

# Evolution of Aid-depending Economy and Search for Self-sustaining Economy

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This paper investigates features of the Korean economy in the 1950s on the presupposition that the 1950's economy is closely related the 1960's economy. This paper analyzes two problems for this purpose. First, it analyzes the effects that aid had on the Korean economy. The proportion of aid given to Korea in terms of total imports was 73 percent, and imported goods financed by this aid consisted mainly of final consumer goods, raw materials and intermediate goods used in the consumer goods industry. This is why the consumer goods industry experienced such rapid growth in the 1950s. In addition, a counterpart fund that accounted for 43 percent of government revenue was used as post-war reconstruction aid, including treasury loans and investment funds. As such, aid was very important in the 1950s Korean economy.

Second, it analyzes how the Korean government responded when its aid-dependent economy fell in crisis. Decreasing aid brought about a decrease in imports and government revenue, which resulted in an economic crisis. The Korean government began to search for ways to build a self-sustaining economy in order to overcome this crisis. Of course, these efforts did not succeed in the 1950s, but they did have an effect on the military government.

Keywords: Aid-depending Economy, Self-sustaining Economy, Economic Reconstruction, Consumer Goods Processing Industry, Three-Year Economic Development Plan, Counterpart Fund, Treasury Loans and Investments

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## I. Introduction

Compared to the economic outcome of the Park Chung-hee government, the

economic outcome of the 1950s is trivial. In fact, the economic outcome of the Park government is twice that of the 1950s, which is measured as the average annual growth rate from 1953, the year national income is first recorded, to 1960. This growth rate was only 3.7 percent while the average annual growth rate from the inauguration of the Park government to 1979 was 8.6 percent (NSO 1998:117). Accordingly, the policy and institution studies of the 1950s generally tend to focus on the differences with the 1960s (Kim Kwang-suk and Westphal 1976; Krueger 1981; Amsden 1989; Haggard, Kim and Moon 1991; Cho 1997; Kim Nak-nyeon 1999; Lee Sang-cheol 2005). Most scholars agree that there exist many differences between the two periods. Nevertheless, it is also true that a continuation can be found in the two periods. This paper aims to analyze the background of the economic base shared by the two periods.

A self-sustaining economy was the basic principle of the economic policies of the two periods. According to the three year economic development plan (hereafter, the three year plan) drafted by the Rhee Syngman government, “the purpose of the plan is to create a foundation of self-sustainability as the first step in achieving the long term challenge of establishing a self-sustaining economic system” (MOR 1960:12). The first five year economic development plan (hereafter, the first plan) by the military government also claims that its purpose was to construct a foundation for realizing a self-sustaining economy (EPB 1962:15).<sup>1</sup> According to a dictionary, self-sustaining economy is an economy that could run by itself. It does not imply a reduction-oriented or protectionist economy. The growth rate set by the three year plan was 5.2 percent, while the first plan aimed for 7.1 percent (MOR 1960:19-20; EPB 1962:19).<sup>2</sup> In addition, to achieve the target growth rates, the two plans did not pursue an autarky economy which would maximize self-sustainability and minimize trade dependence. Instead, they sought an open economic system with an emphasis on close relations with the international economy under the understanding that the expansion of exports was necessary to finance the increase of imports needed for increased production (MOR 1960:19-20).<sup>3</sup> Therefore, a self-sustaining economy in these

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1. The aim to realize a self-sustaining economy is found in all 4 plans implemented by the Park government (EPB 1962:15).

2. The three year plan targeted 2.8 percent for an annual average growth rate for national income per capita not only to increase the gross output but also to improve the national standard of living (MOR 1960: 587).

3. The once popular ‘National Economy theory’ for self-reliant and self-sustaining economy

two periods meant improving the international balance of payments. In other words, raising the investment capital needed to expand domestic production, and decreasing the gap between exports and imports.

It is a well known fact that foreign aid played an important role in maintaining the balance (the gap between investment and savings) at times when domestic savings were at their lowest due to the low level of national income, and when demand for investment was quite high due to the construction of key industries after the destruction caused by the Korean War. In economic policy, there is a significant difference in accepting foreign savings as aid or taking out a loan. What many scholars pointed out in distinguishing the 1950s from the 1960s can be explained as these different types of foreign capital. Cole and Lyman (1971:170) write that a low exchange rate policy that increases the gap between the supply and demand of foreign currency, and a low interest rate policy which increases the gap between the demand and supply of funds, work only in a period of aid maximization and not in a period when exports are maximized.<sup>4</sup> Therefore, the policies and strategies to create a self-sustaining economy differ as the economic environment differs. However, this is not to say that there is no similarity between the two different periods.<sup>5</sup> Based on this understanding, this paper attempts to analyze how the Rhee government responded to the conditions of South Korea's aid-dependent economy in the 1950s as it recognized the limits of foreign aid from the real and financial

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emphasized that “as for the reproduction of national economy, trade dependency must be minimized while maximizing self-sufficient part to a point where trade does not become an important factor in the reproduction of national economy” (Park Hyeon-chaе 1981:295). Nevertheless, the policymakers of this time think that they did not equate self-sustaining economy with autarky economy.

4. This argument became the widely accepted view in mainstream economics. Kim Kwang-suk and Westphal (1976) and Krueger (1981) are prime examples of research on the 1950s and 1960s South Korean economy from this point of view. However, recent research tends to focus on how different industrialization strategies influence private businesses from an institutionalist perspective (Choi Sang-oh 2003; Lee Sang-cheol 2004).
5. Park Tae-gyun (2007) is a leading scholar in research that focuses on the similarities, rather than the differences, of the economies of the two periods. However, unlike this paper, he focuses on the ideas and thoughts of people who created economic policies after being influenced by intellectuals who studied abroad in the 1950s and who were exposed to developmentalist theories and experiences of economic development in other Asian countries, in addition to the internal factors like traditional concept of the public, colonial education, and colonial economic systems dependent on imperialism. Although the experiences and history of policymakers are indeed important, it is widely accepted that the economic reality of the period had a bigger impact.

aspects.

This paper consists of three parts. In the following section, the real aspects of the South Korean economy in the 1950s will be considered. In detail, the total imports, including the foreign aid which defined the characteristics of the industrial structure and reproductive structure after the Korean War, will be examined, followed by an analysis of the attempts to remedy the side effects resulting from the process. In the third section, the financial aspects will be examined. In particular, it will attempt to answer the following questions: What role did the status and management of the counterpart fund—raised through the sale of aid materials—play in the South Korean economy, and what were the negative effects. Lastly, the fourth section will summarize the arguments and highlight the significance of the analyses.

## **II. The Growth of the Processing Industry and the Responses of the Rhee Syngman Government**

The economic reconstruction of South Korea after the Korean War was fueled by the inflows of raw materials, intermediary goods, and capital goods through international trade. Therefore, this section will first examine the institutional aspect of the recovery process through international trade and identify the characteristics of the process. Afterwards, the specific goods imported in this period and their impact on the industrial structure will be analyzed. Lastly, the three year economic development plan designed in the latter half of the 1950s in an attempt to build a self-sustaining economy will be examined, along with its significance.

