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**DEPARTMENT OF STATE
AGENCY FOR INTERNATIONAL DEVELOPMENT
Washington, D.C. 20523**

CAPITAL ASSISTANCE PAPER

**Proposal and Recommendations
For the Review of the
Development Loan Committee**

KOREA - AGRICULTURAL CREDIT LOAN

4890688

AID-ELC/P-967

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DEPARTMENT OF STATE
AGENCY FOR INTERNATIONAL DEVELOPMENT
Washington, D.C. 20523

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AID-DLC/P-967

May 21, 1971

MEMORANDUM FOR THE DEVELOPMENT LOAN COMMITTEE

SUBJECT: Korea - Agricultural Credit Loan

Attached for your review are the recommendations for authorization of a loan in an amount not to exceed \$14,000,000 to the Government of the Republic of Korea to finance the foreign exchange costs of commodity imports which will generate won local currency which in turn will be utilized to provide credit financing for (1) farmers wishing to buy farm equipment, and (2) upgrading agricultural commodity warehousing facilities.

This loan proposal is scheduled for consideration by the Development Loan Staff Committee at a meeting on Wednesday, May 26, 1971.

Rachel R. Agee
Secretary
Development Loan Committee

Attachments:

Summary and Recommendations
Project Analysis
ANNEXES I-IV

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KOREA - AGRICULTURAL CREDIT LOAN

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- I. Korean Economic Performance and Prospects
- II. ROKG Letter of Application
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NOTE: "Annex B", which is referred to at various points throughout the text of this paper contains basic analysis papers of the Korean Food Grain Sub-Sector, dealing with Supply and Demand, Farm Mechanization, Storage, and Fertilizer. Annex B is 266 pages and is not being distributed with the Capital Assistance Paper. Copies may be obtained upon request from the Office of Capital Development and Finance, East Asia Bureau, A.I.D. (Ext. 29048).

LIST OF ABBREVIATIONS AND TERMS

AERI	Agricultural Economic Research Institute
EPB	Economic Planning Board
EUP	Town
GUN	County
MAF	Ministry of Agriculture and Forestry
MT	Metric ton
NACF	National Agricultural Cooperative Federation
Ri-dong	Village
RY	Rice year
SFYP	Second Five Year Plan
TFYP	Third Five Year Plan

UNITS OF MEASURE

Hectare	2.471 acres
Metric ton	2204.623 pounds, avoirdupois
Kilometer	0.621 mile
Tanbo	0.099174 hectare or 9.9174 are
Chongbo	0.99174 hectare or 10 tanbo
Are	1 square meter, 0.0001 hectare, 0.10083 tanbo, or 0.01008 chongbo
Pyong	3.3058 square meters or 35.56 square feet
U.S. dollar	315 won (unless otherwise indicated)

SUMMARY AND RECOMMENDATION

1. Borrower: The Government of the Republic of Korea (ROKG).
Implementing Agencies: The Ministry of Agriculture and Forestry (MAF); The National Agricultural Cooperative Federation (NACF).
2. Amount: Not to exceed \$14 million.
3. Terms: Principal to be repaid over a period of 40 years, including a 10-year grace period; interest to be repaid semi-annually, beginning six months after the first disbursement under the loan, at the rate of 2% per annum during the grace period and 3% per annum thereafter.
4. Description of Activity to be Financed: Proceeds of the loan will be used to finance the procurement of U.S. commodities (and related services) which generate an equivalent amount of local currency (won) for agricultural credit. Credit will be provided to farmers and farm cooperatives to finance (a) domestically-produced small-scale farm equipment, and (b) improved storage facilities.
5. Purpose: The purpose of this loan is two-fold: (a) provision of agricultural credit, thereby increasing food production, and (b) Balance-of-Payments assistance to the ROKG.
6. Estimated Cost of Activity: \$14 million.
7. Other Sources of Financing: Financing, on comparable terms, for these purposes is not known to be available from other free-world sources (see Section I.B.).
8. Statutory Criteria: All statutory criteria have been met (see Annex III).
9. Mission Views: The Mission supports this activity and recommends approval of this loan.
10. Issues: There are no issues presented by this loan proposal.
11. Recommendation: Authorization of a loan in an amount not to exceed \$14 million to the ROKG in accordance with the terms and conditions stated in the draft loan authorization (Annex IV).

Loan Committee

USAID/Korea:

Chairman: Thomas F. Olmstead, Assistant Director for
Economic Affairs, and Staff

Athos G. Revelle, Assistant Director for Program
Implementation, and Staff

Francis Jones, Chief, Rural Development Division, and Staff

Thomas E. Johnson, Chief, Development Loan Division

Theodore B. Carter, Regional Legal Advisor

J. Henry Weigel, Private Enterprise Advisor

AID/Washington:

Loan Officer: Richard B. Perry, EA/CDF

Agricultural Development Advisor: Francis J. LeBeau, EA/TECH

Country Desk: Chester Bell & Priscilla Boughton, EA/NEAP

Legal Counsel: Charles W. T. Stephenson, GC/EA

Economic Advisor: Harold Shafron, EA/DP

Drafted by: Members of the Committee

I. The Proposed Loan: Purpose and Background

A. Purpose

The purpose of this loan is two-fold: (1) the provision of agricultural credit, which will contribute to an increase in food production, and (2) Balance-of-Payments (BOP) assistance.

Credit, in the amount of \$14 million equivalent, will be provided to Korean farmers and farm cooperatives to finance (1) farm mechanization, and (2) improved storage facilities. Insufficient credit for these agricultural inputs has been identified as a major obstacle to increased food grain production. Administration of the credit program will be carried out by the National Agricultural Cooperative Federation (NACF), an institution of considerable importance to the Korean farmer. NACF is the major source of institutional rural credit, the sole supplier of fertilizer and a major supplier of other farming needs. The organization of NACF and its capacity to implement this credit program are discussed in Part III of this paper.

Inasmuch as the entire \$14 million in credit needs represent local currency costs, the method of generating the required currency accomplishes the other purpose of the loan, i.e., BOP assistance to the Republic of Korea Government (ROKG) through the financing of basic import requirements. The ROKG is making progress in reducing the BOP deficit;^{1/} the trade gap, for example, is projected to decline from \$860 million in 1970 to \$306 million in 1974. However, near-term demands on Korea's foreign exchange resources are considerable, and foreign capital requirements will continue at a fairly high level through the next several years (estimated to be \$590 million in 1974). In sum, it is concluded that BOP assistance to Korea is fully justified. This topic is discussed more thoroughly in Part IV of this paper.

B. Background and General Rationale

During the past year there has been considerable study of the agricultural sector. In cooperation with the Ministry of Agriculture (MAF), this work has been reviewed by the Mission in a series of studies undertaken either jointly or separately. The purpose of this effort was to identify those areas where a greater impact could be made by AID capital assistance inputs. Because of the importance of the grain sub-sector, it was decided to concentrate in that area. Further examination led to focus on six specific problem areas: price policy, genetic improvement, mechanization,

^{1/} A general review of Korea's recent economic performance appears as Annex I.

storage, fertilizer use, and transportation. After additional review, three of these were excluded from consideration under this loan: price policy, because of the complexity and the myriad of domestic political considerations which need to be settled by the ROKG; varietal improvement, because the government program in the development of new rice strains is well advanced and further varietal research is being considered by the United Nations; transportation, because the planning and development of the rural road network will take many more months to complete and coordinate. The three areas selected, after this elimination process, were mechanization, storage and fertilizer use, all of which share a common problem in the lack of credit to finance their optimum utilization by Korean farmers. Accordingly, in its Letter of Application for this loan, the ROKG specifically requested that credit be made available for these three purposes (see Annex II).

Further discussions - subsequent to the ROKG's Letter of Application - have led to agreement between the Mission and MAF that local currency proceeds of the loan be used entirely to finance mechanization and storage facilities; \$8 million equivalent will be allocated to mechanization, and \$6 million to storage. However, we plan to provide for flexibility in amounts utilized between these two purposes, subject to A.I.D.'s approval.

Although credit for fertilizer will not be provided under this loan, the Mission feels that increasing the use of fertilizer is quite important to Korean agriculture. Accordingly, as a self-help measure, the ROKG will take steps designed to raise the level of fertilizer usage (see Annex IV, Part 5.b).

Financing for this type of agricultural credit on comparable terms is not known to be available from other free-world sources at this time. Neither the IBRD nor the Export-Import Bank of the U.S. is interested in financing this particular activity. However, the IBRD has under preliminary consideration a \$10 million program of agricultural credit in Korea for such purposes as orchard and sericulture development, and production of swine and poultry; credit for mechanization is also being considered. The IBRD is fully apprised of A.I.D.'s proposed loan, and does not feel that any conflict exists in the area of mechanization. The type of equipment which the IBRD may be willing to finance remains to be identified, and, in any event, the loan will not go forward until about March, 1972.

Korea is also obtaining \$15 million (\$10 million in 1971; \$5 million in 1972) in Japanese export credits for industrial raw materials, textiles and textile equipment; the local currency generated will go into agricultural credit, but the specific uses have not been decided. Terms of this financing are: 13 years including a 3-year grace period, interest at 6½ percent. An additional \$5 million in financing for agriculture, fisheries and dairy equipment will also be provided by Japan.

II. Korea's Third Five-Year Plan and this Loan

The insufficiency of credit for agricultural purposes in recent years is partially a result of the ROKG's emphasis, under the SFYP, on investment in industrial development in order to increase national income. Now that substantial progress has been made in that direction, the ROKG will give increased priority to the agricultural sector under the TFYP (1972-1976). The Final version of the TFYP will not be released until the summer of 1971. However, a preliminary version has been made available, the agricultural sector highlights of which are indicated below.

The Plan has a "Basic Direction" which makes exports, the rural sector, and heavy and chemical industries the major priorities. An annual average GNP growth rate of 8.6% is projected, and the commodity trade gap is to be reduced from \$1.0 billion in 1969 to \$170 million in 1976. A total investment of 3,896.9 billion won is called for, 80.2% of which is to be supplied domestically, and the remaining 19.8% from foreign sources. Under the SFYP, 36.4% of the total investment requirement came from foreign sources.

With respect to the agriculture sector, the Plan has two broad goals: (1) attaining self-sufficiency in rice and increasing income^{1/} by increasing production of food grains and pursuing programs of land rearrangement and farm mechanization; (2) improving health and cultural facilities and expanding electrification and road networks to farm and fishing communities

In order to meet these goals, specific targets have been set, among which the following are directly or indirectly related to this loan:

- (1) Self-sufficiency in Rice: output will be increased by 17.3% from 4,090,000 MT in 1969 to 4,797,000 MT in 1976;
- (2) Use of IR-667: the new rice seed, IR-667 will be planted on 300,000 hectares, starting in 1972;
- (3) Increase in Fertilizer Use: fertilizer use will be increased from 150 kg. per hectare in 1969 to 220 kg. per hectare in 1976.
- (4) Acceleration of Farm Mechanization: the production capacity of farm machinery plants will be expanded, and land under mechanized cultivation will be increased to 450,000 hectares.

^{1/} Average farm household income is projected to increase from W218,000 per year in 1969 to W482,000 per year (1969 prices) in 1976.

The priority being given the agriculture sector in the TFYP is indicated by the large increase in its share of gross investment from 8.4% under the SFYP to 12.6%, or W480.5 billion for fisheries. Table I shows the total planned investment in major project sub-sectors, and compares the central government's share of that investment with the amounts invested and to be invested during the SFYP.

In addition to that shown in Table I are plans for rural electrification, water supply improvement, communications and building improvements, which call for central government investments at levels six times the amounts so invested during the SFYP.

Credit will be a significant factor of investment during the TFYP. In the Agriculture Sector, the central government's share of the total investment target is W335 billion, 46% of which (i.e. W154 billion) is estimated to be in the form of credit. It must be remembered that the foregoing represent investment targets, not firm availabilities of funds. Although a breakdown of the "credit sub-sector" and identification of funding sources is still being developed by the ROKG, the overall dimensions of agricultural credit insufficiency are indicated in Table 2, prepared by the Mission. The agriculture sector's "GNP" has been projected through the end of the TFYP. Based on historical trends and percentage relationships between the sector GNP, total agricultural credit outstanding and agricultural credit from institutional sources, a credit gap has been estimated and projected through the end of the TFYP. Although the proposed input of \$14 million equivalent is not overly impressive in terms of closing the credit gap, a definite impact will be made, particularly when viewed within the framework of the specific credit needs for mechanization and storage.^{1/} Further, the proposed loan, when combined with other planned inputs to the sector - which were outlined in Part I.B. - constitutes a significant contribution to Korea's overall needs for agricultural credit.

