Case Number: 2009-0528-F

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DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001. paper	South Korea: Jobless in Seoul. (1 page)	04/16/1998	P1/b(1)
002. cable	Korea: Next Steps. (5 pages)	01/15/1998	P1/b(1)
003. cable	South Korea: Financial Crisis. (9 pages)	01/15/1998	P1/b(1)
004. report	South Korea: Current Situation. (2 pages)	01/07/1998	P1/b(1)
005. note	Handwritten Notes: Korea Bank Proposals. (3 pages)	n.d.	P1/b(1)

COLLECTION:

Clinton Presidential Records
National Economic Council
Lael Brainard
OA/Box Number: CF 1195

FOLDER TITLE:

Korea Finance [2]

2009-0528-F
vz1401

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

P1 National Security Classified Information [(a)(1) of the PRA]
P2 Relating to the appointment to Federal office [(a)(2) of the PRA]
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PRM. Personal record misfile defined in accordance with 44 U.S.C. 2201(3).
RR. Document will be reviewed upon request.

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

January 23, 1998

MEMORANDUM FOR SECRETARY RUBIN
DEPUTY SECRETARY SUMMERS
UNDER SECRETARY LIPTON
ASSISTANT SECRETARY GEITHNER

FROM: Daniel M. Zelikow DMZ.
Deputy Assistant Secretary (Asia, the Americas & Africa)

SUBJECT: Asia Daily

Attached is the daily Korea update by Redifer, Saeger and Singer.

cc: G. Gensler; C. Atkinson; K. Lissakers; T. Dulaney; J. Piercy; L. Yang; Amb. Bosworth; S. Roth; S. Kristoff; D. Tarullo; T. Truman; D. Zelikow; T. Dulaney; S. Flanders

Korea Update
January 23, 1998

Useable reserves: It was a good day for the BOK. Net hard currency reflows of $240 million boosted estimated useable reserves up to $11.5 million. Total amortization was $850 million, and the rollover ratio was 98%.

- Net reflows for the week were $214 million, offsetting almost half of last week's $467 million outflow. We suspect, although do not have proof, that part of the reflow was repayment of BOK funds provided for inappropriate uses last week.

- The rollover arrangement seems to be functioning reasonably well: the rollover ratio for all creditor countries for the past two weeks has been 82%.

- We've heard the BOK funding window might be closed Monday through Wednesday of next week in observance of the Lunar New Year holidays.

- The international group of central bankers (Ted Truman & company) monitoring the rollover will scale back their conference calls from daily to two times per week (Monday and Friday).

Market Update:

	1/15/98*	1/16/98	1/17/98	1/19/98	1/20/98	1/21/98	1/22/98	1/23/98*
3 Yr Corporate	23.50	23.50	23.50	24.5	24.5	23.3	22.8	22.0
Call loans (overnight)	25.50	23.55	24.05	24.6	24.49	25.81	25.31	NA
Equity Mkt	505.98	488.1	495.9	528.8	533.6	506.66	484.0	486.9
% change	6.5	- 3.5	1.6	6.6	0.9	- 5.1	- 4.5	0.6
Exchange Rate[1]	1605.0	1618.0	NA	1580.00	1642.0	1723.00	1760.00	1745.00
% change	3.9	- 0.8	NA	2.4	- 3.9	- 4.9	- 2.2	0.9

* Preliminary figures, 1/closing rate

<u>Equity/Foreign Exchange/Bond Market</u>: Three-year corporate rates continued to decline with dealers attributing the high liquidity to recent payment of corporate deposits by suspended merchant banks.

Program Implementation

- Klein Maus & Shire Inc. will invest $80 million in troubled Daehan Investment Bank. Daehan will sell $50 million of new shares and $30 million of convertible bonds to Klein Maus, diluting the equity stake of Sungwon Group, Daehan's biggest shareholder, from 37.9% to 18 percent.

- Korea Long-Term Credit Bank and Hana Bank confirmed reports that they are in talks with the International Financial Corp (IFC) for long-term loans of $100 million each.

- A Korea Electric Power Corp (KEPCO) official reported that the Korean government has requested KEPCO sell electricity to many of its clients on credit. Government officials have denied making the request.

- MOFE plans to submit a bill to the National Assembly on bankruptcy law revision, possibly during an anticipated special parliamentary session in February or during the regular session in September. The bill's primary aim is to speed up restructuring of companies under court receivership and protection. Under current law, liabilities of court-protected firms may be frozen for up to 20 years; MOFE's bill would shorten this period to 10 years. The new bill would require companies that report larger liabilities than assets to reduce their capital in order to facilitate a third-party takeover. In addition, controlling shareholders could be stripped of their shares if it were determined that poor management led to corporate failure. MOFE said that it plans to strengthen corporate qualification for court protection and require a court administrator to supervise corporate assets of firms under protection.

