

THE WORLD BANK GROUP ARCHIVES

PUBLIC DISCLOSURE AUTHORIZED

Folder Title: President Wolfensohn - Briefing Materials for President's Speeches - Speaking Engagement and Luncheon - International Finance Corporation [IFC] Annual Participants Meeting - May 6, 1998

Folder ID: 30490711

Series: Speaking engagement briefing materials

Dates: 05/04/1998 – 05/06/1998

Subfonds: Records of President James D. Wolfensohn

Fonds: Records of the Office of the President

ISAD Reference Code: WB IBRD/IDA EXC-13-10

Digitized: 05/21/2025

To cite materials from this archival folder, please follow the following format:
[Descriptive name of item], [Folder Title], Folder ID [Folder ID], ISAD(G) Reference Code [Reference Code], [Each Level Label as applicable], World Bank Group Archives, Washington, D.C., United States.

The records in this folder were created or received by The World Bank in the course of its business.

The records that were created by the staff of The World Bank are subject to the Bank's copyright.

Please refer to <http://www.worldbank.org/terms-of-use-earchives> for full copyright terms of use and disclaimers.



THE WORLD BANK

Washington, D.C.

© International Bank for Reconstruction and Development / International Development Association or

The World Bank

1818 H Street NW

Washington DC 20433

Telephone: 202-473-1000

Internet: www.worldbank.org

PUBLIC DISCLOSURE AUTHORIZED

Luncheon/Speaking Engagement:
IFC's Annual Participants Meeting

Wednesday, May 6, 1998
1:00 - 2:30 p.m.
MC-12th Floor Atrium

DECLASSIFIED
WITH RESTRICTIONS
WBG Archives

Archives



30490711

R2002-036 Other #: 55 Box #: 186505B

President Wolfensohn - Briefing Book for President's Meetings - Meeting Material
Luncheon and Speaking Engagement - International Finance Corporation [IFC]

Archive Management for the President's Office

Document Log

Reference # : Archive-02289

1873

Edit

Print

A. CLASSIFICATION

☒ Meeting Material
☐ Trips
☐ Speeches

☐ Annual Meetings
☐ Corporate Management
☐ Communications with Staff

☐ Phone Logs
☐ Calendar
☐ Press Clippings/Photos

☐ JDW Transcripts
☐ Social Events
☐ Other

B. SUBJECT: LUNCHEON/SPEAKING ENGAGEMENT: IFC'S ANNUAL PARTICIPANTS MEETING // JDW TO MAKE REMARKS // (B) (N) // TIME: 1:00 - 2:30 P.M. // VENUE: MC-12TH FLOOR ATRIUM // CONTACT: PAULA PANTON @ 30381 // OR MARIA C. THOMAS @ 36119 // TO ACCOMPANY - LUIGI PASSAMONTI // NOTES: (2/3-2/4) ITEM CLEARED BY LUIGI // (B) & (SPEAKING POINTS): MARIA C. THOMAS // DUE: FRIDAY, MAY 1 // EXC: LP // ALI (2/5)

DATE: 05/06/98

Brief includes:

- Photographs
- Talking Points: JDW'S Remarks to the Economic Strategy Institute, May 6: "Global Finance and Global Players: Getting the International System Back on Track"
- Background Note, prepared by S. Lazarus, May 3
- Program
- Participants
- Bio
- Korea's Financial Crisis and Policy Challenges, By D. W. Nam

C. VPU

Corporate

☐ CTR
☐ EXT
☐ LEG
☐ MPS
☐ OED
☐ SEC/Board
☐ TRE

Regional

☐ AFR
☒ EAP
☐ ECA
☐ LAC
☐ MNA
☐ SAS

Central

☐ CFS
☐ DEC
☐ ESD
☐ FPD
☐ FPR
☐ HRO

Affiliates

☐ GEF
☐ ICSID
☒ IFC
☐ Inspection Panel
☐ Kennedy Center
☐ MIGA

D. EXTERNAL PARTNER

☐ IMF
☐ UN
☐ MDB/Other IO
☐ NGO
☐ Private Sector

☐ Part I
☐ Part II
☐ Other



2121 PENNSYLVANIA AVENUE, NW
WASHINGTON, DC 20433, USA

WITH THE COMPLIMENTS OF

Dear Mr Wolfensohn:

Thank you for speaking at
the IFC Annual Participants
Meeting. Your speech was the
highlight of the meeting!
These are terrific pictures.

Best regards - Shelley
INTERNATIONAL FINANCE CORPORATION
A Member of the World Bank Group
Lagunas

Don't miss
text also in the
IFC book.

W

Speaking Points for: "Global Finance and Global Players: Getting the International System Back on Track"

James D. Wolfensohn, President
The World Bank

Remarks to the Economic Strategy Institute

May 6, 1998
Washington, D. C.

In the last decades we have witnessed some remarkable events. Private capital flows to developing countries have risen strongly: from \$42 billion in 1990 to \$256 billion last year. At the same time, we have seen some large crises: Mexico in 1994-95 and East Asia today. Put in historical perspective, neither the surges in capital flows nor the recent crises are unprecedented. The last two centuries offer spectacular examples of both. In many ways, having international institutions like the World Bank and the International Monetary Fund, and internationally-oriented countries that do not close their doors at the first signs of trouble, have made it possible to recover more quickly from these crises.

But the economic and social costs are still enormous and reason enough for the international dialogue on designing better institutions and policies. Building an international financial architecture while ignoring the social and development foundations is like erecting a house on sand: It will not last. Our financial policies will not be sustainable if we ignore the 1.3 billion people living in poverty.

