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REPORT TO THE CONGRESS

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U.S. Assistance  
For The Economic Development  
Of The Republic Of Korea

B-164264

BY THE COMPTROLLER GENERAL  
OF THE UNITED STATES

JULY 12, 1973

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COMPTROLLER GENERAL OF THE UNITED STATES  
WASHINGTON, D.C. 20548

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To the President of the Senate and the  
Speaker of the House of Representatives

This report presents our findings, conclusions, and recommendations on the administration and effectiveness of U.S. assistance for the economic development of Korea. We have also issued a classified supplement containing statements of U.S. objectives and discussions of program areas which are necessary, in our opinion, to understand the full implications of present U.S. involvement in Korea.

The review was made as part of our continuing examination of foreign assistance programs, pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

Copies of this report are being sent to the Director, Office of Management and Budget; the Secretaries of State, Defense, and Agriculture; and the Administrator, Agency for International Development.

*James B. Atchey*

Comptroller General  
of the United States

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#### ABBREVIATIONS

AG	Auditor General (AID)
AID	Agency for International Development
CLCC	Convertible local currency credit
CUP	Currency use payment
GAO	General Accounting Office
OPIC	Overseas Private Investment Corporation
MAP	Military Assistance Program
ROKG	Republic of Korea Government

D I G E S T

WHY THE REVIEW WAS MADE

The General Accounting Office (GAO) made this review as part of its continuing effort to assist the Congress in its oversight of U.S. foreign assistance programs.

During fiscal years 1968 through 1972, U.S. direct bilateral economic assistance to Korea totaled \$1,194 million. This includes \$246 million by the Agency for International Development (AID), \$717 million by the Food for Peace (Public Law 480) program, and \$209 million by the Export-Import Bank of the United States. Direct military assistance totaled \$2,635 million.

Korea has benefited also from the substantial U.S. expenditures supporting U.S. military forces stationed in Korea and has received additional substantial sums for sending its troops to Vietnam. (See pp. 8, 9, and 10.)

FINDINGS AND CONCLUSIONS

Discussion of certain matters, such as U.S. objectives, using Public Law 480 funds to offset a reduction in another U.S. assistance program, and the need for continuing military assistance to Korea, is presented in a classified supplemental report for security reasons. A knowledge of these matters is necessary to understand the full implications of present U.S. involvement.

Economic progress with  
continuing problems

Korea's economic growth indicators, such as gross national product and manufacturing output, have been most impressive since 1965, but this economic success may not be as great as it appears.

Indicated economic accomplishments have been achieved but at the expense of a steadily mounting external debt and an increasing trade deficit. (See p. 11.)

Expansion of industry has been emphasized with much less attention being given to social and welfare needs. The rural and urban income gap and the food grain production and consumption gap also have widened. (See p. 11.)

U.S. assistance undoubtedly stimulated Korea's economic expansion, but it also may have contributed, inadvertently, to its economic problems. For example, U.S. concessional aid has helped to make it possible for Korea to get large amounts of nonconcessional credit, but this has caused Korea's external debt situation to worsen. In addition, subsidization of food and fiber programs has built up Korean demand for imported products thus adding to its trade gap. (See p. 11.)

Because of these problems and the high cost of maintaining its vast military force, Korea most likely

will require substantial amounts of concessional capital for years to come.

Need for AID development loans

In the past 10 years, the United States has reduced its AID program considerably. However, other U.S. inputs such as Public Law 480, Export-Import Bank, military assistance, and U.S. expenditures in Korea, have remained high or have increased. This fact and the increased inputs from multilateral organizations means that external assistance to Korea actually has increased. (See p. 11.)

For many years AID focused on developing Korea's industries and subsidizing its commercial import requirements. In recent years, however, AID has restructured its program to emphasize development of the lagging agricultural and social sectors.

The Korean Government has not given adequate attention toward correcting this imbalance of its economy. Korean emphasis on capital development, rather than on sectors, such as agriculture, have aggravated the situation. (See p. 12.)

During 1971 and 1972, most of the AID development loan funds were used to import rice. The AID development loan program has been, in essence, an extension of the Public Law 480 program. Together these two programs seem to serve as a disincentive for the Korean Government to seek an early solution to problems in its agricultural sector. (See pp. 30, 49, and 54.)

With the United Nations and the international lending institutions increasing their assistance to Korea, the Public Law 480 program generating increased amounts which can be

used in the lagging sectors, and the Korean Government's continuing emphasis on other sectors, GAO questions the need for continuing the AID development loan program. (See pp. 10, 14, and 31.)

Administration of AID programs

--U.S. assistance is intended to foster private initiative and competition and discourage monopolies. But in Korea, AID funds have contributed to developing Government-controlled industries. (See pp. 22 to 24.)

--AID loans, intended for developing small- and medium-size firms, have been used instead to assist large well-established firms, some capable of obtaining other financing. (See pp. 24 to 26.)

--Korean textile firms receiving AID loans have not submitted timely reports and certifications on the amounts of textiles exported to the United States, and AID has not verified the accuracy of reports submitted. (See pp. 26 and 27.)

--AID officials have been unable to furnish evidence of joint agreements with the Korean Government on the use of currencies generated from AID loans or on what specific applications have been made of funds. (See pp. 28 to 30.)

--The Korean Government improperly used \$1.8 million in funds and commodities provided by the United States. Korea has not refunded this amount. (See pp. 37 and 38.)

--AID recorded as obligations large amounts of funds for family planning activities without defining the requirements, and commodities obtained for the program were either used for activities other

than family planning or were not used.

Administration of Food for Peace Program

--The Public Law 480 concessional commodity sales program has increased significantly and has been used directly and indirectly to offset cutbacks in other U.S. assistance programs. (See p. 47 and the classified supplemental report.)

--Although the United States has needed large amounts of local currencies for its own purchases in Korea, for a period of time it allowed the percentage of local currency generated from commodity sales allocated for U.S. uses to decline. (See pp. 50 and 51.)

--The United States has incurred financial losses totaling \$404,000 due to late Korean Government deposits of local currencies generated from the sales. (See pp. 51 to 53.)

Changing trade patterns

The United States has done much to enable Korea to develop economically, but the relative U.S. share of Korea's import market is declining as tied assistance decreases. Meanwhile, Japan has significantly increased its sales to Korea and now accounts for a major portion of Korea's trade. (See pp. 68 to 73.)

RECOMMENDATIONS OR SUGGESTIONS

GAO is recommending that the Administrator of AID (1) urge the Korean Government to reassess its roles as

investor and as competitor with the private sector, (2) exercise closer control over the uses of funds as provided for in existing agreements, (3) implement followup procedures to assure the timely receipt of required reports on textile production and exports, (4) continue to press Korea for final settlement on refund claims, and (5) strengthen procedures for determining commodity requirements before obligating funds. (See pp. 34, 35, 38, and 46.)

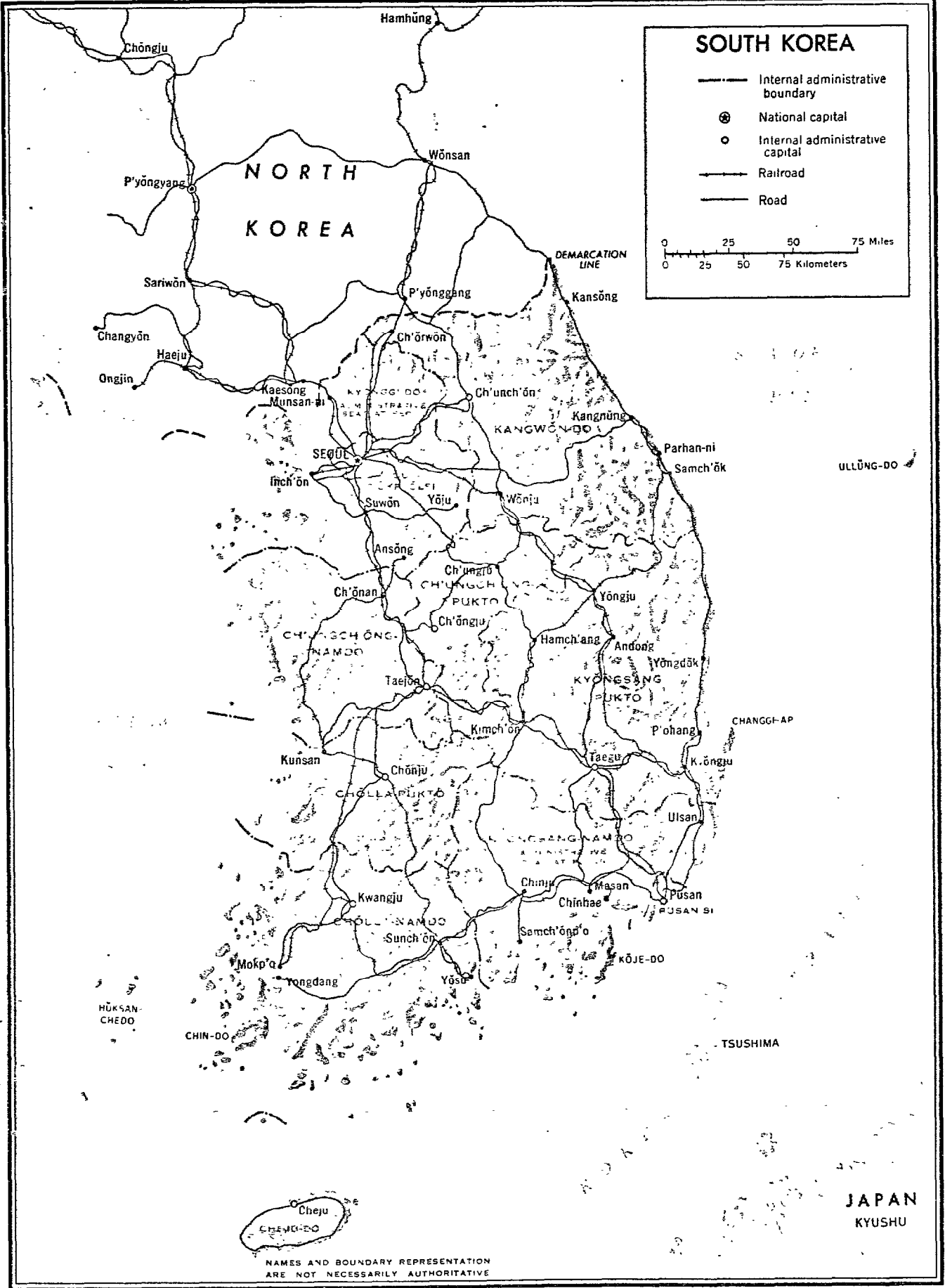
AGENCY ACTIONS AND UNRESOLVED ISSUES

The Department of State and AID stated that, in general, this report is balanced and fair. Few exceptions are taken to GAO judgments and findings on past actions. Differences exist, however, over policies which affect future U.S. economic assistance to Korea. The Department and AID believe that the timing for a phasedown of U.S. economic aid should remain flexible because of the recent irregular performance of the Korean economy and events which have clouded its economic outlook. (See p. 19.)

MATTERS FOR CONSIDERATION BY THE CONGRESS

The Congress should inquire into the Department of State and AID plans for terminating the development loan program for Korea. Such a step would conform to the Nixon doctrine. (See p. 17.)

The Congress should also inquire further into the reasons for the increased Public Law 480 program in Korea and the uses to which the sales proceeds are being put. (See p. 54.)





## CHAPTER 1

### INTRODUCTION

Through fiscal year 1972, U.S. assistance to Korea totaled approximately \$11 billion, including \$5.6 billion for economic assistance programs and over \$5.4 billion in grant military aid. In addition, the cost to the United States for maintaining its military forces in Korea, from 1954 through 1972, was \$9.8 billion.

Since 1963 Korea has had the third fastest growing economy in the world--after Japan and Israel. To a large extent this rapid economic progress has been due to the United States' underwriting a large portion of the country's defense costs and maintaining a significant military force in Korea. Accordingly, the ability of the Korean economy to stand on its own in the future depends on the necessity of assuming the cost of maintaining a large and expensive military establishment.

The Nixon doctrine, announced in July 1969, contends that Asian nations must play a larger role in Asian security and that the United States will play a lesser role. This implies that Korea must assume a credible posture on the international scene and, at the same time, reduce its dependence on the United States.

The U.S. Agency for International Development (AID) Mission feels that, if the United States is to reduce both its military presence and its support for Korean Armed Forces in an orderly fashion without serious adverse political and economic impact, the United States should continue to provide modest levels of economic assistance.

### U.S. ASSISTANCE

The United States has assisted, to a considerable extent, in Korea's rapid economic development and its transformation from an agricultural, rural society to a semi-industrialized, urban economy. From 1946 through 1972, the United States provided \$11 billion in direct economic and military assistance--\$9.8 billion on a grant basis. The types and dollar values of official U.S. bilateral assistance programs are shown in the following table.

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U.S. Assistance to Korea  
(Net obligations and loan authorizations)

	Fiscal years						Total
	1946-67	1968	1969	1970	1971	1972	
	-----(millions)-----						
<b>Economic assistance:</b>							
AID and predecessor agencies	\$2,735.0	\$ 75.2	\$ 45.4	\$ 35.0	\$ 60.6	\$ 30.0	\$ 2,981.2
Loans	270.2	32.0	20.0	20.0	55.0	26.5	423.7
Grants	2,464.8	43.2	25.4	15.0	5.6	3.5	2,557.5
Food for Peace (Public Law 480)	812.3	99.2	192.8	103.7	109.6	211.7	1,529.3
Peace Corps	1.9	1.7	1.4	1.6	1.9	2.0	10.5
Export-Import Bank	3.8	16.2	2.6	85.0	104.7	0.9	213.2
Other	859.5	-	-	-	-	13.1	872.6
<b>Total</b>	<b>\$4,412.5</b>	<b>\$192.3</b>	<b>\$242.2</b>	<b>\$225.3</b>	<b>\$276.8</b>	<b>\$257.7</b>	<b>\$ 5,606.8</b>
<b>Military assistance:</b>							
Credit sales	\$ -	\$ -	\$ -	\$ -	\$ 15.0	\$ 17.0	\$ 32.0
Grants (DOD funded)	327.9	393.8	271.4	237.6	187.2	167.9	1,585.8
Grants (FAA funded)	2,491.8	254.8	138.2	135.8	292.0	152.5	3,465.1
Grants (excess stocks) (note a)	99.3	16.8	41.3	11.3	18.1	14.0	200.8
Transfers under Public Law 91-652	-	-	-	-	86.2	184.7	270.9
<b>Total</b>	<b>\$2,819.7</b>	<b>\$648.6</b>	<b>\$409.6</b>	<b>\$373.4</b>	<b>\$580.4</b>	<b>\$522.1</b>	<b>\$ 5,353.8</b>
<b>Total economic and military assistance</b>	<b>\$7,232.2</b>	<b>\$840.9</b>	<b>\$651.8</b>	<b>\$598.7</b>	<b>\$857.2</b>	<b>\$779.8</b>	<b>\$10,960.6</b>
<b>Loans</b>	<b>306.8</b>	<b>50.9</b>	<b>121.2</b>	<b>148.7</b>	<b>244.8</b>	<b>253.2</b>	<b>1,125.6</b>
<b>Grants</b>	<b>6,925.4</b>	<b>790.0</b>	<b>530.6</b>	<b>450.0</b>	<b>612.4</b>	<b>526.6</b>	<b>9,835.0</b>

<sup>a</sup>Amounts shown are one-third original acquisition value. These transfers do not require appropriation; therefore they are not included in the totals.

In addition to the official assistance provided, Korea benefited considerably from other U.S. inputs, such as defense expenditures supporting U.S. military activities in Korea and Vietnam and excess property transfers.

Economic assistance and support

U.S. bilateral economic assistance to Korea during the period covered by this review, fiscal years 1968-72, totaled over \$1,194 million, the major inflows being \$246.2 million through AID, \$717.0 million in Public Law 480 assistance, and \$209.4 million in Export-Import Bank credits.

AID programs

The AID program in Korea has consisted of supporting assistance grants, technical assistance grants, and development loans. Grants and loans authorized during the period covered by this review amounted to about \$246.2 million, apportioned as follows:

	Fiscal years					Total
	1968	1969	1970	1971	1972	
	(millions)					
Supporting assistance	\$35.0	\$20.0	\$10.0	\$ -	\$ -	\$ 65.0
Technical assistance	6.7	4.2	4.1	3.9	3.1	22.0
Development loans	32.0	20.0	20.0	55.0	26.5	153.5
Family planning	1.5	1.2	.9	1.7	.4	5.7
<b>Total</b>	<b>\$75.2</b>	<b>\$45.4</b>	<b>\$35.0</b>	<b>\$60.6</b>	<b>\$30.0</b>	<b>\$246.2</b>

#### Public Law 480

During fiscal years 1968-72, Korea received about \$717 million worth of U.S. agricultural commodities under Public Law 480. Of this amount about \$549 million was received under the concessional sales program (title I), wherein the commodities are sold for local currencies and, in turn, the Republic of Korea Government (ROK) uses these moneys for military budget support or economic development purposes. An additional \$168 million of agricultural products was granted (title II) to needy Koreans through food-for-work and school-feeding programs and through various voluntary agency welfare and relief activities.

#### Other economic programs

Other U.S. agencies, such as the Export-Import Bank of the United States, the Peace Corps, the U.S. Information Service, and the Overseas Private Investment Corporation, have programs in Korea. These programs are not specifically covered by this review, but their activities are explained in chapter 6.

#### Military assistance and related support

The United States has granted over \$5.5 billion in military assistance to Korea since 1953 of which approximately \$2,635 million was programmed during fiscal years 1968-72. Between 1953 and 1970, expenditures in Korea by Department of Defense activities, including some amounts for the Military Assistance Program (MAP), contributed an estimated \$2.5 billion to Korea's balance-of-payments position. In addition, Korea's economy and balance-of-payments position

benefited through agreements entered into as a quid pro quo for its sending troops to Vietnam. We could not obtain completely accurate figures on just how much Korea benefited from the agreements, but an AID estimate indicates that Vietnam-related foreign exchange earnings amounted to about \$930 million between January 1966 and June 1972.

#### MULTILATERAL AND THIRD-COUNTRY ASSISTANCE

Multilateral organizations and third countries have become an increasingly important source of advisory and financial assistance for Korea. Financial assistance has been received in the form of loans and grants, principally from the World Bank, the Asian Development Bank, the United Nations, Japan, and West Germany. During 1968-71, inputs from these sources amounted to about \$1.5 billion. In addition, the International Monetary Fund advises ROKG on important economic policy considerations and the World Bank sponsors an international economic consultative group for Korea.

The United States is a major contributor to the multilateral organizations and, thus, makes substantial indirect contributions to Korea. In fiscal year 1971 the United States provided 37.5 percent of total contributions to United Nations organizations and programs; and, as of June 30, 1972, it had contributed 20 percent of the total paid-in capital of the Asian Development Bank, 26 percent of the paid-in capital of the World Bank, and 33 percent of all contributions to the International Development Association.

#### PRIOR GAO REVIEW

We last reviewed U.S. assistance to Korea in 1967 and primarily evaluated development loan projects. In our report "Economic Assistance Provided to Korea by the Agency for International Development" (B-164264, July 1968), we concluded that U.S. assistance to some sectors of the Korean economy was not as effective as it might have been. We proposed that AID take action in three specific areas. Followup on the disposition of our proposals is discussed on pages 31 to 33 of this report.

## CHAPTER 2

### KOREAN ECONOMIC DEVELOPMENT AND

#### THE ROLE OF U.S. ASSISTANCE

Korea has had one of the world's most rapidly advancing economies in recent years, especially since 1965. During 1966-71, the average annual increase in gross national product was 10.3 percent, manufacturing output tripled, and exports increased sixfold.

