



AGENCY FOR  
INTERNATIONAL  
DEVELOPMENT

COUNTRY ASSISTANCE PROGRAM

KOREA

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Declassified By Authority*

PART I

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Director AID/USCA  
Date 11/24/24*

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DEPARTMENT  
OF  
STATE



AUGUST 1963

AID FORM 10-120 (7-62)	DATE PREPARED August 7, 1963	COOPERATING COUNTRY Korea	<del>CONFIDENTIAL</del>			
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The message accompanying the CAP submission indicated that Section I of the CAP, which incorporates USOM-proposed refinements of the A.I.D. strategy statement, has been reviewed by the Country Team. Except for reservations on the part of the Military, which have not yet been received by AID/W, the revision represents Country Team consensus. Country Team review of Sections II and III was still in process at the time of the CAP submission.

The CAP is being printed and distributed before completion of Country Team review because of time pressures.

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A.I.D. STRATEGY FOR KOREA  
(USOM additions underlined)

The AID/W strategy statement on Korea, dated March 9, 1963, provides the basic policy guidance for the U.S. economic assistance program in this country. However, the following changes are proposed in order to sharpen definition of both targets and operational tactics. Proposed additions are underscored and deletions bracketed.

I. Objectives

The basic U.S. objective is the maintenance of an independent Republic of Korea, resistant to subversion and, with U.S. assistance, capable of deterring or repelling renewed Communist aggression. Related objectives are the development of a stable, and democratically oriented, and increasingly self-reliant nation in the creation and defense of which the U.S. has been deeply involved. U.S. support enables the Republic of Korea (ROK) to maintain a major military force serving U.S. security interest in Northeast Asia, and to meet an otherwise unmanageable balance of payments gap. Economic development is sought to strengthen Korea against Communist economic competition and subversion and to create a stronger and more nearly self-sustaining economy. Economic grant aid levels should be carefully designed to both reduce the U. S. burden in Korea, and, at the same time foster expanded Korean self-reliance.

II. Country Circumstances

Movement toward the long-term goal of a self-sustaining Korean economy is limited by the heavy burden of a 600,000-man ROK military establishment, the size of which is the subject of a report being prepared for the NSC. STATE and A.I.D. support proposals that the U.S. negotiate with the ROK Government for a phased and substantial reduction of active ROK military forces (see III, sub paragraph 6, below). Pending a decision on this subject, A.I.D.'s ability to

bring about increased self-support and reduced U.S. balance of payments support is restricted. The reduction in the economic burden will, however, be less than proportional to force level cuts.

The failure to achieve significant economic growth and to reduce massive unemployment and under-employment has contributed substantially to political unrest in recent years. Prospects The long-term outlook for economic development in the ROK have has improved, however, as a consequence of several new elements in the Korean situation, including greater Korean Government interest in economic development and export promotion, the availability of other external credits from Europe and the pending prospects of a Korean-Japan settlement, which promises a strong impetus to investment and trade as well as direct Japanese aid. It is assumed that the settlement with Japan will be completed in 1963 or 1964. In the near future, and possibly over a period of several years, however, the internal political situation may have an adverse effect on the progress of the economy. With two revolutions in three years, the prospects remain for continuing political instability, which does not augur well for a favorable short-term climate for economic development.

Korean economic development also requires basic changes in current ROK attitudes, both public and private, and the development of policies and institutions needed to gear the economy to a realistic long-range program. Such changes are needed to generate savings, to encourage and expand private enterprise and to enable the economy to function efficiently, without undue political interference.

The underlying economic problem (with powerful political over-tones) confronting the ROK today is the need to adjust internal consumption to a realistic assessment of total availabilities, including foreign aid, while at the same time pushing hard on the export drive. Consumption in 1962, and at least to date in 1963, has increased in the face of reduced U.S. aid programming. This has been possible because of increased domestic output and increased

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imports financed in part with aid funds programmed in previous years and with Korean-owned foreign exchange, which has resulted in a sharp fall in reserves. High and rising consumption levels were institutionalized by past U.S. aid levels, however justifiable such levels may have been on other grounds, and the ROK is naturally loath to make the necessary adjustments. But adjust Korea must, unless a new reservoir of financing for consumption should be opened up in Japan.

As foreign exchange holdings fall, the price of imported goods will tend to rise, compounding the inflationary pressures which in recent months have been accentuated by the Government's food policies, and in the past several weeks by serious damage to the barley crop.

At the present exchange rate, this trend induces imports so long as KFX lasts and discourages exports. If this process continues for long, an adjustment in the exchange rate may be inevitable.

Inherent in the adjustment referred to above is the need for a rationalization of internal prices consistent with and resulting from the necessary curtailment of imported consumption goods. Effective price stabilization of food grains and essential imported materials will undoubtedly be at a level substantially above the levels which the ROKG is presently seeking to maintain.

With population increase running ahead of food production ever since the Armistice, the achievement of food self-sufficiency (a basic operational objective of the aid program), will be a multi-year effort, hinged in large part on the introduction of balanced fertilizers and other improved farm practices. In the meantime, periodic preoccupation with food problems constitutes a deterrent to stabilization efforts and exaggerates demands for PL 480 deliveries.

The task of adjusting consumption and investment to a realistic assessment of available resources, while expanding exports, calls for action on four fronts:

(a) containing demand for manufactured consumer goods, thus seeking to push more productive capacity into export activity;

(b) the diversion of more indigenous resources from consumption to productive investment;

(c) stabilizing prices in order to prevent wage and other cost pressures in Korean enterprise; and

(d) the selective revision of terms under which commodities are made available to Korea, e.g., the establishment of more realistic terms for development loans, and the requirement of gradually expanding KFX procurement of raw cotton.

### III. A.I.D. Strategy

1. Develop a long-range analysis of total resources availabilities and practicable goals as a basis for A.I.D. decisions, and assist the ROK Government /to prepare a satisfactory economic development plan/ to effectively manage the utilization of scarce resources.

2. Gradually reduce aid funds for maintenance of the economy and to increase funds for development as warranted, thus transferring to the Koreans more and more responsibility to sustain themselves. In addition to DL projects, it will be desirable to consider program loans for developmental commodities should such loans appear to be a useful instrument for furthering the emphasis on sound development. The reductions in Supporting Assistance from \$181 million <sup>a/</sup>in FY 1961 to \$80 million in FY 1964, and to \$75 million in FY 1965, in line with the Mansfield Amendment, have been designed to implement this strategy

a/ Includes \$10 million project support, \$15 million Section 402, and \$20 million stabilization fund.

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and put increasing pressure on Korea to continue to expand its own earnings of foreign exchange, use its foreign exchange increasingly on imports of essential commodities and capital goods, limit its imports of consumer goods, and responsibly manage its internal budget. To this end, the level of Supporting Assistance should not be determined by ROK budgetary requirements, but based upon a determination of unmet and essential import requirements. It must be released incrementally pending an evaluation of ROKG performance, primarily in connection with the planning and use of its own foreign exchange.

A.I.D. recognizes that its strategy of gradual reduction in Supporting Assistance must face the possibility that the Koreans will not trim their plans to available resources and will consequently experience severe inflation. In the event that severe inflation occurs, A.I.D. will withhold its capital development lending as one means of pressure to bring about stability. The ROK Government has been, and will continue to be, warned that wasteful use of Korea's own foreign exchange or irresponsible expansion of the Korean money supply will not justify increased U.S. balance of payments supports.

3. Continue pressing for improvement in ROKG planning techniques and budgetary and tax policies and practices, with stress on a) the containment of inflationary forces; b) modernization of the existing banking and credit system and development of incentives to private capital formation; c) an increased role for private, including foreign, equity investment in the development program; and d) the development of improved accounting, entrepreneurial and managerial abilities. The objectives are sought by direct USOM/ROK negotiations, by advisory service training contracts financed by Development Grants, and by self-help "strings" on our aid.

4. Strengthen Korea's economy by interrelating efforts to--

a) encourage the development of appropriate manufacturing industries in the private sector (because of Korea's shortage of natural resources, Korea's economic viability will depend

in the long-run on adding value to largely imported materials and exporting semi-manufactured and finished goods);

b) encourage the development of medium and small scale, labor-intensive private enterprise to make use of Korea's under-employed but industrious and literate labor force; and

c) seek to assure that crucial economic development objectives are served by the Korea-Japan settlement. Such a settlement is expected to bring in substantial Japanese private and official capital which a U.S.-influenced Korean economic development program should channel into the fields indicated in sub paragraphs (a) and (b) above.

5. Continue to encourage other capital sources to assist Korea on concessional terms while using the U.S./ROK agreement which provides for consultation on ROKG use of its foreign exchange and, if necessary, a curtailment of Development Lending to keep short-term commitments within Korea's capacity to repay.

6. Encourage the most appropriate allocation of total resources, both Korean and U.S., between the dual requirements of defense and economic growth by

a) maintaining a proper balance between aid-generated support for the Korean military budget and support for economic growth purposes; and

b) require the ROK to absorb any expansion of local costs in the military budget, except those increases resulting from changes in U.S. policy, which should be considered as they arise.

