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UNITED STATES INTERNATIONAL DEVELOPMENT COOPERATION AGENCY
AGENCY FOR INTERNATIONAL DEVELOPMENT
Washington, D. C. 20523

COSTA RICA

PROJECT PAPER

ECONOMIC STABILIZATION AND RECOVERY

AID/LAC/P-098

Loan Number: 515-K-037
Grant Number: 515-K-601

UNCLASSIFIED

CLASSIFICATION:

AID 1120-1 (8-66)	DEPARTMENT OF STATE AGENCY FOR INTERNATIONAL DEVELOPMENT	1. PAAD NO. 515-K-037 (Loan) 515-K-601 (Grant)
		2. COUNTRY Costa Rica
PAAD	PROGRAM ASSISTANCE APPROVAL DOCUMENT	3. CATEGORY Cash Transfer
		4. DATE June 17, 1982

5. TO: AA/LAC, Otto J. Reich

6. OYB CHANGE NO.

7. FROM: LAC/DR, Dwight B. Johnson

8. OYB INCREASE

TO BE TAKEN FROM: Economic Support Funds (ESF)

9. APPROVAL REQUESTED FOR COMMITMENT OF: $ 20,000,000

10. APPROPRIATION - ALLOTMENT: 72-1121037 237-65-515-00-50-21 (Grant) 237-65-515-00-58-21 (Loan)

11. TYPE FUNDING: [X] LOAN [X] GRANT

12. LOCAL CURRENCY ARRANGEMENT: [ ] INFORMAL [X] FORMAL [ ] NONE

13. ESTIMATED DELIVERY PERIOD: FY 82

14. TRANSACTION ELIGIBILITY DATE: To be determined

15. COMMODITIES FINANCED

N/A

16. PERMITTED SOURCE		17. ESTIMATED SOURCE	
U.S. only:		U.S.:	$20,000,000
Limited F.W.:		Industrialized Countries:	
Free World:		Local:	
Cash:	$20,000,000	Other:	

18. SUMMARY DESCRIPTION

The purposes of the program are (1) to provide immediate balance of payments support to Costa Rica and (2) to assure the allocation by the Central Bank of Costa Rica (BCCR) urgently needed foreign exchange and credit to the private sector in Costa Rica, particularly to net exporters, with the objective of maintaining levels of production and employment. Of the total $20.0 million cash transfer, $15.o million will be provided as a loan and $5.0 million will be provided as a grant. The BCCR will sell the dollars to state-owned and private commercial banks. The banks, in turn, sell the dollars to their private sector clients to allow the importation of raw materials and intermediate goods for high priority enterprises. The BCCR will use the local currency generated for loans to private industrial and agricultural producers. Priority attention will be given to credit for export-related production. Loans will be made available at market rates of interest.

The loan will be repaid in 40 years including a ten year grace period. The interest rate will be 2% during the grace period and 3% thereafter.

19. CLEARANCES	DATE
LAC/CEN:MSchwartz/JOleson	6/25
GC/LAC:BVeret	6/28
PPC/PB:HHandler (draft)	
ARA/ECP:KBowen (draft)	
FM:WMcKeel (draft)	
DAA/LAC:MDBrown	7/5/82

20. ACTION: [X] APPROVED [ ] DISAPPROVED

AUTHORIZED SIGNATURE DATE

TITLE: Assistant Administrator, Latin America & the Caribbean

CLASSIFICATION:

PROGRAM ASSISTANCE APPROVAL DOCUMENT

COSTA RICA: ECONOMIC STABILIZATION AND RECOVERY

I. SUMMARY AND RECOMMENDATIONS

A. Recommendation

USAID/Costa Rica recommends authorization of an Economic Support Fund Loan of $15,000,000 and an Economic Support Fund Grant of $5,000,000. The dollar loan will be repaid in 40 years including a ten year grace period. The interest rate will be 2% during the grace period and 3% thereafter.

B. Borrower/Grantee

The Borrower/ Grantee will be the Central Bank of Costa Rica (BCCR), which will administer the program through the National Banking System.

C. Program Summary

Costa Rica is experiencing its most serious economic crisis in many decades. Viewed from almost any perspective, the growing deterioration of Costa Rica's economy during the past year has affected all productive sectors of the economy. Imports declined 29% in real terms in 1981, reducing the flow of inputs necessary to maintain national production. An inflation rate estimated at 117% (as measured by the increase in the wholesale price index Dec. 1980 - Dec. 1981) during 1981 resulted from the decrease in imports, continued sizable public sector deficits, and a continuing devaluation of the colon which, in terms of the dollar, has been over 400% and shows no signs of stabilizing. Costa Rica's massive public and private external debt, even if rescheduled, will continue to constrain the economy's recovery for at least the next five years and will create sizable balance of payments gaps. External assistance will be required to help finance these gaps and to ease Costa Rica's difficult road to recovery and structural readjustment toward an export-led development strategy.

The objectives of the proposed economic support program are:

1. To provide immediate balance of payments support to Costa Rica and

2. To assure the allocation by the BCCR of urgently needed foreign exchange and credit to the private sector in Costa Rica, particularly net exporters.

The proposed $20.0 million program will be in the form of an immediate cash transfer to the Central Bank of Costa Rica. The BCCR will sell the dollars to state-owned and private commercial banks. These dollars will supplement foreign exchange resources received by the banks through the liquidation of export earnings and will be sold by the banks to their private sector clients in accordance with the priorities already established by the BCCR.

As a condition of the program, the BCCR will provide resources for the importation from the United States, within six months following disbursement of the cash transfer, of $20.0 million worth of raw materials, intermediate goods and spare parts needed by private enterprises in Costa Rica. The BCCR will document imports of eligible commodities by the private sector and provide the Mission with a report of these transactions. All necessary supporting documents will be maintained by the BCCR for Mission review.

The colones generated from the sale of the dollars will be used for loans to private industrial and agricultural producers. Priority attention will be given to credit for export-related production. Loans will be made available at market rates of interest through rediscounts from the BCCR to the state-owned and private commercial banks*. The BCCR and all participating banks will be encouraged to restructure existing lending policies and criteria which may currently prohibit the extension of credit to businesses which, due to the current economic crisis rather than to long-term difficulties, are unable to meet normal banking standards of creditworthiness.

A complementary D.A. funded grant will provide technical assistance, training and other resources to assist the new Costa Rican administration to deal with the country's economic, fiscal and policy problems. The primary focus of the grant will be on export and investment promotion. A limited amount of assistance will also be provided to the GOCR for improved public administration and in the design and implementation of the longer-term economic support program.

D. Conditions and Covenants

The conditions and covenants proposed for the loan are discussed in Section III G.

II. DESCRIPTION OF ECONOMIC CONDITIONS IN COSTA RICA

A. Overview: Origin of Economic Crisis and Summary of Current Economic Situation

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% per year, adult literacy reached 90%, health services were widely extended, infant mortality declined sharply, the population growth

* The participation of private banks may require legislation. If so, initial participation in the program may be limited to state-owned banks.

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 with a democratic political system.

Costa Rica is now experiencing its most serious economic crisis in many decades. Today, the earlier problem of how to distribute equitably the benefits of economic growth has been replaced by questions of how to share equitably the required economic sacrifice. The declining trend in real growth rates of GDP, which began in 1979, culminated with a negative rate of growth in 1981 of 3.6% (updated since CDSS, see Airgram 11 San José). A further drop of at least 4% is projected for 1982 and, under the most optimistic assumptions, it is believed that, in real terms, the level reached in the 1979 GDP will not be regained until after 1985.

Viewed from almost any perspective, the growing deterioration of Costa Rica's economy during the past year affected, in varying degrees, all productive sectors of society. A major supply side factor behind Costa Rica's decline in national production was a drastic contraction of imports -- 29% in real terms. Because excess aggregate demand was not absorbed by imports as easily as it had been in past years, the internal rate of inflation accelerated sharply. An inflation rate estimated at 117% during 1981 was also spurred on by a sizeable public sector deficit and a continuing devaluation of the colon which, in terms of the dollar, has been over 400% and shows no signs of stabilizing. Open unemployment in mid-1981 was running 8.7% and is expected to reach 14% before the end of 1982. Central American political instability and deep economic recession have contributed to a decline in private capital inflows at a time when Costa Rica, lacking foreign exchange reserves and access to foreign credits, has had to suspend service payments on its $2.6 billion public sector external debt*.

The inescapable conclusion that emerges from a review of these factors is that these adverse trends cannot be easily or quickly reversed. Even if Costa Rica successfully negotiates a rescheduling of its public external debt to reduce its service payments, maintenance of real GDP at the 1981 level during 1982-1986 will be extremely difficult. It would require, according to the GOCR'S latest balance of payments projections, substantial foreign exchange inflows at least through 1986. Assuming a slow recovery of economic activity during 1983-1986, open unemployment would still continue to rise, reaching an alarming 19.4% in 1986.

