury bills. The proceeds of the issue of W 4.8 billion of 90-day Treasury bills to banks at an interest rate of 18 per cent in September 1967 were to be sterilized in the form of deposits with the Central Bank. The staff team inquired about the status of the Government's proposal to set up a Foreign Exchange Equalization Fund for the purpose of acquiring and holding foreign exchange, which was to be financed by transfers from budget revenue and Treasury bill issues. The Korean representatives said that the National Assembly had approved the establishment of the Fund in March, but transfers from revenue have not been included either in the 1968 budget or in the second supplementary budget under preparation for 1967. The Treasury bills issued in September were not linked to the operation of the Foreign Exchange Equalization Fund.

The Budget for 1968 provided for over-all balance, with both revenue and expenditure estimates being about 35 per cent higher than the original budget estimates for 1967. Tax revenue including monopoly profits was estimated to rise by 50 per cent in 1968, raising the ratio of tax revenue to GNP from 9.5 per cent in 1967 to 12.4 per cent. Counterpart fund receipts were estimated to decline further in 1968 and to constitute only 10 per cent of total revenue compared with 16.0 per cent in 1967. Of the projected increase of W 52 billion in tax revenue, about W 7 billion was to be derived from an extensive tax reform, approximately another W 6 billion through higher monopoly profits from increased cigarette prices, and the balance

mostly through the growth in the tax base and through further improvements in tax administration. The large increase in expenditure budgeted for 1968 was mainly related to an increase in transfers to local government associated with shared taxes and a 30 per cent general increase in the salaries of public servants, including defense personnel. This was to be the third annual increase in salaries programmed to compensate public servants for the substantial loss in real wages suffered by them, particularly prior to 1965. Expenditure on capital formation was increased by 46 per cent.

In August, the Government announced proposals for a comprehensive tax reform with the intention to secure legislation in time to make the changes effective from January 1968. In all, two new taxes and thirteen major revisions of existing taxes were proposed. The new taxes were to be levied on telephones and on capital gains from real estate transfers. The revisions covered all major direct and indirect taxes. In the cases of the direct taxes exemption levels were to be raised slightly and the rate structure was to be made more progressive. In order to encourage preferred investment, a new system of investment allowances was to be introduced to supplement the existing special depreciation allowances and the 50 per cent tax exemption applicable to export income. The corporation tax was to be modified in order to encourage the growth of open corporations. A global income tax system was to be introduced for the first time in place of the present schedular system. In view of the administrative problems involved, the new system was to be first applied only to taxpayers with a global annual income above W 5 million. Such taxpayers were estimated to number around 1,500. Revisions of the major indirect taxes, i.e., commodity taxes and liquor and petroleum taxes, were to widen their coverage and to increase the tax rates, thereby raising revenues from such taxes substantially.

As to the reform of tariffs, the main objectives were to make the system more flexible and to restructure it on a more rational basis. Broadly speaking, the new tariff law was to divide goods into protected items and revenue items. Tariff rates on protected items would be determined on the basis of value added, cost difference between domestic and international products, and the degree of essentiality of the goods. Nonprotected items, on the other hand, would be subject to a uniform rate of around 20 per cent with exemptions for industrial machinery and raw materials. In general, protective tariffs would apply to manufactured goods and luxury goods; these latter goods would also be subject to the commodity tax. The new law would authorize the President to change tariff rates within certain limits in the light of changing conditions. At present tariff changes were subject to approval by the National Assembly except those required by international agreements. In the same context it was intended to gradually widen the range of exemptions from the special customs duty.

The Government also intended to raise the price of cigarettes charged by the Monopolies Office and the rates of a number of government enterprises. Railway passenger fares were to be raised by 50 per cent and freight rates

by 30 per cent. Electricity and water rates were also to be raised.^{1/} The additional receipts of government enterprises were to cover the operating losses in the case of some enterprises and to provide surpluses to finance enlarged investment programs.

(2) Credit policy

In March 1967, a new special deposit account (Stabilization Account) was established in the Central Bank. Three reasons prompted this step. First, the amount of Central Bank bonds issued was very close to the statutory ceiling; second, the operation of the Stabilization Account was expected to provide the monetary authorities with a more flexible instrument of credit control than changes in reserve requirements; and, third, since the Central Bank could not legally pay interest on the required reserves of commercial banks, the high marginal reserve requirements in effect since October 1, 1966 (50 per cent against demand deposits and 45 per cent against time and savings deposits) squeezed the earning position of banks. For these reasons, the authorities eliminated the marginal reserve requirements from April 1, but undertook to absorb the same amount of bank liquidity as the marginal reserve requirements did through the Stabilization Account and to a small extent through Central Bank bonds, both of which earned interest of 5 per cent and 10 per cent per annum, respectively. The Korean representatives said that the earning position of banks was still under pressure on account of the narrow margin between the average interest rate paid on bank deposits and that charged on bank credit as well as an increase in wages of bank employees of 20 per cent from April 1967. The 90-day Treasury bills issued were to provide the banks with an asset yielding 18 per cent and thereby ease the banks' earning problem.

Noting some inclination on the part of the Korean authorities to relax credit restraint somewhat in order to ease the banks' earning position, the staff team noted that this problem could be met without jeopardizing the stabilization program by reducing both the application of preferential loan rates of interest and the excess of the interest rate on 18-month deposits (30 per cent per annum) over the maximum loan rate (26 per cent). The staff team also expressed the view that it was desirable to rationalize the present interest rate structure,^{2/} but that it would be premature to effect any significant downward adjustment of the general level of interest rates until reasonable price stability was firmly established. The Korean representatives said that the Government had recently reviewed its interest rate policy and had come to the same broad conclusion. The high interest rate policy had been very successful in promoting saving and the Government did not wish to take any steps which would damage the saving incentive; any reduction should be effected step by step over an extended period.

^{1/} In October railway fares were raised as scheduled and prices of several brands of cigarettes were increased. In November electricity rates were raised by 15 per cent, except for export industries.

^{2/} See Part II, p. 36 and Appendix Table II.

The staff team inquired about the reasons for the continuing rapid increase in time and savings deposits in 1967. Such deposits had risen at a rate of 43 per cent during the first half of 1967, compared with rates of 53 per cent in the first half of 1966 and of 42 per cent in the second half. In fact, the increase in the first half of 1967 has been roughly twice the rate anticipated at the beginning of the year. The Korean representatives said that they had expected a more marked slowing down in the growth rate in 1967 than in fact occurred because they had judged that a considerable part of the increase in quasi-monetary deposits during 1965/66 was of a once-for-all nature reflecting transfer to the banking system of funds which had been circulating in the unorganized money market. The main reasons for the much better performance than expected were the large inflow of personal remittances from Korean soldiers and workers abroad and the continued positive response to the Government's efforts to promote savings. They considered the large growth in installment savings contracts as particularly significant because the depositors contracted to deposit monthly a specified sum over a period of two years. This served as a built-in growth element in quasi-monetary deposits. Generally, they expected that the growth rate in such deposits achieved in the first half of 1967 would be maintained in the second half.

Domestic financing facilities for imports of specified commodities were made available from July 1967 as a step toward curtailing the rapid growth of foreign import credits. Importers were to receive won financing at an interest rate of 24 per cent per annum up to W 140 per dollar of imports in place of the foreign import credits which they were obtaining at much lower rates of interest but often at disadvantageous price quotations. For raw material imports for foreign exchange earning purposes an interest rate of 6 per cent continued to be applied. While this measure would increase bank credit on the one hand, it would also result in foreign exchange payments equal to nearly twice the increase in bank credit for that purpose and thereby exercise some contractionary impact on domestic liquidity.

Considering the financing problems connected with fertilizer operations which had arisen in the past, the staff team asked about the financial implications of increased domestic output of fertilizer and the relatively reduced reliance on imports. The reply was that the Government contracted to buy the entire output of the domestic plants. In the case of production exceeding domestic demand this could result in a large financial burden. The Government therefore was reviewing its procurement policy and also exploring possibilities for export of fertilizer.

3. External economic policy

a. Balance of payments

Gold and foreign exchange reserves rose by \$174 million since the end of 1964 to \$306 million at the end of August 1967. The main factors accounting for this development were increases in exports at an average

annual rate of 42 per cent in the past five years, a sharp increase, particularly in 1966 and 1967, of invisible earnings, and a large inflow of foreign capital which combined more than compensated for the decline in grant aid and the increase in imports.

In 1966, exports increased by 43 per cent over the previous year and a further increase of 40 per cent to \$350 million was set as the target for 1967. In the first six months of 1967, export receipts amounted to \$140 million, or only 40 per cent of the target for the whole year. However, the Korean representatives were hopeful that the target would be reached since exports in the second half of the year generally averaged around 60 per cent of the annual total. Imports rose by 62 per cent to \$680 million in 1966, as a result of the rapid rise in incomes and trade liberalization, and were expected to rise by 21 per cent in 1967. The impact of the liberalization measures taken in July and August 1967 was still uncertain. A trade deficit of \$530 million was expected for 1967 as compared to \$430 million in 1966 and \$245 million in 1965. The increase in the trade deficit was partly compensated by a sharp increase in invisible earnings due in large measure to special factors related to developments in Viet-Nam. Net invisible receipts and sales to UN forces were expected to reach \$156 million in 1967 against \$107 million in 1966 and \$46 million in 1965. The direct impact of the conflict in Viet-Nam on Korea's foreign exchange receipts was estimated at \$53 million in 1966 against only \$16 million in 1965. In the first six months of 1967 direct visible and invisible proceeds from Viet-Nam were already \$53 million, of which \$31 million was in the form of personal remittances by Korean soldiers and workers.

The staff team inquired about prospects of maintaining high growth rates in exports considering that the continuing rise in domestic prices and costs would tend to affect adversely international competitiveness of Korean industries. Moreover, any further proliferation of the numerous export incentives that had contributed materially to the remarkable export performance in the past might render progressively diminishing returns because of increasing administrative complexities. The Korean representatives said that they were aware of the increasing difficulties that would be encountered in expanding exports. However, the Korean traders and manufacturers were acquiring greater experience and were building up trading contacts abroad. Besides, with an increasing scale of production there would be scope for cost reductions. Given declining rates of price increases, which the Government considered as a prime target, and the relatively low level of wages in Korea, they were hopeful of maintaining the export growth momentum, albeit at lower rates of increase than in recent years. As for export incentive schemes, the Korean representatives said that they were gradually changing the nature of their incentives. Hereafter they would primarily be directed to the producer rather than to the trader. Most of the recent changes in export incentive schemes were connected with this shift.

The increased deficit on current account was more than matched by a large inflow of foreign aid and capital in 1966 and in the first half of 1967. The proportion of grants in the total inflow of foreign resources

generally declined. The inflow of grants remained around \$160 million in 1965 and 1966, but was expected to decline to \$145 million or about 16 per cent of estimated imports in 1967. On the other hand, there was a large inflow of capital in the form of public and private loans in 1966. The net inflow of foreign loans amounted to \$205 million, compared with a net outflow of \$2.5 million in 1965, and an annual average net inflow of \$40 million during 1962-64. Official loans increased by \$68 million in 1966, reflecting principally a shift in U.S. official aid from grants to loans, drawings on private long-term loans mainly from Japan and Germany were higher by \$77 million, and there was a sharp increase in short-term trade credits.

With the rapid increase in the amount of foreign loans contracted, Korea's total foreign debt has risen sharply in recent years. In 1966, new official loans contracted amounted to \$153 million,^{1/} against \$77 million in 1965, while new private loans amounted to \$137 million against \$78 million in 1965. In 1967, new official loans were expected to amount to \$150 million and private loans to \$110 million. As of December 31, 1966, the total of outstanding foreign loans with a maturity period of over three years was \$873 million, about equally distributed between official and private loans. During 1966, debt service payments on such loans amounted to \$15 million, or about 3 per cent of current balance of payments receipts as compared to \$7 million or 2.5 per cent in 1965. The Korean representatives estimated that debt service payments on such loans would grow steadily from \$29 million in 1967 to \$67 million in 1971, but could be contained within the Government's self-imposed limit of 9 per cent of annual current account receipts. Foreign loan authorization had been requested for a large number of projects, but in selecting projects the Government would keep the foreign debt burden in line with the limit adopted. Generally, greater attention than in the past would be paid to the terms of loans and the selection of projects to be financed through foreign credits would be more discriminating. The Government was also making greater efforts to attract direct foreign investment and to obtain official loans. The authorization given in 1967 to several foreign banks to open branches in Korea was expected to be helpful in attracting private investors. It was expected that commercial credit approved in 1967 would be less than in 1966.

Short-term foreign obligations, defined as the total amount of letters of credit and "documents on acceptance" (D/A) settlements outstanding and cash loans of less than three years maturity, increased by about \$169 million during 1966 and in the first half of 1967 to \$251 million, equivalent to 29 per cent of estimated imports in 1967. The staff team observed that the increase in such short-term foreign credits had been very sharp, especially in 1967, and well in excess of the amounts estimated by the Korean authorities early in 1967. Even if the outstanding letters of credit and D/A settlements below 90-day maturity were excluded as normal trade financing, the remaining increase in such liabilities equaled \$57 million in the first half of 1967,

^{1/} See Part II, pp. 61-63.

or over 90 per cent of the increase in gross foreign exchange reserves during the same period. Inadequate recognition of this fact could result in excessive confidence about the balance of payments. Moreover, the rapid growth in short-term liabilities could entail serious destabilizing effects on the domestic financial situation and the balance of payments. The Korean representatives said that they were aware of the risks involved in a sharp increase in private short-term liabilities, and that measures had been taken to restrain it. Since July all shippers' usance credits were prohibited and restraint would be exercised by the Ministry of Finance in approving D/A settlements over 90-day maturity. Therefore, a reduction in short-term liabilities outstanding could be expected. Partly as a result, the Korean representatives expected reserves to increase only slightly during the remainder of 1967.

In the light of increasing foreign exchange holdings, the Government initiated in December 1966 a scheme for the granting of loans denominated in foreign currencies at the preferential interest rate of 7.5 per cent to qualified industries and government enterprises from the official foreign exchange reserves. These loans were to reduce the cost of imports of machinery and raw materials for export industries and to reduce recourse to foreign suppliers' credits. The Government announced its willingness to grant such loans up to \$120 million. By the end of June, \$31 million had been allocated. The staff team pointed out that such foreign exchange loans did not absorb domestic liquidity and the exchange holdings used for this scheme had been accumulated substantially through the build-up of short-term liabilities. The Korean representatives said that the Government would like to proceed cautiously in this respect, especially since they did not consider the present level of reserves (four months of imports at the 1967 level) as adequate to meet sharp reversals of the balance of payments position.

b. The restrictive system

Further progress was made in the policy of import liberalization that was initiated in 1965. The number of commodities that could be licensed automatically rose from 1,495 by the end of December 1965 to 3,549 by June 30, 1967, while prohibited items were decreased from 620 to 249. Imports under the automatic licensing category accounted for 83 per cent of imports financed with Korean foreign exchange in 1966 and 87 per cent in the first half of 1967. However, there remained a large number of unspecified items, i.e., commodities which were not included on the import list. Import of an unspecified commodity required application to the Ministry of Commerce and Industry which decided in which category that commodity should be classified.

A further step in import liberalization was taken in July and August 1967 with the introduction of the so-called "negative-list" system. Under this system, which eliminated the category of "unspecified" commodities,

all commodities may be freely imported (i.e., are licensed automatically), unless they are on a negative list, which distinguishes between prohibited and restricted items. Imports of restricted commodities were made subject to the prior approval of the Ministry of Commerce and Industry, or, in some instances, to the approval of another Ministry more particularly concerned with that commodity. Out of a total of about 30,000 items in the Standard Industrial Trade Classification, 19,902 items were placed on the automatic approval list, 5,859 items on the restricted list, and the remaining 4,239 items on the prohibited list.^{1/} This classification cannot be compared with the previous import programs because of the inclusion of previously unspecified items and changes in definitions. The Korean representatives said that a second stage in liberalization was to take effect in January 1968 after the introduction of a new tariff system, so that local industry could be given some reasonable degree of tariff protection. In a third and final stage of liberalization, the Government intended to reduce the negative list to a small number of items prohibited for noneconomic reasons, with all other imports being under automatic approval.

Restrictions on payments for certain invisible transactions, such as banking charges, insurance premiums and subscription in periodicals were removed in 1966, and travel allowances were increased. In July 1967, several restrictions were further reduced. The requirement for nonresidents to register their foreign currency holdings upon entering Korea was eliminated provided they carried only specified currencies. Overseas branches of Korean traders were allowed to maintain under certain conditions accounts in foreign exchange up to specified limits. Allowances for travel and students were further raised. The objective of the remaining controls on payments for invisibles was to prevent unauthorized capital transfers.

c. Exchange rate and exchange certificate market

The exchange certificate market was introduced in March 1965 in order to allow the exchange rate to be determined in response to market forces. Following a short period during which the exchange rate fluctuated it stabilized around W 272 per US\$1 from August 1965, reflecting the exceptionally favorable developments in the balance of payments and the policy of accumulating foreign exchange reserves followed by the authorities.

The exchange certificate market was not very active until recently. Sales of exchange earnings to the Central Bank against won rather than against exchange certificates had increased in 1966. The Government therefore took a number of measures in order to broaden the certificate market and to render it more responsive to changes in the economy. Government-run enterprises were required from August 1966 to buy certificates in order to defray their foreign obligations. The validity of certificates was extended from 15 to 30 days in January 1967, and to 45 days in June. The margin between the Bank of Korea posted buying and selling rates was widened in January 1967, and since March the rates

^{1/} See Part II, p. 71.

applicable to exchange transactions between the Bank of Korea and the foreign exchange banks were set closer to the posted rates in order to reduce the profits of the foreign exchange banks from exchange transactions with the Bank of Korea and thereby to induce them to operate in the certificate market.^{1/} In July, the foreign exchange banks were permitted to operate in the market as dealers, subject to certain maximum limits on their holdings of exchange certificates. Furthermore, these banks were allowed for the first time to hold balances up to certain limits with correspondent banks abroad. The certificate market has become increasingly active and the proportion of certificates issued against export receipts increased from 59 per cent at the end of 1966 to 97 per cent in June 1967. The proportion of exchange receipts on invisibles account against which exchange certificates have been obtained also rose markedly since the end of 1966.

III. Staff Appraisal

Economic activity and growth in Korea have shown remarkable momentum in the last three years. While certain special and perhaps fortuitous factors have played a role in this development, a major factor has been the economic policies pursued by the Government in areas like exchange rate and exports, trade liberalization, interest rates, tax administration, and financial management of the economy. The projected reforms of the tax and tariff structure should help sustain the progress made.

With the achieved momentum in economic activity and the associated growing self-confidence, there may be a tendency to set growth targets the attainment of which may not be feasible in the light of available resources. The Korean authorities are aware of the dangers of renewed rapid inflation that are likely to result from efforts to achieve targets that are out of line with resource availability. The technique of an annual over-all resources budget centered on the mid-year of a three-year period, should facilitate a flexible implementation of the Five-Year Plan in the light of changing conditions.

Inflation remains a matter of concern, considering that from 1965 to 1966 prices rose at an increasing rate, following markedly declining rates of increase in the previous two years. Unless the rates of price increases decline progressively the abatement of inflationary psychology in recent years is likely to reverse itself. Price developments will also have a crucial bearing on the continued role of exports as a leading growth factor in the economy, particularly considering that exports in 1966 still financed only about 37 per cent of total imports.

The increases in certain public utility charges in order to make public enterprises financially self-sustaining should help improve the pattern of resource allocation. On the other hand, agricultural price support financed

^{1/} See Part II, pp. 68-69.

by credits from financial institutions absorbed financial resources at the expense of other sectors of the economy. A review of policies in this area will become increasingly important. The staff believes that this consideration should guide the management of the two newly established Price Stabilization Funds.

The rapid expansion of liquidity emanating from the external sector until mid- 1967 in large part was related to an inflow of short-term capital and created difficulties for financial management. The staff recognizes that the use of new techniques of credit control helped meet some of these difficulties which however were compounded in early 1967 by fiscal deficits. It believes that efforts should be made to again achieve a cash surplus in the fiscal sector in 1967 and to reduce carry-over expenditures into the next fiscal year, and generally restrain growth of bank credit so as to keep pressures on resources within a range compatible with the objective of reducing the rate of price increases.

The present structure of interest rates has become still more complex than it was and differentials between rates at the upper end and rates at the lower end have been widened further. There is a strong case for simplifying the rate structure by narrowing rate differentials. However, for the time being a lowering of the general level of interest rates appears premature, considering that price stability still is to be firmly established.

Korea's balance of payments has changed from deficits in the early 1960's to growing surpluses. While fortuitous factors, e.g., those related to the conflict in Viet-Nam, have contributed in part, the Government has successfully promoted exports and diversified the sources of foreign assistance. However, export incentives have become very complex and any further proliferation is likely to produce diminishing returns. Over the last year or two, foreign borrowing has increased at a very high rate. While the external debt burden is still relatively small it will grow and a continued rapid accumulation of debts at such high rates is bound to lead to difficulties when certain special factors affecting the balance of payments cease to operate. In particular, the rapid growth of short-term foreign liabilities can quickly become a destabilizing factor once a swing occurs in the current and long-term capital accounts of the balance of payments and the scope for rolling over a large short-term indebtedness quickly diminishes. The steps taken recently to reduce short-term foreign borrowings should help diminish such dangers.

As a result of the strong balance of payments position and the authorities' policy of accumulating exchange reserves, the exchange rate in the exchange certificate market has been very stable since the third quarter of 1965. The steps taken by the authorities to widen and activate the certificate market should make the market more responsive to changes in the economy. Progress has been made in the liberalization of restrictions on current payments and transfers. Elimination of remaining direct restrictions on imports should help improve efficiency and viability of the Korean economy. Adjustments in the tariff and commodity tax structure are considered complements to the completion of the import liberalization program. The staff believes however that excessive protection of domestic industries through large increases in tariff rates should be avoided.

IV. Proposed Decision

The following draft decision is submitted for consideration by the Executive Board.

1. This Decision is taken by the Executive Directors in concluding the 1967 consultation with Korea pursuant to Article XIV, Section 4 of the Articles of Agreement.

2. Korea's economy grew in 1966 at an exceptionally high rate and the targets of the second development plan for 1967-71 have generally been revised upward. The Fund welcomes the technique of implementing the plan flexibly through annual over-all resource budgets and believes that caution should be observed in implementation of the plan in order to succeed in reducing the rate of price increases.

3. Adaptations in credit policies from 1966 have generally helped mitigate expansionary pressures from the external sector and in early 1967 also from the fiscal sector. The Fund welcomes the tax measures to be introduced with the budget for 1968 and notes that there remains scope for improving fiscal management to allow growth in bank credit to the private sector without an excessive monetary expansion.

4. Rapid growth in exports of manufactures has been a dynamic element in the economy and should continue to be a central factor for future economic growth. The balance of payments surpluses in 1966 and the first half of 1967 were in a large measure related to special factors and substantial capital inflows. The Fund believes however that further rapid increases in foreign private loans of a short-term nature should be restrained.

5. The Fund welcomes the advances made in liberalization of restrictions on current payments and transfers and in activating the exchange certificate market and believes that continued progress in these areas will help enhance the viability and growth of the economy.

Fund Relations with Korea

Korea became a member of the Fund on August 26, 1955. The original quota of \$12.5 million was raised to \$18.75 million in January 1960, and to \$24 million in February 1966. Twenty-five per cent of the quota was paid in gold. In July 1967 the Board of Governors approved an increase in the quota to \$50 million under the compensatory financing decision (EBD/67/65, Sup. 1). The Korean authorities expect to make the necessary gold and won subscriptions in respect of the new quota early in 1968.

Korea requested the Fund in March 1965 to agree to a stand-by arrangement for a period of one year in an amount equivalent to \$9.3 million, or 50 per cent of its quota (EBS/65/39). The Executive Board approved this request, effective from March 22, 1965. Modification of the terms of this stand-by arrangement was agreed on September 22, 1965 (EEM/65/53). On March 22, 1966 the second stand-by arrangement for \$12 million, or 50 per cent of the quota, became effective (EEM/66/18). In March 1967 the Fund approved the third stand-by arrangement for Korea in an amount of \$18 million, or 75 per cent of its present quota (EEM/67/19). No drawings have been made under any of the stand-by arrangements.

No par value has been agreed for the won. For the stand-by arrangements Korea was required to complete the payments of its subscription at a rate of exchange proposed by Korea and agreed by the Fund. Korea proposed the provisional rate of W 255 per US\$1. The Fund agreed to this provisional rate in Executive Board Decision No. 1845-(65/14), adopted on March 19, 1965. Korea completed payment of its subscription on the basis of this agreed provisional rate of exchange (EBS/65/40).

The Fund has been consulted on several exchange rate changes made by Korea in the past. On May 1, 1964, the Korean Government proposed the adoption of a fluctuating exchange rate, and the Fund agreed to the change and did not object to the temporary maintenance of the multiple currency practices (EEM/64/23). After delays in the implementation of the main features of the exchange reform of May 1964, the fluctuating exchange rate system became effective on March 22, 1965, and was accompanied by an abolition of multiple currency practices and a substantial relaxation of import restrictions (SM/65/76). At the request of the Korean Government, the Fund has provided technical assistance almost continuously since October 1964, and for this purpose a staff member has been stationed in Seoul.

The last Article XIV consultation discussions with Korea were held in Seoul from August 1 to August 12, 1966. The staff report (SM/66/108) was discussed by the Executive Board on October 19, 1966. The Executive Board adopted the following decision:

1. This decision is taken by the Executive Directors in concluding the 1966 consultation with Korea pursuant to Article XIV, Section 4 of the Articles of Agreement.

2. The record of economic growth in Korea has been remarkably good during the past two years, and the immediate prospects appear favorable. The second five-year development plan for the period of 1967 to 1971 places appropriate emphasis on policies to continue growth in an environment of financial stability.

3. The adoption and implementation of annual monetary programs has been successful in slowing the rate of price rise in Korea and in fostering greater confidence in the currency. The measures which have produced near balance in the Government's cash budget have been an important contributory factor. There has, however, been a sharp rise in domestic liquidity during the last year as a result of central bank financing of agricultural programs, a rapid increase in credit extended by commercial banks, and the accumulation of exchange reserves. The Fund believes that fiscal and credit policies should be used to reduce further the rate of price increase. It welcomes the introduction of new techniques of central bank control and the more realistic structure of interest rates and the Government's intention to strengthen the tax system, and believes that these should make possible effective control of inflationary pressures.

4. The balance of payments has improved considerably owing mainly to a sharp rise in earnings from exports and invisibles, and substantial further progress has been made in liberalizing trade and payments. The Fund commends this progress in relaxing restrictions and the emphasis that is being placed in a wide range of government policies on the promotion of exports. The Fund believes that the process of liberalization of restrictions should be continued and that an exchange system substantially free of restrictions will contribute to the achievement of the objectives incorporated in the new development plan.

