

KOREA - 1988 Article IV Consultation
(PART I)

RM1991-0412

ASD DIVISION Country Files

#91802

Box 132
File 1

May 16, 1988 - 88/95

Statement by Mr. Lim on Korea
Executive Board Meeting 88/79
May 18, 1988

My authorities would like to thank the staff for the constructive discussions held in Seoul. They are in general agreement with the staff's analysis including the identification of the main economic issues currently facing Korea and the policy measures required to address them. However, my authorities do have some reservations about the balance of payments forecasts and I will return to this later.

Recent Economic Developments and Prospects

Korea's economic performance in 1987 was impressive in a number of respects. The main features are summarised in table 1 of the staff report.

The noteworthy progress was achieved against a background of an unprecedented labour unrest, culminating in a 22.7 percent increase in wages during 1987 and serious and prolonged political disturbances ahead of the December 1987 presidential elections.

The recent dramatic change of the current account has brought new challenges for economic management and my authorities have implemented a wide range of adjustment measures aimed at reducing the size of external surpluses to more sustainable levels and to reduce distortions in the economy.

- The exchange rate appreciated, by 19 percent against the US dollar between mid-1986 and April 1988. The won is continuing to appreciate this year with more than a 7 percent appreciation during the past 4 months. This is a significant adjustment considering that the U.S. is taking about 40% of Korean exports. Exchange rate changes, the large wage increases in 1987 (and in prospect for 1988) and other adjustment measures have substantially eroded Korea's external competitiveness since mid-1986.
- Import liberalization measures have reduced the share of import items subject to quantitative restrictions from 18.7 percent at the end of 1983 to 4.6 percent on April 1, 1988.
- Tariff reductions reduced the average unweighted basic tariff rate from 23.7 percent in 1983 to 18.1 percent in 1988 and have significantly narrowed the dispersion of tariff rates. Concessional tariffs and temporary tariff cuts have further reduced effective protection for many imports. My authorities are committed to further major tariff reductions in the next few years.

- Export financing has been reduced rapidly for all firms and eliminated for large firms. The authorities have also introduced import financing schemes to encourage import growth.
- Exchange controls on direct investment, overseas investment, and invisibles transactions (including overseas travel and remittances abroad) have been substantially liberalised in the past two years. Measures have also been taken to open up the domestic insurance market to foreign competition.

Macroeconomic policy measures have been supportive of external adjustment and have complemented the structural measures already introduced. My authorities will consider a further reduction in the excise tax should the overall budget be in surplus during the course of the year. Monetary policy will aim at stabilizing prices by containing liquidity growth through sales of Monetary Stabilization Bonds and adjustments of reserve requirement ratio.

Balance of Payments Prospects for 1988

My authorities believe it is too optimistic to expect that the strong balance of payments performance of 1987 will continue throughout 1988. As the effects of the substantial adjustment measures already undertaken and the recent deterioration in Korea's external competitiveness are increasingly being felt the balance of payments surplus will be reduced significantly in the second half of the year.

During the consultation in Korea, the staff prepared two alternative forecasts for the balance of payments for 1988 - one higher side and one lower side (see the table below) - although they used the higher side forecasts in the staff report. My authorities believe current early indicators for exports and imports and prospects for further large wage increases in 1988 point to the lower forecasts as being more realistic.

In this context it should be noted that the EC suspended Korea's privileges under the Generalized System of Preferences (GSP) as of January 1, 1988 and the U.S. announced to withdraw GSP benefits from Korea effective January 1, 1989. About 23% of Korea's exports to the EC and 12%, equivalent to 2.2 billion dollars, of exports to the U.S. would be affected by these actions.

Korea: Balance of Payments, 1987-88

(In billions of US dollars)

	1987 Actual	1988 Staff Forecast*	
		I	II
Exports, f.o.b.	46.2	55.0	58.2
Imports, f.o.b.	-38.5	-48.4	-49.8
Trade balance	7.7	6.6	8.4
Services balance	0.9	1.2	1.9
Transfers	1.2	1.0	1.0
Current Account	9.8	8.8	11.3

* Alternative I assumes a sharper decline in export volume and a larger response to liberalization of tourism and other services payments than Alternative II.

Trends in letters of credit for export and issuances of import licences can be used as advance indicators of export and import developments. Recent developments are set out in the table below. The sharp reduction in growth of export letters of credit and increase in import licences signal that a significant reduction in the trade surplus is likely in the near future.

Growth Trends of Export and Import Indicators (%)

	87.Q1	88.Q1	88.April
	86.Q1	87.Q1	87.April
	%	%	%
Arrival of letters of credit for exports	40	26	18
Issuances of import licences	29	40	44

The strong domestic growth in recent years has been accompanied by rapid wage adjustments. 1987 saw unprecedented nationwide labour unrest culminating in a 23 percent wage increase in the manufacturing sector - the main export sector. (About half of this wage increase in 1987 was carried over into 1988.) Labour unrest and high wage settlements were a significant factor in reducing Korea's external competitiveness in 1987 and this trend is expected to continue into 1988. The national labour unions are demanding a further 30 percent wage increase in 1988 while employers are unwilling to grant more than a 10 percent increase. As a

result there has been a rapid increase in the number of labour disputes. At end-April 1988, 84 percent of Korean companies could not settle their wage negotiations for 1988, indicating the prospect of continuing labour unrest and further significant wage adjustments.

General Observations

I have a number of general observations on Korea's adjustment program and the role Korea can play in correcting global economic imbalances.

1. What role can Korea play in reducing global imbalances?

At the outset, let me say that Korea is prepared to accept its fair share of the adjustment burden required to reduce global imbalances. However, my authorities believe this burden must be shared fairly between surplus and deficit countries. Adjustment is a painful procedure for surplus and deficit countries alike and all economies face political and social constraints on the implementation of adjustment measures. The Korean economy can contribute modestly to the correction of global imbalances but its relative size and state of development must be kept clearly in mind: For example, in 1987 Korea's exports represented 2.7 percent of world trade while its indebtedness (\$US35.6 billion) accounted for 3 percent of the total debt of developing countries.

2. Can exchange rate adjustments alone correct global imbalances?

A second issue is whether exchange rate adjustments alone can correct world trade imbalances. The Annex IV in the recent WEO sheds some light on this issue. It states that:

"As of January 1988, the real effective exchange rate of the US had depreciated by more than 40 percent from its March 1985 peak and had equalled its October 1978 level, which was the low point reached over at least the past thirty years. The real effective exchange rate of Japan was 3 percent below its 1978 peak, while that of Germany was about level with its previous peak, reached in 1979. Thus the current pattern of real exchange rate is close to that of the late 1970s, at which time the current account positions of these three countries were in approximate balance. Despite these substantial adjustments in real exchange rates, trade imbalances have declined only slightly, and current account imbalances for 1987 were at record levels for these countries."

I do not wish to imply by this quote that exchange rate changes do not have a role to play in correcting trade imbalances. Rather, I would suggest that this supports the staff view that an optimum mix of policies, including market opening measures, exchange rate adjustment, domestic demand management measures and wage adjustments, should be implemented in Korea in a balanced manner.

3. Market opening policies versus exchange rate adjustment

A related question is the appropriate balance between market opening (liberalization) measures versus exchange rate adjustments. If adjustment efforts concentrate more on exchange rates than market opening (structural) measures, the world economy is likely to lose some of the benefits of free trade. Exchange rate volatility is likely to increase, creating a more difficult economic climate for a reduction in protection and trade distortions. The recent G-7 statement endorses this view by noting that: "They (the G-7) reiterated that excessive fluctuations of exchange rates could be counterproductive by damaging growth prospects in the world economy."

4. External competitiveness - exchange rate adjustment versus wage increases

Another issue relevant to the Korean case is whether adjustments in external competitiveness are best achieved by exchange rate appreciation or through domestic wage increases. The staff discuss this issue, and on page 29 of the report observe that: "While it would be preferable to achieve the real appreciation largely through nominal exchange rate appreciation rather than through a wage push, in view of the increased labour union activism, part of the real appreciation will result from increases in unit labour costs as happened last year."

The staff have indicated a preference for adjustment through exchange rates rather than through wage increases. However, they also noted that "success in Korea's adjustment efforts will be essential for its overriding goal of providing a sustained rise in the living standards of its people." After many years of successful macroeconomic adjustment, Korea is now facing inevitable demands to raise wage levels and living standards so that all sectors of the economy can share the fruits of past adjustment efforts. This is a natural result of economic development. I believe that to adjust external competitiveness largely through exchange rate appreciation would risk passing up the present opportunity to raise living standards in Korea. It could also undermine the broad political support for continuing economic adjustment and promote costly social unrest.

My authorities therefore agree with the staff that the amount of exchange rate appreciation during the remainder of the year has to be determined in light of the impact of wage settlements on domestic costs and international competitiveness.

5. Measurement of external competitiveness

The staff report contains several measures of Korea's external competitiveness. Korea's external competitiveness, expressed in terms of the nominal effective exchange rate index adjusted by relative export unit values, is set out in the table below.

External Competitiveness
(Percent of change : end of period)

1984	6.1
1985	-7.7
1986	-1.5
1987	3.1

The increase in competitiveness in 1985 and 1986 appears much smaller when the exchange rate index is adjusted by relative export unit values (EUVs). The main reason for this result is that EUVs of Korea's competitors did not change strictly in proportion to currency realignments, implying absorption of some exchange rate changes in profit margins. Consequently, Korea's competitiveness, as measured by the index adjusted by EUVs, stands almost at the same level as in 1984, when Korea experienced a \$1.8 billion trade deficit.

Concluding Remarks

1. My Korean authorities have already undertaken many policy initiatives to reduce the current account surplus over the medium term. The won appreciated by 11 percent against the US dollar between mid-1986 and December 1987. This appreciation has continued in 1988 - in the first four months of the year it appreciated by a further 7 percent against the dollar.

In addition, the large wage increases in 1987 and further substantial increases expected in 1988 have contributed and will continue to contribute importantly to the reduction in the external competitiveness of the Korean economy. Significant market opening measures implemented over the past few years and the strong growth of domestic demand and in some redistribution in favor of low income wage earners will encourage faster import growth in Korea.

Early balance of payments indicators suggest these concerted adjustment efforts are beginning to take effect. However, should these measures prove insufficient to achieve the desirable level of adjustment, my authorities will undertake further actions to strengthen their adjustment effort.

Korea is now preparing an overhaul of the tariff system with the aim of reducing average tariff rates from the present level of 18.1 percent to 11-12 percent by 1989 and to 6-8 percent (the rate applying in large industrial countries) by 1992.

Korean regulation on invisible transactions will be further liberalized so as to conform to the OECD code of liberalization of invisible transactions within 2-3 years.

2. My Korean authorities would like to restate their willingness to play a constructive role in the world economy.

The following table shows that Korea has consistently reduced restrictions on imports at a time when Korea still faces comparatively high protection in its export markets.

Import Liberalization of Korea
versus Protection against Korean Exports

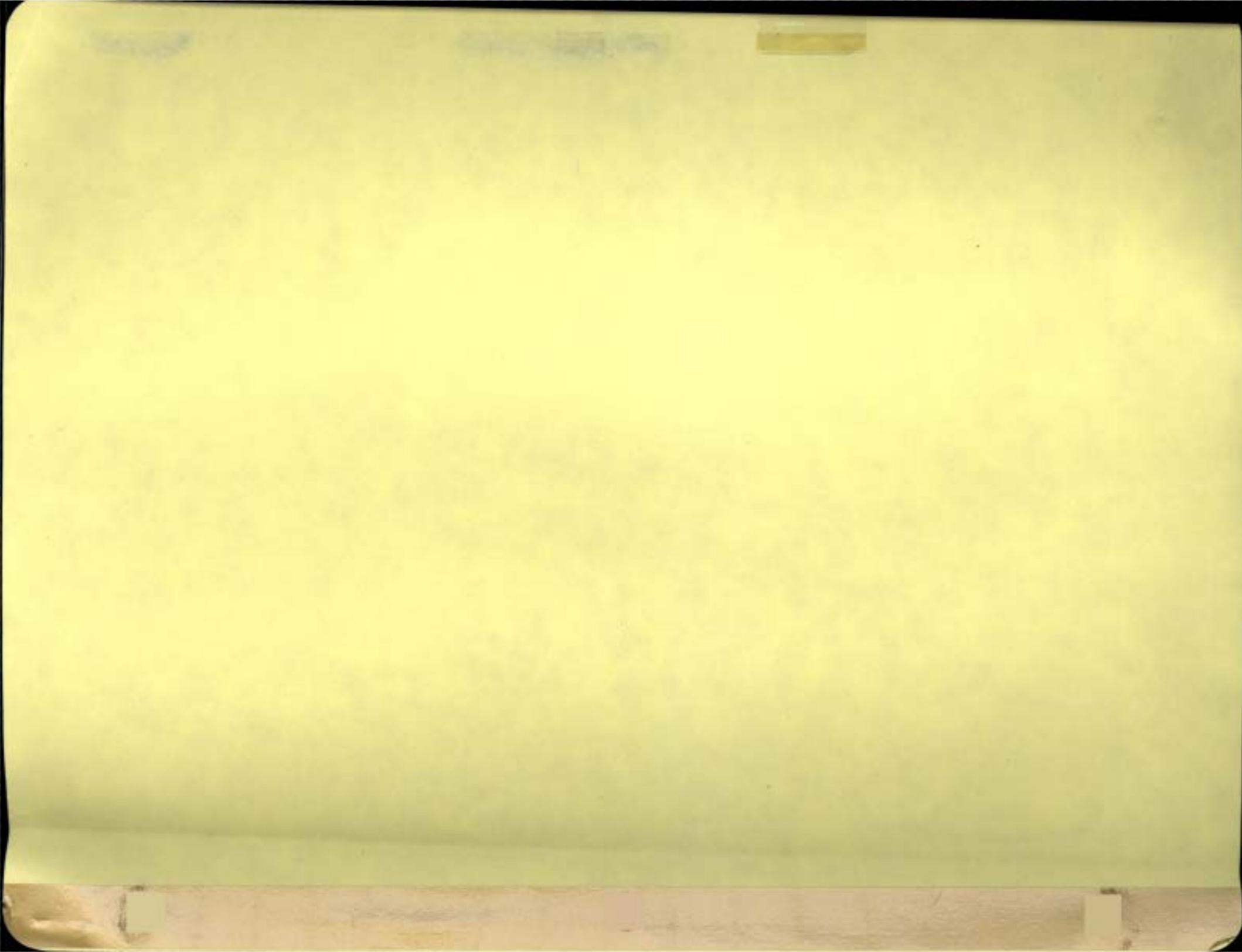
	1983	1984	1985	1986	1987	1988
Ratio of import restrictions by Korea (%)	18.7	15.2	12.3	8.4	6.4	4.6
Ratio of import restrictions imposed by OECD countries on Korean exports (%)	39.9	41.2	36.3	31.0	28.9	n.a.

Korea's willingness to accept its international responsibilities is also reflected in its attitude to the Fund. Korea is committed to contribute SDR 65 million to the ESAF (or twice its calculated contribution based on existing Fund quotas) despite its status as a highly-indebted middle income developing country. Moreover, in December 1987 Korea made an advance repurchase to the Fund of SDR 600 million (despite the existence of a large amount of more expensive commercial debt) in order to release resources for use by other developing member countries.

3. As recently as two or three years ago the Executive Board expressed concern about the rapid increase in Korea's level of indebtedness. Domestically, the Korean authorities' economic development strategy of utilising external debt as a major source of investment was heavily criticised.

After years of adjustment, the external position has now improved and Korea has started to reduce its high level of foreign debt. However, outstanding debt is still 1.7 times higher than the levels of the early 1980s.

In my view it is important that the Fund have a successful model for the debt strategy - a model that proves a country can adjust and subsequently reduce its indebtedness by recording balance of payments surpluses. Korea is that good model, but it must be permitted to bring its adjustment process, started many years ago, to a successful conclusion. To do this it needs the support and encouragement of its economic partners.



(FQL) guestlist (4/20/88)

1988 Article IV Consultation

Guest List for the IMF Reception
held at the Seoul Palace Hotel,
March 25, 1988 at 7-9 p.m.

KIET

Mr. Moon-Shin Hong, President, Korea Institute for Economics
& Technology
Mr. Kang-Won Lee, Director, International Economy Division
Mr. Chul-Kyu Kang, Senior Research Fellow
Mr. Kyoung-Hwie Mihn, Senior Research Fellow
Mr. Jong-Hwa Cho, Senior Research Fellow

KDI

Mr. Bon Ho Koo, President
Mr. Suh Sang-Mok, Vice President
Mr. Choong Soo Kim, Director, Research Planning & Coordination
Mr. Soo Gil Young, Senior Fellow
Mr. Moon Soo Kang, Fellow
Mr. Wong Am Park, Fellow
Mr. Tae-won Kwack, Fellow
Mr. Sung Hee Jwa, Fellow

MINISTRY OF TRADE & INDUSTRY

Mr. Huh Nam Hoon, Vice Minister
Mr. Chae Jae Uk, Director General for Multilateral Trade Affairs
Mr. Shin Kook Hwan, Director General, Trade Bureau
Mr. Lee Seong Jae, Director for Multilateral Trade Affairs
Mr. Lee Won Ho, Director, Trade Policy Division
Mr. Joo Duck Young, Director, Industrial Machinery Division
Mr. Kim Jong Kap, Director for Trade Cooperation
Mr. Noh Young Wook, Director, Trade Promotion Policy Division
Mr. Choo Jun Suk, Director, Industrial Policy Division
Mr. Kim Kyung Sik, Deputy Director for Multilateral Trade Affairs
Mr. Kim Sung Hwan, Deputy Director, Trade Policy Division
Mr. Nah Do Sung, Deputy Director, Export Promotion Division
Mr. Kim Han Soo, Deputy Director, Export Division I
Mr. Baek Doo Ok, Deputy Director, Import Division
Mr. Shim Woo Jung, Deputy Director Trade Promotion Policy Division
Mr. Lee Choong Ho, Deputy Director, Asia Division
Mr. Koh Hak Geun, Deputy Director, Europe Division
Mr. Kwon Ki Heon, Deputy Director, America Division

MINISTRY OF TRADE 7 INDUSTRY (Contd.)

Mr. Lee Il Kyoo, Deputy Director, Industrial Policy Division
Mr. Kim Young Min, Deputy Director, Small & Medium Industry Policy
Division
Mr. Lee Kye Hyung, Deputy Director, Iron & Steel Division
Mr. Lee Seung Hoon, Deputy Director, Trade Investigation

MINISTRY OF ENERGY & RESOURCES

Mr. Choi Sin-Sok, Assistant Minister for Resources Policy
Mr. Yoon Soo-Kil, Director-General of Resources Development Bureau
Mr. Su Joo-son, Director of Energy Policy Division
Mr. Huh Soon-Young, Deputy Director, Energy Policy Division

BANK OF KOREA

Mr. Sung Sang Park, Governor
Mr. Myung Ho Kim, Deputy Governor
Mr. Chang Soo Lee, Auditor
Mr. Chan Moon Park)
Mr. Woo Young Lee)
Mr. Kyung Ho Cho) Assistant Governor
Mr. Han Do Huh)
Mr. Chang Kyu Lee)

Mr. Si Dam Kim, Director, Research Department
Mr. Kyong Hee Oh, Director, Statistics Department
Mr. Shee Yul Ryoo, Director, Monetary Policy Department
Mr. Yeon Jong Choi, Director, Foreign Exchange Department
Mr. Tai Chan Cho, Director, International Department

Mr. Duck Moon Park, Deputy Director, Foreign Exchange Park
Mr. Kang Nam Lee, Deputy Director, Research Department

Mr. Ryo Un-Sun, Chief, Business and Accounts Division, International
Division
Mr. Yoon Jin Rhee, Chief, International Organization Division
Mr. Tae Bong Park, Chief, National Income Division
Mr. Kim Gi Don, Assistant Chief, International Division
Mr. Cha Hyun Jin, Secretariat
Mr. Lee Mun-Hyung

ECONOMIC PLANNING BUREAU

The Honorable Deputy Prime Minister
Mr. Kang Hyong-Wook,, Assistant Minister

International Policy Coordination Office

Mr. Park You-Kwang, Assistant Minister
Mr. Koo Bohn Young, Director-General
Mr. Hyun Ok Seok, Director

Mr. Kang Bong-Gyun, Director-General, Economic Planning Bureau

Overall Planning Division

Mr. Chang Seung-Woo, Director
Mr. Seung woo Chang, Director
Mr. Lee Jong-Gap, Deputy Director
Mr. Chin Young-Kon, Deputy Director

Financial Planning Division

Mr. Maeng Jung-Ju, Director
Mr. Jung Ju Maeng, Director
Mr. Cho In-Kang, Assistant Director

Manpower Development Planning Division

Mr. Kwon O-Kyu, Director
Mr. Kim Hae-Soo, Assistant Director

Mr. Choo Kyung-Ho, Deputy Director, Overall Price Policy Division

Mr. Kim Sung-Jin, Director, Planning & Management Office

Mr. Kang Hyon-Wook, Assistant, Budget Office
Mr. Kim Byung-Il, Director, Budget Policy Division
Mr. Lee Chang-Ho, Assistant, Budget Policy Division

MINISTRY OF AGRICULTURE

Mr. Kim Han-Gon, Director-General, Agriculture Policy Bureau
Mr. Sohn Chan-Joon, Director, International Cooperation Division
Mr. Choi Hyung-Kyu, Deputy Director, International Cooperation Division

MINISTRY OF FINANCE

The Honorable Il Sa-Kong, Minister of Finance
The Honorable Assistant Minister of Finance

Finance Policy Division

Mr. Yoon Jeung-Hyun, Director
Mr. Byun Yang-Ho, Deputy Director

Treasury

Mr. Park Sang-Eun, Director-General, Treasury Bureau
Mr. Yong Kun Lee, Director, Treasury Division
Mr. Ik Joo Kim, Deputy Director, Treasury Division
Mr. Kang Sung-Wook, Assistant Director, Treasury Division
Mr. Oh Se-Woong, Director, Government Accounts Settlement Division
Mr. Lee Don-Young, Deputy Director, Government Accounts
Settlement Division

Mr. Young Bin Kim, Director-General, Insurance Bureau
Mr. Lee Young-Tak, Director-General, National Savings
Coordinator Insurance
Mr. Park Jong-Suk, Inspector General, Insurance Bureau
Mr. Kim Yong-Jin, Director-General, Tax Bureau
Mr. Kang Young-Choo, Director, Administration Division, Insurance Bureau

Mr. Lee Jung-Jae, Director, Foreign Exchange Policy Division
Mr. Kim Yong-Duk)
Mr. Kim Seok-Dong) Deputy Director, Foreign Exchange Policy Division
Mr. Kim Yong-Hwan)
Mr. Kwon Choong-Sik)

Mr. Lee Myung-Kyn, Deputy Director, Overseas Investment Division
Mr. Lee Jong-Min, Director, International Tax Division
Mr. Hong Young-Mahn, Deputy Director, International Tax Division

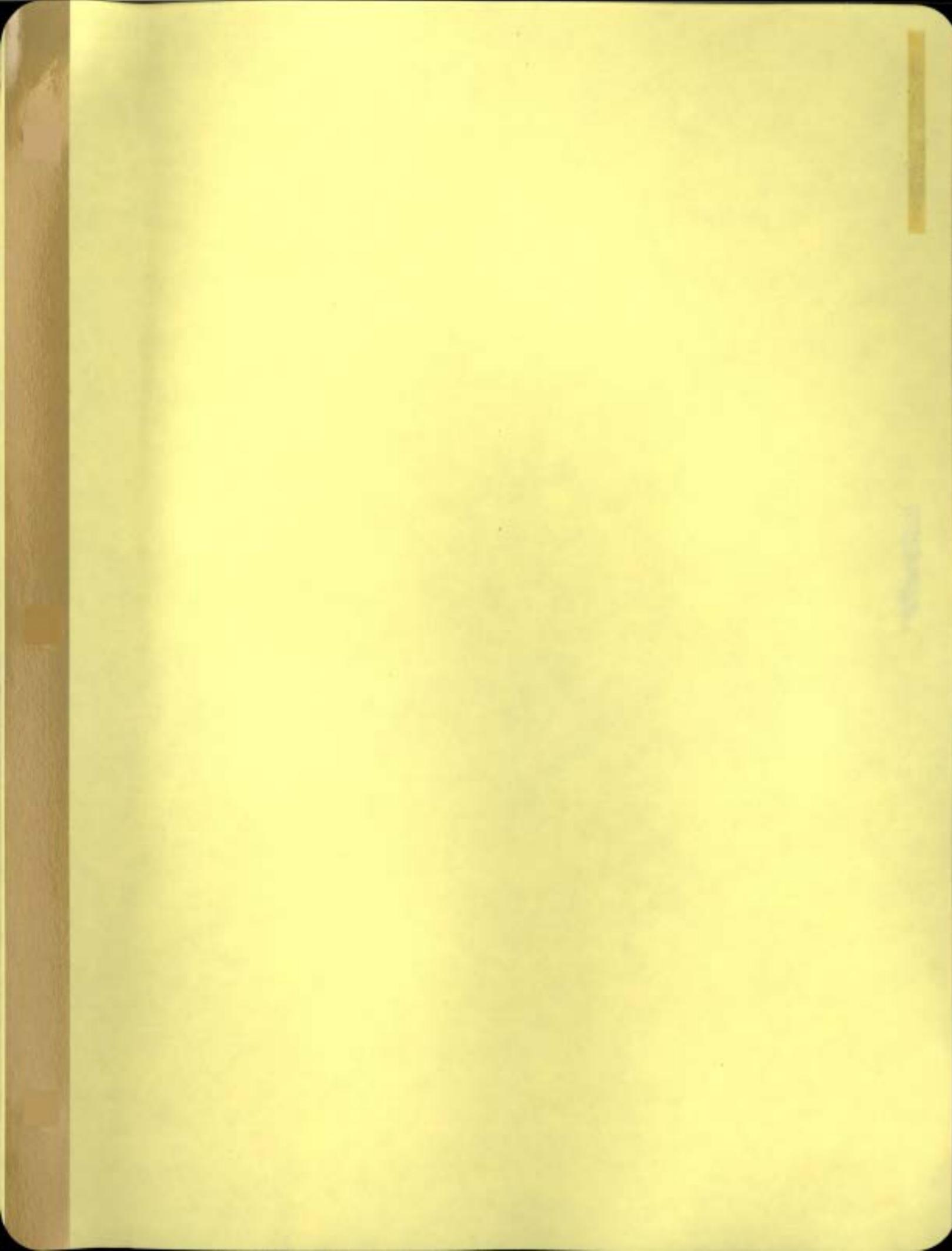
Mr. Yang Mahn-Ki, Director, Foreign Investment Promotion Division
Mr. Chung Sun-Kil, Deputy Director, Foreign Investment Promotion Div.

Mr. Lee Young-Ki, Counsellor to the Minister
Mr. Kim Kyoung-Tae, Director-General, Customs and Tariff Bureau
Mr. Yang Seung-Man, Director of Industry and Tariff Division
Mr. Kang Seuk-Jun, Deputy Director of Industry and Tariff Division
Mr. Kim Chong-Ho, Deputy Director of Customs Cooperation Division

MINISTRY OF FINANCE (Contd.)

Securities Bureau

Mr. Chung Duck-Koo, Director, Securities Policy Division
Mr. Park Hwan-Kyun, Deputy Director, Securities Policy Division
Mr. Jung Keun-Yong, Director Securities Issuance Division
Mr. Kim Tae-Hyun, Director, Securities Administration & Audit Division
Mr. Park Jin-Kyu, Director, Money Market Division



INTERNATIONAL MONETARY FUND

Korea--1988 Article IV Consultation
Staff Comments on Current Policy Issues

After an unexpectedly strong upturn in 1986, rapid growth fuelled by an export boom has continued through early 1988. While a slowdown in exports and some moderation in GNP growth are likely this year, the expansion will nevertheless continue at a high rate. Korea has thus entered a period of high growth accompanied by large current account surpluses. The renewed vigor which the Korean economy has shown over the recent past is most impressive and highly welcome both for Korea and the international economy. The success, however, has also created new problems and presents new challenges for economic policy. The main issues and the mission's position on them are summarized as follows:

(1) Current account surpluses of the present magnitude of around 8 percent of GNP are undesirable over the medium term for domestic as well as international reasons. Domestically, the resulting large liquidity inflows make monetary control increasingly difficult and further distort the pattern of credit flows, and have already led to inflationary pressures. The surpluses also intensify existing international imbalances and are, therefore, inconsistent with a constructive role for Korea in the process of global adjustment. This is particularly so because of the large imbalances in the underlying bilateral trade patterns which already have led to trade frictions.

(2) In line with the requirements for domestic financial stability and structural change as well as with Korea's role and responsibility in the international economy, the authorities should aim at reducing current account surpluses over the medium term to a range of 2-3 percent of GNP. Surpluses in that range would neither imply excessive reserve accumulation nor precipitate external debt reduction. The suggested decline in the surplus would occur gradually and is probably the maximum feasible if the adjustment process is to be smooth and orderly. While such a medium-term target would meet domestic and international objectives, it should be continuously reviewed and revised if necessary in the light of evolving domestic and international developments over the coming years.

(3) Various developments are already at work in the direction of a surplus reduction: the impact of the earlier won depreciation as well as of the earlier oil price and interest rate declines has been spent; wage costs rose sharply in the middle of last year; and further substantial wage increases are expected this year. In addition, there is the effect of market opening measures already implemented and of the exchange rate appreciation which has been initiated in 1987. Prospective trends in domestic demand will also support current account adjustment: as consumption will respond to higher real incomes, the savings ratio should decline from its present level which is historically high. Finally, the growth of international demand is likely to slow down under the impact of adjustment in the U.S. economy.

(4) However, these influences will not be sufficient to bring about the path of current account adjustment suggested above. They need to be supported and reinforced by further adjustment efforts. These should be directed toward

three areas: further market opening, real effective exchange rate appreciation, and ensuring sufficient domestic demand expansion. For adjustment to be effective, action should be taken simultaneously in all three areas. Furthermore, because of the delayed impact of adjustment measures on the current account, it is essential that action is taken at an early stage.

(5) Market opening provides still ample scope. Although the inevitable political constraints have to be recognized, a credible and effective move toward further market opening should be undertaken in the course of the year, encompassing import liberalization and tariff reductions. For import liberalization, the following measures are suggested: reduction in the number of restricted items, including agricultural products, at a substantially faster pace than in the past; early elimination of the surveillance list; simplification of importing procedures; reducing the application of special laws to a minimum number of products, together with a substantial increase in the number of items subject to reporting system instead of licensing. A major overhaul of the tariff structure is planned to be implemented in early 1989. It will reduce the level of nominal and effective protection as well as the disparities in protection levels among industries. This should contribute importantly to medium-term adjustment. In the meantime, tariff cuts over a wide range of items could be effected through concessional tariffs. In particular, additional tariff cuts on selected finished products could be implemented to reduce the rate of effective protection.

(6) Parallel to market opening measures, other liberalization measures should also be considered: restrictions on invisible payments could be eliminated ahead of schedule; implementation of liberalization measures on

overseas investment could be accelerated; the diversification list and localization program should be operated in accordance with comparative advantage. These programs should become increasingly unnecessary as external adjustment is affected through global measures.

(7) The recent exchange rate appreciation against the U.S. dollar should continue in order to achieve a real appreciation in 1988. Appreciation will counteract inflationary pressures through the direct effect of lowering import prices as well as the effect on reducing foreign exchange inflows as it lessens incentives to speculative capital inflows and tends to dampen the current account surplus. It will also support improvements in the structure of domestic production by shifting resources out of less efficient export and import substitution industries. Part of the real appreciation will result from further increases in unit labor costs. Because of the uncertain outcome of the wage negotiations this spring, the amount of further exchange rate appreciation during the remainder of the year will have to be determined in light of the impact of the wage settlements on domestic costs and international competitiveness.

(8) As the economy is operating close to capacity, there is limited scope in the short run to support current account adjustment through demand management. Indeed, monetary policy should contain liquidity expansion to the target of 18 percent through further substantial sales of stabilization bonds to neutralize the impact of foreign exchange inflows. Fiscal policy should take a broadly neutral stance. Thus, the small budget surplus projected for 1988 provides scope for a modest fiscal stimulus. Import duty and excise tax reductions, preferably on consumer durables, would be most suitable as they

would contribute to higher consumption and imports while at the same time dampening price increases. Policies to stimulate the growth of domestic demand will become more important over the medium term to support import growth and to compensate for the effect of slower export expansion and higher import growth on output. Thus, in the medium term, in addition to an easing of fiscal and credit policies, a reduction of interest rates to stimulate private spending could be achieved through the elimination of interest rate and direct credit controls together with a gradual liberalization of the capital account.

The adjustment measures outlined above are far-ranging and entail short-run costs. Their implementation will, therefore, be politically difficult. Perseverance of Korean policymakers as well as understanding of their constraints by Korea's trading partners are certainly needed. Over the medium term, however, these measures should accomplish a successful structural transition of the Korean economy which is essential for maintaining its high growth potential and also for contributing to more harmonious trade relations. Korea will thus further the overriding goal of providing higher living standards to its people, while playing a constructive role in the world economy and moving further toward joining the ranks of the industrialized countries.

Table 1. Korea: Balance of Payments, 1987-88

(In billions of U.S. dollars)

	1987 Actual	1988 Forecast 1/	
		I	II
Exports, f.o.b.	46.2	55.0	58.2
Volume (percent change)	(24.6)	(8.2)	(14.5)
Unit value (percent change)	(9.3)	(10.0)	(10.0)
Imports, f.o.b.	-38.5	-48.4	-49.8
Volume (percent change)	(22.4)	(15.3)	(18.7)
Unit value (percent change)	(6.0)	(8.9)	(8.9)
Trade balance	7.7	6.6	8.4
Services balance	0.9	1.2	1.9
Receipts	(-9.2)	(-10.5)	(-10.0)
Payments	(10.1)	(11.7)	(11.9)
Transfers	1.2	1.0	1.0
Current account (Percent of GNP)	9.8 (8.3)	8.8 (6.0)	11.3 (7.6)
Debt-related capital	-4.8	-3.3	-3.3
Nondebt-related capital	1.8	-0.6	-0.6
Overall balance of payments	6.8	4.9	7.4
Gross reserves (In months of imports of goods and services)	10.2 (2.6)	13.8 (2.8)	14.5 (2.9)
Debt (Percent of GNP)	35.6 (30.2)	30.9 (21.1)	29.1 (19.7)

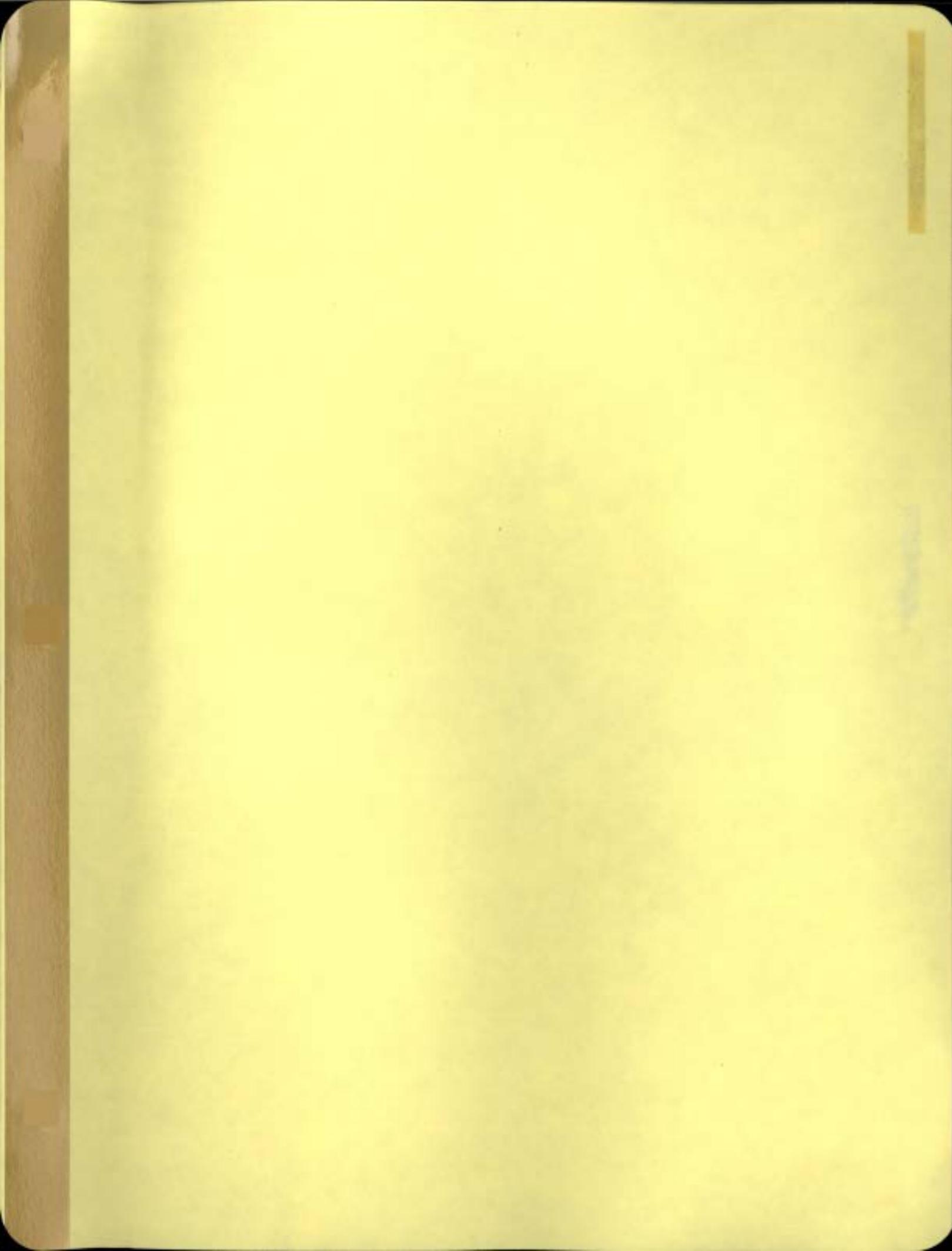
1/ Alternative I assumes a sharper decline in export volume and a larger response of tourist and other services payments to liberalization than Alternative II.

Export Volume

(Percentage change over same quarter a year ago)				Tourist and other service payments (US\$ bn.)								
1987 Actual				1988 Forecast				Actual		Forecast		
Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	1986	1987	1988		
27.9	25.6	21.9	23.1	I	18.7	9.8	3.8	3.8	2.2	2.6	I	3.8
				II	23.0	14.8	13.0	7.8			II	3.2

Table 2. Korea. Medium-Term Adjustment Scenario, 1985-92

	1985	1986	1987	1988	1989	1990	1991	1992
(in billions of US dollars)								
Exports	26.4	33.9	46.2	58.2	67.2	75.7	85.2	95.8
Imports	-26.5	-29.7	-38.5	-49.8	-61.5	-71.9	-81.7	-92.8
Net services and transfers	-0.9	0.4	2.1	2.9	3.0	2.9	2.6	2.0
Current account balance	-0.9	4.6	9.8	11.3	8.7	6.7	6.1	5.0
(In percent of GNP)	-1.1	4.9	8.3	7.6	5.2	3.5	2.9	2.1
Debt related capital flows	0.6	-0.7	-4.8	-3.4	-1.8	-1.2	-0.8	-0.2
Non-debt related capital flows	-2.2	-1.3	1.9	-0.6	-0.4	-0.5	-0.7	-0.9
Overall balance	-2.5	2.6	6.0	7.4	6.6	5.0	4.7	3.9
Gross reserves	8.4	8.6	10.2	14.5	19.3	23.2	27.1	38.8
(In months of imports of goods and services)	2.9	2.7	2.6	2.9	3.2	3.3	3.4	3.4
External debt	46.8	44.5	35.4	29.1	25.6	23.2	21.7	21.2
(In percent of GNP)	55.8	46.8	30.2	19.7	15.2	12.3	10.3	8.9
(Percent change)								
Export volume	4.3	26.4	24.6	14.5	9.8	9.0	9.0	9.0
Import volume	1.8	19.9	22.4	18.7	17.3	13.2	9.9	10.0
Real GNP	5.4	12.5	12.2	10.0	8.0	7.5	7.5	7.5
Real domestic demand	4.0	7.9	8.1	10.0	10.7	9.3	8.2	8.3



INTERNATIONAL MONETARY FUND

Korea--1988 Article IV Consultation Follow Up Visit

List of Minutes of Meetings/Memos

Minute No.	Subject	Date	Time	Author
1	Recent Economic Developments EPB	May 2	15:00	Tseng
2	Trade Developments, MTI	May 3	11:00 14:00	Jul
3	Monetary Developments MOF	May 4	10:30	Tseng
4	Monetary Developments BOK	May 4	15:00	Tseng
5	Tariff Reform MOF	May 6	10:30	Jul
6	International Finance MOF	May 6	15:00	Tseng
7	Minister of Finance	May 6	14:30	Jul
8	Korea Development Institute	May 7	10:30	Neiss

INTERNATIONAL MONETARY FUND

Korea--1988 Article IV Consultation Follow Up Visit

Minutes of Meeting on Recent Economic Developments

Economic Planning Board, May 2, 1988, 3 p.m.

Meeting No.1

Korean Representatives:

Mr. KIM Young, Director
Director, Financial Policy Division
Mr. CHO In Kang, Assistant Director
Financial Policy Division
Mr. PARK Nam Hoon, Assistant Director
Overall Planning Division
Mr. LEE Chang Ho, Assistant Director
Budget Policy Planning Division,
Budget Bureau
Mr. KIM Hae Soo, Assistant Director,
Manpower Planning Division

Fund Representatives

Mr. Neiss
Ms. Tseng*
Ms. Jul

Output and prices

Real GNP growth accelerated to 12 percent during the first quarter of 1988 (year on year) compared to 9 percent in the fourth quarter of 1987. Export and domestic demand remained strong. Exports rose by 35 percent (customs clearance basis, 21 percent increase in volume and 12 percent in unit value). ^{1/} Imports rose even more sharply--by 39 percent (26 percent in volume and 11 percent in unit value). Domestic demand is estimated to have increased by about 11-13 percent. The growth of domestic investment remained strong owing to a recovery in demand for housing, increased public construction and orders for industrial plants and facilities. An investment survey showed that investment appeared to be stronger in industries producing for the domestic market than those producing for exports. Industrial production rose by more than 20 percent, boosted by large increases in the production of autos, industrial machineries, and construction materials. Capacity utilization continued to increase to historically high levels. For the year as a whole, EPB expects real GNP growth to be 10 percent compared to the previous projection of 8 percent; some deceleration of real GNP growth is expected during the remainder of the year as export growth slows.

Prices

There are indications that the economy has entered a phase of overheating; significant bottlenecks have appeared in several key manufacturing sectors, notably some chemical goods, fiber materials and certain steel products.

^{1/} Trade volume and unit value indices published in Bank of Korea's Monthly Statistical Bulletin (Table 53) are based on customs clearance value.

Inflation has accelerated, consumer prices rose by 8 percent in March 1988 and 7 1/2 percent in April, the highest increase since May 1982. Inflation was attributable to shortage of agricultural products and raw materials, raised public utility charges, and higher prices of services and housing.

Labor

About 16 percent of all enterprises employing 100 or more regular employees 1/ have completed wage settlements as of April 17, 1988, compared to 6 percent which settled in March. The settlements provided for average wage increases of 12 percent. The Korean representative explained that the 73 percent of contracts settled referenced in the staff report referred to contracts that were under dispute. The number of labor disputes increased during 1988, from 1.7 per day in January to 7.7 per day in April. However, the Korean representative noted that with the new labor relations laws, the disputes and negotiations tended to be less disruptive compared with last year. The Korean representative said that wage increases in large conglomerates were higher (averaging 15.6 percent) than those in small-and medium-sized firms (averaging 11.3 percent). 2/ Wage negotiations follow the duration of annual contracts, and 80 percent of all enterprises are expected to complete wage negotiations in May. The remaining contracts are expected to be settled with wage increases of 13-14 percent, resulting in average wage increase in 1988 of 21-22 percent, with labor productivity estimated to increase by 9-10 percent, unit labor costs would increase by 11-12 percent on average in 1988.

Budget

At present, there are no plans for major budgetary changes. Tariff reductions are being planned for later in the year. A study to reform the overall tax system is under way, but the conclusions are not yet available. The actual budgetary outcome in 1987 showed a slightly larger surplus than estimated during the previous mission in March, (a surplus of W 0.5 trillion for the central government and W 1.5 trillion for the consolidated central government, equivalent to 1.5 percent of GNP). The Korean representative said that the surplus for the General Account could amount to W 1 trillion in 1988.

Balance of payments

The current account surplus in the first quarter of 1988 was \$3 billion, about \$500 million more than what EPB had expected (\$200 million more than staff projections). Exports increased by 38 percent; it is estimated that export volume rose by 23 percent and unit value by 12 percent. The most

1/ There are 5575 establishments employing 100 or more regular employees, of which 527 are establishments of the 30 large conglomerates which account for 25 percent of all employees. Wage settlements were completed for 889 of these establishments as of April 27, 1988, of which 32 were establishments of the large conglomerates.

2/ Daewoo settled recently with wage increase of 19.1 percent. During 1987, wage increases tended to be higher in manufacturing, electricity, and transportation than in construction and mining.

dynamic exports were automobiles (increase of 80 percent), footwear (67 percent), chemical goods (57 percent), steel and iron products (45 percent), and electric and electronics goods (35 percent). It was explained that the increase in steel exports reflected strong demand in Japan for public construction and that the high growth of footwear exports was due to continued competitiveness of Korean products with the major brand producers. In contrast, toy exports dropped by 20 percent. It was also explained that the high export growth in the first quarter reflected the bulkiness associated with ships exports (\$200 million-\$300 million). The Korean representative expected a deceleration in exports in the remainder of 1988, citing the deceleration in letters of credit received (26 percent in the first quarter compared with 40 percent during the same period a year ago, and 20 percent in April 1988), domestic capacity constraints, booming domestic demand, and the loss of competitiveness due to the won appreciation and wage increases. EPB projects exports to increase by 24 percent in the second quarter (customs clearance basis, 12 percent volume and 11 percent unit value), and 12 percent in the second half of the year (5 percent volume, and 7 percent unit value). For the year as a whole, EPB projects exports to increase by 20 percent (10 percent volume and 9 percent unit value) to \$55 1/2 billion, about \$2 1/2 billion less than the Fund staff's projections made during the March mission.

Imports rose by 36 percent in the first quarter of 1988; import volume rose by 23 percent, and unit value by 11 percent. Owing to the strong growth in domestic demand, particularly investment, imports for domestic use rose by 43 percent; particularly rapid growth was recorded in raw materials (40 percent) and capital goods (58 percent), whereas imports of consumer goods for domestic use rose by only 15 percent. Imports for export production rose by 35 percent (raw materials 32 percent, capital goods 46 percent, and consumer goods 14 percent). Crude petroleum imports rose by 26 percent. For the year as a whole, EPB projects imports to rise by 27 percent to \$49 billion (16 percent volume and 11 percent unit value), about the same as the Fund staff's estimates. EPB expects market opening measures already implemented to add to import demand and to offset the effect on imports of a more rapid deceleration in exports. Import licenses issued rose by 40 percent during the first quarter of 1988 compared with 29 percent during the same period a year ago.

The services surplus declined to \$ 156 million compared to \$ 319 million during the first quarter of 1987. Receipts rose by only 7 percent; travel receipts continued to increase briskly (47 percent), but receipts from overseas construction declined by 7 percent. Service payments rose by 16 percent. The Korean representative attributed the latter to the liberalization measures implemented since late last year, citing in particular the 81 percent increase in payments for travel payments and other services.

Transfers rose substantially, and amounted to \$0.5 billion, nearly half of the amount projected for the entire year. This was attributed to expectation about the continued appreciation of the won.

EPB's current account projection for 1988 is a surplus of \$8 billion, an increase from the \$7 billion projected in March, mainly due to a higher trade surplus. Net transfers are projected to be \$200 million higher than the previous projection of \$1 billion; however, this is offset by a projected \$200 million less in the services surplus.

Direction of trade

The trade surplus with the United States remained largely during the first quarter (at \$1.9 billion) compared with the same period last year. Nevertheless, exports to the United States decelerated to 23 percent in the first quarter while imports from the United States rose by 50 percent. In contrast, the trade deficit with Japan declined to \$1 billion compared to \$1.3 billion in the first quarter of 1987; exports to Japan rose by 61 percent and imports rose by 25 percent. Thus, the share of exports directed to the United States declined to 35 percent in the first quarter compared with 39 percent in 1987, and the share of imports from the United States rose to 23 percent compared with 21 percent. The share of exports directed to Japan increased to 20 percent from 18 percent, and the share of imports from Japan declined to 31 percent from 33 percent. The slower growth of exports to the United States affected nearly all products except for cars and footwear. The rise in exports to Japan were mainly in steel and apparel and textiles.

Measures

Recently implemented market opening measures included: (1) tariff reductions through tariff quotas on 506 items (HS system) are under study, items included are telephones, medicine, and wine; tariff reductions will average 40 percent from the actual rates; under the tariff reform program, tariffs are planned to be reduced from the present 18 percent to 8 percent by 1992; and (2) administrative procedures for imports and exports will be simplified.

INTERNATIONAL MONETARY FUND

Korea--1988 Article IV Consultation Follow-Up Visit

Minutes of Meeting on Trade Developments

Ministry of Trade and Industry, May 3, 1988, 11 a.m. and 2 p.m.

Meeting No. 2

Korean representatives

Mr. Cho Hwan-Eik, Director, Multilateral
Trade Affairs Division
Mr. Kim Jin, Deputy Director,
Multilateral Trade Affairs Division
Mr. Kim Sung-Hwan, Deputy Director,
Trade Policy Division
Mr. Kim Han-Suo, Deputy Director,
Export Division I
Mr. Kim Kyung-Jong, Deputy Director,
Import Division
Mr. Na Do-Sung, Deputy Director,
Export Promotion Division

Fund representatives

Mr. Neiss
Ms. Jul +
Ms. Tseng

The Korean representative stated that trade performance had been impressive in 1986 and 1987. However, since last year they had been experiencing unexpected pressures--labor strikes, a drastic appreciation of the won, and a political crisis resulting from the loss of control of the National Assembly by the Ruling Party after the April 26 elections. Mr. Cho expected exports to continue to grow but at a more moderated pace.

With respect to market liberalization policies, the basic direction would not be changed although the government did no longer have a majority in the National Assembly, not only because it was necessary to smooth trade frictions but because it was required for the domestic economy. There were potential problems with inflation and deriving from the present structure of production. The course of economic policy would not be changed but they would need political consensus from now on and that takes time. Once the opposition parties get involved in the policy process they would become more moderate and it would just be a question of time to obtain consensus.

Exports

They believe that \$ 56 billion of exports in 1988 is a more realistic number than the staff's estimate of \$ 58 billion. Exports expanded by 26 percent in April, down from 35 percent during the first

quarter of 1988 (customs clearance basis, 21 percent increase in volume and 12 percent in unit value). In won terms, a more appropriate measure of volume growth, exports grew by 22 percent during the first quarter of 1988 but by only 11 percent in April. For the year as a whole they are forecasting a 19 percent expansion in exports (10 percent volume and 9 percent unit value). The mission pointed out that although it may turn out that volume expands at a lower rate than originally forecast by the staff, export unit values were rising at a faster pace than originally envisioned. The Korean representatives responded that the sharp increase of export unit values in the first quarter when compared to the first quarter of 1987, was partly due to the fact that export unit values had experienced the sharpest rise in 1987 in the last quarter of the year. They believed that after the large increase in 1987 there was no room for more than a 10 percent increase in export unit values for 1988. In contrast with last year, competitors were depreciating their currencies this year.

Exports on a bop basis increased by 39 percent in the first quarter of 1988 while they grew by 35 percent on a customs clearance basis. The difference stems from some items which such as ships (\$200 to \$300 million) were registered on a customs basis in the fourth quarter of 1987 but only registered on a bop basis in the first quarter of 1988.

The most dynamic export products during the first quarter of 1988 were cars, steel products, chemicals, textile products, and electronic products. Exports of cars expanded by over 80 percent but they will slow down during the rest of the year as the large increase in car exports occurred after the first quarter of 1987. Last year 547,000 cars were exported and 700,000 are forecast to be exported in 1988. Capacity constraints and strong domestic demand are imposing a limit on exports of cars. There have been rumors that quotas may be imposed on exports of cars to the United States. During the first quarter of 1988 car prices increased by 3 percent compared with the same period last year.

Exports of steel products also face capacity constraints and a strong domestic demand. Steel exports, mainly to Japan, expanded very strongly in the last quarter of last year and in the first quarter of this year, when they grew by 66 percent. Exports of footwear grew by 65 percent (Korea has a competitive edge in quality which is expected to last 2 to 3 years) while textiles and electronics expanded by 70 percent.

They are losing competitiveness in textiles and footwear. Last year they were unable to fulfill their textile quota to the US because they were outbid by their competitors. Some export products, such as electronics, are facing demand restraints from the importing countries. The EC is negotiating a quota on exports of microwave ovens, VTRs, color TVs, and color picture tubes. Also, they are imposing export restraints on footwear.

The mission inquired why capacity constraints were not being overcome through investment which was expanding at a very fast rate. The Korean representatives stated that because of the appreciation of the won and the imposition of export quotas, businessmen were shying away from investment for export production. A survey conducted by the Ministry of Trade and Industry early this year showed that investment in the export industries is slowing down. Labor strikes also discourage investment.

Korean businessmen are interested in investing abroad because of profitability reasons stemming from the appreciation of the won. Also, they want to strengthen their economic cooperation with foreign countries to establish a basis for more stable export markets.

Which are the most important demand restraint measures taken by trading partners which explain the slowdown in Korea's exports? Quotas on steel products and footwear, and potential quotas on exports of electronic goods by the EC. Export constraints imposed by the US are particularly important because as a result firms can lose economies of scale which permits them to compete in other markets. The imposition of a quota in itself could result in loss of competitiveness because of the impact it has on investment. The US revised Korea's textile quotas when it adopted the 10-digit Harmonized System. The US maintains the change was neutral but they estimate a 10 percent loss of potential exports resulted from the it, not visible but hidden under technical restrictions.

During the first quarter of 1988, exports to Japan expanded at a very fast rate, especially apparel and clothing and steel products, while demand from the US was sluggish for almost all items, except cars and footwear. Exports of electronic goods increased by 37 percent (45 percent in 1987), exports of VTRs increased by only 6 percent, and exports of toys dropped 20 percent. As the US market represents a 70 percent of the market for toys, total exports of toys expanded by only 0.8 percent during the first quarter of 1988 compared with the same period last year.

Imports

Imports grew by 39 percent during the first quarter of 1988 (on a customs basis, 26 percent in volume and 10-11 percent in unit value). Imports for domestic use increased by 33 percent (raw materials 40 percent, capital goods 58 percent, and consumption goods 15 percent) while imports for export production rose by 35 percent (raw materials 32 percent, capital goods 46 percent, and consumption goods 14 percent). Crude petroleum imports grew by 26 percent. The fastest growing categories of imports included: precision machinery (66 percent), machinery (49 percent), agricultural products (44 percent), and steel

and chemical products (37 percent).

The Ministry of Trade and Industry forecasts a 27 percent increase in imports for 1988 (18-19 percent in volume and 7-8 percent in unit value) compared to a 29 percent increase by the staff.

There have been no additional liberalization measures during April 1988 and none are being contemplated at present. They plan to simplify import procedures.

Despite assertions to the contrary during the consultation, the Korean representatives stated that there is compulsory list for import diversification, besides the 335 items which constitute a voluntary list. This list amounted to 379 items (8-digit CCCN) or 447 items (6-digit HS system) by end 1987. On April 1, 1988 the list was reduced to 226 items (6-digit HS).

INTERNATIONAL MONETARY FUND

Korea--1988 Article IV Consultation Follow-Up Visit

Minutes of Meeting on Recent Monetary Developments

Ministry of Finance, May 4, 1988 10:30 a.m.

Meeting No. 3

Korean representative

Mr. Byeon Yang-Ho, Deputy Director
Financial Policy Division,

Fund representatives

Mr. Neiss
Ms. Tseng*
Ms. Jul

Reserve money

The sharp increase in reserve money during the last two months of 1987 was due to the increase in the required reserve ratio (from 4.5 percent to 7 percent, effective November 23, 1987); this raised deposit money banks' (DMBs) reserves at the Bank of Korea (BOK) by about W 1 trillion; reserve money, adjusted for the change in the reserve requirement, rose by 29 percent rather than the actual increase of 49 percent. The contractionary impact of the increase in the reserve requirement, however, was negligible because banks switched deposits from the Monetary Stabilization Account (MSA) to required deposits. Mr. Byeon explained that the increase in the required reserve ratio was taken more in response to complaints from banks that their profitability was being eroded by the requirement to maintain reserves in the MSA earning a relatively low 8 percent interest than for monetary control purposes. He said that banks preferred to accept a legal requirement to maintain required reserves (at no interest) rather than "window guidance" to make deposits in the MSA, particularly in terms of explaining performance to their shareholders. DMBs maintain only required reserves and deposits in the MSA with the BOK, free reserves are used in the interbank market or for investment in various financial instruments. In terms of deposits in the MSA, Mr. Byeon said that the BOK calculates how much liquidity needs to be absorbed, and apportions the deposits in the MSA among the DMBs.

Bank of Korea's foreign currency deposits with DMBs are maintained: (1) to finance prepayment of external debt by commercial banks; and (2) to finance imports for import diversification. The introduction of these various financing schemes accounted for the W 3.4 trillion (\$4 billion) increase in such deposits. Non-DMBs (mainly KDB, KEXIM, Korea Long-Term Credit Bank, and merchant banks) swapped their externally borrowed funds with the BOK for domestic currency for onlending to domestic firms when Korea experienced current account deficits. Banks have reversed their swaps with BOK (W 1.4 trillion, \$1.7 billion) in 1987 in order to reduce their external liabilities.

The W 2.7 trillion (\$3.3 billion) increase in claims on the private sector represented BOK's lending to non-DMBs (KDB, KEXIM, and KLCB) to supply special loans for imports (under import diversification), and for the prepayment of external debt by private and public enterprises.

external debt by private and public enterprises.

Mr. Byeon considered reserve money to be not as an important instrument for macroeconomic management as in industrial countries; he said that BOK continues to rely mainly on direct credit controls.

Monetary Stabilization Bonds

Of the W 10 trillion MSBs outstanding at end 1987, W 6 trillion are held by nonbank financial institutions (NBFIs), W 2.9 trillion by DMBs, and the remainder by other private nonfinancial entities. Mr. Byeon explained that BOK does not sell MSB directly to DMBs; and in fact, they are discouraged to hold them; he said that DMBs, particularly foreign banks, buy them in the "market". Some of the MSBs held by DMBs are related to swaps. The total net issue of liquidity control bonds (MSBs, Exchange Equalization Bonds, and Treasury bills) amounted to W 7.2 trillion in 1987; gross issue totaled W 11.8 trillion, and redemption amounted to W 4.6 trillion.

Monetary survey

The large increase in domestic credit to the private sector (W 9 trillion, 19 percent) in 1987 was due, in large part, to the special financing made available for import diversification and external debt prepayment (W 2.7 trillion, \$3.3 billion); excluding these special financing, domestic credit would have increased by 13 percent. Although this financing was directed toward imports, it was nevertheless expansionary, because to the extent that some of the imports financed by special loans would have taken place anyway, the special loans expanded the funds available. The uses of domestic credit in 1987 were as follows:

(Change, in trillion wons)

	<u>1987</u>
Private domestic credit	<u>9.0</u>
Of which:	
Special credits (imports, debt prepayment)	2.7
Export financing	- 1.0
General loans (incl. small, medium firms)	2.0
Facilities loans (for exporters)	0.5
Commercial bills	0.5
Agriculture	0.6
Personal loans	0.3
Housing loans	0.4
Securities loans	0.3
Budgetary loans (NIF, housing, fisheries, etc.)	0.3
Others	2.4

Monetary developments in 1988

The growth in broad money continued at a rapid pace, although there has been some deceleration from the 22.5 percent at end December 1987. Broad money grew by 19.1 percent in March 1988 and 18.5 percent in April. Mr. Byeon said that with ₩ 7.5 trillion of the liquidity control bonds falling due in 1988, gross issue of such bonds would need to exceed ₩ 13 trillion. He said that the continued inflow of net foreign assets will make it difficult to maintain the growth of M2 at 18 percent. Mr. Byeon also said that the overall BOP understates the monetary control problem; in particular certain imports and the prepayment of external debt above the line is being financed by an expansion of domestic credit. He said monetary data for 1988 will be supplied to the mission later in the week.

The Bank of Korea is reviewing expanding the coverage of broad money with a view to exclude long-term financial liabilities of commercial banks and to include short-term financial liabilities of NBFIs. He said that the liquidity of CDs issued by NBFIs are often comparable to that of DMBs.

INTERNATIONAL MONETARY FUND

Korea--1988 Article IV Consultation Follow-Up Visit

Minutes of Meeting on Monetary Developments

Bank of Korea, May 4, 1988 3:00 p. m.

Meeting No. 4

Korean representative

Mr. Kim, Director of Research
Bank of Korea

Fund representatives

Mr. Neiss
Ms. Tseng*
Ms. Jul

Mr. Kim discussed measures being implemented to contain the growth of broad money to around 18 percent. Credit to large conglomerates is being reduced. The Bank of Korea has requested enterprises with bank debts of more than W 20 billion to reduce the outstanding debt by 10 percent before the end of this year. In 1987, the large borrowers repaid W 720 billion; he expects such repayments to amount to W 800 billion this year (equivalent to 2 percent of broad money outstanding at end 1987).

Mr. Kim said that the financial community was saturated with MSBs and it is becoming more difficult to "sell" them (in practice moral suasion has been used to induce nonbank financial institutions to purchase specific amounts of MSBs). MSBs outstanding rose to W 14.9 trillion during the first quarter of 1988; the increase of W 4.4 trillion representing about 70 percent of the total increase during the entire last year.

Mr. Kim noted that the special financing for debt prepayment by the private sector is not very popular this year, given the continued appreciation of the won and high domestic interest rates. Users of the special financing must provide 20 percent of the prepayment from their own resources (80 percent is financed by BOK). The repayment is in U.S. dollars, and the interest rate is fixed at 8 percent (it was tied to LIBOR last year).

INTERNATIONAL MONETARY FUND

Korea--1988 Article IV Consultation Follow-Up Visit

Minutes of Meeting on Tariff Reform

Ministry of Finance, May 6, 1988 10:30 a.m.

Meeting No. 5

Korean representatives

Mr. Shin Myoung-Ho, Director General,
Customs and Tariff Bureau
Mr. Park Sang-Tae, Director, Industry
and Tariff Division
Mr. Kang Seuk-Jun, Deputy Director,
Industry and Tariff Division
Mr. Kim Chong-Ho, Deputy Director,
Customs Cooperation Division

Fund representatives

Mr. Neiss
Ms. Jul *
Ms. Tseng

On April 20, 1988 the government announced a proposal for tariff reform, which would cut the average unweighted basic tariff rate from 18.1 percent in 1988 to 7.1 percent by 1993, the present tariff level of the industrialized developed countries. The proposal (attached) gives a tariff reduction schedule which would be frontloaded, with the major tariff cuts to be implemented by January 1, 1989. After this proposal is discussed with other authorities concerned, it will be subject to public fora in the form of seminars to which all interested parties will be invited. They intend to have an agreed draft by the end of June. The draft will then be discussed by the Tariff Reform Commission and then by the Cabinet and the President. They plan to send a proposal to the National Assembly by September.

The proposal does not include changes in the drawback system but they are also reviewing it. Their objective is to reduce tariff exemptions step by step. Also, they intend to incorporate tariff concessions during the five year period, as fast as possible, in the comprehensive basic tariff reduction schedule. The whole system of tariff protection will be reviewed in the context of the tariff reform process.

In 1988, the authorities have implemented tariff cuts through tariff quotas and tariff concessions on two occasions: January 1 and February 24. At present, they are preparing a new list of items that would be subject to tariff quotas starting June or July. They have asked the ministries concerned to submit a list of items, in particular consumption goods, by the end of May. The new list of tariff quotas will be different from the previous ones because it will include final consumption goods as well as raw materials and intermediate goods. It

will extend for another six months (after June 30, 1988) existing tariff quotas on some items. The new list may not be implemented until July because it has to be discussed with concerned ministries as well as in the Cabinet and with the President.