Korean self-sufficiency in the grain sector and agricultural credit to support that sector have been identified in World Bank studies as priority areas for external and domestic financing. This is further highlighted by the fact that the World Bank is also considering loans for agricultural credit in Korea, including possible assistance in the field of farm mechanization (as noted above)

^{1/}=See Part III.B

TABLE I

Investment Targets - Major Agricultural Sub-Sectors

Third Five Year Plan

1972-1976

	(W. billion)		Actual Govt. Investment SFYP	% Increase Govt. Share
	Third Five Year Plan Total Planned Investment	Central Govt. Share		
Supply of New Rice Strains	9,179	9,179	1,323	693
Paddy Rearrangement	45,374	13,612	2,213	615
Irrigation	15,026	11,223	33,777	33
Large Estates Development	41,657	40,252	3,218	1,250
Farm Mechanization	31,972	21,111	2,745	769
Extension & Guidance	18,128	13,424	7,955	169
Livestock	35,396	24,288	7,966	305
Forestation & Erosion Control	22,229	15,000	12,599	127
Fishing Boats	64,069	11,265	8,245	137
Production Facilities	<u>6,089</u>	<u>4,626</u>	<u>3,503</u>	<u>132</u>
Total	288,119	164,931	83,544	197

TABLE 2

AGRICULTURE SECTOR INSTITUTIONAL AND NON-INSTITUTIONAL
CREDIT AND CREDIT GAP 1971-76

Billion won

Year	Agri. GNP ^{1/} A	Institu tional credit as % of GNP ^{2/} (NACF) B	Institu tional credit out- standing (A x B) C	Institu tional credit as % of total agri. credit ^{3/} D	Estimated total agri. credit (C ÷ D) E	Credit gap (E - C) F	Gap in U.S. dollars G
1970 ^{a/}	600.4	12.4	70.2	30	234.0	163.8	50.4
1971	627.6	12.9	81.1	31	261.2	180.1	55.4
1972	660.8	13.5	88.5	32	276.7	188.2	57.9
1973	690.5	13.9	96.0	33	290.8	194.8	59.9
1974	721.6	14.4	103.9	34	305.6	201.7	62.1
1975	754.0	14.9	112.3	35	321.0	208.7	64.2
1976	788.0	15.4	121.4	36	337.1	215.7	66.4

^{a/} Preliminary.

^{1/} 1969 prices. 1971 estimate assumes 4.5% growth equal to growth planned during TFYP.

^{2/} Assumes historical trend continues, estimated at conservative rate of 0.5% increase annually.

^{3/} Trend during 1964-70 estimated to continue at 1% annually.

III. Loan Justification: Agricultural Credit

A. Agricultural Credit in Korea

1. The National Agricultural Cooperatives Federation (NACF)

a. Description and Activities

The NACF has been carrying out various programs of rural banking, credit and marketing since 1961 when it was organized by the merging of two agencies which had for many years been separately responsible for cooperative marketing and agricultural credit. It is a very large organization made up of a central office, administrative offices in each of the nine provinces, and affiliated member cooperatives (an organization chart appears as Figure 1). NACF has approximately 2.2 million members, 93 percent of all Korean farmers.

NACF is the major institutional source of rural credit and a major provider of life and casualty insurance in the rural areas. According to recent estimates, NACF handles two-thirds of all farm supplies and approximately 28 percent of farm products entering commercial markets. The programs of NACF are coordinated with those of the MAF's water and land development agency, the extension service of the MAF and the special development projects of the ROKG. Government and other funds are loaned through the NACF to local land improvement associations and to farmers participating in the special livestock, horticulture, sericulture, mechanization and other programs of agricultural development. General supervision is received from MAF and the Ministry of Finance for those programs in which the Government has a direct investment.

A major reorganization of NACF is underway to reduce the number of village level cooperatives which were carrying out only limited functions. In 1962, there were nearly 20,000 small cooperatives. A merger program was started in 1965 and the target is to have 1,500 myon (township) sized cooperatives by the end of 1974. These cooperatives will be the smallest units within the structure. The next level is the gun (county) cooperative, made up of several village or myon cooperatives. The gun cooperatives and the special purpose horticulture and livestock cooperatives are federated and form the national organization.

In a recent study of Korea's agriculture sector, the IBRD pointed out the need to strengthen the cooperative system by consolidating small cooperatives into larger more efficient units. One requirement of such a consolidation program is adequate storage facilities at the township level, which will be the basic "working level" unit of the system, especially in terms of crop storage and marketing. The improved storage facilities financed by this loan, therefore, will contribute to the strengthening of the cooperative system.

b. Capacity to Implement the Program

The scale of NACF's total business activity indicates its capability to administer sub-loans financed by this proposed loan. Its major

business activities in 1969 were: agricultural loans granted, \$188 million; sales of farm inputs, \$114 million (\$6.5 million in farm implements); marketing of farm products, \$90 million. The sub-lending proposed herein represents an acceleration of on-going activities, and it is well within the administrative capability of NACF to execute this as well as the other aspects of their operations. Table a shows the value and percentage growth of NACF business activities.

2. The Rural Credit Picture

The 1964 Rural Credit Survey

A nation-wide credit survey conducted in 1964 indicated that over ninety percent of all farm households use borrowed money or commodities and that three-fourths of the borrowings came from private sources, usually from within the immediate rural area; half of the credit was from other farmers, friends, and relatives. About two-thirds of this debt is in kind--rice, barley, and other products. In the aggregate, the amount of local credit is substantial but its use--57.6 percent for consumption expense, 23.7 percent for farm operating expenses and 18.7 percent for capital expenses--and the terms and the scale of loans indicate that it is not a very good credit system for agricultural development. The total amount borrowed per family was about 20,360 won (in 1965 prices) with only about 3,800 won being used for capital expenditures. At the 1965 exchange rate of 270 won to the U.S. dollar, capital expenditures from borrowed funds were only about \$14 for the average farmer. The rate of interest on the private loans was estimated at about 60 percent per annum, with a wide range of rates depending upon source of credit and the relationship between creditors and debtors.^{1/} As one would expect with these interest rates, the private loans were usually for less than one year and thus not well adapted to most capital investments needed in agriculture.

In 1964, institutional credit was about 25 percent of the total, most of which was supplied by NACF. Its short-term production loans were at interest rates of 10 to 15 percent depending on the source of funds; some long-term irrigation loans were made at 3.5 percent. Three-fourths of the credit program was for short-term credit, and some twenty two percent of the production credit was diverted to finance consumption by the borrowers.

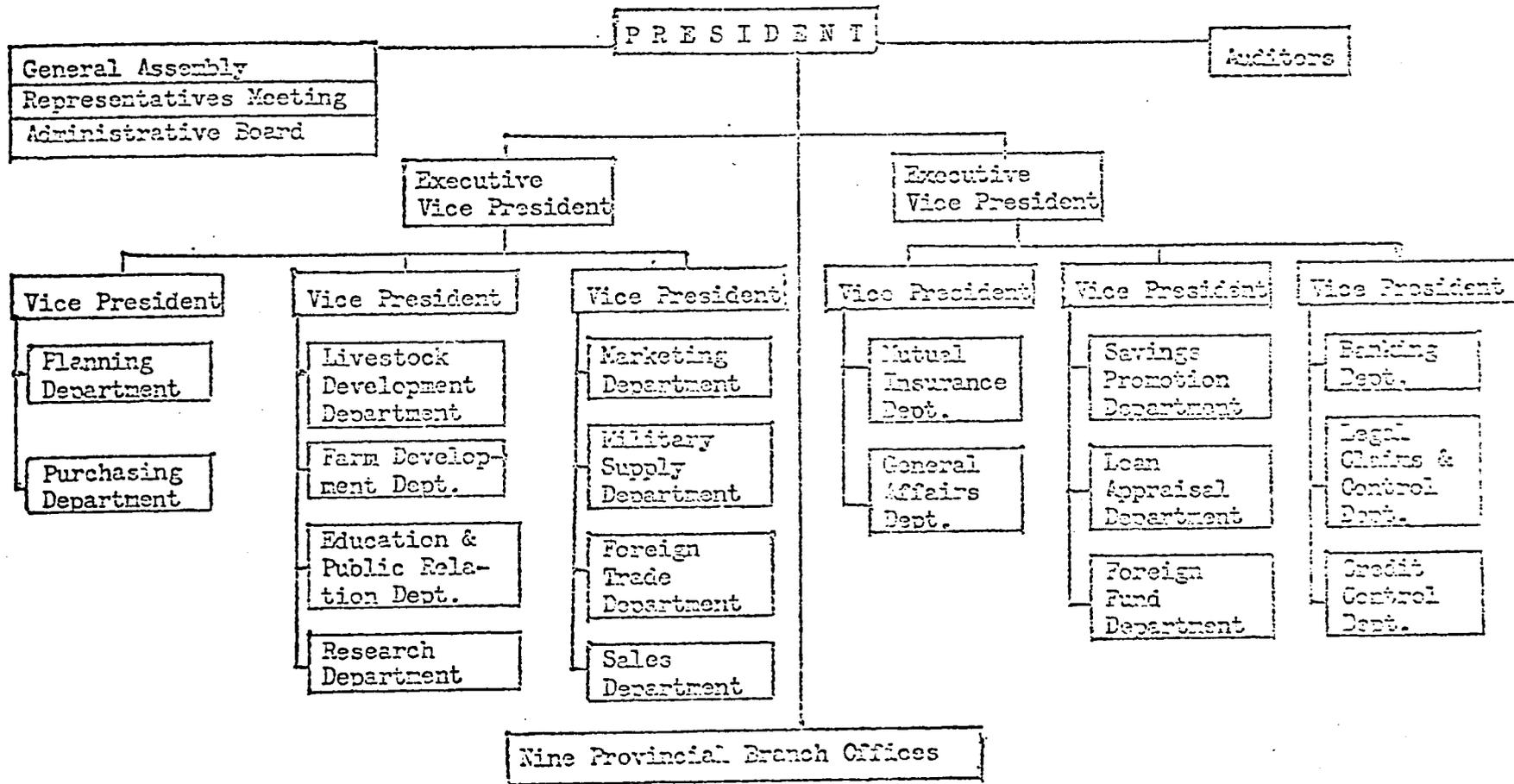
In 1964, the farmers who indicated a need for agricultural credit--about 2/3 of all farmers--estimated credit needs of 5,550 won for short-term credit and 14,480 won for intermediate or long-term credit. These amounts were approximately equal to their total actual borrowing, which were used, however, primarily for priority consumption needs.^{2/} While estimates are not made as to how much production would have increased had adequate credit been available it seems clear that a serious credit bottleneck existed.

^{1/} Rural Credit Survey in Korea, National Agricultural Cooperative Federation Research Dept., Seoul, Korea 1965, pp. 61, 70, 184.

^{2/} Ibid., pp. 169, 186, 132-158.

FIGURE 1

NACF ORGANIZATIONAL CHART



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TABLE 2a
VALUE AND PERCENTAGE GROWTH OF NACF BUSINESS ACTIVITIES^{1/}

Million won

Item	1965		1966		1967		1968		1969		1970	
	Value	Value	Percent change									
Sales of farm chemicals (other than fertilizer)	781	750	-4	818	9	1,282	57	2,539	98	2,327	-8	
Sales of farm implements	205	145	-29	539	272	604	12	1,023	102	900	-26	
Feed	150	32	-79	64	100	410	541	619	51	176	-72	
Seed and livestock	527	836	59	964	15	924	-4	1,266	37	780	-38	
Sales through marketing centers	8,768	12,278	40	14,202	16	17,701	25	36,876	108	32,850	-11	
Sales to military forces	791	295	-	820	3	729	-11	806	11	1,375	71	
Sales through handicraft centers	97	84	-13	28	-67	26	-7	34	31	18	-47	
Mutual insurance	191	735	285	1,512	106	2,357	56	3,671	56	4,978	36	
Deposits	10,641	18,670	75	21,869	17	30,728	41	45,260	47	50,246	11	
Loans	22,500	26,355	17	39,797	51	64,346	62	90,624	41	97,246	7	

^{1/} 1965 constant prices.

Source: NACF.

The Supply of Credit Since 1964

Since 1964, the volume of credit received by the agriculture sector has increased both absolutely and relatively (Table 3). Total bank loans increased 364.6 percent, from 19.5 billion to 90.6 billion won. Loans to the sector also have become larger relative to GNP originating in the agriculture sector, rising from 6.2 percent in 1965 to 12.4 percent in 1970, indicating that farmers are financing a larger share of their production through credit from banking institutions.

While NACF is the major lender to farm borrowers and has increased its loans 266 percent since 1965, other lenders have begun to supply agriculture sector credit in significant quantities. NACF's share of total institutional loans made for agriculture fell from about 100 percent in 1965 to 90 percent in 1970. The central Federation of Fisheries Cooperatives and member cooperatives were the only other major lenders whose total loans, including non-agricultural loans, increased (from 1.6 billion in 1965 to 13.0 billion won in 1969). The Korea Development Bank also has made a few loans for agricultural purposes.

Another new development is NACF's entry into non-agricultural lending. Table 4 shows that 84.8 percent of NACF's loans outstanding were to agricultural borrowers in 1965, whereas only 77.7 percent of its loans were for agricultural purposes in 1970. Total loans by NACF in 1970 were 4.7 times the level in 1965, while agricultural loans were only 3.6 times the 1965 level.

TABLE 3

AGRICULTURE OUTPUT AND OUTSTANDING BANK LOANS
TO AGRICULTURE SECTOR

Year	Billion won								
	Agri- culture sector GNP (A)	Total bank credit (B) a/	Million U. S. dollars (C)	Per- cent (B/A) (C)	Index (D)	Total NACF credit (E)	Per- cent (E/A) (F)	Index (G)	E/B (H)
1965	311.6	19.5	72.0	6.2	100	19.7	6.3	100	101
1966	372.3	23.0	85.2	6.2	117.9	22.7	6.1	115.2	99
1967	395.5	29.3	106.9	7.4	150.3	27.5	7.0	139.6	94
1968	454.5	43.2	153.7	9.5	221.5	41.5	9.1	210.2	96
1969	588.8	69.1	239.9	11.7	354.4	65.4	11.1	331.5	95

Note: Current market prices. The Agriculture sector includes fisheries.

a/ Figures from BOK monthly statistics include NACF but exclude certain types of NACF loans under business operation fund and foreign aid warehouse funds.

b/ October

c/ December.

