PD-AAH-581

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1

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROJECT PAPER FACESHEET

1. TRANSACTION CODE: A (A = ADD, C = CHANGE, D = DELETE)

PP

2. DOCUMENT CODE: 3

3. COUNTRY/ENTITY: COSTA RICA

4. DOCUMENT REVISION NUMBER:

5. PROJECT NUMBER (7 digits): 515-0176

6. BUREAU/OFFICE: A. SYMBOL: LA; B. CODE: 05

7. PROJECT TITLE (Maximum 40 characters): PRIVATE SECTOR PRODUCTIVITY

8. ESTIMATED FY OF PROJECT COMPLETION: FY 84

9. ESTIMATED DATE OF OBLIGATION: A. INITIAL FY 81; B. QUARTER 4 (Enter 1, 2, 3, or 4); C. FINAL FY 81

10. ESTIMATED COSTS ($000 OR EQUIVALENT $1 –)

A. FUNDING SOURCE	FIRST FY B. FX	FIRST FY C. L/C	FIRST FY D. TOTAL	LIFE OF PROJECT E. FX	LIFE OF PROJECT F. L/C	LIFE OF PROJECT G. TOTAL
AID APPROPRIATED TOTAL	2,500	7,500	10,000	2,500	7,500	10,000
(GRANT)	( )	( )	( )	( )	( )	( )
(LOAN)	(2,500)	(7,500)	(10,000)	(2,500)	(7,500)	(10,000)
OTHER U.S. 1. Co-financing				1,500	8,500	10,000
OTHER U.S. 2.						
HOST COUNTRY BANEX		1,000	1,000		2,000	2,000
OTHER DONOR(S)						
TOTALS	2,500	8,500	11,000	4,000	18,000	22,000

11. PROPOSED BUDGET APPROPRIATED FUNDS ($000)

A. APPROPRIATION	B. PRIMARY PURPOSE CODE	PRIMARY TECH. CODE C. GRANT	PRIMARY TECH. CODE D. LOAN	E. 1ST FY 81 F. GRANT	E. 1ST FY 81 G. LOAN	H. 2ND FY I. GRANT	H. 2ND FY J. LOAN	K. 3RD FY L. GRANT	K. 3RD FY M. LOAN
(1) ST	730		810		10,000				
(2)									
(3)									
(4)									
TOTALS					10,000				

A. APPROPRIATION	N. 4TH FY O. GRANT	N. 4TH FY P. LOAN	Q. 5TH FY R. GRANT	Q. 5TH FY S. LOAN	LIFE OF PROJECT T. GRANT	LIFE OF PROJECT U. LOAN
(1)						10,000
(2)						
(3)						
(4)						
TOTALS						10,000

12. IN-DEPTH EVALUATION SCHEDULED: MM 11 YY 83

13. DATA CHANGE INDICATOR. WERE CHANGES MADE IN THE PID FACESHEET DATA, BLOCKS 12, 13, 14, OR 15 OR IN PRP FACESHEET DATA, BLOCK 12? IF YES, ATTACH CHANGED PID FACESHEET.

2 (1 = NO, 2 = YES)

14. ORIGINATING OFFICE CLEARANCE

SIGNATURE: [signature]

TITLE: Stephen P. Knaebel, Mission Director

DATE SIGNED: MM 08 DD 17 YY 81

15. DATE DOCUMENT RECEIVED IN AID/W, OR FOR AID/W DOCUMENTS, DATE OF DISTRIBUTION: MM DD YY

AID 1330-4 (3-78)

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROJECT IDENTIFICATION DOCUMENT FACESHEET (PID)

1. TRANSACTION CODE: C (A = Add, C = Change, D = Delete) — Revision No. 1

DOCUMENT CODE: 1

2. COUNTRY/ENTITY: COSTA RICA

3. PROJECT NUMBER: 515-0176

4. BUREAU/OFFICE: A. Symbol: LA — B. Code: 05

5. PROJECT TITLE (maximum 40 characters): PRIVATE SECTOR PRODUCTIVITY

6. ESTIMATED FY OF AUTHORIZATION/OBLIGATION/COMPLETION

- A. Initial FY: 81
- B. Final FY: 81
- C. PACD: 84

7. ESTIMATED COSTS ($000 OR EQUIVALENT, $1 =)

FUNDING SOURCE	LIFE OF PROJECT
A. AID	10,000
B. Other U.S. 1. Co-financing	10,000
B. Other U.S. 2.	
C. Host Country	2,000
D. Other Donor(s)	
TOTAL	22,000

8. PROPOSED BUDGET AID FUNDS ($000)

A. APPROPRIATION	B. PRIMARY PURPOSE CODE	C. PRIMARY TECH. CODE 1. Grant	C. 2. Loan	D. 1ST FY 81 1. Grant	D. 2. Loan	E. LIFE OF PROJECT 1. Grant	E. 2. Loan
(1) ST	730		810		10,000		10,000
(2)							
(3)							
(4)							
TOTALS					10,000		10,000

9. SECONDARY TECHNICAL CODES (maximum 6 codes of 3 positions each): 840

10. SECONDARY PURPOSE CODE:

11. SPECIAL CONCERNS CODES (maximum 7 codes of 4 positions each)

A. Code	INTR					
B. Amount	10,000					

12. PROJECT PURPOSE (maximum 480 characters)

Establish an integrated program of credit, export management assistance, and export oriented banking services for the producers/manufacturers of nontraditional exports to world markets.

13. RESOURCES REQUIRED FOR PROJECT DEVELOPMENT

Staff: 3.5 p.m. (Mission Staff)
0.75 p.m.(LAC/DR Private Sector Officer)
0.75 p.m. (AID/W Financial Analyst)
0.50 p.m. (RLA or GC/LA Legal Assistance)

Funds $10,000 (Research Contract)
19,000 (Financial Analysis/Tech. Asst. Contract)
6,000 (Export Management Tech. Asst. Contract)
$35,000 TOTAL

14. ORIGINATING OFFICE CLEARANCE

Signature

Title: Mission Director

Date Signed: MM DD YY

15. DATE DOCUMENT RECEIVED IN AID/W, OR FOR AID/W DOCUMENTS, DATE OF DISTRIBUTION: MM DD YY

16. PROJECT DOCUMENT ACTION TAKEN

S = Suspended
A = Approved
D = Disapproved
CA = Conditionally Approved
DD = Decision Deferred

17. COMMENTS

18. ACTION APPROVED BY

Signature

Title

19. ACTION REFERENCE

20. ACTION DATE: MM DD YY

PRIVATE SECTOR PRODUCTIVITY

PROJECT PAPER

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2. Summary of Characteristics of Surveyed Firms (GAMCO Inc.)

3. Selected Illustrative Case Studies of Potential Subborrowers (GAMCO Inc.)

*4. Report on the Evolution of the Banking System's Credit Capacity (Claudio González Vega, La Academia de Centroamérica)

*5. Summary report on the characteristics of nontraditional exporters (La Academia de Centroamérica)

*6. Draft "Structural Design" for an Agro-Industrial Export Company (Guerra and Assoc.)

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* These exhibits have not been included in the Project Paper. They are available as "bulk annexes" in LAC/DR and Mission files.

LIST OF ACRONYMS AND ABBREVIATIONS

AID	Agency for International Development
AA/LAC	Assistant Administrator for Latin America and Caribbean
BANEX	Banco Agro-Industrial y de Exportaciones
BLADEX	Banco Latino Americano de Exportaciones
CACM	Central American Common Market
CAT	Certificado de Abono Tributario
CD	Certificate of Deposit
CDO	Capital Development Office
CDSS	Country Development Strategy Statement
CENPRO	Centro de Promocion de Exportaciones
CODESA	Corporacion de Desarrollo, S.A.
COFISA	Corporacion de Financiamiento Industrial, S.A.
DA	Development Assistance
EFF	Extended Financing Facility
EOPS	End of Project Status
ESF	Economic Support Fund
EXCO	BANEX Export Company
GDP	Gross Domestic Product
GNP	Gross National Product
GOCR	Government Of Costa Rica
GSP	General Schedule Preference
IBRD	International Bank for Reconstruction and Development
ICE	Costa Rica Electricity Institute
IFC	International Finance Corporation
IMF	International Monetary Fund
LAAD	Latin American Agribusiness Development Corporation
LIBOR	London Inter-Bank Borrowing Rate
OFIPLAN	Oficina Nacional de Planificacion y Politica Economica
RECOPE	Costa Rican OIl Refinery
SBN	Sistema Bancaria Nacional
TRACO	BANEX Trading Company
USAID	AID Mission - Costa Rica
WTI	World Trade Institute

I. SUMMARY AND RECOMMENDATIONS

A. Facesheet

B. Recommendations

This Mission recommends that AID approve the following loan to finance the Private Sector Productivity Project.

- o AID Loan: $10,000,000

  Terms: to BANEX -- five percent interest p.a., fifteen year repayment period, including five years grace on amortization; to GOCR (if special "two-step" payment procedure is elected) -- twenty year repayment period including ten years grace on amortization with interest of two percent during the grace period and three percent thereafter.

- o Borrower contribution: $2,000,000

  ($1.0 million prior to initial disbursement and $1.0 million prior to disbursements in excess of $5,700,000.)

- o Commercial Co-financing: $10,000,000

  (Levels tied to the levels of disbursement of AID funds beyond $3,200,000.)

- o Project Total: $22,000,000
  (including co-financing)

- o Disbursement Period: Three years

C. Summary Project Description

1. Borrower

The borrower will be BANCO AGRO INDUSTRIAL Y DE EXPORTATIONES (BANEX) which is incorporated as a private bank member of the Costa Rican National Banking System (SBN). The BANEX Board of Directors and its stockholders include a broad representation of prominent Costa Rican industrialists and agriculturalists. Recently established, BANEX is intended to give the Costa Rican private sector, and especially its industrial and agricultural exporters, a private bank alternative to Costa Rica's state-owned banks, which in recent years have experienced chronic liquidity problems and difficulties in delivering a full range of banking services

2. Project Summary

The Costa Rican economy has been characterized by an import-substituting manufacturing sector which, protected behind high tariff barriers, has found it much more profitable to produce for the domestic market than for export. The country has had recurring and ever-larger trade deficits for most of the past decade, owing to its rapidly rising bill for oil and other imports and a dependence on traditional commodity exports for earning foreign exchange. For Costa Rica to achieve steady economic growth once again, structural changes must be made in the productive agricultural and industrial sectors, and export diversification must take place in order to increase foreign exchange earnings.

The Goal of the Project is to reestablish the dynamic growth of the Costa Rican economy. Expansion of the production and export of nontraditional products to world (non-CACM) markets is the project Sub-goal. The Purpose of the project is to establish an integrated program of credit, export oriented banking services and export management assistance for the producers, manufacturers and brokers of nontraditional exports to world markets. Accordingly, the project includes:

a. Credit

The Costa Rican private sector is currently suffering from an acute credit shortage and liquidity crisis. The balance-of-payments deficits over the past several years, combined with a public sector external debt of more than $2.2 billion (and a debt service ratio of over 25% of export earnings) have resulted in a low international credit rating. Loans from foreign banks and suppliers upon which the private sector once could depend are no longer generally available. The seriously troubled public sector is absorbing most new domestic credit and restricting private sector access to foreign exchange. The credit shortage is the principal obstacle to increasing nontraditional exports to world markets. The latter, in turn, is vital to reestablishing Costa Rica's economic growth.

The project will make subloans totalling at least $12 million to producers, manufacturers, and merchants of nontraditional export products destined for world (non-CACM) markets. The severity of the crisis demands rapid disbursement of credits destined to increase and diversify exports. Subloan interest rates will be at or near market terms. Subloans will be both long-term and short-term, with the length of the repayment period determined by the use to which the money will be put. These uses will include capital investments in plant and equipment, the purchase of raw materials, and working capital.

b. Banking Services

The efficient delivery of export-oriented banking services is essential for increasing the country's exports. While Costa Rica's state banks currently offer such services with varying degrees of efficiency, providing them will be a BANEX speciality. BANEX will develop an in-house capacity to deliver a full range of export-facilitating banking services which it will offer to project subborrowers, other clients of the project's trading company(ies), and other exporters. The success of other project components hinges on the timely, efficient and well-coordinated delivery of these specialized services. Through BANEX and its projected international correspondent banking network, these services can be offered in direct coordination with the project's credit and trading company activities.

c. Export Management

The establishment of a lasting nontraditional export capability directed to world markets will require, in addition to credit and appropriate banking services, the means by which the exporting process can be managed. Export management is a highly specialized function which requires skills and experience. Few Costa Rican producers and manufacturers are also competent exporters. Even those who successfully produce and sell in domestic or CACM markets are seldom equipped to do so for world markets. Not only is specific expertise needed; exporting to nontraditional markets requires investment in equipment, material, and people.

In order to respond to the need for export management expertise, the project will develop within the BANEX structure a comprehensive export management services capability.

The project's Export Management Component has been designed to meet several principal objectives:

- provide producers and manufacturers with commonly needed, basic export management services;

- assist producers and manufacturers of nontraditional export products to establish and maintain a productive capability which meets the demands of the marketplace;

- develop broadly based export management expertise among Costa Rican producers, manufacturers and merchants by including them in the export process;

- make Costa Rican nontraditional products competitive and systematically available in the world market place; and,
- provide producers and manufacturers of export products with lower cost imported raw materials and capital goods, supplier financing, and better knowledge of technical options.

To achieve these objectives BANEX will use AID assistance to organize and capitalize a wholly-owned Costa Rican trading company which will have a U.S.-based purchasing and marketing subsidiary.

While the trading company (TRACO) is expected to become profitable during the life of the project, BANEX will supply equity capital for its initial development and for the expansion of its operations with part of its earnings from the sublending program financed by AID.

3. Summary Findings

The project Committee has reviewed the project for its technical, economic, social, financial, policy, and institutional soundness.

We strongly believe that this project can help to solve some of the fundamental problems which currently plague the Costa Rican economy. The project's export focus not only deals directly with one of the most important underlying obstacles to renewed and steady economic growth, but also takes advantage of certain key aspects of the present economic situation, such as the favorable exchange rate, low pressure and wages, underutilized plant capacity, and policy incentives aimed at reducing the cost of imports and increasing exports. It provides an important new private sector channel for attracting international commercial bank loans, and a way to bring in more foreign exchange by stimulating export sales. Moreover, supporting a risk-taking, production-oriented private bank at this time offers an example which may be as important as the AID money involved. It sends the correct signals about interest rates, export diversification and agile credit delivery to both the public and private sectors. Finally, the project supports an institutionally important, socially beneficial, and hopefully profitable initiative by members of the Costa Rican private sector as part of their efforts to help resolve the economic and institutional problems that their country faces.

The Mission Project Committee has reviewed BANEX's structure and organization; staffing and management; lending regulations and procedures; and management information and accounting control systems. The Committee has concluded that BANEX has the capability to successfully carry out and meet the objectives of the AID project and that it will be able to lend the amounts planned to eligible sub-borrowers for the uses intended. BANEX will require specialized technical assistance to set up TRACO; this has been provided for in the project design and financial plan.

Still, BANEX is a new organization which has only recently begun actual operations; many of its systems are still in the "shake down" stage and others have only been designed and are not yet operational; middle level employees have yet to be hired, and several staff members, though able, are inexperienced. It is for these reasons that the implementation schedule has been conservatively designed and why the Mission intends to include covenants in the loan agreement which will permit us to closely monitor the development of BANEX's systems and management.

4. Project Issues

The issues included in the PID DAEC review cable (Annex B, Exhibit 2) have been taken into consideration; they are discussed in detail in many sections of this Project paper, and summarized below.

a. Strategy

The GOCR's new export-oriented strategy and the probability of successful adherance to it is discussed in detail in Section II.B.2. (The GOCR Response to the Current Macro-Economic Problem and its Changed Long-Term Development Strategy), and in Section IV.C. (Economic Analysis). The new export-oriented strategy is the centerpiece of the GOCR's three-year Extended Financing Facility (EFF) and Structural Adjustment Program (SAP) with the International Monetary Fund (IMF) and is also central to informal discussions with other donors, including AID. The GOCR has had difficulties in adhering to the IMF program in all respects (especially exchange rate policy), principally because the foreign commercial credit inflow that the program anticipated has yet to materialize. Still, the country is currently meeting all of the program's targets, and there are indications already that the GOCR export-led structural adjustment strategy is working[1/].

Apart from questions of compliance with IMF agreement, the principal assurance that the GOCR will continue to pursue policies favorable to exporting is that no other options exist. If Costa Rica is to return to its former level of well-being and maintain an acceptable economic growth rate, the country must increase export earnings.

1/ A recent University of Costa Rica sample survey of manufacturers found that although they expected their overall output to drop by 2.7% in 1981, they expected that 10.3% of their output would go to world markets as opposed to 3.4% in 1980.

b. Co-financing

Co-financing is discussed in detail in parts of Section IV.B.1.b. (Financial Plan and Financial Analysis Summary). BANEX plans for incorporating co-financing are discussed in Section III.C.1.b. (AID and Related Support for BANEX), and the use of co-financed funds is discussed in Section IV.C.2.a.(2), (Subloan Financing. The Detailed Financial Analysis (Annex E, Exhibit 1) compares the projected financial situation of BANEX with and without co-financing. Finally, the conditions and covenants which relate to co-financing are presented in Section V.F.

In summary, co-financing is highly desirable for the project. It not only channels more foreign exchange from private sources into the economy and into BANEX for productive, export directed investment, but co-financing also increases BANEX's long-run profitability and the size of its lending portfolio. Furthermore, co-financing enables a greater portion of the AID loan spread to be invested in export management.

Initially, in discussions held with both BANEX and USAID officials, U.S. private banks expressed considerable interest in co-financing. Recently, however, it has become known that the GOCR wants to renegotiate its entire foreign debt, and in late July the GOCR communicated to all its creditors that it intends to declare a moratorium on the amortization of its debt to commercial banks. This news, as might be expected, caused the interest of commercial banks in a co-financing arrangement to decrease noticeably. Thus, although BANEX and the USAID will continue to pursue co-financing possibilities and the loan agreement will contain provisions encouraging co-financing, we are also forced to recognize that co-financing may not become available immediately. Therefore, the Financial Analysis and the overall project design assumes that no co-financing will be available during the first year of operation. Subsequent conditions precedent are set up so that the disbursement of AID funds are conditioned at several points when cumulative draw downs reach certain levels ($3.2 million, $5.7 million and $8.2 million) unless scheduled amounts are obtained from private sources and disbursed.

The Mission will continue to work closely with BANEX to secure co-financing. However, should co-financing prove to be unavailable or not available on reasonable terms, and if the Mission is convinced that BANEX has used its best efforts to secure co-financing, then the Mission will waive or modify the conditions precedent related to co-financing, as well as the covenant which stipulates that 60% of the AID-financed subloan portfolio must be in long-term loans, when the AID loan is fully disbursed.

c. Debt-Equity Ratio

Based on the analysis suggested in the PID review cable of the various options for calculating the maximum allowable debt-equity ratio (See Annex E, Exhibit 1, Table 2 of the Detailed Financial Analysis), the Mission has decided to include the AID loan as debt in the debt-equity ratio and to discard the "foreign bank debt to equity ratio" as a measure. If, however, BANEX is able to atract significant deposits from the public, these would not be counted as debt in the maximum allowable debt-equity ratio.

As the PID cable suggested, the Mission has examined debt-equity ratios of other financial institutions, including institutions like BANEX (See Annex I, Exhibit 1, Detailed Financial Analysis). We found the progressive yearly increase of the debt-equity ratio from 6:1 in year one to a maximum of 10:1 by the end of year five to be reasonable, conservative, and sound because it offers an appropriate balance between the competing objectives of leverage and security.

d. Guarantee

Questions related to the GOCR guarantee for the loan are discussed in Section IV.B.1.c. of the Financial Plan. The Mission is convinced that AID could safely make a loan to BANEX without the additional security of a GOCR guarantee because of BANEX's conceptual and institutional soundness; its sustained cash flow (even under the worst case sensitivity analysis assumptions); its low exposure to exchange risk; and because the large unmet demand for credit will allow it to lend to firms which are excellent credit risks and which produce exportable goods that would enjoy a long-term comparative advantage in world markets. Nevertheless, the Mission does see some value in the additional security that a GOCR guarantee might offer, given the country's climate of economic instability and erratic exchange rate policy.

As discussed in detail in Section IV.B.1.c., the Mission and BANEX have exhausted all possible guarantee options that do not require Legislative Assembly approval. Because the AID Mission has received assurances that Legislative Assembly approval can be quickly secured (see San Jose 5048), we have included a GOCR guarantee as a condition precedent in the draft loan authorization. However, should the the GOCR Legislative Assembly fail to quickly approve a guarantee arrangement, export producers will not get the loan funds they need and BANEX may suffer considerable financial harm. The Mission therefore believes that AID/W should consider making the loan to BANEX without a GOCR guarantee. Should legislative approval of the loan guarantee not be obtained within a reasonable time after the loan is signed (e.g., 90 days) the Mission

1/ The nationalized banking system is a Costa Rican "sacred cow". Thus a government guarantee to a private bank might produce considerable controversy and debate in the Assembly; consensus on the issue may not be reached quickly.

proposes following the course of action outlined in Section IV.B.1.c.1/; that is, a Mission review and update on risk factors, the formulation of a Mission recommendation to AID/W, and the design of alternative risk minimizing mechanisms. In no case would the Mission waive or modify by implementation letter the requirement of a GOCR guarantee without AID/W authorization.

e. Legal Considerations

(1) TRACO will be a wholly-owned subsidiary of BANEX, S.A. Details on the legal and financial relationships between these companies are contained in the description of the Export Management Component (Section III.C.2.c.), the Institutional Analysis (Section IV.A.1.) and the Detailed Financial Analysis (Annex E, Exhibit 1).

(2) A nonsubordination clause which defines AID's priority vis-a-vis other creditors is included in the draft loan authorization as is a negative pledge clause. Costa Rican laws do not appear to favor Costa Rican creditors (except depositors) over foreigners2/.

f. Project Funding

The need for grant funding was eliminated by providing for an equity advance to TRACO and by increasing the size of the AID loan from $5.0 to $10.0 million (which increased the amounts generated by the loan apread).

g. Sublending Criteria

Section III.C.2.a. (Credit Component), deals with sublending priorities and the characteristics of subborrowers. Specific sublending criteria are spelled out in Section III.C.2.a(3) (Sublending Criteria).

1/ A cleaner alternative could be simply substituting the condition precedent covering the guarantee with one requiring the formulation of acceptable alternative risk-minimizing mechanism (discussed in Section IV.B.1.c.); the cost and possible damage which delay in legislative approval will cause must be balanced against the value to AID (and possible co-financiers) of the additional security that a GOCR guarantee might offer.

2/ The Mission recommends that GC/LAC advise the RLA to obtain local legal advice on this and other matters, including jurisdiction.

D. Participants in the Preparation of the Project Paper

Mission Project Committee

Steve Knaebel, Mission Director
William Phelps, Deputy CRDO
Bastiaan Schouten, Acting Assistant Director, and CRDO

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BANEX

Guillermo Von Breymann, General Manager
Oscar Ramírez, Assistant General Manager

II. BACKGROUND

A. The Project's Macro-Economic Context

From 1950 through 1977, Costa Rica appeared to be a model developing country. During this period the real growth of GDP averaged well over 6% p.a., adult literacy reached 90%, health services were widely extended, infant mortality declined sharply, the population growth rate dropped from 3.7% to 2.4%, and income distribution was quite equitable in comparison to most developing countries. At the end of the period, only about a quarter of the population was living in absolute poverty. Moreover, Costa Rica had attained these achievements as a political democracy.

Costa Rica is now experiencing its most serious economic crisis in many decades. By 1980, the earlier problem of how to distribute equitably the benefits of economic growth had been replaced by questions of how to equitably share the required economic sacrifice. Real gross national income declined by 2.2% per capita in 1978, and by 4.6% in 1979, and undoubtedly declined even more sharply in 1980. The dimensions of the present macro-economic crisis and the inevitability of sharp drops in imports and GDP over the next several years were covered in depth in our FY 83 CDSS. Since that document was written the crisis has become even more acute. As a result the contraction of imports and national production will be even more severe than that which we had anticipated in our CDSS. During 1981, a contraction of imports of 30% to 35% on real terms is taking place, and such a marked contraction in imports will certainly result in a sharply declining GDP--the drop could be as large as 15 percent on a per capita basis, perhaps larger.

The value of the colon in dollar terms has dropped from almost twelve cents to between four and five cents within an eight month period. Given the devaluation of the Costa Rican currency, GNP per capita in dollar terms, which the IBRD estimated at $1,540 in 1978, will drop in 1981 to somewhere in the neighborhood of $1,200-$1,300 (See San Jose 1673). The extent of the drop will depend on the internal rate of inflation, which is accelerating sharply now that excess aggregrate demand is not so easily absorbed by imports (in the first five months of 1981, the wholesale price index increased by 31.5%).

Although the seriousness of the economic adjustment has become evident to most Costa Ricans, because of certain lags its full impact is only now starting to be felt; e.g., in terms of high unemployment, retrenchment of social services, and an annual inflation rate exceeding 80% p.a.. Now, a people with rising material aspirations, fueled by thirty years of a generally improving economic situation, are beginning to feel the full consequences of what a few months ago were only statistics. Faced with a rapidly deteriorating economic situation, Costa Rica's middle class and organized labor has, to date, shown admirable restraint. Demands for wage increases have been moderate given the rate of inflation and the incidence of strikes and worker support for them has been low. Since the submission of the PID for this project a small but well-organized and ruthless leftist terrorist group has emerged on the scene. To date, its success has been limited. It would appear that significant parts of the organization have been discovered and uprooted, in large part, because of widespread citizen collaboration with the authorities. Although the emergence of violent indigenous terrorism in democratic Costa Rica has come as a shock to most Costa Ricans and there has been some panic and capital flight as a result, so far its impact on the already precarious economic and social situation has not been comparable to the effect of violence in neighboring countries. Still, Costa Rican traditions of liberal democracy, social dialogue, and lack of political violence are being severely tested.

B. Relationship of the Project to Costa Rica's Development Strategy and the CDSS

1. The Impact of Past Costa Rican Development Strategies

Our last several CDSS submissions have pointed out that the present macro-economic crisis is not just a passing phenomenon but rather the logical result of several long-term tendencies precipitated by an abrupt shift in the terms of trade which began in 1978. The same strategies which Costa Rica pursued successfully in an earlier period have left legacies that now stand in the way of future development: agricultural and livestock production was expanded by bringing new lands into production, and local manufacturing efforts, first directed at the domestic market and later to the Central American Common Market (CACM), were promoted to achieve substitution of imported industrial goods. The public sector played a key role through investment in infrastructure and helped assure that the benefits of growth were widely distributed through extensive education, health service and social security systems. Now, land-extensive agricultural development is checked because there is not much unexploited land suitable for agriculture left. Import substitution has ceased to be a viable growth strategy, and a public sector living beyond its means has become a destabilizing force. In relation to the project both the consequences of import substitution policies and the role of the public sector merit further discussion.

a. The Legacies of Import Substitution

The GOCR import substitution strategy resulted in rapid industrial growth for a time, with manufacturing as a percentage of GDP increasing from 14% in 1963 to 21% in 1974. However, by the early 1970's the limitations of the strategy for Costa

Rica were already becoming apparent: easy import substitution possibilities had been taken advantage of, and the CACM proved to be a small, easily saturated and, in some instances, unreliable market. Between 1974 and 1979, manufacturing's share of Costa Rica's GDP increased by only 1% (to a total of 22%), and in 1979 the same percentage (19%) of the country's exports went to the CACM as in 1970.

Unfortunately, the import substitution strategy produced a set of policies which worked together to create a distinct anti-export trade environment. Among these policies were a high rate of effective protection[1/], an overvalued exchange rate, and generally subsidized interest rates.

The existence of an anti-export bias was recognized as early as 1973 when a series of export incentives were adopted to overcome it. The most important of these incentives was the CAT, Certificado de Abono Tributario (negotiable tax credit certificates), which gave a 15% income tax credit to non-traditional exporters. In spite of export incentives, a recent (pre-devaluation) IBRD study concluded that an anti-export bias existed for all products that were examined. Export activities for these firms and products were simply not as profitable, on the average, as producing for the domestic market because the effective rates of protection far exceeded effective rates of subsidy for exports. The study concluded that for Costa Rican manufactured exports to experience rapid growth, the incentive structure had to be changed.

High levels of effective industrial protection, an overvalued exchange rate, subsidized interest rates, and other incentives to capital investment such as payroll taxes and rapid depreciation schemes have had several consequences for the economy:

- They have resulted in an industrial sector that has considerable excess capacity, is more capital intensive than optimal, and more import intensive than in the past. In 1960-62 raw material imports for industry averaged 11% of industrial output; that ratio had climbed to 20% in 1975-77. Several studies have shown that 80-90% of manufacturing plants in Costa Rica work only one shift per day. A 1976 OFIPLAN survey found that the number of shifts worked was on the average only 56% of what

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1/ Nominal protection in 1972 ranged from 148% for food products to 17% for basic metals. The 1979 average legal tariff was recently estimated at 60-70% by the World Bank.

entrepreneurs thought technically feasible. The principal reason cited was the lack of markets for the products. This idle capacity means that the country has the potential to supply many new markets; proper incentives can convert it from waste to resource.

- The percentage of imports that can be classed as consumer goods dropped steadily until, in 1979, they accounted for only 22% of the total. The balance consisted of raw materials, capital goods, and petroleum. As a consequence, the prospects for reducing imports without affecting the raw materials and capital goods needed for domestic production are slight.

- The internal terms of trade did not favor agricultural production, especially of non-export crops. As a result, agricultural production has stagnated or declined, especially the production of domestic food crops such as corn and beans.

b. <u>The Legacies of the Activist Public Sector</u>

Uncontrolled public sector growth is another underlying problem of the current crisis which has a bearing on the proposed project. Public sector employment increased from 6.2% of the labor force in 1950 to 16% in 1973 and now stands at 20% of the labor force. During the 1976-1980 period some 37.2% of the new jobs created were in the public sector, and in 1979-80 private employment actually dropped by over 4,000 jobs while public sector employment increased by almost 10,000 jobs. In recent years, the increase in public sector spending has greatly exceeded revenue growth and thus the public sector deficit has grown rapidly. As a percentage of GDP, this deficit increased sharply from an average of 6.5% in 1976-78, to 10.1% in 1979 and 12.5% in 1980. The overall deficit of the major decentralized institutions, whose spending was largely beyond central government control until the creation of the Budget Authority in December of 1979, increased from 423 million colons in 1976 to 2,344 million colons in 1980.

Although various causes exist for the large fiscal deficit, including an excessive dependency on regressive consumption taxes and earmarked revenues, the deficits of public enterprises have played a major role. One entity merits special attention: CODESA, the National Development Corporation. CODESA was originally created in 1973 as a mixed ownership finance company for private sector projects. Because the private sector did not invest in CODESA, it became almost entirely publicly owned. Starting in 1977 CODESA assumed major importance by engaging in substantial investment, mainly as a holding company in cotton ginning, aluminum, cement, and sugar production, and transport. By the end of 1979 CODESA had full or majority control over 13 companies, minority interest in three companies, and was involved through lending or guarantee in an additional 16. Over the last three years CODESA deficits have averaged nearly 20% of the entire public sector deficit. Legally, CODESA has unlimited access to Central Bank financing. Between 1977 and 1980 Central Bank holdings of CODESA paper increased from some 300 million colons to over 2 billion colons, and during both 1978 and 1979 CODESA alone absorbed fully 14% of the total credit creation in the country.

The large and growing public sector debt, both internal and external, has had serious negative consequences for the productivity of the private sector and for the nationalized banking system. The private sector's access to credit has taken second place to the financing of public sector deficits internally; and externally, Costa Rica's lack of dollar reserves has caused a cut-back of even normal supplier credit to the private sector. The public sector is now receiving a larger percentage of new internal credit than the private sector; whereas the public sector received 42% of the new internal credit created in 1977 (with 58% going to the private sector), in 1980 the public sector's share had increased to 62%.

TABLE 1

Delinquency Rates for Credit Outstanding in the National Banking System, September, 1974-1979;%

Period Overdue	1974	1975	1976	1977	1978	1979
1-90 days	22.2	25.4	28.5	25.0	25.7	31.5
91 days-1 year	5.5	8.2	9.9	11.7	12.8	17.4
More than 1 year	3.3	2.6	3.2	4.5	7.9	10.6
TOTAL	31.0	36.2	41.6	41.2	46.4	59.5

Source: Unpublished records of the Central Bank

The preemption of banking system credit by the public sector is aggravated by another problem which inhibits new credit supplies to the private sector--the banking system's increasingly serious delinquency rates. As can be seen in Table 1, not only has overall delinquency increased steadily from 1974 to 1979, but delinquencies over 91 days and over one year have also increased significantly as a proportion of the total. This means that the banking system has less money available for new lending. It should be noted that the rates in Table 1 do not refer to renegotiated or "rolled-over" credits. Although we do not have figures on the latter, they are also thought to be high and further limit credit availability for new projects.

Two causes appear to underline the increasing liquidity problem of the national banking system, and both are related to political control of the system. First, in the past many loans were made for political reasons rather than on the basis of financial soundness. Because many of these projects have not succeeded, delinquency has increased. Secondly, banks have been hesitant to foreclose on assets and write off losses. A couple of factors are probably at work here. Politically-dominated bank boards of directors appear to be reluctant to close down going businesses and increase unemployment. Furthermore, labor unions are strong in the banking system and the income of bank employees' pension funds is related to bank earnings, even if these are only paper earnings1/. The reduction of paper earnings implicit in massive bad debt write-offs is therefore resisted because it would result in serious labor unrest in a vital sector of the economy.

2. The GOCR Response to the Current Macro-Economic Crisis and Its Changed Long-Term Development Strategy

The current Costa Rican macro-economic situation results from long-standing trends. To improve it requires structural adjustment above and beyond aggregate demand management. For the past several years the GOCR has attempted, with only partial success, to implement policies intended to correct those basic underlying tendencies. In May of 1981 it negociated an agreement with the International Monetary Fund (IMF) for a three year Extended Financing Facility (EFF) structural adjustment program. The EFF arrangement follows a 1979 "informal" stabilization program and a formal 1980 Standby and Stabilization Agreement. Although the GOCR was unable to meet the targets of either of the programs (see FY 82 and FY 83 CDSSs), some progress was made on the fiscal front. In addition, the

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1/ Dividends are actually paid on an accrual accounting basis rather than on the basis of cash income realized.

Costa Rican public was educated on the problem--making the success of the current EFF more probable--and several key policy reform measures were undertaken. These policy reform measures when taken together constitute an important, albeit incomplete, change in the economic environment. These steps, not necessarily in order of importance, were: (1) the financial reform, (2) the creation of the Budget Authority, and (3) the exchange rate adjustment.

The financial reform, begun in 1979, permitted domestic interest rates which had previously been highly subsidized to rise, reflecting higher external lending rates as well as internal inflation. As a result market rates replaced subsidized rates for most commercial bank loans (the unfortunate exceptions were small-farmer and small-industry credit). The positive consequences of the financial reform were that interest rates paid for savings became competitive, non-market (including political) rationing of credit was minimized, more economically rational resource allocation was fostered, and massive outflows of capital due to external-internal interest rate differences were avoided[1/], as were exchange controls.

The creation of the Budget Authority in December, 1979, gave the GOCR Executive an instrument to control spending by the decentralized public sector which makes up most of public sector expenditures. How effective this instrument will prove in lessening the public sector deficit still remains to be seen, but until then no instrument of any kind even existed.

Finally, the most important change in the economic incentive environment has been the floating --and subsequent de facto devaluation-- of the colon. Since 1950 the country has experienced four devaluations--all, like the present, were brought on by severe balance of payments pressure. However, the present devaluation has been much larger than any of the previous three. The devaluation changes the country's economic structure. It has been trumpeted as an important means to promote exports, and so far it has not been accompanied by exchange controls or other significant import restrictions.

The current EFF with the IMF for structural adjustment has the following main features:

- the maintenance of a unified rate favorable to exporting;

1/ Interest rate differentials appear to have been a major cause of Honduran, Salvadoran and Guatemalan capital outflows during 1979-80.

- substantial reductions of the public sector deficit by cutting expenditures and a major tax reform (as an "interim" measure until the GOCR Legislature can enact the tax reform, a series of 5-6% **ad valorem** export taxes were enacted)1/;

- a pledge to try to get effective protection levels lowered significantly within the CACM before the end of the year;

- a structural adjustment public investment program which stresses new energy sources, greater agricultural productivity, export-oriented infrastructure development, and export promotion activities2/; and

- limits on external and internal financing of public sector activities and limits on the overall deficits of the public sector, including public enterprises such as CODESA.

If the GOCR can meet the conditions for the EFF, including the unification of the exchange rate and the elimination of the foreign exchange backlog (the so-called **presa**), and abide by its terms over the next three years, a framework will have been established for a significant reorientation of the Costa Rican economy.

The GOCR met its first quarter (June 30, 1981) targets under the IMF Agreement and considerable discipline, both fiscal and monetary, has been shown. For example, in the first four months of 1981, the deficit of the Central Government totalled 181 million colons, compared to a 697 million colon deficit for the same period in 1980. Similarly, during the first quarter of 1981, the money supply increased by only 8.5%, compared to wholesale price increases during the same period of 16%.

1/ This measure can be viewed as a kind of "excess profits tax" on exporters. However, given the massive exchange adjustment, it is not a significant disincentive to exports at this time nor will it become so as long as exchange rate policy remains export-oriented.

2/ This is the weakest aspect of the program in that its stress is on the efforts of the public sector, and includes an important role for public enterprise. This emphasis may have been inevitable, given that the program was quickly put together by public employees. Its direction, however, could probably be influenced by the decisions of international donors regarding its funding.

Despite these efforts, private bank loans were not obtained as anticipated by the EFF agreement. This resulted in serious short-run foreign exchange shortages which drove the dollar up to artificially high levels in the local free market (to 25-27 colons per dollar), and in the banking system (19:1). These unexpectedly high rates of exchange (the IMF agreement calculations were based on a 15:1 rate) will make it very difficult for the GOCR to comply with the IMF September 30, 1981 targets, mainly because of unanticipated public sector deficits in such entities as the Costa Rican Oil Refinery (RECOPE) and the Costa Rican Electricity Institute (ICE). These entities must service dollar denominated debts, but are unable to pass price increases ranging between 100% and 200% on to the consumer, even though in the case of ICE the demand for electricity is highly price inelastic. Dollar debt service represents a large part of ICE's expenses, but the institution will not be able to increase prices - and therefore revenues - enough to match the increase in colon costs caused by the devaluation. As the exchange rate continues to deteriorate, a growing deficit in ICE is almost inevitable, even when electricity rate increases are taken into account.

The picture is also clouded by a recent Costa Rican Supreme Court decision which declared the Executive's suspension of the official rate of exchange and the float of the colon unconstitutional. In addition the Legislature overode an Executive veto of a measure which in effect freezes petroleum fuel prices for the next three months. The Supreme Court's decision on the exchange rate coupled with a slow response by the Legislature in fixing a new exchange rate has caused havoc within the banking system. The decision could well bankrupt private financieras which used Costa Rican-based companies to "retail" dollar denominated debt to the private sector using foreign bank credit lines.

As a partial response to this chaotic situation, the GOCR has temporarily suspended the amortization of $200 - 300 million in short-term public debt. In late July a cable to 139 creditors (including AID) advising them that an intensive review of the country's public external debt is underway with the assistance of three prestigious investment banking organizations. The government will try to roll over short term debt coming due before September 30, and has advised that temporary delays in debt service payments are likely to continue. The GOCR will attempt to pay interest charges on commercial debt and both interest and principal on concessional debt.

Needless to say, interest in cofinancing of this project decreased markedly after the international banks received the GOCR cable. As a consequence, we have planned this project so that it would be feasible even if commercial cofinancing were not obtained in the near future. In the Mission's view, the current economic situation makes the rapid approval and implementation of this project even more critical.

C. Project Rationale

Although solving Costa Rica's long-term macro-economic problems is well beyond the scope of the project, it does have significant potential for dealing with many the fundamental problems which have contributed to the present situation. Supporting a risk-taking, production-oriented private bank at this time offers an example considerably more important than the AID money involved. Moreover, the project's focus on export promotion takes advantage of the GOCR's new economic policy framework and will contribute to its effectiveness. It provides an important new private sector channel for attracting international commercial bank capital inflows, and a way to bring in more foreign exchange by stimulating export sales. It sends the correct signals about interest rates, export diversification and agile credit delivery to both the public and private sectors. Finally, the project supports an institutionally important, socially beneficial, and hopefully profitable initiative by members of the Costa Rican private sector as part of its efforts to help resolve the economic and institutional problems that their country faces.

If Costa Rica's levels of imports and GDP are to recover and if a dynamic economic growth process is to be restored, then Costa Rica, a small trade dependent country, must export more. A November 1980 IBRD study on Trade Incentives and Export Diversification indicates that the rate of growth of traditional exports has been much slower than the rate of growth of nontraditional exports, especially nontraditional exports to world markets i.e., non-CACM. Furthermore, these products have the greatest export potential[1/]. Helping Costa Rica produce and export more of these nontraditional products is what this project is all about.

