



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. That request was approved by the Executive Board of the IMF on December 4, 1997. 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 3, 1997

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

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 December 1997 and January 1998. The latter 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 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,

/s/

/s/

Kyung-shik Lee
Governor
Bank of Korea

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

Attachment

Seoul, Korea
December 3, 1997

Korea—Memorandum on the Economic Program

I. BACKGROUND

1. For the past several decades, prudent macroeconomic policies and continuing structural reforms have propelled Korea along a path of rapid economic development. With per capita GDP rising at an annual average rate of nearly 7 percent, the once poor agrarian economy has been transformed into an advanced industrial economy. At the same time, in the process of development, the limitations of Korea's system of detailed government intervention at the micro level have become increasingly apparent. In particular, the legacy of government intervention has left an inefficient financial sector and a highly leveraged corporate sector that lack effective market discipline.

2. In recent years, the government has implemented structural reforms in a wide range of areas, particularly the financial sector. However, the present financial crisis demonstrates that a more comprehensive and rapid pace of reforms is required to achieve a strong and transparent financial system which operates free of political interference and according to the rules and practices of the advanced industrial countries. Such a financial system is essential for the Korean economy to meet the challenges of globalization and return to a path of rapid sustained growth.

3. Until the present financial crisis, macroeconomic performance in Korea was broadly favorable. During the first three quarters of 1997, real GDP grew by about 6 percent and consumer price inflation declined slightly to 4 percent, while the external current account deficit is expected to narrow to less than 3 percent of GDP in 1997. Fiscal policy has remained prudent, with the budget for 1997 projected to record a small deficit. The monetary aggregate (M2) has edged down to the bottom of its target range in line with the inflation objective.

4. However, since the beginning of the year, an unprecedented number of highly leveraged conglomerates (chaebols) have moved into bankruptcy. The high rate of bankruptcies reflected a number of factors, including excessive investment in certain sectors, weakening export prices, and the government's greater willingness to allow troubled chaebols to fail. The bankruptcies spilled over into a sharp increase in nonperforming loans (defined according to international standards) to W 32 trillion (7 percent of GDP) by end-September, about double their level at end-1996.

5. The present difficulties in the financial sector stem from a lack of market orientation in financial institutions combined with lax prudential supervision. Financial institutions have priced risks poorly and have been willing to finance an excessively large portion of investment plans of the corporate sector, resulting in high leveraging. At the same time, the dramatic decline in stock prices has cut the value of banks' equity and further reduced their net worth. These developments have led to successive downgrades of Korean financial institutions by international credit rating agencies and a sharp tightening in the availability of external finance.

6. Korea's external financing situation deteriorated sharply after October 23, following the decline in the Hong Kong stock market and the downgrading of Korea's sovereign risk status by Standard and Poor's. New external financing has virtually dried up and substantial difficulties are being experienced in rolling over the relatively large amount of short-term debt (estimated at \$100 billion).¹ The won depreciated by about 20 percent against the U.S. dollar through November 30; the stock market index fell by some 30 percent to a ten-year low. Gross official reserves declined sharply, with a large amount used to finance the repayment of short-term debt of Korean commercial banks' offshore branches. While the contagion effects of developments in Southeast Asia contributed to the current crisis, the magnitude and speed of the deterioration in the financial situation owed much to the fundamental weaknesses in Korea's financial and corporate sectors.

II. THE POLICY FRAMEWORK

7. The government has put in place a comprehensive policy package to address decisively and promptly the structural weaknesses that are at the root cause of the present difficulties so as to restore market confidence and arrest the decline of the won. Tighter monetary and fiscal policies will provide the macroeconomic conditions to support comprehensive structural reforms.

8. The government's economic program is built around: (i) a strong macroeconomic framework designed to continue the orderly adjustment in the external current account and contain inflationary pressures, involving a tighter monetary stance and substantial fiscal adjustment; (ii) a comprehensive strategy to restructure and recapitalize the financial sector, and make it more transparent, market-oriented, better supervised and free from political interference in business decisions; (iii) measures to improve corporate governance; (iv) accelerated liberalization of capital account transactions; (v) further trade liberalization; and (vi) improve the transparency and timely reporting of economic data.