7. Provided ROKG performance on the economic front so justifies, and to the extent necessary to prevent severe human distress in the face of food shortages, utilize PL 480 grain deliveries to the fullest possible degree to advance U.S. objectives in Korea. Necessary precaution must be taken to prevent the abuse of the intent of this

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paragraph in order to generate excessive local currency for inflated and unjustified budgetary purposes.

8. It is recognized that in the case of renewed insurgency or the threat of same, the U.S. may have to review its aid strategy.

The military junta has pledged a return to civilian rule, but there has been political turmoil in connection with the fulfillment of this pledge. A.I.D. recognizes that development requires political as well as economic stability; it is not clear at this time whether political problems will materially upset aid strategy. With the prospect of political uncertainty, political developments in the coming twelve months may create conditions which will require adjustments in the aid strategy. The military junta has pledged a return to civilian rule, but there has been political turmoil in connection with the fulfillment of this pledge. A.I.D. recognizes that the desired measure of development requires relative political as well as economic stability.

#### IV. Funding Implications in FY 1964 and 1965

A.I.D. proposes the following levels for FY 1964; \$80 million in Supporting Assistance, \$40-60 million in Development Loans, and \$6.6 million in Development Grants (including Civic Action). (A.I.D. is also requesting a PL 480 program of \$70 million under Title I and \$12 million under Titles II and III. These PL 480 levels are approximately the same as those for FY 1962 and FY 1963.)<sup>a/</sup>

The USOM proposes the following levels for FY 1965: \$75 million in Supporting Assistance, \$50-60 million in Development Loans, \$6.6

<sup>a/</sup> S.A. excludes \$1.2 million of FY 63 refunds which will be re-programmed for Korea from FY 64 NOA; PL 480 recommendation omits Title II Animal Feed Program for Cheju Island.

million in Development Grants (including Civic Action), \$70 million in PL 480 Title I sales and \$13.4 million under Titles II and III.

PL 480 deliveries (except for Title III) will be evaluated and determined in accordance with section III, paragraph 7 above. The actual value involved will depend on presently indeterminate variables but might range from \$60-90 million.

The decision has been made in principle to begin in FY 1964 to resume the transfer to ROKG financing of a total of almost \$40 million of consumables now funded in the MAP. A.I.D. proposes to accomplish the transfer in as short a period as practicable; if an accelerated program is worked out with DOD and STATE, it is likely to require some upward revision in assistance levels.

#### V. Program

The Development Loans and other capital funds are currently focused largely on infrastructural growth (power, transportation, communications, etc.) and on industries which will save foreign exchange, e.g., fertilizer, with most loans going to governmental entities. However, A.I.D. hopes to place increasing emphasis on the private sector. For example, A.I.D. has been working in detail with the Korean Reconstruction Bank, a development bank funded in large part with DLF and counterpart loans, to assure its use of acceptable banking principles, and expects in FY 1964 to fund a major advisory contract. It will also encourage foreign, particularly U.S., private investment. A.I.D. also intends to stimulate the identification and presentation of sound projects, the shortage of which has hindered ROKG development plans.

The Development Grant program provides technical assistance on an important scale in agriculture, public administration and vocational training. In other areas, A.I.D. is providing advice, not primarily in technical skills but in managerial advice and training. Substantial DG funds are also being expended in the search for resources, especially minerals and ground water.

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The Development Grant program is being used to strengthen ROKG management capability and performance in essential fields of investment credit, power production and distribution, fertilizer production, industrial development, monetary and fiscal policy, export promotion, and planning resources use. Additionally, technical assistance is being provided in vocational education, agriculture and fisheries, minerals and coal exploration, public administration, and to a very limited degree in public health, police administration, housing and communications.

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### A. Introduction

The discussion of, and justification for, aid levels in the categories of Supporting Assistance, Development Loans, and Development Grants, which are set forth below, are believed to be consonant with the strategy statement governing U. S. assistance to Korea.

Concerning PL 480, the demand or justification for deliveries of any given volume (except for cotton) will be governed both by "acts of God," as in the case of the shortfalls in rice production in the fall of 1962 and in barley output in June of 1963, and by the wisdom of ROKG policies and actions on the agricultural and related fronts, e.g., fertilizer production. The proposed revisions in the strategy statement seek to more clearly define the role of PL 480 deliveries in meeting U. S. strategical objectives in Korea.

### B. A Recap of Relevant Statistics

1954-1963

In order to provide a backdrop against which to view the USOM's discussion and recommendations on aid levels for FY64 and FY65, there is included here (pages 2 - 6), without any detailed narrative analysis, six statistical series which illustrate clearly the significant economic trends and developments of the past ten years. The USOM believes a brief review of these data lends additional meaning and relevance to the content of the Aid Strategy for Korea and the aid level recommendations herein contained.

### C. USOM Aid Recommendations for U. S. FY 1964 and 1965

#### 1. Import requirements

While its basic commodity studies are not yet complete, the USOM has made estimates of imports by major categories as a preliminary step in developing an aid recommendation. Insofar as possible,

the USOM estimates take account of historical patterns as well as developments in economic activity over the last eighteen months. The import estimates are presented in the table which appears below.

Korea: Estimated Import Requirements, CY 1962/65  
(in millions of dollars)

	1962 <sup>a/</sup>	1963	1964	1965
A. Food and Animals <sup>b/</sup> (PL 480 (food))	42.1 (37.2)	74.4 (55.7)	60.0 (50.0)	60.0 (50.0)
B. Beverages and tobacco	0.1	0.2	0.2	0.2
C. Crude materials (PL 480 cotton)	89.7 (31.3)	100.0 (35.0)	100.0 (32.0)	105.0 (27.0)
D. Mineral Fuels and Lubricants	30.6	30.0	30.0	29.0
E. Animal Fats and Oils (PL 480 tallow)	3.9 (2.0)	3.5 (2.0)	3.5 (2.0)	3.5 (2.0)
F. Chemicals	94.3	90.0	90.0	94.0
1. Fertilizer	(62.3)	(58.0)	(54.0)	(50.0)
G. Mfg. Goods**	73.1	75.4	81.0	70.0
H. Machinery and Transport*	69.8	105.0	129.0	75.0
1. Machinery	(34.5)	(50.0)	(59.0)	(45.0)
2. Electrical Machinery	(28.7)	(30.0)	(25.0)	(10.0)
3. Transport Equipment	(6.6)	(35.0)	(45.0)	(20.0)
I. Misc. Mfgs. **	10.2	12.0	12.0	10.0
J. Misc. N.E.C.	1.6	7.9	2.9	4.3
Total	415.4	498.4	508.6	451.0
Current Imports	(345.0)	(377.7)	(351.6)	(361.0)
Capital	(70.4)	(120.7)	(157.0)	(90.0)

<sup>a/</sup> Actual

<sup>b/</sup> Includes about \$20 million of food grain imports relating to the 1962 rice crop shortfall, and about \$10 million of KFX financed relief grains associated with the 1963 summer grain crop failure.

\* Almost entirely capital goods

\*\* Partly capital goods



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TABLE #1

AID FUNDING (Obligations as of June 30, 1963)  
(In Millions of U.S. Dollars)

	<u>FY 1954</u>	<u>FY 1955</u>	<u>FY 1956</u>	<u>FY 1957</u>	<u>FY 1958</u>	<u>FY 1959</u>	<u>FY 1960</u>	<u>FY 1961</u>	<u>FY 1962</u>	<u>FY 1963</u>
A. Grant Aid	<u>176.1</u>	<u>226.5</u>	<u>296.9</u>	<u>300.3</u>	<u>209.4</u>	<u>214.2</u>	<u>201.5</u>	<u>180.8</u>	<u>93.2</u>	<u>92.4</u>
1. Project (D.S.)	79.4	95.0	74.5	90.4	32.0	31.2	18.0	3.7	0	0
2. Non-Project (D.S. & S.A.)	96.7	131.5	222.4	209.9	177.4	183.0	183.5	177.1	93.2	92.4
B. Technical Assistance (T.C. & D.G.) <sup>a/</sup>	N. A.	0.2	3.8	4.6	5.0	6.3	6.0	5.7	10.7	5.6
C. P. L. 480 <sup>b/</sup>	1.3	25.4	63.6	46.1	72.3	50.1	14.2	78.8	81.3	90.0
D. Loans <sup>c/</sup>	N. A.	N. A.	N. A.	N. A.	N. A.	6.7	11.7	3.2	20.9	12.6
<u>Total</u>	<u>177.4</u>	<u>252.1</u>	<u>364.3</u>	<u>351.0</u>	<u>286.7</u>	<u>277.3</u>	<u>233.4</u>	<u>268.5</u>	<u>206.1</u>	<u>200.6</u>

<sup>a/</sup> Excludes Civic Action.

<sup>b/</sup> Titles I, II, & III, including ocean freight for Titles I & II.

<sup>c/</sup> Obligation basis.

