Volume Title: Foreign Trade Regimes and Economic Development: South Korea

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Volume Publisher: NBER

Volume ISBN: 0-87014-507-X

Volume URL: http://www.nber.org/books/fran75-1

Publication Date: 1975

Chapter Title: Chapter 3: Development of the Trading and Exchange Rate System: Phase I, 1945 to 1953, and Phase II, 1953 to 1960

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Chapter URL: http://www.nber.org/chapters/c4064

Chapter pages in book: (p. 25 - 41)

Chapter 3

Development of the Trading and Exchange Rate System: Phase I, 1945 to 1953, and Phase II, 1953 to 1960

After World War II and during the Korean War, private foreign trade was almost nonexistent apart from a small amount of private barter. The government was the major exporter of a limited range of primary products, and imports were strictly controlled. Nearly all imports were financed by grant assistance or won redemptions by the United Nations Command during the Korean War, and the government itself was the major importer both before and during the war. A multiplicity of exchange rates applied to a variety of transactions, and a black market in U.S. currency and military payment certificates flourished. By the end of the Korean War, the official exchange rate represented a serious over-valuation of the won despite six major devaluations since 1945. The official rate applied to a very narrow range of transactions and was less than one-quarter of the free market rate on export dollars. We would describe the period 1945 to 1953 as a Bhagwati-Krueger Phase I regime "characterized by heavy reliance on quantitative controls leading to an increasingly over-valued exchange rate."

The first six or seven years after the Korean War brought sporadic growth of real GNP, widely fluctuating exports, rapidly growing imports, and an increasing trade deficit financed by UN and U.S. grant assistance. The trade and payments regime required increasingly complex measures to obviate an over-valued exchange rate.

The multiplicity of exchange rates increased after the war. Rates on foreign exchange loans varied by type of commodity imported. Foreign exchange certificates issued for earning exchange through exports were traded on the free market and resulted in separate rates for a variety of types of export, the most important distinction being drawn between Japanese export dollars and other export dollars. Foreign exchange was allocated by various auction and bidding procedures, by lottery, and by an exchange tax system. Advance deposits were required for certain imports.

A variety of export promotion schemes was used during this period: a deposit system to avoid exchange risk, an export-import link system, direct export subsidies, a variety of preferential loans for exporters and export producers, and tariff exemptions. An increasingly complex system for import quotas evolved and tariffs were raised in 1957. Thus the period 1953 to 1960 can be described, in terms of the Bhagwati-Krueger scheme, as Phase II. In this chapter we attempt to describe the trade and exchange regime during the Phase I period, 1945–1953, and the Phase II period that followed.

DEVELOPMENT OF THE BARTER SYSTEM, 1946 TO 1953

In 1946 and 1947, barter trade took place at South Korean ports between foreign merchants (mainly Chinese from Hong Kong and Macao) and Korean exporters. The Koreans, who lacked both experience and capital, acted mainly as brokers for the foreign merchants.

In June 1947, the Chosun Exchange Bank was established for the purpose of stimulating and facilitating private foreign trade. One technique was to encourage the evolution of barter trade into a more efficient form of trade called "trust shipping." Under this system, an exporter submits the documents for export goods (after shipment is made) to the Chosun Exchange Bank. Having collected 10 percent of the value of the goods as a guarantee, the bank delivers the shipping documents to the skipper of the ship. He in turn hands them to a foreign exchange bank in the importing country which passes them on to the importer. Once the importer sells the goods, he buys and ships the goods ordered by the Korean exporter for importation into South Korea and submits the shipping documents to a foreign exchange bank in his country. The shipping documents are then delivered to the exporter through Chosun Exchange Bank channels and his 10 percent guarantee deposit is returned.

The Chosun Exchange Bank established relations with foreign exchange banks in other countries and developed a variety of additional trade settlement procedures. In 1949, South Korea's trade with Japan began to be settled by back-to-back letters of credit (L/Cs) and escrow L/Cs, which were means of assisting barter trade through commercial banks. In the case of back-to-back L/Cs, a Korean exporter, upon receiving notice of a bank letter of credit from importer A in Japan, opened a reciprocal L/C to A in Japan on the basis of the original L/C. Thus the Korean exporter could use his export proceeds only for importing from A in Japan. The escrow L/C method allowed the exporter to use his export proceeds for importing from traders other than A in Japan. The Korean exporter deposited his export proceeds into an escrow account in Japan and was able to use the deposit to pay for his imports from any Japanese trader. In June 1950, the Korea-Japan Open Account was established in accordance with the "Financial Agreement for Trade" between the Republic of Korea and Occupied Japan. South Korea's trade with Japan was settled through the Open Account without any foreign exchange payment until a deficit of $2.5 million was accumulated. After establishment of the Open Account, South Korea's trade with Japan became more important than its trade with Hong Kong, and the trade settlement method was changed to a regular L/C basis.

