

**AIRGRAM**

**DEPARTMENT OF STATE**

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FROM - SECUL

SUBJECT - Economic Planning PROP

REFERENCE -

Attached is a non-capital project paper (PROP) covering Project 489-11-720-587 Economic Planning.

PORTER

PAGE PAGES

1 OF 14

DRAFTED BY <i>RSWhitmer/DMChandler</i>	OFFICE AD/E/AD/P	PHONE NO 4576 4131	DATE 4/21/70	APPROVED BY AD:MGWedeman
AID AND OTHER ARRANGES AD/P-P:AJCoppola		AD/P:AGRevelle		
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NON-CAPITAL PROJECT PAPER (PROP)

Country: Republic of Korea

Project No.: 489-11-720-587

Submission Date:

Original: X Revision No. \_\_\_\_\_

Project Title: Economic Planning

U.S. Obligation Span: FY 1963 through FY 1971

Physical Implementation Span: FY 1963 through FY 1974

Gross life-of-project financial requirements:

U.S. Dollars \$ 2,368,000

Local Currency ₩89,290,000

**A. Summary Description**

The Republic of Korea's (ROK) continued economic development depends greatly upon the nation's continued success in adopting sound economic policies. So far, the Republic of Korea Government (ROKG) has achieved significant progress in implementing such successful economic policies and procedures, resulting in a rapid rate of economic growth ~~of~~ (15.5% in 1969). However, despite recent success, there are still many problems, particularly regarding monetary policy, price stabilization, international trade and balance of payments performance. In addition, Korea needs further policy guidance on the formulation of the important Third Five-Year Plan (1972-1976).

Accordingly, under this continuing project, USAID plans to assist the ROKG in achieving improvements in the following policy areas:

- a) price stabilization;
- b) narrowing of the country's trade gap;
- c) increased domestic savings;
- d) effective management of foreign debt;
- e) rationalization of the foreign exchange rate; and
- f) formulation of a well-conceived, realistic Third Five-Year Plan.

To meet these objectives, it is proposed that the U.S. continue to finance under this project direct-hire and contract advisory services, commodities, ~~and~~ participant training. A summary of the overall financing required for this project is attached hereto.

NON-CAPITAL PROJECT FUNDING

PROP DATE:

PROJECT NO: 489-11-720-387

Dollar Funding (\$000)

<u>Year</u>	<u>Direct Hire</u>	<u>PASA</u>	<u>Contract Services</u>	<u>Participants</u>	<u>Comm- odities</u>	<u>Other Costs</u>	<u>Total</u>
Prior thru FY 1969	191	36	1,000	391	33	142	1,793
FY 1970	109	-	-	201	44	-	324
FY 1971	90	-	20	141	-	-	251
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Total:	390	36	1,020	733	62	142	2,368

Local Currency Funding (\$000)

<u>Year</u>	
Prior thru 1969	39,875
1970	29,415
1971	20,000 est.
	<hr/>
Total:	89,290

## B. Setting/Environment

Following the Korean War, the Republic of Korea's (ROK) economy was beset with many serious problems, including a shortage of domestic savings and foreign investment, ineffective planning, high inflation, minimal exports, and a low per capita income and standard of living. By the early 1960's, a new Republic of Korea Government (ROKG) sought to reverse the prevailing trend and to bring about rapid economic growth. To achieve this goal the ROKG instituted a wide range of austerity measures and improved policies to enable Korea to achieve a higher rate of economic growth. In response to a ROKG request, the U.S. provided policy guidance under the Economic Planning Project which began in FY 1964. Gradually, because of Korea's determination and initiative, supported in part by U.S. assistance, the Korean economy began to respond and grow rapidly. Over the period of 1963-1969, real Gross National Product (GNP) grew at an average annual rate of 10.8% percent.

