PD-AAR-129 39471

UNCLASSIFIED

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

COSTA RICA
PAAD

ECONOMIC STABLIZATION AND RECOVERY (ESR) IV

Project Number: 515-0194
PAAD Number: 515-K-606
515-K-606 A1

AID/LAC/P-217

UNCLASSIFIED

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROGRAM ASSISTANCE APPROVAL DOCUMENT (PAAD)

1. PAAD Number	Project No. 515-0194 Grant 515-K-606 (A.1)
2. Country	Costa Rica
3. Category	Cash Transfer
4. Date	February 1985

To: A/AID M. Peter McPherson	6. OYB Change Number n/a
From: AA/LAC, Victor M. Rivera	8. OYB Increase None To be taken from: Economic Support Funds (ESF)
Approval Requested for Commitment of $ 140,000,000.00	10. Appropriation Budget Plan Code LESA85-35515-KG31 Budget Plan Code 537-65-515-00-50-51

Type Funding	12. Local Currency Arrangement	13. Estimated Delivery Period	14. Transaction Eligibility Date
☐ Loan ☒ Grant	☒ Informal ☐ Formal ☐ None	FY 1985	-

15. Commodities Financed

N/A

16. Permitted Source	17. Estimated Source
U.S. only	U.S. $140,000,000.00
Limited F.W.	Industrialized Countries
Free World	Local
Cash $140,000,000.00	Other

18. Summary Description

The purposes of the program are to provide balance of payments support to A.I.D. stabilization efforts in Costa Rica, and to encourage policy and structural changes aimed at re-establishing dynamic growth in the economy through increased exports. The $140 million grant which will be signed with the Central Government of Costa Rica will consist of a cash transfer to the Central Bank of Costa Rica, the dollar equivalent of which will be made available for sale to private producers. Imports from the U.S. of raw materials, intermediate goods, construction materials, capital equipment, and spare parts in an amount at least equal to the grant will be required. An amount in local currency equivalent to the Grant will be deposited by the Central Bank in the Special Account originally established under ESR II. Disbursements of local currency from the account will be made pursuant to A.I.D. implementation letters for the purposes specified in the PAAD Amendment No. 1. The $140 million authorized hereby will be subject to the Conditions, Covenants, and Special Provision specified in Section IV.E.2 of the PAAD Amendment.

Authority is delegated to AA/LAC to amend the Authorization as may be required to subsequently revise any Covenants or Special Provisions.

The Mission is authorized to vary the disbursement plan contained in Section IV.C.2.a of the PAAD Amendment as required to maintain an even and rational flow of foreign exchange into Costa Rica, but with the provision that the Mission will consult with AA/LAC prior to taking any action to withhold or delay all or any part of a disbursement.

19. Clearances	Date
LAC/DR: DJohnson	3/14/85
GC/LAC: [illegible]	3/13/85
DAA/LAC: [illegible]Brown	
ARA/ECP: [illegible]Beckin	
[illegible]/FM: CChristensen	
[illegible]/PPC: [illegible]	3/19/85
[illegible] CAP: [illegible]	3/11/85

20. Action

☐ APPROVED ☐ DISAPPROVED

Authorized Signature: [signature] Date: 3/19/85

Title

CLASSIFICATION: CONFIDENTIAL

UNCLASSIFIED

AGENCY FOR INTERNATIONAL DEVELOPMENT **PROGRAM ASSISTANCE APPROVAL DOCUMENT (PAAD)**	1. PAAD Number Project No. 0194 515-K-606 2. Country Costa Rica 3. Category Cash Transfer 4. Date
5. LAC, Victor M. Rivera	6. OYB Change Number N/A
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 Budget Plan Code Budget Plan Code

11. Type Funding	12. Local Currency Arrangement	13. Estimated Delivery Period	14. Transaction Eligibility Date
☐ Loan ☒ Grant	☐ Informal ☐ Formal ☐ None	FY 1985	

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 to provide balance of payments support to aid stabilization efforts in Costa Rica, and to promote the objectives of USAID/Costa Rica's Caribbean Basin Implementation Plan through encouraging policy reforms and structural changes which help to re-establish dynamic growth in the economy through increased exports. The $20 million grant will consist of balance of payments support through a cash transfer to the Central Bank of Costa Rica, which, with its own funds, will make available an equivalent amount of dollars for sale to private producers. Imports from the U.S. of raw materials, intermediate goods, construction materials and spare parts in an amount at least equal to the grant will be required. The local currency equivalent of the $20 million grant will be channelled to private commercial banks through a special credit line from the Central Bank.

19. Clearances		Date
LAC/DR:	I. Levy	
GC/LAC:	R. Meighan	1/25
DAA/LAC:	M. D. Brown	
ARA/ECP:	R. Beckham	
M/FM:	C. Christensen	1/25/85

20. Action

☒ APPROVED ☐ DISAPPROVED

Authorized Signature: Marshall Brown

Date: Jan 2 [illegible]

I

TABLE OF CONTENTS

Page

ANNEXES

LIST OF ACRONYMS

AID	Agency for International Development
BCCR	Central Bank of Costa Rica
CACM	Central American Common Market
CBI	Caribbean Basin Initiative
CNP	National Production Council
CODESA	Costa Rican Development Corporation
CP's	Conditions Precedent
ESF	Economic Support Funds
ESR	Economic Stabilization and Recovery
FERTICA	<u>Fertilizantes de Centroamérica</u>
FUCODES	<u>Fundación Costarricense de Desarrollo</u>
GDP	Gross Domestic Product
GOCR	Government of Costa Rica
IBRD	International Bank for Reconstruction and Development
IDB	International Development Bank
IESC	International Executive Service Corps
IMF	International Monetary Fund
INVU	<u>Instituto Nacional de Vivienda y Urbanismo</u>
LAC/DP	Latin American and the Caribbean/Development Planning
LAC/DR	Latin American and the Caribbean/Development Resources

LPSFE	Law for Public Sector Financial Equilibrium
PAAD	Program Assistance Approval Document
PL	Public Law
PP	Project Paper
PVO	Private Voluntary Organization
RECOPE	*Refinadora Costarricense de Petróleo*
ROCAP	Regional Office for Central American and Panama
SAL	Structural Adjustment Loan
SBN	National Banking System
SNAP	*Sistema Nacional de Ahorro y Préstamo*
US	United States of America
USAID	United States AID Mission
USAID/CR	Unites States AID Mission to Costa Rica

I. SUMMARY AND RECOMMENDATIONS

A. Summary

Costa Rica has long been distinguished by its democratic tradition and peaceful nature. Its army was abolished in 1949, and it stands high in the area of human rights. During the quarter century ending in the mid-1970's it appeared to be a model developing country, enjoying substantial rates of economic growth and pursuing growth with equity. Such growth however, was based on a policy of import substitution and on overreliance on traditional agricultural commodities.

In addition, Costa Rica moved away from a market economy, nationalizing its banking system, increasing public sector employment to 20% of the labor force, and investing heavily in inefficient state run enterprises operated by the Costa Rican Development Corporation (CODESA). (By 1984, CODESA was absorbing 34.2 percent of total credit to the public sector and 15.3 percent of all credit, and was contributing to a massive public sector debt with no possibility of repayment.)

When the terms of trade turned against Costa Rica in the late 1970's and the Central American Common Market became a declining and unreliable trading partner, the country resorted to external borrowing to maintain a fixed exchange rate, to compensate for the fall in the value of its exports, and to cover its balance of payments deficit. By 1981, the economy was in a state of crisis and faced with an overwhelming debt service burden.

Since the administration of President Luis Alberto Monge took office in May of 1982, the economy has been stabilized with the help of the IMF, A.I.D., and rescheduling of foreign debt. A.I.D. has signed three prior Economic Stabilization and Recovery Programs (ESR) with Costa Rica for the years 1982-1984. The 1984 ESR III program marked a shift of emphasis from stabilization, to policy reform and structural change required to re-establish economic growth. Under this program, major reforms in credit, interest rate, and exchange rate policies were effected, along with changes to improve the role of the private banking sector and to promote exports. Conditionality also required initial steps in a number of key areas of policy reform and structural change as a basis for further action under subsequent ESR programs.

The ESR IV program is proposed at a level of $160 million in Economic Support Funds (ESF) and all-grant funding. Of this amount, $20 million was approved as a first increment by the PAAD approved on January 28, 1985. This PAAD Amendment No. 1 covers the background, justification and description for the total program, and requests authorization of the remaining $140 million.

The proposed level of $160 million together with inputs from the International Monetary Fund (IMF), the World Bank via its 1985 Structural Adjustment Loan (SAL), and the commercial banks is required to enable Costa Rica to meet targets of the 1985 Standby Arrangement submitted for IMF approval, and to achieve a GDP growth target of 2 percent. These funds would be disbursed as a cash transfer for balance of payments support over a nine month period--not including the initial disbursement effected in January, 1985. Tranching funds in this manner provides a basis both for maintaining an even and rational flow of foreign exchange into Costa Rica, and for enforcing conditionality requirements.

The Government of Costa Rica (GOCR) will be required, as under previous ESR Agreements, to provide an amount of dollars equivalent to the cash transfers, for sale to private, productive enterprises. It will also be required to show that it has imported eligible goods from the United States within a specified time period, in an amount at least equal to the cash transfers.

The GOCR will also be required to provide the local currency equivalent of the Grant for activities consistent with the objectives of the ESR IV program. The equivalent of the $20 million first increment disbursed in January is being added to the Special Credit line established under ESR I, to provide funds for relending by private sector banks. The equivalent of the $140 million to be disbursed under the second Grant Agreement will be credited to the Special Account established at the BCCR under ESR II. Up to the full amount will be provided to the GOCR to assist it in carrying out the divestiture of parastatal enterprises held by CODESA and concomitantly helping to reduce the public sector debt to which it contributes so heavily.

Given the comprehensiveness of the existing conditionality, the effort required to track this, and the need to carry much of this forward to the ESR IV program for follow-on steps, no new areas of conditionality are proposed. However, one area originally addressed in the ESR III program has been targetted for major follow-on emphasis. This involves the above mentioned structural change involving the CODESA divestiture and its impact on the public sector debt.

B. Recommendations

1. That this PAAD Amendment No. 1 be approved in the amount of $140 million for a cash transfer to Costa Rica.

2. That authority be delegated to AA/LAC to amend the Authorization as may be required to subsequently revise any Covenants or Special Provisions.

3. That the Mission be authorized to vary the disbursement plan contained in Section IV.C.2.a as required to maintain an even and rational flow of foreign exchange into Costa Rica, but with the provision that the Mission will consult with AA/LAC prior to taking any action to withhold or delay all or any part of a disbursement.

II. BACKGROUND

A. Historical Conditions

During the quarter century ending in the mid-1970's, Costa Rica appeared to be a model developing country. It operated as a true democracy, pursued a progressive social program, and experienced substantial rates of economic growth. Its Gross Domestic Product (GDP) grew by 7.0 percent per annum from 1966-1970, 6.0 percent per annum from 1971-1975, and 5.3 percent per annum from 1976-1980. Social development was as impressive as economic performance: adult literacy reached 90 percent, infant mortality declined sharply to under 20 per thousand, population growth dropped to 2.6 percent per annum, and open unemployment and underemployment were held to 5 percent and 6 percent of the labor force, respectively. A national system of social security (including near-universal health care), workmen's compensation, and other similar measures were institutionalized. Progress in meeting housing needs was less spectacular, but satisfactory. Income distribution was quite equitable in comparison with most developing countries. Such achievements were based on substantial public sector investment. Schools, health facilities, water and sewerage, roads, electricity, and communications facilities were widely distributed.

During this period, the strong expansion experienced by the Costa Rican economy which paid for this progress was related to (1) the creation of the Central American Common Market (CACM) and (2) the expansion of traditional agricultural exports: coffee, bananas, sugar, and beef. During the 1960's, private entrepreneurs rapidly expanded manufacturing and supplied the domestic market and the CACM under protectionist, import-substitution policies.

By the early 1970's, growth generated through the CACM slowed and the economy began to pay the high but hidden costs of overprotection. Moreover, the structural problems inherent in the import-substitution growth model being followed were not well appreciated. As the decade progressed, interest rates became more subsidized and the exchange rate more overvalued. These forces contributed to heavy reliance on imported inputs, to the creation of excess capacity and to misallocation of foreign exchange. The country continued its expansion of industry and social services, and financed that expansion from inflows of external private capital and earnings generated from expanding traditional exports.

In effect, Costa Rica began to move away from a private sector market economy and towards a state-administered socialist economy as regards prices, wages, control over production, and concessions to special interest groups. The Costa Rica Development Corporation (CODESA) was established in 1972 to promote industrial development in cooperation with the private sector. Unfortunately, the law which established CODESA allowed it access to Central Bank credit to continue supporting unprofitable enterprises once they were established. In the process, it increasingly bought out private sector interests in joint enterprises. As a result, inefficient state enterprises were created during the 1970's. Expanding social services, public utilities, and state enterprises significantly increased the State's bureaucracy from about 6 percent of the labor force in 1950 to over 20 percent by the 1980's. The public sector was thus growing faster than the private sector upon which it was dependent for financial support.

In 1979, the terms of trade turned against Costa Rica as coffee prices fell sharply from their 1977 high and the price of petroleum doubled. Then in the 1980's the CACM, on which Costa Rica had depended so heavily, became a contracting and unreliable market. Costa Ricans were, collectively, living beyond their means.

Economic growth and development achievements contributed to a false sense of invulnerability; Costa Ricans were unprepared to deal with the devastating impact of the world economic recession in the late 1970's, as well as with the limitations of domestic economic policies. In the period 1978-1981, in order to avoid the difficulties of adjustment, the Costa Rican Government engaged in substantial external borrowing to maintain a fixed exchange rate, to compensate for the fall in the value of exports, and cover the balance of payments deficit. This heavy external borrowing gave Costa Rica the dubious distinction of being one of the most indebted nations in the world, on a per capita basis. The authorities also permitted strong monetary expansion in an attempt to maintain existing levels of public and private consumption.

By 1981, net foreign exchange reserves were exhausted and the attempt to maintain real income collapsed with a de facto moratorium on servicing the foreign debt. GDP declined by 2.3 percent in 1981, and by 9.1 percent in 1982. Unemployment and underemployment rates rose by 1982 to at least 9 per cent and 14 per cent respectively. Inflation exceeded 100 percent by end 1981.

In summary, the economic decline can be attributed to much more than world recession and the escalation of political turmoil in Central America. The magnitude of the crisis resulted from failure of specific elements of the development model Costa Rica had followed since the late 1950's. Overreliance on traditional export commodities for foreign exchange generation, the policy of import-substitution, the creation of inefficient state-run enterprises, and heavy public sector borrowing all wrought havoc on the economy, and signaled the need for re-structuring. By the time the administration of President Luis Alberto Monge took office in May 1982, most elements of Costa Rican society were aware of the deteriorating economic situation and sufficiently alarmed to make possible the imposition of the discipline of a stabilization program. Subsequent progress towards stabilization and recovery is discussed in the two sections immediately following.

B. Current Economic Situation

1. Introduction

A detailed analysis of the current status of the Costa Rican economy with accompanying data was prepared for this PAAD Amendment and is attached as Annex II.

In brief, the analysis in Annex II demonstrates substantial fiscal adjustment and monetary restraint since the debt crisis of 1981. GOCR efforts to increase taxes, eliminate subsidies, and to control expenditures is evidenced by several economic trends. Tax revenues have been increased from 18.8 per cent of GDP in 1981 to 23.6 per cent in 1984. The government's overall deficit has been reduced from 13.7 per cent of GDP in 1981, to 2.5 per cent in 1984. Monetary restraint combined with these reductions of the public sector deficit has reduced inflation from 114 per cent in 1981, to 10 per cent in 1984 (as measured by the wholesale price index). Domestic financial stability has been accomplished without major new increases in unemployment which fluctuated between 7.4 per cent and 9.5 per cent over the period and stood at 7.8 per cent by March, 1984. However, there has been a social cost: real per capita GDP has declined 10 percent since 1981 thereby causing a general reduction in the standard of living.

Although the attached analysis demonstrates the degree of fiscal readjustment that has taken place, it also emphasizes the fragility of the economic situation due to Costa Rica's poor balance of payments performance and its external debt situation. With poor export performance, and high interest costs on debt, the current account balance of payments deficit remained unacceptably high at 11 percent of GDP for 1984. As a further example of external imbalance, IMF projections show debt payments approximate 48 percent of exports of goods and services over the next six years without rescheduling and 35 per cent with rescheduling.

Faced with this problem, the GOCR has reached a set of interlocking arrangements for 1985 with the major donors, including the World Bank, A.I.D., the International Monetary Fund (IMF), and the commercial banks. (See San Jose 1984 (C) 09752, San Jose (C) 00153, San Jose (C) 0453). These arrangements continue Costa Rica's stabilization program, and initiate new structural change aimed at overcoming the problem of chronic balance of payments deficits through export expansion and increased foreign investment. The need for donors to promote continued structural change favoring export performance and economic efficiency in allocating resources cannot be overemphasized at this time. The reestablishment of economic growth, and the servicing of Costa Rica's huge external debt of approximately $4 billion will not be possible without these adjustments. Such reforms, although of a long-term nature, have been developed through policy dialog carried out in the context of yearly programs. With respect to A.I.D.'s Economic Stabilization and Recovery Program (ESR) this process has meant considerable carry-over of conditionality from past programs. (See Section III.C below.) In this context, the following sections highlight resource flows, the general economic rationale for overall donor activities, and A.I.D.'s contribution to the GOCR's 1985 program.

2. Balance of Payments

Costa Rica's overall balance of payments deficit in 1984 was $64 million as contrasted with the $22 million surplus projected under the proposed (April 1984) IMF program. Higher imports, greater interest payments and lower project-related capital inflow than projected account for the worsening of performance. However, in January 1985, the IMF and GOCR agreed to a 15 month stabilization program designed to strengthen fiscal performance and the balance of payments position in order to continue a sound economic recovery.

In summary, the GOCR/IMF program for CY 1985 holds growth of imports constant at $1,103 million. Given expected export earnings of $1,065 million, the resulting balance of trade deficit amounts to $38 million. Service payments, including payment of interest on the official debt of $342 million, bring the current account deficit to $300 million. In addition, required amortization payments after debt relief negotiated to date are projected at $211 million, giving a capital inflow requirement of $511 million. Net private capital inflow and disbursements against assistance projects are projected at about $238 million, leaving a balance of payments gap to be financed of $273 million. (For details see Annex II, Table IV). Core financing from major donors under the stabilization program requires the following disbursement and additional debt relief:

- $80 million from the IBRD's Structural Adjustment Loan (SAL).
- $83 million interest and amortization relief from additional debt rescheduling by the Paris Club.
- $190 million in ESF ($160 million proposed under ESF IV, and $30 million from 1st quarter FY 1986 funding)

As a result, the program will generate an overall payments surplus or increase in foreign exchange reserves of $80 million for 1985. IMF resources and a $75 million commercial bank consortium was not counted as capital financing above since they are included in compensating financing as part of the country's reserve position. The IMF Stand-By Arrangement provides for a gross inflow of SDR 54 million from the IMF over the 15-month period to manage cash flow. However, given required repayments to the IMF, the net increase in SDR credit over the period is limited to approximately SDR 12 million ($12 million). The combination of payments surplus and compensatory financing will bring net international reserves to a level of minus $140 million by December 31, 1985 and will eliminate arrears on Central Bank foreign exchange payments by the fourth quarter of 1985. Both targets are established by the proposed IMF Stand-By Arrangement.

A.I.D.'s input into this package is critical to successful implementation of the proposed Stand-by Arrangement. The proposed ESF level is required, along with other official and private capital inflows, to allow Costa Rica to achieve a GDP growth target of approximately 2 percent. Lower

ESF levels would require greater austerity and lower real income, and would seriously hamper movement toward the NBCCA objective of increased employment and growth.

3. Structural Adjustment

The major shift in economic policy to be initiated by the GOCR in 1985 will be the restructuring of external tariffs and export incentives in order to re-orient domestic production toward export promotion. Heretofore, this policy initiative has been blocked by the GOCR's adherence to the highly protective common external tariff of the CACM. An agreement was reached among members of the Common Market in December 1984 to reduce tariffs. This includes lowering nominal tariffs to no more than 70 per cent on final goods. Based on this agreement, the IBRD has agreed to an $80 million SAL in support of tariff reform and export expansion. The steering committee of the consortium of commercial banks has conditioned its lending program on approval of the SAL and necessary tariff revisions and has tied new commercial bank loan disbursements to initial disbursements of the IMF Stand-by Arrangement.

Given the tight interdependency of disbursements of the IBRD, IMF and the commercial banks, the Mission does not propose to condition dollar disbursements against new economic legislation designed to initiate structural reform or against credit and reserve targets for 1985. There is however, a continuation of applicable conditionality from past Agreements, which is discussed in Sections IV.C.2.a and IV.E.2 of this PAAD Amendment.

At the request of the GOCR, the Mission has developed an economic program supporting structural change, to be carried out with local currency equivalent to dollar funds under ESR IV. This program is based on three considerations: (1) the GOCR's request to A.I.D. to help with divesting parastatal enterprises held by CODESA; (2) the need to significantly reduce the allocation of credit to unproductive uses and to improve the financial condition of the Central Bank; and (3) the need to demonetize a large percentage of local currency generated by ESR IV inflows during 1985 in order to stay within the credit ceilings of the stabilization program.

As explained in Section II.A, the GOCR has increasingly placed controls on the pricing system and has expanded its role in the productive process during the last quarter century. This was evidenced by (1) an increasing level of subsidies to autonomous institutions to support low food prices, subsidize fuels and provide cheap farm inputs such as fertilizer, and (2) increased lines of credit to cover the costs of inefficient state enterprises run by CODESA and other autonomous institutions. This problem has been ameliorated with respect to public utilities since 1981, as the GOCR has increased charges to cover costs. However, little has been done to date to address the second aspect of the problem, the high cost of operating inefficient state enterprises through CODESA. The overall magnitude of absorption of domestic credit by CODESA can be seen in the following table.

Table 1

CODESA and Credit Growth, 1979 - 1984
(millions of Colones)

	1979	1980	1981	1982	1983	1984
Domestic Credit	15,874	19,697	22,523	29,720	54,261	59,133
Private Sector, Net	10,389	11,864	13,026	18,094	27,549*	32,648
Public Sector, Net	5,485	7,833	9,497	11,626	26,712	26,485
CODESA, Net	(1,809)	(2,584)	(3,202)	(6,315)	(7,536)	(9,069)
CODESA as:						
% of Public Sector	33.0	33.0	33.7	54.3	28.2	34.2
% of total	11.4	13.1	14.2	21.2	13.9	15.3

(*) Includes rescheduled debt assumed by the Central Bank.

The amount of banking system credit to CODESA amounted to 13.9 percent of total banking system credit in 1983. In spite of this, CODESA enterprises provided only 2,122 direct jobs, or 0.3 percent of the labor force, and accounted for only 1.1 percent of the total production of Costa Rica (i.e. GDP) during 1983. Due to its special legal status, CODESA has obtained large amounts of financing from the Central Bank. Since Costa Rica first began its experiment to promote industrialization through state financing in 1972, and until June 30, 1984, CODESA has accumulated 13.3 billion colones of debt ($266 million at ¢50 : $1.00) which has resulted in a negative net worth of 4.5 billion colones ($90 million) on its own books. This policy has also had major hidden costs to the economy in terms of opportunities forgone. Inefficient CODESA enterprises have used resources that could have been allocated to more efficient private sector activities. In a real sense, the opportunities forgone represent a loss of economic growth.

President Monge's administration has concluded that the next step in strengthening the financial position of the public sector is divestiture of state enterprises and has initiated a process, based on legislation passed by the Legislative Assembly in 1984, to sell or liquidate enterprises controlled by CODESA. A.I.D. will assist that divestiture process with dollar financed technical assistance and the provision of local currency equivalent as described in Section IV.D.2.b of this PAAD Amendment.

C. Objectives and Status of A.I.D.'s Prior Economic Stabilization and Recovery Programs (ESR) in Costa Rica.

A.I.D. administered ESF resources have played a decisive role in the progress toward stabilization and recovery described in Section II.B. above.

A.I.D. has signed three previous ESR Agreements with Costa Rica. The FY 1982 and 1983 Agreements were with the Central Bank of Costa Rica. The FY 1982 program (ESR I) was in the amount of $20 million; the FY 1983 program (ESR II) was for $155.735 million. The FY 1984 program (ESR III) was in the amount of $130 million, of which $35 million was signed with the BCCR, and $95 million signed with the Ministry of Planning (MIDEPLAN). All funds have been fully disbursed.

All three programs, as is the case with the ESR IV program proposed herein, were based on the need to provide balance of payments support to Costa Rica and to increase the amount of foreign exchange available to the private, productive sector. The ESR I and II programs were primarily focussed on stabilization of the economy, restoration of international confidence in Costa Rica, and development of an export and investment strategy. The program objectives were directly in support of the Caribbean Basin Initiative (C.B.I.). Local currency equivalents provided by Costa Rica in conjunction with this balance of payments assistance, and A.I.D. conditionality, reinforced our objectives.

The ESR I and II programs were structured to support an IMF Stand-by Arrangement for 1983. The colon was stabilized, and substantial amounts of local currency credit were made available to the private sector - including the equivalent of some $25 million which were channelled through a new Central Bank credit line to the private banks to provide a competitive alternative to the inefficient state-run banking system. In addition, the GOCR developed and accepted "A Strategy for Export Promotion and Investment", which is currently being implemented with A.I.D. support. (A more detailed description of accomplishments under ESR I and II was provided in the PAAD for ESR III.)

The ESR III program continued the effort to consolidate the stabilization program, but also marked a shift towards greater emphasis on policy formulation and administrative reform, strengthening of the financial intermediation system - particularly through support to private sector financial institutions - and administrative and operational support for expansion of exports and investment. The priorities established by the Mission for the economic reforms under ESR III were:

(1) Improvements in the system for financial intermediation, including credit, interest rates, role of the private banking system, and exchange rate policy; agreement with the IMF; and easing of free zone regulations to encourage exports.

(2) Removal of taxes which were disincentives to exports and production; and the enacting of measures to decrease public sector expenditures.

Two very significant achievements resulted under ESR III from the Mission policy dialogue and use of A.I.D. leverage over disbursements. These were revisions to the Monetary Law of Costa Rica (Ley de la Moneda) and the Organic Law of the Central Bank. The former ended the ability of debtors to pay off hard-currency loans in Costa Rican currency at an official exchange rate less than the market rate. This ability to pay such loans at substantially less than their foreign currency value made it next-to-impossible for the Costa Rican private sector to obtain credit in hard currencies. The other modification to the Organic Law of the Central Bank permitted the BCCR to rediscount funds, financed from external sources, directly to private sector banks. Private banks were previously prohibited from obtaining funds from the BCCR - except on a limited basis where routed thru a parastatal entity to the Special Credit Line originally established under the ESR I Agreement. This latter change marked a major step towards increasing the role of the private banking sector in Costa Rica.

Also as a result of policy dialogue, the GOCR formulated and published a document entitled, "Strategy and Actions in Economic Policy, 1984 - 1986." This document served as a public statement by the Monge administration of its commitment toward extraregional, export-led growth.

ESR III included major conditionality with respect to credit and interest rates in an effort to simplify and rationalize the Central Bank's (BCCR) management of credit. The specifics included limiting subsidized credit for 1984 to 16 percent of total credit provided in 1984 and requiring that such subsidized operations should limit the use of demand deposits captured from the public to finance such operations. All other credit operations undertaken by the banking system were required to be made at real, positive interest rates with the exception of livestock breeding. To assure real, positive rates, the BCCR was required to report on domestic inflation, international interest rates and credit demand if, and when, it adjusted its basic credit Central Bank lending rate.

Because the Costa Rican practice was to employ different lending rates and quantitative credit ceilings for different economic activities, the Mission supported relaxation of both these controls to allow for freer play of market forces. Thus, ESR III required that a maximum of three unsubsidized rates be utilized by the Central Bank, as opposed to five, and that the prevalent "topes", or credit limits for economic activities be reduced. Subsequently, the GOCR reduced the number of "topes" to 23 as opposed to some 53 subclassifications in force in 1983.

The GOCR's 1985 credit program is designed to eliminate more credit limits than were considered by the ESR III covenants (see San José 00561). Within the global ceiling established by the Central Bank for each of the four state commercial banks there are only three broad categories: allocation to subsidized credit, productive activities, and unproductive activities (e.g. commerce, utilities and personal credit). Aside from this, detailed credit rationing has been substantially eliminated.

