# Withdrawal/Redaction Sheet
## Clinton Library

| DOCUMENT NO. AND TYPE | SUBJECT/TITLE | DATE | RESTRICTION |
|---|---|---|---|
| 001. memo | Lloyd Bentsen to POTUS re: Japan (1 page) | 10/28/93 | P5 |
| 002. letter | POTUS to Prime Minister Hosokawa re: Upcoming Meeting in Seattle (2 pages) | circa Oct. 1993 | P1/b(1) Unclass. |
| 003. memo | Robert E. Rubin to POTUS re: Your Meeting with Prime Minister Hashimoto (2 pages) | 04/1196 | P5 |
| 004. memo | Robert E. Rubin to POTUS re: April 25 Meeting with Japanese Prime Minister Hashimoto (2 pages) | 04/23/97 | P5 |
| 005. talking points | re: Key Points for Call to President Kim Young Sam (2 pages) | circa Nov. 1997 | P5 |
| 006. talking points | re: Key Points for Your Call to Prime Minister Hashimoto (2 pages) | circa Nov. 1997 | P5 |
| 007. memo | Karin Lissakers (IMF) to Deputy Secretary Summers & Deputy Assistant Secretary Atkinson re; Mobilizing Funds for IMF Korea Disbursements (1 page) | 12/02/97 | P1/b(1) Unclass. |
| 008. memo | Karin Lissakers (IMF) to Deputy Secretary Summers, Under Secretary Lipton, & Assistant Secretary Geithner re: Managing Director's Briefing on Fund Agreement with Korea (5 pages) | 12/03/97 | P1/b(1) Unclass. |
| 009. memo | Lawrence H. Summers to POTUS re: Your Meeting with President Kim Dae-Jung: Key Economic Issues (1 page) | 06/30/99 | P5 |

**COLLECTION:**

Clinton Administration History project

OA/Box Number: 24124

**FOLDER TITLE:**

[History of the Department of the Treasury - Supplementary Documents] [2]

jp31

### 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]**
**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 advise 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]**
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**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]**

# Japan

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93-128376

DEPARTMENT OF THE TREASURY
WASHINGTON

October 28, 1993

UNDER SECRETARY

MEMORANDUM FOR SECRETARY BENTSEN

FROM: ROGER ALTMAN
LAWRENCE SUMMERS

SUBJECT: PROPOSED MEMORANDUM TO THE PRESIDENT ON JAPAN

Attached for your signature is a proposed memorandum from you to the President recommending he send the attached letter to the Prime Minister of Japan. With your approval we would like to send this to Bob Rubin and Tony Lake today. We need to get them on board before we go to the President.

OK
LMB

94-130336

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

February 2, 1994

MEMORANDUM FOR THE PRESIDENT

FROM: Lloyd Bentsen

SUBJECT: Japanese Stimulus Package

Prime Minister Hosokawa's coalition has reached agreement on a new stimulus package which should help turn the economy around and reduce the current account surplus. Overall, it's better than many expected, but not enough to get the Japanese economy out of the woods.

The package has three main components:

- o a 6.0 trillion yen ($60 billion) income tax cut (slightly less than expected);
- o around nine trillion yen ($80 billion) in additional public works expenditures, land purchases, government lending programs, and other measures; (only four trillion yen ($40 billion) of this latter category is real spending that will translate directly into increased demand); and
- o to pay for the tax cut, a seven percent sales tax called a "social welfare tax" which will replace the current three percent consumption tax, effective April 1, 1997; (this three-year lag is substantially longer than the initial 15 month proposal by the Ministry of Finance, and the delay will help allow the economy to recover to a point where it can better sustain the adverse impact).

This package would contribute roughly 2.5 percentage points to GDP growth over the next two years and take $20 billion off the current account surplus. By itself, however, it will not bring the economy back to full potential or reduce the external surplus to the range of one to two percent of GDP we have sought in the Framework.

And, it is important to note that the package is only part of the story. We need to see what they are doing on the rest of the budget to assess the overall impact.

For this reason, I issued a fairly qualified statement today. I wanted to give us more time to assess the details and to preserve some flexibility for your meeting with the Prime Minister on February 11.

94-1381 53

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

September 26, 1994

MEMORANDUM FOR THE PRESIDENT

FROM: Lloyd Bentsen [signature]

SUBJECT: The Japanese Tax Package

The Japanese coalition government reached agreement on September 22 on a tax package which combines a substantial income tax cut with an increase in the consumption tax in April 1997.

This represents a favorable outcome for the United States. The package is better than the proposals floated last fall, better than what we heard at the Summit in Naples, and better than the options supported by the Finance Ministry over the last several weeks.

The boost to disposable income from the tax cut, on top of the three stimulus packages put in place since the fall of 1992, has created conditions for growth in domestic demand. The IMF expects domestic demand growth in the year to the fourth quarter to reach almost 3.0 percent and to continue roughly at that pace in 1995. The tax cut is worth roughly $1,700 during each of the first three years for the average Japanese household. An equivalent cut in the United States would amount to $80 billion.

The recovery in domestic demand and the yen's appreciation should bring the surplus down significantly over the next few years. The consensus of private forecasts is for a $110 billion current account surplus in 1995, equivalent to 2.4 percent of GDP, well below the $131 billion or 3.1% of GDP recorded in 1993.

Japan is still likely to run a substantial external surplus for some time to come because of its high level of domestic savings relative to domestic investment. At this point, however, Japan is beginning to make progress towards meeting its macroeconomic commitments under the Framework. We will continue to keep a careful watch on policy as it evolves over the next few months and beyond.

On balance, I think we can claim modest success for ensuring that the Japanese government used the fiscal cushion it had when we took office to stimulate demand.

94-138153

DEPARTMENT OF THE TREASURY
WASHINGTON

UNDER SECRETARY

September 23, 1994

**ACTION**

**MEMORANDUM FOR SECRETARY BENTSEN**

**FROM:** **Lawrence Summers**

**SUBJECT:** **The Japanese Tax Package**

Attached is a memorandum we propose you send to the President on the Japanese Tax Package.

RECOMMENDATION: That you sign the attached memorandum.

__________Agree __________Disagree __________Let's Discuss

Edward S. Knight

95-150618

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

October 3, 1995

**MEMORANDUM FOR THE PRESIDENT**

**FROM:** Robert E. Rubin REB

**SUBJECT:** Japan's Economic Outlook

I found the attached note on the broad economic challenges facing Japan quite striking. You might find this useful, given the importance of Japan, the many issues we have with Japan, and your upcoming visit to Japan.

This note provides one view of Japan and obviously some would differ with its conclusions. Nonetheless, I think it provides a useful counterpoint to those that still view Japan as the major economic threat to the United States.

cc: Laura Tyson
Anthony Lake

# TREASURY CLEARANCE SHEET

NO. ____________
Date October 2, 1995

MEMORANDUM FOR: ☐ SECRETARY ☐ DEPUTY SECRETARY ☐ EXECUTIVE SECRETARY
☐ ACTION ☐ BRIEFING ☐ INFORMATION ☐ LEGISLATION
☐ PRESS RELEASE ☐ PUBLICATION ☐ REGULATION ☐ SPEECH
☐ TESTIMONY ☐ OTHER ____________

TO: Secretary Rubin
THROUGH: Deputy Secretary Summers
FROM: Assistant Secretary Shafer
SUBJECT: Japan's Economic Outlook

REVIEW OFFICES (Check when office clears)

☐ Under Secretary for Finance
- ☐ Domestic Finance
- ☐ Economic Policy
- ☐ Fiscal
  - ☐ FMS
  - ☐ Public Debt

☐ Under Secretary for Int'l Affairs
- ☐ International Affairs

☐ Enforcement
- ☐ ATF
- ☐ Customs
  - ☐ FLETC
  - ☐ Secret Service

☐ General Counsel
- ☐ Inspector General

☐ IRS

☐ Legislative Affairs
- ☐ Management
- ☐ OCC

☐ Policy Management
- ☐ Scheduling

☐ Public Affairs/Liaison
- ☐ Tax Policy

☐ Treasurer
☐ E & P
- ☐ Mint

☐ Savings Bonds

☐ Other ____________

| NAME (Please Type) | INITIAL | DATE | OFFICE/ROOM NO. | TEL. NO. |
|---|---|---|---|---|
| **INITIATOR(S)** | | | | |
| INA/L Dwight<br>INA/R Kahn | LWD | 10/2/95 | Office of Industrial Nations and Global Analyses | 622-0159 |
| | | | | |
| **REVIEWERS** | | | | |
| IM/T Geithner | TFG | 10/2/95 | Deputy Assistant Secretary for International Monetary and Financial Policy | 622-0656 |
| L. Summers | approved per Judy G. | 10/2 | | |
| | NCC | | | |
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SPECIAL INSTRUCTIONS

☐ Review Officer ____________ Date: ____________ ☐ Executive Secretary ____________ Date ____________

October 2, 1995

# Is Japan Ready for the 21st Century?

## Summary


- o After 40 years of rapid growth, Japan is mired in its most serious post-war slump. Japan remains a top-rank economic power, but it faces serious challenges that go well beyond the cyclical downturn. A clear break with the old economic model is needed to prepare for the 21st century. In the meantime, after four decades of catch up, the income gap in favor of the United States will widen over the rest of the decade.

- o The Japanese catch-up phase is over. The economy has weakened, and the gap between Japanese and U.S. income and living standards will widen over the rest of the decade.

- o Japan faces numerous challenges in the period ahead that will test perceptions of Japanese resilience and strength.

- o At the same time, Japan will remain the world's second largest market, the closing of which will have repercussions for the United States.

- o The Japanese economic threat is likely to be much less of a preoccupation for its major trading partners in the next decade.


## Recent economic performance

- o Japan's post-war catch-up phase has come to an end. Japanese growth in the 1990s has averaged 2.1%, down from 10.5% in the 1960s and 4% in the 1980s. Export volume gains -- the traditional engine of growth -- are the smallest among major industrial countries over the last 10 years.

- o The consensus forecast is for a weak recovery -- reflecting a sense that more than normal cyclical factors are at work. While Japan has experienced slowdowns before, they have never been as long-lasting.

  - Japan's growth potential has slowed to about the U.S. level, maybe lower. The IMF now forecasts trend output growth at 2 1/4% per year.

- o U.S. living standards -- measured by per capita consumption -- remain 30% higher than Japan's. That gap should widen over the rest of the decade.

  - Japan remains one of the most expensive countries in the world. It has fewer parks, less housing, and lower housing amenities than any major industrial country. Japanese workers work hard -- an average of 38 hours a week -- but only 3/4 as productively as U.S. workers. Only lip service is paid to making Japan a "lifestyle superpower."

**Japanese economic challenges**

- *Financial system duress.* Banks face a massive bad loan problem and are not globally competitive in sophisticated products. Securities firms, insurance companies, and private pension funds are also in difficult shape. It will take years for the industry to work through these problems.

  - Banks are disadvantaged by rules funneling consumer deposits into the Government-run postal saving system. These funds then are allocated administratively by public financial institutions.

  - If Japanese banks cannot expand lending, large companies will have alternatives. But small firms and start-ups -- who at best have limited access to credit and capital markets -- may not get the funds they need to be employment leaders as Japan restructures.

  - Falling asset prices compound the problem. Land prices have fallen 47% in four years. The stock market is down 57% from its end-1989 peak. Yet, price-earnings ratios for equities are higher today then at the height of the financial bubble in 1989 because earnings have crashed.

- *Aging labor, declining skills.* 1/4 of Japan's population will be over the age of 65 by the year 2020. A declining labor force will face an increasing burden of social security and health payments to the elderly.

  - With slow growth and lifetime employment for older workers, unemployment is highest among the young, denying a generation the skills needed for the 21st century.

- *Companies have not restructured.* Japanese firms are burdened by excess labor and outdated organizational structures. A major shake-up is needed. However, resistance from inefficient sectors and fear of job losses -- by some estimates on the order of 12 million -- prevents the deregulation and market-opening measures that would force change.

  - A survey shows that firms consider 28% of their employees excessive.

  - Compared to the United States, Japan has 1/3 the computers and 1/7 the PC users hooked into networks, per capita. Only 8% of Japanese executives use computers regularly, as against 64% for Americans.

