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

COSTA RICA

PROJECT PAPER

ECONOMIC STABILIZATION & RECOVERY VI

AID/LAC/P-373

Project Number: 515-0231
Grant Number: 515-K-608

UNCLASSIFIED

CLASSIFICATION:

AID 1120-1

AGENCY FOR INTERNATIONAL DEVELOPMENT

PAAD

PROGRAM ASSISTANCE APPROVAL DOCUMENT

1. PAAD NO: 515-0231- 515-K-608
2. COUNTRY: Costa Rica
3. CATEGORY: Cash Transfer
4. DATE: May 1987
5. TO: AA/LAC, Dwight Ink
6. OYB CHANGE NO.: N/A
7. FROM: LAC/DR, Terrence J. Brown
8. OYB INCREASE: TO BE TAKEN FROM: Economic Support Funds (ESF)
9. APPROVAL REQUESTED FOR COMMITMENT OF: $ 84,850,000.00
10. APPROPRIATION - LESA-87-35515-KG31 (737-75-515-00-50-71)
11. TYPE FUNDING: ☐ LOAN ☒ GRANT
12. LOCAL CURRENCY ARRANGEMENT: ☒ INFORMAL ☐ FORMAL ☐ NONE
13. ESTIMATED DELIVERY PERIOD: FY 1987
14. TRANSACTION ELIGIBILITY DATE:
15. COMMODITIES FINANCED

16. PERMITTED SOURCE		17. ESTIMATED SOURCE	
U.S. only:		U.S.:	$84,850,000
Limited F.W.:		Industrialized Countries:	
Free World:		Local:	
Cash:	$84,850,000	Other:	

18. SUMMARY DESCRIPTION

The purposes of the program are to provide balance of payments support to stabilization efforts in Costa Rica, and to encourage policy and structural changes aimed at re-establishing dynamic economic growth through increased exports. The $84,850,000 grant will be provided in two tranches as a cash transfers to a special Central Bank account to finance private sector imports from the United States of eligible raw materials, intermediate goods, construction materials, capital equipment, and spare parts. An amount in local currency equivalent to the grant will be deposited by the Central Bank in a separate special account to finance development activities for purposes specified in the PAAD. The $84,850,000 million authorized hereby will be subject to the Conditions, Covenants, and Special Provisions specified in Section IV.E of the PAAD.

With prior consultation with AA/LAC, the Mission is authorized to vary the disbursement plan contained in Section IV.C.2.b of the PAAD. The Central Bank of Costa Rica will provide the colon equivalent of each dollar disbursement at the highest rate of exchange not unlawful in Costa Rica on the date of the dollar disbursement.

19. CLEARANCES	DATE
LAC/DP: WWheeler (draft)	6/3/87
GC/LAC: GDavidson (draft)	6/2/87
LAC/CEN: CCostello (draft)	6/2/87
M/FM/CONT: CChristensen	6/29/87
PPC/EA: KKaufman (draft)	6/5/87
DAA/LAC: MButler	
~~ARA/ECP:WBarmon (draft)~~	6/10/87

20. ACTION: ☒ APPROVED ☐ DISAPPROVED

AUTHORIZED SIGNATURE: Malcolm Butler — DATE: 7/3/87

Dwight A. Ink
Assistant Administrator, Bureau for Latin America and the Caribbean

CLASSIFICATION:

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LIST OF ABBREVIATIONS

AID	Agency for International Development
BCCR	Central Bank of Costa Rica
CAAP	Private Agricultural and Agroindustrial Council
CACM	Central American Common Market
CBI	Caribbean Basin Initiative
CINDE	Costa Rican Coalition for Development Initiatives
CNP	National Production Council
CODESA	Costa Rican Development Corporation
ESF	Economic Support Funds
ESR	Economic Stabilization and Recovery
GDP	Gross Domestic Product
GOCR	Government of Costa Rica
IMF	International Monetary Fund
NHMB	National Housing Mortgage Bank
PAAD	Program Assistance Approval Document
PIE	Investment Promotion Program
SAL	(World Bank) Structural Adjustment Loan

I. SUMMARY AND RECOMMENDATIONS

A. Summary

This document requests authorization of $85.0 million in Economic Support Funds for the 1987 Economic Stabilization and Recovery VI program to be provided as a cash transfer to the Government of Costa Rica. This balance of payments assistance will be used to support the Costa Rican economic stabilization program by providing funds to finance the import from the U.S. of raw materials, spare parts, and intermediate and capital goods required by the Costa Rican productive private sector. The equivalent amount of local currency generated by these dollar funds will be used for activities consistent with U.S. development assistance strategy for Costa Rica such as extension of lines of credit to the private sector, housing, agribusiness development, promotion of non-traditional agricultural exports, privatization and education. Authorization to obligate immediately $83.7 is requested, with the final $1.3 million to be obligated upon LAC advice that reserves for the TCIP and CADO are no longer required. Disbursements are planned in two tranches based on the Costa Rican performance against the criteria and specific covenants described in Section IV.E.2 of this document.

B. Recommendations

1. That this PAAD be approved authorizing the $85.0 million ESR VI program and that initial obligation of a grant of $83.7 million in Economic Support Funds for Costa Rica be authorized, to be provided as a cash transfer.

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

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

II. BACKGROUND

A. Historical Conditions Through 1986

Costa Rica's deeply ingrained democratic traditions, respect for human rights and peaceful nature are well known. For a quarter century ending in the mid-seventies, Costa Rica appeared to be the model developing country, enjoying substantial economic growth rates while pursuing progressive social policies. Its Gross Domestic Product (GDP) grew by 7.0% per annum from 1966-1970, 6.0% per annum from 1971-1975, and 5.3% per annum from 1976-1980. Social development was as impressive as economic performance: adult literacy reached 90%, infant mortality declined sharply to under 20 per thousand, population growth dropped from 3.5% to 2.6 % per annum, and open unemployment and underemployment were held to 5% and 6% 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. Schools, health facilities, water and sewerage, roads, electricity, and communications facilities were widely distributed. Income distribution was quite equitable in comparison with most developing countries.

The progress during this period was financed by substantial public sector investment and a strong expansion of the Costa Rican economy 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 to supply the domestic market and the CACM under protectionist, import-substitution policies.

The structural problems inherent in this import-substitution growth model were not well appreciated. By the early 1970's, growth generated through the CACM slowed and the economy began to pay the hidden costs of overprotection. 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, financed by inflows of external private capital and by earnings generated from expanding traditional exports.

As CACM-generated growth slowed and the initial negative effects of an over protected economy were being felt, Costa Rica began to move away from a private sector market economy towards a state-administered economy as regards prices, wages, and control over production. The Costa Rica Development Corporation (CODESA) was established in 1972 to promote industrial development in cooperation with the private sector. The law which established CODESA allowed it direct access to Central Bank credit, which in turn permitted continued support to unprofitable enterprises. In addition, rather than "spinning off" its investments as originally intended, CODESA increasingly bought out private sector interests in joint enterprises. Thus, the 1970's saw the development of many inefficient state-owned businesses.

These state commercial enterprises, together with expansion of social services and public utilities, increased the public bureaucracy from about 6% of the labor force in 1950 to nearly 20% 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. The CACM, on which Costa Rica had depended so heavily, became a contracting and unreliable market. Thus, because the economic growth and development achievements of previous years had contributed to a false sense of invulnerability, Costa Rica was 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 (GOCR) engaged in substantial external borrowing to maintain a fixed exchange rate, to compensate for the fall in the value of exports, and to 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, 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% in 1981, and by 7.3% in 1982. Unemployment and underemployment rates rose by 1982 to 9% and 14% respectively. Inflation exceeded 100% by the end of 1981.

The economic crisis had a drastic impact on the standard of living of the average Costa Rican. Real wages declined strongly in 1981 and 1982; even after some recovery in 1983, they were at only 74% of the 1979 level.

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 policy which Costa Rica and most of its Central American neighbors 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 restructuring. 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.

The Monge administration began work on an economic stabilization program in July, 1982. It resumed partial payments of over $40 million on the external debt arrearage and successfully negotiated a one-year, $100 million IMF Standby in December of that same year. In addition, AID provided $175.7 million in ESF funds during the period 1982-83. With the balance of payments gap decreased by IMF and AID resources, Costa Rica was able to successfully conclude rescheduling agreements with the commercial banks and the Paris Club for official bilateral creditors to again become current on its external debt service. This, along with new loans from commercial banks, provided an additional $344 million in balance of payments assistance.

Costa Rica began to achieve further balance of payments improvement through the reduction of real incomes and aggregate demand. Nominal values of imports declined from $1,528 million in 1980 to $993 million (CIF) in 1983 and FOB exports declined from $1,001 million to $862 million for the same period. From 1980-1983, import volume declined by about 50% while export volume in 1983 was about the same as 1980 levels. Therefore, the monetary and fiscal restraint of 1982 and 1983 began to slow the previous strong declines in real income, compress imports and start Costa Rica's turn toward economic stabilization. Prices and exchange rates were also stabilized, while consumer and wholesale price indices were increasing at only 10.7% and 5.9% per annum respectively by the end of 1983.

The Costa Rican Central Bank also took steps to unify the exchange rate by eliminating the spread that existed in 1983 between the inter-bank and free market exchange rate. Further, the deficit of the non-financial public sector was reduced from a high of 14.3% of GDP in 1981 to 3.1% in 1983, attributable to cuts in expenditures, tax increases and to price increases mandated by the state for petroleum, public utilities and social security.

In 1984, GDP grew by 8% which was in marked contrast with the lower rates of both the previous and subsequent years (the 1983 GDP growth was 2.9% and in 1985 was 1.2%.) This overheated growth rate was brought about by stabilization of inflation and exchange rate depreciations, increased agricultural production and increases in domestic demand fueled by the monetary, fiscal and wage policies pursued in the second half of 1983. Manufacturing and construction also took strong upturns in 1984. On the negative side, however, expansionary domestic policies during the first part of the year, together with declining capital inflows led to a new liquidity crisis and additional debt servicing troubles. As a further complication, completion of negotiations with the IMF were also delayed. A standstill arrangement, whereby debt service payments to private banks were frozen in mid-year, the introduction of corrective fiscal actions, and the disbursement of $130 million in ESF funds helped tide Costa Rica over these liquidity difficulties.

Serious structural problems also persisted in 1984. Export growth was sluggish and Costa Rica was seriously constrained in its ability to service its foreign debt. Consumption was also not in line with lower real income levels as evidenced by an import driven $181 million trade deficit (by 1985), resulting from increased domestic demand associated with the restoration of stability and increased external assistance.

In response to deteriorating conditions, the GOCR reached a new agreement with the IMF in January 1985 for a 13 month Standby program beginning March 1985. The program was designed to hold the then current account deficit in the balance of payments to 9% of GDP in 1985 replenishing Central Bank net foreign reserve position by $60 million, decreasing Central Bank losses to 4.3% of GDP and the deficit of the non-financial public sector to 1.5% of GDP.

As a complement to this effort, the GOCR developed a medium-term adjustment strategy based on the belief that continued heavy reliance on traditional commodity exports and growth of manufacturing within the CACM framework was insufficient to sustain satisfactory growth. The revised strategy focused on: (1) developing new exports to markets outside the CACM; (2) strengthening private sector initiatives; and (3) reducing the size of the public sector. This strategy was supported by the World Bank which made available a $80 million Structural Adjustment Loan to help in reforming the trade regime, reduce the size of the public sector and, in a larger sense, aid in the restructuring of the economy.

AID under its ESR IV program provided $160 million to assist the GOCR in financing its 1985 stabilization and structural adjustment effort. In addition to the AID and World Bank resources, the IMF's Standby provided $30 million. External financing from Costa Rica's major donors in 1985 totalled $370 million in new monies. Commercial banks agreed to a new credit facility amounting to $75 million, and rescheduled 1985-86 principal obligations. To complete the package, agreement was reached with the Paris Club to reschedule principal and other interest on official bilateral debt falling due during 1985.

Costa Rica's economic performance during 1985 was mixed. Overall growth increased by a modest 1.2%, while inflation accelerated to 15%, reflecting an increase in real wages and exchange rate developments. Export performance was disappointing with a decline to the $930 million level due to decreased banana production, reduced sugar exports and a strong decrease in exports to the CACM. As a result, balance of payments deteriorated and a trade deficit accumulated to a $181 million total. Gross loan disbursements reached about $323 million or about 9% of GDP, in addition to official transfers of $176 million or about 5% of GDP. Despite these large inflows, Costa Rica built up external arrears of about $32 million by the end of the year.

Public finances also worsened in 1985 with the public sector deficit, including Central Bank losses, increasing from 6.6% in 1984 to about 9.5% in 1985. This was mainly due to an increase in Central Bank losses to 8% of GDP. This eroding of public sector finances was due to more expansionary wage and monetary policies than were specified under the IMF Standby program. Despite the size of the total 1985 balance of payments support ($600 million), four separate delays in obtaining approvals by the Legislative Assembly cast doubt on the fate of the program. Approval problems delayed foreign exchange inflows from the SAL and caused non-compliance on the arrearage reduction required for the Standby. A resulting revision of the Standby was completed in October 1985, delaying disbursement of $56.25 million in commercial bank credit until late November 1985 and hurting foreign exchange reserves.

The Arias administration took office in May of 1986 and soon confirmed its interest in continuing stabilization and economic adjustment measures. However, most significantly for 1986, the external debt payment arrears was allowed to grow, apparently as part of a negotiation strategy to obtain new relief arrangements with foreign commercial banks and governments. In addition, the growth of payment arrears was coupled with a lack of new arrangements with the IMF, foreign commercial banks and the Paris Club. The adjusted balance of payments gap for 1986 was $239 million which was financed by ESF and World Bank resources ($121 million) and through increased payment arrears ($165 million).

The GDP growth rate for 1986 is estimated at 3% reflecting zero growth in agricultural output, a 2.7% increase in manufacturing and a 9.4% growth rate for construction. The 3% rate was, however, substantially lower than the increase in real income of Costa Ricans which advanced by 5-6% in 1986 due to higher international prices for coffee and lower prices for petroleum. Also, the total public sector deficit amounted to 5.7% of GDP in 1986 as compared to 7.3% in 1985. This was mainly due to improved financial performance of the state enterprise sector though Central Bank losses (4.4% of GDP in 1986) continued to be a major drain on the economy. The largest element of Central Bank losses continued to be the interest paid out on the external debt contracted in the late 1970s to defend a fixed exchanged rate.

Export earnings increased in 1986 to $1,080 million due to a rise in coffee prices and due to the continued growth in non-traditional exports. Because of this, Costa Rica's trade deficit declined to $86 million.

B. Past ESR Objectives, Strategy and Status

1. Overview--Past ESR Program Rationale

The five previous ESF programs administered by AID, totalling $586.3 million (of which all but $40 million from the 1986 ESR V program have been disbursed), have played a decisive role in the progress toward stabilization and recovery described above.

ASSISTANCE UNDER ESR I-V ($000)

	FY	Signatory	Loan	Grant	Total
ESR I	1982	BCCR	$ 15,000	$ 5,000	$ 20,000
ESR II	1983	BCCR	118,000	37,735	155,735
ESR III	1984	BCCR	35,000	-	-
		GOCR	-	95,000	130,000
ESR IV	1985	BCCR	-	20,000	-
		GOCR	-	140,000	160,000
ESR V	1986	GOCR	-	120,582	120,582
TOTAL			$168,000	$418,317	$586,317

The ESR I and II programs were structured to support the 1983 IMF Stand-by Arrangement. The colon was stabilized, and substantial amounts of local currency credit were made available to the private sector via a new Central Bank credit line to the private banks. In addition, the GOCR developed "A Strategy for Export Promotion and Investment", which is currently being implemented with A.I.D. support.

The ESR III program continued the effort to consolidate the stabilization of the economy, but also reflected a shift towards greater emphasis by AID on structural reform. The Mission's priorities under ESR III included:

(1) Improvements in the system for financial intermediation, including credit, interest rates, the role of the private banking system, and exchange rate policy; 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.

The Mission's policy dialogue associated with ESR III disbursements resulted in significant revisions in the Monetary Law of Costa Rica (Ley de la Moneda) and in 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 which was much lower than the market rate. (The risk to lenders that their loans might be repaid at substantially less than their foreign currency value made it impossible for Costa Rican private financial institutions to make hard currency loans.) The modification to the Organic Law of the Central Bank permitted the BCCR to discount (i.e. loan) funds, financed from external sources, directly to private sector banks. Before this policy change, private banks could not obtain loanable funds through the Central Bank. Thus, this change significantly increased the competitiveness of the banking system in Costa Rica.

The ESR III agreement included major conditions with respect to credit and interest rates in an effort to simplify and rationalize the Central Bank's management of credit. Limits were imposed on subsidized credit for 1984; all other credit operations undertaken by the banking system were required to be made at real positive interest rates. In dialogue with the Mission, the BCCR continued its transition, begun under earlier ESR programs, away from administratively controlled credit allocations, and toward market allocation. The local currency equivalent of $25 million was channelled through the Special Credit Line for the productive private sector.

In ESR IV, the centerpiece of the Mission's strategic agenda was to promote the privatization of the various companies owned by the Costa Rican Development Corporation (CODESA). This process was driven by parallel objectives: (1) to reduce, and possibly eliminate, inefficient public sector participation in commercial enterprises; and (2) to reduce the burden of Central Bank debt accumulated over the years by CODESA operations and losses. Achievement of these objectives will decrease public sector demand for credit, thereby freeing resources for the economically productive private sector. The privatization process also included a further objective: to limit the monetization of local currency made available under ESR programs. (The Mission's privatization program is on going and is further described in Section II.B.3. and Annex III.)

Other objectives of the ESR IV program included enhanced economic stability through lower inflation and a realistic exchange rate policy managed through a series of mini-devaluations. The Mission also continued its focus on a strenghened role for the private sector in achieving sustained growth, most significally by adding to the Special Credit Line to meet the financial needs of private industry and business. Also, efforts were initiated to develop a strategy to increase the contribution of non-traditional exports to non-CACM markets to long-term economic growth.

The ESR V program of $120.6 million initially focused on consolidating the progress made over the previous years, with particular emphasis on the CODESA divestiture process, and on supporting the Arias administration as it picked up responsibility for implementing a sound stabilization program. Under these conditions, an initial disbursement of $40.6 million was made shortly after the Arias administration took office in May, 1986.

However, it soon became clear that the new administration would require considerable time to come to an agreement with the IMF on the terms and conditions for a new Standby. In the absence of one of the principal players supporting the GOCR's stabilization program, therefore, it became necessary to rethink and strengthen the ESR V conditionality with a stronger orientation toward macroeconomic concerns. In consultation with AID/W, the following priority areas were identified for the balance of the ESR V program:

(1) A public expenditure program aimed at reducing the non-financial public sector deficit to 1.3% of GDP by the end of 1986.

(2) Closure of the foreign exchange gap with a program that maintained external credit worthiness, with a specific target of arrearages no higher than $105 million at year end 1986.

(3) A banking system credit program geared to the continued reduction of inflation.

(4) Interest rate policies aimed at clearing credit markets with positive real rates of interest.

(5) An exchange rate and trade regime which maintained a unitary exchange rate without an import license or other control system.

It is significant to note that this explicit macroeconomic conditionality represented a new thrust for AID's balance of payments program in Costa Rica. As is discussed elsewhere in this paper, over the last several years other institutions, particularly the

IMF, the IBRD and the commercial banks, have been working together closely in the context of formal agreements with the GOCR to achieve economic stabilization and recovery through appropriate conditionality. AID has played a supportive role by negotiating conditions related to certain complementary structural adjustment issues (e.g. appropriate credit policies, reform of the banking sector, investment promotion and the CODESA divestiture initiative), and through the regular disbursement of foreign exchange to keep import and production levels up and encourage continued dollar flows from other sources.

The conditionality for ESR V was altered twice, once in September and again in December, 1986. The GOCR, however, still agreed to meet the previously specified arrears and non-financial public sector reduction targets by the end of 1986. On that basis a second disbursement of $40 million was made in September. AID and the GOCR also agreed that the disbursement of the final $40 million would be made upon adoption by the GOCR of an acceptable comprehensive economic/financial plan. Such a plan was finalized in late April 1987, and it is anticipated that disbursement of the remaining $40 million tranche will occur by mid-May 1987.

