

The Unofficial Money Market-

Its Extent and Trend in Business Borrowing⁽¹⁾

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1. Summary

This brief study is to provide summary information on the extent and trend of the unofficial money market in business financing in Korea. Therefore, emphasis was made in collecting data and summarizing the pertinent points rather than trying to cover all aspects of the unofficial money market. It is hoped that this study may serve to update some of the current aspects and trends of the unofficial money market, particularly the business borrowings from the market.

The findings of this study may be summarized as follows:

1. During the 2nd quarter of 1969, about 70% of business firms used credits from the UMM(Unofficial Money Market).
2. In absolute terms, total borrowings of businesses from the UMM have been increasing every year since 1963. The volume for the year of 1968 is estimated at about ₩526 billion with a monthly average of ₩44 billion.
3. However, the ratio of private money market borrowings to total funds furnished to businesses on an annual basis has declined from 13.1% in 1967 to 4.5% in 1968.
4. The UMM borrowings of businesses are influenced by changes in volume of bank loans and foreign loans. This is important because one of the ways to mop up the money flowing in the UMM is to increase supply of credits

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(1) This paper was prepared in December, 1969.

through the banking system and foreign capital inflows.

5. Interest rates of the UMM were generally declining, particularly in the first and second quarters of 1969. Currently as of end 1969 the majority of businesses are borrowing at 3-4%, whereas the rates were 4-5% in 1967.

6. Over 80% of businesses borrowing from the UMM use the proceeds for working capital purpose, particularly for payment of raw materials, labor and checks postdated.

7. The term of business borrowings from the UMM is mostly one month (37.1%), 3 months (23%) or 6 months (21%) for the 3rd quarter of 1969. The percentage has varied a little since 1966 but the pattern is pretty much stabilized as that of 3rd quarter of 1969.

8. About 40% of business borrowers from the UMM borrow without security, about 40% pledging securities. About 50% of small and medium sized business borrowers pledge securities. About 15% of businesses pledges collateral real estate, precious metals or stones.

9. Professional money lenders, and relatives and friends of the borrower are the major sources of private money. In fact over 70% of businesses borrowing from the UMM utilized these two sources during the 2nd quarter, 1969. There is a tendency of specialization that the organized private money market is the major supplier of money to large industries whereas small-medium sized firms rely more on their friends and relatives for private credit.

10. The total size of Kye money for December, 1968 was estimated at ₩35 billion. However, study shows that businesses rely little on Kye for their credit requirement. Kye is mainly for household savings to meet family necessities. It could be one of major sources of bank savings if attractive savings policy is devised by banking system.

II. The Unofficial Money Market—Its Extent and Trend in Business Borrowing

1. Definition

The terms variably referred to as “unofficial money market” or “unorgani-

zed money market" or "private money market" is defined as credit activities outside banking and other similar institutions legally approved for such activities. Currently there are three main components in the private money market. They are (1) Kye which is a time-honored mutual saving and money lending organization for common people in Korea, (2) private finance and loan companies mainly engaged in consumer credit and credit to tradesmen in small amount, and (3) organized private money market which is the largest and most influential engaged mainly in business financing in large sums involving millions of won. In fact, when one talking about the unofficial money market, he is generally referring to this organized private-money market.

2. Organization of the UMM

The organizational structure of the private money market is hidden, thus preventing a clear understanding of it by outsiders. A survey made by a newspaper company in Seoul gives an idea of its organization.⁽¹⁾

According to the report, four big private money lenders divide the market in Seoul. Three of them are owners of large business enterprises and one is a private university foundation. They operate in no fixed place, but in a corner of a tea room or an office room in a building somewhere around Sogong-Dong, Choongmu-Ro, and East—and Southgate Markets. They frequently shift their locations in order to get away from tax officials.

A typical group is organized with contact brokers, middle brokers and money lenders. Credit transactions are carried out between the borrowers and brokers and the borrower seldom meets or sees the money lender. Each money lending group has three or four such units operating in different locations.

As for brokerage, the report says, the average rate is 1/4 of 1% of the credit amount involved, and if the sum involved is rather large, the brokerage is settled through negotiation. However, the brokerage seems to vary according to amount and risk involved. It seems that smaller the

1. Maeil Kyungje, April 17, 1969.

amount and higher the risk, higher the brokerage. For instance, one of the builders who has built a number of medium sized buildings in Seoul told this writer as a-matter-of-factly that the brokerage is 1% of the credit amount ranging around ₩5 million.

3. Size of the UMM

A question which haunts everybody's imagination with respect to the curb market is what is the total size of the private money market in terms of amounts borrowed. In other words what is the size of outstanding borrowings from the private money market.

FKI (Federation of Korean Industries) makes a quarterly survey of the trend of the private money market partly by sending an inquiry to selected business firms through the mail and partly by direct interviews with businessmen. One of the questions was to get some idea of the businessmen's estimate of the size of the private money market. The survey for the 3rd quarter, 1968 shows that most businessmen estimate the size of monthly borrowing from the private money market to be around 20 to 30 billion won in Seoul. But the survey for the comparable quarter in 1969 shows an estimate of 50 to 80 billion won in Seoul. An officer at BOK who is directly responsible for collecting, tabulating and publishing data on the private money market told this writer that the current size of private borrowing per month is estimated at 50—100 billion won. Granted that those figures are nothing but guesses, it should be noted that they think the volume of borrowing from private money market has doubled since a year ago. This reflects their experience in financing business through the private money market.