The sudden outbreak of war on June 25, 1950 reduced foreign trade for some time. Export goods stocked at Pusan were shipped to Japan on consignment, but other export activity virtually ceased because of war damage, transportation bottlenecks, domestic inflation, and other economic disruptions. Though there was practically no private import trade in the latter part of 1950, it became very active in 1951 when the government began to encourage imports to meet wartime shortages.

THE BANK OF KOREA, 1950

In 1950, the Chosun Exchange Bank was absorbed by the newly formed Bank of Korea. The Bank of Korea Law promulgated a new foreign exchange control system that required all private foreign exchange holdings to be deposited at the Bank of Korea where they were insured against exchange loss through their denomination in dollars.

Foreign exchange deposit accounts were classified into four categories: government, export, general, and special. Government accounts received deposits of government-owned foreign exchange. Export accounts contained deposits of foreign exchange by registered exporters and industrial end-users who had acquired foreign exchange through auctions and loans from the Bank of Korea. General accounts held deposits by foreign diplomatic organizations, foreign firms, religious organizations, and individual foreigners and residents approved by the Monetary Board. Special accounts were established for deposits of U.S. currency and military payment certificates.

The Bank of Korea generated foreign exchange assets of its own through dollar redemption of won advances made to UN forces during the Korean War, and through foreign exchange earnings from tungsten exports, the sale of which was a government monopoly. Redemption of won advances by the United Nations Command was the most important source of foreign exchange during the Korean War. Foreign exchange from this source amounted to $62 million in 1952 and $122 million in 1953, or about 62 and 70 percent of total foreign exchange receipts in those years. In addition to receiving foreign exchange from these two sources, the Bank of Korea acted as a broker for the sale of U.S. aid dollars for imports of private-use commodities after the Korean War.[1]

EXCHANGE RATES, 1945 TO 1963

The first official rate was set at 0.015 won[2] to one U.S. dollar in October 1945, equivalent to the yen exchange rate in Japan. It was raised to 0.05 won to the dollar in July 1947. The official rate did not apply to private trade during most of the period; rather, trade was conducted through the deposit system of the Bank of Korea which involved dollar-denominated deposits. In any case, most trade was barter. The official rate applied only to settlements of military government liabilities against the private sector and other minor transactions until late 1952 when it was extended to some private transactions.

As tables 3–1 and 3–2 show, the official exchange rate was adjusted many times as domestic prices rose rapidly between 1945 and 1953. Despite these frequent adjustments, the price-deflated exchange rate exhibited no noticeable trend because of the rapid inflation. The price-deflated rate reached a peak of about 252 won to the dollar (in 1965 won) in early 1949 and another peak in May–June of 1950,[3] but the price-deflated rate during the Korean War and even after the December 1953 devaluation of 300 percent was far below its prewar highs.

From December 1948, a separate exchange rate was established for depositing won into the Counterpart Fund Special Account, in accordance with the "Agreement on Aid between the United States and the Republic of Korea," signed on December 10, 1948.

Under the original "Agreement between the Government of U.S.A. and the ROKG Regarding Expenditures by Forces under Command of the Commanding General, Armed Forces of the Member States of the United Nations," won advances to UN forces for local currency expenditures were to be repaid in dollars by the United Nations Command (UNC) at the official exchange rate effective on the date of such advances from the Bank of Korea. Although the agreement applied to advances made from the time the agreement was signed in July 1950, not many redemptions occurred until the "Agreement on Economic Coordination between the ROK and the Unified Command" was signed in May 1952. Even after that, the redemption of won advances was delayed, mainly because of a dispute between the Korean Government and United Nations Command over the applicable exchange rate.[4]

In February 1953, however, a new agreement stipulated that new won advances would be redeemed within 20 days of the month following an advance. The Combined Economic Board (CEB), which had been established in accordance with the Agreement on Economic Coordination, settled on an exchange rate of 18 won to the dollar for the redemption of won advances made prior to January 7, 1953. The CEB also agreed to readjust the exchange rate on won advances whenever increases in domestic prices made the rate unrealistic. Generally, the exchange rate applied to redemption of won advances was negotiated with each particular redemption. Negotiated rates were usually more favorable to the United Nations Command than the official exchange rate but much lower than the free market rates.

ALLOCATION OF FOREIGN EXCHANGE AND MULTIPLE RATES, 1952 TO 1960

The large inflow of U.S. grant aid, United Nations Korean Reconstruction Agency (UNKRA) assistance, and government receipts of foreign exchange from United Nations Command (UNC) sources created difficulties in allocating foreign exchange to various industrial sectors that lasted for some time after the war. Since private exports were very small compared with total receipts of foreign exchange, most imports in the 1950s had to be financed either by U.S. aid or by government-held foreign exchange (KFX).

