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AGENDA**

EBS/64/73

CONFIDENTIAL

April 30, 1964

To: Members of the Executive Board
From: The Secretary
Subject: Korea - Exchange Reform

There is attached for information a communication from the Korean authorities which was received in the Fund Wednesday evening, April 29. A staff paper and recommendations on the substance of the matter is expected to be distributed later today for consideration at an Executive Board meeting scheduled for Friday, May 1.

Att: (1)

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Dear Mr. Schweitzer:

The Government of the Republic of Korea wishes to inform the International Monetary Fund of a fundamental revision of its exchange system which will become effective in a few days. We intend to establish a unitary, flexible exchange rate with a floor below which it cannot appreciate, but no predetermined limitation on the extent to which the exchange rate can depreciate. Within this framework, the market rate will be created by the purchase and sale of a certificate denominated in foreign exchange.

This new measure, which amounts to devaluation, has been required by the very substantial increase in prices since February 1961 when the relationship of the won to the U.S. dollar was last changed. The resultant balance of payments deficit, particularly in 1963, has led to a drastic tightening of exchange controls, a severe drain of exchange reserves and an increase in short term borrowing abroad. However, a strict budget and credit policy since 1963 has sharply reduced the increase of the money supply. Prices of commodities other than grain are now reaching equilibrium. Although recognizing as the ultimate goal, the establishment of a realistic fixed unitary exchange rate, we believe that Korea's present circumstances require a flexible rate system for the time being. These circumstances are the need to substantially increase our export and other external earnings in order to maintain the necessary imports for a reasonable level of economic growth and to adjust to a gradually declining volume of foreign assistance.

The main characteristics of this system are:

- A. A certificate which will be generated by the surrender of foreign exchange to the foreign exchange authority or issued on the backing of exchange reserve holdings;
- B. A certificate will be required to make foreign exchange payments;
- C. Exceptions to these rules will be exchange surrendered by non-residents, e.g., foreign governments, tourists, etc., and sale of foreign exchange provided by foreign aid programs, e.g., U.S. supporting assistance, PL 480 program, etc., where no certificate will be created or required;
- D. The certificates issued by the foreign exchange authority will be freely negotiable and there will be no restrictions on individuals or institutions that may buy and sell them; certificates will not be accepted by banks as collateral for loans; they will be good for 60 days from the date of issuance; they may be sold to the foreign exchange authority at any time before they expire for won;
- E. All exchange transactions will be conducted at the market rate established in the certificate market, whether or not a certificate is involved;

F. The Bank of Korea will manage the exchange system under terms of reference established by the Ministry of Finance; banks currently licensed to engage in foreign exchange transactions will continue to participate in the exchange market; the Bank of Korea will set buying and selling rates twice daily;

G. The floor rate will be 255 won per U.S.\$1;

H. The effective date will be 12:01 a.m., KST, May 3, 1964.

We propose that the floor rate of 255 won per one U.S. dollar be used in connection with all exchange transactions involving the International Monetary Fund and the Republic of Korea.

The establishment of a realistic exchange rate will permit simplification of the current exchange and licensing system in the near future. The export-import link system will be abolished and a substantial increase in the proportion of imports subject to automatic approval licensing will be undertaken shortly after devaluation. Imports required to fill export orders are already being licensed freely but within the limit of the global quota set by the Bank of Korea.

We believe that this exchange reform will be an important step forward in re-establishing stability to the Korean economy. We hope that the International Monetary Fund will have no objection, and that we may have a reply by the close of business, May 1, KST.

/S/ Tong Kyu Park
Tong Kyu Park
Minister of Finance
Republic of Korea

Mr. Pierre Paul Schweitzer
Managing Director
International Monetary Fund
Washington 25, D.C.