Data available to the Mission indicate that the GOCR failed to comply with the end of 1986 arrearage and non-financial public sector reduction targets. Arrearages amounted to $198 million at year end 1986 as compared to the target level of $105 million. Even after excluding the Revolver Credit Facility, the end of 1986 arrearage level was $148 million. On the second target, the GOCR promised to hold the maximum non-financial public sector deficit to 1.3% of GDP. The first full year data made available in January, 1987, indicated GOCR compliance at the 1.3% level. However, IMF data from March 1987 indicated the level to be 1.5%, and GOCR data from April indicate the level to be 1.8%.

Except for the targets on the non-financial public sector deficit and the growth in external payment arrears, performance on other macro-conditionality elements under ESR V was satisfactory. The total public sector deficit amounted to 5.7% of GDP in 1986 as compared to 7.3% in 1985. This was due mainly to improved financial performance of the state enterprise sector as the central government deficit increased from 2.0% to 3.2% of GDP. Turning to monetary performance, the inflation rate moved up marginally from 11% in 1985 to 15% in 1986, but with banking system net domestic credit increasing by only 16% in 1986 and credit to the public sector increasing by only 4%. In addition, data for the first three quarters of 1986 indicate that the ratio of subsidized credit from the state banks to total credit to the private sector was held below 15% of total banking credit in 1986. Interest rates in banking system and organized credit markets remained generally above 20% on deposits with lending rates ranging from 23 to 35%, i.e. at positive real rates during 1986. The Central Bank also maintained a unified exchange rate during 1986 undertaking 17 minidevaluations which depreciated the dollar-colon exchange rate by 9.8% during the year. For more details see Annex II.

2. Key Conditionality Concepts

An important concept which appears throughout the preceding section is the importance of having the various institutions involved in the GOCR's stabilization program (e.g., the IMF, World Bank and the commercial banks) working in concert to achieve the successful implementation of the program. It has been recognized from the outset that efforts, while not directly tied together, need to be complementary or, as in the case of ESR V, flexible enough to fill in with critical conditionality in the absence of other participants in the program. Past experience in this regard has been positive and a major factor in the success achieved to date. Coordination with these institutions, therefore, will continue to be an ingredient for the future success of the program.

The discussion in the preceding section also documents several key conditionality items, which, over the years have been important elements of the Mission's ESR program. Of these, the Mission believes that those related to the exchange rate, credit allocation and subsidies, interest rates and the financial sector merit continued emphasis because of their potential role in the transition from a stabilization orientation to one which focuses on establishing the basis for a sustained, long term growth.

The unification of the "free" and interbank exchange rates in 1983 and the existing policy of mini-devaluations to make periodic adjustments have created a value of the colon more or less in equilibrium with the currencies of Costa Rica's trading partners. The effect of this policy is to force Costa Rican producers to compete in domestic and external markets on real terms. This has promoted increased efficiency in production and, in foreign markets, has placed a competitive value on Costa Rican goods. In view of the strategy to strengthen the role of the private sector in achieving sustained growth, a "real" value of the local currency and, therefore, production costs provides an incentive to the private sector as well as the confidence to take the risks associated with the production process. Thus, even though there is no reason to believe that the GOCR intends to deviate from the current strategy, conditionality on the exchange rate regime will be maintained.

In terms of credit allocation, the GOCR -- encouraged by Mission policy dialogue -- has taken significant steps to eliminate the detailed process which existed in prior years. Under the terms of the 1987 credit program of the BCCR, all credit allocation will be market driven. To consolidate the progress this final step represents, the

Mission will include a covenant requiring that the 1987 BCCR credit program be fully implemented.

Although progress on subsidized credit has not proceeded as far as on allocations, the general availability of subsidized credit has decreased over the past few years. Building on earlier covenants which have contributed to this process, the Mission will include a covenant to restrict the total amount of subsidized credit available to the private sector through the BCCR and the banking system (see Section IV.E.).

Encouraged by the Mission's policy dialogue, the BCCR has for the past three years moved away from setting interest rates for the banking system toward a system of allowing market forces to have a larger role in the determination of interest rates both for depositors and borrowers. This process was culminated in July, 1986, when the BCCR enacted new measures under which, beginning August 1, 1986, all banks were free to set interest rates on non-subsidized loans according to supply and demand. Thus, for ESR VI the Mission proposes to reinforce the Central Bank policy of allowing market forces to determine banking system interest rates in 1987 and 1988 and require that the BCCR supply the Mission with reports to monitor progress.

The liberalization of interest rate policies has been complemented by other efforts of the Mission to strengthen the private banking system in Costa Rica. The new Monetary Law of 1984 and the changes in the BCCR law to allow private banks to access BCCR rediscount lines are the most noteworthy achievements. In addition, the increase in credit available to the private banks under the Special Credit Line has served to strengthen their capital base and their ability to respond to the demands of the productive private sector. Mission efforts in the financial sector are evolving to complement and build upon these changes as well as those on interest rate policy and credit allocation in order to lead to increased banking efficiency and an improved competitive position of the private banks.

3. <u>Divestiture and Privatization</u>

In 1985, the centerpiece of the Mission's strategic agenda under ESR IV was to begin the divestiture and privatization of subsidiaries and affiliates of the Costa Rican Development Corporation (CODESA). The objectives of the process were (1) to reduce or eliminate inefficient public sector participation in commercial enterprises and (2) to reduce Central Bank debt accumulated over the years by CODESA investments, operations, and losses. Achievement of these objectives would decrease public sector deficits and credit demand, thereby freeing resources for more economic and productive use by the private sector. The process was designed to further an additional objective: to limit the monetization of local currency made available under the ESR programs.

History. The GOCR created CODESA in 1972 to serve as a development bank and venture capital partner, cooperating with the private sector to bring new businesses into existence. According to its original conception, CODESA was intended to play a short-term role in each enterprise. Its investments were expected to be turned over to the private sector when the enterprises became financially viable.

In actual experience, however, the reverse occurred: CODESA has taken a permanent majority or sole ownership position in many enterprises ("subsidiaries"), as well as acquiring significant minority ownership of other businesses ("affiliates"). The public sector has thus become responsible for ownership, operation, and management of a diverse range of commercial activities such as aluminum milling, cement production, sugar refining, cotton processing, woodworking, tuna fishing, and others.

Non-commercial and non-economic factors often characterized the management and staffing of CODESA subsidiaries. Excessive initial costs and inefficient operations generated substantial financial losses over the years. To keep its enterprises functioning, CODESA repeatedly drew on Central Bank credit. CODESA's borrowings increased five-fold from 1979 to 1985, absorbing on the average one-third of all credit available to the public sector.

By mid-1985, CODESA had accumulated debt at the Central Bank of some 11 billion colones. Calculated at a prevailing rate of about 25%, interest on this debt represented a drain on the economy of about 2.75 billion colones ($50 million) per year.

Despite the magnitude of the resources CODESA was consuming, its subsidiaries were providing in 1983, for example, only 2,122 jobs (0.3% of the work force) and producing only 1.1% of GDP.

The administration of Luis Alberto Monge (elected in 1982) began, with AID support, to address the CODESA problem. CODESA debt was consolidated and limits were placed on CODESA's access to BCCR credit. The legislature passed a Financial Equilibrium Law in 1984 which provided the legal mandate and procedures for the sale of CODESA's subsidiaries and affiliates by public bid. The law stipulated that some subsidiaries, such as a railroad and a bus company, would be treated as "public utilities" and transferred to other government entities. Another stipulation provided that shares of a sugar refining plant and a cement company could only be sold to cooperatives. Still another placed a 40% limit on the number of shares of a fertilizer plant and a cement company that could be sold to private interests.

Subsequently, the Cabinet issued regulations with further guidelines for the process. A significant provision was that proceeds from the sale of subsidiaries should be used to reduce CODESA's consolidated debt with the Central Bank.

Participating Agencies. Divestiture was to be carried out under the direction of a National Commission for the Restructuring of CODESA, established by the Cabinet in February, 1985. Its three prominent members were given powers to assist in bringing the divestiture process to a conclusion.

The National Commission was instructed to put CODESA's shares of its subsidiaries and affiliates up for public bid. The minimum sale price for each company was to be established by the Controller General of the Republic, an independent official who reports, not to the President, but to the legislature.

In September, 1985, a private sector Trust was established (1) to bid on CODESA subsidiaries put up for sale by the National Commission, (2) to take actions as necessary to prepare each subsidiary for resale to private purchasers or undertake liquidation, and (3) to carry out such resale or liquidation. The Trust was intended as a mechanism to advance the process of moving subsidiaries out of CODESA, particularly in cases where problems might exist in concluding a prompt sale to an ultimate commercial purchaser. The Trust's operations are funded by local currency generated under the ESR programs.

Five prominent Costa Rican businessmen are serving as Trustees. Recognizing the complexity of preparing subsidiaries for resale and then marketing them effectively, the Mission contracted with Price Waterhouse, First Boston, and International Resource Group to provide expert technical assistance to Trustees when needed. They began work in November, 1985, shortly before the first CODESA subsidiary (ALUNASA, an aluminum milling concern) was put up for public bid by the National Commission.

AID Resources and "Demonetization". In September of 1985, the Missions signed a Memorandum of Understanding with the GOCR which provided an initial installment of ESF-generated local currency equivalent to $140 million to be used to (1) fund purchases of subsidiaries from CODESA by the private sector Trust, or (2) directly offset CODESA's BCCR debt.

The Mission plans to add the equivalent of another $50 million to this program, drawn from local currency generated by 1986 and 1987 ESF grants (see Section IV.D.3 below). This total, equivalent to $190 million, represents a sizable reduction of the $240 million estimated in the 1986 PAAD. The amount presently projected would be sufficient to cover the majority of CODESA losses and debt, but would leave a substantial portion (perhaps $30-40 million equivalent) which the GOCR would have to cover.

These local currency earmarks must be viewed in the light of the "demonetization" objective of the divestiture process.

The collapse of the Costa Rican economy in the early 1980's involved not only shortages of foreign exchange, but also excessive GOCR fiscal deficits and high inflation rates. Infusion of ESF dollars has addressed the foreign exchange problem, while the local currency provided by the GOCR under its ESR agreements has been managed so as not to exacerbate the deficit and inflation problems, or fuel excessive import demand. Specifically, it has been borne in mind that each additional colon spent under ESR programs has an impact on the domestic deficit, and also tends to fuel inflation and import demand by increasing the domestic money supply. Thus, all decisions about uses of ESR local currency funds require a careful weighing of these factors.

By 1984-1985, U.S. dollar assistance to Costa Rica had reached levels at which monetization (i.e. spending) of the full amount of local currency provided under each year's ESR agreement could not be permitted during that year without unacceptable consequences to the economy. Therefore, it was agreed with the IMF that limits would be placed on the annual monetization of colones generated under ESR III and IV. In 1984, no more than $60 million (out of a total ESR grant of $90 million) was to be monetized. The monetization limit for 1985 was equivalent to $80 million (as against a total ESR grant of $160 million).

These concerns remain equally applicable to the ESR programs for 1986 and 1987, and are fundamental to the design of the CODESA divestiture process. When ESR counterpart funds are used to reduce CODESA debt at the Central Bank, these funds are not monetized: only a book transaction occurs, in which parallel reductions are made in the ESR Special Account and in the CODESA debt account. (Exactly the same result occurs whether the reduction of CODESA debt is accomplished by a direct transfer of local currency to the Central Bank, or whether it is achieved through the intermediate step of "buying" a CODESA subsidiary with a local currency "purchase price" which is immediately transferred to the Central Bank to reduce CODESA debt.) The process makes it possible to take advantage of the political leverage of these local currency funds without the fiscal, inflationary, and import-expansion consequences of having them infused into the money economy.

Experience to Date. The divestiture of ALUNASA (an aluminum mill) at the end of 1985 highlighted a structural problem in the original design of the divestiture process. When the Costa Rican Controller General valued the assets of ALUNASA, the minimum bid price he settled on reflected political rather than market considerations. His "adjusted book value" methodology produced a fair estimate of ALUNASA's cost to the country; however, its value to a potential buyer as an economically productive unit was far less than what the country had paid for it. No commercial purchaser would pay more than a fraction of the Controller's price tag.

Bearing in mind the demonetization objective of the process, the private sector Trust was given sufficient local currency to "buy" ALUNASA at the Controller General's price even though it expected to resell the company to a private operator at a much lower price. From a cash flow point of view, it made no difference whether these funds were applied directly to a reduction of the Central Bank's loan balance to CODESA, or whether the same thing was accomplished through the intermediary step of "buying" a CODESA subsidiary at an inflated price.

Despite its acknowledgment of the logic of the above approach, AID/W instructed the Mission to find another mechanism which would avoid the appearance of AID "buying high and selling low".

The Controller General (who is not subject to the direction of the President), has refused to alter his valuation methodology. However, a possible solution to the problem has been reached which could resolve the impasse. From time to time, funds from the AID Special Account would be transferred to the BCCR for the direct reduction of CODESA debt balances, and, in return, the Controller General would agree to permit the sale of subsidiaries at prices below his valuation, as long as the cumulative total of the direct debt-reduction payments is great enough to cover the cumulative difference between the his valuations and the actual sale prices of subsidiaries.

CODESA's sale of ALUNASA to the private sector Trust was concluded at the beginning of 1986. The sale price was transferred to the BCCR to reduce CODESA debt. In line with a covenant of ESR IV, the GOCR's ceiling on public sector credit was reduced by an equivalent amount. By 1988 when all local currency funds are disbursed for CODESA, the impact on the Central Banks financial position will be (1) the recoopment of $190 million in bad debts to CODESA , which, although not officially written off, represent an actual cash flow loss and (2) an annual interest savings equivalent to approximately $38 million.

Because of excess production capacity in a depressed world aluminum market, the private sector Trust has had difficulty in finding a satisfactory buyer for ALUNASA. After a world-wide marketing effort carried out by First Boston, an acceptable bid was received from a group of Costa Rican and U.S. investors. Negotiations with this group have been delayed because of problems between the partners. If these problems are not resolved soon, the Trust will either repeat the marketing process a second time, or liquidate ALUNASA. In the meantime, the Trust has reduced ALUNASA payroll and operational losses to a minimum.

After protracted negotiations, the stock of Atunes de Costa Rica (a tuna fishing company) was sold to the private sector Trust in early 1987. The Trust expects to complete the resale of Atunes assets to private operators by June, 1987.

Four substantial companies have been moved out of CODESA to other GOCR agencies, in accordance with the divestiture statute: FECOSA (a railroad), TRANSMESA (a bus company), the Free Zone Corporation, and MINASA (grantor of mining concessions). The GOCR is absorbing the losses and debts of these companies through bond issues which will probably be equivalent to about $15 million.

CODESA management is proceeding with the disposal of numerous smaller corporations without any involvement from AID or the private sector Trust. Likewise, headquarters staff levels have been significantly reduced.

In recent years, CODESA has had forty-two subsidiaries and affiliates (many of them now inactive, with negligible assets). As of April 1, 1987:

-- 6 have been sold to private owners;

-- 4 have been dissolved and liquidated;

-- 16 are in the process of liquidation;

-- 6 have been transferred to other GOCR agencies;

-- Decisions are pending to sell or liquidate another 8, including several sizable corporations -- ALCORSA (cotton), CATSA (sugar), CEMVASA (cement), and 40% of FERTICA (fertilizer) and CEMPASA (cement);

-- 2 small interests (CODESA's seat on, and shares in, the national securities exchange) are being retained for possible transfer to a successor organization.

Annex III contains a detailed status report on CODESA companies, together with an action plan for the remaining major subsidiaries which has been agreed to among the Mission, CODESA, the private sector Trust, and the National Commission. Presentation of this action plan to the Cabinet for its approval is pending.

The level of progress has been much more satisfactory during the past year than during the preceding period, largely due to President Arias' appointment of new CODESA management which combines competence with a serious commitment to expediting divestiture.

The Fate of the Holding Company. In compliance with a covenant in ESR V, the National Commission presented to the Cabinet, on November 30, 1986, a study which recommended dissolution of the CODESA holding company and creation of a small successor organization which would have a limited development banking function, but which would be precluded by statute from owning equity interests in subsidiaries or affiliates, and from assuming a management role in any business. (Possible exceptions might include the GOCR's remaining 60% shares in FERTICA and CEMPASA, as well as CODESA's interests in the national securities exchange).

At the request of the Cabinet, the study is being reviewed by selected government entities and, thus, no action has been taken so far. However, recent discussions with the GOCR economic team indicate that the political realities involved in a dissolution such as that proposed by the National Commission -- which would require legislative action and the accompanying debate which could result in a challenge to the divestiture process itself -- will preclude it from happening by the previously anticipated date of early 1988.

The Mission is acutely aware of the possibility that the GOCR might decide in future years to repeat the whole fatal experiment of parastatal involvement in industrial and commercial operations. We believe the strongest protection against recurrence of the problem lies in public awareness of the dimensions of the present CODESA disaster and, at a minimum, in obtaining executive branch action to eliminate the potential for CODESA-type acquisitions. For this reason, the Mission will establish specific conditionality requiring the executive branch to continue the prohibition contained in the February 1985 Cabinet decree to limit CODESA's activities such that it will not create, acquire, or operate businesses. (See Section IV.E.2).

4. Status of ESR Covenants

Past conditionality included in the ESR II-V agreements has consisted of ninety-seven covenants in the areas of credit and interest rate policy; foreign exchange and foreign exchange management; export and investment promotion; housing; parastatal divestiture and a variety of policy reform studies, plans and miscellaneous projects. In its September 1986 detailed report on ESR conditionality (1986 San José 09364), the Mission concluded that compliance by the GOCR was generally satisfactory. Fifty-eight covenants which had been completed were formally closed, and another two covenants were closed in March, 1987, having been successfully completed. Compliance with the outstanding covenants continues to be satisfactory, particularly on the divestiture of CODESA subsidiaries and the establishment of a secondary mortgage bank. The most serious case of GOCR non-compliance, i.e. the failure of the Costa Rica Central Bank to maintain a reduction of the banking system net credit ceiling to the non-financial public sector for two months resulting from the sale of a CODESA subsidiary, is now in compliance. The Mission's detailed semi-annual report on ESR covenant compliance was submitted to AID/W in late March, 1987. A detailed reporting of ESR covenant status is contained in Annex V.

III. U.S. INTERESTS, STRATEGY AND RATIONALE

A. U.S. Interests

Costa Rica's long-standing democratic tradition and peaceful nature are unique in Central America. Its army was abolished in 1949, and Costa Rica prides itself on having more teachers than policemen. Its respect for human rights is outstanding at a time when many of its neighbors are major violators of such standards. Both citizen and visitor alike travel freely and safely throughout the land, and refugees from the conflict and oppression in neighboring countries continue to seek its safety. Some 31,000 persons have officially entered Costa Rica as refugees from other Central American countries between 1974 and 1986; estimates of the number of unregistered immigrants range between 60,000 and 250,000.

In its report to President Reagan, the National Bipartisan Commission on Central America (Kissinger Commission) emphasized 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 uniquely important to 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, 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, 1982, and continuing with the Arias administration, and others which are still required, represent a radical shift in outlook and philosophy for Costa Rica, and quite naturally engender public and official concern. While changes have sometimes appeared to us to occur slowly, and may continue to do so, they have sometimes been hard won, with resistance 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. In view of the above and despite severe foreign assistance budget limitations and competing worldwide development priorities that have reduced the 1987 level of ESF assistance for Costa Rica, 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. ESR VI Relationship to Action Plan

The ESR VI program conforms to the Mission Action Plan reviewed and approved in February 1987 in AID/W. As stated in the Action Plan, ESR VI will essentially continue the strategy of past ESR programs which are cast in the framework of those recommendations of the National Bipartisan Commission on Central America (NBCCA) applicable to current constraints to development in Costa Rica. The four main thrusts of the NBCCA recommendations comprise the goals of the ESF program, and concurrently, the goals of the overall Mission program: short-term economic stabilization, basic structural reforms leading to rapid and sustained economic growth, a broad-based sharing of the benefits of growth, and strengthening democratic institutions.