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TABLE #2

BALANCE OF PAYMENT 1955 - 1962  
(In Million US Dollar)

	<u>1955</u>	<u>1956</u>	<u>1957</u>	<u>1958</u>	<u>1959</u>	<u>1960</u>	<u>1961</u>	<u>1962</u>
<u>Receipts</u>								
Exports	17.6	25.2	19.4	17.1	19.7	32.8	40.9	54.8
UNC Earnings	43.2	24.2	43.4	57.6	63.3	62.6	79.7	84.7
U.S. Aid <u>a/</u>	199.8	318.7	356.5	327.9	232.7	264.1	218.9	212.0
Donations	30.6	33.7	28.4	21.0	11.2	11.6	12.6	24.5
Others <u>b/</u>	49.7	-6.6	17.1	-20.5	4.1	10.2	-6.5	81.0
Errors and Omissions	-3.6	-1.2	+1.4	+0.5	+0.1	-2.1	-1.6	-3.6
<u>Total</u>	<u>337.3</u>	<u>394.0</u>	<u>466.2</u>	<u>403.6</u>	<u>331.1</u>	<u>379.2</u>	<u>344.0</u>	<u>453.4</u>
<u>Repayments</u>								
Commercial Imports	280.9	336.5	399.7	338.3	264.4	303.6	276.8	343.1
Capital Imports	46.7	43.6	42.5	39.9	39.4	39.9	39.3	72.1
Others	9.7	13.9	24.0	25.4	27.3	35.7	27.9	38.2
<u>Total</u>	<u>337.3</u>	<u>394.0</u>	<u>466.2</u>	<u>403.6</u>	<u>331.1</u>	<u>379.2</u>	<u>344.0</u>	<u>453.4</u>

a/ Includes SA, PL 480 Titles I, II, & III, DG, DS, TC, & DL.

b/ Change in KFX holdings and other capital movements, and miscellaneous invisibles.

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TABLE #3

PRODUCTION INDEX 1953 - 1962 a/

	<u>1953</u>	<u>1954</u>	<u>1955</u>	<u>1956</u>	<u>1957</u>	<u>1958</u>	<u>1959</u>	<u>1960</u>	<u>1961</u>	<u>1962</u>
Industrial	N.A.	100.0	119.5	146.3	168.8	186.0	213.5	232.6	245.8	287.2
Manufacturing	N.A.	100.0	120.9	146.2	164.3	181.9	202.3	212.8	221.9	259.1
Agricultural	93.8	100.0	103.3	94.9	105.4	112.8	114.4	113.6	N.A.	N.A.

a/ Annual Averages

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TABLE #4

ROK GOVERNMENT FINANCES, 1953 - 1963  
At Current Value

(In Billions of Won)

	<u>1953</u>	<u>1954</u>	<u>1955</u>	<u>1956</u>	<u>1957</u>	<u>1958</u>	<u>1959</u>	<u>1960</u>	<u>1961</u>	<u>1962</u>	<u>1963</u> <sup>a/</sup> (Budget)
1. General Government Revenues	5.0	6.2	11.2	21.1	32.8	34.8	40.2	41.5	51.0	64.0	72.5
2. General Government Expenditures	5.7	8.0	15.0	20.0	33.5	38.8	39.5	39.7	58.4	70.5	74.4
3. General Government Surplus or Deficit (-)	-0.7	-1.8	-3.8	1.1	-0.7	-4.0	0.7	1.8	-7.4	-6.5	-1.9
4. Special Accounts, net	0.1	-1.2	0.4	-1.2	-0.2	0.1	-3.9	1.3	0.7	-3.5	-0.4
5. Total Government Surplus or Deficit (-)	-0.6	-3.0	-3.4	-0.1	-0.9	-3.9	-3.2	3.1	-6.7	-10.0	-2.3

<sup>a/</sup> All revenues and expenditures are treated on net cash basis. National bond and industrial reconstruction bond proceeds and repayment of principal have been deducted from revenues and expenditures through 1962. For 1963 national bond proceeds and repayments are included in the revenue and expenditure figures. For 1961, 1962, and 1963, BOK profit revaluation amounts have been deducted from the revenue figures. Accordingly, the government surplus or deficit reflects the impact of the fiscal sector on the money supply.

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TABLE #5

DATE & NATURE OF CURRENCY REVALUATION (1)  
(Won Value to 1 U.S. Dollar)

<u>Effective Date</u>	<u>Official Rate</u>	<u>Rate for Counterpart Deposit</u>	<u>Rate to UN Soldiers</u>	<u>Rate for Other UN Military Won Transaction</u>
10 Nov. 1951 thru. 31 May 1953	6.0	6.0	6.0	6.0
1 June 1953	6.0	6.0	18.0	18.0
28 Aug. 1953	6.0	18.0	18.0	18.0
15 Dec. 1953	18.0	18.0	18.0	18.0
10 Nov. 1954	18.0	18.0	50.0	18.0
15 Nov. 1954	18.0	18.0	50.0	31.0
10 Jan. 1955	18.0	35.0	43.0	43.0
1 Feb. 1955	18.0	35.0	40.0	50.0
2 May 1955	18.0	35.0	44.0	44.0
6 June 1955	18.0	35.0	48.0	48.0
11 July 1955	18.0	35.0	51.0	51.0
15 Aug. 1955	50.0	50.0	50.0	50.0
28 Aug. 1958 (2)	50.0	50.0	50.0	50.0
20 Jan. 1960	50.0	65.0	65.0	65.0
23 Feb. 1960	65.0	65.0	65.0	65.0
1 Jan. 1961	100.0	100.0	100.0	100.0
2 Feb. 1961	130.0	130.0	130.0	130.0

(1) To convert from Won to Hwan multiply by factor of ten.

(2) From this date through 31 December 1960, 15 Won per dollar was collected from import dollar purchasers as a foreign exchange tax in addition to the 50 Won to 1 U.S. Dollar exchange rate.

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TABLE #6

AID PIPELINE AT THE END OF CALENDAR YEARS 1959-1963  
(In Millions of U.S. Dollars)

	<u>12/31/59</u>	<u>12/31/60</u>	<u>12/31/61</u>	<u>12/31/62</u>	Est. <u>12/31/63</u>
A. Grant Aid	<u>254.1</u>	<u>183.1</u>	<u>143.3</u>	<u>70.8</u>	<u>30.5</u>
1. Project (DS)	112.6	67.3	39.5	22.8	3.9
2. Non-Project (DS & SA)	141.5	115.8	103.8	48.0	26.6
B. Technical Assistance (TC & DG)	9.7	9.8	5.9	10.0	6.9
C. P. L. 480	30.9	4.9	19.7	71.7	70.0
D. Loans	12.7	15.8	17.6	40.2	58.0
<u>Total</u>	<u>307.4</u>	<u>213.6</u>	<u>186.5</u>	<u>192.7</u>	<u>165.4</u>

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The considerations underlying the foregoing estimates are explained below. (The USOM notes that its division of imports between current and capital is still in process of refinement. Thus, as will be explained, these divisions have been made arbitrarily for purposes of this presentation.)

a. Food and Animals

Food imports are expected to increase from about \$42 million in 1962 to about \$74 million in 1963, and thereafter it is expected that imports will level off at about \$60 million, barring food crises similar to those experienced in 1962 and 1963. For 1963 "normal" wheat arrivals are calculated at the level of 550,000 tons compared with "normal" wheat arrivals of about 371,000 tons in 1962, or at \$38.6 million in 1963 compared with \$26 million in 1962. In addition, about 100,000 tons of PL 480 barley financed under the Seventh (1962) Agreement will arrive in 1963, and Title II and III arrivals will be about \$13 million. Given rising consumption trends for wheat, reflecting up-grading of diets as incomes rise, it is entirely possible that despite our recommendations for 500,000 tons for FY 1964 and FY 1965 even 550,000 tons of wheat will be insufficient to meet demand in future years.

b. Beverages and Tobacco

These items are shown at a slight increase to take account of increased imports to handle an expected increase in the tourist trade.

c. Crude Materials

Imports of crude materials jumped from a 1958/61 average of about \$67 million to about \$90 million in 1962. The bulk of the increase occurred in wood and lumber - from about \$7 million to about \$18 million - and in textile yarns - from about \$42 million to about \$50 million. Part of the increase in textile yarns reflected

an abnormally low level of imports during the relatively stagnant 1961; the balance represents increased production for internal use as well as for exports. Imports of cotton were about 240,000 bales in 1962 and 1963 imports will be about 270,000 bales representing an increase of about \$4 million.

Excluding cotton, the USOM has assumed an average increase of about ten percent in the import of crude materials for 1964 and 1965 over 1963, on the assumption of a ten percent increase in requirements to meet current levels of consumption and projected levels of exports, particularly of plywood and cotton fabrics. The USOM believes that perhaps this projected increase may be on the high side, particularly if efforts are made to curtail marginally essential consumption.

d. Mineral Fuels and Lubricants

Imports of POL and, after the completion of the Ulsan Oil Refinery, crude as well as asphalt imports have been estimated to remain at about historical levels. While completion of the refinery is expected to reduce the cost of POL consumption at present levels, provision of POL for the ROKG Military will add to the crude input required to service the economy. Further study is being made by the USOM of this problem but final conclusions will not be available until certain problems relating to the role of the Refinery have been resolved.

e. Animal Fats and Oils

The principal component of this group is beef tallow. While rising consumption should cause these items to increase, greater local availabilities of beef tallow have been assumed as Korea's livestock industry grows, slaughtering becomes systematized, and as detergents make their appearance on the scene.

