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Inflation in Korea

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South Korea has been undergoing a continuous process of inflation since shortly before the end of World War II. The magnitude of this inflation is indicated in the phenomenal increase in two economic indicators. By mid-1956, total money supply was some 870 times the level of the end of 1945 while wholesale prices averaged nearly 1670 times higher. An inflation of this degree and duration has had serious effects on the country's economic growth; among other things it has curtailed production, delayed reconstruction of the war ravaged Korean economy and complicated United States aid to this country.

The Korean inflation is rooted in many factors - among them the partition of the country in 1945 and the devastation caused by hostilities in 1950-51. The inconclusive settlement of these hostilities has made necessary the maintenance of large expensive military forces and has produced an uncertain political and economic climate - more conducive to speculation than investment. Loose budgetary controls, an inadequate tax system, and the failure to apply credit restraints with sufficient firmness have likewise all contributed to the inflation.

Furthermore, the long sequence of inadequate measures to cope with the inflation has badly disorganized South Korean economic arrangements. Some prices are controlled, more or less ineffectively, while others remain free. Barter is widespread and an appreciable part of both Government receipts and payments takes place in kind. Many goods and services produced by Government enterprises are not realistically priced. In general, the price system fails in many areas to allocate resources efficiently in relation to demand.

Attainment of a greater measure of price stability in South Korea is a condition necessary to effective reconstruction and eventual achievement of self support by the country. This paper seeks to determine what progress is being made toward this initial goal of price stability.

Progress of the inflation

In the 40 years of its development as a Japanese colony, Korea attained a relatively high degree of industrialization by Asian standards. A good railway network was built, fertilizer and irrigation projects were constructed, and mining was expanded. A number of hydroelectric power plants were also erected, primarily in north Korea. In the process of this industrialization, Korea had become almost wholly dependent on trade with Japan; moreover practically all business managers and technicians were Japanese. Throughout this period, the country maintained a passive trade balance but capital imports from Japan filled the gap.

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Korea suffered relatively little physical damage during World War II, although plant and equipment were undermaintained and hence deteriorated badly. The Japanese also took some fishing boats and other movable property with them when they left the country. More important in its effect on production than this loss of property, however, was the mass exodus of more than 700,000 Japanese personnel at war's end.

During the second world war, considerable latent inflation had developed in Korea but had been restrained by Japanese controls. With the departure of the Japanese and the consequent disorganization of both business and government, these controls collapsed; prices rose more than 20 fold between July and September of 1945 - when Allied occupation forces took over. The country was divided at the 38th parallel with U.S.S.R. forces occupying the North and U.S.A. forces the South.<sup>1/</sup>

Partition of the country brought many problems. The bulk of heavy industry and electric power generation was concentrated in the North while the South had surpluses of agricultural output and light industry.<sup>2/</sup> With internal trade cut off and exports virtually nonexistent, the South became dependent on outside aid.

Illustrative of the uneven manner in which the productive capacity of the country was divided by partition are the data in table 1. These estimates show that, in addition to a preponderant share of heavy industry, North Korea at the time of partition also contained the greater share of the country's known mineral resources.

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<sup>1/</sup> Originally, merely a line of convenience for the occupying forces, the 38th parallel gradually became a real boundary in light of Soviet intransigence about withdrawing its forces or agreeing on a form of government for a united, independent Korea.

<sup>2/</sup> Electric power continued to flow from North to South Korea until after the establishment of the latter as an independent republic in 1948. When power from the north was cut off, emergency measures were necessary to keep South Korean industry operating.

Table 1

Estimated Percentages of Total Production  
North and South Korea

	South	North
Agriculture (1944 data)		
Rice	64	36
Wheat	99	1
Millet	77	23
Sorghum	11	89
Soy beans	35	65
Cotton	70	30
Industry (1940 data)		
Textiles	86	14
Metal manufacturing	15	85
Ceramics	30	70
Electric power and gas	15	85
Chemicals (mainly fertilizer)	12	88
Minerals (1944 data)		
Coal	21	79
Copper	55	45
Tungsten	54	46
Zinc	25	75
Gold	37	63
Iron ore	3	97
Graphite	44	56

Source: George M. McCune, Korean Economic Digest, January 1946

In the period of U. S. military government, from 1945 to 1948, more than \$300 million in United States aid, primarily in grants, was poured into South Korea. Although consisting mainly of relief supplies, this aid did make possible some recovery of production. Grain output, for example, increased 25 per cent and coal and power output were each tripled. In spite of these increases, shortages of fuel and power still persisted. Even with this outside assistance the inflation progressed fairly rapidly during the occupation period. Prices rose about tenfold. Poor harvests were an uncontrollable factor contributing to the price rise.