The bulk of the ESF resources, .a the policy leverage they afford, will continue to be aimed at:

-- Stabilizing the economy which deteriorated due to: skyrocketing oil prices, political turmoil in other Central American countries, falling prices for primary export commodities and structural factors in the economy, including excessive growth in public sector employment and expenditures, and other economic distortions such as public sector participation in commercial enterprises through subsidiaries of the Costa Rican Development Corporation (CODESA).

-- Assisting in restructuring the economy from an emphasis on public sector investment and import substitution policies to one which looks more to the private sector and exports to achieve long-term growth.

However, preserving Costa Rica as a model of democratic, broad-based development for the region is the primary rationale for U.S. assistance. The goals of stabilization and laying the basis for long-term growth are closely linked to and supportive of this broader rationale.

C. Relation to an IMF Standby and the GOCR Stabilization Program

Despite not having a Standby Arrangement in effect in 1986, the GOCR and the IMF continued discussions throughout the year, culminating in an IMF Mission visit to Costa Rica in December. Based on the results of that visit, in January the GOCR submitted a proposal to the IMF which outlined the performance indicators and targets the government planned to establish to reach agreement on a new Standby.

After studying the proposal, the IMF Mission returned to Costa Rica in March to finalize negotiations on the contents of the GOCR's economic program for the 18 month period to be covered under the Standby. By the end of the month, basic agreement had been reached, and the GOCR submitted its Letter of Intent to the IMF in early April.

For several reasons, acceptance by the IMF of the Letter of Intent for an 18 month Standby Arrangement has been a key assumption of the USAID in preparing this PAAD. First, it establishes the basic macroeconomic conditionality for the GOCR's stabilization program which is the traditional role of the IMF. It also sets out a framework that will allow the GOCR to renew negotiations with the commercial banks which are a critical element in the overall stabilization program. In a similar manner, negotiations with the IBRD on a new SAL will be facilitated. For AID, it allows the Mission to shift the macroeconomic focus of its conditionality required in ESR V to sector related concerns that both complement the macroeconomic conditionality of the IMF and reinforce the Mission's development interests in those sectors. (See Section III.D. below, for more on the Mission's proposed conditionality).

To complete their negotiations on the Letter of Intent, one of the principal issues to be resolved by both parties was the size of the public sector deficit as a percent of GDP. As presented in the draft Letter of Intent, the agreed upon target is to reduce the public sector deficit from 5.8% of GDP in 1986 to 4.0% in 1987. This is to be achieved by controlling Central Government expenditures and by reducing Central Bank losses.

For the former, initial negotiations centered around a two billion colon reduction in expenditures and a two billion colon increase in revenues via new taxes. Ultimately, this formula was dropped in favor of one where quarterly expenditure levels for the Central Government have been established based on projected revenues. If revenues are higher, expenditures will be permitted to increase accordingly. Measurement of compliance with the expenditure ceilings will be part of the periodic reviews the IMF will conduct once the Standby is in effect.

To help reduce its losses, the BCCR approached the Mission with a proposal to use local currency from the new ESR program to essentially pay off existing BCCR obligations (debt) and, therefore, reduce the basis for generating high losses. The Mission fully supports the government's efforts to meet the public sector deficit target, and has agreed to a program that calls for the transfer to the BCCR of up to two billion colones of the principal to be available under ESR VI for this purpose. The transfers will be made in equal amounts on a monthly basis beginning once the Standby becomes effective (estimated to be July 1, 1987) and will continue through the remainder of CY 1987 so long as the expenditure ceilings established in the Standby are satisfied. In addition to helping to reduce BCCR losses, this transfer, or "subsidy", will make a significant contribution to the fiscal portion of the GOCR'S stabilization program because the funds will be demonetized (i.e., there will simply be an internal bookkeeping transaction in the BCCR to record the transfer of funds from one account to another; the funds themselves will not be introduced into the general economy).

D. ESF Assistance Strategy for ESR VI

Stabilization. Economic stabilization remains a principal objective of the Mission's program. The success to date of Costa Rica's stabilization efforts has depended on sizable levels of external balance of payments support. Such support will continue to be required until policy reforms demonstrate their medium and long term effects in the structural revitalization of the domestic economy. (See Annex II, Table IV.)

Policy and Structural Reform. ESR VI will focus on expanding the progress made in three key areas under earlier programs: Continuing exchange rate adjustment ("mini-devaluations") will be necessary to maintain the colon at a real and competitive level; further efforts will be exerted to restrict the amount of subsidized credit provided through the national banking system; and limits on credit to the public sector will be tightened in order to free up economic resources for the more productive private sector.

On December 10, 1986, the Central Bank announced its credit program for 1987. The program completed earlier moves toward financial liberalization by eliminating credit ceilings and all allocative categories for unsubsidized credit. The ESR VI agreement will contain a covenant requiring the Central Bank to maintain the provisions of this revised program.

In addition, through ESR VI conditionality the Mission will promote maintenance of limits on domestic banking credit to the non-financial public sector. The Central Bank will also be required to continue its policy of allowing market forces to determine banking system interest rates in 1987-88 and to simplify its definition of subsidized credit.

Privatization/CODESA. The primary CODESA focus will be on effectively eliminating the possibility for the rebirth of parastatal enterprises. Specifically, the Mission will require that the executive branch limit CODESA's activities such that it will not create, operate, or finance any new subsidiaries. Also, the executive will be required to withhold support for any initiative or legislation that would remove such limitations. In addition, the Mission will maintain flexibility in its application of existing conditionality regarding the divestiture of individual CODESA subsidiaries. Specific mechanics for the privatization of the subsidiaries still to be divested will be established in side agreements outside the context of ESR conditionality. For the larger remaining subsidiaries, a timetable for divestiture completion will be established and will serve to reinforce actions already underway.

Public Sector Employment. Recent studies have demonstrated that over the last twenty years the share of Cost Rican public sector employees to total employment has risen from 13.3% to 19%, or to a total of 157,800 employees by the end of 1986. It has also been demonstrated that public sector wages are on the average 70% higher than comparable private sector jobs.

In an agreement with the World Bank under the first Structural Adjustment Loan, the GOCR decreed that it will reduce public sector employment to 1984 levels by March 1989, or by approximately 3,000 positions. The Mission will reinforce this action by requiring that the public sector employment reduction targets established by the GOCR for March 1989 be achieved and that the GOCR provide quarterly reports beginning September 1987 and continuing through March 1989 on public sector employment and wage compensation regarding the filling of positions, number of employees on board and the public sector wage bill that demonstrates satisfactory progress in meeting these reduction targets. The Mission has entered into this sector to signal its support for implementation of public sector employment reductions and to provide improved information to confirm the status of pledged cuts. Since the topic is politically sensitive within the GOCR, as well as a primary focus of the IBRD, the Mission will address its requirements to the GOCR in a side agreement outside the scope of ESR VI conditionality.

Financial/Banking Sector Reform. ESR V, as amended, began the Mission's involvement in more micro-level oriented reforms within the Costa Rican financial/banking sector because its efficiency is vital to support the Mission's unfolding development strategy, which focuses on an expanded role for the private sector in sustaining economic growth and a number of structural reforms described previously in this section. Historically, public banks have operated in a near monopolistic fashion, and only recently have private banks been able to assume a limited role in the sector. The Mission therefore will require that the GOCR carry out reform within the financial sector and support other reforms already underway to improve the position of the private banks vis-a-vis the public banks, thereby improving the overall efficiency of the banking system.

The major focus of Mission efforts in this sector will be to require reform of Central Bank regulations that will permit the private banks to issue savings instruments of 90 days maturity or longer by the end of 1987 (the current limit is greater than 180 days). The Mission's ultimate objective is for the private banks to receive equal treatment with the public banks -- i.e., to issue instruments with maturities as low as 31 days. While this cannot be fully achieved in 1987 because of the short time frame and the political sensitivities surrounding the public banking sector, this topic will be on the Mission's agenda for conditionality associated with the 1988 ESF program with a view toward reaching this goal by the end of 1988.

Export Promotion. Exchange rate stabilization and an increase in private sector productive credit are ESR VI program components which will contribute directly to export performance, as will the allocation of modest amounts of local currency to export-oriented agricultural activities. In addition, inefficient customs operations and delays in implementing customs reforms have been identified as further areas where intervention by AID would have a positive impact in stimulating the growth of exports. USAID will attempt to remove constraints to investment and export promotion for Costa Rica by requiring the Director General of Customs to implement managerial and administrative improvements identified in past studies funded by the Mission. These improvements address simplification of import procedures, import/export valuation, decentralization, training and procedural reform.

Subsidized Credit and Agricultural Export Promotion. Consistent with past Mission efforts to promote policy and structural reform through limits on subsidized credit and promotion of positive real interest rates, in ESR VI the Mission plans to promote limits on subsidized credit to the agricultural and industrial sector.

A new Agricultural Production law was recently approved by the Legislative Assembly which contains provisions for subsidized interest rates to reschedule outstanding producer loans and other measures that could lead to the increased possibility of loan defaults and have potential negative impacts on non-traditional agricultural exports. The bill authorizes the Ministry of Finance to issue 5.0 billion colones in bonds, to mature in 20 years with amortization beginning in the 11th year and which bear a 6% interest rate. The bonds will be used to buy the delinquent portfolios of small and medium farmers held by the state banks and outstanding as of June 1986. The GOCR-purchased loans will then be rescheduled at terms with a maximum maturity of 12 years at an interest rate of 8% per annum. Income on the rescheduled loans will be used to pay interest and to amortize the bonds. In the likely case that this income does not cover the service of the bonds, the central government would have to cover the difference. The Mission believes that the main impact of the law will be to legitimize the non-payment and rescheduling of these old loans and amounts to a government subsidy to the extent that banks fail to collect from farmers.

The manner in which the Mission should employ ESR conditionality to counteract the negative impact of the Law has been a subject of concern for both the USAID and the Embassy. Although the Law represents a GOCR retrenchment from Mission encouraged progress in liberalizing the financial system, the political sensitivities which surround the Law made it impractical for the Mission to lobby against its passage. Rather, the Mission has decided to include a covenant in the ESR VI agreement that will establish a limit for subsidized credit to both the agricultural and industrial sectors such that new subsidized credit will not exceed the level of subsidized credit outstanding as of December 31, 1986 or by 5,354 million colones (which somewhat exceeds the prior ceiling on subsidized credit). Any loans restructured under the new Agricultural Law will unfortunately have to fall outside such limit as the GOCR has adopted the position that such rescheduling does not involve subsidized credit. However, the Mission will covenant with the Costa Rican executive branch to neither support, sanction nor introduce legislation to provide additional subsidized credit (in other other words, additional to that provided by the new Agricultural Law) for the agricultural and industrial sectors higher than that outstanding as of December 31, 1986.

IV. PROGRAM DESCRIPTION AND RATIONALE

A. The Program

The ESR VI program consists of a $85.0 million ESF grant to Costa Rica in the form of a cash transfer. This PAAD covers the background, objectives, and justification for the entire 1987 ESF program, plus the description of the dollar and local currency sections and their accompanying conditionality. The Mission proposes to obligate $83.7 million in one single agreement, with the balance to be obligated when reserves are no longer required for the TCIP and CADO programs.

The Mission has carried out a series of negotiations with the GOCR Economic Team at the cabinet level, led by the First Vice President, and including the Minister of Finance, the Minister of the Presidency and the President of the Central Bank. It is planned that on-going negotiations with the GOCR will be finalized following review of the ESR VI PAAD in Washington to allow for any modifications in conditionality which may result from the review.

B. Justification for the Grant

The Mission proposes that the $85.0 million to be authorized by this PAAD be provided as a grant. Prior to debt relief, Costa Rican public sector debt service is projected to consume about 60% of all commodity export earnings from 1988-1990. Reducing the burden of this projected debt service to a politically and economically more managable 35% requires annual debt relief averaging $286 million for this period.

Given Costa Rica's high debt servicing burden, maximum grant financing is consistent with U.S. interests in Costa Rica. Grant rather than loan financing reduces the debt service burden and the rate of debt accumulation, thereby supporting our stabilization and recovery objectives.

C. U.S. Dollar Resources

1. Purpose and Terms for Dollar Resources

A total of $85.0 million will be provided to the Central Bank in the form of cash transfers as balance of payments support to Costa Rica. Annex II (Table IV) shows a $400 million projected balance-of-payments gap for Costa Rica in 1987. The level of ESF assistance proposed above remains necessary in order to prevent growth of arrearages to more damaging levels.

In accordance with the FY 1987 Continuing Resolution requirement, a separate account will be established by the GOCR that will permit improved control and monitoring over how the ESF dollars will be used. Section IV.C.2.c., below, provides details on the separate account and the uses proposed by the Mission for the dollar funds. The funds will finance imports from the U.S. of eligible commodities required by the Costa Rican private sector. This use of funds is consistent with the guidance provided in State 052618.

2. Disbursement of U.S. Dollar Resources

a. Justification for Cash Transfer

As was the case in previous ESR programs, the use of cash transfer (rather than a Commodity Import Program) is proposed for the ESR VI program. A cash transfer program will allow a more flexible and responsive disbursement capability than a CIP which is required to manage the flow of foreign exchange into the Costa Rican economy in order to meet balance of payments and cash flow needs. Further, measures to limit capital flight are not needed, since there has been a positive flow of capital into Costa Rica since 1982.

Net private capital inflows to Costa Rica for 1980-1986 were as follows:

1980	-$240.0 million
1981	-$ 69.0 million
1982	$ 16.0 million
1983	$ 68.0 million
1984	$ 24.0 million
1985	$119.0 million
1986	$170.0 million

This trend toward a reflow of private capital to Costa Rica reflects a continuing trend toward stabilization of the economy and improvements in interest and exchange rate structure. Conditionality under the Mission's ESR programs has played a key role in achieving this degree of progress, largely because of the flexibility the cash transfer mechanism has provided in enforcing the conditionality. Continued success in helping to restore economic stability, therefore, will benefit from the cash transfer process.

Finally, Costa Rica is using the AID ESF funds to compensate for foreign exchange inflows lost as a result of factors leading to the current economic crisis. Historically, Costa Rican imports from the U.S. have been well in excess of the dollar amounts made available under ESR Agreements. Total imports from the U.S. amounted to $406 million in 1984, $380 million in 1985 and $358 in the first 10 months of 1986. Illustratively for 1985, eligible import commodities as prescribed by ESF conditionality totaled $380 million, of an overall U.S. import total of $408 million. Thus, as this figure well exceeds the ESF total of that year ($160 million), little would be gained by the institution of a modified Commodity Import Program.

b. Disbursement Plan

An initial tranche of $40 million will be disbursed once the GOCR begins implementation of an approved economic plan for 1987/1988, as well as upon a determination by the Mission of acceptable GOCR compliance with the terms of ESR VI conditionality. It is anticipated that this disbursement can be made in the third-quarter of CY 1987.

The second and final tranche of $45 million will be made upon a determination by USAID/Costa Rica of satisfactory compliance by the GOCR in meeting the economic performance targets set forth in the economic plan referred to above and upon a determination by the Mission of continued satisfactory progress by the GOCR in implementing ESR VI conditionality. The Mission will evaluate GOCR performance in the following areas: (a) cumulative expenditures of the central government, (b) domestic banking system net credit to the non-financial public sector, (c) net domestic assets of the BCCR, (d) the net international reserve position of the BCCR and (e) BCCR external arrears payments. (Limits for the latter two categories may be adjusted as a result of upcoming GOCR negotiations with the commercial banks and creditor governments.) The Mission evaluation will also include an examination of any GOCR failure to achieve specified limits and progress in implementing economic policy reforms in regards to public sector wages, agricultural price supports and interest and exchange rate policies. Of particular significance will be the impact of the recently approved Agricultural Credit Law on the operations and profitability of the domestic banking system, on levels of subsidized credit and on financial sector reform.

The GOCR will be required to make such an analysis available to AID prior to the second disbursement. It is anticipated that this disbursement can be made toward the latter part of the fourth quarter of CY 1987.

Thus, the disbursement plan to be incorporated into the ESR VI assistance agreement is as follows:

ESF VI DISBURSEMENT PLAN

Disbursements (projected)	Grant Funds (U.S. dollars)
First	40,000,000
Second	45,000,000
TOTAL	85,000,000

The Mission requested, and was given, authorization to vary the disbursement plans under ESR II-V as required to assure good management and regular availability of foreign exchange resources. Likewise, the Mission requests authorization to include in the assistance agreement under ESR VI a plan for the disbursement of funds as detailed above, but with the provision that the Mission may vary this plan as required to maintain an even and rational flow of foreign exchange.

However, any variation to the disbursement plan which would involve withholding part or all of a disbursement would be based on prior consultation with AA/LAC.

c) ESF Separate Account

i) The Separate Account and Disbursement Procedures

In conformance with the requirement established in the FY 1987 Continuing Resolution, the GOCR will be required to open a separate account in which all dollar disbursements under the ESR VI cash transfer will be deposited. The account, to be located in a bank selected by the GOCR, will be established solely for this purpose, and has as its objectives that:

-- ESF dollars not be comingled with other GOCR/BCCR funds;

-- ESF dollars finance eligible transactions which are carefully identified by AID;

-- the cash transfer nature of the ESF program not be altered; and

--the mechanism be flexible enough to permit changes based on experience and developments which may affect its efficiency.

As discussed in more detail below, it is particularly important that this new system not impact negatively on the basic rationale for the cash transfer program in Costa Rica -- to provide quick disbursing balance of payments assistance in support of the GOCR's economic stabilization program, thus allowing it to consolidate its impressive progress of the past several years and maintain the external creditworthiness required to achieve the long term objectives of the program.

Disbursements to the separate account will be made pursuant to established cash transfer procedures via electronic funds transfer from the U.S. Treasury to the bank where the account is established. Any deviation from this method will be approved in writing by the Mission Controller.

Disbursements from the separate account will be controlled by the Mission such that funds will be used only for eligible transactions (see the discussion below for proposed eligibility criteria).

ii) Use of Funds

The Mission proposes that, consistent with LAC guidance, dollar funds in the separate account be available to finance the importation of U.S. raw materials, spare parts and intermediate goods required by the Costa Rican private sector. Details of a monitoring system will be worked out with the BCCR in a separate exercise following ESR VI authorization to ensure that ESF funds are used to reimburse the BCCR for eligible commodity imports from the U.S.

Disbursements from the separate account will be made as an "advance" against import requirements. The BCCR will be required to present documentation on a post-facto basis to prove product eligibility under the program. Documentation presented by the BCCR should be documentation already available and provided to the International Transactions Department of the BCCR for imported commodities. This documentation should be available for post-facto verification by outside audit on a batch transactional basis. The BCCR will reimburse the separate account for any transactions found to be ineligible. There will be no need to require more complex transactional information by the BCCR for the following reasons:

-- The level of imports from the U.S. by the Costa Rican private sector has historically exceeded ESF levels by a considerable amount (a situation that will not change in the face of declining

ESF levels), even after eliminating ineligible commodities and public sector imports.

-- As a result of GOCR actions to consolidate exchange rates in 1983 and subsequently adopt a system of mini-devaluations to manage the official exchange rate, black market exchange rates have generally been at a premium of only 3 to 5 percent over the official rate and have never exceeded 10 percent. This, along with the interest cost of the required prior import deposit (30 to 40 days at an annual rate of 30 percent), suggest that the over invoicing of imports is not an attractive vehicle for obtaining foreign exchange for resale in the black market.

-- Capital flight from Costa Rica has not been a continuing problem after the economic crisis of 1980-1982. Rather, the data show that there has been a significant, and growing, return flow of private capital held abroad, with net inflows of $24 million in 1984, $119 million in 1985 and $170 million in 1986.

D. Local Currency Resources

1. Provision of Local Currency Equivalent

Immediately following each dollar disbursement, the Central Bank will deposit an equivalent amount of local currency into a Special Account, as specified in the text of the Special Account covenant included in Section IV.E.2. This local currency equivalent will be calculated at the highest rate of exchange for purchase which is not unlawful as of each disbursement date.

As in past years, the local currency account will earn interest at a rate equal to the basic passive rate established by the BCCR. In keeping with recent guidance on local currency, all interest income will be treated as principal and, as such, its use will be jointly programmed with the GOCR. The amount of interest earned is difficult to estimate since it is a function of the amount on deposit in the special account and how quickly those funds are disbursed.