The GOCR has been making a noticeable effort to establish policies which will result in a competitive and export-oriented economic structure; this project can contribute much to making production for export feasible and attractive. The stability and future growth of the Costa Rican economy will require a major shift from import substitution to production for export; to be successful, this change must begin now.

1/ By nontraditional exports are meant all those exports other than raw coffee, bananas, beef, unrefined sugar and cocoa. Included in nontraditional exports are, therefore, such commodities as roasted coffee, refined sugar, and processed beef and primary exports such as fish and crustaceans, black beans, plantains, and unprocessed vegetables. However, the largest component by far of nontraditional exports is manufactured exports; in 1976 they constituted 85% of the nontraditional exports.

Although the changed incentive framework in Costa Rica now favors the exporter, past inertia is not automatically overcome. The proposed project attempts in a systematic way to assist Costa Rican private sector entrepreneurs overcome the constraints which continue to exist to nontraditional exporting.

III. PROJECT DESCRIPTION

A. Goal, Sub-Goal and Purpose

The Costa Rican economy has long been heavily dependent upon international trade. All of the country's productive sectors have developed in response to the availability of foreign markets; and consequently, its economic well-being has been directly linked to these markets. The country's current crisis is a direct result of a serious and growing trade imbalance. Costa Rica's future growth and the well-being of its people depend on its ability to increase exports. The most promising and desirable avenue for increasing and maintaining higher levels of exports is through continued expansion of nontraditional exports. This project, taking advantage of the new Costa Rican incentive structure, proposes to combine the resources of AID, international commercial banks, and the Costa Rican private sector in a concerted effort to respond to the needs of present and potential private sector producers, manufacturers and brokers of nontraditional exports to world markets.

The Goal of this Project is to reestablish the dynamic growth of the Costa Rican economy. Expansion of the production and export of nontraditional products to world (non CACM) markets is the project Sub-goal.

The Purpose of the project is to establish an integrated program of credit, export management assistance and export oriented banking services for the producers, manufacturers and brokers of nontraditional exports to world markets. (A Logical Framework Analysis is attached as Annex B, Exhibit 1).

B. Project Objectives

The principal project objectives (EOPS indicators) reflect the most serious needs of producers and exporters of nontraditional products. These objectives are:

1. A credit system making loans at market interest rates, with terms and conditions specifically tailored to the needs of eligible producers, manufacturers and brokers of exportable products;

2. A privately-operated export management organization ("Trading Company") through which private sector firms can efficiently carry out the activities associated with exporting;

3. Efficiently provided basic export-oriented banking services; and,

4. A viable, private banking institution which offers an additional private sector alternative for resolution of Costa Rica's banking problems.

C. Detailed Project Description

1. Introduction

a. The Implementing Institution

The development and management of a project with the objectives set out above requires the right institutional environment. It must be housed in an private export bank or similar private entity. There are few private financial institutions from which to choose in Costa Rica; and the need for an emphasis on exports further limits the institutional options.

It is the Mission's judgement that the recently established Banco Agro-Industrial y de Exportaciones (BANEX) is the most appropriate Costa Rican institution for carrying out the project. As a private bank whose main focus is on export financing, BANEX makes a very suitable vehicle for the project and meets all of its basic requirements. As a new institution, BANEX also provides the growth potential through which the project can facilitate both additional international private investment in the Costa Rican private sector and the development of an additional private response to the problems of the country's banking system. BANEX's institutional objectives are highly compatible with those of the project. (See the Institutional Analysis section of this paper for a more detailed description of BANEX).

b. AID and Related Support for BANEX

As a strategy for leveraging its equity, BANEX originally envisioned three sources of money: private commercial or investment banks; purchased funds (time deposits obtained from the general public); and development banks (AID, IBRD, IDB). As BANEX grew and as prudent banking would dictate, BANEX also envisioned obtaining additional equity. These sources of BANEX lending capital are discussed below.

(1) International Commercial Banks

Originally, BANEX saw lines of credit from international commercial banks as being its principal source of loanable funds. However, given the current Costa Rica situation, it has found such loans hard to come by. With the prospect of an AID loan, BANEX's attempts to obtain credit from international commercial sources have focused on securing co-financing; thus in this context, the term co-financing refers to funds obtained from foreign private commercial or investment banks accompanying an AID loan.

While the project is designed to be feasible at the $12 million level (AID's $10 million plus BANEX's $2 million), a major objective of this project is to secure private capital resources which BANEX will use to complement AID funds. Thus, it is planned that the $10 million AID loan will be matched by $10 million of private funds. BANEX will attempt to raise these funds on a term basis (3-5 years) at fixed rates over LIBOR. At present, however, the high cost of borrowing at LIBOR, the economic crisis, faced by Costa Rica (including its public debt roll-over), the political problems in Costa Rica and neighboring countries, and the very newness of the bank make it very hard for BANEX to get such term loans. More likely, and as forecast in the financial analysis, BANEX will only be able to raise short term, one-year loans and lines of credit. (This has been LAAD's experience in its recent loan for agribusiness expansion in the Caribbean.). Given the problems which face COFISA (see San Jose 4831), even the availability of short-term lines of credit is questionable at this time.

BANEX anticipates that co-financed funds would be subloaned principally for short-term working capital. Prudent banking dictates that short-term borrowings be lent out only on terms as short or shorter. BANEX also anticipates that these shorter-term funds could be matched with AID funds on many individual subprojects. If co-financing is obtained, longer-term AID funds would generally be used finance plant, equipment and permanent working capital needs. Co-financing monies, as available, would be applied for short-term lending or for subloans not meetng AID source and origin requirements. In the demand study for this project, a total of over $10.5 million in 28 potential subprojects was identified. Of this total, about 60% was for working capital, the remainder for plant and equipment. This finding is consistent with other studies which indicate that Costa Rican manufacturers are operating at considerably less than full capacity. Thus, the need for working capital at this time is substantial and would represent the optimal use of funds. (Should co-financing be unavailable, AID funds will be more extensively used to meet these short-term credit needs and an exception may have to made to the proposed covenant which requires that by the end of loan disbursement BANEX must have 60% of the AID portfolio in long-term subloans.)

A formal co-financing arrangement between AID and private banks could have several advantages for the project and for BANEX: (1) it would make more resources available for sub-lending; (2) it would enhance BANEX's image with the international banking community; and (3) it may help BANEX get more favorable borrowing rates or terms, or both. The latter is possible because international commercial lenders may feel that their investment is more secure in view of the cross-default clause that would exist in the AID Loan Agreement. This clause would provide that a default on the commercial loan could be considered as a default on the AID loan and vice-a-versa. Co-financier security may also be enhanced by the exchange of information on BANEX operations between AID and the co-financiers providing term lending capital. (This would be provided for in a Memorandum of Understanding which would be signed by AID and the private investor(s)). Similarly, the terms and conditions of the concessional AID loan make it a form of "psuedo-capital". Moreover, the substantial cash flow generated from the wide interest rate spread between the AID loan and the sub-loans also offers a considerable degree of security.

The Mission envisions that co-financing would function as follows. The Loan Agreement will include a cross-default clause. After the loan is signed, the borrower will try to get $10 million from foreign commercial sources. Several banks have already expressed interest, and BANEX anticipates that loans in amounts ranging from $2 to 4 million will be forthcoming1/. The GOCR guarantee will further enhance the attractiveness of the cross default clause. The co-financing funds, if available, will be lent by BANEX approximately pari passu with the disbursement of AID funds.

(2) Purchased Public Funds

Costa Rican laws permit the establishment of private banks. All Costa Rican banks (public and private) are members of the National Banking System (SBN) and are subject to the rights and obligations established in those laws, as well as all Banking regulations issued by the Central Bank, including surveillance by its General Audit Office.

The main distinctions between a state bank and a private bank are:

- A private bank cannot accept sight deposits from the public. Sight deposits are those with terms of less than 30 days, such as checking and savings accounts. "Certificates of Investment" (time deposits) at terms of more than 30 days may be accepted by a private bank.

....

1/ Since GOCR debt rescheduling efforts have begun, however, there has been a noticeable loss of interest on the part of these potential lenders.

- Interest earned from sight or time deposits is tax-exempt if paid by state banks; all interest paid by private banks is subject to taxes.

Thus, BANEX's access to public monies is primarily through Certificates of Investment. The usual terms are from 6 to 36 months, in local currency or US dollars. The Central Bank of Costa Rica establishes reserves on these deposits, which range from 10% for over-30 day deposits in colons, to 100% for local deposits in dollars. The reserve requirement on locally raised dollar deposits makes it impossible to use them as a source of funds.

Rates paid for certificates in colons in the market are from 19.5% for 6 months to 17.5% for over a year. Because of the fiscal discrimination against investors who receive interest paid by private banks, these banks must pay a premium of 1-2% over that paid by state banks for similar deposits.

Funds obtained by means of these investment certificates because of their terms and interest rates, are used mainly for making colon-denominated loans for working capital for industry or commerce. Although it would have to pay high interest rates for term deposits in colons, BANEX is considering entering this market as an additional means of sustaining operations1/.

(3) <u>Development Banks:</u>

BANEX has made preliminary contacts with the IBRD, IDB, IFC, and BLADEX (an IFC-supported export bank based in Panama) to determine if they would be interested in loaning money to BANEX or making an equity investment in the bank. To date only AID has agreed in principal to provide support. The IFC has expressed interest, but is still studying the BANEX proposal.

Negotiations are under way with BLADEX, which was established by the IFC and various public, private and central banks of Central America and the Caribbean to finance the export of agricultural and industrial commodities from the country of origin.

....

1/ BANEX is also studying alternate legal means of attracting funds from the public. One such mechanism would be similar to a NOW account combined with "plastic checking" (credit card checking) which would be similar to schemes now available in the United States. At present BANEX does not wish to "push" these ideas too hard as they would probably involve the use of its Panamanian subsidiary and could hurt its credibility as a Costa Rican bank.

The Central Bank of Costa Rica and Costa Rica's public commercial banks are shareholders in BLADEX, but have not utilized its facilities. BANEX has discussed the possibility of obtaining a line of credit for coffee financing from BLADEX, an arrangement which is likely to require that BANEX become a BLADEX shareholder. BLADEX is currently in the process of drawing up a proposal for consideration by its board and for subsequent presentation to BANEX. These negotiations are likely to continue for the next several months.

IDB representatives are considering the possibility of supporting BANEX through the Venezuelan Trust Fund. This support would probably be in the form of equity. It is not likely, however, that BANEX-IDB negotiations will be completed soon.

(4) Equity-Base

The minimum lawful capital for a Bank in Costa Rica is 5 million colons. As of July 31, 1981 BANEX has authorized and paid-in capital totaling 20.7 million colons (worth about $1 million at current exchange rates vs about $2.5 million as originally planned).

There are banking measures that establish the ratio of purchased (borrowed) funds that can be obtained for each unit of the Bank's own funds. This measure is known as "leverage" or indebtedness. BANEX plans to balance the use of borrowed or purchased money (maximum leverage) with a capacity to absorb losses out of its equity (to establish a reputation as a financially solid institution). BANEX intends to begin operations at about a 6:1 debt to net worth ratio and slowly increase the ratio to 10:1. Further, should BANEX be able to obtain substantial deposits from the public (which are normally a more stable source of long-term funds than lines of credit from foreign banks), BANEX would consider it feasible and financially prudent to raise the debt to equity ratio. Such a step would require prior AID approval. For comparison, the State-owned banks' indebtedness is about 45:1, that of major local finance companies about 10:1, and international banks have ratios ranging between 15:1 and 20:1, and sometimes higher.

An additional factor to be considered in the size of the equity base of any bank is the maximum loan size to any single customer. The National Banking System Law establishes that the maximum loan to any single customer cannot exceed 15% of a lender's equity. This limitation, which can be raised to 25% by special permission of the Central Bank, is a healthly banking policy, and would initially limit BANEX to making loans no larger than $150,000, except with special permission. Obviously, BANEX will attempt to increase its net worth as soon as possible. As a condition to disbursement of AID funds in excess of $5 million, BANEX will be required to obtain an additional $1 million of paid-in capital. The resulting $2 million total of paid-in capital plus retained earnings would allow BANEX to increase its maximum loan size accordingly.

2. Project Activities

a. Credit Component

(1) Levels and Characteristics of Demand

Even though actual or potential markets for exports exist, many Costa Rican entreprenuers who could increase their production for export lack liquidity, access to credit, or both. An actual or potential producer for export may need working capital to make fuller use of existing plant; financing may be needed to buy larger amounts of raw materials, facilities, or to offer supplier credit. In short, financing is usually necessary either to expand production for export or to reorient existing production capability to external markets. Public sector absorption of new credit and the lack of liquidity in the national banking system (SBN) are important reasons why the private sector cannot get the credit it needs. There are other factors, however, which limit private sector liquidity, including some that are inherent in GOCR structural readjustment efforts. Among these causes are:

- Foreign lines of credit from bank and suppliers, upon which Costa Rican businesses depend to finance raw material imports, are no longer generally available. Terms with foreign creditors are "strictly cash", especially in view of current GOCR debt rescheduling efforts.

- The Central Bank measures adopted to settle the foreign exchange backlog (the presa), which was generated between September, 1980 and April, 1981, provide for payment of the exchange differential (between 8.60 and the market rate on day of purchase) to the private sector in negotiable colon and dollar denominated certificates of deposit (CDs). Having either paid the exchange differential in cash or having deposited the colon equivalent (at 8.60) of their foreign exchange obligation, many firms, even exporting firms, have a considerable amount of their cash tied up in the presa. Further, these CDs constitute a significant portion of the existing money supply and their marketability both in Costa Rica and abroad is limited not only by the dollar and colon liquidity crises but because of certain legal problems as well.

- Credit lines denominated in colons or the firm's equivalent liquid assets in colons which were enough to finance a given quantity of raw materials or inventories imported from abroad are no longer adequate at the new exchange rate.

- Because of the liquidity crisis, firms are attempting to postpone payments to each other. Similarly, imported or domestically made products having a high import content and which are priced at inventory replacement cost are not moving in the Costa Rican market because of buyer resistance to higher prices.

Although these factors have a greater effect on the liquidity of firms producing for the domestic market than they have on exporters, few producers sell exclusively to external markets and many potential export producers now produce only for domestic or CACM markets. Thus, most are hurt by cash shortages and the lack of credit in one way or another.

In order to develop a more in-depth understanding of the specific problems, the Mission contracted La Academia de Centro America (headed by Dr. Claudio González Vega; see Annex C, Exhibits 4 and 5) to analyze the macro economic aspects of credit demand. We also asked them to look at the characteristics of the Costa Rican firms that have exported non-traditional products to markets outside CACM during the past several years. The Mission also hired GAMCO, Inc., a development consulting firm, (see Annex C, Exhibit 1, 2, & 3) to make a survey of firms which presently export non-traditional products and which were also identified as likely potential sub-borrowers. The findings and conclusions of the Academia and GAMCO, Inc. follow.

(a) Levels of Demand

The recent economic analyses that have been carried out by various international and Costa Rican organizations have invariably focused on the curtailment of credit to the private sector over the past six years. The actual size of the "credit gap" (unsatisfied credit demand) varies according to the reporting source, but all agree that the gap is considerable. The Academia report estimates that the 1980 private sector credit gap was 4.2 billion colons. Of this amount, the report assigns 673 million colons to the agriculture/livestock sector, and 2.2 billion colons to the industrial sector. Using an average exchange rate of 10 colones per dollar, the dollar equivalent of the 1980 credit gap estimate is 430 million dollars for the private sector as a whole. Anticipating a continuation of the current trend of shrinking supplies of new credits to the private sector, the study assumes that credit available for private sector use will not be greater in 1981 than the 7.2 billion colons supplied in 1980. Calculating that in 1981 private sector credit demand will increase by 40% over 1980 (based on the assumption of zero real growth and a 40% rate of inflation[1/]), the report predicts a 1981 credit demand of approximately 16.1 billion colons.

This would result in a 1981 credit gap of 8.9 billion colons (over 400 million dollars at the current 22 colons to $1 exchange rate). The Academia report estimates the total 1981 credit needs by "productive" sectors as follows:

- Livestock and agricultural: 5.2 billion colons, a 170% increment over the level of credit made available in 1980.

- Industry: 5.1 billion colons, representing a 360% increment over the level of credit made available in 1980.

If credit availability to these sectors remains constant at the 1980 levels (a strong likelihood due to the current economic stabilization programs), the 1981 unmet credit demands in these two sectors will reach the following magnitudes:

- Livestock and agricultural: 2.2 billion colons (approximately 100 million dollars at present the exchange rate of 22:1); and,

- Industry: 3.7 billion colons. (Approximately 168 million dollars).

Until recent months, part of the credit gap was being filled by foreign banks and supplier lines of credit. However, as previously mentioned, the direct foreign lines of credit have become extremely scarce.

In the survey conducted by GAMCO, twenty eight firms producing nontraditional export products to world markets reported total credit needs of $11 million over the next eighteen months alone.

It is not possible to estimate accurately the actual number of producers of nontraditional products destined for world markets. The number of producers having the potential for nontraditional export production is, of course, even more difficult to estimate. The studies contracted by the Mission, however, provide valuable insights into the credit needs of a

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1/ A very conservative estimate, given that during the first five months of 1981 wholesale prices increased by 31.5% and inflation for the full year may well run 60-80%. On the other hand, in real terms, the economy will no doubt decline sharply, a factor which will tend to lower credit demand.

significant sampling of nontraditional export producers. (The Academia study examines data on 163 firms and the GAMCO survey more closely analyzes 28 firms).

GAMCO data reveals that $500,000 is the most commonly cited loan amount needed. This figure is skewed to the high side, however, since most of the firms interviewed by GAMCO were medium and large-size producers for exports (over 60 employees). There is evidence that firms needing working capital subloans would borrow the maximum amount BANEX could lend, even if it were less than the amount that could be used.

The Academia macroeconomic analysis and GAMCO's microeconomic survey findings both reinforce the following conclusions:

- The resources to be made available under the credit component of this project are urgently needed by the producers of nontraditional exports to world markets; and

- The credit of the producers will easily support the proposed disbursement schedule;

Thus, given this credit demand, the size of the credit component is only limited by BANEX's absorptive capacity, which in turn depends on the bank's net worth and the skill and experience of its management and staff. However, because the number of sub-loans will probably range only from 80 to 100, this Mission believes the projected disbursement schedule to be manageble, and probably conservative.

(b) Target Subsectors and Activities and Lending Strategy

The Economic Analysis Section, largely based on Academia data and GAMCO survey findings, identifies a number of product categories which appear to have the greatest potential as non-traditional exports to world markets. BANEX's lending strategy, especially in investment lending, will emphasize areas in which a long-term comparative advantage appears to exist. Loans could be made to raw material producers, processors, or manufacturers. Financing could be made available to all those involved in any phase of a given production/export activity. Frequently, for example, processors might "retail" credit out to individual small producers with whom they have purchase contracts.

The BANEX emphasis on lending to product lines which have a long-term comparative advantage will not only help to accomplish the project's sub-goal but will also minimize BANEX's exchange credit risk. At present, because of the undervalued exchange rate and reduced internal demand, almost anything produced in Costa Rica might be profitably exported. In the intermediate term, however, internal inflation can be expected to equal or surpass the amount of the devaluation, and activities now feasible for export may no longer be so. The idea is to utilize present cost advantages to enter export markets which could be held even if internal costs increase. the degree that present economic parameters such as comparatively low wage rates may not represent long-term tendencies BANEX will have to exercise care in its lending, especially its longer-term lending.

In addition to products, the GAMCO and Academia studies also identified several services which could be exported and which could be financed by loans from BANEX. One opportunity would be lending to commodity exporters and trading companies; another is in the area of international cargo transport brokerage. GAMCO's interviews with exporters and with officials of the Costa Rican Chamber of Industries indicate that the lack of adequate means for shipping to Caribbean markets is considered the second main constraint by half of those interviewed (all firms reported that the lack of credit is a major constraint to the expansion of exports). Chamber of Industry officials stated that some local entrepreneurs have both the know-how and intention to enter the cargo brokerage business if financing were available. If these investments were to materialize, they would, in effect, open up several new markets located in the Caribbean basin's smallest countries. Moreover, the commercial opportunities which these markets offer match the production capabilities of many medium-size Costa Rican firms. That trading company and cargo brokerage services are badly needed underscores the importance of the Export Management Component of the project (TRACO).

c. Demand ~~Characteristics~~ Affecting Loan Terms and Applications

The GAMCO interviews reveal a much stronger demand for short-term financing than for medium and long-term financing, by a 2 to 1 ratio. The most commonly expressed need for short-term financing was to pay for imported raw materials. Working capital uses such as payroll, local materials purchase and other operating expenses were also cited.

Proposed uses of medium term subloans (one to five years) included equipment purchases and agricultural investments. Better utilization of existing plant capacity, according to several managers interviewed, would also result from medium-term loans for permanent working capital.

Long-term credit needs (7 to 8 years) consisted mainly of fixed asset acquisition such as land, buildings and plant equipment. Those who said they needed medium and long-term credit also indicated they would have to have one to two year grace periods for loan repayment.

(2) **Subloan-Financing**

The credit available from AID loan funds, possible commercial bank co-financing, and BANEX's own resources will be directed toward export-oriented borrowers at market or near market interest rates. AID loan funds will be utilized mostly for longer-term investments (3-7 years) in subprojects which require plant, equipment, and permanent working capital: however, subloans will also be made for short-term working capital (less than one year) or export/import credit.

Generally, BANEX will attempt to match long-term borrowings (in this case AID funds) or equity monies with long-term investments for plant and equipment and permanent working capital. Likewise short-term borrowings and lines of credit will be matched with short-term seasonal needs. However, as evidenced by the demand study, many Costa Rican enterprises in the industrial, agricultural, commercial and service sectors already serving the export market have excess plant capacity. These enterprises could readily increase their export sales if working capital could be increased to pay such costs as raw materials, wages, and transportation. During the three year life of this project, substantial loan demand is expected to finance both short term and permanent working capital. It is clear that existing private commercial banks and financieras will not be in a position to supply the needs. Thus, it is expected that BANEX will utilize both AID funds and its own resources and borrowings (from both possible co-financing or from the public) for working capital loans. However, in order to stimulate long-term investment in export-oriented projects which look to the future and do not simply capitalize on present opportunities, BANEX will limit the short-term (less than one year) application of AID funds and roll-overs to 40% of the AID portfolio by the end of the project.

AID funds will be used to promote the export of nontraditional products to nontraditional (non CACM) markets. This is not to say, however, that BANEX will not finance traditional exports, particularly coffee. In fact, it is anticipated that during its first years of operation, coffee financing will represent a substantial portion of BANEX business; such traditional export financing, however, will be undertaken with BANEX capital, purchased money from the public and long and short-term international co-financing.

Based on the demand study, the following are characteristics of the anticipated subloans from AID provided resources:

Maximum Size:	15% of BANEX net worth, initially $150,000, or up to $250,000 with Central Bank and AID approval
Terms:	5 years for plant, equipment and permanent working capital 1 year, renewable, short term working capital
Interest Rates:	3% over 3-year LIBOR for investment loans (presently 19%) 4% over 6 month LIBOR for working capital
Grace Period:	One year for investment loans (two years under certain exceptions)
Use of Funds:	Equipment, raw material (local and imported), and working capital to produce nontraditional exports for world markets
Borrowers:	Existing small, medium and large enterprises in the industrial, agricultural, commercial and service sectors

As can be seen in the Financial Analysis, the spread that will exist between the cost to BANEX for the AID loan and the cost of project loans to sub-borrowers, will generate considerable income. In addition to defraying administrative costs associated with the credit component of the project, this income will allow reserves for bad debts to be maintained, and will pay for setting up and carrying out the Export Management Component of the project.

(3) Sublending Criteria

As previously noted, this project is aimed at expanding the production and export of nontraditional goods and services to world markets. Within this context, BANEX will select sub-borrowers which will enable the project to realize its sub-goal. Thus BANEX loans will:

- contribute to the development or improvement of nontraditional export production and marketing systems. (i.e., bring efficiency and lower costs to the production--transportation--warehousing--distribution chain through which goods and services are marketed for export); and/or,

- contribute to the overall disversification, export sales, profits and market penetration of individual sub-borrowers. (No subprojects will be financed which are not export-oriented, or whose sales are less than 50% destined to world (non CACM) markets, or which do not produce nontraditional products or services.)

Specific loan agreement restrictions will also govern BANEX sublending financed by AID. Unless AID agrees in writing:

- subloans in excess of $250,000 may not be made to a single sub-borrower;

- subloans may not be made to businesses as in which any officer or employee of BANEX has controlling financial interest; and

- subloans in excess of $500,000 may not be made to a single enterprise.

The demand analysis at this time does not indicate that any subloans would finance sugar, citrus or palm oil for export. It is possible, however, that such subprojects could be identified during the course of the loan. If so, they will not be financed with AID funds. Such subprojects could, however, be financed with nonproject related BANEX capital or other commercial resources.

b. Banking Services Component

(1) Introduction

The efficient delivery of export-oriented banking services is essential for increasing the country's exports. While Costa Rica's state banks currently offer such services with varying degrees of efficiency, providing them will be a BANEX speciality. BANEX will develop an in-house capacity to deliver a full range of export-facilitating banking services which it will offer to project sub-borrowers, other clients of the project's trading company(ies), and other exporters. The success of other project components hinges on the timely, efficient and well-coordinated delivery of these specialized services, which in turn demands having an in-house operation. Through BANEX and its projected international correspondent banking network, these services can be offered in direct coordination with the credit and export management project activities, thus ensuring sensitive attention to the appropriateness of financing methods and terms.

There will be no cost to the AID project for the delivery of export-oriented banking services. As an export bank, BANEX will assume reponsibility for these services as part of its normal operations. Project clients (sub-borrowers and trading company clients) will purchase necessary banking services as will other BANEX customers.

(2) The Services

The spectrum of export-oriented banking services will be wide. They will initially include:

- export collection services and bonds to exporters;
- currency management: purchasing and selling, settling of accounts, and futures (if permitted by the Central Bank);
- all "documentary services" required to facilitate payment from buyer to seller, i.e. the various types of letters of credit, cash payments, including advances, and receipts, open and rotating account management, and consignments;
- assistance with and verification of required documentation--e.g. invoices, bills of lading, certificates of insurance, and visas; and
- new market development as a function of BANEX relationships with its correspondent foreign banks and their customers.

In addition to servicing project clients, BANEX banking services will provide an important source of revenue. The fee structure and margins charged for banking services will vary by type of service and sector.

BANEX's ability to capture a portion of the extensive agricultural and industrial market for banking services will in part depend on the clientel it acquires through the project's Credit Component. Along with the subloans for working and investment capital will come normal banking relationships between BANEX and its borrowers who will also utilize BANEX for these other services. Furthermore, members of the BANEX banking staff, technical consultants and trading company staff will be available for a variety of assignments beyond those associated with banking (documentary) services.

The original (pre-AID project) BANEX feasibility study, (Annex D, Exhibit 5) projects substantial gross income from service fees: $205,000 in the first year; $244,000 in the second; and $324,000 in the third year of operations. Neither these potential revenues nor their small incremental costs have been included, to keep the financial projections conservative. The services would, at a minimum, be self-financing in any case.

c. Export Management Component

(1) Background and Rationale

The establishment of a lasting nontraditional export capability directed to world markets will require, in addition to credit and appropriate banking services, the means by which the exporting process can be managed. Export management is a highly specialized function which requires skills and experience. Few Costa Rican producers and manufacturers are also competent exporters. Even those who have successfully sold in domestic or CACM markets are seldom equipped for world markets. Not only is specific expertise needed; exporting to nontraditional markets demands large investments in equipment, material and people.

A precise definition of "export management" which is specific enough to be meaningful is elusive because the concept covers a broad and diverse set of activities. These include but are not limited to foreign market development, moving papers in bureaucracy, and coordinating physical movement and transfer of goods in a timely and dependable manner. Not limited to selling existing production abroad the concept also encompasses feedback to the production activity about market requirements and ways to increase the profitability of exported goods. For the few products moving in international trade which are essentially undifferentiated and traded on commodity exchanges export management is a straight-forward activity involving such things as knowledge of grades and standards, quality control, paper work, and transportation arrangements. Only for these few products is the process so simple, however. It is especially complex for the small amounts of varied nontraditional products which Costa Rican firms will be able to produce and sell competitively abroad in the long-run1/. Selecting volume production, proper marketing arrangements, and efficient exporting will be required if Costa Rica's nontraditional exports are to enter and maintain a significant presence in world markets.

1/ Given present exchange rates almost anything in Costa Rica could be profitably sold abroad. However, as costs increase internally because of inflation, or if the exchange rate drops, many exports will no longer be competitive.

Unfortunately, much of the existing expertise in managing traditional exports is neither appropriate nor readily adaptable to nontraditional exports. In the main, traditional export products are largely undifferentiated and trade in well organized and long established markets. Their export management problems are therefore quite different from those of nontraditional products.

Export management expertise which has developed in exporting to the CACM is probably more applicable to nontraditional exporting. However, lessons learned in producing for and selling to the highly-protected CACM have to be modified for a more competitive market. Among other factors, product quality standards are likely to be higher; a uniform and steady supply may be a more important consideration; grades, standards and consumers tastes will differ, and communication between buyers and sellers will be more complex.

Two factors exist in Costa Rica which make efficient export management especially important. The first is that the most likely nontraditional exporters will not be the largest firms. A November, 1980 IBRD study of Costa Rican export diversification indicates that firms which are presently exporting nontraditional products tend to be intermediate size firms, and that product lines which are the most likely prospects for export (often those presently enjoying low levels of effective protection) are also dominated by firms which tend to be smaller (the industries are more competitive). Clearly, developing export management capabilities in smaller firms is a more difficult task than within larger firms because of the major investments in human and material resources required.

The second factor is that export procedures are quite complex and the paperwork involved is burdensome. The exporter has to obtain numerous licenses, permits, and approvals. Requirements vary depending on the market (CACM, USA, or other) and on the nature of the product. A recent analysis points out that in the simplest (nonincentive) export case, 13 steps are required in four entities; and in the most complex (nonincentive) case 27 steps are required in six entities. The recent elimination of CATs and other tax related export incentives will simplify the export process--reporting needs will be somewhat reduced.1/ It is also the Mission's understanding that the GOCR is taking certain steps to simplify the paperwork and approvals involved in exporting. Still, it is to be expected that successfull management of export paperwork will continue to be a considerable task. 2/

The GOCR has an export promotion agency, Centro de Promoción de Exportaciones e Inversiones (CENPRO). This agency was established with AID assistance in 1968. CENPRO is reasonably well run, but as effective as it might be. However, this is more due to overall government policies and lack of resources than to its own particular failing. CENPRO has acquired valuable experience in certain aspects of the work of export promotion. It has an important role to paly as the institutional embodiment of govrernment concern for exporting, but because it is a public sector institution and subject to myriad of rules and regulations and the cumbersome Central Government budgeting and procurement procedures, its role in export management will, of necessity, be restricted. Clearly, the GOCR should strenghten CENPRO, as it can do valuable work in general market research, information exchange, and other areas of benefit to exporters. However, the actual delivery of export management services can only be achieved through a carefully developed capability within the ranks of the private producers themselves.

(2) BANEX Export Management

In order to respond to the immediate and long-term needs for the development of export management expertise, the project will develop within the BANEX structure a comprehensive export management services capability.

The project's Export Mangement Component has been designed to meet several principal objectives:

1/ A caveat is necessary here. The large though temporary increase in export taxes (from 1% to 5-6% in most cases) that accompanied exchange rate adjustment made that tax fiscally important. However, many companies double invoice in order to reduce their export (and other) tax liabilities (as well as to maintain foreign exchange offshore). Thus, increased GOCR controls may well come in this area.

2/ It has been reported to the Mission that a recent public sector export shipment of perishables spoiled in port during the ten days that were required for necessary paperwork. (It was shipped anyway).

- provide producers and manufacturers with commonly needed, basic export management services;

- assist producers and manufacturers of nontraditional export products to establish and maintain a productive capability which meets the demands of the marketplace;

- develop broadly based export management expertise among Costa Rican producers, manufacturers and merchants through including them in the export process;

- establish a strong, systematic Costa Rican non traditional product presence in the world market place; and

- Provide producers and manufacturers of export products with lower cost imported raw materials and capital goods, supplier financing, and better knowledge of technical options.

(a) <u>Organization and Functions</u>

While the Export Management Component wil. continue to develop in size and form over several years after the project is started, the full range of services to be provided will be available within the first 18 months of project operation. Figure 1 illustrates the organizational structure of the BANEX Export Management Component at its 18 to 24 month stage of development. It is planned that the component will include:

- a wholly-owned Costa Rican based subsidiary Trading Company (TRACO C.R.);

- a wholly-owned U.S. based subsidiary trading company and purchasing office (TRACO U.S.);

- at least one partially-owned export company (EXCO) specializing in a given product line; and

- different financial relationships with groups and individual producers (ranging from equity participation to only paying fees for service).

FIGURE 1

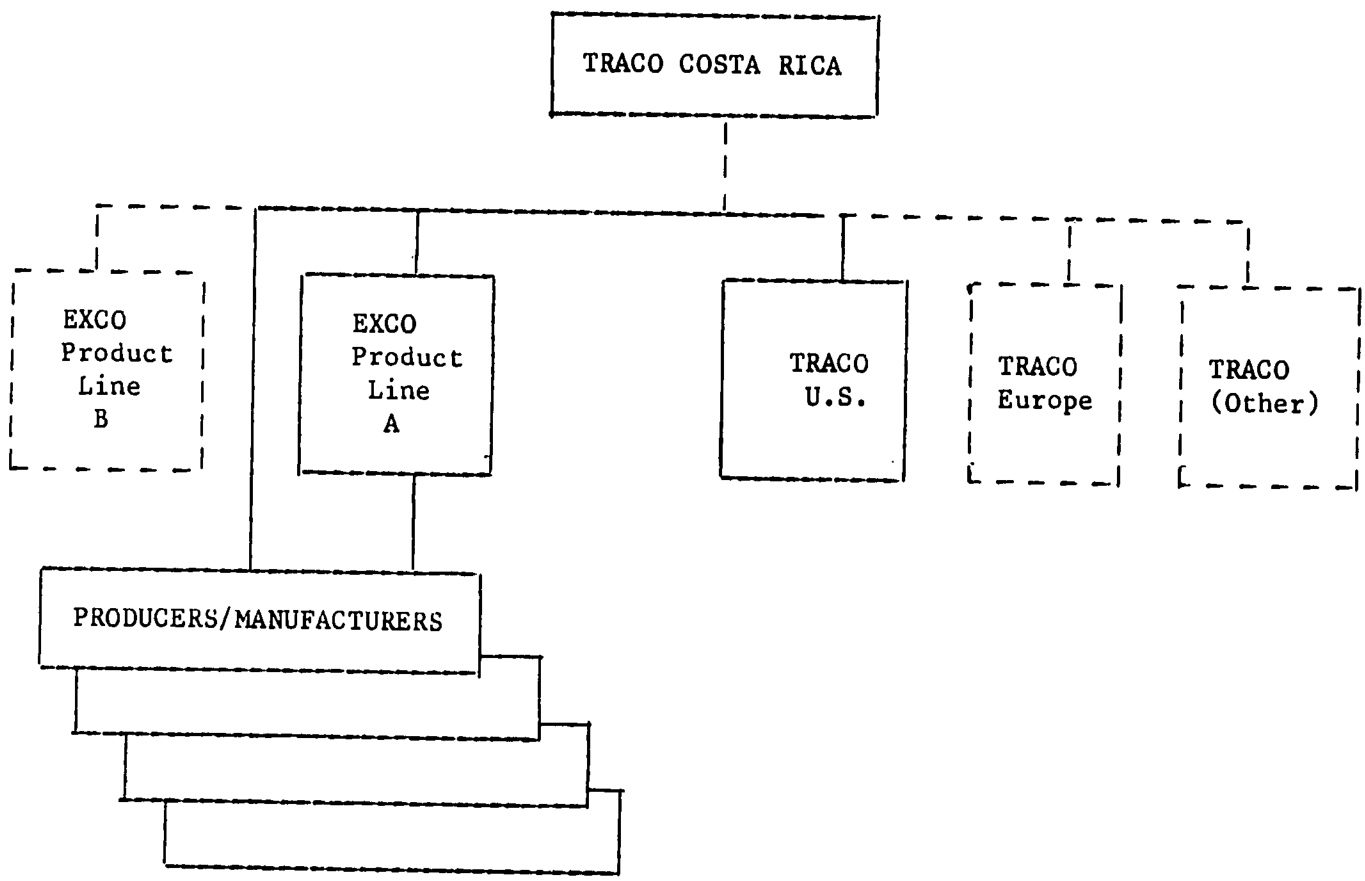
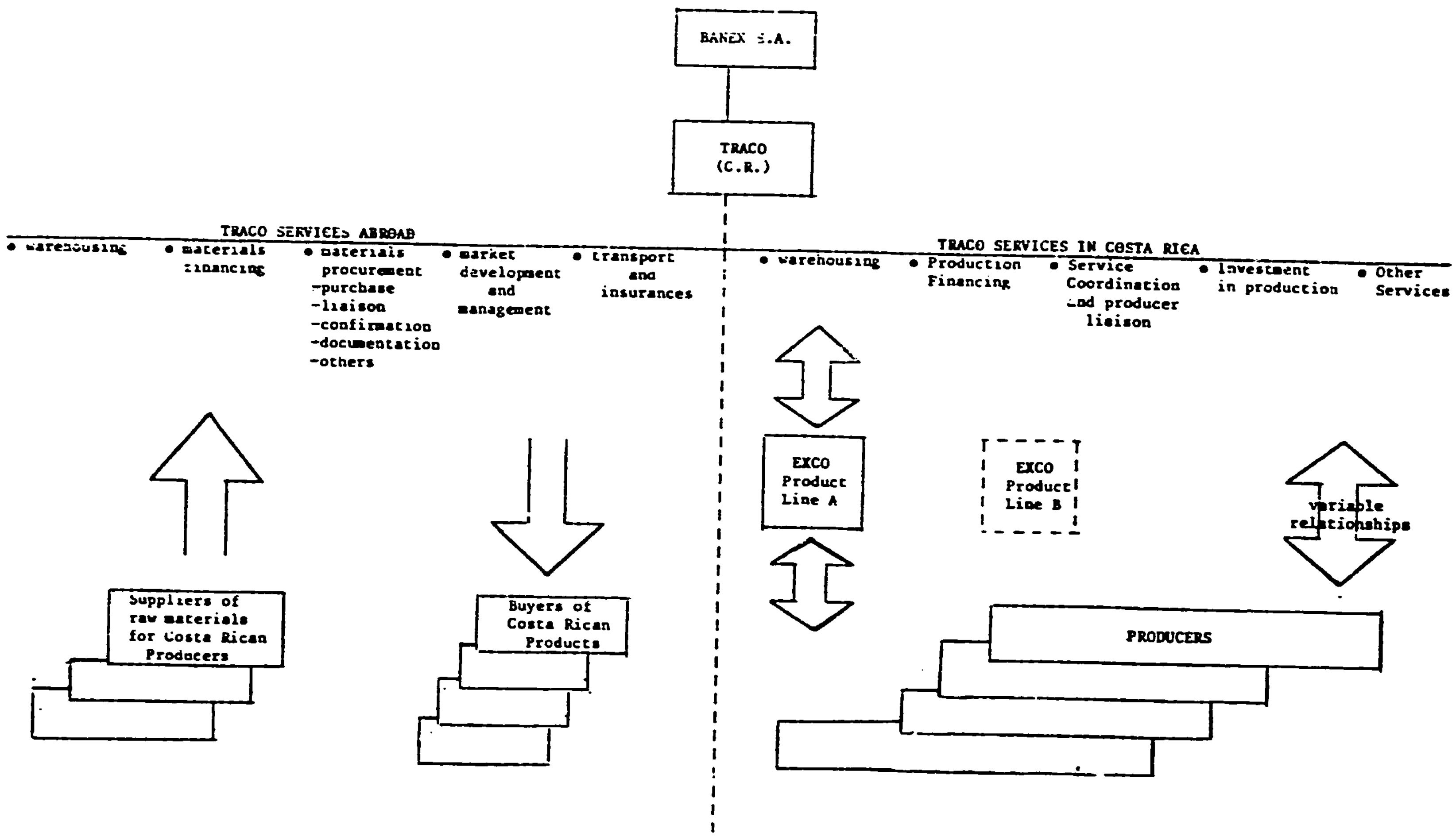

TRACO COSTA RICA
EXCO Product Line B
EXCO Product Line A
TRACO U.S.
TRACO Europe
TRACO (Other)
PRODUCERS/MANUFACTURERS

FIGURE 2


BANEX S.A.
TRACO (C.R.)
TRACO SERVICES ABROAD
• warehousing
• materials financing
• materials procurement
-purchase
-liaison
-confirmation
-documentation
-others
• market development and management
• transport and insurances
TRACO SERVICES IN COSTA RICA
• warehousing
• Production Financing
• Service Coordination and producer liaison
• Investment in production
• Other Services
EXCO Product Line A
EXCO Product Line B
variable relationships
Suppliers of raw materials for Costa Rican Producers
Buyers of Costa Rican Products
PRODUCERS

As also illustrated in Figure 1, other target market TRACOs will be established once TRACO U.S. is fully operational. Similarly, other one product line EXCOs are planned after the first EXCO is in full operation.