Excludes loans for business operation, foreign aid warehouse and general loans.

p/ Preliminary

Source: NACF, and BOK, Monthly Economic Statistics.

TABLE 4
NACF LOANS OUTSTANDING BY INDUSTRY 1965-70^{a/}

Year	Total		Agriculture (A)		Forestry (B)		Fishery (C)		Sub-total (A + B + C)		Million won Manufacturing and Other	
	Value	Per- cent	Value	Per- cent	Value	Per- cent	Value	Per- cent	Value	Per- cent	Value	Per- cent
1965	23,259	100	18,896	81.2	290	1.3	525	2.3	19,711	84.8	3,548	15.2
1966	27,107	100	21,216	78.3	737	2.7	774	2.9	22,727	83.9	4,380	16.1
1967	34,376	100	24,851	72.3	1,358	4.0	1,347	3.9	27,556	80.2	6,820	19.8
1968	52,814	100	38,791	73.5	830	1.6	1,919	3.6	41,540	78.7	11,274	21.3
1969	84,413	100	59,626	70.6	1,086	1.3	4,580	5.4	65,292	77.3	19,121	22.7
1970 ^{b/}	105,361	100	75,627	71.8	1,561	1.5	4,634	4.4	81,822	77.7	23,539	22.3

Note: Current market prices.

^{a/} Includes NACF and city and gun cooperatives.
^{b/} End of December.

Source: NACF.

TABLE 5
PERCENT INCREASE IN NACF LOANS OUTSTANDING
BY INDUSTRY 1965-70

Year	Agri- culture	Forestry	Fishery	Sub- Total	Manu- facturing	Total Loans
1966	13.3	350.8	-11.3	13.5	46.6	16.6
1967	17.3	103.6	110.1	19.8	80.5	25.6
1968	43.8	-15.4	63.1	46.2	105.8	53.6
1969	49.9	17.6	24.5	48.8	97.9	59.6
1970	24.7	39.7	68.1	26.1	37.0	29.1

Source: Table 4

In spite of a large absolute rise in the amount of credit available to agricultural borrowers and an increase in the ratio of farm credit to agricultural GNP, agricultural loans became a smaller and smaller share of total outstanding credit in 1965-70, declining to only 14.2 percent in October 1970 (Table 6). This was because manufacturing and construction industries, particularly, received an increasing share of all credit along with the transportation, electricity, and services industries.

TABLE 6

LOANS AND DISCOUNTS OUTSTANDING OF BANKING INSTITUTIONS, BY INDUSTRY 1965-70

Year	Million won													
	Agriculture		Forestry		Mining & Quarrying		Manufacturing		Commerce		Other		All Industry	
	Value	%	Value	%	Value	%	Value	%	Value	%	Value	%	Value	%
1965	19,478	29.1	1,093	1.6	28,841	43.0	12,147	18.1	5,489	8.2	67,048	100.0		
1966	22,989	24.0	1,790	1.9	44,369	46.4	16,903	17.7	9,550	10.0	95,601	100.0		
1967	29,314	18.1	4,263	2.6	80,006	49.3	29,362	18.1	19,254	11.9	162,199	100.0		
1968	43,180	26.6	8,347	2.8	137,901	47.3	49,736	17.1	52,440	18.0	291,604	100.0		
1969	69,130	13.6	10,587	2.1	238,814	47.1	97,104	19.2	91,269	18.0	506,904	100.0		
1970 ^{a/}	90,643	14.2	12,112	1.9	302,455	47.5	118,632	18.6	112,842	17.7	636,685	100.0		

^{a/} OctoberSource: BOK, Monthly Economic Statistics.

Although the proportion of production costs which farmers pay in cash has increased, the absolute gap between credit needs and available financing may be as great or greater in 1971 than it was in 1964. The findings of the 1964 survey relative to sources of credit, terms, and uses probably are still valid for 1970. Table 7 and Figure 2 present a more detailed picture of the expansion and subsequent construction of rural credit granted by NACF. Loans granted include new loans and extensions of old loans. Figure 2 shows the lack of significant expansion of agricultural credit in 1970 and the contraction which may take place in 1971. This situation is due to the restriction on borrowings allowed under the monetary stabilization programs of the government and difficulty of generating loanable funds from internal sources.

The NACF has estimated that if sufficient loanable funds had been available in 1970 it could have made sound loans in the amounts and in the categories presented in Table 8.

TABLE 7

LOANS GRANTED BY NACF AND PLAN FOR 1971

	Million won in 1965 Constant Prices						
	1965	1966	1967	1968	1969	Est. 1970	Plan 1971
1. <u>Long-term loan</u> for irrigation (35-40 years, 3.5%)	<u>3,828</u>	<u>1,112</u>	<u>1,509</u>	<u>1,448</u>	<u>3,906</u>	<u>1,904</u>	<u>1,878</u>
2. <u>Medium-term</u> (1-10 years, 9% interest)	<u>1,643</u>	<u>1,617</u>	<u>1,676</u>	<u>4,655</u>	<u>8,673</u>	<u>6,930</u>	<u>4,366</u>
(a) Special income enhancement projects.	-	-	-	972	4,606	3,797	2,757
(b) Cultivation, financing, food increased prod., tractors, sprayers & dusters, reclamation, pumping facilities and paddy rearrangement.	1,356	945	1,473	1,548	1,941	1,190	740
(c) Sericulture, financing silkworm house and mulberry field creation.	33	186	-	259	221	375	203
(d) Livestock, barns and pasture development.	208	413	124	712	1,009	874	246
(e) Industrial crops, financing facilities for mushroom culturing house, ginseng production, tobacco leaf drying.	1	15	-	-	80	207	278
(f) Disaster restoration, facilities as emergency measures.	-	-	-	1,051	686	285	-
(g) Rural sidelines, facilities to finance rural sidelines income projects.	-	-	-	-	-	46	-
(h) Forestry, financing reforestation and tree nurseries.	4	1	28	62	60	131	142
(i) Roof improvement	41	57	51	51	70	25	-
3. <u>Short-term</u> (1 year max. 11-24% interest, 20-200,000 won depending on fund sources)	<u>11,035</u>	<u>11,524</u>	<u>15,760</u>	<u>16,704</u>	<u>17,525</u>	<u>13,320</u>	<u>10,933</u>
(a) Farm operation fertilizer, chemicals, hand tools, wages and feed	4,842	3,471	4,024	4,345	7,074	3,926	5,888
(b) Commercial farming-fert., chem., storage, processing, marketing and transport.	-	554	1,439	3,495	2,780	5,628	3,393
(c) Rural agencies, financing operational funds for irrigation, nurseries, silkworm and seedlings.	4,219	5,748	9,046	8,162	7,591	3,766	1,652
(d) Rice lien, loans on stored rice.	1,974	1,751	1,251	702	80	-	-

1/ End of December 1970.

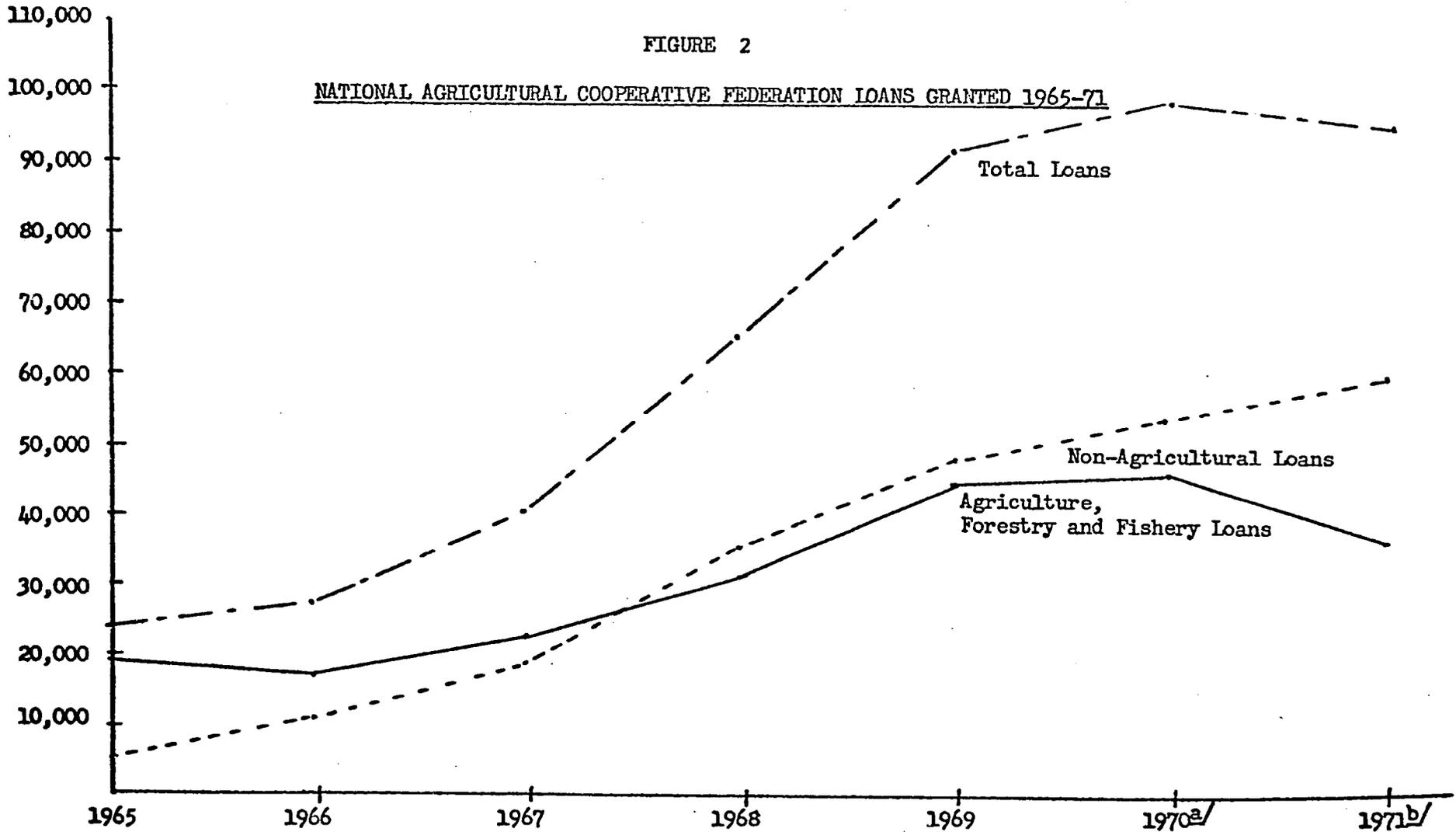
TABLE 7 (Cont'd)

	Million won in 1965 Constant Prices						
	1965	1966	1967	1968	1969	Est. 1970	Plan 1971
4. <u>Cooperatives-Fostering</u> (1-5 years, 9-15% interest)	636	799	662	1,056	1,123	1,748	1,430
(a) Ri/Dong cooperatives, financing operations and facilities.	283	330	276	359	716	1,192	-
(b) Special cooperatives, financing operations and facilities.	353	469	386	697	407	556	-
5. <u>Marketing Loans</u> (1 year max., 9% interest)	-	-	299	398	2,429	1,485	1,742
(a) Collection of agricultural products, financing collection of agr. products for storage and processing.	-	-	-	56	1,235	980	1,661
(b) Feed, financing feed supplies to millers.	-	-	299	342	1,194	505	81
6. <u>Export Financing</u> (6 months max. 6% interest)	-	-	-	-	1,763	11,850	14,765
(a) Export preparation, financing funds for collection of agr. prod. for export.	-	-	-	-	1,460	6,475	6,112
(b) Letter of Credit, loan financing exports.	-	-	-	-	303	5,375	8,653
7. <u>Fisheries</u> (1-5 years 9% interest), loans to fishermen, bait, gear, small boats.	1,113	1,273	1,685	5,810	8,243	8,200	45
8. <u>Sub-total</u> (Agriculture, forestry, and fishery).	18,255	16,325	21,591	30,071	43,662	45,437	35,159
9. <u>Commercial Loans</u> (1 year max., 24% interest, non-agri.), savings promotion.	4,245	10,030	18,056	34,275	46,953	52,809	58,713
10. <u>GRAND TOTAL</u>	22,500	26,355	39,647	64,346	90,615	98,246	93,872

1/ End of December 1970.

Source: NACF, Credit Planning Section.

(Million won)



Note: Figures include refinanced Loans.

a/ End of Dec. 1970. b/ Planned.

Source: Table 7, 1965 constant prices.

TABLE 8

ESTIMATED DEMAND FOR NACF AGRICULTURAL CREDIT IN 1970

Million won in 1965 prices

<u>Short-term</u>		<u>Medium/Long-term</u>		<u>Medium/Long-term</u>	
<u>Farming Operational Loans</u>		<u>Production Facility Loans</u>		<u>Warehouse/storage Loan</u>	
Seeds & seedlings	1.477	Land reclamation & improvement	4.001	Food grain	.396
Livestock	1.334	Irrigation	.509	Horticultural crops	.016
Fertilizer	12.718	Pumps	.275	Special crops	.002
Agr. chemicals	2.784	Seeds & livestock	5.760	Fruits	.206
Feed	4.748	Barns/sheds etc. (prod. facility)	2.724	Livestock	.013
Irrigation	.825	Attachments to buildings	1.909	Forestry	.005
Wages	16.763	Warehouses (farm)	.245		
Small farm implements	3.093	Sprayers	.493	Sub-total	.640
Others	2.435	Tiller	.918		
Sub-Total	46.182	Processing facility	.097		
		Rural roof improvement	.286	<u>Processing facilities</u>	
		Management expenses	1.520	Food grains	.372
		Others	.445	Horticultural crops	.007
		Sub-Total	19.182	Special crops	.046
				Livestock	.105
<u>Marketing Loan</u>				Fruits	.004
Food grain	4.516			Silkworm raising	.108
Horticultural crops	.134			Forestry	-
Special crops	.094			Sub-Total	.642
Fruits	.184				
Livestock	1.254			Grand Total	72.931
Sericulture (silkworm raising)					
Forestry	.003				
Sub-total	6.185				

Credit available in 1970: 44,000

Source: NACF, Credit Planning Section.