- Korean domestic bank officials stated that Korean banks have resumed issuing letters of credit (LCs) carrying no amount limit to importers and exporters. However, traders said importers still faced difficulty getting finance for trade deals directly from local banks due to conditions placed by Korean banks on LC issuances. Specifically, Korean banks are issuing LCs with no limit only on condition that they are accepted by foreign banks, thereby diluting the risk to Korean banks.

- The Korea Confederation of Trade Unions (KCTU) demanded *chaebol* owners step down from management positions, stating "*Chaebol* owners and their children must resign from management, make their personal assets public and donate them to pay companies' debts." The KCTU also demanded that labor participate in management, that mutual debt guarantees among *chaebol* affiliates be abolished, and that *chaebol* begin issuing consolidated financial statements. The latter two conditions are included as part of Korea's IMF program. A KCTU spokesman said the union will organize rallies beginning in early February to push for its *chaebol* reform demands.

U.S. Department of the Treasury

Office of East and South Asian Nations
1500 Pennsylvania Avenue, MT 5221
Washington, D.C. 20220

January 22, 1998

FAX MESSAGE

TO: **Leal Brainard**
Fax: 395-6853

FROM: **Laure Redifer,** International Economist
Phone: (202) 622-1724 Fax: (202) 622-0349

SUBJECT:

Pages, including this cover 1

FACSIMILE MESSAGE

Mark Sobel asked me to fax this to you.

Core Principles to Guide Negotiations for a Korean Refinancing Package

This note lays out several core principles that any refinancing of Korea's short-term external liabilities should meet.

1. Comprehensiveness:

Any refinancing deal should have broad enough coverage of claims that it erases market doubts about the adequacy of Korea's foreign exchange reserves for servicing the short-term external liabilities of the financial and public sectors.

- The deal should encompass the vast preponderance of existing creditor bank claims on Korean financial institutions maturing during some specified time period. The creditor claims should include both on- and off-balance sheet claims.

2. Significant Extension of Maturities

In order to overcome Korea's short-term liquidity crisis, an exchange offer or other refinancing deal should involve a significant lengthening of the maturities of creditor claims on Korea.

3. Quick Closure of Agreement

The refinancing deal should be structured in a way that it can be negotiated and executed quickly. Failure to do so heightens the risk that the current rollover arrangement will unravel and that bilateral support will not be disbursed.

4. Pricing

While new claims at longer maturities may entail higher yields, the price or interest rate of any instruments into which existing claims are swapped should be appropriate and reasonable with respect to the market value of these claims prior to any refinancing deal.

5. New Money

In order to speed the normalization of its external creditor relationships and to strengthen its reserve position, the Korean government should seek to raise an appropriate amount of new money to replenish its foreign exchange reserves, either to coincide with any refinancing deal or shortly thereafter.

Additional Considerations for Evaluating a Re-Financing Deal for Korea

1. Evaluation of Pricing:

Perhaps the most difficult aspect of evaluating any potential deal is assessing whether or not the pricing or the mechanism for pricing are appropriate. It will be critical to balance two differing objectives: first, that creditors not receive terms that are overly generous given what the market value of these claims would have been in the absence of a refinancing deal; second, if terms are too punitive, there will be little incentive for broad participation among creditor banks.

- *Pricing of Existing Claims:* Notional upper and lower bounds for pricing of existing claims can be determined from the secondary market prices of existing Korean paper (KDB bonds). It is clear, however, that in any exchange offer, the prices should not be based primarily on current market rates, but should reflect the market value of these claims prior to any refinancing deal.

- *Pricing of New Money:* The Koreans must be willing to raise new money at market rates, however, punitive those rates currently may seem.

2. Coverage/Scope of Guarantee:

There are a number of issues concerning the possible coverage of any refinancing deal. While the deal should encompass a broad enough range of outstanding external liabilities that Korea's financial crisis can effectively be ended, it is also important to limit the socialization of private sector claims by the Korean government.

Maturity of Claims Eligible for Deal: The current Korean proposal would be offered to creditor banks with claims maturing during the first half of the year.

- Based on estimates at the end of December, $28 billion of financial institution liabilities are maturing during the first half of 1998, with approximately $4 1/2 billion more in both the third and fourth quarters of the year.

- It is critical that the a large enough share of Korea's short-term debt be included in any deal so that the current liquidity crisis is not merely postponed until later this year.

Instruments Covered: There is clear agreement that both on- and off-balance sheet claims on Korean financial institutions should be included in the refinancing deal. Despite current concerns about trade credit drying up, we do not believe trade finance should be part of the deal.

- *Trade Finance:* There appears to be consensus among the Koreans, creditor institutions, and regulatory agencies that trade financing should not be included in the deal. While some creditors may refuse to extend trade credit, this is the safest segment of claims on Korea. Bringing it under the umbrella of a refinancing agreement would tend to impair the normal operation of the market.

Debtor Coverage: On August 25, 1997, the Korean Government issued a public statement indicating that the "Korean Government will ensure the payment of foreign debt liabilities by

Korean financial institutions." The guarantee did not have any legal status until last month, however, when the National Assembly passed a bill allowing the government to guarantee up to $20 billion of commercial bank liabilities.