- *Failures outside manufacturing.* Japan may be at the cutting edge in some visible manufacturing sectors, such as steel, autos, and consumer electronics. But the Japanese are woefully inefficient in many other areas -- computers, household products, chemicals, textiles and apparel, wood and paper products, food processing, and a wide range of services.

- Japan's sheltered <u>computer</u> manufacturers followed government instructions that led them down the dead-end of mainframes. Same story in <u>telecommunications</u>, where Japan hides behind an array of barriers. Without a strong domestic market and toughened by international competition, these firms cannot compete internationally with Microsoft, AT&T or MCI.

o *Bad industries are driving out good.* Resistance to deregulation and a wide range of barriers protecting import-competing firms limits demand for foreign goods, driving up the yen and chasing efficient export-oriented firms abroad.

- At ¥90 to the dollar, Toyota is profitable, but other Japanese producers (e.g., Mazda, Honda) are in deep trouble. NEC already produces half its semi-conductor memory chips overseas. Japanese electronics makers produce more color televisions abroad than at home.

- According to the CIA, Japan's share of the global market for manufactures is now back to levels of the 1970s.

o *Investing heavily, but not well.* High Japanese savings allow high investment rates, but diminishing returns are setting in and easy innovations have been exhausted. The CIA estimates 0-1% return on domestic investment in 1993-94.

- Japan has invested poorly abroad, as well. The net loss on foreign investments since the mid 1980s may be as high as $800 billion.

o *Government becomes a barrier.* The post-war Japanese growth model relied on extensive government intervention in the economy through regulation and moral suasion. The features that worked well during the catch-up period: emphasis on negotiation and consensus building, an education system that rewarded rote memorization over creative thinking, and an emphasis on commercial applications over basic research, are ill-suited for the new global economy that emphases "software" capabilities, global integration, and rapid exchange of information.

**The Japan threat?**

o Japan also has strengths: a high savings rate, a hard-working and literate work-force, technological expertise and a record of resilience to shocks, to name a few. But these strengths can be overestimated.

o *Strong yen.* Those who see Japan as an economic threat point to the strong yen as a sign of strength, rather than a signal that policies are off track.

- The strong yen fallacy recalls the same argument made in the U.S. case in the mid-1980s, at the point of greatest U.S. economic imbalances.

- The strong yen has allowed Japan to become an aid superpower, but may cause frictions as they seek expanded influence.

- *Sustained Technological Dominance.* Some have argued that Japan maintains a substantial technological lead in most important manufacturing industries.

  - However, most U.S. manufacturers believe they have a significant technological advantage in most areas over the Japanese. The areas where Japan may still have the advantage -- efficiency of manufacturing and industrial processes -- may not be particularly helpful in a world where the capacity to innovate is paramount.

- *Domination of Asia.* Others have argued that Japan is dominating the Asian economies at our expense and that the decrease in Japan's industrial capacity reflects simply the shift of that capacity to other Asian economies where it remains under Japanese control.

  - U.S. firms are strong competitors in Asian markets. For example, 21% of Korean imports, 20% of Philippine imports, and 22% of Taiwan imports come from the United States.

  - Concerns about the emergence of a new co-prosperity sphere now seem overstated.

- *High Savings.* While Japan has the highest domestic savings rate in the G-7, domestic changes will dramatically reduce these savings in the future. Japan's retirement age population will grow rapidly, due in part to a more pronounced "baby boom" in Japan than the United States.

# TREASURY CLEARANCE SHEET

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Date October 2, 1995

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☐ TESTIMONY ☐ OTHER ____________________

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THROUGH: Deputy Secretary Summers
FROM: Assistant Secretary Shafer
SUBJECT: Japan's Economic Outlook

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☐ FMS
☐ Public Debt
☐ Under Secretary for Int'l Affairs
☐ International Affairs
☐ Enforcement
☐ ATF
☐ Customs
☐ FLETC
☐ Secret Service
☐ General Counsel
☐ Inspector General
☐ IRS
☐ Legislative Affairs
☐ Management
☐ OCC
☐ Policy Management
☐ Scheduling
☐ Public Affairs/Liaison
☐ Tax Policy
☐ Treasurer
☐ E & P
☐ Mint
☐ Savings Bonds
☐ Other ____________________

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| **REVIEWERS** | | | | |
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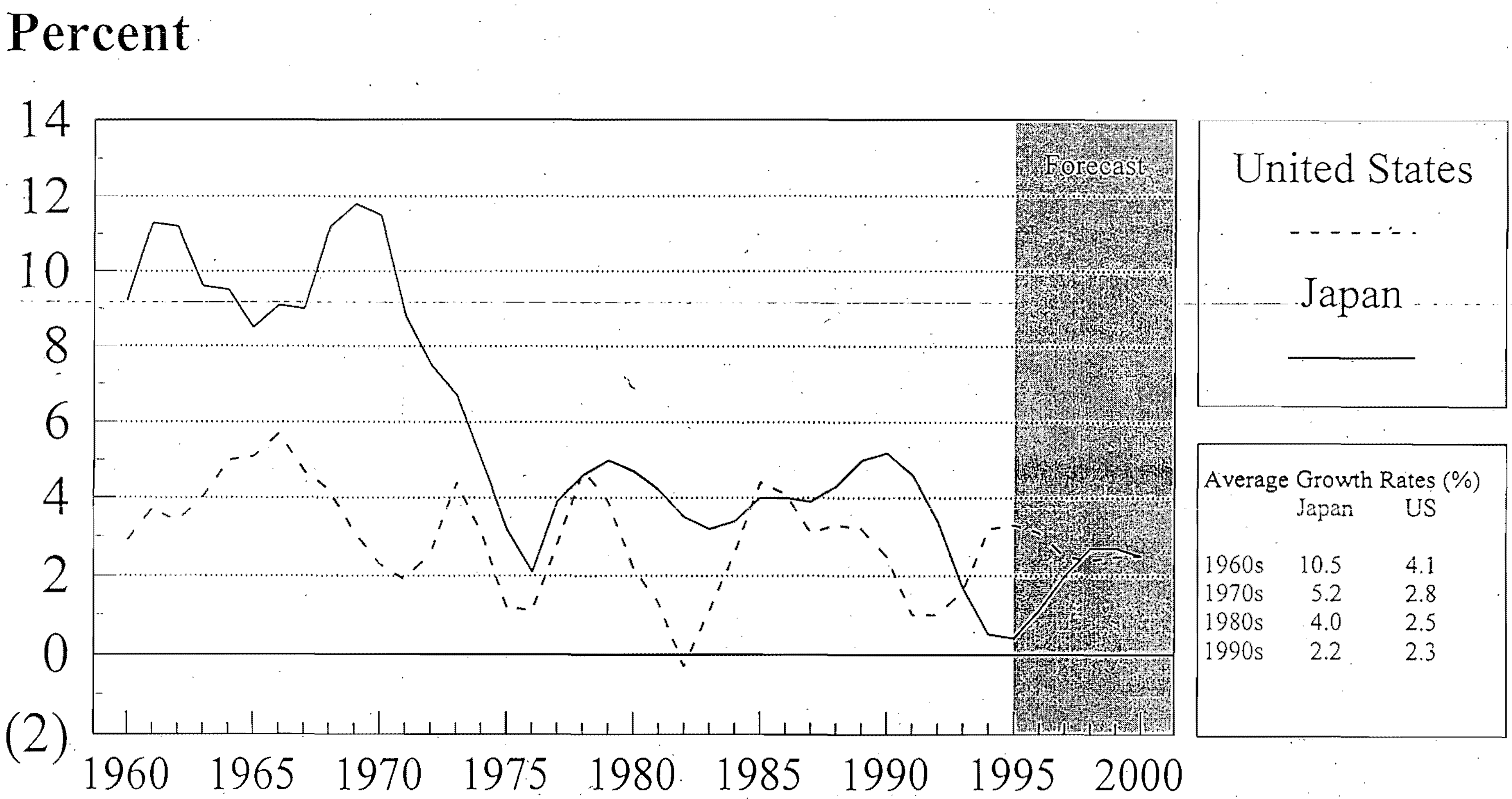
SPECIAL INSTRUCTIONS

☐ Review Officer ____________________ Date: ____________ ☐ Executive Secretary ____________________ Date ____________

# Japan's Post-War Catch-Up Phase Comes to a Close

Japanese and US Growth Rates

3-Year Moving Average

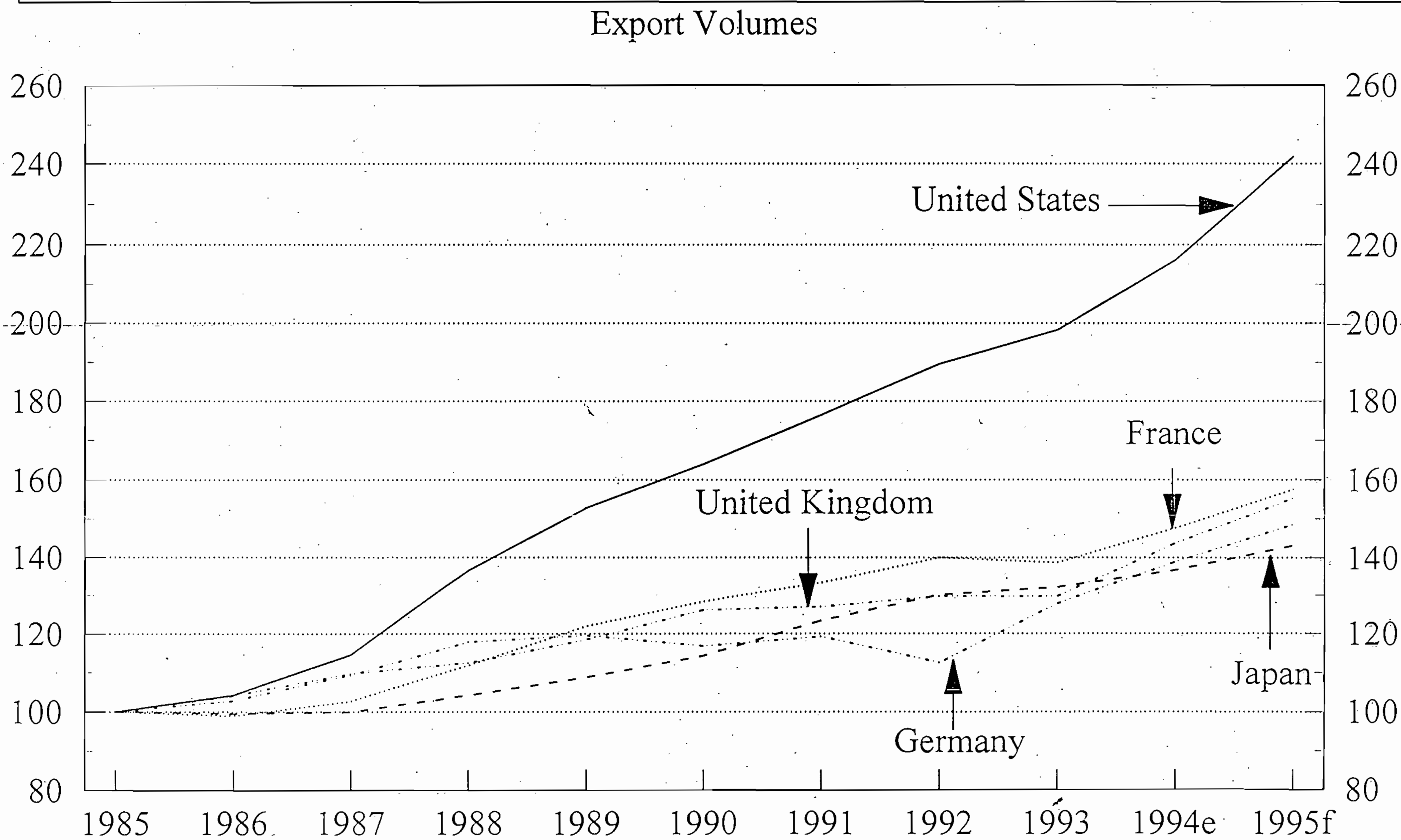



Average Growth Rates (%)

| | Japan | US |
|---|---|---|
| 1960s | 10.5 | 4.1 |
| 1970s | 5.2 | 2.8 |
| 1980s | 4.0 | 2.5 |
| 1990s | 2.2 | 2.3 |