The high amount of interest earnings in the AID Special Account in the BCCR of the past two years has been basically due to the slow disbursement of funds related to the CODESA divestiture and the establishment of the endowment for the Agricultural School for the Humid Tropics. The total funding programmed for both these activities will be largely disbursed without monetization during CY 1987. Another large disbursement from the existing principal will be for the capitalization of the new National Housing Mortgage Bank. Thus, the current principal in the special account will be reduced by a significant amount in 1987.

The new funds to be added to the Special Account from ESR VI are expected to be drawn down fairly rapidly, assuming reasonable GOCR performance on meeting public sector expenditure targets in order to qualify for the subsidy to the BCCR, the major advances anticipated in the CODESA divestiture, and the establishment of the Housing Bank. Funds for the AID-BCCR special credit line are already in demand and will be disbursed shortly after the first dollar disbursement makes local currency available.

Given the above, therefore, the Mission does not expect to see a large build-up of principal and interest in the Special Account. Nonetheless, we continue to believe that the principle of paying interest on the Special Account balance is important not only to maintain the value of the local currency but also as a potent incentive for the GOCR to move quickly on satisfying the conditions for disbursement of the local currency resources.

2. Purpose and Terms for Local Currency Resources

The following table sets out present tentative plans for the general allocation of the local currency counterpart funds available under ESR VI. Specific programming of local currency resource use is a joint USAID/GOCR exercise which will be formalized during negotiations of the Grant Agreement. In this regard, the GOCR has already indicated its interest in establishing a new credit facility directed at supporting investment in the non-traditional agricultural commodities identified as priorities under the Mission's new agribusiness strategy. Future negotiations with the GOCR will assess the relative priority of such a credit line when compared with the other items on this list.

TENTATIVE ESR VI LOCAL CURRENCY ALLOCATION

Activity	Amount (US$ million equivalent)
BCCR Subsidy	32.0
Housing Bank	20.0
CODESA Divestiture	16.0
Local Currency Credit Line	6.0 1/
Investment Promotion	2.4
Agribusiness Strategy	2.4
Central American Peace Scholarships	1.2
Operating Expenses	5.0
TOTAL	85.0

1/ This amount will be supplemented by the Mission's PL480 Title I Section 108 program which, although not channelled through the BCCR, will make additional credit available to the private sector.

This programming focuses only on the principal to be deposited in the AID Special Account at the BCCR following the disbursement of cash transfer dollars. As just pointed out, although this principal earns interest which is subsequently treated as principal to be jointly programmed with the GOCR, the amount to be earned is difficult to establish. Therefore, interest income is not included in this discussion.

A brief description of each of these activities is provided below. Annex IV provides more detail on the process for reaching agreement with the GOCR on local currency use, the management systems in place for monitoring local currency projects and the financial reporting accountability systems employed by the Mission.

a) BCCR Subsidy

As discussed in Section III.C., above, the Mission has agreed to a BCCR proposal under which local currency will be used to reduce BCCR losses as part of a broader program to reduce the public sector deficit as a percentage of GDP. Under the program, monthly transfers of approximately equal amounts will be made from the AID Special Account directly to the BCCR where they will be recorded as an offset to existing BCCR liabilities. Essentially, this will be a bookkeeping transaction within the BCCR and will result in the demonetization of the funds involved.

Transfer of the funds will be directly linked to GOCR performance in complying with Central Government expenditure ceilings established under the IMF Standby. The program will begin once the Standby becomes effective and will continue until the end of CY 1987, so long as the expenditure ceilings are not exceeded. A total of up to $32.0 million is planned for this activity.

b) Housing Bank

The colon equivalent of $20 million is earmarked to help continue capitalizing the new secondary mortgage bank. Legislation creating this National Housing Mortgage Bank (NHMB) passed the legislature in October, 1986, and was signed into law by President Arias in November, 1986. Since that date, the Mortgage Bank has been in the formation stage under the leadership of the Minister of Housing.

The NHMB is modeled on similar institutions in the United States and other countries: it will be a second-tier financial institution specializing in mobilization of capital to finance long-term housing mortgages. The availability of substantial amounts of housing capital on a regular basis is an essential prerequisite to the higher levels of production needed to reduce Costa Rica's housing deficit. To maintain constant rotation of the capital in new shelter projects, the

NHMB will operate in the national securities exchange (Bolsa de Valores) to discount the mortgages generated by approved members of the national housing finance system. The Board of Directors of NHMB will regulate uniform terms and conditions for shelter financing by the various public and private institutions providing housing finance.

c) CODESA Divestiture

$16 million equivalent in local currency will be made available from ESR VI to move the process of CODESA divestiture toward completion and to reduce the accumulated debt burden with the Central Bank created by the past operations of CODESA and its subsidiaries. Originally, these $16 million equivalent were programmed under ESR V; however, to meet commitments under other local currency activities, these funds were reprogrammed to ESR VI. It should be noted, though, that the total amount now programmed for the CODESA program is $190 million equivalent and not the $240 million initially contemplated. The $16 million programmed under ESR VI represents the final increment to reach this new level of $190 million for the CODESA program. Progress toward the disposal of CODESA subsidiaries has been detailed in Section II.B.3. and in Annex III.

d) The Local Currency Credit Line

To date, $120 million equivalent in local currency has been allocated to the Central Bank under earlier ESR agreements for the AID Special Credit Line. Of this total, $90 million has been reserved for use by private Costa Rican banks.

As of March 31, 1987, the banking system had drawn down all $120 million and had disbursed funds to about 550 firms, indicating that the funds were disbursed to ultimate borrowers quickly and efficiently. The Credit Line is managed by the Finance Department in the BCCR which has gained considerable experience with its operations and works efficiently in channelling the funds to the participating banks and their clients. The Mission plans to maintain this arrangement for the management of all new funds added to the Line.

Under ESR VI, credit will continue to be made available to private sector enterprises through the provision of up to $6 million. These additional funds will be channeled exclusively via the private banks. Based on past experience, the Mission expects that existing private sector demand will readily absorb the funds while at the same time increasing loanable assets of private banks and providing incentives to raise equity capital by meeting reserve requirements.

e) Investment Promotion

Since 1983, the Mission has been working to attract foreign industrial investment into Costa Rica via the CINDE Export/Investment Promotion (PIE) program. The program has been instrumental in fostering an awareness among Costa Ricans of the need to generate increased exports and to create an attractive environment in order to achieve this increase. In 1986, PIE's search for investment netted a commitment of 25 firms to Costa Rica, representing a total investment of $22 million.

Working under a well-defined plan, PIE brings Costa Rica to the attention of well-established companies searching for investment opportunities. CINDE/PIE assists these companies by informing them of investment regulations and directing them to potential sources of credit. New foreign investment under the program has resulted in increased production of apparel and electronics, and has introduced new industries in metalourgy and sporting goods. ESR VI will contribute $2.4 million equivalent in local currency to the operations of CINDE/PIE for a continuation of its export promotion activities. These resources will fund primarily staff costs and the operations of overseas and local offices. For the overseas offices, local currency will be converted to dollars by the Central Bank in accordance with existing agreements. Given that the foreign exchange generated by the overseas offices significantly exceeds the cost of their operations, this conversion is viewed as a legitimate and fully justified project expense.

f) Agribusiness Programs

The local currency equivalent of $2.4 million will be reserved for the continued implementation of the Mission agribusiness export expansion program. The Mission's strategy for non-traditional agricultural export expansion is to promote investment in Costa Rican agriculture for diversification into export crops with the potential for high economic return and to assist emerging agroindustries at critical points in the development of export markets in the U.S. and elsewhere. To complement the Mission's work with the investment promotion program of CINDE, support to CINDE's Private Agricultural Advisory Council (PAAC) will be undertaken to promote specific non-traditional agricultural exports and as well as policy reforms required to facilitate the growth of these exports.

g) Central American Peace Scholarships

The equivalent of $1.2 million in local currency is earmarked for the CAPS program, which is providing high school, undergraduate, graduate and short-term training in the United States for individuals who would not otherwise have such an opportunity. These funds will finance local English language training, air fares, family stipends for long-term participants, and other costs.

h) Operating Expenses

In April, 1984, the GOCR and the Mission signed an agreement establishing a Trust Fund for the purpose of providing funds to pay that portion of the Mission's operating expenses which are local currency costs. It was further agreed that local currency made available under the ESR programs would be used for this purpose. Currently, approximately 85% of the Mission's operating expenses are covered under this agreement. The amount programmed under ESR VI for O.E. is $5 million which is the estimated local currency portion of total O.E. costs for FY 1988, including costs associated with equipping the new office building.

E. CONDITIONS AND COVENANTS

Conditionality proposed for the ESR VI program will assure that dollars provided are directed towards achieving the balance of payments and policy objectives of the program, 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 deposited in the Special Account, and that the basis for achievement of objectives identified for the local currency component of the program is established.

The Grant Agreement will be signed by AID, the Central Bank and the GOCR likely in late May. Based on a series of discussions with President Arias' cabinet level economic team--i.e., the First Vice President, Minister of Finance, the Minister of the Presidency and the Central Bank President--substantial progress been made in reaching agreement on ESR VI conditionality. The Mission plans to complete negotiations with the GOCR economic team following the PAAD review in AID/W during the week of May 4, 1987. Negotiations with the GOCR should be successfully concluded by the end of May, which will allow time to incorporate additional guidance, if any, received during the PAAD review.

1. Conditions Precedent to First Disbursement

The Mission plans no special Conditions Precedent to first disbursement. In discussions with the GOCR regarding the establishment of a separate account for the cash transfer dollars, we have been advised that such an account will be established before the Agreement is signed. Therefore, no CP is needed on this new requirement. Consequently, once the statutory conditions of designating authorized representatives for the project (including specimen signatures) and providing an opinion from GOCR legal counsel that the Agreement is a binding commitment have been satisfied, disbursement of funds will be approved.

2. Covenants

The Grant Agreement shall incorporate covenants applying to both the Central Bank and the Central Government. Those applying directly to the Central Bank are the following:

Foreign Exchange for Private Enterprise

-- To provide during calendar year 1987 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 than the amount of all cash transfers received by Costa Rica from the United States Government under the Economic Stabilization and Recovery Program VI, and to report to AID within three months of the last disbursement of these cash transfers, or by June 30, 1988 (whichever is earlier), information sufficient to indicate that such provision of foreign exchange resources has been accomplished.

U.S. Commodity Imports

-- To make available during calendar year 1987 the dollar amount equivalent to that disbursed as cash transfers to Costa Rica under the Economic Stabilization and Recovery Program VI 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 AID by September 31, 1988, or within six months of the last disbursement of these cash transfers (whichever is earlier) that such transactions were accomplished.

Private Sector Credit

-- To agree to an increase in credit available through the private banks to the productive private sector, in an amount of local currency equivalent of up to six million United States dollars ($6,000,000), to increase loanable assets of private banks and to provide incentives to raise equity capital by meeting reserve requirements. This local currency amount shall be calculated at the highest rate of exchange for purchase which, as of the date of the first disbursement of funds under the Economic Stabilization and Recovery Program is not unlawful in Costa Rica.

Subsidized Credit

-- To restrict outstanding balances of subsidized credit for agriculture and industry during calendar years 1987-88 (defined as credit which is extended through the national banking system at interest rates no lower than the basic passive rate) to levels no higher than the level of such credit outstanding as of December 31, 1986, or by 5,354 million colones, and which do not exceed that level by more than 5% on a purely seasonal basis during the course of 1987 and 1988, and to report to AID, within three months of the end of each calendar quarter information sufficient to demonstrate compliance with this condition.

-- With Executive Branch agreement to not sanction, support, promote or cause to be introduced into the legislative process through December 31, 1988, any legislation that would serve to provide additional subsidized credit for the agricultural and industrial sectors higher than the levels of credit outstanding as of December 31, 1986.

Exchange Rate

-- To maintain during calendar year 1987 a unified exchange rate; and to review the appropriateness of the exchange rate on a continuing basis, and revise it when necessary, in accordance with the following factors, among others: relationship of actual and anticipated domestic prices to 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 foreign debt, and non-compensatory net capital inflows.

Positive Real Interest Rates

-- To continue the policy of allowing market forces to determine banking system interest rates in 1987 and 1988, to supply AID with a quarterly report on banking system interest rates, and to undertake consultation with AID upon any evidence in regard to negative real interest rates and collusive arrangements for setting interest rates.

National Credit Program

-- To maintain and implement during calendar year 1987 the credit program announced by the Central Bank's Board of Directors on December 10, 1986, in all of its features.

IMF Reports

-- To provide to AID, from the signing of this agreement until the end of calendar year 1988, copies of all reports to the International Monetary Fund as required under present or future agreements or programs with the Fund; and to provide each such report to AID at the same time that it is provided to the Fund; and, in the event that at any time during such period no agreement or program with the Fund is in effect, to provide to AID during such period reports whose timing and content shall be substantially similar to those currently provided to the Fund.

Special Account for Counterpart Funds

-- Acting in its capacity as financial agent for the Government of Costa Rica for purposes of agreements under this Economic Stabilization and Recovery Program VI, to deposit promptly the equivalent in colons of each dollar disbursement under this Program into the Special Account in the Central Bank originally established under Covenant 6.1(L) of the ESR II Assistance Agreement, which account will pay interest at a rate equal to the interest rate fixed by the Central Bank for six month certificates of deposit; and to calculate the colon equivalent of such dollar disbursement at the highest rate of exchange for purchase which, as of the date of the dollar disbursement, is not unlawful in Costa Rica; and to make disbursements from this Special Account pursuant to AID Implementation Letters.

Price Checking Unit

-- To provide evidence acceptable to AID no later than

60 days following the signature of this Agreement that the Central Bank Price Checking Unit is satisfactorily implementing recommendations for improving its operations as recommended in the PCU Technical Evaluation Report of April 30, 1987 as specified under separate cover and that these recommendations will be completely implemented by March 31, 1988, and thereafter to provide to AID, at the end of each calendar quarter through December 31, 1989, reports in a form acceptable to AID on the operations of the unit, with particular emphasis on actual progress achieved in verifying import and export prices.

Private Bank Certificates of Deposit

-- To reform Central Bank regulations to permit Costa Rican private banks, through their financial departments, to sell Certificates of Deposit with maturities of greater than ninety (90) days by December 31, 1987.

The following covenants will be applied to the Central Government:

CODESA Covenants

-- To obtain Cabinet approval of the proposal to restructure CODESA prepared by the National Commission, or another alternative acceptable to AID, by November 30, 1987.

-- To limit CODESA's activities such that it will not create, operate or finance any new subsidiaries, and withhold Executive Branch support for any initiative or legislation that would remove such limitations, through April 30, 1990.

Customs Improvement

-- To require the Director General of Customs to implement managerial and administrative improvements by June 30, 1987, as recommended by the USAID Customs Advisor in his September, 1986, report, and as communicated in a January 9, 1987, letter to the Director General of Customs by USAID/Costa Rica.

Prior Covenants

-- To comply with the terms of all covenants remaining in effect from earlier Economic Stabilization and Recovery agreements between AID and the Government of Costa Rica or agencies thereof, unless officially closed by AID.

The Grant Agreement will include the following special provision, giving AID the right to enforce compliance with all ESR covenants by suspension of disbursements, if necessary.

-- If AID determines at any time that the Government of Costa Rica is not in substantial compliance with any of the Covenants of this Agreement, or of the Grant, Loan or Assistance Agreements signed on

September 5, 1986
June 24, 1986
March 20, 1985
January 28, 1985
August 1, 1984
May 7, 1984
December 13, 1983 and
July 14, 1982,

or any amendments thereof, between AID and the Government of Costa Rica or the Central Bank of Costa Rica, then in that event AID may suspend disbursements of the Grant until such time as satisfactory compliance has been obtained.

The Mission will also include in the grant agreement a provision that calls for AID to notify the grantee when each disbursement may be requested by the Central Bank. Conditioning each disbursement on AID approval in this fashion makes it easier for the Mission to carry on an effective dialogue whenever a serious issue arises.

As indicated above, the Mission would consult with AA/LAC prior to taking any action to withhold all or part of any disbursement.

Cleared to AE/NCEN
5-14-87 pml

ANNEX I

PRIMER VICEPRESIDENTE DE LA REPUBLICA

COSTA RICA

San José, 7 de mayo de 1987

Señor
Richard Melton
Encargado de Negocios
Embajada de los Estados Unidos
Presente

Estimado señor Melton:

Tengo el gusto de dirigirme a usted para solicitarle la continuación de los programas de asistencia económica con el Gobierno de los Estados Unidos colaborando en los planes de estabilización y recuperación económica del país.

Aprovecho la oportunidad para informar a usted que dentro de estos planes y de la política económica que sigue el Gobierno de Costa Rica se ha avanzado notablemente en las negociaciones con el Fondo Monetario, el Banco Mundial y la Banca Privada Inernacional.

La carta de intensiones presentada al Fondo Monetario ha sido de la aceptación de éste con solamente modificaciones menores. Al Banco Mundial se le presentó con fecha Miércoles 8 de abril de 1987 un documento sobre la estrategia y planteamientos que componen el segundo prestamo de Ajuste Estructural. Con base en esa presentación se han abierto las negociaciones y realizado una primera misión al país para definir el programa de acciones de los próximos dos meses.

Es oportuno señalar que el segundo préstamo de Ajuste Estructural está orientado a continuar con los procesos de cambio y modernización de los sectores productivos (agropecuario e industrial) así como, a la agilización y racionalización de componentes básicos del sector público como lo son, la administración fiscal, la banca estatal y los sectores de transporte y energía. El eje central lo constituye el sistema de comercio internacional y el esfuerzo de exportación de productos no tradicionales. La estrategia fundamental que rige el programa se basa en el fortalecimiento de los sistemas de ahorro interno, de captación de recursos externos y de reconstrucción de los procesos de formación de capital. De manera consistente con los objetivos de la política económica en marcha, el

Gobierno proyecta utilizar los fondos suministrados por la A. I. D. para dar respaldo al desarrollo de diferentes aspectos de este proceso, entre los cuales tiene prioridad la intensificación de programas de transferencia al sector privado de las empresas de CODESA.

Las acciones tomadas en el campo macro-económico tienen por objeto fundamental introducir cambios que resulten en el sector público, en una mejora sustancial en la eficiencia, la calidad y la reducción del costo social que representa la prestación de los servicios correspondientes a la función del Estado. En cuanto al sector privado su propósito es fortalecer y modernizar la capacidad de los sectores productivos para responder adecuadamente a un eficaz crecimiento y expansión de la economía nacional, sustentado en el incremento de la productividad y de la capacidad competitiva en los mercados internacionales.

En este último aspecto, los recursos obtenidos permitirán poner a la disposición de los empresarios nacionales las cantidades de divisas adecuadas para financiar las importaciones necesarias, para continuar con la reactivación de la economía y para mantener un flujo sostenido de crédito para el desarrollo de los nuevos procesos de producción. El Gobierno continuará desarrollando todas aquellas medidas complementarias al programa de Ajuste Estructural, que contribuyan al fortalecimiento del sector privado costarricense.

Deseo reiterarle el firme propósito de mi Gobierno de poner en práctica este proyecto de asistencia de acuerdo con lo manifestado en esta carta y de conformidad con los términos que se acuerden en las conversaciones que espero reanudaremos próximamente.

Atentamente,

Ing. Jorge Manuel Dengo
Primer Vicepresidente de la República

ANNEX II
ECONOMIC TRENDS AND PROBLEMS: APRIL 1987
Revised: 4-10-87

1. The Economic Crisis (1980-1983)

Economic phenomena turned strongly negative in the early 1980s in Costa Rica. Gross Domestic Product (GDP) declined by 2.3% in 1981 and by 7.3 % in 1982, with an increase of only 2.9 % in 1983. Real incomes also declined, and in 1983 on a per capita basis private consumption and investment were only 79 % and 35% of their respective 1977 levels, and real wages were at only 74% of the 1979 level. Inflation increased in 1981 and approximated 80 percent in 1982, and the accelerating inflation was caused by strong exchange rate devaluation (319% in the 18-month period ending December 1981) and by rapid growth of domestic credit. Imports also grew rapidly in the late 1970s (from $ 1.02 billion in 1977 to $ 1.52 billion in 1980), and Costa Rica borrowed heavily from foreign commercial banks to forestall exchange rate devaluation and to cover balance of payment deficits. In the period 1979-1981 current account deficits amounting to $ 1.6 billion were financed largely by foreign commercial bank loans. With the sharp rise in debt service payments, particularly after 1980, a net inflow of external credit could not be maintained. In mid-1981 the GOCR suspended external debt service, essentially to maintain a reasonable level of imports, and at year-end 1982 the external debt service arrears amounted to $ 1.1 billion. The Costa Rican experience of the late 1970s conforms to the usual open economy case in which a destabilizing growth of domestic credit enlarges imports until foreign exchange reserves and external creditworthiness are exhausted, at which time import compression and devaluation combine to produce strong inflation. In addition, the severity of the balance of payments/debt service crisis of 1980-1982 was heightened by the rapid increase in external debt, the strong increase in interest payments on that debt, declining export (mainly coffee) prices, and the loss of Central American export markets.