As a basis for on-going policy dialogue. the ESR III program also required the BCCR to report monthly on its rationale for adjusting or not adjusting its exchange rate. This exercise was intended to assist export development by ensuring review of policies which could affect competitiveness of Costa Rican products abroad. The BCCR has regularly provided its analyses, and periodically devalued the colon in 1984 from 43.50 colones for one dollar to 47.50 colones for one dollar. Futher periodic devaluations are expected for 1985.

In relation to promoting exports, the regulations relating to the free zones are to be revised in response to ESR III conditionality. To complement the World Bank's emphasis on tariff reform in conjunction with its 1985 Structural Adjustment Loan, ESR III called for selective reductions of port charges, port improvements, and analysis and preparation of a plan of action to improve the functioning of Costa Rica's ports. The GOCR has announced a phased reduction of port charges which is expected to be completed by October, 1985. In addition, the port authorities have presented their most critical investment needs for 1985 to the Ministry of Public Works and Transport, and the Ministry of Planning has completed the terms of reference for a determination of possible plans of action to improve port functioning.

ESR IV continues these policy initiatives both by requiring continued compliance with the Covenants still in effect from prior Agreements, and by updating others as required to continue progress. These requirements are detailed in Section IV.E, Conditions and Covenants. It should be noted that other policy reforms treated under ESR III, such as action plans for port administration improvements, pricing policies, and export strategies for the meat and sugar industries will be completed in FY 1985 and will be available as a possible basis for policy dialogue with the new Administration. The approach of dealing with policy and structural change by progressively applying conditionality throughout a series of ESR Agreements over time, is described in Section III.C. below, on ESR IV strategy.

A more comprehensive review of the status of conditionality in effect under prior ESR programs was recently submitted by cable to AID/W. (See San José 1040).

III. U.S. INTERESTS, STRATEGY AND RATIONALE

A. U.S. Interests

Costa Rica is frequently called "The Switzerland of Central America". This reflects not only its Alpine-like landscape, but its long-standing democratic tradition and peaceful nature. Its army was abolished in 1949, and Costa Rica prides itself on having more teachers than policemen. It stands high in the area of human rights, at a time when many of its neighbors are in flagrant violation of these. Both citizen and visitor alike travel freely and safely throughout the land, and refugees from the conflict and oppression in neighboring countries of Central America continue to seek its safety. (Some 19,000 persons have officially entered Costa Rica as refugees from other Central American countries between 1974 and 1984, although that number may be as high as 150,000 when unregistered immigrants are considered.)

The National Bipartisan Commission on Central America (Kissinger Commission) emphasized, in its report to President Reagan, the high degree to which Central America is both vital to U.S. interests, and particularly vulnerable at the present time. The Kissinger Commission clearly articulated how national interests are served by advancing the cause of democracy within the hemisphere. As historically the most successful social democracy in Latin America, Costa Rica is in a unique position to garner support for U.S. policy in Central America. The country serves as a paradigm of peaceful and democratic development for the region.

The recent economic crisis and political turmoil in neighboring countries have severely tested Costa Rican institutions and ingrained democratic traditions; the country has been able, thus far, to withstand the challenges, and, as described in Section II, C above, to undertake some of the difficult policy and structural changes required to re-establish growth and prosperity. It is significant that such changes have taken place within a democratic process, and have been accepted in a peaceful manner. However, many of the policy and structural changes undertaken since the beginning of the Monge administration in May of 1982, and those which are further required, represent a radical shift in outlook and philosophy for Costa Rica, and quite naturally engender public and official concern. Thus, changes have sometimes appeared to us to occur slowly, and may continue to do so. Moreover, they have sometimes been hard won, with resistence and skeptical attitudes still remaining to these and further changes. Thus, any serious deterioration in the economic situation would severely affect the credibility of the recovery effort. For this reason, continued and substantial U.S. assistance is required to reinforce the economic recovery effort, and to reaffirm U.S. commitment to Costa Rica, its democratic process, and peaceful tradition.

B. Overall ESF Assistance Objectives in Costa Rica

Economic recovery in Costa Rica requires that the country move away from the import-substitution model and statist attitudes, towards export-led growth in a more market-oriented economy. It is U.S. belief and policy that this can best be obtained by encouraging revitalization of the more efficient private sector. The corollary to this policy is the reduction of the role of the public sector, which, as described in Sections II.A and B, has contributed to the current economic crisis. The goals and objectives which implement this policy were articulated in the Mission's CDSS Supplement, and have also served as the basis for ESR I-III. ESR IV continues the efforts of these preceeding programs.

The goals of the program are:

--To help re-establish dynamic growth in the Costa Rican economy;

--To assist in reorientation of the economy from its present import substitution bias, to one in which the industrial sector contributes to export-led growth.

Such goals are to be achieved through the following routes:

--Economic Stabilization and Recovery - To relieve Costa Rica's economic crisis by improving its balance of payments situation by: alleviating the shortages of imported goods required for production; increasing credit available to the productive private sector; and restoring international confidence in Costa Rica and its currency. The program is coordinated with, and supports the economic stabilization and recovery aims of the IMF.

--Strengthening of the Financial System - To encourage the further development of private banks and other private financial entities in Costa Rica, in order to expand and improve services to the productive private sector beyond those currently available through the nationalized banking system.

--Expansion of Exports and Investment - Costa Rica will need to export at a higher level, and on a more diversified basis, if it is to recover its former standard of living and reinitiate long term, dynamic economic growth. The aim of this objective is to increase exports, particularly non-traditional products for non-traditional markets, and to increase foreign and domestic investment in enterprises which engage in such production.

--Improved Public-Private Sector Coordination - To develop improved means of collaboration between the public and private sectors in order to contain the current crisis, stabilize the economy, and establish a basis for long term economic growth through export and investment.

--Improved Policy Formulation and Administrative Reform - To establish the attitudes, laws, procedures, and practices which facilitate exports and investments and a more stable and diversified economy. Among the policies which the Mission sees as most desirable are a commitment to a greater role for the private sector in the economy, an exchange rate regime favorable to exports, the reduction of export quotas and controls, decreased incentives for import substitution industries, a broader commitment to free markets in general in order to foster more efficient resource allocation, and monetary and fiscal policies designed to foster greater internal capital formation.

C. Strategy for the ESR IV Program

As described in Section II.C above, the ESR III program for 1984 moved beyond short term stabilization concerns and development of a recovery strategy, towards obtaining actual policy and structural changes. In so doing the Mission recognized that such changes involved a step-by-step process over time, in which efforts from the previous ESR Agreements would be continued, and initial steps would be taken taken towards changes which would be fully realized under later Agreements. Both the ESF Concepts Paper reviewed in January of 1984, and the PAAD for ESR III noted the reasons for this approach, as opposed to singling out only a limited member of reforms where analysis or implementation were sufficiently advanced that the ultimate action/resolution could be obtained within the time frame of a particular ESR Agreement.

The ESR III Agreements included a comprehensive agenda of some 33 items of conditionality. In designing the ESR IV program, this conditionality was reviewed to determine those items which should be carried through to the ESR IV program, and any updating required. The number and comprehensiveness of the conditionality items to be carried over and the magnitude of the monitoring effort required for these is substantial. In addition, there is the need to maintain the flow of dollar disbursements during CY 1985 to support a balance of payments program based on inter-locking agreements with the major donors, the IMF, the IBRD and the commercial banks. Thus, no new areas of conditionality are either needed or feasible under the proposed ESR IV program. However, one area originally addressed under the ESR III program has been targetted for major follow-on emphasis. This involves a key structural change through assisting the GOCR in carrying out the divestiture of the parastatal enterprises under the Costa Rican Development Corporation (CODESA), the state-owned holding company. The results of this effort will specifically address both the problem of the overwhelming public sector debt discussed in Section II.B, "Current Economic Situation", and the objective of moving towards a more market-oriented economy. The Conditions and Covenants proposed for the ESR IV Agreements are described and discussed in Section IV.E of this PAAD Amendment.

The strategy of obtaining maximum impact by directing both the dollar amounts provided by A.I.D. and their local currency equivalents to obtain the objectives of the ESR program will also be continued.

An additional aspect of Mission strategy is to continue the practice of tranching disbursements to the Central Bank to assure progress/compliance with conditionality requirements of both the current Agreement, and prior Agreements with conditionality provisions still in effect.

IV. PROGRAM DESCRIPTION AND RATIONALE

A. Program Components

The ESR IV program consists of a $160 million ESF grant to Costa Rica. A cable (San Jose (C) 0453) was previously submitted for $20 million of the assistance, and was approved by AID/W (State (C) 26398). The cable contained a justification for accelerating obligation and the disbursement of the first increment of the assistance, based on the need to maintain Costa Rica's foreign exchange flow during the period prior to approval and obligation of the full ESR IV program. This PAAD Amendment covers the background, objectives, and justification for the full $160 million program, plus the description of the dollar and local currency aspects, and the conditionality attached thereto.

The $20 million increment previously authorized has been executed as a Grant Agreement with the Central Bank (BCCR), and was disbursed on January 29, 1985 as a cash transfer. The local currency equivalent of the grant is being added to the A.I.D. Special Credit Line originally established under ESR I to provide additional funds for re-lending to the private, productive sector.

The balance of ESR IV, for which authorization is requested by this PAAD Amendment, will provide an additional $140 million dollars grant to Costa Rica which will also be disbursed as a cash transfer. The bulk of the local currency equivalent will be used to assist the GOCR in the divestiture of parastatal enterprises controlled by CODESA, which are contributing to the public sector debt by operating at a loss. Proceeds from resales will be used to reduce debts of CODESA to the Central Bank of Costa Rica. The second Grant Agreement will be signed with the Central Government because the divestiture effort requires actions on the part of the Central Government to which the BCCR cannot legally commit that superior entity. The BCCR will also be a signator to the Agreement, with certain responsibilities reserved to it as was the case with the ESR III Grant Agreement signed with the Ministry of Planning.

B. Justification for the Grant

The Mission proposes that the $140 million to be authorized by this PAAD Amendment be provided as a grant. As confirmed by data on external debt service presented in Annex II (Table V), the ratio of scheduled public sector external debt service to Costa Rica's projected exports of goods and service averaged 51.7% for the five year period 1985-1989. Reducing the burden of this projected debt service to an economically more acceptable 35% requires annual debt relief averaging $270 million during this period. Therefore, given Costa Rica's high debt servicing burden, maximum grant financing is consistent with U.S. interests in Costa Rica. Grant funding reduces the debt service burden and rate of debt accumulation thereby supporting our stabilization and recovery objectives.

In addition, grant funding provides the necessary flexibility required for the proposed local currency uses. The Central Bank enabling legislation prohibits the Bank from granting borrowed funds to any other entity. Local currency equivalents of such funds are also subject to this requirement. Thus, with the exception of the initial $20 million disbursement loaned to commercial banks through the Special Credit Line, the colones equivalent of the remaining $140 million could not be used to achieve the objectives of the ESR IV program if they were loan rather than grant funds.

Finally, any loan obligation incurred by the Central Government must be ratified by the Costa Rican legislature. This process requires many months, and the balance of payments position of Costa Rica does not permit delaying disbursements for the period required to obtain such legislative approval.

C. U.S. Dollar Resources.

1. Purpose and Terms for Dollar Resources

A total of $160 million, of which $20 million in grant funds have been previously authorized, obligated and disbursed will be provided to the Central Bank in the form of cash transfers as balance of payments support to Costa Rica. The need for this level of support is discussed in Section II.B, and in Annex II.

As under the previous three ESR programs, the ESR IV Agreements will require the Central Bank to make an equivalent amount of dollars available for sale to private enterprises in Costa Rica. Also under ESR IV, imports from the United States of raw materials, construction materials, intermediate goods, capital goods, and spare parts required for production in an amount equal to the dollars provided will be required and monitored. Reports on the levels of sales of dollars will continue to be made within three months following each disbursement, and on purchases of imports within six months of the final disbursement.

Covenants (A) and (B) of the initial ESR IV Grant Agreement signed with the BCCR on January 28, 1985, contained the conditionality pertaining to the dollar resources for both the $20 million dollar first increment of the assistance, and the $140 million to be subsequently disbursed under the second Grant Agreement. These Covenants are repeated in Section IV.E.1 of this PAAD Amendment.

The following deals with the ability of the Costa Rican private sector to absorb $160 million in the time frame provided for the assistance (January-October of 1985). In 1983, eligible imports - which were defined more narrowly at that time - amounted to $173 million. The BCCR has subsequently reported importation of some $90 million of the specified types of goods from the U.S. during the four month period, January - April of 1984, when the most recent figures were available. Given this level of past imports, and an expansion of the definition of eligible goods, no problem in achieving the required level of imports is anticipated.

2. Disbursement of U.S. Dollar Resources

a. Disbursement Plan

Disbursement of U.S. dollar resources will be made in ten tranches. The first tranch of $20 million was previously disbursed as a cash transfer per Section IV.A above. The remainder of the $140 million grant is to be disbursed in nine additional increments.

The Mission proposes to continue the practice established under ESR II and III of tranching the flow of dollars to the Central Bank both to provide a basis for enforcing conditionality, and to maintain an even and/or rational flow of foreign exchange into Costa Rica.

Tranching between the initial increment of $20 million and the first disbursement under the second Grant Agreement will be a function of the time lag between the signing of the two Agreements. It is estimated that this lag will be four weeks at the maximum. Tranching of the remaining disbursements will be established in the same manner as for ESR II and III, wherein funds are released at no less than monthly intervals and may not exceed the disbursement plan except as A.I.D. may otherwise agree in writing. The plan proposed for disbursement of the $140 million to be authorized at this time, plus the actual disbursement of the $20 million increment which was effected on January 29, 1985, is as follows:

TABLE IV

ESR IV DISBURSEMENT PLAN

Disbursements	(Million of U.S. dollars) Grant Funds
First Agreement	$20.0
Second Agreement	
First	$21.0
Second	$21.6
Third	$14.2
Fourth	$14.2
Fifth	$14.0
Sixth	$14.0
Seventh	$14.0
Eight	$14.2
Ninth	$12.8
TOTAL	$160.0

The proposed amounts of the disbursements were arrived at in consultation with the Central Bank, and after review of the projected Central Bank cash flow requirements (also incorporated into the IMF program). The Mission believes that the disbursement plan represents a reasonable projection of Costa Rica's foreign exchange needs through October of 1985, vis-a-vis A.I.D.'s assistance, and taking into account all other sources anticipated.

A.I.D. has, nevertheless, found in implementing both ESR II and ESR III, that variations in the disbursement plan were sometimes required due to both the need to allow flexibility to A.I.D. and the Central Bank in managing the flow of foreign exchange given variations in timing of inflows from other sources which may occur, and to the need to "make up" missed disbursements when these were witheld. Thus the Bank has, from time to time, not requested a disbursement for more than a month, but has then needed to request two in close succession, or in combination.

Given this situation, the Mission requested, and was given authorization to vary the disbursement plans under ESR II and III as required to assure good management and regular availability of foreign exchange resources. The Mission therefore proposes and requests authorization to include in the Grant Agreement, a monthly plan for the disbursement of funds, but with the provision that allows this to be varied by the Mission as required to maintain an even and rational flow of foreign exchange. However, any variation to the disbursement plan which involved witholding of all or part of a disbursement would be based on prior consultation with AA/LAC, as discussed in Section IV.E.2, on conditionality.

b. Disbursement Procedures

Standard A.I.D. procedures will be used, with disbursements of the cash transfer being made into a BCCR account in accordance with its instructions. It is anticipated that electronic transfer of funds to a U.S. bank will be employed. However, other procedures would be employed in the now unlikely event of an embargo of said account by BCCR creditors.

c. Justification for Cash Transfer

As was the case in each of the previous ESR programs, use of a cash transfer is proposed for the ESR IV program for several reasons. First, the cash transfer program maximizes the quick disbursement capability which is required to move foreign exchange into the Costa Rican economy in order to meet the balance of payments and cash flow needs and to coordinate with other donors inputs as described in Section II. B. 2 and 3 above. Second, the data indicates that beginning in 1982, there was a positive net flow of private capital into Costa Rica rather than capital flight out of the country, and hence, measures to limit capital flight are not needed.

Net private capital inflows to Costa Rica for 1980-1984 were as follows:

TABLE V 1/

1980	-$240 million
1981	-$ 69 million
1982	+$ 5 million
1983	+$140 million
1984	+$144 million (preliminary)

The trend towards a reflow of private capital to Costa Rica corresponds to the stabilization of the economy and the improvements in the exchange and interest rate structures.

1/ See Annex II, Table IV. (Net private capital inflows are combined with errors and omissions and may be less when final 1984 figures are published.)

Finally, Costa Rica is using the A.I.D. funds to compensate for foreign exchange inflows lost as a result of factors leading to the current economic crisis. It normally trades with the U.S. well in excess of the dollar amounts provided under ESR Agreements. Total imports from the U.S. amounted to $372 million during 1983; between January and April of 1984, imports from the United States were equal to $154 million. Thus, there is nothing to be gained over the current situation by using a CIP, and much to be lost.

D. Local Currency Resources

1. Provision of Local Currency Equivalent

The Central Bank has previously made available the equivalent of the $20 million first disbursement, by increasing the A.I.D. Special Credit Line in that amount as detailed below and in Section IV.E.1.

The remaining equivalent of $140 million will be provided by crediting the A.I.D. Special Account, according to details specified in Section IV. E. 2 for Covenant (A) of the Second Grant Agreement.

2. Purpose and Terms for Local Currency Resources

a. A.I.D. Special Credit Line

The equivalent of $20 million of the first disbursement of the Grant was made available by the BCCR to increase the A.I.D. Special Credit Line, and was directed through this line to the private sector banks for re-lending to productive, private enterprises. The revisions to the Costa Rican Currency Law (Ley de la Moneda) in 1984, gave private banks direct access to Central Bank re-discount lines where these were externally financed, so that such credit lines no longer needed to be channeled through a Government intermediary such as CODESA.

As of December 31, 1984, the private sector banks had disbursed 1.1 billion colones from the Special Credit Line to 131 firms, had 0.4 billion colones of loans in process, and had a "waiting list" of another 1.2 billion colones. The $20 million equivalent represents sufficient funding, with 1985 reflows, to satisfy the private sector bank credit demands, as well as serve as an incentive to increase their capital accounts to access these funds.

The requirement that funds be put in the Special Credit Line will assist the private sector banks in increasing their equity bases. Costa Rican law prohibits the private sector banks from accepting demand deposits, with the result that their cost of funds automatically exceeds the cost for public sector banks. The A.I.D. Special Credit Line thus not only allows the private sector banks the opportunity to obtain funds otherwise not available to them, a 5.5 percent margin between cost of funds and lending rate (18 and 23.5 percent, respectively) allows them to make a reasonable contribution to capital.

b. Assistance to the GOCR in the Divestiture of Parastatal Enterprises and Reduction of Public Sector Debt.

The local currency equivalent of $140 million will be deposited to the A.I.D. Special Account per Covenant (A) described in Section IV.E.2 below, and will be made available to facilitate divestiture of parastatal enterprises held by CODESA. (The details of the program are summarized herein and are described in Annex III). Any balance of the local currency equivalent deposited to the Special Account not ultimately directed to the divestiture activity will remain in the Special Account and will be available to provide support for other activities programmed for local currency funding under procedures originally approved in the ESR II PAAD Amendment No. 2. 1/

A.I.D.'s proposed assistance to the GOCR in divesting parastatal enterprises under the ESR IV Program is the follow-on step to an effort initiated under ESR III. Covenant (F) of the ESR III Grant Agreement signed on August 1, 1984, required that the management of CODESA develop a plan of action and a strategy for divestiture of its holdings. A continuing policy dialogue between the GOCR and the Mission has gone beyond this, and now forms the basis for the proposal contained in this PAAD Amendment to assist the GOCR in divesting its parastatal enterprises.

The proposal builds upon President Monge's suggestion that local currencies from the ESR program be used to help the GOCR with its divestiture plans. The Mission has responded favorably to the suggestion because of the opportunity it provides to achieve economic reform and structural change in the public sector. Specifically, the program will:

- reduce and, possibly eventually eliminate public sector participation in commercial enterprises;

- decrease future public sector demand for credit and allow for more rational allocation of credit to the productive private sector;

- reduce the public debt by transferring local currency to the BCCR to reduce CODESA's debt; and

- demonetize a significant amount of local currency.

The Mission and the GOCR have agreed to a process which conforms to the existing legal structure for selling the shares of CODESA subsidiaries, as established in Article 55 of the Public Sector Financial Equilibrium Law of 1984. In addition to Article 55, the GOCR has issued the

1/ Approved May 27, 1983.

"Reglamento" which makes the law operational and describes the responsibilities of all parties involved in the process, and a Cabinet Resolution which establishes the basic policies to be followed. The Resolution also creates a National Bipartisan Commission which is responsible for carrying out the GOCR's divestiture program.

In accordance with Article 55, shares of CODESA subsidiaries will be sold through public bid, subject to the following stipulations:

- Public utilities cannot be sold to private interests but must be transferred to another GOCR entity. This affects three CODESA subsidiaries.

- Only 40% of the shares of Fertilizantes de Centro América, S.A. (FERTICA) and Cementos del Pacífico, S.A. (CEMPA) can be sold to private interests.

- Central Azucarera Tempisque S.A. (CATSA) and Cementos del Valle must be sold to Costa Rican cooperatives.

Of the 18 subsidiaries currently held by CODESA, therefore, only 11 can be sold without any limitations.

The Controller General of Costa Rica (with technical assistance financed by the Mission with PD&S funds) will value the assets of all the subsidiaries and, in accordance with Article 55, will establish a minimum acceptable selling price for the shares of each subsidiary.

A key element to the divestiture process is that, prior to the sale of each subsidiary, the CODESA holding company will assume its outstanding third party debt (foreign and domestic). To accomplish this, the Central Bank has agreed to extend the necessary credit to the CODESA holding company. As a result, the sole creditor of the subsidiary companies will be the CODESA holding company which, in turn, will have the Central Bank as its sole creditor. This is expected to facilitate the divestiture process by reducing the potential for any legal claims against the assets of the CODESA subsidiaries as the divestiture process takes place.

To minimize direct involvement of AID in the divestiture of CODESA subsidiaries and, therefore, public controversy related to the assistance provided, a private Trust will be created to buy shares and take possession of the CODESA subsidiaries as they are offered for sale. For this purpose, including operating the subsidiaries while in its possession, and prior to their resale or liquidation, the Trust will receive local currency from the AID Special Account. The Trust, will have the necessary technical capacity (legal, management, business, finance) to deal with all phases of the divestiture process and will utilize ESR IV local currency to cover its operating costs. Once it has obtained control through the bid process, the Trust will make all decisions on the resale or liquidation of each enterprise. These subsequent actions are expected to take some time, but the objective of the Trust will be to complete the resale or liquidation of the enterprises as quickly as possible.

The flow of local currency resources will be through the Trust to the Central Bank. When the Trust is established, an account will be created at the Central Bank into which the Mission will transfer sufficient funds to meet the Trust's operating requirements. As CODESA subsidiaries come up for sale, the required funds will be transferred to the Trust immediately prior to the purchase date.

The local currency used to purchase the shares of the subsidiaries will be transferred directly to the Central Bank where it will be credited against the debt of the CODESA holding company. In that the holding company is the creditor of the subsidiaries, the net effect of the reduction of the debt of the holding company is the reduction of the debt of the subsidiaries.

As the Trust resells or liquidates an enterprise, the proceeds will be deposited in its account at the Central Bank. It is the Mission's preference that, when the trust is dissolved at the end of the divestiture process, all funds held by the Trust be transferred to the Central Bank and applied against the outstanding debt of the CODESA holding company.

The resources flowing through the Trust to the Central Bank for the purchase of CODESA subsidiaries and payment to reduce debt will not be sufficient to pay off the entire debt of the CODESA holding company. As the GOCR moves toward the dissolution of the CODESA holding company, the Mission will be prepared to transfer local currency under the FY 1986 ESF program and any local currency remaining under the FY 1985 program directly to the Central Bank to pay off any outstanding CODESA debt.

As a result of A.I.D.'s assistance, by the end of 1985, it is expected that:

- The 11 smaller CODESA enterprises involved in the process will have been transferred to the private sector (i.e., the Trust). This includes Cementos del Valle which, with assistance from the Trust, will have been transferred to a cooperative.

  Of these enterprises, the Trust will have sold or liquidated at least five.

- At least one of the four largest CODESA enterprises will have been transferred to the private sector. The most likely possibility is CATSA which, with assistance from the Trust, will be sold to a cooperative (FYI, such a cooperative is already in the formative stages).

For CEMPA and FERTICA, the 40% maximum the law permits to be sold will have been sold. Along with the 40% share of these enterprises, the GOCR has agreed that a long-term management contract will be given to the minority shareholder. Although this will not take the balance of the ownership out of the public sector, it will provide the potential for improved operations of the enterprises.

3. Monetization Impact of Local Currency

As indicated in Section II.B.3, one of the key considerations in designing the ESR IV program is to demonetize a significant portion of foreign exchange inflows in 1985 in order to assist Costa Rica to remain within credit ceilings of the IMF Stand-by Arrangement and the GOCR's Stabilization Program.

Of the $140 million equivalent that will assist the CODESA divestiture, the Mission estimates that no more than $48 million will eventually be monetized in local currency: $10 million equivalent as budget support to the GOCR, $5 million equivalent to cover employee severance benefits, $2 million equivalent for trust management and assistance, $31 million estimated colon equivalent debt owed in Costa Rica to other than the Central Bank. No more than $13 million is likely to be monetized in 1985: $10 million as budget support to the GOCR, $2 million employee severance benefits, $1 million trust expenses. The colon debt mentioned above, as well as foreign debt, will be assumed by the Central Bank and paid off over several years.

Remaining funds would be used to cancel CODESA debts to the Central Bank. These transactions will be financial in nature, internal to the Central Bank, and will effectively demonetize the local currency equivalent involved. They are, nonetheless, essential to facilitate the sale or closure of firms. They will have a real economic effect by ending an obvious waste of Costa Rican credit resources and allowing a shift in credit allocation toward the private sector once divestiture is accomplished.

E. Conditions and Covenants

Conditionality proposed for the ESR IV program assures that dollars provided are directed towards achieving the balance of payments and policy objectives established for these, that there is continued compliance with conditionality in existing ESR Agreements, that additional efforts required to further policy initiatives started under prior ESR programs are undertaken, that the local currency equivalent to the Grant is established, and that the basis for achievement of objectives identified for the local currency component of the program is established. The specific conditionality for the two Grant Agreements to be signed under the program is as follows:

1. First Grant Agreement

The First Agreement under ESR IV was signed with the Central Bank on January 28, 1985 in the amount of $20 million. In addition to the standard Conditions Precedent (CP's), the Agreement contained the following Covenants.

o COVENANT (A)

To provide during 1985, foreign exchange resources to the National Banking System and other authorized agents for purchase by private enterprises, the total amount of which shall be not less then the amount of all cash transfers received by Costa Rica from the United States Government under the Economic Stabilization and Recovery Program IV, and to report to A.I.D. by March 31, 1986, or within three months of the last disbursement of these cash transfers, that such transactions were accomplished;

o COVENANT (B)

To make available during 1985, a dollar amount equivalent to that disbursed as cash transfers to Costa Rica under the Economic Stabilization and Recovery Programn IV, for the importation from the United States by private enterprises in Costa Rica, including the agricultural sector, of raw materials, construction materials, intermediate goods, spare parts, and capital equipment required for production, and to report to A.I.D. by June 30, 1986, or within six months of the last disbursement of these cash transfers, that such transactions were accomplished;

o COVENANT (C)

To increase the Special Credit Line originally established under Loans 037, 040 and 043, in a local currency amount equivalent to twenty million United States dollars (U.S. $20,000,000), and to channel this amount to the private banks; and that this local currency amount will be calculated at the highest rate of exchange for purchase which, as of the date of disbursement as defined in Section 3.2 of this Agreement, is not unlawful in Costa Rica;

o COVENANT (D)

To provide to A.I.D., in addition to the reports pursuant to Covenants (A) and (B) above, copies of all reports to the International Monetary Fund as these are issued in accordance with the stabilization program.