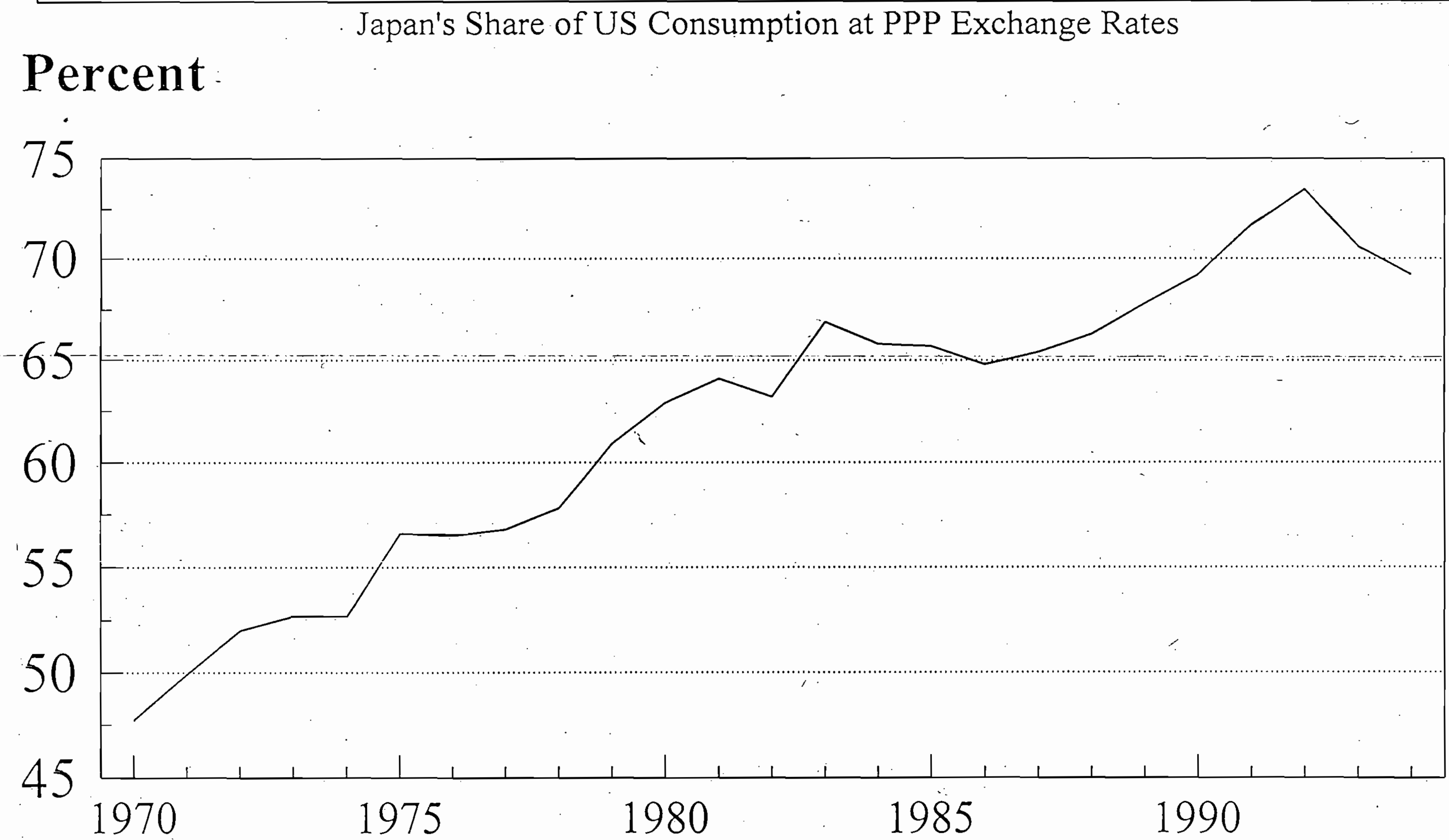
Source: OECD and Treasury Data

# Exports, the Traditional Engine of Growth in Japan, Have Risen Modestly While the US Has Been an Export Powerhouse



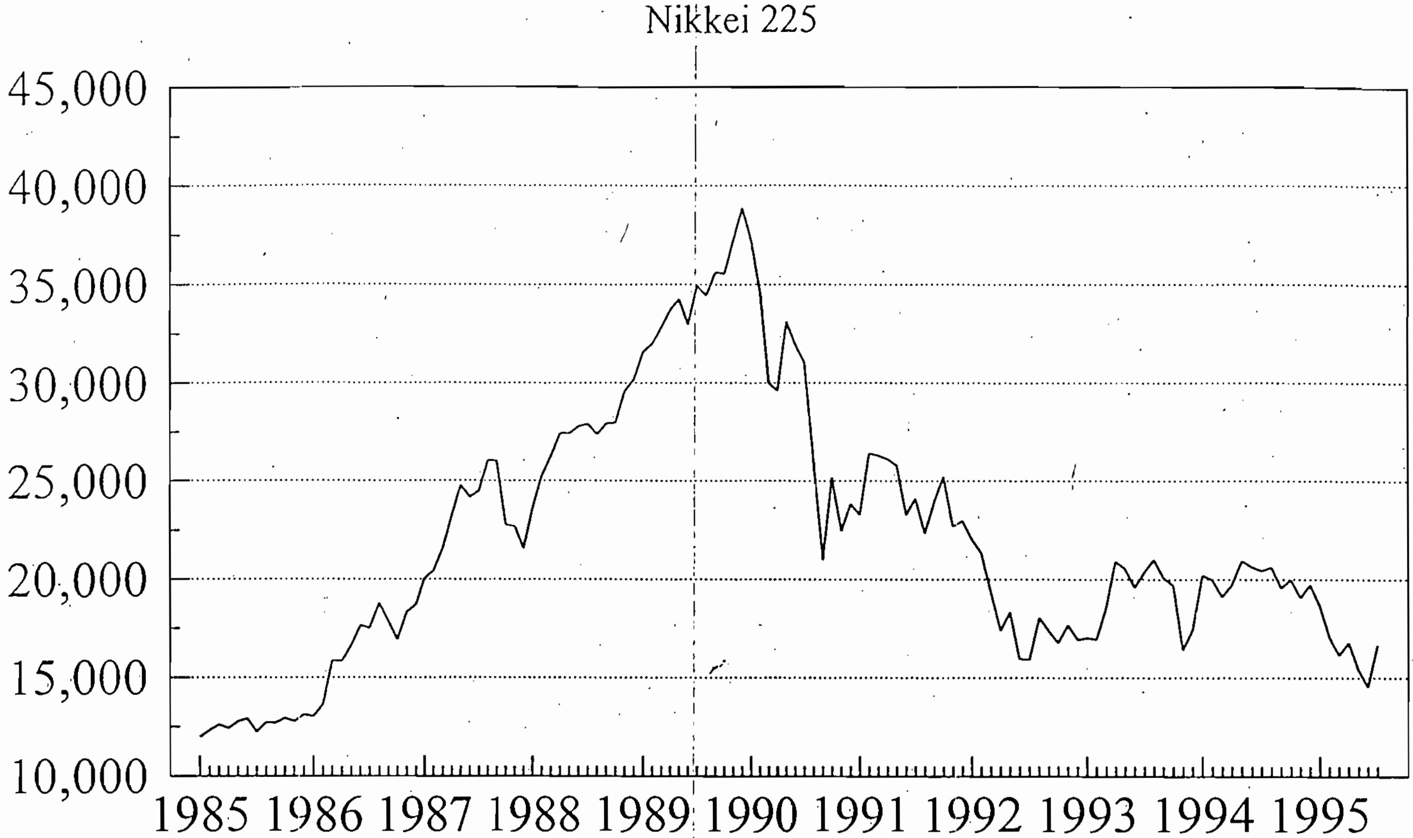

Source: OECD and Treasury Department Data

# Despite High Income Growth, Japanese Per Capita Consumption Is Only 70% of U.S. Levels

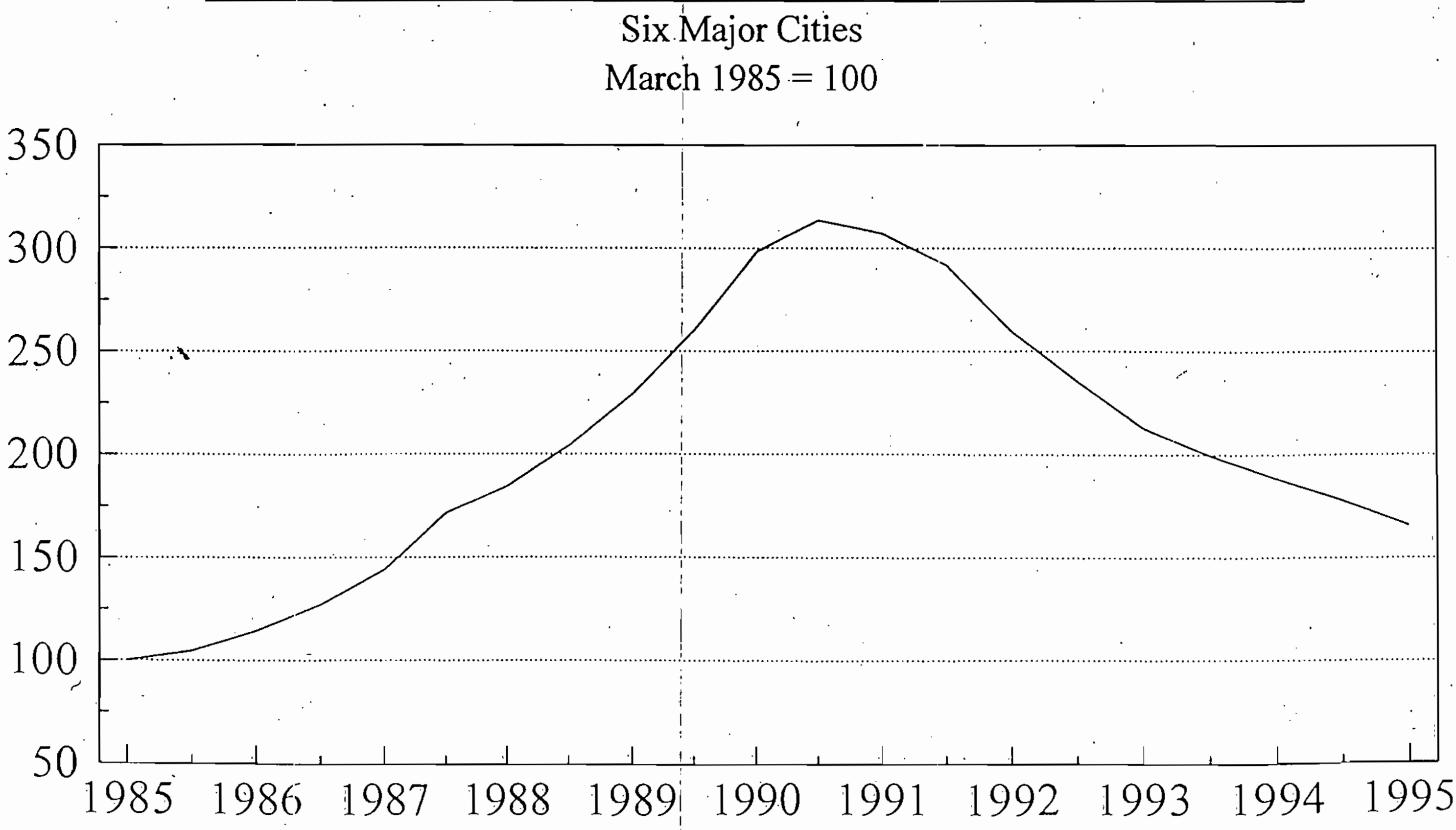



Source: OECD

