This PDF is a selection from an out-of-print volume from the National Bureau of Economic Research

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

Volume Author/Editor: Charles R. Frank, Jr., Kwang Suk Kim and Larry E. Westphal

Volume Publisher: NBER

Volume ISBN: 0-87014-507-X

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

Publication Date: 1975

Chapter Title: Chapter 5: Further Efforts at Liberalization: 1967 to Early 1973

Chapter Author: Charles R. Frank Jr., Kwang Suk Kim, Larry E. Westphal

Chapter URL: http://www.nber.org/chapters/c4066

Chapter pages in book: (p. 56 - 76)

Chapter 5

Further Efforts at Liberalization: 1967 to Early 1973

From 1967 to 1972 the growth of GNP, exports, and imports continued at a very rapid pace. While foreign private capital imports replaced foreign assistance as the major source of foreign savings, the exchange rate, which had been pegged at 270 won to the dollar by the Bank of Korea since August 1965, was allowed to devalue gradually beginning in 1968. The rate reached 326 in June 1971 and then 370 following a further devaluation of 13 percent. Later in 1971, gradual devaluation was allowed to resume and it continued until June 1972 when the rate was pegged at about 400 won to the dollar.

A follow-up trade liberalization program, launched in 1967, switched the positive-list approach to trade controls to a negative-list approach and revised the tariff structure so as to eliminate some of the very high rates. Another tariff reform, discussed throughout much of 1972, was instituted in early 1973.

In August 1972, a new set of economic policy reforms was announced. These reforms included a set of regulations to govern the so-called unorganized money market, reductions in bank interest rates, price stabilization efforts, continued stabilization of the exchange rate, reduction in export incentives, and liberalization of import controls.

Despite these and other attempts at further liberalization and reform, resort to the old price-distorting policies and controls was common. A number of factors were involved. First, any adverse trends in the balance of payments prompted a return to the old methods. For example, when import demand increased sharply in late 1968, the government placed additional import items on the restricted list and increased export incentives.

Secondly, as debt service payments began to rise, even though foreign exchange holdings seemed quite adequate in the late 1960s and early 1970s, concern over future debt repayments increased along with a fear for the vulnerability of the basic balance of payments. Restrictions on capital movements were strengthened in 1970.

Finally, and probably most important, certain vested interests in the business community had much to lose from further liberalization and favored a return to price-distorting mechanisms. Since these interests wielded considerable political power, the tariff reform of 1967 brought few real changes although the initial proposals of the Ministry of Finance would have substantially simplified the tariff structure. The business interests, many of them exporters who benefited greatly from tariff exemptions and wastage allowances, exerted pressure through the Ministry of Commerce and Industry, and thus fostered a bureaucratic struggle between the two ministries. For good measure, related business groups staged a sit-down protest against the tariff change in the offices of the Ministry of Finance.

In another demonstration of their influence, the vested interests exerted strong pressure on the Ministry of Finance just prior to the June 1971 devaluation. The pressure came mainly from large firms with heavy foreign debts because devaluation would greatly increase the burden of repaying their foreign loans, which were denominated in dollars. The holders of foreign debt were compensated by increased availability of local loans. The government also felt it had to peg the exchange rate at its new value rather than continue with a gliding peg.

From 1967 to 1972, pressure to extend export subsidies increased while monopoly rights for new export markets and products were granted in 1967 and 1968. Exporters were ranked according to performance and the more successful were given better administrative treatment. Freight and power rate discounts were given to large exporters, wastage allowances were expanded, and interest rate subsidies on loans to exporters grew very rapidly. In early 1973, however, some of the subsidies were reduced or eliminated.

The period from 1967 to early 1973 can be characterized as a prolongation of Phase IV while attempts to consolidate reforms continued. But South Korea did not quite achieve a completely liberalized Phase IV regime because reforms were periodically retarded by adverse economic developments and by increasingly effective political resistance from certain business interests opposed to further reform.

EFFORTS TO LIBERALIZE TRADE, 1967 TO EARLY 1973

Trade liberalization was attempted in 1967 through a change from the positive-list system of import controls to the negative list,[1] and through tariff reform. The first of these measures was much more successful than the second. The basic impetus for the attempted liberalization was the marked increase in foreign exchange holdings in 1966 brought about by a rapid expansion of commodity exports, increased service earnings expatriated by South Korean nationals in Viet Nam and West Germany, and a larger inflow of foreign loans (including cash loans).

As shown in Table 5–1, the new negative-list program greatly enlarged the number of Automatic Approval (AA) items for import. More than half of the 30,000 commodities specified in the SITC (Standard International Trade Classification) manual became AA items since they were excluded from the negative list. Prohibited or restricted items numbered 336 under the old system and 12,872 under the new. This discrepancy, however, is misleading since items omitted from the positive list had to be treated ad hoc and often were, in fact, prohibited or restricted. If these additional items are taken into account (see figures in parentheses in Table 5–1) the total number prohibited and restricted under the positive-list system comes to 26,484. The increase in imports resulting directly from liberalization was approximately $27 million in the final five months of 1967 and $68 million or 20 percent of total imports in 1968 according to estimates by the Ministry of Commerce and Industry.