The rapid advancement of the Korean economy, which is often referred to as an economic miracle, may not, however, be as great as it appears. The indicated economic accomplishments have been achieved at the expense of steadily mounting deficits in both trade and external debt. Furthermore, expansion of industry has been emphasized and much less attention has been given to social and welfare needs. The rural and urban income gap and the food grain production and consumption gap have widened. Because of these problems and the high cost of maintaining its vast military force, Korea most likely will require substantial amounts of concessional capital for years to come.

The United States has considerably reduced its AID program, citing Korea's rapid economic progress as one reason. However, other U.S. inputs--Public Law 480 loans and grants, Export-Import Bank loans, military assistance, and expenditures on the Korean economy--have remained at high levels or have even increased. In addition, multilateral organization inputs have increased substantially. As a result, total external assistance to Korea has actually increased during the past 10 years.

Past U.S. assistance undoubtedly stimulated Korea's economic expansion, but it may have also contributed, inadvertently, to its problems. U.S. concessional aid has helped to make it possible for Korea to get large amounts of non-concessional credit, but this has increased Korea's external debt. Subsidization of food and fiber programs has built up Korean demand for imported products and this has increased the trade gap.

For many years the AID program focused on developing Korea's industries and subsidizing its commercial import

requirements. Recognizing that development of the Korean economy was unbalanced, AID restructured its program to emphasize development of the lagging agricultural and social sectors. ROKG recognized the imbalance also, as evidenced by Korea's Third Five-Year Economic Development Plan (1972-76) but the problems in these sectors have been aggravated by its emphasis on capital development. For example, additional farm areas have been lost to increased industrialization, urbanization, and road construction.

We believe the United States should set a definite time and prepare definite plans for terminating the AID development loan program. Assistance requirements could be provided through the Public Law 480 program, the Export-Import Bank, and multilateral organizations. The United States could then attain a lower profile in-country and reduce its administrative overhead.

#### KOREA'S CURRENT ECONOMIC PROBLEMS

##### Foreign trade

Korea has particularly emphasized developing export and import substitution industries. However, it is poorly endowed in terms of natural resources and has yet to develop a broad-based, heavy industry. It has had to rely on a high level of imports to support the expanding export program, as well as to achieve some degree of domestic price stability. As a result, Korea has experienced both an increasing trade deficit and a worsening external debt burden.

Exports increased sharply between 1965 and 1971 but imports increased even more, resulting in ever-increasing trade deficits. By 1971 the trade deficit had reached \$1,326 million. During the period 1965-71 Korea's total foreign trade was, as follows:

	<u>1965</u>	<u>1966</u>	<u>1967</u>	<u>1968</u>	<u>1969</u>	<u>1970</u>	<u>1971</u>
	_____ (millions) _____						
Exports (f.o.b.)	\$175	\$250	\$320	\$ 455	\$ 623	\$ 835	\$1,068
Imports (c.i.f.)	<u>463</u>	<u>716</u>	<u>996</u>	<u>1,463</u>	<u>1,824</u>	<u>1,984</u>	<u>2,394</u>
Deficit	<u>\$288</u>	<u>\$466</u>	<u>\$676</u>	<u>\$1,008</u>	<u>\$1,201</u>	<u>\$1,149</u>	<u>\$1,326</u>

## External debt

Korea is facing a serious debt situation, and there are indications that this situation will continue for a number of years. Debts with a maturity of 1 year or more increased more than six-fold from 1966 to 1970. This increase, coupled with the fact that much of the newly contracted debt represents short-term trade credit, has resulted in an aggravated debt service problem.

Korea's external public debt (guaranteed debt with a maturity over 1 year) as of December 31, 1970, was as follows:

	<u>United States</u>	<u>Japan</u>	<u>United Kingdom</u>	<u>Others</u>	<u>Total</u>	<u>Percent United States</u>
	(millions)					
Suppliers	\$ 348.1	\$350.8	\$129.8	\$383.1	\$1211.8	28.7
Private lenders	66.2	.5	91.8	149.8	308.3	21.5
International organizations	-	-	-	219.6	219.6	-
Official aid	622.7	175.0	1.0	58.2	856.9	72.7
Other	<u>23.1</u>	<u>7.7</u>	<u>-</u>	<u>9.4</u>	<u>40.2</u>	<u>57.5</u>
Total	<u>\$1060.1</u>	<u>\$534.0</u>	<u>\$222.6</u>	<u>\$820.1</u>	<u>\$2636.8</u>	40.2

The World Bank has stated that, when a country's debt service rate--the ratio of debt repayments to foreign exchange earnings--reaches 20 percent, it is likely to put a massive strain on the country's debt service capacity. In June 1972 the AID Mission made the following projection of Korea's debt service ratio for the period covered by ROKG's Third Five-Year Plan.

<u>1971</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>
22.8	23.7	22.9	21.5	18.8	16.1

According to AID, the fact that a country has a high debt service ratio does not necessarily mean that rescheduling is inevitable. However, it does suggest extreme vulnerability should exports fall, capital inflows decline, or imports rise unexpectedly.

AID agrees that Korea's external debt will continue to require close attention. It contends, however, that there are reasonable chances that Korea's foreign exchange earnings will continue to grow and its debt obligations will be met properly.

#### Other problem areas

Other major problem areas which ROKG must now contend with include assuming the cost of an expensive military establishment and fulfilling an overdue need for agricultural and social development.

Korea maintains a large and expensive military establishment which has been financed, in a large part, by the United States. Korea is expected to assume more of its defense burden during the Third Five-Year Plan period. Korea will be taking over these costs at a time when its foreign exchange earnings from Vietnam-related activities and from expenditures by U.S. troops stationed in Korea are declining significantly.

To achieve a more balanced economic expansion and to obviate dissension from the affected segments of the population, it will be necessary to place more emphasis on developing agricultural and social sectors which have not kept pace with the rapid advancement of other economical areas because of the emphasis on industrial expansion. Although ROKG has indicated that it will give priority to these sectors, it has continued to stress industrial development.

AID stated that Korean plans and budgets reflected a substantially increased commitment to rural development. Previous plans professed to give priority to the agricultural sector also, but resources were not actually allocated.

#### FUTURE DEVELOPMENT PLANS

Korea's Third Five-Year Plan assesses the growth potential of the economy, sets forth specific objectives, and outlines policies for attaining these objectives. Rather than emphasizing economic growth, which was the basic thrust of the Second Five-Year Plan, the Third Five-Year Plan emphasizes a balanced economic structure.



During the Third Five-Year Plan period, an annual real growth rate of 8.6 percent is postulated. Top priority is to be given to the agricultural sector to enable low-income groups, such as farmers and fishermen, to share more equitably in the country's economic advancement and to help achieve self-sufficiency in major food grains. Other major targets include improving the international balance of payments through continued rapid increases in exports and broadening the industrial base by developing heavy and chemical industries.

In past years, the growing trade deficit was offset by substantial inflows of foreign capital, earnings from Vietnam and U.S. forces in Korea, and relatively modest levels of domestic savings. During the Third Five-Year Plan period, the trend toward an increasing trade deficit is expected to be reversed by maintaining a high export rate while restraining imports and promoting import substitution industries. Foreign exchange needed for imports is to be derived mostly from export earnings.

The U.S. Mission and World Bank assessments of the Third Five-Year Plan were generally favorable, and most of the goals were considered realistic and attainable. However, they did caution against the possibility of shortfalls in domestic resources and of larger than planned external resource requirements if Korea pursued an inflexible course toward the Third Five-Year Plan objectives. If these possibilities develop, Korea could encounter serious external debt management problems.

In commenting on the Third Five-Year Plan's projected external capital requirements, the Mission said that the Korean estimate of \$3.9 billion may be understated. If exports are overestimated by 10 percent, about \$1.3 billion more in foreign capital would be required. Similarly, in the event imports are understated by 10 percent, an additional \$1.5 billion would be necessary. The Mission believes that it is not unlikely that either of these eventualities or a combination of both may occur. Furthermore, the ROKG estimate makes no allowance for (1) servicing the additional debt, (2) the impact of the December 1971 U.S.-Korea textile quota agreement, or (3) an accelerated assumption of its defense burden. In short, Korea's foreign capital requirement may well exceed \$1 billion a year if it is to sustain a growth rate comparable to previous years.

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AID said that events of 1971, in particular, raised doubt that the Third Five-Year Plan's goals could be achieved. The trade gap turned out to be \$200 million more than expected. The agreement between the United States and Korea in 1971, limiting Korean exports of woolen and man-made-fiber textiles to the United States, threatens to reduce Korean foreign exchange earnings by about \$325 million over 5 years. Foreign exchange earnings have also been reduced as a result of reducing U.S. troop strength in Korea and the 10-percent MAP deposit requirement added to aid legislation.

ROLE OF U.S. ECONOMIC ASSISTANCE  
AS KOREA HAS DEVELOPED

U.S. economic assistance has changed and moved in new policy directions as the Korean economy has progressed. In earlier years, the thrust of programs was in economic and industrial development because large economic assistance inputs were needed to rebuild a war-torn country and to develop the infrastructure required for a modern economy. As political and monetary stability took hold and the economy moved ahead, AID policy shifted. The most recent trend has been toward social and agricultural development and influencing high-level policy decisions.

During this transition, the overall dollar level of the AID program declined, and in fiscal year 1970 both the supporting assistance and military budget support segments were terminated.

In July 1971 Mission officials observed that perhaps, if Korea did not depend on American resources to help bear the country's defense expenses, the economic assistance program might have been in a terminal phase. However, Mission plans assume that overall U.S. security and economic interests warrant continuing concessional development loans and Public Law 480 long-term credits, as well as a small technical assistance program.

The Mission is proposing that a mix of U.S. economic assistance is needed to (1) help alleviate Korea's debt service burden and meet needs for long-term concessional foreign capital, (2) achieve Nixon doctrine objectives in the military area, and (3) deal with existing or potential U.S.-Korea economic policy issues, such as the U.S.-Korea textile quota agreement.

## GAO VIEWS ON THE U.S. ROLE

During this review, we did not evaluate political and military justifications for the U.S. economic assistance program because related information was not readily available to us. But on the basis of economic criteria, we believe that:

- The need for continuing AID's development loan program is questionable, since: (1) 87 percent of the funds provided between July 1, 1970, and June 30, 1972, was used for commodities ordinarily included under a Public Law 480 program and (2) the concessional capital required to finance projects similar to those which are now being funded through development loans is available from other sources. (See ch. 3.)
- Korea's agricultural sector is lagging, and the concessional Public Law 480 terms may actually be a disincentive for ROKG to attach the necessary priority to this sector. (See ch. 4.)
- Other nations, particularly Japan, have derived a higher economic return from their capital inputs than the United States has. This situation has occurred although the United States has provided the bulk of the concessional assistance to Korea. (See ch. 7.)

The Mission to Korea has used the increasing Korean external debt as part of its justification for continuing concessional aid. We are of the opinion, however, that past U.S. concessional aid made it possible for Korea to obtain large amounts of nonconcessional credit which helped to create its debt service problem. Continued concessional lending by the United States, especially short-term credits, without effective restraint by ROKG only contributes further to the U.S. burden of protecting Korea's external financial position.

### Need for AID termination plan

We are of the opinion that the need for the AID development loan program is questionable and that a tentative, but reasonably firm phaseout plan, be prepared. This step would

conform with proposals set forth in the Nixon doctrine, and would not affect the continuation of other forms of assistance.

Deciding when to end an AID program in a developing country is just as important as deciding when to establish one. Prolonging the program can create self-help disincentives, while a premature ending risks loss of development momentum.

AID commissioned a case study to assess U.S. assistance to Taiwan. The study used the following criteria to determine when aid to a country should be terminated.

- Levels of domestic savings and investment.
- Competitive strength in international trade.
- Inflow of foreign private investment.
- Access to international lending institutions.
- Foreign exchange reserves.

The phaseout must be planned well in advance because it requires several years. For example, AID economic assistance to Taiwan was terminated in 1965, but initial preparations for ending U.S. aid began in 1960 when AID reached agreement with the host Government on a 19-point program of economic and financial reform. Firm plans for ending this economic assistance were drawn up in 1962.

AID's presentation at the fiscal year 1972 foreign assistance hearings stated that Korea might not need economic assistance in a few years. However, unlike Taiwan, AID has not, as far as we know, identified and reached agreement with ROKG on what specific measures are necessary to prepare Korea for final detachment from its dependence on AID development loans.

Apparently AID has felt that, in approaching the phaseout of the Korean program, it was not necessary to set a time for terminating assistance or formulate a specific termination plan. However, such planning is necessary to arrange an orderly U.S. disengagement and avoid prolonging U.S. aid or creating disincentives for Korean self-help measures.

AID agreed that the concessional element of U.S. assistance should be progressively phased down and terminated as soon as such action becomes consistent with U.S. objectives. Because of the irregular performance of the Korean economy over the past year and recent events which clouded Korea's economic outlook, AID believes that the timing for a phasedown of U.S. economic aid should remain flexible.

#### CONCLUSIONS

We believe that Korea has reached the stage of development where AID should be terminating the development loan program. To extend such programs beyond a reasonable cutoff point primarily on the basis of military or security considerations, is not apparently justified.

#### MATTER FOR CONSIDERATION BY THE CONGRESS

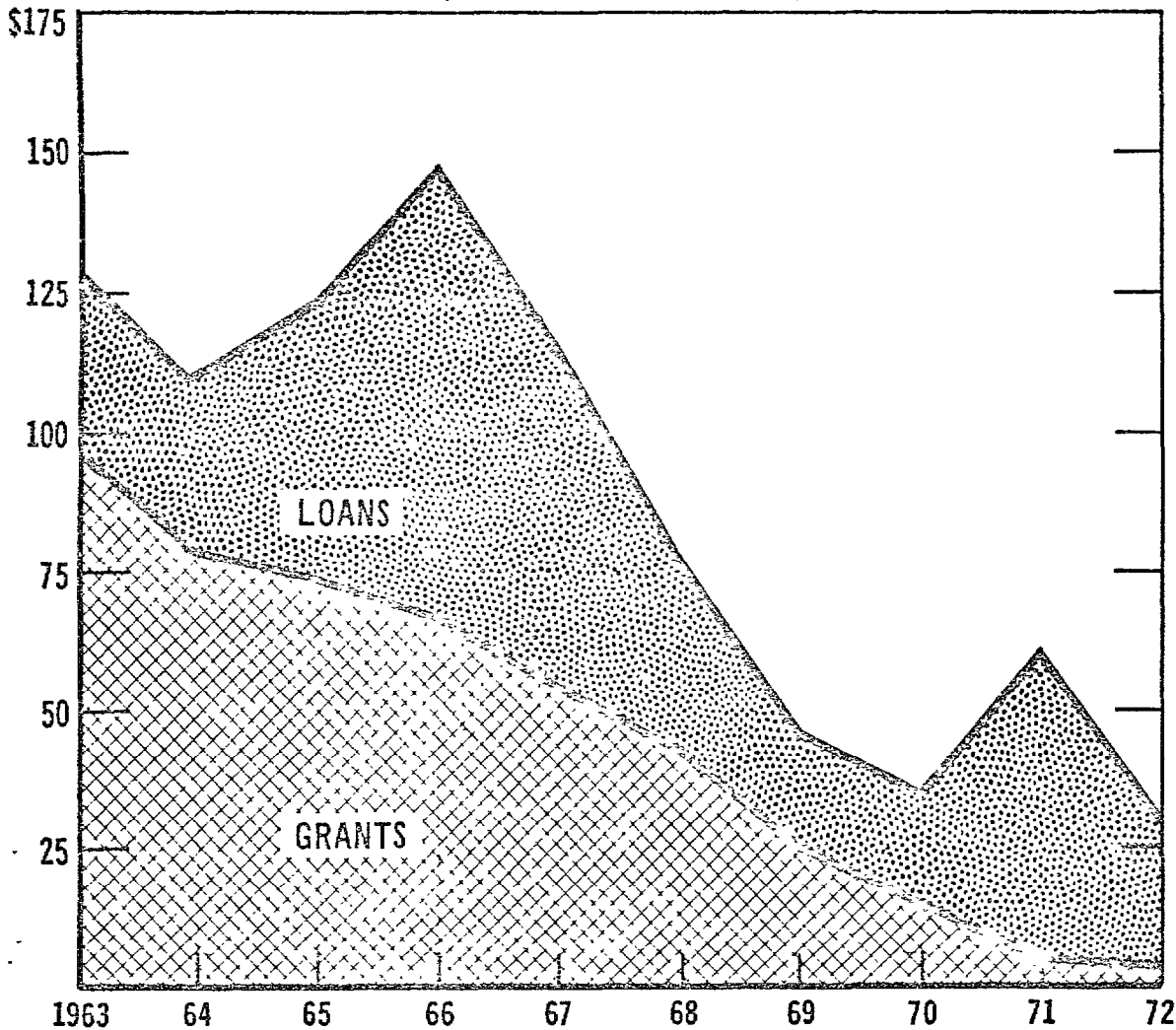
We believe that the Congress may wish to review with the Department of State and AID the feasibility of terminating the development loan program for Korea.

CHAPTER 3

ADMINISTRATION OF AID PROGRAMS

AID and its predecessor agencies provided Korea about \$3 billion in economic assistance through fiscal year 1972. AID programs have generally declined in recent years, and emphasis has shifted from grants to loans. Even so, the level of the present and proposed assistance indicates that AID programs will continue at a moderate level for years to come.

AID PROGRAM FOR FISCAL YEARS 1963-1972  
(In Millions Of U.S. Dollars)



AID programs for the fiscal years 1968-72 included about \$5.7 million for family planning. This is technical assistance but has been funded on a grant basis from development loans, supporting assistance, and technical

assistance funds. Because of this unique funding, family planning is discussed separately.

We reviewed the AID programs for fiscal years 1968-72 to determine if they were contributing to U.S. objectives in Korea and if they were being administered effectively. In general, we found that there is a definite need to improve AID's management.

### DEVELOPMENT LOANS

Development loans are intended to provide less developed countries with credit on concessional terms for their economic growth programs. In Korea, there are four types of development loans: (1) project loans to finance the foreign exchange costs of specific projects, such as creating or expanding industries and capitalizing local credit institutions; (2) program loans for importing commodities to promote development of small- and medium-size industries; (3) commodity loans to purchase U.S. food grains (rice); and (4) sector loans to encourage development of a particular field, such as education or agriculture, through policy and institutional changes.

Between June 1958 and June 1972, AID and its predecessor agencies authorized 49 development loans for Korea, with net obligations amounting to \$425 million. During fiscal years 1968-72, the following development loans were made:

<u>Type</u>	<u>Number of loans</u>	<u>Amount</u>
Intermediate credit institutions	2	\$ 18,000,000
Program loans	3	29,974,686
Project loans	7	32,400,000
Commodity imports	<u>4</u>	<u>71,000,000</u>
	16	151,374,686
Deobligation (project loan)	<u>1</u>	<u>10,000,000</u>
Total	<u>15</u>	<u>\$141,374,686</u>

The Foreign Assistance Act of 1961, as amended, provides for varying repayment terms so that loans can be tailored according to a recipient country's ability to

repay. All development loans to Korea have been made on the most concessional terms available by law. Since 1968, the most concessional terms available have been 40-year loans with a 10-year grace period and interest rates at 2 percent for the grace period and 3 percent for the remaining 30 years. Such terms were considered justified because the United States was providing grant supporting assistance and later because of Korea's emerging debt service burden.