INTERNATIONAL MONETARY FUND

REPUBLIC OF KOREA

PART II

Background Material for 1967 Article XIV Consultation

Prepared by the Asian Department and the
Exchange and Trade Relations Department

November 15, 1967

<u>Contents</u>	<u>Page</u>
Basic Data	iv
I. Internal Economic Developments	1
1. Population, income and production	1
a. Population	1
b. Gross national product	1
c. Gross national product by industrial origin	6
d. Production	8
e. Economic development plans	14
f. Outlook for the Korean economy for 1967 and 1968	16
2. Employment, wages and labor productivity	19
3. Prices	21
4. Financial developments	24
a. Stabilization programs and over-all financial performance in 1966	24
b. Government finance	27
c. Bank finance	36
II. External Economic Developments	52
1. Balance of payments	52
2. Foreign trade	52
a. Exports	52
b. Imports	57
c. Direction of trade	59
3. Invisible trade	59
4. Foreign official grants and loans	60
5. Private transfer payments and private loans	63
6. External debt service schedule	64
7. Direct foreign investment	64
8. International reserves	65

Contents

Page

III. The Restrictive System	67
1. Exchange rate system	68
2. Main features of the exchange control	69
a. Administration of control	69
b. Prescription of currency	69
c. Imports and import payments	70
d. Payments for invisibles	73
e. Export and invisible proceeds	74
f. Capital	74
3. Bilateralism	75

Appendix Tables

I. Labor Force and Employment by Major Industries, 1963-66	81
II. Selected Interest Rates of Banking Institutions	82
III. Reserve Position of Commercial and Other Banks, 1963-May 1967	83
IV. Exports by Commodity Group, 1962-May 1967	85
V. Imports by Commodity Group, 1962-May 1967	86
VI. Exports by Country, 1962-May 1967	87
VII. Imports by Country, 1962-May 1967	88
VIII. Gold and Foreign Exchange Holdings and Debit Balance of the Korea-Japan Open Account, 1960-August 1967	89

Text Statistical Tables

1. Gross National Product, 1962-66	2
2. Composition of Inventory Investment, 1960-66	3
3. Gross Domestic Fixed Capital Formation by Major Industrial Sectors, 1960-66	4
4. Composition of National Saving at Current Market Prices, 1960-66	5
5. Gross National Product by Value, 1962-66	7
6. Output of Foodgrains and Imports of Cereals, 1964-67	9
7. Indices of Industrial Production, 1962-June 1967	10
8. Indices of Selected Manufacturing Production, 1960-June 1967	12
9. Production of Coal and Selected Minerals, 1962-June 1967	13
10. Selected Economic Indicators: First Five-Year Development Plan Targets and Performance	15
11. Second Five-Year Development Plan (1967-71), Selected Targets	17
12. Over-All Resources Budgets for 1967 and 1968	18
13. Trends in Production and Labor Productivity in Mining and Manufacturing Industries, 1961-66	20
14. Wholesale and Consumer Prices, 1962-June 1967	21
15. Changes in the Seoul Consumer Price Index in 1965-June 1967, and Rates of Contribution to the Change by Commodity Categories	23

<u>Contents</u>		<u>Page</u>
16.	Factors Affecting Money Supply, 1964-August 1967	26
17.	Summary of National Government Budgets, Fiscal Years 1963-68	28
18.	Cash Transactions of the Consolidated National Government Budget, 1964-June 1967	30
19.	National Government Development Expenditures Fiscal Years 1962-67	31
20.	Major Components of General Budget Receipts, Fiscal Years 1962-67	33
21.	General Budget Receipts and Expenditures in Relation to Money GNP, 1960-67	37
22.	National Government Debt, 1963-May 1967	38
23.	Composition of Money Supply and Savings Deposits of Banking Institutions, 1964-June 1967	41
24.	Credits of All Banks to the Private Sector Adjusted for the Government Lending Funds, 1963-June 1967	43
25.	Total Export Credits by All Banks, 1962-June 1967	44
26.	Loans of Commercial Banks by Major Industries, 1963-June 1967	45
27.	Overdue Loans of Banks, 1963-June 1967	46
28.	Fertilizer Operations of the NACF, 1964-67	48
29.	GNP, Money Supply and Prices, 1962-June 1967	50
30.	International Transactions, 1962-June 1967	53
31.	Principal Exports, 1962-May 1967	55
32.	Principal Imports, 1962-May 1967	58
33.	Gross Invisible Receipts, 1962-June 1967	60
34.	Gross Imports Finances with U.S. Official Grants-in-Aid, 1960-67	61
35.	Inflow of Foreign Capital, 1962-66	62
36.	External Debt Service Repayments and Schedule	64
37.	Status of Foreign Private Investment, 1965-June 1967	65
38.	Foreign Assets and Liabilities of the Bank of Korea, 1964-June 1967	66
39.	Classification of Imports	70
Annex		-
I.	Import Payment Procedures	76-80
Charts		<u>Facing Page</u>
1.	Relative Share of Major Components of Gross National Expenditure, 1950-66	2
2.1	Factors Affecting Changes in Money Supply, 1964-First Half 1967	26
3.	Liquidity Ratios and Related Items, 1961-First Half 1967	50
4.	International Transactions, Foreign Grants and Loans, Gross Gold and Exchange Reserves, 1962-66	53

Basic Data

Area: 38,027 sq. miles

Population: 29.2 million (at mid-1966)
Annual growth rate: 2.5 per cent (1966)

Per capita GNP: W 35,482 (Approx. US\$131 at the existing exchange rate)

	<u>1964</u>	<u>1965</u>	<u>1966</u>
<u>GNP at 1965 market prices (W Bn.):</u>	750.3	805.9	913.8
Rate of increase (per cent)	8.3	7.4	13.4

Central Government budget (W Bn.):

General budget			
Receipts	76.3	101.3	144.2
Expenditures	74.2	91.7	139.7
All other special accounts			
Surplus (+) or deficit (-)	-3.2	-7.7	-10.0
Consolidated accounting surplus (+) or deficit (-)	-1.1	+1.9	-5.5

Money and related data, at the end of year:

Money supply (W Bn.)	43.1	56.6	69.2
Rate of increase (per cent)	15.5	31.3	22.3
Money savings (W Bn.)	25.9	47.3	102.3
Rate of increase (per cent)	16.7	82.6	116.3

Wholesale price index (1960 = 100), at
the end of year:

	210	224	242
Rate of increase (per cent)	27	7	8

Balance of payments (US\$ Mn.):

Exports, f.o.b.	+120	+175	+250
Imports, f.o.b.	-365	-420	-680
Trade balance	-245	-245	-430
Net official grants and loans received	+158	+127	+198
All others	+84	+123	+354
Over-all balance	-3	+5	+122

Official gold and foreign exchange
reserves (US\$ Mn.):

	132	142	239
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IMF:

Quota: The original quota of \$12.5 million was increased to \$18.8 million in January 1960, and to \$24 million in February 1966. In July 1967 the Board of Governors approved an increase in the quota to \$50 million.

Fund holdings of Korean won: 75 per cent of the present quota.

I. Internal Economic Developments

1. Population, income and production

a. Population

As of 1966, population was estimated to have reached 29.2 million, registering an increase of about 2.5 per cent in 1966 compared with an average rate of 2.7 per cent for the previous five years. The Government hopes to reduce the population growth rate to below 2.4 per cent in 1967 and to 2.0 per cent in 1971, by promoting a nationwide movement in family planning practices. During 1967 the Government plans to provide adequate measures required for the effective implementation of a family planning program and, through various mass communication media, to enlighten people, especially those in rural areas, on the importance of family planning.

b. Gross national product

In 1966, the last year of the First Five-Year Economic Development Plan, gross national product in current market prices registered an increase of 28.1 per cent over the level of 1965 and reached W 1,032.0 billion. In terms of 1965 constant market prices, CNP rose by 13.4 per cent over the 1965 level and the annual average growth rate of 8.3 per cent for the period 1962-66 exceeded the target rate of 7.1 per cent envisaged in the original First Five-Year Economic Development Plan (Table 1). The per capita GNP rose from W 28,398 in 1965 to W 31,418 (\$116) in 1966, or by 10.6 per cent. The rapid increase in GNP in 1966 was associated with significant increases in gross capital formation and in exports of goods and services.

Total consumption expenditures increased by 7.6 per cent in 1966, compared with an annual average growth rate of 5.7 per cent for the previous four years. The share of total consumption expenditures in GNP was 87.8 per cent, the lowest in the entire Plan period. The marginal propensity to consume (defined as the ratio of a change in total consumption to a change in gross national product) for 1966 was 0.52 compared with 0.96 for 1965 (see Chart 1).

The high level of gross domestic investment in 1966 was largely stimulated by the inflow of foreign capital and by the Government's efforts to complete the First Five-Year Economic Plan. Fixed capital formation for the economy as a whole increased by 62 per cent, while gross investment including changes in inventories rose by 75 per cent in 1966, raising the ratio of gross capital formation to gross national product from 15 per cent in 1965 to 23 per cent in 1966. Investment in inventories increased by W 16.8 billion in 1966 at 1965 constant market prices reflecting an increased production of goods and larger imports, as compared with an increase in inventories of W 0.8 billion in 1965 (Table 2).

Table 1. Gross National Product, 1962-66

(In billions of won; at 1965 market prices)

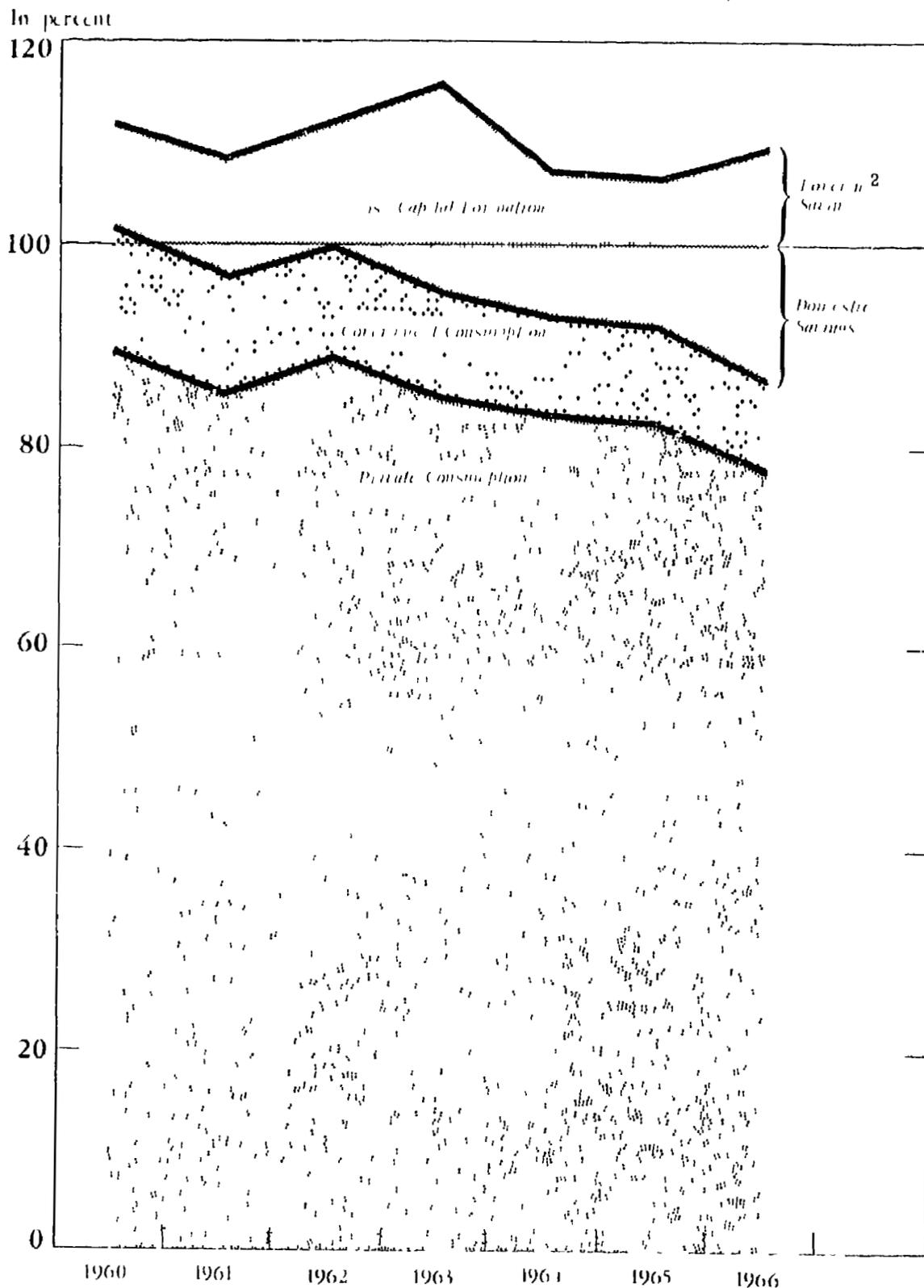
	1962	1963	1964	1965	1966	Growth Rate 1965-66	Annual Average Growth Rate 1962-65
	(In per cent)						
Consumption expenditures	639.40	661.58	691.62	745.10	801.75	7.6	5.7
Private	568.96	587.74	620.44	669.08	716.99	7.2	6.1
Public	70.44	73.84	71.18	76.02	84.76	11.5	2.2
Gross domestic fixed capital formation	84.05	105.95	93.33	117.64	190.63	75.0	17.5
Increases in stocks	-6.06	31.32	21.08	0.84	16.75		
Exports of goods and services ^{1/}	43.19	46.23	55.28	76.26	117.57	54.2	19.3
Less: Imports of good and services	120.20	153.19	114.04	128.93	204.65	58.7	11.7
Statistical discrepancy	-5.41	1.14	3.04	-5.06	-8.23	--	--
Expenditures on gross national product	634.97	693.03	750.31	805.85	913.82	13.4	7.1
Per capita GNP (won)	24,305.00	25,794.00	27,155.00	28,398.00	31,418.00	10.6	4.2

Source: The Bank of Korea, Monthly Statistical Review, Seoul, Korea.^{1/} Includes net factor income from abroad.

CHART 1

KOREA

RELATIVE SHARE OF MAJOR COMPONENTS OF
GROSS NATIONAL EXPENDITURE, 1960-66¹



Source: Table 1

- 1 Statistical discrepancies are included in private consumption
- 2 Deficits in the current account of the balance of payments

Table 2. Composition of Inventory Investment, 1960-66

(In billions of won, at 1965 market prices)

	1960	1961	1962	1963	1964	1965	1966
Agricultural products	-2.2	6.6	-10.9	22.4	18.7	0.8	9.7
Of which: Rice	-2.8	5.6	-13.9	25.5	11.3	-6.5	4.4
Other cereals	0.8	1.2	-1.4	-2.6	9.5	6.3	4.0
Livestock	-0.2	-0.2	4.4	-0.5	-2.1	1.0	1.3
Mineral products	0.6	--	-0.1	0.3	1.2	-0.6	-0.1
Manufactured goods	1.1	4.9	0.7	2.5	5.8	1.6	0.5
Imported raw materials	1.3	-3.8	4.2	6.1	-4.6	-1.0	6.7
Total	0.8	7.7	-6.1	31.3	21.1	0.8	16.8

Source: Data provided by the Korean authorities.

The pattern of investment in the latter part of the Plan period seems to have been consistent with the major objective of the Plan to build an industrial base with expanded secondary and tertiary sectors. As shown in Table 3, in 1965, some 12 per cent of the total fixed investment took place in the agriculture, forestry and fishery sectors, while the amounts of investments in secondary and tertiary sectors accounted for roughly 32 per cent and 56 per cent of the year's total, respectively. In 1966 the weight of investment in the secondary industry increased markedly, especially in the manufacturing sector. The shares of primary, secondary and tertiary sectors in total fixed investment were about 12 per cent, 38 per cent and 50 per cent, respectively. By types of investment, private fixed investment increased by 62 per cent in 1966 and accounted for roughly 78 per cent of the total, while direct government investment and investment of government corporations increased by 58 per cent and 70 per cent, respectively, during the year.

If the rapid growth in gross capital formation in recent years is to be maintained, substantial increases in savings must take place in order to finance investment in a noninflationary manner. This is particularly so in the light of the generally declining ratio of foreign assistance to total investment in recent years. The financing of gross investment for the period 1962-66 is shown in Table 4. The gross national saving is defined as the sum of gross domestic saving and net foreign saving. In 1966, the rate of increase in gross domestic saving in current market prices was 100 per cent as compared with nearly 24 per cent in 1965; as a result the degree of dependence of gross capital formation on foreign saving was reduced from 44 per cent to about 40 per cent. In the initial year of the First Five-Year Plan, foreign saving financed 83 per cent of

Table 3. Gross Domestic Fixed Capital Formation by Major Industrial Sectors, 1960-66

(In billions of won, at 1965 market prices)

	1960	1961	1962	1963	1964	1965	1966
Agriculture, forestry, and fishery	7.0	8.4	6.7	10.3	10.7	13.7	23.2
Mining	1.3	0.4	0.8	1.4	0.9	1.5	2.0
Manufacturing	14.9	13.8	17.8	24.1	22.4	30.5	61.7
Construction	0.6	0.7	3.2	2.4	1.2	1.4	2.0
Electricity and water	2.1	5.5	8.8	13.2	7.4	7.1	9.5
Transportation and communications	11.1	15.0	19.6	25.4	19.6	24.1	47.0
Wholesale and retail trades	3.1	2.6	4.5	4.8	4.6	7.8	7.0
Banking, insurance, and real estate	0.3	0.1	0.2	0.2	0.3	0.5	0.9
Ownership of dwellings	12.9	10.4	10.0	11.1	12.6	13.9	18.4
All others	<u>8.4</u>	<u>8.4</u>	<u>12.5</u>	<u>13.1</u>	<u>13.6</u>	<u>17.1</u>	<u>18.9</u>
Total	61.7	65.3	84.1	106.0	93.3	117.6	190.6
As per cent of GNP	10.5	10.6	13.2	15.3	12.4	14.6	20.9

Source: The Bank of Korea, Monthly Statistical Review, Seoul, Korea.

Table 4. Composition of National Saving at Current Market Prices, 1960-66

(In billions of won)

	1960	1961	1962	1963	1964	1965	1966
1. Gross Domestic Saving							
a. Government sector	-5.01	-5.30	-4.86	-1.32	3.55	14.02	29.08
Provision for capital consumption	1.83	2.06	3.24	3.33	3.46	3.78	4.83
Net saving ^{1/}	-6.84	-7.36	-8.10	-4.65	0.09	10.24	24.25
b. Private sector	8.90	16.62	10.03	34.99	45.33	46.73	92.24
Provision for capital consumption	10.50	12.21	15.65	22.98	33.47	41.95	53.06
Net saving	-1.60	4.41	-5.62	12.01	11.86	4.78	39.18
Total (a+b)	3.89	11.32	5.17	33.67	48.88	60.75	121.32
2. Net Foreign Saving ^{2/}	20.99	25.29	37.72	52.39	49.22	52.67	89.01
3. Statistical Discrepancy	1.92	2.18	2.58	3.62	3.14	5.06	12.78
4. Gross National Saving = Gross Domestic Capital Formation	26.80	38.79	45.47	89.68	101.24	118.48	223.11
Of which: stocks	(0.26)	(4.50)	(-3.15)	(21.64)	(20.70)	(0.84)	(17.12)
5. Gross National Product	246.69	296.82	348.58	487.96	696.79	805.85	1,032.04
6. $\frac{1+3}{5}$ in per cent	2.4	4.5	2.2	7.6	7.5	8.2	13.0
7. $\frac{4}{5}$ in per cent	10.9	13.1	13.0	18.4	14.6	14.7	21.6

Sources: The Bank of Korea, Monthly Statistical Review, Seoul and data provided by the Korean authorities.

^{1/} Excess of current receipts over expenditures. Counterpart funds are included in net foreign saving.

^{2/} No adjustment is made in these figures for undervaluation of the exchange rate.

the economy's gross investment. Main factors responsible for this marked increase in gross domestic saving were the growth of both private and government savings. Government saving was negative until recently and turned positive for the first time in 1964. Private saving on the other hand did not show any clear-cut trend since 1960, although it seems likely that inflationary developments in the early 1960's undermined household saving and impaired the efficiency of banks as financial intermediaries. In 1966, a very large increase in private saving occurred following the interest rate reform introduced in September 1965.

Both exports and imports of goods and services rose markedly in 1966. Exports of goods and services increased by 54 per cent compared with an annual average growth rate of 19 per cent for the period 1962-65, while imports of goods and services rose by 59 per cent as compared with an annual average of only 12 per cent for 1962-65. The marginal propensity to import defined as the ratio of a change in imports to a change in GNP was 0.70 for 1966, compared with 0.27 for 1965.

c. Gross national product by industrial origin

Table 5 shows the amounts of value added by three major industrial groups in the economy for the First Plan period. In 1962, primary industry's share of GNP was 40 per cent, while those of secondary and tertiary industries were 20 per cent and 40 per cent, respectively. By 1966--the end of the First Five-Year Plan--the share of secondary industry had grown to 26 per cent, while those of primary and tertiary sectors had dropped to 38 per cent and 36 per cent, respectively. The table reveals that primary industry grew at a rate of 11 per cent, while secondary and tertiary industries expanded at rates of 17 per cent and 14 per cent, respectively. The performance of the primary sector is striking in view of an annual average growth rate of only 4 per cent in the previous four years. Good weather conditions and extensive use of fertilizers and improved seeds contributed to this rapid growth.

Within the primary industry, agricultural production increased by 7 per cent to contribute around 89 per cent of the growth of this sector in 1966, while forestry output grew by nearly 17 per cent and contributed 7 per cent. The contribution of the fishery industry in 1966 was 4 per cent.

The manufacturing sector comprises about 73 per cent of secondary industry. Value added in the manufacturing sector grew by 16 per cent and contributed 70 per cent of the growth of total secondary industry in 1966. Within the manufacturing sector, production of electrical machinery increased by 56 per cent, followed by transport equipment with 38 per cent. However, in terms of the contribution of various sectors to the growth of secondary industry, textile goods ranked first by contributing 13 per cent, while food and transport equipment contributed each 7 per cent, and electrical machinery sectors 5 per cent. The over-all rates of growth of these various sectors during 1962-66 seem to reflect the development policy of the Government to enhance the importance of the manufacturing sector,

Table 5. Gross National Product by Value Added, 1962-66

(In billions of won; at 1965 market prices)

	1962	1963	1964	1965	1966	Growth Rate 1965-66 (In per cent)	Annual Average Growth Rate 1962-65
Primary Industry	252.37	270.56	314.31	311.63	345.91	11.0	4.1
Secondary Industry	129.60	150.37	159.51	194.36	227.36	17.0	13.9
Of which: Mining	10.86	11.86	13.36	14.73	15.67	6.4	13.8
Manufacturing	95.14	111.63	116.78	142.81	165.76	16.1	14.8
Construction	18.23	20.69	21.83	27.64	34.84	26.0	14.9
Electricity and gas	5.37	6.19	7.54	9.18	11.09	20.8	20.2
Tertiary Industry	253.00	272.10	276.49	299.86	340.55	13.6	6.6
Of which: Transport, storage and communications	20.07	23.47	27.15	32.14	37.67	17.2	15.7
Wholesale and retail trade	103.41	113.19	109.97	119.27	139.43	16.9	6.6
Gross National Product	634.97	693.02	750.31	805.85	913.82	13.4	7.1

Source: The Bank of Korea, Monthly Statistical Review, Seoul, Korea.

particularly those sectors which are considered to be key industries such as transport equipment, petroleum and coal products, glass, clay and stone products. In view of the importance assigned to chemical and basic metal industries in the Second Five-Year Plan, the weights of these two are likely to increase in the future.

Within the tertiary industry, wholesale and retail trades and transport, storage and communications sectors comprised about 50 per cent of the total value added. These two sectors grew similarly at 17 per cent along with the rapid expansion in secondary industry and also the increases in foreign trade.

d. Production

The output of foodgrains increased by 5 per cent in 1966, as compared with only 2 per cent in the previous year (Table 6). Rice production reached 3,919,000 metric tons in the year to register an increase of 11 per cent over the previous year's level, but still about 1 per cent less than the record rice harvest of 1964. In view of the fact that the area under cultivation remained almost the same in the last two years, the increase in rice production wholly reflected an increase in yields. The output of summer grains totaled 2,375,000 metric tons in 1966, a gain of 11 per cent over the 1965 level. In 1965 the barley crop had been adversely affected by poor weather conditions. The production of potatoes decreased in 1966 to reach 3,378,000 metric tons, or about 6 per cent below the level of the previous year. The output of other cereals and pulses also declined in the year to 302,000 metric tons, or by about 7 per cent. Imports of cereals and cereal preparations declined in 1966 and were equivalent to about 6 per cent of the total output of foodgrains as compared with about 7 per cent for 1965. No estimates are available for 1967 foodgrains, except that barley production is estimated to reach 2,250,000 metric tons in the year. In the first half of 1967, the Government imported 40,000 metric tons of rice from Taiwan and planned to import about 87,000 tons of rice from the United States in the second half.

The principal measures taken by the Government to increase agricultural production during 1966 and 1967 were expanded diffusion of improved seeds, distribution of pesticides, expansion of all-weather farming facilities, encouragement for double crops, and reduction of fertilizer prices. In 1966, the Government distributed to farmers 15,000 metric tons of improved rice seeds and 5,000 metric tons of seeds of other cereals, while a total of 20,000 metric tons of improved seeds, including 16,000 metric tons of rice, 2,000 metric tons of barley and wheat, and 2,000 metric tons of other cereals, were already supplied to farmers in 1967. The implementation of an all-weather farming program in 1966 resulted in an increase of 26,000 chungbos (1 chungbo=2.45 acres) in the acreage irrigated and the expansion of the program in 1967 is expected to increase irrigated acreage by about 60,000 chungbos. In addition, about 58 per cent of total arable land in the southern part of the country was used for double crops in 1966 and the Government intends to increase this percentage to 74 in 1967. The reduction in the prices of nitrogen and potash fertilizers by 15 per cent and 10 per cent, respectively, in January 1967 is also expected to increase the use of fertilizer and hence agricultural production.

Table 6. Output of Foodgrains and Imports of Cereals, 1964-67^{1/}

	1964			1965			1966			1967 (Target)		
	Area under culti- vation in 1,000 chungbo	Yield per tambo in k.g.	Total output in metric tons									
Rice	1,205	328	3,954	1,238	283	3,501	1,242	316	3,919	1,255	340	4,267
Summer crops	1,119	166	1,839	1,211	176	2,136	1,148	207	2,375 ^{2/}	1,260	164	2,061
Other cereals and pulses	557	57	316	585	55	323	516	60	302	615	64	394
Subtotal	2,881	--	6,129	3,034	--	5,960	2,906	--	6,596	3,130	--	6,722
Potatoes ^{3/}	181	1,780	3,222	214	1,669	3,577	210	1,608	3,378	227	--	
Total	3,062		9,351	3,246		9,537	3,116		9,974	3,357		
Imports of cereals and cereal pre- parations			647			689			588			
Imports as per cent of total output of foodgrains			6.9			7.2			5.9			
Wholesale prices (monthly average)(1960=100)												
Foodgrains			263			247			260			
Other commodities			190			217			234			

Source: Data provided by the Korean authorities.

^{1/} Output data for 1964-66 are provided by the Ministry of Agriculture and Forestry, while the 1967 targets are made by the Economic Planning Board.

^{2/} Includes the production of barley, naked barley, wheat and rye.

^{3/} Production series for potatoes up to 1966 were revised in July 1967.

The seven-year foodgrain production plan (1965-71), which the Government launched in 1965 with the objective of self-sufficiency in foodgrains in 1968, was incorporated into the Agricultural Development Plan in May 1967. The new five-year agricultural plan, which covers not only foodgrains but also raw silk and other cash crops, envisages self-sufficiency in foodgrains by 1971 and does not foresee any net export or net import of foodgrains after the plan period. The plan envisages an increase in rice production by 37 per cent between 1965 and 1971, barley and wheat by 33 per cent, pulses by 78 per cent, potatoes by 112 per cent, and other cereals by about 46 per cent. The total foodgrain production is to increase by 44 per cent during the same period.

The output of fishery products increased by 8 per cent in 1966, compared with an increase of 7 per cent in the previous year. Fish and shellfish catches rose by 8 per cent and 58 per cent, respectively, in 1966, while the output of seaplants and other marine products increased only moderately. Exports of marine products rose to \$39 million in 1966, an increase of about 38 per cent over the previous year's level, to account for about 16 per cent of the year's total exports. The progress in deep-sea fishing was noteworthy in increasing the exports of marine products.

Over-all industrial production (including mining, manufacturing, and power) increased by 17 per cent in 1966, as compared with 18 per cent in 1965 or 8 per cent in 1964 (Table 7). In the first half of 1967, industrial production was about 15 per cent higher than in the same period of 1966. However, the latest estimates indicate that industrial production may increase by about 20 per cent during the entire 1967.

Table 7. Indices of Industrial Production, 1962-June 1967

(1965 = 100)

	1962	1963	1964	1965	1966	Jan.-June	
						1966	1967
Mining	76.6	87.4	96.2	100.0	110.8	114.1	118.8
Manufacturing	68.6	77.6	82.9	100.0	117.9	124.1	144.3
Electricity	60.8	67.9	83.1	100.0	119.6	117.3	140.8
Total	69.5	78.6	84.9	100.0	117.3	122.6	141.4

Source: The Bank of Korea, Monthly Statistical Review, Seoul, Korea.

Manufacturing production expanded by 18 per cent in 1966, as compared with 21 per cent in the previous year and an annual average increase of 12 per cent during 1962-65. The average capacity utilization rate of the manufacturing sector was 74 per cent in 1966, compared with 71 per cent in the previous year and 50 per cent in 1964. Improved management, increased domestic demand and the effort of the Government to promote exports were largely responsible for the increase in the utilization rate in 1966.