UNKRA and U.S. aid (excluding technical assistance) amounted to approximately $1.9 billion, or about 72 percent of total imports from 1953 to 1960. Of this amount, a large proportion was allocated to private traders and end-users for imports of raw materials, semifinished products and investment goods. In addition to this official aid fund for commercial imports, the government allocated a large amount of government-held KFX to private traders and industries for commercial imports. The UNC also sold dollars directly to the private sector as a means of procuring won currency from November 1954 to August 1955. The major means of allocation in the early post-Korean War period was a system of special foreign exchange loans and a bidding system for sales of KFX and UNC and U.S. aid dollars.

Special foreign exchange loans to private traders, first instituted in December 1952, were finally discontinued in July 1954. Loans totaled approximately $96.1 million and financed about 45 percent of total imports (or 75 percent of private imports) in the same period. The special foreign exchange loans were financed mainly by foreign exchange receipts from redemption of won advances and tungsten exports. There were two different special loan funds. The first was allocated by industry to exporters and raw material end-users on the basis of export performance and raw material needs. The

TABLE 3–1

Nominal Exchange Rates of Won to U.S. Dollar in South Korea, 1945 to 1970

(current won to the U.S. dollar)

	Agreed Rates			Free Market Rates[a]					
Effective Date	Official Exchange Rate	Counterpart Deposit Rate	UN Finance Office[b]	Japan Export Dollars[c]	Other Export Dollars[c]	Other Dollars on Import A/C[d]	U.S. Greenbacks	MPC	Wholesale Price Index[e] (1965 = 100)
Oct. 1, 1945	0.015	—	—	—	—	—	—	—	0.016
July 15, 1947	0.05	—	—	—	—	—	—	—	0.171
Oct. 1, 1948	0.44	—	—	—	—	—	0.74	0.5	0.297
Dec. 15, 1948	0.45	0.45	—	—	—	—	na	na	0.327
June 14, 1949	0.9	0.45	—	—	—	—	2.17	1.64	0.357
Nov. 1, 1949	0.9	0.5	—	—	—	—	2.55	1.93	0.475
Dec. 1, 1949	0.9	0.6	—	—	—	—	2.83	2.31	0.511
Jan. 1, 1950	0.9	0.8	—	—	—	—	3.48	2.57	0.565
Apr. 1, 1950	0.9	0.9	—	—	—	—	2.98	2.35	0.597
May 1, 1950	1.8	1.1	—	—	—	—	2.28	2.03	0.592
May 15, 1950	1.6	1.1	—	—	—	—	2.28	2.03	0.592
June 10, 1950	1.6	1.4	—	—	—	—	2.42	1.79	0.615
June 15, 1950	1.8	1.4	—	—	—	—	2.42	1.79	0.615
June 25, 1950	1.8	1.8	—	—	—	—	2.42	1.79	0.615
Oct. 1, 1950	1.8	2.5	2.5	—	—	—	2.58	2.27	1.11
Nov. 1, 1950	2.5	2.5	2.5	—	—	—	3.42	3.32	1.27
Dec. 1, 1950	2.5	4.0	2.5	—	—	—	6.12	4.32	1.47
Mar. 11, 1951	2.5	4.0	6.0	—	—	—	na	na	2.77
May 1, 1951	2.5	6.0	6.0	—	—	—	9.83	6.38	2.74
Nov. 10, 1951	6.0	6.0	6.0	—	—	—	18.21	12.85	4.52
Avg. 1952	6.0	6.0	6.0	—	—	—	na	na	8.41
Aug. 28, 1953	6.0	18.0	18.0	—	—	—	26.4	17.6	10.8
Dec. 15, 1953	18.0	18.0	18.0	—	—	—	38.7	29.3	11.8
Nov. 10, 1954	18.0	18.0	18.0	77.7	74.0	51.5	65.6	53.0	17.3

Aug. 28, 1953	6.0	18.0	18.0	—	—	—	26.4	17.6	10.8
Dec. 15, 1953	18.0	18.0	18.0	—	—	—	38.7	29.3	11.8
Nov. 10, 1954	18.0	18.0	18.0	77.7	74.0	51.5	65.6	53.0	17.3
Dec. 13, 1954	18.0	18.0	31.0	80.9	78.0	65.4	71.1	57.6	17.8
Jan. 10, 1955	18.0	35.0	43.0	92.3	83.5	59.8	77.2	62.9	23.6
Apr. 18, 1955	18.0	35.0	50.0	75.6	46.6	46.6	74.8	60.5	24.1
June 27, 1955	18.0	35.0	48.0	80.2	56.3	59.0	75.3	57.7	27.7
Aug. 8, 1955	18.0	35.0	51.0	95.0	82.0	75.0	80.2	66.2	32.3
Aug. 15, 1955	50.0	50.0	50.0	95.0	82.0	75.0	80.2	66.2	32.3
Avg. 1956	50.0	50.0	—	107.0	100.8	84.7	96.6	81.0	36.6
Avg. 1957	50.0	50.0	—	112.3	105.7	84.5	103.3	84.5	42.5
Avg. 1958	50.0	50.0	—	122.5	101.5	89.3	118.1	102.9	39.9
Avg. 1959	50.0	50.0	—	139.9	124.7	113.5	125.5	114.9	40.8
Jan. 20, 1960	50.0	65.0	—	164.1	132.0	119.0	132.0	122.3	42.4
Feb. 23, 1960	65.0	65.0	—	171.8	138.7	129.3	144.9	129.2	43.2
Jan. 1, 1961	100.0	100.0	—	156.3	141.6	132.0	139.8	120.6	48.2
Feb. 2, 1961	130.0	130.0	—	147.9	145.4	—	148.3	128.9	50.6
Avg. 1962	130.0	130.0	—	NT	NT	—	134.0	126.5	56.0
Avg. 1963	130.0	130.0	—	169.8		—	174.5	147.8	67.5
May 3, 1964	256.5	256.5	—	314.0		—	285.6	236.2	95.0
Mar. 22, 1965	256.5	256.5	—	279.0		—	316.0	263.0	97.0
Avg. 1966	271.3	271.3	—	—		—	302.7	277.3	108.8
Avg. 1967	270.7	270.7	—	—		—	301.8	276.3	115.8
Avg. 1968	276.6	276.6	—	—		—	304.1	278.1	125.2
Avg. 1969	288.2	288.2	—	—		—	323.6	302.1	133.7
Avg. 1970	310.7	310.7	—	—		—	342.8	333.2	145.9