TABLE 5–1
Total Importable Subitems before and after Adoption of the Negative-List Trade Program

	Program Ended July 24, 1967	New Program[a] Effective from July 25, 1967
Prohibited import items	244 (26,148)[b]	2,617
Restricted import items	92	10,255
Automatic Approval import items	3,760	17,128
Total	4,096	30,000

SOURCE: Ministry of Commerce and Industry.

a. The classification of commodities was based on the SITC Manual published by the United Nations. It was roughly equivalent to the classification in the old program.

b. Total number of prohibited items, i.e., those explicitly prohibited plus those prohibited because they were not listed in any category.

Although the government originally announced that it would gradually expand trade liberalization from the start made in the second half of 1967, the semiannual trade programs adopted in 1968 and afterwards showed a gradual increase in the number of restricted items (Table 5–2). The increase in the number of restricted items became more prominent beginning the second half of 1968 as import demand expanded greatly during 1968 and 1969.

Even under the negative-list system, imports of machinery from countries with which South Korea showed a trade deficit (Japan, for example) required prior approval of the Ministry of Commerce and Industry, regardless of the specifications in the trade program. The negative-list system applied only to new, not used, commodities. Used commodities were subject to a more restrictive set of rules.

The tariff reform announced on November 29, 1967 effective the first of the year was presumably intended to simplify the system along lines suggested by Ronald McKinnon. In his consultant's report (1967), Professor McKinnon proposed a low uniform tariff rate of about 20 percent for most imports and a higher rate (maximum 90 percent) on a selected group of industries that South Korea really wanted to protect. He also proposed that high tariffs on finished goods should be replaced with commodity taxes applicable to both domestic and imported goods.

In the end, however, the basic idea of a low, uniform tariff combined with modestly higher rates for the protection of a selected, small number of industries was not implemented with the result that the new customs law was much the same as the old. The basic rates in the new law are compared with

TABLE 5–2
Import Program for Basic Items, 1967 to 1970

	Prohibited	Restricted	Automatic Approval	Total
Second half 1967 (final)	118	402	792	1,312
First half 1968 (original)	116	386	810	1,312
First half 1968 (final)	71	479	756	1,312
Second half 1968 (final)	76	508	728	1,312
First half 1969 (final)	75	514	723	1,312
Second half 1969 (final)	74	530	708	1,312
First half 1970 (final)	73	526	713	1,312
Second half 1970 (original)	73	524	715	1,312

NOTE: The classification of import items is based on the United Nations' SITC Manual. The total shown in the table is an aggregation of 30,000 subitems.

SOURCE: Ministry of Commerce and Industry.

the old rates by major section of the BTN (Brussels Tariff Nomenclature) classification in Table 5–3. The total number of basic commodities subject to duties was increased from 2,044 to 3,019. The new rates were slightly higher than the old in all major sections of the BTN classification, except for sections 14, 18, and 19. The highest tariff rate in the old law, 250 percent, was now reduced to 150 percent.

TABLE 5–3
Changes in Legal Tariff Rates before and after Tariff Reform, 1967
(simple average rate)

BTN Section	Old Rate (percent)	New Rate (percent)
1. Live animals and animal products	32.5	38.4
2. Vegetable products	38.5	36.8
3. Animal & vegetable fats and oils	39.6	42.3
4. Prepared foodstuffs, beverages, spirits, vinegar, and tobacco	84.3	95.1
5. Mineral products	15.9	25.2
6. Products of the chemical and allied industries	27.6	29.7
7. Artificial resins and plastic materials	32.4	34.5
8. Raw hides and skins, leather, fur skins and articles thereof	55.2	58.1
9. Wood and articles of wood	40.1	44.2
10. Paper making material, paper and paperboard and articles thereof	43.0	54.2
11. Textiles and textile articles	59.0	71.0
12. Footwear, headgear, umbrellas, sunshades, whips, riding-crops, etc.	74.3	82.9
13. Articles of stone, plaster, cement, asbestos, mica, etc.	48.9	53.8
14. Real pearls, precious stones and metals	43.7	36.1
15. Base metals and articles thereof	32.9	35.6
16. Machinery and mechanical appliances	27.4	30.6
17. Vehicles, aircraft, vessels, etc.	39.6	36.2
18. Optical, photographic, cinematographic, measuring, checking and precision instruments and apparatus, etc.	44.4	40.4
19. Arms and ammunition	54.7	37.7
20. Miscellaneous manufactured articles	78.9	81.9
21. Works of art, collectors' pieces and antiques	0	0
Total number of items	(2,044)	(3,019)

NOTE: BTN—Brussels Tariff Nomenclature.
SOURCE: Official *Tariff Tables*, 1964 and 1968.

Weighted average tariff rates by major product groups in the old and new schedules are compared in Table 5–4. The table also compares the actual tariff rates (the ratio of all actual tariff collections to c.i.f. imports) by major product group. While statutory tariffs declined for most categories, actual tariff collections increased because of the pattern of exemptions. It should be noted, however, that the old and new tariff rates shown in Table 5–4 include both the regular tariff rates and the special rates levied to soak up margins on controlled imports, while the simple average tariff rates shown in Table 5–3 represent only the regular tariffs.

Although the legal rate structure remained basically the same, the new 1968 law allowed for greater administrative flexibility. Administrative duties could be levied on restricted commodities when imported in excess of quotas. Under certain conditions, emergency duties, countervailing duties, and so-called beneficial duties could be levied. The government had the authority to change statutory rates by as much as 50 percent by administrative decree.