2. <u>Second Grant Agreement</u>

In addition to the standard C.P.'s to initial disbursement, the GOCR will be asked to covenant in the Second Grant Agreement - except as A.I.D. may otherwise agree in writing - as follows.

a. This Covenant assures establishment of the local currency equivalent of $140 million.

o COVENANT (A)

That the Central Bank, acting in its capacity as financial agent for the Government of Costa Rica for purposes of this Agreement, will promptly deposit the equivalent in colones of each dollar disbursement from the Grant into the Special Account in the Central Bank originally established under Covenant (L) of the ESR II Assistance Agreement, which will pay interest at a rate equal to that paid by the commercial banks on six month time deposits; that the colones equivalent of each dollar disbursement will be calculated at the highest rate of exchange for purchase which, as of the date of the dollar disbursement, is not unlawful in Costa Rica; and that disbursement from this Special Account will be made pursuant to A.I.D. Implementation Letters;

b. Covenants pertaining to continuation of efforts to improve credit and interest rates are:

o COVENANT (B)

That the Central Bank will maintain and implement the credit program announced by its Board of Directors on January 2, 1985 in all of its features;

o COVENANT (C)

That the Central Bank will submit a report to A.I.D., not later than June 30, 1985, on the execution of the national credit programs in 1983 and 1984, in which actual operations will be compared to the planned targets and differences analyzed; and will prepare and submit to A.I.D. reports on the execution of the 1985 credit program every three months;

o COVENANT (D)

That the Central Bank will continue, during 1985 to adhere to Covenants 6.1(A)(4) and (9) of the Loan Agreement for Economic Stabilization and Recovery III, signed between A.I.D. and the Central Bank on May 7, 1984;

The ESR III Covenants updated for 1985 by Covenant (D) above require that positive and rational interest rates continue to be maintained during 1985.

o COVENANT (E)

That the Central Bank, under the limits established in its 1985 credit program, will give credit at interest rates lower than the basic passive rate, only to those activities identified in Covenant 6.1(A) (7) of the Loan Agreement for Economic Stabilization and

Recovery III, signed between A.I.D. and the Central Bank on May 7, 1984, including also livestock breeding;

- COVENANT (F)

  That the Central Bank will assure that credit given at interest rates lower than the basic passive rate as referred to in Covenant (E) of this Agreement will continue to be financed by at least fifty percent from resources other than those captured from the public by the Commercial Banks;

- COVENANT (G)

  That the Central Bank will assure that the National Banking System (SBN) will not authorize credit to the National Production Council (CNP) in 1985, when such credit is designed to cover CNP losses incurred by provision of subsidies; and for the above purpose, subsidies are defined as the difference between the CNP's cost of acquisition of the product plus transport, handling and related administrative expenses and the price at which it sells the commodity;

- COVENANT (H)

  That for purposes of this Agreement, it is agreed that the provisions of Covenants (D), (E) and (F) refer only to credit operations financed from domestic sources, and that the provisions of Covenants (B) and (G) refer to all credit operations, whether domestically or externally financed;

c. The following Covenant updates the Covenant (B) of the ESR III Loan Agreement pertaining to the exchange rate:

- COVENANT (I)

  That during 1985, the Central Bank will maintain a unified exchange rate, and will review the appropriateness of the exchange rate on a continuing basis in accordance with, amongst others, the following factors: the relationship between domestic prices (actual and anticipated) and prices in the principal countries with which Costa Rica has commercial relations, the status of the current account transactions in the balance of payments, service of the foreign debt, and non-compensatory net capital inflows;

d. The following Covenant requires continued compliance with Covenant (D) of the ESR III Loan Agreement, requiring submission of a plan of action for monitoring of import-export transactions:

- COVENANT (J)

  That the Central Bank will implement, upon approval by A.I.D., the plan of action prepared by the Bank for the monitoring of import and export transactions, including the areas related to auditing, investigations, and punitive action;

The following Special Provision provides the basis for requiring continued compliance with conditionality in prior ESR Agreements.

o SPECIAL PROVISION

If A.I.D. determines at any time that the Government of Costa Rica is not in substantial compliance with any of the Covenants of this Agreement, with the Grant Agreement signed on January 28, 1985 between A.I.D. and the Central Bank, with the Grant Agreement signed on August 1, 1984 and its Amendments, with the Loan Agreement signed on May 7, 1984 between A.I.D. and the Central Bank and its Amendments, or with the Agreement signed December 13, 1982, between A.I.D. and the Central Bank and its Amendments, A.I.D. may suspend disbursements of the Grant until such time as satisfactory compliance has been obtained.

Covenants (B) thru (J), and the Special Provision require continued performance in policy reform areas established under previous ESR Agreements. The Mission feels that it is important to require such continued compliance under the ESR IV program, if A.I.D. is to effectively implement its strategy of being able to address major policy/structural reform areas by tackling them on a step-by-step basis over time. (See Section III.C on Strategy for the ESR IV Program). Compliance with existing conditionality to date has been satisfactory as recently reported in San Jose 1040, and the Mission does not anticipate compliance problems under ESR IV.

As previously stated in Section III.C on ESR IV Strategy, the Mission proposes no new areas of conditionality, and will limit major initiatives under the ESR IV program to moving ahead with parastatal divestiture and reduction of the public sector debt, through assistance to the GOCR in the divestiture of CODESA.

Given the scope both of policy-related conditionality in effect from previous Agreements and the singular importance of the CODESA problem relative to the public sector debt, the Mission feels that to refrain from new areas of conditionality and to limit major initiatives under ESR IV makes sense. However, we plan to retain the necessary leverage for meaningful policy dialogue with the GOCR concerning its economic performance. Specifically, the Mission proposes to include in the Second Grant Agreement, as was previously included in the ESR III Grant Agreement, a provision that allows A.I.D. to notify the Grantee when each disbursement may be requested by the Central Bank. This has the effect of conditioning disbursements on A.I.D.'s approval, but without any specified requirements, and thus facilitates the Mission opening a dialogue prior to authorizing the BCCR to request a disbursement, at any point where a serious issue has arisen.

As indicated above in the last paragraph of Section IV.C.2, the Mission would consult with AA/LAC prior to taking any action to withhold or delay all or part of any disbursement.

The conditionality which deals with the parastatal divestiture process, per se, will be included in the Memorandum of Understanding (MOU) to be signed between A.I.D., the BCCR, and the President of Costa Rica. The GOCR will be required to sign the MOU in conjunction with signing the second Grant Agreement. Such conditionality will not be included in the Grant Agreement because it would result in dollar disbursements being tied to a large number of steps in the divestiture process, which runs the risk of delaying these disbursements and thus seriously compromising A.I.D.'s dollar-side objectives, as described in this PAAD Amendment. (The nature of the conditionality pertaining to the divestiture activity is detailed in Annex III.)

e. The following Covenants reinforce ESR IV efforts to help limit credit to the public sector and to reduce public sector debt:

o COVENANT (K)

That reduction in CODESA debt to the banking system attributable to funds provided under this Agreement will cause an equal reduction in the ceiling on the domestic banking system's net credit to the non-financial public sector as proposed under the stabilization plan put forth in the GOCR's Letter of Intent to the IMF of January 11, 1985;

o COVENANT (L)

That CODESA will contract no new credit for itself or its subsidiaries, apart from interest accruals and that required to consolidate the debt of its subsidiaries, beyond that which is needed for short-term, self-liquidating working capital;

o COVENANT (M)

That CODESA will not participate in or otherwise acquire new investment or ownership positions, nor will it extend new credits or guaranties of any form;

o COVENANT (N)

That the Central Bank will promptly make dollars available as required to facilitate divestiture of enterprises held by CODESA, for foreign currency working capital needs of such enterprises, and as may be required to cancel debts of CODESA; and that such dollars will be made available at the ~~lowest~~ highest rate of exchange for sale which, as of the date of the sale, is not unlawful in Costa Rica;

o **COVENANT (O)**

That the balances attributable to the A.I.D. Special Credit Line from Loans 515-K-037 and 515-K-040 will be transferred from CODESA to the Banco Central, or to another financial intermediary(s) acceptable to A.I.D.; and that CODESA will have no further managerial or financial role with respect to those transactions which it originally administered.

Due to the sensitive nature of the activities and requirements surrounding the GOCR's proposed divestiture of CODESA enterprises, negotiations have been carried on at the highest levels, and in confidence. Thus, the details of the proposed covenants have not yet been fully reviewed at the staff level of the GOCR, and some revisions may be required in completing the second Grant Agreement for signature. The GOCR formally announced plans for the CODESA divestiture on February 14, when it reported the Cabinet Resolution to the public, opening the way to such review and discussion. The Mission will advise AID/W by cable of any proposed changes to the Covenants prior to authorization. To facilitate any changes that may be required after authorization, and during the life of the program, this PAAD Amendment requests that the Administrator delegate to AA/LAC, the authority to revise Conditions and Covenants as appropriate.

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROGRAM ASSISTANCE APPROVAL DOCUMENT (PAAD)

2. Country
Costa Rica

3. Category
Cash Transfer

4. Date

5. To
AA/LAC, Victor M. Rivera

6. OYB Change Number
N/A

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 Budget Plan Code
Budget Plan Code

11. Type Funding
☐ Loan ☒ Grant

12. Local Currency Arrangement
☐ Informal ☐ Formal ☐ None

13. Estimated Delivery Period
FY 1985

14. Transaction Eligibility Date

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 to provide balance of payments support to aid stabilization efforts in Costa Rica, and to promote the objectives of USAID/Costa Rica's Caribbean Basin Implementation Plan through encouraging policy reforms and structural changes which help to re-establish dynamic growth in the economy through increased exports. The $20 million grant will consist of balance of payments support through a cash transfer to the Central Bank of Costa Rica, which, with its own funds, will make available an equivalent amount of dollars for sale to private producers. Imports from the U.S. of raw materials, intermediate goods, construction materials and spare parts in an amount at least equal to the grant will be required. The local currency equivalent of the $20 million grant will be channelled to private commercial banks through a special credit line from the Central Bank.

19. Clearances	Date
LAC/DR: I. Levy	
GC/LAC: R. Meighan	1/25
DAA/LAC: M. D. Brown	
ARA/ECP: R. Beckham	
M/FM:C. Christensen	1/28/85
	1/25

20. Action
☒ APPROVED ☐ DISAPPROVED

Authorized Signature
Marshall Brown

Date
Jan 28, 1985

Title
Assistant Administrator

CLASSIFICATION: UNCLASSIFIED

AID 1120-1 (5-82)

31

ACTION AID-00

ACTION OFFICE AALA-01
INFO LACE-03 LADR-03 PPCE-01 PPPB-02 GC-01 GCFL-01 PPDC-01
FM-02 ES-01 RELO-01 TELE-01 MAST-01 /019 A1 X16

INFO OCT-00 COPY-01 CIAE-00 EB-08 DODE-00 ARA-00 L-03
/012 W
------------------260516 161933Z /44/38

O 161901Z JAN 85
FM AMEMBASSY SAN JOSE
TO SECSTATE WASHDC IMMEDIATE 9217

C O N F I D E N T I A L SAN JOSE 00453

AIDAC

FOR DAA/LAC, MARSHALL BROWN

E.O. 12356: DECL: 01/16/91
SUBJECT: ECONOMIC STABILIZATION AND RECOVERY IV (515-0194)

REFS: (A) 84 SAN JOSE 9684, (B) 84 SAN JOSE 9752 (C) 84 SAN JOSE 9941, (D) SAN JOSE 0153

1. SUMMARY. THIS MESSAGE SUMMARIZES THE CURRENT STATUS OF NEGOTIATIONS BETWEEN THE GOCR AND DONOR COMMUNITY FOR BALANCE OF PAYMENTS SUPPORT IN 1985, REVIEWS LATEST PROJECTION FOR FOREIGN EXCHANGE INFLOWS, AND REQUESTS AUTHORIZATION FOR INITIAL INCREMENT OF DOLS 20 MILLION FROM MISSION'S FY 1985 ESF BUDGET FOR THE ECONOMIC STABILIZATION AND RECOVERY IV PROJECT (515-0194). END SUMMARY.

2. AS NOTED IN EARLIER MESSAGES (REFS A AND B), THE KEY LINK IN THE GOCR'S STABILIZATION PROGRAM FOR 1985 HAS BEEN THE APPROVAL OF THE IBRD'S STRUCTURAL ADJUSTMENT LOAN (SAL). THE PRINCIPAL CONDITIONALITY OF THE SAL IS STRUCTURAL REFORM THROUGH CHANGES IN COSTA RICA'S TARIFF SCHEDULE UNDER THE CENTRAL AMERICAN COMMON MARKET. AN AMENDMENT TO THE TREATY GOVERNING THE TARIFF SCHEDULE WAS SIGNED ON DECEMBER 14 IN GUATEMALA (REF C), PAVING THE WAY FOR IBRD APPROVAL OF THE SAL.

3. ON JANUARY 11, THE IBRD LOAN COMMITTEE APPROVED THE SAL AND GAVE INSTRUCTIONS FOR FINAL NEGOTIATION AND SIGNING OF THE LOAN DOCUMENT. IT IS EXPECTED THAT, UPON RATIFICATION OF THE SAL BY THE COSTA RICAN LEGISLATIVE ASSEMBLY, THE IBRD WILL DISBURSE ONE HALF (DOLS 40 MILLION) OF THE SAL, AND THE BALANCE WHEN THE NEW TARIFF STRUCTURE BECOMES EFFECTIVE (OCTOBER 1).

4. ALSO DURING THE WEEK OF JANUARY 7, THE GOCR AND IMF COMPLETED NEGOTIATIONS ON THE FINAL CONTENT OF THE LETTER OF INTENT FOR THE FUND'S 1985 STANDBY PROGRAM. A MAJOR POINT RESOLVED IN THE NEGOTIATIONS WAS THE PROJECTED CASH FLOW FOR 1985 AND THE RELATED PERFORMANCE TARGETS. BASED ON THE AGREEMENT REACHED, THE LETTER OF INTENT IS NOW BEING PREPARED BY THE IMF MANAGEMENT FOR FINAL APPROVAL BY THE BOARD

5. ON THE BASIS OF APPROVAL OF IMF ACCEPTANCE OF THE SAL AND LETTER OF INTENT FOR SUBMISSION TO THE BOARD, THE GOCR ALSO REACHED AGREEMENT WITH THE COMMERCIAL BANKS ON ASSISTANCE LEVELS FOR 1985. THE COMMERCIAL BANKS WILL PROVIDE DOLS 75 MILLION IN NEW CREDIT TO COSTA RICA. THESE FUNDS WILL BE DISBURSED IN INCREMENTS TO COINCIDE WITH QUARTERLY DISBURSEMENTS SCHEDULED BY THE IMF.

6. AS A CONSEQUENCE OF THESE AGREEMENTS, THE FOLLOWING SCHEDULE OF EVENTS IS NOW ANTICIPATED.

- RATIFICATION OF NEW TARIFF TREATY BY COSTA RICAN ASSEMBLY (REQUIRED FOR FINAL SIGNATURE OF THE SAL)	(MID-FEB)
- GOCR/IBRD SIGN SAL AGREEMENT	(LATE FEB)
- IMF STANDBY SIGNED	(LATE FEB)
- RATIFICATION OF SAL BY COSTA RICAN ASSEMBLY	(APRIL)

7. BASED ON THE ABOVE, MAJOR ASSISTANCE DISBURSEMENTS OTHER THAN ESF ARE NOW EXPECTED TO OCCUR AS FOLLOWS:

- INITIAL DISBURSEMENT BY IMF UNDER THE STANDBY (15 MILLION SDR)	(EARLY MAR)
- FIRST DISBURSEMENT BY COMMERCIAL BANKS (DOLS 18.75 MILLION)	(EARLY MAR)
- FIRST DISBURSEMENT UNDER SAL (DOLS 40 MILLION)	(LATE APR/ EARLY MAY)

8. THIS REVISED SCHEDULE OF DISBURSEMENTS IS NOW ANTICIPATED BY THE GOCR AND IMF IN THEIR FINAL PROJECTIONS FOR THE 1985 STABILIZATION PROGRAM. RESERVE AND CREDIT TARGETS UNDER THE PROGRAM HAVE BEEN ADJUSTED TO ACCOUNT FOR THE DELAY TO THE SECOND QUARTER OF DISBURSEMENTS UNDER THE SAL, AS WELL AS THE TIMING OF DISBURSEMENTS BY THE COMMERCIAL BANKS IN TANDEM WITH IMF DISBURSEMENTS. THOSE TARGETS ALSO ASSUME TIMELY DISBURSEMENTS OF ESF OF APPROXIMATELY DOLS 20 MILLION PER MONTH DURING THE FIRST QUARTER OF 1985. FAILURE TO MEET PROJECTED DISBURSEMENT SCHEDULES BY ANY OF THE MAJOR ACTORS INCLUDING AID COULD REQUIRE NEW DISCUSSIONS AND REVISIONS TO THE STABILIZATION PROGRAM.

9. THE MISSION IS CURRENTLY COMPLETING A PAAD COVERING THE FULL LEVEL OF FY 1985 ESF ASSISTANCE. SUBMISSION OF THIS PAAD TO AID/W IS PLANNED FOR LATE JANUARY AFTER FINAL AGREEMENT WITH THE GOCR ON THE PROGRAMMING OF LOCAL CURRENCY GENERATIONS. FOLLOWING AID/W REVIEW IN MID FEBRUARY, MISSION EXPECTS TO OBLIGATE FUNDS IN LATE FEBRUARY AND BEGIN DISBURSEMENTS SHORTLY THEREAFTER IN ACCORDANCE WITH THE SCHEDULE TO BE DEFINED IN PAAD.

10. TO ASSIST THE GOCR IN ACHIEVING ITS FIRST QUARTER TARGET, AND TO MINIMIZE ANY POTENTIAL DISRUPTIONS IN THE PROCESS OUTLINED ABOVE, THE MISSION RECOMMENDS THAT THE INITIAL INCREMENT OF DOLS 20 MILLION FROM THE FY 1985 ESF BUDGET BE PROVIDED IMMEDIATELY WITH THE AIM OF OBLIGATING AND DISBURSING THOSE FUNDS PRIOR TO THE END OF JANUARY.

11. ACTION REQUESTED: IMMEDIATE APPROVAL AND

PAGE 02 OF 02 SAN JO 00453 00 OF 02 161932Z 4632 046884 AID0595
AUTHORIZATION TO OBLIGATE DOLS 20 MILLION IN
ESF GRANT FUNDS UNDER THE ECONOMIC STABILIZATION
AND RECOVERY IV PROJECT (515-0194). PLEASE
PROVIDE APPROPRIATE BUDGET ALLOWANCE AND DELE-
GATION OF AUTHORITY TO SIGN BY CLASSIFIED TELE-
GRAM. WINSOR

UNCLASSIFIED

33

BULK ANNEX

TO

PAAD AMENDMENT NO. 1

Economic Stabilization and Recovery IV

Project 515 - 0194
Costa Rica

Attachment No. 1 to Annex III of the PAAD Amendment

Letter from President Luis Alberto Monge to Ambassador Curtin Winsor, Jr., dated October 5, 1984 (Original in Spanish language)

Letter from President Luis Alberto Monge to Ambassador Curtin Winsor, Jr., dated February 6, 1985 (Original in Spanish language

Attachment No. 4 to Annex III of the PAAD Amendment

Resolution Project of the Council of Government Pertaining to the CODESA Divestiture (Original in Spanish language)

Decree No. 16007-P-MEC of February 4, 1985, establishing the Reglamento for implementing Article 55 of Law No. 6955 (Original in Spanish language)

34

Luis Alberto Monge
Presidente de la República

ATTACHMENT NO. 1
to
ANNEX III of
PAAD AMENDMENT NO. 1
Project 515 - 0194

San José, 5 de octubre de 1984
Casa Presidencial-Santa Ana
2235/84

Señor
Curtin Winsor, Jr.
Embajador de los Estados Unidos
de América
SU DESPACHO

Estimado señor Embajador:

Tengo el agrado de dirigirme a usted en esta oportunidad para plantearle algunas opciones que podrían ser consideradas dentro del programa de asistencia económica del Gobierno Norteamericano y que es administrado por AID. Hay dos ejes centrales en este planteamiento que busca soluciones permanentes al problema económico del país. El primero es el mejoramiento de la eficiencia institucional, y el segundo la creación y el fortalecimiento de un instrumento que pueda garantizar el desarrollo de la vocación agrícola costarricense.

Tomando en consideración la urgencia y necesidad de resolver los problemas creados alrededor de las empresas de CODESA, tanto los originados por razones propias de la entidad, como los de orden financiero que afectan al Banco Central de Costa Rica por el endeudamiento de esta corporación y que tienen una repercusión directa en todo el proceso de reactivación económica nacional, considero oportuno proponer a usted lo siguiente:

1.- Destinar parte importante de los recursos de apoyo financiero para realizar una transacción que permita aplicarlos a la adquisición de las empresas de CODESA, a través de un mecanismo que permita cancelar la deuda que agobia al Banco Central de Costa Rica y transferir al sector privado las instalaciones de estas empresas, dentro de las regulaciones legales vigentes y aprovechando la disposición política actual.

35

2.- El Establecimiento de una Escuela Latinoamericana de Agricultura para el Trópico Húmedo, a nivel universitario, que permita consolidar procesos y tecnología de producción para las regiones de la Vertiente Atlántica costarricense, y que a su vez presenta condiciones similares a las zonas tropicales húmedas de la mayoría de los países de este continente.

Para garantizar el éxito de estos proyectos será de gran importancia canalizar hacia ellos los colones generados por el apoyo microeconómico de la AID. Me permito, señor Embajador, bosquejar a continuación algunos detalles sobre el impacto sobresaliente que ambos proyectos tendrían, subrayando así la importancia que le atribuyo a su ejecución inmediata.

1) <u>Empresas de CODESA</u>

Si logramos destinar toda la moneda nacional generada por las donaciones de la AID durante 1985 y 1986 para saldar la deuda de CODESA con el Banco Central, le ahorraríamos al Estado ₡1000 millones de intereses por año, reduciría la deuda pública hasta una tercera parte y apoyaría nuestra política monetaria, pues al no monetarizar una cantidad tan significativa de colones se contiene efectivamente el proceso inflacionario.

Para asegurar un efecto permanente de esta acción, CODESA no efectuará nuevas inversiones y se limitará su acceso a nuevos créditos con el Banco Central o con el Sistema Bancario Nacional. Al mismo tiempo estamos estudiando algunas soluciones económicas definitivas para las cuatro empresas restantes (CATSA, CEMPA, FERTICA Y ALUNASA).

Debemos basarnos, para el apoyo financiero a CODESA, en lo estipulado en la Ley de Equilibrio Financiero del Sector Público. De tal modo que, si ésta propuesta fuera aceptada, los

Luis Alberto Monge
Presidente de la República

primeros ₡500 millones de aporte se abonarían al Gobierno Central. Debe establecerse después, una reserva para liquidar el pasivo laboral de las empresas que pueden ser traspasados al sector privado, abonando entonces el saldo restante a la deuda de CODESA con el Banco Central.

Sería interesante estudiar la posibilidad de que la Corporación Privada de Inversiones, recientemente organizada y financiada por el AID y los bancos privados comerciales, recibiera las empresas de CODESA. La corporación podría contratar la valorización de las mismas a través de una firma internacionalmente reconocida que bajo criterios totalmente técnicos, defina su futuro, bajo el supuesto de que deben ser traspasadas al sector privado o disueltas como unidades productivas.

La corporación deberá crear un fideicomiso con el producto de la venta o liquidación de las empresas y destinar estos recursos exclusivamente para impulsar el desarrollo agropecuario del país, sin otro lucro que la comisión normal de fideicomiso. En todo momento se debe evitar cualquier crítica de manejo indebido o de enriquecimiento ilícito.

Si esta transacción se puede realizar antes del 1 de enero de 1985, se maximizaría la reducción en el servicio de la deuda pública para el próximo año, lo cual mejoraría notablemente las finanzas públicas.

2) <u>Escuela Latinoamericana de Agricultura para el Trópico Húmedo</u>.

Uno de los objetivos fundamentales de mi Gobierno y que ha sido planteado en muchas oportunidades es la democratización de la economía. Para poder pensar en el logro del mismo no sólo es necesario distribuir la tierra y la riqueza que ella genera, sino también maximizar su productividad.

37

Luis Alberto Monge
Presidente de la República

Es por lo anterior que este segundo proyecto se dirige al desarrollo de tecnología de producción para Costa Rica y otros países, que permitan desarrollar agricultura de pequeña y mediana escala con un alto grado de productividad.

Esto permitiría levantar el nivel de ingreso de los pequeños y medianos agricultores y sobre todo romper el marco tradicional de la agricultura de subsistencia en un extremo y la agricultura extensiva en el otro extremo.

La Escuela Latinoamericana de Agricultura para el Trópico Húmedo debe ser establecida para ofrecer anualmente a 400 jóvenes de diferentes países, la oportunidad de "aprender haciendo"; de alcanzar un título profesional orientado a crear actividades productivas y no meramente académicas, viviendo y estudiando cerca de la tierra en un centro de estudios superiores de alto nivel académico. Será necesario institucionalizar este esfuerzo a través de una fundación o asociación privada sin fines de lucro, que podrá recibir reconocimiento como Misión Internacional. La Junta Directiva y el personal docente podría ser de carácter multinacional al igual que sus estudiantes, asegurando, sin embargo, que Costa Rica obtenga una representación adecuada en el cuerpo docente y en el Directorio, asi como una cuota estudiantil que satisfaga las necesidades de nuestras regiones de Trópico Húmedo que tan importantes son para el desarrollo del país.

El financiamiento de este proyecto requerirá de aproximadamente $10 millones para la compra de terrenos y la construcción de las instalaciones necesarias y $50 millones para la constitución de un fondo patrimonial invertido a perpetuidad en bonos del Banco Central.

La suma total podría coincidir con la donación suplementaria de AID que tuve el gusto de firmar con usted el 30 de setiembre pasado.

Luis Alberto Monge
Presidente de la República

Sr. Curtin Winsor, Jr   5   5/10/84

Este arreglo permitiría no monetarizar la mayor parte de la donación, facilitando así mantenernos dentro de las políticas monetarias establecidas.

Espero su compresivo y positivo apoyo a estas iniciativas para que podamos emprender su ejecución al menor plazo posible.

Agradeciéndole a usted y a la AID la positiva colaboración que nos brindan, me despido de usted con muestras de consideración y estima.

Cordialmente,

LAM/viria

39

Muchas gracias por todo.
Armando

Armando Arauz Aguilar
SEGUNDO VICEPRESIDENTE
DE LA REPUBLICA

7-Feb. 85.

San José, 6 de febrero de 1985
Casa Presidencial - Santa Ana
2351/85

Señor
Curtin Winsor, Jr.
Embajador de los Estados Unidos de América
SU DESPACHO

Estimado señor Embajador:

Tengo el agrado de dirigirme nuevamente a usted en relación con el proyecto que le expuse en mi carta del 5 de octubre de 1984, para transferirle al sector privado las empresas de CODESA.

En cuanto a FERTICA y CEMPA, tropezamos con una limitación impuesta por la Asamblea Legislativa, que solamente autorizó a CODESA a vender el 40% de las acciones de esas empresas. Para atraer inversionistas o posibles compradores de ese porcentaje minoritario, nos parece que es necesario cederle al comprador, por un plazo razonable, la dirección y la administración de esas empresas, para ponerlas a funcionar bajo principios netamente empresariales que garanticen tanto un menor costo para el consumidor como el alto interés nacional que esas empresas estratégicas tienen para el desarrollo del país.

Con ese fin, mi Gobierno se compromete a ofrecer junto con las licitaciones correspondientes, un contrato autónomo de administración que le permita a los adjudicatarios del 40% de las acciones de FERTICA y CEMPA, dirigir y manejar esas empresas bajo una organización técnicamente eficiente y económicamente rentable. Quedarán a salvo, desde luego, los controles que el Estado deba reservarse para asegurar su buen funcionamiento y el estricto cumplimiento de las obligaciones de los contratistas.

../.

40

Luis Alberto Monge
Presidente de la República

Señor
Curtin Winsor, Jr.
Embajador de los Estados Unidos de América
SU DESPACHO

6/2/85

Aprovecho esta oportunidad para reiterarle la firme decisión de mi Gobierno de llevar a cabo este proyecto con la ayuda de su ilustrado Gobierno, en los términos convenidos.

Agradeciéndole a usted y a la A.I.D. la positiva colaboración que continúan brindándonos, me despido de usted con muestras de consideración y estima.

Cordialmente,

LAM/nav

Aprobado por el Consejo

to ANNEX III PARA AMENDMENT No. 1 to PROJECT 515-0194 ECR: III

SEGUNDO VICEPRESIDENTE DE LA REPUBLICA

COSTA RICA

CODESA

Proyecto de Resolución

CONSEJO DE GOBIERNO

CONSIDERANDO:

I. Que la ley de creación de CODESA, N°5122 de 16 de noviembre de 1972, establece en su Artículo 4 que la Corporación tendrá entre otros objetivos promover el desarrollo económico del país, mediante el fortalecimiento de las empresas privadas costarricenses dentro del régimen nacional de economía mixta.

II. Que CODESA ha promovido y financiado mayoritariamente la creación de varias empresas industriales y de servicios, haciendo uso de sus recursos propios y del crédito público y privado.

III. Que tanto CODESA como sus empresas experimentan una grave situación financiera resultado del endeudamiento en que ha incurrido la corporación para establecer y operar estas empresas, principalmente a partir de 1980.