Even if one were to conclude that the demand for credit in 1970 was somewhat less than estimated or the soundness of the loans questionable, the fact that the total estimated demand exceeded the available institutional supply of funds by over 60 percent suggests a definite credit shortage in agriculture. Of course, it is not surprising that demand for NACF credit exceeds the supply when NACF provides less than one-third of all farm credit at rates far below the rates of other lenders. An indication of the credit shortage is the expectation that NACF may not be able to continue in 1971 its average rate of expansion of agricultural credit, which has been increasing annually at about 50 percent of the 1965 level.

If one assumes curb (free market) interest rates for short-term loans--the only kind readily available--which are about 60 percent per year, it is unlikely that much is being invested in capital equipment or land improvement from loans from private lenders. With thirty percent of farm credit from NACF at 15 percent interest, and seventy percent of farm credit at 60 percent interest, the weighted average of 46 percent is higher than bank rates, and capital might be expected to flow to agriculture. This does not happen, partially because the 60 percent interest paid is not the net return to lenders, who have considerable losses from high risk without security, as well as the expenses of making and collecting many small loans, much of which is for consumption purposes. Furthermore, urban curb rates are reputed to be equally high and the loans probably less risky. Because non-farm income is about 70 percent of national income, most loanable funds are generated in the non-agricultural sector and because interest rates are high there also, these funds tend to remain in the urban sector. The government's push for economic development in industry with its supporting monetary policy also has contributed to the current credit shortage in agriculture.

The rapid expansion of the money supply in 1968 and 1969 forced a subsequent monetary stabilization program in which agricultural credit, among others, was curtailed. NACF's problems in borrowing from Bank of Korea and in getting government appropriations are further complicated by the large deficit in the fertilizer account which results from circumstances beyond its control. Borrowing for the fertilizer account must be within the NACF's total borrowing ceiling and NACF's other loans are reduced by the deficit in the fertilizer account.

In order to generate loan funds for farmers and the rural community, NACF has engaged in a nation-wide program of commercial banking. This program has resulted in considerable sums of money being placed on deposit and some funds deposited by non-farmers are being used for agricultural loans. But, given normal reserve requirements and the necessity to make commercial loans to the non-agricultural depositors in order to keep these accounts, the net flow into agriculture, while significant, has not generated the financing required by a developing agriculture. The trends in non-farm deposits and loans are illustrative of the relative ease in securing self-generated capital for the non-agricultural sector.

The Creditworthiness of Farmers

Contrary to popular belief, the overdue loan record of the farm sector in October 1970 was better than for any other major industry. Only 7.7 percent of the value of all farm sector loans were overdue while the average for all industry was 11.6 percent. The poorest record was in the mining and quarrying industry where 25.5 percent of the value of all loans were overdue. However, 35.2 percent of the number of agricultural loan accounts were overdue, implying that a large part of the small agricultural loans were in default. The number and value of farm loan accounts which are not paid on time fluctuates annually with the yield of the rice harvest. In a moderately good crop year, such as 1970, most loans are repaid promptly.

B. The Need for Agricultural Credit

1. Farm Mechanization

The farm mechanization process commenced only recently in Korea and, as a result, large farm equipment, such as four-wheel tractors and combines, are virtually unknown. At the end of 1968, only 108 four-wheel tractors were in use. However, there has been, particularly in the last four years, a significant increase in the numbers of small power equipment in use on farms. Even the percentage increase in the number of power tillers has been large - above 40 percent each year since 1962 (Table 9). Nevertheless, the absolute level of mechanization is still low with only 12,882 tillers in use in 1970, an average of one tiller for each 194 farm households. The use of power water pumps and power sprayers and dusters is considerably more widespread but there is still only one water pump per 43 farm households. Korea, for example, had only one percent as many tractors and tillers per 1,000 farm households in 1970 as Japan had in 1967. The ratio for other farm power equipment is similar.

TABLE 9
QUANTITY OF POWER EQUIPMENT ON FARMS 1960-70

Year	Power Tillers		Power Sprayers and Dusters		Power Thrashers		Power Pumps	
	Q'ty	% In- crease	Q'ty	% In- crease	Q'ty	% In- crease	Q'ty	% In- crease
1960	153	-	-	-	3,886	-	6,911	-
1961	30	-80.4	310	-	4,794	23.4	3,736	-45.9
1962	93	210.0	714	130.3	8,022	67.3	12,292	229.0
1963	386	315.1	3,071	330.1	9,495	18.4	13,171	7.2
1964	653	70.0	5,133	67.3	14,610	53.9	15,350	16.5
1965	1,111	70.2	7,579	47.7	18,909	29.4	26,029	69.6
1966	1,555	40.0	8,798	16.1	22,338	18.1	29,929	15.0
1967	3,819	145.6	12,768	45.1	25,474	14.0	31,613	5.6
1968	6,225	63.0	11,568	-9.4	26,675	4.7	37,796	19.6
1969	8,832	41.9	27,807	140.4	-	-	49,534	31.1
1970	12,882	45.9	44,807	61.1	-	-	57,447	16.0

Source : Agricultural Yearbook 1969 and AERT.

Along with other characteristics of farming in Korea, low wage rates relative to the rest of the world tended in the past to discourage Korean farmers from introducing agricultural equipment and encouraged continuation of labor-intensive methods. As domestic wages rose without offsetting increases in the exchange rate, duties, or foreign prices, machinery became more and more profitable to adopt.

Since 1965 farm wage rates have increased much faster than either imported or domestically-produced equipment prices, thereby making mechanization more and more profitable.

The small size of Korean farms has prevented farmers from utilizing large farm equipment efficiently and from accumulating enough saving to pay the purchase price of relatively expensive farm equipment. While the percentage of farms under one chongbo in size has declined from 73 percent in 1960 to 66.4 percent in 1969, the fact remains that about two-thirds of the farms cultivate less than 2.5 acres. Only 1.6 percent of the farms cultivate more than 7.5 acres.

Economic trends encouraging mechanization. Korean agriculture is no longer a labor-surplus sector. At the beginning of the decade Korea was characterized as a labor surplus economy with large amounts of redundant labor in the agricultural sector. By the end of the period this situation was radically different. The high rate of economic growth, particularly in manufacturing but also in the other non-agricultural sectors, resulted in a migration of labor out of the agricultural sector. Through this process the redundant labor supply has been absorbed. This can be demonstrated by observing the real wage rate. In a surplus labor economy, the migration of labor out of agriculture and into the non-agriculture sectors would not effect the real wage since the labor was redundant. However, once the redundant labor had been absorbed by the non-agriculture sectors, additional outmigration would result in increases in the real wage. The real agricultural wage remained constant from 1959 to 1962. Since 1962 the real wage has risen each year. The 1969 level was about 50 percent above the 1962 level. This supports the contention that Korea has moved beyond a labor surplus economy stage and is now an economy where labor is scarce. In such an economy, labor saving mechanization frees labor to move to alternative areas of higher productivity, e.g., manufacturing.

The trends of the 1960's and the projections of the TFYP demonstrate the fundamental structural changes that are occurring and are expected to continue in Korea. These trends all point toward the need for increasing labor productivity in agriculture and the substitution of non-labor inputs for the previously cheap and plentiful labor. Substantial movement in this direction has already been underway for a number of years. Up to the present, farm input substitution has largely taken the form of chemical inputs although a significant amount of mechanization also has occurred. Increased utilization of chemical inputs is expected to continue.

Farm input prices have changed very disproportionately since 1965 with farm machinery prices increasing from 50 to 75 percent while by October 1970 farm wages had increased nearly 200 percent. Thus, the changes in input prices have encouraged mechanization markedly.

The shortage of labor and the rise in farm wage rates are particularly significant for the largest farms where mechanization is most likely to take place. The percent of hired labor used increases sharply as the size of farms increases, rising from about 12 percent on farms of less than 0.5 chongbo to above 40 percent on farms of over 2 chongbo.

The share of total labor contributed by the family declines steadily as the size of the farm increases, falling from nearly 84 percent on the smallest farms to slightly under 50 percent on the largest farms. Hired labor costs, therefore, are a larger part of production costs on large farms than on small farms, thus forcing the larger farmers to consider labor saving devices as farm wage rates rise more rapidly than equipment prices.

Credit for Farm Equipment. Until recently the demand for credit for farm equipment or machinery has been a relatively small element of total credit needs. There was a general surplus of rural labor and most tasks were performed by labor intensive methods. The 1964 credit survey indicated that farmers used only 1.6 percent of their borrowed funds for farm machinery. Another 14 percent was used for large equipment, processing facilities, buildings or other capital expenditures. Of total capital expenditures per farm, only 4.9 percent was for farm implements in 1964. In short, credit needs for farm machinery were relatively small in 1964. Table 10 shows that loans for agricultural equipment have increased somewhat faster than total agricultural credit since 1965.

TABLE 10

OUTSTANDING AGRICULTURAL AND AGRICULTURAL EQUIPMENT LOANS 1965-70

Year	Million won				
	Outstanding Agricultural equipment loans	Agricultural equipment loans in Million U.S. dollars ^{1/}	Index	Per cent of Total	Total outstanding agriculture loans
1965	6,562	24.2	100.0	35.5	18,491
1966	7,553	27.9	115.1	35.2	21,437
1967	9,728	35.5	148.2	38.1	25,547
1968	14,038	50.0	213.9	36.6	38,367
1969	24,000	83.3	365.7	38.1	62,910
1970 ^{a/}	31,273	100.5	476.5	39.2	79,811

^{a/} October. ^{1/} Converted at annual average exchange rate.

Source: BOK, Monthly Economic Statistics.

By 1970 the needs for farm machinery had changed considerably because of: (1) the out-migration of younger persons from rural areas; (2) greater reliance on power sprayers and threshers; and (3) the need for mechanized tilling and transportation equipment. As out-migration continues and crop yields continue to increase there will be an additional need for mechanical grain drying and harvesting equipment.

Out-migration of labor from agriculture and substitution of labor-saving machinery for the departed labor will raise land and labor productivity and will reduce production cost per unit of output.

Because farm implements are costly, relative to average farm income, the need for credit to finance them is crucial to any effort toward mechanization. Even a continuation of current trends in the demand for farm implements will require a substantial amount of credit.

Table 11 shows how the NACF, the major supplier of the large farm equipment, has expanded its sales. After the drought years of 1967 and 1968, NACF expanded direct sales (stated in 1965 constant prices) by 104 percent in 1969 and another 36 percent in 1970. Direct sales are those under which NACF provides credit for approximately 50 percent of the value of the equipment. Consignment sales are made by local cooperatives selling on commission for local manufacturers. The local cooperatives provide their own credit programs for these sales, but the credit supplied is probably not more than 10 percent of the value of the implements. A considerably larger volume of business could be done if credit were available: (1) to manufacturers, so they could produce and display more items; and (2) to farmers for purchase of needed items.

It is estimated that investment in mechanization during the TFYP will be \$80 million equivalent. Approximately 60 percent of that investment, i.e. \$47.9 million, will be in the form of credit. Based on the average annual rate at which NACF increased its supply of credit for mechanization in the period 1964-1969, the amount to be available during the TFYP will be about \$20.4 million, vs. requirements of \$48 million (see Table 12). The resulting gap of \$27.5 million will be partially filled by this loan; the tentative allocation of \$8 million equivalent would meet requirements for roughly 18 months. Additional sources of financing remain to be identified.

2. The Storage Deficiency

The grain storage deficiency is very costly to the Korean economy in foreign exchange. The losses which could be avoided by an investment expenditure of about \$33.5 million equivalent in improved grain storage facilities are expected to cost the economy from \$46 million to \$52 million annually in additional food imports during the TFYP.

TABLE 11

NACF FARM IMPLEMENT/TOOL BUSINESS ^{1/}

Item	1967		1968		1969		1000 Won (Est.) 1970	
	Number	Value	Number	Value	Number	Value	Number	Value
Direct Purchase								
Power tillers	2,160	582,724	2,450	671,777	2,921	833,100	3,581	1,210,376
Power duster/sprayer	1,982	81,564	1,168	50,715	12,884	544,400	24,000	1,008,000
Power sprayer					2,000	233,800		
Motors					253	20,900		
Power thresher					19	1,500		
Hand sprayer							37,500	300,000
Sub-Total		664,288		722,442		1,633,700		2,518,376
Consignment Sales								
Shoulder sprayers	26,145	94,457	32,827	126,253	34,641	136,300		
Power dusters	4	384			710	46,700		
Power sprayers	6,002	6,443	1,728	12,573	10,539	82,200		
Weeders	7,935	2,661	1,430	10,993	9,472	3,700		
Threshers	1,062	7,205	10,037	3,790	2,339	31,600		
Straw mat machine	6	60	213	4,237				Not Available
Fans	786	1,213	852	1,725				
Hand tools/other	119,135	8,814	129,806	12,321		22,700		
Plows	550	73	915	128	6,893	14,500		
Potato cutter	1,070	137	1,172	2,903				
Hand sprayer	798	2,566	237	622	374	2,000		
Decorticator	20	2,588	157	2,278				
Feed mixing machine			119	20,202				
Carts/carriers					12,227	78,000		
Sub-Total		133,475		198,025		417,700		721,600
Grand Total		897,763		920,467		2,051,500		3,239,970

^{1/} Current prices. Source: NACF.