### **1. Recovery Through International Trade and Foreign Aid**

During the colonial period, the Korean economy had an average annual growth rate of 3.9 percent. This was possible due to an increase in trade dependency. In fact, the degree of trade dependency during this period grew rapidly from 23 percent in 1915 to 63 percent in 1935 (Kim Nak-nyeon ed. 2006:361-362). This demonstrates that international trade played an important role in the cycle of the national economy in terms of the market and productive resources like raw materials, intermediary goods, and capital goods. This general importance is why restoring international trade, which was destroyed after liberation and the

division of the Korean peninsula, was a priority in the reconstruction of the ruined economy.

In January 1946, the U.S. military government issued ordinance number 39—“Regulations of Foreign Trade”—to restore international trade. It stipulated the restoration of international trade under the tight control of the state. Such a policy continued even after the establishment of the South Korean government. According to the economic clause of the Founding Constitution (legislated on July 17, 1948), “international trade shall be under state control” (Article 87). The second constitutional amendment in November 1954, which revamped the economic clause, also maintained the policy of state-controlled international trade with a minor addition saying “according to law.”<sup>6</sup>

The state control of international trade was carried out through the trade business registration system (TBRS) and the license system for exports and imports based on the trade plans.<sup>7</sup> The TBRS required all traders involved in international trade to register their records of export and import transactions at the Ministry of Trade and Industry (Sanggongbu). The license system required all traders to seek approval from the state before any export or import transaction occurred. Such controls changed drastically in September 1955. With the abolition of the existing license system, all trades that conformed to the export and import plan announced by the Sanggongbu would be deemed approved, while exports were to be supervised by the customs office and imports by the Bank of Korea (BOK).<sup>8</sup> To support the new system, the trade management system was overhauled in 1955 from a positive list system of the export plan to a negative list system. The import plan still used the positive list system while the import quota system—by products, regions, and amounts—was abolished in 1955.<sup>9</sup>

<Table 2.1> shows the international trade of South Korea in the 1950s. Two distinctive characteristics appear when compared to that of the 1960s. First, stag-

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6. The fifth constitutional amendment in December 1962 also stipulates that “the state shall nurture international trade and regulate and coordinate it” (Article 11).

7. Sanggongbu gosi je 44 ho (Ministry of Trade and Industry Notice No. 44). ‘Daeomuyeokja deungnokje’ (International Traders Registration System). February 1, 1950.

8. Sanggongbu gosi je 224 ho (Ministry of Trade and Industry Notice No. 224). ‘Suchuripjeolcha gaejeongui geon’ (A Case Related to the Reform of the Procedures of Export/Import). September 3, 1955.

9. Sanggongbu gosi je 196 ho (Ministry of Trade and Industry Notice No. 196). ‘1954 nyeondo habangi minganmuyeokheogabangchim mit suchuripgyeheok’ (Private Trade License Guidelines and Export/Import Plan for the Latter Half of the 1954). December 28, 1954.

**Table 2.1** Trade Structure and Import Sources in the 1950s (Unit: U.S. \$1,000)

	Export		Import		Balance of Trade	Foreign Currency Gap	Balance of Invisible Trade	
	(a)	General (b)	Aid	Total (c)	(a-b)	(c-a)		Government Transaction
1952	27,733	53,630	160,535	214,165	-25,897	186,432	66,261	62,035
1953	39,585	153,630	191,806	345,436	-114,045	305,851	120,524	122,026
1954	24,246	93,926	149,401	243,327	-69,680	219,081	45,221	40,507
1955	17,966	108,628	232,787	341,415	-90,662	323,449	56,329	54,803
1956	24,595	66,166	319,897	386,063	-41,571	361,468	22,293	20,164
1957	22,202	68,148	374,026	442,174	-45,946	419,972	43,483	41,204
1958	16,451	67,190	310,975	378,165	-50,739	361,714	67,227	65,499
1959	19,162	80,966	210,743	291,709	-61,804	272,547	60,213	64,145
1960	31,832	97,168	231,947	329,115	-65,336	297,283	62,031	63,006

1. The amount of aid is calculated by subtracting technological aid and administration costs from total aid.

Source: KITA (1961); BOK (1962)

nation in exports is evident. Although exports in 1949 (before the Korean War) amount to 7 million dollars (KITA 1972:240-241) and reach 40 million dollars in 1953, the highest amount in the decade, the level fluctuates showing a cyclical pattern of ups and downs. As a result, exports in proportion to GNP remained low at 1 to 2 percent throughout the 1950s (NSO 1998:116). Compared to Taiwan, which went through a similar experience, the result of the 1950s is very low.<sup>10</sup> Another fact that supports the hypothesis is that imports far exceed exports. The import-export ratio (c/a) in 1952 was 7.7 and increased to 19.9 in 1957 and 10.3 in 1960. As a result, not only the balance of trade (a-b), but also the currency gap defined as the gap between imports and exports became far greater than the exports.

10. If the export amount in 1930 is set to 100, the export index in 1960 for Taiwan is 146 whereas for South Korea it is 37 (堀和生 1994:192-193). The Korean War played a critical role in such a difference. For the South Korean government, it was much more important to reconstruct the war damage than to focus on exporting. As a result, South Korea had no choice but to export primary industry goods only (Choi Sang-oh 2003:143-153).

How is this possible? Understanding how the trade deficit and the currency gap were maintained is at the core of revealing the characteristics of the South Korean economy in the 1950s. As <Table 2.1> indicates, the gaps are maintained by the balance of invisible trade and aid. Unlike the balance of trade with chronic deficit, the balance of invisible trade is always in surplus, an amount far exceeding the trade deficit in total. The reason for the surplus balance of invisible trade is the surplus the South Korean government made from transactions with the UN (U.S.) forces in Korea (called government transactions).<sup>11</sup> However, what is more important than the balance of invisible trade is foreign aid. Unlike loans which one has to pay back in the future, aid not only has no obligation for repayment but it also plays an important role in countering the huge currency gap, characteristic of the period. From the total funds for imports, aid made up 75 percent in 1952, 83 percent in 1956, and 71 percent in 1960. As such, the average proportion of aid was 73 percent throughout the 1950s and played a leading role in determining the range and contents of the economic reconstruction after the war. The reason that the South Korean economy in the 1950s was called an “aid-depending economy” is because of the fact that the reconstruction was financed mainly by foreign aid.

## 2. The Growth of the Consumer Goods Processing Industry

According to a survey by Gongbocheo (Ministry of Information), the damage incurred during the Korean War amounted to 410.59 billion hwan which was 85 percent of the GNP in 1953 (MOI 1953:212-229; BOK 1968:14). Although this survey underestimates the war damage by considering only the material assets like social overhead capital, houses, companies, etc., it is a starting point for estimating the degree of destruction caused by the war. The greatest amount of damage (43 percent) occurred in the area of social overhead capital such as roads, railroads, ports, telecommunications, and electric power. Next was residential housing, equalling 39 percent of the total damage. Lastly, the destruction of business establishments directly related to production made up 16 percent of the total damage, which was about half of the total industrial production facili-

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11. A prime example of the government transactions is the dollar currency which the South Korean government receives from the UN forces as payment to its Korean currency loan given to the UN forces stationed in Korea. Other examples include the UN forces' foreign procurement and public facilities fees. For a detailed discussion, see Choi Sang-oh (2000).

ties before the war (KDB 1955:996-997).