IV. Que el objetivo de CODESA no puede lograrse en tanto sus recursos estén comprometidos en la operación de las empresas en condiciones deficitarias y en el servicio de su deuda acumulada; así como porque sus requerimientos crediticios reducen las disponibilidades para el sector privado productivo.

V. Que el Estado es el socio mayoritario de CODESA y por tanto de sus -

(Quinto borrador-Doc. 0130W)

empresas; que el Estado ha impulsado el desarrollo de CODESA con el propósito de fortalecer los proyectos de sus empresas y transferirlas a los sectores privados.

VI. Que conviene al interés público y al fortalecimiento de la empresa privada costarricense dentro del régimen de economía mixta, que CODESA venda las acciones de sus empresas y aplique el producto de la venta a la reducción de su deuda con el sector público (Banco Central de Costa Rica, principalmente).

VII. Que la Asamblea Legislativa depositó en el Consejo de Gobierno la responsabilidad de poner a la venta las acciones de las empresas de CODESA por Ley N°6955 de 24 de febrero de 1984, y autorizó a CODESA a realizar la venta con el concurso específico de la Contraloría General de la República.

POR TANTO,

El Consejo de Gobierno, de conformidad con el artículo 55 de la Ley para el Equilibrio Financiero del Sector Público N°6955 de 24 de febrero de 1984 y su Reglamento,

ACUERDA:

Artículo 1°- Establecer las siguientes políticas para la actividad ordinaria y futura de CODESA, como objetivos que CODESA y sus empresas deberán seguir y observar estrictamente a manera de directrices vinculantes, con el concurso de la Administración Pública en general y en especial de la Contraloría General de la República y el Banco Central de Costa Rica:

43

a) CODESA debe vender inmediatamente sus empresas, conforme a las regulaciones de la presente resolución.

b) CODESA no efectuará nuevas inversiones ni participará en la formación de nuevas empresas.

c) CODESA no contraerá obligaciones nuevas ni dará garantías para financiar inversiones, salvo los compromisos ya adquiridos y debidamente ratificados por el Consejo de Gobierno.

Artículo 2°- Fíjase el año 1985 para el cabal cumplimiento de dichos cometidos. Cumplida esta etapa, el Consejo de Gobierno se pronunciará acerca de las acciones futuras que se deben tomar con relación a la Corporación Costarricense de Desarrollo S.A.

Artículo 3°- Para vender las acciones de sus empresas CODESA deberá observar las limitaciones y el procedimiento establecidas por el artículo 55 de la Ley N°6955 de 24 de febrero de 1984, denominada "Ley para el Equilibrio Financiero del Sector Público", y su Reglamento.

Artículo 4°- Se ordena la venta de todas las acciones pertenecientes a CODESA, de empresas creadas por escritura pública, con las siguientes salvedades:

a) Las empresas que desarrollan funciones públicas propias del Estado --Ferrocarriles de Costa Rica, S.A. (FECOSA), Transportes Metropolitanos, S.A. (TRANSMESA), y la CORPORACION DE LA ZONA FRANCA DE EXPORTACION, S.A.-- no serán enajenadas ni vendidas a particulares. FECOSA y TRANSMESA trasladarán todas sus

44

operaciones al Ministerio de Obras Públicas y Transportes (MOPT), bajo el control y la dirección del MOPT, como actividades propias de su competencia. La CORPORACION DE LA ZONA FRANCA DE EXPORTACION, S.A. trasladará todas sus operaciones al Centro para la Promoción de las Exportaciones y de las Inversiones (CENPRO), bajo el control y la dirección del CENPRO, como actividades propias de su competencia. Cuando el MOPT y CENPRO asuman dichas operaciones, CODESA deberá disolver y liquidar las tres compañías a que se refiere este párrafo.

b) De las acciones de Fertilizantes de Centroamérica, S.A. (FERTICA) y Cementos del Pacífico, S.A. (CEMPA), CODESA licitará solamente la venta del 40%, de las acciones de esas empresas que le pertenecen, junto con un contrato de administración a largo plazo.

Artículo 5°- Si CODESA no consigue vender las acciones de sus empresas por el trámite de licitación pública, entonces CODESA disolverá y liquidará inmediatamente las empresas cuyas acciones no haya podido subastar, según lo dispuesto por los capítulos VIII y IX, Titulo I del Libro Primero del Código de Comercio. En los casos de CEMPA y FERTICA el Consejo de Gobierno decidirá en cada caso lo que corresponda.

Artículo 6°- CODESA le dará al producto de la venta de las acciones o de los activos de sus empresas, el destino señalado en el artículo 55 de la Ley 6955 y su Reglamento.

45

Artículo 7°- Nómbrase una Comisión integrada por las siguientes personas:

a) El señor Claudio Volio Guardia, quien actuará como presidente de la Comisión.

b) El señor Ing. Ricardo Echandi Zurcher

c) El señor Lic. German Serrano Pinto.

Los tres miembros acordarán las normas relativas a su funcionamiento.

Las instituciones del Estado brindarán a la Comisión todas las facilidades necesarias para su cometido.

Los fines de esa Comisión serán los siguientes:

a) Encargarse a nombre de CODESA y por delegación suya, de la venta o la disolución y liquidación de las empresas de CODESA, con los poderes necesarios y conforme a las disposiciones legales y reglamentarias aplicables.

b) Demandar y vigilar el estricto y puntual cumplimiento de la política contenida en esta resolución y cualquier disposición aplicable e informar al Consejo de Gobierno para que éste resuelva lo que ha lugar.

c) Facilitar la intervención de la Contraloría General de la República según lo dispuesto en el artículo 55 de la Ley N°6955 y su Reglamento.

Artículo 8°- Comuníquese este acuerdo al Consejo de Administración de CODESA para que lo someta a la aprobación de la Asamblea general de accionistas de CODESA y vele por su ejecución y estricto cumplimiento.

ACUERDO FIRME.

47

Alcance Nº 4 a La Gaceta Nº 24

DIARIO OFICIAL

AÑO CVII | La Uruca, San José, Costa Rica, lunes 4 de febrero de 1985 | 8 Páginas

PODER EJECUTIVO

DECRETOS

Nº 16007-P-MEC

EL PRESIDENTE DE LA REPUBLICA
Y LOS MINISTROS DE LA PRESIDENCIA Y DE ECONOMIA Y COMERCIO,

Considerando:

1º—Que mediante ley Nº 6811 de 10 de setiembre de 1982 se materializó la preocupación del Gobierno en la búsqueda de una solución a la difícil situación que genera el problema fiscal que afronta desde esas épocas el país, para lo cual y para honrar los compromisos internacionales contraídos y con el propósito adicional de evitar que aumente el déficit del Gobierno, la Asamblea Legislativa autorizó la venta de las acciones de las empresas de CODESA, con miras a resolver esa situación.

2º—Que pese a que tal disposición se plasmó en normativa, las limitaciones impuestas por esa ley al Ejecutivo no permitieron una solución práctica al problema.

3º—Que por el contrario, conforme continúa la misma situación, el déficit del Gobierno Central persiste y se agrava entre otras en razón del alto costo del servicio de la deuda acumulada por CODESA y sus empresas.

4º—Que la ley Nº 6955 de 24 de febrero de 1984, denominada "Ley para el Equilibrio Financiero del Sector Público", abundando en la búsqueda de una solución viable al problema antes señalado, volvió a autorizar a CODESA a vender las acciones de sus empresas, estableciendo esta vez un procedimiento para ello, dentro de la misma filosofía primeramente citada.

5º—Que resulta de interés público reglamentar el artículo 55 de la ley supracitada, sea la Nº 6955 de 24 de febrero de 1984, a fin de facilitar el pronto cumplimiento de su objetivo, que en última instancia es acabar definitivamente con el endeudamiento de CODESA y sus empresas con el Banco Central de Costa Rica.

Por tanto,

Con base en las facultades que les confiere el artículo 140, inciso 3) de la Constitución Política y la misma ley Nº 6955 de 24 de febrero de 1984,

DECRETAN:

Artículo 1º—Se declara de interés público la venta de acciones o en su caso la disolución y liquidación de empresas pertenecientes a la Corporación Costarricense de Desarrollo, S. A. (CODESA).

Artículo 2º—Cuando el Consejo de Gobierno tome el acuerdo de vender las acciones de las empresas de CODESA, esta deberá, dentro de los treinta días siguientes, solicitarle a la Contraloría General de la República, conforme lo ordena el artículo 55 de la ley Nº 6955 de 24 de febrero de 1984, un avalúo de las acciones que se ofrecerán en venta. A la solicitud acompañará completa toda la información que tenga al respecto, así como los libros y registros donde conste íntegramente la situación contable y financiera de cada empresa, con el fin de facilitar la pronta valoración de las acciones. Asimismo, CODESA le dará inmediatamente a la Contraloría General de la República toda la información adicional que la Contraloría le solicite.

Artículo 3º—Requerida la valoración de las acciones, CODESA contará con un plazo que no excederá al que la ley Nº 6955 de 24 de febrero de 1984 señala para que la Contraloría se pronuncie, para preparar el o los carteles de licitación pública, los cuales deberá someter inmediatamente al visado de la Contraloría General de la República en acatamiento a lo que prevé el inciso c) del supracitado artículo 55. Los carteles se publicarán una vez en "La Gaceta" y durante dos días consecutivos en la prensa nacional, por lo menos en dos de los diarios de mayor circulación. Entre la fecha de la publicación en "La Gaceta" y el día de apertura de las ofertas deberá mediar un plazo no mayor de 30 días hábiles ni menor de 20 días hábiles.

Artículo 4º—Cada cartel deberá contener cuando menos la siguiente información:

a) Descripción de las acciones ofrecidas en venta, del porcentaje de capital que representan, y la circunstancia de estar libres de todo gravamen. Adicionalmente CODESA deberá entregar a los compradores interesados estados financieros de cada empresa que reflejen adecuadamente todos los activos y pasivos, aun los contingentes, y las operaciones de cada una.

b) El precio base en colones sobre el que CODESA considerará ofertas, no será inferior al avalúo de la Contraloría.

c) La hora y fecha de presentación de las plicas así como del acto de su apertura, al que podrán concurrir los interesados, de conformidad con el artículo 109 y siguientes del Reglamento de la Contratación Administrativa.

d) El lugar donde se deben depositar o entregar las propuestas, en sobre cerrado y rotulado.

e) Requisitos que deben cumplir los oferentes, los cuales deben ser expresos y específicos. No se aceptarán ofertas parciales por acciones de una misma empresa.

f) La obligación de ceñirse a los términos y condiciones del cartel, so pena de una eventual descalificación en razón del interés público.

g) El plazo de vigencia que deberán tener las ofertas y garantías, acorde con los artículos 45, 62 y 280 del Reglamento de la Contratación Administrativa.

h) Indicación expresa de quienes están inhibidos para participar en la licitación.

i) Garantía: los oferentes deberán depositar en el Banco Central de Costa Rica, con cada propuesta, una garantía de participación del 5% del valor de la oferta, en dinero efectivo o en cualquier otro valor de los permitidos por el artículo 61 del Reglamento de la Contratación Administrativa. Para garantizar la formalización del contrato privado de cesión de las acciones, el adjudicatario deberá rendir una garantía de cumplimiento del 5% del monto de la adjudicación. La garantía de cumplimiento podrá sustituirse por la garantía de participación. Si el adjudicatario no deposita oportunamente en el Banco Central de Costa Rica el precio ofrecido, completo, perderá la garantía de cumplimiento a favor de CODESA.

j) La forma de pago del precio, que deberá ser mediante cheque certificado a la orden del Banco Central de Costa Rica y que el adjudicatario deberá depositar en el Banco Central de Costa Rica antes del vencimiento del plazo para la firma del contrato privado de cesión de las acciones.

k) Plazo para adjudicar, que no deberá exceder de treinta días hábiles.

l) Plazo para la formalización del contrato privado de cesión de las acciones, no mayor a treinta días hábiles. El comprador será responsable del pago de todos los gastos que ocasione el traspaso de las acciones.

m) Advertencia de que la licitación solamente podrá ser declarada desierta por resolución motivada y razonada de CODESA.

Artículo 5º—Durante el trámite de las licitaciones CODESA será responsable de mantener en buen estado todos los bienes y activos de las empresas cuyas acciones haya ofrecido en venta y garantizará que las empresas no serán explotadas abusivamente y que no se dispondrá de bienes o productos que no sean parte del giro corriente y usual de las empresas.

Para el traspaso de las acciones CODESA deberá entregar al comprador todos los libros legalizados, al día, y un balance de situación de la empresa aceptable al comprador, debidamente certificado el balance por contadores públicos de ambas partes, que refleje adecuadamente todos los activos y pasivos, aun los contingentes. Si surgieran discrepancias irreconciliables, el comprador podrá rehusar la firma del contrato y exigir la devolución de la garantía por falta de cumplimiento de CODESA, con daños y perjuicios.

Artículo 6º—En el concurso a que se ha hecho referencia tendrán prioridad, en igualdad de circunstancias, las organizaciones sociales de trabajadores jurídicamente constituidas y que hayan participado y cumplido con el cartel respectivo.

Artículo 7º—Cuando el Consejo de Gobierno acuerde poner a la venta las acciones de las empresas de CODESA, los bancos del Sistema Bancario Nacional deberán crear conforme lo dispone la ley, líneas preferenciales de crédito que conduzcan a posibilitar la participación de las organizaciones sociales, las que deberán ser hechas del conocimiento público dentro de la primera mitad del plazo para la recepción de las ofertas.

Artículo 8º—Caso de que la venta por licitación llegare a resultar infructuosa, en virtud del interés público de cumplir los objetivos supracitados y los compromisos antes indicados, CODESA procederá de conformidad con lo que el Consejo de Gobierno acuerde.

Artículo 9º—El producto que CODESA obtenga de la venta de acciones o activos de sus empresas, a partir del 1º de enero de 1985, lo destinará única y exclusivamente al pago de sus obligaciones con el Banco Central de Costa Rica. El Banco Central de Costa Rica cobrará y le acreditará a CODESA el valor de los cheques depositados en el Banco Central de Costa Rica por cada comprador adjudicatario de acciones, cuando el Banco reciba aviso por escrito de CODESA de haber sido firmado por ambas partes el correspondiente contrato.

Artículo 10.—Las acciones de las empresas que desarrollan funciones públicas propias del Estado, Ferrocarriles de Costa Rica, S. A. (FECOSA), Transportes Metropolitanos, S. A. (TRANSMESA), y las de la Corporación de la Zona Franca de Exportación, S. A., no serán enajenadas ni vendidas a particulares. FECOSA y TRANSMESA trasladarán todas sus operaciones al Ministerio de Obras Públicas y Transportes (MOPT), bajo el control y la dirección del MOPT, como actividades propias de su competencia. La Corporación de la Zona Franca de Exportación, S. A., trasladará todas sus operaciones al Centro para la Promoción de las Exportaciones y de las Inversiones (CENPRO), bajo el control y la dirección del CENPRO como actividades propias de su competencia. Cuando el MOPT y CENPRO asuman dichas operaciones, CODESA gestionará la disolución y liquidación de las compañías a que se refiere este artículo.

Artículo 11.—Las disposiciones de este Reglamento son de interés público, y los acuerdos que para ejecutarlo tome el Consejo de Gobierno, constituirán directrices vinculantes para sus ejecutores, en conformidad con las potestades que otorga al Poder Ejecutivo el Título Cuarto, Capítulo Primero de la Ley General de la Administración Pública.

Artículo 12.—Rige a partir de su publicación.

Dado en la Presidencia de la República.—San José, al primer día del mes de febrero de mil novecientos ochenta y cinco.

LUIS ALBERTO MONGE

El Ministro de la Presidencia,
DANILO JIMENEZ VEIGA.

El Ministro de Economía y Comercio,
ODALIER VILLALOBOS GONZALEZ.

5C(1) - COUNTRY CHECKLIST

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

A. GENERAL CRITERIA FOR COUNTRY ELIGIBILITY

1. FAA Sec. 481; FY 1984 Continuing Resolution. Has it been determined or certified to the Congress by the President that the government of the recipient country has failed to take adequate measures or steps to prevent narcotic and psychotropic drugs or other controlled substances (as listed in the schedules in section 202 of the Comprehensive Drug Abuse and Prevention control Act of 1971) which are cultivated, produced or processed illicitly, in whole or in part, in such country or transported through such country, from being sold illegally within the jurisdiction of such country to United States government personnel or their dependents or from entering the United States unlawfully? — No

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

49

3. 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

4. FAA Sec. 532(c), 620(a), 620(f), 620D; FY 1982 Appropriation Act Secs. 512 and 513. Is recipient country a Communist country? Will assistance be provided to Angola, Cambodia, Cuba, Laos, Vietnam, Syria, Libya, Iraq, or South Yemen? Will assistance be provided to Afghanistan or Mozambique without a waiver?

No

5. ISDCA of 1981 Secs. 724, 727 and 730. For specific restrictions on assistance to Nicaragua, see Sec. 724 of the ISDCA of 1981. For specific restrictions on assistance to El Salvador, see Secs. 727 and 730 of the ISDCA of 1981.

N/A

6. 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

7. FAA Sec. 620(l). Has the country failed to enter into an agreement with OPIC?

No

8. FAA Sec. 620(o); Fishermen's Protective Act of 1967, as amended, Sec. 5. (a) Has the country seized, or imposed any penalty or sanction against, any U.S. fishing activities in international waters?

Yes. However, exact location of fishing vessel is in dispute.

(b) If so, has any deduction required by the Fishermen's Protective Act been made?

No

9. FAA Sec. 620(q); FY 1982 Appropriation Act Sec. 517. (a) Has the government of the recipient country been in default for more ~~than~~ six months on interest or principal of any AID loan to the country? (b) Has the country been in default for more than one year on interest or principal on any U.S. loan under a program for which the appropriation bill appropriates funds?

No

10. FAA Sec. 620(s). If contemplated assistance is development loan or from Economic Support Fund, has the Administrator taken into account the amount of foreign exchange or other resources which the country has spent on military equipment? (Reference may be made to the annual "Taking into

Yes

Consideration" memo: "Yes, taken into account by the Administrator at time of approval of Agency OYB." This approval by the Administrator of the Operational Year Budget can be the basis for an affirmative answer during the fiscal year unless significant changes in circumstances occur.)

11. 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?

No

12. 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? (Reference may be made to the Taking into Consideration memo.)

No

13. FAA Sec. 620A; FY 1982 Appropriation Act Sec. 520. 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

No

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

14. FAA Sec. 666. Does the country object, on the 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

15. 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 transferred a nuclear explosive device to a non-nuclear weapon state, or if such a state, either received or detonated a nuclear explosive device, after August 3, 1977? (FAA Sec. 620E permits a special waiver of Sec. 669 for Pakistan.) — No

16. ISDCA of 1981 Sec. 720. Was the country represented at the Meeting of Ministers of Foreign Affairs and Heads of Delegations of the Non-Aligned Countries to the 36th General Session of the General Assembly of the U.N. of Sept. 25 and 28, 1981, and failed — No

to disassociate itself from the communique issued? If so, has the President taken it into account? (Reference may be made to the Taking into Consideration memo.)

17. ISDCA of 1981 Sec. 721. See special requirements for assistance to Haiti. — N/A

18. FY 1984 Continuing Resolution. Has the recipient country been determined by the President to have engaged in a consistent pattern of opposition to the foreign policy of the United States? — No

B. FUNDING SOURCE CRITERIA FOR COUNTRY ELIGIBILITY

1. Development Assistance Country Criteria — N/A

a. 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?

2. Economic Support Fund Country Criteria

a. FAA Sec. 502B. Has it been determined that the country has engaged in a consistent pattern of gross violations of internationally recognized human rights? If so, has the country made such significant improvements in its human rights record that furnishing such assistance is in the national interest? — No

b. <u>ISDCA of 1981, Sec. 725(b)</u>. If ESF is to be furnished to Argentina, has the President certified that (1) the Govt. of Argentina has made significant progress in human rights; and (2) that the provision of such assistance is in the national interests of the U.S.?

N/A

c. <u>ISDCA of 1981, Sec. 726(b)</u>. If ESF assistance is to be furnished to Chile, has the President certified that (1) the Govt. of Chile has made significant progress in human rights; (2) it is in the national interest of the U.S.; and (3) the Govt. of Chile is <u>not</u> aiding international terrorism and has taken steps to bring to justice those indicted in connection with the murder of Orlando Letelier?

N/A

53

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 is 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.

Standard Item Checklist has 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 nonproject assistance;

   Congress has been notified through AID FY 1985 Congressional Presentati A Congressional Notification will al be utilized for Congressional reviev

   (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 action is 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 further preconditions for obligat are necessary prior Costa Rica compliance is satisfactory.

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 practices; (e) improve technical efficiency of industry, agriculture, and commerce; and (f) strengthen free labor unions.

   Assistance will increase internatio trade, foster private initiative an competition, and improve technical efficiency if industry, agricultur and commerce.

A.

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. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).

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

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.

Agreements with GOCR encourage use of local currencies for local needs.

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

No

B. FUNDING CRITERIA FOR NONPROJECT ASSISTANCE

1. Nonproject Criteria for Security Supporting Assistance

a. FAA Sec. 531. How will this assistance support promote economic or political stability? Is the country among the 12 countries in which Supporting Assistance may be provided in this fiscal year?

The Assistance will support efforts of the GOCR to cope with critical immediate balance of payments problems, provide foreign exchange to the productive private sector and support efforts to achieve economic structural reforms.

2. Nonproject Criteria for Development Assistance N/A

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

B2b

(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; [103A] 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, integrated delivery systems to provide health and family planning services, especially to rural areas and poor; extent to which assistance gives attention to interrelationship between (A) population growth and (B) development and overall improvement in living standards 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? — N/A

(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

B2

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 productive 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 long-range objectives? — N/A

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.

B3

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.

N/A

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 an 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?

60

ANNEX II

ECONOMIC TRENDS AND PROBLEMS: JANUARY 1985

1. Economic Trends and Events 1980-1983

Economic growth amounted to only 0.8% in 1980 and subsequently Gross Domestic Product (GDP) declined by 2.3% in 1981 and 7.3% in 1982. The 1983 stabilization program brought GDP growth in that year to 2.3 % and we expect that 1984 GDP growth will turn out on the order of 4-5%. (The most recent publicly available estimate of the Central Bank, which dates from October, is 3.4 percent; see Table I.) When set beside a population growth rate of 2.5% per annum, GDP performance of 1983 and 1984 represents stagnation. Moreover, real incomes and consumption are below recent historic norms. Based upon national accounting estimates for 1983, on a per capita basis, 1983 GDP was 89% of the 1977 level, and consumption was 81% and investment 35% of their 1977 levels. Private consumption per capita in 1983 was 79% of the 1977 level. Real wages declined strongly in 1981 and 1982 and, even after some recovery in 1983 were at only 74% of the 1979 level.

Inflation reached high rates in 1981 and 1982; for example, on an average annual basis the wholesale price index registered a 65 percent increase in 1981 and a 108 percent increase in 1982. High inflation in those years is explained by strong exchange rate devaluation (319% in the 18-month period ending with December 1981) and by accelerating expansion of domestic credit, which registered nominal rates of growth increasing from 35 percent in 1978 to 105 percent in 1982. Lower rates of inflation before 1981, i.e. less than 25 percent per annum, are explained by orthodox economic theory, which suggests that excessive growth of domestic credit will enlarge imports and the balance of payments deficit until foreign exchange reserves and external creditworthiness are exhausted and then spill over into inflation. The point of external bankruptcy was reached in Costa Rica with the accumulation of external debt payment arrears at year-end 1982 amounting to $ 1.1 billion. The dampening of the inflationary process in 1983, with a reduction in the average annual rate to 24% and a year-end inflation rate of 11% (as measured by the consumer price index) resulted principally from substantial balance of payments support inflows (approximately $270 million in 1983) as well as a significant return flow of private capital related to restoration of exchange rate stability.

Costa Rica's weakened balance of payments has been a fundamental constraint on economic growth in recent years. Current account deficits amounting to $ 1.6 billion in 1979-1981 were financed by foreign commercial bank loans, but with the sharp rise in debt service payments, particularly after 1980, a net inflow of external credit could not be maintained. In 1981 the GOCR suspended external debt service, essentially to maintain a reasonable level of imports. The balance of payments/debt service crisis of 1981 was caused by the rapid increase in external debt, a sharp increase in interest payments on that debt, declining export (mainly coffee) prices, loss of Central American export markets, and (up to 1982) by imports increased by domestically-generated demand pressures. However, by the end of 1983, after commercial bank and Paris Club rescheduling agreements, Costa Rica was again current on contractual external payments.

Apart from IMF and ESF resources and external debt reschedulings (which closed the B/P gap in 1983), Costa Rica's balance of payments improvement rested upon decreased imports which resulted from the reduction of real incomes and aggregate demand. Costa Rica's trade deficit declined from $527 million in 1980 to $28 million in 1982 and $121 million in 1983. Specifically, in nominal dollar values imports (CIF) decreased from $1,528 million in 1980 to $991 million in 1983 and exports (FOB) declined from $1,001 million in 1980 to $870 million in 1983. Related to reduction of the trade deficit, import volume (referring to imports of goods and non-factor services per national accounts) declined by about 50 percent from 1980 to 1983. In contrast, the volume of 1983 exports of commodities and non-factor services (from national accounts) was nearly the same as in 1980. Thus, the economy achieved a very substantial compression in imports as related to exports. Reduction of domestic demand through monetary restraint and reduction of the fiscal deficit underlie this achievement. However, the reduction in real imports is also related to very low levels of domestic investment. For example, in 1982-83 investment was only 43 percent of the level of 1979-80, and, if continued for long, this would impair achievement of structural adjustment and future economic growth.

In July 1982, shortly after coming to office, the Monge administration also resumed partial payments on external debt service arrears, and such payments amounted to over $40 million in 1982. A one-year IMF Standby was approved on December 20, 1982 (and amended on April 26, 1983) which provided approximately $100 million (SDR 92.5 million). The stabilization program supported by this Standby was designed to reduce inflationary pressures, to promote orderly exchange markets, and to facilitate resumption of public sector external debt service. Furthermore, the agreement was a necessary element in the GOCR-commercial bank debt rescheduling and a pre-condition to the Paris Club bilateral debt rescheduling. On January 10, 1983 the GOCR signed a debt rescheduling agreement under the aegis of the Paris Club with ten creditor countries which rescheduled principal and interest in arrears and falling due between July 1, 1982 and December 31, 1983 to a seven-year period beginning December 1985. On April 22, 1983, the GOCR signed a memorandum of understanding with foreign commercial banks, covering all principal in arrears and falling due in 1984. These payments were rescheduled to a period beginning in 1987 and ending in 1991. In addition, the agreement provided a revolving credit fund in favor of Costa Rica, but of self-liquidating and diminishing character, composed of fifty percent of interest payable and due in 1983.

62

The Government of Costa Rica complied with the 1983 IMF Standby. The quantitative tests in this agreement included no net decline in official international reserves (adjusted for certain arrearage liquidations), limits on Central Bank expansion of credit to the economy and on banking system credit to the non-financial public sector, and limits on the contracting of public sector external debt. Substantial IMF and U.S. ESF assistance provided essential support to the 1983 balance of payments and was crucial to GOCR efforts to bring about exchange rate stability and to reduce the rate of inflation. By the end of 1983 the consumer and wholesale price indices were increasing at annual rates of only 10.7 and 5.9 percent, respectively. In addition, the five colon spread that had existed between the inter-bank and "free" market exchange rates was eliminated during the course of 1983. The major Costa Rican contribution to the stabilization program was the reduction of the public sector deficit. This deficit, which had increased from 6.7% of GDP in 1977 to a high of 14.3% in 1981 was reduced to 9.0% in 1982, 3.4% in 1983, and an estimated 2.5 % in 1984 (see Table II). The reduction of the deficit can be attributed in part to expenditure cuts that began in 1982 but also in large measure to increases in the charges of the state-owned petroleum refinery, public utilities, social security contributions, and taxes in general. Private domestic purchases of government securities were a major source of financing of the public sector deficit in 1983.

Some aspects of Costa Rica's 1983 economic performance turned out better than expected and lulled policymakers into a premature reactivation of the economy. In particular, the larger-than-anticipated reduction in inflation of 1983 impacted on the economy via the relationship between increased real credit and real demand. For example, in real terms credit to the private sector increased by about 40 percent in 1983 (see Table III). Despite this high rate of expansion, private sector holdings of money and quasi-money grew by about 20 percent in real terms, and this growth related strongly to a return flow to Costa Rica of financial assets previously held abroad by Costa Rican residents. At least $ 100 million of the $ 140 million net inflow on private capital and errors and omissions now registered in Costa Rica's balance of payments for 1983 is simply return flight of liquid financial capital (see Table IV). This return flight of capital is attributable to a rise in real interest rates in Costa Rica, which shifted from a negative 60% per annum in December 1982 to a positive 11% per annum by December 1983 as well as to the appreciation of the then legal free bank market exchange rate from 1.84 cents per Colon in September 1982 to 2.29 cents in December 1983.