Our review of development loans disclosed that (1) the development of private enterprise was not adequately stressed, (2) loans designed to encourage the development of small and medium industries achieved only limited success, (3) loans were not effective in encouraging ROKG to meet certain economic stabilization goals, (4) loans were not adequately monitored to insure that restrictions of exports to the United States were complied with, (5) local currencies generated from two-step loan agreements were not adequately controlled, and (6) the need for continuing development loan funds to Korea was questionable.

Some of the same deficiencies reported in a prior GAO report, "Economic Assistance Provided to Korea by the Agency for International Development" (B-164264, July 16, 1968), still exist; such as, delays in completing projects and slow utilization of loans to intermediate credit institutions.

Inadequate emphasis on private enterprise development

The Foreign Assistance Act firmly establishes the U.S. policy of encouraging recipient countries to increase the flow of international trade, foster private initiative and competition, and discourage monopolistic practices.

ROKG controls major sectors of the economy, largely through equity investment. This includes the banking, power, transportation, iron and steel industries; the petrochemical complex; and agriculture. AID funds have contributed to developing these enterprises, and in some instances past AID actions or inactions have tended to perpetuate Government control rather than encourage their sale to private enterprise.



### Government control of fertilizer industry

The fertilizer industry illustrates AID's involvement in ROKG-controlled industries. Not only does ROKG control the fertilizer production facilities but also fertilizer marketing and distribution.

U.S. assistance was largely responsible for establishing the industry. The International Cooperation Administration (predecessor to AID) financed Chungju Fertilizer Corporation's first plant in 1957. In 1965, AID development loan funds, totaling \$48.8 million, were provided for two projects owned equally by ROKG and two U.S. firms. In September 1969 a \$5 million loan partially financed an ammonia/urea plant which will be Korea's sixth major fertilizer plant when completed. Of the six, AID has financed four, while Japan and Germany have each financed one. All are either ROKG-owned or substantially under Government control.

Each of the two 1965 loan agreements contained a covenant stipulating that ROKG would enter into written consultations with AID on the sale of the Government's interest in these plants to the Korean private sector. To date ROKG has not initiated such action. It appears ROKG will be even less likely to sell its interests to the private sector because the Chungju Corporation has become a holding company for other Government and semi-Government petrochemical enterprises and has reinvested dividends in them.

According to AID, ROKG concluded that only Chungju had the technical capability and capital necessary to take the lead in developing a petrochemical industry in Korea. AID also stated its intent to divest itself of ownership in the petrochemical companies but not at the expense of lengthy delays in developing these import-substitutive industries.

### Government control in agriculture

The National Agricultural Cooperative Federation provides another example of AID support to a State enterprise. This is one of the largest enterprises in Korea and effectively controls major aspects of agriculture. The Federation's interests include agricultural credit and insurance,

and it is the only organization to provide basic agricultural services to the Korean farmers, such as marketing, processing of agricultural products, sale of fertilizer, etc.

During our review period, two development loans were made which provided the equivalent of \$42 million in local currency to the Federation--\$28 million to capitalize accounts and \$14 million to provide credit for farm mechanization and grain storage facilities. In addition, the equivalent of \$15 million in Public Law 480-generated local currency was provided in 1970 to enable the Federation to keep its accounts payable with fertilizer firms current.

Although a cooperative in name, the Federation is not a cooperative association organized and financed by farmers. Legislation, supposedly temporary, passed by the Korean National Assembly in 1962 removed most of the democratic features found in the law that established the Federation. As a result the Ministry of Agriculture and Forestry (an ROKG agency) supervises and controls detailed Federation operations and sets overall policy. Because farmers have little control of the Federation and only a small investment in its capital structure, they tend to look at it as an arm of the Central Government.

AID agreed that ROKG does exercise strong control over major segments of the economy and, in some instances, does so through direct Government ownership of firms. It pointed out that the number of companies it owned or partially owned had been reduced to 63 by the end of 1971 but did not refute the examples cited.

#### Loans for developing small- and medium-size firms

A significant amount of AID loan funds, from both program loans and subloans provided through intermediate credit institutions, were used to assist large, well-established firms that were capable of obtaining financing from other sources.

AID authorized five loans totaling \$45 million to intermediate credit institutions for financing foreign exchange requirements of small- and medium-sized firms and to promote economic development. Of this amount, \$18 million

was made available during fiscal years 1968-72. However, the loan agreements were not specific enough to insure that the funds were used as intended. For example, firms of the Hyun Dai conglomerate (with worldwide offices) have obtained more than \$1.1 million of these subloans. The ability of this organization to raise outside capital was illustrated when the Korean press reported that the Hyun Dai Construction Company had received ROKG approval to obtain \$50 million in commercial loans from Europe for constructing a large shipyard.

Three program loans made after 1968 totaled about \$30 million and provided additional funding for small and medium industries. One purpose of these loans was to encourage the expansion of small and medium industry by providing soft-term loans for importing machinery, equipment, and spare parts. These loans have not helped expand small and medium industries to the extent possible because of circumventions of a loan agreement provision which imposed maximum amounts of \$75,000 to \$100,000 for each end use by any applicant.

An audit by the AID Auditor General (AG) of a \$10 million program loan, authorized in fiscal year 1969, disclosed that certain large organizations circumvented this limitation by using the names of affiliates or new entities created for the sole purpose of obtaining additional loan funds. The scope of the AG audit involved the use and planned use of about \$2.8 million worth of equipment imported by 28 sub-borrowers. The auditors found that five end users, under the names of various subborrowers, had obtained a total of \$1.9 million, or 68 percent, of the \$2.8 million.

Expanding their review to include two other program loans, the auditors found that the same five end users had obtained about \$4.3 million of the \$30 million made available by these three loans. One university foundation, under 15 different affiliated applicants, obtained 23 subloans amounting to about \$2.2 million. The foundation used these loans to finance three large projects: a hospital, a tourist hotel, and an engineering laboratory.

The auditors concluded that this situation persisted due to the lack of AID monitoring. Although a valid need exists to promote the development of small- and medium-sized

industry in Korea, it is apparent that these loans have contributed only partially toward this objective. Furthermore, AID loans may have inadvertently aided in the monopolization of markets by supporting the development of large, well-established firms and organizations.

AID agreed that the limitation on maximum subloan size had been circumvented and said that refund claims of \$3 million had been filed.

Compliance with restriction  
on export limitations

Section 620(d) of the Foreign Assistance Act prohibits the use of development loans for constructing or operating enterprises which compete with U.S. enterprises, unless the country agrees to limit exports to the United States to no more than 20 percent of a facility's annual production for the life of the loan.

Korea exports substantial quantities of textiles to the United States and through fiscal year 1971 about \$16.3 million in development loans had been provided to Korea's growing textile industry.<sup>1</sup> In reviewing AID loans used to purchase \$778,000 of U.S. textile equipment displayed during a May 1969 trade exhibit, we found that the loan recipients had not timely submitted required quarterly reports to the Mission on the volume of production and exports to the United States. The Mission had not made adequate followup to insure receipt of these reports nor had it obtained an independent verification of them.

The Mission had inquired about these reports as early as May 1970. The initial reports were not received until June 1971. All of the reports received simply stated that no textiles had been exported to the United States. To the best of our knowledge, no attempt had been made to verify that the equipment was not being used to manufacture items for export to the United States.

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<sup>1</sup> In addition, the Export-Import Bank of the United States had loaned approximately \$17 million for purchasing textile equipment, of which \$9.2 million was a result of an October 1971 U.S. trade exhibition.

AID agreed that, because required nonexport certifications were not received, followup inquiries should have been made. According to AID, verifying that equipment was not being used to manufacture items for U.S. export might not be too difficult when all the facilities were financed with AID funds but would be extremely difficult in the case of a program or intermediate credit institution loan where only one or two pieces of equipment had been financed by AID.

The recent imposition of a textile quota on Korea and other East Asia countries reflects United States concern about competition with U.S. textile industry. In view of this concern and the restriction provided in Section 620(d) of the Foreign Assistance Act, we believe the Mission should monitor the activities of loan recipients more closely to insure compliance with existing agreements and legislation. Special attention should be given to textiles and other commodities which are exported chiefly to the United States.

## Control over local currency

All development loans made to Korea during the review period were two-step agreements. Under this arrangement, the loans were made to ROKG which, in turn, reloaned the funds. ROKG repays AID over a longer period of time and at a lower interest rate than the ultimate borrower is required to pay. During fiscal years 1968-71, this procedure generated the equivalent of about \$176.4 million in local currency to support the ROKG budget. Our review disclosed that AID had not adequately monitored these funds and, as a result, had lost a significant opportunity to exercise leverage over ROKG in effecting U.S. objectives in Korea.

In May 1966, AID and ROKG established guidelines to govern the use of these funds. In accordance with the guidelines, a foreign loan repayment special account was established as a clearing account for all local currency accruing to ROKG under loan agreements with foreign governments, individuals, and international organizations.

A U.S. subaccount was established within the repayment account to receive, after January 1966, all local currency generations derived under development loan agreements between the U.S. and Korean Governments. The local currency accumulated in the U.S. account was to be released (1) to meet the ROKG repayment obligation, (2) to make loans and grants for Korea's economic and social development, and (3) to defray the expenses of administering the account.

No release of the funds, except to meet ROKG's repayment obligations, was to be made from the U.S. account without agreement between ROKG and AID. Such agreement was to be reached during annual joint reviews and consultations. An additional provision required an annual determination as to what portion of the coming year's expected income could be granted and what portion could be loaned to insure that sufficient funds would be available to meet future interest and principal payments.

Mission officials were unable to furnish us with records indicating what joint agreements had been reached with ROKG on the use of these funds or what specific applications had been made of U.S. account funds.

As stated previously, the funds in this account are substantial; during fiscal years 1968-71, an equivalent of approximately \$176.4 million was received and \$176.2 million disbursed. In fact, the total for the 4-year period exceeded the value of new development loans authorized by about \$50 million. However, we noted that, during the same period, these local currency funds were being disbursed without AID consultation and agreement, AID capital projects were experiencing delays due to local currency shortages, and additional development loans were being made to generate local currency.

Construction of the Seoul sewage treatment plant is an example of project delays due to local currency shortages. Under terms of the agreement signed in 1966, the plant was scheduled for completion in 1970 but was only 30-percent complete as of June 1972. Although other problems plagued this project, the need for local currency to finance the construction of an essential interceptor unit was a major factor. AID stated that the lack of local currency was caused by a dispute between ROKG and the city of Seoul over which should support the project. ROKG eventually released the funds but only after AID strongly protested that the project and the use of AID funds were being unjustifiably delayed.

AID has authorized new development loans to generate local currency for financing projects, such as family planning, agricultural credit, warehouse construction, and capitalization of government accounts. Two such loans totaling \$49 million were approved for 1971, and four loans for \$26.5 million were approved for 1972.

In our opinion, AID should take the steps necessary to insure that U.S. subaccount funds are used to support AID-endorsed economic and social development projects. Effective supervision over the release of these funds should substantially increase AID's leverage in achieving U.S. objectives in Korea.

AID recognizes its responsibilities under the 1966 Foreign Loan Repayment Special Account Agreement with Korea and has increased its surveillance over this account. New operating procedures have been established to insure that there will be continuous followup with senior ROKG officials

and that ROKG will submit reports on how it used U.S.-generated local currency within the specified sectors and activities programed.

Need for continuing development loan program

According to AID, leverage on behalf of Korean economic stabilization has been accomplished by (1) the size of the aid package, (2) withholding the offer of program loan assistance (development loans) until the annual economic stabilization self-help agreements were negotiated and (3) tying the release of portions of program loan funds to the fulfillment of stabilization targets. This leverage has not been sufficient, however, to discourage ROKG from increasing its external debt to the present problem level. Therefore it is doubtful whether the smaller programs now planned--the development loans portion at about \$20 million annually--can provide effective leverage.

We also question the need of continuing AID's development loan program for the following reasons.

Development loans used for overflow  
from Public Law 480 program

AID granted seven development loans totaling \$81.5 million between July 1, 1970, and June 30, 1972. ROKG used four of these loans, which accounted for \$71 million or 87 percent, to purchase U.S. commodities--three for rice and one for tallow.

AID stated that these loans met Korean needs for rice on concessional terms when it appeared that the Public Law 480 budget could not accomodate further rice sales. It is our opinion, and AID agreed, that financing agricultural commodities is more properly a function of the Public Law 480 program than of development loans. Therefore, we believe that supplemental Public Law 480 funds should have been requested. Using a major portion of the loan funds for this purpose further questions the need for a development loan program in Korea.



Concessional capital available  
from other sources

In the early 1960s, U.S. development loans were the only foreign capital extended to Korea on soft terms. However, conditions have changed and, in our opinion, Korea can now obtain foreign exchange and local currency needed for development purposes from other sources.

The Export-Import Bank and Public Law 480 programs have expanded considerably, and other countries, notably Japan and West Germany, are now extending soft-term loans to Korea. The World Bank and Asian Development Bank are also extremely active in Korea and provide more than \$100 million a year for a variety of development projects.

We also noted an example of private capital available for a project which obtained development loan funds. An AID loan for \$5 million was provided to finance an ammonia/urea plant for ROKG even though private sources, both Korean and foreign, had indicated interest in investing in the plant. ROKG discouraged these sources, however, because it wanted a 100-percent Government-owned facility.

Followup on prior GAO report

In the prior GAO report we recommended that AID (1) take adequate measures to facilitate the implementation of loans so that lengthy delays would be prevented; (2) reevaluate the necessity of future development loans for small and medium industry development; and (3) make every effort to demonstrate to ROKG the benefits of an adequate coal development policy and take measures to assist the ROKG in developing this industry. During this review we substantiated the validity of these recommendations.

Project delays

Capital assistance projects continue to be unnecessarily delayed for the same reasons previously reported, namely (1) failure of ROKG or the loan beneficiary to furnish agreed amounts of local currency, (2) procurement problems, (3) poor support and performance by U.S. engineering firms, and (4) project revisions.

In commenting on our previous report, AID informed us that it was not satisfied with the delays on capital projects, but that it was difficult to establish a norm for construction. AID explained that a system of review and approval actions would be inaugurated in an attempt to reduce or eliminate such delays.

During our current review, we noted similar delays indicating that these procedural changes are ineffective. Our previous report showed that an electric transmission project, which was to have been completed in 1966, had been delayed almost 2 years due to (1) failure of the loan recipient to meet conditions precedent to financing and (2) numerous changes made in subprojects. In 1967, AID approved a second transmission project for \$12.7 million and similar problems were experienced. Severe delays forced the Korean Electric Company to obtain outside financing to initiate certain high-priority subprojects, and a major revision to the AID loan was necessary. The project originally was scheduled for completion in late 1969 or early 1970. As of September 1972, 5 years after the loan was made, this project was only 51-percent complete and none of the planned subprojects were complete.

#### Loans to intermediate credit institutions

In the previous report, GAO questioned the need for AID's continued support of intermediate credit organizations because previous loans had been obligated very slowly and other funding sources, such as the World Bank and Asian Development Bank, were available. Both points have been substantiated.

At the time of the prior GAO review, AID was considering an additional loan of \$12 million to the Korean Development Bank. In response to our draft report, AID stated that this loan would not be released until the 1966 bank loan funds were exhausted.

The loan was subsequently authorized in June 1968 for a total of \$15 million. At that time approximately \$3.2 million, or 27 percent, of the 1966 loan was still available for subloans. The balance of the 1966 loan was not exhausted until December 1969, or 18 months after the 1968 loan was authorized.

The proceeds of the 1968 loan became available in June; however, the first subloan was not made until May 1969, almost 1 year later. As with other intermediate credit institution loans, the balance of the proceeds moved slowly. This is indicated in the following schedule.

<u>Year</u>	<u>Number of loans</u>	<u>Amount</u>
1969	6	\$ 3,819,808
1970	6	4,021,603
1971	<u>15</u>	<u>6,423,681</u>
	<u>27</u>	<u>\$14,265,092</u>

In addition to slow commitment, only about \$4 million of these subloans had been disbursed through October 1971. The balance of the subloan commitments represents material and equipment yet to be shipped.

The second GAO contention has also been substantiated. Between January 1968 and December 1971, the World Bank and Asian Development Bank extended \$90 million in loans to the Korean intermediate credit institutions.

#### Encouragement of coal resources development

GAO previously recommended that AID encourage ROKG to develop its coal resources to support Korea's heavy industry power requirements, provided primarily by the Korean Electric Company and thereby save the foreign exchange used to import oil. This position was based on studies indicating that developing coal resources adequate to meet the company's annual fuel requirements would save up to \$696 million in Korean foreign exchange over a 20-year period.

An AID official informed us that AID was no longer trying to encourage ROKG to do so, primarily because the electric company had retired many of its coal-fired units. To reduce oil imports for 1972, however, ROKG requested several State-operated industrial enterprises to use more coal.

## Recommendations

The composition of the AID program has changed since our prior review. For example AID is no longer making loans to intermediate credit institutions and capital project assistance has declined. Therefore even though the prior recommendations were valid at that time, we believe that a re-statement of the recommendations is not warranted. Following are our recommendations to the problems found during the current review:

- The ROKG controls major sections of the Korean economy, largely through equity investment. AID funds have contributed substantially to the development of these ROKG-controlled industries and past actions, or lack of action, by AID have tended to perpetuate government control.

We recommend that the Administrator of AID urge ROKG to reassess its Government role as investor and competitor with the private sector.

- Loans intended for the development of small- and medium-size firms were used to fund large projects and to assist large, well-established firms, some of which were capable of obtaining the needed financing from other sources.

The Administrator of AID should monitor these loans closer as provided for in existing agreements to insure that funds are used to benefit small- and medium-size industries.

- The failure to adequately monitor the application of local currency funds generated under provisions of development loan funds has allowed the United States to lose a significant opportunity for exercising leverage over ROKG in effecting U.S. objectives in Korea.

Therefore, we recommend that the Administrator of AID closer control the uses of these funds as provided for in the existing agreements.

--Quarterly production and export reports, required from Korean textile firms which receive U.S. development loans, have not been timely. The U.S. Mission concurred with this point and agreed that following up on these reporting requirements would be appropriate.

We recommend that the Administrator of AID implement followup procedures to assure the timely receipt of required reports.

--The need for the present development loan program is questionable because 87 percent of the funds authorized between July 1, 1970, and June 30, 1972, were used to obtain agricultural commodities which would be more appropriate to the Public Law 480 program, concessional capital for development purposes is now available from other sources, and the level of the program is now too small to provide effective leverage on ROKG fiscal policy. As stated on page 19, we believe that the Congress may wish to inquire into plans for terminating this program.

## SUPPORTING ASSISTANCE

The \$2 billion in supporting assistance grants provided to Korea before the program's termination in 1970 was used to import U.S. commodities, which were needed for Korea's reconstruction and industrial development following the Korean War. Most of the local currency funds from the sale of these commodities was used for ROKG projects--primarily military budget support.

Our review of the supporting assistance program is limited because its inputs have been discontinued and most of the local currency funds have been expended. However, two administrative deficiencies warrant comment: losses due to (1) late deposits of local currency and (2) failure to collect refunds.

### Late deposit of local currency

During fiscal year 1971, AID disbursed \$13.7 million through authorized letters of credit in U.S. banks. Upon receipt of a billing from the Mission, ROKG is supposed to deposit an equivalent amount of local currency in special accounts (U.S. uses and country uses). The Mission issued billings for the fiscal year between September 1970 and August 1971. As of November 1971, ROKG had deposited local currency equivalent to \$7.2 million. At the then-current exchange rate, another \$5.1 million equivalent was still unpaid.