## With the Bursting of the Bubble Economy Stock Prices Have Fallen From Their Peak



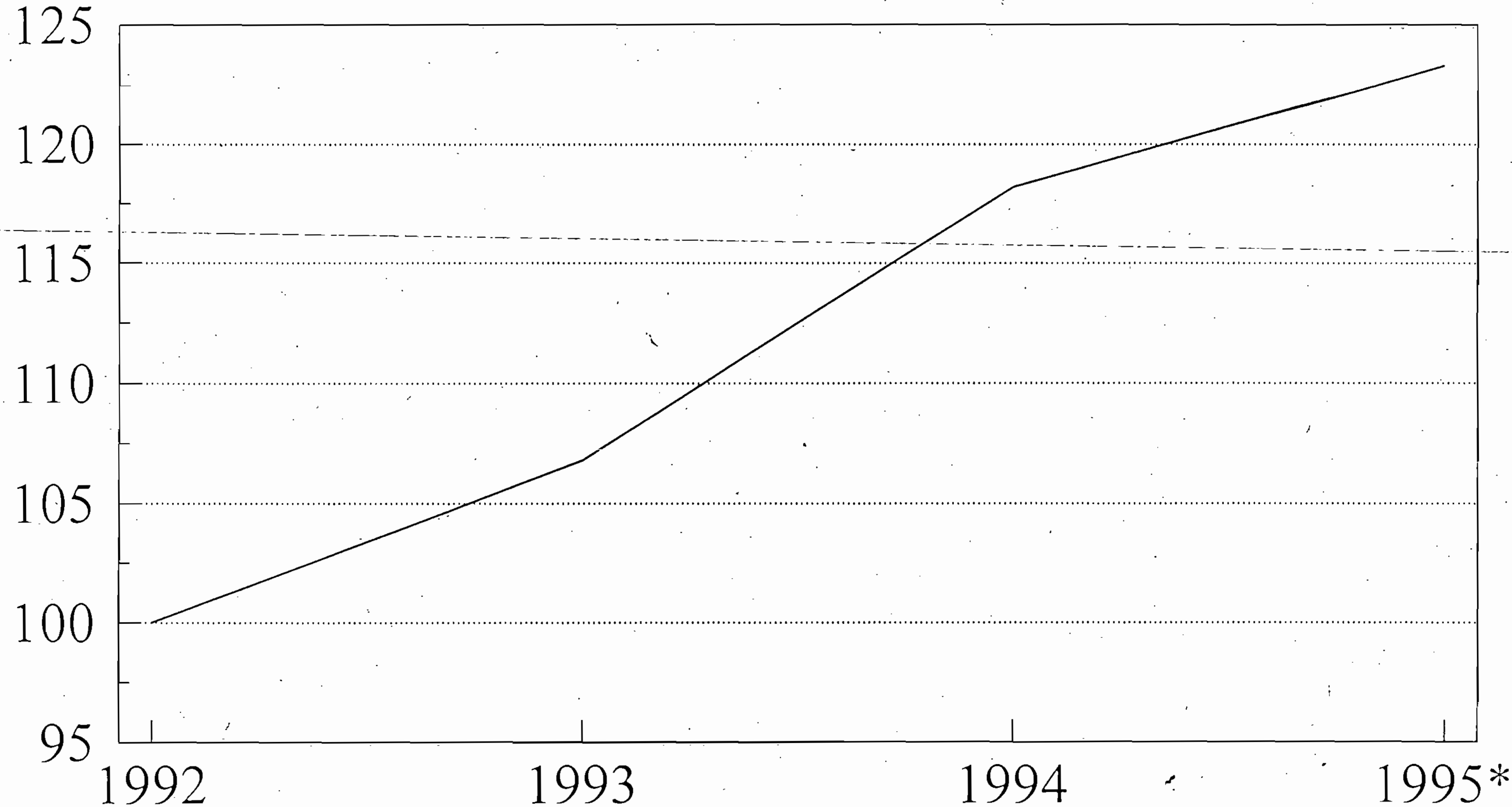

## Land Prices Have Also Fallen Dramatically




Source: Japan Real Estate Institute

# Competitive US Manufacturing Firms Are Increasing Their Penetration of the Japanese Market

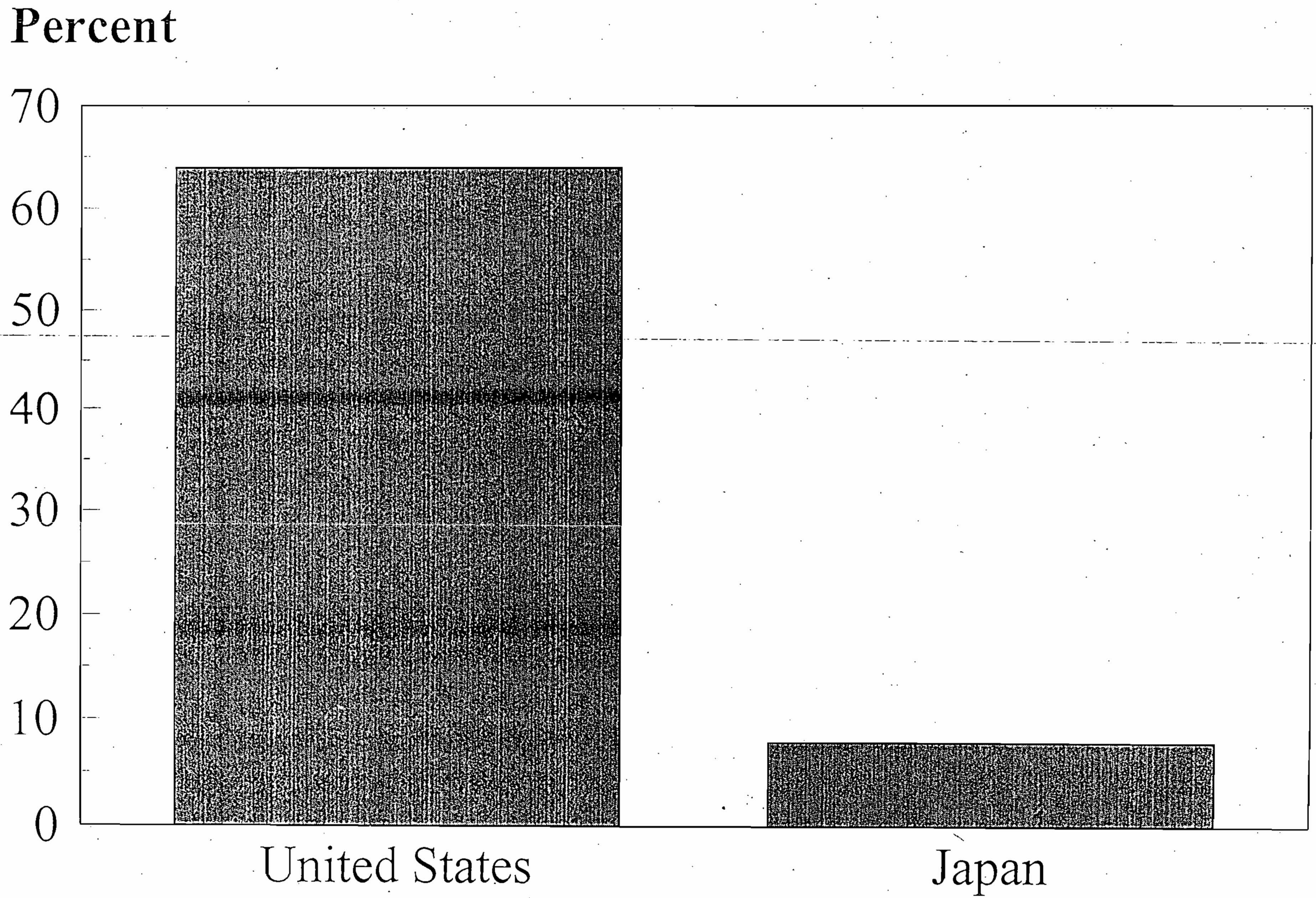
US Exports As A Share of Japanese Industrial Production




* First Five Months of the Year

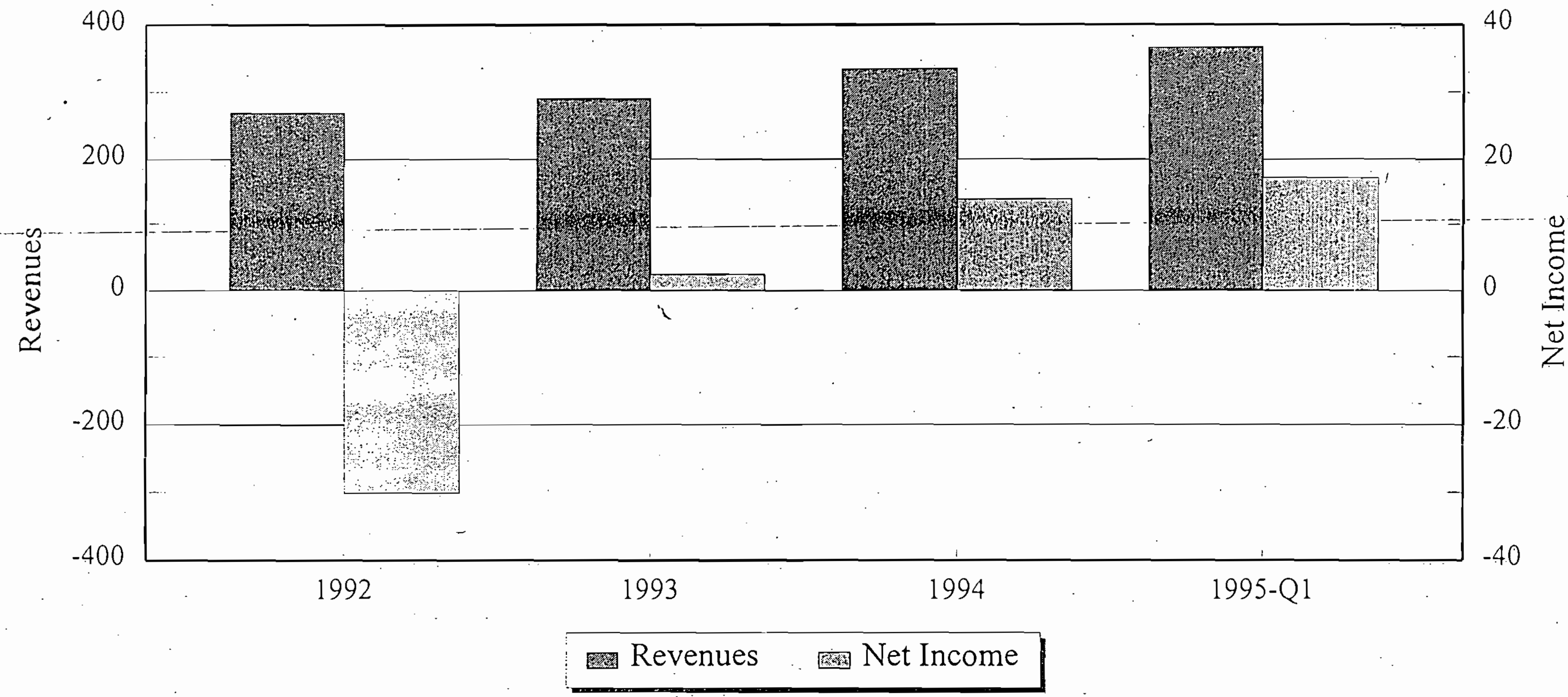
# Japanese Executives Are Not As In Tune With the Information Age