Costa Rican policymakers judged that a substantial net inflow of private capital as well as official project disbursements would continue in 1984, thereby covering some expansion of imports, and they allowed banking system credit to expand rapidly (an over 30% annual rate) through the first half of the year. However, the foreign exchange position of the Central Bank deteriorated and by the second quarter of 1984 arrearages on external payments began to accumulate anew. Moreover,

67

even though the GOCR had negotiated a Standby with the IMF in March 1984, it was unable to comply promptly with the "prior conditions" attached to that arrangement. Most observers here judge that delays in securing Legislative Assembly approval to Executive Branch economic proposals was caused by the lack of leadership in economic affairs that followed the departure of the President of the Central Bank, and _de facto_ leader of the Government's economic team, in March.

By mid-1984, imports were running about 20% higher than one year earlier, and this signalled the need for corrective measures to dampen aggregate demand and imports. In June, the Monge administration tightened credit conditions and also approved several tax and fiscal measures to reduce the fiscal deficit, and in August, President Monge restructured the economic team, thus providing a basis for renewed negotiations with the IMF and a re-drafting the Letter of Intent. In August, also, the Government obtained Legislative Assembly approval for the Ley de Moneda (Currency Law) as was required for 1984 ESF assistance, and in early September the Government obtained Legislative Assembly approval for a fiscal package required by the IMF to reopen Standby negotiations. In October, negotations with the IMF produced a new draft Letter of Intent and also the need for confirmation of commitments of an $ 80 million World Bank Structural Adjustment Loan (SAL) and a $ 75 million credit from foreign commercial banks. These commitments were not secured until the middle of January along with a final modifications of the Letter of Intent and of quantitative performance targets of the IMF program. The IMF also required confirmation of important B/P assistance items in order to assure, at least on an _a priori_ basis, elimination of an unfinanced B/P gap in 1985.

2. Economic Performance in 1984 and Outlook for 1985

Despite some deviations from macroeconomic performance as set out in the non-formalized March 1984 IMF program, notably a larger-than-projected deterioration in external accounts, the fact that the GOCR undertook corrective monetary and fiscal measures beginning in June 1984, has served to maintain continuity in the stabilization effort. Even if the GOCR had promptly effected the nine "prior actions" required by the IMF (prior to submission of the March Standby to the Executive Board), a dampening of monetary expansion, i.e. tighter credit, would have been necessary. Present preliminary data on 1984 balance of payment aggregates (see Table IV) indicate that imports increased by 12% as compared with the March IMF program projected increase of 2.4% ($ 1,015 million CIF). Even though commodity export earnings were also higher than projected (by $ 45 million), external payment arrearages amounted to $ 167 million at year-end 1984. These arrearages, which are _ex post_ evidence of an unfinanced B/P gap, can be attributed to an unplanned growth of imports, delay in receipt of the commercial bank credit, and also certain other external credit shortfalls.

The major GOCR policy commitments included in the January 1985 Letter of Intent are as follows: (1) a limit on the over-all deficit of

64

the nonfinancial public sector of 1.5 % in 1985, (2) no recourse by the nonfinancial public sector to net financing by the domestic banking system or to a net increase in bond placements outside the banking system, with the over-all fiscal deficit financed mainly by the use of foreign long-term borrowing on concessional terms, (3) a $ 25 million limit on new public sector external borrowing of up to 5-year term and a $ 50 million limit on such borrowings of up to 12-year term (except for the $ 75 million commercial bank loan which is treated as a compensatory inflow), (4) maintenance of positive real rates of interest in the domestic system of financial intermediation, (5) a flexible exchange rate policy which adjusts the exchange rate to reflect changes in the balance of payments and domestic and trading partner prices, (6) the elimination of foreign exchange payment arrears, other than those related to rescheduling agreements under negotiation, during the course of 1985 and under specific quarterly ceilings, (6) a pledge not to introduce or intensify restrictions on current (non-capital) international transactions, (7) a pledge to limit price controls and subsidies to a limited number of basic consumer products ,mainly benefitting low imcome groups, (8) a pledge to a wage policy geared to reducing inflationary pressures while minimizing the effects of price increases on low-income groups with private sector minimum wages and public sector wages adjusted in absolute amounts in accordance with the increased cost of the "canasta basica." Specific quantitative ceilings are attached quarterly to cumulative central government expenditures, domestic banking system net credit to the nonfinancial public sector, net domestic assets (credit) of the Central Bank, the stock of external payment arrears, and a quantitative floor is attached to the Central Bank's net international reserve position. The main objectives of this program are to continue low inflation, to reduce the balance of payments current account deficit, with a specific goal of $ 300 million for 1985, and to replenish foreign exchange reserves of the Central Bank, with a specific goal of $ 60 million for 1985. Apart from political will on the part of the GOCR to carry out the program, the Standby is a key prior condition for the rescheduling of debt with external creditors.

The goodness of any economic program resides in the consistency of its program elements with each other and in the degree of realism of the assumptions underlying each element. The 1984 status and projections for 1985 of public finances, money and credit, the balance of payments, and economic output, prices, and employment are set out in the following paragraphs.

Production, Employment, Real Income. Latest available data on inflation (December) indicate a 12-month basis increase in the consumer price index of 17.3% and in the wholesale price index of 12.2%. Official projections on aggregate output, which date from October 1984, indicate an over-all growth rate for GDP at 3.4% in 1984 and 1.7% in 1985 (see Table I). However, we expect that 1984 GDP has grown at a higher rate, possibly at a rate close to 5%. Open unemployment is estimated at 7.8% for 1984; the employed labor force

/
67

grew by 4% during the year; and the latest data on real wages (March 1984) registers a March-to-March increase of 6.8%. More broadly, per capita GDP for 1984 is about 89% of the 1977 level.

Public Sector Finances. As is shown in Table II, the (nonfinancial) public sector has moved toward financial equilibrium in recent years with the over-all deficit declining from 9.0% of GDP in 1982 to 3.4% in 1983, 2.5% of GDP in 1984, and a projected increase for 1985 is 1.5%. As a result of tax measures introduced throughout the period, central administration revenues increased from 13.5% of GDP in 1982 to 19.2% of GDP in 1984 and a further increase to 20.5% is expected for 1985, thereby bringing the total increase to 7 percentage points of GDP for the period 1982 to 1985. Public sector finances have also been strengthened through reduction of the deficits of public enterprises from 6.0% of GDP in 1982 to 0.4% of GDP as projected for 1985, and this is explained by changing their current (operating) result from a deficit of ¢ 3.0 billion in 1982 to a surplus of ¢ 4.4 billion in 1985 mainly as a result of periodic increases in the tariffs of public utilities. Table II also shows substantial expansion of public sector expenditures in real terms as indicated by growth in percentage terms which outstripped inflation as well as in the ratio to GDP. However, the 1985 program promises significant moderation of this growth, which insofar as the central government is concerned is limited under the Standby through cumulative quarterly ceilings.

The Monetary Program. As indicated by Table III (which does not employ a uniform exchange rate for conversion FX denominated assets and liabilities), global banking system net domestic credit (assets) expanded by 12.4% in 1984 and a 17.3% increase is programmed for 1985. Credit to the private sector increased by 18.5% in 1984 and 14.0% is programmed for 1985. Private sector holdings of money and quasimoney (banking system liabilities) increased by 11.2% in 1984 and the projected increase for 1985 is 15.9%. It should be noted that the annual data on net credit to the public sector, particularly for 1983 and 1984, are distorted by the Central Bank assumption of public sector debt service in December 1983 (because this is accounted as a large expansion of public sector debt to the banking system even though public sector entities did not receive a local currency cash inflow from this transaction). The bulk of the net credit to the public sector in 1984 and 1985 corresponds principally to losses of the National Production Council (CNP) on commercialization of grain and to accrued interest on its outstanding credits to CODESA. As is discussed further in this annex, Central Bank has large losses, which are registered in the "other" account in Table III. These losses arise principally from Central Bank payment of interest on its own external debt and have the impact of increasing the domestic currency issue of the Central Bank (and the the stock of domestic money in Costa Rica). Central Bank losses for 1985 are estimated at ¢ 9.3 billion, i.e. the equivalent of 5.6% of GDP and $ 186 million, and this exceeds the 1985 programmed amount of credit expansion to the public and private sectors taken together.

Balance of Payments. After an over-all surplus of $ 74 million in 1983, Costa Rica's balance of payments has registered a $ 64 million deficit in 1984. The 1984 performance is substantially worse than the $ 22 million surplus anticipated in the March IMF program. At present we lack firm evidence in the form of detailed official preliminary estimates of 1984 balance of payments items. The very preliminary estimates for 1984, presented in Table IV, are the best present estimates of Central Bank staff. The deficit on current account is $ 70 million higher than anticipated (in the March 1984 IMF Program) and results mainly from higher imports (which were $ 95 million higher). In addition, the net inflow on capital account is moderately ($ 16 million) lower. It should be noted that further refinements in estimates should reduce the very large residual which is accounted as a net inflow on private capital and errors and omissions and amounts to $ 144 million. This inflow largely offsets a decline in official capital project disbursements, which at $ 171 million is $ 64 million lower than the March 1984 projection and $ 13 million below that of 1983. Turning to 1985, the economic program aims at generating a $60 million over-all surplus. Attainment of this goal depends on no import growth, which, in turn, depends critically on holding to a tight credit program. Financing the $ 300 million current account deficit depends, inter alia, on ESF disbursements of at least $ 160 million, $ 168 million of relief on commercial bank debt amortization, $ 83 million of Paris Club (bilateral) debt relief, disbursement of an $ 80 million World Bank SAL, and a new credit of $ 75 million from commercial banks, which is accounted as a compensatory flow and will reduce external payment arrears.

Debt Service and Relief. Table V is a projection of service of Costa Rica's public sector external debt based repayment schedules as of 1984. Without rescheduling or other relief, the projected debt service ratios for the five-year period 1985-1989 exceeds 50% of earnings from exports of goods and non-factor services. Rescheduling relief per IMF assumptions lowers the average debt service ratio to 36.6% for this period. In point of fact, in 1984 Costa Rica's cash foreign exchange payments to service public sector debt were equivalent to 27.8% of exports of goods and services. Based upon existing evidence one could postulate that the plausible and politically feasible limit for Costa Rican public sector debt service ratio is about 35%. This limit implies that Costa Rica would need $ 270 million of debt service relief in each of the years 1985-1988. In this regard, any increments to debt service, even in the form of long term loans, would contribute to near-future debt rescheduling.

61

TABLE 1

COSTA RICA: SELECTED ECONOMIC INDICATORS, 1981-1985

	1981	1982	1983	Estimate 1984	Projection 1985
GDP in Current Prices (M/C/)A/	57,103	98,457	125,069	146,049	165,473
GDP in Current Prices (M.$)B/	2709	2551	3025	3246	3309
GDP in Costant Prices (1977=100)	110	102	104	108	110
GDP Per Capita in Constant Prices (1977=100)	99	89	89	89	89
Growth of GDP (Percent Change)					
Gross Domestic Product	-2.3	-7.3	2.3	3.4	1.7
Basic Productive Sectors	-1.2	-10.8	2.5	4.8	1.8
(Agriculture)	(5.1)	(-4.7)	(3.9)	(2.1)	(1.9)
(Manufacturing)	(-0.5)	(-11.4)	(1.2)	(4.5)	(2.1)
(Construction)	(-21.7)	(31.9)	(2.7)	(20.8)	(0)
Government	1.8	-2.9	-1.6	0.4	-1.0
Other Sectors	-4.3	-4.5	3.1	2.7	2.2
Prices (Percent Change)					
GDP Deflator (Annual Average)	41.1	86.4	24.0	12.9	10.0
Consumer Prices (Dec. to Dec.)	65.1	81.8	10.7	17.3	N.A.
Wholesale Prices (Dec. to Dec.)	117.2	79.1	5.9	12.2	N.A.
Unemployment (Percent)C/	7.4	9.5	9.0	7.8	N.A.
Real Average Wages (1977=100)	96	73	86	98D/	N.A.
Public Sector	90	67	74	84D/	N.A.
Private Sector	95	74	90	102D/	N.A.
Exchange Rate (Colones per US$) (Selling Price - December)					
Official Market	19.92	20.50	20.50	20.50	N.A.
Banking Market	36.01	40.50	43.65	48.00	N.A.
Free Market	38.27	45.70	43.65	48.00	N.A.

Notes
A/ Millions of Colones
B/ Millions of U.S. dollars
C/ March of each year
D/ March 1984

TABLE II

OPERATIONS OF THE NONFINANCIAL PUBLIC SECTOR, 1982-1985

	1982	1983	Program (A) 1984	Program (A) 1985
	(In millions of colones)			
Central Administration	-3,258	-4,137	-3,765	-2,890
Current revenue	13,317	21,585	28,085	33,891
Expenditure	-16,575	-25,722	-31,850	-36,781
Current	(-14,363)	(-20,631)	(-26,482)	(-29,966)
Capital	(-2,212)	(-5,091)	(-5,368)	(-6,815)
Rest of general government	704	1,787	1,139	1,098
Revenue	10,496	12,610	15,475	17,382
Current	(9,828)	(11,975)	(15,056)	(16,896)
Capital	(668)	(635)	(419)	(486)
Expenditure	-9,792	-10,823	-14,335	-16,284
Current	(-8,799)	(-9,984)	(-13,046)	(-14,696)
Capital and net lending	(-993)	(-839)	(-1,289)	(-1,588)
Public enterprises	-6,303	-1,895	-1,081	-688
Revenue	18,374	28,305	33,367	36,676
Current	(18,239)	(27,786)	(33,113)	(36,444)
Capital	(135)	(520)	(254)	(232)
Expenditure	-24,677	-30,200	-34,448	-37,364*
Current	(-21,260)	(-26,300)	(-29,942)	(-31,990)
Capital and net lending	(-3,417)	(-3,900)	(-4,506)	(-5,279)
Public sector current account deficit (-)	-3,036	4,429	6,783	10,579
General government	-267	2,100	2,014	4,629
Public enterprises	-2,769	2,329	4,769	5,950
Public sector overall deficit (-)	-8,857	-4,245	-3,707	-2,480
External	1,789	2,219	3,420	6,350 (B)
Domestic	3,002	2,026	287	-3,870
Banking system	(2,332)	(1,161)	(--)	(...)
Other	(670)	(865)	(287)	(...)
Interest in arrears	4,066	--	--	--
Memorandum items				
Public sector revenue	17,011	32,408	42,062	50,678
Public sector expenditure	-25,868	-36,653*	-45,769	-53,158
Current	(-19,836)	(-27,953)	(-35,209)	(-40,096)
Capital and net lending	(-6,032	(-8,695)	(-10,560)	(-13,062)

69

TABLE II -(Continued)

OPERATIONS OF THE NONFINANCIAL PUBLIC SECTOR

	1982	1983	Program (A) 1984	Program (A) 1985
	(Annual percentage change)			
Public sector revenue	65.7	90.3	29.8	20.5
Public sector expenditure	40.4	41.6	24.9	16.1
Current	(62.1)	(41.9)	(25.9)	(13.9)
Capital and net lending	(-2.6)	(40.6)	(21.4)	(23.7)
	(In percent of GDP)			
Public sector deficit	-9.0	-3.4	-2.5	-1.5
Revenue	17.3	25.9	28.8	30.6
Expenditure	26.3	29.3	31.3	32.1
Current	(20.1)	(22.4)	(24.1)	(24.2)
Capital	(6.2)	(6.9)	(7.2)	(7.9)
Central administration deficit	-3.3	-3.3	-2.6	-1.7
Revenue	13.5	17.3	19.2	20.5
Expenditure	16.8	20.6	21.8	22.2
Current	(14.6)	(16.5)	(18.1)	(18.1)
Capital	(2.2)	(4.1)	(3.7)	(4.1)
Memorandum items				
Public sector current account deficit (-)	-3.1	3.5	4.6	6.4
General government	(-0.3)	(1.6)	(1.3)	(2.8)
State enterprises	(-2.8)	(1.9)	(3.3)	(3.6)
Public sector fixed capital formation	4.7	5.5	5.9	6.5

Sources: Ministry of Finance and IMF staff estimates (November 1984)

(A) Excludes ESF grant disbursements which are channeled directly to the private sector.
(B) Includes IBRD/SAL disbursements (US$80 million).

(*) Denotes number which does not add as presented in source table.

TABLE III

MONETARY ACCOUNTS 1979 - 1985

	1979	1980	1981	1982	1983(A)	1984	1985
I. CENTRAL BANK							
Net International Reserves	303	-6,299	-12,532	-46,391	-6,084	-8,333	-6,260
Official Reserves	303	-2,061	-2,905	-2,591	2,596	6,333	4,816
Payments Arrears	-	-4,238	-9,627	-43,800	-1,827	-2,205	-
Revolving Trade Credit Facility	-	-	-	-	-6,853	-12,461	-11,076
Net Domestic Assets	2,237	9,194	16,958	53,328	15,032	19,071	18,500
Net Credit to Public Sector (B)	4,983	7,340	9,651	11,885	29,000(D)	28,773	32,842
Net Position with Banks	-490	-1,817	-3,194	-9,619	-8,507(D)	-5,550	-5,697
Stabilization Bonds	-371	-286	-1,542	-4,755	-5,090	-5,265	-5,300
Government Trust Funds (C)	-	-	-	-	-	-4,725	-8,575
M/L Term Foreign Liabilities	-3,217-	-7,928	-8,376	-24,414	-68,127	-71,142	-85,872
Counterpart Arrears	-	4,238	9,627	43,800	1,827	2,205	-
Other Net (E)	1,332	-7,647	10,792	36,431	65,929	74,775	91,102
Currency Issue	2,540	2,895	4,426	6,937	8,948	10,738	12,240
II. BANKING SYSTEM							
Net International Reserves	528	-6,293	-12,353	-45,890	-4,380	-6,629	-4,366
Net Domestic Assets	17,535	32,609	44,800	113,931	128,810	144,761	169,822
Net Credit to Public Sector (B)	5,485	7,833	9,497	11,626	26,712	26,485	30,554
Credit to Private Sector	10,389	11,864	13,026	18,094	27,549	32,648	37,218
Other (E)	1,661	12,912	22,277	84,211	74,549	85,628	102,049
Government Trust Funds (C)	-	-	-	-	-	4,725	8,575
M/L Term Foreign Liabilities	3,687	8,060	9,209	27,028	69,998	72,878	86,741
Liabilities to Private Sector	14,376	18,256	23,238	41,013	54,432	60,529	70,140

Notes to this table are stated at the bottom of Table VII.

TABLE IV

COSTA RICA: BALANCE OF PAYMENTS, 1981-1985
(Millions of U.S. Dollars)

	1981	1982	1983	1984(B) Prelim.	1985(C) Proj.
Exports, FOB	1,003	869	870	950	1,065
Imports, CIF	-1,213	-894	-991	-1,110	-1,103
Balance of Trade	-211	-25	-121	-160	-38
Nonfactor services	77	100	105	71	94
Private, Int. and Profit	-11	1	-6	-5	-14
Official Interest	-308	-342	-356	-320	-372
(Paid)	(-160)	(-106)	(-316)	(-240)(D)	(-342)
(Unpaid/Rescheduled)	(-148)	(-236)	(-40)	(-80)	(-30)
Balance on Services	-243	-240)	-258	-254)	-292
Transfers	27	30	23	23	30
Balance on Curr. Act.	-426	-236	-356	-391	-300
Private Capital & E+O	-69	5	140	144	67
Official, Capital, Net	25	-83	290	183	293
Disbursements	335	197	344	301	421
(Projects)		(177)	(184)	(171)	(171)
(ESF Loan & Grant)		(20)	(161)	(130)	(170)
(CIDA Grant)		--	--	--	--
(IBRD SAL)		--	--	--	(80)
Amortization	-310	-280	-240	-336	-379
(Paid)	(-99)	(-63)	(-94)	(-145)(E)	(-156)
(Unpaid/Rescheduled)	(-211)	(-217)	(-146)	(-191)	(-221)
Amortization Relief	--	--	146	191	221
(Commercial Banks)	--	--	(119)	(135)	(168)
(Paris Club)	--	--	(27)	(56)	(53)
Interest Relief	--	--	40	27	30
Balance on Capital Account	-44	-78	430	327	360
Over-all Balance	-470	-314	74	-64	60
Financing (A)	470	314	-74	64	-60
Accum.(+), Reduction(-) of arrears	359	453	-331	126	-167
Conversion of CDs	--	--	49	n.a	--
Revolver Credit Facility	--	--	152	49	75
Valuation Adjustment	5	-11	9	n.a.	--
Other Net Official Reserves	106	-129	48	-111	32

Source: Central Bank of Costa Rica and IMF

Notes to this table are stated at the bottom of Table VII.

TABLE V

PROJECTED DEBT SERVICE AND DEBT RELIEF, 1985-1990

	1983	1984	1985	1986	1987	1988	1989	1990
Debt Service (M$)(A)	596	656	791	865	914	906	842	805
Amortization	240	336	419	486	530	509	433	390
Interest	356	320	372	379	384	397	409	415
Exports of Goods and Services (M$)	1,194	1,287	1,410	1,542	1,683	1,808	2,010	2,193
Debt Service as Percentage of Exportsof Goods and Services (%)	49.9	51.0	56.1	56.1	54.3	50.1	41.9	36.7
Debt Service after Debt Relief (IMF Calculation) (M$)	410(B)	358(B)	523	609	668	649	625	607
Debt Service after Debt Relief as Percent of Exports of Goods and Services (%)	34.3	27.8	37.1	39.5	39.7	35.9	31.1	27.7
Debt Relief (M$)	186	298	268	256	246	257	217	198

Source: Prepared by IMF; cited sources:
IBRD Debt Reporting Service GOCR and IMF Staff estimates

Notes: (A) M$ is million of U.S. dollars.
(B) In 1983 and 1984 debt service after debt relief includes only effectively paid debt service.

TABLE VI

NET INTERNATIONAL RESERVES OF THE CENTRAL BANK OF COSTA RICA 1982-1984

(December 31 of Each Year - Millions of U.S. Dollars)

	1982	1983	1984
I. NET OFFICIAL RESERVES	-114.9	-94.6	-32.3
Assets	244.3	305.6	420.6
Freely Disposable	133.9	34.2	96.1
Gold	13.3	n.a.	9.2
Bank Deposits	83.9	-17.7	20.2
Foreign Exchange	36.7	1.3	1.3
Securities	--	50.0	65.4
Special Drawing Rights	--	0.6	--
Other Assets	110.4	271.4	324.5
Time Deposits (CA Central Banks)	41.2	134.8	184.8
Multilateral (CA clearing arrang.)	53.4	97.9	115.1
Contribution to CA Stab. Fund	15.8	17.8	19.2
Other		19.9	5.4
Liabilities	-359.2	-400.2	-452.9
Net Position with IMF	-92.9	-192.6	-160.0
Other Short-Term	-266.3	-207.6	-292.9
Revolving Credit	--	152.3	201.9
Drawing in CA Stab. Fund	n.a.	32.0	30.0
Banco de México (and clearing)	n.a.	5.0	40.8
Banco República de Colombia	n.a.	5.0	5.0
Other	n.a.	13.3	15.2
II. PAYMENT ARREARS	-1,095.0	-40.6	-166.6
Over 15 working days (imports)	n.a.	40.6	26.0
Other	n.a.	--	140.6
III. NET INTERNATIONAL RESERVES (I+II)	-1,209.9	-135.2	-198.9

Source: Central Bank of Costa Rica and IMF

14

TABLE VII

COMPOSITION OF EXTERNAL DEBT SERVICE ARREARS OF THE PUBLIC SECTOR .

(December 31, 1984; in millions of U.S. dollars)

Owed to:	Principal	Interest	Total
Commercial Banks	1.8	44.5	46.3
Multilaterals	14.4	6.6	21.0
Bilaterals	25.2	13.1	38.3
Bonds	12.7	9.2	21.9
CD's "Presa"	-	5.6	5.6
Suppliers	6.2	1.3	7.5
Total	60.3	80.3	140.6

Source: Central Bank

Notes to Table III.

Source: Central Bank of Costa Rica and IMF staff estimates.

Notes: Exchange rates utilized for conversion of foreign exchange to colones is as follows per U.S. $ 1.00: (1979) 8.57 colones, (1980 and 1981)) 15 colones, (1982) 40 colones, (1983 and 1984) 45 colones, and (1985) 50 colones.

(A) Includes the full effect of the rescheduling of external payment arrears.

(b) Includes exchange subsidies.

(C) Includes AID grants and IBRD/SAL couterpart deposits.

(D) Includes rescheduled external debt assumed by the Central Bank on behalf of the public sector and commercial banks.

(E) Includes valuation adjustment and net losses.

Notes to Table IV.

: (A) Minus (-) is increase in net international reserve position; positive sign (+) is decrease.

(B) The 1984 estimates are preliminary Central Bank estimates as of January 1985.

(C) The 1985 estimates are latest available IMF projections and are as of November 1984 and ESF is shown therein at $ 170 million (instead of $ 190 million per cash flow projection of IMF per January Letter of Intent). However, we have adjusted the compensatory account adjusted by us to eliminate FX payment arrears and account the $ 75 million loan from commercial banks as compensatory item, as per instructions of Central Bank and IMF.

(D) Includes $60 million unpaid and interest that is not designated as rescheduled.

(E) Includes $80 million of unpaid amortization that is not designated as rescheduled.

2. Structural Problems

Structural problems are those suseptible only to medium term interventions and policy reform. For Costa Rica, with a small open economy, export growth is the lifeline to higher standards of living. Along with other obvious goals, such as the avoidance of sharp declines in real income and sharp increases in unemployment, export expansion is an important goal of structural transformation.

The structure of existing trade arrangements encourages production for the small domestic and regional market rather than for markets outside the region. However, slow growth in the regional market must be assumed under the best of circumstances. Moreover, a recent study shows that the net effect of Costa Rica's exports to the CACM is not large. In the most prosperous years of the CACM, Costa Rica's exports of manufactured goods to the region represented about 12% of the gross value of industrial production and that about 80% of industrial output was consumed internally. Even if in the late 1970s and early 1980s exports of manufactured goods to the CACM equaled one-fifth of commodity exports, the value added of these goods would amount to only 1.6 % of GDP. Apart from low impact, the CACM Common External Tariff (CET) imparts a high degree of effective protection to final consumer goods industries. Consequently, consumer goods industries avoid the competition that would help them be price competitive in third country markets.

The colon is overvalued in the sense that the market clearing exchange rate without substantial external balance of payments assistance would be much higher (and with lower real incomes in Costa Rica). There are also other concepts which may suggest overvaluation of the colon. Using purchasing power parity methodology and a second quarter of 1974 base, by mid-1984 the colon was found not to be overvalued when the trading partner factor was limited to the U.S. Apparent overvaluation when other trading partners are included in the calculation reflects mainly the strength of the U.S. dollar in world currency markets rather than overvaluation of the colon. In Costa Rica the 1983 unification of the "free" bank and inter-bank exchange rates and the reduction in the percentage of export proceeds that had to be liquidated at the official rate effectively devalued the colon by 8%. In October 1984, the colon was devalued in one step by 9.1%, and further small devaluations are likely in 1985. Thus, according to the purchasing power parity concept, the colon does not appear to be overvalued.

There is a third sense in which the colon may be overvalued, and this is termed "structural" overvaluation and may exists because protective tariffs increase the imported costs of imports competing with local manufactures and decrease the effective demand for such imports. This results in a lower demand for foreign exchange (and lower exchange rate) than would exist in the case of no import tariffs or import tariffs

16

aimed solely at fiscal income. A fourth sense in which the colon may be overvalued is that nontraditional exports will not expand unless they are sufficiently profitable. Given practical limits to export subsidies, i.e., the impact on fiscal expenditures and foreign competitor legal retaliation, exchange rate devaluation is the remaining most effective policy tool for increasing export profitability. Recourse to this tool may be necessary even if, for distributional reasons, increased profits for certain other exports are captured via increased taxes. Given the relative openness of the Costa Rican econony, which entails high inflation pass-through from devaluation, real effective devaluation on the order of 5% per annum is probably a politically feasible limit due to the adverse effect on real incomes from stronger devaluation. Such devaluation would only outrun domestic inflation by about 5 percentage points, e.g. a devaluation of 15% in the context of 10% inflation. Thus, it is not inconsistent to press for continuing devaluation while eschewing the stronger devaluations which are quickly eroded by accelerating inflation.

