

UNCLASSIFIED  
CLASSIFICATION

IND  
PD-ABD-828

For each address check one ACTION | INFO

DATE REC'D. 75910

AID/W TOAID A 1708

1968 MAY 25 PM 2 03

KS  
336.095195  
K846  
8 Mitchell

AID  
DATE SENT  
C.S. 5/29/68

DISTRIBUTION

ACTION

EEH9

FROM - SEOUL

INFO.

FTEC

SUBJECT - End of Tour Report - James A. Mitchell 1755/20

EA

REFERENCE -

ENEA

Transmitted herewith is End of Tour Report by James A. Mitchell,  
Industrial Development Advisor, Industry Engineering Division.

PCETER

Attachment: End-of-Tour Report (Control No. U-519)

489-15-230-606.3

Industrial Planning

OTHER AGENCY

CIA

DOD

NSA

STATE

PAGE 1 OF 9 PAGES

DRAFTED BY <i>[Signature]</i> [Signature]	OFFICE IED-I	PHONE NO. 2286	DATE 5/16/68	APPROVED BY: [Signature] DeJ Costanzo
---	-----------------	-------------------	-----------------	---

ID AND OTHER CLEARANCES

IED:IMade  
AD/ICP/BJ/...

IED  
FERS  
CAR

UNCLASSIFIED  
CLASSIFICATION

**ATTACHMENT****End-of-Tour Report (Control No. U-513)**Name: James A. MitchellJob Title: Industrial Development AdvisorCountry of Assignment: KoreaTour of Duty Began: April 19, 1966Tour of Duty Ended: May 23, 1968Prior Country Assignment Years: NoneProject Activity: Industrial Planning, 489-15-606.3**SUMMARY**

It is evident that the USOM/K Industrial Planning project may have made certain worthwhile contributions to the development of Korea's industry and to the ROEKO planning and appraisal process. Based on this, it is believed that similar programs could be considered in other countries where industry is emerging but, that for greater effectiveness, it would be preferable that the programs be responsible to the Program Office or Economics group. The Korean experience would also indicate that Industrial Planning was most effective when operating in cooperation with other Divisions through a Joint Investment Committee and through loan committees but that greater emphasis should probably be placed on the review and analysis of industry sectors equally with individual projects.

Observation of the development and state of Korean industry generally indicates a number of problems in the near future, partly as a result of trying to grow too fast too soon. These, coupled with the continued tendency of a segment of Korean businessmen to look for the "quick buck", the tendency of the RMO for "development by edict" and the aggressiveness of Japanese business, may combine to cause Korea some severe problems in its export program. The results could require a combination of voluntary bankruptcies, increased direct export subsidies, and devaluation of the currency.

Despite current problems, there appears to be some reason for controlled optimism about Korea's future industrial climate. A number of opportunities appear to exist for sound investment. In sum, Korea may have an excellent chance to maintain sound economic growth.

**PROGRAM ACCOMPLISHMENTS**

It is believed that the Industrial Planning project No. 489-15-606.3, which was established within USOM/K in 1966 may have made some lasting contributions to the development of Korean industry, to the project review and appraisal

UNCLASSIFIED

2

process as being developed within the ROEI, and to the direction of ROEI industrial planning generally. Despite the fact that such advice was apparently ignored and projects continued by the ROEI in the face of contrary economic-technical logic, there is growing evidence that planning for several industries has been influenced by advice given to the ROEI through various media. The most notable areas where it seems apparent that USOM advice was adopted are enumerated as follows:

1. A specific project for project exchange of petrochemical projects suggested by USOM has apparently received official blessing of the ROEI and the Republic of China as an initial step in economic cooperation between the two countries.
2. Some of the recommendations made to the ROEI for the development of their petrochemical industry have been adopted, particularly (1) the lowering of tariff barriers to spur the development of end product industries and (2) the development of larger single plants with a balanced, integrated complex.
3. Recommendations made through the JIC on a number of projects and industries have apparently had a delayed success in persuading the ROEI to reexamine certain industries and projects. Most notable is shipping where the government is now apparently reviewing a number of ship acquisition projects.

