OFFICE MEMORANDUM

TO: Memorandum for the Record
FROM: Raymond J. Goodman

DATE: June 12, 1974

SUBJECT: KOREA: Visit of Mr. Yie Joon Chang, Minister of Commerce and Industry

Mr. Chang, Minister of Commerce and Industry of the Republic of Korea called on Mr. McNamara on June 4, accompanied by the following: Ambassador Pyong-choon Hahn, Chin Shik Noh, Commercial Attaché at the Korean Embassy, Pil Soo Park, Assistant Minister of International Cooperation, Ministry of Commerce and Industry and Joun Young Sun, Chief, Commercial Division # 2, Ministry of Foreign Affairs. Messrs. Knapp, Bell and Goodman were present and Mr. Shin, Alternate ED.

Minister Chang said he brought a message of greetings and thanks from President Park for all the help that the Bank had given to Korea in the recent past. Mr. McNamara asked the Minister to reciprocate the greetings and to congratulate the President on Korea's magnificent export performance which was particularly noteworthy in view of the present disturbed monetary and trade conditions.

A few minutes were spent discussing Korea's program for rural development, the so-called Sae Maeul movement. The Minister gave an account of how the program was initiated and managed at the various levels - village, county and province - stressing that the work was mainly carried out by village labor, with such assistance from the central government as seemed essential.

cc: Mr. Loos

RJGoodman/rf
OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara
FROM: Raymond J. Goodman
DATE: May 24, 1974
SUBJECT: KOREA: Meeting with the Minister of Commerce and Industry

Attached is a brief which has been prepared for your meeting with His Excellency Yie Joon Chang, Minister of Commerce and Industry, on June 4, 1974.

cc: Messrs. Knapp
    Weiner
    ILloos/pme
Minister Chang is visiting Washington from June 2-5 to participate in the sixth Korea-US Commerce Ministers Meeting scheduled for June 1 through June 5. The expansion of trade, the supply of raw materials and cooperation in Korea's heavy and chemical industry projects are likely topics for discussion at the meeting. In connection with the last item, Minister Chang is planning to visit Pittsburgh for discussions with the U.S. Steel Corporation which is undertaking a feasibility study of the second steel mill project and is attempting to work out a joint venture for implementing the project.

Minister Chang headed a seven-man economic mission to the Middle East from April 26-May 15. The object of this mission was to develop firmer economic and trade ties particularly with Saudi Arabia, which supplies more than half of Korea's crude oil imports, and Kuwait.

The Minister also participated in a meeting in Beirut of the Korean diplomatic mission chiefs assigned to the Middle East. The purpose of this meeting, as well as a similar meeting held in Abidjan, was to develop a strategy to "block the advance" of North Korea in the Middle East and African regions and to develop economic, trade and technical cooperation links with the countries in these areas.

The Korean Embassy is unaware of any specific matters the Minister may wish to discuss during the meeting and expect it to be merely a courtesy call. It is possible, however, that the Minister may reiterate the request he made to Mr. Goodman during his visit to Seoul in April that the Bank should make a program loan of $200 million to cover the enhanced current account deficit resulting from a slower rate of increase of exports than expected. If this is raised, the Minister might be informed that it had been decided to make a program loan of $75 million which, together with some $95 million to the two development banks, would provide very nearly the amount requested in the form of quick-disbursing loans in FY75.

The Minister may inquire about the Bank's plans for assisting industrial development in Korea. While we intend to continue assisting the industrial sector primarily through the Korean financial intermediaries, including the Korea Development Bank and the Medium Industry Bank in addition to the Korea Development Finance Corporation - the sole channel of Bank lending for industry hitherto - we intend monitoring the loans to them to ensure that the economic benefits, rather than the financial returns to the banks, are maximized. Furthermore, we expect the Industrial Sector Mission, scheduled for the fall of this year, to take an in-depth look at the country's long-term industrial strategy in order to review investment priorities in the manufacturing sector, focusing particularly on the targets set for heavy and chemical industry and on the role of medium and light industries and the potential for their further expansion. Moreover, as the Korean plans envisage the creation of a considerable number of off-farm jobs in the rural areas so as to achieve parity between urban and rural incomes, the mission will also review the small and medium industry sector program. The Bank's lending to industry in Korea will be reviewed in the light of the findings of the mission.
Yie Joon CHANG, 49, was appointed Minister of Commerce and Industry in the cabinet reshuffle of December 3, 1973, exchanging his portfolio as Minister of Construction with Nak Sun LEE. Chang (pronounced CHUNG), a career civil servant, is an authority on U.S.-Korean economic aid, and has been involved in formulating Korea's foreign investment policy. He is an able and articulate economist. A native of North Korea, Chang graduated from Seoul National University (1949) and Vanderbilt University (1957). During 1961-64, he was economic attaché in the Korean Embassy in Washington, returning to Seoul to become an Assistant Minister of the Economic Planning Board (EPB). Positions held by him subsequently included that of Vice President of the Korea Development Finance Corporation, Vice Minister of Agriculture and Forestry, and Vice Minister of the EPB, followed by his appointment as Minister of Construction on January 4, 1972. Minister Chang is an enthusiastic tennis player and speaks English fluently.
TO: Memorandum for the Record

From: Bernard R. Bell

Subject: KOREA - Visit of Mr. Tae, Wan-Son
Deputy Prime Minister

Mr. Tae, Wan Son, Deputy Prime Minister of Korea, called on Mr. McNamara on July 12. Mr. Knapp, Mr. Goodman and Mr. Bell were also present.

The call was essentially a courtesy call. The Minister expressed his pleasure that the Bank was planning a program loan to Korea in the current fiscal year. He indicated that this would be extremely helpful in view of the heavy burden of payments for oil and the slow-down in the growth of exports resulting largely from the decline in the level of economic activity in Japan and in the United States. He mentioned that exports thus far this year had been running at a rate about 40 percent higher than in the preceding year, but that the continuation of this rate in the balance of the year was contingent on development in the Japanese and U.S. activities.

July 23, 1974

BRBell:ea
Mr. Bernard E. Bell  
(through Mr. Gregory B. Votaw)  
July 5, 1974  

David Loos, Chief, Division 1E, East Asia & Pacific  

KOREA - Visit of Mr. Tae, Wan-San, Deputy Prime Minister  

Mr. Yang, Yoon Sae, Economic Minister of the Korean Embassy, called this morning to say that the Deputy Prime Minister is expected to arrive in Washington on Tuesday, July 9 and had indicated that he would like to meet with Mr. McNamara and Mr. Gaud on the 10th or 11th (a meeting with EXIM Bank officials has been scheduled for 2:30 p.m. on the 11th). Mr. Yang also informed me that they wished to arrange a lunch to be hosted by the Deputy Prime Minister which they would like Mr. McNamara, Mr. Knapp and other senior officials of the Bank and IFC, who deal with Korean affairs, to attend.  

According to Mr. Yang, the main purpose of Mr. Tae's visit to Washington is for discussions with the EXIM Bank which is developing a sizable program of lending to Korea. He is also planning to call on senior government officials.  

I would recommend that, if Mr. McNamara could find the time to see the Deputy Prime Minister, a meeting be arranged. Mr. Yang was not aware of any specific matters that the Deputy Prime Minister would wish to discuss with Mr. McNamara.  

Mr. Tae visited Washington at the end of May 1973 and met with Mr. McNamara on May 30. A copy of the record of the discussions at that meeting is attached for your information.  

As far as the lunch is concerned, perhaps Mr. Knapp would wish to host one instead.  

I will inform Mr. Gaud of the request for a meeting with him.  

DLoos/zp  
Attachment  

N.B. As of July 8, The Deputy Prime Minister has the following openings on his calendar, and hopes that it will be possible to see Mr. McNamara:  

Wednesday, July 10 - until 10:45; after 2:30  
Thursday, 11 - until 10:30  
Friday, 12 - morning  

D. Loos
Although it is expected that the Deputy Prime Minister's meeting with Mr. McNamara will be primarily a courtesy call, it is possible that Mr. Tae will revert to some of the issues discussed at the meeting he had with Mr. McNamara on May 30, 1973 (a copy of the record of the discussions at that meeting is attached).

A. Amount and Terms of Bank Loans

In recent discussions with the Korean authorities, they expressed their appreciation of the substantial increase in Bank lending proposed for FY 75. The inclusion of a program loan of $75 million in the lending program was welcomed. This, together with the proposed loans to the Korea Development Finance Corporation and the Korea Development Bank, will provide about 43 percent of the total lending program for FY 74 and 75 ($392 million) in the form of quick-disbursing loans which are required to mitigate the effects of the additional burden of about $1,500 for the two years (calendar 1974 and 1975) resulting from the increased oil prices. (A copy of the lending program approved at the recent CPP Review Meeting is attached.)

One of the issues discussed at the last meeting the Deputy Prime Minister had with Mr. McNamara was the percentage of total project cost financed by the Bank. Mr. Tae requested at that meeting that the proportion of Bank financing be increased above 50 percent and also that longer grace and repayment periods, particularly for agricultural projects, be provided. It was decided at the recent CPP Review Meeting that as a general rule the Bank would finance at most 50 percent of the total cost of Bank-supported projects in Korea, which would be a continuation of the practice adopted in FY 74. In many cases this would provide a substantial element of local cost financing which is justified by the enhanced emphasis on agricultural and regional development in the Bank's lending program and the increasing efficiency and capacity of the Korean construction industry.

B. Counterpart Funds

The larger program of Bank lending to Korea is pendant on the Government's willingness to increase commensurately the budget allocations for public investment to ensure the availability of adequate counterpart funds. The budgetary constraints resulting from the impact of the energy crisis are already tending to affect the provision of counterpart funds for on-going projects. This problem has been compounded by the substantial increases in the total cost of the projects due to higher rates of price escalation than had been expected when the projects were appraised. The importance of making adequate provision in the budget for the counterpart
funds required for Bank-financed projects was stressed in recent discussions with the Korean authorities. A possible solution to this problem would be to use the counterpart funds generated by the proposed program loan (Won 30 billion) specifically for Bank-financed projects.

C. The Pohang Steel Mill - Stage II

At the last meeting the Deputy Prime Minister indicated that they were hoping that the Bank would provide $50-60 million for the second stage. The Korean authorities were, however, advised subsequently that the Bank had decided not to proceed with a loan for this project. The main reasons for this decision were conveyed to Mr. Kim, Special Advisor on heavy and chemical industry, and Mr. Shin, the Alternate Executive Director, who met with Mr. Cargill on July 30, 1973. They were informed that there was no question about the technical or managerial soundness of the project and that it was its obvious strengths that had led to the view that adequate financing should be available from other sources than the Bank. The project has been deleted from the lending program.

July 8, 1974
OFFICE MEMORANDUM

TO: Memorandum for the Record
FROM: David Loos
SUBJECT: Annual Meeting, Washington D.C. 1974 - Meeting with the Korean Delegation

DATE: October 4, 1974

1. The following members of the Korean Delegation called on Mr. McNamara at 5:00 p.m. on September 27:

   Mr. Yong Hwan Kim - Minister of Finance
   Mr. Sung Whan Kim - Governor, Bank of Korea
   Mr. Chang Hee Kim - Director, Foreign Exchange Bureau, Ministry of Finance
   Mr. Byong H. Shin - Alternate Executive Director, Bank

   Messrs. Bell, Votaw and Loos were also present.

2. General economic slowdown: In response to Mr. McNamara's inquiry about the current Korean economic situation, the Minister of Finance stated that they found themselves in a difficult position. Although the performance in the first half of the year was good resulting in a growth rate of 15.3 percent in real terms, disquieting signs began to appear in the third quarter which suggest that the growth rate in the second half would be around 5 percent, so that the annual rate would be about 9-10 percent. There were many imponderables which made it difficult to forecast the performance in the future, but, in formulating the budget for 1975, they had assumed a growth rate of 8 percent, which was likely to continue in 1976, with an increase of 9-10 percent thereafter.

3. The downward revision of the expected growth rate resulted from the very considerable increases in the price of oil and other raw materials. The further consequence of this was that the long-term Perspective Plan, which emphasizes the development of petrochemical and heavy industries, was likely to have to be revised with greater emphasis being given to the engineering and machine-building sector. The Minister also felt that in future export performance should be viewed more in terms of increased value added in Korea than in terms of gross magnitudes. Also, Plans should give greater attention to the problem of income disparity and the development of the less developed areas of the country. The Minister noted that these matters had been discussed in somewhat greater detail at the meeting with Mr. Bell that morning.

4. Counterpart financing: Mr. McNamara then expressed his concern that adequate Government counterpart funds be provided to complete Bank-supported projects expeditiously. This, he said, was a matter of concern because the proposed volume of lending to Korea was large and was premised on the assumption that adequate counterpart funds would be forthcoming from the Government.
5. Development Council: Mr. Shin said that the Council was to be discussed at a meeting of representatives from the South East Asian Countries on Saturday morning. It appeared that they were all in support of the IBRD Draft and would have no difficulty in supporting it. Mr. McNamara expressed the hope that the Development Council would, as its first item of business, address the question of the action the OPEC and OECD countries should take to meet the needs of those developing countries which were in desperate straits because of the very substantial increases in oil and foodgrain prices.

6. External Financing: The discussion then turned to sources of the foreign capital required to reach the planned levels of growth. The Minister indicated that they would be looking to the multilateral sources for increasing assistance as the bilateral sources were drying up. The Bank Group would be the major source, with the Asian Development Bank also expected to increase its commitments to about $100 million annually. They also expected the IMF to increase the allocation from the Special Oil Facility, which, based on Korea's existing quota, had first to be limited to only SDR 60 million ($72 million) compared with an oil import bill of some $1.2 billion this year. Action expected shortly by the Fund Board would increase the allocation in the current year to about SDR 100 million. The question of increasing Korea's basic Fund quota from SDR 80 million to SDR 285 million was also under consideration and, if this were approved as expected next year, the drawing under the Special Facility in 1975 could be as much as SDR 150-200 million. The Minister stated that this enhanced amount, together with increased assistance from the Bank Group and the ADB, should enable Korea to manage without excessive recourse to the Euro-dollar market after 1976. Meanwhile, they would have to borrow from the Euro-dollar market to finance the expected deficit in 1975 and the first half of 1976 and had contacted banks in New York. The indications were that the terms on which funds would be forthcoming would be onerous: interest at 2 percent above the London Inter-bank Rate and a repayment period of 5-7 years.

7. In conclusion, Mr. McNamara said he hoped that increased lending to Korea would be possible as a result of larger resources being available to the Bank and justified by the merits of projects proposed by Korea. In spite of the adverse effects of the recent developments on the country's economic growth, he was very optimistic about Korea's prospects.

