STRICTLY
CONFIDENTIAL

May 20, 2019 TF.

# Office Memorandum

To: Mr. Boorman

December 8, 1997

From: David Burton DB

Subject: **Briefing for Senior Staff on S.E. Asia and Korea**

Mr. Fajgenbaum mentioned that missions are being asked by country authorities about what has been happening in Asia and the role the Fund has been playing. However, the staff is not sufficiently well informed to provide much of a response, and he suggested that a briefing for senior staff on developments in Asia and the programs with Indonesia, Korea, Philippines, and Thailand would be useful. This struck me as a good idea.

ASIA/PACIFIC

9 DEC 97 11: 18

cc: Mr. Leddy
Mr. Ferran

Mr Neiss.

I know you are all under great stress, but I think an hour or so spent with mission chiefs from other departments would be of great value. I would be happy to help. Let me know if you see a way to do this!

JB 12/8/97

DECLASSIFIED
By ______ Date 11/26/19

01:23 09 DEC '97 P.01

cc: BBA
DG
DDS.

# Office Memorandum

To: Mr. Neiss

From: Sharmini Coorey and Gary Moser

Subject: **Korea: Revised Call Rate Series**

December 8, 1997

STRICTLY CONFIDENTIAL

May 20, 2019 TF.

Following a meeting with the authorities today, we decided to change the call rate series monitored under the program to one with a broader coverage of transactions brokered through the Korea Money Trade Corporation (KMTC) and in the inter-bank market (excluding investment trust companies). The previous series covered only transactions brokered through the KMTC.

You will notice that the rate of 24.9 percent for Friday, December 5 reported to you earlier is now recorded at 23.6 percent (see attached table). The previous rate was based on transactions brokered by the KMTC through the late afternoon. (It is common practice for the Bank of Korea to release early data to the press for publication). The weighted average of all transactions for that day in the new series is reported at 23.6 percent—after also having reached 25 percent during the afternoon—because rates settled back in the final hour of trading. (The call rate covered by the previous series recorded an average of 24 percent for the day).

Attachment

cc: Ms. Tseng

Table . Korea: Daily Financial Indicators, 1997.

| | Mon 17-Nov | Tues 18-Nov | Wed 19-Nov | Thurs 20-Nov | Fri 21-Nov | Mon 24-Nov | Tues 25-Nov | Wed 26-Nov | Thurs 27-Nov | Fri 28-Nov | Mon 1-Dec | Tues 2-Dec | Wed 3-Dec | Thurs 4-Dec | Fri 5-Dec | Mon 8-Dec |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Market Interest Rates** | | | | | | | | | | | | | | | | |
| Call Rate 1/ | 14.5 | 14.7 | 14.9 | 14.7 | 14.1 | 14.8 | 15.0 | 15.2 | 15.2 | 12.7 | 11.7 | 11.2 | 15.0 | 20.8 | 23.6 2/ | 21.4 |
| 91 Day CD | 14.1 | 14.2 | 14.3 | 14.7 | 14.9 | 15.5 | 15.2 | 17.0 | 16.5 | 15.5 | 15.0 | 15.5 | 15.5 | 15.5 | 15.5 | 15.5 |
| 3 year CB | 13.4 | 13.7 | 14.0 | 14.3 | 14.5 | 16.1 | 17.6 | 18.6 | 17.3 | 15.6 | 17.5 | 18.2 | 18.7 | 18.9 | 19.2 | 23.0 |
| **Bilateral Exchange Rates** | | | | | | | | | | | | | | | | |
| Won per $ | 990.6 | 1,012.8 | 1,035.5 | 1,139.1 | 1,145.0 | 1,085.0 | 1,122.0 | 1,110.0 | 1,119.5 | 1,170.0 | 1,187.0 | 1,235.0 | 1,196.0 | 1,170.0 | 1,230.0 | 1,342.4 |
| Percent change (+ appreciation) 3/ | -2.6 | -2.2 | -2.2 | -9.1 | -0.5 | 5.5 | -3.3 | 1.1 | -0.8 | -4.3 | -1.4 | -3.9 | 3.3 | 2.2 | -4.9 | -8.4 |
| Yen per $ | 125.4 | 125.5 | 126.1 | 125.7 | 126.8 | ... | 127.7 | 127.1 | 127.0 | 127.0 | 128.3 | 128.7 | 128.6 | 129.2 | 129.1 | ... |
| Percent change (+ appreciation) 3/ | ... | 0.0 | 0.0 | 0.0 | 0.0 | ... | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | ... | ... |
| **Nominal Effective Exchange** | 88.7 | 88.3 | 86.6 | 84.4 | 77.1 | 78.5 | 80.1 | 79.0 | 79.3 | 79.5 | 76.1 | 75.6 | 71.5 | 71.0 | ... | ... |
| **Stock Market Index** | 497.0 | 494.7 | 502.6 | 488.4 | 506.1 | 450.6 | 439.6 | 438.7 | 433.2 | 411.9 | 393.2 | 376.9 | 379.3 | 405.8 | 434.1 | 414.9 |
| Percent change | 5.6 | -0.5 | 1.6 | -2.8 | 3.6 | -11.0 | -2.4 | -0.2 | -1.3 | -4.9 | -3.6 | -4.1 | 0.6 | 7.0 | 7.0 | -4.4 |
| **International Reserve** | | | | | | | | | | | | | | | | |
| Official Reserves | 26.0 | 25.3 | 24.9 | 24.0 | 23.8 | 24.2 | 24.2 | 24.2 | .. | 24.4 | 24.4 | 24.0 | 14.6 | 14.8 | 20.3 | ... |
| Usable Reserves 4/ | 16.5 | 16.1 | 14.4 | 13.4 | 13.0 | 12.1 | 10.8 | 9.6 | .. | 7.5 | 6.8 | 6.0 | 5.9 | 6.4 | 11.3 | ... |

Source: Bank of Korea; and staff estimates.

1/ Revised series. Represents weighted average of the overnight call rate brokered by the Korea Money Trade Corporation and in the interbank market (excluding Investment Trust Companies).

2/ Overnight call rate for KMTC transactions reached 24.9 percent by late afternoon on Dec. 5, before settling back in the final hour of trading.

3/ Calculated as the percent change of nominal exchange rate in foreign currency terms from the previous column.

4/ Defined as official reserves minus deposits at overseas branches.

Cc: BBA
DG
DJ5

# Office Memorandum

To: Mr. Neiss

December 8, 1997

From: Okyu Kwon [signature]

**STRICTLY CONFIDENTIAL**

May 29, 2019 AF.

Subject: **Publication of the Staff Report on Korea**

1. The staff report on the stand-by arrangement for Korea was leaked to the Chosun Ilbo, one of the leading Korean newspapers. Obviously this means the contents of the report are no longer confidential.

2. I came to understand, after a discussion with you over the phone last night, that in such a case, my Government could make the report public without any prior approval from the IMF. Would you please confirm this in writing as soon as possible?

DECLASSIFIED

By [signature] Date 4/26/19

FROM Legal.

# *Office Memorandum*

To: Mr. Kwon December 8, 1997

From: Hubert Neiss

Subject: **Korea--Publication of Staff Report**

(which, until it is translated into English, cannot be confirmed as being either complete or accurate)

I consulted with the Legal Department on the issue we discussed ~~last~~ night. The legal situation is that, despite the publication of the report by Chosun Ilbo, Board agreement to publish the report by the Government is still needed before the Government itself makes the report public.

You could make this request to the Board today under "other business."

cc: Mr. Gianviti
Mr. Munzberg

**STRICTLY CONFIDENTIAL**
May 20, 2019 T.F.

**DECLASSIFIED**
By [signature] Date 4/16/19

**INTERNATIONAL MONETARY FUND**

→ Mr Neiss

Ireland,

As discussed, the attached may be of interest (Prepared by Matthew Fisher).

David

**David Goldsbrough**

# Office Memorandum

To: Mr. Neiss December 9, 1997

From: Wanda Tseng WT

Subject: **Korea: Call Rate**

We are now reporting 2 call rates.

The first call rate shown in the table refers to the average daily rate intermediated by the KMTC (Korea Money Trade Corporation) and the interbank market at the close of the day. We do not get this rate usually until the next day because the market closes late (at varying times) in the evening and it takes several hours to calculate the daily average.

The second call rate is the rate at 4:30. This rate excludes the interbank market and is often cited in the Korean newspapers.

Also we learned that there is a ceiling on all interest rates--25 percent since 1983. The ceiling can be raised to 40 percent by presidential decree. Further increases in the ceiling requires legislative approval.

cc: BBA, DG.
DJ8

MINISTRY OF FINANCE AND ECONOMY
THE REPUBLIC OF KOREA

8 December 1997

**STRICTLY CONFIDENTIAL**

May 20, 2019 TF.

Mr. Hubert Neiss
Director, Asia Pacific Department
International Monetary Fund
Washington, D.C.

Dear Mr. Neiss:

I am writing in regard to the recent leakage of the confidential IMF staff report prepared by your mission for a standby loan to Korea. Chosun Ilbo, one of Korea's leading daily newspapers, published the full text of the staff report today. This leak is adversely affecting financial market sentiments and the credibility of the Korean government.

We understand distribution of staff papers is required to be strictly limited. In this context, the Ministry requests the IMF launch an official investigation into this matter. Please contact us with the results of this investigation as soon as they are available.

Sincerely,

W. S. Kim

Woo-Suk Kim
*Director General for*
*International Finance and Securities*

**DECLASSIFIED**
By ______ Date 11/26/19

12-08 11:43 MON FROM:MOFE-KOREA 02-503-9275 TO:202 623 4795 PAGE:02

**From:** Sylvie Durand-Jansiac
**To:** oed-fd
**Date:** 12/8/97 4:51pm
**Subject:** **Other Business--Public of Staff Report on Korea**

Please bring the following message from the Secretary to the attention of your Executive Director:

At the end of today's (**Monday, December 8**) Board meeting, Mr. Kwon will ask the Board to consider his request to permit the publication of the staff report for Korea's request for a Stand-By Arrangement (EBS/97/222, 12/3/97).

**CC:** OMD, ATTENDAN, SECAI, SECDO, SECEB

**WITHDRAWAL NOTICE**

THIS DOCUMENT IS IN THE COURSE OF A PUBLIC DISCLOSURE REVIEW PROCESS

| | |
|---|---|
| **Department/Division/ Collection:** | Asia and Pacific Department Records |
| **Series/Subseries:** | Asian and Pacific Department Director's Office Files - Asian Crisis |
| **Box number:** | A8-047 |
| **File number:** | 6 |
| **ADLIB ref. number:** | 430 |
| **File title & dates:** | Republic of Korea - Chronological files, December 1997 |
| **Doc. title & dates:** | Handwritten Note on Korean Program, December 8, 1997 |
| **Doc. Classification:** | Strictly Confidential |

**OCDE**
ORGANISATION DE COOPÉRATION ET DE DÉVELOPPEMENT ÉCONOMIQUES

**OECD**
ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

DEPARTEMENT DES AFFAIRES ECONOMIQUES
ECONOMICS DEPARTMENT

Branche des Etudes Nationales et des Perspectives Economiques
Country Studies and Economic Prospects Branch

cc: ... DS S.

Deputy Director/Directeur Adjoint

# TELEFAX

**STRICTLY CONFIDENTIAL**

May 20, 2019 TF.

| | |
|---|---|
| Date: | **8 December 1997** |
| To: | **Mr Bijan AGHEVLI** |
| Fax number: | **202 623 4795** |
| From: | **Val KOROMZAY** |
| Phone number: | **(33-1) 45 24 88 05** |
| Fax number: | **(33-1) 45 24 16 49** |
| Number of pages: | **2** |

**DECLASSIFIED**
By ___ Date 11/26/17

*If transmission is not well received, please contact the operator at (33-1) 45 24 88 61*

---

Dear Bijan,

Thanks for your reply, and the accompanying documents which give us as clear a picture as we will need to be getting on with the work.

On the macro-settings -- you are right that the fiscal adjustment is rather less stark than we had gathered from the early press reports. The monetary policy does look very tight, but its formulation obviously allows rates to come down, perhaps fairly quickly, once confidence is restored; and immediate tightness may be a good think if it speeds that restoration. On the other hand, getting 12-monthly inflation down to 5.5 per cent by December may be difficult depending on pass-through of exchange-rate depreciation. We will have to hope that the experience of the 1992 devaluations in the EMS -- with very low pass-through -- repeats itself. We'll keep our fingers crossed that the policy settings prove consistent with the growth forecast. There are strong downside risks in our view.

On the structural side, the measures to strengthen the banking system are well-directed even if some of them are likely to prove very divisive in Korea. We can only hope that the government has the capacity to handle the politics, and the likely social discord. We note that there is no *ex ante* ceiling on the support the government can provide to strengthen the system. This is appropriate, as one really cannot judge how much will be needed. Our view is to get the restructuring over with quickly rather than leaving institutions twisting in the breeze with half measures. The hard part may be facing down the existing shareholders... it is just so unclear to what extent they were relying on implicit government guarantees and to what extent the government can walk away from these.

The programme makes clear that there is still work to be done on the corporate governance issue. A question for us at this point is whether consolidated accounting is even possible for the conglomerates as presently structured because they apparently have no legal identity. We will be looking at this and other issues this week? Could you let me know who at the World Bank will be working on corporate governance issues so we can establish a trilateral framework?

I look forward to hearing from Wanda Tseng... we were colleagues once (19 years ago) at the Council of Economic Advisors.

Lets keep in touch,

**WITHDRAWAL NOTICE**
THIS DOCUMENT IS IN THE COURSE OF A PUBLIC DISCLOSURE REVIEW PROCESS

| | |
|---|---|
| **Department/Division/ Collection:** | Asia and Pacific Department Records |
| **Series/Subseries:** | Asian and Pacific Department Director's Office Files - Asian Crisis |
| **Box number:** | A8-047 |
| **File number:** | 6 |
| **ADLIB ref. number:** | 430 |
| **File title & dates:** | Republic of Korea - Chronological files, December 1997 |
| **Doc. title & dates:** | Korea - Some Urgent Issues, Memo from Mr. Hubert Neiss to The Managing Director and The Deputy Managing Director, December 7, 1997 |
| **Doc. Classification:** | SECRET |

STRICTLY CONFIDENTIAL

May 20, 2019 TF.

# Office Memorandum

| | | |
|---|---|---|
| To: | The Managing Director<br>The Deputy Managing Directors | December 7, 1997 |
| From: | Hubert Neiss HN | |
| Subject: | **Korea: Further Work** | |

I would like to suggest to form interdepartmental working groups to prepare Fund positions in the following two areas:

- **An exit strategy from the blanket guarantee** given by the government in August. This strategy must aim at reducing the scope of the guarantee without undermining market confidence and government credibility. This is a tricky area, and we could consider hiring an outside advisor to assist us.
- **Trade liberalization measures** to be taken unilaterally. We must go beyond "more should be done, and faster," and specify concrete and timebound actions, which would be commitments for the first review. This can be quite complicated, and possibly we should also think of getting the benefit of an outside expert.

cc: Mr. Mussa
Mr. Boorman
Mr. Guitian
Mr. Cross

DECLASSIFIED
By ______ Date 11/26/19

O:\DOC\AI\HN\71206KR1.MEM December 7, 1997 (3:13pm)

**From:** Pihuan Cormier
**To:** ogoodger
**Date:** 12/7/97 9:49pm
**Subject:** Pls see attached memo which Mr. Neiss...

may make some changes to.

**WITHDRAWAL NOTICE**

THIS DOCUMENT IS IN THE COURSE OF A PUBLIC DISCLOSURE REVIEW PROCESS

| | |
|---|---|
| **Department/Division/ Collection:** | Asia and Pacific Department Records |
| **Series/Subseries:** | Asian and Pacific Department Director's Office Files - Asian Crisis |
| **Box number:** | A8-047 |
| **File number:** | 6 |
| **ADLIB ref. number:** | 430 |
| **File title & dates:** | Republic of Korea - Chronological files, December 1997 |
| **Doc. title & dates:** | Email from P. Pfeffermann to IFC, Question on External Funding, December 8, 1997 |
| **Doc. Classification:** | Strictly Confidential |

**CLOSED DOCUMENT**
IN ACCORDANCE WITH THE POLICY ON ACCESS TO THE
IMF ARCHIVES

This [X] document or [ ] file has been removed as it belongs to the following category:

- [ ] Legal documents and records that are protected by attorney client privilege;
- [X] Personnel files and medical or other records pertaining to individuals;
- [ ] Documents and proceedings of the Grievance Committee;
- [ ] Records furnished to the Fund by external parties, including members, with security marking confidential or above (declassification can be requested)
- [ ] Other sensitive:

| | |
|---|---|
| **Department/Division/ Collection:** | Asia and Pacific Department Records |
| **Series/Subseries:** | Asian and Pacific Department Director's Office Files - Asian Crisis |
| **Box number:** | A8-047 |
| **File number:** | 6 |
| **ADLIB ref. number:** | 430 |
| **File title & dates:** | Republic of Korea - Chronological files, December 1997 |
| **Doc. title & dates:** | Resume of Mr. Kim Hyoung-min, December 6, 1997 |

00:51 05 DEC '97

## INTERNATIONAL MONETARY FUND

| MSG. NO. | DATE December 5, 1997 | PAGE 1 OF 3 |
|---|---|---|

**TO** Charles Adams

Fax no. 623-4432

**STRICTLY CONFIDENTIAL**

May 20, 2019 TF.

Please see attached.. I have also attached the closing call rates in won and dollars for the two banks in the Bloomberg overnight rate. The call rates in won show the 600 basis points decline and a sharp increase close of business Thursday.

Salud!

Alex Hoffmaister

**DECLASSIFIED**

By ____ Date 11/26/19

Attachment

Charles --

(P.S. How are you doing? More important--how are my plants doing??

-- Pr[illegible])

12/4/97 6:59 PM

Korea: Interbank loan interest rates, 11/25-12/4

| | | | | Thanksgiving 1/ | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Mon 24-Nov | Tues 25-Nov | Wed 26-Nov | Thu 27-Nov | Fri 28-Nov | Sat 29-Nov | Mon 1-Dec | Tues 2-Dec | Wed 3-Dec | Thu 4-Dec |
| Banque Indosuez-Seoul (Won call) 2/ | 13.90 | 13.90 | 13.90 | 13.70 | 11.00 | 10.00 | 8.50 | 7.00 | 7.00 | 13.00 |
| ($ call) | ... | ... | 5.63 | ... | ... | 5.80 | 5.78 | 5.65 | 5.65 | 5.40 |
| Hong Kong, Shanghai Banking Corporation (Won call) | 13.90 | 13.90 | 13.90 | 13.70 | 11.00 | 10.00 | 8.50 | 7.00 | 7.00 | 13.00 |
| ($ call) | 5.56 | 5.56 | 5.59 | ... | ... | 5.81 | 5.69 | 5.63 | 5.63 | ... |

Source: Bank of Korea; Banque Indosuez-Seoul; and HKBC.

1/ These foreign bank subsidiaries were closed during the Thanksgiving holiday.

2/ On Monday and Tuesday November 24th and 25, the Banque Indosuez-Seoul did not enter into the interbank loan market.

Table Korea: Daily Financial Indicators, 1997.

| | Mon 17-Nov | Tues 18-Nov | Wed 19-Nov | Thurs 20-Nov | Fri 21-Nov | Mon 24-Nov | Tues 25-Nov | Wed 26-Nov | Thurs 27-Nov | Fri 28-Nov | Mon 1-Dec | Tues 2-Dec | Wed 3-Dec | Thurs 4-Dec |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Market Interest Rates** | | | | | | | | | | | | | | |
| Call Rate 1/ | 15.0 | 14.3 | 14.7 | 14.5 | 14.5 | 15.4 | 15.7 | 13.2 | 15.7 | 13.9 | 12.4 | 12.6 | 15.8 | 21.1 |
| 91 Day CD | 14.1 | 14.2 | 14.5 | 14.7 | 14.9 | 15.5 | 15.2 | 17.0 | 16.5 | 15.5 | 15.0 | 15.5 | 15.5 | 15.5 |
| 3 year CB | 13.4 | 13.7 | 14.0 | 14.3 | 14.5 | 16.1 | 17.6 | 18.6 | 17.3 | 15.6 | 17.5 | 18.2 | 18.7 | 18.9 |
| **Bilateral Exchange Rates** | | | | | | | | | | | | | | |
| Won per $ | 990.60 | 1012.80 | 1035.50 | 1139.05 | 1145.00 | 1085.00 | 1122.00 | 1110.00 | 1119.50 | 1170.00 | 1187.00 | 1235.00 | 1196.00 | 1170.0 |
| Percent change (+ appreciation) | -2.62 | -2.19 | -2.19 | -9.09 | -0.52 | 5.53 | -3.30 | 1.08 | -0.85 | -4.32 | -1.43 | -3.89 | 3.26 | 2.22 |
| Yen per $ | 125.40 | 125.50 | 126.05 | 126.70 | 126.80 | ... | 127.70 | 127.10 | 127.00 | 127.00 | 128.25 | 128.70 | 128.60 | 129.2 |
| Percent change (+ appreciation) | | 0.00 | 0.00 | 0.00 | 0.00 | ... | 0.01 | 0.00 | 0.00 | 0.00 | 0.01 | 0.00 | 0.00 | 0.00 |
| **Nominal Effective Exchange** | 88.70 | 88.30 | 86.60 | 84.40 | 77.10 | 78.50 | 80.10 | 79.00 | 79.30 | 79.50 | 76.10 | ... | ... | |
| **Stock Market Index** | 496.98 | 494.66 | 502.59 | 488.41 | 506.07 | 450.60 | 439.59 | 438.70 | 433.10 | 411.91 | 393.16 | 376.87 | 379.31 | 405.8 |
| Percent change | 5.6 | -0.5 | 1.6 | -2.8 | 3.6 | -11.0 | -2.4 | -0.2 | -1.3 | -4.9 | -3.6 | -4.1 | 0.6 | 7.0 |
| **International Reserve** | | | | | | | | | | | | | | |
| Official Reserves | 26.0 | 25.3 | 24.9 | 24.0 | 23.8 | 24.2 | 24.2 | 24.2 | | 24.4 | 24.4 | 24.0 | 14.6 | 14.8 |
| Usable Reserves /3 | 16.5 | 16.1 | 14.4 | 13.4 | 13.0 | 12.1 | 10.8 | 9.6 | | 7.5 | 6.8 | 6.0 | 3.9 | 6.4 |

Source: Bank of Korea; and staff estimates.

