

Capital Market and Economic Development (II)

—A Study on Policies to Promote the Capital Market in Korea—

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III. The Influence of Capital Market on Korean Economic Development

A. Financing of long-term industrial fund

The influence of capital market over economic development is to be evaluated in accordance with the degree of smoothness of the flow of long-term industrial capital, the reason being that such capital mobilized through capital market fails to be a boosting power for economic development and rather upset circulatory order in the economy, when it flows into non-productive sectors rather than that of industries.

A total of 373.9 billion shares amounting to ₩109.8 billion was transacted during 1956—1962. This implies that a total of ₩15.7 billion was mobilized into the capital market on the annual average. Of the above total, the number of the shares and the amount of money involved in the transactions were 167.9 billion shares and ₩100.8 billion in stocks and 206.3 billion shares and 8.9 billion won in national bond.

During the past seven years, the Korean capital market has experienced two stock booms; the former is national bond boom in 1959 in which national bonds amounting to ₩21 billion were transacted while the latter is a stock boom in

1962 in which stocks amounting to a total of ₩98.37 billion were transacted.

These two booms imply a certain extent of feasibility to mobilize domestic capital through our capital market which has a variety of institutional discrepancies.

Rather than problems concerning feasibility of domestic capital mobilization, however, it has much importance for how much the mobilized capital has been made available for industrial development, boosting economic development in this country. As for the details of the stocks transacted during the same period of time, the number of stocks listed reached fifteen (15); 5 Bank Stocks, 2 Insurance Companies Stocks, 5 Industrial Stocks, 2 Non-industrial Stocks and one other.

The question as to where the capital so mobilized has been used can be easily answered by reviewing the stocks on which the investment was mainly concentrated, out of the above five categories transacted. In other words, this will be

Table 12. Capital Mobilization in the Korean Capital Market

		No. of shares (In 1,000 shares)	Amount (In 1,000Won)	Non-industrial Amount(₩1,000)	Stocks Ratio(In %)
1956	Stock	1,440,690	394,183	73,862	18.7
	Bond	9,084,130	299,466		
1957	Stock	2,114,130	414,036	116,612	28.1
	Bond	60,921,050	2,000,667		
1958	Stock	1,290,735	180,185	78,063	23.0
	Bond	45,990,800	1,481,986		
1959	Stock	8,715,198	763,311	608,488	79.7
	Bond	45,667,750	2,116,446		
1960	Stock	2,700,969	275,242	151,335	54.9
	Bond	28,300,100	1,330,178		
1961	Stock	3,141,694	440,115	136,811	42.4
	Bond	15,218,300	910,903		
1962	Stock	148,250,756	98,374,914	67,637,740	68.7
	Bond	1,152,010	821,370		
Total	Stock	167,654,172	100,841,986	68,852,911	68.3
	Bond	206,343,140	8,961,016		
Grand Total		373,997,312	109,802,992		

Source: The 1963 stock exchange statistical year book.

Note: "Non-industrial stocks" indicates the stocks of the Korean Stock Exchange and the Korea Securities Financing Co.

a qualitative review of capital flow rather than a quantitative analysis of capital mobilization.

As shown in the Table 12, the total amount of stock sales in capital market during the past seven years stood at a total of ₩100.8 billion. However, capital invested in non-industrial stocks reached ₩68.8 billion, or 68.3% of the total amount transacted.

In spite of the fact that the amounts of capital invested in non-industrial stocks during 1956—1958, however, were kept at a level of less than 30% of the total amount transacted, they have increased more than 40% since 1959, i.e., ₩610 million was concentrated on investment in non-industrial stocks such as KSE and KSF Co. stocks, out of a total of ₩760 million. In the 1962 stock boom, investment in non-industrial stocks amounted to ₩63.7 billion, 68.7% of the total transacted (₩98.4 billion).

This fact implies that most of the capital mobilized through the capital market was used for non-industrial purposes rather than industrial purposes. In other words, the capital mobilized through the Korean capital market failed to be utilized efficiently for the increase of real capital by means of facilities expansion and production increase of producers' goods, and it has been allocated to non-industrial uses without boosting the increase of real capital in Korea.

From the above view-points, there is no doubt that the Korean capital market has exerted lesser influence and upon our economic development, and severe criticism because of the inefficiency of our capital market was inevitable.

B. Inefficient capital market and its factors

The basic reasons which cause our capital market to be inefficient and provide lesser influence for economic development are thoroughly reviewed below.

FIRST. The most outstanding socio-economic factor is, *inter alia*, considered to be a few wealthy family groups that possesses most of the stocks. Their family-type corporations constitute approximately 90% of the total, hindering development and progress of our capital market for the following two reasons.

Due to their reluctance to list their stock in the capital market, in an attempt to maintain non-joint stock corporations, and integrate capital and management, supply of stocks to capital market is further withered and deflated.

Due to the fact that the distribution of the stocks is extremely limited in its scope, the demand for stocks is considerably decreased in capital market. In other words, family-type corporations strictly limit dispersion of their stocks to persons other than their own family members, thus forming a kind of monopoly capital

and causing maldistribution of wealth in the society. On the other hand, this monopoly capital is likely to be utilized for speculative market manipulation, in the form of commodities cornering and hoarding, thus touching of price spirals. Due to the large fluctuations of commodity prices, even the liquid capital is heavily concentrated on commodity markets because investment in commodity markets is much more advantageous than that in the capital market. In particular, non-productive investment is to be concentrated in commodity markets in order to hedge the inflation. Such a flow of capital shifting towards commodity markets from capital market is to decrease the demand for stocks in the latter market.

Table 13. Corporation by Types (As of June, 1959)

Types	Number of Corporations	Ratio
Family type	5,769	95.9%
Joint-stock-type	346	4.1%
Total	6,115	100.0%

Source: The Taxation Bureau, The Ministry of Finance.

SECOND, another major cause of the inefficiency of the capital market is considered to be the narrow and limited scale of the stock underwriting market.