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f. Chemicals

Imports of chemicals increased from a 1958/61 average of about \$68 million to about \$94 million in 1962. A substantial portion of this rise was accounted for by fertilizer which rose from a four-year average of \$48 million to \$62 million in 1962. Another large portion of the increase resulted from imports of organic and inorganic chemicals from a four-year average of about \$5.2 million to about \$12 million.

For purposes of projections, the USOM has assumed that 1963 fertilizer imports will drop, reflecting the first full year of capacity production by Chung-ju Fertilizer Plant and some output from the newly-established Honam Fertilizer plant. A further drop is estimated for 1964 on the assumption that the full capacity of Honam (85,000 tons) will be available and a levelling-off is assumed for 1965. These figures are, at best tenuous, and will be affected by greater understanding and, thus, use of mixed fertilizers as well as by fruition of certain plans now underway for expansion of production.

Further increases should occur in the requirements for other chemicals. For example, paid-in capital in chemical plants alone increased from about ₩100 million in 1961 to nearly ₩500 million in 1962. Other chemical-using industries, e.g., rubber products and glass, have shown similar increases in capitalization and associated rises in capacity and production.

g. Manufactured Goods

Imports in 1962 of manufactured goods were about \$73 million compared with a previous four-year average of about \$45 million. The bulk of the increase is accounted for by textile yarns, e. g., rayon and other synthetic fibers, which rose by about \$12 million over the previous four-year average, and by base metals which rose by nearly \$15 million. While modest increases are projected in

imports, principally for base metals, the USOM believes that demand for these items will level down during the period under review as a result of some tapering off of investment activity. Moreover, in the case of synthetics, one nylon yarn plant, financed by an AID loan will go into production this year and others are in the planning stage. Off-setting this prospective increase in production of synthetic fibers is the presently unassessed possibility of significantly expanded exports of such things as "Stretch-nylon" yarn.

h. Machinery and Transport Equipment

The USOM has not completed its detailed analysis of imports under this heading in the light of known facts about draw-down of foreign credits and loans, including DL. The data for transport and electrical equipment are the most solid at this time. For example, during 1963, Korea can expect to get DL-financed diesel locomotives with a value of about \$7 million, a substantial part of IDA-financed rolling stock worth a major part of \$14 million, some \$3 million worth of Japanese self-propelled cars, and vessels of various kinds for, perhaps, \$10 million. In 1964, deliveries of ships under the French/Italian Fishing Agreements should burgeon and Korea will also get additional diesels worth about \$10 million. By 1965, loan-financed equipment is expected to drop off and imports will once again include mostly replacement items and spare parts.

In the field of electrical equipment, various power projects underway, approved and planned, will account for the bulk of equipment in this category. In addition, modernization of Korea's power transmission and distribution system will require substantial inputs.

Industrial machinery estimates are, at best, informed guesses at this time, but the orders of magnitude are consistent with the USOM's knowledge of approved and planned foreign loans and credits as well as with its information about normal replacement machinery and spare parts.



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i. Misc. Mfgs. and Misc.

These are "Catch-all" items which encompass clocks, watches, scientific and precision instruments, cameras, film books, etc. The projections may be too high in terms of what the economy needed to maintain minimum levels of production and consumption. Having no other basis on which to proceed at this time, the USOM has accepted the 1962 level as about "normal".

As noted above, the USOM has not yet worked out a definitive basis for separating capital and consumption items in the import list. For purposes of this presentation, the USOM has assumed that 70-80% of machinery and transport equipment imports represent net new investment and that the balance of the estimated capital goods imports can be attributed to the manufactured goods category which includes substantial amounts of iron and steel products which, ultimately, will be reflected in net investment figures. (The USOM notes that its method for estimating is crude and, e. g., ignores the fact that almost every item of imports contains elements of investment either in use or as inventory additions. The USOM expects to be able to categorize imports more precisely during the course of the next presentation.)

2. Per Capita Consumption

Reflecting the rising trend in domestic production, which, in turn, reflects the rising trend in commercial and capital imports, per capita consumption in Korea has shown substantial increases since 1953-55. Following is a list of indices that demonstrate this rising trend in per capita consumption:

Indices of Per Capita Private Expenditures in Constant Prices  
(1955 = 100)

	<u>1953</u>	<u>1959</u>	<u>1962</u> <sup>a/</sup>
Food	97.5	110.7	118.1
Beverages	98.3	111.7	66.7
Tobacco	91.2	103.6	121.9
Clothing	111.7	133.1	127.1
Personal Care	136.2	158.5	234.0
Recreation	124.3	165.5	131.1
Rent	95.9	108.2	110.5
Fuel and Light	104.7	127.5	130.2
Furniture	90.5	100.0	78.6
Household Operations	109.8	116.8	130.5
Transportation	140.4	167.3	215.4
Misc. Services	100.0	116.3	77.5
Total Above	102.2	118.6	120.9

a/ Preliminary

With the exception of expenditures for beverages, furniture, and miscellaneous services, all of the indices point to increased standards of well-being for the Korean people. Other indices, as shown below, lead to the same conclusions:

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Indices of Per Capita Consumption of Various Consumer Items  
(1955 = 100)

	<u>1953</u>	<u>1959</u>	<u>1962</u>
Refined Sugar	2.2	138.2	114.0
Beer	8.2	114.8	44.3
Soft Drinks	a/	154.2	233.3
Canned Food	59.5	102.4	50.0
Tobacco Products	86.2	102.3	113.8
Cotton Cloth	a/	166.1	146.4
Woolen Cloth	a/	102.6	105.8
Rayon Cloth	a/	103.2	92.4
Nylon Cloth	a/	437.2	1774.4
Silk Cloth	a/	177.1	162.7
Laundry Soap	105.6	115.4	125.0
Toilet Soap	85.7	152.7	165.9
Matches	92.0	92.0	104.0
Pencils	40.1	128.7	85.4
Rubber Shoes	97.2	157.4	179.6
Sewing Machines	93.6	83.7	313.5
Newsprint	53.6	273.7	446.1
Letters Mailed	a/	136.3	198.9
Residential Lighting	a/	239.6	260.7
Residential Electricity Consumers	a/	106.9	118.9
Automatic Telephones	56.0	204.4	423.7
Telephone Subscribers	a/	199.3	322.0
Bicycles	38.8	53.0	177.6
Private Passenger Cars	63.2	131.4	79.6
Taxis	48.3	199.6	247.7
Taxi Passengers	24.5	410.4	644.3
Bus Passengers	46.6	168.0	183.5
Railroad Passengers	85.2	111.4	143.9
Licensed Barbers	a/	134.9	179.2
Beauty Specialists	a/	305.9	446.3

	<u>1953</u>	<u>1959</u>	<u>1962</u>
Movie Theaters	a/	490.0	670.0
Primary School Classrooms	83.5	134.1	155.5
Middle School Classrooms	83.5	150.0	166.5
High School Classrooms	a/	145.0	150.0
University Classrooms	100.0	145.5	214.2

a/ Data not available

The foregoing data provide a partial explanation for the apparent increase in "maintenance of the economy" imports over the last four years. The data should be treated with extreme caution for the present because the per capita increases in consumption which are revealed by a number of the figures appear to have been concentrated upon a relatively small proportion of the population, notably the "urban elite". Thus, as indicated in Section I of this submission, it will be possible and indeed necessary to take measures to check increases in this kind of consumption in order to divert resources to investment. Any program designed for this purpose will necessarily involve highly selective tax and fiscal measures rather than across-the-board measures such as national sales taxes or excises.

As part of the overall program of research and analysis relating to Korea's import requirements, USOM is conducting an intensive investigation into the total evolution of consumption patterns over the post-war period in order that it may develop a more realistic appraisal of Korea's import needs.