Within the manufacturing sector, the production of transport equipment recorded the highest growth rate of 61 per cent in 1966, followed by electrical machinery (35 per cent), wood and cork (33 per cent), petroleum and coal products (24 per cent), food (24 per cent), and printing and publishing (23 per cent) (Table 8). In the first six months of 1967, manufacturing production was about 16 per cent higher than in the corresponding period of 1966. The largest expansion took place in food (33 per cent), followed by electrical machinery (28 per cent), textiles and printing and publishing (25 per cent) beverages (24 per cent and petroleum and coal products (22 per cent). The production of chemicals in the first half of 1967 was 17 per cent higher than in the same period of last year, due primarily to the operations of the three new fertilizer plants with the combined production capacity of 859,000 metric tons. In the field of petroleum and coal products, the Government expanded the capacity of the Ulsan oil refinery from 35,000 barrels per day to 55,000 barrels per day in 1967 and plans to raise the processing capacity to 215,000 barrels by 1971.

Mining output increased by 11 per cent in 1966, compared with an increase of 4 per cent in 1965 and 10 per cent in 1964. The sharpest increase in production was recorded for zinc concentrate (65 per cent), followed by Kaoline (55 per cent), talc (55 per cent), and silver (16 per cent) (Table 9). The output of coal expanded by 14 per cent in 1966 to reach 11.6 million metric tons, of which about 263,000 metric tons were exported. The output of iron ore amounted to 0.79 million metric tons in 1966 to register an annual rate of growth of 7 per cent. Because of the shortage of refining facilities in the country, most of the iron ore output has been exported in recent years. In the case of tungsten, which occupies a large weight in Korean mining, the output has continuously declined in recent years due largely to the poor reserves in tungsten mines, but export earnings from this product have increased on account of higher prices to about \$9.5 million in 1966. Because of the absence of any refining facility and the existence of undeveloped machinery and metallic industries in the economy, there is almost no domestic demand for tungsten. The sharpest decline in 1966, however, occurred in the production of salt (-41 per cent). In the first six months of 1967, the over-all output of mining products was 4 per cent more than in the same period of the previous year.

Total power generation expanded by about 20 per cent in 1966, although the power-generating capacity has remained the same in the last two years. Therefore, the increase in the output of electricity in 1966 was solely due to the increase in the capacity utilization from 48 per cent in 1965 to

Table 8. Index of Selected Manufacturing Production, 1960-June 1967
(1965 = 100)

	1961	1962	1963	1964	1965	1966	Jan. - June	
							1966	1967
Food	103	99	108	79	100	124	116	154
Beverages	83	79	71	75	100	120	134	166
Textiles	58	67	70	81	100	111	108	135
Tobacco	52	60	62	72	100	104	98	112
Wood and cork	72	86	103	84	100	133	156	179
Paper and paper products	64	76	93	94	100	116	124	123
Printing and publishing	52	65	69	85	100	123	117	146
Leather and leather products	93	95	86	98	100	120	119	67
Rubber products	68	71	84	97	100	101	107	106
Chemicals	58	69	86	88	100	120	130	152
Petroleum and coal products	37	43	48	69	100	124	130	159
Glass, clay and stone products	45	59	63	88	100	118	141	150
Basic metal	59	83	93	108	100	119	131	133
Metal products	69	86	115	71	100	113	115	131
Machinery	96	132	97	89	100	102	106	89
Electrical machinery	39	71	93	104	100	135	130	166
Transport equipment	33	34	62	65	100	161	183	192
Miscellaneous	64	91	119	97	100	123	129	173

Source: The Bank of Korea, Monthly Statistical Review, Seoul, Korea.

Table 9. Production of Coal and Selected Minerals, 1962-June 1967

	1962	1963	1964	1965	1966	January - June	
						1966	1967
Coal (million M/T)	7.4	8.9	9.6	10.2	11.6	1.0	1.1
Tungsten concentrate (1,000 S/T)	6.4	5.2	5.1	4.2	4.1	0.4	0.3
Iron ore (million M/T)	0.47	0.50	0.68	0.74	0.79	0.06	0.05
Gold, refined (1,000 kg.)	3.3	2.8	2.4	2.0	1.9	0.2	0.2
Silver, refined (1,000 kg.)	12.8	13.8	12.6	13.5	15.6	1.3	1.3
Amorphous graphite (1,000 M/T)	183.4	338.0	262.4	254.3	128.8	10.2	5.8
Kaoline (1,000 M/T)	38.2	52.3	60.5	72.2	112.1	11.0	7.2
Talc (1,000 M/T)	28.4	32.4	43.9	35.7	53.6	5.1	3.8
Limestone (million M/T)	1.3	1.4	2.2	3.1	2.9	0.3	0.3
Zinc concentrate (1,000 M/T)	0.8	2.3	5.1	14.2	23.4	1.9	1.6
Salt (1,000 M/T)	388.1	230.1	385.6	668.9	393.5	140.0	124.7

Source: The Bank of Korea, Monthly Statistical Review, Seoul, Korea.

58 per cent in 1966. In the first five months of 1967, the capacity utilization rate showed a continuous upward trend to reach 69 per cent in May, reflecting a sharp increase in demand for industrial power. During January-June 1967, total power generation was about 20 per cent higher than in the corresponding period of 1966. During 1967 the production capacity is to be increased from the 1966 level of 769,000 kw. to 1,007,000 kw. Moreover, as the Second Five-Year Plan anticipates rapidly increasing demand for electric power, the Government plans to expand the installed power-generating capacity further to 2,816,000 kw. by 1971.

e. Economic development plans

A comparison of actual achievements with major selected targets of the First Five-Year Economic Development Plan (1962-66) is provided in Table 10. The actual average annual growth in GNP of 8.3 per cent was higher than projected in the Plan. Major factors associated with this higher rate of growth were a larger growth in agricultural output than had been planned. Manufacturing output expanded at the planned rate. Outputs of such products as oil and cement in 1966 exceeded the planned production targets for the year, but the production of electric power, coal, and fertilizer fell short of the targets.

The actual ratio of gross capital formation to GNP of 17 per cent for the Plan period fell short of the planned target of about 23 per cent. Likewise, the actual ratio of gross domestic saving to GNP for the plan period was 6.3 per cent as opposed to the planned 9.2 per cent. However, both the investment and saving ratios realized in 1966 were more or less in line with the Plan projections for that year. In the external sector, annual exports rose strikingly to reach \$250 million in 1966, exceeding the target by 81 per cent, while net invisible receipts and the inflow of foreign loans and capital were 99 per cent and 83 per cent, respectively, of the planned targets..

The Second Five-Year Economic Development Plan (1967-71) was originally drafted in July 1966 and approved by the National Assembly in the latter part of that year (see SM/66/108, Part II, pp. 12-15). The basic priorities in the Plan included self-sufficiency in foodgrains, a rapid expansion of merchandise exports and promotion of import substitution industries including petrochemicals, machinery and integrated steel mills. An annual average rate of growth in GNP in real terms of 7 per cent was planned for the Plan period, with the agricultural sector growing annually by an average rate of 5 per cent, the mining and manufacturing sector by 11 per cent and the rest of the economy by about 7 per cent. The total planned investments for the plan period amounted to W 980 billion, implying an annual average increase in investment of 10 per cent and an increase in the ratio of investment to GNP from 15 per cent in 1965 to 20 per cent in 1971. Domestic saving was estimated to finance 62 per cent of total investment, while foreign saving, which would amount to \$1.4 billion, would account for 38 per cent of the total investment. The domestic saving estimates were based on the assumption that marginal propensity to save

Table 10. Selected Economic Indicators: First Five-Year
Development Plan Targets and Performance

	First Five-Year Plan		(B) (A) X100
	Planned Targets (A)	Actuals (B)	
1. Annual average rate of increase in GNP (1962-66)	7.1 (at 1961 mar- ket prices)	8.3 (at 1965 mar- ket prices)	117
(Of which: manufacturing sector)	15.0	15.0	100
2. Total power generation (MW)	4,509 (planned year- end 1966)	3,886 (1966)	86
Coal production (1,000 M/T)	11,740 (1966)	11,613 (1966)	99
Oil refinery (1,000 barrel)	9,300 (1966)	12,646 (1966) ^{1/}	136
Cement (1,000 M/T)	1,370 (1966)	1,880 (1966)	137
Fertilizer (1,000 M/T) (Urea)	238 (1966)	173 (1966)	73
Rice (1,000 suk)	20,567 (1966)	27,217 (1966)	132
Industrial railroad con- struction (Km)	271 (1962-66)	..	--
Diesel engine imports	100 (1962-66)	78 (1962-66)	78
Passenger car imports	100 (1962-66)	115 (1962-66)	115
Freight car imports	1,000 (1962-66)	1,471 (1962-66)	147
Urban telephone circuit lines (1,000)	158 (1962-66)	..	--
3. Exports, f.o.b. (\$ Mn.)	138 (1966)	250 (1966)	181
Imports, c.i.f. (\$ Mn.)	492 (1966)	716 (1966)	146
Invisible receipts, net (\$ Mn.)	108 (1966)	107 (1966)	99
Inflow of foreign loans and capital (\$ Mn.) ^{2/}	426 (1962-66)	352 (1962-66)	83
4. Gross capital formation/GNP (In per cent)	22.6 (1962-66)	16.9 (1962-66) ^{3/}	75
Gross domestic saving/GNP	9.2 (1962-66)	6.3 (1962-66)	68
Foreign saving/GNP	13.4 (1962-66)	10.3 (1962-66)	77

Source: Data provided by the Korean authorities.

^{1/} Produced by Korea Oil Corporation.

^{2/} Excludes foreign official grants-in-aid.

^{3/} Gross domestic saving/GNP and foreign saving/GNP do not add up to gross capital formation in per cent due to statistical discrepancies (at 1965 constant market prices).

disposable income would amount to 30 per cent during the period, compared with 23 per cent during 1963-65. Merchandise exports were projected to increase from \$175 million in 1965 to \$550 million in 1971, an increase of 214 per cent, while merchandise imports were estimated to rise to \$912 million in 1971. With the net invisible receipts estimated at \$169 million for the last year of the Plan period, this implied an increase in the deficit in the current account from \$199 million in 1965 to \$243 million in 1971.

In the light of the favorable economic developments in 1965 and 1966, the Government expects to complete some of the major targets of the Plan possibly by mid-1970, i.e., within three and a half years. Although the Second Five-Year Economic Development Plan itself remains the basic frame of development priorities, new projections have been made for the Plan period ending 1971 (Table 11). Gross national product is now projected to grow at an annual average rate of 10 per cent during the Plan period and consequently GNP should be 50 per cent higher than in 1965 by the first half of 1970 and be 83 per cent higher than in 1965 in the target year of 1971. The new projection for total investment requirements amounts to W 1,430.3 billion for the five-year period to exceed the previous investment target by about 46 per cent. Domestic saving in the new projections was expected to account for 71 per cent of the total investment and to reach a total of W 1,009 billion during 1967-71. Within the external sector, merchandise exports for 1971 were estimated to reach \$750 million instead of \$550 million, while merchandise imports were to be \$1,372 million or some 43 per cent higher than the original estimate for the last year of the Plan period. With net invisible receipts of \$325 million projected for 1971, the deficit in the current account of the balance of payments was expected to total about \$297 million in 1971.

f. Outlook for the Korean economy for 1967 and 1968

Beginning from 1967, the Government adopted the concept of an Over-All Resources Budget (ORB) as an annual program designed to facilitate effective implementation of the Second Five-Year Economic Plan. The ORB will be formulated in advance of the year to which it is to apply and will (1) analyze current economic conditions and trends, (2) establish supply and demand targets for major sectors and commodities for the Plan year, and (3) contain appropriate economic policy measures to achieve the targets set forth.

The ORB for 1967 envisaged a growth rate of 10.5 percent for 1967 to reach W 1,010 billion of gross national product at 1965 constant market prices (see Table 12). This growth rate is higher than the original target rate envisaged in the Second Five-Year Plan. In order to achieve the projected growth rate, major emphasis is to be placed on the expansion of exports, full utilization of both new and existing productive facilities, and a further expansion of social and economic overhead capital, such as transportation and communications.

More than 52 per cent of the projected increase in GNP in 1967 is to be accounted for by the increase in exports of goods and services in that year, thereby increasing the ratio of exports to GNP to 17 per cent in 1967

Table 11. Second Five-Year Development Plan (1967-71), Selected Targets
(At 1965 constant market prices)

	Original Targets (A)	New Pro- jections (B)	$\frac{(B)}{(A)} \times 100$
1. Gross National Product (1971) (Bn. won)	1,169.7	1,478.4	126.4
Agriculture, forestry and fishery	397.3	445.4	112.1
Mining and manufacturing	314.2	382.8	122.2
Social overhead and other services	458.2	659.2	143.8
Annual Average Rate of Increase in GNP (1967-71)	7.0	10.0	
Rate of Increase in Per Capita GNP (1965-71)	31.3	60.5	
2. Sector/Industry Target (1971)			
Total power-generating capacity (1,000 kw)	1,650	2,816	170.7
Coal production (1,000 M/T)	13,762	17,000	123.5
Oil refinery (1,000 barrel)	35,094	56,100	159.9
Cement (1,000 M/T)	4,520	5,180	114.6
Fertilizer (1,000 M/T)	374	374	100.0
Passenger railway transportation (Mn. passenger/km)	10,915	13,218	121.1
Freight transportation (Mn. ton/km)	7,264	9,208	126.8
National highway (km)	5,899	8,186	138.8
Exports, f.o.b. (\$ Mn.)	550.0	750.0	136.4
Imports, c.i.f. (\$ Mn.)	962.1	1,371.5	142.6
Invisible receipts (\$ Mn.)	168.7	324.5	192.4
3. Investment and Savings (1967-71)			
Total investment (1967-71) (Bn. won)	980.1	1,430.3	145.9
Total investment (1967-71) (\$ Mn.)	(3,692.8)	(5,389.4)	
Domestic savings (Bn. won)	602.9	1,009.1	167.4
Foreign savings (\$ Mn.)	1,421.1	1,587.4	111.1
(Long-term capital) (\$ Mn.)	(835.0)	(1,190.0)	(142.5)
Gross Capital Formation/GNP (1967-71) (In per cent)	19.1	23.2	
Gross Domestic Savings/GNP (1967-71) (In per cent)	11.7	16.4	
Gross Domestic Savings/Total Investment (1967-71) (In per cent)	61.5	70.6	

Source: Data provided by the Korean authorities.

Table 12. Over-All Resources Budgets for 1967 and 1968^{1/}

(In billions of won; at 1965 market prices)

	1966		1967		Increase rate (In per cent)	1968		Increase rate (In per cent)
	Amount	Per cent	Amount	Per cent		Amount	Per cent	
Gross national product	913.82	100.0	1,009.77	100.0	10.5	1,110.75	100.0	10.0
Consumption expenditure	801.75	87.8	867.86	85.9	8.2	939.83	84.6	8.3
Government	84.76	9.3	102.68	10.1	21.1	116.21	10.5	13.2
Private	716.99	78.5	765.18	75.8	6.7	823.62	74.1	7.6
Investment	207.38	22.7	228.24	22.6	10.1	263.25	23.7	15.3
Exports of goods and services	117.57	12.8	167.87	16.6	42.8	198.20	17.8	18.1
Imports of goods and services	204.65	22.4	254.20	25.1	24.2	290.53	26.1	14.3
Statistical discrepancy	-8.23	-0.9	--	--	--	--	--	--

Source: Data provided by the Korean authorities.

^{1/} Derived from the monthly report on economic trends made in June by the Economic Planning Board.

from 13 per cent in the previous year. Exports of goods and services are expected to increase by about 43 per cent to reach W 168 billion (at 1965 constant market prices) in 1967. Gross investment is expected to be 23 per cent of GNP in 1967, with an annual growth rate of about 10 per cent. To finance a substantial part of the increase in domestic investment, domestic saving of W 142 billion is expected for 1967. Net foreign saving is expected to be about W 86 billion, a decline of about W 1 billion from the 1966 level. As a result, the ratio of domestic saving to total investment is to increase from about 58 per cent in 1966 to about 62 per cent in 1967. Total consumption is to increase by 8 per cent in 1967. Government consumption is expected to rise by around 21 per cent due primarily to increases in salaries of government employees, while private consumption is to increase by 7 per cent in 1967. The marginal propensity to consume is estimated at 0.69 for 1967 compared with 0.52 in 1966.

The ORB for 1968 estimates that gross national product in 1965 constant market prices will increase by 10 per cent in 1968. Total consumption is projected to increase 8 per cent in 1968 at the same rate as in 1967. The marginal propensity to consume for 1968 is estimated at 0.71. Gross investment is expected to increase by 15 per cent in 1968 to reach W 263 billion. About 65 per cent of the total investment is to be financed by domestic saving, which is projected to increase by 20 per cent during the year. The rate of expansion in exports of goods and services is estimated at 18 per cent for 1968, compared with a projected increase of about 43 per cent for 1967. Imports of goods and services are expected to increase by 14 per cent in 1968, compared with 24 per cent in 1967.

2. Employment, wages and labor productivity

The rate of unemployment to economically active population declined slightly to 7.1 per cent in 1966 from 7.4 per cent a year before (see Appendix Table I). There was also a slight decline in the proportion of employment in agricultural, forestry and fishery sectors from 59 per cent in 1965 to 58 per cent in 1966, reflecting an underlying structural change in the economy. The proportions of employment in other sectors of the economy changed little, except an increase in the relative size of employment in the government sector.

Real wages in the mining and manufacturing sectors increased in 1966 slightly more and nominal wages considerably more than labor productivity. The rate of increase in labor productivity in the manufacturing sector was a modest 2.0 per cent as compared with an average rate of 8.8 per cent for the period 1962-65; in the mining sector the increase was only 1.6 per cent in 1966 as opposed to an average increase of about 4.3 per cent in the previous four years (see Table 13). Nominal wages increased in these sectors by about 16-17 per cent in 1966. Consequently, with the increase in wholesale prices by about 8 per cent during the year, real wages in the mining and manufacturing sectors rose by about 8 per cent compared with an annual average decline of about 3 per cent for the previous four years. Before 1965, changes in money wages tended to lag behind the movement of prices for fairly long periods and real wages had declined even when labor productivity rose significantly.

Table 13. Trends in Production and Labor Productivity in Mining and Manufacturing Industries, 1961-66

(1960 = 100)

	1961	1962	1963	1964	1965	1966	Growth Rate 1965-66 (In per cent)	Annual Average Growth Rate 1962-65
1. Employment ^{1/}								
Mining	100.8	111.4	126.7	136.8	132.1	145.5	10.1	7.2
Manufacturing	93.1	106.1	112.6	110.5	113.5	125.9	10.9	5.2
2. Industrial production								
Mining	113.4	134.6	153.6	169.1	175.7	196.5	11.8	11.7
Manufacturing	104.8	121.3	137.8	147.2	177.5	200.9	13.2	14.3
3. Monthly earnings of production workers								
Mining	112.8	124.6	136.4	159.5	196.9	228.7	16.2	15.1
Manufacturing	109.2	115.0	127.3	154.6	180.8	210.8	16.6	13.6
4. Labor Productivity								
$\frac{(2)}{(1)} \times 100$								
Mining	112.5	120.8	121.1	123.6	133.0	135.1	1.6	4.3
Manufacturing	112.0	114.8	122.4	133.2	156.4	159.6	2.0	8.8

Sources: The Bank of Korea, Monthly Statistical Review; Korean Productivity Center, Labor Productivity Index, Seoul, Korea.

^{1/} A labor-input index based on a Bank of Korea sample survey of production worker man-days.

3. Prices

During 1966, wholesale prices rose by 8 per cent compared with 7 per cent in 1965. There had been an annual average increase of 19 per cent during the 1962-65 period (see Table 14). Wholesale prices of grains rose by 10 per cent during 1966 compared with a decline of 3 per cent a year before, while wholesale prices of nongrain commodities increased by 8 per cent in 1966 in contrast to an increase of 9 per cent in 1965. Wholesale prices of some goods increased considerably more. For example, wholesale prices of machinery and machine parts rose by 15 per cent, fuel and power by 12 per cent, lumber by 9 per cent, fiber products by 9 per cent.

Table 14. Wholesale and Consumer Prices, 1962-June 1967

	Wholesale Prices (1960=100)				Consumer Prices (1965=100)	
	All com- modities	Grains	Others	Imported goods	All cities	Seoul
1962	124	131	123	126		
1963	149	208	139	150		
1964	201	263	190	211		
1965	221	247	217	253	100	100
1966	238	260	234	252	111	112
1964						
December	210	235	205	243		
1965						
March	214	233	211	254	98	98
June	225	257	219	251	100	100
September	227	264	220	254	102	102
December	224	228	223	252	100	101
1966						
March	230	243	228	252	107	107
June	241	261	238	252	112	112
September	246	296	237	252	115	115
December	242	251	240	251	116	117
1967						
January	241	254	238	238	116	117
February	242	262	238	236	118	119
March	244	267	239	236	119	120
April	250	300	241	236	123	123
May	254	314	243	235	124	124
June	254	308	245	236	122	122

Sources: The Bank of Korea, Monthly Statistical Review, Seoul, Korea, and Economic Planning Board.

Seoul consumer prices increased by 16 per cent during 1966 compared with 10 per cent in 1965. The Economic Planning Board's newly constructed consumer price index for all cities showed an increase slightly less than that for Seoul city in 1966. The consumer prices of housing rose by 10 per cent (13 per cent in 1965), fuel and light by 28 per cent (7 per cent), other services by 19 per cent (19 per cent), food and beverages by 15 per cent (5 per cent), and clothing by 16 per cent (17 per cent in 1965). The price increase in food and beverages contributed about 46 per cent to the over-all rise in consumer prices in 1966 as compared with 26 per cent in the preceding year. The contribution of the category of fuel and light to the over-all price change in 1966 was 9 per cent compared with 4 per cent in 1965, while that of clothing in 1965 and 1966 were 20 per cent and 13 per cent, respectively. Public utility rates, notably electricity, transportation and communications, were raised in 1966 to improve the financial position of the respective enterprises.

In the first half of 1967, wholesale prices increased by 5 per cent compared with 8 per cent in the corresponding period of 1966. Wholesale prices of grains increased by 23 per cent compared with 15 per cent in the same period of 1966, while wholesale prices of nongrain items rose 2 per cent in 1967 as opposed to 7 per cent a year before. The greater increase in the prices of grains was largely attributable to a 27 per cent increase in the price of rice during the period, while declines in the prices of fertilizers, fiber and fiber products contributed to the smaller rate of increase in other prices. The recent price developments seem to suggest that the income elasticity of demand for rice is high since people prefer rice to other cereals such as barley with increasing incomes. Wholesale prices of imported goods declined by 6 per cent in the first half of 1967, compared with a decline of 0.2 per cent in the corresponding period of 1966, reflecting the effect of further import liberalization and the stable foreign exchange rate. The Seoul consumer price index, estimated by the Economic Planning Board, increased about 4 per cent in the first half of 1967 compared with 12 per cent in the corresponding period of 1966.

The principal measures used to check price increases are policies of financial restraint, gradual liberalization of imports, and the improvement in domestic distribution facilities. In 1967, the Government plans to limit the rise in wholesale prices within 7 per cent and in consumer prices within 10 per cent. The Government also will use the price stabilization funds to moderate fluctuations in prices of strategic products, such as logs, newsprint paper, cement and cotton yarn. The Government lifted its direct price control on briquets in 1966, with only its control on wheat flour remaining.

Table 15. Changes in the Seoul Consumer Price Index in 1965-June 1967, and Rates of Contribution to the Change By Commodity Categories^{1/}

(In per cent)

	1965		1966		1967 (June)	
	Rate of change	Rate of contribution to the change	Rate of change	Rate of contribution to the change	Rate of change	Rate of contribution to the change
Total items	<u>10.3</u>	<u>100</u>	<u>16.5</u>	<u>100</u>	<u>4.2</u>	<u>100</u>
Food and beverages	5.1	26	14.8	46	3.2	38
Housing	12.8	9	9.8	4	2.8	6
Fuel and light	6.8	4	27.8	9	-0.1	-
Clothing	17.5	20	16.3	13	3.3	6
Other goods and services	18.7	41	19.3	28	7.6	49

Source: The Bank of Korea, Monthly Statistical Review, Seoul, Korea.

^{1/} Changes from year-end to year-end. (Figures may not add up due to rounding.)

4. Financial developments

As in previous years, a fairly comprehensive financial stabilization program was in operation in 1966, providing for limits on the over-all permissible increase in money supply. Under the stand-by arrangement between Korea and the Fund, the stabilization program placed ceilings on the expansions of net domestic assets of the Central Bank and on Central Bank credit to the Government, consistent with the desirable order of increase in money supply.

a. Stabilization programs and over-all financial performance in 1966

Under the second stand-by arrangement between Korea and the Fund, credit expansion was subject to two limits during the period from March 22, 1966 to March 21, 1967: (1) a ceiling of W 48.0 billion over net domestic assets of the Central Bank, and (2) a ceiling of W 52.4 billion on Central Bank credit to the Government up to November 1966, and W 46.9 billion for the remaining period of the stand-by arrangement. These ceilings entailed a maximum increase in the Central Bank's net domestic assets of W 8.5 billion during 1966 and by another W 1.0 billion in the remaining period of the stand-by arrangement. Such an expansion in primary liquidity, along with a moderate increase in foreign assets and a rise in quasi-monetary deposits was expected to generate a growth in money supply of about 15 per cent during a period of 14 months.

The Central Bank's net domestic assets including fertilizer credit expanded in 1966 by only W 1.7 billion and declined in the first three months of 1967, although the money supply expanded by more than 30 per cent during the period, due largely to the increase in foreign assets. As of March 25, 1967, the net domestic assets of the Central Bank totaled W 40.5 billion, W 7.5 billion below the ceiling of W 48.0 billion provided for under the 1966 stand-by arrangement. The ceiling on the credit to the Government was also observed with the exception of a marginal excess for a few days in the second half of 1966. As of March 25, 1967, it amounted to W 46.6 billion, slightly below the ceiling allowed under the stand-by arrangement.

Korea entered into a third stand-by arrangement for the period of one year from March 22, 1967. In light of the experience of 1966, a ceiling has been set on the growth of total primary liquidity defined as the total net domestic and net foreign assets of the Central Bank. The objective was thereby to limit the growth in money supply to 15 per cent during the stand-by period. This ceiling allows through December 1967 an increase in primary liquidity of W 11.0 billion over the level outstanding at the end of 1966 of W 80.1 billion, and a further increase of W 2.0 billion for the remaining period of the stand-by arrangement. In addition, a ceiling is placed on total Central Bank credit to the Government, and this is set at W 52.9 billion at the end of 1967 and at W 46.9 billion for the remaining period of the stand-by arrangement.

Developments under the over-all financial stabilization program are summarized in Table 16. Money supply increased by 22 per cent in 1966. This monetary expansion was associated with a much larger generation of liquidity from the external sector than had been expected at the beginning of the year, a rise in bank credit to the private sector of 44 per cent, and a rise in fertilizer credit. Quasi-monetary deposits, however, rose by about 116 per cent following the sharp upward adjustment in deposit interest rates in September 1965, and fiscal operations registered a cash surplus of W 2.6 billion. The rise in quasi-monetary deposits was much larger than expected at the beginning of the year, but the fiscal surplus fell considerably short of the projected amount of W 5.3 billion. This occurred principally because counterpart fund receipts lagged behind schedule and because government purchases of summer and fall grain produced an unplanned deficit of W 3.1 billion in the Grain Management Special Account. Net credit to local governments also increased by W 1.2 billion. The increase in quasi-monetary deposits of W 55 billion during 1966 exceeded the rise in bank credit to the private sector of W 32 billion during the year, and net credit to this sector declined by W 23 billion from the level outstanding at the end of 1965. The increase in fertilizer credit of W 6.7 billion in 1966 included W 5.3 billion which the NACF borrowed from the Central Bank to repay its liabilities to the Counterpart Fund account (see Chart 2).

The large generation of liquidity from the external side was related to the increased receipts of foreign exchange on current and capital accounts of the balance of payments. The expansionary impact of the foreign sector on the money supply was W 31.6 billion in 1966. At the end of 1966, the monetary system's foreign assets in terms of won were slightly larger than the outstanding money supply. At the end of 1965 they had been equivalent to about 73 per cent of the outstanding money supply.