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1/ The last Economic Mission estimated that if the GNP growth rate were to be 8-9 percent during 1974-77, gross annual disbursements of medium- and long-term loans of $1.4 billion will be needed on average during this period requiring commitments averaging $1.8 billion annually.

Cleared with and cc: Mr. Votaw

cc: Mr. Knapp
Mr. Ljungh
Mr. Bell

DLoos/GBVotaw:pme
SUPPLEMENT
TO
1974 BRIEFING PAPER - KOREA

As a result of the Cabinet changes effected on September 17, 1974, MR. YONG HWAN KIM, the new Minister of Finance, will head the Korean delegation to the Annual Meeting in place of Mr. Duck Woo Nam who has been appointed Deputy Prime Minister.

Mr. Kim was born on February 5, 1932, and graduated from the College of Law of the Seoul National University. He served in various capacities in the Ministry of Agriculture between 1956 and 1970, being Assistant Minister for Agricultural Policy in the period 1968-70. He was Secretary to the President for Foreign Loan Affairs (1970-72), Vice Minister of Finance (1972-73) and First Senior Secretary to the President for Economic Affairs from 1973 until his appointment as Minister of Finance.

The other members of the delegation will be:

Mr. Sung Whan Kim - Governor, Bank of Korea
Mr. Chang Hee Kim - Director of Foreign Exchange Bureau, Ministry of Finance
Mr. Bong H. Kay - Director, Asian Development Bank
Mr. Byong H. Shin - Alternate Executive Director, Bank
TO: MEMORANDUM FOR THE RECORD

FROM: David Loos, Chief, Division E Country Programs, East Asia and Pacific
      (through Mr. Bernard R. Bell, Regional Vice President, East Asia
      and Pacific)

SUBJECT: KOREA - Mr. McNamara's Meeting with H.E. Duck Woo Nam, Deputy Prime
          Minister and Minister, Economic Planning Board

1. Mr. McNamara met with H.E. Duck Woo Nam at 2 p.m. on Tuesday,
   February 13, 1975. The Deputy Prime Minister was accompanied by Assistant
   Minister Suk Joon Suh and Director Hung Koo Kang of the Economic Planning
   Board, Mr. Yoon Se Yang of the Korean Embassy and Mr. B. H. Shin, Technical
   Advisor to the Executive Director for Korea. Messrs. Knapp, Bell, Votaw and
   Loos were also present for the Bank.

2. The DPM conveyed to Mr. McNamara President Park's good wishes which
   Mr. McNamara reciprocated.

3. The DPM referred to some of the key elements in Korea's economic
   situation. He indicated that the growth rate in 1974 had been 8.2 percent
   with exports at a little over $4.5 billion and imports at around $6.3 billion.
   The overall deficit of about $1.8 billion had been financed by medium and long-
   term capital, official and private, and an increase of $900 million in short-
   term debt. There had been some lay-offs but the unemployment situation was
   not yet critical.

4. The overall deficit this year is expected to be of the order of $1.5
   billion. Some doubts had been expressed about their ability to attain the
   targeted export figure of $6 billion but the deficit was unlikely to be larger
   even if exports fell somewhat short of expectations since import requirements
   may also prove to be overstated due to some decline in import prices and the
   availability of sizable inventories. The deficit in 1975 would be met by
   medium and long-term borrowing of some $1.2 billion from official and private
   sources and drawings from the IMF and short-term financing.

5. In response to a question by Mr. McNamara on the prospects of borrow-
   ing in the Euro-dollar market, the DPM stated that in the early part of last
   year they had not attempted to tap this source to the extent they might have
   because they felt that the terms and conditions were not attractive. However,
   these had worsened and the syndicated bank loan of $200 million, which they
   expected to finalize shortly, would carry the onerous terms of repayment over
   five years and interest at two points over LIBO. Nevertheless, there were good
   prospects for closer and more effective cooperation with the OPEC countries,
   particularly Saudi Arabia and Iran. Economic Cooperation Treaties had already
   been entered into with them, but it would take time before the effects were
   felt. Meanwhile, they required assistance to deal with a difficult economic
   situation and the main purpose of his call on Mr. McNamara was to solicit more
   assistance from the Bank.
6. The DPM indicated the following specific areas in which they would need such assistance:

(i) **Program Loan**: The request for an increase in the amount of the loan from $75 million to $100 million had been made because it was essential to help finance the production and investment needs of industry and especially the export sector. The increase in the amount of the proposed loan to the Korea Development Bank to $60 million, for which the DPM expressed his gratitude, would also help. Moreover, the local currency counterpart funds could be used to finance Bank-supported and other development projects which were experiencing cost overrun problems.

Mr. McNamara said he was aware of the need and the justification for the increased amount and that, subject to any problems that may be encountered in the further processing of the loan, it was likely that a loan of the magnitude requested could be made.

(ii) "Sae Maeul" Project: The DPM outlined the objectives and content of the "Sae Maeul" Movement, which had been started about three years ago to develop agriculture and the rural areas. The experience gained since this Movement was started had enabled them to develop programs to make this technique of comprehensive regional and social development more effective. A package project had been prepared covering many elements: expansion of minor irrigation facilities; paddy land rearrangement; comprehensive watershed development; rural electrification; farm road improvement; village water supply, etc. - and Bank-financing was requested for this. The total cost of this project is estimated at $272 million; they would wish the Bank to finance $155 million with the rest being provided from budgetary sources.

Mr. McNamara expressed the view that the project appeared to be the kind the Bank would like to support since it seemed to be of high priority and merit and affected a large number of people. The DPM asked whether it could be appraised at an early date. Mr. Bell indicated that we would need to review the information available on the Program and the availability of the necessary staff before we could indicate the timing of a mission. Mr. McNamara suggested that the Region consider the question of how soon a mission could be scheduled and that the details of the project be further discussed by the Bank's staff with the Korean officials presently in Washington.

(iii) **Housing Project**: The DPM stated that their current strategy was to maintain the level of investment, and thereby the growth momentum and employment, through projects which required less foreign exchange and were more labor intensive. Greater emphasis was being given to agricultural development under the "Sae Maeul" Movement and to housing and public works. They planned to construct 70,000 housing units for low income groups this year and requested Bank assistance for this.

/rural clinical and sanitary facilities;
(iv) The Korea Securities Finance Corporation (KSPC): With regard to the IFC's investment in the KSPC, the DPM expressed his concern over the decision to reduce the amount of the IFC loan from $5 million to $2.5 million. There had also been the question of the interest rate; in discussion with the IFC he had, however, agreed to the suggested increase from 10 percent to 10.5 percent. In response to Mr. McNamara's inquiry about why this was not being treated as a domestic financing operation and not a sort of program loan which was not appropriate for IFC financing, the DPM said that they had tried to draw on the domestic capital market but that the situation in Korea was very different from that in the United States where security and finance companies underwrite loans. The problem was how to obtain the funds to lend to security dealers and underwriters to create similar facilities in Korea. (He cited the Brazilian case where AID had provided such financing.) The Government has provided Won 3 billion, and they had hoped to supplement this amount with the IFC contribution. He maintained that financial projects such as this would be as productive as physical projects.

Mr. McNamara agreed that financial projects are often highly productive; he understood the problem, which he had discussed earlier in the day with Mr. von Hoffman, and would try to find a solution to it. However, he was not in a position to give the DPM a definitive answer.

(v) Planning Assistance: The DPM said that his Government would like the Bank's role in the preparation of the Fourth Plan to be larger than in connection with the earlier Plans. They would like to receive substantial Bank assistance not only in reviewing but also in the actual formulation of the Fourth Plan. They intended seeking and expected to obtain UNDP financing of much of the consulting expertise needed and were proposing that the Bank act as the Executing Agency. They would like Bank support for this request. Mr. Bell said we would support their request and hoped to be able to provide maximum support to the Government in the preparation of the Plan. He pointed out that, even if UNDP financing of substantial outside expertise were arranged, a considerable amount of Bank staff time would be involved beyond that now provided or contemplated in the Bank's administrative budget.

7. In conclusion, the DPM expressed his appreciation of the Bank's assistance in the past and requested that the Bank's lending to Korea be increased to $500-600 million annually since prices have escalated and project costs have increased substantially. In this connection, he asked that the financing of the "Sae Maeul" project be additional and not in lieu of other proposed project financing. He conceded that he might be asking too much.

8. Mr. McNamara said that while Korea was not asking too much and needed such amounts of assistance, it was more than the Bank could provide given existing limits on the Bank's total lending program. It was because Korea had so spectacular a record of economic performance that the Bank has been inclined to provide more for Korea than for other countries of comparable size. The amount of around $300 million which would be lent to Korea in FY75 out of a
MEMORANDUM FOR THE RECORD

February 25, 1975

The total Bank lending volume of about $3.5 billion was a high proportion. While he disagreed with the limitation on Bank lending imposed by the Board and would endeavor to obtain Board agreement to increase the size of the program when the next five-year program is considered in May or June, for the time being it was necessary to operate within the established limits and to apportion the available resources equitably among the developing countries. In these circumstances, he would be misleading the DPM if he left the impression that his request could be met.

cc: Mr. McNamara's Office
    Mr. Knapp
    Mr. Kirmani
    Mr. Hasan
    Mr. Ruddy

DLoos/GBVotaw/BRSell/pme
TO: Mr. Robert S. McNamara  
FROM: Bernard R. Bell  
SUBJECT: KOREA - Meeting with H.E. Duck Woo Nam, Deputy Prime Minister and Minister, Economic Planning Board  

DATE: February 14, 1975

Attached is a brief prepared for your meeting with H.E. Duck Woo Nam, scheduled for 2 p.m. on February 18, 1975.

Attachment

cc: Mr. Knapp
DLoons/pme
A BRIEF FOR
MR. McNAMARA'S MEETING
WITH
HIS EXCELLENCY DUCK WOO NAM
DEPUTY PRIME MINISTER OF KOREA AND MINISTER
ECONOMIC PLANNING BOARD

1. Korea's current economic situation and the Bank's role in assisting
them to surmount the problems they are encountering are likely to be the
topics which the Deputy Prime Minister will wish to discuss with Mr. McNamara.

A. The Economy

2. Recent information indicates that the balance of payments position,
especially in the first half of 1975, may be more difficult than was envisaged
when the program loan was appraised in September/October 1974. In 1974,
although exports increased to about $4.4 billion compared with $3.2 billion
in 1973, the current account deficit was about $1.8 billion, $800 million of
which was financed from inflows on the capital account including direct
private foreign investment, medium and long-term loans to the Government
and private sector, and short-term trade financing. The overall balance of
payments deficit was $1 billion — considerably higher than the estimate at
the time the program loan was appraised. About $600 million was met from
short-term borrowing by the banking system, and a total of about $1.85 million
was provided by the IMF (oil facility — $108 million, gold and first credit
trenches — $48 million, and SDR's — $29 million). In addition a bridging
loan of $100 million came from the syndicate of US banks who are expected
to provide the Bank of Korea shortly with a loan of about $200 million.
(The terms are repayment over 5 years, including one year's grace, and interest
at two points over the London Inter-Bank Rate). The balance of the overall
deficit last year was met mainly by a reduction in the Bank of Korea's
foreign exchange assets.

3. For 1975, the Government's export target is $6.0 billion and the
current account deficit is forecast at $1.1 billion. This improvement depends
heavily on a recovery of exports in the second half of the year. The first
half of the year will be extremely difficult. There is not yet any sign of a
pick-up in export earnings (in fact the LC openings were still declining in
January). In the first half of 1975, the overall balance of payments deficit
is likely to continue to run at an annual rate of almost $1 billion. Korea
will have to rely on continued support from the commercial banks in this
period (with perhaps a further decline in Bank of Korea foreign exchange
assets). This will result in a further substantial decline in Korea's
net foreign exchange reserves which were less than $100 million at the end
of 1974. Most of the quick-disbursing official assistance, and the use of
the IMF oil facility and any funds that can be obtained from OPEC countries
this year will probably become available only in the second half of the year.
However, the commercial banks are becoming quite nervous about their already
high exposure in Korea, since the recovery of exports in the second half of
the year is by no means assured. In these circumstances, the Korean authorities
are most anxious to obtain as much quick-disbursing loan capital, on suitably
long term, as they can.
B. Bank Assistance

4. The FY75 Lending Program: In recent discussions, the Korean authorities expressed their appreciation of the substantial increase in Bank lending proposed for FY75; the decision to increase the amount of the proposed program loan from $75 million to $100 million in response to their request will be welcomed. This, together with the proposed loan to the Korea Development Bank (KDB), will provide $160 million (about 40 percent of the Lending Programs in FY74 and FY75) in the form of quick-disbursing loans which are required to mitigate the additional burden resulting from the increased oil prices. The revised FY75 Lending Program is as follows:

<table>
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<tr>
<th>Project</th>
<th>Amount ($ Million)</th>
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<tr>
<td>Secondary Cities Regional Project</td>
<td>15.0</td>
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<td>Education III</td>
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<tr>
<td>KDB I</td>
<td>60.0</td>
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<tr>
<td>Railways V</td>
<td>100.0</td>
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<tr>
<td>Program Loan</td>
<td>100.0</td>
</tr>
<tr>
<td></td>
<td><strong>297.5</strong></td>
</tr>
</tbody>
</table>

5. The fifth loan to the Korea Development Finance Corporation was scheduled for Board presentation on June 17, 1975. Although we could probably have advanced it by about two weeks, it is being rescheduled for July to comply with the instruction that the FY75 program be kept within the amount of $300 million approved at the CPP Review Meeting in May 1974.

6. The Level of Lending in FY76-79: The DPM may inquire about the level of lending planned for Korea beyond FY75. The approved Lending Program provides for an average annual level of lending of $225 million in FY76-79. (A copy of the most recent Table IVA-Korea Operations and Lending Programs - is attached. It does not reflect the changes in the FY75 Program referred to above and those that may be recommended for the subsequent years in the CPP due for review in August 1975).

C. Topics relating to Bank Operations which the DPM may raise

7. A Second Program Loan: At the last CPP Review Meeting, it was decided that a second program loan of $50 million should be maintained in the FY76 program on the understanding that its inclusion was not to be interpreted as a firm commitment and that it should be reviewed at the appropriate time. The Korean authorities have requested that a second program loan be made, if possible by December 1975, in view of the continuing impact of the enhanced oil prices and international inflation on the economy. They have not been
informed of the Bank's position on this. The DPM may well request an even larger second program loan than the first and that this be provided in addition to the Bank's proposed project lending in view of his fears, which we share, that if adequate resources are not available, Korea's growth momentum would be retarded with serious effects on employment.