- *Merchant Banks:* While the Government's statement of August 25 also covered the liabilities of the merchant banks, the fact that most of these institutions are insolvent should preclude them from receiving the type of liquidity support envisioned in an exchange offer.

- *Non-Financial Corporations*: Non-financial corporations should **not** be included in any restructuring deal or enjoy any form of sovereign guarantee. Restructuring of creditor claims on non-financial corporations is the sole responsibility of the creditor and debtor.

- *New Commercial Bank Financing:* While a signficant portion of existing claims on Korean commercial banks will almost undoubtedly require some form of sovereign guarantee in any refinancing deal, new lending to commercial banks should not be given a sovereign guarantee.

  - According to the IMF program, the blanket guarantee on bank deposits is to be eliminated by the end of 2000. Until a limited deposit insurance system is in place, it may be difficult for the government to roll-back its blanket coverage.

- *Claims of Non-Participants:* Those creditors not participating in any refinancing deal should not be guaranteed timely repayment by the government.

3. Regulatory Treatment

The nature of any debt restructuring will have important regulatory implication for the creditor banks, including not just accounting and disclosure of possible charge-offs, but also the capital adequacy treatment of creditor claims.

4. Long-Term Sustainability

Any restructuring of financial institution liabilities should be consistent with or not preclude ongoing efforts by Korea to develop a sustainable capital structure.

- While lengthening the maturity of existing claims and any new money will alleviate Korea's current liquidity problems, these transactions do not address the over-leveraged nature of Korean corporations or the insolvency of at least some financial institutions.

- The need for quick closure on a refinancing deal will most likely preclude a comprehensive solution to Korea's financial situtation. The terms on which the Korean Government assumes any claims of financial institutions should nonetheless be consistent with efforts to increase the solvency of financial institutions and de-leverage non-financial corporations.

Any refinancing deal should not impair the likelihood of normal commercial relationships resuming within a reasonable time period.

Korea Update
January 22, 1998

Useable reserves: There was a relatively small net ouflow of Bank of Korea (BoK) foreign currency reserves today of $13 million. Banks rolled-over 86% of the estimated $1 billion coming due.

- International banks (with the exception of the Belgians) have agreed to a rollover of short term debt through the end of March, but the Fed has confirmed that it is unlikely that there will be any agreement in writing.

Refinancing arrangement: A Korean delegation met with a group of large international banks in NYC yesterday to begin hammering out details on an agreement to refinance short-term Korean banking debt. The delegation hopes to conclude negotiations within the next 10 days, with closing of a deal by mid-February. The next meeting is scheduled for tomorrow.

- The Korean proposal would exchange debt obligations of some $23.6 billion coming due in 1998. Maturities would be extended to 1, 3, or 5 years. Eligible claims would not include merchant banks' liabilities, trade credits or off-balance sheet (derivatives) items.

- Korea has proposed negotiating with a narrower group of creditor banks, leaving out those from smaller countries. There is concern that this could jeopardize participation in the rollover.

- The government would raise new money to augment reserves once the refinancing deal was completed. It was well understood by all parties that this may result in a delay in disbursement of USG funds, depending on the comprehensiveness of the refinancing deal.

Market Update:

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Equity Mkt	475.1	505.98	488.1	495.9	528.8	533.6	506.66	484.0
% change	2.5	6.5	- 3.5	1.6	6.6	0.9	- 5.1	- 4.5
Exchange Rate	1671.0	1605.0	1618.0	NA	1580.00	1642.0	1723.00	1760.00
% change	5.2	3.9	- 0.8	NA	2.4	- 3.9	- 4.9	- 2.2

* Preliminary figures

<u>Equity/Foreign Exchange/Bond Market</u>: Stocks fell for a second day this week, led by Korea Electric Power Corp, which accounts for 15% of the index. Bank stocks were also hard hit after the BoK reported that Korea's 26 commercial banks lost a combined 3.9 trillion *won* ($2.3 billion) in 1997.

- Yields fell on three year corporates as some investment trusts bought blue chip issues. Meanwhile, S&P has said that a credit rating upgrade for South Korea hinges on the outcome of negotiations between the government and creditor banks.

Program Implementation

- MOFE Minister Lim urged the top five *chaebol* to take bolder restructuring efforts, including swapping profit-making core businesses among groups, according to state-run press. Lim reportedly said the government will give tax breaks on gains resulting from swaps of major businesses.

- Kia Group, struggling under $10 billion of debt, has said it will sell real estate and shed nine of its 16 remaining companies, including Asia Motors and Kia Steel, to keep Kia Motors and its other affiliates afloat.

  - The nearly insolvent automaker also stated that it is negotiating with Ford Motor Co. and other potential U.S. investors to raise $625 million in capital. Ford directly owns 9.39% of Kia, as well as a smaller indirect stake through its minority shareholding in Mazda Motors.