TRACO will function as the principal link between Costa Rican producers and their foreign buyers and suppliers, and will offer a comprehensive package of export management and purchasing services. Figure 2 illustrates the range of TRACO services in Costa Rica and abroad.

(aa) TRACO Services Abroad

Through its foreign based subsidiaries 1/, TRACO will provide services which will: (1) market Costa Rican products in foreign countries and, (2) assist Costa Rican producers in purchasing raw and intermediate materials and capital goods from foreign sources at lower cost and under more favorable conditions than at present.

Warehousing and financing will constitute major TRACO overseas services. Through the initial U.S. based TRACO, Costa Rican producers will be able to secure financing (the supplier credit cut-back because of "Costa Rican risk" will be overcome) and logistical support for trade with U.S. suppliers and buyers. These services will make it easier to buy raw materials and capital goods in the U.S. in several ways. By warehousing these purchases in the U.S. until they are needed in Costa Rica, financing of the materials will be more easily and inexpensively secured. Warehousing facilities in the U.S. will also permit larger bulk purchases. In addition, Costa Rican products being exported can be warehoused and financed in the market country until they reach the end user.

Procurement services are also key to the TRACO overseas operations. Using its above described warehousing and financing capacity, and taking advantage of its U.S. based status, TRACO will allow Costa Rican producers to obtain their raw materials under the best possible conditions--taking full advantage of domestic prices, prompt payment discounts, competitive pricing capability and other such condition which are rarely available through international

....

1/ New York will be the location of the first TRACO off-shore subsidiary because of: (1) the importance of the U.S. market; (3) its concentration of world-linked trading and financial services; and (4) the location of the World Trade Institute--TRACO's principal technical assistance source.

purchases. Furthermore, by not having to import raw materials until they are actually required, Costa Rican producers can better distribute import tax liabilities and other import related costs. TRACO procurement services will range from actual purchasing, to TRACO acting as a bidding or confirming agent. Thus, this service can meet the needs of those Costa Rican importers who have their own purchasing capabilities as well as to those who do not. Finally, better knowledge about potential U.S. and other foreign suppliers of raw materials, capital goods, technologies, foreign government export incentives, and financing will lower costs for Costa Rican producers (thus saving scarce foreign exchange).

TRACO provided or facilitated transportation, insurance, documentation, and other logistical support services will also make foreign sales and purchases less cumbersome.

Paramount, of course, among the TRACO overseas services are the Market Liaison (market development and management) services. These will be provided in two ways: (1) As a back-up, supplemental service to experienced exporters, TRACO can provide market intellingence, research, transportation logistics, documentation assistance and information, and aid regarding regulations. (2) TRACO will also provide complete export sales assistance to Costa Rican producers having little or no exporting experience.

Key to TRACO's foreign based subsidiary operation is its flexibility. It will be able to gear its services to the needs of almost any actual or potential nontratidional exporter --from the sophisticated to the very inexperienced.

(bb) TRACO services in Costa Rica

The Costa Rica-based TRACO will provide the same services domestically as those provided by TRACO abroad. In addition to warehousing services, which are essential to the export process, TRACO (CR) will link its activities closely to those of the BANEX Banking Services and Credit Components to facilitate export related financing. By coordinating financing with warehousing services, TRACO will enable producers to use their inventory as loan collateral and reduce risks associated with foreign collections.

Particularly unique to TRACO (CR) operations are its producer liaison and investment functions. Because consistency of supply and quality is essential to successful exporting, TRACO must assist producers to understand and meet the supply requirements of their markets. This assistance will be provided through coordination of market intelligence with TRACO overseas, through securing required technical assistance for production, processiong and packaging, and through combining of smaller producer's output. TRACO will "lock-in" individual producers and manufacturers through long term contracts which establish TRACO's responsibilities for service and those of the producer regarding joint ventures with individual producers as well.

In addition to servicing the needs of individual producers, TRACO will help organize and assist groups of producers with common product lines who are interested in developing their own export management expertise. Such groups, when developed, will serve to decentralize many aspects of export management--especially those aspects which are unique to the individual product lines. Whereas TRACO will focus its attention on providing a broad range export management services, producer groups will concentrate on refining the marketing of their common product lines. Supported by the TRACO system, this concentration should maximize the market penetration of various product lines.

To further strengthen the export capabilities of producer groups, TRACO will encourage and assist such groups to form companies for exporting specific products. These companies (EXCOs) will be joint ventures of TRACO and the associated producers. They will initially depend heavily on TRACO management systems; as the EXCOs develop their own expertise, however, they will gradually depend less on TRACO and begin to assume more of the responsibility for their own export marketing. EXCOs are expected to eventually become centers of specialized exporting knowledge for their own and related products lines. Many of the core management services, however, will continue to be provided by TRACO. To ensure management coordination and growth of expertise during EXCO development, TRACO will maintain strong equity positions in the EXCOs. Additionally, in order to guarantee initial consistency of product quality and supply, the EXCOs may be contractually obliged to export through TRACO for a specific period of time. The contractual relationship between TRACO and the EXCOs will also require that the EXCOs invest in the BANEX system. A negotiated percentage (as small as 0.5%) of EXCO sales will be used to purchase BANEX stock. A similar arrangement may also be made with individual users of TRACO services, involving them more thoroughly in the BANEX/TRACO system, thus broadening BANEX ownership, and enhancing the growth potential of the BANEX-led export drive. Such producer participation will also help provide needed additional BANEX capital (which could be leveraged) and permit the producers to share in the profits generated by BANEX/TRACO. If producers for export are not "locked-in" to the BANEX/TRACO system, the temptation to abandon it once links to export markets are established will be great.

(b) Implementation Schedule

TRACO implementation will begin with the contracting of the services of the New York based World Trade Institute (WTI)[1/] and the hiring of the TRACO (C.R.) General Manager (Annex G, Exhibit 2 presents the planned TRACO implementation schedule). In addition to providing the General Manager with guidance in the development of the TRACO organization, WTI will initially provide the basic exporting and purchasing services which will eventually be more fully developed and provided by the TRACO organization. WTI will remain under contract to BANEX for at least two years. This arrangement will allow BANEX to offer interim export management services while TRACO is in the organizational process. WTI will also be responsible for structuring and providing on-the-job training for TRACO staff. The General Manager will, with WTI guidance, organize both the US and Costa Rica TRACO operations.

By the beginning of the second year, TRACO will have its procurement and basic export management operations in place. It will begin to generate revenues early in year two, and will be fully operational by the end of the year. The first EXCO, a major milestone in TRACO implementation, is expected to be established and operational by the third quarter of year two.

Although additional TRACO subsidiaries in other foreign market areas (i.e. Europe, the Caribbean and Latin America and perhaps, eventually, Japan and the Orient) are planned, schedules for their development have not yet been established. Much will depend on the experience of TRACO-U.S. Likewise, TRACO will develop additional EXCO

1/ The Draft Loan Authorization includes a waiver to permit BANEX to use loan funds to contract with WTI on a predominant capability basis. WTI, an AID/PPC grantee and agency of the Port Authority of New York, has been involved in the design of the Export Management Component of the Project. Is uniquely able to provide BANEX with the U.S. technical assistance services it needs, as well as to train BANEX and TRACO staff in New York and Costa Rica.

operations based on the experiences gained through the initial EXCO development.

(c) Capitalization; Revenues and Costs

(aa) Capitalization

The establishment and maintenance of a strong capital base is critical to TRACO's operations. It must quickly develop a credible, broadly based export management capability. It msut be able to negotiate and secure export credit for its U.S. based procurement operation. Analysis of TRACO costs and revenues indicates that it will reach the break-even point during its fourth year of operation. After that point, TRACO will be able to sustain an adequate level of equity through its own profits. Until that point, however, TRACO's equity will come from a series of investments made by BANEX S. A. (Costa Rica)

Within the first weeks of project implementation, BANEX S.A. will take a $400,000 equity position in TRACO[1/]. This amount will be drawn from AID loan funds through a special advance disbursement covenant in the Loan Agreement. BANEX will charge no interest or fees for the advance to TRACO but will eventually receive dividends from TRACO.

Additionally, BANEX will invest 100% of its income from the spread between the AID loan and its subloans in TRACO during the first three years of BANEX operation. This investment level will be reduced to 50% of yearly earnings beginning in year four, and will continue over the life of the AID Loan to BANEX. This investment schedule will assure that TRACO has sufficient capital during its developmental phases (see Financial Analysis, Annex E).

(bb) Revenues

TRACO will reach its break-even point during year four of its operation. Sources of TRACO revenue will include income from export management, procurement fees, various service fees and others. For purposes of these projections, only the export management and procurement fees are being considered. Annex E, Exhibit 2 contains a description of the means by which TRACO revenues have been projected.

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1/ This capitalization of TRACO is needed to permit TRACO-U.S. to become a viable credit risk for U.S. suppliers and banks.

	Year-1	Year-2	Year-3
o Export Management	$25,000	$200,000	$525,000
o Procurement	$10,000	$ 62,000	$ 90,000
o Other	Not-estimated	Not-estimated	Not-estimated
o TOTAL	$35,000	$262,000	$615,000

(cc) Costs

TRACO costs (See Annex E, Exhibit 2), based on the growth strategy established in the TRACO schedule for implementation will total $338,000, $504,000, $644,000 and $811,000 in years one through four respectively. The costs will be related primarily to personnel, technical assistance and other operating expenses. Many of the costs which would ordinarily be associated with the development and maintenance of the U.S. based TRACO operations (e.g. rent & telecomunications) will be absorbed during the first two years by the World Trade Institute as a part of its technical assistance contract.

As discussed earlier, TRACO costs will exceed its revenues during the first three years of its operation. TRACO will be heavily dependent during this period on investments by BANEX. By year four, however, TRACO will begin to realize a net profit. While costs can be expected to increase substantially during year five and beyond, TRACO revenues will also increase significantly as it becomes established in the market place.

Costs beyond year four are projected to increase primarily as a result of inflation. As additional TRACOs are added, their costs are estimated to be roughly equivalent to those of the US based TRACO, and are so reflected in the projections.

IV. PROJECT ANALYSES

A. Institutional Analysis

1. BANEX Structure and Organization

Originally, BANEX was conceived as an alternative credit channel for financing agricultural products for export, especially coffee.1/ It was later decided to expand its concept to include the industrial sector. Consequently, its Board of Directors and shareholders include a broad range of agriculturalists and agro-industrialists. Having obtained an initial capital subscription of approximately $1 million by January, 1981, the founders of BANEX identified the following objectives for their endeavor:

- develop an institution through which the private productive sectors of the country can actively participate in the necessary evolution of the banking industry;
- respond to the credit and bank services needs of the agricultural and industrial sectors;
- establish for the country's productive groups a specialized banking institution knowledgeable in the export promotion field; and,
- reduce credit dependency on state banks and a variety of financial intermediaries (The founders of BANEX hoped that by demostrating greater agility and efficiency than the four state-owned banks, with which BANEX will compete, policy and administrative changes to be introduced in the National Banking System over the long run, that will lead to more imaginative and effective delivery of credit to the productive sector).

In order to realize these objectives, BANEX was incorporated as a member private bank of the National Banking System with both domestic and offshore (Panama) operations. It is

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1/ Coffee financing in Costa Rica is mainly provided by a handful of coffee exporters who operate using lines of international bank credit (mainly from German banks). Costa Rican coffee producers generally feel that they would be able to get better coffee prices if the financing and buying of coffee were separated.

necessary for BANEX to have a subsidary outside Costa Rican jurisdiction in order to carry out banking activities that: a) imply a high risk for the bank if carried out under Costa Rican jurisdiction; and b) are not profitable in Costa Rica because of local laws or regulations.

Among the activities that are high risk under Costa Rican jurisdiction is the making of foreign currency denominated loans between Costa Rican entities. According to a recent Costa Rican Supreme Court decision, for example, it is legal for Costa Rican entities to cancel obligations denominated in foreign currencies at the official exchange rate of 8.60 to $1.00[1/]. Similarly, the possible "plastic checking" scheme, refered to earlier, may only be feasible using the Panamanian subsidiary.

BANEX has thus been structured to provide all services allowed by Costa Rican law, while minimizing risk. It is also developing a specialized international business department through which it is setting up correspondent banking relationships in the U.S., Europe, and Central and South America. Through this department BANEX will offer its clients a full line of banking services specifically designed to finance and otherwise facilitate the production, sale and delivery of exports.

BANEX officially began its operations on July 1, 1981. While the bank is still carrying out a number of start up activities,

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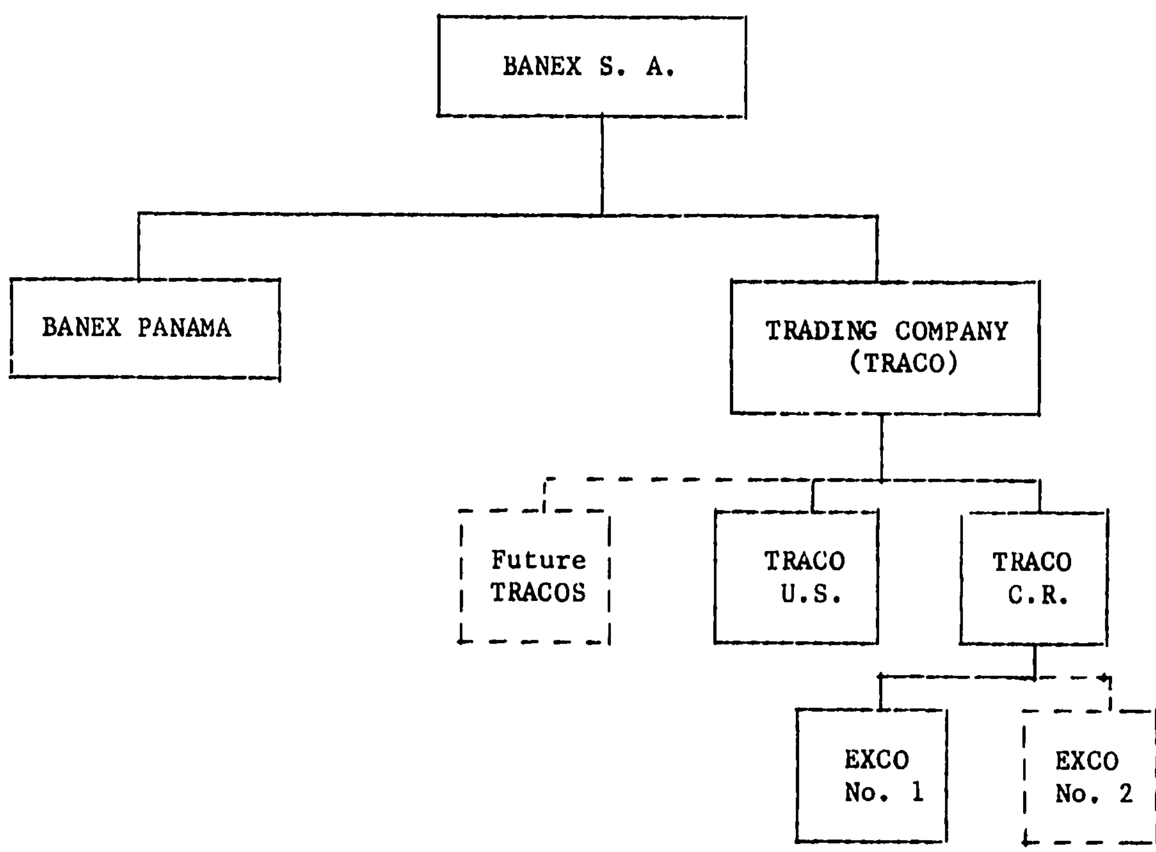
1/ This decision was one of the principal factors that has led to COFISA's current difficulties (see San Jose 4831). COFISA did not create its Panamanian subsidiary until 1978, and COFISA (C.R.) still holds about $30.0 million of COFISA's total portfolio ($90.0 million). Exchange loses on the COFISA (C.R.) portfolio because of the court decision could be massive and exceed COFISA's net worth. Another, and perhaps more basic, problem was that COFISA lent primarily to importers, many of whom, because of the massive colon devaluation (over 200%) are unable to amortize dollar-denominated debt (at least in the short-term). Thus, even debtors to COFISA (Panama) are unable to service their debts, a factor which has led to COFISA's lack of liquidity.

BANEX, taking lessons from the COFISA experience, will from the start make dollar loans through its Panamanian subsidiary primarily to exporters (whose dollar-denominated receipts should allow them to service dollar debt without difficulty--see Economic Analysis). BANEX colon-denominated loans will be made from its colon-denominated capital and from such colons as it is able to obtain from the public through the sale of "investment certificates."

it is now a fully operational organization. BANEX's negotiations with this Mission as the project was being put together had a significant influence on the bank's structure and the scope of its activities. Figure A illustrates the BANEX structure including its project funded export management operations.

FIGURE A

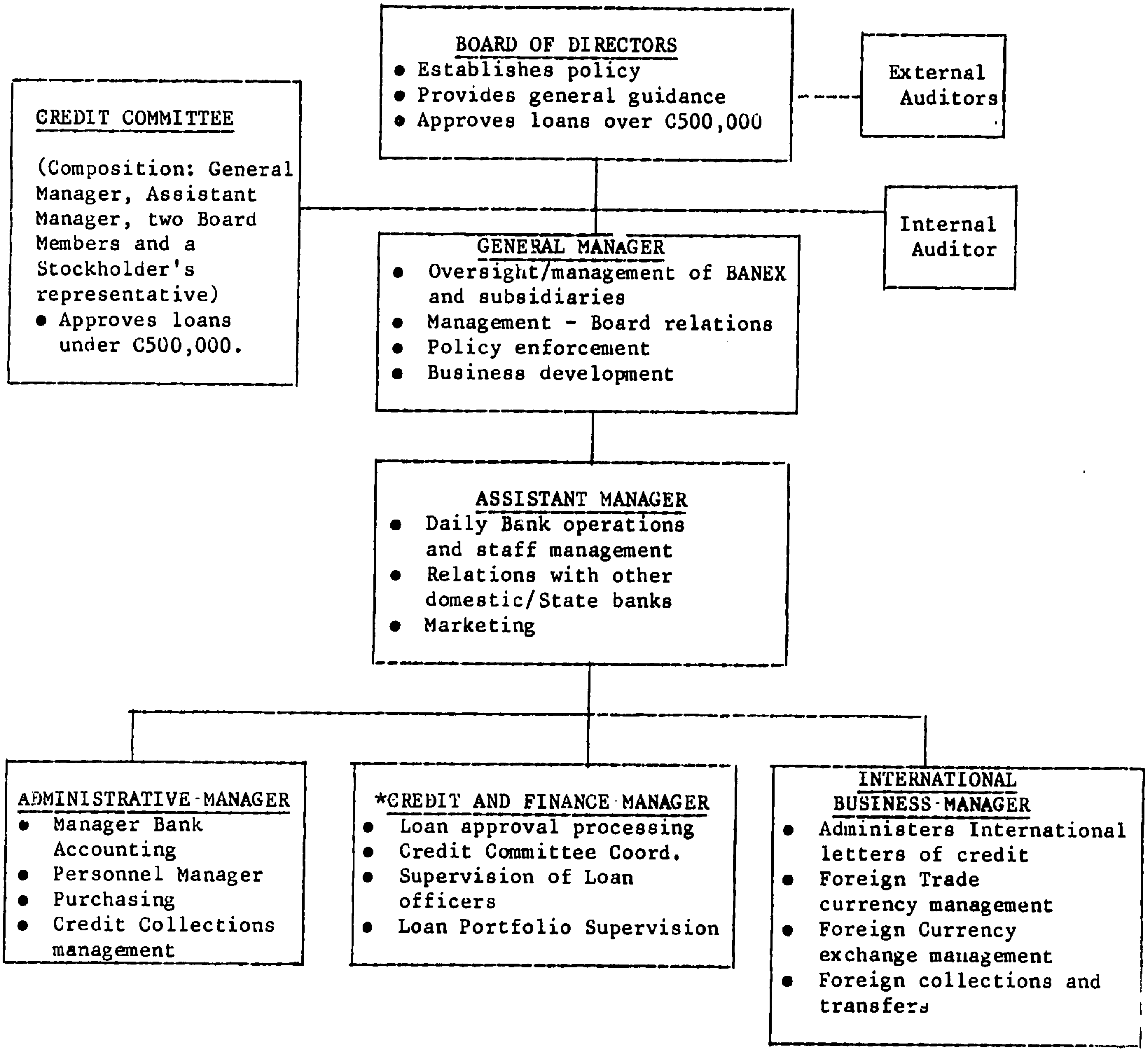
BANEX STRUCTURE



The Trading Company (TRACO) is the major variation from the original BANEX concept. TRACO, whose functions and organization were described in detail earlier, will be founded as soon as possible after project signing. At present BANEX-Panama is only a shell company. The heart of BANEX is BANEX, S.A., whose current organizational structure is in illustrated in Figure B.

FIGURE B

ORGANIZATIONAL STRUCTURE OF BANEX S.A.



*NOTE: Credit and Finance Management will be performed by the Assistant Manager until growth justifies the additional employee.

2. BANEX Staffing; Managment and Ownership

BANEX is staffing the organization slowly as business volume grows in order to minimize the portion of the bank's capital used to cover start-up costs. Still, four of the five managers and the Internal Auditor are now in place, as are such employees as guards, cashiers, and secretaries. For the present the Assistant Manager is also performing the functions of the Credit and Finance Manager. It is the Mission's assessment that present BANEX staff forms a nucleous around which a capable full staff can be built in the future. The BANEX Board of Directors is drawn from a good cross section of successful Costa Rican entreprenuers who bring know-ledge and clout to the bank, both of which are needed during the start-up phase. Similarly, the bank's stock is widely held, and among its owners are a broad range of Costa Rican enterprises, many of which are involved in exporting. Curriculum Vitae of BANEX's principal officers and Board Members are included in Annex D, Exhibit 1, as is a listing of the bank's stockholders.

3. BANEX Lending Regulations and Procedures

The AID Mission has reviewed BANEX's Lending Regulations and Procedures. These include:

- Procedures for Loan Evaluation and Approvals, including the Regulations for the Analysis and Recommendation of Loans (financial analysis, guarantees, risk analysis conformance with lending policies, other debt).
- Required loan documentation
- Procedures for Loan Signing and Disbursement
- Loan Monitoring and Follow-up Procedures, inluding loan aging and credit classification
- Loan collection and Follow-up procedures.
- Norms for credit classification

A copy of the Lending Procedures and Regulations is included in Annex D, Exhibit 3. The formal submission of these procedures and regulations by BANEX for AID's review and approval is a condition precedent to disbursement.

4. BANEX Management and Control Systems

BANEX has also submitted to AID its forms, control documents and accounting system nomenclature. These are included in Annex D, Exhibit 4, (in LAC/DR and Mission bulk files).

5. Conclusions

The Mission Project Committee has reviewed BANEX's structure and organization; staffing and management, lending regulations and procedures; and management information and accounting control systems. The Committee has concluded that BANEX has the capability to successfully carry out and meet the objectives of the AID project. BANEX will require technical assistance to set up TRACO; this has been provided for in the project design and financial plan.

Because BANEX is a new organization and some members of its staff are still inexperienced, the Project Committee recommends the inclusion of both a condition precedent to disbursement and a covenant regarding AID review of the adequacy of BANEX management staff; both are contained in the draft project authorization.

B. Financial Plan and Financial Analysis Summary

1. Financial Plan

a. Project Resources

The project budget totals $12.0 million. Of this amount, $10.0 million will be provided by a 15 year AID loan at five percent p.a., with a five year grace period. The Borrower, BANEX, will provide $2.0 million as follows: (1) its existing paid-in capital of 20.7 million colons, which at present exchange rates equals approximately $1.0 million, and (2) an additional amount of capital, the equivalent of $1.0 million, which would be paid-in prior to AID's disbursement of more than $5.0 million. It is conservatively estimated that the loan will be disbursed in three years, with cumulative disbursements of $3.2 million (including a $700,000 equity investment in TRACO) in year one; $5.7 million in year two; and $10.0 million by the end of year three.

b. Co-financing

Although the project has been designed to be feasible with only the AID and BANEX contributions, it is the clear intention of both the USAID and the Borrower that BANEX secure private commercial co-financing in the amount of $10.0 million for relending. To that end, the project loan agreement will include a cross-default clause as well as provision for the exchange of information between AID and potential cofinanciers. Similarly, the subsequent conditions precedent to disbursement when cumulative totals reach $3.2 million, $5.7 million, and $8.2 million require that co-financing funds be obtained and disbursed1/. Likewise, the covenant which restricts

1/ These subsequent conditions precedent are included because the greater spread on the AID loan than that obtained by lending funds from commercial sources would naturally encourage BANEX to disburse all of the AID loan first.

AID-financed sublending for short-term purposes to 40% of the entire portfolio also contemplates co-financing[1/]. Unfortunately, since the recent announcement by the GOCR of a moratorium on its commercial debt amortization, the interest of many commercial banks in co-financing this project has waned sharply. Thus the project has been designed to be feasible with or without co-financing because such funds may not be available immediately or may not be available on reasonable terms and conditions.

The Mission will continue to work closely with BANEX to secure co-financing. However, should co-financing prove to be unavailable or not available on reasonable terms, and if the Mission is convinced that BANEX has used its best efforts to secure co-financing, the Mission will then waive, or modify by implementation letter, the subsequent conditions precedent in question as well as the convenant regarding the percentage of AID-financed sublending which must be in loans of longer maturity than one year.

c. GOCR Guarantee

Given the present economic rules of the game in Costa Rica and existing export oriented incentive structure, the Mission is convinced that this project is feasible and that AID could safely make a loan to BANEX without the additional security of a GOCR guarantee. The factors that lead us to this conclusion are mentioned in various parts of this paper and can be summarized as follows:

- Credit demand: All indications are that the credit demand for working capital and investment of the type this project will provide vastly exceeds the amount that can be supplied. Thus BANEX should easily be able to lend the amounts contemplated to high quality, low risk clients whose products could have a long-term comparative advantage in world markets. The subloan portfolio can probably be placed much more rapidly than our conservative financial analysis indicates (which would result in higher profits and greater cash flow than indicated).

....

1/ This is because it is assumed that co-financing monies would be used mainly for working capital, which according to the credit demand study constitutes about two-thirds of the total credit demand.

- Low exchange risk. Because subloans would be made in dollars by BANEX's Panamanian subsidiary to finance production or marketing activities linked to export markets, the exchange risks are low. Only a complete reversal of the economic incentive structure or a significant change in foreign exchange liquidation policies could seriously increase this risk. Given Costa Rica's pressing need to increase exports, it is highly unlikely that any GOCR measures would significantly alter the existing export incentive policies.

- Sustained cash flow. The Financial Analysis, which follows, indicates that BANEX's cash flow would be sufficient to enable the bank to repay the AID loan even under the worst foreseeable conditions.

- BANEX soundness: Our examination of BANEX's proposed lending policies, procedures, criteria, control systems, and management indicates that both the BANEX concept and the BANEX institution are sound.

The reader will note that the foregoing conclusions are based on the supposition that the present "rules of the game" will remain in place. Unfortunately, one of the problems in the current Costa Rican economic situation is that the rules of the game are constantly in flux. Therefore, and given the fact that the USAID has received assurances that Legislative Assembly1/ approval of the GOCR guarantee will be quickly forthcoming (see Negotiating Status Section), the Mission has included the requirement for a GOCR guarantee as a condition precedent to disbursement. Nevertheless, should the political judgement that the GOCR Legislative Assembly will quickly ratify the guarantee arrangement prove to be in error, the Mission believes that AID/W should give consideration to making the loan to BANEX without a GOCR repayment guarantee. Should the Legislative Assembly fail to

1/ The Mission and BANEX have exhausted all other guarantee possibilities. A Central Bank guarantee to a private bank is not legal; the maximum amount that the Costa Rican Development Corporation (CODESA) could legally guarantee is $4.2 million; and the combined capital of all the public commercial banks would be insufficient to legally guarantee the loan.

approve the guarantee within a reasonable time after the loan is signed, (e.g., 90 days), the Mission proposes the following course of action:

- o The Mission would conduct a review which would include an updated Financial Analysis, as well as a review and update on the exchange rate situation, export proceed liquidation policies, Costa Rica's debt service situation, and changes in banking laws or policies.

- o Based upon that review the Mission would make a recommendation to AID/W as to the risk involved in making the loan without a GOCR guarantee.

- o If the Mission were to recommend proceeding without a GOCR guarantee, alternative risk minimizing mechanisms such as sinking funds would be explored1/.

In any case, the Mission would secure AID/W authorization before waiving the GOCR guarantee requirement.

d. Special Repayment Procedure

The draft Project Authorization includes, and the Loan Agreement would include, a provision which would allow the GOCR to use a special repayment procedure (two-step repayment procedure). If the GOCR elected to utilize this procedure (and the AID Mission agreed), BANEX could repay the GOCR in local currency (or dollars if need be) and the GOCR would, in turn, repay AID in dollars. The repayment terms to the GOCR would be 20 years with interest being two percent (2%) during a ten year grace period and three percent (3%) thereafter. Because the terms to the GOCR differ from those to BANEX (15 year loan, 5% p.a$., five year grace period)

1/ One such possibility could be the off-shore sale of dollar bonds in amounts equal or close to the outstanding AID Loan balance. The proceeds of the bond sales would be held in an interest bearing escrow account in a U.S. financial institution, the ownership of which would revert to AID in case of BANEX default. There would of course be a cost of this to BANEX and the project. One way to defray this cost and maintain the integrity of the project design would be to offer BANEX a loan with a lower interest rate and a longer repayment period.

a significant stream of local currency would be generated1/. "Two-stepping" the loan would have the following advantages:

- o The general AID policy of lending to private borrowers on harder terms would not hurt Costa Rica as a country; Costa Rica would still get AID funds on the most concessional terms that AID currently permits it to receive.

- o The two-step arrangement could be offered by AID as an inducement for the GOCR to guarantee the loan (in effect, it would be a type of guarantee commission).

- o Even if the loan were eventually made without a GOCR guarantee, the GOCR repayment agreement option, if exercized, would provide AID a partial guarantee in that the GOCR would be liable to AID for all payments made into the two-step fund by BANEX (but only these payments). The payments for which the GOCR would be liable would include the resources generated by the spread between the interest rate paid by BANEX and that paid by the GOCR, as well as the differing amortization periods.

2. Financial Analysis Summary

a. BANEX

A detailed financial analysis-- including pro-forma balance sheets, profit and loss statements, source and application of funds, and cash flow projections-- is contained in Annex E, Exhibit 1.

The principal assumptions underlying that analysis are:

1/ AID and the GOCR would agree on the uses of the GOCR-owned local currencies. In Costa Rica, three AID loans are presently "two-stepped" (05, 010, 019) and AID exercises a significant influence (and has veto power) over the local currency uses. If two-step resources were to be generated from this loan, AID would attempt to negotiate an earmaking of these resources for export promotion activities or for the support of other USAID program activities.

- The $10.0 million AID loan is drawn down 32% in year one, 57% in year two, and fully disbursed by year three.

- $10.0 million of co-financing becomes available beginning in year two and is fully disbursed by year four. In year five through fifteen BANEX's total portfolio increases substantially because of commercial borrowing averaging $10.0 million per year. Both co-financing resources and commercial bank borrowings are obtained at 1.5% over LIBOR.

- The AID and BANEX equity portfolios are lent out at 3.4% over LIBOR; co-financed and commercial borrowings are lent out at 4.0% over LIBOR.

- BANEX transfers $2.8 million from the AID loan spread to TRACO over the project's fifteen year life.

- Fee income increases from $296,000 in year one, to almost $1.4 million in year ten, and reaches almost $3.5 million in year fifteen.

- G & A expense drops from 9.8% of the outstanding loan portfolio in year one to 4.1% in year two, and remains constant at 2.0% of portfolio in years five through fifteen.

- The debt-to-equity ratio increases slowly from year one to year seven and remains at about 10 to 1 from then on.

The general conclusions of the analysis are:

- By year fifteen BANEX will be able to create an export financing loan portfolio of $128 million.

- BANEX will transfer enough funds to TRACO to have established four trading companies by year fifteen.

- BANEX's a rate of return on investment will average 19.1% between years seven and fifteen (the rate or return is higher in earlier years, except for year one).

Several sensitivity analyses were performed to test key assumptions:

- o The absence of co-financing or commercial borrowing drastically reduces sublending activities and lowers the rate of return to about 15% in years seven through ten. Still, the bank is able to pay off the AID loan and create several TRACOS.

- o A dropping LIBOR from 13% in year one to 10% in year four decreases net income by some 40% in years three through seven and by lesser amounts later.

- o In analyzing the adequacy of the bad debt reserve, the 1% bad debt expense (which is conservatively calculated on year-end balances and not on the average portfolio balance during the year) has to be combined with legal reserves which the National Banking Law requires. As a result the total bad debt reserve is equal to 3.6% of outstanding loans by year fifteen, an extremely conservative figure by normal banking standards.

In conclusion, the financial analysis of BANEX indicates that it will be able to create a significant export financing portfolio, transfer $2.8 million from the AID loan spread to capitalize TRACOS, and amortize the AID loan.

b. TRACO

Pro-forma projections of TRACO's operations are presented in Annex E, Exhibit 2. These projections indicate that the first TRACO will break even between years three and four and produce a profit in the neighborhood of $300,000 in year five. That profit, together with the anticipated $250,000 of equity investment by BANEX from the AID loan spread in year five, would permit of another TRACO to be set up in that year.

C. Economic Analysis[1/]

1. Areas to be Addressed by the Project

a. The Balance of Payments

The need to relieve Costa Rica's very serious balance of payments situation and to help the country diversify its sources of foreign exchange constitutes the most important argument in favor of the proposed project. The Central Bank's balance of payments projection, summarized in Table 1, shows that the overall balance of payments deficit increased from $41 million in 1978 to $82 million in 1979 and to $456 million in 1980. The actual decline in net international reserves was held down to $173 million in 1980 only due to the accumulation of arrears (i.e. the non-payment of debts) to the tune of $283 million in 1980. The Central Bank very optimistically projects the balance of payments deficit to disappear in 1981. The authorities hope to pay off $96 million in arrears in 1981 by means of IMF credits. Note, however, that this highly optimistic projection is based on the following assumptions:

(1) A projected increase in the total value of exports in spite of the drop in coffee prices between 1980 and 1981[2/] and the cutback in the coffee export quota: The Central Bank projects an increase of coffee exports to new markets to offset the decline in price.

(2) A sharp decline in imports: Imports are projected to decline by 12 percent in current dollars, which probably means a 20 to 25 percent drop in real terms. Import data over the first four months of 1981 showed a 16 percent decline (in current dollars) over the same period last year. Thus, Costa Rica's Gross Domestic Product is bound to decline significantly in 1980, much more than the 1.5 percent decline that is currently projected by the Central Bank.

(3) Official capital inflows are projected at $350 million in 1981. Given the reluctance of foreign commercial banks to provide credit to Costa Rica, this figure is unlikely to be attained, and could fall short of the target by as much as $100 to $200 million.

....

1/ This section borrows heavily from a report prepared on July 20, 1981, for the Mission by Clark Joel, ROCAP Regional Economist. Joel's complete report is ANNEX F.

2/ The drop in prices takes into account recent frosts in Brazil (next year, however, because of these frosts, quotas could increase).

TABLE 1

COSTA RICA: SUMMARY BALANCE OF PAYMENTS
(In millions of U.S. dollars)

	1978	1979	Prel 1980	1981
Current Account	-363	-566	-661	-460
Trade balance	-302	-455	-512	-260
Exports f.o.b.	(864)	(942)	(1,017)	(1,039)
Imports c.i.f.	(-1,166)	(-1,397)	(-1,529)	(-1,353)
Oil	/113/	/184/	/223/	/230/
Non oil	/1,053/	/1,213/	/1,306/	/1,123/
Services and Transfers (net)	-61	-111	-149	-200
Capital account Private1/	319	459	182	454
Public	235	390	362	350
Nonfinancial2/	(216)	(187)	(209)	(183)
Financial3/	(19)	(203)	(153)	(167)
SDRs and gold revaluations	3	25	23	
Overall balance	-41	-82	-456	--
Arrears	--	--	283	-96
Official net international reserves (increase-)	41	82	173	96 4/

1/ Determined as a residual; includes net errors and ommisions.
2/ Rest of Public Sector. i.e. all institutions other than those listed under "Financial."
3/ Central Bank, commercial banks, INVU (Housing), INS (Insurance Companies), INFOCOOP, Banco Popular, IFAM, DECAP. This item excludes IMF assistance which finances the balance of payments gap.
4/ To be covered by IMF funds.

Source: Central Bank (as agreed with IMF).

(4) The net private capital outflow, which was $180 million in 1980, is projected to become a net inflow of $104 million in 1981. Since this figure was obtained as a residual, it has little validity as a prediction. No net private capital in flow is more likely.

In conclusion: while the Central Bank's balance of payments forecast for 1981, with its 20 to 25 percent decline of imports in real terms, is a dismal prospect, the reality may well prove to be worse owing to the fact that the projection is based in highly optimistic assumptions with respect to exports and capital flows on both private and official account. It is clear that Costa Rica must give first priority to investment projects designed to increase exports or reduce import requirements.

b. Export Diversification

The diversification trend over the past decade has been very encouraging. Industrial exports increased from 23 percent to 36 percent (see Tables 2 and 3), while total exports of the traditional products (coffee, bananas, meat and sugar) declined from 73 percent in 1970 to 55 percent in 1980. Still, in 1980, three export products --coffee, sugar and bananas-- together accounted for 48 percent of total export earnings. Clearly, the diversification trend must continue.

Between 1960 and 1979, the Central American Common Market grew rapidly and provided an excellent outlet for Costa Rica's nontraditional products. Beginning in 1978-79, however, the CACM experienced major balance of payment difficulties and a stagnant real GDP. Over the next two to three years at least, the CACM cannot be counted upon to provide significant underpinning for Costa Rica's manufacturing industry. Thus, there appears to be no alternative but to focus on outside markets.

c. Private Sector Working Capital

While credit to the public sector expanded by 40 percent between the end of 1979 and 1980, the expansion of credit to the private sector increased by only 13%. This means a substantial reduction in real terms since the wholesale prices increased by 21.6% during the year. The loanable funds of the commercial banking system had to be diverted to finance the public sector deficit. Moreover, the commercial banking system has been plagued by a very serious delinquency problem equal to between 40 and 50 percent of the total loan portfolio, which further restricts the ability of the banks to provide credit. As a result, the private sector is experiencing of a severe credit shortage. The proposed project is designed to help relieve these problems by channeling funds to an institution that is not part of the public banking system.

TABLE 2

COSTA RICA: EXPORTS FOB BY PRINCIPAL PRODUCT
-percentage shares-

	1970	1975	1978	1979	1980 1/
Total F.O.B. Exports	100.0	100.0	100.0	100.0	100.0
Traditional products	72.7	65.1	64.7	64.8	54.9
Coffee	31.6	19.6	36.3	33.8	24.2
Banana	28.9	29.2	19.6	20.4	19.8
Meat	7.8	6.5	7.0	8.7	6.9
Sugar	4.4	9.8	1.8	1.9	4.0
Other products	27.3	34.9	35.3	35.2	45.1
Agricultural	4.2	7.2	9.4	8.2	8.7
Industrials	23.1	27.7	25.9	27.0	36.4

1/ Preliminaries

Source: Central Bank

TABLE 3

COSTA RICA: EXPORTS BY PRINCIPAL PRODUCT
(by millions of dollars)

	1970	1975	1978	1979	1980 1/
TOTAL F.O.B. EXPORTS	231.2	493.3	864.9	934.4	1.017.8
COFFEE	73.1	96.9	313.7	315.4	246.2
Volume (thousands of quintals)	1.502	1.673	1.817	2.117	1.551
Price	48.66	57.93	167.10	148.95	158.81
BANANA	66.8	144.3	169.9	190.5	201.2
Volume (thousands of tons)	856	1.105	1.058	1.025	960
Price	78.00	130.00	161.00	186.00	210.00
MEAT	18.0	32.1	60.3	81.7	70.4
Volume (millions of kilos)	17.5	29.8	34.5	31.6	25.9
Price	1.03	1.08	1.75	2.59	2.72
SUGAR	10.1	48.2	15.9	17.5	40.5
Volume (thousands of quintals)	1.465	1.525	1.488	1.502	1.570
Price	6.92	31.60	10.68	11.65	25.81
OTHER PRODUCTS	63.2	172.0	305.0	329.3	459.2
Agricultural	9.7	35.4	80.9	76.8	88.2
Industrials	53.5	136.6	224.1	252.5	371.0

1/ Preliminaries

Source: Central Bank

TABLE 4

COSTA RICA: EXPORTS OF MANUFACTURED PRODUCTS
(Including Foodstuffs but Excluding Fertilizers)
Over 1971-80
(In millions of dollars)

	To CACM	To Outside CACM	Total
1971	45.7	17.5	63.2
1972	48.2	19.6	68.0
1973	67.9	25.7	93.7
1974	97.7	42.1	139.8
1975	100.8	41.9	142.8
1976	127.7	73.8	201.5
1977	167.4	100.6	268.1
1978	169.1	110.0	279.1
1979	172.3	138.0	310.3
1980	-	-	444.8
Average Annual Compound Growth Rate			
1971-74	28.8	34.0	30.3
1974-77	19.7	33.7	24.2
1977-79	1.5	17.1	7.6

Source: Dirección General de Estadística y Censo.