8. **Assistance for the Agricultural and Rural Sectors:** We understand that the DPM is also likely to ask for greater Bank support of their efforts to develop the agricultural and rural sectors. They are giving the highest priority to such development and particularly to the "Sae Maeul" (New Community) Movement which President Park initiated in 1971 to improve the quality of rural life and to reduce the income disparity between the rural and urban areas. The Economic Mission, presently in Korea, is examining the proposals made by the Korean authorities, including assistance in financing a "Sae Maeul" package project.

9. **The Amount and Terms of Bank Loans:** One of the issues discussed at previous meetings the Koreans had with Mr. McNamara was the percentage of total project cost financed by the Bank. They requested that, for projects with relatively low foreign exchange components, the proportion financed by the Bank should be increased over 50 percent and also that longer grace and repayment periods - particularly for agricultural projects - be provided. During the last CPP review, it was decided that, as a general rule, the Bank would limit the financing of projects to 50 percent or the foreign exchange component, whichever was higher. This was expected to provide a substantial element of local cost financing as a result of the increased emphasis on agricultural and regional development projects.

10. **Supplementary Financing:** Substantial cost overruns are being experienced on three of the 17 Bank-supported ongoing projects, primarily as a result of the marked increases in import prices since the projects were appraised. The Korean authorities have requested supplementary financing in these cases, and the DPM may do so again. At the review of problem projects in July 1971, Mr. Knapp indicated that he would be reluctant to consider such supplementary financing especially since considerable local cost financing was already provided and because counterpart funds would be generated by the forthcoming program loan to Korea.

11. **Provision of Counterpart Funds:** The proportion of Bank financing has a bearing on another issue - the provision of counterpart funds by the Government for Bank-supported projects. Success of a larger program of Bank lending to Korea is dependent on the provision of adequate counterpart funds by the Government. Its ability to do so had been affected in the last two years by its efforts to deal with other major problems, such as inflation. However, as a result of the emphasis that has been placed on this matter in recent discussions with the Korean authorities, adequate provision for Bank-financed projects has been made in the current budget.
D. Bank Assistance in the Preparation of the Fourth Five-Year Plan:

12. Mr. Mahn Je Kim, President of the Korea Development Institute, visited the Bank last month to convey a request from the Korean authorities for Bank assistance in the preparation of the Fourth Plan (1977-81). The Korean authorities have now presented a proposal outlining the assistance they need. A separate memorandum on this subject is being prepared.

E. OPEC Financing

13. The latest CPP for Korea (May 2, 1974) noted that the extent to which Korea's resource requirements could be met by recycling some of the massive resources of the OPEC countries was uncertain. Since then, Korea has achieved some success in tapping these resources; the Korea Development Bank recently placed $19 million of its Industrial Finance Debentures in Abu Dhabi at 6.5 percent interest with repayment over 15 years, including six years of grace. The KDB is endeavoring to raise a further $100 million from the OPEC countries through its New York banking contacts. Given the Bank's involvement in planning for investment of funds from these countries, Mr. McNamara might ask the DPM for an account of Korea's experience with OPEC and the Government's assessment of their future prospects for OPEC financing. The DPM himself may inquire about the possibility of obtaining Bank assistance in raising investment funds for Korea from OPEC sources and about the prospects of some of the OPEC countries participating in the Consultative Group on Korea.

Attachments:
   A Biographical Note
   Table IVA - Korea Operations and Lending Programs

February 1975
BIOGRAphICAL NOTE

Mr. Nam was born on October 10, 1924, graduated from Seoul National University and received a PhD degree in Economics from Oklahoma State University in 1961. He was Professor of Economics at Kookin University (1963-64), Yonsei University (1964) and Sogang University (1964-69). In 1969, he was appointed Minister of Finance and remained in that office until assuming his present position as Deputy Prime Minister and Minister, Economic Planning Board in September 1974.

Mr. Nam is recognized as having excellent knowledge of the Korean economy and a keen awareness of the economic problems confronting the country, and has published many books and articles on various aspects of the Korean economy. He has travelled extensively and is well-versed in English.
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MEMORANDUM FOR THE RECORD

From: Bernard R. Bell

Subject: Annual Meeting, Washington, D.C. 1975 - Meeting with the Korean Delegation

1. The following members of the Korean Delegation called on Mr. McNamara at 11 a.m. on August 29, 1975:

   H.E. Yong Hwan Kim - Minister of Finance
   Mr. Sung Hwan Kim - Governor, Bank of Korea
   Mr. Byong H. Shin - Special Adviser to the President
   Mr. Jong Kun Park - Chief, First Loan Division, Economic Planning Board

   Messrs. Knapp, Bell, Votaw, Hasan and Loos were also present.

2. Recent economic developments: The Minister of Finance outlined developments since the beginning of 1974. He said that Korea had experienced a very difficult economic situation last year and in the first half of 1975. The current account deficit during the eighteen-month period was $3.6 billion ($2.0 billion in 1974 and $1.6 billion in the first six months of 1975). This was financed by $1.3 billion of long-term external finance, $800 million of trade credits and $1.5 billion borrowing through the banking system (including a $200 million syndicated bank loan). However, there had been a turning point in the last two or three months. Exports to Europe and the Middle East were increasing; Saudi Arabia and Iran were the main markets in the Middle East and purchased primarily construction materials and textiles with earnings from construction contracts adding to the foreign exchange receipts. Moreover, imports appeared to be stabilizing, and the June production index showed a 13.2 percent increase over the June 1974 figure. In view of this, the current account deficit for the second half of the year was expected to be only $200 million; the rate of GNP growth in real terms for 1975 as a whole is foreseen as 6.4 percent.

3. Prospects for 1976: Because of the positive signs of an upturn and the bumper crop expected in the fall, the payments deficit in 1976 was likely to be of the order of $1.4 billion; this was associated with a growth of 8 percent in real terms. If the price of oil should be increased by 15 percent, the estimated payments deficit would be a little over $1.5 billion. Korea intended to avoid another build up in the volume of short-term credits, but planned rather to attempt to improve the maturity structure of their external debt; the Government hoped to obtain gross foreign capital inflows of $1.8 billion in 1976.
4. Bank lending: The Minister of Finance referred to the overall amount of $325 million proposed for Bank lending in FY76. He urged that this amount be increased and particularly that a larger program loan, of $100 million, be provided. He stressed the importance of quick-disbursing program lending not only as a support to development programs but also as an effective way to assist with Korea's balance of payments problem.

5. Mr. McNamara indicated that he would not make a final decision at this time but would study carefully the briefing paper which the Minister had handed to him. However, he wished the Minister to understand the reasons why the prospects for increasing the amount of Bank lending to Korea in FY76 were remote. The position had changed considerably over the last seven or eight years; the Bank Group's worldwide lending commitments had increased during this period from some $1 billion a year to $6 billion in FY75 and are expected to be some $7 billion in FY76. This would provide about $3.50 per person for the two billion people in developing member countries. In the Korean case, the proposed lending was about $10 per capita. The situation which obtained earlier (in which credit-worthiness, and not the availability of resources, was the constraint on Bank lending to a particular country) no longer prevailed; the limits imposed by the stipulation in the Bank's Articles of Agreement regarding the relationship between the lending level and subscribed capital were now being approached and, until a solution to this problem was worked out in the next few years, there would be severe constraints on the volume of Bank lending. In these circumstances, Korea would have received an allocation of about $100 million if it were not for her extraordinary economic achievements which justified a program of the magnitude proposed.

6. As far as the program loan was concerned, Mr. McNamara pointed out that the Bank was basically a project lending institution, and it was only because of Korea's special circumstances that a second program loan in an amount of $75 million was proposed. It was not possible to decide at this stage that the amount of the loan would be increased.

7. Third Window: Mr. McNamara indicated that, while the Board had approved Third Window lending in principle, the commitments to the interest subsidy fund by donor countries were not yet sufficiently firm or in hand to permit decisions regarding allocations.

8. Export diversification: Mr. McNamara complimented the Koreans on their success in diversifying their export markets, thereby reducing their dependence on the U.S. and Japan. He agreed that there was an increasing tendency on the part of countries to impose trade restrictions in view of the growing unemployment within their borders; however, this problem was not one that applied to Middle Eastern markets.

9. OPEC Financing: In response to Mr. McNamara's enquiry about the success the Korean authorities had had with obtaining resources from the OPEC countries, the Minister said that they had developed close contact with
the Iranians and the Saudi Arabians. They had received a positive response from the Saudi Fund for Development (SFD), but had failed to get a commitment from the Saudi Arabian Monetary Agency in respect of either commercial or official loans which they had sought. The Korea Development Bank was also attempting to issue its Industrial Finance Debentures (in an amount of $20 million) in Kuwait. Mr. McNamara said he was glad that the SFD would be willing to co-finance some Bank-supported projects in Korea. He suggested that Mr. Knapp should take up with Mr. Al-Hamed of the Kuwait Fund the question of assistance to Korea. (Later in the week Votaw spoke to Al-Hamed, who said the Kuwait Fund was very interested in Korea, where he hoped to visit on his next trip to Asia. This conversation was reported to Minister Kim.)

10. **Future Bank Group Operations:** Mr. McNamara referred to the complex and difficult challenges to be faced in the next three or four years. These included the fifth IDA replenishment and the selective and general capital increases, without which Bank lending would have to be severely curtailed. There was need for prompt constructive international action if the Bank Group was to play an effective role in the next 25 years as it had in the past. The Minister indicated Korea's strong support for all these proposals of Management, which would permit continued expansion of Bank Group activities in support of international economic development.

Cleared with and cc: Mr. Votaw
cc: Messrs. McNamara, Knapp, Bell, Kirmani, Hasan

ILcos/pme
ANNEX I

BIOGRAPHICAL SKETCHES

Yong Hwan KIM - Minister of Finance

Mr. Kim was born on February 5, 1932, and graduated from the College of Law of the Seoul National University. He served in various capacities in the Ministry of Agriculture between 1956 and 1970, being Assistant Minister for Agricultural Policy in the period 1968-70. He was Secretary to the President for Foreign Loan Affairs (1970-72), Vice Minister of Commerce and Industry briefly in 1972, Vice Minister of Finance (1972-73) and First Senior Secretary to the President for Economic Affairs from 1973 until his appointment as Minister of Finance in 1974.

Sung Hwan KIM - Governor, Bank of Korea

Mr. Kim is 55 years old and is a graduate of the Fukushima Commercial College in the northern part of Japan. In 1961, he was appointed a Director in the Bank of Korea and has been Governor of the Bank since 1970.
MEMORANDUM FOR THE RECORD

May 20, 1976

FROM: David Loos, Chief, Division E Country Programs, East Asia and Pacific

SUBJECT: KOREA - Mr. McNamara’s Meeting with H.E. Duck-Woo Nam, Deputy Prime Minister and Minister, Economic Planning Board

1. Mr. McNamara met with H.E. Duck-Woo Nam at 3 p.m. on Thursday, May 13, 1976. The Deputy Prime Minister (DPM) was accompanied by Mr. B.H. Shin of the President’s Office, Director Tchah of the Economic Planning Board, Director Ham of the Ministry of Foreign Affairs and Minister Yang of the Korean Embassy. Messrs. Votaw, Burmester and Loos were also present for the Bank.

2. The DPM expressed his appreciation of the support the Bank had given Korea, particularly in the last two years which had been a very difficult period. The work the Bank staff and consultants had done to assist in the preparation of the Fourth Plan had been extremely useful. Mr. McNamara said that he was glad that the Bank had been able to provide assistance to Korea which had done what it could to help itself. He referred to the measures Korea had taken to adjust to the changing international economic climate and to offset the adverse effect of external factors.

3. The DPM outlined the developments in 1975 and the first four months of 1976. He said that Korea had done better than most developing countries. The GNP growth rate in 1975 had been of the order of 8 percent and exports had grown by about 10 percent. The performance in the first four months of this year showed a marked improvement; manufacturing output was 36 percent higher than in the corresponding period of 1975, exports were 56 percent higher, the balance of payments situation seemed to be considerably stronger and prices appeared to be stabilizing. The outlook was, therefore, considerably brighter than it had been a year ago. However, the severe impact on the economy of the oil crisis and the recession had made it impossible to achieve the earlier objective of closing the balance of payments gap by 1976. They now hoped to do so by the end of the Fourth Plan in 1981. The assumptions on which the Fourth Plan was being based were export growth at 17 percent a year compared with 23 percent in the last five years and imports at 12 percent per annum compared with 9 percent in the preceding five years. They expected to achieve a current account balance of $13 billion in exports and imports by 1981.

4. The next three years were critical. The DPM, thus, requested that the Bank provide a larger volume of assistance in these years, and a lesser amount in the subsequent two years of the Fourth Plan. They had assumed an average of some $400 million annually in the Plan period.
He informed Mr. McNamara that he had spoken to Mr. Bell about this and had been told that the total Bank lending in FY77 would be of the order of $5-5.8 billion, but that Mr. McNamara had not decided on the allocation of this amount among the various borrowing countries. Mr. Bell had, however, indicated that the amount for Korea would be somewhat less than the $400 million they had requested.

5. Mr. McNamara pointed out that the capital structure of the Bank had been the subject of review over the last ten months or so. A final decision had not been taken, but the selective capital increase had been approved by the Board last week. He was confident that total lending in FY77 would be of the order of about $5.8 billion. However, what was even more important was the decision about further capital increases in the subsequent years. Although the actual capital subscriptions would not be required until the mid-eighties, unless approval in principle was received in the course of the next year, lending would have to be held at the FY77 level. The position of IDA was even more of a problem. The U.S. had not met its commitment under the Fourth Replenishment, and unless the Fifth Replenishment was agreed to, it would not be possible to provide further IDA credits after about May next year. Mr. McNamara, while pointing out some of the difficulties Part I countries were experiencing, said the need was now and, therefore, he intended to raise the question of Bank/IDA resources and lending programs at the Annual Meeting in Manila so that the Governors could focus on this crucial question.

6. As far as lending to Korea was concerned, Mr. McNamara said that not only the Region but also he himself wished to do as much as was required to support Korea's development efforts, which were addressed to such issues as more equitable income distribution and the general improvement in the quality of life of all segments of the population. However, it would be misleading if he gave the impression that there was a high probability of being able to provide $400 million in FY77. He could assure the DPM that Korea would get more than the average, but this would not take the figure to near $400 million. There were about one billion people in the borrowing countries and, assuming that the total lending in FY77 was $5.8 billion, the per capita amount would be $5.8. Korea, with a population of some 40 million, would, therefore, receive a minimum of $232 million. He assured the DPM that Korea would receive more than this, but not the $400 million the DPM had requested. The DPM expressed the hope that the trend limiting the Bank's lending capacity would be reversed and said that Korea was considering making a small contribution to IDA. Mr. McNamara said that they should do so, because this would support the efforts to raise adequate resources under IDA.