In July 1982, shortly after coming to office, the Monge administration initiated work on an economic stabilization program. As a first step, it 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 which provided approximately $100 million (SDR 92.5 million). In addition, US ESF assistance amounted to $175.7 million in 1982-1983. Buttressed by IMF and ESF resources to help close the balance of payments gap, by the end of 1983 the Government of Costa Rica had concluded commercial bank and Paris Club rescheduling agreements, and Costa Rica was again current on contractual external debt service. Apart from B/P support assistance, Costa Rica's balance of payments improvement was brought about through the reduction of real incomes and aggregate demand. In this regard, the nominal dollar values of imports (CIF) declined from $1,528 million in

1980 to $993 million in 1983 and exports (FOB) declined from $1,001 million in 1980 to $862 million in 1983. Furthermore, as measured by national accounting estimates, import volume (referring to imports of goods and non-factor services per national accounts) declined by about 30 percent from 1980 to 1983, but 1983 export volume was slightly higher than in 1980; see Table II. Thus, the monetary and fiscal restraint initiated in 1982 and maintained in 1983 arrested the strong reduction of real income and also brought about a very substantial compression in imports as related to exports.

Even though the December 1982 IMF Standby was of short (one-year) duration, the IMF and ESF money amounted to $ 255 million in 1983, and this was buttressed by an additional $ 344 million in debt relief from foreign governments and commercial banks and in new money from commercial banks (equivalent to about half of the interest payments to the banks). The 1983 stabilization effort obtained rapid recovery of price and exchange rate stability. 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 between the inter-bank and "free" market exchange rates that had existed at the outset of 1983 was eliminated by the Central Bank during the course of the year. Apart from exchange rate unification, the Monge administration also reduced the deficit of the nonfinancial public sector. 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, and 3.1% in 1983. 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 to tax measures.

2. Economic Performance in 1984, 1985 and 1986

Production. In 1984 real Gross Domestic Product (GDP) grew by 8.0 % according to revised official estimates; see Tables I and II. This contrasts with the lower rates of growth in the preceding and following years. In 1983 GDP grew by 2.9 % and this followed the large absolute declines of GDP of 1981 (-2.3 %) and 1982 (-7.3 %). In 1985 GDP grew by 1.0 % and in 1986 GDP grew by 4.2 %. The high rate of growth of 1984 was brought about by three forces, as follows: (a) the ending strongly adverse economic phenomena in 1983, in particular the high exchange rate depreciation and inflation, which took place largely in 1982, (b) an upswing in agricultural production due to favorable climatic conditions, and (c) a rise in domestic demand fueled by the expansionary monetary, fiscal, and wage policies pursued in late 1983 and early 1984. Growth rates for sectors leading the 1984 recovery were as follows: agriculture (10.1 %), manufacturing (10.4 %), construction (23.6 %), and other services (6.2 %). GDP growth was much lower in 1985 due to more restrictive demand management and to weaker performance of the basic productive sectors. Agricultural output declined sharply to -2.9 % in 1985 due to reduced coffee and banana production, and these sectors account for nearly half of Costa Rican agricultural output. The growth rate for the manufacturing sector was also lower in 1985 (3.2 %) due in part to a sharp decline in exports to the Central American Common Market (CACM) region (from $ 192 million in 1985 to $ 129 million in 1986) related to the trade debt problems afflicting the region and in part to a lower rate of increase in private sector disposable income. GDP growth in 1986 reflects mixed tendencies. The 1986 growth of agricultural production at 0.8 % reflects below-normal climatic influences, and the growth of manufacturing output, which registered an increase of only 3.0 %, was adversely affected by continued decline in exports to the CACM region (from $ 129 million to an estimated $ 96 million). Construction activity (which accounts directly for 4.3 % of GDP by value-added) registered a 1986 growth rate of 1.3 %. However, local observers indicate that private sector construction activity advanced strongly in 1986 while public sector construction activity declined. (Stronger confirmation of this hypothesis will be possible when more detailed information from national accounting data are available on the components of 1986 Gross Domestic Investment.)

Income, Consumption, and Investment. The increased growth rate for GDP in 1986 relates mainly to the increase in the real incomes of Costa Ricans, which increased during 1986 as a function of higher prices for coffee exports and lower prices for imported petroleum. Reflecting this improvement in terms of trade, Gross Domestic Expenditure, i.e., the sum of Total Consumption and Gross Domestic Investment (see Table II), increased by 6.7 % in 1987 and by 31.4 % since 1982 with rates of growth of 8.8 % in 1983, 7.6 % in 1984, and 5.2 in 1985. This increase arises from the combination of a higher volume of export earnings and import expenditures and can be attributed in part to high external financing to Costa Rica's balance of payments. The favorable performance of the total resources available to the Costa Rican economy (i.e., of Gross Domestic Expenditure) has allowed sustained and simultaneous increases in consumption and investment. Gross Domestic Investment increased by 12.1 percent in 1986, and in 1986 this statistic amounted to 98.4 % of the 1977 level as compared with levels that lower than 75 % of during the years 1981, 1982, and 1983. Private Consumption also grew by 5.8 % in 1986 and reached 112.7 % of the 1977 level and even surpassed the level of the last pre-crisis year (1979). Even so, on a per capita basis, 1986 Private Consumption amounted to 88.5 % of the 1977 level and Gross Domestic Investment amounted to 77.3 % of the 1977 level.

Inflation, Real Wages, and Employment. Throughout the three year period 1984-1986 the annual inflation rate has been in the 10-20 % range. As measured by the consumer price index for the 12-months ending in December of each year, inflation amounted to 17.3 % during 1984, to 10.9 % during 1985, and to 15.4 % during 1986. As measured by household surveys (usually taken three times each year) real wages increased by

13.2 % in 1984 and average real wages in 1984 amounted to 98 % of the 1977 level. Survey data for July 1985 indicate a further increase inreal wages in 1985 amounting to 5.4 %. Payroll data (of workers subject to social security and health benefits) indicate a 8.7 % increase in average real wages in 1985 and 3.4 % in 1986 (through July). The employment situation has also improved in recent years. The rate of open unemployment, which reached a high of 9.5 % in March 1982, amounted to 7.8 % in March 1984, 6.3 % in March 1985, and 6.1 % in March 1986. According to official estimates, the employed labor force grew by 4.2 % during the year ending March 1984, 5.6 % during the year ending March 1985, and 4.1 % during the year ending March 1986. In regard to underemployment, according to data from the March 1985 household survey, people who had part-time jobs and wanted to work longer hours amounted to a standardized 4.0 % of the labor force, and people who worked full-time but received less than the legal minimum wage amounted to a standardized 4.2 % of the labor force.

Public Sector Finances. The total financial deficit of the public sector amounted to 14.6 % of GDP in 1982, and with the stabilization effort of 1983 that deficit was reduced to 8.6 %. Subsequent progress in reducing the public sector deficit has been slow. In 1984 the deficit was reduced to 6.5 %; but in 1985 the deficit increased to 7.2 %; and preliminary data for 1986 indicate a deficit of 5.3 %; see Table III. Central Bank losses, which amounted to an estimated 3.8 % of GDP in 1986, are a major element in the public sector financial gap, and they have the same money-creation impact as monetization of deficits of the nonfinancial public sector. Central Bank losses arise from the imbalance between the size of its interest-earning assets and its interest-paying liabilities, and the largest element of the latter is interest on external debt contracted by the Central Bank in the late 1970s to defend a fixed exchange rate. In recent years the nonfinancial public sector has moved toward financial equilibrium with a deficit declining from 9.0 % of GDP in 1982 to 3.6 % in 1983, 1.9 % in 1984, 1.9 % in 1985, and 1.5 % in 1986. As shown in Table III, the nonfinancial public sector contains three sub-sectors: the central administration (or central government), the rest of general government (which contains, as the largest single element, Social Security Institute, and also 370 decentralized agencies and 85 municipalities), and the state enterprise sector (which contains 13 entities of which the largest are the National Petroleum Refinery---RECOPE--, the State Electric and Telephone Company---ICE---, the National Development Corporation---CODESA---, and the National Agricultural Production Council---CNP). The state enterprise sector has moved marginally from deficit to surplus in recent years mainly as a function of RECOPE profits, telephone and electricity tariff adjustments, and a reduction of CNP losses. The rest of general government has been in surplus largely due to the 1983 increase in social security payroll taxes. The deficit of the central administration amounted to 3.4 % in 1982 and ranged from a high of 3.6 % in 1983 to a

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low of 2.0 % in 1985 but without a defined trend. Central administration total revenues increased from 14.4 % of GDP in 1982 and amounted to 17.0 % of GDP in 1984, 16.6 % in 1985, and 15.9 % in 1986. Based upon the evidence presented in Table III, it appears that the central administration management has sought revenues to cover expenditures rather than for the purpose of reducing the deficit.

Monetary Performance. Banking system credit to the private sector grew by 52.1 % in 1983, but by substantially lower rates during the following three years—by 17.9 % in 1984, 16.1 % in 1985, and 15.9 % in 1986; see Table IV. In addition, the growth of banking system net domestic assets amounted to only 7.8 % in 1984, 15.5 % in 1985, and 8.1 % in 1986. Thus, with expansion of credit to the private sector and net domestic assets barely matching the rate of inflation, monetary policy can be termed conservative. In regard to banking system credit to the nonfinancial public sector, the standard monetary accounts presentation of net credit to the public sector is distorted due to the accounting treatment of the rescheduling of external public sector debt. Two alternative definitions of credit to the public sector are also presented in Table IV. Definition I includes credit created by the rescheduling of external debt but excludes·excludes its effect in calculating annual percentage changes, and Definition II also includes such credit but adds in Central Bank losses. Neither definition indicates strong increases in banking system net financing to the nonfinancial public sector. By and large, this finding reflects governmental policy buttressed in 1984 by prolonged negotiations with the IMF, in 1985 by a Standby arrangement, and in 1986 by negotiations with the IMF and by direct sales of Treasury bonds to the private sector investors. Private sector holdings of money and quasimoney (banking system liabilities) increased by 10.4 % in 1984, 17.4 % in 1985, and 22.2 % in 1986, growing more or less in line with the rate of inflation and responding to the positive real rates of interest existing on liquid savings instruments. In 1986 money (M1) grew by 37.6 % and quasimoney grew by only 12.1 %. However, these statistics are somewhat misleading because this performance was largely the result of people switching from Central Bank stabilization bonds (which are included in the definition of quasimoney) to Treasury bonds (which are not included in that definition) due to higher yields of the latter (about one percentage point higher). Monetary policy in Costa Rica is constrained by the general openness of the economy, by high real interest rates prevailing throughout world money markets, and by the existing mini-devaluation (crawling peg) exchange rate program. These constraints produce interest rates in Costa Rica's organized financial markets that are effectively in the range of 25 % to 35 % per annum and thus strongly positive in real terms. Credit users complain about high positive real interest rates and from time to time about the lack of credit. However, with the 9.8 % devaluation (12-month basis to December) registered in 1986 we judge that the 21.0 % to 24.5 % per annum rates on six-month commercial bank

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certificates of deposit (in December 1986) was adequate inducement to Costa Ricans for holding local currency as compared with dollars. We also suspect, however, that lower local currency deposit rates, e.g. below 20 %, would risk inducement to capital flight and to the dollarizing of the Costa Rican economy.

Balance of Payments. Strong import compression induced by real devaluation and lowered real incomes reduced import expenditures from $ 1.5 billion in 1980 to less than $ 0.9 billion in 1982. Thereafter, imports rose to about $ 1.0 billion in 1983 and to $ 1.1 billion in 1984 and 1985; see Table V. Despite a saving of about $ 55 million due to lower petroleum import cost in 1986, import expenditures continued to grow in 1986 and amounted to an estimated $ 1.16 billion. On the export side, commodity export earnings (FOB) declined from $ 1.0 billion in 1981 to $ 0.87 billion in 1982 and $ 0.86 billion in 1983. In 1984 export earnings moved back to the $ 1.0 billion level due in part to the growth of nontraditional exports to outside of Central America. However, 1985 export performance was disappointing with a decline to the $ 0.93 billion level due to decreased banana production, reduced sugar exports, and a strong decline in exports to the CACM. In 1986 export earnings increased to $ 1.08 billion due to increased coffee prices and to continued growth of nontraditional exports to non-Central American markets. From a low of $ 24 million in 1982, Costa Rica's trade deficit increased in successive years to a high of $ 181 million in 1985 due to rising imports driven upward mainly as a function of increasing domestic demand associated with restoration of stability and increased external assistance. In 1986, however, the growth of import demand was generated mainly by external forces, i.e., from higher incomes associated with higher coffee prices and with expansion of nontraditional exports, and the trade deficit declined to $ 86 million due to the large increase in export earnings. In regard to other current account items, the net inflow on nonfactor services has increased due to the growth of value-added of drawback export firms (from $ 17 million in 1983 to $ 37 million in 1986). Official interest also declined from $ 328 million in 1983 to an estimated $ 275 million in 1986, and this was due to the lower interest cost of the variable rate portion of the public sector external debt. Costa Rica's balance of payments current account deficit amounted to $ 250 million in 1984 (6.8 % of GDP), to $ 300 million in 1985 (7.8 % of GDP), with a subsequent decline in 1986 to $ 198 million (4.7 % of GDP).

Balance of Payments Assistance. The largest element in financing B/P current account deficits is external assistance. As is shown in the Table V (i.e., in the section presenting the B/P financial gap), these operations, include disbursements of ESF (Economic Support Funds of the USG) and of World Bank SALs, debt relief from Paris Club (governments) and foreign commercial banks, and net IMF resource flows amounted to $ 300 million in 1984, $ 578 million in 1985, but declined to only $ 238 million in 1986. In the gap format, the reduction of existing foreign exchange payment arrears adds to the gap (because that uses foreign exchange) and the accumulation of new arrears reduces the gap (because that saves foreign exchange). In 1985 debt relief arrangements and ongoing programs with the IMF and World Bank provided sufficient resources to reduce arrearages (to about $ 33 million at year-end 1985). During 1986 payment arrears were allowed to grow again, apparently as part of a negotiation strategy aimed at obtaining new debt relief arrangements with foreign commercial banks and governments. In addition, the growth of payment arrears in 1986 also compensated for the lack of new arrangements with the IMF, foreign commercial banks, and the Paris Club. The Table V gap format, which presents preliminary estimates for 1986 capital and compensatory account items, confirms the supposition (made in April 1986) that the 1986 gap required new financing approximating $ 240 million. That is, retrospectively per Table V, the basic financial gap ($ 305 million) less previous debt relief ($ 133 million) plus year-end 1985 payment arrears ($ 33 million) and the net projected outflow to the IMF ($ 34 million) amounted to $ 239 million. This gap was financed by World Bank and ESF resources amounting to $ 121 million and the remainder was financed (and even overfinanced) through a large accumulation of payment arrears ($ 165 million). Clearly, in absence of B/P assistance in 1986 Costa Rica would have had to cut back on imports. The weakness of Costa Rica's external accounts is illustrated by the fact that it would have to reduce imports to live solely on cash flow. By this, we mean that if Costa Rica stopped all service of external debt and had to forego all capital inflows as a consequence, imports would still have to be reduced even without a net outflow of private capital. Taking 1985 as an example, imports would have to be cut by $51 million, which is the shortfall in cash flow calculated by excluding payment of official interest from the current account balance.

3. Debt Relief Activities

By 1982 Costa Rica's external debt had increased substantially and relative to GDP, and by year-end 1982 public sector external debt was equivalent to 122 % of GDP as compared with 33 % in 1978-1979, and the ratio of public sector debt service to exports of goods and services rose from 31 % in 1978-1979 to 54 % in 1982. After suspension of public sector debt service in August 1981, lengthy negotiations were undertaken, and Costa Rica reached agreement with bilateral and commercial bank creditors in 1983. In regard to bilateral creditors, in January 1983, the GOCR signed a debt rescheduling agreement under the aegis of the Paris Club with ten creditor countries which rescheduled 85 % of the principal and interest in arrears at June 30, 1982 and falling due between July 1, 1982 and December 31, 1983 to a seven-year period beginning December 1985. The total debt relief provided under this agreement is estimated at $ 136 million. In regard to commercial bank

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creditors, in April 1983, the GOCR signed a memorandum of understanding with foreign commercial banks, covering 95 % of principal in arrears and falling due in 1983 and 95 % of principal 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 Facility in favor of Costa Rica (of self-liquidating and diminishing character) composed of fifty percent of interest payable and due in 1983. Including the arrangements noted above as well as the restructuring of suppliers' credits and dollar denominated certificates of deposit (issued by the Central Bank), the 1983 arrangements provided relief amounting to $ 941 million ($ 749 million in regard to arrears and $ 192 million in regard to debt service falling due in 1983).

Negotiations between the IMF and Costa Rica on a new program were delayed in 1984, and a new Standby did not go into effect until March 1985. For that reason Tranche II of the 1983 agreement with commercial banks did not go into effect until early 1985, and total debt relief in 1984 was less than had been expected. New arrears, principally to bilateral creditors and commercial banks, were accumulated in the second half of 1984. In early 1985 the GOCR reached debt relief agreements with bilateral creditors (the ten creditor countries in the Paris Club) and with the foreign commercial banks. The 1985 Paris Club agreement (April 22, 1985) rescheduled official credits contracted before July 1, 1982 and falling due from January 1, 1985 to March 31,1986 (the consolidation period) or in arrears at December 31, 1984. However, debt service resulting from Costa Rica's 1983 Paris Club agreement was not eligible for restructuring. In the 1985 agreement, 90 % of the debt service in the consolidation period was rescheduled with a five-year grace period (to 1991) followed by a five-year repayment period. The arrears at the end of 1984 were rescheduled with a three-year grace period and eight-year repayment period. Each of the two 10 % residual amounts were scheduled to be paid in three installments (from 1985 to 1988).

In January 1985 the Government of Costa Rica and foreign commercial bank creditors agreed to reschedule 100 % of maturities falling due to participating commercial banks in 1985 and 1986, to the provision of $ 75 million in new credit, and a shift in maturity dates of the Revolving Trade Credit (mainly from 1986 to 1987). This agreement was finalized in May 1985. The principal due in 1985 and 1986 was rescheduled over a ten-year period with a three-year grace period followed by a seven-year repayment period. The 1985 agreement with the Bank Steering Committee was conditioned upon Costa Rica being in compliance with the 1985 Standby, to approval by the World Bank and GOCR of a Structural Adjustment Loan, and upon the GOCR seeking comparable debt relief from other creditors on debt of similar maturities.

Despite the size of the 1985 B/P support package, which approximated $ 0.6 billion, cross-conditionality among agreements coupled with four separate episodes of delays in necessary action by the Costa Rican Legislative Assembly, cast doubt, at times, on the fate of the program. For example, delay in obtaining Legislative Assembly approval for the World Bank Structural Adjustment Loan (SAL) from early June to August 1985 delayed slated foreign exchange inflows (from the first tranche of the SAL and from the second tranche of the commercial bank new credit facility) and caused noncompliance at the end of June 1985 on the arrearage reduction test in the Standby. In addition, the August (mid-year) review of the Standby by IMF staff also suggested the need for correction of the public sector financial program, and the IMF required a supplementary Letter of Intent which also touched on several issues including central administration revenues and expenditures, wage policy, exchange rate policy, and foreign exchange deposits. Agreement was reached with the IMF in early October 1985, and Costa Rica was once again in compliance with the Standby. Even so, revision of the Standby delayed the marketing of the the commercial bank $ 75 million new credit facility, and the second tranche ($ 56.25 million) of this credit was not available until late November 1985. Thus, during most of 1985 Central Bank holdings of freely-disposable foreign exchange reserves were low.