1/ Weighted average of the daily call rate brokered by the Korea Money Trade Corporation.

2/ Calculated as the percent change of nominal exchange rate in foreign currency terms from the previous column.

3/ Defined as Official Reserves minus deposits at overseas branches.

cc: HN

INTERNATIONAL MONETARY FUND

December 5, 1997

Mr. Aghevli,

You will be interested in the sharp divergences between the overnight call rate in Korea, as reported by Bloomberg and Reuters. Obviously there is something inconsistent with one or the other, or, perhaps, both of these call rates.

Att.

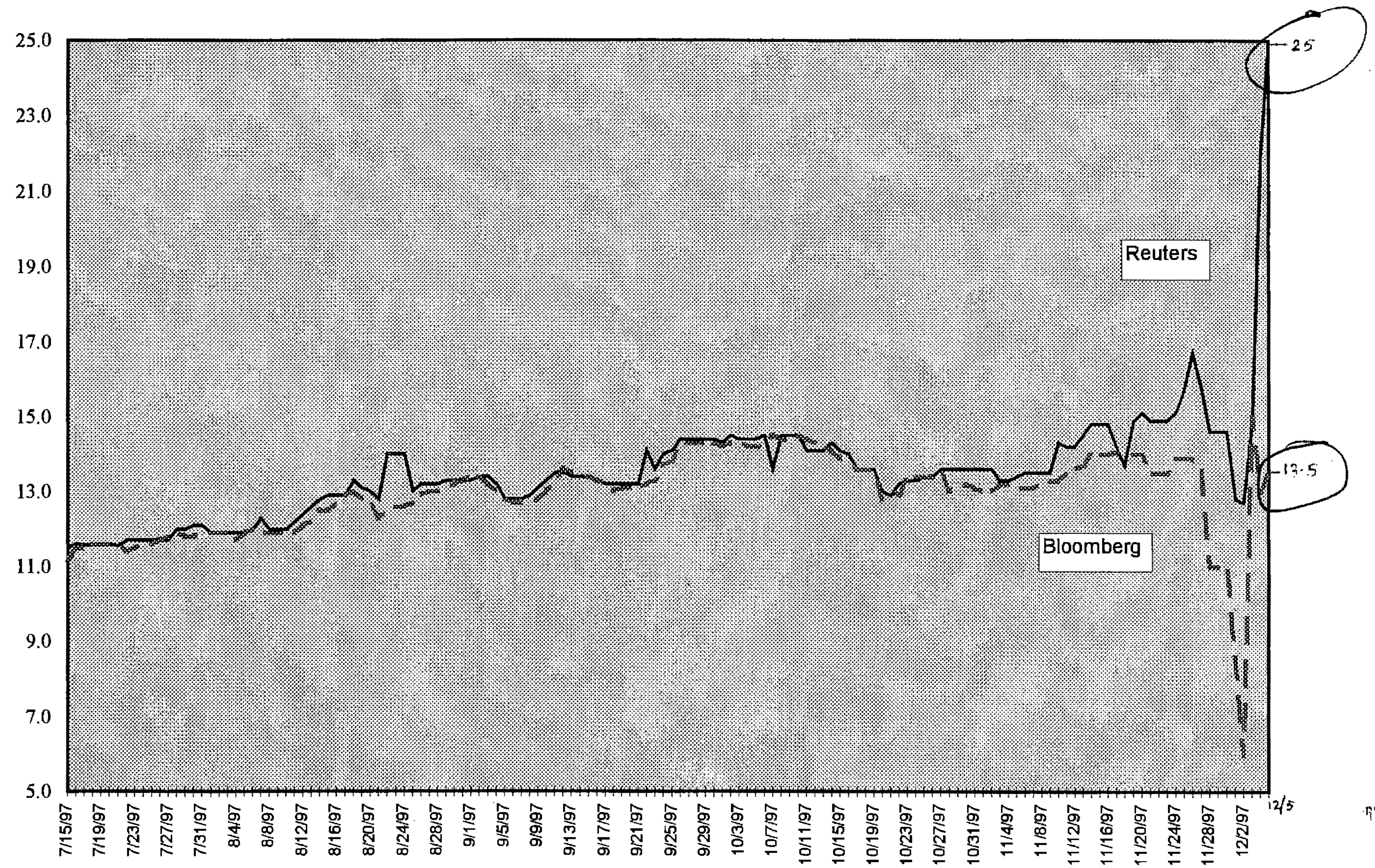
cc: Mr. Boorman
Mr. Evans

DW.



David Williams
(7-308, ext. 3-8305)

KOREA: OVERNIGHT CALL RATE JULY 1 - DECEMBER 5, 1997



Mr. Neiss / Mr. Aghevli

INTERNATIONAL MONETARY FUND
WASHINGTON, D.C. 20431

CABLE ADDRESS
INTERFUND

December 5, 1997

**STRICTLY CONFIDENTIAL**

May 20, 2019 TF.

Fax to Mr. Joong-Kyung Choi, Director Financial Cooperation Dept.
Ministry of Finance and the Economy

Fax No. 503-9272

Thank you for your fax of December 5 on the staff report on Korea's request for stand-by arrangement. The staff report contains our standing of the agreement reached with the Korean Government, including point 2 concerning Fund staff's comments on the draft bills for financial sector reform, referred to paragraph 23 and 25 of the staff report. My understanding is that the MAE team has received these assurances.

The Board meeting concerning Korea's request is now in progress. At this late stage, we are not able to make any changes to the staff report. If you wish to do so, Mr. Kwon would have to make this request during the Board meeting.

Wanda Tseng
Deputy Director
Asian and Pacific Department

DECLASSIFIED
By ____ Date 4/26/19

8|11

Dec 5, 97

**Korea: Questions/Information for the Board Meeting**

**STRICTLY CONFIDENTIAL**

May 20, 2019 NF.

**I. Question raised by Directors at the December 2 Meeting**

1. *Is strengthening the Employment Insurance Scheme (EIS) the only labor market issue? Please provide details on this and other labor market measures under consideration.*

2. *Why haven't insolvent merchant banks been closed immediately? What will happen to the couple of commercial banks in trouble?*

- The authorities indicated that the government does not have the requisite legal powers to close merchant banks immediately.

- Operations of 9 merchant banks and 2 commercial banks suspended. Specific procedures established to close these merchants banks in three months and commercial banks in four months if they fail to submit rehabilitation plans (within 30 days) and successfully implement them.

3. *What are the specific prior actions in the program? What actions will the Koreans commit to before the elections? Will the Koreans significantly raise interest rates before the program is approved? Why have short-term rates been lowered significantly in the last few days? What is the staff telling the Koreans on interest rates?*

- There is a prior action that the call rate will be increased substantially and sufficiently to strengthen the won.. The call rate reached 21 percent on December 4 (see Table 1).
- Short term rates fell between November 27 and December 3, because of a substantial injection of liquidity in support of financial institutions by the Bank of Korea.
- The staff has made it clear that interest rates should be raised significantly as a prior action and should be maintained at high levels until markets stabilize and the downward pressure on the won eases. Beyond the immediate term, if the won appreciates, a cautious and gradual easing of interest rates may be considered. The authorities should be in close consultation with Fund staff about the conduct of monetary policy.

4. *What specific assumptions about the roll over of external debt are being made in the program? Detailed information on the staff assumptions on rollover by type of creditor and for on-shore and off-shore credits is expected.*

DECLASSIFIED

By [signature] Date 11/26/19

• The baseline projections assume a 100 percent rollover of short-term external debt of Korean financial institutions falling due of US$30 billion in December. The short-term debt of Korean corporations are mainly trade-related are assumed to be rolled over completely.

5. *How can staff be sure that Parliament will pass the three key financial sector reform bills given the previous deadlock?*

• Calling a special session of the National Assembly shortly following the Presidential elections on December 18 to pass these bills is a condition for completing the second bi-weekly review.

• Although the Fund cannot commit authorities to the outcomes of their legislative process, there is now strong political support for the bills. One reason for the previous deadlock was the absence of key supporters when the bills were considered by the National Assembly.

6. *Is the reserve draw down fully explained by the rollover problem? Are there other capital outflows?*

• The bulk of the reserve draw down is explained by the rollover problem, although there may be some other capital outflows (staff report Table 6).

7. *How will Korean banks obtain the liquidity to obtain foreign currency loans from the BOK? Are the loans collateralized? Will all banks be charged the same spread above LIBOR? Is the agreed spread of 400 basis points above LIBOR? Will insolvent financial institutions be able to get these foreign currency loans? How will the BOK limit access to foreign currency loans?*

• There is a continuous performance criterion that specifies that the interest are charged by the BOK on foreign exchange injections to Korean commercial banks or their overseas branches shall not be below 400 basis points above LIBOR.

8. *Is the support of the three main political candidates being sought before the program goes to the Board*?

• The support of the three main political candidates was a condition for presenting the program to the Board. All three candidates have supported the program in public statements.

## II. Other issues

***1. The change in program assumptions about external financing and the rollover of external debt.***

*1. The change in program assumptions about external financing and the rollover of external debt.*

We have checked and there is no substantive problem with the adjustments made by Bijan. However, we note the following:

• In Table 6, the capital account balance in 1997:Q4 should be changed from US$16,485 to US$19,485 for the capital account to add up.

• The table on reserve money (staff report Table 4) identifies the foreign exchange deposits at DMB branches abroad separately and someone may raise questions about its consistency with the assumption of 100 percent rollover. Although the line is now inconsistent with the corresponding revised BOP number (staff report Table 6), it does not matter very much because it is netted out within NDA. (NFA of the BOK is consistent with the NIR projection in the BOP).

*2. The call rates from Bloomberg*

These may differ from the call rates we monitor because Bloomberg covers only two banks (Indosuez and Hong Kong, Shanghai Banking Corporation) while the rate we monitor is an average of many banks that is quoted by brokerage houses. The two banks covered by Bloomberg are less risky, hence the call rate is lower than the rate we use; however, the Bloomberg rate did rise on December 4 by 6 percentage points (see Table 2).

*3. Questions regarding short-term external debt, external financing, and intervention by BOK.*

(See Tables 3-6).

*4. Changes to the Staff Report*

On paragraph 5, you may want to be aware that directed lending refers to requirements that commercial banks meet lending targets for small and medium-size industries. Hence, the issue is not one of a level playing field, but rather of quasi-fiscal operations which should be included in the budget. In any case, directed lending accounts for a very small proportion of total bank lending.

*5. Recent imposition of capital controls*

If there are any questions in this area, you may find it useful to look at the memo from Charles Adams to Mr. Kwon dated November 6, 1997: "Korea--Measures to Stabilize Stock Markets and the Foreign Exchange Market."

11|11

Q: Is strengthening the Employment Insuarance scheme (EIS) the only labor market issue? Please provide details on this and other labor-market measures under consideration.

- The Employment Insurance scheme has been in place since mid-1995. The Korean economy has not tested the effectiveness of the EIS in easing the burden of layoffs and expediting reemployment yet. The EIS is compared to other OECD countries not very generous and some scope exists to strengthen the scheme by broadening the base: the maximum duration of payments is very short (6 months) and many workers are not covered by the scheme (in particular young workers and those dismissed due to reasons for which held responsible). The replacement rate is roughly in line with OECD countries (50 percent of the average daily income).

Other labor market measures:

- Enhance labor market flexibility by easing dismissal rulings under mergers and acquisitions and corporate restructuring, which continue to rely on time-consuming court rulings.

- Encourage active labor market policies by allowing for private job placement agencies and temporary employment agencies, both which are currently permitted.

- Given the prospect of large layoffs, there is a need to upgrade the vocational training system. Training, currently, is primarily of on-the job nature (i.e., at work).

cc: Foss

# Office Memorandum

STRICTLY CONFIDENTIAL

May 20, 2019 TF.

To: Okyu Kwon
Alternate Executive Director

December 5, 1997

From: Karin Lissakers
U.S. Executive Director

Subject: **Overdraft Bank Accounts for Bankrupt Korean Firms**

This morning's edition of the Wall Street Journal carried a disturbing article regarding the IMF program for Korea (attached). According to the article, the Bank of Korea is considering allowing bankrupt firms to maintain their overdraft bank accounts in an effort to maintain their access to liquidity. We recognize that this report may be mistaken, and have asked staff for clarification. If true, however, it is a cause for serious concern. In our view, such action to maintain bankrupt companies' access to liquidity instead of freezing their accounts would represent a clear case of directed lending and a failure to carry through with normal bankruptcy provisions, and thus contrary to the terms of the program as set forth in the Letter of Intent. I would appreciate it if you would follow up with your authorities on this issue.

cc: Stanley Fischer
Hubert Neiss

ASIA/PACIFIC

5 DEC 97 2:

DECLASSIFIED
By ___ Date 11/26/19

**From:** Charles Adams
**To:** baghevli
**Date:** 12/5/97 12:05pm
**Subject:** Korea: Question from US ED's Office

Todd Schneider (US) called to ask about a reference in the WSJ to the BOK proposing to keep bank overdrafts open for bankrupt companies. (Rubin expressed concern about the report)

I've spoken to Jim Gordon who will follow up.
Charles Adams

**CC:** hneiss

Dec.
12/5/97

**INTERNATIONAL MONETARY FUND**

MR. CROSS

The MD has asked for a list of people whom he wishes to invite for lunch.

Hubert Neiss

# HQ Staff involved in the Korean operation

**Deputy Managing Directors' Offices**
Mr. Owen Evans
Ms. Benedicte Christensen
Mr. Jean Clement

**FAD**
Mr. Peter Heller

**RES**
Mr. Michael Mussa
Mr. Flemming Larsen

**TRE**
Mr. David Williams
Mr. Edgardo Decarli

**PDR**
Mr. Jack Boorman
Mr. Joaquin Ferran

**LEG**
Mr. Francois Gianviti
Mr. John Hagan

**MAE**
Mr. Manuel Guitian
Mr. Tomas Balino

**APD**
Mr. Hubert Neiss
Mr. Bijan Aghevli

**SEC**
Mr. Reinhard Munzberg
Mr. Alexander Mountford

**ADM**
Ms. Burke Dillon
Mr. Michael Gehringer

**EXR**
Mr. Peter Hole
Ms. Kathleen White

This list is, of course, not complete, a larger list of staff invited by Mr. Fischer for drinks last Friday is attached.

From: Keila Moses
To: Sdurandjansiac
Date: 12/4/97 5:22pm
Subject: Further list of Korean heroes

Please add David Hawley to the EXR list.

Herewith the list of names from the other departments:

FAD: Peter Heller

RES: Fleming Larsen

TRE: David Williams
Edgardo Decarli
Klaus Boese
Christopher Clarke
Curtis Hatch

PDR: Jack Boorman
Joaquin Ferran
Matthew Fisher
Adam Bennett
Elenita Dee

LEG: F. Gianviti
John Hagan

MAE: M. Guitian
T. Balino

APD: Hubert Neiss
B. Aghevli
D. Goldsbrough
Charles Adams
Marcus Rodlauer
Tom Rumbaugh
Mary-Lou Yupangco
Carolina Villegas
Margaret Tan
Ollie Goodger
Vera Jasenovec
Sherine Pratt
Sylvia Perez
Lakshmi Sahasranam
Kamlesh Sehmi
Nansi Lee
Anita Jupp

I believe these are all the names. Thanks a million. km

**Secretary's Department:**

Reinhard Munzberg
Alexander Mountford
Kenneth Friedman
Sylvie Durand-Jansiac
Susan Yeager
Gayle Schofield
Ellen Witmer
Cheryl Shotwell
Robert Boykin
Pura Mohan
Mariko Cool

**Administration:**
Ms. Dillon

**Audio:**

Wayne Bingham
Michael Gehringer
Shelton Gallun
Kevin Emerick
Harold White
Mila Dimitrijevic

**Telecommunication:**

Kathy Harty
Dave Knocke

**External Relations:**

Peter Hole & Elza Comia (Sec.)
Kathleen White & David Hawley

**Chauffeurs:**

Renato Bangit
Seydou Zina

**Print Shop:**

Hege Kedlaya

Jerome Jones

MANAGEMENT:

Stanley Fischer (no message)
Owen Evans
Benedicte Christensen
A. D. Ouattara
Jean Clement
Keila Moses
Virginia Farinas
S. Sugisaki

Dec. 5 '97

FOSS
SC
Kuwn/TC
DOS
PDR

To: Mr Neiss; Mr Tsang; Ms Meesook; Ms Cooray; Mr Gordon
From: D. Goldsbrough



The attached summarizes the initial draft of the MAS/SFED report on off-balance sheet items.

**Off-balance sheet items**

- The major item reported was a large volume of guarantees, mainly in foreign currency, totaling $19 billion. The authorities explained that the bulk of these (80-90 percent) relate to trade financing through the opening of letter of credit. While it is impossible to predict whether such guarantees could be called, and when, experience in most countries indicates that trade financing arrangements are usually of better quality than other banking assets.

- Derivative transactions are modest in scale and appear to be well matched, and the cash flow impact in the short-run ($200 million in January) is small. The bulk of the business is in foreign exchange swaps in major currencies, and the motivation seems to be hedging rather than to assume new risk

- A small number of banks have done business in credit derivatives (total return swaps and credit default swaps). The underlying assets appear to be of good quality.

- There is a need to refine and improve reporting systems and to extend the supervision of such items to the specialized banks and merchant banks not presently supervised. The merging of supervisory responsibilities of all financing institutions will help in this effort

- Finally, discussions with commercial banks yielded a less sanguine picture. The bankers stressed that risks may be concentrated in the smaller banks and the securities houses, both of which were outside the present study.

DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

EBS/97/222
Supplement 2

CONFIDENTIAL

December 5, 1997

To: Members of the Executive Board

From: The Secretary

Subject: **Republic of Korea—Stand-By Arrangement**

Attached for the records of Executive Directors is the text of the Stand-By Arrangement for the Republic of Korea, as agreed at Executive Board Meeting 97/116 (12/4/97).

Att: (1)

## Korea: Stand-By Arrangement

Attached hereto* is a letter from the Deputy Prime Minister/ Minister of Finance and Economy and the Governor of the Bank of Korea dated December 3, 1997 (the "Letter"), with attached memorandum (the "Memorandum"), requesting a stand-by arrangement and setting forth:

(a) the objectives, policies and measures that the authorities of Korea intend to pursue for the period of this stand-by arrangement; and

(b) understandings of Korea with the Fund regarding reviews that will be made of progress in realizing the objectives of the program and of the policies and measures that the authorities of Korea will pursue for the period of this stand-by arrangement.

To support these objectives and policies the International Monetary Fund grants this stand-by arrangement in accordance with the following provisions:

1. For a period of three years from December 4, 1997, Korea will have the right to make purchases from the Fund in an amount equivalent to SDR 15,500 million, subject to paragraphs 2, 3, 4, and 5 below, without further review by the Fund.