It is entirely possible, of course, that many of the accomplishments would have been achieved without the presence of an industrial planning project. But it seems clear that the program had some effect in catalyzing the type of thinking required within certain elements of government and has tended to strengthen the hand of those who might otherwise have been stayed more by political considerations alone.

#### PROGRAM PROBLEM AREAS

It should be noted that the program was most effective in those areas such as the JIC where it was in close cooperation with other USOM Divisions, Program, Economic, and Private Enterprise, and that as could be suspected, it functioned best when tied specifically to projects where loan funds were involved or hoped for. It was also more effective where advice could be given well in advance of any commitments having been made. Curiously, the program was an almost total failure at achieving the introduction of new products or industries -- one of the prime reasons for its establishment.

Certain danger areas exist in undertaking future programs of this sort, not only for the U.S. technician involved, but for the Mission and the host country. In addition to the ever present problem that U.S. economic development thinking is not directly transferrable -- the basis for success of a project in a

developing country may well be based on factors not stated in its presentation -- it has become clear toward the end of two years that industrial planning must focus as much on industry sectors as on individual projects. In other words equal stress should be placed on sector economics (macroeconomics) as on the success of individual projects (microeconomics). Both are important.

Given the rapid development of Korean industry, the rapid influx of short term supplier credit loans, and Korea's need to export or die, several severe if not critical problems have come to light through an examination of industrial sectors. If not corrected shortly, it is feared that some of these problems resulting from rapid backward integration with high debt service costs could either strangle the very export markets which Korea needs and which have formed the basis for construction of new plants or force the ROEB to adopt uneconomic direct subsidization. Another result may well be to force a fairly substantial devaluation of the currency. A prime example is the Acrylic fiber industry which has been almost totally developed within the past two years to feed the export market for acrylic sweaters which is now Korea's largest single export item. It seems probable that the new, high cost, small fiber and spinning plants which carry a high debt service burden with rapid repayment will be unable to supply the sweater manufacturers with yarn at a price at which Korea will be able to compete with Japan, Taiwan, Hong Kong, and Singapore. Yet over half of Korea's supply is expected to be exported. For details see the memorandum, "Acrylic Fiber Industry Review", dated December 12, 1967.

#### RECOMMENDATIONS FOR FUTURE PROGRAMS

Based on a two year experience with industrial planning in Korea, a number of recommendations can be made for future action, not only for Korea but other Missions where an industrial base is beginning to develop. These can be summarized as follows:

1. Industrial planning should probably be established within the Program and/or Economic Office or, at a minimum, directly associated with them to avoid becoming too technically or project oriented. Also, generally, it is these offices which work most closely with the host government planners and such association is essential for information, continuity, and giving advice prior to the time when commitments may have been made.
2. The Korean experience indicates that joint effort of several divisions working through a Joint Investment Committee or similar host government - Mission body is ideal for transmitting advice as well as for collecting industrial intelligence. The establishment of such working committees with the teeth to look at and advise on all projects involving foreign loans is strongly recommended -- providing they are in fact working committees.
3. Utilize the industrial planning function to study sectoral economics equally with project reviews and project planning. Use it to point the

UNCLASSIFIED

-4-

way to priorities of investment and investment return. This may mean the function, if established in the future, should utilize individuals with industrial background paired with individuals having economic background. This might help strengthen both types of advice and assure a more balanced overview. Again the Korean experience indicates that the host government will listen, if given good advice.

4. Do not attempt to combine industrial planning with the identification and development of new products. This tends to dilute the planning effort which can probably better be achieved through industrial extension work where the individuals involved work closely with and can gain the confidence of individual industrial firms.
5. While the industrial planning function is not to be continued in Korea at this time, ~~understand that the government is not planning to continue the industrial planning function in any form of planning effort seems worthwhile.~~ This would appear to be most needed in helping the ROKG formulate the industrial portion of its Third Five Year Plan, which might argue for retaining someone with an industrial background to take part in this exercise as a specific project.