Public sector and central government current account savings are small and even with impressive reduction of the deficit of the nonfinancial public sector, for the financial and nonfinancial public sector, taken as a whole, the projected deficit for 1985 amounts to 7% of GDP. The restoration of current account savings in public sector enterprises is due mainly to surpluses generated by the state-owned petroleum company, RECOPE, and to catch up of charges in the state public utility enterprises. At present CNP and CODESA are the major public sector enterprises with operating deficits. In past years the absence of public sector savings has generally meant that the government had to resort to excessive domestic and foreign borrowing to finance public sector investment. Even though the Monge adminstration has reduced the deficit of the nonfinancial public sector, this improvement has come mainly from revenue increasing changes rather than through prioritization and containment of expenditures. The continuing use of stop-gap revenue measures suggests the need for a durable restructuring of the public sector finances.

When the ESR programs were initiated (1982), the Costa Rican system of financial intermediation departed strongly from an efficient system. Credit quotas and differential interest rates, which favor some economic sectors over others, made financial intermediation inefficient because some activities of low profitability were financed and others of higher profitability were starved for funds. Central Bank subsidies, mainly in the form of differentially low interest rates, have demonstrably failed to meet the aims used to justify such subsidies. Despite lip service to the aim of reaching small producers, the state-owned commercial banking system had also failed notably at this task. For example, in one state bank, 1.6% of the loans accounted for more than 45% of the credit. Moreover, the state commercial banks still use antiquated management practices and over-staffing which generate high costs for borrowers and low returns to depositors and fail to channel adequate credit to the newer and more productive sectors of the economy. In recent months the

17

GOCR has taken measures which improve this situation, as follows: (1) the currency law reform of August 1984 facilitated the use by Costa Rican business of financial resources denominated in foreign currencies; (2) the increased availability of direct re-discount facilities from the Central Bank to the private banks (which cannot legally accept demand and savings deposits from the domestic private sector) enables these banks to compete with less disadvantage with the state commercial banks; and (3) in January 1985 the Central Bank has nearly eliminated the "topes" system of credit allocation which for many years had played a key role in the non-price allocation of credit in Costa Rica and has reaffirmed a policy of limiting subsidized credit (to about 15% of total private sector credit) and of maintaining positive real rates of interest. (See also, the recent Mission cable on this topic, San Jose 0561, "Costa Rica's 1985 Credit Program.")

3. Central Bank Losses

It is also obvious that if the Central Bank could legally write-off its CODESA assets, it would probably do so willingly if this would also end further CODESA claims on Central Bank credit. The reform that is sought by means of CODESA divestiture is a reduction of the potential drain of Central Bank credit resources to CODESA, which has up to now employed those resources in such a way as to fail to obtain the social opportunity cost of credit. Within the limit of credit expansion for the Central Bank which is compatible with the over-all objective of economic stability, credit to CODESA, along with credit to the public sector in general, should be viewed as reducing credit available to the private sector, where credit now earns an average interest rate in excess of 20 percent per annum. Even though we might not want to go so far as to say that any and all credit to the public sector fails to earn the social opportunity cost of credit, given the size of the public sector in the Costa Rican economy, devoting all credit resources to public finance would only reduce and not eliminate the need for tax revenues. Therefore, given this consideration and apart from seasonal influences, credit allocated to the public sector generally reduces credit resources available to the private sector.

Undoubtedly, there was a hope and desire by the Costa Rican authorities who approved CODESA access to the Central Bank credit, that CODESA would be able to service its debt to the Central Bank. In this sense, CODESA debt to the Central Bank differs from that of the central government and most of the rest of the public sector. In regard to central government debt, which expanded greatly in the period 1980-1982, there was no such supposition. When the government borrowings from the Central Bank are obviously excessive in terms of price stability, the usual result is strong monetary expansion at the same time. Therefore, the interest charged is usually reckoned as unimportant because any such charges would be overwhelmed by future borrowings. As noted above, it is appropriate to view CODESA's debt to the Central Bank as depriving the private sector of the same amount of credit and the Central Bank of that amount of earnings on its domestic assets.

The economic significance of Central Bank financial losses consists in money creation mainly in the form of expanded Central Bank currency issue. Standard IMF monetary tables (see Table III) demonstrate the more usual elements creating and extinguishing money. For example, a balance of payments surplus (i.e., increase in net international reserves) or an increase in banking system credit to the public (private) sectors increases money in circulation, and a balance of payments deficit (i.e., decrease in net international reserves) or a decrease in banking system credit to the public (private) sectors reduces money in circulation. Apart from these influences, the major source of monetary expansion in Costa Rica arises from losses of the Central Bank which originate from the difference between interest earned and interest paid. Table VIII, prepared by Central Bank staff in conjunction with the IMF Mission of September 1984, estimates the interest earned and paid by the Central Bank for 1984 and 1985. Per the projections in this table, Central Bank's 1984 losses amounted to ¢ 7.7 billion, and 1985 losses will amount to ¢ 9.3 billion. (The respective U.S. dollar equivalents are $ 154 million and $ 186 million at an exchange rate of ¢ 50 per $ 1.00.) Several Central Bank payment items arise from interest payments on its external debt, i.e., short term foreign liabilities, the IMF, the Revolver Trade Credit Facility, and the Central Bank's own regular medium and long-term debt. Other payment items relate to interest paid to commercial bank for use of deposits denominated in foreign exchange and interest paid on stabilization bonds. The Central Bank's assumption of the external payment obligation of public sector debt in December 1984 gives rise to receipts as well as payments, and this operation should be a wash if properly managed.

The fact that Central Bank annual losses now amount to over $ 150 million signals previous policy errors and that equivalent credit for productive uses is foregone. In reference to the component accounts of Central Bank domestic assets (see Table III), it should be noted that losses are registered in "Other Net" along with several other sub-entries of minor importance. As projected, the "Other Net" account expands by nearly ¢ 16 billion in 1985. (This is larger than the ¢ 9 billion shown in Table VIII due to exchange rate conversion in Table III at a ¢ 45 at the end of 1984 and ¢ 50 at the end of 1985.) In reference to the projection for 1985 presented in Table III, it can be noted that Central Bank credit to the entire public sector expands by about ¢ 4 billion and that total Costa Rican credit to the private sector expands by less than ¢ 5 billion. Thus, with a fair comparison, Central Bank losses are larger than total credit to the Costa Rican economy. CODESA contributes with annual losses to the Central Bank that are presently (1984) running at an annual rate of ¢ 1.1 billion.

TABLE VIII

ESTIMATED NET LOSSES OF THE CENTRAL BANK, 1984 - 1985

(In millions of colones)

	Proj. 1984 (¢45=US$1)	Proj. 1985 (¢50=US$1)
I. Interest earned	5,852	6,248
1. Rescheduling - Tranche I	3,060	2,864
- Tranche II		592
2. Interests received	2,792	2,792
II. Interest paid	13,141	15,122
1. Short term F/E liab.	486	288
2. IMF	556	682
3. Revolver	1,363	1,875
4. M/L term		
Regular	3,496	4,185
Rescheduling - Tranche I	4,550	4,980
- Tranche II	-	555
5. Bank deposits F/E	1,390	1,545
6. Stabilization bonds	1,012	1,012
7. "Traspasos"	288	-
III. DIFFERENCE (I-II)	-7,289	-8,874
IV. OTHER NET OPERATING LOSSES	-438	-438
V. TOTAL LOSSES (III+IV)	-7,727	-9,312

Source: Central Bank of Costa Rica (9/14/84)

Note: According to Central Bank staff, accounting for this table is on a cash-flow basis, i.e. receipts and payments received in currency rather than on an accruals basis.

4. Monetization Impacts of Transactions Related to CODESA Divestiture

In general the term monetization signifies that money in circulation outside the banking system is increased. In addition, we use the term demonetization to signify a situation when potential monetization is eliminated. The following discussion examines the general impact of ESF inflows and disbursements on Central Bank accounts and also examines specific transactions that are likely to occur in the context of CODESA divestiture.

(a) Impact of AID's loan and grant disbursements on Central Bank accounts

Net Domestic Assets of the Central Bank are defined for IMF program purposes, as the difference between Net Official International Reserves and Currency Issue (banknotes and coins held by the public and by commercial banks). Looking at the Central Bank balance sheet this is equivalent to the algebraic sum of all the remaining Central Bank accounts (other than Currency Issue and Net Official International Reserves). These other accounts include, on the liability side of the balance sheet, the Governments (AID) Trust Fund account and the Central Bank's medium and long-term external liability account. When AID disburses foreign exchange to the Central Bank (makes a dollar deposit in a US bank correspondent of the Central Bank), the Central Bank writes the following bookeeping entry:

Debit : Official International Reserves (increases)
Credit: Government (AID) Trust Fund (the grant portion; increases)
Medium and Long-Term Foreign Liabilities (the loan portion; increases)

Referring to the accounts in colones, Net Official International Reserves increase with this transaction by the equivalent colon amount of the foreign exchange disbursement and the Net Domestic Assets of the Central Bank decrease by exactly the same amount. This result holds independently of whether the foreign exchange disbursement made by AID originated in a grant or in a loan. Up to this point, no monetization (defined as an increase in money in circulation) has occurred.

From the above explanation, it follows logically that if during 1985 AID disburses to Central Bank $160 million (or 8.0 billion colones), Net Official International Reserves will increase by this amount and Net Domestic Assets of the Central Bank will decrease by 8.0 billion colones. The resulting decrease in Net Domestic Assets is independent of whether this amount is registered by Central Bank as a grant or as a loan.

4

(b) <u>Impact of reducing CODESA's debt to Central Bank from the Government (AID) Trust Fund Account</u>

In order to register this transaction, the Central Bank will have to write the following entry:

Debit : Government (AID) Trust Fund (decreases)
Credit: Public Sector Net (and CODESA loan account) (decreases)

Inasmuch as both accounts are included in the subset of accounts defined as Net Domestic Assets, the recording of this transaction, since it reduces both accounts in the same amount, has no net impact on the Net Domestic Assets (aggregate) of the Central Bank. Moreover, there is no monetization, i.e. increase in money in circulation.

(c) <u>The impact of various payments from the Government (AID) Trust Fund to non-banking system recipients.</u>

Present information indicates that operations related to CODESA divestiture will involve: (1) a possible budget support payment to the central government, (2) severance payments, (3) trust fund operating expenses, (4) payments to local suppliers, and (5) payments to foreign suppliers and banks.

To register payments (1) through (4) the following entry will be made:

Debit : Government (AID) Trust Fund (decreases)
Credit: Public Sector Net (and CODESA loan account) (decreases)

To register payments to foreign suppliers and banks in foreign exchange:

Debit: Government (AID) Trust Fund (Net Domestic Assets increase)
Credit: Foreign Exchange Assets (Official International Reserves decrease)

Since operations (1) through (4) involved in these transactions are included in the subset of accounts defined as Net Domestic Assets, no change will take place upon the creation of this credit to CODESA but rather when the beneficiaries withdraw their deposits. Obviously when they withdraw deposits, Net Domestic Assets and money in circulation will increase by the full amount of these payments. In the context of the ceiling on Central Bank Net Domestic Assets under the IMF Standby, increases in this variable that are not presently programmed are likely to cause problems, and we examine the approximate magnitude of that prospective problem. Some payments, e.g. repayment of domestic private sector creditors, cash severance payments, and trust fund expenditures, are obvious monetizations. However, certain arrangements might be employed to reduce the monetization of these payments.

gV

(d) Arrangements To Reduce/Avoid Monetization

To avoid the impact on Central Bank Net Domestic Assets due to disbursements from the Government (AID) Trust Fund, the following mechanism could be used:

(1) The disbursement, if required, of the colon equivalent of $ 10 million (colon equivalent) made from the Trust Fund to the central government could be used as budget support or applied to reduce the central government net debt to the Central Bank. As budget support, it is monetized; as used for reducing central government debt to the Central Bank, it would be demonetized because in the recording of this transaction will decrease the Government (AID) Trust Fund account and Public Sector Net Credit account by the same amount with the net domestic assets aggregate remaining unchanged.

(2) In regard to domestic suppliers, payment of these claims in money is monetization. However, and particularly with a view to claims in arrears, creditors may be willing to accept partial payment in cash and the remainder in Central Bank notes and bonds, and this would spread out the monetization impact. Since the total of such claims is on the order of $ 30 million, the 1985 monetization impact could probably be kept to $ 10 million or less.

(3) Even though severance pay claims are on the order of $ 5 million, the effective cash payments in 1985 would probably be much lower.

(4) Presently available information indicates that foreign suppliers and banks are owed $ 17 million and $ 40 million respectively. We suspect that this is a mixed bag with some credits simply representing revolving credits that are being liquidated and renewed, but which in event of liquidation of particular enterprises might prove to be politically onerous. Any such liquidation removes foreign exchange from the task of balance of payments support along with the problem of increasing Central Bank Net Domestic Assets and reducing official foreign exchange reserves by the amount of any cash liquidation, both of which are subject to IMF quantitative limits. Prudence suggests, therefore, need for close consultation of all parties to reduce significant loss of foreign exchange from these payments in 1985.

(e) The Probable Magnitude of 1985 Monetization

We suspect that the inescapable monetization that would appear in 1985 lies in the range of $ 10-20 million. This assumes, in particular, that that no net payment of foreign exchange to external creditors will be necessary in 1985 and that domestic private sector creditors can be persuaded to wait a while for complete payment.

(f) Examples of Changes in Central Bank Accounts

	Estimated Balance 31 Dec.1984 (Million ₡)	Case 1	Case 2	Case 3	Case 4
Net Official Intl. Res.	(8,333)	X			X
Net Domestic Assets	19,071	X		X	X
Public Sector, Net	26,773		X		
Banks, Net	(5,550)				
Bonds	(5,265)				
Government (AID) Trust Fund	(4,725)	X	X	X	X
M/L Term Foreign Liabilities	(71,142)	X			
Other	76,980				
Currency Issue	(10,738)			X	

Notes: Regarding end of 1984 data, net official international reserves are negative and figures in parenthesis correspond to liability accounts. Liability accounts increase with credits and asset accounts with debits. Entries in accounts indicated by " X " illustrate cases 1 through 4 explained below.

Case 1
AID disburses foreign exchange to the Central Bank. Net official international reserves increase and Central Bank's medium and long term foreign liabilities and/or government (AID) trust fund increase; net domestic assets decrease. Effect=demonetization with potential for monetization.

Case 2
Reduction of CODESA's debt to Central Bank. Public sector net (CODESA account) and government (AID) trust fund decrease; net domestic assets remain unchanged. Effect=demonetization.

Case 3
Recording of the following payments from the government (AID) trust fund: budget support, trust fund operating expenses, payments to local suppliers and severance payments. Government (AID) trust fund decrease, net domestic assets increase and currency issue increase. Effect = monetization.

Case 4

Payment to foreign suppliers and banks from the government (AID) trust fund. Net official international reserves and governemt (AID) trust fund decrease, net domestic assets increase. Effect = no monetiztation and no balance of payments support.

84

ANNEX III

PARASTAL DIVESTITURE AND REDUCTION OF PUBLIC SECTOR DEBT OF COSTA RICA

I. BACKGROUND

A. The Problem

The Costa Rica Development Corporation (CODESA) was created in 1972 to serve as a development bank/venture capital partner with the private sector to bring new businesses into existence. CODESA's role in each enterprise was intended to be primarily short term, with the objective of turning its interests/ holdings over to the private sector as the enterprises became financially viable.

Experience has shown, however, that the opposite has happened. Rather than reducing its participation, CODESA has taken a majority or sole owner position in many of the enterprises. Consequently, the public sector, through CODESA, has become responsible for the management of commercial activities, and has exhibited the classic results which argue against such public sector participation: inadequate technical/management skills, investment decisions made without proper attention to profitability, poor financial controls, subsidized prices for products -- all of which contribute to inefficient, financially unviable enterprises.

To keep the enterprises operating, CODESA has become heavily indebted from continued borrowing through its access to credit at the Central Bank (BCCR). Table 1 provides an indication of the extent of CODESA's negative impact on credit available to the rest of the economy.

Table 1

Costa Rica Credit Growth
(millions of colones)

	1979	1980	1981	1982	1983	1984
Total Net Credit	15,874	19,697	22,523	29,720	54,261	59,133
Net to Private Sector	10,389	11,864	13,026	18,094	27,549	32,648
Net to Public Sector	5,485	7,833	9,497	11,626	26,712	26,485
Net to CODESA	(1,809)	(2,584)	(3,202)	(6,315)	(7,536)	(9,069)
CODESA as						
% of Public Sector	33.0	33.0	33.7	54.3	28.2	34.2
% of total	11.4	13.1	14.2	21.2	13.9	15.3

(
Ch

Since 1979, credit to CODESA has increased five fold and has consistently accounted for one-third of all credit to the public sector. Despite the magnitude of credit flowing to CODESA, in 1983 its subsidiaries provided only 2,122 direct jobs (0.3% of the labor force) and accounted for only 1.1% of GDP. Thus, the continued operation of CODESA enterprises has had a significant negative impact on the economy by absorbing a high level of resources that could have been allocated to more efficient private sector activities.

B. Rationale for Divestiture and AID Assistance

The negative consequences of CODESA's past and potential future impact have not gone unnoticed. The Monge Administration has taken a series of actions since coming to power in 1982 to address this problem. These include the consolidation of CODESA's debt, placing a budgetary limit on CODESA's credit through the BCCR, charging CODESA with developing divestiture plans for 1985, and obtaining passage of the Public Sector Financial Equilibrium Law which includes the legal procedures that CODESA is to follow in selling the stock of its subsidiaries.

Given this background, President Monge then proposed that AID assist the GOCR in implementing its efforts to divest parastatal enterprises held by CODESA by targetting local currency generated under the Economic Stabilization and Recovery Program to support the process (President Monge's letters to the U.S. Ambassador are appended as Attachment 1). The Mission has responded favorably to the proposal because of the opportunity it provides to achieve economic reform and structural change in the public sector and to utilize local currency which otherwise would have been sterilized due to monetization limits established in the IMF's stabilization program. Specifically, the process will result in:

- A reduction, and possibly the eventual elimination of public sector participation in commercial enterprises;
- A decrease in future public sector demand for credit, and the more rational allocation of credit to the productive private sector; and
- A reduction in the total outstanding public debt by transferring local currency to the BCCR to be credited against CODESA's debt.

C. CODESA Companies and Financial Situation

When CODESA was created in 1972, it had authorized capital of 100,000 shares, split between the private (33,000) and public (67,000) sectors. As of June 30, 1984, CODESA shares totalled 402,022, of which 402,000 were owned outright by the GOCR. The law creating CODESA also authorized obtaining funds for CODESA activities by issuing bonds and securities, obtaining loans and by discounting credit documents at the BCCR. The latter was most significant since it provided CODESA with practically unrestricted access to credit.

96

Currently, CODESA holds interest in 18 enterprises. The following eight companies are detailed in CODESA's consolidated financial statement as of June 30, 1984. (See Attachment 2 for details).

Fertilizantes de Centro América, S.A.(FERTICA)
Cementos del Pacífico, S.A. (CEMPA)
Aluminios Nacionales, S.A. (ALUNASA)
Central Azucarera Tempisque S.A. (CATSA)
Algodones de Costa Rica, S.A. (ALCOSA)
Tempisque Ferryboat, S.A.
Fletamento Marítimo, S.A.
Inmobilarias Temporales, S.A.

Not detailed in the Consolidated statement are:

Ferrocarriles de Costa Rica (FECOSA)
Transportes Metropolitanos, S.A. (TRANSMESA)
Cementos del Valles, S.A. (closed)
Desarrollo Agroindustrial, S.A. (DIASA) (closed)
Acuacultura S.A. (closed)
Stabapari S.A. (closed)
Consolidación de Compañías Agrícolas e Industriales
Corporación Zona Franca de Exportación
Maderas y Acabados S.A.
Atunes del Puerto S.A.

Of these 18 enterprises the principal contributors to CODESA's financial problems are FERTICA, CEMPA, ALUNASA and CATSA (the "big four"). Table 2 provides a summary of CODESA's financial status as of June 30, 1984.

CODESA's total debt through June, 1984, is ₡13,314 million ($266 million), of which ₡4,306 million ($86 million) is directly allocable to the eight subsidiaries specifically identified in the consolidated financial statement. Although most of this debt is with the public sector (BCCR), CODESA also has other local currency debt (primarily to local suppliers) amounting to ₡1,544 million ($31 million) as well as debt with foreign banks and suppliers of ₡2,815 million ($57 million). Section II.C.3, below, addresses how this third party debt will be handled as divestiture proceeds.

CODESA's unaudited total book assets (not shown on the Table) are ₡8,800 million ($176 million), of which ₡2,300 million ($46 million) represents plant and machinery. The book difference between debt and assets reflects CODESA's accumulated losses of ₡4,500 million ($90 million). It is estimated that the cost of servicing CODESA's debt is now close to ₡1,100 million ($22 million) annually. With most of CODESA's companies operating at a loss, this situation can only deteriorate, leading to further demands on the limited credit resources in Costa Rica.

81

TABLE 2

CODESA'S TOTAL LIABILITIES AS OF JUNE 30, 1984 IN THOUSAND OF COLONES
(Consolidated Companies)

	DUE TO NATIONAL BANKS AND BCCR (1)	OWES TO PUBLIC SECTOR COMPANIES (2)	(1 + 2) TOTAL DUE TO PUBLIC SECTOR (3)	OTHER COLON DEBT (4)	DUE TO FOREIGN BANKS (5)	DUE TO FOREIGN SUPPLIERS (6)	TOTAL LIA- BILITIES (7)	NET PLANT ASSETS (8)
1. FERTICA	0	854,504	854,504	183,714	489,641	336,359	1,864,218	386,730
2. ALUNASA	92,016	236,547	328,563	181,558	21,548	362,402	894,071	434,890
3. CATSA	45,127	725,222	770,349	65,137	8,249	25,292	869,027	796,943
4. CEMPA	20,679	382,543	403,222	47,490	12,760	91,603	555,075	560,412
5. ALCODONES DE C.R.	28,753	49,766	78,519	39,714	0	0	118,233	32,706
6. TEMPISQUE FERRYBOAT	19	1,149	1,168	490	0	0	1,658	2,980
7. FLETAMENTO MARITIMO	0	357	357	1,639	0	0	1,996	313
8. INMOBILIARES TEMPO-RALES	0	1,446	1,446	0	0	0	1,446	35,043
9. SUBTOTAL SUBSIDIARIES	186,594	2,251,534	2,438,128	519,742	532,198	815,656	4,305,726	2,270,835
10. CODESA	6,476,489 4/	0	6,476,489	1,024,713	1,482,365	24,767	9,008,334	12,939 2/
GRAND TOTAL	6,663,083 4/	2,251,534 1/	8,914,617	1,544,455	2,014,563	804,423	13,314,058 3,4/	2,283,774
DOLLAR EQUIVALENT (MILLION) 5/	133	45	178	31	40	17	266	46

1/ Includes ₡2,218,547 owed to CODESA.
2/ Excludes ₡275,823 of "Permanent Investments".
3/ Excludes ₡2,345,013 of Contingent Liabilities.
4/ Includes ₡1,944,046 of debt owed by FECOSA/TRANSMESA or transferable to other COCR agencies.
5/ Calculated at ₡50/$

II. DESCRIPTION OF THE PROCESS

A. Introduction

Following the receipt of President Monge's letter, the Mission has explored a variety of ways to address the CODESA problem. A key consideration has been the political sensitivity surrounding divestiture of parastatal enterprises -- made more sensitive in this case because 1985 is an election year in Costa Rica. In this context, the Mission has recognized the high degree of risk associated with the program, most specifically that the GOCR may not fulfill its commitments due to political pressure. The nature and direction of the political situation is a critical factor, but one which cannot be predicted or controlled. Consequently, what has been negotiated thus far with senior GOCR officials is recognized as tentative, with the understanding that future variations may be necessary as the divestiture process unfolds and political conditions change.

Nonetheless, actions already taken by the GOCR provide considerable evidence of the will to carry out the divestiture process. Most important are the recent publication of the "Reglamento" and issuance of a Cabinet "Resolution" which, in addition to Article 55 of the Public Sector Financial Equilibrium Law (Law 6955), provide the basis for initiating the divestiture of CODESA enterprises (see discussion below). In addition, the Mission has designed the flow of local currency resources to maximize control and to provide the incentives for full GOCR participation.

B. Objectives

The principal objective of the proposed program is to support the GOCR divestiture efforts with the aim of completing the process (i.e., transfer of CODESA subsidiaries from public to private ownership) in as short a period as possible. With this in mind, the Mission and the GOCR have agreed that all activities will be carried out within the framework established by Article 55 of the Public Sector Financial Equilibrium Law (Law 6955) which concerns selling the shares of CODESA subsidiaries. (Section III.A., below, describes Article 55 of the Law. Attachment 3 contains a translation of Article 55). Specifically, it is Mission policy that divestiture will be best served by avoiding prolonged public debate. Therefore, the process must avoid any action that raises the possibility of a legal challenge or involvement of the Legislative Assembly because of the added time factor it would entail.

A key feature of the program and critical to achieving this objective is that, prior to the sale of the subsidiaries, all third party debt of those subsidiaries will be assumed by the CODESA holding company. As a consequence, each subsidiary will have only one creditor (i.e., the CODESA holding company). This is expected to eliminate delays in divesting of the subsidiaries caused by claims from outside creditors. Similarly, potential new owners will not view outside debt as a constraint in taking over an enterprise, which is expected to facilitate decisions on purchasing an enterprise or its assets.

A second important objective of the program is to use ESF local currency equivalent in a manner which provides the greatest positive economic impact while remaining within the limitations established under the IMF's 1985 Standby Arrangement. The use of local currency to help reduce CODESA's debt with the GOCR achieves this objective because, as a financial transaction internal to the BCCR, the resources ($110-$120 million equivalent) are effectively "demonetized" since they do not leave the BCCR to become part of the money supply.

C. Role of the GOCR

The degree of success of the CODESA divestiture depends on the political will of the GOCR to proceed. As mentioned above, Article 55 of Law 6955 provides the legal basis for the divestiture. In addition to the Law, the Executive has issued a "Reglamento" and a Cabinet "Resolution" which provide further support for carrying out the process. (Attachment 4 contains translated copies of both documents.)

1. Law 6955 (Article 55)

This Law establishes the procedures under which CODESA can sell the shares it holds in its subsidiary companies. In theory, the process to be followed is straight forward and involves offering the stock in public bid and selling it to the highest bidder above an established minimum price.

Under the Law, two GOCR institutions are involved in the process: CODESA, which is charged with carrying out sales of stock, and the Office of the Controller General, which is responsible for establishing the minimum acceptable price for all stock to be offered in the bidding process.

Article 55 contains the following stipulations:

- Public utilities cannot be sold to private interests but must be transferred to another GOCR entity. This affects FECOSA and TRANSMESA which will be transferred to the Ministry of Transportation and Public Works. Also affected is the Corporación Zona Franca de Exportación which will be transferred to the Export Promotion Center (CENPRO).

- Only 40% of the shares of FERTICA and CEMPA can be sold to private interests.

- CATSA and Cementos del Valle must be sold to Costa Rican cooperatives.

Article 55 also stipulates that the GOCR is to receive 50% of the income from the sale of CODESA enterprises up to a maximum of ₡500 million. Although the law only refers to sales in 1984, the Mission believes the spirit of the law is for payment to be made whenever the enterprises are sold. Therefore, the transfer of this amount to the GOCR's general revenues is planned; payment, however, will be conditioned upon Mission review of the GOCR's performance and continued commitment to carry out the divestiture process.

2. Reglamento

A Reglamento has been issued by the Executive with the purpose of clearly describing the responsibilities of all parties to the process set out in Article 55 of Law 6955. In essence, the Reglamento, which is required by the Costa Rican legal system, provides the details for making the law operational.

3. Resolution

As a further indication of its commitment to the CODESA divestiture, President Monge's Cabinet has issued a resolution which supports the divestiture process.

In the resolution, the Cabinet has also established a three person Bipartisan Commission to be responsible for carrying out the divestiture of CODESA's subsidiaries, to facilitate the participation of the Controller General in the process, and generally to assure that all responsibilities under Article 55 and the resolution are being fulfilled. The Commission will be financed by AID with local currency resources and will have sufficient funding to hire special consultants to assist with technical problems as they arise.

Most important, the resolution establishes the following three policies that will guide the GOCR's efforts in the process: that CODESA must sell its enterprises immediately; that CODESA will not make new investments nor participate in the formation of new enterprises; and that CODESA will not contract new obligations or provide guarantees to finance investments.