They do not envisage additional tariff concessions. Tariff quotas could be implemented for some items for which concessions have been requested but have not been granted yet. They do not feel there is any need to implement additional measures in this area. Also, there are no measures planned with respect to emergency or adjustment tariffs.

Tariff Reform Plan for 1989-'93

April 30, 1988

Ministry of Finance

KOREA

TARIFF REFORM PLAN

I. Outline

On April 20, 1988, the Ministry of Finance of Korea announced its draft of a comprehensive tariff reform plan designed to cut the average tariff rate of 18.1 percent to 7 percent, the present level of ^{OECD} developed countries, by 1993.

The Ministry will draw up a master plan by August that reflects extensive public opinion obtained through public forums and consultations with the relevant authorities concerned.

The final proposal will be submitted to the National Assembly for approval during its regular session in September this year, and hoped to be in effect as of January 1, 1989.

II. Background

The Korean government adopted the five-year Tariff Pre-Indication System, an annual tariff reduction program, in 1984. One of the major advantages of this long range program was to allow domestic industries time to adjust themselves to upcoming tariff changes by giving them early notice.

With the termination of this program by year's end, the Ministry of Finance decided to review and revise the overall tariff scheme and to design another five-year program for 1989-93.

While recognizing the necessity to control Korea's recent trade surplus by promoting import^{ation} and domestic demand, the Ministry will also emphasize a plan that contributes to the progress of international free trade.

III. Objectives

The main objectives of the reform draft are as follows:

- contribute to the promotion of international trade by eliminating tariff barriers
- minimize differences in the range of tariff rates *amongst the similar home and industries*
- ensure efficient reallocation of resources *by reducing tariff escalation*
- promote balanced development of both exportation and domestic demand *by reducing export supports and the excessive protection for domestic production*

IV. Key Elements

One of the most important elements of this reform plan is to drastically cut current tariff rates to a level similar to those of developed industrial countries.

The average rate will be lowered from the present 18.1% to 12.6% in early 1989, and will gradually reach 7.1% by 1993. Accordingly, the present 16.9% on manufactured goods will be reduced to 11.5% and 6.1% in 1989 and 1993, respectively. As a result, actual rates in effect will be at 3.0% in the target year.

It will also affect all items of industry in each sector. The result will be a remarkably slow-moving escalation in the range of tariff rates in accordance with degree of manufactural process, i.e. in the order of raw materials, processed products, consumer products.

End
Key indicators are given in the following tables.

Tariff Rate Trends

(unit: %)

	Current ('88)	Yearly trends				
		'89	'90	'91	'92	'93
Central rates	20	15	13	11	9	8
Average rates						
Total	18.1	12.6	11.2	9.5	8.1	7.1
Manufactured products	16.9	11.5	9.9	8.4	6.9	6.1
Agro-fishery products	25.2	18.8	18.1	15.4	14.7	12.4
* Rates in effect	8.0 (as of '87)	4.8	4.3	3.8	3.3	3.0

* Rates in effect: tariff rates to be borne by taxpayers in practice after reduction, refund, reimbursement, etc.

Raw Materials

(unit: %)

	Current rate	Percentage decrease	'89	'90	'91	'92	'93	Example Major-items
Non-Competitive	5	60-80	1-2	1-2	1-2	1-2	1-2	Raw ores
Competitive	10	70	5	5	4	4	3	Raw rubber, raw hide

Manufactured Products

(unit: %)

	Current rate	Percentage decrease	'89	'90	'91	'92	'93	Major-items
General	20	60	15	13	11	9	8	Central-rate
Processed products	20	75	15	11	9	7	5	Cotton yarn
Consumer products	30	73	20	16	13	10	8	Garments, electronics
Luxuries	50	84	20	16	13	10	8	Jewelry

Agro-fishery Products

(unit: %)

	Current rate	Percentage decrease	'89	'90	'91	'92	'93	Major-items
Raw farm products	10	70	5	5	4	4	3	Corn, beef tallow
General products	20	60	15	13	11	9	8	Fish, minor cereals
Cash crops / products	30	33	30	30	25	25	20	Meat
"	40	38	35	35	30	30	25	Livestock products
"	50	40	40	40	35	35	30	Fruit
High tariff items	100	70	50	50	40	40	30	Liquor

As shown in the tables above, the degree of tariff cuts will be highest in 1989 and will proceed at a slower pace thereafter. ^{tariff cuts will be put into}
~~in the beginning year of 1989 for the purpose of earlier advancement of the effect~~

For items for which a uniform lowerment of tariffs proves difficult, as determined by consensus, the item-by-item formula will be implemented as an alternative in order to compensate for the disadvantages in general reduction where tariffs on items in the same categories would be unified by drastically reducing the rates on those items which carry high tariffs.

V. Prospects of the Effect

It is expected that this Tariff Reform Plan will:

- promote equilibrium in the trade balance by lowering tariff rates and increasing importation.
- strengthen Korean industries' international competitiveness through ~~the~~ lower prices of raw materials.
- stabilize domestic prices as a result of importation ^{lower cost} ~~with less cost and~~
- increase consumers' welfare by broadening their choice in buying foreign commodities.

Submitting itself willingly to a drastic decrease in tariff revenue, the government ^{is confident that this tariff reform plan will be carried} ~~will carry out the tariff reform resolutely in order to contribute to the world-~~
~~wide trade expansion.~~ ^{out so as to contribute to further development of}
^{the national economy and to world trade.}

INTERNATIONAL MONETARY FUND

Korea--1988 Article IV Consultation Follow-Up Visit

Minutes of Meeting on International Finance Developments

Ministry of Finance, May 6, 1988 3:00 p.m.

Meeting No. 6

Korean representatives

Mr. LEE Jung-Jae, Director,
Mr. KIM Suk-Dong, Deputy Director,
Mr. KIM Yong-Ouk, Deputy Director,
Mr. PARK Dai-Tong, Deputy Director,
all Foreign Exchange Policy Division,
Ministry of Finance

Fund representatives

Mr. Neiss
Ms. Tseng*
Ms. Jul

Current account

The current account surplus rose to \$3 billion in the first quarter of 1988 compared with \$2.1 billion in the same period a year ago, owing to continued strong export growth and inflows of private transfers. Exports increased by 38 percent (23 percent volume and 12 percent unit value). Mr. Kim said that the strong export growth during the first quarter was partly due to the speeding up of exports in anticipation of won appreciation. The strong growth of exports and domestic demand boosted imports which rose by 36 percent (23 percent volume and 11 percent unit value). The net services surplus declined to \$156 million compared with \$319 million in the first quarter of 1987. Services receipts rose by 7 percent; although travel receipts rose by 47 percent, receipts from overseas construction declined by 7 percent. Service payments rose by 16 percent reflecting mainly the 81 percent increase in travel payments and the 29 percent increase in other service payments. This was attributed to the liberalization measures affecting invisibles payments implemented since late last year. Private transfers nearly doubled compared with the first quarter of 1987 due to expectations about won appreciation. Mr. Kim said that measures were implemented to discourage speculative inflows in late March and that transfers was on a downward trend in April.

In the light of the first quarter developments, the Government's current account projections for the year was raised to a surplus of \$8 billion from the \$7 billion projected in March. Exports has been revised upward by \$1 billion, net transfers upward by 200 million, and invisibles surplus downward by 200 million. Despite the strong export growth in the first quarter, labor strife and the won appreciation would adversely affect export performance in the remainder of the year. 1/

1/ During the prolonged strike at Daewoo, Daewoo's car exports ceased in April.

Direction of trade

The trade surplus with the United States remained largely unchanged in the first quarter of 1988 (\$1.9 billion) compared with the same period a year ago. Nevertheless, the underlying export and import trends indicate a narrowing of the surplus in the remainder of the year. During the first quarter, export growth decelerated to 23 percent, while import growth accelerated to 50 percent. Moreover, letters of credit received in the first quarter from the United States rose by only 7 percent compared with 33 percent in the same period a year ago, while import licenses issued (for imports from the U. S.) rose by 47 percent compared with 21 percent a year ago. The trade deficit with Japan declined owing to strong import demand and the competitiveness of Korea's exports in Japan as well as Korea's efforts at import diversification. The deficit with Japan declined to \$1 billion compared to \$1.3 billion in the same period a year ago; exports rose by 61 percent and imports by 25 percent.

Capital account, external debt, and reserves

The non-debt-related capital account recorded a surplus of \$0.6 billion, mainly reflecting net inflows of medium- and long-term capital. ^{1/} Errors and omissions also showed net inflows of \$0.5 billion. External debt was reduced by \$880 million to \$34.7 billion. The scheduled and actual amortization of medium-and long-term debt during the first quarter were as follows:

(In millions of U. S. dollars)

Total amortization	<u>1770</u>
Scheduled amortization	1180
Prepayment	590
Public sector	150
Financial institutions	440
DMBs	130
Non-DMBs	310

During 1987, of the \$5.9 billion in prepayment by financial institutions, \$2.6 billion was by DMBs, and \$3.4 by non-DMBs.

Debt service payments totaled \$2.5 billion including prepayment (\$1.8 billion amortization and estimated \$700 million interest), and \$1.9 billion excluding prepayment. The debt service ratio declined to 16 percent including prepayment, and 12.2 percent excluding prepayment.

^{1/} Mr. Kim later explained that the \$619 million net inflow under "other debt" should not be classified as debt. He said these flows were related to "irregular" activities of the private sector in the forward exchange market to circumvent credit controls. He said the nature of these flows had both current and capital account characteristics; he was uncertain how they should be classified and for now would include them in the capital account as "other non-debt-related flows."

International reserves of the banking system rose to \$13.7 billion during the first quarter, and the import cover rose slightly to 2.7 months. Excluding the foreign reserves held by branches of foreign banks in Korea, total reserves was \$12.6 billion. Reserves of the Bank of Korea rose to \$7 billion at end-March 1988 from \$3.6 billion at end 1987.

Short-term debt

Short-term debt remained largely unchanged, as the increase in trade-related debt was offset by a decline in banking sector debt. This was in contrast to 1987 when trade-related short-term debt rose while non-trade related debt declined. Mr. Kim said that last year's developments was the result of measures implemented during 1986-87 to discourage short-term trade-related borrowing, for example by reducing the items eligible for trade credits. He also said that in the first quarter of 1988, the increase in short-term trade credits reflected the expansion of imports, while the decline in banking sector short-term debt was due to shift from reliance on refinances to financing by the BOK by banks.

Mr. Kim said that in practice it was difficult to distinguish between trade and non-trade related short term debt. He said that the present classification was agreed with previous Fund missions, but that it was difficult to maintain accurate statistics on short-term debt.

Monetary survey

Mr. Kim explained that Bank of Korea's foreign currency deposits with DMBs and BOK's claims of the private sector (which are the non-DMBs, KDB, KEXIM, and KLCB) are resources made available to financial institutions to repay external debt, finance imports under the special financing program (for imports from sources other than Japan), or substitute for foreign financing. In the case of DMBs, the DMBs could use the funds to repay their own external debt, for onlending to the private sector for repayment of private sector external debt, or to finance exports (previously DMBs had refinanced export bills with foreign borrowing). When DMBs use the funds to repay their own external debt or for onlending to the private sector for repayment of private external debt, the monetary effect is neutral. In the former, the decline the NFA is offset by an increase in NDA; in the latter, the decline in foreign assets is offset by a decline in foreign liabilities.

The terms of loans for prepayment of external debt are harmonized with those on the debt being repaid. The terms for import financing are 90 days for raw materials and up to 10 years for capital goods. Mr. Kim said the specifics (e.g. interest rates) will be provided to the mission later by the International Finance Division. Of the \$3 billion special import financing provided last year, \$1 billion was disbursed in 1987, \$1.7 billion will be disbursed this year. (\$2 billion for capital goods and \$0.7 billion for raw materials) An additional \$3 billion in special import financing is available in (\$2 billion for capital goods and \$1 billion for raw materials).

INTERNATIONAL MONETARY FUND

Korea--1988 Article IV Consultation Follow-Up Visit

Minutes of the Meeting with the Minister of Finance
May 5, 1988 at 4:30 p.m.

Meeting No. 7

Korean representative

The Honorable Sakong Il, Minister of Finance

Fund representatives

Mr. Neiss
Ms. Jul*
Ms. Tseng

Mr. Neiss stated that the mission had concluded that there had been no major changes since the consultation, that the assessment remained unchanged, and that the forecast was broadly in line with that included in the staff report and that no revisions were intended. The policy course continued to be the same, although the policy environment had changed and there was a need to wait and see how the process of policy implementation would evolve. The mission still envisioned another year of strong growth, of strong domestic demand, a large current account surplus, and inflationary pressures. Probably the outcome of the wage negotiations would show larger wage increases than forecast previously and this would have implications for competitiveness.

The Minister agreed with the mission's conclusions. He thought that the political developments would not affect the basic direction of the economic policy but that the government would have to engage in more strenuous efforts to persuade politicians on policy issues and to avoid the policy course to drift by giving in to populist demands. The Minister thought that they could defend and would defend their policy stance but that there would be some difficulties.

The Minister stated that he had no problems with the staff report. Mr. Neiss pointed out that the appraisal included some points which had not been discussed by the consultation mission which were not meant for Korea but for other countries. It was stated that Korea plays a more important role in the world economy today and should contribute to the world adjustment process, but that Korea was relatively small and other countries should not expect a big contribution. The appraisal pointed out that if other countries do not adjust, Korea's adjustment effort would not be effective to reduce world imbalances because its surplus would shift to other countries. Also, for welfare reasons, international and domestic, it was better to open markets than to appreciate.

The Minister stated that he had been advocating the last point all along. He expected that the surplus would decline in the second half of the year, in a gradual manner and not in a disruptive form.

Mr. Neiss stated that the immediate potential problem was inflation. The increase in liquidity resulting from the external surplus was more difficult to absorb, large wage increases, a fast growing economy with bottlenecks arising, were all factors which could push the annual rate of inflation to 6-8 percent for 1988.

The Minister believed that the current account surplus would go over \$ 7 billion in 1988 because of invisibles and transfers, which would present larger surpluses than originally foreseen. They would do their best to reduce these surpluses but they would have to watch the trade account closely too.

The Minister expressed that they would like to publish the Staff Report. Mr. Neiss suggested that they could publish the appraisal and other excerpts. The Minister agreed with this point.

Mr. Neiss stated that the mission intended to include in the supplement the tariff reform proposal pointing out that it was still a proposal which could suffer modifications. The Minister agreed and mentioned that besides the tariff reform they would be working on a tax reform and on a financial reform during 1988.

Tentative Itinerary for IMF Follow-up Mission

'88. 5.2 (Mon)

- 11:00 Courtesy call on Mr. Hwan-Kyun Lee,
Director-General, Int'l Finance Bureau,
MOF
- 11:30 Courtesy call on Mr. Bong-Gyun Kang,
Director-General, Economic Planning Bureau,
EPB
- 12:00 Luncheon hosted by Mr. Bong-Gyun Kang,
EPB
- 15:00 Discussion on Recent Economic Development,
EPB
WT

5.3 (Tue)

- 10:30 Courtesy call on Mr.
Director-General,
- 11:00 Discussion on Recent Trade Development, MTI
AMJ
- 12:00 Luncheon hosted by Mr. Hwan-Kyun Lee, MOF
- 15:00 Discussion on Recent Trade Development
(continued)
AMJ

Saturday KDI AMJ
BOK Research WT.

INTERNATIONAL MONETARY FUND

Korea--1988 Article IV Consultation

List of Minutes of Meetings/Memos/Tables

Minute No.	Subject	Date	Time a.m./p.m.	Author
1	Courtesy call on the Minister of Finance	Mar. 14	3:00	Baban
2	Meeting at Korea Institute of Economics and Technology	Mar. 15	10:30	Baban
3	Courtesy Call on Mr. Seung Park, Senior Secretary to the President for Economic Affairs	Mar. 15	3:00	Tseng
4	Meeting with KDI	Mar. 15	4:00	Le Fort
5a*	Technical Meeting on Trade Matters	Mar. 16	11:00	Jul
5b	Meeting with Vice Minister of Trade and Industry	Mar. 16	10:30	Jul
6	Technical Meeting on Tariff	Mar. 16	5:00	Tseng
7	Technical Meeting on National Income Accounts and Prices	Mar. 16		Baban
8	Courtesy call on the Deputy Prime Minister	Mar. 17	9:30	Le Fort
9	Technical Meeting on Labor Matters	Mar. 17		Baban
10	Technical Meeting on International Finance	Mar. 17	2:30	Tseng
11	Technical Meetings at EPB on the 1988 Budget	Mar. 17	4:00	Katz
12	Technical Meeting on Money and Credit	Mar. 18	9:30	Le Fort

13*	Meeting with Korea Foreign Traders Association	Mar. 18	11:30	Jul
14	Technical Meeting on Economic Management Plan and BOP	Mar. 18	2:00	Tseng
15	Technical Meetings on Fiscal Developments in 1987 and Policies	(Mar. 18 (" 22	5:00 9:30	Katz Katz
16	Technical Meeting on Energy Matters	Mar. 21	3:30	Baban
17	Meeting on Agricultural Matters	Mar. 21	5:00	Baban
18*	Meeting on Securities	Mar. 22	2:00	Le Fort
19*	Meeting on Foreign Investment	Mar. 22	11:00	Jul
20	Meeting on Industrial Policy	Mar. 22	2:00	Baban
21	Policy Meeting on BOP	Mar. 22	3:00	Tseng
22	Policy Meeting on International Finance	Mar. 23	10:00	Tseng
23*	Policy Meeting on Trade	Mar. 23	3:30	Jul
24*	Policy Meeting on Tariffs	Mar. 23	5:00	Jul
25	Final Meeting	Mar. 25	3:35	Baban

* Indicates drafts not finalized.

MEMORANDA

1.	Real (Unit Labor Cost) Effective Exchange Rates	Mar. 18	Tseng
2.	Estimation of Korean Money Demand	Mar. 22	Le Fort
3.	48-Hour Report to Management	Mar. 30	Neiss
4.	Memo from Mr. Narvekar to MD & DMD	Mar. 30	Neiss

KOREA--TABLES

tb8kr1	- Real Effective Exchange Rate Relative Unit Labor Costs, 1980-87
tb8kr2	- Real Effective Exchange Rate Normalized Relative Unit Labor Costs, 1980-87

- tb8kr3 - Real Effective Exchange Rate, Relative Unit Costs, (Korea Productivity Index) 1980=100
- tb8kr10 - Indicators of Competitiveness, 1979-88
- tb8kr5 - 1987 Trade Projection Using Actual Data for "Independent Variables", 1986-87
- tb8kr9 - Exchange Rate Assumptions, 1987-88
- tb8krbop- Balance of Payments Projections, 1987-88
- tb8kr4 - Export Projections, 1987-88
- tb8kr13 - Export Volume Projections, 1986-88
- tb8kr8 - Export Unit Value Projection, 1987-88
- tb8kr6 - Import Projections, 1987-88
- tb8kr7 - Service Account Projections, 1987-88
- Table 7 - Impact of Liberalization, Tariff Cuts and Financing of Imports
- Table 8 - National Accounts
- tb8kr11 - Monetary Survey, 1983-88
- tb8kr12 - Projection Results for Broad Money (M2), 1984-88
- tb8kr14 - Balance of Payments, 1987-88 (In billions of U.S. dollars)
- tb8kr15 - Medium-Term Adjustment Scenario, 1985-92
- tb8kr16 - Selected Economic Indicators, 1985-88

STAFF REPORT TABLES

- srkrtb1 - Balance of Payments, 1985-88
- srkrat4 - Monetary Survey, 1983-88
- srkrat5 - Outstanding External Debt by Maturity and Borrower, 1985-88
- srkrat3 - Summary Account of the Consolidated Central Government, 1985-88
- srkrtba - External Current Account Balance in Korea and Major Industrial Countries, 1985-88
- srkrtbb - Summary of Economic Indicators, 1985-88
- srkrtbc - Medium-Term Scenario, 1985-92

mm8kr4 - Concluding Statement to the IMF 1988 Article IV
Consultation Discussions

INTERNATIONAL MONETARY FUND

Korea--1988 Article IV Consultation

Meeting with the Minister of Finance
March 14, 1988, at 3:00 p.m.

Meeting No. 1

Korean Representatives:

The Honorable Sakong Il, Minister of Finance
Mr. Hwan-Kyun Lee, Director-General

Fund Representatives:

Mr. Neiss
Mr. Baban*
Ms. Tseng
Mrs. Jul
Mr. Katz
Mr. Le Fort

After an exchange of pleasantries, the Minister of Finance stated that the IMF has been highly valued in Korea as a source of independent and objective opinion. Such opinion has been useful for persuading the public, which continue to harbor a deficit mentality. Up until recently, the emphasis has been more exports, less imports. Now, it's the other way around and it has not been easy to persuade the public as well as officials outside the economic ministries about the need for change.

During the second half of 1987, political factors and the labor unrest made progress in liberalization difficult. Despite the large wage increases, 1987 came out better than expected. Of course, these wage increases came late in the year and their main impact will be in 1988. Already, there is great concern about inflationary pressures.

Managing monetary aggregates has been especially difficult. To sterilize foreign exchange inflows, monetary stabilization bonds has been sold in large quantities, as much as W 2 trillion in one month. The Ministry of Finance is now working on further liberalization of invisibles and transfers. One problem that needs to be resolved is that if outward flows are liberalized, more inward flows result. This has been observed in Taiwan.

minkiet (3/26/88) RB

INTERNATIONAL MONETARY FUND

Korea--1988 Article IV Consultation

Minutes of Meeting at Korea Institute of Economics
and Technology

March 15, 1988, at 10:30 a.m.

Meeting No. 2

Korean Representatives:

Mr. Kang-Won Lee, Director, International
Economy Division
Mr. Chul-Kyu Kang, Senior Research Fellow
Mr. Kyoung-Hwie Minh, Senior Research Fellow
Mr. Jong-Hwa Cho, Senior Research Fellow

Fund Representatives:

Mr. Neiss
Mr. Baban*
Ms. Tseng
Mrs. Jul
Mr. Katz
Mr. Le Fort

KIET's staff representatives made the remarks summarized below.

Part of KIET's research agenda is the effect of external shocks on various sectors and the economy as a whole. Every January, the staff forecasts trade flows and adjusts these forecasts quarterly. The KIET model is primarily geared for sectoral projections. KDI's model is more elaborate and tends to forecast macroeconomic variables better.

When the external current account shifted into surplus in 1986, there was a question of whether it was a transitory phenomenon. There was also a consensus that the level was appropriate and the same figure was expected for 1987. The outcome for 1987 turned out to be much better, but about half of the surplus may be transitory. The wait and see attitude was reinforced by the advent of labor unrest.

On the basis of a model, Dr. Cho has made forecasts of trade flows under varying assumptions of nominal exchange rate appreciation against the U.S. dollars. The model, which is patterned after Prof. Sims' VAR model, has 12 variables, 5 forecasting variables and 7 exogenous variables. The following were assumed: import prices would rise by 5 percent in 1988 and 1989, wages would rise by 15 percent in 1988 and 1989, M2 would rise by 18 percent in 1988 and 1989, and the interest rate would remain at the current level. Export unit values are endogenous. The following results were obtained (with trade flows in nominal billions of U.S. dollars):

	1988	1989
Case A. Appreciation	--	--
Exports	53.2	58.9
Imports	45.7	52.6
Trade balance	7.5	6.3
Case B. Appreciation	10	10
Exports	52.8	56.9
Imports	45.8	52.7
Trade balance	7.0	4.2
Case C. Appreciation	15	10
Exports	52.7	55.8
Imports	45.8	52.8
Trade balance	6.9	3.0
Case D. Appreciation	20	10
Exports	52.5	54.6
Imports	45.8	52.8
Trade balance	6.7	1.8

The model indicates that the appreciation would begin to have substantive effects from the fifth quarter, hence the small difference between the 1988 scenarios. In the 1989 scenarios, the decline in the trade balance owes mainly to movements in exports, as the import value remains practically the same for all scenarios. As a rule of thumb, a 10 percent appreciation would result in a US\$ 1 billion decline in exports, a 0.6 billion increase in imports, a 2 percentage point decline in GNP, a 2 percentage point decline in the GNP deflator, and a 3 percent decline in WPI before its' effect peters out. The weaknesses of this model are: it uses nominal trade flows, does not disaggregate exports (between traditional and new) and imports (between oil, non-oil for export use, and non-oil for domestic consumption), and assumes a symmetric response to both devaluation and appreciation.

The relative insensitivity of imports to the appreciation of the exchange rate points to the need for market opening policies. There is also a need to make the import system transparent and more streamlined. The import surveillance system should be scrapped. The liberalization of sector-specific laws at the behest of U.S. pressure will also have an impact but its' aggregate effect is difficult to measure. (It was noted that 16 foreign cars were imported in 1987 and that about 200 would be imported in 1988). Licensing procedures, even for those imports on the automatic approval list, still tend to be long. Each requirement has had a rationale in the past but simplification could be effected. At the administrative level, there is a need for greater awareness of liberalization policy so that where there is room for discretion it would be exercised in the favorable direction. Tariffs should also be reduced, though this takes time because it has to be approved by the National Assembly. The simplest approach would be a uniform reduction.

The insensitivity of imports to won appreciation may also reflect the rigidity of Korea's trading relationship with Japan. Trading relationships established since colonial times, cultural and geographic proximity, adaptation of products to Korean tastes could overwhelm moderate price changes. In the last two years, Japanese export prices have increased tremendously and price effects would be more evident. The trade deficit with Japan is declining and Korea is increasingly becoming a source of inputs for Japanese industry.

Turning to industrial policy, among the important issues would be automation in the wake of large wage increases, the international strategy for footwear and textiles which face severe competition and protectionism, foreign investment in electronics, import of technology particularly for the machinery sector, and industrial organization (fair trade, monopoly, oligopoly, etc.). Several years ago, industrial policy shifted from supporting specific industries towards the support of technological development and labor adjustment policies. With the won appreciating and wages rising, factor substitution is likely to ensue. Companies are on their own as to how they would enhance labor productivity. Adequate labor absorption is not likely to be a problem if the economy is growing. KIET has a study on productivity trends by sector but it has not been translated into English.

Companies will be able to adjust to expected shocks. Wages are now expected to rise at a fast rate because of past repression. Similarly, won appreciation within an expected range could also be adjusted to. Fellows mentioned 10 percent and 12-15 percent. They felt, however, that a high rate of won appreciation in both 1988 and 1989 would be difficult to implement for political reasons.

INTERNATIONAL MONETARY FUND

Korea--1988 Article IV Consultation

Courtesy Call on Mr. Seung Park, Senior Secretary to
the President for Economic Affairs at the Blue House
Tuesday, March 15, 1988 at 3:00 p.m.

Minute No. 3

Korean Representatives:

Mr. Seung Park, Senior Secretary to the
President for Economic Affairs
Mr. Shim, Secretary to the President for
Economic Affairs

Fund Representatives:

Mr. Neiss

Ms. Tseng*

Present:

Mr. Lim, Alternate Execu-
Executive Director for
Korea in the IMF

Mr. Park said that the authorities are implementing policies to restructure the Korean economy in response to the current account surplus. He noted that Korea has benefited from the expansion of world trade and is becoming a developed economy; therefore, Korea has increased responsibility for ensuring the continued growth of the world economy; the interests of Korea and important trading partner countries do not diverge.

Mr. Park said that the authorities are determined to limit the current surplus to a reasonable level over the medium-term, recognizing that large surpluses are detrimental to economic growth and price stability. Monetary control is already difficult with the large external surpluses and the inflows of speculative capital. He thought two or three years will be needed to effect external adjustment. He said that the authorities are well aware of what needs to be done, but needs time to reorient public opinion from a "deficit mentality" to a "surplus mentality" and to develop the political consensus to implement the measures, particularly in view of the new democratization process. An important objective of economic policies is to transfer the fruits of growth to the taxpayers. This implies increasing consumption, by widening the market for imports, lowering tariffs, and appreciating the exchange rate.

Mr. Neiss said that this consultation is the regular Article IV consultation where all aspects of economic developments and policies will be discussed. External sector developments are of course prominent under current circumstance. The mission views external adjustment from a medium-term

prospective, recognizing that policy adjustments this year will have limited impact on the current account this year because of time lags. The time lags in adjustment point to the importance of early action and of using all policy instruments together to achieve a smooth adjustment over the medium term. Mr. Neiss said that the successful transition of the Korean economy will contribute to more harmonious international trading relationships.

INTERNATIONAL MONETARY FUND

Korea--1988 Article IV Consultation

Meeting with the Korean Development Institute (KDI)
Tuesday, March 15, 1988, at 4:00 p.m.

Meeting No. 4

Korean Representatives:

Mr. Koo Bon-Ho, President
Mr. Jwa Sung-Hee)
Mr. Kim Choong-Soo)
Mr. Kwack Tae-Won) KDI
Mr. Park Won-Am)
Mr. Kang Moon-Soo)
Mr. Young Soo-Gil)
Mr. Oum Bong-Sung)

Fund Representatives:

Mr. Neiss
Ms. A.M. Jul
Mr. Baban
Ms. Tseng
Mr. Katz
Mr. La Fort*

Observer:

Mr. Lim Chang-Yuel, Alter-
nate Executive Director
for Korea in the IMF

Current account forecast

The 1987 current account surplus was largely underestimated by KDI and by the Fund's mission--while the actual surplus reached US\$9.78 billion, KDI's estimate was only US\$6.0 billion and the Fund's US\$6.9 billion. Three reasons were given to explain the underestimation of the surplus, including the higher-than-expected growth of world trade, the lower-than-expected dollar interest rate and the stronger-than-expected depreciation of the dollar.

KDI forecasted a less favorable international economic environment during 1988 than that of 1987. For 1988, KDI projected a current account surplus of US\$8 billion, a GNP growth rate of 8.5 percent, and an annual inflation rate, as measured by the average CPI, of 7.5 percent. Export value is projected to increase by 19.5 percent (12.5 percent volume and 6.5 percent unit value) to \$55.2 billion; import value is projected to increase by 28.2 percent (19.2 percent volume and 7.6 percent unit value) to \$49.4 billion. The trade surplus is projected to decline to \$5.8 billion. KDI import forecast included \$1.5 billion of additional imports as a result of liberalization measures.

KDI considered the present level of the current account surplus to be excessive and thought that the surplus should be reduced by increasing the level of imports and by reducing exports. Trade liberalization and incentives to increase private investment were preferred over a currency appreciation as instruments to adjust the surplus. Over the medium term, the current account

surplus was expected to decline to US\$2.5 billion by 1992, while GNP growth and inflation would stabilize at 7.5 and 4 percent, respectively. Foreign debt would be reduced to less than 10 percent of GNP by 1992.

Trade liberalization

In the past, the lifting of quantitative restrictions had been more important than tariff reductions in the trade liberalization. Given the progress achieved, however, trade liberalization should now concentrate on the reduction of tariffs. In January, tariffs were reduced to an average level of 18 percent. Tariffs on 300 products were reduced, some of which were in response to U.S. pressures. Tariff quotas (reduced tariff rates for a certain level of imports) were applied to some intermediate products to reduce price pressures due to domestic supply shortages. The scheduled lifting of quantitative restrictions and the reduction of tariffs affecting agricultural products has been moved forward. The import surveillance system will be reduced and eliminated by end-1988. After the present liberalization program in 1988, the future plan is to reduce the level of tariffs to that of OECD countries and to eliminate quantitative restrictions on manufactured products. However, the liberalization of agricultural products could be delayed as a result of political difficulties.

In addition, the reform of special laws inconsistent with the GATT was under study. The Government was undertaking a study of the costs created by import restrictions.

Labor costs

After the labor disputes of September 1987, the level of wages has increased rapidly. Preliminary estimates indicated that the annual average wage index for 1987 exceeded that of the previous year by about 12 percent. Furthermore, the wage increase of the last quarter of 1987 would have a carry-over effect to the average wage index of 1988 estimated at 6 percent. Taking into account wage settlements thus far in 1988 (increase of 12 percent), the average wage index for 1988 is projected to increase by 18 percent. The wage increase and a larger-than-usual increase in the labor force due to demographic reasons are expected to create a slight increase in the unemployment rate.

Deficiencies of the data prevented an adequate forecast of the effects of the wage hike on the unit labor costs. Wages represented only a limited part of labor compensations and more detailed statistics were not available. In addition estimations of labor productivity were biased due to the unavailability of statistics on man-hours worked.

Government spending

In order to achieve a balanced growth of the Korean economy and to fulfill promises given during the Presidential campaign, the Government had considered an expansion of 0.5 to 1 trillion won in government spending during 1988. The financing was available from the proceeds of the privatization of public corporations. However, the plan was cancelled due to its inflationary implications. Given the extremely high capacity utilization rate in the manufacturing sector--estimated at about 90 percent--it was considered that any expansion in domestic demand would lead to an acceleration of inflation.

Exchange rate policy and inflation

The importance of keeping a stable exchange rate for an adequate allocation of resources and the need to avoid zig-zag policies--a sharp appreciation today may lead to the need for a depreciation tomorrow--was stressed by Dr. Koo. The J curve effect--according to which a real appreciation leads to an improvement of the trade balance in the short run--was also cited as a reason for the limited impact of appreciation for current account adjustment in the short run.

The anticipation of a further appreciation of the won has created uncertainties in the business community. A one-shot appreciation was not seen as resolving the uncertainties because a sudden adjustment could exacerbate the fears of the business community. In 1987, the Korean won experienced an effective real depreciation and it is accepted that an appreciation in 1988 is a necessary outcome. It is estimated that a 10 percent nominal appreciation would lead to a reduction of consumer prices of 3 to 4 percent after a year.

The possibility of moving to a floating exchange system was disregarded on the grounds of the lack of a market for foreign exchange.

Structural reform

Rapid economic growth and the current account surplus created the conditions for modernization and adjustment. The level of investment should be increased to modernize the manufacturing sector and adapt the economy to a different environment. KDI saw no apparent merits for pre-payment of the foreign debt given the alternative uses for those resources in the domestic economy.

Structural reforms should include the liberalization of the trade system, but not the opening of the capital account. The high rates of returns of Korean assets should not be enjoyed by foreigners--at least not before the domestic capital market is broadened and deepened and before domestic interest rates are more in line with international levels.

INTERNATIONAL MONETARY FUND

Korea--1988 Article IV Consultation

Meeting on Trade Matters, Ministry
of Trade and Industry

Wednesday, March 16, 1988, 10:00 a.m. and 3:00 p.m.

Meeting No. 5 a

Korean Representatives

Fund Representatives

Mr. Jae Uk, Director General
Mr. Won Ho Lee, Director
Mr. Jong Kap Kim, Director
Mr. Gi Heon Kwon, Deputy Director
Mr. Woo Jung Shim, Deputy Director
Mr. Sung Hun Lee, Deputy Director
Mr. Gye Hyung Lee, Deputy Director
Mr. Choong Ho Lee, Deputy Director

Mr. Neiss
Ms. Tseng
Ms. Jul *
Mr. Baban
Mr. Katz
Mr. Le Fort

Mr. Lim, IMF, Alternate Executive Director

The Korean representatives stated that with respect to the trade questionnaire they had received from the Fund, they were in the course of negotiations in the Uruguayan Round and that their position was not settled and some points had to be consulted with the relevant ministries. After consultations they would give the mission answers in a written form.

Liberalization measures

1. 145 items to be liberalized April 1, 1988 bringing the liberalization ratio to 95.4 percent. 2 items (sugar products) were put back in the restricted list, 9 items were liberalized ahead of schedule, with 361 items to remain restricted instead of 370. According to an estimate by the Korean Development Institute (KDI), the effects of the liberalization measures amounted to US\$ 1.2 billion in 1987 and will amount to US\$ 1.3 billion in 1988.

2. Surveillance list. 48 items (8-digit CCCN) remaining in the list since January 1, 1988. On April 1, 1988 23 items will be taken off the list. The system will be abolished at the end of 1988 instead of January 1, 1988, which was the original schedule because of complaints by the private industry.

3. Special laws. 53 items will be removed from the application of special laws effective April 1, 1988. Also, 87 items will be switched from the licensing system to a reporting system. Items covered by special laws will amount to less than 1,700 (8-digit CCCN). Under the Harmonized System (HS-10 digit) classification adopted January 1, 1988, 2009 items will still be subject to special laws, or about a 20 percent of the total items.

4. Further import liberalization measures were being planned under a schedule to last three years, up to 1991.

Korean Trade Commission (KTC)

The KTC was established July 1, 1987. It had received only one petition under the rules of the Import Relief System (IRS) until now, but the Korean representatives believed more petitions would be filed this year as knowledge of the new system spreads. The only petition so far was filed last November and they were still investigating the case. The investigation will take 270 days to be completed and then 60 more days are required for determination of injury. The item under investigation is used for gas ranges and is a liberalized item.

The only petition filed so far was filed last November and they are still investigating the case. The investigation will take 270 days to be completed and then 60 more days are required for determination of injuries. The item, used for gas ranges, is a liberalized item.

The IRS is in conformity with Article XIX of the GATT regulations. The Import Surveillance System (ISS) was an ad-hoc procedure adopted during the 1983-88 liberalization program to prevent import surges. In theory, there is no relation between the KTC and the implementation of adjustment and emergency tariffs. However, in practice, while the authority for tariffs rests with the MOF, the implementation of trade policies is an interministerial consultative process.

Export Promotion

Export financing was being provided to exporters, but after Korea achieved a trade surplus in 1986 and because the government needed to reduce domestic liquidity expansion, these loans had been reduced gradually. Starting February 1, 1988 only the small and medium-sized firms receive this type of loans at the ratio of W 45:1 to US\$ 1. These loans have no preferential interest rates relative to commercial loans, they only provide exporters with credit availability.

Why is there a need for exporters to get loans? The Government has been trying to promote small and medium-sized enterprises as part of its structural reforms. Small and medium-sized firms account for only 20 percent of total exports but for 98 percent of total export loans.

Promised to provide information on export financing (attached).

Antidumping duties

Imposed by the US, Canada and Australia. On 7 items by the US, on 18 items by Canada, and on 3 items by Australia for a total of 27 items. Exports of these items amounted to US\$ 354 million during the first nine months of 1987. The products include color TVs, color TV picture tubes, phot albums (US). These items do not include those under investigation like Hyundai cars by Canada.

Do these duties constitute a serious restriction on Korea's exports? The range of duties imposed vary. At present the US imposes anti-dumping duties on color TVs that go from 1.37 percent to 3.49 percent. Photo-albums were imposed a 64.8 percent duty by the US. However, the US imposed a very small duty on the same product imported from Taiwan because in Korea this industry is a very weak one and cannot keep its bookkeeping in accordance with US regulations. It was exporting US\$ 30 million to the US market prior to the imposition of the duty and was completely wiped out of that market after the antidumping duty.

Final determination on a request filed in Canada for imposing antidumping duties on Hyundai's passenger cars to be ruled by March 23. Average duty requested 26.3 percent, with 40.1 percent for the larger car, 30.1 percent for the Stellar, and 16.2 percent for the Excel. (Ruling was in favour of Hyundai).

Steel exports have been substantially reduced by the imposition of VERs. Korea's main complaint in this area is that no restrictions have been applied against Canada and EC countries. In 1987 the share of the US market of unrestricted suppliers increased from 24.4 percent to 30.9 percent.

Trade barriers of developed countries on major industrial goods such as textiles, electronics, footwear and steel were a major barrier for Korean export growth. They also led to less investment in this field, less GDP growth and less employment. The Korean representatives believed that the effects of trade barriers on exports had been large but they did not have an estimate.

Voluntary Export Controls (VERs)

Three types of VERs:

- 1) Controls based on government to government agreements.
- 2) Controls based on private business agreements.
- 3) Genuine voluntary export controls.

Under 1) 5 items, under 2) 3 items (color TVs and footwear to the UK, and stainless steel tableware to the US and several European countries), and under 3) 3 items (footwear to the US and Canada, cotton yarn to Australia and Canada, and containers).

Generalized System of Preferences (GSP)

A study conducted in 1982 by the US Department of Labor concluded that tariff concessions under the GSP had resulted in a 10.8 percent larger imports on average. Thus, assuming that the withdrawal of the benefit results in a 10.8 percent decline, the effect on Korea's exports to the US effected under the GSP would amount to a cut of about US\$ 250 million as US\$ 2.2 billion were being effected under that system. Korea will be graduated from the US's GSP effective January 1, 1989. The Korean representatives were concerned not so much about the

absolute amount, but about the impact of graduation on exports by small and medium-sized enterprises which would be the ones affected.

GSP programs are stipulated in GATT regulations to help developing countries through trade instead of aid. This graduation measure was a unilateral measure and should be discussed in the GATT forum.

If the same elasticity is assumed for exports effected under the GSP to the EC than that for the US, the impact on Korean exports of the suspension of GSP benefits would be US\$ 125 million as 23 percent of the exports to the EC were affected by the suspension of GSP privileges.

Trade developments

The main forecasting error for 1987 was in exports which were US\$ 2.5 billion too low. The forecast was an increase of 20 percent in volume and it was 24 percent. The main reason for this error was to be found in exports of sophisticated goods. Actual exports of these goods were much more than originally projected. For example, passenger cars were projected to grow by 50 percent and increased by 103.9 percent. The same error was made for exports of computers, semiconductors, microwaveovens, which increased by more than 40 percent on average. These type of exports grew by US\$ 3 billion to US\$ 7.4 billion in 1987. The main five items were newly exported ones, which have been exported from 1984 or 1985 onwards.

On a customs clearance basis, exports for 1988 were projected at US\$ 55 billion while imports were projected at US\$ 52 billion. These figures were revised upwards from US\$ 52 billion and US\$ 49.6 billion, respectively. Export projections by products had not been done for the revised total. On a balance of payments basis, the trade surplus is estimated at US\$ 5 billion. As to the exchange rate assumption used for these projections, they said they would provide us with that information later.

Export unit values for 1987 will not be published until the end of March. It is estimated that they increased by 9.1 percent in 1987. Why did they increase so much? Because of the won appreciation, increase in the quality of goods, and more technology intensive goods. Also, there was a cost push element. Export unit values for 1988 were projected to increase by about 8 percent. Why less than in 1987, when the same factors that affected them in 1987 will be at work in 1988? The increase in export unit values up to last year were never less than the wage increases. However, the Korean representatives believe that it will be difficult to accelerate the increase in export prices in 1988 because they will lose competitiveness. Exporters and producers are worried about labor disputes. If labor costs increase by more than 10 percent they believe they will lose competitiveness.

Textiles, garments and toy exports increased by only one-digit figures in January-February 1988 compared to 30 percent last year. Some exporters were actually losing markets. Despite a good performance in exports in January-February 1988, exports declined in volume.

Import unit values in 1987 increased by 5 to 6 percent. In 1988 they will increase more than in 1987 (by about 9 percent) because prices of raw materials were increasing.

Effect on exports of exchange rate appreciation: export volume declines by 2.5 percent in the first year if won appreciates by 10 percent. The effect is larger a year later. Import elasticity is much smaller than that of exports. Industries which are labor intensive and not so heavily dependent on imports are affected much more by an appreciation of the won than those which are import intensive. Last year the overall wage increase was 17.2 percent. Before the labor disputes, wages had increased by only 8.8 percent. Wages were generally settled in the spring. After the disputes, wages increased by 8.4 percent. The impact of last year's wage increase will be larger this year and they were expecting further labor disputes. Employees were asking for wage increases of 29.3 percent while employers are talking about a 7.5 percent increase. If wage increases this year exceed 10 percent they will hamper exports of manufactured goods. Wage increases should be settled by end of April.

Import ratios. A rough estimate gives a 25 to 30 percent ratio of imports to domestic demand in the manufacturing sector and less than 15 percent in the agriculture and fishery fields.

Export Financing

(100 million won)

25'	'86	'87			'88.1
		10	11	12	
Products loan <i>9,824</i>	12,182	8,935	8,308	7,602	6,472
Material import loan <i>4,255</i>	4,687	3,005	2,602	2,260	2,010
Material buying loan <i>12,319</i>	15,254	16,062	14,915	13,748	13,113
End products buying loan <i>1,866</i>	11,362	3	3	3	3
all including loan / 0	40	53	51	59	79
Total <i>30,243</i>	33,527	28,057	25,879	23,672	21,671

Loanable amounts per U.S dollar

(won per U.S. dollar)

	Large firms	Small & Medium firms
Previous	670	700
Feb. 13, 1987	645	680
Apr. 21, 1987	575	680
June. 2, 1987	475	630
Aug. 7, 1987	375	630
Oct. 30, 1987	275	580
Dec. 30, 1987	175	520
Feb. 8, 1988	0	450

Korea : Anti-dumping Duties Affecting Exports

(As of February 29, 1988)

<u>Country</u>	<u>Number of Commodities Affected</u>
U. S	6
Canada	17
Australia	3
Total	26

INTERNATIONAL MONETARY FUND

Korea--1988 Article IV Consultation

Meeting with Vice Minister of Trade
and Industry

Wednesday, March 16, 1988, 10:30 a.m.

Meeting No. 5b

Korean Representatives

Mr. Nam-Hoon Huh, Vice Minister of
Trade and Industry

Fund Representatives

Mr. Neiss
Ms. Tseng
Ms. Jul *
Mr. Katz
Mr. Le Fort

Mr. Neiss stated that this mission was a regular Fund consultation mission so it would cover all aspects of the Korean economy. However, it was on trade, balance of payments and inflation matters that the mission had the most questions.

The Vice Minister agreed that the most important areas were trade, the BOP and inflation and as far as his Ministry was concerned the most important was trade. The revaluation of the won was a pending issue for his Ministry. Regarding this issue, the mission should consult the Ministry of Finance. At the Ministry of Trade they were aware of the importance of the role played by the exchange rate and of the surging frictions with their main trading partners.

Their main area of concern was the restructuring of industry in Korea. They were in close contact with other ministries in this area. Small and medium-sized industries were suffering from the worsening profitability associated with the appreciation of the won. They were making efforts to work up measures to help these enterprises.

The Vice Minister also commented on the impact of liberalization measures in managing the balance of payments. At the moment the liberalization ratio had attained 95.4 percent, and with regards to most markets Korea was open and the surveillance system had been improved. Most manufactures were liberalized and through this opening the Ministry of Trade played an important role in the management of the BOP.

Mr. Neiss agreed that various measures, like further opening and appreciation of the won, play a role in the managing of the trade surplus. To some extent there is a trade-off; the faster the liberalization the less need there is for appreciation. But if liberalization is slow and difficult, the more the need for appreciation. It is important to reduce the trade surplus not only to reduce international frictions but it is necessary to maintain financial stability in the domestic economy. Mr. Neiss requested the Vice

Minister's views on the possibilities at present on the implementation of both types of measures: liberalization and appreciation. Which were the government's plans for the near future?

The Vice Minister responded that with regards to market opening, the Korean government had implemented the system of prior notice (announcing liberalization measures two or three years in advance) until 1988. Beyond 1988 they were planning to implement another prior import notice system for 3 years starting 1989. The problem was not in the manufacturing sector but in agriculture and in other imports under special laws. They would like to expedite market opening and he believed that it was feasible. Internal consultations among concerned ministries were being conducted.

With regards to appreciation of the won, the Vice Minister believed that it was part of the government policies together with liberalization. The policy mix would be decided after taking into account domestic as well as international circumstances.

With regards to tariff reduction, the Vice Minister stated that it was his understanding that the modal rate for manufactured products was 20 percent at present and that the government was planning to reduce it to 10 percent. The structure of tariffs was handled by the Ministry of Finance, but the Ministry of Trade and Industry had a strong interest in maintaining balance among products, that is, among raw materials and finished products as well as among industries. The present trend in Korea with respect to tariffs was a declining one and they were going to continue that trend.

Mr. Neiss expressed that there had been important progress in the past in opening the economy and that all the measures outlined by the Vice Minister were in the right direction. The mission wished the government all the success and would follow developments with great interest.

INTERNATIONAL MONETARY FUND

Korea--1988 Article IV Consultation

Technical Meeting on Tariff Matters
Ministry of Finance
March 16, 1988 at 5:00 p.m.

Meeting No. 6

Korean Representatives:

Mr. Yang Seung-Mahn, Director, Customs
& Tariff Bureau
Mr. Kim Chong-Ho, Deputy Director,
Customs & Tariff Bureau
Mr. Yim Tae-Hee, Deputy Director,
Customs & Tariff Bureau

Fund Representatives:

Ms. Jul
Mr. Baban
Ms. Tseng*
Mr. Katz
Mr. Le Fort

Institutional framework

Tariffs may be changed by adjusting the basic tariff, or through tariff concessions and tariff quotas. The Korean representative explained that the relevant legislation sets the maximum possible reductions in basic tariff rates beyond which further reductions would require revisions in the legislation. Changes in basic tariffs become effective at the beginning of the year; they are usually not changed during the year, and such changes require approval by the National Assembly. Tariff changes with tariff concessions and tariff quotas are more flexible. Tariff concessions are intended to reduce trade frictions; discretionary cuts of up to 50 percent of the basic rates may be made, and the cuts are permanent. Tariff quotas, intended to alleviate price pressures due to domestic supply shortages for specific commodities, are temporary, and are effective for a period of three months to a maximum of one year.

Tariff changes in 1988

The tariff classification system has changed to the Harmonized System (HS) from the eight-digit CCCN system. Changes in the basic tariff rates have affected the following number of items:

	January 1986			January 1987			January 1988		
	In-crease	De-crease	No change	In-crease	De-crease	No change	In-crease	De-crease	No change
Total	14	621	1,666	1	251	2,049	13	568	1,720
Manufactured prod.	14	516	1,472	1	206	1,795	13	496	1,493
Agricultural prod.	--	105	194	--	44	255	--	71	228

The data on average unweighted tariff rates in Table U-27 of the Questionnaire are calculated using the basic tariffs; the averages would be lower if concessional tariff quotas and tariff reductions were taken into account.

Tariff concessions on 319 items (HS10 digit) were implemented on February 24, 1988, with reductions averaging 6.1 percentage points. Tariff reductions with tariff quotas were implemented on 356 items on January 1, 1988, with reductions averaging 9.9 percentage points, and on an additional 117 items on February 24, 1988, with reductions averaging 7.5 percentage points.

The budgetary costs of tariff reductions in 1988 are estimated to be W 250 billion.

Adjustment and emergency tariffs

Although the Trade Act, which became effective on July 1, 1987, contains provisions for the import of adjustment tariffs, all adjustment tariffs were abolished. Emergency tariffs, applied in accordance with the safeguards clause of the GATT, presently are applied on seven products, although some of the rates were reduced on July 1, 1987 as shown below:

	Basic Tariff	Effective	
		Emergency tariff	
		January 1, 1987	July 1, 1987
Acetaminophen	20	30	30
Talcum powder	10	20	15
Casein	25	30	30
Ferro manganese	15	25 1/2	20
Silico manganese	15	25 1/2	20

1/ Adjustment tariff.

Adjustment tariffs are also imposed on oil and oil products, although not for protection purposes. The tariff rate on oil and oil products was reduced to 10 percent in October 1987 from 24.5 percent.

Exemptions from tariffs are granted for selected items such as machinery and electronics products which cannot be produced domestically. The Ministry of Finance issues such exemption notices once or twice a year; these exemptions are given to all users.

Import surcharges

The Korean representative thought that the import surcharge on agriculture products were not imposed last year but asked the mission to verify with the Ministry of Agriculture (confirmed by the Ministry of Agriculture).

The Korean representative was not familiar with the importers' acquisition fee; he gave an example of surcharges imposed on an imported automobile. There is a 30 percent customs duty, a 2.5 percent defense tax on the c.i.f. value of the automobile, and a special excise tax on automobiles of 40 percent or 20 percent depending on the size of the automobile (more or less than 2,000 cc, respectively). The special excise tax is imposed on the sum of the c.i.f. value plus custom duty plus 10 percent margin; and applies to both imported and domestic automobiles.

Future tariff reform

There are plans to continue with tariff reform after the current program is completed this year. A Special Commission for Tariff Reform, comprising scholars, businessmen, government officials, was established in February 1988, and will make recommendations for future tariff reform by September 1988.

Export incentives

Customs duties on raw materials are refunded when the imports are used in export production. There is also a customs duties defined system where payment of import duties on intermediate imports can be delayed for small- and medium-sized exporting firms up to two months, and no interest is charged.

INTERNATIONAL MONETARY FUND

Korea--1988 Article IV Consultation

Minutes on Technical Meeting on National Income
Accounts and Prices
Economic Planning Board, March 16, 1988

Meeting No. 7

Korean Representatives:

Mr. Jong-Gap Lee, Deputy Director,
Overall Planning Division
Mr. Young Kon Chin, Deputy Director,
Overall Planning Division
Mr. Kyung Ho Choo, Deputy Director
Overall Price Division

IMF Representatives:

Mr. Roy Baban*
Mr. G. Le Fort

Mr. Lee stated that the 1986 national income statistics in the questionnaire are the final figures. He provided tables which had the obsolete 1986 base and estimates for 1987 (which the Bank of Korea prepared in December 1987) and projections for 1988 which were provided by KDI. The Bank of Korea is expected to release new 1987 figures around March 25.

Mr. Lee stated that 8 percent growth was projected for 1988 and 7 percent per annum thereafter. KDI estimated potential growth to be around 7.5 and EPB decided to use 7 percent in its medium term scenario, which is now in the process of being revised. Tentatively, the current account surplus is projected at \$ 7 billion in 1988, \$ 6.7 billion in 1989, declining to \$6 billion by 1991. The savings ratio, estimated at 35.8 percent in 1987, is estimated to decline slightly to 35.5 percent in 1988, declining by 0.5 percentage per annum thereafter. The savings ratio was not estimated through an equation.

The deceleration of growth in 1988 is primarily accounted for by the deceleration of the growth rate of exports, owing to won appreciation, wage increase, and protectionism. Final consumption, gross capital formation, and imports will grow at roughly the 1987 rates. The growth of merchandise exports is projected to decelerate from 23.8 percent in 1987 to 7.7 percent in 1988. The growth of gross fixed investment will also decelerate but substantial accumulation of stocks will maintain the growth of gross capital formation at 15 percent. Final consumption growth will remain at 8 percent, with some acceleration in private consumption and some deceleration in government consumption. Optimism about market opening policies is reflected in only a slight decline in the growth rate of merchandise imports from 21.5 percent in 1987 to 19.2 percent in 1988, despite the marked slowdown in exports. Imports of services will also decelerate only slightly from 10.7 percent in 1987 to 10 percent in 1988, reflecting increased payments for travel and use of intellec-

tual property and other services.

Mr. Choo stated that inflationary pressures in the last quarter of 1987 emanated primarily from pressures on food prices owing to crop damage in the wake of the August floods. Wage increases may have also been a factor but Mr. Choo believed that adverse supply effects were primarily to blame. Among the nonfood categories, clothing also registered an acceleration in prices in the last quarter. Mr. Choo stated that it was difficult to pinpoint the precise factors for this increase; it was possible that higher wages and higher nonwage input costs might have been responsible.

The CPI increase is forecast to decline from 6.1 percent (December over December) in 1987 to 4-5 percent in 1988. The main assumptions underlying this forecast is normal weather and the adoption of various price stabilization measures. The WPI increase is forecast to remain stable at 2-3 percent. Implicit in this forecast is that import prices in US dollar terms would increase on average at the 1987 rate.

Mr. Choo emphasized that maintaining price stability has been given the utmost priority in economic policy. On March 10, 1988, the prices of oil derivatives including gasoline and Bunker C oil were lowered by 10.6 percent on average. In addition, no increases will be adopted for railroad fares, postal fees, piped water fees, and sewage charges during 1988. Later in the month, special excise taxes on 30 items would be reduced from a range of 5-100 percent to a range of 3.5-7 percent. Affected goods include: sporting goods, air conditioners, refrigerators, washing machine, TVs, electric home appliances, motorbikes, automobiles, pianos, VTRs, coffee, sugar, soft drinks, and wool yarn. Also planned were a reduction of gasoline prices outside Seoul and Pusan by 6 percent in early April and a reduction of intercity telephone charges by 10 percent in July.

(Subsequent to the meeting, press reports indicated that electricity charges would be reduced by 3.6 percent on average on March 21, 1988. As in previous years, when oil and electricity charges are reduced, the government institutes price surveillance to ensure that industrial prices are reduced to reflect reduced costs. The press reported that on March 21, factory prices for 23 industrial products (mainly plastics, chemicals, and steel products) would be reduced by 0.3-2 percent. Estimates attributed to the Ministry of Trade and Industry indicate that wholesale prices would decline by 0.5 percent as a result.)

INTERNATIONAL MONETARY FUND

Korea--1988 Article IV Consultation

Meeting with the Director of the Economic Planning Board
and Deputy Prime Minister
Thursday, March 17, 1988, 9:30 a.m.

Meeting No. 7

Korean Representatives:

Mr. Rha Woong-Bae, Deputy Prime Minister,
Economic Planning Board
Mr. Kang Bon-Gyan, Director-General,
Economic Planning Board
Mr. Huh No-Choong, Director, International
Organization

Fund Representatives:

Mr. Neiss
Ms. Jul
Mr. Baban
Ms. Tseng
Mr. Katz
Mr. Le Fort*

The Deputy Prime Minister expressed his appreciation for the advice that the Fund has provided to Korea in the past and his interest in receiving an objective assessment of the present situation and recommendations on the required policy actions.

The DPM thought there is a need for a structural adjustment of the Korean economy, particularly the need for adjusting the exchange rate to produce a real appreciation and for opening the economy to imports. However, he anticipated political difficulties in implementing the needed policy reforms. The labor unrest of late last year and the presidential and the elections have interrupted policy reform. He expected that during the course of this year policy adjustments would continue.

In the DPM's opinion, the agricultural sector is the most distorted and the most difficult to reform. Great difficulties have been confronted when attempting to reduce the subsidies implicit in the protection to the agricultural sector. The replacement of protection by direct subsidies would create a burden on the budget, which could become permanent, and may be used as a precedent by other sectors.

The DPM said that the probability of successfully implementing structural reforms could be enhanced by educating the Korean people on the characteristics of the proposed structural reforms. The education should be directed to modify the deeply ingrained "deficit mentality" after years of foreign debt accumulation and scarce external resources.

For 1988, the DPM projected a significant reduction in the current account surplus as a result of a slowdown in exports and an acceleration in imports growth. For the medium term, the Minister projected a current account surplus at a level equivalent to 2.3 percent of GNP and that by 1991 Korea's external debt would be matched by its holdings of foreign assets (including deferred payments exports).

INTERNATIONAL MONETARY FUND
 Korea--1988 Article IV Consultation
 Minutes of Meeting on Labor Matters
 Economic Planning Board, March 17, 1988

Meeting No. 9

Korean Representatives:

Mr. Okyu Kwon, Director,
 Manpower Policy Division

Fund Representatives:

Mr. Neiss
 Mr. Baban*
 Ms. Tseng

Mr. Kwon stated that the number of labor disputes and the number of lost man-days due to labor disputes rose dramatically in 1987, as follows:

	1985	1986	1987
Total disputes	114	265	3,311
Total man-days lost	19,000	64,300	6,791,411

Settlements also resulted in higher rates of increase in nominal wages (including bonuses and overtime pay) from September onwards, as follows:

	Jan.-Aug.	Sept.-Oct.	Dec.	Annual Average
All industries	7.0	14.1	19.0	10.1
Manufacturing	7.4	17.1	22.7	11.6

Up to March 15, 1988, with 73 percent of 1988 contracts settled, basic wages rose on average by 12.2 percent (weighted by number of employees, does not include lunch allowances, overtime, and bonuses). When all 1988 contracts are settled, about the end of May, a somewhat higher rate of increase is expected to prevail. Contract agreements are usually based on the basic wage, which is pensionable. Two kinds of nonpensionable bonuses are given: an expected bonus, which is really disbursed as part of the basic wage, and a real bonus, which depends on the performance of the firm.

If an index for manufacturing wages is constructed, with the end of 1986 as 100, using the figures in the preceding paragraph would yield an end of 1987 index of 122.7 and an average figure for 1987 of 111.6. If the index rises by 12.2 percent to 137.7 in March and stays at that level throughout the rest of the year, the annual average index figure for 1988 would be 134, implying an increase of about 20 percent. If inflation is in the order of 3-4 percent,

real wages would rise by about 16-17 percent. And if labor productivity increases by about 8 percent, unit labor costs would rise by about 7-8 percent. This is in contrast to negative unit labor costs in 1987 (8 percent increase in real wages and 11 percent increase in labor productivity).

Mr. Kwon was asked to explain the reasons behind the official forecast of an increase in unemployment from 3.4 percent in 1987 to 3.7 percent in 1988. He stated that in 1987, the rapid increase in employment reflected the rapid expansion of export-related manufacturing and, in the fourth quarter, an acceleration in the growth of employment in the service sector due to the presidential elections. He made the point that in the export sector, demand was met more by increased employment than increased capital investment. In 1988, the economically active population is expected to increase at a somewhat slower rate but this will be counteracted by an increase in the participation rates of females and elder people (age 60 and over). On the demand side, export and overall growth is expected to slow down. With the large increase in wages and the introduction of the national pension plan, there will be less demand for labor, particularly in the labor-intensive industries. Moreover, the prospect of continuing high wage increases will increase investment in automation.

The introduction of minimum wages at the beginning of 1989 is estimated to increase the total wage bill by 0.5 percent. By law, another 1.5 percent increase in the total wage bill will result from the national pension scheme. According to the KDI's quarterly employment model, both together will have the effect of reducing employment by 0.7 percent. As for medical insurance, the burden of premiums will be shared by the subscribers and the government. The official position is to keep the government share at 20 percent; workers' institutions hope that that share would be closer to 50 percent.

The survey of labor costs on page 56 of the printed questionnaire is not updated because the survey is conducted only every three years. The next survey will be conducted this year.

Mr. Kwon stated that several labor related laws have been amended in the wake of the labor unrest in late 1987. Under the Trade Union Law, different industries with different locations within the same company can have their own union. Previously, one union represented one firm. As a result, the number of unions proliferated from 2,600 to 4,100. Under the Labor Dispute Settlement Act, the cooling off period was reduced from 20 days to 10 days for an ordinary firm, and from 30 days to 15 days for a public utility. Also, mediators in the Labor Relation Council were always government officials; now, private mediators are possible. Under the Labor Management Council Law, all companies with 100 workers or more should have a council. In the past, the establishment of these council were more restricted and none were established in the agricultural sector. Now, through these councils, monthly meetings would be held whereby the firm's investment plan, employment plan, and balance sheet, as well as working conditions would be discussed. The Central Labor Management Council will be revitalized. Chaired by the Ministry of Labor, there are 35 members, 10 from management, 10 from labor, and 15 from public interest groups. In the past, this Council was not very active. Lastly, the Korea Labor Institute was established. Its mandate is like that of the Korea Development Institute, but the focus will be on labor matters.

INTERNATIONAL MONETARY FUND

Korea--1988 Article IV Consultation

Technical Meeting on International Finance
Ministry of Finance
Merch 17, 1988 at 2:30 p.m.

Meeting No. 10

Korean Representatives:

Mr. Lee Jung-Jae, Director, Foreign Exchange
Policy Division, MOF
Mr. Kim Suk-Dong, Deputy Director, Foreign
Exchange Policy Division, MOF
Mr. Kim Yong-Duk, Deputy Director, Foreign
Exchange Policy Division, MOF
Mr. Pak Duck-Moon, Deputy Director, Foreign
Exchange Department, Bank of Korea
Mr. Lee Kang-Nam, Deputy Director, Research
Department, Bank of Korea

Fund Representatives:

Mr. Neiss
Ms. Jul
Mr. Baban
Ms. Tseng+
Mr. Katz
Mr. Le Fort

Current account developments 1987

The current account surplus increased to \$9.8 billion (8.3 percent of GNP) in 1987, compared with \$4.6 billion (4.9 percent of GNP) in 1986. The larger surplus reflected a near doubling of the trade surplus and the shift of the services balance to surplus from deficit.

The trade surplus rose to \$7.7 billion in 1987, compared with \$4.2 billion in 1986. Exports rose by 36 percent and imports rose by 30 percent; the volumes of exports and imports both grew strongly (24 percent and 22 percent, respectively); and the terms of trade improved by 3 percent. Export unit values rose by 9 percent reflecting the effects of the appreciation of the won against the U.S. dollar and wage increases. Import unit values rose by 7 percent reflecting mainly the 20 percent increase in oil prices, non-oil import unit values increased by only 6 percent. 1/

The services balance shifted to a surplus of \$0.9 billion in 1987, compared with a deficit of \$0.6 billion in 1986. This reflected mainly a 49 percent increase in travel receipts, a 58 percent increase on receipts from overseas construction, and a 12 percent decline in interest payments on external debt. The increase in travel receipts reflected increases in both the number of tourists (13 percent) and per capita expenditures (31 percent). The

1/ World trade prices for non-oil primary commodities rose by 4 percent and for manufactures by 12 percent.

increase in overseas construction receipts reflected the results of market diversification and improved external demand.

