Withdrawal/Redaction Sheet
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DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001. memo	Robert E. Rubin to POTUS re: Your Meeting with Thailand's Prime Minister Chuan Leekpai (1 page)	03/12/98	P5
002. memo	Acting Secretary (IMF) to Members of Executive Board re: Republic of Korea - Second Quarterly Review Under Stand-By Arrangement - Letter of Intent (1 page)	05/04/98	P1/b(1) (C)
003. letter	Chol-Hwan Chon & Kyu-sung Lee to Michel Camdessus re: Letter of Intent - South Korea (2 pages)	05/02/98	P1/b(1) (C)
004. memo	re: Updated Memorandum on Economic Program for Second Quarterly Review, 1998 (19 pages)	circa May 1998	P1/b(1) (C)
005. memo	Todd Scneider (IMF) to Jason Singer re: Korea - Round II (1 page)	05/27/98	P1/b(1) Unclass.
006. report	re: Republic of Korea - 1998 Article IV Consultation & Second Quarterly Review Under Stand-By Arrangement (IMF document) (5 pages)	05/27/98	P1/b(1) Unclass.

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[History of the Department of the Treasury - Supplementary Documents] [8]

jp37

RESTRICTION CODES

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THAILAND

1997-SE-008687

THE DEPUTY SECRETARY OF THE TREASURY
WASHINGTON

ACTION

MEMORANDUM FOR SECRETARY RUBIN

FROM: LAWRENCE H. SUMMERS LS

SUBJECT: Possible Bridge Loan for Thailand

ACTION FORCING EVENT:

Thailand may request U.S. bridge loan assistance to supplement its IMF program. It does appear possible for the ESF to offer, as part of a multilateral bridge package, a moderate amount of short-term bridge financing. Any bridge could have multiple tranches, with actual disbursements tied to corresponding loan disbursements from the IBRD and the ADB, thus minimizing the period of exposure for the ESF. The D'Amato Amendment certification requirements apply when there are more than 60 days between the date of an ESF loan disbursement and the date of its scheduled repayment.

We will need to consult with Congressional leadership prior to going ahead with any final decision. There may be a negative Congressional reaction. It is too early at this stage to know if Congress will take action to hold up any Treasury assistance.

RECOMMENDATION:

That you authorize us to explore the feasibility of a Treasury bridge loan, with primary emphasis on participation in a multilateral bridge. If there is a viable plan, we will seek your authorization to begin actual negotiations

Approve ✓ Disapprove ______ Let's Discuss ______

BACKGROUND/ANALYSIS:

Before discussing the pros and cons of a multilateral versus a bilateral mechanism, some analysis is necessary of technical issues, as well as pros and cons, for any form of bridge loan for Thailand.

1. Technical Issues:

- Future World Bank and ADB financial sector loans for Thailand would have to back any bridge. In the near-term, the two institutions are going to announce a willingness to provide (optimistically) a total of up to $2 billion in such loans for Thailand.

- There has been some discussion of a multilateral bridge repaid by the second tranche of an IMF program. The Europeans (and Treasury staff) consider this option to be completely

EXECUTIVE ...

unacceptable because (1) there is uncertainty whether the Thais in the future would be able to satisfy Fund conditionality for release of the second tranche, and (2) it would undermine conditionality as bridge creditors might pressure the Fund to loosen up.

- But the quality and quantity of the World Bank and ADB financial sector loans are unsure, because the loans are still in an early stage of gestation. Neither bank has developed the outline of a financial sector loan, and neither has sent a project appraisal mission yet to Bangkok for such a loan. (At the height of the Mexican crisis, the World Bank and the IDB announced an intention to lend $3.25 billion to Mexico. Most programs were not brought to the respective boards for several months after the announcement. Also, in Mexico's case, the two banks had done more preparatory work on the new loans than the IBRD and the ADB have done in the instant case.)

- It remains to be seen whether both institutions could prepare, approve, and then make effective a sufficient amount (e.g., $2 billion) in quick-disbursing loans within the next few months.

- Actual disbursements under the bridge loans could occur in tranches, with the amount disbursed in each tranche equaling the amount of the corresponding tranche of a particular ADB or IBRD loan.

- Disbursement would not occur until a letter came from the respective bank's management stating both that management had recommended to the board that a particular financial sector loan be approved and that all other conditions for the first disbursement had been met. The exposure time for bridge lenders would thus be roughly 20 days.

2. General Pros and Cons For Any Thai Bridge Loan

<u>Pros</u>

- Provides official endorsement of the Thais' economic policies and some encouragement for private financial institutions to maintain or increase their exposure.

- Can be done with an assured source of repayment -- IFI financing.

- Gives the U.S. a seat at the table and signals a concern for financial stability in Asian markets.

- Gives the U.S. a basis to require more detailed information from Thailand should it be necessary.

Cons

- The loan could cast doubt on the adequacy of the "emergency financing mechanism" established in response to the Halifax Summit request.

- Timing could be awkward, given the desirability of avoiding any complication of Treasury efforts to achieve Congressional approval of the NAB -- Congress goes to conference on the NAB in September. But the reaction may be minimal. Congress did not scrutinize U.S. participation in a similar Argentine facility two years ago, at a time when the ESF lending to Mexico had attracted great attention.

- There may be confusion in the public mind between U.S. participation in a short-term Thai bridge loan, backed by IFI financing, and Treasury's medium-term facility for Mexico. The latter model was recently characterized as not likely to be used for Thailand.

3. The Multilateral Option

This would be a BIS-led operation, patterned after the $1 billion bridge to Argentina in 1995. The BIS would provide the actual bridge financing to Thailand, but the BIS members participating would have to guarantee Thai repayment to the BIS. (For the Argentine bridge, the U.S. guarantee, extended by the FRBNY and ultimately backed by the Exchange Stabilization Fund, was for 25% of each Argentine drawing.)

Pros

- This would demonstrate multilateral support for an effort to stabilize Asian currency markets, and thus would help diminish public and Congressional criticism.

- Exposure would be shared, and it is likely that the overall U.S. exposure would be reduced. Also, without U.S. participation, the Europeans might be less willing to participate.

- The BIS would draft all documentation. The BIS would be better positioned to put pressure on the ADB and IBRD management and boards, exerting multilateral pressure for loans of acceptable quality and quantity The BIS would also be more able to head off Asian or Japanese bridge lenders seeking backing for their facilities from the same World Bank or ADB loans

Cons

- The BIS takes a long time to put together bridge facilities, and has to clear all changes with each participating central bank -- a tough process in August. The time required for a bridge could be double that required for a bilateral facility.

- In dealing with the U.S.G., the BIS will talk directly only to the Federal Reserve. This complicates Treasury's participation in drafting the necessary documents.

4. The Bilateral Option

This would be a classic, short-term ESF bridge loan, set up in the form of a swap line upon which Thailand could draw dollars up to a certain amount.

Pros

- Will give greater visibility to the U.S. contribution to assistance to Thailand.

Cons

- More likely to attract Congressional and public attention.

- Would require major effort by Treasury, and close coordination with the Thai Government.

5. Congressional Considerations

Under either scenario, we will need to consult with the Banking, Foreign/International Relations, Finance, Ways and Means, and Appropriations Committees prior to going ahead with any final decision. If a decision is made to provide some form of U.S. assistance, our involvement will be needed in advising not only the Chairs and Ranking Members of the relevant committees, but also Leadership. In light of our Mexico experience and the difficulties we have faced moving the NAB through Congress, the Hill may not be very receptive.

It is our view that any assistance involving a "loan" will draw immediate comparisons to the Mexico situation, particularly from Chairman D'Amato. His staff has already indicated that, if Thailand's economic condition were to deteriorate significantly, then there would be no way to predict Congressional reaction.

The most significant mitigating factor, however, is that Congress has tended to hold the Asian governments in high regard for their economic policies, despite the Korean and Japanese bank crises. If so, criticism of Thailand and U.S. assistance would be muted.

Congress will be most interested in the level of U.S. exposure; measures that could have been taken to avoid the crisis altogether; the integrity of the IMF's past and future involvement; and the reconciliation of this IMF assistance program with the pending existence of the NAB and the need for a Quota Increase, which is known by the relevant committees to be on the horizon.

6. Legal Considerations

With either option, there could be D'Amato Amendment limits on the ESF loan or guarantee.

If the time period of ESF exposure (time of disbursement to time of repayment) is 60 days or less: No D'Amato amendment coverage -- no matter what amount of financing.

If exposure is over 60 days: No matter what amount of financing, there will have to be a Presidential certification to both banking committees that there is an OMB-approved interest rate on the loan and that the ESF lending is adequately backed by an assured source of repayment.

If exposure is over 180 days: Again, no matter what amount of financing, there will be the above requirements plus, under the ESF statute, a Presidential notification to Congress that "unique and emergency circumstances" justify a loan or a credit with a maturity over six months.

If exposure is over 180 days and for an aggregate amount over $1 billion: All of the requirements above, plus, under D'Amato, Treasury will need an act of Congress, unless the President certifies a threat to vital US economic interests or to the stability of the international financial system. Possible Congressional "veto" of such Presidential action.

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8/7/97
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TREASURY CLEARANCE SHEET

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Date ____________

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x ACTION ☐ BRIEFING INFORMATION ☐ LEGISLATION

☐ PRESS RELEASE ☐ PUBLICATION ☐ REGULATION ☐ SPEECH

MEMORANDUM FOR: SECRETARY RUBIN

FROM: DEPUTY SECRETARY SUMMERS

SUBJECT: Possible Bridge Loan for Thailand

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Legislative Affairs

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☐ OCC

☐ Policy Management
- ☐ Scheduling

☐ Public Affairs/Liaison

☐ Tax Policy

☐ Treasurer

☐ E & P
- ☐ Mint

☐ Savings Bonds

☐ Other ____________

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REVIEWER(S):				
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7 (SU)

8/6/97

ESF

MEMORANDUM FOR SECRETARY RUBIN

FROM: LAWRENCE H. SUMMERS

SUBJECT: Possible Bridge Loan for Thailand

ACTION FORCING EVENT:

Thailand may request U.S. bridge loan assistance to supplement its IMF program. It does appear possible for the ESF to offer, as part of a multilateral bridge package, a moderate amount of short-term bridge financing. Any bridge could have multiple tranches, with actual disbursements tied to corresponding loan disbursements from the IBRD and the ADB, thus minimizing the period of exposure for the ESF. The D'Amato Amendment certification requirements apply when there are more than 60 days between the date of an ESF loan disbursement and the date of its scheduled repayment.

RECOMMENDATION:

That you authorize us to explore the feasibility of a Treasury bridge loan, with primary emphasis on participation in a multilateral bridge. If there is a viable plan, we will seek your authorization to begin actual negotiations.

Approve ______ Disapprove ______ Let's Discuss ______

BACKGROUND/ANALYSIS:

Before discussing the pros and cons of a multilateral versus a bilateral mechanism, some analysis is necessary of technical issues, as well as pros and cons, for any form of bridge loan for Thailand.

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- Future World Bank and ADB financial sector loans for Thailand would have to back any bridge. In the near-term, the two institutions are going to announce a willingness to provide (optimistically) a total of up to $2 billion in such loans for Thailand.

- There has been some discussion of a multilateral bridge repaid by the second tranche of an IMF program. The Europeans (and Treasury staff) consider this option to be completely unacceptable because (1) there is uncertainty whether the Thais in the future would be able to satisfy Fund conditionality for release of the second tranche, and (2) it would undermine conditionality as bridge creditors might pressure the Fund to loosen up.

1997-SE-008971

THE DEPUTY SECRETARY OF THE TREASURY
WASHINGTON

August 15, 1997

ACTION

MEMORANDUM FOR SECRETARY RUBIN

FROM: LAWRENCE H. SUMMERS

SUBJECT: THAILAND - BIS BRIDGE LOAN

ACTION FORCING EVENT:

A number of monetary authorities, including the Bank of Japan, have approached the BIS to coordinate a bridge loan for the Bank of Thailand to demonstrate the support of the international financial community. The total amount of the BIS facility would be up to $1 billion. The BIS proposed facility would bridge to disbursements expected from the World Bank and the ADB. (BIS bridging to the second tranches of the IMF and the Export-Import Bank of Japan is off the table for now.) The Assistant General Manager of the BIS, Andre Icard, has sent a letter (Tab B) to Chairman Greenspan requesting agreement in principle on the loan.

The participation of the United States and monetary authorities from other G-10 countries would take the form of an agreement to guarantee and repay the BIS in the event Thailand failed to repay it. Mr. Icard has proposed that the United States and other G-10 central banks (excluding the Bank of Japan), plus the Spanish and Austrian central banks, back one-half of the total BIS bridge, and that the Asian central banks and the BIS, acting for its own account, back the other half of the BIS bridge. In any event, assuming that the U.S. share in its half of the BIS loan is approximately 35-40%, based on the relative IMF quota shares of the participating countries, the total amount of all U.S. participation in all such bridge drawings would not exceed $200 million.

The U.S. participation would be modelled after our participation in the 1995 $1 billion BIS facility for Argentina.

RECOMMENDATION:

That you sign the attached letter to Chairman Greenspan (Tab A) confirming Treasury's agreement in principle to participate in the G-10 section of the proposed BIS bridging loan for Thailand. Each bridge drawing would have to be repaid within 60 days. The actual bridge drawings from the BIS would be contingent upon having appropriate preconditions in place, including adequate assurances of timely sources of repayment. Such assurances would include "comfort letters" from the Presidents of the World Bank and the ADB reporting that Thailand has satisfied all major loan conditions and that the President has recommended to the respective board that the disbursement be approved.

Approve ✓ ______ Disapprove ________ Let's Discuss _______

EXECUTIVE SECRETARIAT

and ADB loans, which are not yet developed. The total amount of the BIS facility would be up to $1 billion.

The conditions of effectiveness for all the WB and ADB loans are unique, and will have to be studied during the preparation of the final documentation. ESF practice for financing bridged to IFI disbursements has prevented the actual bridge drawing by the borrower until the source of repayment is assured. Thus, each BIS drawing will be disbursed only upon receipt of a "comfort letter" from the MDB stating that all major loan conditions for that disbursement have been satisfied. In light of these conditions and the IFI lending schedule above, this means that the first drawing on the BIS facility might not occur until early next year. Each drawing would probably be repaid by its corresponding IFI disbursement within 3 weeks, and no later than 60 days. The BIS has proposed that drawings not be made to any IFI disbursement coming after the end of May 1998.

Congressional Consultation

The proposed facility will not trigger any D'Amatc Amendment requirements.

Treasury has informed the relevant Congressional committee staff both of its intention to participate in the BIS bridging facility and the general terms of the facility.

Attachments: Tab A -- Letter to Chairman Greenspan (for signature)
Tab B -- Letter of 8/13/97 from Andre Icard to Chairman Greenspan

4. The question whether to pre-finance the second tranches of the IMF and JEXIM loans would be considered later, in case of need and in the light of financial and economic conditions.

I hope your institution will be able to agree to this proposal and look forward to your reply by Monday, 18th August. I would be happy to answer any questions you may have; my direct telephone number is +41 61 280 87 70 and my mobile telephone number is +41 79 321 28 14.

Yours sincerely,

André Icard

Attachment

DRAFT.

Statement in support of the Thai adjustment programme

The monetary authorities of the G-10 countries and [xx] other Asian and European countries, together with the BIS, are agreed that they stand ready in case of need to support the Bank of Thailand by providing liquidity on a short-term basis, under conditions to be determined. The funds would be made available as BIS credits, backed by the monetary authorities in question, to pre-finance loans of international organisations.

08/15/97 09:21 INTERNATIONAL FINANCE → 9 202 6220658 NO.513 P005/008

R0891 P.2/5

C: Truman

Thailand Group

done

EC

Yasuo Matsushita
GOVERNOR

Bank of Japan

MAILING ADDRESS:
CPO BOX 203
TOKYO 100-91
JAPAN
TEL 3-3279-1111

August 15, 1997

Dear Alan,

I thank you for you kind support to our efforts to provide a BIS-based bridging loan to the Bank of Thailand. I would like to let you know that today I sent the attached letter to G10 Governors to encourage them to join in the BIS facility.

I heard that the IMF is somewhat skeptical about the need to bridge the IMF loan, and I am concerned that this could negatively affect G10 central banks' willingness to participate in this part of the overall BIS facility. So I emphasized in the attached letter the important symbolic effect of including in the facility the possibility of bridging the second tranche of the IMF loan at this stage, and organizing the bridge loan when it is deemed necessary. I sent a similar letter to the Managing Director of the IMF as well.

I also mentioned in the letter Governor Chaiyawat's recent visit of our Bank. As Mr. Truman had asked Mr. Nagashima to encourage the Bank of Thailand to increase transparency of its foreign reserve position, I raised this issue during the meeting. Governor Chaiyawat agreed that it is important to disclose the BOT's overall forward position (in fact, he said disclosing it is his own responsibility to the Thai general public), and confided to me his plan to do so shortly after the IMF Board approves the program.

With warmest regards,

Yasuo

Attachment

Yasuo Matsushita
GOVERNOR

Bank of Japan

MAILING ADDRESS:
CPO BOX 203
TOKYO 100-91
JAPAN
TEL 3-3279-1111

August 15, 1997

Dear Governor / President,

As you probably know very well from media reports and other sources, the situation in Thailand has been moving very fast and, in my view, in the right direction. The Thai authorities have accepted a Fund-based economic adjustment program. The IMF Board of Executive Directors is scheduled to meet on August 20 to discuss the Thai economic package, and is expected to approve a loan amounting to approximately $4 billion.

We, the Bank of Japan, think that the Thai authorities' decision to cooperate with the Fund is a very appropriate one, and strongly hope that this helps the currency and financial markets in Thailand as well as some neighboring countries to stabilize in due course. There is always a risk, however, that their currencies face another speculative attack and are unduly put under downward pressure. Also, Thailand will from now on need to undergo a process of economic adjustment, which is certainly not very palatable for the Thai general public. For these reasons, it is highly useful for Thailand to receive an additional support or endorsement from the international financial community, so that market confidence will be strengthened and the Thai general public will clearly see the legitimacy of the IMF-based program. I believe that the BIS's and G10 central banks' initiative to cooperate in providing a bridging loan facility would serve this purpose very well.

I have been closely in touch with the Bank of Thailand, and Governor Chaiyawat came to see me on Tuesday this week. He had attended on the previous day the donors' meeting held in Tokyo in which Asian countries gave their generous support to Thailand by pledging a substantial amount of medium-term credit. He expressed his sincere hope that G10 central banks would also support his efforts to stabilize the Thai economy through the provision of a bridging loan. He very convincingly presented various adjustment measures the Thai authorities are planning to implement, and I was impressed by his capability as well as his sense of responsibility. So I told him that I will offer my full support to the Bank of Thailand so that it can receive a BIS bridging loan.

You have probably read by now a letter from Mr. Icard, Assistant General Manager of the BIS, explaining the outline of the bridging loan facility currently envisaged. Please note that the facility includes bridging the second tranche disbursements of the IMF and the Japanese Export-Import Bank loans. Whether this is in fact needed depends on the timing of the second tranche disbursements (i.e. whether there is some time lag between when the Fund becomes reasonably sure that the September performance criteria will be met and the Managing Director can recommend the drawing of the second tranche to the Executive Board, and when the second tranche funds become available for drawing), and also on Thailand's foreign reserve conditions at that time. Therefore, Thailand may actually find it unnecessary to obtain short-term liquidity by drawing the BIS bridging loan, but even if this is the case, I believe that it is extremely important that, by including the possibility of bridging an IMF loan in addition to the World Bank and ADB loans, the G10 central banks can show their unanimous support to the Thai authorities' economic adjustment efforts based on the Fund's program.

More than a score of BIS bridging loans have been formulated in the past, but none has been made to Asian countries. For this and other reasons I stated above, I would like to ask you to give a favorable consideration to this matter, and hope that you will give the Bank of Thailand your kind support, by not excluding the bridging of the IMF's second tranche at this stage and organizing the bridge loan when it is deemed necessary. However, for now, all we need to do is to express in general terms our intention to cooperate with Thailand in the form of a statement, without indicating specific contents of the bridging facility. I am sure that all G10 countries can agree at least on this point by the time the IMF Executive Board decides on the loan to Thailand.

TREASURY CLEARANCE SHEET

No. ______

Date ______

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x ACTION ☐ BRIEFING INFORMATION ☐ LEGISLATION

☐ PRESS RELEASE ☐ PUBLICATION ☐ REGULATION ☐ SPEECH

MEMORANDUM FOR: SECRETARY RUBIN

FROM: DEPUTY SECRETARY SUMMERS

SUBJECT: Thailand-BIS Bridge Loan

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☐ IRS

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☐ Management

☐ OCC

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☐ Public Affairs/Liaison
- ☐ Tax Policy

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

☐ Other ______

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REVIEWER(S):				
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Jim Lister	JL	8/15	**DO/IMF/Rm. 5050**	**622-0112**
Todd Crawford	TC	8/15	**INA/Rm. 5221-MTB**	**622-0359**
Linda L. Robertson			**L/Rm. 3134-MTB**	**622-1900**
Edward S. Knight			**G/Rm. 3000-MTB**	**622-0287**
Tim Geithner	TFG	8/15/97	**IM/Rm. 3221-MTB**	**622-0656**

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☐ Review Officer Date: ☐ Executive Secretary Date

1998-SE-001736

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

FEB [illegible] 98

INFORMATION

MEMORANDUM FOR SECRETARY RUBIN
DEPUTY SECRETARY SUMMERS
UNDER SECRETARY LIPTON

FROM: Timothy Geithner

SUBJECT: Thailand: Next Steps

Overview: This memo outlines some options for ways we might reinforce Thailand's prospects for recovery with a package of stronger economic reforms and additional IFI -- and perhaps private market -- financing.

Strengthened IMF Program

An IMF mission is currently in Thailand. As part of the March review, the Thais will be reinforcing their policy package. Many elements are already falling into place under Finance Minister Tarrin's leadership.

-- **Fiscal.** Due to slower than expected growth and consequent revenue shortfall, Thailand will be unable to meet its original target of a 1% of GDP surplus. The IMF has tentatively agreed that fiscal targets will be adjusted to reflect lower growth estimates. On balance, the deficit in 1998 will be contained to 1.5-2% of GDP. The Thais intend to take some offsetting supplementary revenue measures, including eliminating exceptions on the VAT that would yield 0.4% of GDP, and to earmark privatization revenues for bank restructuring costs.

