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Testimony



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South Korea: Black Marketing of  
U.S. Provided Goods and Efforts  
To Prevent It

Statement of  
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Before the  
Subcommittee on Oversight of  
Government Management  
Committee on Governmental Affairs  
Senate



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Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss our review of black market activities by U.S. military personnel and Department of Defense (DOD) civilian employees, their dependents, and others living in South Korea and U.S. efforts to control black marketing.

Black marketing is the act of transferring duty-free goods acquired from U.S. Forces Korea (USFK) commissaries, base exchanges, and other retail outlets to unauthorized individuals for profit or personal gain. The Status of Forces Agreement requires the U.S. government, in cooperation with the Republic of Korea, to prevent the black marketing of these goods. The U.S. government has criticized the Republic of Korea for not cracking down on black marketing and for its trade restrictions and high tariffs on foreign products. The Korean government has criticized the U.S. for not doing enough to prevent black marketing. These criticisms are all valid because neither government is aggressively or effectively trying to prevent it, and the Korean government continues its trade restrictions and high tariffs.

We observed that black marketing of USFK duty-free goods is taking place and we believe that it is widespread throughout South Korea. However, we are unable to determine how much of the goods are making their way to the black market. We saw goods from the USFK retail system in numerous Korean markets and stores. Also, retail

sales rates indicate that the authorized population could not be consuming all of the merchandise sold. In addition, the investigative case files and analyses of USFK enforcement groups also indicate that the problem is widespread.

The USFK ration control system, which costs almost \$12.1 million per year, has weaknesses which make it ineffective in detecting and deterring black marketeers. Honest users of the ration control system believe that black marketing is a moral issue and would like to see it stopped. They complain that the black marketing frequently prevents them from buying what they want because (1) limited store space is taken up by large quantities of items wanted on the black market at the expense of other items either not stocked or stocked in limited quantities and (2) black marketeers buy up existing stocks before honest customers have a chance to buy them.

REQUIREMENTS UNDER THE  
STATUS OF FORCES AGREEMENT

Under the Status of Forces Agreement with South Korea, U.S. military personnel and other specified individuals are entitled to purchase items from USFK retail outlets, which are not subject to Korean taxes. In return for this privilege, these authorized users have an obligation not to sell or transfer these duty-free items to others not authorized to receive them. The U.S. armed forces, in

cooperation with the Korean government, are required under the Status of Forces Agreement to take steps necessary to prevent abuse of this privilege.

The stated objectives of the ration control system are to fulfill U.S. obligations under the Status of Forces Agreement regarding the disposition of duty-free goods, ensure that adequate supplies of goods are available to meet the needs of authorized purchasers, and deter black market activities. Based on 1987 data, USFK estimated that it costs almost \$12.1 million to operate the ration control system--\$2.7 million in direct costs and \$9.4 million in indirect costs. Indirect costs are made up of partial salary costs for personnel who spend most of their time on non-ration control duties.

There has been a ration control system in South Korea since the end of the Korean War. USFK has used various versions of manually controlled systems, including punch cards and coupon books. None were totally effective in stopping the black marketeers. USFK changed the system in 1971 by replacing the paper cards with the current plastic ration control plate, which is similar to a credit card.

## RATION CONTROL SYSTEM

The current ration control system utilizes three types of controls: monthly monetary limits, monthly quantity limits, and specifically controlled items. A ration control plate and a picture identification card are normally required when making purchases. Temporary ration control cards are used until the plates are issued.

Purchases of duty-free goods are recorded through the use of the plastic ration control plate. The plate is embossed with raised identification data, such as the individual's name, social security number, rank, sex, family size, and expiration date. When an authorized patron makes a purchase, the sales clerk anvils the plate onto a three-part sales card, which is similar to running a credit card through an embossing machine. One copy of the sales card is kept by the individual, another copy is kept by the retail outlet, and one copy is sent to the USFK Data Management Division for processing. At the Data Management Division the paper cards are read by an optical character reader and recorded in a database.

An individual's purchases are accumulated in this database each month by social security number. Each month sales data are analyzed against the control limits to determine if violations have occurred. The database identifies those individuals who exceed their monthly limits or buy unauthorized items. Purchase

reports for violators are produced monthly and sent to the violator's military unit for appropriate action--counseling, reprimand, courts-martial, etc.

#### ROLES AND RESPONSIBILITIES

In addition to the computerized process, there are various military organizations involved in managing and enforcing the ration control program and deterring black market activities. USFK Assistant Chief of Staff, J-1 (Manpower and Personnel Directorate), and its Data Management Division implement and manage the ration control program. Area, installation, and unit commanders have various responsibilities to ensure compliance with the ration control system and administer disciplinary actions.

There are various military law enforcement groups involved in trying to suppress black market activities. USFK's provost marshal investigates lost and stolen documents, maintains a file of controlled-item sales cards, collects data on black market trends, and coordinates efforts to suppress black market activities. The Army Criminal Investigation Command (CID) and the Air Force Office of Special Investigations (OSI) investigate violations of the ration control system and black market activities. They mainly handle major investigations involving items valued at more than \$1,000. The Army military police and the

Air Force security police at the installation level investigate the smaller, less involved black market cases.

There are three major military organizations in South Korea that sell duty-free goods. The largest in terms of retail sales is the Army and Air Force Exchange Service (AAFES), which has 103 retail outlets in South Korea. This includes eight main exchanges, 38 branch stores, 33 small annexes, 13 military clothing stores, and 11 auto parts and gasoline stations. AAFES outlets sell items ranging from refrigerators and televisions in its exchanges and branch stores down to snack foods and beer in its annexes. The Army's Far East Commissary District operates three full-service food stores and other smaller annexes in South Korea. Similarly, the Air Force Commissary Service operates two full-service stores and other small annexes. The commissaries sell all types of grocery items, including meats, fruits, cigarettes, cheeses, juices, snacks, and Korean food. There are also 28 Class Six outlets, currently operated by AAFES.<sup>1</sup> The Class Six outlets sell liquor, wine, beer, cigarettes, cheeses, juices, snacks, and other items.

AAFES is a sales-oriented, profit-motivated, and nonappropriated funded organization. It is the largest contributor to the military Morale, Welfare, and Recreation Fund. Fifty percent of AAFES' net

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<sup>1</sup>Class Six is the name given to the Army and Air Force package beverage operation. The name was changed from Class VI to Class Six when AAFES took over management on March 25, 1989.

profits are contributed to the fund and the remainder is used for capital improvements.

The commissaries, while also sales-oriented, sell their merchandise at cost plus a 5-percent markup. They are primarily stock-funded and the funds are used to pay for operating expenses and construction.

#### EVIDENCE OF THE BLACK

#### MARKET PROBLEM

Black marketing is a problem in South Korea. We know that products sold at USFK commissaries, base exchanges, Class Six stores, and other retail outlets are finding their way into the Korean economy because we saw the items during our visits to the large black market shopping areas, as well as in regular retail stores and small shops. We also know that items are sold on the black market for between two and three times their price in USFK retail stores.

Even though we know black marketing is occurring, we cannot accurately measure the magnitude in terms of the number of people participating or the value of USFK duty-free goods that reach Korean retail outlets. Also, USFK, OSI, and CID officials are unable to estimate, with any confidence, how many people are participating in black market activities or how much of the U.S.-



provided goods reach the black market. However, as we will discuss today, we believe it is a serious problem and that the current ration control system cannot ensure items purchased in USFK retail outlets do not reach Korean markets and stores.

Large Number of Korean Retail  
Outlets Selling USFK Duty-free Goods

It is not difficult to spot the signs of the black market due to the large number of Korean markets and stores selling USFK duty-free items. Many of these items still have the price stickers from the USFK retail outlets still on them.

One such market is called Namdaemun, one of several large black market shopping areas in Seoul, where there are many small shops selling a variety of USFK duty-free goods along with Korean products. Many of the items still have the exchange or Class Six price sticker on them. Commissary items are not as easily identified because the commissaries no longer use price stickers. Commissary meats, however, can still be identified by their price stickers.