The Office of National Tax Administration (ONTA) compiles data on business borrowings from the private money market and publishes a report periodically. Table I shows number of businesses which borrowed from the private money market, interest paid out for such loans and total borrowings for the period of six years from 1963 to 1968.

From the table, it should be noted that the amount of borrowings and

Table 1

(In million won)

Year	Number of businesses	Tax amount withheld on type "c" interest	Interest income	Total borrowing
1963	2,199	196	1,960	49,000
1964	2,441	426	4,260	106,500
1965	3,645	796	7,960	199,000
1966	6,488	953	9,550	238,250
1967	8,781	1,754	17,540	438,500
1968	17,000	3,474	21,057	526,425

Source: Office of National Tax Administration

Note : Tax rate applicable to "c" type interest income was 10% until 1967, but it has been raised to 16.5% since 1968.

number of businessmen who use private money increased every year during the period, and in 1968, it reached ₩526 billion which is about 4 times the year end money supply in 1968 of ₩140 billion. The monthly average was about ₩44 billion for 1968.

ONTA's report on business borrowings from the unofficial money market is based on businessmen's tax withholding on their type "c" interest payment which is the interest income earned by the unofficial money market lenders. Of course, people engaged in the unofficial money lending tend to under-report their interest income from such lending. From the borrower's side, however, such borrowings are likely to be exaggerated for the purpose of taking advantage of tax law which allows exemption of interest payment as business expense. One way for more an efficient catching of interest earnings from the unofficial money market lendings is to trace the lenders from the borrowers side, which has not been vigorously pursued by tax officials for fear of discouraging business activity and because of borrower's unwillingness to disclose their source of borrowing for fear of losing supply source of business capital. A new method which ONTA is currently contemplating to determine the amount of borrowings from the unofficial money market by businesses, is to measure sales of the firm with the average sales figures of the

particular industry published by BOK, and see if the amount of borrowing from the unofficial money market is shown with exaggeration by reducing sales amount, which is believed to be a widely practiced way of dodging taxes. This new method of determining amount of borrowing by businesses from the unofficial money market will face difficulties in actual application because lower sales and larger amount of unofficial money market borrowing of a particular firm than the average level of BOK study is, may be, the true situation of the business firm concerned.

On the other hand, according to unpublished data prepared by BOK, corporations engaged in lending their money through unofficial money market, in many cases, report part of their operational income as interest income from the unofficial money market lending in order to take advantage of the margin between tax rate of 16.5% applicable to such interest income and corporate income tax ranging from 22% to 49.5%.⁽²⁾

With all its shortcomings and uncertainties the ONTA's statistics on type "c" interest income which has bearing to the unofficial money market is, however, the only official report periodically prepared and made available to interested parties in Korea on size of the UMM. In preparing its fund flow analysis, BOK uses ONTA's report on tax amount collected on "c" type interest income to show sources of fund supply for business corporations to finance their investment. Table 2 shows how the corporate sector has been meeting their fund requirement for investment from outside sources since 1966, including the borrowings from the unofficial money market.

According to the table the amount of funds obtained by the corporate sector from the private money market was ₩13.1 billion in 1968 which was about 5% of their total fund requirement. This is a decrease of 43.3% over the 1967 level of the private money market borrowing of ₩23.1 billion. Over 80% of outside financing was done in the form of bank borrowing (42.5%) and overseas borrowing (40.6%) in 1968. The bank borrowing and the overseas borrowing in 1967 were 38.8% and 37.9% respectively. In other words, bank borrowings and overseas borrowings by corporate sector in 1968 were

2. Bank of Korea, Quarterly Survey Report on UMM.

expanded over the 1967 level, and of the private money market borrowings were reduced from the 1967 level. On a quarterly basis, during the first quarter of 1969, the private money market borrowing decreased by ₩10.7 billion, due to the general economic trend which was moving rather slowly for the period due to seasonal factors. However, in the second quarter, the amount of the private money market borrowing by the corporate sector increased by ₩11.6 billion, accounting for 10% of their total outside financing. The increase was necessitated by the relative decrease in bank loans for the period. In general, the volume of the private money market borrowing depends largely on changes in the amount of bank loans and overseas borrowings in Korea, but not the other way around because of the fact that the interest rates charged on bank loan and foreign loan are much lower than that of the private money market credit.

What we have discussed so far is how much business corporations are borrowing from the unofficial money market in order to meet a part of their fund requirements. The amount for 1968 of such borrowing was ₩13.1 as estimated by BOK. But ONTA's estimation of total business borrowing for the same year was ₩526.4 billion. Then the question arises as to why such differences in estimations?

To answer the question, the following points should be noted. BOK's figure is based on the flow concept, meaning it represents the net change in total borrowings by business corporation for a period. In other words, ₩13.1 billion is the net increase of total borrowing by corporations in 1968 over 1967.

Also, BOK's figure is, as specifically mentioned above, borrowings by business corporations excluding proprietorships and partnerships which are not legal entities, but which are included in ONTA's estimation.