While the economy has achieved notable growth, numerous policy problems may seriously impede continued growth. The two principal problems which hamper further progress toward economic self-sufficiency are the growth of domestic savings and the growing trade gap. Inflation is the principal obstacle to the growth of domestic savings. Although good progress has been made over the last few years, more recent actions by the ROKG have raised the spectre of a renewed bout with hyperinflation. The money supply and domestic credit were greatly expanded in the second half of 1969, in connection with a political referendum, ~~seriously~~ threatening the ROKG's stabilization and development programs.

Before Korea can achieve a significant measure of economic independence, it must bring its trade gap under control. The trade gap grew from \$240 million in 1965 to about \$ 1 billion in 1969. This situation reflects a set of inadequate policies on inducing foreign debt, the foreign exchange rate, import control and export promotion. It also indicates a growing distortion in cost/price relationships between domestic and foreign costs and prices which is damaging to the economy. Probably the most critical problem is the question of the foreign exchange rate which is not permitted to fluctuate freely. Instead, the exchange rate is pegged at a lower level in an attempt to control inflation, an overvaluation which encourages imports and discourages exports.

These policies have led to a debt problem which might, if not adequately dealt with, lead to an international crisis of confidence in Korea's future. The ROK's foreign debt\* is now over \$2.5 billion and the amount of debt due for payment in future years is rising markedly (\$315 million in 1970).

\* on a contracted basis

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Such repayments can not be sustained unless foreign lenders remain convinced of Korea's credit worthiness and are prepared to continue to advance new credit.

As the Korean economy grows over the next few years, it should be possible for the ROK to assume a greater responsibility for its own defense and to devote a larger share of its own income for that purpose. This possibility will become more significant as the U.S. continues to reduce its financial assistance to the ROK defense establishment thereby placing a new burden on Korea's banking system and domestic capital markets. Therefore, the ROKG needs to plan now for this eventuality, and develop new sources of domestic financing in support of Korea's defense needs.

A complicating factor involved in Korea's efforts to reach economic self-sufficiency is the role of the ROKG in the normal operations of the economy. There is recent evidence to suggest that the Government's intervention in the economy is substantial. This intervention is not confined to questions of economic policy, but involves detailed allocation of credit and the management of individual business firms. The last year has seen less reliance on the market forces of a liberal economy and increased ~~xxx~~ recourse to direct Government controls. If continued, this would decrease the degree of freedom of economic opportunity and place private individuals in greater need of seeking ROKG or political sanction for their economic ventures and activities.

On the distribution side of national income, the continuing, and perhaps worsening, gap between the rural and urban areas is a source of growing concern to the ROKG. The income difference between the two sectors is mainly due to the accelerated growth of the industrial sector which was planned and achieved during the Second Five Year Plan. The disparity has now been recognized by the ROKG and attempts are being made to reduce the gap through "social development" plans. Greater equality can be achieved through different income distribution patterns or by actions of the ROKG to increase educational opportunities, to provide better health services, and to improve the level of urban housing. The U.S. is also interested in such programs.

In light of the above conditions, the ROK desires further U.S. assistance and advice on current policy issues including monetary policy and price stabilization, international trade and balance of payments. This advisory assistance is necessary to help counter recent disturbing trends and to maintain sound economic growth.

In addition, Korea needs help in formulating long-range plans and policies. The formal framework for coordinating the ROKG economic policies is a system of Five-Year Plans and the associated series of annual Overall Resources Budgets. In each Five Year Plan the ROKG sets medium-term goals and policy guidelines and directions. Sometime during the first half of each

year, the annual Overall Resources Budget makes recommendations to the various government agencies on policies and budget expenditures which should be made during the next budget year in order to achieve the Five-Year Plan targets. The ROKG has formally requested that the U.S. provide technical assistance in the formulation of the Third Five Year Plan (1972-76), similar to that provided for the Second Five Year Plan (1967-71).