In addition to large markets, there are "hawkers" on the streets of Itaewon, a shopping area near the Yongsan Army Garrison in Seoul, selling all types of American products, such as beer, wine, canned meats, and jars of peanut butter and jelly. There are also stores

selling a variety of repriced American products. If a sticker or two is peeled back, the commissary, exchange, or Class Six stickers can be seen. Small Korean shops everywhere are selling a variety of American and Korean food items.

Food and liquor are not the only items sold on the black market. We also found Korean appliance stores selling a variety of American appliances. Again one must look close, but the evidence is there. In one store we visited, a General Electric refrigerator (19.6 cubic feet) still had an AAFES sticker on its shipping box.

#### Unusually Large Sales and Purchase Rates

While we cannot precisely measure the magnitude of the problem, current sales and purchase rates for some items popular on the Korean economy help indicate the magnitude. Items such as rice, Spam, hot dogs, cheese, chicken, hair spray, and Chivas Regal Scotch have unusually high sales rates.

When we calculated per capita sales rates we used all 70,328 authorized consumers during 1988, not just likely consumers, as our universe. Our universe included 37,428 service members with no dependents in Korea, in addition to 8,000 service members with 15,909 dependents. There are also 1,557 civilians with no dependents in Korea and another 2,483 civilians with 4,951 dependents. Given the large number of authorized consumers with

no dependents in Korea who can obtain their meals in military dining facilities and most live in barracks, we believe that our universe of consumers is overstated. As a result, many of the per capita sales rates we computed for items popular on the black market are understated. However, we believe it indicates the magnitude of the problem. (See attachment 1 for additional USFK demographic data.)

### Consumable Items

We calculated the per capita sales rates for selected USFK duty-free items we saw frequently on the black market. Based on these calculations, we found unusually high sales rates for rice, Spam, hot dogs, cheese, hair spray, and Scotch whisky. In addition, we obtained a commissary study showing unusually high chicken sales during the 1988 Summer Olympics Games.

Of the consumable items, sales of duty-free rice were much higher than expected. Our analysis indicated that during 1988 more than 170 pounds of rice was shipped into South Korea for every authorized consumer. (See attachment 2 for our computation of the annual consumption rate for rice.) This is significantly larger than the U.S. 1987-88 annual consumption rate of 13.6 pounds per person. The rate for Army dining facilities was 10.3 pounds of rice for all active duty personnel stationed in South Korea.

The following case illustrates excessive rice purchases. A dependent wife was accused, based on a review of commissary sales records, of purchasing over 1,400 pounds of rice during an 8-month period. This was an average monthly rice purchase of 179 pounds. During the months of August and September 1987, records showed that she purchased 300 and 325 pounds of rice, respectively.

The amount of Spam sold was over 1.1 million cans (about 326,000 pounds), or almost 12 pounds per person per year. The rate for hot dogs was over 45 packages or between 365 and 456 individual hot dogs per person per year. Sliced American cheese is a big seller, too. Sales came to 34 pounds or 816 slices for every man, woman, and child stationed in South Korea.

Another popular item for black marketeers is Aqua Net hair spray, which is one of many types of hair spray sold in USFK retail outlets in South Korea. The commissaries and exchanges sold over 33 cans for each eligible female stationed in Korea, including female spouses and children.

Sales of chicken during the Summer Olympics Games vividly illustrates black market activity. During the Seoul Olympics chicken sales in the commissary grew to the point where they were running out of chicken. Sales of 40-ounce bags of chicken drumsticks increased from 12,000 bags per month to an estimated

40,000 bags per month. After the Olympics, sales went back to normal.

The Commander of the Army Far East Commissary District attributed the high sales volume mainly to the black market demand for chicken drumsticks during the Olympics. According to the Commander, the Olympics helped increase the demand for chicken 3.5 times its normal rate. When the stock of chicken was depleted, the commissary issued high priority requisitions to have chicken flown in from the United States. Table 1 shows the growth in sales for 40-ounce bags of chicken drumsticks.

Table 1: Average Sales of 40 Ounce Bags of Chicken Drumsticks During the Olympics

	Sales	
	<u>Actual</u>	<u>Estimated For Month</u>
Average sales through April 1988	12,000	
Monthly sales:		
May	15,400	
June	17,000	
July 1st through 13th	24,000	40,000
August 1st through 5th	9,500	
6th through 7th	1,800	40,000

Note: Estimated sales for month were calculated by commissary officials based on partial monthly sales.

Chivas Regal Scotch Whiskey  
and Other Alcoholic Beverages

Sales of Chivas Regal Scotch whiskey really show the impact of the black market. We saw it in large quantities in Korean black market stores. Class Six stores in South Korea sold a significant amount of Chivas Regal 12-year-old Scotch (314,748 one-liter bottles) in 1988. The Scotch sold for \$22.70 a bottle. It was the number one best selling liquor, outselling the next, Jim Beam Bourbon, by more than 8,400 one-liter bottles per month. The next best selling Scotch, Johnnie Walker Black Label, is fifth on the list, but is outsold by Chivas Regal by more than 20,600 one-liter bottles per month. Chivas Regal Royal Salute 21-year-old Scotch, which sold for \$65 per 750-milliliter bottle, was the eighth best selling alcoholic beverage at 25,680 bottles, during the year.

We believe that most of the Chivas Regal, both the 12-year and 21-year-old bottle, is sold to black marketeers. We saw many boxes of Chivas Regal, many with Class Six price stickers still attached, in Korean markets and stores. The Scotch seemed to be every place. According to CID and OSI officials, Chivas Regal is the drink of choice for Koreans who can afford it.

We compared overall sales of Chivas Regal 12-year-old Scotch and the number of active duty military in South Korea with Chivas sales and the number of active duty military in Europe and found that

sales were significantly larger in Korea.<sup>2</sup> In Europe approximately 306,000 military members purchased 47,085 liters of Chivas Regal during fiscal year 1988. That is 0.15 liters per soldier per year. This did not put Chivas Regal in the top 25 best sellers. In Korea approximately 45,500 active duty military members purchased 314,748 liters of Chivas Regal during calendar year 1988. This is 6.9 liters per soldier per year. In other words, fewer military members in Korea--15 percent of the total in Europe--purchased more than six times the number of Chivas Regal bottles purchased in Europe. On a per capita basis, this means that 46 times more Chivas Regal was purchased in Korea as was purchased in Europe. (See attachment 3 for a comparison of sales in South Korea and Europe.)

There are other alcoholic beverages that have unusually high consumption rates, but none is as unusual as Chivas Regal. Paul Masson Rare Edition Wine and Paul Masson Carafe Trio Wine are numbers three and four, respectively, on the Korean best selling list, but are not ranked in the top 12 in Europe. (See attachment 4 for a listing of the 12 best selling brands in South Korea and how they rank in Europe.)

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<sup>2</sup>Active duty military in Europe includes Air Force and Army personnel as of September 30, 1988. Active duty military in South Korea includes all service members as of September 30, 1988.

## HOW THE BLACK

### MARKETEERS OPERATE

There are a number of schemes used by black marketeers to acquire USFK duty-free goods. These schemes generally fall into two groups. One group circumvents or works outside the provisions of the ration control system and the other group works within the established system of controls. Both ways are difficult to detect and stop.

We identified the following schemes by reviewing investigative case files of violators, interviewing military criminal investigators and police, and actual on-scene observations. Generally, in all of the schemes black marketeers work as a team or as an organized ring, with several dependent wives assisting the ring leader or leaders by recruiting other dependents and service members to purchase duty-free goods.

#### Black Marketing Outside the Ration Control System

Working inside the ration control system is not the only means of abusing the system. There are a number of schemes used by black marketeers to purchase USFK duty-free items that work outside the ration control system. These include racetracking; using cashiers and clerks, mostly Koreans, as accomplices; diverting items from



the warehouse or showroom while still paying for them; and using fraudulent or altered ration control documents.

### Racetracking

Racetracking is defined as making multiple daily purchases from the same or different sales facilities but always keeping the purchase under \$5 to either avoid ration control or to circumvent shelf limits.