Debt service payments in arrears are not included in this total; if they were, the public external debt would exceed $2.8 billion (as of 10/1/81).

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 drop of 20% in Costa Rica's terms of trade between 1977 and 1979. First, coffee prices fell sharply from their 1977 high and this was followed by the doubling of the price of petroleum in 1979. The inability of the Costa Rican economy to adjust to the relativedecline in the value of its exports had serious consequences: substantial public sector external borrowing, increasingly at commercial rates, was required to cover the growing current account deficits; reserves were drawn down to negative levels; and uncontrolled monetary expansion, in a desperate attempt to maintain internal prices, generated inflationary pressures.

This rapid deterioration called for an urgent transition to new growth strategies. The same strategies which Costa Rica pursued successfully in an earlier period left legacies that continue to stand in the way of economic recovery and future development: agriculture and livestock production 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 remaining. Import substitution is no longer a viable growth strategy, and a public sector living beyond its means has become a destabilizing force.

The GOCR import substitution strategy resulted in rapid industrial growth for a time. However, by the early 1970's the limitations of the strategy for Costa Rica were already becoming apparent: easy import substitution possibilites had been taken advantage of, and the CACM proved to be a small, easily saturated and, in some instances, unreliable market. Moreover, the strategy produced a set of policies which worked together to create a distinct anti-export trade environment. These policies included high levels of effective industrial protection, an overvalued exchange rate, subsidized interest rates, and other incentives to capital investment which have had several consequences on the economy. First, they resulted in an industrial sector that has considerable excess capacity, is more capital intensive than optimal, and is highly dependent on imported inputs for production. Secondly, the structure of imports shifted: imports of consumer goods dropped steadily while imports of raw materials, capital goods and petroleum increased. As a consequence, the prospects for reducing imports without affecting domestic production became slight. Finally, the internal terms of trade did not favor agricultural production, especially of non-export crops. As a result, agricultural production has until recently stagnated or declined, especially the production of domestic food crops.

Uncontrolled public sector growth is another underlying problem of the current crisis. Public sector employment increased from 6% of the labor force in 1950 to 15% in 1973 and now stands at 20% of the labor force. In 1979-1980 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 greatly exceeded revenue growth and thus the public sector deficit grew rapidly. As a percentage of GDP, this deficit increased from an average of 6.5% in 1976-1978, to 10.1% in 1979 and 12.5% in 1980.

In 1981 central government expenditures were brought under greater control, an improvement not matched by the major public autonomous institutions such as the Social Security Institute (CCSS), the National Power and Telephone Company (ICE), and the National Petroleum Refinery (RECOPE). While the central government deficit of 2.8 billion colones in 1980 declined to 1.9 billion colones in 1981, the combined deficit of the major autonomous institutions ballooned from 1.5 billion to 2.9 billion colones during the period. The devaluation, coupled with government resistance to further increases in the prices of utilities and imported fuels and medical supplies, has been a major cause of the large combined deficit of the autonomous institutions. The prospects for continued improvement in the GOCR's fiscal accounts so far during 1982 are not good. Though fiscal discipline was improved in 1981, the outlook now is that the current GOCR administration will depend on monetary expansion for covering operating deficits until the new administration assumes office in May. Thus, the feasibility of substantially reducing the fiscal deficit for 1982 by the new government in six months' time will be made much more difficult.

Over the past several years, the Government has been unable, despite several attempts, to implement policies intended to correct these basic underlying structural problems. In June, 1981, the GOCR negotiated a three-year Extended Financing Facility (EFF) structural adjustment program with the International Monetary Fund. The EFF followed a 1979 self-imposed stabilization program and a formal 1980 Stand-by Agreement with the IMF.

The GOCR did not meet the targets of any of these programs, but some progress was made on the fiscal front. A financial reform, begun in 1979, allowed domestic interest rates for bank credit (with the exception of small-farmer and small-industry lending) and savings to rise, thus reducing external-internal interest rate differences. The creation of the Budget Authority in late 1979 gave the GOCR Executive for the first time an instrument to control spending by the decentralized public sector. How effective this instrument will prove in lessening the public sector deficit remains to be seen, but for 1982 the Budget Authority has set maximum deficit levels for the public sector's six largest entities. Finally, the most important change in the economic incentive environment has been the devaluation of the colon. It is an important means to promote exports, but so far the severe credit crunch and the squeeze on foreign exchange suffered by the productive sectors has impeded their ability to take full advantage of this favorable condition and, as a result, the devaluation has not had as desirable an effect on increasing exports as could be possible.

A more detailed analysis of the macro-economic situation in Costa Rica is contained in the Mission's FY 1984 CDSS (pp 3-35), as well as a number of comprehensive studies which have been conducted during the last 18 months*. Therefore, the balance of this section will be limited to a brief analysis of certain aspects of the economy directly related to the proposed assistance program described in Section III of this PAAD.

B. External Debt

Perhaps the most serious economic problem facing Costa Rica is its massive external debt. Public sector external debt is currently estimated to exceed $2.8 billion, including unpaid interest, while private external debt is estimated between $900 million and $1.5 billion. An estimated 12.8% of the public external debt is in short-term obligations, and approximately 40% of the total debt was contracted at high interest rates from foreign commercial banks. Approximately 30% is owed to multilateral lenders, while most of the remainder is owed to bilateral lenders and foreign suppliers (see Table 1).

Table 2 shows that without a debt rescheduling, principal and interest due in the last quarter of 1981 and in 1982 total $948 million. This is equivalent to about 68% of projected export earnings during this period, not counting the $126 million in arrears as of October 1, 1981. This is clearly an unsupportable burden. There is no alternative for Costa Rica but to reschedule its external debt. The CDSS described the GOCR's proposal to restructure its debt with foreign commercial banks. Negotiations based on this proposal are proceeding, but do not appear to be near conclusion. However, as Table 3 demonstrates, even if the debt is rescheduled along the lines of the present proposal, Costa Rica's debt service burden will continue to be extremely heavy for at least the next five years. According to a recent study by the Academia de Centroamérica,

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* These studies include Clarence Zuvekas, Jr., Costa Rica: A Review of Macro-Economic Conditions, with Projections to 1985, September 12, 1981; Academia de Centroamérica, Costa Rica: Una Economía en Crisis, December 1981; Academia de Centroamérica, Costa Rica: Problemas Económicos para la Década de los 80, December 1980; IBRD, Costa Rica: Current Economic Position and Prospects, November 1980; IBRD, Costa Rica: Trade Incentives and Export Diversification, November 1980; and University of Costa Rica, Evolución de la Industria en Costa Rica durante el Año 1981 y Perspectivas para 1982, December 1981.

TABLE 1

Structure of the Public Sector External Debt as of 7/15/81

	$ 000	%
Short-Term	334,073	12.8
Multilateral Lenders	12,000	0.5
Bilateral Lenders	77,801	3.0
Commercial Banks	244,272	9.3
Medium-and Long-Term	2,280,128	87.2
Multilateral Lenders	795,523	30.4
Publicly Issued Bond Debt	132,800	5.1
Bilateral Lenders	280,594	10.7
Commercial Banks	788,211	30.2
Certificates of Deposit (re. Trade Indebtedness)	283,000	10.8
Total Public External Debt	2,614,021	100.0

Table 2

Contractual Debt Service of the Public External Debt Before Restructuring Projected as of 10/1/81

($000,000)

	Arrears	1981*/82	1983	1984	1985	1986
Principal	67.8	629.0	281.5	311.4	295.7	234.3
Interest	58.3	318.6	199.7	161.6	123.5	89.7
Total	126.1	947.6	481.2	473.0	419.2	324.0

(Total 1981*/82 to 1986= $2,645)

Table 3

Projected Contractual Debt Service of the Public
External Debt After Rescheduling
($000,000)

	1981*/82	1983	1984	1985	1986
Principal	92.5	137.3	157.2	366.4	279.0
Interest	436.4	365.7	420.8	485.6	582.0
Total	528.9	503.0	578.0	852.0	861.0

(Total 1981*/82 to 1986 = $3,322.9)

*Refers to the fourth quarter of 1981.

the country's debt service would require 40% of export earnings over the 1982-86 period and, in 1985 and 1986, this requirement would be approximately 50%*. Therefore, Costa Rica's need to service its external debt will continue to place severe constraints on the country's economic recovery and its efforts to gradually eliminate its balance of payments disequilibrium.