-- **Financial sector reform.** The IMF and the government are considering proposing a new approach to Thailand's financial sector problems. While only a portion of the Thai banking system was thought to be insolvent when the IMF devised its initial strategy, the deepening impact of the crisis on the real economy has resulted in widespread bank insolvency, probably 100%. The most important difference in the new approach is the use of public funds to recapitalize banks. (See Tab A for a more complete list of elements to include in a comprehensive restructuring plan).

The IMF review now underway is negotiating the enhanced elements of the package. We may want to encourage the IMF to press for accelerating reforms, especially those in the financial sector, as this is key to the microeconomic restructuring of the economy.

Bilateral Support

In preparation for the Chuan visit, State has put together a bilateral package of financing including support from USAID, Exim, OPIC and some FMS debt rescheduling. State envisions that the size of the combined package could range from $400-600 million. Tab C contains a list of elements that might be contained in a bilateral package.

Possible Augmentation of Thai Financial Package

Recent data indicate that the balance of payments is improving more rapidly than expected just a month ago. The current account has moved strongly into surplus in recent months, reflecting the sharp fall-off in domestic demand. Rollover rates for short-term debt have been higher than expected. Reports suggest foreigners are beginning to invest in the stock market (see Tab B on revised BOP estimates).

There are still, however, concerns about the financial adequacy of the program. The Fund is looking into this issue right now. An estimated $53 billion in liabilities owed by the public and private sector comes due this year, including $18 billion of Central bank forward contracts. In an effort to protect reserves, the IMF program assumes that those debts that are not rolled over will be financed in the foreign exchange market. This will place substantial downward pressure on the baht. In addition, there is a strong undercurrent of concern given that reserves are roughly $25 billion, whereas central bank forward contracts coming due this year are $18.3 billion.

Thailand: 1998 Maturing External Liabilities
(USD billions)

	Short-term Debt	(owed by banks)	(owed by non-bank)	**Central Bank Forwards**	(of which onshore)	(of which offshore)	**Total Short-term & Forwards**
1st Qtr.	11.1	(6.4)	(4.7)	9.1	(6.4)	(2.7)	20.2
2nd Qtr.	7.2	(4.5)	(2.7)	7.1	(2.4)	(4.7)	14.3
3rd Qtr.	11.0	(8.4)	(2.6)	1.7	(0.3)	(1.4)	12.7
4th Qtr.	5.7	(3.1)	(2.6)	0.4	(0.0)	(0.4)	6.1
Total 1998	**35.0***	**(22.4)**	**(12.6)**	**18.3**	(9.1)	(9.2)	**53.3**

* About $20 billion is owed to foreign banks. Another $8 billion is owed to Thai banks.

Our estimates -- calculated on the basis of admittedly incomplete information -- indicate that Thailand has an adequately financed package. But these calculations hinge upon important assumptions regarding rollover rates for short-term external bank debt and for central bank forward contracts, and make no allowance for off-balance sheet transactions.

1998 BOP Inflows/Outflows and Reserves *
(USD billions)

Outflows (pessimistic scenario)	USD bns	Inflows/Reserves (pessimistic scenario)	USD bns
Short-term debt rolloffs of 30%	10.5	Current Acct.	4.0
Forward Contract rolloffs of 65%	11.9	IFI and Bilateral Financing Package	3.9
		M.& L-Term Cap	4.3
		Reserves (end-Dec. 1997)	25.9
Total	**22.4**	**Total**	**38.1**
		Reserves (end-Dec. 1998)	**15.7**

* IMF is assuming 50% rolloff of forward contracts. In Dec., short-term debt rolloffs were 20%. The table assumes that short-term debt rolloffs would be matched by Central Bank foreign exchange draw-downs to offset downward pressure on the baht. The present practice, however, is for such flows to feed into the market. The IMF also assumes about $1.5 billion in net portfolio inflows which are excluded from the above table.

On balance, given the political backdrop, the tenuous nature of the balance of payments calculations, and our desire to buttress Thailand in the face of the uncertainties in Indonesia, I believe that there is a good case for signaling at this time that we would support some augmentation of the Thai financing package. Against this background we may want to consider announcing that we would support tapping the IMF's Supplemental Reserve Facility (SRF) for up to $5 billion should it be needed, conditioned upon Thailand raising private sector financing through bonds or bank loans.

Considerations. If we were to gain acceptance for SRF funding, this initiative would be seen by the Thais as a strong signal of U.S. support and would shield us from pressures to use the ESF to provide contingent support for Thailand. The funds could help promote market differentiation to better insulate Thailand from regional shocks.

On the other hand, without a clear and compelling financing need, it might set a bad precedent for others, crimp IMF liquidity further, and complicate our efforts to constrain Camdessus' liberal lending policies.

If we decide to support SRF funding, we need to consider how the Thais use the funds. Listed below are several options.

-- **Option I: Increase international reserves.** Along with demonstrating U.S. support for Thailand, this option may increase overall confidence in Thailand given earlier concerns regarding the adequacy of the international support package. However, it may not be a very efficient use of resources. The cost of these funds will exceed what Thailand will earn from them; and the resources would do nothing directly to alleviate exchange rate pressures or the microeconomic problems that are contributed to them.

-- **Option II: Peg the baht at a substantially higher value.** If successful, this option would substantially ease the liquidity and solvency problems of many Thai companies and financial institutions. However, given the large potential demand for dollars to repay short-term debts, Thailand's reserves could fall rapidly.

-- **Option III: Partially offset downward pressure on the baht caused by commercial bank repayment of short-term debts.** (The scenario in the BOP table assumes the Central Bank fully offsets these rolloff flows.) This option would have the Central Bank offset a primary downward force on the baht caused by rolloffs of short-term debts. For example, a 20% rolloff of short-term debt in 1998 represents a $7 billion hard currency demand within the baht foreign exchange market. Interventions or regular auctions of foreign exchange would increase the liquidity of the baht exchange market and accommodate selling pressure on the baht emanating from short-term debt rolloffs. Such "intervention" would probably be **heavily sterilized** so as to limit upward pressures on interest rates.

-- **Option IV: Create a special Central Bank window for commercial bank repayment of short-term debts.** This option would basically produce the same positive effects as Option III. Presumably the exchange rate used by the Central Bank would reflect the prevailing market rate. The downside risk is that demand for this window could be very substantial, forcing the Central Bank to close it. In addition, the optics of setting up a special window for banks may not be good.

If we decide to go forward with additional IMF financing, we would recommend a combination of Options I and III. Option III, by definition, includes a combination with Option I.

Bank Restructuring in Thailand

An IMF mission left for Thailand on February 2 to negotiate a banking system restructuring plan with the Thai government. The fundamental purpose of the plan is to 1) recapitalize the banking system quickly in order avoid a financial system breakdown with severe costs to the real economy, 2) lessen the severity and duration of a credit crunch that would exacerbate the decline in economic activity, and 3) attract new capital (confidence) to be the basis for a resumption in lending.

The IMF's initial strategy focused on finance companies. The main elements were: 1) closure of insolvent finance companies, 2) comprehensive guarantee of liabilities, 3) improvements in prudential standards, and 4) creation of bad bank/good bank (Financial Restructuring Agency/Asset Management Corporation) to deal with assets of the finance companies.

The IMF recognizes that its initial strategy has to be modified. This is because the scale of Thailand's banking sector problem has increased significantly since the initial IMF and World Bank financial sector programs were announced last August and September, respectively. While only a portion of the Thai banking system was insolvent then, the deepening impact of the crisis on the real economy has resulted in widespread bank insolvency, probably 100% now. (Nonperforming loans widely estimated at 25% of total loans.) Credit is extremely tight although the central bank is supplying substantial liquidity support to banks. While a credit crunch is part of the adjustment process, there is a concern that if it continues too long the impact on the real economy could spiral.

The Fund is also aware that efforts by banks to implement interest and loan classification/capital adequacy standards and promote rapid recapitalization without government intervention would create a massive credit crunch. At the same time, writing down current owners' equity to account for problem loans would take them out of the picture, but without sufficient additional sources of private capital and a pool of managers that could step in. Foreign banks are holding off on buying Thai banks while the situation deteriorates. Legal hurdles remain to the sale of banks to foreign investors. The need to attract new capital means, in turn, that there is more urgency in addressing the bad loan problem and applying immediately international standards for loan classification and disclosure, with adequate capital.

The New Approach

The most important difference in the new approach is the use of public funds to recapitalize banks. If the banking system is truly insolvent and there is a reluctance by private investors to invest in banks in light of the uncertainty that exists, a case can be made for government assistance. The government assistance must be subject to the appropriate conditions to limit moral hazard.

The Fund is inclined toward a mechanism that will involve the following elements:

- write downs in the equity of current owners (partial or total, depending on the condition of the bank after assets have been accurately valued);
- retention of current managers (reflecting the limited managerial pool);
- injection of private capital from existing or new (possibly foreign) investors;
- matching injection of government capital (with preferred stock or possibly a form of subordinated debt with provisions for participation in gains);
- keeping problem loans on the banks' books (reflecting hopes to improve chances for workouts);
- provisions to limit losses of new owners (black-hole protection); and
- timely implementation of capital adequacy, loan classification and provisioning rules.

While in our view of the Fund's intended approach is sound in terms of creating the right incentives and limiting moral hazard, the details of the plan must be examined. For example, we will need to examine closely the alternative of using subordinated debt as the means to recapitalize banks.

The bank restructuring plan agreed by the Fund and Thai government should be designed to balance fairly the range of competing interests, minimize moral hazard and create incentives for sound management of banks going forward. Ideally, any public support for a bank should be accompanied by a write-down of the equity of current shareholders and the replacement of management. However, in Thailand there is not a pool of managers that can step in and run all the banks, and there are a number of relatively well-run banks that have simply been overwhelmed by the impact of the crisis.

Consequently, there should be distinctions in approach between good banks and bad banks. Owners and managers of bad banks should be replaced, with entirely new investors found if possible, or else the bank should be closed. In the case of good banks, there should be partial write-downs in shareholder equity and additional capital put up by either current owners or new investors (or both) to match the government's contribution. This should be structured to provide for participation in up-side gains for all contributors.

With profound uncertainty over the condition of the banks, new private investors will want to have stop-loss (or "black-hole") protection, which could be structured in a number of ways. However, the exposure of the government should be symmetrical -- the price for black-hole protection should be additional government participation in the up-side gains.

On balance, it may often be better to leave the bad assets on the books of the banks to work out than to sell them to an asset management company. The interests of foreign investors also have to be taken into account, while recognizing that the sale of the largest banks to foreign investors at distressed prices would face strong political opposition.

The Ideal Model for Banking System Restructuring

Following is a list of the elements of our "Stage 2" ideal model for a Thai banking system restructuring plan, which should be announced to the market as a comprehensive plan:

1. **Use public funds to recapitalize banks (open bank assistance):**

- The government (through a restructuring fund or agency) should purchase shares in eligible banks via some combination of cash or securities. The shares should have rights to common stock (e.g., in the form of equity warrants or convertible preferred stock) to allow the government to sell its shares to the market when the operation is complete. *(Preferred stock should be used to give preference over existing shareholders, but not depositors, in the event of bankruptcy; subordinated debt should not be used since it does not dilute existing shareholders or provide the government with upside benefits.)*

- The use of government funds should be subject to the several conditions to minimize moral hazard:

  -- a write-down of existing equity owners' shares;
  -- a matching formula (e.g., 1:1 or 1:2) for injection of private domestic or foreign capital into common stock; *(It is important to dilute the shares of existing shareholders to avoid a subsidy to them.)*
  -- priority of public claims over those of common shareholders, but not depositors;
  -- replacement of old management by new management; *(could be waived if the managerial pool is limited and the bank's management was sound.)*
  -- repayment of public funds based on bank earnings;
  -- a sunset provision; and
  -- if the shares are non-voting, the government should maintain some authority over a bank similar to that of shareholders.

- To encourage new investors, the government should establish a "stop-loss" agreement with a bank to protect create greater certainty for new investors against unknown losses from bad assets. Some percentage (e.g., 90%) of charge-offs above some agreed level would be absorbed first by existing shareholders and then by the government.

- Funding through the restructuring funds could be via any combination of the following mechanisms: on-budget; specially-issued bonds collateralized against, say, future privatization proceeds (*aka* the Japanese plan); and/or World Bank/ADB funding.

2. **Address the insolvent bank problem:**

The Thai government will have to assess the viability of each bank and determine which ones should be closed. Resolutions should be handled via one of the following three standard methods:

a) **Open bank assistance transaction** (noted in #1 above);

b) **Deposit payoff:** pay off depositors and liquidate assets;

c) **Purchase and assumption transaction (closed-bank transaction):** existing shareholder equity is written down against bad assets; managers are replaced; the bank is reopened under the ownership of a healthy institution, which has assumed the deposit liabilities and perhaps some of the assets. The restructuring agency or fund would provide assistance (negative bidding) to conclude the transaction.

3. **Clean up the bad assets on the books of solvent financial institutions:**

- The government's asset management agency should be used only for its original purpose of resolving bad assets from finance companies that cannot be sold. For commercial banks, a new scheme should be used. Banks should utilize the "Good Bank/Bad Bank" concept to place the bad assets in a separate entity within the bank for separate workout. Banks should be encourage to form private asset management consortia to pool resources.

  (The option creates the right incentives for old and new shareholders, allows new investors to come in quickly, maintains the assets on the books to allow an orderly workout, and allows bank debtors to keep their credit lines open.)

- For the long term, the government should announce its intent to reform bankruptcy laws and foreclosure procedures.

- For the long term, the government should take steps to develop an asset-backed securities market.

4. **Improve accounting standards and disclosure requirements**

- Regulators and banks need to disclose balance sheet information immediately.

- Thailand should introduce US GAAP (or high-quality, international acceptable accounting standards) for its banking and corporate sector over a fixed time period (e.g., five years).

5. **Strengthen banking supervision and standards**

- The government needs to establish a timetable to implement the Basle *Core Principles*, with more immediate focus on measures to restore market confidence, such as: strengthening supervisory procedures (e.g., Prompt corrective action) and prudential standards, strengthening the banking authority.

- The Government of Thailand should reiterate its commitment under the IMF program to implementing strict capital adequacy standards, accompanied by loan classification and provisioning rules. *(Implementing the new standards should improve the confidence of the market.)*

6. Open markets to foreign investment

- Raise the 25% ceiling on foreign ownership of banks without government approval to 100%.

- Allow branches of foreign banks to lend based on the capital of the parent.

- Allow foreign ownership of banks even after the ten year period.

7. Continue the guarantee system for bank liabilities for a set period

- Continue to guarantee all bank liabilities (except shareholder equity and subordinated debt holders) for a limited time period with an advance warning for lifting the general guarantee and moving to a limited deposit insurance system.

- Establish a deposit insurance corporation, funded by the commercial banks using risk-based premia, to guarantee deposits (per account or per individual) up to a specific ceiling. The fund should have a call on banks for additional reserves, if needed.

8. Improve Corporate Governance

- Privatize state-owned banks, where possible, over time.

- Improve transparency of the ownership structure of banks and the structure of connected lending or affiliations and introduce appropriate restrictions on non-arms length transactions between banks and their affiliates.

- Introduce legal protections for minority shareholders and ensure voting rights and participation.

- Strengthen legal and financial sanctions against owners, directors, and senior management to ensure proper behavior.

9. Take measures to reduce the "credit crunch"
- Introduce micro-lending for small and medium-size enterprises from government and/or World Bank and ADB sources.

- Encourage the development of an asset-back securities market.

THAILAND - Revised Estimates

Balance of Payments	1H1997	2H1997	1Q1998	2Q1998	2H1998	1998
FX reserves at begin-period	37.30	30.90	25.90	23.98	20.74	25.90
Current account balance	-5.00	1.00	1.00	1.00	2.00	4.00
Capital account balance	1.30	-17.30	-3.92	-5.24	-2.19	-11.35
Medium and long-term capital	4.30	2.20	1.25	1.25	1.80	4.30
Short-term capital	0.40	-5.40	-2.22	-1.44	-3.34	-7.00
Other	-3.40	-2.60	-0.25	-0.25	1.05	0.55
Forwards/swaps	0.00	-11.50	-2.70	-4.80	-1.70	-9.20
E&O	-2.70	2.40	0.00	0.00	0.00	0.00
Net balance	-6.40	-13.90	-2.92	-4.24	-0.19	-7.35
Financing package		8.90	1.00	1.00	1.90	3.90
Fund		2.40	0.20	0.20	0.30	0.70
Other		6.40	0.80	0.80	1.60	3.20
FX reserves at end-period	30.90	25.90	23.98	20.74	22.45	22.45
Months, import coverage	5.78	4.84	5.05	4.37	4.73	4.73

Assumptions:

1) 80% rollover on maturing debt - this includes bank and non-bank debt (with about $4 billion in unaffected trade credits)
2) 50% rollover on forwards
3) $4 billion current account surplus
4) 1998 imports of $57 billion (avg over 1996-1997 was $67 billion)

Possible Elements in a U.S. Bilateral Package
(USD millions)

Identified by State

Economic Assistance	$70
FMS Debt Restructuring	$54
Peace Corps	$14
USIA Support for Visiting Students	$10
Sub-total	$148

Other Possible Sources

Ex-Im Bank Short-term Insurance	$250
OPIC Insurance	$150
Sub-total	$400
Total	**$548**

TREASURY CLEARANCE SHEET NO. ___________

MEMORANDUM FOR: x SECRETARY X DEPUTY SECRETARY ☐ EXEC. SECRETARY
☐ ACTION BRIEFING INFORMATION ☐ LEGISLATION
☐ PRESS RELEASE ☐ PUBLICATION ☐ REGULATION ☐ SPEECH
☐ TESTIMONY OTHER

FROM: Timothy Geithner, Assistant Secretary (International Affairs)

SUBJECT: Thailand: Possible Next Steps

REVIEW OFFICES (Check when office clears)

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

☐ Under Secretary for International Affairs
☐ International Affairs

☐ Enforcement
☐ ATF
☐ Customs ☐ Public Affairs/Liaison
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☐ Secret Service
x General Counsel
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WMurden	CM/for		Dir./IMD	2-1255
DZelikow			DAS/IN	2-7222

SPECIAL INSTRUCTIONS

1998-SE-001857

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INFORMATION

MEMORANDUM FOR SECRETARY RUBIN
DEPUTY SECRETARY SUMMERS
UNDER SECRETARY LIPTON

DRAFT

FROM: Timothy Geithner

SUBJECT: Thailand: Next Steps

Thailand and the IMF have just reached agreement on a Letter of Intent which is expected to go to the Board in late February. The IMF mission head was very pleased with the results of the review. A more detailed report of the Fund's latest mission is attached. The program includes the following highlights.

-- **Monetary Policy** is to be focussed on stabilizing the baht, ultimately with the view to maintaining this policy until the baht rises to the low to mid-40s.

-- The 1998 **fiscal deficit** target is now 2% of GDP, compared to the earlier target of a 1% surplus, reflecting the fall-off in tax revenues due to lower-then-expected growth.

-- **Financial reform** is going forward as well as can be expected. The government has moved quickly by intervening in four banks in the past six weeks, and plans to announce soon new bank supervision guidelines. Progress in cleaning up the frozen finance companies is also moving forward, albeit slowly.

-- The **capital account** is now projected to be in deficit by $14 billion in 1998 compared to earlier estimates of a balance due to higher-then-expected rolloffs of short-term debts. A **sharp improvement in the current account and higher-than-projected international reserve levels** at the end of 1997, however, will largely offset the projected deterioration in the capital account.

Against this background, Fund staff has reached the same conclusion that we had, namely that the Thai program is adequately financed for the time being. But it intends to review this issue again in May.

I'm still inclined to believe that we should privately make a case to the Thais, perhaps with some public sign, that we would be prepared to support providing Thailand with supplemental resources, through the SRF, later this year if such augmentation is needed.

As you know, a Treasury team led by Bill Murden went to Thailand and has returned. The general assessment is that the Thais are now doing a satisfactory job with the frozen finance companies but face many difficult hurdles in disposing the assets, and the restructuring agencies need to coordinate efforts better with the Finance Ministry and Central Bank. With respect to commercial banks there is a general sense (except by the IMF) that things will get worse before getting better. Questions regarding recapitalization still need to be resolved.

Thailand: Briefing from IMF Staff
(February 12, 1998)

On Friday morning, IMF staff in Bangkok briefed Treasury on the status of the Fund Program. The IMF Mission Head was very pleased with the review. The markets seem to have growing confidence in the economic team; the baht has appreciated significantly in recent weeks; and there seems to be continued public support for the program.

Macroeconomic Developments

GDP is expected to decline by 3% in 1998 resulting in a steep drop in import demand. Inflation is currently running at 14%, but is expected to average in the high single digits over 1998. The current account is expected to be in surplus by $7 billion or 4% of GDP. The IMF will conduct another review in Thailand in May.

Fiscal Policy

The IMF knew by the fourth quarter that Thailand could not meet its fiscal targets for 1998. The Fund is not concerned about the slippage given the decline in domestic demand and the huge turnaround in the current account. Thailand has already undertaken major efforts to limit spending and the government has agreed to some small fiscal measures. But the IMF is **not** pressing for more. Thus, on the basis of the new assumptions, the central government deficit is projected to be 1.5% of GDP, and the state enterprises will be in deficit by 0.5% of GDP for a total of 2% of GDP in 1998. The earlier IMF target was a 1% surplus.

Monetary and Exchange Rate Policies

The 1998 monetary targets will remain unchanged and Thailand has met all targets so far. Thailand and the IMF have agreed that the primary objective of monetary policy is to focus on using interest rates to stabilize the baht. The agreed strategy is to consolidate and hold any upward trends in exchange rate appreciation. Over the coming period, the Fund and the Thais want to see the baht exchange rate settle in the low to mid-40s range. In the very near term, however, the Fund would not view any modest weakening of the baht as warranting a response through higher interest rates. The IMF is focussing on the overnight repurchase rate. This rate was running about 25% several weeks ago, but has dropped to 20% since and remained there for several days notwithstanding the appreciation of the baht. The IMF does not think that recent statements by Thai officials regarding the need to ease interest rates implied that the government planned to alter its interest rate policy until exchange rate objectives were met. The inference was that these statements were made for domestic consumption.

Financial Sector Reform

The Thais have moved quickly to close those finance companies that needed to be closed. With respect to the frozen finance companies, the World Bank has the lead. The IMF hoped that the Bank would have moved more quickly in addressing the problem of cleaning up the portfolios so that the IMF could concentrate on the Thai banks. Two institutions have been developed to deal with the bad assets of the finance companies. A key objective is to prevent liquidation of the assets of the seized finance institutions from depressing the value of the assets of remaining finance companies and banks.