The question of what direction the South Korean economy would take after the Korean War is closely related to the kinds of goods it would import. Not all businesses depend on imported goods, including foreign aid. In 1960, 95 percent of the total businesses were companies with 5 employees to 49 employees. These companies managed to buy raw materials, intermediary goods, and capital goods and sell their products all in the domestic market. Nevertheless, the value added produced by these companies was only 47 percent of the total, far from leading the economic reconstruction (Lee Gyeong-ui 1987:328). In this sense, it could be said that the companies and types of industries that participated in international trade—buying imported goods and rapidly expanding their productivity—were able to lead the economic growth in the 1950s.

<Table 2.2> illustrates the various kinds of goods imported in the 1950s. Originally, total imports were estimated by adding the total amount of aid to general imports. However, this presented a problem in that the existing data did not consider the details of project aid by product, but only by project base such as education and health. In addition, project aid is used in most public enterprises like agriculture and natural resources development, restoration of electric power, road, railroad, and seaport facilities.<sup>12</sup> Therefore, the total import amount used in <Table 2.2> was calculated by adding general imports to non-project aid after evaluating that there would be no problem in considering only the non-project aid to examine the impact imports had on the growth of private businesses. Nevertheless, it is important to note that aid is a substantial portion (72 percent) of the total import amount of that period.

<Table 2.2> indicates twenty major import items in the 1950s and their amounts. As shown in the table, they make up 85 percent of total imports. The first characteristic found in the table is that there is a high demand for reconstruction and construction of industrial establishments which were destroyed during the Korean War. This is evident from the fact that the import of fuels, raw materials, intermediary goods, and capital goods greatly exceeds the import of final goods. Final consumer goods in <Table 2.2> consists of food, textile goods,

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12. In the case of economic aid in 1957, the amount of project aid totalled 109 million dollars. Among this, the fund allocated to the development of agriculture and natural resources, reconstruction of social overhead capital, and state projects like building fertilizer plants was 91 million dollars. The remaining 18 million dollars was invested in the reconstruction of private businesses (MOF 1959:71-98).



**Table 2.2** Change of Total Import by Product and Source

(Unit: U.S. \$1,000, %)

		1953	1955	1957	1958	1960	1953-60 Total
Total Import	Aid	191,806	232,787	374,026	310,975	231,947	2,021,582
	Project Aid	7,962	110,385	105,161	69,119	50,530	519,623
	Non-project Aid (a)	183,844	122,402	268,865	241,856	181,417	1,501,959
	General Imports (b)	161,351	81,027	38,979	44,841	84,898	593,275
	Total Imports (c=a+b)	345,195	203,429	307,844	286,697	266,315	2,095,234
Food	Rice, Amount (d)	123,269	35.7	2,692	1.3	49,001	15.9
	Barley d/c	19,502	6.8	574	0.2	221,286	10.6
	Flour Amount	19,651	1,444	660	46	-	24,192
	Subtotal General	71,299	1,444	4,350	615	-	80,099
	Aid	71,621	2,692	45,311	18,933	574	165,379
	Total (e)	142,920	4,136	49,661	19,548	574	245,478
	e/c	41.4	2.0	16.1	6.8	0.2	11.7
Raw Material als	Wheat Amount (f)	7,199	3,982	24,329	33,886	19,807	126,465
	f/c	2.1	2.0	7.9	11.8	7.4	6.0
	Cotton Amount (g)	9,120	22,039	28,232	31,263	29,622	193,008
	g/c	2.6	10.8	9.2	10.9	11.1	9.2
	Rubber Amount	3,214	3,686	3,708	4,303	7,153	37,350
	Raw Sugar Amount	-	4,165	9,685	6,026	6,036	39,554
	Wool Amount	16	290	65	776	7,535	14,985
	Molasses Amount	851	1,339	2,519	3,067	2,057	14,564
	Subtotal General	4,550	5,735	4,048	6,651	18,456	61,277
	Aid	15,850	29,766	64,490	72,670	53,754	364,649
Total (h)	20,400	35,501	68,538	79,321	72,210	425,926	
	h/c	5.9	17.5	22.3	27.7	27.1	20.3
Fuels	Oil Amount (i)	11,045	7,215	20,357	24,667	22,005	137,139
	i/c	3.2	3.5	6.6	8.6	8.3	6.5
	Coal Amount	1,780	3,211	2,900	10,569	2,138	25,906
	Subtotal Aids (j)	12,825	10,426	23,257	35,236	24,143	163,045
	j/c	3.7	5.1	7.6	12.3	9.1	7.8
Intern ediary Goods	Combed Yarn Amount	5,373	10,066	10,585	9,416	2,566	60,606
	Rayon Yarn Amount (k)	9,474	9,058	13,580	13,630	10,127	93,421
	k/c	2.7	4.5	4.4	4.8	3.8	4.5
	Other Yarns Amount	5,467	9,156	2,197	4,380	8,768	42,092
	Paper Amount	5,832	10,608	8,805	11,683	5,816	68,973
	Fertilizer Amount (l)	38,809	49,675	57,346	48,357	45,081	378,721
	l/c	11.2	24.4	18.6	16.9	16.9	18.1
	Steel Amount	4,971	3,445	5,975	4,940	7,580	39,856
	Lumber Amount	6,391	5,530	4,359	4,044	7,769	40,415
	Subtotal General	34,524	41,916	10,946	14,708	25,626	188,045
	Aid	41,793	55,622	91,901	81,742	62,081	536,039
Total (m)	71,317	97,538	102,847	96,450	87,707	724,084	
	m/c	22.1	47.9	33.4	33.6	32.9	34.6
Textiles Amount	18,552	5,532	1,628	409	172	35,402	

**Table 2.2** Continued

		1953	1955	1957	1958	1960	1953-60 Total
Final	Medicines Amount	4,227	5,567	6,028	6,986	4,894	44,466
Goods	Machinery Amount (n)	19,645	15,137	14,152	18,332	23,853	141,987
	n/c	5.7	7.4	4.6	6.4	9.0	6.8
	Subtotal General	22,934	15,298	9,286	9,450	13,619	115,880
	Aid	19,490	10,938	12,670	16,277	15,300	105,975
	Total (o)	42,424	27,922	21,808	25,727	28,919	221,855
	o/c	12.3	12.9	7.1	9.0	10.9	10.6

1. The amount of aid is calculated by subtracting technological aid and administration costs from total aid.
2. The reason for the different figures for general imports in <Table 2.2> and <Table 2.1> is because <Table 2.2> excludes miscellaneous products when calculating the figures by product.
3. Other yarns include cotton yarn, nylon yarn, and spun yarn while textiles include cotton fabrics, nylon fabrics, and clothing.
4. Products that fall under paper and machinery were totalled as one without distinction.