D. A.I.D. Assistance

AID assistance to the divestiture process will consist of financial resources, both dollars and local currency, for technical assistance and for the purchase of the shares of CODESA subsidiaries when offered for sale in the public bid process. To minimize direct involvement and, therefore, public controversy related to AID's assistance, a private Trust will be created to buy the shares and take possession of the CODESA subsidiaries. The Trust will be a key to achieving rapid divestiture because, as a private entity, the transfer from public control will be accomplished once the Trust takes possession of a subsidiary. Subsequent resale or liquidation of an enterprise will not involve the public sector.

1. Dollar Assistance

In accordance with Article 55 of Law 6955, the Controller General must establish a minimum acceptable selling price for the shares of each CODESA subsidiary before it can be offered for sale through the public bid process. This is a highly technical procedure involving a full audit, valuation of assets (plant, equipment, stock) etc., which the Controller General staff cannot carry out because of limited personnel. Therefore, the Mission will finance consultant services (using PD&S funds) to assist the Controller General in this effort.

a\

In addition to the above assistance, it is expected that technical services will also be necessary to assist the National Commission and the Trust carry out their respective tasks. While some of these services will be available in Costa Rica, the need for consultants from the U.S. is also anticipated, and the Mission will provide necessary PD&S funds to finance those consultants.

2. Local Currency Assistance

Local currency will be provided under the Economic Stabilization and Recovery IV project. Up to $140 million equivalent has been programmed to cover: funding for the purchase of the shares of subsidiaries, costs associated with operating the Trust (including technical assistance and costs associated with operating enterprises while controlled by the Trust), payment to GOCR general revenues in accordance with Article 55 of Law 6955, and a severance fund for workers employed by CODESA subsidiaries. Section III A., below, discusses the flow of these resources.

3. The Trust Mechanism

As noted above, a private Trust will be created *inter alia* to provide AID with a mechanism for removing itself from direct participation in the divestiture process. The Trust will have the necessary technical capacity -- legal, financial, investment, management -- to deal with all phases of the divestiture process. The costs of operating the Trust will be financed with a portion of the $140 million local currency equivalent programmed under the ESR IV project.

The Trust will have two basic functions: (a) buying the shares of CODESA subsidiaries when they are offered for sale including, in the case of CATSA and Cementos del Valle where the Trust cannot buy shares because of the limitations of Article 55, providing necessary assistance (technical and financial) so that cooperatives that can purchase the shares are able to do so; and (b) after purchasing the shares, taking the responsibility for resale or liquidation of the enterprises.

For the time between purchase of shares and resale or liquidation, the Trust will be responsible for operating the respective enterprises. The length of time, complexity and cost of such operations will vary among the enterprises. For all but FERTICA, CEMPA, ALUNASA and CATSA, however, it is expected that such considerations will be minimal since several enterprises are already closed, others will move quickly to liquidation, and a few others may be operating at a profit and are expected to be resold quickly. Any cost incurred by the Trust during this period will be financed from the funds available to the Trust under ESR IV.

To prepare for the resale or liquidation of each enterprise, the Trust will be responsible for carrying out thorough evaluations that cover financial (assets and liabilities) and legal (claims from creditors and shareholders) matters, as well as assessing future operating potential as a viable private concern. The Trust will not have sufficient staff nor technical expertise in all areas associated with the analysis for resale or liquidation; therefore, resources (dollars and local currency) will be provided to contract the necessary consultant services.

E. The Process

A two track system has been developed for the planned assistance to the divestiture process. The first involves the sale of the shares of CODESA subsidiaries and the corresponding support provided to the Trust and the GOCR as the necessary legal and financial transactions are carried out. The second is the reduction of CODESA's debt by the BCCR.

1. Divestiture

As discussed above, the Controller General will be responsible for valuation of the assets of each CODESA subsidiary in order to establish the corresponding minimum acceptable price for the sale of shares. Once the minimum price has been set, CODESA and the Controller General will publish a notice of intent to sell and provide all interested parties with complete information on the respective enterprises, including the amount of the minimum acceptable bid for the shares.

Prior to the sale of each subsidiary, the CODESA holding company will assume all third party debt of the subsidiary, so that its entire debt will be consolidated with one creditor. As noted previously, consolidating all debt with one creditor is expected to facilitate the eventual sale of the subsidiary since the potential for claims by outside creditors will be eliminated.

To assume this debt, the CODESA holding company will receive the necessary credit from the BCCR. The BCCR has agreed to extend this credit because it will permit the consolidation of the holding company's debt with one creditor -- the BCCR. Subsequently, as the subsidiaries are sold to the Trust, proceeds from the sale will be transferred directly to the BCCR.

As the enterprises are offered for sale, the Trust will bid the minimum acceptable price and will draw on local currency made available under the program to pay for the purchase of the shares. Once it owns an enterprise, the Trust will move as quickly as possible to resell or liquidate as appropriate. Costs for operating the enterprises while owned by the Trust will be financed by ESR IV local currency available to the Trust. As an enterprise is sold or liquidated, the proceeds will go to the Trust to help cover its operating requirements. It is the Mission's preference that all funds remaining in the Trust when it is dissolved will be transferred to the BCCR and applied to remaining debt of the CODESA holding company.

2. Debt Reduction

The debt to be reduced by the divestiture process will be that of the CODESA holding company which is held by the BCCR. As discussed above,

97

the holding company will assume the third party debt of each subsidiary using ...t extended by the BCCR. Thus, the sole creditor of the subsidiaries will ... holding company which, in turn, will have the BCCR as its sole ...r. The BCCR, therefore, will be the ultimate creditor and, as it ...s resources received against the debt of the holding company it will, in ...ect, be reducing the subsidiaries' debt with the holding company.

The purchase price paid by the Trust for a subsidiary will go directly to the BCCR to be credited against the debt of that subsidiary with the CODESA holding company or otherwise used in accordance with Article 55. This will result in the reduction of the liabilities of the subsidiary now owned by the Trust. After a subsidiary is purchased by the Trust, any remaining liabilities of that subsidiary to the CODESA holding company will be paid off in its entirety by the Trust. Thus, when the Trust moves to resell the subsidiary, it will be more attractive to potential buyers because its debt will have been eliminated.

When the divestiture of the CODESA subsidiaries has been completed, the holding company will still have debt outstanding with the BCCR. The Mission is prepared to provide the resources to pay off that latter debt (with local currency equivalent which may be provided under the FY 1986 ESR program, and any remaining under the FY 1985 ESR program) if the GOCR takes the necessary steps to achieve the full structural change made possible by the divestiture process; i.e., to move toward the dissolution of the CODESA holding company. Until such time that the GOCR begins that process, the balance of the local currency will remain in the AID Special Account.

III. FINANCIAL ANALYSIS

A. <u>Flow of Local Currency Resources</u>

For each disbursement of dollars under the ESR IV project, the local currency equivalent will be deposited into the AID Special Account at the BCCR. As outlined in the Mission's PAAD, dollar disbursements will be tranched; therefore, local currency deposits will also be made on a tranched basis throughout 1985.

Several alternatives were considered by the Mission for the disbursement of local currency, including a single up-front payment to the BCCR, several tranches associated with major progress in achieving divestiture, and payment on a *pari pasu* basis when enterprises are put up for sale. The alternative finally selected is the latter.

When the Trust is established, an account will be created in the BCCR for its financial requirements. The Mission will transfer sufficient funds to the account to meet the initial operating requirements of the Trust, and subsequently will replenish the account based on cash needs. As

94

individual subsidiaries come up for sale, the Trust will request that the funds necessary for the purchase be transferred to its account immediately prior to the purchase date. This process will keep the local currency funds in the AID Special Account until they are needed by the Trust.

The purchase price paid by the Trust for each subsidiary will be transferred directly to the BCCR. As discussed above, the amount credited to CODESA may be less than the purchase price should AID agree to transfer some funds to GOCR general revenues.

As the Trust resells or liquidates an enterprise, the proceeds will be deposited in its account at the BCCR and used to cover operating costs of the Trust and to apply toward the purchase of enterprises put up for sale at a later date. At the end of the divestiture process, all remaining funds held by the Trust will be transferred to the BCCR and applied against CODESA debt.

B. Monetization Impact

A major objective of AID's assistance to the divestiture process is to minimize the monetary impact of the local currency equivalent established in conjunction with the AID assistance. The use of local currency to reduce CODESA's debt with the BCCR is a key to achieving that objective. Nonetheless, some monetization will occur as a result of the following activities:

- the possible transfer of up to ¢500 million to the GOCR's general revenues;

- operating costs of the Trust, including technical assistance organized and paid for by the Trust and working capital while enterprises are controlled by the Trust;

- severance pay for workers; and

- payment by the CODESA holding company to third party creditors of the CODESA subsidiaries as is planned in order to facilitate divestiture;

- operation of the bipartisan commission for the divestiture process.

IV. OUTPUTS

The specific outputs expected to be achieved as a result of AID assistance are related to the principal objectives established for the program:

- transfer of CODESA subsidiaries from public to private ownership;

- restructuring allocation of credit resources to private sector productive enterprises;

- reducing public sector debt; and
- minimizing the monetization of local currency.

As has been noted, funds available from the Mission's FY 1985 ESF program will not be sufficient to complete the divestiture process and to pay off the entire CODESA debt. Nonetheless, with resources that are available, it is expected that, by the end of 1985:

- The 11 smaller CODESA enterprises involved in the process will have been transferred to the Trust. This includes Cementos del Valle which, with assistance from the Trust, will have been transferred to a cooperative.
- Of these enterprises, the Trust will have sold or liquidated at least five.
- At least one of the four largest CODESA enterprises will have been transferred to the private sector. The most likely possiblity is CATSA which, with assistance from the Trust, will be sold to a cooperative. (FYI, such a cooperative is already in the formative stages.)
- For CEMPA and FERTICA, the 40% maximum the law permits to be sold will have been sold. Along with the 40% share of these enterprises, the GOCR has agreed that a long-term management contract will be given to the minority shareholder. Although this will not take the balance of the ownership out of the public sector, it will provide the potential for improved operation of the enterprises.

The Mission expects to continue providing support to the divestiture process in FY 1986 with the final objective of dissolving CODESA in the next GOCR administration. The possibility of leveraging FY 1986 funds to obtain changes in the law to permit the transfer of the remaining 60% of FERTICA and CEMPA to the private sector is one alternative that will be explored. The continued reduction of CODESA's debt is planned in FY 1986 through the flow of local currency committed by AID to the divestiture of the CODESA enterprises.

VI. CONDITIONS/COVENANTS

The ultimate achievement of the economic reforms and structural adjustements envisioned by this program will, in large part depend on two factors: tight monetary controls as CODESA debt is reduced, and CODESA not being in a position to continue using scarce credit resources. With this in mind, the Mission plans to condition its assistance on the GOCR's commitment:

- Not to expand public debt by the amount CODESA's debt is reduced; thus, all IMF ceilings, net of CODESA debt reduction, will be maintained; and
- Not to permit new investment guarantees or borrowing by CODESA.

96

ATTACHMENTS TO ANNEX III

ATTACHMENT 1 - Letter from President Luis Alberto Monge to Ambassador Curtin Winsor, Jr., dated October 5, 1984 1/

- Letter from President Luis Alberto Monge to Ambassador Curtin Winsor, Jr., dated February 6, 1985 1/

ATTACHMENT 2 - CODESA Consolidated Statement of Assets and Liabilities as of June 30, 1984

ATTACHMENT 3 - Article 55 of Law No. 6955 of March 2, 1984

ATTACHMENT 4 - Resolution Project of the Council of Government Pertaining to the CODESA Divestiture 1/

- Decree No. 16007-P-MEC of February 4, 1985, establishing the Reglamento for implementing Article 55 of Law No. 6955 1/

1/ Original Spanish language documents are available in Bulk Annex files of LAC/DR/CEN.

San José
October 5, 1984
Casa Presidencial, Santa Ana
2235/84

Mr. Curtin Winsor, Jr.
Ambassador of the United
States of America
San José

Dear Mr. Ambassador:

It is a pleasure to write to you at this time to propose to you some alternatives that could be considered within the economic assistance program of the North American Government which is administered by AID. There are two central axes in this proposal which look for permanent solutions to the economic problems of the country. The first is the improvement of institutional efficiency, and the second the creation and strengthening of an instrument that could guaranty the development of the agriculture vocation in Costa Rica.

Taking into consideration the urgency and necessity to resolve the problems created around the enterprises of CODESA, both those created for reasons of the entity itself as well as those of a financial order that affect the Central Bank of Costa Rica because of the indebtedness of the corporation and that have a direct repercussion in the entire process of national economic recovery, I consider it oportune to propose the following to you:

1. Direct an important part of the financial assistance resources to achieve a transaction that permits the application of those resources to the purchase of the CODESA enterprises, through a mechanism that permits the cancellation of the debt that burdens the Central Bank of Costa Rica and transfer to the private sector the installations of these enterprises, within existing legal regulations and taking advantage of the current political disposition.

2. The establishment of a Latinamerican School of Agriculture for the Humid Tropics, at the university level, that permits consolidation of the process and technology of production for the Costa Rican region of the Atlantic Slope and, at the same time, provides conditions similar to humid tropical zones in the majority of the countries of this continent.

To guaranty the success of these projects it will be of great importance to channel to them the colones generated by the macroeconomic assistance of AID. Permit me, Mr. Ambassador, to outline below some details about the real impact that both projects would have, thereby underlining the importance that is attributable to their immediate implementation.

98

1) CODESA Enterprises

If we achieve channelling all the local currency generated by AID donations during 1983 and 1984 to pay off the debt of CODESA with the Central Bank, we would save the State ₡1,000 million in interest annually, reduce the public debt by one third and assist our monetary policy aims. By not monetizing a very significant amount of colones, the inflationary process is effectively contained.

To assure the permanent effect of this action, CODESA will not undertake new investments and its access to new credit with the Central Bank or with the National Banking System will be limited. At the same time, we are studying some definitive economic solutions for the four remaining enterprises (CATSA, CEMPA, FERTICA and ALUNASA).

For the financial assistance to CODESA, we must base ourselves on what is stipulated in the Public Sector Financial Equalibrium Law. In such a manner, if this proposal were accepted, the first ₡500 million of assistance would be passed to the Central Government. Later, a reserve must be established to liquidate the labor liabilities of the enterprises that can be transferred to the private sector, leaving them the remainder of the CODESA debt with the Central Bank.

It would be interesting to study the possibility of the Private Investment Corporation, recently organized and financed by AID and the private commercial banks, receiving the CODESA enterprises. The Corporation could contract the valuation of the enterprises through an internationally recognized firm that under completely technical criteria, define their future, under the supposition that they must be passed to the private sector or dissolved as productive entities.

The Corporation would create a trust with the proceeds of the sale or liquidation of the enterprises and channel those resources exclusively for promoting the agricultural development of the country receiving no profit other than the normal commission of a trust. At all times whatever criticism of improper management or illicit enrichment must be avoided.

If this transaction can occur before January 1, 1985, it would maximize the reduction on the service on the public debt for the next year, which would noticeably improve public finances.

2) Latinamerica School of Agriculture for the Humid Tropics

One of the fundamental objectives of my Government and that has been proposed on many occasions is the democratization of the economy.

To be able to think in the achievement of this objective it is not only necessary to distribute the land and the riches it generates but also to maximize its productivity.

It is for the above reason that this second project is directed at the development of production technology for Costa Rica and other countries that permit development of small and medium scale agriculture with a high level of productivity.

This would permit raising the income level of small and medium farmers and, most of all, break the traditional framework of subsistence agriculture at one extreme and extensive agriculture at the other extreme.

The Latinamerican School of Agriculture for the Humid Tropics must be established to offer, on an annual basis, to about 400 young people from different countries the opportunity to "learn by doing"; to reach a professional level oriented toward creating productive activities and not just academics, living and studying close to the land in a center of studies at high academic levels. It will be necessary to institutionalize this effort through a foundation or private association that will be able to receive recognition as an International Mission. The Board of Directors and the teaching staff could be of multinational character, as is the case for all students assuming, however, that Costa Rica obtains an adequate representation in the teaching staff and the Director, as well as a student quota that satisfies the needs for our Humid Tropic region that are so important for the development of the country.

The financing of this project will require approximately $10 million for the purchase of land and the construction of the necessary installations, and $50 million for the creation of an endowment invested permanently in bonds of the Central Bank.

The total sum could coincide with AID's supplementary grant that I had the pleasure to sign with you on September 30, 1984.

This manner would permit the non-monetization of the majority of the grant, facilitating in that fashion maintaining ourselves within the established monetary policies.

I await your comprehensive and positive assistance to these initiatives so that we can undertake their implementation in as short a time possible.

Thanking you and AID for the positive collaboration that you have given us, I leave you with my consideration and esteem.

Cordially,

Luis Alberto Monge

100

Mr. Curtin Winsor, Jr.
Ambassador of the United States of America

Dear Mr. Ambassador:

I am happy to write to you again with respect to the project I referred to in my letter dated October 5, 1984, regarding the transfer of CODESA enterprises to the private sector.

With regard to FERTICA and CEMPA, there is a limitation imposed by the Legislative Assembly that authorizes CODESA to sell only 40% of the shares of those enterprises. In order to attract investors or possible purchasers of such a minority percentage, we considered it necessary to grant to the purchaser, for a reasonable period of time, the direction and administration of those enterprises in order to put them under net enterprise principles that both guarantee the least cost possible for the consumer, and take into consideration the national interest that those strategic enterprises have for the development of the country.

For that purpose, my Government commits itself to offer together with the correspondent requests for bids, autonomous management contracts which will permit the awardees of the 40% of FERTICA and CEMPA shares to direct and manage those enterprises, organizing them so as to be technically and economically profitable. Excepted, of course, will be the controls that the Government must retain to assure that it discharges its duty, and that the contractors strictly comply with their obligations.

I take this opportunity to reiterate the firm decision of my Government to carry out this project with the support of your distinguished Government, under the agreed terms.

Thanking you and A.I.D. for the positive collaboration that both continue giving us, I remain with the highest regard and esteem.

Cordially,

Luis Alberto Monge

BALANCE DE SITUACIÓN CONSOLIDADO

Al 30 de junio de [illegible]

(Miles de colones)

ACTIVOS

ACTIVO CIRCULANTE

Caja y bancos	33.851
Inversiones transitorias - Anexo #1	863.343
Cuentas por cobrar - Anexo #2	820.106
Estimación para cuentas dudosas	(21.612)
Documentos por cobrar - Anexo #3	697.778
Intereses por cobrar	36.446
Inventarios - Anexo #4	1.678.303
Gastos prepagados	10.694
Anticipos a terceros	32.091
Bonos CODESA AI 1980	36.357
TOTAL ACTIVO CIRCULANTE	3.[illegible].343

ACTIVO FIJO

Documentos por cobrar largo plazo - Anexo #3	1.879.942
Intereses por cobrar largo plazo	111.604
Inmuebles, maquinaria y equipo - Anexo #3	3.976.793
Depreciación acumulada - Anexo #3	(993.047)
Inversiones permanentes - Anexo #1	304.921
Estimación para valuación inversiones permanentes - Anexo #1	(29.898)
Bonos CODESA AI 1980	344.043
TOTAL ACTIVO FIJO	6.005.760

OTROS ACTIVOS

Gastos de organización y preoperación	300.304
Amortización acumulada	(101.264)
Denuncios mineros	1.000
Gastos diferidos sobre proyectos en estudio	36.320
Depósitos en garantía	9.093
Cultivos diferidos (neto)	86.[illegible]
Inmuebles, maquinaria y equipo para la venta - Nota #2	26.634
Cargos diferidos por revaluación de pasivos en US$ - Nota #3	307.087
Otros cargos diferidos	42.064
Semovientes	828
Excesos pagado sobre el valor por libros de los activos adquiridos	195.349
TOTAL OTROS ACTIVOS	1.005.074

TOTAL ACTIVOS 8.790.377

PASIVO Y PATRIMONIO

PASIVO CIRCULANTE

Cuentas por pagar	843.638
Documentos por pagar a Bancos del Exterior - Anexo #6	813.[illegible]
Documentos por pagar no bancarios al exterior - Anexo #7	606.173
Documentos por pagar a Bancos Nacionales - Anexo #8	879.437
Documentos por pagar no Bancarios Nacionales - Anexo #9	185.385
Bonos emitidos en poder del Banco Central - Anexo #10	1.[illegible].957
Impuestos por pagar	20.[illegible]
Depósitos a favor de terceros	4.[illegible]
Intereses por pagar	2.071.919
Aportes y retenciones por pagar	21.[illegible]
Gastos acumulados	32.[illegible]
TOTAL PASIVO CIRCULANTE	6.[illegible]

PASIVO A LARGO PLAZO

Documentos por pagar a Bancos del Exterior - Anexo #6	1.[illegible].313
Documentos por pagar no Bancarios al exterior - Anexo #7	134.[illegible]
Documentos por pagar a Bancos Nacionales - Anexo #8	1.636.[illegible]
Documentos por pagar no Bancarios Nacionales - Anexo #9	-
Bonos emitidos en poder del Banco Central - Anexo #10	[illegible]
TOTAL PASIVO A LARGO PLAZO	6.[illegible]

OTROS PASIVOS

Acumulaciones	[illegible]
Ingresos diferidos	2.[illegible]
TOTAL OTROS PASIVOS	[illegible]

TOTAL PASIVOS	13.[illegible]
Intereses minoritarios	[illegible]

PATRIMONIO

Capital acciones	[illegible]
Superávit aportado - Nota #4	[illegible]
Superávit por revaluación de activo fijo	[illegible]
Superávit donado	[illegible]
Utilidades o (pérdidas) acumuladas	(4.[illegible])
Utilidades o (pérdidas) del período	([illegible])
TOTAL PATRIMONIO	(4.[illegible])

TOTAL PASIVO Y PATRIMONIO 8.790.377

Cuentas de orden	1.169.325
Obligaciones contingentes	2.343.[illegible]

Lic. Walter Rodríguez [illegible]
Jefe Depto. de Contabilidad
y Presupuesto

102

CORPORACION COSTARRICENSE DE DESARROLLO

CODESA

ESTADO DE RESULTADOS CONSOLIDADO

Período: del 1° de octubre de 1983 al 30 de junio de 1984

(Miles de colones)

INGRESOS DE OPERACION	
Ventas	1.931.383
Servicios prestados	94.950
Intereses y comisiones subsidiarias no consolidadas	62.824
Intereses y comisiones de terceros	141.860
Total Ingresos de Operación	2.231.017
INGRESOS DE CAPITAL	
Intereses sobre bonos CODESA 4% 1980	47.758
Total Ingresos de Capital	47.758
TOTAL INGRESOS DE OPERACION	2.278.775
COSTOS Y GASTOS DE OPERACION	
Costo de los productos vendidos	1.723.178
Costo de los servicios prestados	35.595
Gastos de distribución y ventas	95.373
Gastos generales y de administración	167.603
Gastos financieros	1.170.507
Diferencias de cambio	35.692
Amortización de exceso de costo sobre el valor en libros	27.328
Amortización de gastos de organización y preoperación	20.453
Total Costos y Gastos de Operación	3.275.729
RESULTADOS DE OPERACION	(996.954)

../

.../
Estado de Resultados Consolidado

OTROS INGRESOS

Intereses y comisiones	7.347
Otras partidas	30.943
Ajustes a períodos anteriores	11.859
Otras partidas	120.975
Total Otros Ingresos	171.124

OTROS GASTOS

Ajuste a períodos anteriores	3.332
Otras partidas	85.952
Total Otros Gastos	89.284

Resultados antes Impuesto sobre la Renta	(915.114)
Impuesto sobre la Renta	-
Resultados antes partidas extraordinarias	(915.114)
Partidas extraordinarias	-
Resultados antes intereses minoritarios	(915.114)
Intereses minoritarios	8.984
RESULTADO NETO	(906.130)

105

CORPORACION COSTARRICENSE DE DESARROLLO
C O D E S A

ESTADO DE RESULTADOS CONSOLIDADO
PERIODO DEL 1° DE OCTUBRE DE [illegible] AL 30 DE JUNIO DE [illegible]
(Miles de Colones)

	CONSOLIDADO	AJUSTES Y ELIMINACIONES	TOTALES	CODESA	FERTILIZANTES DE CENTROAMERICA S. A.	CEMENTOS DEL PACIFICO S. A.	ALUMINIOS NACIONALES S. A.	CENTRAL AZUCARERA TEMPISQUE S. A.	ALGODONES DE COSTA RICA S. A.	TRANSPORTE FERRY [illegible] S. A.	[illegible] MARITIMO S. A.
INGRESOS DE OPERACION											
Ventas	1.931.383	-	1.931.383	-	830.718	349.066	306.187	343.412	-	-	-
Servicios prestados	84.938	-	84.938	-	36.332	-	-	-	39.392	9.226	-
Intereses y comisiones Subsidiarias Consolidadas	-	(113.084)[a]	113.084	113.084	-	-	-	-	-	-	-
Intereses y comisiones Subsidiarias no Consolidadas	62.824	-	62.824	50.584	-	-	-	-	12.240	-	-
Intereses y comisiones de terceros	141.880	-	141.880	[illegible]	-	-	-	-	2.298	-	3.007
TOTAL INGRESOS DE OPERACION	2.331.017	(113.084)	2.344.101	314.223	937.050	349.066	306.187	343.412	73.930	9.226	3.007
INGRESOS DE CAPITAL											
Intereses sobre Bonos CODESA al 1980	47.738	-	47.738	47.738	-	-	-	-	-	-	-
TOTAL INGRESOS DE CAPITAL	47.738	-	47.738	47.738	-	-	-	-	-	-	-
TOTAL INGRESOS	2.378.773	(113.084)	2.391.839	361.961	937.050	349.066	306.187	343.412	73.930	9.226	3.007
COSTOS Y GASTOS DE OPERACION											
Costo de los productos vendidos	1.723.178	-	1.723.178	-	847.036	234.814	327.848	230.541	43.139	-	-
Costo de los servicios prestados	35.595	-	35.595	-	18.469	-	-	-	10.226	6.900	-
Gastos de distribución y ventas	95.373	-	95.373	-	34.662	43.198	15.513	-	-	-	-
Gastos generales y de administración	167.603	3.398[c]	164.005	73.291	18.916	14.496	16.736	33.050	3.385	1.194	3.935
Gastos Financieros	1.170.507	(137.102)[c-b]	1.307.609	1.018.294	136.238	31.634	58.[illegible]	55.892	7.321	101	-
Diferencias de cambio	35.693	990[c]	34.702	29.834	-	1.376	2.533	939	-	-	-
Amortización de exceso de costo sobre valor en libros	37.328	37.338	-	-	-	-	-	-	-	-	-
Amortización gastos de organización y preoperación	20.433	-	20.433	-	-	10.939	6.770	3.744	-	-	-
TOTAL COSTOS Y GASTOS DE OPERACION	3.275.729	(105.184)	3.380.913	1.120.439	1.055.320	338.637	427.028	341.466	64.071	8.195	3.939
RESULTADO DE OPERACION	(896.956)	(7.898)	(989.054)	(774.658)	(88.270)	(9.391)	(120.841)	1.946	9.859	1.031	1.068
OTROS INGRESOS											
Certificados de abono tributario	7.347	-	7.347	-	-	-	7.347	-	-	-	-
Intereses y comisiones	30.943	-	30.943	-	8.154	682	8.202	13.905	-	-	-
Ajustes a periodos anteriores	11.839	-	11.839	3.624	-	-	1.288	6.947	-	-	-
Otros productos	120.975	-	120.975	11.309	63.440	19.213	10.783	12.833	108	289	-
TOTAL OTROS INGRESOS	171.124	-	171.124	14.933	72.594	19.895	27.620	33.685	108	289	-
OTROS GASTOS											
Ajustes a periodos anteriores	3.332	-	3.332	-	-	(332)	-	3.638	-	-	36
Otros gastos	85.952	-	85.952	1.392	69.733	3.914	5.878	2.300	2.315	-	-
TOTAL OTROS GASTOS	89.284	-	89.284	1.392	69.733	3.582	5.878	5.938	2.315	-	36
Resultado antes impuesto sobre la renta	(815.116)	(7.898)	(907.216)	(761.117)	(85.429)	6.922	(99.099)	31.693	7.452	1.320	1.062
Impuesto sobre la renta	-	-	-	-	-	-	-	-	-	-	-
Resultado antes partidas extraordinarias	(815.116)	-	-	-	-	-	-	-	-	-	-
Partidas extraordinarias	-	-	-	-	-	-	-	-	-	-	-
Resultado antes intereses minoritarios	8.984	8.984[a]	-	-	-	-	-	-	-	-	-
Intereses minoritarios											
RESULTADO NETO	(906.130)	1.086	(907.216)	(761.117)	(85.429)	6.922	(99.099)	31.693	7.452	1.320	1.062

CORPORACION COSTARRICENSE DE DESARROLLO

CODESA

ESTADO DEL COSTO DE LOS PRODUCTOS VENDIDOS

PERIODO DEL 1° DE OCTUBRE DE 1983 AL 30 DE JUNIO DE 1984

(Miles de Colones)

