ICR Review
Operations Evaluation Department

Report Number : ICRR10655

1. Project Data :		Date Posted :	07/06/2000	
PROJ ID:	P056521 OEDID: L4399		Appraisal	Actual
Project Name :	Second structural adjustment loan	Project Costs (US$M)	2,000	2,000
Country:	South Korea	Loan/Credit (US$M)	2,000	2,000
Sector, Major Sect .:	Economic Management, Multisector	Cofinancing (US$M)	0	0
L/C Number:	L4399			
		Board Approval (FY)		98
Partners involved :		Closing Date	06/30/1999	06/30/1999
Prepared by :	Reviewed by :	Group Manager :	Group:	
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2. Project Objectives and Components

a. Objectives

SALII was part of a series of loans to restore financial stability, mitigate the social costs of adjustment, and implement structural reforms in the financial and corporate sectors to pave the way for Korea's return to strong and sustained growth.

b. Components

(1) macroeconomic policies; (2) structural reforms including (a) financial sector reform, including the resolution of weak financial institutions, strengthening of prudential regulation and supervision, and capital market development, (b) corporate sector reform, including corporate debt restructuring, reform of corporate governance and competition policies, and reform and privatization of state-owned corporations, and (c) labor market reform and strengthening of social safety nets. There are a large number of components in the policy matrix to specify precise actions to implement these components.

c. Comments on Project Cost, Financing and Dates

The $2,000 million project was disbursed in two equal tranches. SALII was approved on October 22, 1998, became effective on October 23, 1998, and closed as scheduled on June 30, 1999.

3. Achievement of Relevant Objectives :

1. The macroeconomic objectives were exceeded as GDP grew by 10.7 percent in 1999 and international financial confidence returned. Inflation in 1999 was only 1.4 percent, the current account balance remained strongly positive (at $25 billion) for the second year in a row, and short-term debt was held to $35 billion, a slight increase of about $4 billion over 1998 but still well below the 1996 level of $93 billion and 1997 level of $64 billion. 2. (a) financial sector reforms included restoration of solvency of the banking system as all banks except for two small ones complied with the 8 percent threshold for capital adequacy by second tranche release, the Financial Supervisory Commission (FSC) was strengthened, Korea First Bank was privatized and progress was made towards the privatization of Seoul Bank, and capital market development assisted by strengthening the regulatory and institutional framework (b) corporate sector reforms that resulted in 90 companies undergoing insolvency processing included enforcement of rules that make it more difficult for companies to avoid restructuring , while the Top 5 conglomerates (chaebol) reached agreement with their lead banks on capital structure improvement plans, and agreed to eliminate cross guarantees by March, 2000. Corporate governance improvements including improving shareholders' rights and increasing the number of board members who were outside directors and improving financial transparency and accountability reforms, including strengthening the Korea Institute of Certified Public Accountants and audit committees of the boards of directors. Improved Competition Policies included a strengthened Fair Trade Act helping the KFTC deal more effectively with mergers and acquisition, the Foreign Investment Promotion Act to liberalize foreign investment (which contributed to the stock market rebound), and the Act on Comprehensive Regulation of Cartels. The KFTC was strengthened to enhance its capacity to deal more effectively with Chaebol-related problems such as swaps among the Chaebol. The GOK also implemented a program to reform and privatize state-owned enterprises, including improving the management structure of SOEs, identifying SOEs for sale (SOE's account for about 10% of GDP), and designing a strategy to develop the institutions and regulations for privatization. 3. Labor market and social safety net reform included (a) enforcement of layoff provisions allowing

enterprises to lay off workers, (b) easing restrictions on manpower leasing and contract labor, (c) expanding unemployment insurance to include unemployed workers of all firms, (d) improving targeting (including means-testing) of social expenditures with budget increases for public works programs and other social expenditures which resulted in a with a doubling of social expenditures, and (e) legislation was enacted to revise the Public Fund Management Act and a phased reduction of forced government appropriations from the national Pension Fund was implemented.

4. Significant Outcomes /Impacts:

The economy rebounded and grew by 10.7% in 1999 as the government implemented the program. Confidence returned to the financial markets. The corporate and financial sectors continued restructuring programs which bode well for sustainability of the recovery. Labor market reforms will lead to greater mobility, but with a more adequately funded and better targeted social safety net.

5. Significant Shortcomings (including non-compliance with safeguard policies):

6. Ratings:	ICR	OED Review	Reason for Disagreement /Comments
Outcome:	Satisfactory	Satisfactory	
Institutional Dev .:	Substantial	Substantial	
Sustainability:	Likely	Likely	
Bank Performance:	Satisfactory	Satisfactory	
Borrower Perf .:	Satisfactory	Satisfactory	
Quality of ICR:		Satisfactory	

7. Lessons of Broad Applicability :

(1) Strong client ownership has a clear impact on the success of the program. This is especially important in wide-ranging programs such as SALII in which the government needs to work closely with the private sector and non-government stakeholders to ensure that the program is both broadly acceptable and broadly supported. While the Government felt that the program was overspecified; given the fact that it was achieved makes a judgment difficult as to whether this was a valid point. (2) An integrated and comprehensive approach with clear linkages among the sectors is important in an economy such as Korea's, given the capacity of the government. This also facilitates effective monitoring and feedback. (3) Staffing flexibility was important to achieve results as the Bank drew on staff with previous experience on Korea to make up for the lack of recent Bank operations and ESW.

8. Audit Recommended? ○ Yes ● No

9. Comments on Quality of ICR :

The attention to lessons learned is commendable. The quality of the ICR overall is satisfactory.