4. The Outlook for 1987

The outlook for the Costa Rican economy in 1987 is influenced by uncertainties related to the petroleum and coffee prices. The main elements of governmental economic policy for 1987 were set out by the Central Bank President and Minister of Finance in a joint presentation on governmental economic policy for 1987 to Costa Rican businessmen and officials in December 1986; see 86 San Jose 12678. They explained that the 1987 program would include continuation of the system of minidevaluations (a crawling peg exchange rate), reliance on orthodox instruments of monetary control (open market operations and reserve requirements) rather than directed allocation of credit, and interest rates determined mainly by market forces. The Central Bank President also stated that commercial banks would be free to allocate credit and that the domestic banking system would not be a net lender to the public sector. In the fiscal area, the Minister of Finance noted that public sector finances had deteriorated in 1986 due mainly to a reduction in the tax burden due mainly to the granting of exemptions. He promised that taxes would not be increased on domestic production and foreign trade but he projected increased taxes on automobiles and high-value houses as a source of additional fiscal revenue. He also noted that in intial discussions the IMF staff had required reduction of the public sector deficit by as much as 3.0 % of GDP (from the projected "without measures" situation for 1987) and that agreement in this area, as opposed to other areas, would be difficult.

The projected service (i.e. interest and maturing principal) of public sector external debt in 1987 approximates $ 900 million, which amounts to about 85 % of commodity export earnings. Efforts to obtain external assistance to close the 1987 balance of payments gap began in the second half of 1986. At a September meeting with the commercial banks, the Government of Costa Rica announced cessation of service payments on external debt to commercial banks. Subsequently, the Government presented a request for a rescheduling of all debt to commercial banks outstanding at June 30, 1986 with payment of interest through 1988 at 4.0 % interest p.a. (per annum) and at 5.0 % interest p.a. from 1989 to June 30, 1993, and at the lesser of LIBOR or 6.0 % p.a. thereafter. A twenty-five year term was also requested including a seven-year grace period, and repayment thereafter would be based upon a formula related to performance of GDP and interest payments. The Bank Steering Committee turned down this plan and requested that Costa Rica obtain an arrangement with the IMF as a precondition to debt relief. In his December presentation the Central Bank President noted that apart from the rescheduling of maturing principal, participation from foreign commercial banks was needed in 1987 either in the form of new money or lower interest rates and that Costa Rica was paying the banks up to $ 5 million per month as interest (approximately half of the contractual interest).

The visit of President Arias to Washington in December 1986 gave renewed hope for a negotiated settlement of the problem of high service burden of external debt. Costa Rican officials also met with IMF and World Bank officials, and an IMF Mission came to San Jose in December and held consultations for three weeks. A second IMF Mission came to San Jose in March 1987, and an agreement in principle on an 18-month Stanby was reached. IMF staff approval of the Letter of Intent and related documents for this Standby is expected during the second half of April. However, further implementation of the Standby awaits agreement in principle with major external creditors (the Bank Steering Committee and the Paris Club) on amounts of debt relief for 1987. In addition, the GOCR recently presented an initial program paper to the World Bank in regard to a second Structural Adjustment Loan.

At this writing we recognize that uncertainties exist concerning the direction of GOCR economnic policy, as evidenced by difficulties surrounding action on the tax package in the Legislative Assembly and the recent resignation and reinstatement of Eduardo Lizano as Central Bank President. We recommend the counsel of caution in regard to possible changes in GOCR economic policy, but we also believe that the Costa Rican authorities have a reasonable prospect of closing the 1987 foreign exchange gap.

Balance of Payments. The Mission and IMF/Central Bank projections for Costa Rica's 1987 balance of payments and exports are presented in Tables V and VI. The fact of pending negotiations with important external creditors impart uncertainty to projections of 1987 balance of payments. In regard to 1987, column (A) is the Central Bank/IMF projection of December 1987; column (B) is the Mission revision based upon additional information on potential debt relief; and column (C) is the Central Bank/IMF projection of March 1987. At present, detailed data on exports consistent with the latter projection is not yet available. However, the current account deficit is similar to the earlier versions. The critical assumptions underlying our column (B) projection of Costa Rica's 1987 balance of payments include coffee export earnings (FOB) at $ 294 million dollars (as compared with $ 374 million in 1986), import expenditures (CIF) at $ 1,180 million (up only slightly from the $ 1,163 million of 1986), interest on public sector external debt at $ 293 million, and a current account deficit at $ 279 million. As projected for 1987, a moderate (4.4 %) decline in export earnings coupled with a small increase in import expenditures (1.5 %) and small increase in the deficit on net service income underlies an $ 81 million increase in the deficit on current account.

The column (A) version did not project debt relief but found that the gap prior to such relief would amount to $ 699 million. Our examination of the the prospects for debt relief finds a reasonably probable estimate amounting to $ 586 million composed of $ 508 million from the rescheduling of amortization and $ 78 million from the rescheduling of interest. This $ 586 million is composed as follows (with amounts stated in millions of dollars in parentheses): (a) rescheduling of the 1986 maturity of the Revolver Credit Facility (40), (b) rescheduling of 1987 maturities of the Revolver Credit Facility (161), (c) rescheduling of 1987 maturities of other commercial bank loans (182), (d) rescheduling of 1986 maturity of other commercial bank loans (9), (e) rescheduling of 85 % of 1987 Paris Club maturities not previously rescheduled (17), (f) rescheduling of 85 % of 1987 maturities of loans from governmental authorities in Mexico and Venezuela (44), (g) rescheduling of Floating Rate Notes in arrears at year-end 1986 (18), (h) rescheduling of Certificates of Deposit of the Presa maturing in 1987 (37), (i) rescheduling of 85 % of interest slated to Paris Club creditors during 1987 (18), and (j) interest relief or fresh money from foreign commercial bank creditors (60). The March 1987 Central Bank/IMF projection indicates amortization relief of $ 468 million (the sum of $ 307 million in relief denoted "above the line" plus conversion of 1986 maturities of the Revolver Credit Facility to a medium term credit, i.e, additional relief of $ 161 million) plus $ 19 million in interest relief). This is $ 109 million lower than the column (B) projection. Present information indicates that the column (C) projection did not include interest relief or fresh money from foreign commercial bank creditors, and we believe that estimates for certain other items may also differ. We expect that the IMF will not be able to proceed with processing the Standby until substantial closure of the $ 97 million gap obtains. The IMF Standby performance criteria for improvement of the net international reserves and foreign exchange arrears of the Central Bank set goals of $ 160 million for the former and $ 125 million for the latter. However, these goals are hedged to state that the if the timing of rescheduling or negotiated terms differ from those assumed in the reserve targets, these targets will be revised. We judge that presentation of a single version of Costa Rica's 1987 balance of payments must await agreement in principle with the major external creditors and information on the amounts and timing of debt relief.

Per the B/P gap format (see Table V continuation), in reference to column (B) the deterioration on current account is reflected in a basic financial gap projected at $ 406 million in 1987 as compared with $ 305 million in 1986. The full elimination of payment arrears would absorb $ 198 million and, for tabular convenience we also treat the $ 161 million of the Revolver Credit Facility maturing in 1987 as an arrear. For this reason, the total 1987 financial gap amounts to $ 765 million. We project that debt relief plus other balance of payments assistance will amount to $ 692 million, leaving an over-all deficit of $ 73 million. In the column (C) version the financial gap amounts to $ 695 million and payment arrears are not completely liquidated during 1987 ($ 44 million would remain at the end of the year). This plus modest usage of official reserves ($ 20 million) helps in close the gap. Both versions confirm that even though the amount of required B/P assistance for 1987 is high, potential coverage exists within the prospects of a feasible negotiation.

The Monetary Program. The 1987 monetary program is an integal part of the Standby program that the GOCR expects to become effective in the second half of 1987 and is consistent with the objectives of lowering the rate of inflation and strengthening the Central Bank's net international reserve position. The 1987 monetary program is designed to reduce the rate of inflation to about 10 % by the end of 1987. The monetary program projects that banking system net domestic credit to the nonfinancial public sector will decline by 6.0 % in 1987 and credit to the private sector will increase by 13.3 % in 1987. The program also implies that banking system total net domestic credit will grow by 8.7 % in 1987 and this is somewhat lower than the anticipated rate of inflation, emphasizing the restrictive nature of the program. In regard to management of the instruments of monetary control, reserve requirements on demand and up to 30-day deposits will be increased from the present 32 % to 35 % over a two month period and those on 30- to 180-day deposits will be increased from 21 % to 23 % over the same period. Earlier in the year, Central Bank announced in its 1987 credit program that it would abandon credit ceilings as a means to control the expansion of monetary aggregates, giving banks freedom in allocating credit, and that Central Bank would rely more on orthodox instruments of monetary control, namely changes in reserve requirements on bank

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deposits and open market operations, i.e., sales and purchases of stabilization bonds. In regard to interest rates, according to present regulations, financial intermediaries are allowed to set their interest rates both on deposits and loans with the following provisions: the minimum lending rate can not be lower than their six-month deposit rate, and the maximum lending rate can not exceed the six-month deposit rate by more than 9 percentage points during the first half of 1987 and by more than 8 percentage points thereafter. As long as interest rates are determined by market forces (and not by administrative fiat), we expect that they will continue to be positive in real terms.

Public Sector Financial Operations. Data conforming with IMF methodology and prepared by the Ministry of Finance on the financial operations of the nonfinancial public sector are presented in Table III. Data for 1986 are preliminary estimates (revised in conjunction with the March 1987 IMF Mission), and data for 1987 are projected both "without" and "with" measures to generate new tax revenues and to reduce expenditures. In the 1987 "without measures" situation total public sector deficit would approximate 6.2 % of GDP and in the 1987 "with measures" situation the deficit would approximate 4.1 % of GDP. In regard to the "without measures" situation the 1987 deficit of the central administration at 3.4 % of GDP is the same as in 1986, the 1987 surplus of the rest of general govenment is slightly lower (1.4 % of GDP versus 1.6 % of GDP), and the state enterprise sector moves to a 0.1 % of GDP deficit in 1987 versus a 0.3 % surplus in 1986. The measures to reduce the 1987 public sector deficit impact mainly on the central administration and on the Central Bank. The initial program related to December 1986 GOCR consultations with the IMF aimed at reducing the public sector deficit by cutting 1987 central administration expenditures by approximately ₡ 2.0 billion and increasing revenues also by approximately ₡ 2.0 billion (by means of the tax package discussed above) and also with a 2.0 billion subsidy of ESF local currency to reduce Central Bank losses. The Standby as presently formulated specifies a cumulative quarterly expenditure ceiling for the central administration, and this ceiling can be raised by the extent to which the specified quarterly revenue goals are surpassed. In reference to Table III column (C), the limit on 1987 central administration expenditures without additional revenues (above ₡ 41,820 million) is ₡ 47,400 million.

Turning to Central Bank losses, we note that the functional importance of Central Bank losses arises from the expansion of the stock of money that these losses create. The loss arises from the difference between interest earnings and expenditures of the Central Bank, and external debt acquired by the Central Bank during the late 1970s increased interest expenditures. Thus, to buy foreign exchange the Central Bank prints and sells local currency. The March 1987 estimate of Central Bank losses for 1987 is ₡ 8.8 billion including the ₡ 2.0 billion subsidy from the ESF local currency account noted above.

Economic Growth. Based upon local economic forecasts and evidence we judge that Costa Rica's GDP will growth by 2.0 % to 3.0 % in 1987. We expect that the restrictive fiscal and credit policies described above will constrain growth of aggregate demand. Moreover, restrictive demand management is necessary due to low foreign exchange reserves and continuation of tight external resource availability. Furthermore, with lower coffee prices and higher petroleum prices as compared with 1986, Costa Rica's terms of trade are less favorable and real income is lower. In contrast to 1986, a year in which the total resources available to the Costa Rican economy (i.e., Gross Domestic Expenditures) grew by 6.7 %, we expect that this variable will growth at a substantially lower rate in 1987, in the range of 1.5 to 2.0 %. In general terms the impetus to growth of GDP in 1987 will come from a good coffee crop, an increase in banana production, resurgent private sector construction activity, and continued growth in nontraditional exports to markets outside of Central America. We do not expect substantial (i.e., higher than 3.0 %) growth for the manufacturing sector output due to lack of growth of domestic real income and also to unresolved problems in the financing of Central American trade as well as to lower demand implied in the exchange rate depreciations of Guatemala and El Salvador.

TABLE I: SELECTED ECONOMIC INDICATORS, 1983-1987

	1983	1984	1985	1986	1987
GDP in Current Prices (A)	129,314	163,011	192,425	239,231	261,241
GDP in U.S. Dollar Equivalent (B)	3,112	3,671	3,813	4,234	4,150
GDP in Constant Prices 1977=100	105	113	114	119	122
GDP Per Capita in Constant Prices, 1977=100 (C)	89	94	92	93	93
Growth of GDP in Constant Prices (Percent Change)					
Gross Domestic Product	2.9	8.0	1.0	4.2	2-3
Basic Productive Sectors	3.0	11.3	0.3	3.9	2.4
---Agriculture	4.0	10.1	-2.9	0.8	2.0
---Manufacturing	1.8	10.4	3.2	7.1	3.0
---Construction	4.7	23.6	1.3	1.3	1.5
Government	-1.6	1.5	0.5	1.5	N/A
Other Sectors	3.8	6.2	1.7	5.1	N/A
Prices (Percent Change)					
GDP Deflator (Annual Average)	28.9	16.7	16.9	15.7	10.0
Consumer Prices (Dec. to Dec.)	10.7	17.3	10.9	15.4	N/A
Wholesale Prices (Dec. to Dec.)	5.9	12.2	7.6	11.9	N/A
Unemployment (Percent) (D)	9.0	7.8	6.3	6.1	N/A
Employed Labor Force (thousands)(D)	739.1	770.4	813.4	846.6	N/A
Real Average Wages (1977=100)					
---From DGES/MinLab Employ. Survey	86	98	103	N/A	N/A
Public Sector	74	84	88	N/A	N/A
Private Sector	90	102	108	N/A	N/A
---From Payroll reports to Soc. Sec.	92	97	106	110	N/A
Public Sector	85	87	97	102	N/A
Private Sector	97	105	113	116	N/A
Exchange Rate (colones per U.S. $) (Selling Price, December 31)					
Official Market (E)	20.50	20.50	20.50	20.50	N/A
Banking or Unified Market	43.65	48.00	53.95	59.25	N/A

Notes:

(A) Millions of Colones; conforms to March 1987 IMF/GOCR tables.

(B) Millions of U.S. Dollars

(C) Per capita GDP was calculated based upon the population series from the Central Bank (official) National Accounts 1976-1985, and a 2.67 percent population growth rate was used to obtain data for 1986 and 1987.

(D) March of each year

(E) A constitutional requirement not used for any transactions.

TABLE II: PERFORMANCE OF GROSS DOMESTIC PRODUCT, 1980-1987

	1980	1981	1982	1983	1984	1985	1986	1987 (proj.)
A. As Percent of 1977 Real Value								
Gross Domestic Product	112.4	109.8	101.8	104.7	113.1	114.2	119.0	122.0
Imports of Goods & Services	106.8	78.7	64.4	74.6	82.6	82.6	94.6	n.p.
Exports of Goods & Services	108.6	120.7	114.1	112.6	125.3	118.2	120.9	n.p.
Gross Domestic Expenditure	111.4	93.6	82.6	89.9	96.7	101.7	108.5	110.4
Total Consumption	109.7	100.8	92.4	96.1	102.5	106.4	112.0	113.9
Private Consumption	108.9	99.6	90.1	95.1	102.0	106.5	112.7	n.p.
Public Consumption	113.3	106.9	104.2	101.1	105.1	106.2	108.4	n.p.
Gross Domestic Investment	116.4	72.5	54.0	71.9	79.8	87.8	98.4	100.0
Per Capita Basis:								
Gross Domestic Product	103.6	98.5	88.9	89.0	93.7	92.1	93.5	93.3
Total consumption	101.1	90.5	80.7	81.7	84.9	85.8	87.9	87.1
Private consumption	100.5	89.4	78.6	80.9	84.4	85.8	88.5	n.p.
Gross Domestic Investment	107.4	65.1	47.2	61.1	66.0	70.8	77.3	76.9
B. Growth by Sectors of Origin								
Agriculture	-0.5	5.1	-4.7	4.0	10.1	-2.9	0.8	2.0
Manufacturing	0.8	-0.5	-11.4	1.8	10.4	3.2	7.1	3.0
Construction	-1.1	-21.7	-31.9	4.7	23.6	1.3	1.3	1.5
Basic Productive Sectors(*)	0	-1.2	-10.8	3.0	11.3	0.3	3.9	2.4
Government	3.6	1.8	-2.9	-1.6	1.5	0.5	1.5	n.p.
Other Service Sectors	0.9	-4.3	-4.5	3.8	6.2	1.7	5.1	n.p.
Gross Domestic Product	0.8	-2.3	-7.3	2.9	8.0	1.0	4.2	2-3

C. Aggregates and Sectors as Percentage of Gross Domestic Product in 1984-1985

Gross Domestic Product	100.0	Agriculture	20.1
Net Foreign Balance	6.4	Manufacturing	21.9
Imports of Goods & Services	32.3	Construction	4.3
Exports of Goods & Services	38.7	Basic Productive Sectors	46.3
Gross Domestic Expenditure	93.6	Commerce	16.4
Total Consumption	73.4	Transportation	7.3
Private Consumption	61.2	Financial Services	5.8
Public Consumption	12.2	Housing	7.2
Gross Domestic Investment	20.3	Personal Services	4.2
Gross Fixed Investment	18.9	Electricity	3.1
Change in Inventories	1.5	Other Service Sectors	44.0
		Government	9.8
		Total: Gross Domestic Product	100.0

Source: Constructed from official national accounts (Central Bank of Costa Rica).
Note: Basic Productive Sectors is the sum of Agriculture (i.e., Agriculture, Forestry, Hunting, and Fishing), Manufacturing (i.e., Manufacturing, Mining, and Quarrying), and Construction. n.p. signifies not projected.

TABLE III: OPERATIONS OF THE NONFINANCIAL PUBLIC SECTOR 1984-1987
(In millions of colones)

	1984	1985	1986(A)	Without Measures 1987(B)	With Measures 1987(C)
Central Administration	-4,966	-3,940	-8,245	-8,887	-5,423
Revenue	27,012	32,005	38,030	41,183	43,977
Expenditure	31,978	35,945	46,275	50,070	49,400
Current	(26,586)	(30,144)	(36,858)	(42,585)	(42,476)
Capital and net lending	(5,391)	(5,802)	(9,417)	(7,485)	(6,925)
Rest of General Government	2,468	3,017	3,920	3,607	3,687
Revenue	15,176	19,336	25,364	28,295	28,295
Current	(14,909)	(18,765)	(24,882)	(27,715)	(27,715)
Capital	(267)	(571)	(483)	(580)	(580)
Expenditure	12,708	16,319	21,444	24,687	24,607
Current	(11,916)	(14,535)	(18,809)	(20,526)	(20,526)
Capital and net lending	(792)	(1,784)	(2,636)	(4,162)	(4,082)
State Enterprises	7	-2,479	642	-284	20
Revenue	34,152	36,950	43,269	46,793	46,793
Current	(33,860)	(36,659)	(41,621)	(45,722)	(45,722)
Capital	(292)	(291)	(1,648)	(1,071)	(1,071)
Expenditure	34,145	39,429	42,628	47,077	46,773
Current	(30,217)	(35,065)	(37,358)	(40,049)	(40,165)
Capital and net lending	(3,928)	(4,364)	(5,269)	(7,029)	(6,609)
Public Sector Current Account Deficit (-)	7,061	7,685	11,508	11,460	14,249
General Government	3,418	6,092	7,245	5,787	8,691
State Enterprises	3,642	1,594	4,263	5,673	5,558
Nonfinancial Public Sector Overall Deficit (-)	-2,491	-3,402	-3,684	-5,564	-1,716
Net Residual(D)	-598	-313	0	0	0
Deficit Financing	3,089	3,715	3,684	5,564	1,716
External Net	1,460	699	-	-	-
Domestic	-471	-1,054	-	-	-
Banking System	(-959)	(-1,633)	-	-	-
Other	(488)	(579)	-	-	-
External Arrears	2,100	-3,096	-	-	-
Rescheduling	0	7,166	-	-	-

(In Percent of GDP)

	1984	1985	1986(A)	Without Measures 1987(B)	With Measures 1987(C)
Central Administration					
Deficit (-)	-3.1	-2.0	-3.4	-3.4	-2.1
Revenue	(17.0)	(16.6)	15.9	15.8	16.8
Expenditure	(-20.2)	(-18.7)	-19.3	-19.2	-18.9
Rest of General Government					
Deficit (-)	1.2	1.6	1.6	1.4	1.4
State Enterprises Deficit (-)	0	-1.3	0.3	-0.1	0
Nonfinancial Public Sector Overall Deficit (-)	-1.9	-1.9	-1.5	-2.1	-0.7
Central Bank Net Operating Losses (E) (-)	-4.6	-5.3	-3.8	-4.1	-3.4
Total Public Sector Deficit(-)	-6.5	-7.2	-5.3	-6.2	-4.1

Source: IMF and Ministry of Finance (March 1987)

Notes to Table III

Data are based on the reduced public sector which comprises the Central Government and the 18 largest decentralized institutions and public enterprises.

