AN ANALYSIS OF SAVING, INTEREST RATES AND INCOME IN KOREA 1953-1972

by

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CHAPTER I

INTRODUCTION

On September 30, 1965 the Monetary Board of the Republic of Korea announced that the nominal interest rate on the 18-month time deposits was being raised to 30 percent from the previous level of 15 percent in annual simple rate, and that the regular commercial loan rate being raised to 26 percent from the previous level of 14 percent. The impact of this sharp increase of interest rates on bank deposits and loans was immediate and spectacular. The constant-price value of time and savings deposits rose by 50 percent in the next three month, by 110 percent in 1966, and by 80 and 100 percent in each of the next two years. At the end of 1971 the real value of time and savins deposits was nearly sixteen times the 1965 level. Stated differently, they rose from 3 percent of 1965 GNP in September 1965 to 20 percent at the end of 1968, and to 27 percent at the end of 1971. On the other hand, this inflow of saving to the banks made possible an expansion of constant-price bank loans by 34 percent in 1966, 45 percent in 1967, 61 percent in 1968, and 64 percent in 1969. These growth rates, compared with those of minus 16 percent and minus 17 percent for deposits and loans respectively in 1964, look even more dramatic and spectacular than at first glance.[1] Therefore, it is quite certain that these sharp increases in private saving and its sustained higher levels in the succeeding years must have directly resulted from the September, 1965 interest rate reform.

However, the widely accepted view in the economic profession is that saving is primarily determined by income only, and that "it cannot even be said in advance whether an increase in the interest rate will increase or decrease saving."[2] Consequently, most countries have been inclined to take a relatively low interest rate policy in order to stimulate investment demand, without much worrying about the supply of saving. Most developing countries have also been following this policy in the hope of achieving rapid growth rate to catch up with the more developed countries.

But Korea's experience in the 1965 interest rate reform presents a remarkable exception to this general trend and offers strong evidence that the prevailing Keynesian view may not be adequate for all economies, especially for some developing countries at a certain stage of development. And if Korea's successful interest rate reform can further be proved to have some generalized applicability, it would certainly be a valuable lesson for other developing countries with similar conditions.

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[1]See Gilbert T. Brown, Korean Pricing Policies and Economic Development in the 1960s (Baltimore and London: The Johns Hopkins University Press, 1973), p. 179-184.

[2]Ibid., p. 182.

This report, therefore, examines the effects of interest rates on saving in Korea. Original data from 1953 to 1972 will be used to investigate the relationship between saving, interest rate, and income. The basic method of analysis is adopted from Gilbert Brown's book "Korean Pricing Policies and Economic Development in the 1960s",[1] which will be further explained in chapters 3 and 4.

[1]Ibid., p. 193-199.