In the last six weeks the Central Bank has also intervened in four banks, virtually wiping out the equity positions of the former stockholders, along with changing management; the government hopes to re-privatize these institutions before the end of the year. The key issue from the Fund's perspective is not the finance companies, but what to do with the commercial banks that represent 80% of the financial sector. All the banks will need to be recapitalized. The government's plan is to encourage private investors. The Thais want to avoid the perception that the government will re-capitalize the banks so as not to discourage private investors.

The recent break-off of discussions involving Citibank purchasing majority control of First Bangkok City Bank was due to Citibank's realization that the Thai bank was in deeper trouble than initially assumed. Citibank's actions were also probably influenced by its decision to enter negotiations with another Thai bank. ING is also reported to be in advanced discussions with another Thai bank. The government plans to announce soon new banking standards that will take effect in 2000. World Bank technical assistants are helping the Thais in restructuring the financial system. Fund staff noted that the financial restructuring program was going along as well as can be expected given the capital shortage.

External Financing

The IMF had originally assumed the capital account would be in balance in 1998. However, due to higher-than-expected rolloff rates, the capital account is expected to be in deficit by $14 billion. But the BOP still seems adequately financed. The current account is now expected to be in surplus by $7 billion, compared to an earlier deficit assumption of $2.5 billion. Reserves at the end of 1997 were near $27 billion, about $4 billion above IMF projections, partly because the Thais had allowed more of the short-term rolloffs to be fed into the market than the IMF had expected. Fund staff said that they would not be averse to allowing reserves to finance $3-5 billion of the projected larger capital outflows. However, the Thais were concerned about market perceptions should reserves fall below $23 billion -- currently a legal floor that the Thai-government could change. Fund staff also noted that there was some additional financing from the Japan export credit agency and from the ADB. **The Fund's bottom line is that Thailand's external financing package is adequate for now. It will review this issue again in May.**

With respect to short-term debts, foreign banks hold the bulk of it. The rollover rates of these banks have been about 85-90%. However, the rollover rates of Thai banks has been about 60%, and the rate for corporations has been 50-60%. The Thais have been exhorting Japanese banks to roll over their debt, with success. With respect to central Bank forward contracts, the IMF programs remains unchanged. Forward contracts totaled about $18 billion at the end of the year, and are programed to decline to $9 billion by end-1998.

TREASURY CLEARANCE SHEET NO. ____________

MEMORANDUM FOR: x SECRETARY X DEPUTY SECRETARY ☐ EXEC. SECRETARY
☐ ACTION BRIEFING INFORMATION ☐ LEGISLATION
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☐ TESTIMONY OTHER

FROM: Timothy Geithner, Assistant Secretary (International Affairs)

SUBJECT: Thailand: Next Steps

REVIEW OFFICES (Check when office clears)

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WMurden			Dir./IMD	2-1255
DZelikow			DAS/IN	2-7222

SPECIAL INSTRUCTIONS

98-SE-003017

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

ASSISTANT SECRETARY

March 10, 1998

ACTION

MEMORANDUM FOR SECRETARY RUBIN

FROM: Timothy Geithner TFG
Assistant Secretary (International Affairs)

SUBJECT: Memo to the President for his Meeting with Thai Prime Minister Chuan

ACTION FORCING EVENT:

The President is scheduled to meet with Prime Minister Chuan Leekpai beginning at 11:00 am on Friday, March 13. A separate and more detailed briefing is forthcoming for: 1) your March 13, 9:15 am, bilateral with Prime Minister Chuan at Blair Ho[illegible] and 2) your participation in the Cabinet Room meeting with the President and Prim[illegible] at 11:05 am where economic and financial issues will be discussed.

RECOMMENDATION:

That you sign the a[illegible]

Agree ✓

NCC OK to autopen 3/12/98

cc: Larry Summers

Add Trade finance

Withdrawal/Redaction Marker
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DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001. memo	Robert E. Rubin to POTUS re: Your Meeting with Thailand's Prime Minister Chuan Leekpai (1 page)	03/12/98	P5

This marker identifies the original location of the withdrawn item listed above. For a complete list of items withdrawn from this folder, see the Withdrawal/Redaction Sheet at the front of the folder.

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RESTRICTION CODES

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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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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]

1998-se-003017

EXECUTIVE SECRETARIAT CORRESPONDENCE MEMO COVER SHEET

Tuesday, March 10, 1998

PROFILE #: 1998-SE-003017

DATE CREATED: 03/10/1998

PRIORITY: [redacted]

ADDRESSEE: Robert E. Rubin
Secretary

AUTHOR: Geithner, Timothy
International Affairs

SUBJECT: Memo To The President For His Meeting With Thai Prime Minister Chuan

ABSTRACT: Memo to the President for his Meeting with Thai Prime Minister Chuan.

RM 3419

TO REVIEWERS

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TO EXECUTIVE SECRETARY

IN:

TO THE SECRETARY

DATE SIGNED:

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3/10/98

03/10/1998 03:51:57 PM

Economic Developments and Key Commitments in Thailand's IMF Letter of Intent

Macroeconomic Situation: Real GDP is expected to fall 3-3.5% in 1998, compared to a decline of 0.4% in 1997. Unemployment rose 3.5% in mid-1997 to 4.8% at end-1997. Inflation is expected to total 10.6% for 1998. Despite the nearly 100% depreciation of the baht from July to January, price pressure has been held in check by falling demand, low wage pressures and the small import-content share in consumer goods.

Monetary and Exchange Developments and Policies: Monetary figures are on track with the IMF program. Interest rates were raised in December and early January to counter the weakening baht. However, the political consensus for maintaining high short-term interest rates -- currently 21-25% -- is fragile.

Fiscal Developments and Policies: The Thai government met December IMF targets, but with considerable and growing difficulty due largely to the recession. They sought IMF revisions in the 1998 program to avoid aggravating the economic downturn and to accommodate additional social safety net expenditures. We supported their request and the IMF agreed to revise the 1998 target to a deficit of 2% of GDP, compared to the former target of a 1% surplus.

External Sector Developments and Outlook: While the projected 1998 current account has improved from a deficit of $2.5 billion to a surplus of $4.4 billion, the capital account outlook has deteriorated due to negative regional developments and downgrading by rating agencies. Net capital outflows are projected to be $14 billion in 1998. The projected financing gap is expected to be covered by a $4 billion decline in reserves to $23 billion (4.9 months of imports), disbursements from the $17.2 billion official financing package developed last summer -- $4.3 billion -- and $1.6 billion from newly identified loans from the Asian Development Bank and Japan. We do not expect that Thailand will require additional financing. Nonetheless, our announcement of support for Thailand's access to the IMF SRF, if needed, should enhance market confidence that the program will be adequately financed.

Financial Sector Reform: The government plans to complete the auction of assets from the 56 frozen finance companies by end-1998, and will develop plans to restructure and re-privatize four intervened banks. While this timetable is ambitious, they should not be dissuaded from it. By end-March, the government will issue guidelines and a phased timetable to strengthen loan classification and provisioning rules so as to bring banks in line with international standards by the end of the year 2000.

Privatization Program and Corporatization Law: In the near term the Thais will focus on privatizing the transportation, utility and energy sectors. The government is developing a new Corporatization Law to clarify the legal status of state enterprises to facilitate privatization and strengthen the regulatory framework. The bankruptcy law will be revised to permit orderly reorganization so that heathy parts of an insolvent corporation can continue to function. Amendments to the Alien Employment Act and Alien Business Law will increase foreign participation in the Thai economy, principally through liberalization of foreign ownership rules.

March 9, 1998

TREASURY CLEARANCE SHEET

NO. ________

Date: February 26, 1998

MEMORANDUM FOR: ■ SECRETARY ☐ DEPUTY SECRETARY ☐ EXEC. SECRETARY
■ ACTION ☐ BRIEFING ☐ INFORMATION ☐ LEGISLATION
☐ PRESS RELEASE ☐ PUBLICATION ☐ REGULATION ☐ SPEECH
☐ TESTIMONY ☐ OTHER ________

FROM: Assistant Secretary Geithner

THROUGH:

SUBJECT: Breifing for The President's Meeting with Thailand's Prime Minister

REVIEW OFFICES (Check when office clears)

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

☐ Under Secretary for International 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)	INIT.	DATE	OFFICE	TEL. NO.
INITIATOR(S)				
CMcCoy	cm	3/9	UIINA	x1747
REVIEWERS				
TCrawford	TWC	3/9/98	UIINA	x0359
DZelikow	DMZ	3/10/98	UIIN	x7222

SPECIAL INSTRUCTIONS

☐ Review Officer Date

☐ Executive Secretary Date

(04/89) DO F 80-02.1

1998-SE-006456

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

May 27, 1998

ASSISTANT SECRETARY

INFORMATION

MEMORANDUM FOR DEPUTY SECRETARY SUMMERS
UNDER SECRETARY LIPTON

FROM: Timothy F. Geithner TFG
(International Affairs)

SUBJECT: Recent Reviews of Thailand and Korea's IMF Programs

Attached are the recent review documents for Thailand and Korea, as well as OASIA staff's comments on these countries' programs.

Tab A Memcon of meeting with IMF division head for Thailand
Thailand's fourth Letter of Intent (LOI)

Tab B Memo critiquing Korea's (LOI)
Korea's LOI
Draft U.S. Executive Director's Board statement

Thailand

The program appears to be on track and adjusting to the changing developments in Thailand, and we should support it in the Board review on June 10. We are concerned about continued political support for the reform program in the face of rising unemployment and widespread bankruptcies. We are also concerned that Thai banks may not be able to recapitalize themselves by market means, prolonging the current liquidity crunch and jeopardizing the recovery of the financial sector. Jonathan Fiechter has told us that the World Bank is already working on a "Plan B" for these banks.

The revised program allows for further loosening of fiscal and monetary policies. The latter is contingent upon continued stability of the baht. The LOI also spells out more details on legal and regulatory reforms to promote financial sector reform. Corporate debt restructuring is moving forward on a voluntary basis, but several reforms are still needed to speed up the process. The Thai government is not considering any sort of FICORCA arrangement, and the LOI outlines upcoming steps to improve the environment for private-led corporate restructuring.

Korea

The Board meeting is tentatively scheduled for May 29, 1998. Korea has met its performance criteria for end-March and therefore qualifies to receive the next tranche of IMF funds.

However, we remain concerned about Korea's momentum on financial and corporate sector restructuring, and raise a number of concerns with Korea's most recent letter of intent. Most troubling is the issue of 'rescue lending' and guarantees from commercial banks and government policy banks such as KDB to over leveraged conglomerates. We believe that we should request that Fund staff prepare a supplement to the review on this topic, including data and information on conditionality associated with such lending and on how rescue loans impact Korea's broader goals of maintaining market confidence, recapitalizing the financial system, and restoring a framework for economic growth.

To: Tim Geithner

Date: 5/27/98, 3:32PM

DEPARTMENT
OF TREASURY
Office of the
Assistant Secretary for
International Affairs
Office of East and South
Asian Nations

Re: Thailand's Third Review under the IMF's Stand-By Arrangement

Attached are a memorandum summarizing a May 20 conversation with the IMF's division head for Thailand and Thailand's fourth Letter of Intent (LOI).

As noted in yesterday's Asia Daily, the MEP allows for further loosening of fiscal and monetary policies. The latter is contingent upon continued stability of the baht. The MEP also spells out more details on legal and regulatory reforms to promote financial sector reform. Corporate debt restructuring is moving forward on a voluntary basis, but several reforms are still needed to speed up the process. The Thai government is not considering any sort of FICORCA arrangement, and the MEP outlines upcoming steps to improve the environment for private-led corporate restructuring.

While the program appears to be on track and adjusting to the changing developments in Thailand, we are concerned about continued political support for the reform program in the face of rising unemployment and widespread bankruptcies. We are also concerned that Thai banks may not be able to recapitalize themselves by market means, prolonging the current liquidity crunch and jeopardizing the recovery of the financial sector. Jonathan Fiechter has said that the World Bank is already working on a "Plan B" for these banks.

Patrick Stuart
Room 5221
Phone 622-1724

cc: Dan Zelikow, Todd Crawford, Bill Murden, Teresa Rutledge

MEMORANDUM OF CONVERSATION

FROM: Patrick Stuart, INA

SUBJECT: Conversation with Ranjit Teja, Chief Economist/Division Head, Thailand

I met with Mr. Teja and Todd Schneider on May 20 to discuss results of the recent IMF mission and the outlook for Thailand in the coming months.

Policy Revisions

Output continues to fall in Thailand, with the Fund now estimating a decline of 4-5%. (Note: Some private sector analysts are even more pessimistic, and the Deputy Finance Minister publicly stated that the economy could contract by as much as 6%.) Consumption is falling, partly due to the wealth effect (drop in stock and real estate prices). The Fund is not seeing consumption smoothing. Instead, people are tightening their belts in anticipation of job losses.

Fiscal: Fund staff will recommend to the board a loosening of the fiscal stance from a 2% deficit to a 3% deficit (still excluding financial restructuring costs). Roughly half of this will be increased social safety spending, chiefly public work projects. The other half will be due to declines in revenue: VAT and import duties are down, and the Finance Ministry will have to give some corporate tax refunds due to plummeting profits. The expected automatic stabilizer effect will be between 0.3% and 0.5%.

Monetary: The Fund and Thais are still committed to keeping a tight rein on interest rates. There will be a gradual loosening of interest rates as long as the baht continues to show stability. The review document will show some change in monetary aggregate targets, but no one really has a handle on the relationship between growth, money demand, and interest rates. For example, instead of increasing, velocity now looks to flatten out or decline this year.

Banking and Credit

The IMF is concerned about the lack of credit to the real sector. Staff recognize that there are real reasons why the banks are avoiding this risk and are hesitant to push too hard on the banking sector.

Corporate debt restructuring is a key point, here. The current pace is slow and few deals have been reached. The largest problems are tax regulations and other legal hurdles that do not make debt restructuring attractive for all parties. For example, banks are taxed on accrued interest even though the bank may never have received payment. The Fund has some internal disagreement on tax issues, with tax purists apparently pushing a position that will disadvantage Thai banks, but the Asia division sees this as extraordinary circumstances that require some flexibility to get debt restructuring going.

Fund staff reached agreement with the Thais on legal reforms to remove these hurdles. There are no plans for any sort of FICORCA or government "sweeteners" to induce debt restructuring. (I pointed out that the Bank of Thailand had given away all its sweeteners through the FIDF.)

Recent Takeover of Seven Finance Companies: Teja said it was absolutely the right thing to do. At two of the seven, there was an active run on deposits, with these fincos left holding almost nothing but liabilities to the FIDF.

World Bank Efforts: Teja gave a much more positive assessment of WB efforts than last December. Now that Fiechter is in charge, he said that Staff is overall very satisfied.

<u>External Developments</u>

Reserve Levels and Forwards/Swaps: The Thai apparently used the recent inflow of capital for two large bank recapitalizations as an opportunity to increase reserves. At one point early this month, reserves exceeded $30 billion. The roll-off of some of the last forward contracts began mid-month. About $2.5 billion has rolled off, with more to come in the near future. They should be left with at least $25 billion in reserves after the roll-offs.

Exports and Trade Finance: The small-economy model of exports is not working: Thailand is not a price-taker. While Thailand has seen a 7-8% rise in export volume this year, the dollar amount is down, meaning that unit price levels are falling substantially. The IMF staff think that increased competition among the crisis economies and the sagging Japanese economy may be to blame for the falling prices. There are complaints by Thais and others that the Koreans are dumping anything and everything to get cash.

Fund staff believe that the upcoming bond issue will be helpful in getting export finance to some of the SMEs that have been missing out. They have a series of understandings with the Thai authorities for monitoring to ensure that this is not going to be wasted.

Bangkok
May 26, 1998

Dear Mr. Camdessus:

1. Very significant progress has been made in implementing the economic program since the second program review. The last three months have witnessed an important turnaround in market confidence. The exchange rate has appreciated by about 35 percent since early this year, and has stabilized since mid-March, allowing a steady lowering of short-term interest rates. The Bank of Thailand (BOT), taking advantage of improved market conditions, has been able to rebuild its foreign exchange reserves. Thailand's first sovereign bond issue since the onset of the crisis is planned in the coming months.

2. These favorable developments have followed from the government's strict adherence to the economic program. All quantitative and structural performance criteria for March 31, 1998 related to macroeconomic policies and financial restructuring have been observed.

3. We draw special attention to the progress being made in financial restructuring. We have announced the phased implementation of tighter loan classification and provisioning rules, which will be gradually brought up to full observance of international best practice over the next two years. Banks have made considerable progress in recapitalization: two large banks have just completed major international share issues, and another two have developed strategic partnerships with foreign banks. Tighter loan classification and provisioning standards are contributing to increased confidence and investor interest in bank recapitalization. To facilitate financial restructuring, five emergency decrees have been approved by the Cabinet, four of which have been ratified by an extraordinary session of Parliament on May 25, 1998, and the remaining one shall be considered shortly during the same extraordinary session.

4. Nevertheless, while important progress has been made in the financial sector, conditions in the real economy are still deteriorating as the economic decline during the first half of 1998 is proving to be deeper than previously anticipated. Both domestic and external factors have contributed to the revised economic outlook, some of them directly associated with prolonged contagion from developments in the region. Domestically, there has been more pronounced weakness in private consumption and investment demand, and continued liquidity shortages.

5. Against the background of considerable progress in stabilization, the immediate priority under the program is to minimize any further decline of the economy and bring about early recovery, while sustaining the stabilization gains. Thus, the focus of policies will shift to adapting macroeconomic settings, strengthening structural policies, and ensuring the adequacy of the social safety net.

6. An updated economic policy memorandum of this government is presented in the attachment. We draw attention to six key areas where strengthened understandings have been developed in order to alleviate liquidity shortages in the economy, accelerate restructuring, protect the disadvantaged, and prepare the ground for an early recovery:

- First, regarding our macroeconomic policies, there is room for further cautious reductions in interest rates and somewhat higher monetary growth rates in line with recovering money demand. Distortions in the money market created by FIDF financing are also to be reduced by raising more long-term funds to substitute for its short-term borrowing. All of this should greatly improve liquidity conditions. In addition, we will use the proceeds of the sovereign bond issue to strengthen the specialized banks and increase their capacity to meet the credit needs of key sectors; the policy framework of the specialized banks is to be strengthened for this purpose.

- Second, in light of the larger current account surplus, there is room to adjust the fiscal target and, thereby, contribute directly to minimizing any further decline of the economy. Thus, the overall public sector deficit target under the program for 1997/98 is proposed to be changed from 2 percent of GDP to 3 percent of GDP.

- Third, we have developed concrete measures to strengthen the social safety net and increase well-targeted public works programs, and have allocated an additional ½ percent of GDP in the 1997/98 Budget for this purpose.

- Fourth, with the recovery contingent on effective corporate debt restructuring, important steps are being taken in this area. The legal and institutional framework is being strengthened and made more supportive through reform of the bankruptcy act, foreclosure procedures, and other laws. In addition, we are liberalizing further foreign investment restrictions in key sectors in order to increase resources for restructuring.

- Fifth, financial sector reforms continue to focus on the need for the core banking system to continuously strengthen its capital, based on best international practices for loan loss provisioning that have already been introduced; implementation guidelines will be developed by midyear.

- Sixth, the coming months will see the auction of more complex assets by the FRA, and we will be developing a strategy to strengthen the finance company sector, as well as to resolve the status of the four intervened banks. This is essential to minimize the need for any future FIDF support for these institutions.

7. Although we are greatly encouraged by the strengthened foreign exchange reserve position, we need to remain especially vigilant in light of the continuing regional tensions. Thus, we will keep the financing of the program under close review to assure that, with IMF support, the program remains fully financed at all times.

8. The immediate period ahead will continue to be very difficult in Thailand, but the country is becoming much better placed to overcome the remaining challenges and to prepare

for a sustainable recovery. Were new pressures to arise, the government stands ready to take whatever additional measures are necessary to ensure the success of the program, and will consult with the Fund, as indicated earlier.

Sincerely,

/s/
Tarrin Nimmanahaeminda
Minister of Finance

/s/
M. R. Chatu Mongol Sonakul
Governor, Bank of Thailand

Attachments

Mr. Michel Camdessus
Managing Director
International Monetary Fund
Washington, D.C. 20431

MEMORANDUM ON ECONOMIC POLICIES OF THE ROYAL THAI GOVERNMENT

May 26, 1998

I. MACROECONOMIC FRAMEWORK AND POLICIES FOR 1998

1. The macroeconomic framework adopted in February 1998 has been reassessed against the background of an economy that is weaker than anticipated, particularly during the first half-year, and an external position that has improved more markedly. At this third review of the program, the key objective is to minimize any further decline in the economy and bring about an early recovery, while sustaining the restoration of confidence witnessed in recent months. Both macroeconomic policy settings and strengthened structural policies are being designed to give preeminence to this objective.

2. The weaker economy during the first-half of 1998 lies behind the revision in the economic outlook for the year as a whole, a decline in real GDP of about 4–5½ percent. A number of external and domestic factors are contributing to this outlook. The continued unsettled conditions in the region are a key factor, reducing export demand below previous projections, and delaying the recovery in private capital flows. Domestically, consumption and investment demand have both been weaker than previously expected. The modified policy framework adopted at this review (Table 1), aims at accelerating structural reforms and offsetting some of the weakness in private demand, and should help the economy bottom out by about midyear, and begin to recover during the latter part of 1998. Inflation is now expected to peak at just over 12 percent, during the second quarter of 1998, and should be contained at 10.5 percent for the year as a whole, restrained by the weaknesses in the real economy. The BOT's foreign exchange reserves have remained well above the program floor, reflecting a larger current account surplus and a slightly smaller deficit in the capital account. These inflows, together with other initiatives summarized below, will contribute to easing progressively liquidity shortages in the economy.

Monetary and Exchange Rate Policy

3. Stabilization of the exchange rate will remain the primary objective of monetary policy, but there is now room to adapt the monetary program to better assure the liquidity needs of the private sector. However, against the background of a significant strengthening of the currency since January, the recent stability of the baht within a more realistic range, and the substantial restoration of the BOT's reserves, there is room for further cautious reductions in the overnight repurchase rate. Correspondingly, the monetary program for 1998 is being adapted to take account of improved market confidence and a stronger outlook for money demand, and M2A growth in 1998 is now projected at 9 percent. The December 1998 target for reserve money growth will be kept closely under review, within a target range of about 6½–8 percent, and we will use the increased room provided exchange rate stability is maintained. However, if there is increased pressure on the exchange rate, we will raise interest rates and tighten the monetary program as necessary. Annex A contains the revised NDA

performance criteria through September 1998 and the new indicative targets for reserve money.