The difference, an equivalent of \$1.4 million, represents a loss of local currency because ROKG delayed deposits during a period when the exchange rate of the Korean currency was declining. The \$1.4 million included almost \$68,000 which had been allocated for U.S. uses and therefore represented a direct loss to the United States. This loss could have been reduced or completely avoided by either (1) insisting that ROKG make more prompt deposits or (2) including maintenance-of-value provisions in supporting assistance program agreements.

A somewhat similar situation was found in the Public Law 480 program. (See pp. 51 and 52.)

AID advised us that ROKG made large deposits after the GAO in-country review thereby making the U.S. portion of deposits current and reducing the overall counterpart delinquency to \$463,968 as of December 31, 1972. To prevent any loss to the United States, AID now insists that ROKG make immediate deposits of counterpart funds for U.S. uses.

#### Failure to collect refund claims

From December 1966 through October 1970, the Mission requested that ROKG refund about \$1.8 million because of the improper use of funds in such programs as supporting assistance, Public Law 480, and excess property. The refund claims included over \$1 million in dollar claims and about \$800,000 in local currency claims.

The supporting assistance program agreements state that refund claims are to be paid within 90 days after receiving the request. However, as of October 1972, ROKG had not made any refunds. The Mission is considering a ROKG proposal to allow refunded amounts to be reprogramed which contradicts the terms of the basic program agreements.

The agreements state that, if ROKG fails to comply with any provision in the agreement, AID may decline to issue further letters of commitment or other disbursing authorization and may suspend or cancel those outstanding. The agreements stipulate that refunds paid by ROKG would reduce AID's obligation under the agreement and that the amount thereof would not be available for re-use.

ROKG has proposed that U.S. dollar claims be settled by direct reimbursement authorization technique. Under this technique an outstanding letter of commitment from the supporting assistance program would be reduced by the amount of U.S. dollar claims and ROKG would deposit an equivalent amount of foreign exchange earnings in a U.S. bank for importing commodities under the grant agreement. The United States would then reimburse ROKG directly for the imported commodities. This, in effect, would make the refunded amount available for re-use.

In January 1971, AID reduced the credit available under the 1969 supporting assistance agreement by \$684,000--the amount of the claims originating from February 1967 to

April 1969. However, at the time of our field review, ROKG still had not deposited an equivalent amount of foreign exchange in a U.S. bank. According to AID, any ROKG proposal to reprogram the refunds would be examined carefully to determine whether it would be in the best U.S. interests.

In addition, ROKG had neither (1) settled the outstanding local currency refund claims nor (2) paid an October 1970 dollar refund claim of \$369,700 for excess property items unaccounted for, improperly sold, or misused. AID stated that outstanding pending refund claims against ROKG is a particularly troublesome issue. According to AID, numerous requests for settlement have been made without much success, but it will continue to press for early liquidation of the amounts due.

### Recommendation

We recommend that the Administrator of AID continue to press ROKG for final settlement of the claims for the \$1.8 million not refunded to the United States. Since AID has informed us that ROKG has deposited enough counterpart funds to make the U.S. uses portion current, we are not making any recommendation on late deposits.

### TECHNICAL ASSISTANCE

AID provided about \$97.6 million in technical cooperation and development grants during fiscal years 1955-72 to promote Korea's economic and social development. This assistance included project-related commodities, professional advisory services, and training for some 3,000 Koreans in the United States and other countries. The program decreased from \$8.2 million in 1968 to \$3.5 million in 1972 and now emphasizes agriculture, education, and family planning.

In reviewing the effectiveness of ongoing and recently completed AID projects, we found that the statement of goals and objectives on some projects was too broad to permit a meaningful assessment of the projects' success. However, steps were being taken which should substantially improve the Mission's planning and evaluation procedures.

We also found that ROKG was reluctant to support certain types of projects which the United States considered



appropriate and that participant training projects had not emphasized the private sector adequately.

#### Need for increased ROKG support

ROKG budget support for some AID technical assistance projects has been limited. This may be due to the ready availability of local currency generated by U.S. loan and grant agreements or to ROKG priorities not coinciding with those of the United States as in family planning and social services.

AID recognized the lag in developing the social sector and attempted to increase ROKG interest in this area. ROKG's Third Five-Year Plan acknowledged that the social sector had not received adequate emphasis but stated that it now would. However, a United Nations official informed us that, although ROKG emphasized the social sector in speeches and announcements, there was little interest in actuality. The United Nations Development Program receives few ROKG requests for assistance in the social sector.

An AID project aimed at improving social welfare, medical and retirement insurance, urbanization, environmental quality, and ROKG's ability to deliver critical services was canceled in October 1971. ROKG's reaction to the proposed project was noncommittal, indicating that Koreans felt the American-designed social welfare project was either inappropriate or of low priority. AID said, however, the project plans were abandoned primarily because it believed the project was too vast in scope and threatened to be unmanageable.

At the time of our review, the Mission was attempting to insert the social welfare and urban planning portions of the canceled project into another project. ROKG, however, is still giving priority to economic development and defense areas.

#### Emphasis on the public sector

Emphasis on participant training has been in the public rather than the private sector. Of the 161 individuals identified as being processed for training in fiscal year 1970, only 39 individuals, or 24 percent, came from the private sector.

In a banking and credit administration project, 37 participants were trained during the period 1968-70. Of these, 31 came from ROKG agencies or banks in which ROKG owned a majority interest. The other six participants came from banks in which ROKG held an interest ranging from 29 to 43 percent. We were informed that the Mission had tried to get participants from the local commercial banks for the project, but ROKG opposed the idea.

We also noted that the eight participants in the private investment promotion project during 1969-70 came from ROKG agencies. Furthermore, AID projects being considered at the time of our review continued to emphasize the public sector or areas where ROKG exercised considerable influence. AID officials said that their efforts to increase the number of participants from the private sector had been complicated because some of the firms competed with U.S. firms or could pay for their own training.

#### Need for coordinating donor inputs

From 1968 through 1970, Korea received approximately \$15 million to \$20 million annually in technical assistance from various external donors, principally the United Nations and AID. ROKG has the most complete information and is responsible for planning and executing these programs, but it has not taken an active role in coordinating the various donor programs. The Mission has made informal attempts to arrange formal meetings between AID and the other donors, but ROKG has not been receptive to the idea.

Lack of coordinated planning between the donors and ROKG would appear to have a detrimental effect on the donors' ability to apply their available resources where needed most. In view of the increased participation by the United Nations and other countries in the technical assistance area, we believe there is a need for improved coordination of donor inputs.

## HEALTH AND FAMILY PLANNING

AID has been assisting the Koreans with their family planning program since the program's inception in 1962. Until fiscal year 1967, AID assistance was on a relatively small scale, totaling \$84,534, and was limited primarily to overall health policy and planning. The program was greatly expanded after 1967, as a result of an amendment to the Foreign Assistance Act, entitled "Title X - Programs Relating to Population Growth," which provided separate funds for such use. During 1968-72, title X assistance amounted to approximately \$5.7 million. Local currency generated from supporting assistance provided approximately \$3,450,000 in counterpart funds and \$228,000 in trust funds during fiscal years 1969-72.

We limited our review of this program because the AG had previously performed a comprehensive audit of it. However, some of the problems noted demonstrate a definite need for improved administration: (1) the lack of ROKG budget support has hindered the program, (2) large amounts of title X-financed commodities either have not been used at all or have been used for health care activities unrelated to family planning, (3) large amounts of funds have been obligated at yearend and, in some cases, without necessary implementing documentation, (4) the program is experiencing a very high participant dropout rate, and (5) reported program accomplishments may be overstated and project goals unrealistic.

### ROKG budget support

In 1970 the Mission reported that the lack of adequate local currency was a chronic problem and additional local currency was required to absorb and use external inputs. ROKG budgeted \$9.1 million<sup>1</sup> during the years 1966-71 for the family planning project, but its contribution to the family planning budget as a percentage of both the health and national budgets declined from about 30 percent in 1966 to 11 percent in 1971 while AID's participation increased substantially. In addition, counterpart funds generated by U.S. aid programs supplied about 82 percent of the total ROKG budget support for maternal and child health care and family planning during 1969 and 1970.

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<sup>1</sup>Converted at the average fiscal year 1971 exchange rate of 318 "won" (Korean currency) to \$1 U.S.

For 1971, the family planning budget of \$2.2 million was cut to \$1.5 million and was then increased to \$1.9 million by a supplemental appropriation.

At the time of our field review, ROKG had significantly reduced the 1972 budget for family planning from \$2.1 million to \$1.1 million even though the 1972 project agreement required that the 1971 level be maintained. As a result, the 1972 funding level was considered insufficient to meet local currency needs until it was supplemented by \$7 million from AID's \$35 million development loan for rice.

The 1972 budgetary reductions were all made in contraceptive services. Consequently, the targeted reduction in the population growth rate cannot be achieved. In addition, it would be impossible to effectively use the commodities and contract services programed in the fiscal year 1972 project agreement.

Subsequently AID told us that ROKG was attempting to restore the reductions in the 1972 budget and that support for the family planning program will now come entirely from ROKG revenue sources rather than from counterpart funds as in the past.

#### Commodity use

In a recently completed review of family planning activities in Southeast Asia, GAO found that title X funds had been used to obtain commodities and services which (1) were in excess of the program's needs and (2) primarily benefited other programs--mostly general health care. In Korea, the AG tested the use of AID-financed commodities valued at \$1.7 million and reported a similar situation. Certain commodities were not needed at the operating sites for which they were procured, and other commodities used had no relationship to family planning. For example:

1. AID provided commodities valued at \$663,000 to 191 ROKG health centers for family planning services. Visits to 25 centers showed that overhead projectors, surgical equipment, hand calculators, duplicating machines, and public address systems were either not

- needed and being stored or not be being used for family planning activities. For the 191 health centers, such commodities amounted to over \$300,000.
2. To support family planning activities at 1,002 ROKG health subcenters, AID provided about \$686,000 in medical equipment. The auditors found that \$29,755 of this equipment, which had arrived in December 1970, was still being stored as of June 1971. Other examples of improper commodity use at the subcenters included:
    - a. AID procured 684 refrigerators to strengthen the maternal and child health system. Of the 33 refrigerators inspected, most were being used for storing vaccine for epidemic diseases and none were being used to support family planning activities. The auditors believed that requirements were not clearly definitized as to planned specific uses and quantities needed. They believed that benefits to family planning were secondary and that it would have been more proper to use ROKG funds rather than family planning grant funds.
    - b. A total of 384 subcenter kits valued at \$316,000 were procured for the subcenters. At the 26 subcenters visited, the auditors found that the kits were either not used or used for programs other than family planning. Certain items from the kits were used on a limited basis in only seven cases, and the items used--flashlights stethoscopes, trays, etc.--were for treatment of patients unrelated to the family planning program. The AID Mission decided not to defer procurement of an additional \$600,000 of kits because of the 18-month leadtime required for delivery. The Mission stated that it was taking action to insure proper use of both the kits on hand and those being ordered.
  3. AID procured 46 units of hospital equipment, costing \$184,000, for provincial hospitals. Approximately \$27,000 of such units were in storage because similar equipment had been provided by the United Nations Children's Fund. At the eight provincial hospitals visited, the auditors found that the AID-furnished

equipment was not being used for family planning services. In most cases, it was used for general operations of the hospital and for treatment of patients not related to family planning.

After our field review, AID said that remedial actions had been taken to correct deficiencies and that it had eliminated commodity funding for the Korean family planning program in fiscal year 1973. The Mission is working with the ROKG Minister of Health and Social Affairs to identify situations where family planning commodities are not being properly used and to transfer these commodities to units where they can be used for the purposes intended.

A review of future commodity needs led to a cutback of \$232,000 in fiscal year 1972 planned obligations and eliminated some items from future budgeting. The Mission is also reexamining the need for commodities in the procurement pipeline and is canceling those which are not in a shipment status and those no longer considered essential. These cancellations will result in further deobligations of funds.

#### Programing of funds

AID entered into project agreements and recorded as obligations large amounts of title X funds at yearend without defined requirements in some cases. This could have contributed to the nonuse of commodities. This situation is similar to the problem described in our report, "Assistance to Family Planning Programs in Southeast Asia," (B-173240, May 23, 1973).

For fiscal years 1968 through 1971, AID recorded as obligations \$3.8 million--about 81 percent of its total recorded obligations for this program--during the last month of the fiscal year. In fact, project agreements for \$3.2 million of the \$3.8 million were signed on June 29 and 30 of fiscal years 1968 through 1971.

On several occasions, the AID Mission Director waived the administrative requirement that project agreements and implementing documents be issued simultaneously. For example, in 1971 the implementing documents--the documents specifying program requirements for over \$400,000 worth of commodities--were administratively waived twice, for a total of 180 days after the end of the fiscal year. This amount was part of the \$850,000 recorded as an obligation on June 30, 1971--the last day of the fiscal year.

Project agreements were signed and funds were recorded as obligations at yearend without defined requirements so that the funds would not be lost to the program. Title X funds ordinarily cannot be used for other programs because of the specific nature of the appropriation. This fact was recognized by the Director in 1968 when he stated that the reason for the administrative waiver was that the Mission had been requested to obligate funds for family planning as rapidly as possible because they were to be used for family planning activities only.

We did not attempt to determine on an individual basis whether the project agreements entered into at yearend without defined requirements were sufficiently specific to constitute valid obligations. We believe that AID should make such a determination for each project agreement entered into with the host government. Nevertheless, the practice of signing project agreements at yearend without definitive implementing documents--even if the agreements are sufficiently specific to constitute valid obligations--is a poor management procedure which should be discontinued.

#### Other problems areas

The AG also reviewed the U.S.-ROKG counterpart fund established for family planning activities--local currency equivalent of approximately \$3.45 million for fiscal years 1969-71. The AG report stated that ROKG had not maintained a separate account for these counterpart funds and their use had not been monitored by the Mission. Indications were that counterpart funds had been commingled with ROKG's national budget funds and used for purposes not normally considered proper, such as for entertainment costs. However, due to the commingling, the AG could not attribute such expenditures solely to counterpart funds even though such funds had provided most of the local currency input to the family planning project.

According to independent studies and analyses of census data, ROKG had attained its 1962 goal of reducing the population growth rate from greater than 3 percent in 1960 to about 2 percent in 1971. Although we did not examine the methods used in the computation, we believe that reported accomplishments may be overstated. A Mission official informed us that ROKG vital statistics are not reliable and as much as 40 percent goes unreported. In addition, a recent study by the

Korean Institute for Research in the Behavioral Sciences estimated that only 23 percent of the Korean women practice family planning and that 45 percent of the participants drop out of the program.

We believe that future project goals may be unrealistic. ROKG's Third Five-Year Plan is intended to reduce the population growth rate to 1.5 percent by 1976. AID agreed that this was an ambitious target. Nevertheless, AID believes that the target is attainable, if the program's future long-range requirements are clearly identified and a sufficient amount of resources are available.

We believe that this goal cannot be achieved before ROKG budget support improves and even then, there are other constraints. The Mission reported that recent reductions had been as much the result of sociological changes as the effect of the Government-sponsored program. The United Nations Regional Representative also indicated that program inputs would have to be increased considerably and that the post-Korean War baby-boom age group would have to be motivated toward small families.

#### Recommendation

Large amounts of title X funds have been obligated at yearend and, in some cases, without necessary implementing documentation. Furthermore, the lack of adequate ROKG support has hindered program accomplishment.

We are therefore recommending that the Administrator of AID strengthen procedures for determining commodity requirements before obligating funds.



## CHAPTER 4

### ADMINISTRATION OF FOOD FOR PEACE PROGRAM

The Food for Peace program was authorized in 1954 by the Agricultural Trade Development and Assistance Act (Public Law 480). Assistance under the act may take the form of (1) long-term-credit sales to foreign governments at low interest rates, repayable in dollars or convertible local currencies (title I), or (2) donations to governments, multilateral institutions, and private U.S. voluntary agencies (title II).

Through fiscal year 1972, Korea received over \$1.5 billion worth of agricultural commodities at world market prices. This included over \$1 billion in concessional sales and \$493 million in donations. During fiscal years 1968-72, these programs amounted to \$549 million and \$168 million, respectively.

Our review concentrated primarily on the larger title I program where we found a number of problems in the U.S. administration of the program. In reviewing the title II program, we made use of AG reports which (except for one report on the school lunch program) disclosed only minor deficiencies.

#### CONCESSIONAL SALES PROGRAM

The Public Law 480 sales program for Korea has increased significantly. In fiscal year 1972, the United States agreed to supply \$204 million of commodities under title I, compared with \$95 million in fiscal year 1971. According to AID, the 1972 level reflected a number of special considerations: (1) greatly increased Korean requirements for imported food grains (from \$136 million in 1965 to \$400 million in 1971), (2) the higher level of the MAP transfer offset, (3) a Korean request for special aid to counter an economic slowdown in 1971 and 1972, and (4) a U.S. policy decision to increase Public Law 480 support during the ROKG's Third Five-Year Plan period.

With the general reduction of AID-funded programs in Korea during the 1960s, title I has become the largest U.S. economic assistance program in Korea and, thus, the

principal economic tool through which U.S. foreign policy objectives in Korea are being carried out.

Amendments to Public Law 480 in 1966, directed a transition from local currency sales to dollar credit sales by December 31, 1971. The amendments also provided that, to the extent such a transition was not possible, credit sales for local currency convertible into dollars should be used. The following schedule shows that the Korean program has shifted to sales on a convertible local currency credit (CLCC) basis and that substantial amounts of the local currency proceeds were used for military budget support in the past.

Title I Programs

In Terms of Currency Uses During Fiscal Years 1968-72

	<u>1968</u>	<u>1969</u>	<u>1970</u>	<u>1971</u>	<u>1972</u>	<u>Total</u>
	(millions)					
Country uses:						
Military budget support	\$53.7	\$ 32.0	\$32.3	\$20.0	\$ -	\$138.0
Cooley loans	2.8	2.9	3.2	-	-	8.9
Economic development (CLCC)	-	<u>82.0</u>	<u>40.5</u>	<u>54.9</u>	<u>162.8</u>	<u>340.2</u>
Total	<u>56.5</u>	<u>116.9</u>	<u>76.0</u>	<u>74.9</u>	<u>162.8</u>	<u>487.1</u>
United States uses	<u>22.6</u>	<u>23.7</u>	<u>18.3</u>	<u>18.0</u>	<u>35.3</u>	<u>117.9</u>
Initial payment	-	<u>1.6</u>	-	<u>2.0</u>	<u>6.1</u>	<u>9.7</u>
Total sales agreements	<u>\$79.1</u>	<u>\$142.2</u>	<u>\$94.3</u>	<u>\$94.9</u>	<u>\$204.2</u>	<u>\$614.7</u>

We believe that availability of a large concessional sales program for agricultural products serves as a disincentive for ROKG to solve problems within its agricultural sector early. Inadequate ROKG priorities for this sector have also resulted in widening the rural and urban income gap and food grain production and consumption gap. The Mission attributes these problems to the low levels of investment for agriculture and partially to the ROKG practice of

importing rice on concessional terms to keep rice prices down. The Mission said that this policy, inspired by the desire to stabilize the cost of living, reduced incentives to increase productivity and encouraged consumption.

In our review of the Public Law 480 concessional sales program for Korea, we also found that:

- It has been increased and is being used indirectly to offset reductions in another U.S. assistance program. (See classified supplement to this report.)
- Development loans were used to import food grains during 1971 and 1972, although this type of transaction is a more proper function of the Public Law 480 program.
- Although the United States has a need for large amounts of local currencies for purchases in Korea, it allowed the percentage of local currency generated from commodity sales for U.S. uses to decline.
- Financial losses were incurred because of late deposits of local currencies generated from title I sales.
- AID has not independently verified ROKG's use of local currency generated under CLCC sales agreements.
- ROKG has not fully complied with self-help provisions of sales agreements.