In my remarks today, I would like to put the current troubles of Asia in historical context. I would also like to put them in the context of the larger development challenges we still face.

THE 4 WAVES OF PRIVATE CAPITAL FLOWS

THE FIRST WAVE: 1870-1914

From the United Kingdom to the major emerging markets: the United States, Canada, Australia, Argentina, and Brazil.

The flows funded up to half of domestic investment.

THE SECOND WAVE: the 1920s

From New York to Latin America and Southern and Eastern Europe.

The second wave ended with the “debt crisis” of the 1930s: the default of almost every Latin American country, Poland, Germany and others.

Countries responded by turning inward, erecting protectionist barriers.

Substantial private flows to developing countries did not resume for 40 years.

THE MARSHALL PLAN

After World War II there were no private flows.

Marshall Plan provided \$12 billion, which was 1.2 percent of American GDP (compared to 0.1 percent of GDP for the U.S. aid budget today).

THE THIRD WAVE: 1970s - 1982

Oil price shock created supply of funds (petrodollars) and demand for funds (countries with increased import bills).

80 percent of the private flows were in the form of debt, and 80 percent of these went to the public sector.

20 percent of private flows in the form of foreign direct investment.

The third wave ended with Mexico in 1982, followed by serious debt problems for more than 40 other countries in Latin America and Africa.

Lending to developing countries slowed to a trickle for almost a decade.

THE FOURTH WAVE IS DIFFERENT

THE FOURTH WAVE: 1990-1997

Began in 1990 with the recovery of loans to developing countries at the same time as the large expansion of foreign direct investment and the advent of portfolio equity.

Net long-term private capital flows to developing countries reached \$256 billion in 1997 – more than 6 times the \$42 billion level in 1990.

Over that same period, official flows have drifted down from \$56 billion to \$44 billion.

BROAD-BASED EXPANSION

Not an adjustment to a temporary shock, but a broad-based expansion in profitable investment opportunities abroad.

\$120 billion in foreign direct investment (50 percent of total).

\$103 billion in loans and bond issues (40 percent of total). At 1.7 percent of developing country GDP, this is exactly where they were in 1981.

\$32 billion in portfolio equity (10 percent of total).

SHOULD BE PUT IN PERSPECTIVE

Still, capital flows fund only one-sixth of developing country investment, with the rest of the funding coming from the \$1.4 trillion saved by developing countries.

THE COMPOSITION MAKES THE FLOWS MORE ROBUST

Loans are risky because they do not share risks: If a country does well, then repaying its loans is not very difficult. In contrast, the highly indebted poor countries suffer from the double burden of poor economic performance and excessive difficulties in repaying their loans.

The chance that short-term loans will not be renewed leads to the risk that a crisis of liquidity will turn into a crisis of solvency.

Equity investments share risks, although they have the risk of a sudden withdrawal.

FDI brings not just capital, but also knowledge and access to foreign markets. It is more stable: investors do not pull their factories out of a country at the push of a button.

SUMMARY: GLOBAL INSTITUTIONS HAVE REDUCED RISKS

The debt crisis of the 1930s stopped developing country access to international capital for 40 years, in part because of the isolationist responses it triggered.

The debt crisis of the 1980s stopped developing country access to international capital markets for almost 10 years.

Present indications are that the current crisis may have interrupted access for only 4 months. (New lending, and bond and equity issues to developing countries slowed to a trickle from November through February, especially in Latin America. The preliminary indications from March and April suggest that, outside the crisis countries in East Asia, they may have returned to earlier rates.)

OFFICIAL FLOWS CONTINUE TO BE IMPORTANT

Private flows are 6 times greater than overseas development assistance and loans from official sources.

Sectors. Very little capital goes to certain *sectors* like health and education. Also, although much private capital goes to infrastructure, for instance, very little of it goes to roads, and still less to rural roads.

Instruments. Many developing countries having relatively little access to long-term debt finance.

Uneven across countries.

A dozen countries, representing half of the developing world's GDP, have received 75 percent of the funds.

Only a handful of low-income countries have received significant amounts relative to the size of their economies.

Sub-Saharan Africa got only \$8 billion of the \$256 billion in private money, 3 percent of the total. Much of this went to South Africa.

140 countries get less than 5 percent of the private capital flows.

Uneven across time. Countries tend to get the most foreign capital when they are doing well and in least need of it. When they are doing badly – even when the problem is clearly temporary – the private capital flows often dry up.

e.g. Korea and Thailand were growing strongly, saving over one-third of GDP, and attracting large capital inflows that were adding relatively little to their growth. Now that they are in greater need of foreign capital, they have a harder time attracting it.

Official assistance and loans can complement private investment by making countries more productive and easing them through bad times.

THE REAL COST OF FINANCIAL CRISES

CRISES ARE INCREASINGLY FREQUENT

In the last decade, Scandinavia (Finland, Norway, and Sweden).

Savings and loan crisis in the United States.

More than 50 other banking crises in the developed and developing world in the last two decades.

THEY CAN BE OF VERY LARGE MAGNITUDES

The Indonesian Rupiah has fallen 70 percent since July.

The currencies in Thailand, Malaysia, the Philippines, and Korea have all fallen by about a third in this period.

The currency crises have triggered banking crises in many of these countries.

Banking crises are expensive to resolve. The record is Argentina, which spent more than 50 percent of its GDP resolving its 1980-82 banking crisis.

FINANCIAL RECOVERY, BUT REAL EFFECTS PERSIST

Thailand is the best emerging stock market in 1998 (up 36 percent in U.S. dollar terms) and Korea is a close second (up 27 percent).