2. (a) Purchases under this stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 4,100 million until December 18, 1997, the equivalent of SDR 6,700 million until January 8, 1998, the equivalent of SDR 8,200 million until February 15, 1998, the equivalent of SDR 10,800 million until May 15, 1998, the equivalent of SDR 12,600 million until August 15, 1998, the equivalent of SDR 13,325 million until November 15, 1998, the equivalent of SDR 14,050 million until February 15, 1999, the equivalent of SDR 14,231.25 million until May 15, 1999, the equivalent of SDR 14,412.5 million until August 15, 1999, the equivalent of SDR 14,593.75 million until November 15, 1999, the equivalent of SDR 14,775 million until February 15, 2000, the equivalent of SDR 14,956.25 million until May 15, 2000, the equivalent of SDR 15,137.5 million until August 15, 2000, and the equivalent of SDR 15,318.75 million until November 15, 2000.

(b) None of the limits in (a) above shall apply to a purchase under this stand-by arrangement that would not increase the Fund's holdings of Korea's currency subject to repurchase beyond 25 percent of quota.

3. Korea will not make purchases under this stand-by arrangement that would increase the Fund's holdings of Korea's currency subject to repurchase beyond 25 percent of quota.

*See EBS/97/222 (12/3/97).

(a) during any period in which the data at the end of the preceding period indicate that

(i) the limit on the net domestic assets of the Bank of Korea described in Annex A to the Memorandum, or

(ii) the floor on the minimum level of net international reserves of the Bank of Korea described in Annex B to the Memorandum

is not observed; or

(b) if, at any time prior to the completion of the second review specified in the Letter, the interest rate charged by the Bank of Korea on foreign exchange injections to Korean commercial banks or their overseas branches specified in Annex D of the Memorandum does not exceed the floor set forth in such Annex; or

(c) if, at any time during the period of the arrangement, the Korean authorities accumulate external payments arrears; or

(d) after December 17, 1997, January 7, 1998, February 14, 1998, May 14, 1998, August 14, 1998, November 14, 1998, February 14, 1999, August 14, 1999, February 14, 2000, and August 14, 2000, until the respective reviews contemplated in the Letter have been completed; or

(e) if, at any time during the period of the stand-by arrangement, Korea

(i) imposes or intensifies restrictions on the making of payments and transfers for current international transactions; or

(ii) introduces or modifies multiple currency practices; or

(iii) concludes bilateral payments agreements which are inconsistent with Article VIII; or

(iv) imposes or intensifies import restrictions for balance of payments reasons.

When Korea is prevented from purchasing under this stand-by arrangement because of this paragraph 3, purchases will be resumed only after consultation has taken place between the Fund and Korea and understandings have been reached regarding the circumstances in which such purchases can be resumed.

4. Korea will not make purchases under this stand-by arrangement during any period in which Korea has an overdue financial obligation to the Fund or is failing to meet a repurchase expectation (a) in respect of a noncomplying purchase pursuant to Decision No. 7842-(84/165) on the Guidelines on Corrective Action, (b) in respect of a purchase in support of debt and debt service reduction operations pursuant to Decision No. 9331-(89/167), as amended, (c) pursuant to subparagraph 16(a) or 33(a) of Decision No. 8955-(88/126), as amended, on the Compensatory and Contingency Financing Facility, or (d) pursuant to section 2, paragraph (f) of the Guidelines for Fund Support for Currency Stabilization Funds.

5. Korea's right to engage in the transactions covered by this stand-by arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of Korea. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 5, purchases under this arrangement will be resumed only after consultation has taken place between the Fund and Korea and understandings have been reached regarding the circumstances in which such purchases can be resumed.

6. Purchases under this stand-by arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, unless, at the request of Korea, the Fund agrees to provide SDRs at the time of the purchase.

7. Korea shall pay a charge for this stand-by arrangement in accordance with the decisions of the Fund.

8. (a) Korea shall repurchase the amount of its currency that results from a purchase under this stand-by arrangement in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those relating to repurchase as Korea's balance of payments and reserve position improves.

(b) Any reductions in Korea's currency held by the Fund shall reduce the amounts subject to repurchase under this paragraph in accordance with the principles applied by the Fund for this purpose at the time of the reduction.

9. During the period of the stand-by arrangement, Korea shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to Korea or of representatives of Korea to the Fund. Korea shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Korea in achieving the objectives and policies set forth in the Letter and Memorandum.

10. In accordance with the Letter, Korea will consult the Fund on the adoption of any measures that may be appropriate at the initiative of the government or whenever the Managing Director requests consultation because any of the criteria in paragraph 3 above have not been observed or because the Managing Director considers that consultation on the program is desirable. In addition, after the period of the arrangement and while Korea has outstanding purchases in the upper credit trenches, the government will consult with the Fund from time to time, at the initiative of the government or at the request of the Managing Director, concerning Korea's balance of payments policies.

# *Office Memorandum*

To: Mr. Fischer December 5, 1997

From: David Burton DB

Subject: **Bank-Fund Collaboration in Strengthening Financial Sectors--Revised Draft of Supplementary Procedures**

Please find attached a draft of the supplementary procedures for collaboration (Attachment II of the memo from Messrs. Boorman and Ahmed of November 19), revised along the lines discussed yesterday morning. It has been agreed with Mr. Knight and Mr. Singh.

Attachment

ASIA/PACIFIC

5 DEC 97 1: 29

cc: Mr. Boorman (o/r)
Mr. Guitian (o/r)
Mr. Neiss (o/r)
Mr. Leddy
Mr. Knight
Mr. Singh

STRICTLY CONFIDENTIAL

May 20, 2019 PF.

DECLASSIFIED

By ______ Date 11/26/19

**ATTACHMENT II**

## ENHANCING EFFECTIVE COLLABORATION IN THE FINANCIAL SECTOR

1. We reaffirm the letter and spirit of the joint agreement discussed in August by the two Boards, including the collaboration mechanisms it sets out. The following specific suggestions are all aimed at better carrying out the objectives of that agreement.

2. Given the role of the Bank in the financial sector and the close links of the financial sector to overall stabilization and adjustment programs led by the Fund, ~~there should be collaboration~~ the Bank should be kept closely informed on the overall stabilization and adjustment program when the program has a major financial sector reform component that will involve substantial World Bank technical assistance, or structural adjustment lending. ~~Such collaboration would occur even when the Bank is not planning an accompanying structural adjustment loan.~~

3. ~~That collaboration would~~ In most cases this would involve the full participation of a Bank staff member on Fund missions working on overall stabilization/adjustment programs with a major financial sector component; there would also be full Bank participation on Fund missions working on overall financial sector programs (when, because of urgency, the Fund is taking the lead on the financial sector.)

4. Similarly, there should be as far as possible joint design and negotiation of structural reform programs for financial sectors ~~programs~~. Joint participation in financial sector missions will facilitate this process as well as subsequent hand-off of programs to the Bank. ~~These~~This will ensure that we draw on the best from both institutions, and promote a shared view of content and timing, including the degree of flexibility that should be built into the program. This will also provide an opportunity for both institutions to express disagreements directly to the other party rather than indirectly through the process of implementing the program with the government.

5. In countries where the Bank and the Fund are both involved in the financial sector, the Bank should have specific terms of reference for financial sector missions which are discussed with the Fund in draft, even if on a very quick turn-around basis, as well as shared in final version. The Fund should similarly discuss specific terms of reference in draft with the Bank as well as sharing the final version. This will help delineate separate and shared responsibilities and help assure consistency of approach.

6. For purposes of efficiency, and given limits on staff and budgets, once a joint strategy has been agreed upon, there will often be a division of labor between the two institutions. Where possible, missions of the institution taking leadership in a given area

should include a member of the other institution. This will help deal with consistency and information problems.

7. Both institutions will make an effort to maintain continuity in staffing for financial sector work on country cases. This will help to ensure consistency of programs over time, and the close personal relations needed for effective collaboration.

8. The Bank and the Fund should each have ~~produce~~ general guidelines on bank restructuring to give guidance to missions. Both staffs should work together to ensure a consistent approach. Generally, guidelines for each institution would go more into detail on the areas of emphasis of that institution within the financial sector.

9. In countries where the Bank has already been working on the financial sector, it should share its agenda with the Fund. The agenda presented to the Fund should be consistent with the Bank's overall and regional strategies.

10. In planning for programs in general and in specific countries or specific missions, both sides need to lay out needs and constraints clearly. For example, the Bank needs to explain clearly to the Fund limits on its control of consultants financed under projects or Borrower-executed trust funds. (On highly sensitive issues where close monitoring of advice is important, Bank staff should consider the feasibility, subject to budget constraints, of alternative financing mechanisms.) Both organizations must reach agreement on target dates, their feasibility and impact on program quality. Allowance will need to be made for the need to move quickly in crisis situations.

11. Last, and most important, is culture. The points above will not produce the desired results in the two institutions or in the countries we are assisting, unless there is a culture of collaboration. The Bank needs to have a culture in the financial sector of rapid response (and develop procedures and resources to better do so), more confidentiality than usual in the "open" Bank culture, and clarity in "institutional" positions.

The Fund needs to develop a culture of more openness and full inclusion and consultation of Bank colleagues, including planning and negotiation of programs. It needs to brief Bank staff fully on the financial sector and other aspects of Fund programs and assure that the authorities adequately brief the government counterparts of Bank financial sector missions.

While changes in culture are extremely hard to achieve, a more collaborative spirit will benefit both organizations. It will only occur if there is a clear personal commitment by senior managers and if the internal incentive systems of both organizations reward such behavior.

ASIA/PACIFIC-

5 DEC 97 1: 25

INTERNATIONAL MONETARY FUND

December 5, 1997

To: Mr. Fischer

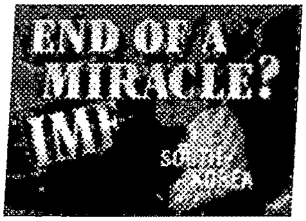
Subject: **NewsHour with Jim Lehrer on Korea**

You may care to take a glance at the transcript of last night's NewsHour segment on the Korean crisis which had, as commentators, Jeffrey Sachs, Mary Bush, Byoung-Joo Kim, and Meredith Woo-Cummings.

Attachments

cc: Mr. Neiss
Mr. Aghevli
Mr. Anjaria (or)

Peter Hole
(12-518, ext. 38979)




# A WOUNDED ASIAN TIGER

**December 4, 1997**

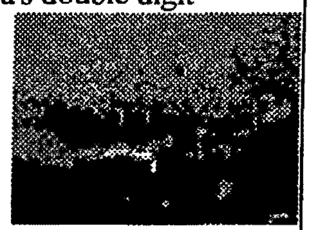
*NEWSHOUR TRANSCRIPT*

---

*With the recent currency crisis and instability in the Asian markets, the South Korean economy has fallen on hard times and just this week accepted a bail-out from the International Monetary Fund. Following a background report, Elizabeth Farnsworth explores the cause for the crisis, the recovery plan and what the future may hold for the country with four experts.*

---

ELIZABETH FARNSWORTH: South Korea's double digit economic growth of the 70's and 80's was known as the Miracle on the Han River, because much of the boom took place along that river in and near Seoul. It's the same river that refugees fled across in the early days of the Korean War as invading North Korean troops pushed South. The war left the capital city and the economy of South Korea in ruins, but rebuilding began as soon as fighting ended in 1953.



## The Miracle on the Han River.

The economy picked up steam in the 1960's, and then took off. By 1994 South Korea, with 43 million people, was the world's largest producer of home appliances, the second largest producer of semi-conductor chips, and the second largest ship builder, more semi-conductors by last year, Korea was the 11th largest economy in the world, as large

A RealAudio version of this segment is available.

**NEWSHOUR LINKS:**

***December 4, 1997:***
**A discussion of the bail-out plan for South Korea.**

***November 26, 1997:***
**What did the APEC summit accomplish?**

***November 25, 1997:***
**Asia's leaders search for answers at the APEC meeting in Vancouver.**

***November 24, 1997:***
**The APEC shows a grim economic forecast for Asia.**

***October 28, 1997:***
**The instability of Asian stocks causes worldwide fluctuations.**

as Thailand, Indonesia and Malaysia combined. Kim Hyung Won is a former ambassador to the U.S..

KIM KYUNG WON: Personally, looking back upon my own life, I feel as if I have lived through several centuries. Korean society went from the 18th century to the 21st century in a matter of three decades. Just, we jumped through history at a dizzying pace.

## The economic slow-down.

ELIZABETH FARNSWORTH: The dizzying pace slowed at the end of the 80's. Economic growth dropped from ten

percent or more a year to around 6 percent as Korea struggled to adapt to the rise of other Asian economies with lower labor and other costs. By the mid 90's--in the Southern Korean City of Pusan, only four Nike factories remained of the 16 that had in earlier years produced 2 million pairs of shoes per month. Nike, like many companies, has moved on to Vietnam and other low-wage Asian countries.

Other problems began to emerge from the close relationship among the government, banks and conglomerates known as "chaebol." These are the huge companies like, Daewoo, Hyundai, and Samsung that dominate Korea. Partly because of their clout, the government has been unwilling to open up the economy to much foreign competition. A visitor to Seoul sees almost no foreign cars, for example.

**_October 23, 1997:_**
**The Hong Kong stock market drops 10 percent.**

**_February 11, 1997:_**
**U.S. Ambassador James T. Laney discusses the labor strikes and rallies in South Korea.**

**_November 25, 1996:_**
**APEC agrees to eliminate tariffs on computers and telecommunications equipment.**

**_November 21, 1996_**
**A panel of experts discuss President Clinton's Asia-Pacific Tour.**

**_December 28, 1995:_**
**A report on the arrest of two former South Korean presidents and the bribery charges against the country's top business leaders.**

**Browse the NewsHour's coverage of Asia.**

**OUTSIDE LINKS**

**The homepage for the South Korean embassy in Washington, D.C.**

**The homepage for the International Monetary Fund.**

This year Korea's problems multiplied. Several conglomerates went bankrupt, leading to ballooning bad loans at the nation's banks, which then tightened credit, causing more failures. Seven chaebol have now sought protection from creditors. The situation was exacerbated by the currency slides and bank and business failures in southeast Asia--which had been a major market for Korean goods. At the Asia-Pacific Economic Cooperation Summit late last month, Korea's foreign minister explained his view of the crisis.

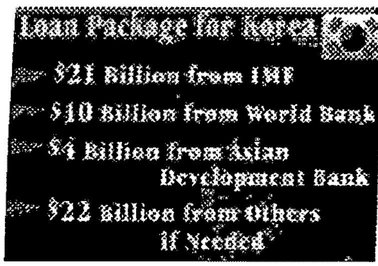
YOO CHUNG-HA, Foreign Minister, South Korea: I would like to emphasize that the current foreign exchange instability has been triggered by the cases of some insolvencies of large companies. I have emphasized within the APEC meeting that there is an essential health of the Korean economy. Now we have been taken, more or less, by surprise by the speculative winds, and we believe this is because of some contagion effect that's very much psychological.

## The bail-out plan.

ELIZABETH FARNSWORTH: In the past two and a half weeks, Korea's currency, the won, has lost nearly 30 percent of its value and the stock market has fallen to half its value two years ago and is now at its lowest level in more than 10 years. Two weeks ago President Kim Young Sam and other leaders said they would not seek help from the International Monetary Fund, which had just given large loans to Thailand and Indonesia. But last week, the government began negotiations with the fund, and yesterday a $57 billion agreement--the largest IMF loan package ever--was announced jointly by the IMF and the Korean Finance Minister.

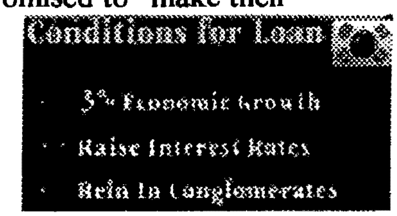
LIM CHANG-YUEL: (speaking through interpreter) Today's agreement will open a new door for the South Korean economy to enter into a new era.

MICHEL CAMDESSUS, Managing Director, IMF: I am confident that this program will also contribute to the needed return of stability and growth in the region.



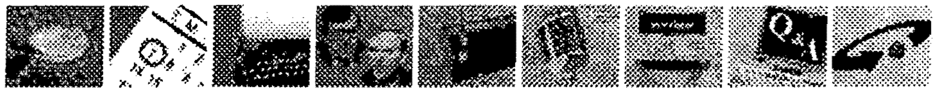

ELIZABETH FARNSWORTH: The loan deal, which must still be approved by the IMF board, reportedly includes $21 billion from the IMF; $10 billion from the World Bank; $4 billion from the Asian Development Bank; and, if necessary, $22 billion more from other countries, including the United States.

In return, Korea apparently agreed to target next year's economic growth rate at 3 percent, down from 6 percent this year; to raise interest rates, and to rein in the large conglomerates. Korea's finance minister promised to "make their management transparent and refrain from excessive borrowing." Yesterday, the Korean government also ordered nine merchant banks to suspend operations, giving them until March 1st to restructure their finances. Finance Minister Lim Chang Yuel told the Korean people he was sorry.




LIM CHANG-YUEL: (speaking through interpreter) I apologize on behalf of the staff of the finance ministry to the people. The conglomerates have declared bankruptcies due to the debts they acquired. And the financial sector has become inefficient and also heavily in debt. The currency crisis in the Southeast Asian countries led to our own foreign currency crisis. We did not respond wisely. I apologize for having to take the bailout package from the IMF.

ELIZABETH FARNSWORTH: The bailout package comes just two weeks before presidential elections in South Korea, the third since the end of military rule a decade ago.




|Search|Past Programs|Essays & Dialogues|Shields & Gigot|
|Letters|RealAudio|Off Camera|Forums|Home|

IMF

Dec 2, 97

Strictly Conf.

STRICTLY CONFIDENTIAL

May 20, 2019 T.F.

# KOREA

## Summary of the Economic Program

### Macroeconomic Policies

1. **Objectives**

The program is intended to narrow the external current account deficit to below 1 percent of GDP in 1998 and 1999, contain inflation at or below 5 percent, and—hoping for an early return of confidence—limit the deceleration in real GDP growth to about 3 percent in 1998, followed by a recovery toward potential in 1999.

2. **Monetary policy and exchange rate policy**

- To demonstrate to markets the authorities' resolve to confront the present crisis, monetary policy will be tightened immediately to restore and sustain calm in the markets and contain the impact of the recent won depreciation on inflation.
- In line with this policy, the large liquidity injection in recent days will be reversed, and money market rates, presently 14–16 percent, will be allowed to rise to a level that stabilizes markets.
- Money growth during 1998 will be limited to a rate consistent with containing inflation at 5 percent or less.
- A flexible exchange rate policy will be maintained, with intervention limited to smoothing operations.

3. **Fiscal policy**

- A tight fiscal policy will be maintained in 1998 to alleviate the burden on monetary policy and to provide for the still uncertain costs of restructuring the financial sector.
- The cyclical slowdown is projected to worsen the 1998 budget balance of the consolidated central government by about 0.8 percent of GDP. The present estimates of the interest costs of financial sector restructuring is 0.8 percent of GDP. Offsetting measures amounting to about 1.5 percent of GDP will be taken to achieve at a minimum budget balance and, preferably, a small surplus. This will be achieved by both revenue and expenditure measures to be determined shortly. These may include, among others:
    - increasing VAT coverage and removing exemptions;

- widening the corporate tax base by reducing exemptions and certain tax incentives;
- widening the income tax base by reducing exemptions and deductions;
- increasing excises, luxury taxes, and transportation tax;
- reducing current expenditures particularly support to the corporate sector; and
- reducing low priority capital expenditures.

**Financial Sector Restructuring**

1. The following financial sector reform bills submitted to the National Assembly will be passed before the end of the year:

- A revised Bank of Korea Act, which provides for central bank independence, with price stability as its main mandate.
- A bill to consolidate supervision of all banks, including specialized banks, merchant banks, securities firms, and insurance companies in an agency with operational and financial autonomy, and with all powers needed to deal effectively with troubled financial institutions.
- A bill requiring that corporate financial statements be prepared on a consolidated basis and be certified by external auditors.

2. **Restructuring and reform measures**

- Troubled financial institutions will be closed or if they are deemed viable, restructured and/or recapitalized. A credible and clearly defined exit strategy will include closures as well as mergers and acquisitions by domestic and foreign institutions, provided the viability of the new groupings is assured. Clear principles on sharing of losses among equity holders and creditors will be established.
- The disposal of nonperforming loans will be accelerated.
- The present blanket guarantees which will end in three years will be replaced by a limited deposit insurance scheme.
- A timetable will be established for all banks to meet or exceed Basle standards.
- Prudential standards will be upgraded to meet Basle core principles.

- Any support to financial institutions will be given on strict conditions.
- All support to financial institutions, other than BOK liquidity credits, will be provided according to pre-established rules, and recorded transparently.
- Accounting standards and disclosure rules will be strengthened to meet international practice. Financial statements of large financial institutions will be audited by internationally recognized firms.
- Manpower in the unit supervising merchant banks will be sufficiently increased to make supervision effective and to allow proper handling of troubled banks.
- The schedule for allowing foreign entry into the domestic financial sector will be accelerated, including allowing foreigners to establish bank subsidiaries and brokerage houses by mid-1998.
- Borrowing and lending activities of overseas' branches of Korean banks will be closely monitored to ensure that they are sound. Nonviable branches will be closed.
- BOK's international reserve management will be reviewed with the intention to bring it closer to international practice. Deposits with overseas branches of domestic banks will not be increased further, but gradually withdrawn as circumstances allow. Financial institutions will be encouraged to improve their risk assessment and pricing procedures, and to strengthen loan recovery; actions in these areas will be reviewed as part of prudential supervision.