Table 3 shows bank borrowings, other borrowings mostly from UMM and overseas borrowings, outstanding at year end from 1964 to 1968. At the end of 1968, it was ₩55 billion. Although the volume outstanding of the UMM borrowing more than doubled each year since 1966 its percentage against total borrowing is around 9% each year end except 1967 when it was 11.7%.

This is mainly due to the decreased increasing rate of bank loans to meet greatly expanded total investment requirement of business corporations in 1967.

Table 2**Fund Supply of Corporate Sector¹⁾**

(In billion won)

	1966		1967		1968		1/4 1969		2/4 1969	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Self-financing (savings)	33.1	25.2	47.7	21.3	68.4	19.5	n. a. ²⁾	—	n. a.	—
Outside financing	98.3	74.8	176.5	78.7	281.3	80.5	64.5	—	115.9	—
Total	131.4	100.0	24.2	100.0	349.7	100.0	—	—	—	—
Outside financing	98.3	100.0	176.5	100.0	281.3	100.0	64.4	100.0	115.9	100.0
Indirect financing	25.5	25.9	69.9	39.6	121.5	43.2	44.1	68.4	45.2	39.1
Bank borrowing	23.9	24.4	68.5	38.8	119.4	42.5	33.8	52.5	43.3	37.4
Non-bank borrowing	1.6	1.5	1.4	0.8	2.1	0.7	10.3	15.9	1.9	1.7
Direct financing	22.9	23.3	39.7	22.5	45.5	16.2	2.8	4.4	31.3	27.0
Bond, stock	12.6	12.9	10.8	6.1	28.9	10.2	11.8	18.4	17.9	15.4
Other security	0.7	0.7	5.7	3.3	3.5	1.3	1.7	2.7	1.8	1.6
Private money market borrowing			3.1	13.1	13.1	4.7	-10.7	-16.7	11.6	10.0
Overseas borrowing	49.9	50.8	66.9	37.9	114.3	40.6	17.5	27.2	39.3	33.9

Source: BOK, Monthly Economic Review, Vol. 23, No. 7, p.28.

BOK, Fund Flow Analysis for 2nd Quarter, 1969.

1. Trade credits and other type of credit such as deferred payments and receipts and receipts in advance excluded.
2. n. a. stands for not available.

The increase in bank loans and foreign borrowings in 1968 relieved business corporations somewhat of the pressure to rely on the private money market for its needed capital, thus the percentage of the outstanding private money market borrowings fell to 9.1% for the year end. In other words

Table 3

Bank Loans, Foreign Loans and Unofficial Money Market Borrowings
of Corporations, Outstanding at End Year

(In million won)

	1964	%	1965	%	1966	%	1967	%	1968	%	65/64	66/65	67/66	68/67
Bank borrowings	51,322	66.2	78,591	67.7	104,116	51.8	173,994	48.2	295,448	48.4	53.1	32.5	67.1	69.8
Bank of Korea	2,881	3.7	12,458	10.7	18,501	9.2	20,100	5.6	27,900	4.6	332.4	48.5	8.6	38.8
Commercial banks	12,653	16.3	22,458	19.3	32,659	16.2	60,626	16.8	125,169	20.5	77.5	45.4	85.9	106.5
Special banks	32,678	42.1	39,290	33.9	47,021	23.4	85,965	23.8	132,967	21.8	20.2	19.7	82.8	54.7
Non bank borrow.	3,110	4.0	4,385	3.8	5,935	3.0	7,303	2.0	9,412	1.5	41.0	35.3	23.1	28.9
Other borrowing	7,243	9.3	9,477	8.2	19,058	9.5	42,182	11.7	55,429	9.1	31.0	101.1	121.3	31.4
Foreign borrowings	18,980	24.5	28,019	24.1	77,897	38.7	144,762	40.1	259,101	42.5	47.8	178.0	85.8	79.0
Total	77,545(100)		116,087(100)		201,071(100)		360,938(100)		609,978(100)		49.7	73.2	79.5	69.0

Source: BOK, Statistical Yearbook for 1967, 1968, & 1969

1. Non-bank borrowings are the borrowings from insurance companies and trust accounts.
2. Other borrowings are consisted of mostly private money market borrowings as per BOK official.

on an outstanding basis, volume of the UMM borrowing of business corporation per year is about 9% of their total borrowing providing yearly variation depending upon increases or decreases in bank loans and overseas borrowings.

The MIB (Medium Industry Bank) for their own use, conducts a semi-annual survey on trend of borrowings from the private money market by the small-medium sized manufacturing firms. Table 4 shows ratio of private money market borrowings to total borrowings by those firms. The total outstanding borrowing from the private money market by all firms for the first half of 1969 reached ₩12 billion or 8.9% against total borrowings of ₩135 billion. The ratio, however, has been declining since the end of 1967 when it was 12.4%. The industry which relied most heavily on UMM borrowing was transportation equipment (27.7%) for the end of 1967, food and beverage (32.6%) for the first half of 1968, and footwear and clothing (21.2%) for the first half of 1969. Such phenomena are, according to MIB analysis, due to ROK/G loan policy which excludes industries such as food-beverage, and footwear and clothing from its priority list, whereas textile industry was provided credits with top priority, thus showing only 6.4% of its reliance on the private money market for the end of the first half of 1969. Other factors contributing to heavy reliance on the private money market by those industries are inventory production to meet seasonal demand (in case of food and beverage), reduction in sales amount resulting from excess competition (in case of footwear and clothing), and increase in disguised demand for capital in response to ROK/G investment expansion policy (in case of transportation equipment).