Prior to the crisis, the Korean unemployment rate was hovering around 2 percent. Since then it has more than tripled, rising to 6.5 percent in March. Over 1 million people have lost their jobs and the unemployment rate is now the highest ever recorded in Korea.

Indonesia

5 million Indonesians may have lost their jobs due to the combined effects of the financial crisis and the drought.

The poverty rate, which had come down from 64 percent in 1975 to 11 percent in 1995, could rise up to as much as high as 20 percent. That is another 18 million people who could be in poverty.

Another 40 million people are hanging precariously just above the poverty line.

Brazil

Financial collapse and recovery:

Stock market was down 40 percent.

Spread on international loans rose from 186 basis points to 527 basis points.

Domestic interest rates jumped up 29 percentage points.

Gross international capital flows, other than FDI, virtually halted.

In the last few months, interest rates have come down, the stock market has gone up, and capital flows have resumed strongly.

Continued effects on people:

The unemployment rate has risen for three straight months, hitting 8.2 percent in March, compared to 4.8 percent in December 1997. This is the highest rate in Brazil since they began collecting the statistics a decade ago. This is 2½ million people losing their jobs.

Average effects. Research by the World Bank has found that in developing countries, 5 years after a financial crisis gross domestic product is 7 percent lower on average than it would have been without a crisis.

Long lasting effects on poverty. Higher unemployment and slower growth have even longer lasting effects on poverty. When people lose their jobs for extended periods, they lose some of their skills and their connection to the workforce. They feel more marginalized and excluded from society. These problems can be difficult to reverse. A bout of high unemployment can translate into lower productivity, sustained higher unemployment, and greater social problems for very long periods of time.

PREVENTING AND MITIGATING CRISES

FLUCTUATIONS AND CRISES ARE INEVITABLE, BUT WE CAN PREVENT AND MITIGATE THEM

Domestic reforms include greater information, better financial regulation, and improved corporate governance.

International reforms. There is much we can do at the international level to facilitate and complement these domestic reforms:

Information. Collect, standardize, and share. The IMF is taking the lead on this with its Special Data Dissemination Standard.

Standards in accounting, auditing, disclosure, asset valuation, bankruptcy, and corporate governance, like the Basle Committee's Core Principles. The Interim Committee called for these.

Risk Sharing. Too often we place all of the blame, and all of the exhortations for improvement, on the borrower. All loans require a willing borrower and willing lender. Greater responsibility is required by lenders. This will only occur if they bear the full share of the costs of their decisions. Ensuring this

happens may require the development of risk-sharing institutions and practices at the international level.

PRINCIPLES FOR REFORM

Robustness. We have seen crises in transparent countries (e.g. Scandinavia) and in countries with a sophisticated regulatory apparatus (e.g. the United States). What we need are economic systems that are robust against a modicum of fallibility. Nuclear reactors are designed to withstand several simultaneous mistakes. To make economies that can only withstand one and then blame the country after it melts down is not a very good way to proceed.

Strengthening long-term flows, minimizing the risk of short-term flows

At the least, should not encourage short-term flows (like the Bangkok International Banking Facility).

May want to discourage them, while encouraging FDI and long-term flows.

MANY PLAYERS ARE REQUIRED TO GET THE SYSTEM BACK ON TRACK

CANNOT REFORM JUST THE FINANCIAL ARCHITECTURE

Development, in the broadest sense, complements other reforms.

WE FACE PRESSING LONG-TERM CHALLENGES

1.3 billion people live on less than \$1 a day.

2.8 billion people live on less than \$2 a day.

10 million children under the age of 5 die every year in developing countries. This is less than the roughly 20 million children under the age of 5 who died in 1962 (and with a population twice as large). But it is still too much.

1 billion adults cannot read.

In many Latin American countries the richest 20 percent of the population have 60 percent of the income and the bottom 20 percent have only 2 or 3 percent. The bottom 10 percent often have less than 1 percent of the total income.

WE MUST ENSURE THAT EVERYONE PARTICIPATES IN GROWTH, AND IS PROTECTED FROM THE WORST EFFECTS OF CRISES

THIS WILL REQUIRE GLOBAL PLAYERS: GOVERNMENTS, NGOs,
CIVIL SOCIETY, ETC.

IFC's Annual Participants Meeting
May 5-6, 1998
Background Note

Key facts of IFC's B Loan portfolio:

- IFC's B Loan portfolio is currently \$8.9 billion in 248 projects.
- There are 231 different institutions participating in the program and 1,662 individual loan participations.
- Our top ten participant banks are:
 1. Dresdner Bank
 2. ING Group
 3. Credit Lyonnais
 4. Banque Nationale de Paris
 5. Societe Generale
 6. ABN Amro Bank
 7. FMO
 8. Sanwa Bank
 9. Bayerische Vereinsbank
 10. Rabobank International
- We expect to approve about \$3.3 billion of B Loans for FY98.

The current environment for IFC B Loans:

- Following the Asia crisis, the banks have indicated clearly to us that they are looking to IFC and the B Loan program more than ever. Japanese banks, although they are reducing overall lending exposure, see IFC as a critical link in meeting their responsibilities for relationship banking and most expect to continue to participate in B Loans.
- Many banks have given strong indications of the desire to increase their partnership with IFC in the current environment.
- The fall-out from Finance One in Thailand appears to be very limited.
- The banks are relying on IFC to keep them informed and take a lead role in the restructuring of problem projects in Thailand and Indonesia.
- Several banks have a preponderance of exposure in Indonesia and Thailand with IFC and need special attention.

