



International Monetary Fund

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The following item is a Letter of Intent of the government of Korea, which describes the policies that Korea intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Korea, is being made available on the IMF website by agreement with the member as a service to users of the [IMF](#) website.

Seoul, Korea
December 24, 1997

Mr. Michel Camdessus
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Camdessus:

In the immediate period ahead, Korea faces the urgent task of restoring market confidence. To this end, the government is pursuing the following strategy: (1) strengthening the economic program through advancing measures already agreed under the stand-by arrangement and implementing additional measures designed to enhance stabilization and structural goals; (2) discussing with foreign banks possibilities of improving the rollover of short-term borrowing and gaining access to medium-term market borrowing; and (3) discussing possibilities of additional and advanced disbursements of official resources.

In support of the measures to strengthen stabilization and reform, we request that the phasing of purchases under the arrangement be modified to allow for a purchase to be made on December 30, 1997.

The measures to strengthen the program are concentrated in the following areas:

1. **Monetary policy** - to restore order in the foreign exchange market and provide appropriate incentives for holding won-denominated assets, interest rates have been raised substantially, reaching about 30 percent on December 24. Further increases will be implemented, if necessary. At the same time, care is being taken to ensure that unequal distribution of liquidity in the system that has developed in recent weeks does not lead to a liquidity crunch in important sectors of the economy that could cause bankruptcies of viable firms ([Box 1](#)).

2. **Capital market opening** - the government will lift all capital account restrictions on foreign investors' access to the government, corporate, and special bond markets as of January 1, 1998, and will accelerate the announced schedule for liberalizing equity inflows. We will, according to a timetable to be set in consultation with the IMF mission in mid-January 1998, eliminate all barriers to capital inflows in the money market ([Box 2](#)).

3. **Financial sector restructuring** - the government is developing and implementing a comprehensive restructuring plan for the financial sector that will include the merger and closure of insolvent institutions. In this context, measures will be accelerated wherever feasible, and will be guided by the procedures set out in our earlier letter, most notably that existing shareholders will bear the first burden. Details of the restructuring strategy are being worked out with financial and technical support from the World Bank and the AsDB under their structural lending operations (Box 3).

4. **Reserve management and exchange rate policy** - we have taken further measures to reduce recourse of banks to the BOK to cover their debt-service obligations, including a further substantial increase in the penalty rate of BOK loans to commercial banks. We intend to increase this rate progressively as needed in order to provide strong incentives for banks to seek alternative sources for servicing their short-term debts. As soon as the viability of the foreign exchange cashflow is restored, the separate window will be abolished and banks will have to obtain their total foreign exchange requirements in the market. We intend to take this action at the earliest opportunity in consultation with the Fund (Box 4).

5. **Trade policy** - we will accelerate measures to open the economy to imports and eliminate trade-related subsidies in order to increase competition and efficiency in the domestic economy. We will make binding under WTO the liberalization of financial services as agreed with the OECD (Box 5).

6. **Labor market policies** - while the program aims to minimize the inevitable slowdown in economic growth, we will aim to facilitate the necessary movement of workers from declining firms to other employment possibilities. The government expects to shortly announce its views on labor market and wage issues, as well as on a fair sharing of the burden between employers and workers in the case of labor redundancies (Box 6).

7. **Fiscal policy** - the initial fiscal adjustment of the program will be maintained despite higher costs to the government associated with the larger depreciation of the won and with financial sector restructuring.

8. **Data publication** - we intend to publish periodically, after completion of preparatory work, data on total external debt and its relevant components.

The measures to strengthen the program have the full support of the economic team of the incoming government. We will monitor the implementation of these measures in close cooperation with the IMF, the IBRD, and the AsDB.

Yours sincerely,

/s/

Kyung-shik Lee
Governor
Bank of Korea

/s/

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

Attachments

Box 1. Monetary Policy

	Measures	Timing
1.	Raise call rates to 30 percent, or above if needed, to stabilize the exchange rate.	• Call rate rose to about 30 percent on December 24, 1997.
2.	Eliminate interest rate ceiling	<ul style="list-style-type: none"> • Increase in interest rate cap from 25 percent to 40 percent was approved by cabinet on December 16 and became effective on December 22. • Submit legislation to National Assembly to remove interest rate ceiling as soon as necessary procedures are completed, but not later than February 28, 1998.
3.	Sterilize activated amounts from W11.3 trillion liquidity support package provided to the financial sector, as needed to keep overall liquidity sufficiently tight to maintain interest rates at adequate levels.	• Injection amounted to W3 trillion through December 23; W2.8 trillion of this injection absorbed through issue of MSBs by December 23. Additional sterilization operations being undertaken.