Continued success in the realization of the ROKG economic goals in a period of rapid growth and structural change requires an ever increasing number of highly trained Korean economists. Over the past six years, approximately 50 Koreans have received training as professional economists under this project. Many of these U.S. trained economists are now playing an important role in the development process in key positions with the Economic Planning Board, Bank of Korea, Ministry of Finance, and other Government ministries and agencies. Further training is needed to solidify past gains and help assure further economic development.

### C. Strategy

The U.S. strategy involved in this project is to support the ROKG goal of continued economic growth and the achievement of economic self-sufficiency. The U.S. plans to help the ROK attain its goal by providing policy advice on long-range economic planning as well as on current policy issues. In this regard, it is clear that Korea is at one of the most important policy junctures in her modern economic history. The choice is either (1) stabilize the economy now through policy measures similar to those employed by West Germany in 1948 or Japan in 1949 and usher in a long period of high prosperity with stability and growing international confidence in the ROK, or (2) take partial measures, politically easier to achieve, and bring on a period of mediocre economic progress, uneven in nature and at a rate of progress considerably less than the nation could achieve. The U.S. believes that it is in the best interests of the ROK and within its ability to take the former course, and U.S. policy advisers therefore are attempting to encourage action in that direction.

While advising on overall policy matters, U.S. technicians are also recommending policy measures which are designed to counter some recent disturbing trends and to restore appropriate internal/external, price/cost relationships in Korea. Some of the specific issues currently encountered involve a controlled foreign exchange rate, insufficient reliance on market forces in favor of government decisions regarding allocation of resources,

an inadequate level of domestic savings, excessive domestic credit expansion, and a threatened spiraling inflation.

While this technical assistance project places emphasis on the economic problems generated by the economic successes of recent years, it is not intended to imply that the underlying high-priority requirement of sound and rapid growth of such key economic variables as national output and exports is to be ignored. The pattern of economic policies and practices which have led to the achievements of the last few years need regular reassessment and revision. The incentives, for example, which were effective during the last five years may not be the best types for the next five years. Therefore, the ancillary problems of economic progress should not divert the attention of economic planners from the primary desire of the both the U.S. and ROK Governments that self-sustaining, real economic growth emerge from the efforts of all concerned. Preoccupation with these important but ancillary problems could obscure more fundamental problems within the structure of the economy. For these reasons this project envisions a continuing review and assessment of structural characteristics in order to assist the ROKG in building an economy which has long-run viability with substantially reduced U.S. economic and military aid.

The U.S. uses a variety of means to help the ROKG in improving its policies and in achieving the goal of continued economic growth and self-sufficiency. In addition to advice on the Five Year Plans and current economic matters, these instruments include grants for commodities, technical assistance, a foreign investment promotion program, a technical training program, and soft loans for commodities, capital projects, and technical assistance. Commodity import programs are used to help solve immediate problems of commodity scarcity. Technical assistance in planning, capital projects, and investment promotion are used for medium-term economic growth. Technical training is used for increasing the long-run supply of management and policy-making skills. Other technical assistance projects, including Rural Policy Planning and Development and Industrial Development, concern specific areas also related to this particular project.

The International Monetary Fund, the International Bank for Reconstruction and Development, the Asian Development Bank, and the United Nations Agencies (FAO, WHO, ILO and UNDP) all provide short-term and/or specialized policy advice to the ROKG. The UNDP also provides long-term advisers in regional physical planning. AID has provided a broad range of long-term, coordinated policy advice.

**D. Planned Targets, Results and Output**

This project is designed to improve ROKG policies relating to current economic matters and to help formulate the Third Five-Year Plan. To achieve the objectives of this project, the following targets are proposed:

1) Monetary Policy and Price Stabilization - Reasonable price stability is necessary to permit more of the people to share in the improved standards of living and general economic welfare resulting from economic growth. Inflation tends to cut down on the real savings of the public and consequently deters channeling of surplus resources into savings which are essential for establishing a broad base for future growth. Monetary policy is of pivotal importance in this regard.