How much do business firms borrow from UMM in order to finance their working capital requirement? What is the ratio of private money to working capital of business firms. According to a FKI study (see Table 5) in third quarter of 1969, 73% of industries finance 10% to 30% of their working capital with borrowing from the private money market, which is about same in the comparable period in 1968. About 20% of industrial firms rely on the private money market to finance more than 40% of their working capital, whereas it was 17% in 1966, 19% in 1967, and 19.4% in 1968, respectively. In other words, the number of business firms which rely on private

Table 4 Ratio of Private Money Market Borrowing to Total Borrowing by Small-Medium Manufacturing Industries, Outstanding at End of Half Year (In million won)

	End 1967			End of June, 1968			End of June, 1969		
	Total Private Money		B/A (%)	Total Private Money		B/A (%)	Total Private Money		B/A (%)
	(A)	(B)		(A)	(B)		(A)	(B)	
Manufacturing	54,753	6,788	12.4	70,984	6,779	9.6	135,685	12,040	8.9
Food	5,207	887	17.0	5,611	628	11.2	9,352	1,347	14.4
Beverage	2,142	421	19.7	2,285	744	32.6	3,715	656	17.7
Textile	11,421	1,244	10.9	13,820	952	6.9	25,076	1,606	6.4
Footwear & Clothing	1,596	383	24.0	2,874	502	17.5	4,987	1,056	21.2
Lumber & Wooden Prod.	2,278	320	14.0	3,001	305	10.2	5,791	694	12.0
Furniture	677	93	13.7	1,122	122	10.9	1,846	202	10.9
Paper & PaperProd.	1,606	176	11.0	2,238	108	4.8	4,660	188	4.0
Printing	2,300	238	10.3	2,953	223	7.6	4,082	447	11.0
Leather	473	32	6.8	507	29	5.7	1,066	129	12.1
Rubber Prod.	955	63	6.6	1,108	45	4.1	2,338	84	3.6
Chemical Prod.	5,784	825	14.3	6,864	615	9.0	12,016	554	4.6
Petroleum Prod.	2,796	287	10.3	2,938	286	9.7	7,309	485	6.5
Stone, Clay & Glass	2,060	314	15.2	2,589	377	14.6	6,071	752	12.4
Basic Metal	1,339	171	12.8	2,145	160	7.5	3,858	696	18.0
Metal Prod.	2,644	256	9.7	3,592	363	10.1	6,560	765	11.7
Machinery	2,478	284	11.5	3,590	606	16.9	7,362	979	13.3
Electrical Appl.	1,692	180	10.6	2,461	283	11.5	4,673	529	11.3
Transport. Equip.	1,385	383	27.7	1,523	264	17.3	3,565	417	11.7
Other	5,920	231	3.9	9,763	167	1.7	21,268	454	2.1

Source: MIB, unpublished data

money market to finance more than 40% of their working capital has been increasing since 1966. Heavy reliance on expensive short-term private money is a sign of weakness in capital structure of businesses and it is one of the major causes of business failures in Korea.

Table 5 Ratio of Private Money Market Borrowing to Working Capital of Business Firms

(As % of Number of Businesses)

	1966 3rd quart.	1967 2nd quart.	1968 3rd quart.	1969 3rd quart.
Less than 10%	22.8	24.2	24.3	29.5
11%-20%	25.2	13.4	29.1	19.5
21%-30%	32.6	32.0	20.4	24.0
31%-40%	11.9	11.4	6.8	5.5
41%-50%	9.2	9.5	11.6	14.0
51% or Over	8.2	9.5	7.8	7.5
	(100)	(100)	(100)	(100)

Source: Federation of Korean Industries, Survey Reports on Trend of Private Money Market, published quarterly.

4. Trend of Interest Rates

As to the trend of interest rates, a BOK study finds that more businesses are paying 5%. 17.2% of businesses are paying 3.5% and 16.3% paying 4.5%. This is compared with 5% interest paid by majority of businesses in 1967, 1968 and even in the first quarter of 1969 but with decreasing scale. In other words, the trend of interest rates in the UMM is downward. (See Table 6) This should be interpreted as a reflection of increased availability of credits from the banking and overseas sources in 1969 v. s. the tight credit condition in 1967. Another study made by FKI confirms the downward trend of interest rates in 3rd quarter but in case of the small medium industries, the majority of businesses are paying 4.5-5% interest, which is somewhat higher than the interest rate large industrial firms are paying.