When we conducted our review, purchases of merchandise under \$5 were not anvilled and did not count against the shoppers monthly monetary limit. As a result, shoppers making multiple purchases of items under \$5 became one of the more visible and blatant violations of the ration control system. One CID case we reviewed involved the surveillance of an AAFES convenience store. The CID identified several dependent wives who made frequent trips to the store and each time left with a purchase under \$5. One shopper made seven purchases within an hour at this store. According to the case file, store staff were condoning the practice to circumvent the ration control system.

Racetracking can be very profitable, as an Army CID analysis of racetracker profit potential shows. Shopping at one housing area in Seoul, they estimated a racetracker could earn about \$57 in 30 minutes. To avoid detection, a shopper from this housing area can

take an exchange taxi cab to Yongsan--about a five minute ride--and visit several other convenience stores. Using this method, a CID special agent estimated a racetracker, after paying all taxi cab fares, could earn about \$171 in less than 2.5 hours.

In some locations racetracking was made easier by the retail outlets' stockage policy and store location. For example, at Yongsan Army Garrison AAFES operated two convenience stores side-by-side, sharing one common wall. The stores sold similar American products that are valued on the black market, such as hot dogs, cheese and hair spray. Exchange management's rationale for the two stores carrying similar products was that each store had somewhat different hours.

At one housing area in Seoul there are three separate retail outlets: a commissary, an exchange, and an exchange-managed delicatessen and ice cream store. At least two and sometimes all of the outlets sold similar American products, such as rice, hot dogs, chicken, cheese, and shampoo--items in demand on the Korean economy. We visited this housing area and saw a large number of shoppers buying items popular on the black market. Many purchases were under \$5. Again, the rationale given was different store hours of operation.

## Use of Cashiers and Clerks

Another typical black market operation uses cashiers and sales clerks who either record the purchase amount under the actual total or do not record it at all. This prevents the purchase value from being entered into the ration control system, thereby allowing more items to be purchased. In these cases the employees are Korean. Nearly 98 percent of AAFES' personnel in South Korea, 5,040 out of 5,164, are local national employees. Both the Army and Air Force commissary systems also employ large numbers of Koreans as cashiers.

Cashier complicity with shoppers is a major problem, according to a CID commander. Investigative case files contain numerous examples of this type of involvement.

One case in particular stands out which addresses the coordinated manner in which ration control offenses are planned and executed. It involved six Korean cashiers at the Osan Air Base Commissary. According to OSI documentation, the operation was well organized and run as if it were a legitimate business, with participants sharing profits. Dependent wives from Osan and Camp Humphreys, an Army camp located near Osan, were recruited as shoppers by several women acting as ring leaders. Others were introduced to the ring by friends already involved.

Prior meetings or prearranged signals were used to identify which cashier and shopper were members of the ring. The shopper would attempt to go through the check-out line of a particular cashier, usually shopping off-peak hours to avoid being forced to use a cashier they did not know. More than 15 women were linked to the ring in some fashion. One made over \$500 profit in 11 visits to the Osan Commissary. Another had \$27,000 in a bank account, and the source of most of the money could not be accounted for other than from black marketing.

The cashiers used several methods to prevent recording the purchase. If not being observed they either would not anvil the sale or anvil it for less than the actual purchase. More commonly, the cashier would anvil the amount properly, but hide the card for later destruction.

The shopper took the items to one of several black market houses off-base. She received almost \$80 profit for each \$100 of purchases, which she split with the cashier.

Based on the details of this case and other cases involving similar schemes, the OSI estimated the impact of this investigation on black market activities. Prior to the OSI investigation, the commissary was selling between 15,000 and 20,000 25-pound bags of rice a month. However, ration control records showed that only 8,000 to 9,000 bags were being anvilled. The month after the

cashiers were apprehended, the commissary sold 6,000 fewer bags of rice.

Several other case files also indicate the extent to which AAFES employees are involved. Prior to a July 1988 purchase at an exchange, a soldier was told by a black marketeer to take a six pack of juice to the television counter so that the sales clerk would know he was there for a particular television. The black marketeer gave the soldier \$60 to use as a bribe for two exchange workers to expedite the sale of a television. In his testimony the soldier said he followed these instructions.

Another soldier testified in June 1988 that as bait to entice him into black marketing the black marketeer told him he had connections who could ensure the sales cards would not be recorded. Four of his eight exchange purchases never got into the ration control database. The CID investigators who ran the case presumed the hard copies of the sales cards were destroyed or removed from the ration control system.

AAFES taxi cab drivers and Korean gate guards at U.S. military facilities are implicated in black marketing activity. AAFES taxi cabs are used to transport the military member or dependent to the retail outlet, wait during the purchase, and then drive to a location where the purchased goods are transferred to the black market. During discussions with U.S. military investigators, they

said that taxi cab drivers and in some cases Korean gate guards are part of the overall black market scheme.

### Diversion of Duty-free

#### Items by Employees

Another scheme is diversion, which involves employees, usually Korean nationals, buying items from the U.S. retail outlets for their own use or resale to black marketeers. According to the Chief of the AAFES Merchandise Security Office in Korea, the diverted items usually end up on the black market. The employee or employees diverting the items normally ensure that the money representing the retail selling price is put into the cash register and rung up as a sale. It appears like the item was sold legitimately and no crime was committed. This reduces the chance of generating criminal investigations.

According to USFK officials, black marketeers pay for items they sell and prefer not to sell stolen goods. USFK officials said that actual theft is not that significant. While our work did not disclose theft, as a major problem, we did find instances of theft, such as inventory shortages, that could have resulted from black marketing. For example, during fiscal year 1988, three main exchanges had inventory shortages of over \$1.2 million.

The following case involves the diversion of about \$30,000 in televisions and stereo equipment. It took place while the items were being transported from Osan Air Base to the Main Exchange at the Yongsan Army Garrison in Seoul. OSI was tipped off to the diversion and arranged to have the vehicle watched leaving Osan and arriving at Yongsan. The truck left Osan carrying the equipment but arrived at the Yongsan Main Exchange empty. According to the driver's testimony, he sold the merchandise between the two locations and planned to put the money for the cost of the merchandise back into the system after he returned to Osan. According to the OSI case file, approximately one month after the diversion, the driver's wife paid the exchange \$30,000 in restitution for her husband's crime.

#### Use of Fraudulent and Altered Documents

We believe the use of fraudulent documents to make high value item purchases from AAFES stores is one of the most serious black market problems because of the potential dollar amounts involved. Although it is impossible to know just how many purchases, and thus their value, are made using fraudulent documentation, many of the investigative case files involve people who used fraudulent documents. Documents most often used illegally are the permanent ration control plates, temporary ration control cards, identification cards, and letters of authorization.

The purchasers in most cases are U.S. military members who are approached by Korean nationals and asked if they want to make extra money. If they show interest they are given false identification and ration control plates and sufficient cash, transported to exchange outlets, and told what items to purchase. According to some case files, the scheme includes the service members giving their military identification card and ration control plate to the black marketeers in exchange for the forged documents. Once the member carries out the buy and transfers the merchandise to the black marketeers, the service member gets his identification card and plate back.

The service member is encouraged, by the black marketeer, to make multiple purchases in a short period of time. To facilitate this numerous exchanges are visited. For example, according to one case file, one service member made eight purchases, including television sets and refrigerators, totaling almost \$3,500 on three shopping days between May 31 and June 8, 1988, at five different stores.

Illustration of the Extent  
of Black Marketing Using  
Fraudulent Plates

The CID did an analysis to determine the number of fraudulent purchases made with altered or counterfeit ration control plates.



It analyzed high value item purchases of selected types of items (e.g., refrigerators, televisions, etc.) at the Yongsan Main Exchange and at the Exchange Furniture Store--two stores out of eight main exchanges, 38 branch exchanges, and 33 annexes in the AAFES system in South Korea.

We analyzed AAFES sales of the same types of appliances and stereo equipment at the same two stores and combined our analysis with the work performed by CID. This analysis showed that as much as 26 percent of certain types of appliances and stereo equipment sold were purchased with fraudulent ration control plates. Table 2 shows the results of these analyses for purchases between September 1, 1988 and April 15, 1989.