Source: KITA (1954:X 2-14; 1955:XI 3-15; 1956-1957: (Statistics) 8-19; 1959: (Statistics) 18-28; 1961: (Statistics) 59-68); BOK (1955:176-177; 1957:224-225; 1959:218-221; 1962 230-231).

and medicines included in final goods. This total makes up 16 percent of the total imports. In particular, food imports in 1953 and 1957, a large portion of consumer goods, are higher than usual due to the food shortages caused by poor harvests in the previous years. Accordingly, it would be safe to expect that in normal circumstances the proportion of imports on final consumer goods would be very low on one hand, and the proportion of imports on intermediary goods and capital goods would be very high on the other. Such figures would show that the South Korean economy aimed to increase the supply through the reconstruction and expansion of the domestic production establishment, instead of meeting household demand through imports.

The second characteristic is that despite the strong final demand by households and businesses, the import substitution industrialization in this period concentrated on the consumer goods industry which mainly aimed to meet the final demand of households. As shown in <Table 2.2> raw materials (20 percent of the total imports) consist of food ingredients such as wheat, raw sugar and molasses, and textile materials such as wool and cotton. In particular, cotton, a raw material for the cotton mill industry, is the third largest import (9.2 percent) following fertilizer, rice and barley. As for the import of intermediary goods, most items are related to the consumer goods industry like rayon yarn and

combed yarn. They make up 9.4 percent of total imports. Aside from importing raw materials and intermediary goods related to the consumer goods industry, the import of machineries also shows that South Korea intended to develop its economy centered on the consumer goods industry.<sup>13</sup> 7 percent of the total imports is in machineries, and 24 percent of the total machineries consists of spinning machineries and parts. In the case of aid, construction materials needed for the reconstruction of industries were imported through the project aid. In 1957, among the funds invested for the reconstruction of private businesses, 326 million dollars (18 percent) was allocated to the textile industry (MOF 1959:71-98).

More importantly, these import characteristics are directly reflected in the industrial structure. The major share of textile and food industries in value add within the manufacturing industry is self evident as it amounts to 62 percent in 1953, 66 percent in 1957, and 59 percent in 1960. The percentage of the consumer goods industry including these two industries is 83 percent in 1953, 83 percent in 1957, and 80 percent in 1960 (BOK 1968:82-85). While Cole and Lyman (1971:158) describe the industrial structure of the South Korean economy in the 1950s to be a consumer goods industry dependent on aid, the economic reconstruction by the aid fund eventually resulted in the growth of the consumer goods processing industry only.

### 3. Crisis of Accumulation Structure and the Government's Response

The South Korean economy, centered on the processing industry dependent on aid (imports), faced a crisis as it headed into the latter half of the 1950s. Most importantly, the U.S. aid policy changed toward the reduction of grant-in aid and increases in loans. As a result, aid to South Korea, which was the major source of imports, declined. As shown in <Table 2.1>, aid reached its peak in 1957 with 374 million dollars and began to decline to 232 million dollars in 1960. As the industrial structure was centered on the processing industry, the situation would

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13. South Korea's economic reconstruction centering on the consumer goods industry was largely due to foreign economic policy by the U.S., the aid grantor, rather than the intensions of the Rhee government. Contrary to the Rhee government's goal of economic reconstruction, the foreign economic policy of the Eisenhower administration emphasized military first economic stability more than economic development. As a result, mainly raw materials and capital goods were sent to South Korea for the reconstruction of the consumer goods industry (李鍾元 1996).

lead to a recession in the manufacturing industry and a decline in the economic growth rate unless new sources of imports were found. The economic growth rate which was 6 percent in 1954 increased to 8.8 percent in 1957, however it reversed its course and declined to 5.5 percent in 1958 and 2.3 percent in 1960 (BOK 1968:16-17).

Such a downturn in the economic growth rate arises from a crisis of accumulation in the structure of an aid-dependent economy. Therefore, to remedy this problem, it is natural that the South Korean government decided to become self-sufficient, or attempt to change the existing policies and institutions to create a self-sustaining economy. The three year plan drafted in 1958 is a prime example of such efforts. A self-sustaining economy with an aim to reach a certain standard of living can be realized only when the economy is capable of supplying foreign currency to pay for the imports needed for domestic production and consumption on its own. In other words, a self-sustaining economy is determined by how the foreign exchange gap, defined by the difference between exports and imports, is managed. In the 1950s when South Korea had a processing industry centered industrial structure, the solution was to increase exports and carry out import substitution industrialization to minimize the spending of foreign currency.

<Table 2.3> shows the major figures of the three year plan. First, considering the past GNP trend, the plan set a 5.2 percent economic growth rate. To achieve this target, it planned for rapid growth centered on the manufacturing (secondary) industry. A total of 63.93 billion hwan was assigned to the investment fund for the three years, allocated mostly to the tertiary industry (51 percent) which required the largest investment. However, the secondary industry grew the fastest. Looking at the manufacturing industry, the industries that received the most investment from the Rhee government were cement, fertilizer, steel, soda ash, and pulp (MOR 1959:52-59). Despite high domestic demand, the levels of production in these industries were terribly low, creating high demand for imports. In the case of fertilizer, the expected domestic consumption was 980,000 tons or 65.3 million dollars in 1957. However, the expected domestic production in the same year was only 20,000 tons or 900,000 dollars. What this means is that the government planned to import the difference of 64.4 million dollars (MOR 1955:77-78). Accordingly, the industries that the Rhee government invested heavily in during this period were import substitution industries. The reason for this was to reduce the spending of foreign currency to improve the international balance of payments. A decrease in imports during the three

**Table 2.3** Major Contents of the Three Year Plan

(Unit: billion hwan)

	Basic Year (1958)	1960	1961	Target Year	Average Annual Growth Rate (%)
GNP	1,099.6	1,213.9	1,278.2	1,348.5	5.2
Primary Industry	445.6	480.1	498.3	517.0	3.8
Secondary Industry	196.6	242.9	269.9	300.6	11.2
Tertiary Industry	457.4	490.9	510.0	530.9	3.8
Gross Domestic Capital Formation	148.0	184.6	212.1	242.6	13.2 (100)
Primary Industry	29.9	33.1	38.1	43.1	9.6 (18)
Secondary Industry	35.7	52.4	65.8	78.0	21.6 (31)
Tertiary Industry	82.4	99.1	108.2	121.5	10.2 (51)
Export (U.S. \$1,000)	16,666	37,690	53,920	63,590	39.8
Import (U.S. \$1,000)	376,892	344,848	343,318	345,521	-2.1
KFX	47,412	72,430	78,545	88,000	16.7
Aid	329,480	262,918	238,433	217,311	-9.9
DLF, Private Capitals	-	9,500	26,340	40,210	105.7

1. GNP and Gross Domestic Capital Formation are based on the 1955 constant price.

2. Secondary Industry includes mining, manufacturing, and construction.

3. The figures for Gross Domestic Capital Formation in parentheses indicate the proportion of each industry

Source: MOR (1960:418-419, 606-607, 618-619).

years (see <Table 2.3>) is expected on account of the decreased demand for imports resulting from import substitution industrialization. On the other hand, setting the annual export growth rate during the three year plan to 40 percent reflects the government's desire to raise its foreign currency to the level of import demand needed for economic growth. For the Rhee government—seeking economic growth with low development in the producer goods industry—the aim for a self-sustaining economy rested on being able to raise funds to maintain the high demand for imports. As shown in <Table 2.3>, the rapid growth of exports was not enough to maintain the import demand and South Korea was forced to depend on foreign resources including aid. Nevertheless, what is significant about the three year plan is that it reflected the change of U.S. aid policy; expecting it to decrease, and actively introducing Development Loan

Fund (DLF) and foreign direct investment (private capitals).