9. The principal macroeconomic objectives of the program include: building the conditions for an early return of confidence so as to limit the deceleration of real GDP to about 3 percent in 1998 followed by a recovery toward potential in 1999; containing inflation at or below 5 percent; and building international reserves to more than two months of imports by 1998.

A. Macroeconomic Policies

Monetary policy and exchange rate policy

10. The main objective of monetary policy is to contain inflation to 5 percent in 1998 and limit downward pressure on the won. To demonstrate to markets the government's resolve to confront the present crisis, monetary policy will be tightened immediately to restore and sustain calm in the markets and contain the inflationary impact of the recent won depreciation. In line with this policy, the large liquidity injection in recent weeks will be reversed, and money market rates² will be allowed to rise sufficiently and will be maintained at that level or higher as needed to stabilize markets.

11. The day-to-day conduct of monetary policy will be guided by movements in the exchange rate and short-term interest rates which will be used as indicators of the tightness of monetary conditions. A flexible exchange rate policy will be maintained, with intervention limited to smoothing operations. Monetary and exchange rate policy will be implemented in close consultation with the staff.

12. The inflation target reflects a very limited pass-through of the recent depreciation of the won to the aggregate price level. Financial restructuring and the sharp slowdown in economic growth are expected to reduce the demand for money. Hence, in order to achieve the inflation objective, the government will aim to reduce broad money growth (M3) from an estimated 16.4 percent at end-September 1997 to 15.4 percent at end-December 1997, and to a rate consistent with the inflation objective in 1998. This deceleration will be achieved by reducing the limits on reserve money. Open market operations will be used to contain the expansion of the net domestic assets of the Bank of Korea within the program limits.

B. Fiscal Policy

13. Fiscal policy in Korea has traditionally been formulated prudently, and in recent years the consolidated central government budget has been in broad balance, with government savings of around 8 percent of GDP and a low level of public debt. For 1998, a tight fiscal policy will be maintained to alleviate the burden on monetary policy and to provide for the still uncertain costs of restructuring the financial sector. The 1998 budget of the consolidated central government provided for a small surplus ($\frac{1}{4}$ percent of GDP). However, the slowdown in growth is projected to worsen the 1998 balance by about 0.8 percent of GDP. In addition, the interest costs of financial sector restructuring are presently estimated at 0.8 percent of GDP. Offsetting measures amounting to about $1\frac{1}{2}$ percent of GDP will be taken to achieve at a minimum budget balance and, preferably, a small surplus.

14. The program's targeted fiscal adjustment would be achieved with measures on both revenues and expenditures. Upfront fiscal action comprising an increase in the transportation tax and the special excise tax has already been taken to demonstrate the government's commitment to implement the program strictly. Other measures on the revenue side are likely to include widening the basis of the corporate tax, income tax, and

the VAT. On the expenditure side, specific plans will be formulated to reduce current expenditures and net lending, and to reduce low priority capital expenditure.

C. Financial Sector Restructuring

15. The centerpiece of the program is a comprehensive restructuring and reform plan for the financial sector. The government recognizes that left uncorrected, problems in a limited number of financial institutions could affect the health of the entire system and undermine confidence in Korea's financial system. Therefore, the government is taking bold and decisive action to address the problem of troubled financial institutions and to open the financial sector to foreign investment. Prompt action will also be taken to enact the necessary legislation to set up a strong and independent supervisory agency, strengthen and consolidate prudential supervision, and increase transparency. This will be followed by time-bound action plans for the orderly exit of nonviable institutions as well as for procedures and policies to deal with weak, but viable financial institutions, and measures to improve the commercial orientation and risk management of the financial sector.

16. Shortly following the Presidential elections in December, a special session of the National Assembly will be called to pass the following financial sector reform bills:

- 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.