During the first eight months of 1967, the money supply rose by W 10.2 billion to register an increase of nearly 15 per cent over the level at the end of 1966, as compared with an increase of 10 per cent in the same period of the previous year. The net credit to the fiscal sector remained the same at W 14.4 billion during the period, while the fertilizer sector added W 2.9 billion to the money supply due primarily to a seasonal increase in fertilizer credit. The foreign sector again played a major role in expanding the money supply by adding W 11.4 billion during the first eight months of 1967. These increases in money supply, however, were partly offset by the net credit position of the private sector. Private credit expanded during the period by W 58.7 billion, an increase of 57 per

Table 16. Factors Affecting Money Supply, 1964 - August 1967^{1/}

(In millions of won)

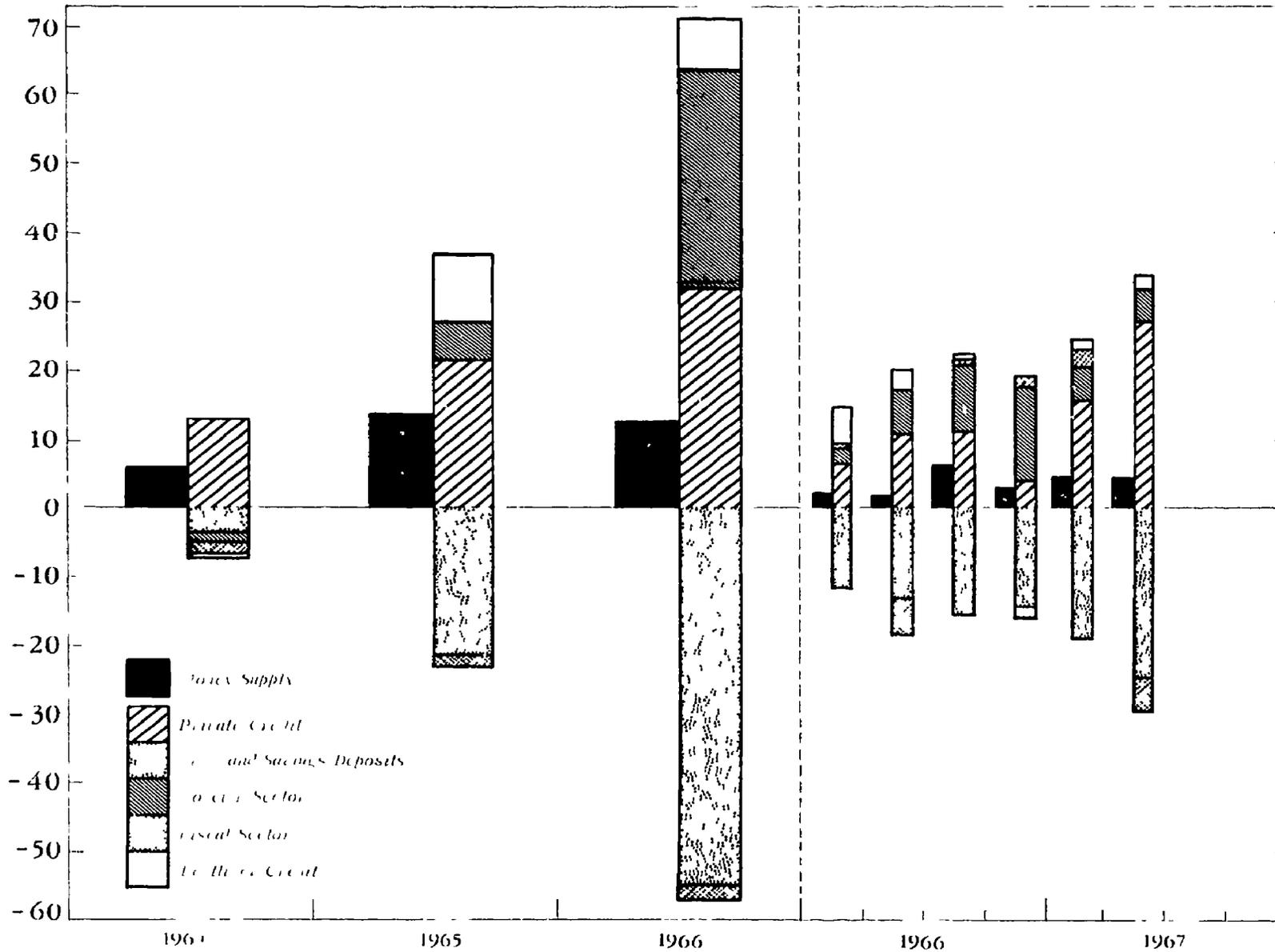
	1964	1965	1966	1966					1967		
				1st qtr	2nd qtr	August (Change over June)	3rd qtr	4th qtr	1st qtr	2nd qtr	August (Change over June)
Total Domestic Credit	+10.8	+29.6	+35.9	+11.8	+8.3	+4.3	+12.3	+3.5	+19.2	+24.2	+18.2
Fiscal sector	-1.7	-1.9	-2.6	+0.4	-5.4	-1.8	+0.8	+1.6	+2.5	-5.0	+2.5
Private credit	+12.7	+21.6	+31.8	+6.2	+10.9	+5.9	+11.0	+3.7	+15.3	+27.1	+16.3
Fertilizer credit ^{2/}	-0.2	+9.9	+6.7	+5.2	+2.8	+0.2	+0.5	-1.8	+1.4	+2.1	-0.6
Time and Savings Deposits ^{3/}	-3.7	-21.4	-55.0	-11.9	-13.0	-9.7	-15.8	-14.3	-19.4	-24.8	-18.6
Foreign Sector	-1.5	+5.5	+31.6	+2.1	+6.3	+7.6	+9.6	+13.6	+4.8	+4.7	+1.9
Money Supply	+5.8	+13.5	+12.6	+2.1	+1.6	+2.0	+6.1	+2.8	+4.5	+4.1	+1.6
(Money Supply Outstanding, at End Of)	(43.1)	(56.6)	(69.2)	(58.7)	(60.3)	(62.3)	(66.4)	(69.2)	(73.7)	(77.8)	(79.4)

Source: Data provided by the Korean authorities.

^{1/} Changes during each period. Total changes may not add up to changes in money supply due to rounding.^{2/} Net of cash balance held by NACF fertilizer account.^{3/} Includes savings of government corporations.

FACTORS AFFECTING CHANGES IN MONEY SUPPLY, 1964-FIRST HALF 1967

(In billions of won)



cent as compared with an increase of 32 per cent in the same period of 1966, but this was more than offset by an increase of W 62.8 billion in time and savings deposits, resulting in a W 4.1 billion contraction in money supply.

b. Government finance

(1) Budgetary performance in 1966

The administrative budget of the Central Government consists of the "general budget" and the "special accounts." The former refers mostly to the transactions of the Government performing traditional public functions, while the latter refers to the transactions of the public agencies producing and selling goods and services generally on a commercial basis. Major accounts included in the category of special accounts are: railways, communications, tobacco and ginseng monopoly, grain management, and office supplies.

As shown in Table 17, the original 1966 general budget passed by the National Assembly in December 1965 provided for expenditures of W 121.9 billion, an increase of 29 per cent over that of 1965, and the consolidated total budget including special accounts totaled W 208.9 billion. The original budget was expected to generate a surplus of W 1.3 billion in the general budget but a deficit of W 2.4 billion in special accounts, thereby resulting in a consolidated deficit of W 1.1 billion for fiscal year 1966. However, the National Assembly passed two supplementary budgets in April and in October, primarily to provide for increases in economic development expenditures necessary for the completion of the first Five-Year Plan. The final revision brought the size of the general budget to W 142.6 billion, an increase of 41 per cent over the actual level of 1965, and of 17 per cent over the original 1966 budget. As a result, the ratio of the budget to GNP rose from 12 per cent in 1965 to 14 per cent in 1966.

With the second supplementary budget, economic development expenditures came to W 41.4 billion, an increase of 93 per cent over the actual 1965 level, while ordinary and national defense expenditures totaled W 59.4 billion and W 40.5 billion, respectively, recording increases of 46 per cent and 35 per cent, respectively, over the actual levels of 1965.

On the revenue side, the final administrative budget for 1966 provided for tax revenues of W 83.2 billion, a gain of 52 per cent over the previous year's level, and in addition substantial increases in monopoly profits, trust funds and interest revenues, and other nontax revenues. The ratio of tax revenues to GNP in current prices was to increase from 7 per cent in 1965 to 9 per cent in 1966. In its final form, the 1966 administrative budget was expected to have a surplus of W 1.3 billion in the general budget but a deficit of W 14.9 billion in the special accounts, thereby having a net deficit of W 13.6 billion in the consolidated budget, of which W 8.9 billion was to be financed by foreign borrowing.

Table 17. Summary of National Government Budgets, Fiscal Years 1963-68^{1/}

(In billions of won)

	1963	1964	1965	1966	FY 1966 Approved		Approved FY 1967 ^{3/}	Proposed FY 1968
					Original	Revised		
General Budget								
Receipts (a + b)	69.8	76.3	101.3	144.2	121.9	142.6	163.7	221.5
1. Taxes	31.1	37.4	54.7	87.6	66.2	83.2	107.1	159.4
2. Monopoly profits	4.6	4.6	3.6	7.5	7.5	7.5	9.0	14.8
3. Other revenue	7.8	7.1	9.5	18.3	17.3	18.8	21.5	25.2
a. Total revenue (1+2+3)	43.5	49.1	67.8	113.4	91.0	109.5	137.6	199.4
b. Counterpart funds	26.3	27.2	33.5	30.7	30.9	33.1	26.1	22.1
Expenditure (1+2+3)	71.7	74.2	92.1	139.7	120.6	141.3	163.7	221.5
1. Ordinary	30.7	33.7	40.8	58.5	52.6	59.4	78.6	107.1
2. Defense ^{2/}	20.5	23.8	29.9	40.5	38.5	40.5	48.0	60.3
	(150.0)	(15.0)	(19.5)	(25.9)	(24.5)	(25.9)	(24.6)	
3. Economic development	20.5	16.7	21.4	40.7	29.5	41.4	37.1	54.1
Surplus (+) or deficit (-)	-1.9	+2.1	+9.2	+4.5	+1.3	+1.3	--	--
All Other Special Accounts								
Surplus (+) or Deficit (-)	-0.4	-3.2	-1.4	-10.0	-2.4	-14.9	-7.4	.
Consolidated Surplus (+) or Deficit (-)	-2.3	-1.1	+7.8	-5.5	-1.1	-13.6	-7.4	
Financed by:								
Cash balance (increase (-) or decrease (+))	-2.7	-3.9	-6.3	-4.3			-1.0	
Counterpart fund balance								
Borrowing from the Bank of Korea (increase (+) or decrease (-))	0.5	5.4		3.6		+6.2	0.1	
Net sales of bonds	1.8	-1.0	-1.5	-1.3	-1.4	-1.4	-1.1	
Borrowing from abroad	2.8	0.6		7.5	2.5	8.9	7.4	

Source: Data provided by the Korean authorities.

1/ Fiscal year corresponds to calendar year, however, accounts for any one year are closed toward the end of January of the following year. 2/ Figures in brackets relate to portion financed by counterpart funds.

3/ First supplementary budget.

The actual performance of the 1966 administrative budget^{1/} shows that almost all planned expenditures in the general budget were made during the budget period, while actual receipts in the general budget increased more than anticipated. As a result, the general budget yielded a surplus of about W 4.5 billion. Expenditures in the special accounts fell short of the expected amount, due largely to slower imports of the property claims fund from Japan. Receipts of the special accounts, in spite of W 7.5 billion of borrowing from abroad, W 3.6 billion of borrowing from the Bank of Korea, and revenue increases in the monopoly special account, fell short of the anticipated amount, to generate a deficit of around W 10.0 billion. As a result, the actual amount of the consolidated budget deficit came to about W 5.5 billion.

Cash operations of the consolidated government budget, which bear a more direct link with the over-all financial stabilization program, are summarized in Table 18 for the period 1964-67. The table shows that cash operations in 1966 generated a surplus of W 6.4 billion compared with W 2.0 billion in 1965 and that this resulted from a surplus in the general budget and a net positive balance in special accounts including external borrowing. Cash receipts on general account during 1966 totaled W 138.2 billion, a gain of 46 per cent over the 1965 level, due largely to significant increases in tax revenues, customs duties and monopoly profits. Cash expenditures rose by 50 per cent in 1966. The monetary impact of the cash surplus in the budget appeared in the form of a decline in the Central Bank's credit to the Government by about W 2.4 billion and increases in cash balances of the Government by W 4.0 billion.

(2) Administrative budgets for fiscal years 1967 and 1968

The original budget for fiscal year 1967 was approved by the National Assembly in December 1966. The general budget was balanced at W 163.3 billion, showing an increase of 14.5 per cent over the revised 1966 level. After the National Assembly passed the first supplementary budget in March 1967, the general budget remained in balance as the revision provided for an increase in ordinary expenditures by W 0.4 billion and a corresponding increase in nontax revenues. The revision was made to meet the administrative expenses for the May and June elections. The general budget is, therefore, balanced at W 163.7 billion, a gain of 15 per cent over the revised 1966 general budget. The special accounts, however, are expected to produce a deficit of W 7.4 billion in 1967 as compared with the budgetary deficit of W 14.9 billion in the 1966 budget estimates. The net deficit of the consolidated budget, therefore, amounts to W 7.4 billion for 1967 which is expected to be matched by foreign borrowing of an equivalent amount (Table 17).

^{1/} Major differences between the administrative and cash budgets are the difference in accounting basis (e.g., cash vs. accrual basis) and in coverage of the period (calendar year vs. fiscal year basis). Although the fiscal year corresponds to a calendar year, administrative budget accounts are closed toward the end of January of the following year. In addition in the administrative consolidated budget presentation external borrowing is shown as financing of the deficit on special account.

Table 18. Cash Transactions of the Consolidated National
Government Budget, 1964-June 1967^{1/}

(In billions of won)

	1964	1965	1966	January-June	
				1966	1967
General Budget					
Receipts	<u>74.4</u>	<u>94.8</u>	<u>138.2</u>	<u>61.2</u>	<u>73.1</u>
Internal taxes	<u>27.5</u>	<u>40.0</u>	<u>67.3</u>	<u>26.2</u>	<u>36.0</u>
Customs duties	8.4	12.6	17.7	8.0	12.9
Monopoly	4.5	3.6	7.5	3.7	3.3
Counterpart funds	27.2	29.7	29.4	17.3	11.5
Others	6.8	8.9	16.3	6.1	9.4
Expenditures	<u>71.8</u>	<u>89.3</u>	<u>133.8</u>	<u>55.9</u>	<u>73.2</u>
Ordinary	<u>32.4</u>	<u>40.9</u>	<u>58.1</u>	<u>26.5</u>	<u>38.0</u>
Defense	24.1	28.6	39.4	17.3	20.6
Investment and loans	15.3	19.8	36.3	12.2	14.6
Surplus (+) or deficit (-)	+2.6	+5.5	+4.4	+5.3	-0.1
Special Accounts, Net	<u>0.4</u>	<u>-3.1</u>	<u>+0.5</u>	<u>+1.4</u>	<u>+7.6</u>
Grain management	<u>0.5</u>	<u>-3.4</u>	<u>-3.1</u>	<u>-0.1</u>	<u>5.7</u>
Monopoly enterprise	-0.1	0.3	0.6	0.1	-0.3
Railway and communications	-0.1	--	1.4	0.7	-0.8
Others	0.1	0.1	1.6	0.7	3.0
Carry-over and Nonbudgetary Accounts, Net	<u>-0.5</u>	<u>-0.4</u>	<u>1.5</u>	<u>+0.4</u>	<u>-6.2</u>
Consolidated Surplus (+) or Deficit (-)	<u>+2.5</u>	<u>+2.0</u>	<u>+6.4</u>	<u>+7.1</u>	<u>+1.3</u>
Financed by:					
Overdraft, increase(+)	+1.7	+3.7	-2.4	-3.0	-0.5
Cash balance, increase (-)	-4.2	-5.7	-4.0	-4.1	-0.8
Industrial bonds	--	--	--	--	--

Source: Data provided by the Korean authorities.

^{1/} Foreign loans are included in both receipts and expenditures.

On the expenditure side, the 1967 general budget allows considerable increases in all expenditures categories except those for economic development. As compared with the 1966 budget estimates, ordinary and national defense expenditures are expected to increase by 32 per cent and 19 per cent, respectively, reflecting mainly increases in salaries of government employees (by 23 per cent). The amount of economic development expenditures in the general budget is expected to reach W 37.1 billion during 1967, a decline of W 3.6 billion from the actual 1966 level, but such expenditures allocated in special accounts total W 31.1 billion, a gain of W 2.4 billion. Total development expenditures will therefore amount to W 68.2 billion in 1967, as compared with W 69.4 billion in 1966 (Table 19).

Table 19. National Government Development Expenditures,
Fiscal Years 1962-67

(In billions of won)

	1962	1963	1964	1965	1966	1967 (Approved)
Source of funds						
General government sector	23.9	20.5	16.7	21.4	40.7	37.1
All other special accounts	<u>3.3</u>	<u>6.8</u>	<u>7.0</u>	<u>8.1</u>	<u>28.7</u>	<u>31.1</u>
Total	27.2	27.3	23.7	29.5	69.4	68.2
Use of funds by industries						
Agriculture and forestry	7.4	5.1	4.5	6.9	13.7	11.0
Fishery	0.5	1.2	0.5	1.4	5.2	5.0
Mining	1.4	0.5	0.5	0.5	1.0	1.5
Manufacturing	4.5	4.9	3.9	6.6	11.0	8.9
Electricity	3.4	3.7	3.4	1.1	2.8	2.2
Railway transportation	1.5	4.8	2.6	3.0)	14.9	16.7
Highway and ports	1.8	1.3	1.2	1.9)		
Communications	1.1	1.3	2.6	3.8	8.0	8.1
All others	<u>5.6</u>	<u>4.5</u>	<u>4.5</u>	<u>4.2</u>	<u>11.8</u> ^{1/}	<u>14.8</u> ^{1/}
Total	27.2	27.3	23.7	29.5	69.4	68.2

Source: Data provided by the Korean authorities.

^{1/} Includes W 5.5 billion in 1966 and W 6.0 billion in 1967, for education.

The pattern of development expenditures shown in Table 19 reveals that the development of tertiary industry is given added emphasis in 1967 with a view to accelerating the expansion of transportation and communications facilities. About 58 per cent of the total development expenditures in the budget are allocated to tertiary industry as compared with 51 per cent in 1966. The shares of primary and secondary industries are 24 per cent and 18 per cent in 1967, while they were 28 per cent and 22 per cent, respectively, in 1966.

On the revenue side, tax receipts in the 1967 budget amount to W 107.1 billion, accounting for 65 per cent of the total budgetary revenues for the year (Table 20). This amount of tax receipts reflects an increase of W 19.5 billion or 22 per cent over the collections in the previous year. This increase is to be brought about through improvement in tax collections, expansion in the tax base and effective prevention of tax evasion. In view of further import liberalization to be carried out during 1967, revenues from customs duties are expected to increase considerably. However, counterpart fund receipts are expected to decline by W 4.6 billion from the previous level of W 30.7 billion. As a result, the share of domestic revenues in the budget would rise to 84 per cent in 1967, compared with 79 per cent in 1966. The ratio of total tax revenues, including monopoly profits and local government taxes, to GNP was 10.7 per cent in 1966 compared with 8.7 per cent a year before. This ratio is expected to remain at about the same rate in 1967.

Cash operations of the consolidated government budget realized a surplus of W 1.3 billion in the first half of 1967, as compared with a surplus of W 7.1 billion in the same period of the previous year. Cash operations of the general budget realized a deficit of W 0.1 billion, compared with a surplus of W 5.3 billion in the first half of 1966, due primarily to an increase in ordinary expenditures of the Government and receipts of the Counterpart Fund Account lagging behind the scheduled amount. Operations of the special accounts, on the other hand, produced a surplus of W 7.6 billion in the first six months of 1967 (a surplus of W 1.4 billion in the same period of 1966), reflecting largely increases in receipts from the sale of rice by the Grain Management Special Account, but this was offset by a deficit of W 6.2 billion of carry-over and non-budgetary expenditures. These carry-over expenditures are usually made in the first half of a year without having matching carry-over revenues. In addition, unusually large outlays had been made in 1967 by non-budgetary accounts, e.g., by local authorities and public entities not covered by the national government budget, drawing temporarily on central government resources. As the nonbudgetary accounts receipts increase in the second half, these drawings are expected to be refunded.

Table 20. Major Components of General Budget Receipts,
Fiscal Years 1962-67^{1/}

(In billions of won)

	1962	1963	1964	1965	1966	1967 ^{2/} (Approved)
1. Direct taxes	7.6	9.9	14.0	18.9	35.3	42.6
Personal income	4.9	5.9	8.6	11.7	20.3	25.1
Corporate income	2.0	3.0	4.1	5.7	10.9	14.2
Registration, others	0.7	1.0	1.3	1.5	4.1	3.3
2. Indirect taxes	20.5	21.1	23.5	35.7	52.3	46.1
Commodity	6.6	6.1	5.3	7.0	10.3	12.6
Business	1.9	2.5	3.2	4.5	7.3	10.4
Liquor	2.5	2.8	2.9	3.8	6.3	8.1
Travel	0.7	0.9	1.0	1.2	2.8	3.9
Petroleum products	1.9	2.3	2.0	3.2	3.7	4.9
Other internal	0.2	0.1	0.9	3.5	4.3	6.2
Customs	6.7	6.4	8.2	12.6	17.6	18.4
3. Total taxes (1+2)	28.2	31.1	37.4	54.7	87.6	107.1
4. Monopoly profits	4.0	4.6	4.6	3.6	7.5	9.0
5. Other nontax revenues ^{3/}	13.4	7.8	7.1	9.5	18.3	21.5
6. Total receipts (3+4+5)	45.6	43.5	49.1	67.8	113.4	137.6
7. Local government taxes	5.2	7.3	8.7	11.3	15.4	12.7
8. (3+4) as per cent of GNP	9.5	7.5	6.2	7.3	9.2	9.5
9. (3+4+7) as per cent of GNP	1.0	9.0	7.3	8.7	10.7	10.6

Source: Data provided by the Korean authorities.

^{1/} Excludes counterpart fund receipts.^{2/} First supplementary budget.^{3/} Includes mainly transfers from government-owned enterprises, public school fees, property sales, trust fund income and loan repayments associated with the past fiscal lending funds.

After establishing normal diplomatic relations with Japan in 1965, the Property Claims Fund Special Account was established within the government budget for the first time in March 1966 to ensure the most effective use of such funds (SM/66/108, Part II, pp. 27-29). This special account has two components: a local currency collection account for sales of goods imported with property claims funds, and a loan repayment account for loan repayments by those importing capital goods with official credits. In 1966, actual revenues of the former amounted to W 5.39 billion, while those to the latter totaled about W 28 million. Actual expenditures of the Account reached W 4.99 billion, all for economic development, thus resulting in a surplus of about W 0.43 billion in 1966. The bulk of economic development outlays under the program went to the agriculture and fishery sectors and to small and medium industries. In the approved 1967 budget, won collection and loan repayment revenues are expected to reach about W 8.2 billion and W 487 million, respectively, while expenditures, exactly matching the revenues, will total W 8.69 billion.

For many years the Government has been conducting procurement and sales of foodgrains through its Grain Management Special Account, partly to secure foodgrains for military forces, prisoners and some government institutions and partly to minimize seasonal fluctuations of foodgrain prices. The amount of foodgrain procured for the former has been relatively stable for the past five years, whereas that for the latter has shown erratic changes in response to the conditions of crops. In 1966, domestic procurement of foodgrains totaled 499,000 metric tons including 298,000 metric tons of rice and 201,000 metric tons of other cereals, while foodgrain imports amounted to 31,000 metric tons. Of the total procurement, about 225,000 metric tons were used during the year for the purpose of price stabilization. In contrast, in 1965 the total amount of foodgrains domestically procured and imported by the Government had amounted to 336,000 metric tons and 131,000 metric tons, respectively. In these operations, the price applied to grain procurement was based on estimates of the cost of farm production, while the sale price of government-held grains was on the basis of procurement price plus incidental costs. However, some deficits have occurred in cash operations of the Grain Management Special Account of the budget in the past, partly because the incidental expenses were not fully covered in the sale price and partly because part of procured foodgrains remained in inventories. In 1966, cash operations of this special account produced a deficit of W 3.1 billion.

In the approved budget for 1967, the Grain Management Account shows a balanced position. However, in the first half of 1967, the GMSA realized a cash surplus of W 5.7 billion, due primarily to the sales of rice in April to the public in an amount of W 6.4 billion for the purpose of stabilizing the rice price. The Account, however, is expected to produce a deficit in an order of W 9.7 billion during the second half of the year in which purchases of summer and fall foodgrains are to be made with increased purchase prices (rice price by 7 per cent and barley price by 8.3 per cent). The Government intends to seek additional revenues to adjust the deficit of the Account in a second supplementary budget to be submitted to the National Assembly.

In connection with approval of the budget for 1967, the National Assembly authorized the establishment of two price stabilization funds. One, in an amount of W 6 billion, is to supplement the operations of the Grain Management Special Account and of the NACF in smoothing seasonal fluctuations in prices of agricultural products. The other, in an amount of W 5 billion, is to help stabilize the prices of some 12 key domestic and imported commodities, including cotton yarn, building materials, and petroleum products. No budgetary appropriations were made for these two funds. Rather, their operations were envisaged to be financed from realized revenue surpluses in other accounts and, within the framework of the stabilization program, by Central Bank overdrafts. During the second half of 1967, the Agricultural Prices Stabilization Fund, the size of which is to be raised to W 20.0 billion within five years, is expected to finance additional government purchases of barley in an amount of W 2.7 billion and the required expenditure, if necessary, will be met by borrowings from the Bank of Korea. As for the General Price Stabilization Fund, the outstanding borrowings of the Fund from the Bank of Korea amounted to W 803 million as of the middle part of July 1967. The commodities purchased under the program were cement, newsprint, wood and lumber. The borrowing is to be repaid by the end of 1967.

In addition to these funds, the National Assembly also passed a bill in March 1967 authorizing the establishment of a Foreign Exchange Equalization Fund designed to regulate the amount of liquidity generated or contracted in the external sector of the economy. No appropriation was made for the Fund in the approved 1967 budget.

The general budget for fiscal year 1968, as proposed to the National Assembly in the early part of September 1967, balances expenditures and revenues at W 221.5 billion, representing an increase of W 57.8 billion or 35 per cent over the current 1967 budget level. Economic development expenditures in the proposed budget for 1968 amount to W 54.1 billion, an increase of 46 per cent over the level of the 1967 budget, while national defense outlays will total W 60.3 billion to register an increase of W 12.3 billion or 26 per cent over 1967. Ordinary expenditures of the Government will total W 107.1 billion to reflect an increase of W 28.5 billion or 36 per cent over the level of the current year, of which about W 9.4 billion or 33 per cent will represent increases in salaries by 30 per cent of all government employees.

On the revenue side, internal taxes will amount to W 128.0 billion, an increase of W 39.3 billion or 44 per cent over the amount for 1967. About W 7 billion of the increase in internal tax revenues is expected to come from the planned introduction of the new tax reform. Monopoly profits of the Government will total W 14.8 billion in 1968 compared with W 9.0 billion for 1967, while tariff revenues, totaling about W 31.4 billion, are expected to increase by about 70 per cent in 1968 due to the planned reform of the existing tariff structure and to expected increases in imports as a result of import liberalization. By contrast, the counterpart fund will decline in 1968 to W 22.1 billion, a decline of about 15 per cent from the level of 1967, to reduce the proportion of budgetary revenues from foreign sources to 10 per cent in 1968 from the present level of 16 per cent.

No budget data are available at this time on the special accounts, except that the budget for these accounts will total about W 146.3 billion to reflect an increase of about 27 per cent from the 1967 level, and will be balanced taking account of the foreign aid received by some accounts.

Budgetary receipts and expenditures for 1967 and earlier years in relation to estimated GNP are presented in Table 21. The ratio of receipts to GNP reached a peak in 1962 and declined thereafter, reaching 7.0 per cent in 1964, the lowest in recent years. It is expected to reach 11.3 per cent in 1967 compared with 11.0 per cent in 1966.

(3) National government debt

Gross internal debt of the national government declined by W 3.8 billion in 1966, whereas external debt rose by W 7.3 billion in the same year (Table 22). As of the end of May 1967, internal debt, however, increased from the 1966 level by W 2.4 billion to reach a total of W 48.9 billion. External debt in the same period reached W 72.1 billion to increase by W 6.5 billion. The ratio of the national government's gross internal debt to GNP was about 5 per cent in 1966, as compared with 6 per cent in the previous year.

c. Bank finance

(1) Credit policy and developments

Monetary and credit policy during 1966 and in the early part of 1967 was largely dictated by the necessity of absorbing rising liquidity generated by the external sector of the economy. For this purpose, the monetary authorities issued Central Bank bonds, raised reserve requirements against bank deposits, and established a Currency Stabilization Account with the Central Bank. Marginal reserve requirements against the bank deposits of commercial banks were in effect between September 1, 1966 and March 31, 1967, and the Currency Stabilization Account was established in the Central Bank on March 1, 1967. Notwithstanding these measures of restraint, domestic bank credit increased by 44 per cent during 1966, extended mostly to export and other preferred industries at preferential interest rates. The Government also approved the recourse by preferred industries to foreign sources for working capital. These policies contributed to the large growth in liquidity by facilitating an inflow of short-term funds from abroad, while at the same time mitigating the restraining effect of high ordinary bank lending rates on the demand for bank credit.