TABLE 5–4
Weighted Average Tariff Rates Compared: Major Product Groups, Old and New Schedules
(percent)

Product Group	Statutory Tariffs		Actual Tariff Collections per Unit of c.i.f. Value	
	1966	1968	1966	1968
Agriculture, forestry, and fishing	33.4	28.5	11.5	14.2
Processed foods	55.2	54.1	6.6	25.5
Tobacco and beverages	132.6	106.3	22.3	40.3
Mining and energy	11.8	13.5	6.2	7.7
Construction materials	34.5	25.0	8.1	12.7
Intermediate products I	31.9	40.7	6.8	12.7
Intermediate products II	51.8	44.7	10.6	14.4
Nondurable consumer goods	74.2	43.2	12.6	9.0
Consumer durables	74.5	73.7	20.4	34.4
Machinery	25.5	47.0	8.7	7.5
Transport equipment	12.8	19.8	1.4	1.6
Scraps and unclassifiable	25.4	33.1	8.3	18.2
Noncompetitive imports	21.9	16.9	21.9	9.2
Weighted Average	43.1	40.6	9.9	15.6

NOTE: Statutory and actual tariff rates include both the regular and special tariff rates. The average tariff rates were first obtained for 231 nonservice input-output sectors, weighted by actual imports and then aggregated into the major product groups using total supply weights for respective years.

Even after the adoption of the new regular tariff schedule, the special tariffs were still effective. The system of tariff exemptions under the new law remained almost the same as before. Imports of raw materials for the production of exports, capital goods for export production and other major industries, and capital goods imports by foreign-owned enterprises were exempt from custom duties. Since exemptions were substantial and growing, mainly because of increased exports and increased tariff exemptions related to exports, the legal tariff structure did not have the same significance as it might have had in other countries.

The government made some adjustments, however, to the list of tariff exemptions in the period following the tariff reform. For instance, in October 1968 the government removed 14 commodities from the customs-exempt list, including cement and petroleum. In addition, machinery and equipment for fertilizer and automobile plants and highway construction were transferred from the tariff-exempt list to the tariff-reduced list.

As import demand increased rapidly in late 1968, the government tightened import prepayment deposit requirements for some categories of imports, and further raised the amount of prepayment per dollar of import in 1969. Prepayment requirements for non-aid-financed imports on an L/C basis from "specified areas" (within 10 days shipping time, mainly Japan) were raised from 150 percent in the second half of 1968 to 200 percent in 1969 on items whose basic tariff rates were in the range of 30–49 percent, except for 13 items. In 1970, all prepayment requirements were set equal to the 1968 level regardless of source. The prepayment requirements for imports on a documents-against-payment (D/P) basis were raised from 30 to 50 percent in 1969 on imports from the "specified areas"; however, for imports from other areas the 5 percent prepayment requirement was maintained as before. In addition, items whose basic tariff rates exceeded 50 percent and nonessential and luxury commodities designated by the United Nations Economic Commission for Asia and the Far East were excluded from the list of items importable on a D/P basis.

For imports on documents-against-acceptance (D/A) and on a usance basis, an annual ceiling was established for each year. In 1969, the prepayment requirements were raised from 10 to 30 percent on D/A imports from the "specified areas," while a 30 percent prepayment requirement on usance imports was maintained. Prepayment requirements for D/A and usance imports from all areas were unified at 30 percent in 1970.

In late 1972 and early 1973, some additional liberalization measures were taken. The number of automatic approval items was increased by eliminating some of the previously restricted items from the negative list, and the number of quota items was also reduced, while quota amounts per restricted item tended to increase.

In early 1973, the special tariff, which had been used to tax large differences between international and domestic market prices for some imports, was completely abolished. There was also a general tariff reform, effective from February 5, 1973, which changed regular tariff protection to encourage new import substitution industries and reduce protection of old industries. Tariff rates on heavy industrial and chemical products and intermediate goods were raised, while the previous high rates on finished goods, particularly textile products, were generally reduced by about 10 to 50 percentage points. The Ministry of Finance announced that the reform brought about a reduction in the simple average tariff rate from 38.8 to 31.3 percent. The tariff reform, however, increased administrative authority to adjust the tariff rates within 100 percent of the legal rate. In fact, the tariff authorities established the administrative rates on some imported raw materials much lower than the legal rates, in order to minimize the domestic cost-push effect of increases in international prices of major industrial raw materials which took place in 1973. Domestic commodity tax rates on both imported and domestically produced commodities, particularly on electrical appliances and other household goods, were also reduced by about 10 to 15 percentage points.

GROWTH OF EXPORT SUBSIDIES

Export incentives continued to grow from 1967 to early 1973 (Table 3–3). Preferential loans became an increasingly powerful tool for export promotion after the interest rate reform of 1965. Since the reform raised ordinary bank loan rates to 26 percent per annum (at which rate the excess demand for loans was still positive) while leaving the rates on export loans unchanged, interest subsidies implicit in the preferential loans for export increased considerably after September 1965. Because of the increased differential between commercial bank interest rates and preferential export rates and the proliferation of various preferential loans for exports, the implicit interest subsidies for exports increased from approximately 1.3 billion to 15.3 billion won, or from 7.6 won per dollar of export to 17.3 won between 1965 and 1970.[2] As a percentage of total exports valued at the official exchange rate, interest rate subsidies increased from about 3 percent in 1965 to 6 percent in 1970.