Capital account developments 1987

The capital account recorded a deficit of \$4.8 billion on debt-related capital, a surplus of \$0.6 billion on nondebt-related capital, and a surplus in errors and omissions of \$1.3 billion.

Nondebt-related capital flows arise from suppliers' credits extended by Korean residents (mainly shipbuilders and other capital goods manufacturers), direct and portfolio foreign investment, and other asset transactions (e.g., overseas subsidiaries, short-term trade credits). The nondebt-related capital account balance shifted to surplus from deficits in previous years. This was mainly due to increases in inflows of net foreign direct investment, export suppliers' credit, and reduction on payment for overseas subsidiary debt. Foreign direct investment rose by 36 percent reflecting the favorable business environment in Korea and the liberalization of controls on foreign investment. Export suppliers' credit showed an inflow mainly because the gross outflow of new suppliers' credits declined to \$1.1 billion in 1987 from \$2.1 billion in 1986 reflecting sluggishness in the shipbuilding industry. Amortization payments on the stock of promissory notes held by Koreans rose slightly to \$1.3 billion because of the relatively high interest rate (8 percent) on promissory notes. Thus, there was a net inflow of suppliers' credits of \$0.2 billion together with sales of promissory notes amounting to \$0.2 billion. Payment for overseas subsidiary debt decreased to \$0.3 billion in 1987 from \$1.0 billion in 1986 reflecting the restructuring of the overseas construction industries.

Mr. Kim Suk-Dong said that he was unable to determine the reason for the large positive entry of errors and omissions in 1987, noting that errors and omissions accounted for only 1.5 percent of the value of total trade. Nevertheless, he speculated that acknowledged that exchange rate expectations may have induced an acceleration in export receipts and delay in import payments, giving rise to the surplus on errors and omissions.

External debt developments

Total amortization amounted to \$14.9 billion in 1987, of which \$9 billion represented prepayment of external debt. Prepayment by financial institutions amounted to \$6.8 billion (financed by the Bank of Korea, including swaps), the public sector \$1.5 billion (financed by fiscal resources and foreign currency loans), and the private sector \$0.7 billion (financed by foreign currency refinancing loans).

Gross foreign financing requirements (for amortization, export suppliers' credit, reserve increases, errors and omissions, and others) amounted to \$5.7 billion in 1987. After account is taken of nondebt financing (gross direct investment inflows and sales of promissory notes), gross borrowing requirements amounted to \$4.8 billion.

Total external debt fell by \$8.9 billion to \$35.6 billion (30.2 percent of GNP) in 1987. As the prepayment of external debt affected medium- and long-

term debt, the proportion of short-term debt rose to 25.8 percent of total debt, compared with 20.8 percent in 1986. As most of the short-term debt represented trade credits, there was little scope for further reduction in short-term debt. The debt service ratio rose to 32.3 percent reflecting the prepayment of external debt; excluding prepayments, the debt service ratio was 16.4 percent.

International reserves

Gross reserves rose to \$10.2 billion at end-1987; however, the import cover fell to 2.6 months. Excluding foreign exchanges reserves held by the local branches of foreign banks, gross reserves rose to \$9.2 billion at end-1987.

Surplus management measures

Measures implemented to manage the current account surplus in 1987 included: (1) import liberalization (removing 167 items from the restricted list, thereby increasing the liberalization ratio to 93.6 percent); (2) reducing the average unweighted basic tariff rate to 19.3 percent from 19.7 percent; (3) reducing the number of items on the surveillance list to 48 items from 106 items; (4) revising special laws; (5) providing special financing (at preferential interest rates, 1.25 percentage points above LIBOR) for imports from countries with which Korea has a trade surplus; (6) reducing the domestic financing ratio for exports; (7) relaxing controls on invisibles payments; and (8) appreciation of the won.

Liberalization of invisible payments

Controls on invisibles payments were liberalized on three occasions--in July 1987 and December 1987, and March 1988. In July 1987, the measures taken were: (1) basic travel allowance for business and was maintained at \$3,000 and to \$3,000 for tourism, and for students the basic allowance was maintained at 2,000 but mostly allowances increased from \$1,000 to \$1,500; (2) automatic payment for foreign services was raised from \$10,000 to \$50,000; (3) payment of advertising expenses to intermediaries and agents was permitted (previously, only direct payment to advertising entities was permitted); and (4) personal remittances for subsistence allowance, living expenses, and other personal expenses up to \$500 was permitted. In September 1987, the age limit for overseas travel for tourism was lowered to 45 from 50.

In December 1987, the following measures were implemented: (1) the basic travel allowance was increased to \$5,000, and procedures for overseas travel expenditures were simplified; the age limit for overseas travel for tourism was lowered to 40; (2) holding and usage of multiple credit cards for travellers were permitted; (3) surrender requirements were relaxed by permitting residents to hold up to \$5,000 in unused travel expenses and increasing the ceiling of foreign exchange holdings for money exchanges and coin dealers; (4) automatic payment for foreign services was increased to \$100,000; (5) personal remittances were raised to \$1,000; and (6) the denomination of international contracts in won was permitted.

In March 1988, the following measures will be implemented: (1) A partial negative list system will be introduced for invisibles payments; automatic

payments for current transactions up to \$10,000 will be permitted; automatic payments for all external transactions up to \$2,000 will be permitted; (2) residents may hold foreign currency in cash or travellers checks up to \$5,000 regardless of the source of the foreign exchange. Additional measures being considered for implementation in April 1988 include: (1) portfolio investment for securities companies of up to \$30 million, and for investment trusts and insurance companies of up to \$10 million will be permitted; (2) the age limit for overseas travel for tourism will be lowered to 35 years; and (3) the ceiling and eligibility for emigrant expenses will be increased.

Overseas investment

Relaxation of controls concerning overseas investment will be phased, taking into account its impact on promoting internalization and the portfolio management capability of domestic firms. In the initial stage, the emphasis will be on investments that introduce high technology or that overcome barriers for exports.

The following measures were implemented in 1987 (dates in parentheses indicate when the measure was introduced): (1) The types of business eligible for overseas investment were increased to include real estate and services (April 15, 1987). Investment in real estate was permitted, without limitation, when it is related to doing business, including the purchase of warehouses, offices, representatives' headquarters, and for supporting security; contractors were encouraged to raise funds locally to finance their real estate development; however, the purchase of real estate for speculation was prohibited. In addition to investment in general manufacturing, which was already permitted, investment in service industries, including hotels, restaurants, and transportation, were permitted. (2) Investment in kind was permitted for private enterprises, e.g. purchase of machinery (April 15, 1987). (3) The administrative procedures for approving overseas investment were simplified; the amount of investment requiring review by the Committee on Overseas Investment Project was raised to \$5 million from \$1 million (April 1, 1987). (4) The limits on retention of profits for overseas investment was raised to \$500,000 from \$50,000 and eliminated on March 25, 1988. (5) An automatic approval system for investments not exceeding \$1 million was introduced for investments which met certain appraisal standards by the financing bank. 1/ (6) Financial assistance for overseas investment was increased and the terms made more attractive. The Korea Export-Import Bank will provide overseas investment credit amounting to W 40 billion in FY 1988; the interest rates were lowered to 9 percent from 10 percent and to 8.5 percent (on March 9, 1988) for large firms and to 8 percent from 9 percent and to 7 percent (on March 9, 1988) for small- and medium-sized firms. Effective January 1988, KEXIM began direct lending to the local subsidiaries of Korean firms. (7) The Overseas Development Cooperation Fund (EDCF) provides concessional loans to Korean private firms to support their venture projects in developing countries. (W 5 billion was allocated to the Operational Program of EDCF in FY 1988). (8) Tax incentives have also been granted to overseas investment by raising the maximum reserve ratio of the reserves for overseas investment deficit to 15 percent from 10 percent (reserves are deducted from

1/ Requirements Checking System whereby automatic permission is given when the score in an appraisal prepared by a bank is not less than 60 points or 55 points for small- and medium-sized firms.

taxable income, and payment of taxes on these reserves are postponed). (9) The information system for overseas investment was strengthened.

Capital account projections 1988

Projections for the capital account for 1988 were provided after the meeting. On the basis of a current account surplus of \$7 billion, MOF projects amortization (including \$1 billion for the banking system) to amount to \$7 billion; gross borrowing requirement to be \$2.7 billion; and net debt-related outflows (including banking system) to amount to \$4.4 billion. Mr. Kim Suk-Dong explained that the gross borrowing is undertaken both by the public and private sectors and include loans already contracted and borrowings to prepay external debt. Of the amortization of \$7 billion, \$3.4 billion will represent prepayments. Mr. Kim said that prepayment beyond 1988 will be relatively small as the proportion of external debt with unfavorable terms would have been reduced significantly. Net nondebt-related outflows are projected to be \$0.6 billion, mainly reflecting the increase in overseas investment and export suppliers' credit given. External debt would fall by \$4.7 billion to \$31 billion and reserves would increase by \$1.8 billion to \$12.0 billion.

Later, Mr. Kim supplied capital account projections on the assumption that the current account surplus will be \$11 billion. He said that \$1 billion of the surplus will be used to reduce external debt (\$0.5 billion above the line and \$0.5 billion below the line), and that the remainder \$4 billion will be used to increase reserves.

INTERNATIONAL MONETARY FUND

Korea--1988 Article IV Consultation

Minutes of Meetings at Economic Planning Board on the 1988 Budget
Thursday, March 17, 1988, 4:00 p.m.

Meeting No. 11

Korean Representatives:

Mr. Kim Byung-Il, Director, Budget Policy)
Division)
Mr. Yoon Young-Dae, Director, Budget) EPB
Policy Division)
Mr. Jang Byung-Wan, Assistant Director,)
Budget Policy Division)
Mr. Lee Chang-Ho, Assistant Director,)
Budget Policy Division)

Fund Representatives:

Mr. Neiss
Ms. Jul
Mr. Baban
Ms. Tseng
Mr. Katz*
Mr. Le Fort

Saturday, March 19, 1988, 10:00 a.m.

Korean Representatives:

Mr. Kim Sung-Jim, Director, Planning and)
Management) EPB
Mr. Lee Chang-Ho, Assistant Director,)
Budget Policy Division, EPB)

IMF Representative:

Mr. Katz*

Tuesday, March 22, 1988, 2:00P.M.

Korean Representative:

Mr. Lee Chang-Ho, Assistant Director, Budget
Policy Division, EPB

IMF Representative:

Mr. Katz*

The Korean representatives noted that fiscal policy for 1988 was designed to minimize the recourse of the Government to the banking system, and help to absorb the liquidity increase generated by the balance of payments surplus, and thus reduce inflationary pressures. Following a surplus in the consolidated central government accounts in 1987, the Korean representatives were of the view that a surplus in 1988 was also likely. As revenue projections were prepared in July of last year the strong revenue performance recorded in 1987 could not be taken into account. Thus, while revenue was programmed to increase by some 14 percent over the 1987 budget, the increase over the

preliminary 1987 outcome is only 4.5 percent. Whereas a supplementary budget is not likely in view of the inflationary impact of such a measure, a favorable revenue performance could give rise to further reductions in tax rates on consumer goods.

No new tax measures were introduced with the 1988 budget, although several changes took place before and after the budget went into effect. On October 1987, the duty rate on imported petroleum was lowered from 24.5 percent to 10 percent; in late March 1988 special excise taxes on 30 consumer items were lowered from 5-100 percent to 3.5-70 percent. In addition, the education tax which was introduced in 1982 for a period of five years has been extended.

Total expenditure and net lending were budgeted to increase by 12.9 percent over the 1987 budget, with current and capital spending rising at the same rate.

The wage bill is budgeted to increase by 17.6 percent over last year. Wages to government employees are planned to rise by an average of 13.6 percent following an increase of 7.8 percent in 1987, with lower wage earners receiving--a relatively larger increase. Employment in the Government is expected to rise by 2.9 percent following a similar increase in the previous two years. The expansion in government employment reflects largely increases in the number of teachers and police. Recent developments in government employment are as follows:

	1985	1986	1987	1988 Budget
Total government employment	464,394	472,550	485,812	499,400
Percentage over previous year	1.8	2.8	2.8	2.8

Subsidies and other current transfers are budgeted to increase by 15.7 percent over 1987. Local government will receive in addition to the 13.27 percent of total internal tax revenue sharing, W 180 billion from government monopoly revenue.

The agency for foreign aid--Official Development Assistance (ODA) has programmed to expand its foreign activities on grants and loans from \$94 million in 1987 to \$172 million; grants are expected to increase from \$9.1 million to \$10.7 million. Loans are granted for a period of 20 years with interest ranging from 4 to 6 percent although the interest charge on most loans is only 4 percent interest.

The financing of the budget deficit was to consist of domestic sources: W 746 billion from the banking system and W 827 billion from nonbank sources. According to the definitions of the monetary survey, net credit from the banking system to the Government will amount to W 153 billion. If a smaller budget deficit were recorded, net bank credit to the Government would adjust accordingly leaving nonbank borrowing intact. Net financing abroad will be virtually zero. External debt repayments in 1987 by the central government amounted to \$1,111 million, of which prepayments were \$250 million. Total

prepayments of external debt by the government including government-guaranteed debt equalled \$2,522 million, of which prepayments--\$1,496 million. In 1988, the Government is expected to prepay about \$1 billion on external debt including government-guaranteed loans.

Priorities under the budget include defense, education and social and rural development.

The defense budget has been targeted at 6 percent of GNP as a medium-term objective. As economic growth in recent years exceeded original budget projections, the rate of growth of defense expenditure lagged behind and its share in GNP declined somewhat. In 1988, the defense budget was programmed to grow by 13.0 percent over the 1987 budget.

Expenditure on education is budgeted to increase by 17.0 percent over 1987. The education budget is composed of two categories: expenditures for national education establishments and services, and transfers to local governments earmarked for primary and secondary education. An important objective of the 1988 education budget is the reduction in the number of students per class in primary and secondary schools from 58 to 56 students. To this end, the number of teachers and the appropriations for construction of school facilities have been raised.

The 1988 budget introduces three basic social security programs: national pension system, minimum wage and nationwide medical insurance system.

Under the new national pension system, all employers and employees are required to contribute 1.5 percent of gross wages. The national pension will be consolidated with the central government and its contributions will be invested in selected securities or lent through the Fiscal Investment and Financing Special Account (FIFSA) to the National Housing Fund. In 1988, contributions are expected to reach W 550 billion, whereas managing expenses will amount to W 22 billion. The minimum wage legislation which was introduced with the 1988 budget will have no direct budgetary implications as no government employees are at the minimum wage range.

Medical insurance programs will be extended to rural areas in 1988 and to urban areas in 1989. The extension of insurance to rural areas will cover some 8 million new participants. Total cost of the program in 1988 is estimated at W 230 billion, of which budgetary support will amount to W 81 billion, as the Government plans to bear a portion of the insurance premium for rural low income groups. Under the medical insurance program, participants pay 2 percent of their gross income and receive coverage of 80 percent of hospitalization and 55 percent, physician costs.

Government expenditure on science and technology are budgeted to increase by 13.9 percent over 1987 to W 630 billion, or 0.6 percent of GNP. Combined with private sector investments, total national spending on R&D is expected to rise from 2 percent of GNP in 1987 to 2.4 percent in 1988.

INTERNATIONAL MONETARY FUND

Korea--1988 Article IV Consultation

Technical Meeting on Money and Credit,
Ministry of Finance
Friday, March 18, 1988, 9:30 a.m.

Meeting No. 12

Korean Representatives:

Mr. Byeon Yang-Ho, Deputy Director
Financial Policy Division

Fund Representatives:

Mr. Neiss
Mr. Baban
Mr. Le Fort*

Monetary target

Mr. Byeon agreed that in an open economy with fixed exchange rate, the supply of money is endogenously determined by money demand. In his opinion, the fast growth of the Korean economy coupled with its increasing monetization were causing a rapid growth of monetary aggregates and were a reason for considering higher targets for monetary growth. The monetary target for 1987 for the annual growth of end of period M2 had been listed as a range of 15 to 18 percent; the upper limit of the target range was exceeded in 1987 as end-of-period M2 (excluding Certificates of Deposit) increased by 19.3 percent. The monetary target for 1987 could not be set at a higher level because an annual growth of M2 exceeding 18 percent is not politically acceptable. The public is very aware of the risks of overheating the economy and have a marked fear of inflation.

The monetary target for 1988 considers an annual growth of the end of period M2 equal to 18 percent and was derived from projections of 9 percent growth in real GNP, 5 percent inflation in consumer prices and 4 percent reduction in the income velocity of money. The latter is consistent with the trend of increasing monetization of the Korean economy.

The monetary authority was studying modifications of the money supply definition used to set the monetary target. The new money definition would exclude time deposits in the banking sector with maturity period exceeding a certain limit.

Monetary stabilization bonds

In order to curb the fast growth in monetary aggregates, the Bank of Korea increased the sale of monetary stabilization bonds (MSB); during 1987, the stock of bonds outstanding was increased from 3.1 trillion to 7.6 trillion won. In addition, open market operations directed to the reduction of liquidity were

also conducted through the sale of Treasury bills and Foreign Exchange Equalization Bonds.

Nonbank financial institutions have been directed to buy MSBs in order to share with the Bank of Korea (BOK) the cost of reducing the growth of money supply and controlling inflation. The financial institutions that have accepted MSBs from the BOK have made losses as the interest rate paid by the bonds is lower than the one of alternative investments and the bonds are traded in the secondary market at a discount. The MSBs have maturities ranging from 26 to 360 days and pay interest at an annual rate of 12.5 percent. In the secondary market, the yield of Monetary Stabilization Bonds fluctuates between 15 and 16 percent per year. About 50 percent of the bonds issued are held by the NBFIs and the other half is resold in the secondary market to insurance companies, securities firms, and to the general public.

The monetary authority has imposed ceilings on the commercial banks' outstanding CDs and have issued recommendations on the interest rate the CDs can pay on them. The ceilings are imposed in order to shelter the nonbanking financial institutions (NBFIs) from the competition of commercial banks and to enlarge the market for stabilization bonds. In March 1988, the ceilings for commercial bank CDs was 2.6 trillion won and the amount outstanding was below 1.6 trillion; the interest rate on CDs, 10.25 percent, was well below the secondary market yield of stabilization bonds, 15 percent.

Mr. Byeon explained that the monetary authority has to weigh the advantages of controlling monetary expansion and inflation with the effects of the restrictive credit policy on the interest rates and financial markets. An excessive emphasis in monetary control, added to the uncertainties created by political developments and the exchange rate adjustment, could eventually lead to a reduction of stock market prices, a private sector portfolio shift toward real estate and soaring real estate prices. The increase in real estate prices is considered to cause significant increases in production costs.

Credit controls

A large current account surplus can be made compatible with price stability through tight domestic credit and high interest rates. In order to achieve this result, commercial banks have received window guidance according to which a convenient level of credit has been suggested; commercial banks are directed to keep the undisbursed funds in the monetary stabilization account, which pays an annual interest rate of 3 percent. The reserve requirements for banking institutions have been increased from 4.5 percent to 7 percent and no interest is paid on reserve deposits. The amount of banking sector credit made available to exporters by the banking system has been reduced from W 670 per dollar exported to zero for big firms, and from W 700 per dollar exported to W 450 per dollar exported for small- and medium-sized firms. The monetary board has reduced the rediscount ratio from 60 percent to 40 percent for large firms; and the big conglomerates have received indications to reduce their level of domestic credit from the banking system in amounts ranging from 5 to 10 percent.

At the present level of the controlled interest rate and given the tight credit policy implemented to meet the monetary target, there is an excess demand for credit that has led to the use of direct credit controls. The

direct credit controls create incentives to over-borrow and to delay as much as possible the repayment of credit outstanding because private firms have no guarantees that they will have access to credit in the future and they prefer to hold additional monetary or financial assets instead of reducing their indebtedness.

Foreign borrowing by private firms is forbidden, moreover large private firms have been persuaded to reduce their external debt in spite of the lower cost of foreign borrowing relative to domestic. These restrictions have allowed to partially avoid the liquidity expansion that would otherwise result from the international interest rate differential--interest rates in won exceeds comparable dollar interest rates in the international market and the won is expected to appreciate against the dollar. In addition, foreign credit restrictions are used to achieve the social goal of reducing the foreign debt.

The system of credit controls and the efforts directed to curbing the liquidity expansion has had negative effects on the profitability of financial institutions including commercial banks, nonbanking intermediaries and the central bank.

- The higher required reserve ratio on bank deposits coupled with the suggested credit limits and the low interest paid by the monetary stabilization account (relative to the yield of alternative assets) have reduced the profitability of the commercial banks.

- The acceptance at face value of stabilization bonds that are priced at a discount in the secondary market has reported losses to nonbanking financial institutions (NBFIs). The NBFIs by purchasing MSBs at face value have made an annual loss estimated at about W 140 billion in 1987. That result is obtained considering a total stock of MSBs of 5.6 trillion won and that the annual yield of MSBs in the secondary market exceeded the face yield of the bond by 3.5 percent.

- The Bank of Korea has made losses estimated at W 580 billion through the sale of MSBs. These losses represent the excess of the interest paid on outstanding MSBs by the BOK (estimated in W 720 billion) over the return obtainable by investing the proceeds of the bonds in the accumulation of net foreign assets. The BOK issues bonds in won offering an interest rate of 12.5 percent and uses the proceeds to accumulate net foreign assets (reducing foreign liabilities or accumulating foreign assets) that yield only 8 percent in dollars, while the dollar depreciated by 6.7 percent against the won. The bond interest rate was assumed equal to 12.5 percent, the international interest rate in dollars equal to 8 percent, and the annual won-dollar appreciation rate equal to 3 percent, the stock of bonds outstanding was assumed equal to 5.76 trillion won.

Interest rates

Mr. Byeon explained that there have been no significant changes in the interest rate during last year. The only interest rates that genuinely represent market forces is the interest rate in the unregulated money market which has been relatively stable since mid-1985 at an annual rate of 25 to 27 percent. The controlled loan interest rates have been kept stable with ranges between 10 and 12 percent; and the interest rate paid by time deposits and CDs

have also been kept stable ranging from 6 to 11 percent per annum depending on maturity.

The monetary authority was not opposed to the liberalization of interest rates, however the business community has lobbied against that reform as they consider that the interest rates would increase if the rates were let to follow market forces. In addition, the limitations and underdevelopment of the market for securities have made firms dependent on the financial systems to obtain the required financing for their operations and expansion.

INTERNATIONAL MONETARY FUND

Korea--1988 Article IV Consultation

Meeting with the Korean Foreign Trade
Association

Friday, March 18, 1988, 11:30 a.m.

Meeting No. 13

Korean Representatives

Mr. Sun-Ki Lee, Vice Chairman
Mr. Seh Hyung Choi, Executive Director

Fund Representatives

Mr. Neiss
Ms. Jul +
Mr. Katz

Mr. Lim, IMF, Alternate Executive Director

The Korean Foreign Trade Association (KFTA) is a private organization which has more than 1,300 members who are either exporters or importers or both. It extends various services to its members by providing information concerning markets, commodities, government policies, trade environment in Japan, the US and other countries. Also, it makes recommendations on trade policy to the government.

By and large, the members of KFTA are becoming more concerned by the pressures being exercised by other countries. In terms of the policy measures being implemented, KFTA members feel less pressure from the liberalization drive than from the appreciation of the won. Some firms were still expanding, others were going bankrupt.

KFTA was strongly recommending to the government to accelerate the liberalization process and to slow down the appreciation of the won. Wages had increased 20 percent already, there had been a reduction in the government financing of exports, Korea will be graduated from the US's GSP next year, and prices of raw materials in the international markets were increasing. Last year's appreciation of the won was more easy to absorb because the yen and the Taiwanese dollar were moving in the same direction as the won, but now these currencies were depreciating vis-a-vis the dollar. This resulted in a loss of competitiveness, bankruptcies and unemployment. Ten companies had already stopped exporting-- small and medium-sized enterprises. Japan and Taiwan had enjoyed trade surpluses for many years and had built muscles, while Korea had only two years of surpluses and its muscles were still weak. The won was not a convertible currency so it was impossible to tell what its value should be.

Mr. Neiss pointed out that although it was true that wages were increasing in Korea much more rapidly than in competitor countries, Korea's wage levels were still much lower than in competing countries. Mr. Lee agreed but pointed out that another negative effect on competitiveness came from the increased cost in the imports of raw materials originating in Japan due to the strong yen. While Japan could squeeze local suppliers to absorb the effects of the appreciation

of its currency, Korea was not in a position to do that.

To the question of why Korea was not switching to the US market, Mr. Lee responded that there were genuine difficulties to do so. The KFTA had prepared a list of 350 items whose importation could in principle be shifted to the US market, but US suppliers were very slow in responding compared to the Japanese suppliers.

Thus, the KFTA was recommending a slow appreciation of the won to give time for rationalization of management, increase in productivity, and investment in research and development to take place. They should move to open the market faster. The KFTA would like the government to remove all non-tariff barriers instead of accelerating the appreciation of the won. Problem areas were those where the US cannot substitute for Japanese imports. The US can only sell to Korea agricultural products, high-tech products, and services. The US could not sell more of these products to Korea even if the won was adjusted. Agricultural goods already represented one tenth of imports, high-tech products were not produced in Korea, and in services US management was more advanced. So, if Korea opens its market imports of these kinds of products could increase without any harm done to the Korean producers. All these imports were related to market opening and were not price related.

To the question of how fast can Korea open its market, Mr. Lee answered by explaining the import liberalization drive which had already taken place and did not elaborate with respect to the future.

INTERNATIONAL MONETARY FUND

Korea--1988 Article IV Consultation

Technical Meeting on Economic Management Plan
and Balance of Payments
Economic Planning Bureau
March 18, 1988 at 2:00 p.m.

Meeting No. 14

Korean Representatives:

Mr. Maeng Jung-Ja, Director,
EPB, Financial Planning Division
Mr. Cho In-Kang, Assistant Director,
EPB, Financial Planning Division
Mr. Chin Young-Kon, Assistant Director,
EPB, Overall Planning Division
Mr. Lee Jong-Kap, Assistant Director,
EPB, Overall Planning Division

Fund Representatives:

Mr. Neiss
Ms. Jul
Mr. Baban
Ms. Tseng*
Mr. Katz
Mr. Le Fort

The Korean representatives provided the attached tables which show the differences between projected and actual current account outcomes in 1987 and current account projections for 1988.

The projections were discussed at a subsequent technical meeting. The main differences between the EPB and Fund staff projections were exports and services payments. EPB's export projections are based on letters of credit received through (most of) the first quarter of 1988. The substantial deceleration in exports is attributable to the effects of the wage increases, the appreciation of the won, and domestic capacity constraints (with the operating ratio in the manufacturing sector reaching a historical high of 90 percent). The Fund representative said that the staff's projections for exports also imply a substantial deceleration in exports during 1988. However, the Fund representative questioned the plausibility of the sharp deceleration projected by EPB, particularly the growth rate for the first quarter (28 percent) which is below the growth recorded, thus far during 1988 (39 percent through mid-March). EPB's projections for new exports also show sharper deceleration, compared with the Fund staff's projection. The Korean representative cited protectionism, particularly the antidumping charges on automobiles in Canada, as an important factor for the sharp deceleration in new exports. Quarterly data on new exports which were provided subsequently did not show a decelerating trend for new exports in 1987.

On the import side, the EPB projections included \$2.5 billion imports on account of policy measures (\$1.5 billion for special foreign currency loan and \$1.0 billion for import liberalization and tariff cuts). The Korean

representative said it was difficult to determine whether imports financed by these loans were indeed additional imports, but considered that some of them could be additional because of the favorable terms of the foreign currency loans. Of the \$3 billion in loans provided in 1987, \$1 billion goods were imported in 1987, and the remainder \$2 billion goods would be imported in 1988; in addition, another \$3 billion in loans is available in 1988. In calculating the \$1.5 billion additional imports on account of financing, EPB assumed that 40 percent of the \$2 billion imports carried over from 1987 would represent additional imports, and 60 percent of the imports financed by 1988 loans would be imported in 1988, of which 40 percent would represent additional imports.

EPB projections for travel and other services payments were \$0.6 billion above staff estimate. The Korean representative said that the liberalization measures implemented during the latter part of 1987 and early 1988 will increase services payments significantly. The Fund representative noted that the staff projection for travel and other services payments was already higher than growth rates recorded in previous years; travel payments are projected to increase by 25 percent in 1988, compared with 14-15 percent in 1986-87; other services payments are projected to increase by 20 percent in 1988, compared with 13-19 percent in 1986-87.

INTERNATIONAL MONETARY FUND

Korea--1988 Article IV Consultation

Minutes of Meetings with the Ministry of Finance
on Fiscal Developments in 1987 and Policies
Friday, March 18, 1988, 5:00 p.m.
and continued Tuesday, March 22, 9:00 a.m.

Meeting No. 15

Korean Representatives:

Mr. Lee Chong-Min, Director, International
Taxation Division
Mr. Hong Young-Man, Deputy Director,
International Taxation Division
Mr. Kim Ok-Joo, Deputy Director, Treasury Dept.
Mr. Lee Pon-Young, Director, Settlement Division
Mr. Uh Se-Woong, Deputy Director, Settlement
Division
Mr. Lee Yong-Keun, Director, Treasury Division

Fund Representatives:

Mr. Katz*

These meetings focused on revenue developments in 1987, revenue projections for 1988, tax policy issues, and the expenditure outcome of 1987.

The Korean representatives said that the strong revenue performance of 1987--19.1 percent increase over 1986--was well in excess of original budget projections and reflected the sharp increases in exports, imports and domestic economic activity; tax revenue increased even more rapidly--20.2 percent over 1986.

Strong growth was recorded in corporate income tax receipts--40.9 percent over 1986. As corporation pay income tax in two installments--July of the same tax year on assessed income and March of the following year on the actual balance for the previous year, the possible negative effects of the currency appreciation and the wage awards did not have an adverse effect on corporate income tax in 1987. Revenue from individual income tax and social security contribution also rose sharply largely as a result of wage awards which were granted in the second half of the year.

Taxes on goods and services recorded a more modest increase--8.2 percent--well below the growth of private consumption and short of the 1987 budget projection. Excise tax revenue rose by 10 percent reflecting a reduction in tax rates on consumer durables in mid-1987; the revenue loss of this reduction was estimated at W 128 billion and its effect on the wholesale price index--0.22 percent.

Taxes on imports, including the 2.5 percent defense tax, increased by 36.4 percent as a result of a sharp rise in imports and an increase in the import duty on petroleum to 24.5 percent from 5-15 percent in most of 1986. Revenue from the import duty on petroleum increased from W 192 billion in 1986 to W 400 billion in 1987. The average effective import duty rate on total imports rose from 5.0 percent to 10.1 percent in 1987 and average duty rate excluding petroleum increased from 5.3 to 5.8 percent, notwithstanding some reductions in tariff rates.

The 1988 budget introduced no new revenue measures. However, the reduction in the petroleum import duty from 24.5 to 10 percent in October of 1987 is expected to result in revenue loss of W 160 billion in 1988; and the cut in special excise tax rates of end-March 1988 from 5-100 to 3.5-70 percent is projected to reduce revenue by W 170 billion in 1988 and lower the wholesale price index by 0.29 percent.

Since the 1988 revenue projections were prepared in July of 1987, the strong revenue performance could not have been foreseen and as a result the rate of increase of revenue projected in the 1988 budget over the 1987 preliminary actuals is 4.5 percent, while nominal GNP is expected to increase by 14.5 percent. The Korean representatives explained that one way of adjusting the 1988 revenue projections would be to apply the rate of growth of revenue in the 1988 budget over the 1987 budget--13.7 percent--to the 1987 preliminary actual revenue.

Turning to tax incentives to saving, the Korean representative explained that interest income is treated more favorably than either corporate or wage income. Interest income is not globalized with other sources of income and is subject to a tax of 10 percent, well below the 33 percent corporate tax and equal to the low range of tax brackets for individual income. In addition, small savers with accounts up to W 5 million per household are subject to a 5 percent withholding tax provided that such deposits remain with the banking system for more than one year. Also, certain categories of savings receive tax credit. Residents with savings through the National Savings Association can deduct an amount equivalent to 5 percent of the saving from the global income tax amount; members of Employees Stock Holding Associations with saving through the association for holding of stock of their company can deduct from the global income tax an amount equivalent to the saving; and members of such associations who receive their company stock as bonus or retirement allowance can deduct 15 percent of the acquisition value of the stocks from the global income tax amount.

The Korean representative noted that these clauses provide incentives to saving, in particular to small household depositors. The reduction of the withholding tax rate on interest income of deposits up to W 5 million from 10 to 5 percent effective 1985 could have been a contributing factor to the upsurge of the national saving rate, although a quantification of its impact would be a difficult undertaking.

On export promotion schemes through the tax system, the Korean representatives explained that a build-up of reserve for export loss for overseas market developments, and for price fluctuations have virtually no effect on tax revenue. They merely delay the tax payment from the year during which the reserve has been appropriated to the following three years (the tax

is paid in three equal instalments). The possibility was raised, however, that under conditions of steady expansion in exports, the first two reserves would be expanding and thus there would be a more permanent revenue loss: the revenue loss would be equal to 1 percent of the increase in the won value of exports multiplied by the 55 percent corporate tax rate. Consequently, in 1987 the increase in exports amounted to W 8,122.8 billion and the revenue loss (as a result of the increase in the reserve for export loss) would be W 26.8 billion (W 55.6 billion for the first two reserves, or 0.7 percent of the increase in exports). It was also explained that the special depreciation allowance to exports has a negligible effect on tax revenue because it is limited to 50 percent of the ordinary depreciation amount.

The Korean representatives noted that the Ministry of Finance was considering to have these incentives abolished during the course of 1988.

Turning to the expenditure outcome in 1987, the Korean representatives remarked that preliminary actual data would not be available before April 15, 1988; the various funds and special accounts submit their 1987 balances by end-March. As preliminary data on the General Account and the Grain Management Fund are available, they suggested that temporarily the 1987 preliminary actuals would be based on the 1987 budget adjusted for the General Account and the Grain Management Fund taking account of the flood relief. Thus, the original central government expenditure budget of W 18,603 billion would have to be raised by W 500 billion--flood relief, less W 78 billion of unused funds to a sum total of W 19,025 billion and revenue would be adjusted upward by W 1,537 billion over the original budget to W 18,860 billion. The resulting deficit would amount to W 165 billion compared with an original deficit of W 1,280 billion. Owing to a less favorable performance of the Grain Management Fund, revenue of the consolidated central government would have to be lowered by W 73 billion to W 18,821 and expenditure raised by W 112 billion to a total of W 19,192 billion; and the ensuing deficit would equal W 371 billion, compared to an original budget deficit of W 1,301 billion.

The Korean representatives noted that the balances of the other accounts are likely to be more favorable and the resulting deficit could therefore be smaller. They indicated that they would send to the IMF the revised version of tables IV-1 through IV-4 of the 1988 questionnaire as soon as they become available (after April 15, 1988).

INTERNATIONAL MONETARY FUND

Korea--1988 Article IV Consultation

Technical Meeting on Energy Matters
Ministry of Energy and Resources
March 21, 1988, 3:30 p.m.

Meeting No. 16

Korean Representatives:

Mr. Joo-Sok Suh, Director, Energy Policy
Division
Mr. Soon-Young Huh, Deputy Director,
Energy Policy Division

IMF Representatives:

Mr. Baban*

Mr. Suh stated that figures for energy use per won of real output showed a declining trend during the last five years. Though decreases in this ratio was recorded annually for the last five years, he cautioned that year to year changes could be misleading because the numerator is not corrected for unused capacity. Energy plants always have to function at certain minimum output levels regardless of demand. He therefore suggested that the trend would be the more meaningful concept for analysis.

Despite recent price decreases in the international and domestic price of energy, the government is not flagging in its energy conservation efforts. Energy audits of heavy energy consumers is a continuing program. Industries themselves have a substantial interest in saving energy to reduce costs in a climate of rising wages. Savings are also generated by shifts in the industrial structure from heavy industries towards high technology and service industries.

In decomposing energy demand by sector over the medium term, the most marked change will be the increasing share of transportation in total demand. This primarily reflects the increased ownership of private cars. This prospect is mirrored in the rising share, from 1988 onward, of petroleum in energy by source, primarily at the expense of the share of coal. The shares of nuclear energy and hydroelectric power will remain relatively stable during 1988-91. KEPCO has contracted for the building of #13 and #14 plants by 1996 and there are no present plans for further plants beyond these two. LNG imports over the medium term will be limited to 2 million tons per annum. The pace of conversion of plants as well as investment in distribution facilities to private homes and commercial facilities will limit increased use of LNG. Also, the controversy over pricing with Indonesia is still not resolved. Both Korea and Indonesia agreed that LNG shipments should be priced at Indonesia's "realized" price for petroleum exports. However, this has been interpreted by

Indonesia to mean the posted price, which works out to \$190 per ton. Korea has no means to check actual discounted prices. Negotiations are continuing.

Several days ago, domestic prices of petroleum products were reduced by an average of 10.6 percent, partly to reduce price pressures and partly to pass on the effects of won appreciation against the US dollar. This has made domestic coal even less competitive, necessitating further subsidies while the industry is being rationalized. Further domestic oil price reductions are possible in the course of 1988, if the won continues to appreciate and international oil prices remain stable.

Petroleum, bituminous coal, and uranium are 100 percent imported. In addition, 11.2 percent of anthracite coal is imported. As energy requirements rise with development, the import dependence ratio is expected to increase from 78 percent in 1986 to 83 percent by 1991. To reduce the vulnerability of Korea to disruptions of supply, Korean companies have been given incentives (technical assistance, access to funds, and tax allowances) to invest in joint energy ventures abroad. While joint ventures in oil, bituminous coal, anthracite coal, and uranium have been entered into, those for bituminous coal have made the most progress. In 1987, the share of joint ventures in bituminous coal imports reached 18.7 percent, compared with 3 percent five years ago. By 1996, Korea aims for joint ventures to account for 30 percent of bituminous coal imports, 20 percent of oil imports, 20 percent of anthracite coal imports, and 30 percent of uranium imports.

INTERNATIONAL MONETARY FUND

Korea--1988 Article IV Consultation

Technical Meeting on Agricultural Matters
Ministry of Agriculture, March 21, 1988, at 5:00 p.m.

Meeting No. 17

Korean Representatives:

Mr. Han-Kon Kim, Director-General,
Agricultural Policy Bureau
Mr. Chan Joon Sohn, Director, Agricultural
Policy Division
Mr. Hyung-Kyn Choi, Deputy Director,
Agricultural Policy Division

IMF Representative:

Mr. Baban*

Mr. Kim stated that, overall, 1987 was a difficult year for agriculture. There were two typhoons and five periods of heavy rainfall, 2 in July and 3 in August. The resulting floods damaged about 462,000 hectares of land. Rice was the most badly affected and total harvest declined for the third year in a row. Heavy rainfall came during the seeding period for radish and Chinese cabbage and the prices of these products doubled over the those in the previous year. The barley and wheat crop was harvested in June and escaped damage. The increase in barley and wheat production in 1987, after three years of continued decline, reflected a substantial increase in demand for barley for brewing of alcoholic and nonalcoholic beverages. Consuming companies have entered into buying contracts with farmers, specifying quantities, species, and prices. The Government approves of this arrangement, as the farmers are assured in advance of a market at agreed prices.

The 9 percent decline in the fish catch in 1987 partly reflects the unusually high level achieved in the previous year. Also, climatic conditions in 1987 were not as favorable. Adverse weather reduced the number of fishing days, and therefore the number of fishing trips. Also, the temperature of the water rose on average, reducing the yield for cold-water species.

The most important new measure taken in 1987 in the agricultural sector was the establishment of a facility to reduce the indebtedness of farmers to the unorganized financial market, where interest rates were as high as 22 percent. On March 12, 1987, the Government allocated W 1 billion in funds to enable the national cooperative federations of agriculture, livestock, and fisheries to extend loans at low rates for the retirement of high-interest indebtedness. As of March 10, 1988, about 87 percent this fund had been disbursed. In addition to this sweeping measure, the Government also reduced interest rates selectively to revitalize certain sectors.

The establishment of new rural industrial estates, with a view to diversifying the rural income sources and balanced regional growth, has been vigorously pursued. This program was started in 1986 and with 45 more estates built in 1988, the total would rise to 122. The industries in these estates need not necessarily be related to agriculture, there are no restrictions in this regard. Firms are attracted to locate to these estates by infrastructural development borne by the Government, tax exemptions, and lower interest rates (9 percent instead of 11.5 percent).

No import surcharges have been levied on coffee, sugar, or any other product. The legal documentation has been prepared but the Government has held off from implementing it. The IMF staff member indicated that such surcharges run counter to the spirit of current policy, which points to liberalization. The funds collected were supposed to be destined to an integrated rural development fund, but this could just as well be provided through the budget.

The deficit in the Grain Management Fund continues to be of concern to the authorities and in 1987, the purchase price for rice was raised by 6 percent while the selling price was raised by 12.5 percent. Consequently, the implicit subsidy declined from W 11,530 per 80 kilogram bag to W 9,040 per 80 kilogram bag. In the case of barley, the implicit subsidy rose slightly from W 3,210 to W 3,430 per 76.5 kilogram bag, but operations in barley are fairly small. The Fund purchases mainly low quality rice. In early March 1988, to ease pressure on food prices, the price of rice sales from stock was reduced by 10 percent. The buying prices for rice and barley are announced just before the harvest, in the light of inflation and market conditions.

INTERNATIONAL MONETARY FUND

Korea--1988 Article IV Consultation

Meeting on Securities and Insurance

Ministry of Finance

Tuesday, March 22, 1988 at 10:30 a.m.

Meeting No. 18

Korean Representatives

Mr. Chung Duck-Koo, Director
Securities Policy Division
Mr. Park Hwan-Kyun, Deputy Director

Fund Representatives

Mr. Baban
Mr. Le Fort*

1. Policy measures

Mr. Chung explained that the authorities have implemented several measures in order to help further the development of direct corporate financing, to enhance public confidence in the stock market and increase the number of market participants, and to increase the access to the capital market of small and medium-sized firms. These measures include: the revision of the Securities and Exchange Law, and of the Law on Fostering the Capital Market; the privatization of public corporations; incentives to direct savings by people in the low income brackets to the securities market; and the establishment of an over-the-counter market for small and medium-sized firm shares.

The new legislation protects the control by current owners of companies that go public and provides additional incentives for issuing new stock. Current owners are protected from takeovers by limiting the number of share that nonprincipal owners can hold. Each principal stock holder (those that currently control the big firms and conglomerates) can hold up to 30 percent of the company shares; the holdings of shares by all other investors (nonprincipal owners) are limited to 10 percent of the total. The new legislation have abolished many restrictions to the issue of stock by private companies allowing firms going public to issue stock at market price instead of at par value.

A tax credit was given to small investors in the securities market. Those earning W 600,000 or less can invest up to 30 percent of

the monthly salary in the security market and enjoy a tax credit equivalent to 10 percent of the value of the investment.

In addition, financial liberalization measures directed to ease restrictions on the domestic stock market and to improve its links with the international market were implemented in 1987. These measures include the establishment of the Korea-Europe Fund, the further issue overseas of convertible bonds, and the authorization to domestic securities companies to hold foreign exchange up to 10 million U.S. dollars.

2. Developments

Mr. Chung explained that the stock market has been in strong rally mainly due to the robust and improved growth prospects of the economy, to the large expansion of liquidity and to expectations of a future internationalization of the domestic capital market. The links of the Korean market with the international capital market are very limited due to the restrictions imposed on the holdings of Korean Securities by foreign residents. Thus, the effects of the international stock market crash on the domestic market were very small and, by the end of 1987, had already been reversed. Most recently, the stock market entered into an adjustment phase in response to higher interest rates and to the expectations of large increases in the supply of stocks caused by firms' attempts at raising capital in the stock market.

In 1987, the composite stock price index increased by more than 90 percent. One week after the international stock market crash of October 1987, stock prices in Korea began to fall, but before the end of the year they recovered surpassing the pre-crisis level. The composed price indicator, which stood at 516.1 on "black Monday," fell to 509.1 by the last day of October, then recovered, reaching 525.1 by the end of the year. From the end of 1987 to mid-February 1988, stock prices had increased by 27 percent, however, at the end of March stock prices stood at a level 20 percent higher than that of end-1987.

The rapid rise in stock prices was faster in domestic industries including banking, insurance and construction than in the export industries. In Mr. Chung's opinion, this result reflects expectation on sectoral growth and is partly due to the negative impact that rising wages and currency appreciation will have on export industries. The financial and construction sectors are not expected to be affected as much by the labor unrest and by the turbulent and changing international environment as is the export sector.

In 1986 and 1987, capital market activity was very strong and the stock and bond markets were characterized by their dynamic development and growth. The development of the capital market was reflected in a fast increase in the direct financing of corporations. The growth of the capital market consisted in an increasing number of market

participants (the number of share holders and of companies listed increased sharply); and in an increasing value of transactions (the turnover of stocks and bonds, measured by their sale value, more than doubled). The total direct corporate financing increased from W 3.5 trillion in 1985 to W 5.1 trillion in 1987. While bond financing stood almost at the same level during the last three years, stock financing through public offerings and offerings to shareholders increased from W 0.3 trillion in 1985 to W 1.9 trillion in 1987.

3. Forecast and future policy actions

In Mr. Chung's opinion, a continuation of the present tendencies in the capital market appears most likely. Stock prices are expected to continue growing, but at a slower pace than previous years and the size of the market should continue to expand. In 1987, the daily average transaction reached a volume of 5.7 million shares and a value of W 70.8 billion; in 1988 it is expected that the daily average volume will be about 8 million shares and the value will range from W 120 to W 150 billion. In the first two months of 1988 daily average transactions reached a volume of 70.2 million shares and a value of W 182.1 billion. It is also expected for 1988 new stock issues for about W 3 trillion, and new bond issues for about W 3.4 trillion. In 1987, new issues were W 1.9 trillion for stocks and W 3.2 trillion for bonds.

In Mr. Chung's opinion the current size of the Korean stock market is an impediment to expedite the internationalization of the capital market. The market is so small (US\$33 billion, equivalent to one-half of total IBM stock) that can be subject to hostile take over and cornering from abroad. Other limitations for internationalization include the unavailability of public information on the financial condition of domestic companies, and the lack of adequate regulations to control inside-trading. In his opinion a sizable market growth and important structural changes should precede the internationalization of the domestic capital market. In the meantime, an indirect link with the international capital market will be provided through selling abroad mutual fund shares (like Korea Fund, Korea Euro-fund) and issuing abroad convertible bonds. In addition, the limitations on the holdings of foreign assets by domestic residents will be reduced.

INTERNATIONAL MONETARY FUND

Korea--1988 Article IV Consultation

Meeting on Foreign Investment and Economic
Cooperation, Ministry of Finance 1/
Tuesday, March 22, 1988, 11:00 a.m.

Meeting No. 19

Korean Representatives

Mr. Mahn-Ki Yang, Director, Foreign
Investment Policy Division
Mr. Yeun Yong-Ro, Deputy Director,
Economic Cooperation Division
Mr. Sung Bae Kim, Assistant Director,
Economic Cooperation Bureau

Fund Representatives

Ms. Jul *
Mr. Seban

Mr. Yang delivered a set of answers to the questions which had been advanced by the mission prior to the meeting (attached).

Last year there was a record level of foreign direct investment applications. They amounted to US\$ 1.1 billion compared to only US\$ 300 million in 1986. The liberalization drive had been important, although there were some sectors where the ratio was still low, well below the average. To attract foreign direct investment a sector has to present a high liberalization ratio, grant tax incentives, have an adequate infrastructure and high skilled workers. The international competitiveness of the won was also a very important element.

In regional terms, investments by European countries expanded significantly in 1987, in particular in the steel sector. European firms were more interested in investing in Korea than the Japanese firms. The share of the US was also declining.

In terms of the liberalization plans, Mr. Yang stated that they will open the services sectors gradually. They were preparing regulations concerning investment in the insurance sector (provided to us at the meeting on March 28).

They will abolish most tax incentives for export industries effective April or May 1988. The tax incentive system will remain only in the area of high tech industries and for investments by Koreans residing in foreign countries. Incentives provided consist of income, corporate, dividend, acquisition and registration tax exemptions. Import duty exemptions are effective only for industries in the manufacturing sector which are exempt from income tax. The import duty exemption was

1/ Additional clarifications on the material provided in this meeting were obtained from Mr. Yang at a meeting on March 28, 1988.

reduced last year to only 70 percent of the duties. Also, until last year there were several industries benefiting from tax incentives, such as hotels, export industries, and high-tech-industries.

At present the Ministry of Finance was worried about getting too much foreign direct investment because the cash ratio of foreign investment was very high : 70 percent. The price of land was high and the domestic suppliers could supply a large portion of the required capital equipment. They expected the cash ratio to increase to about 80 percent at the end of this year. The only tool they had to discourage foreign investment was to reduce tax incentives.

Economic Development Fund

Two projects had been approved as of December 1987. Approved by the Korean government but not yet accepted by the countries concerned. One was a project in Indonesia, a bypass amounting to US\$ 13 million, the other was a project for procurement of locomotives in Nigeria amounting to US\$ 10 million.

The Fund operates on the basis of applications. The capital for the Fund amounts to US\$ 50 million. Loans will be given in won, to be converted to US\$ at the Bank of Korea. Given the appreciation of the won, interest rates charged are at present too high so they were revising the terms.

Discuss measures implemented in 1987 regarding foreign investment in industrial sector and measures being considered to be implemented in 1988 and beyond.

- On April 6, 1987, twenty-six more manufacturing industries were opened to foreign investors with their removal from the Korean government's "Negative List". This revision means that foreigners may now invest in 97.5 percent of Korea's manufacturing industries, making the manufacturing sector almost completely open. Likewise, the combined percentage for all industrial sectors has now increased to 78.9 percent.

- On July 1, 1987 a variety of changes made to improve Korea's foreign investment system went into effect according to the revision of the Enforcement Decree and Working Rules of the Foreign Capital Inducement Act. The changes were part of the government's ongoing policy to liberalize foreign investment and included expansion of the Automatic Approval System, relaxation of post-investment controls, and reduction of special tax incentives.

- The Korean government will revise the Negative List to increase industries in which foreign investment is allowed, while it will reduce tax exemptions granted to foreign investors so that domestic and foreign invested firms will be able to compete on an equal basis.

- In addition, our government is stressing a policy of qualitative, rather than quantitative development and will diversify foreign investment source by encouraging foreign investment from European countries.

Discuss measures implemented in 1987 regarding foreign investment in the services sector and measures being considered to be implemented in 1988 and beyond.

- In July 1984, the government introduced the Negative List System in an effort to open foreign investment to foreigners. This resulted in liberalization of 97.5 percent of the manufacturing industry. We are now pursuing similar liberalization of the service sector, but at a graduated pace to protect the competitiveness of the infant domestic industry. Recently, the government abolished numerous restrictions imposed on the service sector including general trade, movie distribution and production and advertising industries in which foreign investors have displayed much interest.

- The Korean government will continue to gradually open the service sector in accordance with the national economic & social development.

(Unit : US\$ million)

Year \ Sector	Manufacturing	Service	Agriculture, Fishing, Mining	Total
'81	129	23	1	153
'82	122	65	2	189
'83	103	164	2	269
'84	254	167	1	422
'85	181	347	4	532
'86	269	87	1	354
'87	775	281	4	1,060

Discuss the effects of the measures implemented so far in foreign investment approved and effected by sectors and by countries.

Nineteen-eighty-seven witnessed increased levels of foreign investment in Korea. Surmounting difficult challenges on the domestic front, Korea ended the year boasting a total foreign investment approved amount that tripled that of 1986.

A. Investment by Country

Total foreign investment on an approval basis reached US\$1,060 million compared to US\$354 million in 1986. Total investments approved by country show the US at US\$225 million, 21 percent of total investments with 98 investment projects. Japan invested US\$494 million in 207 projects, representing 47 percent of total investmetns. European countries invested US\$210 million in 40 projects, a 20 percent share of total investments. Investments by other countries recorded US\$101 million for 33 proejects, 9 percent of the total.

B. Investment by Industry

Translated into investment according to industry, the manufacturing sector garnered the largest share of foreign investment, recording US\$775 million on an approval basis for 322 projects, 73 percent of total investments. Foreign investments in the service sector also increased substantially with total investment amount at US\$ 281 million for 36 projects, 26.5 percent of total investments. The agriculture, fishing and mining industry recorded the smallest share of foreign investment with US\$3 million, 0.5 percent of total investments.

C. Analysis

This outstanding performance brings the total foreign investment amount since 1962 to nearly US\$4.7 billion. Further, accompanying the new investment projects was a change in their composition. Responding to efforts by the Korean government, foreign investments have diversified with increased investment by European countries and greater investment in the manufacturing sector, particularly high-technology industries.

Foreign investments increased despite adverse domestic conditions because of Korea's continued efforts to provide a favorable investment climate and to liberalize foreign investment. The strong Japanese yen also had a positive effect.

D. Contribution of Foreign Investment to Export and Employment in Korea.

Foreign-Invested firms have been contributing to Korea's capital accumulation, technical transfer and trade balance.

In particular as of the end of 1986, the foreign-invested enterprises produced 1.8 of GNP. And the foreign-invested enterprise's exports and employment accounted for about 11% of the total exports and 5.2% of all the manufacturing industries.

E. Prospects for 1988

The outlook for foreign investment in 1988 is similarly bright. A robust economy and prime investment climate makes Korea an ideal investment country.

As Korea continues to further liberalize its markets, with particular focus on the service sector, and initiate steps to further simplify foreign investment procedures, it expects to attract greater numbers of foreign investors.

(Unit : Million Dollar)

Classification	Approved Amount					Effected Amount				
	'62-'84	'85	'86	'87	Total	'62-'84	'85	'86	'87	Total
By Country	2,746.0	531.7	353.7	1,060.2	4,692.8	1,922.0	235.8	477.4	624.8	3,260.0
Japan	1,398.3	363.4	137.7	494.4	2,395.5	957.9	68.7	267.3	372.7	1,666.6
United States	835.5	109.1	125.1	255.1	1,327.7	562.0	120.3	161.1	101.4	944.8
Europe	243.4	40.0	63.4	210.0	556.3	184.0	34.1	31.7	79.3	329.1
Others	268.8	19.2	27.5	100.7	413.3	218.1	12.7	17.3	71.4	319.5
By Industry	2,746.0	531.7	353.7	1,060.2	4,692.8	1,922.0	235.8	477.4	624.8	3,260.0
Chemical	384.8	44.8	30.8	153.4	608.3	339.0	20.9	15.0	45.7	420.6
Foodstuffs	95.6	3.6	44.4	50.3	194.0	64.6	4.2	17.9	39.2	125.9
Pharmaceutical	67.2	11.2	12.7	33.6	128.3	48.5	8.0	18.6	24.7	99.8
Metal	112.8	2.6	7.6	17.5	139.2	90.5	3.4	2.0	6.9	102.8
Machinery	136.5	50.7	29.8	87.6	261.1	88.4	6.0	17.1	25.8	137.3
Electronic	405.1	55.8	66.6	208.2	735.3	310.4	37.9	39.7	157.4	545.4
Financial Services	146.9	17.3	10.1	16.1	190.9	164.5	20.0	5.6	17.3	207.4
Hotels and Tourism	540.9	312.3	61.6	248.9	1,160.6	265.8	10.2	217.9	213.0	706.9
Construction	44.6	16.1	-	54.7	54.7	21.7	19.8	-	9.0	50.5
Others	811.6	17.3	90.1	189.9	1,220.4	528.6	105.4	143.6	85.8	863.4

Table V-34 of the questionnaire lists the amounts of foreign investments approved (by countries and by sectors). Have these amounts been affected and if not. Could we please have a table showing amounts actually effected.

Table V-34. Korea: Approval of Foreign Direct Investment by Home Country and Industry, 1983-87

(In millions of U.S. dollars during period)

	1983	1984	1985	1986	1987	Cumulative total approvals
By home country	267.8	419.1	531.7	353.7	1,060.2	4,692.8
Japan	167.5	163.8	363.4	137.7	494.4	2,395.5
United States	53.4	191.0	109.1	125.1	255.1	1,327.7
Europe	3.4	49.8	40.0	63.4	210.0	556.3
Others	3.5	14.5	19.2	27.5	100.7	413.3
By industry	<u>267.8</u>	<u>419.1</u>	531.7	353.7	1,060.2	4,692.8
Chemical	7.6	6.7	44.8	30.8	153.4	608.3
Foodstuffs	5.9	18.4	3.6	44.4	50.3	194.0
Pharmaceutical	20.8	6.4	11.2	12.7	33.6	128.3
Metal	1.8	5.1	2.6	7.6	17.5	139.2
Machinery	19.6	131.5	50.7	29.8	87.6	261.1
Electronics	41.4	67.5	55.8	66.6	208.2	735.3
Financial services	3.3	13.3	17.3	10.1	16.1	190.9
Hotels and tourism	155.7	118.4	312.3	61.6	248.9	1,160.6
Construction	3.9	22.5	16.1	-	54.7	54.7
Others	7.8	29.3	17.3	90.1	189.9	1,220.4

Source : Data provided by the Korean authorities.

- Total approved amounts have increased in recent years.
- There is a time lag of 1 to 2 years between approval of investment and actual inflow of approved amounts.
- Therefore, the ratio of actual inflows to approved amount for each year except in 1985 have decreased.

(Unit: million dollar)

	'86	'87
Actual invested amount (A)	477	625
Approved investment amount (B)	354	1,060
Ratio (A/B)	135%	59%

Provide amounts of investment approved and effected in the newly liberalized sectors.

Approval Date	Authorized projects	Foreign Investor	Foreign Investment Amount	Foreign Investment Ratio
1. 19.	Movie distribution	20th Fox	US\$100,000	100%
"	"	United International Pictures of Netherlands	"	"

87/12 general
 No distribution US\$100,000
 (private)

to import and sell in films and
 do raw materials to be processed for
 export using a bonded-warranty
 as clear certification.

INTERNATIONAL MONETARY FUND

Korea--1988 Article IV Consultation

Technical Meeting on Industrial Policy
At the Ministry of Trade and Industry,
March 22, 1987, at 2:00 p.m.

Meeting No. 20

Korean Representatives:

Fund Representative:

Ministry of Trade and Industry:

Mr. Lee Il-Kyu, Deputy Director
Industrial Policy Division
Mr. Kim Young-Min, Deputy Director
Small and Medium Industry Bureau

R. Baban*

Mr. Lee stated that the text on industrial policies and measures taken to support small and medium sized industries for 1986 and the early part of 1987 which was sent earlier by Mr. Baban is accurate. Since then, only one other set of rationalization measure applying to the urea and complex fertilizer industry has been adopted under the Industrial Development Law. Effective January 1, 1988, the import of chemical fertilizers was liberalized. Moreover, under the tariff quota system, the tariff on ammonia inputs was reduced from 10 percent to 2 percent. The Government also decided to privatize a state-run fertilizer company (Yongnam) and is negotiating the terms of sale to the Dongbo group, one of the 35 largest conglomerates. To provide incentives for this particular sale, the Government will ease the credit limit on the acquiring conglomerate as well as the limit on equity holdings between related companies, which is 40 percent under the Fair Trade Act.

Mr. Lee stated that overall industrial policy continued to be guided by several principles. Structural adjustment in the industrial sector would be smoothed by rationalizing declining industries, while promoting the transfer of high technology to growing industries. The scope of investment would be wide, thereby avoiding concentration, and consistent with international comparative advantage. The modernization of industries would be promoted to increase the productivity of existing plants. To promote balanced regional development, the establishment of rural industries would be encouraged. Mr. Lee stated that his division was in charge only of the overall framework for industrial policy. Detailed sectoral policies could be obtained from the various bureaus in the Ministry of Trade and Industry.

Mr. Kim regretted that he could not explain in English the developments in the small and medium industries in 1987. He provided a pamphlet on policies in English and two pamphlets in Korean on developments in 1987.

INTERNATIONAL MONETARY FUND

Korea--1988 Article IV Consultation

Policy Meeting on Balance of Payments
Economic Planning Board (EPB),
March 22, 1988, at 3:00 p.m.

Meeting No. 21

Korean Representatives:

Mr. Kang Bong-Kyun, Director-General, EPB
Mr. Maong Jung-Ju, Director, Financial
Planning Division, EPB
Mr. Chang Seung-Woo, Director, Overall
Planning Division, EPB
Mr. Cho In-Kang, Asst. Director, Financial
Mr. Lee Jong-Gap, Asst. Director, Overall
Planning Division, EPB

Fund Representatives:

Mr. Neiss
Mr. Baban
Ms. Jul
Ms. Tseng*
Mr. Katz
Mr. Le Fort

Current account projections

The current account surplus in 1987 was \$3-4 billion more than projected. Although the authorities intended to limit the surplus to around \$7 billion, policy adjustments were interrupted during the second half of the year because of uncertainties created by political developments and the labor strikes. Mr. Kang said that policymakers were cautious because they recalled that in the aftermath of severe political disturbances in 1980, export growth decelerated and real output declined, the only such decline in modern Korean history.

Mr. Kang said that policy adjustments implemented last year and the deterioration in external competitiveness brought about by the large wage increases are already working to reduce the current account surplus. The surplus declined from \$4 billion in the first half of 1987 to \$3 billion in the second half. Letters of credit received in the first quarter of 1988 declined to 20.6 percent compared with 27.9 percent in the fourth quarter of 1987 and 41.4 percent in the second and third quarters of 1987. On this basis, EPB projects the growth of export value to decelerate to 28.4 percent in the first quarter of 1988, 19.3 percent in the second quarter, and 8.1 percent in the latter half of the year (implying volume growth of 19 percent in the first quarter, 10 percent in the second quarter, and 4 percent in the second half of 1988).

Mr. Neiss said that the main differences between the projections prepared by the Fund staff and the EPB were exports and, to a lesser extent, services payments. Both projections incorporate a deceleration of export growth; while

there are uncertainties about the sharpness of this deceleration, he questioned the plausibility of virtually no growth in exports in the second half of this year. He said that the focus of discussions should not be on a specific forecast for the current account, but rather on the policies that will be implemented to manage the current account surplus. If adequate policies are in place, then the current account surplus will adjust over the medium term, although the surplus for 1988 could remain large due to lags. He noted that adjustment measures were interrupted during the second half of 1987 because of political developments; if additional action is delayed this year, adjustment will be further postponed and could become more disruptive.

Medium-term objectives

The authorities are preparing revisions to the Sixth Plan and details are not yet available. The medium-term objectives for the current account are to reduce the surplus to \$7 billion (5 percent of GNP) in 1988 and to \$6 billion (2-3 percent of GNP) by 1992. This adjustment path will enable external debt reduction to around \$20 billion by 1992 which will be matched by reserves and other foreign assets (deferred payments exports).

Mr. Kang said that the authorities' policy for current account adjustment will be import liberalization and tariff cuts, structural adjustment in industry and agriculture, and exchange rate flexibility. He said that this is only the third year of current account surplus for Korea after nearly three decades of deficits; adjustment of public opinion to a "surplus mentality" is slow. He thought that given developments already in place and the policy adjustments the authorities plan to make, drastic changes in policies are not needed to achieve adjustment. There are concerns about the impact of rising labor costs. If wage increases in the order of what occurred last year and early this year were to continue (20 percent), external competitiveness would deteriorate significantly unless further gains in productivity were made. Certain weak exporting firms have already closed down. Domestic savings will also decline from the present high level of 36 percent as the private sector adjust their consumption to higher incomes. The authorities have strong determination to achieve a reduction in the current account surplus and will make policy adjustments as necessary to achieve this objective.

INTERNATIONAL MONETARY FUND

Korea--1988 Article IV Consultation

Policy Meeting on International Finance
Ministry of Finance,
Wednesday, March 23, 1988 at 10:00 a.m.

Meeting No. 22

Korean Representatives:

Mr. Lee Hwan-Kyun, Director-General, International Finance Bureau
Mr. Lee Jung-Jae, Director, Foreign Exchange Policy Division
Mr. Kim Yong-Duk, Deputy Director, Foreign Exchange Policy Division
Mr. Kim Suk-Dong, Deputy Director, Foreign Exchange Policy Division
Mr. Pak Duck-Moon, Deputy Director, The Bank of Korea
Mr. Lee Kang-Nam, Deputy Director, The Bank of Korea

Fund Representatives:

Mr. Neiss
Mr. Baban
Ms. Jul
Ms. Tseng*
Mr. Katz
Mr. Le Fort

The authorities will aim to reduce the current account surplus in 1988 to \$7 billion through accelerated market opening, tariff cuts, and liberalization of exchange controls. While primary emphasis will be on these instruments, exchange rate policy will also be used to support current account adjustment. Mr. Lee noted that current account surpluses of Japan and Taiwan prevailed for more than ten years, and that Japan is the largest creditor country in the world while Taiwan has the second largest holding of foreign exchange reserves. In contrast, Korea's surpluses have been used to reduced external debt.