#### Development loans for rice imports

Three AID development loans, totaling \$66 million, were made during 1971 and 1972 to finance part of Korea's rice import requirement. The terms of these loans were similar to those of recent CLCC rice sale agreements--dollar repayment over 40 years with an interest rate of 2 percent during the first 10-year grace period and 3 percent over the remaining 30 years.

We believe this type of transaction is a more proper function of the Food for Peace program. This matter raises questions regarding the validity of requirements for development loans to Korea which was discussed in Chapter 3.

## Local currency for U.S. uses

The United States has significantly increased its Public Law 480 concessional sales program for Korea without requiring a similar increase in local currency for U.S. uses. As a result, the United States has not taken full advantage of the opportunity the program provides for improving U.S. balance-of-payments position.

The important role which the program could have on improving U.S. balance of payments has been recognized in certain amendments made to the Food for Peace legislation. These amendments included provisions for (1) the transition from local currency sales to sales either for dollar credits or CLCC and (2) increased U.S. use of local currencies generated by the resale of Public Law 480 commodities.

In Korea, however, the percentage of local currency allotted for U.S. uses has actually decreased. The concessional sales program, including the development loans for agricultural commodities, expanded from \$47.4 million in 1967 to \$226.2 million in 1972. During this period, U.S. uses portion increased from \$9.5 million to \$35.6 million while Korea's country uses portion expanded from \$37.9 million to \$184.5 million. Thus, the U.S. uses actually declined from 20 percent to less than 16 percent primarily because (1) local currency payments earmarked for U.S. uses in the sales agreements for rice were eliminated and (2) the development loans for agricultural commodities generated no funds for U.S. uses.

CLCC agreements for rice had no currency use payment (CUP) provisions until 1972, but CLCC agreements for agricultural commodities other than rice have contained a CUP provision since 1969. The CUP was between 30 and 35 percent in the agreements for 1969 through 1971 but was reduced to 20 percent in the 1972 agreement.

The potential effect on U.S. balance of payments is obvious, in that, during fiscal year 1971, the U.S. Army Finance Office in Korea purchased \$72.6 million in local currency from the Bank of Korea. We were informed that the highly concessional nature of the rice agreements was necessitated by Japanese competition but after 1972 the sales agreements would have hardened terms because Japan's rice

surpluses had declined. After our review AID said that the portion for U.S. uses has been increased to 25 percent and should continue to show yearly increases.

Losses due to late deposits of local currency

CUP provisions under CLCC agreements provide that, during the commodity delivery period, a specified percentage of the dollar credit extended under the agreement is payable in local currency upon notification by the United States. In the past, the Mission converted the dollar value of CUP to a local currency equivalent before requesting ROKG to deposit it. The local currency equivalent was based on the exchange rate applicable at the time the United States made dollar payments for the commodities.

From September 1970 through July 1971, the Mission requested ROKG to deposit the local currency equivalent of \$4,318,000. Because of delays in making the deposits and a depreciating exchange rate, the dollar equivalent of actual local currency deposits was only \$4,182,000 at the date of deposit, a loss of about \$136,000 in U.S. purchasing power.

An additional loss of about \$268,000 was incurred because ROKG delayed in making a CUP deposit and a devaluation of the local currency followed almost immediately. On April 2, 1971, the Mission requested ROKG to deposit \$2,336,895 in local currency equivalent. However, the deposit was not made until June 21, 1971, and the Regional Disbursing Officer in Manila was not notified of the deposit until June 25, 1971. The local currency was only briefly available for U.S. expenditure before the devaluation.

The U.S. need for this local currency was demonstrated by its Eighth Army's purchase of \$3 million of local currency on June 17 and 25, 1971, at substantially higher exchange rates. From April 2 through June 11, 1971, the Eighth Army had made several other purchases of local currency, totaling about \$21.3 million.

We informed the Mission of these matters and were told that the billing procedure for local currency deposits had been changed so that requests for deposits would be made in dollar equivalents only. The applicable exchange rate, therefore, is the prevailing rate on the date of deposit. The

Mission further stated that ROKG was being billed for past losses resulting from exchange rate differences. In November 1972 we were told that ROKG had been billed for the equivalent of \$324,024, but payment had not been received.

Control over use of local currencies  
generated under CLCC agreements

The law requires that local currency generated from the sale of commodities and designated for country use under CLCC agreements be used for economic development purposes mutually agreed upon by the two governments. Other than the arrangements made concerning indirect use of local currency generations for military purposes (see p. 49), AID was not independently verifying that funds were actually being used for the agreed purposes but was basing determinations on unverified reports received from ROKG instead.

Subsequent to our review AID said that it no longer requires deposits of title I country-owned proceeds into a special account. However, for existing agreements which require this, the Mission will monitor local currencies under new and tighter procedures. In either case, ROKG will still be obligated to submit periodic reports certifying the receipt and expenditure of the sales' proceeds.

Self-help provisions

Each Public Law 480 agreement requires recipient countries to undertake certain mutually agreed self-help measures to increase per capita food production and improve storage and distribution of agricultural commodities.

Past self-help measures have not been effective in increasing Korean food production. Korean food imports increased from \$136 million in 1965 to \$400 million in 1971. We reviewed the specific self-help measures undertaken by ROKG in compliance with the 1970 title I agreement, dated March 20, 1970, which disclosed the following:

- ROKG agreed to encourage the private production, marketing, and distribution of limestone for use in agriculture. It devoted approximately \$1 million to develop local private limestone production facilities; however, procurement, marketing, and distribution of limestone continued to be solely functions of the Government.
- ROKG agreed to distribute at least 500,000 metric tons of limestone for use on farms in the year after

the signing of the agreement and to make every reasonable effort to reach a target of 750,000 metric tons. ROKG statistics showed that limestone sold from April 1, 1970, to March 31, 1971, amounted to only 440,000 metric tons.

--Fertilizer application was to be increased by 15 percent in the year following the agreement. The target was not reached, in fact, it decreased by 5.6 percent from 535,000 metric tons to 505,000 metric tons during the year ended March 31, 1971.

AID contends that ROKG has made a concerted effort in the agricultural self-help field and that where progress has fallen short, it has often been due more to over-ambitious goals than to ROKG failure. We believe, however, that these facts demonstrate the need for ROKG and the Mission to pursue self-help targets more vigorously.

### Conclusions

We believe that the larger concessional sales program has served as a disincentive for ROKG to solve problems within its agricultural sector early. Both AID and the Department of State disagree, pointing out that ROKG is budgeting for, and planning ways to meet, the ambitious rural development objectives of its Third Five-Year Plan. The prior Plan stressed the rural sector also, but it applied development resources primarily to the industrial area. In considering the size and makeup of future Public Law 480 agreements and overall U.S. assistance for Korea, the Department of State should give full attention to the actual application of ROKG resources.

AID has taken steps which have done much to remedy the local currency problems found during our review. Therefore, we are not making any recommendations on this matter.

### MATTER FOR CONSIDERATION BY THE CONGRESS

In considering the uses of funds being generated by the sales program, such as indirect military support, the Congress may wish to inquire further into the reasons for the increased Public Law 480 program in Korea and the uses to which the sales proceeds are put.



## DONATIONS AND DISASTER RELIEF PROGRAMS

Title II of Public Law 480 authorizes the donation of agricultural commodities for humanitarian and economic-community development purposes. Title II commodities have been provided to Korea since 1954; about \$168 million were provided during fiscal years 1968-72.

At the time of our review, title II commodities were being provided to support the school lunch program, rural road development, and various voluntary agency programs. In addition, through 1971 the United Nations World Food Program in Korea was supported entirely with title II commodities. During 1972 the Korean World Food Program received its first non-U.S.-source commodity, about \$4.5 million worth of canned beef, principally from Denmark.

### Administration of the school lunch program

AID has provided agricultural commodity assistance to Korean school children since 1954, largely for humanitarian reasons. During fiscal years 1968-72, this program received about \$52 million.

In 1969, AID and ROKG agreed to institutionalize the school lunch program within Korea's educational structure and to transform the welfare-oriented school lunch program for needy children into a program covering all elementary school students. The strategy called for developing a program which would be basically recipient funded but which would not eliminate those children unable to pay. The program called for decreasing Public Law 480 inputs, with final contributions in fiscal year 1972. To offset this phaseout, ROKG was to expand its assistance to the program and it was anticipated that some assistance would be provided by the World Food Program.

In reviewing this program in 1971, the AG reported that ROKG had failed to offset the phaseout and, as a result, thousands of students were denied lunches. According to the project plan, the ROKG program for 1971 was to have provided lunches for 1,630,000 students; 1,413,000 recipient-funded and 217,000 ROKG-subsidized lunches. However, the actual ROKG program included only 350,000 recipient-funded and 26,000 ROKG-subsidized lunches or 25 percent and

12 percent, respectively, of the planned goals, and ROKG had not applied the ability-to-pay criteria in schools with recipient-funded lunch programs.

AID delayed requesting approval of the fiscal year 1972 program until it received assurances that ROKG would strengthen its school feeding program. ROKG's assurances included submitting a budget request to finance a ROKG-subsidized program for 230,000 students during 1972 as the program plan required and establishing a reduced goal of 450,000 students to be covered under the recipient-funded program. In addition, AID was told that a school feeding law would be introduced in the Korea National Assembly during 1972.

ROKG's failure to meet program goals is attributable, in part, to the low funding priority which it gave the program and a lack of participation by the World Food Program. In addition, the Mission informed us that the goals established for the recipient-funded program in 1969 were set unrealistically high.

In our opinion, AID should have coordinated its contributions more closely with ROKG's participation and performance throughout the program's phase-down period. Not doing so resulted in inadequate ROKG contributions which, in turn, caused the program to fall short of its goals.

AID agreed and added that it was working closely with the ROKG Ministry of Education to insure that the final year of title II contribution was part of an enlarged and better administered effort.

## CHAPTER 5

### IMPACT OF MILITARY PROGRAMS

Although this review focused primarily on U.S. economic assistance programs and their effect on the Korean economy, U.S. military programs have also had considerable impact on the Korean economy.

During fiscal years 1968 through 1972, the programmed input from various U.S. military programs totaled over \$2.6 billion. Not all of these inputs directly benefit Korea economically, yet they represent a cost to the United States.

#### Programed Inputs to Korea From U.S. Military Programs

<u>Type of input</u>	<u>Fiscal years</u>					<u>Total</u>
	<u>1968</u>	<u>1969</u>	<u>1970</u>	<u>1971</u>	<u>1972</u>	
	(millions)					
Military assistance service funded program	\$393.8	\$271.4	\$237.6	\$187.2	\$167.9	\$1,257.9
MAP	254.8	138.2	135.8	292.0	152.5	973.3
Transfers under Public Law 91-652 (note a)	-	-	-	86.2	184.7	270.9
Military excess programs (note b)	16.8	41.3	11.3	18.1	14.0	101.5
Credit sales	-	-	-	15.0	17.0	32.0
Total	<u>\$665.4</u>	<u>\$450.9</u>	<u>\$384.7</u>	<u>\$598.5</u>	<u>\$536.1</u>	<u>\$2,635.6</u>

<sup>a</sup>Transfers of U.S. defense articles which belonged to U.S. forces withdrawing from Korea.

<sup>b</sup>Transfers of excess property are included at one-third of acquisition cost.

The above amounts do not include expenditures by U.S. military organizations in Korea (about \$690 million during fiscal years 1968-71) or inputs from U.S. economic assistance programs used to support the Korean military budget. The amounts of the economic programs were reflected in the chart on page 8. As an example, the Public Law 480 program has been used to partially offset the ROKG cost for resuming the MAP Transfer program. The other major economic aid input has been through the military budget support program.

## MILITARY BUDGET SUPPORT

Since the Korean War, a large portion of the U.S. assistance-generated local currency has gone to support the ROKG military budget. During fiscal years 1968-72, approximately \$229.4 million in local currency was released for this purpose; \$150.6 million was from Public Law 480 sales and \$78.8 million was from supporting assistance counterpart funds. These funds were provided as general budget support and were not earmarked for any particular military purpose.

At one time the United States provided as much as 96 percent of the ROKG military budget. The level has been declining, and by 1970 the United States was financing only 45 percent of Korea's defense burden. Correspondingly, supporting assistance grants were ended in fiscal year 1970, and local currency for military budget support was not included in fiscal year 1972, or in later, program plans.

## MILITARY ASSISTANCE AND INPUTS

Official U.S. assistance has upgraded Korea's defense capability, and also represents a direct economic benefit to ROKG to the extent that ROKG would have had to procure the items if the United States had not furnished them. In addition, Korea's "invisible" trade account has shown large surpluses in recent years, mainly because of Vietnam earnings and foreign exchange receipts from U.S. Forces stationed in Korea.

### Military Assistance Program

From the end of the Korean War through 1971, grant assistance to Korea through MAP amounted to more than \$3 billion. A 5-year MAP program to modernize Korea's Armed Forces, beginning in fiscal year 1971, called for an additional \$1.5 billion in grant aid.

During the period covered by this review (fiscal years 1968-72), MAP totaled \$973 million. Most of this was used to obtain equipment, supplies, and services to operate and maintain ROKG's existing force capability. The United States also contributed to ROKG defense articles with an acquisition cost of about \$575 million; \$304 million of this material was excessive to U.S. needs and \$271 million was

authorized for turnover to ROKG in connection with the reduction of U.S. Forces in Korea (Public Law 91-652).

While MAP inputs represent a cost to the United States and an addition to Korea's defense capability, the actual contribution of this assistance to the Korean economy could not be determined. Likewise, the transfers of equipment and supplies may or may not represent an economic benefit to Korea. This depends on what domestic resources, if any, Korea would have used to procure and maintain the same or alternate items.

#### Military Assistance Service Funded Program

ROKG deployed a force of about 48,000 military personnel to Vietnam, primarily between February 1965 and July 1967. During negotiations preceding deployment, ROKG sought U.S. commitments to insure that the deployments would not impair Korea's defense or adversely affect the level of U.S. military assistance. Another negotiating premise was that the troop dispatch should not adversely affect Korea's economic development.

In return the United States agreed to provide Korea with various forms of military and economic assistance. The military assistance portion was funded primarily through a Military Assistance Service Funded program. From its inception in 1966 through fiscal year 1972, this program totaled over \$1.6 billion in Korea. A portion of its expenditures resulted in foreign exchange earnings to Korea.

#### Other major inputs

During fiscal years 1968-72, U.S. defense expenditures entering Korea's international balance of payments were estimated at \$1.6 billion. This economic benefit was about evenly divided between spending in support of and by U.S. Forces stationed in Korea and foreign exchange earnings from Korea's participation in Vietnam.

#### Defense expenditures in Korea

The cost of maintaining U.S. Forces in Korea from the end of the Korean War through fiscal year 1972, amounted to

an estimated \$9.8 billion with an estimated \$3 billion entering Korea's international balance of payments. These expenditures included purchases by U.S. personnel and their dependents; expenditures by nonappropriated fund activities; local nationals' salaries; and local procurement of material, supplies, and construction.

Expenditures by U.S. Forces, Korea, averaged \$172 million annually between 1968 and 1971. In fiscal year 1971, however, the United States reduced authorized troop strength from 63,000 to 43,000. It has been estimated that 20,000 U.S. troops spend about \$60 million annually in Korea. In addition to this direct loss of foreign exchange income, local procurement and employment of Korean nationals at U.S. military installations will be reduced.

#### Vietnam-related inputs

The Mission estimated that, from 1966 through June 1972, Korean foreign exchange earnings from Vietnam totaled about \$925 million. This amount consisted of \$397 million for U.S. military commodity procurements, service contracts, and construction contracts; \$356 million in remittances by Korean personnel in Vietnam; \$81 million for commercial exports to Vietnam; \$72 million for the net additional costs program and special letter of credits disbursed; and \$18 million in death and disability gratuities for Korean forces serving in Vietnam.

#### Need for continued military support

Our discussion of the need to continue U.S. military support to Korea is included in a classified supplement to this report.

## CHAPTER 6

### OTHER U.S. PROGRAMS AND EXTERNAL ASSISTANCE

#### EXPORT-IMPORT BANK OF THE UNITED STATES

The Export-Import Bank provides direct loans and financial guarantees to develop additional export markets for U.S. goods and services. The Bank has had a loan program in Korea since fiscal year 1967, and as of June 30, 1972, the authorized loans totaled over \$213 million. Loan funds have been used for purposes, such as a nuclear power plant and jet passenger aircraft. Loans are generally made for a period of 8 to 10 years at an interest rate of 6 percent plus 0.5 percent annual commitment fee.

The Bank's loan guarantee program protects loans made by commercial banks to exporters or foreign borrowers. It can cover either commercial risks, such as insolvency of the buyer, or political risks, such as expropriation or confiscation. Guarantees authorized as of June 30, 1972, totaled about \$131.9 million.

#### OVERSEAS PRIVATE INVESTMENT CORPORATION (OPIC)

OPIC is a U.S. Government corporation established in 1971 to assume the overseas investment incentive programs previously administered by AID. These incentive programs include (1) insurance against the political risks of expropriation, currency inconvertibility, war, revolution, or insurrection and (2) financial guarantees of loans or equity investment against default or loss from any cause other than fraud or misrepresentation by the investor. OPIC's charter states that it is to be self-sustaining in its financing and is to apply the principles of risk management to its insurance program.

As of June 30, 1972, 80 Korean projects were covered by the insurance-guarantee program. These projects had about \$100.9 million in U.S. equity investment, \$381.1 million in loans, and \$9.3 million in royalties; and total cumulative coverage amounted to approximately \$539.2 million for convertibility, \$512.6 million for expropriation, and \$536.1 million for war.

The Korean program makes up a large portion of OPIC's total worldwide coverage. At the end of fiscal year 1972, it made up about 11.5 percent of OPIC's total insurance portfolio for convertibility, 8.1 percent of its

expropriation insurance, 13.3 percent of its war coverage insurance, and 25.6 percent of its guarantees.

#### PEACE CORPS

More than 600 volunteers have served in Korea since the Peace Corps program was established in 1966, and the present level of 250 to 300 volunteers is expected to continue for the next several years. As of June 30, 1972, cumulative obligations for the program totaled about \$10.5 million. Inputs in 1971 and 1972 amounted to about \$2 million annually.

From the beginning, Peace Corps programs have focused primarily on educational activities, such as teaching English as a second language at college and middle schools. Other areas of current emphasis include tuberculosis control, science teaching, tourism, and various professional health and social services. We were advised that a recent internal audit disclosed only minor administrative discrepancies.

#### U.S. INFORMATION SERVICE

To carry out its program in Korea, the U.S. Information Service employs a staff of about 14 Americans and 96 Koreans and has an annual budget of approximately \$1.5 million. The Service is involved in (1) radio, television, and publications, (2) motion pictures, (3) libraries and cultural programs, and (4) research.

#### SURPLUS PROPERTY CREDIT

In 1948 the United States transferred surplus property to Korea valued at \$24.9 million. ROKG agreed to reimburse the United States for this amount plus interest at 2-3/8 percent. Late in 1948, certain real property was transferred to the United States which reduced the amount to \$20.9 million. No further payment was made until 1971.

Under an agreement reached between the United States and ROKG in 1971, an amortization schedule was established for repaying the principal plus \$8.4 million in interest. Payments were to be made in 14 annual installments. The first payment of \$1 million, due July 1, 1971, was made in September 1971 and the second payment was made in January 1973.



## MULTILATERAL AND THIRD-COUNTRY ASSISTANCE

Since 1968, multilateral organizations and third countries have become an increasingly important source of financial assistance for Korea, as shown in the table below. The World Bank and Asian Development Bank, in particular, have shown great interest in Korea, and loans from these organizations are expected to play an increasing role in future Korean development. Since the United States is a large contributor to those organizations, their programs constitute a form of indirect U.S. assistance.