The above discussion refers only to the public sector external debt. While little is known about the structure or amount of private external debt, it is reasonable to assume that the majority was contractedon short terms and at high interest rates from commercial banks and suppliers. Given the shortage of foreign exchange, the economic downturn in Costa Rica and the rest of Central America, and the massive devaluation of the colon, the service of private external debt will be extremely difficult and is likely to threaten the continued viability of a major portion of Costa Rica's industry. At present, no major efforts are being considered to renegotiate this debt in a generalized or systematic fashion. Consequently, each firm is left to its own devices to restructure its debt with its creditors.

C. Balance of Payments Situation

The massive devaluation of the colon vis-a-vis the dollar, foreign exchange scarcities and government austerity measures combined to limit Costa Rica's negative trade balance to $174 million in 1981, compared to a negative $543 million in 1980. This, in turn, caused the current account deficit to shrink by some $298 million. As a result, international reserves declined by only $50 million in 1981, compared to the record loss of $198 million experienced in 1980.

This improvement in the balance of trade, and in the overall balance of payments came at a high cost, however. While exports expanded by only 3% in current prices (entailing a reduction of 6-8% in their purchasing power), imports contracted by 22% in current prices, and by some 29% in real terms. Cuts in imports could not be confined to non-essentials; imports of capital goods, construction materials, raw materials and intermediate goods dropped as well. This was a major factor in Costa Rica's GDP decline in 1981.

A number of projections of the balance of payments have been made, each with slightly varying assumptions. Two of the most recent were made by Clarence Zuvekas in his September 1981 report entitled Costa Rica: A Review of Macro-Economic Conditions, with Projections to 1985, and by the Academia de Centroamérica in its December 1981 study of Costa Rica: Una Economía en Crisis. Both conclude that the balance of payments will continue to be substantially negative for the next five years.

* Academia de Centroamérica, Costa Rica: Una Economía en Crisis, December 1981, p. 145.

The FY 1984 CDSS contains two sets of balance of payments projections for the 1982-1986 period. These projections are contained in Table 4 and are described in some detail in pages 14-16 of the CDSS. According to these projections, maintenance of GDP at the 1981 level, in real terms, throughout this period would require substantial additional foreign exchange resources. These requirements range from $192 million in 1982 to $669 million in 1986 (see Table 4). If these additional resources were not made available, imports would have to contract and/or debt service payments would have to be stretched out further. These projections show that Costa Rica's balance of payments difficulties will not only be substantial in 1982, but that they will persist over the next several years. The problem may, in fact, become more serious unless a number of corrective steps are taken, including structural adjustments to bring the public sector's chronic deficits under control and to promote a reorientation of the incentive system of the economy to favor expanded exports.

D. Effects of Economic Crisis on Private Sector

The most adverse effects of the current economic crisis on the private sector have been in two areas: access to foreign exchange to purchase needed inputs and service foreign debt, and access to credit, especially working capital.

1. Foreign Exchange Situation

The national currency has taken a severe beating during the last fifteen months. The colon was being quoted at 45 to the dollar in mid-March, compared with the early January, 1981, rate of about ¢12 to the dollar. The import-intensive structure of Costa Rican industry has meant that the costs of crucial raw materials to keep industrial production moving tripled and even quadrupled in a period of less than a year. The country's lack of dollar reserves and inability to service its external debt caused previously available external suppliers' credit sources to dry up. Manufacturers instead have had to resort to their own resources (when they have been able to) to finance increasing working capital requirements resulting from the devaluation. According to a survey conducted by the University of Costa Rica's Economic Research Institute, the severe lack of traditional sources of credit meant that self-financing became the single most important source of finance for medium and large industry during 1981*. Another worrisome indicator revealed by the same survey is the fact that fully two-thirds of the same medium and large firms with external debt are actively seeking to renegotiate payment schedules with their creditors. This implies that there is little hope for increased inflows of private capital in the near future.

University of Costa Rica, Instituto de Investigaciones en Ciencias Económicas, Evolución de la Industria en Costa Rica durante el Año 1981 y Perspectivas para 1982, San José, Costa Rica December, 1981.

Table 4

Costa Rica: Balance of Payments, 1980 - 1986 (millions of US$)

	Prelim. 1980	1981	1982 A	1982 B	1983 A	1983 B	1984 A	1984 B	1985 A	1985 B	1986 A	1986 B
		-----------	-----------	-----------	-----------	PROJECTED	-----------	-----------	-----------	-----------	-----------	-----------
A. Current Account	-679.1	-381.6	-181.0	-372.7	-200.0	-441.1	-200.0	-565.5	-200.0	-695.4	-200.0	-868.8
Trade Balance	-543.3	-173.8	-6.3	-198.0	-5.7	-212.4	20.7	-312.9	29.8	-409.8	38.8	-534.8
Exports, FOB	1000.9 1/	1031.0 2/	1133.0	1133.0	1251.7	1251.7	1297.6	1297.6	1361.8	1361.8	1415.1	1415.1
Imports, CIF	-1544.2 1/	-1204.8 2/	1139.3	-1331.0	-1246.0	-1464.1	-1276.9	-1610.5	-1332.0	-1771.6	-1376.3	-1949.9
Net Services and Transfers	-135.8	-207.8	-174.7	-174.7	-205.7	-228.7	-220.7	-252.6	-229.8	-285.6	-238.8	-334.0
Interest on Public Debt	-163.0	-276.0	-260.0	-260.0	-308.5	-331.5	-328.5	-360.4	-348.5	-404.3	-368.5	-463.7
Actual Payments	-163.0	-150.0	-260.0	-260.0	-308.5	-331.5	-328.5	-360.4	-348.5	-404.3	-368.5	-463.7
Arrears	-	-126.0	-	-	-	-	-	-	-	-	-	-
Other Services and Transfers, Net	27.2	68.2	85.3	85.3	102.0	102.8	107.8	107.8	118.7	118.7	129.7	129.7
B. Capital Account	214.8	332.0	-152.0	152.0	200.0	200.0	200.0	200.0	200.0	200.0	200.0	200.0
Official Capital, Net	396.0	217.6	181.0	181.0	200.0	200.0	200.0	200.0	200.0	200.0	200.0	200.0
Financing of Interest in Arrears	-	126.0	-126.0	126.0	-	-	-	-	-	-	-	-
Amortizations in Arrears	-	-207.0 3/	-207.0	-207.0	-	-	-	-	-	-	-	-
Financing of Amortizations in Arrears	-	207.0 3/	-	-	-	-	-	-	-	-	-	-
SDR allocation	5.6	5.4	-	-	-	-	-	-	-	-	-	-
Private Capital, Net	-186.8	-17.0	-	-	-	-	-	-	-	-	-	-
Sub Total (A + B)	-464.3	-49.6	-333.0	-524.7	-	-241.1	-	-365.5	-	-495.4	-	-668.8
Arrears ("Presa")	266.2	-	-	-	-	-	-	-	-	-	-	-
Refinancing of External Debt	-	-	333.0	333.0	-	-	-	-	-	-	-	-
Additional Financing Required (Hypothesis B)	-	-	-	191.7	-	241.1	-	365.5	-	495.4	-	668.8
Change in Net Reserves	-198.1	-49.6 2/	-	-	-	-	-	-	-	-	-	-

1/ Final figures; these include balance of payments adjustments. 2/ Preliminary figures. 3/ Amortization payments not made are compensated by the item, "financing of amortizations in arrears."

A number of policy decisions by authorities further served to cloud the picture. One of the more significant of these was the Central Bank's handling of the large backlog of commitments to sell foreign exchange at the official rate which had not been liquidated at the end of 1980 when the colon was first floated (the presa). As a means of liquidating the presa, the Central Bank issued negotiable Certificates of Deposit in colones and dollars with the latter to be used as payment for foreign obligations. The dollar-denominated CDs were heavily discounted in local trading. Upon maturity of the first scheduled amortization payments on the dollar CD's, the Central Bank announced that it would not be able to meet its obligation. Besides contributing further to the illiquidity affecting the private sector, nonpayment also sent very damaging signals to overseas creditors.

At present there is a three-tiered exchange rate system in Costa Rica. The "official" rate is set at ¢20 the dollar and is used for a limited number of transactions involving medicines and the expenses of students overseas. The banking system uses a "free banking rate" which is established by majority vote of a committee of the state-owned and private banks and the 16 financieras operating in the country. While this rate is theoretically a floating rate, it is presently pegged at ¢38.25 to the dollar. There is reportedly considerable resistance among members of the banking committee to increasing this rate significantly out of fear of the impact of a higher rate on the viability of many businesses and what this would mean to their own portfolios. The "free market rate" is the floating rate and is used for all unofficial transactions. This rate varies daily and is presently around ¢50 to the dollar.