In the end, the three year plan was never implemented. It is true that the Rhee government did not have as strong a will to carry out the plan compared to the Park government. Nevertheless, it shows a continuation of the South Korean economy with its structural problems and the government's strategy to overcome those problems. The problems facing the South Korean economy and the remedies were already prepared in the latter half of the 1950s. What is important is that all it needed was the coming of a strong leadership that could carry out the remedies.

### **III. Creation of Counterpart Fund, Treasury Loans and Investment**

Foreign aid that alleviates the growing foreign currency gap also contributes greatly to the reduction of the disparity between the domestic investment fund and savings; the internal supply of capital. In this section, the creation of a counterpart fund to relieve the savings gap will be examined followed by an analysis of what role and how important the counterpart fund played in the finance of the South Korean government. Lastly, the treasury loans and investment, with the counterpart fund as its major fund, will be discussed.

#### **1. Creation of a Counterpart Fund and the Exchange Rate Problem**

The counterpart fund denotes the amount of U.S. currency aid converted by an exchange rate agreed by the South Korean and U.S. governments. Such a funding mechanism was based on the agreement on aid between South Korea and the U.S., signed in December 1948. According to the aid agreement, when the South Korean government receives aid in U.S. currency, it will report to the Bank of Korea which will then deposit the amount, denominated in local currency using an exchange rate agreed upon by the U.S. and South Korea, within a special account.<sup>14</sup> As such, the size and management of the counterpart fund, which are required conditions for aid supply, were the central issues within the Korean and U.S. governments. Let us look at the accumulation of the counterpart fund.

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14. "The Aid Agreement between the Republic of Korea and the US." Article 5.2. December 10, 1948.

Logically, there are two factors that determine the size of the counterpart fund. One is the exchange rate applied when converting the U.S. currency aid to South Korean currency. The other is the actual size of the aid fund. In other words, the size of the counterpart fund will change as the exchange rate fluctuates, while the actual amount of aid remains fixed. On the other hand, the amount of aid will determine the size of the counterpart fund when the exchange rate remains constant. Therefore, the amount of aid decided by the foreign policy of the U.S. government and the exchange rate policy of the Rhee Syngman government became the central issues.

The South Korean government, with a negative view on changing the exchange rate, demanded an increase in the amount of aid given, whereas the U.S. government, who was reluctant to increase the amount of aid, sought to change the exchange rate to meet the target. Such conflict of interests was usually expressed through tensions during the South Korea-U.S. economic meetings. For example, when the U.S. delegation, led by H. Tasca, visited South Korea in April 1953 and when President Rhee visited the U.S. in July 1954, the position of South Korea, which demanded an increase in the amount of aid, collided with the position of the U.S., arguing for an increase in the exchange rate. This same confrontation was repeated in the South Korea-U.S. economic meeting in 1955 (Choi Sang-oh 2000).<sup>15</sup> After the counterpart fund exchange rate was set to 500 hwan per dollar in August 15, 1955, the exchange rate adjustment was linked to the domestic wholesale price index. As a result, tension between the two countries surrounding the exchange rate adjustment was greatly reduced.

**Table 3.1** Change of the Counterpart Fund Exchange Rate in the 1950s  
(Unit: hwan per dollar)

	1951.5.1	1953.12.15	1955.1.10	1955.8.15	1960.1.20	1961.1.1
Counterpart Fund	60	180	350	500	650	1,000
Green Back	87	390	730	810	1,317	1,300

1. In the case of the Green Back exchange rates, all figures are a monthly average with the exception of January 10 and August 15, 1955. The figure for January 1, 1961 is the average exchange rate for December 1960.

Source: KITA (1954:X-40; 1956-1957: (Statistics) 99; 1958: (Statistics) 145; 1959: (Statistics) 63; 1961: (Statistics) 89).

15. For a detailed discussion, see Choi Sang-oh (2000: Chap. 3.2.2 and 3.4.1).

**Table 3.2** Revenue and Expenditure Structure of the General Public Account (Settled Amount)

(Unit: million hwan, %)

	1950	1953	1954	1955	1957	1958	1959	1960	1961
Taxes	430	20,960	51,990	110,540	117,360	146,590	220,860	249,710	231,990
Tobacco and Other Taxes	160	4,000	5,850	10,000	16,200	21,210	22,700	23,000	26,450
Other Special Account Income	190	4,020	2,230	960	130	-	-	-	21,340
Miscellaneous Income	50	2,650	4,950	18,460	12,010	14,710	9,240	24,300	50,340
Subtotal (a)	830	31,630	65,020	139,960	145,700	182,510	252,800	297,010	330,120
Government Bond	-	2,030	3,340	13,680	15,230	18,000	5,000	10,000	7,000
Government Bond for Industry Rehabilitation	-	5,000	12,940	19,610	29,640	8,490	2,100	1,910	29,840
Borrowing	1,530	20,200	23,200	-	9,500	22,300	6,400	8,010	6,000
Subtotal (b)	2,360	58,860	104,500	173,250	200,070	231,300	266,300	316,930	372,960
Foreign Aid (c)	130	7,960	44,700	150,540	224,510	245,800	189,100	167,630	240,580
Total (d)	2,490	66,820	149,200	323,790	424,580	477,100	455,400	484,560	613,540
Defense	1,320	32,610	59,920	106,380	112,460	127,320	139,190	147,070	165,990
Police	400	5,690	13,100	21,910	20,180	23,720	28,470	29,170	37,650
Subtotal (e)	1,720	38,300	73,020	128,290	132,640	151,040	167,660	176,240	203,640
Economic Reconstruction Cost	190	-	27,720	58,960	120,260	147,550	103,600	93,600	183,500
Others	520	22,390	41,300	94,190	97,130	112,380	128,960	150,110	184,390
Current Expenditure (f)	2,240	60,690	114,320	222,480	229,770	263,420	296,620	326,350	388,030
Total (g)	2,430	60,690	142,040	281,440	350,030	410,970	400,220	419,950	571,530
a/f	37.1	52.1	56.9	62.9	63.4	69.3	85.2	91.0	85.1
b/g	97.1	97.0	73.6	61.6	57.2	56.3	66.5	75.5	65.3
e/g	70.8	63.1	51.4	45.6	37.9	36.8	41.9	42.0	35.6
c/d	5.2	11.9	30.0	46.5	52.9	51.5	41.5	34.6	39.2

1. - denotes 'Not Applicable'.

2. The fiscal year for 1954 is from April 1, 1954 to June 30, 1955. The fiscal year for 1955 is from July 1, 1955 to December 31, 1956. There is no data for 1956.

Source: Hangukjaejeong 40 nyeonsa pyeonchanwiwonhoe (1991b:63-65); Kim Myeong-yun (1967:89-95).