4. The monetary program allows the proceeds of the anticipated sovereign bond issue to be used to strengthen the four specialized banks. For this purpose, the policy framework of the specialized banks will be reviewed and strengthened ahead of their recapitalization (paragraph 15 below). On this basis, we expect that the specialized banks will be able to expand their lending operations at market rates, especially to the export sector, building on the recently negotiated trade finance facilities with the Export Import Bank of Japan ($600 million) and the AsDB ($1 billion).

Fiscal Policy

5. Although recent revenue and expenditure developments have been well within established program targets, the deeper-than-anticipated recession makes it likely that there will be further revenue shortfalls later in the fiscal year, especially in corporate income taxes as well as with respect to the earnings of state enterprises. In addition, we have concluded that existing arrangements for social safety net spending need to be strengthened more rapidly than previously anticipated to provide greater relief to displaced workers. Therefore, we propose to revise the target for the 1997/98 overall public sector balance from minus 2 percent of GDP to minus 3 percent of GDP (defined under the program on a GFS basis and excluding the costs of financial restructuring. See Annex B). This will also help offset the greater deflationary impulse from contracting private consumption and investment. Within this total the central government deficit will rise from 1.6 percent of GDP to 2.4 percent of GDP. Roughly one-half of this revision will reflect higher social safety net spending, while the remainder will comprise the effect of lower revenues as we allow automatic stabilizers to take effect.

6. Regarding the state enterprise sector, we expect that the small deficit will rise somewhat, from 0.4 percent to 0.6 percent of GDP, during 1997/98, reflecting lower earnings. Adjustments have been made to prices for goods and services provided by state enterprises, including for electricity, air-conditioned buses and trains, and for water use. However, bus and rail fares for the poorest members of society have been maintained as part of our social safety net, and we will ensure that emerging arrears in the State Railways and in the Bangkok Metropolitan Transport Authority are cleared by the end of June 1998 by budgetary transfers within the fiscal framework.

7. We have also formulated the preliminary fiscal framework for 1998/99. Against the expectation of a small economic recovery during 1999, there will be room to reduce the fiscal deficit from that currently projected for 1997/98. Thus, we expect to contain the overall public sector deficit to no more than 2½ percent of GDP in 1998/99, signaling the continued structural strength of Thailand's public sector despite the economic crisis. The central government deficit will be about 1½ percent of GDP. This target includes the costs of financial sector restructuring. Toward this end, the government has set itself the ambitious objective of issuing about B 500 billion of government bonds by the end of the 1998/99 fiscal year (paragraph 18). About 1 percent of GDP will be the deficit of the public enterprises. The

1998/99 fiscal framework will be reassessed during the next quarterly review, ahead of its formal adoption in September 1998.

External Sector

8. External current account adjustment is also proceeding more quickly than envisaged just a few months ago, mainly reflecting the deep recession, and we now expect to record a current account surplus of about $8.5 billion or about 7 percent of GDP in 1998. Export performance has been weaker than expected, partly because of declining agricultural and manufactured good prices, as well as lower external demand; therefore, import compression remains, for now, the principal source of external adjustment. However, progressively during 1998, we expect the balance between import compression and export growth to shift, and the current account surplus to narrow.

9. The capital account is developing broadly as envisaged in key areas. Most of the offshore forward and swap obligations incurred in 1997 have now been settled, and we are confident that the total stock of such obligations will be reduced to about $9 billion by end-1998, comprising only domestic obligations related to liquidity management. Also, there has been greater stability in recent months of short-term credit lines. In particular, the rollover rate for the Thai banks and the corporate sector has recently risen. Moreover, foreign direct investment recovered somewhat in recent months owing to share issues associated with commercial banks' recapitalization (see below). Against this, there were some outflows from nonresident baht accounts earlier in the year.

10. We have been encouraged by the entry of Canada into the financing package, which will offset some erosion in the package from other sources. In addition, we intend to place a sovereign bond issue in international markets in the coming months. Overall, we expect that more ambitious external targets can be set for the 1998 program. The modification of the June 30 performance criterion on net international reserves and the data for the September 30 external performance criteria are specified in Annex C. In addition, the envisaged amendment of the Currency Act allows for greater flexibility in reserve management. For all these reasons, we are confident that the economic program remains comfortably financed.

II. FINANCIAL SECTOR RESTRUCTURING

11. Financial sector reform remains the cornerstone of our economic program. Our policies seek a continuous strengthening of the solvency and liquidity of domestic financial institutions. Banks and finance companies are facing sharply declining credit quality and falling earnings because of the economic downturn. At the same time, we continue to deal decisively with unviable financial institutions, while protecting depositors and creditors in order to maintain confidence in the financial system. Our policies are summarized in Boxes A and B.

Strengthening the Core Banking System

12. Our strategy continues to be targeted at augmenting the capital base of all domestic financial institutions, and this process is being facilitated by the tighter loan classification and

provisioning standards. Major commercial banks have succeeded in raising private capital, and many smaller banks continue discussions with foreign strategic partners. About $3 billion of new private capital has been raised since last November, most of it from foreign investors. This process has been driven by the introduction at the end of March 1998 of new loan classification and loan loss provisioning rules consistent with international best practices. The new loan classification rules will take effect on July 1, and the associated provisioning requirements—to be implemented gradually—will be the driving force behind future bank recapitalization.

13. The four *intervened banks* continue to operate subject to strict supervision by the BOT. Their funding has been regularized by converting most of their short-term liabilities to the FIDF into long-term obligations at funding rates closer to those of core banks. We are developing a strategy for their resolution and privatization, and have accordingly contracted an investment bank to develop least-cost proposals by midyear. We expect to have adopted a strategy for these banks by end-July.

Strategy for Remaining Financial Institutions

14. The 35 remaining *finance companies* are subject to the same recapitalization requirements and loan classification and provision rules as banks. Some finance companies have been recapitalized and have found viable market niches, but many others are very small and will need to be consolidated. Consistent with this strategy, and following the modalities of previous interventions in banks, on May 18, 1998, we have intervened in seven finance companies that were unable to raise capital. A majority state-owned finance company (KTT) is leading the consolidation effort. This consolidation strategy shall apply to other finance companies which do not comply with their Memoranda of Understanding with the BOT.

15. Regarding specialized financial institutions, it is our intention to make increased use of these institutions to make credit available to the economy. Therefore, it is vital to ensure that they are financially sound, properly regulated and supervised, and adequately capitalized. Accordingly, these institutions and their overall policy framework will be assessed promptly with the assistance of the World Bank, with the view to identifying any problems by June 30, 1998.

Asset Disposal of the 56 Closed Finance Companies

16. The Financial Sector Restructuring Agency (FRA), working closely with World Bank consultants, has completed the rules and procedures for auctioning the assets of the closed companies. The FRA has successfully auctioned a substantial amount of physical assets since March. The next stage is to auction more complex hire-purchase and loan portfolios, and this is scheduled to begin shortly with a first auction comprising $1.2 billion of hire-purchase loan portfolios. The FRA has contracted an investment bank to professionally market the assets in order to stimulate bidder interest. All financial institutions in Thailand, including BIBF, are eligible to participate in the auctions. An important precondition to these next auctions is to remove the major impediments to asset transfers; it is our intention to address these problems through an emergency decree by the end of May.

17. The organization and procedures of the Asset Management Corporation (AMC) are broadly in place, and an increase of its capital to B 10 billion has been authorized. It is expected that the AMC as well as the Radanasin Bank (RAB) will shortly fully define their own bidding procedures and funding policies in order to bid for the financial assets offered by the FRA. To assure the efficiency and integrity of the process, a third party review of FRA/AMC/RAB procedures will be completed by September 1998. It is not envisaged that other state agencies would participate in the auctions.

FIDF Policies and Operations

18. As previously declared, the government has decided to take full financial responsibility for the losses of the Financial Institutions Development Fund (FIDF) by converting FIDF debt into government debt. This conversion will start with a government bond issue of B 500 billion in FY 1998-99; the interest costs of these bonds will be met by the Budget, with their amortization being met partly by 90 percent of the future realized profits of the BOT, and partly by privatization proceeds. The Ministry of Finance is working out the terms and conditions, as well as the institutional framework, for issuing these bonds with the aim of separating the mechanism for FIDF's borrowing needs from the BOT's management of short-term interest rates. In its capacity as lender of last resort for the financial system, the FIDF will charge a lending rate that will be the highest in the system for new lending. Finally, and perhaps most importantly, we will continue to move toward devising, by the end of the year, a deposit insurance scheme to replace the comprehensive guarantee of the financial system presently provided via the FIDF.

Strengthen Supervision and Regulation

19. The BOT's supervision of financial institutions is focussing on loan portfolio values and capital adequacy. This effort has taken the form of a set of Memoranda of Understanding (MOUs) with undercapitalized banks and all finance companies, supported by targeted on-site examinations. The BOT intends to continue this process by entering by mid-August into a new set of MOUs with all financial institutions; new MOUs will be signed subsequently, until the new year 2000 provisioning rules have been met.

20. Given that problem loans in Thailand will need to be restructured, it is essential to develop detailed operational guidelines to make the new loan classification and provisioning rules fully effective, and to provide banks with incentive to restructure their loans. These guidelines, which are crucial for a restoration of normal credit flows in the financial system, will need to be consistent with international best practices to be credible, while also taking into account the deep systemic difficulties facing Thai borrowers. We envisage that these new guidelines will be fully in effect by mid-June 1998. The operational guidelines on collateral valuation will also be introduced by mid-June 1998.

21. The government is conducting a broad review of banking and financial sector legislation and regulation with the view to identifying the need for changes and finalizing proposals for legal and regulatory reforms to be taken later in 1998. We are in the process of bringing in experts from G-7 central banks to provide support for a High-Level Commission

which is being established to develop concrete recommendations on how to strengthen central banking and supervision in Thailand. Finally, the BOT will strengthen the capacity of its supervisory staff through recruitment and retraining.

III. Supporting and Revitalizing the Real Sector

22. A major strengthening in economic and legal institutions is needed to help the large number of financially distressed firms and displaced workers cope with the challenge of adjusting to the new economic environment. Thus, we are accelerating many of the initiatives in this area that were foreshadowed at the time of the last review of the program.

Corporate Restructuring and Legal Reform

23. Corporate restructuring with external and domestic creditors is crucial to the recovery of the private sector. We are encouraged that such restructuring is under way, and is being pursued on a voluntary and market-oriented basis. The government is committed to facilitating this process through legal and tax reform that would establish the appropriate enabling framework; the key steps toward this end are summarized in Box C. The government will encourage banks and corporate bodies to create voluntary creditor committees and debt-workout units. A consultative committee drawing together domestic creditors, mainly banks, and corporate debtors has already been set up. One of its first recommendations—to clarify the accounting and provisioning rules for restructured loans—has been acted on and it is hoped that, in this way, the government can contribute to removing the institutional obstacles to debt restructuring, especially facilitating debt workouts outside of formal bankruptcy court. The government has already announced that public funds will not be used to bail out corporate units, and this basic principle is reaffirmed.

24. To improve corporate governance, the SEC has embarked on a review of accounting principles and practices to bring them in line with international best practices by end-1998. This will result in enhanced transparency and disclosure standards on the part of all listed companies. Companies listed on the Stock Exchange of Thailand will be required to disclose all liabilities (including external liabilities and off-balance sheet liabilities). Other steps are also being taken to increase accountability to shareholders. These measures to improve corporate governance should be finalized by June 30, 1998.

Privatization and Competition

25. The government has now drawn up a concrete agenda to implement the restructuring and privatization program that was presented in the February Memorandum on Economic Policies, and these are elaborated in Box D. To ensure an adequate consensus for the government's privatization program, we are embarking on an increased dialogue with workers and other affected parties. The program presented in the last Letter of Intent is reaffirmed, and a specific timetable for individual enterprises will be developed by the time of the next quarterly review.

26. The government also places considerable importance in deepening the external openness of Thailand's economy, and increasing foreign direct investment flows into the economy. Such increased investment flows will contribute directly to relieving the liquidity shortages in many sectors. As such, the government will shortly propose to Parliament amendments to the Alien Business Law, as well as to other associated laws, aimed at liberalizing foreign investment limits in selected sectors during the second half of the year.

Social Safety Net

27. A social safety net adequate to the task of protecting those left vulnerable by the economic crisis is a key priority of the government. In consultation with the major nongovernmental organizations and labor leaders, we have further elaborated on the design of the social safety net. These have allowed greater specification of the social safety net measures anticipated at the last program review, and the strengthened program is presented in Box E. This program is being implemented in close collaboration with the AsDB (a social sector loan was approved on March 12), the World Bank (approval of the social investment project loan is planned for July 1998), and the Overseas Economic Cooperation Fund. In addition, it is expected that the government will accelerate public employment creation in small infrastructure programs in the agricultural sector, and increase funds for retraining programs and lending to the unemployed to facilitate self-employment activities within the increased margin provided by the fiscal program.

IV. Disclosure and Transparency in Economic Policy

28. The dissemination of timely and accurate economic information is essential in bolstering market confidence and ensuring a stable recovery. We have already subscribed to the special data dissemination standards (SDDS), and we expect to be in full compliance with it by the end of the year. We have also steadily increased the quantity, scope, and timeliness of economic data in the Bank of Thailand's monthly press release and on the Worldwide Web. Additional plans to improve the transparency and timeliness of data reporting are under way. Thus, during the second half of the year the government will, among other things, shorten reporting lags and add to its list of regularly published data, including a medium-term schedule of external public and private debt obligations falling due. We have also reduced the reporting lag on international reserves and on net forward obligations to one week, and these data will, henceforth, be available weekly, effective July 1998. Steps to develop quarterly GDP estimates are under way, and it is our intention to improve the frequency and quality of labor market data, as well as to improve indicators of the real economy and financial sector soundness, to help improve the quality of macroeconomic policymaking. A review is also now under way to adjust monetary data for the impact of financial sector restructuring.

Table 1. Thailand: Macroeconomic Framework, 1996-98

	1996	1997	1998	
			Second	Third
	Revised	Estimate	Review	Review
Real GDP growth (percent)	5.5	-0.4	-3 to -3.5	-4 to -5.5
Consumption	6.7	0.1	-5.0	-8.0
Gross fixed investment	6.0	-16.0	-21.0	-24.0
CPI inflation (end period, percent)	4.8	7.7	10.6	10.0
CPI inflation (period average, percent)	5.9	5.6	11.6	10.5
Saving and investment (percent of GDP)				
Gross domestic investment	41.7	35.0	29.1	28.2
Private, including stocks	31.5	23.5	17.6	16.4
Public	10.2	11.5	11.5	11.8
Gross national saving	33.7	32.9	33.0	35.0
Private, including stat. discrepancy	20.6	22.2	23.0	25.6
Public	13.1	10.7	10.0	9.5
Foreign saving	7.9	2.0	-3.9	-6.9
Fiscal accounts (percent of GDP) 1/				
Central government balance	2.4	-0.9	-1.6	-2.4
Revenue and grants	19.5	18.3	15.8	15.5
Expenditure and net lending	17.1	19.2	17.4	17.9
Overall public sector balance	2.7	-2.1	-2.0	-3.0
Monetary accounts (end period, percent)				
M2A growth	12.7	2.1	5.1	9.0
Reserve money growth	12.0	4.7	6.6	6.6-8.0
Balance of payments (billions of US$)				
Exports, f.o.b.	54.7	56.7	60.1	57.5
Growth rate (in dollar terms)	-1.9	3.8	6.2	1.4
Growth rate (volume terms)	-5.1	9.2	10.6	8.8
Imports, c.i.f.	70.8	61.3	56.8	50.5
Growth rate (in dollar terms)	0.6	-13.4	-7.7	-17.7
Growth rate (volume terms)	-4.0	-11.8	-5.2	-13.6
Current account balance	-14.4	-3.0	4.4	8.5
(percent of GDP)	-7.9	-2.0	3.9	6.9
Capital account balance	16.5	-15.6	-12 to -14	-14 to -16
Medium- and long-term	11.3	6.3	2-3	4-6
Short-term 2/	5.2	-21.9	-15 to -16	-18 to -20
Overall balance	2.2	-18.6	-8 to -10	-6 to -8
Gross official reserves (end year)	38.7	27.0	23-25	26-28
(Months of imports)	6.6	5.3	4.9-5.3	6.2-6.7
(Percent of short-term external debt)	103.0	90.1	109-118	114-123
Forward position of BOT (end year) 3/	-4.9	-18.0	-9.0	-9.0
External debt (percent of GDP)	49.9	59.6	76.3	72.5
(billions of US$) 4/	90.5	91.8	85.9	89.7
Public sector	16.8	24.5	31.7	32.3
Private sector	73.7	67.3	54.2	57.4
Medium- and long-term	36.2	37.4	33.6	34.5
Short-term	37.6	29.9	20.6	22.8
Debt service ratio 5/	12.1	15.8	18.8	19.5

Sources: Information provided by the Thai authorities; and staff estimates.

1/ On a fiscal year basis.
2/ Including outflows associated with the closing of swap and forward contracts by the Bank of Thailand, and errors and omissions.
3/ Consistent with the elimination of all BOT offshore forward and swap obligations by end-1998.
4/ Excludes loans (estimated at around $4 billion at end-1997), proceeds of which were not brought by Thai corporations into Thailand.
5/ Percent of exports of goods and services.

Box A. Action Plan for Financial System

Measure		Date
I. BANKING SYSTEM		
1.	• Signing of new MOUs with all banks on recapitalization through end-1998. • New MOUs will be signed subsequently until the new provisioning rules for the year 2000 have been met.	August 15, 1998 (performance criterion)
2.	Radahanasin Bank to acquire foreign strategic partner.	1998
II. SPECIALIZED STATE BANKS		
3.	Assessment of supervision and regulatory framework.	June 30, 1998
4.	Recapitalization.	September 30, 1998
III. FINANCE COMPANIES		
5.	• Signing of new MOUs with all finance companies on recapitalization through end-1998. • New MOUs will be signed subsequently until the new provisioning rules for the year 2000 have been met.	August 15, 1998
IV. REGULATORY AND SUPERVISORY FRAMEWORK		
6.	BOT to issue operational guidelines for restructured loans and valuation of collateral.	Mid-June 1998
7.	Review of central bank, commercial bank, and finance company laws.	May-Oct. 1998
8.	Measures to upgrade supervisory skills, including training and recruitment.	Ongoing
9.	Amendment of the Currency Act.	October 31, 1998
10.	Issue new prudential regulations, including foreign exposure and lending to related parties.	December 31, 1998
11.	Cabinet approval of drafts of new BOT, Banking, and Finance Companies Acts.	December 31, 1998
12.	Establish stricter requirements for auditing and accounting for all financial institutions, consistent with international best practices, including stricter requirements for disclosure.	December 31, 1998
V. TAX CODE		
13.	Implement full tax deductibility for provisioning to meet the year 2000 standard, even if provisioning is accelerated.	September 30, 1998
14.	Make tax rules consistent with rules on accrual of interest according to loan classification and provisioning requirements.	September 30, 1998
VI. COMPREHENSIVE DEPOSIT GUARANTEE		
15.	Finalize plan for deposit insurance scheme to replace the guarantee over the medium term.	December 31, 1998

Box B. Action Plan for Restructuring

	Measure	Date
I. ASSET SALES FOR 56 CLOSED FINANCE COMPANIES		
1.	FRA to begin the process of disposing loan portfolios.	Initiated
2.	Amend FRA, and FRA-related, laws to guarantee rights to title, remove specific impediments to asset transfers, and facilitate an efficient and speedy disposal of assets, specifically: • Buyers to receive clear and indisputable rights to the assets. • Remove procedures for notification of approval by borrowers when loans are transferred, by allowing affected persons to lodge an objection at least 3 days prior to the date of auction. Validity of the objection shall be decided by FRA whose decision shall be final. • Maintain the continuity of the auction process by minimizing potential disruption from bankruptcy filings. • Secure FIDF entitlement (through exemption from Article 94(2) of the Bankruptcy Act).	May 31, 1998
3.	Effective suspension of PLMO operations.	Early June, 1998
4.	AMC to be fully operational in all procedures, with bidding methodology, information systems, and funding policies in place.	June 15, 1998
5.	MOF to complete a third party review of procedures and effectiveness of FRA, AMC, and Radahanasin Bank.	September 30, 1998
6.	FRA to complete asset sales.	December 31, 1998
II. INTERVENED BANKS		
7.	Contract with investment bank to prepare a restructuring strategy aimed at their eventual privatization.	Done
8.	BOT to issue operational procedures, including limits on the structure and growth of assets and liabilities.	May 31, 1998
9.	Presentation to BOT of restructuring strategy.	July 15, 1998
10.	MOF/BOT to adopt strategy and prepare for implementation.	July 31, 1998
III. FIDF POLICIES		
11.	FIDF to formally release collateral in closed finance companies and implement pari passu treatment with other creditors.	Done
12.	The government to assume financial responsibility for FIDF losses. Ministry of Finance to announce full details of issuance of up to B 500 billion in government bonds during fiscal 1998-99, with interest payments incorporated in the central government budget.	June 30, 1998

Box C. Thailand: Legal, Procedural, and Tax Reforms to Facilitate Financial and Corporate Restructuring

Measure	Date
I. BANKRUPTCY LAW	
Enact amendments, including the following:	
• Repeal or modify Section 94 (2), to allow unsecured creditors who have provided financing in good faith prior to an insolvency proceeding, to file their claims in a subsequent bankruptcy proceeding of the debtor.	• Cabinet approval: Done
• Provide for voting on a reorganization plan by classes of creditors, including one class for bondholders if their claims are not subordinated.	• The Government to seek Parliamentary approval, expected by: October 31, 1998 (performance criterion).
• Provide for specific and comprehensive provisions allowing for the rescission of payments and transfers undertaken prior to a reorganization or a liquidation proceeding, including a period of at least one year for transactions between the debtor and related parties, and make these provisions applicable to both liquidation and reorganization proceedings.	
• Replace the discretionary power of court to confirm or reject reorganization plans by objective rules for court confirmation of plans of reorganization, which were approved by creditors, including that no dissenting class of creditors nor the debtor would involuntarily receive less value under the plan than they would in a liquidation.	
• Provide specific rules on assumption or rejection of outstanding contracts, including contracts to extend credit, unexpired leases and other executory contracts and personal services contracts and make them applicable to both reorganization and liquidation proceedings.	
• Require courts to approve a petition for a reorganization proceeding unless there is no reasonable likelihood that the reorganization could offer a greater return to creditors than a liquidation.	
• Include a provision clarifying that the conversion in baht of creditors' claims denominated in foreign currency is solely for purposes of calculating votes weighted by the amount of creditors' claims.	
II. FORECLOSURE AND OTHER RELATED REFORMS	
Objectives: • To facilitate debtors in the provision of collateral which enables them to receive credit; • To facilitate creditors in the enforcement of secured claims; • To remove impediments to the rehabilitation of financial enterprises; • To increase the provision of secured credit in the economy over the medium term.	