### 3. Balance of Payments Projections

Using the import requirements data presented in the foregoing section and estimates of earnings and capital transactions,

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the USOM has made balance of payments projections, which appear in the table below:

Korea: Balance of Payments Estimates, CY 1963/64/65  
(In millions of dollars)

	<u>1963</u>	<u>1964</u>	<u>1965</u>
A. Merchandise			
1. Imports <sup>a/</sup>	498.4	508.6	451.0
2. Exports	80.0	100.0	110.0
3. Trade Balance	-418.4	-408.6	-341.0
B. Net Invisibles	97.0	106.0	110.0
1. UNC	(75.0)	(70.0)	(70.0)
2. Donations	(20.0)	(23.0)	(26.0)
3. Other (net)	(2.0)	(13.0)	(14.0)
C. Balance on current account	-321.4	-302.6	-231.0
D. Net capital and FX <sup>b/</sup>	88.0	84.0	29.0
1. Private	(40.0)	(53.0)	(21.0)
2. Official	(15.0)	(43.0)	(19.0)
3. Down payments and loan service (-)	(17.0)	(16.0)	(21.0)
4. KFX	(50.0)	(4.0)	(10.0)
E. Deficit before AID and PL 480	233.4	218.6	202.0
F. AID and PL 480	233.4	218.6	202.0
1. PL 480	92.7	83.4 <sup>c/</sup>	83.4
a. Title I	(79.3)	(70.0)	(70.0)
b. Title II and III	(13.4)	(13.4)	(13.4)
2. AID	140.7	135.2	118.6
a. D.G. <sup>d/</sup>	(6.7)	(6.6)	(6.6)
b. D.L.	(19.0)	(37.0)	(37.0)
c. S.A. <sup>e/</sup>	(115.0)	(91.6)	(75.0)

- a/ Includes about \$20 million of food grain imports relating to the 1962 rice crop shortfall, and about \$10 million of relief grains associated with the 1963 summer grain crop failure.
- b/ Excluding DL.
- c/ Excludes amounts to compensate for CY 1963 barley losses during January-June 1963.
- d/ Including Civic Action.
- e/ 1963: Prior year pipeline (\$48 million) plus (\$67 million) of FY63 funds;  
1964: FY63 funds (\$25.4 million) plus FY64 funds (\$66.2 million);  
1965: FY64 funds (\$15 million) plus FY65 funds (\$60 million).

Exports are expected to rise by about \$20 million in 1964 and by another \$10 million in 1965 over the level estimated for 1964. A number of factors account for this anticipated increase. Korea is showing an increasing ability to produce good quality manufactured goods, notably textiles and metal products. Efforts to augment and modernize Korea's fishing fleet should permit greater catches of shrimp and crustacea which appear to have an almost unlimited market, at least in terms of production envisioned. Perhaps most important, reductions in external aid and KFX reserves will force Korean producers to look outward for markets and the earnings with which to purchase needed import items.

UNC earnings for 1963 reflect a reduction from earlier estimates by about \$10 million, as receipts during the first six months of 1963 were below expectations. It is not yet clear at this time whether UNC earnings will continue to decline or not, but the USOM has thought it prudent to show lower estimates for UNC earnings during 1964 and 1965 on the assumption that efforts to curb the "gold-flow" will be continued and broadened.

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(NOTE: A greater retention rate for "U.S. uses" of PL 480 sales proceeds is being advocated by the USDA for this purpose. The inter-relationships between this "dollar saving" and S.A. levels must be examined carefully.) Korea's recent investment in additional ocean-going vessels is expected to both reduce freight payments on imports and permit Korea to ship a greater portion of her exports. Moreover, some increase in travel income may be expected as Korea develops more facilities for accommodating tourists. On the other hand, investment income is expected to decrease by about \$2 million a year as a result of sharp reductions in Korean KFX during 1962 and 1963. On balance, the modest increases in invisibles would appear reasonable although, given any relaxation by Korea of existing restrictions on foreign travel and other payments, the increases might not be realized.

Capital receipts are expected to rise sharply in 1964 if the projects committed or definitely planned go forward. Since the bulk of these non-US government loans and credits are relatively short-term, they can be expected to impose an increasingly heavy burden on Korea's foreign exchange reserves. On the other hand, some evidence exists that the ROKG is having second thoughts about this kind of commitment and some retrenchment may take place in coming months. To the extent this happens, capital imports will not be as high as presently estimated and the rate of growth which the ROKG hopes to attain will thereby be reduced but not, in the judgment of the USOM, seriously. Indeed, provision of the local resources necessary for utilizing imported capital on the scale estimated would probably cause serious strain on the economy.

Section F of the foregoing table shows AID and PL 480 assistance which includes both pipeline utilization as well as the new obligational authority which is recommended in the section which follows.

#### 4. AID and PL 480 Recommendations

On the basis of the import requirements and balance of payments analyses of the foregoing sections, and after taking account of pipeline adjustments, the USOM makes the following recommendations for AID and PL 480 levels (in millions of dollars):

<u>Aid Source</u>	<u>Actual 1962/63</u>	<u>1963/64</u>	<u>1964/65</u>
<u>AID</u>	112.3	148.4	111.6
SA	92.4	81.2 <sup>a/</sup>	75.0
DL <sup>b/</sup>	12.6	60.6	30.0
DG <sup>c/</sup>	7.3	6.6	6.6
<u>PL 480</u>	92.7 <sup>d/</sup>	83.4 <sup>d/</sup>	83.4
Title I	(79.3)	(70.0)	(70.0)
Title II and III	(13.4)	(13.4)	(13.4)

<sup>a/</sup> Includes NOA \$1.2 million reflecting AID commitment to reprogram balance of FY 1963 ROK refund.

<sup>b/</sup> Commitments basis.

<sup>c/</sup> Includes Civic Action.

<sup>d/</sup> Includes 550,000 tons of wheat as CY 1963 requirements, reflecting 1962 rice harvest shortfall but the 1963/64 figure does not include amounts to compensate for CY 1963 barley losses during January-June 1963.

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These recommendations reflect the U. S. desire to gradually reduce support for "maintenance of economy" purposes, while expanding development loans for productive investment and a broadening of the self-support capabilities of the Korean economy. It will be shown in the discussion of development lending that Korea possesses the absorptive capacity to fully and productively utilize the level of loans proposed. The figures on Development Grants reflect the establishment of priorities (or goals) for the use of such funds and their concentration, in the main, on these priorities. Specific comments on the AID recommendations follow.

a. Supporting Assistance

CY63 will see the virtual disappearance of the relatively large aid-financed pipeline which has played so major a role in softening the impact of the sharp reductions in new supporting assistance funds available in FY62 and 63 (see B-6 above). Except for the additional \$15 million PA'd just prior to the end of FY63 and to be released during the first half of FY64, subject to ROKG performance on stabilization, the SA pipeline is expected to be drawn down to approximately \$11.6 million by December 31, 1963. At the same time, maintenance of economy imports (current consumption plus investment maintenance or replacement) reached a new high in CY62 of about \$345 million and, with present trends, will rise still further in CY63 to a possible level of about \$378 million, including additional food grain imports relating to the 1962 rice crop shortfall, and relief grains associated with the 1963 summer grain crop failure obtained with KFX. When the expanded capital imports are added to these figures, total imports for CY62 reached about \$415 million and for CY63 may reach approximately \$498 million. Imports at these levels resulted in a KFX drawdown in CY62 of \$40 million and, including KFX financed food grain imports in CY63, will cause at least a \$50 million reduction in CY63. At this time (July 29) it is indeed problematical whether the ROKG will exercise the self-discipline necessary to meet the agreed stabilization target of \$115 million in KFX reserves at December 31, 1963.

The USOM believes that the capital imports in CY64 may be less than estimated as a result of pressures created by falling KFX reserves and inadequacy of domestic savings. This view is increasingly shared by key EPB personnel, including the Chairman and new Deputy Chairman. For example, \$30 million is charged against imports of fishing craft under the Italian fishing deal. There is much likelihood that this tentative arrangement will be re-designed and reduced. On the other hand, the figure for CY65 may be low, inasmuch as both attenuated CY64 and new undertakings will result in increases.

Both current and capital imports (with the resultant increases in debt service costs) should come under critical review in the weeks ahead as Korea's KFX position worsens. Any significant reduction in KFX reserves below \$100 million will engender serious uncertainties in the business community and have an adverse effect on prices. A partially compensating benefit should be the pressures falling reserves will exercise on the ROKG to adopt a more thrifty posture on the entire economic front. It must therefore be assumed that as early as possible during CY64, the ROKG should strike a precarious balance in its KFX position and prevent further deterioration of its reserves. Such action will require more rigorous screening of both current and capital imports than has yet been undertaken.

On the export side, the USOM expects a total export level in CY63 of approximately \$80 million and in CY64 of approximately \$100 million. While there is a corresponding increase in the import component of such exports, the USOM believes that there are opportunities for comparable and offsetting contraction of imports for purely internal and marginally essential consumption, without adversely affecting the upward trend in exports.

An overly simplified balance of payments statement for "maintenance of economy" and capital purposes would look something like the following:

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(In millions of dollars)

Availabilities	Current Imports			Capital Imports		
	1963	1964	1965	1963	1964	1965
PL 480	92.7	83.4	83.4	-	-	-
Supporting Assistance	115.0	91.6	75.0	-	-	-
DG & Civic Action	5.0	5.0	5.0	1.7	1.6	1.6
Development Loan				19.0	37.0	37.0
Short-term Credits a/	-	-	-	55.0	96.0	40.0
KFX	5.0	-	-	45.0	4.0	10.0
Earnings less down payments and Loan Servicing	<u>160.0</u>	<u>171.6</u>	<u>197.6</u>	<u>-</u>	<u>18.4</u>	<u>1.4</u>
Total	377.7	351.6	361.0	120.7	157.0	90.0

a/ Includes an allowance for a few non-U.S. long-term credits.