Table 6

Trend of Interest Rates on Monthly Bases of
Unofficial Money Market

(As% of Number of Businesses)

	1967		1968		1969		
	3rd quart.	4th quart.	2nd quart.	3rd quart.	4th quart.	1st quart.	2nd quart.
Less than 3%	1.9	1.5	1.2	2.2	2.9	4.8	3.3
3%	2.4	4.4	4.7	3.6	3.2	3.9	4.8
3.5%	5.8	7.4	6.6	8.5	9.0	15.2	17.2
4%	18.7	22.5	26.2	28.3	27.3	25.2	33.5
4.5%	12.9	12.2	13.3	12.1	16.2	13.5	16.3
5%	42.8	35.8	35.1	35.9	34.2	28.3	19.6
5.5%	5.8	5.4	4.7	1.8	2.5	3.9	1.9
6%	7.7	7.8	4.7	6.3	3.6	3.5	2.9
Over 6%	2.0	3.0	3.5	1.3	1.1	1.7	0.5
	(100)	(100)	(100)	(100)	(100)	(100)	(100)

Source: BOK, Survey Report on Unofficial Money Market, published quarterly.

5. Maturity of the UMM Borrowings

Majority of businesses are borrowing from the unofficial money market for a period of one month or 3 months or 6 months. In particular, 37.1% of businesses borrow for 1 month, 22.7% for 3 months and 20.6% for 6 months. (See Table 7.) More large business firms are borrowing for 1 month than are the small-medium sized firms. The most frequent reason businesses gave for borrowing for 1 month was that the credit was expensive. The analysis of terms confirms that the unofficial money market is primarily a short term money market.

6. Purposes of the UMM Borrowings

What are the purposes for business borrowing from the UMM? Table 8 shows the majority are borrowing to pay for raw-material. In particular,

Table 7

Terms of Unofficial Money Market Credit

(As % of Number of Businesses)

	1966		1967		1968		1969	
	3rd quart.	2nd quart.	1st quart.	3rd quart.	1st quart.	3rd quart.	1st quart.	3rd quart.
1 month	27.6	41.6	32.3	42.9	38.1	37.1		
2 months	13.3	9.8	11.6	14.3	15.0	11.3		
3 months	26.1	26.9	33.5	25.9	21.2	22.7		
4 months	2.5	1.2	2.4	—	0.9	3.1		
5 months	2.5	0.8	3.7	2.6	4.4	5.2		
6 months	28.0	19.5	16.5	14.3	20.4	20.6		
	(100)	(100)	(100)	(100)	(100)	(100)		

Source: FKI, Survey Report on Unofficial Money Market

62.6% of the businesses borrowed to pay for raw material in 3rd quarter of 1969, 15.2%, to pay for acquiring facilities and 8.8% to take care of payroll. The FKI's study shows that the number of businesses borrowing for the purpose of payment of raw-material is increasing among small-medium sized businesses whereas the number of businesses borrowing for the purpose of acquiring facility is increasing among large businesses. Such trend varies according to type of business, too. Businesses such as clay, stone and glass product, mining, and transportation are borrowing money from the unofficial money market to acquire property, whereas businesses such as beverage, paper product, rubber product, petroleum, machinery, electric appliance are borrowing to pay for raw-material.

7. Collateral Requirement

Easy access to credit is said to be one of the primary reasons for businessmen to rely on private money market. In the 3rd quarter of 1969, 42% of businesses were borrowing on credit and 41.5% of businesses obtain credit from the market by pledging securities as collateral (See Table 9). This is compared with the bank's rigid requirement of loan collateral in the form

Table 8

Purposes of Business Borrowings from Unofficial
Money Market

(As % of Number of Businesses)

	1966		1967		1968		1969	
	3rd quart.	2nd quart.	1st quart.	3rd quart.	1st quart.	3rd quart.	1st quart.	3rd quart.
1. Raw Material	65.7	68.6	67.1	59.3	60.5	62.6		
2. Facility	10.8	13.9	14.4	13.0	10.5	15.2		
3. Labor	6.6	4.2	6.6	7.4	12.1	8.8		
4. To pay debt	11.7	5.1	7.8	12.0	10.5	8.4		
5. Other	2.9	8.2	4.1	8.2	6.4	5.0		
	(100)	(100)	(100)	(100)	(100)	(100)		

Source: FKI, Survey Report on Unofficial Money Market.

of, primarily, real property, and the expenses of pledging real estate property. Doing away with such pawn-shop type of bank operation is certainly a practical way, among other things, of resolving problems in double structure of money market in Korea.

Table 9

Trend of Security Requirements for Unofficial
Money Market Credit

(As % of Number of Businesses)

	1966		1967		1968		1969	
	3rd quart.	2nd quart.	1st quart.	3rd quart.	1st quart.	3rd quart.	1st quart.	3rd quart.
No. collateral	43.3	41.6	39.3	36.4	39.2	42.0		
Securities	39.8	42.4	48.6	47.3	41.6	41.5		
Real estate	6.0	7.2	4.6	4.5	10.4	6.6		
Others	10.9	8.8	7.5	11.8	8.8	9.8		
	(100)	(100)	(100)	(100)	(100)	(100)		

Source: FKI

8. Lenders of the UMM

Finally, who are the lenders of private money market? The major supplier of the private money to businesses has been traditionally, according to a BOK study, professional curb market money lenders. However, a recent survey indicates that more businesses borrow money from friends and relatives than from professional money lenders. (See table 10.) FKI interprets such trend as a result of increasing emphasis on safety in providing private loan. BOK's further study shows, however, that the professional money lenders, or shall I say the organized private money lenders, are concentrating on large borrowers, whereas more small medium sized businesses are getting loans from their friends and relatives.