17. Troubled financial institutions will be restructured and recapitalized within a specified time frame and according to a transparent and well coordinated strategy. A credible and clearly defined exit strategy will involve requiring troubled institutions to present a viable rehabilitation plan, and closing of insolvent financial institutions and those failing to carry out their rehabilitation plans within specified periods. Restructuring could also involve 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. A timetable will be set for all banks to meet or exceed Basle standards. The disposal of nonperforming loans will be accelerated. All forms of assistance to banks, including through the Korean Asset Management Corporation (KAMC) and the deposit insurance funds will be provided only as part of viable rehabilitation plans. All support to financial institutions, other than Bank of Korea liquidity credits, will be recorded transparently in the fiscal accounts. Market-oriented terms and conditions will be established for any support to financial institutions. In addition, the present blanket guarantees will be phased out and replaced by a limited deposit insurance scheme.

18. The operations of nine technically insolvent merchant banks were suspended on December 2, 1997 with depositors fully protected. These banks' foreign exchange operations will be transferred to other institutions. The consolidated deposit insurance corporation, to be created after the National Assembly passes the necessary legislation before the end of the year, will issue bonds to provide the funds to meet the deposit insurance obligations. The government will guarantee these bonds and bear the interest costs.

19. The government announced its plans to propose an amendment of the related laws to the first session of the National Assembly immediately after the elections, to allow foreign financial institutions to participate in mergers and acquisition of domestic financial institutions in a friendly manner and on equal principle. For merchant banks, foreign participation is allowed up to 100 percent.
20. The government began a first round of cleaning up the financial sector by implementing the following measures:
21. The nine merchant banks were immediately placed under the control of the MOFE and have been required to submit a rehabilitation plan within 30 days. If the MOFE fails to approve such plans, the institution will have its license revoked. Without approved rehabilitation plans, these banks will not be eligible to participate in the KAMC program of bad asset purchases or receive any financing from the deposit insurance fund. Until the rehabilitation plan has been approved, the control officer appointed by the MOFE will cease lending by the institution to any new borrowers (including interbank lending), permit no increase in the institution's off balance sheet exposure (i.e., extension of guarantees), and prohibit the purchase of any securities other than those guaranteed by the government. The control officer may continue to allow limited additional lending to existing borrowers on a case-by-case basis. Rehabilitation will be monitored in close consultation with the Fund. If the head of the supervisory authority concludes that rehabilitation has not been successful within three months, the institution will be closed.
22. Remaining merchant banks are required to present a program of recapitalization/downsizing by December 31, 1997 that will allow them to meet at least a 4 percent capital requirement ratio by March 31, 1998, 6 percent by June 30, 1998, and 8 percent by June 1999. Those ratios would be computed after applying the provisioning requirements set for commercial banks. Failure to obtain supervisory approval of the program or to meet the schedule will lead to suspension of foreign exchange business and could lead to revocation of license.
23. Two commercial banks in distress are required to prepare a plan, in about two months, to meet the Basle capital standards within four months after approval of the plan. Until that plan has been approved by the supervisory authorities, these banks will be subject to the intensive supervision by the supervisory authorities. That plan could initially include merger with another financial institution or disposal of some or all of their banking business, to restore their profitability to an acceptable level and meet the minimum solvency requirements set by the supervisory authorities. Rehabilitation will be closely monitored in cooperation with the Fund. If the head of the supervisory authority concludes that rehabilitation has not been successful within four months, the institution will be closed.
24. Other commercial banks are required to make full provisioning for their impaired assets and for their securities losses by end-March 1998. They will agree a timetable with the supervisory authority by June 1998 to achieve current minimum capital standards within a time frame of six months to two years. The program will include a precise implementation schedule. Until such recapitalization is achieved, they will be prevented from distributing dividends, their senior management remuneration will be frozen, and significant expansions of their operations will be subject to prior approval of the supervisory authorities.
25. The rehabilitation plans submitted to supervisory authorities by financial institutions will specify the sources and amounts of new capital, a clear schedule to meet Basle capital adequacy standards and provisioning requirements, and confirmation from the supplier of funds; indicate changes in management and ownership if that is the intention; present a business plan that defines the activities on which the institution will concentrate and those that it will desist from, and set out measures to reduce costs; and detailed steps to improve

internal governance, risk assessment and pricing, and loan recovery. When and if the plan is approved by the relevant supervisory authority, the institution will enter into a managerial contract or memorandum of understanding, which will include a schedule for implementation. In case an institution's plan is rejected by the supervisory authority as not credible, or is not implemented as agreed, the institution will be taken under the direct control of the supervisory authority until final disposition of its business.