7. The DPM referred to the success they had had in developing their relations with the oil surplus countries, particularly Saudi Arabia and Iran. There were more than 7,000 Koreans working in those two countries, and they had been successful in winning contracts to the value
of over $800 million in Saudi Arabia. Korean workers had proven to be intelligent and diligent and he expected Korean contractors to secure more contracts in Saudi Arabia. The Saudi Fund for Development (SFD) had already provided a loan of $35 million for a ports project and a further loan of $35 million was to be finalized next month. Mr. McNamara said he had told the SFD that they could have any of the Bank’s projects for financing in whole or in part. He was going to Saudi Arabia next week to discuss the possibility of their providing additional resources to the Bank.

8. In response to a question by Mr. McNamara, the DPM said they had been in close touch with the Iranians and had had an interministerial meeting in Seoul last November. Unfortunately, Minister Ansary, who had led the Iranian delegation, had had a heart attack and this had slowed down progress on the various matters that had been agreed to.

9. Finally, the DPM suggested that Mr. McNamara should visit Korea after his visit to Saudi Arabia. He said that President Park had asked him to convey his invitation to Mr. McNamara. Such a visit would enable him to see the results of the Bank’s support and the developments since his last visit more generally. Mr. McNamara requested the DPM to express his thanks for the invitation to the President and said he would very much like to accept, but would not find it possible to do so in the near future.

Cleared with and cc: Mr. Votaw
cc: Mr. McNamara’s Office
Mr. Knapp
Mr. Bell
Mr. Kirmani
Mr. Hasan
Mr. Ruddy
Mr. Diamond (esp. para. 6)

DLoos:at
OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara
FROM: Gregory B. V.
DATE: May 10, 1976

SUBJECT: KOREA: Meeting with H.E. Duck-Woo Nam, Deputy Prime Minister and Minister, Economic Planning Board

Attached is a brief prepared for your meeting with H.E. Duck-Woo Nam, scheduled for 3 p.m. on May 13, 1976. The brief may have to be modified or supplemented in the light of further information we expect to receive from Mr. Bell, who is presently in Korea, on the topics the DFM would like to discuss.

Attachment:
DLoos:1ka
1. Korea's current economic situation and prospects and the Bank's role in assisting the Government's development efforts are likely to be the topics which the Deputy Prime Minister will wish to discuss with Mr. McNamara.

A. The Economy

2. A detailed review of economic developments and the Government's policy response in recent years, together with a discussion of the current economic situation and the medium term problems and prospects, is given in the President's Report on the Second Program Loan (Report No. P-1764-KO, dated February 17, 1976); a statement on the Government's "Growth and Stabilization Policy" is included as Annex IV of the Report. In accordance with this policy, the principal Government objectives for 1976 are to reduce the balance of payments deficit to $1.5 billion (from $1.9 billion in 1975) and to hold the increase in wholesale prices to a level of around 10 percent, as compared with just over 20 percent in 1975. Data available subsequent to the preparation of the report on the Program Loan suggest that the projections for 1976 are likely to be achieved. There has been a considerable improvement in the first quarter of the year continuing the trend which commenced in the last quarter of 1975. Exports are buoyant, imports are being maintained at planned levels and price increases have declined quite markedly. It is possible that exports and GNP will grow significantly faster than current targets, but the accumulation of demand pressures might make it more difficult to restrain inflation to the level envisaged.

3. As noted in the statement on "Growth and Stabilization Policy", an increase in domestic savings is an immediate policy objective. Strong action has been taken to control inflation and measures adopted to increase savings, such as the special scheme which came into effect on April 1 offering incentives for household savings among those in the lower and middle income brackets. In the preparation of the Fourth Five Year Plan, the Government has recognized the importance of mobilizing more domestic savings and additional measures might well be necessary to achieve the targets.

a/ A copy of the report is attached.
B. The Fourth Five Year Plan

4. Bank staff have been very closely associated with the Korean authorities in the formulation of the Fourth Five Year Plan for the period 1977-81. In addition to normal consultations, there has been a considerable intensification of contacts through the UNDP Planning Assistance Project, for which the Bank is the Executing Agency. Consultations have taken place on the macroeconomic framework of the Plan as well as sectoral investment programs and policies. It is expected that a reasonably firm draft of the Five Year Plan will be available for review by the Basic Economic Mission which will visit Korea in June/July 1976. A team of officials from the Economic Planning Board and the Korean Development Institute is expected to spend a week in Washington (May 17-21) for discussions of the draft Plan with Bank staff.

C. External Assistance

5. In 1973, it appeared that Korea was well on the way to eliminating net inflows of foreign capital. However, international economic difficulties of the last two years have caused a re-emergence of the resource constraint. The adverse shift in the international terms of trade by 18.6 percent in 1974 and an estimated 11.6 percent in 1975 caused Korea to suffer a real income loss of the order of 7 percent (at 1970 prices and exchange rates) and gross national income rose by only 4.2 percent in 1974 and 3.2 percent in 1975 compared with increases of 6.7 percent and 15.2 percent in the previous two years. As noted in paragraphs 13 to 25 of the attached President's Report, the Korean Government has already taken and is contemplating a number of measures to adjust to this new situation and to strengthen the balance of payments. However, as a result of the recent developments, progress towards the goal of eliminating net capital inflows is likely to take longer than originally expected if the optimum use of Korea's growth possibilities is to be assured. The ability to obtain foreign capital in adequate amounts and on reasonable terms will, thus, continue to be a severe challenge to Korea. While commercial borrowing can be used effectively to supplement official capital, it is an unreliable and expensive base for the type of capital dependent development policy Korea has pursued and intends pursuing. Korea's future growth performance will, therefore, depend to a significant degree on the availability of official capital.

6. The Korean authorities are aware that raising resources to the extent and in the form required if their plans are to be implemented will not be an easy task. They realize that they may well have to lower their sights as they did when the international economic events of the last two years caused them to modify significantly their long-term investment plans which had been prepared in 1973. We expect them to continue to adopt this pragmatic approach but do not consider it necessary at this stage to discourage them from proceeding with the formulation of their plans on the lines they propose, since an essential part of Korea's development strategy is to build the production capacity for a continued expansion of exports without
which the balance of payments outlook might deteriorate substantially. While the projected targets are quite ambitious, the performance in the last decade or so suggests that, given the necessary support, it is not beyond their capacity to achieve them. In any case, the Basic Economic Mission will give us an opportunity to undertake a detailed examination of their plans, including the question of the availability of both domestic and foreign capital.

7. A summary of the estimated resource requirements and possible sources of financing during the period 1975 to 1981, and the assumptions on which the estimate is based, are set out in Attachment I. As indicated, the resource gap (balance on goods and non-factor services) is expected to decline from $1,900 million in 1975 to $200 million in 1981; it is possible that the deficit will be eliminated shortly thereafter. This will be negated in part by the increase in amortization payments, which are estimated to rise from $143 million to $1,170 million in the corresponding period. Consequently, we estimate that gross disbursements of medium- and long-term loans of about $1,900 million will be required on average each year. This will require commitments of about $2,300 million annually during the 1976-81 period. These projected requirements provide for an increase in Korea's reserves to a level sufficient to cover only about 2-1/2 months' imports by 1981, as indicated in Attachment I. In view of Korea's heavy trade dependence (presently about 60 percent of GNP and expected to increase to about 70 percent by 1981), it would be prudent for the Korean authorities to increase reserves even further.

8. As suggested above, obtaining external capital of this order of magnitude will not be easy; official and commercial commitments were only $975 million and $800 million respectively in 1975. Moreover, bilateral concessional assistance is expected to continue to decline, and it is likely that, after 1977, the net inflow from the IMF, on the basis of the existing facilities, will be very small or possibly negative. Korea's vigorous efforts to tap the resources of the OPEC countries have already borne fruit, but the extent to which further amounts will be forthcoming from this source is uncertain. Furthermore, the sources from which Korea obtains assistance are limited, since it has no access to aid from the Eastern Bloc and has not yet developed substantial ties with other European countries. Korea will, therefore, have to look to the Bank and ADB for substantial volumes of assistance.

9. The servicing of borrowing on the scale envisaged is not likely to pose a problem, provided about half the new commitments would be forthcoming from official sources (Governments, Eximbanks and international organizations). Assuming that the average maturity of total external borrowing remains at about 13 years (including about three years of grace), and that the average interest rate is maintained at around 8 percent, Korea's debt service ratio is projected to increase to about 15 percent of export earnings by 1978 and
to decline thereafter to about 12 percent by 1981. Starting in 1980, it should be feasible for Korea to phase out net official development assistance quite rapidly and rely increasingly on commercial sources. However, if an excessive proportion of Korea's capital requirements in the next few years is obtained on more onerous terms than we have assumed, there is likely to be an accumulation of amortization payments around 1980 which could create a debt servicing problem.

D. Bank Assistance

10. The case for increasing the level of Bank/IFC lending to Korea in the next two fiscal years is a cogent one. Over the last decade or so, Korea has demonstrated that it has both the will and the ability to use the resources available to it to the best advantage. This is reflected in the way in which the Bank-supported projects and programs have been implemented. Its ability to maintain the growth momentum, which is necessary if the required employment opportunities are to be provided and the standard of living and quality of life of all its people are to be improved, will depend in large measure on its ability to secure on reasonable terms the external resources it requires into the 1980's. As indicated above, the heavy recourse to short-term borrowing in 1974 and 1975 (which increased from $456 million outstanding at the beginning of 1974 to $1,900 million at the end of 1975) makes it essential that Korea continue to increase its export earnings, so that its debt service obligations at the end of the decade will not be excessive.

11. The Government has sought our views on a wide range of economic issues and has given them considerable weight in policy formulation. The Bank has an important role as Chairman of the Consultative Group to help persuade other official lenders to maintain a satisfactory level of official development assistance; commercial lenders are also influenced quite considerably by the Bank's assessment of Korea's economic situation and by the Bank's role in supporting its development efforts. It is vital, therefore, that the Bank's support should not be reduced at this crucial stage.

12. Based on the regional allocations received from Mr. Knapp on April 16, the lending program for Korea has been set at $1.5 billion for the period FY77-81; the Region has recommended a commitment level of $360 million in FY77, dropping to $250 million in FY81 (from $227 million to $130 million in real terms, using the commitment deflator as per P&B's Table IV of April 30), reflecting Korea's declining reliance on foreign savings. While this implies relatively high per capita lending ($94.6), it is necessary to point out that Bank Group lending to Korea from FY63 through FY74 amounted to only $610 million, or an average of some $1.5 per capita annually. Consequently, even with the proposed level of lending, the share of the Bank Group in Korea's total external debt (outstanding) would be about 1½ percent and its share in Korea's debt service of the order of 7 percent, by 1981. Korea's share of total debt outstanding to the Bank Group is estimated to remain below 4 percent through 1981.
13. The Level of Lending in FY77: The Korean authorities have indicated that the DFM may request Bank lending in an amount of $30.8 million for FY77. The allocation of this amount as proposed by the Koreans and the provision in our current lending program are set out in Attachment II. During their recent visit to Seoul, Messrs. Votaw and Loos advised the Koreans that lending at a level of over $400 million was quite out of the question in FY77, due to the constraints on the Bank's total commitment authority, however justified an increase might be in terms of Korean economic policies and plans.

14. Industrial Machinery Project: In response to a request from the DFM that the Bank consider providing a loan of $95 million to meet the foreign exchange cost of an industrial machinery project to be implemented by Hyundai International Inc., Mr. McNamara's letter of April 30, 1976 indicated that there were a number of factors which had to be considered before a decision could be taken on whether to proceed with processing a Bank loan for this project, and suggested that, as the first step, the details be discussed by the Korean delegation when it visited Washington later this month.

15. The Industrial Projects Department has carried out a preliminary review of the loan application and suggested that the Hyundai Company should send representatives to the Bank in early June to clarify certain aspects of the proposal, particularly in regard to the project content and marketing and licensing arrangements, and to discuss what further action should be taken to prepare the project thoroughly. A cable has been sent to the Economic Planning Board accordingly (a copy is attached).

Attachments:  External Capital Requirements
               The FY77 Lending Program
               Cable re The Industrial Machinery Project
               Biographical Note
               President's Report - Program Loan

May 10, 1976
# ATTACHMENT I

**KOREA: External Capital Requirements**

(millions of dollars)

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<tbody>
<tr>
<td>Resource Gap</td>
<td>2,423</td>
<td>2,381</td>
<td>2,412</td>
<td>2,176</td>
<td>1,877</td>
<td>1,244</td>
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<tr>
<td>Net Factor Payments and Transfers (includes interest payments)</td>
<td>2,072</td>
<td>1,859</td>
<td>1,510</td>
<td>1,069</td>
<td>194</td>
<td>525</td>
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<td>Amortization</td>
<td>-32</td>
<td>79</td>
<td>278</td>
<td>337</td>
<td>533</td>
<td>438</td>
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<td>Sources</td>
<td>2,423</td>
<td>2,381</td>
<td>2,412</td>
<td>2,176</td>
<td>1,877</td>
<td>1,244</td>
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<tr>
<td>Private Investment</td>
<td>104</td>
<td>42</td>
<td>135</td>
<td>203</td>
<td>280</td>
<td>241</td>
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<td>Medium and Long-Term Loans (gross)</td>
<td>1,136</td>
<td>1,504</td>
<td>1,989</td>
<td>2,066</td>
<td>2,289</td>
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<td>Other Inflows (net)</td>
<td>423</td>
<td>915</td>
<td>288</td>
<td>80</td>
<td>-225</td>
<td>-216</td>
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<td>Use of Net Reserves</td>
<td>760</td>
<td>-80</td>
<td>0</td>
<td>-173</td>
<td>-47</td>
<td>-299</td>
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The principal factors underlying these projections are:

1. Export growth at 20 percent per annum in current prices during 1977-81.
2. Import growth at 16 percent per annum in current prices during 1977-81.
4. Amortization of medium and long-term debt rising from $443 million in 1975 to $1,170 million in 1981.
5. Maintenance of gross foreign exchange holdings at 2.5 months of current year's imports.
6. An improvement in the maturity profile of external debt, reducing the proportion of short-term debt in total debt outstanding from 25 percent at the end of 1975 to 11 percent by 1981.