  - Korea Development Bank, the biggest creditor of Kia Motors, will swap 300 billion *won* ($174 million) of loans for an equity stake in the auto maker, according to local press reports.

- Dongsuh Securities Co, formerly Korea's fourth-largest securities firm but now insolvent, cut half its 1,500 employees and will close 36 of its 82 branches as part of restructuring efforts. The company expects to be sold to a third party.

- BoK's injection of liquidity over the upcoming lunar new year holidays is expected to drop by as much as 30% this year compared to 1996, according to the *Seoul Economic Daily*. The paper cited BoK plans to inject between 2.4 trillion *won* ($1.37 billion) and 2.8 trillion *won* into the banking system over four days staring January 22, ahead of the holidays between January 27 and January 29.

- Korea's 26 commercial banks lost a combined 3.9 trillion *won* ($2.3 billion) in 1997, compared with a net profit of 939 billion *won* in 1996. Two-thirds of the banks lost money, led by the top six banks which accounted for 85% of the red ink. Losses would have been at least twice as high if the banks had been required to fully provision for impaired loans and losses from securities holdings. However, full provisioning would prevent many banks from meeting capital standards set by the Bank of International Settlements.

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BN/Effing

AFP-uf SKorea-IMF-labor
Story: e0141
Time: 13 0524 GMT 01 98
Ref:

IMF chief reaches understanding with tough South Korean labor unions
(UPDATES with second meeting. Pictures)
by C. W. Lim

SEOUL, Jan 13 (AFP) - IMF chief Michel Camdessus faced off with South Korea's tough labor unions Tuesday and appeared to have cracked their resistance to massive layoffs to pull South Korea out of its financial crisis.

Spokesmen for the country's two umbrella labor unions, the Federation of Korean Trade Unions (FKTU) and the more-militant Korean Confederation of Trade Unions (KCTU), said they now understood the need for dialogue on the issue.

"It was a good opportunity for us to understand each other," KCTU spokesman Kim Yoo-Sun said after the back-to-back hour-long closed-door meetings at a five-star hotel here.

"We reached a good understanding," said IMF regional director Hubert Neiss, who accompanied Camdessus to the meetings.

Kim, whose union brought the country to a standstill last year fighting an unpopular labor law which included layoffs, said contacts between the International Monetary Fund (IMF) and the unions would continue when the IMF sets up an office in Seoul in February.

He and a KFTU spokesman both indicated they would drop their resistance to joining a labor-management-politician consultative group suggested by president-elect Kim Dae-Jung to work out a layoffs law.

But both also stuck to their demand that a parliamentary session scheduled for this month to legalize layoffs, especially in the finance sector, be postponed until consultations with the unions could be held.

An FKTU spokesman told journalists at the end of the first meeting that Camdessus assured them he had demanded that Seoul work out a strong insurance system for the unemployed, funded by budget cuts in non-essential sectors.

The union spokesman said Camdessus had also told them that clear, trustworthy layoff guidelines were needed before the world could regain confidence in the Korea economy, and "the sooner they were put in place the better."

Layoffs and free movement of labor, he quoted the IMF chief as saying, were a necessary part of any free-market economy and the IMF was open to a "continuing dialogue" with the unions.

The FKTU in turn called on Camdessus to help them work out a layoff system through dialogue with business management.

They also urged him to prevent parliament from pushing through any layoff laws until after the unions had been consulted.

The KCTU, whose representatives included a union leader from the central Bank of Korea, said Camdessus had told them that an assurance of layoffs was a part of Seoul's pledge to the IMF in return for a massive bailout in December.

Unless world markets could be assured that Seoul was sticking to its pledges on the bailout package, South Korea could face a worse financial and economic debacle, he told the union leaders.

The IMF is leading a 57-billion-dollar rescue package for the ailing South Korean economy -- history's largest financial bailout.

cwl/kw/akp

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P3 Release would violate a Federal statute [(a)(3) of the PRA]
P4 Release would disclose trade secrets or confidential commercial or financial information [(a)(4) of the PRA]
P5 Release would disclose confidential advice between the President and his advisors, or between such advisors [a)(5) of the PRA]
P6 Release would constitute a clearly unwarranted invasion of personal privacy [(a)(6) of the PRA]

C. Closed in accordance with restrictions contained in donor's deed of gift.
PRM. Personal record misfile defined in accordance with 44 U.S.C. 2201(3).
RR. Document will be reviewed upon request.