NOTE: MPC—military payment certificates; na—not available; NT—no transactions.

SOURCE: Bank of Korea; Korean Traders Association; USAID, Korea Mission.

a. Monthly and annual averages.

b. Rate applied from Oct. 1, 1950 to Aug. 15, 1955; rate paid UN soldiers raised to 50 won Nov. 10, 1954; rate for other UN transactions raised to 31 won Dec. 13, 1954; the two rates made identical Jan. 10, 1955.

c. Figures represent: nonpreferential dollar rate until 1955; export dollar rate on L/Cs, Dec. 1955 to Jan. 1961; and the rate on export dollar certificates, Feb. 1961 to May 1961. Export dollar rate from 1963 represents the effective free market rate (i.e., the official rate plus export premium). Export premium market ended with exchange rate reform, March 1965.

d. Separate rate on missionary and service dollars effective from Sept. 1954 to Jan. 1961.

e. Seoul index, 1945 to 1954; national index thereafter. Monthly and annual averages.

TABLE 3–2

Price-Level-Deflated Exchange Rates of Won to U.S. Dollar in South Korea, 1945 to 1970

(1965 constant won to the U.S. dollar)

Effective Date	Agreed Rates: Official Exchange Rate	Agreed Rates: Counterpart Deposit Rate	Agreed Rates: UN Finance Office[b]	Free Market Rates[a]: Japan Export Dollars[c]	Free Market Rates[a]: Other Export Dollars[c]	Free Market Rates[a]: Other Dollars on Import A/C[d]	Free Market Rates[a]: U.S. Greenbacks	Free Market Rates[a]: MPC
Oct. 1, 1945	93.8	—	—	—	—	—	—	—
July 15, 1947	29.2	—	—	—	—	—	—	—
Oct. 1, 1948	148.1	—	—	—	—	—	249.2	168.4
Dec. 15, 1948	137.6	137.6	—	—	—	—	na	na
June 14, 1949	252.1	126.1	—	—	—	—	607.8	459.4
Nov. 1, 1949	189.4	105.3	—	—	—	—	536.8	406.3
Dec. 1, 1949	176.1	117.4	—	—	—	—	553.8	452.1
Jan. 1, 1950	159.3	141.6	—	—	—	—	615.9	454.9
April 1, 1950	150.8	150.8	—	—	—	—	499.2	393.6
May 1, 1950	304.1	185.8	—	—	—	—	385.1	342.9
May 15, 1950	270.3	185.8	—	—	—	—	385.1	342.9
June 10, 1950	260.2	227.6	—	—	—	—	393.5	291.1
June 15, 1950	292.7	227.6	—	—	—	—	393.5	291.1
June 25, 1950	292.7	292.7	—	—	—	—	393.5	291.1
Oct. 1, 1950	162.2	225.2	225.2	—	—	—	232.4	204.5
Nov. 1, 1950	196.9	196.9	196.9	—	—	—	269.3	261.4
Dec. 1, 1950	170.1	272.1	170.1	—	—	—	416.3	293.9
Mar. 11, 1951	90.3	144.4	216.6	—	—	—	na	na
May 1, 1951	91.2	219.0	219.0	—	—	—	358.8	232.0
Nov. 10, 1951	132.7	132.7	132.7	—	—	—	402.9	284.3
Avg. 1952	71.3	71.3	71.3	—	—	—	na	na
Aug. 28, 1953	55.6	166.7	166.7	—	—	—	244.4	163.0
Dec. 15, 1953	152.5	152.5	152.5	—	—	—	328.0	248.3
Nov. 10, 1954	104.0	104.0	104.0	449.1	427.7	297.7	379.2	306.4
Dec. 13, 1954	101.1	101.1	174.2	454.4	438.2	367.4	299.4	323.6