Table 2: Purchases with Fraudulent Ration Control Plates  
September 1, 1988 to April 15, 1989

<u>Type of item</u>	<u>Total number purchased</u>	<u>Purchased with fraudulent plates</u>	
		<u>Number</u>	<u>Percent</u>
Washers	150	39	26.0
Refrigerators/freezers	456	111	24.3
Ranges	129	15	11.6
Dryers	31	2	6.5
Music systems	1,134	72	6.4
Speakers	1,768	72	4.1
Televisions	2,461	97	3.9
Video recorders	<u>2,057</u>	<u>30</u>	<u>1.5</u>
<b>Total</b>	<b><u>8,186</u></b>	<b><u>438</u></b>	<b><u>5.4</u></b>

The value of the 438 items purchased with fraudulent plates over the study period was \$303,074.

We also analyzed the sales of brand name merchandise for the same period and found that the results are more dramatic. For example, 39 percent of the General Electric (GE) washers and 29 percent of the GE refrigerators (three different models) sold were bought using fraudulent documents. Table 3 shows results of this analysis.

Table 3: Selected Items Purchased at Yongsan with Fraudulent Ration Control Plates September 1, 1988 through April 15, 1989

<u>Item and unit price</u>	<u>Total number purchased</u>	<u>Purchased with fraudulent plates</u>	
		<u>Number</u>	<u>Percent</u>
GE washers (\$435)	90	35	38.9
GE refrigerators (\$1,150)	118	38	32.2
GE refrigerators 19.6 (\$680)	91	29	31.9
20" Sony televisions (\$479)	78	20	25.6
GE refrigerators 17.7 (\$560)	107	26	24.3
Magic Chef 30" ranges (\$425)	67	12	17.9
27" Sony televisions (\$930)	128	20	15.6
40" Pioneer televisions (\$2,195)	34	5	14.7
Admiral refrigerators (\$895)	49	7	14.3
25" Sony televisions (\$920)	255	33	12.9
Kenwood music systems (\$1,130)	189	17	9.0
Magic Chef 20" ranges (\$350)	52	3	5.8

Note: Refrigerator sizes are shown in cubic feet, where known.

Our analysis only includes purchases using fraudulent ration control plates. Fraudulent purchases made with temporary ration control cards, which never are entered into the ration control

system, or purchases made with valid ration control plates and later transferred illegally to the black market are not included.

CID also performed a study of the use of fraudulent ration control plates to purchase AAFES merchandise at Camp Casey. This fiscal year 1988 study at the Camp Casey Exchange indicated fraudulent documents were used to purchase 674 high value items costing \$258,908. Items purchased were similar to those purchased in the study described above.

Recent Examples of  
Black Market Activity

The following are two recently discovered examples of black market purchases using fraudulent cards. They could also be examples of diversion. The first example came from our analysis of AAFES items. We noted that the Yongsan Main Exchange received 14 Pioneer 40-inch screen televisions during a span of less than two-weeks in late March and early April 1989. The televisions regular selling price was \$2,195 each. A count of these items indicated there were only three on-hand as of April 15, 1989. Eleven televisions were sold or otherwise disposed of within a 16-day period between the time they were received at the exchange and the time we made our count. Because we felt that such activity was unusual especially for an item of such high value, we requested the AAFES Safety and

Security Office in Seoul perform an analysis of these activities and furnish us a report.

The AAFES' report indicated all 14 televisions had been sold. Twelve were sold between the 8th and the 16th of April. The two remaining televisions were sold in May and June. CID data showed that 3 of the 12 televisions sold in April were purchased with fraudulent ration control plates. More importantly, only four of the televisions sold were recorded in the ration control database. All sales for which valid plates were used should have been recorded. This indicates someone may have destroyed the sales cards to keep them from being reflected in the ration control database.

The second example occurred when an Army Internal Review team noticed that bowling ball sales at the Camp Casey and Camp Humphreys bowling centers were way beyond reasonable limits. At Camp Casey, 8 people purchased a total of 119 bowling balls during the period May 1 through October 23, 1988. At Camp Humphreys, internal review staff identified 20 individuals who purchased more than 4 balls each (a total of 432 balls) from July 19 to September 30, 1988. One individual purchased 108 bowling balls, another 61, and yet another purchased 50. Many of these sales were made using fraudulent ration control plates. According to internal review reports, bowling balls sell for three or four times more on the Korean economy than at the USFK bowling centers.

### Black Market Earnings

#### From Exchange Items

Black marketing can be very profitable and, according to case files, money is one of the major inducements for involvement. The case files give details on how much the suspect can make selling exchange items on the black market. One soldier's case file indicated he was paid at least \$1,870 for purchasing 17 items from July 2 to September 18, 1988--a period when he made 13 separate shopping trips at 5 different exchanges. His testimony indicated he earned \$60 for each video cassette recorder, \$150 for each television, and \$450 for a refrigerator he purchased for the black market ring.

### Black Marketing within the

#### Ration Control System

It is possible to stay within the limits of the ration control system and still black market. As stated earlier, the system currently has three types of controls: monthly monetary limits, monthly quantity limits, and specially controlled items. Some limits may actually encourage black marketing, and some controls have been reduced.

## High Monthly Dollar Allowances

### Contribute to Black Marketing

Many of the military commanders we met with believe the monetary limits imposed by the ration control system are too high-- especially for service members with no dependents in South Korea. These service members are authorized to spend up to \$500 each month for consumable goods.<sup>3</sup> Since most of these service members live on base (approximately 88 percent in 1988) and many eat in military dining facilities (almost 19.7 million meals were served in Army and Air Force dining facilities in Korea during fiscal year 1988), many commanders do not believe that these service members require \$500 worth of goods. Due to the high monetary limit, personnel could use the amount above their own personal needs to purchase items for resale on the black market.

To see for ourselves, we visited the Army Commissary in Seoul to observe the customers. Within minutes we saw a soldier, whose ration control plate indicated he had no dependents in Korea, purchase \$117 worth of goods. Although the purchase was within the service member's monetary limit, the types of items purchased were those found on the black market. For example, the service member brought, among other items, a 25-pound bag of rice, four packages of chicken franks (hot dogs), two jars of peanut butter, one 3-

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<sup>3</sup>All military personnel were authorized commissary privileges effective June 8, 1982.

pound package of American cheese (72 slices), one Agree shampoo, two jars of honey, one jar of mayonnaise, five cans of pineapple juice, two jars of Tasters Choice coffee, one jar of Cremora, one jar of sesame oil, two cases of Coke, two packages of chicken legs, and three cans of mixed nuts.

Minutes later we observed another enlisted soldier also with no dependents in Korea purchase \$182 worth of goods. His purchases, also within the monetary limit, were similar to those of the first service member. Among other items, he purchased a 25-pound bag of rice, six packages of chicken franks, and five hair conditioners.

The Security Officer, USFK Provost Marshal, said that it is extremely difficult to detect abusers who are shopping for the black market within their dollar limits. Except for the transfer of goods to the black marketeer, these individuals are completely within their rights. The products they buy may, in some cases, be a tipoff. However, to prove they are black marketing they must be followed and observed transferring or reselling the goods to someone who is not authorized to have them.

Many unit commanders believe the monthly dollar limits are too high. However, the USFK official position is that the dollar limits are adequate to ensure a good quality of life and spending flexibility for military personnel. The limits for a family size of one are based on an individual who is authorized to reside off



post as well as the individual living in the barracks and eating at the military dining facility. However, these individuals are not treated differently for ration control purposes but receive the same dollar limit. A few commanders said that the monthly limit should be closer to \$200 for a service member living on base with no dependents in Korea.

The monetary limits were changed twice, once in August 1985 and again in July 1987. According to a USFK document, these "changes are based on a periodic review that evaluates the imposed ration control limits in light of salaries versus commodity costs, black marketing trends, and the dollar/won ratio." However, USFK officials were unable to produce a copy of the last review. Table 4 shows changes in the monthly monetary limits.