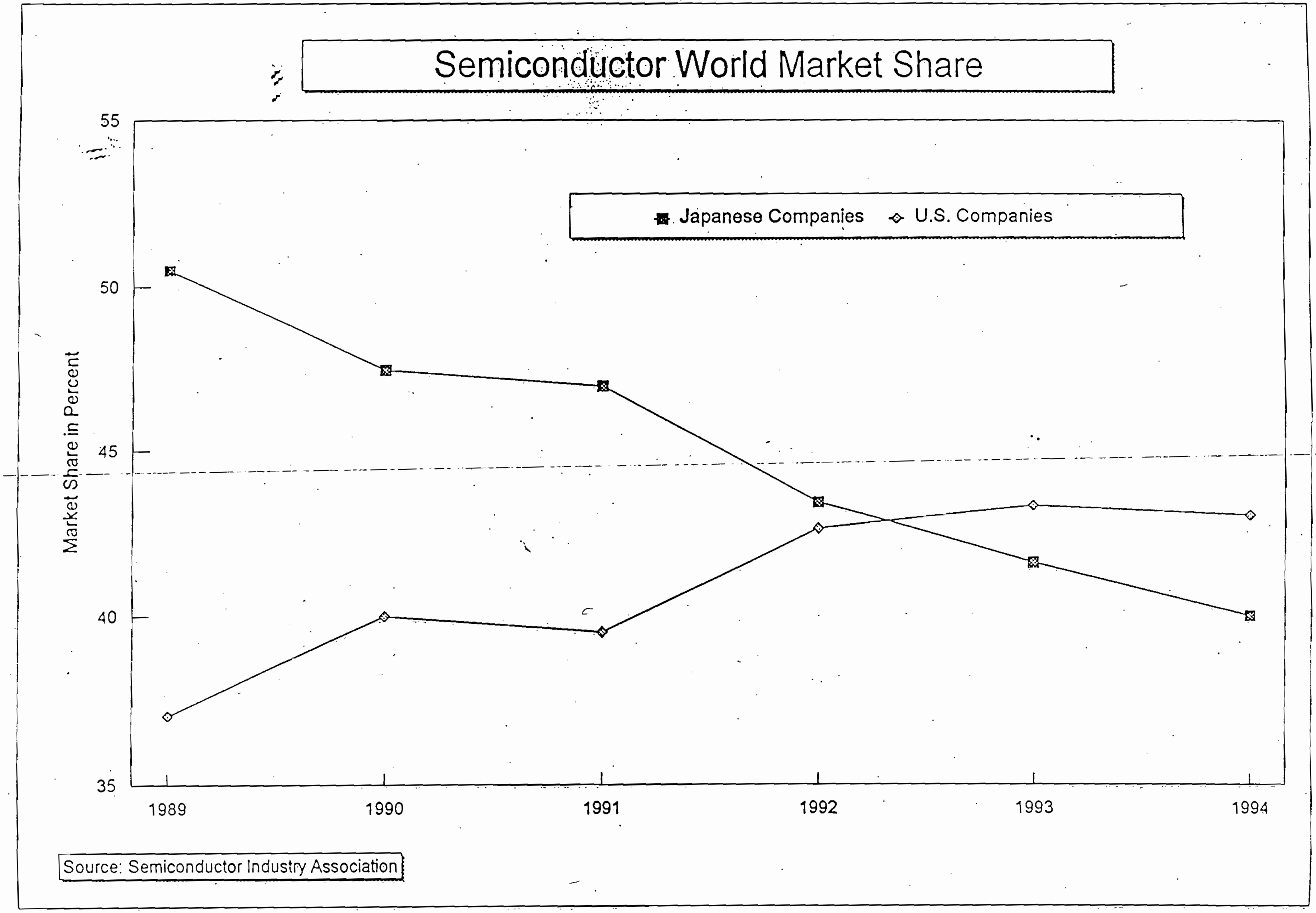
Share of Executives Who Use Computers 1994



Big Three US Automakers

Revenues and Net Income - $ Billions




Semiconductor World Market Share
Japanese Companies
U.S. Companies
Market Share in Percent
55
50
45
40
35
1989
1990
1991
1992
1993
1994
Source: Semiconductor Industry Association

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**RESTRICTION CODES**

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

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1996-SE-002440

THE DEPUTY SECRETARY OF THE TREASURY

WASHINGTON

MEMORANDUM FOR SECRETARY RUBIN

FROM: Deputy Secretary Summers

SUBJECT: Memo to the President: Economic and Financial Issues for the State Visit to Japan

ACTION FORCING EVENT:

The attached memo updates the President on the economic agenda with Japan for his meeting with Prime Minister Hashimoto.

RECOMMENDATION:

Than you sign the attached memo.

__________ Agree __________ Disagree __________ Let's Discuss

Attachment:

Memo to President Clinton

1997-se-004218

97-SE-004218

THE DEPUTY SECRETARY OF THE TREASURY
WASHINGTON

POTUS

**ACTION**

- P.M. Hashimoto Mtg w/ Potus
- concerns w/ contractionary policies + impact on C/A
- do not believe deregulation package will offset contractionary impact

**MEMORANDUM FOR SECRETARY ROBERT E. RUBIN**

**FROM:** Deputy Secretary Lawrence H. Summers

**SUBJECT:** Memorandum to the President on Hashimoto Visit

**ACTION FORCING EVENT:**

Japanese Prime Minister Hashimoto will meet the President on April 25. Economic issues loom large on our agenda. Fiscal consolidation and yen depreciation raise the prospect of a significant increase in Japan's current account surplus.

**RECOMMENDATION:**

That you sign the attached memo to the President, highlighting key economic issues to raise with Prime Minister Hashimoto (see Tab A).

___✓___ Agree ________ Disagree ________ Let's Discuss

**BACKGROUND:**

The April 25 Summit provides a key opportunity to follow up on issues you raised during your April 4 trip to Tokyo. We forecast very slow growth of domestic demand in Japan this year due to rapid fiscal contraction. If the current account surplus continues to increase as we project, we will need to press the case for a temporary slowdown in the pace of fiscal consolidation. We support Japan's plans to strengthen and reform its financial system and would urge expeditious actions to improve competition, transparency and disclosure, and to reduce systemic risk.

We understand the Japanese hope the Summit discussions will focus on shared objectives (e.g., deregulation, domestic-demand-led growth, avoidance of growing current account surpluses) and avoid fractious issues such as the pace of fiscal consolidation. However, we would like to lay the groundwork for a discussion of fiscal policy later this year if domestic-demand-led growth falters.

Attachment: Tab A: Memorandum to the President

NCC (Alan K.) delivered to WH 4/23/97

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| DOCUMENT NO. AND TYPE | SUBJECT/TITLE | DATE | RESTRICTION |
|---|---|---|---|
| 004. memo | Robert E. Rubin to POTUS re: April 25 Meeting with Japanese Prime Minister Hashimoto (2 pages) | 04/23/97 | P5 |

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November 27, 1997

MEMORANDUM FOR THE PRESIDENT

FROM: Robert Rubin

SUBJECT: Talking Points for Your Calls to President Kim Young Sam and Prime Minister Hashimoto

Attached are some points for the calls we discussed.

2

# Withdrawal/Redaction Marker
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| DOCUMENT NO. AND TYPE | SUBJECT/TITLE | DATE | RESTRICTION |
|---|---|---|---|
| 005. talking points | re: Key Points for Call to President Kim Young Sam (2 pages) | circa Nov. 1997 | P5 |

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|---|---|---|---|
| 006. talking points | re: Key Points for Your Call to Prime Minister Hashimoto (2 pages) | circa Nov. 1997 | P5 |

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# KOREA

1997-SE-012787

DEPARTMENT OF THE TREASURY
Washington
November 25, 1997

TO: Secretary Rubin
Deputy Secretary Summers

FROM: Timothy Geithner

SUBJECT: Reflections on Korea and IMF Program

Here is a draft note, prepared by Mark Sobel, outlining what we believe should be the main elements of a Korean program with the IMF. There is also a discussion of some related financing issues at the end of the paper.

cc: Lipton, Atkinson, Zelikow, Sobel

NCC to RER (reading)
NCC to ES

NCC cc to IMF
ES

11/25/97

Please log

Jan

**ELEMENTS OF AN IMF PROGRAM FOR KOREA** (draft: 11/25/97; 5:30 p.m.)

Korea has been a remarkable post-war success, achieving rapid rates of growth (nearly 9% p.a.) and rising real per capita income (7% p.a.) for several decades. Macroeconomic management has by and large been sound, with fiscal and monetary policies generally kept in check, even to this day.

But the Korean model, somewhat akin to Japan, has been founded upon the nexus of relations between the government, banking, and corporate sectors under which governmentally directed credit was funneled through the financial system to the large chaebols. This system, while it may have helped Korea achieve its remarkable successes, has increasingly come under strain in recent years and been unable to keep pace with the forces of globalization.

**Policy Adjustments**

Financial Sector Restructuring

In particular, the Korean system is founded on a culture of interconnected lending, constrained competition, a lack of transparency in accounting, and inadequate financial supervision. These relationships have been accentuated in recent years as Korean firms sought market share, at the expense of profitability, and undertook major new investments in response to yen appreciation. As a result, banks have become over-extended in their lending to the chaebols and the latter have become over-leveraged.

- o The leading chaebols have debt/equity ratios of 4:1. (check)
- o The major banks have exposure alone of some $3 billion to recently bankrupted chaebols, equal to 30% of equity and more than three years of core profits.

Thus, the primary challenge of a Fund program for Korea is to tackle this nexus. While this process will take many years to unfold, Korea must begin to change its microeconomic foundations in a bold, up-front and resolute manner that convinces markets that fundamental changes are underway.

First and foremost, this will have important implications for the structure of monetary policy and for the regulation of the financial system itself.

The main changes needed in the structure of monetary policy are the following.

- o Stop directed credit. Though Korea has been liberalizing its financial system, directed credits through jawboning, policy lending, and government sponsored banks has resulted in a banking system that acts as an agent of the government. The quid pro quo in the equation is that the government has followed a de facto "too big to fail" policy and ultimately bears the risk of default. The government also for many years chose bank presidents and even now still exerts influence over their selection. Thus, bank management has been responsive to the political system and has not developed a credit culture that is skilled in risk assessment or risk pricing. Symbolic of this, the return on assets of the top 12 Korean banks were well below 1%, whereas large U.S. banks average 1.5-2%.

- Stop government influence on interest rates. The government has almost completely liberalized the interest rate regime. But it is understood that the commercial banking sector is still subject to administrative guidance and that banks set interest rates in an administered way, rather than by open competition. In addition, the government has recently depressed rates through a series of special below-market rate loans to banks coupled with copious repurchase agreements.

- The system is perpetuated by the lack of an independent central bank, which effectively takes its cues from the Ministry of Finance and Economy. A Presidential Commission for Financial Reform has proposed that the central bank be made independent (in exchange for giving up its bank supervisory functions). Parliament recently refused to act on this proposal, though it may do so in coming weeks.

Korea should endorse the Basle Committee's 25 core principles with a credible timetable for implementation. Along these lines, the main elements of a systemic restructuring of the Korean banking system should be:

- Strengthen the bank supervisory function. Insure that the supervisory function is independent and includes broad enforcement authority.

- Disclosure of capital position. A fuller range of information about asset quality needs to be disclosed, especially the amount of classified loans and associated provisioning. As part of this, standards for NPLs need to be tightened. The overdue period for NPLs should be reduced from 6 months to 3 months and the overdue amount should include both principal and interest.

- Introduce an effective exit policy for weak banks that emphasizes closing and clean-up rather than keeping weak institutions alive through recapitalization with public funds or through forced mergers with stronger institutions. Public monies should be used to protect depositors. The Korea Asset Management Commission (with $10 billion -- sufficient to cover just 14%-35% of NPLs) should be charged with injecting liquidity into the system through the sale of non-performing assets. Foreign participation and asset securitization should be part of these asset sales. (Bankruptcy law?)

- Deposit insurance is only now being created in Korea -- the government is raising such insurance from less than 1 trillion won to nearly 9 trillion won (x% of deposits), because it was not needed in an environment in which banks were too big to fail. To reduce moral hazard risks, insurance should only be extended to depositors, not all external creditors.

- Toughen supervisory requirements. Korea should accelerate the imposition of full credit provisioning and the marking to market of securities positions. In this regard, large lending limits to chaebols should be reduced and enforced. In addition, there needs to be timetables on the restoration of minimum ratios, preferably higher than the Basle 8. The IMF estimates that while the published capital adequacy position of Korean banks is 9%, more prudent provisioning practices could reduce the ratio to 4-6%.

- Reform accounting standards and improve transparency. Acceptance of recognized internal and external audit procedures and a requirement that the major banks be audited by international audit firms would help restore credibility.

Monetary and Exchange Rate Policy

The conduct of monetary policy will need to balance many considerations, especially the trade-off between interest rate adjustment and possible exchange rate depreciation at a time of disruption in the financial system. (NOTE: The Fed is working on a paper that will address this issue, but their preliminary reaction is that the Korean data is not sufficiently transparent to allow them to reach a conclusion on the matter.) The Koreans have recently widened the daily won fluctuation band to 10% and stopped intervening due to the shortage of reserves.

Preliminary indications from the Koreans are that they will be highly resistant to anything more than a very modest and gradual tightening in monetary policy. They argue that the won is fine where it is and that higher interest rates will only disrupt the financial system.

- Maintaining the current level of interest rates would mitigate pressures on the banking system, but it cannot be overemphasized that such a policy clearly cannot -- and must not be seen -- as a substitute for a comprehensive and decisive clean-up of the financial system.

- But higher interest rates would help promote exchange rate stability, forestall capital outflow and attract inflow, and restore confidence. To the extent there are unhedged positions in the financial system, it would avert losses on these.