The Independent Korean Government, which took over in 1948, was unable to cope immediately with the difficult problems of achieving financial stability and restoring the economy. The price advance, which had been slowed somewhat under military government, began to pick up momentum again during this period after 1948. By early 1950, however, there were signs that progress toward stabilization was beginning to be made.

All economic plans were, of course, overturned with outbreak of the Korean war in 1950. During the fighting, production naturally declined while government expenditures, financed chiefly by advances from the Central Bank, mounted enormously. South Korean Government estimates indicate that over 40 per cent of all industrial facilities and power generating stations were damaged in the fighting and that the total war damage was about \$1.8 billion - roughly equal to the gross national product for the year just prior to the invasion.

Although actual fighting ended in June 1951, the armistice was not concluded until two years later. Throughout this period prices continued to soar. Since the end of hostilities both the United States and the United Nations have furnished large ~~scale~~ foreign aid to South Korea but this aid has not as yet fully succeeded in checking the price rise.

The actual course of the money supply and of wholesale prices in South Korea over the past ten years is apparent from table 2. This table shows that the price level in a recent month is some 200 times higher than in 1947; unfortunately it is still increasing except for an occasional seasonal fall in grain prices.

Table 2

## South Korea-Money Supply and Prices

End of year	Money supply <sup>1/</sup> (Billion hwan)	Wholesale prices (Seoul) (1947=100)
1945	.1	12
1946	.2	55
1947	.5	100
1948	.7	163
1949	1.2	223
1950	2.8	334
1951	7.3	2,194
1952	14.3	4,751
1953 <sup>2/</sup>	30.3	5,954
1954	58.1	7,629
1955	93.5	13,816
1956 (July)	101.0	20,508

Source: Monthly Statistical Review, Bank of Korea

<sup>1/</sup> Money supply is defined for this purpose as currency notes outside banks plus both private and government demand deposits, adjusted for items in process of collection.

<sup>2/</sup> In February 1953, a currency conversion was carried out, substituting 1 hwan for each 100 won, the unit of value prior to that time.

Changes in the money supply and in the price level have been roughly but by no means exactly proportional to one another. Occasionally, for short periods, the two have moved in opposite directions as the following quarterly figures for two recent years show:

South Korea: Percentage Changes in Money Supply and Wholesale Prices, 1954 and 1955, by quarters

	Money supply	Wholesale prices (Seoul)
1954		
I	+22	-8
II	+25	+9
III	+8	+35
IV	+18	+10
1955		
I	+3	+15
II	+25	+22
III	+14	+27
IV	+25	-19

One reason for the divergence between the two series is that the wholesale price index is heavily weighted by grain prices which show a seasonal variation. Another is that import arrivals, which can have important effects on prices in a small economy so dependent on outside support, have been somewhat irregular.

Factors in the monetary expansion

The rapid increase in the money supply of South Korea has been attributable to (a) the chronic budget deficits financed mainly by central bank borrowing and (b) the heavy bank lending to the private sector. This lending is evidence both of the shortage of savings in South Korea and of the reluctance of people to invest their savings in industrial activities during a period of severe monetary disturbance. It is also evidence of the lack of an effective policy of monetary restraint by either the Central Bank or the Government.

The upward course of bank loans during recent years may be seen in the following figures:

South Korea: Outstanding Loans of All Banking Institutions  
(Billion hwan)

	Total	To private sector
1951	4.0	2.3
1952	12.5	5.6
1953	34.2	16.0
1954	42.6	29.8
1955	86.2	64.9
1956 (March)	90.7	73.0

Source: Bank of Korea, Economic Review 1956

The figures in column 1 include central bank loans to the commercial banks and also formal loans to certain government agencies that borrow directly from the Central Bank outside the budget; but they do not include the overdrafts from the Government that are the chief means of covering budget deficits. The bulk of the credit expansion has nevertheless been for the private sector, as may be seen from column 2. Evidence that credit expansion has been an active factor in the inflation may be obtained from the following comparison; over the 4 years 1952-55, loans to the private sector increased more than 4 1/2 times as fast as prices rose. Moreover many loans were granted for primarily speculative purposes and were renewed for fairly long periods.