Table 4: Ration Control Monetary Limits

<u>Period</u>	<u>Family size</u>					
	<u>One</u>	<u>Two</u>	<u>Three</u>	<u>Four</u>	<u>Five</u>	<u>Six or more</u>
Prior to July 1985	\$275	\$550	\$680	\$850	\$ 980	\$1,075
August 1985 to June 1987	\$256	\$470	\$580	\$725	\$ 835	\$ 915
July 1987 to current date	\$500	\$700	\$800	\$900	\$1,000	\$1,200

Some purchases do not count against the monthly monetary limits. Because expensive items sold in exchange outlets would use up the monthly dollar limits, the ration control system exempts purchases

of single items priced at \$50 or more from counting against the limitations. Among other items which might sell for less than \$50 but do not count against the limits are the following:

- military uniforms and accessories;
- records, computer software, and other prerecorded items;
- clothing and footwear;
- liquor, cigarettes, and beer whose alcohol content is over 3.2 percent by weight;
- wine, soft drinks, water, and ice;
- gasoline; and
- nonconsumable, Korean-made products.

#### Monthly Quantity Limits

Cigarettes and some types of alcoholic beverages are the only duty-free items that have limits on the amount an individual can buy during the month. In the past more items were controlled but limits have been eliminated for such black market items as coffee, salt, mayonnaise, pepper, and Tang. Table 5 shows ration control monthly limits for alcoholic beverages and cigarettes based on family size.

Table 5: Ration Control Quantity Limits

<u>Family size</u>	<u>Alcoholic beverages</u>	<u>Cigarettes</u>
One	Four units	60 packs
Two or more	Seven units	100 packs

Note: Liquor and beer are rationed in units. One case (24 cans or bottles) of beer with over 3.2 percent alcohol by weight is one unit and one bottle of liquor is one unit. Partial units are accumulated through the month. Wine is not recorded or avvilled.

Although alcoholic beverages and cigarettes are controlled, we found that people could purchase some of these items without it counting against the quantity limits. For example, individual purchases of less than \$1 do not count against the limits. In addition, all types of wine, and beer with 3.2 percent or less alcohol content by weight do not count against the limits. We saw both of these items on the black market.

Controlled High Value Items

Purchases of certain types of merchandise, such as televisions, refrigerators, ranges, washers, and dryers, are specifically controlled and recorded in the ration control database. In some cases service members and civilians must obtain approval to purchase these items. Any individual purchasing one of these items may be required to account for or show disposition of these items before they leave Korea, but not in all cases.

Individuals below the pay grade equivalent of E-6 or GS-6 are required to obtain written permission to purchase controlled high value merchandise costing \$50 or more. All other individuals may purchase controlled items without permission. Purchases of controlled items are recorded in the ration control system and purchasers may be required to account for any item purchased while in Korea. This requirement, however, is not applied all the time. According to commanders, it is applied more to individuals suspected of ration control abuses.

#### Ration-free Items

Controlled items such as food, cigarettes, liquor, and appliances are not the only items traded on the black market. There are some items that are not controlled (ration-free items) and we also saw them on the black market.

Authorized personnel can purchase as many of these items as they want each month, and the purchase will not count against any control limits. Among other things, we saw wine, light beer, military uniforms, clothing, and U.S.-made toys in many Korean markets and stores. Many of the items still had AAFES and Class Six price stickers on them.

U.S. and Korean investigation groups have also documented black market cases involving wine. A recent investigation at Kwang-Ju

City, near Osan Air Base, identified a person trying to sell 85 bottles of liquor, wine, and other items that came from U.S. retail outlets, according to OSI.

According to a USFK position paper on our observations, the Command is considering how best to control items that are ration-free, including products sold at the Class Six stores.

WEAKNESSES IN THE RATION  
CONTROL SYSTEM

The current ration control system is not being implemented as designed. Controls are in place to prevent many of the violations we have described; however, they are not being followed. In addition, some sales data, especially for sales involving temporary ration control cards, are missing from the system. Also, changes have further weakened the ration control system. All of these weaknesses contribute to the black market.

Procedures to Prevent Abuses  
are not Being Followed

USFK has established regulations and procedures to prevent ration control abuses. For example, USFK Regulation 60-1, "Exchange Service, Ration Control," requires that cashiers verify identifications and avail all required sales. In addition,

procedures are in place which require checks for fraudulent and altered purchase documents and for lost and stolen ration control plates. In many cases managers, cashiers, and sales clerks, most of whom are Korean, do not always comply with the requirements of the ration control system. Headquarters AAFES' management officials told us that ration control is a USFK appropriated fund responsibility. AAFES officials support the USFK ration control system, but they do not believe that they should or can police the system, therefore, they do not.

#### Requirement to Verify Identification

USFK Regulation 60-1 specifies that cashiers shall perform identification procedures at the time of purchase. The regulation requires the cashier to inspect the ration control plate or temporary card and the purchaser's identification, even if the items purchased do not count against the dollar limit or are not anvilled. According to the regulation, the reason for this is because some facilities do not have entrance monitors and because some individuals try to circumvent the system by using a different plate or temporary card at the cash register.

We found in our daily purchases at exchange outlets, Class Six stores, and smaller commissaries and annexes that the only documentation required was the ration control plate, and only if the item had to be recorded in the ration control database. Consistently, when we purchased items in some AAFES outlets we

were only asked for the ration control plate. It was rare for any purchase that the ration control plate and the identification were compared. Entrance into the main exchanges and the large commissaries was different because the plate and the identification were scrutinized. However, as Regulation 60-1 warns this check can be circumvented by using a different plate or temporary card at the cash register. For this reason, it is important for the cashier to verify the purchaser's identification.

#### Requirement to Anvil Sales

We have already discussed the collusion between shoppers and cashiers at commissaries and in the purchase of high value items in exchanges, but evidence indicates failing to anvil sales is common and widespread throughout the system. AAFES' Safety and Security Office has identified cases when exchange managers and sales clerks did not anvil purchases as required. For example, in January 1988 a merchandise security specialist conducted an on-site review of the Camp Falling Water Exchange. The specialist concluded that from October 27 through November 25, 1987, only 106 (11.7 percent) of the 907 customer transactions that should have been, were actually avvilled.

A 1988 review of the Camp Red Cloud Post Branch Exchange showed that approximately 72 percent of the sales were not avvilled. The retail manager admitted to security specialists that he failed to

anvil merchandise sold. According to the memorandum of inquiry, the manager said this was done in an attempt to increase sales because some customers will put merchandise back on the shelf when he tries to anvil it. A sales clerk at the same exchange also said that he does not anvil in an effort to increase overall sales. He also admitted that he sometimes fails to ring the merchandise up at the right price. For instance, a 3-pound box of cheese priced at \$7.75 would be rung up as \$6.20 representing the price of a case of soda, which does not require anvilling. The difference would then be made up in another transaction. The clerk said that he also rings up customers' purchases as separate transactions under \$5 to avoid the requirement to anvil sales totaling \$5 or more.

Checks for Fraudulent  
and Altered Plates

Procedures are established to check for fraudulent and altered documents; however, retail employees apparently are not following the procedures. In some cases the same fraudulent plates and identifications are used repeatedly in the same retail outlets. According to a USFK report, AAPES clerks and managers are unable to identify the simplest errors when shown bogus plates.



Checks for Lost  
and Stolen Plates

In addition to fraudulent and altered ration control plates, purchases of high value items are made with lost and stolen plates. Although the USFK Provost Marshal provides lists of lost and stolen plates to retail outlets and cashiers are supposed to make sure the plate being used has not been lost or stolen, they frequently do not.

Regulation 60-1 requires that a copy of the lost or stolen ration control plate report be maintained at each cash register. Cashiers are required to check this report against the purchaser's plate or temporary card if the purchase is for controlled items, alcohol, cigarettes, or if the purchase exceeds \$100.

A team from the Data Management Division conducted several ration control staff assistance visits at commissary and exchange outlets at the end of March 1989. According to their reports, one common finding was that the lost or stolen report, if available, was not being used.