Attendance at the Annual Participants Meeting:

- Over 110 financial institutions will be represented at the meetings. These include both commercial banks and institutional investors from Europe, Asia, the Middle East and North and South America.
- Over 175 bankers will participate in the meetings.

- Representatives from other multilateral and bilateral institutions and export credit agencies have also been invited.
- Most of the institutions represented at the meeting have worked in partnership with IFC, but a few are new to IFC and the meetings will serve as their opportunity to learn more about IFC.

Special features of the meetings:

- Seats will only be assigned for the four head tables for the lunch on Wednesday.
- On Tuesday and Wednesday, in the IFC atrium, there will be a variety of information available to participants: the Business Partnership Center will have a kiosk displaying material; IFC publications will be displayed; and two computers will be running on the IFC website.
- The atrium will also feature a "museum" of IFC tombstones.
- A select group of press representatives have been invited to the reception and the dinner on Tuesday night.
- A photographer will be at the reception and dinner on Tuesday night and will offer photographs for purchase by the participants on Wednesday.
- A press release has been sent out announcing the Participants Meeting.
- A new Syndications brochure has been prepared and will be available at the meetings.



Record Removal Notice



File Title President Wolfensohn - Briefing Materials for President's Speeches - Speaking Engagement and Luncheon - International Finance Corporation [IFC] Annual Participants Meeting - May 6, 1998		Barcode No. 30490711		
Document Date May 5-6, 1998	Document Type Meeting arrangements			
Correspondents / Participants				
Subject / Title IFC Annual Participants' Meeting				
Exception(s) Information Provided by Member Countries or Third Parties in Confidence				
Additional Comments		The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information or other disclosure policies of the World Bank Group. <table border="1"><tr><td>Withdrawn by Diego Hernández</td><td>Date May 1, 2025</td></tr></table>	Withdrawn by Diego Hernández	Date May 1, 2025
Withdrawn by Diego Hernández	Date May 1, 2025			

Duck-woo NAM

Dr. Duck-Woo Nam was born in suburban Seoul, Korea on October 10, 1924. After receiving his B.A. in political science from Kookmin University, Seoul, in 1950, Dr. Nam worked as a junior economist with the Bank of Korea before re-entering academic life as associate professor of economics at his alma mater.

While teaching economics at Kookmin (1954-64), Dr. Nam was granted leave to pursue postgraduate studies first at Seoul National University (M.A. in economics, 1956) and later at Oklahoma State University (M.S. in economics, 1960, and Ph.D. in economics, 1961). Dr. Nam has also done postdoctoral work at the Graduate School of Business, Stanford University.

In 1964, Dr. Nam accepted an appointment as professor of economics at Sogang University, Seoul, and in 1969 was named finance minister by then president Park Chung Hee. Dr. Nam earned the dual distinction of being one of the youngest men ever to hold this key portfolio (age 45 at time of appointment) as well as being the longest-serving finance minister in the history of the Republic of Korea (five years).

In 1974, President Park asked Dr. Nam to oversee Korea's economic development program in the capacity of deputy prime minister and minister of economic planning, posts which he held concurrently until 1978. During the 1970s Dr. Nam achieved international prominence as one of the world's most successful economic planners. Dr. Nam was named by President Park in January 1979 as his special assistant for economic affairs.

The summit of Dr. Nam's government career was reached in September 1980 with his appointment as Prime Minister of the Republic of Korea by President Chun Doo Hwan. Following his tenure as Prime minister, he served as a member of the president's Advisory Council on State Affairs during 1982 and 1983.

In 1984, he was elected to the Board of Directors of the World Trade Centers Association. Dr. Nam was also a member of the Standing Committee of the Pacific Economic Cooperation Council (PECC) for the period of 1983-1993. He was a member of the Board of Governors of the East-West Center based in Honolulu,

Hawaii during 1984-1993.

Dr. Nam is a former chairman of the Korea International Trade Association – the central association of all Korean trading firms – and assumed active direction of the KITA's wide-ranging activities (1983-1991). He also served concurrently as the chairman of the Korea-U.S. Economic Council, which promotes economic cooperation between the United State and Korea.

Dr. Nam presently serves as chairman of the Korea Sanhak Foundation and remains involved with the Korea International Trade Association as advisor. End.

Duck-Woo NAM

Academic Background

1950	B.A. in Political Science, Kookmin University
1956	M.A. in Economics, Seoul National University
1960	M.S. in Economics, Oklahoma State University
1961	Ph.D. in Economics, Oklahoma State University
1968-1969	Post-Doctoral Study under ICAME Program, Stanford University

Present Positions

1994 -	Advisor, Korea International Trade Association
1993 -	Honorary Chairman, Korea National Committee for Pacific Economic Cooperation
1983 -	Chairman, Korea Sanhak Foundation

Professional Career

1952-1954	Junior Economist, The Bank of Korea
1954-1964	Assistant Professor & Professor, Kookmin University
1964-1969	Professor of Economics, Sogang University
1969-1974	Minister of Finance, Republic of Korea
1974-1978	Deputy Prime Minister and Minister of Economic Planning, Republic of Korea
1979	Special Assistant to the President for Economic Affairs
1980-1982	Prime Minister, Republic of Korea
1982-1983	Member, Advisory Council on State Affairs to the President, Republic of Korea
1982-1983	Chairman, Korea-Japan Cooperation Council
1985-1988	Chairman, National Preparatory Committee for the Seoul Olympic
1983-1991	Chairman and CEO, Korea International Trade Association
1983-1991	Chairman, Korea-U.S. Economic Council
1983-1991	President, Korean Commercial Arbitration Board
1983-1988	Chairman of the Board, The Korea Herald, a daily English news paper.
1983-1992	Member, Standing Committee for Pacific Economic Council. (PECC), Singapore.
1984-1993	Member, Board of Directors, World Trade Centers Association, New