Dec. 15, 1955	152.5	152.5	152.5	—	—	—	328.0	248.3
Nov. 10, 1954	104.0	104.0	104.0	449.1	427.7	297.7	379.2	306.4
Dec. 13, 1954	101.1	101.1	174.2	454.4	438.2	367.4	299.4	323.6
Jan. 10, 1955	76.3	148.3	182.2	391.1	353.8	253.4	327.1	266.5
Apr. 18, 1955	74.6	145.2	207.5	313.7	193.4	193.4	310.4	251.0
June 27, 1955	65.0	126.4	173.3	289.5	203.2	213.0	271.8	208.3
Aug. 8, 1955	55.7	108.4	157.9	294.1	253.9	232.2	248.3	205.0
Aug. 15, 1955	154.8	154.8	154.8	294.1	253.9	232.2	248.3	205.0
Avg. 1956	136.6	136.6	—	292.3	275.4	231.4	263.9	221.3
Avg. 1957	117.6	117.6	—	264.2	248.7	198.8	243.1	198.8
Avg. 1958	125.3	125.3	—	307.1	254.4	223.8	296.0	257.9
Avg. 1959	122.5	122.5	—	342.9	305.6	278.2	307.6	281.6
Jan. 20, 1960	117.9	153.3	—	387.0	311.3	280.7	311.3	288.4
Feb. 23, 1960	150.5	150.5	—	397.6	321.1	299.3	335.4	299.1
Jan. 1, 1961	207.5	207.5	—	324.3	293.8	273.9	290.0	250.2
Feb. 2, 1961	256.9	256.9	—	292.3	287.4	—	293.1	254.7
Avg. 1962	232.1	232.1	—	NT	NT	—	239.3	225.9
Avg. 1963	192.6	192.6	—	251.6		—	258.5	219.0
May 3, 1964	270.0	270.0	—	330.5		—	300.6	248.6
Mar. 22, 1965	264.5	264.5	—	287.6		—	325.8	271.1
Avg. 1966	249.4	249.4	—	—		—	278.2	254.9
Avg. 1967	233.8	233.8	—	—		—	260.6	238.6
Avg. 1968	220.9	220.9	—	—		—	242.9	222.1
Avg. 1969	215.6	215.6	—	—		—	242.0	226.0
Avg. 1970	213.0	213.0	—	—		—	235.0	228.4

NOTE: MPC—military payment certificates; na—not available; NT—no transactions. These figures are the nominal exchange rates shown in Table 3–1 deflated by the wholesale price index (1965=100) included in the same table.

SOURCE: Bank of Korea; Korean Traders Association; USAID, Korean Mission.

a. Monthly and annual averages.

b. Rate applied from Oct. 1, 1950 to Aug. 15, 1955; rate paid UN soldiers raised to 50 won Nov. 10, 1954; rate for other UN transactions raised to 31 won Dec. 13, 1954; the two rates made identical Jan. 10, 1955.

c. Figures represent: nonpreferential dollar rate until 1955; export dollar rate on L/Cs, Dec. 1955 to Jan. 1961; and the rate on export dollar certificates, Feb. 1961 to May 1961. Export dollar rate from 1963 represents the effective free market rate (i.e., the official rate plus export premium). Export premium market ended with exchange rate reform, March 1965.

d. Separate rate on missionary and service dollars effective from Sept. 1954 to Jan. 1961.

second was allocated to major domestic industries for imports of capital goods. The loans were to be repaid in dollars after 60 days for imports from Japan and after 90 days for imports from other areas.

In the allocation of special foreign exchange loans, borrowers were required to make an initial deposit at the Bank of Korea in won equal to the loan at the official exchange rate. In the case of the first special loan fund, when shipping documents were delivered, the borrowers were required to make an additional deposit equal to the difference between the official exchange rate and a special rate for each commodity, depending on the domestic-price/import-price ratio. These special rates ranged from 15.5 to 29.6 won to the dollar compared with an official rate of 6.0 won to the dollar from November 1952 until the end of the war in 1953. The official exchange rate was applied in the case of the second loan fund.

From August 1953, however, all applicants to the first loan fund were required to deposit 20 won per dollar and those to the second loan fund 18 won per dollar at the time of loan allocation. In addition to these requirements, first loan fund applicants were to make a one-year time deposit of 4 won per dollar and second loan fund applicants were to make a notice deposit of 4 won per dollar.

After this system was discontinued, foreign exchange was allocated by competitive bidding. Bidding accomplished the sale of $5 million of KFX on October 18, 1954 and of nearly $40 million of UNC and U.S. military aid dollars from November 29, 1954 to August 8, 1955. In 1954, bids for won per dollar ranged from 46.1 to 69.3 won while the official rate remained at 18.