Annex B describes in detail the present procedures for liquidating foreign exchange earnings from exports and making these resources available for imports through the banking system. All export proceeds are required to be sold through the national banking system. A bank must purchase 10% of the export earnings at the official rate of ¢20 to $1, and the remaining 90% at the free banking rate. Thus, exporters are currently required to sell their foreign exchange proceeds at an average rate of ¢35.48 to the dollar, a rate which is approximately 30% below the current floating free market exchange rate. Further, the purchasing bank is required to sell 51% of the foreign exchange export earnings to the Central Bank, primarily to be used for public sector purposes, leaving the bank with only the remaining 49% to sell to its clients for imports or other foreign exchange requirements. The Central Bank has issued a series of directives to the banking system governing the use of the 49% of export earnings left to them. These directives provide that priority in the allocation of these foreign exchange resources be given to imports needed by the productive sector and a number of other uses. The Central Bank has resisted adopting more stringent controls on the use of these foreign exchange resources, reportedly because of the IMF's opposition to strict exchange controls.

Until recently, exporters were allowed to use their foreign exchange earnings first to cover the costs of any imported inputs for their production, up to the total amount of export earnings. This _sistema de adelantos_ provided exporters a certain degree of security that their needs for imported raw materials or intermediate goods would be met, at least to the extent they themselves earned foreign exchange to meet these requirements. The current system, however, changes considerably the situation confronting the exporter, and creates a number of difficulties for the private sector in general. Net exporters frequently require more than 49% of the value of their product for imported raw materials or intermediate goods, and businesses producing primarily for the domestic market are especially hard-hit. While some commercial banks allow exporters who bring them foreign exchange earnings to repurchase as much as they need of the remaining 49%, others require exporters to "go to the end of the line". In most cases, the only access businesses have to foreign exchange is through the street market. This has not only been a major factor in the rapid devaluation of the _colon_ in that market, but it is also a major disincentive to exporters. Furthermore, to the extent that there remains a major difference between the banking and free market exchange rates, the shortage of foreign exchange within the banking system will be aggravated. A significant spread provides a powerful disincentive to turn over export earnings at the lower banking rate, while at the same time increasing demand for foreign exchange at the banking rate. It is expected that an agreement with the IMF will provide for an elimination of or a substantial reduction in the differential between these two rates.

2. Credit Availability

The shortage of foreign exchange to finance imports has been accompanied by a severe reduction in the amount of credit available to the private sector during the past two years. This credit shortage is especially acute due to the increased need for working capital to finance inputs made much more expensive by the devaluation of the _colon_, and as traditional sources of suppliers or foreign bank credit have dried up. Increased access to credit by the private sector is essential if a major structural transformation from a highly-protected import-substitution based economy to one geared to extra-regional export expansion is to be implemented successfully.

During the eleven month period from January 1 - November 30, 1981, total credit of the consolidated banking system increased by 10%. However, credit to the private sector increased by only 7.6%, which was sharply negative in real terms. For the 23-month period from January 1, 1980 to November 30, 1981, bank credit to the private sector expanded by 21.8%, during which time the consumer price index in San José rose by 91%.

Credit outstanding to the private sector dropped by some 21% in real terms during 1981 in comparison with 1980. During the first six months of 1981, manufacturing industries received only one-third of the real flow of new credit that had been made available during the same period in 1978. In mid-1981, the level of credit outstanding to this sector was 40% lower, in real terms, than in June 1977. In addition, high delinquency rates for outstanding bank loans have reduced even further the resources available for new lending to the productive sector. Thus, the private sector has been forced to bear a disproportionate share of the monetary belt-tightening burden, at a time when new credit is most critically needed to maintain economic activity.

In a study conducted in 1981 by the Academia de Centroamérica entitled Evolution of the Banking System's Credit Capacity, the unsatisfied credit demand in 1980 was estimated to be over ₡4.2 billion ($430 million at the average 1980 exchange rate of ₡10:$1). The study calculated an estimated credit gap for 1981 of over ₡8.9 billion (approximately $200 million at the current exchange rate). In fact, 1981 proved to be even worse than anticipated for the private sector due to virtual elimination of all foreign lines of credit to Costa Rican producers.

It is clear, therefore, that the unavailability of both domestic and foreign credit has been a major adverse factor in the private sector's efforts to cope with Costa Rica's economic crisis.

3. Contraints on Expansion of Credit to the Private Sector

The principal constraints on the expansion of credit for the private sector have been the need to finance large public sector deficits from domestic credit resources and the disappearance of foreign sources of credit. However, another factor is beginning to emerge as an important problem as well. The size of the private external debt coupled with the high rate of delinquencies on outstanding colon loans has meant that many businesses which badly need credit to operate are no longer creditworthy by traditional banking standards. The balance sheets of most businesses in Costa Rica, reflecting the country's economic problems during the last two years, give a very negative picture of the viability and prospects of these firms. The commercial banks, especially the state-owned banks which channel the vast majority of credit to the private sector, have been reluctant to modify their loan approval policies and practices to fit this new situation. As a result, many businesses are unable to qualify for loans. As the financial condition of Costa Rican businesses continues to deteriorate, the creditworthiness of firms, and the innovativeness of the banking system in meeting the needs of these firms, will become increasingly important.

4. Capital Flight

Disinvestment through capital flight does not appear to be a major concern in Costa Rica at present. However, there does appear to be a form of "forced" capital flight, mostly through under-invoicing on exports. This practice, to the extent that it is occurring, is probably due to the shortage of foreign exchange domestically to service foreign debt and purchase imported inputs and the resulting need for foreign exchange resources outside the country for these purposes, rather than a desire to move assets out of the country on a permanent basis.

As foreign exchange becomes more available and with a closer approximation of the banking and free market exchange rates, this form of "forced" capital flight should cease.

E. Future Prospects

The future prospects of the Costa Rican economy depend on the ability of the GOCR to reach agreement with the IMF on an economic stabilization program. Without commitment to and good performance in implementing such a stabilization program, Costa Rica's future is bleak. The newly-elected GOCR, which took office May 8, 1982, appears dedicated to far-reaching reforms and to the negotiation and signature of a workable agreement with the IMF.

The specific conditions of a new IMF agreement have not yet been determined. However, from past IMF agreements and conversations with Central Bank and IMF officials, it can be assumed that any future agreement will require the GOCR to adopt measures in the following areas:

1. Effect substantial increases in the rates charged by public utilities, i.e., ICE (electricity and telephone), RECOPE (oil) and ICAA (water), to eliminate or reduce the budgetary deficits of these entities.

2. Hold the 1982 deficit of the central government down to about 2.5 to 3.0 billion colones, and the combined deficit of the consolidated public sector to 5 to 6 billion colones.

3. Place tight limits on bank credit expansion (an overall limit as well as one applied specifically to the public sector) to reduce pressures on the price level and on the balance of payments.

4. Place limits on new external borrowing (except perhaps for debt roll-overs or refinancing).

5. Establish a unified (or nearly unified), flexible exchange rate, or at least allow the continuing functioning of a free foreign exchange market (alongside the "official" market) at which all residual transactions can take place (i.e., all transactions that are not eligible to draw on official or banking system-controlled resources).

6. No further tightening of exchange controls.

The exchange rate policy of the new GOCR will be especially important. Indications are that the new Government will seek to maintain the three-tiered exchange rate system, but shift responsibility for establishing the banking rate from the existing banking system committee to the Central Bank. If the three-tiered system remains in effect, it will be extremely important to minimize the differential between the banking rate and the free market rate. Otherwise, as indicated above, serious disincentives to exporting will continue, to the ultimate detriment of the country's ability to generate foreign exchange and of its economic recovery program.

III. PROGRAM DESCRIPTION

A. U. S. Interests and Assistance Strategy

Costa Rica's economic crisis, particularly when placed in the context of the political and economic disruptions affecting all of Central America, poses serious challenges to the country's political and economic system. It is not certain how Costa Ricans will react to a protracted period of high unemployment, eroding purchasing power, periodic food shortages, and cut-backs in public services. The new Costa Rican administration which took office in May will not only have to face head-on the country's economic difficulties and undertake a series of difficult and far-reaching measures. It will also have to convince the country that its severe economic problems are being dealt with effectively, that the austerity measures will pay off, and that the necessary sacrifices will be shared equitably.

This is likely to be an extremely difficult task. It is clear that a long period of stringent financial and fiscal discipline will be required of Costa Rica's government and people and that the economy must undergo a far-reaching structural adjustment. U.S. interest in Costa Rica is to assist it in carrying out the required adjustment in a manner which preserves the basic tenants of a democratic society and a free market economy. In this context, U.S. objectives in Costa Rica in the short- and medium-term are:

-to help stabilize the economy;

-to assist in restoring international financial confidence in Costa Rica;

-to promote production, particularly in the industrial and agricultural sectors, with special emphasis on increasing exports;

-to support the establishment of a firm basis for sustainable economic growth founded on equity and a progressive private sector; and

-to help protect the foundations of Costa Rica's democratic political system.