<Table 3.1> shows the exchange rates used for the counterpart fund. Counting an increase to 40 hwan per dollar in December 12, 1950, the counterpart fund exchange rate increased a total of five times until 1960. It remained fixed for a period of time until it suddenly jumped. Such a pattern reflects the process of negotiation at the economic meetings as the South Korean government sought to fix the exchange rate whereas the U.S. wanted an increase in the exchange rate. Although some scholars (Cole and Lyman 1971:168-172) interpret the exchange rate policy of the Rhee government as an aid-maximizing policy, it is inadequate considering the fact that it is U.S. foreign policy and economic conditions that basically determined the decision-making process of the aid, and not the exchange rate policy of the South Korean government.<sup>16</sup>

The tension between the South Korean and U.S. governments around the size of the counterpart fund was closely related to the financial status of the South Korean government and the question of how the counterpart fund would be used. For this, a detailed examination of the question is required.

## 2. General Public Account Revenue-Expenditure Structure and the Counterpart Fund

The Korean War was a shock to the Rhee government which wanted to stabilize the economy and earnestly carry out economic development based on ECA aid. As discussed, the impacts of the war were evident from the fact that the money supply increased greatly as the government needed to raise war funds and social overhead capital, and industrial establishments were greatly damaged. Moreover, the Korean War became an opportunity for the South Korean government to find legitimacy in building a strong military that would be able to deter another aggression from North Korea (Cole and Lyman 1971:164). This translated into an expansion of government expenditures. Accordingly, the two goals of the post-war reconstruction and the need to maintain strong military power not only increased in the demand for treasury funds but also limited room for

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16. Recently, the low exchange rate policy of the Rhee government has become a controversial issue in related studies. Although there exists a consensus on the point that the post-war reconstruction, in other words, import substitution industrialization, carried out by the Rhee government produced positive results, there exist some disagreement among scholars about the close relationship between the import substitution industrialization policy and the South Korean economy in the 1950s (Choi Sang-oh 2000, 2003; Kim Nak-nyeon 2004; Lee Sang-cheol 2004).

maneuver in the 1950s.

<Table 3.2> shows the general public account's<sup>17</sup> revenue and expenditure structure in the 1950s, comprised of four features. First, the current expenditure greatly exceeded the current revenue, creating a chronic budget deficit. Normally, the current expenditure is calculated by adding all the expenditures with the exception of the economic reconstruction expense which is more of a capital expenditure. However, in the 1950s, the current expenditure could not be balanced with the current revenue (the subtotal (a) in the Revenue section of <Table 3.2>). The ratio of current revenue to current expenditure (a/f) was 37 percent in 1950. It increased with time after the war, rising to 52 percent in 1953, 63 percent in 1955, and 85 percent in 1958. Nevertheless, the increase was not enough to relieve the budget deficit. In other words, based on the current revenue, the budget of the South Korean government was in poor shape as it could not fund the current expenditure, let alone the capital expenditure.

Second, even with the inclusion of government bonds, government bonds for industry rehabilitation, and borrowings to the current revenue, the amount was not enough to meet the total expenditure. The subtotal (b) of the Revenue section in <Table 3.2> shows government revenue calculated by adding the current revenue and borrowings fund. This amount grew rapidly, led by the borrowings fund before 1955 and current revenue after 1955. However, there still existed a huge deficit based on the total expenditures, including the capital expenditure (economic reconstruction expense). The proportion of the domestic fund (current revenue + borrowings fund) to the total expenditure (b/g) was very high in 1950 and 1953 at 97 percent. However, with the strong economic reconstruction underway after the war, the proportion decreased to 62 percent in 1955, 67 percent in 1959, and 65 percent in 1961. This goes to show that the domestic fund was not enough for the total expenditure spent by the government.

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17. Since the central government created special accounts even for normal financial activities in the 1950s, it would be difficult to understand the entire financial activities of the central government with the general account only. Therefore, this paper considers the following special accounts as part of the general public account when examining the financial activities of the central government: the counterpart fund special account, government bond special account (integrated into the general account in 1958), government bond for industry rehabilitation special account (integrated into the general account in 1958), military spending special account (integrated into the general account in 1958), and economic reconstruction special account (Hong Seong-yu 1965:22; Kim Myeong-yun 1967:117; Compilation Committee for the 40 Year History of South Korean Finance 1991a:232-233).

Third, the Rhee government's policy to maintain strong military power is the most important factor in the increase in the budget expenditure. As shown by <Table 3.2>, the proportion of military expenses, which includes the defense expense and the expense for maintaining police and other law enforcement agencies (e/g), were considerably high in the time of war, representing 71 percent in 1950 and 63 percent in 1953, while after the war the proportions remained high at 46 percent in 1955 and 42 percent in 1959. One of the reasons for the percentages remaining at a high level even after the war is that the number of soldiers, which increased drastically during the war, kept increasing even after the war. The number of soldiers in the South Korean Army at the time of ceasefire was 570,000. This number increased to 720,000 in 1957 with the Army Expansion Plan implemented after the war. The number declined slowly but remained constant at around 600,000 after 1961 (Kim Myeong-yun 1967:132-133).<sup>18</sup> As such, the annual budget had to accommodate for such a large number of soldiers, which limited not only the current expenditure but also the capital expenditure, thus becoming the major factor in the budget deficit.<sup>19</sup>

Fourth, in order to cover the expenses for post-war reconstruction and military spending, the South Korean government required foreign funds in addition to the domestic fund. In <Table 3.2> the figures for foreign aid imply a counterpart fund. As shown in the table, the percentage of the counterpart fund in the total revenue (c/d) remained low at 12 percent in 1953. However, it increased rapidly with the introduction of reconstruction aid to 53 percent in 1957 and 35 percent in 1960. In other words, the budget of the South Korean government in the 1950s depended heavily on the counterpart fund which took up 43 percent of the revenue on average.

In summary, the Rhee government maintained substantial military spending in order to support the large military at time of semi-war, and this led the government to increase the current expenditure to an amount reaching a budget

18. The number of soldiers at the founding of the Republic of Korea in August 1948 was 50,000. It increased to 100,000 at the outbreak of the Korean War and continued to rise to 250,000 in 1952 (李鍾元 1996: 75).

19. The military spending shown in <Table 3.2> excludes the military power augmentation spending (ammunition and other equipments) and other maintenance expenses such as subsidiary and uniform expenses given by the U.S. as part of military aid (BOK 1957:I-21; Cole and Lyman 1971:173). There is also a report showing that the military spending by the Republic of Korea amounts to 40 percent of the total military spending of the Korean Army (MOF 1967:50).

deficit. Of course, the budget deficit was substantially covered by the borrowings fund. Nevertheless, it could not cover the entire expenditure, including the economic reconstruction expense. In the end, the two goals of the Rhee government—post-war reconstruction and strong military power—were achieved through the creation of a counterpart fund raised by selling aid materials.