- In the case of Thailand and Indonesia, currencies have fallen by over 40% against the dollar since the beginning of the crisis period, suggesting that priority should be accorded to monetary policy tightening as a means of avoiding further overshooting.

- The won is down roughly 20%. On a real effective basis, the won has also depreciated far less than many of Korea's neighbors. Three month Korean interest rates are 14%, while inflation is under 5%, suggesting that real interest rates are considerably positive. Korean exports are still highly competitive -- export volumes are up over 20%.

- On balance:

  -- Korea has little alternative but to continue floating and to use reserves to support the won at this time would not be prudent.

  -- There is probably a need for modestly increasing Korean interest rates to support the won. But the extent of the necessary tightening is probably less than indicated in the cases of Thailand and Indonesia.

-- Opening up the capital account (see below) could attract inflows and lessen pressures on monetary policy as a means of supporting the won. A more counter-cyclical fiscal policy could also put upward pressures on interest rates and attract capital inflow.

Capital Account Liberalization

Korea has traditionally taken a slow and incremental approach to capital account liberalization, especially on inflows. In the context of the current liquidity crisis, measures to reduce or eliminate restrictions on capital inflows -- some of which are already slated for future liberalization under WTO or OECD frameworks -- should be sharply accelerated, particularly as a means of supporting the exchange rate while lessening pressures on interest rates.

o Limits on aggregate foreign ownership of listed Korean shares (currently at 26% and slated under the OECD schedule to go to 29% by 1999) should be eliminated or set at a substantially higher level [NB: this has traditionally been the firewall against Japanese ownership of Korean companies]

o Permit foreign investment in the financial sector. Foreign banks are not allowed to establish subsidiaries (this is technically national treatment since the government has not granted any new licenses for many years), there are severe constraints on foreign ownership of domestic banks, securities investment trust, investment advisory, and credit rating companies. Korea's across-the-board limit on this sector has no OECD equivalent.

o Liberalize the domestic bond market to allow full foreign participation. Liberalization of the debt market to this point has been focused almost exclusively on trade credits. The recent stabilization package opens the door for foreign purchases of guaranteed and non-guaranteed corporate debt with maturities greater than three years. While this is an improvement over the OECD schedule (liberalization of convertible non-guaranteed bonds above 5 years maturity), further liberalization appears necessary to generate sufficient foreign interest.

o Permit foreign banks to base lending on parent rather than branch capital. Regulations on lending for foreign banks (only branches are allowed) are based on local rather than parent capital.

o Relax or eliminate applicable foreign exchange controls. Banks currently face restrictions and approval requirements on amounts and uses of foreign currency-denominated loans, as well as limits on amounts and uses of foreign exchange.

o Open the door for foreign direct investment. There is currently a myriad of licensing, approval, and sector-specific restrictions that have severely restricted the inflow of FDI (total FDI was only about $2 billion in 1995). As a result, Korea relies heavily on volatile short term portfolio flows to finance its external deficit.

## Fiscal Policy

Korean fiscal policy is essential sound, with the general government having been in balance since 1993. Nonetheless, the fiscal position is likely to swing into modest deficit next year.

- o Comprehensive financial restructuring will entail recapitalization of the banking system. The interest costs associated with the recapitalization will need to be put on-budget. (Assuming bad debts of 11% of GDP, half of which are recoverable, the annual interest cost on recapitalization at a 14% interest rate would be roughly 3/4% of GDP.)

- o Lower growth will result in less rapid growth in revenues.

On the one hand, the IMF will likely urge some fiscal tightening to ease pressures on interest rates and absorb part of the needed adjustment in the private sector balance. On the other hand, fiscal tightening at this time would be pro-cyclical. Allowing Korea to run a deficit to reflect the pressures on its finances would provide a counter-cyclical impulse, and put some upward pressures on interest rates which could limit the need, otherwise, for monetary policy tightening.

## Prevention

Greater transparency and increased provision of data helps check imprudent behavior by forewarning markets as to when problems are emerging. Market sources regard Korea as very closed, untransparent and opaque. Korea could take a number of steps in this regard.

- o Disclose the amount of official forward exposure and foreign exchange deposits held in the banking system.

- o Weekly reporting of reserves.

- o As discussed above, adopt international standards for classifying bad loans and publish the results.

- o Full disclosure on external liabilities.

## Structural Reforms

Fund staff, perhaps supported by the OECD, should review Korean competition policies and include measures to strengthen the functioning of domestic markets. It would be very useful to examine comprehensive steps for deregulation, including the concentration of the chaebols.

There is concern that Korea's strong labor unions will impede a needed adjustment in real wages, though there have been some statements of the belt-tightening sort from some union leaders. Unlike the Indonesian case where Congress criticized the country strongly for its treatment of labor unions, Korea has among the strongest labor unions in the world.

**Financing**

A judgment on the appropriate amount of program financing will be reached in the context of the upcoming Fund mission to Seoul.

At this juncture, we have a few skeletal facts on the Korean financial situation and it is not especially clear that the Fund's data is much better.

- o The current account is now running at less than a $10 billion annual rate. Some analysts believe that Korea may even run a small current account surplus next year.

- o Reserves are currently around $25 billion, and there have been $6 billion in forward sales, less than $1 billion of which mature this year. Anticipated reserve loss is $3 billion for the rest of November and $8-9 billion in December.

- o Short term external debt is $112 billion -- $42 billion is owed by domestic financial institutions of which $20 billion comes due this year; $50 billion is owed by foreign branches of domestic institutions; $20 billion is owed by domestic corporations.

    - -- We do not know enough about the debt and its components to make judgments on how much might roll-off and how much might be rolled-over. The Koreans have not heretofore been forthcoming on data on this subject.

    - -- The markets believe that the short term external debt is on the order of $60-75 billion and speculate that if one-third of this amount rolled-off, it would likely equal or exceed the present level of reserves.

- o The Koreans reportedly hold $26 billion of foreign exchange in commercial banks; they reported to Geithner/Truman that these deposits could not be withdrawn from the commercial banking system, presumably as this would be tantamount to a run-off.

- o Sovereign debt is 1.1% of GDP. This is a small amount of official debt and one point of emphasis of a Fund program should be to compel the Koreans to go as quickly to the market, regardless of the spread.

    - -- However, market participants are not especially sanguine as to the market's potential appetite for Korean paper and instead emphasize the need for a hefty international package. Until a Fund program is in place and the dust settles a bit (Q1 or Q2 1998), they believe it would be premature for Korea to hit the markets. If the Korean issue were fully guaranteed, there is concern that some participants would dump existing Korean paper -- held by many in the market -- that does not include an explicit guarantee. Participants suggest that far more transparency would be essential.

    - -- In general, the markets view the Koreans with great suspicion -- they question the Korean's willingness to be forthcoming with information, to deliver on commitments, and to overcome political and bureaucratic resistance to change.

- The Koreans have given numerous indications to the press about the desired size of the total package, in all cases emphasizing figures on the high side. The Central Bank Governor told Geithner and Truman that a $30 to $40 billion package would be needed to rebuild Korean reserves to $50 billion. How they reached this figure is unclear.

Below are several options on a financing package.

**IMF*** **$20 billion**

-- **$10 billion from standby/EFF.**

-- **$10 billion from new emergency liquidity facility/window.**

**World Bank/ADB** **$5-6 billion**

**Bilaterals as a second line of defense only:**

**A.** **Undefined commitments (United States, Japan and others a la Indonesia).**

**B.** **$15 billion: $5 billion, United States; $5 billion, Japan; and $5 billion from others.**

**C.** **$35 billion: $10 billion, United States; $10 billion, Japan; and $15 billion from others.**

* **A decision will need to be taken on whether to activate the GAB in this context.**

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| DOCUMENT NO. AND TYPE | SUBJECT/TITLE | DATE | RESTRICTION |
|---|---|---|---|
| 007. memo | Karin Lissakers (IMF) to Deputy Secretary Summers & Deputy Assistant Secretary Atkinson re; Mobilizing Funds for IMF Korea Disbursements (1 page) | 12/02/97 | P1/b(1) Unclass. |

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|---|---|---|---|
| 008. memo | Karin Lissakers (IMF) to Deputy Secretary Summers, Under Secretary Lipton, & Assistant Secretary Geithner re: Managing Director's Briefing on Fund Agreement with Korea (5 pages) | 12/03/97 | P1/b(1) Unclass. |

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**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 World Bank**
Washington, DC 20433
U.S.A.

1. C.\
& file

**DATE:** December 23, 1997

**TO:** Deputy Secretary Summers
Under Secretary Lipton/DLoevinger
DAS Schuerch/JEichenberger/DAS Atkinson/MSobel
USED: IMF & ADB

**FROM:** Jan Piercy, U.S. Executive Director

**SUBJECT:** Update: World Bank Board Meeting on Korea

This morning's Board consideration of the $3 billion Economic Reconstruction Loan (ERL) was adjourned to give Jim Wolfensohn time needed to provide the Board with clearer picture of the risks the Bank is taking. **Jim has promised to give the Board an updated assessment of where things stand on: (1) the status of the second line of defense, and (2) the prospects for a moratorium on commercial debt.** Board discussion will resume at 2:30 p.m.

- there is strong member support for proceeding with the proposed loan while acknowledging the risks involved. If possible, members would like to avoid having Bank disbursements immediately flow to commercial creditors if a moratorium is expected.

- the amount of the ERL is broadly acceptable; with the focus on a vehicle for additional assistance appearing to shift towards accelerating the first structural adjustment loan.

  - *Korea asked for negotiations on a SAL to begin after Christmas. Japan also called for a speed up in SAL negotiations, and we, the FRG and France indicated there may be am early need to discuss accelerated assistance.*

  - *Wolfensohn stated that while he had no intention of recommending another round of liquidity financing, he wanted the Bank to assist consistent with its development mandate.*

- the Board is also prepared to support the proposed lending terms.

  - *Korea criticized the terms as "onerous" and most borrowing countries stated they should not be viewed as a precedent for future Bank lending. The US, UK and some others stated a preference for higher charges.*

- on bilateral support: the Netherlands (no amount cited) and Switzerland ($300 million) announced they will participate.

The World Bank
Washington, DC 20433
U.S.A.

**DATE:** December 23, 1997

**TO:** Deputy Secretary Summers
Under Secretary Lipton/DLoevinger
DAS Schuerch/JEichenberger/DAS Atkinson/MSobel
USED: IMF & ADB

**FROM:** Jan Piercy, U.S. Executive Director

**SUBJECT:** PART II: Update: World Bank Board Meeting on Korea

**The Board formally approved the $3 billion Economic Reconstruction Loan (ERL) to Korea this afternoon.** The funds will be disbursed "in the speediest manner possible".

Jim Wolfensohn opened the session with a strong recommendation that the Bank proceed with the loan. His rationale included:

- his personal confidence in the commitments of the GOK;
- the adverse impact a delay would have on market confidence;
- the extreme nature of the crisis, and the hope that IBRD funds (plus ADB funding expected to be approved tomorrow) would contain the situation through December; and
- the indications (but no guarantees) that there could soon be agreement by other parties that would help meet financing requirements in January and February.

Wolfensohn reiterated his view that the Bank is not a "firefighter", and that the current loan -- while it clearly provides badly needed liquidity -- should be viewed primarily as part of a package to support a program of financial reform agreed by the GOK. Wolfensohn restated his position that "in the absence of any new information" he would be opposed to any additional lending outside the framework of a Bank structural adjustment program.

Board support was unanimous and -- given the fact that the loan parameters were thoroughly discussed in the morning session -- member interventions brief. There were no references to the size of the package other than the UK noting that the situation was fluid and that "all options should be kept open" and France noting that the Bank should "stand ready to do more". *(It would have been helpful if they had been able to back the US and Japan on this issue earlier in the process.)*

1997-SE-013833

From David Lipton (David Loevinger)

12/23/97

**Q&A for POTUS on Asian Crisis and Korea**

INFORMATION

X

**Question:** Why isn't the United States doing more to restore financial stability in Korea and more generally in Asia?

Isn't the IMF doing more harm than good by imposing austerity on the economies in distress?

**Answer:**

o The United States is strongly committed to the restoration of financial market stability in Asia.