26. In consultation with the Fund, the government will prepare a comprehensive action program to strengthen financial supervision and regulation in accordance with international best practice standards. To carry out this program the government will seek technical assistance from the Fund and other international institutions. The government will consult with the Fund regarding progress in implementing this action program at the time of review in mid-1998.

27. Specialized banks and development institutions are to be subject to the same prudential standards that apply to commercial banks, and their financial statements are to be subject to external audits under the same rules applicable to other financial institutions.

28. The government is convinced of the need not only to address the immediate problems of the financial system, but more fundamentally to set the basis for a strong domestic financial system. To do this, efforts will be made to increase market discipline, strengthen prudential supervision, and regulation in accordance with international best practice standards, increase the manpower needed for effective supervision, and strengthen the legal framework. Accounting standards and disclosure rules will be strengthened according to institutional best practices. Financial statements of large financial institutions will be audited by internationally recognized firms. Prudential standards will be upgraded to meet Basle core principles. Financial institutions will be encouraged to refine their risk assessment and pricing procedures, and to strengthen loan recovery; actions in these areas will be reviewed as part of prudential supervision.

29. Borrowing and lending activities of overseas branches of Korean banks will be closely monitored to ensure that they are sound. New injections of foreign exchange by the Bank of Korea to Korean commercial banks or their overseas' branches will carry a penalty rate of 400 basis points above LIBOR. This penalty rate will be periodically reviewed. The Bank of Korea's deposits with nonresident branches and affiliates of domestic financial institutions will not be increased after end-December 1997 but will be gradually reduced as soon as circumstances permit. Moreover, Bank of Korea's international reserves management practices will be reviewed with the aim of bringing them in line with international best practices.

D. Other Structural Measures

Trade liberalization

30. The government has undertaken substantial trade liberalization since the early 1980s which has resulted in the removal of quantitative restrictions on all but a few items and lowered the average tariff rate on manufactured goods to around 6 percent. Nevertheless, further liberalization will help enhance domestic competition. At the time of the first full review, a timetable will be set in line with WTO commitments to eliminate trade-related subsidies, restrictive import licensing and the import diversification program. Steps will also be taken to streamline and improve the transparency of the import certification procedures.

Capital account liberalization

31. To increase competition and efficiency in the financial system, the schedule for allowing foreign entry into the domestic financial sector will be accelerated. Foreign financial institutions will be allowed to participate in mergers and acquisitions of domestic financial institutions in a friendly manner and on equal principles. By mid-1998, foreign financial institutions will be allowed to establish bank subsidiaries and brokerage houses. Effective immediately foreign banks' will be allowed to purchase equity in domestic banks without restriction, 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.

32. The government plans to accelerate substantially its ongoing capital account liberalization program. The government has announced that the ceiling on aggregate foreigners' ownership of listed Korean shares would be increased from 26 percent to 50 percent by end-1997 and to 55 percent by end-1998. The ceiling on individual foreign ownership will be increased from 7 percent to 50 percent by end-1997 (excluding hostile takeovers). Legislation concerning hostile takeovers will be submitted to the first special session of the National Assembly to harmonize Korean legislation on abuse of dominant positions in line with other industrial countries' standards. By end-February 1998, the present timetable for capital account liberalization will be accelerated by taking steps to liberalize other capital account transactions, including those restricting foreigners' access to domestic money market instruments and the corporate bond markets, and by further reducing restrictions on foreign direct investment by simplifying approval procedures.

33. The traditional policy of channeling international borrowing through domestic financial institutions for onlending to the corporate sector rather than allowing or encouraging the corporate sector to borrow directly on international capital markets has served to make the financial system more vulnerable to changes in general conditions in international capital markets and shifts in international investor sentiment regarding Korea. Moreover, the guarantees extended by the government to the financial sector have, in effect, made much of Korea's external borrowing a contingent liability of the government. Therefore, a timetable will be set by end-February 1998 to eliminate restrictions on foreign borrowing by corporations.