This sort of calculation indicates Korea's unhealthy reliance on short-term credits to finance capital imports. As stated earlier the ROKG is having second thoughts about short-term capital import commitments, and accordingly some retrenchment may take place. On the other hand, the above table indicates that there is very little margin to make up possible cut-backs in short-term credits out of current income. For these reasons the USOM believes the aid levels envisioned are on the tight side. However, as indicated in the basic assistance strategy statement, program loans could provide relief from foreign exchange stringency, if that should be needed, if Korea's performance on other fronts so warranted.

b. PL 480

In making the recommendations which follow, the USOM has taken into account the diverse considerations that inevitably bear on this type of program, e.g., the desire and long term need to reduce Korean dependence on PL 480 deliveries, the desire to develop, in the long run, normal commercial markets for U.S. agricultural products, the desire to

diversify Korean dietary patterns, the necessity to prevent PL 480 deliveries from constituting a disincentive to the progress of Korean agriculture, and the ever present need to generate local currency for high priority U.S. purposes in Korea. This last consideration, as indicated in the Aid Strategy Paper, is of diminishing significance but cannot be entirely disregarded under present circumstances. The USOM's recommendations give due regard to these different and sometimes conflicting factors.

The USOM proposes that the following recommendations be incorporated in the next (Ninth) PL 480 Agreement, which should be negotiated during October 1963, after the size of this fall's rice crop is determined. Deliveries would commence in January 1964. The Agreement should attempt to cover, to the fullest possible extent, the shortfall in requirements for the entire CY64.

The USOM is currently developing such stipulations as may be necessary or desirable in connection with this Agreement.

i. Wheat

Aside from extraordinary food requirements stemming from the failure of the 1963 summer grain harvest, the USOM is recommending for CY64 PL 480 wheat deliveries under Title I of 500,000 M/T. Further, the USOM is seriously considering the proposal that the Ninth PL 480 agreement stipulate that this wheat and the resultant wheat flour be procured and distributed through commercial channels only. The figure of 500,000 M/T reflects the growing commercial market for wheat products in Korea and the desirability of encouraging the dietary diversification this wheat flour consumption represents. The recent increase in the extraction rate to 85% may be a precedent which it would be wise to establish as a permanent practice. The Ninth Agreement will also have to make some provision for the carry-over of the 1963 barley crop shortfall into CY64. Two hundred and fifty to three hundred thousand (250-300,000) tons of additional grain may be required for this purpose.

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ii. Cotton

The USOM believes the ROK should gradually expand its KFX procurement of raw cotton. We doubt the wisdom of indefinitely perpetuating the dependence of Korea's largest industry (in employment terms) on aid-provided raw materials, the continued PL 480 availability of which is at best uncertain. Any abrupt cessation of "surplus" deliveries of raw cotton under present circumstances would create severe problems both for U.S. aid administration and for the ROKG.

Korea's current KFX procurement of cotton will approximate \$3 million during CY63 under the terms of existing arrangements. The USOM proposes that: a) Title I deliveries under the Ninth PL 480 agreement (to be executed this fall) be limited to a maximum of 225,000 bales; b) the ROK during CY64 be required to buy from U.S. sources through normal commercial channels, not less than \$5 million worth of raw cotton; and c) that each year thereafter ROK KFX procurement from U.S. sources be increased by not less than \$5 million per year.

This requirement is reasonable and, provided suitable corrective actions are taken in the management of ROK KFX reserves, within the capability of the country. In subsequent messages the USOM will spell out in some detail the justification for this proposal.

iii. Other Commodities

The USOM recommends that the following amounts of corn, tallow, and milo be provided under Title I in the Ninth PL 480 agreement:

Corn	20,000 tons	(\$1 million)
Tallow	10,000 tons	(2.0 million)
Milo	10,000 tons	(.6 million)

iv. Titles II and III

It is assumed that there will be no need for the continuation of the emergency Title II program initiated as the result of the summer crop losses this year. The recently established Title II program under the supervision of the voluntary agencies will be watched carefully and, if felt justified, will be continued. The Cheju Island animal feed program should continue through 1965. Title III programs should continue at about the present level which represents Voluntary Agency plus Ministry of Health and Social Affairs judgments about relief requirements and the ability of the Agencies and the Budget to handle them.

c. Development Loans

Recognizing the continuing trend in foreign assistance as a shift from grant to loan activities, and in consideration of the growing desire and ability of the Korean Government to sustain a progressive drive toward eventual economic viability, the USOM is placing increasing emphasis in this area of its overall program. During FY63, loans approved were dominantly in the public sector and clearly directed toward support and improvement of key priorities such as power, railroads and fuel. It is planned to continue this emphasis during FY64 with loans in the fields of power, transportation and communications, and for the development of city water systems. Beginning in FY65, the emphasis will move strongly toward the private sector of industry. By this time, USOM efforts toward transforming the Korean Reconstruction Bank into a strong development banking institution should enable us to utilize it as an effective instrument for channeling loans to Korean industry.

The Mission continuously emphasizes that Development loans must be viewed and used not only as a U.S. contribution to Korea's financial requirements, but also as an instrument for improving the quality of Korean performance in economic development. This emphasis is carried out in fact by basing loan approval upon Korean acceptance of

clearly defined conditions precedent and covenants which set forth the policies and actions required to achieve the objectives of institutional reform and effective use of AID funds.

For example, basic conditions precedent and covenants in the Kusan Power Loan Agreement (an FY 1963 loan approval) require the ROKG and Korea Electric Company: a) to adopt the "Classification of Accounts for Public Utilities" developed by the U.S. Federal Power Commission; b) to approve the 1962 valuation of rates of depreciation for KECCO and place that valuation on their books; c) not to incur any debt in excess of the equivalent of \$2 million for expansion of power generation capacity, without USOM approval; d) to implement financial, managerial, and operation policies, practices and procedures satisfactory to the Mission; e) to establish improved cost accounting, statistical and budgetary procedures; and f) to establish rates that will assure a satisfactory return on KECCO invested capital.

The specific objectives sought by applying such conditions to Development Loans are to obtain accurate information about the borrower's financial situation so that necessary remedial measures can be applied; to achieve realistic budgets which can be used as effective management tools; to promote the application of sound and businesslike management policies, i.e., proper return on investment; and to encourage prompt adjustment of rates when costs increase through inflation or when revenues are insufficient to provide for investment needs.

In order to deal effectively and efficiently with the many and varied problems associated with development loans and related activities, a new technical division was recently established in the USOM. This Division will concentrate its efforts in the fields of investment and finance and will actively seek to assist Korea in developing and implementing the kinds of fiscal, monetary and foreign exchange policies that will make the proposed higher levels of total lending more effective. In concert with the USOM's Industry and Mining Division, close attention will be given to identifying areas

and projects which will encourage and facilitate U.S. private investment, preferably on a joint-venture basis with Korean entrepreneurs. This will serve to broaden the self support capabilities of the Korean economy. Efforts will also be made through the Cooley loan program to expand participation by U.S. firms in development of the Korean economy. The following table and related comments indicate the USOM's plans and reasoning for development lending activities during FY64 and FY65.

DEVELOPMENT LOANS (COMMITMENTS BASIS)

(Millions of \$)

FY 1964

1. Power Transmission (#1)	7.2
2. Diesel Locomotives	10.7
3. Water Supply - Taegu	2.4
4. Telecommunications	8.3
5. Water Supply - Seoul	6.0
6. Fertilizer Plant	20.0 a/
7. Power Transmission (#2)	6.0
TOTAL FY 1964	60.6

FY 1965

8. Iron and Steel Plants	15.0
9. Development Bank Lending	10.0
10. Larger-scale Industries	5.0
TOTAL FY 1965	30.0

a/ May be committed in FY 1965.

1. The two Transmission and Distribution Loan Projects, in the amounts of \$7.2 and \$6.0 million, respectively, are a consistent outgrowth of the power program in Korea in that they will improve the efficiency of



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electric power distribution, enhance service availability and reliability, and promote the optimum utilization of the power produced by Korea's present and expanding generation system.

2. The provision of 95 diesel electric locomotives to the Korean National Railroad under American grant assistance in the late 1950's demonstrated the sizeable foreign exchange and operating economies which result from the retirement of antiquated coal burning locomotives. The FY 1963 loan of \$8,300,000 provided an additional 30 diesel locomotives and an FY 1964 loan of \$10,700,000 for 65 locomotives will complete the dieselization of the Railroad.

3. Taegu, Korea's third most important city in terms of population and industrial development, has been impeded in its growth and economic development by an inadequate supply of water to meet health and industrial requirements. A \$2,400,000 loan will finance the expansion of water production, treatment and distribution facilities to meet the City's needs over the next ten years.

4. The Telecommunications Loan Project of \$8.3 million will be used to expand toll telephone and telegraph facilities and overseas radio facilities and thereby contribute to the development of a completely effective telecommunications system in Korea.