(A) Preliminary.

(B) IMF/Ministry of Finance projection.

(C) IMF/Ministry of Finance projection with measures to cut expenditures and Central Bank losses and to increase revenues.

(D) The net residual is the difference between the deficit obtained from accounting records (above the line) plus imputed interest (to account for interest in arrears) and the deficit obtained through the inspection of the financing flows.

(E) Central Bank net operating losses are on accruals basis.

TABLE IV: MONETARY ACCOUNTS 1984-1987
(December 31 of each year;
Millions of Colones)

	1984	1985	1986	1986	1987(A)
Exchange rates used for conversion of FX to colones:	45.00	56.50	56.50	63.00	63.00
---Central Bank---					
Net International Reserves	-11,800	-3,748	-7,124	-7,941	48
Official Reserves	-2,030	-1,154	1,962	2,188	2,977
Payments Arrears	-9,770	-2,593	-9,086	-10,129	-2,930
Net Domestic Assets	21,685	17,004	24,386	25,204	19,567
Net Credit to Public Sector(B)	30,340	35,300	45,499	48,772	48,031
Net Credit to Banks	-10,566	-12,444	-11,078	-12,052	-13,620
Government Trust Funds (C)	-4,478	-10,985	-18,263	-18,263	-23,220
Stabilization Bonds	-4,895	-5,586	-6,228	-6,228	-9,933
Long-term Foreign Liabilities	-70,183	-95,456	-104,619	-116,654	-119,343
Other Assets Net	71,697	103,582	109,989	119,500	134,722
Counterpart Arrears	9,770	2,593	9,086	10,129	2,930
Currency Issue	9,885	13,256	17,262	17,262	19,615
---Banking System---					
Net International Reserves(D)	-558	1,089	5,403	6,025	6,187
Net Domestic Assets	137,525	182,563	197,370	221,466	240,750
Net Credit to Public Sector(B)	25,470	29,302	28,119	41,946	39,413
Central Government	(10,209)	(11,897)	(13,647)	(19,372)	(20,646)
Rest of Public Sector	(15,261)	(17,405)	(14,472)	(22,574)	(18,767)
Credit to Private Sector	32,470	37,782	43,779	43,914	49,753
Other Assets Net	69,815	112,886	116,386	125,477	148,654
Counterpart Arrears	9,770	2,593	9,086	10,129	2,930
Government Trust Funds(C)	4,478	10,985	18,263	18,263	23,220
Long-term Foreign Liabilities	72,882	99,648	95,276	118,026	119,552
Liabilities to Private Sector	59,607	73,019	89,234	91,202	104,165
Money	25,710	28,970	39,857	39,857	45,417
Quasi-money	33,897	44,049	49,377	51,345	58,748

Source: Central Bank of Costa Rica and IMF (March 1987).

TABLE IV (CONTINUED) Percentage Change(F)

Banking System	1984	1985	1986	1987(A)
Net Domestic Assets	7.8	15.5	8.1	8.7
Net Credit to Public Sector (B)	-5.9	-1.8	-4.0	-6.0
Definition (II) (E)	4.0	15.0	3.9	7.9
Net Credit to Private Sector	17.9	16.1	15.9	13.3
Liabilities to Private Sector	10.4	17.4	22.2	14.2
Money	14.4	12.7	37.6	14.0
Quasimoney	7.7	20.8	12.1	14.4

Notes:

(A) Projected data.

(B) Includes debt assumed by the Central Bank on behalf of the public sector related to the rescheduling of external debt. This reflects only an accounting entry in which the increase in Central Bank external liabilities is offset by an equivalent increase in Central Bank credit to the nonfinancial public sector. For the purpose of annual comparison, the IMF/Central Bank staff have adjusted the data to show the effect of such accounting at the beginning of the year; for that reason, percentage changes are not affected.

(C) Includes the local currency counterpart of grants to the Government and to Central Bank from ESF and World Bank SAL.

(D) Includes external payment arrears.

(E) The definition II version of banking system credit to the public sector includes all Central Bank losses, which are registered in "other assets net" of the Central Bank. Central Bank losses arise principally from interest which must be paid on Central Bank own external borrowings and from exchange transactions. This definition does not follow the prescription of legal beneficiary but rather lack of independence of the Central Bank from GOCR political authority (as has been recognized as fostering external borrowing which created subsequent losses).

(F) Percentage changes have been calculated using the same exchange rates for the conversion of foreign exchange to colones in each of the years compared.

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TABLE V: BALANCE OF PAYMENTS, 1983-1987
(Millions of U.S. Dollars)

	1983	1984	1985	1986 Estim.	1987 (A)	1987 (B)	1987 (C)
Exports, FOB	862	998	930	1,077	1,029	1,029	1,055
Imports, CIF	-993	-1,102	-1,111	-1,163	-1,180	-1,180	-1,204
Balance of Trade	-131	-105	-181	-86	-151	-151	-149
Nonfactor Services	122	123	125	133	134	134	137
Private Interest, Profit	14	0	-11	-7	-18	-18	-18
Official Interest	-328	-314	-280	-275	-293	-293	-289
(Paid)	(-275)	(-209)	(-245)	(-196)	(—)	(—)	(-269)
(Unpaid/Rescheduled)	(- 52)	(-105)	(-35)	(-79)	(—)	(—)	(-20)
Balance on Services	-192	-191	-166	-160	-177	-177	-170
Transfers	31	46	47	48	49	49	39
Balance on Current Account	-292	-250	-300	-198	-279	-279	-280
Private Capital and E.+ O.	68	24	119	170	100	100	60
Official Capital, Net	274	98	317	-24	-102	484	182
Disbursements	350	296	408	235	290	290	263
(Projects)	(194)	(166)	(208)	(115)	(165)	(165)	(138)
(ESF)	(156)	(130)	(160)	(81)	(125)	(125)	(125)
(IBRD-SAL	—	—	(40)	(40)	—	—	—
Amortization	-267	-339	-358	-392	-392	-392	-407
(Paid)	(-93)	(-110)	(-74)	(-210)	(—)	(—)	(-100)
(Unpaid/Rescheduled)	(-174)	(-229)	(-284)	(-183)	(—)	(—)	(-307)
Amortization Relief	157	154	250	131	n.p.	508	307
(Commercial Banks)	n.a.	n.a.	(146)	(107)		(392)	
(Paris Club)	n.a.	n.a.	(24)	(6)		(17)	
(Bonds)	—	—	(61)			(55)	
(Mexico & Venezuela)	—	—	(20)	(18)		(44)	
Interest Relief	34	—	23	2		78	19
Other	—	-12	-6	—	—	—	—
Balance on Capital Account	342	122	436	146	-2	584	242
Over-all Balance	50	-128	137	- 52	-281	305	-38
Financing (+ is B/P deficit)	-50	128	-137	52	-418	-328	38
Accum.(+), Reduc.(-) of Arrears	-749	175	-113	165	-198	-198	-154
Rescheduling of Arrears	1,070	—	57	—	—	—	108
Conversion of CDs	52	—	—	—	—	—	—
Revolver Credit Facility	152	50	75	0	-161	-161	0
Valuation Adjustment	8	—	—	—	—	—	—
Net Official Reserves	58	-97	99	-113	-59	31	-13
(Net Use IMF Resources	(99)	(-34)	(30)	(-16)	(-59)	(-19)	(-33)
(Other Offic. Reserves	(-41)	(-63)	(-129)	(-97)	(0)	(50)	(20)
Implied Gap	0	0	0	0	699	23	97

TABLE V: (CONTINUED)

Balance of Payments Financial Gap Format for 1984-1987
(Millions of U.S. Dollars)

		1984	1985	1986	1987(B)	1987(C)
	Current Account Balance	-250	-300	-198	-279	-280
Plus	Private Capital and E. & O.	24	119	170	100	60
Plus	Official Amortization	-339	-358	-392	-392	-407
Plus	Other Official	-12	-6	---	---	---
Plus	Project Loans	166	208	115	165	138
Equals	Basic Financial Gap	-411	-336	-305	-406	-489
Plus	Reduction (-) or Increase (+) of Arrears	175	-113	165	-359*	-207*
Equals	Financial Gap (-)	-236	-449	-140	-765	-695
Less	(Financial Inflows)	(300)	(578)	(238)	(692)	(579)
	ESF Loan & Grant	130	160	81	125	125
	Debt Relief	154	273	133	586	487
	Revolver Credit Facility	50	75	0	0	0
	IMF Net Resources	-34	30	-16	-19	-33
	IBRD Sructural Adjustment Loan	---	40	40	---	---
Equals	Over-all Balance	63	129	97	-73	-117
Less	Change in FX Reserves (- is an increase)	-63	-129	-97	50	20
Equals	Per B/P Accounting	0	0	0	23	97

Note: This table is a restatement of capital and compensatory accounts shown above, but with enlarged detail.

In regard to 1987, (A) is based upon the IMF-Central Bank projection of December 1986; (B) is based upon (A) plus our judgements regarding debt relief; and (C) is the March 1987 projection of IMF-Central Bank (and decomposition of debt relief by creditor is not available for this projection). Column (C) includes the rescheduling of the Revolver Credit Facility and 1987 maturities to foreign commercial banks but interest relief and/or fresh money from foreign commercial banks is not included.

*The projected reduction of payment arrears in 1987 includes rescheduling of 1987 maturities of the Revolver Credit Facility.

TABLE VI: EXPORTS BY PRINCIPAL PRODUCTS, 1983-1987
(Value in millions of U.S. dollars,
volume in thousands of units,
and prices in U.S. dollars)

	1983	1984	1985	1986	1987
Coffee					
Value	230.0	267.3	310.0	373.7	293.8
Volume (46 Kg. sacks)	2,357	2,457	2,632	1,915	2,350
Price (per 46 Kg.)	97.6	108.8	117.8	195.2	125.0
Bananas					
Value	240.4	251.0	212,2	224.3	238.8
Volume (Metric tons)	1,012	1,020	856	925	965
Price (per Metric ton)	237.5	246.1	247.9	242.5	247.5
Beef					
Value	31.9	44.9	55.6	64.9	52.0
Volume (Metric Tons)	13.9	21.2	28.1	36.9	28.1
Price (Per MT.)	2,295	2,120	1,980	1,760	1,850
Sugar					
Value	23.8	35.5	10.5	18.5	12.7
Volume (46 Kg. sacks)	1,173	2,231	697	1,281	1,185
Price (per 46 Kg.)	20.3	15.9	15.0	14.5	10.7
Sub-total:Traditional Exports	526.1	598.8	588.3	681.5	597.3
Non-Traditional Exports	336.0	400.2	342.0	395.1	431.3
To: Central American Common Market	196.9	191.5	129.2	96.0	100.0
To: Panama	33.5	33.5	31.4	39.0	40.0
To: Rest of the World	105.6	175.2	181.4	260.1	291.3
Total Exports, FOB*	862.1	999.0	930.3	1,076.6	1,028.6
Value-added from Drawback Exports*	17.2	26.1	35.0	37.0	40.0

Source: Central Bank of Costa Rica (December 1986) as revised by AID.

Note: *The value-added from drawback exports is excluded from exports (FOB) in Table V, but it is included in nonfactor service income.

TABLE VII:
NET INTERNATIONAL RESERVES OF THE CENTRAL BANK OF COSTA RICA, 1983-1986
(December 31 of each year; millions of U.S. dollars)

	1983	1984	1985	1986
1. NET OFFICIAL RESERVES	-92.8	-28.4	-79.2	34.2
Assets	306.7	420.3	492.7	557.2
Freely Disposable	58.6	95.7	111.7	134.4
Gold	24.4	8.8	19.1	26.2
Bank Deposits	32.7	20.2	81.7	11.9
Foreign Exchange	1.3	1.3	0.9	1.8
Securities	—	65.4	9.5	92.3
SDRs	0.6	---	0.5	2.2
Other Assets	248.1	324.6	381.0	422.8
Time Deposits (CA Central Banks)	134.8	184.8	238.8	365.4
Multilateral (CA clearing arrangements)	87.8	115.1	113.7	31.1
Contribution to CA Stab. Fund)	17.8	19.2	19.2	22.5
Other	7.7	5.5	9.3	3.8
Liabilities	-399.5	-448.7	-539.1	-523.0
Net Position with IMF	-191.9	-155.6	-188.6	-172.4
Revolving Credit Facility	-152.3	-201.9	-276.8	-276.9
Other Short-Term	-55.3	-91.0	-73.7	-73.7
Drawing in CA Stab. Fund	-32.0	-30.0	-30.0	-33.7
Banco de México (and clearing)	-5.0	-40.8	-3.2	0
Banco República de Colombia	-5.0	-5.0	-3.7	-0.8
Other	-13.3	-15.2	-36.8	-39.2
Adjustment of Short-Term Liabilities (IMF)	---	---	-32.8	---
2. PAYMENT ARREARS	-40.6	-144.4	-32.6	-197.7
Over 15 working days (imports)	40.6	26.0	—	-0.3
Other	—	118.4	-32.6	-197.4
3. NET INTERNATIONAL RESERVES (1+2)	-133.1	-172.8	-111.8	-163.5

Source: IMF for 1983; Central Bank of Costa Rica for 1984, 1985, and 1986.

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TABLE VIII

COMPOSITION OF FOREIGN EXCHANGE PAYMENT ARREARS,
DECEMBER 31, 1986
(Millions of U.S. dollars)

Creditor	Principal	Interest	Total
Commercial Banks			
Medium and Long term	9.1	44.5	53.6
Revolver Credit Facility	40.1	9.7	49.8
Bonds	17.6	---	17.6
CDs of the Presa	---	2.8	2.8
Bilateral (Governments)	39.1	22.9	62.0
Multilateral (IFIs)	4.6	7.0	11.6
Total Related to Public Sector External Debt	110.5	86.9	197.4
Arrears of Over 15 Working Days to Importers			0.3
TOTAL			197.7

Source: Central Bank of Costa Rica

ANNEX III

CODESA STATUS AND ACTION PLAN

This Annex consists of three parts:

1. Summary
2. Status Report Regarding Each Subsidiary and Affiliate, as of April 22
3. CY 1987 Corporation Divestiture Plan, as of April 12

1. Summary

	Action Pending	Sold	Dissolved and Liquidated	Transfered	In process of Dissolution and Liquidation	Retained	Total
Subsidiaries	6	3	3	4	13	1	30
Affiliates	2	3	1	2	3*	1	12
	8	6	4	6	16	2	42

(*) including one in process of sale

2. Status Report Regarding Each Subsidiary and Affiliate, as of April 22

a. Subsidiaries

1.	Acuacultura, S. A.	Sold
2.	Algodones de Costa Rica, S. A. (ALCORSA)	See 1987 Divestiture Plan
3.	Aluminios Nacionales, S. A.	Sold
4.	Atunes de Costa Rica, S. A.	Sold
5.	Atunes del Puerto, S. A.	In process of dissolution and liquidation
6.	Cía. Industrial Pesca Escama, S. A.	In process of dissolution and liquidation
7.	Central Azucarera Tempisque, S. A. (CATSA)	See 1987 Divestiture Plan
8.	Cementos del Valle, S. A. (CENVASA)	See 1987 Divestiture Plan
9.	Cementos del Pacífico, S. A. (CEMPASA)	See 1987 Divestiture Plan
10.	Consolidación de Compañías Agric. e Industriales, S. A.	Dissolved and liquidated
11.	Consorcio de Exportación de Productos Costarricenses, S. A.	In process of dissolution and liquidation
12.	Corp. para el el Desarrollo Agroind. Costarricense, S. A.	In process of dissolution and liquidation
13	Corp. de la Zona Franca de Exportación, S. A.	Transfered (CENPRO)
14.	Dist. Costarricense de Cementos, S. A.	Dissolved and liquidated
15.	Ferrocarriles de Costa Rica, S. A.	Transfered (INCOFER)
16.	Fertilizantes de Centroamérica (Costa Rica), S. A.(FERTICA)	See 1987 Divestiture Plan
17.	Guacamaya, S. A.	In process of dissolution and liquidation
18.	Guacanal, S. A.	In process of dissolution and liquidation
19.	Ingenio Tempisque, S. A.	In process of dissolution and liquidation
20.	Inmobiliarias Temporales, S. A.	In process of dissolution and liquidation
21.	Oficina de Fletamento Marítimo, S. A.	In process of dissolution and liquidation
22.	Sedemat, S. A.	In process of dissolution and liquidation
23.	Tempisque Ferry Boat, S. A. (TEMPISQUE)	See 1987 Divestiture Plan
24.	Transmesa	Transfered (MOPT)
25.	Transportes Aéreos Continentales, S. A.	In process of dissolution and liquidation
26.	Centro Permanente de Ferias y Convenciones, S. A.	In process of dissolution and liquidation
27.	Industrial Petrolera del Atlántico, S. A.	In process of dissolution and liquidation
28.	Azufrera de Guanacaste, S. A.	Dissolved and liquidated
29.	MINASA	Transfered (MIEM)
30.	Puesto de CODESA en la Bolsa Nacional de Valores	Retained in CODESA

b. Affiliates

1.	Subproductos del Café, S. A.	Sold
2.	Bolsa Nacional de Valores, S. A.	Retained in CODESA (40%)
3.	Servicios Aéreos Nacionales, S. A.	Sold
4.	LACSA	Sold
5.	Namucar	Transfered (MOPT)
6.	Multifert	Transfered (BCCR)
7.	Pancafé	Dissolved and liquidated
8.	Macasa	Licitation Pending
9.	Stabapari	Licitation Pending
10	Compañía Consolidada de Terrenos de Oro	In process of sale

c. Affiliates of DAISA

1.	INACO	In process of liquidation
2.	EXPOFRESCO	In process of liquidation

3. CY 1987 CORPORATION DIVESTITURE PLAN

Note: There follows the near final draft (as of April 12, 1987) of the CY 1987 Corporation Divestiture Plan, covering all the major remaining subsidiaries of CODESA. This plan has been reviewed by the National Commission, CODESA, AID and FINTRA. Several legal and technical details are being examined and the agreed text, taking these into account, should be in final form about May 1, for submission to the Cabinet. Divestiture is proceeding on the basis that the main lines are agreed.

1. ALCORSA (cotton)

   - Second licitation, with due date of February 26, attracted no bidders. National Commission has extended by 30 work days. Further extension will be needed.

   - CODESA and FINTRA are cooperating to interest a group of producers and users to purchase. CODESA has issued invitations for other groups to come forward.

   - AID will probably not authorize FINTRA to bid. However, if a serious group of purchasers can be identified, and assuming that they are willing to make a substantial financial commitment, FINTRA may be authorized to provide some financing of their acquisition of ALCORSA capital assets. AID/FINTRA funds cannot be used for working capital (i.e. crop financing).

   - In the event that no satisfactory sale of ALCORSA shares can be arranged, the Consejo de Gobierno will be asked to issue a decree authorizing CODESA, under the general guidance of the National Commission, to dissolve ALCORSA and liquidate its assets at the best price which can be obtained by CODESA management.