TABLE 12

NACF ACTUAL AND PROJECTED CREDIT FOR FARM MECHANIZATION
AND FARM MECHANIZATION CREDIT GAP

Year	Actual and projected NACF equipment credit ^{1/} (million won)	Equipment credit U. S. dollars	Credit required for mechani- zation	Mechani- zation credit gap
1970 ^{a/}	1,256	3.9	-	-
1972 ^{b/}	1,278	3.9	7.3	3.9
1973	1,302	4.0	8.4	4.4
1974	1,325	4.1	9.1	5.0
1975	1,349	4.2	10.3	6.1
1976	1,373	4.2	12.3	8.1
Total 1972-76	6,627	20.4	47.9	27.5

Note: \$ = 1/325. 1969 constant prices.

^{a/} Estimate. Figure of 1,190 million won in 1965 prices includes some non-equipment loans. (Annex B-2, Table 7)
 Estimate by NACF Loan Planning Department.

^{b/} Assumes equipment credit does not increase in 1971 because of credit squeeze.

^{1/} Assumes 1965-69 trend of increase in credit continues at 1.8% annually.

From 39 percent to 45 percent of the existing storage capacity is Class C, unsuitable for food storage. About 50 percent of NACF facilities and 37.6 percent of private facilities are substandard. It is estimated that elimination of the storage deficit as of 1971 would require an investment of \$8.1 million in the public sector; private sector storage requirements need detailed study. In terms of the value of imported grains, the annual impact of this investment would not only be about 1.5 times the investment required, but, year after year throughout the economic life of the warehouses, would continue to keep the food grain imports as much as 33 percent below the level which otherwise would be necessary.

Off-farm storage is required for the 50 percent of the rice production which is not consumed by the farm population. About 44 percent of the grain marketed is released from farms during the 3-month period of November through January following the harvest; the remainder gradually thereafter. During the TFYP, the portion of production consumed on the farm is expected to decline to about 44 percent, chiefly because of the reduction of the farm population. Of the remaining percentage entering commercial markets, the portion handled by public agencies - primarily NACF - probably will increase from about 30 percent in 1970 to 40 percent in 1976. This will result from MAF's price stabilization program, which is expected to make grain storage somewhat less profitable for private firms. Thus, additional improved storage will be needed at the ri-dong level.

NACF has embarked on a long-term program to consolidate its storage warehouse facilities into fewer total centers as part of its cooperative consolidation program to reduce the number of cooperatives from 16,000 in 1968 to 1,500 in 1974. This program generally is consistent with the recommendations of a 1966 study conducted for USAID/Korea on reform of the cooperative system. The plan calls for 1,500 100-pyong warehouses costing approximately \$13,300 each. Of these, 310 have been constructed. NACF had originally planned to complete construction of the remaining 1,190 facilities by 1974, at an estimated cost of \$15.9 million. Due to the lack of financing the target date for completing the program would have to be extended to 1977, unless additional credit is available. The allocation of additional credit under this loan would permit NACF to complete construction of the storage facilities by the original date of 1974. It is estimated that NACF will be able to provide a maximum of \$6.8 million for the program, leaving a gap of \$9.1 million, or about \$3 million per year over the construction time. The tentative allocation of \$6 million equivalent from this loan would cover the gap for two of the three years.

IV. Loan Justification: Balance of Payments; and Debt Service Considerations

The \$14 million loan will also assist Korea with its sizeable BOP gap by financing current account agricultural import requirements. Such dollar financing together with utilizing the local currency generated to provide agricultural credit to close the grain gap will have a significant favorable impact on Korea's BOP deficit. Of a total BOP deficit estimated to be \$648.4 million in 1971, \$147.5 million is attributable to grain import requirements.

In looking ahead toward Korea's economic self-sufficiency, a key issue clearly is whether the country's BOP can be managed in such a way as to sustain international financial confidence and thereby insure a continuing flow of foreign capital. In 1968 and 1969 Korea experienced rapid economic growth with real GNP increasing 13.3 and 15.9 percent, respectively. Although exports grew in excess of 35 percent each year, the trade deficit increased from \$835 million in 1968 to \$990 million in 1969. The rapid overall economic growth during this period stimulated substantial growth in imports which accounted for the rising trade deficit.

Recently, USAID/Korea has completed a series of BOP projections for the period 1970-74. Using a national income accounts macromodel, three sets of assumptions were examined with different BOP implications. Table 13 sets forth these comparative projections. The assumptions are explained below.

Alternative A (Basic Model)

The basic model, alternative A, was intended to be an extension of recent trends. That is, a continuation of recent growth and inflation rates, (11 percent real GNP growth rate and a 12 percent inflation rate) and additionally, a continuation of the trend in recent years for inadequate changes in the exchange rate to compensate for inflation. This was an attempt to project what would happen if recent policy measures to reduce excess demand in the economy were not successful, the domestic price rise continued unabated, and with an increased overvaluation of the won.

The results are a trade gap and foreign capital requirement, not only greater than that planned for the Third Five Year Plan, but one which would lead to a serious debt problem. The BOP projections in the Korea Rice Loan (489-H-079) authorized in January 1971 were based on this assumption.

Alternative B

Examined, as alternative B, was the implication of the Third Five Year Plan projected growth rate but with no other changes in the basic model, alternative A. The growth rate drops to a postulated 9 percent but the relationship between domestic inflation and the foreign exchange rate stays the same as in the basic model, alternative A. In other words, it was assumed that the exchange rate would not become more realistic during the period. It was also

assumed exports would be the same, perhaps an optimistic assumption in a lower growth rate situation. The result of alternative B was a significant improvement in the balance of payments over alternative A. But, more importantly, the trade gap and foreign capital requirements continued to exceed those postulated in the Third Plan.

Alternative C

Examined, as alternative C, was the implication of not only the Third Plan growth rate, but also, the exchange rate relationship to domestic prices (or the inflation rate) becoming more realistic. That is, the domestic price/foreign price ratio improves to equal a 35 percent devaluation in the effective exchange rate during the period. There was more significant improvement in the balance of payments. The trade gap dropped to \$304 million in 1974 or about the same gap projected for the TFYP.

While there are many variables involved, we now believe alternative C, based on a 9% growth rate and an improvement in the exchange rate, represents the most likely set of assumptions. In 1970 the ROKG established GNP growth rate targets through 1976 which were considerably lower than the rates experienced in the past. According to preliminary estimates, real growth in GNP will be about 10% in 1970 with a trade gap of about \$990 million. The Third Five Year Plan assumes a growth rate of 9% annually, and we believe the ROKG will continue to take measures to maintain growth rates lower than in the past. We believe that ROKG officials understand the serious consequences of and need to avoid an overheated economy with concomitant inflation, adverse balance of payments effects, and increased requirements for foreign capital. No par value for the Korean Won has been established with the IMF. Since March 22, 1965 a flexible exchange rate system has been in effect. The system involves a market in exchange certificates. The Bank of Korea announces a daily "basic concentration rate" for the U.S. dollar. The Bank of Korea is committed to buying exchange offered to it by foreign exchange banks, but is not obliged to sell exchange. The rate has been allowed to depreciate but not at a rate sufficient to offset inflation. Now that Presidential elections are over we also believe that it is likely that ROKG officials will be in a position to move toward a more realistic exchange rate.

Even under assumption C (See Table 14, page 34) with a low growth rate and an improved exchange rate, the trade gap would be \$306 million in 1974 and net foreign capital requirements would remain substantial, amounting to \$590 million. This suggests that even though Korea's overall BOP position will probably improve over the next few years, a continued influx of fairly high levels of foreign capital would be required to finance Korea's economic development needs.

It is estimated that Korea's principal and interest payments on foreign loans of over one year maturity will rise from \$127 million in 1969 to \$314 million in 1970 and eventually amount to roughly \$600 million in 1974 (See Table 15). According to USAID projections, annual debt service payments as a percentage of ROK foreign exchange earnings, are expected to rise from

11 percent in 1969 to 25 percent in 1971 and drop somewhat to about 22 percent in 1974. (Foreign exchange earnings include receipts for goods and services and investment income.)

In view of Korea's BOP situation, continuation of A.I.D.'s concessional development lending terms is deemed appropriate for this loan. On such lending terms, servicing of this loan will require no more than \$350,000 in any one year during the ten-year grace period and a maximum of approximately \$888,000 per year thereafter - that amount declining as principal is repaid. With export earnings projected to increase regularly and substantially over the coming years above the 1969 level of \$658 million and with Korea's balance of trade gap projected to continue to decline from the 1969 level, it is judged that there are reasonable prospects for repayment of this loan.

KOREA: ALTERNATIVE BALANCE OF PAYMENTS PROJECTIONS 1970-74

	Options	1970	1971	1972	1973	1974
1. Exports, F.O.B.	a,b,c	888.0	1,165.0	1,494.0	1,882.0	2,294.0
2. Imports, F.O.B.	a	1,824.5	2,123.7	2,431.2	2,766.0	3,116.5
	b	1,791.0	2,041.0	2,276.0	2,528.0	2,801.0
	c	1,748.0	1,959.0	2,155.0	2,369.0	2,600.0
3. Trade Gap (1-2)	a	-936.5	-958.7	-937.2	-884.0	-822.5
	b	-903.0	-876.0	-782.0	-646.0	-507.0
	c	-860.0	-794.0	-661.0	-487.0	-306.0
4. Net Receipts for Services	a	153.8	113.8	20.9	-43.1	-105.8
	b	157.8	108.8	16.9	-46.1	-105.8
	c	160.8	113.8	25.9	-34.1	-90.8
5. Net Investment Income	a	-57.2	-89.0	-136.6	-194.5	-257.3
	b	-57.2	-86.2	-128.5	-176.4	-221.5
	c	-57.2	-82.9	-119.5	-159.1	-195.3
6. Net Goods and Services (3+4+5)	a	-859.9	-933.9	-1,052.9	-1,121.6	-1,185.6
	b	-802.4	-853.4	-893.6	-868.5	-834.3
	c	-756.4	-763.1	-754.6	-680.2	-592.1
7. Net Transfers Receipts	a,b,c	157.0	114.7	107.6	91.5	75.2
8. Net Current Account	a	-682.9	-819.2	-945.3	-1,030.1	-1,110.4
	b	-645.4	-738.7	-786.0	-777.0	-759.1
	c	-599.4	-648.4	-647.0	-588.7	-516.9
9. Changes in Foreign Exchange Holdings (Increase (-))	a	-48.0	-41.0	-41.0	-68.0	-104.0
	b	-37.0	-52.0	-25.0	-49.0	-82.0
	c	-25.0	-21.0	-16.0	-39.0	-71.0
10. Net Capital Requirements (8+9)	a	730.9	861.8	985.0	1,098.6	1,214.6
	b	682.4	770.7	811.0	781.9	841.1
	c	624.2	669.4	665.0	627.7	587.9

Note:

- Option (a) Assumes - High Growth and Deteriorating Exchange Rate
 (b) Assumes - Low Growth and Deteriorating Exchange Rate
 (c) Assumes - Low Growth and Improvement in Exchange Rate

TABLE 14

KOREA: BALANCE OF PAYMENTS: OPTION (C)

Item	Actual		Projected		Millions of Dollars		
	1968	1969	1970	1971	1972	1973	1974
1. Exports, F.O.B.	186.2	658.3	838.0	1,165.0	1,494.0	1,862.0	2,294.0
2. Imports, F.O.B.	1,322.0	1,650.0	1,748.0	1,959.0	2,155.0	2,369.0	2,600.0
3. Trade gap (1-2)	-335.8	-991.7	-910.0	-794.0	-661.0	-487.0	-306.0
4. Net receipts for services	174.7	201.9	160.8	113.8	25.9	-34.1	-90.8
5. Net investment income	-5.4	-4.6	-57.2	-82.2	-119.5	-159.1	-195.3
6. Net goods & services(3+4+5)	-666.5	-794.4	-756.4	-663.1	-754.6	-680.2	-592.1
7. Net transfer receipts	226.1	213.6	157.0	114.7	107.6	91.5	75.2
8. Net current account (6+7)	-440.4	-550.8	-599.4	-648.4	-647.0	-588.7	-516.9
9. Changes in foreign exchange holdings (increase (-))	-40.4	-161.8	-25.0	-21.0	-16.0	-39.0	-71.0
10. Net capital requirements(8+9)	476.7	716.6	624.4	669.4	663.0	627.7	587.9
11. Errors & omissions	4.1	-4.0	0	0	0	0	0

Note : Projection assumes low growth and improvement in exchange rate.