Date: May 7, 1976

SOURCE: Divisional Estimates
## THE FY77 LENDING PROGRAM

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<th>Project</th>
<th>Korean Proposal $ Million</th>
<th>Amount in Current Program $ Million</th>
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<tr>
<td>Second Agriculture Credit</td>
<td>27.0</td>
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<td>Yong San Gang II Irrigation</td>
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<td>KDB II</td>
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<td>Urban Housing</td>
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<tr>
<td></td>
<td><strong>430.8</strong></td>
<td><strong>360.0</strong></td>
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</tbody>
</table>

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1/ Proposal presented by Government during Mr. Votaw’s recent visit to Seoul.

2/ Program proposed by Region.

3/ Based on appraisal estimates.

4/ Foreign exchange component.

5/ Amount being reviewed by appraisal mission presently in field. Government may propose that this be deferred to FY78 and that the Industrial Machinery project be substituted for it in FY77.

6/ Not in Mr. Kirmani’s memo of April 23 to Mr. Adler.
FURTHER TO MR. McNAMARA'S LETTER OF APRIL 30 RE THE INDUSTRIAL MACHINERY PROJECT COMMA THE LOAN APPLICATION HAS NOW BEEN REVIEWED AND WE WISH TO EXPLORE POSSIBILITY OF WORKING TOGETHER WITH HYUNDAI INTERNATIONAL INC. ON THE PROJECT STOP THE PROJECT IS VERY COMPLEX AND AN ASSESSMENT OF ITS MERITS WOULD ENTAIL DETAILED ANALYSES OF MAJOR INDUSTRIES WHICH WILL BE PRINCIPAL PURCHASERS OF THE OUTPUT STOP BOTH MR. SUN KI LEE AND PRESIDENT CHUNG INDICATED DURING OUR RECENT VISIT TO SEOUL THAT ARRANGEMENTS COULD BE MADE FOR A TEAM FROM THE COMPANY TO VISIT WASHINGTON TO DISCUSS PROJECT AND FURNISH FURTHER DETAILS STOP WE HOPE THIS CAN BE SCHEDULED IN EARLY JUNE AS OUR TECHNICAL STAFF CONCERNED WITH THIS TYPE OF PROJECT WILL BE ON MISSION UNTIL THEN STOP DISCUSSIONS WILL HAVE TO COVER A BROAD RANGE OF TOPICS INCLUDING THE FOLLOWING COLON

AAA  RATIONALE FOR INCLUDING PRODUCTION LINES FOR VARIOUS PRODUCTS AND FOR PROJECT SCOPE
BBB  NATURE OF LICENSING AGREEMENTS FOR PRODUCTION OF PROPOSED PRODUCTS
CCC  PHASING AND BUILD UP OF SPECIFIC PRODUCT LINES
DDD  MARKET AND MARKETING ARRANGEMENTS INCLUDING CREDIT FACILITIES FOR DOMESTIC SALES AND EXPORTS
EEE  ACTIVITIES AND GENERAL ASPECTS CONCERNING HYUNDAI STOP

HOPE PROPOSED TIMING FOR TEAM'S VISIT IS CONVENIENT REGARDS

VOTAW
INTBAFRAD
Biographical Note

Mr. Nam was born on October 10, 1924, graduated from Seoul National University and received a PhD degree in Economics from Oklahoma State University in 1961. He was Professor of Economics at Kookin University (1963-64), Yonsei University (1964) and Sogang University (1964-69). In 1969, he was appointed Minister of Finance and remained in that office until assuming his present position as Deputy Prime Minister and Minister, Economic Planning Board in September 1974.

Mr. Nam is recognized as having an excellent knowledge of the Korean economy and a keen awareness of the economic problems confronting the country, and has published many books and articles on various aspects of the Korean economy. He has travelled extensively and is well-versed in English.

Mr. Nam is widely respected in Korea and abroad for his personal integrity as well as high intelligence. He has proven to be a keen and thoughtful reader of reports by Bank staff and consultants, concerning both government policy and project matters; he is also an excellent administrator who has resolved project implementation difficulties promptly whenever it has been necessary to bring these to his attention.
MEMORANDUM FOR THE RECORD

FROM: S. Shahid Husain

DATE: September 24, 1977

Mr. McNamara's Meeting with the Korean Delegation

1. The Korean delegation to the Annual Meetings which consisted of Messrs. Yong Hwan Kim, Minister of Finance; Sung Whan Kim, Governor, Bank of Korea; Byong Hyun Shin, Special Assistant to the President for Economic Affairs; Hwa June Tchah, Economic Planning Board; and Yoonsae Yang, Economic Minister, Embassy of Korea, called on Mr. McNamara at the Sheraton Park Hotel on September 24, 1977. Mr. Husain was also present. The following are the main points that arose in the discussion.

2. The Minister of Finance conveyed to Mr. McNamara the regards of President Park as well as his appreciation of the expansion of World Bank lending in Korea and the World Bank's role in support of the Korean development effort. In response to Mr. McNamara's inquiry about the status of the Korean economy, Mr. Kim gave the following account of recent developments.

3. He said that, while in 1976 exports had increased by 50% and the GNP by 10%, 1977 was expected to be a very good year also. The value of exports in 1977 is expected to be over $10 billion and the current account of the balance of payments would either be in balance or would show a small deficit. Despite the expected growth of the economy by about 10%, performance in respect of prices, particularly because of the excellent balance of payments position and the excessive liquidity created by it, would not be as good as expected, and the year might end with an inflation rate of about 13%. Regarding 1978, Korea expected to achieve an increase in exports of about 25% with foreign exchange reserves at the end of 1978 being somewhat in excess of $4 billion. Mr. Kim said that, despite this excellent performance, Korea would continue to need substantial assistance from the World Bank and other international sources since a substantial part of Korea's debt (more than $10 billion) had maturities of less than last year. There was, therefore, a need for improving the debt structure. Mr. Kim said that Korea was constantly trying to upgrade the quality of its exports, but was concerned about the resurgence of protectionism in the industrial countries.

4. Mr. McNamara expressed his admiration of the determination with which the Korean authorities were pursuing the objective of economic development. While confirming that the Bank would continue to extend a
high level of assistance, he suggested that the Korean authorities tapped other sources also. He made particular mention of commercial sources of funds which at the present stage of Korean development could be an important source of development finance. Mr. Kim said that various institutions in Korea were trying to tap this source.

5. Mr. McNamara said that the Bank's ability to increase its lending would depend very substantially on whether a significant increase in the Bank's capital would be approved by the member countries. In this regard, he had suggested to the Board that discussions on the various issues relating to the capital increase be held between now and the end of the year, with a view to reaching a specific conclusion in early 1978. Mr. Kim said that Korea would fully support a substantial increase in the Bank's capital.

cc: Messrs. McNamara
    Knapp
    Votaw
    Kirmani
    Hasan
    Loos

SSHusain:bcl
MEMORANDUM FOR THE RECORD

FROM: David Loos, Chief, Division E, Country Programs Department, East Asia and Pacific Regional Office

SUBJ: KOREA: Mr. McNamara’s Meeting with H.E. Yie-Joon Chang, Minister of Energy and Natural Resources

1. Mr. McNamara met with H.E. Yie-Joon Chang at 6:30 p.m. on Wednesday, April 26, 1978. The Minister was accompanied by Mr. Bong Suh Lee, Assistant Minister, Ministry of Energy and Natural Resources, and Minister Yoon Sae Yang and Counsellor Heung Koo Kang of the Korean Embassy. Messrs. Koch-Weser and Loos were also present for the Bank.

2. The Minister referred to the 15-Year Perspective Plan prepared by the Korea Development Institute which forecast a real growth of GNP at about 10% per annum. The main task of his Ministry was to develop the optimum energy mix in support of the economic growth on the scale envisaged and to review the 15-Year Power Program, which had been developed using the WASP model, to ensure that the correct inputs had been used. Korea was lacking efficient experts in this field and had sought UNDP financing in an amount of $200,000 - 250,000 for a study of the energy sector in Korea, which would encompass a system analysis of the various component parts and help formulate a long-term comprehensive energy sector development program. He had requested that the Bank be executing agency for this study and was deeply appreciative of the Bank's quick, affirmative response. Mr. McNamara said the Bank was delighted to assist in this important task.

3. The Minister referred to his discussions with Secretary Schlesinger and other officials in the U.S. Administration, and with the U.S. Exim-Bank regarding the financing of nuclear plants in Korea. He expected the U.S. Exim-Bank to contribute some $800 million towards the cost of the two plants, estimated at about $2 billion. They would seek financing of the rest of the plant and equipment on a component basis rather than on a turnkey basis as had been done in the case of the first two plants. In addition to the establishment of nuclear power plants, they were trying to diversify the sources of electricity by exploring the possibilities of establishing coal-fired thermal plant and had already received some 20 offers.

4. In conclusion, the Minister said they were thinking of the possibility of obtaining Bank financing for a power project. Mr. McNamara responded that such a request would have to be considered in the light of the fact that power projects could attract financing from other sources than the Bank.

cc: Messrs. Koch-Weser, Husain, Please, Howell and Beach

April, 1978
BIOGRAPHICAL NOTE

Yie-Joon CHANG, Minister of Energy and Natural Resources

Born in July 1924, Mr. Chang graduated from the College of Commerce, Seoul National University, and later studied in the U.S. at the Graduate School, Vanderbilt, Tennessee. He started his career as an economic planner in 1960 at the Ministry of Reconstruction and served as Counsellor at the Korean Embassy in Washington, D.C. between 1961 and 1964. He was appointed Assistant Economic Planning Minister in 1964, Vice Minister of Agriculture and Fisheries in 1967, Vice Minister, Economic Planning Board in 1968, and Minister of Construction in January 1972. From December 1973, until his appointment as Minister of Energy and Natural Resources in January 1978, Mr. Chang served as Minister of Commerce and Industry, and is considered to be one of the chief architects of Korea's recovery from the recession of 1974-75 and of its outstanding export performance in subsequent years.

April 1978
THE KOREAN ENERGY SECTOR

Korea's energy resources are limited to anthracite coal (equivalent to about 30 years of 1975 production) and hydro power (estimated at around 2,000 MW, of which less than a third is currently developed). Korea's tidal power potential is under study. Exploration for hydro-carbons, which has been underway for several years, has not yet resulted in any commercial discovery.

The growth of the energy sector in the late 1960's and early 1970's was rapid, the performance of the various subsectors: coal, power, and petroleum, being generally satisfactory. In the early 1970's it appeared that the future expansion of the energy sector was to be based primarily on relatively inexpensive imported oil and that domestic coal was to be progressively phased out. However, the increase in the relative prices of fuels and particularly of petroleum in 1973 and 1974 drastically altered the supply pattern and induced the Government to reconsider Korea's energy policy. The Government's response to the oil crisis was impressive: prices of petroleum products were increased in line with international prices, a comprehensive energy conservation program was launched, and policies formulated for the development of domestic energy resources. These actions brought about significant results: in 1974, the increase in final energy consumption was limited to about 7% compared to an average growth of 11.2% p.a. over the 1966-74 period; production in the coal sector in 1975 was increased by more than 25% over 1973 levels. Further, the Government's plans for the various subsectors were consolidated into a more comprehensive energy program which was incorporated in the Fourth Five Year Plan.

The main objectives of this program are to continue to achieve an overall economic growth rate of about 9% p.a. while reducing the rate of growth of energy consumption through a series of energy conservation measures and relying to a greater extent on domestic resources (coal and hydro) and nuclear power than on oil. The total gross investment in the energy sector is projected to account for 16.5% of overall gross investment, the total cost of the program, at 1975 prices, being estimated at about 2.7 trillion won (US$5.7 b). Of this, 34% is to be allotted for the development of power facilities, 7% for coal, and 6% for petroleum.

While the IBRD's Basic Mission to Korea in 1976 agreed with the major thrust of the Government's overall energy program, it pointed to the serious financial, technical and manpower problems which could hamper the realisation of the program, and urged on the Government the need to arrive at a long-term system development plan which would be based on the evaluation of the relative costs and benefits associated with alternative modes of power generation, alternative generation/transmission mix patterns, alternative tariff policies, and alternative time schedules.
The Government, recognizing the need to vest the responsibility for the formulation of energy policy in a single authority, set up, in January 1978, a new Ministry of Energy and Natural Resources, headed by Mr. Yie-Joon Chang. The Minister is apparently seized of the need for a comprehensive review of the sector, and has requested the UNDP to finance, and the IBRD to be executing agency for, a study, estimated to cost $250,000, which will encompass a system analysis of the component parts of the energy sector, and will help formulate a comprehensive energy sector development program. The Bank has conveyed its willingness to act as executing agency for the project.
June 26, 1978

MEMORANDUM FOR THE RECORD

FROM: David Loos, Chief, AEADE

SUBJECT: KOREA: Mr. McNamara’s Meeting with H.E. Duck-Woo Nam, Deputy Prime Minister and Minister, Economic Planning Board

1. Mr. McNamara met with H.E. Duck-Woo Nam at 12:30 p.m. on Wednesday, June 21, 1978. The Deputy Prime Minister was accompanied by the Korean Ambassador, H.E. Yong Shik Kim. Mr. Wei of the Economic Planning Board and Counselor Kang of the Korean Embassy were present for the signing of the loan documents pertaining to the third loan to the Korea Development Bank and for the initial stage of the discussions. Mr. S. Shahid Husain was also present for the Bank. Messrs. Koch-Weser, Dinh, Soussan and Loos were present for the signing of the KDB documents and for the initial discussions.

2. The DPM expressed his appreciation of the support the Bank had given Korea and applauded Mr. McNamara’s public statements on the key developmental issues, particularly regarding the importance of poverty redressal in the developing world. Mr. McNamara said he was pleased that the Bank had been able to support Korea’s development efforts, but pointed out that it was the Koreans themselves who were primarily responsible for the spectacular economic achievements in recent years.

3. The DPM stated that the Korean economy was growing rapidly; GNP growth in the first five months of this year was around 15.8 percent, resulting from what appeared to be an industrial explosion. However, this impressive performance was accompanied by concomitant problems. The economy appeared to be overheated: the rate of inflation at the end of May was 7 percent compared with the end of last year and 11 percent as compared with the end of May 1977; construction costs were rising rapidly due to the increasing construction activity both in Korea and that undertaken by Korean construction companies overseas. The Government had taken measures to deal with this problem. Public utility rates had been increased to reflect costs more adequately, interest rates had been increased markedly, the selling price of grain adjusted to reduce the deficit in the Grain Management Fund and imports liberalized.