- a) Price Stabilization - For the price stabilization program, U.S. advisors will assist the ROKG in establishing policies to limit the annual increase in the Consumer Price Index to 4-6%, (by the end of FY 1970).
- b) Domestic Savings - For the domestic savings program, the objective is to raise the ratio of domestic savings to GNP to 20% (by end of FY 1970). It is estimated that the incremental-capital-output-ratio is about 2.0 (2:1), indicating that the above savings rate could finance a 10% annual real GNP growth rate.
- c) A final objective is to reduce the ROKG's preponderant role in the allocation of credit and management of business.

2) International Trade and Balance of Payments - Due to the nature of an open economy like Korea's, policies related to international trade and the balance of payments are critically important. Of immediate concern are ROKG policies regarding international trade and the difficulties expected to be encountered in connection with repayment of short-term loans and servicing of long-term obligations. Special attention must be given to the use of the exchange rate mechanism as a corrective device rather than direct government controls of any sort. Foreign exchange management must also be improved greatly.

- a) The first objective is to assist the ROKG to institute an exchange rate and trade policy which will encourage exports, discourage imports, and ration foreign debt take-on. The target is to assist the ROKG to adopt a policy using the

following measures: (1) an exemption of tariffs for exporters; (2) a subsidy to exporters that will equal (but not exceed) the protection to the domestic market offered by the tariff system; (3) an interest-equalization tax on foreign loans; (4) a fixed exchange rate which is devalued periodically as necessary to correct unhealthy overvaluation caused by domestic inflation; and (5) a loan fund, perhaps with preferential interest rates, that the ROKG can use to ease the repayment problems caused to foreign debt holders by such devaluations (by FY 1971).

- b) The second target is to urge the ROKG to make available on a timely basis to all concerned governments and international institutions complete and detailed reports covering such areas as: (1) all foreign debt outstanding; (2) projections of debt repayment obligations; (3) projections of sources of funds for repayment; and (4) a description of ROKG programs designed to correct any shortfall of repayment funds under repayment obligations (by FY 1971).
- 3) Capital and Money Markets - A sound capital and money market system is one of the cornerstones of a self-sustaining economy. Accordingly, this project will be carefully coordinated with the specific targets included in the existing Improved Administration of Banking and Credit Project and the planned Private Enterprise Development Project to encourage a more independent banking system, to make domestic funds more competitive with foreign funds, and to allocate more investment to a rapidly growing private enterprise sector (by end of FY 1971).
- 4) Financing of Defense - The target is for the ROKG to formulate a plan by which the ROKG can domestically finance Korea's defense efforts during the 1970's. A tentative plan should be completed by the end of FY 1971.
- 5) Statistical Services. The Bureau of Statistics (BOS) of the Economic Planning Board (EPB) has acquired a computer for its many data collection programs which include: the census of small and medium industry, mining and manufacturing, commerce, construction, population, housing, and agriculture, surveys of national income, national wealth, and family living; import and export statistics; and local government statistical undertakings. The target for this project is to set up a sound and efficient data collection and data handling system for greater efficiency in compiling, analyzing, and making available important statistical information related to the nation's economy (in FY 1971).

- 6) The Third Five-Year Plan - The major reasons for developing a new plan are: a) to establish desirable, well thought-out, achievable economic goals; b) to choose the best methods and policies (economic, political, administrative, social, and technological) for achieving these goals; and c) to establish measurable implementation targets in order to judge and evaluate achievement.

As a result of joint efforts by the ROKG and USAID, the Korean economy is expected to achieve most of the major Second Five-Year Plan goals at least a year earlier than anticipated. The preparatory work for the formulation of the Third Five-Year Plan (TFYP) has already begun and will, as in previous instances, emphasize selection of a sound development strategy and complementary ROKG policies.