TABLE 5

COSTA RICA: EXPORTS OF MANUFACTURED PRODUCTS
(OTHER THAN FOODSTUFFS AND FERTILIZERS)
1971-1980
(In millions of dollars)

	To CACM	To Rest of World	Total
1971	42.9	11.8	54.7
1972	45.3	13.3	58.6
1973	64.0	15.4	79.4
1974	91.7	27.4	119.1
1975	93.7	24.6	118.3
1976	122.2	45.5	167.6
1977	155.2	58.9	215.9
1978	154.3	58.9	213.2
1979	164.7	78.5	243.2
1980	247.2	117.2	364.4
Average Annual Compound Rate:			
1971-74	28.8	32.4	29.6
1974-77	19.2	30.9	21.9
1977-80	16.8	24.4	19.1

Source: Dirección General de Estadística y Censo

d. Employment

With a reduction of 20 to 25 percent or more in the level of real imports, the GDP is bound to decline substantially in real terms; this cannot be help but cause significant unemployment. Although accurate unemployment statistics do not exist, there is no doubt that it has increased greatly. Between March 1978 and March 1981, the open unemployment rate is estimated to have risen from 4.8 to 7.4 percent, while the total sub-utilization rate (which includes underemployment) rose from 11.0 to 15.9 percent. Because of measurement methodology these figures probably underestimate the actual seriousness of the unemployment problem to a considerable degree. The project is expected to help alleviate the unemployment problem --or prevent it from getting worse --since many of the areas of greatest growth potential for nontraditional production are also labor intensive. Because of the devaluation, Costa Rica's wages are competitive with other Central America and Caribbean countries, particularly considering the comparatively high level of training and literacy of the Costa Rican labor force.

2. Potential for Exports of Nontraditional Products to Outside the CACM

The growth trend in the exportation of manufactured products over the past decade gives some indication of Costa Rica's export potential in this area.

Table 4 shows the trend of exports of manufactured products including foodstuffs, while Table 5 excludes foodstuffs. The following conclusions stand out:

a. The growth in the export of manufactured products to the CACM and the outside world over the past decade has been truly phenomenal. Total exports of manufactured products, including foodstuffs, increased at an average annual rate of 30 percent during 1971-74 and 24 percent in the 1974-77 period. However, the growth slowed to only 7.6 percent during 1977-79 (Table 4).

b. If foodstuffs are excluded from the statistics the growth is no less impressive: 30 percent in the 1971-74 period, 22 percent in 1974-77 and 19 percent in 1977-80 (Table 5).

c. The rate of growth of exports of manufactured products to the rest of the world is even higher than to the CACM. The reverse was the case during the decade of the 1960's.

d. It is remarkable that even during the troubled year of 1980, exports of manufactured goods (other than foodstuffs) to the rest of the world increased by 50% in current dollars (Table 5,).

Thus, there can be little question but that Costa Rica's nontraditional export industries, particularly for manufactured products exported to outside the CACM, have made great strides over the past decade, a trend that persisted through recent years (in spite of the overvalued exchange rate).

3. Identification of Areas of Greatest Growth Potential

On the basis of analysis of trends in export statistics, as well as interviews with major exporters conducted by the AID Mission's economic consultants, the following product categories stand out as offering the greatest potential in the area of nontraditional exports to outside the CACM:

a. Foodstuffs, including fruits, vegetables, root plants, spices, marine products and chocolate. There appears to be a substantial potential foreign market for both fresh and processed fruit and vegetable products, although transportation difficulties will have to be overcome in the case of shipping fresh produce.

b. Flowers, plants and seeds.

c. Textiles, including synthetic yarn and cloth.

d. Apparel.

e. Shoes and leather goods.

f. Wood and wood products, particularly furniture. Costa Rican furniture is well made and enjoys a good reputation internationally.

g. Fertilizer and chemicals, including insecticides and fungicides.

h. Medicines and pharmaceutical products.

i. Plastic products including cellophane bags, plastic bottles and plastic sheeting.

j. Electric batteries.

The diversity of the above products and their upward sales trend suggests a strong potential, if the problems discussed below can be solved.

4. Major Bottlenecks

Interviews with bankers and major industrialists conducted by the Mission and its consultants, suggest that there are a number of serious bottlenecks constraining the continued expansion of exports of nontraditional products to outside the CACM. The main ones are:

a. The acute foreign exchange shortage, which makes it very difficult for business firms, including exporters, to obtain foreign exchange for imports of essential raw materials and parts; and has led to a cut-off from traditional sources of credit from foreign banks and suppliers.

b. Uncertainty with regard to governement intentions: this applies particularly in the area of the foreign exchange rate and the allocation of foreign exchange resources. Over the past year, devaluation was followed by a dual exchange rate, then by floating the colon. At the time, of this analysis it would appear that the authorities do not have the necessary foreign exchange reserves to defend any fixed exchange rate. Clearer and more consistent government policy on taxation and interest rates is also needed.

c. A serious credit squeeze: while credit extended to the private sector increased in nominal terms (by 13.5%) in 1980, the increase did not keep pace with inflation. Thus, domestic credit declined in real terms. The situation is much more serious considering that foreign sources of bank and supplier credit were cut off during this period. Bankers say the credit squeeze occurred because available funds were divided to the public sector to finance the large budget deficit; they also blame the very high delinquency rate. They note that 40 to 50 percent of the total loan portfolio of the banking system is delinquent by more than six months, and that non-recoverable loans may go as high as 25 percent of the total portfolio. Thus, the banking system is facing a very serious liquidity crisis and the private sector is bearing the brunt of the shortage of loanable resources.

d. Failure of the banking system to provide needed services: aside from its inability to accomodate the credit requirements of the private sector, the nationalized banking system is faulted for the low level of service it is providing to exporters. For example, banks are very slow in collecting and remitting the proceeds of Costa Rican exports; they do not maintain normal correspondent bank relations and do not provide bank references. These considerations were primary factors in the private sector's decision to promote the establishment of BANEX.

e. The tariff structures: the common external tariff of the Central American Common Market (CACM) provides a high level of effective protection by applying high tariffs on finished consumer goods and much lower tariff rates, including generous exemptions, on intermediate and capital goods. This favors assembly-type operations and channels resources into import-competing industries in lieu of export industries. The World Bank strongly argues for a revision of the tariff structure. Unfortunately, this is not a step that Costa Rica can adopt unilaterally.

f. Transportation problems: high freight rates and scarcity of transportation facilities, particularly of refrigerated facilities for perishable products, was indentified as a major obstacle to increasing exports beyond the CACM. While transport is a problem even in the case of Costa Rica's perishable products to the United States, it is particularly serious for exports to the Caribbean. There are no direct flights to the Caribbean islands and all shipments must be channeled through Miami.

g. Other problems: other problems identified by the private sector include its inability to produce large quantities for a sizeable market (a major obstacle for sales to the U.S. and Europe); the lack of grading standards, quality control and difficulties in maintaining uniformity of product; insufficient technical know-how; and lack of knowledge on the part of most potential exporters about export procedures, market requirements and potential customers in the U.S. and Europe.

5. Role of the Proposed Project

Significant progress has been made in dealing with some of the problems described above, but much remains to be done. While it cannot be claimed that the proposed project will remove all remaining obstacles, it addresses a number of them. In the first place, BANEX will get $10 million in additional foreign exchange resources, much of which will be used to provide working capital, which, along with foreign exchange, is probably what is most needed to substantially increase nontraditional exports. An illustrative estimate of the possible impact of such financing on exports will be attempted in the following section. Second, the new institution that AID will help capitalize (TRACO through BANEX) is expected to provide a number of services currently not available. These include research and information regarding foreign markets; foreign market development including product promotion, technical information exchange, and buyer contacts; technical assistance in product preparation, packaging, and production scheduling; financial management guidance; coordination of cooperative marketing, and transportation; and assistance with the export paper work. BANEX will provide a number of banking services, including special collection services, assistance in opening letters of credit, negotiating lines of credit, and others.

6. The Project's Potential Impact on Nontraditional Export

Quantification of the likely increase in exports of nontraditional products to world markets made possible by the project was attemped by GAMCO INC, a private consulting firm contracted by the Mission. GAMCO had interviewed 22 potential sub-borrowers at the time of this writing. The GAMCO study reveals that short-term working capital constitutes the greatest single need of the potential project sub-borrowers. The interviewees estimate that each dollar in available working capital could generate two dollars of net export income. GAMCO explains these results by noting that all the other necessary factors of production are there --the labor, plant and equipment, the entrepreneurship -- so that the working capital is, in many cases, the only missing element. By providing credit for working capital, all the existing investment in fixed capital and human resources is taken advantage of. This abnormal situation is not likely to prevail over the fifteen-year AID loan repayment period. The illustrative estimates that are part of this analysis therefore are based on much more conservative assumptions.

If a $10 million co-financing arrangement can be put together, the combined AID-co-financed loan would be $20 million. If two-thirds, or $13 million, of the total were placed in working capital subloans which turn-over twice a year, and if each dollar loan generates one dollar of net additional export earnings (instead of the two dollars resulting from the GAMCO survey), we would obtain an increase in net exports of $26 million a year. Assuming that these favorable conditions prevail only over a five-year period, the $20 million loan package would generate an additional $130 million of exports during just the first five years. Such favorable conditions cannot be expected to continue indefinitely, so that a less favorable ratio must be assumed in the following ten years. On the other hand, the substantial increase in new exports projected during the first five years would generate profits that would be available for additional working and fixed capital investment. Even if it is assumed that each dollar in loans would generate only $0.50 in new exports during the following 5 years, the total net exports generated would be over $200 million during the first ten years following disbursements.

Given the nature of the project, i.e., the fact that the sub-borrowers and the export potential of their activities cannot be precisely identified at this stage, the numbers cited above are obviously only illustrative. These figures strongly support the conclusion that the project has great potential in terms of foreign exchange earnings and export diversification, a top priority need of the Costa Rican economy.

7. Importance of Ensuring Turnover of Credit

For BANEX lending to have the favorable multiplier effect on exports described above, it is essential that exporters be permitted to repay the BANEX foreign exchange loan promptly and in foreign exchange, so that it will become immediately available for relending. If the process gets caught up in a changed Costa Rican foreign exchange control system, it could easily break down. For example, if all foreign exchange proceeds from exports must be turned over to the Central Bank which would then proceed to ration out exchange in accordance with its system of priorities, or if exporters are forced to repurchase the foreign exchange required to repay the loan at a higher rate than the one they receive from the Central Bank for their export proceeds, the operation of the fund could suffer substantial delays and could even become unprofitable. Fortunately, a mechanism currently exists that would prevent this from occurring. This is "the system of advances" ("sistema de adelantos") which has been in force for some time, was suspended earlier this year, and has been reinstituted on July 9. Under this system, the Central Bank agrees to allow exporters to repay their foreign loans from banks or suppliers before selling the remaining export proceeds to the Central Bank. Thus, a loan from BANEX could be repaid to that institution since only the net proceeds must be turned over to the Central Bank at the rate it sets. It is clear that AID and BANEX must carefully monitor the exchange rate regime to assure the continuing foreign exchange liquidity of BANEX.

D. Social Analysis

1. General Impact of the Macro-Economic Situation on the Poor

Costa Rica's current economic crisis is particularly detrimental to the poor. In addition to sharing inflation and other serious consequences of the crisis with the rest of the population, the poor also suffer disproportionately from unemployment and shrinking social services budgets. Although economic recovery is necessary for the well-being of the entire population, it is critical for the restoration of a rate of economic growth sufficient to support a desirable level of social services. By directing essential resources to the producers and manufacturers of nontraditional exports, the project will generate greater production for export, contributing thereby to overall economic recovery. From that will come more employment, higher real wages, and better social services. Thus Costa Rica's increasingly numerous poor will be the ultimate beneficiaries of the project.

In many lesser developed countries, the argument that general economic growth will be equitably distributed to all sectors of society (including the poor), might not be valid. Costa Rica, however, has long had a strong commitment to the equitable distribution of wealth. History demonstrates that this commitment transcends administrative turnovers, economic variables and other short term conditions. The Mission is confident that social concern is a part of the fabric of Costa Rican society, and that efforts to better the country's economic status will also improve the quality of life of its poor.

2. Job Creation

The project is expected to have a direct and significant impact on the country's unemployed and marginally employed. The GAMCO survey (See Annex D, Exhibits 1 and 2) reveals the following employment-related statistics covering twenty-eight producers of nontraditional exports:

- If the reported credit needs (approximately $10.5 million) of all surveyed firms were to be completely satisfied today, approximately 1,500 new jobs would becreated within these firms during twelve months1/. Additionally, much of the reported credit need is critical to the continued operation of many of the firms surveyed. Thus, credit input of the type proposed by the project would play an important role in the preservation of large numbers of existing jobs.
- Characteristic of the firms which were surveyed by GAMCO is a large percentage of female workers. Women make up over half of the workforce of sixty-eight percent of the firms surveyed.

3. Impact on Rural Populations

Many nontraditional product lines have backward linkages which are of significance to the country's rural populations. Agriculture, agro-business, wood product industries, fisheries and leather product industries are heavily dependent on raw materials and other inputs from the rural sector. Rural employment

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1/ To put this number into perspective it will be recalled that from 1979 to 1980 private employment actually decreased by 4,000 jobs. Moreover, during the 1976-1980 an average of only 17,100 jobs per year were created in the entire private sector. Given that these 1,500 jobs are added directly to the employment base, the multiplier effect should result another 3,000 to 4,500 jobs created indirectly.

and the quality of rural life are, therefore, directly linked to the production of these potential sub-borrowers1/.

4. Other Social Benefits

Additional social impact is expected from the project.

- Jobs created by the manufacturing sector (which will participate heavily in the project) are often more stable than those available in other sectors. Generally, salary levels are higher and fringe benefits more comprehensive.

- The country's tax base will be broadened both from greater income, from export and from the increased production which is stimulated by the project. Given the current 5% ad valorum tax on all exports, the increase in exports which would result from meeting the credit needs of the surveyed firms would generate a minimum of one million additional tax dollars.

- Numerous "spin-off" businesses are likely to be developed as a result of the expected increase in output generated by the project2/. Direct "feeder" industries will expand, and related service industries such as transportation, warehousing, printing and others will be stimulated.

1/ One of the businessmen interviewed, an ornamental plant grower and exporter, reported a need for both short and long term credit in order to significantly expand exports to nontraditional markets. His nursery currently employs over 150 farmers from a nearby small community. Income from this employment supplements their farm income and enables them to remain on their farms where they continue to be agriculturally productive.

2/ Examples among the firms GAMCO surveyed include:

- Wood products and their related forest management, harvesting and wood processing activities;

- agrobusiness activities, which require agricultural production, transportation and numerous supportive activities; and

- two manufacturers of plastic bags which are used by commodity brokers to wrap agricultural products (e.g. bananas).

V. PROJECT IMPLEMENTATION

A. Project Management

1. Role of AID

The Mission Capital Development Office (CDO) will have primary responsibility for monitoring the project. With the assistance of the Mission Controller and when required Mission managment, the CDO will:

- o review and forward for processing BANEX requests for disbursements;
- o review and process applications for subloan which require AID approval;
- o review BANEX reports and other related correspondence, taking action as needed;
- o supervise project evaluation activities;
- o monitor project activity, ensuring compliance with conditions and convenants, taking management action as necessary; and,
- o report on the project to Mission Management and AID/W as appropriate.

2. Role of BANEX

a. The Credit Component

BANEX will be responsible for fully developing and installing of all sublending managment systems and procedures (after obtaining AID's approval). BANEX will also develop and formalize all sublending policies, in accordance with the conditions of the AID loan. The policies, systems and procedures will include those which govern[1/]:

- o business development and related outreach activities;

1/ Most regulations, procedures, and systems have been designed and submitted to the Mission for review and are included in Annex D, Exhibit 3. They will be formally submitted and approved as a condition precedent to disbursement.

- evaluation and approval of loan applications;
- loan processing and formalization;
- loan monitoring and,
- collections.

b. The Export Management Component

BANEX will, during first quarter of project implementation, develop and submit for AID review a detailed implementation plan for the Export Management Component. The plan will follow the preliminary designs contained in the Project Paper

BANEX will be fully responsible for development, capitalization and management of the Trading Company (TRACO), in accordance with the specifications of the loan agreement and supporting documents.

c. Overall Project Management

BANEX will develop and manage all systems required to provide for overall project management.

In addition, BANEX will:

- monitor sub-lender activities and report on the use of loan funds by sub-borrowers as necessary to ensure compliance with AID procurement regulations in accordance with the Loan Agreement; and,
- cooperate fully with AID project audits and joint evaluations.

B. Summary Project Implementation Schedule

1. Credit Component

We expect that the first subloans will be made within the first quarter of project operation. We estimate --conservatively-- that twenty-five percent (25%) of the loan will be used for making subloans by the end of the first year. The rest of the loan will be disbursed at the rate of 25% in year two and 50% in year three.

2. Banking Services Component

BANEX's banking services will also become available during the first quarter. Although banking services will develop in size and scope as the project grows, a full range of banking services is expected to be available by the third quarter of project operation.

3. Export Management Component

While it is likely that TRACO will provide some export management services during its early phases, full TRACO operations are planned to begin during the second quarter of the second year of project operation. (See Annex G, Exhibit 2). The entire basic TRACO system, including possibly its first Export Company (EXCO), will be in place and operational during the third quarter of the second year.

C. Evaluation

The project will be evaluated through the periodic measurement of the performance of each of its components against corresponding objectives. Prior to any disbursement of Loan funds, BANEX will develop baseline data and establish evaluation methodologies, including data collection policies, procedures and means. BANEX will also develop specific, measurable indicators of component performance.

- Credit Component performance indicators will focus on portfolio size, impact of subloans on nontraditional exports, characteristics of sub-borrowing enterprises and various measures of subproject and portfolio macro-economic and social impact.

- Performance indicators related to the Banking Services Component will measure of service volume and type, as well as BANEX's "share" of the banking services market; surveys of client opinion regarding service expediency, quality and costs will also be made.

- Export Management Component performance indicators will show the numbers of firms and export volume by productive sector, and the impact of component services on client enterprises and component profits.

BANEX will be responsible for continuous monitoring of the activities of all three components. AID will receive from BANEX quarterly activity reports on the progress of each component in relation to performance objectives. When \$3.7 million have been disbursed, AID and BANEX will evaluate the project; one in-depth evaluation will be made when \$5.7 million have been disbursed and another will be done at the end of the project. (Draft performance indicators for project evaluation are included in Annex G).

D. Disbursement Procedures

AID will make a dollar advance to create a rotating fund the balance of which will equal BANEX's projected sub-lending disbursement or equity investment needs for a thirty day period. This advance will be held by BANEX in a non-interest bearing account. The advance will be replenished by AID upon BANEX's submission to AID of vouchers and supporting documentation which evidence sub-loan disbursements or equity investments.

The dollar advance to BANEX is necessary to permit it to make dollar-denominated loans through its Panamanian subsidiary1/. Sub-loans or portions thereof denominated in U.S. dollars using the BANEX rotating fund will normally be used for local currency financing. AID Letters of Commitment will normally be used for the financing of imported items.

As explained under the Export Management Component, TRACO plays a key role in the project. In addition to facilitating sales for exporters, it must be able to efficienty by and sell products. TRACO will be an important mechanism through which Costa Rican exporters will obtain supplier credits untainted by the general Costa Rican credit risk. To be able to undertake these transactions, TRACO must be well capitalized, and its assets must be sufficiently liquid. Therefore, in addition to using AID loan funds (and normal disbursement procedures) to finance TRACO operating expenses, BANEX will use up to \$350,000 of AID loan funds to estabish TRACO's working capital. The \$350,000 will be placed in an account with a U.S. based financial institution2/ and will be used

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1/ Dollar denominated loans must be made using the Panamanian subsidiary because Costa Rican law allows payment of foreign currency denominated obligations at the official exchange (presently 8.60)

2/ The funds, held in escrow, will be placed in special short-term, liquid financial investments. Monitoring and control mechanisms governing use of the funds will be submitted for AID review and approval. The controls will provide adequate safeguard of the funds without handicapping their liquidity and efficient utilization.

by TRACO U.S. to purchase goods and guarantee supplier credit for Costa Rican producers. Thus, including the anticipated $350,000 in first year TRACO operating expenses and the $350,000 TRACO working capital, BANEX equity investment in TRACO will total $700,000 in year one[1].

As TRACO begins to generate profits, the initial BANEX investment may be returned to BANEX to be used for lending, as long as TRACO net worth does not fall below $350,000[2]. (The returns are currently projected to occur in years three and four of project operation.)

AID funds will be disbursed at a rate approximately *pari passu* with the disbursement of funds supplied by the commercial co-financier[3]. However, given that the co-financing negotiation may not be completed until several weeks after the project has begun, AID funds initially may be disbursed ahead of corresponding co-financed funds. Disbursements of AID funds in excess of $3.200,000, however, will be contingent upon evidence that BANEX has secured and disbursed co-financed funds of not less than $2,500,000 from an acceptable private commercial source.

Disbursements of AID funds in excess of $5,700,000 and of 7,500,000 will be conditioned on evidence of *pari passu* disbursements of co-financed funds and on satisfactory project evaluation results.

E. Procurement Procedures

Procurements by BANEX, its subsidiaries and sub-borrowers with AID loan funds will be made in conformance with AID procurement policies as described in Handbook 1, Supplement B, Chapter 19, Intermediate Credit Institutions. The provisions of Handbook 11 will govern purchases made by BANEX and its subsidiaries for its own account, except as follows:

....

1/ This $700,000 is in addition to the AID loan spread profits which will also be transferred into TRACO as established in the Financial Plan and Covenants.

2/ $350,000 is estimated to be the minimum amount of capital TRACO will require to perform its purchasing and supplier guarantee functions.

3/ See Financial Plan Section for discussion regarding feasibility of co-financing.

- Requirements will not apply to subloans of less than $25,000.

- Dollar procurement of agricultural commodities will be permitted by BANEX, its subsidiaries, and subborrowers.

- BANEX or TRACO may use up to $300,000 of loan funds to contract with the World Trade Institute on a predominant capability basis.

The above exceptions require specific waivers which are discussed below in the waiver section. In addition, because the credit demand analysis indicates that pharmaceutical products are an important potential nontraditional export, importing bulk pharmaceuticals by a subborrower could be justified. Any dollar procurement of bulk pharmaceuticals would be carried out in accordance with Section 4c 3a (2) of Handbook 1, Sup. B, except that in accordance with Section 19 A 3(d) 4 of Handbook 1, Sup. B, any such procurement would probably follow negotiated procurement procedures.

The source and origin of all loan-funded procurements, except shelf items, will be restricted to Code 941 of the AID Geographic Code Book and the cooperating country (CACM).

Banex management will have responsibility for monitoring procurement and regular reports will be rendered to USAID/CR. BANEX will advise its sub-borrowers of the restrictions on loan-financed dollar and local currency procurement and these purchases will be monitored using Letter of Commitment-Letter of Credit procedures. BANEX will set up a special system to monitor sub-borrower loan-funded shelf-item procurement of Code 899 origin to assure that the total amount of those purchases made with the proceeds of subloans exceeding $25,000 does not exceed $250,000 unless a specific waiver is granted.

F. <u>Conditions and Covenants</u>

The following conditions and covenants will be included in the loan agreement. These conditions and covenants are similar to those utilized with other private borrowers such as COFISA and LAAD.

1. <u>Conditions Precedent to Initial Disbursement</u>

Except as AID may otherwise agree in writing, the following are conditions precedent to initial disbursements of AID funds:

a. an opinion of counsel acceptable to AID to the effect that this Agreement has been duly authorized by the Board of Directors of the Borrower and duly executed on behalf of the Borrower, and that it constitutes a valid and legally binding obligation of the Borrower in accordance with all its terms;

b. a statement, duly authenticated, of the name of the person holding or acting in the office of the Borrower and of any additional representatives, together with a specimen signature of each person named in such statement;

c. an opinion of counsel acceptable to AID that Borrower has been duly organized under the laws of Costa Rica, that Borrower has taken all corporate and legal action required under the laws of Costa Rica and has full powers essential to implement the project, that there are no legal inhibitions to the implementation of the project and that capital has been subscribed in the amount of 20.7 million colones;

d. a statement from the Borrower setting forth the basic policies, rules, regulations, procedures, terms, and interest rates eligibility criteria to be used in making investments and subloans, and such other statements concerning the status and operations of Borrower as appropriate.

e. a statement from the Borrower setting forth the procedures it will follow in reviewing, analyzing and administering investments and subloans to be made by the Borrower;

f. certified copies of Borrower's charter, by-laws and operating policies which have been approved by Borrower's Board of Directors;

g. evidence that the Borrower has hired managers and staff satisfactory to AID;

h. a plan for the periodic audit of subloans by the Borrower;

i. evidence that the Borrower has obtained a guarantee of repayment agreement from the Government of Costa Rica or from an agency thereof.

2. Conditions Precedent to Disbursements in Excess of $3,200,000

a. Prior to any disbursement under the Project Agreement or the issuance of any commitment in excess of $3,200,000, the Borrower shall furnish to AID, except as AID may otherwise agree in writing, evidence that the Borrower has disbursed as subloans no less than $2,500,000 of funds obtained from private sources.

b. Prior to any disbursement under the loan in excess of $3,200,000, satisfactory progress toward achievement of the project's sub-goal and purpose has to have been made, as determined by AID.

3. Conditions Precedent to Disbursements in Excess of $5,700,000

a. Prior to any disbursement under the Loan in excess of $5,700,000, the Borrower will furnish to AID, except as AID may otherwise agree in writing, evidence that Borrower has obtained additional paid-in capital raising total paid-in capital to the equivalent of $2,000,000.

Additionally, the Borrower will furnish to AID evidence that the Borrower has obtained from private sources and disbursed in sublendings from those sources no less than $5,700,000.

b. Prior to any disbursement under the loan in excess of $5,700,000, satisfactory progress toward achievement of the project's sub-goal and purpose has to have been made, as judged by AID.

4. Conditions Precedent to Disbursements in Excess of $8,300,000

a. Prior to making any disbursement under the loan in excess of $8,300,000, the Borrower shall, except as AID may otherwise agree in writing, furnish to AID evidence that the Borrower has disbursed as subloans no less than $8,300,000 of funds obtained from private sources.

5. Special Covenants

a. Project Evaluation

The Parties agree to establish an evaluation program as part of the Project. Except as the Parties otherwise agree in writing, during Project implementation this program will follow the guidelines set out below. Evaluations will be carried out whenever the Parties judge it to be necessary, but at a minimum will be done before disbursements over a total of $3,200,000 and of $5,700,000 are allowed, and at the end of project. Guidelines:

- an assessment of progress toward attainment of the objectives of the project;
- identification and examination of problem areas or obstacles which may stand in the way of reaching the project's objectives.
- evaluation, to the degree feasible, of the overall development impact of the Project;
- review of the timing of disbursements of funds provided by this Loan, private banks and the Borrower.

b. <u>Limitations on Borrower</u>

(1) Except as AID may otherwise agree in writing, the Borrower shall not:

(a) use AID Loan funds to pay administrative or operating expenses of the Borrower;

(b) permit the use of AID funds to finance any subproject or to make subloans to any sub-borrower in excess of the equivalent of two hundred fifty thousand United States Dollars ($250,000);

(c) make, without prior AID approval, an equity investment in or subloans to businesses or other activities in which any officer or employee of the Borrower has controlling financial interest;

(d) make subloans or investments in any single enterprise in excess of $500,000;

(e) maintain a reserve for bad debts that is less than one percent (1%) of all outstanding loans;

(f) appoint as the manager of any subsidiary a person whose appointment has not been approved in advance and in writing by AID;

(g) declare or pay dividends on any class of stock of the Borrower from sources other than accrued earnings (after providing adequate reserves for bad debts);

(h) declare or pay dividends on any class of stock of the Borrower prior to July 1, 1983;

(i) declare or pay cash dividends on any class of stock exceeding eighteen percent (18%) of Borrower's net worth; or

(j) incur any indebtedness which would enjoy a position superior to the obligation incurred under the AID Loan.

(2) Except as AID may otherwise agree in writing, the Borrower covenants that utilization of repayments of subloans will conform with the purposes of the Project as set forth in Annex I of the Loan Agreement until the Loan from AID is repaid in full.

(3) Except as AID may otherwise agree in writing, the Borrower covenants that it will not permit its debt to net worth ratio to exceed 6:1 during year one, 7:1 during year two, 8:1 during year three; 9:1 during year four and 10:1 during years five through fifteen of the loan agreement.

(4) Use repayments of principal of loans made using AID resources for purposes other than those for which AID loan funds were originally intended until the AID Loan is fully paid.

(5) Except as AID may otherwise agree in writing, the Borrower covenants to submit a report to AID each quarter during the life of this Agreement. These reports will cover events that occurred during the previous three months, and contain a breakdown of subprojects, showing types of industry, commitments and disbursements, terms and conditions of financing, uses of Borrower and AID funds and other comments as appropriate.

(6) Except as AID may otherwise agree in writing, the Borrower covenants to utilize at least one hundred percent during the first three years, and at least 50% thereafter, of the interest income from subloans made using AID funds less the following: interest paid on the AID loan; allowable operating expenses (per covenant "c", below); social benefits and tax payments required by law; and bad debt losses; to establish and operate the Export Management Component of the Project.

c. Allowable Deductions of BANEX Operating and Legally Required Expenses

(1) AID will not allow deductions of BANEX operating expenses from the interest income generated by the AID-financed subloan portfolio to exceed the following percentage of said portfolio, unless AID agrees otherwise beforehand and in writing:

Average Outstanding Portfolio	Allowed Annual Operating Expenses as a Percentage of Average Outstanding Portfolio
Up to $3.2 million	5.0%
From $3.2 million to $5.7 million	4.0%
Over $5.7 million	2.5%

(2) On a yearly basis, the percentage of taxes and other payments required by law that AID will allow to be charged against the income BANEX obtains from lending AID funds will equal the percentage of such income in relation to BANEX's total income (including that from banking services); however, this percentage must not exceed fifty percent.

d. Except as AID may otherwise agree in writing, BANEX will at no time during the period of the loan agreement allow the net worth of TRACO to fall below $350,000.

e. Except as AID may otherwise agree in writing, TRACO will pay no cash dividends during its first five years of operation.

f. Negative Pledge

So long as the Borrower shall owe any amounts to AID hereunder, the Borrower shall not, without the prior written consent of AID, mortgage, pledge, otherwise hypothecate or encumber any of its assets or properties (promissory notes, acceptances, accounts receivable, contractual rights, shares, securities, any collateral, etc.) obtained through, or evidencing financing made by the Borrower with funds obtained from AID hereunder; provided, however, that, at the request of AID, the Borrower shall grant security interest in such assets and properties in favor of AID necessary to create, perfect and preserve such valid security interest in favor of AID; provided, further, that this Section shall not apply to the assets or properties of the Borrower initially obtained through, or evidencing, financings made by the Borrower with funds from AID hereunder if and when such funds have been repaid to AID, to the extent of such repayment; and provided, finally, that should the situation stated in the second proviso of this Section occur after the security interest in the respective asset or property, or any part thereof, has been granted, then at the request of the Borrower, AID shall do whatever is necessary to cancel such security interest.

g. Consultations

Borrower agrees to consult from time to time with AID concerning the steps taken by Borrower to seek cofinancing from private banking sources.

h. Availability of BANEX Stock for Purchase by the Public

As long as the Borrower shall owe any amounts to AID hereunder, except as AID may otherwise agree in writing, BANEX will increase annually the amount of newly issued stock which is available for public subscription by at least ten percent of the total amount of subscribed stock.

i. Negotiating Status

(1) BANEX

This project has been developed in close coordination with BANEX management and staff. BANEX's management and Board of Directors have reviewed the proposed conditions and covenants and find them acceptable. It is therefore expected that loan negotiations will be accomplished rapidly and that loan signing could take place within seven to ten days after authorization.

(2) Government of Costa Rica

After loan signing, and as a condition precedent to disbursement, a Special Repayment and Loan Guarantee Agreement will be negotiated with the Government of Costa Rica. As discussed in the Financial Plan, the Legislative Assembly will have to ratify such a guarantee. This project and the need for a GOCR guarantee have been discussed with the National Planning Office (OFIPLAN), with high level officials the Costa Rican Government, and with leaders in the Legislative Assembly; all of these individuals agree that it would be desirable for the GOCR to issue this guarantee. The specific terms of a repayment agreement and guarantee, however, have yet to be negotiated. Ratification by the Legislative Assembly of Loan Agreements with AID and other lenders has in the past held up the start of the activities to be financed for many months. Since February, 1981, however, the Assembly has approved nine foreign loans totalling $155 million due to an apparent realignment of forces within the Assembly. The AID Mission has received assurance that Legislative Assembly approval can be speedily secured (See San Jose 5048).

j. Waivers

The Mission is seeking three exceptions to AID procurement policy.

(1) Contract with World Trade Institute on a Predominant Capability Basis:

It is requested that BANEX or its subsidiaries be allowed to use up to $300,000 of loan funds to negotiate a contract with the World Trade Institute (WTI). WTI assists producers and manufacturers in developing countries to export their products. WTI, an agency of the Port Authority of New York, has specialized personnel, facilities the right location, and the in the export management field to permit it to give BANEX the technical assistance it will require to organize TRACO. WTI's expertize in this area has been developed and maintained during the many years that it has received grant support from AID through PPC. As far as we can tell, WTI's capability in the area of developing country export management is unique.

This waiver is requested pursuant to Section 2.4.2(d) of Handbook 11 and can be granted by AA/LAC, in consultation with AA/SER.

(2) Dollar Procurement of Agricultural Commodities

The studies carried out in preparing this project indicate that there are several possible exporters of processed foods, principally snacks. These firms may require working capital to import agricultural commodities such as corn, beans, or vegetable oils to supplement the domestic production of these items which they buy locally. Dollar procurement of these commodities by the subborrower or TRACO would be limited to the United States; the most likely markets for the snack foods are in the Caribbean.

The following are additional considerations regarding this waiver request:

- Although a possible PL 480, Title I program is under discussion, it has yet to be approved and would, in any case, involve commodities for internal domestic consumption, principally wheat.

- The volumes to be imported would not significantly affect the U.S. availability or prices of the commodities.

- There is no likely other donor financing.

Pursuant to Section 4C 1a(1)(a) of Handbook 1, Sup B, dollar-financed imports of the types of agricultural commodities which might be paid for by subloans requires AID/W approval. In accordance with 4C 1d of Handbook 1, Sup. B, these policies can be waived by the Assistant Administrator having program responsibility. Such a waiver is hereby requested.

(3) Applicability of Special Procurement Policies to Subloans of Less than $25,000

Pursuant to Section 19A 3a(1) of Handbook 1, Sup. B, AID does not require adherence to any special procurement policies on ICI subloans of less than $5,000. Among the considerations given in setting this $5,000 limit is the recognition that AID could not easily monitor small subborrower compliance with procurement policies. If BANEX, a new institution, were to effectively monitor procurements of its smaller subborrowers, its operating costs would go up significantly, and the speed with which it could approve and disburse subloans would go way down. One of the fundamental reasons for this project is to help set up an organization that can channel credit to productive enterprises efficiently and quickly. Given the economic crisis facing Costa Rica and a credit-starved private sector, time is a critical element. We therefore strongly recommend that AID not require any special procurement policies on "local currency" loans of $25,000 or less. According to 19D 1 of Handbook 1, the Geographic Assistant Administrator has the authority to waive the application of procurement requirements to subloans under a certain amount.

BANEX

BANCO AGRO INDUSTRIAL Y DE EXPORTACIONES S.A

Agosto 14, 1981

Señor
Stephen P. Knaebel
Director
Agencia para el Desarrollo Internacional
Presente

Estimado Sr. Knaebel:

Sirva la presente para dirigir a usted y a la Agencia que representa, solicitud formal de un préstamo de diez millones de dólares (U.S.$10.000,000.00), para llevar a cabo un programa de apoyo y fomento a la exportación de productos no tradicionales, a mercados no tradicionales, fuera del Area, según proyecto ya estudiado por ustedes.

Es del conocimiento general que Costa Rica debe incrementar sus exportaciones en corto plazo, como una de las pocas alternativas de que dispone para resolver su problema de balanza de pagos, y sus efectos.

Ahora bien, para exportar el país necesita de crédito, de una estructura bancaria de exportación, y de empresas comercializadoras que tengan la especialización para lograr el éxito en mercados mundiales. Actualmente Costa Rica carece de esa infraestructura necesaria para exportar.

Nuestro proyecto pretende ayudar a resolver esos tres escollos.

Tenemos la certeza de que A.I.D. comparte nuestras ideas sobre este tema. Su apoyo en esta etapa con fondos semilla, es crucial para permitir su efectiva y pronta realización. Además, según las evaluaciones ya en sus manos, estamos seguros que el monto solicitado tendrá un excelente efecto multiplicador como recursos de desarrollo.

Confiamos en que esta solicitud sea resuelta en forma favorable para Banex y Costa Rica.

Atentamente,

BANCO AGRO INDUSTRIAL Y
DE EXPORTACIONES S.A.

Guillermo von Breymann
Gerente General

GvB/meu

TELEFONO 33-41-01 - TELEX: 3065 BANEX C.R APARTADO 7044 - SAN JOSE COSTA RICA

PROJECT AUTHORIZATION

Name of Country: Costa Rica

Name of Entity: Banco Agro-Industrial y de Exportaciones (BANEX)

Name of Project: Private Sector Productivity

Number of Project: 515-0176

Number of Loan: 515-W-035

1. Pursuant to Section 106 of the Foreign Assistant of 1961, as amended, I hereby authorize the Private Sector Project for Costa Rica involving planned obligations of not to exceed ten million ($10,000,000) United States dollars in Loan Funds over a three year period from the date of authorization, subject to the availability of funds in accordance with AID OYB/allotment process, to help in financing foreign currency and local currency costs of the project.

2. The project ("Project") consists of establishing an integrated program of credit, export management assistance and export oriented banking services for producers, manufacturers and exporters of nontraditional extra CACM exports.

3. The Project Agreement, which may be negotiated and executed by the officer to whom such authority is delegated in accordance with A.I.D. regulations and Delegations of Authority, shall be subject to the following essential terms, covenants and major conditions, together with such other terms and conditions A.I.D. may deem appropriate:

a. Interest Rate and Terms of Repayment

The Borrower (BANEX) shall repay the loan to A.I.D. in U.S. dollars within fifteen (15) years from the date of first disbursement of the loan, including a grace period of not to exceed five (5) years. The Borrower shall pay to A.I.D. in U.S. dollars, interest from the date of first disbursement of the loan at the rate of five percent (5%) per annum, on the outstanding disbursed balance of the loan and on any due and unpaid interest accrued thereon.

(1) If, prior to the first interest payment under the loan is due, the Government of Costa Rica so elects, Borrower shall

fulfill its United States dollar obligation under the loan by paying to the Government in the currency of Costa Rica, the equivalent, determined as of a time and in a manner satisfactory to A.I.D., of the United States dollar amounts payable to A.I.D. under (a) above, and, in such event, the Goverment shall pay to A.I.D.:

(i) the equivalent in United States dollars of all amounts, paid to the Government by the Borrower, as follows:

(a) all interest immediately upon receipt subject to the Goverment's right to retain all payments in excess of two (2%) percent per annum during a grace period of not to exceed ten (10) years from the date of the first disbursement under the loan ("Government grace period").

(b) Principal within twenty (20) years including a grace period of not to exceed ten (10) years from the date of the first disbursement under the loan ("Government grace period");

(ii) Interest in United States dollars of two (2%) percent per annum during the Government grace period, and three (3%) percent per annum thereafter, on all amounts of outstanding principal paid by Borrower to the Goverment from the respective dates of such payments of principal.

b. <u>Source and Origin of Goods and Services</u>

Goods and services, except for ocean shipping, financed by A.I.D. under the loan shall have their source and origin in countries included in A.I.D. Geographic Code 941, or in countries that are members of the Central American Common Market, except as A.I.D. may otherwise agree in writing. Ocean shipping financed by AID under the loan shall, except as A.I.D. may otherwise agree in writing, be financed only on flag vessels of the United States, or of countries that are members of the Central American Common Market.

c. <u>Conditions Precedent to Initial Disbursement</u>

Prior to any disbursement, or the issuance of any commitment documents under the Project Agreement, the Borrower shall, except as A.I.D. may otherwise agree in writing, furnish to A.I.D. in form and substance satisfactory to A.I.D.:

1. a statement from the Borrower setting forth the basic policies, rules, regulations, procedures, terms, interest rates and eligibility criteria to be used in making investments and subloans, and such other statements concerning the status and operations of Borrower as appropriate.