	TOTALES	CEMENTOS DEL PACIFICO S. A.	ALIMENTOS NACIONALES S.A.	FERTILIZANTES DE CENTROAMERICA S. A.	CENTRAL AZUCARERA TEMPISQUE S. A.	ALGODONES DE COSTA RICA S. A.
COSTO PRIMO						
Materiales Directos	891.377	100.709	56.758	547.508	177.048	9.354
Mano de Obra Directa	60.148	3.226	14.478	26.071	6.961	9.412
TOTAL COSTO PRIMO	951.525	103.935	71.236	573.579	184.009	18.766
CARGA FABRIL						
Materiales Indirectos	52.687	-	-	14.067	38.620	-
Mano de Obra Indirecta	91.131	23.168	-	66.973	-	990
Gastos Indirectos	551.638	89.307	255.286	155.750	27.912	23.383
Ajuste de Inventarios	-	-	-	-	-	-
TOTAL CARGA FABRIL	695.456	112.475	255.286	236.790	66.532	24.373
COSTO DE PRODUCCION	1.646.981	216.410	326.522	810.369	250.541	43.139
Más:						
Inventario Inicial Productos en Proceso	51.894	36.729	15.165	-	-	-
Menos:						
Inventario Final Productos en proceso	50.620	34.788	15.832	-	-	-
COSTO DE LOS ARTICULOS TERMINADOS	1.648.255	218.351	325.855	810.369	250.541	43.139
Más:						
Inventario inicial de los artículos terminados	461.270	8.391	66.999	385.880	-	-
Transferencia de los centros de producción	-	-	-	-	-	-
Costos de Exportación	18	18	-	-	-	-
Compras de Productos Terminados	38.208	38.208	-	-	-	-
Menos:						
Inventario final de los artículos terminados	423.759	9.340	65.206	349.213	-	-
Transferencias	-	-	-	-	-	-
Auto consumo	814	814	-	-	-	-
Traspaso a Ganancias y Pérdidas	-	-	-	-	-	-
COSTO DE LOS PRODUCTOS VENDIDOS	1.723.178	254.814	327.648	847.036	250.541	43.139

106

ATTACHMENT 2
Page 6 of 7

CODESA

BALANCE DE SITUACION CONSOLIDADO
AL 30 DE JUNIO DE [illegible]
(Miles de Colones)

	CONSOLIDADO	AJUSTES Y ELIMINACIONES	TOTALES	CODESA	FERTILIZANTES DE CENTROAMERICA S. A.	CEMENTOS DEL PACIFICO S. A.	ALUMINIOS NACIONALES S. A.	CENTRAL AZUCARERA TEMPISQUE S. A.	ALGODONES DE COSTA RICA S. A.	FLETAMIENTO MARITIMO S. A.
ACTIVO CIRCULANTE										
Caja y bancos	33.857	-	33.857	11.000	-	10.391	6.420	2.855	1.781	299
Inversiones transitorias	163.345	-	163.345	60.624	96.732	-	-	2.100	-	4.069
Documentos por cobrar	497.778	-	497.778	430.939	58.146	970	932	73	4.268	2.450
Cuentas por cobrar	820.160	(212.697)c	1.032.857	311.256	318.986	46.893	281.190	23.500	48.925	2.004
Estimación para cuentas dudosas	(21.612)	-	(21.612)	(13.199)	-	(737)	(7.099)	(225)	(258)	(94)
Intereses por cobrar	36.468	-	36.468	27.335	-	-	6.057	-	2.317	139
Inventarios	1.478.203	-	1.478.203	2.483	835.003	186.132	303.760	133.547	16.343	-
Gastos pagados por adelantado	10.696	-	10.696	677	2.376	2.137	233	5.042	170	10
[illegible]	32.091	-	32.091	3.167	-	11.712	-	17.213	-	-
Bonos CODESA al 1988	36.357	-	36.357	36.357	-	-	-	-	-	-
TOTAL ACTIVO CIRCULANTE	3.087.543	(212.697)	3.300.240	870.667	1.311.261	257.688	592.073	184.106	73.546	8.877
ACTIVO FIJO										
Cuentas por cobrar largo plazo	-	-	-	-	-	-	-	-	-	-
Documentos por cobrar largo plazo	1.879.942	(1.861.276)c	3.741.218	3.737.679	-	-	-	1.597	1.943	-
Intereses por cobrar largo plazo	111.604	(75.816)c	187.420	187.420	-	-	-	-	-	-
Inmuebles, maquinaria y equipo	2.876.793	-	2.876.793	27.199	865.473	646.127	476.448	953.708	42.083	413
Revaluación del activo fijo	-	-	-	-	-	-	-	-	-	-
Depreciación acumulada	(393.047)	-	(393.047)	(14.260)	(278.735)	(85.715)	(41.558)	(156.871)	(9.377)	(98)
Inversiones permanentes	304.931	(2.983.773)A-B	3.288.894	3.288.360	-	-	-	26	300	-
Estimación para valuación de inversiones permanentes	(29.098)	-	(29.098)	(29.098)	-	-	-	-	-	-
Bonos CODESA al 1988	144.443	-	144.443	144.443	-	-	-	-	-	-
TOTAL ACTIVO FIJO	4.895.760	(4.920.865)	9.816.623	7.341.931	586.738	560.412	434.890	798.460	34.949	315
OTROS ACTIVOS										
Gastos de organización y preoperación	300.304	-	300.304	-	15.931	145.833	91.200	43.250	4.042	-
Amortización acumulada	(101.264)	-	(101.264)	-	(5.880)	(43.949)	(22.920)	(24.384)	(4.042)	-
Documentos [illegible]	1.000	-	1.000	-	-	1.000	-	-	-	-
Costo diferido sobre proyectos en estudio	36.520	-	36.520	36.520	-	-	-	-	-	-
Depósitos en garantía	9.693	-	9.693	135	417	1.343	1.040	5.475	40	397
Subsidios diferidos (neto)	80.833	-	80.833	-	-	-	-	70.866	9.967	-
Inmuebles, maquinaria y equipo para la venta (neto)	26.636	-	26.636	5.166	-	-	-	-	21.470	-
Cargos diferidos por revaluación de pasivos	307.887	-	307.887	187.261	315.864	-	2.091	2.671	-	-
Otros cargos diferidos	42.068	-	42.068	-	20.045	4.095	17.928	-	[illegible]	-
[illegible]	828	-	828	-	-	828	-	-	-	-
Exceso pagado sobre el valor en libros de las acciones adquiridas	100.549	100.549 D-F	-	-	-	-	-	-	-	-
TOTAL OTROS ACTIVOS	805.054	100.549	704.505	229.082	346.378	108.172	89.877	97.886	31.477	397
TOTAL ACTIVO	8.788.377	(5.032.993)	13.821.370	8.441.700	2.044.377	927.282	1.116.840	1.080.550	139.971	9.789
Cuentas de orden	1.169.525	-	1.169.525	1.126.035	-	8.439	-	34.631	400	-
Obligaciones contingentes - Bono	2.365.013	(1.239.269)	3.604.282	3.604.282	-	-	-	-	-	-

-[illegible] al [illegible] 2,551,700
[illegible] 4,315,064

BALANCE DE SITUACION CONSOLIDADO
AL 30 DE JUNIO DE 1985.
(Miles de Colones)

	CONSOLIDADO	AJUSTES Y ELIMINACIONES	TOTALES	CODESA	FERTILIZANTES DE CENTROAMERICA S. A.	CEMENTOS DEL PACIFICO S. A.	ALUMINIOS NACIONALES S. A.	CENTRAL AZUCARERA TEMPISQUE S. A.	ALGODONES DE COSTA RICA S. A.	FLETAMENTO MARITIMO S. A.	INMOBILI. TEMPORA S. A.
[illegible]											
[illegible] por pagar	643.638	-	643.638	464.142	53.952	31.093	37.546	29.717	27.123	65	-
[illegible] por pagar a Bancos del Exterior	813.048	-	813.048	624.166	171.790	12.760	4.332	-	-	-	-
[illegible] por pagar en bancarios al Exterior	686.175	-	686.175	[illegible]	387.[illegible]	16.879	162.602	8.863	-	-	-
[illegible] por pagar Bancos Nacionales	829.427	-	829.427	667.374	-	80.670	48.816	86.377	24.962	-	-
[illegible] por pagar en bancarios nacionales	125.185	-	125.185	-	-	5.310	111.069	8.800	-	-	-
[illegible] en poder del Banco Central	3.208.557	-	3.208.557	3.208.557	-	-	-	-	-	-	-
[illegible] por pagar	33.761	-	33.761	-	-	14.338	8.210	-	10.992	-	-
[illegible] a favor de terceros	4.351	-	4.351	3.191	-	-	15	-	-	1.163	-
[illegible] por pagar	2.871.919	-	2.871.919	2.767.467	74.818	3.157	25.948	-	429	-	-
[illegible] por pagar	21.330	-	21.330	903	-	573	747	18.670	106	15	-
[illegible] acumulados	57.388	-	42.255	3.409	34.667	4.001	-	15.133	-	178	-
	-	-	-	-	-						
PASIVO CIRCULANTE	8.294.799	-	8.294.799	6.752.409	622.338	106.016	642.285	105.366	63.673	1.603	-
A LARGO PLAZO											
[illegible] y avances por pagar CODESA	-	(1.990.248) C	1.990.248	-	(822.238)	352.172	212.015	336.172	66.870	357	1.446
[illegible] por pagar CODESA	-	(228.299) C	228.299	-	(32.266)	15.583	14.903	160.727	3.096	-	-
[illegible] por pagar a Bancos del Exterior	1.201.515	-	1.201.515	[illegible]	317.[illegible]	-	17.216	8.349	-	-	-
[illegible] por pagar en bancarios al Exterior	154.248	49.328 C	104.920	[illegible]	-	[illegible]	-	16.628	-	-	-
[illegible] por pagar Bancos Nacionales	1.630.385	-	1.630.385	[illegible]	-	-	-	[illegible]	3.791	-	-
[illegible] por pagar en bancarios Nacionales	-	-	-	-	-	-	-	-	-	-	-
[illegible] en poder del Banco Central	1.994.704	-	1.994.704	1.[illegible]	-	-	-	-	-	-	-
PASIVO A LARGO PLAZO	4.980.842	(2.169.219)	7.150.061	4.470.324	1.172.335	444.809	244.134	761.830	53.557	357	1.446
[illegible]											
[illegible]	35.816	-	35.816	1.567	20.177	3.350	7.632	1.617	1.003	236	-
[illegible] diferidos	2.581	-	2.581	2.581	-	-	-	-	-	-	-
[illegible] PASIVOS	38.397	-	38.397	4.168	20.177	3.350	7.632	1.617	1.003	236	-
[illegible]	13.314.038	(2.169.219)	15.482.239	11.226.881	1.814.890	555.075	894.071	869.027	118.233	1.996	1.446
[illegible] minoritarios	24.566	24.566 A-B	-	-	-	-	-	-	-	-	-
[illegible]											
[illegible]	402.022	(328.783) A-B	730.805	402.020	6.650	200.000	65.800	10.000	32.435	50	50
[illegible] aportado	29.900	(1.528.159) A-B-D	1.558.059	33.190	811.431	339.195	252.868	281.380	1.973	1.745	35.916
[illegible] por revaluación activos fijos	6.653	(227.195) B-D	233.848	1.797	208.710	-	-	-	-	4.836	18.476
[illegible]	1.364	-	1.364	1.364	-	-	-	-	-	-	-
[illegible] o (pérdidas) acumuladas	(4.084.050)	(805.289) A-B-F	(3.278.767)	(2.462.435)	(501.884)	(173.910)	-	(111.570)	(20.122)	100	-
[illegible] o (pérdidas) del período	(909.130)	1.086	(907.216)	(761.117)	(95.428)	6.922	(99.099)	31.093	7.452	1.062	-
[illegible]	(4.550.247)	(2.868.340)	(1.661.907)	(2.783.181)	249.487	372.207	222.769	211.503	21.738	7.793	54.442
[illegible] Y PATRIMONIO	8.788.377	(5.012.993)	13.821.370	8.441.700	2.066.377	927.282	1.116.840	1.080.530	139.971	9.789	55.888
[illegible] de orden	1.169.525	-	1.169.525	1.128.055	-	8.439	-	34.631	400	-	-
[illegible] contingentes	2.365.813)	(1.238.269)	3.506.282	3.604.282	-	-	-	-	-	-	-

4,236,396

108

1. Article 55

CODESA is authorized sell the shares of its businesses, with prior agreement, in each case, of the Council of Government, in the form and conditions that the same establish in accordance with the following stipulations:

a) CODESA will be able to sell all of its shares of businesses created by public document, except those set forth in inserts h) and l).

b) The Controller General of the Republic will render a report about the sale of each business, to the Legislative Assembly at the latest 30 days after they are effectuated.

c) The sale of whatever shares referred to in this article will be done by public bid, except for those set forth in insert l), and the respective announcement must be approved before the sale by the Controller General within a period of 15 days.

ch) The bid will not be awarded if the offer is less than the value of the shares that the Controller General of the Republic must have established prior to the publication of the announcement, within a thirty day period.

d) Appeals of awards will be done before the Controller General of the Repüblic, in accordance with what is established in the Financial Administration Law of the Republic and in the Administrative Contracting Regulations. The Controller must resolve the appeal within two months.

e) In the sale of shares, all other conditions being equal, social organizations of workers will be given priority. The National Banking System will create preferential lines of credit, through a system that permits priority financing to such organizations as well as for those (bids made by) small national investors who want to acquire shares of the businesses of CODESA.

f) From the income that CODESA receives in 1984 from the sale of shares of its businesses, 50%, up to a maximum of ¢500,000,000, will be given as a special contribution to the Government of the Republic. These funds shall be incorporated in the budget of the Government.

109

The other 50% will go to CODESA to pay its obligations with the Banco Central.

g) Of the stock belonging to the State in the firms FERTICA and Cementos del Pacífico S.A., only 40% can be sold.

h) None of the businesses that develop whatever of the activities specified in Article 121, paragraph 14 of Political Constitution, may be reduced by any percentage. (Note: No sales of power companies, minerals, communications, railroads, docks, airports, etc.)

i) The National Banking System may finance small national investors and social organizations of workers in the purchase of the shares of CODESA.

j) In the purchase of the shares, no employees or staff members of CODESA, nor of its subsidiaries, may participate, unless it is a group of employees or workers of the same constituted as some kind of social organization of workers. The sale of shares referred to in this article will be subject to the prohibitions established in article 107 of the Financial Administration Law.

k) The shares belonging to CODESA in CATSA and Cementos del Valle, can be sold only to the national cooperative sector, according to a prior appraisal on the part of the Controller General of the Republic, and following the steps of a public bid.

2. <u>Article 56</u>

The Costa Rican Central Bank is authorized to finance CODESA the same average rate that CODESA has to pay during 1984 for loans granted before January 1, 1984. This financing will have the following characteristics:

a) Credit given to finance interest on loans granted to CODESA with external resources will use an interest rate equal to the weighted average of the interest on the original loans, with a grace period of three years.

b) Credit given to finance interest on loans given to CODESA with domestic funds will use an iterest rate equal to the weighted average on the original loans, with loans of a grace period of three years and a twenty year maturity

The Costa Rican Central Bank will demand the guarantees required for the loans hereby authorized.

3. Article 57

All the public institutions and enterprises that buy stocks or that carry out whatever other stock exchange operations, must do it through the post CODESA has in the National Stock Market. The State Banks are an exception to this stipulation.

\\\

CODESA

RESOLUTION PROJECT

COUNCIL OF THE GOVERNMENT

CONSIDERING:

I. That the law that created CODESA, No. 5122 dated November 16, 1973, establishes in Article 4 that the Corporation will have, among other objectives, the promotion of the economic development of the country by strengthening the Costa Rican private enterprises within the national system of a mixed economy.

II. That CODESA has mainly promoted and financed the creation of various industrial and service enterprises, using its own resources and public and private credit.

III. That CODESA, as well as its enterprises, is experiencing a serious financial situation as a result of the debts incurred by the corporation in order to establish and operate these enterprises, mainly since 1980.

IV. That CODESA's objective cannot be achieved if its resources are used in the operation of enterprises in deficit conditions and in the service of its accumulated debt, as well as because its credit requirements reduce the possibilities for the productive private sector.

V. That the Government is the major shareholder of CODESA and therefore of its enterprises, that the Government has supported CODESA's development with the purpose of strengthening its enterprises' projects and transferring them to the private sector.

VI. That it is in the public interest and for the strengthening of the Costa Rican private sector within the concept of a mixed economy, that CODESA now sell the shares of its enterprises and use the proceeds from these sales to decrease its debt with the public sector (Central Bank of Costa Rica, mainly).

VII. That the Legislative Assembly conferred on the Council of the Government the responsibility of selling the shares of CODESA enterprises by Law No. 6955 dated February 24, 1984 and authorized CODESA to carry out the sale with the specific concurrence of the Comptroller General of the Republic.

THEREFORE,

The Council of the Government, in accordance with Article 55 of the Financial Equilibrium Law for the Public Sector, No. 6955 dated February 24, 1984 and its Regulations,

112

AGREES:

ARTICLE 1: To establish the following policies for the current and future activities of CODESA, with the objective that CODESA and its enterprises must follow and strictly accept as entailing rules, with the concurrence of the Public Administration in general and particularly of the Comptroller General of the Republic and the Central Bank of Costa Rica:

a. CODESA must immediately sell its enterprises, in accordance with the provisions of this resolution.

b. CODESA must not incur new investments nor participate in the creation of new enterprises.

c. CODESA must not incur new obligations nor will provide guarantees to finance investments.

ARTICLE 2: 1985 was determined to be the year for the fulfillment of said commitments. Once this stage is complied the Council of the Government will make a decision regarding the future actions that must be taken with respect to the Costa Rican Development Corporation, S.A. (CODESA)

ARTICLE 3: In selling the shares of its enterprises, CODESA must accept the limitations and follow the procedures established in Article 55 of Law 6955 dated February 24, 1984, entitled "Financial Equilibrium Law of the Public Sector", and its Regulations.

ARTICLE 4: It is mandatory to sell the shares that CODESA owns in enterprises created by public document, with the following exceptions:

(a) The enterprises that exercise public functions directly related with the Government - Ferrocarriles de Costa Rica, S.A. (FECOSA); Transportes Metropolitanos, S.A. (TRANSMESA); and the CORPORACION DE LA ZONA FRANCA DE EXPORTACIONES, S.A. - will not be transferred nor sold to private firms. FECOSA and TRANSMESA will transfer all of their operations to the Ministry of Public Works and Transportation (MOPT), under the supervision and direction of MOPT, as inherent activities of its concern. The CORPORACION DE LA ZONA FRANCA DE EXPORTACIONES, S.A. will transfer all of its operations to the Centro para la Promoción de las Exportaciones y de las Inversiones (CENPRO), under the supervision and direction of CENPRO, as inherent activities of its concern. Once MOPT and CENPRO assume these operations, CODESA must dissolve and sell the three enterprises referred to in this paragraph.

(b) Of the Fertilizantes de Centroamérica, S.A. (FERTICA) and Cementos del Pacífico, S.A. (CEMPA) shares, CODESA will offer, through bidding, the sale of only 40% of the shares owned by it together with a long-term administrative contract.

113

ARTICLE 5: CODESA will immediately dissolve and sell the other enterprises whose shares have not been able to be sold through public bidding procedures, in the manner established in Chapter VIII and IX, Title I of the First Book of the Commercial Code. In the case of CEMPA and FERTICA, the Council of the Government will make the correspondent decision in each case.

ARTICLE 6: CODESA will give the proceeds from the sale of the assets of its enterprises the destination indicated in Article 55 of Law 6955 and its Regulations.

ARTICLE 7: A Commission is appointed and is composed of the following persons:

a) Mr. Claudio Volio Guardia, who will serve as President of the Commission,

b) Mr. Ricardo Echandi Zurcher,

c) Mr. German Serrano Pinto.

The three members will agree on the rules with respect to the operation of the Commission.

The Government institutions will provide the Commission with all the necessary support in doing its duties.

The purposes of that Commission will be the following:

(a) Be responsible, in the name of CODESA and by delegation, for the sale or disolution of CODESA's enterprises with the required power and in accordance with the applicable legal dispositions.

(b) To demand and watch over the strict and prompt fulfillment of the policy contained in this resolution and any other applicable conditions and inform the Council of the Government so that it can bring these matters to completion.

(c) Facilitate the intervention of the Comptroller General of the Republic as established in Article 55 of Law No. 6955 and its Regulations.

ARTICLE 8: The President will inform CODESA's Board of Directors about this resolution for their knowledge, implementation and strict fulfillment.

FIRM AGREEMENT

REGULATION PERTAINING TO ARTICLE 55 OF THE LAW No. 5569/84

February 4, 1985

DECREE No. 16007-P-MEC

The President of the Republic and the Ministers of the Presidency and of Economy and Commerce

CONSIDERING:

1. That by means of Law 6811 dated September 10, 1982, the Government's preoccupation to search for a solution to the difficult fiscal problem faced by the country materialized, for which, and in order to accomplish the international commitments incurred and with the additional purpose of avoiding the increase of the Government's deficit, the Legislative Assembly authorized the sale of the shares of CODESA enterprises, with the intention of solving this situation.

2. That notwithstanding that such disposition became a norm, the limitations imposed by that law on the Executive did not permit a practical solution to the problem.

3. That on the contrary, the same condition continues, the Central Government deficit persists and it is aggravated by among others, the high service costs of the accumulated debt of CODESA and its enterprises.

4. That the Law 6955 dated February 24, 1984, entitled "Financial Equilibrium Law for the Public Sector", searching for viable solutions to the problem aforementioned, again authorized CODESA to sell its enterprises' shares, establishing this time a procedure for such sale, within the same philosophy first mentioned.

5. That it is of public interest to establish regulations under Article 55 of the aforesaid law, No. 6955 dated February 24, 1984, in order to facilitate the prompt fulfillment of its objectives, that in the final analysis is to definitively put an end to the debts of CODESA and its enterprises with the Central Bank of Costa Rica.

THEREFORE,

Based on the power invested by Article 140, item 3) of the Constitution and same Law No. 6955 dated February 24, 1984,

IT IS DECREED

ARTICLE 1: The sale of the shares or, in any event, the dissolution and sale of the enterprises owned by the Costa Rican Development Corporation (CODESA) is declared to be of public interest.

ARTICLE 2: Once the Council of the Government agrees to sell the shares of the enterprises of CODESA, CODESA must, within the thirty days following request of the Comptroller General of the Republic, in accordance with Article 55 of Law 6955 dated February 24, 1984, an appraisal of the shares that will be sold. Complete information on this request must be attached, as well as the books and records where the accounting and financial situation of each enterprise is totally stated, in order to facilitate the prompt appraisal of the shares. Additionally, CODESA will immediately submit to the Comptroller General of the Republic all the additional information that the Comptroller requests.

ARTICLE 3: Once the appraisal of the shares is requested, CODESA will have a period which will not exceed the one indicated in Law 6955 dated February 24, 1984, for the Comptroller to render judgment, in order to prepare the public bid announcement(s), which must be immediately submitted to the Comptroller General of the Republic in accordance with the provisions of item c) of the aforementioned Article 55. These announcements will be published once in "La Gaceta" and during two consecutive days in the national press, at least in two of the newspapers with the greatest circulation. Between the publication date in "La Gaceta" and the opening date of the offers, there must be a period of no more than 30 working days and no less than 20 working days.

ARTICLE 4: Each announcement must include at least the following information:

(a) A description of the shares offered for sale, the percentage of the capital that they represent, and that they free and clear of all encumbrances. Also, CODESA must submit to the interested purchasers the financial statements of each enterprise that adequately show the assets and liabilities, as well as contingencies, and the operations of each one.

(b) The base price in colones over which CODESA will consider offers, not less than the appraised value established by the Comptroller.

(c) The date and time for the submission of the offers as well as for the bid opening which all interested parties may attend, in accordance with article 109 and subsequent articles of the Administrative Contracting Regulations.

(d) Location where the offers must be deposited or submitted, in a sealed and labeled envelope.

(e) Requirements that the offerers must fulfill, which must be clear and specific. Partial offers for shares of a one enterprise will not be accepted.

(f) The necessity of limiting the offers to the terms and conditions of the announcement, on penalty of eventual disqualification for reasons of public interest.

116

(g) The period of validity that the offers and guarantees must have, in accordance with article 45, 62 and 280 of the Administrative Contracting Regulations.

(h) Clear indication of the individuals or firms that cannot participate in the bid.

(i) Guaranty: The offerers must deposit with each proposal in the Central Bank of Costa Rica, a participation guaranty of 5% of the value of the offer, in cash or in any other value permited by article 61 of the Administrative Contracting Regulation. In order to guarrantee the execution of the private contract for the transfer of the shares, the awardee must submit a compliance guaranty of 5% of the amount of the award. The participation guaranty can be substituted for the compliance guaranty. If the awardee does not deposit in the Central Bank of Costa Rica the complete offered price in timely fashion, he will lose the compliance guaranty in favor of CODESA.

(j) The terms of payment, which must be made by certified check to the order of the Central Bank of Costa Rica, and which the awardee must deposit in the Central Bank of Costa Rica before the expiration of the term for signing the private contract for the transfer of the shares.

(k) Period of time to make the award, which must not exceed thirty working days.

(l) Perdio of time for execution of the private contract for the transfer of the shares, which must not exceed 30 working days. The purchaser will be responsible for the payment of all the costs involved in the transfer of the shares.

(m) Warning that the bid can only be declared invalid by reasonable resolution of CODESA.

ARTICLE 5: During the bidding process, CODESA will be responsible for maintaining in good condition all the goods and assets of the enterprises whose shares are being offered and will guarantee that the enterprises will not be exploited abusively and that it will not make available to itself goods and products which do not form a part of the usual and ordinary operation of the enterprise.

For the transfer of the shares, CODESA must give the purchaser all the official books, up to date, and financial statements of the enterprise, acceptable to the purchaser, the financial statements duly certified by public accountants from both parties, which adequately show all the assets and liabilities, as well as contingencies. In the case of irreconciliable discrepancies, the purchaser may refuse to sign the contract and demand the return of the guaranty, with damages, due to lack of fulfilment on the part of CODESA.

ARTICLE 6: In the bidding, priority will be given, all other circumstances being equal, to legally constituted social organizations of workers that have participated and complied with the respective announcement.

ARTICLE 7: Once the Council of the Government agrees on selling the shares of CODESA's enterprises, the banks of the National Banking System must create, in accordance with what the law establishes, preferential credit lines to make the participation of the social organizations possible, which must be made public within half the time allowed for the receipt of the offers.

ARTICLE 8: If the sale by bidding is unsuccessful, by virtue of the public interest to fulfill the aforementioned objectives and the commitments above indicated, CODESA will proceed in accordance with what the Council of the Government agrees.

ARTICLE 9: The proceeds CODESA obtains from the sale of the shares or assets of its enterprises, starting on January 1, 1985, will be assigned only and exclusively to the payment of its obligations with the Central Bank of Costa Rica. The Central Bank of Costa Rica will charge and credit to CODESA, the value of the checks deposited in the Central Bank of Costa Rica by each purchaser of shares, when the bank is informed in writing by CODESA that the respective contracts have been signed by both parties.

ARTICLE 10: The shares of the enterprises that exercise public functions directly related to the State - Ferrocarriles de Costa Rica, S.A. (FECOSA); Transportes Metropolitanos, S.A. (TRANSMESA); and the CORPORACION DE LA ZONA FRANCA DE EXPORTACIONES, S.A. - will not be transferred nor sold to private firms or individuals. FECOSA and TRANSMESA will transfer all of their operations to the Ministry of Public Works and Transportation (MOPT), under the supervision and direction of MOPT, as inherent activities of its concern. The CORPORACION DE LA ZONA FRANCA DE EXPORTACIONES, S.A. will transfer all of its operations to the Centro para la Promoción de las Exportaciones y de las Inversiones (CENPRO), under the supervision and direction of CENPRO, as inherent activities of its concern. Once MOPT and CENPRO assume these operations, CODESA will conduct the dissolution and liquidation of the enterprises referred to in this article.

ARTICLE 11: The provisions of this Regulation are of public interest, and the agreements taken by the Council of the Government in order to implement them will constitute an enabling directive for its execution, in accordance with the power invested to the Executive by the Fourth Title, First Chapter of the General Law of Public Administration.

ARTICLE 12: In force on the date of its publication.

Done in the Presidency of the Republic. San José, on the 1st day of the month of February of nineteen eighty five.

LUIS ALBERTO MONGE

The Minister of the Presidency	The Minister of Economy and Commerce
Danilo Jiménez Veiga	Odalier Villalobos Gonzalez