Exchange rate policy

The appreciation of the won, which was initiated during the first half of 1987, was interrupted during the second half of the year because of political developments, particularly uncertainties for exports and international competitiveness arising from large wage increases. However, the appreciation of the won resumed in the early months of 1988. The won appreciated by 5.5 percent vis-a-vis the U.S. dollar between end-December and March 22, 1988 (to Won 750.8). In real effective terms, as measured by the Korean authorities (WPI-based index), the won depreciated 3.3 percent between June-December 1987, but appreciated by 7.1 percent between December and February 1988.

The authorities manage the exchange rate in light of developments in the balance of payments and movements in the exchange rates of major currencies.

Mr. Lee said that there is no target for the real exchange rate for the remainder of the year, although he indicated that the real rate will be more appreciated if there were indications for the current account surplus to exceed the official target of \$7 billion.

The authorities plan to continue with their present exchange rate regime (managed floating). A floating rate regime is a longer term objective which would be developed together with further liberalization of the financial system.

Market opening policies

The proportion of unrestricted imports will increase from 93.6 percent as of December 31, 1987 to 95.4 percent on April 1, 1988. The average unweighted basic tariff rate was reduced from 19.3 percent in 1987 to 18.1 percent on January 1, 1988. Exchange controls on current transactions have shifted from a positive to a partial negative list system. The administrative procedures for approving invisibles payments have been made more efficient. The age limit on travel was lowered on two occasions in 1987 (July and September from 50 to 45 to 40). In July 1988, the age limit will be further reduced to 30, and complete abolition of the age limit in January 1989 is under consideration. Allowances for travel expenses was also raised to \$10,000 per person, and there are no limits for business travel. Mr. Lee thought that liberalization of invisible payments (travel and other payments) will have significant impact on reducing the invisibles surplus. He said the invisibles surplus already declined during 1987 from \$640 million in the first half of the year to \$310 million during the second half. He thought the invisibles surplus in 1988 will remain at about the 1987 level (\$1 billion).

Overseas investment

Restrictions on overseas investment by Korean residents have been liberalized. On March 25, 1988, individuals are permitted to invest up to \$1 million abroad, the requirement for inward remittances of investment earnings has been abolished, and procedures for approving overseas investment have been simplified by abolishing the interministry review process. The Government has also provided financial support for overseas investment, including reducing interest rates (loans for overseas investment are provided by the KEXIM bank, interest rate was lowered from 9 percent to 8.5 percent for large firms, and from 8 percent to 8.5 percent for large firms, and from 8 percent to 7 percent for small and medium firms), and improving terms (the financing ratio was increased from 70 percent to 80 percent for large firms, and from 80 percent to 90 percent for small and medium firms, and the repayment period was extended from 7 years to 10 years).

Foreign investment

Restrictions on foreign investment have been eased further. On April 6, 1988 (?), 26 manufacturing sectors were removed from the restricted list, making 97.5 percent of all manufacturing sectors in Korea open to foreign investment; overall 78.9 percent of all industries are open to foreign investment. As a result of revisions of foreign investment laws on July 1, 1987, investments in unrestricted sectors are automatically approved, post-

investment controls (remittances of profit) were abolished, and tax incentives for foreign investment were reduced so as to put both foreign and domestic firms on equal footing.

Capital controls

The authorities are considering restrictions on capital inflows to deter speculative capital inflows. However, the review process is not yet complete and details about the measures are not available.

External debt management

Prepayment of medium- and long-term external debt amounted to \$9 billion in 1987, of which \$6.8 billion was accounted for by the banking system, \$1.5 billion by the public sector, and \$0.7 by the private sector. In 1988, with a projected current account surplus of \$7 billion, prepayment of external debt is projected to be \$3.4 billion (\$1.9 billion banking system; \$1 billion public sector; \$0.5 billion private sector). Resources supporting the prepayment of external debt for the banking system are swaps, for the public sector are fiscal resources of the Government and for public invested enterprises and the private sector are foreign currency loans.

The authorities are modifying their Sixth Plan, including the objectives for external debt reduction over the medium term. Tentatively, the objectives are to reduce the current account surplus to \$7 billion in 1988 and \$6 billion during the medium term; external debt will be reduced from \$36 billion in 1987 to \$31 billion in 1988, \$27 billion in 1989, \$24.5 billion in 1990, \$23 billion in 1991, and \$22 billion in 1992. The medium-term objectives for reserves are not yet available, but Mr. Lee indicated that after external debt reduction, the current account surpluses will be used to finance overseas investment and some build-up of reserves.

Article VIII status

In response to a question from the mission, the authorities indicated that they will review the possible change to Article VIII status for Korea. The authorities thought that Korea has fulfilled all the prerequisites for Article VIII status with the exception of the convertibility of the Korean won for nonresidents, which could be a possibility in the near future. Mr. Neiss said that shift to Article VIII status will be in line with the liberalization of the Korean economy and the growing importance of Korea in the world economy. Mr. Neiss said that the Fund will provide information on the legal requirements for Article VIII status.

INTERNATIONAL MONETARY FUND

Korea--1988 Article IV Consultation

Meeting on Trade Policy, Ministry
of Trade and Industry
Wednesday, March 23, 1988, 3:30 p.m.

Meeting No. 23

Korean Representatives

Mr. Jae Uk, Director General, Multilateral
Trade Affairs
Mr. Won Ho Lee, Director, Trade Policy Division
Mr. Young Wook Noh, Director Trade Promotion
Policy Division
Mr. Han Soo Kim, Deputy Director, Export Division I
Mr. Sung Hwan Kim, Deputy Director, Trade Policy
Division
Mr. Sung Hun Lee, Deputy Director, Korean Trade
Commission
Mr. Young Tahk Park, Deputy Director, Industrial
M/C Division
Mr. Two-Ok Park, Deputy Director, Import Division

Fund Representatives

Mr. Neiss
Ms. Tseng
Ms. Jul *
Mr. Baban
Mr. Katz
Mr. Le Fort

Liberalization measures

With respect to further liberalization measures it was clarified that the newspaper article report stating that 40 items would be liberalized soon was erroneous. They were discussing if they should be liberalized because of price pressures but no decision had been made. They were discussing how to liberalize the remaining 361 restricted items. There were many items which would not be liberalized even by 1991 and this would be consistent with GATT principles. Items restricted were recommended items (their importation could be authorized if needed) and not prohibited. Their importation could be recommended because of price pressures.

As to the effect of the liberalization measures on imports they did not have an estimate. They had asked KIET to analyze these effects but the study was not ready yet. It should be finalized by the latter part of April.

The purpose of the surveillance list was not to restrict imports but to monitor the amounts imported. Even if these items were liberalized some of them were politically sensitive, for example luxurious goods which were regarded by the people as unnecessary items and they were put in the surveillance list just to prevent a surge in the imported amounts. The Import Relief System (IRS) was not in place prior to

July 1, 1987 so the surveillance list was implemented because dumping by foreign suppliers could occur when an item was liberalized. To the question of what would happen if the surveillance list was eliminated April 1, 1988, the Korean representatives answered that there had been a lengthy discussion about that and that it was concluded that the producers of the relevant products were not ready for the elimination of the list. Even if there would be only 8 months difference, many producers were reluctant and were insisting that the government maintain the announced schedule. Only 25 items remain in the list, mainly agricultural products. The Presidential decree for the enforcement of the Foreign Trade Act had already established the end of 1988 as the elimination date for the surveillance list so there was no need to continue discussing the issue.

With respect to import procedures, the Korean representatives stated that there was no bureaucratic red tape on items subject to automatic licensing. The Ministry of Trade and Industry had the authority to issue licenses but had delegated it to the foreign exchange banks which issue licenses without restrictions. Red tape may occur for the non-automatic licensing items. Imports subject to automatic licensing require three documents : an application form, an L/C, and the import contract. Items subject to special laws face a more cumbersome system. MTI was reviewing the applications of the special laws and a few days ago they had excluded 57 items from the application of these laws and had shifted 87 items from the licensing system to a reporting system. Last year they had streamlined the application of special laws tremendously.

Export restrictions

For the period January-September 1987, total exports amounted to US\$ 25.6 billion with US\$ 7.42 billion subject to restrictions (28.9 percent). These restrictions were affecting exports very seriously, especially electronic goods, footwear, and steel products. These restrictions also affected the level of investment in the domestic economy and reduced imports.

What does the decline in the ratio of restricted exports to total exports to OECD countries mean? For the main trading partners the ratio was not changing much: for Canada it had increased, for the US it had decreased a little, for Japan it had decreased a lot, for Australia it had decreased a little, for the EC countries it had increased, for the Nordic countries it had increased. They promised to provide detailed information by countries on these ratios (attached).

The total number of export restrictions had remained more or less stable since 1983 at about 100 items. They provided a list with the number of investigations started every year since 1983 (attached).

Export restrictions put pressure on producers to diversify markets and in that sense, the Korean representatives stated that they thought these restrictions could be beneficial to the country as in the long-run they help to strengthen the export structure. Export restraints had

led to increased sophistication of export products and had helped to alleviate the export concentration in certain countries. For example, the share of footwear exports to the US had declined from over 70 percent of total footwear exports in 1986 to 65 percent in 1987, that of exports of stainless steel kitchenware had decreased from 50 percent in 1986 to 40 percent in 1987, that of textile exports had dropped by 5 percentage points during the same period. Export restraints to the US had induced export surges to other countries, especially the EC countries. To the mission's counterargument that this market diversification will result in export restrictions by the EC, there was no answer from the Korean representatives.

In terms of the behaviour of exports subject to restrictions relative to those not subject to restrictions, it had been varied. Exports of iron and steel only grew by 2-3 percent in 1987, while textiles under quota increased by 37 percent while total textile exports grew by 34 percent.

Localization program

The main objective of the program was to substitute imports by reducing imports of raw materials and capital goods. Also, to develop new technology to increase the welfare of the country.

Two types of measures were being implemented:

- a) Technical assistance to small and medium sized firms.
- b) Provide reference information by announcing localization items. Once an item was announced by the government, private banks used that information when lending to small and medium-sized enterprises (project lending). It was only used as reference information.

So far they have announced 1,555 items since February 1986 when the program started. Criteria used to announce an item: a) There should be a request from at least one firm which was going to develop the item in question; b) Imports of the item should be mainly from Japan or a country with which Korea has a trade deficit; and c) The item should represent a technological contribution to the country.

The import substitution effect of the localization program had been estimated at US\$ 1.2 billion for 1986 and 1987. This number had been calculated by adding the estimated (by the private companies) import substitution effects of the items effectively developed (651 out of the 1,555 announced). This number could be overestimating the substitution effects by substantial amounts because the firms could have overestimated the potential substitution effects when requesting the announcement of an item so as to make the item appear more favourable and also because some of the substitution could have occurred even in the absence of the program.

Diversification program

The objective of the program was to diversify import markets away from Japan to the US and EC.

Measures implemented:

a) Dispatching buying missions to the US (1) and the EC(1) in 1987. The mission to the US was a 50-member mission, with the total amount purchased amounting to US\$1,969 million including aircraft and machinery. They will dispatch two missions to the US this year, one in May, the other one in October.

b) Designated 100 large companies as the main target firms to expedite the diversification program and designated 235 items as the objective of the diversification. They were encouraging these companies to do their best to shift their import source from Japan to the US and EC.

c) Established in June 1987 a consulting center to solve the obstacles to import from the US and EC.

d) They were trying to establish an After Service System (ASS) for imports of machinery. The system was to be managed by the Buyers Agents Association. These agents would get together to service the machinery they import in cooperation with the relevant firms.

e) Provided US\$ 3 billion in foreign financing for imports originating in the US and EC in 1987 and will provide another US\$ 3 billion this year.

f) Designated another 100 items for diversification, with the government and the private sector providing information concerning these imports. They will hold exhibitions of these goods produced in the US and EC and also in Japan.

They did not have information concerning the reaction of Japanese firms to this program. The Korean private sector has been very cooperative, large companies were expediting diversification. Japan had complained to the GATT on the products designated but not on the program.

They had a critical imbalance with Japan. Imports from Japan were needed to be able to export to Japan as well as to other countries. They were trying to decrease the deficit with Japan even if there was a disadvantage when importing from other sources. They needed to do their best to diversify so as to reduce their dependency on Japanese raw materials and parts. If Japanese exporters manipulated their export scheme, Korea would be affected. The main purpose of the diversification was to avoid overdependency and they were willing to pay the cost of it.

Also, they were trying to increase their exports to Japan by dispatching sales missions, establishing a permanent exhibition hall, and by allocating export quotas on a ratio of 2 to 1 to those exporting to Japan. There had been a reduction in the trade deficit with Japan in 1987 mainly due to the appreciation of the yen.

Korean Trade Commission (KTC)

Not much had been happening yet in this area because:

- 1) Of the short history of the KTC, local firms were not familiar with the new system.
- 2) The surveillance system was still in place and the most sensitive items were protected under this system. Companies will need the Import Relief System (IRS) in 1989 to protect themselves from a surge in imports, so the number of petitions is expected to increase in the future.

Export Projections for 1988

The Korean representatives were very concerned with what they considered to be overoptimistic export projections by the mission. They stated that up to now the won appreciation had been less than that of the yen and the Taiwanese dollar but that for 1988 both currencies were depreciating while the won was appreciating at an annual rate of more than 20 percent. Also, wages had increased by 17.2 percent in 1987 with effects being felt this year when the wage rate was expected to increase by 15 percent. Great problem for manufacturing exports. This month, the LC's acceptance rate of growth had dropped to 12 percent compared to a 35-40 percent increase in the second half of 1987. They were rather pessimistic on the expansion of exports in the latter part of 1988. They were analyzing very carefully the projections in terms of the composition of exports. Producers of textiles and in miscellaneous industries were very pessimistic on export performance in the latter part of 1988 and these items were still very important export items. They could not understand the Fund's projections. They asked the mission to be cautious and to gather all the pertinent information. pertinent information.

Mr. Neiss replied that the mission was projecting a decline in the export volume from 24 percent in 1987 to 14 percent in 1988 and that we were assuming a 5 percent appreciation of the won (which had already taken place) as we did not know what was planned for the rest of the year. We had also incorporated the high increase in wages but had included the fact that productivity was increasing very fast, largely compensating for the wage increase with the effect on costs being much smaller.

Closing of firms in 1987 amounted to 1.8 percent of the number of firms exporting, while in 1988 this percentage had climbed to 16.8.

Export of Restricted Items (by country)

(Unit: US\$ thousand, %)

year	1985			1986			1987 (1-9)		
	Total Export (A)	Export under Restriction (B)	Ratio (B/A)	Total Export (A)	Export under Restriction (B)	Ratio (B/A)	Total Export (A)	Export under Restriction (B)	Ratio (B/A)
U. S	10,754,100	4,656,224	43.3	13,879,958	4,620,791	33.3	13,084,487	3,634,218	27.8
Canada	1,228,650	381,745	31.1	1,247,699	438,762	35.2	1,005,173	467,436	43.9
Japan	4,543,434	1,453,815	32.0	5,425,746	1,065,162	19.6	5,732,870	1,131,508	19.7
Australia	368,774	127,920	34.7	534,589	138,266	25.9	441,847	95,792	21.7
EC (common)	3,160,040	933,196	29.5	4,304,836	1,537,721	35.7	4,682,417	1,800,881	38.5
- W. Germany	979,326	312,192	31.9	1,241,842	448,204	36.1	1,433,003	545,544	38.1
- U. K	913,364	220,466	24.1	1,034,094	328,613	31.8	1,066,602	438,403	41.1
- France	315,779	131,352	41.6	543,047	204,676	33.7	628,448	239,767	38.2
- Netherlands									
- Belgium	460,213	152,129	33.1	759,547	237,575	31.3	720,056	285,059	39.6
- Luxemburg									
- Denmark	62,053	28,828	46.5	99,660	42,113	42.2	101,240	49,120	48.5
- Italy	184,288	76,902	41.7	319,164	149,610	46.9	384,235	157,304	41.0
- Greece	231,296	6,417	2.8	115,431	8,926	7.7	78,657	16,521	21.0
- Ireland	13,721	6,135	44.7	17,205	7,456	43.3	17,658	6,266	35.5
- Spain				143,208	47,654	33.3	210,920	52,662	25.0
- Portugal				31,638	1,771	5.6	41,598	10,144	24.4
Finland	32,700	2,362	7.2	55,178	4,436	8.0	68,321	7,461	10.9
Norway	484,757	11,306	2.3	379,687	15,493	4.1	79,543	14,820	18.6
Sweden	208,843	28,263	13.5	181,306	37,636	20.8	404,622	39,129	9.7
Austria	70,011	14,814	21.6	93,898	20,841	22.2	115,597	18,918	16.4
New Zealand	37,922	37,922	100.0	76,465	76,465	100.0	87,314	n.a	n.a
Total Export to above country	20,889,231	7,648,792	36.63	26,179,362	8,116,944	31.0	25,674,877	7,426,687	28.9
Total Export of Korea	30,283,122		25.3	24,714,470		23.4	33,326,833		22.3

Initiated Number of Anti-Dumping Cases against Korea

Year	'83	'84	'85	'86	'87
Number	15	11	15	13	10

INTERNATIONAL MONETARY FUND

Korea--1988 Article IV Consultation

Meeting on Tariff Policy, Ministry
of Finance

Wednesday, March 23, 1988, -5:00 p.m.

Meeting No. 24

Korean Representatives

Mr. Yang Seung-Mahn, Director, Customs
and Tariff Bureau
Mr. Kim Chong-Ho, Deputy Director,
Customs and Tariff Bureau
Mr. Yim Tae-Hee, Deputy Director
Customs and Tariff Bureau

Fund Representatives

Mr. Neiss
Ms. Jul *
Mr. Baban
Ms. Tseng
Mr. Katz
Mr. Le Fort

Tariff measures implemented

Basic tariff rates had been reduced as scheduled. For some items tariff reductions had been accelerated using the flexible tariff system. A guideline of the tariff reduction program had been to achieve 20 percent rates for most manufactured products(modal rate). As some of the manufactured products had a 10 or 15 percent tariff rate at the start of the tariff reduction process, their rates were increased to 20 percent in some cases and those increases accounted for reported tariff increases according to the basic tariff modification schedule announced in 1983. Tariff reductions were one of the factors which had contributed to the increase in the volume of imports in the past few years.

Tariff measures planned

A special commission had been formed to conduct an overall review of tariff levels and structure. The concrete level of tariff reduction will be decided by that committee. The revision will be finalized by end July 1988 and is expected to be approved by end December 1988 by the National Assembly and to be implemented with the 1989 budget. The present tariff structure was determined in 1983. The main objective of the restructuring is to narrow the dispersion of tariffs by processing stages and across industries. Under the present system, the tariff policy was determined by the Ministry of Finance (MOF) while the industrial policy (restructuring) was decided by the Ministry of Trade and Industry (MTI). Starting with this next revision of tariffs it is certain that there will be more emphasis on tariff policy than on industrial policy as such. The overall tariff rate will be lowered and the tariff structure modified. The objective is to even effective protection among industries with a lower central rate for raw materials than for finished goods.

The tariff reductions implemented so far via concessional tariffs will be incorporated into the basic tariff. They will probably continue to use tariff quotas on specific items, as the purpose of tariff quotas and emergency tariffs is to respond to changing economic conditions, internationally and domestically. The government had applied the quota system to stabilize domestic prices.

Emergency tariffs were set in accordance with GATT principles. They conformed to Article XIX of the GATT. If imports increased too much in volume they could cause serious injury to the domestic industry and emergency tariffs were imposed. They were trying to minimize the number of items subject to these tariffs. A large trade surplus and trade frictions had led the government to minimize the use of these tariffs. Also, at present they were no longer using adjustment tariffs.

Will the administration of the emergency tariff system be transferred from the Ministry of Finance to the Korean Trade Commission? Not at this stage. Request for imposition of an emergency tariff could come from the Ministry of Trade and Industry, from the Ministry of Agriculture, or from other authorities concerned with the Ministry of Finance deciding on the imposition of the tariff. Both functions could be integrated.

It is very difficult to eliminate the drawback system. The long-term plan of the government is to abolish this system as well as other tariff exemptions.

They will apply the same guidelines for agricultural and manufactured products, but they will continue to protect agriculture the same as other countries do by continuing preferential treatment to this sector. There is a discussion going on between the MOF and the Ministry of Agriculture in this respect but the present tariff schedule on agricultural products will be reduced. It is a very delicate political problem. The enormous gap between rural income and urban income and the fact that it is widening should be taken into account.

How will the tariff reduction schedule be affected by the Uruguayan Round?

It will be decided by the Korean Trade Commission(KTC). In their opinion, the KTC will reduce tariff rates prior to the conclusion of the Uruguayan Round, because there are many supporters of tariff reductions although many producers are against it. Then they would reduce tariffs to the level the government wants to achieve through the Uruguayan Round. The Korean representatives stated that they expect the tariff level of Korea to be the same as that of the advanced countries at the completion of the Round and that they will try to get credit for unilateral changes. The government wants to reduce tariff rates to cooperate with the international economy, to increase trade flows with other countries.

The introduction of the Harmonized System (10-digit HS) has required

negotiations among countries because in adopting the new system countries increased existing concessional rates. Korea conducted six sessions of negotiations with trading partners, because even if Korea did not modify rates when it adopted the HS, other trading partners did.

INTERNATIONAL MONETARY FUND

Korea--1988 Article IV Consultation

Minutes of the Final Meeting
March 25, 1988, at 3:35 p.m.

Meeting No. 25

Korean Representatives:

Mr. Yang Seung-Man, Director,
Customs Bureau, MOF
Mr. Chae Jae-Uk, Director-General,
Ministry of Trade and Industry
Mr. Lee Won-Ho, Director, Ministry of
Trade and Industry
Mr. Lee Hwan-Kyun, Director-General,
Ministry of Finance
Mr. Hong Jae-Hyong, Assistant Minister, MOF
Mr. Maeng Jung-Ju, Director, Economic
Planning Board
Mr. Kim Han-Gon, Director-General,
Ministry of Agriculture
Mr. Huh Noh-Choong, Director, MOF
Mr. Park Cheul, Deputy Director, Bank of Korea

IMF Representatives:

Mr. Neiss
Ms. Jul
Mr. Baban*
Ms. Tseng
Mr. Katz
Mr. Le Fort

The Assistant Minister Hong invited representatives of various ministries to make comments on the mission's statement.

Director-General of the Ministry of Trade and Industry suggested that the text on the diversification and localization programs should read to the effect that these programs should be pursued in accordance with comparative advantage and that they should be reviewed (rather than phased out) as global adjustment of trade proceeds. Mr. Lee of MTI added that localization is one of the most important programs of his ministry. Korea has a large structural surplus with Japan and it is necessary to reduce that surplus, partly through localization, and partly through shifting purchases to the United States and the European Community. Korea wants a sound relationship with its three largest trading partners. It is not the intention of MTI to have these programs forever.

Mr. Neiss said that there is no fundamental disagreement. He recognized that these programs were adopted not to make trade more advantageous for Korea but to redress trade imbalances, which have given rise to trade frictions. Nevertheless, there are costs involved and the point is not to have them permanently. As adjustment proceeds, bilateral balances would also be reduced.

In brief, Korea should not be obliged to intervene in a manner not compatible with comparative advantage.

Director-General Kim of the Ministry of Agriculture suggested that the adjective "accelerated" should be replaced by "gradual" in the reference to import liberalization, including agricultural products. His ministry is now in the process of formulating its 1988-91 liberalization program. He felt that accelerated was too strong a word.

Mr. Neiss stated that agriculture should be liberalized as a matter of principle. Accelerated could mean faster than in the past or faster than planned in the future. Since the latter has not been disclosed, the former could be construed as its meaning. The world should know that Korea is reacting to calls for adjustment. If the text is too weak, it will only invite more criticism. "Accelerated" could be replaced with "substantially faster pace than in the past" to make the meaning clear.

Assistant Minister Hong, referring to the recommendation on exchange rate policy, suggested the removal of the word "recent" before trend and the adjective "significant" before real appreciation. Mr. Neiss stated that it was important to know what is meant and how best to present it. The mission recommends a significant exchange rate appreciation, not a drastic amount which will induce shock, but certainly more than last year. He stressed that real appreciation does not just refer to the won/US dollar rate, it also takes into account domestic cost factors and movements in other exchange rates. He suggested that the authorities do not read too much in the word "significant". There are uncertainties in the labor market and the recommendation could be modified in the light of developments. If the wage round in 1988 turns out to result in substantial wage increases, another careful look at the exchange rate issue would be needed. It may be that substantial real appreciation may occur through wages. Before the staff appraisal is written, the staff will consult with the authorities to find a way to state the staff's position without undesirable side effects in Korea.

Assistant Minister Hong requested that the Korea target for the current account surplus be included in the staff report.

In his closing statement, Mr. Hong thanked the mission for its efforts to analyze the Korean economy. The mission's statement would be useful as a reference, particularly during this time of transition. There is a clear consensus in the direction of economic policy and on the instruments of adjustment. Where there is a difference of view is on the strength of the process of adjustment now underway. He assured the mission that Korea will utilize all available tools to contain the external surplus to a manageable level. He again thanked the mission for its understanding of Korean policies and constraints.

Mr. Neiss thanked the authorities and their staff for their assistance and cooperation. He noted that the difference in view of the strength of the adjustment underway underlies the wait-and-see position of the authorities and mission's position that the Government should press ahead with further adjustment measures.

INTERNATIONAL MONETARY FUND

April 15, 1988

Mission members:

Please find attached a corrected
version of Minute No. 10.

WT
Wanda Tseng

Attachment

INTERNATIONAL MONETARY FUND

Korea--1988 Article IV Consultation

Technical Meeting on International Finance
Ministry of Finance
March 17, 1988 at 2:30 p.m.

Meeting No. 10

Korean Representatives:

Mr. Lee Jung-Jae, Director, Foreign Exchange
Policy Division, MOF
Mr. Kim Suk-Dong, Deputy Director, Foreign
Exchange Policy Division, MOF
Mr. Kim Yong-Duk, Deputy Director, Foreign
Exchange Policy Division, MOF
Mr. Pak Duck-Moon, Deputy Director, Foreign
Exchange Department, Bank of Korea
Mr. Lee Kang-Nam, Deputy Director, Research
Department, Bank of Korea

Fund Representatives:

Mr. Neiss
Ms. Jul
Mr. Baban
Ms. Tseng*
Mr. Katz
Mr. Le Fort

Current account developments 1987

The current account surplus increased to \$9.8 billion (8.3 percent of GNP) in 1987, compared with \$4.6 billion (4.9 percent of GNP) in 1986. The larger surplus reflected a near doubling of the trade surplus and the shift of the services balance to surplus from deficit.

The trade surplus rose to \$7.7 billion in 1987, compared with \$4.2 billion in 1986. Exports rose by 36 percent and imports rose by 30 percent; the volumes of exports and imports both grew strongly (24 percent and 22 percent, respectively); and the terms of trade improved by 3 percent. Export unit values rose by 9 percent reflecting the effects of the appreciation of the won against the U.S. dollar and wage increases. Import unit values rose by 7 percent reflecting mainly the 20 percent increase in oil prices, non-oil import unit values increased by only 6 percent. 1/

The services balance shifted to a surplus of \$0.9 billion in 1987, compared with a deficit of \$0.6 billion in 1986. This reflected mainly a 49 percent increase in travel receipts, a 58 percent increase on receipts from overseas construction, and a 12 percent decline in interest payments on external debt. The increase in travel receipts reflected increases in both the number of tourists (13 percent) and per capita expenditures (31 percent). The

1/ World trade prices for non-oil primary commodities rose by 4 percent and for manufactures by 12 percent.

increase in overseas construction receipts reflected the results of market diversification and improved external demand.

Capital account developments 1987

The capital account recorded a deficit of \$4.8 billion on debt-related capital, a surplus of \$0.6 billion on nondebt-related capital, and a surplus in errors and omissions of \$1.3 billion.

Nondebt-related capital flows arise from suppliers' credits extended by Korean residents (mainly shipbuilders and other capital goods manufacturers), direct and portfolio foreign investment, and other asset transactions (e.g., overseas subsidiaries, short-term trade credits). The nondebt-related capital account balance shifted to surplus from deficits in previous years. This was mainly due to increases in inflows of net foreign direct investment, export suppliers' credit, and reduction on payment for overseas subsidiary debt. Foreign direct investment rose by 36 percent reflecting the favorable business environment in Korea and the liberalization of controls on foreign investment. Export suppliers' credit showed an inflow mainly because the gross outflow of new suppliers' credits declined to \$1.1 billion in 1987 from \$2.1 billion in 1986 reflecting sluggishness in the shipbuilding industry. Amortization payments on the stock of promissory notes held by Koreans rose slightly to \$1.3 billion because of the relatively high interest rate (8 percent) on promissory notes. Thus, there was a net inflow of suppliers' credits of \$0.2 billion together with sales of promissory notes amounting to \$0.2 billion. Payment for overseas subsidiary debt decreased to \$0.3 billion in 1987 from \$1.0 billion in 1986 reflecting the restructuring of the overseas construction industries.

Mr. Kim Suk-Dong said that he was unable to determine the reason for the large positive entry of errors and omissions in 1987, noting that errors and omissions accounted for only 1.5 percent of the value of total trade. Nevertheless, he speculated that acknowledged that exchange rate expectations may have induced an acceleration in export receipts and delay in import payments, giving rise to the surplus on errors and omissions.

External debt developments

Total amortization amounted to \$14.9 billion in 1987, of which \$9 billion represented prepayment of external debt. Prepayment by financial institutions amounted to \$6.9 billion (financed by the Bank of Korea, including swaps), the public sector \$1.5 billion (financed by fiscal resources and foreign currency loans), and the private sector \$0.7 billion (financed by foreign currency refinancing loans).

Gross foreign financing requirements (for amortization, export suppliers' credit, reserve increases, errors and omissions, and others) amounted to \$5.7 billion in 1987. After account is taken of nondebt financing (gross direct investment inflows and sales of promissory notes), gross borrowing requirements amounted to \$4.8 billion.

Total external debt fell by \$8.9 billion to \$35.6 billion (30.2 percent of GNP) in 1987. As the prepayment of external debt affected medium- and long-

term debt, the proportion of short-term debt rose to 25.8 percent of total debt, compared with 20.8 percent in 1986. As most of the short-term debt represented trade credits, there was little scope for further reduction in short-term debt. The debt service ratio rose to 32.3 percent reflecting the prepayment of external debt; excluding prepayments, the debt service ratio was 16.4 percent.

International reserves

Gross reserves rose to \$10.2 billion at end-1987; however, the import cover fell to 2.6 months. Excluding foreign exchange reserves held by the local branches of foreign banks, gross reserves rose to \$9.2 billion at end-1987.

Surplus management measures

Measures implemented to manage the current account surplus in 1987 included: (1) import liberalization (removing 167 items from the restricted list, thereby increasing the liberalization ratio to 93.6 percent); (2) reducing the average unweighted basic tariff rate to 19.3 percent from 19.7 percent; (3) reducing the number of items on the surveillance list to 48 items from 106 items; (4) revising special laws; (5) providing special financing (at preferential interest rates, 1.25 percentage points above LIBOR) for imports from countries with which Korea has a trade surplus; (6) reducing the domestic financing ratio for exports; (7) relaxing controls on invisibles payments; and (8) appreciation of the won.

Liberalization of invisible payments

Controls on invisibles payments were liberalized on three occasions--in July 1987 and December 1987, and March 1988. In July 1987, the measures taken were: (1) basic travel allowance for business and culture was maintained at \$3,000, for tourism raised to \$3,000, and for students the basic allowance was maintained at 2,000 but monthly allowances were increased from \$1,000 to \$1,500; (2) automatic payment for foreign services was raised from \$10,000 to \$50,000; (3) payment of advertising expenses to intermediaries and agents was permitted (previously, only direct payment to advertising entities was permitted); and (4) personal remittances for subsistence allowance, living expenses, and other personal expenses up to \$500 was permitted. In September 1987, the age limit for overseas travel for tourism was lowered to 45 from 50.

In December 1987, the following measures were implemented: (1) the basic travel allowance was increased to \$5,000, and procedures for overseas travel expenditures were simplified; the age limit for overseas travel for tourism was lowered to 40; (2) holding and usage of multiple credit cards for travellers were permitted; (3) surrender requirements were relaxed by permitting residents to hold up to \$5,000 in unused travel expenses and increasing the ceiling of foreign exchange holdings for money exchanges and coin dealers; (4) automatic payment for foreign services was increased to \$100,000; (5) personal remittances were raised to \$1,000; and (6) the denomination of international contracts in won was permitted.

In March 1988, the following measures will be implemented: (1) A partial negative list system will be introduced for invisibles payments; automatic

payments for current transactions up to \$10,000 will be permitted; automatic payments for all external transactions up to \$2,000 will be permitted; (2) residents may hold foreign currency in cash or travellers checks up to \$5,000 regardless of the source of the foreign exchange. Additional measures being considered for implementation in April 1988 include: (1) portfolio investment for securities companies of up to \$30 million, and for investment trusts and insurance companies of up to \$10 million will be permitted; (2) the age limit for overseas travel for tourism will be lowered to 35 years; and (3) the ceiling and eligibility for emigrant expenses will be increased.

Overseas investment

Relaxation of controls concerning overseas investment will be phased, taking into account its impact on promoting internalization and the portfolio management capability of domestic firms. In the initial stage, the emphasis will be on investments that introduce high technology or that overcome barriers for exports.

The following measures were implemented in 1987 (dates in parentheses indicate when the measure was introduced): (1) The types of business eligible for overseas investment were increased to include real estate and services (April 15, 1987). Investment in real estate was permitted, without limitation, when it is related to doing business, including the purchase of warehouses, offices, representatives' headquarters, and for supporting security; contractors were encouraged to raise funds locally to finance their real estate development; however, the purchase of real estate for speculation was prohibited. In addition to investment in general manufacturing, which was already permitted, investment in service industries, including hotels, restaurants, and transportation, were permitted. (2) Investment in kind was permitted for private enterprises, e.g. purchase of machinery (April 15, 1987). (3) The administrative procedures for approving overseas investment were simplified; the amount of investment requiring review by the Committee on Overseas Investment Project was raised to \$5 million from \$1 million (April 1, 1987). (4) The limits on retention of profits for overseas investment was raised to \$500,000 from \$50,000 and eliminated on March 25, 1988. (5) An automatic approval system for investments not exceeding \$1 million was introduced for investments which met certain appraisal standards by the financing bank. 1/ (6) Financial assistance for overseas investment was increased and the terms made more attractive. The Korea Export-Import Bank will provide overseas investment credit amounting to W 40 billion in FY 1988; the interest rates were lowered from 10 percent first to 9 percent then to 8.5 percent (on March 9, 1988) for large firms, and from 9 percent to 8 percent and then to 7 percent (on March 9, 1988) for small- and medium-sized firms. Effective January 1988, KEXIM began direct lending to the local subsidiaries of Korean firms. (7) The Overseas Development Cooperation Fund (EDCF) provides concessional loans to Korean private firms to support their venture projects in developing countries. (W 5 billion was allocated to the Operational Program of EDCF in FY 1988). (8) Tax incentives have also been granted to overseas investment by raising the maximum reserve ratio of the reserves for overseas investment deficit to 15 percent from 10 percent (reserves are deducted from

1/ Requirements Checking System whereby automatic permission is given when the score in an appraisal prepared by a bank is not less than 60 points or 55 points for small- and medium-sized firms.

taxable income, and payment of taxes on these reserves are postponed). (9) The information system for overseas investment was strengthened.

Capital account projections 1988

Projections for the capital account for 1988 were provided after the meeting. On the basis of a current account surplus of \$7 billion, MOF projects amortization (including \$1 billion for the banking system) to amount to \$7 billion; gross borrowing requirement to be \$2.7 billion; and net debt-related outflows (including banking system) to amount to \$4.4 billion. Mr. Kim Suk-Dong explained that the gross borrowing is undertaken both by the public and private sectors and include loans already contracted and borrowings to prepay external debt. Of the amortization of \$7 billion, \$3.4 billion will represent prepayments. Mr. Kim said that prepayment beyond 1988 will be relatively small as the proportion of external debt with unfavorable terms would have been reduced significantly. Net nondebt-related outflows are projected to be \$0.6 billion, mainly reflecting the increase in overseas investment and export suppliers' credit given. External debt would fall by \$4.7 billion to \$31 billion and reserves would increase by \$1.8 billion to \$12.0 billion.

Later, Mr. Kim supplied capital account projections on the assumption that the current account surplus will be \$11 billion. He said that \$1 billion of the surplus will be used to reduce external debt (\$0.5 billion above the line and \$0.5 billion below the line), and that the remainder \$4 billion will be used to increase reserves.





Office Memorandum

Mr. Neiss
cc: HX
Div E

1988 APR -7 AM 10:49

ASIAN DEPARTMENT

April 6, 1988

To: Mr. Tanzi
From: Menachem Katz *MJK*
Subject: Korea: The 1988 Article IV Consultation
Back-to-Office Report

I participated in a staff team, headed by Mr. Neiss (ASD), that visited Seoul during March 14-30, to conduct the 1988 Article IV consultation.

Korea's remarkable economic performance has continued despite political upheaval and labor unrest. Rapid growth (12 percent) fueled by strong export performance, price stability, and a large current account surplus--US\$10 billion equivalent to 8 percent of GNP--were the main characteristics of the Korean economy in 1987. We expect economic growth to remain strong in 1988 and the current account to record a surplus of some US\$11 billion. In order to avoid a rekindling of inflation and trade frictions, the authorities aim at reducing the current account surplus over the medium term to 2-3 percent of GNP. To this end, significant market opening measures and tariff reductions have already been implemented and further measures are being planned; and the wage increases of late last year have resulted in a 13 percent real appreciation as measured by relative unit labor costs. New wage awards are expected during April/May of this year.

Fiscal policy in 1987 was designed to be somewhat more expansionary than in the previous year (Table attached). The accounts of the consolidated Central Government were programmed to be in balance, with revenue remaining constant as a proportion of GNP and expenditure rising by 1 percentage point; the change in the fiscal stance was to turn from a negative 0.8 percent of GNP to a positive impulse of about 1 percent. The Central Government was budgeted to move from balance in 1986 to a deficit equivalent to 1 1/2 percent of GNP.

However, owing to a stronger than projected performance of exports and imports and buoyant domestic economic activity, revenue was considerably higher. As a result, the consolidated Central Government is estimated to have recorded an overall surplus equivalent to about 1 percent of GNP, and the slightly expansionary effect of fiscal policy on domestic demand envisaged in the original 1987 Budget was replaced by a neutral fiscal stance.

The Central Government recorded a balanced budget. Helped by an increase in the import duty on petroleum and larger import value, import tax revenue rose by 36 percent over 1986; and largely owing to a sharp increase in exports, corporate income tax rose by 40 percent; special excise rates on 30 consumer durables were reduced in mid-1987 but their impact on revenue was small. On the expenditure side, a severe flood in mid-year necessitated a supplementary budget of

W 500 billion (0.5 percent of GNP) in the second half of the year. Notwithstanding the supplementary budget and a somewhat larger deficit for the Grain Management Fund as a result of less favorable price developments, the sharp increase in revenue more than offset the higher expenditure. Nonfinancial public enterprises, largely owing to a slowdown in investment, have recorded an overall surplus of 0.5 percent of GNP, compared to a balance in the original budget.

In 1988, fiscal policy was programmed to be moderately more expansionary. The consolidated Central Government targeted an overall deficit equivalent to 1 percent of GNP, implying a positive stimulus to aggregate demand of 3/4 percent of GNP; the central government deficit was budgeted at the equivalent of 1.2 percent of GNP. No new tax measures were introduced with the 1988 budget, although a reduction in excise taxes of mid-1987 and a lowering of the petroleum import duty from 24.5 to 10 percent in October of 1987 were expected to have some negative effect on revenue. Also, owing to lower petroleum prices and lower petroleum levy, revenue of the Petroleum Business Fund was projected to be considerably lower. On the other hand, the introduction of the National Pension Plan is expected to contribute some 1/2 percent of GNP to the consolidated central Government revenue. Nonfinancial public enterprises were budgeted to be broadly in balance, with investment activity recovering following a decline in 1987.

Other programs presented with the 1988 budget were minimum wage legislation--no budgetary impact; and the introduction of medical insurance to rural areas which would extend coverage to 8 million new participants at a small cost to the budget.

Owing to the fact that central government revenue projections were made before the strong revenue performance of 1987 became evident and a subsequent upward revision of macroeconomic indicators for 1988, the receipts program in the original 1988 budget appears considerably underestimated. Recognizing the potential budget surplus and in an attempt to counteract inflationary pressures, the authorities lowered excise taxes on 30 consumer goods from 5-100 percent to 3.5-70 percent, effective April 1, 1988; the revenue loss of this tax reduction would be relatively small. Revised staff projections indicate that the consolidated Central Government would record an overall surplus of about 1 percent of GNP--equal to the overall surplus in 1987; the impact of fiscal policy on domestic demand would be virtually neutral.

As the economy is operating at about full capacity, there is limited scope in the short run to support current account adjustment through demand management without igniting inflation. Fiscal policy should take a broadly neutral stance. The small surplus projected for the consolidated Central Government in 1988--about 1 percent of GNP--provides scope for a modest fiscal stimulus. As fiscal stimulation through expenditure increases is likely to be inflationary, it would be preferable to stimulate domestic demand through tax reduction. In

particular, import duty and excise tax reductions on consumer durables would stimulate consumption and raise imports while counteracting inflationary pressures.

Over the medium term, as export growth decelerates, fiscal and monetary policies should play an important role in maintaining domestic demand at adequate levels. In addition to an easing of fiscal policy, the structure of the tax system should be reformed so as to reduce the existing bias against imports and consumption, and in particular, the reliance on import taxes for revenue, the tax incentives for saving and the remaining advantages in the tax system to exporters (estimated at about 1 percent of the increase in the value of exports in 1987).

Attachment

cc: Mr. Neiss
Mr. Tait
Mrs. Ter-Minassian
Mr. Nashashibi

3/29/88

Table . Korea: Summary of the Consolidated Central Government, 1/ 1985-88

	1985	1986	1987 Budget	1987 Prel.	1988 Budget	1988 Proj.
	(In billions of won)					
Revenue	15071	16969	18712	20128	20586	22510
Expenditure and net lending	15270	16092	18797	19275	21580	21580
Overall balance	-199	877	-85	853	-994	930
Financing	199	-877	85	-853	994	-930
Domestic	-241	-731	42	-896	996	-928
Bank	-195	-351	-612	-1550	168	-1756
Nonbank	-46	-380	654	654	828	828
Foreign	440	-146	43	43	-2	-2
	(In percent of GNP)					
Revenue	20.7	20.2	20.2	20.6	19.5	20.2
Expenditure & net lending	21.0	19.2	20.3	19.8	20.4	19.3
Overall balance	-0.3	1.0	-0.1	0.9	-0.9	0.9
Financing	0.3	-1.0	0.1	-0.9	0.9	-0.9
Domestic	-0.3	-0.9	0.0	-0.9	0.9	-0.9
Bank	-0.3	-0.4	-0.7	-1.6	0.2	-1.6
Nonbank	-0.1	-0.5	0.7	0.7	0.8	0.7
Foreign	0.6	-0.2	0.0	0.0	-0.0	-0.0
Memorandum items:						
Fiscal impulse	-0.80	-0.88	0.96	-0.03	0.75	0.27
GNP (billions of won)	72850	83976	92571	97532	105611	111577

Sources: Data provided by the Korean authorities; and staff estimates.

1/ Includes : General Account, Special Accounts, Government Funds, Public Enterprise Funds the Petroleum Business Fund (PBF), and the Public Service Pension Fund.
Totals may not add up due to rounding.



Office Memorandum

→ MD

VLL
2002
Apr. 3, 1988

CONFIDENTIAL

March 30, 1988

TO: The Managing Director
The Deputy Managing Director ✓

FROM: P.R. Narvekar PRN

SUBJECT: Korea--1988 Article IV Consultation Discussions

Attached is the mission's back-to-office report.

Korea's remarkable export performance has continued and the Korean economy has remained strong despite prolonged political upheaval and labor unrest last year. The current account surplus doubled to nearly \$10 billion (8 percent of GNP) in 1987, and a surplus of similar magnitude is in prospect for this year. X

The authorities aim at a reduction in the surplus to 2-3 percent of GNP over the medium term, both to maintain domestic price stability and to avoid exacerbating international trade frictions. They intend to take further measures to ensure a desirable course of adjustment. However, the task of the new Government--which is more open and more susceptible to popular pressures--will be made increasingly difficult by strong domestic opposition to further liberalization as well as to exchange rate appreciation. The additional measures may, therefore, be less strong and be implemented more gradually than we would wish.

The Executive Board discussion is scheduled for mid-May and we plan to issue the staff report by mid-April. The authorities have agreed to our proposal for a follow-up staff visit before the Board meeting. X

Attachment

cc: ETR, EXR, FAD, LEG, RES, SEC, TRE, Mr. Hugh Simpson

1.00 MAR 30 PM 5:13
OFFICE OF THE
DEPUTY MANAGING DIRECTOR

RECEIVED
1988 APR -4 AM 9:49
ASIAN DEPARTMENT



Office Memorandum

CONFIDENTIAL

TO: The Managing Director
The Deputy Managing Director

March 30, 1988

FROM: Hubert Neiss

SUBJECT: Korea--1988 Article IV Consultation

A mission ^{1/} was in Seoul from March 14-30 for the 1988 Article IV consultation discussions. The last consultation discussion took place in May/June 1987. The 1987 Article IV consultation, however, was not completed because of political unrest during most of the second half of last year.

Despite the political upheaval and widespread strikes, the vigorous economic boom which started in 1988 has continued. The year 1987 was again one of remarkably strong export performance, rapid growth of output and investment, low inflation, and a large current account surplus (Table 1). The surplus doubled to nearly \$10 billion (8 percent of GNP), and we estimate a surplus of similar magnitude for 1988. It is now evident that the surprisingly fast swing in the current account during 1986 was more than a transitory phenomenon and that for some time Korea will have current account surpluses.

The authorities are determined to reduce the surplus from its present level as it endangers domestic price stability and leads to further trade frictions. They aim at reducing it to 2-3 percent of GNP over the medium term. The reduction would avoid excessive reserve accumulation and precipitate external debt reduction, and is probably the maximum feasible in the medium term. We supported their current account objective and discussed a possible adjustment scenario (Table 2). It will, of course, have to be reconsidered in light of evolving domestic and international developments.

Several factors are already working toward current account adjustment: export growth is slowing down as the favorable external effects of 1985-86 (yen appreciation, oil price decline, interest rate decline) are largely spent and as the economy is being subject to substantial wage increases and labor activism which are unprecedented in Korea. (Wage increases have already resulted in a 13 percent real appreciation as measured by relative unit labor costs.) The expected slowdown in world demand as a result of adjustment in the U.S. economy will also dampen export growth. Furthermore, significant import liberalization measures taken last year and early this year, together with strong domestic demand, will support the tendency to reduce the surplus.

^{1/} Mr. Neiss, Ms. Tseng, Mr. Baban, Mr. Le Fort (all ASD), Ms. Jul (ETR), Mr. Katz (FAD) and Ms. Lee (secretary, ASD).

While recognizing these influences, we emphasized that additional measures were needed to ensure the desirable path of current account adjustment. Because of the delayed impact of these measures, we also urged the authorities to take them at an early stage and not wait until increased domestic inflationary pressures stemming from the external surplus as well as increased bilateral trade frictions force them into action.

The authorities are in any case continuing the course of adjustment and plan further action. Additional import liberalization, including liberalization of agricultural products, and tariff cuts, are in preparation, and the won appreciation against the U.S. dollar has been significantly accelerated since the beginning of this year (over 6 percent during January-March). With the economy operating close to capacity, the scope for domestic demand expansion is modest in the short run. We recommended further import duty and excise tax reductions, but consider the authorities' stance of a broadly neutral budget as appropriate. We also agree with their 1988 target for money growth of 18 percent which will again require large sales of central bank bonds to absorb the liquidity created by the external surplus.

While there is thus basic agreement on the assessment of the economic situation and the policies needed, differences in degree remain. The authorities expect (or hope) that the factors already at work to reduce the current account surplus will be more powerful than we assume, and they forecast the surplus for this year to fall to \$7 billion (5 percent of GNP). Accordingly, they feel that the urgency for early action is somewhat reduced and prefer a more gradual implementation of additional measures in light of the evolving external situation. Their position no doubt reflects the increasing domestic political pressures on the new and more open Government: farmers have stiffened their resistance to further import liberalization, and exchange rate appreciation is increasingly opposed by exporters who also have to absorb fast rising labor costs. Nevertheless, the authorities are strongly determined to persevere with their adjustment effort. Understanding by trading partners of the constraints on policy-making in the present Korean situation is certainly needed.

Consensus on the details of the adjustment package is still emerging within the new Government, and, in any case, the strength of needed additional adjustment measures this year will have to be reassessed in the light of the outcome of the current wage round (April/May) and the further development of exports (performance in January/February continued strong, but the authorities expect a sharp slowdown thereafter). A follow-up staff visit, to which the authorities have agreed, will provide an update of developments and policies before the Board meeting in mid-May.

Attachments

cc: ETR, EXR, FAD, LEG, RES, SEC, TRE, Mr. Hugh Simpson

Table 1. Korea: Selected Economic Indicators, 1985-88 ^{1/}

	1985	1986	1987 Prel.	1988 Proj.
	(Annual percentage changes, unless otherwise specified)			
National income, employment, and prices				
GNP at constant prices	5.4	12.3	12.0	10.0
GNP deflator	4.1	2.7	3.7	4.0
Consumer prices (end of period)	3.1	1.4	6.1	4.0
Unemployment rate	4.0	3.8	3.4	3.7
External sector ^{2/}				
Exports, f.o.b.	0.4	28.3	36.2	26.0
Imports, f.o.b.	-3.3	12.3	29.7	29.3
Export volume	4.3	26.4	24.4	14.5
Import volume	1.0	19.9	21.8	18.8
Terms of trade	0.5	8.3	2.8	1.0
Nominal effective exchange rate ^{3/}	-16.0	-6.9	-4.6	0.8 ^{4/}
Real effective exchange rate ^{3/5/}	-15.9	-6.9	-1.8	0.8 ^{4/}
Real effective exchange rate (relative unit labor costs) ^{3/}	17.3	-13.0	13.3	...
Consolidated central government				
Revenue	10.2	12.6	18.6	11.8
Expenditure and net lending	8.3	5.4	19.8	12.0
Money and credit				
Net domestic assets ^{6/}	27.0	10.7	2.4	5.4
Public sector ^{6/}	(0.1)	(0.1)	(-4.6)	(-3.7)
Private sector ^{6/}	(25.5)	(20.6)	(25.6)	(19.9)
Money and quasi-money ^{6/}	16.8	18.6	19.3	18.1
Interest rate (end of period, one-year time deposit)	10.0	10.0	10.0	10.0
	(In percent of GNP)			
Consolidated central government				
Revenue	20.7	20.2	20.6	20.2
Expenditure and net lending	21.0	19.2	19.8	19.3
Deficit	-0.3	1.0	0.9	0.9
Domestic bank financing	-0.3	-0.4	-1.6	-1.6
Other domestic financing	-0.1	-0.5	0.7	0.7
Foreign financing	0.6	-0.2	—	—
Gross domestic investment	31.1	29.8	29.8	30.0
Gross domestic savings	28.6	33.0	35.9	35.5
External current account	-1.1	4.9	8.3	7.6
External debt ^{7/}	55.8	46.8	30.0	20.1
Short-term debt ^{8/}	23.0	20.8	26.1	31.1
Debt service ratio ^{9/}	23.8	24.7	32.3	15.7
Interest payments ^{9/}	11.1	8.8	5.7	3.8
	(In billions of U.S. dollars)			
External current account	-0.9	4.6	9.8	11.3
Overall balance of payments	-2.5	2.6	6.8	6.9
Total external debt	46.8	44.5	35.6	29.9
Gross international reserves	8.4	8.6	10.2	15.3
(Months of imports of goods and services)	(2.9)	(2.7)	(2.6)	(3.1)

Sources: Data provided by the Korean authorities; and staff estimates.

^{1/} Components may not add up to totals due to rounding.^{2/} Based on U.S. dollar values.^{3/} End of period, depreciation is negative.^{4/} Change December 1987-December 1988.^{5/} Information Notice Index.^{6/} In relation to broad money at the beginning of year.^{7/} Includes public, publicly guaranteed, and private debt of all maturities.^{8/} As percent of total external debt.^{9/} As percent of exports of goods and services, includes interest in short-term debt.

Table 2. Korea: Medium-Term Adjustment Scenario, 1985-92

	Actual			Projections				
	1985	1986	1987	1988	1989	1990	1991	1992
(In billions of U.S. dollars)								
Exports	26.4	33.9	46.2	58.2	67.2	75.7	85.2	95.8
Imports	-26.5	-29.7	-38.5	-49.8	-61.5	-72.0	-81.7	-92.8
Net services and transfers	-0.9	0.4	2.1	2.9	3.0	2.9	2.6	2.0
Current account balance	-0.9	4.6	9.8	11.3	8.6	6.6	6.1	5.0
(In percent of GNP)	(-1.1)	(4.9)	(8.3)	(7.6)	(5.1)	(3.5)	(2.9)	(2.1)
Debt-related capital flows	0.6	-0.7	-4.8	-3.9	-2.1	-1.2	-0.7	-0.2
Nondebt-related capital flows	-2.2	-1.3	1.9	-0.6	-0.4	-0.5	-0.7	-0.9
Overall balance	-2.5	2.6	6.8	6.9	6.2	5.0	-4.7	3.9
Gross reserves	8.4	8.6	10.2	15.3	19.4	23.2	27.1	30.8
(In months of imports of goods and services)	(2.9)	(2.7)	(2.6)	(3.1)	(3.2)	(3.3)	(3.4)	(3.4)
External debt	46.8	44.5	35.6	29.9	25.7	23.2	21.9	21.4
(In percent of GNP)	(55.8)	(46.8)	(30.0)	(20.1)	(15.2)	(12.3)	(10.3)	(9.0)
(Percent change)								
Export volume	4.3	26.4	24.4	14.5	9.8	9.0	9.0	9.0
Import volume	1.0	19.9	21.8	18.8	17.3	13.1	9.9	10.0
Real GNP	5.4	12.3	12.0	10.0	8.0	7.5	7.5	7.5
Real domestic demand	4.0	8.3	10.2	10.7	10.8	9.2	8.2	8.3
(In percent of GNP)								
Gross domestic savings	28.6	33.0	35.9	35.4	34.0	32.3	31.7	30.9
Gross domestic investment	31.1	29.8	29.8	30.0	30.3	30.1	30.0	29.9

Sources: Data provided by the Korean authorities; and staff projections.



Office Memorandum

Div. E
Files

CONFIDENTIAL

TO: The Managing Director
The Deputy Managing Director

March 30, 1988

FROM: P.R. Narvekar *PRN*

SUBJECT: Korea--1988 Article IV Consultation Discussions

Attached is the mission's back-to-office report.

Korea's remarkable export performance has continued and the Korean economy has remained strong despite prolonged political upheaval and labor unrest last year. The current account surplus doubled to nearly \$10 billion (8 percent of GNP) in 1987, and a surplus of similar magnitude is in prospect for this year.

The authorities aim at a reduction in the surplus to 2-3 percent of GNP over the medium term, both to maintain domestic price stability and to avoid exacerbating international trade frictions. They intend to take further measures to ensure a desirable course of adjustment. However, the task of the new Government--which is more open and more susceptible to popular pressures--will be made increasingly difficult by strong domestic opposition to further liberalization as well as to exchange rate appreciation. The additional measures may, therefore, be less strong and be implemented more gradually than we would wish.

The Executive Board discussion is scheduled for mid-May and we plan to issue the staff report by mid-April. The authorities have agreed to our proposal for a follow-up staff visit before the Board meeting.

Attachment

cc: ETR, EXR, FAD, LEG, RES, SEC, TRE, Mr. Hugh Simpson



Office Memorandum

CONFIDENTIAL

TO: The Managing Director
The Deputy Managing Director

FROM: Hubert Neiss

SUBJECT: Korea--1988 Article IV Consultation

March 30, 1988

A mission ^{1/} was in Seoul from March 14-30 for the 1988 Article IV consultation discussions. The last consultation discussion took place in May/June 1987. The 1987 Article IV consultation, however, was not completed because of political unrest during most of the second half of last year.

Despite the political upheaval and widespread strikes, the vigorous economic boom which started in 1988 has continued. The year 1987 was again one of remarkably strong export performance, rapid growth of output and investment, low inflation, and a large current account surplus (Table 1). The surplus doubled to nearly \$10 billion (8 percent of GNP), and we estimate a surplus of similar magnitude for 1988. It is now evident that the surprisingly fast swing in the current account during 1986 was more than a transitory phenomenon and that for some time Korea will have current account surpluses.

The authorities are determined to reduce the surplus from its present level as it endangers domestic price stability and leads to further trade frictions. They aim at reducing it to 2-3 percent of GNP over the medium term. The reduction would avoid excessive reserve accumulation and precipitate external debt reduction, and is probably the maximum feasible in the medium term. We supported their current account objective and discussed a possible adjustment scenario (Table 2). It will, of course, have to be reconsidered in light of evolving domestic and international developments.

Several factors are already working toward current account adjustment: export growth is slowing down as the favorable external effects of 1985-86 (yen appreciation, oil price decline, interest rate decline) are largely spent and as the economy is being subject to substantial wage increases and labor activism which are unprecedented in Korea. (Wage increases have already resulted in a 13 percent real appreciation as measured by relative unit labor costs.) The expected slowdown in world demand as a result of adjustment in the U.S. economy will also dampen export growth. Furthermore, significant import liberalization measures taken last year and early this year, together with strong domestic demand, will support the tendency to reduce the surplus.

^{1/} Mr. Neiss, Ms. Tseng, Mr. Baban, Mr. Le Fort (all ASD), Ms. Jul (ETR), Mr. Katz (FAD) and Ms. Lee (secretary, ASD).

While recognizing these influences, we emphasized that additional measures were needed to ensure the desirable path of current account adjustment. Because of the delayed impact of these measures, we also urged the authorities to take them at an early stage and not wait until increased domestic inflationary pressures stemming from the external surplus as well as increased bilateral trade frictions force them into action.

The authorities are in any case continuing the course of adjustment and plan further action. Additional import liberalization, including liberalization of agricultural products, and tariff cuts, are in preparation, and the won appreciation against the U.S. dollar has been significantly accelerated since the beginning of this year (over 6 percent during January-March). With the economy operating close to capacity, the scope for domestic demand expansion is modest in the short run. We recommended further import duty and excise tax reductions, but consider the authorities' stance of a broadly neutral budget as appropriate. We also agree with their 1988 target for money growth of 18 percent which will again require large sales of central bank bonds to absorb the liquidity created by the external surplus.

While there is thus basic agreement on the assessment of the economic situation and the policies needed, differences in degree remain. The authorities expect (or hope) that the factors already at work to reduce the current account surplus will be more powerful than we assume, and they forecast the surplus for this year to fall to \$7 billion (5 percent of GNP). Accordingly, they feel that the urgency for early action is somewhat reduced and prefer a more gradual implementation of additional measures in light of the evolving external situation. Their position no doubt reflects the increasing domestic political pressures on the new and more open Government: farmers have stiffened their resistance to further import liberalization, and exchange rate appreciation is increasingly opposed by exporters who also have to absorb fast rising labor costs. Nevertheless, the authorities are strongly determined to persevere with their adjustment effort. Understanding by trading partners of the constraints on policy-making in the present Korean situation is certainly needed.

Consensus on the details of the adjustment package is still emerging within the new Government, and, in any case, the strength of needed additional adjustment measures this year will have to be reassessed in the light of the outcome of the current wage round (April/May) and the further development of exports (performance in January/February continued strong, but the authorities expect a sharp slowdown thereafter). A follow-up staff visit, to which the authorities have agreed, will provide an update of developments and policies before the Board meeting in mid-May.

Attachments

cc: ETR, EXR, FAD, LEG, RES, SEC, TRE, Mr. Hugh Simpson

Table 1. Korea: Selected Economic Indicators, 1985-88 1/

	1985	1986	1987 Prel.	1988 Proj.
	(Annual percentage changes, unless otherwise specified)			
National income, employment, and prices				
GNP at constant prices	5.4	12.3	12.0	10.0
GNP deflator	4.1	2.7	3.7	4.0
Consumer prices (end of period)	3.1	1.4	6.1	4.0
Unemployment rate	4.0	3.8	3.4	3.7
External sector 2/				
Exports, f.o.b.	0.4	28.3	36.2	26.0
Imports, f.o.b.	-3.3	12.3	29.7	29.3
Export volume	4.3	26.4	24.4	14.5
Import volume	1.0	19.9	21.8	18.8
Terms of trade	0.5	8.3	2.8	1.0
Nominal effective exchange rate 3/	-16.0	-6.9	-4.6	0.8 4/
Real effective exchange rate 3/5/	-15.9	-6.9	-1.8	0.8 4/
Real effective exchange rate (relative unit labor costs) 3/	17.3	-13.0	13.3	...
Consolidated central government				
Revenue	10.2	12.6	18.6	11.8
Expenditure and net lending	8.3	5.4	19.8	12.0
Money and credit				
Net domestic assets 6/	27.0	10.7	2.4	5.4
Public sector 6/	(0.1)	(0.1)	(-4.6)	(-3.7)
Private sector 6/	(25.5)	(20.6)	(25.6)	(19.9)
Money and quasi-money 6/	16.8	18.6	19.3	18.1
Interest rate (end of period, one-year time deposit)	10.0	10.0	10.0	10.0
	(In percent of GNP)			
Consolidated central government				
Revenue	20.7	20.2	20.6	20.2
Expenditure and net lending	21.0	19.2	19.8	19.3
Deficit	-0.3	1.0	0.9	0.9
Domestic bank financing	-0.3	-0.4	-1.6	-1.6
Other domestic financing	-0.1	-0.5	0.7	0.7
Foreign financing	0.6	-0.2	—	—
Gross domestic investment	31.1	29.8	29.8	30.0
Gross domestic savings	28.6	33.0	35.9	35.5
External current account	-1.1	4.9	8.3	7.6
External debt 7/	55.8	46.8	30.0	20.1
Short-term debt 8/	23.0	20.8	26.1	31.1
Debt service ratio 9/	23.8	24.7	32.3	15.7
Interest payments 9/	11.1	8.8	5.7	3.8
	(In billions of U.S. dollars)			
External current account	-0.9	4.6	9.8	11.3
Overall balance of payments	-2.5	2.6	6.8	6.9
Total external debt	46.8	44.5	35.6	29.9
Gross international reserves	8.4	8.6	10.2	15.3
(Months of imports of goods and services)	(2.9)	(2.7)	(2.6)	(3.1)

Sources: Data provided by the Korean authorities; and staff estimates.

1/ Components may not add up to totals due to rounding.

2/ Based on U.S. dollar values.

3/ End of period, depreciation is negative.

4/ Change December 1987-December 1988.

5/ Information Notice Index.

6/ In relation to broad money at the beginning of year.

7/ Includes public, publicly guaranteed, and private debt of all maturities.

8/ As percent of total external debt.

9/ As percent of exports of goods and services, includes interest in short-term debt.