**Other Structural Measures**

1. **Trade liberalization**

Timetables will be set, in compliance with the WTO commitments, at the time of the first review, to:

- eliminate trade-related subsidies;
- eliminate restrictive import licensing;
- eliminate the import diversification program; and
- streamline and improve the transparency of the import certification procedures.

## 2. Capital account liberalization

- The present timetable for capital account liberalization will be accelerated by taking steps to:
  - liberalize foreign investment in the Korean equity market by increasing the ceiling on aggregate ownership from 26 percent to 50 percent by end-1997 and to 55 percent by end-1998.
  - effective immediately, for foreign banks seeking to purchase equity in domestic banks in excess of the 4 percent limit requiring supervisory authority approval, the supervisory authority will allow such purchases provided that the acquisitions contribute to the efficiency and soundness of the banking sector; legislation will be submitted to the first special session of the National Assembly to harmonize the Korean regime on equity purchases with OECD practices (with due safeguards against abuse of dominant positions.)
  - allow foreign investors to purchase, without restriction, domestic money market instruments.
  - allow foreign investment, without restriction, in the domestic corporate bond market.
  - further reduce restrictions on foreign direct investment through simplification of procedures.
  - eliminate restrictions on foreign borrowings by corporations.

## 3. Corporate governance and corporate structure

- Timetable will be set by the time of the first review to improve the transparency of corporate balance sheets, including profit and loss accounts, by enforcing accounting standards in line with generally accepted accounting practices, including through:
  - independent external audits,
  - full disclosure, and
  - provision of consolidated statements for business conglomerates.
- The commercial orientation of bank lending will be fully respected, and the government will not intervene in bank management and lending decisions. Remaining

directed lending will be eliminated immediately. While policy lending (agriculture, small business, etc.) will be maintained, the interest subsidy will be borne by the budget.

- No government subsidized support or tax privileges will be provided to bail out individual corporations.

- The "real name" system in financial transactions will be maintained, although with some possible revisions.

- Measures will be worked out and implemented to reduce the high-debt-to-equity ratio of corporations, and capital markets will be developed to reduce the share of bank financing by corporations (these will be reviewed as part of the first program review).

- Measures will be worked out and implemented to change the system of mutual guarantees within conglomerates to reduce the risk it involves.

4. **Labor market reform**

- The capacity of the new Employment Insurance system will be strengthened to facilitate the redeployment of labor, in parallel with further steps to improve labor market flexibility.

5. **Information provision**

- There will be regular publication of data on foreign exchange reserves, including the composition of reserves and net forward position with a two weeks delay initially. Data on financial institutions, including nonperforming loans, capital adequacy, and ownership structures and affiliations will be published twice a year. Data on short-term external debt will be published quarterly.

Dec. 3, 97

Korea

STRICTLY CONFIDENTIAL

May 20, 2019 [illegible]

**Summary of the Economic Program**

**Macroeconomic Policies**

1. **Objectives**

The program is intended to narrow the external current account deficit to below 1 percent of GDP in 1998 and 1999, contain inflation at or below 5 percent, and—hoping for an early return of confidence—limit the deceleration in real GDP growth to about 3 percent in 1998, followed by a recovery toward potential in 1999.

2. **Monetary policy and exchange rate policy**

- To demonstrate to markets the authorities' resolve to confront the present crisis, monetary policy will be tightened immediately to restore and sustain calm in the markets and contain the impact of the recent won depreciation on inflation.

- In line with this policy, the large liquidity injection in recent days will be reversed, and money market rates, presently 14–16 percent, will be allowed to rise to a level that stabilizes markets.

- Money growth during 1998 will be limited to a rate consistent with containing inflation at 5 percent or less.

- A flexible exchange rate policy will be maintained, with intervention limited to smoothing operations.

3. **Fiscal policy**

- A tight fiscal policy will be maintained in 1998 to alleviate the burden on monetary policy and to provide for the still uncertain costs of restructuring the financial sector.

- The cyclical slowdown is projected to worsen the 1998 budget balance of the consolidated central government by about 0.8 percent of GDP. The present estimates of the interest costs of financial sector restructuring is 0.8 percent of GDP. Offsetting measures amounting to about 1.5 percent of GDP will be taken to achieve at a minimum budget balance and, preferably, a small surplus. This will be achieved by both revenue and expenditure measures to be determined shortly. These may include, among others:

- increasing VAT coverage and removing exemptions;
- widening the corporate tax base by reducing exemptions and certain tax incentives;
- widening the income tax base by reducing exemptions and deductions;
- increasing excises, luxury taxes, and transportation tax;
- reducing current expenditures particularly support to the corporate sector; and
- reducing low priority capital expenditures.

**Financial Sector Restructuring**

1. The following financial sector reform bills submitted to the National Assembly will be passed before the end of the year:

- A revised Bank of Korea Act, which provides for central bank independence, with price stability as its main mandate.
- A bill to consolidate supervision of all banks, including specialized banks, merchant banks, securities firms, and insurance companies in an agency with operational and financial autonomy, and with all powers needed to deal effectively with troubled financial institutions.
- A bill requiring that corporate financial statements be prepared on a consolidated basis and be certified by external auditors.

2. **Restructuring and reform measures**

- Troubled financial institutions will be closed or if they are deemed viable, restructured and/or recapitalized. A credible and clearly defined exit strategy will include closures as well as mergers and acquisitions by domestic and foreign institutions, provided the viability of the new groupings is assured. Clear principles on sharing of losses among equity holders and creditors will be established.
- The disposal of nonperforming loans will be accelerated.
- The present blanket guarantees which will end in three years will be replaced by a limited deposit insurance scheme.
- A timetable will be established for all banks to meet or exceed Basle standards.

- Prudential standards will be upgraded to meet Basle core principles.
- Any support to financial institutions will be given on strict conditions.
- All support to financial institutions, other than BOK liquidity credits, will be provided according to pre-established rules, and recorded transparently.
- Accounting standards and disclosure rules will be strengthened to meet international practice. Financial statements of large financial institutions will be audited by internationally recognized firms.
- Manpower in the unit supervising merchant banks will be sufficiently increased to make supervision effective and to allow proper handling of troubled banks.
- The schedule for allowing foreign entry into the domestic financial sector will be accelerated, including allowing foreigners to establish bank subsidiaries and brokerage houses by mid-1998.
- Borrowing and lending activities of overseas' branches of Korean banks will be closely monitored to ensure that they are sound. Nonviable branches will be closed.
- BOK's international reserve management will be reviewed with the intention to bring it closer to international practice. Deposits with overseas branches of domestic banks will not be increased further, but gradually withdrawn as circumstances allow. Financial institutions will be encouraged to improve their risk assessment and pricing procedures, and to strengthen loan recovery; actions in these areas will be reviewed as part of prudential supervision.

**Other Structural Measures**

1. **Trade liberalization**

Timetables will be set, in compliance with the WTO commitments, at the time of the first review, to:

- eliminate trade-related subsidies;
- eliminate restrictive import licensing;
- eliminate the import diversification program; and
- streamline and improve the transparency of the import certification procedures.

2. **Capital account liberalization**

- The present timetable for capital account liberalization will be accelerated by taking steps to:

  - liberalize foreign investment in the Korean equity market by increasing the ceiling on aggregate ownership from 26 percent to 50 percent by end-1997 and to 55 percent by end-1998.

  - effective immediately, for foreign banks seeking to purchase equity in domestic banks in excess of the 4 percent limit requiring supervisory authority approval, the supervisory authority will allow such purchases provided that the acquisitions contribute to the efficiency and soundness of the banking sector; legislation will be submitted to the first special session of the National Assembly to harmonize the Korean regime on equity purchases with OECD practices (with due safeguards against abuse of dominant positions.)

  - allow foreign investors to purchase, without restriction, domestic money market instruments.

  - allow foreign investment, without restriction, in the domestic corporate bond market.

  - further reduce restrictions on foreign direct investment through simplification of procedures.

  - eliminate restrictions on foreign borrowings by corporations.

3. **Corporate governance and corporate structure**

- Timetable will be set by the time of the first review to improve the transparency of corporate balance sheets, including profit and loss accounts, by enforcing accounting standards in line with generally accepted accounting practices, including through:

  - independent external audits,

  - full disclosure, and

  - provision of consolidated statements for business conglomerates.

- The commercial orientation of bank lending will be fully respected, and the government will not intervene in bank management and lending decisions. Remaining

directed lending will be eliminated immediately. While policy lending (agriculture, small business, etc.) will be maintained, the interest subsidy will be borne by the budget.

- No government subsidized support or tax privileges will be provided to bail out individual corporations.

- The "real name" system in financial transactions will be maintained, although with some possible revisions.

- Measures will be worked out and implemented to reduce the high-debt-to-equity ratio of corporations, and capital markets will be developed to reduce the share of bank financing by corporations (these will be reviewed as part of the first program review).

- Measures will be worked out and implemented to change the system of mutual guarantees within conglomerates to reduce the risk it involves.

4. **Labor market reform**

- The capacity of the new Employment Insurance system will be strengthened to facilitate the redeployment of labor, in parallel with further steps to improve labor market flexibility.

5. **Information provision**

- There will be regular publication of data on foreign exchange reserves, including the composition of reserves and net forward position with a two weeks delay initially. Data on financial institutions, including nonperforming loans, capital adequacy, and ownership structures and affiliations will be published twice a year. Data on short-term external debt will be published quarterly.

Dec. 4, 97

STRICTLY CONFIDENTIAL

May 20, 2019 AF.

# Korea

## Summary of the Economic Program

### Macroeconomic Policies

1. Objectives

The program is intended to narrow the external current account deficit to below 1 percent of GDP in 1998 and 1999, contain inflation at or below 5 percent, and—hoping for an early return of confidence—limit the deceleration in real GDP growth to about 3 percent in 1998, followed by a recovery toward potential in 1999.

2. Monetary policy and exchange rate policy

- To demonstrate to markets the authorities' resolve to confront the present crisis, monetary policy will be tightened immediately to restore and sustain calm in the markets and contain the impact of the recent won depreciation on inflation.
- In line with this policy, the large liquidity injection in recent days will be reversed, and money market rates, presently 14–16 percent, will be allowed to rise to a level that stabilizes markets.
- Money growth during 1998 will be limited to a rate consistent with containing inflation at 5 percent or less.
- A flexible exchange rate policy will be maintained, with intervention limited to smoothing operations.

3. Fiscal policy

- A tight fiscal policy will be maintained in 1998 to alleviate the burden on monetary policy and to provide for the still uncertain costs of restructuring the financial sector.
- The cyclical slowdown is projected to worsen the 1998 budget balance of the consolidated central government by about 0.8 percent of GDP. The present estimates of the interest costs of financial sector restructuring is 0.8 percent of GDP. Offsetting measures amounting to about 1.5 percent of GDP will be taken to achieve at a minimum budget balance and, preferably, a small surplus. This will be achieved by both revenue and expenditure measures to be determined shortly. These may include, among others:

- increasing VAT coverage and removing exemptions;

- widening the corporate tax base by reducing exemptions and certain tax incentives;

- widening the income tax base by reducing exemptions and deductions;

- increasing excises, luxury taxes, and transportation tax;

- reducing current expenditures particularly support to the corporate sector; and

- reducing low priority capital expenditures.

**Financial Sector Restructuring**

1. The following financial sector reform bills submitted to the National Assembly will be passed before the end of the year:

- A revised Bank of Korea Act, which provides for central bank independence, with price stability as its main mandate.

- A bill to consolidate supervision of all banks, including specialized banks, merchant banks, securities firms, and insurance companies in an agency with operational and financial autonomy, and with all powers needed to deal effectively with troubled financial institutions.

- A bill requiring that corporate financial statements be prepared on a consolidated basis and be certified by external auditors.

2. **Restructuring and reform measures**

- Troubled financial institutions will be closed or if they are deemed viable, restructured and/or recapitalized. A credible and clearly defined exit strategy will include closures as well as mergers and acquisitions by domestic and foreign institutions, provided the viability of the new groupings is assured. Clear principles on sharing of losses among equity holders and creditors will be established.

- The disposal of nonperforming loans will be accelerated.

- The present blanket guarantees which will end in three years will be replaced by a limited deposit insurance scheme.

- A timetable will be established for all banks to meet or exceed Basle standards.

- Prudential standards will be upgraded to meet Basle core principles.
- Any support to financial institutions will be given on strict conditions.
- All support to financial institutions, other than BOK liquidity credits, will be provided according to pre established rules, and recorded transparently
- Accounting standards and disclosure rules will be strengthened to meet international practice. Financial statements of large financial institutions will be audited by internationally recognized firms.
- Manpower in the unit supervising merchant banks will be sufficiently increased to make supervision effective and to allow proper handling of troubled banks.
- The schedule for allowing foreign entry into the domestic financial sector will be accelerated, including allowing foreigners to establish bank subsidiaries and brokerage houses by mid-1998.
- Borrowing and lending activities of overseas' branches of Korean banks will be closely monitored to ensure that they are sound. Nonviable branches will be closed.
- BOK's international reserve management will be reviewed with the intention to bring it closer to international practice. Deposits with overseas branches of domestic banks will not be increased further, but gradually withdrawn as circumstances allow. Financial institutions will be encouraged to improve their risk assessment and pricing procedures, and to strengthen loan recovery; actions in these areas will be reviewed as part of prudential supervision.

**Other Structural Measures**

**1. Trade liberalization**

Timetables will be set, in compliance with the WTO commitments, at the time of the first review, to:

- eliminate trade-related subsidies;
- eliminate restrictive import licensing;
- eliminate the import diversification program, and
- streamline and improve the transparency of the import certification procedures.

2. **Capital account liberalization**

- The present timetable for capital account liberalization will be accelerated by taking steps to:

  - liberalize foreign investment in the Korean equity market by increasing the ceiling on aggregate ownership from 26 percent to 50 percent by end-1997 and to 55 percent by end-1998.

  - effective immediately, for foreign banks seeking to purchase equity in domestic banks in excess of the 4 percent limit requiring supervisory authority approval, the supervisory authority will allow such purchases provided that the acquisitions contribute to the efficiency and soundness of the banking sector; legislation will be submitted to the first special session of the National Assembly to harmonize the Korean regime on equity purchases with OECD practices (with due safeguards against abuse of dominant positions.)

  - allow foreign investors to purchase, without restriction, domestic money market instruments.

  - allow foreign investment, without restriction, in the domestic corporate bond market.

  - further reduce restrictions on foreign direct investment through simplification of procedures.

  - eliminate restrictions on foreign borrowings by corporations.

3. **Corporate governance and corporate structure**

- Timetable will be set by the time of the first review to improve the transparency of corporate balance sheets, including profit and loss accounts, by enforcing accounting standards in line with generally accepted accounting practices, including through:

  - independent external audits,

  - full disclosure, and

  - provision of consolidated statements for business conglomerates.

- The commercial orientation of bank lending will be fully respected, and the government will not intervene in bank management and lending decisions. Remaining

directed lending will be eliminated immediately. While policy lending (agriculture, small business, etc.) will be maintained, the interest subsidy will be borne by the budget.

- No government subsidized support or tax privileges will be provided to bail out individual corporations
- The "real name" system in financial transactions will be maintained, although with some possible revisions.
- Measures will be worked out and implemented to reduce the high-debt-to-equity ratio of corporations, and capital markets will be developed to reduce the share of bank financing by corporations (these will be reviewed as part of the first program review).
- Measures will be worked out and implemented to change the system of mutual guarantees within conglomerates to reduce the risk it involves.

4 **Labor market reform**

- The capacity of the new Employment Insurance system will be strengthened to facilitate the redeployment of labor, in parallel with further steps to improve labor market flexibility.

5. **Information provision**

- There will be regular publication of data on foreign exchange reserves, including the composition of reserves and net forward position with a two weeks delay initially. Data on financial institutions, including nonperforming loans, capital adequacy, and ownership structures and affiliations will be published twice a year. Data on short-term external debt will be published quarterly.

Mr. Aghevli S.O.S!

Thanks for your help. Wanda

Dec 4, 97

**STRICTLY CONFIDENTIAL**

May 20, 2019 TF.

Korea' policy package has been formulated in the context of an urgent need to deal with a financial crisis. The rapid deterioration of confidence, while partly attributable to the contagion effects of developments in Southeast Asia, fundamentally reflected structural weaknesses in Korea's corporate and financial sectors and the authorities' inability to take early and decisive action. Moreover, the lack of transparency, particularly regarding data on international reserves and short-term debt, hampered effective surveillance. Thus, the current situation is a crisis that might have been adverted.

In the staff's view, the government's comprehensive policy package represents a welcome and much needed policy response to address market concerns. The bold actions that have already been taken provides a good basis for the early return of confidence. Sustaining a tighter macroeconomic stance in the immediate period ahead should be a priority to restore calm to markets and provide the macroeconomic conditions to support comprehensive structural reforms. It would also be important for the political leaders, who have pledged their support for the policy package, to garner public support and foster ownership of the program.

Tighter monetary policy at this juncture is particularly important to help stabilize the won and achieve a smooth adjustment of the current account. Interest rates and exchange rates will need to be continuously monitored to ensure that the program's objectives are not undermined by a premature easing of monetary policy. The program contains safeguards and biweekly reviews to secure an effective monetary policy. A prudent fiscal policy should be maintained to alleviate the burden on monetary policy and to provide for the still uncertain costs of restructuring the financial sector. Some upfront measures have been taken, but it would be important to follow through in implementing the other needed adjustments.

A comprehensive strategy to restructure the financial sector is a centerpiece of the program. A number of bold action has been taken to address insolvent institutions. Prompt implementation of an orderly exit strategy for banks, opening the financial sector to foreign investment, improving supervisory and regulatory standards, increased transparency, and eliminating government interference in bank management and lending decisions should lay the basis for a sound financial system. It would also to important to follow through to enact the legislation necessary to establish an independent central bank and a consolidated and autonomous supervisory authority. The Bank of Korea's reserve management practices and internal controls as well as monitoring the borrowing of overseas branches of domestic financial institutions need to be strengthened substantially.

Significant liberalization of the capital account is envisaged under the program, and up front action on several key areas have been implemented, notably in the financial sector and foreign investment in equity markets. It would be important to follow through on the government's policy commitments to accelerate liberalization in the other areas.

The recent experience has demonstrated the importance of transparency of economic information for effective surveillance and maintaining market confidence. It would be important to move ahead with the timely publication of information on foreign exchange reserves, composition of reserves and net forward position, short term debt, and conditions of financial situation.

In the present environment of financial market turbulence and political uncertainty, there are clear risks to the realization of the program's objectives. The authorities have taken difficult measures, but need to sustain implementation of their policy commitments. Any policy slippage could weaken market sentiment further, compound short-term rollover problems, and worsen an already critical situation. The present comprehensive reform and liberalization program represents a strong beginning, but its strict and sustained implement will be key to building the financial and corporate sectors that are needed for Korea to meet the challenges of globalization.

There is an urgent need to improve corporate governance and the corporate structure.. The program's initial focus is on improving transparency,

cc: FOSS
DIV. 5

INTERNATIONAL MONETARY FUND
WASHINGTON, D.C. 20431

FIRST DEPUTY MANAGING DIRECTOR

CABLE ADDRESS
INTERFUND

December 3 1997

The Honorable Kyung-shik Lee
Governor
The Bank of Korea
110, 3–GA Namdaemun-Ro
Jung-Gu
Seoul, 100-794
Republic of Korea

Dear Governor Lee:

I would like to thank you for meeting with me during my brief visit to Korea last week, and for the very productive discussions we held. I would like to thank you also for the kindness extended to me by Mr. Shin and your staff in helping make the arrangements for the trip, despite the difficult circumstances.

We in the IMF look forward to cooperating closely with the Government and the Bank of Korea in the coming months, as we endeavor to help you in dealing with the recent economic difficulties. I know your determination to again put the Korean economy on the right track, and can assure you we will do everything we can to help.

With thanks and best personal regards

Yours sincerely

Stanley Fischer

Stanley Fischer

ASIA/PACIFIC

3 DEC 97 4:30

**From:** Peter Heller
**To:** hneiss,baghevli
**Date:** 12/4/97 5:48pm
**Subject:** Korean Corporate Governance -Forwarded

Concerning the earlier request for possible assistance in the governance sphere, I pass this on for your consideration.