Table 5–5 shows the growth of the various subsidized loan schemes for exports between 1967 and 1970. Loans for offshore procurement and credit for imports of capital equipment grew rapidly beginning in 1967. In 1968 and 1969, the export industry operating loans (financed from the Counterpart Fund) and export industry promotion loans were abolished. In their place, the government introduced loans for domestic production of raw materials used

TABLE 5–5

Preferential Loans for Exports, 1967 to 1970

	Outstanding Credit (million won as of December 31)				Annual Interest Rate		
	1967	1968	1969	1970	(percent)	Term	Remarks
1. Export credit	6,618	8,072	11,866	19,129	6.0	90–135 days	200 won per dollar through '69, 220 won in '70 and 260 won in '71
2. Loans for suppliers of U.S. offshore procurement	3,399	3,567	5,291	4,510	6.0	90 days	150 won per dollar through '68, 180 won in '69 and 220 won in '70
3. Credit for imports of raw materials for export	17,835	20,239	31,868	49,981	1.5	60 days	Green card exporters exempted from guarantee fees
(Payment guarantee)	(11,292)	(8,859)	(14,201)	(21,244)			
(Domestic usance-foreign exchange)	(62)	(29)	—	—	6.0	90–135 days	Foreign exchange value of imports
(Import loans)	(6,481)	(11,351)	(17,666)	(28,737)	6.0[a]	90–135 days	Won equivalent of imports
4 Export usance	652	550	1,986	4,463	6.0	90–120 days	Won loan per dollar equivalent to export credit
5. Loans for export	—	—	35	154	6.0	90–120 days	Won loan per dollar equivalent to export credit

6. Foreign exch[illegible]

							export credit
6. Foreign exchange loans for import of capital goods for export industries	1,849	7,802	10,297	21,372	12.0	3–5 years	80 percent of import value through '68 and 90 percent in '69
7. Export industry promotion loans	61	368	28	7	26.0	90 days	Abolished in 1969
8. Export industry operating loans (Counterpart Fund)	193	—	—	—	18.0	1 year	Abolished after 1968
9. Equipment loans for conversion into export industry	1,531	2,237	2,536	2,826	12.0	5 years	A maximum of 10 million won to those industries specified by the Ministry of Commerce and Industry
10. Loans for export specializing industries	292	563	742	807	12.0	5 years	
11. Loans for production of raw materials	—	—	134	833	6.0	90–120 days	220 won per dollar in '69 and '70
12. Loans for preparing agricultural and fishery products for export	—	—	3,413	4,001	12.0	90–180 days	70 percent of required funds
Total	32,430	43,398	68,196	108,083			

SOURCE: Bank of Korea; Medium Industry Bank.
a. Raised to 9.0 percent per annum, June 1971.

in producing exports and for processing of agricultural and fishery products for export in May and September 1969 (rows 11 and 12, Table 5–5).

The flexible wastage allowance grew in importance as an incentive to export during the late 1960s as the proportions of wastage allowed gradually increased for many industries. The Korean Traders Association (1969) estimated that the implicit subsidies arising from the wastage allowances on imported raw materials averaged 12.7 won per dollar export, or about 4.6 percent of the official exchange rate in 1968. The amount of subsidies per dollar, however, showed a wide variation by type of export commodity. For instance, the subsidies implicit in wastage allowances were as high as 48 to 59 won per dollar of export (about 17 to 21 percent of the official exchange rate) for woolen fabrics, rayon fabrics, and footwear. Business firms and trade associations have lobbied persistently for increased wastage allowance.

The total amount of tax concessions for export grew rapidly from 1965 to 1970 (Table 5–6). Relief per dollar of export more than doubled in those six years.

As mentioned in Chapter 3, importer's licenses were granted only to firms whose export performance met minimum standards. The minimum exports required for a license, which were set at $30,000 in 1964, were raised to $100,000 in 1966, $200,000 in 1969, and $300,000 in 1970. In addition, in 1969, traders were graded in four classes (blue-, white-, yellow-, and red-card holders) on the basis of annual export performance. High performance traders were given a number of special benefits, including exemption of col-

TABLE 5–6
Tax Concessions for Exports, 1965 to 1970

	1965	1966	1967	1968	1969	1970
Internal tax (millions of won)	2,838	5,021	7,724	11,127	17,207	26,330
Regular and special tariff (millions of won)	2,962	5,333	8,224	19,261	22,551	34,700[a]
Total tax relief (millions of won)	5,530	10,354	15,952	30,388	39,758	61,030
Total exports[b] (millions of dollars)	175.1	250.3	334.8	486.2	658.3	882.2
Tax relief per dollar of export (won)	31.6	41.4	47.6	62.5	60.4	69.1

SOURCE: National Tax Administration.
a. Preliminary figures.
b. Includes military goods sales abroad.

lateral for regular and special tariffs, relaxation of tax surveillance, and preferential treatment in foreign exchange allocations for overseas activities.