Table 2. Korea: Medium-Term Adjustment Scenario, 1985-92

	Actual			Projections				
	1985	1986	1987	1988	1989	1990	1991	1992
(In billions of U.S. dollars)								
Exports	26.4	33.9	46.2	58.2	67.2	75.7	85.2	95.8
Imports	-26.5	-29.7	-38.5	-49.8	-61.5	-72.0	-81.7	-92.8
Net services and transfers	-0.9	0.4	2.1	2.9	3.0	2.9	2.6	2.0
Current account balance	-0.9	4.6	9.8	11.3	8.6	6.6	6.1	5.0
(In percent of GNP)	(-1.1)	(4.9)	(8.3)	(7.6)	(5.1)	(3.5)	(2.9)	(2.1)
Debt-related capital flows	0.6	-0.7	-4.8	-3.9	-2.1	-1.2	-0.7	-0.2
Nondebt-related capital flows	-2.2	-1.3	1.9	-0.6	-0.4	-0.5	-0.7	-0.9
Overall balance	-2.5	2.6	6.8	6.9	6.2	5.0	4.7	3.9
Gross reserves	8.4	8.6	10.2	15.3	19.4	23.2	27.1	30.8
(In months of imports of goods and services)	(2.9)	(2.7)	(2.6)	(3.1)	(3.2)	(3.3)	(3.4)	(3.4)
External debt	46.8	44.5	35.6	29.9	25.7	23.2	21.9	21.4
(In percent of GNP)	(55.8)	(46.8)	(30.0)	(20.1)	(15.2)	(12.3)	(10.3)	(9.0)
(Percent change)								
Export volume	4.3	26.4	24.4	14.5	9.8	9.0	9.0	9.0
Import volume	1.0	19.9	21.8	18.8	17.3	13.1	9.9	10.0
Real GNP	5.4	12.3	12.0	10.0	8.0	7.5	7.5	7.5
Real domestic demand	4.0	8.3	10.2	10.7	10.8	9.2	8.2	8.3
(In percent of GNP)								
Gross domestic savings	28.6	33.0	35.9	35.4	34.0	32.3	31.7	30.9
Gross domestic investment	31.1	29.8	29.8	30.0	30.3	30.1	30.0	29.9

Sources: Data provided by the Korean authorities; and staff projections.



Office Memorandum

→ MD*

CONFIDENTIAL

TO: The Managing Director
✓ The Deputy Managing Director

March 4, 1988

FROM: P.R. Narvekar PRN

→ Mr. Narvekar
P2
DOE
March 9, 1988

SUBJECT: Korea--1988 Article IV Consultation Discussions

Attached is the briefing paper for the 1988 Article IV consultation discussions with Korea. It has been cleared by Mrs. Junz (ETR) and comments were received from Messrs. Crockett (RES), Francotte (LEG), Gupta (TRE), and Mrs. Ter-Minassian (FAD).

The spectacular boom of the Korean economy has continued despite major political unrest last year, and the current account surplus--despite fast growing domestic demand--has increased further and substantially, reaching close to \$10 billion (8 percent of GNP). Trade frictions with the United States have recently escalated, resulting, among other things, in strong resentment in Korea.

The mission's discussion will focus on policies which will reduce the surplus to an acceptable level over the medium term (the next 4-5 years) and create a domestic and international environment conducive to a more harmonious development of the Korean economy. The position the mission would convey to the authorities is summarized as follows:

1. Korea must now take greater responsibility for maintaining a viable international trade and payments system.
2. Current account surpluses of the magnitude in prospect are not consistent with this responsibility, nor with the requirements of the domestic economy.
3. Over the medium term, surpluses should, therefore, be cut in half to a range of \$5-6 billion (2-3 percent of GNP).
4. Policies required to achieve this outcome are, essentially, further substantial market opening and a significant exchange rate appreciation, while strong domestic demand is maintained.
5. Since these policies will affect the current account only with a considerable lag, it is all the more important that strong action is taken at an early stage.
6. It would be helpful to Korea if such action is announced before the Executive Board meeting. The mission will point out to the authorities that the proposed second mission in mid-April was intended in a spirit of being helpful and that the offer was still open.

100 MAR -4 PM 5:39
OFFICE OF THE
DEPUTY MANAGING DIRECTOR

APR 10 1988
MAR 10 21:00:45

The above position vis-a-vis the Korean authorities implies that our position vis-a-vis the international community would be as follows:

1. A reduction in Korea's surpluses to 2-3 percent of GNP over the medium term would avoid a precipitate reduction of debt or an excessive buildup in reserves.^{1/} It would, therefore, be consistent with Korea's international responsibilities. It also is probably the maximum feasible.

2. A surplus substantially above the desirable medium-term range is unavoidable this year, given the well-known delays in the impact of policies on the current account. This should be accepted, provided the new Government puts strong adjustment policies in place in the very near future.

The Research Department has reservations on the mission's position outlined above regarding Korea's current account surplus; a memorandum from Mr. Crockett is attached.

Mr. Neiss' last day in the office is March 9.

Attachments

cc: ETR
FAD
LEG
RES
TRE
Mr. Simpson

- I agree with the emphasis in the brief on the need to take early actions to move toward the medium term target of 2-3% of GNP - whether that target is "acceptable" can be evaluated over time in light of domestic and international economic developments.

^{1/} External debt presently amounts to 30 percent of GNP and international reserves are equivalent to 2.5 months of imports. If the deficit reduction is realized, external debt in 1992 would be 10 percent of GNP and international reserves equivalent to 3.5 months of imports.



Office Memorandum

CONFIDENTIAL

TO: The Managing Director
The Deputy Managing Director

March 4, 1988

FROM: P.R. Narvekar *PRN*

SUBJECT: Korea--1988 Article IV Consultation Discussions

Attached is the briefing paper for the 1988 Article IV consultation discussions with Korea. It has been cleared by Mrs. Junz (ETR) and comments were received from Messrs. Crockett (RES), Francotte (LEG), Gupta (TRE), and Mrs. Ter-Minassian (FAD).

The spectacular boom of the Korean economy has continued despite major political unrest last year, and the current account surplus--despite fast growing domestic demand--has increased further and substantially, reaching close to \$10 billion (8 percent of GNP). Trade frictions with the United States have recently escalated, resulting, among other things, in strong resentment in Korea.

The mission's discussion will focus on policies which will reduce the surplus to an acceptable level over the medium term (the next 4-5 years) and create a domestic and international environment conducive to a more harmonious development of the Korean economy. The position the mission would convey to the authorities is summarized as follows:

1. Korea must now take greater responsibility for maintaining a viable international trade and payments system.
2. Current account surpluses of the magnitude in prospect are not consistent with this responsibility, nor with the requirements of the domestic economy.
3. Over the medium term, surpluses should, therefore, be cut in half to a range of \$5-6 billion (2-3 percent of GNP).
4. Policies required to achieve this outcome are, essentially, further substantial market opening and a significant exchange rate appreciation, while strong domestic demand is maintained.
5. Since these policies will affect the current account only with a considerable lag, it is all the more important that strong action is taken at an early stage.
6. It would be helpful to Korea if such action is announced before the Executive Board meeting. The mission will point out to the authorities that the proposed second mission in mid-April was intended in a spirit of being helpful and that the offer was still open.

The above position vis-a-vis the Korean authorities implies that our position vis-a-vis the international community would be as follows:

1. A reduction in Korea's surpluses to 2-3 percent of GNP over the medium term would avoid a precipitate reduction of debt or an excessive buildup in reserves.^{1/} It would, therefore, be consistent with Korea's international responsibilities. It also is probably the maximum feasible.

2. A surplus substantially above the desirable medium-term range is unavoidable this year, given the well-known delays in the impact of policies on the current account. This should be accepted, provided the new Government puts strong adjustment policies in place in the very near future.

The Research Department has reservations on the mission's position outlined above regarding Korea's current account surplus; a memorandum from Mr. Crockett is attached.

Mr. Neiss' last day in the office is March 9.

Attachments

cc: ETR
FAD
LEG
RES
TRE
Mr. Simpson

^{1/} External debt presently amounts to 30 percent of GNP and international reserves are equivalent to 2.5 months of imports. If the deficit reduction is realized, external debt in 1992 would be 10 percent of GNP and international reserves equivalent to 3.5 months of imports.



Office Memorandum

RECEIVED

1988 MAR -4 PM 12: 24

cc: ^{PPN} WTo

To: Mr. Neiss
From: A.D. Crockett *Adc*
Subject: Korea--Briefing Paper

ASIAN DEPARTMENT March 4, 1988

I attach some comments on this brief that have been prepared by Ms. Schultze-Ghattas.

On the occasion of the last consultation with Korea, this department expressed some reservations with the line the staff proposed to take in relation to the authorities' medium-term payments objectives. We still have these reservations.

In particular, we cannot agree with the statement that "the international community should accept surpluses in the range of \$5-6 billion" without qualification. Given that the surplus expected for the current year is \$10-\$12 billion, it will clearly be some time before it comes down to the range of \$5-6 billion: to that extent the issue is somewhat academic. However, we have considerable reservations about endorsing, on a country-by-country basis, medium-term balance of payments "targets" that may well be internationally inconsistent.

Should you find it impossible to modify the brief in accordance with our suggestion, we would appreciate your drawing this matter to management's attention.

Attachment

cc: Mr. Frenkel
Mr. Tanzi
Mr. Francotte
Mr. Gupta
Mrs. Junz

INTERNATIONAL MONETARY FUND

KOREA

Briefing Paper - 1988 Article IV Consultation

Prepared by the Asian, Exchange and Trade Relations,
and Fiscal Affairs Departments

(In consultation with the Legal, Research,
and Treasurer's Departments)

Approved by P.R. Narvekar and H.B. Junz *PRN* *[Signature]*

March 4, 1988

I. Introduction

A staff team will visit Seoul during March 13-30 to hold discussions for the 1988 Article IV consultation. 1/ The team will consist of Hubert Neiss (head), Roy Baban, Wanda Tseng, Guillermo Le Fort (all ASD), Ana Maria Jul (ETR), Menachem Katz (FAD), and Florence Lee (secretary, ASD). Discussions for the 1987 Article IV consultation were combined with the supplemental consultation of May 18-June 5, 1987, but not completed because of the presidential elections. The Executive Board discussed the staff report for the supplemental consultation (EBS/87/134, 6/22/87) on July 6, 1987.

II. Political Developments

Following a year of major political unrest, President Roh Tae Woo was inaugurated on February 25, 1988 in the first peaceful transition of

1/ The mission will also collect information and hold discussions on trade issues that are to be covered in the comprehensive trade report being prepared by ETR.

power in Korea's modern history. He won the election with a 37 percent plurality after the two main opposition candidates split their 55 percent majority. Roh retained key members of the previous Cabinet, including the Minister of Finance and the Minister of Trade and Industry, who was appointed as Deputy Prime Minister and Minister for Economic Planning. Further cabinet changes are expected following the National Assembly elections in March/April, and the Olympic Games in September.

III. Economic Developments

1. Background

Since 1986, the Korean economy has grown rapidly and its external position has strengthened beyond expectations. This is in striking contrast to the early 1980s when the economy experienced a period of serious internal and external imbalances and Korea became a major debtor in the developing world. The spectacular change in 1986 was preceded by a prolonged adjustment effort (there were four stand-by arrangements with the Fund) and supported by changes in external conditions, in particular the fall in oil prices and international interest rates, and the depreciation of the U.S. dollar.

2. Developments in 1987

The boom, which began in 1986, continued in 1987 despite prolonged political disturbances in midyear. GNP growth, supported by foreign demand and domestic investment, rose from a weak (by Korean standards) 5 1/2 percent in 1985 to more than 12 percent in 1986 and 1987.

Domestic investment continued at a high level (30 percent of GNP) while domestic savings rose to an historically high level of 36 percent of GNP in 1987 from 29 percent in 1985. Unemployment fell to below 3 percent. There has been growing concern about inflation, which accelerated from 1 percent in 1986 to 6 percent in 1987 (year-on-year), reflecting weather-induced increases in food prices, wage increases in the aftermath of labor disputes last summer, and the continuation of high rates of liquidity expansion. Average labor costs in the manufacturing sector are estimated to have risen by 20-25 percent in 1987.

The current account which had moved from a deficit of \$0.9 billion (1 percent of GNP) in 1985 to a surplus of \$4.6 billion (5 percent of GNP) in 1986, reached a surplus of \$9.8 billion (8 percent of GNP) in 1987. The surplus in 1987 far exceeded the Government's original target of \$5 billion and the supplemental consultation's projection of \$7 billion. Owing to the strengthening of competitiveness brought about by the 24 percent real depreciation of the won between early 1985 and mid-1986, the coming to fruition of several large, long-term investments in new export products, and strong external demand, export volume rose by 25 percent compared with a projection of 21 percent; and unit value rose by 9 percent compared with a projection of 7 percent (Table 1). New export products recorded particularly high rates of growth (e.g., automobiles, 107 percent; electric goods, 67 percent; electronics, 54 percent.) The high growth of exports and overall economic activity raised import demand substantially; the volume of imports grew by 22 percent. Nevertheless, the more rapid growth of

Table 1. Korea: Current Account 1987 1/

	1987		Difference (2) - (1)
	Supplemental Consultation Projection (1)	Estimated Actual (2)	
<u>(In billions of U.S. dollars)</u>			
Trade balance	4.8	7.7	2.9
Exports	43.5	46.2	2.7
Imports	-38.7	-38.5	-0.2
Services	1.0	0.9	-0.1
Receipts	10.1	10.1	--
Payments	-9.1	-9.2	-0.1
Transfers	1.0	1.2	0.2
Current account	6.9	9.8	2.9
<u>(Percent change)</u>			
Memorandum item:			
Export value	28.2	36.2	
Volume	20.4	24.6	
Unit value	6.5	9.3	
Import value	30.3	29.7	
Volume	19.3	22.1	
Unit value	9.3	6.3	

Source: Staff estimates.

1/ Components may not add up to total due to rounding.

exports and some improvement in the terms of trade resulted in a doubling of the trade surplus. The services account also shifted into surplus, reflecting higher tourism receipts and lower interest payments on external debt. The current account surplus, together with net inflows of nondebt related capital, have been used mainly to reduce external debt, which fell from \$45 billion (47 percent of GNP) at end-1986 to \$35 billion (30 percent of GNP) at end-1987. While gross international reserves rose by \$1 billion to \$10 billion, the import cover fell slightly to 2.5 months.

The increase in Korea's current account surplus has been accompanied by growing bilateral imbalances with its two largest trading partners. Korea's bilateral surplus with the United States reached \$9 billion in 1987 and its bilateral deficit with Japan was about \$6 billion.

Macroeconomic policies had moderately expansionary effects on demand. Mainly reflecting a rebound in net lending and a supplementary budget for flood relief in the second half of the year, the consolidated central government position moved from balance in 1986 to a deficit of about 1 percent of GNP in 1987, implying a fiscal stimulus of about 1 percent of GNP. Credit policy has remained oriented toward preventing the sharp increases in net foreign assets from undermining monetary control. The Government's recourse to bank credit declined, and private credit growth was curtailed directly through restrictions on export-related credits and on credits extended to the major conglomerates, and indirectly through open market operations and increases in the Bank of

Korea's rediscount rate and the reserve requirement. Despite these measures, broad money growth continued to exceed the official target of 18 percent.

The authorities continued a slow appreciation of the won vis-a-vis the U.S. dollar until midyear. Concerned about the impact of the labor cost increase after the strikes during the summer, they moved even more cautiously in the remainder of the year. The won appreciated by 8 percent against the dollar during 1987; its real effective value remained largely unchanged.

3. Outlook for 1988 and the medium term

On the basis of current policies and the present world economic outlook exercise, the staff would again expect a strong expansion of output--about 8-10 percent, with inflation remaining modest at 5-7 percent, and a current account surplus of \$10-12 billion in 1988. ^{1/} The official targets are for a deceleration of real GNP growth to 8 percent, with inflation at 5 percent, and a reduction in the current account surplus to \$6 billion.

The medium-term scenario indicates, on existing policies, continued current account surpluses above \$10 billion. However, surpluses of these magnitudes are not sustainable because they would create inflation and distort the production structure at home and intensify protectionism abroad.

^{1/} Although imports increased strongly in January 1988, the continued expansion of exports resulted in a current account surplus of \$0.8 billion.

IV. Policy Issues

At the conclusion of the supplemental consultation in July 1987, the summing-up indicated that Directors supported the authorities' medium-term debt reduction objectives, but also considered that further adjustment efforts were necessary to avoid excessive surpluses. They agreed that these efforts would have to focus on further market openings and exchange rate appreciation, given the limited scope for expansionary demand management policies.

The Korean economy plays an increasingly important role in the development of the East Asian region, and in the world economy. Although Korea's surplus represents only a small fraction of the U.S. deficit, Korea must increasingly share responsibility for maintaining a viable international trade and payments system. Current account surpluses of the magnitudes in prospect would not be consistent with this responsibility. The authorities themselves are aiming at reducing the current account surplus to about \$5-6 billion, taking account of the present international climate as well as the detrimental impact on the domestic economy of larger surpluses. This is probably the maximum feasible reduction in the medium term. In view of the still large debt outstanding (still 30 percent of GNP) and the need to build up reserves from their relatively low level (at present equivalent to 2.5 months of imports), there is a rationale for maintaining current account surpluses over the next few years. Surpluses in the range of \$5-6 billion would keep debt reduction and reserve buildup at a moderate pace--outstanding debt in 1992 would amount to 10 percent of GNP and reserves would be

equivalent to 3.5 months of imports--and be consistent with Korea's international responsibility. However, this means reducing surpluses to about half of what is presently in prospect, which requires a major and determined policy effort. Such an effort must combine substantive steps to further open the domestic market with a significant appreciation of the exchange rate, and be accompanied by the maintenance of strong domestic demand. Since the required current account adjustment can only be achieved over the medium term, the mission will underscore the importance of early and decisive action. The discussions will, therefore, concentrate on putting policies in place which, over time, will reduce the surplus to an acceptable level and provide a suitable domestic and international setting for the evolution of the economy.

1. Market opening policies

The rapid turnaround in Korea's trade account led to serious trade frictions, in particular with the United States, which absorbs 40 percent of Korea's exports and with which Korea had a large trade surplus in 1987. Highly publicized and often acrimonious bilateral negotiations have involved market opening for beef, cigarettes, insurance, advertising, and intellectual property rights. Both the United States and the European Community have withdrawn GSP benefits for Korea.

In response to pressures and as a continuation of a liberalization program begun in the early 1980s, market opening was accelerated in

1987. 1/ In early 1988, the authorities announced their intentions to further accelerate market opening. The specifics have not been fully developed. Some of these measures have been designed to directly affect bilateral imbalances with the United States and Japan (export restraints, the import diversification program, and the localization program).

The mission will assess the progress made thus far and urge the authorities to substantially increase their market opening efforts. This will, in particular, include an accelerated timetable for removing quantitative restrictions and lowering tariffs, with special emphasis on those manufactured products in which Korea has recently developed comparative advantage and for agricultural products, and an early phasing out of the import surveillance list. To enhance the effectiveness of market opening measures, the mission will encourage greater transparency and simplification of the trade system; and review the recent revision of special laws. It will also urge the authorities to remove the remaining exchange restrictions on invisibles which are maintained in accordance with the transitional arrangements of Article XIV, thus setting the stage for a shift to Article VIII status, and to further ease restrictions on overseas investment by Korean

1/ The program involves increasing the share of automatically approved imports, lowering tariffs, easing restrictions on invisible transactions, and reducing restrictions on foreign investment. In addition, measures have been implemented to prevent indirect restrictions on imports, including the introduction of a more transparent system of safeguards against import surges and some revision of special laws affecting trade, which are often criticized by trading partners as limiting access to Korean markets.

residents. In general, the mission will strongly argue in favor of a generalized approach to adjustment rather than relief from bilateral pressures through specific discriminatory measures, such as incentives to import from or restrain exports to specific markets.

2. Exchange rate policy

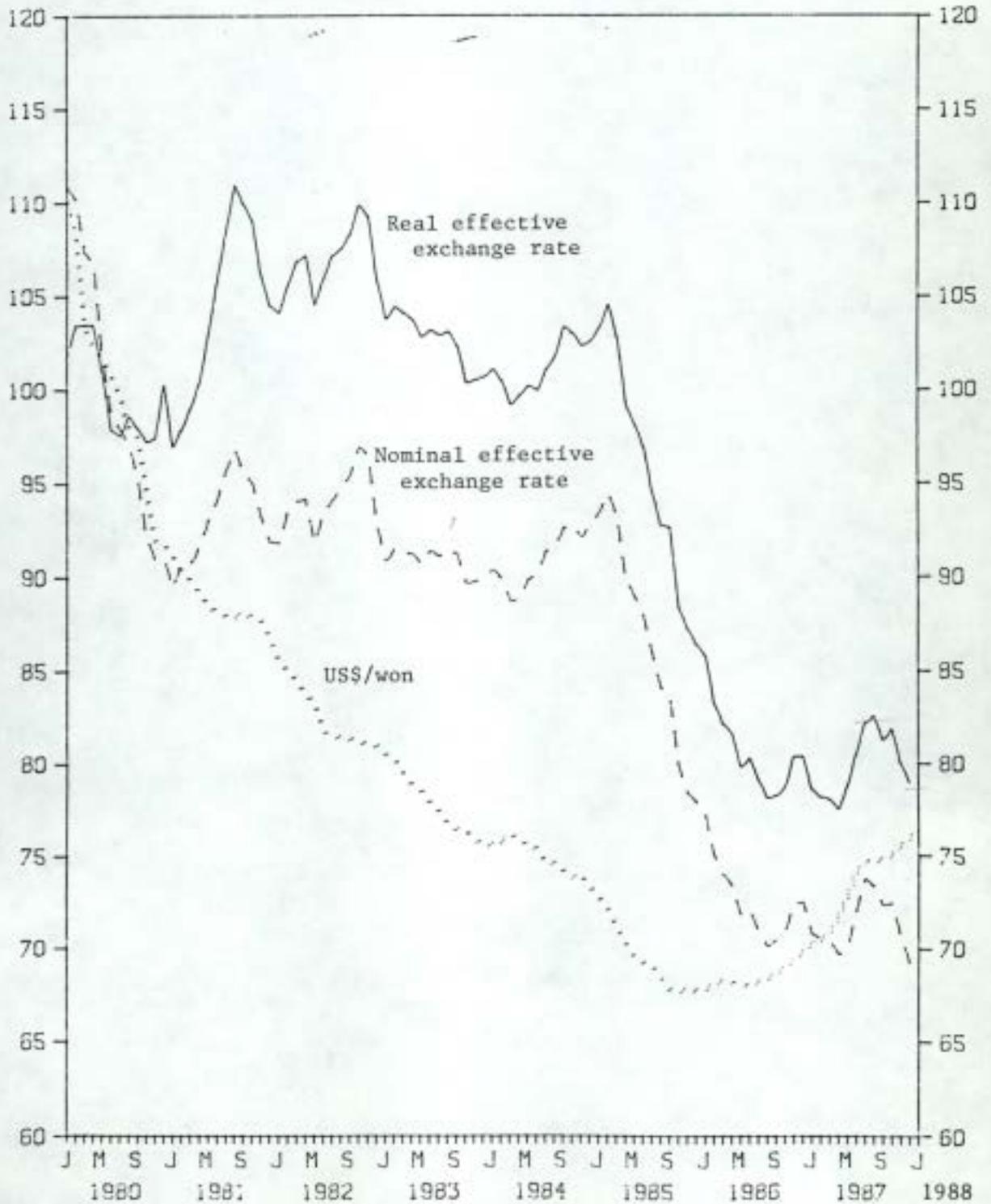
The real exchange rate depreciated substantially between early 1985 and mid-1986, reflecting the pegging of the won to the sharply depreciating U.S. dollar. Since mid-1986, this link has been loosened and the won appreciated moderately (by 11 percent) against the U.S. dollar. Measured by the CPI-based Information Notice Index, the real exchange rate depreciated by 24 percent between early 1985 and mid-1986, and has since remained unchanged (Chart 1). Measured by relative unit labor costs, the real exchange rate declined by 21 percent during 1985-86 and appreciated by 13 percent in 1987, mainly owing to the large wage increases in mid-1987 (Chart 2).

The staff team will assess the effect of recent real exchange rate developments on trade flows. Given present balance of payments prospects, there is a need for further real appreciation in order to reduce the current account surplus to the target of \$5-6 billion. The mission will reach a view on the extent of further appreciation, taking into account the authorities' intentions on further market openings as well as the prospects for the forthcoming spring wage negotiations.

3. Demand management policies

The 1988 budget is designed to have a virtually neutral impact on demand with the consolidated central government deficit budgeted to

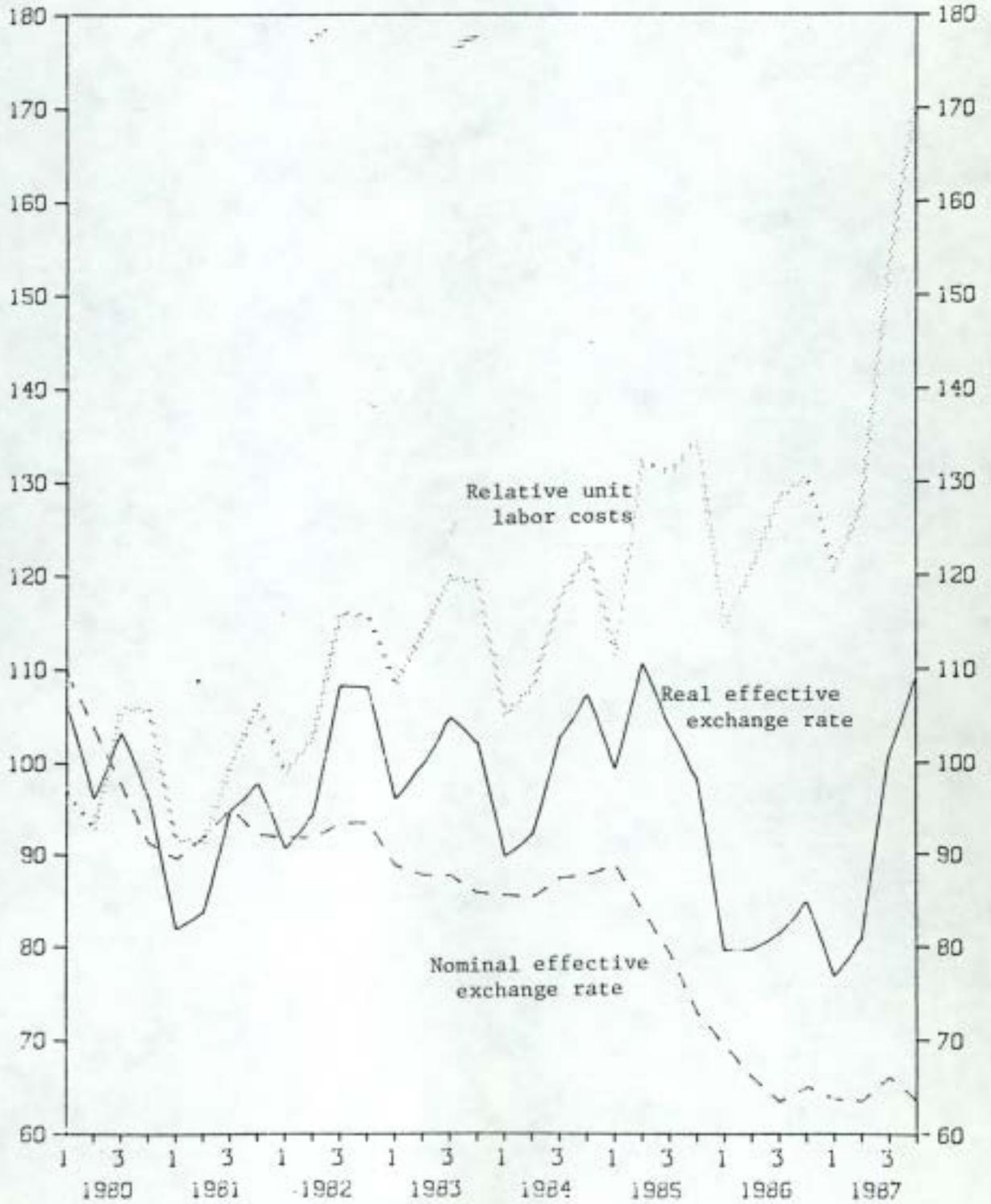
Chart 1
KOREA
EXCHANGE RATE DEVELOPMENTS, 1980-JANUARY 1988
(1980=100)



Source: IMF, Information Notice System.

Chart 2

KOREA
DEVELOPMENTS IN THE REAL EFFECTIVE EXCHANGE RATE
BASED ON RELATIVE UNIT LABOR COSTS, 1980-87
(1980=100)



Source: Staff calculations.

decline to 1/2 percent of GNP. The projected decline in the deficit reflects the expectation that revenues will rise by slightly more than nominal GNP owing to the higher corporate and personal incomes in 1987 while expenditures are budgeted to rise by slightly less than GNP. The main features of the 1988 budget are relatively large increases in spending on defense, education, and social welfare programs, including an expansion of medical insurance, and the introduction of national pension and minimum wage systems. The mission will assess the appropriate role for fiscal policy in supporting domestic demand and current account adjustment, and the impact of fiscal policies on savings.

The sharp increase in net foreign assets of the banking system continues to push the growth of broad money above the official target of 18 percent. Measures introduced in 1987 to limit the growth of domestic credit described above are to be continued in 1988. Commercial bank interest rates, which are regulated, have not been adjusted since mid-1986, and are at relatively high real levels. The mission will review the authorities' money growth targets, the effectiveness of measures to contain the increase in domestic credit, and the effects of continued regulation of bank interest rates.

4. Financial market liberalization

The authorities have been implementing measures to liberalize and reform the financial system. Although progress has been hindered by the high level of nonperforming assets in the banking system, several measures have been taken: the gap between market interest rates and the regulated lending and deposit rates has been narrowed; new deposit

instruments have been introduced; interest rates on most types of negotiable securities issued by the private sector have been liberalized; and regulations on the foreign issue of securities and on foreign banks' activities in Korea have been eased. Measures were also implemented to encourage direct equity financing by large enterprises to develop the capital markets. The mission will review progress in financial market liberalization and plans for further reforms.

Beyond that, the mission will discuss the longer-term issues of capital market liberalization and the desirability of letting market forces play a more decisive role in exchange rate determination by moving to a flexible exchange rate regime.

NSC: st80302kr 3/3/88

Table 2. Korea: Selected Economic Indicators, 1983-88

	1983	1984	1985	1986	1987 Prel.	1988 Proj.
	(Annual percentage changes, unless otherwise specified)					
National income, employment, and prices						
GDP at constant prices	11.9	8.4	5.4	12.5	12.2	8-10
GDP deflator	3.9	3.8	4.1	2.3	3.0	5-7
Consumer prices (end of period)	2.0	2.4	3.2	1.3	5.8	5-7
Unemployment rate	4.1	3.8	4.0	3.8	2.3 1/	...
External sector 2/						
Exports, f.o.b.	11.1	13.5	0.4	28.3	36.2	20
Imports, f.o.b.	6.4	9.6	-3.3	12.3	29.2	21
Export volume	15.5	9.8	4.3	26.4	24.6	9
Import volume	11.6	8.2	1.0	19.9	22.1	12
Terms of trade	0.9	2.1	0.5	8.3	2.9	2
Nominal effective exchange rate 3/	-3.0	3.0	-16.0	-6.9	-4.6	...
Real effective exchange rate 3/	-4.8	1.9	-15.9	-6.9	-1.8	...
Consolidated central government						
Revenue	15.1	15.1	10.5	12.9	13	16
Expenditure and net lending	2.0	13.2	7.8	8.2	19	13
Money and credit						
Net domestic assets 4/	22.8	17.1	27.0	10.7	2.5	...
Public sector 4/5/	-0.7	-0.2	0.2	0.1	-4.9	...
Private sector 4/	22.4	18.6	25.4	20.6	25.7	...
Money and quasi-money	15.2	10.6	16.8	18.6	19.2	...
Interest rate (end of period, one-year savings deposit)	8.0	10.0	12.0	12.0	12.0	...
	(In percent of GDP)					
Consolidated central government						
Revenue	19.7	20.1	20.4	19.9	19.4	19 1/2
Expenditure and net lending	21.3	21.4	21.2	19.8	20.4	20
Deficit	-1.6	-1.3	-0.8	0.1	-1.0	-1/2
Domestic bank financing 6/	-0.4	-0.2	0.2	0.5	0.4	—
Other domestic financing	1.3	1.0	0.2	-0.5	0.6	1/2
Foreign financing	0.7	0.5	0.6	-0.2	—	—
Gross domestic investment	29.9	31.9	31.1	30.2	30	30
Gross domestic savings	25.3	27.9	28.6	32.8	36	36
External current account	-2.1	-1.7	-1.1	4.9	8.3	7-8
External debt 7/	53.1	52.3	55.8	46.8	30.2	20-21
Short-term debt 8/	30.0	26.5	23.0	20.8	26.0	33
Debt service ratio 9/	20.9	22.8	23.8	24.7	30.1	20
Interest payments 9/	10.5	11.4	11.1	8.8	5.7	6
	(In billions of U.S. dollars)					
External current account	-1.6	-1.4	-0.9	4.6	9.8	10-12
Overall balance of payments	-1.3	-1.4	-2.5	2.6	6.8	5-6
Total external debt	40.4	43.0	46.8	44.5	35	28-30
Gross international reserves	7.5	8.2	8.4	8.6	10	12
(Months of imports of goods and services)	(2.8)	(2.8)	(2.9)	(2.7)	(2.5)	(2.5)

Sources: Data provided by the Korean authorities; and staff estimates

1/ October 1987.

2/ Based on U.S. dollar values.

3/ Information Notice Index. End of period, depreciation is negative.

4/ As a percentage of previous year's stock of money and quasi-money (M2 plus other liabilities).

5/ Includes Fertilizer Fund.

6/ In terms of monetary accounts.

7/ Includes public, publicly guaranteed, and private sector bank and nonbank debt of all maturities.

8/ As percent of total external debt.

9/ As percent of exports of goods and services; includes interest on short-term debt and debt service to the Fund.

Korea - Fund Relations
(As of January 31, 1988)

(Amounts in millions of SDRs,
unless otherwise specified)

I. Membership Status

- (a) Date of membership: August 26, 1955
(b) Status: Article XIV

(A) Financial Relations

II. General Department

- (a) Quota: SDR 462.8 million
- | | <u>Amount</u> | <u>Percent of quota</u> |
|---------------------------------------|------------------|-------------------------|
| (b) Total Fund holdings of Korean won | 831.9 | 179.76 |
| (c) Fund credit: | 369.7 | 79.9 |
| Of which: Credit tranches | 160.0 | 34.6 |
| CFP | 209.8 | 45.3 |
| SFF | -- | -- |
| EAR | -- | -- |
| (d) Reserve tranche position: | SDR 0.68 million | |
| (e) Current Operational Budget: | Included | |
| (f) Lending to the Fund: | None | |

III. Recent Stand-By and Special Facilities

- (a) Most recent stand-by arrangement
- (i) Duration: July 12, 1985 to March 10, 1987
 - (ii) Amount: SDR 280 million
 - (iii) Utilization: SDR 160 million
 - (iv) Undrawn balance: SDR 120 million
- (b) Previous stand-by arrangements during the last 10 years
- (1) (i) Duration: October 22, 1975 to June 30, 1976
 - (ii) Amount: SDR 20 million
 - (iii) Utilization: SDR 9 million
 - (iv) Undrawn balance: SDR 11 million
 - (2) (i) Duration: May 6, 1977 to December 31, 1977
 - (ii) Amount: SDR 20 million
 - (iii) Utilization: --
 - (iv) Undrawn balance: SDR 20 million

- (3) (i) Duration: March 3, 1980 to March 2, 1982
cancelled February 12, 1981
(ii) Amount: SDR 640 million
(iii) Utilization: SDR 320 million
(iv) Undrawn balance: SDR 320 million
- (4) (i) Duration: February 13, 1981
to February 12, 1982
(ii) Amount: SDR 576 million
(iii) Utilization: SDR 576 million
(iv) Undrawn balance: --
- (5) (i) Duration: July 8, 1983 to March 10, 1985
(ii) Amount: SDR 575.775 million
(iii) Utilization: SDR 575.775 million
(iv) Undrawn balance: --

(c) Special facilities in last 2 years
Compensatory financing: None

IV. SDR Department (As of January 31, 1988)	Amount	Percent of allocation
(a) Net cumulative allocation:	72.9	100.0
(b) Holdings:	22.0	30.2
(c) Current Designation Plan:	5.20	7.1

V. Administered Accounts

- (a) Trust Fund Loans: Not eligible
(b) SFF Subsidy Account: None

VI. Financial Obligations due to the Fund:

	Overdue Financial Obligations (3/31/88)	Principal and Interest Due			
		Feb.-Dec. 1988	1989	1990	1991
Principal Repurchases	--	144.9	129.9	75	20
Charges and Interest including SDR and TF (provisional)	--	<u>24.9</u>	<u>14.9</u>	<u>7.8</u>	<u>3.6</u>
Total	--	169.8	144.8	82.8	23.6

(B) Nonfinancial RelationsVII. Exchange rate arrangement

The exchange rate is determined daily on the basis of a currency basket; the rate was US\$1 = W 781.6 on January 31, 1988.

VIII. Last Article IV Consultation

Staff discussions for a supplemental consultation pursuant to the Principles and Procedures on Surveillance were held during May 18-June 5, 1987. The staff report (EBS/87/134) was discussed by the Executive Board on July 6, 1987.

Staff discussions were held during May 23-June 13, 1986; the staff also held the second review under the 1985-87 stand-by arrangement. The staff report (EBS/86/194) was discussed by the Executive Board on September 19, 1986. This consultation was conducted after 14 months. The following decisions were adopted:

1986 Consultation

1. The Fund takes this decision in concluding the 1986 Article XIV consultation with Korea, in the light of the 1986 Article IV consultation with Korea conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).
2. Korea maintains restrictions on payments and transfers for current international transactions as described in EBS/86/194 and SM/86/230 in accordance with Article XIV. The Fund welcomes the progressive liberalization by Korea of these restrictions and encourages the authorities in their determination to remove them as Korea's external position improves.

Review Under Stand-By Arrangement

1. Korea has consulted with the Fund in accordance with paragraph 4(d) of the stand-by arrangement for Korea (EBS/85/151, Supplement 2, 7/15/85), and paragraph 3 of the letter dated May 17, 1985 from the Minister of Finance of Korea, as modified by paragraph 19 of the letter dated December 6, 1985 from the Minister of Finance of Korea in order to review the progress made by Korea in implementing the program supported by the stand-by arrangement and to reach understandings on suitable performance criteria for the remaining period of the arrangement.
2. The letter dated July 25, 1986 from the Minister of Finance of Korea shall be attached to the stand-by arrangement, and the letter dated May 17, 1985, with annexed memoranda, as heretofore modified shall be read as supplemented and modified by the letter of July 25, 1986.

3. Accordingly,

- (a) the ceiling on net credit to the public sector from the banking system referred to in paragraph 4(a)(i) of the stand-by arrangement shall be as set out in the table attached to the letter of July 25, 1986;
- (b) the ceiling on the net domestic assets of the banking system referred to in paragraph 4(a)(ii) of the stand-by arrangement shall be as set out in the table attached to the letter of July 25, 1986; and
- (c) the limits on outstanding disbursed external debt referred to in paragraph 4(b) of the stand-by arrangement shall be as set out in the table attached to the letter of July 25, 1986.

IX. Technical assistance

1. STA: A visit to discuss monetary and external debt statistics took place in January-February 1985.
2. FAD: A tax review mission took place in May 1985.

X. Resident Representative

The Resident Representative's office was closed in July 1987.

Korea: Activities of the World Bank

During 1980-83, macroeconomic issues were at the core of the World Bank's dialogue with Korea, with heavy reliance on structural adjustment lending. Since that time, the country strategy has been focused increasingly on major sectoral issues, particularly financial sector, energy, agricultural, transport, and urban development policies. The balance between sector and project lending in each area is influenced strongly by a judgment on how Bank resources can be used to help the Government implement policy changes.

The first structural adjustment loan encompassed structural reform programs related to energy saving and improvements in industrial efficiency. Key components of the energy program included adjustments on retail prices for gasoline, diesel fuel, and coal; studies of electric power tariffs and petroleum product pricing; energy diversification in the form of liquefied natural gas (LNG); and analyses aimed at industrial structure and building energy conservation. With respect to industrial policy, the Government undertook a program to restructure and rationalize certain industries, withdraw gradually from investment decision making at the firm level, and foster competition through fiscal incentives, and import liberalization.

The second structural adjustment loan continued to support the Government's comprehensive adjustment program in the areas of industry, energy, and public sector efficiency. In industry, the program included import liberalization, reforms in import tariffs, liberalization of foreign investment, and restructuring of the fertilizer industry. In energy, the program included measures to improve pricing and investment planning in the electric power sector; pricing, taxation, and regulatory reforms in the petroleum and coal sectors; the introduction of LNG as an alternative energy source; and the fostering of energy conservation. In the public sector, measures were aimed at augmenting resource mobilization, reducing budget deficits, and increasing efficiency of the public enterprises. Both structural adjustment loans are now fully disbursed and a completion report has been prepared.

The industrial finance loans were designed to support the Government's long-range program of financial liberalization. The reforms are expected to improve resource allocation and raise efficiency in financial intermediation through enhancing the role of market forces in interest rate determination, increasing competition within the financial sector, and reducing the role of the Government in credit allocation. Priorities in the second loan include enhancing the underlying strength of the commercial banking sector, and constraining the indebtedness and improving the structure of the debt of the corporate sector. Measures to influence the price, composition, and quantity of

debt include interest rate adjustments and a reduced role of preferential credit. Measures to provide a more prominent role for equity capital include incentives to promote shareholding in the securities market.

The Bank staff's assessment of progress under the various loans is that Korea's overall economic performance in recent years has been impressive. Most major economic indicators, including GNP growth, the balance of payments, price behavior, and the public sector deficit, have shown significant improvement, reflecting both short-term stabilization and medium-term structural policies. Overall implementation of the program of macroeconomic reform has been careful, well-balanced, and successful. It has been associated with a broad process of liberalization in the areas of trade, foreign investment, and financial sector policies. The Government's policy signals have been consistent and its actions faithful to the announced reforms. Further measures continue to enjoy strong support from policymakers.

Korea: Lending of the World Bank Group
(As of December 31, 1987)

	<u>IBRD</u>	<u>IDA</u>	<u>Total</u>	<u>Percent</u>	<u>Undisbursed</u>
<u>(In millions of U.S. dollars)</u>					
Commitments					
Agriculture and social development	651.71	32.78	684.49	10.8	1.34
Education	268.15	35.00	303.15	4.8	45.13
Development finance corporations	1,264.12	—	1,264.12	19.9	85.21
Industry	484.68	—	484.68	7.6	33.37
Population	30.00	—	30.00	0.5	2.89
Power	332.74	—	332.74	5.2	141.50
Program lending/SAL	725.00	—	725.00	11.4	—
Tourism	24.88	—	24.88	0.4	—
Transportation	1,441.79	47.80	1,489.59	23.5	186.47
Urbanization	605.83	—	605.83	9.6	286.04
Water supply and sewerage	400.54	—	400.54	6.3	75.47
Total	6,229.44	115.58	6,345.02	100.0	857.42
Repayments	2,052.99	11.49	2,064.48		
Total outstanding (including undisbursed):	4,989.52	104.09	5,093.61		
Commitments for FY 1987	200.00	—	200.00		
Structural adjustment loans:	A loan of \$250 million, approved in December 1981, was fully disbursed by January 1983. A second loan of \$300 million, approved in November 1983, was fully disbursed by September 1984.				
Financial sector loans:	A first industrial finance project loan of \$255 million to support financial sector liberalization was approved in June 1983. A second loan of \$222 million was approved in June 1985.				

1/ Adjusted for cancellation.

- Recent economic work: Three reports have been completed since 1984; recent economic developments (July 1986); the conduct of industrial policy (July 1986), and external liability management (November 1986). Work on monetary management and trade strategy in the context of a balance of payments surplus is currently under way.
- IFC activity: As of March 31, 1987, total loan and equity commitments amounted to \$176.7 million of which, \$135.8 million has been cancelled, terminated, repaid, or sold. \$6.3 million remains undisbursed.
- Technical assistance: The IBRD has provided technical assistance to Korea through its standard lending operations for projects. In addition, the IBRD acted as the executing agent for a UNDP Planning Assistance Project for the preparation of the Fifth and Sixth Five-Year Plans, and for the UNDP project for task forces set up under the IBRD structural adjustment loans.
- Aid consultative group: The final meeting of the Consultative Group for Korea was held under the chairmanship of the IBRD in Seoul on July 16, 1984.



Office Memorandum

RECEIVED

1988 MAR -4 PM 12: 24

cc: PRN
WTO

To: Mr. Neiss
From: A.D. Crockett *Adc*
Subject: Korea--Briefing Paper

ASIAN DEPARTMENT March 4, 1988

I attach some comments on this brief that have been prepared by Ms. Schultze-Ghattas.

On the occasion of the last consultation with Korea, this department expressed some reservations with the line the staff proposed to take in relation to the authorities' medium-term payments objectives. We still have these reservations.

In particular, we cannot agree with the statement that "the international community should accept surpluses in the range of \$5-6 billion" without qualification. Given that the surplus expected for the current year is \$10-\$12 billion, it will clearly be some time before it comes down to the range of \$5-6 billion: to that extent the issue is somewhat academic. However, we have considerable reservations about endorsing, on a country-by-country basis, medium-term balance of payments "targets" that may well be internationally inconsistent.

Should you find it impossible to modify the brief in accordance with our suggestion, we would appreciate your drawing this matter to management's attention.

Attachment

cc: Mr. Frenkel
Mr. Tanzi
Mr. Francotte
Mr. Gupta
Mrs. Junz



Office Memorandum

TO: Mr. Crockett

FROM: M. Schultze-Ghattas *MSG*

SUBJECT: Korea--Briefing paper for the 1988
Article IV Consultation

March 4, 1988

The main comment on the above briefing paper concerns the Korean authorities' target range for the current account balance over the next few years. The paper supports the authorities' view that in order to allow debt reduction and reserve build-up at a moderate pace, Korea will have to maintain current account surpluses in the range of \$5-6 billion over the medium term (p. 6). This argument was also presented in the last Staff Report (EBS/87/134, p. 5) and at the time it was already questionable whether the envisaged target range implied indeed just debt reduction "at a moderate pace" or rather a strategy of "overkill." However, even if the authorities' view was correct at the outset, the situation appears to have changed significantly since mid-1987.

According to the last staff report (p. 5), the authorities' objective is to reduce outstanding external debt to \$30 billion (20 percent of GNP) by 1991. The current account target of \$5 billion in the medium term relates to this objective. At the same time, the current account surplus was projected to amount to US\$6.9 billion in 1987, and US\$7.7 billion in 1988, assuming an unchanged world environment and no further measures to reduce the surplus. Total outstanding external debt was expected to decline from US\$45 billion (47 percent of GNP) at end-1986 to US\$40 billion (35 percent of GNP) at end-1987.

In the event, Korea recorded a current account surplus of US\$9.8 billion in 1987, considerably larger than anticipated, and total outstanding external debt declined to US\$ 35 billion (30 percent of GNP) at end-1987. For 1988, a current account surplus of US\$10-12 billion is forecast, and external debt outstanding is expected to decline to US\$28-30 billion (20-21 percent of GNP), the level originally envisaged for 1991. It could be argued that the "overshooting" of the current account in 1987 and presumably also in 1988 (since further measures to reduce the external imbalance would take effect only with a time lag) now requires a corresponding downward adjustment of the medium-term target. It would seem appropriate to mention these issues in the briefing paper. It would also seem reasonable to point out that the external debt, on the staff's medium-term estimates for the current account, might be totally eliminated by 1991.

As regards the policy measures that should be taken in order to reduce the current account imbalance, the emphasis is rightly on market opening measures and exchange rate appreciation. However, the briefing paper is perhaps too cautious about the role of fiscal policy

in the adjustment process. Given the extent of the imbalances, it is difficult to imagine adequate adjustment without the support from fiscal policy.

It might also be useful to evaluate the possible contribution that other structural policies might make to the adjustment process, particularly those that affect the private sector's investment and saving behavior.

cc: Mr. Larsen



Office Memorandum

TO: Mr. Neiss

March 4, 1988

FROM: Helen B. Junz *HBJ*

SUBJECT: Korea--Draft Brief

I am attaching comments made by my colleagues on the above draft brief. Following our discussion, I am satisfied that the general policy thrust is described appropriately. However, you may wish to take into account the comments on marketing opening measures and the question regarding ^{policy measures} ~~market content~~ to allow the exchange rate regime to be opened to market forces.

Attachment

cc: Mr. Acquah
Ms. Kelly

Korea--Comments on Draft Brief

The brief adequately discusses the pertinent issues involved in Korea. There is no doubt that the most fundamental one is preventing the emergence of unsustainably large external current account surplus with the potential to destabilize domestic economic conditions as well as engender strong protectionist pressures in partner countries. Given the overall stance of financial policies and some upward push in wage costs and inflation, the needed external adjustment must rely logically on market opening arrangements along with an appropriate exchange rate policy. The question is to give content to this approach particularly as regards the time frame for implementing the various components of the adjustment (e.g., tariff reductions, reducing restrictions, etc., footnote, p. 7). To illustrate the point, how soon are the authorities to remove remaining exchange restrictions, or to shift to Article VIII status? In this context, the brief could usefully sharpen its focus in the area of exchange rate policy. It raises the issue of "the desirability of letting market forces play a more decisive role in exchange rate determination by moving to a flexible exchange rate regime." This issue is a critical one. It would be useful to spell out the concept of flexibility (p. 10).

The current account appears quite robust and there is a suggestion that it is unlikely to be dented in the short term, "given the lags in the reaction of trade flows" (p. 6). Yet, the brief seems to accept an overall payments surplus in a target range of US\$5-6 billion for 1988 (p. 6 and Annex Table), a target recommended to the international community as one which "would keep debt reductions and reserve build-up at a moderate pace." Is this target feasible, and in the case of overshooting what is the implication for reserve and external debt policy?

As regards the thrust of macroeconomic policies, we do feel that the contribution of domestic demand is not quite spelled out. For example, the 1988 budget is designed merely to be "neutral" in its impact, even though the fiscal stimulation provided to the economy in the preceding year was only modest (about 1/2 percent of GNP, and "macroeconomic policies" had moderately expansionary effects on demand" (p. 4). In light of the apparent difficulties in compressing the external surplus in the short term, it would seem appropriate to give a clearer indication of the role that fiscal policy could play in the external adjustment, albeit without endangering price stability.

On specific points the brief should take into account the following comments.

1. Market-opening

In the area of market opening measures more precision in the brief would be desirable. At a general level, the mission should argue for greater transparency and simplification of the trade system.

In the agricultural sector quantitative restrictions appear to be the principal barrier to imports. These include border measures, as well as Special Laws (e.g., the Grain Management Law, the Feed Management Law, etc.) and state-managed trading of most agricultural imports.

A significant reduction in protection would appear to require a major modification of Special Laws and State Trading practices as well as liberalization of more traditional border measures (QRs and tariffs). The mission will therefore need to fully understand the operation of the Special Laws and State Trading practices. In this respect the brief notes (page. 7, footnote 1) that the Special Laws have been revised; it is not clear, however, whether these revisions involve a major liberalization.

Special Laws also appear to be an important protective device for manufactured products. Also effective protection of finished products may be increased by the use of tariff quotas (temporary tariff reductions for items - mainly raw materials and intermediate products-- in short supply) and the recently introduced localization program (this provides various forms of financial assistance, including foreign currency loans at below market interest rates, and aims to deepen Korea's industrial structure, particularly in the upstream automobile and electronics subsectors). Also importers acquisition fees appear to be almost as important as tariffs in some sectors (e.g., automobiles). Defense surcharges are also applied to most imports. Significant market opening is likely to require adjustments in all these areas--in addition to reductions in normal QRs and tariffs.

With regard to the import surveillance list (page 8) the brief should clarify, if possible, if the more transparent safeguard system (which replaces the import surveillance system and adjustment tariff) has already been introduced as is stated in footnote 1, page 7.

2. The comment on the bottom of page 6 regarding "lags in the reaction of trade flows" to policy changes does not seem to be entirely consistent with trade developments in 1986 and 1987.

Finally, the brief should indicate that (a) the mission will collect information and hold discussions on trade issues that are to be covered in the comprehensive trade report being prepared by ETR and (b) "it will be proposed that the next Article IV consultation discussions be held on the 12-month cycle."



Office Memorandum

cc: WT

RECEIVED

1988 MAR -4 PM 1:16

TO: Mr. Neiss

ASIAN DEPARTMENT

March 4, 1988

FROM: Mrs. Ter-Minassian *J.T.M.*

SUBJECT: Briefing Paper for the 1988 Article IV Consultation with Korea

I have a few comments on your interesting brief for the consultation with Korea.

Perhaps the brief would benefit from a fuller discussion of recent trends in competitiveness--as measured by alternative indicators, including, if available, relative export prices, indices in relative profitability of exports and domestic goods, etc.--and of the staff's views on the implications of the recent sharp rise in relative unit labor costs for competitiveness in a longer-term perspective.

I agree entirely with the emphasis placed in the brief on a comprehensive effort to liberalize the economy, in areas such as import restrictions, capital controls, the financial system, and the exchange rate market. Indeed, as close an approximation to floating as is feasible in the current institutional framework of Korea's exchange and financial markets would be desirable, given the difficulty of assessing the appropriate levels of the exchange rate in the short and medium term. A more flexible exchange rate policy could probably make an important contribution to a sustained reduction of the current account surplus over the next few years, if it was accompanied by a tighter monetary policy and a relatively expansionary fiscal policy. Such a policy mix, especially if supported by the liberalization program referred to above, would sustain real domestic absorption while moderating inflationary pressures (which, as the brief points out, are beginning to build up, following the wave of labor unrest and wage increases in 1987).

The room for a moderately expansionary fiscal policy stance seems to me to be provided by the relatively low level of the public deficit. Perhaps the brief could indicate more explicitly that the mission will discuss the scope and nature of a selective fiscal stimulus, exploring in particular the desirability of stepping up public investment or of reducing some indirect tax rates, which would help dampen inflation and domestic savings.

cc: Mr. Tanzi
Mr. Tait
Mr. Nasashibi
Mr. Katz



Office Memorandum

HN

TO: Mr. Acquah

March 4, 1988

FROM: Margaret Kelly *MRK*

SUBJECT: Korea - Briefing Paper for the Article IV Consultation

The brief correctly states that large "surplus ... are not sustainable because they would create inflation and distort the production structure at home and intensify protectionism abroad" (page 5). It further notes that action is required particularly in the areas of market opening and exchange rate policies.

Following are some specific comments on trade issues. In addition, the brief should indicate that the mission will collect information and hold discussions on trade issues that are to be covered in the comprehensive trade report being prepared by ETR.

1. Market-opening

In the area of market opening measures more precision in the brief would be desirable. At a general level, the mission should argue for greater transparency and simplification of the trade system.

In the agricultural sector quantitative restrictions appear to be the principal barrier to imports. These include border measures, as well as Special Laws (e.g., the Grain Management Law, the Feed Management Law, etc.) and state-managed trading of most agricultural imports.

A significant reduction in protection would appear to require a major modification of Special Laws and State Trading practices as well as liberalization of more traditional border measures (QRs and tariffs). The mission will therefore need to fully understand the operation of the Special Laws and State Trading practices. In this respect the brief notes (page. 7, footnote 1) that the Special Laws have been revised; it is not clear, however, whether these revisions involve a major liberalization.

Special Laws also appear to be an important protective device for manufactured products. Also effective protection of finished products may be increased by the use of tariff quotas (temporary tariff reductions for items - mainly raw materials and intermediate products-- in short supply) and the recently introduced localization program (this provides various forms of financial assistance, including foreign currency loans at below market interest rates, and aims to deepen Korea's industrial structure, particularly in the upstream automobile and electronics subsectors). Also importers acquisition fees appear to be almost as important as tariffs in some sectors (e.g., automobiles).

Defense surcharges are also applied to most imports. Significant market opening is likely to require adjustments in all these areas--in addition to reductions in normal QRs and tariffs.

With regard to the import surveillance list (page 8) the brief should clarify, if possible, if the more transparent safeguard system (which replaces the import surveillance system and adjustment tariff) has already been introduced as is stated in footnote 1, page 7.

2. The comment on the bottom of page 6 regarding "lags in the reaction of trade flows" to policy changes does not seem to be entirely consistent with trade developments in 1986 and 1987.

3. Finally, I am attaching an article from the Financial Times (3/3/88) concerning Korea's trade surplus in January 1988.

S Korea's trade surplus jumps 20% in January

BY MAGGIE FORD IN SEOUL

SOUTH Korea's current account surplus for January leapt 20 per cent, pushed up by a 41 per cent rise in exports compared with last year, according to figures from the Bank of Korea, the central bank.

Exports rose to almost \$4bn, with cars showing a 94 per cent rise, and electronics sales up 46 per cent. Imports rose 49 per cent compared with January last year, with crude oil up 73 per cent and machinery up 67 per cent. The January trade surplus reached \$643m, and invisibles boosted the current account surplus to \$817m.

The figures for the first month place in doubt government forecasts of a current account surplus for the year of \$5bn-\$6bn. Seoul is under severe pressure from the US to reduce its trade surplus with Washington from the \$9.8bn recorded last year.

Mr James Baker, the US Treasury Secretary, who visited Seoul last week for the inauguration of President Roh Tae Woo, strongly urged South Korea to liberalise its markets to imports and appreciate the won currency.

The won is appreciating at an annualised rate of 20 per cent against the US dollar and some economists believe that the pace may be accelerated. They note that quicker appreciation could moderate the inflationary tendencies at present causing concern.

Companies, which are thought likely to be able to absorb a rise of between 10 and 15 per cent, would see stronger effects on profitability above that level. The Korea Traders Association yesterday expressed concern over the effect of won revaluation on small companies, warning of possible bankruptcies.

Company results, Page 33

cc: WST

INTERNATIONAL MONETARY FUND

March 4, 1988

Mr. Neiss

Korea--Briefing Paper for
the 1988 Article IV
Consultation

Attached is a copy of page 8
of the above-mentioned paper, on
which I have written my comments.

for *Alfonso*
Pierre Francotte

Pierre Francotte

[Are these the only remaining Art XIV restrictions?]

phasing out of the import surveillance list. It will also ^{ease} encourage the authorities to remove ^{the} remaining exchange restrictions on invisibles which are maintained in accordance with the transitional arrangements of Article XIV, ^{thus} ~~which will also qualify it to shift to Article VIII status, and to~~ setting the stage for a further ease restrictions on overseas investment by Korean residents.

In general, the mission will strongly argue in favor of a generalized approach to adjustment rather than relief from bilateral pressures through specific discriminatory measures, such as incentives to import from or to restrain exports to specific markets.

2. Exchange rate policy

The real exchange rate depreciated substantially between early 1985 and mid-1986, reflecting the pegging of the won to the sharply depreciating U.S. dollar. Since mid-1986, this link has been loosened and the won appreciated moderately (by 11 percent) against the U.S. dollar. Measured by the CPI-based Information Notice Index, the real exchange rate depreciated by 24 percent between early 1985 and mid-1986, and remained unchanged thereafter (Chart 1). Measured by relative unit labor costs, the real exchange rate declined by 21 percent during 1985-86 and appreciated by 13 percent in 1987, mainly due to the large wage increases in mid-1987 (Chart 2).