2. a statement from the Borrower setting forth the procedures it will follow in reviewing, analyzing and administering investment and subloans to be made by the Borrower;

3. certified copies of Borrower's charter, by-laws and operating policies which have been approved by Borrower's Board of Directors;

4. evidence that the Borrower has employed management and staff satisfactory to A.I.D.;

5. a plan for the periodic audit of subloans by the Borrower;

6. evidence that the Borrower has obtained a guarantee of repayment agreement from the Government of Costa Rica or from an agency thereof acceptable to A.I.D.

d. <u>Condition Precedent to Disbursements in Excess of $3,200,000</u>

Prior to any disbursement under the Project Agreement or the issuance of any commitment documents in excess of $3,200,000, the Borrower shall, except as A.I.D. may otherwise agree in writing, furnish to A.I.D., evidence that the Borrower has disbursed as subloans no less than $2,500,000 of funds obtained from private sources.

e. <u>Condition Precedent to Disbursements in Excess of $5,700,000</u>

Prior to any disbursement, or the issuance of and commitment documents under Project Agreement the Loan in excess of $5,700,000, the Borrower shall, except as AID may otherwise agree in writing, furnish to A.I.D, evidence that Borrower has obtained additional paid in-capital raising total paid-in capital to the equivalent of $2,000,000.

Additionally, the Borrower will furnish to A.I.D., except as AID may otherwise agree in writing evidence that the Borrower has obtained from private sources and disbursed in sublendings from those sources no less than $5,700,000.

f. Condition Precedent to Disbursements in Excess of $8,200,000

Prior to any disbursement, or the issuance of any commitment documents under the Project Agreement in excess of $8,200,000, the Borrower, shall, except as A.I.D. may otherwise agree in writing, furnish to A.I.D. evidence that the Borrower has disbursed as subloans no less than $8,200,000 of funds obtained from private sources.

g. Covenants

The Borrower shall covenant that, unless A.I.D. otherwise agrees in writing, it will:

(1) establish an evaluation program as part of the Project. The program will include, during the implementation of the Project and at one or more points including prior to disbursements of amounts in excess of $3,200,000, $5,700,000 and at the end of the project, the following:

(i) an assessment of progress toward attaintment of the objectives of the Project;

(ii) identification and examination of problem areas or obstacles to accomplishment of project objectives;

(iii) evaluation, to the degree feasible, of the overall development impact of the Project;

(iv) review the timing of disbursements of funds provided by this Loan, private sources and the Borrower.

(2) not utilize A.I.D. Loan funds to pay administrative or operating expenses of the Borrower, excepting start-up expenses of the Borrower's Trading Company Subsidiary;

(3) not permit use of A.I.D. funds to finance any subproject or to make subloans to any sub-borrower in excess of the equivalent of two hundred fifty thousand United States Dollars ($250,000);

(4) without prior A.I.D. approval, make no subloans to, or equity investments in, business or other activities in which any officer or employee of the Borrower or their immediate family has a controlling financial interest;

(5) not make subloans or investments in any single enterpise except its wholly-owned trading company in excess of $500,000;

(6) not maintain a reserve for bad debts of less than one percent (1%) of all outstanding loans;

(7) not appoint as the manager of any subsidiary a person whose appointment has not been approved in advance in writing by A.I.D.;

(8) not declare or pay cash dividends on any class of stock of the Borrower from sources other than accrued earnings (after providing adequate reserves for bad debts);

(9) not declare or pay dividends on any class of stock of the Borrower prior to July 1, 1983;

(10) not declare or pay dividends on any class of stock exceeding eighteen percent (18%) of Borrower's net worth;

(11) not incur any indebtedness which would enjoy a position superior to the obligation incurred under the A.I.D Loan.

(12) Not permit its debt to net worth ratio to exceed 6:1 during year one, 7:1 during year two, 8:1 during year three, 9:1 during year four and 10:1 during years five through fifteen of the loan agreement.

(13) Not use repayments of principal from the A.I.D. loan for purposes other than those for which A.I.D. loan funds were originally made.

(14) Utilize repayments of subloans in conformance with the purposes of the Project as set forth in Annex I of the Loan Agreement.

(15) Submit a report to A.I.D. each quarter during the life of this Agreement. Each report will contain a breakdown of subprojects, showing types of industry,

commitments and disbursements, terms and conditions of financing, uses of Borrower and A.I.D. funds, an aging of accounts and other comments as appropriate.

(16) Utilize at least one hundred percent (100%) during the first three years, and at least fifty percent (50%) thereafter, of the interest income from subloans made using A.I.D. funds less the following: interest paid on the A.I.D. loan; allowable operating expenses as defined in Annex I, legal deducations and tax payments required by law; and bad debt-expenses; to establish and operate the Export Management Component of the project as described in Annex I.

(17) Not as long as it shall owe any amounts to A.I.D. hereunder, mortgage, pledge, otherwise hypothecate or encumber any of its assets or properties (promissory notes, acceptances, accounts receivable, contractual rights, shares, securities, any collateral, etc.) obtained through, or evidencing financing made by the Borrower with funds obtained from A.I.D. hereunder; provided, however, that, at the request of A.I.D. the Borrower shall grant security interest in such assets and properties in favor of A.I.D. necessary to create, perfect and preserve such valid security interest in favor of A.I.D.; provided, further, that this Section shall not apply to the assets or properties of the Borrower initially obtained through, or evidencing, financings made by the Borrower with funds from A.I.D. hereunder if and when such funds have been repaid to A.I.D., to the extent of such repayment; and provided, finally, that should the situation stated in the second proviso of this Section occur after the security interest in the respective asset or property, or any part thereof, has been granted, then at the request of the Borrower, A.I.D. shall do whatever is necessary to cancel such security interest.

(18) consult from time to time with A.I.D. concerning the steps taken by Borrower to seek cofinancing from private banking sources.

h. <u>Waivers</u>

The following waivers are hereby approved:

(1) The Borrower or its subsidiaries may contract for technical assistance, training and other services with

the World Trade Institute on a predominant capability basis.

(2) The Borrower, its subsidiaries and its subborrowers may use A.I.D. loan funds for dollar purchases of the agricultural commodities of United States origin described in Section 4C 1a(1)(a) of Handbook 1, Supplement B, without prior A.I.D. approval.

(3) No special procurement policies will be required on local currency subloans of $25,000 or less.

____
Assistant Administrator
Bureau for Latin America
and Caribbean

______________ 1981

Clearances: ____________
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RLA:J.R.Clyne 7/30/81

5C(1) COUNTRY CHECKLIST

Listed below are, first, statutory criteria applicable generally to FAA funds, and then criteria applicable to individual fund sources: Development Assistance and Economic Support Fund.

A. GENERAL CRITERIA FOR COUNTRY ELIGIBILITY

1. FAA Sec. 116. Has the Department of State determined that this government has engaged in a consistent pattern of gross violations of internationally recognized human rights? If so, can it be demonstrated that contemplated assistance will directly benefit the needy?

   The Department of State has not so determined

2. FAA SEC. 113. Has particular attention been given those programs, projects, and activities which tend to integrate women into the national economies of developing countries, thus improving their status and assisting the total development effort?

   Subprojects are expected to create a significant number of new jobs for women.

3. FAA Sec. 481. Has it been determined that the government of the recipient country has failed to take adequate steps to prevent narcotics drugs and other controlled substances (as defined by the Comprehensive Drug Abuse Prevention and Control Act of 1970) produced or processed, in whole or in part, in such country, or transported through such country, from being sold illegally within the jurisdiction of such country to U.S. Government personnel or their dependents, or from entering the U.S. unlawfully?

   No.

4. FAA Sec. 620(b). If assistance is to a government, has the Secretary of State determined that it is not dominated or controlled by the international Communist movement?

   Yes.

A. EX 3

5. FAA Sec. 620(c). If assistance is to the government liable as debtor or unconditional guarantor on any debt to a U.S. citizen for goods or services furnished or ordered where (a) such citizen has exhausted available legal remedies and (b) the debt is not denied or contested by such government? — No.

6. FAA Sec. 620(e)(1). If assistance is to a government, has it (including government agencies or subdivisions) taken any action which has the effect of nationalizing, expropriating, or otherwise seizing ownerhsip or control of property of U.S. citizens or entities beneficially owned by them without taking steps to discharge its obligations toward such citizens or entities? — No.

7. FAA Sec. 620(f), 620D; Continuing Resolution Sec. 511, 512 and 513; ISDCA of 1980 Secs. 717 and 721. Is recipient country a Communist country? Will assistance be provided to Angola, Cambodia, Laos or Vietman? (Food and humanitarian assistance distributed directly to the people of Cambodia are excepted). Will assistance be provided to Afganistan or Mozambique without a waiver? Are funds for El Salvador to be used for planning for compensation, or for the purpose of compensation, for the confiscation nationalization, acquisition or expropriation of any agricultural or banking enterprise, or property or stock thereof? — No.

8. FAA Sec. 620(i). Is recipient country in any way involved in (a) subversion of, or military aggression against, the United States or any country receiving U.S. assistance, or (b) the planning of such subversion or aggression? — No.

9. FAA Sec. 620(j). Has the country permitted, or failed to take adequate — No.

A. EX 3

measures to prevent, the damage or destruction, by mob action, of U.S. property?

10. FAA Sec. 620(k). Does the program furnish assistance in excess of $100,000,000 for the construction of a productive enterprise, except for productive enterprises in Egypt that were described in the Congressional Presentation materials for FY 1977, FY 1980 or FY 1981?

No.

11. FAA Sec. 620(l). If the country has failed to institute the investment guaranty program for the specific risksof expropriation, inconvertibility or confiscation, has the AID Administrator within the past year considered denying assistance to such government for this reason?

The Administrator has not considered such an action.

12. FAA Sec. 620(m). Is the country an economically developed nation capable of sustaining its own defense burden and economic growth and, if so, does it meet any of the exceptions to FAA Section 620(m)?

No.

13. FAA Sec. 620(o); Fishermen's Protective Act of 1967, as amended, Sec. 5. If country has seized, or imposed any penalty or sanction agains, any U.S. fishing activities in international waters,

a. has any deduction required by the Fishermen's Protective Act been made?

No.

b. has complete denial of assistance been considered by AID Administrator?

No.

14. FAA Sec. 620(q); Continuing Resolution Sec. 518. (a) Is the government of the recipient country in default for more than six months on interest or principal of any AID loan to the

No.

country? (b) Is the country in default exceeding one year on interest or principal on any U.S. loan under a program for which the Continuing Resolution appropriates funds?

No.

15. FAA Sec. 620(s). If contemplated assistance is development loan or from Economic Support Fund, has the Administrator taken into account the percentage of the country's budget which is for military expenditures, the amount of foreign exchange spent on military equipment and the amount spent for the purchase of sophisticated weapons systems? (An affirmative answer may refer to the record of the annual "Taking into Consideration" memo: "Yes, taken into account by the Administrator at time of approval of Agency OYB." This approval by the Administrator of the Operational Year Budget can be the basis for an affirmative answer during the fiscal year unless significant changes in circumstance occur).

Yes, taken into account by the Administrator at the time of approval of Agency OYB.

16. FAA Sec. 620(t). Has the country severed diplomatic relations with the United States? If so, have they been resumed and have new bilateral assistance agreements been negotiated and entered into since such resumption?

Costa Rica has not severed relations with the U.S.

17. FAA Sec. 620(u). What is the payment status of the country's U.N. obligations? If the country is in arrears, were such arrearages taken into account by the AID Administrator in determining the current AID Operational Year Budget?

Costa Rica is meeting its U.N. obligations.

18. FAA Sec. 620A; Continuing Resolution Sec. 521. Has the country aided or abetted, by granting sanctuary from prosecution to, any individual or group which has committed an act of international terrorism? Has the country aided or abetted, by granting

No.

sanctuary from prosecution to, any individual or group which has committed a war crime?

19. FAA Sec. 666. Does the country object, on basis of race, religion, national origin or sex, to the presence of any officer or employee of the U.S. who is present in such country to carry out economic development programs under the FAA? — No.

20. FAA Sec. 669, 670. Has the country, after August 3, 1977, delivered or recieved nuclear enrichment or reprocessing equipment, materials, or technology, without specified arrangements or safeguards? Has it detonated a nuclear device after August 3, 1977, although not a "nuclear-weapon State" under the nonproliferation treaty? — No.

B. FUNDING SOURCE CRITERIA FOR COUNTRY ELIGIBILITY

1. Development Assistance Country Criteria

a. FAA Sec. 102(b)(4). Have criteria been established and taken into account to assess commitment progress of the country in effectively involving the poor in development, on such indexes as: (1) increase in agricultural productivity through small-farm labor intensive agriculture, (2) reduced infant mortality, (3) control of population growth, (4) equality of income distribution, (5) reduction of unemployment and (6) increased literacy. — Yes.

b. FAA Sec. 104(d)(1). If appropriate, is this development (including Sahel) activity designed to build motivation for smaller families through modification of economic and — Not specifically although greater employment of women may have such an effect.

social conditions supportive of the desire for large families in programs such as education in and out of school, nutrition, disease control, maternal and child health services, agricultural production, rural development, assistance to urban poor and through community-based development programs which give recognition to people motivated to limit the size of their families?

1. <u>Economic Support Fund Country Criteria.</u>

   a. <u>FAA Sec. 502B:</u> Has the country (a) engaged in a consistent pattern of gross violations of internationally recognized human rights or (b) made such significant improvements in its human rights record that furnishing such assistance is in the national interest? **N/A**

   b. <u>FAA Sec. 532(f).</u> Will ESF assistance be provided to Syria? **N/A**

   c. <u>FAA Sec. 609.</u> If commodities are to be granted so that sale proceeds will accrue to the recipient country, have Special Account (counterpart) arrangements been made? **N/A**

   d. <u>FAA Sec. 620B.</u> Will ESF be furnished to Argentina? **N/A**

5C(2) - PROJECT CHECKLIST

Listed below are statutory criteria applicable generally to projects with FAA funds and project criteria applicable to individual funding sources: Development Assistance (with a subcategory for criteria applicable only to loans); and Economic Support Fund.

CROSS REFERENCES: IS COUNTRY CHECKLIST UP TO DATE? HAS STANDARD ITEM CHECKLIST BEEN REVIEWED FOR THIS PROJECT?

A. GENERAL CRITERIA FOR PROJECT

1. Continuing Resolution Unnumbered; FAA Sec. 634A; Sec. 653(b).

   (a) Describe how authorizing and appropriations Committees of Senate and House have been or will be notified concerning the project; (b) is assistance within (Operational Year Budget) country or international organization allocation reported to Congress (or not more than $1 million over that figure)?

   The Committees on appropriations of the Senate and the House were notified of this project through the Congressional Presentation, and a Congressional Notification advising them of IAD's intention to increase the size of the loan and eliminate a grant component.

2. FAA Sec. 611(a)(1). Prior to obligation in excess of $100,000, will there be (a) engineering, financial other plans necessary to carry out the assistance and (b) a reasonably firm estimate of the cost to the U.S. of the assistance?

   Yes.

3. FAA Sec. 611(a)(2). If further legislative action if required within recipient country, what is basis for reasonable expectation that such action will be completed in time to permit orderly accomplishment of purpose of the assistance?

   Legislative approval is required if the loan is to receive a Government Guarantee. While difficulties with the ratificatior process have interfered with an AID loan, recent loans have been quickly ratified. No difficulty is anticipated with this loan.

4. FAA Sec. 611(b); Continuing Resolution Sec. 501. If for water or water-related land resource construction, has project met the standards and criteria

   N/A

A 6x3

as set forth in the Principles and Standards for Planning Water and Related Land Resources, dated October 25, 1973?

5.	FAA Sec. 611(e). If project is capital assistance (e.g., construction), and all U.S. assistance for it will exceed $1 million, has Mission Director certified and Regional Assistant Administrator taken into consideration the country's capability effectively to maintain and utilize the project?	**Yes.**
6.	FAA Sec. 209. Is project susceptible of execution as part of regional or multilateral project? If so why is project not so executed? Information and conclusion whether assistance will encourage regional development programs.	**No.**
7.	FAA Sec. 601(a). Information and conclusions whether project will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; and (c) encourage development and use of cooperatives, and credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture and commerce; and (f) strengthen free labor unions.	**The project is specifically designed to encourage a, b and c. Items c, d and f are likely to be indirectly encouraged.**
8.	FAA Sec. 601(b). Information and conclusion on how project will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).	**The project contemplates an AID cofinancing relationship with a U.S. private lender. The required technical assistance and training is scheduled to be secured through U.S. private sources.**
9.	FAA Sec. 612(b), 636(h); Continuing Resolution Sc. 508. Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet	**A subsequent condition precedent will encourage the investment of additional local capital; the U.S. owns no local currencies in Costa Rica.**

the cost of contractual and other services, and foreign currencies owned by the U.S. are utilized in lieu of dollars.

10. FAA Sec. 612(d). Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release? — N/A

11. FAA Sec. 601(e). Will the project utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise? — Yes.

12. Continuing Resolution Sec. 522. If assistance is for the production of any commodity for export, is the commodity likely to be in surplus on world markets at the time the resulting productive capacity becomes operative, and is such assistance likely to cause substantial injury to U.S. producers of the same, similar or competing commodity? — N/A

B. FUNDING CRITERIA FOR PROJECT

1. Development Assistance Project Criteria

a. FAA Sec. 102(b), 111, 113, 281(a). Extent to which activity will (a) effectively involve the poor in development, by extending access to economy at local level, increasing labor-intensive production and the use of appropriate technology, spreading investment out from cities to small towns and rural areas, and insuring wide participation of the poor in the benefits of development on a sustained basis, using the appropriate U.S. institutions; (b) help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help

Analysis predict that the project will:

- **Substantially generate new and preserve existing employment, including areas of employment having large female work forces;**
- **increase labor intensive production; and**
- **improve the quality of life of rural as well as urban dwellers.**

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themselves toward better life, and otherwise encourage democratic private and local governmental institutions; (c) support the self-help efforts of developing countries; (d) promote the participation of women in the national economies of developing countries and the improvement of women's status; and (e) utilize and encourage regional cooperation by developing countries?

b. FAA Sec. 103, 103A, 104, 105, 106, 107: Is assistance being made available: (include only applicable paragraph which corresponds to source of funds used. If more than one fund source is used for project, include relevant paragraph for each fund source.)

(1) (103) for agriculture, rural development or nutrition; if so (a) extent to which activity is specifically designed to increase productivity and income of rural poor; 103A if for agricultural research, full account shall be taken of the needs of small farmers, and extensive use of field testing to adapt basic research to local conditions shall be made; (b) extent to which assistance is used in coordination with programs carried out under Sec. 104 to help improve nutrition of the people of developing countries through encouragement of increased production of crops with greater nutritional value, improvement of planning, research, and education with respect to nutrition, — N/A

particularly with reference to improvement and expanded use of indigenously produced foodstuffs; and the undertaking of pilot or demonstration of programs explicitly addressing the problem of malnutrition of poor and vulnerable people; and (c) extent to which activity increases national food security by improving food policies and management and by strengthening national food reserves, with particular concern for the needs of the poor, through measures encouraging domestic production, building national food reserves, expanding available storage facilities, reducing post harvest food losses, and improving food distribution.

(2) (104) for population planning under sec. 104(b) or health under sec. 104(c); if so, (i) extent to which activity emphasizes low-cost, integrated delivery systems, for health, nutrition and family planning for the poorest people, with particular attention to the needs of mothers and young children, using paramedical and auxiliary medical personnel, clinics and health posts, commercial distribution systems and ther modes of community research. — N/A

(4) (105) for education, public administration, or human resources development; if so, extent to which activity strengthens nonformal education, makes formal — N/A

education more relevant, especially for rural families and urban poor, or strengthens management capability of institutions enabling the poor to participate in development; and (ii) extent to which assistance provides advanced education and training of people in developing countries in such disciplines as are required for planning and implementation of public and private development activities.

(5) (106; ISDCA of 1980, Sec. 304). for energy, private voluntary organizations, and selected development activities; if so, extent to which activity is: (i) (a) concerned with data collection and analysis, the training of skilled personnel, research on and development of suitable energy sources, and pilot projects to test new methods of energy production; (b) facilitative of geological and geophysical survey work to locate potential oil, natural gas, and coal reserves and to encourage exploration for potential oil, natural gas, and coal reserves; and (c) a cooperative program in energy production and conservation through research and development and use of small scale, decentralized, renewable energy sources for rural areas;

(ii) technical cooperation and development, especially with U.S. private and voluntary of regional and international development, organizations;

(iii) research into, and evaluation of, economic development process and techniques;

(iv) reconstruction after natural or manmade disaster;

(v) for special development problems, and to enable proper utilization of earlier U.S. infrastructure, etc., assistance;	**The project will address a critical credit shortage and facilitate nontraditional export growth.**
(vi) for programs of urban development, especially small labor-intensive enterprises, marketing systems, and financial or other institutions to help urban poor participate in economic and social development.	**The project will extend credit, management and marketing assistance to Costa Rican producers.**
c. (107) is appropriate effort placed on use of appropriate technology? (relatively smaller, cost-saving, labor using technologies that are generally most appropriate for the small farms, small businesses, and small incomes of the poor.)	**N/A**
d. <u>FAA Sec. 110(a).</u> Will the recipient country provide at least 25% of the costs of the program, project, or activity with respect to which the assistance is to be furnished (or has the latter cost-sharing requirement been waived for a "relatively least developed" country)?	**N/A**
e. <u>FAA Sec. 110(b).</u> Will grant capital assistance be disbursed for project over more than 3	**N/A**

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years? If so, has justification satisfactory to Congress been made, and efforts for other financing, or is the recipient country "relatively least developed"?

f. FAA Sec. 281(b). Describe extent to which program recognizes the particular needs, desires, and capacities of the people of the country; utilizes the country's intellectual resources to encourage institutional development; and support civil education and training in skills required for effective participation in governmental processes essential to self-government.

The program supports a Costa Rican initiative.

g. FAA Sec. 122(b): Does the activity give reasonable promise of contributing to the development of economic resources, or to the increase of productive capacities and self-sustaining economic growth?

Yes.

2. Development Assistance Project Criteria (Loans Only)

a. FAA Sec. 122(b): Information and conclusion on capacity of the country to repay the loan, at a reasonable rate of interest.

The country is undergoing severe economic problems. Nevertheless it appears quite capable of repaying the Loan; no previous AID loan made to Costa Rica has been in arrears for longer than two months.

b. FAA Sec. 620(d): If assistance is for any produ[illegible] enterprise which will c[illegible] with U.S. enterprises, is there an agreement by the recipient country to prevent export to the U.S. of more than 20% of the enterprise's annual production during the life of the loan?

N/A

A · Ex. 3

3. <u>Project Criteria Solely for Economic Support Fund</u>

a. <u>FAA Sec. 531(a).</u> Will this assistance promote economic or political stability? To the extent possible, does it reflect the policy directions of FAA Section 102? **N/A**

b. <u>FAA Sec. 531(c).</u> Will assistance under this chapter be used for military, or paramilitary activities? **N/A**

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A. [illegible] 3

5C(3) -- STANDARD ITEM CHECKLIST

Listed below are the statutory items which normally be covered routinely in those provisions of an assistance agreement dealing with its implementation, or covered in the agreement by imposing limits on certain uses of funds.

These items are arranged under the general headings of (A) Procurement, (B) Construction, and (C) Other Restrictions.

A. Procurement

1.	FAA Sec. 602. Are there arrangements to permit U.S. small business to participate equitably in the furnishing of commodities and services finance?	Yes.
2.	FAA Sec. 604(a). Will all procurement be from the U.S. except as otherwise determined by the President or under delegation from him?	Yes.
3.	FAA Sec. 604(d). If the cooperating country discriminates against U.S. marine risk with a company or companies authorized to do a marine insurance business in the U.S.?	The country does not so discriminate
4.	FAA Sec. 604(e); ISDCA of 1980 Sec. 705(a). If offshore procurement of agricultural commodity or product is to be financed, is there provision against such procurement when the domestic price of such commodity is less than parity? (Exception where commodity financed could not reasonably procured in U.S.)	No such procurement is anticipated.
5.	FAA Sec. 603. Is the shipping excluded from compliance with requirement in section 901(b) of the Merchant Marine Act of 1936, as amended, that at least 50 per centum of the gross tonnage of commodities (computed separately for bulk carriers, dry cargo liners, and tankers) financed shall be transported on privately owned U.S.-flag commercial vessels to the extent that such vessels	No.

are available at fair and reasonable rates?

7. FAA Sec. 621: If technical assistance is financed, to the fullest extent practicable will such assistance, goods and professional and other services be furnished from private enterprise on a contract basis? If the facilities of other Federal agencies will be utilized, are they particularly suitable, not competitive with private enterprise, and made available without undue interference with domestic programs? — **Yes.**

8. International Air Transport: Fair Competitive Practices Act, 1974. If air transportation of persons or property is financed on grant basis, will provision be made that U.S. carriers will be utilized to the extent such service is available? — **N/A**

9. Continuing Resolution Sec. 505: If the U.S. Government is a party to a contract for procurement, does the contract contain a provision authorizing termination of such contract for the convenience of the United States? — **N/A**

B. Construction

1. FAA Sec. 601(d): If capital (e.g., construction) project, are engineering and professional services of U.S. firms and their affiliates to be used to the maximum extent consistent with the national interests? — **N/A**

2. FAA Sec. 611(c): If contracts for construction are to be financed, will they be let on a competitive basis to maximum extent practicable? — **Yes.**

3. FAA Sec. 620(k): If for construction of productive enterprise, will aggregate value of assistance to be — **It will not.**

furnished by the U.S. not exceed $100 million?

C. Other Restrictions

1.	FAA Sec. 122(b): If development loan, is interest rate at least 2% per annum during grace period and at least 3% per annum thereafter?	Yes.
2.	FAA Sec. 301(d): If fund is establish solely by U.S. contributions and administered by an international organization, does Comptroller General have audit rights?	N/A
3.	FAA Sec. 620(h). Do arrangements exist to insure that United States foreign aid is not used in a manner which, contrary to the best interests of the United States, promotes for assists the foreign aid projects or activities of the Communist-bloc countries?	Yes.
4.	Continuing Resolution Sec. 514: If participants will be trained in the United States with funds obligated in FY 1981, has it been determined either (a) that such participants will be selected otherwise than by their home governments, or (b) that at least 20% of the FY 1981 fiscal year's funds appropriated for participant training will be for participants selected otherwise than by their home governments?	No participant will be selected by the host government.
5.	Will arrangements preclude use of financing:	
	a. FAA Sec. 104(f): To pay for performance of abortions as a method of family planning or to, motivate or coerce persons to practice abortions; to pay for performance of involuntary sterilization as a method of family planning, or to coerce or provide financial incentive to any person to undergo sterilization?	Yes.

b. FAA Sec. 620(q). To compensate owners for expropriated nationalized property? — Yes

c. FAA Sec. 660. To provide training or advice or provide any financial support for police, prisons, or other law enforcement forces, except for narcotics programs? — Yes

d. FAA Sec. 662. For CIA activities? — Yes

e. FAA Sec. 636(i). For purchase, sale, long-term lease, exchange or guaranty of the sale of motor vehicles manufactured outside U.S., unless a waiver is obtained. — Yes

f. Continuing Resolution Sec. 504. To pay pensions, annuities retirement pay, or adjusted service compensation for military personnel? — Yes

g. Continuing Resolution Sec. 506. To pay U.N. assessments, arrearages or dues. — Yes

h. Continuing Resolution Sec. 507. To carry out provisions of FAA section 209(d) (Transfer of FAA funds to multilateral organizations for lending.) — Yes

i. Continuing Resolution Sec. 509. To finance the export of nuclear equipment fuel, or technology or to train foreign nationals in nuclear fields? — Yes

j. Continuing Resolution Sec. 510. Will assistance be provided for the purpose of aiding the efforts of the government of such country to repress the legitimate rights of the population of such country contrary to the Universal Declaration of Human Rights? — N/A

k. Continuing Resolution Sec. 516. To be used for publicity or propaganda purposes within U.S. not authorized by Congress? Yes

B. Exh. 1

ANNEX B, EXHIBIT 1

PROJECT DESIGN SUMMARY
LOGICAL FRAMEWORK

(INSTRUCTION: THIS IS AN OPTIONAL FORM WHICH CAN BE USED AS AN AID TO ORGANIZING DATA FOR THE PAR REPORT. IT NEED NOT BE RETAINED OR SUBMITTED.)

Life of Project:
From FY 81 to FY 84
Total U.S. Funding $10,000,000
Date Prepared:

Project Title & Number: PRIVATE SECTOR PRODUCTIVITY, 515-0176

PAGE

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
Program or Sector Goal: The broader objective to which this project contributes: A-1	Measures of Goal Achievement: A-2	A-3	Assumptions for achieving goal targets: A-4
GOAL To reestablish dynamic growth in the Costa Rican economy	a 6.0% p.a. growth rate in GDP during the 1985-1990 period	Central Bank	1. Other economic factors will compliment efforts to expand nontraditional exports. 2. Costa Rican political stability continues.
SUB-GOAL To expand the production and export of nontraditional products to world markets	increase non-traditional exports to non-CACM countries to 1/2 of all Costa Rican exports.	Central Bank	1. GOCR policy will continue to give adequate incentive to exporters. 2. Levels of CACM protection for imports substituting manufacturers will decrease.

PROJECT DESIGN SUMMARY
LOGICAL FRAMEWORK

Life of Project
From FY 81 to FY 84
Total U.S. Funding $10,000,000
Date Prepared

Project Title & Number PRIVATE SECTOR PRODUCTIVITY, 515-0176

PAGE 2

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
Project Purpose: (B-1)	Conditions that will indicate purpose has been achieved: End-of-Project status. (B-2)	(B-3)	Assumptions for achieving purpose: (B-4)
To establish an integrated program of credit, export management assistance, and export oriented banking services for the producers, manufacturers and merchants of nontraditional exports to world markets	1. A system of credit which makes loans at market interest rates, with terms and conditions specifically tailored to the needs of eligible producers, manufacturers and merchants of exportable nontraditional products	Project Reports and Evaluation	
	2. A privately operated mechanism ("Trading Company") through which the private sector can manage the processes associated with exporting	Project Reports and Evaluation. Satisfaction of related conditions precedent	
	3. Efficiently provided basic export oriented banking services	Project Reports and Evaluation	
	4. A viable, private banking institution which offers an additional private sector alternative for resolution of Costa Rica's banking problems	Assessment against financial projections	4. Foreign banks willing to establish lines of credit with BANEX

PROJECT DESIGN SUMMARY
LOGICAL FRAMEWORK

Project Title & Number: PRIVATE SECTOR PRODUCTIVITY, 515-0176

Life of Project:
From FY 81 to FY 84
Total U.S. Funding $10,000,000
Date Prepared

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
Project Outputs (C-1)	Magnitude of Outputs: (C-2)	(C-3)	Assumptions for achieving outputs: (C-4)
	Yr 1 / Yr 2 / Yr 3		
1. Outstanding loan portfolio at end of year ($000)	2,000 / 6,000 / 10,000	Disbursement Records and Project Reports.	
2. Financing of Trading company development, [illegible] start-up and operation [illegible]	o 100% of net AID portfolio earnings during years one, two and three; and at least 50% during years four through fifteen o BANEX additional investment as necessary to maintain a liquid TRACO capital base of at least $350,000.	Disbursement Records and Audit.	2. Satisfactory technical assistance will be available on a timely basis.

B. 3 4

PROJECT DESIGN SUMMARY
LOGICAL FRAMEWORK

Life of Project:
From FY 81 to FY 84
Total U.S. Funding $10,000,000
Date Prepared:

Project Title & Number: PRIVATE SECTOR PRODUCTIVITY, 515-0176

PAGE 4

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
Project Inputs: (D-1)	Implementation Target (Type and Quantity) (D-2)	(D-3)	Assumptions for providing inputs: (D-4)
BANEX a. Lending capital	$1 million in year one, $1 million in year two (Total: $2 million)	1. Annual Audit, project reports	
AID Loan	$10.0 million	2. Disbursement records	
(Possible private bank co-financing)	($10.0 million)	(Project reports, Audit)	Co-financing available on acceptable terms.

B. E. 2. 1

AMERICAN EMBASSY SAN JOSE

TELEGRAM

ACTION: AID
INFO:
AMB
DCM
CHRON-11

ANNEX B
EXHIBIT 2

UNCLASSIFIED

CAPITAL DEVELOPMENT
USAID/COSTA RICA
JUN 2 2 50 PH '81

Route to	Act	Info
MD		✓
AD		✓
LO	X	
URD		
PO		
TO		
HRO		
CONT		
RDO		
ADM		
GSO		
PER		
MR		✓
CPU		
ROCAP		
Action taken/date		

P 020154Z JUN 81
FM SECSTATE WASHDC
TO AMEMBASSY SAN JOSE PRIORITY 5345
BT
UNCLAS STATE 142335

AIDAC

E.O. 12065: N/A

TAGS:

SUBJECT: DAEC REVIEW OF PRIVATE SECTOR PRODUCTIVITY

1. SUMMARY. SUBJECT PID WAS REVIEWED AND APPROVED ON MAY 13, 1981. THE PRINCIPAL ISSUES DISCUSSED WERE: (A) PROJECT STRATEGY, (B) RELATIONSHIP BETWEEN BANEX AND THE TRADING COMPANY, (C) CO-FINANCING, (D) THE DEBT EQUITY RATIO, AND (E) PROJECT FUNDING. THE FOLLOWING COMMENTS AND GUIDANCE ARE PROVIDED TO ASSIST MISSION IN FINAL PROJECT DEVELOPMENT AND PREPARATION OF THE PROJECT PAPER (PP).

2. STRATEGY. GIVEN THAT COSTA RICA IS EMBARKING ON A SERIES OF NEW ECONOMIC POLICIES, THAT THESE PROPOSED POLICY CHANGES WILL MOST LIKELY BE EXTREMELY SLOW TO TRANSLATE INTO DESIRABLE ACTION, AND THE FACT THAT THE EXPORT-ORIENTED STRATEGY PROPOSED IN THE PID IS ALSO A NEW DIRECTION FOR COSTA RICA, THE PP SHOULD INCLUDE A COMPREHENSIVE DISCUSSION AS TO HOW THE STRATEGY WILL FIT INTO THE NEW POLICY ENVIRONMENT. IN ADDITION, THE LEVEL OF SUPPORT OR COMMITMENT BY THE GOCR TO SUCH A STRATEGY SHOULD ALSO BE COVERED. SPECIFICALLY, QUESTIONS CONCERNING GOVERNMENT'S ABILITY AND WILLINGNESS TO ALTER THE IMPORT-SUBSTITUTION BIAS OF THE ECONOMY AND TO PROVIDE ADEQUATE INCENTIVES FOR EXPORTING SHOULD BE ADDRESSED.

3. CO-FINANCING. ALTHOUGH THE PID STATED THAT CO-FINANCING WAS NOT ESSENTIAL TO THE PROPOSED PROJECT, BUREAU VIEWS THE CO-FINANCING ELEMENT AS HIGHLY DESIRABLE.

4. DEBT-EQUITY RATIO. SEVERAL QUESTIONS WERE RAISED CONCERNING THE PROJECTED DEBT-EQUITY RATIOS OF BANEX. IT IS NOT CLEAR WHAT THE JUSTIFICATION IS OR WHY THE AID LOAN WILL NOT BE INCLUDED AS DEBT IN BANEX'S FOREIGN-BANK-DEBT TO-EQUITY RATIO. SUGGEST THAT MISSION CALCULATE DEBT-EQUITY RATIO WITH AND WITHOUT THE AID LOAN AMOUNT AS DEBT. IN ADDITION, RECOMMEND THAT MISSION REVIEW OTHER FINANCIERAS' DEBT-EQUITY RATIOS.

UNCLASSIFIED

5. GUARANTEE. GIVEN THE CORRELATION IN THE PAST OF NON-GUARANTEED LOANS AND DEFAULT ON LOANS, BUREAU VIEWS GOVT. GUARANTEE FOR PROPOSED LOAN AS ESSENTIAL. SUGGEST BANEX PRINCIPALS PURSUE GUARANTEE WITH CENTRAL BANK.

6. LEGAL CONSIDERATIONS. THE FOLLOWING LEGAL CONSIDERATIONS SHOULD BE ADDRESSED IN THE PP: (A) THE LEGAL AND FINANCIAL RELATIONSHIP BETWEEN BANEX AND THE TRADING COMPANY; AND (B) THE LOAN AGREEMENT SHOULD INCLUDE A NON-SUBORDINATION CLAUSE IN ORDER TO INDICATE AID'S PRIORITY VIS-A-VIS OTHER CREDITORS. ANY COSTA RICAN LAWS PERTAINING TO THIS ISSUE SHOULD BE DISCUSSED IN THE PP.

7. PROJECT FUNDING. IT WAS DECIDED THAT THE PROJECT WILL NOT REQUIRE A GRANT COMPONENT; HOWEVER, TO GENERATE MORE FUNDS FOR THE TRADING COMPANY EARLY IN THE PROJECT, MISSION MIGHT CONSIDER REDUCING INTEREST RATE FROM 5 PERCENT TO 2 PERCENT DURING EARLY YEARS.

8. SUB-LENDING CRITERIA. THE PP SHOULD DESCRIBE PROPOSED SUB-LENDING CRITERIA.

9. TDY ASSISTANCE. INQUIRY WAS MADE TO LAC CONTROLLER CONCERNING POSSIBILITY OF INCREASING MISSION TRAVEL BUDGET. INCREASE IS UNLIKELY; THEREFORE, RECOMMEND MISSION REVIEW AND PRIORITIZE FUTURE TRAVEL COMMITMENTS AND ADVISE AID/W ACCORDINGLY.

10. BECAUSE OF LACK OF SPECIFIC FOCUS ON RURAL DEVELOPMENT, PROJECT OYB IS BEING SHIFTED ENTIRELY TO THE SDA ACCOUNT, WITH NO CHANGE IN OVERALL DOLS 5 MILLION LEVEL.
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BT
#7385

SUMMARY OF REPORTED CHARACTERISTICS OF SURVEYED FIRMS

No	NONTRADITIONAL PRODUCT	SHORT-TERM CREDIT NEEDED	LONGER-TERM CREDIT NEEDED	POTENTIAL EMPLOYMENT IMPACT	POTENTIAL NET FOREIGN EXCHANGE IMPACT
1	Ornamental Plants				
	1st Project		200,000	25	400,000
	2nd Project		500,000	150	1,000,000
2	Pineapples & Hearts of Palm				
	1st Project		300,000	18	1,000,000
	2nd Project		220,000	40	400,000
3	Frozen Yuca & Tropical Fruits		100,000	245	1,200,000
4	Breakfast Cereals & snacks		500,000	75	450,000
5	Corn & Potatoes snacks	200,000		52	918,000
6	Cacao Products	500,000			800,000
7	Baby Garments	100,000			220,000
8	Men's knit shirts				
	1st Project	500,000			650,000
	2nd Project		500,000	125	864,000
9	Women's Undergarments	200,000		40	420,000
10	Wood Furniture	300,000		24	1,200,000
11	Educational toys	40,000		7	90,000
12	Wood Doors	400,000	100,000	75	1,600,000
13	Sail Boats	350,000	150,000	45	720,000
14	Leather Furniture	400,000		25	1,020,000
15	Canned Seafood		500,000	125	2,000,000
16	Women's shoe bottoms	240,000		40	1,350,000
17	Polyethelene and Cellophane Bags & Sheets	250,000	500,000	20	850,000
18	Miscellaneous Plastic Products	500,000		17	900,000
19	Miscellaneous Footware	450,000		27	864,000
20	Rubber Sandals and shoes	400,000		120	720,000
21	Polyethelene Bags and sheets		325,000	60	500,000
22	Miscellaneous Plastic Products	450,000		38	675,000
23	Eye glass Lenses	150,000		11	205,000
24	Stoves and Refrigerators	500,000		35	720,000
25	Carbon pages & Typewriters Ribbons	250,000		30	450,000
26	Writing Pads	375,000		30	520,000
	TOTALS	6,555,000	3,895,000	1,499	22,706,000

PRODUCT: ORNAMENTAL PLANTS

The firm has been in business since 1978. It produces 15 varieties of ornamental plants, all of which are exported to the U.S. The present annual export volume is 3 million "cuttings" that generate $600,000 in sales. The operation involves two different facilities:

- o A farm in San Carlos Province where the soil and climate conditions are ideal for successful growth of plant stocks. The farm employs 150 people (high labor intensity) which represents the entire available labor force of the nearby rural community; and,

- o A greenhouse and packing facility in Alajuela (close proximity to International Airport), where the cuttings (after developing roots) are packed and shipped to the U.S. by air. This facility employs 50 people.

A. Financial Needs: Current plans include two different expansion projects that would increment exports to the U.S. regional (southwest and southeast) markets. The first project requires an investment of $200,000, to expand the Alajuela packing facility. The funds would be used for infrastructure items, such as greenhouse structures and space, packing area and related equipment, and work-bench areas. A four year term loan would be required for the repayment of this investment. If funds are available, this expansion could take place within 6 months.

The second expansion could take place within 18 months. It would require a $500,000 subloan and a repayment period of 7 to 8 years, including a one year grace period. The funds would be as utilized follows:

- o $375,000 to acquire farm land, and to buy and build the necessary infrastructure (e.g. farm equipment, irrigation system, farm structures).

- o $125,000 for permanent working capital, part of which would be used to contract production with other farmers for the growth of specific plant varieties.

B. Development Impact: The first ($200,000) expansion would increase production from 3 to 5 million cuttings which would result in approximately $400,000 in additional export sales (a 66% increase over present levels). It would also result in the employment of 25 additional workers, a 50% increase over the present labor force.

The $500,000 expansion would double the 5 million cuttings production level. This would result in $1 million of additional export sales, and the employment of approximately 150 more farmers.