Certain exporters were given monopoly rights in new export markets or for the export of new commodities. The system originated in 1962 but was not applied to many commodities until 1967. Monopoly rights were given, among others, for the following commodities: arrowroot wallpaper (all countries), processed brassware (Japan), apples and pears (Taiwan), silk for sashes (Japan), artificial eyelashes (EEC), oak leaves (Japan), and rice cake (Japan).

Finally, railway freight rates on export minerals were given a 30 percent discount beginning in 1967. Export industries with power-receiving capacity of less than 200 KWH whose electric power costs amounted to more than 20 percent of total manufacturing costs were granted a 30 percent discount on electricity charges.

As a follow-up on the August 1972 reforms, many export incentives were reduced. The 50 percent reduction in tax on corporation and individual business income earned from export business was abolished. The government also announced a gradual adoption of a tariff-rebate system under which tariffs are collected at first on all imports but collections for imported raw materials for exports are refunded later when actual exports occur. Until 1973, imports of raw materials for exports were granted tariff exemptions at the time of customs clearance, and tariffs plus some penalty were imposed later when importers did not fulfill export obligations. Finally, the preferential interest rate on export credit was raised from 6 to 7 percent. This slight increase, combined with the general reduction in ordinary bank loan rates, reduced the implicit subsidies from preferential loans to the export sector.

EXCHANGE RATES

From August 1965 through 1967, the exchange rate was pegged by the Bank of Korea at about 271 won to the dollar. Beginning in 1968, the won was allowed to devalue gradually, at a rate believed to be sufficient to maintain purchasing power parity. The rate had reached 326 by June 1971, an annual rate of increase close to 9 percent, when an abrupt devaluation of 13 percent brought the rate to 370. Until the end of the year, the rate remained at this value and then after further gradual devaluation, the won was pegged at about 400 to the dollar in June 1972.

The U.S. dollar, meanwhile, underwent two devaluations. The first, of about 10 percent in early 1972, resulted from the Smithsonian Agreement of December 1971. The second, also 10 percent, stemmed from a parity change for the dollar in February 1973 and from the subsequent flotation of other currencies against the dollar in the spring of 1973. These changes had the effect of devaluing the won with respect to currencies other than the dollar. Since most of South Korea's foreign trade is carried on with countries other than the United States, these changes in the value of the dollar made a great difference in the cost of Korea's imports and the prices of her exports.

Table 5–7 lists exchange rates on a purchasing-power-parity basis taking into account the changes in the value of the won with respect to major currencies other than the dollar. Thus for 1972, the official rate averaged, over the year, 391.8 won to the dollar. The purchasing-power-parity rate was 254.1, and the purchasing-power-parity rate adjusted for changes in the value of other currencies was 271.9 won to the dollar.

In 1972 and early 1973, the Korean currency was very strong. Previously 1965 had been regarded as the year when the exchange value of the

TABLE 5–7
Official Exchange Rate at Purchasing Power Parity, 1965 to 1973
(1965 prices)

	1965	1970	1971	1972	1973 (April)
1. Official exchange rate (won per dollar)	265.4	310.7	347.7	391.8	398.9
2. Trade-weighted average WPI of major trading partners (1965=100)	100.0	112.8	114.2	117.2	128.9
3. Korea's WPI (1965=100)	100.0	146.0	158.4	180.7	187.7
4. Purchasing-power-parity exchange rate 1 × 2 ÷ 3	265.4	240.0	250.7	254.1	273.9
5. Trade-weighted effective[a] devaluation due to foreign currency realignments (percent)	—	—	—	7.0	10.0
6. Purchasing-power-parity exchange rate including foreign currency realignments	265.4	240.0	250.7	271.9	301.3
7. Annual increase (percent)	—	2.4	4.5	8.5	10.8

SOURCE: Table 5–8; Bank of Korea, *Monthly Statistics*, April 1973; Economic Planning Board, "Monthly Report on Economic Trends" (Briefing material for the President, in Korean), June 11, 1973; U.S. Department of Commerce, *Commerce Today*, April 2, 1973, p. 4.

a. Exchange rates of the won vis-à-vis other major currencies were expressed in terms of dollars using the dollar rate for major currencies prevailing in the base period, 1965. These rates in terms of dollars were averaged using trading shares as weights in a weighted-average calculation.

won placed Korea in its strongest competitive position ever. Yet compared with 1965, the purchasing-power-parity exchange rate in April 1973 was 13 percent higher. It was particularly favorable for exports, not only because of the various devaluations both of the won and the dollar, but also because of relative rates of inflation. Wholesale prices in Korea's major trading partners increased about 10 percent by April 1973 compared with the average for 1972, while the South Korean index showed an increase of only 4.6 percent during the same period.

Between 1970 and April 1973, the purchasing-power-parity rate adjusted for currency realignments increased significantly (see line 7 of Table 5–7). By 1972, the rate was 13 percent higher than it had been in 1970 and by April 1973 it was 26 percent higher.

QUANTITATIVE ESTIMATES OF THE RESTRICTIVENESS OF THE TRADE AND PAYMENTS REGIME, 1958 TO 1970

Tables 5–8 and 5–9 show how the trade and payments regime has varied in degree of restrictiveness, both for exports and imports, and how various measures of effective exchange rates have changed over time.

