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The Chairman's Summing Up at the Conclusion of
the 1979 Article IV Consultation with Korea
Executive Board Meeting 80/35 - March 3, 1980

In their discussion of the 1979 Article IV consultation with Korea Executive Directors noted the deterioration in Korea's economic and financial situation in 1979 and warmly commended the authorities on the vigorous policy measures taken recently in the context of a financial program; they agreed to support that program with a stand-by arrangement.

It was noted that after many years of remarkable growth performance, the rate of growth of the economy dropped sharply in 1979. At the same time, inflation accelerated and the current account deficit of the balance of payments widened substantially. While the slowdown in growth was partly related to measures to moderate excessive domestic demand pressures introduced in the first half of 1979, the adverse developments in 1979 were heavily influenced by external factors such as the weakening of external demand, greater protectionism abroad, and the increase in oil prices. It was noted that exports had also suffered from a gradual weakening of Korea's external competitiveness over the past three years--a weakening due to the deterioration of Korea's cost situation, especially in the field of wages. The recent devaluation of the exchange rate should help strengthen the balance of payments.

Directors endorsed the Government's courageous policy objective of curbing domestic inflation while maintaining minimum acceptable growth. The authorities' intention to exercise fiscal and monetary restraint and the recent significant upward adjustment in interest rates were felt to be timely and welcome. In light of the rapid increase in wages in recent years, which has contributed to demand pressures and to the erosion of Korea's external competitiveness, Directors supported the authorities' efforts to moderate future increases and noted that the target in this area implied a reduction in real wages. Directors acknowledged that in 1980, and beyond, Korea would remain highly dependent on capital inflows from abroad; they expressed the hope that the Government's stabilization program and the stand-by relationship with the Fund would facilitate these capital flows.

Commenting on the structural reforms the authorities intended to introduce during the next two years, Directors stressed that the planned relaxation of Government controls on the economic and financial system was particularly important. By moving from preferential credit allocation toward more market-related interest rates, the authorities would improve resource allocation and strengthen the instruments of overall demand management. Directors commended the authorities on the wide range of energy conservation measures introduced over the past year, and especially the passing through to consumers of oil price increases, and the

efforts undertaken to diversify energy sources. The changes planned in the tax system should also bring about greater equity and a more efficient allocation of resources.

Directors welcomed the measures taken since 1978 to liberalize imports and the exchange system. They expressed their satisfaction with the authorities' decision not to reverse these measures despite the sharp deterioration in the external accounts. Several Directors also expressed the hope that the Korean authorities' objective of restoring external balance would not be frustrated by protectionist measures abroad.

Finally, Directors noted the recent adoption by the Korean authorities of a new exchange rate regime, and expressed the hope that the new regime would provide the authorities with adequate flexibility in that area.