TABLE 15

KOREA: DEBT SERVICE RATIOS

Item	Million of dollars						
	Actual		Projected				
	1968	1969	1970	1971	1972	1973	1974
A. Foreign Exchange Earnings	880.2	1,150.7	1,373.2	1,621.8	1,904.8	2,279.4	2,657.8
1. Export, F.O.B.	486.2	658.3	808.0	1,165.0	1,494.0	1,832.0	2,294.0
2. Service earnings	381.6	454.5	443.2	414.2	267.5	350.0	340.4
3. Investment income receipt	12.4	37.9	42.0	42.6	43.3	47.4	53.4
B. Principal and Interest Payments on Debt of Maturities 3 Years and Above	59.6	102.0	160.2	243.5	310.8	341.1	441.6
C. Principal and Interest Payments on Debt of One to Three Years	16.6	25.0	134.0	157.0	120.0	130.0	148.0
D. Debt Service Ratio on Foreign Obligations with Maturities of Three Years and Above D = B/A x 100	6.8	8.9	13.1	15.0	16.3	15.0	16.4
E. Debt Service Ratio on Obligations with Maturities of One Year and Above E = B + C/A x 100	8.7	11.0	22.9	24.7	22.6	20.7	21.9

V. Loan Implementation

A. NACF and the Credit Program

In pursuit of agricultural credit objectives, the National Agricultural Cooperative Federation (NACF) will have the primary responsibility for implementation of the various forms of agricultural credit. Discussions between the Mission and the ROKG indicate that the ROKG's planning, with respect to the implementation of this credit program, is fairly well advanced. It should be remembered that the credit to be made possible by this AID loan is simply an incremental financial resource which will enable the NACF to increase its volume of lending for the purposes of mechanization and improved storage facilities. As indicated in an earlier section of this paper, NACF has managed an agricultural credit program of substantial proportions for a number of years, and the addition of these credit funds should present no administrative problem for the institution. However, to clarify the precise relationships and responsibilities among MAF, NACF, and the end-users, (local ri/dong cooperatives or individual farms) under this loan, the ROKG (i.e. MAF and NACF) will be required to prepare a detailed plan for the establishment and operation of the credit program. In regard to the financing of farm mechanization (i.e. equipment), it is intended that the Korean private sector will play a significant role; this will be discussed in a later section.

These funds will be administered on a revolving basis, i.e. loan repayments will be recycled. Payment of principal and interest will be made from NACF to the ROKG in local currency. The terms of the NACF's obligation to the ROKG remain to be negotiated. The USAID is of the view that the terms should be the same as A.I.D.'s terms to the ROKG; this would allow the credit funds to expand, especially during the 10-year A.I.D. grace period. On the other hand, the foreign exchange risk will be borne by the ROKG and an interest rate differential may be required to compensate for this risk.

B. Credit Procedures

1. Mechanization

At present, nearly all farm equipment sales on credit are handled through NACF, which acts as both equipment dealer and banker. Farmers and cooperatives needing credit apply directly to NACF for both the equipment purchase and the necessary financing. However, future credit for farm mechanization, including that level formerly provided by NACF and those additional credit funds provided by this loan will be

made available whereby NACF or another institutional lender will provide only the required financing; the equipment sale will be a direct transaction between manufacturer and farmer. The manufacturer would have the responsibility of investigating the farmer's credit worthiness and deciding whether to accept his installment note. The note would then be discounted with the financial institution (NACF or a commercial bank). Specific details of discounting and other aspects of the proposed arrangement, such as the portion of credit risk to be taken respectively by the manufacturer and the financial institution, interest rate differentials, etc., are still under discussion. These details will be contained in the implementation plan which is to be submitted as a condition precedent to initial disbursement of dollar loan funds.

Terms of sub-loans to farmers will be as follows:

Interest Rate: 9%.

Maturity: maximum of five years, depending upon type of equipment.

Down Payment: 30% to 50% of purchase price, depending upon type of equipment.

Collateral: lien on the equipment financed.

2. Storage Credit Procedures

NACF will review all applications for loans from cooperatives or other borrowers and determine the need for additional and/or improved facilities. In reviewing applications, consideration will be given to such criteria as: (a) volume of business conducted by the cooperative, (b) size of membership, and (c) existing facilities of the cooperative. Borrowing cooperatives also will be expected to provide land for the construction site and, whenever possible, self-help labor.

NACF has proposed that loan agreements between NACF and ri/dong cooperatives be for a period of 20 years, including a grace period of five years, with interest at 9 percent per annum during the grace period and 10 percent thereafter. Normal NACF collateral requirements, which applied to the construction of 310 warehouses built by local ri/dong cooperatives during 1969 and 1970, will be applied to warehouses constructed under this loan.

NACF will prepare a status report every six months during the construction phase detailing warehouses constructed, under construction, planned for construction, and loan applications under consideration. The content and format of the report will be jointly agreed to between the MAF, NACF and USAID. The purpose of the report is to

monitor the construction program and determine whether undischursed loan funds should be shifted to one of the other two eligible investment areas as defined by the loan. When all warehouses financed under this loan have been completed, a final status report will be submitted.

C. Disbursement of Funds

It is the Mission's estimate, after discussions with the MAF, that the demand for credit will result in loan-generated local currency being disbursed over approximately an 18-month period, ending in late 1972 or early 1973. Of the total \$14 million, \$8 million (equivalent) will be needed during the period ending July 1, 1972, the remainder thereafter.

D. Local Currency Generation Procedures

It is A.I.D.'s intention to generate the local currency by a method which is consistent with the basic purposes of the loan and which minimizes the implementation burden to all parties concerned. These aims could best be met by financing the purchase of a basic commodity (or commodities) which Korea must import on a regular basis, thereby accomplishing both the purposes of currency generation and BOP assistance in a timely and effective manner. It is A.I.D.'s judgment that financing the purchase of one or two agricultural commodities would provide the most satisfactory results in terms of the foregoing objectives. This conclusion was reached after giving consideration to other possible methods of currency generation.

(1) The typical "program loan" approach of financing a broad range of machinery, equipment, spare parts, etc., is not felt to be desirable because (a) the implementation and monitoring requirements are burdensome to both the host country and A.I.D., at a time when A.I.D. is attempting to reduce its loan-related field staff; and (b) the procurement cycle for a broad range of equipment, etc., is time-consuming and would not generate the required local currency as rapidly as is necessary for the credit program.

(2) The Special Letter of Credit mechanism is being phased out by A.I.D., and therefore no longer available for use in this instance.

(3) Direct purchase of local currency with dollars is somewhat inflationary and, in addition, would be adverse to U.S. balance of payments.

The ROKG is in favor of the A.I.D.-proposed method of generating local currency, and has suggested that the loan proceeds be used to finance the purchase of U.S. wheat and/or rice.

Korea's import requirement for wheat in 1971 is estimated to be 1,294,000 M/T. Of this total about 641,000 M/T are expected to be supplied under PL 480 Title I sales agreements. Usual marketing requirements (UMR's) are established at 325,000 M/T, leaving a balance uncovered by PL 480 or UMR's of about 328,000 M/T. At \$62 per M/T, this represents \$19.7 million.

With regard to rice, the ROKG quite recently advised A.I.D. that an additional 200,000 to 300,000 M/T above that already purchased would be required this year in order to meet substantially increased demands and stabilize prices. Approximately half of the additional requirement will likely be supplied by Japan, and the remainder by the U.S.

The composition of the CY 1972 PL 480 program has not yet been determined nor have UMR's been established. However, we anticipate that Korean import requirements for wheat will increase during CY 1972, PL 480 Title I sales will decrease, and a similar situation as in CY 1971 (with requirements above PL 480 and UMR's) will exist.

Although the proposed financing of wheat and/or rice does not appear to present an issue, it is recommended that the loan not be restricted as to specific commodities; a certain degree of flexibility is obviously desirable. U.S. Department of Agriculture agrees with the foregoing.

The ROKG will prepare, as a condition of the loan, a coordinated schedule which gives the proposed timing of procurement, shipments, generation of local currency, and disbursement of currency for credit purposes.

The question of maintaining the value of the local currency generated under the loan has been considered. If there is a time lag between the generation of won currency and disbursement for agricultural credit purposes, NACF will either lend the funds to commercial borrowers or deposit it in interest-bearing accounts; the earnings thereon would be attributed in whole or in part to maintaining the real value of the credit funds. In recent years, the rate on short-term commercial loans has been upward of 20 percent per annum. Further, in the case of farm equipment, the historical rate of inflation in price has been substantially less than the increase in the wholesale price index, which increased by only 9 percent in 1970.

Commodity procurement procedures will be subject to A.I.D.'s Regulation 1, except where modifications are essential in order to accommodate the special situations of the agricultural commodity trade. As in the case of the previously-cited Rice loan to Korea, A.I.D.'s Office of Food for Peace will provide assistance in the area of procurement monitoring, and will coordinate A.I.D.'s consultations with USDA on various aspects of commodity procurement. Third-country consultations will be conducted, as in the case of PL 480 sales.

E. A.I.D. Implementation Responsibilities

The basic implementation responsibility under this loan will rest with USAID/Korea. Authority will be delegated to draft, negotiate and sign the Loan Agreement, and to issue the basic implementation letter and other similar documentation. Once the Conditions Precedent to Disbursement have been approved by AID/Washington, the time required for monitoring purposes will likely be very moderate, and no increase in Mission staff will be needed.

AID/Washington (Office of Capital Development and Finance, Bureau for East Asia) will reserve the authority to determine whether Conditions Precedent to Disbursement have been satisfied, and will have the responsibility of monitoring commodity procurement, reviewing and approving Invitations for Bid and purchase contract awards, and the modification of terminal dates. No increase in staff will be required.

With regard to NACF's administration of the credit program, A.I.D.'s monitoring responsibilities will not extend beyond the initial utilization of the \$14 million equivalent for designated credit purposes, at which point the A.I.D. project would be considered complete.

ANNEX I

Korean Economic Performance and Prospects^{1/}

The impressive expansion of the Korean economy in recent years continued in 1970. (Note: figures for 1970 are in most cases provisional.) GNP grew by 9.7% in real terms, down somewhat from the 11.7% average for the period 1965-1969 as well as from the 15.9% achieved in 1969, but still a highly satisfactory level. Although the decline was occasioned largely by monetary restrictions, other factors, in particular poor weather at harvest time, also played a part. The composition of GNP continued to reflect the shift of the economy away from its traditional agricultural base towards manufacturing. The contribution of manufacturing to GNP, which was only 13% in 1960 and 18% in 1965, in 1969 increased to 25% and in 1970, 26%. The agricultural sector's contribution to GNP in the meantime moved in the opposite direction: from 41% in 1960 to 26% in 1970, identical with that of manufacturing (in constant prices).

In manufacturing in 1970, emphasis continued to be placed on the development of export and of import substitution industries. Whereas exports in 1969 amounted to \$658 million, an increase of 35% over the previous year, in 1970 they rose to \$883 million, an increase of 34% over the previous year*. Efforts to develop a broadly based heavy industry have still had only a limited effect, however, and a very high level of imports continues to be required to support expanding exports and also, to some extent, to achieve reasonable domestic price stability. Largely because of these factors, 1970 imports reached \$1,753 million, \$870 million more than exports on an f.o.b. basis. Imports in 1970 were only 6% above the 1969 figure of \$1,650 million, however. The 1969 increase over the previous year was 25% and the average rate of increase for the period 1965-1969 was 36%. The sharp fall in the rate of increase of imports, like the downturn in the growth rate of GNP, is to a considerable extent attributable to the monetary restrictions imposed in connection with the 1970 stabilization program discussed below, particularly through its action on the level of investment.

While the contribution of agriculture to GNP continued to decrease in relative terms, production in absolute terms is still rising. In 1970 the rate of increase was only 2%, compared with nearly 12% in 1969, but both figures were largely the result of the vagaries of the weather. Despite imports of 540,000 tons in

^{1/}Prepared by USAID/KOREA, February 2, 1971, as Seoul TOAID A-72

*on a customs clearance rather than a settlements plus others basis.

1970, compared with a domestic crop of 3.9 million tons, Korea expects to attain self-sufficiency in rice by the end of the 1970s.

Gross investment in 1969 amounted to ₩451 billion (\$1.5 billion) in terms of 1965 prices, an increase of 30% over the previous year. In 1970, however, gross investment dipped to ₩434 billion in 1965 prices, a decline of about 4% largely on account of monetary restrictions. Domestic savings registered only a 10% increase in 1970 over the previous year in real terms. This compared with a real increase of 41% in 1969 and an average increase of 36% in the period 1965-1969. The comparison is somewhat distorted, however, by the effects of changes in grain inventories. Further, domestic savings financed a larger percentage of gross investment in 1970 (64%) than in 1969 (57%).

The monetary restrictions imposed in 1970 were designed to counter the excessive liquidity introduced into the economy in 1969. In that year both domestic credit and money supply rose by about 58% and 44% respectively, and the reserve base, which is defined as the assets of the Bank of Korea, by 49%. To these developments the rapid increase in 1969 of investment, of imports, and also of the trade deficit can at least in part be attributed. In 1970, the expansion of domestic credit was limited to about 26% and that of money supply to about 23%, while the reserve base increased by 25%. By virtue of this monetary restraint, significant improvements were registered in the relative rates of increase of imports and exports while the growth of GNP, though somewhat reduced, remained high. Further, domestic savings financed a higher proportion of the gross investment that took place. With respect to price increases, the policy of monetary restraint was less successful, at least for the time being. In fact wholesale prices rose 9.1% in 1970, compared with 6.8% in 1969, and the Seoul consumer price index rose 12.7% in 1970 compared with 10.1% in 1969. The GNP deflator for 1970 was 14.0%, compared with 12.1% for 1969. To some extent, however, the 1970 price increases represented a delayed effect of monetary expansion in 1969. In addition such special factors as a hike in the government support price of rice much larger than that of the previous year were involved. With continued monetary restraint, the moderation of the rate of price increases in 1971 should be possible.

Heavy investments, combined with still relatively modest levels of domestic savings, have continued to result in substantial foreign capital inflows. Korea's external debt increased substantially in 1970, as it did also in 1969. The amount of new debt with a maturity one year and over actually incurred in 1970 was around \$725 million, compared with an estimated \$681 million in 1969. Korea's outstanding external debt with a maturity three years and over reached about \$1.8 billion at the end of 1970. The size of this debt, together with the importance to the country of continued international creditworthiness, call for careful debt management in future years.