This bank credit expansion has occurred in spite of a loan ceiling system under which quarterly quotas are set for certain commercial loans.<sup>1/</sup> This direct method of credit control is considered necessary because interest rates are too low to be an effective deterrent to borrowing in an inflationary situation; but the system has not been conspicuously successful.

The course of economic events in South Korea over the past ten years might perhaps have been expected to bring about persistent foreign exchange deficits and loss of external assets, thus at least partially offsetting the domestic budget deficits and the internal credit expansion. However, this gap in the balance of payments has been filled by American aid, with the result that no overall external payments deficit has been experienced. On the contrary foreign exchange holdings have in general increased over the past 6 years, as the following figures show:

Gold and Foreign Exchange Holdings of the Bank of Korea  
(Millions of U. S. dollars)

End of Year	Amount
1950	26.8
1951	38.0
1952	82.7
1953	108.7
1954	107.8
1955	96.1
1956 (August 31)	97.5

<sup>1/</sup> This ceiling system was adopted in 1950 as part of a comprehensive reform of the Korean banking system. For a description of this reform see A. I. Bloomfield and J. P. Jensen, Banking Reform in South Korea, 1951. While the ceiling system is in principle a powerful weapon for credit restraint, it has not been so used by the Korean Monetary Board.

This apparent increase should be qualified by the fact that, over this period, Korea has been building up, by means of imports from Japan, an open account debt to that country that now amounts to \$47.5 million. No payment on this account has been made, although the reserves are earmarked. Taking account of this debt, unobligated foreign exchange reserves were only \$50 million on August 31, 1956.

While some increase in external assets is understandable in view of the large internal credit expansion and the heavy receipts from foreign aid, it may be questioned whether the cause of price stability would not have been promoted by somewhat greater use of these reserves for imports, particularly to expand productive capacity. At any rate United States support has enabled Korea to increase her external assets and thus maintain a currency backing while systematically inflating that currency.

Government revenue and expenditure

Korea does not have a unified budget; hence comprehensive and accurate figures for total government receipts and expenditures are virtually unobtainable. However, it is known that the budget has been continuously in deficit in spite of U. S. aid. One indirect indication of the magnitude of this deficit is provided by the following figures of central bank credit extended to the ROK Government. Credit for this purpose is measured by government overdrafts less deposits in the Bank of Korea plus national bonds held by the BOK.

Credit Extended by Bank of Korea to ROK Government  
(Billion hwan)

Calendar Year	
1946	.06
1947	.11
1948	.12
1949	.11
1950	2.02
1951	2.20
1952	1.65
1953	5.64
1954	26.64
1955	32.12

Source: Bank of Korea

It may be noted that the increase in central bank credit to the Government has been somewhat more rapid than the rise in prices. For example, from 1951 through 1954, this credit expanded more than 3 times as much as prices. Moreover, central bank credit to the Government does not measure the full budget deficit because some bonds have been placed outside the banking system by semi-compulsory methods.

The budgetary structure of the South Korean Government is complex with separate defense, general, and reconstruction budgets as well as numerous special accounts. Details of the defense budget are, for obvious reasons, not made public. The reconstruction, or counterpart fund budget, draws its receipts from U. S. and U. N. aid and includes as expenditures not only outlays for reconstruction projects but also transfers to the defense and general budgets. Further budgetary complications arise from the facts that certain state enterprises borrow directly from the Bank of Korea and that receipts and payments in kind enter the budget accounts at arbitrary prices well below market values. In view of these facts, it is extremely difficult to interpret published figures dealing with South Korean Government transactions accurately.

Bearing in mind these qualifications, the latest available published budget, for the fiscal year 1955-56, may be consolidated in the manner shown in table 3.

Table 3

South Korea: Approximate Consolidated Budget  
Fiscal Year 1955-56  
(Billion hwan)

<u>Revenue</u>			
Taxes		73.5	
Other general budget receipts		18.0	
Counterpart fund proceeds		<u>148.5</u>	
Total revenue			240.0
<u>Expenditure</u>			
National defense		105.5	
Other general budget		66.0	
Economic reconstruction		66.5	
Grain management net expenditure		11.0	
Other special a/c net expenditure		<u>1.7</u>	
Total expenditure			250.7

Several facts concerning table 3 are noteworthy. United States aid (counterpart fund) receipts are included at virtually the full programmed amount, with no allowance for possible United States budget cuts or delays in arrival of aid goods. Both project aid (capital goods) and saleable commodities are included in the expected receipts. Less than 40 per cent of expected budget expenditures are covered by taxes and other current operating receipts. Special accounts are included only on a net rather than a gross basis.