U.S. economic support assistance can help Costa Rica ease the strain of the austerity measures it must take over the next several years. In addition, it can provide the GOCR incentives to undertake difficult policy changes and structural reforms that otherwise might not be possible. As such, economic assistance can be perhaps the principal means of furthering U.S. objectives in Costa Rica in the short- and medium-term. However, U.S. assistance should not substitute for or permit the postponement of the difficult measures the GOCR must take.

The Mission foresees an economic support program of substantial proportions over the next 4-5 years, as described in the FY 1984 CDSS. The focus of this program will be:

- critical balance of payments support to help arrest the current decline, minimize the collapse of the private sector and stabilize the economy;

- financing to alleviate the critical shortage of raw materials, intermediate goods and spare parts for industry;

- financing to help meet the working capital requirements of the productive private sector;

- employment generation; and

- technical assistance to public entities and private groups in export and investment promotion, and in the development and implementation of a new, export-led development strategy for Costa Rica.

B. <u>Program Objectives</u>

The objectives of the proposed economic support program over the next 4-5 years were set forth above. The specific purposes of the $20.0 million program described in this PAAD are:

1. To provide immediate balance of payments support to Costa Rica and

2. To assure the allocation by the BCCR of urgently needed foreign exchange and credit to the private sector in Costa Rica, particularly net exporters with the objectives of maintaining levels of production and employment.

To achieve these objectives, an immediate cash transfer ESF loan of $15.0 million and $5.0 million grant are proposed. The loan and grant will have a life of six months from date of signature of the program agreement.

C. Justification for Cash Transfer

In designing the program, the Mission weighed the merits of a cash transfer and commodity import program (CIP) and the experience with both in other countries in the Caribbean Basin and elsewhere. Based on an analysis of the advantages and disadvantages of each approach, the Mission concluded that the cash transfer mechanism was the only means to achieve the objectives of this $20.0 million program. U.S. interests are best served by an immediate disbursement of dollars to provide balance of payments support and assist the Costa Rican private sector. The economic situation demands an immediate infusion of foreign exchange resources, with a minimum of procedural delays. The productive sector of the economy urgently needs access to additional foreign exchange to import inputs to keep their businesses operating. Systems already exist through which these additional resources can be channelled quickly to the private sector with reasonably good assurances of reaching productive enterprises. Although the CIP approach would provide more precise control over the use of U.S. resources, given the need for an immediate infusion of resources, the marginal gains in accountability from the CIP approach for this particular program do not justify the initial delays this mechanism would entail. Based on an examination of the banking system, we have estimated that from 3 to 6 months would be required to set up a CIP in Costa Rica. The cash transfer mechanism will also require less staff to administer, both at the Central Bank of Costa Rica and the Mission. In view of the demands on already limited staffs to design and implement the broader economic reforms and stabilization program, the Mission concluded that the cash transfer approach was the most appropriate for this tranche of the economic support program. Furthermore, the cash transfer approach, as designed, will provide the Mission with an opportunity to influence overall GOCR policies and procedures regarding access by private producers to scarce foreign exchange resources and private sector access to much needed productive credit. This approach would, therefore, have an impact on Costa Rica of significance well beyond the $20.0 million provided through this program.

D. U.S. Dollar Resources

1. Use of U.S. Dollar Resources

A $20.0 million cash transfer to the Central Bank of Costa Rica (BCCR) is proposed. Because of the serious economic problems facing Costa Rica and the country's enormous external debt, A.I.D.'s most concessional loan terms (40 years amortization, 10 years grace period, 2% interest during grace period, 3% thereafter) are requested. The loan and grant will be disbursed in their entirety to the BCCR upon satisfaction of conditions precedent to disbursement.

The system for allocating foreign exchange export earnings was described briefly in Section II. D. above and in detail in Annex B. The BCCR will use this system for channelling the dollar resources from the loan to private importers. The BCCR will sell the dollars at the free banking exchange rate to the state-owned and private commercial banks of the national banking system. These dollars will supplement foreign exchange resources received by the banks through the liquidation of export earnings and will be sold to their clients at the banking rate in accordance with the priorities already established by the BCCR. The Central Bank will require, however, that these dollars be used exclusively for private enterprise clients of the banks.

2. Management of U.S. Dollar Resources

A special account will be established in the name of the BCCR into which the $20 million will be deposited and from which the dollars will be drawn by the BCCR exclusively for sale to the participating commercial banks. The account will be held by an appropriate off-shore banking institution in order to safeguard against the embargoing or attaching of the funds by the GOCR creditors.

The BCCR will covenant to require that participating banks sell the dollars exclusively to private producers.

GOCR reporting responsibilities will be satisfied by providing the Mission with evidence of disbursements from the account to the participating commercial banks.

E. Use of Local Currency Generation

1. Loan

The colones generated through the sale of the $15 million loan proceeds will be used by the BCCR to establish a discount line from which credit will be extended by participating commercial banks to the private productive sector, with emphasis on medium and longer term working capital lending. Priority targets for the credit will be established in order to maximize the developmental impact of the credit program. The emergency nature of the effort, however, will require that the targets be broadly defined and that obstacles to rapid disbursement of the fund be minimized.

Credit Targets

All private producers (including agricultural and industrial producers) will be eligible to apply through the participating banks for credit under the program. Priority attention, however, will be given to export related production. Eligible applicants will include:

-net foreign currency earners (exporters);

-domestic producers of raw materials and intermediate goods which serve as direct inputs to production for export;

-providers of essential services to exporters (i.e. product transportation services); and

-import substitution producers/manufacturers.

Credit applications will be considered without discrimination from those exporters who require colon credit in order to purchase dollars for foreign inputs for export production. Lending under this program and the determination of an applicant's creditworthiness will be generally governed by standard bank lending criteria. Special consideration will be encouraged, however, for priority target applicants who, due to the current economic crisis rather than to long-term difficulties, are unable to meet normal standards for creditworthiness. While it is not expected that unreasonable risks will be taken with the fund, more dynamic methods of lending will be encouraged, such as lending against inventory and/or against market orders. In order to encourage participating banks to adopt more flexible, credit policies and criteria, the program will consider offering special discounting rates, and risk reduction mechanisms.

2. Grant

The colones generated through the sale of the $5 million grant will be deposited by the BCCR in a special account from which the Corporacion Costarricense de Financiamiento Industrial, S.A. (COFISA), a major development finance institution, will borrow for sublending to the private sector. These resources would complement a new $10 million AID Development Assistance loan to COFISA, thereby providing the private sector with both colon and dollar credit. COFISA will repay the $5 million equivalent colon loan into a separate SBN account which will be jointly managed by the Mission and private sector representatives. Withdrawals will be made from the account to finance selected export/investment promotion efforts and to further other objectives of the Caribbean Basin Initiative.

3. Local Currency Program Management

The BCCR will manage the credit program through a standard system of BCCR discounting through the state-owned and private commercial banks*. All loan applications, credit decisions, processing and monitoring will occur at the level of the participating bank.

The participation of private banks in the program may require Legislative Assembly action. Therefore, initial participation in this program may be limited to the state-owned banks.

The BCCR will render monthly reports to the Mission, providing a description of the status of the special account and a list of all related lending transactions by participating bank. The reports will also include pertinent information regarding institutional problems and other impediments to program operation.

While priorities for lending will be governed by the general targets established for the program, credit decision making and loan processing will occur according to normal banking practice (as modified by encouragement for special lending criteria as described above).

3. Interest Rates and Terms

Loans to producers will be made at commercial rates of interest. To compensate participating banks for assuming the additional risks associated with the adoption of more dynamic credit policies, the BCCR will agree to allow the participating banks a larger than normal spread for lending under this program.

F. Description of Complementary Grant Program

The following is proposed as PID for a $1.0 million grant to complement the ESF cash transfer. The grant is an extremely important element of the U.S. economic support program for Costa Rica. It will provide technical assistance, training and other resources to assist the new Costa Rican administration deal with the economic, fiscal and policy problems it will face immediately. The grant will reinforce not only this first tranche of ESF assistance to Costa Rica, but will also help lay the foundation for subsequent phases of the economic support program.

The primary focus of the grant will be on export and investment promotion. A limited amount of assistance will also be provided to the GOCR to improve public administration and in the design and implementation of the longer-term economic support program. The activities proposed to be financed by the grant are described below. Given the uncertainties that remain regarding the nature of the Government's stabilization program and economic policies in general, these activities may be modified somewhat during the implementation of the grant.