Table 5–8 analyzes the effective exchange rate for exports. To obtain these figures, the average export dollar premium and total subsidies per dollar of export are added to the official exchange rate. For the period 1958–61, an excess of the average free market price of export dollar certificates over the official exchange rate was taken as export premium per dollar. In 1963 and 1964 a premium emerged because of the export-import link and the free market sale of import entitlements attached to export dollars.

The won value of total export subsidies increased greatly over the decade of the 1960s from 1.2 to 86.5 won per dollar of export. Direct subsidies were important briefly from 1961 to 1964, but internal tax exemptions, customs duties exemptions, and interest rate subsidies were all important throughout most of the decade. Subsidies on freight and power rates, monopoly rights, and administrative incentives are not quantified in Table 5–8 because they are relatively small.[3]

Table 5–9 lists the components of the effective exchange rate on imports. Two separate effective rates are determined, one based on legal tariff rates, and the other including an adjustment for exemptions from the legal tariff rates. In addition to an adjustment for tariffs, the foreign exchange tax and total premia on export dollars per dollar of imports are added to the average official exchange rate. The total adjustment based on actual tariffs, labelled total actual tariffs and tariff equivalents per dollar of import in row B8 of

TABLE 5–8
Price-Level-Deflated and Purchasing-Power-Parity Effective Exchange Rates on Exports, 1958 to 1970

	1958	1959	1960	1961
A. Official exchange rate (won per dollar)	50.0	50.0	62.5	127.5
B. Average export dollar premium (won per dollar)	64.0	84.7	83.9	14.6
C. Export subsidies				
1. Direct subsidy payments (mil. won)	—	—	—	307
2. Internal tax exemptions (mil. won)	na	na	na	na
3. Customs duties exemptions (mil. won)	na	na	na	na
4. Interest rate subsidies (mil. won)[a]	19	25	38	39
5. Total export subsidies (1–4) (mil. won)	19	25	38	346
6. Total exports (mil. dollars)[b]	16.5	19.8	32.8	40.9
7. Won subsidies per dollar export (5÷6) (won)	1.2	1.3	1.2	8.5
D. Effective exchange rate on exports (A+B+C7)	115.2	136.0	147.6	150.6
E. Korea's wholesale price index (1965=100)	39.9	40.8	45.2	51.2
F. Price-level-deflated effective exchange rate on exports (D÷E)	288.7	333.3	326.5	294.1
G. Average wholesale price index of major trade partners (1965=100)[d]	97.2	97.7	97.9	98.3
H. Purchasing-power-parity effective exchange rate on exports (F×G)	280.6	325.6	319.6	289.1

Table 5–9, fluctuated between 1958 and 1965 from 14 to 38 won to the dollar. Between 1965 and 1970, however, it remained remarkably steady at about 25 won to the dollar. Legal average tariffs and tariff equivalents on imports increased markedly, from 23.3 won per dollar of import in 1962 to 72.0 won in 1970. The increasing level of customs duty exemptions, however, kept actual tariff collections per dollar of imports almost constant. The adjustments for obtaining effective rates of exchange do not make allowance for price premia resulting from quantitative restrictions, although these are taken into account in the effective rates of protection calculated in Chapter 10. This omission should not, however, be very important, since the special tariffs, originally instituted in July 1961, tend to soak up such premia because of the way they are administered.

The effective exchange rates for both exports and imports are deflated by two price indexes: the South Korean wholesale price index and a purchasing-power-parity index. The latter is the ratio of the South Korean wholesale

1962	1963	1964	1965	1966	1967	1968	1969	1970
130.0	130.0	214.3	265.4	271.3	270.7	276.6	288.2	310.7
—	39.8	39.7	—	—	—	—	—	—
566	354	350	—	—	—	—	—	—
310	527	992	2,838	5,021	7,724	11,127	17,207	26,330
255	571	1,197	2,692	5,333	8,224	19,261	22,551	34,700[c]
47	248	719	1,330	2,571	4,935	7,395	9,690	15,280
1,178	1,700	3,258	6,860	12,925	20,883	37,783	49,448	76,310
54.8	86.8	119.1	175.1	250.3	334.8	486.2	658.3	882.2
21.5	19.6	27.4	39.2	51.6	62.4	77.7	75.1	86.5
151.5	189.4	281.4	304.6	322.9	333.1	354.3	363.3	397.2
56.0	67.5	90.9	100.0	108.8	115.8	125.2	133.7	145.9
270.5	280.6	309.6	304.6	296.8	287.6	283.0	271.7	272.3
97.6	98.3	98.5	100.0	102.8	104.0	105.6	108.8	112.8
264.0	275.8	305.0	304.6	305.1	299.1	298.8	295.6	307.2

NOTE: na—not available.

SOURCES: Bank of Korea; Ministry of Finance; USAID, Korea Mission.

a. Interest rate subsidies were calculated by estimating the average interest rate on all outstanding loans to business firms at about 26 percent. This was taken as an estimate of the equilibrium interest rate, and interest rate subsidies were taken as the subsidy element of all loans at less than 26 percent. The estimate of the average interest rate on loans was derived from Kim Mahn Je (1970).

b. Includes military goods sales abroad.

c. Estimated by applying the average rate of tariff exemptions on imports of raw materials and capital goods for export in 1968–69 to the value of c.i.f. imports for exports in 1970, because actual exemption figures not available.

d. An average of wholesale price indexes in the United States and Japan, weighted by Korea's annual trade volume with the respective countries. It is noted that Korea's imports from and exports to the United States and Japan generally increased from about 43 percent of Korea's total trade volume in 1958 to 83 percent in 1970.