C. Constraints: Three additional constraints to expansion were reported. The San Carlos farm production cannot be expanded past the 5 million cuttings production levels due insufficient land and a shortage of farm labor within the area. It was also reported that there are no reliable air cargo facilities at the present time. This has an adverse effect on shipping schedules, and carries additional risks due the perishable nature of the products.

D. Additional Comments: There is excellent growth potential for this type of activity. Ideal soils and climatic conditions as well as the country's nearness to the U.S. makes this a viable investment. There are at least four other enterprises that BANEX could assist, including the largest ornamental plants grower in Latin America. If BANEX maximum subloan size cannot provide all the financing that is required, it could perhaps act as an intemediate credit institution for two other AID related regional programs: LAAD's agribusiness expansion programs, and/or CABEI's rural enterprises project.

PRODUCT: WOOD FURNITURE

The firm started operations four years ago. During its initial stage, it was more of an artisan activity than its present "production line" type of manufacturing. The product line includes: beds, sofas, chairs, and dining room tables. The installed production capacity can process $330m^3$ of raw materials every month. Presently, only 80 m^3 are being processed. Ninety percent of the raw materials are processed into furniture that is exported to Puerto Rico and Santo Domingo. Exports are vital to the firm because the domestic market is much too small to support its operation. The firm's current export volume is $60,000 per month. It employs 65 people, 60 of which are production workers (25 females).

A. Financial Needs: A $300,000 line of credit is needed for working capital purposes and to provide 60 to 90 days credit to foreign buyers. The production cycle is 180 days long because wood has to be pre-dried for a period of 3 to 4 months. In addition, wood has to be purchased and inventoried in a large enough quantity so as to assure the supply of raw materials during the three month rainy season.

B. Development Impact: The line of credit would increase monthly exports by $100,000. Since no imported raw materials are required, this increase in exports would result in an annual increase in net foreign exchange earnings of $1.2 million. It would also allow for utilization of 85% of installed plant capacity, and the creation of 24 additional jobs.

C. Constraints: The lack of credit is only constraint that restricts the expansion of exports.

D. Additional Comments

The growth potential of the firm is excellent. The Puerto Rican market is very large and can absorb at least three times the present production capacity. A potential U.S. client could buy 25,000 chairs per month if the firm could produce them. Transportation to Puerto Rico is not a problem, because the Sea Land transportation company offers regular rool-on/roll-of services, and charges preferential rates for furniture items.

PRODUCT: EDUCATIONAL TOYS

The firm was established two and a half years ago, and has been operating under license from Milton Bradley (Mass., U.S.). Its productline includes 15 varieties of wooden educational toys and 10 models of cloth dolls. The Milton Bradley license gives the firm exclusive marketing rights for Central America and the Caribbean Basin. Recently, Colombia has been added to the firm's market area because Milton Bradley can no longer supply that market due a shortage in Southern U.S. of the type of soft wood necessary to make the toys. The market distribution of the products is: 60% of sales to the Costa Rican market, and 40% to the CACM (Guatemala and Honduras). The present annual export dollar volume is $75,000. The plant operates one shift, and only 65% of installed capacity is being utilized. Thirty people are employed, twenty two of these are production workers (7 females). Potential exists for export to Puerto Rico, Aruba, Curazao, Margarita and Colombia.

A. Financial Needs: A $40,000 line of credit is required. Half would be used for working capital and half to renovate production equipment.

B. Development Impact: The line of credit would permit the full utilization of installed plant capacity, and would expand annual exports by $100,000. Since 10% of every exported dollar represents imported raw materials, the annual net foreign exchange earnings would be $90,000. Seven new production jobs would be created if a BANEX line of credit becomes available.

C. Constraints: Lack of credit sources, and lack of assistance to find new markets, which is be needed because of shrinking CACM markets.

D. Additional Comments: The firm is presently a small operation. If it is able to export successfully to Colombia and/or Puerto Rico, these markets are large enough to allow significant export expansions within the near future.

PRODUCT: LEATHER FURNITURE

The firm began operating in 1975 in the workshop area of a vocational training school where many of the present workers received on-the-job training. The following year a plant site was acquired and sales volume reached 17 million colons. By 1980 the sales volume had reached 30 million colons. Eighty percent of sales are exports and, until last year, half of these exports went to the CACM. Exports to Central America have currently been reduced, however, due the political and economic problems that exist within the area. Sales to these latter markets are being replaced by exports to the Mexican, Canadian, and U.S. market. Present (1981) dollar export is $240,000. The firm employs 180 people, 150 of which are production workers (75 females). The present plant capacity utilization is 75%.

A. Financial Needs: A $400,000 line of credit is required to finance working capital needed for export expansion to the Mexican and U.S. markets.

B. Development Impact: The line of credit would contribute to monthly expansion of exports by $100,000 (a 40% increment). Presently, the firm imports part of its leather requirements (35%) because Costa Rican sources can not supply all the demand. Therefore, 15% of every export dollar represents imported raw materials. A BANEX subloan would contribute to the generation of $1,020,000 in net annual foreign exchange. In addition, 25 more production jobs would be created as a result of the full utilization of installed plant capacity.

C. Constraints: Lack of credit sources, and the political and economic problems within the CACM.

D. Additional Comments: The firm has developed an excellent reputation for producing attractive, high quality products. It manufactures recliner chairs (leather and suede) for an American firm that sells them under the brand name of Hush Puppies. The prospects for export growth are excellent.

PRODUCT: CANNED SEAFOOD

The firm was established in 1975 and is located in the Pacific coastal town of Golfito. It owns and operates a fishing boat that has a capacity to catch and refrigerate 25 tons per day. However, the canning plant can process only 5 tons of fish per day. The traditional catch has been sardines and tuna. Most of the canned production is sold to the CACM region. The export volume has been 2000 boxes per month, which represent a dollar value of $50,000. The total employment is 75 people (55 females).

A. Financial Need: A $500,000 six year term loan (including one year grace period) is necessary to expand the canning facility so that 10,000 boxes can be exported every month. The new production would be exported to Santo Domingo and to Venezuela.

B. Development Impact: The new production (8000 boxes) would increment monthly exports by $200,000. Thus, a BANEX subloan would contribute to the generation an additional $2 million of foreign exchange (the plant would operate 10 months every year). In addition, the plant expansion would create 125 new jobs, most of these going to females.

C. Constraints: Limited canning capacity, and lack of credit sources.

D. Additional Comments: The present exchange rates have opened up several nontraditonal markets that could absorb several times the production of the planned expansion. Therefore, the growth prospects within the next few years are very good. It is likely that a second major expansion will take place in three more years.

PRODUCT: WOMEN'S SHOE BOTTOMS

The firm was established 1 1/2 years ago by a Mexican company. It produces over 40 varieties of women's shoe soles and heels. The sales volume is presently 120,000 pair per month. The installed production capacity is 300,000 pair per month. Sixty percent of the sales volume is sold in Costa Rica. The other 40% is sold in the CACM region, the income from which is approximately $150,000 per month. The labor force is composed of 180 people, of these 150 are production workers (39 females).

A. Financial Needs: A $240,000 line of credit is needed to finance working capital and export credit.

B. Development Impact: A BANEX subloan would allow the firm to serve two nontraditional markets by exporting 40,000 pairs/month to Puerto Rico and 10,000 pairs/month to Santo Domingo. This would increase total exports by $1.8 million. The imported raw material content of every dollar is 25%. Therefore, the annual net foreign exchange earnings would be approximately $1.35 million. In addition, 40 new jobs would be created as a result of .ter capacity utilization.

C. Constraints: Lack of credit sources necessary to expand exports to nontraditional markets.

D. Additional Comments: The growth prospects for this firm are excellent. It has no long-term debts, and production and marketing expertise is provided tne Mexican partners. The firm has recently been contacted by an American firm that is interested in purchasing 20,000 pairs of soles per month.

PRODUCT: EYE LENSES

Established in 1977, this is the only enterprise of its kind in the CACM area. It processes finished and semi-finished eye lenses, which require unique machines (diamond cutting) and highly skilled technicians. Fifty percent of its production is sold in Costa Rica, thirty percent to the CACM, and twenty percent to nontraditional markets (U.S., Panama and Venezuela). Presently, it has a capacity to process 750 pairs per day (one shift), but it is only producing 400 pairs. A two shift operation could increase output to 1250 pairs a day. The annual export volume under present conditions is $90,000. Fifteen people are employed by the firm, 11 of which are production technicians.

A. Financial Needs: A $150,000 line of credit is needed for working capital purposes.

B. Development Impact. A BANEX subloan to support exports to nontraditional markets would increase exports by $250,000. Thirty percent of every export dollar represents imported raw materials, therefore the annual net foreign exchange earnings would be $205,000. By working two shifts, 11 new apprentices would be hired.

C. Constraints: This firm has been particularly affected (due its size) by both the lack of credit sources and the economic problems of the CACM area.

D. Additional Comments: The existence of skilled workers that process high quality lenses is important to Costa Rica. In a way, the long-run growth prospects of the firm will depend on the availability of economical transportation to serve small Caribbean markets that are difficult to reach at the present time.

PRODUCT: STOVES AND REFRIGERATORS

The firm was established twenty years ago, shortly after the CACM was created. It is a widely held corporation (over 200 stockholders), and its common stock was the first one to be was traded in the Costa Rican stock market. Its product line includes stoves and refrigerators for household use, and commercial refrigeration units. Sales in 1980 reached 130 million colones. Approximately 50% of its production is exported ($7 million in 1980). Most of the exports go to the CACM, but 15% is marketed in Grand Cayman, Aruba, Curazao, Panamá, Trinidad y Tobago, and Surinam. The firm's labor force is composed of 380 people, 250 of which are production workers (60 females). The present annual productive capacity (45,000 domestic refrigerators, 30,000 stoves and 7,000 commercial refrigeration units) is being utilized at a 70% level.

A. Financial Needs: A $50,000 line of credit for working capital purposes is required to continue exporting to the Caribbean Basin and to open markets in Chile.

B. Development Impact: A BANEX subloan would augment nontraditional exports by $1.2 million. Since 40% of every export dollar represents imported raw materials, the annual net foreign exchange earnings would be $720,000. In addition, 35 new jobs would be created, and at least 50 present jobs would be preserved.

C. Constraints: The political and economic problems of the CACM member countries has seriously affected this firm. Therefore, the need to shift its export orientation to nontraditional markets is a matter of vital importance. Like all other firms that were interviewed, the lack of credit sources was cited as a major constraint.

D. Additional Comments: This firm is operated by some of Costa Rica's more reputable entrepreneurs. The feasibility of economically reaching the Chilean market it is still not yet established.

PRODUCT: WRITING PADS

The firm was established in 1934 and is presently the major Costa Rican producer of writing pads, and the second largest producer of paper bags. Eighty-five percent of its writing pad production is sold in Costa Rica, the other fifteen percent is exported to the CACM. Production capacity is 125,000 boxes per year. Presently, only 50,000 boxes (40% of capacity) are being produced. Recently made marketing contracts confirm that the remaining 75,000 boxes of potential production could be exported to Puerto Rico and Santo Domingo. The firm employs 170 people, 150 of these are production workers (100 female).

A. Financial Needs: A $375,000 line of credit would be used for working capital purpose.

B. Development Impact: A BANEX subloan would allow the firm to generate $950,000 of additional exports. Since 45% of every export dollar represents imported raw materials (paper from U.S.), the net foreign exchange earnings would be $520,000. The subloan would also help to create 30 new jobs.

The demand for writing pads in the CACM is a seasonal (January to March). on The seasonal peak demand in Puerto Rico and Santo Domingo takes place between July and September. Thus, the ability to export to nontraditional markets would stablize production throughout the year.

C. Constraints: Lack of credit.

D. Additional Comments: A BANEX subloan would assist this well known Costa Rican enterprise to begin exporting to nontraditional markets for the first time in 45 years.

ANNEX D, EXHIBIT 1

CURRICULUM VITAE :

- BOARD OF DIRECTORS
- AUDIT COMMITTEE
- GENERAL MANAGER

Name	:	Mario Barrenechea	DIRECTOR
Marital Status	:	Married	
Nationality	:	Costa Rican	
Profession	:	Economist	
Languages	:	Spanish, English, French	

EDUCATION :

Bachellor in Sociology
Universidad de Navarra, Spain

Doctorate in Economic Sociology
Joint program of London School of Economics (London) and Universidad de Navarra (Spain).

Master in Finance
INSEAD (European Institute of Business Administration, France)
Area of Specialty : Financial Analysis and Planning

EXPERIENCE :

1976 : Financial Analyst, Chase Manhattan Bank (Paris Branch)
Southern European Division

1977 - 1979: Assistant to Representative of First National Bank of Boston for Central America

1979 to present : Associate Consultant for von Breymann, Torres y Asociados S.A.

BANKING EXPERIENCE :

- As Financial Analyst : usual duties and functions of a financial analyst
- As Assistant to Representative of First National Bank of Boston :
  a.- Placement and control of the Bank's portfolio in Central America
  b.- Periodic analysis of the Area's economic situation

c.- Follow-up and control of other business relating to the Bank in Central America

- As Financial Assistant to Executive Vice President of Corporación Internacional de Boston S.A. (an F.N.B.B. Subsidiary)

  a.- Planning and control of the activities of the Corporation

  b.- Analysis and control of the Corporation's portfolio

- As Associate Consultant for von Breymann, Torres y Asociados S.A.

  Management of Consulting Projects, specializing in Planning, Control, Finance.

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DIRECTOR
VICE PRESIDENT

Name	:	Richard Beck
Marital Status	:	Married
Nationality	:	Costa Rican
Profession	:	Industrialist
Languages	:	English, Spanish

EDUCATION

Michigan State University. B. A. Honoris in Business Administration.

EXPERIENCE :

20 years	Atlas Eléctrica S.A. : Producer of refrigerators and stoves: President and Founder.
3 years	Productos de Concrecto, S.A.: Director
2 years	Kativo S.A. : Director
7 years	Polypak, S.A. : President and Founder.

OTHER EXPERIENCE :

1969	National Commission for the Reorganization of Public Finances	Member
1970	Presidential Commission for Banking Reform	Member
1973 - 1975	Chamber of Industries of Costa Rica	President, Honorary President
1974 - 1975	President of Chambers Group (an advisory group to the President of Costa Rica)	Coordinator
	Bolsa Nacional de Valores (Costa Rican Stock Exchange)	Director
	Centro de Promoción de Exportaciones	Director
	La Vivienda, Mutual de Ahorro y Préstamo	Director
1976 - 1979	CODESA (Costa Rica's Development Bank)	Director, President

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DIRECTOR
PRESIDENT

Name	:	Alberto Dent
Marital Status	:	Married
Nationality	:	Costa Rican
Profession	:	Industrial Engineer
Languages	:	Spanish, English

EDUCATION :

1969 : California State Polytechnic University
Pomona, California, U.S.A.
Industrial Engineering, B.S.I.E.

1972 : California State Polytechnic University
Pomona, California, U.S.A.
Master in Business Administration M.B.A.
(Specialty : Bank and Finances)
Honor Graduation.

EXPERIENCE :

1972 - 1981 DENT E HIJOS, S.A.
General Manager
(Coffee, Real Estate)

1977 -1981 COMPAÑIA COSTARRICENSE DEL CAFE, S.A. (CAFESA)
President (Supplier of goods and services to farmers)

1978 - 1981 MUNDO ELECTRONICO, S.A.
President

1975 - 1981 CONSULTORA TECNICA ADMINISTRATIVA, S.A.
President

1975 - 1980 CAMARA NACIONAL DE CAFETALEROS
Advisory Committe to Board of Directors
Member

1969 - 1970 PROYECTOS INDUSTRIALES. S.A.
Director of Industrial Engineering

Name	:	Rodolfo Jiménez-Borbón DIRECTOR
Marital Status	:	Married
Nationality	:	Costa Rican
Profession	:	Industrialist
Languages	:	Spanish, English

EDUCATION :

Secondary School	:	Colegio Seminario, Costa Rica and Lawrenceville School, U.S.A.
College	:	Wharton School of Business Administration, U.S.A. and Universidad de Costa Rica

EXPERIENCE :

20 years	Hacienda Juan Viñas S.A. (sugar and coffee)	General Manager
20 years	Hacienda La Isabel, S.A.	General Manager
20 years	Hacienda El Cacao, S.A.	General Manager
20 years	Hacienda Curridabat, S.A.	General Manager
15 years	Florida Ice and Farm Co.,S.A. (Brewery)	Director
2 years	Industria Centroamericana de Vidrio, S.A.	Director
2 years	Vidriera Centroamericana, S.A. Costa Rica	Director
2 years	American Ice Cream Company	Director
10 years	Manager and owner of several real estate companies.	

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Name	:	Walter Kissling	DIRECTOR
Marital Status	:	Married	
Nationality	:	Costa Rican	
Profession	:	Industrialist	
Languages	:	Spanish, English, German	

EDUCATION :

5 years	Colegio Seminario, Costa Rica
Seminars	I.N.C.A.E.
Seminars	Harvard University

EXPERIENCE :

24 years	Kativo Chemical Ind. (Paints, plastics, adhesives inks, carpets, etc. manufacturing and marketing in 11 countries)	President since 1968
	HB Fuller Company (St. Paul, Minn.) (industrial waxes and adhesives)	Senior Vice President
	CORMAR	Founding Director
	Comité Nacional I.N.C.A.E. Costa Rica	President
	I.N.C.A.E. (Nicaragua)	Founding Director
	ENVASA	Director
1964 -present	Costa Rican Chamber of Industries	Director and President (1978-1980) Honorary President.

BANKING EXPERIENCE :

- Founding Director of Banco Centroamericano de Divisas (established in March, 1970), A subsidiary of Citizens and Southern Int'l Bank).

- Founding Director of Valores de Centro América, S.A., (constituted in January, 1968)

- Director, Banco Central de Costa Rica , fr.1969 - 1970.

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Name	:	Carlos Montealegre DIRECTOR .
Marital Status	:	Single
Nationality	:	Costa Rican
Profession	:	Industrialist
Languages	:	Spanish, English, French

EDUCATION :

4 years	Bellarmine College Prep.	Secondary School
4 years	Georgetown University	Business Administration

EXPERIENCE :

12 years	Cafetalera Montealegre S.A. (coffee)	General Manager
5 years	Beneficios Montealegre S.A. (coffee)	General Manager
	Cámara de Cafetaleros	Director
	Compañía Costarricense del Café, Sociedad Anónima	Director
	Compañía Continental Sociedad Anónima (coffee export)	Director
	Servicios y Equipos Mecánicos Sociedad Anónima. (International Harvester in Costa Rica)	Director

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Name	:	José Antonio Orlich	DIRECTOR
Marital Status	:	Married	
Nationality	:	Costa Ricàn	
Profession	:	Industrialist	
Languages	:	Spanish, English	

EDUCATION :

1969 - 1972	University of St. Louis Business Administration

EXPERIENCE :

1974 to date	Cafetalera Pilas and affiliates (coffee)	General Manager
1980 to date	Francofin (a subsidiary of Banque Nationale de Paris)	Member Board of Directors

My duties in Cafetalera Pilas include the administration of credit to producers, an annual sum of approximately ₡ 25 million, to 3.500 clients. Also, negotiations for the obtention of loans, both in Costa Rica and abroad, for approximately US$ 4,000.000.- yearly.

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Name : Fabio Pacheco Sánchez AUDIT COMM.

Marital Status : Married
Nationality : Costa Rican
Profession : Zootechnician
Languages : Spanish, English

EDUCATION :

2 years	East Tennessee State College
1950	Bachelor of Science
2 years	Cornell University, Ithaca : Post Graduate

EXPERIENCE :

1960 - 1970	Sánchez Cortés Hermanos, S.A. (coffee, sugar, real estate)	Vice Manager
1970- current	Sánchez Cortés Hermanos, S.A.	Vice President
1968- current	Compañía Costarricense del Café, S.A.	President and Director
5 years	Beneficio La Ribera S.A.	Director
2 years	Ingenio Taboga, S.A.	Director

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Name : Benjamín Piza DIRECTOR

Marital Status : Married
Nationality : Costa Rican
Profession : Industrialist
Languages : Spanish, English

EDUCATION :

Secondary School : Liceo Costa Rica
Allen Military Academy

Business Administration : Texas A&M College
University of Maryland

BUSINESS EXPERIENCE :

9 years	Pan American World Airways Supervisor, Manager.
10 years	Pan American Standard Brands General Manager Central America & Panamá.
9 years	Compañía Centroamericana de Conservas General Manager.
9 years - current	Seagram's de Costa Rica, S.A. President and General Manager

OTHER :

Member of the board of :

- Cámara de Representantes de Casas Extranjeras
- Cámara de Agricultura
- Instituto Costarricense de Turismo
- Costa Rican Chamber of Industries (current President)

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Name : Mario Rojas AUDIT COMM.

Marital Status	:	Married
Nationality	:	Costa Rican
Profession	:	Agricultural Engineer
Languages	:	Spanish, English

EDUCATION :

1955	Lincoln School, Costa Rica Secondary School
1961	University of Florida, Gainesville Bachelor in Agriculture

EXPERIENCE :

20 years	Hacienda Atirro (coffee and sugar)
	- Manager
1978 - current	Asamblea Legislativa, Gobierno de Costa Rica (Congress)
	- Deputy, Vice-President (current)

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Name	:	Jorge Sánchez	DIRECTOR
Marital Status	:	Married	
Nationality	:	Costa Rican	
Profession	:	Economist	
Languages	:	Spanish	

EDUCATION :

5 years	Universidad de Costa Rica
	- B.S. in Economics
1 year	CEPAL (Comisión Económica para América Latina)
	- Post Graduate

EXPERIENCE :

Public Sector

1 year	Banco Anglo Costarricense Official
9 years	Banco de Costa Rica Official
5 years	Office of the President of Costa Rica -Director, Economic Integration
1970 - 72	Government of Costa Rica -Vice-Minister Economy, Industry and Commerce
1972 - 77	Government of Costa Rica -Minister of Economy, Industry and Commerce
1972 - 77	Centro Promoción Exportaciones -President, Board of Directors
1972 - 77	Banco Central de Costa Rica -Member Board of Director
1972 - 77	CODESA (Corporación Costarricense de Desarrollo) -Member Board of Directors
1972 - 77	COOPESA (Cooperativa de Servicios Aeroindustriales S.R.L.) -Member Board of Directors
1972 - 77	ICAP (Instituto Centroamericano de Administración de Empresas) -President General Assembly
1972 - 77	ICAITI (Instituto Centroamericano de Investigación y Tecnología Industrial) -President Board of Directors
1974 - 77	BCIE (Banco Centroamericano de Integración Económica) -President, Assembly of Governors (75-76)
1974 - 77	Oficina del Café -President Board of Directors

1974 - 77	Liga Agrícola de la Caña -President Board of Directors (72-73)
1973 - 74	Consejo Técnico de Aviación Civil -President Board of Directors.

PRIVATE SECTOR :

3 years	Cámara de Industrias de Costa Rica -Director
7 years	Inversiones Sánchez S.A. -President
3 years	Agroindustrias San Carlos S.A. -President
3 years	Maíz Industrial de Guanacaste S.A. -Vice President
3 years	Tortillas del Norte S.A. -Vice President
3 years	Residencias del Oeste S.A. -President
2 years	Transacciones FINEXPO S.A. -Director

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Name	:	Guillermo von Breymann GENERAL MANAGER
Marital Status	:	Married
Nationality	:	Costa Rican
Profession	:	Industrial Engineer, specialized in Business Administration
Languages	:	Spanish, English, Portuguesse

EDUCATION :

1964 - 1965 Bachelor in Industrial Engineering, Illinois Institute of Technology, Chicago.

1972 - 1973 Master in Business Administration London School of Economics and Political Science London, England. Honorable Mention.

EXPERIENCE :

1968 - 1972 IBM of Costa Rica, S.A. in charge of preparing studies for computer applications for customers.

1973 - 1976 Sub-representative of First National Bank of Boston for Central America with headquarters in San José, Costa Rica. Responsibilities included the Management of Corporación Internacional de Boston S.A., a finance company subsidiary of the Bank in Costa Rica, the attention of the Bank's direct operations in Central America, including Costa Rica, and Director in two other finance companies, subsidiaries of the Bank in other Central American countries.

1976 - 1978 Administrative Manager of Banco Centroamericano de Integración Económica in Tegucigalpa, Honduras.

1979 to date — Founding partner of von Breymann; Torres y Asociados S.A.

BANKING OR TECHNICAL FINANCE EXPERIENCE :

During his years with IBM he was in charge of directing a series of studies and analysis of systems, in more than thirty Costa Rican companies in order to adapt them to electronic data processing methods, including a variety of commercial, industrial, and services companies.

During his years withthe First of Boston he acquired experience in the evaluation of proyects, in analysis and financial planning; in credit and loan portfolio administration, in relations with the Central Bank of Costa Rica; credit instruments and international banking, including the obtention and contracting of financial resources.

In his last position at the Banco Centroamericano de Integración Económica, he directed the activities of the following six departments :
Human Resources, Organization and Methods, Data Processing, Accounting, General Administrative Services and Employee Benefits Fund.

In von Breymann, Torres y Asociados he was the partner responsible for the development of the project of Banco Agro Industrial y de Exportaciones S.A., from its inception to its current status.

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AUDIT COMM.

Name : Samuel Yankelewitz

Marital Status : Married

Nationality : Costa Rican

Profession : Chemical Engineer

Languages : Spanish, English

EDUCATION :

YEARS		
5	Liceo de Costa Rica	Secondary
1963	Universidad Nacional Autónoma de México	Chemical Engineer

EXPERIENCE :

YEARS		
1963 - 1969	Universidad de Costa Rica	Professor of Chemical-Engineering
1973 - 1974	Instituto Jaim Weisman	President Board of Directors
1970 - 1981	Cámara de Industrias de Costa Rica	Director
1973 - 1981	Yanber, S. A. (plastics)	General Manager - founder
1977 - 1981	Poliuretanos, S. A.	President - founder
	Corporación Internacional de Finanzas	Director - founder

CURRICULUM VITAE

Auditor

Name:	Juan Rafael Valverde-Marín
Marital Status:	Married
Nationality	Costa Rican
Profession:	Auditor, Bachelor of the University of Costa Rica.

Experience:

1968-1972	Banco Anglo Costarricense Credit and Collection Officer
1972-1974	Ceciliano y Cía., representatives of Coopers & Lybrand Auditor
1974-1975	Tarjetas de Crédito de Costa Rica (Diner's Club) General Manager
1975-1979	Banco Crédito Agrícola de Cartago Assistant Auditor
1979-1981	Empresas Juan Dada Vasiliades Auditor
1981	Banco Agro Industrial y de Exportaciones S.A. Auditor

CURRICULUM VITAE

Head International Department

Name:	Peter Nigel Pemberton
Marital Status:	Married
Nationality:	British
Profession:	Banker
Languages:	English, Spanish, German

Experience:

1988-1966	District Bank Ltd, Oxford Accounting Dept.
1966-1968	Toronto Dominion Bank, Montreal Accounting and Administrative Officer
1968-1972	Royal Bank of Canada, Bahamas Manager
1972-1973	Toronto Dominion Bank, Vancouver Assistant Manager, Credit Dept.
1973-1974	International Bank, Cayman Islands Assitant President
1975-1976	Latin American Bank, San José Assistant Vice-President
1977-1981	Cartpak Ltd, England Accounting and Computer Officer
1981	Banco Agro Industrial y de Exportaciones S.A. Head International Dept.

CURRICULUM VITAE

Assistant - General Manager

Name:	Oscar Rodríguez U.
Marital Status:	Married
Nationality:	Costa Rican
Profession:	Industrial Engineer, specialized in Business Administration
Languages:	Spanish, English

Education:

1970-1974	Bachelor in Industrial Engineering Georgia Institute of Technology
1974-1976	Master in Business Administration INCAE - Specialization in General Management and Finance.

Experience:

1976-1978	Metalco S.A. - Finance Manager of a metal galvanizing concern selling in the Central American market from Costa Rica.
1978-1981	Machinery and Tractors Ltd. - Administrative Manager of Caterpillar/Mack dealership in Costa Rica. In charge of handling multi-million operations with more than twelve United States first rate financial institutions, including direct participation in negotiations with Government institutions such as Eximbank and OPIC. Responsabilities also included the operation of the Credit department with more than 2,500 customers and a loan portfolio in excess of nine million dollars. Co-founder of an offshore finance company used to channel financial resources to the Dealership's end users.

ANNEX D, EXHIBIT 2 /

B A N E X

BRIEF DESCRIPTION OF STOCKHOLDERS

SUBSCRIBER	NO. OF SHARES ($1,000 each) PAID IN	ADDITIONAL SUBSCRIBED (to be paid on April 30, 1981)	DESCRIPTION
Von Breymann, Torres y Asociados S. A.	1290		Consulting group, specialized in administration and finance. Senior partners: Guillermo von Breymann, Leopoldo Torres, Mario Barrenechea, Rodrigo Zapata
Credomatic Internacional, S. A.	1237		Diversified financial company, main activity credit cards (Master Charge & VISA), operating in Central, parts of South America & the Caribbean. Owned by a variety of Central American investors, with a Wells Fargo Bank participation.
Beneficio El Alamo Ltda.	250	100	One of Costa Rica's largest coffee millers. The group processed in 1979 about 110,000 "fanegas". Owned by the Orlich family. Mr. José Luis Orlich is a member of BANEX's Board of Directors
Cafetalera Pilas, S.A.	100	250	
José Luis Orlich	200		
Compañía Costarricense del Café, S. A.	930		A supplier of fertilizers, agrochemicals, and other farm supplies, along with technical advice, to over 600 stockholders-farmers and others. President: Alberto Dent, a BANEX Director.
Poliplásticos S. A.	200		Manufacturer of plastic bags. Majority owned by Mr. Samuel Yankelewitz and Mr. Isaac Sachtel.
Maxel S. A.	150		
Ancamofi S. A.	100		Investment companies owned by Mr. Yankelewitz and Mr. Isaac Sachtel.
Poliuretanos S. A.	100		Manufacturer of polyutherane shoe components owned by a group of local investors (S. Yankelewitz) and Alfa Group of Mexico.
Corporación Canadiense de Inversiones S. A.	250		Investment companies of the Pedro Befeler family.
Berbetjoan S. A.	100		
Charna Dachner	50		Mrs. Pedro Befeler.
Rolando Befeler	50		Mr. Befeler is President and majority owner of Fábrica Acorazado (textiles/apparel) and Tienda Don John (chain of 18 retail stores)
Beatriz Befeler	50		
Tobías Kader	400		President and majority owner of Industrias Mil Colores and Tienda Mil Colores, a textile company and related retail outlets.
Carlos Kader	100		
Elena Terán Ferrer	500		Mrs. Richard Beck. Mr. Beck, a BANEX Director, is President and majority owner of Atlas Eléctrica, S. A., a producer of refrigerators, stoves and other related equipment. Mr. Beck has served in high public positions and has been President of the Chamber of Industries.

SUBSCRIBER	NO. OF SHARES (₡1,000 each) PAID IN	ADDITIONAL SUBSCRIBED (To be paid on April 30, 1981)	DESCRIPTION
Oscar Ríos A.	500		Private investment. Mr. Ríos is a senior executive of Yanber, a plastic products exporter.
El Arroyo Ltda.		500	Investment company owned by Mr. Alvaro Jenkins (ex-Minister of Transportation). Mr. Jenkins' main line of activity is Azucarera El Viejo, which produced over 12,000 tons of sugar in 1979.
Samuel Guzowski		500	Founder and important investor in Plasticos para la Construcción, a PVC tube factory in joint venture with the Amindus group of Switzerland.
Hacienda Juan Viñas S.A.	200		One of the largest "haciendas" in the country, producing about 32,000 "fanegas" of coffee and 15,000 tons of sugar (1979). Owned by the Jiménez-de-la-Guardia family. The family also has strong interest in the largest newspaper, La Nación; brewery, Florida Ice & Farm); glass factory; ice cream; real estate, etc. Mr. Rodolfo Jiménez is a BANEX Director.
La Nación S. A.	200		
. Beneficiadora Cachí S.A.	150		. Coffee mill owned by Mr. Ramón Aguilar and Fernando F. Terán. Milled about 100,000 "fanegas" in 1980.
. Peter Schoenfeld & Co. SA	100		. Coffee export house, majority owned by Mr. Ramón Aguilar and Mr. Juergen Platte. Costa Rica's largest, exporting over 400,000 "quintals" in 1980.
. Beneficio San Andrés SA	50		. A coffee farm of the Ramón Aguilar family.
. Cía. Mercantil e Industrial Alvarado y Jurado Ltda.	100		. Investment company of Fernando F. Terán.
Flora de Carrizal S.A.	150		Farm holding companies owned by Roberto Hernández and family, coffee growers.
Roberto Hernández e Hijos Ltda.	150		
María Eugenia Hernández	21		
Roberto Hernández	20		
San Roberto Ltda.	8		
María Ester Hernández	1	25	

SUBSCRIBER	NO. OF SHARES (₡1,000 each) PAID IN	ADDITIONAL SUBSCRIBED (to be paid on April 30, 1981)	DESCRIPTION
Compañía Textil Centroamericana S. A.	175		A vertically integrated textile and apparel manufacturer.
Israel Nowalski	175		Mr. Nowalski is President and majority owner of this company.
Gregorio Rojas	250		President, and with his family, owner of Beneficio Atirro (19,000 "fanegas" in 1979) and Central Azucarera Turrialba (14,500 tons of sugar in 1979). Mr. Mario Rojas, of the family, is a BANEX member of the Audit Committee.
Beneficio Atirro S. A.	100		
Popito S. A.	300		Investment company of Juan Dada, President and majority owner of Dada, S. A., a textiles/apparel company.
Plásticos Star, S. A.	250		Producer of plastic products. Majority owned by the Artiñano family. President is Benito Artiñano.
Jorge Reifer	50		Private investments of the Reifer family.
Mike Reifer	50		
Eduardo Reifer	50		
Mario Reifer	50		
Alberto Reifer	50		
. Costa Rican Cocoa Products, S. A.	100		. Producer of cocoa and chocolate products.
. Ernesto Ruiz	50		. President and majority owner of Costa Rican Cocoa Products.
. Inversiones Agrícolas Comerciales Ruiz G.,SA	50		. Investment company of Mr. Ernesto Ruiz.
Cafetalera Industrial La Meseta Ltda.	200		Coffee mill belonging to Alessandro Poma and Luigi Laurencich. The mills in the Laurencich-Poma group produce about 220,000 "fanegas" (1979), making them one of Costa Rica's largest.
Productos de Concreto SA	200		Cement products manufacturer owned 62% by Holderbank Financiére Glaris S. A. The rest of the stockholders are a variety of local investors.
Corporación Lachner y Sáenz S.A.	200		A diversified corporation, one of Costa Rica's largest with main activities in the automotive (General Motors, Datsun) and real estate fields. Majority owned by Carlos and Guillermo Lachner.

SUBSCRIBER	NO. OF SHARES (₡1,000 each) PAID IN	ADDITIONAL SUBSCRIBED (to be paid on April 30, 1981)	DESCRIPTION
Kativo Chemical Industries S. A.	200		A diversified chemical industry with production and sales in 11 Latin American countries. A subsidiary of H.B. Fuller Co.
Cafetalera Tournon S.A.	200		Coffee mill. 1979 volume: 42,000 "fanegas".
Stanley Lindo		200	Owner of coffee farms producing about 15,000 "fanegas".
Beneficios Montealegre	200		Coffee mill. Farms and mills in the group produced 137,000 "fanegas" in 1979, making them one of the most important in Costa Rica. The group is also heavily involved in real estate and other investments. Mr. Carlos Montealegre is a BANEX Director.
El Gallito Industrial SA	200		Producer of cocoa and chocolate products, owned by the Enrique and Raúl Odio families.
Textiles Nylon de Costa Rica, S. A.	75		Apparel manufacturers. Both owned by Mr. Carlos Blau, Mr. Samuel Lustig, and Mr. José Wasserman.
Industria Nacional de Lanas, S. A.	75		
Inversiones Sánchez S.A.	50		Investment companies of Jorge Sánchez-Méndez, ex-Minister of Economy and a BANEX Director.
Intercomercial Ltda.	10		
Tortillas del Sur, S. A.	50		A corn products distributor.
International Finance Advisory Group	100		Investment company of Mr. Humberto Pacheco.
Enrique Weisleder	100		President and majority owner of Rilasa, home appliances importer.
Bairo S. A.	100		A coffee export house, majority owned by Mr. Antonio Rodríguez. Exported about 45,000 "quintals" in 1979.
Alberto Dent	25		Mr. Alberto Dent is a BANEX Director. Manager and part owner (the rest, his family) of Dent e Hijos, a coffee and real estate concern owning some of the best residential land in the San José area.
Rodolfo Dent	25		
María Cecilia Dent	25		
Inversiones Amca, S. A.	25		An investment company of Mr. Alberto Dent.

SUBSCRIBER	NO. OF SHARES (₡1,000 each) PAID IN	ADDITIONAL SUBSCRIBED (to be paid on April 30, 1981)	DESCRIPTION
Corporación Internacional de Finanzas S. A.	100		Finance company owned by a group of local investors.
Incesa, S. A.	100		Manufacturer of bathroom ceramic fixtures. An affiliate of American Standard, in partnership with Manuel Lacayo.
Botica Francesa S. A.	100		Cosmetics and drugs manufacturer, majority owned by Mr. Edmundo Gerli.
Exclusiv S. A.	100		A producer of top quality leather and cloth furniture currently sold in over 10 countries, including the US and Canada. Majority owned by Messrs. Asmin Wiedemann, Rodrigo de Bedout, Rodrigo Crespo, and Gustavo Iglesias.
Fabio Pacheco-Sánchez	100		Part owner of Sánchez Cortés Hnos., S. A. (coffee, real estate) and Ingenio Taboga (19,000 tons in 1979). A BANEX member of the Audit Committee.
Franz Sauter	100		Civil Engineering Consulting Firm.
Goldy Lev Joselewics	100		Private investment.
Luelf S. A.		100	Investment company owned by the Urgellés and Penón family, whose line of business is wooden fine furniture.
Alumiplastic S. A.		100	A producer of fine home and office furniture whose majority owners are Mr. Eric Brenner and Mr. Rodrigo de Bedout.
Hering & Hering Ltda.	100		A cocoa exporter. Its majority owner is Alberto Hering.
Santa Rosa Ltda.	40		Investment companies of the Quirós-Guardia family. Mr. Rodolfo Quirós-Guardia is an ex-Minister of Agriculture.
Casaric S. A.	40		

SUBSCRIBER	NO. OF SHARES (₡1,000 each) PAID IN	ADDITIONAL SUBSCRIBED (to be paid on April 30, 1981)	DESCRIPTION
F. J. Orlich Ltda.	50	50	. Coffee farm and mill producing 35,000 "fanegas" in 1979, owned by the Orlich family. Mr. Francisco J. Orlich, deceased, was President of Costa Rica.
Rodolfo Orlich	25	25	. President of F. J. Orlich Ltda.
Walman S. A.	50		An investment company of Walter Kissling, President of Kativo Chemical Industry, and a BANEX Director. Mr. Kissling is an ex-President of the Costa Rican Chamber of Industries.
Aurora S. A.	50		Investment company of Francisco Colina, industrialist (Papeles y Cartones, S. A.) and Sea-Land representative in Costa Rica.
Cooperativa de Caficultores de Jorco R. L.	50		Coffee mill organized as a cooperative. Produced about 80,000 "fanegas" in 1969.
Agencia Aduanal, S. A.	50		Customs Agency and maritime freight representatives with over 35 years in the business.
Ernesto González Sucs.	50		Coffee farm and mill, producing 23,000 "fanegas" in 1979.
Alimentos Jacks de Centro América S. A.	50		Snacks manufacturer. Its President and majority owner is Mr. Andrés Pozuelo.
Luis Cortés-Rojas	25		Majority owners of El Dorado Ltda., one of Costa Rica's largest coffee roasters for local consumption.
Rodolfo Cortés-Rojas	25		
Guerra Hnos., S. A.	30		Investment company of Ciro Guerra, an ex-Minister of Economy.
Hacienda Solimar Ltda.	25		Cattle ranch owned by Mr. Oscar Pacheco and Mrs. Flora González.
Benjamín Piza	25		Private investor. Mr. Piza is President of Seagram's Costa Rica (a Seagram's subsidiary) and current President of the Chamber of Industries, as well as a BANEX Director.
Coopecoronado	25		A milk processing cooperative.
Agro Inversión S. A.	10		President: Rogelio Coto.

SUBSCRIBER	NO. OF SHARES (₡1,000 each) PAID IN	ADDITIONAL SUBSCRIBED (to be paid on April 30, 1981)	DESCRIPTION
Guillermo Castro-Echeverría	10		Private investment.
Mercado de Valores de Costa Rica S. A.	10		Member of Costa Rica's Stock Exchange.
Stanley Maduro	10		Private investment.
Alvaro Fernández	10		Private investment.
Jorge Pelecano	10		Private investment.
Palex S. A.	5		An investment company of Maggie Breedy de Rivero.
Omar Acuña Vargas	5		President and majority owner of Laboratorios Ancla, S. A.
Gerardo Hess	1		Private investment.
Arnoldo Montoya	1		Private investment.

BANEX LENDING REGULATIONS AND PROCEDURES

A. Loan evaluation and approval

- The customer interested in obtaining a credit from BANEX will fill the Loan Request Form (Solicitud de Crédito).