Table 10 Lenders of Unofficial Money Market

(As % of number of businesses)

	1967		1968			1969	
	3rd quart.	4th quart.	2nd quart.	3rd quart.	4th quart.	1st quart.	2nd quart.
Professional money lender	39.8	34.8	31.0	35.1	33.0	35.9	32.9
Friend & relative	20.4	21.2	21.2	18.0	21.6	25.8	46.2
Partner	11.4	11.6	10.2	12.2	12.5	8.8	5.7
Employee	—	—	—	—	—	—	—
Finance co.	1.5	1.0	2.0	0.9	1.1	—	1.0
Kye	11.5	6.6	8.2	6.8	6.2	6.9	0.5
Other	15.4	24.8	27.4	27.5	25.6	22.6	13.7
	(100.0)	(100.0)	(100.0)	(100.0)	(100.0)	(100.0)	(100.0)

Source: BOK

As private finance companies and Kye are providing money to only 1% and 0.5% of businesses respectively they are insignificant suppliers of credit as far as business finance is concerned. According to BOK study on Kye, the total size of Kye money during the last month of 1968 is estimated at

₩35 billion (₩14 billion monthly in 1964), which is about a quarter of the total money supply for the period. But, most of Kye money is used for household financing such as marriage, education, housing, clothing, furniture, personal ornaments, and some individuals utilize Kye as a means of saving because they believe return on saving through Kye is higher than return on bank saving.⁽³⁾

III. Concluding Comments and Suggestions for Policy Direction Regarding the UMM

1. Total size of the UMM borrowing is estimated at about ₩100 billion on monthly basis, consisting of ₩55 billion of business borrowings, ₩35 billion of Kye money, and perhaps another ₩10 billion of credits from finance companies and among private persons as of end of 1968. As the bank-credits are squeezed during the last quarter of 1969, the UMM borrowings are expected to grow larger by the end of 1969. As of the end of 1968, the money supply stood at ₩149.8 billion. The UMM borrowing of ₩100 billion is certainly a disturbing figure, as far as the monetary aspect of the economy is concerned. Because it means that about 67% of money supply is circulating through the UMM. The relative importance of the UMM borrowing by businesses v. s. bank loans has, however, somewhat declined since 1968. Also UMM interest rates have moved downward. The relative decline in the UMM credit activities might be attributed to either the increase in individual financial assets, or from reduction in the financial assets of other sectors. The BOK analysis of the fund flow indicates that the former is the case, which is a desirable thing.

2. There is a set of factors which necessitate the existence of the UMM and, furthermore, make it a unique way in the Korean economy. The first factor is that bank interest rates on deposits and loans are set artificially low by the Government, thus causing a gap between the bank rates and the free market rates of the UMM. Unless the nominal bank rates are increased by

3. Weekly Cho-Sun, March 9, 1969, p. 12

other advantages or changes there will continue to exist a gap between the cost of bank money and the UMM money and money will flow from the former into the latter whenever it is possible. There is a consensus that some of the bank loans and or foreign loans, especially cash loans at relatively low international rates, are flowing into the UMM. The second factor is a corollary to the first factor; a businessman who obtains a bank loan uses the loan proceeds for his business operation, but lends out his earnings or other funds to the UMM rather than plowing them back into the business or depositing them with a bank. One of the results of such a practice is rather well known among businessmen that a business may fail but never the businessman, and the other is the demand for bank loans and foreign cash loans is unsatisfiable. The third factor is that whenever there is a large amount of imports on extended D/A basis perhaps, stretching over two to three years for repayment, there is an increase in supply of funds in UMM. The importer sells the imported goods at a high domestic price and lends out the proceeds through the UMM at 3~4% monthly rate until the due date of import payment. Thus, importers harvest a fantastic profit beyond one's imagination under the present circumstances.

3. As to the question whether the UMM is good or bad, the following points may be enlightening.

The UMM in most of the less developed countries act as a brake on economic growth in a number of important respects. They hold down the rate of capital formation by diverting a portion of saving to consumption. They lead to an investment mix that tends to be less productive over time than would be the case if allocation of saving to investment were determined by responsible and specialized institutions concerned with expanding the productive base of the economy. They insulate a large portion of the economy from public control and policy. They deprive the fiscal authorities of some revenue and, hence, of control over real resources. They create a pattern of interest rates which weigh heavily on those least able to bear the explicit or imputed costs of borrowing. Finally, they perpetuate forms of behavior not conducive to social discipline and responsibility. (4)

On the other hand, it should be recognized that the UMM fulfills many needs which are not being satisfied elsewhere. Specifically, in a monthly average of business finance, the UMM supplies about ₩45 billion of capital to businesses and such financing is done on credit with speed to meet the particular need of a business at a particular time. Thus the UMM has developed practices and forms which turn out to be remarkably efficient in relation to their purposes. Some of the practices in the UMM have evolved from deeply held customs. Indeed, the two types of markets are both complementary and competitive.

Therefore, the mere prohibition or elimination of some of the activities performed in the UMM is not likely to do much good. Rather, the task of the organized financial markets is to take over and absorb those activities by enlarging the scope of the organized money and capital markets and correspondingly reducing the size and the scope of the UMM.