From August 29, 1955 until May 1957, the official means of allocating KFX was by lottery at the official exchange rate. From May 1957 to August 1958 a modified bidding system was reestablished. Foreign exchange was allocated to those applicants who offered the largest advance won deposits when the total amount of such advances was equal to or less than the total amount of foreign exchange to be allocated at the official exchange rate. If total advance deposits exceeded the won equivalent of the total value of foreign exchange to be allocated, allocation was first made to industrial end-users and traders with a past record of importing respective commodity items in the allocation of U.S. aid, nonproject dollars. Remaining funds were then allocated to other applicants, with priority given to those who were willing to purchase the most national bonds.

After August 1958, the bidding system of allocating foreign exchange was replaced by a combined foreign exchange tax and bidding system in accordance with the Temporary Foreign Exchange Tax Law of 1958. Under the tax system, a basic tax rate of 15 won per dollar was applied to *all* foreign exchange purchases. In the allocation of foreign exchange for commercial imports only, foreign exchange was allocated to those applicants who paid the biggest additional tax (above the basic rate) by using a competitive bidding system. Only licensed exporters and importers were eligible for the foreign exchange sales while industrial end-users were not.

These complicated methods of allocating foreign exchange created an effective exchange rate for most imports that was substantially above the official rate. The major exception was in the allocation of project-related U.S. aid funds where the counterpart deposit rate was applied. The exchange rate for counterpart deposits was almost the same as the official exchange rate except for the first eight months of 1955 (Table 3–1).

For some time after the Korean War the official exchange rate was only applicable to government transactions, project-related foreign assistance, sales of foreign exchange to students studying abroad, and after August 1955, sales of won to the United Nations Command. The official rate was, however, important to the South Korean government since it was the rate applied to won redemptions from and won sales to the United Nations Command. For this reason, the government resisted devaluation of the official exchange rate. Strong pressure was applied, however, by the United States, using its leverage by delaying release of aid funds and special foreign exchange stabilization grants as incentives to devaluation. The result of all this pressure was two big devaluations. The official exchange rate was raised from 6.0 won to the dollar to 18.0 won on December 15, 1953. The rate of 18.0 won to the dollar was maintained through August 15, 1955, when the rate was changed to 50.0 won. The official rate of 50.0 won was in effect until February 1960 (Table 3–1), when it was raised to 65.0 won to the dollar.

Special exchange rates applied to export earnings. The rates on exports were much better for exporters than the official rate. These rates emerged because of import entitlements attached to certificates earned for exports to various areas under various types of financing. The certificates were traded in a free market.

Two basic rates applied to export earnings: one on Japan export dollars usable only for imports from Japan and another on other export dollars. The free market rate on foreign exchange earned from exports to Japan was higher than the rate on foreign exchange earned from export to other countries, as shown in Table 3–1. The difference was caused by government attempts to limit imports from Japan to the amount earned from exports there.

The difference between Japan and other export dollars was even further accentuated. A higher free market rate prevailed for preferential export dollars (those linked to imports of popular items) than for general export dollars from 1953 to August 1955. A higher rate also prevailed for export dollars on a letter of credit (L/C) basis than on export dollars on a documents-against-payment (D/P) basis from August 1955 to January 1961. The free market rates on Japan and other export dollars shown in the table represent the rates on nonpreferential export dollars through August 1955 and thereafter rates on export dollars on an L/C basis.

In addition to export dollar rates, there was a free market rate on dollars used for missionary transactions and service payments and receipts[5] which was much lower than the rate on export dollars.

Multiple exchange rates on export and other dollars were formed in the curb markets prior to 1957 and the system was given legal support from December 1957 onwards. In other words, the Monetary Board ruled that foreign exchange could formally be transferred from one trader's import account in the Bank of Korea to another's, and that missionary dollars could be transferred to export accounts with the government's approval. Starting in December 1957, the Bank of Korea actually acted as a broker for transactions of privately owned foreign exchange at the market exchange rate.

The multiplicity of exchange rates and means of allocating foreign exchange from 1953 to 1960 is staggering to comprehend: special foreign exchange loans of two types, bidding, lottery, foreign exchange tax systems, won redemption rates, a counterpart deposit rate, a variety of export dollar rates, special rates for missionary transactions, and prior to August 1955, two rates for sales of won by the Bank of Korea to the UNC, one for conversion of UN soldiers' pay and another for all other transactions. Other rates shown in Table 3–1 are black market rates for U.S. currency and U.S. military payment certificates (MPC).

TARIFFS

In 1946, a uniform tariff rate of 10 percent was imposed by the United States Military Government on all imports except those financed by foreign assistance. In early 1949, the government began a tariff reform program that culminated in a new law on customs duties effective January 1950. The aims of the new system were to increase government tariff revenue and to provide greater protection for domestic industries. The new customs code listed more than a thousand import items and specified the tariff rate applicable to each. The new simple average of all tariff rates was around 40 percent. The basic structure of tariff rates was as follows:

(1) no duties on food grains and noncompetitive equipment and raw material imports required for industrial, educational, cultural, and sanitation facilities;

(2) a 10 percent duty on essential goods for which domestic production was small relative to demand and on unfinished goods not produced in Korea;

(3) a 20 percent duty on unfinished goods produced in Korea;

(4) a 30 percent duty on finished goods not produced in Korea;
(5) a 40 percent duty on finished goods produced in Korea;
(6) 50 to 90 percent duties on semiluxury goods; and
(7) more than 100 percent duty on luxury goods.