- York.
- 1984-1993 Chairman, Korea National Committee for Pacific Economic Cooperation
- 1984-1993 Member, Board of Governors, East-West Center, Honolulu
- 1991-1994 Honorary Chairman, Korea International Trade Association

Commendation

- 1978.12 Order of Service Merit, Blue Stripes
1982. 1. 7 Order of Diplomatic Service Merit, Grand Gwang-Hwa Medal
- 1985.3.28 Hall of Fame, College of Business Administration, Oklahoma State University, USA
- 1987.8.12 Henry G. Bennet Distinguished Service Award, Oklahoma State University, USA
1987. 11. 4 "Centennial Alumnus" Award, National Association of State Universities and Land-Grant Colleges (NASULGC)

Personal Data

Born October 10, 1924

Married, two sons, one daughter

Plays Golf

Major Publications

In Korean:

- 1958 A History of Economic Thought, Yangmoon Publishing Company, Seoul
- 1962 A History of Economic Thought (Co Authored), Pubmoon Publishing Company, Seoul
- 1963 A Dictionary of Economics (Co-Editor), Bakyong Publishing Company Seoul.
- 1965 Price Theory (Revised Edition), Bakyong Publishing Company, Seoul.
- 1966 A Dictionary of Economics: Student Edition (Co-Edited), Bakyong Publishing Company, Seoul
- 1997 Korean Economy in the age of Globalization, Samsung Research Institute

In English:

- 1968 *Determinants of Money Supply and the Scope of Monetary Policy* (Co-Authored) Sogang University Press, Seoul

- 1979 "Korea: The Social and Economic Conditions for Sustained Growth,"
Asian Affairs, Nov.-Dec. 1979, pp.69-78.
- 1981 "Population Research and Population Policy in Korea in the 1970"
(Co-Author), Population and Development VII(4), Dec. 1981,
pp. 651-669
- 1982 "Changing Patterns of Trade and Trends in Trade Policy in the Asia
-Pacific Region," Building a Pacific Community, East-West Center,
Honolulu, Distributed by the University of Hawaii Press, pp.119-138.
- 1997 *Korea Economic Growth in a Changing World*, Samsung Research Institute,
Seoul

Korea's Financial Crisis and Policy Challenges*

By D.W. Nam

It is a singular honor for me to be invited this evening to share with you some of my thoughts on Korea's financial crisis and policy challenges. Before I begin, I would like to take this opportunity to express my sincere appreciation for the financial support and policy guidance provided to my government by the World Bank and the IFC during my days in government service throughout the 1970s. Without the World Bank's generous and valuable assistance, Korea's rapid economic growth in that period might have not been possible. Unfortunately, Korea stumbled at the threshold of the developed countries, and I am here this evening to speak about this.

Causes of the Liquidity Crisis.

There are diverse explanations of the causes of the financial crisis in Korea, but most analysts agree that liquidity shortage lies at the heart of the crisis that was resulted from excessive borrowing of hedge fund by the private sector or, to put it another way, a mismatch between short term borrowing and long term investment, even though Korea's economic fundamentals were strong prior to the onset of the crisis. Needless to say, there are many other underlying causes, including structural weakness in banking and corporate governance, inadequate transparency and lax bank supervision.

Those structural weaknesses, however, were well known in the international financial community before the onset of the crisis. They only came to the surface when Korea began to open its financial markets in response to outside pressure. The root of the trouble was that Korea moved to liberalize its capital markets without making the necessary internal adjustments including liberalization of its domestic financial market, narrowing the wide disparity in the interest rate between domestic and international markets, modernizing banking services, strengthening bank supervision, and liquidation of bad debts accumulated within the financial system.

When Korea liberalized its financial markets to some degree early in the 1990s, foreign investors thought that portfolio investment in Korea would be profitable as long as the value of the won remained stable against the dollar, given the high interest rate of 12-13% per annum in Korea which was far above the cost of borrowing (6-7%) in their home countries. They also thought that stock prices in Korea were generally undervalued, and overall economic performance was fairly good. As a result, the inflow of foreign portfolio investment, starting from almost insignificant amounts before 1990, increased rapidly and the cumulative total from 1991 to 1996 was estimated at as much as \$48 billion.⁽¹⁾

At the same time, banks and big companies took advantage of the liberalization of the capital market to take out low-cost short-term loans abroad for long-term physical investments, and even portfolio investment abroad including Russian "junk bonds".

Unfortunately, policymakers and central bankers in Korea, with no experience with hedging operations in the globalized market, were not aware of the danger inherent in the volatility of the hedge funds, and no one could see a liquidity crisis just around the corner that would be triggered by the financial crisis in the Southeast Asian countries.

As the hedge funds were flowing in, the value of the Korean won tended to appreciate (Korea's foreign exchange rate was not pegged to dollar as in Thailand), even though the current account had been showing a chronic deficits since 1990, peaking at \$23 billion in 1996.

The Korean experience illustrates that the floating exchange rate system no longer functions as a mechanism by which to automatically regulate the current accounts of the member countries of the IMF as envisaged by the architects of the system, because the foreign exchange rate is no longer determined by commodity trade alone but much more by the cross-border movement of the short-term capital in the globalized financial market. This is, I believe, a fundamental challenge facing the international monetary system today.