4. Thus posed, the issue becomes one of enlarging the scope of organized finance and to devise means of the relative size of the two types of markets and of developing indices capable of judging whether the above aims are being achieved. In Korea, there is statistical data pertaining to the trend and extent of the UMM, periodically prepared by BOK, MIB, FKI frequently referred to in this study.

One broad index has been suggested by U Tun Wai which seeks to measure the size of the organized markets (and thus, by implication, that of the UMM) by calculating two ratios over time, the ratio of currency held by the public to total money supply and the ratio of commercial bank credit to domestic national income (see Charts I and II⁽⁵⁾).

In most developing countries the ratio of currency to money supply is about 50 per cent, compared with 20 or 30 per cent in the developed countries. The ratio of bank credit to national income hovers around a median of 28 per cent for all less developed countries. In 1963, this ratio was in the range

4. Aleck A. Rozental, Draft of Final Report on Finance and Development in Thailand, Vol. I., pp I 41-42

5. U Tun Wai suggests ratio of demand deposits to total money supply, which is simply reciprocal to currency in circulation. If M is money supply, Y national income, D demand deposits, C risk assets, A and L total assets and liabilities, then; $D/M[M/Y(C/A/D/L)]=C/Y$

of 50 to 45 per cent for such countries as Argentina, Brazil, Ceylon, Greece, Philippines, Tunisia, and the UAR but was less than 20 per cent for Ghana, Jamaica, Jordan, Korea, Malaysia, Mexico, Nicaragua, and Sudan. For the highly developed countries, the ratio ranged from 47 to 148 per cent. (6)

For Korea, the ratio of currency to money supply appears to be within the range for countries in similar stage of development, i. e., about 50 per cent. The ratio of commercial bank credit to national income is much lower than most of the developing countries. This may be due to the fact that about the half of the total bank loans are lent through the special banks such as KDB, MIB, Housing Bank, Citizens Bank, and NACF, which were excluded from the ratio. Even if the special bank loans are included, however, the ratio of bank credit to national income for Korea is still lower than the medium ratio of 28 per cent for developing countries. Such a low ratio indicates the unusually active UMM activities in Korea.

The indices are so crude and broad that they alone can not give any firm idea in measuring the trend and scope of the organized money markets v. s. the UMM, but they could be very useful if supplemented with statistical data on the UMM such as the flow of fund analysis, trend of interest rates of the UMM, etc., which are available periodically in Korea.

5. The policy direction regarding the UMM should be, then, to devise ways and means to improve the efficiency and scope of the organized money market, and to remove or rationalize the underlying factors which cause and necessitate the active and growing UMM activities in Korea. For instance, a developed capital market should be able to take over the UMM function of facility loans to businesses, which run about 10 per cent of business borrowing, from the UMM. The commercial banks should be able to take over the UMM function as the supplier of short-term business credits by enlarging the scope of their operations, and improving their efficiency, which may include, among other things, assuring greater flexibility of the commercial banks in setting deposit and loan rates, developing bank

6. *op cit.*, p. I-48.

employees not as bank clerks but as responsible and independent bankers capable of appraising the credit worthiness of borrowers, improvement in bank portfolio management in such a way that bank assets correspond to the needs of businesses as currently expressed in the UMM activities, and tailoring bank liabilities in such a way that they are attractive and convenient enough to keep savings of individuals and businesses away from flowing into the UMM and to channel them into bank deposits. Finally, the gap between bank and the UMM interest rates will not disappear by any artificial and direct manipulation of bank rates. Interest rate is the market function of supply and demand for capital at a given time. As such, the interest rate, which is the price of money should be let free to find its own equilibrium level at current demand and supply condition of money market. Experience shows that when the official rates were brought up to the comparable level of the free market rate since 1965, a large part of money of the unorganized money market was successfully channeled into bank deposits, thus reducing the scope and volume of the private money market.

When it is necessary to lower the interest rates for the purpose of economic policy, the monetary authority should take measures to influence the interest rates by causing changes in demand for or supply of money, but not by direct manipulation of the rates. Such measures might include reduction of the differentials between the rates charged by the special banks and commercial banks and also the rates charged differently by banks according to type of loan and industry, and imposition of interest equalization tax on foreign loans. These measures would contribute not only to reducing excess demand for money and thus enlarging funds available for efficient investors, causing downward movement of the over-all level of interest rates, but also for the organized financial institutions to gradually taking over the function of the UMM and reducing its scope.