The proposed schedule for drawing up the various parts of the TFYP are as follows:

- a) Long-term projections (1969 - 1989): the scale of the economy and income level, industrial structure, balance of payments, and population and employment (by end of FY 1970);
- b) Aggregate (Micro) Planning (1969 - 1976): forecasts of production by industry, domestic and foreign savings, investment demand, and balance of payments (by end of FY 1970);
- c) Forecasts for Demand of Major Commodities and Sectors: agricultural products, major manufactured products, electricity, energy, transportation, storage, communication, industrial water, and employment (by end of FY 1970);
- d) Sectoral Program (Micro): domestic government and private savings by sector and export and import forecasts (by FY 1971);  
in
- e) Investment Program: review and selection of proposed projects, regional development plans, and provincial and rural electrification proposals (by FY 1971);  
in
- f) Reconciliation and Adjustment of Separate Plan Formulation Efforts: adjustments between Aggregate Plan and Sectoral Programs (by FY 1971); and  
in

E) Development of Policy Measures to Support Planned Program

(by FY 1971).

It is targeted that the Plan will be completed by the end of FY 1971.

E. Course of Action

Under this proposal AID will continue to finance U.S. direct-hire and contract technical services, ~~and~~ commodities<sup>and</sup> participant training throughout the remaining life of the project. These activities will be coordinated with AID's Development and Program Loans, the PL 480 credit sales, other AID technical assistance projects, as well as related efforts by the U.N., IMF and other donors. The ROKG will also continue to make comparable contributions.

USAID proposes to provide up to four full-time, direct-hire advisors as well as numerous short-term and contract specialists to advise the ROKG on improved economic policies related to current issues and to the formulation of the Third Five-Year Plan. In addition, there will be 29 participants in FY 1970 and 16 in FY 1971 in fields affecting economic policy and planning. This project will also finance the purchase of textbooks, professional journals, reference works and other library materials for use by the ROK officials who are helping to formulate and implement the Third Five Year Plan.

Some of the specific courses of action proposed under this project areas follows:

- 1) Monetary Policy and Price Stabilization - Through the services of a fiscal - monetary economist and contract specialists:
  - a) assist the Ministry of Finance (MOF), Bank of Korea (BOK) and Economic Planning Board (EPB) in preparing and implementing an appropriate stabilization program. This activity should include the preparation of a report on the appropriate levels of the money supply and/or reserve base which would help slow inflation to target levels;
  - b) develop a ROKG program to provide incentives to the private sector to increase private domestic savings;
  - c) urge the ROKG to minimize its role in the allocation of credit and management of industries; and

- d) help formulate quantitative estimates of the effect on the general price level of minor and major changes in the exchange rate and the rice price.

## 2) International Trade and Balance of Payments -

- a) A direct-hire international trade economist will compile data on the ROK's foreign debt outstanding as of the end of CY 1969, projections for the next ten years of debt repayment obligations, and projections for the next ten years of sources of funds for repayments;
- b) from the data compiled under (a), ~~EXX~~ USAID advisors will help formulate various programs designed to enable EPB, MOF, and the Korean Exchange Bank (KXB) to manage its foreign debt more effectively so that repayment obligations can be met and the nation's continued economic growth enhanced;
- c) assist the ROKG in revising its tariff system and subsidy program for exporters in order to keep imports at manageable levels and to increase exports;
- d) advise the ROKG on the inter-relationship of the proposed interest equalization tax and foreign loans, and further assist the ROKG with the passage and implementation of the interest-equalization tax; and
- e) help the ROKG study the effects of devaluation, understand its importance, and devise a system to ease the impact of these necessary devaluations.

## 3. Capital and Money Markets

This important area will be assisted by two other technical assistance projects, the existing Improved Administration of Banking and Credit project, due to terminate at the end of FY 1970, and the proposed Private Enterprise Development Project, due to start in FY 1971. Thus, the only course of action required in the Economic Planning Project will be to help coordinate these activities within the overall framework of the U.S. - ROKG stabilization development programs.