#### OBSERVATIONS ON KOREAN INDUSTRY

From two years of close observation it seems fair to say that the Korean industrial economy is in a boisterous but possibly unstable state. There has been too much development by edict - exporting to carry favor - projects with inadequate financial equity - and plain bad projects. Some Korean businessmen still appear too apt to be looking for the quick buck and initially uninterested in whether the project makes an operating profit. There are far too many seriously deficient plants now operating which are either non-competitive or would be without high tariff barriers or virtual prohibition of import. Against this ~~of~~ potential economic problems, stand the Japanese businessmen and the Korean residents of Japan through whom Japanese business operates in Korea.

The major apparent faults in the development of Korean industry stem from trying to grow too fast too soon. These may be summarized as follows:

1. In its rush to backward integrate into the production of industrial raw materials, Korea is making a potential mistake in approving and building plants which are or will be too small to compete in world markets. In order to attempt to overcome some of this disadvantage, the ROKG has established inordinately high demand targets based on heavy exports. In order to reach these export targets, manufacturers have resorted for the volume, low-priced markets by buying needed raw materials at dumping prices from Japan. But once local raw material is available, Korea will not be able to utilize the imported low-priced raw materials because it has based plant approvals and size on heavy export sales. In one or two

industries the demand for 1971 is based on 90 percent as exports. Raw material prices will then have to go up or the ROKG will have to directly and heavily subsidize them, and/or the price to the local market will have to be increased further. In addition, it is probable that the ROKG will have to initiate increased direct subsidies to the export goods manufacturers who now make a good portion of their profit from link import of raw materials over and above direct import which they then sell on the local market at considerable profit. But, if Korea loses a portion of its hastily built export markets, the raw material plants will have to run at part capacity, therefore at higher cost. The most significant danger, however, still appears to be that, in link building a large portion of the capacity of whole industries in two to three years, heavy debt service burdens must be carried in the early crucial years so that any market setback could make it cheaper for a number of companies to declare voluntary bankruptcy.

2. Related to the problem of growing too fast, a severe shortage of local currency has developed with two major results. Companies faced with inadequate capital or equity have asked for bigger loans so that part would be available to them on a cash basis. This has involved apparent markups in the size of the loan, hence the plants start off with a higher capitalization than they should have. The high capital costs combined with fairly fast repayment terms, and low-equity, mean inordinately high fixed costs in early years and necessitate high profit margins if the businesses are to succeed.

Also as a result of local capital shortages, Korean companies must pay inordinately high interest rates for their local borrowing. Thus the high cost of local money coupled with an unusually high foreign borrowing with fast repayment schedules and a very thin equity portion -- sometimes no more than an inflated value placed on the land -- mean that Korean companies must make very substantial profits almost from the first.

In general, it has been possible up to now for Korean firms to make large profits on almost any venture. Korea has been short of production capacity in almost every category. To prevent draining its foreign reserves Korea has restricted imports in almost every category. On top of these factors the ROKG has placed commodity taxes on many basic goods -- even including all chemicals and resins -- to restrict the consumption of what it has called luxury goods. All of these coupled with the fact that the average Korean appears to spend all he makes has made it possible for Korean industry to produce almost anything at any price and sell it without undue regard to quality, consistency, or lasting qualities.

But, with the sudden and rapid emphasis on exports coupled with the rapid increase in manufactured raw materials and intermediate products, Korean industry will suddenly find itself in the position of having to be competitive and quality oriented all at once. But in meeting this challenge, it will be severely

UNCLASSIFIED

handicapped by the factors listed earlier: small plants, high capitalization, therefore high money costs, rapid repayment of foreign loans, high interest costs on local money, and a thin equity position.

Despite the potential problems inherent in trying to grow too fast, it is probably too early to tell whether real trouble will develop. Because, fortunately, there are factors working to slow down the rapid growth. One of these is the natural cautiousness of the foreign investors and lenders; another is the unwillingness of other countries to allow credits to Korea to exceed certain limits. These factors may well combine to act as a sufficient brake to the actual growth of Korea's backward integration into such key industries as petrochemicals, synthetic fibers, steel, and aluminum so that the dependent end-product industries will be able to grow to sufficient size to support them before they are actually realized.