MAE

**From:** Emil Sunley
**To:** Pheller
**Date:** 12/4/97 12:39pm
**Subject:** Korean Corporate Governance

In my previous incarnation at Deloitte & Touche, I worked closely with Sung-il Chris Park, the U.S. audit partner (for over 20 years) who heads the Korean practice for the U.S. firm. Our colleagues in the Asian Department, I believe, would benefit from meeting with Mr. Park, who goes to Korea every month and is fully knowlegeable about the weakness of the accounting standards and profession in Korea. He would have useful insights on what will be needed to achieve significant reforms. Mr. Park is a naturalized U.S. citizen, trained at Seoul University, the University of Wyoming and the University of Michigan.

I would be most pleased to arrange for him to come down from New York for a morning or a day.

**CC:** Vsummers, LEbrill

cc: FG
WH
JH
DMW

# Office Memorandum

01290I

To: Mr. Fischer                                                     December 3, 1997

From: Bijan B. Aghevli

Subject: **Korea**

I am attaching the side-letter on prior actions which has just arrived. The Letter of Intent is on its way and we will circulate it as soon as we have it.

Attachment

cc: Messrs. Mussa, Boorman, Gianviti, Guitian, Munzberg, Williams, Ferran

**WITHDRAWAL NOTICE**

THIS DOCUMENT IS IN THE COURSE OF A PUBLIC DISCLOSURE REVIEW PROCESS

| | |
|---|---|
| **Department/Division/ Collection:** | Asia and Pacific Department Records |
| **Series/Subseries:** | Asian and Pacific Department Director's Office Files - Asian Crisis |
| **Box number:** | A8-047 |
| **File number:** | 6 |
| **ADLIB ref. number:** | 430 |
| **File title & dates:** | Republic of Korea - Chronological files, December 1997 |
| **Doc. title & dates:** | Letter to Mr. Michel Camdessus from Mr. Chang Yuel Lim - Prior Actions, December 3, 1997 |
| **Doc. Classification:** | SECRET |

**STRICTLY CONFIDENTIAL**

May 20, 2019 T.F.

Seoul, Korea
December 3, 1997

Mr. Michel Camdessus
Managing Director
International Monetary Fund
Washington, D.C.

Dear Mr. Camdessus:

1. The attached Memorandum on the Economic Program outlines the policies that Korea intends to implement over the next three years to address the fundamental causes of its current financial difficulties, thereby restoring and sustaining market confidence and returning the economy to a path of strong sustainable growth. In support of this program, Korea hereby requests a three-year stand-by arrangement from the International Monetary Fund in an amount equivalent to SDR 15.5 billion.

2. As the circumstances did not permit a full specification of the program, the government has implemented strong prior actions to demonstrate its seriousness to strictly implement its policy commitments. A full specification of the program will be put together with the assistance of an IMF team. The program will be reviewed by the Executive Board in January 1998. This review will expand the scope of performance criteria, set performance criteria for March and June 1998, and set structural benchmarks. The main focus of the four additional quarterly reviews (in February, April, July, and November) during the first year of the program will also be determined at that time. The review under the emergency procedures will be combined with the first review under the arrangement in January 1998. There will be semi-annual reviews in 1999 and 2000.

3. We believe that the policies outlined in the attached Memorandum will serve to quickly restore market confidence. We are putting in place a comprehensive policy package to deal with insolvent and weakened financial institutions, to further liberalize the Korean economy, and to improve corporate governance. These reforms will be supported by prudent monetary and fiscal policies.

4. Accordingly, in the event the situation stabilizes, as we expect it will, Korea intends to forego some of the subsequent purchases and make advance repurchases as soon as conditions permit. Furthermore, the Korean authorities are aware that a new facility, called for at the Manila summit of Asian Finance and Central Bank Deputies, on November 19, for the provision of short-term financing to augment a stand-by arrangement, is being prepared for consideration by the Executive Board of the International Monetary Fund. As soon as such a facility becomes available to members, Korea intends to request that its stand-by arrangement be amended so as to permit the associated resources remaining to be purchased to come both

from the credit tranches and from the facility, in a manner consistent with the purposes and modalities of the facility.

5. The Korean government is firmly committed to implement the policies outlined in the attached memorandum and will ensure that the policies are adequate to achieve the objectives of the program. The Korean government remains firmly committed to take any additional measures that may be necessary for this purpose. During the period of the proposed stand-by arrangement and thereafter, Korea will consult with the Managing Director of the Fund on the adoption of any measures that may be appropriate, at the initiative of either the Korean authorities or the Managing Director, in accordance with the Fund's policies on such consultations. We will also provide the Fund with such information that it requests on the progress made in policy implementation and achievement of program objectives.

Yours sincerely,

Kyung-shik Lee
Governor
Bank of Korea

임창열

Chang-yuel Lim
Deputy Prime Minister and
Minister of Finance and Economy

12-03 15:36 WED FROM:INTL RELATIONS OFFIC 8227595826 TO:12026234661 4-320 PAGE:01

ORIG: TRE

CC: MR. G.F. TAYLOR

APD

cc: FOSS

# THE BANK OF KOREA

110, 3-Ga, Namdaemun-Ro, Jung-Gu, Seoul 100-794, Korea
(Telephone: 82-2-759-5695<office>, 82-2-514-4871<home>)

## Facsimile Transmittal Form

| | | |
|---|---|---|
| Date: | December 3, 1997 | (Total Pages: 1) |
| To: | Mr. Klaus Boese<br>Deputy Chief of Operations Division<br>International Monetary Fund | (Fax No: 202-623-4661) |
| From: | Hyunchul Shin<br>Director<br>International Relations Office<br>The Bank of Korea | (Fax No: 82-2-759-5826) |

STRICTLY CONFIDENTIAL
May 20, 2019 TF.

Further to my colleague's telephone conversation with you last night, I would like to confirm the following matters related to the stand-by credit to be extended to Korea.

1. On what day will the Bank of Korea be able to make the first purchase from the IMF under the stand-by arrangement? Is it the same day as that of the Executive Board meeting or the following day?

2. If the Bank of Korea is able to make the first purchase immediately after the Executive Board meeting, what measures should be taken in advance on our part? Do we have to send the request form for the purchase prior to the Executive Board meeting? If so, we would appreciate it if you could send us the request form as soon as possible so that we may fill in the details and send it to you by the time you designate.

3. What amount is available for the first purchase under the stand-by arrangement and what percentage is it out of the total amount of the stand-by arrangement?

4. If we make the first purchase in U.S. dollars, what day's U.S. dollar/SDR rate is applied? And what day's Korean won/SDR rate is applied for our bank's crediting to the Fund's No.1 account with us?

I look forward to hearing from you as soon as possible, and send my sincere regards.

DECLASSIFIED
By ___ Date 11/26/19

Hyunchul Shin

D:\97[illegible].hwp (Dec.03/97, 14:10)

97 DEC -3 AM 7:31 045602

IMF EV
RECEIVED

**KOREA**

**1997**

Dec. 3

The IMF notes the successful conclusion of staff discussions with the Korean authorities and the pledges of support coming from the World Bank, ADB, and countries in the group of potential participants in the supplemental financing support package for Korea.

Dec. 4

The Board approves and SDR 15.5 billion Stand-By Arrangement for Korea and releases a disbursement of SDR 4.1 billion.

INTERNATIONAL MONETARY FUND
WASHINGTON, D.C. 20431

cc: FOSS
DIV. 5

FIRST DEPUTY MANAGING DIRECTOR

CABLE ADDRESS
INTERFUND

ASIA/PACIFIC

4 DEC 97 8:52

December 3 1997

The Honorable Chang-yuel Lim
Minister of Finance and Economy
Ministry of Finance and Economy
Government Building No. 2
Kwacheon, Kyunggi-Do, 171-11
Seoul
Republic of Korea

Dear Mr. Lim:

I would like to thank you for the two meetings we held during my brief visit to Korea last week, and for the frank and intensive discussions we held. Of course, much has happened since then, and I know under what enormous pressure you have been operating. It must have been one of the most difficult and critical responsibilities that has been placed on a Korean policymaker ever; I believe history will record your role with gratitude.

We in the IMF look forward to cooperating closely with the Government of Korea in the coming months and perhaps years. I know your determination to again put the Korean economy on the right track, and I know how much work and dedication that will demand. I can assure you we will do everything we can to help.

With thanks and best personal regards

Yours sincerely

Stanley Fischer

Stanley Fischer

HN

INTERNATIONAL MONETARY FUND
WASHINGTON, D.C. 20431

FIRST DEPUTY MANAGING DIRECTOR

DECLASSIFIED
By ____ Date 11/26/19

CABLE ADDRESS
INTERFUND

December 2 1997

**STRICTLY CONFIDENTIAL**

May 20, 2019

Honorable Peter Costello
Department of the Treasury
Parkes Place
Canberra, ACT 2600
Australia

Dear Peter:

We are very close to agreeing a package of measures with the Korean authorities which the Managing Director will recommend to the IMF Executive Board for approval.

I understand that you discussed with the Managing Director whether Australia would be willing to assist Korea financially, contingent upon such an outcome. The Managing Director said he would regard this as a most constructive development.

ASIA/PACIFIC—

3 DEC 97 9:40

Several other countries in Asia, North America and Europe, who feel a close relationship with Korea have also indicated a willingness to assist should supplementary financing be required. As soon as the Managing Director is in a position to do so, he intends to issue a public statement incorporating this wording:

"....a number of important economies (including at this stage Australia, Canada, France, Germany, Italy, Japan, the United Kingdom and the United States) have indicated that, in the event that unanticipated adverse external circumstances create the need for additional resources to supplement Korea's reserves and resources made available by the IMF and other international financial institutions, they would be prepared to consider making available supplemental financing in support of Korea's program with the IMF. This second line of defense is expected to total at least US$[20] billion."

In the statement, it would be useful to have a broad understanding and consistency among participating countries and with the IMF in their public statements about their financial commitments. This is why the Managing Director would appreciate your confirmation that we may include Australia in the list of countries. Furthermore, and while we could perfectly well go along with an unquantified statement of yours, this being a matter for you, an amount of up to $1 billion from Australia would be a valuable contribution to this supplementary financing arrangement.

Sincerely yours

Stan Fischer

Stanley Fischer
Acting Managing Director

CC: mission members

Dec. 2/97

Hubert/Wanda

1. I am attaching a chart which Jack keeps showing to indicate how sharply interest rates have declined in Korea. Please reconcile why the rates on his chart show a different picture than the ones we use, and why is it that the rates we look at are a better indicator of monetary conditions. Also, how is the commitment that short term interest rates would be raised by 4 percentage points be translated within the next two days. There is a great deal of tension over this issue and Fisher is pressed by Jack to ask the MD not to conclude unless interest rates actually rise by the agreed amount.

2. I am also attaching a note and tables prepared by PDR providing the portfolio of short term debt repayments. Please confirm that this analysis is correct. It shows a very gloomy picture.

We have a meeting at 11:00 a.m. and I would appreciate it if Wanda will call me back by no later than 10:45 a.m. my time. Sorry for this but you can imagine how difficult it is at this end as well, albeit nothing like your end.

Regards

**STRICTLY CONFIDENTIAL**

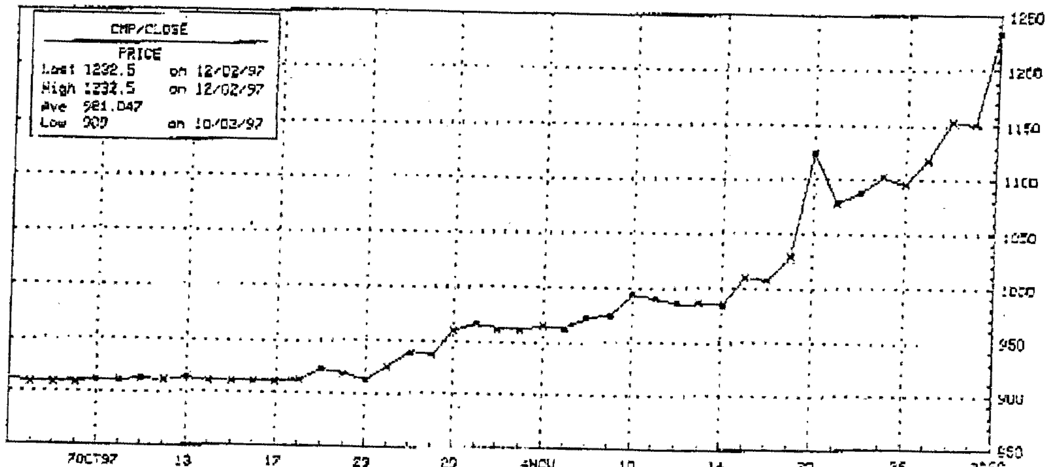
May 20, 2019 DF.

Bijan

KRW ↓1232.5 +81.0 1230.0/1235.0 Curncy GP
At 03:09 Op 1187.5 Hi 1267.5 Lo 1187.5 1230.0

## LINE GRAPH for KRW SOUTH KOREAN WON SPOT

RANGE 10/ 1/97 TO 12/ 2/97 PERIOD D (D-W-M-Q-Y)
1(1=PRICE,2=US$/WN)

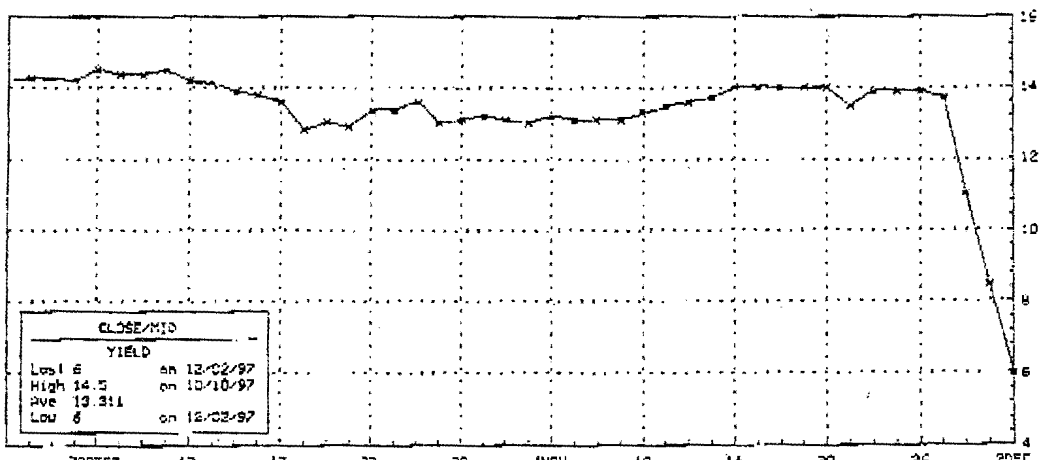





12 DG37 Index GP

## LINE GRAPH for KOREAN WON O/N RATE

RANGE 10/ 1/97 TO 12/ 2/97 PERIOD D (D-W-M-Q-Y)

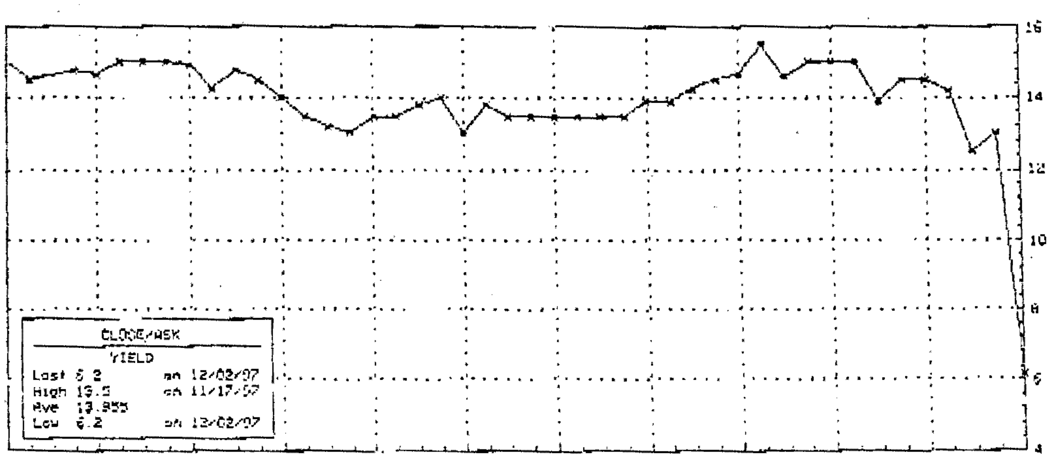





12 DG37 Index GP

## LINE GRAPH for SEOUL INTERBANK 15 DAYS

RANGE 10/ 1/97 TO 12/ 2/97 PERIOD D (D-W-M-Q-Y)

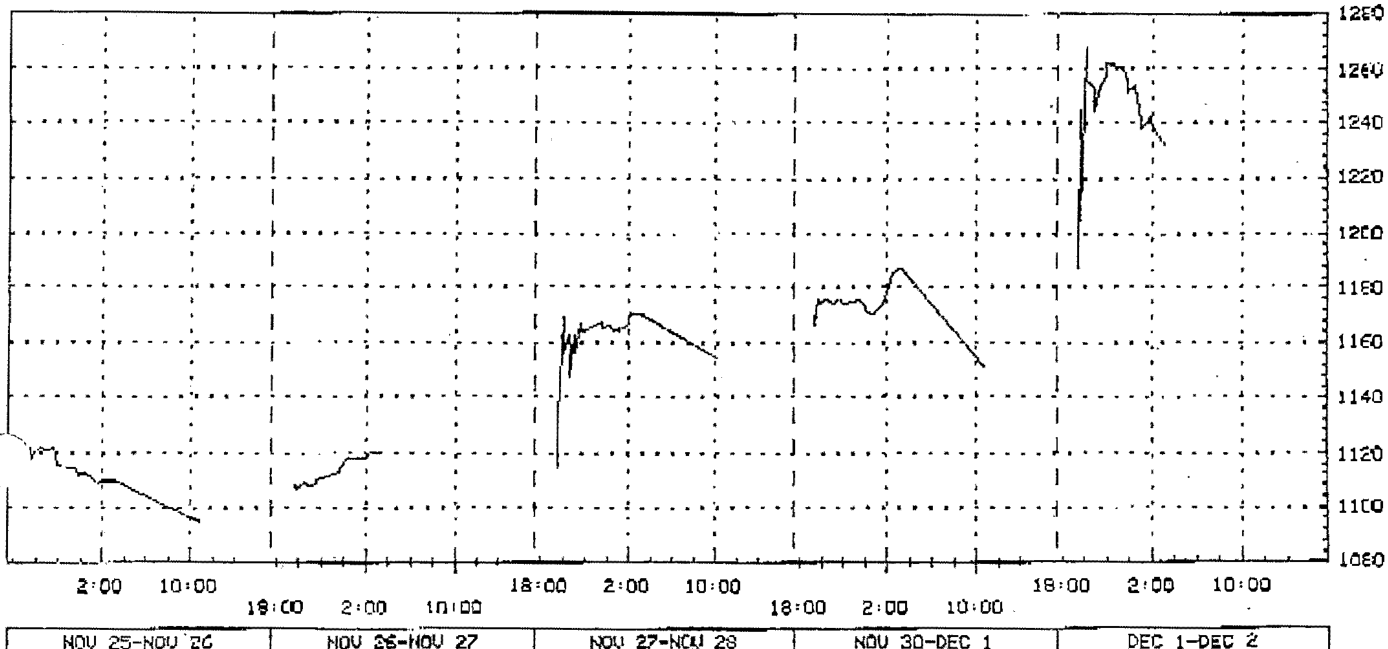


Curncy GIP

Monitoring enabled.

5-DAY CHART KRW SOUTH KOREAN WON SPOT - CMP 17:30 To 17:29 8:17

Hi 1267.5 Lo 1187.5 Op 1187.5 #Ticks 103 3:09 ↓ 1232.5 +81.0



This was agreed at Headquarters on basis of the attached note which is with the mission - assumptions made by Headquarters staff

**Korea—Short-Term Debt**

General considerations:

- on the creditor side, we do not have a breakdown between banks and nonbanks. Generally, it may be easier to arrange a rollover of claims held by foreign banks (since bank lending tends to be based more on relations with the debtor), but the willingness of such banks to roll over may be affected by a tightening of provisioning requirements against lending to Korea in their country of residence. Willingness to roll over loans to weak institutions will be affected by the extent to which markets believe there will be a further round of bank closures and the way in which the creditors of suspended institutions were treated.
- even if creditors were willing to roll over, all Korean agents (bank and nonbank) can be assumed to have become more averse to exchange risk. This will lead to a decline in the demand for foreign currency borrowing, regardless of the supply.
- also, short-term debt appears to be rather spread out among creditors (at least judging by the country distribution) making a "rush for the exit" more likely.

Maturities:

Current estimates are that US$30 b (over one quarter of the total) falls due in December (this seems very large), US$15 b in Q1 1998, US$10 b in Q2 1998—i.e., a total of US$55 b over the next seven months. One survey (which is being questioned) suggests that US$16 b of the amount outstanding at end-September has already been repaid in Oct-Nov.