All Sales Data are not Recorded

Another weakness of the system is missing data. There are instances where the current ration control system is not able to

identify violators because actual sales data are not entered in the database. There are a number of reasons why sales data are never entered into the database. For example, all purchases made with a temporary ration control card (USFK Form 46) are not entered into the database because many purchasers with temporary cards are new comers or people on travel whose name and records are not documented in the database. Thus, the sales data would have no master file to be stored in and would be recorded as unmatched data and rejected.

Another reason is that some retail outlets are late in reporting sales data to the Data Management Division. When this happens, monthly sales data dealing with monetary and quantity limits are not entered if they are received after the fifth working day of the following month.

Additionally some morale, welfare, and recreation retail facilities (e.g., bowling centers) were not reporting any sales data to the division. This means that data on high demand items, such as bowling equipment, were not collected and reported to commanders and supervisors. For example, we found that the Osan Bowling Center was not reporting sales. In response to our observations, the Data Management Division issued a letter reminding all morale, welfare, and recreation facilities they are required to anvil and report sales.

Changes Have Weakened the  
Ration Control System

Since 1987, USFK has made changes to the system that we believe have weakened it and made black marketing easier. They increased the threshold for anvilling, reduced the number of personnel required to obtain written approval to purchase controlled items, and reduced the types of merchandise requiring written authorization to purchase. USFK also eliminated funding for retail outlet ration control monitors.

Increased Anvil Threshold

In July 1987, USFK increased the threshold for anvilling from \$1 to \$5. USFK realized that this increase could lead to more racetracking. However, the increase was also supposed to reduce the number of sales cards to process, improve the timing of ration control reports, and provide greater convenience to the customer. As of July 1, 1989 (subsequent to our review in Korea), the dollar limit for anvilling was reduced to \$2. According to USFK, the reason for the change was to reduce racetracking, which had become one of the most visible and blatant violations of the ration control system, and ensure better availability of goods on store shelves. This change means that sales totaling over \$1.99 are supposed to be recorded against service members' monetary limits.

Reduced Purchase Approval  
for Certain Buyers

Controlled items are defined as accountable high value (\$50 or more) items that are in demand on the black market. On October 1, 1987, USFK reduced the number of personnel required to obtain written approval to purchase controlled merchandise. To make these purchases more convenient, personnel in pay grades equivalent to E-6 or GS-6 or above no longer are required to obtain written approval to purchase the first or subsequent controlled items. During 1988, this change added almost 14,700 active duty military personnel, not including their dependents, to those who can buy high value items without authorization.

The requirement remains in effect for personnel in pay grades equivalent to E-5 or GS-5 and below. The approval must be documented on USFK Form 48, "Letter of Authorization Purchase Record," and the applicant is supposed to demonstrate a valid need for the item before the responsible commanding officer or supervisor approves the form.<sup>6</sup> Once the letter of authorization is approved, the purchaser takes one copy to the exchange to make the buy and the unit maintains the other copy. According to

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<sup>6</sup>According to USFK Regulation 60-1, "Exchange Service, Ration Control," personnel residing in government bachelor quarters or barracks may not purchase washing machines, clothes dryers, ranges, refrigerators, or freezers using a Form 48 unless the item is authorized for use in government quarters, there is a statement of nonavailability of government furniture, and there is a demonstrated need for the item.

regulation, the purchaser has 30 days to make the buy and return the form to the unit. Many of the military commanders we met, however, required less time.

#### Items Control Reduced

Effective October 1, 1987, USFK reduced the types of merchandise requiring written authorization to purchase. The command deleted 13 items from the controlled list of items and consolidated the remaining 32 items into 15 categories. Some of the items deleted from the list were typewriters, dish sets, irons, rice cookers, vacuum cleaners, and air conditioners. The USFK Black Market Steering Group concluded that the items deleted from the list were no longer high demand items on the black market. The group also concluded that many of the items on the list were generic and could be consolidated to simplify the purchase process for customers and sales clerks. Although this change has simplified the process, some of these items are still in demand on the black market. Consequently, AAFES' 1988 shipments of some of these items to Korea for sale were unusually high. For example, Corning Visionware dish sets and irons were 35,079 and 49,177, respectively. In comparison, toasters and toaster ovens which were not controlled items but popular with black marketeers, sold 42,536 units.

Eliminated Ration

Control Monitors

At the end of fiscal year 1988, because of severe budget constraints, USFK eliminated ration control monitors. This move should save about \$1 million a year in personnel costs. The monitors, who were employed at about 25 percent of the retail outlets, had broad responsibilities to help prevent black marketing. They checked identifications, ration control plates, and temporary ration cards at the entrance of major retail outlets and collected sales slips and cards at the exits. They could also require a patron to sign a register of items purchased. In addition, monitors were allowed to punch a hole or tear in half an altered or fraudulent plate or temporary card.

In opposing the action to remove funding for the monitors, an Army provost marshal said they were especially useful in controlling purchases made with fraudulent documents. They were an invaluable source of information to CID, OSI, and the military police providing one to three leads for each monitor every month. The provost marshal also said sales personnel are generally more concerned with accurate sales transactions and/or making a profit, not the validity of identification cards or ration control plates.

We found in our review of OSI case files that all five cases

involving the use of fraudulent documents were initiated by ration control monitors.

THE NUMBER OF AUTHORIZED  
PURCHASERS HAS GRADUALLY  
INCREASED

In addition to changes in the control system itself, the number of dependents authorized to use U.S. retail facilities in South Korea has gradually increased since 1982. Giving more dependents ration privileges, according to USFK documents, was supposed to increase the quality of life for U.S. troops. The effect of this, however, was increases in the number of people who typically are associated with the black market.

In 1982, USFK established the "limited-command sponsored" dependent category for dependents of non-command-sponsored individuals who extended their tour of duty to at least as long as the command-sponsored tour (24 months). Beginning July 5, 1982, these dependents of military personnel were given access to the commissaries, exchanges, and Class Six outlets with the same ration control limits as command-sponsored dependents. During 1988 there were 6,671 dependents in this category. On October 1, 1982, eligible dependents of U.S. civilian employees were granted limited-command sponsorship with the same benefits allowed to

military dependents. During 1988 there were 1,160 dependents in this category.

At the end of 1982, USFK submitted a proposal to DOD to allow about 3,000 non-command sponsored dependents access to commissaries and exchanges in South Korea. A one-year test program was implemented on December 1, 1984, allowing these dependents to shop in the commissaries, exchanges, and Class Six outlets. However, the comprehensive test plan was not submitted, as requested, to the Chairman, House Committee on Appropriations, for review. The Command simply implemented the test and has continued it for nearly 5 years.

In total these changes added over 10,000 dependents to the list of eligible patrons. By the end of 1985, virtually all dependents in South Korea had access to USFK retail facilities.

U.S. AND KOREAN EFFORTS TO  
DETER BLACK MARKET ACTIVITIES

Under the Status of Forces Agreement, the U.S., in cooperation with the Korean government are responsible for preventing abuses of the ration control system and deterring black market activities. Enforcement is a major part of this responsibility, and the two governments should cooperate toward these ends. However, both governments have criticized each other for not doing enough to



solve the problem. On the U.S. side, the government has criticized the Koreans for not doing enough in law enforcement and lifting trade restrictions on U.S.-made products. On the Korean side, the government has criticized the U.S. government for not doing enough to prevent U.S.-provided goods from being sold on the black market. Both criticisms are valid because neither government has aggressively or effectively tried to eliminate the black market and its causes.

#### U.S. Enforcement Efforts

U.S. enforcement efforts against the black market in South Korea are only a portion of the enforcement activities carried out by the Army's CID and provost marshal and the Air Forces's OSI and security police. U.S. enforcement groups have jurisdiction over ration control violations by U.S. military.

Army CID performed 147 black market investigations--22 percent of the total 655 investigations in fiscal year 1988. As table 6 shows, this was an increase in the number of black market cases from fiscal year 1987.

Table 6: Army CID Black Market Cases for Fiscal Years 1987 through 1988

	<u>Fiscal Year</u>	
	<u>1987</u>	<u>1988</u>
Total cases investigated	673	655
Black market cases	119	147
Percent	18	22

USFK provost marshal issued a 1988 report on the number of black market cases appearing on their military police records throughout South Korea. Table 7 shows the categories of the 532 cases involving possible ration control violations.