Korea's problems are not unknown in rapidly developing economies, and the Korean government is fully aware of their existence. The degree of economic development already achieved has been due in no small measure to the policies followed by the government. Past interest and exchange reforms have resulted in substantial increases in domestic savings and also have provided incentives for industrial development, particularly in the export sector. The government should also be credited with recognition of the need for long-range economic planning, with the formulation of three five-year plans and the successful implementation of two, and with fiscal policies and tax reforms which have allowed it to make substantial contributions to domestic savings. It is reasonable to expect that effective steps will be taken to resolve the issue presently confronting the economy.

In 1971 the outlook is for a continuation of rapid economic growth but nearer the rate of 1970 than 1969. Assuming reasonable monetary restraint, along with continued expansion of exports and an increase in agricultural output of 4 or 5%, real growth of about 10% may be expected. In relation to GNP domestic savings are expected to decline somewhat, while foreign savings will fall to some extent in absolute terms. Nevertheless gross investment will rise absolutely, reversing the 1970 trend, even though not in relation to GNP. The trends of 1971 may generally be expected to continue in 1972



ECONOMIC PLANNING BOARD
REPUBLIC OF KOREA
Seoul, Korea

March 11, 1971

The Honorable
Howard E. Houston, Director
United States Agency for International
Development
Seoul, Korea

Dear Mr. Houston:

With this letter I would like to present my Government's request for a Loan of Fourteen Million Dollars (U.S. \$14,000,000) under Development Loan financing. This Loan would further the development of the agricultural sector of the Korean economy by generating and making available for developmental purposes won proceeds which otherwise would not be available for such uses.

The agricultural sector has been designated by our Government as one of the highest priority areas in the Third Five-Year Economic Plan. In addition, self-sufficiency in the major grains is listed as one of the major goals of the plan. Our Government's commitment to the development of the agricultural sector is reflected in the radical increase in the sector's share of total projected investment for the TFYP. The agricultural sector's share of total investment would rise to 12.6 per cent in the TFYP as opposed to 8.4 per cent in the Second Five-Year Plan.

It should be noted that while the Government's intention, as expressed in the Third Five-Year Plan, is to devote a considerably greater share of investment resources to agriculture, secure sources of funding for this additional investment is not yet in sight. Accordingly, one of the purposes of this loan is to provide some of that increased financing for agriculture.

As mentioned in the above, certain aspects of the agricultural sector are in need of assistance and it is hereby requested that the generated won proceeds be allocated to

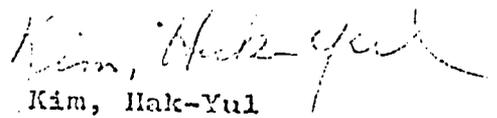
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them. It is contemplated that the won proceeds will be used:

- (1) to provide credit financing for farmers wishing to buy farm equipment, which can reduce production costs and alleviate shortages of agricultural labor.
- (2) to upgrade agricultural commodity warehousing facilities by financing construction of storage facilities. This will alleviate the spoilage problem of past years.
- (3) to increase the use of fertilizer on rice, barley, wheat and corn and thereby raise farm production.

Your favorable consideration and necessary action in this connection will be highly appreciated.

Sincerely yours,



Kim, Hak-Yul
Deputy Prime Minister
and
Minister of Economic Planning Board

STATUTORY CRITERIA CHECKLIST FOR DEVELOPMENT

ASSISTANCE: Development Loan Fund

COUNTRY PERFORMANCE

A. Programs Towards Country Goals

1. FAA Sec. 201(b)(5), 201(b)(7), 201(b)(8), 208. Discuss the extent to which the country is:

(a) making appropriate efforts to increase food production and improve means for food storage and distribution;

(a) from 1960 through 1969 the National Income accounts show that the value added in the agriculture sector increased by 50% (an average growth of 5% per year or a growth rate of 4.3%). Significantly, this decade included the two drought years of 1967 and 1968; however, significant investments have been made in irrigation facilities which will minimize future weather influences on production.

In the past two years, rice prices have been allowed to increase substantially more than the 5% increase allowed in the previous three years. This increase will provide additional incentive for farmers to use fertilizer and pesticides required to increase production.

Substantial effort and expenditure is being made to introduce new rice varieties. One of the goals of this loan is to increase food storage capacity.

(b) creating a favorable climate for foreign and domestic private enterprise and investment;

(b) Korea has taken a number of effective steps to create a favorable investment climate. A liberal foreign investment law was enacted, and intensive study is being undertaken by the ROKG of means of expanding capital markets. An investment center has been established.

The 1969 U.S. Industrial Machinery Exhibition held in Seoul produced sales amounting to \$4.6 million dollars worth of U.S. manufactured machinery and equipment. A similar exhibition is due to be held during 1971 in Seoul.

Domestic investment has been assisted by a number of A.I.D. loans such as the loan to the Korea Development Bank.

(c) increasing the people's role in the developmental process;

(c) Koreans are basically a homogeneous people whose society is relatively free and politically stable. Korea does not possess deep sectional, religious or social cleavages. Korea's rapid economic development benefits increasingly larger segments of the population.

(d) allocating expenditures to development rather than to unnecessary military purposes or intervention in other free countries' affairs;

(d) Korea has wisely allocated its resources in such a way as to maximize its economic development while maintaining sufficient military forces to insure a relative freedom from threatened external aggression. Korea is not intervening in other free and independent nations' affairs.

(e) willing to contribute funds to the project or program;

(e) the program under the sector loan envisages the generation of local currencies under a dollar commodity loan to be utilized to accomplish the goal of developing particular areas of the agricultural sector which are agreed upon by the ROKG and the U.S. The currencies generated by the sector loan will be additive and host country contributions of funds will not be a factor in the implementation of the loan. Institutional infrastructure support, however, will be fully provided by the host country.

(f) making economic, social and political reforms such as tax collection improvements and changes in land tenure arrangement; and making progress toward respect for the rule of law, freedom of expression and of the press, and recognizing the importance of individual freedom, initiative, and private enterprise;

(f) Korean land reform programs have eliminated the large land-holding class and have created a large number of independent farmers who own their own small farms. The ROKG has assisted in the establishment of a number of farm and fishery cooperatives which have been of significant assistance to the independent farm and fishery communities. Our Mission has also assisted the ROKG in its efforts to reform the equity of tax rates and collection procedures.

These reforms have greatly increased both the amount of taxes collected and the equity with which the program is administered. The promotion of democratic institutions in Korea is covered in detail in TOAID A-994, 3/6/67 and TOAID A-1220, 2/26/68.

(g) responding to the vital economic, political and social concerns of its people, and demonstrating a clear determination to take effective self-help measures.

(g) The ROKG has made significant progress in its efforts to provide a better life for the average Korean citizen. The Government has encouraged the rapid expansion of small and medium industry, stimulated the development of farmer credit unions and fishing cooperatives and has helped in many other ways to better the lot of its people. (See TOAID A-994 and TOAID A-1220).

B. Relations with the United States

1. FAA Sec. 620(c). Is the government indebted to any U.S. citizen for goods or services furnished or ordered where: (a) such citizen has exhausted available legal remedies, including arbitration, or (b) the debt is not denied or contested by the government, or (c) the indebtedness arises under such government's or a predecessor's unconditional guarantee?
 1. No situation is known to exist.
 2. The loan is not intended for such purposes.
 3. No such actions are known.
2. FAA Sec. 620(d). If the loan is intended for construction or operation of any productive enterprise that will compete with U.S. enterprise, has the country agreed that it will establish appropriate procedures to prevent export to the U.S. of more than 20% of its enterprises annual production during the life of the loan?
3. FAA Sec. 620(c)(1). Has the government, or any government agency or subdivision within the country, (a) nationalized or expropriated property owned by U.S. citizens or by any business entity not less than 50% beneficially owned by U.S. citizens, (b) taken steps to repudiate or nullify existing contracts or agreements with such citizen or entity, or (c) imposed or enforced discriminatory taxes or other exactions, or restrictive maintenance or operational conditions? If so, what steps has it taken to discharge its obligations under international law toward such citizen or entity?

4. FAA Sec. 620(j). Has the country permitted, or failed to take adequate measures to prevent, the damage or destruction by mob action of U.S. property, and failed to take appropriate measures to prevent a recurrence and to provide adequate compensation for such damage or destruction?

4. No such situation is known to have occurred.

5. FAA Sec. 620(l). Has the government instituted an investment guaranty program under FAA Sec. 221 (b)(1) for the specific risks of inconvertibility and expropriation or confiscation?

5. Yes.

6. FAA Sec. 620(o); Fishermen's Protective Act, Section 5. Has the country seized, or imposed any penalty or sanction against, any U.S. fishing vessel on account of its fishing activities in international waters?

6. No.

7. FAA Sec. 620(q). Has the country been in default, during a period in excess of 6 months, in payment to the U.S. on any FAA loan?

7. No.

8. FAA Sec. 620(t). Have diplomatic relations between the country and the U.S. been severed? If so, have they been renewed?

8. Diplomatic relations between Korea and the United States have not been severed.

C. Relations with Other Nations and the U.N.

1. FAA Sec. 620(i). Has the country been officially represented at any international conference when that representation included planning activities involving insurrection or subversion directed against the U.S. or countries receiving U.S. assistance?

1. Korea is not known to have been so represented.

2. FAA Secs. 620(a), 620(n); App. Secs. 107(a), 197(b), 116. Has the country sold, furnished, or permitted ships or aircraft under its registry to carry to Cuba or North Vietnam, items of economic, military or other assistance?

2. No.

3. FSS Sec. 620(u); App. Sec. 108. What is the status of the country's U.N. dues, assessments or other obligations? Does the loan agreement bar any use of funds to pay U.N. assessments, dues or arrearages?

3. The Republic of Korea is not a member of the United Nations. The loan agreement will stipulate that only eligible commodities can be procured with the proceeds of the loan. The Loan Agreement will also restrict use of generated local currency to accomplishment of identified goals.

D. Military Situation

1. FAA Sec. 620(i). Has the country engaged in or prepared for aggressive military efforts directed against the U.S. or countries receiving U.S. assistance?

1. No.

2. FAA Sec. 620(s). What is (a) the percentage of the country's budget devoted to military purposes, and (b) the amount of the country's foreign exchange resources used to acquire military equipment? Is the country diverting U.S. development assistance or PL 480 sales to military expenditures?

2. (a) Korean defense budget expenditures as a percent of GNP have risen only slightly from 3.7% in 1965 to 4.1% in 1969. For the period 1967-1969 these expenditures were 4.1% of GNP, not significantly above the mean for the region.

(Findings on these questions are to be made for each country at least once each fiscal year and, in addition, as often as may be required by a material change in relevant circumstances.)

(b) Foreign exchange purchases of military items were about \$3 million over the period 1965 to 1968 and accounted for a negligible portion of the defense budget. In 1969 they were about \$1 million, or 1% of total imports. Korean requirements for imports of military equipment have been provided under the Military Assistance Program.

State and A.I.D. have reviewed Korean actions under the Symington Amendment and have concluded that Korea is not diverting U.S. development assistance or PL 480 sales to military purposes. They also determined that Korea is not diverting its own resources to unnecessary military expenditures to a degree which materially interferes with its development. The Country Team concurs. The following points were among those taken into account in reaching this conclusion.

It is United States policy to assist South Korea in developing the capability to defend itself from Communist attack from the north and to counter Communist attempts at internal subversion. We also support South Korean contributions to regional mutual security efforts in Southeast Asia. At present South Korea has 50,000 troops participating in the allied war effort in South Vietnam. Substantial military expenditures are necessary to support these objectives, and we are contributing to the Korean defense budget to help them finance these costs.

Korean defense budget expenditures as a percent of central government expenditures have declined from 32.0% in 1965 to 20.4% in 1969, below the mean for the region of 27.2%.

U.S. military budget support derived from PL 480 and Supporting Assistance proceeds has been decreasing, and at the same time the Koreans have been increasing their own military expenditures. The self-financed portion of the Korean defense budget has increased from 38.1% in 1965 to 75.5% in 1969. However, these expenditures have remained relatively stable as a percent of total central government expenditures: 11.7% in 1965 as compared to 15.4% in 1969. Korean self-financed defense expenditures as a percent of GNP rose from 2.7% in 1968 to 3.2% in 1969.

3. FAA Sec. 620(v). Has the country purchased "sophisticated weapons systems", disbursements for which are required during the current A.I.D. fiscal year? If so, has the withholding of an equivalent amount of A.I.D. assistance been adequately provided for? If withholding is not provided for, has there been a Presidential Determination that such purchase is important to the national security of the U.S.?

3. Korea has made no such purchases, and it is not anticipated that any such purchases will be made by Korea during the current fiscal year.

CONDITION OF THE LOAN

A. General Soundness

-- Interest and Repayment

1. FAA Secs. 201(d), 201(b)(2). Is the rate of interest excessive or unreasonable for the borrower? What capacity does the borrower have to repay the loan at a reasonable rate of interest? Is the rate of interest less than 2% per annum during the grace period? Less than 3% per annum following the grace period? Is the rate of interest higher than the country's applicable legal rate of interest?

1. The proposed loan contains a rate of interest which is concessory. The borrower has the capacity to repay the loan at the rates of interest to be required. The rates in the proposed loan are 2% per annum during the grace period and 3% per annum thereafter for the remaining thirty years of the repayment period. The interest rate is not higher than the country's applicable legal rate of interest.