After the revision of the Interest Rate Restriction Act on September 14, 1965, the interest structure remained the same with only some minor changes being made in 1966 and in the first half of 1967 (Appendix Table II). First, effective February 1, 1966, the interest rate on commercial bank overdrafts was raised to 28 per cent a year from the previous level of 26 per cent. Second, effective March 13, 1967, the Central Bank's rate on loans for promoting export industries was lowered from the previous

Table 21. General Budget Receipts and Expenditures in Relation to Money GNP, 1960-67

(In billions of wcn)

	Money GNP	Receipts ^{1/}		Expenditures ^{2/}		Counterpart Funds	
		Amount	Ratio to GNP	Amount	Ratio to GNP	Amount	Ratio to GNP
1960	246.7	28.9	11.7	41.3	16.7	13.6	5.5
1961	296.8	28.5	9.6	55.8	18.8	22.3	7.5
1962	348.6	45.6	13.1	82.0	23.5	28.7	8.2
1963	488.0	43.5	8.9	71.7	14.7	26.3	5.4
1964	696.8	49.1	7.0	74.2	10.6	27.2	3.9
1965	805.9	67.8	8.4	92.1	11.4	33.5	4.2
1966	1,032.0	113.4	11.0	139.7	13.5	30.7	3.0
1967 ^{3/}	1,219.8	137.6	11.3	163.7	13.9	27.1	2.2

Source: Data provided by the Korean authorities.

^{1/} Excludes counterpart fund receipts.

^{2/} Excludes small amount of debt redemption.

^{3/} GNP data represent an official forecast. Budget data are on the basis of the first supplementary budget.

Table 22. National Government Debt, 1963-May 1967

(In billions of won, outstanding at end of period)

	1963	1964	1965	1966	1967 May 31
<u>Internal Debt</u>					
National construction bonds ^{1/}	6.0	5.0	3.7	2.4	2.3
Industrial reconstruction bonds ^{2/}	12.8	12.8	12.8	12.8	12.8
Communication bonds ^{3/}	0.4	0.4	0.4	0.3	0.3
Overdraft on BOK ^{4/}	28.0	29.7	33.4	31.0	32.6
Subtotal	47.2	47.9	50.3	46.5	48.9
<u>External Debt^{5/}</u>					
Payable in won	0.4 (3.0) ^{6/}	0.7 (2.7)	0.6 (2.4)	0.6 (2.2)	0.6 (2.2)
Payable in foreign exchange	2.8 (21.9)	6.9 (27.1)	7.4 (29.1)	18.5 (67.4)	23.5 (85.3)
Subtotal	3.2 (24.9)	7.6 (29.8)	8.0 (31.5)	19.1 (69.6)	24.1 (87.5)
Total	50.4	55.5	50.3	65.6	72.1

Source: Data supplied by the Korean authorities.

^{1/} and ^{3/} Interest bearing 5 per cent a year, both mature in eight years.

^{2/} and ^{4/} Interest bearing 2 per cent a year, maturity varies from 20 to 40 years for ^{2/} and from 1 year to more than a year for ^{4/}.

^{5/} The equivalent won amounts are calculated at W 130 per U.S. dollar for 1963, W 255 per U.S. dollar for 1964 and 1965, and W 275 per U.S. dollar for 1966. Includes only amounts recorded as receipts into the National Government Budget.

^{6/} Amount of foreign exchange in parentheses in millions of U.S. dollars.

28 per cent to 23 per cent per annum. Lastly, effective June 29, 1967, the interest rates on commercial bank loans financing exports and loans for suppliers to the U.N. forces were lowered from 6.5 per cent a year to 6 per cent. At the same time, the interest rate on commercial bank loans financing imports of raw materials for foreign exchange earning purposes was set at 6 per cent per annum, while the interest rate on bank loans financing imports of raw materials for purposes other than earning foreign exchange and imports of industrial equipment was set at 24 per cent a year. The preferential rates on bank loans financing imports came under the "Regulations Concerning Import Financing" in June 1967, which established a new import financing system designed to relax importers' burden of financing imports after the system of imports on shippers' usance credit and on D/A basis were restricted.

The marginal reserve requirements of 50 per cent of the increase in demand deposits and 45 per cent for time deposits were applied on deposits in excess of the respective average balances outstanding in the second half of September 1966. The imposition of these marginal requirements over the regular reserve requirements raised the average requirement ratio and contributed to the greater absorption of liquidity. Effective April 1, 1967, the marginal reserve requirements were eliminated, but the average reserve requirements of 35 per cent against demand deposits, 20 per cent against short-term time deposits, and 15 per cent against long-term deposits remained in effect. Funds released as a result of the abolition of marginal reserve requirements were immediately absorbed into Bank of Korea stabilization bonds and into a special deposit with the Central Bank. Of W 8.1 billion released, W 6.1 billion was initially transferred to the blocked Currency Stabilization Account with the Central Bank, while W 2.0 billion was absorbed into stabilization bonds. The Korean authorities have continued to absorb in the Bank of Korea the same amount of commercial bank liquidity as under the eliminated marginal reserve requirement. The replacement of legal reserves with the Central Bank interest-earning liabilities of the Bank of Korea, like Bank of Korea bonds and blocked deposits in the Special Account, has helped to relieve the earnings position of commercial banks which had been squeezed by the high reserve requirements against deposits and the interest rate paid on long-term deposits in excess of the bank lending rates.

The Currency Stabilization Account was established as an additional instrument of credit control, particularly in view of the statutory limit on the issue of Central Bank stabilization bonds. The amount of deposits in the Account do not constitute part of required legal reserves of the banks. The Central Bank pays an interest rate of 5 per cent per annum on the outstanding average balance of such deposits in each month. As of the end of June 1967, the amount of deposits in the Account totaled W 20.1 billion.

Other measures of credit control applied in 1966 and early 1967 included the placement of Central Bank stabilization bonds with banks and the shifting of part of the excess reserves of commercial banks to deposits

with the National Agricultural Cooperatives Federation (NACF) and the Medium Industry Bank (MIB) in order to reduce the latter's dependence on Central Bank credit. The Central Bank's practice of selling stabilization bonds was introduced in March 1966. Under its statute the Central Bank can issue such bonds up to 10 per cent of outstanding money supply. Initially, stabilization bonds in an amount of W 1.0 billion were issued. These bonds had a maturity of 91 days and carried an effective rate of interest of 5 per cent per annum. Effective October 1, 1966, the monetary authorities raised the interest rate from 5 per cent to 10 per cent per annum. The outstanding balance of these bonds at the end of 1966 was W 4.6 billion. Upon the elimination of marginal reserve requirements against the deposits of banks, W 2.0 billion was absorbed into these bonds. As of the end of June, the outstanding balance of Bank of Korea bonds was W 7.0 billion.

Beginning from May 1966, the Central Bank instructed commercial banks to place part of their excess reserves in three-month time deposits with the NACF and the MIB at an annual rate of interest of 10 per cent. The measure was designed to absorb part of the liquidity of commercial banks in order to curb their potential credit expansion, and also to reduce the dependence of the NACF and the MIB on the rediscounting facility of the Central Bank. The amount of such deposits totaled W 1.5 billion in May 1966 and rose to W 4.1 billion at the end of 1966. The system came to an end on May 1, 1967 and the outstanding balance of W 3.6 billion in the deposits was repaid by the NACF and the MIB and simultaneously absorbed into the Currency Stabilization Account.

The introduction of additional instruments of monetary and credit control in 1967 is under consideration. The National Assembly passed in February 1967 a bill authorizing the issuance of Treasury bills. In September 1967, the Government issued 90-day Treasury bills in an amount of W 4.75 billion, carrying an interest of 18 per cent per annum.

(2) Deposit and credit developments

Quarterly developments in demand deposits and time and savings deposits of banking institutions during 1966 (Table 23) clearly bring out the effect of the interest rate reform of September 1965. At that time, the annual interest rate on time deposits was increased from 9.0 per cent for 3-month deposits to 18.0 per cent, from 15.0 per cent for 12-month deposits to 26.4 per cent, and from 15.0 per cent for 18-month deposits to 30.0 per cent.

The objectives of this reform were to increase savings, to transfer funds from the curb market into banks, and to effect better allocation of loans. Following the reform, the increase in time and savings deposits gained momentum. A part of this increase, particularly immediately after the interest rate reform, probably reflected transfers from the curb market. Most of the subsequent increase has been due to higher real returns

Table 23. Composition of Money Supply and Savings Deposits of Banking Institutions, 1964-June 1967

(In billions of won)

	1964	1965	1966				1967					
	Dec.	Dec.	Mar.	June	Sept.	Dec.	Jan.	Feb.	Mar.	Apr.	May	June
1. Demand deposits	18.2	25.0	29.1	28.5	25.2	26.3	30.6	29.2	30.9	29.3	30.9	31.4
2. Currency in circulation	24.9	31.6	29.6	31.8	41.1	42.9	42.2	45.2	42.8	48.3	46.4	46.4
(As per cent of money)	(58)	(56)	(50)	(53)	(62)	(62)	(58)	(61)	(58)	(62)	(60)	(60)
3. Money supply	43.1	56.6	58.7	60.3	66.3	69.2	72.9	74.5	73.7	77.6	77.3	77.8
4. Long-term savings deposits	17.2	35.8	44.2	55.4	70.8	80.1	84.4	98.7	96.8	102.2	107.3	113.1
5. Short-term savings	8.6	11.5	15.0	16.8	17.2	22.2	23.5	23.1	24.9	31.1	32.9	33.4
6. Total deposits (4+5)	25.9	47.3	59.2	72.2	88.0	102.3	107.9	111.8	121.7	133.3	140.2	146.5
7. Total liquidity (3+6)	69.0	103.9	117.9	132.5	154.3	171.5	180.8	186.3	195.4	210.9	217.5	224.3
8. 2/7 in per cent	36.1	30.4	25.1	24.0	26.6	25.0	23.3	24.3	21.9	22.9	21.3	20.7
9. 6/7 in per cent	37.5	45.5	50.2	54.5	57.0	59.7	59.7	60.2	62.3	63.2	64.5	65.3
10. GNP (annual, at current prices)	696.8	805.9				1,032.0						
11. 3/10 in per cent ^{1/}	5.8	6.2				6.1						
12. 7/10 in per cent ^{1/}	9.2	10.7				13.3						

Source: Data provided by the Korean authorities.

^{1/} Amounts of money supply and total liquidity applied are the average of the amount outstanding at the beginning and the end of the year.

on such deposits--due to increased deposit interest rates and abatement of inflation. The sharp growth in time and savings deposits has been sustained throughout 1966 and 1967. During 1966, the increase was 116 per cent compared with an average annual rate of increase of about 26 per cent in 1964 and 1965 prior to the reform. Long-term deposits rose by 124 per cent in 1966 and short-term deposits by 93 per cent. As a result of the sharp increases in these deposits, their ratio to total liquidity (money plus quasi-monetary deposits) increased to 60 per cent at the end of 1966, from 46 per cent at the end of 1965.

In the first half of 1967, total time and savings deposits grew by W 44.2 billion or by 43 per cent as compared with W 24.9 billion or 52 per cent in the same period of 1966. Long-term time and savings deposits increased during the period by 41 per cent, while short-term time and savings deposits rose by 50 per cent. The increase in time and savings deposits in the first half of 1967 has been much larger than anticipated; this was largely related to the continuing incentive of high deposit interest rates, the active savings campaign of the Government, and the large increase in exchange earnings, particularly from invisibles. Demand deposits increased by 14 per cent in the first half of 1966 to account for about 47 per cent of money supply, but declined in the second half of the year by 8 per cent, accounting for only 38 per cent of the total money supply at the end of the year. In the first half of 1967, demand deposits rose by 19 per cent, accounting for 40 per cent of money supply in June.

Along with the growth of quasi-monetary deposits, bank credit to the private sector expanded considerably during 1966. Over-all bank credit to the private sector rose by 44 per cent (Table 24) in 1966 compared with 43 per cent in 1965. The manufacturing sector, especially export industries, received the bulk of bank credits. The relative importance of commercial bank loans increased during 1966 to account for almost 38 per cent of the total in December 1966 compared with 34 per cent a year before, although the rate of expansion in such credit was slower at 54 per cent in 1966 as compared with 62 per cent a year earlier. Loans of all specialized banks also expanded rapidly, but the rate of expansion was relatively slower than that of commercial banks. NACF loans, including antiusury loans, increased by 21 per cent in 1966 in contrast to a mere 3 per cent increase in the year before, while loans of the MIB and Citizens National Bank (CNB) and the Korean Reconstruction Bank (KRB) expanded by 42 per cent and 28 per cent, respectively. Portfolio investments and credits of trust fund accounts of banking institutions also rose by 46 per cent in 1966 compared with 16 per cent in 1965.

In the first half of 1967, over-all bank credit to the private sector expanded by 41 per cent, compared with 24 per cent in the same period of the previous year. The largest expansions occurred in loans of commercial banks and those of the MIB, CNB and the Foreign Exchange Bank (FEB), which increased by 29 and 28 per cent, respectively. Commercial bank loans accounted for 39 per cent of the total gross credit to the private sector

Table 24. Credits of All Banks to the Private Sector Adjusted for the Government Lending Funds, 1963-June 1967

(In billions of won, outstanding at the end of period)

	1963	1964	1965				1966				1967					
			March	June	Sept	Dec	March	June	Sept	Dec	Jan	Feb.	March	April	May	June
1. Loans to the private sector	78.7	87.5	91.8	97.4	97.2	111.3	116.8	129.5	141.7	152.9	154.5	157.2	165.0	172.5	150.0	189.3
a. Ordinary commercial banks	22.8	23.1	26.0	26.8	27.2	37.5	40.4	45.1	50.1	57.9	58.4	60.0	63.7	64.8	67.7	74.6
b. NACF, including antitrustary loans net	17.4	19.5	18.9	21.0	21.8	20.0	20.6	24.2	26.7	24.1	24.7	25.0	25.3	28.9	29.9	30.3
c. MTB, CNB and ILB	9.0	10.7	11.3	12.4	13.2	14.7	15.7	17.1	18.8	20.9	20.8	21.2	22.4	23.6	25.6	26.8
d. KRB, including equity investment	28.8	33.1	34.1	34.4	36.1	38.6	39.7	42.7	45.9	49.3	49.7	50.0	52.6	54.2	55.6	56.4
e. Over the guarantee credit and MOK loans to private sector	0.7	1.1	1.5	0.8	0.9	0.5	0.4	0.4	0.3	0.7	0.9	1.0	1.0	1.0	1.2	1.2
2. Portfolio investments, including trust fund accounts ^{1/}	7.3	8.2	8.3	8.6	9.3	9.5	10.0	10.9	12.8	13.9	14.0	14.1	14.9	15.3	15.4	16.2
3. Offsets (-) ^{2/}	48.0	54.9	56.0	57.1	57	60.1	60.8	63.2	67.6	75.8						
4. All other, i.e., net of domestic assets and liabilities of all banks	-0.4	9.5	14.1	11.9	10.5	11.2	12.1	11.7	13.1	12.7	61.1	59.4	60.9	62.0	61.7	59.4
Total (1+2 - 3+4)	37.6	50.3	58.2	58.8	61.4	71.9	78.1	89.0	100.0	103.7	107.4	111.9	119.0	125.8	133.7	146.1

Source: Data provided by the Korean authorities.

^{1/} Mostly held by commercial banks.

^{2/} Consists largely of funds advanced by the Government.

during the period. The increased role of commercial banks in extending credit to the private sector in recent years resulted in a rise in the proportion of working funds in total bank credits from 64 per cent at the end of 1965 to 66 per cent in December 1966 and 69 per cent in June 1967. Portfolio investments and credits from trust fund accounts of banks expanded by 17 per cent in the same period, compared with 15 per cent in the previous six-month period.

During the period of five years from 1962 to 1966, various export credits outstanding expanded sharply to reach W 8.9 billion at the end of 1966. The rate of increase appeared to have accelerated in recent months as the total outstanding balance of credits amounted to W 11.1 billion at the end of June 1967 (Table 25). Outstanding loans for exports totaled W 3.6 billion at the end of 1966, an increase of W 2.4 billion since the end of 1962 but a decline of W 0.3 billion from the level of the previous year, and thereafter expanded sharply to W 6.2 billion at the end of June. The Bank of Korea usance credit, which was introduced in early 1964, expanded markedly during 1966 but declined slightly in the first half of 1967. The financial stabilization program of 1967 places a year-end ceiling of W 13.5 billion over the total of export credits outstanding. The comparable ceiling for 1966 was W 10.5 billion.

The manufacturing sector received relatively more credit of commercial banks than other sectors in recent years (Table 26). In December 1966, the share of the manufacturing sector in total commercial bank credit was 56 per cent, as compared with 54 per cent a year before, while that of commerce, banking, and real estate sectors declined from 28 per cent in December 1965 to 23 per cent a year later. However, this tendency was temporarily reversed in the first half of 1967, in which the share of the manufacturing sector declined to 55 per cent while that of commerce, banking, and real estate sectors rose to 25 per cent.

Table 25. Total Export Credits by All Banks, 1962-June 1967

(In millions of won)

	Outstanding at the end of					1967 June	Rate of change in 1966 (In per cent)
	1962	1963	1964	1965	1966		
Loans for exports	1,204	1,818	1,858	3,861	3,628	6,216	-6.2
BOK usance credit			3,106	2,776	4,989	4,721	79.7
Overdue guarantee credit			97	158	274	180	73.4
Total	1,204	1,817	5,061	6,801	8,891	11,117	30.7

Source: Data provided by the Korean authorities.

Table 26. Loans of Commercial Banks by Major Industries,
1963-June 1967

(In per cent)

	1963	1964	1965		1966				1967	
			Sep.	Dec.	Mar.	June	Sep.	Dec.	Mar.	June
<u>Manufacturing Sector</u>	<u>50</u>	<u>51</u>	<u>48</u>	<u>54</u>	<u>54</u>	<u>55</u>	<u>54</u>	<u>56</u>	<u>57</u>	<u>55</u>
Textile	14	14	14	14	14	14	14	13	13	13
Food and beverage	9	9	7	9	8	8	8	8	8	8
Chemicals	4	4	4	5	5	5	5	6	6	6
Others	23	24	23	26	27	28	27	29	30	28
<u>Commerce, Banking, and Real Estate</u>	<u>26</u>	<u>26</u>	<u>33</u>	<u>28</u>	<u>29</u>	<u>26</u>	<u>26</u>	<u>23</u>	<u>23</u>	<u>25</u>
Foreign trade and wholesale	19	19	26	23	25	23	22	20	20	22
Others	7	7	7	5	4	3	4	3	3	3
<u>Services</u>	<u>6</u>	<u>5</u>	<u>4</u>	<u>4</u>	<u>3</u>	<u>4</u>	<u>5</u>	<u>5</u>	<u>5</u>	<u>5</u>
<u>All Others</u>	<u>18</u>	<u>18</u>	<u>15</u>	<u>14</u>	<u>14</u>	<u>15</u>	<u>15</u>	<u>16</u>	<u>15</u>	<u>15</u>
Total	100	100	100	100	100	100	100	100	100	100

Source: Data provided by the Korean authorities.

Despite an interest rate of 36.5 per cent per annum on overdue loans, such loans of commercial banks and specialized banks averaged about 10 per cent of their total loans during 1966 and in the first half of 1967 (Table 27). Overdue loans of the commercial banks and the NACF rose considerably at the end of 1966, which raised the ratio of such loans to total credits of all banks to 12 per cent. Since 1965, overdue loans of specialized banks have shown first declining and later stable trends. Generally inadequate equity capital of major bank borrowers, cumbersome legal procedures for foreclosing mortgages, coupled with a much higher interest rate in the nonbank money market than in banks, and disproportionately large loans to a few borrowers were principal factors responsible for this high ratio of overdue loans to total bank credit.

Despite the rapid growth in time and savings deposits since September 1965, the liquidity position of commercial banks and specialized banks as measured by their free excess reserves has remained tight in recent years (Appendix Table III). Factors responsible for this were the relatively

Table 27. Overdue Loans of Banks, 1963-June 1967^{1/}
(In billions of won, outstanding at the end of period)

		1963	1964	1965		1966				1967	
				Sept.	Dec.	Mar.	June	Sept.	Dec.	Mar.	June
Commercial banks	Total loans (A)	22.8	23.1	27.2	37.4	40.4	45.1	50.1	57.9	63.7	74.6
	Overdue (B)	3.7	3.3	2.2	5.6	3.2	7.7	4.3	9.2	5.5	13.4
	B/A in per cent	16	14	8	15	8	17	9	16	9	18
NACF	Total loans (A)	19.7	23.1	25.1	23.3	24.0	27.4	29.8	27.1	28.3	34.2
	Overdue (B)	6.3	6.8	2.5	3.3	3.4	3.7	2.6	5.0	5.3	4.9
	B/A in per cent	32	29	10	14	14	13	9	18	19	14
MIB	Total loans (A)	5.9	6.5	7.7	8.4	8.8	9.3	9.8	11.1	11.7	13.6
	Overdue (B)	0.7	0.6	0.6	0.4	0.7	0.8	0.9	0.7	1.1	1.1
	B/A in per cent	12	9	8	5	8	9	9	7	9	8
CNB	Total loans (A)	0.9	1.0	1.2	1.4	1.4	1.6	2.2	2.7	3.1	4.3
	Overdue (B)	0.2	0.1	0.1	0.03	0.05	0.05	0.06	0.05	0.08	0.07
	B/A in per cent	22	10	8	2	3	3	3	2	2	2
KRB	Total loans (A)	27.6	31.7	34.6	36.8	37.9	40.8	43.5	46.6	49.5	52.8
	Overdue (B)	3.3	3.4	2.6	1.8	1.8	1.9	1.9	2.1	2.1	2.8
	B/A in per cent	12	11	8	5	5	5	4	4	4	5
All banks	Total loans (A)	77.0	85.1	95.8	107.3	112.5	124.1	135.5	145.4	156.3	180.7
	Overdue (B)	14.1	14.2	8	11.1	9.2	14.1	9.8	17.1	14.0	22.4
	B/A in per cent	18	17	8	10	8	11	7	12	9	12

Sources: Bank of Korea, Monthly Statistical Review, Seoul, and data provided by the Korean authorities.

^{1/} Total loans of each bank include the credit outstanding only; therefore, exclude portfolio investments.

rapid expansion in bank credit, and the increase in average reserve requirements in February 1966 and the introduction of marginal reserve requirements in October. Total deposits of commercial banks subject to reserve requirements increased by 76 per cent in 1966, while required reserves rose by 179 per cent. In addition, as noted earlier, the Central Bank issued its own bonds to commercial banks and absorbed bank resources into blocked special account deposits with it. The net liquidity position of specialized banks deteriorated throughout 1966, primarily due to borrowings from the Central Bank to finance fertilizer operations. While total deposits of these banks expanded by 106 per cent, required reserves increased by 248 per cent during 1966. Although the system of marginal reserve requirements was abolished at the end of March 1967, the liquidity position of commercial banks and specialized banks continued to be very tight in the first half of 1967 because of the large amount of bank liquidity absorbed in the blocked deposits with the Central Bank. In May 1967, free excess reserves of commercial banks stood at W 7.6 billion, while those of specialized banks were W 26.7 billion.

Following the change in fertilizer procurement and related policies in the early part of 1965 (EES/65/152, p.5), NACF borrowing from the Central Bank was W 12.3 billion at the end of 1965, primarily to finance fertilizer stocks of W 11.1 billion (Table 28). During the first half of 1966, the borrowing of the NACF from the Central Bank increased by W 8.0 billion to reach W 20.3 billion. Such borrowing was associated mainly with an increase in fertilizer stocks and a large payment to the Counterpart Fund Account. This relatively large increase in NACF credit to the agricultural sector and hence in the NACF borrowing from the Central Bank in the first half of a year in part was seasonal. Such credit normally declines in the last quarter of a year as collections are made following the rice harvest. In the second half of 1966, a sharp decline in inventories occurred as fertilizer sales increased. The loan repayment of the Grain Management Special Account to the NACF in an amount of W 5.2 billion during the period reduced the amount of NACF borrowing to W 18.5 billion.

In the first half of 1967, the borrowing of the NACF from the Central Bank rose because of seasonal increases in inventories during the first quarter and in accounts receivable on credit sales during the second quarter. By the end of June, such borrowing reached W 22.4 billion. Fertilizer stocks are projected to increase during the remaining months of 1967 to reach W 17.4 billion by the end of the year. Accounts receivable on credit sales were estimated to increase in the third quarter but to decline in the last quarter. As a result, the amount of borrowing is expected to decline to W 21.3 billion by the end of December from the level of June.

As regards the cash/credit sales ratio under the fertilizer program, the Government had planned to bring it to 60:40 in 1966 but achieved only a ratio of 51:49, as compared with 56:44 in 1965. The target ratio for

Table 28. Fertilizer Operations of the NACF, 1964-67

(In billions of won)

	1964	1965	1966					1967						
	Dec.	Dec.	Mar.	June	Sept.	Dec.	Jan.	Feb.	Mar.	Apr.	May	June	Sept. (projected)	Dec.
Assets (use of funds)														
Inventory	3.3	11.1	13.3	17.6	12.3	11.4	13.4	15.0	16.9	14.5	14.6	15.4	16.6	17.4
Accounts receivable	3.1	6.4	4.6	7.3	12.9	7.0	7.0	7.0	5.6	6.6	7.2	8.3	10.3	3.9
Others	--	1.1	4.6	1.8	1.7	1.0	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.7
Total	6.4	18.6	22.5	26.7	26.9	19.4	20.9	22.5	23.0	21.6	22.3	24.2	27.4	22.0
Liabilities (supply of funds)														
Accounts payable, for	3.9	6.0	3.4	1.6	1.0	0.5	0.6	0.9	0.7	0.6	0.7	0.7	0.6	0.6
AID fertilizer	3.4	5.4	2.8	--	0.7	0.2	0.2	0.2	0.2	0.3	0.2	0.2	0.1	0.1
KFX fertilizer	--	--	--	1.0	--	--	--	--	--	--	--	--	--	--
Domestic fertilizer	0.5	0.6	0.6	0.6	0.3	0.3	0.4	0.7	0.5	0.3	0.5	0.5	0.5	0.5
Funds received in advance and other	0.6	0.8	2.1	5.2	5.6	0.5	1.2	1.3	2.4	0.9	1.0	1.5	5.0	0.6
Total	4.5	6.8	5.5	6.8	6.6	1.0	1.8	2.2	3.1	1.5	1.7	2.2	5.6	1.2
Net Assets	1.9	11.8	17.0	19.8	20.3	18.5	19.1	20.3	19.9	20.1	20.6	22.0	21.8	21.8
Financed by:														
Borrowing from BOK	2.1	12.3	16.0	20.3	20.2	18.5	18.5	20.1	20.3	21.1	21.8	22.4	22.5	21.3
Borrowing from NACF credit account, increase (+) or, decrease (-)	-0.2	-0.5	1.0	-0.5	0.1	--	0.6	0.2	-0.5	-1.1	-1.1	-0.3	-0.7	-0.5

Source: Data provided by the Korean authorities.

1967 is again 60:40. In the first half of 1967 a ratio of 55:45 was achieved, as compared with 50:50 in the same period a year ago. The reduction in the prices of certain types of fertilizer helped to raise the cash ratio in 1967.

As stated previously, the construction of three new fertilizer plants with the combined production capacity of 859,000 metric tons was completed during the first half of 1967 and they are now in operation. As a result, domestic production of fertilizer is expected to supply about 25 per cent of the total estimated fertilizer demand in 1967, as compared with the actual ratio of 13 per cent in 1966. In view of the fact that the Government is under contract with domestic producers of fertilizer to buy the entire fertilizer output, overproduction of certain types of fertilizer in the economy could result in a potentially large financial burden on the fertilizer account. Therefore, the Government is reviewing its contract with the domestic producers and also exploring the possibilities of export to reduce such potential financial burden in the event of overproduction.