### Inflow of Foreign Capital From Multilateral Organizations and Third Countries

	<u>1968</u>	<u>1969</u>	<u>1970</u>	<u>1971</u>	<u>Total</u>
	—————(millions)—————				
<b>Multilateral organizations:</b>					
World Bank Group	\$ 16.3	\$ 85.0	\$ 60.0	\$ 92.2	\$ 253.5
Asian Development Bank	-	11.3	17.5	53.8	82.6
United Nations	<u>5.2</u>	<u>7.4</u>	<u>8.4</u>	<u>7.1</u>	<u>28.1</u>
<b>Total</b>	<u>\$ 21.5</u>	<u>\$ 103.7</u>	<u>\$ 85.9</u>	<u>\$ 153.1</u>	<u>\$ 364.2</u>
<b>Third Countries:</b>					
Japan:	<u>\$ 140.5</u>	<u>\$ 145.4</u>	<u>\$ 140.8</u>	<u>\$ 213.9</u>	<u>\$ 640.6</u>
Official loans and grants (note a)	50.8	52.3	41.7	101.9	246.7
Private inputs (note b)	89.7	93.1	99.1	112.0	393.9
Germany:	<u>38.7</u>	<u>40.6</u>	<u>39.1</u>	<u>33.9</u>	<u>152.3</u>
Official loans (note b)	3.9	1.3	1.3	18.2	24.7
Private inputs	34.8	39.3	37.8	15.7	127.6
Other countries:	<u>63.6</u>	<u>125.1</u>	<u>114.9</u>	<u>40.4</u>	<u>344.0</u>
Official loans	.4	.5	1.0	5.4	7.3
Private inputs	<u>63.2</u>	<u>124.6</u>	<u>113.9</u>	<u>35.0</u>	<u>336.7</u>
<b>Total</b>	<u>\$ 242.8</u>	<u>\$ 311.1</u>	<u>\$ 294.8</u>	<u>\$ 288.2</u>	<u>\$ 1,136.9</u>

<sup>a</sup> Includes \$122.9 million in grants as part of the June 1965 Property and Claims Agreement.

<sup>b</sup> Consists of commercial loans and direct investment.

## Consultative Group for Korea

The World Bank sponsors an international economic consultative Group for Korea<sup>1</sup> which is a forum on Korea's economic progress and continued capital needs. The first meeting was held in December 1966 in Paris and meetings have been held annually since 1968.

The meetings feature World Bank, International Monetary Fund, and ROKG statements on economic performance, plans, policies, and potential. Donor country representatives make short statements pointing out areas of accomplishment and concern and outline bilateral assistance plans for the following year. The Korean delegation also circulates a shopping list of projects for which foreign assistance is desired.

## World Bank

During fiscal years 1968 through 1972, the World Bank group<sup>2</sup> had authorized about \$311.9 million for Korea. Of this amount, \$227.5 million was provided through seven long-term loans at prevailing business interest rates, \$76.4 million was extended as concessional International Development Association credits, and \$8 million was invested in Korea through the International Finance Corporation.

Loans were made for railways, irrigation, education, highway construction, and to fund intermediate credit institutions. In addition, at the October 1971 meeting of the Consultative Group the World Bank agreed to participate in financing Korea's Third Five-Year Plan.

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<sup>1</sup>Membership normally includes Australia, Belgium, Canada, the Republic of China (Taiwan), France, Germany, Italy, Japan, the United Kingdom, the United States, with the International Monetary Fund and the United Nations Development Program participating. Representatives of the Asian Development Bank have been present as observers.

<sup>2</sup>International Bank for Reconstruction and Development and its associated agencies--International Development Association and International Finance Corporation.

## Asian Development Bank

Asian Development Bank loans to Korea amounted to \$133.9 million as of June 30, 1972. Of this amount over \$51 million was authorized in fiscal year 1972. As in the case of the World Bank the Asian Development Bank agreed to help finance Korea's Third Five-Year Plan.

In September 1971 a \$10.6 million loan was authorized for expanding power transmission facilities. The loan was for 20 years at 7-1/2-percent interest. Prior loans were made for (1) a petrochemical plant, (2) subloaning by intermediate credit institutions, (3) a feasibility study of a multipurpose dam project, and (4) cold storage facilities. Loan terms ranged from 6-7/8- to 7-1/2-percent interest with repayments scheduled over periods of 10 to 20 years.

## United Nations assistance programs

The United Nations Development Program and related United Nations economic and technical assistance programs contributed about \$28 million to Korea's development during 1968-71. Projects were carried out in forestry, fisheries, agriculture, regional and urban planning, precision instrument training, public health, and educational planning.

## Aid from Japan

Other than the United States, Japan has been Korea's largest source of grant aid. One of the principal results of the normalization of Japan-Korea relations in 1965, was the Property and Claims Agreement which has major sections dealing with grant aid, loans, and commercial credits.

Regarding grant aid, the agreement provided for a total of \$300 million, with approximately 10 percent to be released annually over the 10-year period 1966-75. These funds have been used for purchasing construction and textile raw materials, developing the Korean fishing industry, and other projects. Although ROKG would like this rate accelerated, indications are that Japan will maintain the planned increments. By December 1971, \$185.8 million of this grant aid had been authorized.

Under the loans section, Japan agreed to furnish \$200 million in government-to-government loans over a

10-year period. As with the grant funds, Korea would like to accelerate arrival of these loans. However, it is expected that these will continue to come in at the rate of approximately \$20 million annually. About \$109 million had been provided by December 1971. These loans have been used for infrastructure improvements such as railroads and communications.

A third stipulation in the agreement provided for \$300 million in commercial credits extended over a 10-year period. In 1967, this amount was increased by \$200 million. The credits are not extended on a fixed schedule, and the entire \$500 million will probably be expended before the end of the 10-year period. These credits have financed a variety of projects, particularly in textiles, fisheries, electric power, and aluminum smelting.

In addition to the agreement assistance, Japan provides government loans and technical assistance to Korea. At the fifth annual conference in July 1971, the Japanese pledged between \$360 million and \$430 million in government loans to support Korea's Third Five-Year Plan. As a member of a multilateral donor group (the Colombo Plan), Japan has been providing about \$500,000 annually in technical assistance; Korea has asked that this be increased to a million dollars annually.

#### Other assistance

Assistance to Korea from sources other than the United States, Japan, and multilateral organizations has been mostly in the form of public and commercial loans. During the period 1968-71, commercial loans totaled about \$472 million and public loans about \$31.9 million. Grant aid from these other sources has been insignificant, and little improvement is expected in the near future.

Most of the commercial loans have been supplier credit transactions having the official guarantee of the exporting country. For the period 1968-71, \$126.9 million came from West Germany, \$140.5 million from France and Italy, \$81.9 million from the United Kingdom, and \$122.8 million from other countries. These loans financed a variety of projects but textiles received special emphasis. Terms for this private debt averaged 8-percent interest with repayment over a 10-year period.

Of the \$31.9 million in public loans received in the 1968-71 period, West Germany provided \$24.7 million. In the period 1962-67, West Germany had authorized some \$36 million for railroad rolling stock, telecommunication, coal mine development, waterworks, and small industry. These loans and the remainder of the public debt are repayable over 15 years at 7-percent interest.

In addition, Korea is a member of the International Monetary Fund and has a standby arrangement to borrow up to \$30 million. As of April 30, 1971, the end of the Fund's fiscal year, Korea had not used any of the \$30 million.

## CHAPTER 7

### KOREA'S TRADE RELATIONS

#### WITH THE UNITED STATES AND JAPAN

One of Korea's most pressing problems is its external trade deficit. During its Third Five-Year Plan period, Korea hopes to improve the situation by maintaining a high export growth rate while restraining imports. The following table illustrates how the trade deficit has grown and shifted in the past decade.

	1962		1969		1970		1971	
	Amount	Percent of total	Amount	Percent of total	Amount	Percent of total	Amount	Percent of total
	(millions)		(millions)		(millions)		(millions)	
United States	\$208.4	56.8	\$ 214.5	17.8	\$ 189.6	16.5	\$ 146.5	11.0
Japan	85.7	23.3	620.5	51.7	575.0	50.1	691.8	52.2
Third countries	72.9	19.9	366.1	30.5	384.2	33.4	488.4	36.8
Total	\$367.0	100.0	\$1,201.1	100.0	\$1,148.8	100.0	\$1,326.7	100.0

The large trade deficit with Japan developed because Korea relied heavily on Japanese goods when expanding its own industries, while Korean exports to Japan suffered because of Japanese import restrictions and high tariff rates.

The trade deficit with the United States declined, however, because (1) U.S. items imported under the bilateral economic assistance programs declined, (2) U.S. firms did not compete effectively with other nations in the Korean commercial import market, and (3) the United States became the principal outlet for Korean products. In a somewhat related matter, U.S. businesses received only a small portion of the foreign exchange procurement awards made from funds loaned to Korea by international lending institutions, even though the United States had been a large contributor to these institutions. Again Japan has been the primary beneficiary.

#### DIRECTION OF TRADE

As U.S. grant aid declined, Korean imports were financed to a greater extent with foreign exchange and Korea looked increasingly toward Japan as the source for its offshore needs.

In 1962 Japan was the largest buyer of Korean exports and the United States was the largest supplier of Korea's import requirements. By 1971 the situation had reversed.

	<u>Percent of total</u>	
	<u>1962</u>	<u>1971</u>
Imports from:		
Japan	26	40
United States	52	28
Exports to:		
Japan	43	25
United States	22	50

### TRADE WITH THE UNITED STATES

Over the 1962-71 period, Korea's trade deficit with the United States was reduced from \$208 million to \$147 million. The main reasons were that:

- The United States became the principal outlet for Korea's rapidly expanding export industry. Korean exports increased from \$12 million in 1962 to \$532 million in 1971, and the U.S. share increased from 22 percent to 50 percent.
- U.S. goods imported under certain U.S. economic assistance programs, such as AID's supporting assistance program, declined.
- U.S. firms were not competing effectively with those of other countries, primarily Japan, in furnishing the basic raw materials, machinery, and equipment needed for Korea's expanding industrial sector.

Following is a list of selected categories of Korean foreign exchange imports during 1970.

	<u>United States</u>	<u>Japan</u>	<u>Others</u>	<u>Total</u>
	<u>(millions)</u>			
Textile yarn and fabrics	\$0.5	\$84.2	\$41.0	\$125.7
Machinery, not electrical	6.4	38.4	62.3	107.1
Machinery, electrical	1.6	7.0	26.9	35.5
Transport equipment	1.5	46.6	25.7	73.8
Iron and steel	1.0	48.2	13.8	63.0
Chemical elements and compounds	1.2	18.7	51.5	71.4

Machinery products, transportation equipment, and chemicals are beginning to replace agricultural products and semimanufactures as Korea's leading imports. Therefore, the outlook for an improvement in the U.S. trade picture seems doubtful unless the following competitive disadvantages can be overcome.

1. The United States is geographically more distant from Korea than Japan is, which affects both shipping costs and delivery time.
2. Computation of tariffs on delivered cost rather than on acquisition cost favors Asian suppliers.
3. U.S. follow-on servicing and spare parts stockage is not as good as Japanese firms.
4. Korean businessmen are more experienced in dealing with the Japanese.
5. The AID Mission has stated that U.S. items of comparable quality cost as much as, if not more than items available from other countries.

The inability of U.S. firms to overcome these competitive disadvantages was demonstrated by the lack of U.S. participation in offshore procurement awards resulting from loans made by international lending institutions.

Value of Awards Fiscal Year 1971

	<u>Total</u>		<u>World Bank</u>		<u>Asian Development Bank</u>	
	<u>Amount</u>	<u>Percent</u>	<u>Amount</u>	<u>Percent</u>	<u>Amount</u>	<u>Percent</u>
	(millions)		(millions)		(millions)	
Japan	\$16.59	73.5	\$5.74	62.3	\$10.85	81.2
Others	5.67	25.1	3.33	36.2	2.34	17.5
United States	.31	1.4	.14	1.5	.17	1.3
<b>Total</b>	<b>\$22.57</b>	<b>100.0</b>	<b>\$9.21</b>	<b>100.0</b>	<b>\$13.36</b>	<b>100.0</b>



The inability of U.S. firms to compete effectively with other countries for Korean orders indicates that the overall U.S. trade position will probably worsen as it moves away from bilateral assistance, which requires that the commodities involved be of U.S. origin, to multilateral assistance, which does not designate the commodity's origin.

In commenting on our draft report, the Department of State and AID stated that, since the realignment of world currencies in December 1971, the Japanese exchange rate advantage over U.S. products in Korean markets has been reduced by about 16 percent. Subsequently, in February 1973, the exchange rate advantage was again reduced. On the basis of the new rates of exchange, Korean importers should find that U.S. products are more competitive, although Japanese companies may reduce profits to retain their markets. It takes time for shifts in relative exchange rates to make an impact on the direction of trade, but in the long run it should help U.S. exports to Korea.

#### TRADE WITH JAPAN

Korea's chronic trade deficit with Japan, which accounted for more than half the total deficit in recent years, is a serious stumbling block in Korea's efforts to improve its trade balance. Korea's principal exports have changed from primary products (basic or unfinished goods) to manufactured goods. Korean manufactured goods do not sell well in the Japanese market, therefore its exports to Japan have continued to be mainly primary products.

According to a study by the Korea Exchange Bank, Korea's trade balance could be improved if Japan would (1) further liberalize imports of primary products, (2) reduce tariff rates on major Korean export items, (3) include more Korean export products under the Japanese preferential tariff system, and (4) increase the number of Korean items favored with a reduced value added tariff.

Japan has liberalized its import restrictions (quotas) in recent years, but as of September 1971 there were still restrictions on 40 items--more than in other economically advanced countries. For example, the United States controlled 5 items, Canada 4 items, Italy 18 items, Great Britain 25 items, and West Germany 38 items.

Of the 40 restricted items, 28 are primary products. This adversely affects Korean-Japanese trade because primary products make up more than half of Korea's exports to Japan. Major primary product exports to Japan still on the import restriction list include laver, fish, dried cuttlefish, and anthracite coal.

Japanese tariff rates are among the highest of any advanced country, and its Government is apparently reluctant to lower these rates, particularly for the primary products that are Korea's major exports to Japan. Tariff reduction measures taken by Japan in 1971 affected several Korean export products, but these measures did not apply to such major Korean export items as lavar, fish, raw silk, woven silk fabrics, footwear, and plywood.

Japan also has a value-added tariff whereby tariffs are imposed on the value added to goods processed outside the country, i.e., raw materials exported from Japan to another country for processing and later returned as finished products. Only 14 items, mostly electronic, are eligible for either reduction or exemption from these duties, and Korean-Japanese trade on these items is minimal. On the other hand, clothing --and especially the Japanese sash which is processed mainly in Korea and is the nation's largest single export to Japan--is not favored under the Japanese system.

In commenting on our draft report, AID and the Department of State stated that, after GAO's field review, Japan reduced both the number of basic items with import restrictions from 40 to 33 and the tariff rates on certain imports. The tariff rate reduction measure, which became effective in November 1972, has a number of restrictions however, and there are indications that it will not affect Korean exports as much as the Koreans had originally contemplated.

## CONCLUSIONS

When the United States imposed quotas on textile imports and a temporary 10-percent surtax on all imports, the adverse effects on Korea and other developing countries received widespread attention. A relatively lesser known but more serious obstacle in Korea's efforts to improve its trade imbalance is Korea's chronic deficit with Japan. In recent years Japan accounted for more than half of Korea's total trade deficit, and it appears likely that Korea's overall

deficit will remain if the unfavorable trade balance with Japan does not improve considerably.

U.S. exports to Korea have declined, as a percent of total Korean imports, as tied aid has decreased, and U.S. businesses have been getting a very small portion of the foreign exchange purchases from the international lending institutions loans. Therefore, except for subsidized agricultural commodities, U.S. commercial trade prospects appear dim.

## CHAPTER 8

### SCOPE OF REVIEW

This review of U.S. contributions to the Korean economy emphasizes official economic assistance programs for fiscal years 1968-72. Our in-country review was performed primarily at the U.S. Mission to Korea and the joint U.S. Military Advisory Group in Seoul, Korea. Work was also done at other locations in Korea, including the offices of the Peace Corps, the U.S. Information service, and the International Monetary Fund Representative; at the Regional Disbursing Office, Manila, the Philippines; and in Washington, D.C., at the Departments of State, Defense, and Agriculture, and AID.

We reviewed agency files and records, including the testimony of agency officials appearing before congressional committees, and conducted extensive interviews with the officials in charge of U.S. programs in Korea. In addition, we examined special studies commissioned by AID and reports and other economic data compiled by various Korean sources.

DEPARTMENT OF STATE  
AGENCY FOR INTERNATIONAL DEVELOPMENT  
WASHINGTON, D.C. 20523

(To be considered unclassified  
upon removal of amendment)

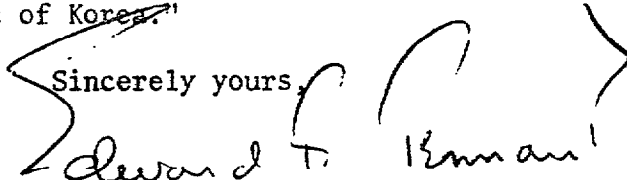
NOV 17 1972

Mr. Oye V. Stovall  
Director  
International Division  
U.S. General Accounting Office  
Washington, D. C. 20548

Dear Mr. Stovall:

I am forwarding herewith a memorandum dated October 27, 1972 from Mr. Alfred D. White, Acting Assistant Administrator of the Bureau for Asia, which presents the joint comments of the Department of State and AID on the U.S. General Accounting Office's draft report titled, "U.S. Assistance for Economic Development of the Republic of Korea."

Sincerely yours,



Edward F. Tennant  
Auditor General

Enclosure: a/s

APPENDIX I

DEPARTMENT OF STATE  
AGENCY FOR INTERNATIONAL DEVELOPMENT  
WASHINGTON, D. C. 20523

ASSISTANT  
ADMINISTRATOR

OCT 27 1972

MEMORANDUM FOR: Mr. Edward F. Tennant  
Auditor General

SUBJECT: General Accounting Office Draft Report,  
"U.S. Assistance for the Economic Development  
of the Republic of Korea"

The GAO's draft report "U.S. Assistance for the Economic Development of the Republic of Korea" is based on a comprehensive review and examination of U.S. economic assistance activities in Korea during the years 1968 through 1971. We have appreciated the chance to review the Report prior to its publication. Our detailed comments, keyed to the chapters and sections of the draft report, are attached. The comments also represent the views of the Department of State which has asked A.I.D. to respond to the GAO on a joint State-A.I.D. basis.


We understand the Departments of Defense and Agriculture are submitting separate statements. However, the attached State-A.I.D. comments have been reviewed and concurred in by the Agriculture Department.

In general, we have found the Report to be balanced and fair and we have taken few exceptions to GAO judgments and findings as to past actions. In many cases, GAO conclusions coincide with our own. Our differences are largely over policies which affect the future of U.S. economic assistance to Korea. In this regard, we are hopeful that the GAO will, in its report to the Congress, include as full a statement of our views as is possible.

We feel that most of the Report and our response thereto can be unclassified. We agree with the classification of the U.S. objectives in the first chapter. Only those sections of chapter 4 which give specific details of future military budget plans and present or future negotiations with the ROKG need be classified. We would recommend "Confidential" for these portions. We have left to the Department of Defense comments on chapter 5. In chapter 6, there are comments on the U.S. Information Service which should be classified as is shown in the attachment. The section on aid from Japan, in chapter 6, can be considered unclassified.