Even though there are a few financial groups and stock underwriting groups specializing in stock underwriting in Korea, their investment scales are very tiny due to the lack of capital. Therefore, their investment activities have been repeated for mainly replacing the stocks in lower stock-yield with those in higher stock-yield, making no further development.

As the result, the secondary market was stagnant, and the issue of new stocks has been greatly hindered.

The THIRD factor is the improper function of stock counselors for common investors and the lack of experience and knowledge regarding stock investment among the general public.

Owing to the fact that the higher degree of knowledge and experience is required for stock investment, most of the common investors in underdeveloped countries depend their determination as to investment upon suggestions made by investment counselors.

In addition, the investment counselors hesitate to recommend the common investors to invest since they feel great responsibility for suggestions they make for the common investors lacking the knowledge of and experiences in investment.

As a result, it is inevitable that stock transactions become inactive and sluggish in such countries.

On the contrary, the common clients in well-developed countries such as the United States, are absolutely free and independent from the suggestions made by investment counselors, the reason being that they have the knowledge and experience in abundance. Because of this independence, the common clients are able to make their own final decision on investment, accepting the suggestions of the counselors for only information. Therefore, such difficulties as experienced by underdeveloped countries could not be found in well-developed countries.¹⁾

The FOURTH factor is in monetary field. The capital market is not only affected by speculative capital, but also by fluid capital.

As a tight monetary control policy is implemented by the Central Bank, investment in capital market is to decline and also the demand for stocks in capital market. The loan ceiling system has been enforced by the Korean Central Bank since 1950, as the most positive and direct countermeasure for credit expansion under inflation.

Such a measure as the above is based on re-discount within a limit of the increase of deposits. Therefore, the above system is considered to be very effective for maintaining equilibrium in money supply and demand. However, it fails, on the other hand, to play the role of sensible credit adjustment for promptly adapting to economic situations.

In particular, the serious situations which faced our capital market at its close-down on 4 Dec. 1962 were caused by irrational establishment of margins with dishonored private checks, could have been relieved, to a considerable extent, if the money ever was not so tight as case at that time.

This kind of slump in capital market was experienced by the Philippines in 1960. In the last quarter of 1960, a deflationary policy was put into effect by the Philippines Central Bank; as a side-effect of this policy, the capital market has suffered great consequences and transacted the stocks amounting to only 100,000 pesos out of one million pesos bargained, thus decreasing demand for new stocks and freezing functions of the stock issuance market during 1960—1962.²⁾ Such fact as the above proved that the volume of credit for stock transaction must have exceeded a certain magnitude which can only be surpassed under conditions of an easy money policy. Mr. Fritz Machlup emphasized this point in his "Stock

1) H.K. Charles Worth & Richard W Hooley "The need for a effective capital market", *International Development Review*, volume V., No.3, Sept., 1963.

2) H.K. Charles Worth & Richard W. Hooley, *op. cit.*, p. 27.

market, credit and capital formation".¹⁾

Accordingly, it is considered that a higher priority for loans should be given to capital flowing into the capital market in order to foster our capital market and expedite its proper function.

The FIFTH factor is the lack of various technical data and reference which might help stock demanders to form correct judgement. Even if common investors wished to invest in a certain corporation, the earning records of respective corporations are not available to them. In addition, the investment house or financial institutions do not have well-qualified specialists who are experts on economic survey on the newly or already issued stocks and the analysis of money flow.

The SIXTH factor is considered to be the low domestic savings rates. The average total capital formation rate of 13.5% was noted during the past ten years, 1953—1962, in Korea. Of this average rate, the capital formation by domestic savings constituted 3.8% while that by foreign aid 9.7%. Korea shows

Table 14. Gross Domestic Investment Rates, Savings Rates & Dependability on Foreign Aid

(Unit: %)

	Gross investment rate (Domestic)	Domestic savings rates	Foreign savings rates
1953	15.3	7.3	8.0
1954	11.5	5.9	5.6
1955	11.7	3.5	8.2
1956	4.8	—8.7	13.5
1957	17.4	5.6	11.8
1958	14.2	4.5	9.7
1959	16.5	3.6	7.9
1960	12.4	3.4	1.0
1961	15.5	6.0	9.5
1962	15.5	2.1	13.4
Average	13.5	3.8	9.7

1) Fritz Machlup: "Stock Market, Credit and Capital Formation", London, William Hodge and Company, 1940, pp. 47~8. He said that three conditions are necessary for a tie-up of money capital in security transactions..... one of the necessary conditions which must be fulfilled if there is to be a tying-up of money capital concerns the extent of credit quantities. The volume of credit must have exceeded a certain magnitude—a magnitude which can only be surpassed under conditions of an easy money policy.

the lowest domestic savings rate among the various countries in the ECAFE region, and such a lowest rate is assumed to be one of the major factors to decrease the demand for stocks

The SEVENTH factor is considered to be the disharmonious structure of the interest rates in Korea, which deprives close and systematic interrelationship among various funds, and hinders smooth capital mobilization and the flow of funds.

In a normal rate structure, the interest on long-term loan is highest, the rate on debenture is lower than that on long-term loan, and the short-term commercial loan rate is lower than that on debenture. But our money interest rate is mainly in favour of short-term commercial loans, thus applying comparatively lower interest rates to long-term loans. For example, while the interest rate on short-term commercial loans is 15.69% per annum, interest rate on long-term loan of less than fifteen years is 8% per annum. So, the companies, which they need more funds depend upon the long-term loans from the Korean Reconstruction Bank even though they could issue the stock to supply the funds. They do not want to issue the stock because the interest rate on long-term loans are lower than the stock dividends that they have to pay to the stockholders.

The EIGHTH factor is considered to be the lack of legal institutional framework such as S.E.C. in the United States, which is to maintain the stock prices stabilized from sharp rising and declining.

Due to the fact that such structure is not existing in Korea, such urgent problems as sudden rise in stock prices are impossible to cope properly in our capital market.