Box 2. Capital Account Liberalization		
Types of measures	Measures	Timing
1. Equity market	• Raise ceiling on aggregate foreign ownership of listed Korean shares from 26 to 50 percent and the individual ceiling from 7 to 50 percent.	December 12, 1997
	• Increase the aggregate ceiling on foreign investment in Korean equities to 55 percent.	December 30, 1997
	• Eliminate the aggregate ceiling on foreign investment in Korean equities.	End-1998
	• Allow foreign investors to buy equity in the stock market (as well as over the counter) for the purpose of friendly mergers and acquisitions, without limits.	December 30, 1997
2. Bond market	• Allow foreign investment in the guaranteed corporate bond market (for maturities greater than three years) with limits at 10 and 30 percent for individuals and in aggregate respectively.	December 12, 1997
	• Eliminate all limits on foreign investment in non-guaranteed bonds issued by small- and medium-sized companies.	December 12, 1997
	• Raise aggregate limits for foreign investment in non-guaranteed corporate (convertible) bonds from 30 to 50 percent.	December 12, 1997
	• Eliminate all individual limits for foreign investment in corporate bonds.	December 23, 1997

	<ul style="list-style-type: none"> Allow foreigners to invest in government and special bonds, up to the aggregate ceiling of 30 percent. 	
	<ul style="list-style-type: none"> Eliminate all foreign investment ceilings for the government, special, and corporate bond markets, including for maturities of less than 3 years. 	December 30, 1997
3. Money market	<ul style="list-style-type: none"> Set timetable, in consultation with IMF mission, to permit unlimited foreign investment in domestic money market instruments. 	Mid-January 1998.
	<ul style="list-style-type: none"> Obtain National Assembly approval to reactivate treasury bill issues. 	February 25, 1998
4. Corporate borrowing	Lift the restriction on foreign borrowing of over 3 years maturity.	December 16, 1997
	<ul style="list-style-type: none"> Raise the maximum term of deferred payment credit for imports to 180 days. 	December 12, 1997
	<ul style="list-style-type: none"> Consult with IMF mission on lifting remaining maturity restrictions on foreign borrowing by corporations. 	Mid-January 1998
5. Financial institutions	Allow foreign banks and brokerage houses to establish subsidiaries.	March 31, 1998
6. Foreign borrowing	<ul style="list-style-type: none"> Place prudential controls on short-term external borrowing of financial institutions. 	March 31, 1998

Box 3. Financial Restructuring		
Types of measures	Measures	Timing
1. Deal with financial crisis	<ul style="list-style-type: none"> Establish a high-level task force chaired by the MOFE to coordinate development and implementation of a strategy to address the present financial crisis. Task force to include BOK, MOFE, KAMC, KDIC, and private sector. Terms of reference describing the objectives and staffing of the task force will be finalized by December 30. 	December 26, 1997
	<ul style="list-style-type: none"> Bank of Korea to limit its funding of financial institutions to short-term liquidity support. 	December 24, 1997
	<ul style="list-style-type: none"> Establish a high-level team, led by the MOFE to enter into negotiations with foreign commercial bank creditors to facilitate extensions of outstanding short-term debt and prepare access to medium-term borrowing. 	December 24, 1997
		December 1997