Mr. Edward F. Tennant

We hope the attached comments will be of assistance.

  
Alfred D. White  
Acting Assistant Administrator  
Bureau for Asia

Attachment:

State-A.I.D. Detailed Comments on  
GAO Draft Report Entitled  
"U.S. Assistance for the Economic Development  
of the Republic of Korea"

Digest and Chapter 1, Introduction (Pages 1-11) [See GAO note 2, p. 95.]

[See GAO note 1, p. 95.]

Chapter 2, Korean Economic Development and the Role of U.S. Assistance  
(Pages 12-22)

Korea's External Debt: (Pages 14-15)

We agree that Korea's external debt will continue to require close attention. Korean borrowing overseas has been substantial and it is expected to continue to be at high levels during the 1972-1976 Third Five Year Plan period. Restraint in foreign borrowing, particularly in the short-term category, maximization of domestic savings, and continued strenuous efforts to increase foreign exchange earnings will all be necessary. We do not feel, however, the Korean debt situation is as worrisome as the GAO report suggests. In our opinion, there are reasonable grounds for optimism in the Korean case that foreign exchange earnings will continue to grow as in the past and that debt obligations will be properly met.

[See GAO note 1, p. 95.]



[See GAO note 1, p. 95.]

BEST DOCUMENT AVAILABLE

Other Areas (Page 16)

The Report's comment, page 16, that the ROKG continues to stress industrial expansion despite professions to the contrary, is not supportable, in our view, considering recent actions taken by the ROKG in the agricultural sector. As the GAO noted, the Korean Third Five-Year Plan (TFYP) stresses "balanced economic structure" and accords top priority to the development of the agricultural sector. For example, the 1972 and proposed 1973 budgets reflect a substantially increased commitment to development of the rural sector. In the year 1973, agriculture and fisheries will receive about 31% of the development budget. Moreover, the ROKG's "New Community" program (Sae Maoul), a massive effort designed to stimulate the rural sector, was initiated in 1971 and is now being substantially expanded in resources and scope. Such actions should help achieve Third Five-Year Plan objectives for the agricultural sector.

GAO Views on the U.S. Role: (Pages 19-20)

The Report's opinion on such matters as the need for continuing A.I.D.'s development loan program and the terms of the PL 480 programs are commented upon in those sections of this paper dealing with these areas.

A.I.D. Termination Plan: (Pages 20-22)

[See GAO note 1, p. 95.]

The USAID did agree that the concessional element of U.S. assistance should be progressively phased down and terminated as soon as such action becomes consistent with U.S. objectives. There is no intention on our Mission's or on the Agency's part to prolong U.S. economic assistance beyond the point when it ceases to be necessary for the attainment of U.S. objectives or would create disincentives to Korea's self-sufficiency. It is our opinion, however, that in the light of the irregular performance of the Korean economy over the past year and of recent events which have clouded the Korean economic outlook, the timing for a phase down of U.S. economic aid should remain flexible.

The 1972-1976 period of the Third Five-Year Plan may well prove to be the most crucial of Korea's recent history. While past economic progress has been significant, the achievement of Third Plan objectives - such as balance of payments improvement and better distribution of economic benefits throughout Korean society - is by no means assured. The U.S. interest in an independent and economically viable Republic of Korea remains clear.

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In summary, we believe that the U.S. economic assistance program can make its long-term contribution by supporting, to the extent possible, the goals of the ROKG's Third Five Year Plan. This support should involve continued A.I.D. development lending, PL 480 long-term credits on concessional terms, and technical assistance. The provision of such assistance through the period of the Plan could be the capstone of the U.S. economic and security assistance to Korea and should lead to the acceptance and establishment of a firm foundation for an economic, social and political order which fulfills the requirements of U.S. basic policy objectives.

Chapter 3, Administration of the A.I.D. Program

DEVELOPMENT LOANS (Pages 24-41)

Private Enterprise Development: (Pages 26-29)

We agree that the ROKG exercises strong control over major segments of the economy and in a number of instances does so through direct government ownership of firms. Government ownership, however, has been reduced significantly over the years. In 1969, the ROKG owned or partially owned 103 companies; by the end of 1971 this number had been reduced to 63. For the GAO's reference, the following is a list of major enterprises which reflect the disposition of stock holdings in the past four years.

	<u>Govt. ownership prior to disposal</u>	<u>Present Govt. ownership</u>
Korea Express Co.	51.1	None
Hankuk Machinery Co.	69.4	None
Korea Shipping Corp.	61.7	None
Korea Shipbuilding Co.	76.1	None
Inchon Heavy Ind.	47.5	None
Dae Han Iron Ore Co.	100	None
Korean Airlines	96.8	None
Korea Oil Corp.	75.0	50% (KIB)
Korea Smelting Corp.	100	None
Korea Salt Corp.	87.0	None
Commercial Bank of Korea	75.7	21.6%*

\*The ROKG is currently attempting to dispose of the balance of its ownership. The stock in this bank has already been subscribed more than 70% by the private sector since the shares became available in July 1972.

[See GAO note 1, p. 95.]

While A.I.D. funds have been of substantial benefit to some enterprises in which the Korean Government has an ownership interest - notable examples have been the Korea Electric Company, the Korean National Railroad and the Chungju Fertilizer Corporation -

it should be noted that (1) the fields were often ones in which only the Government had adequate capital for the major investments required; (2) U.S. private firms were able to become equity partners in joint ventures with ROKG-owned firms by virtue of AID-OPIC investment insurance and guaranties, and (3) far greater amounts of A.I.D. dollar and local currency funds over the years have aided Korean private enterprises through the loans of the Korean development banks and through the provision of foreign exchange for imported machinery and raw materials.

The Government and the Fertilizer Industry: (Page 27)

[See GAO note 1, p. 95.]

As the Report states "U.S. assistance was largely responsible for the establishment of this industry." The prime objective was to increase Korean use of chemical fertilizer. The government-owned Chung Ju Fertilizer Corporation was established in the late 1950's when it was decided by the ROKG to develop an indigenous Korean fertilizer industry. U.S. aid to the new industry was therefore channeled to the Chung Ju Corporation.

When the petrochemical industry was being planned in the mid-1960's a time-consuming, in-depth search was made by ROKG to locate private entity Korean partners, but with little result. It soon became evident that only Chung Ju had the technical capability and capital to take the lead in the petrochemical development. It is still the government's stated intent, however, to divest itself of ownership in the petrochemical companies but, we understand, not at the expense of lengthy delays in the development of these import-substitutive industries.

The Government and Agriculture: (Page 28)

As the GAO noted, A.I.D. has from time to time aided the National Agricultural Cooperative Federation (NACF). This is because NACF is the only institution now existing in Korea which offers agricultural credit at relatively low rates of interest. The only major alternative sources of credit for Korean farmers are private money lenders, who have charged interest rates running as much as 5% to 10% per month. The interest rates charged by the NACF normally run from 3.5 to 15% per annum, with the rate depending on the purpose of the loan and source of funding. Korean commercial banks do not provide agricultural credit loans.

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NACF is also the only organization able to provide a number of basic agricultural services for farmers such as marketing, processing of agricultural products, sale of fertilizer, etc. Its operations admittedly have indicated a number of management shortcomings which the ROKG, A.I.D. and other donors hope to see corrected. On A.I.D.'s part, a study of the NACF was carried out this year by Michigan State University under an A.I.D. contract. The MSU team recommended a major reorganization of NACF, for greater efficiency and better service to farmers. The World Bank under a recent \$10.5 million loan to NACF for agricultural credit, will be financing management consulting services for NACF, to improve management information systems and recommend organizational changes. Moreover, the ROKG has indicated its intention to act on recommendations for reorganizing NACF so it is our expectation that the operations of the NACF will show a great improvement in the years to come.

### Loans for Small and Medium Sized Firms: (Pages 29-31)

The total of AID development loans to intermediate credit institutions (ICI's) was, before deobligation of unused funds and sub-loan cancellations, \$45 million (not \$53 million) as follows:

	<u>Million \$</u>
Korea Development Bank 3 loans totalling	32.0
Medium Industry Bank (1 loan)	8.0
Korea Development Finance Corp (1 loan)	5.0
	<u>45.0*</u>

\*Deobligations, etc., have reduced this amount to \$38.1 million.

The development loans were made available to the three ICI's to finance small and medium-sized firms which needed foreign exchange and to promote economic development. The Report asserts that a "significant amount" of the A.I.D. loan funds helped large well-established firms. It is, of course, arguable as to what is "significant" and what constitutes a "large, well-established firm." The detailed criteria governing every ICI sub-loan, however, required special attention be given to the size of the firms requesting sub-loans, the size of the sub-projects, special circumstances for lending - in special cases - to firms which were subsidiaries of larger firms, coordination among banks and many other matters, to assure that financially sound and economically meritworthy projects were financed by the development banks with A.I.D. funds. In some instances too high a degree of financial risk mitigated against ICI and A.I.D. approval for particular sub-projects despite developmental attractiveness.

With respect to A.I.D. program loans and the AID Auditor General's findings as to circumvention of limitations on maximum sub-loan size (discussed in pp 30 and 31) refund claims of \$3 million have been filed.

[See GAO note 1, p. 95.]

Restrictions on Export Limitations: (Pages 32-33)

Regarding the quarterly reports from textile machinery purchasers using the program loan, our Mission has acknowledged that since a number of certifications of non-export were not received as required, follow-up inquiries were in order to assure continued receipt of these certifications.

The Report suggests that an attempt be made to go beyond the certification and to independently verify that equipment financed by A.I.D. not be used to manufacture items for U.S. export. While such a monitoring task might not prove too difficult in the context of a project loan, where all the productive facilities are financed with A.I.D. funds, it is extremely difficult in the case of a program or ICI loan where only one or two pieces of equipment have been financed by A.I.D.

Finally, we should point out that with respect to the Korean-U.S. agreements on cotton, woolen and man-made fiber textiles, ROKG exports are monitored by the ROKG using a textile visa system, and, of course, by the U.S. Customs Bureau.

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### Control over Local Currency Generations: (Pages 33-35)

A.I.D. recognizes its responsibility under the 1966 Foreign Loan Repayment Special Account Agreement with Korea and has increased its surveillance over this account. New operating procedures have now been established which will ensure that there will be continuous follow-up with senior ROKG officials and adequate reports will be received as to use of U.S. generated local currency within specified sectors and activities as programmed.

The Report, page 35, is correct with reference to the Seoul Sewerage Treatment project; a major, or at least significant factor, in the delay of this project was a lack of local currency. The problem centered around a dispute between the National Government and the City of Seoul over which level of government should support the project. The problem was eventually solved when the ROKG released funds after a strong A.I.D. protest that the project and the use of the A.I.D. dollars were being unjustifiably delayed.

### Need for Development Loan Program: (Pages 35-36)

[See GAO note 1, p. 95.]

The plans are to continue A.I.D. development lending on a modest scale during the Korean Third Five Year Plan period (1972-1976) (1) because of the U.S. interest in the continuation of Korean development and (2) because foreign capital needs during the Third Plan period will be very large, probably in excess of \$4 billion. While other donors are expected to contribute substantial amounts of capital for Korean development in the years ahead there is no assurance that foreign capital targets will be met.

[See GAO note 1, p. 95.]

We generally agree with the opinion that financing of agricultural commodities is more properly a function of PL 480 than development loans. As indicated above, however, Korea's need for long-term concessional credit must be viewed from the perspective of total capital requirements and which instruments can be used to meet such requirements. Korea's need for commodity imports, moreover, is clearly greater than that which can be provided through the PL 480 program, Commodity Credit Corporation credit sales, or from non-U.S. sources.

The three rice loans cited in the GAO Report (page 36) met Korean needs for rice on concessional terms, at points in time, when it appeared that the PL 480 budget could not accommodate further rice sales and when financing arrangements had to be completed for the Koreans to be assured their rice import requirements would be met. Additionally, the first rice loan, \$35 million, made in January 1971, served to insure that the Korean residual

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requirement for rice, 200,000 metric tons - beyond the 400,000 MT pledged earlier by the Japanese and 200,000 MT financed within the PL 480 budget - would be accommodated.

It is, of course, correct, as the Report states on Page 36, that concessional capital is available for Korea from sources besides A.I.D., such as the World Bank and the Asian Development Bank. However, not all of the sources cited by GAO lend on a long-term maturity basis, i.e. over 20 years. The U.S. Export-Import Bank, for example, and some of the lending sources in Japan and West Germany do not lend on concessional terms. Again the question of whether AID concessional loan funds are needed has to be judged in terms of Korean total capital requirements, how much can be expected to be forthcoming from others and what constitutes an acceptable mix of short, medium and long term foreign capital for the Korean situation.

It is our opinion that modest level of A.I.D. development lending continues to be justified on this basis.

With respect to the two development loans mentioned at the bottom of page 36 and the top of page 37, the two industrial petrochemical projects - an acrylonitrile plant, with a U.S. investor involved, and an ammonia/urea fertilizer project - were high priority industrial undertakings and although financing had been secured for the major portion of the projects from European and Korean sources, A.I.D. funds were required to complete the financing packages. This was because some of the equipment and services had to be secured from the U.S. and no other U.S. source could be found despite strong efforts by the project sponsors.

Follow-Up on Prior GAO Report: (Page 37)  
Project Delays: (Pages 37-38)

It is true that some A.I.D. projects have been delayed in the past; it is probably unavoidable that some projects will be delayed in the future, for various reasons, despite our best efforts. We note that the Report offers no specific criticism other than that delays occurred. Delays are often brought about by the stringency of A.I.D. rules and procedures which were designed to assure that U.S. loan funds are spent prudently. In our view, A.I.D. would be more justifiably criticized if short cuts were taken to avoid rules and procedures simply to expedite projects.

SUPPORTING ASSISTANCE (Pages 41-44)

Deposits of Local Currency: (Page 42)

As noted in the GAO report, Supporting Assistance-generated counterpart deposits were sometimes delayed in the past. Except for a small loss to the 5 percent U.S. use's account, the delayed deposits have resulted primarily in less local currency for the 95 percent country use purposes. The ROKG has made up this short-fall by providing from its own resources the difference between the programmed amounts and the counterpart availabilities.

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The A.I.D. Mission is continuing to press the ROKG for prompt deposit of all counterpart. Although our Mission has had difficulty reconciling the GAO figures, the ROKG has made large deposits since the GAO review and has substantially reduced the counterpart delinquency. To prevent any loss to the U.S., we now insist that the ROKG make immediate deposits of the U.S. uses counterpart. This U.S. portion of deposits is now current.

### Refund Claims: (Pages 43-44)

The continuation of pending refund claims against the ROKG is a particularly troublesome issue between A.I.D. and the ROKG. We have made numerous requests for settlement without, so far, much success. We will continue to press for early liquidations of the amounts due.

The reprogramming of refunds, in the cases the GAO cites, is not a settled issue. As the Report notes, we have not yet received the funds owing to A.I.D. We would expect to examine carefully any proposal to reprogram the funds to determine whether it would be in the best U.S. interests.

### TECHNICAL ASSISTANCE (pages 44-47)

The GAO observation that the goals and objectives of some technical assistance projects have been too broadly stated to permit a meaningful assessment of success, is a fair criticism. In the summer of 1971, the A.I.D. Mission began a program to institute new project design and evaluation concepts and in our opinion, this has greatly clarified project objectives. During FY 1972, fourteen technical assistance project evaluations (continuing and terminating projects and sub-projects) were conducted by the AID Mission's project review panel. The main byproducts of this effort have been a redefinition and identification of: (a) programming goals, linking them directly to ROKG Third Five-Year Plan priorities; (b) manageable and achievable technical assistance project purposes; (c) what conditions we expect at the successful completion of projects; and (d) schedules for inputs to meet changed conditions.

### Need for Increased ROKG Support: (Pages 45-46)

The GAO Report has drawn the conclusion that the ROKG has not adequately supported AID technical assistance projects and attributes part of the cause to "ROKG priorities not coinciding with those of the United States." The Report is critical of ROKG efforts in the social sector, particularly, noting that a planned AID technical assistance project, which was to encompass a number of social welfare areas, was abandoned in October 1971.

At the outset, it should be noted that administration of U.S. economic assistance is within the content of U.S. foreign policy objectives and that one of the principles of the Nixon Doctrine is <sup>that</sup> development decisions are made by the host government. As we have stated earlier, the ROKG has addressed



social problems in their Third Five-Year Plan, though the Plan is admittedly vague in programmatic terms. As regards the proposed A.I.D. Social Welfare project, the project plans were abandoned by A.I.D. owing principally to our own judgment that the project was too vast in scope and threatened to be unmanageable. Moreover, we found the ROKG reaction to the proposal to be non-committal, indicating that an American-designed social welfare project was felt by the Koreans to be either inappropriate or of low priority.

The Public Sector: (Pages 46-47)

The GAO believes that the A.I.D. participant training program for Koreans reflects an inappropriate emphasis on individuals in the public sector. A.I.D. participant training program activities, in the first instance, represent only a portion of the foreign training that Koreans avail themselves of. For example, many private firms arrange for their employees to receive training overseas without recourse to the ROKG or A.I.D. In addition, many Koreans in private firms receive overseas training under arrangements with contractors and suppliers, some of which are under loan contracts financed by A.I.D. and other donors. Also, Koreans from private organizations receive training under the U.S. Government Fulbright Program and through private foundations, such as the Asia Foundation, which are supported in part by the U.S. Government.

The A.I.D. efforts to increase the number of private sector individuals, under the grant-financed technical assistance program, have been complicated by questions of the propriety of assisting certain private companies - e.g. where the firms are competitive in world markets with U.S. firms or where the firms are able to pay for the training themselves. We have established arrangements whereby companies may now self-finance participant training under the A.I.D. program.

Coordinating Donor Inputs: (Page 47)

We agree with the GAO view that coordination among aid donors and with ROKG is essential if technical assistance resources are to be used where they are needed most. However, it should again be noted that donors do not have a free hand to plan technical assistance without regard for ROKG priorities and considerations. In Korea, the Economic Planning Board (EPB) serves in a coordinating capacity as the senior cabinet ministry within the ROKG. The EPB receives donor proposals, coordinates resource inputs and leads the Korean delegation to the meetings of the international consultative group on Korea. The role of the donor is thus supportive rather than determinative.

Health and Family Planning: (Pages 47-54)

While ROKG budget support for the population/family planning program has in the past been less than A.I.D. might have desired, it nonetheless has been sufficient to support the program in an impressive manner. As the Report states, the ROK National Assembly cut the CY 1972 budget for family planning; however, the reduction is now in the process of being restored; it has received cabinet approval and is being submitted in a supplemental budget, a budgetary

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device used successfully in previous years. In a year of austere budgeting, we see this as a significant indication of the importance attached to this critical endeavor by the ROKG. Also noteworthy is the fact that the entire budgetary support for the program will be strictly from ROKG revenue sources, unlike past years when much of the budgetary funding was derived from counterpart funds.

Remedial action has been taken to correct the commodity utilization deficiencies noted by the A.I.D. Auditor General and cited in the report, pp. 49-50. Our Mission is currently working with the Minister of Health and Social Affairs to identify situations where family planning commodities are not being properly utilized and are making arrangements to shift these commodities to units which will use the items for the family planning purposes intended.

Additionally, a detailed review of future commodity needs has led to a cutback of \$232,000 in FY 1972 planned obligations and has eliminated some items entirely from future budgeting. The A.I.D. Mission is presently reviewing the status of all commodities currently in the procurement pipeline to re-examine the essentiality of the commodities on order. As a result of this review, the A.I.D. Mission intends to cancel those not in shipment status that are no longer considered essential to project needs and will take the necessary action to deobligate the funds. The USAID has also eliminated funding for commodity support for the program in FY 1973.