In conclusion, it is to be noted that our capital market is not functioning efficiently and well enough to supply industrial capital, although the feasibility to mobilize domestic capital amounting to approximately 15.7 billion won per annum has been proved.

IV. The Policies to Promote the Korean Capital Market

The basic policies to be worked out for making our capital market efficient are considered to be measures to eliminate all aforementioned factors which have brought about inefficiencies to the functions of the capital market.

As such measures are worked out simply, as the basic measures to eliminate the negative factors, however, these could not be relevant and effective policies, lacking consistency. Therefore, the relevance and the timing are to be ensured in the implementation of policies so as to be matched with, and suitable for mecha-

nism of capital market.

In general, the capital market is formed by transactions held between stock suppliers and buyers, or, supply and demand of stock, at a certain place, time and prices.

Accordingly, consideration should be made to the stock listings and the distribution on the part of the suppliers, or on the supply side, the stock underwriting on the part of the buyers, or demand side and stock prices on the both sides of demand and supply of stocks.

In addition to the above, a drastic boosting in terms of monetary and taxation policies, is considered to be imperative in order to expedite effective functioning of the capital market.

Therefore, a variety of such problematical points will be reviewed and analyzed in order to obtain the proper basic policies to be implemented.

1. Stock Listing Policy

According to the current status of the stock-listing in Korea, the listed stocks are not only small, but also many problematical points needing improvement are involved in the quality of the stocks. Therefore, the quantitative and qualitative problems of stocks will be separately discussed here. The qualitative problems of the stocks arise, as learned above, when the stocks are classified into the categories of industrial and non-industrial stocks. At present, industrial stocks constitute only 33.3% of the total in our capital market. Furthermore, most of such industrial stocks are of manufacturing industries producing consumer goods. It is considered that this contradiction has to be eliminated immediately, shifting in favor of industrial stocks of producer goods manufactures from the current consumer goods manufactures.

As one method, a new provision to check the stock listing of non-industrial stocks should be supplemented to the current "Stock Market Listing Requirements" of the Korean Stock Exchange, because there is no such a provision at present.

In addition to the above, the discriminating restriction should be imposed on non-industrial stocks of the current listed stocks. One of the methods is to increase the margin rate of non-industrial stocks to be higher than that of industrial stocks. At present, the margin rate of 50% is being applied to both industrial and non-industrial stocks. However, it is recommended that the margin rate of non-industrial stocks should be hiked to 100% from the current level of 50%.

The next problem to be covered is to increase the number of the listed stocks in order to increase the supply of stocks, thus expanding the current scale of our capital market furthermore.

As of 1961, the number of the stocks listed in various countries is as follows; 1,163 in the United States, 599 in Japan, 90 in the Philippines and 15 in Korea.

The problem is how to increase the number of the listed-stocks. As effective methods, the followings are considered.

(a) Measure should be worked out to list the aforementioned stocks, of all 43 enterprises which have not yet been listed despite their adaptabilities for stock-listing.

- (1) Bank loans to these corporations should be discontinued, the reason being that they are depending their capital supply on loans of banking institutions, even though they are capable of providing the capital through dispersing their stock ownership, after listing in the stock market.

Furthermore, for these corporations it's very convenient to obtain credit loans, at a lower rate of interest from the banking institutions, because of their close relationship and acquaintance with the banks.

As for the family-type corporations, the utilization of the credit loans from the banking institutions is very advantageous for profit, and freedom from managerial intervention of other shareholders, because there is no need to disperse stock ownership in securing the capital.

As far as the banking institutions are concerned, they are apt to issue loans to the aforesaid enterprises due to the greater capabilities of supplying the collaterals. Therefore, the fund which could be expanded more effectively should be absorbed into these corporations.

In view of the above mentioned, these corporations should be urged to list their stocks in the stock market in order to expedite the supply of long-term industrial capital, discontinuing loans hitherto provided by the banking institutions to these corporations.

- (2) Preferences should be given to well-operating corporations who list their stocks in the stock exchange market, in terms of income tax discount or exemption during a certain period of time or preferential allocation of foreign exchange in order to induce and encourage them to list their stocks voluntarily.
- (3) The last method is the compulsory listing of stocks. This requires the enactment of law in which stocks of enterprises whose capital amounts to more than ₩100 million should be required to list their stocks.

Applying these several methods to increase the number of the listed-stocks, the aforementioned 43 enterprises whose capital amounts to more than ₩100 million should be compelled to list their stocks, thus increasing the number of the stock-listed enterprises from 15, at present, to 58 (approximately 4

times).

(b) Measures should be initiated and worked out to increase the number of the listed-stocks by listing the stocks of the enterprises in the stock market, whose future progress of enterprises can be assured, even though they fail to meet the requirement of the current stock-listing procedures.

In order to bring the above measures to a success, the followings are recommended.

- (1) A "Stock-listing review committee" should be established. This committee should consist of specialists who have thorough knowledge of economics. Through review by this committee, the stocks of excellent enterprises that have higher investment priority should be listed on the stock exchange market.
- (2) Stocks of these enterprises should be underwritten by a private development bank, the reason being that it is necessary to provide financial boosting and support to those enterprises in order to foster them and assure their dividend payments from the viewpoint that they are very excellent enterprises that could assure us progress and profit even if they fail to meet requirements of the stock-listing procedure.

This method is considered to be very fruitful; fostering of enterprises is in accord with stock-listing conditions and expansion of the stock market.

Stocks underwritten by the private development bank, are to be gradually placed on sale in the stock market, and so become secondary stock transactions. Thus, assets and resources of this private development bank itself would be made safe.

2. Underwriting of Stock

As previously mentioned, an increase in the number of the listed stocks calls for an increase of stock underwriting activities. And then, the solution of technical problems, bearing on stock underwriting must be initiated.

In other words, the earning records concerning profits of enterprises wishing to acquire new capital are to be placed before the general public, and all financial statements and detailed contract among enterprises be distributed to all shareholders and government agencies concerned.