4. The DPM indicated two areas of particular importance in the further development of the Korean economy. These were (a) the training of adequate higher skilled manpower, including engineers and technicians, and (b) the development of the machinery industry. As far as (a) was concerned, an application had been made to the Bank for a loan for a higher education sub-sector project, which he hoped would be processed as expeditiously as possible. Mr. McNamara responded that, if the preparatory work to be undertaken by the Government agencies concerned proceeded speedily, the Bank would do what it could to expedite the processing of the loan. With regard to (b), the DPM said that he had been shocked by the findings...
of the Bank mission on the capital goods industry in Korea, and requested technical and financial assistance from the Bank in dealing with the problems which the industry was facing. Mr. Husain pointed out that the Bank was already assisting the development of the machinery industry through its lending to the development banks and its sector work, but agreed to consider the possibility of providing more direct assistance when the Government's application was received.

P.S. Later during lunch with Messrs. McNamara and Husain, the DPM briefed them on the Korean economy. He asked whether Korea could count on the continuance of the recent levels of support during the next five years. Mr. McNamara responded that, subject to a suitable increase in the Bank's Capital and subject to equitable developmental policies, this should not be particularly difficult.

cc: Mr. McNamara's Office
Mr. Husain
Mr. Please (o/r)
Mr. Kirmani
Mr. Fuchs
Mr. Moore
Mr. Johanson

SSHussain/DLoos:ct
A BRIEF FOR:
MR. McNAMARA'S MEETING
WITH
HIS EXCELLENCY DUCK-WOO NAM
DEPUTY PRIME MINISTER OF KOREA AND MINISTER
ECONOMIC PLANNING BOARD

1. Korea's current economic situation and prospects, and the Bank's role in assisting the Government's developments efforts are likely to be the topics which the Deputy Prime Minister will wish to discuss with Mr. McNamara. The DPM will be accompanied by the Korean Ambassador, H.E. Yong Shik Kim. A Biographical Note on the DPM is attached.

A. Current Economic Situation

2. A note on the recent developments and future prospects of the Korean economy is attached. The Korean economy has recovered from the recession of 1974-75 and has exceeded the targets of output, exports and GNP growth in the first eighteen months of the Fourth Plan period (1977-81). A major contributory factor has been the high quality of economic management and the pragmatic and flexible approach of policy makers to the changing economic circumstances. However, the economy faces a number of problems which are not easy of solution. The longer-term sector problems are being addressed in the 15-Year perspective plan for the period to 1991. A detailed analysis of this perspective plan will be undertaken in the course of the next economic mission which is scheduled for September 1978. Its report will form the basis of the discussions at the next Consultative Group meeting scheduled for April/May 1979. The Korean authorities have raised the question of the venue of these meetings and have suggested that if the next one cannot be held in Seoul, at least the one following be held there. This will be discussed at the next meeting which is likely to be held in Paris.

B. The Level of Bank Lending

3. The FY78 program for Korea has been completed. It consisted of six projects for a total $439 million (as compared with $443.5 million for seven projects in FY77). The FY79 program recommended by the Region amounts to $500 million for five projects. The program consists of:

   a. a proposed loan of up to $100 million to the Korea Development Finance Corporation - the private financial intermediary serving the industrial sector with which we have been associated since its inception in 1967 and which has received six Bank loans since then;

   b. a $125 million loan for the Chungju Multipurpose Project, which will help improve industrial and municipal water supply as well as enhance the hydro-power generation capability;
c. the Fourth Highway Project for which a loan of $135 million is planned. This project will help improve Korea's national highway network. Further, it marks an attempt on our part to become involved in the development of the secondary and tertiary road system in Korea.

d. a $100 million sub-sector loan for higher education. Korea's industrialization program which calls for entering into more complex fields of manufacturing than hitherto will require increasingly high levels of technological competence on the part of its labor force, particularly at the higher levels. The presently rigid system of higher technical training would not be capable of responding adequately to these changing labor market needs and suffers from wide variations in the quality of facilities and staff. The proposed project would seek to modernize and expand the system of higher technical education by: (i) expanding the output of industrial technicians by increasing the training capacity of junior technical colleges; (ii) improving the quality of engineering education through curriculum revision and provision of better equipment; and (iii) modernizing and expanding the program of management and accountancy training. This is an FY80 project, one on which the Koreans place great emphasis and which they wish to have implemented as early as possible. We share this sense of urgency and will make every effort to advance it to the extent possible.

e. a loan of about $30 million for an electronics project, the major aim of which is to effect the transfer of technology and to streamline research and development activities related to this important export-oriented industry.

4. An Urban Housing Project, which would provide housing for the lower income groups, has been under preparation for many months. However, we were informed recently that the Government does not wish to proceed with the project as originally conceived, which called for small (26m² to 40m²) row houses, utilizing the traditional floor heating system fuelled by coal. They feel that, in view of the Government's recently formulated energy policy which places considerable emphasis on the encouragement of the use of oil rather than coal for heating due to Korea's diminishing supply of the latter resource, and the relative efficiency of central heating, together with the desirability of maximizing land utilization under the present conditions of scarcity and high cost, the project should provide for the construction of high-density, multi-storied housing, rather than detached, row housing. On this basis, they have proposed a minimum size of 50m².

5. This policy raises two fundamental issues, namely, whether housing of the size proposed would be affordable by the lower income groups without substantial direct subsidies, and whether Korea could make a real impact
on the formidable housing problems it faces with such a policy. We feel that the answer to both questions is in the negative and that no useful purpose would be served in our continuing to attempt to develop a project of the kind we consider would be responsive to the two issues referred to above. We will, however, continue our dialogue with the Government on housing issues through our economic and sector work and other related projects.

6. The proposed lending program for Korea during the period FY79-83 is $2.3 billion. A Country Program Paper is scheduled for review by Mr. McNamara in October this year.

C. Korea's Fifth Five Year (1982-86) Development Plan

7. The Deputy Prime Minister is likely to ask for assistance in the preparation of the Fifth Five Year Development Plan (1982-86) on which the Korean authorities intend to begin work in 1979. The Bank was very closely associated with the formulation of the Fourth Five Year Development Plan through its role as Executing Agency for a UNDP-financed Planning Assistance Project. Further, our 1976 Basic Mission dovetailed its activities into those of the UNDP Planning Project and the efforts of the Korean planners. It may not be possible for us to devote the same amount of manpower for this purpose, but we will help to the extent possible.

D. Counterpart Funds

8. The successful implementation of a larger program of Bank lending to Korea is dependent on the Government providing adequate counterpart funds. The increase in the deficits in extra-budgetary accounts, the enhanced defense expenditures and a larger investment program are placing increasing demands on budgetary resources. The opportunity may be taken to stress again the importance of the Government providing adequate counterpart funds in support of the Bank's larger lending program.

Attachments:

I. A Note on "Recent Economic Developments and Prospects"
II. Biographical Note

June 19, 1978
RECENT ECONOMIC DEVELOPMENTS AND PROSPECTS

Recent Trends

The Korean economy was among the hardest hit by the twin shocks of sharply increased import costs and the world-wide recession in 1974-75. The current account deficit, which had been narrowed significantly from over $800 million in 1971 to only $309 million in 1973, widened to $2 billion annually during 1974-75 as a result of a four-fold increase in import costs which caused a 19 percent deterioration in Korea's terms of trade. The average GNP growth rate in 1974-75 slowed to 8.5 percent or about half the 1973 level, and employment generation declined somewhat in spite of the Government measures to support private employment and increase public sector employment through public works programs.

This presented Korea's economic managers with a more difficult situation than had been experienced since Korea embarked on its course of export-oriented growth in the sixties. Their response demonstrated the high quality of their economic management and their willingness to adopt flexible policies in the light of changing economic circumstances.

The set of policy measures that were adopted in 1975 to counter the effects of the oil shock and international stagflation included devaluation, tax concessions, and special loans at preferential interest rates to enable industrial enterprises maintain their level of production and employment. The 1975 policy package was intended to sustain the productive capability of the Korean economy so that its growth momentum could be maintained to take advantage of an expected recovery in international demand. These measures were successful, as indicated by the growth performance in 1976. The improvement in the balance of payments and the resultant bolstering of Korea's reserves from the equivalent of less than two months of current payments to nearly four months was due to the sharp spurt in export growth, a 14 percent improvement in the terms of trade due to a recovery of export prices and a slow-down in import prices from their record levels in 1974-75, and also as a result of a largely unexpected boom in earnings from construction contracts by Korean firms in the Middle East and a brisk recovery in the tourist trade to its 1973 level. Total export earnings increased steadily throughout the period and, while total external debt rose to $6 billion or 32 percent of GNP in 1975 from only $3 billion in 1973 and further to over $8.8 billion or 28 percent of GNP by the end of 1977, the debt service ratio declined from over 14 percent in 1973 to about 11 percent at the end of 1977.

The Fourth Five-Year Plan, 1977-81

The Plan calls for a total investment of $39 billion (in 1975 prices) with emphasis on increasing industrial output and exports from the heavy industry and more skill-intensive industries, on the development of economic and social infrastructure, and on the maintenance of a high level of employment to enable the absorption of the fast-growing labor force. The
Bank mission, which reviewed the Plan, endorsed its programs and priorities, but felt that investment was understated and the domestic savings projections somewhat ambitious, implying a substantially higher level of external capital requirements than was indicated in the Plan. The Mission estimated that about $2.5 billion would be required in new commitments from official and commercial sources, or somewhat higher than the $2 billion projected in the Plan. A domestic marginal saving rate of about 30 percent was considered more realistic than the 35 percent projected in the Plan.

The first eighteen months of the Plan have confirmed that the Bank Mission's assessment remains essentially valid. As was to be expected, the high levels of output, exports and GNP growth (15.5 percent) achieved in 1976 when the economy recovered from the deep recession of the previous two years, could not be maintained in 1977. Nonetheless, the balance of payments improved further due to additional gains in the terms of trade, and invisible earnings also recorded unprecedented levels on account of construction contracts and tourism receipts. Consequently, GNP grew by slightly over 10 percent, higher than that the target rate of 9 percent, and, for the first time, the current account was in surplus.

Major Issues and Problems

Despite the continuation of a high level of economic expansion so far in 1978, the Korean economy is still faced with a number of problems, arising in part from the past record of high growth, but also as a result of the structural thrust of its future growth. Inflationary pressures, which had decelerated from their 1974-75 levels during 1976, began to accelerate again during the second half of 1977. First, the rapid growth of the economy and the emergence of excess demand at home was reinforced by rising demand from the external construction boom, which entailed the export of over 40,000 workers during 1976-77, and put pressure on wages. Increases in industrial wages as a whole averaged about 30 percent per year during 1975-77 led by an increase of over 40 percent in wages in the construction, wholesale and retail sectors. Secondly, the increase in net foreign exchange earnings from overseas construction contracts, which rose from less than $10 million 1975 to over $600 million in 1977, resulted in a sharp increase in Korea's net foreign assets and was, in 1977, equivalent to the total increase in the money supply. By the end of 1977, the rate of growth of the money supply had averaged about 38 percent per year over the preceding eighteen-month period, increasing the pressure on domestic prices. Another factor accounting for the rate of inflation has been the unexpected increases in 1977 and 1978 in the deficits of the Grain Management Fund, which had been reduced at the beginning of 1976. A part of the increased deficits has been due to increased grain purchases arising from the exceptionally good rice harvests of the 1976-77 seasons. However, a substantial proportion of the deficit reflects the continuation of the policy of subsidizing farmers and consumers through the differential purchase and release prices of rice and barley. The Government has attempted to curb inflation by reducing the impact of foreign exchange earnings on domestic money supply by sterilizing some of the additional inflow, and more importantly by liberalizing imports.
A decision on the final size of the public sector deficit in 1978 is yet
to be made; interest rates have just been increased significantly in an
effort to reduce excess demand and dampen inflationary pressures.

A second major problem area concerns the quota restrictions
in various OECD countries which are affecting most of Korea's traditional
exports and some of the new products, such as steel. Besides, compe-
tition from other LDC's is increasing and Korea's attempts to switch
to more skill-intensive products in line with its comparative advantage
is proving to be somewhat more difficult at both the production and
marketing ends than was the case for Korea's labor-intensive exports.
Thus, the planned structural shifts may be effected at a slower pace than
projected in the Plan.

A third major area of concern, in view of the high level of investment,
is the realization of the planned level of domestic savings. Public savings
are constrained by the deficits in the extra-budgetary accounts, as well
as by the sharp rise in defense expenditures. Recent tax revisions,
including the introduction of a 10 percent value added tax and a defense
surcharge to supplement revenues allocated to defense, have increased
overall tax buoyancy, but not to the degree required to meet additional
public investment needs. As a result of the tight budgetary position,
counterpart funds are insufficient for Bank and other public
projects. Private savings have been increasing rapidly since the 1976
boom, but it is essential that real interest rates are maintained if
financial savings targets are to be met.

The economy's ability to provide incremental employment to meet its
fast growing labor force is another cause for concern. During the 1970's, the
labor force grew at 4.0 percent per year and employment increased at
just 4.1 percent, or barely sufficient to maintain the level of
employment. While the overall growth of the economy is expected to average
9-10 percent as planned, employment elasticities would have to remain
close to the historical level of about 37 percent over the next several
years if the increase in the labor force is not to raise the unemployment
rate.

The 15-Year Perspective Plan

A Perspective Plan is being prepared for the period up to 1991; it
envisages a continuation of the high growth strategy which is essential
if both the employment and the equitable income distribution objectives are
to be achieved. GNP is expected to increase at 10 percent in real terms
and export growth is projected to remain high at about 15 percent
per year in real terms, compared with the 16 percent assumed in the Fourth
Plan. Annual planned investment is about $8 billion, but as in
the Fourth Plan, the estimate is probably understated to the extent of
about 5-10 percent, partly due to the rather favorable incremental capital
output ratios assumed, and partly because the growth assumptions may be
somewhat conservative. A major emphasis of the Perspective Plan is the development of the manpower sector to bridge an expected shortfall of as much as 1.6 million scientists, technicians and craftsmen during the 15-year period. The Bank is currently involved in helping the Government design measures to deal with this problem under a higher education sub-sector project now under preparation.