#### 4) Financing of Defense

USAID will provide limited advisory services to assist the ROKG in finding alternative sources of financing once all US military budgetary support has terminated (scheduled for CY 1970). The Mission will advise the ROKG on the best means of effecting this change with a minimum of disruption to Korea's development.

#### 5) Statistical Services

USAID contract advisor(s) will continue to assist the ROKG, in particular the Economic Planning Board's Bureau of Statistics (BOS), to establish a new computer-based data handling system. USAID advisors and ROKG officials will also, where possible, utilize the computer facilities available at the AID-financed Korean Institute of Science and Technology (KIST) in Seoul.

#### 6) The Third Five-Year Plan (TFYP)

USAID's assistance to the ROKG in the formulation of the TFYP will consist of advisory services by the direct-hire staff and a larger consultant group, whose members will arrive in Korea at various times during the remaining life of this project. The latter group will be composed of development economists, financial advisors, an agricultural development expert, an industrial development specialist, an international trade economist, a manpower planning expert, and other planning specialists.

The above advisors will assist the ROKG, primarily EPB, to plan Korea's overall development during the next Five Year Plan. Their task will be to assist the ROKG in the formulation of the plan, to help make individual or sectoral goals consistent with the objectives of the entire plan, to identify potential obstacles to the successful implementation of the TFYP, and to help devise quantitative or other appropriate policies to handle such problems.

In addition to the above duties, USAID direct-hire advisors, as well as some contract specialists, will assist in fulfilling normal U.S. Mission economic reporting requirements because the Embassy Economic Section and USAID's Economic Planning Section have been merged into one unit.

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PROJECT AUTHORIZATION

1. PROJECT TITLE Economic Planning	3. COUNTRY KOREA	4. AUTHORIZATION NUMBER 0064
		5. AUTHORIZATION DATE 6/4/70
		6. PROP DATED

7. LIFE OF PROJECT

a. Number of Years of Funding: 9  
 Starting FY 19 63; Terminal FY 19 71

b. Estimated Duration of Physical Work  
 After Last Year of Funding (in Months): 24

FUNDING BY FISCAL YEAR (in U.S. \$ or \$ equivalent)	DOLLARS (\$000s)		P.L. 480 CCC + FREIGHT	LOCAL CURRENCY Exchange Rate: \$1 = ₩ 305			
	GRANT	LOAN		U.S. OWNED		HOST COUNTRY	
				GRANT	LOAN	JOINTLY PROGRAMMED	OTHER (\$000s equiv)
Prior through Actual FY 69	1,793						
Operational FY 70	324						
Budget FY 71	251						
B + 1 FY 70							
B + 2 FY							
B + 3 FY							
All Subsequent FY's							
<b>TOTAL</b>	<b>2,368</b>						

8. DESCRIBE SPECIAL FUNDING CONDITIONS OR RECOMMENDATIONS FOR IMPLEMENTATION, AND LIST KINDS AND QUANTITIES OF ANY P.L. 480 COMMODITIES

9. CONDITIONS OF APPROVAL OF PROJECT

6/2/70

(Use continuation sheet if necessary)

10. Approved in substance for the life of the project as described in the PROP, subject to the conditions cited in Block 10 above, and the availability of funds. Detailed planning with cooperating country and drafting of implementation documents is authorized.

This authorization is contingent upon timely completion of the self-help and other conditions listed in the PROP or attached thereto.

This authorization will be reviewed at such time as the objectives, scope and nature of the project and/or the magnitudes and schedules of any inputs or outputs deviate so significantly from the project as originally authorized as to warrant submission of a new or revised PROP.

A.I.D. APPROVAL	CLEARANCES	DATE
<i>[Signature]</i> SIGNATURE	EA/NEAP:CSbell, Jr. <i>[Signature]</i>	<i>[Date]</i>
<i>[Signature]</i> TITLE	EA/NEAP:CFShook <i>[Signature]</i>	<i>[Date]</i>
<i>[Signature]</i> DATE	A/CONT	