The staff team will assess the effect of recent real rate developments on trade flows. Given present balance of payments prospects, there is a need for further real appreciation in order to reduce the current account surplus to the target range of \$5-6 billion. The staff will reach a view on the extent of further appreciation, taking into account the authorities' intentions on further

Table 1. Korea: Exports Projection

28-Mar-88

Korea: Trade Projections "B" last review:	TTabd Value of Exports (Mill US\$)	Export Unit Values (1980=100)	Terms of Trade (1980=100)	Export Value (Base. Adj.)	Industrial Countries Export U.V. (1980=100)	T. Partners Real Demes. (1980=100)
	YH	PX	PX/PM	XGAD	PF1	YW
Q1: 1985	5967	97.20	107.17	152.34	93.68	110.22
Q2: 1985	6573	95.50	106.28	155.98	94.14	111.55
Q3: 1985	6772	94.40	105.24	160.91	95.84	112.66
Q4: 1985	7207	94.00	104.56	167.56	98.14	113.79
Q1: 1986	6803	95.50	108.52	182.17	100.69	114.70
Q2: 1986	8337	95.80	114.73	196.30	103.21	116.07
Q3: 1986	8959	97.30	118.51	206.53	104.14	117.00
Q4: 1986	9814	98.40	117.28	217.98	104.34	117.47
Q1: 1987	9257	101.60	118.41	233.00	106.33	118.06
Q2: 1987	11419	104.50	117.81	246.50	109.09	119.12
Q3: 1987	12023	107.10	118.34	251.81	109.96	120.79
Q4: 1987	13148	109.80	116.68	268.60	112.93	121.99
Source:	IMF-IFS	MSB-BOX		IMF-WEO	IMF-WEO	
Projections						
Q1: 1987	10337	100.72	117.39	224.32	106.33	118.06
Q2: 1987	10964	104.71	118.05	228.86	109.09	119.12
Q3: 1987	11407	108.22	119.58	230.37	109.96	120.79
Q4: 1987	11895	113.36	121.10	238.14	112.93	121.99
Q1: 1988	13602	112.50	117.49	271.20	117.11	122.00
Q2: 1988	14056	114.48	117.44	275.42	119.92	122.61
Q3: 1988	14509	115.39	117.35	280.58	121.84	123.35
Q4: 1988	14975	117.05	117.13	286.97	123.42	124.21
Q1: 1989	15510	119.04	117.37	292.25	124.66	125.08
Q2: 1989	16011	120.67	117.68	297.62	126.15	125.95
Q3: 1989	16521	122.36	118.03	303.04	127.67	126.84
Q4: 1989	17064	124.18	118.36	308.25	129.07	127.85
Q1: 1990	17462	124.94	118.50	313.49	129.59	128.74
Q2: 1990	17912	125.87	118.55	319.19	130.50	129.65
Q3: 1990	18426	127.02	118.56	325.38	131.67	130.55
Q4: 1990	18985	128.19	118.59	332.19	132.86	131.60
Q1: 1991	19525	129.21	118.82	338.95	133.65	132.52
Q2: 1991	20120	130.63	119.06	345.47	134.72	133.45
Q3: 1991	20724	132.06	119.28	352.00	135.93	134.38
Q4: 1991	21342	133.50	119.51	358.59	137.16	135.32
Q1: 1992	21886	134.39	119.70	365.31	137.84	136.27
Q2: 1992	22509	135.64	119.86	372.24	138.95	137.22
Q3: 1992	23182	137.11	119.96	379.25	140.20	138.18
Q4: 1992	23882	138.45	120.08	386.82	141.60	139.15
1986 actual	33913	96.89	114.76	200.75	103.09	116.31
1987 actual	45847	106.12	117.72	247.80	109.58	119.84
1987 projected	44604	107.15	118.93	238.75	109.58	119.84
1988 projected	57142	115.06	117.19	284.83	120.57	123.04
1989	65116	121.63	117.70	307.05	126.89	126.43
1990	72785	126.55	118.39	329.88	131.15	130.14
1991	81711	131.40	119.01	356.64	135.37	133.92
1992	91460	136.46	119.74	384.42	139.65	137.71
Percentage Change						
1987 actual	35.2	9.5	2.6	23.4	6.3	3.0
1987 projected	31.5	10.6	3.6	18.9	6.3	3.0
1988 projected	24.6	8.4	-0.5	14.9	10.0	2.7
1989	14.0	5.7	0.4	7.8	5.2	2.8
1990	11.8	4.0	0.6	7.4	3.4	2.9
1991	12.3	3.8	0.5	8.1	3.2	2.9
1992	11.9	3.8	0.6	7.8	3.2	2.8

Table 2. Korea: Imports Projection

29-Mar-88

Korea: Trade Projections "B" last review:	TTabd Value of Imports (Mill US\$)	Import Unit Values (1980=100)	Import Volumes (Seas. Adj.)	Non-Oil Imports		
				Value	Import Unit Values (1980=100)	Import Volumes (Seas. Adj.) (1980=100)
				(Mill US\$)	(1980=100)	(1980=100)
03/28/88 12:44 AM						
	MN	PM	MSR2	MNND	PND	MNOSA
Q1: 1985	6311	90.70	136.63	4422	86.47	149.00
Q2: 1985	6679	90.80	132.11	4855	87.08	141.48
Q3: 1985	6359	89.70	134.70	4706	85.97	147.36
Q4: 1985	7112	89.90	141.92	5114	85.33	152.09
Q1: 1986	6979	88.00	155.73	6023	86.82	202.13
Q2: 1986	7329	83.50	157.64	6223	85.84	183.95
Q3: 1986	7357	82.10	170.28	6280	86.54	195.36
Q4: 1986	8042	83.90	171.95	6778	87.59	198.66
Q1: 1987	7834	85.80	179.29	6670	86.46	224.78
Q2: 1987	9891	88.70	200.27	8310	88.47	238.35
Q3: 1987	9829	90.50	206.37	8483	90.34	252.90
Q4: 1987	10192	94.10	205.80	8687	92.50	252.80
Source:	IMF-IFS	NSB-BOK	MN/PM	MN-MDN	PM and PD	
Projections						
Q1: 1987	8934	85.80	186.78	7426	86.46	270.52
Q2: 1987	9330	88.70	188.63	7691	88.47	272.20
Q3: 1987	9819	90.50	194.63	8148	90.34	271.59
Q4: 1987	10715	94.10	204.27	9872	92.50	246.23
Q1: 1988	11015	95.75	218.58	9201	95.35	259.77
Q2: 1988	11477	97.48	223.73	9539	97.74	262.73
Q3: 1988	11902	98.84	228.81	10055	99.30	272.59
Q4: 1988	12291	99.93	233.71	10830	100.59	289.83
Q1: 1989	12888	101.43	241.46	11271	101.88	297.82
Q2: 1989	13495	102.54	250.09	11536	103.11	301.21
Q3: 1989	14134	103.67	259.07	11878	104.24	306.76
Q4: 1989	14730	104.91	266.78	12229	105.39	312.39
Q1: 1990	15204	105.44	274.01	12571	105.70	322.70
Q2: 1990	15706	106.18	281.09	13311	106.65	336.00
Q3: 1990	16258	107.13	288.36	13990	107.51	349.99
Q4: 1990	16862	108.10	295.41	14604	108.58	362.07
Q1: 1991	17469	108.75	305.24	15154	109.23	373.48
Q2: 1991	18143	109.72	314.19	15723	110.11	384.41
Q3: 1991	18836	110.71	323.29	16330	111.10	395.70
Q4: 1991	19555	111.71	332.63	16999	112.10	408.24
Q1: 1992	20219	112.27	342.22	17681	112.77	422.09
Q2: 1992	20966	113.17	352.04	18424	113.67	436.33
Q3: 1992	21777	114.30	362.04	19208	114.69	450.85
Q4: 1992	22598	115.33	372.34	20024	115.73	465.81
1986 actual	29707	84.32	163.90	25303	86.71	195.03
1987 actual	37746	90.02	195.05	32150	89.64	239.72
1987 projected	38798	89.98	200.59	32137	89.59	239.75
1988 projected	46684	98.06	221.47	39625	98.36	269.25
1989	55248	103.20	249.04	46915	103.69	302.40
1990	64031	106.75	279.04	54576	107.19	340.29
1991	74002	110.27	312.20	64206	110.68	387.73
1992	85560	113.81	349.72	75338	114.27	440.67
Percentage Change 1987 actual	27.1	6.8	19.0	27.1	3.4	22.9
1987 projected	30.6	6.7	22.4	27.0	3.3	22.9
1988 projected	23.7	8.9	13.5	23.3	9.7	12.3
1989	18.3	5.2	12.5	18.4	5.4	12.3
1990	15.9	3.4	12.0	16.3	3.4	12.5
1991	15.6	3.3	11.9	17.6	3.3	13.9
1992	15.6	3.2	12.0	17.3	3.2	13.7

Table 3. Korea: Relative Prices Projection

28-Mar-88

Korea: Trade Projections "B" last review: 03/28/88 12:44 AM	Real	Consumer	RF	Relative	GSEY.ZF
	Exchange Rate (1980=100)	Price Index	Nom. Exchang Rate W/US\$	Unit Labor Cost (1980=100)	Wages Monthly Earnings (1990=100)
	PDI/e*PM	PDI	E	w/(t+E*PM)	WGA
Q1: 1985	106.92	139.53	836.72	74.41	165.23
Q2: 1985	104.00	140.47	867.04	78.31	184.52
Q3: 1985	104.07	141.40	882.95	80.17	194.78
Q4: 1985	103.61	142.43	891.27	80.65	203.17
Q1: 1986	107.23	143.60	887.08	72.55	182.40
Q2: 1986	113.25	144.03	887.05	78.44	191.64
Q3: 1986	116.51	144.77	882.18	86.25	211.02
Q4: 1986	115.46	144.50	869.50	86.27	217.61
Q1: 1987	115.60	145.60	855.69	75.34	195.75
Q2: 1987	117.57	148.10	827.80	77.26	205.38
Q3: 1987	119.29	149.57	807.54	84.15	227.74
Q4: 1987	117.65	151.90	799.24	93.21	264.63
Source:		IMF-IFS	IMF-IFS		IMF-IFS
Projections					
Q1: 1987	115.23	145.27	855.69	75.34	195.75
Q2: 1987	116.06	146.20	827.80	77.26	205.38
Q3: 1987	118.22	148.22	807.54	84.15	227.74
Q4: 1987	120.78	155.83	799.24	93.21	264.63
Q1: 1988	121.00	152.25	766	91.48	250.00
Q2: 1988	121.41	152.28	750	90.30	252.56
Q3: 1988	121.44	152.38	740	88.80	255.15
Q4: 1988	121.25	153.82	740	86.81	267.76
Q1: 1989	122.00	157.09	740	87.33	279.37
Q2: 1989	122.74	159.77	740	88.11	291.17
Q3: 1989	123.50	162.54	740	88.90	303.47
Q4: 1989	124.15	165.36	740	89.60	316.29
Q1: 1990	124.53	166.69	740	89.26	323.55
Q2: 1990	124.83	168.27	740	88.84	331.35
Q3: 1990	125.10	170.14	740	88.25	339.34
Q4: 1990	125.40	172.09	740	87.66	347.53
Q1: 1991	126.01	173.95	740	88.27	359.69
Q2: 1991	126.55	176.28	740	88.46	371.67
Q3: 1991	127.09	178.62	740	88.66	384.04
Q4: 1991	127.62	180.99	740	88.86	396.83
Q1: 1992	128.12	182.61	740	88.92	407.78
Q2: 1992	128.58	184.73	740	88.82	419.50
Q3: 1992	128.99	187.16	740	88.54	431.55
Q4: 1992	129.41	189.47	740	88.35	443.95
1986 actual	113.14	144.23	881.45	80.88	200.67
1987 actual	117.13	148.77	822.57	82.45	223.37
1987 projected	117.28	148.88	822.57	82.49	223.37
1988 projected	121.20	152.68	749.00	89.24	253.87
1989	123.06	161.19	740.00	88.50	297.58
1990	124.95	169.30	740.00	88.49	335.44
1991	126.80	177.46	740.00	88.57	378.06
1992	128.76	185.93	740.00	88.65	425.69
Percentage Change 1987 actual	3.5	3.1	-6.7	1.9	11.3
1987 projected	3.7	3.2	-6.7	2.0	11.3
1988 projected	3.5	2.8	-8.9	8.2	18.1
1989	1.5	5.6	-1.2	-0.8	12.8
1990	1.5	5.0	0.0	-0.0	12.7
1991	1.5	4.8	0.0	0.1	12.7
1992	1.5	4.8	0.0	0.1	12.6

Table 4. Korea: Macro Projection

28-Mar-88

Korea: Trade Projections "G" last review: 03/28/88 12:44 AM	Econ. Active Population (Seas. Adj.)	REVISED	Permanent Income	Capital
		Adjusted Labor Productivity (Seas. Adj.)		Stock in Manuf. (Seas. Adj.)
	LSFSA	TEC1FSA	YPRM	SKM
Q1: 1985	16278	170.14	13743	35044
Q2: 1985	16363	174.45	13462	35569
Q3: 1985	16458	178.82	13957	36089
Q4: 1985	16553	183.25	13069	36605
Q1: 1986	16679	187.74	14615	37114
Q2: 1986	16807	192.28	14738	37619
Q3: 1986	16947	196.89	15535	38117
Q4: 1986	16950	201.55	14776	38609
Q1: 1987	17267	206.27	16624	39095
Q2: 1987	17448	211.04	16671	39574
Q3: 1987	17645	215.86	17646	40046
Q4: 1987	17747	220.05	17950	41050

Source:

Projections				
Q1: 1987	17267	206.27	16624	39095
Q2: 1987	17448	211.04	16671	39574
Q3: 1987	17645	215.86	17646	40046
Q4: 1987	17747	220.05	17950	41050
Q1: 1988	17922	225.87	18383	41779
Q2: 1988	18099	231.94	18825	42522
Q3: 1988	18277	237.97	19280	43278
Q4: 1988	18457	243.15	19745	44047
Q1: 1989	18594	248.45	20175	44829
Q2: 1989	18732	253.86	20614	45626
Q3: 1989	18871	259.39	21063	46437
Q4: 1989	19011	265.04	21522	47262
Q1: 1990	19152	270.81	21991	48102
Q2: 1990	19294	276.70	22470	48957
Q3: 1990	19437	282.73	22959	49827
Q4: 1990	19581	288.89	23459	50712
Q1: 1991	19726	295.18	23970	51613
Q2: 1991	19873	301.61	24492	52531
Q3: 1991	20020	308.18	25025	53464
Q4: 1991	20169	314.89	25570	54414
Q1: 1992	20318	321.75	26127	55381
Q2: 1992	20469	328.75	26696	56365
Q3: 1992	20621	335.91	27278	57367
Q4: 1992	20774	343.23	27868	58386
1986 actual	16846	194.62	53664	37865
1987 actual	17527	213.31	68891	39941
1987 projected	17527	213.31	68891	39941
1988 projected	18189	224.71	76234	42906
1989	18802	256.68	83375	46039
1990	19366	279.78	90879	49399
1991	19947	304.36	99058	53006
1992	20545	332.41	107989	56875
Percentage Change				
1987 actual	4.0	9.6	15.5	5.5
1987 projected	4.0	9.6	15.5	5.5
1988 projected	3.8	10.0	10.7	7.4
1989	3.4	9.4	9.4	7.3
1990	3.0	9.0	9.0	7.3
1991	3.0	9.0	9.0	7.3
1992	3.0	9.0	8.9	7.3

Table 5. Korea: National Accounts Projection

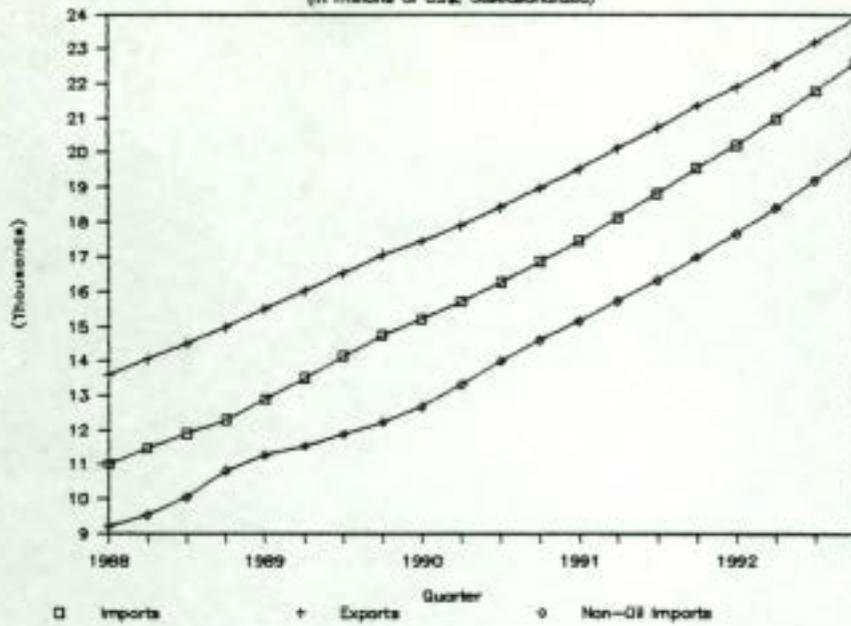
29-Mar-98

Korea: Trade Projections "B" last review:	Real	Real	Real	Real	Exports of	Imports of	Real	Net
	Domestic Demand	Government Consumption	Gross Capital Formation	Fixed Private Consumption	Goods and non-f. serv. non-f. serv.	Goods and non-f. serv. non-f. serv.	Expend. on GDP	Factor Income
03/28/88 12:44 AM	(B.1980 Mon)	(Seas. Adj.)	(Seas. Adj.)	(Seas. Adj.)	(B.1980 Mon)	(B.1980 Mon)	(B.1980 Mon)	(B.1980 Mon)
	DDN	GCSA2	INVSAA2	PCSA2	EXPSA	IMPAA	GDPAA2	NFI
Q1: 1985	12020	1316	4292	7873				
Q2: 1985	12556	1213	4151	7325				
Q3: 1985	13847	1231	4359	8109				
Q4: 1985	15124	1268	4355	9401	5239	5208	15155	-522.4
Q1: 1986	12955	1343	4934	6678	5954	5697	13039	-498.5
Q2: 1986	15024	1314	5001	8709	6349	5775	15523	-561.3
Q3: 1986	15295	1440	5138	8718	6657	6155	15723	-380.0
Q4: 1986	16365	1528	4876	9959	6822	6222	16881	-436.6
Q1: 1987	14816	1452	5748	7516	7494	6713	15408	-339.0
Q2: 1987	16535	1569	5650	9316	7866	7372	16840	-412.7
Q3: 1987	16790	1647	5815	9328	7971	7274	17299	-300.1
Q4: 1987	17389	1706	5430	10253	8503	7254	18449	-401.5
Source: NA/1987-90K								
Projections								
Q1: 1987	14816	1452	5748	7516	7021	6770	15067	-339.0
Q2: 1987	16535	1569	5650	9316	7163	6839	16859	-412.7
Q3: 1987	16790	1647	5815	9328	7210	7054	16946	-300.1
Q4: 1987	17389	1706	5430	10253	7140	7404	17125	-401.6
Q1: 1988	17527	1712	6053	9763	8488	7923	18093	-279.5
Q2: 1988	17742	1729	6199	9815	8620	8109	18253	-279.5
Q3: 1988	17950	1746	6348	9866	8782	8293	18449	-279.5
Q4: 1988	18181	1763	6501	9916	8982	8471	18691	-279.5
Q1: 1989	18703	1798	6658	10248	9147	8752	19098	-158.6
Q2: 1989	19283	1832	6818	10632	9315	9065	19534	-158.6
Q3: 1989	19882	1868	6983	11021	9484	9390	19976	-158.6
Q4: 1989	20361	1904	7151	11306	9648	9670	20329	-158.6
Q1: 1990	20805	1941	7324	11529	9812	9931	20685	-78.4
Q2: 1990	21258	1979	7500	11778	9990	10188	21060	-78.4
Q3: 1990	21721	2018	7681	12022	10184	10452	21453	-78.4
Q4: 1990	22244	2057	7866	12221	10397	10744	21897	-78.4
Q1: 1991	22825	2097	8056	12672	10608	11063	22370	-25.2
Q2: 1991	23375	2137	8250	12987	10813	11388	22800	-25.2
Q3: 1991	23939	2179	8449	13310	11017	11718	23229	-25.2
Q4: 1991	24516	2221	8653	13642	11223	12056	23683	-25.2
Q1: 1992	25107	2264	8862	13981	11433	12404	24137	11.6
Q2: 1992	25712	2308	9075	14329	11650	12760	24603	11.6
Q3: 1992	26333	2353	9294	14685	11870	13122	25080	11.6
Q4: 1992	26967	2399	9518	15050	12107	13496	25579	11.6
1986 actual	53640	5625	19950	34065	25682	23959	61165	-1876
1987 actual	65530	6374	22644	36512	31834	28613	67996	-1453
1987 projected	65530	6374	22644	36512	28534	28067	65997	-1453
1988 projected	71411	6951	25100	39360	34872	32796	73485	-1118
1989	78229	7403	27510	43216	37594	36876	78947	-634
1990	86027	7995	30371	47661	40383	41315	85095	-314
1991	94654	8634	33409	52611	43661	46225	92090	-101
1992	104120	9325	36749	58045	47060	51782	99398	46
Percentage Change								
1987 actual	9.9	13.3	13.5	7.2	24.0	19.9	11.2	
1987 projected	9.9	13.3	13.5	7.2	11.1	17.6	7.9	
1988 projected	9.0	9.1	10.8	7.8	9.5	14.6	8.1	
1989	9.5	6.5	10.0	9.8	7.8	12.4	7.4	
1990	10.0	8.0	10.0	10.3	7.4	12.0	7.8	
1991	10.0	8.0	10.0	10.4	8.1	11.9	8.2	
1992	10.0	8.0	10.0	10.3	7.8	12.0	7.9	

Korea: Trade Projections "B" last review: 03/28/88 (B.1986 Won) 12:44 AM (Seas. Adj.)		Real GNP
		GNP8A2
Q1: 1985		
Q2: 1985		
Q3: 1985		
Q4: 1985		14632
Q1: 1986		12540
Q2: 1986		14962
Q3: 1986		15343
Q4: 1986		16444
Q1: 1987		15069
Q2: 1987		16427
Q3: 1987		16399
Q4: 1987		18048
Source:		
Projections		
Q1: 1987		14728
Q2: 1987		16446
Q3: 1987		16646
Q4: 1987		16724
Q1: 1988		17813
Q2: 1988		17974
Q3: 1988		18169
Q4: 1988		18412
Q1: 1989		18940
Q2: 1989		19375
Q3: 1989		19817
Q4: 1989		20181
Q1: 1990		20606
Q2: 1990		20981
Q3: 1990		21374
Q4: 1990		21819
Q1: 1991		22344
Q2: 1991		22774
Q3: 1991		23213
Q4: 1991		23658
Q1: 1992		24148
Q2: 1992		24615
Q3: 1992		25091
Q4: 1992		25590
1986 actual		59289
1987 actual		66542
1987 projected		64544
1988 projected		72368
1989		78313
1990		84781
1991		91989
1992		99445
Percentage Change		
1987 actual		12.2
1987 projected		8.9
1988 projected		8.8
1989		8.2
1990		8.3
1991		8.5
1992		8.1

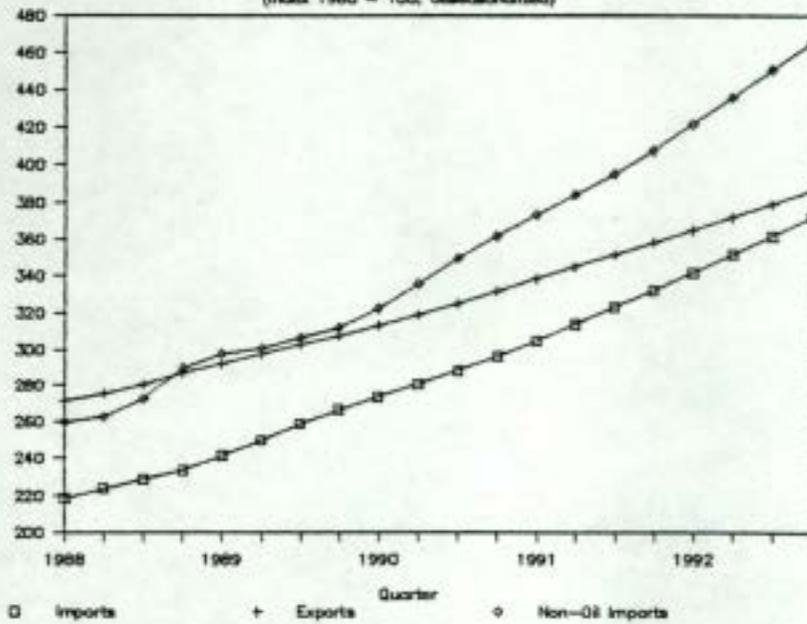
Korea: Trade Value Projections

(in millions of US\$, deseasonalized)



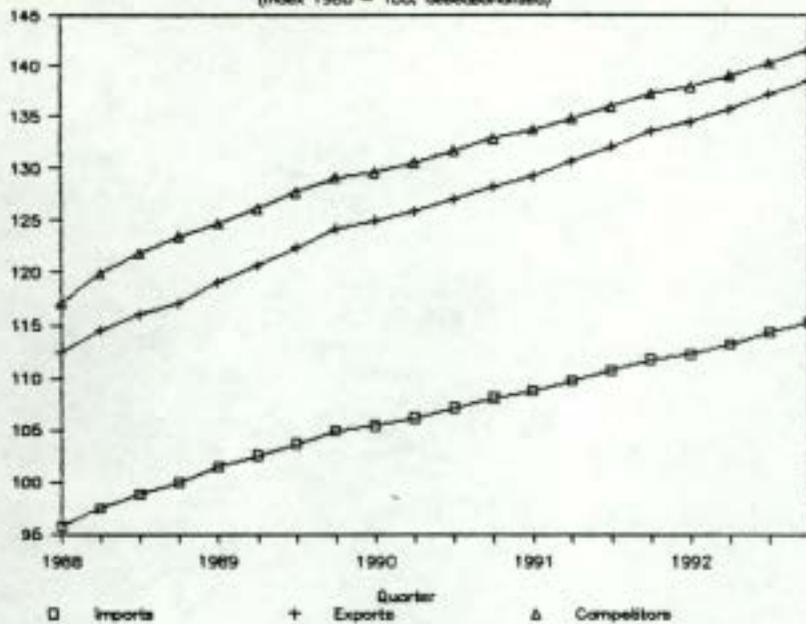
Korea: Trade Volume Projections

(Index 1980 = 100, deseasonalized)



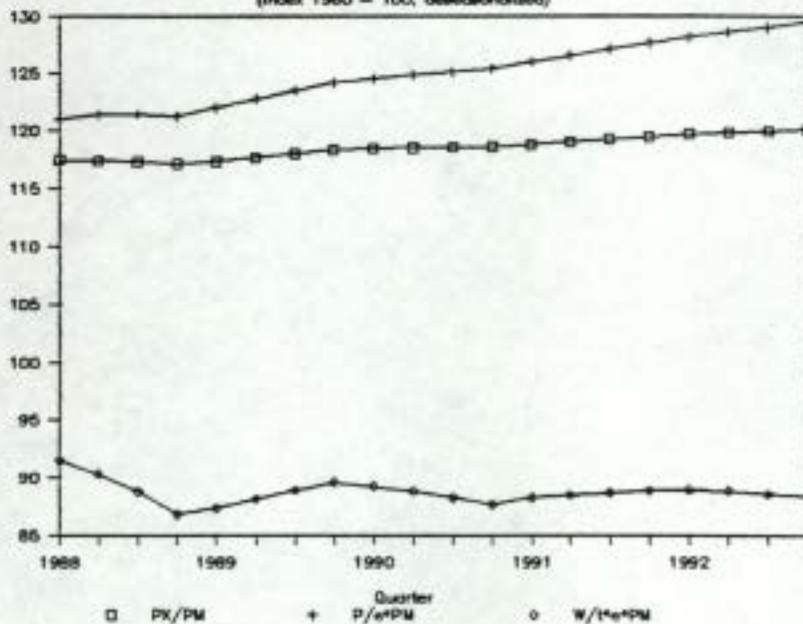
Korea: Trade Unit Value Projections

(Index 1980 = 100, deseasonalized)



Korea: Relative Price Projections

(Index 1980 = 100, deseasonalized)



Korea: Monetary Survey, 1983-88

End of Period	1983	1984	1985	1986	1987	Projections for 1988	
						Scenario A	Scenario B
(In billions of won)							
Net foreign assets	-5,082	-6,191	-7,697	-6,128	-1,605	3,564	3,564
Assets	6,387	7,375	8,122	8,332	8,647	10,987	10,987
Liabilities	11,469	13,566	15,819	14,460	10,252	7,423	7,423
Swaps with nondeposit money banks	-863	-1,234	-2,333	-1,566	-145	--	--
Net domestic assets	28,883	32,802	39,669	42,805	43,650	45,925	43,907
Domestic credit	31,847	36,859	42,561	48,698	56,074	60,038	62,331
Public sector	2,013	1,973	2,013	2837	412	-1,124	-1,124
Private sector	29,834	34,886	40,548	46,661	55,662	61,162	63,455
Net other items	-2,964	-3,257	-2,892	-5,893	-12,424	-14,113	-18,424
Of which: Monetary Stabilization Bonds	(-1,018)	(-1,525)	(-528)	(-3,088)	(-7,555)	(-9,044)	(-13,355)
Exchange Equalization Fund Bonds	(--)	(--)	(--)	(--)	(--)	(-200)	(-200)
Broad money plus certificates of deposit	22,938	25,377	29,639	35,110	41,900	49,489	47,471
Narrow money	6,783	6,821	7,558	8,809	10,107	12,042	11,535
Quasi-money	16,155	17,885	21,087	25,024	30,172	35,947	34,436
Certificates of deposit 1/	--	671	1,074	1,277	1,621	1,500	1,500
(Annual percentage change in relation to the stock of broad money) 2/							
Net foreign assets	-3.8	-4.8	-5.9	5.3	12.9	12.3	12.3
Swaps with nondeposit money banks	-3.8	-1.6	-4.3	2.6	4.0	0.3	0.3
Net domestic assets	22.8	17.1	27.0	10.7	2.4	5.4	0.6
Domestic credit	21.7	18.4	25.6	20.7	21.0	9.5	14.9
Public sector	-0.7	-0.2	0.1	0.1	-4.6	-3.7	-3.7
Private sector	22.4	18.6	25.5	20.6	25.6	13.1	18.6
Net other items	1.1	-1.3	1.4	-10.0	-18.6	-4.0	-14.3
Of which: Open market operations 3/	(-4.4)	(-2.2)	(3.9)	(-8.7)	(-16.8)	(-4.0)	(-14.3)
Broad money plus certificates of deposit	15.2	10.6	16.8	18.6	19.3	18.1	13.3
(Annual percentage change)							
Net domestic assets	18.7	13.5	20.9	8.0	2.0	5.2	0.6
Private sector credit	17.6	14.3	19.0	15.1	19.3	7.1	11.2

Source: Data provided by the Korean authorities.

1/ Certificates of deposit issued by commercial banks.

2/ Stock at the beginning of the period.

3/ Money Stabilization Bonds Issued by the Bank of Korea and Exchange Equalization Fund Bonds issued by the Government.

Korea--Table of Contents

Table 1	Balance of Payments, 1987-88
Table 2	Export Projections, 1987-88
Table 3	Export Volume Projections, 1986-88
Table 4	Export Unit Value Projections, 1987-88
Table 5	Import Projections, 1987-88
Table 6	Service Account Projections, 1987-88
Table 7	Impact of Liberalization, Tariff Cuts and Financing of Imports, 1983-88
Table 8	National Accounts, 1985-88

Table 1. Korea: Balance of Payments Projections, 1987-88

(In billions of U.S. dollars)

	1987	1988	
		EPB	IMF
Exports, f.o.b.	46.2	54.0	58.2
Volume (percent change)	24.6	8.2	14.5
Unit value (percent change)	9.3	8.0	10.0
Imports, f.o.b.	38.5	49.0	49.8
Oil	3.6	4.1	4.1
Volume (percent change)	-7.6	15.3	15.3
Unit value (percent change)	19.7	--	--
Non-oil	34.9	44.9	45.7
For domestic use	19.1	25.7	25.0
Volume (percent change)	21.6	26.3	19.0
Unit value (percent change)	4.6	6.5	9.7
For export production	15.8	19.2	20.7
Volume (percent change)	32.4	14.1	19.3
Unit value (percent change)	4.6	6.5	9.7
Trade balance	7.7	5.0	8.4
Services balance	0.9	1.0	1.7
Transfers balance	1.2	1.0	1.0
Current account	9.8	7.0	11.1
Assumptions			
Real GNP	12.2	8.0	10.0
Real domestic demand	10.2	8.5 1/	10.0 2/
Foreign demand	3.0	...	2.7
Oil price (\$/barrel)	17.0	17.0	17.0
LIBOR	7.5	...	7.5
Won/US\$	822.5	...	749.0

1/ Excludes inventories.

2/ Includes inventories.

Table 2. Korea: Export Projections, 1987-88

	1987	1988	
		EPB	IMF
<u>(In billions of U.S. dollars)</u>			
Total exports, f.o.b.	46.2	54.0	58.2
New exports	8.3	9.9	10.5
Other exports	37.9	44.1	47.7
<u>(Percent change)</u>			
Total exports	36.2	16.9	26.0
Volume	24.6	8.2	14.5
Unit value	9.3	8.0	10.0
New exports	61.8	19.2	26.5
Volume	48.1	10.4	15.0
Unit value	9.3	8.0	10.0
Other exports	31.6	16.4	25.8
Volume	20.4	7.7	14.4
Unit value	9.3	8.0	10.0
Memorandum items:			
Microwave ovens	43	11	20
VTRs	62	14	25
Magnetic tapes	14	10	10
Computers	58	32	32
Semiconductors	45	14	14
Automobiles	95	24	37

Table 3. Korea: Export Volume Projections, 1986-88

	Export Volume Index	Percent Change (1)	Export Volume Index	Percent Change (2)	Seasonal Factors
	1980=100	Same period year ago	Seasonally adjusted	Previous period	
1986	203.4	26.6	202.6	26.2	
Q1	165.5	19.6	182.2	6.8	90.9
Q2	202.2	25.8	198.0	8.7	102.1
Q3	214.0	28.4	208.7	5.4	102.5
Q4	231.8	30.1	221.6	6.2	104.6
1987	253.0	24.4	252.3	24.5	
Q1	211.7	27.9	233.2	5.2	90.7
Q2	253.9	25.6	248.6	6.6	102.2
Q3	260.9	21.9	254.7	2.5	102.4
Q4	285.4	23.1	272.8	7.1	104.7
1988	288.6	14.1	288.6	14.4	
Q1	260.3	23.0	286.9	5.2	90.7
Q2	291.6	14.8	285.4	-0.5	102.2
Q3	294.9	13.0	287.9	0.9	102.4
Q4	307.7	7.8	294.0	2.1	104.7
Export value		(US\$ mn.)	(Percent change)		
1987					
Jan.		2,831			
Feb.		2,902			
Mar.		3,574			
Q1		9,307			
1988					
Jan.		3,925	38.6		
Feb.		4,094	41.1		
Mar. (assumed) 1/		4,825	35.0		
Q1		12,844	38.0		
Unit value			12.3		
Volume			22.9		

1/ First 15 days of March, estimated increase in export value is 36.7 per cent.

Table 4. Korea: Export Unit Value Projection, 1987-88

(Percent change, unless otherwise indicated)

	1987	1988
Export unit value (in U.S. dollar)	9.3	10.0
US\$/won rate	7.2	9.8 1/
Export unit value (in won)	2.0	1.4 2/
Production costs	-0.4 3/	4.1 3/
Unit labor costs	0.7	7.3
Wage	11.6	18.0
Productivity	10.8 4/	10.0
Imported inputs (in U.S. dollar)	-2.4 (4.6)	-- (9.7)
Domestic inputs (WPI)	0.3	4.0
Unexplained	2.0	--
Memorandum items:		
Won/dollar rate	822.5	749.0
Export unit value of competitor industrial countries	7.0	10.0 5/
WEO world trade prices		
Manufacturers	12.0	8.0
Oil	28.9	--
Non-oil primary commodities	3.5	9.3

1/ Assume 88 percent passthrough.

2/ Assumed passthrough 35 percent.

3/ Assumed weights for labor costs (.40), imported inputs (.30), and domestic inputs (.3).

4/ Korea Productivity Center index.

5/ WEO projection of 10 percent increase in export unit value of competitor industrial countries (export weighted) is based upon a 4 percent increase in export unit values of industrial countries in SDR terms and 6 percent depreciation of the dollar vis-a-vis the SDR.

Table 5. Korea: Import Projections, 1987-88

	1987	1988	
		EPB	IMF
<u>(In billions of U.S. dollars)</u>			
Total imports, f.o.b.	38.5	49.0	49.8
Oil	3.6	4.1	4.1
Non-oil	34.9	44.9	45.7
Domestic use	19.1	25.7	25.0
Export production	15.8	19.2	20.7
<u>(Percent change)</u>			
Import value	29.7	27.3	29.3
Volume	22.4	20.1	18.7
Unit value	6.0	6.0	8.9
Oil value	10.6	15.3	15.3
Volume	-7.6	15.3	15.3 1/
Unit value	19.7	--	--
Non-oil value	32.1	28.7	30.7
Volume	26.3	20.8	19.2
Unit value	4.6	6.5	9.7
Domestic use value	27.2	34.6	30.6
Volume	21.6	26.3	19.0
Unit value	4.6	6.5	9.7
Export production	38.5	21.5	30.9
Volume	32.4	14.1	19.3
Unit value	4.6	6.5	9.7
Assumptions:			
Elasticity of import volume (domestic use) to domestic demand		1.6	1.0
Elasticity of import volume (export production) to export volume	1.3	1.3	1.3
Policy factors (US\$ bn.)		2.5	2.0 1/
Liberalization		1.0	1.5
Financing		1.5	0.5

1/ Assumed elasticity with respect to real GNP = 0.7 plus restocking which increases volume by an additional 8.3 percentage points.

Table 6. Korea: Service Account Projections, 1987-88

(In billions of U.S. dollars)

	1987	1988	
		EPB	IMF
Receipts	10.1	11.4	11.9
Freight and insurance	1.8	3.2	3.6
Investment income	0.8	1.0	1.0
Overseas construction	1.0	0.5	0.5
Travel	2.3	2.8	2.9
Transportation	0.9	-- 1/	-- 1/
Other	3.3	3.9	3.9
Payments	9.2	10.4	10.2
Freight and insurance	0.8	3.6	3.7
Investment income	3.6	2.8	3.1
Travel	0.7	1.3	0.9
Transportation	2.0	-- 1/	-- 1/
Other	1.9	2.5	2.3
Overseas construction	0.2	0.2	0.2
Net services	0.9	1.0	1.7

1/ Included with freight and insurance.

Table 7. Korea: Impact of Liberalization, Tariff Cuts and Financing of Imports

(In millions of U.S. dollars)

	1983	1984	1985	1986	1987	Proj. 1988
	(In 1983 prices)					
A. Actual non-oil imports domestic use (c.i.f.)	11386	12229	12786	16680	20096	23922
B. Estimated non-oil imports domestic use without measures (c.i.f.) 1/	11386	12445	12934	13971	15382	16931
	(In current prices) 2/					
C. Actual non-oil imports domestic use (c.i.f.)	11386	12538	12561	15922	20159	26314
D. Estimated non-oil imports domestic use without measures (c.i.f.) 1/	11386	12756	12701	13398	15428	18624
E. Impact of measures (C-D) (accumulated flows)		-218	-140	2524	4731	7690
F. Annual impact of measures		-218	78	2664	2207	2959

1/ Assumes that these imports grow at the same rate as real domestic demand, that is, assumes an import elasticity equal to one.

2/ Rows A. and B. reflatd by non-oil import unit values.

Table 8. Korea: National Accounts

3/20 11p

	1985	1986P	1987P	1988 IMF	1988 Off.
1 Exp on GDP (1980 prices)					
Final consumption	37191.6	39689.5	42886.2	46311.0	46311.0
Household	31676.3	33657.8	36069.5	38877.6	
Priv. non-profit inst	370.1	406.7	442.6	482.4	
Total private	32046.4	34064.5	36512.1	39360.0	39360.0
General Government	5145.2	5525.0	6374.1	6951.0	6951.0
Gross capital formation	17769.1	19639.3	22487.6	25600.0	25854.0
Gross fixed capital form	17355.7	19950.4	22643.7	25100.0	24884.0
Increase in stocks	413.4	-311.1	-156.1	500.0	1050.0
AGGREGATE DOMESTIC DEMAND	54960.7	59328.8	65373.8	71911.0	72165.0
Exports of goods & service	20279.5	25682.3	31834.6	36285.0	34478.0
Goods	16637.9	21008.3	26008.3	29779.5	28011.0
Services	3641.6	4674.0	5826.3	6505.5	6467.0
Imports of goods & serv	28124.1	23859.0	28612.7	33869.0	33743.0
Goods	16785.8	20289.1	24407.8	28972.0	29394.0
Services	3338.0	3569.9	4204.9	4896.9	4349.0
Statistical discrepancy	-441.7	14.3	-599.2	0.0	0.0
Expenditure on GNP	54674.4	61166.4	67996.5	74327.0	72900.0
Net factor income	-1969.0	-1876.6	-1453.6	-1135.0	-1058.0
GNP	52705.4	59289.8	66542.9	73192.0	71850.0
Nominal GNP	72849.8	83833.0	96995.9	110955.5	
GNP deflator	4.1	2.3	3.1	4.0	
2 RATES OF CHANGE					
Final consumption		6.7	8.1	8.0	8.0
Household		6.3	7.2	7.8	
Priv. non-profit inst		9.9	8.8	9.0	
Total private		6.3	7.2	7.8	7.8
General Government		9.3	13.3	9.1	9.1
Gross capital formation		10.5	14.5	13.8	15.0
Gross fixed capital form		15.0	13.5	10.8	9.5
Increase in stocks					
AGGREGATE DOMESTIC DEMAND		7.9	10.2	10.0	10.4
Exports of goods & services		26.6	24.0	14.0	8.3
Goods		26.3	23.8	14.5	7.7
Services		28.4	24.7	11.7	11.0
Imports of goods & serv		18.6	19.9	18.4	17.9
Goods		20.8	20.3	18.7	20.4
Services		6.9	17.8	16.5	3.4
Statistical discrepancy					
Expenditure on GDP		11.9	11.2	9.3	7.2
Net factor income		-4.7	-22.5	-21.9	-27.8
GNP		12.5	12.2	10.0	8.0

tb8kr9 (3/20/88) WT

Korea: Exchange Rate Assumptions, 1987-88

	1987	1988
Won/dollar average (percent change \$/won)	822.5 7.2	749.0 1/ 9.8
	(Percent change, annual average)	
SDR/won (1) / (2)	-2.7	4.0
\$/won (1)	7.2	9.8
\$/SDR (2)	10.2	5.6
Real effective rate (CPI)	-1.0	...
CPI Korea	3.0	6.0
CPI industrial countries	3.0	3.0
Unit labor cost Korea	3.3	12.0
Unit Labor cost industrial countries	-0.3	0.6
Export unit value Korea	9.3	11.5
Export unit value industrial countries	6.9	9.6

1/ Implies quarterly values of:

1988	Q1	Q2	Q3	Q4
Won/US\$	765	750	740	740

Korea: 1987 Trade Projection Using Actual Data for "Independent Variables", 1986-87

	1986	1987		
		Supplemental Consultation Projection	Revised Projection with Actual Data	Estimated Actual
<u>(In billions of U.S. dollars)</u>				
Export value	33.9	43.5	43.4	46.2
Import value	29.7	38.7	39.0	38.5
Oil	3.3	4.4	4.2	3.6
Non-oil	26.4	34.3	34.8	34.9
For domestic use	15.0 1/	17.8	18.3	19.1
For export production	11.3 1/	16.5	16.5	15.7
<u>(Percent change)</u>				
Export value		28.2	28.0	36.2
Volume		20.4	17.1	24.6
Unit value		6.5	9.3	9.3
Import value		30.3	31.3	29.7
Volume		19.3	23.5	22.4
Unit value		9.3	6.3	6.0
Oil import value		35.7	29.9	18.6
Volume		7.0	8.5	-7.6
Unit value		26.8	19.7	19.7
Non-oil import value		29.7	32.3	32.1
Volume		21.2	26.5	26.3
Unit value		7.0	4.6	4.6
Imports for domestic use		23.2	22.0	27.2
Volume		15.1	16.6	21.6
Unit value		7.0	4.6	4.6
Imports for export production value		37.5	46.0	38.5
Volume		28.5	39.6	32.4
Unit value		7.0	4.6	4.6
Assumptions:				
Real GNP		10.0	12.2	12.2
Real domestic demand		8.6	10.2	10.2
Foreign demand		2.4	3.0	3.0
Oil price (\$/barrel)		18	17	17

1/ Data revised. At the time the supplemental consultation projections were made, imports for domestic use were \$14.4 billion and for export production \$12.0 billion.

Korea: Indicators of Competitiveness 1/, 1979-88

	Information Notice Index	Relative Unit Labor Costs	Relative Normalized Unit Labor Costs	Relative Export Unit Values
<u>(Percent change, end of period)</u>				
1979	15.6	15.8	15.8	2.1
1980	-12.3	-32.7	-31.2	-10.5
1981	4.1	2.2	2.5	4.4
1982	1.3	1.1	0.5	-0.7
1983	-4.8	-5.7	-8.6	-0.1
1984	1.9	5.0	0.5	6.1
1985	-15.9	-16.9	-17.3	-7.7
1986	-6.9	-15.9	-13.0	-1.5
1987	-1.8	11.6	13.3	3.1
<u>(Percent change, period average)</u>				
1979	...	5.6	7.7	6.1
1980	...	-16.5	-18.5	-6.0
1981	4.4	-12.5	-8.5	-0.2
1982	2.4	3.7	-1.0	-1.1
1983	-3.9	-5.4	-5.2	-1.0
1984	-1.4	-1.1	-3.5	3.8
1985	-5.7	-1.9	-6.7	-0.4
1986	-15.6	-23.8	-20.7	-6.2
1987	-1.0	-0.5	0.7	2.8
1988 Jan.	0.8 2/			

1/ Increase is appreciation.

2/ December 1987-January 1988.

Table 3. Korea: Real Effective Exchange Rate, Relative Unit Costs, (Korea Productivity Center Productivity Index) 1980 = 100

	Relative Unit Costs	Real Effective Rate
1980	100.0	100.8
Q1	103.5	113.5
Q2	102.3	106.0
Q3	99.7	97.2
Q4	95.0	86.6
1981	95.8	88.1
Q1	97.0	86.7
Q2	93.2	85.7
Q3	96.7	91.8
Q4	96.1	88.4
1982	98.7	91.4
Q1	101.5	93.1
Q2	96.7	88.8
Q3	100.9	94.2
Q4	95.7	89.4
1983	99.0	86.4
Q1	100.6	89.2
Q2	98.3	86.1
Q3	98.4	86.1
Q4	98.5	84.3
1984	99.0	85.5
Q1	101.2	86.3
Q2	96.0	81.7
Q3	98.0	85.5
Q4	101.1	88.5
1985	103.6	83.9
Q1	102.3	90.7
Q2	107.1	89.5
Q3	103.2	81.5
Q4	101.8	73.9
1986	97.0	63.9
Q1	100.1	69.3
Q2	95.5	62.9
Q3	96.6	61.2
Q4	95.8	62.2
1987	99.1	63.6
Q1	96.0	61.0
Q2	92.8	58.8
Q3	98.6	65.1
Q4	109.2	69.4

Table 2: Korea: Real Effective Exchange Rate
 Normalized Relative Unit Labor Costs, 1980-87
 (Index 1980 = 100)

	Normalized Relative Unit Labor Costs	Real Effective Rate
1980	96.3	96.7
Q1	95.2	104.4
Q2	96.7	100.2
Q3	96.9	94.4
Q4	96.5	87.9
1981	102.1	94.0
Q1	99.9	89.3
Q2	101.8	93.5
Q3	103.8	97.8
Q4	103.6	95.4
1982	106.8	98.2
Q1	104.7	96.0
Q2	104.2	95.6
Q3	107.2	100.1
Q4	108.1	101.0
1983	112.0	97.9
Q1	109.7	97.3
Q2	112.3	98.4
Q3	113.8	98.9
Q4	113.1	96.8
1984	114.5	98.8
Q1	113.8	97.1
Q2	113.7	96.8
Q3	114.3	99.8
Q4	116.1	101.7
1985	118.8	96.1
Q1	114.4	101.4
Q2	122.0	101.9
Q3	118.3	93.5
Q4	120.5	87.5
1986	120.1	79.1
Q1	117.9	81.6
Q2	119.6	78.8
Q3	121.5	77.0
Q4	121.5	78.9
1987	128.3	83.1
Q1	120.4	76.5
Q2	122.1	77.4
Q3	126.1	83.2
Q4	144.4	95.3

Table 1: Korea: Real Effective Exchange Rate
 Relative Unit Labor Costs, 1980-87
 (Index 1980 = 100)

	Relative Unit Labor Costs	Real Effective Rate
1980	100.4	100.0
Q1	103.9	114.0
Q2	94.6	98.0
Q3	101.8	99.2
Q4	101.2	92.2
1981	97.2	89.5
Q1	97.4	87.1
Q2	92.9	85.3
Q3	96.4	91.5
Q4	102.1	94.4
1982	108.2	100.2
Q1	104.7	96.0
Q2	104.8	96.1
Q3	112.1	104.7
Q4	111.1	103.8
1983	115.2	100.7
Q1	114.6	101.6
Q2	116.1	101.7
Q3	116.0	101.5
Q4	114.3	97.8
1984	113.1	97.7
Q1	111.2	94.9
Q2	110.1	93.7
Q3	114.0	99.5
Q4	117.2	102.6
1985	127.3	102.9
Q1	118.5	105.0
Q2	134.2	112.1
Q3	127.2	100.5
Q4	129.2	93.8
1986	123.4	81.3
Q1	121.1	83.9
Q2	122.3	80.6
Q3	124.9	79.2
Q4	125.4	81.4
1987	139.8	89.7
Q1	128.9	81.9
Q2	131.0	83.1
Q3	146.2	96.5
Q4	153.3	97.4

eg8kr6 (3/22/88) WT

Korea--1988 Article IV Consultation
Agenda for Policy Meeting in International Finance

Wednesday, March 23, 1988 at 10:00 a.m.

1. Exchange rate policy, developments in 1987, future exchange rate policy, floating exchange rate regime.
2. Foreign exchange controls, plans for liberalization, impact on payments.
3. International capital market policies:
 - overseas investment;
 - foreign investment.
4. External debt management:
 - plans for prepayment of public sector debt;
 - plans for prepayment of debt by financing:
institutions and nonbank private sector;
 - objectives for reducing debt in medium term.

Korea--1988 Article IV Consultation

Agenda for Policy Discussion on Fiscal Matters
Friday, March 18, 1988 at 4:40 p.m.

1. Revenue developments in 1987 in relation to the original 1987 budget projections (Table IV-2, page 128 in the 1988 Answers to the Questionnaire).
2. The increase in the effective import duty rate in 1987; the impact of the reduction in the duty on petroleum imports from 24.5 percent to 10 percent, as well as changes in duty rates on other products.
3. The impact of the reduction in excises on consumer durables in 1987.
4. Preliminary 1987 budgetary outcome (Tables IV-1, p. 127; Table IV-3, p. 129; and Table IV-4, p. 130).
5. New tax measures in the 1988 budget; revenue projections for 1988.
6. Incentives to saving in the tax system.

ag8kr3 (3/15/88) WT

Topics for Technical Meeting on Economic Management
and Balance of Payments

Friday, March 18, 1988, at 3:00 p.m.

1. Macroeconomic projections for 1988 and in the medium term (e.g., growth, inflation, current account).
2. Quantitative estimates of effects on exports of increase in wages.
3. Quantitative estimates of effect on current account of recently announced measures to deal with the current account surplus.
4. Targets for domestic savings and investment in 1988 and over the medium term. Policy measures underlying these targets.
5. Target for external debt reduction and external reserves in 1988 and in the medium term.

Korea--1988 Article IV Consultation

Topics for Discussion--Monetary Sector Developments
and Policies

Friday, March 18, 1988 at 10:00 a.m.

I. Recent Developments

1. Monetary Aggregates

- Deviations of actual from target values in 1987.
- Income velocity and demand for monetary aggregates.
- Ceilings applied to the issue of CD's.

2. Developments in the Financial Markets.

- Interest rates of domestic financial instruments and local credit.
- Secondary market for monetary stabilization bonds.
- Comparison of formal and informal market interest rates.

3. Activities of foreign banks.

- Forward exchange markets.
- Domestic and foreign interest rates and private international capital flows.

4. Projections for 1988: Targets and assumptions.

- Monetary aggregates: Domestic credit and net foreign assets.
- Interest rates.

II. Policy Measures

1. Measures to control the expansion of liquidity.

- Domestic credit restraint; BOK rediscount; minimum reserve requirements.
- Monetary stabilization bonds. Type of instruments.
- Controls on international capital flows.

2. Controls on interest rates.

- Extent and effectiveness of the controls on the interest rates.
- Rationale for the interest rate level selected.
- Restrictions on the allocation of credit.
- Restrictions on the issue of financial instruments.

Korea--1988 Article IV Consultation

Agenda for Meeting on Budget Policy
Thursday, March 17, 1988 at 4:40 p.m.

1. Macroeconomic parameters and objectives of the 1988 budget.
2. Revenue projections for 1988 in light of the higher than budgeted revenue in 1987.
3. Priorities in the expenditure program--the introduction of a pension scheme and a minimum wage, and the plan to extend the coverage of the national health insurance.
4. Wage policy and employment in the public sector.
5. Plans for prepayment of external public debt.
6. Debt services; financing of the 1988 budget deficit; the budgetary implications of the exchange equalization bonds; the functioning of the Fiscal Investment and Financing Special Account (FIFSA).
7. Foreign aid: existing program, plans for expansion, budgetary impact.
8. The role of budgetary policies over the medium term in reorienting the structure of production toward domestic demand.

qs8kr4 (3/16/88) WT

Questions for Technical Meeting on International Finance

Thursday, March 17, 1988, at 2:30 p.m.

Developments

1. Please discuss the substantial increase in receipts on travel and the large positive entry of errors and omissions in 1987.
2. Please discuss reasons for the net inflows on account of nondebt related asset transactions, particularly export suppliers' credits.
3. Please discuss the early repayment of external debt in 1987 and the plans for 1988 and beyond.
4. Please discuss the early repayment of external debt by the private sector. Please discuss the utilization of the Bank of Korea's foreign currency loan scheme and any plans to hasten debt repayment by the private sector.

Policies

5. Please discuss recent changes in controls on invisible payments and current plans for further relaxation of controls.
6. Please discuss recent changes in the policy regarding overseas investments by Korean residents. Are there any plans for changes in these policies?
7. Please discuss recent changes in policies regarding other capital inflows and outflows. Are there any plans for further changes?
8. Please discuss the current policy with respect to the extension of short-term trade credits, and any plans for changes in these policies.
9. Please describe the operations of the forward exchange market.

10. Please provide debt service projections through 1992 for the stock of outstanding debt at end-1987, assuming no new borrowing. Please distinguish amortization payments above and below the overall BOP line.

11. Please provide projections for the capital account for 1988-92.

qs8kr2 (3/15/88) RB

Questions for Technical Meeting on Labor Matters

Thursday, March 17, 1988 at 10:00 a.m.

1. Please provide a table on man-days lost per annum as a result of work stoppages during 1982-87.
2. Please provide a table on wage increases by major selected sectors after labor disputes in 1987. Kindly explain the estimate of 10 percent nominal wage increase for 1987 and 6 percent carryover for 1988 (seems to be on low side).
3. Please estimate the relative contribution of lower growth, higher wages, and increased automation to the estimate of 3.7 percent unemployment in 1988.
4. Please update Table II-2 on wages and labor productivity as much as possible.
5. Please provide estimates of the likely impact of minimum wage legislation on wages and employment.
6. Please update the table on labor costs of enterprises on page 56 of the printed answer to questionnaire.

Questions for Technical Meeting on Trade Matters

Wednesday, March 16, 1988 at 11:00 a.m.

Trade developments

1. Please discuss reasons for the substantially larger growth in the volume of exports and imports in 1987 compared with projections made during the supplemental consultation in May 1987. Please discuss the performance of new exports in 1987 compared with projections.

2. Please discuss developments in export unit values in 1987 and 1988. What is the outlook for the trade balance in 1988.

3. Please discuss any quantitating estimates of the effects on the trade balance of: (1) changes in the real effective value of the won, (2) changes in protectionist measures, and (3) Korea's trade liberalization program.

4. Please discuss developments in the competitiveness and profitability of export industries. Please provide any quantitative estimates of the impact of the increase in wages.

5. Please discuss developments in import penetration in Korea, e.g., the proportion of imports in domestic demand, and in major product categories (e.g., agriculture, manufacturing, major manufactured products)

6. Please provide data on crude petroleum imports (f.o.b.)

	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>
Value	5,572	5,771	5,326		
Volume (barrels mn.)	192.9	199.7	198.3		
\$/barrel	28.8	28.0	26.7		

Please provide quarterly import values for oil and non-oil imports for 1983-87.

Questions for Technical Meeting on National Income
Accounts and Prices

Wednesday, March 16, 1988 at 10:00 a.m.

A. National income accounts

1. Please provide 1987 data in the following questionnaire tables:

Tables I-1 to Tables I-3, household savings, composition of private consumption, increase in stocks, gross capital formation. Please comment on main developments in 1987 (Questions I-1 to I-3).

2. Please provide 1988 forecasts for Tables I-1 to Tables I-3. Please provide key assumptions for these forecasts (Question I-4). Please comment on the sustainability in the medium term of the 1987 savings rate of about 35 percent.

3. Please provide estimates of GNP potential growth and underlying methodology (Question I-7).

4. Please complete Tables I-6 to I-12 on manufacturing production and discuss major developments in 1987 (Question I-9).

5. Please provide details on the utilization of special foreign currency loan system (amounts, type of imports, source of imports) for 1987, so far in 1988, and projection for whole of 1988.

6. Please provide more specific detail on major industrial policy measures taken since beginning of 1987. Please describe the forms and amounts of technical assistance, financial support, and tax incentives extended.

7. Please explain the wide range in the value of projected new overseas contracts for 1988 (Table I-14).

B. Prices

1. Please explain the impact on food price increases in the last quarter of 1987 of flooding and wage increases in September-October 1988.
2. Please list reductions of indirect and import taxes in 1987 directed to lower price pressures.
3. Please describe methodology underlying 1988 forecasts of 2-3 percent for WPI and 4-5 percent for CPI.

Country: Korea
Dates of Mission: 3/14/88-3/30/88

- () Tentative
 () Agreed with ED
 (X) Finalized with authorities

Mission Members: H. Neiss
 W. Tseng
 R. Baban
 G. Le Fort
 A.M. Jul
 M. Katz

		<u>Scheduled</u>	<u>Submitted</u>	
<u>Questionnaire:</u>	To mail -	3/1/88	
<u>Briefing Paper:</u>	To Editor -			
	To Front Office -		3/2/88	
	To Departments -		3/3/88	
	To Management -		3/4/88	
<u>Staff Report:</u> (X)	To Editor -	4/8/88		
	To Front Office -	4/12/88		Reviewer:
	To Departments -	4/14/88		
() CFF	To Management -	4/18/88		
() Stand-by Review	To Secretary's	4/25/88		
<u>RED:</u>	To Editor -	4/22/88		
	To Front Office -	4/27/88		Reviewer:
	To Departments -			
	To Secretary's -	5/6/88		

(90-days' deadline):

Work Assignments: 1/

Area

Responsibility

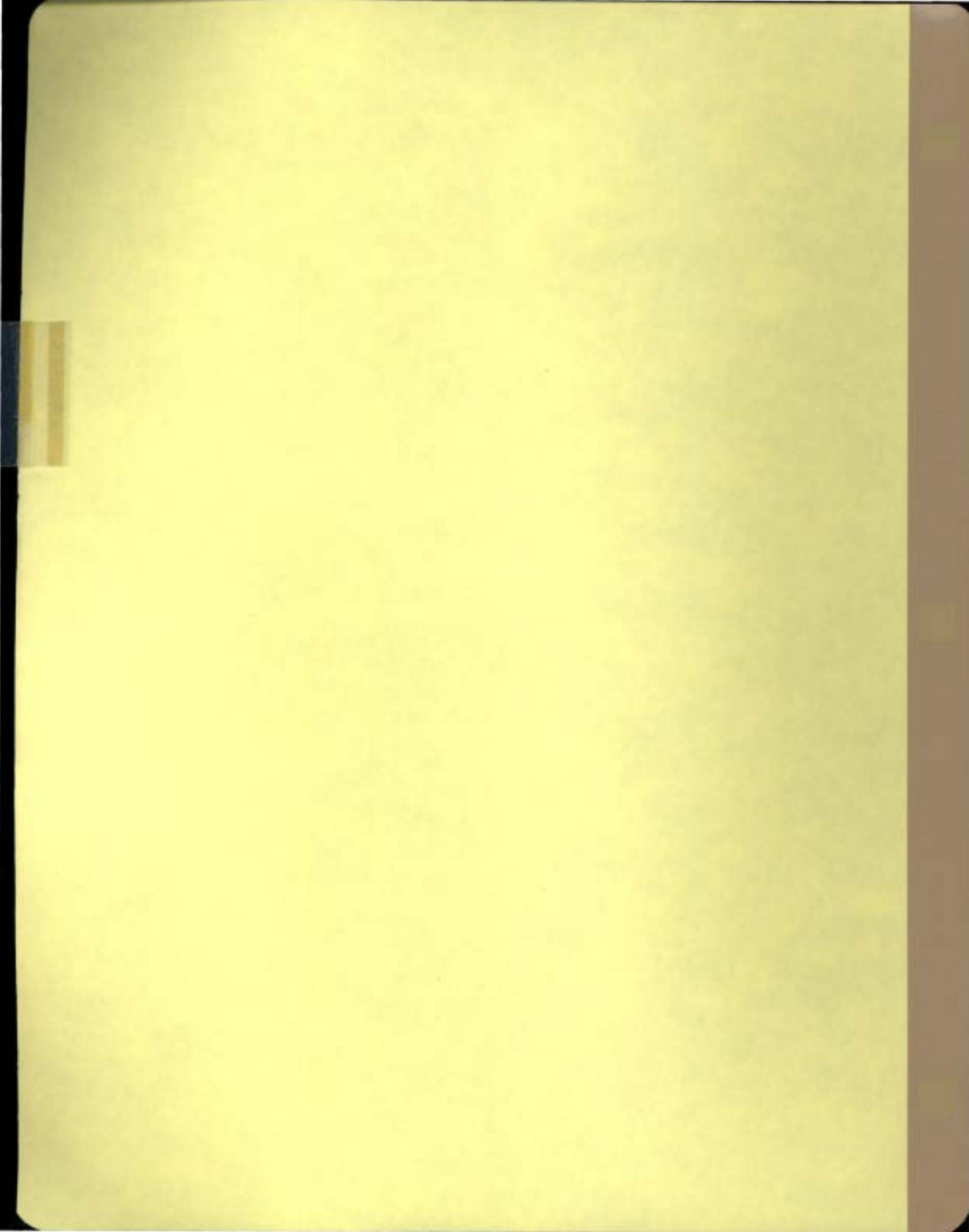
Next Schedule

Date

Date

Consultations: (12-15 cycle:) May 1988 (18-24 cycle:)
 Mid-term review:
 Stand-by:

1/ Specific areas of background preparation for the mission will be provided separately.



KOREA

Questionnaire for the 1988 Article IV Consultation

I. Real Sector Developments

National accounts and economic plan

1. Please provide two copies of the latest issues of the Economic Statistics Yearbook (BOK), National Income Accounts (BOK), Yearbook of Labor Statistics (MOL), Financial Statements Analysis (BOK), Flow of Funds Account in Korea (BOK), and Annual Report on the Price Survey. Please provide five copies of the Economic Management Plan for 1988 (EPB) and Monthly Statistics of Korea (EPB).
2. Please revise and update with annual data for 1983-87 Tables I-1 and I-2 on gross national product by expenditure and by industrial origin. Please revise and update with annual data Table I-3 on investment and savings.
3. Please comment on the developments during 1987 in major expenditure aggregates. In particular:
 - a. Household and corporate savings and factors affecting them.
 - b. Composition of private consumption.
 - c. Investment and factors affecting it, particularly for export production; also, please provide data on investment by industrial sectors.
 - d. Inventory accumulation.
4. In Tables I-1 to I-3, please provide projections for 1988 (Tables I-2 at constant 1980 prices). Please comment on the underlying

assumptions regarding demand conditions (external and domestic), investment (private and public), savings (private and public), and prices.

5. Please provide, if available, input-output tables (including any derived tables) of the Korean economy.

6. Please list the concrete measures taken to stimulate domestic demand under the April 18, 1987 announcement and assess their impact so far.

7. Please provide estimates of the potential growth of GNP for 1988-92. Please explain the methodology used in estimation. Kindly provide copies of technical studies (either in Korean or English from BOK, KDI, KIET or other research institution) which estimate a potential growth function for Korea.

Sectoral developments

8. Please revise and update (including projections) Tables I-4 and I-5 on agricultural output and the foodgrain management program, and discuss developments in 1987 and prospects for 1988. Please list agricultural policy measures introduced since the beginning of 1987.

9. Please revise and update Tables I-6 to I-12 on manufacturing production. Please discuss the outlook for the manufacturing sector in 1988 and 1989. Also, please discuss developments in major industries, particularly regarding capacity utilization and profitability, and factors underlying them.

10. Please list major industrial policy measures taken the beginning of 1987. Please describe in detail their purpose, the mechanisms involved, and effects observed so far.

11. Please revise and update Tables I-13 and I-14 on domestic and overseas construction orders. Please comment on developments in 1987 and prospects for 1988-89. Please list policy measures introduced since the beginning of 1987 that affect domestic and overseas construction activity.

12. Please revise and update Table I-15 on petroleum imports, exports, and production and Table I-16 on energy consumption by source and by use, including projections through 1989. Please review developments in the energy area, indicating any measures taken since the beginning of 1987.

13. Please revise and update Tables I-17 to I-21 on domestic prices for electricity, petroleum products, and domestic coal, and on the nuclear power plant construction program. Please comment on recent developments in energy prices. Please list changes in the tariff and variable levy on crude oil imports since the beginning of 1987.

II. Employment, Wages and Prices

1. Please revise and update (including projections) Tables II-1 and II-2 on employment, labor force labor productivity, wages, and income. Please comment on developments in 1987 and prospects for 1988-89.

2. Please update with latest information II-3 and II-4 on average earnings and number of days worked in mining and manufacturing industries, and average household income.-
3. Please describe steps to be taken towards the establishment of the national medical insurance, pension, and minimum wage systems in 1988. Please provide, if available, data on nonwage labor cost for 1980-87, together with a comparable wage cost series.
4. Please revise and update Table II-5 on price developments. Please comment on price developments in 1987 and prospects for 1988 and 1989. Please assess the effect of exchange rate changes on export and import prices, wholesale prices, and consumer prices. Please describe the methodology used to forecast CPI, WPI, and the GDP deflator.
5. Please list the changes in major publicly administered prices since the beginning of 1987. What were the contributions of changes in publicly administered prices to the CPI increase in 1987?

III. Money and Credit

1. Please provide five copies of the latest issue of the Bank of Korea's Monthly Bulletin and Principal Economic Indicators. Also, please provide two copies of Financial System of Korea (BOK).
2. Please revise and update the attached Tables III-1 to III-4 on monetary survey, financial survey, NBFI's survey, and reserve money.
3. Please review and update attached Table III-5 on issuance and redemption of CDs. What are the current ceilings, if any, on the issue of CDs and applicable interest rates?

4. Please comment on recent developments in money, quasi-money, liquidity, foreign assets and liabilities, and the major components of domestic credit. Please discuss developments in income velocity of broad money and the factors affecting the relative growth of bank and nonbank deposits. Also, please explain the reasons for the movements during the past year in the reserve money multiplier with respect to broad money.
5. Please discuss the issues of liquidity growth caused by the improved external accounts and the measures taken and/or plans to deal with this problem.
6. Please update the attached Tables III-6 and III-7 on interest rates. Please comment on the appropriateness of the present level of interest rates and discuss measures taken and/or planned to liberalize interest rate policy further.
7. Please provide quarterly data on interest rates in the unorganized money markets since 1985. Please describe any major changes in these markets in response to monetary policy generally.
8. Please list policy measures taken during 1987 and 1988 to influence monetary and credit conditions.
9. Please update the attached Table III-8 on domestic credit by financial institutions, and describe measures taken since the beginning of 1987 affecting the activities of nonbank financial institutions.
10. Please update the attached Table III-9 on the allocation of directed credit and comment on developments in such credits during 1987.

11. Please update the attached Table III-10 and III-11 on the activities of the National Investment Fund and the National Housing Fund and comment on recent and proposed activities for these two funds.
12. Please update the attached Tables III-12 to III-18 on the securities markets and comment on recent development in these markets and on measures taken and/or planned to affect these markets. In particular, please describe the impact of the decline of stock market prices abroad in October 1987 on stock prices in Korea and the economy generally.
13. Please update the attached Tables III-19 to III-22 on foreign bank branches in Korea and foreign currency loans.
14. Please update the attached Table III-23 on Bank of Korea swap transactions.
15. Please discuss the financial liberalization measures taken during 1987 and their effects on 1987 and plans in this respect for 1988.
16. Please update the attached Tables III-24 on bank credit extended to special accounts, budgetary funds, and government invested enterprises.
17. Please describe policy towards nonperforming liabilities of ailing companies to banks and progress made in 1986 and 1987 towards enabling stronger firms to absorb these liabilities.

IV. Public Finance

1. Please provide two copies of each of the following publications:
 - a. Summary of the Budget for fiscal years 1987 and 1988 (EPB)
 - b. Summary of Government Finance in Korea, 1987 (MOF)

c. Settlement of Government Accounts on Revenues and Expenditures (1987)

d. Any other publication containing financial data on the public sector (latest available year).