### 3. Management of the Counterpart Fund and the Treasury Loans and Investments

Although it was before the Korean War when the problem of managing the counterpart fund was raised,<sup>20</sup> earnest discussions on the issue began after the introduction of the massive U.S. aid provided for war reconstruction. Large amounts of aid came from the U.S. even during the war. However, it was mostly relief aid and contributed little to the counterpart fund.<sup>21</sup> The aid that was received after the war was sold to the public, creating the counterpart fund, and thus raised the problem of management. In December 1953, the problem became official when an agreement on the Combined Economic Board for the Economic Reconstruction and the Fiscal Stabilization Plan was signed. The agreement stipulated that the counterpart fund should be used for the expenses of the aid agencies in South Korea, to meet the legitimate demand for allocated investment for reconstruction, for the special accounting for defense, and for others as agreed to by the Combined Economic Board.<sup>22</sup> In response to such changes, the South Korean government passed the Counterpart Fund Special Account Act (Act No. 311) in March 1954 and began to systematically manage the counterpart fund.

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20. The first agreement between South Korea and the U.S., just before the Korean war, on the usage of the counterpart fund prescribed the use of the fund for the supplementary budget. However, the plan was never implemented and the counterpart fund continued to accumulate. In May 1952, when the economic coordination agreement was signed, the entire amount of the counterpart fund accumulated under the ECA aid was used to pay for the government's debt (KDB 1964a:2-3).

21. Baek Du-jin, then minister of finance, testified at a National Assembly session about the aid received during the Korean War of which 80 percent was distributed freely and 20 percent was sold (Minutes of the General Session of the National Assembly 2-15-37. March 20, 1953).

22. The Agreement on the Combined Economic Board Article 8. This agreement required the South Korean government to apply 180 hwan per dollar exchange rate to the counterpart fund for the aid materials that arrived after August 28, 1953.

The above table shows the expenditure structure of the counterpart fund deposited in the Counterpart Fund Special Account. Having rapidly increased with the growth of aid until 1959, the counterpart fund began to decrease and was mainly used for three areas, excluding the agreement related expense and foreign supply special account.<sup>23</sup> First, a portion of the counterpart fund was transferred to the defense fund of the general public account to pay for the military expense. This took up 35 percent of the total expenditure (a/d). Second, the

**Table 3.3** Expenditure Structure of the Counterpart Fund Special Account  
(Unit: million hwan, %)

	1953	1954	1955	1957	1958	1959	1960	TOTAL
Transfer to	1,666	12,729	51,200	48,330	48,300	53,000	42,535	257,760
Defense (a)								
Economic	-	11,058	48,394	84,469	82,831	57,926	48,484	333,162
Reconstruction (b)								
Special Account		8,057	43,406	82,441	80,108	55,652	46,040	315,704
Handling Cost		677	2,698	2,028	2,723	2,274	2,444	12,844
Others		2,324	2,290	-	-	-	-	4,614
Private Loans (c)	-	6,619	11,994	18,102	51,423	31,112	16,538	135,788
Private Loans		6,619	11,994	12,457	28,784	29,967	15,238	105,059
Others		-	-	5,645	22,639	1,145	1,300	30,729
Others	-	2,829	4,320	2,498	3,013	3,173	3,622	19,455
Agreement Expense		530	2,619	819	1,429	1,830	2,101	9,328
Foreign Supply		902	1,701	1,524	1,584	1,343	1,521	8,575
Special Account								
Others		1,397	-	155	-	-	-	1,552
Total (d)	1,666	33,235	115,908	153,399	185,567	145,211	111,179	746,165
a/d	100.0	38.3	44.2	31.5	26.0	36.5	38.3	34.5
b/d	-	33.3	41.8	55.1	44.6	39.9	43.6	44.6
c/d	-	19.9	10.3	11.8	27.7	21.4	14.9	18.2

1. Net based expenditure (settled account).

Source: MOF (1967); BOK (1956:IV 163-163; 1858:III 119-120; 1959:III 130-131; 1961:124-125; 1962:128-129).

23. The foreign supply special account is set up for imported goods for the government, with the exception to aid materials and grains.

counterpart fund was used to fund the economic reconstructions and private loans, including the treasury loans and investments (c/d). The expenditure for economic reconstruction is subdivided into the economic reconstruction special account, handling costs, and others (transportation special account and telecommunication special account) while the private loans expenditure consisted of the private loans given out by the Korea Development Bank and the Agriculture Bank. Taking up 45 percent of the total expenditure, the former is used as treasury investment (b/d) while the latter is used as treasury loans (18 percent), thus, the treasury loans and investments covered 63 percent of the total counterpart fund expenditure. As such, the counterpart fund was mainly used on treasury loans and investments for economic reconstruction after the war.

<Table 3.4> shows the funding sources of treasury loans and investments. Although the treasury loans and investment fund is raised from various sources, the counterpart fund is the most important source. The percentage of the counterpart fund in treasury investments is 77 percent on average and 56 percent in treasury loans. The second important source of treasury investments is general

**Table 3.4** Composition of Treasury Loans and Investment Funds by Source  
(Unit: million hwan, %)

	Treasury Investment					Treasury Loans				Treasury Loans and Investments	
	Counter part Fund (a)	General Account	Others	Total (b)	a/b	Counter part Fund (c)	Government Bond for Industry Rehabilitation	Others	Total (d)		c/d
1953	-	4,560	1,370	5,930	-	-	5,000	-	5,000	-	10,930
1954	8,260	7,300	2,480	18,040	45.8	8,950	12,560	-	21,510	41.6	39,550
1955	40,360	8,850	1,680	50,890	79.3	14,290	18,600	-	32,890	43.4	83,780
1957	86,270	7,140	3,260	96,670	89.2	18,100	25,510	8,200	51,810	34.9	148,480
1958	71,200	14,790	-	85,990	82.8	49,060	-	9,100	58,160	84.4	144,150
1959	57,720	15,780	-	73,500	78.5	33,630	-	15,560	49,190	68.4	122,690
1960	46,640	25,500	-	72,140	64.7	16,100	-	13,390	31,690	50.8	103,830

1. Investments for public corporations directly run by the government like tobacco, transportation, and telecommunication were excluded.

2. The others include Agricultural Land Reform Special Account, Vested Property Settlement Special Account, and Grain Management Special Account.

Source: KDB (1964a:14-15).

account current revenue, whereas for treasury loans it is government bonds for industry rehabilitation. As shown in <Table 3.4>, the treasury loans and investments which grew rapidly with the full introduction of aid, began to decline in 1957 with the implementation of the Fiscal Stabilization Plan and the reduction of aid. Nevertheless, its role in the national economy did not diminish. From 1953 to 1960, the treasury loans and investment fund made up 32 percent of the general public account revenue and 63 percent of the gross domestic fixed capital formation (Kim Myeong-yun 1967:174).