In addition, all share-holders and government agencies concerned should be allowed to conduct an audit over the enterprises, in accordance with their legal rights, and investment houses and the banking institutions should be reinforced with specialists to conduct an economic survey or analysis on all stocks in circulation.

- (a) A legal action enabling the establishment of a private development bank is

required in order to increase stock-underwriting, upon successful solution of the technical problems involved.

The major function of this bank is to invest in industries, underwrite stocks for investment and disperse the underwritten stocks through the stock market at an optimum time. Therefore, it should be capable of assuming the primary risk of stock investment and be closely related to capital market. Besides this, the bank must make every effort to make good choice in stock for investment, and conceive a relevant way to ensure a smooth flow of the fund, and find the market to sell stocks and select the proper time for public sales.

This bank should also prepare herself to select several adventurous projects. After a certain period of time when the industries are well fostered and matured, the bank should sell the stocks of these enterprises to the secondary market, such as insurance companies. As for insurance companies, they are able to underwrite stocks with less danger than that involved in the stock underwriting by the bank, because it is the secondary underwriting. As soon as success or failure of industrial projects is disclosed, the insurance companies are able to sell those underwritten stocks to private investors, protecting such individual investors from the dangers of stock investment. As a result, the general public can take part in stock investment in a well-stabilized atmosphere.¹⁾

In the United States, such private development banks as the above, exist at present, playing the role of an intermediary in stock underwriting between investment houses and insurance companies.

One of the major problems facing the private development bank would be, how to prevent a financial blockade, which indicates that investment by the bank in certain enterprises becomes fixed and their financial capabilities are frozen.

Issue of long-term notes (bills) is assumed to be a good measure to prevent such financial blockade, e.g., 10% of total bills (notes) issued would expire annually if such bills are issued continuously for ten years.

As a result, such long-term bills (notes) would be a great help to the private development bank in its drive and effort to expand development loans. In other words, long-term bills would facilitate turn-over of fluid capital, thus being capable of providing strong financial supports to new industrial projects or substituting them with stocks gradually.

The next important problem in the establishment of private development bank would be the character and competence of the managerial staff, the reason being that the investment in new projects is to be determined through their assessment

1) H.K. Charles Worth & Richard W. Hooley, op. cit., p. 28.

and review.

(b) In conjunction with private development banks, efforts should be made to develop the secondary stock underwriting institutions such as life-insurance companies, fire and other insurance companies, private pension fund, mutual funds, trust bureaus of city banks, school foundations, etc.

There are 13 damage insurance companies in Korean, and their total assets amounted to a total of approximately 2.44 billion won as of 30 September 1963. Of this total amount of assets, the detailed breakdown of investment is as follows; 0.52 billion won (21.4%) in stocks, 0.02 billion won in national bond. In addition, investment in real estates constitutes 23% while various deposits 26.1% of the total. Therefore, a total of 1.15 billion won (49.1%) could be newly invested in stocks, provided that those deposits and investment in real estates are to be shifted toward stock investment, thus fostering capital market in great strides.¹⁾

(c) A specialized investment counsellor system should be established and strengthened further in order to guide common investors who are the third stock underwriters to sound investment.

Establishment of an investment counsellor system is urgent since our common investors are lacking the experiences and specialized knowledge concerning stock investment and are unable to make correct judgement on stock investment.

Common investors are, on the whole, relying on indirect suggestion or guide of stock dealers and staff-members of the stock exchange market, at present in making their decisions to invest. However, they have no legal responsibilities in guiding and offering suggestions. Therefore, proper measures should be worked out by the government to foster them in the form of a public accountant in order to legalize their activities, to offer suggestions for fair transactions. Otherwise, a great bottleneck is considered to be confronted with the third stock-underwriting, and systematic relations from the first to the third stock underwriting structure would collapse.

(d) Functions of the stock underwriting groups now existing at the stock-dealers' association, should be further reinforced, because the groups are not operating well enough to absorb new stocks smoothly.

In this connection, the government should work out proper measures to expedite development of this stock underwriting group capable of grasping correctly the quantity of the stocks, determining the optimum sale prices, estimating available funds, etc., required for stock underwriting in close coordination with K.R.B.,

1) The Korean Reinsurance Corporation, "Monthly Insurance Review", Nov. 1963, p. 87.

other banking institutions, insurance companies, private pension fund and others concerned. In order to ensure the above functions, the government should take, as may be necessary, a legal action.

According to Article 5 of the **Extraordinary Law Concerning Disposal of Government and Public-owned Property**, the Government-held stocks are to be sold through the stock exchange market. Direct sales of these stocks through **negotiated contract** are to be limited to the banking institutions established in accordance with the Bank Law and Trust Companies established by the Law Concerning Insurance and Trust Business.

However, stock dealers who are defined as stock underwriters in the **current stock transaction law**, are excluded. Therefore, it is recommended strongly that the respective law is to be so amended as to enable the current stock underwriting group which is consisted of stock-dealers to underwrite stocks.

3. Distribution of the Stocks

Along with the increase in the number of stock-listed enterprises and the expedition of smooth stock-underwriting, wide distribution of the stock ownership should take place. The problem of stock distribution is so important that of a modern economic society is characterized as so-called people's capitalism.

Modern capitalism is represented in terms of nominal value of securities (bond, debentures and stocks). Through free circulation and assignment of these securities, securities in small amount can be widely dispersed among the general public so that they own a small portion of industrial capital. This process is called people's capitalism. Therefore, there are a few who call people's capitalism, securities' capitalism. This indicated qualitative change of capitalism, and it is also to be noted that the contents of capitalism varies by securities to a considerable extent.

Wide dispersion of securities' ownership among the general public is not considered to be incidental, but achieved through well-established organizations. In addition, it is learned that a wide dispersion of securities' ownership can be brought about, only by drastic activities of specialized investment advisory agencies, that provide the common investors with scientific and rational guidance and advice pertaining to investment.

In order to expedite the functions of investment and the dispersion of securities' ownership, the followings are considered necessary

a. **The securities investment trust** system should be established in order to ensure independency of investment functions.