Freedom of Information Act - [5 U.S.C. 552(b)]

b(1) National security classified information [(b)(1) of the FOIA]
b(2) Release would disclose internal personnel rules and practices of an agency [(b)(2) of the FOIA]
b(3) Release would violate a Federal statute [(b)(3) of the FOIA]
b(4) Release would disclose trade secrets or confidential or financial information [(b)(4) of the FOIA]
b(6) Release would constitute a clearly unwarranted invasion of personal privacy [(b)(6) of the FOIA]
b(7) Release would disclose information compiled for law enforcement purposes [(b)(7) of the FOIA]
b(8) Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA]
b(9) Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

THE WHITE HOUSE

WASHINGTON

December 31, 1997

INFORMATION

MEMORANDUM FOR THE PRESIDENT

THROUGH: SYLVIA MATHEWS

FROM: DANIEL K. TARULLO DKT

SUBJECT: Update on South Korea Financial Stabilization

Purpose

To update you on implementation of measures to strengthen Korea's financial stabilization program.

Background

The package of additional policy measures, creditor forbearance and accelerated disbursements assembled last week has buoyed confidence. Since the package was announced, the Korean stock market has stabilized, and creditors have rolled over a substantial amount of obligations coming due. The resulting decrease in foreign reserve run-off, in combination with an additional IMF disbursement of $2 billion, have enabled Korea to close out the year with a comfortable cushion of reserves. Indeed, Korea registered a net drain of only $0.1 billion on Wednesday, against a potential $2.5 billion in maturing obligations that could have been called in.

Nonetheless, this is only a temporary reprieve. Provisional agreement by the largest bank creditors to roll over short-term obligations will afford only one month of additional breathing space in which to cobble together a more lasting solution. Such a solution would most likely involve replacing short-term private credits with medium-term government or government-guaranteed obligations. Key details (coverage, instruments, maturities, seniorities) remain to be resolved, along with subsidiary issues, such as the participation of smaller lenders and the treatment of off-balance-sheet risk.

Finalization of the agreement among banks is a precondition for disbursement of $8 billion in bilateral back-up resources, including $1.7 billion from the U.S. Exchange Stabilization Fund. Treasury and the Fed aim to finalize both the private sector agreement and the bilateral disbursements in parallel in early January.

cc: Vice President
Chief of Staff

KOREA 12/31/97

Off Bal Sheet in Dom Finl Instns

170 B

30-35	Cocredit
4	bank guarantees of sub overseas borrowing
50	forex contracts
70	interest rate / primarily dom.

very lax / thin supervision

LT Liabs

Finl Insts	44.2
(30.5 Res. Dom.)	
Dom corps	17.6
Public sector	11.0

ST Liabs

Dom Finl Insts	37.4
(Resident dom 12.9 Overseas branches + subs of banks 15.0 Offshore entity 9.5)	
Forn bank branches	17.2
Dom Corps	25.6
	153

TALKING POINTS FOR USE BY ADMINISTRATION OFFICIALS ON KOREA

- o The Korean government has announced new measures today, endorsed by the President-elect, aimed at bolstering confidence and promoting stability. These measures will further strengthen the comprehensive economic reform effort underway.

- o In support of Korea's enhanced policy program, and in the context of a significant voluntary extension of the maturities of existing claims by creditor banks and adequate Korean efforts to tap new sources of private finance, we are prepared to support action to advance existing commitments of official finance.

  - -- This would include the acceleration of IMF disbursements to Korea.

  - -- Also in this context, the United States is prepared to join with the G-7 and other countries to disburse a substantial portion, $8.0 billion or roughly one-third, of the supplemental financial commitments that they have made.

- o The U.S. share of this supplemental finance would total $1.7 billion from the Exchange Stabilization Fund in the form of a short-term swap with a market-related interest rate, and would be accompanied by safeguards to protect our financial commitment.

- o Korea is vital to American interests. It is a longstanding ally, one of the world's larger economies and a major trading partner. Restoring confidence in Korea is also crucial for promoting financial stability in Asia. Our country's health and prosperity increasingly depends on the global financial stability and the vitality of others throughout the world.

12/24/97
11:02 am

Congressional Talking Points

National Security Rationale

- United States reliability as a security partner will be questioned by Koreans and others in the region if we do not stand by Korea in time of need/do all that is possible.

- North Korean reaction to increasing domestic tension caused by economic collapse unknown; at one end of the spectrum, North could attempt to take advantage of domestic instability. U.S. support for South Korea is important deterrent to North Korean missteps.

- Effect on four party peace talks unknown; South Korean ability to provide economic benefits expected by the North Korea in exchange for difficult tension reduction measures may be hampered.

- Generous Host Nation Support may be reduced; translates into direct increase in U.S. defense budget. Korean reduction of HNS may influence Japanese HNS, which is considerable. HNS reduction could affect our ability to maintain U.S. forward deployed forces.

- Korean and regional force modernization programs at risk; as budgets tighten, procurement considerations move to cheapest available vice best compatible.

    - Integration of foreign (Russian) equipment into alliance poses actual risks to U.S. forces (interoperability) and increases difficulty of command and control of combined forces.

    - Delayed or cancelled equipment acquisition translates into lost commercial transactions and possible effect on U.S. jobs.