Chart I

Percentage of Commercial Bank Loans & Discounts to National Income

Source: BOK, Economics Statistics Yearbook

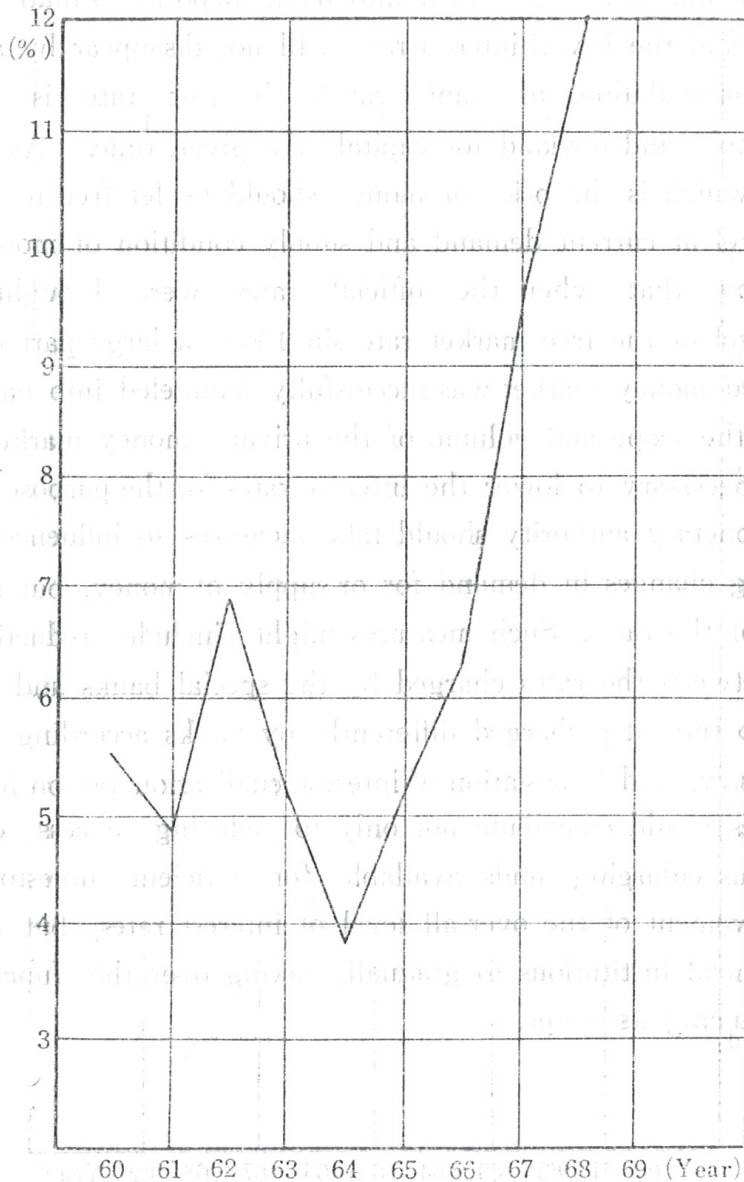
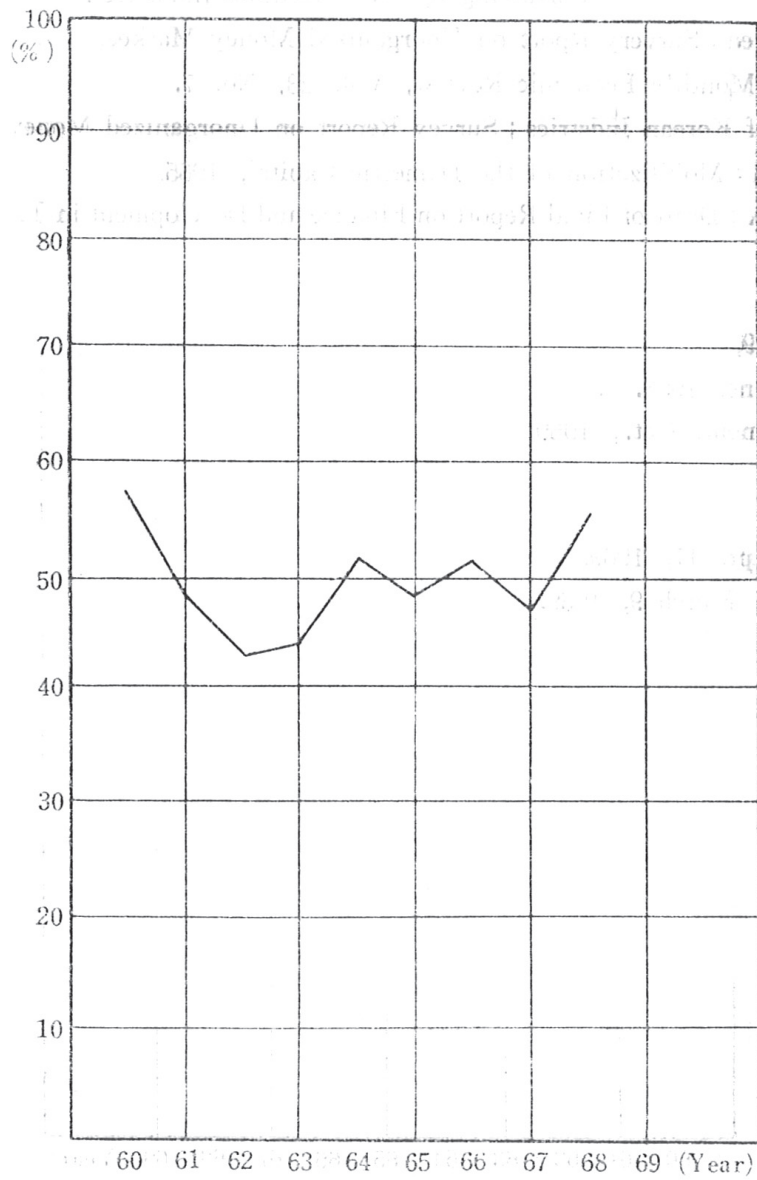


Chart II
Percentage of Currency in Circulation
to Money Supply

Source: BOK, Economics Statistics Yearbook



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