- Based on the Loan Request Form, the Credit Manager will assign a loan officer to the customer, who will be responsible for the relationship with the customer from the initial stages of analysis and approval to the final stages of collection of the loan.

1. Regulations for the Analysis and Recommendation of Loans

a. Financial analysis

The loan officer must perform a financial analysis of the potential credit customer, aiming to asses the repayment capacity, the guarantees offered, and the real purpose of the requested funds. Also, he must verify that the proposed purpose of the funds are in accordance with the objectives of the Bank.

The main steps that must be followed in the financial analysis are as follows:

1) Evaluate the moral references of the owners and managers of the Company requesting the credit. In performing this task, banking and commercial references must be obtained.

2) Determine the ability of the Company to generate sufficient funds from the usage of the loan so as to guarantee the satisfactory repayment of the loan.

3) Spread Sheet analysis of the financial statements of the Company, determining the relevant financial indicators and their trends.

4) Analysis of personal financial statements of owners and/or guarantors of the potential customer.

5) Determine the ability of the Company to generate alternate sources of repayment if necessary.

6) Evaluate the guarantees offered in terms of their liquidity (degree of convertibility to cash) and of their coverage of the credit.

7) Determine additional risks faced by the Company,either monetary, political, or of any other nature.

8) Determine if the loan being requested is adequate for the Company, especially as regards to the amortization period vs. stated use of funds and to the financial structure of the Company.

9) Determine if the proposed investment scheme for the loan is in accordance to the Credit program sought by BANEX.

10) Determine if the loan being requested does not exceed the legal limits of BANEX's credit policy.

11) Determine the feasibility of generating additional revenue (Bank services) based on the approval of this loan.

Once the financial analysis is performed as per the previous guidelines, the loan officer will proceed to classify the customer based on the norms described in the Credit Classification Manual.

Subsequently, the Loan officer must present his recommendations in reference to the approval of the loan. The Loan officer can only recommend credits classified as A or B. (categories described in the Credit Classification Manual) Nonetheless, type C credits can be recommended on an exceptional basis, as long as sufficient valid reasons exist.

The recommendations given by the Loan officer must be written down in the Recommendations form (Hoja de Recomendaciones). As noted in said form, the recommendations must refer to four basic areas:

1) A brief description of the loan operation being proposed to BANEX.

2) A brief description of customer, highlighting relevant aspects such as legal status, moral characteristics of principals and management, financial situation (based on diagnosis mode), and guarantees offered.

3) In those cases where the customer has other credit operations with the Bank, a brief comment must be made on BANEX's experience in dealing with this customer.

4) Finally, the Loan officer must give his recommendation about the approval of the loan request, explaining the reasons for his decision.

The Recommendations Form has the appropriate space in the upper right corner for classifying the customer risk. The loan officer must fill his corresponding space, as per the Credit Classification Manual.

2. Filing procedures for Customer Documentation

Before passing the loan request to decision-taking levels, the loan officer must be sure that the financial analysis and customer documentation is complete.

To this effect, a Credit Application file must be opened (File de Ruta de la Solicitud de Crédito). This file is the guideline that the loan officer must use to secure the necessary information to support the customer's credit diagnosis.

The credit application file's front cover is divided in 4 sections:

a. In the first section, the Loan Officer must write down general information about the customer, that is, customer's name, office empowered by the Company to sign, address, telephone number, and telex number.

b. The second section of the front cover describes the legal documents requested and their date of request will be written down; as well as the date the requested documents were handed by the customer to BANEX. The diagnosis cannot be completed, nor the file handed to the Credit manager, unless all the documentation is complete. (The last column of this section states whether the requested documents are already in the Bank files. A document not yet handed in by the customer can be detected by the lack of date in this column.

c. The third section of the file's front cover, describes all financial information contained in the file, or requested to the customer.

The first column of this section shows the date in which information or documents were requested. The second column contains the name of the document or information. The third column contains the date in which the information sent by the customer was received. Finally, the fourth column shows whether the information is already in the Bank files.

As in the case of the legal documents sections, the loan officer will know which information is missing if the date in the last column is not shown. The loan officer cannot complete his diagnosis of the Credit, nor pass the file to the Credit manager unless all documents are complete.

The last section of the file is a record of the internal flow of the file, showing the movement the file has had within the Bank. The length of time the file remains in the hands of the differente employees of the Bank will permit estimating the efficiency of the loan approval process by comparing actual elapsed time with the predetermined times set by the Bank in its credit approval policy.

The loan officer must keep a General Comments Sheet on the loan operation (Hoja de Comentarios). In this sheet, brief comments must be made of every communication or activity the Loan Officer performs related to this operation. The purpose of this sheet is to allow any Bank employee to know in which stage the loan request is at present, and of the different situations that have been encountered since the loan was requested. This sheet must form part of the Credit Application file.

The first column of the General Comments Sheet contains the date the comment was made, the second column contains the initials of the employee who made the comment, and the third column contains the comment itself.

The Credit Application file must contain at least the following information and/or documents:

- General Comments Sheet
- Recommendations Form
- Loan Request Form
- Copy of legal incorporation document
- Certification of legal empowerments with their due dates
- Copy of assessment of appraiser about the guarantees offered
- Audited financial statements of the Company for the last 3 years.
- Spread sheet of the Financial statements

3. Regulations for Loan Approvals

Once the Credit Officer has filled out the Recommendations Form, he must pass the Credit Application File to the Credit Manager.

If the credit is less than ₡ _____________, the Credit Manager may approve or refuse such credit. If the credit is more than ₡ ____________, but less than ₡500,000.00, the decision can be taken by the Credit Committee. If the credit surpasses ₡500,000.00, the decision must be taken by the Board of Directors.

The credit decisions remitted to the Board of Directors must be accompanied by a specific recommendation of the Credit Committee.

The people involved in taking the credit decision must evaluate the credit classification given by the Loan Officer, and write down their own evaluation of the credit in the corresponding space of the Recommendations Form.

If the loan request is denied, a stamp of refusal must be stamped to the Credit Application file and to the Credit Request Form. The reasons for denying the credit must be written down in the General Comments Sheet. If the customer has no previous operations with the Bank, the Credit Application file must be filed in the Refused Loan Requests Section. If the customer has previous operations with the Bank, the pertinent information of the Credit Application File must be stored in the Customer Credit File.

If the loan request is approved, the Credit Application file must be stamped with an approval seal, writing down the necessary comments in the General Comments form and in the loan request form. The loan officer proceeds then to fill the loan approval form (carátula) and sends it to the Formalization Section.

B LOAN FORMALIZATION

Once the loan operation has been approved, the loan officer must write the customer an advising letter, notifying him of the loan's approval, the conditions under which the loan is granted, the documents necessary for the credit constitution, and the date at which the Bank's offer expires.

Based on the information contained in the loan approval form, the formalization section will proceed to open a loan operation file with the loan approval form as front cover. The operation will be formalized using a Promissory Note of Costa Rican jurisdiction (Banex S.A.) or Panamanian jurisdiction (Banex International S.A.), or with lieu or Mortgage instruments which not only identify the loan operation but the guarantee as well.

It is important to note that in those cases in which the loan is formalized by a promissory note, the interest payments must be documented, and the late interest payments must be indicated.

Any document offered in guarantee must be endorsed as follows:

"The present promissory note serves as guarantee to the loan operation _____, of ______________ Company with the Banco Agro-industrial y de Exportaciones S.A. (BANEX)".

The endorsement of this document must be done by an officer of the requesting Company with sufficient legal powers.

The documents formalizing the guarantees offered by the Company are prepared, as well as the loan repayment Register (Registro de Operación). This last is done with the instructions contained in the loan approval form.

If there is going to be any delay in the loan formalization, the formalization section must communicate the reasons to the loan officer so that he can advise his client.

The check to be given to the customer is prepared, having deducted first any commissions or interest payments as consigned in the loan approval form.

A new general comments form will be kept in the loan operation file, and serves the purpose of keeping a record at the loan operations during the repayment period.

Photocopies of the Guarantees will be placed in the loan operations file and the originals will be placed in the vault under safekeeping (see Manual for Vault Procedures). A receipt will be issued by the vault employee indicating where the documents are stored.

With the loan already formalized and disbursed, the loan Operations file will be the one were all collections correspondence with the customer will be kept.

This file must contain:

1. Loan approval form.

2. General Comments form on the operation.

3. Vault receipt of where documents are stored.

4. Correspondence sent to customer collections correspondence sent to customer and their responses.

C

LOAN FOLLOW-UP

The Bank loan officers will be responsible for a constant follow-up on the accounts assigned to them, in such a way, that the assets of the Bank are protected.

The Credit Manager, the Credit Committee, and the Board of Directors, will perform periodic evaluations on the loan portfolio according to the individual classification of each loan, as per the procedure established in the Manual of Norms for the Classification of Credits.

The credit Committee will have a monthly meeting with the purpose of revising outstandings loans and following up on collection efforts. The frequency of these meetings can be modified if the characteristics of the loan portfolio merits it.

The Credit Manager and the Credit Committee will use the Aging Analysis by Credit classification Report (Estado de Antiguedad de Saldos por tipo de cliente), and the Aging Analysis by Loan Officer report (Estado de antiguedad de Saldos por Oficial de Crédito), as working tools to supervise the loans outstanding.

The Aging Analysis by Credit Classification report will serve as the instrument by which to analyze and reclasify accounts, and thus take the necessary steps to avoid specific accounts from becoming problematic collections.

The Aging Analysis by Loan Officer report will insure that the necessary follow-up be given to the individual portfolio of each loan officer, and will also serve as a source of information to judge the individual performance of each loan officer.

In the loan follow-up meetings the Credit Manager or the Credit Committee can reclasify an account, as long as there is sufficient elements of judgement that justify the account being from one credit category to another, as described in the Manual of Norma for Classification of Customers.

....

In these meetings the Loan Officer must present his account's case and be prepared to answer questions presented by management or the Credit Committee.

Internal Auditing will have the responsability and authority to reclasify customer credits, as long as there are enough reasons to do it and in accordance to the Norms for Credit Classification. When the internal auditor reclasifies a customer's credit, he must notify management, the Credit Committee and the Loan Officer.

Loan requests that must be taken to the Board of Directors, will be done jointly by the Credit Committee and the Loan Officer, at which time the Credit Committee will present their recommendation.

A credit reclassification report (Reporte de Reclasificación de Créditos) will be made on a monthly basis.

D

LOAN COLLECTIONS

It will be a norm of the Bank to send ten days prior to each installment due date an advising notice (aviso de vencimiento).

The operations department will use a listing of all loans and the dates in which collections must be made (Listado de Cobros por Cliente). This report will be produced on a monthly basis.

A similar report on the expected collections of the month (Listado de Cobros por mes) will also be provided on a monthly basis.

All past dues and/or problems with the client must be communicated to the Loan Officer, via memorandum.

Upon payments of installments on loan outstandings, a receipt will be made. When the customer completely pays his operation, all legal documents will be returned cancelled. In order to retrieve documents from the vault, procedures must be followed as outlined in the Manual of Vault norms and procedures.

Before releasing the documents, the collections department must make sure that photocopies of all legal documents are kept in the customer's file.

When the customer receives the canceled original documents, he must sign the appropiate receipt (Recibo de documentos).

The collections department will produce on a monthly basis a summary of all collections received and of all past dues per customer, identifying the loan officer responsible for the account (Resumen de cobros del mes). The first two columns of this report contain the credit classification and client's name respectivelly. The third column has the amount to be collected in that month according to the repayment schedule. The fourth column shows the actual sum collected during the month. The last column identifies the loan officer responsible for the account.

E. Norms for Credit Classification

The Bank will classify all credit subjects in five categories:

Type A:

Type A customers are those who can pay with no problem, and who have enough readily-convertible guarantees to offer as collaterals.

Type B:

Type B customers are as financially solid as Type A customers, but cannot offer enough readily-convertible guarantees.

Type C:

Type C customers are those from whom the Bank may expect payment difficulties during the life of the loan, but who can offer enough adequate guarantees.

Type D:

Type D customers are those from whom the Bank may expect payment difficulties during the life of the loan, and concurrently, cannot offer solid guarantees.

Type E:

Type E customers are those who present such a critical situation that legal collection problems can be expected.

The above classification will be used for the following purposes:

1. During the credit analysis stage of the loan, the loan officer must classify the potential credit in one of those categories.

   This classification will be an important indicator which will help determine the convenience to the Bank of approving the loan.

   It is the Bank policy not to accept credit applications classified as C, D, or E. Nonetheless, a type C credit may be approved if the loan officer has sufficient arguments to demonstrate that accepting the loan is to the Bank's convenience.

2. During the loan follow-up stage, the individual clients' classification will determine the frequency of the follow-up and the hierarchical level where the revision will be made.

   The frequency of the follow-up and the hierarchical level where the revision will be made are outlined in the following table:

Credit Classification	Frequency of Follow-Up	Hierarchical Level Involved
A	every 6 months	Credit Manager
B	every 3 months	Credit Manager
C	every month	Credit Committee
D	every month	Board of Directors
E	every month	Board of Directors

The credit classification of an account can be modified during the loan follow-up stage, according to circumstances.

Internal auditing will have the responsibility and authority for reclassifying accounts, which in their judgement are not in accordance with the Norms for Credit Classification; but it is the Credit Manager and the Credit Committee who are firstly responsible in doing the necessary reclassifications.

Any modification to the classification criteria must be submitted and approved by the Board of Directors.

I. DETAILED FINANCIAL ANALYSIS

A. Basic Assumptions

1. AID funds will be drawn down according to the following schedule:

(U.S. 000)

YEAR	SUBLOANS	TRACO	TOTAL OUTSTANDING
1	2,500	700	3,200
2	2,500	-	5,700
3	4,300	-	10,000

The idea is to maximize subloan disbursements; however, when total AID disbursements reach certain levels, access to more AID funds by BANEX will be conditioned on the bank having obtained and loaned funds from private sources. These conditions precedent to further AID disbursement are intended to leverage the AID loan and double the inflow of credit from abroad; we think such co-financing is not likely to be available during the first year of operation.

2. LIBOR rates are projected as follows1/:

YEARS	LIBOR (Percent P.A.)
1	16
2	15
3	14
4-15	13

3. The average interest rates charged on subloans made from the four sources of funds available to BANEX are assumed to be the following:

AID portfolio	LIBOR + 3.4%
BANEX equity portfolio	LIBOR + 3.4%
Co-financing portfolio	LIBOR + 4.0%
Commercial portfolio1/	LIBOR + 4.0%

1/ As of August 13, 1981 LIBOR (the London Interbank Borrowing Rate) was as follows: one month, 17.625%; two months, 18.125%; three months, 18.375%; six months, 18.437%; one year, 17.8125%; two years, 16.875%; three years, 16.75%.

The AID and BANEX equity lending at a rate of LIBOR+3.4% is based on the assumption that 40% of those portfolios will consist of short-term loans and 60% of long-term loans; the short-term loans will generate commissions plus interest estimated at the equivalent of LIBOR + 4.0%; because the long term loans do not generate such commissions (they are not "turned over" as frequently), the long-term lending rate is estimated at LIBOR +3.0%.

Co-financing and commercial portfolios will probably be obtained on a short-term basis, placed in short-term loans and therefore it is assumed that these funds will be in order to match maturities.

All of the above rates are quite competitive in the Costa Rican financial market.

4. The cost of loanable funds is fixed at 5% p.a. for AID funds, and assumed to be LIBOR + 1.5% p.a. for the co-financing and commercial funds1/.

5. Maximum allowable leverage (debt to equity ratio) is assumed as follows:

YEAR	MAXIMUM LEVERAGE
1	6 to 1
2	7 to 1
3	8 to 1
4	9 to 1
5-15	10 to 1

In the early years the projections are based on the assumption that the maximum available leverage is not used.

6. To project portfolio increases, the increments from AID, Co-financing and Commercial sources are assumed to be disbursed at mid-year. BANEX equity and Retained Earnings are assumed to be made available at the beginning of each year. Financial income and expenses are calculated based on these assumptions.

1/ In the main, these funds will come from short and medium-term credit lines of international banks. Cost assumptions are perhaps slightly low; however, the sensitivity analysis on the estimates of LIBOR indicates that this assumption is not critical.

7. Because of present economic conditions, it is assumed that co-financing funds will not be available until year two. Additionally, although the maximum Debt to Equity Ratios would permit it, no commercial funds are assumed to be received until year five; this allows time for BANEX to establish a track record and increase its equity.

8. The opening Balance Statement of BANEX in year one is derived from actual accounting figures as of June 30, 1981, projected to September 30, 1981, i.e., year one starts 9-30-81.

9. An increase in the paid-in capital of BANEX up to US$ 2 million is shown in year two as per the agreed-upon covenants. Further capitalization of BANEX throughout the life of the project is feasible and expected, out is not shown in order to keep the projections conservative.

10. A dividend policy of 10% of the equity to be paid out at the beginning of the year is maintained starting in year three. Dividends are payable in the year subsequent to their being declared.

11. The AID amortization schedule contains twenty-one semi-annual payments of US$ 476,190, approximately; the first payment is made at the end of year five, and the last at the end of year fifteen.

12. A cash cushion of US$ 25,000 is kept in negotiable instruments throughout the fifteen years, and no income is assumed from these securities in order to be conservative.

13. A Bad Debt Expense of 1% of loans outstanding is charged every year. This is treated directly as an expense and not as a reserve, and thus is not reflected on the Balance Sheet. Furthermore, the National Banking System Law (Article 154) requires reserves equaling 10% of profits before taxes and other legal deductions. These reserves are kept for contingencies arising from bad debts, and in effect increase the actual bad debt reserve substantially.

14. The National Banking System Law (Article 154) requires that 10% of profit before taxes and reserves be deducted and held in reserve for an Employee retirement fund, and 5% for CONAPE (Higher Education Financing Loan Fund).

15. Income taxes are 50% of taxable income.

16. Even though AID subloans will be disbursed through BANEX INTERNATIONAL S.A. and the profits from this Panamanian

subsidiary are tax free under precent Costa Rican legislation, these profits have been included in taxable income; a pending tax reform, which Congress is expected to approve, will make these profits taxable.

17. An equity investment of US$ 700,000 is made in TRACO in year one from the AID loan proceeds. this initial BANEX equity is returned to the AID sublending portfolio in years three and four. Additional equity investments will be made in TRACO after year one. These increments are equivalent to 100% of the net income generated by AID funds during the first three years, and 50% of net income from AID sources for the remaining years. These incremental yearly transfers to TRACO will be returned to BANEX in subsequent years as TRACO's cash flow from operations allows.

18. Estimated service income for the first year was based on capturing 5% of the total Collections and Letters of Credit market, plus carrying out foreign exchange transactions averaging US$ 400,000 per month. Service income increases 15% per annum in years two through five, and 20% per annum from then on. The reason for this higher growth is that by the end of year five TRACO will be fully operational, generating banking services volume greater than that of prior years.

19. General and Administrative Expenses for year one were obtained by analyzing the individual expense categories. General and Administrative expenses grow through year five at the rate of 15% per annum, and then stabilize at 2.0% of total BANEX portfolio.

20. It assumed that no dividends are paid from TRACO to BANEX.

21. An exchange rate of 20 colones to the dollar has been used throughtout.

B. Analysis of Projected Financial Statements

Projections were made of the BANEX Balance Sheets, Profit and Loss Statements, Sources and Applications of Funds, and Cash Flow for the fifteen years of the loan. A ten year cash flow of TRACO was also prepared. These projections were made based on the assumptions presented in Section A of this Exhibit, some of which are discussed in the context of this analysis. A sensitivity analysis section is also included to test how critical certain key assumptions are to the overall viability of the project.

1. Balance Sheet Projection (Table 1)

a. In accordance with the covenants of the project, additional equity is shown in year two, increasing total paid-in capital to US$ 2 million. To be conservative no further capital increases were assumed However, the covenant agreed upon, that in any given year treasury stock must always be available for sale to the public in an amount equivalent to 10% of the stock outstanding in the previous year, combined with the profit generating capacity of the bank, should result in additional paid-in capital. More equity in turn will improve financial indicators and produce higher profits.

b. Retained earnings are shown apart from legal reserves, and grow to a substantial US$ 6.5 million by year fifteen, even though 10% dividends are paid out every year beginning in year four and a total of US$ 2.8 million is transferred to Traco during the life of the project.

TABLE 1
PROJECTED PRO-FORMA BANEX SHEET ($000)

Year	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
ASSETS:															
Cash & Banks	175	183	436	286	328	276	345	365	436	439	564	633	754	936	1100
Negot. Securities	25	25	25	25	25	25	25	25	25	25	25	25	25	25	25
Loan Portfolio:	3275	9407	19213	25551	32361	46737	56061	65454	69867	79351	83838	93450	103131	112933	127913
AID	2500	5000	9600	10000	9524	8572	7620	6668	5716	4764	3812	2860	1908	956	0
Cofinancing	0	2500	7500	10000	10000	10000	10000	10000	10000	10000	10000	10000	10000	10000	10000
Commercial	0	0	0	0	10000	25000	35000	45000	50000	60000	65000	75000	85000	95000	110000
Bank Capital	775	1732	1732	1732	1732	1732	1732	1732	1732	1732	1732	1732	1732	1732	1732
Retained Earnings	0	175	381	819	1105	1433	1709	2054	2419	2855	3294	3858	4491	5245	6181
TRACO Equity	700	1050	1100	1050	1300	1550	1750	1950	2150	2350	2500	2600	2700	2750	2800
Org. Expenses (Net)	125	62	0	0	0	0	0	0	0	0	0	0	0	0	0
Fixed Assets (Net)	44	33	22	11	0	0	0	0	0	0	0	0	0	0	0
TOTAL ASSETS	4344	10783	20798	23923	34014	48588	58181	67794	72478	82165	86927	96708	106610	116644	131838
LIABILITIES:															
Loans Payable:															
AID	3200	5700	10000	10000	9524	8572	7620	6668	5716	4764	3812	2860	1908	956	0
Cofin. Banks	0	2500	7500	10000	10000	10000	10000	10000	10000	10000	10000	10000	10000	10000	10000
Comm. Banks	0	0	0	0	10000	25000	350000	450000	500000	60000	65000	75000	85000	95000	110000
Total Liabilities	3200	8200	17500	20000	29524	43572	52620	61668	65716	74764	78812	87860	96908	105956	120000
NET WORTH:															
Capital Paid	1043	2000	2000	2000	2000	2000	2000	2000	2000	2000	2000	2000	2000	2000	2000
Legal Reserve	24	25	141	266	418	575	762	966	1199	1447	1739	2062	2430	2858	3345
Retained Earnings	---77	--528	-1157	-1657	-2072	-2441	-2799	-3160	-3563	-3954	-4376	-4786	--5272	--5830	--6493
Net Worth	1144	2583	3298	3923	4490	5016	5561	6126	6762	7401	8115	8848	9702	10688	11535
Liabilities + Net Worth	4344	10783	20798	23923	34014	48588	58181	67794	72478	82165	86927	96708	106610	116644	131838
Bad Debt Reserve	33	94	192	256	324	467	561	655	699	794	838	935	1031	1129	1279
Debt/Worth	2.8	3.2	5.3	5.1	6.6	8.7	9.5	10.1	9.7	10.1	9.7	9.9.	10	9.9	1
G+A Exp/Portfolio (%)	9.8	4.1	2.2	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	
ROI (%)	9.7	42.1	27.7	26.8	22.9	20.5	19.8	19.2	19.5	18.5	18.8	18.2	18.8	19.3	

c. The AID subloan portfolio is shown as being disbursed in accordance with the project covenants. Co-financing is assumed to become available starting in year two and forms an integral part of the project. Nonetheless, as can be appreciated from the Sensitivity Analysis, the project remains feasible even in the unlikely event that no co-financing or commercial funds can be attracted during the entire life of the project.

d. Even though there exists unused debt equity capacity which would permit bank borrowings from year one onwards, as Table 2 demonstrates, these funds are not projected to be available until year five. The maximum leverage allowed is highly conservative in the banking industry.

e. The total loan portfolio grows to a substantial US$ 128 million by year fifteen. It is worth noting that the AID loan acts as seed capital which permits such impressive growth. During the early years of the project, AID subloans represent over 50% of total portfolio, and as the project matures, AID's part of total loans outstanding diminishes until it finally disappears.

TABLE 2
COMPARISON OF BANEX PROJECTED AND MAXIMUM ALLOWABLE DEBT-EQUITY RATIOS

Year	Maximum Debt-Equity Ratio	Projected Debt-Equity Ratio	Projected Debt-Equity Ratio, Excluding AID Loan From Debt
1	6.0	2.8	-
2	7.0	3.2	1.0
3	8.0	5.3	2.3
4	9.0	5.1	2.5
5	10.0	6.6	4.5
6	10.0	8.7	7.0
7	10.0	9.5	8.1
8	10.0	10.1	8.9
9	10.0	9.7	8.8
10	10.0	10.1	9.5
11	10.0	9.7	9.2
12	10.0	9.9	9.6
13	10.0	10.0	9.8
14	10.0	9.9	9.8
15	10.0	10.1	10.1

f. The Traco equity position is created by capitalizing US$ 700,000 at the start of year one from AID loan proceeds. This equity will be increased by 100% of net profits from lending AID funds during the first three years and 50% of such net profit during the remaining years. BANEX will be able to return US$300,000 in year three and US$400,000 in year four to its lending protfolio. This payment is offset by the transfers BANEX will be making to Traco during those years. It has been estimated that TRACO can sustain its start-up losses with these transfers without its equity position falling under 50% its original level. It should be pointed out that in the projections BANEX gets no income from its equity investment in TRACO. Nonetheless, BANEX pays interest to AID on the funds disbursed to TRACO.

2. <u>Profit and Loss Statement Projection</u> (Table 3)

a. Interest income is projected based on a variable LIBOR Rate (assumption no. 3) plus financial margins (assumption no 4). LIBOR Rates are projected with a downward trend which reduces the interest income throughout the project life: the expectation is that inflation in major money market countries will decrease over time.

b. Interest rates are fixed at 5% for the AID loan, and LIBOR plus 1.5% for co-financing and commercial funds. Since the interest rates paid for the co-financing and commercial funds are projected to go down at the same pace as the interest rates on the money lent out, both rates being tied to LIBOR, the spread between interest income and interest expense from private borrowings remains the same (although the absolute amounts of the margins earned per dollar loaned abviously decrease).

TABLE 3

PROJECTED PRO-FORMA BANEX PROFIT AND LOSS STATEMENT ($000)

LIBOR %	16	15	14	13	12	13	13	13	13	13	13	13	13	13	13
Year	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
INCOME:															
Interest AID Portfolio	242	690	1270	1607	1601	1484	1328	1172	1015	859	703	547	391	235	78
Interest Cofin. Port.	0	237	900	1487	1700	1700	1700	1700	1700	1700	1700	1700	1700	1700	1700
Interest Comm. Port.	0	0	0	0	850	2975	5100	6800	8075	9350	10625	11900	13600	15300	17425
Interest BANEX Capital	150	231	301	284	284	284	284	284	284	284	284	284	284	284	284
Inter. Ret. Earn. Port.	0	32	66	134	181	235	280	337	397	468	540	633	737	860	1014
Fee Income	296	344	398	478	561	673	808	969	1163	1396	1675	2010	2412	2894	3474
Total Income	688	1534	2935	3990	5177	7351	9500	11262	12634	1405	15527	17074	19124	21273	23975
EXPENSES:															
Interest AID loan	97	222	392	500	[illegible]	464	417	369	322	274	226	179	131	83	36
Interest Cofin. Banks	0	206	775	1269	1450	1450	1450	1450	1450	1450	1450	1450	1450	1450	1450
Interest Comm. Banks	0	0	0	0	725	2537	4350	5800	6887	7975	9062	10150	11600	13050	14862
Gen.and Admin.	320	384	461	553	663	935	1121	1309	1397	1587	1677	1869	2063	2259	2558
Bad Debt Exp.	33	61	98	64	68	143	94	94	44	95	44	97	96	98	150
Total Expenses	450	872	1726	2386	3406	5529	7432	9022	10100	11381	12459	13745	15340	16940	19055
Income less Expenses	238	662	1209	1604	1771	1822	2068	2240	2534	2676	3068	3329	3784	4333	4919
TRACO Equity	0	350	350	350	250	250	200	200	200	200	150	100	100	50	50
Income Before Deduc.	238	311	859	1254	1521	1572	1868	2040	2334	2476	2918	3229	3684	4283	4869
Deductions:															
5% CONAPE	12	16	43	63	76	79	93	102	117	124	146	161	184	214	243
10% Empl. Fund	24	31	86	125	152	157	187	204	233	248	292	323	368	428	487
INCOME BEFORE TAX:	202	264	730	1066	1293	1336	1588	1734	1984	2104	2480	2745	3132	3641	4139
Income Tax	101	132	365	533	646	668	794	867	992	1052	1240	1372	1566	1820	2069
NET INCOME	101	482	715	883	897	918	994	1067	1192	1252	1390	1473	1666	1871	2126
Uses:															
Legal Reserve	24	31	86	125	152	157	187	204	233	248	292	323	368	428	487
Retained Earnings	77	101	279	150	165	119	158	161	203	191	272	310	386	508	613
TRACO	0	350	350	350	250	250	200	200	200	200	150	100	100	50	50
Dividends	0	0	258	330	392	449	502	556	613	676	740	812	885	970	

c. Fee income is based on an estimated 5% penetration of the documentary credit market and a modest foreign exchange transaction volume of US$ 400,000 per month. Fee income grows at 15% per annum until year five and 20% per year from then on. These yearly increments are quite conservative taking into account the small initial market sahre, the large lending vlumes to be handled by the Bank and the natural banking services market that Traco will create.

d. General and Administrative expenses have been estimated for the first year based on an analysis individual expense categories. Expenses are projected to grow at 15% per year until year four, at which time they begin to grow at a higher rate, maintaining a ratio of 2% of the outstanding loan portfolio, which is an adequate level of G & A expense for banking operations.

e. The bad debt is treated as a loss and reserve considered for bad debts is created as an expense each year; it is calculated as 1% of the incremental loan portfolio. As will be seen in the Sensitivity Analysis section, this 1% expense, when combined with the legal reserve that must be established for the same purpose, becomes 3% of the outstanding loan portfolio by year ten, an ample bad debt margin.

f. It should be pointed out that the AID loan portfolio profits are tax free since they are generated through the Panamanian subsidiary. Although loans will necessarily be disbursed from the offshore unit to avoid exchange risks, the projections assume that this income is taxed, in view of possible future modifications to the laws governing income taxes which are currently being considered by the Costa Rican Legislature.

g. Net income is broken down into the legal reserves, transfers to TRACO, dividends, and retained earnings. This has been done to provide for a better understanding of the flow of funds and does not form part of the profit and loss statement. Dividends are not to exceed 10% of net worth at the beginning of the year, per annum, payable during the following year, starting in year three.

3. <u>TRACO Component Projection</u>

Table 4 shows projected net profits generated by lending the AID funds, and a condensed cash flow for the TRACO components.

The interest earned and paid on the AID subloans portfolio is obtained from the BANEX profit and loss statement.

General and Administrative Expenses are calculated as 2.5% of the AID subloans outstanding except for year one (when 5% is allowed) and year two (4% allowed). Bad debt expenses are calculated as 1% of year-end loans outstanding. Taxes and other legal deductions are charged to the income from the AID portfolio in the same proportion that this income represents of the total income generated by BANEX for any given year. The reason for assigning these expenses based on income generated and not on percentage of total portfolio is that the Banking Services Department, which generates considerable income, must assume its share of these expenses, but does not have a loan portfolio.

The net AID profit derived by the above process determines the size of the yearly transfers of BANEX to TRACO. The lower half of Table 4 shows the Cash Flow and the transfers. Individual yearly transfers may not coincide with the 100% or 50% of profit theoretically to be transfer, but care has been taken so t on a cumulative basis the transfers made to TRACO fulfill the loan covenants. As can be seen, the cumulative transfers amount to US$ 2.8 million, which, is enough to start the original Traco, plus as many as three more TRACOs in other locations, independent of TRACO's own capacity to generate income.

Taxes paid by the BANEX project during the fifteen years that the AID loan is outstanding amount to $14.2 million; these revenues will produce social benefits for the country as a whole.

5. Cash-Flow-Projections (Table 5)

Detailed income and outflow projections demonstrate the financial feasibility of the project from a cash flow stand-point. Several simplifications have been made. For example, interest income and expense are assumed to be reflected in the Profit and Loss Statement on a cash basis rather than on a accrual basis. Likewise, the yearly bad debt expense is assumed to be equal to the bad debt reserve, and consequently it is shown in the Cash Flow.

TABLE 4
BANEX AID LOAN: INCOME GENERATED BY SPREAD
TRACO: PROFORMA CASH FLOW

Year	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
AID Income share	3[illegible]	45%	43%	40%	31%	20%	14%	10%	8%	6%	5%	3%	2%	1%	1
Allowable G + A/Port.	5.0%	4.0%	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%	2
BANEX															
AID Loan Portolio	2500	5000	9600	10000	9524	8572	7620	6668	5716	4764	3812	2860	1908	956	–
Interest Earned	242	690	1270	1607	1601	1484	1328	1172	1015	859	703	547	391	235	78
Interest Paid	97	222	392	500	500	464	417	369	322	274	226	179	131	83	36
G + A Expense	125	200	241	250	238	214	191	167	143	119	95	72	48	24	0
Bad Debt Expense.	25	25	46	4	0	0	0	0	0	0	0	0	0	0	0
CONAPE	4	7	18	25	24	17	13	10	9	7	7	5	4	2	1
Empl Ret. Fund	8	14	37	50	47	34	26	20	19	15	15	10	7	4	2
Tax	35	59	157	213	200	145	111	87	79	63	62	41	31	18	7
Income Generated	(52)	163	379	565	592	610	570	519	443	381	298	240	170	104	3[illegible]
Avail. to TRACO	0	163	379	283	296	305	285	260	221	191	149	120	85	52	16
Investment in TRACO	700	350	350	350	250	250	200	200	200	200	150	100	100	50	50
From TRACO	–	–	300	400	–	–	–	–	–	–	–	–	–	–	–
Avail. Invest.	(700)	(887)	(558)	(225)	(179)	(124)	(39)	21	42	33	32	52	37	39	5
Equity in TRACO	700	1050	1100	1050	1300	1550	1750	1950	2150	2350	2500	2600	2700	2750	2800
TRACO															
Proforma Cash Flow															
Initial BANEX Invest.	700														
Revenue	35	262	615	878	1200										
BANEX Investment	–	350	350	350	250										
Out Flows															
Expenses	338	504	644	811	892					N O T	P R O J E C T E D				
Repayment to BANEX	–	–	300	400	–										
Cummulative Balance	397	505	526	543	1101										
New TRACOS	*				*										

TABLE 5

BANEX PRO-FORMA CASH FLOW PROJECTIONS ($000s)

Year	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
INCOME:															
AID Loans		2500	4300	–	–	–	–	–	–	–	–	–	–	–	–
Co-financing Loans		2500	5000	2500	–	–	–	–	–	–	–	–	–	–	–
Commercial loans		–	–	–	10000	15000	10000	10000	5000	10000	5000	10000	10000	10000	15000
Capital, paid-in		957	–	–	–	–	–	–	–	–	–	–	–	–	–
Interest Income		1190	2537	3512	4616	6678	8692	10293	11471	12661	13852	15064	16712	18379	20501
Service Income		344	398	478	561	673	808	969	1163	1396	1675	2010	2412	2894	3474
TRACO Repayments		–	300	400	–	–	–	–	–	–	–	–	–	–	–
AID Subloans Repayments, Net		–	–	–	476	952	952	952	952	952	952	952	952	952	956
Total Income		7491	12535	6890	15653	23303	20452	22214	18586	25009	21479	28026	30076	32225	39931
OUTFLOWS:															
AID funds lending		2500	4600	400	–	–	–	–	–	–	–	–	–	–	–
Co-financing lending		2500	5000	2500	–	–	–	–	–	–	–	–	–	–	–
Commercial lending		–	–	–	10000	15000	10000	10000	5000	10000	5000	10000	10000	10000	15000
Retained earnings lending		175	206	438	286	328	276	345	365	436	439	564	633	754	936
Lending from BANEX equity		957	–	–	–	–	–	–	–	–	–	–	–	–	–
Interest expense		428	1167	1769	2675	4451	6217	7619	8659	9699	10738	11779	13181	14583	16348
General & Admin. expense		310	388	542	652	935	1121	1309	1397	1587	1677	1869	2063	2259	2558
Bad debt expense		61	98	64	68	143	94	94	44	95	44	97	96	98	150
Reserves		47	129	188	228	236	280	306	350	372	438	484	552	642	730
Income taxes		132	365	533	646	668	794	867	992	1052	1240	1372	1566	1820	2069
Dividends		–	–	258	330	392	449	502	556	613	676	740	812	885	970
Investments in TRACO		350	350	350	250	250	200	200	200	200	150	100	100	50	50
Repayments to AID		–	–	–	476	952	952	952	952	952	952	952	952	952	956
Total Outflow		7460	12303	7042	15611	23355	20383	22194	18515	25006	21354	27957	29955	32043	39767
Net Cash Flow		31	232	(152)	42	(52)	69	20	71	3	125	69	121	182	164
Cash at beginning		175	206	438	286	328	276	345	365	436	439	564	633	754	936
Cash at end		206	438	286	328	276	345	365	436	439	564	633	754	936	1100

TABLE 6

SOURCES AND USES OF FUNDS ($000)

Year	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
SOURCES:															
Increase AID Liability		2500	4300	0	0	0	0	0	0	0	0	0	0	0	0
Increase Cofin. Liability		2500	5000	2500	0	0	0	0	0	0	0	0	0	0	0
Increase Comm. Liability		0	0	0	10000	15000	10000	10000	5000	10000	5000	10000	10000	10000	15000
Repayment of AID Subloans		0	0	0	476	952	952	952	952	952	952	952	952	952	956
Capital, paid-in		957	0	0	0	0	0	0	0	0	0	0	0	0	0
Net Income		482	715	883	897	918	994	1067	1192	1252	1390	1473	1666	1871	2120
Depreciations/Amort.		74	73	11	11	0	0	0	0	0	0	0	0	0	0
Cash Reductions		0	0	152	0	52	0	0	0	0	0	0	0	0	0
Repayments from TRACO		0	300	400	0	0	0	0	0	0	0	0	0	0	0
Total		-6513	10388	-3946	11384	16922	11946	12019	-7144	12204	-7342	12425	12618	12833	18076
USES															
Increase AID subloans		2500	4600	400	0	0	0	0	0	0	0	0	0	0	0
Increase Co-finan. subloan		2500	5000	2500	0	0	0	0	0	0	0	0	0	0	0
Increase BANEX equity Loans		957	0	0	0	0	0	0	0	0	0	0	0	0	0
Increase Comm. subloans		0	0	0	10000	15000	10000	10000	5000	10000	5000	10000	10000	10000	15000
Increase Ret. Earn. loans		175	206	438	286	328	276	345	365	436	439	564	633	754	936
Repayments to AID		0	0	0	476	952	952	952	952	952	952	952	952	952	956
Increase TRACO equity		350	350	350	250	250	200	200	200	200	150	100	100	50	50
Cash increases		31	232	0	42	0	69	20	71	3	125	69	121	182	164
Dividends		0	0	258	330	392	449	502	556	613	676	740	812	885	970
Total		-6513	10388	-3946	11384	16922	11946	12019	-7144	12204	-7342	-12425	-12618	12823	18076

6. Sensitivity Analysis

a. Lack of Co-financing

Three basic assumptions have been tested in the Sensitivity Analysis. First, an analysis was made of the impact on the project's net income of the availability of co-financing or commercial funds. The unlikely worst possible condition, that is not being able to secure any additional funds during the fifteen years, was simulated. Net income is of course drastically reduced as can be seen in Table 8. However, no loss is sustained in any given year. The project is feasible even under these extremely conservative assumptions. The net income generated by the AID loan diminishes because the proportionate amount of General and Administrative expenses charged to income from the AID-financed portfolio increases.

Under the alternative of no co-financing and no commercial borrowings, BANEX would gradually become a banking services institution and an investor in TRACO, rather than predominantly a credit institution. Service income represents over 35% of total income by year eight and its relative importance in relation to total income continues to grow. Likewise, by year ten the BANEX investment in TRACO represents over 15% of total assets and this percentage keeps increasing.