Corporate governance and corporate structure

34. The government recognizes the need to improve corporate governance and the corporate structure. Toward that end, transparency of corporate balance sheets (including profit and loss accounts) will be improved 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 (except for prudential regulations). Directed lending will be eliminated immediately. While policy lending (e.g., agriculture, small business, etc.) will be maintained, the interest subsidy will be borne by the budget.

35. To strengthen market discipline, bankruptcy provisions according to Korean law will be allowed to operate without government interference. No government subsidized support or tax privileges will be provided to bail out individual corporations.

36. To ensure the transparency of financial transactions and reduce scope for corruption, the "real name" system in financial transactions will be maintained, although with some possible revisions.

37. With the assistance of international and regional multilateral financial organizations, a plan will be formulated by late 1998 to encourage the restructuring of corporate finances, including measures to reduce the high debt to equity ratio of corporations, develop capital markets to reduce the share of bank financing by corporations, and change the system of cross guarantees within conglomerates. These will be reviewed in the first full review.

Labor market reform

38. 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.

Information provision and program monitoring

39. To improve transparency and allow market participants to make informed assessment of economic developments, the publication and dissemination of key economic data will be improved. Beginning January 1, 1998, data on foreign exchange reserves, including the composition of reserves and net forward position will be published monthly with a two weeks delay initially, and data on financial institutions, including nonperforming loans, capital adequacy, and ownership structures and affiliations will be published twice yearly. Data on short-term external debt will be published quarterly. Efforts will also be made to improve the timeliness of data on local government finances, and progress in this area will be reviewed in mid-1998. In addition, by end-March 1998, Korea will post its meta data on the Fund's Special Data Dissemination Standards.

40. During the period of the arrangement, the government will not accumulate any new external payments arrears, and will not impose new or intensify existing restrictions on payments and transfers for current international transactions, or introduce or modify multiple currency practices, or conclude bilateral payments agreements that are inconsistent with Article VIII of the Fund's Articles of Agreement, or impose new or intensify existing import restrictions for balance of payments reasons.

41. The following quarterly quantitative performance criteria will be set to monitor progress under the program: (i) a ceiling on net domestic assets of the Bank of Korea and (ii) a floor on net international reserves of the Bank of Korea. There will also be an indicative floor on the consolidated central government budget surplus on a cash basis (including the carrying cost of financial sector support). These quantitative performance criteria, indicative targets, and precise definitions of quantitative variables monitored under the program are set out in attached Annexes A-C. Other performance criteria and benchmarks are given in Annexes D and E. There will be two biweekly reviews in December 1997 and January 1998 and four full quarterly reviews under the arrangement during the first year in February, April, July, and November 1998.

42. To ensure effective program monitoring, the government will request the opening of a resident representative office of the IMF in Seoul.

¹At end September 1997, including debt contracted by residents, nonresident branches and affiliates of domestic financial institutions, and offshore banking debt contracted by domestic banks.

²Call rate, 91-day CD, and three-year corporate bond rates.

ANNEX A

Monetary Sector

Outstanding stock as of:	Limit (In trillions of won)
Net domestic assets ¹	
End-September 1997	1,721
End-December 1997 (performance criterion)	10,950
Reserve money	
End-September 1997 (actual)	22,275
End-December 1997 (indicative limit)	23,270
Broad money (M3)	
End-September 1997 (projected)	688,760
End-December 1997 (indicative limit)	709,775

¹Net domestic assets is defined as the difference between reserve money and the won equivalent (converted at program exchange rates) of net adjusted international reserves as defined in the program.

Reserve money is defined as the bank notes and coins issued plus reserve deposits of domestic money banks.

M3 is defined as M2 plus deposits of other financial institutions, debentures issued, commercial bills sold, "deposits of credit unions", mutual credits of the National Federation of Fisheries, "Community Credit Cooperatives", Mutual Savings and Finance Cooperatives situated in local and reserve life insurance company, certificates of deposit, repurchase agreements, and cover bills. M2 is defined as currency in circulation, plus deposit money (demand deposits at monetary institutions, time and savings deposits, and resident's foreign currency deposits at monetary institutions.)