Table 7: USFK Provost Marshal Ration Control Violations Breakdown for 1988

<u>Offense</u>	<u>Number of cases</u>
Wrongful transfer of duty-free goods	216
Multiple purchases to avoid anvilling	102
exceed shelf limits	98
Wrongful use and disposition of another's ration control plate, identification card, or letter of authorization	51
Circumvention of the ration control system	39
Failure to show disposition of control items	<u>25</u>
Total	<u>531</u>

Air Force OSI initiated 40 black market cases and 10 customs-related cases during 1988--all involving criminal fraud. In addition, Air Force security police initiated 71 black market cases during this period. The majority of these cases involved racetracking.

#### Statistics on Violators

A significant number of individuals violate the ration control system. According to USFK Pamphlet #4, "Ration Control," more than 1,000 individuals violate system limits every month. It notes that although many have simply exceeded the limits, others flagrantly violated the system.

Statistics on offenders who have received Article 15's or courts-martial are maintained for all services in Korea by the USFK judge advocate.<sup>7</sup> According to commanders, many of these individuals were problem soldiers and were punished for both black marketing and other criminal offenses. Table 8 shows the number of personnel punished for these offenses.

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<sup>7</sup>An Article 15 is a non-court martial punishment administered under the Uniform Code of Military Justice.

Table 8: Number of Black Market Actions Taken

	Calendar Year		
	<u>1987</u>	<u>1988</u>	<u>1989<sup>a</sup></u>
Courts-martial	64	66	12
Article 15's	<u>229</u>	<u>168</u>	<u>30</u>
Total	<u>293</u>	<u>234</u>	<u>42</u>

<sup>a</sup>January 1 through March 31, 1989

Many investigations lead to results other than Article 15 or courts-martial. These include losing some or all of the ration control privileges for the military members and their dependents, losing on-base driving privileges, or being debarred from a U.S. base or bases Korea-wide.

Korean Government

Enforcement Efforts

At a 1986 Status of Forces Agreement meeting, U.S. officials requested that the Korean government close down the retail stores that openly sold U.S. provided duty-free goods and do more to identify and punish Koreans involved in black market activities. U.S. officials also requested that the Koreans close the black market area called Namdaemun in Seoul. As far as we know none of these actions were done. In February 1989, we visited the Namdaemun black market area and saw many shops still selling black market items.

Even though the Korean government has prosecuted some customs and/or black market offenders, a 1988 OSI talking paper on the black market noted that while both the Korean customs authority and Korean national police know about the problem, only a limited number of prosecutions of Korean offenders have occurred. However, OSI concluded that the Korean government has little interest in prosecuting black marketeers or deterring black marketing because the black market is an accepted part of the Korean economy.

Another OSI document discussing a 1988 news segment on black market activities in South Korea concluded that the U.S. government should encourage the Koreans to assist in enforcement efforts or the U.S. will never completely resolve the black market issue.

In contrast, USFK officials told us that U.S. authorities should not question how the Korean government enforces its own laws because it is within its sovereign prerogative.

The Korean government does maintain statistics on customs and/or black market offenses. According to U.S. and Korean officials, in actuality the Korean government does not have a law against black marketing. Instead, it is considered a customs violation. According to the Korean customs liaison in the USFK judge advocate's office, the Korean Office of Customs collects

statistics on these offenses and provides them to USFK. The liaison said the statistics shown in table 9 are a combination of customs and/or black market offenses and that black market cases cannot be broken out from customs offenses.

Table 9: Korean Nationals Processed Both Administratively and Judicially for Black Market and Customs Offenses

Calendar Year			
<u>1987</u>	<u>1988</u>	<u>1989<sup>a</sup></u>	<u>Total</u>
1,347	2,111	306	3,764

<sup>a</sup>January 1 through March 31, 1989

#### Trade Restrictions

In addition to law enforcement, many U.S. officials believe the key to deterring black market activities in South Korea is for the Korean government to lift its trade restrictions on U.S.-made and other foreign products and to also reduce its tariffs. USFK officials expect that as the trade barriers lessen there would be an increase in U.S. and other foreign products on the Korean economy, which in turn would decrease the demand for items from USFK retail outlets.

The 1988 tariffs on some items still remain high. For example, the Korean government has 100-percent tariffs on beer, wine, and whiskey. Chivas Regal Scotch sold for \$22.70 per bottle in the Class Six stores and about \$45 on the Korean economy. Korea also

had 30-percent tariffs on large appliances--such as refrigerators, ranges, and washing machines--and speakers and music systems. According to a Korean Ministry of Finance document, tariffs on these items are scheduled to decrease through 1993.

According to the Executive Vice President of the American Chamber of Commerce in Korea, the way to eliminate the black market is through opening the Korean market to imports through legitimate business channels, not the control of rations. The use of a ration control system is contrary to the goal of U.S. economic policy towards Korea, which is to get the Koreans to open up their markets to more U.S. imports. The Executive Vice President also said that the Korean government's policy is to keep its markets closed to foreigners. Through the black market, the Korean government is able to keep its markets closed and still have the products it wants, at a cost below what it would cost the Koreans to produce the same item or to import it. The black market serves the very officials who are supposed to make policy and laws to eliminate it.

According to U.S. Embassy officials in Korea, U.S. black market items could take business away from Korea. These include high value items such as electronic equipment and appliances. The Republic of Korea holds that it cannot open its markets to outsiders because the Korean people fear over-competition. This is a uniquely Korean concept, which means that open markets put pressure on the existing products. Embassy officials concluded

that the Republic of Korea protects inefficiency because the government does not trust the various markets to govern themselves.

THE COST FOR BLACK  
MARKET ACTIVITIES

The cost for black market activities can be viewed from two perspectives, cost to the U.S. government and the taxpayer and the cost to authorized consumers, who do not black market their purchases. In dollar terms the real cost to the U.S. government is unknown. It is important to note, again, that in almost all of the ration control and black market cases discussed today the retail system is receiving the money for the item purchased. This money is used to purchase more goods for resale, build recreational facilities, fund morale and welfare activities, pay employees' salaries, etc. The morale cost to authorized consumers who do not black market is more difficult to measure but may be significant.

Monetary Costs

Total sales in Korea for U.S. commissaries, exchange stores, Class Six stores, and other retail facilities were about \$250.4 million during fiscal year 1988, as shown in table 10.



Table 10: USFK Retail Facility Sales for Fiscal Year 1988

<u>Outlet</u>	<u>Amount</u>
AAFES	\$150,182,000
Army Commissary	\$ 56,546,000
Air Force Commissary	\$ 30,534,000
Class Six	<u>\$ 13,160,000</u>
Total	<u>\$250,422,000</u>

The estimated appropriated funds support during the same period was approximately \$23.7 million (see attachment 5). Of this amount, \$17.3 million was for transportation cost, \$6.3 million was civilian and military salaries, and the remainder was operations and maintenance costs. We estimate that for every \$100 spent in USFK retail outlets on items for the black market, about \$9.50 of appropriated funds were used to pay transportation costs, personnel costs, and operating and maintenance costs which in turn benefits the black marketeers. This is in addition to the almost \$12.1 million cost to run the ration control system. (See attachment 6 for a breakdown of these costs.)

Nonmonetary Costs

The morale cost to authorized consumers who do not black market is expressed in terms of anger and frustration. They see, as we did, a system that is ineffective and evidence of the black market on a daily basis as racetrackers work over the USFK retail system. They complain that the items they go shopping for are often not available due to black market demand. They also complain that

retail outlets tend to overstock items in demand on the Korean economy which takes up shelf space for items needed to accommodate the average family and single soldier. Based on our visits to the USFK retail outlets and black markets, we believe that their complaints are valid.

Some of these authorized consumers believe that Korean authorities are not concerned with Korean abusers of the system and therefore these abusers, outside of U.S. jurisdiction, are not being punished. They feel that U.S. military personnel are being manipulated by Korean black marketeers and if caught are left to take full responsibility for their actions. Investigative case files support this view. They also see black marketing as a moral issue more than a dollars and cents issue. Even if there were no costs to the U.S. government, they would like to see black marketing stopped simply because it is wrong.