- Longer-term inability for Korea to stabilize its economy may affect Korea's ability to play a leading role in the LWR project. Would fall to U.S. to organize international effort

- Longer-term inability for Korea to stabilize its economy [illegible] affect Korea's ability to play a leading role in the LWR project. Would fall to U.S. to organize international effort to make up shortfall (already difficult to raise funds for KEDO), or renegotiate. Ultimately could affect North Korean commitment to dismantle its nuclear program.

Draft 12/23/97 9:00 p.m.

Statement by the Finance Ministers and Central Bank Governors of the G-7 Nations

We welcome the announcement by the Korean authorities of additional measures to strengthen macroeconomic policy and accelerate structural reforms, particularly in the financial sector. This enhanced program of prior policy actions and reform is an important step that will contribute to the restoration of financial stability and a return to growth.

We also welcome the decisions by the World Bank and the Asian Development Bank to disburse a total of $5 billion this week in support of a program of structural reforms and financial sector restructuring.

In support of Korea's enhanced policy program, and in the context of a voluntary program to extend the maturities of existing claims by international bank creditors on Korean financial institutions and adequate progress by Korea toward accessing new sources of finance, we would be prepared to support action to advance existing commitments of official finance, including the acceleration of IMF disbursements, and the disbursement of a substantial portion, $8 billion, of the supplemental financial commitments made by the G-7 and other countries.

In this context, together with the other participants in this program, we have agreed on a set of operational conditions for the provision of supplemental finance to the Korean authorities. Under this common approach, the availability of this supplemental finance will be conditioned on the forceful and consistent implementation of the policies outlined by the Korean authorities in the context of the programs supported by the IMF, the World Bank and the Asian Development Bank and any additional policies that are necessary; will carry appropriate market-related interest rates; and will be made available in the form of short-term instruments renewable at the option of the creditors.

The international financial community shares an important interest in the success of Korea's efforts to restore economic and financial stability. A successful program will require a continued sustained commitment to reform by the Korean authorities, appropriate financial support from the official sector conditioned on the strong policies necessary to restore confidence, and a successful effort by the Korean authorities to secure longer term financing from private creditors and the international capital markets.

Korea
Why is additional liquidity necessary so soon?

Question: The IMF program for Korea is barely three weeks old. Shouldn't it be given more time to work?

Answer:

- o The key to success in Korea is for the country to implement a strong economic reform program.

- o We believe that Korea's IMF program is sound. It contains important measures aimed at a fundamental restructuring of the Korean economy over time and measures oriented toward boosting confidence.

- o Many of these measures are already being implemented and having an effect, though their impact will take time. Also, markets were adversely affected at the outset of the program by ongoing political uncertainties surrounding the Presidential campaign, the release of economic data that were worse than expected, and some public miscues.

- o In light of recent developments, we believe it may take longer than previously expected to restore confidence and that supplemental reinforcing policy measures and financing are needed to hasten reforms and stability.

Korea
Did the Koreans lie to the IMF?

Question: Why isn't the IMF program working? Why were anticipated payments flows so far off? Did the Koreans lie about the state of their finances and economy?

Answer:

o To the best of our knowledge, Korea is abiding by the terms of its IMF commitments. Indeed, it has taken important restructuring measures aimed at promoting confidence. These measures are already helping promote essential adjustments. But they will take time to work.

o Further, confidence has been adversely affected by several factors, including some ill-advised public statements, electoral uncertainty in light of the Presidential elections, and the release of economic data which were worse than market participants had expected.

o We believe that Korea is facing up realistically to its problems. But taking into account these considerations, we believe that the restoration of confidence will take longer than previously expected.

Korea
What would default mean?

Question: What would happen if there was a default? Would the consequences be primarily economic and financial in nature, or would our security be threatened?

Answer:

- We believe that the consequences of default would be serious and that we should seek to avoid these, given our belief that appropriate additional reforms and financing may be able to restore confidence.

- A severe disruption of payments in Korea could result in much more financial contagion in emerging markets, create a heightened potential for competitive devaluations, and affect U.S. growth and trade accounts very adversely.

- This could also be destabilizing to the Korean peninsula.

- Further, our economic well-being depends ever-increasingly on the stability of the international financial system, especially in an era of globalization.

Korea: Additional IMF conditionality

Question:

What new policy steps will the Koreans be required to take to qualify for these additional and accelerated funds?

Answer:

- Korea's IMF programis essentially a sound one, but in light of developments since its inception, we believe that pace and progress of implementation need to be intensified to help restore market confidence.

- As a condition for the additional financing, the Korean government has committed to further policy actions in four areas: conservation of foreign-currency reserves, tighter monetary policy, further capital account liberalization and accelerated restructuring of the financial sector. These conditions build on the IMF program approved in early December. The Korean parliament is expected to enact all necessary implementing legislation immediately in a special session.

- Taken together, these measures will help demonstrate Korea's resolve to put its economic house in order and restore financial stability. We are encouraged by President-elect Kim Dae Jung' recognition of the extreme urgency of the situation and commitment to do everything possible to fulfill Korea's policy pledges.