-- Financing

1. FAA Sec. 201(b)(1). To what extent can financing on reasonable terms be obtained from other free-world sources, including private sources within the U.S.?

1. No other free-world financing institution has expressed an interest in financing such a transaction.

-- Economic and Technical Soundness

1. FAA Secs. 201(b)(2), 201(c). Indicate the activity's economic and technical soundness; does the loan application, together with information and assurances, indicate that funds will be used in an economically and technically sound manner?

1. The projected sector loan program activity is economically and technically sound, and the loan application and other information available to the Mission indicates that the loan funds and local currencies generated thereby will be used in an economically and technically sound manner.

2. FAA Sec. 611(a)(1). If substantive technical or financial planning is required, have engineering, financial, and other plans necessary to carry out assistance, and a reasonably firm estimate of the cost of assistance to the U.S., been completed?

2. The necessary financial and other planning has been completed.

3. FAA Sec. 611(b); App. Sec. 101. Have plans for a water or related land resource construction project or program included a cost-benefit computation? Does the project or program meet the relevant U.S. construction standards and criteria used in determining feasibility?

4. FAA Sec. 611(e). If this is a Capital Assistance Project with U.S. financing in excess of \$1 million, has the principal A.I.D. officer in the country certified as to the country's capability effectively to maintain and utilize the project?

3. No such project or program is contemplated.

4. This is not a Capital Assistance Project.

B. Relation to Achievement of
Country and Regional Goals

-- Country Goals

1. FAA Secs. 207, 281(a).

Describe this loan's relation to:

(a) institutions needed for a democratic society and to assure maximum participation on the part of the people in the task of economic development;

(b) enabling the country to meet its food needs both from its own resources and through development, with U.S. help, of infrastructure to support increased agricultural productivity;

(c) meeting increasing need for trained manpower;

(d) developing programs to meet public health needs;

(e) assisting other important economic, political and social development activities, including industrial development; growth of free labor unions, cooperatives and voluntary agencies; improvement of transportation and communication systems; capabilities for planning and public administration; urban development; and modernization of existing laws.

2. FAA Sec. 201(b)(4). Describe the activity's consistency with and relationship to other development activities, and its contribution to realizable long-range objectives.

1. (a) There is no direct relationship between the loan and the cited institutional goal.

(b) Proceeds of the loan will be used solely to finance the importation of a commodities in order to generate local currencies for agricultural development purposes, which will assist Korea in reaching the cited goals.

(c)(d)(e) There is no direct relationship between the Loan and (1) meeting the increasing need for trained manpower, (2) developing programs to meet public health needs and (3) the other developmental goals of (e) except that the sector loan program will in part seek to encourage farm planning, achieve a measure of cooperative consolidation and help free agricultural labor for industrial development.

2. In the use of local currency to be generated by commodity imports, the loan is consistent with other developmental activities in Korea and will contribute to the realization of such long-range objectives as self-sufficiency in food production and overall agricultural development.

In addition, it will promote efficiency in agricultural production through some forms of mechanization; it will also improve balance of payments.

3. FAA Sec. 201(b)(9). How will the activity to be financed contribute to the achievement of self-sustaining growth?

3. As previously indicated, local currency generated by the loan will be used for the development of agreed-upon areas of the agricultural sector - which among others includes efforts to narrow the food grain gap and thereby helping to achieve self-sustaining growth and to conserve foreign exchange as well, by reducing storage losses, increasing fertilizer applications, reducing input costs, and increasing output by mechanization.

4. FAA Sec. 201(f). If this is a project loan, describe how such project will promote the country's economic development, taking into account the country's human and material resource requirements and the relationship between ultimate objectives of the project and overall economic development.

4. Not a project loan.

5. FAA Sec. 201(b)(3). In what ways does the activity give reasonable promise of contributing to development of economic resources, or to increase of productive capacities?

5. See paragraphs 1, 2, and 3 above.

6. FAA Sec. 281(b). How does the program under which assistance is provided recognize the particular needs, desires, and capacities of the country's people; utilize the country's intellectual resources to encourage institutional development; and support civic education and training in skills required for effective participation in political processes?

6. The loan recognizes the basic need of the Korean people for agricultural development which will enable them to utilize to the fullest possible extent available agricultural resources. There is at best only an indirect relationship between the loan and development of intellectual resources and support of civic education and training in skills required for effective participation in political processes.

7. FAA Sec. 601(a). How will this loan encourage the country's efforts to: (a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use of cooperatives, credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture, and commerce; and (f) strengthen free labor unions?

8. FAA Sec. 202(a). Indicate the amount of money under the loan which is: going directly to private enterprise; going to intermediate credit institutions or other borrowers for use by private enterprise; being used to finance imports from private sources; or otherwise being used to finance procurement from private sources.

9. FAA Sec. 611(a)(2). What legislative action is required within the recipient country? What is the basis for a reasonable anticipation that such action will be completed in time to permit orderly accomplishment of purposes of loan?

-- Regional Goals

1. FAA Sec. 619. If this loan is assisting a newly independent country, to what extent do the circumstances permit such assistance to be furnished through multilateral organizations or plans?

7. As previously stated, use of loan-generated local currency should contribute to improving the technical efficiency of agriculture and through disbursal of local currencies in the private agricultural sector encourage development and use of domestic financial institutions; otherwise, there will be little or no effect on the specific development objectives stated in this section (601(a)) of the FAA.

8. The total amount of the loan will be used to finance procurement from private sources.

9. No new legislation is required.

1. Korea is not a newly independent nation.

2. FAA Sec. 209. If this loan is directed at a problem or an opportunity that is regional in nature, how does assistance under this loan encourage a regional development program? What multilateral assistance is presently being furnished to the country?

2. This loan is not directed at a regional problem.

Korea is a member of the Asian Development Bank (ADB) and is receiving assistance from the World Bank. Both of these organizations are expected to become increasingly active in Korea.

C. Relation to U.S. Economy

-- Employment, Balance of Payment, Private Enterprise

1. FAA Secs. 201(b)(6); 102, Fifth. What are the possible effects of this loan on U.S. economy, with special reference to areas of substantial labor surplus? Describe the extent to which assistance is constituted of U.S. commodities and services, furnished in a manner consistent with improving the U.S. balance of payments position?

1. There is no adverse effect from this loan on the U.S. economy or on areas of substantial labor surplus. The U.S. will be an eligible source country of commodities made eligible under the loan. Also, 50/50 shipping will apply.

2. FAA Secs. 612(b), 636(h). What steps have been taken to assure that, to the maximum extent possible, foreign currencies owned by the U.S. and local currencies contributed by the country are utilized to meet the cost of contractual and other services, and that U.S. foreign owned currencies are utilized in lieu of dollars?

2. The loan proceeds will be used exclusively to generate local currencies. The use of the sector loan technique takes into account availabilities of U.S. and Korean owned local currencies and undertakes a program which is additive to projected uses of those currencies.

3. FAA Sec. 601(d); App. Sec. 109. If this loan is for a capital project, to what extent has the Agency encouraged utilization of engineering and professional services of U.S. firms and their affiliates?

3. This is not a capital project, nor are such services contemplated.

If the loan is to be used to finance direct costs for construction, will any of the contractors be persons other than qualified nationals of the country or qualified citizens of the U.S.? If so, has the required waiver been obtained?

4. FAA Sec. 608(a). Provide information on measures to be taken to utilize U.S. Government excess personal property in lieu of the procurement of new items.

5. FAA Sec. 602. What efforts have been made to assist U.S. small business to participate equitably in furnishing of commodities and services financed by this loan?

6. FAA Sec. 621. If the loan provides technical assistance, how is private enterprise on a contract basis utilized? If the facilities of other Federal agencies will be utilized, in what ways are they particularly suitable; are they competitive with private enterprise (if so, explain); and how can they be made available without undue interference with domestic program?

7. FAA Sec. 611(c). If this loan involves a contract for construction (that obligates in excess of \$100,000), will it be on a competitive basis? If not, what factors make that impracticable?

4. Excess property has no relation to the financing of commodity imports under the loan or to expenditure of local currencies generated thereby. However, in the event that U.S. excess property might have a use in a project developed under the sector loan acquisition would be considered.

5. Commodity procurement under the loan will be limited to established A.I.D. procurement procedures and will follow normal commercial trade practices to the maximum extent allowable, thereby assisting U.S. small business to participate in furnishing the commodities to be financed.

6. The loan does not provide technical assistance. Facilities of no U.S. agencies will be used to assist AID in the sector loan.

7. The loan does not involve such a construction contract.

-- Procurement

1. FAA Sec. 604(a). Will commodity procurement be restricted to U.S. except as otherwise determined by the President?

1. Commodity procurement under this loan will adhere to the President's directives regarding the untying of AID procurement as set forth in applicable AID Regulations.

2. FAA Sec. 604(b). Will any part of this loan be used for bulk commodity procurement at adjusted prices higher than the market price prevailing in the U.S. at time of purchase?

2. No.

3. FAA Sec. 604(e). Will any part of this loan be used for procurement of any agricultural commodity or product thereof outside the U.S. when the domestic price of such commodity is less than parity?

3. No.

D. Unrelated Requirements

1. FAA Sec. 201(b). Is the country among the 20 countries in which development loan funds may be used to make loans in this fiscal year?

1. Yes.

2. App. Sec. 112. Does the loan agreement provide, with respect to capital projects, for U.S. approval of contract terms and firms?

2. Not applicable.

3. FAA Sec. 620(k). If the loan is for construction of a productive enterprise, with respect to which the aggregate value of assistance to be furnished will exceed \$100 million, what preparation has been made to obtain the express approval of Congress?

3. Not applicable.

CAPITAL ASSISTANCE LOAN AUTHORIZATION

Provided from Development Loan Funds
(Korea: Agricultural Credit Loan)

Pursuant to the authority vested in the Administrator of the Agency for International Development (hereinafter called "A.I.D.") by the Foreign Assistance Act of 1961, as amended, and delegations of authority issued thereunder, I hereby authorize the establishment of a loan pursuant to Part I, Chapter 2, Title I, the Development Loan Fund, to the Government of the Republic of Korea (Borrower) of up to Fourteen Million Dollars (\$14,000,000) to finance the foreign exchange costs of commodity imports which will generate won local currency which in turn will be utilized to provide credit financing for (1) farmers wishing to buy farm equipment, and (2) upgrading agricultural commodity warehousing facilities.

1. Interest and Terms of Repayment

The interest on this Loan shall be two percent (2%) per annum for the first ten (10) years of the loan and three percent (3%) per annum for the remainder of the term of the loan. The loan shall be repaid within forty (40) years from the date of the first disbursement under the loan, including a grace period of ten (10) years, on the basis of level semi-annual installments of principal and interest during the repayment period. Terms of repayment to the Borrower from a revolving credit fund or funds established with local currency generations shall be subject to A.I.D. approval.

2. Currency of Repayment

Provision shall be made for repayment of the loan and payment of the interest in United States dollars.

3. Other Terms

Source: Commodities financed under this loan shall be of U.S. source and origin. The eligible source for commodity-related services shall be the U.S., except that (i) for ocean freight, subject to the limitations of the U.S. Cargo Preference Law, countries in A.I.D. Geographic Code 941 shall also be eligible sources, and (ii) for marine insurance, subject to U.S. law and A.I.D. regulations, countries in such Code 941 and the Borrowing country shall also be eligible sources.

4. Conditions Precedent to Disbursement

The loan shall provide that, unless A.I.D. shall otherwise agree in writing, as conditions precedent to the first disbursement of the loan, there shall be presented to A.I.D. in form and substance satisfactory to A.I.D.:

a. A comprehensive statement of the loan implementation procedures which the Borrower through the Ministry of Agriculture and Forestry (MAF) and the National Agricultural Cooperative Federation (NACF), and/or the Korean private sector, as appropriate, will follow with regard to the financing of construction of storage facilities and farm equipment sales. This shall include a comprehensive statement of the loan implementation procedures as regards the relationships and responsibilities among the Borrower, MAF, NACF, and end-users of won-financed items, together with the contemplated terms, which shall be subject to A.I.D. approval, of financing extended to farmers and farm-support organizations.

b. A plan for the allocation of won proceeds generated under the loan.

c. A coordinated schedule which details the proposed timing of commodity procurement, shipments, generation of local currency, and disbursement of currency for credit purposes.

5. Covenants

Unless A.I.D. shall otherwise agree in writing, the Borrower shall covenant that:

a. The Borrower, MAF and NACF shall comply with all of the terms and conditions of the comprehensive implementation plan provided in satisfaction of the conditions precedent to disbursement, and, to the extent that Korean private lending institutions participate in the credit program being financed by this loan, Borrower will endeavor to assure said institutions' compliance with the implementation plan.

b. Official MAF fertilizer usage targets for calendar year (CY) 1971 will be set at least fifteen percent (15%) higher than that of actual fertilizer usage during CY 1970, and fertilizer usage targets for CY 1972 will be set fifteen percent (15%) higher than actual fertilizer usage during CY 1971. Borrower will incorporate the target figures in the official supply and demand plans for the respective years, and will use its best efforts to encourage the actual usage of fertilizer to the extent and in the amounts specified as the targets for such usage.

c. The Borrower shall establish arrangements whereby farmers and farmers' organizations - as an alternative to purchasing equipment on credit from NACF - may obtain financing through domestic equipment suppliers for farm equipment purchased directly from said suppliers.

6. Other Terms and Conditions

The loan shall be subject to such other terms and conditions as
A.I.D. shall deem advisable.

John A. Hannah

Date