	Enact legislation in technical consultation with the World Bank, aimed at achieving the above objectives through reform of the secured creditors' rights legislation by amending laws related to foreclosure, including if necessary: (i) the Civil and Commercial Code, to facilitate the enforcement of secured creditors' claims, or (ii) the Civil Procedure Code, to accelerate the process of judicial foreclosures; or other laws: • Finalize draft legislation. • Cabinet approval of amended legislation and procedures. • The government will seek Parliamentary approval of amended legislation.	• June 30, 1998 • July 31, 1998 • October 31, 1998
III.	**REMOVAL OF TAX DISINCENTIVES**	
1.	A working group will submit a draft regulation to the Minister of Finance allowing deferral of taxes on cash free asset transfers, share acquisitions, and mergers.	July 15, 1998
2.	The Ministry of Finance will review the Revenue Code in order to remove any impediments to corporate debt and equity restructuring, including: • limits on deductibility of interest expenses; • promotion of debt restructuring in selected cases; and • encouragement of mergers and acquisitions in support of corporate reorganization.	September 30, 1998
IV.	**DEBT WORKOUTS**	
1.	Encourage formation by banks of voluntary creditor committees to exchange information of corporate debt restructuring.	June 30, 1998
2.	Encourage formation of debt workout units by banks and corporate bodies with the help of international experts.	June 30, 1998
V.	**OTHER MEASURES TO IMPROVE CORPORATE DISCLOSURE AND GOVERNANCE**	
1.	Consolidate all external liabilities and off-balance sheet liabilities in financial statements of all listed companies.	June 30, 1998
2.	Bring accounting standards to international best practices.	December 31, 1998
3.	Increase accountability to shareholders by requiring the Board of Directors of each listed company to appoint an audit committee to supervise its operations. Directors with managerial responsibility or those related to its major shareholders will not be eligible for membership of the audit committee. • All new companies to be listed. • Existing listed companies	Immediate 1999

Box D. Thailand: Privatization Strategy	
Objective	
The long-term objectives of this strategy are the following: • Free up public resources, so that they can be more efficiently reallocated to higher priorities, including health and education; • Increase competition, providing better value to consumers through improved services and prices; • Promote productivity and higher labor welfare; • Reduce the public debt and budgetary burden; and • prepare for globalization of trade in services. The success of this process requires, among other things, the widest possible consensus with all interested parties, including state agencies and employees of state-run enterprises.	
Measure	**Date**
1. State Enterprise Office	
Establish Office of State Enterprises and Government Portfolio in Ministry of Finance which will (i) support and coordinate the privatization of state enterprises; (ii) develop private participation in infrastructure; (iii) monitor state enterprises; and (iv) manage the government portfolio. • Cabinet approval. • Appoint key staff.	 Early June, 1998 June 30, 1998
2. Privatization Strategy and Action Program	
Prepare in coordination with state agencies and submit for review to an appointed consulting firm the Master Plan for State Enterprise Reform. The Master Plan will set out, with clear deadlines, the medium-term strategy for privatization and state enterprise restructuring in the following key areas: • objectives, organizational arrangements, strategy of privatization and the future role of the state; • timetables and sequence for the corporatization and divestiture of selected state enterprises (including energy, telecommunications, water, railways); • choice of the divestiture strategy for each of the selected state enterprises (full or partial privatization through joint ventures, private placements or public offers); • establishment of an effective regulatory framework for transport, water, energy, and telecommunications; and • improved monitoring of remaining state enterprises. Cabinet approval and public announcement of Master Plan.	Aug. 31, 1998
3. Development of Regulatory Framework for Selected Sectors	
• Announce details of effective regulatory framework for the public utilities to be applicable to private sector operators, especially in water, power, and telecommunications, to promote competition and regulate monopolies;	Sept. 30, 1998
• Establish regulatory capacity for telecommunications and energy sectors: – Cabinet approval; – expected passage by Parliament (if needed); and	 Sept. 30, 1998 Dec. 31, 1998
• Initiate study on the regulatory capacity for water and transport sectors, with a view to complete its implementation by end-1999.	Aug. 31, 1998
4. Legal Framework to Enable Privatization of Public Enterprises	
• Corporatization Law aimed at facilitating the incorporation of state enterprises: – approval by Cabinet; – expected passage by Parliament	 June 9, 1998 Oct. 31, 1998
• Identify details of other necessary legislation, including the need for an omnibus Privatization Law, to allow private sector participation in key sectors.	July 31, 1998

Box E. Thailand: Expanding and Strengthening the Social Safety Net

1. Adoption of a Social Investment Project (SIP) aimed at mitigating the social costs of the crisis in the short term. The project has three main objectives: (i) to generate immediate employment by supporting high priority labor-intensive programs; (ii) to improve chances of employment by providing training for the unemployed; and (iii) to support social programs used by the vulnerable which are now threatened by budget cuts.

The project includes B 21.6 billion of additional spending over the next 3½ years, backed by B 15.3 billion of World Bank loans, and includes the following measures:

Employment
Supplementary support of existing government job-creation programs:

- rehabilitation of cultural, historical and recreational sites (Tourism Authority of Thailand);
- construction of village roads, weirs and reservoirs (Ministry of Interior);
- school building repair, footpath construction (Bangkok Metropolitan Administration);
- rehabilitation and repair of river weirs (Royal Irrigation Department).

Expenditure: B 10 billion
Employment impact: more than 500,000 man-months over 2½ years

Training
Expansion of vocational and technical training for the unemployed (Ministry of Labor and Social Welfare).
Expenditure: B 1½ billion over 2½ years
Impact: more than 300,000 3-month training places

Health
Improved and expanded coverage of the Low Income Public Assistance Health Insurance Scheme (Ministry of Health):
Expenditure: B 1¼ billion over 2½ years
Additional coverage: 1½ million people per annum

Supplementary financing of the Community Based Care of Patients with AIDS Program (implemented through NGOs):
Expenditure: B 90 million

Rural Development
Expansion of the Rural Industrial Employment Promotion Program (Ministry of Industry, with implementation support from NGOs), to stimulate investment and employment:
Expenditure: B 310 million over 2½ years
Impact: 84 new industrial enterprises, 3000 permanent jobs created

Strengthening Decentralization and Community Participation

Two new funds will be created to support local investments aimed at reducing poverty and creating new employment opportunities:

The **Social Investment Fund** will provide grants to support rural community projects

The **Regional Urban Development Fund** will provide sub-loans to help municipalities expand their investment programs.

Expenditure:	B 7.8 billion over 3½ years
Employment Impact:	475,000 man-months through more than 11,000 sub-projects

Monitoring Poverty and Improved Targeting

Creation of a special unit within the Ministry of Finance to monitor SIP performance and effectiveness, working with the World Bank to ensure improved targeting and efficient delivery of SIP social programs.

2. Social assistance programs under the AsDB's Social Sector Program Loan, involving expenditures of approximately B 20 billion over two years.

Labor Market and Social Welfare Policy

- Establish a center for providing retraining, counseling, and placement-support services for the unemployed. Extend social security coverage to at least six months for laid-off workers, to include medical, maternity, disability, and death benefits.

Education and Health

- Expand scholarship and loan programs to minimize student dropouts;
- Protect operational budgets for teacher training and instructional materials in science, mathematics, and foreign language education;
- Reallocate the budget toward health programs for the poor and redeploy health staff to rural areas;
- Maintain program coverage for maternal, child health, and HIV/AIDS activities.

3. **Price-based Measures to Cushion the Impact of the Adjustment Program**

- Maintenance of urban bus and rail fares at subsidized prices, with a budgetary impact of about B 3 billion annually.

4. The government has already decided to increase severance pay to ten months for workers with more than ten years service, and has also established an Assistance Fund to ensure that workers dismissed from bankrupt firms receive adequate cash support. The government is currently considering an enhanced strategy to strengthen further the social safety net. Toward this, the government has just extended social security benefits (including medical, maternity, disability, and death) for those unemployed, from six months up to 12 months.

MONETARY TARGETS

The definitions of all performance criteria and indicative targets are unchanged from the second review.

1. Performance Criterion on Net Domestic Assets of the BOT

Outstanding Stock as of:[1]	Ceiling (In billions of baht)			
	Second Review		Third Review	
End-March 1998	-115	(performance criterion)[2]	-144	(actual)
End-June 1998	31	(performance criterion)	-17	(performance criterion)
End-September 1998	51	(indicative)	-2	(performance criterion)
End-December 1998	...		30-37	(indicative)[3]

[1]Calculated as the average of the closing positions on the last five working days of the month and the first five working days of the following month.
[2]Adjusted for the factors noted below.
[3]Performance criterion to be set at future review of the arrangement within this range.

The NDA of the BOT are defined as the difference between reserve money and the net foreign assets of the BOT (NFA) valued in Thai baht. Reserve money consists of currency in circulation (with banks and with the rest of the public), and financial institutions' deposits at the BOT, and reserve eligible securities if any. The NFA are the net claims of the BOT on nonresidents, in all currency denominations. For the purposes of program monitoring, the baht value of NFA of the BOT will be calculated using the exchange rates given in Annex D.

The following adjustments will apply:

- The NDA limit is based on a baseline path of NFA that includes projected reserve losses on forwards and swaps and spot intervention consistent with the balance of payments projections (Annex D). The NDA ceiling will be adjusted downwards to the extent that NFA exceeds the baseline projection for any reason. The NDA ceiling will not be adjusted upwards for any shortfall in NFA relative to its baseline.

- Changes in reserve regulations will modify the NDA ceiling according to the formula:

$$\Delta NDA = \Delta r \cdot B_0 + r_0 \cdot \Delta B + \Delta r \cdot \Delta B$$

where r_0 denotes the reserve requirement ratio prior to any change; B_0 denotes the reservable base in the period prior to any change; Δr is the change in the reserve requirement ratio; and ΔB denotes the immediate change in the reservable base as a result of changes in its definition.

2. Indicative Targets for Reserve Money

Outstanding Stock as of:[1]	Indicative Limit (In billions of baht) Second Review	Third Review
End-March 1998	480	451 (actual)
End-June 1998	464	468
End-September 1998	469	471
End-December 1998	...	505-512[2]

[1]Calculated as the average of the closing positions on the last five working days of the month, and the first five working days of the following month. The average stock of reserve money during the first quarter was about B 460 billion.
[2]Indicative limit to be set within this range at the next review of the arrangement.

The indicative target on reserve money will be adjusted for changes in reserve regulations in line with the adjustment generated to the NDA limits.

FISCAL TARGETS

The definitions of all performance criteria and indicative targets are unchanged from the Second Review. For purposes of monitoring compliance with performance criteria, payments or financing arrangements with respect to capitalization of the proposed Asset Management Company, the Financial Restructuring Agency, the Radhanasin Bank, and any capitalization of financial institutions undertaken by the government will be effectively excluded as indicated below.

1. Performance Criterion on the Cumulative Balance of the Central Government

	Floor (In billions of baht)	
	Second Review	Third Review
Cumulative balance from September 30, 1997 to:		
December 31, 1997	-27 (actual)	-27 (actual)
March 31, 1998	-62 (performance criterion)	-27 (actual)
June 30, 1998	-47 (performance criterion)	-70 (performance criterion)
September 30, 1998	-50 (indicative)[1]	-117 (performance criterion)[2]

[1]Performance criterion to be set at the time of future reviews of the arrangement.
[2]Of this increase, about B 28 billion reflects possible rephasing of foreign financing.

The above floors on the cash balance of the central government are defined as in the treasury accounts, excluding amortization.[1] Receipts from privatization will be excluded from the calculation of the central government balance in the above performance criterion. Likewise, spending on financial sector restructuring, as defined above, is excluded. Interest payments arising from the fiscalization of FIDF obligations are also excluded.

[1]"Treasury accounts" data are being used for monitoring purposes, on account of their greater timeliness. These accounts exclude all spending from foreign-financed projects, and also net off amortization payments. Expenditures arising from foreign-financed projects are, however, captured in GFS accounts, which are the basis for the program's target. (Thus, the performance criteria do not fully capture total government spending, although an allowance has been made for projected foreign-financed expenditure.) The cash deficit equals revenue minus expenditure plus the balance of the "nonbudgetary accounts" (120 revolving funds).

2. Performance Criterion on Banking System Net Credit to the Public Sector

	Limit (In billions of baht)	
	Second Review	Third Review
December 31, 1997	-380 (actual)	-380 (actual)
March 31, 1998	-328 (performance criterion)[1]	-360 (estimate)
June 30, 1998	-350 (performance criterion)	-314 (performance criterion)
September 30, 1998	-346 (indicative)	-277 (performance criterion)

[1]Adjusted by the excess BOP support channeled to the government relative to the program baseline (Annex D) evaluated at the actual exchange rate.

The banking system is defined as the BOT plus the commercial banks. The public sector is defined as the central government, extrabudgetary funds, local government, and the nonfinancial public enterprises. Accordingly, net credit to the public sector is defined as the difference between banking system claims on the public sector minus the latter's deposits with the banking system, as reported in the M2 monetary survey.[2]

The following adjustments will be made:

- The limit will be lowered by the excess of BOP support channeled to the government relative to the program baseline (Annex D).
- The limit will be raised by the amount of bonds and other government obligations, if any, held as a result of bank recapitalization or from fiscalizing FIDF operations.

[2]In the monetary survey, net credit to extrabudgetary funds is included within "net credit to government," while net credit to local governments is included in "net credit to nonfinancial public enterprises."

3. Indicative Targets on Central Government Expenditure

Central government expenditure is as reported in the treasury accounts, and excludes amortization. The following indicative limits, **cumulative from the start of the fiscal year,** will apply:

	Indicative Limit (In billions of baht)	
	Second Review	Third Review
October 31, 1997	65 (actual)	65 (actual)
November 30, 1997	133 (actual)	133 (actual)
December 31, 1997	203 (actual)	203 (actual)
January 31, 1998	264	263 (actual)
February 28, 1998	331	326 (actual)
March 31, 1998	407	394 (actual)
April 30, 1998	469	469
May 31, 1998	534	534
June 30, 1998	605	620
July 31, 1998	671	689
August 31, 1998	744	768
September 30, 1998	835	872

The indicative limit will be raised by the amount of payments made in connection with financial sector restructuring, as defined above, and by the amount of interest payable on bonds issued for the purpose of fiscalizing FIDF debt.

EXTERNAL SECTOR TARGETS

The definitions of all performance criteria and indicative targets are unchanged from the Second Review program.

1. Performance Criterion on Net International Reserves of the BOT

	Floor (In millions of U.S. dollars)			
	Second Review		Third Review	
Stock as of July 31, 1997	1,144	(actual)		
Cumulative change from level on July 31, 1997				
End-December 1997	5,954	(actual)[1]		
End-March 1998	3,900	(performance criterion)	8,592	(actual)
End-June 1998	5,500	(performance criterion)	8,800	(performance criterion)
End-September 1998	7,200	(indicative)	10,500	(performance criterion)
End-December 1998	...		12,500	(indicative)[2]

[1] Revised up from $5,761.
[2] Performance criterion to be set at future reviews of the arrangement.

For monitoring purposes, the Fund defines NIR of the BOT as the sum of the U.S. dollar value of: (i) gross official reserves in foreign currencies minus gross liabilities in foreign currencies; and (ii) the net forward position of the BOT, defined as the difference between the face value of foreign currency denominated BOT off-balance sheet (forwards, swaps, options, and any futures markets contracts) claims on nonresidents and foreign currency obligations to both residents and nonresidents.

Gross foreign assets will include all foreign currency-denominated claims of the BOT, including monetary gold, holdings of SDR, and the reserve position in the IMF. Excluded from gross foreign assets will be participation in international financial institutions, as well as holdings of nonconvertible currencies, holdings of precious metals other than gold, and claims on residents. Gross foreign liabilities are all foreign currency denominated liabilities of contracted maturity up to one year plus the use of Fund credit. (Short-term liabilities that are part of the balance of payments financing package under the program are excluded.) All assets and liabilities will be valued using the exchange rates and gold price shown in Annex D.

2. Performance Criterion on Contracting or Guaranteeing of New External Debt

The limit applies to the contracting or guaranteeing by the public sector (as defined in Annex B, Section 2) of new nonconcessional external debt with an original maturity of more than one year, which is defined as loans containing a grant element of less than 35 percent on the basis of currency-specific discount rates based on the OECD commercial interest reference rates. Excluded from the limits are credits extended by the IMF and from the balance of payments financing package envisaged under the program, including from IBRD and AsDB, and countries in the region. Debt falling within the limit shall be valued in U.S. dollars at the exchange rate prevailing at the time the contract is entered into, or guarantee is issued. Information on the contracting and guaranteeing of new debt falling both inside and outside the limit will be reported monthly to the Fund.

	Limit (In millions of U.S. dollars)	
	Second Review	Third Review
Cumulative from August 10, 1997		
End-December 1997	865 (actual)	
End-March 1998	7,500 (performance criterion)	1,488 (actual)
End-June 1998	8,000 (performance criterion)	8,000 (performance criterion)
End-September 1998	9,000 (performance criterion)	9,000 (performance criterion)
End-December 1998	...	9,000 (indicative)[1]

[1]Performance criterion to be set at future revisions of the arrangement.

3. Performance Criterion on the Stock of Short-Term Debt Outstanding

The public sector will not contract or guarantee any new debt of maturity up to one year. Excluded from these limits are guarantees associated with the financial system restructuring, the balance of payments financing package envisaged under the program, normal import-related credits, forward contracts, swaps, and other future market contracts.

PROGRAM ASSUMPTIONS AND CONVERSION RATES

1. Program Baselines for Selected Variables

	1998		
	June	September	December
	(In billions of baht)		
Baseline NFA of the BOT			
Second Review	433	418	...
Third Review	485	474	474
	(In billions of U.S. dollars)		
BOP support provided to central government (cumulative from August 1997)			
Second Review	1.3	1.8	...
Third Review	1.0	1.4	1.6

2. Exchange Rates and Gold Price to be Used Under the Program[1]

	Baht per Unit of Foreign Currency
U.S. dollar	31.9982
Japanese yen	0.2710
Deutsche mark	17.4265
Pound sterling	52.3476
French franc	5.1723
Swiss franc	21.1404
SDR	43.4734
ECU	34.2957
Gold price (U.S. dollars per ounce)	326.3000

[1]Currencies not shown here will first be converted into U.S. dollars using the official rate used by Fund's Treasurer's Department on July 31, 1997.

To: Distribution

Room: ____________ Date: 5/27/98

Department of the Treasury
Office of the Assistant Secretary for International Affairs
Office of East Asian Nations

Subject: Korea's LOI and Treasury Concerns

1. Korea's IMF Board Review to receive its $1.9 billion tranche is scheduled to be held May 29, 1998. Of particular note: The IMF's most recent table of 'Financing Requirements' for Korea does not incorporate any bilateral creditor (aka second-line) support.

2. Attached is a list of Treasury concerns regarding Korea's most recent Letter of Intent. The list reflects input from a broad range of Treasury personnel/offices.

3. Overall the LOI appears solid, however, we have raised a number of specific issues, including:

   - monetary policy flexibility
   - sufficiency of social safety net
   - financial sector restructuring measures
   - corporate sector restructuring measures
   - trade liberalization measures
   - rescue lending

4. We propose requesting a supplemental Staff paper on rescue lending given Korea's current efforts to recapitalize and restructure the financial sector.

JKS

Jason K. Singer
Korea Desk
Tel: 622-1727

Attachment: Treasury Concerns with Korea's LOI, Korea's LOI, Draft Board Statement per Todd Schneider

Distribution: TGeithner, DZelikow, CAtkinson, MLundsager, TCrawford, BMurden, WWarthin, JLister, SShah, CLowery, TRutledge, CDumler, TSchneider

Korea's New LOI and Treasury Concerns

The Board meeting is tentatively scheduled for May 29, 1998. Korea has met its performance criteria for end-March and therefore qualifies to receive the next tranche of IMF funds. However, we remain concerned about Korea's momentum on financial and corporate sector restructuring, and raise below a number of concerns with Korea's most recent letter of intent. Most troubling is the issue of 'rescue lending' and guarantees from commercial banks and government policy banks such as KDB to over leveraged conglomerates. We believe that we should request that Fund staff prepare a supplement to the review on this topic, including data and information on conditionality associated with such lending and on how rescue loans impact Korea's broader goals of maintaining market confidence, recapitalizing the financial system, and restoring a framework for economic growth.

LOI Stated Objectives

- Sustain the restoration of confidence and consolidate the progress made in resolving the external financing crisis;
- Minimize disruptions to the real economy and support economic recovery in the latter half of the year; and
- Restructure the financial and corporate sector to minimize the risks of future crisis and lay the foundation for resumed growth.

Macro Projections/Reserves

Macro targets are negotiated and, as such, may not reflect Fund's true outlook. Real GDP growth projection of -1% seems a bit optimistic (IIF predicts -5%). The current account surplus of \$21 - \$23 billion (about 7% GDP) seems reasonable.

Second Line of Defense

The LOI makes no specific mention of second-line funds, however, within the IMF's "Financing Requirements" table **there is no allocation for support from official bilateral creditors in 1998**. It would appear that the IMF's calculations do not incorporate any second-line funds.

WB/ADB

The IMF's 'Financing Requirements' table calls for the World Bank and Asian Development Bank to disburse \$2.0 billion and \$0.7 billion respectively.

Market Borrowing by Government

The amount of foreign financing to be raised in 1998 by the ROKG in the market has been raised from \$7 billion to \$9 billion. This breaks down into the \$4 billion already raised plus an expected \$5 billion to be raised in Q4 1998.

Monetary/Exchange Rate Policy

Still allows for call interest rates to be lowered in line with market conditions "...subject to the objective of maintaining stability in the foreign exchange market." One would hope that the term 'market conditions' includes broader Asian context, i.e. contagion from Indonesia, yen movement, etc.

BOK Foreign Exchange Window
The window was scheduled to be closed on May 15, 1998. By June 30, 1998 the BOK will agree with domestic banks on a schedule of repayment of emergency support with all repayment due by end-June 1999. Upon agreement of payment schedules, penalty interest rates on amount of emergency support outstanding will be reduced to a uniform 400 bps above LIBOR. Any overdue amounts will be subject to LIBOR + 800 bps.