1. **Foreign borrowing of domestic banks and of foreign branches and affiliates of domestic financial institutions**

Outstanding at end-Sept: US$61 b
(US$26 b by domestic banks, + US$11 b "offshore banking of domestic financial institutions", +US$24 b by foreign branches and affiliates of domestic financial institutions)[1]

Risk of withdrawal: This lending is likely to be affected by an increase in perceived risk of lending to Korean organizations. Also, the general considerations above apply.

Assumed outflows:

- The authorities are assuming 70 percent in the present environment.
- This seems reasonable in the current environment.
- This might fall to, say, 30 percent with a credible package.

---

[1]Not entirely clear where borrowing by foreign affiliates and on-lent to domestic banks is classified, but assume there is no double-counting and that foreign affiliates are subject to the same pressures as domestic banks.

2. **Branches of foreign banks**

Outstanding at end-Sept. 1997: US$14 b

Risk of withdrawal: It can perhaps be assumed that parent banks will not press for repayment if their branches are in difficulties. However, the general considerations above apply.

Assumed outflows:

- The authorities are assuming "no jeopardy of default", ie (presumably) currently no withdrawals.
- This is perhaps overoptimistic in light of the general considerations noted above. Assume current outflows of 20 percent.
- These could fall to, say, 5 percent with a credible package.

3. **Resident private sector**

Outstanding at end-Sept. 1997: US$26 b

Risk of withdrawal: The authorities believe that this debt is largely trade-related and likely to be rolled over relatively automatically. The latter would be true for financially strong institutions, but may not be true for all. The general considerations apply for non-trade-related debt.

Assumed outflows:

- The authorities are probably assuming none (because of the trade-related nature).
- Assuming most but not all of this is trade-related, assume 20 percent in the current environment.
- This might fall to 5 percent with a credible package.

4. **Nonresident Korean corporations**

Outstanding at end-Sept. 1997: US$24 b

Risk of withdrawal and consequences:[2] To the extent that these companies are financially separate from their parent and that such separation holds in times of stress (and that both of these things are also perceived to be true), the ability of these companies to roll over their debt should be broadly unaffected. If it is affected, it can perhaps be assumed that these companies will turn to the financial market in their country of residence (simply paying higher interest rates), or that the parent company will allow them to struggle/go under.

---

[2]We assume that to the extent that any of this lending was intermediated to Korean resident corporations, it is captured under 3 above. If it is not, the amount outstanding and the implications of the assumed withdrawal rate under 3 above would be worse.

Assumed outflows: None.

**In sum**

In the present environment, we get the following estimates for outflows over the year beginning Oct. 1:

- Authorities, in the present environment: a weighted average of 42 percent. For the year Oct 1997-Sept 1998, this would amount to US$43 b. This is broadly consistent with their estimate that US$17 b out of a total of US$30 b will be repaid in December, but difficult (but not impossible, given the apparent high seasonality) to mesh with their estimate that US$16 b was already repaid by end-November.
- Our estimate in the present environment: a weighted average of 50 percent (US$51 billion for the year Oct 1997-Sept 1998). This may be more in line with what appears to have happened so far—though again the seasonality is unclear, and the data are questionable.
- All in all, 40-50 percent may be a reasonable estimate of withdrawals in the current environment.
- Our estimate, with a credible package: 20 percent. If the maturities quoted above are right, this would translate into US$6 b in Dec (if a package is adopted quickly), US$3 b in Q1, US$2 b in Q2. This would mean a total of US$11 b through mid-1998, on top of what has been repaid so far (a possible US$16 b in Oct-Nov).

**WITHDRAWAL NOTICE**

THIS DOCUMENT IS IN THE COURSE OF A PUBLIC DISCLOSURE REVIEW PROCESS

| | |
|---|---|
| **Department/Division/ Collection:** | Asia and Pacific Department Records |
| **Series/Subseries:** | Asian and Pacific Department Director's Office Files - Asian Crisis |
| **Box number:** | A8-047 |
| **File number:** | 6 |
| **ADLIB ref. number:** | 430 |
| **File title & dates:** | Republic of Korea - Chronological files, December 1997 |
| **Doc. title & dates:** | Korean Loan, Memo from Stanley Fischer to the Managing Director - Korean Loan, December 2, 1997 |
| **Doc. Classification:** | Strictly Confidential |

**STRICTLY CONFIDENTIAL**

Dec 2, 97 HN

May 20, 2019 TF.

**Implications of closures of the merchant banks for the financial and the real sector**

- Large exposure of commercial banks to merchant banks.

  As of end-September 1997, commercial banks' (including their trust accounts) claims on merchant banks amount to 14.6 trillion won.[1] The largest 8 banks account for 77 percent of this exposure.

  3 of the largest 8 banks, Chohung, Korea First and Seoul, each have an exposure to the merchant banks amounting to 10-12 percent of their total assets. As Korea First and Seoul banks are already in "distress" closing of merchant banks may have implications depending on the burden-sharing between different creditors. However, this is no argument for not closing the merchant banks as delaying their closure will further increase the eventual costs.

  Also, these numbers reflect the exposure of commercial banks to **all** merchant banks (I have requested information on their exposure to specific merchant banks).

- Large off-balance sheet exposures of the merchant banks

  Commercial paper (promissory notes) sold by merchant banks amount to about 67 trillion won. The merchant banks report to the MOFE that about 7 trillion of these CP are guaranteed. However, the MOFE has information that the amount guaranteed is actually much larger; the Korean Institute of Finance estimates that the CP guaranteed by merchant banks are about 60 trillion won which is basically 90 percent of total CP sold by merchant banks. CP sold by the 12 technically insolvent institutions amount to about 46 trillion won.

  The Korean authorities claim that trust accounts of commercial banks are the holders of most of these CP and that closing of merchant banks may lead to instability in the financial markets as the holders of the trust accounts will move their money out of these accounts. First of all, under the amended deposit insurance act the trust accounts are insured. Second, the initial claim is under the issuer (that is the enterprise issuing the CP) and not all of them ~~are bankrupt, i.e. they will honor their~~ debt.

DECLASSIFIED

By [signature] Date 11/26/19

[1] These claims include loans, call loans, deposit placements, securities holdings and guarantees.

- Merchant banks provide funding to small and medium-size enterprises which do not have access to commercial bank funding due to lack of collateral. Closure of some merchant banks may affect some of these enterprises if they are unable to shift their business to the surviving merchant banks. This may arise as surviving merchant banks may have difficulty raising funds due to the uncertainty about their own future (asymmetric information argument; public does not know which banks are solvent and which ones are not). Also the surviving merchant banks may be more "cautious" in extending loans (credit crunch argument). To the extent that the "orphaned" enterprises are current in servicing their debt it will be easier to get funding from other sources.

**WITHDRAWAL NOTICE**
THIS DOCUMENT IS IN THE COURSE OF A PUBLIC DISCLOSURE REVIEW PROCESS

| | |
|---|---|
| **Department/Division/ Collection:** | Asia and Pacific Department Records |
| **Series/Subseries:** | Asian and Pacific Department Director's Office Files - Asian Crisis |
| **Box number:** | A8-047 |
| **File number:** | 6 |
| **ADLIB ref. number:** | 430 |
| **File title & dates:** | Republic of Korea - Chronological files, December 1997 |
| **Doc. title & dates:** | Email from Bijan to Hubert/Wanda on the Note that Stan had mentioned, December 2, 1997 |
| **Doc. Classification:** | Strictly Confidential |

**From:** Sylvie Durand-Jansiac
**To:** Korea
**Date:** 12/2/97 5:33pm
**Subject:** **Possible Restricted Informal Meeting tomorrow morning, 12/3/97 -- 9:00 a.m.**

As announced today by Mr. Fischer, there may be a **restricted informal meeting** at **9:00 a.m.** tomorrow, **Wednesday, December 3, 1997** in room **2:530** on Korea. It is hoped to arrange a video conference with the Managing Director. If that is not possible, an arrangement will be made for an audio conference. Please limit attendance to **one** person per office. Please submit the names of staff who will be attending by e-mail to SdurandJansiac or Sriyait. Please be advised that staff whose names are not on the approved attendance list will not be admitted.

This meeting is subject to confirmation at **8:30 a.m.** tomorrow.

**CC:** SECAI, SECDO, SECEB

BBA
AS
CA

HN

CC: msn memb

# *Office Memorandum*

**STRICTLY CONFIDENTIAL**

May 20, 2019 TF.

To: Mr. Aghevli

December 2, 1997

From: J. Ferran for JF

Subject: **Korea**

The attached table suggests a phasing for disbursements under the arrangement--which would tranche the first three purchases on a roughly two weekly basis. For each disbursement we have suggested some conditionality based on our impression of the intentions expressed in the documents we have seen at Headquarters. It is for the mission to decide if conditions associated with each purchase are appropriate--both as to content and timing.

We would leave it to the mission to decide the specific conditionalities along with the authorities. The aim, however, is to have a process which helps to ensure rapid progress in implementing the measures that are promised in the letter of intent.

~~Faxed~~
Dec 2, 97

**DECLASSIFIED**

By [signature] Date 11/26/19

**STRICTLY CONFIDENTIAL**

May 20, 2019 DF

Wanda,

I am confused: the reserve table gives the last number for thursday Dec 11, i.e. yesterday

Your note on "FX market today" refers to today (Dec 12)

how are these numbers to be reconciled?

the 180 + 100 are to be deducted from 9.3 yesterday so usable res are 8.9 today?!

NN

cc: BBA.

# *Office Memorandum*

To: The Managing Director

From: Stanley Fischer SF

Subject: **Attached**

**STRICTLY CONFIDENTIAL**

May 20, 2019 TF.

December 1, 1997

Attached are two memos as requested, one on what now seem to be the critical issues in the negotiation, the other the list of measures that should be passed if the National Assembly were called into session.

I understand from Mr. Neiss that Mr. Lim has called on him to continue negotiations. He has agreed to do so, with the goal of narrowing differences, but has told Mr. Lim that the final agreement will have to be made with you. It could be though that Mr. Neiss gets most of what we are asking for by the time you arrive.

cc: Mr. Ouattara
Mr. Sugisaki
Mr. Neiss

**DECLASSIFIED**

By ____ Date 11/26/19

# *Office Memorandum*

To: Mr. Neiss — December 1, 1997

From: Stanley Fischer SF

Subject: **Korea—LOI**

Thank you for clarifying the issues we had raised earlier. There are, however, a number of outstanding issues which still need to be resolved, perhaps by the Managing Director, if a satisfactory agreement cannot be reached prior to his arrival.

1. The limit of 7 percent set on corporate ownership by a single foreign entity is very low and does not allow a meaningful liberalization of the capital market. You should try to raise this limit significantly as a **prior action**.

2. I understand that the Koreans have agreed to allow foreign ownership of commercial banks under certain circumstances. Please clarify this and ensure that these circumstances are not defined too narrowly.

3. The issue of directed lending is critical to an efficient allocation of resources. The authorities should be pressed to eliminate all directed credit as a **prior action** or, at a minimum, agree to a timetable for their quick elimination in a relatively short period.

cc: The Managing Director
Mr. Cross

A:\KOR-LOI.WPD December 1, 1997 (10:26pm)

December 1, 1997

**Issues that Should be Dealt with if the National Assembly is Called**

1. A bill authorizing the issuance of government bonds to replenish the deposit insurance fund for guarantees extended to merchant bank deposits (point 4 of prior actions).

2. The amendment of related laws to allow foreign financial institutions to participate in mergers and acquisition of domestic financial institutions (point 5 of prior actions).

3. The increase in the ceiling on aggregate ownership of listed Korean shares (including the limit set on single foreign entities), as well as the other changes to further reduce restrictions on foreign direct investment, allow foreign investors to purchase money market instruments, allow foreign investment in the domestic corporate bond markets, and eliminate restrictions on foreign borrowings by corporations (as specified in the 5 bullet points under the heading capital account liberalization in the summary of the economic program).

4. The bills relating to financial sector reform (specified in three bullet points under the heading financial sector restructuring in the Summary of the Economic Program). These include: the revised Bank of Korea Act, the bill to consolidate supervision of all banks, and the bill requiring preparation of corporate financial statements on a consolidated basis.

**WITHDRAWAL NOTICE**

THIS DOCUMENT IS IN THE COURSE OF A PUBLIC DISCLOSURE REVIEW PROCESS

| | |
|---|---|
| **Department/Division/ Collection:** | Asia and Pacific Department Records |
| **Series/Subseries:** | Asian and Pacific Department Director's Office Files - Asian Crisis |
| **Box number:** | A8-047 |
| **File number:** | 6 |
| **ADLIB ref. number:** | 430 |
| **File title & dates:** | Republic of Korea - Chronological files, December 1997 |
| **Doc. title & dates:** | Handwritten Note from David Goldsbrough to Hubert Neiss - A Few Initial Suggestions on the Korea Positions, December 2, 1997 |
| **Doc. Classification:** | Strictly Confidential |

TO: Managing Director 12/1/97

Fr: HN

Korea

DECLASSIFIED
By [initials] Date 11/26/19

STRICTLY CONFIDENTIAL
May 20, 2019 TF.

- The attached documents were finalized after a long meeting tonight.
- While the summary and the side letter contain most of the additional suggestions, the prior action part is still flawed
- The DPM is very keen to get your reaction this morning, either directly from you or through me.

- the DPM's contact numbers are:

| (your time) | (number) |
|---|---|
| 7am to 8am | 822-770-0090 |
| after 8am | 8211-255-9036 |

- the expanded version of the letter of intent will be ready later today.
- the documents have simultaneously been sent to HQ

- I have briefed the officials in town from the US Treasury (Lipton) and the Jap. MOF (Shimura) on the main elements of the program..

Dec. 7, '97



5. **What is the outstanding stock and average maturity structure of the Bank of Korea's foreign currency deposits at domestic and overseas branches?**

At the end of November, the outstanding stock of BOK foreign currency deposits held by domestic financial institutions was US$42 billion, including US$17 billion at overseas branches and US$25 billion at domestic branches. Deposits to overseas branches ranged in maturity from overnight deposits (53 percent) to maturities of one month (26 percent) to maturities of one year (21 percent) while domestic branch deposits ranged in maturity from 1-3 months (64 percent) to 6 months to one year (36 percent).

| | Nov. 97<br>US$ bil. | Interest rate |
|---|---|---|
| **Total Foreign Currency Deposits of BOK at domestic banks** | 42 | |
| **At Overseas branches** | 17 | |
| Overnight deposits | 9 | From repo rate plus 25 bp to LIBOR plus 400 bp |
| Maturities of one year | 3.5 | Repo rate plus 25 bp |
| Maturities of one month | 4.5 | Repo rate plus 25 bp |
| **At Domestic branches** | 25 | |
| Maturities of 6-12 months | 9 | LIBOR |
| Maturities of 1-3 months | 16 | LIBOR to LIBOR plus 25 bp |

6. **How much of these BOK deposits carry penalty rates?**

The deposits carry different rates (as shown above), though almost all the deposits carry some level of penalty, from 25 basis points above the repo rate to 400 basis points above LIBOR. From the 2nd of December, any foreign exchange liquidity support carries a penalty rate of LIBOR plus 400 basis points. There appears to be some uncertainty on the application of the penalty rate. While we had understood that the penalty rate was changed on new injection of liquidity (including rollovers), in today's meeting it was suggested that rollovers were not charged the penalty rate. We intend to clarify these issues further tomorrow.

STRICTLY CONFIDENTIAL

May 20, 2019 FF.

DECLASSIFIED

By ______ Date 11/26/19

cc: BBA.

# *Office Memorandum*

To: The Managing Director

December 1, 1997

From: Stanley Fischer SF

**STRICTLY CONFIDENTIAL**

May 20, 2019 TF.

Subject: **Attached**

Attached are two memos as requested, one on what now seem to be the critical issues in the negotiation, the other the list of measures that should be passed if the National Assembly were called into session.

I understand from Mr. Neiss that Mr. Lim has called on him to continue negotiations. He has agreed to do so, with the goal of narrowing differences, but has told Mr. Lim that the final agreement will have to be made with you. It could be though that Mr. Neiss gets most of what we are asking for by the time you arrive.

cc: Mr. Ouattara
Mr. Sugisaki
Mr. Neiss ✓

DECLASSIFIED
By ______ Date 11/26/19

# *Office Memorandum*

To: Mr. Neiss December 1, 1997

From: Stanley Fischer SF

Subject: **Korea—LOI**

Thank you for clarifying the issues we had raised earlier. There are, however, a number of outstanding issues which still need to be resolved, perhaps by the Managing Director, if a satisfactory agreement cannot be reached prior to his arrival.

1. The limit of 7 percent set on corporate ownership by a single foreign entity is very low and does not allow a meaningful liberalization of the capital market. You should try to raise this limit significantly as a **prior action**.

2. I understand that the Koreans have agreed to allow foreign ownership of commercial banks under certain circumstances. Please clarify this and ensure that these circumstances are not defined too narrowly.

3. The issue of directed lending is critical to an efficient allocation of resources. The authorities should be pressed to eliminate all directed credit as a **prior action** or, at a minimum, agree to a timetable for their quick elimination in a relatively short period.

cc: The Managing Director
Mr. Cross

A:\KOR-LOI.WPD December 1, 1997 (10:26pm)

December 1, 1997

**Issues that Should be Dealt with if the National Assembly is Called**

1. A bill authorizing the issuance of government bonds to replenish the deposit insurance fund for guarantees extended to merchant bank deposits (point 4 of prior actions).

2. The amendment of related laws to allow foreign financial institutions to participate in mergers and acquisition of domestic financial institutions (point 5 of prior actions).

3. The increase in the ceiling on aggregate ownership of listed Korean shares (including the limit set on single foreign entities), as well as the other changes to further reduce restrictions on foreign direct investment, allow foreign investors to purchase money market instruments, allow foreign investment in the domestic corporate bond markets, and eliminate restrictions on foreign borrowings by corporations (as specified in the 5 bullet points under the heading capital account liberalization in the summary of the economic program).

4. The bills relating to financial sector reform (specified in three bullet points under the heading financial sector restructuring in the Summary of the Economic Program). These include: the revised Bank of Korea Act, the bill to consolidate supervision of all banks, and the bill requiring preparation of corporate financial statements on a consolidated basis.

LW

**STRICTLY CONFIDENTIAL**

cc: CA
DS
AS

F-A-D

May 20, 2019 TF.

# *Office Memorandum*

DECLASSIFIED

By [signature] Date 11/26/19

To: Mr. Aghevli

December 1, 1997

From: J.M. Davis

Subject: **Korea—Draft Staff Report for 1997 Article IV Consultation**

Developments in the last six week have been fast-paced and dramatic. With the negotiating team currently finalizing the outline of a Fund-supported program, perceptions are likely to change further in the short term. Thus, while clearly written and presented, the draft report inevitably appears dated and subject to substantial revision. Against this background, we have some doubts as to whether it is useful to circulate the staff report at this point, instead of merging it with the forthcoming program documents. Given these reservations, and the fact that we have seen much of the material in the context of the recent brief, we offer only the following comments:

- We welcome the staff appraisal's call for greater market orientation and transparency in the banking system (paragraph 29). An eventual fiscal table should include a full treatment of all bank restructuring costs, along the lines suggested in Mr. Chu's memoranda of November 17 and 20 (also, see below). The staff appraisal might usefully call for the withdrawal of "extensive informal political influence" (paragraph 16) in the financial sector.

- It is difficult to assess fiscal policy when the staff is still discussing the contents of the new fiscal package, and when 1998 GDP has been revised down so substantially relative to the Article IV mission brief of September. The report should quantify the estimated budgetary impact of the cyclical slowing in 1998. Concerning the staff appraisal, we support the thrust of the recommendations in the first half of paragraph 30, but the second half will clearly need to be reviewed in light of the ongoing discussions.

- The report could elaborate on the extent of past government intervention in restructuring large companies (mentioned in Box 1) and on the possibilities for reducing direct and indirect support to industry. The staff appraisal should strongly eschew such support.

- We look forward to the opportunity to comment on the paragraphs on structural policies when they become available. Section D will be important for providing the basis for appraising measures to improve labor market flexibility, as well as for assessing the costs of a likely rise in unemployment.

Specific comments:

- In line with the recommendation for a more transparent presentation of the consolidated central government balance (paragraph 34), non-transparent quasi-fiscal transactions should be clearly identified. These include the new fund for special low-interest loans to troubled financial institutions (paragraph 13) and the quasi-fiscal activities of the BOK and the development and specialized banks (paragraph 25).
- It would be useful to indicate why "profit transfers from the BOK have generally been zero" and to justify why "the BOK's support for the financial sector was not expected to indirectly influence the budget" (footnote 22).
- A footnote should spell out the definitions of "problem," "nonperforming" and "irrecoverable" loans (paragraph 19).
- In paragraph 21, we suggest replacing "continued to meet" with "reach," since it is our understanding that not all banks currently reach Basle standards.

cc: PDR, RES, LEG

Contributor: I. Lienert

HN

cc: CA
DG
AS

# Office Memorandum

To: Mr. Aghevli December 1, 1997

From: Eduardo Borensztein

Subject: **Korea—Staff Report for 1997 Article IV Consultation**

It is clear that this report has already been largely overtaken by events. Thus, we think that it would only make sense for the Board to consider it as a background to the forthcoming request for an arrangement. While there is also not much to be gained by applying hindsight to the appraisal of the situation that was made by the staff at the time of the consultation, some of the critical developments and issues deserve to be considered in the proper perspective. With this in mind, we offer the following brief comments.