5. A loan of \$6,000,000 to Seoul City will finance the construction of a new water treatment plant, new water intakes and additional transmission and distribution facilities. Seoul has more than 10% of Korea's total population and leads the nation in commerce and industry. With the assistance of the loan, Seoul's water capacity will be increased from 320,000 to 500,000 metric tons of water produced per day, thus enhancing the development potential of this major industrial area.

6. AID Development Loan financing will be required in FY 1964 or FY 1965 to assist in establishment of a plant to produce mixed fertilizers. While precise plans as to plant output, location and cost are

still in the formative stage, it appears that a loan of approximately \$20,000,000 will be needed to carry out this phase of an agreed long range fertilizer program.

7. See paragraph 1 above.

8. Loans totalling \$15,000,000 will be required in FY 1965 to expand and modernize existing Korean iron and steel plants and mills. This program will reduce Korea's dependence on imports of these basic industrial materials.

9. A loan of \$10,000,000 will be made to the Korean Reconstruction Bank in FY 1965 for sub-lending as foreign exchange loans to medium-sized private enterprises in fields of economic priority.

10. It is anticipated that Development Loans totalling \$5,000,000 will be required in FY 1965 for private industrial enterprises of larger size than those eligible to receive financing through the Korean Reconstruction Bank.

USOM considers development loans as that form of assistance which will most effectively stimulate Korean self-help practices. Loan projects are not looked upon as separate ends in themselves, but are designed to overcome major obstacles or impediments to orderly growth and to supply essential foreign exchange capital in such a way as to assure its most effective use. Loans will be made at a rate consonant with Korea's capacity to absorb them effectively and will be conditioned upon continuing improvement in management practices and operational techniques. This includes training of manpower and the development of a skilled industrial labor force. Side benefits will be an improved economic climate, thus making later development projects more attractive for international investment and financing. In order to more quickly accomplish the transition from grant aid to that of obtaining international type financing, USOM recommends that the present terms of 3/4% interest, 40 year term, 10 year grace period be modified,

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and that development loans approved for Korea beginning in FY 1964 be at 2 1/2%, 25 - 30 years and with a five year grace period.

The above loan program is designed to achieve realistic goals. It will provide a yardstick to measure Korean effort and to gauge the effectiveness of U.S. assistance in the development of the Korean economy.

d. Local Currency Programming

During CY 1963, the USOM took a further step to bring counterpart releases into line with AID Guidelines. Of about ₩25 billion of sales proceeds and counterpart programmed, ₩15 billion is being released as budget support for the military budget and about ₩ 5 billion is being granted in support of the Economic Development Special Account. The latter account totaled about ₩15 billion (since cut to about ₩13 billion) and funds under U.S. control will be released without attribution on the basis of USOM review of the budget and its finding that the budget is, in general, moving in the right direction. The remainder of U.S. controlled funds were released by separate project agreements as loans to the Korean Reconstruction Bank, the Medium Industry Bank and the National Agricultural Co-operatives Federation.

The ROKG reports to PROV/MAAG on all military expenditures (not just that part relating to counterpart and sales proceeds). Under the new procedure, it also reports to the USOM on all grant economic development activities and upon all loan activities. Thus, in terms of information and opportunity to make suggestions for change, the budget support approach affords the U.S. side greater chance for review and control than under the old system of direct attribution to projects. Thus, in principle, if the economic development account goes out of control, the USOM is in a position to hold up all releases and not just those relating to particular projects or sub-projects.

In recent years, the U.S. side has been troubled by the vexing problem of dividing U.S. controlled local currency funds between military and economic uses. In both 1962 and 1963, this problem was resolved only after lengthy discussions between Washington and the field. For example, of about ₩25 billion of U.S. controlled funds in 1963, the final decision was to release ₩15 billion for the military budget and the balance for economic grants and loans. Since the military budget also received ₩15 billion in 1962 out of a total of about ₩29 billion, it is apparent that the economic side has borne the brunt of the reduction.

The USOM notes the following language in the U.S. Assistance Strategy Statement, "... the level of Supporting Assistance should not be determined by ROK budgetary requirements, but based upon a determination of unmet and essential import requirements." These unmet and essential import requirements are a function of the entire operation of the Korean economy, including the military budget, but they are not a result of the military budget alone.

The USOM has given much consideration to the argument favoring a single lump sum budget contribution, leaving the distribution of such aid-generated funds among the various budgetary claimants to the ROKG. While favoring this position as a long-term policy, it is our view that such a change in present practice should not be made, with respect to the military budget, until there is a resolution of the level-of-forces issue now pending in U.S. Government circles.

Except for presently continued attribution of specific amounts of local currency to the military budget, the USOM would propose for CY64 and thereafter that all other local currency budget support be provided on a lump sum basis without attribution to any specific sector of the budget. Such a procedure permits us to review the entire budget and be satisfied about its general content and direction. Given satisfactory completion of such a review, it would make little difference if any particular expenditure, except for the military, were financed by ROKG or by U.S. controlled local currency.

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### III Summary of Program Content

#### A. Introduction

The A.I.D. Strategy Statement in Section III sets forth generalized focal points as the basis for program activity. From the point-of-view of program operations, the USOM has translated these focal points into the following operational goals applicable to FY 64 and FY 65 program activities. (These goals assume a reduction in supporting assistance and the search for third country participation, on favorable terms, in Korea's development effort.)

- a) the establishment and maintenance of relative price stability during the next 18-24 months;
- b) the improvement of ROK managerial practices in government, in government corporations, and in the private sector;
- c) the development of Korea's productive base in agriculture, infrastructure, and industry, along rational lines and insuring the most productive use of scarce resources; and
- d) the expansion of export earnings.

There is a close inter-dependence between each of these operational targets. As the pinch on Korean resources becomes more acute, the importance (and hopefully the ROK awareness) of the essentiality of action on all four fronts becomes more apparent. Given the kinds and amounts of aid recommended above, AID/W and the USOM will have leverage of no small proportions with which to encourage Korean "receptivity" to the broad objectives set forth in the strategy paper and their implementing tactics as reflected in the USOM's day-to-day operations. In addition, local currency programming and releases have at least a marginal utility in this respect. The four operational goals listed are discussed below.

#### 1. The Establishment and Maintenance of Price Stability

During the course of FY 63 the USOM, with the assistance of the economic officers of the Embassy, has been pressing the ROKG to invoke actions designed to dampen the steadily rising price levels of recent years. The major points of attack have been budget deficits, rapidly expanding credit (both governmental and commercial), the resultant rise in money supply, and the curtailment of too rapid drawdown of Korea's foreign exchange reserves (KFX). In May of this year (1963) agreement was reached on specific year-end targets for all four of these factors. At this time it appears probable that these targets will be achieved except for the end-of-year KFX position. The ROKG has drawn down its reserves at an unprecedented rate and unless most drastic corrective action is taken, reserves will probably fall below the agreed level. Under the agreement the availability of \$15 million SA from FY 63 funds is contingent on these targets being met. This position may be modified to the extent that the ROKG has felt it necessary to spend KFX for food grain procurement in order to offset, in part, the loss of the 1963 summer grain crops. Such expenditures (approximately \$10 million) may be considered an appropriate deduction from the agreed end-of-year KFX position. The USOM believes that success of this program is a sine qua non for growing self-sufficiency in Korea within the context of a relatively free enterprise, democratic society. The wastes, distortions and misallocations caused by continuing inflation would not only delay Korea's progress towards viability but also would increase the U. S. aid bill for Korea, given our political commitment to defend the country. The USOM has made it abundantly clear to the ROKG that adherence to the stabilization targets is a prerequisite for the \$15 million of SA and any further Development Loans approvals during FY 64.

#### 2. The Improvement of ROK Managerial Practices in Government, in Government Corporations, and in the Private Sector

The term "managerial practices" as used here means the entire

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range of functions involved in the decision-making process, whether in government or in private business. In the sector of Government itself, senior USOM officers are in continuous contact with SCNR members, the Prime Minister, Cabinet Ministers, and other senior ROKG personnel discussing the major economic issues confronting the nation and the relative merits of alternatively possible decisions. Such issues would include, inter alia, the magnitude and character of the ROKG budget, the expansion of tax revenues, the diversion of planned investment from the public to the private sector, the conduct of price stabilization programs, the size and character of KFX uses, and the priorities of the country's investment program and their implementation. USOM personnel, at both management and technical levels, are engaged both individually in their contacts with ROKG counterparts and through joint projects in counselling the ROKG on these and other similar problem areas. The approval or nonapproval of key segments of the annual aid program represents a powerful leverage for the encouragement of the ROKG if wisely used in these far-reaching issues.

AID-financed management consulting teams are working with key Government corporations in power generation and distribution, coal production and fertilizer manufacture. These teams are concerned, as circumstances may dictate, with problems of corporate organization, finance, cost-accounting, operational efficiency and investment planning. All these efforts are designed to strengthen the operational efficiency, costing, and other functional requirements leading to sound decision-making and profitability of these enterprises. These efforts take on added importance as the Government moves towards a policy of inviting private equity participation and ultimate sale of these enterprises to private interests.