2. Please update attached Tables IV-1 through IV-4 on operations of the consolidated public sector and the central government including budgetary projections for 1988. Please also provide the tables on the consolidation of the public sector (as, for example, Tables K-1 and K-2 of the supplement to the answers to the 1987 questionnaire). Please discuss the main reasons for any differences between the actual outcome and budgetary projections of revenue and expenditure in 1987.

Please describe any progress made in incorporating local governments and government-invested enterprises in the public sector consolidation.

3. Please provide data on the operations of the public enterprises and funds included in the consolidated public sector (Grain Management, Monopoly, National Railway, Communication, and Supply) during 1985-87. (If possible, please use the same format as is used for the Grain Management Fund in Table IV-5.) Please also provide Tables IV-6 and IV-7 for 1986 and 1987. Please update Table IV-8 and discuss the main factors affecting the outcome of Grain Management S/A and Grain Management Fund in 1987 and the projections for 1988.

4. Please specify the assumptions on the real GNP growth rate, GNP deflator, and exchange rate used in preparing the 1988 budget. Please discuss differences between the current outlook for the 1988 budget and the original estimates.

5. Please list all tax and expenditure measures implemented or planned during 1987 and 1988 and itemize their actual or expected impact on the fiscal accounts. Please describe progress in the implementation of the national health, national pension, and minimum wage plans and their expected budgetary impact.

6. Please update Table IV-9 and discuss developments during 1986-88 in the operations of local governments. Please provide any available data on the transactions of local governments with the central government (e.g., transfers, subsidies, and revenue sharing) and on their borrowing requirements.

7. Please provide a list of "nongovernment funds" and data on their operations. Please include data on the Civil Service Pension Fund and the Petroleum Business Fund.

8. Have there been any changes in the list of Special Accounts and Special Budgetary Funds included in the consolidated public sector as given in Table IX of the Appendix of the 1986 Recent Economic Developments report? Please update Tables IV-10 and IV-11 and provide similar tables for the National Housing Fund. Please provide a statement of the amount of central government expenditure and revenue channeled through the Special Accounts and Special Budgetary Funds and any transactions between the general account and the Special Accounts and Special Budgetary Funds.

9. Please update Tables IV-12 to IV-14 and comment on the overall financial position of government invested enterprises. Please provide a table on transactions between the central government and the government

invested enterprises (including taxes, transfers and subsidies, interest payments, lending and repayments, and purchases of goods and services), a table on the outstanding external debt of public enterprises, and a table detailing liabilities of the enterprises for 1986-1987. Please describe any recent or planned changes in government policies dealing with pricing, investment or external borrowing policies of government invested enterprises.

10. Please update Tables IV-15 through IV-24 and describe differences between the composition of financing planned in the initial 1987 budget and the actual composition of financing.

11. Please update Tables IV-25 to IV-27 and comment on the reasons for recent trends in the types of debt instruments outstanding and the major holders of debt instruments. How have recent financial liberalization measures affected the composition of both the types of debt instruments and holders of debt?

12. Please discuss the budgetary projections for the sixth five-year plan period (1986-91) highlighting major changes in the budgetary strategy from the fifth five-year plan.

V. External Sector

1. Please revise and update Tables V-1 to V-14. For Table V-1, please provide quarterly import unit values for oil, and non-oil imports for 1983-87. On Tables V-1 and V-2, please explain the main factors for the differences between the projected and actual outcomes for 1987.

2. Please make medium-term projections for 1988-92 on Tables V-15 to V-19.
3. Please update Tables V-20 and V-21 on export profitability and developments in unit labor costs (in the export and import competing industries separately, if available).
4. Please discuss the performance of Korea's principal export sectors, identifying those products which have been the most and the least dynamic ones, for 1985-87 as well as the outlook for 1988 and the medium-term. Please discuss the main factors which explain the change in the composition of exports. In your reply, please comment on the importance of the following factors for each major export sector:
 - (i) movements in the real effective exchange rate of the won and relative movements in the exchange rates of major currencies;
 - (ii) changes in protectionist measures; (iii) changes in international oil prices; (iv) changes in international interest rates; and
 - (v) measures related to the restructuring of export industries, export promotion schemes, and export financing.
5. Please describe the impact of relative movements in the exchange rates of major currencies on the geographic pattern of Korea's exports. Please describe the impact of protectionist measures in Korea's major trading partners on the geographic pattern of Korea's exports.
6. Please list and discuss measures implemented and planned to restructure export industries since the beginning of 1986.

7. Please list and discuss measures implemented and planned to curtail export financing loans since the beginning of 1987.
8. Please list and discuss measures implemented and planned related to export promotion schemes other than those described in questions V-6 and V-7.
9. Please update Tables V-22 to V-24 on import restrictions on Korean exports to OECD countries. Please give details by country (U.S., Japan, EC, Canada, and others). Also, please include in Table V-22 which products have been subject to anti-dumping duties and/or to countervailing duties and by what countries. Please describe the major issues in the bilateral trade negotiations with these countries in recent years, and how they have been resolved. Please discuss the major issues pending in these negotiations with the United States, EC, Canada, Japan and other OECD countries and the current status of these negotiations.
10. Please list the voluntary export restraints (VERs) currently in effect, indicating those negotiated bilaterally or adopted unilaterally. Table V-22 shows for 1985 and 1986 a decline in the share of selected major export products subject to restrictions by the OECD countries. Does this mean (a) that the overall level of nontariff barriers was reduced, (b) that exports were diverted to unrestricted products in unrestricted markets, or (c) that the barriers were so effective that the exports affected by the barriers declined?
11. Please provide data on GSP coverage of Korean exports. Please provide estimates on the effects of the EC's ruling that Korea would no

longer be a beneficiary of their GSP scheme and of the United States' ruling to the same effect, starting January 1, 1989?

12. Please comment on the recent developments in trade barriers against Korea's exports of steel and steel products, and their impact. Are there any other VER's currently in effect other than those with the United States and the EC? Are there any arrangements with Japan and Australia? What has been the response of the Korean steel industry to trade restrictions in its major overseas markets? How successful has been the attempt to circumscribe these barriers by raising the degree of manufacturing, for example?

13. Please discuss the impact on Korea's steel exports after the phasing out of the internal quotas in the EC. Please discuss the status of U.S. restraints on Korean steel exports and the terms likely to apply after 1989.

14. Please list and explain restrictions currently in effect against Korea's exports of electronic goods, footwear, and other items. Please assess their impact.

15. Please update Table V-25 which summarizes Korea's import liberalization schedule by industry for the period 1983-88 and indicate which items were liberalized ahead of schedule. Please complete Table V-26 and discuss the impact of import liberalization measures on the total value of imports. What was the increase in imports of previously restricted items after liberalization? Please indicate the nature of imports restricted. Please explain the criteria used in approving licenses. Please list the items that are to remain restricted when the

current liberalization program is completed. Please explain the reasons for maintaining restrictions on these items.

16. After the current liberalization program is completed in 1988, a large portion of agricultural products, a number of textile products, some chemical products, and the luxury goods are to remain restricted.

a. Please describe the prospects for liberalization in these sectors.

b. Please describe the main obstacles to liberalize agricultural products.

c. Please explain the reasons for protecting textile products in which Korea has lost its competitiveness or the automobile industry in which Korea has become competitive.

17. Please describe major changes in the trade and payments procedures governing imports of unrestricted items.

18. Please provide a list of items subject to emergency and adjustment tariffs over the period since the beginning of 1987, indicating the respective rates. Were there any instances of continuous renewal of the emergency and adjustment tariffs on certain items?

19. Please list the liberalized items which are presently on the import surveillance list. How many applications for items on the surveillance list were submitted in 1986 and 1987? How many import licenses were issued? Please indicate the number of applications submitted, approved, the respective import values, and the number of items covered. In answering the question, please explain the criteria used in approving licenses. Were there any mechanisms other than licenses used to

restrain imports in the surveillance list? What is being planned with respect to the surveillance system?

20. Please list and discuss measures implemented and planned related to the granting of trading business licenses. How are foreigners treated in issuance of trading licenses? Are there any administrative surveillance procedures in addition to the requirements on the capital and L/C value?

21. Please list and discuss the main items restricted by special laws and their effectiveness. Please give estimates of the value of imports that are subject to approval by various ministries under the special laws. Please describe the scope for liberalizing the application of the special laws, and the measures being considered at present in this respect.

22. Please update Table V-27 showing trends in average unweighted tariff rates. Please describe the impact of recent tariff changes on effective rates of protection in various sectors. Please provide data on trends in import-weighted tariff rates. Please describe progress made in narrowing the dispersion of tariff rates. Do exemptions apply, and if so, please give the principles (type of product, use, or geographical origin or destination) used in granting exemptions? Please list the items on which relatively high tariffs are still maintained.

23. Please indicate measures planned after 1988 in the areas of tariff reduction, dispersion of tariffs, emergency and adjustment tariffs, and tariff quotas.

24. Please explain the relative importance of tariffs as a source of government revenue and as an instrument of protecting domestic industries. Please explain the rationale of the importers' acquisition tax. Does it apply to all imports or to only some commodities? Does the percentage vary among products?

25. Please describe major changes in quotas and other nontariff barriers implemented by Korea since 1983. Please indicate what measures are being planned in this area.

26. Please discuss the importance of the tariff quota system. Please indicate to what items it has been applied, and the value of imports affected. What are the reasons for relying on this temporary measure rather than permanent tariff cuts?

27. Please discuss the measures implemented to reduce the deficit with Japan and success achieved by these measures.

28. Please list and describe measures implemented or planned to spur development of the parts and components industry (or localization program). Please discuss how this program is compatible with efforts to reduce the trade surplus? Are there any import restrictions on the items listed in the localization list? Is the financial assistance provided for localization a form of subsidy?

29. Please comment on measures implemented during 1987 and planned for 1988 on foreign exchange controls on invisibles.

30. Please update Table V-28 on overseas construction. Please discuss measures implemented or planned to restructure the construction industry. Please discuss the evolution of overdue payments owed to

Korean firms and their overseas subsidiaries, noting any agreements reached to reschedule these payments.

31. Please update Tables V-29 on the outstanding stock of debt held by overseas subsidiaries. Please provide data for the period since the beginning of 1987 on repayment of overseas debt by Korean parent companies and banks. Please discuss the outlook for overseas debts and their repayment by Korean resident companies and banks during 1988.

32. Please update Table V-30 on average terms on external loans.

33. Please update Table V-31 on syndicated loans of financial institutions and bond issues and Table V-32 on new public and commercial loans.

34. Please discuss plans to accelerate the repayment of external debt, indicating the factors that are taken into account in selecting debt for repayment or refinancing.

35. Please comment on measures planned regarding overseas investment by domestic residents and on the liberalization of capital transactions.

36. Please update Tables V-33 and V-34 on foreign direct investment in 1987 and envisaged in 1988. Please discuss developments in foreign direct investment, particularly in liberalized industries. Please discuss trends in actual foreign investment inflows to foreign investment approved in 1986-87. What are the restrictions remaining regarding foreign investment? What are the industries that remain closed to foreign investors and why? What are the restrictions remaining in respect to ownership? What is the current plan of opening up more industries to foreign capital?

37. Please update Table V-35 on inter-office "A" accounts of foreign banks.
38. Please update Table V-36 on KEXIM's holdings of promissory notes.
39. Please discuss the impact of measures taken since 1984 to open the Korean economy further to foreign portfolio investment. What limit is now placed on the value of investment trusts through which foreign residents can indirectly invest in Korean bonds and equity? Please update Tables V-37 and V-38. Have restrictions on foreign investment in Korean equities been modified to prevent the conversion of CBs and Drs into equity claims?
40. Please describe changes in regulations and institutional arrangements governing the contracting of external debt since June 1987.
41. Please list date, and comment on any other changes in Korea's exchange and trade system since June 1987 which were not described in answer to preceding questions.
42. Please complete Tables V-39 to V-41 for the years 1980, 1984, 1985, 1986, and 1987 on regional concentration of imports and exports by product categories.

Table I-1. Korea: Gross National Product by Expenditure
at Current Prices, 1983-87

	1983	1984	1985	1986	1987
	(In billions of won)				
Consumption	44,035	47,857	52,019	56,359	
Private	37,282	40,778	44,126	47,474	
Government	6,753	7,079	7,893	8,885	
Investment	17,621	21,207	22,645	25,281	
Gross fixed capital formation	18,480	20,795	22,436	26,246	
Change in stocks	-859	412	209	-965	
Exports of goods and services	22,246	25,830	27,327	35,341	
Imports of goods and services	23,028	26,037	26,923	30,355	
Statistical discrepancy	129	10	443	-116	
Net factor income from abroad	-2,017	-2,459	-2,661	-2,677	
Gross national product	58,986	66,408	72,850	83,833	
	(Percentage change)				
Memorandum item:					
Nominal GNP	16.3	12.6	9.7	15.1	

Source: Data provided by the Korean authorities.

Table I-2. Korea: Gross National Product by Expenditure and Industrial Origin at Constant Prices, 1983-87

(In billions of won at constant 1980 prices)

	1983	1984	1985	1986	1987
Consumption	33,627	35,373	37,192	39,690	
Private	28,816	30,538	32,046	34,065	
Government	4,811	4,835	5,145	5,625	
Investment	14,745	17,492	17,769	19,639	
Gross fixed capital formation	15,017	16,618	17,356	19,950	
Change in stocks	-272	875	413	-311	
Exports of goods and services	18,054	19,855	20,280	25,682	
Imports of goods and services	18,593	20,465	20,124	23,859	
Statistical discrepancy	-89	-383	-442	14	
Net factor income from abroad	-1,635	-1,870	-1,969	-1,877	
Gross national product	46,109	50,003	52,705	59,290	
By industrial origin:					
Agriculture, forestry, and fishing	7,436	7,453	7,809	8,157	
Mining and quarrying	685	742	793	824	
Manufacturing	14,096	16,188	16,805	19,736	
Electricity, gas, and water	1,131	1,420	1,698	2,026	
Construction	4,276	4,540	4,749	5,095	
Wholesale and retail trade, restaurants and hotels	6,142	6,716	7,107	8,209	
Transport, storage, and communication	3,688	3,974	4,170	4,614	
Financing, insurance, real estate, and business services	4,946	5,469	6,313	7,135	
Community, social, and personal services	1,453	1,590	1,700	1,832	
Producers of government services	3,091	3,112	3,167	3,263	
Other ^{1/}	-814	-1,202	-1,607	-1,600	

Sources: Data provided by the Korean authorities.

^{1/} Includes producers of private nonprofit services, import duties, net factor income from abroad, and imputed bank service charges (offset).

Table I-3. Korea: Investment and Savings, 1983-87

	1983	1984	1985	1986	1987
(In billions of won at current prices)					
Investment	17,621	21,207	22,645	25,281	
Gross fixed capital formation	18,480	20,795	22,436	26,246	
Dwellings	3,452	3,409	3,494	4,379	
Nonresidential buildings	3,456	4,137	4,138	4,373	
Other construction	4,714	4,369	6,132	5,953	
Transport equipment	1,929	2,262	2,382	3,205	
Machinery and other equipment	4,823	5,502	6,209	8,288	
Change in stocks	-859	412	209	-965	
Domestic savings	14,951	18,551	20,831	27,475	
Private sector <u>1/</u>	10,680	13,864	15,775	21,982	
Government <u>2/</u>	4,271	4,687	5,055	5,493	
Foreign savings	2,799	2,666	2,257	-2,309	
Net transfers from the rest of the world	1,536	1,570	1,499	1,739	
Net borrowing from the rest of the world <u>3/</u>	1,264	1,096	758	-4,048	
Statistical discrepancy	-129	-10	-443	116	
(In percent of GNP)					
Investment	29.9	31.9	31.1	30.2	
Gross fixed capital formation	31.3	31.3	30.8	31.3	
Construction	19.7	19.4	18.9	17.5	
Machinery and equipment	11.6	11.9	11.9	13.8	
Change in stocks	-1.5	0.6	0.3	-1.2	
Domestic savings	25.3	27.9	28.6	32.8	
Private sector	18.1	20.8	21.7	26.2	
Households	7.6	9.9	10.6	...	
Corporations	10.5	11.0	11.1	...	
Government	7.2	7.1	6.9	6.6	
Foreign savings	4.7	4.0	3.1	-2.7	
Net transfers from the rest of the world	2.6	2.4	2.1	2.1	
Net borrowing from the rest of the world	2.1	1.7	1.0	-4.8	

Source: Bank of Korea, Monthly Statistical Bulletin.1/ Including public enterprises.2/ Central and local government.3/ Conceptually equivalent to the current account deficit.

Table I-4. Korea: Agricultural and Fishing Output, 1963-88

(In thousands of metric tons) 1/

	1963	1964	1965	1966	1967	1988 Proj.
Grains	6,544 (3.4)	6,675 (2.0)	6,635 (-0.6)	6,454 (-2.7)		
Rice <u>2/</u>	5,404 (4.4)	5,682 (5.1)	5,626 (-1.0)	5,607 (-0.3)		
Barley and wheat	930 (14.1)	825 (-11.3)	582 (-29.1)	458 (-21.3)		
Other	210 (-11.8)	168 (-20.0)	193 (14.8)	190 (-1.5)		
Pulses	233 (-9.3)	226 (-3.0)	234 (-7.9)	199 (-14.9)		
Fish catch <u>3/</u>	2,793 (5.6)	2,910 (4.2)	3,103 (6.6)	3,660 (17.9)		
Memorandum item:						
Percentage change in agriculture, forestry, and fishing output (national accounts)	6.5	0.2	4.8	4.4		

Source: Ministry of Agriculture and Fisheries.

1/ Annual percentage changes in parentheses.2/ The rice harvest is mainly in the fourth quarter of the calendar year, and therefore falls in the subsequent rice years, which begins on October 1.3/ About one half of the catch is from coastal fishing and about one fourth each is from aquaculture and deep sea fishing.

Table I-5. Korea: Grain Management Fund Operations, 1983-88

(In thousands of metric tons)

	Years ending September 30					
	1983	1984	1985	1986	1987	1988
Rice						
Opening stock	1,374	1,511	1,247			
Domestic purchases ^{1/}	1,091	1,219	1,217			
Imports	216	—	—			
Other	33	23	-6			
Available supplies	2,714	2,707	2,458			
Domestic sales	1,203	1,325	1,026			
Exports	—	135	—			
Other	—	—	—			
Closing stock	1,511	1,247	1,432			
Barley						
Opening stock	343	493	495			
Domestic purchases	505	428	236			
Other	56	-50	-18			
Available supplies	904	871	713			
Domestic sales	411	376	528			
Other	—	—	—			
Closing stock	493	495	185			
(In won at end of period)						
Memorandum items:						
Rice (80 kilogram bag)						
Purchase price	55,970	55,970	57,650			
Selling price	52,280	52,280	54,260			
Barley (76.5 kilogram bag)						
Purchase price	33,780	33,780	34,460			
Selling price	28,000	30,000	31,420			

Source: Data provided by the Korean authorities.

^{1/} Purchases are mainly in October-December; therefore procurement from the 1985 crop occurs in October-December 1984.

	1983	1984	1985	1986	1987
	<u>(In billions of won)</u>				
Total assets					
Fixed assets					
Current assets					
Fixed liabilities					
Current liabilities					
Net worth					
Net sales					
Financial cost					
Normal profit					
	<u>(In percent)</u>				
Fixed assets/net worth					
Current assets/ current liabilities					
Fixed assets/fixed liabilities and net worth					
Net worth/total assts					
Normal profit/net worth					
Normal profit/total assets					
Normal profit plus financial cost/ Total assets					
Normal profit/net sales					

Table I-13. Korea: Domestic Construction Orders, 1983-88

	1983	1984	1985	1986	1987	1988 Proj.
<u>(In billions of won at current prices)</u>						
By purchaser	4,735	5,187	5,389			
Public sector	2,815	3,107	3,460			
Central government	(626)	(604)	(748)			
Local government	(914)	(1,186)	(1,115)			
Public enterprises	(1,146)	(1,133)	(1,386)			
Other	(130)	(185)	(211)			
Private sector	1,863	2,039	1,830			
Manufacturing	432	543	563			
Nonmanufacturing	1,431	1,495	1,267			
Foreign organizations	57	41	98			
By type of construction	4,735	5,187	5,299			
Buildings	426	3,117	2,944			
Dwellings	(947)	(1,569)	(1,205)			
Other	(1,479)	(1,548)	(1,739)			
Civil engineering works	2,253	1,969	2,355			
Special trade works	56	80	90			
<u>(In thousand square meters of floor area)</u>						
Memorandum item:						
Permits issued	39,693	39,563	38,215			
Dwellings	21,708	20,551	20,606			
Commercial	10,182	10,088	9,498			
Industrial	3,412	4,746	4,139			
Other	4,392	4,177	3,972			

Source: Economic Planning Board, Monthly Statistics of Korea.

Table I-14. Korea: Overseas Construction, 1983-88

	1983	1984	1985	1986	1987	1988 Proj.
<u>(In millions of U.S. dollars)</u>						
New contracts	10,444	6,502	4,691			
Middle East	9,023	5,910	4,285			
Other countries	1,421	592	406			
<u>(Number of agreements)</u>						
Work agreements	236	237	170			
Middle East	180	183	132			
Other countries	56	54	48			
<u>(Number of workers at end of period)</u>						
Korean labor force overseas	159,368	130,906	96,016			
Middle East	147,810	121,156	91,013			
Other countries	11,558	9,750	5,003			

Source: Data provided by the Korean authorities.

Table I-15. Korea: Import, Export, Production and Inventory
of Petroleum and Petroleum Products, 1983-89

	1983	1984	1985	1986	1987 Est.	1988 Proj.	1989 Proj.
Imports							
Value (millions of U.S. dollars)							
c.i.f.							
f.o.b.							
Volume (million barrels)							
Unit value (f.o.b. U.S. dollar/ barrel)							
Exports							
Value (millions of U.S. dollars)							
Volume (millions of barrels)							
Production (million barrels)							
Inventory (million barrels)							

Table I-16. Korea: Sources and Uses of Energy, 1983-89
 (In millions of barrels of oil)

	1983	1984	1985	1986	1987	1988	1989
						Projection	
Sources							
Oil							
Coal							
Hydroelectricity							
Nuclear							
Firewood							
LNG							
Uses							
Transport <u>1/</u>							
Industry							
Residential and commercial							
Public and other							

Source: Ministry of Energy and Resources.

1/ Including international bunkering.

KRC--cqt7krI-17 2/16/88

Table I-17. Korea: Domestic Prices of
Electricity, 1983-87

(End of period; in won/KWH)

	1983	1984	1985	1986	1987
Residential service					
Public/commercial service					
Industrial service					
Street lighting service					
Average domestic prices					

Source: Data provided by the Korean authorities.

Table I-18. Korea: Retail Prices of Petroleum
Products, 1983-87

(In won per liter at end of period)

	1983	1984	1985	1986	1987
Gasoline (regular)					
Diesel					
Kerosene					
Memorandum item:					
Import price of crude oil (won/kl)					

Source: Data provided by the Korean authorities.

KRC--cqt7krI-19 2/16/88

Table I-19. Korea: Prices of Domestic Coal, 1983-87

(End of period; in won/ton)

	Grade <u>1/</u>	1983	1984	1985	1986	1987
1st	(5,200 - 5,399)					
2nd	(5,000 - 5,199)					
3rd	(4,800 - 4,999)					
4th	(4,600 - 4,799)					
5th	(4,400 - 4,599)					
6th	(4,200 - 4,399)					
7th	(4,000 - 4,199)					
8th	(3,750 - 3,999)					
9th	(3,500 - 3,749)					

Source: Data provided by the Korean authorities.

1/ Calorific value in Kcal/kg.

KRC--cqt8krI-20 2/29/88

Table I-20. Korea: Nuclear Power Plants
Construction Program

Plant No.	Reactor type	Capacity (MWE)	Construction progress (As of Dec. 31, 1987)	Commercial operation
-----------	--------------	-------------------	---	-------------------------

Source: Data provided by the Korean authorities.

Table II-2. Korea: Wages and Labor Productivity, 1984-87

(Index, 1980 = 100)

	Nominal wages			Real wages			Labor productivity		
	All industries	Mining	Manufacturing	All industries	Mining	Manufacturing	All industries	Mining	Manufacturing
1984									
1985									
1986									
1987									
1988									

Source: EPB, Monthly Statistics of Korea.

Table II-3. Korea: Wages and Man-days, 1984-87
(Won/Day)

	Earnings			Man-days		
	Mining and manufac- turing	Mining	Manufac- turing	Mining and manufac- turing	Mining	Manufac- turing
1984						
Q1						
Q2						
Q3						
Q4						
1985						
Q1						
Q2						
Q3						
Q4						
1986						
Q1						
Q2						
Q3						
Q4						
1987						
Q1						
Q2						
Q3						
Q4						
1988						
Q1						

Source: EPB, Monthly Statistics of Korea.

KRC--cqt8kr2-4 (2/29/88)

Table II-4. Korea: Average Household Income, 1984-87

(In won) -

	Income	Salaries and wages	Business home work	Other income
1984				
Q1				
Q2				
Q3				
Q4				
1985				
Q1				
Q2				
Q3				
Q4				
1986				
Q1				
Q2				
Q3				
Q4				
1987				
Q1				
Q2				
Q3				
Q4				
1988 (Proj.)				
Q1				

Source: EPB, Monthly Statistics of Korea.

Table III-1. Korea: Monetary Survey, 1983-88

End of Period	1983	1984	1985	1986				1987				1988
				March	June	Sept.	Dec.	March	June	Sept.	Dec.	Proj.
	(In billions of won)											
Net foreign assets	-5,062	-6,191	-7,497	-7,920	-7,953	-6,569	-6,128	-4,522				
Assets	6,387	7,375	8,122	7,619	7,913	8,629	8,332	8,131				
Liabilities	11,449	13,566	15,819	15,539	15,866	15,198	14,460	12,653				
Swaps with nondeposit money banks	-863	-1,234	-2,333	-2,528	-2,455	-2,225	-1,566	-1,382				
Net domestic assets	28,883	32,802	39,669	40,972	42,036	41,858	42,862	41,457				
Domestic credit	31,647	36,059	42,561	43,549	44,901	45,892	46,694	46,508				
Public sector	(2,013)	(1,973)	(2,013)	(1,820)	(1,352)	(946)	(2,037)	(721)				
Private sector	(29,634)	(34,086)	(40,546)	(41,729)	(43,549)	(44,946)	(46,657)	(47,787)				
Net other items	-2,964	-3,257	-2,892	-2,577	-2,865	-4,034	-5,852	-7,051				
of which:												
Monetary Stabilization Bonds	(-1,018)	(-1,525)	(-528)	(-583)	(-965)	(-1,996)	(-3,088)	(-3,462)				
Exchange Equalization Fund Bonds	(-)	(-)	(-)	(-)	(-)	(-)	(-)	(-120)				
Broad money plus CIs	22,938	25,377	29,639	30,524	31,628	33,064	35,148	35,553				
Narrow money	6,783	6,821	7,558	7,170	6,924	7,615	8,847	7,758				
Quasi-money	16,155	17,885	21,007	22,000	23,563	24,314	25,004	25,697				
CIs ^{1/}	-	671	1,074	1,354	1,141	1,135	1,277	2,098				
	(Annual percentage change in relation to the stock of broad money) ^{2/}											
Net foreign assets	-3.8	-4.8	-5.9	-4.8	-0.6	4.4	5.3	11.0				
Swaps with nondeposit money banks	-3.8	-1.6	-4.3	-3.5	-3.0	0.1	2.6	3.8				
Net domestic assets	22.8	17.1	27.0	26.6	22.2	11.6	10.7	1.7				
Domestic credit	21.7	18.4	25.6	25.2	22.9	17.1	20.7	16.3				
Public sector	(-0.7)	(-0.2)	(0.1)	(0.8)	(0.2)	(-1.3)	(0.1)	(-3.6)				
Private sector	(22.4)	(18.6)	(25.5)	(24.4)	(22.7)	(18.4)	(20.6)	(19.9)				
Net other items	1.1	-1.3	1.4	1.4	-0.7	-5.5	-10.0	-14.6				
of which: Open market operations ^{3/}	(-4.4)	(-2.2)	(3.9)	(2.3)	(-1.7)	(-5.3)	(-8.6)	(-9.8)				
Broad money plus CIs	15.2	10.6	16.8	18.3	18.6	16.1	18.6	16.5				
	(Annual percentage change)											
Net domestic assets	18.7	13.5	20.9	20.2	16.4	8.6	8.0	1.3				
Private sector credit	17.6	14.3	19.0	17.8	16.2	13.3	15.1	14.5				

Source: Data provided by the Korean authorities.

^{1/} Certificates of deposit issued by commercial banks.

^{2/} Stock at the beginning of the period.

^{3/} Monetary Stabilization Bonds issued by the Bank of Korea and Exchange Equalization Fund Bonds issued by the Government.

Table III-2. Korea: Financial Survey, 1983-88 1/

End of Period	1983	1984	1985	1986				1987				1988 Proj.
				March	June	Sept.	Dec.	March	June	Sept.	Dec.	
(In billions of won)												
Net foreign assets	-9,098	-11,099	-14,828	-15,199	-15,422	-14,220	-13,150	-11,533				
Assets	6,630	7,697	8,465	7,969	8,170	8,793	8,487	8,271				
Liabilities	15,728	18,796	23,293	23,163	23,592	23,013	21,637	19,804				
Domestic credit	50,950	61,553	75,379	78,239	81,652	84,456	88,949	91,258				
Government (net)	-692	-848	-920	-1,202	-1,682	-2,100	-1,027	-2,238				
Official entities	570	570	570	570	570	570	570	570				
Private sector	51,072	61,831	75,729	78,871	82,764	85,986	89,406	92,926				
Total liquidity	36,678	43,970	53,518	55,654	59,058	62,727	67,214	70,272				
Money	6,783	6,821	7,558	7,170	6,924	7,615	8,847	7,758				
Quasi-money	16,155	17,885	21,007	22,000	23,563	24,314	25,024	25,697				
Certificates of deposit	--	618	926	942	846	931	1,046	1,851				
NBFi deposits	14,950	20,009	25,575	27,024	29,139	31,293	34,061	36,471				
(Less inter-institution deposits)	(1,210)	(1,363)	(1,548)	(1,482)	(1,414)	(1,426)	(1,764)	(1,505)				
Other items	5,174	6,484	7,033	7,386	7,172	7,509	8,585	9,453				
Debentures issued	692	1,005	1,103	1,130	1,086	1,162	1,240	1,303				
Monetary stabilization bonds	204	167	97	14	128	371	680	1,406				
Other	4,278	5,312	5,833	6,242	5,958	5,976	6,665	6,744				
(Annual percentage change)												
<u>Memorandum item:</u>												
Total liquidity	21.5	19.9	21.7	21.3	24.1	24.1	25.6	29.3				

Sources: Data provided by the Korean authorities; and Fund staff estimates.

1/ The financial survey covers the banking system and the nonbank financial institutions (NBFIs).

Table III-3. Korea: NBFIs Survey, 1983-88

(In billions of won)

	1983	1984	1985	1986				1987				1988 Proj.
				March	June	Sept.	Dec.	March	June	Sept.	Dec.	
Net foreign assets	<u>-4,016</u>	<u>-4,909</u>	<u>-7,131</u>	<u>-7,447</u>	<u>-7,712</u>	<u>-7,885</u>	<u>-7,259</u>	<u>-7,286</u>				
Assets	243	322	343	344	257	165	154	140				
Liabilities	4,259	5,231	7,474	7,791	7,969	8,050	7,413	7,426				
Domestic credit	<u>20,156</u>	<u>26,762</u>	<u>33,985</u>	<u>36,195</u>	<u>38,182</u>	<u>39,970</u>	<u>41,638</u>	<u>44,534</u>				
Government (net)	-2,135	-2,251	-2,363	-2,452	-2,463	-2,476	-2,494	-2,389				
Private sector	22,291	29,013	36,348	38,647	40,645	42,446	44,132	46,923				
Deposits	<u>14,950</u>	<u>20,009</u>	<u>25,575</u>	<u>27,042</u>	<u>29,157</u>	<u>31,312</u>	<u>34,101</u>	<u>36,471</u>				
Other items	<u>1,190</u>	<u>1,844</u>	<u>1,279</u>	<u>1,906</u>	<u>1,313</u>	<u>773</u>	<u>278</u>	<u>777</u>				
Debentures												
issued	778	935	1,053	1,158	1,186	1,255	1,373	1,199				
Other	412	909	226	548	127	-482	-1,095	-422				

Source: Data provided by the Korean authorities.

Table III-4. Korea: Reserve money, 1953-68

(In billions of won)

End of period	1963	1964	1965	1966				1967				1968 Proj.
				March	June	Sept.	Dec.	March	June	Sept.	Dec.	
Net foreign assets	704	862	1,289	1,017	903	1,903	1,464	1,609				
Assets	(2,218)	(2,685)	(2,983)	(2,726)	(2,947)	(3,897)	(3,404)	(3,487)				
Liabilities	(-1,514)	(-1,823)	(-1,694)	(-1,709)	(-2,044)	(-1,994)	(-1,940)	(-1,878)				
Swaps with nondeposit money banks	-863	-1,234	-2,333	-2,528	-2,455	-2,225	-1,566	-1,382				
Bank of Korea foreign currency deposits with deposit money banks	49	43	41	39	39	1,102	1,338	2,282				
Net claims on government	1,358	954	887	925	321	-42	613	-419				
Claims	(2,123)	(2,072)	(2,066)	(2,066)	(2,066)	(2,075)	(2,066)	(2,092)				
Deposits	(-765)	(-1,118)	(-1,179)	(-1,141)	(-1,745)	(-2,117)	(-1,447)	(-2,511)				
Net claims on other official entities	570	570	570	570	570	570	570	570				
Claims on deposit money banks	5,279	7,140	9,167	9,486	9,716	9,770	9,587	9,856				
General loans and rediscounts	(3,213)	(5,039)	(6,784)	(6,968)	(6,899)	(7,335)	(7,408)	(7,600)				
Specialized loans and rediscounts ^{1/}	(1,983)	(2,014)	(2,287)	(2,441)	(2,740)	(2,358)	(2,179)	(2,256)				
Other	(83)	(87)	(96)	(77)	(77)	(77)	(-)	(-)				
Claims on private sector	141	140	172	172	171	171	183	183				
Monetary Stabiliza- tion Bonds	-2,497	-2,496	-1,900	-1,993	-2,165	-3,261	-4,285	-6,003 ^{2/}				
Monetary stabiliza- tion account (DB)	-377	-920	-4,185	-4,365	-4,196	-4,295	-3,826	-3,544				
Other items	-270	-811	611	456	684	843	977	1,269				
Reserve money	4,095	4,248	4,319	3,799	3,588	4,536	5,053	4,421				
(Percent change)	(7.1)	(3.7)	(1.7)	(3.4)	(-0.7)	(2.2)	(17.0)	(16.4)				

Source: Data provided by the Korean authorities; and staff estimates.

^{1/} Includes rediscounted directed export credit (up to the rediscountable amount).

^{2/} Includes ₩ 120 billion in Exchange Equalization Fund Bonds.

Table III-5. Korea: Issuance and Redemption of CDs, 1984-87
(In billions of won)

	Ceiling	Issued	Redeemed	Outstanding	Change
1984 June		598.3	--	598.3	598.3
July		228.6	--	826.9	228.6
August		113.8	63.7	877.0	50.1
September		196.4	339.7	733.7	-143.3
October		199.8	213.8	719.7	-14.0
November		131.2	118.3	732.6	12.9
December		243.8	292.3	684.1	-48.5
1985 Q 1		760.8	526.1	918.9	234.8
Q 2		766.9	726.4	959.5	40.6
Q 3		800.9	762.2	998.2	38.7
Q 4		872.6	797.4	1,073.4	75.2
1986 Q 1		1,127.0	846.1	1,354.3	280.9
Q 2		702.8	916.1	1,141.0	-213.3
Q 3		932.6	938.2	1,135.4	-5.6
Q 4		1,055.7	913.7	1,277.4	142.0
1987 Q 1		1,021.1	200.5	2,098.0	820.6
Q 2					
Q 3					
Q 4					
1988 Q 1					

Source: Data provided by the Korean authorities.

Table III-6. Korea: Selected Interest Rates on Deposits, 1983-88

(In percent per annum)

End of period	1983	1984	1985	1986				1987				1988 Feb.
				March	June	Sept.	Dec.	March	June	Sept.	Dec.	
<u>Deposit money banks</u>												
Household checking deposits	8.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0		
Time deposits												
Over 3 months	7.6	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0		
Over 6 months	7.6	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0		
Over 1 year	8.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0		
Savings deposits <u>1/</u>	8.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0		
Installment savings deposits <u>1/</u>	8.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0		
Property formation deposits <u>2/</u>												
2 years	19.5	19.5	15.3	15.3	15.3	15.3	15.3	15.3	15.3	15.3		
5 years	21.0	21.0	16.9	16.9	16.9	16.9	16.9	16.9	16.9	16.9		
Certificates of deposit (CDs)	--	11.0	11.75	11.0 <u>3/</u>	11.0	11.0	11.0	11.0	11.0	11.0		
<u>Nonbank financial institutions</u>												
Money in trust (2 years)	8.6	10.6	10.6	10.6	10.6	10.6	10.6	10.6	10.6	10.6		
Investment and finance companies												
Bills resold: 8-29 days	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5		
60-90 days	8.5	8.5	8.5	8.5	8.5	8.5	8.5	8.5	8.5	8.5		
Mutual credit cooperatives												
Time deposits (1 year)	9.0	10.5	11.0	11.0	11.0	11.0	11.0	11.0	11.0	11.0		
<u>Memorandum items:</u>												
Yield on corporate bonds <u>4/</u> (differential over 1-year time deposits)	14.2 (6.2)	14.1 (5.0)	13.6 (3.6)	12.4 (2.4)	12.8 (2.8)	12.8 (2.8)	12.8 (2.8)	12.8 (2.8)	13.0 (3.0)			

Sources: Bank of Korea, Monthly Statistical Bulletin; and data provided by the Korean authorities.1/ From April 1985, savings deposits and preferential installment savings deposits for household were introduced, and the maximum interest rates on those deposits are 12 percent and 13 percent, respectively.2/ These rates included only the interest paid by banks and the government subsidy. In addition, employees are encouraged to contribute to the yield on these assets.3/ From March 1986, selling rate of CDs was liberalized.4/ Averages.

Table III-7. Korea: Selected Interest Rates on Loans, 1983-88

(in percent per annum)

End of period	1983	1984	1985	1986	1987				1988 Feb.
					March	June	Sept.	Dec.	
Bank of Korea									
Rediscount on prime commercial bills	5.0	5.0	5.0	7.0	7.0				
Rediscount on exports	5.0	5.0	5.0	7.0	7.0				
Commercial banks									
Discounts on bills	10.0	10.0-11.5	10.0-11.5	10.0-11.5	10.0-11.5				
Loans for exports	10.0	10.0	10.0	10.0	10.0				
Overdrafts	10.0	10.0-11.5	10.0-11.5	10.0-11.5	10.0-11.5				
Loans on installment savings deposits	10.0	10.0-11.5	10.0-11.5	10.0-11.5	10.0-11.5				
Term loans									
1-3 years	10.0	10.0-11.5	10.0-13.0	10.0-12.0	10.0-12.0				
3-8 years	10.0	10.0-11.5	10.0-13.5	10.0-12.0	10.0-12.0				
8-10 years	10.0	10.0-11.5	10.0-13.0	10.0-12.0	10.0-12.0				
Other financial institutions									
Korea Development Bank									
Equipment for key industries	10.0	10.0-11.5	10.0-13.0	10.0-13.0	10.0-13.0				
Using government funds	10.0	10.0	10.0	10.0	10.0				
Using foreign funds	15.0	10.6-14.3	10.4-12.7	LIBOR+2.0	LIBOR+2.0				
Korea Housing Bank									
Private	10.0	10.0-11.5	10.0-11.5	10.0-11.5	10.0-11.5				
Public	8.0	8.0	8.0	8.0	8.0				
Mutual savings and finance companies	20.0	18.5	18.0	15.0-16.5	15.0-16.5				
Mutual credit cooperatives	13.0	13.5	14.5	14.5	14.5				
Agricultural cooperatives 1/	10.0	10.0	10.0	8.0	8.0				
National Investment Fund (NIF)									
National Housing Fund (NHF) 2/	10.0	10.0	10.0	10.0	10.0				

Sources: Bank of Korea, Monthly Statistical Bulletin; and data provided by the Korean authorities.1/ Applies also to loans for fishery.
National housing construction.

Table III-8. Korea: Domestic Credit by Financial Institutions, 1983-87 ^{1/}

(Changes in billions of won and in percent of total)

	1983		1984		1985		1986		1987	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
Banking system	<u>4,153</u>	<u>50.4</u>	<u>3,997</u>	<u>37.7</u>	<u>6,604</u>	<u>47.8</u>	<u>5,916</u>	<u>43.6</u>		
Nonbank financial institutions	<u>4,079</u>	<u>49.6</u>	<u>6,606</u>	<u>62.3</u>	<u>7,222</u>	<u>52.2</u>	<u>7,654</u>	<u>56.4</u>		
Development institutions	750	9.1	1,360	12.8	1,708	12.3	523	3.9		
Savings institutions	1,004	12.2	1,425	13.4	2,945	21.1	3,357	24.7		
Investment institutions	1,477	18.0	2,646	25.0	1,405	10.2	2,752	20.3		
Insurance companies	848	10.3	1,175	11.1	1,164	8.4	1,022	7.5		
Total domestic credit	<u>8,232</u>	<u>100.0</u>	<u>10,603</u>	<u>100.0</u>	<u>13,826</u>	<u>100.0</u>	<u>13,570</u>	<u>100.0</u>		

Source: Data provided by the Korean authorities.

^{1/} Total domestic credit corresponds to Financial Survey; domestic credit of the banking system corresponds to Monetary Survey net of transactions with the NBFIs.

Table III-9. Directed Credit Outstanding by Banking and Financial Institutions, 1983-87

(In billions of won)

End of period	1983	1984	1985	1986	1987
Loans with banking funds	4,135	4,721	6,165	7,252	
Export loans by DMBs	(2,620)	(2,765)	(3,130)	(3,445)	
Machine industry promotion loans by DMBs	(--)	(--)	(--)	(--)	
Loans for equipment for export industries by DMBs	(186)	(176)	(595)	1,867	
Special equipment loans by DMBs	(--)	(--)	(--)	(--)	
Industrial rationalization loans by DMBs	(--)	(--)	(--)	(--)	
KEXIM loans for export on credit	(1,329)	(1,779)	(2,440)	(1,940)	
Loans with government funds	1,007	1,158	1,297	889	
Loans for medium industries by DMBs	(22)	(25)	(30)	(29)	
Foreign loan funds by DMBs	(262)	(286)	(325)	(344)	
Korea Development Bank loans	(723)	(848)	(942)	(516)	
Loans with NIF funds	2,828	2,889	2,938	2,827	
Loans by DMBs	(831)	(909)	(966)	(1,055)	
Loans by Korea Development Bank	(1,581)	(1,517)	(1,448)	(1,389)	
Loans by KEXIM	(416)	(462)	(524)	(383)	
Total	<u>7,970</u>	<u>8,768</u>	<u>10,400</u>	<u>10,968</u>	
Total directed credit as a percent of total loans and discounts to the private sector by banking and financial institutions	<u>15.6</u>	<u>14.2</u>	<u>13.7</u>	<u>12.3</u>	

Source: Data provided by the Bank of Korea.

Table III-10. Sources and Loans of the National Investment Fund

(In billions of won)

	1985		1986		1987		1988 Plan	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
Sources								
National Savings Associations	17.9	3.8	17.4	3.2				
Public funds	-87.7	-18.5	-68.8	-12.5				
Banking institution	83.5	17.6	42.9	7.8				
Insurance companies	-10.0	-2.1	-107.2	-19.5				
Collection of loans	453.5	95.6	650.2	118.0				
Carryover from previous year	<u>16.9</u>	<u>3.6</u>	<u>16.4</u>	<u>3.0</u>				
Total	474.1	100.0	550.9	100.0				
Loans								
Heavy and chemical industries	319.4	68.8	414.7	74.1				
Electric power industries	40.0	8.6	40.0	7.1				
Projects to increase food production	25.0	5.4	25.0	4.5				
Deferred payment exports	<u>80.0</u>	<u>17.2</u>	<u>80.0</u>	<u>14.3</u>				
Total	464.4	100.0	559.7	100.0				

Source: Data provided by the Korean authorities.

Table III-11. Sources and Uses of the National Housing Fund

(in billions of won)

	1984		1985		1986		1987		1988 (Plan)	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
Sources										
National Housing Pre-emption Subscription										
Deposits	191.9	18.9	26.5	3.6	-46.1	-8.1				
National Housing Bonds	279.7	27.6	215.8	29.6	204.8	35.9				
National Housing Fund Bonds	--	--	--	--	--	--				
Olympic Lotteries	11.8	1.2	10.7	1.5	11.5	2.0				
Deposits from the various funds	-12.1	-1.2	-6.7	-0.9	75.2	13.2				
Government contributions	--	--	--	--	100.0	17.5				
Borrowing from IBRD	5.7	0.6	41.2	5.7	17.3	3.0				
Collection of loans	29.3	2.9	35.6	4.9	50.5	8.9				
Carry-over from previous years	421.6	41.6	342.0	46.9	129.3	22.6				
Others	<u>85.7</u>	<u>8.5</u>	<u>63.2</u>	<u>8.7</u>	<u>28.7</u>	<u>5.0</u>				
Total	1,013.5	100.0	728.3	100.0	571.2	100.0				
Uses										
Loans to										
Local government	162.6	16.0	191.9	26.3	158.7	27.8				
The Korea National Housing Corp.	191.1	18.9	201.6	27.7	201.8	35.3				
Private constructors, etc.	132.4	13.1	175.4	24.1	184.4	32.3				
National organizations, etc.	--	--	--	--	0.2	--				
Loans for housing-site development, etc.	180.0	17.8	30.0	4.1	--	--				
Deposits to KHB, etc.	<u>347.4</u>	<u>34.3</u>	<u>129.4</u>	<u>17.8</u>	<u>26.1</u>	<u>4.6</u>				
Total	1,013.5	100.0	728.3	100.0	571.2	100.0				

Source: Data provided by the Korean authorities.

Table III-12. Korea: Financing Through the Securities Market
(In million Won)

Year	Public Offering		Offering to shareholders	Total
	Stocks	Bonds		
1970	2,068	--	5,083	7,151
1971	850	--	2,090	2,940
1972	1,080	9,928	13,733	24,741
1973	21,475	3,450	29,623	54,548
1974	14,337	27,870	32,080	74,287
1975	39,875	33,450	82,929	156,255
1976	74,005	86,280	101,941	262,226
1977	44,113	176,480	141,860	362,453
1978	41,521	326,340	285,201	653,062
1979	4,875	624,630	211,927	841,432
1980	345	963,700	170,803	1,134,848
1981	3,045	1,036,148	302,996	1,342,189
1982	--	2,112,169	276,867	2,389,036
1983	30,800	1,426,524	431,769	1,889,093
1984	81,390	1,804,063	397,672	2,283,125
1985	35,060	3,176,744	259,528	3,471,332
1986				
1987				

Source: Data provided by the Korean authorities.

Table III-13. Korea: Ownership of Listed Stocks by Type of Holder

	1984	1985	1986	1987	1984	1985	1986	1987
	(Share holdings in thousand)				(Ratio to total shares in percent)			
Government and State corporations	15,242				0.21			
Banking institutions	491,415				6.61			
Securities companies	453,586				6.10			
Insurance companies and other corporations	2,313,952				31.14			
Individuals	3,993,129				53.74			
Foreigners	<u>163,582</u>				<u>2.20</u>			
Total	7,430,906				100.0			

Source: Data provided by the Korean authorities.

Table III-14. Korea: Ownership of Listed Stocks by Size of Holdings

	1984	1985	1986	1987	1984	1985	1986	1987
	<u>(Number of holders)</u>				<u>(Holdings in thousand)</u>			
Less than 100	161,172				7,043			
100-999	274,949				105,510			
1,000-9,999	214,543				737,321			
10,000-99,999	65,011				1,637,521			
100,000 and more	<u>8,059</u>				<u>4,943,511</u>			
Total	723,734				7,430,906			
	<u>(Ratio to total number in percent)</u>				<u>(Ratio to total shares in percent)</u>			
Less than 100	22.27				0.09			
100-999	37.99				1.42			
1,000-9,999	29.64				9.92			
10,000-99,999	8.98				22.04			
100,000 and over	<u>1.11</u>				<u>66.53</u>			
Total	100.00				100.00			

Source: Data provided by the Korean authorities.

Table III-15. Korea: Securities Market Activities

Year	Stock Turnover		Bond Turnover	
	Volume (Thou. shares)	Value (Mil. won)	Par Value (Mil. won)	Sales Value (Mil. won)
1970	79,174	42,874	4,216	3,579
1971	50,523	34,376	11,098	7,283
1972	84,689	71,050	10,205	8,678
1973	130,066	160,642	9,156	7,939
1974	157,419	179,428	4,484	3,431
1975	310,547	333,906	16,658	13,518
1976	591,776	628,677	43,779	36,697
1977	1,271,521	1,375,268	135,863	130,532
1978	1,368,462	1,741,506	245,726	238,682
1979	1,560,646	1,327,813	547,114	523,270
1980	1,645,337	1,134,019	910,701	889,976
1981	3,074,558	2,534,160	1,425,243	1,410,523
1982	2,782,389	1,973,466	6,282,842	6,247,548
1983	2,750,739	1,752,628	3,457,410	3,348,281
1984	4,350,270	3,118,205	2,393,219	2,252,043
1985	5,563,809	3,620,600	3,778,913	3,578,092
1986				
1987				

Source: Data provided by the Korean authorities.

Table III-16. Korea: Average Yields of Listed Stocks and Bonds

End of Period	Dividend Yield Rate	P/E Ratio	Yield on Bond (Gov't public bond)
1975	13.7	5.3	21.1
1976	12.7	6.6	21.6
1977	14.2	5.9	20.7
1978	12.9	5.9	21.6
1979	17.8	3.8	25.2
1980	20.9	2.6	28.8
1981	16.4	3.1	23.6
1982	13.5	3.4	17.24
1983	9.0	3.8	13.74
1984	5.4	4.5	13.69
1985	5.3	5.2	13.9
March	5.0	5.0	14.9
June	5.3	5.4	13.0
September	5.8	5.4	13.7
December	5.6	5.6	12.8
1986			
March			
June			
September			
December			
1987			
March			
June			
September			
December			

Source: Data provided by the Korean authorities.

KRC—cqt&kr3-17—2/29/88

Table III-17. Korea: Composite Stock Price Index Based on
Aggregate Market Value Method

(January 4, 1980 = 100)

	1980	1981	1982	1983	1984	1985	1986	1987
January								
February								
March								
April								
May								
June								
July								
August								
September								
October								
November								
December								
Year	106.9	131.4	127.3	121.21	142.46	163.37	272.62	

Source: Data provided by the Korean authorities.

Table III-18. Korea: Key Statistics on Listed Stocks

End of Period	No. of Listed Companies	No. of Holders (<u>thousands</u>)	No. of Shares (<u>millions</u>)	Capital Amount (<u>w. bil.</u>)	Market Value
1970	48	76	159	134	98
1971	50	82	170	141	109
1972	66	103	210	174	246
1973	104	200	305	252	426
1974	128	200	488	381	533
1975	189	291	825	643	916
1976	274	568	1,583	1,153	1,436
1977	323	395	2,117	1,492	2,351
1978	356	963	2,959	1,914	2,893
1979	355	872	3,507	2,202	2,609
1980	352	753	3,876	2,421	2,527
1981	343	696	4,048	2,410	2,959
1982	334	682	4,705	2,811	3,300
1983	328	709	5,444	3,239	3,490
1984	336	724	7,407	4,336	5,148
1985	342	744	7,955	4,665	6,570
1986					
1987					

Source: Data provided by the Korean authorities.

KRC--cqt8krtbU--2/25/88

Table III-19. Korea: Aggregate Loans and Deposits
of Foreign Bank Branches in Korea

(In millions of U.S. dollars, end of period)

End of	Loans and Discounts		Deposits	
	Won	Foreign Currency	Won	Foreign Currency
1973	41.2	63.5	35.2	5.0
1974	44.8	100.8	36.4	18.8
1975	162.6	109.5	61.7	38.7
1976	256.5	124.3	89.2	71.9
1977	426.8	418.1	120.9	77.0
1978	543.5	872.1	189.5	29.7
1979	609.2	1,393.9	191.3	30.9
1980	932.7	2,027.0	236.2	66.5
1981	1,208.8	2,171.7	296.2	132.6
1982	1,462.6	2,216.4	297.3	425.0
1983	1,685.7	2,283.6	391.2	276.2
1984	2,065.7	2,846.2	470.7	329.4
1985	2,260.7	3,178.3	443.4	301.9
1986				
1987				

Source: The Bank of Korea.

Table III-20. Korea: Source of Funds of Foreign Banks in Korea

(In millions of U.S. dollars, end of period)

	Deposits		Inter-Office Transfers in Foreign Currency		(In percent)
	Won	Foreign currency	Total	Swaps	
1973	35.2	5.0	65.0	6.4	(--)
1974	36.4	18.8	88.2	6.2	(--)
1975	61.7	38.7	231.5	114.2	(--)
1976	89.2	71.9	323.7	217.3	(--)
1977	120.9	77.0	776.7	335.4	(--)
1978	189.5	29.7	1,214.8	380.1	(--)
1979	191.3	30.9	1,811.4	399.4	(--)
1980	236.2	66.5	2,841.7	914.6	(18.9)
1981	296.2	132.6	3,017.4	1,006.6	(10.0)
1982	297.3	425.0	3,379.0	1,521.4	(18.6)
1983	391.2	276.2	3,778.3	1,705.4	(14.2)
1984	470.7	329.4	4,411.4	1,818.8	(13.6)
1985	443.4	301.9	4,733.9	1,873.4	(12.6)
1986					
1987					

Source: Bank of Korea.

Note: Figures in parentheses indicate the proportion absorbed by the monetary stabilization account or stabilization bonds among swap transactions.

KRC--cqt8krtbW--2/25/88

Table III-21. Korea: Total Deposits in Foreign Currency

(In millions of U.S. dollars, end of period)

	Korean Banks			Foreign Bank Branches		
	Resident	Nonresident	Total	Resident	Nonresident	Total
1972	146.0	25.2	171.2	4.1	0.6	4.7
1973	163.1	10.7	173.8	4.0	1.0	5.0
1974	151.6	11.6	163.2	17.4	1.4	18.8
1975	100.8	114.7	215.5	10.7	28.0	38.7
1976	124.6	331.5	456.1	19.2	52.7	71.9
1977	251.1	307.6	558.7	58.6	18.4	77.0
1978	274.1	114.9	389.0	16.3	13.4	29.7
1979	208.1	138.1	346.2	25.8	5.1	30.9
1980	280.6	192.7	473.3	59.7	6.8	66.5
1981	256.2	239.8	496.0	120.8	11.9	132.6
1982	410.0	234.1	644.1	414.1	10.9	425.0
1983	675.7	377.9	1,053.6	261.5	14.7	276.2
1984	705.4	594.7	1,300.1	301.0	28.4	329.4
1985	961.6	878.0	1,839.6	260.9	41.0	301.9
1986						
1987						

Source: The Bank of Korea.

KRC--cqt8krbX

Table III-22. Korea: Foreign Currency Loans of Deposit Money Banks

End of Period	Foreign Currency Loans	
	Won Billion	U.S. dollar million
1984		
December	3,143.1	3,798.8
1985		
March	3,308.6	3,716.7
June	3,359.0	3,773.3
September	3,423.2	3,845.4
December	3,291.9	3,697.9
1986		
March		
June		
September		
December		
1987		
March		
June		
September		
December		

Source: The Bank of Korea.

Table III-23. Korea: Bank of Korea Swap Transactions

(In millions of U.S. dollars)

	1985				1986				1987			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Volume												
Domestic banks	3,774.9	5,861.6	6,103.8	5,387.1								
Foreign bank branches	<u>1,007.4</u>	<u>553.2</u>	<u>576.0</u>	<u>1,077.8</u>								
Total	4,782.3	6,414.8	6,679.8	6,464.9								
Outstanding (end of period)												
Foreign bank branches	1,849.7	1,877.2	1,885.7	1,873.4								
Of which:												
MSA and MSB	(249.8)	(249.8)	(248.5)	(236.2)								
Domestic banks	<u>6,115.4</u>	<u>7,267.9</u>	<u>8,234.0</u>	<u>8,271.1</u>								
Total	8,005.1	9,145.1	10,119.7	10,144.5								

Source: Bank of Korea.

Table III-24. Korea: Bank Credit Extended
to Special Accounts, Budgetary Funds and
Government Invested Enterprises

(In billion Won, end period)

	1983	1984	1985	1986	1987
The Bank of Korea	<u>2,644.8</u>	<u>2,643.5</u>	<u>2,637.0</u>		
General account	390.0	390.0	390.0		
Grain Management Fund	1,642.0	1,642.0	1,642.0		
Government Supply Fund	35.0	35.0	35.0		
Fund for potential farmers and fishermen	7.8	6.5	--		
Government invested enterprises	570.0	570.0	570.0		
Deposit money banks	<u>1,610.8</u>	<u>1,894.3</u>	<u>1,735.1</u>		
Government invested enterprises	1,610.8	1,894.3	1,735.1		
Other financial institutions	<u>2,139.1</u>	<u>2,970.0</u>	<u>2,707.3</u>		
National railroad special account	508.1	498.4	498.4		
Government invested enterprises	1,631.0	2,471.6	2,208.9		
Total	<u>6,394.7</u>	<u>7,507.8</u>	<u>7,079.4</u>		

Source: Data provided by the Korea authorities.

Table IV-1. Korea: Operations of the Central Government and the Consolidated Central Government, 1983-88 ^{1/}

	1983	1984	1985	1986	1987		1988
				Actual	Budget	Actual	Budget
(In billions of won)							
Central government							
Revenue	11,537	12,603	12,922	15,841	17,323		
Expenditure	12,200	13,446	14,867	15,927	18,603		
Deficit (-)	-663	-843	-945	-86	-1,280		
Net financial transactions between the central government and the public funds ^{2/}	-286	-80	+232	21	-20		
Consolidated central government							
Revenue	11,595	13,040	14,505	15,856	17,357		
Expenditure	12,546	13,963	15,218	15,921	18,657		
Deficit (-)	-951	-923	-713	-65	-1,300		
Financing	951	923	713	65	1,300		
Domestic	552	613	273	211	1,257		
Bank ^{3/}	(-245)	(-40)	(319)	(591)	(603)		
Nonbank	(797)	(653)	(-46)	(-380)	(654)		
Foreign	399	310	440	146	43		
(In percent of GNP)							
Central government							
Revenue	19.7	19.3	19.3	18.9	18.7		
Expenditure	20.9	20.6	20.6	19.0	20.1		
Deficit (-)	-1.2	-1.3	-1.3	-0.1	-1.4		
Net financial transactions between the central government and the public funds	-0.5	-0.1		
Consolidated central government							
Revenue	19.9	20.0	20.1	18.9	18.7		
Expenditure	21.5	21.4	21.0	19.0	20.2		
Deficit (-)	-1.6	-1.4	-1.0	-0.1	-1.4		
Financing	1.6	1.4	1.0	0.1	1.4		
Domestic	0.9	0.9	0.4	0.3	1.4		
Bank ^{3/}	(-0.4)	(-0.1)	(0.5)	(0.7)	(0.7)		
Nonbank	(1.3)	(1.0)	(-0.1)	(-0.4)	(0.7)		
Foreign	0.7	0.5	0.6	-0.2	--		
Memorandum item:							
GNP	58,986	66,408	72,317	83,833	92,571		

Sources: Data provided by the Korean authorities; and staff estimates.

^{1/} Includes: General Account, Special Accounts, Government Funds, and Public Enterprise Funds. The figures for the public sector are actuals and are not corrected for changes in definition. The removal of the Korea Telecommunications Authority from the accounts in 1982 reduced revenue and expenditure by more than 1 percent of GNP. The removal of the Civil Servants Pension Fund and Special Account in 1983 reduced revenue and expenditure by almost 1 percent of GNP, and the overall deficit, by 0.1 percentage point of GNP.

^{2/} Includes payments of profits to the government, primarily from the tobacco and ginseng tea monopoly, receipts of subsidies, primarily by the Grain Management Fund, and capital transfers from the Government.

^{3/} Bank financing as defined in the monetary survey; domestic nonbank financing includes small discrepancies between cash and accrual accounting in the fiscal presentation. For a reconciliation of the fiscal and monetary accounts see Appendix Table 4.

Table IV-2. Korea: Central Government Revenue, 1983-88

(In billions of won)

	1983	1984	1985	1986	1987		1988
				Actual	Budget	Actual	Budget
Tax Revenue ^{1/}	<u>10,207</u>	<u>11,077</u>	<u>12,105</u>	<u>13,882</u>	<u>15,216</u>		
Taxes on net income, profits, and capital gains	2,609	2,867	3,475	3,967	4,358		
Company, corporate, or enterprise	(1,205)	(1,345)	(1,630)	(1,731)	(1,954)		
Individuals	(1,404)	(1,522)	(1,845)	(2,236)	(2,404)		
Social security contributions	131	157	207	250	322		
Taxes on property	106	98	80	102	110		
Taxes on goods and services	5,221	5,629	5,933	6,709	7,310		
General sales taxes	(2,559)	(2,825)	(2,901)	(3,272)	(3,580)		
Selective excises on goods and services	(1,723)	(1,824)	(2,082)	(2,328)	(2,654)		
Profits of fiscal monopolies	(939)	(963)	(950)	(1,109)	(1,076)		
Taxes on international trade	1,772	1,921	1,950	2,349	2,602		
Other taxes	368	405	460	505	514		
Montax revenue	<u>1,210</u>	<u>1,433</u>	<u>1,632</u>	<u>1,839</u>	<u>1,841</u>		
Capital revenue	<u>120</u>	<u>93</u>	<u>185</u>	<u>119</u>	<u>266</u>		
Total revenue	<u>11,538</u>	<u>12,603</u>	<u>13,922</u>	<u>15,840</u>	<u>17,323</u>		
Total revenue and grants	<u>11,538</u>	<u>12,603</u>	<u>13,922</u>	<u>15,840</u>	<u>17,323</u>		

Sources: Data provided by the Korean authorities; and staff estimates.

^{1/} Includes defense surtax and education tax and surtax allocated to individual categories as appropriate.

Table IV-3. Korea: Economic Classification of Central Government Expenditure and Net Lending, 1983-88

(In billions of won)

	1983	1984	1985	1986 Actual	1987 Budget	1987 Actual	1988 Budget
Current expenditure	<u>9,145</u>	<u>10,213</u>	<u>11,523</u>	<u>12,830</u>	<u>14,564</u>		
Expenditure on goods and services	4,618	4,763	5,419	5,990	6,776		
Wages and salaries	(1,676)	(1,757)	(1,892)	(2,060)	(2,222)		
Other purchases of goods and services ^{1/}	(2,942)	(3,006)	(3,527)	(3,930)	(4,554)		
Interest payments	687	857	993	1,135	1,345		
Domestic	(330)	(455)	(527)	(571)	(719)		
Foreign	(357)	(402)	(466)	(564)	(626)		
Subsidies and other current transfers	3,840	4,593	5,111	5,705	6,443		
To enterprise funds	(35)	(387)	(469)	(383)	(310)		
To local governments	(2,818)	(3,102)	(3,375)	(3,875)	(4,317)		
To financial institutions	(39)	(26)	(34)	(20)	(80)		
To households, nonprofit institutions, and others	(918)	(1,046)	(1,198)	(1,387)	1,694		
To abroad	(30)	(32)	(34)	(38)	(42)		
Capital expenditure	<u>1,536</u>	<u>1,662</u>	<u>1,814</u>	<u>2,119</u>	<u>2,417</u>		
Acquisition of new and existing fixed capital assets	862	896	976	1,226	1,294		
Purchases of land and intangible assets	97	144	80	98	128		
Capital transfers	500	554	720	809	828		
To enterprise funds	(34)	(--)	(--)	(22)	(25)		
To others	(465)	(554)	(720)	(787)	(803)		
Purchases of inventories	77	69	37	86	167		
Net lending ^{2/}	<u>1,519</u>	<u>1,572</u>	<u>1,530</u>	<u>978</u>	<u>1,622</u>		
To enterprise funds	-19	54	42	69	54		
To others	1,538	1,518	1,488	909	1,568		
Total expenditure and net lending	<u>12,200</u>	<u>13,446</u>	<u>14,867</u>	<u>15,927</u>	<u>18,603</u>		

Sources: Data provided by the Korean authorities; staff estimates.