Voluntarism and the Banks

Question

Are the banks being forced to reschedule?

Answer

- o The is not an involuntary rescheduling by the banks.
- o It is being done voluntarily, reflecting the shared interest of the international financial community in Korea's efforts to restore economic and financial stability.
- o These efforts require sustained reforms by Korea, appropriate official support, and a successful effort by Korea to secure longer term financing from private creditors and international capital markets.

How Long Will the Bilateral Loans be Outstanding?

Question:

How long will the bilateral loans be outstanding? What's their maturity? Are they tied together?

Answer:

- These will be short-term loans, extended in the form of currency swaps for Korean won. They will carry 60-day maturities, renewable at the lenders' option.
- Upon maturity, the U.S. and the other creditors will consider rollover requests subject to demonstrable need - i.e., continuing market pressures - and satisfactory compliance with all existing policy conditionality. Additional policy conditionality may also be required for any rollovers, which would carry increasing risk premiums over time.
- The "second-line" creditors will lend in a coordinated fashion, according to a common set of terms and conditions. They will all be repaid simultaneously and before the IMF is repaid.

Korea: Aren't we just bailing out foreign banks?

Question:

Why are you so concerned about giving the Koreans funds to pay off foreign banks? Shouldn't they have to take their losses like everybody else?

Answer:

- The purpose of this financial assistance - and of the originial IMF package - is not to bail out foreign banks or any other class of investors. The purpose is to provide the government with sufficient reserves to restore financial stability and rebuild market confidence. While it is true that some foreign lenders will benefit indirectly if stabilization occurs successfully, this is not why we are supporting the financial assistance package.

- It is our judgment that the failure to restore stability to Korea could have very serious negative effects on the region - including Japan - and therefore on the economic and security interests of the United States.

- Any brief look at the performance of Korean currency, equity and debt markets over the last few months will clearly indicate that lenders and investors have taken substantial losses, and will continue to do so. We have no specific intention of shielding these investors from the consequences of their own imprudent decisions.

Korea: Who's contributing? How much?

Question:

Which other countries will be advancing funds in January? How much will each contribute? How was it decided that $8 billion is the right amount? Why not the whole $25 billion that's been promised?

Answer:

- A total of 11 other countries is expected to advance funds as part of the "second line of defense," including Japan and the rest of the G-7.

- In the context of appropriate private financial commitments, we believe that the $8 billion, combined with the accelerated [$2-4 billion] from the IMF and World Bank, should provide sufficient liquidity to tide the economy over until the intensified policy measures begin to restore stability.

- We do not believe that full disbursement of the $25 billion in "second-line" commitments is necessary or appropriate at this time.

How Long Will the Bilateral Loans be Outstanding?

Question:

How long will the bilateral loans be outstanding? What's their maturity? Are they tied together?

Answer:

- These will be short-term loans, extended in our case in the form of currency swaps for Korean won. They will carry 60-day maturities, renewable at the lenders' option.
- Upon maturity, the U.S. and the other creditors will consider rollover requests subject to demonstrable need - i.e., continuing market pressures - and satisfactory compliance with all existing policy conditionality. Additional policy conditionality may also be required for any rollovers, which would carry increasing risk premiums over time.
- The "second-line" creditors will lend in a concerted fashion, according to a comparable set of terms and conditions. They will all be repaid simultaneously and before the IMF is repaid.

Korea: How safe are the U.S. loans? How do we know we'll be repaid?

<u>Question:</u>

What assurances do you have that the U.S. and other countries will be repaid? What collateral do you have?

<u>Answer:</u>

- The terms and conditions of the swap agreement will minimize any risk to U.S. taxpayers. The loans would be for short, 60-day periods, in the form of swaps, and would carry full sovereign guarantees. They would be renewable at our option, and they would carry significant premiums to incentivize early repayment. They will be on an equal basis with other bilaterals, and will be repaid before the IMF.

- Beyond these safeguards, we will not hold any specific collateral.

Korea
Is Korea about to default?

Question: Is Korea about to default? If so, why are you throwing good money after bad?

Answer:

- While the IMF program is sound, it will take longer than previously expected to restore market confidence.

- As a result, Korea's short term liquidity situation is serious and there is a risk of severe payment disruptions, especially if additional steps are not taken very soon to reinforce the policy reforms underway and provide further financing.

- We believe, both from an economic and political interest, that it is in our self-interest to make this effort. Korea is a longstanding ally, a major trading partner, and a key player in the Asian region and more generally. Our economic health depends importantly on the stability of the international financial system.

Talking Points: Calls to Hill on Accelerated Financing for Korea

- Calling to update you on the current situation in Korea and outline the steps we are now contemplating to manage it over the next several days and weeks. As you will appreciate, this information is very market-sensitive and needs to remain confidential until any related public announcements are made.

- We believe that the IMF program for Korea is basically sound and that some very positive implementation steps have been taken recently by the Korean government. We are also very encouraged by Kim Dae Jung's early statements reaffirming his commitment to the program.