Exchange rate policy is described as "relatively flexible" in several places (paragraph 15 and paragraph 27, for example). Given the reported heavy intervention by the authorities in the forward and spot markets to stem the decline in the won for several weeks, the report could give more precision to this "relatively flexible" characterization. Further, the reluctance of the authorities to increase interest rates as was needed to support exchange rate policy should be indicated more clearly in paragraph 27, which currently only states that "monetary policy was not tightened very much".

The staff appraisal does not mention some key elements that are necessary for the financial reform effort to be successful. In particular, fostering competition, including by allowing the entry of foreign institutions, should be mentioned. Also, the role of the extensive controls exerted by MOFE on the financial sector, including credit allocation and other management decisions, in contributing to the weakness and subsequent crisis in the financial system should be mentioned.

The paper ascribes the high rate of bankruptcies of conglomerates to a number of facts including very high investment in sectors such as semiconductors and petrochemicals, and the weakening in export prices of semiconductors (pages 7-8). However, none of the five bankrupt chaebols (Hanbo, Sammi, Jinro, Kia and New Core) are major producers of semi-conductors.

cc: Mr. Mussa
Mr. Boorman
Mr. Heller
Mr. Gianviti

STRICTLY
CONFIDENTIAL
May 20, 2019 T.F.

INTERNATIONAL MONETARY FUND

November 26, 1997

To: Mr. Mussa

Subject: **Korea**

Mike:

This is highly confidential and for your eyes only.

Attachment

DECLASSIFIED
By [signature] Date 11/26/19

Bijan B. Aghevli
(4-320, ext. 37177)

Mr. Mussa's Eyes Only
Please do not copy.

URGENT
SECRET

11/26/97

B. Aghevli

TO: Managing Director
Deputy Managing Directors

from: H Neiss

Korea - Foreign Exchange Situation.

Our first discussions with BOK show that the foreign exchange situation is more serious than we had believed:

- A large part of BOK's reserves are unusable; they consist of deposits with Korean commercial banks which have used them to pay off short-term debt.
- During the last few days, 70% of short-term debt falling due has not been rolled-over, and BOK lost about $1 billion a day.

There is a danger that BOK will run out of usable reserves before Dec 18, the date planned for the Board meeting:

- Today's reserves are \$24 bil, but they include \$15 bil deposits which are not liquid, i.e. usable reserves are only \$9 bil.

- Total short-term debt falling due between today and end-December is \$15 bil, and if the recent trend continues, some \$10 bil would have to be paid off. (In addition, there will be some other outflows in the capital and current accounts)

As a fall-back position, I can think of two possibilities:

- Establishing a credit line from friendly central banks (similar to the credit to India in 1991 by the Bank of England and the Bank of Japan.

- Arranging with creditor banks that withdrawals of short-term debt are honored through medium-term government bonds (the government has, in any case, given an informal guarantee to creditors).

Another possibility, finishing the program negotiations in one week is barely feasible and may not be credible.

The authorities themselves have only mentioned a BIS bridging loan, but I cautioned them that this could take too much time to arrange.

We will try to get a clearer picture of the short-term debt situation and the position of commercial banks tomorrow.

I have been in telephone contact with Mr. Fischer on this.

cc: Mussa, Boorman.

**WITHDRAWAL NOTICE**

THIS DOCUMENT IS IN THE COURSE OF A PUBLIC DISCLOSURE REVIEW PROCESS

| | |
|---|---|
| **Department/Division/ Collection:** | Asia and Pacific Department Records |
| **Series/Subseries:** | Asian and Pacific Department Director's Office Files - Asian Crisis |
| **Box number:** | A8-047 |
| **File number:** | 6 |
| **ADLIB ref. number:** | 430 |
| **File title & dates:** | Republic of Korea - Chronological files, December 1997 |
| **Doc. title & dates:** | Fax from John Chambers, CFA (Standard & Poor's), to Mr. Hubert Neiss - Copy of the Letter sent to Mr. Young-Wook Chin, Director of the International Finance Division at the Korean Ministry of Finance, Decmebr 9, 1997 |
| **Doc. Classification:** | Strictly Confidential |

3

cc: BBA
DDS

**STRICTLY CONFIDENTIAL**

May 20, 2019 T.F.

INTERNATIONAL MONETARY FUND

December 9, 1997

To: The Managing Director
The Deputy Managing Directors
Mr. Neiss

For your information.

DECLASSIFIED
By ____ Date 11/26/19

RM

Reinhard Munzberg
(12-100, ext. 36675)

# *Office Memorandum*

To: The Secretary December 9, 1997

From: Okyu Kwon

Subject: **Korea: Concluding Remarks**

Please take in the following:

1. Page 4 : 2nd to last paragraph : second sentence, beginning "They expressed...". Please read as follows "...resources would be disbursed **consistent with the purposes and modalities of the new facility.** Several Directors also...", as was expressed in the Letter of Intent.

2. Please note that my authorities do not approve of the Concluding Remarks being made publicly available.

Attachment

# *Office Memorandum*

SECRET

December 9, 1997

STRICTLY CONFIDENTIAL

May 20, 2019 T.F.

To: Mr. Aghevli
Mr. Goldsbrough
Mr. Knight
Mr. Larsen/Mr. Chadha
Mr. Hagen

From: Thomas Leddy

Subject: **Korea—Financing Scenarios**

For 2:00 p.m. meeting today.

Attachment

cc: Mr. Boorman
Mr. Ferran
Mr. Burton
Mr. Hicklin
Mr. Fisher

## Korea: External Financing Scenarios

**Korea's usable official reserves are low and hemorrhaging**. On plausible assumptions, reserves are now at the highest level they will record in December; they will be under $6 billion by the beginning of next week; and will be virtually exhausted by the end of the year. Accordingly, there is an urgent need to mobilize additional capital.

**Two scenarios could be envisaged: The first would be to secure new loans from private and official creditors. The second scenario–a debt restructuring–would be the last resort.**

- **The scenarios are alternatives**–it is difficult to see how a restructuring could be combined with new borrowings.

- **Time is of the essence**–unless additional capital can be mobilized rapidly, reserves will dwindle, and there would be merit in ***calling a halt to an inexorable process of reserve loss***.

### Scenario 1: Sovereign Borrowing

*Pros*

☞ Avoids a default which would be very costly for Korea and the international monetary system more generally (including the erosion of the Fund's catalytic role).

☞ Would provide scope for allowing unhedged private sector borrowers to reduce their exposure to exchange rate risk while protecting the balance of payments.

*Cons*

☞ Gives rise to moral hazard from the perspective of creditors and debtors.

☞ Likely to require substantial increase in lending by official creditors in order to allow for reduction in exposure of private creditors, which would be of uncertain duration and magnitude.

☞ May not be feasible.

*Modalities*

- **Contract sovereign short-term lines for $4-5 billion, to bridge to a bond issues in early to mid-January**

--Would help to limit the magnitude of the reduction in the exposure of private creditors to Korea's country risk, while allowing a reduction in creditors' exposure to commercial risk.

--Preferable to have a "plain vanilla" bond issue with an attractive spread (300-350 b.p.) than borrowing with more exotic instruments, such as loans with exchange rate options (*c.f. Indonesia*) which lack transparency and risk to be very expensive.

--Not feasible to have a bond issue before the end of the year;

--Private sector syndicated bridge would help to ensure a market for bonds, as banks would, to some extent, be locked in.

--Korean officials have little relevant experience with this type of operation. They probably require TA (possibly from the New York FRB) with approach to potential lead banks and normal fee arrangements. Fund staff would be well placed to help authorities evaluate competing financing options.

- **Try to persuade Japan to provide a bridge to AsDB and IBRD loans**

--There would be little point in wasting valuable time in trying to persuade either Bank to accelerate their procedures.

--BIS would not be willing to provide a bridge to a disbursement associated with a loan which has yet to be negotiated.

- **Convene meeting of bilateral creditors with a view to the rapid mobilization of concerted support**

--Could expand list of potential contributors beyond those from which favorable indications have been received (China? Singapore?)

**Scenario 2: Debt Restructuring Options**

***Pros***

☞ Would limit creditor and debtor moral hazard.

☞ Would ensure that private creditors contributed to the eventual financing package, and avoid a "bailout" financed with a substantial volume of official resources.

*Cons*

☞ Could lead to a protracted interruption in Korea's access to international capital markets, to the detriment of the prospects for growth.

☞ Could have severe adverse contagion effects, which are difficult to quantify *ex ante*, and would be impossible to control *ex post*.

☞ Announcing a default shortly ***after the approval of a Fund arrangement could damage the Fund's most powerful weapon–its catalytic role***. (I.e., in future cases, the approval of a Fund arrangement might not provide financial markets with confidence that the need for forced financing through the accumulation of arrears could be avoided. Without such confidence it is unlikely that new spontaneous financing could be mobilized).

*Modalities*

The strategic objectives are assumed to be:

☞ To arrange for an orderly restructuring of Korea's external debt that minimizes economic dislocation, and facilitates a normalization of creditor relations.

☞ To the extent possible, limit uncertainty and chaotic relations which could have severe adverse contagion effects.

This suggests that the authorities should take decisive steps to impose a moratorium, rather than simply suspend their assistance to troubled banks, and allow a creeping default–which would gradually engulf the entire banking system–to emerge.

- **The first step would be to impose exchange controls which prohibits payment of loans with an original maturity of less than [five] years.**

- **To facilitate negotiation of restructuring agreements and limiting economic dislocation there would be merit in:**

    - **Limiting the** ***scope of the exchange restrictions*** **to repayments of** ***principal***, while allowing payments of *interest (including penalty interest)* to continue.

    - An official announcement that **payments restructured on terms at least as favorable as some specified minimum** (such as overall maturities of [five] years, including [two] years of grace) **would be exempted from exchange control regulations** would help to underscore that Korea's difficulties are a liquidity crisis, rather than an attempt to renege on her debt.

- The specification of a **cutoff date for narrowly defined trade credit** could facilitate a retention of access to normal trade lines. This could present an obvious danger of circumvention—one approach would be to require that new qualifying loans be channeled through commercial banks, and that banks found to be involved in a circumvention of the regulations would automatically lose their banking licence.

Following the imposition of exchange controls, the authorities would face two basic choices:

- **Offer to make all debt sovereign**

- **Require non-sovereign debt to be restructured without the direct involvement of the sovereign**

**A. Impose exchange controls; declare debt sovereign, and initiate negotiations**

***Pros***

--Likely to provide fastest settlement on finest terms (as creditors would have no commercial risk).

--By limiting degree of disorder, may tend to minimize contagion effects.

--Provided terms are seen as being reasonable (i.e., with an acceptable spread) may help to minimize risk of litigation, though risk would remain in respect on the guaranteed portion.

--Could limit moral hazard vis-à-vis original borrowers through the government demanding local currency counterpart.

--Option of reducing private sectors' oversold position by offering to convert foreign currency liability into won at a market related exchange rate (i.e., swap rates).

***Cons***

--Moral hazard; creditors would be "bailed out." While they would be required to lengthen maturities, they would suffer no losses with respect to the possible insolvency of the original borrowers.

--It may be possible to limit the coverage of the restructuring ***to exclude claims on entities already in bankruptcy***, to the extent that they are not covered by the governments guarantee of August, but cannot apply an ex-post test to borrowers which are subsequently forced into liquidation.

**B. Exchange controls; allowing private sector to "work it out"**

Authorities would announce exchange controls, and at the same time announce minimum acceptable terms of a restructuring, to indicate that foreign exchange would be made available to honor revised terms.

**There would be a question regarding debts apparently covered by the "guarantee" announced by the Minister of Finance on August 25.** One approach would be for the authorities to acknowledge the guarantee, and to accept obligations in respect to loans contracted or guaranteed by Korean financial institutions which:

- o were contracted after the announcement;
- o were rolled over after the announcement;
- o included options which entitled creditors to *pre-payment* after August 25

☞ Under this approach it would not be possible to discriminate between loans contracted by solvent and insolvent financial institutions.

☞ Much of the short-term debt is reported to be on maturities of six months or less. Accordingly, well over half of the stock of Korean financial institutions short-term debt may already be covered by the guarantee.

An alternative approach would be for the authorities to refuse to acknowledge the validity of the guarantee. This would:

- o Risk triggering a swirl of litigation against the Republic of Korea (see arrears paper).
- o Likely make an already difficult process even more difficult and protracted.

On the assumption that the government would acknowledge the validity of the guarantee at least on the loans listed above, the non-sovereign portion of debt would be restructured by negotiation between private creditors and debtors.

***Pros***

--Commercial risk would be maintained by creditors on that part of the debt. Restructured debts would be treated in parallel with other claims in the event of bankruptcy. Minimizes creditor moral hazard.

--No danger of litigation against the sovereign in respect of the imposition of exchange controls (protected by the Act of State Doctrine).

***Cons***

--Negotiations between large numbers of individual creditors and debtors could be complex, and would likely become protracted, thereby delaying an eventual return to market access.

--Complex process of negotiations could have adverse effects on the ability of other emerging market economies to weather the storm.

DECLASSIFIED
By K Date 11/26/19

Dec. 9, 97

**STRICTLY CONFIDENTIAL**

May 20, 2019 TK

**Korea: External Financing Scenarios**

**Korea's usable official reserves are low and hemorrhaging.** On plausible assumptions, reserves are now at the highest level they will record in December; they will be under $6 billion by the beginning of next week; and will be virtually exhausted by the end of the year. Accordingly, there is an urgent need to mobilize additional capital.

**Two scenarios could be envisaged: The first would be to secure new loans from private and official creditors. The second scenario–a debt restructuring–would be the last resort.**

- **The scenarios are alternatives**–it is difficult to see how a restructuring could be combined with new borrowings.

- **Time is of the essence**–unless additional capital can be mobilized rapidly, reserves will dwindle, and there would be merit in ***calling a halt to an inexorable process of reserve loss***.

**Scenario 1: Sovereign Borrowing**

*Pros*

☞ Avoids a default which would be very costly for Korea and the international monetary system more generally (including the erosion of the Fund's catalytic role).

☞ Would provide scope for allowing unhedged private sector borrowers to reduce their exposure to exchange rate risk while protecting the balance of payments.

*Cons*

☞ Gives rise to moral hazard from the perspective of creditors and debtors.

☞ Likely to require substantial increase in lending by official creditors in order to allow for reduction in exposure of private creditors, which would be of uncertain duration and magnitude. why ??

☞ May not be feasible.

*Modalities*

- **Contract sovereign short-term lines for $4-5 billion, to bridge to a bond issues in early to mid-January**

--Would help to limit the magnitude of the reduction in the exposure of private creditors to Korea's country risk, while allowing a reduction in creditors' exposure to commercial risk.

--Preferable to have a "plain vanilla" bond issue with an attractive spread (300-350 b.p.) than borrowing with more exotic instruments, such as loans with exchange rate options (*c.f. Indonesia*) which lack transparency and risk to be very expensive.

--Not feasible to have a bond issue before the end of the year;

--Private sector syndicated bridge would help to ensure a market for bonds, as banks would, to some extent, be locked in.

--Korean officials have little relevant experience with this type of operation. They probably require TA (possibly from the New York FRB) with approach to potential lead banks and normal fee arrangements. Fund staff would be well placed to help authorities evaluate competing financing options.

- **Try to persuade Japan to provide a bridge to AsDB and IBRD loans**

--There would be little point in wasting valuable time in trying to persuade either Bank to accelerate their procedures.

--BIS would not be willing to provide a bridge to a disbursement associated with a loan which has yet to be negotiated.

- **Convene meeting of bilateral creditors with a view to the rapid mobilization of concerted support**

--Could expand list of potential contributors beyond those from which favorable indications have been received (China? Singapore?) HKSAR?

**Scenario 2: Debt Restructuring Options**

***Pros***

☞ Would limit creditor and debtor moral hazard.

☞ Would ensure that private creditors contributed to the eventual financing package, and avoid a "bailout" financed with a substantial volume of official resources.

*Cons*

☞ Could lead to a protracted interruption in Korea's access to international capital markets, to the detriment of the prospects for growth.

☞ Could have severe adverse contagion effects, which are difficult to quantify *ex ante*, and would be impossible to control *ex post*.

☞ Announcing a default shortly ***after the approval of a Fund arrangement could damage the Fund's most powerful weapon–its catalytic role.*** (I.e., in future cases, the approval of a Fund arrangement might not provide financial markets with confidence that the need for forced financing through the accumulation of arrears could be avoided. Without such confidence it is unlikely that new spontaneous financing could be mobilized).

*Modalities*

The strategic objectives are assumed to be:

☞ To arrange for an orderly restructuring of Korea's external debt that minimizes economic dislocation, and facilitates a normalization of creditor relations.

☞ To the extent possible, limit uncertainty and chaotic relations which could have severe adverse contagion effects.

This suggests that the authorities should take decisive steps to impose a moratorium, rather than simply suspend their assistance to troubled banks, and allow a creeping default–which would gradually engulf the entire banking system–to emerge.

- **The first step would be to impose exchange controls which prohibits payment of loans with an original maturity of less than [five] years.**

- **To facilitate negotiation of restructuring agreements and limiting economic dislocation there would be merit in:**

  o **Limiting the *scope of the exchange restrictions* to repayments of *principal*,** while allowing payments of *interest (including penalty interest)* to continue.

  o An official announcement that **payments restructured on terms at least as favorable as some specified minimum** (such as overall maturities of [five] years, including [two] years of grace) **would be exempted from exchange control regulations** would help to underscore that Korea's difficulties are a liquidity crisis, rather than an attempt to renege on her debt.

- The specification of a **cutoff date for narrowly defined trade credit** could facilitate a retention of access to normal trade lines. This could present an obvious danger of circumvention—one approach would be to require that new qualifying loans be channeled through commercial banks, and that banks found to be involved in a circumvention of the regulations would automatically lose their banking licence.

Following the imposition of exchange controls, the authorities would face two basic choices:

- **Offer to make all debt sovereign**
- **Require non-sovereign debt to be restructured without the direct involvement of the sovereign**

## A. Impose exchange controls; declare debt sovereign, and initiate negotiations

*Pros*

--Likely to provide fastest settlement on finest terms (as creditors would have no commercial risk).

--By limiting degree of disorder, may tend to minimize contagion effects.

--Provided terms are seen as being reasonable (i.e., with an acceptable spread) may help to minimize risk of litigation, though risk would remain in respect on the guaranteed portion.

--Could limit moral hazard vis-à-vis original borrowers through the government demanding local currency counterpart.

--Option of reducing private sectors' oversold position by offering to convert foreign currency liability into won at a market related exchange rate (i.e., swap rates).

*Cons*

--Moral hazard; creditors would be "bailed out." While they would be required to lengthen maturities, they would suffer no losses with respect to the possible insolvency of the original borrowers. → Why not, if they don't make local currency counterpart payments?

--It may be possible to limit the coverage of the restructuring ***to exclude claims on entities already in bankruptcy***, to the extent that they are not covered by the governments guarantee of August, but cannot apply an ex-post test to borrowers which are subsequently forced into liquidation. → Why?

## B. Exchange controls; allowing private sector to "work it out"

Authorities would announce exchange controls, and at the same time announce minimum acceptable terms of a restructuring, to indicate that foreign exchange would be made available to honor revised terms.

**There would be a question regarding debts apparently covered by the "guarantee" announced by the Minister of Finance on August 25.** One approach would be for the authorities to acknowledge the guarantee, and to accept obligations in respect to loans contracted or guaranteed by Korean financial institutions which:

- o were contracted after the announcement;
- o were rolled over after the announcement;
- o included options which entitled creditors to *pre-payment* after August 25

☞ Under this approach it would not be possible to discriminate between loans contracted by solvent and insolvent financial institutions. Why not?

☞ Much of the short-term debt is reported to be on maturities of six months or less. Accordingly, well over half of the stock of Korean financial institutions short-term debt may already be covered by the guarantee.

An alternative approach would be for the authorities to refuse to acknowledge the validity of the guarantee. This would: Possibility of introducing weak guarantee means?

- o Risk triggering a swirl of litigation against the Republic of Korea (see arrears paper). → offer M-T bonds
- o Likely make an already difficult process even more difficult and protracted.