Past experience has shown a tendency for receipts to be over-estimated. For example, in the fiscal year 1953-54 tax receipts were budgeted at nearly 21 billion hwan but only 18 billion were collected. In 1954-55, the discrepancy was even larger - 35 billion hwan actual against nearly 52 billion expected. If a similar discrepancy appears in 1955-56, the actual budget deficit may be considerably larger than table 3 shows. Thus, while the reliability and internal consistency of these budget figures is uncertain, they do show in a general way the heavy dependence on United States aid and the importance of defense expenditures in total Korean Government outlay. These figures do not include United States direct military aid but only defense support. The projected deficit is not large but supplementary budgets authorizing additional expenditures have been the rule in the past and may be expected again.

The budget for fiscal 1957, now being prepared, is expected to show an even larger current deficit before including United States aid because (a) of pay increases to be granted both military and civilian employees, and (b) use of more realistic prices for rice collected and distributed in kind. The pay increase is necessary and was postponed in the 1956 budget. The revaluation of rice in government accounts affects the underlying fiscal position of the Government because relatively more rice will be purchased at market prices and relatively less levied on the growers at fixed low prices. In spite of its budget effect, this may be a desirable step toward getting back to a monetary basis for government receipts and payments.

Somewhat more than half of the additional expenditure proposed in the 1957 budget is to be covered by added revenue from taxes and higher prices of government monopolized goods and services. In the opinion of some United States observers in Korea, this is a near maximum effort by the ROK Government toward budgetary balance at this time.

The framework within which United States aid is administered does provide at least the essential machinery to achieve economic stabilization provided the Korean Government makes a sufficient effort. In brief, import and investment programs are coordinated through a combined economic board with United States and Korean representation. This board directs the use of United States aid and is in a strong position to make persuasive recommendations to the Government for fiscal and monetary measures that will promote stability. It is primarily because of the leverage provided by American aid that the inflation may finally be halted.

#### Magnitude of foreign aid

The importance of foreign aid in the Korean budget has already been pointed out - more than 60 per cent of total revenue deriving from this source in the current budget. Equally important is the fact that aid goods imports were nearly 75 per cent of total South Korean imports during 1955. Foreign aid has totalled more than \$1.4 billion over the past 11 years, exclusive of direct

military assistance, as the following figures show:

Foreign Economic Aid and Relief Supplies Received  
(Millions of U.S. dollars)

Year	Amount
1945	5
1946	49
1947	175
1948	180
1949	117
1950	59
1951	106
1952	160
1953	193
1954	147
1955	244
Total 1945-55	<u>\$1,435</u>

These figures include both United States and United Nations aid, the latter being less than 10 per cent of the total.

Under the procedures now in force for United States aid, arrivals of goods in Korea lag far behind United States appropriations as well as expenditures for this purpose. The interval between appropriation and expenditure averages approximately one year while shipping time averages about 3 months.<sup>1/</sup> Thus a considerable period is required to raise or lower the local impact of aid programs in Korea to meet changes in the country's economic position.

In recent years, United States aid has settled into a pattern under which about two-thirds of the total is provided in the form of saleable commodities and one-third of the total is for reconstruction and development work (projects). This is evident from the FY 1956 operational program of I.C.A. shown on the following page:

<sup>1/</sup> Cf. Hearings before Subcommittee of House Appropriations Committee on Mutual Security Appropriations for 1957, p. 587 et. seq.

I.C.A. FY 1956 Aid Program  
(Millions of U.S. dollars)

Project Assistance	90.9
Agriculture and natural resources	6.5
Industry and mining	39.3
Transportation	26.7
Health and sanitation	2.3
Education	3.6
Community development and housing	8.5
Technical cooperation	5.0
Saleable commodities	206.1
Agricultural commodities	48.5
Fuels	21.0
Fertilizer	57.0
Other materials	79.6
Total program	<u>302.0</u>

Source: Combined Economic Board, Korea. Agreement of January 3, 1956

No significant change in this pattern is at present contemplated, at least through the fiscal year 1958, assuming availability of appropriations.