Investment trust indicates a structure which is specialized for operation, deposits and survey of funds collected from a great number of small-scale investors, and

investment by categories of securities, districts and enterprises for the sake of distribution of dangers, so as to furnish profit of investment evenly to such small investors.

Investment through this **investment trust** is very advantageous to small-scale investors in terms of the following; 1) distribution of the risk involved in investment. In other words, the objects of investment could not be chosen by the individual in wide range due to the small and limited amount of their investment. However, a great deal of the funds formed by such small amounts from individual investors can be properly invested in various objects of investment so as to eliminate risks involved in concentrated investment, 2) assurance of advantages, stability and secrecy in investment. In other words, investors are not required to disclose contents of his investment to others, only retaining a certificate of beneficial interest in the investment trust system. In addition, investment through **investment trust** can be accomplished scientifically. Under the current unstable economic situations that necessitate considerable variations, investment could not be made at random, but must depend on scientific analysis of the economic trends, details of enterprises and the psychological pattern of investors, in order to attain profit income. From the above viewpoint, scientific investment can be assured by the **Investment trust** which has specialized advisors for those tasks. The kind of investment trust in the United States will be described here briefly. According to Article 4 and 5 of the U.S. investment company act enacted in 1940, the breakdown of investment trust companies is as follows:

1. Face-amount Certificate Co.
2. Unit Investment Trust
3. Management Company
 - (a) Open-end Co.
Closed-end Co.
 - (b) Diversified Co.
Non-diversified Co.

The Face-amount Certificate Company as the name indicates is the company which issues a face-amount certificate upon completion of annual or quarterly installment payments for a period of 10 to 15 years. The Unit Investment Trust Company indicates contract-type investment trust in England. This company is established in accordance with trust contracts, and defined to issue certificates of indivisible holdings per unit investment.

On the other hand, the management company is a supplemented contract-type trust fund in England or open-end company in Japan. The characteristic of the

open-end company in the United States is that it is based on **trust type** rather than contract type in the issue of common stocks.

The open-end company here indicates the type of trust company which is to purchase and repay for stocks of the investor, whenever he wants to sell, while the close-end company indicates type which issues stocks not responsible for re-purchasing or re-payments. The characteristics of the diversified company is that more than 75% of total assets is contained in currency, government bond, stocks of other enterprises and other securities, and one investment should not exceed 5% of the total investment scale.

Legal action is required to be taken in order to realize the above mentioned investment trust system. While special laws that enable the establishment of such a trust system have been put into effect in well-developed countries, they are not available in Korea at present.

According to Article 25 (management of trusted assets) of the current trust law, it is defined as investment in securities, free from restrictions of other provisions, provided that there is a special contract. Our trust system is, however, not comparable to those in well-developed countries that are enforced by separate laws, even though they are the same in the form of contract. Accordingly, legal action to enact a separate law bill is urgent in Korea.

b. The terms of the stock distribution in the current stock-listing procedures should be so revised as to ensure smooth distribution of stock ownership.

The total number of the share-holders is to be more than 150 to meet our stock-listing criterion at present, while it is 2,500 in Japan and 1,500 in the United States. This fact implies that the requirement for our stock-listing criterion concerning the number of the share-holders is limited to too small a number of share-holders in comparison with those of other countries.

The major bottleneck confronted with the distribution of stock ownership in Korea is the lack of measures to disperse the stock ownership in small denominations. In other words, small scale share-holders who are in possession of less than 500 shares, must constitute more than 20% of the total share-holders. However, the number of the share-holders who possess more than 4 million shares are limited to no more than 10% of the total number of the stocks in Japan. In the case of the United States, 500,000 shares at least, must be widely dispersed among the general public, in order to warrant a broad distribution of stock ownership.

As of 1961, capital possession per share-holder on the base stock listing criterion amounted to \$5,128, \$778 and \$66,667 in Korea, Japan and the United States respectively. This implies that the capital possession per share-holder in Korea is much higher than that of Japan, indicating that it is a fact hindering dispersion

of stock ownership in small amounts. Therefore, action should be taken to lower our capital possession per share-holder to the level of Japan, so as to accelerate popularization of stock ownership.

c. Stock sales market should be expanded. In Japan, all stock dealers companies have concentrated their efforts on the inducement of stock investment, establishing their agencies in department stores.¹⁾ Our effort should also be focused on encouragement of stock transactions in small amounts by following such institutional advantages as the above.

It is considered that such a measure is very helpful for industrial capitalization of small fragmental capital and improvement of public consumption pattern, the reason being that bonuses, pension, severance payments can be sunk in the purchasing of stocks that have higher yield rates.

In addition, convenient transactions must be ensured by expanding stock sales' market to other public facilities such as department stores, because small-scale investors are not apt to visit stock brokers directly.

Most of the general public in Korea are prejudiced because stocks are only being transacted in Seoul, and pay no attention at all to stock market. Accordingly, a nation-wide expansion of the stock market is imperative in Korea.

In connection with stock dividend, a legal action is desired so as to ensure convenience in payments of dividend by means of a "coupon" system.

4. Monetary policy

Formation of an effective capital market is governed by monetary policies to a considerable extent. In other words, the efficiency of the capital market is beyond expectation without flexible application of relevant monetary policies.

Due to the large gap between rates of money interest and rates of price spiral caused by the inflation prevailing in Korea, the flow of liquid capital is apt to be shifted from capital market toward commodity market, where this capital stimulates speculations in commodity transactions. Therefore, monetary policies should be enforced toward eliminating the above, bearing great importance in terms of the formation of an efficient capital market.

Monetary policies enforced by the Bank of Korea during the past ten years have been passive and lacking in efficiency, flexibility and drastic control. This implies that **selective credit control**, most suitable to underdeveloped countries in their monetary control, was not implemented in Korea.