(3) Developments in the security market

The Seoul Stock Exchange handles both spot and future transactions with the shares of 24 companies listed and the monthly average volume of transactions has rarely surpassed the W 2.0 billion level during the past few years. Such market inactivity is partly attributable to the lack of interest in security investment on the part of the general public but fundamentally to the fact that entrepreneurs in Korea are, for the most part, reluctant to break away from the existing form of closed family corporation. Recently, however, dealings in some stocks have become active after the Government announced its second public sales of W 0.8 billion worth of the government-held stocks. In 1966, W 1.1 billion worth of government-owned shares were sold through the Stock Exchange. In addition, the tax reform bill of the Government, which is to be sent to the National Assembly in September 1967, contains many provisions designed to stimulate the growth of open corporations. Thus far, however, the amount of new capital raised through the stock market has been small.

(4) Money supply, velocity, and prices

Table 29 suggests that the income velocity of total liquidity continued to decline in 1966 for the second consecutive year. The income velocity of money also declined in 1965 but remained fairly constant in 1966 at the level of the previous year at 16, which reflects a development that may have been related to the comparatively higher rate of price rise during most of 1966 as compared with 1965. The income velocity of money rose slightly in the first half of 1967, while the income velocity of total liquidity declined further in the same period (Chart 3).

Table 29. GNP, Money Supply and Prices, 1962-June 1967

	1962	1963	1964	1965	1966	1967 June
GNP in current prices (W bn.)	348.6	488.0	696.8	805.9	1,032.0	1,219.8 ^{1/}
Annual change (per cent)	17.5	40.0	42.8	15.7	28.1	18.2
Money supply (W bn.) ^{2/}	34.0	37.0	40.2	49.9	62.9	73.5
Annual change (per cent)	27.8	8.8	8.6	24.1	26.1	16.9
Total liquidity (W bn.) ^{3/}	48.0	57.6	64.3	86.5	137.7	198.3
Annual change (per cent)	42.0	20.0	11.6	34.5	59.2	44.0
Income velocity of money (GNP/money)	10.3	13.2	17.3	16.2	16.4	16.6
Income velocity of total liquidity (GNP/total liquidity)	7.3	8.5	10.8	9.3	7.5	6.2
Wholesale price index (1960 = 100)	127	165	210	224	242	254
Annual change (per cent)	11.4	29.9	27.3	6.7	8.0	5.0

Sources: Compiled from the Bank of Korea, Monthly Statistical Review, Seoul, and data provided by the Korean authorities.

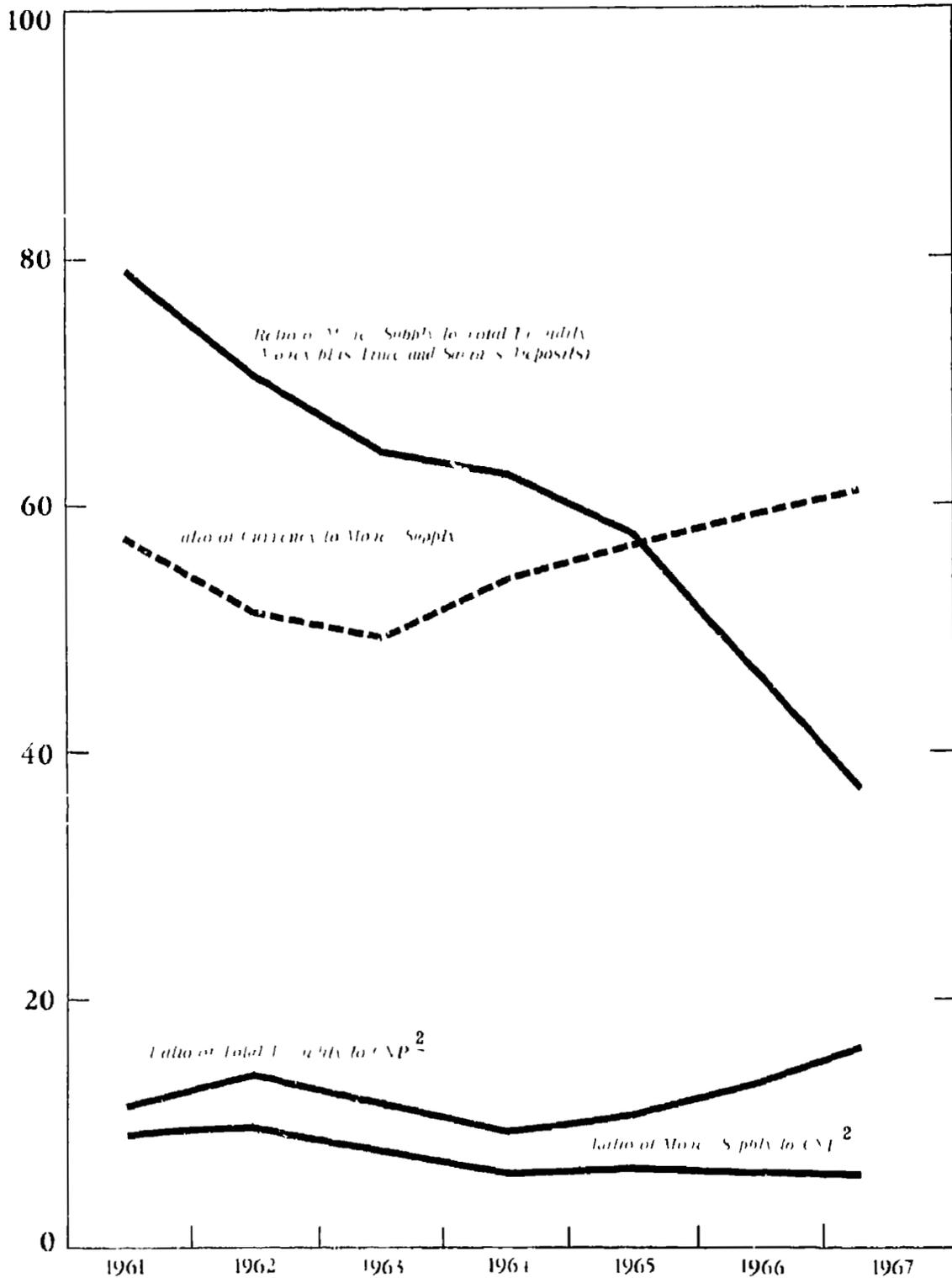
^{1/} GNP estimates for 1967 are based on the projection of W 1,219.8 billion.

^{2/} An average of the amount outstanding at beginning and end of each year for 1962-66, and at beginning and end of June for 1967.

^{3/} Money supply plus time and savings deposits.

CHART 3
 KOREA
 LIQUIDITY RATIOS AND RELATED ITEMS,¹
 1961 - FIRST HALF 1967

In percent



Sources: Bank of Korea, Monthly Statistical Review, and Table 20

¹ Currency, money supply and total liquidity are an average of amount outstanding at beginning and end of year for 1961-66 and at beginning of year and end of June for 1967

² GNP estimates for 1967 are based on the projection of W 1,210.8 billion.

(5) The Foreign Exchange Bank of Korea

The Foreign Exchange Bank of Korea (FEB) was created in August 1966, with a paid-in capital of W 10 billion subscribed by the Bank of Korea, to take over from the Bank of Korea the day-to-day operations in foreign exchange. The Bank of Korea, however, has kept its over-all administrative control over the foreign exchange operations within the framework of the regulations set by the Ministry of Finance. The FEB started its operations on January 30, 1967. Its major functions include: (1) sales and purchases of foreign exchange, holding and operation of foreign currency funds, and other foreign exchange transactions; (2) loans, discounts of notes, guarantees of obligations, and acceptances of notes; (3) receipts of deposits; (4) overseas investments, and (5) handling letters of credit. The maximum limit on (2) above is equal to seven times the aggregate of the capital and the reserves of the FEB. This limitation, however, does not include (1) loans for exports, imports or any other foreign transactions, (2) loans to be made in foreign countries, and (3) guarantees for payment obligations with respect to the repayment of principal and interest of loans guaranteed for payment by the Government. The FEB may also issue abroad foreign exchange financing debentures expressed in foreign currencies; the amount of such debentures (except those whose repayment is guaranteed by the Government or those issued for the purpose of repaying the principal and interest of debentures already issued) may not exceed twenty times the aggregate of the capital and the reserves of the Bank. All official foreign exchange reserves are now deposited at the Foreign Exchange Bank. The Bank of Korea receives interest on the foreign exchange deposited with the FEB and still retains its control on the use of these reserves. The Foreign Exchange Bank of Korea is allowed to hold up to \$40 million in foreign assets on its own account.

The Minister of Finance may, under the provisions of the Foreign Exchange Bank of Korea Act, supervise the business and issue orders necessary for supervision of the FEB, although he may delegate in part to the Monetary Board or to the Governor of the Bank of Korea his authority on authorizations, approval, supervision or other business matters related to the enforcement of the Act.

With the establishment of the Foreign Exchange Bank of Korea, the Government authorized in 1967 the elevation of five commercial banks to the Class-A status. These Class-A commercial banks, like the Foreign Exchange Bank of Korea, are authorized to maintain international correspondent agreements with foreign banks abroad and are allowed to hold a maximum of \$2-5 million in foreign assets on their own account. Apart from these domestic banks, five foreign commercial banks (three U.S. banks and two Japanese banks) have been permitted by the Government to conduct banking business in Korea. Excepting a few restrictions imposed on these foreign banks such as a minimum capital requirement and limitations on certain types of loans, they will be treated like domestic banks.

II. External Economic Developments

1. Balance of payments

As shown in Table 30 and Chart 4, the balance of payments situation improved continuously in the period 1962-66. The over-all deficit of about \$50 million in 1962 and 1963 was reduced to \$3.4 million in 1964 and changed into a surplus of about \$5 million in 1965. The over-all payments surplus reached a record level of \$122 million in 1966. The rapid expansion in exports of goods and services, increases in both official and private loans, especially the latter, were major factors in this development. At the same time imports rose sharply as a result of the liberalization of trade and the buoyant economic activity in the country. In 1966, imports amounted to \$680 million as compared to \$420 million in 1965, an increase of 62 per cent. As a result, the trade deficit widened from \$245 million in 1965 to \$430 million in 1966. The deficit in current account also increased from \$199 million in 1965 to \$323 million in 1966, despite a marked increase in receipts from invisibles.

In the capital account, net receipts from private transfer payments and private loans almost tripled to \$243 million in 1966, thus offsetting partially the deficit on current account. Net official grant and loan receipts increased from \$127 million in 1965 to \$198 million in 1966. This increase resulted from an increase in U.S. official loans which more than offset a decline in U.S. official grants, and from an inflow of Property and Claims Funds from Japan.

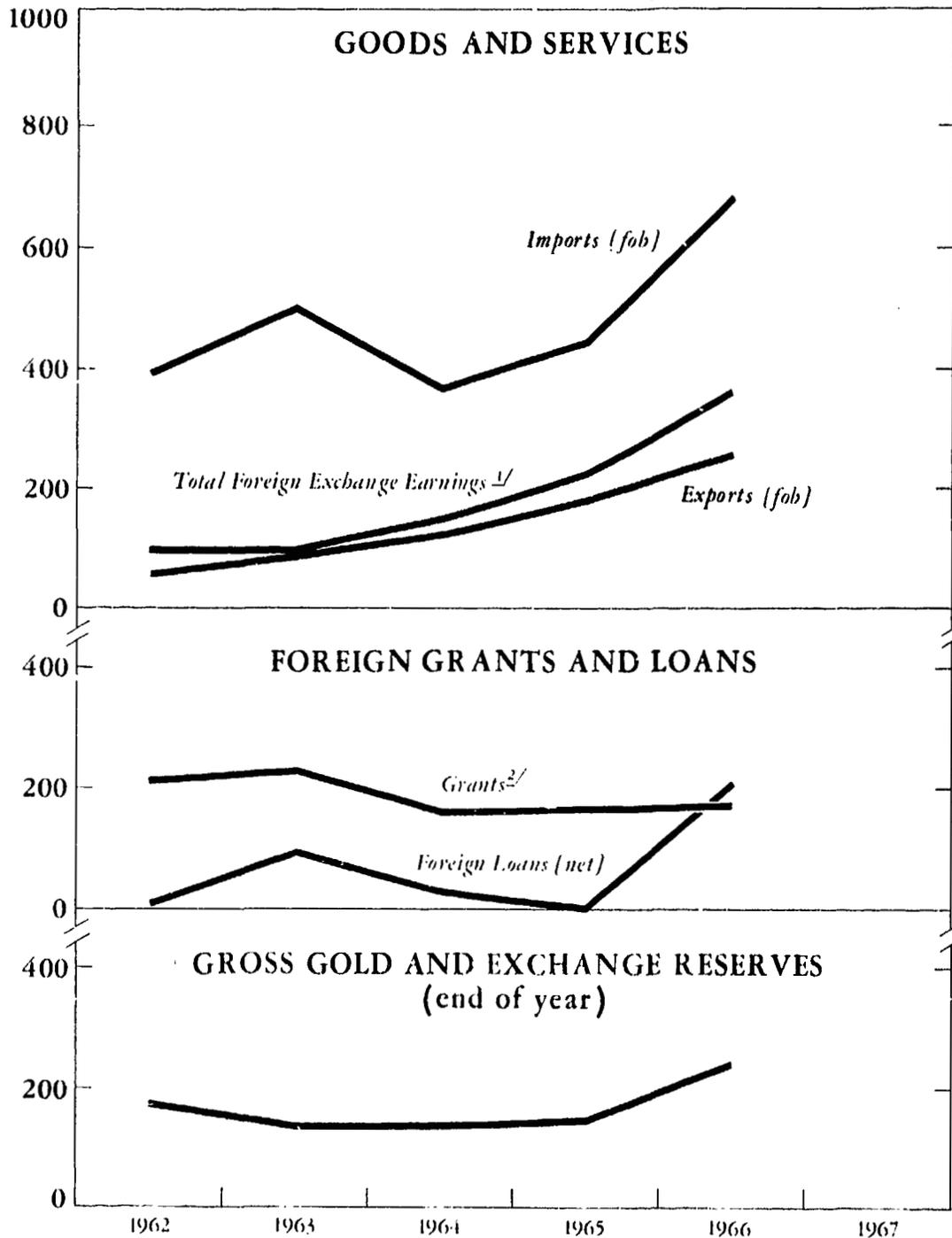
In the first half of 1967, there was an over-all payment surplus of \$61 million which compares with a surplus of \$37 million in the first half of 1966 (Table 30). Although the trade deficit increased to \$236 million from \$181 million in the first half of 1966, net invisible receipts more than doubled, net private loans inflow, largely short-term, increased by 60 per cent and official grants and loans increased by 44 per cent.

2. Foreign trade

a. Exports

Korean merchandise exports virtually stagnated in the late 1950's at a very low level. During 1957-59 exports averaged \$19 million and in 1960 they amounted to only about \$33 million. The rate of growth in exports during the First Five-Year Plan period (1962-66) has been remarkable. In 1966, the last year of the Plan, exports grew at an annual rate of 43 per cent, as compared with 46 per cent in 1965. The average annual rate of growth for the period 1962-66 was 42 per cent, which compares with a general increase in world trade of about 9 per cent annually during the period. The major factors responsible for this trade expansion can be found in the growth of domestic industry and in various exchange and export promotion measures adopted by the Government.

CHART 4
KOREA
INTERNATIONAL TRANSACTIONS,
FOREIGN GRANTS AND LOANS,
GROSS GOLD AND EXCHANGE RESERVES, 1962-1966
(In millions of U.S. dollars)



Sources: Table 30, Part II and Table VIII, in appendix.

¹ Include export and net invisible receipts.

² Include grants of relief goods from private institutions, U.S. Government grants and Japanese Property and Claims grants.

Table 30. International Transactions, 1962-June 1967

(In millions of U.S. dollars)

	1962	1963	1964	1965	1966	January - June	
						1966	1967
A. Goods and Services							
Exports, f.o.b.	54.8	86.8	120.0	175.6	250.4	116.6	139.5
Imports, f.o.b.	-390.1	-497.0	-364.9	-420.3	-679.9	297.4	375.1
Trade balance	-335.3	-410.2	-244.9	-244.7	-429.5	-180.8	-235.6
Sales to foreign military forces	84.7	58.3	63.7	74.0	100.9	40.8	67.6
Freight and insurance on imports	-37.1	-43.9	-30.1	-32.4	-46.8	-24.3	-27.9
Aid services	-6.1	-9.2	-8.0	-6.6	-6.2	-3.0	-2.5
Other services	1.8	2.2	-1.7	11.1	58.6	24.0	46.0
Total	-292.0	-402.8	-221.0	-198.6	-323.0	-143.3	-152.4
B. Private Transfer Payments and Miscellaneous Capital							
Grants of relief goods from private institutions	12.3	22.5	18.4	29.1	42.8	38.9	15.3
Other transfer payments	24.2	29.5	35.5	39.6	54.8	23.2	32.6
Drawings on loans	--	17.9	12.4	41.9	118.7	51.3	52.4
Other ^{1/}	-7.5	26.3	-5.4	-36.0	26.3	3.0	34.3
Total	29.0	96.2	60.9	74.6	242.6	116.4	134.6
C. Net Errors and Omissions	-1.6	-1.0	-1.1	2.4	4.4	1.9	-9.9
D. Total (A through C)	-264.6	-307.6	-161.2	-121.6	-76.0	-25.0	-27.7
E. Net Official Grants and Official Loans Received							
U.S. Government grants (net)	199.8	205.8	138.8	133.2	94.2	44.1	46.1
Drawings on U.S. Government loans	4.4	27.3	7.2	1.7	73.1	28.6	40.1
Drawings on other official loans	--	15.6	8.4	3.4	--	--	--
Other ^{2/}	10.1	10.4	3.4	-11.8	30.7	-11.2	2.4
Total	214.3	259.1	157.8	126.5	198.0	61.5	88.6
F. Total (D + E)	-50.3	-48.5	-3.4	4.9	122.0	36.5	60.9
G. Monetary movements							
IMF accounts	--	--	--	--	-1.3	-1.3	--
Payments agreement liabilities to Japan	5.2	-7.0	1.0	0.8	-7.5	-4.9	--
Other short-term assets, net (increase -)	45.1	55.5	3.3	-5.2	-113.1	-30.2	-60.9
Monetary gold (increase -)	--	--	-0.9	-0.5	-0.1	-0.1	--
Total	50.3	48.5	3.4	-4.9	-122.0	-36.5	-60.9

Sources: International Monetary Fund, Balance of Payments Division and data provided by the Korean authorities.

^{1/} Includes repayments on long-term private loans, direct investment and net of short-term trade credits.^{2/} Includes trade credits on U.S. surplus agricultural commodities, U.S. Government holdings of won and Japanese PAC grants.

As Table 31 shows,^{1/} although the over-all exports increased rapidly during 1966, rates of growth varied greatly from product to product. Whereas dried laver, rice, veneer sheets and plywood, clothing and raw silk showed annual increases above the average, there were products such as steel plates and sheets, iron ore and concentrates and anthracite coal, exports of which declined during the year due to changes in external demand.

One important development in the recent expansion of Korea's exports is the marked increase in the share of manufactured goods in total exports. In 1960, the exports of manufactured goods (defined to include SITC 5-8) totaled only \$5 million; they increased to \$11 million in 1962, and the shares of these products in total exports in these two years were 17 per cent and 19 per cent, respectively. In 1966, the amount of such exports totaled \$154 million, accounting for roughly 62 per cent of the total exports of the year. This qualitative change in the composition of Korea's exports in such a short period reflects the development policy of the Government to promote a large manufacturing sector in the economy. The growth of exports of manufactured goods has been associated with an increase in the imports of raw materials. The Government's export policy has been directed toward increasing the net value added by the manufacturing sector.

The Government envisages a growth in merchandise exports at an annual average rate of 25 per cent during the Second Five-Year Economic Development Plan. Although this expansion is considerably lower than during the last five years, it may still be an ambitious target in the latter part of the 1960's, when viewed in the context of possible changes in special external circumstances such as the war in Viet-Nam. For 1967, the export target is set at \$350 million, or 40 per cent over the 1966 level. In the first half of 1967, however, exports amounted to \$140 million, or only 20 per cent over the amount registered during the corresponding period of 1966. The target includes \$249 million to be earned from the exports of manufactured goods to enlarge the share of the exports of secondary industry to 71 per cent.

The major export promotion measures have remained basically the same since the previous Consultation (see SM/66/108, Part II, p. 49). These include: preferential bank loan financing for exports; a 50 per cent tax reduction on income earned from exports; automatic approval for imports of raw materials to be used for exports; and preferred licensing treatment of capital goods imports to be used by the export industry, together with total or partial exemptions from tariffs and advance deposit requirements for imports of commodities to be used by the export industry. Modifications made since the 1966 consultation include the following: imports of capital goods for export industries were permitted on a deferred payment basis (1-3 years); complete exemption from business tax for producers of export goods (beginning June 8, 1966); exporters having an annual exchange earning record of \$50,000 or more were permitted to import raw materials into bonded areas up to the amount equivalent to that used in the preceding six months (beginning August 4, 1966); and complete exemption from customs duties of machinery imported for the production of export products (effective September 21, 1966); payment guarantee fees for imports of raw materials to be used

^{1/} Table IV in the Appendix contains export values of various commodities classified on the basis of the United Nations' Standard Industrial Trade Classification.

Table 31. Principal Exports, 1962-May 1967

(In millions of U.S. dollars)

	1962	1963	1964	1965	1966	<u>1967</u> Jan.- May	Growth Rate 1965-66 (In per cent)
Fish and fishery products	8.3	9.1	15.2	17.8	21.7	12.1	16.3
Dried laver	0.7	1.5	5.5	3.3	8.7	0.3	163.6
Rice	8.9	0.8	2.4	3.2	6.8	--	112.5
Raw waste silk	4.2	5.1	6.4	7.4	12.5	7.3	68.9
Iron ore and concentrates	3.8	5.9	6.0	6.8	6.1	2.3	-10.3
Tungsten ore and concentrates	3.4	3.1	4.7	6.4	9.5	3.9	48.4
Anthracite coal	2.7	2.6	2.4	1.9	1.5	0.4	-21.1
Veneer sheets and plywood	2.1	5.8	11.4	18.0	29.9	11.6	66.1
Cotton fabrics	1.8	4.3	11.1	10.5	10.1	5.7	-4.0
Clothing	1.1	4.6	6.6	20.7	33.4	18.6	61.4
Steel plates and sheets	0.5	2.3	2.1	10.2	7.1	--	-30.4
Others	<u>17.3</u>	<u>35.7</u>	<u>45.3</u>	<u>58.9</u>	<u>103.0</u>	<u>49.1</u>	<u>50.9</u>
Total	54.8	86.8	119.1	175.1	250.3	111.3	42.9

Source: The Bank of Korea, Monthly Statistical Review, Seoul, Korea.

in exports and for customs clearance of such raw materials were reduced from 3 per cent to 1.5 per cent (beginning January 1, 1967). From the same date, the requirements of exports of \$50,000 or more and of the storage of raw materials in bonded warehouses until the arrival of export letters of credit or export contracts were dropped, and the amount of raw materials that could be imported prior to exports was changed to 25 per cent of the raw materials used in production for export in the previous year.

In addition, continuous use was made of the export loan system in 1966. The rate of interest for export loans was lowered to 6.0 per cent per annum from 6.5 per cent on June 29, 1967 and the loan ceiling was increased from W 7.5 billion for 1965 to W 10.5 billion in 1966, and to W 13.5 billion in 1967. The qualifications required for export loans were liberalized during the year and loans were made to exporters having an annual exchange earning of \$50,000 or more, or \$100,000 worth of export letters of credit in the previous year. This prerequisite for receiving export financing was abolished on March 13, 1967. Since January 1967, the amount of loans authorized for exports on the basis of D/A, D/P, consignment sales, and exports on bonded warehouse transaction terms, was raised from W 120 per US\$1 to W 200 per US\$1, the amount already applicable to other exports.

For the purpose of attaining the export target in 1967 through expanding the capacity of export industries, and in order to reduce reliance on suppliers' credits, the Korean authorities have been granting loans in foreign currency from the official exchange reserves. A first installment of \$30 million was announced on December 29, 1966, in order to finance import of equipment needed especially for 31 export items, including raw silk, veneer sheets and plywood, sweaters, dried laver, etc. The list was increased to 33 export items on May 6, 1967 by adding wrapping materials and vessels. As for the settlement of these imports, foreign exchange certificates equal to 25 per cent of the L/C must be surrendered at the time of opening the L/C and another 25 per cent at the time of releasing the B/L. For the remaining 50 per cent, credit denominated in foreign exchange is given by foreign exchange banks with an interest rate of 7.5 per cent per annum (lowered to 6.5 per cent per annum from March 9, 1967). Half the amount of the credit must be repaid within a year from the date of release of the B/L and the remainder within two years.

On July 22, 1967, another tranche of \$30 million of such credits was authorized. The amount of foreign exchange certificates to be surrendered at the time of opening L/C was lowered on the same date from 25 per cent to 10 per cent of the L/C (but raised from 25 per cent to 30 per cent in case of imports from those countries where standard transit time to Korea does not exceed 10 days) and the amount to be surrendered at the time of release of the B/L was also lowered from 25 per cent to 10 per cent of the L/C amount (but raised from 25 per cent to 40 per cent in the case of imports with a standard transit time not exceeding 10 days). For the remaining 80 per cent (or 30 per cent for imports with a standard transit

time of less than 10 days), a bank credit in foreign currency is given by the foreign exchange banks at an interest rate of 6.5 per cent per annum. Half the amount of the credit must be repaid within eighteen months and the remainder within thirty months from the date of release of the B/L (within a year and two years, respectively, in the case of imports with a standard transit time not exceeding 10 days).

For the import of equipment and facilities recognized to be needed for foreign exchange earnings or for the production of import-substitutes, loans in foreign currency with a maturity of five years were also introduced on May 18, 1967. Two tranches of \$30 million each have been announced under this scheme. In the settlement of these imports, foreign exchange certificates corresponding to 20 per cent of the L/C amount must be surrendered at the time of opening the L/C. For the remaining 80 per cent, a bank credit in foreign currency is given by the foreign exchange banks at an interest rate of 7.5 per cent a year. This loan matures in five years including a two-year grace period, with repayment on an annual installment basis.

b. Imports

Table 32 shows the value of principal imports during 1962 and 1966, while Appendix Table V shows classified imports in terms of the Standard Industrial Trade Classification. Total imports (c.i.f.) increased by 55 per cent to reach a record level of \$716.4 million in 1966, compared with an increase of 15 per cent in 1965. Textile machinery and parts showed the highest rate of growth due largely to the Government's efforts to expand the capacity of textile export industry, while the rapid increase in imports of transport equipment was due largely to the imports of ships for the fishery industry.

The qualitative change in the composition of imports is shown in Appendix Table V. In 1960 more than 63 per cent of total imports were manufactured goods, but in 1965 the share of manufactured products dropped to around 55 per cent, suggesting an underlying change in the industrial structure of the economy. This tendency, however, was reversed in 1966 on account of a sharp increase in imports of textile machinery and transport equipment.

Another aspect of the qualitative change in Korea's imports can be seen in the increasing importance of commercial imports relative to aid and loan-financed imports. In 1960 commercial imports accounted for only 28 per cent of the total imports; in 1965-66 their share had increased to around 55 per cent. The declining weight of official aid imports is noteworthy in this context. Official aid imports accounted for 68 per cent of the total in 1960 but the share declined to 30 per cent in 1965, and to 21 per cent in 1966.

Table 32. Principal Imports, 1962-May 1967

(In millions of U.S. dollars)

	1962	1963	1964	1965	1966	<u>1967</u> Jan.- May	Growth Rate 1965-66 (In per cent)
Cereals and cereal preparations	40.1	107.2	60.8	54.4	61.3	23.2	12.7
Crude rubber	6.9	7.9	5.9	8.4	9.4	4.0	11.9
Lumber, pulp, paper and paper products	30.4	34.4	29.8	31.7	59.6	26.3	88.0
Raw cotton, textile fibers, yarn and products	79.0	85.9	72.5	86.7	111.7	53.3	28.8
Petroleum and its products	28.4	32.2	25.9	28.9	40.6	20.9	40.5
Fertilizer	62.3	48.9	19.0	33.7	50.7	22.7	50.4
Iron, steel, and nonferrous metals	29.4	40.9	19.0	33.7	50.7	22.7	50.4
Electric machinery, apparatus and appliances	28.7	22.3	19.7	12.6	26.1	18.7	107.1
Textile machinery and parts	6.5	8.6	9.6	9.4	28.6	8.9	204.3
Transport equipment	6.6	31.3	11.6	25.2	50.0	55.9	98.4
Others	<u>103.5</u>	<u>141.6</u>	<u>106.6</u>	<u>77.8</u>	<u>189.5</u>	<u>106.4</u>	<u>77.8</u>
Total	421.8	560.3	404.4	463.4	716.4	349.2	54.6

Source: The Bank of Korea, Monthly Statistical Review, Seoul, Korea.

c. Direction of trade

Appendix Tables VI and VII show the geographical distribution of Korea's exports and imports for the period 1962-66. In 1966, Korea's exports were almost equally divided between Asia and North America, as compared with the overwhelming dominance of exports to Asia in 1962. Even in 1965, the share of Asia was 49 per cent as opposed to 37 per cent for North America. The increasing share of North America is entirely due to the growing importance of the United States as an export market. Korea's exports to the U.S. increased by 55 per cent in 1966 to reach \$96 million, accounting for 38 per cent of the total exports. Major export items included plywood, veneer sheets, silk, clothing, wigs and cotton textile goods.