Under the new tariff system, the same tariff rates applied to both commercial and aid-financed imports after September 1950. Duties from aid-financed imports became an important source of government revenue during and after the Korean War.

In 1952, the government announced tariff exemptions on imports of machinery and equipment required for certain major industries, including electric power, shipbuilding, metal working, machinery, chemicals, oil refining, textiles, mining, and fishing. For the shipbuilding, machinery, and mining industries, tariff exemptions were expanded to imports of required raw materials.

In 1957, changes in tariff rates resulted in a 4.1 percentage point increase in the simple average rate. Since the structure of domestic production changed significantly after 1950, some adjustments of tariff rates were made to protect domestic industries. The basic structure of tariff rates remained the same, however: lower rates on raw materials than on semifinished goods, and lower rates on noncompetitive finished goods than on competitive finished goods.

IMPORT CONTROLS

An import and export licensing system was instituted in April 1946. The stated purpose of the system was to prevent the import of nonessential goods and the export of essential domestic products. Until the import quota system was adopted in February 1949, the government simply announced imports that could be licensed and those that were prohibited. There was no attempt to control the quantity of any imports which could be licensed.

When the import quota system was instituted, the government began to control both the types and quantities of imports on the basis of a comprehensive commodity demand and supply program. The quota system was applied quarterly from 1949 to 1953 and semiannually after November 1953. Importable commodities were classified at three levels (section, group, and item). Substitution of item quotas within the same group was usually possible with the approval of the Ministry of Commerce and Industry. Import quotas were also specified separately with respect to imports from Japan and imports from other areas.

After devaluation in August 1955, the Ministry of Finance announced that the import quota system would be replaced by a more flexible system of import licensing. The semiannual trade program which was subsequently drawn up contained a list of items that could be imported under license. In 1956 the program included a list of automatically approved items for which licenses would be issued by the Ministry of Finance without authorization by the Ministry of Commerce and Industry (MCI). The program also listed restricted items that did require the MCI's permission. Items that were neither restricted nor automatically approved were presumed to be prohibited from import. In the trade program for the first half of 1957, the government added many new items for import and included a detailed specification for each imported item.

The trade program was applicable only to South Korea's normal trade transactions, and excluded United States aid-financed imports. Such imports were administered by the Ministry of Reconstruction in accordance with the annual project and nonproject assistance programs agreed upon between the South Korean government and the USAID mission. Therefore, the Ministry of Commerce and Industry had to prepare the semiannual trade program in coordination with the U.S. commodity assistance program.

EXPORT PROMOTION

The multiple exchange rate system, which favored exporting, arose from the grant of import entitlements to holders of foreign exchange earned by export, or from the export-import link system as it is known in South Korea. The first such scheme was the preferential export system adopted in June 1951. Under this system, exporters of so-called nonessential domestic products[6] were given the right to use 1 to 10 percent (average 5 percent) of export earnings for importing about 40 different popular items not normally approved for import. The system was reinforced in 1953 and early in 1955 by increasing the proportion of export earnings that could be used for importing popular items. The system was abolished in late 1955.

After 1955, the multiple exchange rate system was maintained by sales of dollar-denominated deposits held by exporters in the Bank of Korea. With the dollar deposit system, exporters were insured against exchange risk, since their foreign exchange earnings took the form of dollar-denominated deposits at the Bank of Korea. Deposits could be sold to importers at a market price, generally higher than the official exchange rate. The deposit system was abandoned in 1961 when attempts were made to unify the exchange rate.

In addition to the multiple exchange rate system, exports were favored through tariff exemptions on imports of raw materials (as of 1959), direct subsidies for some exports, and preferential credit. On January 20, 1955, the Ministry of Commerce and Industry announced the provision of 3.9 million won for export subsidies in that year. Export subsidies were paid on five items:

50 won per ton of kaolin exports, 42.5 won per ton of agalmatolite, 100 won per ton of flourite, 1,500 won per ton of dried anchovy, and 700 won per ton of dried fish. In 1956, export subsidies were suspended when the government failed to provide for them in the budget. The export subsidy regulation was not implemented until 1961 when an allowance was made in the budget.

Exporters also received preferential credit terms on trade credits (credits which enable exporters to receive payment in local currency before delivery to final users in importing countries), foreign exchange loans for importing capital goods and raw materials, and production loans in local currency. Trade credits for exports were given preference in the allocation of domestic loans and were managed outside the quarterly loan ceilings which were part of the price stabilization efforts of the late 1950s. Export credits were made at preferential interest rates, and in assessing the collateral value of export letters of credit (L/Cs) or shipping documents, the market exchange rate rather than the official rate was used.