	<ul style="list-style-type: none"> Bank of Korea will suggest that banks and merchant banks voluntarily cease payment of all dividends through June 1999. 	
2. Deal with insolvent merchant banks	<ul style="list-style-type: none"> Identify and suspend 14 insolvent merchant banks 	December 2-10, 1997
	<ul style="list-style-type: none"> All merchant banks to submit preliminary rehabilitation plans 	December 30, 1997
	<ul style="list-style-type: none"> Agree upon criteria for judging rehabilitation plans of suspended merchant banks 	December 30, 1997
	<ul style="list-style-type: none"> Develop procedures for revocation of licenses of suspended merchant banks (that fail to submit rehabilitation plans, whose plans are rejected, or who fail to implement approved plans) 	January 22, 1998
	<ul style="list-style-type: none"> All merchant banks to submit revised rehabilitation plans 	February 7, 1998
	<ul style="list-style-type: none"> Hire internationally-recognized firms and experts to conduct due diligence of the balance sheets of merchant banks and to assess rehabilitation plans. 	January 20, 1998
	<ul style="list-style-type: none"> Complete assessment of rehabilitation plans. 	March 7, 1998
3. Strengthen commercial banks	Place Korea First Bank and Seoul Bank under intensive supervision by Bank Supervision Office.	December 24, 1998
	<ul style="list-style-type: none"> Assume government control of these institutions and remove management responsible for losses. Amend relevant legislation to empower the supervisory body to write down equity of current owners to absorb existing losses. 	February 25, 1998
	<ul style="list-style-type: none"> Hire outside experts to develop privatization strategy, and identify bad assets for transfer to KAMC. 	February 25, 1998
	<ul style="list-style-type: none"> Issue clear guidelines governing foreign investment in domestic financial institutions 	January 20, 1998
	<ul style="list-style-type: none"> Require submission of plans for capital restoration from all commercial banks not meeting Basle capital standards as of March 31, 1998. 	May 15, 1998
4. Strengthen deposit insurance scheme	<ul style="list-style-type: none"> Submit legislation to grant the relevant authorities the right to issue necessary quantities of bonds to meet the 100 percent deposit guarantee. 	December 30, 1997

5. Enact legislation to strengthen supervision	<ul style="list-style-type: none"> Enact financial reform bill to (a) amend Bank of Korea Act, (b) consolidate and significantly strengthen bank supervision, and (c) require corporations to prepare consolidated balance sheet. 	December 30, 1997
	<ul style="list-style-type: none"> Submit legislation to give the supervisory authority clear authority to close insolvent institutions. 	February 28, 1998
	<ul style="list-style-type: none"> Bankruptcy law will be reviewed and draft legislation will be prepared with the objective of streamlining bankruptcy procedures. 	March 31, 1998

Box 4. Exchange Rate Policy and Reserve Management

Measures	Timing
1. Abolish daily exchange rate band	December 16, 1997
2. Limit foreign exchange intervention to smoothing operations	Ongoing
3. Raise interest rate on Bank of Korea foreign exchange loans to commercial banks as high as needed to conserve reserves	Rate has been gradually increased from 400 basis points above LIBOR on December 2 to 1,000 basis points by December 23, 1997. Rate will be raised to 1,500 basis points above LIBOR by December 31, 1997, if necessary.
4. Monitor strictly need for Bank of Korea foreign exchange loans to banks unable to rollover foreign currency debt	From early December 1997, banks have been required to submit detailed lists of amounts falling due and demonstrate that all of their available foreign currency assets have been liquidated.
5. Monitor strictly Bank of Korea foreign exchange loans so as to ensure use of funds limited to debt repayment	Ongoing
6. Eliminate interest rate ceiling on resident foreign exchange accounts above 3 months.	December 22, 1997
Eliminate interest rate ceiling for resident foreign exchange accounts below 3 months.	December 31, 1997

Box 5: Trade Policy

Types of measures	Measures	Timing
1. Trade-related subsidies	Eliminate trade-related subsidies (four)	Submit to National Assembly a bill to abolish three trade-related subsidies, and abolish one subsidy administratively at the

	(committed to WTO by end-1998)	time of National Assembly approval, expected in March 1998.
2. Import liberalization	Phase out Import Diversification Program (presently covering 113 items) (committed to WTO by end-1999)	
	a. Liberalization of 25 items	December 30, 1997
	b. Liberalization of additional 40 items	July 1998
	c. Liberalization of additional 32 items	December 1998
	d. Liberalization of remaining items	June 1999
	<ul style="list-style-type: none"> The number of items subject to adjustment tariffs to be reduced from 62 to 38. 	January 1, 1998
	<ul style="list-style-type: none"> Import certification procedures are being harmonized with WTO standards and their implementation will be strengthened. 	Ongoing
3. Financial services liberalization	<ul style="list-style-type: none"> Binding of liberalization agreed with OECD as part of commitments to WTO. 	Announcement in January 1998

Box 6. Labor Market Policies		
Types of measures	Measures	Timing
1. Improve labor market flexibility	<ul style="list-style-type: none"> Announce government views on labor market and wage issues, as well as on a fair sharing of the burden between employers and workers in the case of labor redundancies. 	January 1998
2. Strengthen government employment insurance system	<ul style="list-style-type: none"> Announce plan to support the unemployed, intensify training and restructure labor market. 	February 1998
3. Ease burden of layoffs and expedite redeployment	<ul style="list-style-type: none"> Submit the temporary employment agencies bill to the National Assembly. 	February 1998