On the assumption that the government would acknowledge the validity of the guarantee at least on the loans listed above, the non-sovereign portion of debt would be restructured by negotiation between private creditors and debtors. *

***Pros***

--Commercial risk would be maintained by creditors on that part of the debt. Restructured debts would be treated in parallel with other claims in the event of bankruptcy. Minimizes creditor moral hazard.

--No danger of litigation against the sovereign in respect of the imposition of exchange controls (protected by the Act of State Doctrine).

***Cons***

--Negotiations between large numbers of individual creditors and debtors could be complex, and would likely become protracted, thereby delaying an eventual return to market access.

--Complex process of negotiations could have adverse effects on the ability of other emerging market economies to weather the storm.

Bilaterals.

US

Canada

UK

Switzerland ?

Sweden ?

France

Germany

Italy

Japan

Belgium

Netherlands?

**WITHDRAWAL NOTICE**

THIS DOCUMENT IS IN THE COURSE OF A PUBLIC DISCLOSURE REVIEW PROCESS

| | |
|---|---|
| **Department/Division/ Collection:** | Asia and Pacific Department Records |
| **Series/Subseries:** | Asian and Pacific Department Director's Office Files - Asian Crisis |
| **Box number:** | A8-047 |
| **File number:** | 6 |
| **ADLIB ref. number:** | 430 |
| **File title & dates:** | Republic of Korea - Chronological files, December 1997 |
| **Doc. title & dates:** | Korea - Publicity Campaign, Memo from Wanda Tseng to Mr. Neiss, December 9, 1997 |
| **Doc. Classification:** | Strictly Confidential |

**WITHDRAWAL NOTICE**

THIS DOCUMENT IS IN THE COURSE OF A PUBLIC DISCLOSURE REVIEW PROCESS

| | |
|---|---|
| **Department/Division/ Collection:** | Asia and Pacific Department Records |
| **Series/Subseries:** | Asian and Pacific Department Director's Office Files - Asian Crisis |
| **Box number:** | A8-047 |
| **File number:** | 6 |
| **ADLIB ref. number:** | 430 |
| **File title & dates:** | Republic of Korea - Chronological files, December 1997 |
| **Doc. title & dates:** | Meeting with Executive Directors, Memo, December 9, 1997 |
| **Doc. Classification:** | Strictly Confidential |

**WITHDRAWAL NOTICE**

THIS DOCUMENT IS IN THE COURSE OF A PUBLIC DISCLOSURE REVIEW PROCESS

| | |
|---|---|
| **Department/Division/ Collection:** | Asia and Pacific Department Records |
| **Series/Subseries:** | Asian and Pacific Department Director's Office Files - Asian Crisis |
| **Box number:** | A8-047 |
| **File number:** | 6 |
| **ADLIB ref. number:** | 430 |
| **File title & dates:** | Republic of Korea - Chronological files, December 1997 |
| **Doc. title & dates:** | Indonesia and Korea, Memo from Stanley Fischer to Mr. Neiss and Mr. Aghevli, December 9, 1997 |
| **Doc. Classification:** | Strictly Confidential |

**STRICTLY CONFIDENTIAL**

May 20, 2019 DF-

Dec. 9, '97

URGENT

DECLASSIFIED
By [signature] Date 11/26/19

TO Mr Fischer/Sugisaki
FR H Neiss

Korea - Today's Developments (so far)

- The downgrading of Korean banks by Moody's and Stand. & Poors (from A- to BBB-) was another shock to markets.
- After the won dropped by another 10% (to 1750) in the first 10 minutes, they closed the markets
- BOK is allocating subsequently $500+ for "legitimate needs" (debt service & import bills I guess)
- We are talking them out of an emergency decree requiring exporters to surrender, and domestic companies & banks to sell their for. exchange to BOK.
- We are suggesting to raise the interest ceiling and to abandon the 10% ER band before they open the market tomorrow.
- The Governor is now in favor of a BOJ bridge, but still rejects their earlier offer of a 3-day only bridge (i.e. for 15th to 18th)
- Based on his conversation with the MD, Lim is preparing a request for a "safety net" to Matsunaka (there could have been some misunderstanding)
- Lim wants the MD to see his communication before he passes it on. Since the MD has no fax at home (I assume), Wanda will fax it to me + I will send it on to you (I don't know when)
- Lim feels great urgency, the Governor much less. I assume reserves are still around $10 bil.

3

cc: BBN
DN S

# *Office Memorandum*

**STRICTLY CONFIDENTIAL**

May 20, 2019 NF.

December 9, 1997

To: Mr. Boorman
Mr. Guitian
Mr. Neiss

From: Peter Hole

Subject: **Adding Korea to Factsheet on Treatment of Private Creditors and Shareholders under Fund-supported Programs**

To assist Fund management in responding to media inquiries we **urgently** need a revision of the attached draft factsheet (which has not been released) to add brief factual notes on treatment of private creditors, shareholders and depositors under on the Korea program, and to update the facts regarding Thailand and Indonesia. Additions to the cover page are also needed to clarify any differences in treatment of foreigners and nationals.

// Could someone in each department please be designated to work with Mr. Russell to produce a revised version by cob tomorrow, December 10? //

Attachment

cc: Mr. Anjaria (o/r)
Mr. Cross

DECLASSIFIED
By ____ Date 11/26/19

**Treatment of Private Creditors and Shareholders under Fund-supported Programs**

An important element of the Fund supported programs with Indonesia and Thailand, designed to combat the liquidity pressures in these countries, is restructuring of the financial sectors. This requires technically complex and politically difficult reforms.

One of the fundamental principles of these programs is to ensure that the creditors and shareholders of **insolvent** institutions bear the losses they would have sustained in the context of liquidations conducted under bankruptcy procedures: They have not been "bailed out." Whenever public resources are used to support the restructuring of suspended institutions, the strategy entails the removal of previous owners (through writing down their equity) and replacing management.

Under the programs, no liquidity support is to be given to insolvent institutions. In addressing the problems posed by institutions which are undercapitalized but solvent, and which are experiencing liquidity problems, the authorities have provided liquidity support. Such support is conditional upon the recapitalization of the institutions. Under the programs, financial institutions will undertake incisive restructuring programs, in order to improve their operations and to restore them to full financial health. The provision of liquidity to such banks avoids a default, although it clearly has the potential to allow creditors to unwind their exposure. This should not pose a cost to the public purse, however, as such banks would be in a position to repay the liquidity support as their financial health improves. Moreover, in light of the measures taken by the authorities under their Fund supported programs, there would be much less reason for creditors to wish to unwind their exposures.

There has also been no "bail out" of **holders of publicly traded instruments**. Recent months have witnessed substantial declines in the market prices of Indonesian and Thai equities and bonds. These losses have been borne entirely by the holders of these instruments.

Finally, it should be underscored that there are no provisions in Fund supported programs for special treatment for **shareholders of corporations** which are forced into bankruptcy. Any payments they receive will be strictly in conformity with the applicable laws. In cases where national authorities had granted guarantees to certain types of depositors or creditors prior to entering into policy negotiations with the Fund, the Fund staff has emphasized to authorities that the financial program must contain appropriate measures to ensure that any likely recourse to official guarantees can be met while still achieving a sustainable fiscal position in the medium term.

## Treatment of Private Sector under Financial Sector Reforms: The Facts

### Thailand

Up-front action: suspension of 16+42=58 finance companies (from a total of 91).

- In unviable companies, shareholders' equity and subordinated debt will be written down in the first instance to cover losses.
- FIDF [the lender of last resort] lending rates have been raised above the highest deposit rates in the system and all liquidity support will be subject to conditionality.

Depositors will be treated as follows:

- In the 16 suspended finance companies, claims will be restructured in the form of nonnegotiable instruments, with 6-60 month maturities depending on the size of the claim, and carrying market interest rates;
- In the 42 other suspended companies, the instruments will be on similar terms, but negotiable.
- In all domestic banks and remaining finance companies, depositors claims will be honored promptly in cash (in baht).

Creditors will be treated as follows:

- In the first group of 16 suspended finance companies, claims will be renegotiated or honored in accordance with liquidation procedures;
- In the second group of 42 suspended companies, claims will be restructured in the form of negotiable instruments similar to the arrangement for depositors, but with an interest rate of 2 percent per year, i.e., substantially below market rates; and
- In all domestic banks and remaining finance companies, creditors' claims will be honored promptly in cash (in baht) through the Financial Institutions Development Fund.

**Indonesia**

Up-front action: closure of 16 banks (from a total of 240).

- Shareholders have had their capital written down.

- Insolvent banks have been closed and weak, but viable, institutions have been required to formulate and implement rehabilitation plans.

- The government will not guarantee repayment of the liabilities of closed banks except for small depositors who will be compensated promptly (within two weeks after bank closure) for up to Rp20 million per depositor per bank. Payments to depositors will be administered by Bank Indonesia and funded by the government.

- Bank Indonesia will streamline its lender of last resort function. Loans to illiquid but solvent banks will be provided in accordance with stringent access conditions. These loans will be collateralized and extended to individual institutions at increasingly punitive interest rates. Any emergency assistance to banks to prevent systemic risks will be explicitly guaranteed by the government.

**WITHDRAWAL NOTICE**

THIS DOCUMENT IS IN THE COURSE OF A PUBLIC DISCLOSURE REVIEW PROCESS

| | |
|---|---|
| **Department/Division/ Collection:** | Asia and Pacific Department Records |
| **Series/Subseries:** | Asian and Pacific Department Director's Office Files - Asian Crisis |
| **Box number:** | A8-047 |
| **File number:** | 6 |
| **ADLIB ref. number:** | 430 |
| **File title & dates:** | Republic of Korea - Chronological files, December 1997 |
| **Doc. title & dates:** | Korea - Contingency Planning, Memo from Thomas Leddy to the IMF MD and DMD, December 9, 1997 |
| **Doc. Classification:** | SECRET |

Cc: BBA To Handle
DS.
DOS.

# Office Memorandum

To: Mr. Neiss

From: Malcolm Knight

Subject: **Korea--Recent Financial Sector Developments**

December 8, 1997

**STRICTLY CONFIDENTIAL**

May 20, 2019 TF.

Following up on my e-mail message to you of last Friday and your conversation this morning with Mr. Baliño, I would like to get your views on the following proposed course of action for MAE immediate work on Korea.

## 1. Legislation

The draft legislation on the Korea Bank Act and on the Supervisory Agency is being translated. We will review it here in collaboration with LEG. MAE staff in the field, to be joined by Mr. Asser (LEG), would then discuss our comments with the authorities. Staff would contact headquarters in case the authorities proved unreceptive to the comments, in order to seek management support. Mr. Baliño would go back to Seoul later this week to discuss these matters, as well as others, as mentioned below.

The discussions on legal issues will deal not only with technical points but also with sensitive topics that have important policy implications. In this connection, I would welcome your views as to whether the authorities would welcome the mission, and be prepared to engage in meaningful discussions in this pre-election period.

## 2. Collaboration with IBRD and ADB

I share your view regarding the urgency of promptly agreeing with the IBRD and ADB on an appropriate distribution of labor among the Fund and those institutions. MAE staff in the field have already started collaborating with the IBRD team in Seoul. However, as you suggested to Mr. Baliño, it is essential that clear understandings be reached between staff at Fund and World Bank headquarters and appropriate contacts be established with the ADB before Mr. Baliño leaves for Seoul. Mr. Baliño would follow up on these matters with World Bank and ADB staff in the field and, if necessary, would stop over in Manila on his return to headquarters for discussions with the ADB.

// In this connection, we would propose that APD call a meeting early this week with the corresponding region staff in the World Bank to endeavor to agree on the distribution of the follow-on work on the financial sector. Of course, MAE will be pleased to participate in this meeting, and to discuss with you the likely areas o~~f ADB involvement.~~ //

C:\WIN\TEMP\NEISS.MEM December 8, 1997 (2:29pm)

**3. Recapitalization of Seoul Bank**

MAE staff in Seoul have just seen newspaper accounts indicating that one of the troubled commercial banks (Seoul Bank) is being recapitalized by the government. It is unclear whether existing shareholders are being made to bear any losses, as provided in point 6, page 3, of the side letter to the standby. Also, Deputy Prime Minister Lim's letter to the Managing Director of December 4 indicates that one of the nine insolvent merchant banks (Cheongsol Merchant Bank) had all business suspended, but in the case of the other eight only certain activities seem to have been suspended (we are translating the letter of suspension that we just received, in order to assess the scope of the measure).

The MAE mission in Seoul will seek to get a clear understanding of these matters as early as possible and report its findings to headquarters.

// Given the urgency of these issues, I would welcome an opportunity to discuss these matters with you as soon as possible. //

cc: Mr. Guitián (o/r)
Mr. Aghevli
Mr. Alexander
Mr. Asser
Mr. Baliño
Mr. Downes

cc: Foss, CA
Div. 5

**STRICTLY CONFIDENTIAL**

May 20, 2019 TF.

# Office Memorandum

December 8, 1997

To: Mr. Neiss

From: Sharmini Coorey

Subject: **Korea: Adjustor for Performance Criteria on NIR and NDA**

In the program, the performance criterion on NIR for the fourth quarter of 1997 is adjusted upward by the amount of any emergency financing in excess of the baseline and downward by the amount of any shortfall (with offsetting adjustments to the performance criterion on NDA). Concerns have been raised that the downward adjustor does not include a limit as is standard in many programs. Emergency financing, excluding the Fund drawing, in the fourth quarter baseline is US$11 billion. Given the performance criterion of US$2.2 billion (adjusted for the Fund drawing), this would imply, in the worst case (i.e., no financing outside the Fund), a NIR of floor of -US$8.8 billion. While such a potential decumulation may seem large at first glance, we would argue that this is appropriate in the near term for Korea for the following reasons:

ASIA/PACIFIC

8 DEC 97 9:55

- Although many structural changes are clearly needed, the present macroeconomic situation in Korea is not one where a current account adjustment is required because of excessive aggregate demand growth. Rather, Korea faces a serious liquidity problem due to the non-rollover of short-term external debt. The level of its total external debt is quite low in relation to GDP and aggregate demand is already compressed under the program. While the standard limit on the downward NIR adjustor is intended to require more adjustment in the event of a shortfall in financing, in the case of Korea, the appropriate response is to finance the immediate liquidity problems (conditional on appropriate structural reforms) while raising interest rates sharply to stem capital outflows.

- Korea faces an imminent threat of default. The program envisages that if full financing were available in December, gross reserves would be built up by US$5 billion from US$7.4 billion at end-November. If the non-rollover of short-term external debt continues, Korea would have three alternatives to default. It could use up the little gross reserves that remain, borrow in international capital markets, or adjust its current account through a further (costly) increase in interest rates. The program initially provides for the first option; i.e., the use of reserves.

- Medium- and long-term borrowing would also be an option and the program does not limit such borrowing. However, the amounts which can be raised in the near term may be limited. (The Government of Korea still faces relatively good terms in private capital markets).

**DECLASSIFIED**

By ______ Date 11/26/19

- Alternatively, there is a (small) chance that the Bank of Korea may be able to borrow short-term in private markets to avert a default. The NIR floor allows such borrowing to substitute for shortfalls in official financing. The case for not allowing such a substitution is weak given Korea's low level of debt, the Government's relatively favorable position in private markets, and the fact that official financing from bilateral sources would most likely have been short-term and at market interest rates.

- Borrowing in private markets to avert default would involve a substitution of sovereign debt for private debt. However, this does not involve anything new since such a substitution was already envisaged in the original baseline projection which allowed for official external financing.

- Adjustment, beyond that envisaged in the program, is likely to be costly. In the event of a shortfall in financing, a limit on the downward NIR adjustor would require the Bank of Korea to accumulate reserves, putting further downward pressure on the won. As the program includes commitments that a depreciation would be countered by further increases in interest rates as a first line of defense, the magnitude and duration of high interest rates may well be more than sustainable.

- The issue of a limit on the downward adjustor is likely to be moot since the chances are that the Bank of Korea will be unable to borrow in private markets. In this case, once reserves are depleted—and there is no official external financing—there would be little choice but to adjust in order to avoid default.

cc: Ms. Tseng
Mission members

INTERNATIONAL MONETARY FUND

TO: Mr Neiss

12/8/97

FROM: Jack Boorman

Hubert,

May I have your reaction to the attached. We will need early on to decide a plan of action.

# Office Memorandum

cc: BBA
DG
DDs

To: Mr. Boorman

From: Matthew Fisher MMF.

Subject: **Korea: What Can Markets Calculate?**

December 8, 1997

**STRICTLY CONFIDENTIAL**

May 20, 2019 NF.

The following information is available from wire services:

--Usable reserves were $6 billion on December 2 (see today's Blue Sheet);

--The size and timing of Fund purchases;

--Short-term debt maturities in December are believed to be $20 billion;

--No concrete details on the "second line" of defense;

--Presidential candidate Kim Dae-Jung reversed a pledge he made earlier to honor an IMF agreement (see today's Blue Sheet);

In the absence of information regarding the daily profile of loan maturities, market might expect the maturities to be uniform at $1 billion a day. With the low level of reserves, banks might expect others to "rush for the exit", and so might assume that only 30 percent of the loans will be rolled over. Banks may also assume that no transactions fall due on Christmas day.

It is but the work of a moment to calculate that on these assumptions reserves are now at their highest level this month; by next Monday reserves would be below $6 billion; and that by year end reserves would be less than $1 billion (Table). It is also obvious that any bunching of short-term debt maturities would accelerate the decline in reserves.

**Implications**

In the absence of good news in terms of the availability of additional financing, banks' propensity to rollover their debt will continue to decline, bringing forward the inevitable exhaustion of reserves.

Accordingly, there is an urgent need to mobilize additional capital. Would suggest:

--Contract sovereign short-term lines for $4~~-5 billion, to bridge to a bond issues in~~ early to mid-January.

DECLASSIFIED

By ___ Date 11/26/19

--Try to persuade Japan to provide a bridge to AsDB and IBRD loans (there would be little point in wasting valuable time in trying to persuade either Bank to accelerate their procedures).

--Convene meeting of bilateral creditors with a view to the rapid mobilization of concerted support.

Attachment

cc: Mr. Leddy
Mr. Ferran
Ms. van der Willigen

| Bank of Korea's Official Usable Reserves | | | | | |
|---|---|---|---|---|---|
| | (In billions of US dollars) | | | | |
| | **Stock** | **Non-rollover** | **Inflows** | | |
| End November | 7.5 | | | | |
| 1-Dec | | | | | |
| 2-Dec | 6 | | | | |
| 3-Dec | 5.3 | 0.7 | | | |
| 4-Dec | 5.1 | 0.2 | | | |
| 5-Dec | 4.4 | 0.7 | | | |
| 6-Dec | 4.4 | | | | |
| 7-Dec | 4.4 | | | | |
| 8-Dec | 9.2 | 0.7 | 5.5 | First purchase | |
| 9-Dec | 8.5 | 0.7 | | | |
| 10-Dec | 7.8 | 0.7 | | | |
| 11-Dec | 7.1 | 0.7 | | | |
| 12-Dec | 6.4 | 0.7 | | | |
| 13-Dec | 6.4 | | | | |
| 14-Dec | 6.4 | | | | |
| 15-Dec | 5.7 | 0.7 | | | |
| 16-Dec | 5 | 0.7 | | | |
| 17-Dec | 4.3 | 0.7 | | | |
| 18-Dec | 3.6 | 0.7 | | | |
| 19-Dec | 5.3 | 0.7 | 2.4 | Second purchase | |
| 20-Dec | 5.3 | | | | |
| 21-Dec | 5.3 | | | | |
| 22-Dec | 4.6 | 0.7 | | | |
| 23-Dec | 3.9 | 0.7 | | | |
| 24-Dec | 3.2 | 0.7 | | | |
| 25-Dec | 3.2 | 0 | | | |
| 26-Dec | 2.5 | 0.7 | | | |
| 27-Dec | 2.5 | | | | |
| 28-Dec | 2.5 | | | | |
| 29-Dec | 1.8 | 0.7 | | | |
| 30-Dec | 1.1 | 0.7 | | | |
| 31-Dec | 0.4 | 0.7 | | | |
| | | | | | |
| Total | 0.4 | 13.5 | 7.9 | | |

# Office Memorandum

To: Mr. Knight

December 8, 1997

From: Hubert Neiss

Subject: **Korea**

**STRICTLY CONFIDENTIAL**

May 6, 2019 TF.

These are my quick reactions to your memo.

1. **Legislation**

Since the draft laws had already been agreed by the National Assembly previously (they only decided to postpone the vote), we should only intervene if there are substantive difficulties in the text that would go against the authorities' commitments regarding financial sector reform in the LOI. Also, we have to do this very quickly.

2. **IBRD and AsDB collaboration**

I think a meeting with relevant World Bank staff to coordinate activities of the MAE and World Bank missions is urgent. I am happy to be present at that meeting which should properly be called by MAE and not by APD.

3. **Recapitalization and other issues**

We should discuss these issues as soon as we get a report from the MAE mission in Seoul.

cc: Mr. Fischer
Mr. Guitian