Korea faces another potentially serious problem in its efforts to develop industrially -- competition from Japan. And while discussion of such a problem must be part conjecture and therefore possibly unsuitable for a report of this nature, the potential problem is a very real one. The basis for the problem stems from two factors which have combined to help make Japan successful: (1) the Japanese businessman is both shrewd and aggressive and has amassed sufficient capital to be able to operate on a 15 percent or less return on total investment; (2) Japan thinks of Asia in general and Korea in particular as its sphere of dominant interest. These are facts and while the particular effect depends on individual Japanese businessmen, Japan is both making the majority of industrial loans to Korea and is supplying a vast majority of the industrial equipment. It is also fact that Japanese pricing controls and is largely what establishes both Korean customs duties and Korean market prices.

The rest is conjecture. Two years of observation indicate that most plants being sold in Korea and most loans being made are at inflated prices. This leads to conjecture that Japanese business has a de facto equity position, possibly through Korean nationals residing in Japan, despite the BOEM ban against Japanese investment. The size of this equity and the amount of control which either is being or can be exerted is, of course, also subject to conjecture.

#### OPPORTUNITIES FOR INDUSTRIAL DEVELOPMENT IN KOREA

Despite the problems facing Korea in the development of its industrial economy and the competition from Japan, it appears to the writer that there are also a number of reasons for controlled optimism. There are several reasons for this -- some internal, some external -- which add up to the fact that, of the possible choice of various developing countries for foreign investment, Korea is probably one of the better. Contributing factors include:

Internal

- a. Stable Government
- b. Less receptive to foreign investment
- c. Educated, hard working labor force
- e. Climate
- e. People spend what they make
- f. Low resistance to new methods
- g. No religious taboos
- h. Sizeable potential internal market due to population

External

- a. Low relative labor cost
- b. Ease of shipments because of proximity to Japan
- c. Worldwide emphasis developing for global business.
- d. Lack of many other more viable alternatives

Based primarily on the availability, teachability, and cost of labor in Korea, it would appear that there are a sizeable number of opportunities for industrial projects in Korea which, if and as they are identified and started will materially assist Korea in emerging as an industrial country with a solid future. Some of the more obvious examples of these opportunities include:

1. Shipbuilding for export

To be done right this requires heavy foreign investment and import of technology and must be tied to competitive world buying. If these can be achieved, the low Korean labor cost should make Japanese yards non-competitive. Size of the labor force required - 30,000 to 50,000 - would stimulate the economy. Amount of procurement required would stimulate local manufacture.

2. Special investment castings and/or mold and die industries also for export of special or custom items to foreign design and order.

To be done right this requires exacting specifications on metals and the right to import same. Otherwise it is labor intensive.

3. Custom molding of Plastics

Limited runs of plastic molded, cast, and one of a kind parts, etc. are becoming increasingly expensive in developed countries due to high labor requirement which cannot be amortized over quantity production. There should therefore be a place in Korea for the development of several industries based on imported technology and materials to produce such

items under sub contract. Examples include:

Aircraft molded parts  
Pleasure boat hulls  
Sports car bodies  
Industrial cabinets for special machinery  
Short run molded articles and accessories

4. Assembly operations generally

Electronics  
Case goods  
Multiple part, non-electric machinery

In addition to the glamorous export industries, it would appear that there are a number of ready made opportunities in Korea for investment in projects for local consumption. A few of these are reviewed for the record as follows:

1. Reclamation of sulfur from by-product gypsum as produced by the Yong Nam and Chinhae Fertilizer plants. See memorandum on subject dated January 23, 1967.
2. Gypsum wallboard from same source as above to replace Korea's reliance on imported wood for local plywood. See exchange of letters with U.S. Gypsum during 1966 and 1967.
3. Cellular concrete building products for improved insulating structural materials. See letters to Vice Minister Kim, Tae Dong in 1966 and Kim, Hak So, MNC February 23, 1968.
4. Oil Exploration in the Yellow Sea.