-- We are actively engaged in assisting the Asian authorities, through both close consultations and financial support -- through the multilateral financial institutions and by committing to provide a "second line of defense" if needed.

o But the key to restoring financial stability are strong policies that will boost investor confidence and do so quickly. This is what the IMF is recommending.

o Restoring confidence is a prerequisite to creating conditions in which growth can eventually resume.

**If asked about accelerating US/IMF, etc. financial support:**

o Policies to restore financial market confidence take some time to take hold.

o We think that with perseverance on reforms, the financial support that has been put in place will help Asian economies find their way through this situation successfully.

EXEMPT

# 1998-SE-000328

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

ASSISTANT SECRETARY

December 30, 1997
Revised January 2, 1998

**MEMORANDUM FOR SECRETARY RUBIN**
**DEPUTY SECRETARY SUMMERS**

**FROM:** Timothy Geithner TFG
Assistant Secretary (International Affairs)

**SUBJECT:** Negotiation of $5 billion ESF Facility for Korea

This memorandum summarizes the main points which we have worked out with the other bilateral creditors for the "Second Line of Defense" and sets forth the process we envision for negotiating the agreements with Korea. We will keep you informed of progress in preliminary discussions and seek your formal consent to the ESF agreement when finalized.

Agreed Term Sheet

Attached at TAB A is the "final" version of the U.S. Term Sheet. An earlier version was agreed following discussions among IMF Executive Directors representing G-7 countries (in accordance with a process set up by G-7 Deputies) and broadened to include the other six participants -- the four remaining G-10 countries (Belgium, Netherlands, Sweden, Switzerland), Australia and New Zealand. This version primarily reflects changes to reflect our discussion on December 31, but we are confident that they will be acceptable to the other participants.

Principles

The Principles (also at TAB A) were worked out with other participants' Executive Directors to provide a basis for the term sheets each country was to develop. As they include elements of negotiating strategy, they are not being provided to Korea. (They include a general provision which is not reflected in the term sheet -- that the creditors have a high degree of confidence that activation of their arrangements will lead to a successful outcome.)

Conditions and Terms

In the context of the broad framework of conditions you have laid out, including an appropriate role for private bank lenders, several conditions will apply to any release of the U.S. share (about $1.7 billion) of the $8 billion anticipated in January. The principal conditions and terms of our agreement include the following:

- Korea is in **compliance with the IMF program** and takes any **necessary additional policy measures**, and has done enough to **encourage rollovers and raise new money** from private sector creditors;

*We will make these determinations at the time of each request for a drawing and any subsequent rollovers, thus preserving our options and enabling us to maximize pressure on the Koreans.*

- drawings on a revolving basis in the form of **60-day** instruments, **renewable** up to a maximum of **five times** (i.e., maximum period outstanding of approximately 360 days, depending on whether maturity date is a business day), but **further rollovers possible** at our discretion, **unless a repurchase under the IMF arrangement is required within the next 60 days**.

*We are doing swaps, as usual; some of the others will do direct loans. As for initial drawings, rollovers are at the option of the lenders, permitting us to insist on additional conditions.*

*Building in the flexibility to permit a drawing to be rolled over beyond one year will enable us to avoid having to execute new agreements if, at that time, we decide Korea is not in a position to repay. The reference to repurchase under the IMF arrangement will enable the bilateral financing to track the new IMF short-term facility, which stipulates an "expectation" of repayment beginning after one year but provides for approval of deferral of initiation of repayment for up to another year.*

- **one year duration**, i.e., no drawings permitted after one year anniversary of effectiveness of agreement, but duration **may be extended** if we decide circumstances warrant

*There will be a stronger presumption against drawings after the one year anniversary than against rollovers. As for rollovers, no drawing would be permitted if a repurchase under the IMF arrangement is required within the next 60 days.*

- **interest rate** at a premium over cost of funds of at least 350 basis points

*We expect other lenders will agree to our decision to revise the phrasing of the interest rate provision in order to discourage the Koreans from trying to negotiate a lower premium. It will also cover any need on our part to comply with "ICRAS" procedures that could call for a higher premium in order to reflect risk of USG lending to Korea, if Korea is downgraded under the procedures. A premium of 350 basis points is well above the current ICRAS formula, which OMB staff estimate at 55 basis points, and also above the ICRAS premium that would apply if Korea underwent four downgrades.*

*The rate could also be higher, at our discretion, if another lender charged a higher premium.*

*The choice of a minimum of 350 reflects a desire for bilateral lending to carry a higher premium than the minimum 300 basis point premium for IMF financing from the new Supplemental Reserve Facility, and thus to maintain incentive for early repayment.*

- **"pari passu"** disbursement, repayment, etc., among the lenders' transactions

  *We will have the right to condition a drawing on proportionate participation by all lenders and to require repayment no later than for other lenders.*

- right to **limit Korea's ability to use funds** provided by requiring at the time of each drawing (and rollover) that some or all of the proceeds be used to increase reserves, as defined in the IMF program or another definition of our choosing

  *This provision will enable us, inter alia, to require that Korea retain at least $2 billion of usable reserves, over and above the amounts outstanding from all bilateral lenders, as a form of security that our money could be repaid at any time.*

- requirement that the Government of Korea **guarantee** performance by the Bank of Korea, which will be the obligor under our agreement

  *This may require that Korea enact authorizing legislation, but is an important element of protection for us.*

- **reporting requirements** that will furnish us with daily reserve figures and such additional information we require to ensure that they are "clean". e.g., identify any placements with Korean banks

- right to **accelerate** at our discretion if an event of default occurs

<u>Steps for Concluding Individual Agreements</u>

- As soon as they are finalized, I will ask Amb. Bosworth to deliver our term sheet and draft agreement to Finance Minister Lim and Bank of Korea Governor Yi.

- We will also provide the draft agreement to other bilateral creditors to help them get started on their own legal agreements; some of them are relying on the BIS to draft a model agreement.

- Bosworth would indicate that the term sheet represents the consensus of the bilateral creditors and is being reflected in preparation of their own term sheets, and that its basic provisions are thus not subject to negotiation.

- He would also indicate that a team of Treasury and New York Fed attorneys, headed by Neal Wolin, plus an OASIA representative (Jim Lister), will arrive in Seoul over the weekend to discuss drafting details on the ESF Facility.

- This process should be complete by Tuesday, after which we would circulate the revised draft agreement to other bilateral creditors.

- Bosworth would remind the Koreans of their responsibility to complete agreements with the other bilateral creditors and indicate U.S. readiness to host a policy-level meeting of all creditors and Korean officials, convened by Korea, in New York, to expedite finalization of the agreements. This could be as early as the end of the week, i.e., January 8 or 9.

- The aim would be to have all the agreement become effective before the anticipated disbursement date (if effectiveness occurs only just before disbursement, we would need to coordinate waivers of the periods of notice for a drawing). As you know, disbursements will be contingent on a satisfactory agreement between the private banks and Korea.

cc. Under Secretary Lipton

Attachments: TAB A: U.S. Term Sheet and Creditors' Agreed Principles

JANUARY 2, 1998 7:00 P.M.

# EXCHANGE STABILIZATION FACILITY FOR SOUTH KOREA

In light of Korea's economic and financial situation and its potential to lead to a deterioration of confidence in other countries in the region, U.S. authorities are prepared to provide back-up short-term financial assistance to Korea in conjunction with its IMF program.

Such assistance would be available only on a contingent basis In the event of (a) unexpected adverse circumstances which, despite compliance with other policy conditions under the Fund program, increased the pressure on Korea's reserves, resulting in substantial depletion of those reserves, and (b) a subsequent determination by U.S. authorities, in consultation with the IMF Managing Director and with the authorities of other countries providing back-up short-term financial assistance, that Korea had taken additional adjustment measures deemed necessary to combat the pressure, the United States would stand ready to consider requests for financing to supplement purchases under the IMF program, subject to Korea's continued adherence to the revised set of policy understandings and conditions for purchases, and to certain other conditions specified by U.S. authorities.

The United States would participate through the Department of the Treasury's Exchange Stabilization Fund, with the Federal Reserve Bank of New York acting as agent, on the terms and under the conditions outlined below. The facility ("ESF Facility)" would be activated through a joint decision of U.S. and Korean authorities upon determination by U.S. authorities, in consultation with the IMF Managing Director and with the authorities of other countries providing back-up short-term financial assistance, that the resources available under the IMF program should be supplemented.

**AMOUNT:**

- $5 billion.

**DRAWINGS:**

- On a revolving basis in the form of 60-day swaps with the Bank of Korea, guaranteed by the Government of Korea, that could be rolled over, in whole or in part, at the discretion of the U.S. authorities.

- No drawing may occur more than one year following effectiveness of the ESF Facility unless U.S. authorities decide that circumstances justify an extension of this period.

- Notwithstanding the above, no rollover or drawing may take place if a repurchase under the IMF arrangement is required to be made within the following 60 days or if an event has occurred requiring early repayment on the ESF Facility as set forth below.

**TERMS:**

- *Maturity:* 60 days

- *Interest rate:* The cost of funds to the U.S. Treasury (bond equivalent of prevailing market rate at close of business day immediately preceding drawing on latest issue of 13-week Treasury bills) plus an appropriate premium determined by the Treasury, which will be at least 350 basis points and no less than the premium being charged under comparable arrangements with other countries.

- *Early repayment:* immediate repayment of any existing outstanding amounts if, subsequent to the drawing or drawings giving rise to those amounts, Korea makes any repurchases under the IMF program or any repayment ahead of schedule on any other foreign currency indebtedness, or fails to make repayment as scheduled on any amounts outstanding on the ESF Facility or under comparable arrangements with other countries or to meet one or more of the ongoing obligations.

**CONDITIONS TO EACH DRAWING AND ONGOING OBLIGATIONS:**

- Determination by U.S. authorities, in consultation with the IMF Managing Director and with the authorities of other countries providing back-up short-term financial assistance, that, due to adverse circumstances, Korea needs short-term financing to supplement financing provided under the IMF program.

- Korea has made substantial and appropriate use of its available reserves, as determined by U.S. authorities in consultation with the IMF Managing Director and the authorities of other countries providing back-up short-term financial assistance, and has drawn or will simultaneously draw amounts under arrangements with such other authorities comparable to the ESF Facility that are in proportion to the amounts drawn under the ESF Facility.

- Written notification by the IMF Managing Director that Korea remains eligible to make purchases as scheduled under the IMF Stand-by arrangement.

- Determination by U.S. authorities, in consultation with the IMF Managing Director and with the authorities of other countries providing back-up short-term financial assistance, that Korea has implemented any additional economic measures deemed necessary, including any strengthening of the IMF program determined by the IMF, to counter the unexpected pressure on its reserves.

- The IMF and other IFIs have taken necessary steps to achieve timely disbursement under their respective programs, including acceleration of disbursement schedules where appropriate, and Korea has taken all necessary steps to be eligible for such disbursements.

- Korea has fully explored, and has taken all necessary steps to gain maximum access to, new private market financing and maintenance of an appropriate degree of existing financing.

- Korea undertakes to maintain its reserves at such levels which, as determined by U.S. authorities, are appropriate in light of drawings under the ESF Facility and arrangements extended by authorities of other countries providing back-up short-term financial assistance.

- Korea has provided daily reports on reserves and reserve-related transactions of Korean authorities and any other information requested by U.S. authorities from the date of effectiveness of the ESF Facility until its expiration.

- Without the approval of the U.S. authorities, neither the Government of Korea nor the Bank of Korea may use its assets to secure any material foreign currency indebtedness. If the Government of Korea or the Bank of Korea does grant such security, the obligations under the ESF Facility will be given equal benefit of such security. These obligations will rank pari passu with all other unsecured foreign currency indebtedness of the Government of Korea or the Bank of Korea.

Proposed Principles for Activation of Second Line

1. In consultation with the IMF Managing Director, bilateral creditors may determine that additional funds are necessary and appropriate to supplement resources made available by the IFIs.

2. As a basic principle, bilateral creditors decide individually whether to activate their respective arrangements, but consult among themselves with the aim of achieving "pari passu" participation (timing and magnitude) and terms and conditions. They will have shared with each other and with the IMF Managing Director the terms and conditions of their individual agreements.

   Individual bilateral creditors may condition their participation on the participation of some or all other such creditors.

   Individual bilateral creditors may require that disbursements of other such participating creditors be at least proportional to the size of their respective arrangements.

   Individual bilateral creditors may require that their own disbursements be provided no sooner than disbursements of other participating bilateral creditors, and be repaid no later.