#### CONCLUSIONS

We observed that products sold at USFK commissaries, exchanges, and other retail outlets are finding their way into the Korean retail market because we saw the items during our visits to the large black market shopping areas, as well as in regular retail stores and small shops. The volume of sales in the USFK retail outlets for some items popular on the black market, such as rice, hot dogs,

cheese, Chivas Regal Scotch, are too high for the eligible population to consume.

Black marketing occurs, in part, because many of the system's current controls and procedures are frequently not enforced by the retail management and employees. Even when they are enforced, the system provides the black marketeers opportunity to stay within its limits and continue business. It also occurs because Korean tariffs make U.S.-imported goods into Korea very expensive. It is cheaper and easier to secure the goods from the established U.S. retail system illegitimately than to try and compete legitimately.

Although the costs to the U.S. government are unknown, black market activities inconvenience and frustrate honest shoppers. They believe the control system is ineffective and they frequently cannot buy the items they want. They do not feel the Koreans are doing their part and would like to have the abuses of the system stopped.

Mr. Chairman, that concludes my prepared statement. We would be happy to respond to any questions.

GENERAL DEMOGRAPHIC DATA USFK PERSONNELAVERAGE FOR CALENDAR YEAR 1988

<u>Category</u>		<u>Number</u>
Total active duty U.S. military, accompanied <sup>a</sup>		8,000
Male	7,791	
Female	209	
Officer	1,528	
Enlisted, above E-5	2,578	
Enlisted, E-5 and below	3,894	
Total military dependents		15,909
Command-sponsored dependents	6,671	
Non-command-sponsored dependents	2,647	
Limited command-sponsored dependents	6,591	
Korean born spouses	5,372	
Non-Korean born spouses	2,628	
Total under 36 months of age	3,082	
Live on base <sup>b</sup>	7,169	
Live off base <sup>b</sup>	14,945	
Total active duty U.S. military, unaccompanied <sup>a</sup>		37,428
Male	33,325	
Female	4,103	
Officer	3,962	
Enlisted, above E-5	6,628	

## ATTACHMENT 1

## ATTACHMENT 1

Enlisted, E-5 and below	26,838	
Live on base <sup>b</sup>	32,927	
Live off base <sup>b</sup>	5,284	
Total civilians, accompanied <sup>c</sup>		2,483
Male	2,225	
Female	258	
Total dependents		4,951
Command-sponsored dependents	3,602	
Non-command-sponsored dependents	189	
Limited command-sponsored dependents	1,160	
Korean born spouses	1,443	
Non-Korean born spouses	1,040	
Total under 36 months of age	487	
Total civilians, unaccompanied		1,557
Male	1,089	
Female	468	
Total average personnel		70,328

## Notes:

<sup>a</sup>Active duty military figures also include U.S. military reserves, and U.S. active duty military personnel traveling to Korea for more than 90 days who have requested permanent ration control plates.

<sup>b</sup>The on- and off-base figures for active duty military do not include foreign military or active duty military personnel traveling to Korea for more than 90 days and U.S. military reserve personnel. These figures are not an average for 1988 but rather a

snapshot of the command as of January 4, 1989. On- and off-base figures for civilians are unavailable.

Civilian figures include U.S. military retirees and widows, invited contractors, DOD dependent schools teachers, direct hire American Embassy, non-Korean United Nations Command Military Armistice Commission members. Third-country military members are included in the active duty military figures.

COMPARISON OF UNITED STATES AND USFK  
PER CAPITA RICE SHIPMENTS AND/OR SALES

Rice shipments and/or sales to USFK  
during 1988 (pounds):

	Amount
Shipments for Army commissaries	6,433,000
Shipments for Air Force dining facilities and commissaries	3,000,000
Shipments for Army dining facilities	326,000
Total 1988 shipments	9,759,000
AAFES average monthly sales times 12 months	2,217,000
Total shipments and/or sales	11,976,000

PER CAPITA CONSUMPTION FOR  
AUTHORIZED PERSONNEL COMPARED  
WITH U.S. POPULATION AND  
ARMY DINING FACILITIES IN KOREA

Average number of personnel in South Korea during 1988 eligible for commissary and exchange privileges	70,328
Per capita shipments and/or sales of rice in South Korea (pounds)	170
Per capita consumption of rice of U.S. during the 1987-88 marketing year per U.S. Department of Agriculture (pounds)	13.6
Per capita consumption of rice in dining facilities by Army active duty personnel in South Korea (pounds)	10.3

TOTAL SCOTCH WHISKEY SALES IN EUROPE AND  
TOTAL SCOTCH WHISKEY ISSUES IN KOREA

<u>Organization</u>	<u>Number of active duty military<sup>a</sup></u>	<u>Total Scotch liters</u>	<u>Chivas (liters)</u>			
			<u>Total</u>	<u>12-year-old</u>	<u>12-year-old per capita</u>	<u>21-year-old</u>
U.S. Forces Europe	305,947	228,140	48,615	47,085	0.15	1,530
U.S. Forces Korea	45,501	496,396	334,008	314,748	6.93	19,260

Note<sup>a</sup> As of September 30, 1988, and U.S. Forces Europe includes Army and Air Force personnel only, while U.S. Forces Korea includes all service personnel.

Note: Table compares fiscal year 1988 U.S. Forces Europe (Army and Air Force only) sales versus U.S. Forces Korea calendar year 1988 issues to stores because fiscal year 1988 U.S. Forces Korea sales data were not available.



TOP 12 BRANDS OF LIQUOR/WINE BASED ON THE  
QUANTITY ISSUED FOR SALE IN KOREA

<u>Brand</u>	<u>Korea</u>	<u>Europe</u>	
		<u>Army</u>	<u>Air Force</u>
Chivas Regal 12-year-Scotch	1	N/R	N/R
Jim Beam Bourbon Whiskey	2	2	2
Masson-Rare Edition Wine	3	N/R	N/R
Masson Carafe Trio Wine	4	N/R	N/R
Johnnie Walker Black Scotch	5	N/R	N/R
Mogen David Red Wine	6	N/R	N/R
Seagram Natural Citrus Wine Cooler	7	N/R	N/R
Chivas Royal Salute 21-Year Scotch	8	N/R	N/R
Andre White Sparking Wine	9	3	6
Seagram Wild Berries Wine Cooler	10	N/R	4
Andre Pink Champagne	11	N/R	N/R
Mogen David Concord	12	N/R	N/R

Note: N/R = Not ranked among the top 12 brands.

USFK RETAIL FACILITY APPROPRIATED  
FUNDS SUPPORT (FISCAL YEAR 1988)

<u>Outlet</u>	<u>Amount</u>
Army and Air Force commissary combined support <sup>a</sup>	
Transportation costs	\$12,173,000
Army commissary	
Operations and Maintenance costs	64,000
Personnel	
Military	355,000
Civilian	4,734,000
Air Force commissary	
Operations and Maintenance costs	18,000
Personnel	
Military	187,000
Civilian	1,057,000
AAFES	
Transportation costs	4,651,000
Class Six	
Transportation costs	<u>486,000</u>
Total	<u>\$23,725,000</u>

<sup>a</sup>Includes both surface and airlift transportation costs for Army and Air Force commissary goods.

COST OF USFK RATION CONTROL SYSTEMFISCAL YEAR 1987

<u>Direct costs</u>	<u>Amount</u>
Personnel <sup>a</sup>	
Data management	\$ 667,900
201st Signal Support Company	156,000
Investigators	820,000
Issuing agencies	<u>523,000</u>
Total	\$ 2,166,900
Supplies	397,196
Equipment	4,725
Contract	104,500
<u>Total direct cost</u>	<u>\$ 2,673,321</u>
<u>Indirect costs</u>	
Personnel	9,362,188
<u>Total costs<sup>b</sup></u>	<u>\$12,035,509</u>

<sup>a</sup>Prior to January 1989 personnel costs included funding for Ration Control Monitors at \$991,296. The monitors were eliminated for budgetary reasons.

<sup>b</sup>These costs are the latest available from the USFK Data Management Divisi