A variety of general control measure such as bank rate, and legal reserve ratios,

1) Robert A. Lindgren, and Atsumari Takeyama, op. cit., p. 45.

have been put into effect by the Bank of Korea, as well as a loan-ceiling system for a tight control of inflation.

Due to the excessive emphasis on quantitative control, however, qualitative control has been neglected. In view of the current circulatory order and economic progress, which are far behind those of other countries, more active and strategic **selective credit control** is required. The necessity of this control is further stressed particularly for the formation of an efficient capital market in Korea.

a. The first priority of loan-preferences should be given to industries to be selected by the "stock-listing review committee."

Priority-list of loans is to be prepared by use of the fund in demand, thus drastically curbing loans for non-productive use.

Such allocation of funds would lead our efforts to achieve a self-sufficient economy, to success, by improving the investment pattern of the national economy.

Such "discriminating fund allocation" policy by loan priority have been generally enforced in well-developed countries during or since the war. But, due to the fact that the demand for funds is in excess of the supply, and the inflation needs to be checked drastically in underdeveloped countries, the afore-said policy is normally enforced in underdeveloped countries during their period peace.¹⁾

b. Regulation of stock market credit should be enforced. This implies a selective control to regulate and adjust the amount of credit to be used in speculation of securities, by changing margin rates concerning stocks and other securities.

In the case customers wanting to borrow funds from banks or stock dealers in mortgage of securities, monetary institutions are able to regulate the supply of funds for stock exchange credit by varying ceilings of securities-lien loans, if necessary. If the margin rate is 70%, for example, the amount of loans to be granted by stock dealers to customers is 30% of the value of the secured securities, and 70% of prices of secured securities is to be furnished by the customers.

Upon the increase of margin rates of stocks, the following two by-effects can be obtained; 1) demand for fund for speculations in stocks transactions is curbed because of the limit of speculative profit income to be accrued by purchasing stocks with borrowed money; 2) supply of funds from banks and stock dealers is so curbed as to increase margin rates, the reason being, that the gap between the market quotations of securities and the margin requirements is the allowable amount of loans of stocks dealers.

As a result, the monetary authorities would be able to vary ceiling of securities-

1) The Central Bank of the Philippines, "Portfolio Ceilings on Philippines Commercial Bank Credits", *Central Bank News Digest*, Vol. XI. No. 23, (June 1959), p. 4.

lien loans by varying the margin rates. Selective credit control over stock market loans was originally developed in the United States. In 1933, U.S. Bank law was so revised as to limit the credit of the member banks issuing securities transactions. In accordance with the revised U.S. Bank law, loans from the Federal reserve bank were discontinued to the member banks that had issued excessive amounts of credit for securities transactions. In addition, it prohibited the member banks from making loans on accounts of others.¹⁾

In 1934, the U.S. securities transaction law was further reinforced and strengthened, and sharp rise of stock quotations from Feb. 1945 to Feb. 1947, was successfully controlled by varying the margin rates. In February 1945, the margin rate increased up to 50% from 40% due to the sharp rise in stock quotations. It further increased to 75% in July 1945 and 100% in January 1946. A margin rate of 100% was maintained by February 1947, and dropped finally to 75% due to a declining trends of stock quotations.²⁾

c. Open market operation should be made by the Central Bank, since it is a direct and positive means, not only of stabilizing the value of the currency in terms of regulation of money supply, but also of affecting stock investment to a considerable extent.

During the stock boom in May 1962 our central bank failed to take part in open market operations, to check sharply rising stock quotations. As a result, the demand for stocks was in excess of supply, bringing about an unprecedented sharp rise in stock quotations in Korea.

If the central bank had adopted drastic measures to supply the stocks sufficiently to meet the increased demand for stocks, good effects could be brought about in dispersing the abundant government owned stocks and in controlling stock prices at the time.

The development of the stock market and availability of sufficient stocks are, of course, a prerequisite for open market operation. Excessive transactions of the central bank beyond the absorbable power of stock market resulted sometimes in sharp rise or decline of stock quotations in the stock market. In addition, excessive possession, as well as underpossession, of stocks by the central and city banks, limit the effect of open market operations.

However, the stock boom in May 1962 seems to be exceptional, because the sharp rise of stock quotations was caused by the lack of the supply of stocks to meet the increased demand. Provided that the central bank placed the stocks in

1) Herbert V. Prochnow, *The Federal Reserve System*, New York, 1960. pp. 150---

2) Lester V. Chandler, *Inflation in the U. S. A. 1940~48*, Harper & Brothers Publishers, New York.

their possession on public sales, the sharply increased demand for stocks could have been fulfilled, thus bringing stock prices to a decline.

5. Taxation Policy

Taxation policy is another important factor in making capital market efficient. The law bills concerning capital market are the corporation tax law and the income tax law.

The corporation tax law was enacted on November 7, 1949. However, it has been partially revised about 9 times since the original enactment. The last amendment was made on December 8, 1961. The provision concerning the capital market is Article 16 of the law, i.e., "corporation tax shall be imposed at a rate of 20% of total annual income."

Tax rates of 17% and 20% had been applied to joint-stock and non joint-stock companies respectively before it was revised. However, it was revised again later to an unitary rate of 20%, abolishing classification into joint-stocks and non joint-stocks companies because of the failure to achieve the planned effect. On the other hand, the new amendment called for drastic measures to boost and expedite the expansion of enterprises in terms of taxation by discounting corporation tax rate by 50% during the 5 years, for the sake of those corporations who increase capital, through either stock-listing in the capital market, or public floatation by other methods.

Even though this amendment has proved to be a further development of corporation tax system possible and helped industrial progress, it has failed to affect the capital market, the reason being, that the provision concerning 50% discount of corporation taxes as mentioned above failed to induce and encourage stock-listing of enterprises.

a. Therefore, a discriminative imposition of corporation tax is recommended between the corporations that have listed stocks and the corporations that have not, in spite of their capabilities to meet the requirements of the current stock-listing procedure. A corporation-tax rate of 20% should be increased to 30% for the latter, while it should be lowered to 20% for five years upon listing their stocks, as well as for other corporations who have already listed their stocks, in order to expedite the stock-listing, and increase the types of the listed stocks.

b. As for the law concerning income tax to be imposed on dividend; dividend income to be paid by stock-listed corporations was defined as non-taxable income in Article 14 of the current law concerning income tax.

