

## THE IMF BAILOUT: A CALL FOR RESTRUCTURING

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### *Crisis Emerges in November*

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On November 21, newly-appointed Deputy Prime Minister and Minister of Finance and Economy Lim Chang-yuel announced that the Korean government had decided to approach the IMF for financial assistance to help overcome the recent difficulties in the financial and currency markets. The announcement had been long expected by analysts, even though the Government had been repeatedly denying for weeks that such actions would be needed. After Korea was rebuffed by the U.S. and Japan in its requests for direct bilateral assistance, though, asking the IMF for help was unavoidable.

According to the Bank of Korea, Korea's foreign currency reserves stood at \$30.51 billion at the end of October. Throughout November, though, the Bank of Korea (BOK) was forced to supply dollars to the market almost daily, which rapidly depleted its already thin reserves. Investors remained skeptical of the central bank's claims that fears of a currency crisis were unfounded, especially since the BOK refused to release exact figures on the level of its reserves. Currency traders soon lost faith in the government's pronouncements that it would defend the won at a certain level, only to see them make the same claim at a different level a few days later.

A financial market stabilization package was announced on Nov. 19, which included a widening of the daily fluctuation band for foreign exchange from 2.25% to 10%. The day after the band's expansion, the won's freefall accelerated, with the won/dollar exchange rate hitting 1130 won/dollar. The Korean Govern-

ment had no other option but to turn to outside help.

Initially, Korea announced that it was requesting around \$20 billion in aid, \$5.5 billion of which was Korea's share of the IMF fund. However, most analysts estimate that at least \$50 to 60 billion is needed, and the Korean government has recently admitted that the total amount of money needed from the IMF and other contributors will be around \$55 billion, if not more.

Many are decrying the request for IMF aid as a loss of national economic sovereignty and a national shame. While that may be overstating the case a bit, never has it been clearer that the Korean economy is in troubled times and that the long-discussed fundamental restructuring of the Korean economy will finally have to take place.

### *The IMF's Conditions*

The IMF will demand that Korea change its basic economic policies. The stabilization program will center around three main areas: the external sector, the financial sector, and the government sector. Regarding the external account, the current account deficit will need to be reduced and Korea will need to boost its foreign currency reserves. For the financial sector, insolvent financial institutions will need to be liquidated or restructured, and financial reform will need to be implemented more actively. In addition, business financial costs and unnecessary government regulations will also have to be addressed.

<Table 1> Basic Results of the IMF Negotiations

Area	Contents
Macro Economy	<ul style="list-style-type: none"> <li>• 1998 GDP growth target of 3%</li> <li>• Reduction of current account deficit to within 1% of GDP</li> <li>• Consumer inflation of 5% or below</li> <li>• Maintaining domestic interest rates between 18 ~ 20%</li> <li>• Reducing the government budget (by 7.5 trillion won in 1998), increasing the value added tax by 1%</li> </ul>
	<ul style="list-style-type: none"> <li>• Increasing the foreign stock ownership limit (total 50%, individual 25%)</li> <li>• Open the short-term bond, government and public bond, and CP markets within the year</li> <li>• Close down insolvent overseas branches of financial institutions</li> </ul>
Financial Reform	<ul style="list-style-type: none"> <li>• Increase limit on foreign ownership of banks to 51%</li> <li>• Establish comprehensive financial supervisory body</li> <li>• Limit increase in DC to 8%</li> <li>• Abolish system of cross-guarantees among group subsidiaries</li> <li>• Adopt consolidated financial statement system</li> <li>• Adopt international accounting standards among financial institutions</li> </ul>
Trade Labor	<ul style="list-style-type: none"> <li>• Abolish import diversification system</li> <li>• Allow layoffs in restructuring</li> </ul>

*"To reduce current account deficit to within 1% of GDP and to stabilize the exchange rate, the GDP growth target will be lowered to around 3%."*

*"An institutional framework which allows active mergers and acquisitions (M&As) and market entry/exit within the financial sector is needed to allow a comprehensive restructuring of the industry."*