One factor that has complicated United States aid to South Korea has been the stubborn adherence of the Korean Government to arbitrary exchange rates that overvalued the local currency, and to discriminatory multiple exchange rate practices that discouraged development of normal trade. The official exchange rate has been dropped in successive steps from won 15=\$1 (established at the beginning of military government) to hwan 500=\$1 (established in August 1955) but these changes have lagged well behind price developments and have not approximated purchasing power parities. In 1950 and 1951, large local currency advances to pay United Nations troops were made without offsetting dollar settlements because of inability to agree on a proper rate; this expansion of unbacked local currency contributed heavily to inflation at that time.<sup>1/</sup>

From December, 1953 until August, 1955, most United States aid deliveries generated counterpart only at the rate of hwan 180=\$1 although this was progressively below a realistic rate. For example, United States Army auction sales of dollars for local currency during this period took place at weighted average rates ranging from 258<sup>2/</sup> (November 29, 1954) to 729 (August 8, 1955). Black market rates ran considerably higher.

<sup>1/</sup> Initially, the United States hoped to obtain local currency without dollar deposits as a Korean contribution to the joint war effort. This soon proved impractical but even after the principle of dollar deposits was agreed upon a protracted delay occurred before a rate was agreed.

<sup>2/</sup> This rate might have been even higher had it not been for official pressure on bidders for dollars not to pay rates the Government considered too high.

Since August 15, 1955, most United States aid has been accounted for at a rate of hwan 500=\$1 by agreement between the two governments; <sup>1/</sup> this agreement specified this rate would be maintained provided prices did not rise more than 25 per cent within a year. The line was barely held within this limit and the rate, which has come to be regarded by President Rhee as a cornerstone of the Korean stabilization program, will be continued for a further period yet to be determined. Actually, this rate still overvalues the hwan somewhat; rough estimates have indicated that a rate of about 750 to 1 would more nearly represent an appropriate parity. Korea is, however, making an effort to simplify her exchange rate structure and may be able eventually to achieve a unitary rate. This would be an important step forward.

Due to the large portion of United States aid required for direct military support, only limited progress is being made in rebuilding the South Korean economy toward self sufficiency. Production, however, is increasing slowly and exports may pick up once stabilization is achieved. Self support continues to be a far away goal, however, so long as a 20 division military force must be maintained in a state of combat readiness. No relaxation of tension that would permit even partial demobilization of this force seems yet in sight. There is, however, a body of both Korean and American opinion that believes the country's military forces are larger than necessary and that some demobilization is both practical and desirable. North Korean forces, on the other hand, have been considerably strengthened with men and equipment since the armistice. Clearly the proper size of the South Korean military establishment is a matter for military judgment and beyond the scope of this paper.

Foreign trade

Korea's overseas trade has been chronically unbalanced in recent years as the following table makes clear.

South Korea: Foreign Trade (Millions of U.S. dollars)					
	1952	1953	1954	1955	1956 (1st 6 months)
Exports	27.7	39.6	24.3	17.6	12.6
Imports - total	213.3	350.0	258.9	326.5	152.7
Commercial	53.6	153.6	93.9	82.5	23.3
Foreign aid	159.7	196.4	165.0	244.0	129.4

Source: Bank of Korea, Monthly Statistical Review

Exports are at a very low level in relation to imports and are not increasing significantly. Korean exports consist in the main of minerals and marine products (fish and seaweed). No significant export surplus of rice has yet been developed, nor is this likely, in view of the enlarged population of the southern zone, unless cheaper imported cereals are substituted for rice in

<sup>1/</sup> Lower rates remained in force for fertilizer and coal deliveries for temporary periods.

the Korean diet. This was done to a certain extent during the Japanese occupation.

Recent trends in certain of the individual commodities exported by South Korea are shown in the following table:

South Korea: Leading Exports  
(Million hwan)

	1951	1952	1953	1954	1955
Metallic ores	235	955	1755	461	2865
Raw silk	10	52	247	759	882
Fish and seafood	16	156	315	193	210
Seaweed	28	79	95	104	275
Graphite	17	50	43	118	501
Agar-agar	6	42	194	378	527

Source: Bureau of Customs: Ministry of Finance

The apparent progress shown in this table is illusory and attributable entirely to the rising prices of export goods in terms of local currency. In dollar terms exports since 1953 have actually declined. In part, this is attributable to lack of an aggressive policy for expanding export trade.

The decline in ore exports in 1954 was due principally to termination of the agreement with the United States for the sale of tungsten concentrate at premium prices for strategic stockpiling. This agreement ended March 31, 1954 with United States stockpile goals fulfilled.

Apart from the decline in minerals, a few other exports such as fresh fish, bristles and ginseng have been making gradual progress in 1956 but there is little expectation that a large increase in export earnings can be achieved in the near future. Very little progress has so far been made toward a balanced international trade with its corollary of reduced dependence on United States aid.