^{1/} Includes foreign military sales credits from foreign governments^{2/} Includes foreign borrowing directly on-lent to the private sector and to nonfinancial public enterprises classified as "others."

Table IV-4. Korea: Functional Classification of Central Government Expenditure and Net Lending, 1983-88 ^{1/}

	1983	1984	1985	1986 Actual	1987 Budget	1987 Actual	1988 Budget
(In billions of won)							
General public services	1,237	1,208	1,401	1,553	1,597	1,647	
Defense ^{2/}	3,403	3,573	3,958	4,502	4,376	5,071	
Education	2,189	2,258	2,462	2,740	2,713	3,100	
Health	180	173	192	231	232	460	
Social security and welfare	569	670	779	1,019	968	1,138	
Housing and community amenities	589	1,061	719	954	615	666	
Other community and social services	104	111	147	166	168	167	
Economic services ^{1/}	2,430	2,567	3,251	3,395	2,886	3,713	
Unallocable (includes interest and transfers to local government)	1,500	1,825	1,958	2,426	2,372	2,641	
Total expenditure and net lending	<u>12,200</u>	<u>13,446</u>	<u>14,867</u>	<u>16,986</u>	<u>15,927</u>	<u>18,603</u>	
(Percent of total)							
General public services	10.1	9.0	9.4	9.1	10.0	8.8	
Defense	27.9	26.6	26.6	26.5	27.5	27.2	
Education	17.9	16.8	16.6	16.1	17.0	16.7	
Health	1.5	1.3	1.3	1.4	1.5	2.5	
Social security and welfare	4.7	5.0	5.2	6.0	6.1	6.1	
Housing and communities amenities	4.8	7.9	4.8	5.6	3.9	3.6	
Other community and social services	0.8	0.8	1.0	1.0	1.0	0.9	
Economic services	19.9	19.1	21.9	20.0	18.1	20.0	
Unallocable (includes interest and transfers to local government)	12.3	13.6	13.2	14.3	14.9	14.2	
Total expenditure and net lending	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	

Sources: Data provided by the Korean authorities; and staff estimates.

^{1/} Includes National Investment Fund loans and net lending from foreign borrowing directly orient to nonfinancial public enterprises and the private sector. Almost all of these funds are classified in economic services, although some appear in general research, health, and community development.

^{2/} Includes foreign military sales credits from foreign governments.

Table IV-5. Korea: Grain Management Fund Operations, 1983-88 ^{1/}

(In billions of won)

	1983	1984	1985	1986 Actual	1987 Budget	1987 Actual	1988 Budget
Operating receipts	944	939	1,029	1,018	764		
Rice sales	561	570	469	573	378		
Barley sales	97	68	61	44	43		
Sales to central government	160	167	204	191	228		
Other grains	26	75	148	193	99		
By-products ^{2/}	111	60	147	17	15		
Operating expenditures	1,186	1,448	1,368	1,371	1,154		
Domestic rice purchases ^{3/}	575	930	1,010	970	827		
Rice imports	84	57	--	--	--		
Domestic barley purchases	275	208	121	92	80		
Other grains	--	--	--	--	--		
Other grain imports	7	9	6	1	--		
Handling and storage charges ^{4/}	142	142	119	92	82		
Interest payment	90	90	100	98	147		
Other ^{5/}	12	12	12	64	18		
Operating surplus/deficit (-)	-242	-509	-339	-299	-390		
Financing	242	509	339	299	390		
Domestic	243	511	341	320	444		
BOK	293	1	-79	50	39		
Net borrowing	(250)	(--)	(--)	(--)	(--)		
Use of cash balances	(43)	(1)	(-79)	(50)	(39)		
Deposit Money Banks ^{6/}	-115	180	-30	-49	150		
Borrowing	(90)	(780)	(750)	(650)	(800)		
Amortization	(204)	(600)	(800)	(699)	(650)		
Nonbank sources ^{6/}	65	--	--	-31	-20		
Borrowing	(510)	(--)	(--)	(20)	(--)		
Amortization	(446)	(--)	(--)	(51)	(-20)		
Government subsidy	0	330	450	350	275		
Foreign	-1	-2	-2	-21	-54		
Borrowing	--	--	--	--	--		
Amortization to Government	--	--	--	--	--		
Fund financing S.A.	1	2	2	21	54		

Source: Data provided by the Korean authorities; and staff estimates.

^{1/} Calendar-year basis.^{2/} Includes miscellaneous revenue.^{3/} Includes previous-year rice and rice purchases financed by deferred payment.^{4/} Includes management expenses of Grain Management Special Account (GMSA).^{5/} Includes transfers to GMSA.^{6/} Represents Grain Bonds. Beginning in 1984 data for DMBs include sales of grain bonds nonbank sources.

KRC--cqt8kr4-8--2/22/88

Table IV-8. Korea: Average Price, 1986-88

(Unit = won)

	Rice (80 kg)	Barley (76.5 kg)
<hr/>		
Ry 1986		
a. The average import price (FOB/MT: brown rice)		
b. Average domestic purchase price		
c. Overall average purchase price		
d. Average release price to public		
e. Average release price to Government		
Ry 1987		
a. The average import price (FOB/MT: brown rice)		
b. Average domestic purchase price		
c. Overall average purchase price		
d. Average release price to public		
e. Average release price to Government		
Ry 1988		
a. The average import price (FOB/MT: brown rice)		
b. Average domestic purchase price		
c. Overall average purchase price		
d. Average release price to public		
e. Average release price to Government		

Source: Data provided by the Korean authorities.

Table IV-9. Korea: Operations of General Government, 1983-87

	1983	1984	1985	1986 <u>1/</u>	1987
(In billions of won)					
1. Consolidated Central Government <u>2/</u>					
Total revenue and grants	11,595	13,040	14,505	15,856	
Total expenditure and net lending	12,546	13,963	15,218	15,921	
Overall balance	-951	-923	-713	-65	
2. Consolidated Local Governments					
Total revenue and grants	2,739	3,079	3,406	3,990	
Total expenditure and net lending	2,661	2,993	3,567	3,808	
Overall balance	78	86	-161	182	
3. General Government (1+2)					
Total revenue and grants	14,334	16,119	17,911	19,846	
Total expenditure and net lending	15,207	16,956	18,785	19,729	
Overall balance	-873	-837	-874	117	
(In percent of GNP)					
1. Consolidated Central Government <u>2/</u>					
Total revenue and grants	19.7	19.6	20.1	18.9	
Total expenditure and net lending	21.3	21.0	21.0	19.0	
Overall balance	-1.6	-1.4	-1.0	-0.1	
2. Consolidated Local Governments					
Total revenue and grants	4.6	4.6	4.7	4.8	
Total expenditure and net lending	4.5	4.5	4.9	4.5	
Overall balance	0.1	0.1	-0.2	0.3	
3. General Government (1+2)					
Total revenue and grants	24.3	24.2	24.8	23.7	
Total expenditure and net lending	25.8	25.5	25.9	23.5	
Overall balance	-1.4	-1.3	-1.2	0.2	

Source: Data provided by the Korean authorities; and staff estimates.

1/ Actual for Consolidated Central Government; budget for Consolidated Local Governments and for General Government.

2/ Corresponds to the concept of the "consolidated central government" in Table 1.

Table IV-5a. Korea: Operations of Local Governments, 1963-68

	1963	1964	1965	1966	1967		1968
					Budget	Actual	Budget
(In billions of won)							
1. Current revenue	2,681	3,017	3,339				
Tax	1,397	1,508	1,655				
Nontax	1,284	1,509	1,684				
2. Capital revenue	120	126	137				
3. Total revenue (1+2)	2,801	3,143	3,476				
4. Grants	3,093	3,425	3,718				
I. Total revenue and grants (3+4)	5,895	6,568	7,194				
1. Current expenditure	3,371	3,603	4,304				
2. Capital expenditure	2,347	2,872	3,098				
3. Total expenditure (1+2)	5,718	6,475	7,302				
4. Net lending	328	367	319				
II. Total expenditure and net lending (3+4)	6,046	6,862	7,521				
III. Overall balance (II-1)	-151	-294	-327				
IV. Financing	151	294	327				
1. Domestic	151	294	327				
Domestic money banks	-194	52	303				
Others	345	243	224				
(In percent of total)							
1. Current revenue	45.5	45.9	46.4				
Tax	23.7	23.0	23.0				
Nontax	21.8	23.0	23.4				
2. Capital revenue	2.0	1.9	1.9				
3. Total revenue (1+2)	47.5	47.9	48.3				
4. Grants	52.5	52.1	51.7				
I. Total revenue and grants (3+4)	100.0	100.0	100.0				
1. Current expenditure	55.8	52.5	54.6				
2. Capital expenditure	38.8	41.9	41.2				
3. Total expenditure (1+2)	94.6	94.4	95.8				
4. Net lending	5.4	5.6	4.2				
II. Total expenditure and net lending (3+4)	100.0	100.0	100.0				
III. Financing	100.0	100.0	100.0				
1. Domestic	100.0	100.0	100.0				
Domestic money banks	-129.3	17.5	31.5				
Others	228.3	82.5	68.5				

Sources: Data provided by the Korean authorities; and staff estimates.

Table IV-10. Korea: Sources of Uses of Funds of the National Investment Fund, 1983-88

(In billions of won)

	1983	1984	1985	1986	1987	1988
				Budget	Actual	Proj.
Sources of Funds						
National savings associations						
Trust funds of various public entities						
Banking institutions						
Insurance and trust companies						
Repaid loans						
Other						
Total						
Uses of funds						
Heavy and chemical industries						
Electric power						
Food production						
Exports by deferred payment						
Other						
Total						

Source: Data provided by the Korean authorities.

Table IV-11. Korea: Operations of the National Investment Fund, 1983-88

(In billions of won)

	1983	1984	1985	1986	1987 Budget Est.	1987 Actual	1988 Proj.
Revenue							
Current revenue							
Capital revenue							
Expenditure and net lending							
Current expenditure							
Capital expenditure							
Net lending							
Deficit ^{1/}							

Source: Data provided by the Korean authorities.

^{1/} This operational deficit includes intersaccount transactions which make it uncomparable with the overall deficit of the consolidated central government.

Table IV-12. Korea: Summary of the Operations of the Government Invested Enterprises, 1983-88

	1983	1984	1985	1986 Actual	1987 Budget	1987 Actual	1988 Budget
(in billions of won)							
Korea Electric Power Company							
Operating revenue	2,914	3,184	3,425	3,649	3,961		
Current expenditure	1,924	1,969	2,048	1,706	2,085		
Operating surplus	990	1,215	1,377	1,943	1,876		
Investment	1,748	1,676	1,729	1,476	1,496		
Net financing requirement	-758	-461	-352	467	380		
Korea Telecommunications Authority							
Operating revenue	1,142	1,388	1,826	2,085	2,341		
Current expenditure	568	622	1,046	816	820		
Operating surplus	574	766	780	1,269	1,521		
Investment	865	988	1,141	1,113	1,240		
Net financing requirement	-291	-222	-361	156	281		
Total							
Operating revenue	5,748	6,319	7,364	8,114	9,402		
Current expenditure	3,956	4,378	5,302	4,722	5,888		
Operating surplus	1,792	1,941	2,062	3,392	3,514		
Investment	2,917	2,989	3,504	3,096	3,446		
Net financing requirement	-1,125	-1,048	-1,442	296	68		
Financing							
Domestic bank	(31)	(107)	(626)	-328	210		
Domestic nonbank	(438)	(506)	(567)	305	182		
Foreign	(656)	(435)	(249)	-274	-460		
(in percent of GNP)							
Total							
Operating revenue	9.8	9.7	10.2	9.7	10.2		
Current expenditure	6.8	6.7	7.3	5.7	6.4		
Operating surplus	3.0	2.9	2.8	4.0	3.8		
Investment	4.9	4.5	4.8	3.7	3.7		
(in percent of gross domestic investment)	(16.6)	(14.1)	(15.5)	12.2	(...)		
Net financing requirement	-1.9	-1.6	-2.0	0.4	0.1		
Financing							
Domestic bank	-0.1	-0.2	-0.9	-0.4	0.2		
Domestic nonbank	-0.7	-0.7	-0.8	0.4	0.2		
Foreign	-1.1	-0.7	-0.3	-0.4	-0.5		

Sources: Data provided by the Korean authorities; and staff estimates.

Table IV-13. Korea: Operations of the Government-Invested Enterprises, 1983-88

(In billions of won)

	1983	1984	1985	1986	1987	1988
				Actual	Budget	Actual
1. Korea Electric Power Corporation						
Operating revenue	2,914	3,184	3,425	3,649	3,961	
Total expenditure	3,672	3,645	3,777	3,182	3,581	
Net financing requirement	-758	-461	-352	467	380	
2. Laihun Coal Corporation						
Operating revenue	172	187	189	198	198	
Total expenditure	162	134	201	195	223	
Net financing requirement	10	53	-12	3	-25	
3. Korea Highway Corporation						
Operating revenue	105	125	171	246	266	
Total expenditure	87	121	174	241	363	
Net financing requirement	18	4	-3	5	-97	
4. Korea National Housing Corporation						
Operating revenue	513	491	468	661	802	
Total expenditure	630	837	909	767	1,021	
Net financing requirement	18	4	-3	-106	-219	
5. Industrial Sites and Water Resource Development Corporation						
Operating revenue	201	157	298	318	336	
Total expenditure	197	195	320	343	381	
Net financing requirement	4	-38	-22	-25	-45	
6. Korea Land Development Corporation						
Operating revenue	149	191	414	348	442	
Total expenditure	171	263	456	415	564	
Net financing requirement	-21	-72	-42	-67	-122	
7. Agricultural Promotion Corporation						
Operating revenue	126	122	110	121	121	
Total expenditure	128	120	116	127	115	
Net financing requirement	-2	2	-6	-6	6	
8. Korea Telecommunications Authority						
Operating revenue	1,142	1,388	1,826	2,085	2,341	
Total expenditure	1,434	1,610	2,187	1,929	2,060	
Net financing requirement	-292	-222	-361	156	281	
9. Korea Broadcasting System						
Operating revenue	210	265	259	253	306	
Total expenditure	173	201	262	235	293	
Net financing requirement	37	64	-3	18	13	
10. Korea Gas Corporation						
Operating revenue	4	15	15	6	374	
Total expenditure	31	69	157	143	430	
Net financing requirement	-27	-54	-142	-137	-56	
11. Korea National Tourism Corporation						
Operating revenue	35.4	39.4	43.5	64.0	66	
Total expenditure	25.5	32.2	39.3	62.0	73	
Net financing requirement	3.8	-3.3	-3.4	2.0	-7	
12. Korea Mining Promotion Corporation						
Operating revenue	29.0	30.5	28.2	27.0	29	
Total expenditure	25.2	33.8	31.6	30.0	28	
Net financing requirement	3.8	-3.3	-3.4	-3.0	1	
13. Korea Petroleum Development Corporation						
Operating revenue	12.2	7.5	8.0	10.0	13	
Total expenditure	40.5	12.5	9.2	27.0	49	
Net financing requirement	-28.3	-5.0	-1.2	-17.0	-36	
14. General Chemical Co., Ltd.						
Operating revenue	49.1	20.8	5.2	6.0	1	
Total expenditure	30.8	-1.2	-1.4	2.0	4	
Net financing requirement	18.3	22.0	6.6	4.0	-3	
15. Agricultural and Fisheries Development Corporation						
Operating revenue	13.7	21.0	28.3	34.0	48	
Total expenditure	36.0	17.6	93.0	50.0	51	
Net financing requirement	-22.3	3.4	-64.7	-16.0	-3	
16. Korea Overseas Dev. Corporation						
Operating revenue	2.4	2.7	3.1	4.0	5	
Total expenditure	2.4	2.7	3.1	4.0	5	
Net financing requirement	—	—	—	—	—	
17. Korea Trade Promotion Corporation						
Operating revenue	23.9	29.0	26.0	30.0	32	
Total expenditure	22.1	29.4	26.0	30.0	32	
Net financing requirement	1.8	-0.4	—	—	—	
18. Korea Labor Welfare Corporation						
Operating revenue	17.8	15.6	24.0	32.0	38	
Total expenditure	7.3	14.2	24.0	15.0	31	
Net financing requirement	5.3	0.3	—	17.0	7	
19. National Textbook Co., Ltd.						
Operating revenue	28.7	28.9	24.0	23.0	24	
Total expenditure	23.4	28.6	24.0	21.0	31	
Net financing requirement	5.3	0.3	—	2.0	-7	
Total operating revenue	5,748	6,319	7,364	8,114	9,402	
Total expenditure	6,873	7,367	8,806	7,818	9,334	
Net financing requirement	-1,125	-1,048	-1,442	296	68	

Source: Data provided by the Korean authorities.

Table IV-14. Korea: Sales, Income, and Employment of Government-Invested Enterprises, 1986-87

(In billions of won)

	1986			1987		
	Sales	Income	Employment (No. employed)	Sales	Income	Employment
1. Korea Electric Power Corporation	3,649,170	1,437,614	24,586			
2. Daihan Coal Corporation	196,003	-2,449	14,230			
3. Korea Highway Corporation	229,041	93,067	2,422			
4. Korea National Housing Corporation	636,196	75,580	2,516			
5. Industrial Sites and Water Resource Development Corporation	318,189	35,298	1,584			
6. Korea Land Development Corporation	328,436	95,695	1,121			
7. Agricultural Promotion Corporation	116,262	241	1,830			
8. Korea Telecommunications Authority	1,839,053	483,195	50,092			
9. Korea Security Printing and Mining Corporation	100,470	8,115	2,905			
10. Korea Gas Corporation	--	--	610			
11. Korea National Tourism Corporation	63,874	10,241	607			
12. Korea Mining Prom. Corporation	20,053	2,121	438			
13. Korea Petroleum Dev. Corporation	10,277	-1,373	410			
14. Korea General Chemical Co., Ltd.	5,937	3,889	46			
15. Agriculture and Fisheries Marketing Corporation	33,911	1,629	601			
16. Korea Overseas Development Corporation	3,460	-106	197			
17. Korea Trade Prom. Corporation	29,635	-644	567			
18. Korea Labor Welfare Corporation	24,839	-1,175	1,398			
19. National Textbook Company, Ltd.	22,916	1,476	554			
Total	7,627,722	2,242,414	106,714			

Source: Data provided by the Korean authorities.

Table IV-15. Korea: Financing of Consolidated Public Sector Operations, 1983-88

(in billions of won)

	1983	1984	1985	1986	1987		1988
					Budget	Actual	Budget
I. Domestic financing <u>1/</u>							
1. From monetary authorities							
1.1 Net borrowing							
1.2 Change in deposits							
2. From deposit money banks							
2.1 Net borrowing							
2.2 Change in deposits							
3. Other							
II. Financing abroad <u>2/</u>							
4. From international development institutions (net)							
5. From foreign governments (net)							
6. Other (net)							
III. Financing (I + II)							

1/ Includes Treasury bonds, industrial reconstruction bonds, reimbursement securities for requisitioned properties, borrowing of the National Investment Fund, Grain Fund bills, national railroad bonds, national housing bonds, National Housing Fund bonds, and telephone bonds.

2/ Includes foreign borrowing directly on-lent to the private sector and to nonfinancial public enterprises.

3/ Includes foreign military sales credits from foreign government.

Table IV-18. Korea: Financing of Central Government Operations, 1983-87

(In billions of won)

	1983	1984	1985	1986	1987
1. Domestic financing					
(1) From Monetary Authorities					
1.1 Net borrowing					
1.2 Change in deposits					
(2) From deposit money banks					
2.1 Net borrowing					
2.2 Change in deposits					
(3) Other					
2. Financing abroad <u>1/</u>					
(4) From international develop- ment institutions (net)					
(5) From foreign government (net)					
(6) Other (net)					
(7) Foreign military sales credit					
3. Financing (1+2)					

1/ Includes foreign borrowing directly on-lent to the private sector.

KRC--cqt8kr4-21--2/29/88

Table IV-21. Korea: Issues of Treasury Bills, 1983-88

(In billions of won)

	1983	1984	1985	1986	1987	1988 Budget
Issues						
Redemption						
Outstanding amount at end year <u>1/</u>						

Table IV-21. Korea: Outstanding Amounts of Treasury Bills
(By Holder), 1983-88

(In billions of won)

	End- 1983	End- 1984	End- 1985	End- 1986	End- 1987	1988 Budget
Bank of Korea						
Deposit Money Banks						
Other						
Total						

Table IV-22. Korea: Financing by Type of Debt Instrument of Public Sector and Central Government Operations, 1983-87

(in billions of won)

	1983		1984		1985		1986		1987	
	Central Govt.	Public Sector								
Total financing										
Domestic financing										
Long-term bonds										
Long-term loans and advances										
Short-term loans and advances										
Other liabilities										
Changes in cash, etc.										
Financing abroad										
Long-term loans n.e.c.										

Source: Data provided by the Ministry of Finance.

Table IV-23. Korea: Financing by Type of Holder of Consolidated Central Government Operations, 1983-88 ^{*/}

(In billions of won)

	1983	1985	1986	1987		1988
				Budget	Actual	
Domestic financing ^{1/}	552	613	211			
From monetary authorities	125	-380	-151			
Net borrowing	285	-51	-8			
Change in deposits	-160	-329	-143			
From deposit money banks (net)	-89	786	742			
Other	516	208	-380			
Financing abroad ^{2/}	399	310	-146			
From international development institutions (net)	291	364	44			
From foreign governments (net) ^{3/}	103	-52	14			
Other (net)	5	-3	-204			
Financing	951	923	65			
Memorandum items: ^{4/}						
Net credit from banking system to public sector in fiscal accounts	36	406	591			
Less: Government loans to DMBs ^{5/}	356	265	375			
Less: Complimentary period transactions ^{6/}	-74	161	59			
Plus: Carryover from previous year ^{7/}	--	--	--			
Plus: Net credit from BOK to Fertilizer Fund ^{8/}	100	--	--			
Plus: Net credit from BOK to Fund for Wage & Salary Earners Fortune Formation Saving ^{9/}	--	--	--			
Less: Treasury Bill	--	--	153			
Equals: Net credit from banking system to public sector in monetary accounts	-145	-40	24			

Sources: Data provided by the Korean authorities; and staff estimates.

^{*/} Includes: General Account, Special Accounts, Government Funds, and Public Enterprise Funds.^{1/} Includes highway construction bonds, industrial reconstruction bonds, Reimbursement Securities Claim Fund, borrowing of the National Investment Fund, NIF bonds, Grain Management Fund grain purchase certificates, grain bonds, and telephone bonds. It excludes deferred payments for rice producers that carry over to a subsequent fiscal year.^{2/} Includes foreign borrowing directly on-lent to the private sector and to nonfinancial public enterprises.^{3/} Includes foreign military sales credits from foreign governments.^{4/} The fiscal and monetary accounts in this report use, as do the authorities, different definitions for the position of the public sector with the banking system: (1) government lending funds in deposit money banks are treated as net lending in the fiscal accounts at the time they are placed in deposit money banks, whereas the monetary data include these funds in government deposits (netted out against claims on the Government) until they are drawn down; (2) the fiscal year runs from January 1 to December 31, but includes a complimentary period in the following January; prior to 1983 this period was January 1-20; since 1983, January 1-15; and (3) bank borrowing by the Fertilizer Fund, a government-directed agency in the private sector, is included in the monetary accounts as net credit to the public sector.^{5/} Includes government lending funds channeled through DMBs to third parties. Differs from IFS, line 26f, in that government's holdings of DMB bonds are excluded in IFS, but included here, and IFS deletes all extrabudgetary fund accounts of less than W 5 billion, while all funds are included here.^{6/} The January 1-20 complimentary period for the fiscal year was abolished in 1982. However, the fiscal year still includes settlement of certain tax payments during January 1-15 in the following year made through small bank branches and rural post offices of the Ministry of Communications' exchange office.^{7/} Carry-over items appear only in budgets; they disappear on settlement.^{8/} Net credit to the Fertilizer Fund is included in the monetary definition, but the Fertilizer Fund is not defined as part of the public sector in the fiscal accounts.^{9/} Net credit to Fund for Wage & Salary Earners Fortune Formation Saving is included in the monetary definition, but the Fund for Wage & Salary Earners Fortune Formation Saving is not defined as part of the public sector in the fiscal accounts.

Table IV-25. Korea: Distribution of Outstanding Central Government and Public Sector Debt by Class of Holder, 1984-87

(In billions of won)

	1984		1985		1986		1987	
	Central Govt.	Public Sector						
I. Domestic debt <u>1/</u>								
1. Monetary authority								
Bonds								
Loans and advances								
2. Deposit money banks								
Bonds								
Loans and advances								
3. Other								
II. Foreign debt <u>2/</u>								
4. International development institutions								
5. Foreign governments								
6. Other								
III. Total debt (I + II)								

Source: Data provided by the Ministry of Finance.

1/ Includes Treasury bonds, grain bonds, NIF bonds and borrowings, reconstruction bonds, and reimbursement securities for requisitioned property, NHF bonds, national railroad bonds.2/ Includes foreign borrowing by government directly on-lent to the private sector and public enterprises, and foreign military credits.

Table IV-26. Korea: Distribution of Outstanding Central Government and Public Sector Debt by Type of Debt Instrument, 1983-87

(In billions of won)

	1983		1984		1985		1986		1987	
	Central Govt.	Public Sector								
Total debt										
Domestic debt <u>1/</u>										
Long-term bonds										
Long-term loans, n.e.c.										
Short-term loans, and advances										
Other liabilities										
Foreign debt <u>2/</u>										
Long-term loans										

Source: Data provided by the Ministry of Finance.

1/ In the public sector, includes Treasury bonds, grain bonds, NIF bonds and borrowings, industrial reconstruction bonds, and reimbursement securities for requisitioned property, NHF bonds, national railroad bonds.

2/ In the public sector, includes foreign borrowing by Government directly on-lent to the private sector and public enterprises, and foreign military sales credits.

KRC-cqt&r4-27-2/29/88

Table IV-27. Korea: Holdings of Government Bonds, 1986-88

(In billions of won)

	1986			1987 I			1987 II			1987 III			1987 IV			1988 I		
	BCK	DME	Sub- Total	BCK	DME	Sub- Total	BCK	DME	Sub- Total	BCK	DME	Sub- Total	BCK	DME	Sub- Total	BCK	DME	Total
Industrial Construction Bonds																		
Highway Construction Bonds																		
Reimbursement Securities for Requisitioned Properties																		
Grain Bonds																		
NIF Bonds																		
NF Bonds																		
Treasury Bill																		
Other																		
Total																		

Source: Data provided by the Korean authorities.

Table V-1. Korea: External Sector Developments, 1983-87

(Annual percentage changes, unless otherwise indicated)

	1983	1984	1985	1986	1987	
					Proj.	Actual
Exports--value (U.S. dollars)	11.1	13.5	0.4	28.3	28.2	
Volume	15.5	9.8	4.3	26.4	20.4	
Unit value	-3.8	3.4	-3.7	1.5	6.5	
Imports--value (U.S. dollars)	6.4	9.6	-3.3	12.3	30.3	
Volume	11.6	8.2	1.0	19.9	19.3	
Oil	6.8	2.3	1.8	9.8	7.0	<u>1/</u>
Non-oil	13.5	10.1	0.6	23.1	21.2	
Unit value	-4.7	1.3	-4.2	-6.3	9.3	
Oil	-12.0	-2.8	-5.7	-42.8	26.8	
Non-oil	-2.8	2.4	-3.7	3.4	7.0	
Terms of trade	0.9	2.1	0.6	8.3	-2.6	

Sources: Data provided by the Korean authorities; and staff estimates.

1/ Refers to crude petroleum only.

Table V-2. Korea: Balance of Payments, 1983-87

(In millions of U.S. dollars)

	1983	1984	1985	1986	1987	
					Proj.	Actual
Trade balance	-1,763	-1,036	-19	4,206	4,771	
Exports, f.o.b.	23,204	26,335	26,442	33,913	43,490	
Imports, f.o.b.	-24,967	-27,371	-26,461	-29,707	-38,720	
Services (net)	-435	-878	-1,446	-628	1,041	
Receipts	7,178	7,316	6,664	8,052	10,121	
Payments	-7,613	-8,194	-8,110	-8,679	-9,079	
Transfers (net)	593	541	578	1,039	1,040	
Current account	-1,605	-1,373	-887	4,617	6,852	
Capital account	1,272	900	-736	-1,468	-3,476	
Debt-related flows	1,904	638	604	-667	-2,276	
Medium- and long-term capital	1,113	1,514	1,090	-264	-2,276	
Nonbank financial						
institutions <u>1/</u>	40	721	423	328	-750	
Net foreign borrowing	932	1,130	1,672	-578	-750	
Swaps with Bank of Korea	-892	-409	-1,249	906	--	
Public sector (net)	795	764	320	-126	-650	
Private sector (net)	278	29	347	-466	1,376	
Short-term capital	791	-876	-486	-403	--	
Other asset transactions	-632	262	-1,340	-801	-1,200	
Medium- and long-term capital	-735	144	-1,238	-812	-1,200	
Export suppliers' credits <u>2/</u>	-677	181	-940	-406	-800	
Foreign direct investment <u>3/</u>	68	110	233	435	300	
Overseas investment <u>4/</u>	-126	-37	-34	-110	-400	
Overseas subsidiaries <u>5/</u>	--	--	-524	-1,042	-300	
Other	--	-110	27	311	--	
Short-term capital	103	118	-102	11	--	
Allocations of SDRs	--	--	--	--	--	
Errors and omissions	-942	-894	-880	-544	-750	
Overall balance	-1,275	-1,367	-2,503	2,605	2,626	
Financing	1,275	1,367	2,503	-2,605	-2,626	
Assets (increase in reserves -)	140	-833	-12	-226	-400	
Liabilities	1,135	2,200	2,515	-2,379	-2,226	
Medium- and long-term	2,302	2,022	2,695	-981	-2,226	
Use of Fund credit	160	320	-235	-126	-317	
Swaps with nonbank financial						
institutions	892	409	1,249	-906	--	
Other <u>6/</u>	1,250	1,293	1,681	51	-1,909	
Short-term	-1,167	178	-180	-1,398	--	
Memorandum item:						
Current account/GNP (in percent)	-2.1	-1.7	-1.1	4.9	5.9	

Source: Data provided by the Korean authorities.

1/ Comprises mainly loans to the Korea Development Bank (KDB), the Export-Import Bank of Korea (KEKIM), Korea Long-Term Credit Bank, and merchant banks; excludes the amount of swaps with the Bank of Korea, which is shown under "financing."

2/ Export credits minus sales of promissory notes.

3/ Net foreign investment in Korea by nonresidents.

4/ Net direct investment abroad by Korean residents.

5/ Liabilities of overseas subsidiaries of Korean companies.

6/ Includes valuation adjustments.

Table V-3. Korea: Detailed Balance of Payments, 1985-87

(In millions of U.S. dollars)

	1985		1986		1987	
	Credit	Debit	Credit	Debit	Credit	Debit
Current account						
Long-term capital account						
Public and commercial loans						
Public loans						
Commercial loans						
Direct investment						
Export suppliers' credits						
Suppliers' credits						
F/N sales						
Development banks						
Loans						
Bonds						
Swaps						
Merchant banks						
Loans						
FRCD						
Bond						
Private bonds						
Overseas subsidiaries						
Long-term trade credits						
"Cash loan" (1-3 years)						
Overseas investment						
Other debt						
Other nondebt						
Short-term capital						
Trade credit						
Oil bill						
Export on credit						
Other						
Errors omission						
Overall balance						
Financing						
Assets						
Liabilities						
Medium- and long-term						
IMF						
Loan						
Bond						
FRCD						
A a/c						
Swap						
Short-term						
Refinance						
A a/c						
Others						
Others						

Source: Data provided by the Korean authorities.

Table V-4. Korea: Exports by Major Commodity Groups, 1983-87

(In millions of U.S. dollars)

	1983	1984	1985	1986	1987
Primary products	1,358	1,458	1,403	1,889	
Manufactured products	22,865	27,787	28,880	32,826	
Heavy industrial	13,281	16,597	17,628	18,329	
Machinery	(881)	(1,221)	(1,796)	(2,963)	
Of which:					
automobiles	(97)	(209)	(539)	(1,378)	
Electronics	(3,478)	(4,783)	(4,895)	(7,620)	
Steel	(3,566)	(3,954)	(3,712)	(3,786)	
Chemicals	(1,621)	(1,955)	(2,185)	(2,145)	
Ships ^{1/}	(3,735)	(4,684)	(5,040)	(1,815)	
Light industrial	9,584	11,190	11,252	(4,497)	
Textiles	(6,051)	(7,079)	(7,004)	(8,734)	
Other	(3,533)	(4,112)	(4,248)	(5,763)	
Total exports	24,223	29,245	30,283	34,715	
	(In percent of total)				
Primary products	5.6	5.0	4.6	5.4	
Manufactured products	94.4	95.0	95.4	94.6	
Heavy industrial	54.8	56.8	58.2	52.8	
Machinery	(3.6)	(4.2)	(6.0)	(8.5)	
Of which:					
automobiles	(0.4)	(0.7)	(1.8)	(4.0)	
Electronics	(14.4)	(16.4)	(16.2)	(22.0)	
Steel	(14.7)	(13.5)	(12.3)	(10.9)	
Chemicals	(6.7)	(6.7)	(7.2)	(6.2)	
Ships ^{1/}	(15.4)	(16.0)	(16.6)	(5.2)	
Light industrial	39.6	38.3	37.2	41.8	
Textiles	(25.0)	(24.2)	(23.1)	(25.2)	
Other	(14.6)	(14.1)	(14.1)	(16.6)	
Total	100.0	100.0	100.0	100.0	

Sources: Data provided by the Korean authorities; and staff estimates.

^{1/} Beginning July 1984, customs statistics no longer include repaired or converted ships when the proportion of value added is less than 5 percent; beginning January 1986, customs statistics no longer include repaired ships.

Table V-5. Korea: Direction of Exports, 1983-87
(In percent of total)

	1983	1984	1985	1986	1987
Industrial countries	66.5	69.2	70.0	75.4	
Of which: Australia	1.3	1.3	1.2	1.5	
Canada	2.6	3.0	4.2	3.6	
EC	12.8	11.3	10.4	12.4	
Japan	13.8	15.8	15.5	15.6	
United States	33.8	36.0	36.2	40.0	
Oil exporting countries ^{1/}	11.4	6.9	6.2	5.1	
Of which: Saudi Arabia	5.9	3.4	3.3	2.5	
Non-oil developing countries	17.9	20.8	20.1	16.9	
Of which: Africa	1.6	1.3	2.0	1.1	
Asia	12.4	13.9	12.6	11.9	
Other Europe	0.7	1.0	1.4	0.3	
Middle East	1.2	1.3	1.0	0.8	
Western Hemisphere	2.0	3.4	3.2	2.8	
Others	4.2	3.1	3.7	2.6	
Total	100.0	100.0	100.0	100.0	

Sources: IMF, Direction of Trade Statistics and data provided by the Korean authorities.

^{1/} The group of oil exporting countries comprises: Algeria, Indonesia, Iraq, Kuwait, Libya, Nigeria, Oman, Qatar, Saudi Arabia, United Arab Emirates, and Venezuela.

Table V-6. Korea: Composition of Imports by End Use, ^{1/} 1983-86

	1983	1984	1985	1986	1987
(In millions of U.S. dollars)					
Consumer goods, except grains	1,525	1,625	1,473	1,954	
For re-export	595	671	600	905	
For domestic consumption	930	954	873	1,049	
Grains	1,288	1,311	1,180	1,138	
Industrial raw materials	15,564	17,590	17,402	17,165	
Petroleum	5,572	5,771	5,572	3,346	
For export	410	582	725	555	
For domestic production	5,162	5,189	4,847	2,791	
Others	9,992	11,819	11,830	13,819	
For export production	4,935	6,201	6,232	7,333	
For domestic production	5,057	5,618	5,598	6,486	
Capital goods	7,815	10,106	11,081	11,327	
For export production ^{2/}	3,409	5,140	5,937	3,927	
Of which: ships for repair	(1,489)	(2,450)	(3,297)	(-)	
For domestic production	4,406	4,966	5,144	-7,400	
Total	26,192	30,632	31,136	31,584	
(In percent of total)					
Consumer goods, except grains	5.8	5.3	4.7	6.2	
For re-export	2.3	2.2	1.9	2.9	
For domestic consumption	3.5	3.1	2.8	3.3	
Grains	4.9	4.3	3.8	3.6	
Industrial raw materials	59.4	57.4	55.9	54.3	
Petroleum	21.3	18.8	17.9	10.6	
For export	1.6	1.9	2.3	1.8	
For domestic production	19.7	16.9	15.6	8.8	
Others	38.1	38.5	38.0	43.7	
For export production	18.8	20.2	20.0	23.2	
For domestic production	19.3	18.3	18.0	20.5	
Capital goods	29.8	33.0	35.6	35.9	
For export production ^{2/}	13.0	16.8	19.1	12.4	
Of which: ships for repair	(5.7)	(8.0)	(10.6)	(-)	
For domestic production	16.8	16.2	16.5	23.5	
Total	100.0	100.0	100.0	100.0	
Memorandum item:					
Imports for export production	35.7	41.1	43.3	40.3	

Source: Data provided by the Korean authorities.

^{1/} Includes imports of products for final assembly and re-export.

^{2/} Components for export products; does not include investment goods used to produce exportables. From 1986, customs statistics no longer include ships for repairs.

Table V-7. Korea: Imports by Country of Origin, 1983-87

(In percent of total)

	1983	1984	1985	1986	1987
Industrial countries	63.5	64.4	64.5	73.4	
Of which: Australia	3.7	3.6	3.6	3.4	
Canada	1.7	2.1	2.0	2.2	
EC	8.4	9.1	9.5	10.2	
Japan	23.8	24.9	25.3	34.4	
United States	24.0	22.5	21.5	20.7	
Oil exporting countries ^{1/}	16.2	13.3	11.2	7.1	
Of which: Saudi Arabia	7.8	4.6	2.5	2.0	
Non-oil developing countries	15.6	16.6	18.1	14.7	
Of which: Africa	0.8	0.7	0.9	0.6	
Asia	9.9	10.2	9.8	8.8	
Other Europe	0.6	0.6	1.2	0.2	
Middle East	0.5	0.5	0.6	0.7	
Western Hemisphere	3.7	4.6	5.5	4.4	
Others	4.7	5.7	6.3	4.8	
Total	100.0	100.0	100.0	100.0	

Source: IMF, Direction of Trade Statistics (1987 Yearbook).

^{1/} The group of oil exporting countries comprises: Algeria, Indonesia, Iraq, Kuwait, Libya, Nigeria, Oman, Qatar, Saudi Arabia, United Arab Emirates, and Venezuela.

Table V-8. Korea: Invisibles Account, 1983-87

(In millions of U.S. dollars)

	1983	1984	1985	1986	1987
Receipts	7,178	7,316	6,664	8,052	
Freight and insurance	1,478	1,577	1,324	1,464	
Other transportation	944	851	758	709	
Travel	596	673	784	1,548	
Investment income	581	719	794	812	
Of which:					
Direct investment	38	54	44	52	
Overseas construction	1,890	1,710	985	635	
Other	1,689	1,786	2,019	2,884	
Payments	7,613	8,194	8,110	8,679	
Freight and insurance	428	528	522	670	
Other transportation	1,434	1,317	1,346	1,556	
Travel	555	576	606	613	
Investment income	3,421	3,948	3,977	4,020	
Of which:					
Direct investment	97	89	116	166	
Overseas construction	150	64	214	185	
Other	1,625	1,761	1,445	1,636	
Invisibles balance	-435	-878	-1,446	-627	
Memorandum item:					
Net receipts on overseas construction	1,740	1,646	771	450	

Source: Bank of Korea.

Table V-9. Korea: Foreign Borrowing Requirements, 1983-87

(In millions of U.S. dollars)

	1983	1984	1985	1986	1987
Gross financing requirements	6,703	7,195	7,660	4,854	
Current account deficit	1,605	1,373	887	-4,617	
Amortization <u>1/</u>	2,644	3,031	3,468	5,796	
Export suppliers' credits	1,407	964	1,778	970	
Reserve increase	-74	740	99	207	
Errors and omissions	943	894	880	543	
Others	178	193	548	1,955	
Nondebt financing	831	1,316	1,088	1,042	
Direct investment inflows <u>2/</u>	101	171	250	478	
Sales of P/Ns	730	1,145	838	564	
Gross borrowing requirements	5,872	5,879	6,572	3,812	
Short-term borrowing	-256	-690	-693	-1,476	
Private sector	894	-871	-486	-351	
Financial institutions	-1,150	181	-207	-1,125	
Medium- and long-term borrowing	6,128	6,569	7,265	5,306	
Public loans	1,494	1,424	1,024	880	
Commercial loans	973	858	964	1,620	
Financial institutions	2,183	3,090	4,333	1,725	
Bank loans	1,810	2,054	2,368	640	
Bonds	133	585	1,219	523	
FRCDe	140	245	370	10	
Other	100	206	376	552	
IMF facilities	204	587	132	139	
Other borrowing	1,274	610	812	924	
Medium-term import credit	293	299	292	293	
Cash borrowing	60	0	0	10	
Private bonds	113	200	238	151	
Trade bills	400	100	250	-	
Swaps	408	0	0	-	
Others	0	11	32	470	
Memorandum items:					
Export credits, net of					
P/N sales	677	-181	940	406	
Credits extended, net <u>3/</u>	1,407	964	1,778	970	
P/N sales	730	1,145	838	564	

Sources: Data provided by the Korean authorities; and staff estimates.

1/ Excluding amortization in the A-accounts of local branches of foreign banks.2/ Gross inflows.3/ Net of amortization payments received on promissory notes held by Korean residents.

Table V-10. Korea: Foreign Assets and Liabilities
of the Banking System, 1983-87

(In millions of U.S. dollars)

	1983	1984	1985	1986	1987
Foreign assets	7,494	8,222	8,383	8,627	
Bank of Korea	2,272	2,680	2,793	3,263	
Gold	31	31	31	32	
SDRs	64	31	40	18	
Reserve position in Fund	--	--	--	1	
Foreign exchange	2,177	2,618	2,722	3,212	
Rest of banking system <u>1/</u>	5,222	5,542	5,590	5,364	
Domestic banks	4,638	4,970	4,956	4,692	
Foreign banks	585	572	634	672	
Foreign liabilities	14,014	15,742	17,334	16,049	
Bank of Korea	1,353	1,570	1,511	1,548	
Of which: use of Fund credit	1,353	1,570	1,508	1,545	
Rest of banking system <u>1/</u> <u>2/</u>	12,661	14,172	15,823	14,501	
Short-term refinancing	4,740	4,444	3,903	2,066	
Medium-term loans	2,788	3,282	5,087	4,831	
Interoffice "A" accounts	3,997	4,596	4,843	5,665	
Deposits	393	623	919	560	
Others	744	1,226	1,071	1,378	
Net foreign assets	-6,244	-7,243	-8,651	-6,904	
Memorandum items:					
Net foreign assets	-6,520	-7,520	-8,951	-7,228	
Bank of Korea	919	1,110	1,282	1,715	
Rest of banking system <u>1/</u>	-7,439	-8,629	-10,233	-8,943	
Interoffice "A" accounts <u>3/</u> of foreign banks	276	277	300	324	
	(In months of imports of goods and services)				
Gross foreign assets	2.8	2.8	2.9	2.7	
Bank of Korea	0.8	0.9	1.0	1.0	
Rest of banking system <u>1/</u>	1.9	1.9	1.9	1.7	

Sources: Data provided by the Korean authorities; and staff estimates.

1/ Defined to include deposit money banks, KEB, KDB, KEXIM, and KLCB.2/ Excluding long-term borrowing of KDB, KEXIM, and KLCB.3/ Not included in gross reserves.

Table V-11. Korea: Outstanding External Debt by Maturity and Borrower, 1983-87

(In millions of U.S. dollars)

	1983	1984	1985	1986	1987
Medium- and long-term debt	28,263	31,628	36,030	35,254	32,453
Maturity over three years	26,353	29,612	33,684	33,568	30,773
Financial institutions	(8,400)	(10,719)	(14,367)	(14,048)	(...)
Nonbank financial institutions	(4,247)	(5,256)	(7,139)	(7,083)	(...)
Commercial banks	(4,153)	(5,463)	(7,228)	(6,965)	(...)
Of which:					
Interoffice "A" account	(1,044)	(1,276)	(1,500)	(1,678)	(...)
Public sector	(10,292)	(11,056)	(11,376)	(11,250)	(...)
Private sector	(6,307)	(6,267)	(6,433)	(6,725)	(...)
Use of Fund credits	(1,354)	(1,570)	(1,508)	(1,545)	(...)
Maturity over one and up to three years	1,910	2,016	2,346	1,686	1,680
Nonbank financial institutions	(63)	(134)	(48)	(36)	(...)
Commercial banks	(1,007)	(971)	(1,033)	(1,273)	(...)
Of which:					
Interoffice "A" account	(837)	(801)	(863)	(1,213)	(...)
Other	(840)	(911)	(1,265)	(377)	(...)
Short-term debt	12,115	11,425	10,732	9,256	9,096
Private nonbank sector	4,947	4,126	3,640	3,289	...
Trade credit	(4,114)	(3,025)	(2,727)	(2,445)	(...)
Loans for oil imports	(584)	(804)	(637)	(498)	(...)
Advance receipts of exports, and others	(249)	(297)	(276)	(346)	(...)
Banking sector	7,168	7,299	7,092	5,967	...
Interoffice "A" account	(1,474)	(1,798)	(1,737)	(2,105)	(...)
Refinance	(4,740)	(4,444)	(3,903)	(2,066)	(...)
Nonresident deposits	(163)	(218)	(298)	(223)	(...)
Other	(791)	(839)	(1,154)	(1,573)	(...)
Total	40,378	43,053	46,762	44,510	41,549
Memorandum items:					
Trade-related short-term debt ^{1/}	9,438	8,274	7,267	5,009	...
Nontrade-related short-term debt	2,677	3,151	3,465	4,247	...
Borrowings of nonresident Korean entities ^{2/}	5,710	5,976	6,076	5,619	...
Trade financing	(1,887)	(2,167)	(2,175)	(2,534)	(...)
Construction financing	(3,672)	(3,631)	(3,560)	(2,722)	(...)
Other	(151)	(178)	(341)	(363)	(...)

Source: Data provided by the Korean authorities.

^{1/} Comprises trade credit, loans for oil imports, and refinances.^{2/} External borrowing of Korean branches or subsidiaries residing abroad, not included in total external debt.

Table V-12. Korea: External Debt by Creditor, 1980-87

(In millions of U.S. dollars)

	1980	1981	1982	1983	1984	1985	1986	1987
Total debt outstanding								
Medium and long term								
Public and publicly guaranteed								
Official creditors								
Government								
International organization								
Private creditors								
Financial institutions								
Other								
Without public guarantee								
Financial institutions								
Other								
Short-term debt								

Source:

Table V-13. Korea: Debt Service, 1983-87 ^{1/}

(In millions of U.S. dollars)

	1983	1984	1985	1986	1987
Interest ^{2/}	3,187	3,820	3,687	3,686	
Medium- and long-term debt	(2,226)	(2,532)	(2,692)	(2,913)	
Short-term debt	(961)	(1,288)	(995)	(773)	
Amortization ^{3/}	3,164	3,850	4,192	6,700	
Financial institutions	(401)	(582)	(810)	(1,983)	
Public sector	(493)	(660)	(704)	(1,006)	
Private sector	(1,129)	(1,108)	(1,128)	(1,526)	
Other ^{4/}	(1,141)	(1,500)	(1,550)	(2,185)	
Total debt service	6,351	7,670	7,879	10,386	
Debt service ratio ^{5/}	20.9	22.8	23.8	24.8	
Interest payments ratio ^{5/}	(10.5)	(11.4)	(11.1)	(8.8)	
Amortization payments ratio ^{5/}	(10.4)	(11.4)	(12.7)	(16.0)	
Memorandum items:					
Average interest cost (percent per annum)	8.2	9.2	8.2	7.9	
3-month LIBOR (percent per annum)	9.6	10.8	8.4	6.8	
Exports of goods and services	30,382	33,651	33,106	41,765	
	<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>1991</u>	<u>1992</u>
	Proj.	Proj.	Proj.	Proj.	Proj.
Projected amortization payments on debt at end-1987 ^{4/} (In percent of MLT debt at end-1987)					
Projected interest payments on debt at end-1987					

Source: Data provided by the Korean authorities.

^{1/} Includes IMF.^{2/} Estimates of interest payments exclude management fees and charges on new commitments; interest payments on rediscounted export credit; promissory notes are included on a net basis.^{3/} On medium- and long-term debt only.^{4/} Includes bonds, foreign currency deposits, IMF, medium-term trade credits, and estimated amortization on medium- and long-term items in the A-accounts of local branches of foreign banks.^{5/} In percent of exports of goods and services.

KRC: cqt8kr5-14 2/29/88

Table V-14. Korea: Prepayment of Medium-
and Long-Term Debt

(In millions of U.S. dollars)

	1986	1987	1988 Proj.
Public Sector			
Private Sector			
Banking Sector			
Total			

Source:

KRC cqt7krV-15 4/23/87

Table V-15. Korea: Principal Assumptions for Medium-Term
Projection, 1988-92

	1988	1989	1990	1991	1992
--	------	------	------	------	------

(In billions of won)

Domestic economy

Aggregate domestic demand
Net exports of goods and
services
Gross national product

(Percent change)

GNP
Aggregate domestic demand
Real GNP
 Manufacturing
 Fixed investment
Real aggregate domestic demand
GNP deflator

Exchange rate (won/US\$)

International economy

World trade volume
LIBOR (6 months)
Oil (US\$/barrel)

Source: Data provided by Korean authorities.

KRC cqt8kr5-16 2/29/88

Table V-16. Korea: Medium-Term Balance of Payments
Projections and Assumptions, 1988-92

	1988	1989	1990	1991	1992
--	------	------	------	------	------

(In millions of U.S. dollars)

Trade balance

Exports, f.o.b.

Imports, f.o.b.

 Oil

 Non-oil

 For domestic use

 For export production

(Percent change)

Trade volume

 Exports

 Imports

 Oil

 Non-oil

Unit prices

 Exports

 Imports

 Oil

 Non-oil

Values

 Exports

 Imports

 Oil

 Non-oil

KRC cqt7krV-17 2/25/88

Table V-17. Korea: Service and Transfer
Account Projections, 1988-92

(In millions of U.S. dollars)

	1988	1989	1990	1991	1992
Service receipts					
Freight and insurance					
Investment income					
Of which: Direct investment					
Overseas construction					
Travel and transportation					
Other					
Service payments					
Freight and insurance					
Investment income					
Interest					
Other					
Of which: Direct investment					
Travel and transportation					
Other					
Net services					
Transfer					
Private					
Official					

Table V-18. Korea: Balance of Payments, 1988-92

(In millions of U.S. dollars)

	1988		1989		1990		1991		1992	
	Credit	Debit								
Current account balance										
Trade balance										
Service balance										
Transfers balance										
Long-term capital										
Public and commercial loans										
Public loans										
Commercial loans										
Direct investment										
Export suppliers' credits										
Suppliers' credits										
P/N sales										
Development banks										
Loans										
Bonds										
Swaps										
Merchant banks										
Loans										
FICD										
Bond										
Private bonds										
Overseas subsidiaries										
Long-term trade credits										
"Cash loan" (1-3 years)										
Overseas investment										
Other debt										
Other nondebt										
Short-term capital										
Trade credit										
Oil bill										
Export on credit										
Other										
Errors and omissions										
Overall balance										
Financing										
Assets										
Liabilities										
Medium and long term										
DF										
Loan										
Bond										
FICD										
A a/c										
Swap										
Short term										
Refinance										
A a/c										
Others										
Others										

Source: Data provided by the Korean authorities.

KRC: cqt8kr5-19 2/29/88

Table V-19. Debt Service Projections, 1988-92 1/
(In millions of U.S. dollars)

	1988	1989	1990	1991	1992
Total debt service payments					
Amortization					
Above the line					
Below the line					
Interest					

Source: Data provided by the Korean authorities.

1/ On the basis of debt outstanding at end 1987, including IMF credit.

Table V-20. Korea: Export Profitability, 1984-87

(In percent)

Normal Profit to Net Sale				Normal Profit to Total Assets				Total Assets Turnover			
1984	1985	1986	1987	1984	1985	1986	1987	1984	1985	1986	1987
Export enterprise											
Domestic enterprise											

Source: The Bank of Korea, Financial Statements Analysis.

KRC cqt7krV-21 2/17/88

Table V-21. Korea: Development in Unit Labor Cost, 1984-87

(Export industries, 1980 = 100)

	Wage Index	Labor Productivity Index	Unit Labor Cost Index
1984			
Q1			
Q2			
Q3			
Q4			
1985			
Q1			
Q2			
Q3			
Q4			
1986			
Q1			
Q2			
Q3			
Q4			
1987			
Q1			
Q2			
Q3			
Q4			

Table V-22. Korea: Trend of Restrictions on Major Exports to the OECD, 1982-86

(In percent) ^{1/}

	1982	1983	1984	1985	1986	1987
Textile products	55.8	59.1	64.3	64.6	53.7	
Steel products	43.0	39.0	47.3	27.1	30.1	
Footwear	78.4	79.5	85.2	87.5	17.7	
Fishery products	26.6	26.3	28.8	23.5	26.5	
Electronic products and parts	16.2	16.3	12.2	13.4	36.4	
Silk products	79.3	71.9	67.3	66.7	65.9	
Cutlery	30.7	79.6	72.7	24.2	39.9	
Tires and tubes	5.2	7.0	50.0	3.6	6.2	
Television sets	28.3	51.2	40.8	35.7	...	
Total selected products	<u>42.8</u>	<u>39.8</u>	<u>41.2</u>	<u>36.1</u>	<u>31.0</u>	
Memorandum item:						
Share of selected products in total exports	(27.5)	(26.5)	(28.5)	(25.5)	(23.4)	

Source: Data provided by the Korean authorities.

^{1/} Value of Korean exports under restrictions to total exports of the selected products.

Table V-24. Korea: Trade Measures Affecting Exports
(As of December 31, 1987)

Country	Commodities Affected (Value of exports in 1987 (millions of US\$))	Main types of Measures	Year of Intro- duction
---------	--	---------------------------	------------------------------

Source:

Table V-25: Korea: Import Liberalization Schedule
by Industry, 1983-88

	Total Items	Number of Restricted Items					1988 Announced
		1983	1984	1985	1986	1987	
		Implemented					
Dairy products, food and drinks	1,386	363 (73.8)	336 (75.8)	302 (78.2)	280 (79.8)	275 (80.2)	270 (80.5)
Chemical products	2,182	117 94.6	109 95.0	94 95.7	49 97.8	19 99.1	9 99.6
Steel and metal products	797	68 91.5	58 92.7	35 95.6	5 99.4	0 100.0	0 100.0
Machinery	1,414	421 70.2	311 78.0	240 83.0	149 89.5	94 93.4	0 100.0
Electrical and machinery appliances, and electronics	494	204 58.7	186 62.3	129 73.9	64 87.0	22 95.5	0 100.0
Textiles and leather garments	1,089	210 80.7	105 90.4	75 93.1	42 96.1	33 97.0	23 97.9
Other	553	99 82.1	98 82.3	95 82.8	79 85.7	65 88.2	65 88.2
Total	7,915	1,482 81.3	1,203 84.8	970 87.7	668 91.6	508 93.6	367 95.4

Sources: Data provided by the Korean authorities; and staff estimates.

Note: 1. Items in the 8-digit classification of the Customs Cooperation Council Nomenclature (CCCN).

2. Figures in parentheses indicate share of unrestricted items in total at the end of the year.

3. Total number of CCCN 8-digit items was changed from 7,560 in 1983 to 7,915 in 1984 due to the reclassification of CCCN K.

Table V-26. Korea: Import of Liberalized Items, 1983-88

(In millions of U.S. dollars)

	1983	1984	1985	1986	1987	1988 Proj.
Total imports						
Imports of liberalized items						

Table V-27. Korea: Average Unweighted Tariff Rate, 1985-88

(In percent)

	1985	1986	1987	1988 Proj.
Total				
Agricultural products <u>1/</u>				
Chemical products <u>2/</u>				
Textile, leather, wood, and paper products <u>3/</u>				
Steel and metal products <u>4/</u>				
Machinery and others <u>5/</u>				

Source: Data provided by the Korean authorities.

1/ CCCN ch. 1-24.2/ CCCN ch. 25-40.3/ CCCN ch. 41-63.4/ CCCN ch. 64-83.5/ CCCN ch. 84-99.

Table V-28. Korea: Overseas Construction, 1982-87

	1982	1983	1984	1985	1986	1987
	<u>(In millions of U.S. dollars)</u>					
New contracts	13,383	10,444	6,502	4,691		
Middle East	12,674	9,023	5,910	4,285		
Other countries	1,991	1,421	592	406		
	<u>(Number of agreements)</u>					
Work agreements	262	236	237	170		
Middle East	216	180	183	132		
Other countries	46	56	54	48		
	<u>(Number of workers at end of period)</u>					
Korean labor force overseas	171,170	159,368	130,906	96,016		
Middle East	160,002	147,810	121,156	91,013		
Other countries	11,168	11,558	9,750	5,003		

Source: Data provided by the Korean authorities.

Table V-29. Korea: External Debt of Overseas
Subsidiaries, 1983-87

(In millions of U.S. dollars)

	1983	1984	1985	1986	1987
Total debt					
I. Breakdown by type of company					
Trading companies					
Construction companies					
Others					
II. Breakdown by type of guarantee					
Stand-by letter of credit					
Parent company					
Unguaranteed					
III. Breakdown by type of creditor					
Overseas branch of Korean banks					
Foreign banks					
Memorandum item:					
Repayment of overseas debts by Korean parent companies and banks					

Source: Data provided by the Korean authorities.

Table V-30. Korea: Terms on External
Borrowing, 1982-87 1/

	1982	1983	1984	1985	1986	1987
	<u>(In percent)</u>					
<u>Interest rate or spread</u>						
Public and publicly guaranteed						
Governments						
International organizations						
Private suppliers						
Financial institutions						
Other						
Private nonguaranteed						
Financial institutions						
Other						
	<u>(Number of years)</u>					
<u>Maturity and grace period</u>						
Public and publicly guaranteed						
Governments						
International organizations						
Private suppliers						
Financial institutions						
Other						
Private nonguaranteed						
Financial institutions						
Other						

Source: Data provided by the Korean authorities.

1/ Debt with maturities of more than three years.

KRC--cqt7krV-32 2/32/88

Table V-32. Korea: Public Loans New Contract, 1987-88

Major product (Date of contract)	Borrower (Sponsor)	Lender	Amount ('000 \$)	Interest rate (percent)	Maturity period (including grace period)
--	--------------------	--------	---------------------	----------------------------	--

Source: Data provided by the Korean authorities.

Table V-33. Korea: Foreign Direct Investment--Eligibility by Industry

	Before July 1, 1984		Under the Amended Capital Inducement Act			
	Total number of industries	Industries eligible for foreign investment	Total number of industries	Industries eligible for foreign investment		
				Eff. from 7/1/84 to 10/13/85	Eff. from 10/14/85 to 4/5/87	Eff. from 4/6/87
Agriculture	12	8	140	5	8	8
Mining	25	23	26	12	21	21
Manufacturing	400	381	522	449	483	509
Electricity, gas, and water	4	2	6	3	3	3
Construction	18	10	31	29	31	31
Wholesale and retail trade	113	68	139	90	105	105
Transport and communication	47	7	53	9	16	16
Finance, insurance, and business services	64	11	75	21	31	31
Community and social services	152	11	106	42	63	63
N.e.i.	--	--	1	--	1	1
Total	855	521	999	660	762	788
(Percent share)	(100.0)	(60.9)	(100.0)	(66.1)	(76.3)	(78.9)

Source: Data provided by the Korean authorities.

Table V-34. Korea: Approval of Foreign Direct Investment
by Home Country and Industry, 1983-87

(In millions of U.S. dollars during period)

	1983	1984	1985	1986	Cumulative approvals at end-1987
By home country	267.8	419.1			
Japan	167.5	163.8			
United States	53.4	191.0			
Europe	23.4	49.8			
Others	23.5	14.5			
By industry	267.8	419.1			
Chemical	7.6	6.7			
Foodstuffs	5.9	18.4			
Pharmaceutical	20.8	6.4			
Metal	1.8	5.1			
Machinery	19.6	131.5			
Electronics	41.4	67.5			
Financial services	3.3	13.3			
Hotels and tourism	155.7	118.4			
Construction	3.9	22.5			
Others	7.8	29.3			

Source: Data provided by the Korean authorities.

Table V-35. Korea: Inter-office 'A' Account
of Foreign Banks, 1983-87

(In millions of U.S. dollars)

	1983	1984	1985	1986	1987
I. Inter-office 'A' account					
II. Commercial loans					
III. Bank loans					
Revised inter-office 'A' account (I-II-III)					
Swaps					
Medium-term <u>1/</u>					
Short-term <u>2/</u>					
Loans in foreign currency					
Long-term					
Medium-term					
Short-term					
Other (short-term)					
Revised inter-office 'A' account by maturities					
Long-term					
Medium-term					
Short-term					
Memorandum item:					
Amortization payments on medium- and long-term 'A' accounts					

Source: Data provided by the Korean authorities.

1/ 368 days - 376 days.

2/ 3-6 months.

KRC cqt7krV-36 2/18/88

Table V-36. Korea: KEXIM Promissory Note Inventory, 1985-87

(In millions of U.S. dollars)

	1985	1986	1987
Increase in holdings			
Eligible for rediscount			
Ineligible for rediscount			
Decrease in holdings			
Rediscounts			
Acquired in previous years			
Acquired during year			
Redemptions			
Outstanding stock (end of period)			

Source: Data provided by the Korea authorities.

Table V-37. Korea: Convertible Bonds Prices

	85 Dec.	86 Mar.	86 Jun.	86 Sep.	86 Dec.	87 Mar.	87 June	87 Sept.	87 Dec.
Samsung Electronics Co., Ltd.	98.5	117	168.5	218	232	280	323	425	392
Daewoo Heavy Industries Ltd.	-	-	118	113	112.5	122	148	173	154
Yokong Ltd.	-	-	-	100	103	126	160	172	153

Source: Data provided by the Korean authorities.

KRC: cqt8kr5-38 2/29/88

Table V-38. Korea: Convertible Bonds

	Samsung	DHL	Yukong
Issue Date	85. 12. 19	86. 5. 23	86. 7. 15
Issue Amount (U\$ mil.)	20	40	20
Maturity (years)	15	15	15
Coupon (%)	5	3	3
Issue price (%)	100	100	100
Conversion premium (%)	30 - 100	50	55
Commencement of Conversion period	87. 10. 19	87. 1.. 23	88. 1. 15
Basic stock price (won)	1,149	1,279	3,371
Listing	Luxembourg SE	Luxembourg SE	Luxembourg SE

Source: Data provided by the Korean authorities.

Table V-39. Korea: Regional Concentration of Exports by Categories of Products

(In millions of U.S. dollars)

	Industrial countries					Oil exporting countries	Non-oil developing countries	Other
	Total	Australia	Canada	EC	Japan			
Primary products								
Manufactured products								
Heavy industrial								
Machinery								
Of which:								
Automobiles								
Electronics								
Steel								
Chemicals								
Ships								
Light industrial								
Textiles								
Apparel								
Footwear								
Other								
Total exports								

Source: Data provided by the Korean authorities.

KRC: cqt8kr5-40 2/29/88

Table V-40. Korea: Regional Concentration of Imports by End-Use

(In millions of U.S. dollars)

	Industrial countries					Oil exporting countries	Non-oil developing countries	Other
	Total	Australia	Canada	EC	Japan			
Consumer goods excluding goods For re-exports For domestic consumption								
Grains								
Industrial raw materials								
Petroleum								
For export								
For domestic production								
Others								
For export production								
For domestic production								
Capital goods								
For export production								
Of which:								
Ships for repair								
For domestic production								

Source: Data provided by the Korean authorities.

KRC: cqt8kr5-41 2/29/88

Table V-41. Korea: Regional Concentration of Exports by Categories of Products

(In millions of U.S. dollars)

	Industrial countries					Oil exporting countries	Non-oil developing countries	Other
	Total	Australia	Canada	EC	Japan			
Total imports								
Primary products								
Manufactured products								
Heavy industrial								
Machinery								
Electronics								
Steel								
Chemicals								
Ships								
Light industrial								
Textiles								
Apparel								
Footwear								
Other								
Total exports								

Source: Data provided by the Korean authorities.