The ceiling on net domestic assets and the indicative limit on reserve money will be increased (decreased) for any increase (decrease) in required reserve ratios.

ANNEX B

Net International Reserves of the Bank of Korea (BOK)

	Floor (In billions of U.S. dollars)
End-September 1997 (actual)	21.1
End-December 1997 (performance criterion)	11.2

For monitoring purposes, net international reserves of Bank of Korea (NIR) is defined as the sum of (i) the U.S. dollar value of gross foreign assets in foreign currencies minus gross liabilities in foreign currencies, and (ii) reserves against foreign currency deposits.

Gross foreign assets will include all foreign currency-denominated claims of BOK, including monetary gold, holdings of SDRs, and the reserve position in the IMF. Excluded from gross foreign assets will be participation in international financial institutions, as well

as holdings of nonconvertible currencies, claims on residents, and deposits of the BOK at overseas branches and subsidiaries of Korean banks. Gross foreign liabilities are all foreign currency denominated liabilities of contracted maturity up to and including one year plus the use of Fund credit. All assets and liabilities will be valued at program exchange rates.

The net forward position is defined as the difference between the face value of foreign currency-denominated BOK off-balance sheet (forwards, swaps, options, and any futures market contracts) claims on nonresidents and foreign currency obligations to both residents and nonresidents.

The floor on NIR will be adjusted:

(i) downward by the U.S. dollar equivalent (converted at the program exchange rate) of the increase in foreign liabilities of the BOK associated with the emergency financing package.

(ii) upward by the amount of financing under the emergency financing package in excess of the program baseline (and downward by any shortfall).

(iii) upward by the amount by which deposits of the BOK at overseas branches and subsidiaries of domestic financial institutions are below the baseline specified in the program.

(iv) upward for any increase in the net forward position over the end-November position of US\$6.2 billion.

ANNEX C

The Consolidated Central Government Balance

	Limit (In trillions of won)
Balance for 1997 (indicative floor)	-2.0

The consolidated central government balance is defined as the consolidated balance of the central government (comprising the general accounts, and the special budgetary funds) and the public enterprises special accounts. The balance is the difference between total revenues and the sum of total expenditures and net lending. Expenditures include all interest costs associated with the restructuring of the financial sector borne by the public sector (including monetary authorities and public banks).

ANNEX D

Interest rate on foreign exchange injections by the Bank of Korea to Korean commercial banks or their overseas branches

Through the period to the completion of the second biweekly review, the interest rate charged by the Bank of Korea on foreign exchange injections to Korean commercial banks or their overseas branches shall not be below 400 basis points above LIBOR. This will be a performance criterion.

This floor shall be reviewed at the time of the second biweekly review of the program and a new performance criterion may be set for the period after January 8, 1998.

ANNEX E

REVIEWS

All reviews will examine developments under the program, particularly (but not exclusively) in the monetary and foreign exchange areas, and whether the program is on track to achieve its objectives, as well as compliance with any applicable performance criteria.

In addition, the following benchmarks have been set:¹

- a. **First biweekly review** (to be completed on or about December 18, 1997)
 - o Compliance with understandings between the Korean authorities and the Fund regarding the implementation of interest rate policy.
- b. **Second biweekly review** (to be completed on or about January 8, 1998)
 - o Call a special session of the National Assembly shortly following the Presidential elections in December to pass the following reform bills: a revised Bank of Korea Act that provides for central bank independence, with price stability as its main mandate; a bill to consolidate bank supervision; and a bill requiring that corporate financial statements be prepared on a consolidated basis and be certified by external auditors (as discussed in paragraph 16 of the Memorandum on the Economic Program).
 - o Submit legislation to the first special session of the National Assembly to harmonize the Korean regime on equity purchases with OECD practices.
 - o Submit legislation concerning hostile takeovers to harmonize Korean legislation on abuse of dominant positions in line with industrial countries' standards.
 - o Publication of foreign reserve data.
 - o The Bank of Korea's deposits with nonresident branches and affiliates of domestic financial institutions will not be increased after end-December 1997.

¹Additional benchmarks will be added at the time of reviews, for subsequent reviews.