1. Export and Investment Promotion - $650,000

As noted above, major structural reforms are required to reorient the Costa Rican economy toward non-traditional exports to regions beyond Central America. The Caribbean Basin Initiative presents Costa Rica with an excellent opportunity to move quickly in that direction. However, to be effective, substantial thinking and analysis must go into designing new export-promotion strategies. In addition, major efforts will have to be made to attract new, export-oriented private investments to Costa Rica. Given the current economic crisis, this will not be easy.

The major portion of the grant program will emphasize export and investment promotion. Five discrete activities are envisioned:

a. Institutional development

Technical assistance and training will be provided to the Ministry of Economy, Industry and Commerce, to its Center for Export Promotion (CENPRO), and to interested private sector entities to improve and expand their export and investment promotion efforts. Assistance to CENPRO will aim at strengthening its capabilities in export and investment promotion, and upgrading its role within the GOCR in analysis and policy making in this area. Private organizations will also be assisted to develop their own export and investment promotion efforts and to work with the Government to develop improved export promotion policies. A total of 18 work-months of technical assistance ($180,000) and training through short courses in the U.S. and other Caribbean Basin countries ($20,000) will be provided.

b. Free Trade Zones

Costa Rica is presently planning the development of two Free Trade Zones to attract "production sharing", assembly type industries. Industries locating in these zones will provide much-needed employment and foreign exchange export earnings. Costa Rica is presently working with the Interamerican Development Bank on the expansion of this effort, and the IDB expects to provide capital assistance within the next year to implement the project. To complement the proposed IDB loan, the grant will provide technical assistance (18 wm - $180,000), training (short courses - $20,000), and a limited amount of travel expenses ($50,000) associated with the promotion of the Free Trade Zones and the attraction of foreign investors to these zones.

c. Production technology

While there are many opportunities to expand non-traditional exports in Costa Rica, local producers and manufacturers frequently lack knowledge and information on the product quality, packaging and presentation required by extra-regional markets. Twelve work-months ($120,000) of short-term technical assistance will be provided to help Costa Rican private sector entities assist local enterprises with export potential to understand better, and orient their production technology and standards to, the requirements of non-traditional markets, especially the U.S. market in light of the trade incentives which are part of the CBI.

d. Improved export procedures

One disincentive to expanded exports is the onerous paperwork associated with exporting. A small amount of technical assistance (4 wm - $40,000) will be provided to the BCCR, other public sector entities and to the banking system to help make exporting procedures and paperwork more efficient, less time-consuming and less costly.

e. Economic policy studies

Much analysis remains to be done on the best means of reorienting a complex system of incentives away from import substitution and toward export promotion. Two economic policy studies (estimated cost: $45,000 each, or a total of $90,000) will be financed to analyze further the existing constraints to increasing exports and to make recommendations to the GOCR for policy changes that will provide greater incentives to exports and export-related investment and to implement an export-led development strategy.

2. <u>Improved Public Administration - $60,000</u>

The grant will provide a small amount of short-term technical assistance to the GOCR to complement assistance expected from the IMF and the World Bank in improved financial management, tax and other revenue administration, more efficient administrative systems, and policies with respect to the efficient functioning of the financial system. These resources will allow the Mission to respond to high priority needs of the new GOCR administration in areas essential to the implementation of an economic stabilization program and improved management of the public sector budget.

3. <u>Program Design and Implementation - $280,000</u>

The activities described in this PAAD are only a first phase of what is expected to be a program of several years to assist Costa Rica in its economic recovery. A great deal of additional work will be required to design and implement successfully this program. The grant will provide the Mission with resources to finance studies and advisory assistance to work with it and the GOCR to design and implement programs related to economic stabilization and recovery, private sector assistance, export promotion, and employment generation. Examples of the type of assistance that might be provided include (a) further investigation of the private sector debt situation and its effect on access to and demand for foreign exchange or <u>colon</u> credit; (b) design of the mechanisms necessary to initiate and operate a Commodity Import Program which could be financed with future ESF assistance; (c) further analysis of appropriate mechanisms for providing expeditious foreign exchange and/or <u>colon</u> credit to exporters or other industries; and (d) design of a municipal, labor-intensive public works program which could be financed with local currency generations of future ESF programs.

The grant will be obligated in a series of separate grant agreements with GOCR and private sector entities, or individual Mission contracts as appropriate. The short-form grant agreement will be used to minimize the additional staff time required to implement the program. It is expected that in most cases A.I.D. direct contracting will be used to expedite the procurement of services. Close coordination with the GOCR will be maintained on each activity.

G. Conditions, Covenants and Negotiating Status

The proposed program has been discussed with the BCCR and members of the banking system. However, because of the transition period between GOCR administrations, the absence of firm appointment of several key officials in the incoming administration, the absence of clear indications of the specific economic policies that the new government will pursue in several important areas, and the status of negotiations with the IMF on the specific provisions of a stabilization program, it has not been possible to negotiate fully the details of the proposed program with the GOCR. The Mission believes that the program as described in this PAAD reponds to the needs of Costa Rica and to the policy directions of the new GOCR administration.

Proposed conditions precedent to disbursement of the loan and grant are:

1. An opinion of counsel acceptable to A.I.D. that the loan agreement has been duly authorized and/or ratified by and executed on behalf of the Central Bank of Costa Rica, and that it constitutes a valid and legally-binding obligation of the Central Bank of Costa Rica in accordance with all of its terms.

2. A statement of the name of the person holding or acting in the office of the Central Bank of Costa Rica, and of any additional representatives, together with a specimen signature of each authorized person specified in such statement.

In addition to these conditions, the Mission proposes that the Program Agreement include various covenants relating to the implementation of the program and policy changes which are necessary for the country's economic recovery effort to be successful. These covenants are as follows:

The Central Bank of Costa Rica will covenant:

1. To increase its planned allocation of foreign exchange resources to the National Banking System by not less than $20 million for purchase by private and private-public mixed enterprises within six months following disbursement of the Assistance.

2. To use or permit the use of local currency generated from the sale of United States dollars made available under the Grant for programs, agreed to by AID, undertaken by private sector institutions in Costa Rica; and use or permit the use of other local currency generated by sale of United States dollars made available hereunder for programs jointly agreed to by the Parties.

3. To take measures, and seek legislative changes that may be required, to allow private commercial bank members of the National Banking System to participate in any local currency credit program financed by the loan.

4. To increase the ceiling for credit programmed for the industrial sector in 1982 by not less than the local currency equivalent of fifteen million dollars.

5. To agree to and implement an economic stablization program acceptable to the International Monetary Fund.

6. To undertake measures to promote greater agricultural and manufactured exports from Costa Rica.

7. To provide resources for the importation from the United States, within six months following disbursement of the Assistance, of twenty million dollars worth of raw materials, intermediate goods and spare parts needed by private enterprises in Costa Rica; and

8. To adopt and maintain a system whereby producers earning foreign exchange through exports shall obtain preferential access to foreign currency in order to procure imported raw materials, intermediate goods and spare parts needed for continued production.

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?	Yes.
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.
5. FAA Sec. 620(c). If assistance is to the government, is the government liable as debtor or unconditional guarantor on any	No.

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?

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 ownership 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 Vietnam? (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 measures to prevent, the damage or destruction, by mob action, of U.S. property? No.

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 Congres- No.

sional Presentation materials for FY 1977, FY 1980 or FY 1981?

11. FAA Sec. 620(l). If the country has failed to institute the investment guaranty program for the specific risks of 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 against, 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 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?

Yes. A waiver, however, has been approved by US Secretary of State.

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

Yes.

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).

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 was not among those countries whose arrearages it was deemed necessary be taken into account by the AID Administrator in his "Taking Into Consideration Memorandum" in determining the current AID Operational Year Budget

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

No.

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 received 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.

N.A.

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 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?

N.A.

2. Economic Support Fund Country Criteria.

a. FAA Sec. 502B. 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?

Costa Rica has not engaged in a consistent pattern of gross violations of internationally recognized human rights.

b. FAA Sec. 532(f). Will ESF assistance be provided to Syria?

N.A.

c. FAA Sec. 609. If commodities are to be granted so that sale proceeds

N.A.

will accrue to the recipient country, have Special Account (counterpart) arrangements been made?

d. FAA Sec. 620B. Will ESF be furnished to Argentina? N.A.

3A(2) - NONPROJECT ASSISTANCE CHECKLIST

The criteria listed in Part A are applicable generally to FAA funds, and should be used irrespective of the program's funding source. In part B a distinction if made between the criteria applicable to Security Supporting Assistance and the criteria applicable to Development Assistance. Selection of the appropriate criteria will depend on the funding source for the program.