3. Bilateral creditors are satisfied that

   - Korea has made substantial and appropriate use of its available reserves;
   - Korea is in compliance with the policy program supported by the IMF;
   - Korea has taken or will take appropriate additional measures to strengthen the program, as agreed by the IMF and the bilateral creditors, if needed, e.g., in response to adverse developments not anticipated in that program;
   - the IMF and other IFIs have taken necessary steps to achieve timely disbursement under their respective programs, including acceleration of disbursement schedules where appropriate, and Korea has taken all necessary steps to be eligible for such disbursements; and
   - Korea has taken all necessary steps to gain maximum access to new private market financing and to encourage maintenance of an appropriate degree of existing financing.

4. Bilateral creditors have a high degree of confidence that activation of their arrangements will lead to a successful outcome.

5. Bilateral creditors may require that the Government of Korea guarantee claims on the Bank of Korea arising under their respective arrangements, and that Korea maintain its reserves at a level or levels above the present or future targets levels in the IMF program to reflect the impact of their disbursements.

6. In regards to the terms of the financing, it would be provided in the form of short-term instruments, 60 days, renewable at the option of the creditor up to a maximum total of one year, but no new financing or rollover may occur later than one year after entry into force of a bilateral creditor's arrangement. Bilateral creditors will endeavor, in consultation with each other, to establish consistent interest rates; generally, the rate charged will reflect appropriately the degree of risk and will be no less than the greater of (a) the benchmark cost of funds to the bilateral creditor plus a premium of 350 basis points, or (b) a rate reflecting another appropriate premium over the benchmark relevant to its financing. The Federal Reserve Bank of New York is prepared to act as agent for those bilateral creditors providing financing in U.S. dollars.

7. All outstanding financing from a bilateral creditor is to be repaid within one year of its initial provision of financing but in any event no later than Korea's first repurchase under the IMF program following such provision of financing. Bilateral creditors may require immediate repayment if a repayment is not made as scheduled on their respective arrangement or on the arrangement of another bilateral creditor, or if Korea fails to meet one or more of the ongoing obligations under their arrangement.

Washington, D.C.
December 30, 1997 7:20 p.m.

# TREASURY CLEARANCE SHEET

NO._________
DATE:_______

MEMORANDUM FOR: ☐ SECRETARY ☐ DEPUTY SECRETARY ☐ EXECUTIVE SECRETARY
☐ ACTION ☐ BRIEFING ☐ INFORMATION ☐ LEGISLATION
☐ PRESS RELEASE ☐ PUBLICATION ☐ REGULATION ☐ SPEECH
☐ TESTIMONY ☐ OTHER ____________

**FROM:** Assistant Secretary Timothy F. Geithner
**THROUGH:**
**SUBJECT:** Negotiation of $5 billion ESF Facility for Korea

**REVIEW OFFICES (Check when office clears)**

☐ Under Secretary for Finance
☐ Domestic Finance
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☐ Secret Service
☐ General Counsel
☐ Inspector General
☐ IRS
☐ Legislative Affairs
☐ Management
☐ OCC
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☐ Scheduling
☐ Public Affairs/Liaison
☐ Tax Policy
☐ Treasurer
☐ E & P
☐ Mint
☐ Savings Bonds
☐ Other__________

| NAME (Please Type) | INITIAL | DATE | OFFICE | TEL. NO. |
|---|---|---|---|---|
| INITIATOR(S) | | | | |
| J. Lister | kor-rrls.d30 | 12/30/97 revised 1/2/98 | International Monetary Policy | 622-0112 |
| REVIEWERS | | | | |
| C. Atkinson | CA | 1/2/98 | DAS, Intl. Monetary & Financial Policy | 622-0489 |
| D. Zelikow | DZ | 1/1/98 | DAS, Asia, the Americas & Africa | 622-7222 |
| N. Wolin | NW | 1/2/98 | Deputy General Counsel | 622-0283 |

**SPECIAL INSTRUCTIONS**

☐ Review Officer ________ Date ________ ☐ Executive Secretary ________ Date ________

DO F 70-02.1 (04/89)

1998-SE-011035

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

September 24, 1998

ASSISTANT SECRETARY

**INFORMATION**

**MEMORANDUM FOR SECRETARY RUBIN**
**DEPUTY SECRETARY SUMMERS**

**FROM:** Timothy F. Geithner TFG
Assistant Secretary, International Affairs

**SUBJECT:** Korea and the ESA

The Koreans sent a delegation to us last week to propose that we finalize the Exchange Stabilization Agreement (ESA). The Koreans have no intention of drawing immediately on the ESF but wish to finalize the agreement to send a positive signal to the market as well as to establish the backup capacity to draw on the funds in the event of another foreign exchange crisis.

To reach an agreement, the Koreans are prepared to accept the measure in our current ESA draft that requires Korea to suffer from a "substantial depletion" of foreign exchange reserves before ESF funds could be made available. The delegation also indicated some possible flexibility on other key points including our requirement that Korea obtain the National Assembly's approval for a sovereign guarantee that would cover our entire $5 billion second-line commitment, with the guarantee to be made directly to Treasury, not the FRB.

However, there remain several outstanding issues. The Koreans have proposed that they have the right to draw under the ESA even if Korea begins to repay the IMF under its SRF program. Korea remains strongly opposed to the ESA clause that allows Treasury to require the GOK to carry out additional economic and financial measures (determined by Treasury) so long as any ESA funds remain outstanding. Price continues to be an issue with the Koreans, who indicated a willingness to accept our minimum proposed pricing (350 bps), so long as this is the maximum spread. The Koreans have also proposed probably unacceptable demands related to the negative pledge clause, the acceleration provision, the financial information section, and the submission to jurisdiction provision.

We are in the process of discussing whether we think it would make sense to conclude an agreement even if the Koreans are willing to accept our remaining conditions. We will get back to you with our recommendations.

# Withdrawal/Redaction Marker
## Clinton Library

| DOCUMENT NO. AND TYPE | SUBJECT/TITLE | DATE | RESTRICTION |
|---|---|---|---|
| 009. memo | Lawrence H. Summers to POTUS re: Your Meeting with President Kim Dae-Jung: Key Economic Issues (1 page) | 06/30/99 | P5 |

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**RESTRICTION CODES**

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P4 Release would disclose trade secrets or confidential commercial or financial information [(a)(4) of the PRA]
P5 Release would disclose confidential advise 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]

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**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]
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b(9) Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

**TREASURY CLEARANCE SHEET** NO. 99-SE-001109

Date June 24, 1999

**MEMORANDUM FOR:** ☐ SECRETARY ☒ DEPUTY SECRETARY ☐ EXECUTIVE SECRETARY

☐ ACTION ☐ BRIEFING ☐ INFORMATION ☐ LEGISLATION

☐ PRESS RELEASE ☐ PUBLICATION ☐ REGULATION ☐ SPEECH

☐ TESTIMONY ☐ OTHER ______

FROM: Assistant Secretary Truman

SUBJECT: Memo to the President for Kim Dae Jung Visit

REVIEW OFFICES (Check when office clears)

☐ Under Secretary for Finance
- ☐ Domestic Finance
- ☐ Economic Policy
- ☐ Fiscal
  - ☐ FMS
  - ☐ Public Debt

☐ Under Secretary for Int'l Affairs
- ☐ International Affairs

☐ Enforcement
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- ☐ Customs
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- ☐ Secret Service

☐ General Counsel
- ☐ Inspector General

☐ IRS

☐ Legislative Affairs
- ☐ Management
- ☐ OCC

☐ Policy Management
- ☐ Scheduling

☐ Public Affairs/Liaison
- ☐ Tax Policy

☐ Treasurer
- ☐ E & P
  - ☐ Mint
- ☐ Savings Bonds

☐ Other ______

| NAME (Please Type) | INITIAL | DATE | OFFICE/ROOM NO. | TEL. NO. |
|---|---|---|---|---|
| **INITIATOR(S)** | | | | |
| M. Giancola | MG | 6/24 | INA/4416 NYA | 622-1727 |
| | | | | |
| **REVIEWERS** | | | | |
| C.McCoy | MG for | 6/24 | INA/4421 NYA | 622-0337 |
| J.Gagnon | JD | 6/24 | INA/4423 NYA | 622-0359 |
| D.Zelikow | DMZ | 6/24 | IN/3222 MT | 622-7222 |
| R.Munk | RZM | 6/27 | GC/MT | 622-1899 |
| N.Wolin | NW | 6/28 | GC/MT | 622-0287 |
| Meg Lundsager | (See 2nd page) | | IT.MT | 622-0168 |
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**SPECIAL INSTRUCTIONS**

☐ Review Officer Date: ☐ Executive Secretary Date

# TREASURY CLEARANCE SHEET

NO. 99-SE-007109
Date June 24, 1999

MEMORANDUM FOR: ☐ SECRETARY ☒ DEPUTY SECRETARY ☐ EXECUTIVE SECRETARY
☐ ACTION ☐ BRIEFING ☐ INFORMATION ☐ LEGISLATION
☐ PRESS RELEASE ☐ PUBLICATION ☐ REGULATION ☐ SPEECH
☐ TESTIMONY ☐ OTHER ____

FROM: Assistant Secretary Truman

SUBJECT: Memo to the President for Kim Dae Jung Visit

REVIEW OFFICES (Check when office clears)

☐ Under Secretary for Finance
- ☐ Domestic Finance
- ☐ Economic Policy
- ☐ Fiscal
  - ☐ FMS
  - ☐ Public Debt

☐ Under Secretary for Int'l Affairs
- ☐ International Affairs

☐ Enforcement
- ☐ ATF
- ☐ Customs
- ☐ FLETC
- ☐ Secret Service

☐ General Counsel
- ☐ Inspector General

☐ IRS

☐ Legislative Affairs
- ☐ Management
- ☐ OCC

☐ Policy Management
- ☐ Scheduling

☐ Public Affairs/Liaison
- ☐ Tax Policy

☐ Treasurer
- ☐ E & P
- ☐ Mint
- ☐ Savings Bonds

☐ Other ____

| NAME (Please Type) | INITIAL | DATE | OFFICE/ROOM NO. | TEL. NO. |
|---|---|---|---|---|
| **INITIATOR(S)** | | | | |
| M. Giancola | MG | 6/24 | INA/4416 NYA | 622-1727 |
| | | | | |
| **REVIEWERS** | | | | |
| C.McCoy | MG for | 6/24 | INA/4421 NYA | 622-0337 |
| J.Gagnon | JD | 6/24 | INA/4423 NYA | 622-0359 |
| D.Zelikow | DMZ | 6/24 | IN/3222 MT | 622-7222 |
| R.Munk | | | GC/MT | 622-1899 |
| N.Wolin | | | GC/MT | 622-0287 |
| Meg Lundsager | ML | 6/28 | IT.MT | 622-0168 |
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SPECIAL INSTRUCTIONS

☐ Review Officer ____ Date: ____ ☐ Executive Secretary ____ Date ____

99-SE-007109

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

ASSISTANT SECRETARY

ACTION

**ACTION**

**MEMORANDUM FOR DEPUTY SECRETARY SUMMERS**

**FROM:** Edwin Truman
Assistant Secretary, International Affairs

**SUBJECT:** President Clinton's meeting with Kim Dae-Jung

**ACTION-FORCING EVENT:**

On July 2, 1999, President Clinton will host Korean President Kim Dae-Jung for a luncheon and an oval office meeting. The main topic of the meetings will be North Korea and security issues, however economic issues will also be discussed.

**RECOMMENDATION:**

That you send the attached memorandum on key economic issues to President Clinton prior to his meetings with Kim.

Agree N LL OK to autopen 6/30/99 Disagree ________ Let's Discuss ________

**BACKGROUND:**

In the memo, you make the points that Korea has been recovering remarkably well from its crisis but that there is more work to be done in the area of financial- and corporate sector reform. You indicate that reform of the top five *chaebol* is a difficult challenge for Kim, but that carrying through with such reform is essential to the long-term health of the Korean economy. You also emphasize the importance of avoiding giving preferential treatment to specific industries in the reform effort. Finally, you raise the issue of Korea's desire to continue borrowing from the World Bank at concessional rates, which we believe is inappropriate.

Attachments:

Tab A: Memorandum to the President on key economic issues

cc: Under Secretary Geithner

EXECUTIVE SECRETARIAT