Fiscal Policy
With macro projections changed, fiscal deficit allowance raised from 1.2% GDP to 1.75% GDP.

Social Safety Net
The social safety net has been expanded both monetarily and in scope to include firms with more than 5 employees. However, there would appear to be room to further expand the social safety net, in light of the sharp and rapid increase in unemployment even prior to expected widespread layoffs by large chaebols. In addition, much of the unemployment is from 'mom & pop' operations with less than 5 employees, leaving this group without a net.

Financial Sector Restructuring
The plan for the undercapitalized commercial banks seems to be sound and has a short enough fuse to get restructuring going. The questions are what happens if the banks' plans are unacceptable and the ROKG doesn't want to close them, and what the timeframe is for the FSC to act if the plan(s) are not accepted. One questionable point is the 1.5 trillion won recapitalization of Industrial Bank of Korea. The IMF rep says this is aimed at freeing up funds to lend to SME's, since IBK was set up as the lender to SME's. It's not clear, however, where the funds are coming from, whether the existing shareholders' equity will be written down, as in the case of Korea First and Seoul Bank, and whether there will be an eventual privatization of the government's funds.

The "use of public funds for bank restructuring" is an area of concern. Although this issue is mentioned, we would like to see it expanded. In an IMB document relating to Japan endorsed by Summers, Greenspan and others and given to Clinton, we stated that public support to banks should be only in exceptional circumstances and subject to strict conditionality. The LOI conditions should be improved to further limit moral hazard. Such elements could include:

- ensure government injections are in the form of preferred stock or instruments convertible to preferred stock
- include conditionalities such as change in management and directors, dilution of shareholders' equity, bank restructuring measures (staff reductions, dividend cuts, etc.)
- write-down of bad assets, in case of capital injections
- government purchase of bad assets at estimated market value.

There are a number of additional questions regarding financial sector restructuring:

- The LOI is unclear on the limit of 25% on lending to an individual borrower. This is likely 25% of capital, but it could be 25% of loans. Either way, 25% seems high; the U.S. uses 15% of capital, with rules on combining borrowers. Can go up to 25% with only certain collateral.)

- What is the effect of requiring capital against trust accounts? This could increase the need for more capital, however we agree with the statement.

- Why only requiring 8% capital for merchant banks? They are more risky and should have higher requirements. The LOI does state that merchant banks will be required to move towards higher requirements.

We are also very concerned with how 'rescue lending' is affecting banks' balance sheets and the implications for successful financial sector recapitalization.

Corporate Sector Restructuring

On corporate restructuring, there are two principles that aim to avoid government direction of restructuring efforts and injections of public funds for corporate restructuring. At the same time, the LOI urges the government to encourage banks to set up private creditor committees with outside participation to exchange information and discuss restructuring modalities. This appears to be a worthwhile step in pushing forward the banks' own efforts and getting some outside expertise that will hopefully be transferred to the banks, however, it is important that the government not be involved enough to provide the appearance of directing or influencing the restructuring process. It is not clear how KDB guarantees fit with this principle.

In order to encourage investment and M&A activity, the LOI requires the ROKG to eliminate the ceiling on foreign acquisition of stock without Board approval. Legislation must be submitted by June 30, 1998. This is a useful step toward hostile takeovers that might cause some firms to take a quicker and closer look at their own restructuring plans so as not to lose management control.

The three disclosure and monitoring requirements aim at improving regulators' and commercial banks' ability to assess credit risk and workout capabilities of corporate borrowers. These are useful steps, which are required to be completed by June 30, and so should be timely enough to contribute to accelerating the restructuring process.

Aside from strengthening disclosure requirements, not much is aimed directly at the corporations themselves, but the onus is being placed on their lenders to force the restructuring process. Lenders are supposed to separate viable from non-viable firms and subsequently cease lending to the non-viable group. Given the IMF's mandate, this seems to be appropriate. The combination of pressure from their banks and fear of hostile takeovers by foreign investors may provide enough incentive to the firms to move more quickly.

Specialized and Development Banks
The LOI calls for "specialized banks" such as IBK, KDB, etc. to 'sign contracts for diagnostic reviews' by November 15, 1998. It's questionable why there is a delay of several months for these banks to begin reviews.

The FSC is not required to begin supervising and regulating prudential aspects of all specialized and development banks until June 30, 1998. However, the LOI allows until November 15, 1998 for regulations to be issued extending prudential regulations applied to commercial banks to be applied to specialized and development banks. This seems somewhat at odds, i.e. supervising the banks without having extended prudential regulations or conducting diagnostic reviews.

Consolidated Supervision
Extension of supervisory arrangements to NBFIs is not required until January 1, 1999. Recommend accelerating extension.

Trade Liberalization
In general, the ROKG has managed to implement a successful series of trade liberalization efforts, opening up their economy to foreign investment. The positive steps include:

* eliminating import bans,
* removing investment limits on foreign ownership of firms,
* eliminating tax subsidies for export market development, and
* offering specific details on Korea's plan to improve the transparency and accountability of the financial operations of Korea's corporations.

Two areas of concern are:

* Korea committed to reducing from 62 to 38 the number of items subject to tariff adjustment. However, 22 items, including batteries, have been transferred back to the general tariff schedule with no reduction in the tariff rate.

* Korea has delayed revising import certification procedures.

Rescue/Policy/Directed Lending

Although the LOI makes no specific mention of rescue lending, we are highly concerned with the actual and anecdotal evidence of 'rescue loans' extended by commercial banks to large corporations. The Article IV notes that during the first quarter of 1998 such rescue loans amounted to some 1.1 trillion *won*, compared with total new lending of 7.2 trillion *won* by the banks during that period. Particularly troubling is the report that some of these loans were extended at below-market interest rates. The Staff report notes that these loans are reportedly being made by banks independent of any government intervention, however, we believe, and also sense that the market believes, the government authorities retain an important role in bank lending operations both formally, through the Financial Supervisory Committee and related offices, and informally through relations with bank and *chaebol* management.

To cite some recent, well-publicized examples that demonstrate our concerns:

- Creditors of Korea's Keopyung Steel Chemical Co and its two sister firms agreed to extend by one year the maturity on loans owed by the three firms.

- In the case of rescue loan bailout of Dong Ah Group, Lee Hun-jai, the Chairman of the Korea's newly-established Financial Supervisory Commission, defended creditor banks' extension of some 600 billion *won* in emergency loans, and their agreement to rollover existing loans. Harkening back to the 'too big to fail' mentality of the past, Lee commented, "If you take the worst case, (it) may cause the total collapse of the financial system... We have to weigh the social costs of a bankruptcy."

- Of note, Dong Ah's main creditor is SeoulBank, which was taken over by the government earlier this year. A domestic news article noted that "Initially, creditor banks were opposed to providing further assistance. But the decision was overturned almost overnight following a decision by the state-run Korea Development Bank to provide Dong-Ah with a payment guarantee for the introduction of foreign capital."

- MOFE Minister Lee, quoted in an interview with a domestic newspaper, commented, "Non-viable industrial groups will be immediately let go starting in June." While the line could be quoted out of context, the Bloomberg article comments, "The remarks...contradict recent government pledges not to interfere in bank lending policies."

- The *Korea Economic Daily,* citing creditor banks, reports that Asia Motors Co, the truck-making subsidiary of the Kia Group, will receive 120 billion *won* ($85.7 million) in emergency loans from creditor banks. State-owned Korea Development Bank and other creditors reportedly decided to offer 50 billion *won* early next month as an initial portion of the loan.

While rescue lending may not constitute 'directed lending' and may therefore not be a strictly-defined violation of Korea's program, we believe that rescue lending may be detrimental to fulfilling the goals of Korea's program and is in fact jeopardizing market confidence in Korea's ability and willingness to fulfill its commitments.

With this in mind, we could ask IMF staff to prepare a supplement to the review on the rescue lending issue, including specific loans, dates, amounts, and the impact of rescue lending on Korea's goals to restructure its financial and corporate sectors.

Withdrawal/Redaction Marker
Clinton Library

DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
002. memo	Acting Secretary (IMF) to Members of Executive Board re: Republic of Korea - Second Quarterly Review Under Stand-By Arrangement - Letter of Intent (1 page)	05/04/98	P1/b(1) (C)

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COLLECTION:

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FOLDER TITLE:

[History of the Department of the Treasury - Supplementary Documents] [8]

jp37

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)]

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b(7) Release would disclose information compiled for law enforcement purposes [(b)(7) of the FOIA]
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b(9) Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

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DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
003. letter	Chol-Hwan Chon & Kyu-sung Lee to Michel Camdessus re: Letter of Intent - South Korea (2 pages)	05/02/98	P1/b(1) (C)

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DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
004. memo	re: Updated Memorandum on Economic Program for Second Quarterly Review, 1998 (19 pages)	circa May 1998	P1/b(1) (C)

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DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
005. memo	Todd Scneider (IMF) to Jason Singer re: Korea - Round II (1 page)	05/27/98	P1/b(1) Unclass.

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DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
006. report	re: Republic of Korea - 1998 Article IV Consultation & Second Quarterly Review Under Stand-By Arrangement (IMF document) (5 pages)	05/27/98	P1/b(1) Unclass.

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TRADE

95-141644

UNDER SECRETARY

DEPARTMENT OF THE TREASURY
WASHINGTON, D. C.

January 18, 1995

INFORMATION

MEMORANDUM FOR SECRETARY RUBIN

FROM: Lawrence H. Summers
Under Secretary, International Affairs

SUBJECT: Potential U.S. Trade Retaliation Actions Against China and the EU

SUMMARY:

USTR has initiated the process of imposing trade restrictions on imports from **China**, for exploitation of our intellectual property, and **the EU**, in retaliation for their restrictions on U.S. distributors of bananas. It is possible that these trade sanctions might be avoided if further negotiations succeed. However, I bring this issue to your attention at this time because of the trade volumes involved and the importance of these two trading partners.

China IPR:

Despite months of intense negotiations with China on improving its intellectual property rights regime, little tangible progress has been made. Although China has taken some recent steps toward improving its protection of foreign intellectual property rights, it is not clear that these steps will inhibit the proliferation of piracy activities. Thus, retaliation appears to be justified under section 301 of the Trade Act of 1974, under which USTR has already determined China's actions "unfair". Negotiations are scheduled to resume on January 18. If we are not satisfied at the end of this final round of negotiations, we will initiate retaliation.

Estimated costs to U.S. companies from piracy activity in China exceed $1 billion annually. USTR has already published a list of items for possible retaliation amounting to $2.8 billion in annual U.S. imports from China. The retaliation list will be narrowed, based on public comments received over the next 30 days, to approximately $1 billion worth of trade. This represents approximately 3.2 percent of U.S. imports of goods from China in 1993.

At this time, no effective date for retaliation has been set. Moreover, because the type of trade sanctions to be applied (i.e., prohibitive tariffs vs. a certain percentage-level tariff) and the particular goods have not yet been decided, the potential inflationary impact of these sanctions is not known. However, dislocation to the U.S. economy should be limited because imports

EXECUTIVE SECRETARIAT

from countries other than China would not be affected. Trade retaliation on our part has the potential, though, to lead to counter-retaliation and to chill overall relations with China.

Bananas: Effective January 1995, the EU instituted a complex set of import licensing requirements that reduces their imports of bananas from this hemisphere in favor of those from former colonies. On top of this, bananas produced by U.S. affiliates (Chiquita) in the hemisphere are receiving less favorable treatment in obtaining licenses.

USTR has determined under section 301 that the EU banana import policy unfairly restricts U.S. banana distributors. USTR will publish a request for comments on possible retaliation this week. Action might be taken as early as February, but further delay would be permitted under our laws.

The final retaliation figure has not yet been determined. Preliminary interagency estimates are approximately $180 million, while industry representatives are arguing irreparable damage, possible bankruptcy, and claiming damages as high as $1.1 billion. The U.S. will examine imports of both goods and services for potential trade action, but it will be difficult to find an action that provides good leverage without violating our WTO obligations. Total U.S. imports of goods and services from the EU were $97.9 billion and $39.8 billion, respectively, in 1993.

TREASURY CLEARANCE SHEET

NO.____________

Date ___January 5, 1995___

MEMORANDUM FOR: SECRETARY ☐ DEPUTY SECRETARY ☐ EXECUTIVE SECRETARY

☐ ACTION ☐ BRIEFING ☐ INFORMATION ☐ LEGISLATION
☐ PRESS RELEASE ☐ PUBLICATION ☐ REGULATION ☐ SPEECH

FROM: Under Secretary Summers
SUBJECT: Potential U.S. Trade Retaliation Actions

REVIEW OFFICES (Check when office clears)

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

☐ Under Secretary (International)
- ☐ 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	TEL. NO.
INITIATOR(S)				
J.MacLaughlin	JM	1-9-95	ITT	622-1723
M.Wileden	MW	1-9-95	ITT	622-1536
REVIEWERS			GC	622-0287
E.Knight				
J.Shafer	JCS	1-12-95	IA	622-0060

SPECIAL INSTRUCTIONS

☐ Review Officer ______________ Date ______________ ☐ Executive Secretary Date

DO F 80-02.1 (04/89)

1999-SE-000083

- 12/28/98
- original memo to President from Gene Sperling et al prepared by WH
- RER's comments drafted by Meg L. and cleared by LS per NCC and revised per RER by NC. NC sent comments to WH.

- RER/MKA memo prepared by Mike Froman and Meg Lundsager
- NCC to RER (signature)
- RER ~~signed~~ ok to Autopen
- Osie Autopenned and delivered to State/WH
- NCC cc to RER

- Please log and file

THE WHITE HOUSE

WASHINGTON

December 29, 1998

MEMORANDUM FOR THE PRESIDENT

FROM: **Gene Sperling**
Samuel Berger
Larry Stein

SUBJECT: **Additional Options for Providing Relief to the Steel Industry**

Purpose:

To consider additional steel options for possible inclusion in the January 5 report to Congress.

Overall Trade Context

Despite our best efforts to bring members of your international economic team together on this issue, there continues to be a deep division of opinions. To ensure that we reflect this division accurately, we have made certain that each member of the economic team has had an opportunity to read and comment on this memorandum.

As you know, there are several highly consequential decisions on the trade agenda for the next year, such as whether and how to pursue fast track and whether to launch a WTO Round. Because there is a report on steel due to Congress on January 5, the most immediate of these decisions is whether to take any additional actions to provide relief to the steel industry. Nonetheless, any decisions on steel must be made in the context of your broader trade agenda and overall goals on the international economy.

As you know from our discussions, there are several competing policy goals at stake. All of your economic advisers want to be responsive to the legitimate concerns of steel workers and the steel industry. All of your advisers are committed to sustaining your strong record on open markets, which has been a central tenet of your economic philosophy. All are acutely concerned that at this fragile moment in international markets, U.S. leadership can make the difference between a robust recovery with a continued commitment to open internationalism and the kind of vicious cycle of protection and depression that characterized the 1930s.

All of your advisors want the least-protectionist outcome. However, there are differences among your advisers as to whether to take action beyond the antidumping cases already underway and, if so, what actions. Some believe that if you are not willing to take exceptional action to address this high-profile case of trade disruption, the Congressional counter reaction will be far more damaging, rolling back your trade accomplishments and dooming further market opening. They are concerned that this will undermine any domestic support for the 1999 WTO ministerial and make fast track virtually impossible. Others feel that extraordinary aid to the steel industry, beyond what is available under current U.S. trade laws, would fundamentally compromise your record on open markets and could be the first shot in an accelerating protectionist spiral both in the United States and abroad, similar to Smoot-Hawley and the competitive devaluations of the 1930s, that would ultimately damage the U.S. economy. Asia is currently in the throes of the worst financial crisis in 50 years. Asian economies must export in order to achieve recovery; that is why this Administration has pressed Japan to promote domestic demand-led growth and open its market. A trend towards protectionism in the United States would only encourage other major importing nations to follow our lead, delaying or reversing recovery around the world.

<u>Recent Activity Concerning the Steel Industry</u>

As outlined in our December 10 memorandum, the Administration has taken several steps to address alleged unfair trade practices in the steel industry, including forceful actions to enforce our trade laws, expedite the dumping investigations, and exert bilateral pressure. Commerce has engaged Russia on its request for a suspension agreement to explore whether this mechanism could provide effective, timely relief. These actions very well could begin yielding significant relief soon, although hot-rolled sheet imports from Japan and Russia continued to increase rapidly in November.

In addition, the Japanese have told us their steel exports to the U.S. will fall to 1997 levels or less starting late this year and the Russians have told us that they will agree to zero exports to the U.S. for some months as part of a negotiated settlement on the hot-rolled sheet dumping case. However, our data provide no evidence of this yet; as noted above, steel imports from Japan and Russia in November -- particularly hot-rolled sheet imports -- show a continued rapid rise.

Steel unions, industry and the Steel Caucus appreciate the forceful statements you made during your trip to Asia, and acknowledge the steps taken by Secretary Daley on the dumping cases, including the critical circumstances finding. Nevertheless, they are concerned the dumping cases will take too long and will fail to provide comprehensive, global relief. Further, industry has expressed opposition to a suspension agreement with Russia, on the grounds that it would not provide relief commensurate with a successful dumping determination; the union supports such an agreement, but only if it leads to comprehensive relief for all products from Russia. The steel industry, the steel workers, Senator Rockefeller and other members of the Steel Caucus support additional, immediate action to stem the rise in steel imports. It is worth noting that we are likely to face a trade bill from Senate Finance or House Ways and Means this year that will contain over 20 possible amendments to our trade statutes that have been crafted by the steel industry's lawyers, all of which will present enormous difficulties for us.

On the other hand, there is significant concern that actions to limit steel imports would raise domestic steel prices and undermine the competitiveness of domestic steel-using industries, which are economically more significant than the domestic steel industry. You have received letters opposing steel protection from Caterpillar and a broad coalition of interests including El Paso Energy Corporation, Enron Corporation, Michelin, the American Institute for International Steel, the Association of International Automobile Manufacturers, Consumers for World Trade, the Domestic Petroleum Council, the International Association of Drilling Contractors, the Precision Metalforming Association and the Steel Service Center Institute, who stress that more jobs are at stake among steel-users than steel-makers. We expect that 20-30 major U.S. CEOs will send you a letter shortly on trade priorities, which will ask you to resist domestic pressures to close the U.S. market and recommend a global standstill on restrictive trade measures.

Issues for Decision

The threshold decision is whether to do anything beyond current or future cases filed by industry. The adverse consequences of such additional action are described above and in the balance of this memo, as are the arguments supporting additional action. Below we outline several possible measures for your consideration. Although the focus of the industry, union and Steel Caucus has been almost exclusively on trade policy options, we also include options on tax relief and adjustment assistance that could provide significant relief to the steel industry without sending troubling protectionist signals.

Background on Section 201 Safeguards Law: The first two options involve Section 201 of the Tariff Act of 1974, which provides relief for industries injured by a surge of imports regardless of whether there is any unfair practice contributing to the rise. Section 201 investigations can be initiated by the industry or "self-initiated" by the President, the House Ways and Means Committee, or the Senate Finance Committee. Under 201, an affirmative finding of injury or threat thereof by the International Trade Commission (ITC) provides the President with considerable discretion and flexibility to implement a comprehensive, global remedy that can include quantitative restraints. An affirmative finding provides discretion to impose provisional relief, with a preference for use of tariffs, for up to 200 days as soon as three months after filing, and longer-term relief, including quotas, within eight months of filing for as long as three years without compensation to exporting nations. The relief can cover a broad range of remedies, is time-limited, must be liberalized over time -- in contrast to antidumping remedies -- and permits some differentiation among exporting countries.

Precedent for 201: There have been 67 investigations under Section 201, resulting in 35 affirmative injury findings and relief in 20 cases. Steel and steel-related products have been heavily represented, accounting for eight investigations, resulting in six affirmative injury findings and relief in four cases. Overall, the Executive Branch has requested Section 201 investigations for only three industries: apple juice in 1985, steel in 1983, and canned mushrooms in the late 1970's. This Administration self-initiated an investigation on honey in 1995 under a related statute -- section 406 -- which covers safeguards for non-market economies. The House Ways and Means and Senate Finance Committees have requested investigations twice.

1. Conditional Commitment to Self-Initiate a Section 201 Case

Steel company representatives, Senator Rockefeller, and the steel union are pushing for a conditional commitment from the Administration now that we would be prepared to self-initiate a Section 201 case in the future, and ask that it be expedited if and when the industry was confident enough in the data that they wanted us to bring a case. As you will see in the recommendation section, some of your advisors support conditional self-initiation (if and when the data support a case) as well as other industry requests such as expedited procedures and protecting existing steel-dumping orders. However, you should know that, in addition to self-initiation, the industry also has requests that all of your advisors would be opposed to, such as committing in advance to providing specific relief in the case of an affirmative finding. Senator Rockefeller has already indicated his support for initiation of a steel 201 case by the Senate Finance Committee.

- Pros: Proponents argue 201 self-initiation would permit the Administration to take forceful action that could lead directly to clear, understandable relief while avoiding excessive protectionism, since it would fall within existing statutory authorities and there are clear precedents. Moreover, Section 201 was designed precisely to cushion a domestic industry from a temporary surge in imports resulting from unanticipated forces in the global economy (rather than a long-term shift in America's competitiveness or domestic practices). Further, Section 201 provides more effective relief than antidumping because it allows the President to impose global remedies involving all exporting countries and a host of related products. In contrast, the antidumping laws provide relief on a piecemeal basis, specific to particular exporting countries and product categories, so that imports from other countries or related products often rush to fill the gap (data for November show this is already happening). Further, Section 201 can be less protectionist than anti-dumping since relief must be liberalized over time and end after three years. Finally, because 201 provides for a formal proceeding in which opposing domestic interests register their concerns, it provides cover to fashion a more balanced remedy.

- Cons: Some are concerned that such a strong executive initiative could be the type of action that many of your advisors worry could lead to a protectionist spiral in this highly sensitive time. Shifting emphasis away from unfair trade laws to safeguards could encourage others to follow suit, closing markets and choking recovery. Second, there is considerable concern about making an open-ended commitment now since there is doubt whether the industry can meet the injury standard for relief at this juncture, since most steel companies are expected to be profitable for 1998 overall and will show industry-wide losses only in the fourth quarter, and the ITC normally examines profitability over a five-year period. If and when data indicate injury, the steel industry has resources and know-how to file 201 action itself. (The earliest we will be able to judge this is when fourth-quarter data become available in late January.) Third, this commitment would set a dangerous precedent, inviting other domestic industries to request similar protection and drawing us down a slippery slope; in fact, even supporters believe we should take this step only if we are prepared to draw the line and say no to similarly situated industries in the future, a difficult line to hold. Fourth, a positive 201 finding would put you in the difficult position of choosing between the competing interests of domestic steel producers and steel-consuming industries. Finally, steel protection could be very costly to U.S. economy.