TABLE 5-9

Price-Level-Deflated and Purchasing-Power-Parity Effective Exchange Rates on Imports, 1958 to 1970

	1958	1959	1960	1961
A. Official exchange rate (won per dollar)	50.0	50.0	62.5	127.5
B. Tariff & tariff equivalents				
1. Actual tariff collections (mil. won)	2,969	3,559	5,150	5,306
2. Tariff exemptions (mil. won)	na	na	na	na
3. Foreign exchange tax (mil. won)	1,425	4,722	5,046	251
4. Premiums for total exports (mil. won)[a]	1,056	1,677	2,752	597
5. Total actual tariffs and tariff equivalents (1+3+4) (mil. won)	5,450	9,958	12,948	6,154
6. Total legal tariffs and tariff equivalents (1+2+3+4) (mil. won)	na	na	na	na
7. Total c.i.f. imports (mil. dollars)	378.2	303.8	343.5	316.1
8. Actual tariffs and tariff equivalents per dollar import (5÷7) (won)	14.4	32.8	37.7	19.5
9. Legal tariffs and tariff equivalents per dollar import (6÷7) (won)	na	na	na	na
C. Effective exchange rate on imports				
1. Official exchange rate plus actual tariffs per dollar of import	64.0	82.8	100.2	147.0
2. Official exchange rate plus legal tariffs per dollar of import	na	na	na	na
D. Price-level-deflated effective exchange rate on imports (deflated by line E in Table 5-8)				
1. C1÷E from Table 5-8 (actual basis)	160.4	202.9	221.6	287.1
2. C2÷E from Table 5-8 (legal basis)	na	na	na	na
E. Purchasing-power-parity effective exchange rate on imports				
1. D1 × G from Table 5-8 (actual basis)	155.9	198.2	216.9	282.2
2. D2 × G from Table 5-8 (legal basis)	na	na	na	na

price index to a weighted average wholesale price index of major trading partners (the United States and Japan). The effective exchange rate deflated by the South Korean wholesale price index is called the price-level-deflated effective exchange rate while the effective exchange rate deflated by the purchasing-power-parity index is denoted the purchasing-power-parity effective exchange rate. As an indicator of the incentive effect for exports and the relative price of imports, the purchasing-power-parity effective exchange rates are the most meaningful.

1962	1963	1964	1965	1966	1967	1968	1969	1970
130.0	130.0	214.3	265.4	271.3	270.7	276.6	288.2	310.7
6,847	6,708	8,509	12,847	18,003	25,413	37,881	44,724	50,924
2,919	5,464	7,236	9,682	20,295	32,374	66,411	86,240	92,000[b]
79	—	—	—	—	—	—	—	—
—	3,455	4,728	—	—	—	—	—	—
6,926	10,163	13,237	12,847	18,003	25,413	37,881	44,724	50,924
9,845	15,627	20,473	22,529	38,298	57,787	104,292	130,964	142,924
421.8	560.3	404.4	463.4	716.4	996.2	1,462.9	1,823.6	1,985.0
16.4	18.1	32.7	27.7	25.1	25.5	25.9	24.5	25.7
23.3	27.9	50.6	48.6	53.5	58.0	71.3	71.8	72.0
146.4	148.1	247.0	293.1	296.4	296.2	302.5	312.7	336.4
153.3	157.9	264.9	314.0	324.8	328.7	347.9	360.0	382.7
261.4	219.4	271.7	293.1	272.4	255.8	241.6	233.9	230.6
273.8	233.9	291.4	314.0	298.5	283.9	277.8	269.3	262.3
255.1	215.7	267.6	293.1	280.0	266.0	255.1	254.5	260.1
276.2	229.9	287.0	314.0	306.9	295.3	293.4	293.0	295.9

NOTE: na—not available.
SOURCE: Table 5–8.
a. Average premium per dollar export given in Table 5–8 multiplied by total value of exports for each year.
b. Estimated by applying the average ratio of tariff reductions and exemptions to the value of c.i.f. imports in 1968–69 to the value of imports for 1970.

The bias toward export promotion in the trade and payments regime is clearly revealed by a comparison of purchasing-power-parity effective exchange rates for exports and imports (Table 5–10). The effective exchange rate for exports exceeded the effective exchange rate for imports by a wide margin in every year except for 1961–62 and 1965. In the periods 1958 to 1960 and 1963 to 1964, the major difference in effective rates for exports and imports was caused by the export dollar premium. The devaluations of January and February 1961 were soon followed by exchange rate unification. The net effect on the export side was that the price-deflated effective exchange rates declined rather than rose between 1960 and 1961. Thus, the devaluation was more than offset by the elimination of premiums as far as exports were concerned. On the import side, the price-deflated effective exchange rate of won to the dollar increased sharply as the result of the devaluation. Thus, the effective rates for exports and imports were brought closely into line in 1961 and 1962.