* The views expressed herein do not necessarily reflect the views of the organizations with which the author is affiliated.
1. The Bank of Korea, *Economic Statistics Yearbook*, 1997, p.208

Meanwhile, well informed foreign creditors became concerned about Korea's short-term debts and large current account deficits, particularly in light of the financial crisis that was unfolding in Thailand and Indonesia and even in Japan in a different context. Eventually, foreign investors started to pull their money back out of Korea by dumping stocks and bonds, and refusing to roll over maturing loans to Korean banks and private companies. The reversal of the capital flow depressed stock prices and drove the won further down against the dollar, rapidly draining the foreign exchange reserves of the central bank. The debt crisis had begun.

The IMF intervention

Five months have passed since Korea, on December 3 last year, agreed to the IMF regime of crisis management in return for the IMF loan packages of \$58.35 billion(2 in bailout. The IMF undertook to apply its traditional prescriptions of unrestricted floating of the foreign exchange rate, high interest rates, and tight monetary and fiscal policies -- all of which are aimed at continuing the orderly adjustment in current external accounts, building up international reserves, and containing inflationary pressures. In addition to the macro policy framework, the IMF recommended to the Korean government a comprehensive strategy for structural reforms designed to recapitalize the financial sector and make it more transparent, market-oriented, and better supervised and to restructure corporate governance toward more prudent management and a healthier relationship with the financial system.

The Macro Management

Since the shortage of liquidity lies at the heart of Korea's financial crisis, the availability of funds from international sources was the primary requirement for Korea to overcome the crisis. To the extent that foreign capital is readily available, the need for the drastic depreciation of the won and the need for abnormally high interest rates will be reduced and foreign creditors will be more confident of their credits being honored. Yet in reality this was not the actual path Korea could take.

Thanks to the help from the IMF, the World Bank, the ADB, and other financial institutions in industrial countries, Korea has been able to improve its liquidity position in the past five months. So far, \$24 billion out of the \$58 billion package pledged by the IMF and others has been disbursed to Korea as of the end of April. In March, 123 banks in 31 countries agreed to reschedule short-term debt of \$21.6 billion (94.8% of the amount requested) for new terms longer than one year or more. In addition, the Korean government was able to raise \$4 billion in the New York money market by selling government bonds in April. This will improve Korea's debt profile by reducing the proportion of short term debt in total external obligations(3 from 63.5% in 1996 to about 30%.

The transfusion of funds helped Korea restore relative financial stability as can be seen in the following developments.,

- Foreign exchange rate, which skyrocketed from 840 won per dollar at the end of 1996 to a peak of, 1,962 won on December 23, gradually came down to 1,336 won as of April 30.
- The current account surplus in the past four months totaled more than \$10 billion mainly due to decreases in imports of capital goods and payment for services, including tourism.
- Foreign exchange reserves available for payments increased from a meager \$8.8 billion at the end of 1997 to more than \$30 billion at the end of April- a target originally set to be attained by the end of June.
- The call rate that at one time soared to 40% per annum has come down to around 22%, while the yield on corporate bond has come down from 29% at the end of last year to 18.3% in early April.

On the other hand, the abnormally high interest rates combined with a credit crunch have been taking a heavy toll on the economy as evidenced by the following developments.

- Industrial production has been decreasing since December last year -- down -11% in January and down -2% in March from a year ago.
- The rate of inflation in terms of the consumer price index rose from 4.5% at the end of last year to 9.0% at the end of March this year.
- More than 10,000 firms have gone bankrupt since last December, and the rate of operation of surviving firms is currently as low as 60% of capacity,
- Unemployment has reached 2 million and will continue to increase, threatening social stability,
- The IMF and the government had to revise their growth forecasts of GDP from the original 2-3% to minus 1-2 % for this year. Research institutes in Korea are predicting around minus 3%.

Looking at the current economic turmoil, I am moved to speculate that a bold "one shot"

2. The IMF loan package includes \$21 billion from the IMF, \$10 billion from the IBRD, \$4 billion from ADB, \$10 billion from Japan, \$5 billion from the U.S, and \$8.35 billion from other developed countries.

3. "Total external obligation" of \$150.3 billion in the IMF definition at the end of February is larger by \$30.1 billion than the "total foreign debt" in the World Bank definition.

infusion of funds immediately following the IMF intervention might have reduced the scope of won depreciation and the rise in the interest rate, lessening their negative effects, and making structural adjustments much easier. In any case, I am pleased to hear that the IMF finally agreed to a policy of lower interest rates.

With the growing pain of adjustment, many uncertainties remain, including a potentially devastating banking crisis in Japan that could make Japanese banks wary of rescheduling Korean debt, a weakening yen that could hurt Korean exporters, and the possibility of eventual devaluation of the Chinese Yuan that could undermine Korea's trend toward exchange rate stability.

Aware of these prospects, and Korean government is now trying to increase foreign exchange reserves to \$40 billion by the end of this year with the aid of the projected current account surplus of more than \$20 billion; The government will support a syndicated loan of \$3 billion by domestic banks plus an increase in credit lines and continuing role-overs of maturing loans held by banks and private corporations. At the same time, the government will be amending relevant laws and regulations to fully liberalize foreign investment and the capital market and allow hostile M&A by foreign investors.

Nonetheless, I should stress that it would be very difficult for Korea to regain international confidence and for private Korean companies to return to the international capital market unless Korea accelerates the pace of structural reform in banking and corporate governance. This is indeed a daunting challenge to the Korean government and business community, which will be discussed in the following sections.

