

April 20, 1955

Letter, Harold Lady to Syngman Rhee

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Summary:

Harold Lady proposes changes to the Korean government's methods of managing inflation and paying contractors.

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CONFIDENTIAL*cc Mr Park
Finance Min
Reconstr.**Lady*

MEMO NO. 45

April 20, 1955

Dear President Rhee:

Subject: Controlling Government Expenditures

It is my understanding that there are three limitations on the disbursement of Korean Government funds:

- 1) Appropriations in the approved budget
- 2) Availability of balances in funds derived from -
 - a. Government revenues
 - b. Proceeds from the sale of American aid goods (with Combined Economic Board approval)
 - c. Borrowings from banks, subject to ceilings imposed by the National Assembly
- 3) The amount of printed currency physically available.

There is evidence that the use of the balanced-fund and no-printing devices (2 and 3 above) is doing great harm. For example, although the Ministry of National Defense has not exceeded its budget, it is reputed to be an average of four months in arrears in paying the contractors who have supplied it with goods and services. Many of the honest contractors have been forced into bankruptcy. They must pay up to 15% a month to their creditors because bank loans have been made unavailable by the Government-imposed credit ceiling. Hence a delay of from four to eight months in receiving the money the Government owes them spells financial ruin.

Contractors are now reluctant to do business with their Government and few, and sometimes none, of them respond to a request for bids to furnish goods and services for the Military. The bids that are received are 60% to 100% above normal prices to compensate for the risk involved. It is the necessity for paying these artificially high prices ~~rather~~ more than the effects of inflation that have made the budget inadequate.

It is understood that Korean law requires settlement of all fiscal year 1955 debts to contractors by July 31. If the volume of past due Government bills, which is already very large, is permitted to grow until July 31, it will probably exceed Hw10,000,000,000 for the Defense Ministry alone. Paying these debts all in the month of July would add over 25% to the currency in circulation and have a severe inflationary impact. It would be better, from the standpoint of controlling inflation, to pay the Government's debts to contractors now, L/



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before the total becomes larger, and follow the policy of always meeting obligations promptly as they are incurred.

Other examples of ill effects from attempting to control inflation by using the balanced-fund and no-printing devices are that February Army pay was two to three weeks late (the soldiers were paid on time for March) and, as of today, April 20, no funds have been furnished the military forces for April subsistence. This avoids being a calamity only because the Ministry of Agriculture furnished rice without payment and some units of the Military are able to earn Hwan by various unofficial methods.

In the United States there are only two effective limitations on Government disbursements: (1) appropriations by Congress, and (2) instructions (called "apportionments") issued by the President to each Government agency telling it how much indebtedness it may incur in the next three-month period. Apportionments are made through the Budget Bureau, which is a part of the Executive Office of the President. Whenever obligations are incurred by Government agencies, they are paid with reasonable promptness. As most of the U. S. revenues are received in the second half of the fiscal year, and there is rarely a surplus in the Treasury, obligations are paid during part of each year by printing money, a fact that is concealed from the general public by the pretense that the Government borrows from the banks by selling them bonds. Actually, most bonds are sold to the Federal Reserve Banks, and the Government prints money and lends it to these Government-controlled banks so that they can lend it back to the Government. Inflation and deflation are prevented by maintaining public faith in the integrity of the Government and keeping a reasonable relationship between total outstanding currency and credit and the total goods and services available for purchase.

It is recommended that the Korean Government adopt a system similar to that of the United States except that it could very well dispense with the pretense of selling bonds to Government-controlled banks. This would mean that the Government would prevent too great an increase in currency in circulation by refraining from incurring indebtedness instead of by refusing to pay promptly for the goods and services it has purchased. If you wish me to discuss with the Budget Office the mechanics of instituting a control of liabilities through apportionments, I shall be happy to do so. It is believed that such a system could be put into effect by an Executive Order and that the concurrence of the National Assembly is not required.

Harold
Harold Wendell Lady

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