TABLE 7

SENSITIVITY ANALYSIS

BANEX PRO-FORMA BALANCE STATEMENT (No Co-financing; [illegible]0)

LIBOR %	16	15	14	13	13	13	13	13	13	13
Year	1	2	3	4	5	6	7	8	9	10
ASSETS:										
Cash & Banks	175	183	436	676	242	241	275	270	136	270
Negot. Securities	25	25	25	25	25	25	25	25	25	25
Loan Portfolio:	3275	6907	11690	12526	12726	12016	11305	10626	9946	9130
AID funds	2500	5000	9600	10000	9524	8572	7620	6668	5716	4764
BANEX Capital	775	1732	1732	1732	1732	1732	1732	1732	1732	1732
Ret. Earnings	-	175	358	794	1470	1712	1953	2228	2498	2634
TRACO Equity	700	1050	1100	1050	1300	1450	1450	1450	1550	1600
Org. Exp. (Net)	125	62	0	0	0	0	0	0	0	0
Fixed Assets (Net)	44	33	22	11	0	0	0	0	0	0
Total Assets	4344	8260	13273	14288	14293	13732	13055	12373	11687	11025
LIABILITIES:										
AID Loan	3200	5700	10000	10000	9524	8572	7620	6668	5716	4764
NET WORTH:										
Capital, Paid-in	1043	2000	2000	2000	2000	2000	2000	2000	2000	2000
Legal Reserve	24	50	135	292	447	616	802	993	1159	1362
Retained Earnings	77	510	1138	1996	2322	2544	2633	2712	2782	2899
Net Worth	1144	2560	3273	4288	4769	5160	5435	5705	5941	6261
LIABIL. + NET WORTH	4344	8260	13273	14288	14293	13732	13055	12373	11657	11025
Bad Debt Reserve	33	69	117	125	127	127	127	127	127	127
Debt to Net Worth Ratio	2.8	2.2	3.1	2.3	2.0	1.7	1.4	1.2	1.0	0.8
G & A Exp./ Portfolio (%)	9.8	5.1	3.3	3.4	3.0	3.0	4.1	4.8	5.6	6.7
ROI (%)	9.7	40.0	27.9	31.0	21.2	18.7	15.3	15.0	14.1	15.4

TABLE 8
SENSITIVITY ANALYSIS
BANEX PRO-FORMA PROFIT & LOSS STATEMENT (No Co-financing; $000s)

Year	1	2	3	4	5	6	7	8	9	10
INCOME:										
Interest: AID	242	690	1270	1607	1601	1484	1328	1172	1015	859
Interest BANEX Capital	150	231	301	284	284	284	284	284	284	284
Interest Ret. Earnings	-	32	62	130	241	281	320	365	410	432
Fee Income (Services)	296	344	398	478	561	673	808	969	1163	1396
Total Income	688	1297	2031	2499	2687	2722	2740	2790	2872	2971
EXPENSES										
Interest-AID	97	222	392	500	500	464	417	369	322	274
Gen & Admin. Expenses	320	352	387	426	382	420	462	508	559	615
Bad Debt Expenses	33	36	48	8	2	-	-	-	-	-
Total Expense	450	610	827	934	884	884	879	877	881	889
TRACO Equity	-	350	350	350	250	150	-	-	100	50
INCOME BEFORE TAX & DEDUC.	238	258	854	1565	1553	1688	1861	1913	1662	2032
Legal Deductions										
5% CONAPE	12	13	43	78	78	84	93	96	83	102
10% Empl. Retmnt Fund	24	26	85	157	155	169	186	191	166	203
Taxable Income	202	221	726	1330	1320	1435	1582	1626	1413	1727
Income Tax	101	110	363	665	660	717	791	813	706	863
NET INCOME:	101	459	713	1015	910	868	791	813	807	914
USES:										
Legal Reserve	24	26	85	157	155	169	186	191	166	203
Retained Earnings	27	83	278	508	76	72	89	79	(30)	67
TRACO equity	-	350	350	350	250	150	-	-	100	50
Dividends	-	-	-	-	429	477	516	543	571	594
Estimated TRACO Div.	-	-	-	-	-	145	145	145	155	160
Adj. Ret. Earnings ($)	-	-	-	-	-	217	234	145	155	212
Adj. Ret. Earnings (%)						201	163	184	N.A.	241
Increment in N. Worth						145	290	435	590	750

The Bank's leverage capacity would be under utilized, as the average debt-to-equity ratio of 1.85 for the first ten years demonstrates. This low utilization gets even lower as retained earnings grow over the years. Although net profits are affected by a constantly smaller loan portfolio, in no year is a loss sustained. Dividends equivalent to 10% of the beginning period's equity can be paid but starting only in year five. Nonetheless, a satisfactory return on investment is obtained, as the average 20.8% for the first ten years demonstrate.

Funds transferred to TRACO would be sufficient to start two new TRACOS, one in year one, and another in year five.

b. Effect of Lower Than Projected LIBOR

It was necessary to test the impact of lower future interest rates because the LIBOR rates affect the financial income of both the AID-financed and BANEX equity portfolios. An extreme case was tested by assuming LIBOR rates three points below the already conservative projections of a dropping LIBOR. LIBOR rates of 13% in year one, 12% in year two, 11% in year 3 and 10% in year four and thereafter result in income reductions the of 20-25% in later years. The impact is considerable on net position of the Bank, but does not imperil the feasibility of the project.

TABLE 9
SENSITIVITY ANALYSIS
BANEX AID LOAN: INCOME GENERATED BY SPREAD
TRACO: PROFORMA CASH FLOW (No Co-financing, $000s)

YEAR	1	2	3	4	5	6	7	8	9	10
AID Income Share	35%	50%	50%	50%	50%	50%	48%	42%	35%	29%
Allowable G & A/Portfolio	5.5%	4.5%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%
BANEX										
AID Loan Portfolio	2500	5000	9600	10000	9524	8572	7620	6668	5716	4764
Interest Earned	242	690	1270	1670	1601	1484	1328	1172	1015	859
Interest Paid	97	222	392	500	500	464	417	369	322	274
Gross Profit	145	468	878	1107	1101	1020	911	803	693	585
General & Admin. Exp.	137	225	288	300	286	257	229	200	171	143
Bad Debt Expense	25	25	46	4	0	0	0	0	0	0
CONAPE	4	7	21	39	39	42	45	40	29	30
Empl. Reetmnt. Fund	8	13	42	78	77	84	89	81	58	59
Taxes	71	55	181	333	330	358	380	341	247	251
Income Generated	(37)	143	300	353	369	279	168	141	188	102
Available to TRACO	0	143	300	353	369	140	84	71	94	51
Investment in TRACO	700	350	350	350	250	150	–	–	100	50
From TRACO	–	–	300	400	–	–	–	–	–	–
Available Invest. (Cum)	(700)	(907)	(657)	(254)	(135)	(145)	(61)	10	(4)	(3)
Equity in TRACO	700	1050	1100	1050	1300	1450	1450	1450	1550	1600

TRACO PROFORMA CASH FLOW	1	2	3	4	5	6–10
Initial BANEX Invest.	700					
Revenue	35	262	615	878	1200	
BANEX Invest.	–	350	350	350	250	
Out Flows:						
Expenses	338	504	644	811	892	N O T P R O J E C T E D
Repayment to BANEX	–	–	300	400	–	
Cummulative Balance	397	505	526	543	1101	
New TRACOS	*				*	

TABLE

LIBOR RATE SENSITIVITY ANALYSIS ($000s)

Year	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
LIBOR %	16	15	14	13	13	13	13	13	13	13	13	13	13	13	13
Financial Income	392	1190	2537	3512	4616	6678	8692	10293	11471	12661	13852	15064	16712	18379	20501
Financial Expense	-97	-428	1167	1769	2675	4451	6217	-7619	-8659	-9699	10738	11779	13181	14583	16348
Gross Profit	-295	-762	1370	1743	1941	2227	2475	-2674	-2812	-2962	-3114	-3285	-3531	-3796	-4153
Adjusted LIBOR %	13	12	11	10	10	10	10	10	10	10	10	10	10	10	10
AID Income L+3.4%	205	578	1051	1313	1308	1212	1085	957	830	702	575	447	319	192	64
BANEX Capital L+3.4%	127	201	249	232	232	232	232	232	232	232	232	232	232	232	232
Ret. Earnings L+3.4%	--	-27	-55	-110	-148	-192	-229	-275	-324	-382	-441	-517	-602	-702	-825
Subtotal	332	806	1355	1655	1688	1636	1546	1464	1386	1316	1248	1196	1153	1126	1124
Comm+Cofin. Margin	-	31	125	218	375	688	1000	1250	1438	1625	1813	2000	2250	2500	2813
Less AID Fin. expense	97	223	392	500	500	464	417	369	322	274	226	17[illegible]	131	83	36
Adjusted Gross Profit	235	614	1088	1373	1563	1860	2129	2345	2502	2667	2835	3017	3272	3543	3901
Difference in G. Profit	(60)	(148)	(282)	(370)	(378)	(367)	(346)	(329)	(310)	(295)	(279)	(268)	(259)	(253)	(252)
Net BANEX Income	101	482	715	883	879	918	994	1067	1192	1252	1390	1473	1666	1871	2120
Diff. G. Prof./Net Income	59%	30%	39%	41%	42%	39%	34%	30%	26%	23%	20%	18%	15%	13%	11%

TABLE 11
BAD DEBT EXPENSE SENSITIVITY ANALYSIS ($000)

Year	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
Loans Outstanding	3275	9407	19213	25551	32361	46737	56061	65454	69867	79351	83838	93450	103131	112933	127913
Cum. Bad Debt Expense	33	94	192	256	324	467	561	655	699	794	838	935	1031	1129	1279
Legal reserve	24	545	141	266	418	575	762	966	1199	1447	1739	2062	2430	2658	3345
Total Bad Debt Expense	57	149	333	522	742	1042	1323	1621	1898	2241	2577	2997	3461	3987	4624
Total Bad Debt Expense/ Loan outstanding (%)	1.7	1.6	1.7	2.0	2.3	2.2	2.4	2.5	2.7	2.8	3.1	3.2	3.4	3.5	3.6
0.05 additional bad debt expense	16	31	49	32	34	72	47	47	22	47	22	48	48	49	75
Less Legal Deductions	2	5	7	5	5	11	7	7	3	7	3	7	7	7	11
Less Income Taxes	8	15	24	16	17	36	23	23	11	23	11	24	24	24	37
Net Impact	6	11	18	11	12	25	17	17	8	17	8	17	17	18	27
Original Net Income	101	482	715	883	897	918	994	1067	1192	1252	1390	1473	1666	1871	2120
Impact as % of Income	5.9	2.2	2.5	1.2	1.3	2.7	1.7	1.5	0.6	1.3	0.5	1.1	1.0	0.9	1.

c. Higher Than Expected Bad Debt

An analysis was made of the bad debt reserve. The legal reserve created by the Bank each year in accordance with the National Banking law can be used to offset bad debts. The resulting total reserve grows to 3.6% of total loans outstanding by year fifteen, an extremely conservative percentage by normal banking standards. Additionally, the effect on profits of creating an additional reserve equal to one half percent of total loans outstanding was tested. The impact of this larger reserve percentage on the banks overall position is not significant; as profits diminish by about one percent.

7. General Conclusions

Several conclusions can be drawn from the foregoing analyses. First, the bank should be able to create a loan portfolio of US$128 million by the end of year fifteen. In a credit starved economy such as Costa Rica's, placing these funds over fifteen years seems feasible.

Second, in the process of creating the bank, enough funds are transferred to TRACO to permit the operations of up to four different TRACOS by year fifteen.

Third, the bank not only is able to cover its expenses under the assumptions made but is strong enough to sustain the large downside variations tested and still turn a profit.

In summary, although the project is based on very defendable assumptions, including co-financing and commercial borrowing and conservative LIBOR projections, it is feasible even under much more adverse conditions. The project should greatly improve Costa Rica's capacity to increase exports by creating up to four trading companies and a loan portfolio in excess of US$128 million for financing exports.

TRACO PERFORMANCE PROJECTIONS

A. Export Management Revenue

Costa Rican nontraditional exports to non-CACM markets increased at an average annual rate of 26% between 1971 and 1979 (See Economic Analyses Section). Given the 50% growth in exports of all Costa Rican manufactured products in 1980, nontraditional exports beyond the CACM are likely to have increased dramatically as well. The effect of the current colon devaluation and efforts to expand exports should stimulate even more rapid growth during 1981, 1982 and beyond1/. Calculating the annual rate of growth of nontraditional exports to world markets at the very conservative rate of 30% per year over the 1979 level, the following volumes can be expected (in millions of dollars):

1980	179.4
1981	233.2
1982	303.2
1983	394.1

In order to estimate the percentage of the export management market that TRACO can anticipate, the Mission has conducted various analyses.

1. According to the expert advice of World Trade Institute (WTI) consultants2/ a fully operational TRACO, with WTI assistance, could capture at least 3% to 4% of the country's export management business. Applying a more conservative estimate of between 2.5% to 3%, it

1/ A recent survey carried out by the University of Costa Rica Economic Research Institute among a sample of manufacturing firms indicated that they expected their total 1981 physical output to decrease by 2.7% from 1980, that their production for the internal market would decrease by 12.1% (from 73.2% of total volume to 66.17%), that production for the CACM and Panama would remain constant, while the production destined to the rest of the world would increase by 197.4% (from 3.4% to 10.3% of total volume).

2/ The World Trade Institute consulted with the Mission throughout the design of the Management Export Component.

can be anticipated that if fully operational in 1982, TRACO would manage export volume in excess of $10 million. Given the standard export management fee range of 5% to 10% of total export value, and applying the more conservative 5% figure, TRACO export management revenue in 1982 would total approximately $500,000.

On this basis, and projecting TRACO operating efficiency at 10% in year one (1981,82), 80% in year two (1982,83) and 100% beginning in year three (1983,84), it can be expected that TRACO export management revenue will be as follows:

Year	Estimated Revenue
1	$ 29,000
2	$303,000
3	$551,000

2. Considerable basis for the design of TRACO was provided by Guerra and Associates Inc., a successful U.S. based trading company (see Annex C, Exhibit 6). According to Guerra, most trading companies staff their offices on the "rule of thumb" that each of the company's "traders" or account managers produces an average of five times his/her salary per year in export management earnings. Using this "rule" and projected TRACO staffing (see Table 1 of the Section "TRACO Operating Costs"), TRACO staff could produce earnings of:

Year	Earning Potential
1 (4 mos. productivity)	$ 83,300
2 (full productivity)	$500,000
3 (full productivity)	$750,000

3. The GAMCO survey of twenty-six nontraditional exporters (See Annex C, Exhibit 1) identified potential within those firms for export volume of well over $30 million by 1982. If only 25% of those exports were to be managed by TRACO, it would earn $375,000 in its second year of operation.

Clearly, estimating TRACO's potential export managemènt revenue is not an easy task. The Mission has chosen to use conservative estimates in order to offer a "down side" presentation.

B. Procurement Revenue

With the assistance of the World Trade Institute, the Mission has made the following projections regarding TRACO potential procurement service revenues:

- o In year one, TRACO will serve ten clients, each having an annual export production volume of $1 million.
- o Imported inputs average 25% or, in the case of these TRACO clients, $250,000 per client. Purchases of foreign raw materials would total $2.5 million.
- o Procurement fees start at 2.5% of purchase price.

The above factors would permit TRACO to earn $62,500 in procurement fees during the first year.

C. Other Revenues

Several other revenue sources will exist for TRACO. For purposes of maintaining a conservative estimate, however, they are not included in these projections. These sources will include:

- o Service fees for credit guarantees;
- o warehousing and brokerage fees;
- o sales commissions from suppliers; and
- o interest earnings on investments made with the TRACO capital.

In order to estimate revenue beyond year three of operation, the Mission has projected an even rate of growth based on the pattern established during the first three years. The development of additional TRACOs is scheduled, and their rates of earning are projected roughly equivalent to those of the original U.S. based TRACO.

D. TRACO Operating Costs

Assisted by the World Trade Institute and Guerra and Associates, the Mission has developed the following projections of cost for the operation of TRACO-Costa Rica and its U.S. based subsidiary. Additional foreign based TRACOs have been scheduled. Their costs are also based on these cost estimates (plus inflation).

TABLE 1. ESTIMATED TRACO COSTS

	YEAR			
	1	2	3	4
o Genl. Manager (CR)	85.	90.	100.	110.
o Genl. Manager (US)	43.	90.	100.	110.
o Asst. Mgr. (CR)	0.	55.0	60.0	65.
o Purchasing Agent (US)	0.	40.0	45.	50.
o Mktng Mgrs. (US)	0.	0.	50. (12)	120.
o Import/Export Clks (CR)	17.	30.(x2)	72.	80.
o Secretarial (CR)	20.	24.(x2)	58.	65.
o Secretarial (US) (personnel costs include aprox. 40% fringe benefits)	0.	0.	28. (x2)	60.
o Consultation/TA	150.	150.	50.	50.
o Travel	15.	25.	30.	35.
o Consumables, Rentals, Equipment, Misc. (estimated at 10% of staff costs)	8.	33.	51.	66.
TOTAL	338.	504.	644.	811.

Clark Joel
July 20, 1981

ECONOMIC ANALYSIS SECTION OF PRIVATE SECTOR PRODUCTIVITY PROJECT

This analysis will cover the following points: economic justification of the proposed project; review of growth trends in the export of manufactured products to outside the CACM and evaluation of potential for continued growth; identification of specific areas where Costa Rica's growth potential is greatest; review of major bottlenecks to the continued rapid growth of manufacturing exports to outside the CACM and assessment of the extent to which effective measures have been adopted by the Government of Costa Rica to address these obstacles; the contribution of the proposed project to overcoming some of the major remaining bottlenecks; and a quantified assessment of the impact that the project could have on the expansion of experts of non-traditional products to outside the CACM.

1. Project's Major Justification

A. The Balance of Payments: the need to relieve Costa Rica's very serious balance of payments situation and to help the country diversify its sources of foreign exchange constitutes the most important argument in favor of the proposed project. The central bank's balance of payments projection summarized in Table 1 shows that the overall balance of payments deficit increased from $41 million in 1978 to $82 million in 1979 and to $456 million in 1980. The actual decline in net international reserves was held down to $173 million in 1980 only due to the accumulation of arrears (i.e. the non-payment of debts) to the tune of $283 million in 1980. The central bank very optimistically projects the balance of payments deficit to disappear in 1981. The authorities hope to pay off $96 million in arrears in 1981 by means of IMF credits. Note, however, that this highly optimistic projection is based on the following assumptions:

(1) A projected increase in the total value of exports in spite of the sharp drop in coffee prices between 1980 and 1981 and the cutback in the coffee export quota. The central bank projects an increase of coffee exports to new markets to offset the decline in price.

(2) A sharp decline in imports. Imports are projected to decline by 12 percent in current dollars, which probably means a 20 to 25 percent drop in real terms. Import data over the first fourth months of 1981 showed a 16 percent decline (in current dollars) over the same period last year. Thus, Costa Rica's Gross Domestic Product is bound to decline significantly in 1980, much more than the 1.5 percent decline that is currently projected by the central bank.

(3) Official capital inflows are projected at $350 million in 1981. Given the reluctance of foreign commercial banks to provide credit to Costa Rica, this figure is unlikely to be attained, and could fall short of the target by as much as $100 million.

(4) The net private capital outflow which was $180 million in 1980 is projected to become a net inflow of $104 million in 1981. Since this figure was obtained as a residual, it has little predictive validity. A net private capital flow figure of zero is more likely to be realistic.

In conclusion: while the central bank's balance of payments forecast for 1981, with its 20 to 25 percent decline of imports in real terms, is a dismal prospect, the reality may well prove to be worse owing to the fact that the projection is based on highly optimistic assumptions with respect to exports and capital flows on both private and official account. It is clear that Costa Rican authorities must give first priority to investment projects designed to increase exports or reduce import requirements.

B. A second major aspect of the project's justification is the country's need to continue the process of diversifying its exports. The diversification trend over the past decade has been very encouraging: total exports of the traditional products (coffee, bananas, meat and sugar) declined from 73 percent in 1970 to 55 percent in 1980, while industrial exports increased from 23 percent or 36 percent (see Tables 2 and 3). Still, in 1980, three export products -- coffee, sugar and bananas -- together accounted for 48 percent of total export earnings. Clearly, the diversification trend must continue.

Between 1960 and 1979, the Central American Common Market grew rapidly and provided an excellent outlet for Costa Rica's non-traditional products. Beginning in 1978-79, however, the CACM experienced major balance of payment difficulties and a stagnant real GDP. Over the next two to three years at least, the CACM cannot be counted upon to provide a significant underpinning for Costa Rica's manufacturing industry. Thus, there appears to be no alternative but to focus on outside markets.

C. Third, the project responds to the private sector's urgent need for an infusion of working capital. While credit to the public sector expanded by 40 percent between the end of 1979 and 1980, the expansion of credit to the private sector increased by only 13%. This means a substantial reduction in real terms since the wholesale price increased by 21.6% during the year. The loanable funds of the commercial banking system had to be diverted to finance the public sector deficit. Moreover, the commercial banking system has been plagued by a very serious delinquency problem equal to 40 to 50 percent of the total loan portfolio, which further seriously restricts the ability of the banks to provide credit. As a result, the private sector complains of a severe credit shortage. The proposed project is designed to avoid these problems by channeling funds to an institution that is not part of the nationalized banking system.

D. Aside from providing the private sector with badly needed credit funds, the proposed project is designed to address a number of other problems that have proved to be serious obstacles to the expansion of non-traditional exports to outside the CACM. These will be discussed in some detail in Section 4.

E. Finally, the project can be expected to contribute toward the reduction of the substantial increase in the unemployment rate that is expected to take place this year. With a 20 to 25 percent reduction in the level of real imports, the GDP is bound to decline substantially in real terms which cannot help but significantly affect the unemployment rate. While no reliable unemployment statistics exist, it is known to have increased significantly. Between March 1978 and March 1981, the open unemployment rate is estimated to have risen from 4.8 to 7.4 percent, while the total sub-utilization rate (which includes underemployment) rose from 11.0 to 15.9 percent. It is suspected that these figures substantially underestimate the actual seriousness of the unemployment problem. The project is expected to alleviate the unemployment problem -- or prevent it from getting worse -- owing to the fact that many of the areas in which the country has the greatest potential comparative advantage (discussed below in Section 3) are labor intensive. Following devaluation, Costa Rica's wages are competitive with other C.A. and Caribbean countries, particularly after account is taken of the relatively high level of training and literacy of the Costa Rican labor force.

2. Potential for Exports of Non-Traditional Products to Outside the CACM

The growth trend in the exportation of manufactured products over the past decade gives some indication of Costa Rica's export potential in this area.
Table 4 shows the trend of exports of manufactured products including foodstuffs, while Table 5 excludes foodstuffs. The following conclusions stand out:

a. The growth in the export of manufactured products to both the CACM and the outside world over the past decade has been truly phenomenal. Total exports of manufactured products, including foodstuffs, increased at an average annual rate of 30 percent over 1971-74 and 24 percent over 1974-77.

However, the growth slowed to only 7.6 percent over 1977-79 (Table 4).

b. If foodstuffs are excluded from the statistics, the growth is no less impressive: 30 percent over 1971-74, 22 percent over 1974-77 and 19 percent over 1977-80 (Table 5).

c. The rate of growth of exports of manufactured products to the rest of the world is even higher than to the CACM. The reverse was the case during the decade of the 1960's.

d. It is remarkable that even during the troubled year of 1980, exports of manufactured goods (other than foodstuffs) to the rest of the world increased by 50% in current dollars (see Table 5).

Thus, there can be little question but that Costa Rica's non-traditional export industries, particularly for manufactured products exported to outside the CACM, have made substantial strides over the past decade, a trend that persisted through recent years.

3. Identification of Areas of Greatest Growth Potential

On the basis of analysis of trends in exports statistics, as well as interviews conducted by the AID Mission's economic consultants with major exporters, the following product categories stand out as offering the greatest potential in the area of non-traditional exports to outside the CACM:

a. Foodstuffs, including fruits, vegetables, root plants, spices, marine products and chocolate. There appears to be a substantial potential foreign market for both fresh and processed fruit and vegetable products, though a significant transport bottleneck will have to be addressed in conjunction with fresh produce.

b. Flowers, plants and seeds.

c. Textiles, including synthetic yarn and cloth.

d. Apparel.

e. Shoes and leather goods.

f. Wood and wood products, particularly furniture. Costa Rican furniture is well made and of international renown.

g. Fertilizer and chemicals, including insecticides and fungicides.

h. Medicines and pharmaceutical products.

i. Plastic products including cellophane bags, plastic bottles and plastic sheeting.

j. Electric batteries.

The diversity of the above products and their generally upward trend suggests a strong potential, provided the various bottlenecks discussed below can be overcome.

4. Major Bottlenecks

Interviews with bankers and major industrialists conducted by the Mission and its consultants, suggest that there are a number of serious bottlenecks constraining the continued expansion of exports of non-traditional products to outside the CACM. The main ones are:

a. The acute foreign exchange shortage, which makes it very difficult for business firms, including exporters, to obtain foreign exchange for imports of essential raw materials and parts; and has led to a cut-off from traditional sources of credit from foreign banks and suppliers.

b. Uncertainty with regard to government intentions: this applies particularly in the area of the foreign exchange rate and the allocation of foreign exchange resources. Over the past year, devaluation was followed by a dual exchange rate policy, then by a float. At this time, there are reports that the government plans to go back to a single exchange rate of 15 colones to the dollar, though it would appear that the authorities do not have the necessary foreign exchange reserves to defend that rate. There is also uncertainty with regard to government policy in the areas of taxation and interest rates.

c. A serious credit squeeze: while credit extended to the private sector increased in nominal terms (by 13.5%) in 1980, it fell short of keeping pace with inflation. Thus, domestic credit in real terms declined. The situation is much more serious if it is considered that foreign sources of bank and supplier credit were cut off during this period. Bankers attribute the credit stringency to the diversion of available funds to the public sector to finance the large budget deficit; and to the very high delinquency rate. They note that 40 to 50 percent of the total loan portfolio of the banking system is delinquent by more than six months, and that non-recoverable loans may go as high as 25 percent of the total portfolio. Thus, the banking system is facing a very serious liquidity crisis and the private sector is bearing the brunt of the shortage of loanable resources.

d. Failure of the banking system to provide needed services: aside from its inability to accommodate the credit requirements of the private sector, the nationalized banking system is faulted for the low level of service it is providing to exporters. For example, banks are very slow in collecting and remitting the proceeds of Costa Rican exports; they do not maintain normal correspondent bank relations and do not provide bank references. These considerations were primary factors in the private sector's decision to promote the establishment of BANEX.

e. The tariff structure: the common external tariff of the Central American Common Market (CACM) provides a high level of effective protection by applying high tariffs on finished consumer goods and much lower tariff rates, including generous exemptions, on intermediate and capital goods. This favors assembly-type operations and channels resources into import-competing industries in lieu of export industries. The World Bank strongly argues for a revision of the tariff structure. Unfortunately, this is not a step that Costa Rica can adopt unilaterally.

f. Transportation problems: high freight rates and the scarcity of transportation facilities, particularly of refrigerated facilities for perishable products, was identified as a major obstacle to increased exports to outside the CACM. While transport is a problem even in the case of Costa Rica's perishable products shipped to the United States, it is particulary serio - exports to the Caribbean. There are no direct flights to the Caribbean islands and all shipments must be channeled through Miami.

g. Other problems: other problems identified by the private sector include its inability to produce large quantities for a sizeable market (a major obstacle for sales to the U.S.

and Europe); absence of grading standards, quality control and difficulty of ensuring uniformity of product; deficiencies in technical know-how; and lack of knowledge by most potential exporters of export procedures, market requirements and suitable contacts with potential customers in the U.S. and Europe.

5. <u>Extent to which these Bottlenecks are being Addressed</u>

Significant progress has been made in addressing some of the bottlenecks described above, but much remains to be done. The most important remedial measures taken by the government include the following:

a. Devaluation: there can be no question but that the colon was substantially overvalued at 8.6 to 1 and that the Costa Rican authorities held on to that rate far too long. Thus, the free-floating of the colon removed one of the major obstacles to the exportation of non-traditional products. Unfortunately, the legality of the floating exchange rate has been called into question, and it now appears that a fixed rate will be adopted instead. Uncertainty still prevails with respect to the level at which the rate will settle, and whether any rate significantly below the free market rate can be defended by the authorities.

b. Another major step forward is the development of an Extended Fund Facility arrangement with the IMF which will provide Costa Rica with drawing rights for SDR 276.75 million over a three-year period. It is hoped that this agreement will facilitate somewhat Costa Rica's prospects for obtaining additional loans from foreign commercial banks. Perhaps most importantly, the agreement provides for a tight fiscal program limiting the overall deficit of the non-financial public sector to no more than ₡5,250 million in 1981 by cutting expenditures and raising tax collections, and includes other measures designed to remove the sources of the considerable monetary-balance of payments disequilibrium. The 1981 monetary program permits a 28 percent expansion (in current colones) of credit to the private sector, a significant amount, though it is still likely to prove insufficient to keep pace with the expected inflation.

6. Role of the Proposed Project

While it cannot be claimed that the proposed project will remove all remaining obstacles, it addresses a number of them. In the first place, it is hoped that the project will provide BANEX with $20 million in additional foreign exchange resources, most of which will be used to reduce the deficiency in working capital, which, along with the foreign exchange shortage, is probably the most important bottleneck to a substantial increase in non-traditional exports. An illustrative estimate of the possible impact of such financing on exports will be attempted in the following section. Second, the new institution that AID will capitalize (BANEX) is expected to provide a number of services currently not available -- including research and information regarding foreign markets, foreign market development including product promotion, technical information exchange, buyer contacts, technical assistance regarding project preparation, packaging, production scheduling, financial management guidance, coordination of cooperative marketing, marketing and transportation, and assistance with the export paper work. BANEX will also provide a number of banking services, including special collection services, assistance in opening letters of credit, negotiating lines of credit, and obtaining bills of lading. We have noted that these services are not currently available and constitute a significant obstacle to the expansion of non-traditional exports.

7. The Project's Potential Impact on Exports of Non-Traditional Products to the Rest of the World

An attempted quantification of the possible impact of the project on additional exports of non-traditional exports to outside the CACM was attempted by Jorge Morelos, a private economic consultant who had interviewed 22 potential sub-borrowers at the time of this writing. Since the greatest current need of the export sector is for working capital, he concentrated on the impact on potential export earnings of short-term credits from a foreign exchange revolving fund that would enable exporters to purchase raw materials, parts and other intermediate goods, as well as meet their local currency expenses. He asked each interviewee how much additional exports could be generated for each $1 in credits for working capital provided. By averaging his responses, he found that potential exporters believed that two dollars of <u>net</u> exports could be obtained for each one dollar in working capital loans received. Morelos underscored the fact that he was referring to <u>net</u> exports, i.e. the net proceeds remaining after deducting payment for imported raw materials and parts. Moreover, the turnover of this working capital fund would be between two and three times a year.

Morelos explained these extraordinarily favorable results on the basis of the fact that all the cooperant factors of production are there -- the labor, plant and equipment, the entrepreneurship -- so that the working capital is, at this stage, the only true bottleneck. By providing the credit to break it, we are in fact taking advantage of all the investment in fixed capital and human resources already made. He admits, however, that this is not a normal situation that could be expected to prevail over the fifteen-year period that the AID loan would remain at BANEX's command.

We are, therefore, basing our illustrative estimates on much more conservative assumptions.

Let us assume that of the $20 million combined AID commercial bank loans, two-thirds or $13 million will be placed in the working capital revolving fund. Assuming it revolves only twice a year, and that each dollar loan will generate one dollar of net additional exports (instead of the two dollars resulting from Morelo's survey), we would obtain an increase in net exports of $26 million a year. Assuming that these favorable conditions prevail only over a five-year period, we would generate an additional $130 million of exports over the first five years alone. Such favorable conditions cannot be expected to continue indefinitely, so that a less favorable ratio must be assumed over the following ten years. On the other hand, account must be taken of the fact that the substantial increase in new exports projected during the first five years would generate profits that would be available to provide additional resources for both working and fixed capital investment. Even if we assume that each $1 in loans would generate only $.5 in new exports during the following 5 years, the total net exports generated would be over $200 million during the first ten years following disbursement.

Given the nature of the project, i.e. the fact that the sub-borrowers and the export potential of their activities cannot be identified at this stage, the figures cited above are obviously only illustrative. Yet, they provide substantial support for the conclusion that the project has enormous potential in terms of foreign exchange earnings and export diversification, and thus meets a high priority need of the Costa Rican economy at this time.

8. Importance of Ensuring the Revolving Nature of the Credit Provided by BANEX

For the revolving fund to have the favorable multiplier effect on exports described above, it is essential that exporters be permitted to repay the BANEX foreign exchange loan promptly and in foreign exchange, so that it will become immediately available for relending. If the process gets caught up in Costa Rica's foreign exchange control system, it could easily break down. For example, if all foreign exchange proceeds from exports must be turned over to the central bank which would then proceed to ration out exchange in accordance with its system of priorities, or if exporters are forced to repurchase the foreign exchange required to repay the loan at a higher rate than the one they receive from the central bank for their export proceeds, the operation of the fund could suffer substantial delays and could conceivably become unprofitable. Fortunately, a mechanism currently exists that would prevent this from occurring. This is "the system of advances" ("sistema de adelantos") which has been in force for some time, was suspended earlier this year, and has been reinstituted on July 9. Under this system, the central bank agrees to allow exporters to repay their foreign loans from banks or suppliers before selling the remaining export proceed to the central bank. Thus, a loan from BANEX could be repaid to that institution since only the net proceeds must be turned over to the central bank at the rate it sets. It is clear that AID must assure itself of the revolving nature of any loan that BANEX grants by inserting a suitable provision in the loan agreement.

TABLE 1

COSTA RICA: SUMMARY BALANCE OF PAYMENTS
(In millions of U.S. dollars)

	1978	1979	Prel 1980	1981
Current Account	-363	-566	-661	-460
Trade balance	-302	-455	-512	-260
Exports f.o.b.	(864)	(942)	(1,017)	(1,039)
Imports c.i.f.	(-1,166)	(-1,397)	(-1,529)	(-1,353)
Oil	/113/	/184/	/223/	/230/
Non oil	/1,053/	/1,213/	/1,306/	/1,123/
Services and Transfers (net)	-61	-111	-149	-200
Capital account Private 1/	319	459	182	454
Public	235	390	362	350
Nonfinancial 2/	(216)	(187)	(209)	(183)
Financial 3/	(19)	(203)	(153)	(167)
SDRs and gold revaluations	3	25	23	6
Overall balance	-41	-82	-456	---
Arrears	--	--	283	-96
Official net international reserves (increase-)	41	82	173	96 4/

1/ Determined as a residual; includes net errors and ommisions.
2/ Rest of Public Sector. i.e. all institutions other than those listed under "Financial."
3/ Central Bank, commercial banks, INVU (Housing), INS (Insurance Companies), INFOCOOP, Banco Popular, IFAM, DECAP. This item excludes IMF assistance which finances the balance of payments gap.
4/ To be covered by IMF funds.

Source: Central Bank (as agreed with IMF).

Table 2

COSTA RICA: EXPORTS FOB
BY PRINCIPAL PRODUCT
-percentage shares-

	1970	1975	1978	1979	1980 1/
Total F.O.B. Exports	100.0	100.0	100.0	100.0	100.0
Traditional products	72.7	65.1	64.7	64.8	54.9
Coffee	31.6	19.6	36.3	33.8	24.2
Banana	28.9	29.2	19.6	20.4	19.8
Meat	7.8	6.5	7.0	8.7	6.9
Sugar	4.4	9.8	1.8	1.9	4.0
Other products	27.3	34.9	35.3	35.2	45.1
Agricultural	4.2	7.2	9.4	8.2	8.7
Industrials	23.1	27.7	25.9	27.0	36.4

1/ Preliminaries

Source: Central Bank

Table 3

COSTA RICA: EXPORTS BY PRINCIPAL PRODUCT
(by millions of dollars)

	1970	1975	1978	1979	1980 1/
TOTAL F.O.B. EXPORTS	231.2	493.3	864.9	934.4	1.017.8
COFFE	73.1	96.9	313.7	315.4	246.2
Volume (thousand of quintals)	1.502	1.673	1.817	2.117	1.551
Price	48.66	57.93	167.10	148.95	158.81
BANANA	66.8	144.3	169.9	190.5	201.2
Volume (thousand of tons)	856	1.105	1.058	1.025	960
Price	78.00	130.00	161.00	186.00	210.00
MEAT	18.0	32.1	60.3	81.7	70.4
Volume (millions of kilos)	17.5	29.8	34.5	31.6	25.9
Price	1.03	1.08	1.75	2.59	2.72
SUGAR	10.1	48.2	15.9	17.5	40.5
Volume (thousand of (quintals)	1.465	1.525	1.488	1.502	1.570
Price	6.92	31.60	10.68	11.65	25.81
OTHER PRODUCTS	63.2	172.0	305.0	329.3	459.2
Agricultural	9.7	35.4	80.9	76.8	88.2
Industrials	53.5	136.6	224.1	252.5	371.0

1/ Preliminaries

Source: Central Bank

TABLE 4

COSTA RICA: EXPORTS OF MANUFACTURED PRODUCTS
(Including Foodstuffs but Excluding Fertilizers)
Over 1971-80
(In millions of dollars)

	To CACM	To Outside CACM	Total
1971	45.7	17.5	63.2
1972	48.4	19.6	68.0
1973	67.9	25.7	93.7
1974	97.7	42.1	139.8
1975	100.8	41.9	142.8
1976	127.7	73.8	201.5
1977	167.4	100.6	268.1
1978	169.1	110.0	279.1
1979	172.3	138.0	310.3
1980	-	-	444.8
Average Annual Compound Growth Rate			
1971-74	28.8	34.0	30.3
1974-77	19.7	33.7	24.2
1977-79	1.5	17.1	7.6

Source: Dirección General de Estadística y Censo.

TABLE 5

COSTA RICA: EXPORTS OF MANUFACTURED PRODUCTS
(OTHER THAN FOODSTUFFS AND FERTILIZER),
1971-1980
(In millions of dollars)

	To CACM	To Rest of World	Total
1971	42.9	11.8	54.7
1972	45.3	13.3	58.6
1973	64.0	15.4	79.4
1974	91.7	27.4	119.1
1975	93.7	24.6	118.3
1976	122.2	45.5	167.6
1977	155.2	60.8	215.9
1978	154.3	58.9	213.2
1979	164.7	78.5	243.2
1980	247.2	117.2	364.4
Average Annual Compound Rate:			
1971-74	28.8	32.4	29.6
1974-77	19.2	30.9	21.9
1977-80	16.8	24.4	19.1

Source: Dirección General de Estadística y Censo

DRAFT PERFORMANCE INDICATORS FOR PROJECT EVALUATION

The number and type of variables that could serve as measurable indicators of performance differ by project component:

A. Credit Component

The credit component evaluation variables are grouped into four different categories:

1. Portfolio Related Variables

o Total number and dollar volume of subloans.

o Breakdown of number and dollar volume of subloans, arranged by economic subsector.

o Total number and dollar volume of short, medium and long term subloans; and a summary of utilization of funds by type of terms.

o Breakdown of number and dollar volume of short, medium and long term subloans (including summary of utilization) arranged by economic subsector.

o Total number and dollar volume of uncollectable and delinquent (including period of delinquency) subloans.

o Breakdown of number and dollar volume of uncollectable and delinquent subloans, arranged by economic subsector and by time terms.

2. Export Market Related Variables

o Total dollar volume of exports resulting from AID subloan financing, arranged by market country.

o Breakdown of total number of units and dollar volume of exports arranged by product and by market country.

3. Macro Economic and Social Indicators

o Estimates of total value added of exports resulting from AID subloan financing, arranged by economic subsector.

- o Net inflows of foreign exchange (minus imported raw materials) generated as a result of AID subloan financing, arranged by economic subsector.

- o Dollar value relationship between total exports generated by AID subloan financing and: a) total exports, and b) total nontraditional exports

- o Dollar and unit volume relationship between total Costa Rican nontraditional exports and those generated by AID subloan financing, arranged by economic subsector.

- o Total employment and wage bill generated (including significant backward linkages) as a result of AID subloan financing arranged by economic subsector, by function (e.g. professional vs. nonprofessional) and by sex.

4. <u>Enterprises Related Variables</u>

- o Size of subborrowing firms, in terms of total assets, volume of sales and size workerforce, by economic subsector.

- o Export income: pre vs. post subloan export levels, and/or shifts from domestic and CACM markets to world markets.

B. <u>Banking Services Related Variables</u>

- o Total annual revenue and number of individual banking transactions per category of services (e.g. letters of credit vs. collections, etc.)

  - o Estimates of BANEX "national market share" per category of banking services

  - o Annual opinion survey among selected number of BANEX clients concerning: 1) expediency of services, 2) service quality and 3) cost of services.

C. <u>Export Management Services Related Variables</u>

- o Total number of firms utilizing services arranged by economic subsector.

- Volume of total exports and imports managed by TRACO arranged by economic subsectors and by export market.
- Sales and employment impact on individual enterprises resulting from TRACO export management services.
- Annual profits/losses of TRACO.

Methodology and Schedule

1. BANEX offices will ensure accurate completion of a data base file with each subloan (design of sheet to be reviewed and approved by USAID prior to initial disbursement).

2. BANEX will monitor all subloans to ensure sub-borrower compliance with AID regulations and subloan conditions.

3. BANEX will provide USAID with quarterly reports of project progress toward subgoal.

4. In-depth evaluations will be conducted at disbursement points $3.2 million $5.7 million and $10 million.

ANNEX G, EXHIBIT 2

TRACO IMPLEMENTATION SCHEDULE

	YEAR 1 Quarter				YEAR 2 Quarter			
	1st	2nd	3rd	4th	1st	2nd	3rd	4th
o TRACO advance capitalization	X							
o Here TRACO General Manager	X							
o Contract World Trade Institute	X							
o Hire Genl Mgr of US Office		X						
o Complete basic organization of US office			X					
o Complete basic organization of CR TRACO office				X				
o Begin Procurement operations					X			
o Identify/Verify first export product line					X			
o Begin export operations						X		
o Establish EXCO-product line A							X	