Structural Reform

Korea's effort for structural reform dates back to the former administration, as illustrated by the 19 pieces of legislation which were pending with the National Assembly before the financial debacle took place last November, and long before the newly elected president, D.J. Kim, was sworn into office on February 25 this year. The National Assembly hurriedly passed the reform bills with minor revisions on December 30 in

response to the outbreak of the crisis and the ensuing onset of the IMF regime.

The major contents of the reform bills include: greater independence of the central bank with single objective of promoting price stability; establishing a consolidated supervisory body with jurisdiction over all financial institutions; requiring the large conglomerates – or chaebol - to disclose audited and consolidated financial statements; limiting the practice of cross guarantees among chaebol member companies for loans from financial institutions; easing M&A by both domestic and foreign firms; further opening of the financial market to foreign participation; and legalizing layoffs of employees in case of merger, acquisition, and corporate restructuring. Thus, the reform measures effected by the legislation were more or less in conformity with IMF recommendations. However much more remains to be done.

Banking Reform

As for banking reform, the Korean banking system has been plagued by three major institutional setbacks: (1) lack of managerial independence from the government and close ties with business conglomerates; (2) lack of a responsible managerial system to ensure accountability to shareholders and (3) lax supervisory functions of the government. These institutional defects and unhealthy practices can be remedied by the changed laws and regulations and by the setting up of the new supervisory body. The real issue is to how to pay for the consequences of the institutional legacies, that is to say, to clean the huge burden of bad debts accumulated within the financial system, dispose of insolvent banks, recapitalize financially weaker banks, and make shareholders take their losses.

So far, licenses of 13 merchant banks and one investment trust company have been revoked. Also, the government has suspended three merchant banks and two securities companies. The two major commercial banks are currently on sale, preferably to foreign investors. All banks have been directed to submit restructuring plans to meet the BIS capital-adequacy requirement by the end of April. At that point, the Financial Supervisory Commission will evaluate their plans, and by the end of June, will decide the modality of

restructuring and will impose prompt corrective actions. If a bank fails to meet the corrective measures within the set time table, then it will be merged or closed. All banks except a few banks are currently striving to meet the minimum requirement of the equity-asset ratio of 8% by recalling loans and limiting new lending only to highly selected clients.

Under the credit squeeze and deterioration of the economy, business failures are increasing, and if the present pace of business failure continues, the non-performing assets are likely to reach, by the end of this year, 100 trillion won, (about \$74 billion) or 25% of GDP projected for 1997, according to a forecast by the Korea Development Institute (KDI), Korea's most influential think tank for economic policies.

The Korea Asset Management Corporation (KAMC) was set up to buy up non performing assets of the banks by using the Resolution Trust Fund capitalized by the government and the banking community. The Fund has been authorized to issue public bonds in the amount of 12 trillion won (about \$8,8 billion) this year for the purpose. An additional 10 trillion won will be needed to buy up a half of the non-performing assets (100 trillion won) projected for this year by the KDI.

Recapitalization of viable financial institutions will also require injection of public funds. Let me explain why this is imperative. According to a KDI estimate, a capital increase of about 35 trillion won (about \$30 billion) is needed for the banks as a whole to meet the IBS capital requirement at the present time. However neither existing bank share holders nor new investors are likely to buy new bank shares given the current situation in which bank credit is dried up and the economic outlook is uncertain. The banks are seeking M&A with foreign banks or investors, but this cannot be done overnight. The only way open to the banks is to reduce their risk assets, which will, however, end up increasing business failures and non-performing assets. This is a dangerous situation threatening to undermine industrial base of Korean economy.

Two alternatives are available to the government. One is to make the capital ratio requirement more flexible, allowing banks approach the 8% target in steps over time. After all, the ratio is in a sense a political number agreed upon at the G12 meeting of central bank

presidents in July 1988. There is no absolute ground for the ratio. The other option is to use public funds to increase bank capital with the understanding that the government divest shares as soon as the bank is taken over by new shareholders and management. Notwithstanding the market ideology of moral hazard, there seems to be no other alternative. For this reason, the government has allocated 7.2 trillion won for the recapitalization of the failing banks as a means of attracting foreign buyers.

There is still another need for public funds in the resolution of insolvent banks. Since the liability of bank stockholders is limited to the value of their stocks, the remaining loss has to accrue to depositors or other creditors. Under the present circumstances, it seems inevitable that the government will have to assume most of the loss. Accordingly, the government has authorized the Deposit Insurance Corporation to issue bonds for the amount of 12 trillion (about \$8,8 billion) for the protection of depositors with insolvent banks.

Corporate Governance

The core issue in restructuring of business conglomerates is to make the chaebol reduce their debt-equity ratios from the current average of more than 400% to 200%. This has been agreed in principle between the chaebol and their main banks. Under this agreement, the chaebol are required to sell off some of their member companies as well as real assets, including land.

The major difficulty here is that even though the chaebol want to sell assets to raise money, few domestic firm have the funds to buy them and it takes time to find foreign investors and negotiate with them for sale or M&A. Moreover, 40 trillion won is needed to lower the chaebol's debt-equity ratios to 200%, which is equal to about 40% of the total current value of stocks listed on the stock exchange.