2. Easing Injury Standard for Safeguards Law (Section 201)

The steel industry, steel workers, and the Steel Caucus believe that the current legal standard for injury under 201 is too high to allow effective relief and seek Administration support for legislation easing the standard. Under current U.S. law, increased imports must be a "substantial cause of serious injury, or threat thereof," where imports must be an important cause and not less important than any other cause. USTR proposes to loosen the standard to ensure that the U.S. injury standard is no more stringent than that required by the WTO. The WTO injury standard requires simply that increased imports "cause or threaten to cause serious injury." It is worth noting that some of your advisers are willing to support this legislative change only as part of a bid for fast track or other market-opening legislation because this would send a more balanced signal to our trade partners and could be useful in securing broad Congressional support, while others disagree that connecting this to market-opening legislation would in any way mitigate the protectionist signal.

- Pros: Proponents believe this option will mitigate calls for the Administration to take industry-specific protectionist action because by making 201 cases more attractive it channels industry pressure toward availing themselves of remedies under the trade laws. The proposed change would use the flexibility permitted under current WTO guidelines to make 201 more accessible and effective -- consistent with the Administration's position that American workers should have effective, accessible tools to adjust to the forces of globalization. Further, some argue this change remedies an existing asymmetry that favors antidumping relief over safeguards relief because the antidumping injury standard is lower, and, as noted above, 201 remedies can be less protectionist than anti-dumping. As also noted above, 201 provides cover to fashion a balanced remedy because domestic opponents formally register their concerns.

- Cons: Opponents are concerned this action could send a dangerous protectionist signal because it goes beyond the framework of existing trade laws and would lower the injury standard for all industries for all time, in response to pressure coming in a single sector at a single point in time. Further, because this action in and of itself does nothing directly to afford relief to the steel industry, it is likely to be pocketed and may do little to stem calls for additional immediate action. Third, encouraging greater use of 201 will increase the burden on you of choosing between domestic interests in deciding appropriate relief in safeguard cases, in contrast to the antidumping laws, where remedy decisions are made by the Commerce Department and the ITC (although, as noted above, there is disagreement on this point). Finally, the proposed bill could become the vehicle for additional, more protectionist legislation (such as proposals for changes to our dumping laws), which the industry's lawyers are already shopping around.

3. Steel Import Licensing and Early Data Release

The steel industry has asked the Administration to institute an import licensing system for steel in order to obtain data for their trade cases on a more timely basis than the current 45-day lag. However, instituting a licensing system would require legislation. An alternative method to obtain early data release would be to ask Census to release import data for all industries as soon as they become available -- which is approximately a three-week lag. Although this approach would not require legislation, Census is opposed because it would entail releasing import data roughly three weeks in advance of export data.

- Pros: Proponents argue that instituting a steel import licensing system would be relatively benign, since it would be fully consistent with the WTO rules and would assist the industry in availing itself of remedies under existing trade laws more rapidly and effectively. This would be non-protectionist because it would be an automatic licensing system, something which our NAFTA partners, Canada and Mexico, currently have in place.

- Cons: Opponents are concerned this action could be seen as a protectionist first step toward implementing quantitative restrictions and undermine progress we have made in phasing out quotas and discriminatory licensing systems abroad. This could be seen as precisely the type of border harassment that our exporting industries have opposed in foreign markets. Moreover, it would not afford any direct relief and could take several months to operationalize. Third, instituting such a system would require additional budgetary resources for Customs. It would also require legislation, which could open the door to additional protectionist measures. Finally, it would be difficult to resist requests for similar licensing systems for other industries.

4. Tax Relief

As we have discussed with you, we have developed an option to provide tax relief to the steel industry. Currently, corporations are allowed to carry back losses for two years. Thus, a company experiencing net operating losses today can offset the amount of these losses against taxes paid on any profits earned in the two previous years. In effect, the company today receives a refund of the previously paid taxes. The proposed tax option would extend this carry-back period to five years, specifically for the steel industry. This would increase the pool of previous taxes paid that could be offset with current losses and, therefore, provide financial relief in the form of larger tax refunds. This measure explicitly conveys the policy choice being made: a transfer payments is made to the steel industry financed by other parts of the U.S. economy and does so in a manner that does not generate costs exceeding the benefits to steel, unlike resorting to the trade options. This option would lose revenues of between $0.5 billion and $0.9 billion over five years. Treasury is still working on the revenue raisers to pay for our new tax cut proposals. You will need to make this decision in the context of the other tax priorities that are competing for this limited pool of funds. The decision here is whether to put the steel tax option on our list of new tax priority proposals (e.g., stay-at-home parents, green bonds) that will compete for these funds.

- Pros: This tax proposal safeguards your commitment to open markets and avoids the substantial risk of sending a protectionist signal at a fragile time in the global economy. The proposed tax relief is a concrete response that would have the support of both labor and management. If enacted, it would provide cash to affected steel companies, which could help to stave off layoffs. Finally, this is defensible tax policy: just as it is reasonable that losses in May should be allowed to offset profits in September, it is arguable that losses three years ago should be allowed to offset profits today.

- Cons: This option may not provide relief in a timely manner, since passage of a "signable" tax bill is expected to happen late in the process if at all. Second, the proposal begs the question, "Why just steel?" and will result in pleas from other troubled industries. It raises significant concerns about the practice of affording tax relief to specific industries. Moreover, we are on record in support of shortening, not lengthening, carryback periods. Finally, while shareholders of steel companies would benefit, it is not guaranteed that any benefit will flow to employees; since this proposal is backward-looking, it will not affect prospective steel sales for these companies nor the corresponding demand for labor. Finally, a tax benefit specific to the steel industry is likely to be criticized as a domestic subsidy by our trading partners, but it is likely it would withstand a WTO challenge.

5. Provide Additional Federal Assistance to Steelworkers and Communities

All of your advisors agree that we should take all available steps to help steelworkers and distressed steel communities through your strong commitment to adjustment assistance. As you know, there are an array of existing government programs that can and should be mobilized to help them, such as community development grants, business development grants, and technical assistance, all available through the Economic Development Administration; income support, job retraining, and search assistance under the Job Training Partnership Act; Trade Adjustment Assistance; as well as programs coming under HUD, SBA, Education, and other federal agencies.

So far, the union has been uninterested in discussing trade adjustment assistance with us because they view it as "burial insurance," and want to keep the focus on trade relief. However, there is likely to be substantial interest in economic development assistance for communities and temporary relief for workers that does not require switching jobs or industries. There may also be a new receptivity to working with us on adjustment assistance for several reasons. First, in a meeting with the Vice President, Senator Byrd recently pressed for "disaster assistance" for steel comparable to that provided for agriculture and proposed for Hurricane Mitch victims in Central America. Second, Senators Byrd and Rockefeller have specifically requested help for Weirton, WV, where Weirton Steel has already laid off 800 workers -- one-third of the work force.

Gene Sperling, Karen Tramontano, the Department of Labor, and others are working to step up the Administration's profile and coordination on these adjustment assistance programs. We are also considering naming a dedicated, full-time, high-level "steel coordinator" to help workers and communities identify and access the full range of federal resources. Beyond that, we are examining additional proposals to aid distressed industries in our current budget proposals, such as a significant expansion in training adjustment. We are also exploring ways to provide additional tools to distressed communities that are consistent with our budget resources.

Recommendations

1. Conditional Commitment to Self-Initiate a Section 201 Case: Secretary Rubin, Secretary Albright, Deputy Secretary Summers, Sandy Berger, the Chief of Staff's office, Jack Lew, and Janet Yellen oppose a conditional commitment to self-initiate a Section 201 investigation. Secretary Daley, Leon Fuerth and David Beier recommend that, at this juncture, we should be prepared only to support the industry's request for such an investigation. Ambassador Barshefsky recommends that we be prepared to consider the question of self-initiation and to consider a request to the ITC to expedite relief only at such time as the industry and its outside advisers determine that Section 201 is the appropriate course to follow. Larry Stein would not oppose the option, but believes that changing the 201 injury standard is a better option. Secretary Herman, Gene Sperling, and Lael Brainard support conditional self-initiation; the NEC believes it is less protectionist than changing the injury standard because it is simply showing a strong commitment to enforcing existing law as opposed to an across-the-board legislative change and that one could easily communicate that the Administration was initiating action that could lead to understandable comprehensive tariff or quota relief.

____ Support conditional commitment now _____ Postpone consideration _____ Reject

2. Easing Injury Standard for Safeguards Law (Section 201): Secretary Rubin, Secretary Albright, Sandy Berger, Deputy Secretary Summers, Janet Yellen, and Lael Brainard oppose a change to the 201 injury standard. Leon Fuerth and David Beier recommend that we should indicate to Senator Rockefeller that we would be prepared to work with him but not take ownership of the proposed legislation. The Chief of Staff's office, Jack Lew, and Ambassador Barshefsky would support such legislation only in the context of a broader market-opening bill. Gene Sperling is generally opposed to changing 201, but would find it acceptable if we were both not self-initiating and putting it in the context of an overall open-market agenda. Secretary Daley, Secretary Herman, and Larry Stein support a WTO-consistent change in the 201 injury standard; they believe this is a less protectionist action than self-initiation.

____ Support _____ Reject _____ Further consideration

3. Steel Import Licensing and Early Data Release: Secretary Rubin, Secretary Albright, Janet Yellen, Deputy Secretary Summers, Gene Sperling, the Chief of Staff's office, Larry Stein, and Lael Brainard oppose this option. Jack Lew, Sandy Berger, Leon Fuerth and David Beier do not support this option, but are not strongly opposed. Ambassador Barshefsky would recommend re-opening Census policy, in particular early release of import data for the steel industry alone. Secretary Daley supports the licensing concept if properly structured, and Secretary Herman would support it only if we do not proceed with either 201 option.

____ Support import licensing legislation ____ Revisit Census policy on early release of import data ____ Further consideration

4. Tax Relief: Secretary Albright, Sandy Berger, Janet Yellen, Secretary Daley, Ambassador Barshefsky, Jack Lew, Gene Sperling, the Chief of Staff's office, Larry Stein, and Lael Brainard support this option. Leon Fuerth and David Beier believe this option requires further study. Secretary Herman is concerned this option would open a Pandora's box of requests from other industries. Secretary Rubin agrees with Secretary Herman that this option would open a Pandora's box, but observes that it has the advantages of making explicit the cost of action to support the steel industry and of avoiding the potentially vast adverse alternatives. While both Ambassador Barshefsky and Secretary Daley support this option, they recognize that it could be subject to a WTO challenge, which they believe could be overcome.

____ Include in tax package if the are sufficient offsets ____ Do not include in tax package

Secretary Rubin believes that the trade options put at risk your economic legacy as an advocate for openness to change, whether brought by new technology or open markets, and risk an enormous adverse impact on our economic health and that of the global economy, if our actions lead to substantial increases in protectionism here and abroad. That possibility is now being broadly cited in discussions of major risks to the global economy. Trade restrictions here will also undermine the ability of countries in crisis to recover, further adversely impacting our economy. Obviously, the politics of this situation are difficult and need to be thought through, but Secretary Rubin thinks that your strong leadership against protectionism could be as critical to our economic well being going forward as your strong leadership on other politically difficult economic challenges has been to our strong economy of the past six years.

Secretary Rubin believes that this decision is of such profound importance that if you wish to proceed with additional trade actions, he requests -- as does Ambassador Barshefsky -- that you have an NEC/NSC international economic team meeting to discuss these options and their implications for the U.S. and global economies.

Update on Steel Industry Trends

Steel imports from Russia and Japan continued their rise in October, the most recent month for which figures are available. Imports of all steel mill products for the first ten months of this year are at record levels, up roughly 28 percent over the same period last year. In addition, projected imports for November show a continued rise.

Including these November projections, for the first eleven months of 1998, imports of steel mill products from Russia increased 61 percent over the same period last year, while imports of all steel mill products from Japan increased 169 percent. Import penetration for all steel products (for which we do not yet have November projections) has risen to 29.5 percent for the year through October as compared to 24.2 percent for the same period last year. With respect to hot-rolled sheet, the product comprising the bulk of steel trade, total imports for the first eleven months of this year are up 78 percent over the same period last year, with import penetration rising to 36.2 percent for the year through October as compared to 24.4 percent for the same period last year. Imports of hot-rolled sheet from Russia are up 98 percent over the first 11 months and imports from Japan are up 438 percent over the first 11 months, while imports from Korea are up less than 1 percent over that same period.

Capacity utilization for hot rolled sheet and strip has fallen from 93.2 percent in the first quarter of 1998 to 78 percent in the fourth quarter through December 5. Total steel employment has fallen to 226,300, a loss of 10,000 jobs over the last year.

Attachment

December 28, 1998

MEMORANDUM FOR PRESIDENT CLINTON

FROM: Madeleine K. Albright MKA
Robert E. Rubin R.E.R.

SUBJECT: Steel Imports

We are writing out of the deeply held belief that adopting restrictions on steel imports that go beyond the rigorous enforcement of our laws on unfair trade would threaten our economic well being and important foreign policy interests.

Under your leadership, this administration is already taking action to deal with allegedly unfair trade. We are proceeding expeditiously on the steel antidumping case, which covers hot rolled steel products accounting for nearly 50 percent of the 1998 import surge in steel. The preliminary determination of critical circumstances against Japan and Russia made by the Commerce Department has virtually halted hot rolled steel imports from these countries, which provide over 50 percent of our hot rolled steel imports.

We are exploring a suspension agreement with Russia which would likely result in a moratorium on Russia's hot rolled steel exports and a subsequent return to more moderate levels. In addition, the agreement may limit exports of cold-rolled steel to prevent Russia from switching production into those products.

Taking any of the trade actions now under consideration that go beyond this active enforcement of our current laws could have serious adverse impacts on the US and global economies.

First, whatever benefits might be derived by the steel industry and its workers from such restrictions would almost certainly be greatly exceeded even under normal circumstances by the adverse impact such restrictions would have on jobs and incomes in other industries and among consumers. By some estimates, for every extra job that is preserved in the steel industry, there will be five fewer jobs in related industries, such as machinery and automobiles.

This could be greatly exacerbated if steel protectionism leads to pressure for protectionism in other industries and greater protectionism abroad.

Second, there is a real question about whether a surge in fairly traded imports would cause long term damage, given the structure of the steel industry and its cyclical nature. Moreover, it is always difficult to distinguish whether stress in an industry is caused by import surges or by other economic changes. But more importantly, trade actions taken to protect the steel industry will generate other pleas for special consideration from other industries. Furthermore, by supporting the legislative proposals under discussion we would risk inviting other, more protectionist changes in our trade laws. If adopted, these remedies would leave more restrictive trade practices permanently in place even though the original complaint arose over a temporary surge in steel imports that no longer existed.

Third, adopting such restrictions, particularly at this critical juncture in the global financial crisis, would undermine our efforts to support reformers abroad who face enormous domestic pressures of their own to close their markets to imports from the US and elsewhere. Such a signal coming from the US, the world's most successful economy, could well spur protectionism around the world. Furthermore, recovery from financial crisis tends to be led by exports, and protectionist actions here would damage those countries whose return to growth is enormously in our economic and foreign policy interests, further delaying a return of our export growth to pre-crisis levels. It is worth remembering that a central factor in the Depression of the 1930s was trade protectionism as manifested by the Smoot-Hawley tariff and competitive devaluations.

More broadly, restrictions could have significant additional adverse impacts on our security interests and our relations with key foreign partners. In this environment, a policy decision to increase protection could also adversely affect financial markets.

While we do our part, it is important that other major economies, particularly the EU and Japan, lift their obstacles to steel imports so that the burden is more equitably shared. We have vigorously pushed the EU to do more, and we should continue to press both Europe and Japan. Any protectionist measures on our part would undercut this effort.

While the politics of open markets are very difficult, the economics are unambiguous: open markets have been crucial to American's economic success of the past six years. Maintaining a strong, open US economy, in turn, is critical to everything you are seeking to accomplish in your Presidency. This is not an easy course to maintain, but it is the right one, both for our economic and our foreign policy interests.

Suggested Rubin Revisions to Steel Memo to the President

1. First page (circled page 4)

The memo needs to make clear that the President is making a choice on whether to take actions beyond anti-dumping cases already underway, and if so, what actions. Therefore, at start of third paragraph change sentence that reads "However, there are differences among your advisers on the appropriate balance." to "There are differences among your advisers as to whether to take action beyond the antidumping cases already underway, and if so, what actions."

In the 6th lines of that paragraph, after "first shot in an accelerating protectionist spiral," add "both in the United States and abroad." After Smoot Hawley, add "and competitive devaluations of the 1930s."

At the end of this paragraph on the next page, add "The Japanese have told us their steel exports to the US will fall to 1997 levels or less starting this past fall and the Russians have told us that they will agree to zero exports to the US for some months as part of a negotiated settlement on the hot rolled sheet dumping case. According to Japanese data, the decline in Japanese steel exports is already underway, but due to transport time, the decline probably will not show up until November and December data are released in January and February."

2. Second page (circled page 5)

Start discussion with "The threshold decision is whether to do anything beyond current or future cases filed by industry. The adverse consequences of such additional action are described above and in the balance of this memo, as are the arguments supporting additional action."

3. Third page (circled page 6)

Under pros: 7th line down on section 201 providing more effective relief that antidumping does not explain that this would be in addition to antidumping cases. Modify sentence to read "Further, section 201 provides more effective relief than antidumping, assuming antidumping cases could be halted which they cannot unless industry withdraws them, because..."

In cons: Add in second point about injury relief point that "If and when data indicate injury, steel industry has resources and knowhow to file 201 action itself."

At end of third point about setting precedent, after 'only if we are prepared to draw line and say no to similarly situated industries in the future' add "It may well be practically and politically impossible to draw that line and say no to other industries, pulling us down a long slippery slope."

4. Fourth page (circled page 7)

Add in cons, in fourth point "Other advisers feel involving Fast Track does not diminish the adverse consequences of going down the road of legislated changes and believe furthermore that Fast Track is very likely to be politically undoable given wide differences on labor and environmental provisions."

5. Fifth page (circled page 8)

In tax relief section, 8th line down, after 'larger tax refund.' Insert "This measure explicitly conveys the policy choice being made: a transfer payment is made to the steel industry financed by other parts of the US economy and does so in a manner that does not generate costs exceeding the benefits to steel, unlike resorting to the trade options."

In cons add point "A tax benefit specific to the steel industry may be a countervailable subsidy under WTO rules."

At start of section on additional federal assistance to steel workers, add introduction:

"As you said in your many speeches advocating NAFTA, change and openness to change are key to our economic progress. All change, whether generated by new technology or new trade, confers not only benefits to the whole country, but inevitably will bring dislocation to some. This is not a reason to stand in the way of change, but rather a reason for providing appropriate help to those dislocated. You said something to the effect that workers cannot be guaranteed that they will have jobs for a lifetime -- that 7 or 8 job changes are more likely -- but they can be equipped to get the benefits of change and the opportunities it brings."

6. Recommendations

Secretary Rubin and Deputy Secretary Summers oppose the first three options. On option 4 note that "Secretary Rubin agrees with Secretary Herman that this option would open a Pandora's box of requests from other industries, but observes that it has the advantages of making explicit the cost of action to support the steel industry and of avoiding the potentially vast adverse alternatives."

Add note after four recommendations:

"Secretary Rubin believes that the trade options put at risk your economic legacy as an advocate for openness to change, whether brought by new technology or open markets, and risk an enormous adverse impact on our economic health and that of the global economy, if our actions lead to substantial increases in protectionism here and abroad. That possibility is now being broadly cited in discussions of major risks to the global economy. Trade restrictions here will also undermine the ability of countries in crisis to recover, further adversely impacting our economy. Obviously the politics of this situation are difficult and need to be thought through, but Secretary Rubin thinks that your strong leadership against protectionism could be as critical to our economic well being going forward as your strong leadership on other politically difficult economic challenges has been to our strong economy of the past six years.

<u>Secretary Rubin believes that this decision is of such profound importance that if you wish to proceed with additional trade actions, he requests that you meet with the appropriate members of your Cabinet and other officials to discuss these options and their implications for the US and global economies."</u>

DRAFT

December 24, 1998

MEMORANDUM FOR THE PRESIDENT

FROM:

SUBJECT: Additional Options for Providing Relief to the Steel Industry

Purpose:

To consider additional steel options for possible inclusion in the January 5 report to Congress.

Context

There are several highly consequential decisions on the trade agenda for the next year, such as whether and how to pursue fast track and whether to launch a WTO Round. Because there is a Congressionally-mandated report on steel due on January 5, the most immediate of these decisions is whether to take any additional actions to provide relief to the steel industry. Nonetheless, any decisions on steel must be made in the context of your broader trade agenda and overall goals on the international economy.

As you know from our discussions, there are several competing policy goals at stake. All of your economic advisers want to be responsive to the legitimate concerns of steel workers and the steel industry. All of your advisers are committed to sustaining your strong record on open markets, which has been a central tenet of your economic philosophy. All are acutely concerned that at this fragile moment in international markets, U.S. leadership can make the difference between a robust recovery with a continued commitment to open internationalism and the kind of vicious cycle of protection and depression that characterized the 1930s.

However, there are differences among your advisers on the appropriate balance. Some believe that if you are not willing to take exceptional action to address this high-profile case of trade disruption, the Congressional counter reaction will be far more damaging, rolling back your trade accomplishments and dooming further market opening. Others feel that extraordinary aid to the steel industry would fundamentally compromise your record on open markets and could be the first shot in an accelerating protectionist spiral, similar to Smoot-Hawley. Asia is currently in the throes of the worst financial crisis in 50 years. Asian economies must export in order to achieve recovery; that is why this Administration has pressed Japan to promote domestic demand-led growth and open its market. A trend towards protectionism in the United States would only encourage other major importing nations to follow our lead, delaying or reversing recovery around the world.

As outlined in our December 10 memorandum, the Administration has taken several steps to address alleged unfair trade practices in the steel industry, including forceful actions to enforce

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our trade laws, expedite the dumping investigations, and exert bilateral pressure. Commerce has engaged Russia on its request for a suspension agreement to explore whether this mechanism could provide effective, timely relief. These actions are likely to begin yielding significant relief soon.