CROSS-REFERENCES: IS COUNTRY CHECKLIST UP TO DATE? IDENTIFY.
HAS STANDARD ITEM CHECKLIST BEEN REVIEWED?

A. GENERAL CRITERIA FOR NONPROJECT ASSISTANCE

1. App. Unnumbered; FAA Sec 653(b)

(a) Describe how Committees on Appropriations of Senate and House have been or will be notified concerning the non-project assistance;

An advice of Program Change notifying the Congress of the use of $20 million of Economic Support Funds was sent to Congress.

(b) is assistance within (Operational Year Budget) country or international organization allocation reported to the Congress (or not more than $1 million over that figure plus 10%)?

Yes.

2. FAA Sec. 611(a)(2). If further legislative actionis 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?

No.

3. FAA Sec. 209, 619. Is assistance more efficiently and effectively given through regional or multilateral organizations? If so why is assistance not so given? Information and conclusion whether assistance will encourage regional development programs. If assistance is for newly independent country, is it furnished through multilateral organizations or in accordance with multilateral plans to the maximum extent appropriate?

No.

4. FAA Sec. 601(a); (and Sec. 201(f) for development loans). Information and conclusions whether assistance will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use of cooperatives, credit unions, and savings and loan associations; (d) discourage monopolistic practies; (e) improve technical efficiency of industry, agriculture, and commerce; and (f) strengthen free labor unions.

The objectives the assistance provided include increasing the flow of international trade, fostering private initiative and competition, and improving the technical efficiency of industry, agriculture and commerce.

5. FAA Sec. 601(b). Information and conclusion on how assistance will encourage U.S. private trade and investment abroad and encourage private U.S. particpation in foreign assistance programs (includ- ing use of private trade channels and the services of U.S. private enterprise).

The project is specifically intended to enhnace U.S. private investment in Costa Rica and to expand U.S. markets for Costa Rican products.

6. FAA Sec.. 612(b); Sec 636(h). Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services, and foreign currencies owned by the United States are utilized to meet the cost of contractual and other services.

N.A.

7. FAA Sec. 612(d). Does the United States own excess foreign currency and, if so, what arrangements have been made for its release?

The U.S. does not own excess Costa Rican currency.

B. FUNDING CRITERIA FOR NONPROJECT ASSISTANCE

1. Nonproject Criteria for Economic Support Funding

a. FAA Sec. 531. How will this assistance support promote economic or political stability?

Assistance will:

- support efforts of GOCR to cope with current economic problems.
- provide immediate balance of payments support.
- provide foreign exchange and credit to the Costa Rican private sector.

2. Nonproject Criteria for Development Assistance

a. FAA Sec. 102(c); Sec. 111; Sec. 281a. Extent to which activity will (1) effectively involve the poor in development, by extending access to economy at local level, increasing labor-intensive production, spreading investment out from cities to small towns and rural areas; and (2) help develop cooperatives, assist rural and urban poor to help themselves toward better life, and otherwise encourage democratic private and local government institutions? — N.A.

b. FAA Sec. 103, 103A, 104, 105, 106, 107. Is assistance being made available: /include only applicable paragraph -- e.g., a, b, etc. -- which corresponds to sources of funds used. If more than one fund source is used for assistance, include relevant paragraph for each fund source./ — N.A.

(1) /103/ for agriculture, rural development or nutrition; if so, extent to which activity is specifically designed to increase productivity and income of rural poor; /103 A/ if for agricultural research, is full account taken of needs of small farmers; — N.A.

(2) /104/ for population planning or health; if so, extent to which activity extends low-cost, integraded delivery systems to provide health and family planning services, especially to rural areas and poor; extent towhich assistance gives attention to interrelationship between (A) population growth and (B) development and overall improvement — N.A.

in living standard in developing countries. Is activity designed to build motivation for small families in programs such as education in and out of school, maternal and child health services, agriculture production, rural development, and assistance to urban poor?

(3) [105] for education, public administration, or human resources development; if so, extent to which activity strengthens nonformal education, makes formal education more relevant, especially for rural families and urban poor, or strengthens management capability of institutions enabling the poor to participate in development; N.A.

(4) [106] for technical assistance, energy, research, reconstruction, and selected development problems; if so, extent activity is; N.A.

(a) to help alleviate energy problem;

(b) reconstruction after natural or manmade disaster;

(c) for special development problem, and to enable proper utilization of earlier U.S. infrastructure, etc., assistance;

(d) 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.

(5) /107/ by grants for coordinated private effort to develop and disseminate intermediate technologies appropriate for developing countries. N.A.

c. FAA Sec. 207; Sec. 113. Extent to which assistance reflects appropriate emphasis on: (1) encouraging development of democratic, economic, political, and social institutions; (2) self-help in meeting the country's food needs; (3) improving availability of trained worker-power in the country; (4) programs designed to meet the country's health needs; (5) other important areas of economic, political, and social development, including industry; free labor unions, cooperatives, and Voluntary Agencies; transportation and communication; planning and public administration; urban development, and modernization of existing laws; or (6) integrating women into the recipient country's national economy. N.A.

d. 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 supports civic education and training in skills required for effective participation in governmental and political processes essential to self-government. N.A.

e. FAA Sec. 201(b)(2)-(4) and -(8); Sec. 201(e); Sec. 211(a)(1)-(3) and -(8). Does the activity give reasonable promise of contributing to the development of economic resources, or to the increase of produc- N.A.

tive capacities and self-sustaining economic growth; or of educational or other institutions directed toward social progress? Is it related to and consistent with other development activities, and will it contribute to realizable longrange objectives?

f. FAA Sec. 201(b)(6); Sec. 211(a)(5), (6). Information and conclusion on possible effects of the assistance on U.S. economy, with special reference to areas of substantial labor surplus, and extent to which U.S. commodities and assistance are furnished in a manner consistent with improving or safeguarding the U.S. balance-of-payments position. N.A.

3. Nonproject Criteria for Development Assistance (Loans only) N.A.

a. FAA Sec. 201(b)(1). Information and conclusion on availability of financing from other free-world sources, including private sources within the United States.

b. FAA Sec. 201(b)(2); 201(d). Information and conclusion on (1) capacity of the country to repay the loan, including reasonableness of repayment prospects, and (2) reasonableness and legality (under laws of country and United States) of lending and relending terms of the loan.

c. FAA Sec. 201(e). If loan is not made pursuant to a multilateral plan, and the amount of the loan exceeds $100,000, has country submitted to AID in application for such funds together with assurances to indicate that funds will be used in an economically and technically sound manner?

d. FAA Sec. 202(a). Total amount of money under loan which is going directly to private enterprise, is going to intermediate credit institutions or other borrowers for use by private enterprise, is being used to finance imports from private sources, or is otherwise being used to finance procurements from private sources?

4. Additional Criteria for Alliance for Progress — N.A.

/Note: Alliance for Progress assistance should add the following two items to a nonproject checklist./

a. FAA Sec. 251(b)(1)-(8). Does assistance take into account principles of the Act of Bogota and Charter of Punta del Este; and to what extent will the activity contribute to the economic or political integration of Latin America?

b. FAA Sec. 251(b)(8); 251(h). For loans, has there been taken into account the effort made by recipient nation to repatriate capital invested in other countries by their own citizens? Is loan consistent with the findings and recommendations of the Inter-American Committee for the Alliance for Progress (now "CEPCIES", the Permanent Executive Committee of the OAS) in its annual review of national development activities?

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 financed?	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 insurance companies, will commodities be insured in the United States against marine risk with a company or companies authorized to do a marine insurance business in the U.S.?	Yes.
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 be procured in U.S.)	N.A.
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	No

vessels are available at fair and reasonable rates?

7. <u>FAA Sec. 621.</u> 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. <u>International Air Transport. Fair Competitive Practices Act, 1974.</u> 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?	Yes.
9. <u>Continuing Resolution Sec. 505.</u> 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?	Procurement contracts will contain such provision.

B. <u>Construction</u>

1. <u>FAA Sec. 601(d).</u> If a 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. <u>FAA Sec. 611(c).</u> If contracts for construction are to be financed, will they be let on a competitive basis to maximum extent practicable?	N.A.
3. <u>FAA Sec. 620(k).</u> If for construction of productive enterprise, will aggregate value of assistance to be furnished by the U.S. not exceed $100 million?	N.A.

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? N.A.

2. FAA Sec. 301(d). If fund is established 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 or 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? Yes.

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(g). 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 Yes.

law enforcement forces, except for narcotics programs?

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? No.

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

FOREIGN EXCHANGE FINANCIAL TRANSACTIONS

1. INSTITUTIONS

There are 5 institutions or types of institutions that play a part in financial intermediation as concerns foreign exchange transactions: the Central Bank, 4 nationalized commercial banks, 4 private banks, 16 "financieras", and 27 licensed money exchange firms. Only the banks and some of the financieras are authorized to handle export and import transactions.