- However, with the new government just elected and yet to take office, it will take longer than expected to restore market confidence. Korea's short-term liquidity position has now become precarious. If the international community does not act urgently to stabilize the situation, the risk of serious economic and security consequences is high.

- Korea is simply too important to American interests for us not to take every prudent measure possible to restore stability and confidence. We believe that additional near-term steps are now warranted. Secretaries Rubin, Albright and Cohen and NSA Berger fully concur in the course of action under consideration.

- With respect to the public sector, these steps combine tougher Korean policies with accelerated external financial support - including U.S. loans. They are fully consistent with the commitments made at the outset of the program by the Korean government, the international financial institutions, and individual creditor nations such as the United States.

- The private-sector financial community also will play an integral role in this effort. We are working with international banks to explore ways to make private financing available to Korean financial institutions by renewing and extending existing maturities and facilitating access to international capital markets.

- We believe these are necessary, responsible actions to help prevent further financial contagion and contain the risk of escalating economic damage to the region and, most importantly, to the United States.

Additional Public-Sector Measures: 3 Basic Components

- **(1) Intensified Korean Policy Actions**: The Korean government will be required to intensify and expedite policies to improve foreign reserve management, tighten monetary policy, further liberalize the capital account, and accelerate restructuring of intensify and expedite policies to improve foreign reserve management, tighten monetary policy, further liberalize the capital account, and accelerate restructuring of the financial sector. The Korean Parliament is expected to enact all necessary implementing legislation immediately in a special session.

- **(2) Accelerated IFI Disbursements**: The IMF and the World Bank will accelerate parts of their planned January/February disbursements into late December, in a combined amount of $2-4 billion.

- **(3) U.S. and other bilateral loans**: The U.S., Japan and other creditor nations - over a dozen in all - will announce this week their intention to disburse a portion of the financing commitments they made as part of the original IMF-led package. A total of about $8 billion will be advanced in early January. The U.S. share of the total will be in the range of $1.75 - $2 billion.

- U.S. loans (from the Exchange Stabilization Fund) would be extended under terms and conditions that minimize the risk to American taxpayers. The loans would:

  *carry the sovereign guarantee of the Korean government
  *be extended for short, 60-day periods, renewable at U.S.'s option
  *carry high premiums to encourage fast repayment
  *require strict compliance with all IMF conditionality
  *be on an equal basis with other bilateral creditors
  *be repaid before IMF loans

- **IN SUMMARY, Korea is very important to American economic and strategic interests, and, in our judgment, wholly justifies the series of steps we are considering. The risk of inaction at this juncture is incompatible with those interests.**

Rudman, Mara E.

From: Rudman, Mara E.
Sent: Wednesday, December 24, 1997 10:59 AM
To: @LEGISLAT - Legislative Affairs
Subject: READOUT SKOREA CONGRESSIONAL CALLS [UNCLASSIFIED]

READOUT FROM SOUTH KOREA CONGRESSIONAL CALLS:
as of Dec 24, 10am

Treasury (Rubin and Summers)
- **Lott** thought the US # was going to be higher, so he was pleasantly surprised. Thought the move is risky, but necessary.
- **Gingrich** spent 45 minutes on phone w/ Rubin. Supportive but concerned about others. Thought US amount didn't matter. Gave suggestions such as having Summers reach out to Chris Cox; getting labor unions involved to help w/ Gephardt wing; getting G. Shultz involved to help w/ House Republicans generally.
- **Daschle** has minor concern that is G-7 related (don't know what it is), other than that, thinks U.S. is doing the right thing here.
- **Gephardt** *(NOTE: Jim, this is different than what I reported earlier on the conference call. This version is more accurate.)* conversation was very brief. He said nothing bad, but it was clear to Rubin that he would not be supportive.
- **Bennett** said should do whatever need to do. Supportive.
- **Obey** was supportive, but stressed that the "IMF should hit the Koreans hard."
- **Leach** was supportive.

State calls (Talbott, Eizenstat, Pickering)

- **J. Kerry** was very supportive. Asked how much more might be necessary down the road. Should do whatever it takes.
- **Biden** supportive, but wanted to know conditionality terms/facts ASAP. (State is working on it for him.)
- **Helms** was extremely supportive, to State's surprise. He asked about repayment terms, how much others would be affected, etc. Emphasized that he understood Korea was extremely important.
- **Gilman** was neutral. Expressed understanding for why U.S. was going this way, but was gathering information, not expressing an opinion on the decision.
- **Hamilton** surprised Pickering in being less supportive than Pickering expected. He didn't say he disagreed w/ the decision, but expressed some concern, particularly about the security of the funds.

DOD calls

- Cohen reached **Gingrich** and **Lott** to back up Rubin. No readout on substance.
- Slocombe left messages w/ all the others, but was not able to reach anyone directly. Staff spoke w/ **Carl Levin's** staff director, who assured that Levin would be supportive.