Steel unions, industry and the Steel Caucus appreciate the forceful statements you made during your trip to Asia, and acknowledge the steps taken by Secretary Daley on the dumping cases, including the critical circumstances finding. Nevertheless, they are concerned the dumping cases will take too long and will fail to provide comprehensive, global relief. Further, industry has expressed opposition to a suspension agreement with Russia, on the grounds that it would not provide relief commensurate with a successful dumping determination; the union similarly opposes such an agreement unless it provides effective relief on all products from Russia. The steel industry, the steel workers, Senator Rockefeller and other members of the Steel Caucus support additional, immediate action to stem the rise in steel imports.

On the other hand, there is significant concern that actions to limit steel imports would raise domestic steel prices and undermine the competitiveness of domestic steel-using industries, which are economically more significant than the domestic steel industry. You have received letters opposing steel protection from Caterpillar and a broad coalition of interests including El Paso Energy Corporation, Enron Corporation, Michelin, the American Institute for International Steel, the Association of International Automobile Manufacturers, Consumers for World Trade, the Domestic Petroleum Council, the International Association of Drilling Contractors, the Precision Metalforming Association and the Steel Service Center Institute. We expect that twenty to thirty major U.S. CEOs will send you a letter shortly on trade priorities, which will ask you to resist domestic pressures to close the U.S. market and recommend a global standstill on restrictive trade measures.

Issues for Decision

Below we outline several additional possible measures for your consideration. Although the focus of the industry, union and Steel Caucus has been almost exclusively on trade policy options, we also include options on tax relief and adjustment assistance that could provide significant relief to the steel industry without sending troubling protectionist signals.

Background on Section 201 Safeguards Law: The first two options involve Section 201 of the Tariff Act of 1974, which provides relief for industries injured by a surge of imports. Section 201 investigations can be initiated by the industry or "self-initiated" by the President, the House Ways and Means Committee, or the Senate Finance Committee. Under 201, an affirmative finding of injury or threat thereof by the International Trade Commission (ITC) provides the President with considerable discretion and flexibility to implement a comprehensive, global remedy that can include quantitative restraints. An affirmative finding provides discretion to impose provisional relief in the form of tariffs as soon as 3 months after filing, and broader remedies, including quotas, within 8 months of filing for as long as 8 years. The relief can cover a broad range of remedies, is time-limited, must be liberalized over time -- in contrast to antidumping remedies -- and permits some differentiation among exporting countries.

Precedent for 201: There have been 67 investigations under Section 201; resulting in 35 affirmative injury findings and relief in 20 cases. Steel and steel-related products have been heavily represented, accounting for 8 investigations, resulting in 6 affirmative injury findings and relief in 4 cases. Overall, the Executive Branch has requested Section 201 investigations for only three industries: apple juice in 1985, steel in 1983, and canned mushrooms in the late 1970's. The House Ways and Means and Senate Finance Committees have requested investigations twice.

1. Conditional Commitment to Self-Initiate a Section 201 Case:

Steel union and company representatives and Senator Rockefeller are pushing for a conditional commitment from the Administration now that we would be prepared to self-initiate a Section 201 case in the future, if and when we determine the data support such a case. Senator Rockefeller has already indicated his support for initiation of a steel 201 case by Senate Finance.

- Pros: Proponents argue 201 self-initiation would permit the Administration to take forceful action that could lead directly to clear, understandable relief while avoiding excessive protectionism, since it would fall within existing statutory authorities and there are clear precedents. Moreover, Section 201 was designed precisely to cushion a domestic industry from a temporary surge in imports resulting from unanticipated forces in the global economy (rather than a long-term shift in America's competitiveness or domestic practices). Further, Section 201 provides more effective relief than antidumping because it allows the President to impose global remedies involving all exporting countries and a host of related products. In contrast, the antidumping laws provide relief on a piecemeal basis, specific to particular exporting countries and product categories, so that imports from other countries or related products often rush to fill the gap.

- Cons: Some are deeply concerned this action could be the first shot in an accelerating protectionist spiral, which could be very damaging to world trade and growth in the middle of the worst financial crisis in 50 years. Shifting emphasis away from unfair trade laws to safeguards could encourage others to follow suit, closing markets and choking recovery. Second, there is doubt whether the industry can meet the injury standard for relief at this juncture, since most steel companies are expected to be profitable for 1998 overall and will show industry-wide losses only in the fourth quarter, and the ITC normally examines profitability over a 5-year period. Third, this commitment would set a dangerous precedent, inviting other domestic industries to request similar protection. in fact, even supporters believe we should take this step only if we are prepared to draw the line and say no to similarly situated industries in the future. Fourth, a positive 201 finding would put you in the difficult position of choosing between the competing interests of domestic steel producers and steel-consuming industries. Finally, steel protection could be very costly to U.S. economy.

2. Easing Injury Standard for Safeguards Law (Section 201)

The steel workers, the steel industry and the Steel Caucus believe that the current legal standard for injury under 201 is too high to allow effective relief and seek Administration support for legislation easing the standard. Under current U.S. law, increased imports must be a "substantial cause of serious injury, or threat thereof," where imports must be an important cause and not less important than any other cause. USTR proposes to loosen the standard to ensure that the U.S. injury standard is no more stringent than that required by the WTO. The WTO injury standard requires simply that increased imports "cause or threaten to cause serious injury."

- Pros: Proponents believe this option avoids excessive protectionism because it focuses attention on a broad legislative change, enabling us to channel industry pressure toward availing themselves of remedies available under the trade laws. The proposed change would use the flexibility permitted under current WTO guidelines to make 201 more accessible and effective -- consistent with the Administration's position that American workers should have effective, accessible tools to adjust to the forces of globalization. Further, some argue this change remedies an existing asymmetry that favors antidumping relief over safeguards relief because the antidumping injury standard is lower.

- Cons: Opponents are concerned this action could send a dangerous protectionist signal because it goes beyond the framework of existing trade laws and would lower the injury standard for all industries for all time, in response to pressure coming in a single sector at a single point in time. Further, because this action in and of itself does nothing directly to afford relief to the steel industry, it is likely to be pocketed and may do little to stem calls for additional immediate action. Third, encouraging greater use of 201 will increase the burden on you of choosing between domestic interests in deciding appropriate relief in safeguard cases, in contrast to the antidumping laws, where remedy decisions are made by the Commerce Department and the ITC. Fourth, some of your advisers are willing to support this legislative change only as part of a bid for fast track or other market-opening legislation because this would send a more balanced signal to our trade partners and it could be useful in securing broad Congressional support. Finally, the proposed bill could become the vehicle for additional, more protectionist legislation (such as proposals for changes to our dumping laws), which the industry's lawyers are already shopping around.

3. Steel Import Licensing

The steel industry has asked the Administration to institute an import licensing system for steel in order to obtain data for their trade cases on a more timely basis than the current 45-day lag. Under an automatic licensing system, importers would be required to obtain a license from Customs to import steel, and the data collected would be made available to the public. Canada and Mexico currently have similar systems in place. Instituting a licensing system would require legislation.

- Pros: Proponents argue that instituting a steel import licensing system would be relatively benign, since it would be fully consistent with the WTO rules and would assist the industry in availing itself of remedies under existing trade laws more rapidly and effectively.

- Cons: Opponents are concerned this action could be seen as a protectionist first step toward implementing quantitative restrictions and undermine progress we have made in phasing out quotas and discriminatory licensing systems abroad. This could be seen as precisely the type of border harassment that our exporting industries have opposed in foreign markets. Moreover, it would not afford any direct relief and could take several months to operationalize. Third, instituting such a system would require additional budgetary resources for Customs. It would also require legislation, which could open the door to additional protectionist measures. Finally, it would be difficult to resist requests for similar licensing systems for other industries.

4. Tax Relief

As we have discussed with you, we have developed an option to provide tax relief to the steel industry. Currently, corporations are allowed to carry back losses for two years. Thus, a company experiencing net operating losses today can offset the amount of these losses against taxes paid on any profits earned in the two previous years. In effect, the company today receives a refund of the previously paid taxes. The proposed tax option would extend this carry-back period to five years, specifically for the steel industry. This would increase the pool of previous taxes paid that could be offset with current losses and, therefore, provide financial relief in the form of larger tax refunds. This option would lose revenues of between $0.5 billion and $0.9 billion over five years. Treasury is still working on the revenue raisers to pay for our new tax cut proposals. You will need to make this decision in the context of the other tax priorities that are competing for this limited pool of funds. The decision here is whether to put the steel tax option on our list of new tax priority proposals (e.g. stay-at-home parents, green bonds) that will compete for these funds.

- Pros: In contrast to the trade policy options outlined above, the tax proposal safeguards your commitment to open markets and avoids the substantial risk of sending a protectionist signal at a fragile time in the global economy. The proposed tax relief is a concrete response that would have the support of both labor and management. If enacted, it would provide cash to affected steel companies could help companies stave off layoffs. Finally, this is defensible tax policy: just as it is reasonable that losses in May should be allowed to offset profits in September, it is arguable that losses three years ago should be allowed to offset profits today.

- Cons: This option may not provide relief in a timely manner, since passage of a "signable" tax bill is expected to happen late in the process if at all. Second, the proposal begs the question, "why just steel?" and will result in pleas from other troubled industries. It raises significant concerns about the practice of affording tax relief to specific industries. Moreover, we are on record in support of shortening, not lengthening, carryback periods. Finally, while shareholders of steel companies would benefit, it is not guaranteed that any benefit will flow to employees; since this proposal is backward- looking, it will not affect prospective steel sales for these companies nor the corresponding demand for labor.

5. Provide Additional Federal Assistance to Steelworkers and Communities

We are looking at ways to strengthen adjustment assistance for steelworkers and affected communities. Although the union is characteristically loathe to discuss trade adjustment assistance, which is derided as "burial insurance," there is substantial interest in economic development assistance for communities and temporary relief for workers that does not require switching jobs or industries. In a meeting with the Vice President, Senator Byrd pressed for "disaster assistance" for steel comparable to that provided for agriculture and proposed for Hurricane Mitch victims in Central America. In addition, Senators Byrd and Rockefeller have specifically requested help for Weirton, West Virginia, where Weirton Steel has already laid off 800 workers -- one-third of the work force -- and we anticipate similar requests from other steel mills in the months ahead.

Several programs at Commerce and Labor currently provide assistance for trade-impacted communities and workers. Commerce's Economic Development Administration (EDA) can provide: grants to help a community develop an economic adjustment strategy, Revolving Loan Funds to help support small business start-ups or expansion, grants for infrastructure improvements (including development of a business incubator or industrial park), and technical assistance to small firms affected by foreign competition (such as supplier firms to a steel plant). EDA can respond to an application for a strategy/technical assistance grant in as little as 2-4 weeks. The Department of Labor can provide job retraining and search assistance to dislocated workers under Title III of the Job Training Partnership Act (JTPA) and to trade-impacted workers under the Trade Adjustment Assistance (TAA) program. So far, few dislocated steelworkers appear interested in TAA's generous retraining and income support benefits, because they require workers to train for a *new* occupation, and many workers believe -- often correctly -- that they will be recalled by their former employer. (For example, the plant in Weirton has said it plans to recall workers in January.)

We are looking a range of options for enhancing existing adjustment assistance. For a start, we would recommend establishing an interagency task force on steel adjustment -- with a dedicated, full-time, high-level "steel coordinator" -- to help workers and communities identify and access the full range of federal resources, including from HUD, SBA, Education and other agencies as well as Commerce and Labor. Beyond that, we are examining additional proposals to aid distressed industries experiencing temporary pressures such as steel (e.g. no-interest loans to meet credit obligations or health insurance payments, direct assistance to communities to ensure that the temporary drop in tax revenues does not disrupt basic services). However, we must be careful that such proposals are consistent with the Administration's overall approach to dislocated workers and distressed communities. Although we would not be ready to incorporate these more expansive options into the January 5 report, we would aim to finalize a proposal and identify the necessary budgetary resources -- if any -- by the time of your State of the Union address.

RECOMMENDATIONS

1. Conditional Commitment to Self-Initiate a Section 201 Case: Madeleine Albright and Janet Yellen oppose a conditional commitment to self-initiate a Section 201 investigation. Charlene Barshefsky, Bill Daley, Leon Fuerth and David Beier also oppose, although they recommend that we should support the industry's request for such an investigation. Jack Lew would not oppose this option, but believes that changing the 201 injury standard is a better option. Alexis Herman and Gene Sperling support conditional self-initiation; the NEC believes it would send a less protectionist signal than changing the injury standard. [Sandy Berger, Larry Stein, Bob Rubin, Larry Summers...]

____ Support ____ Reject ____ Further Consideration

2. Easing Injury Standard for Safeguards Law (Section 201): Madeleine Albright, Janet Yellen, and Lael Brainard oppose a change to the 201 injury standard. Leon Fuerth and David Beier recommend we should indicate to Senator Rockefeller that we would be prepared to work with him but not take ownership of the proposed legislation. Gene Sperling would support such legislation only in the context of a broader market-opening bill. Charlene Barshefsky, Bill Daley, Jack Lew and Alexis Herman support a WTO-consistent change in the 201 injury standard; they believe this is a less protectionist action than self-initiation. [Sandy Berger, Larry Stein, Bob Rubin, Larry Summers...]

____ Support ____ Reject ____ Further Consideration

3. Steel Import Licensing: Madeleine Albright, Janet Yellen, Bill Daley, Gene Sperling and Lael Brainard oppose this option. Jack Lew, Leon Fuerth and David Beier do not support this option, but are not strongly opposed. Charlene Barshefsky supports this option and Alexis Herman would support it if we do not proceed with either 201 option. [Sandy Berger, Larry Stein, Bob Rubin, Larry Summers...]

____ Support ____ Reject ____ Further Consideration

4. Tax Relief: Madeleine Albright, Janet Yellen, Bill Daley, Charlene Barshefsky, Bill Daley, Jack Lew, Gene Sperling and Lael Brainard support this option. Leon Fuerth and David Beier believe this option requires further study. Alexis Herman is concerned this option would open a Pandora's box of requests from other industries; she would oppose it as long as we proceed with some action on 201. [Sandy Berger, Larry Stein, Bob Rubin, Larry Summers...]

____ Include in tax package if the are sufficient offsets.

____ Do not include in tax package.

Update on Steel Industry Trends

Steel imports from Russia and Japan continued their rise in October, the most recent month for which figures are available. Imports of all steel mill products for the first ten months of this year are at record levels, up roughly 28 percent over the same period last year. **[Commerce will provide non-public November trade data]** For the first ten months of 1998, imports of steel mill products from Russia increased 47 percent over the same period last year, while imports of all steel mill products from Japan increased 162 percent. Import penetration for all steel products has risen to 29.5 percent for the year through October as compared to 24.2 percent for the same period last year. With respect to hot-rolled sheet, the product comprising the bulk of steel trade, total imports for the first ten months of this year are up 65 percent over the same period last year, with import penetration rising to 36.2 percent for the year through October as compared to 24.4 percent for the same period last year. Imports of hot-rolled sheet from Russia are up 71 percent and imports from Japan are up 399 percent, while imports from Korea fell roughly 1 percent. Capacity utilization for hot rolled sheet and strip has fallen from 93.2 percent in the first quarter of 1998 to 78 percent in the fourth quarter through December 5. Total steel employment has fallen to 226,300, a loss of 10,000 jobs over the last year.

[Treasury has requested that CEA provide data on employment changes in steel versus the rest of U.S. industry.]

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Thursday, December 24, 1998

Clinton Becomes Grinch to Steelworkers

▪ Economy: Layoffs mean bleak Christmas in Weirton, W.Va., where 1992 vow to halt dumping is remembered.

By MARK FRITZ, Times Staff Writer

WEIRTON, W.Va.--Justin Arango wants a gift this Christmas that isn't necessarily cool, computerized, flashy or furry. The degree of his desire became obvious Saturday, when he climbed aboard Santa's knee.

"Can you find my dad a job?" the 5-year-old asked the local St. Nick, breaking every heart within earshot inside Weirton's crowded community center.

Justin's dad, Troy Arango, chokes up just a little when he tells this story. "Santa said it about tore him up," he says.

Arango recently lost his job at the company where his father and grandfather had worked until retirement. He is among the roughly 900 steelworkers who have been laid off for the holidays in a small town carved into the hills of the Ohio Valley. They comprise almost one-fifth of the work force of the Weirton Steel Corp., the main employer for miles around.

They represent only a small fraction of the 600,000 American workers who have been furloughed in 1998, which some labor analysts believe will set a layoff record for this decade. It is a record that is being aided mainly by bad economies overseas and partly by the end of a taboo against trimming payrolls just when people are trimming their trees.

The situation is somewhat special here, however, because it demonstrates how public support for President Clinton can change when his most potent asset, the generally strong economy, suddenly vanishes. Or, in this case, collides with questions about his credibility.

Nobody here seems to care much whether the president had an affair or tried to cover it up. Instead, their hostility is focused like a laser beam on a single day in 1992 when, in the midst of their famous bus campaign through America's heartland, then-Gov. Clinton and then-Sen. Al Gore sat on a stage in their flannel shirts and promised to protect Weirton workers from cheap steel from abroad.

Clinton's Remarks on Videotape

Clinton, campaigning in a solidly Democratic town that has provided blue-collar backdrops for both John F. Kennedy and Franklin D. Roosevelt, uttered remarks that have been preserved on plenty of local videocassettes, which people are eager to play to show how badly they've been betrayed.

"I want to first make sure we enforce strictly the anti-dumping laws and the laws against unfair subsidized steel being dumped into this country," Clinton told the cheering audience on July 19 of that year, in the same hall where Justin Arango would pass his plaintive plea on to Santa Claus. "That's not fair. If they're doing things for their steel we're not doing for ours, they shouldn't have access to our markets."

Failure to stop illegal dumping is exactly what people believe has lightened their grocery bags and put them in the unemployment line. Though the administration says it is working hard to convince its trading partners to control dumping, many here consider their plight the direct result of a broken promise.

"We went out and campaigned for him," says Mark Glyptis, the union president. "He has completely turned his back on what he said."

"There are promises to be kept," says Democrat Tamara Pettit, the local state representative.

"They take it personally," says Richard K. Riederer, the chief executive officer of Weirton Steel.

At the Independent Steelworkers Union hall, workers laid off in two swoops, first in November and then again last week, picked up frozen turkeys, packages of macaroni and other foods donated by local businesses and individuals. In interview after interview, the steelworkers held one man responsible.

"The president sat here in Weirton and said if you voted for him, these things wouldn't happen," says Norm Kidd, a 39-year-old father of two who got laid off after 12 years on the job.

The American steel industry maintains that producers from Asia, South America and Russia have been selling subsidized steel in this country below the market prices or production costs in their own countries, a violation of anti-dumping regulations. The House in October asked Clinton to bar steel imports from 10 nations for a year, yet he has been reluctant to do so.

Riederer was part of delegations that met with Gore last week and Clinton last month to air their grievances. The issue is complicated by the fact that most of the countries accused of dumping, such as Russia and South Korea, are in precarious economic positions. And big U.S. manufacturers are anxious to keep bargain-basement steel rolling in.

Clinton has pressed this country's trading partners to voluntarily take steps to curb dumping in the United States, said Roger Salazar, a presidential spokesman. But he said the practice is widespread because so many markets for steel and other products have dried up because of the global economic crisis, making the strong U.S. economy even more attractive to countries trying to export their way out of trouble.

Issue Raised on Asian Journey

Clinton raised the steel-dumping issue with South Korea and Japan during his Asian trip last month, and the administration has promised to unveil a plan for curbing imports next month.

"The president and the vice president are very concerned about the impact this is having on our steel industry," Salazar said.

Not concerned enough, people here say, because dumping

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continues and job losses mount. Steel executives want the administration to impose quotas and penalties now to halt the cuts, which are expected to reach 10,000 workers by year's end.

"President Clinton by an executive order could stop the pain," says Chamber of Commerce head Don Rigby. "He's chosen not to do so."

The big problem is the time it is taking the Commerce Department to investigate the complaints that the steel industry filed in September, Riederer said.

"They're not easy issues to resolve overnight," said Commerce Department spokesman Morrie Goodman. "It's a global economy we live in. Issues are not isolated."

The layoffs here are considered temporary, and some people could be called back early next year, though the company--which saw orders fall 25% this quarter--was making no guarantees. Many are worried that the cutbacks are a sign of worse things to come.

"The timing couldn't be worse," says appliance store owner John Koval, who says even some people who have not been laid off have canceled Christmas layaway orders. Koval figures his sales are off 8% to 10%. Everything here, he says, emanates from the steel plant. "A guy gets laid off at Weirton Steel, where does he go? McDonald's? What they do is leave town."

The plant is a sprawling, steam-spewing expanse that snakes through downtown like a colossal life-support system, something that does far more than supply the country with Campbell's soup cans, among other things. Signs and banners hung in store windows and strung over streets urge locals to "Stand up for steel."

Since the 1970s, the plant's work force has shrunk from almost 13,000 to fewer than 5,000 significantly more productive workers. At one point the workers bought the plant themselves. Layoffs are a way of life, and some people with a dozen years or more find themselves losing their job for the second or third time.

Arango grew up in Weirton but found steadier work in Florida, where he worked as a welder in nuclear power plants for a dozen years. Yet he and his wife longed to raise their kids in this exceedingly friendly and peaceable little town of 22,000, about 45 minutes west of Pittsburgh, so they came back nearly four years ago when Weirton Steel was hiring.

Now he and his wife, Donna, have decided not to exchange gifts this year, though Justin and 14-year-old Dan will find presents under the tree. "You can't deny the kids Christmas," says Arango.

Luckily, Arango just shot a deer. That, plus a donated turkey and some strategic shopping, should stretch food staples over many meals. "A big thing of Velveeta goes a long, long way," says Arango.

Benefits Are Gone After 6 Months

Unemployment and six months of supplemental benefits should approach about 65% of his pay, he says. Workers here average between $35,000 and $45,000 a year, by far the best wage around. Yet jobless and medical benefits for people with less than 20 years of employment run out in six months.

As the best employer around, some workers will wait seemingly forever for a chance to get back in. Alberta Miller was forced to quit her job in the mill in the 1950s, when women who married were routinely laid off, and got it back in 1989 when her husband died of cancer. She was laid off again two years ago and had been the next person in line to be called back this spring when the latest crisis hit.

All she wants to do is get back in long enough to beef up her retirement benefits.

"I'm 62 years old, and I wanted so badly to help with my pension," says Miller, who was a dispatcher in the tin mill. "I loved working for Weirton Steel. I was so lucky to get back in after my husband died."

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