In 1963 and 1964, export dollar premia emerged again through the market for import entitlements, and the effective exchange rates for exports and imports again diverged sharply. The devaluation of May 1964, from 130 to 257 won to the dollar, the float in the spring of 1965 to 271 won to the dollar, and the 1964 unification of rates again brought the effective rates for exports and imports into line. Despite the enormous nominal devaluation between 1963 and 1965 (about a 115 percent increase in the won/dollar rate) the purchasing-power-parity effective won/dollar rate for exports rose only about 11 percent. On the import side, however, the devaluation was more effective.

After 1965, the export and import rates moved increasingly out of line because of rapidly growing export subsidies. Export subsidies as a percent of the effective exchange rate are compared with actual tariffs and tariff equivalents as a percentage of the effective exchange rate in Table 5–10. By 1970, about one-fifth of the effective exchange rate for exports represented subsidies of one form or another.

The quantitative estimates, outlined in tables 5–8 through 5–10, confirm the impressions of our analysis of individual trade and exchange rate policies —liberalization efforts in 1961–62 and 1964–65, followed by rapid backsliding in 1963 and gradual backsliding from 1967 to 1971. This pattern emerges most clearly in looking at columns D and E of Table 5–10. The premia and subsidies as a percentage of the effective exchange rate on exports follow the pattern of the liberalization efforts. Column G shows, however, that tariffs and tariff equivalents declined steadily as a percentage of the effective exchange rate on imports from 1959 to 1970 (except for a slight increase in 1967). The major reasons are the elimination of the foreign exchange tax in 1962, the gradual shift of imports toward capital goods with low or zero tariffs, and the increasing tariff-exempt importation of raw materials for export industries.

TABLE 5–10

Comparison of Purchasing-Power-Parity Effective Exchange Rates

TABLE 5–10

Comparison of Purchasing-Power-Parity Effective Exchange Rates for Exports and Imports, 1958 to 1970

	Purchasing-Power-Parity Effective Exchange Rate on Exports[a] (A)	Purchasing-Power-Parity Effective Exchange Rate on Imports[b] (B)	Ratio (A÷B) (C)	Percentage Components of Effective Exchange Rate on Exports			Percentage Components of Effective Exchange Rate on Imports	
				Premia[c] (D)	Subsidies[d] (E)	Official Exchange Rate[e] (F)	Tariff and Tariff Equivalents[f] (G)	Official Exchange Rate[g] (H)
1958	280.6	155.9	1.80	55.5	1.0	43.5	22.5	77.5
1959	325.3	198.2	1.64	62.2	1.0	36.8	39.6	60.4
1960	296.6	216.9	1.37	56.7	0.8	42.5	37.6	62.4
1961	289.1	282.2	1.02	9.7	5.6	84.7	13.2	86.8
1962	264.0	255.1	1.03	0.0	14.1	85.9	11.2	88.8
1963	275.8	215.7	1.28	21.3	10.3	68.7	12.2	87.8
1964	305.0	267.6	1.14	14.1	9.7	76.2	13.2	86.8
1965	304.6	293.1	1.04	0.0	12.8	87.2	9.4	90.6
1966	305.1	280.0	1.09	0.0	15.9	84.1	8.4	91.6
1967	297.4	266.0	1.12	0.0	18.2	81.8	8.6	91.4
1968	298.8	255.1	1.17	0.0	21.9	78.1	8.5	91.5
1969	295.6	254.5	1.16	0.0	20.6	79.4	7.8	92.2
1970	307.2	260.1	1.18	0.0	21.8	78.2	7.6	92.4

a. Based on row H, Table 5–8.
b. Based on row E1, Table 5–9.
c. Row B, Table 5–8, as percent of row D.
d. Row C7, Table 5–8, as percent of row D.
e. Row A, Table 5–8, as percent of row D.
f. Row B8, Table 5–9, as percent of row C1.
g. Row A, Table 5–9, as percent of row C1.

SUMMARY AND CONCLUSIONS

From 1967 until June 1971, the effective exchange rate for exports was maintained by gradually increasing export subsidies. Attempts were made to liberalize import controls and tariffs but these foundered. A devaluation of the won in June 1971, two dollar devaluations in 1972 and 1973, and a yen revaluation caused the balance of payments to improve markedly and export subsidies were partly dismantled in early 1973.

Under increasing pressure from business interests the government in late 1972 adopted a basically different strategy—one in which price inflation and interest rates would be reduced and the exchange rate held stable. Though the short-run response of the economy and the balance of payments has been satisfactory, prior devaluations and a worldwide economic boom have been more important factors than the reforms in producing the desired result. It remains to be seen whether these policies will succeed in the long run. The strength of the won may be eroded by continuing high costs of petroleum, grains, and other natural resources that Korea imports in large quantities. It may be impossible to keep prices in check and further devaluations may be required to keep the economy growing at a rapid pace.

NOTES

1. Under the positive-list system, only those items listed in the trade program could be imported or exported, subject to specifications made in the program. But under the negative-list system, the trade program lists only those items whose imports or exports are either prohibited or restricted. Therefore, unlisted items in the negative-list program represent Automatic Approval items, whereas the unlisted items in the positive-list program are either prohibited or restricted.
2. See Table 5–8 for details on interest rate subsidies.
3. Subsidies by the wastage allowance on imported raw materials are considered to be included in internal tax and customs duties exemptions, since the tax and customs duties exemptions include exemptions for the proportion of wastage allowance (both technological wastage loss and additional allowances).