2. IMPORTING PROCEDURES

Step 1:

Importer obtains a pro-forma invoice or its equivalent from his supplier.

Step 2:

Importer prepares (in quadruplicate) a Central Bank form entitled "Register of Confirmed Import Order" locally known as "El Registro". This form shows the importer's patent number, the economic sector which corresponds to his activity; the name of the exporter; the NAUCA code, quantity, description, country of origin, and value of the commodities to be imported; the approximate shipping and arrival dates; and the form, timing and amounts of the payments to be made.

The form is taken to the Central Bank where a transaction number is stamped on the 4 copies, three of which, together with the pro-forma invoice, are returned to the importer--normally within 24 hours.

It is important to note that the Central Bank action at this point is for statistical purposes only. It has no authority, under present law, to deny a transaction number to any import request. It simply checks the conformance of the data on the pro-forma invoice with the data on the form and assigns the operation a consecutive number. There is no commitment, explicit or implied, that foreign exchange will be made available for the import, or that the merchandise will be allowed to enter the country under customs and other laws.

Step 3:

The importer confirms his order to the supplier and, unless the supplier is prepared to ship on open account, takes the numbered "Registro" to a local bank and makes arrangements for payment. (A copy of the "Registro" is retained by the commercial bank and the transaction number is shown on all consequent documents prepared by the bank in connection with the particular import).

At present, with very few exceptions, suppliers will ship only against irrevocable letters of credit; the local commercial banks usually require the importer to provide up front 100% of the value of the transaction in dollars (all or some of which may be sold to the importer by the commercial bank, but quite frequently the importer has to secure the foreign exchange outside of the banking system); and the correspondent banks, where the Letter of Credit is opened, require that the value of the Letter of Credit be deposited in escrow with them before undertaking the operation. There are many variations on the above, particularly in the case of private, commercial banks which have established off-shore subsidiary banks.

Step 4:

When shipping documents are received by the importer (either directly from the supplier or through the local commercial bank), he takes them to the Ministry of Finance where the physical import is authorized and certain taxes calculated. This operation normally takes 3 to 4 days. However, if the importer believes that he is entitled to any duty exemption, e.g. semi-finished commodities intended for value added and re-export, he first takes the documents to the substantive Ministry concerned (Industry or Agriculture) for approval of his exemption. This operation normally takes another 4 days. Thus, if an exemption is involved 7 or 8 working days elapse after arrival of the shipping documents before the importer is in a position to move to the next step. (Because of these delays and storage charges in customs (see below) importers are increasing specifying use of air courier services rather than the mails for shipping documents).

Step 5:

After documents are cleared by the Ministry(s), the importer selects a Customs Agent and turns the approved documents over to him, together with a copy of the numbered "Registro". By law, the importer cannot deal directly with the Customs Authority. The Customs Agent proceeds to pay the duties and remove the commodities from customs. Normally, this operation is completed in 3 or 4 days.

Step 6:

The Customs Office sends a copy of the duty liquidation to the Central Bank, showing the transaction number of the Registro on the liquidation document.

3. GENERATION AND AVAILABILITY OF FOREIGN EXCHANGE FOR IMPORTS

All exports are licensed and all exporters are required to sell the foreign exchange proceeds to a bank or other authorized entity of the commercial banking system. There is, at present, no system of centralized control for tracking foreign exchange receipts against individual export transactions. However, working with aggregates, and after making adjustments for recent changes in procedures such as prior coffee export deposits, Central Bank officials claim that the volume of foreign exchange sold through the banking system when compared to aggregate value declared on export licenses is consonant with historical practice, i.e. 80-90% of aggregate export license value entering the banking system through official liquidations. Thus, the position of the Central Bank is that if there is any significant leakage of export earnings from official channels it derives either from underpricing on the export licenses or from contraband exports. There is no attempt by the authorities to check on the former;and, according to newspaper reports, the latter may be rather large. Despite this Central Bank position,there is generalized belief that other,unidentified, types of leakage are prevalent.

Such export earnings as enter the banking system are liquidated to the exporter as follows: 10% at the official rate of 20 colones to the dollar; and 90% at the free banking rate, currently 37.20 colones to the dollar; which results in a net rate of 35.48 colones per dollar to the exporter. This compares with the street rate,presently fluctuating around 44 colones per dollar, a 19% difference.

The 10% of the export value captured at the official rate is sold, in its entirety, by the commercial bank to the Central Bank. The Central Bank then makes these dollars available at the official rate of 20:1 to the Social Security system for imports of medicines and medical equipment; to certain students studying abroad; to importers of medicines, raw material for manufacture of medicine, and medical and surgical equipment; to treatment of illness abroad when arranged for through the Social Security system; and possibly for other social purposes.

An additional 41% of the total value of the export is also sold by the commercial bank to the Central Bank, but at the free banking rate. The destination of these dollars is as follows:

6% for use by the Central Bank in servicing interest payments on public sector debt to international institutions.

25% for petroleum purchases (and possibly other uses) by RECOPE.

10% for use by the Costa Rican Electricity Institute (ICE).

The net result of the above is that the commercial bank is left with 49% of the value of the export towards satisfying the foreign exchange requirements of its importer clients. Since this is clearly insufficient, the commercial banks--as indicated above--require that the importer obtain all or part of the needed foreign exchange directly, i.e. at the street rate. There are no available data on the volume of foreign exchange traded at the strret rate.

4. LIMITATIONS ON THE USE OF FOREIGN EXCHANGE BY THE BANKING SYSTEM

The Central Bank has issued a series of directions to the commercial banks governing the use of the 49% of export earnings left to them. There are no limitations on use of foreign exchange resources acquired either by the banks or by their clients from other sources.

The directives provide that export earnings shall be used in a priority fashion, by the commercial banks to finance:

- Raw material imports
- Agricultural inputs
- Medicines
- Basic grains
- Petroleum and its derivatives
- Spare parts
- Requirements of the Center for Promotion of Exports and Investment (CENPRO) for its off shore offices
- Payment for services needed for industrial manufacture, such as royalties
- Imports undertaken pursuant to free trade treaties, where payment is effected through the Chamber of Compensation
- Expenses of non-registered students studying abroad
- Medical services abroad
- Export service expenditures, limited to bank charges, customs services, registry of trademarks and patents, and transport expenditures.

The directives also provide that amortization and interest payment on public sector debt requires prior approval of the Central Bank.

Finally, it is worth noting that: (a) until February 10, 1982 the directives permitted the use of export earnings for servicing private sector external debt; and (b) a directive was issued in early March, 1982 which provided that during 10 working days, starting on March 11, 1982, industrial exporters would be entitled to buy foreign exchange in amounts up to one half of the 90% pf their export earnings liquidated at the free banking rate.

It is understood that the broad foreign exchange use categories listed in the directives and the language of the directives themselves which "suggest" to the commercial banks what they should and should not do, is due in part to concern with previous International Monetary Fund insistance on an open import market system. It is also understood that this same broad treatment of priority import categories has led to some confusion in the banks and to a practice of seeking to secure interpretations on many individual import transactions.

5. REPORTING TO THE CENTRAL BANK AND COMPUTERIZATION OF THE DATA

In Section 2, step 2 above, the data listed on the import registry forms ("Registro") was described. This data is computerized by: (a) NAUCA code, (b) country of origin, and (c) individual importer. Printouts are made monthly, with data for the month and cumulatively. At present, there is about a 2 months time lag.

The commercial banks provide a daily report to the Central Bank on their purchases and sales of foreign exchange, with supporting documentation on each transaction. Where the sale is for an import transaction, the "Registro" number is shown. The data on these daily reports is not computerized.

The data provided to the Central Bank by the Customs Office (See Section 2, step 6 above) is also computerized by: (a) NAUCA code and country of origin; (b) Economic Use Category and NAUCA code; and (d) Origin by economic class (CIUU system) and NAUCA code.

6. STORAGE CHARGES WHILE IN CUSTOMS

There are no storage charges during the first five working days that imports are held in customs. Starting with the sixth day, charges are made. For small items, the charges are made on a value basis. For larger shipments, charges are calculated on a space occupied basis.

7. REGULATIONS RELATING TO INSURANCE ON IMPORTS

The National Insurance Institute (INS) has a monopoly on all insurance written in Costa Rica. Thus any insurance on an import transaction effected here (e.g. on goods in storage in customs) would have to be written with the INS.

Insurance actions undertaken abroad do not come under the INS monopoly.

It is not clear whether a Letter of Credit issued by a domestic commercial bank and which specified that the shipper was to provide and charge for specified insurance coverage would or would not be regarded as a local insurance transaction.