The various reconstruction programs for South Korea have projected substantial increases in export earnings as feasible, and of course necessary for achievement of self support. For example, the Nathan report prepared for the United Nations in 1953, contemplated a four fold increase in exports between 1953 and the present time and an eight fold increase by 1959. Instead of this rather optimistic expectation, exports have actually declined. More recently, the Korean Government has adopted a 5 year plan for foreign trade which contemplates exports may expand by 1963 to \$175 million per year, including \$45 million of rice. This is more realistic but still a difficult target.

Continued inflation as well as adherence to unrealistic exchange rates and exchange practices have contributed to this failure of exports so far to increase. More fundamentally, however, it is becoming clear that restoration of the Korean economy is a far more difficult and time consuming process than was visualized several years ago.

### Production trends

Achievement of price stability in South Korea requires continued steady expansion of production with more restraint on consumption; this restraint can come partly from elimination of budget deficits and a more effective credit control. In the field of production, however, recent developments are only moderately encouraging. For example, in 1955 total gross national product is estimated to have increased less than 3 per cent over 1954 in constant prices. Output of agriculture, marine products, tungsten and gold mines, and certain other industries - including wool textiles, cement, and rubber shoes - declined slightly. Nevertheless industrial production as a whole is estimated to have been more than 50 per cent above 1949 - a fair record in view of the hostilities. The most impressive gains in production during 1955 (about 3 per cent) were recorded in cotton textiles - Korea's largest manufacturing activity.

In 1956, good progress has been made in expanding anthracite and electric power output; also some gains have been made in textiles and in manufacturing production generally - with the exception of a few items such as cement and paper that continue to lag. The catch of marine products has also increased slightly and crops are a little better than in 1955, although rice production will show no increase.

In general, the present position is that production in most areas is increasing but at a far slower rate than had been hoped in most of the plans for Korean reconstruction. This points again to the difficulty of calculating a definite termination date for United States aid.

### Prospects for economic stabilization

An end to the Korean inflation is not yet in sight, although there is some evidence of increasing fiscal and monetary responsibility on the part of the present South Korean Government. The plain fact is that the country cannot hope to support a large military force in a state of mobilization from her own limited resources, and simultaneously also reconstruct a war ravaged economy. It would appear that the United States finds direct support of Korean military forces an economical alternative to maintenance of larger United States forces in the Far East and also acknowledges a certain responsibility for helping Korea rebuild her shattered economic base.

It is interesting that at present, Korean criticism of the United States aid program takes the line that too little is going into reconstruction

and economic development and too much into military support. This criticism may be discounted somewhat because Korea, in common with most less developed countries, undoubtedly desires to proceed faster with economic development than it can realistically expect to solve the organization and management problems accompanying this development. Nevertheless, there is a valid point at issue, namely that it is only the investment portion of United States aid that contributes to the country's long run economic potential, which must be brought to a point that will finally enable aid to be tapered off without causing economic collapse.

The Korean Government is showing much greater determination to eliminate deficit financing and to balance its budget but is less enlightened in its pricing policy for government enterprises,<sup>1/</sup> and most deficient of all in effective credit control. Moreover, the Government still holds a mass of business property vested when the Japanese left. This should, for the sake of efficiency, be turned over to private ownership and operation as rapidly as possible but progress in this direction is painfully slow. While rapid accomplishments can perhaps not be expected, a forceful program to take the Government out of business ought to be part of a Korean stabilization program.

At present, Korean prices are not rising rapidly because of the seasonal impact of the harvest; this superficial stability can probably be maintained for the rest of 1956. The real danger will come early in 1957 when a new budget must be drawn up and a new aid level programmed. There will be increasing pressure from various United States sources to limit aid to Korea; this pressure may be wholesome if it does not go too far. It seems rather plain that Korea has come to depend a little too much on American aid to the neglect of measures it could take to help itself, for example rebuilding its trade with Japan.

The evidence seems clear that United States aid in the past year has been more effective than previously, both because of the larger volume of aid goods arrivals and because of the exchange rate agreement. The level of imports is high enough now to permit stabilization if the right internal financial policies are followed.

In brief, South Korea is making progress toward halting its inflation but has not yet taken all the necessary steps. One can only hope that additional measures necessary to achieve this goal will not be further delayed.

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<sup>1/</sup> One reason for the systematic underpricing of products of government enterprises is that many of these prices can be increased only with legislative approval, which is time consuming.