Financing the Plan

The investment program in the Fourth Plan relies on an annual inflow of about $2.5 billion in external medium and long-term capital, about 40 percent of which is expected from official sources; the longer-term Perspective Plan envisages an elimination of the need for foreign savings by the early 1980's. Although Korea's enhanced creditworthiness has increased its access to commercial financing, the maintenance of the high growth strategy, on which the crucial employment and income distribution objectives depend, makes it necessary for Korea to receive official financing with longer maturities on a substantial scale, at least for the rest of the Fourth Plan period.
Mr. Nam was born on October 10, 1924, graduated from Seoul National University and received a Ph.D. degree in Economics from Oklahoma State University in 1961. He was Professor of Economics at Kookin University (1963-64), Yonsei University (1964) and Sogang University (1964-69). In 1969, he was appointed Minister of Finance and remained in that office until assuming his present position as Deputy Prime Minister and Minister, Economic Planning Board in September 1974.

Mr. Nam is recognized as having excellent knowledge of the Korean economy and a keen awareness of the economic problems confronting the country, and has published many books and articles on various aspects of the Korean economy. He has travelled extensively and is well-versed in English.
KOREA: Third Loan to the Korea Development Bank (KDB)
Background information for Loan Signing, scheduled
for June 21, 1978 at 12:30 p.m.

The Bank's third loan to KDB in an amount of $110 million is scheduled
to be signed by Mr. McNamara and Mr. Duck-Woo Nam (the Korean Deputy Prime
Minister) on behalf of the Borrower (KDB) and the Republic of Korea (Guarantor).

Korea's export-oriented industrial sector has been the engine of the
country's phenomenal economic growth over the last decade or so. It contributes
about 36 percent of GNP and is responsible for over 90 percent of the country's
commodity exports. During the last five years, the sector has contributed
about 50 percent of the increase in GNP and employment. Our economic and
sector work indicates that an extrapolation of export-oriented industrial
growth is the soundest strategy for the country, while it attempts to deepen
its industrial structure, provide more employment opportunities for the growing
labor force and further reduce income disparities. The key role which the
industrial sector is expected to play in Korea's future economic development
forms a major premise in the formulation of the Bank's lending strategy. The
advisability of utilizing a substantial proportion of the resources which the
Bank can make available to Korea to assist industry has led us to give a large
measure of support to three highly efficient financial intermediaries operating
in Korea - KDB, the Korea Development Finance Corporation and the Medium
Industry Bank.

KDB is the largest institutional source of industrial finance in Korea.
In 1977, it directly financed about a fifth of fixed manufacturing investment
and it assisted in the financing about a third of total fixed capital formation.
The projects which KDB has supported have had a major impact in generating
exports and providing employment opportunities. KDB also makes a valuable qualitative
contribution to the industrial sector through its efficiency as a resource
allocator, its promotional activities, its resource mobilization efforts and
its considerable economic and industrial research work. The Bank's first
loan of $60 million to KDB was made in 1975. A second loan of $82.5 million
was approved in November 1976. During our association with this institution, the
Bank has been impressed by its efficiency and the progressive policies it has
evolved in order to play a prominent role in the rapid growth of the economy's
most dynamic sector.

We are confident that the Bank funds would be used for high priority
schemes in an efficient and expeditious manner.

One particularly encouraging fact about the KDB is the energetic
and successful efforts which have been made to raise capital from foreign
commercial sources.
An interesting feature of this project is that $10 million of the loan will be made available by KDB to its subsidiary, the Korea Industrial Leasing Company, to finance labor-intensive projects benefitting small scale enterprises.

The loan is an expression of our recognition that KDB plays a vital role in Korea's industrial development.
September 26, 1978

TO: Memorandum for the Records
FROM: Stanley Please, Director, AEA
SUBJECT: KOREA -- Meeting Between Minister of Finance and Mr. McNamara

1. Mr. McNamara met with members of the Korean delegation to the Annual Meeting, on September 24, 1978. Present from the delegation were Finance Minister Kim, Central Bank Governor Shin and Minister (Economic) Yang, and from the Bank were Messrs. Husain, Please and Koch-Weser. Mr. McNamara invited Minister Kim to report on the progress of the Korean economy which was regarded by everybody as such an outstanding example for the developing world.

2. The Minister indicated that although his Government was proud of its successes, there were, nevertheless, problems. Firstly, inflation was running at between 12 and 14% at present and the Government regarded this as too high and requiring urgent attention. Secondly, the balance of payments situation was somewhat less positive than had been hoped although the Government was not unduly worried on the matter. Whereas exports had been targetted at about $12.5 billion and would probably achieve this level in 1978, imports were significantly higher than anticipated at about $13.9 billion as compared with the target of $13.5 billion. This had arisen out of a situation in which GNP growth had reached something like 13 to 14%, as compared with the 10% target. As a consequence of these developments the trade gap was likely to be about $1.4 billion and the current account deficit about $500 million. It was the Government's intention to reduce the growth rate to the targetted level of 10% during 1979 for it was considered that this represented the "appropriate balance between growth and stability." This rate of growth would also permit the absorption of an adequate number of people into employment. At the same time it was intended that exports would grow at something like 25% in money terms and at about 15% in real terms during the future years.

3. Mr. McNamara questioned whether it would be possible for exports to rise at this rate given, in particular, the protectionist tendencies in the world. The Minister felt that the target was realistic. A major element in Government strategy was to use import liberalization to achieve the export targets. The Government's thinking in this regard was that import liberalization would not only make industries more competitive and based on comparative advantage, but also that by liberalizing Korea would have a strong bargaining counter with OECD countries in trying to ensure that the latter relaxed on barriers to imports from Korea and other developing countries. With this in mind, measures had been taken in May of this year to increase the share of imports covered...
by liberalization measures from 52% to 61% and further measures were being taken during the present month to increase this share to 65%. Mr. McNamara congratulated the Government on this action and said that the Minister should use the opportunity of his visit to Washington to emphasize to OECD Governments, particularly the U.S., these measures that Korea was taking to liberalize on imports.

4. Mr. McNamara said to the Minister that he was aware that the Government was beginning preparation for the next Plan and that the Bank would be delighted to assist this work. If this required additional Bank manpower to be devoted to this purpose he would be prepared to support this need.

5. Mr. McNamara emphasized to the Minister the great importance for the future of the Bank and of the developing world that there should be a formal decision early next year on a substantial capital increase for the Bank. He requested the Minister to consider this need and, if he agreed, to provide not only direct support for the proposed capital increase but also to encourage the Bank's major shareholders and particularly the U.S. and Japan to take action in support of the capital increase. It was important that major beneficiaries of Bank money and especially those who recognized the importance of the Bank to their countries' development should make known to the OECD countries the urgency of the capital increase. The Minister agreed to do his best to act on Mr. McNamara's request.

6. Mr. McNamara emphasized the Bank's concern over the shortage of local currency for financing Bank projects. He emphasized that this was not only unfortunate from the point of view of delayed implementation of projects but that it had an indirect adverse effect on the replenishment of the Bank's capital. Countries which considered the need for a substantial increase in the Bank's capital could always point to the fact that existing commitments were not being disbursed according to plans and therefore that the need for additional replenishment was less than was being asserted. The Minister undertook to take the matter up when he returns to Korea.

7. Finally, Mr. McNamara asked the Minister to continue to give support to IDA particularly as the Bank was moving in to the early stages of negotiating IDA VI. He hoped that this support would not only be of a general nature but that the Korean Government would find it possible to contribute to IDA funds. Mr. McNamara recognized that the Minister would not wish to respond to this request at this stage but the Minister undertook to ensure that the Government gave the request full consideration.

SPlease/lo

cc: Messrs. McNamara, Stern, Chenery and Knapp
    Husain, Kirmani, Hasan, Ruddy, Loos, Bussink, Agarwala and Hawkins
TO: Memorandum for the Record

FROM: Stanley Please (Director, AEA) 

DATE: October 2, 1979

SUBJECT: KOREA - Meeting Between Mr. McNamara and the Korea Delegation 
1979 Annual Meetings, Sava Center, Belgrade, Yugoslavia

1. Mr. McNamara met with members of the Korea delegation on October 1, 1979. Present were: Messrs. Woun Gie Kim, Minister of Finance; Byong Hyun Shin, Governor, Bank of Korea; Sang Chul Suh, Alternate ED; Lee, Husain, Please and Koch-Weser.

2. After expressing his Government's appreciation for World Bank support for its development programs, Minister Kim emphasized the difficulties which now confronted the economy, in particular, the rise in oil prices and the increased rate of price inflation. It had been hoped to phase out net foreign borrowing by the end of the Fourth Plan, but in fact continued external borrowing would be required well into the 1980s. Even so, lower growth rates than in the past must be expected in the future yet at the same time increased emphasis had to be given to the social sectors and to the problems of the poor. He hoped that the Bank would continue to provide large financial support to the country, including increased sector and program lending.

3. Mr. McNamara emphasized the high regard in which Korea's economic performance was held in the Bank. The problem for the 1980s was whether a high growth rate could be maintained and at the same time programs to alleviate the social problems developed. The Bank would continue its support for the country's development effort.

4. Minister Kim raised the question of increased voting power in the World Bank. Mr. McNamara emphasized that whilst only the Government could decide when to raise the matter with the Board and Governors, his own view was that it would be better to await the approval of the capital increase. Any action which might delay the capital increase would be particularly detrimental to countries such as Korea.

5. Minister Kim concluded by reiterating a standing invitation to Mr. McNamara to visit Korea.

Cleared with and cc: Mr. Husain


SPlease:bce
MEMORANDUM FOR THE RECORD

From: David Loo (Chief, AEADE)

Subject: KOREA - Mr. McNamara's Meeting with H.E. Hahn-Been Lee, Deputy Prime Minister and Minister of Economic Planning

1. Mr. McNamara met with H.E. Hahn-Been Lee at 1:45 p.m. on Tuesday, February 19, 1980. The Deputy Prime Minister (DPM) was accompanied by Mr. Tchah, Assistant Minister for Economic Cooperation, Economic Planning Board, Mr. Lee, Economic Minister at the Korean Embassy in Washington, and Mr. Kim, Director-General, Bureau of Planning, Economic Planning Board. Mr. Suh, Alternate Executive Director, participated in the meeting. Messrs. S. Shahid Husain, Koch-Weser and I were also present for the Bank.

2. The DPM expressed the hope that Mr. McNamara would visit Korea in this important period of change. He characterized the thirty-five years since independence as a period of tremendous development of the economy and of education. This was punctuated by a social outburst in 1961 during which the students came to the fore and the seeds of change resulting from an increasingly educated society were sown. Broadly-based education and industrial development and the growth of a well educated middle class in both the rural and urban areas, of which there were very few parallels, led in the subsequent period to pressures to develop a democratic society.

3. The problems the country faced in the 1980s were twofold. The first was how to provide people with the opportunity to participate in, and share the benefits of, economic development, and the second was how to ensure sustained economic growth at say 7-9% per annum.

4. Regarding the situation in the short-term, the DPM said that the period 1979–81 was destined to be a period of readjustment. A stabilization program was initiated at the beginning of 1979, which had proved rather successful. Inflation resulting from domestic factors alone had been kept to the level of 8% and, if it had not been for the increase in oil prices in July 1979, the target of single digit inflation would have been achieved; the increase in oil prices had pushed the increase in the Wholesale Price Index in 1979 to 24%. The situation had been aggravated by a further increase in oil prices in December 1979, which would cause the cost of oil imports alone to go up by $3 billion to the level of $6 billion in 1980; this has nearly a third of the estimated total value of exports in the year, compared with 17% in 1975-79 and 6-7% in the late sixties. The impact of the substantial increase in oil prices and of the death of President Park in October 1979 had created a very difficult situation. The new Cabinet had taken drastic steps to ensure that the stabilization program would be even more effective and to initiate measures to prevent the further deterioration in the economic situation.
5. The DPM summarized his comments by saying that there were four problems which the country was facing. These were:

(a) the need to make the stabilization program even more effective;
(b) the impact of oil price increases;
(c) the recession in the industrialized countries which constituted Korea's traditional markets; and
(d) the political trauma in the aftermath of the assassination of President Park.

Despite these difficulties, the Government had taken drastic measures, such as the devaluation of the Won and the increase in interest rates, which were necessary to deal particularly with the problems of export competitiveness and growing unemployment. About 4% of the labor force was presently unemployed and, if these measures had not been taken, this would have risen to around 8%; the goal was to keep unemployment below 6% of the labor force. As a result of all these factors, economic growth in 1980 was expected to be of the order of 3-5% - a very moderate level - but he expected the growth rate to increase to about 7-8% in the ensuing years.

6. Mr. McNamara said that he was extremely interested in what the Koreans were trying to do in very difficult circumstances, particularly because their objectives of greater participation in the benefits of economic growth and in political power were ones which he felt other countries should also set for themselves. Korea's economic performance in recent years had been very impressive and had exceeded the Bank's expectations. The broad participation of the people in the benefits of the social and economic progress that had been made was particularly impressive. However, there seemed to have been some diminution in the scope and extent of such participation in recent years. This was a cause for concern and a matter which should receive more attention.

7. Mr. McNamara pointed out that another matter that caused great concern was Korea's need for very large inflows of external capital. He asked from where such large volumes of capital would come. As far as the Bank's contribution was concerned, he expressed the view that no other country utilized the assistance afforded better and that, while a decision had not been taken as yet on what the best form of assistance would be, he recognized the problem the Koreans were facing and would be willing to assist them in dealing with it.

8. In response to Mr. McNamara's inquiry about the sources of foreign capital, Mr. Kim said that the estimated current account deficit of some $5 billion in 1980 would be financed by short-term borrowing of about $1 billion, long-term loans and credits of $3.5 billion, of which they expected to receive about $500 million from the Bank and a similar amount
from other multinational and public institutions, about $1 billion from commercial banks, and the balance through such forms of financing as suppliers’ credits. They expected the current account deficit to decline by about $500 million a year and to reach the level of around $2.5 billion by 1985. In response to a question by Mr. Husain about whether there were any difficulties in raising capital from the foreign commercial banks, the DPM said they could get what they needed, but that it was necessary to stress their basic selling point which was the Korean people, in whom their real strength lay. The children born in the post-Korean War baby boom were now entering the labor market and, given the great strides that had been made in the education field (most of those entering the labor force had at least a ninth grade education), were capable of working efficiently in enterprises utilizing higher levels of technology.

9. The DPM pointed out further that the combination of improved technology, the stronger financial position of enterprises, which they were trying to bring about by tax incentives to induce them to plough back profits, and the high level of education of the labor force would enable enterprises to upgrade their products, particularly for export. He felt that Korea could develop its export potential to a level which would be somewhere between Japan’s and the emerging Mainland China’s. There was already evidence of this in that lathes and milling machines were being exported to Japan and there was the possibility of exporting similar items to Mainland China and other Asian countries.