However, there is no provision applied to dividend income paid by corporations that did not list their stocks. Therefore, it is recommended an income tax rate of 20% should be applied to dividend income of the non stock-listed corporations.

Income-tax rates on dividend in major countries are 15% in the United States, 15% in France, 18% in Italy and 10% in Japan. A comparatively higher rate of 20% in our country is necessary, in order to encourage and expedite the stock-listing.

It is not necessary to repeat again, that the object of such rated corporation-tax, must be the corporations that have not listed their stocks on the stock market, in spite of their ability to meet the requirements of the stock-listing procedures.

6. Stabilization of Stock Prices

It is considered that all factors affecting stock prices could not be described in detail here. In addition, it is difficult to establish positive theories or rules enabling the advance forecast of stock prices. As a whole, there are two factors affecting stock prices at the capital market.

One is an external factor happening outside of the capital market which plays the basic role in the fluctuation of the stock prices, and affecting the stock prices on the long-term basis, while the other technical factor involved inside of the capital market affects the stock prices on the short-term basis.

The former is the basis of the conventional theory and it is quoted that the basic cause of stock price movement is the anticipation of changes in corporate earnings.¹⁾ This implies that stock price movement is governed by the profits of the corporations issuing the stocks. In this case, the basic details to cause fluctuation of the stock prices are profits, interest rates, prices of commodities, G.N.P. inventory, strikes, etc. and affect stock prices on the long-term basis.

However, the problem facing us is the latter, the technical factor affecting stock prices on the short-term basis inside of the capital market.²⁾

These technical factors are the basis of the confidence theory, emphasizing mainly the fact that the psychological state of short-term transactors, affect the stock prices in capital market. The short-term transactors indicate the speculators in stock market, and the stock prices are considerably affected by their speculative transactions. The major details of technical factor are as follows:

a) Volume

As quoted, the volume goes with the trends, the volume of transaction bears great importance.³⁾ If a rise in stock prices is noted in the bull market, the volume of transactions in the bear market is to increase. The buying force exceeds the selling force at this stage to be and is called the bull. On the contrary, the stock prices would decline if the volume of transactions is decreased.

1) George. L. Leffler, *The Stock Market*, The Ronald Press Co., New York, 1957, p. 499.

2) *Ibid.*, p. 500.

3) *Ibid.*, p. 557.

If volume of transactions increases, in spite of the declining of the stock prices in the bull market, on the other hand, the stock market is bearish because the stock owners want to sell out their stocks. However, when the volume of transactions is decreased in spite of the gradual increase of stock prices, it indicates that the demand for stocks is very weak in the stock market, implying the feasibility to bring "the bull" into the stock market.

b) Breath of the Market

This indicates the number of stock descriptions to be transacted in the stock exchange market. In the New York Stock Exchange Market, approximately 1,500 kinds of stocks are listed at present. The variations in the number of stock descriptions transacted in the stock exchange bears great importance on the trends of stock prices, e.g., if quotations of 500 kinds of stocks at maximum are increased, while those of 200 kinds of stocks at a minimum, are lowered, and those of 200 kinds of stocks remained at a constant level on a certain date, this is assumed to be the "bull". In this case, the stock prices are increased. In the adverse, however, stocks prices are lowered.

c) High and low bids in the bull market themselves affect the stock quotations indirectly. In other words, common investors are apt to buy low priced stocks, rather than high priced stocks in the bull market, the reason being that much profit can be obtained by purchasing low priced stocks rather than high priced stocks.

For example, a profit rate of 10% is accrued as the quotation of stocks priced 10 won per share is increased by 1 won. In case of the quotation of stocks priced at 100 won per share is increased by 1 won, however, the profit rate is just 1%.

As a result, attention of common investors is focused on such low priced stocks in the bull market, at first, since they are considered to be stocks one can invest in with safety. Accordingly, purchasing of those stocks is at its peak. Finally, stock quotations of those stocks decline sharply, declined by the decrease of speculations, since those are considered to be stocks no longer profitable.

d) Reactions to News

This implies that the stock prices in the capital market are considerably affected by the market reactions to news. If there is no due reactions in the capital market in spite of news very favourable for stock transactions and determination of stock prices, it is called as "bearish", thus failing to stimulate the bull market. If stocks are not sold in the bear market in spite of news, unfavourable to stock exchange, on the contrary, it is called as "bullish", and common investors would not sell out their stocks.

Thus, the status of the demand and supply, governed by reactions of common investors to news affects stock prices in capital market.

e) Continuously rising trends in stock prices provides itself considerable influence to the formation of stock quotations. It indicates that the continuous rising trends in stock prices is maintained during one month from a certain date when stock prices are hiked.

This tendency was revealed in the study conducted by Mr. Alfred Cowles. For his study, Cowles conducted detailed analyses on 1,200 types of stock during 1836—1935, and arrived at the conclusion that 62.5% of the total stock discriptions mentioned above, maintained a continuous rising trend for one month after prices are once hiked, and the remaining 37.5% maintained the adverse trends.¹⁾

Thus, this continuous rising trends of stock prices causes fluctuation of the market quotations, stimulating common investors and affecting the demand and supply of stocks in capital market.

In addition to the five factors explained above, there is a political factor which affects the stock prices to a considerable extent in capital market, i.e., war, budget, and the trends of the Government and the National assembly, etc., become sometimes the most important and decisive factor in the determination of stock prices.²⁾

It is learned that there is a variety of factors affecting stock prices and the stock price is the most sensible barometer of economic activities. Therefore, multilateral consideration should be paid to stabilization of stock prices.

Stock prices in our capital market are governed by short-term and technical factors which are based on the “confidence theory” rather than the “conventional theory.”