The Report states (page 51) that large amounts of Title X funds have been obligated at year's end. While this has been true in past years, for a variety of reasons, FY 1972 funds for the Health and Family Planning project were obligated in November 1971. This early obligation of funds resulted from a concerted attempt by the A.I.D. Mission to improve programming practices.

We share some of the doubts reflected in the Report about the accuracy of Korean population statistics. Recognizing the shortcomings in Korean vital registration, A.I.D. has, in the past two years, FY 1971 and 1972, provided technical assistance under the Health and Family Planning project to improve population statistical data.

We agree that the TFYP goal of reducing the population growth rate to 1.5 percent per year by 1976 is an ambitious target. Nonetheless, we would submit that the target is attainable, if future long-range requirements of the program are clearly identified and a sufficient amount of resources are directed thereto. Toward this end, A.I.D. population officers will participate this fall in a multi-donor consortium sponsored and led by the United Nations Fund for Population Activities (UNFPA) to review and evaluate, with the ROKG, progress of all donor family planning programs in order to identify future requirements of the Korean family planning program for the next five years.

Chapter 4, Administration of the Food for Peace Program: (Pages 55-68)

PL 480 and Military Support: (Pages 58-60)

[See GAO note 1, p. 95.]

Section 103(b) of the PL 480 Act provides that no agreements for sales for local currencies be signed after the December 31, 1971 deadline and therefore, in the absence of local currency sales, there would normally not be any currencies available for the purposes outlined in Section 104. However, the Congress also enacted the so-called "Purcell Amendment," the proviso at the end of Section 103(b), which specifically states with respect to dollar or convertible local currency credit sales that "except where (the President) determines it would be inconsistent with the objectives of the Act, (he) shall determine the amount of foreign currencies needed for the uses specified in subsections (a), (b), (c), (e), and (h) of Section 104, and the agreements for such credit sales shall provide for payment of such amounts in dollars or in foreign currencies. . . ." Section 104(c) is of course the section relating to common defense, including internal security. Thus, it is permissible, where deemed appropriate, to continue to grant local currencies under the Purcell Amendment to aid-recipient countries for military assistance purposes in the common defense.

In Korea, however, the U.S. is now adhering to another arrangement under PL 480 which is also permissible under that legislation. Instead of granting local currencies back to Korea under Section 103(b), the U.S. requires that all local currency proceeds from the sale of commodities financed under PL 480 agreements be for economic development purposes. As with many foreign assistance inputs, this additional resource gives the host country additional options with respect to the use of its own resources. And, as is true with any such input of foreign aid, as long as that input is used in accordance with governing legislation, as is true of the local currencies generated here, there is nothing illegal, directly or indirectly, in whatever use this permits with respect to the aid-recipient's own resources.

Furthermore, as we have noted, while it would have been legally permissible, by virtue of Section 103(b) above, to have granted U.S. owned local currencies accruing to the U.S. under PL 480 to the ROKG for this purpose, in this case the PL 480 currencies come from the "country use" portion of the PL 480 agreements, that is the sales proceeds for the ROKG of the commodities financed under the credit agreements. These proceeds belong to the ROKG since it is obligated to pay for the commodities in dollars.

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[See GAO note 3, p. 95.]

### Development Loans for Rice Imports: (Page 60)

The assertion that the Development Loan program has been used to overcome budgetary limitations under PL 480, Title I has been answered in our remarks relating to the DL program.

### Local Currency Generations for U.S. Uses: (Pages 60-62)

In commenting on the need for local currency for U.S. uses, the GAO Report correctly notes that the U.S. has significantly increased the PL 480 sales program for Korea. In fiscal year 1972, the U.S. agreed to supply a total \$204 million of commodities under PL 480 Title I as compared with the FY 1971 level of \$93 million. This substantially higher level reflected a number of special considerations--greatly increased Korean requirements for imported food grains, the higher level of the MAP transfer offset in FY 1972 (see earlier comments), a Korean request for special aid to counter an economic slowdown in 1971 and 1972 and a policy decision by the U.S. Government to increase PL 480 support during the Third Five-Year Plan period. It was felt that despite Korean success in achieving the goals of its Second Five-Year Plan significant economic obstacles lay ahead and that the U.S. interest was clearly to assist in the attainment of the overall objectives of the Third Plan - notably a greatly strengthened balance of payments. Korean food imports had grown from \$136 million in 1965 to \$400 million in 1971. PL 480, which has helped Korea over the years in meeting its food needs on concessional terms, was selected to be the major element of the increased U.S. support.

Events of 1971, in particular, cast doubt that Third Five-Year Plan goals could be achieved. The trade gap turned out to be \$200 million more than expected. In addition, the agreement the U.S. reached with Korea in 1971, to limit Korean exports of woolen and man-made fiber textiles to the U.S., threatened to reduce Korean foreign exchange earnings by \$325 million over five years, according to estimates by U.S. Government economists. There were reduced foreign exchange earnings as a consequence of the reduction of U.S. troop strength in Korea and the 10% MAP deposit requirements was introduced into the aid legislation.

With respect to the local currency provisions of PL 480 agreements, at the same time the decision was reached to increase the level of PL 480 support, it was also decided to aid Korea for a limited period by increasing the "country use" portion of the sales proceeds generated under PL 480

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agreements. The increase was not substantial, however, when you take into account all factors, including the terms of the MAP transfer offset and the rice sales. This action temporarily reversed the trend of previous years towards higher U.S. uses and lower country uses. The trend has been resumed again, however, and we expect U.S. use to show yearly increases.

### Deposits of Local Currency: (Pages 62-63)

The problem of losses due to late deposit of local currency, which has concerned USG officials for many months, has in our opinion now been satisfactorily resolved. As a result of discussions with the U.S. Treasury, the billing procedure for the deposit of local currency has been changed. Requests for deposits are now made in U.S. dollar equivalent only and the applicable exchange rate will be the prevailing rate on the date the deposit is made by the Korean Government. The rate used is the telegraphic transfer selling rate, the highest rate which can be legally used for currency exchanges. Therefore, in the future, even if a deposit should be delayed, it will not result in a reduced amount of Korean Won received (barring an increase in the Won's value) because the rate used will be the highest rate possible on the day the payment is made. In any event, the ROKG is now making the proper local currency deposits promptly after receipt of billing from the U.S.

Additionally, the Korean Government is being billed for the Won difference between the rates of exchange stated in prior billings and the rate of exchange in effect on the dates payments were made. Thus, any losses incurred on previous billings as a result of late deposits are being collected from the Korean Government. The ROKG has already been billed for the Won equivalent of \$324,024.60 for losses due to late deposits before the billing procedure was changed. Appropriate payment is expected promptly.

### Control Over Use of Local Currencies Generated Under CLCC Agreements: (Page 64)

It is no longer A.I.D. policy to require deposits of Title I country-owned proceeds into a special account. However, where we have existing agreements which require this, the local currencies will be monitored by the A.I.D. Mission under new and tighter control procedures. In either case, the Korean Government will still be obligated to submit periodic reports certifying to the receipt and expenditure of the sales proceeds.

### Self-Help Provisions: (Page 64)

The Report questions the contribution of self-help measures made to (a) increasing food production; (b) the encouragement of limestone production by private producers; and (c) the meeting of the ROKG self-help goals for limestone distribution and fertilizer application.

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We call the GAO's attention to the detailed comments of the AID Mission during course of the GAO review. In brief, the Mission noted that with respect to food production:

[See GAO note 1, p. 95.]

3. Production increases are particularly difficult to achieve in Korea because of land limitations, which has been recently aggravated by additional farm areas lost to increased industrialization, urbanization and road construction. Also the available land is already being intensively cultivated and producing yields among the three or four highest in the world.

With respect to limestone self-help targets, the Mission noted:

1. The production of limestone by private producers has in fact been encouraged by the ROKG. But marketing and distribution have been handled by the NACF and units of government because of the subsidy involved to promote its use and the circumstance that only the NACF has a nationwide outlet system.
2. Although the ROKG did not achieve the 1970-1971 target of distributing 500,000 metric tons of limestone to farmers, the 440,000 metric tons they did sell represented 88 percent of the goal.

In response to the Report's comment that fertilizer usage was not increasing, as one of the self-help targets called for, the AID Mission noted that:

"In the last analysis fertilizer application depends largely on the farmer, since it is he who decides how much fertilizer to use. The ROKG continues to provide a substantial fertilizer subsidy, however, and usage continues to grow. Mission information shows that fertilizer usages in CY 1970 was 563,000 metric tons, or an increase of five percent over the CY 1969 usage; and in fact, fertilizer application has increased every year since 1966. It is more meaningful to compare the CY 1970 achievement with CY 1969, rather than with a PL 480 Agreement year which combines fractions of two separate calendar years."

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We endorse the judgment provided to the GAO earlier by the Mission:

"...the ROKG has made a concerted effort in the agricultural self-help field. Where progress has fallen short, it has often been due more to over-ambitious goals being set rather than the ROKG failure to achieve meaningful results."

### Conclusions and Recommendations: (Pages 65-66)

We do not agree with the GAO conclusion that the size of the PL 480 concessional sales program has served as a disincentive for the ROKG to seek solutions to problems within its agriculture sector. The size of the program reflects a number of U.S. and Korean considerations: among them are the need of Korea for substantial amounts of concessional financing during the Third Five-Year Plan, the desire of Korean citizens to see their economic progress translated into higher standards of living, the U.S. desire to continue supporting Korean economic progress, as well as the U.S. desire to expand markets for American agricultural commodities.

Furthermore, we see no lagging interest on the part of the ROKG to increase Korean agricultural production or promote the welfare of its rural population, either as a consequence of PL 480 concessional sales or, as the Report suggests in an earlier section, because of an alleged preference for industrialization over agricultural development. As discussed earlier, the ROKG is taking concrete budgeting and planning steps to implement the ambitious rural development objectives of its Third Five-Year Plan.

Thus, it is our judgment, concurred in by the Departments of State and Agriculture, that continued substantial PL 480 assistance to Korea is fully justified in terms of both U.S. and Korean interests.

[See GAO note 1, p. 95.]

### Administration of the School Lunch Program: (Pages 67-68)

We agree with the GAO opinion that we should have coordinated our program contributions more closely with the ROKG's participation and performance. We are working closely with the Korean Ministry of Education to assure that the final year of Title II contribution to the ROKG school lunch program is part of an enlarged and better administered effort.

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### Chapter 5, Impact of Military Programs: (Pages 69-76)

A separate reply to the GAO report on the military programs in Korea has been prepared by the Department of Defense.

### Chapter 6, Other United States Programs and External Assistance: (Pages 77-86)

The United States Information Agency has asked that we pass along to GAO a suggested revision of the paragraphs at the bottom of page 79 and the top of page 80.

### U.S. Information Service: (Page 79)

[See GAO note 3, p. 95.]

Page 80 - To carry out its program, USIS employs a staff of about 14 Americans and 96 local nationals and has an annual budget of approximately \$1.5 million. Specific....research.

### Chapter 7, Korea's Trade Relations with Japan and the United States: (Pages 87-94)

With respect to Japanese import restrictions, it is suggested that the information in your draft report be updated to show that, since April 1972, there are 33 basic items, rather than 40, to which import restrictions apply.

[See GAO note 1, p. 95.]

Moreover, in regard to the section in your draft report on competitive disadvantages in trade with Korea, it is suggested that you add a statement along the lines of the following:

Since the realignment of world currencies in December 1971 the Japanese exchange rate advantage over U.S. products in Korean markets has been reduced by about 16%. On the basis of the new rates of exchange, Korean importers should find that U.S. products are more competitive, although Japanese competitors may reduce profits in order to retain their markets. The impact of the shifts in relative exchange rates takes time to be felt, but over the longer term it is virtually certain to help our exports to Korea.



[See GAO note 1, p. 95.]

GAO notes:

1. Deleted comments relate to matters in the draft report which are omitted from, or modified in, the final report.
2. Page number references refer to pages of the draft report and may not be the same in the final report.
3. Deleted comments contain classified information. They were used to the extent considered appropriate in preparing the classified supplemental report.



DEPARTMENT OF AGRICULTURE  
OFFICE OF THE SECRETARY  
WASHINGTON, D. C. 20250

November 21, 1972

Mr. Oye V. Stovall  
Director  
United States General  
Accounting Office  
Washington, D. C. 20548

Dear Mr. Stovall:

This is in response to your request for Department comments on the proposed GAO report to the Congress on the review of "U.S. Assistance for the Economic Development of the Republic of Korea."

We have reviewed and concurred in the comments being submitted to you by the Department of State and the Agency for International Development. Their detailed comments deal with overall U.S. economic assistance activities in Korea and include comments on various aspects of Public Law 480.

Because of our responsibility with respect to P.L. 480 programs, we are submitting our comments on parts of the report relating to the administration of Public Law 480.

The section on P.L. 480 and military support on pages 58-60 contains a statement that the Title I, P.L. 480 legislation does not allow proceeds generated under the program to be used for purposes other than economic development and that "the Congress passed an amendment to the law which precluded the use of P.L. 480 for other than economic development purposes after December 31, 1971." This statement relates to the claim that P.L. 480 Title I was used as an indirect means of supporting the Military Assistance Program (MAP). Although sales for foreign currencies are not permitted after December 31, 1971, section 103(b) of P.L. 480 provides:

"...except where he determines that it would be inconsistent with the objectives of the Act, the President shall determine the amount of foreign currencies needed for the uses specified in subsections (a), (b), (c), (e), and (h) of section 104 and the agreements for such credit sales shall provide for payment of such amounts in dollars or in foreign currencies upon delivery of the agricultural commodities...."

In the case of the P.L. 480 agreement with Korea being reviewed, it was decided to provide for credit arrangements for 80% of the amount financed under the agreement and 20% of the amount financed to be paid on demand and used for payment of U.S. obligations. It was decided not to provide for additional amounts to be paid on demand for the purposes specified under section 104(c) (i.e., to be made available as a grant for the common defense) in order to obtain a better return to the United States.

Your review of this agreement also implies that the proceeds from the sale of commodities financed under P.L. 480 on credit terms must be used for economic development purposes additional to those for which funds are available in the recipient country's budget. The P.L. 480 statute does not require that the economic development purposes to which the sales proceeds are devoted be additional to those which would otherwise be carried out.

On pages 60-62, the proposed report indicates that the U.S. has significantly increased the P.L. 480 concessional sales program for Korea without requiring a similar increase in the generation of local currency for U.S. use, and in fact, the percentage of local currency generated for the U.S. has decreased. The substantially higher level of P.L. 480 programing results from a number of considerations such as increased Korean requirements for food grain imports, the request by Korea for special assistance because of an economic slowdown in 1971-72 and a decision by the U.S. to increase P.L. 480 support during the Third Five-Year Plan period. At the same time, it was decided to assist Korea for a limited period by reducing the portion of the amount financed by the United States which must be paid on demand for U.S. uses. Taking into account the rice sales and other factors, including the MAP transfer offset, the decrease in payments for U.S. uses was not substantial. We have already resumed the trend of previous years toward higher U.S. uses in recent agreements, and we plan to continue to negotiate annual increases in U.S. use portions of P.L. 480 agreements with Korea.

We appreciate the opportunity to comment on the proposed report. Concerning your questions on the classification of our comments and the report, we concur in the recommendations made by State/AID, and the comments of this Department can be unclassified.

Sincerely,



Carroll G. Brunthaver  
Assistant Secretary

PRINCIPAL OFFICIALS HAVING  
MANAGEMENT RESPONSIBILITIES OVER MATTERS  
DISCUSSED IN THIS REPORT

	<u>Tenure of office</u>	
	<u>From</u>	<u>To</u>
<u>DEPARTMENT OF STATE</u>		
SECRETARY OF STATE:		
William P. Rogers	Jan. 1969	Present
Dean Rusk	Jan. 1961	Jan. 1969
ASSISTANT SECRETARY FOR EAST ASIAN AND PACIFIC AFFAIRS:		
Marshall Green	Apr. 1969	Present
William P. Bundy	Mar. 1964	Apr. 1969
<u>AGENCY FOR INTERNATIONAL DEVELOPMENT</u>		
ADMINISTRATOR:		
John A. Hannah	Mar. 1969	Present
Rutherford M. Poats (acting)	Jan. 1969	Feb. 1969
William S. Gaud	Aug. 1966	Jan. 1969
ASSISTANT ADMINISTRATOR, BUREAU FOR ASIA (note a):		
Donald G. MacDonald	Feb. 1972	Present
DIRECTOR, OFFICE OF EAST ASIA DEVELOPMENT PROGRAMS (note a):		
Willard H. Meinecke (acting)	Aug. 1971	Jan. 1972
ASSISTANT ADMINISTRATOR FOR EAST ASIA (note a):		
Roderic L. O'Connor	July 1969	July 1971
Robert H. Nooter (acting)	May 1969	July 1969
John C. Bullitt	May 1967	May 1969

<u>Tenure of office</u>	
<u>From</u>	<u>To</u>

AGENCY FOR INTERNATIONAL DEVELOPMENT (continued)

ASSISTANT ADMINISTRATOR, BUREAU FOR  
SUPPORTING ASSISTANCE:

Robert H. Nooter	Aug. 1972	Present
Roderic L. O'Connor	Aug. 1971	Aug. 1972

U.S. MISSION TO KOREA (note b)

U.S. AMBASSADOR:

Philip C. Habib	Oct. 1971	Present
William Porter	Aug. 1967	Aug. 1971
Winthrop G. Brown	Aug. 1964	June 1967

DIRECTOR, AID/KOREA (note c):

Michael H. B. Adler	May 1971	Present
Howard E. Houston	Jan. 1970	Apr. 1971
Miles Wedeman (acting)	Nov. 1969	Jan. 1970
Henry J. Costanzo	Sept. 1967	Nov. 1969
Joel Bernstein	July 1964	Aug. 1967

DEPARTMENT OF DEFENSE

SECRETARY OF DEFENSE:

Elliot Richardson	Jan. 1973	Present
Melvin R. Laird	Jan. 1969	Jan. 1973
Clark M. Clifford	Mar. 1968	Jan. 1969
Robert S. McNamara	Jan. 1961	Feb. 1968

ASSISTANT SECRETARY OF DEFENSE  
(INTERNATIONAL SECURITY AFFAIRS):

Lawrence S. Eagleburger (acting)	Jan. 1973	Present
G. Warren Nutter	Mar. 1969	Jan. 1973
Paul G. Warnke	Aug. 1967	Feb. 1969
John T. McNaughton	Mar. 1964	July 1967

<u>Tenure of office</u>	
<u>From</u>	<u>To</u>

DEPARTMENT OF DEFENSE (continued)

## CHIEF, JOINT MILITARY ASSISTANCE

## ADVISORY GROUP, KOREA:

Major General H. S. Cunningham	Sept. 1972	Present
Major General John S. Lekson	Mar. 1970	Sept. 1972
Major General Livingston N. Taylor	June 1968	Mar. 1970
Major General Raymond B. Marlin	June 1966	June 1968

DEPARTMENT OF AGRICULTURE

## SECRETARY OF AGRICULTURE:

Earl L. Butz	Dec. 1971	Present
Clifford M. Hardin	Jan. 1969	Nov. 1971
Orville L. Freeman	Jan. 1961	Jan. 1969

<sup>a</sup>In August 1971 and February 1972, AID revised its organizational structure. The changes in titles are reflected accordingly.

<sup>b</sup>U.S. Embassy and AID/Korea functions are combined in the U.S. Mission to Korea.

<sup>c</sup>Also acts as Counselor for Economic Affairs for the U.S. Embassy in Korea.

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