

## TWO YEARS UNDER IMF PROGRAM: AN ASSESSMENT

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This month marks the second anniversary of the so-called IMF era. On December 3, 1997, the IMF and the Korean government reached an agreement, which set forth a massive amount of bailout program<sup>1)</sup> and ensuing strict economic reform standards. After the severe depression resulting from the IMF policy prescription in the first half of 1998, the Korean economy managed to return to its growth track from the last quarter of 1998. Along with the macroeconomic fluctuations, every sector in the economy should have experienced unprecedented reforms, the restructuring processes which were mostly suggested by the IMF and other international institutions. Because of the apparent recovery in major economic indicators as well as the remarkably improved foreign currency condition, many economists pick the Korean economy as a "model case" among the countries which received the IMF's help. In fact, there is an expectation that Korea may graduate from the IMF program in the next year. However, as in all economic phenomena, not only opportunities but certain kinds of risks at the same time are embedded in the current economic situation. When recovering from an economic crisis, especially when the opportunities are bright enough, one needs to pay more attention to the hidden risks. The time, therefore, is quite ripe to evaluate the

overall performance of the Korean economy under the IMF program, to identify potential dangers lying ahead, and finally to address future missions.

### *What Were Achieved*

Foreign currency shortage and sovereign debt problem were resolved faster than other areas. It is a direct result from the bailout program and current account surpluses. Korea's current account, which was a major culprit of the foreign exchange crisis, recovered from deep-rooted deficits to a stunning \$40 billion surplus in 1998. It is forecast that the surplus will continue in this year with more than \$20 billion. In effect, the usable foreign currency reserves were merely \$3.3 billion on November 26, 1997, but jumped to more than \$66 billion as of October 1999. The foreign debt situation showed an improvement in terms of both size and term structure. The total external liabilities<sup>2)</sup> exceeded \$160 billion when the Korean government first requested a bailout; and

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1) The IMF bailout program is composed of SRF(Supplemental Reserve Facility) and SBA(Stand-By Arrangement). When put together, the total amount is \$19.5 billion. In addition to this direct assistance, the IMF arranged lines of credit from advanced nations for a back-up facility.

2) This is the IMF's official terminology for foreign debt.

almost 60% of this amount was short-term debts which were due within a year. As of September 1999, the total external liabilities decreased to \$140 billion and less than a quarter of it is short-term debts, a significant portion of which are related with foreign trades. Moreover, the Korean government recently repaid all of its SRF and SBA fund borrowed from the IMF. Owing to these developments, stability returned to the domestic exchange market. The won/dollar rate once hiked almost up to 2,000 won/dollar in March 1998; but continuous inflows of dollars into the market from the latter part of this year helped stabilize the rate around 1,200 won or even lower.

The most remarkable recovery occurred in the macroeconomy. In fact, the earlier part of the IMF era can be phrased as "a severe recession period" mainly due to incredibly high interest rates and tight money supply, which

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were suggested in the IMF policy review with the Korean government. As a result, the real GDP growth rate marked a -5.8%, the worst in the modern history of the Korean economy. From the latter part of 1998, fortunately, the economy regained momentum for a rebound after the IMF switched its policy prescription from tight policy to flexible one. This upward trend managed to continue until these days, showing a remarkable recovery compared to 1998. For instance, the third quarter posted a 12.3% growth on a y-o-y base. Along with this recovery, the capacity utilization rate climbed up to 80% level from 60% in 1998. Unemployment

rate is also showing improvement month after month, even though it seems difficult to recover the pre-crisis level of 3% or below.

Restructuring<sup>3)</sup> is another way to review the revolutionary changes in the Korean economy. In spite of the fact that the restructuring was a "forced" act in its nature, the Korean government, businesses, and workers succeeded in securing the minimum level of consensus to pursue the restructuring process without serious hindrances. From the beginning of 1998, the banking industry has witnessed exits of many debt-ridden banks; meanwhile, the survived ones have to meet the BIS standard which regulates the soundness of their asset structures. By the first quarter of next year when the restructuring of ITCs (Investment Trust Companies) is completed, one can expect that domestic financial institutions will be equipped with sound asset structure and advanced management. The corporate sector restructuring is under progress as well. Policy changes regarding the corporate restructuring can be classified into three areas: managerial conducts, financial structure, and business portfolio. Introduction of the GAAP and other measures to guarantee the managerial transparency especially of Korea's chaebols fall in the first category. Requirement to meet 200% debt-equity ratio for major chaebol and ensuing enforcement measures are included in the second category. The direction of business portfolio restructuring which is often called "Big Deal" has been decided by mid-1999. Labor market could not be an exception to the overall restructuring. In 1998, the Korean government, the labor and the businesses managed to reach a tripartite agreement for the first time in history. Even if chronic disputes could emerge from time to time, it is worthwhile to honor the original intent and thus to keep a stable labor market

3) Regarding restructuring, readers should refer to previous issues of the *VIP Economic Report* for a thorough survey. In addition, this month's issue contains an article which delves into the corporate sector restructuring in greater details.

for smooth economic recovery. Contrary to the substantial changes in other areas, the public sector restructuring is lagging behind schedule. Notwithstanding criticisms from the private sector for the delay itself, the Korean government should speed up the restructuring process in order not to impede the gaining of competitive edges in other areas.

Ever since the crisis broke out, sovereign credibility became an indispensable factor in evaluating the Korean economy, a nation that experienced a severe foreign currency shortage. The credibility expressed in terms of credit ratings by international agencies also improved substantially. Stabilized currency condition, improved debt structure, continued restructuring, and fast recovery of the domestic economy worked together to enhance Korea's credibility. Major rating agencies such as Moody's and S&P have continuously upgraded Korea's ratings from "non investment" category to "investment" category.

### *How To Address Weaknesses*

The economy is thriving on a "higher-than-expected" recovery; however, with regard to the nature and the by-products of the recovery, there are several negative factors. First, the rebound in economic indicators heavily depends upon the increase in consumption expenditure and exports. Since facility investment remained sluggish until recently, many economists worry that the Korean economy's long-term growth capability might be undermined or at least not fully prepared. Second, the Korean society is taking an unprecedented test; its level of integration is being threatened. The high unemployment rate and the widening gap between the rich and the poor are the culprit of this phenomenon. Third, a new kind of burden emerges; national debt has become a policy

issue after massive raise in the government's fiscal expenditure. Fourth, in terms of industrial policy, no vision or blue print is yet to be found. The ongoing corporate sector restructuring is focusing on "curing" and "eradicating" rather than on "building" or "establishing." Without an adequate long-term vision, the Korean economy may well lose its position as an industrial powerhouse even in manufacturing.

In order to fix these problems, several policy principles should be re-established. Consistency is the primary virtue. Especially in the macroeconomic policy, the government and the BOK should maintain the current stance. By doing so, businesses can regain incentives to make facility investment, as the corporate restructuring approaches the end. For a higher social integration, the government's role is crucial in the sense that further profound reform will be needed in tax policy and labor market policy. When the sectoral restructuring is completed, the Korean economy will possess a more efficient economic system than before in almost every sector. However, the more important problem is how to run this new "system." Making a full use of the new

system requires advanced conducts in the forefront of public administration. Meanwhile, the absence of a long-term vision can be worked out only through cooperation between policy-makers and businesses. First of all, they must reach the consensus that the Korean economy's foremost mission is "sustained growth" among others. Based on this goal, they should re-design the entire industry and work out how to incorporate management based on high technology and knowledge with the current industrial structure. **VIP**

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