10. Mr. McNamara agreed that the emphasis on education and technology development was the right one, as was the desire to make Korean exports more competitive. In this connection, he endorsed the Government’s decision to raise interest rates because it would ensure a more rational allocation of capital and reduce waste. However, he stressed the importance of taking further timely action if the current account deficit did not decline as envisaged, pointing out that governments in power could and should take the required decisions even if they were difficult. Mr. McNamara also pointed out that the current account deficits indicated by Mr. Kim differed substantially from those projected by Bank staff and suggested that they should be carefully examined by the economic mission presently in the field. In connection with the further actions by the Government that may be required, including major structural changes which the DPM stated were necessary, Mr. Husain said, and Mr. McNamara agreed, that the Bank would provide such assistance as it could in support of such measures.

Cleared with and cc: Mr. Husain

cc: Mr. McNamara’s Office
Mr. Jaycox (o/r)
Mr. Kirmani
Mr. Hasan

DLoos:dc
KOREA: BRIEFING NOTE FOR MR. McNAMARA'S
MEETING WITH H.E. HAHN-BEEN LEE, DEPUTY PRIME MINISTER AND MINISTER
OF ECONOMIC PLANNING, REPUBLIC OF KOREA

1. H.E. Hahn-Been Lee, the recently appointed Deputy Prime Minister (concurrently Minister of Economic Planning) of the Republic of Korea is scheduled to call on Mr. McNamara at 1:45 p.m. on Tuesday, February 19, 1980. His biographical data is attached as Annex I. Mr. Lee assumed his present position as part of President Kyu Hah Choi's Cabinet which took office after the latter's election following President Park's assassination last October. A note written by Mr. S.S. Husain (RVP, AEN) on the political ramifications consequent upon President Park's demise is attached as Annex II. We have been informed that Mr. Lee would like to brief Mr. McNamara on Korea's current economic position and prospects and to discuss the level of support which he expects the Bank to extend to his country in the next few years in the pursuit of its development objectives.

Current Economic Situation

2. The remarkable performance of the Korean economy during the last two decades has been documented in various Bank reports and the latest economic report entitled "Korea: Rapid Growth and Search for New Perspectives" was issued on May 15, 1979. At the time of the meeting of the Consultative Group for Korea held in Paris in June 1979, optimism was expressed about the future growth prospects of the country. It was estimated that, in order to attain a GNP growth rate of 9% p.a., Korea would need a gross external capital inflow of about $4.5 billion per year during 1979-81.

3. Developments in 1979. Significant changes have taken place in the Korean economy since the Consultative Group meeting. The major emphasis of economic policy in 1979 was on stabilization by following a tight credit policy. This resulted in the growth rate of real GNP declining to a level of 7% in 1979. The price of petroleum has more than doubled within less than a year and this has contributed to a widening of the current account gap both by slowing down export growth and increasing the import bill. President Park Chung Hee, the chief architect of modern Korea, was assassinated in October 1979 and the political and economic consequences of this event may be felt for quite some time.

4. As a result of adverse developments on the domestic as well as the external fronts, 1979 appears to have been a year of what the IMF staff report (January 2, 1980) calls a "pronounced turnaround". The rate of growth of real GNP dropped from 12.3% p.a. during 1976-78 to 7% in 1979, as indicated above, and of manufacturing value-added from 19.2% p.a. to 12.8% p.a. The rate of inflation (consumer price) accelerated from 12.6% p.a. during 1976-78 to 22.0% during 1979, and the rate of unemployment, which had
been declining steadily during the seventies, increased from 3.2% in 1978 to 4% in 1979. After a period of rapid growth over 15 years, the export volume appears to have experienced a decline in 1979 (for the first time). The current account deficit widened from 2% of GNP in 1978 to about 7% in 1979.

5. Recent Policy Measures. As in the past, the Korean Government is showing resilience and pragmatism in its economic management. The sharp increase in the price of oil was promptly passed on to consumers. During 1979, domestic oil prices were raised (in two steps) by about 75% and electricity prices by 55%. There was a substantial price increase in most downstream petroleum products and in most products for which electricity is a major input. In January 1980, the Government announced a devaluation of the Won by about 20% (from Won 485 to Won 580 to the US dollar), increased most deposit and lending rates by about 6 percentage points (the prime rate was increased from 18% to 24%) and announced a program for further tightening of credit. It also invited the IMF for negotiations of a standby agreement. Vigorous efforts are also afoot for promoting exports and mobilizing oil imports from Middle East countries, where Korea has a large presence through its sizeable construction contracts. However, even with these measures, it is expected that the GNP growth rate in 1980 will be only 3-5% and that the current account deficit would be about $5 billion.

6. Areas of Concern. Korea’s recent record of economic management makes one hopeful that it will tide over its present difficulties and resume its growth path as it did during the oil crisis of 1974/75. However, there are several areas of concern:

(a) the drastic slowdown in GNP growth during 1979/80, particularly because it follows a period of a very high level of investment in 1977/78;

(b) the substantial slowdown in export growth, particularly because it started before the oil price hike of 1979 and because it is more severe than in the case of its competitors, such as the Republic of China, Hong Kong and Singapore;

(c) the payoff from the investment in heavy machinery production facilities has been below expectations and the debt-equity ratios of the major companies remain very high;

(d) the Government seems to be intent on a policy of further tightening of credit and a deliberate slowdown of growth in order to reduce inflation drastically (a goal which has proved elusive so far) at a time when the country is going through a political transition and it is important that the confidence of the business community — both domestic and foreign — should not be undermined.

7. An Economic Mission is scheduled to visit Korea this month to examine the above issues and explore alternative scenarios for 1980/81 under alternative policy assumptions. The Bank is also associated
with the formulation of Korea’s Fifth Five Year Plan (1982-86) through its role as Executing Agency for a UNDP-financed project for planning assistance to Korea.

8. **External Resource Requirements.** Pending the results of the Economic Mission, our judgment at this point is that in order to achieve its employment and income distribution objectives, Korea should aim at a growth rate of at least 8-9% p.a. during the 1980s. In order to achieve such growth rates during 1980-81, Korea would need a minimum of $7.5 billion per year of external capital inflows. (The increase of $3 billion per year in foreign capital requirements over the earlier estimates is due entirely to the increased oil import bill). Even though, the bulk of these resources would come from private commercial sources, a high level of quick disbursing assistance from international agencies (about $1 billion per year from IMF and IBRD for the next three years) would be critical for Korea’s success in mobilizing the external resources required for revitalizing its growth process.

9. **Relations with the IMF.** The recent IMF Mission to Korea has agreed on a stand-by program under which the Korean Government will be entitled to draw SDR640 million in the two year period 1980-81 in quarterly installments of SDR80 million each. The Government is expected to send the signed Letter of Intent shortly and the arrangement is scheduled to be discussed by the Fund’s Executive Directors on March 5, 1980.

10. The program is based on the following assumptions in respect of 1980 (the targets for 1981 will be discussed and established by the end of 1980):

(a) real growth of GNP in 1980 of 3%;

(b) a Balance of Payments deficit (defined as the decline in net foreign assets, including long-term borrowing by the commercial banks) of $1.7 billion in 1980; and

(c) a 20% increase in the GNP deflator, a 22% increase in consumer prices and a 27% increase in wholesale prices on an end-year basis, in 1980.

11. It covers the following elements:

(a) a limit of 15.5% on effective credit expansion in the first half of 1980; the level for the second half of 1980 will be determined before the end of June, in the light of the performance in the first half. The target for the year as a whole is 32%;

(b) the borrowing limit for 1980 in respect of both public and private sector loans of maturities of over one year to and including 12 years on the basis of commitments is set at
$6 billion, including a subset of $1 billion for loans of over one year and up to five years maturity. The limits for 1981 will be discussed and set before the end of 1980; and

(c) in addition to the devaluation of the Won and the changes in the interest rates regime, which were announced on January 12, 1980, the structural adjustments suggested in the program would encompass some changes in the income tax rates which would not have a major impact on revenue, but would be important for resource allocation and equity reasons; the liberalization of the financial system which would result in enhanced autonomy for the banking sector with greater reliance on the market system and less on preferential credit allocations; and more effective measures to reduce Korea’s dependence on oil by the switch, to the extent possible, from oil to coal and other measures to reduce the dependence on oil imports.

12. One of the steps the Government intends taking to reduce inflation is to campaign vigorously to convince employers and labor to limit wage increases to a maximum of 15% in 1980.

The Bank’s Lending Program

13. Korea, unlike some other middle-income countries, is not a resource surplus country. As indicated above, it will require substantial capital inflows over the next few years if it is to maintain its progress along the path of export-led growth, which it has followed so successfully in the past, in order to provide the employment opportunities that its growing labor force requires and to ensure that the population at large continues to experience an improvement in its quality of life, e.g., by being given greater access to better housing and educational opportunities. In this context, it is important that the Bank continue to supplement the financial resources Korea is able to raise commercially and to assist the country in coping with the new problems the economy faces as it becomes more sophisticated and complex. At the Management Review of the last CPP (held on October 11, 1978), a Lending Program of $2.5 billion for the FY80-FY84 period was approved. The FY80-81 approved Lending Program is $885 million (the FY80-84 Project Specific Lending Program is attached as Annex III). To date, in the current fiscal year, loans have been approved for a second Gwangju Regional Development Project ($65 million); the third Small and Medium Industry Bank Project ($60 million); a Population Project ($30 million), and the Gojeong Thermal Power Project ($115 million). A $100 million loan for higher technical education is due for Board presentation on February 19, 1980. The Bank’s first loan to the Citizens National Bank (CNB) in an amount of $30 million to assist small-scale industrial enterprises has been appraised as has the proposed Seventh Railroad Project ($75 million). Both of these projects are due to be negotiated before the end of March.
14. A loan of $80 million for this project was made in June 1977. Physical progress is satisfactory. However, subsequent to the approval of the loan, the Government licensed three other firms for the manufacture of similar equipment to that being produced under the Bank-assisted project. Consequently, domestic orders for power plant equipment were split among the four firms. In order to rectify the situation, the Government ordered the four firms to merge into two groups. As a result, it proposed that Hyundai International Inc. (HII) - the beneficiary of the Bank loan - merge with Hyundai Heavy Industries (HHI). Subsequent communications from the Government indicate that the ownership and management of HII's Changwon plant, which is financed through the Bank loan, will be taken over by HHI, and that the financial and legal arrangements were being worked out. The Government has confirmed that no action having any material bearing on the legal, technical or financial aspects of the project would be taken without the Bank's prior consent.

15. We have informed the Government that, while we do not wish to prejudge the question of the change in the beneficiary, contractual arrangements authorizing such change can only be undertaken with the prior consent of the original beneficiary (HII) and the Bank. Further, such change would necessitate an evaluation of the new beneficiary and the submission to the Bank's Executive Directors of revised loan documents reflecting the changes agreed among all the parties concerned, including the Government, HII, HHI and the Bank. For this purpose, we have asked the Government to send us a detailed proposal agreed to by the Korean parties regarding the contemplated changes in the ownership and management of the project. We understand that such a proposal will be made available to the Bank when the DPM visits Washington on February 19 and are scheduling a mission for the first week of March which will review the implications of the proposal for project implementation in the context of the heavy machinery sector in general. The Government has confirmed that, in the interim, necessary arrangements are being made to effect payments for supplies and services under the project without recourse to the Bank loan. We have informed the Government that, if a mutually acceptable solution is worked out, the Bank will consider reimbursing it in respect of expenditures incurred in the interim period which would appropriately fall within the terms of the Loan Agreement.
BIOGRAPHICAL NOTE

HAHN-BEEN LEE

Hahn-Been Lee was born on February 9, 1921. He obtained a Bachelor’s Degree from the Seoul National University in 1949 and attended the Harvard University Graduate School of Business Administration where he obtained a Master’s Degree in Business Administration in 1951. Lee served in various capacities with the Korean Government from 1957 to 1965. He became Director-General of the Budget Bureau in 1957. In 1961 he was promoted to the position of Vice Minister of the Ministry of Finance. During 1963-65, Lee was Korea’s Ambassador to Switzerland at which time he was also accredited to Austria, the European Economic Community and the Vatican. In 1966, he returned to Korea as Dean of the Seoul National University Graduate School of Public Administration; he held this position until 1970 when he became Director of the Technology and Development Institute at the East-West Center in Honolulu. Lee returned to Korea in 1973 as President of the Soong Jun University. He was President of the Ajou Institute of Technology at Suwon from 1977–79 when he was appointed to his present position.

Lee has combined the life of a bureaucrat and an academic. It is noteworthy that he has taken a considerable interest in the development of the program of higher technical education for which, coincidentally, a loan is being presented to the Bank’s Executive Directors on the day he is scheduled to meet Mr. McNamara. Lee is an articulate man and speaks English fluently. He is the author of a number of books on development issues.
OFFICE MEMORANDUM

TO: Files
FROM: Edward V.K. Jaycox, Director, AEA
DATE: January 12, 1981
SUBJECT: Annual Meeting 1980, Meeting of Korean Officials with Mr. McNamara

1. On September 27, Mr. Lee Seung-Yun, Minister of Finance, Mr. Kang Kyong Shik, Assistant Minister for Planning, Economic Planning Board, and Mr. Choo Byung-Kug, Assistant Minister for International Finance, Ministry of Finance met with Mr. McNamara. Also present were Messrs. Stern, Husain, Jaycox and Koch-Weser.

2. It was essentially a courtesy call. Minister Lee thanked Mr. McNamara for the assistance of the Bank over the past years of Mr. McNamara's presidency, congratulated him on the work of the Bank in general, and wished him well in the future. At Mr. McNamara's request Mr. Lee gave a brief run-down on the current state of the Korean economy and the Government's current plans. Mr. Lee did this and also briefed Mr. McNamara on socio-political developments and the timetable now in mind for movement to a new constitution and newly elected government.

3. Minister Lee said that the Korean authorities had submitted to the Bank a plan for structural adjustment that they hoped the Bank could support with a structural adjustment loan. Mr. Husain briefly explained the status of this proposal and our timetable to assess it.

4. Mr. McNamara outlined the financial realities of the coming decade as he saw them, and the implications of these on the Bank's own financial needs. He asked for Korea's support of the energy affiliate which could be an important part of any solution. He noted Korea's close relationship with many members of OPEC and OECD and hoped that they would use their influence whenever the occasion would arise.

5. Mr. Lee assured Mr. McNamara of Korea's support for the benefit of all.

6. The meeting ended with Mr. Lee inviting Mr. McNamara to visit Korea to see first-hand the results of IBRD assistance to Korea, and how far development has progressed since his last visit.

cc: Messrs. Stern, Husain, Koch-Weser/Lafourcade
E VKJaycox:ncp