In view of recent changes in the industrial and hence export structures of the economy, which now specializes more in the production and export of relatively labor-intensive manufactured products, a decline in importance of Asia as Korea's major export market is understandable. It is likely that Asia's share will decline further in the future, although increases in exports to Japan and Viet-Nam may at least temporarily offset such a trend. Exports to Japan amounted to \$66 million in 1966, an increase of 51 per cent, and this raised Japan's share to 26.5 per cent compared with 25 per cent in 1965. On the other hand, Korea's exports to Hong Kong and Viet-Nam declined during the year and their shares dropped to 4 per cent and 6 per cent, respectively, from their previous 6 per cent and 9 per cent in 1965. A gradual increase in the share of exports to Europe is also noteworthy. This increase is likely to continue in the future in the light of the complementary relationship between factor endowments in Korea and countries in that area.

The geographical distribution of imports also shows Asia and North America as the two major sources of imports. In recent years, the share of Asia has been increasing, especially that of Japan, while that of the United States has been declining. Korea's rising trade deficit with Japan reflects this tendency. The share of Asian suppliers was 54 per cent in 1966, compared with 28 per cent in 1960, while that of the U.S. was 39 per cent in 1960 and 35.4 per cent in 1966. Imports from Asia reached \$385 million in 1966, an increase of 69 per cent, due largely to an increase in imports from Japan which totaled \$294 million. Although its share declined, the value of imports from the U.S. increased in 1966 to reach \$254 million, an increase of 39 per cent.

3. Invisible trade

In 1966 the surplus in invisible trade totaled \$107 million, compared with \$46 million for 1965. The growth in invisible receipts was particularly striking in 1966 when they totaled \$204 million against \$114 million in 1965. This trend continued in 1967 and gross invisible receipts now exceed export earnings (Table 33). The most notable change in this respect is the increase in the receipts from "governmental transactions, namely receipts from sales to U.N. forces and diplomatic missions. The total receipts from sales to

U.N. forces amounted to \$103 million in 1966, or \$27 million above the 1965 level. The expenditures of foreign diplomatic missions in Korea, the expenditures by the U.S. Government from the proceeds of surplus agricultural commodities and other government receipts also increased in 1966 to about \$36 million from \$14 million in 1965. Receipts from freight and insurance came to about \$10 million in 1966 compared with \$4.5 million a year before, while expenditures of foreign tourists in Korea totaled \$16.2 million in 1966, a gain of \$8.5 million over the 1965 level. Remittances from Korean technicians and soldiers in Vietnam contributed to the increase of "other services" from \$6.8 million in 1965 to \$32.2 million in 1966.

Table 33. Gross Invisible Receipts, 1962-June 1967

(In millions of U.S. dollars)

	1962	1963	1964	1965	1966	Jan.-June 1967
Freight and insurance on merchandise	3.4	2.8	2.5	4.5	9.9	3.8
Other transportation	0.8	2.0	2.9	3.4	3.9	2.9
Travel	3.1	2.7	2.8	7.7	16.2	8.3
Investment income	5.2	3.4	3.8	3.7	5.6	4.4
Government, n.l.e.						
Military	84.7	58.3	63.7	74.0	100.9	67.6
Other	5.8	13.8	12.0	14.1	35.6	32.8
Other services	<u>5.4</u>	<u>5.7</u>	<u>3.3</u>	<u>6.8</u>	<u>32.2</u>	<u>24.3</u>
Total	108.4	88.7	91.0	114.2	204.3	144.1

Sources: IMF, Balance of Payments Division and data provided by the Korean authorities.

4. Foreign official grants and loans

The inflow of foreign grants has been declining in recent years, especially U.S. grant aid in the form of supporting assistance and PL 480. The total amount of supporting assistance has declined almost continuously from \$225 million in 1960 to \$65 million in 1966. U.S. government grants may further decline to \$37 million in 1967 (Table 34).

The amount of official loans contracted doubled in 1966 to reach \$153 million, as compared with \$76.5 million in 1965, comprising \$46 million of Japanese loans out of the property claims funds, \$95 million from U.S. aid, and \$12.5 million from Germany (Table 35). Arrivals under official loans also rose significantly during 1966 to reach \$73 million, an increase of \$68 million over the 1965 level, due largely to a rapid disbursement in AID loans financing the construction of the third and fourth fertilizer plants and the imports of diesel locomotives. The Japanese loans, under the \$200 million loan agreement, were for financing six projects including the imports of diesel locomotives, the Han River bridge repair works, irrigation projects and assistance to medium- and small-scale industries. The loans carry the interest rate of 3.5 per cent per annum and are to be repaid in 20 years including 7 years of grace period.

Table 34. Gross Imports Financed with U.S. Official Grants-in-Aid,^{1/} 1960-67

(In millions of U.S. dollars)

	Grants	PL 480 Title I	Total
1960	225	20	245
1961	154	45	199
1962	165	67	232
1963	119	97	216
1964	88	61	149
1965	72	59	131
1966	65	27	92
1967 ^{2/}	37	36	73

Source: The Bank of Korea, Monthly Statistical Review, Seoul, Korea.

^{1/} Gross figures are based on import data of the Ministry of Finance and vary from the balance of payments data.

^{2/} Estimates.

The AID loans in 1966 applied to 11 projects such as the construction of a thermal power plant and imports of diesel locomotives and raw materials, and are to be repaid in 40 years including 10 years of grace period with an interest rate of 2.5 per cent per annum (1 per cent during the grace period).

Table 35. Inflow of Foreign Capital, 1962-66^{1/}

(In millions of U.S. dollars)

	1962	1963	1964	1965	1966	Total 1962-66
1. Official Loans ^{2/} (Actual imports)	73.0 ^{3/} (7.1)	9.5 (43.2)	37.9 (11.6)	76.5 (4.9)	153.3 (73.1)	350.2 (139.9)
2. Private Loans ^{2/} (Actual imports)	1.8 (--)	54.0 (23.7)	61.9 ^{4/} (10.8)	78.1 (35.6)	137.4 (112.8)	333.2 (182.9)
a. Government guaranteed	-- (--)	54.0 (22.0)	60.1 (10.7)	74.0 (33.4)	84.3 (102.0)	272.4 (168.1)
b. Commercial bank guaranteed	-- (--)	-- (--)	-- (--)	-- (--)	51.0 (7.6)	51.0 (7.6)
c. Without guarantees	1.8 (--)	-- (1.7)	1.8 (0.1)	4.1 (2.2)	2.1 (3.2)	9.8 (7.2)
3. Subtotal (1+2) (Actual imports)	74.8 (7.1)	63.5 (66.9)	99.8 (22.4)	154.6 (40.5)	290.7 (185.9)	683.4 (322.8)
4. Direct Investment (Actual imports)	0.6 (--)	5.4 (5.5)	0.8 (0.5)	22.6 (5.0)	13.5 (13.4)	42.9 (24.4)
5. Total (3+4) (Actual imports)	75.4 (7.1)	68.9 (72.4)	100.6 (22.9)	177.2 (45.5)	304.2 (199.3)	726.3 (347.2)

Source: The Bank of Korea, Annual Report 1966, Seoul, Korea.

^{1/} Based on loan agreements signed for official loans, the opening of letters of credit or letters of guarantee issued by the Bank of Korea for commercial loans, and the issue of approval of the Minister of Economic Planning Board for foreign investment.

^{2/} Classification into "official" and "private" is based on the status of the lender.

^{3/} Includes \$20.5 million contracted in the period 1959-61.

^{4/} Excludes \$20 million commercial loans from Japan contracted in 1964.

The new German loans will finance 3 projects and totaled \$12.5 million. The projects include Pusan City waterworks and assistance to medium- and small-scale industries. The loans for the first two projects are to be repaid over a period of 20 years including 5 years of grace period at an interest rate of 3 per cent, while the loan for the last project is to be repaid in 14 years including the grace period of 2 1/2 years, at an interest rate of 5 per cent.

5. Private transfer payments and private loans

During 1966 the inflow of private transfer payments amounted to \$103 million as compared with \$74 million in 1965. With an outflow of private transfer payments of \$6 million in 1966 and \$5 million in 1965, the net transfer payments into Korea totaled \$97 million and \$69 million in 1966 and 1965, respectively. This increase in private transfer payments reflects an increase of grants of relief goods from private institutions, in connection with PL 480 Titles II and III, and an increase in foreign remittances.

The amount of private loans contracted totaled \$137 million in 1966, against \$78 million in 1965 while arrivals under such loans amounted to \$113 million, a threefold increase over the level of 1965 (Table 35). The bulk of private loans came from Japan after normalization of diplomatic relations between Korea and Japan. Of private loans, those guaranteed by the Government accounted for 61 per cent and those guaranteed by commercial banks for 37 per cent in 1966. The remainder were the loans without repayment guarantee and all of these were made by the U.S. and Germany. In 1965, the share of the government-guaranteed loans was 95 per cent, while the remaining 5 per cent of the total loans were without any guarantee. The government-guaranteed loans were heavily concentrated in cement and fertilizer industries in 1966, whereas loans guaranteed by commercial banks principally went to the textile industry. German and French loans carried a relatively longer repayment period of 12-13 years, while U.S. and Japanese loans carried 6-8 years of redemption period.

In addition to these private loans, "short-term" obligations, defined as L/C and D/A settlements outstanding, and cash loans of less than three years maturity, increased considerably during 1966 and also in the first half of 1967. At the end of 1965, the total amount of these short-term obligations stood at \$83 million; they increased to \$154 million by the end of 1966, a gain of some 86 per cent. In the first semester of 1967, they rose further to about \$251 million or some 63 per cent more. Of these short-term obligations, cash loans increased by \$6 million in 1966 to reach the level of \$8 million by the end of the year and stood at \$10 million in June 1967.

6. External debt service schedule

Total external debt outstanding, including both principal and interest, totaled \$873 million at the end of 1966 (Table 36). During 1966, debt service payments amounted to \$15 million (or 3.3 per cent of current receipts), as compared with the payment of \$7 million in 1965 (or 2.5 per cent of current receipts). In view of the relatively less favorable terms under which private loans can be obtained, the policy of the Government has been to secure more foreign official loans and to induce an inflow of direct foreign investments. The Government intends to limit service payments to 9 per cent of current account receipts. In fact, the law on guaranteeing repayment for loans, as amended on July 14, 1966, provides that annual debt service arising from the government-guaranteed loans be maintained within the 9 per cent limit.

Table 36. External Debt Service Repayments and Schedule

(In millions of U.S. dollars)

	Actual		Debt outstanding including interest as of Dec. 31, 1966	Repayment Schedule ^{1/}				
	1962-65	1966		1967	1968	1969	1970	1971
Official loans	1.3	1.3	480.6	2.3	4.5	6.3	6.6	7.1
Private loans	17.5	14.0	392.8	26.5	39.7	59.9	71.3	60.3
Total	18.8	15.3	873.4	28.8	44.2	66.2	77.9	67.3

Sources: The Economic Planning Board and the Bank of Korea, Seoul, Korea.

^{1/} Established on the basis of debt outstanding as of December 31, 1966, loans already signed in 1967 by August 15, and estimates of loans to be signed in 1967 after August 15.

7. Direct foreign investment

The number of direct foreign investments authorized totaled 18 in 1966, an increase of 7 over the previous year's level, but the value of these investments totaled only \$14 million as compared with \$23 million in 1965. However, the amount of direct investment actually made during 1966 was \$13 million, a marked increase over \$5 million in 1965. The bulk of direct investment actually made was by the Swift Consortium and the Gulf Oil Corporation of the U.S. to construct the third and fourth fertilizer plants.

The remainder went to electronics and food industries. Investment incomes, which foreign investors received during the year, totaled \$229,000, an increase of \$132,000 over the previous year's level. The foreign investment by source and by industry are shown in the following table.

Table 37. Status of Foreign Private Investment, 1965-June 1967^{1/}

(In millions of U.S. dollars)

	1965		1966		1967	
	Amount	Ratio (Per cent)	Amount	Ratio (Per cent)	January-June Amount	Ratio (Per cent)
By country:						
United States	21.3	94.3	9.3	68.9	11.4	100.0
Japan	1.2	5.3	3.8	28.1	--	--
Others	0.1	0.4	0.4	3.0	--	--
Total	22.6	100.0	13.5	100.0	11.4	100.0
By industry:						
Petrochemical	21.3	94.2	1.8	13.3	2.8	24.6
Electronic	0.4	1.8	6.8	50.4	8.0	70.2
Food processing	--	--	3.4	25.2	--	--
Textile	--	--	0.2	1.5	--	--
Automobile	--	--	0.7	5.2	--	--
Others	0.9	4.0	0.6	4.4	0.6	5.2
Total	22.6	100.0	13.5	100.0	11.4	100.0

Source: General Status of Foreign Capital Inducement, published on June 13, 1967 by the Economic Planning Board.

^{1/} Based on approval.

8. International reserves

International reserves increased by 69 per cent in 1966 to reach a record level of \$239 million by December, as compared with a 7.5 per cent increase in 1965. The growth in reserves has continued in 1967 and reserves increased by \$64 million in the first 8 months to reach \$303 million on August 31, 1967 (Appendix Table VII). An immediate effect of this rapid increase in international reserves was an expansion in domestic liquidity. As shown in Table 38, net foreign assets of the Bank of Korea increased continuously throughout 1966, resulting in an increase

Table 38. Foreign Assets and Liabilities of the Bank of Korea,
1964-June 1967

(In millions of U.S. dollars)

	At the end of							
	1964	1965	1966				1967	
			Mar.	June	Sept.	Dec.	Mar.	June
I. Assets^{1/}								
Time deposits	105.8	98.0	108.3	107.9	137.8	177.5)		
Due from the EOK account with banks abroad	3.8	4.9	9.5	10.4	9.1	13.0)	221.3 ^{3/}	212.5 ^{3/}
Foreign exchange pending collection	8.5	19.2	12.8	19.2	22.7	22.0)		
Export usance bills	2.1	1.7	1.7	1.7	1.7	1.6)		
Interoffice accounts	6.7	12.0	13.9	16.3	16.9	18.7)		
Loans in foreign currency	--	--	--	--	--	--)	6.7	14.9
Others	1.8	1.2	2.2	3.3	1.6	1.3)	1.3	1.4
Total^{2/}	128.7	137.0	148.4	158.8	189.8	234.1	229.3	228.8
II. Liabilities^{1/}								
Resident deposits	0.9	1.8	0.7	1.9	1.4	1.3)		
Remittance pending	0.8	1.9	3.1	2.7	3.7	4.1)		
Loan payable	10.0	10.0	10.0	--	--	--)		
Export and import guarantee money	52.8	35.9	38.1	35.6	40.0	29.4)	79.9 ^{3/}	44.3 ^{3/}
Korea-Japan open account	43.3	44.1	40.7	39.2	38.8	36.6)		
Exchange certifi- cates issued	0.1	0.2	0.1	0.2	0.1	0.1)		
Others	2.8	5.6	9.4	12.5	6.0	15.3)	0.1	0.1
Total	110.7	99.5	102.1	92.1	90.0	86.8	80.0	44.4
III. Net Foreign Assets (I-II)	18.0	37.6	46.3	66.7	99.8	147.3	149.3	184.4

Source: The Bank of Korea.

^{1/} Excludes contra-account of acceptances and guarantees, gold tranche with the Fund and about \$3 million of gold.^{2/} Total assets vary from the gross gold and exchange holdings as given in Appendix Table VIII, since the latter includes foreign exchange holdings of commercial banks and Foreign Exchange Bank.^{3/} Since February 1, 1967, these foreign assets and liabilities of the Bank of Korea have been transferred to the Foreign Exchange Bank of Korea, and they appear now as a single account in the books of the Bank of Korea.

of nearly \$110 million by the end of the year. This compares with an increase of \$20 million in 1965. In the first half of 1967, they rose further to \$184 million.

The Government initiated in December 1966 the granting of loans denominated in foreign currencies to qualified industries and government enterprises from the government-held foreign exchange reserves (see section on exports above). Of the first \$30 million set aside for loans to finance capital goods imports, \$28 million was allocated and the L/Cs were opened for about \$20 million by the first part of July. As for the second \$30 million of foreign exchange loans with a maturity of five years, only about \$3 million was allocated by the early part of July.

III. The Restrictive System

Since the last Article XIV consultation in August 1966, the restrictive system of Korea has evolved toward a greater degree of liberalization of quantitative controls on imports and invisible payments. The Government has also undertaken certain measures to broaden the exchange certificate market and to render it more responsive to changes in the economy. The period of validity of exchange certificates was extended from 15 days to 45 days and the maximum spread between the Bank's buying and selling rates was widened and exchange banks were permitted within certain limits to operate in the market as dealers.

Regarding restrictions on trade and payments, the policy of liberalization was pursued vigorously in 1966 and in the first half of 1967. An important step in import liberalization was taken in July and August 1967 with the introduction of the so-called "negative list" system. Under this system, which puts an end to the previous import programs, all commodities may be freely imported unless they belong to a negative list, which is itself divided into a prohibited list and a restricted list. There was little change in the advance deposit schemes which remained very complex. Restrictions on payments for invisibles were further relaxed. Since April 1966 payments for bank charges, insurance premiums, communication fees, and periodicals have been licensed automatically, and in November 1966 expense allowances for travelers abroad were increased. Since July 1967 nonresidents need not register their foreign currency holdings upon entering Korea if they are carrying only specified currencies; overseas branches of Korean traders could maintain under certain conditions accounts in foreign exchange up to certain limits; allowances for travel were raised from \$500 to \$900 per month and living allowances for students were raised from \$150 to \$300 per month.

A new Foreign Exchange Bank of Korea was created in August 1966 to take over from the Bank of Korea the day-to-day operation of all transactions in foreign exchange while the Bank of Korea kept its over-all administrative control on the foreign exchange market. The Foreign Exchange Bank of Korea started its operations on January 30, 1967 (see Part II, p. 51).

1. Exchange rate system

No par value for the Korean won has been established with the Fund. Since March 22, 1965, there has been a fluctuating exchange rate determined in an exchange certificate market.

The Bank of Korea announces daily the buying and the selling rate for foreign exchange (BOK posted rate for customers). This is the rate at which commercial banks authorized to deal in foreign exchange (called foreign exchange banks) buy or sell foreign exchange. The Governor of the Bank of Korea is given discretion to move the Bank's posted rates, i.e., both selling and buying rates, in either direction within 2 per cent of the rate prevailing in the certificate market on the previous day; a change of the posted rate beyond this limit requires prior approval of the Minister of Finance. In determining its daily posted rate, the Bank has been guided principally by the weighted average market rate of the previous day. During the second half of 1966 and until January 16, 1967, the posted rates of the Bank of Korea have remained stable at W 270.36 per US\$1, buying, and W 272.00 per US\$1 selling. In January 1967 the maximum spread between the Bank's buying and selling rates was widened to 1.8 per cent from 0.6 per cent, leading to posted rates that varied slightly around W 267.59 per US\$1, buying, and W 272.50 per US\$1 selling. Since March 17, 1967, the rates applicable to the exchange transactions between the Bank of Korea and the foreign exchange banks were set within 0.1 per cent of the Bank of Korea's posted rates for customers instead of 0.6 per cent as previously, in order to reduce the profit of the foreign exchange banks on their exchange transactions with the Bank of Korea, and induce them to operate in the certificate market where they could earn a larger profit margin. In addition, on July 18, 1967, the foreign exchange banks were permitted to operate in the market as dealers, with certain maximum limits on their inventory of exchange certificates. As a result of these measures, the certificate market has become very active and the proportion of certificates issued against export receipts rose from 59 per cent in October-December 1966 to 97 per cent in June 1967, while the proportion of certificates issued against invisible receipts rose from 22 per cent to 39 per cent in the same period. The certificate market rate fluctuated around W 271.48 per US\$1.

Exchange certificates are issued by the Foreign Exchange Bank of Korea and other exchange banks against all foreign exchange earnings in specified currencies surrendered by residents. Sales of foreign exchange by non-residents (essentially tourists and UN forces stationed in Korea) or sales of nonspecified currencies must be effected at the BOK posted buying rate. Foreign exchange receipts of the Government are, in practice, converted directly at the BOK buying rate although they may be occasionally exchanged for certificates which are sold in the market. Exchange certificates are also issued against official foreign exchange reserves and against receipts of U.S. supporting assistance. All foreign exchange proceeds, however, may alternatively be exchanged for won at the buying rate posted by the Bank of Korea. Exchange certificates are now valid for 45 days; expired certificates may be surrendered at the posted rate of the date of expiration or of the date

of surrender, whichever is lower. The short maturity of the certificates and the high rates of interest prevailing in the domestic money market have discouraged speculative holdings of such certificates.

Exchange certificates are required for all foreign exchange expenditures except for payments for imports under U.S. PL 480, payments by commercial banks in connection with their banking transactions, payments less than the equivalent of US\$50, and payments made by certain companies which are now authorized to maintain balances in foreign exchange abroad and use them for their foreign payments (air lines, ship lines, insurance companies and certain government corporations). In most foreign exchange expenditures by the Government, the Bank of Korea sells exchange certificates to the Government at its BOK posted rate but the certificate transaction is purely bookkeeping.

2. Main features of the exchange control

a. Administration of control

The Ministry of Finance is in charge of exchange control, subject to the approval of the Cabinet. It carries out policy with respect to prescription of currency and method of settlement, foreign exchange operations, payments for nonmerchandise transactions, and capital transactions and transfers. The Foreign Exchange Bank of Korea, whose capital is wholly subscribed by the Bank of Korea, has taken over the functions of the latter for all transactions in foreign exchange. As the Government's agent, the Bank of Korea regulates operations in the certificate market and is authorized to intervene in it. The Bank has also been given authority to control receipts and payments related to invisibles. The Foreign Exchange Bank of Korea and five commercial banks (exchange banks), as well as the branch offices in Korea of foreign banks are authorized to engage in foreign exchange operations.

The trade program (for imports financed by KFX) is prepared by the Ministry of Commerce and Industry. The selection of permitted imports is the responsibility of the Ministry of Commerce and Industry. Imports financed by foreign aid funds are programmed separately by the Economic Planning Board in consultation with the Ministry of Commerce and Industry and import licenses are issued by the Foreign Exchange Bank of Korea.

b. Prescription of currency

The proceeds of exports must be obtained in Canadian dollars, deutsche mark, French francs, Hong Kong dollars, Italian lire, pound sterling, Swiss francs, U.S. dollars or, since July 18, 1967, Swedish krona. The methods of payment on account of other settlements require the approval of the Ministry of Finance.

c. Imports and import payments

(1) Import procedures

All imports require licenses; for certain imports licenses are automatically issued upon application. No licenses are issued for any goods originating from communist countries and for certain imports from all other countries.

Imports are divided into two categories: those paid for with Korean foreign exchange (so-called KFX imports) and those paid for with foreign aid funds. KFX imports were classified until July 1967 as automatic approval, semi-restricted, prohibited or unspecified items.

The progress toward liberalization of quantitative import controls until June 30, 1967 is shown in Table 39.

Table 39. Classification of Imports

(In number of items in the Korean import lists)

	Dec. 31, 1965	Dec. 31, 1966	June 30, 1967	1967 2nd half program
Automatic Approval	1,495	2,357	3,549	3,761
Semirestricted	124	134	92	91
Restricted	14	--	--	--
Prohibited	620	386	249	244

Source: Data provided by the Korean authorities.

In the trade program announced early June for the second half of 1967, automatic approval items (3,761) consisted mainly of essential consumer goods and certain raw materials and capital goods; these items were to be licensed automatically and to account for about 87 per cent of KFX imports. Semirestricted items (91) were not subject to individual quotas but required the approval of competent ministries for other than balance of payments reasons, such as reasons of public health. Prohibited imports covered 244 commodities, mainly luxuries, home industry protective and locally available goods. The category of restricted items was abolished on December 1, 1966.

The import control system was changed from July 1967. In the new system, all commodities may be freely imported (i.e., applications for import licenses are automatically approved) unless they belong to a "negative list." The negative list includes commodities that are prohibited and commodities that are restricted. By the end of September, the classification of commodities between the prohibited, restricted and automatic approval categories was, on the basis of the number of items in the Standard Industrial Trade Classification, the following:

	<u>Number of SITC Items</u>	<u>Per Cent</u>
<u>Negative List</u>		
Prohibited	4,239	14.1
Restricted	5,859	19.5
<u>Automatic Approval</u>	<u>19,902</u>	<u>66.4</u>
Total	<u>30,000</u>	<u>100.0</u>

The classification of these items by the Ministry of Commerce and Industry was made according to the following criteria:

i. As automatic approval: items which are not domestically produced, or when produced, are considered competitive with foreign products of the same kind. Items whose domestic price is considered to be too high or whose quality is inadequate.

ii. As restricted items: certain items may be allowed only to end-users. Certain items may be permitted to be imported in limited quantities under an import quota system, to the extent of a certain percentage of export performance in order to give impetus to domestic industry for better quality. Other items may be permitted to be imported on a case-by-case basis upon recommendation, according to domestic demand and supply conditions.

iii. As prohibited: luxuries, items prohibited for non-economic reasons and some domestically produced goods.

Imports of raw materials for the production of exports are approved automatically irrespective of whether they are classified as automatic, restricted, or prohibited items. Foreign aid imports are classified as either automatic approval items or restricted items. In principle, no commodities imported with foreign aid funds are included among the KFX imports, but in exceptional cases payment for imports usually financed with aid funds may be made with KFX exchange. Import licenses are granted only to registered traders; to maintain the status of a registered trader, a minimum value of US\$100,000 of exports is required each year.

On August 22, 1966 it was announced that the Ministry of Commerce and Industry, in approving imports that require the Ministry's recommendation, would give priority to goods originating in countries with which Korea maintained a favorable trade balance. These countries were listed as Burma, Singapore, Thailand, Viet-Nam, Belgium, the Netherlands, Sweden, the United Kingdom, the United States and the territory of Okinawa.

(2) Import payments

Payments for KFX imports are made, in principle, against a letter of credit. Payments for raw material imports for the production of exports may also be made against documents (D/P basis) or within 90 days from the acceptance of documents (D/A basis). Any settlement other than the above requires the approval of the Ministry of Finance.

Import payments are made by tendering exchange certificates to the authorized banks. In principle, exchange certificates are surrendered in full amount, at the time of opening letters of credit. (See Annex I.)

As an exception to this, in the case of imports to be used for the production of exports, importers are allowed under prescribed conditions to submit, up to varying amounts, bank guarantees denominated in foreign currencies in place of exchange certificates until bills of lading for the import are released. (Bank guarantees are available at a cost of 1.5 per cent a year.) Since December 23, 1966, traders could import raw materials for exports without making an advance deposit at the time of opening the import letter of credit; this exemption applied to imports corresponding to up to 25 per cent of the value of raw materials they had used for exports in the preceding year. In the case of imports to be used for the production of exports for which an export letter of credit has been obtained, a bank guarantee may be used for the full amount of imports and the certificates may be surrendered when the bills of lading are released. In the case of imports for exports supported by a related export contract, the importers are required to tender exchange certificates corresponding to a minimum 10 per cent of imports when the letter of credit is opened (the margin requirement) and the balance of 90 per cent may be met with bank guarantees until the bills of lading are released.

Imports of raw materials in the prohibited category are permitted provided they are used for exports; they are subject to exchange certificate requirements of 30 per cent and 20 per cent of the value, respectively, to be fulfilled at the time of opening letters of credit. These requirements apply to all imports except to 38 items including raw cotton and cotton textiles and to such import items needing more than 10 days in transit irrespective of whether the importers have received an export letter of credit, an export contract, or whether they are entitled to imports under the above-mentioned export performance criteria (see Annex I). Import of equipment needed to manufacture certain export items such as raw silk, veneer sheets and plywood, sweaters, etc., has been allowed in limited amount under special payment procedures.