Treasury investment and treasury loans differ greatly according to their management policies and where the funds are allocated. First of all, the treasury investment fund (62 percent of the total) was spent on reconstruction projects carried out by various government agencies. In detail, the funds were mainly allocated to the reconstruction of social overhead capital such as agrarian improvement and rebuilding roads, railroads, telecommunications, seaports, urban infrastructure, governmental facilities, schools, and housings (BOK 1959:III 123-125; KDB 1964a:19). On the other hand, the treasury loans (38 percent of the total) were given to financial institutions which in turn were loaned to private businesses. The major financial institutions were KDB and Agriculture Bank (formerly Geumyungjohapyeonhaphoe; National Financial Cooperative Federation). The proportion of treasury loans distributed to financial institutions in the total fund for loans held by financial institutions was 48

**Table 3.5** Performance of Treasury Loans by Expenditure

(Unit: million hwan, %)

	General Industry Fund (a)	Irrigated Agriculture Fund (b)	Small and Medium Businesses Fund	Housing Fund	Total (c)	a/c	b/c
1953	5,000	-	-	-	5,000	100.0	-
1954	16,950	4,560	-	-	21,510	78.8	21.2
1955	20,290	11,600	-	1,000	32,890	61.7	35.3
1957	26,240	16,440	6,000	3,130	51,810	50.6	31.7
1958	31,920	22,040	500	3,700	58,160	54.9	37.9
1959	24,530	17,500	480	6,680	49,190	49.9	35.6
1960	14,800	12,270	1,220	2,100	31,690	46.7	38.7

1. The total of 1960 includes a 1.3 billion hwan export promotion fund.

Source: MOF (1967: 119).

percent. Among this, KDB had 70 percent, Agriculture Bank 25 percent and others had 5 percent (KDB 1964a:23). The reason that the Agriculture Bank received a larger fund compared to other banks is because it was established as an exclusive financial institution for irrigated agriculture loans. Be that as it may, there is no question that KDB was central to the management of treasury loans.

As shown in <Table 3.5>, treasury loans were mostly divided into general industry funds and irrigated agriculture funds. The proportion of these two funds in the treasury loans was 100 percent in 1953, 82 percent in 1957, and 85 percent in 1960. Obviously, a detailed analysis of the KDB's loans performance report is necessary to determine which fund is related to which industry. Examining the loans of KDB by industry from 1954 to 1960, shows that loans were distributed to the following sectors: manufacturing (52 percent), agriculture and fishery (16 percent), construction (11 percent), and electric, gas, and water (9 percent). Looking at the manufacturing sector by specialty, it includes the chemical industry (14 percent of the total loans), textiles (10 percent), ceramics (6 percent), metal (5 percent), and food products at 5 percent (KDB 1964b:590-593).<sup>24</sup> Such an order in the proportions of the loans matches the priority given by the South Korean government in the post-war reconstruction process, such as rebuilding of fertilizer plants, spinning mills, cement plants, panel glass plants, and a blast furnace at the Samhwa Steel Plant and construction of smelting facilities at the Janghang Smelter Plant.

In summary, the counterpart fund created by the sale of aid material was mostly used to fund the military expense and treasury loans and investments. In the 1950s, the allocation of funds to the treasury loans and investments is particularly important. If treasury investment focused on improving social welfare and restoring social overhead capital that supports production activities of private businesses, then treasury loans were used to improve irrigated facilities construction of power facilities, and reconstruction and promotion of private businesses according to the reconstruction plan designed by the government. Despite the positive roles of treasury loans and investments, their limitation was the fact that they depended too much on the counterpart fund. With the decrease of aid in the latter half of the 1950s, inevitably the fund for treasury loans and invest-

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24. These figures are taken without distinguishing between treasury funds and financial funds. Nevertheless, considering the fact that 84 percent of the total fund for loans was in treasury funds, one should never underestimate the role of treasury funds in funding KDB loans (KDB 1964b:590-593).



ments decreased. In such a circumstance, independence of funding is recognized as one of the most important conditions for economic development. A series of tax reforms aimed to increase the fiscal revenue in the latter half of the 1950s reflected the will of the South Korean government to increase the funding source that would substitute the counterpart fund.

#### **IV. Conclusion**

It is a widely accepted fact that there were clear differences in South Korea's economic policies, strategies of industrialization, and the will to implement such policies and strategies between the 1950s and 1960s. Nevertheless, there existed a strong continuation between the 1950s and the 1960s; a continued effort by the South Korean government to recognize the structural characteristics of the South Korean economy and remedy it. What the South Korean government attempted was to realize a self-sustaining economy through increased exports and import substitution industrialization. Based on such an understanding, this paper analyzed the background of the South Korean government's policy toward a self-sustaining economy centering on the South Korean economy of the 1950s. The summary of the paper is as follows.

1. Foreign aid introduced in two spheres played a critical role in the reconstruction and development of the South Korean economy in the 1950s. First of all, foreign aid which was 73 percent of the total fund for imports, shaped the contents of the economic reconstruction of South Korea. Destroyed by the Korean War and lacking resources, capital, and technology, the success of South Korea's economic reconstruction was determined by the recovery of international trade, more specifically, the scale and contents of imports. An analysis of the total imports, including aid and general imports, shows that the major portion of imports consisted of raw materials (including fuels), intermediary goods, and capital goods used for the reconstruction and development of the consumer goods industry. Such a concentration led to the formation of an industrial structure centered on the consumer goods processing industry. Another defining characteristic is the counterpart fund raised through the sale of aid materials, heavily influencing the South Korean economy. Taking 43 percent of the revenue of the general public account, the counterpart fund not only stabilized but stimu-

lated the South Korean economy by funding social overhead capital, the reconstruction of industrial establishment, and the defense which was the main factor in the fiscal deficit. Furthermore, the financial loans to private companies through financial institutions contributed greatly to the improvement of irrigated facilities, and the development of private enterprises in various industries like chemical, textile, ceramics, and metal. As such, the South Korean economy of the 1950s was an economy heavily dependent on foreign aid.

2. As discussed so far, foreign aid had an important impact in the reproductive structure of the South Korean economy of the 1950s. Nevertheless, its limitations were also evident. Most importantly, the grant-in aid from the U.S. was not a secure source of funding, according to the needs of the South Korean economy. The aid-depending economy of South Korea that was maintained with continuous flows of aid went into a crisis in 1957 with a decrease in aid. Therefore, the latter half of the 1950s was a period where the South Korean government was forced to search for strategies to compensate for the foreign currency gap and saving-investment gap created by the reduction in aid, and to achieve stable economic growth. In other words, this was a period when the South Korean government searched for ways to create a basis for a self-sustaining economy. First, the Rhee government actively sought to expand exports to close the foreign currency gap, and implement the three year economic development plan for import substitution industrialization of products with large domestic demand like cement, fertilizer, steel, soda ash, and pulps. Second, to close the savings gap maintained by the counterpart fund, the government needed higher tax revenue. To do so, it carried out a series of tax reforms. Although these attempts did not produce substantial results, they touched upon the problems which the South Korean economy had to resolve in order to achieve continuous growth. It could be said that the need to move away from a aid-depending economy and to construct a self-sustaining economy was already recognized in the 1950s. As such, there existed a process to slowly build a self-sustaining economy through various endeavors.

To recap, for South Korea, the 1950s was a reconstruction period for an economy dependent on aid and, at the same time, a period when the government was searching for ways to construct a self-sustaining economy with the limits of foreign aid being recognized. The will and means to build a self-sustaining econo-

my formed within the 1950s was fulfilled by the military regime which was strong enough to implement them.

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