In addition to the export credit system, a series of arrangements gave exporters preferential access to foreign exchange loans. Beginning in June 1950, foreign exchange loans were granted to exporters on the basis of export L/Cs. These loans made it possible for an exporter to import even before his export proceeds became available. The system was abolished after the adoption of the special foreign exchange loans in December 1952.

The first special foreign exchange loan fund, which operated from December 1952 to July 1954, gave preference to exporters. Initially, more than half of the funds were allocated on the basis of past export performance. Foreign exchange loans allocated to exporters could be used for importing consumer goods. The export incentive effect of the special foreign loan system, however, declined in the later stage because of the continuous increase in the proportion of the first special loan fund allocated to industrial end-users rather than to exporters.

Beginning in September 1959, credit was made available for up to 75 percent of production costs of exporters through an export operating loan fund of 200 million won financed by counterpart funds. The interest rate was 10 percent with a term of less than a year.

Another method of encouraging exports is implicit in the system under which traders are licensed. Under the Trade Transactions Law of 1957, all exporters and importers were required to register at the Ministry of Commerce and Industry. A prerequisite for registration was a minimum export of $3,000 for exporters and a minimum export of $10,000 for importers in 1958. This form of trading system is unusual in that the importer's registration was granted according to his export performance. Minimum exports for registration were raised in 1959 to $5,000 for exporters and $20,000 for importers. To *maintain* the status of exporters and importers, traders had to sustain an annual export

TABLE 3–3
Major Export Incentives

Description	Dates Applicable
Tariff exemptions on imports of raw materials and spare parts	1959–72
Domestic indirect and direct tax exemptions	1961–72
Accelerated depreciation	1966–72
Tariff and tax exemptions granted to domestic suppliers of exporting firms	1965–72
Wastage allowance subsidies	1965–72
Import entitlement linked to exports	1951–55, 1963–65, and 1966–71
Reduced rates on public utilities	1967–71
Registration as an importer conditional on export performance[a]	1957–72
Dollar-denominated deposits held in Bank of Korea by private traders[b]	1950–61
Korean Trade Promotion Corporation	1964–72
Monopoly rights granted in new export markets[c]	1967–71
Direct export subsidies	1955–56 and 1961–64
Export targets by industry	1962–72
Credit subsidies	
Export credits[d]	1950–72
Foreign exchange loans	1950–54 and 1971–72
Production loans	1959–72
Bank of Korea discount of export bills	1950–72
Import credits	1964–72
Capital loans by medium industry bank	1964–72
Offshore procurement loans	1964–72
Credits for overseas marketing activities	1965–72

NOTE: Though many of these incentives applied after 1972, this table is up to date only until 1972.

a. Minimum export by trader wishing to register as an importer increased from $10,000 in 1958 to $300,000 in 1970.

b. From December 1957 to 1961, these deposits could be sold legally. Black markets, however, were well developed long before 1957.

c. Authority existed from 1962, but was not widely used until 1967.

d. The rate on export credits was gradually lowered over the whole period.

performance exceeding a certain standard. Minimum exports were $10,000 for export business and $50,000 for import business in 1958. A year later minimum requirements for registration were raised by 100 percent.

Table 3–3 lists the major export incentives that were offered Korean firms from 1950 to 1972. Though most of them were not applied until after 1960, some had already appeared by that date.

END OF AN ERA

By 1960, foreign trade and economic institutions had progressed from the complete disarray of the early 1950s. However, the bureaucratic mechanisms that governed trade and payments were complex and cumbersome. Despite full recovery from the Korean War, the South Korean economy began to stagnate in the early 1960s for reasons given in Chapter 2. As political repression led to deepening disenchantment with the Rhee regime, the stage was set for the student revolution of April 1960 and the economic changes that followed.

NOTES

1. Allocating U.S. aid dollars to private importers was no problem until after the Korean War. During the war U.S. aid mainly took the form of civil relief goods imported and distributed directly by the U.S. military authorities.
2. Fifteen won in currency used at that time. There have been two currency reforms since 1945: a 100:1 revaluation in February 1953 and a 10:1 revaluation in June 1961. All won figures in this volume are converted to current denominations.
3. These peaks reflect the period in which the official exchange rate was adjusted upward on the basis of an average black market exchange rate or a weighted average price of dollars derived from Bank of Korea dollar auctions. These auctions, held in 1949 and early 1950, were not a major allocation mechanism; rather, they were a means of testing the market price of foreign exchange so that the official rate could be adjusted.
4. Because of this delay, the South Korean government suspended won advances beginning December 15, 1952, and advised the UNC to redeem the accumulated advances and to procure won currency from the Bank of Korea. In return, the UNC stopped the supply of petroleum products for civilian use.
5. Missionary transactions included remittances by foreign religious organizations for charities in Korea. Service dollars were those earned by providing services to UNC. These dollars could be transferred to the import account with the approval of the government.
6. The total of 57 items included starfish, dolls, lacquerwares, and nuts.