The USOM has initiated steps to conduct a Management Survey of the Korean Reconstruction Bank as a preliminary to assignment of a consulting team to improve investment banking practices. A more regular turn-over of loan funds as a result of the application of sound banking procedures will, in the USOM's judgment, have as salutary effect

on domestic investment as on quantitative increase in savings. The USOM has also brought about ROKG action to increase the rate of interest on counterpart loans to levels more nearly consonant with the real cost of money in Korea. Power loan rates, for example, have been raised from 3 to 6% while the basic charge for revenue-producing private enterprise has been standardized at a minimum of 8%.

In the private sector itself, an AID-financed university contract group is carrying on management seminars for managerial personnel of Korean business firms. Special emphasis is being given to cost-accounting, use of certified public accountants, the bases for decision-making, etc. After a long gestation period, these activities are now gaining wide-spread and enthusiastic support in the business community.

In this general area, the USOM is encouraging the use of university personnel by both Government and business to initiate research projects on specific problem areas where existing data on which judgments can be based is lacking.

At every opportunity, the ROKG is being urged to apply modern techniques to its economic processes. DL loan approvals provide an excellent occasion to stipulate specific improvements in the conduct of the activity or enterprise the loan is designed to support. It is the intention of the USOM to exploit this method to the full.

Closely related to the issues just discussed is the need for a rational economic development program compatible with the indigenous and foreign resources which Korea can hope to muster. The present Five-Year Plan is a mechanistic compilation of projects based upon a pre-determined growth rate and an arbitrary assumption about capital/output ratios. While the ROKG has already recognized that the growth rate inherent in the Plan is unrealistic in the light of available resources, including domestic saving, it has not yet taken the steps this recognition dictates. The USOM has obligated money to finance an Economic Planning Advisory Group which it is hoped will contribute much to the growth of sound economic policy and action.

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3. The development of Korea's productive base in agriculture, infrastructure, and industry, along rational lines and insuring the most productive use of scarce resources.

As described above, the investment program of Korea's so-called Five-Year Plan represents a "mechanistic compilation of projects" with little or no realism either in estimates of funding availabilities or in judging the most economic use of resources. A great deal of the USOM's efforts during the past year have been directed towards dissuading the ROKG from undertaking unsound and unrealistic capital projects, e.g., an integrated iron and steel plant (\$160-175 million), a large urea fertilizer plant (\$45-55 million), and a wholly-owned and operated government oil refinery. The USOM's efforts have been successful, largely because of the influence exercised by the U.S. through the continued Korean need for U.S. economic assistance and the Korean awareness of this need.

On the other hand, the prospects for expanding self-reliance are indeed dependent upon a healthy growth of Korean productive capability, particularly in the export and import-saving categories. Under existing circumstances altogether too great a portion of Korean industrial capacity is based on imported raw materials or fully manufactured components and oriented toward expanding domestic consumption. The perpetuation of this condition only expands import requirements and contributes little or nothing to a resolution of the ever-present balance of payments problem.

The fruits of legitimate and justifiable productive investment can be more certain, in the USOM view, if private foreign (mainly U.S.) equity and managerial participation is associated with such investment. Encouragement and appropriate assistance has been and will continue to be given to all U.S. firms which are exploring investment opportunities in this country. Already a large U.S. private oil firm has signed an agreement with the government-sponsored Korean Oil Company providing a \$5 million equity in, and a \$20 million loan for, the oil refinery now under construction. This U.S. firm will participate, managerially, in all facets of KOCO's operations -- refining; distributing, and marketing.

It will provide crude oil under competitive terms to KOCO for refining supply. Similarly, the USOM, with substantial support and back-stopping from AID/W, has been encouraging the U.S. fertilizer industry to participate on a similar basis in the expansion of fertilizer production in Korea, looking to the time when the foreign exchange component of fertilizer cost could be reduced by approximately 50%. This effort appears promising and decisions should be forthcoming in the months immediately ahead.

It is hoped that a normalization of ROK/Japanese relations will permit the introduction of Japanese capital and managerial skills into the Korean economy. This could have far-reaching and mutually beneficial effects through the closer association of two nations, geographically close and to a degree at least economically complementary.

The basic purposes behind the search for foreign private investment are the introduction of new capital, new managerial competence, new methods, and the resultant assurance that AID-supported capital projects, as well as others, will have the fullest possible prospects of achieving underlying AID objectives.

Mobilization of domestic investment funds will also be largely a function of a successful stabilization program, and thereby, a stable exchange rate. Some increases in capital accumulation could occur were the Government to take sharp measures to curb consumption and increase public savings through increased taxes. However, given the history of inflation which has characterized the post-Korean War period, really serious attempts to increase public savings would meet with great resistance and efforts on the part of consumers to maintain accustomed living standards or on the part of producers to invest in quick profit opportunities.

Korea must choose her investment projects with care and critical examination. Resources are scarce and U.S. grant aid is

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falling. Priorities must be determined and funds allocated in that manner which will best serve the dual objectives of expanding self-reliance and greater economic opportunity for the Korean people. Certain basic services are essential -- power, fuel, transport, communications and water supply. (See Section II para 3 above for a discussion of development loans in these fields.) On these fronts, progress must keep abreast of need. Yet even in these fields, expenditures must be carefully screened to insure the maximum service at least cost, and a rational balance of funding between competing claimants. On the manufacturing front, exports and import-savings must take priority over expanding consumer satisfactions, at least for the years immediately ahead.

In agriculture the production of basic food-stuffs, which has fallen far behind the rate of population growth, is the first priority. As pointed out elsewhere in this paper, the solution of the food problem calls for use of proper fertilizers, improvement in agricultural practices, fuller utilization of land resources, properly administered credit programs, adequate economic incentives, and a host of other actions all aimed at modernization of the rural economy. The USOM is seeking to concentrate its energies on those facets of the over-all problem which best lend themselves to corrective action in the foreseeable future. Government's administrative actions can be influenced with relative speed as compared to the time required to reshape traditional patterns of thought and conduct in the farm community.

It is to the above-stated needs that the USOM effort is directed. USOM personnel in each of these fields are continually using all the instruments at hand to induce Korean policy and action into the necessary framework.

#### 4. The Expansion of Exports

Inherent in the total approach to Korean economic progress is the need for a sharp and continuing expansion of export earnings. Performance on this front since 1959 (export level of \$20 million) to the

present (anticipated 1963 level of \$80 million) can be identified as the reflection of falling grant aid levels, of growing economic sophistication, and of the broadened productive base of the economy.

At some point along this rising export curve, the ROK will increasingly encounter obstacles to further export expansion, e.g., the effects of an over-valued currency, the lack of standardization in produce specifications, the lack of adequate quality control, the lack of experience in market development, physical bottlenecks in the processes of production and transport, and, last but not least, bureaucratic rigidities in the operations and regulations of the ROKG. (Note: the Korean Traders Association has already called attention to a large number of the latter impedimenta.) Increase in exports will be most encouraged, in the final analysis, by steady reductions of foreign assistance whose effect will be to force the ROKG and the commercial and business community to look outward. Nevertheless, the USOM's Industry and Mining and Program Divisions have begun studies to discover those industries and products which do or could lend themselves to export. It has already provided specific advice to Korean industry on such problems as standardization -- through the National Industrial Research Institute -- marketing and other problems which are obstacles to increased exports.

The USOM is initiating consultation with the ROKG about policies and means for establishing a better climate for export production through the use of direct and indirect tax measures, through the banking system, and by streamlining regulations and procedures relating to allocation of resources to export industries and the mechanics of the export trade.

A major problem area will be the tendency on the part of Government and the business community to justify expanded credit and investment with the expectation of expanding exports, with little or no regard as to whether an export potential actually exists. Here the answer lies in some clear determination and judgment, in

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advance, as to whether Korean circumstances give reasonable assurance, in any specific case, that exports will indeed result, thereby justifying the expenditure.

Basically, in addition to gradual reductions in aid, significant increases in exports will depend upon price stabilization and establishment of a realistic rate for the Won as well as upon measures to curb the growth in domestic consumption.

While the responsibility for, and actions toward, the export drive are the responsibility of the ROKG, the USOM is considering what steps, if any, might be undertaken by A.I.D. to lend more effective support to this effort than are now within the competence of our present USOM organization. We incline to the view that if the ROKG shows a reasonable measure of maturity in dealing with current stabilization problems, A.I.D. should consider the retention, by contract, of the services of an outstanding trade promotion firm which could organize a team for a one year tour in Korea. The team might consist of a design engineer, a quality control engineer, a marketing specialist, a cost accountant, etc., who could work with Korean business and Government on specific aspects of the export promotion drive. This subject will be examined and discussed with AID/W during the near future. In the meantime, the USOM will continue to use its limited capability to the best possible advantage.

In conclusion, the success of this export effort will largely hinge on the effort to stabilize costs and prices, to improve managerial practices, to mobilize funds for sound investment, and to rationalize economic processes in Korea. The measure of success in one area will, in the main, reflect the success in all. Given the uncertainties which plague the Korean scene, political and economic, progress will probably be erratic and, at best, gradual.