In addition, our capital market is assumed to comprise in two groups; one group that consists of a few share-holders in possession of a large number of stocks, and the other, that consists of a great number of small share-holders in possession of a lesser number of stocks.

The former plays a major role in the fluctuation of stock prices by means of artificial manipulation of the transactions volume, while the latter does not extend much influences over fluctuation of stock prices. Therefore the quotation that “the public is always wrong”, is considered to be appropriate in our capital market.

The following policy-measures can be conceived in an attempt to stabilize stock prices in our capital market.

First: The “Stock Price Stabilization Committee” should be established so as to work out a systematic, well-timed and positive measure for the stabilization of

1) Alfred Joles, “Fashions in Forecasting”, *Fortune*, March, 1949, p. 180.

2) G.L. Leffler op. cit. pp. 519—521

stock prices. This committee must be similar to the Stock Exchange Commission in the United States, in its organization, and be subordinate to the President in order to be able to cope with sharp changes in stock prices.

Second: The special Securities Stabilization Fund is to be established. Whenever the capital market is confronted with serious difficulties, due to the lack of settlement funds required for coping with the sharp rising of stock prices, this Fund should be able to loan out its funds for smooth settlement of account under the direction of the aforesaid "Stock Price Stabilization Committee."

For instance, the accident, such as the close-down of the capital market in May 1962 that was caused by lack of a settlement Fund, could have been prevented in advance by the establishment of the Special Securities Stabilization Committee.

In addition, this Fund is to be utilized for the prevention of speculations and prices' fluctuations, and for maintenance of fair formation of stock prices on capital market.

Third: A new type open market operation department should be established in the Central Bank, which is to work out positive and drastic measures, for open market operation, whenever it is directed by the Stock Price Stabilization Committee.

Fourth: The margin system should be further reinforced and drastically implemented. This indicates that the margin system should be applied drastically to the stock exchange loans of the Central Bank and time-transactions in capital market.

The margin system did not get to be implemented correctly in our capital market which closed on December 4, 1962. In particular, the capital market was placed into a slump at that time by dishonored private checks, and failed to achieve the pre-planned effect of a margin system, because private checks were accepted in lieu of currency or bank-issued checks.

As for the margin rates, to be applied on stock exchange loans of the central bank, it must be varied at the direction of the "Stock Price Stabilization Committee."

V. Conclusion

It has been analyzed and reviewed how such contributions toward economic development have been made by our capital market, and there have been presented several policies to make it efficient.

To summarize briefly;

First, our capital market was capable of mobilizing a total of ₩15.7 billion on the annual average during the past seven years.

Second, the capital mobilized was used for non-industrial purposes.

Third, non-industrial use of capital is attributed to the fact that non-industrial stocks became popular stocks, and most of the capital was concentrated on them, thus keeping our capital market inefficient.

Fourth, effort should be made to encourage and expedite the listing of industrial stocks, clapping non-industrial stocks down under strict restrictions. In order to bring the above to a success, the following methods are recommended.

(1) Stocks of enterprises which are able to meet the requirements of the current stock-listing procedures should be immediately listed in capital market.

(2) Stock-listing of enterprises which are unable to meet the requirements of the current stock-listing procedures, but having bright future prospect, should be recommended through such organization concerned as the "Stock-Listing Review Committee."

Fifth, Stock underwriting capabilities should be further expanded by means of the following:

(1) Prompt solution of technical problems involved in stock underwriting.

(2) Reinforcement of functions of the stock underwriting group now existing at the stock dealers' associations.

(3) Establishment of private development bank.

(4) Expedition of development of the secondary stock underwriting market.

(5) Establishment of "Investment Counselor System" for correct guidance of the general public, the third stock underwriters, as to stock investment.

Sixth, broad distribution of stock ownership is strongly encouraged in stock distribution policies for the realization of people's capitalism by means of the followings:

(1) Realization of "Securities Investment Trust" system for independence of investment function.

(2) Nationwide expansion of stock sales market by establishing branches or agencies at all department stores.

(3) Expansion of stock distribution by revising conditions relating to the stock distribution in the requirement of current stock-listing procedures.

(4) Implementation of such monetary and taxation policies as necessary in abolishing family-type corporations, and measures to ensure current payments of dividends.

Seventh, positive and strategic "selective credit control" measures most suitable to our economic situations must be worked out as supplemently policies such as;

(1) Higher priority in the supply of capital is to be given to enterprises so selected by the "Stock-Listing Review Committee."

- (2) Regulation of Stock Exchange Credit loans is to be put into effect.
- (3) Drastic and timely open market operation by the Central Bank, whenever need be.
- (4) Inducement of domestic capital into capital market by correcting disharmonious structure of money interest.

Eighth, Stock-listing is to be encouraged and expedited to a maximum extent in terms of the following taxation policies.

- (1) Discriminative imposition of corporation-tax on stock-listed and non stock-listed enterprises in order to induce the latter to list their stocks in capital market.
- (2) Discriminative imposition of income-tax on dividends paid by stock-listed and non stock-listed enterprises to induce the latter to stock-listing.

Ninth, Stabilization measures of stock prices is to be strengthened in terms of the followings:

- (1) Establishment of the "Stock Price Stabilization Committee" in order to cope with the fluctuation of stock prices immediately.
- (2) Establishment of the "Special Securities Stabilization Fund.
- (3) Correct enforcement of the margin system under the direction of the "Stock Price Stabilization Committee."

However, it should be further stressed that the aforesaid measures and policies should be enforced comprehensively and drastically under strong leadership.

Based on the fact that partial enforcement of the above measures and policies could not bring about successful achievement of promoting the capital market, since they have close, systematic interrelationship one with another, great institutional reform should be made in capital market by a drastic surgical operation.

For over-all and systematic coordination of those policies, the "Capital Market Promotion Committee" is to be established under the control of the President, where a scientific study is to be conducted to increase "real capital" by industrial use of liquid capital through the formation of an efficient capital market, so as to make it a major source of long-term industrial capital.