*Implications*

One of the key conditions to the IMF's aid package is that Korea must lower its GDP growth rate target for 1998. The GDP growth rate for this year is projected to be between 6.0-6.2%, and before the crisis, the target for 1998 was to be around 6%. To reduce current account deficit to within 1% of GDP and to stabilize the exchange rate, the GDP growth target will be lowered to around 3%. The consumer price index increases will be targeted at 5% or less. The Korean Government will also need to adopt a tight fiscal and monetary policy. Increases in the money supply will be limited to around 10% or so, meaning that interest rates will raise to between 15% to 20%. As a result of the slower growth rate and restructuring in the financial sector, the unemployment rate will rise above 4% (about

900,000 total unemployed).

The pace of financial reform and liberalization will also need to be hastened. In addition to the swift passage and implementation of the financial reform bills being held up at the National Assembly, additional regulations which will expand the bank ownership limits, introduce financial holding companies, liberalize entry into the financial industry, and make supervisory functions more transparent also need to be passed. An institutional framework which allows active mergers and acquisitions (M&As) and market entry/exit within the financial sector is needed to allow a comprehensive restructuring of the industry. Also, since firms will find it more difficult to raise funds under the tight monetary policy, measures regarding business financing will need to be revised or liberalized.

The government sector in Korea has also been criticized much lately as a weakness of the

Korean economy. Accordingly, it too will have undergo dramatic changes. First and foremost is the liberalization or elimination of various administrative regulations, particularly in terms of market access and exit. The government budget will have to be reduced by around 10% or 7.5 trillion won, which will invariably mean a reduction in the size and number of government institutions or increased privatization.

The labor market will invariably go through major changes in the course of economic restructuring, especially since it is also singled out often as a major factor undermining Korea's competitiveness. Therefore measures to

allow more flexibility in layoffs and also to minimize the adverse effects of the changing labor situation need to be devised and implemented.

*How This Will Affect Korea*

As was mentioned before, the IMF is insisting that GDP growth be limited to 2.5 to 3% to keep the current account deficit within 1% of the GDP. Growth will be propelled by increased exports, while domestic demand (consumption and investment) will drop  
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<Table 2> HRI's Forecast for Major Economic Indicators in 1998

		(Unit: \$100 million, %)		
		'96	'97(e)	'98(e)
Economic Growth	GDP	7.1	6.2	2.6 ~ 3.0
	Total Consumption	6.9	5.0	2.4 ~ 2.6
	Private Consumption	6.9	4.8	2.8 ~ 3.0
	Gross Fixed Capital	7.1	-2.1	-6.0 ~ -5.7
	Facility Investment	8.2	-7.4	-6.4 ~ -6.2
	Construction Investment	6.3	1.1	-5.9 ~ -5.5
	Current Account Balance	-237.2	-133	-2 ~ 6
	Trade Balance	-152.8	-47	72 ~ 80
	Exports (Customs Clearance Basis)	1,297	1,370	1,484 ~ 1,492
	(growth rate, %)	(3.7)	(5.6)	(8.3 ~ 8.9)
National Account	Imports (Customs Clearance Basis)	1,503	1,471	1,463 ~ 1,472
	(growth rate, %)	(11.3)	(-2.2)	(-0.5 ~ 0.1)
Price Indicators	Consumer Price Index (Compared to previous year)	4.5	4.3	4.8 ~ 5.3
	Corporate Bond Rate (year end)	12.6	13.5 ~ 14.0	18 ~ 20
	Won/dollar Exchange Rate (year end)	844.2	1,000 ~ 1,050	1st H 1,050 ~ 1,100 2nd H 1,000 ~ 1,050
	Yen/dollar Exchange Rate (year end)	116.0	125 ~ 130	1st H 130 ~ 135 yen 2nd H 125 ~ 130 yen
	Unemployment (yearly average) (total unemployed)	2.0	2.5	4.1 ~ 4.3 (about 900,000)

\* Note : 'e' stands for estimates