To help the chaebol sell off their real estate, the government has taken the following measures, among others: provision of 3 trillion won for the Korea Land Corporation to buy up real estate from the chaebol and other companies; allowing commercial banks to issue

asset-backed trust securities against a pool of real estate collateral; providing temporary tax incentives to induce business firms to sell real estate for the purpose of debt repayment; and full liberalization of the capital market to attract foreign investors to buy assets held by the chaebol and other companies. Thus, Korea Inc. is now offering for sale to foreign investors at "bargain basement" prices a wide variety of assets including companies, banks, real estate, portfolios investment and what not.

Despite all these measures, it seems unrealistic to assume that the chaebol will be able to restructure themselves in a short period of time. More realistic and workable measures seem to be in order.

Safety Net.

The IMF medicine has produced some positive results as we have seen, yet its negative side effects of mass unemployment and massive business failures cannot be underrated or ignored. Some safety net is called for to protect labor and small and medium sized business, who are the economic players least responsible for the foreign debt crisis. The safety net provided by the government to the labor includes unemployment insurance, retraining, financial aid to subsistence households, and job creation through expansion of public works. The government has allocated two trillion won in the budgetary program for these purposes.

Unfortunately, there is no well established safety net to protect viable companies under the IMF program. The single most valuable program of safety net came from the World Bank in the form of Structural Adjustment Loan (SAL). On March 26, the Bank approved the first installment of \$2 billion SAL for Korea, which will be used for payments of imported raw materials by small and mid-sized enterprises. This is exactly what we need under the present situation. I must stress that unless healthy businesses continue their industrial and trade activities, withstanding the brunt of the reform policies, there is no way to increase exports and stabilize the nation's external account.

The same observation seems to have led the Ministry of Finance and Economy to unveil on April 14 a plan to create a one trillion-won (about \$700 million) for buying shares in companies and another 1 trillion-won debt restructuring fund for rolling over short-term debts of viable companies impacted by the IMF measures. The funds to be established in June will be capitalized by the Korea Development Bank and other financial institutions. Hopefully, the funds will then be expanded by drawing upon the World Bank, Asian Development Bank, and other international sources.

It has been reported that the World Bank has not responded positively to the idea of using the bank's funds for such purposes. However, there seems to be some miscommunication among the Korean government, the World Bank and the mass media.. As far as I know, the funds proposed are not intended to bail out failing companies nor buy up non-performing assets of the banks; they were intended to provide a safety net to healthy businesses to prevent them from becoming innocent victims in the course of financial reform. There are many viable small and medium sized companies and venture businesses which are highly innovative and competitive in the international market in the normal business environment. Nothing is more urgent for the Korean economy than increasing export revenue. However exports are not increasing these days despite the weakness of won mainly because of the high interest rate and credit squeeze. It is simple common sense that no company can possibly survive paying interest on loans as high as 20-30% per annum. The healthy companies deserve a safety net and some reasonable protection. I hope the IFC looks into this matter carefully and positively and work out an effective program for the purpose I defined above, which will also help the structural reform led by the World Bank proceed more smoothly.

Fiscal viability

Using public funds to aid businesses is criticized for violating market principle and for the moral hazard involved. However, we cannot ignore the fact that the system of market discipline is inadequate in Korea and that's why structural reform is called for. Given the present circumstances, there is no other alternative than using public funds in

banking reform. The real question is whether the cost involved is sustainable in the fiscal sector without prejudice to sound fiscal management. Korea is fortunate in this respect as it has a relatively small government debt equal to about 15% of the GDP.

According to the KDI, about 67 trillion won (about \$50 billion) will be needed over the next five years to help the banking system to clear up its bad debts, increase equity capital, and assume the net loss of the closed banks. The amount is equivalent to 9% of the projected GDP for 1998 or 16% if interest payments on the public bonds are included. This is comparable to 12-15% for Mexico in the financial crisis of 1995. The KDI estimate is based on many assumptions regarding relevant variables, but it provides an order of magnitude involved and a useful perspective on solving the budgetary problems.

The required funds could be raised mostly by new issue of public bonds to pay for the purposes outlined above, involving a minimum flow of cash, and therefore less risk of crowding out private businesses in the money market. Amortization of the bonds in ten years will require a fiscal outlay of 7 trillion, less than 1.5% of GDP each year. This can be met by budgetary cuts including defense expenditure, and increasing tax revenue, which, however, require political courage and determination. On balance it seems safe to say that the fiscal sector can accommodate the cost of structural reform without an unbearable impact on the welfare of the people in the coming years

Concluding Remark

I have made some general observations on the major policy challenges facing the Korean government in its effort to resolve the current financial crisis. Although much remains to be done, I, as a former civil servant, am impressed by the amount of work which has already been done in a short period of time by the policymakers in the Korean government, the IMF, and the World Bank not only with regard to crisis management and but also in mapping future course of action to address the challenges facing Korean economy. I am pleased to say that, formidable as these challenges are, the Korean people and the new government headed by President D.J. Kim are firmly committed to overcome the difficulties and hardship with the help of the international financial institutions, including the World Bank and the IMF as well as our friends and allies, above all the

United States.

It is true that the Korean economy has stumbled in the course of globalization. Yet, in historical perspective, the current crisis may be viewed as the necessary price of transition and renewal for the coming century. In that sense, what is happening in Korea now is developmental in nature. In a sense, the current financial crisis is a blessing for the Korean economy because ongoing reforms promise to bring about a new economic order in which free and fair competition will prevail and all economic players will be better able to exert their best efforts for themselves and society.

There was a time when Korea was heralded as a showcase for the success of the U.S. foreign policy and international development policies represented by the World Bank and the IMF. I am personally confident that Korea will again be seen as a success story for democratization and globalization in Asia, playing particularly a pivotal role in Northeast Asia during the years to come.

Thank for your time and attention.