The procedures of payments for imports financed by foreign aid differ substantially from those financed by the KFX: they also vary in accordance with the source of aid. (See Annex I.) In respect of U.S. aid (supporting assistance) imports, certain cash advance deposits in won are required at the time of applying for imports. For the U.S. imports which require the "Small Business" notice or a purchase authorization under U.S. procurement procedures, an amount of W 55 per US\$1 must be deposited when the application for imports is made; an additional deposit of W 200 per US\$1 is required prior to the issuance of the import license which follows completion of the "Small Business" procedure^{1/} or purchase authorization. For imports exempted from these regulations, a deposit of W 255 per US\$1 is required at the time of applying for the import license. Upon the release of the bills of lading, payments are made in exchange certificates for the full amount of imports and the cash advance deposits are then refunded.

Regarding imports under U.S. PL 480, an initial cash deposit of W 50 per US\$1 is required at the time of applying for imports, and an additional deposit of W 50 per US\$1 is made prior to the issuance of the import license (for imports of raw cotton a bank guarantee may be submitted instead of the second W 50 per dollar cash deposit, but for imports of tallow the second cash deposit of W 205 per US\$1 is required.) Settlement for the remainder is made in won when the bill of lading is released, and no exchange certificates are required.

Regarding the imports financed by Japanese aid (property claims), an advance deposit scheme is applied for imports through the Government Supply Office (GSROK) including fertilizers. Deposits have to be made in exchange certificates in the amount of 5 per cent at the time of the application for imports and 60 per cent when the import licenses are issued. The remainder of the value of import (35 per cent) is paid in exchange certificates upon the release of the bill of lading.

Imports of the Government and government-operated enterprises are not subject to the above advance deposit requirements, irrespective of whether they are financed by Korean foreign exchange or foreign aid. Letters of credit for such imports are opened by the authorized banks in exchange for promissory notes denominated in foreign exchange, and payments are made in exchange certificates when the bill of lading is released.

d. Payments for invisibles

All payments for invisibles require individual licenses. Payments for invisibles connected with foreign trade transactions and for certain other items, such as bank charges, insurance premiums, communication fees,

^{1/} This procedure requires a publication of the specification of goods to be financed by U.S. aid in the "Small Business Circular" of U.S. AID for a period of 45 days; certain imports, e.g., those not exceeding the amount of US\$5,000 at a time or those related to an exclusive agency contract, are exempted from this requirement.

periodicals, and payments made in connection with remittances of profits and capital repayments on loans and investments that had been approved by the Government, are licensed automatically. Import licenses are issued on c. and f. basis upon request. However, for imports paid for with Korean foreign exchange, licenses are issued only for transport in Korean ships. Exceptions are made to this upon recommendation from the Korean Ship-Owners Association that Korean ships are not available for transport of the particular import. The same rule also applies for the transport of Korean exports by foreign bottoms. As a result of the recommendation requirement from the Korean Ship-Owners Association, about 65-70 per cent of the trade between Korea and Japan are reserved for Korean ships. The comparable figure for total trade is about one third. The Korean Ship-Owners Association has no pooling agreement regarding imports shipped in non-Korean bottoms. Regarding the foreign aid imports, the general U.S. rule of minimum 50 per cent utilization of U.S. ships is applied for all U.S. aid imports. No discrimination in favor of aid-giving countries' boats is applied in respect to aid imports from Japan and Germany.

Exporters whose foreign exchange earnings exceed the equivalent of US\$100,000 a year may use part of such earnings for business travel or other trade promotion purposes, such as maintaining overseas branches. In addition, exporters are authorized to use exchange earnings up to an amount of US\$5,000 a month for the expenses of their overseas branches. All travelers abroad may purchase up to \$900 per month, to which an additional \$200 per trip may be obtained as extra expenses.

Foreign and Korean currency notes may not be exported without permission. Departing foreigners may reconvert unused won notes into U.S. dollars and they may take out any foreign exchange that they had registered on entry.

e. Export and invisible proceeds

All exports to communist countries, and exports of certain goods (such as raw cotton, raw hides, certain precious metals, certain ores and minerals, pulp, and lumber) to all countries, are prohibited. Certain exports require individual licenses. All other exports may be made freely under an automatic approval procedure.

The export proceeds in prescribed foreign exchange must be surrendered to the exchange banks at the buying rate posted by the Bank of Korea or be exchanged into equivalent foreign exchange certificates. The same treatment applies to all proceeds derived from invisibles. The import of Korean currency notes requires special authorization. Travelers may bring with them any amount of designated foreign currencies without registration upon entry.

f. Capital

All capital remittances require approval. Foreign capital investment, loans from abroad, and imports of capital goods on a long-term basis are regulated by the Foreign Capital Inducement Law of August 3, 1966. Under

this law, foreign investors may invest without any limit, or minimum national participation requirement, subject to approval by and registration at the Economic Planning Board. Free remittance of profits and repatriation of capital up to 20 per cent a year, two years after the original capital investment was made are guaranteed. Liberal tax exemptions (100 per cent the first five years, 50 per cent the following three years) are granted to foreign enterprises together with exemption from customs duties on imports of capital goods.

3. Bilateralism

The only bilateral payments agreement is with the Republic of Viet-Nam, signed in December 1962. However, it has not been operative; no bilateral account has been established and all settlements have been made in convertible currencies.

The bilateral payments agreement with Japan was terminated on March 19, 1966. A balance of about \$45 million of the bilateral account due from Korea was to be settled in equal installments over ten years, with the proceeds of funds to be granted by Japan for the settlement of Korean property claims following the ratification of the normalization treaty of December 18, 1965.

A barter arrangement with Indonesia was concluded on December 9, 1965, involving export of cotton textiles up to \$2 million to Indonesia by Korean traders in exchange for commodities included in the import program. Settlements were to be made through an escrow account. However, no transaction has taken place under this arrangement nor has the escrow account been established.

IMPORT PAYMENT PROCEDURES

(As of August 10, 1967)

	Applications for Import	Approval of the Applications (Issuance of Import Licenses)	Opening of Letters of Credit ^{1/}	Releasing of Bills of Lading ^{1/}	
<u>I. Imports of the private sector</u>					
1. KFX imports other than those for exports	-	-	Exchange certificates in full amount.	-	
2. KFX raw material imports for exports					
(a) Imports supported by an export letter of credit.	-	-	Letters of guarantee in full amount denominated in foreign currency issued by authorized banks.	Exchange certificates for the full amount upon release of bills of lading. ^{2/}	- 76 -
(b) Imports supported by an export contract	-	-	Exchange certificates corresponding to 10 per cent of L/C. Bank guarantees corresponding to 90 per cent of L/C.	Exchange certificates for the amount covered by bank guarantees. ^{2/}	
(c) Other imports ^{3/}	-	-	Letters of guarantee in full amount denominated in foreign currency issued by authorized banks.	Exchange certificates for the full amount upon release of bills of lading. ^{2/}	PART II ANNEX I

	Applications for Import	Approval of the Applications (Issuance of Import Licenses)	Opening of Letters of Credit ^{1/}	Releasing of Bills of Lading ^{1/}
(d) Imports of the prohibited list items, except cotton textiles, etc.	-	-	Exchange certificates corresponding to 30 per cent of L/C. Bank guarantees corresponding to 70 per cent of L/C.	Exchange certificates for the amount covered by bank guarantees.
3. KFX equipment and facilities for exports and etc. (for detail, see pages 103-105 and 91-92 of Answer for 1967)				
(a) Equipment and facilities for exports.	-	-	Exchange certificates equivalent to 10 per cent of L/C.	Exchange certificates equivalent to 10 per cent of L/C. ^{2/}
(In case the standard transit terms are less than 10 days)	-	-	Exchange certificates equivalent to 30 per cent of L/C.	Exchange certificates equivalent to 40 per cent of L/C. ^{6/}
(b) Imports by Government-run enterprises and other public institutions.	-	-	Exchange certificates equivalent to 10 per cent of L/C.	- 7/
(c) Equipment, facilities and raw materials by government-invested enterprises and public foundations qualifying a juridical person.		-	Ditto	Ditto

	Applications for Import	Approval of the Applications (Issuance of Import Licenses)	Opening of Letters of Credit ^{1/}	Releasing Releasing of Bills of Lading ^{1/}
(d) Equipment and facilities for use of foreign exchange earnings, import substitute industries or for projects under the Five-Year Economic Development Plan.	-	-	Exchange certificates equivalent to 20 per cent of L/C.	Ditto
4. KFX capital goods imports by export industries on D/A basis.	-	-	-	Settlement by exchange certificates up to three years from acceptance.
5. U.S. aid imports other than PL 480.				
(a) Subject to U.S. procurement regulations or S.B. notice.	Cash deposits in the amount of W 55 per \$1.	Additional cash deposits in the amount of W 200 per \$1.	-	Exchange certificates in full amount (advance deposits are refunded).
(b) Others (exempted from the requirement under (a) above).	-	Cash deposits in the amount of W 255 per \$1.	-	Ditto
6. U.S. PL 480 imports				
(a) Raw cotton	Cash deposits in the amount of W 50 per \$1.	Bank guarantees in the amount of W 50 per \$1.	-	Settlement of the remainder by won payments (Of the amount W 100 per \$1 may be credited.)

	Applications for Import	Approval of the Applications (Issuance of Import Licenses)	Opening of Letters of Credit	Releasing of Bills of Lading
(b) Tallow	Ditto	Additional cash deposits in the amount of W 205 per \$1.	-	Settlement of the remainder by won payments.
(c) Others	Ditto	Additional cash deposits in the amount of W 50 per \$1.	-	Settlement of the remainder by won payments.
7. Japanese aid imports (other than fertilizer)	Exchange certificates in the amount of 5 per cent of application.	Exchange certificates in the amount of 60 per cent of the allo- cation.	-	Exchange certificates for the remainder of the allocated amount (35 per cent).
8. Japanese aid imports through OSROK	-	-	-	Exchange certificates in full amount.
II. Imports of the Government and Government-run enterprises	-	-		
1. Ordinary imports of the Government.	-	-	Promissory notes denominated in foreign currency issued by autho- rized banks.	Settlement by ex- change certificates upon release of bill of lading. ^{8/}
2. Government imports under the Government's obliga- tional authority.	-	-	Payment guaran- tees submitted by the chief of central government organs.	Settlement by ex- change certificates upon release of bill of lading. ^{8/}

For footnotes see p. 80.

- 1/ For imports for which payment is made on a D/A or D/P basis, see "Payments for Imports".
- 2/ Those who receive bank credit in local currency make full payments in local currency in 135 days after the release of the bill of lading.
- 3/ Exporters are permitted to import raw materials up to the value equivalent to 25 per cent of the total raw materials imported during the past one-year period prior to arrival of export letters of credit or the conclusion of export contracts.
- 4/ Applies to all such imports, irrespective of whether the importers have received an export letter of credit, an export contract or whether they are entitled to imports under the export performance criteria as indicated above (footnote 3).
- 5/ For the settlement of the remaining 80 per cent of L/C amount, a bank credit in foreign currency is given by the foreign exchange banks at an interest rate of 6.5 per cent per annum. Half the amount of the credit must be repaid within 18 months and the remainder within 30 months from the date of release of the B/L.
- 6/ For the settlement of the remaining 30 per cent of L/C amount, a bank credit in foreign currency is also given. However, half the amount of the credit must be repaid within 12 months and the remainder within 24 months from the date of release of the B/L.
- 7/ For the settlement of the remaining 90 per cent (80 per cent in case of (d) of L/C amount, also a bank credit in foreign currency is given at an interest rate of 7.5 per cent per annum. This credit matures in five years including two years grace period, with repayment on an annual installment basis.
- 8/ Exchange certificates are issued by Foreign Exchange Bank of Korea against won payments.

Table I. Labor Force and Employment by Major Industries, 1963-66
(Quarterly average)

	1963	1964	1965	1966
Gainfully employed (1,000 persons)	7,947	8,210	8,522	8,659
Economically active population (1,000 persons)	8,683	8,893	9,199	9,325
Total population (14 years old and over, in 1,000 persons)	15,684	16,348	16,591	16,849
Employment or per cent of economically active population	91.5	92.3	92.6	92.9
Unemployment as per cent of economically active population	8.5	7.7	7.4	7.1
Major sectoral employees as per cent of total employment	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>
Agricultural, forestry and fishery	63.2	61.9	58.7	58.2
Mining, manufacturing and construction	11.2	11.2	13.1	13.0
Commerce	9.9	10.5	11.5	11.3
Government	3.4	3.4	3.0	4.2
All other services	12.3	13.0	13.7	13.3

Source: The Bank of Korea, Monthly Statistical Review, Seoul.

Table II. Selected Interest Rates of Banking Institutions

(In p r cent per annum)

	Bank of Korea					Commercial banks						NACF			
	Export and UN supply loans	Rice lien loans	Com-mercial bills	Other bills	Purchase of aid goods	Export bills	Import bills	Com-mercial bills	Other bills	Over-draft	Over-due loans	Rice lien loans	General fund loans	Agriculture and forestry loans	Cooper-ative business loans
Lending Rates															
Previous rate	3.5	4.0	11.5	13.5	9.5	6.5		14.0	16.0	18.5	20.0	11.0	16.0	16.0	9.1
New rate ^{1/}	3.5	4.0	21.0	23.0	23.0	6.5		24.0	26.0	26.0	36.5	11.0	26.0	23.0	12.2
A further revision effective Dec 1, 1965	--	--	28.0	28.0	26.0 ^{2/}	6.0	(6.0 ^{2/} effective June 29, 1967)	--	--	28.0	--	--	--	--	--
							(24.0 effective June 29, 1967)			(effective Feb 1, 1966)					
Deposit Rates															
	Time Deposits				Savings		Short-Term Savings								
	3-6 months	6-12 months	12-18 months	Over 18 months	National Savings Association	Installment	Notice	Savings							
Previous rate		9	12	15	15	16.8	10.0	3.65	3.60 ^{4/}						
New rate ^{1/}		1.5-2.2 ^{3/}	2.0-2.2 ^{3/}	2.2-2.5 ^{3/}	3.0	30.0	30.0	5.00	12.00 ^{4/}						

Source: Data provided by the Korean authorities

^{1/} New rate became effective from September 30, 1965 for all banks other than the Central Bank, and from November 16, 1965 for the Bank of Korea

^{2/} From March 13, 1967, the rate on Central Bank loans for export promotion is 23 per cent per annum. Commercial bank loans for raw material imports for foreign exchange earning purposes will carry an annual interest rate of 6 per cent, while the interest rate on loans for imports of raw materials and industrial facilities for purposes other than earning foreign exchange is 24 per cent.

^{3/} The Monetary Board set a maximum interest rate of time deposits at 2.5 per cent a month. The interest rates paid by banking institutions are as follows: 1.5 per cent a month for 3-month time deposits, 2.0 per cent for 6-month deposits; 2.2 per cent for 12-month deposits, and 2.5 per cent for 18-month deposits

^{4/} The actual rate agreed upon by the Korean Banking Association is 7.2 per cent per annum.

Table III. Reserve Position of Commercial and Other Banks,
1963-May 1967

(Daily average in billions of won)

	Deposit ^{1/}	Reserve Holdings	Required Reserves ^{2/} (1)	Excess Reserves (2)	Borrowing (3)	Free Excess Reserves (2 minus 3)
Commercial banks						
1963 December	26.2	4.1	4.0	0.1	2.6	-2.5
1964 December	26.2	3.1	2.9	0.2	4.5	-4.3
1965 March	28.1	3.0	3.1	--	5.3	-5.4
June	34.0	4.1	3.8	0.3	0.5	-0.2
September	36.3	5.1	4.8	0.3	1.0	-0.7
December	45.3	7.0	6.7	0.3	4.1	-3.8
1966 March	54.7	13.6	13.1	0.5	3.7	-3.2
June	62.9	14.7	14.4	0.3	3.6	-3.3
September	73.8	16.5	16.3	0.2	3.8	-3.6
December	79.7	19.0	18.7	0.3	3.7	-3.4
1967 March	95.1	26.0	25.7	0.3	4.4	-4.1
May	108.4	23.8	23.6	0.2	4.9	-4.7
Other banks^{3/}						
1963 December	9.1	1.6	1.4	0.2	4.9	-4.7
1964 December	11.3	1.7	1.3	0.4	7.3	-6.9
1965 March	12.2	1.8	1.4	0.4	6.9	-6.5
June	14.2	1.8	1.6	0.2	13.0	-12.8
September	15.9	2.2	2.1	0.1	14.2	-14.1
December	17.1	2.9	2.5	0.4	17.0	-16.6
1966 March	19.4	5.1	4.9	0.2	16.9	-16.7
June	25.6	6.4	6.0	0.4	21.5	-21.1
September	31.1	7.1	6.8	0.3	22.7	-22.4
December	35.2	9.0	8.7	0.3	22.1	-21.8
1967 March	40.1	17.0	10.9	6.1	20.7	-14.6
May	42.7	9.9	9.6	0.3	26.2	-25.9

For footnotes see page 84.

Footnotes to Table III

Source: The Bank of Korea, Monthly Statistical Review, Seoul, Korea.

1/ Covers deposits subject to reserve requirements prior to January 16, 1966. Uncleared checks and bills were deducted from demand deposits; thereafter they are subject to reserve requirements.

2/ During 1965 the minimum reserve requirements were adjusted twice: effective July 16 minimum reserve requirements were raised from 12 per cent to 16 per cent against demand deposits while those against time and saving deposits remained unchanged at 10 per cent. At the same time, the ratio of vault cash authorized to be held as reserves was reduced from 25 per cent to 10 per cent of required minimum reserves; effective from December 1, the reserve requirements were raised to 20 per cent against demand deposits, time and savings deposits were classified into short-term and long-term time deposits with a reserve ratio of 12 per cent against the former and 10 per cent for the latter. Effective February 1, 1966, the reserve ratio was raised further to 35 per cent against demand deposits, to 15 per cent against long-term time and savings deposits, and to 20 per cent against short-term time and savings deposits. Effective from October 1, 1966, marginal reserve requirements were imposed; 50 per cent against demand deposits and 45 per cent against time and savings deposits, in excess of the respective average balance outstanding at the end of September 1966.

3/ Covers RACF, MIB and CNB.

Table IV. Exports by Commodity Group, 1962-May 1967

(In millions of U.S. dollars)

	1962	1963	1964	1965	1966	1967 (Jan.-May)	Growth Rate 1965-66 (In per cent)	Average Annual Growth Rate 1962-65 (In per cent)
Total exports	54.8	86.8	119.1	175.1	250.3	110.5	42.9	44.2
Food and live animals (SITC 0)	21.9	18.1	26.4	28.2	41.3	14.2	46.5	20.4
Beverages and tobacco (SITC 1)	0.1	0.3	0.2	0.9	6.9	3.9	66.7	116.7
Crude materials, inedible, except fuels (SITC 2)	19.3	26.2	31.4	37.0	46.7	22.5	26.2	15.8
Mineral fuels, lubricants and related materials (SITC 3)	2.0	2.6	2.5	1.9	1.5	0.4	-21.1	-1.9
Animal and vegetable oils and fats (SITC 4)	0.1	0.1	0.1	0.1	0.1	--	--	--
Chemicals (SITC 5)	1.0	0.9	0.6	0.4	0.7	0.3	75.0	-2.5
Manufactured goods classified by material (SITC 6)	6.2	28.1	42.3	66.4	84.2	34.8	26.8	129.2
Machinery and transport equipment (SITC 7)	1.4	4.1	2.2	5.5	9.6	4.1	74.5	68.1
Miscellaneous manufactured articles (SITC 8)	2.0	6.4	13.2	34.5	59.2	30.3	71.6	159.4
Not classified (SITC 9)	0.1	0.1	0.2	0.2	0.2	0.1	--	1.1

Source: The Bank of Korea, Monthly Statistical Review, Seoul, Korea.

Table V. Imports by Commodity Group, 1962-May 1967^{1/}

(In millions of U.S. dollars)

	1962	1963	1964	1965	1966	1967 (Jan.-May)	Growth Rate 1965-67 (in per cent)
Total imports	421.8	560.3	404.4	463.4	716.4	349.2	54.6
Food and live animals (SITC 0)	48.6	120.6	68.2	63.5	72.4	27.8	14.0
Beverages and tobacco (SITC 1)	0.1	0.3	0.1	0.2	0.3	0.3	50.0
Crude materials, inedible, except fuels (SITC 2)	89.7	107.1	97.1	110.0	153.9	69.8	39.9
Mineral fuels, lubricants and related materials (SITC 3)	30.6	34.4	28.5	31.3	42.4	22.2	35.5
Animal and vegetable oils and fats (SITC 4)	3.9	4.8	3.9	3.8	5.5	2.6	44.7
Chemicals (SITC 5)	94.3	80.0	84.3	103.4	134.5	32.7	30.1
Manufactured goods classified by material (SITC 6)	73.1	88.3	46.1	71.2	125.2	66.0	75.8
Machinery and transport equipment (SITC 7)	69.8	115.6	69.5	73.1	171.7	122.2	287.6
Miscellaneous manufactured articles (SITC 8)	10.2	8.0	5.3	6.8	10.5	5.6	54.4
Not classified (SITC 9)	1.5	1.2	1.3	0.2	--	--	--

Source: The Bank of Korea, Monthly Statistical Review, Seoul, Korea.^{1/} On c.i.f. basis.

Table VI. Exports by Country, 1962-May 1967

(In millions of U.S.dollars)

Destination of Exports f.o.b.	1962	1963	1964	1965	1966	1967 (Jan.-May)	Rate of Growth of Exports 1965-66 (In per cent)	Per Cent of Total			
								1962	1965	1966	1967
Asia	35.7	53.7	66.0	85.8	104.8	43.7	22.1	65.1	49.0	41.9	39.5
Japan	23.5	24.8	38.2	44.0	66.3	28.6	50.7	42.9	25.1	26.5	25.9
Hong Kong	4.7	9.1	11.6	10.8	9.5	5.6	-12.0	8.6	6.2	3.8	5.1
Viet-Nam	0.8	12.1	6.3	14.8	13.8	2.1	-6.8	1.5	8.5	5.5	1.9
Others	6.7	7.7	9.9	16.2	15.2	7.4	-6.2	12.2	9.3	6.1	6.7
Europe	6.3	7.9	15.7	21.4	34.1	13.6	59.8	11.5	12.2	13.6	12.3
Sweden	0.2	0.4	1.6	5.1	9.8	3.4	92.2	0.4	2.9	3.9	3.1
United Kingdom	1.6	1.6	6.5	3.6	5.1	3.1	41.7	2.9	2.1	2.0	2.8
Germany	0.2	1.3	1.1	3.2	7.0	2.1	118.8	0.4	1.8	2.8	1.9
Others	4.3	4.6	6.5	9.5	12.3	5.0	29.5	7.8	5.4	4.9	4.5
North America	12.1	24.5	36.0	64.2	101.6	48.5	58.3	22.1	36.7	40.6	43.9
United States	12.0	24.3	35.6	61.7	95.8	46.7	55.3	21.9	35.2	38.3	42.4
Canada	0.1	0.2	0.4	2.5	5.8	1.8	132.0	0.2	1.4	2.3	1.6
Latin America	0.4	--	0.3	0.4	0.9	0.3	125.0	1.7	0.2	0.4	0.3
Africa	--	0.1	0.3	2.1	7.0	3.5	233.3	--	1.2	2.8	3.2
Others.	0.3	0.5	0.7	1.2	1.9	0.9	58.3	0.5	0.7	0.7	0.8
Total	54.8	86.8	119.1	175.1	250.3	110.5	42.9	100.0	100.0	100.0	100.0

Source: The Bank of Korea, Monthly Statistical Review, Seoul, Korea.

Table VII. Imports by Country, 1962-May 1967

(In millions of U.S. dollars)

Origin of Imports c.i.f.	1962	1963	1964	1965	1966	1967 (Jan.-May)	Per Cent of Total					
							1962	1963	1964	1965	1966	1967
Asia	141.5	208.4	146.2	228.2	384.9	199.6	33.5	37.2	36.2	49.2	53.7	57.2
Japan	109.2	159.3	110.3	166.6	293.8	156.0	25.9	28.4	27.2	36.0	41.0	44.7
China (Taiwan)	7.3	15.0	5.2	10.5	10.8	10.0	1.7	2.7	1.3	2.3	1.5	2.9
Hong Kong	0.3	6.1	5.9	7.5	7.7	4.2	0.1	1.1	1.5	1.6	1.1	1.2
Philippines	13.1	12.2	9.0	11.1	21.0	7.9	3.1	2.2	2.2	2.3	2.9	2.3
Malaysia	6.6	2.1	1.3	2.5	10.1	5.6	1.6	0.4	0.3	0.5	1.4	1.6
Others	5.0	13.7	14.7	30.0	41.4	15.9	1.2	2.4	3.6	6.4	5.8	4.6
Europe	41.4	41.8	39.2	40.6	55.8	32.8	9.8	7.5	9.7	8.7	7.8	9.4
Germany	19.2	22.7	23.9	16.1	20.3	7.2	4.6	4.1	5.9	3.4	2.8	2.1
United Kingdom	6.3	5.2	3.2	1.2	2.2	1.2	1.5	0.9	0.8	0.3	0.3	0.3
Netherlands	1.6	5.4	4.0	2.8	2.8	2.0	0.4	1.0	1.0	0.6	0.4	0.6
Italy	4.9	3.3	4.5	6.2	16.1	4.1	1.2	0.6	1.1	1.3	2.2	1.2
Others	9.4	5.2	3.6	5.1	14.5	18.3	2.2	1.0	0.9	1.1	2.0	5.2
North America	222.4	287.5	204.6	183.9	256.4	110.6	52.7	51.3	50.6	39.6	35.8	31.7
Canada	2.0	3.5	2.5	1.6	2.7	1.5	0.5	0.6	0.6	0.3	0.4	0.4
U.S.A.	220.3	284.1	202.1	182.3	253.7	109.1	52.2	50.7	50.0	39.3	35.4	31.2
Latin America	6.6	1.5	1.6	2.2	3.7	1.3	1.6	0.3	0.4	0.5	0.5	0.4
Africa	1.9	0.7	1.3	4.0	7.1	0.5	0.5	0.1	0.3	0.9	1.0	0.1
Others	8.0	20.4	11.4	4.5	8.6	4.4	1.9	3.6	2.8	1.0	1.2	1.3
Total	421.8	560.3	404.4	463.4	716.4	349.2	100.0	100.0	100.0	100.0	100.0	100.0

Source: The Bank of Korea, Monthly Statistical Review, Seoul, Korea.

Table VIII. Gold and Foreign Exchange Holdings and Debit Balance of
the Korea-Japan Open Account, 1960-August 1967

(In millions of U.S. dollars)

	Gold	Foreign Exchange	Total ^{1/}	Debit Balance on Korea-Japan Open Account
1960	1.8	155.2	157.0	44.1
1961	1.8	205.2	207.0	44.2
1962	1.9	166.8	168.6	49.4
1963	1.9	129.6	131.5	42.4
1964	2.8	128.9	131.7	43.3
1965				
March	2.9	117.0	119.9	50.6
June	3.2	110.0	113.2	47.9
September	3.3	118.8	122.0	44.2
December	3.3	138.3	141.6	44.1
1966				
March	3.3	150.0	153.3	40.7
June	3.3	160.8	164.1	39.2
September	3.4	190.8	194.2	38.8
December	3.4	235.8	239.2	36.6
1967				
January	3.4	245.3	248.7	36.6
February	3.4	262.1	265.5	36.6
March	3.4	265.1	268.5	36.6
April	3.4	288.4	291.8	36.6
May	3.4	306.4	309.8	36.6
June	3.4	296.7	300.2	36.6
July	3.4	303.7	307.1	36.6
August	3.4	303.0	306.4	36.6

Sources: The Bank of Korea, Monthly Statistical Review, Seoul, Korea; and IMF, International Financial Statistics.

^{1/} Foreign exchange holdings comprise all official and bank holdings. The Government deposited its foreign exchange holdings with the Bank of Korea until March 1961; since then, the Government has not owned any foreign exchange. Five commercial banks hold a small amount of foreign exchange beginning in April 1962, and the newly established Foreign Exchange Bank also handles foreign exchange since 30 January, 1967. The Bank of Korea holdings also include some privately deposited foreign exchange and a \$10 million borrowing of the Bank in November 1963 from a U.S. commercial bank which was paid in May 1966. Above data represent gross holdings.