   - Target Timing: Divestiture or commencement of liquidation by July 31, 1987.

2. CEMVASA (cement)

   - First licitation with due date of February 11 attracted no interest or bids from the national cooperative sector.

   - CEMVASA is neither functioning nor viable. Impartial expert study confirms this.

- The financial position of minority shareholders' (12.5% private; 4.5% INVU) is valueless. CEMVASA liabilities in the real market exceed assets.

- The Consejo de Gobierno has been asked to issue a decree authorizing CODESA, under general guidance of the National Commission, to dissolve CEMVASA and liquidate its assets at the best price which CODESA management can obtain.

- In discussions with CODESA, the country's active cement companies, INCSA and CEMPASA, have indicated willingness to consider purchase of moveable assets. INCSA would be required to pay cash, and CEMPASA would be required to accept equivalent liabilities—as a wash transaction in order to adhere to the provisions of agreed covenants.

- FINTRA may be authorized to buy, at reasonable prices, and to dispose of, residual assets if not otherwise sold.

- Target timing: Divestiture June 30, 1987.

3. CATSA (sugar)

- The first licitation failed because of price and lack of organization by the cooperatives. Shares were offered to the national cooperative sector, according to a prior appraisal by the Controller General and following steps of a public bid in compliance with the law.

- The national cooperative sector remains interested if a viable organization and financing plan can be produced and if the price approaches real value. CODESA has organized a study committee, and, a technical and financial analysis is also being undertaken (C.F. Schaffer).

- The Consejo de Gobierno will be asked to issue a decree which:

  authorizes CODESA, under the general guidance of the National Commission, to sell CATSA shares or assets to a "private entity" which will commit itself to a specific plan to be negotiated so as to provide the national cooperative sector with an opportunity to participate in the ownership of CATSA on commercially reasonable terms, and to provide financing to assist the purchase.

— authorizes CODESA, under the general guidance of the National Commission, to s⁻ll CATSA assets at the best price which CODESA manage ..t can obtain.

- FINTRA will constitute the "private entity".

- CATSA shares will be sold marginally below "real value". A significant portion of this discounted price can be financed by FINTRA, with recourse to shares but not to the purchaser. The purchasers can anticipate that any repayments on the financed portion would be made over time from CATSA dividends.

- FINTRA would offer shares, first, to cooperatives and cane growers willing to constitute themselves as cooperatives. If any shares remain unsold, they would then be offered to cooperative members and cane growers. Any remaining shares would be offered, at an appropriate time, to the Costa Rican public.

- FINTRA would be required to arrange for management by a competent organization, to include if necessary competent external management and technical assistance. A fee should be provided to the managers which might include profit sharing or shares in the business.

- Target Timing: Preliminary financial and technical report by mid-April, final report by early May. Recommendation of Study Committee by end-April. Divestiture by July 31.

4. TEMPISQUE FERRY

- There was a GOCR commitment to pr.vatize this company by December 31, 1986. There is a group of workers interested in the purchase of the concession—and the new/nearly new ferry to be bought or leased.

- Viability of privatization depends principally on a fare rate structure which would permit a financial return on investment of 30–40% per year. A new fare structure is under consideration by the MOPT.

- There is considerable interest in the government at present in exploring the feasibility of constructing a bridge across the Tempisque River, which would obviate the need for a ferry.

- In view of uncertainties, and if sale can not be realized quickly, the Consejo de Gobierno will be asked to issue a decree which authorizes the transfer of the company to the MOPT, on the understanding that if the bridge is not to be built within a reasonable period, the GOCR would take steps to privatize—consistent with its previous commitment. Likewise, the decree would authorize issuance of bonds to compensate CODESA for the transfer of the company.

- Target timing. Feasibility study to be completed by June 30, 1987. Divestiture by privatization or transfer to the MOPT by August 31, 1987.

5. FERTICA (fertilizer)

- The law requires that no more than 40% of the shares be sold and the decision has been taken at the Presidential and Consejo de Gobierno level to contract for management for a reasonable period as part of a share sale package, or alternatively, a straight management contract apart from sale of shares.

- There have been preliminary negotiations with Norsk Hydro which has shown considerable interest in discussing technical assistance, administration and marketing, but now declines to purchase shares at this time.

- A search for other possible bidders is in process.

- The Controller General has made a valuation and a licitation should be issued as soon as there are good prospects for bidders.

- If a serious group of Costa Rican producers were interested in purchasing FERTICA, similar to the CATSA proposal, i.e. sale of shares in a corporate structure the potential purchasers might advocate a change in the law to allow 100% sale of shares.

- Any remaining GOCR-owned shares should be transferred to the CODESA successor organization.

- The first licitation should be issued as soon as a search for bidders has been completed. If this licitation fails, there should be a decision taken on whether to negotiate for a management contract with an appropriate party. At the same time, a further alternative which might be explored at the political leval would be a public offering of 40% (or even 100%) of FERTICA shares to Costa Rican farmers.

- Target timing — Divestiture of 40%, or at least the execution of a management contract, should be effected by August 31, 1987.

6. CEMPASA (cement)

   - The law requires that no more than 40% of the shares be sold; the decision has been taken at the Presidential and Consejo de Gobierno level to contract for management for a reasonable period as part of a share sale package, or alternatively, a straight management contract apart from sale of shares.

   - At this point, no politically acceptable foreign or domestic party has shown any interest in investment in CEMPASA and/or management of the company. CODESA management will conduct a further search. Present prospects for success do not appear great. In any event current management of CEMPASA is considered reasonably capable.

   - If no acceptable investor/manager can be identified, one of the following alternatives may be pursued:

     — Sale of shares to the general public plus employee share ownership.

     — Alternatively, divestiture of the 40% could be deferred indefinitely.

     — Management of CEMPASA could be strengthened by contracting for technical assistance.

   - Any remaining GOCR-owned shares should be transferred to the CODESA successor organization.

   - Target timing — A first licitación should be issued as soon as possible. Decision on later steps should be made by May 31, 1987.

LOCAL CURRENCY ACCOUNTABILITY

This Annex has been prepared in response to the growing interest in various quarters regarding how local currency resources are managed. Specifically, there is increasing concern that AID have the opportunity to examine appropriate supporting documentation to verify that agreement on uses of local currency has not been violated.

Until recently, there has been very little guidance from AID/W on this matter and, as a consequence, Missions have responded differently in their approaches to local currency management -- ranging from completely hands off to direct control. Since USAID/Costa Rica opted for the direct control approach to local currency management, the Mission is in excellent position to provide whatever documentation is deemed necessary for this purpose. The following discussion outlines the systems that are currently in place. It should be noted that they have evolved over the years based on Mission experience, and it is expected that they will continue to change as the circumstances warrant.

1. Agreement on Local Currency Use

The basic foundation for local currency use agreements is that the funds will be jointly programmed by the government and the Mission. There have been two ways in which this has occurred: (1) by identifying in considerable detail the individual activities for which local currency would be used directly in the Project Agrement controlling the disbursement of ESF cash transfer dollars (e.g., ESR III and ESR IV); and (2) by identifying the general areas in which the local currency would be used in the Project Agreement, but leaving specific activity identification until a later stage (e.g., ESR V).

Although the funds are owned by the GOCR, the Mission has looked at the local currency as a resource to help achieve its development strategy. In this regard, the Mission has negotiated with the GOCR to agree on activities that are consistent with that strategy at both the macro (i.e., the structural adjustments to be achieved through the CODESA divestiture) and micro (e.g., support to PVO activities) levels. In keeping, with the overall economic stabilization objectives of our program, activities such as the CODESA divestiture and the endowment for the Agricultural School for the Humid Tropics were also attractive because the funds are used in a non-monetized fashion; that is, the funds are not disbursed into the economy.

Whether agreed to in detail as part of the Project Agreement or at a later date, no activity is finally approved until a justification is prepared in accordance with a format designed by the Mission to document its priority and relationship to the Mission's strategy (see attached Mission Operations Memorandum, dated November 19, 1984). Each justification is reviewed by the Mission and approved on its merits. Experience has shown that the justifications often require some modifications before they are approved because the Mission staff detects potential implementation problems or has ideas that should facilitate implementation.

Once the justification is approved, the Mission prepares a Memorandum of Understanding (MOU), which is employed as the local currency equivalent of a Project Agreement. The contents of the MOU have been refined based on experience, but its basic function is to specify the terms and conditions applied to the use of the local currency. It includes a budget and a description of the activity being financed. When finalized, the MOU is signed by the Mission and the implementing institution (usually a private sector entity). In those cases where the activity being financed has not been specifically agreed to by the GOCR in prior documentation (e.g., the Project Agreement or a PIL), the GOCR also signs the MOU to indicate concurrence with the use of the funds.

2. Mission Local Currency Management Systems

The MOU is the basic document the Mission uses to manage its local currency portfolio. Each MOU is sequentially numbered under the ESR agreement from which the funding is made available.

The Mission's Program Office keeps a record of all funds available (including interest earned) by each ESR agreement and is responsible for assuring that sufficient funds are available for an activity before the justification can be approved. This is a critical control point because the Mission has adopted a policy of not incrementally funding local currency activities (except in a few cases) so as not to build up a "mortgage". As a consequence of this policy, the only outstanding mortgage after 1987 will be the final increment to the new Housing Bank (the local currency credit line is excluded here since the amounts it receives can be adjusted from year to year).

For each MOU a project officer is designated who is responsible for monitoring the status and progress of the respective activity. The degree of monitoring required varies according to the size, complexity, and importance to strategy of the activity, with the larger ones taking considerable input while the smaller ones take very little effort. At a minimum, however, project officers must be familiar enough with the status of each activity to certify when additional disbursements are required (only in a few cases is 100% of an activity's budget disbursed up front). For the larger activities (approximately 10), the project

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officer prepares a semi-annual report like that required for dollar projects, which is then incorporated into the Mission's semi-annual portfolio review process. Also, project officers are required to coordinate with the Controller's Office to assure that each MOU is audited by an independent auditing firm (each MOU provides funds in its budget for this purpose).

3. Financial Reporting/Accountability Systems

As already noted, each MOU has a budget. Depending on how the activity is to be implemented, funds are disbursed from the AID Special Account in the BCCR to (1) the separate account established for the activity by the implementing institution, (2) the Mission Trust Fund used when the Mission directly implements an activity such as a study or evaluation, or (3) the separate Mission Trust Fund used for Operating Expenses (Note: the OE costs are not covered by an MOU but by the bilateral Trust Agreement negotiated in April 1984).

The vast majority of the local currency activities are implemented by the respective institution selected for that purpose. In accordance with the MOU, funds are disbursed on an as needed basis. Additional disbursements are made upon presentation of a financial report, signed by the project officer, that shows how much of the previously disbursed funds have been used and how much more is required. Generally, funds are provided to cover costs for a 90 day period.

No distinction is made as to the category of local currency use (e.g., counterpart, PVOs, etc.) Rather, the MOU system allows the Controller's Office to maintain detailed records on all commitments and disbursements. The system is computerized and follows the MACS process which provides additional control on the management of the funds. In that the Mission's local currency portfolio has been audited several times by the RIG, the system has been particularly useful in responding to their questions.

4. Specific Uses of Local Currency Deposits

The proposed uses of local currency under the ESR VI agreement are identified in the PAAD. As under earlier agreements, these activities will also undergo the justification and MOU process.

Under the agreements for ESR II-V, over 130 separate local currency activities have been financed. Of these, 64 have been completed and another 36 are expected to be completed by the end of CY 1987. Of the remaining activities, approximately five are of the "big ten". The Mission will continue to tighten and reduce the number of activities as instructed by AID/W guidance. The Mission's Program Office has developed a system utilizing DBase III which contains detailed information on each MOU (e.g., amount committed, implementing institution, estimated completion date, amount disbursed and a projection on when remaining funds will be disbursed). With this system, a variety of reports can be designed and generated based on the information. An example of a report which shows all the local currency disbursements made under ESR IV by date, implementation letter and amount is attached. Others can be prepared and are available at the Bureau's request.

UNITED STATE OF AMERICA

AGENCY FOR INTERNATIONAL DEVELOPMENT

USAID MISSION TO COSTA RICA

ATTACHMENT 1

NOTICE Nº CY-038-84

DATE November 19, 1984

CHAPTER 700

OPERATIONS MEMORANDUM

SUBJECT: Mission Procedures for approval and management of activities financed with local currency under the Economic Stabilization and Recovery Programs.

I. Background

The purpose of this Mission Order is to establish the procedures to be followed for approval and management of local currency activities financed with local currency under the Economic Stabilization and Recovery Programs.

II. Activity Identification

Activities may be proposed for funding by any technical or staff office. Such programing may occur in the development of the PAAD Authorization or PAAD Agreement for the Economic Stabilization and Recovery Programs, or on an *ad hoc* basis where an opportunity is identified outside of the context of normal resource programing. All *ad hoc* activities proposed for funding should first be presented to the Program Division for registration of the proposal. The Program Division is responsible for maintaining a record of funding requests and the projected demand on future funds. No proposal should be developed without first obtaining Program Division assurance that funding can be made available.

III. Activity Preparation and Approval

A. Proposal Preparation

All activity proposals are to be presented by the sponsoring office using the format provided in Attachment 1. In those cases where the initial inquiry is presented through the Office of the Director, a technical or staff office will be assigned the responsibility of compiling Attachment 1. The proposal must specify the suggested method of implementation and disbursement (see Section IV B).

B. Clearance and Approval Process

Once the proposal is prepared, the drafting office will route it to:

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1. Program Division - for clearance indicating that the activity is consistent with Mission program strategy or represents an activity best classified as a "Target of Opportunity".

2. Project Development Division - for clearance indicating that the implementation plan, reporting, and monitoring activities are sound, and for review of procurement plans.

3. Contract Officer - if the activity contains substantial procurement actions.

4. Controller - for financial analysis and validation of funds availability.

5. Deputy Director/Director - for approval

Once approved, the original proposal will be filed in PDD. PDD will send copies to the office assigned the responsibility of managing the activity as well as to the Program Division and Controller Offices.

IV. Obligation

A. Obligation of Funds

The documentation required to obligate a given activity is determined by the nature of that activity, and is best described in terms of bilateral or unilateral assistance as historically employed by AID. Bilateral assistance involves AID and another institution, which may be from either public or private sector and which will administer the activity directly or through an implementing entity. In this case, PDD will prepare a Memorandum of Understanding (MOU) or Letter Grant based on the activity proposal and include standard clauses as defined in Attachment II to this memorandum. Clearance of these documents must include the offices which cleared the proposal. The Controller's Office will check funds availability against the BCCR Special Account as part of the clearance process. Signature of the MOU or Letter Grant obligates funds for the activity.

Unilateral assistance occurs when the Mission directly implements an activity. In those instances, funds are obligated through the Trust Fund Agreement where, after assuring funds availability, a Mission signed contract, purchase order, invitational travel order, etc. serve as the obligating documents.

All obligating documents will contain the objectives of the activity, a work plan which will include the time frame for achieving expected outputs, a financial budget or plan, and disbursement and reporting mechanisms. The depth of detail should reflect the level of prudent management (see definition in Attachment III) required by the nature of the activity. If appropriate, funds for external audit (generally 3 percent of activity cost) should be in the financial plan, and the Grantee may be allowed a 15 percent variation between line items as initially budgeted.

Signed, final copies of all obligating documents will be sent to the Project Development Division for distribution to the Controller, the Program Division, and action office(s).

B. Implementation/Disbursement Mode

There are three possible implementation and disbursement methods for local currency activities: (1) direct implementation by Grantee, (2) USAID implementation through a Grantee, and (3) direct AID implementation. In preparing a proposal, the method selected is to be specified and justification provided for employing that method.

The method selected for implementation/disbursement has significant implications for the depth of the financial analysis performed in obtaining Controllers clearance. On those projects where disbursement to a Grantee is directly from the BCCR, the financial analysis review limits statutory considerations to audit rights and legal status of the Grantee. In cases where a Trust Fund disbursement is recommended, all normal AID financial and statutory considerations will apply. Of importance in all cases is the requirement for the Grantee to be able to demonstrate financial accountability.

1. Direct Implementation by the Grantee

Implementation of activities by the Grantee is the preferred implementation method as AID requirements for supervision and management are thereby minimized. However, the implementation plan defined in the MOU should be sufficient to clearly delineate responsibilities. Upon satisfaction by the Grantee of actions required prior to authorization of disbursement by the Mission, the PDD will prepare a Project Implementation Letter (PIL) to the BCCR requesting a transfer of funds from the AID Special Account at the BCCR to the Grantee. Usually, AID should not participate further in the implementation of these activities. However, AID will review such financial and technical reports as may be required to assure fiscal and managerial integrity of the activity.

2. USAID Implementation through the Grantee

AID may choose to implement some activities, components thereof, or specific procurement actions, through a Grantee, because the Mission has an overriding interest or simply as a function of prudent fiscal management. Examples of these activities could be local currency support for an ongoing AID project or direct assistance to a Ministry or other implementing organizations. In such cases, funds will be transferred through the PIL process from the Special Account to a Trust Account maintained by the Mission Controllers Office. Subsequently, a Memorandum of Understanding will be prepared and co-signed between AID and the Grantee following the clearance process described above. Procurement documentation, if required and depending upon the funding amount and complexity of the activity, will also be subject to clearances. The choice of such documentation and the manner of its preparation will follow normal Mission procurement procedures, utilized for direct or host country procurement, depending upon the particular circumstance.

3. AID Implementation

In a limited number of cases, AID may directly implement an activity without a Grantee as, for example, in auditing certain of the activities or other Mission Projects. In these cases, funds will be transferred to the Trust Account through the PIL rocess and obligated in accordance with the procedures outlined in Section ., above.

In each of the latter cases of activity implementation the guiding principle of the Trust Fund Arrangement is that the GOCR places full faith and trust in AID to manage the Trust Fund Account as we would manage U.S. funds. Documentation may thus require a PIO/P, purchase order or contract for obligating, and submission of SF 1034 vouchers for administrative approval and payment.

V. Administration of Funds

A. Disbursements from the BCCR Special Account to the account of the Grantee, its implementing entity, or to the AID Trust Account, will be authorized by Implementation Letter prepared by the Project Development Division following validation of funds availability by the Controller's office. Normally, funds will be transferred in tranches based on specific activity needs rather than the full amount at one time. The schedule for disbursement will be identified in each obligating document.

B. In all cases where AID makes disbursements to the Grantee or an Implementing Entity, the Controller will maintain adequate accounts showing disbursements and balances by activity/obligation.

C. The Controller will make disbursements from the Trust Account on the basis of approved disbursement schedules, or an approved disbursement request from the Mission unit managing the activity, such as an administratively approved SF 1034.

VI. Accounting and Reporting

A. The Controller will maintain an accounting system for the BCCR special account and the AID Trust Fund Account and will regularly report to AID/W on the status of the Trust Account. AID will issue financial reports to the BCCR on both the BCCR special account and the Trust Account when reasonably requested by the BCCR.

B. Recipients of AID funding will be required to maintain books and records in accordance with sound accounting principles and practices. Moreover, AID will, if the circumstances merit it, require the recipients to finance from their own funds or project funds annual independent external audits, to support validity of uses of AID provided funds.

C. Trust Account accounting and reporting will be consistent with AID regulations and procedures, as stipulated in AID HB 19 Chapter 5.

VII. Ownership of Property

Property acquired by a grantee with local currency as described herein must be titled in the name of the recipient when purchased. The recipient must also maintain a detailed accounting record of property provided by AID.

VIII. Duration of Mission Order

This Operations Memorandum will remain in full force and effect until modified or rescinded by the Mission Director.

Daniel A. Chaij
Mission Director

Attachment: Annex I
Annex II

ATTACHMENT I

LOCAL CURRENCY ACTIVITY JUSTIFICATION

TO:

FROM:

SUBJECT: Approval for Local Currency Grant Funding

1. Background and Description of Activity (who, what)

2. Priority Justification (why do it)

3. Timing of Activity

4. Other AID activities with Grantee or similar Institution

5. Implementation Plan (AID/Grantee)/Responsibilities of The Parties

6. Disbursement Mechanism and Payment Provisions

7. Monitoring/Reporting Requirements

8. Total Cost (Prelim. Budget)

Clearance:
PRD______________
PDD______________
CONT______________

Approved______________________
Disapproved______________________
Date______________________

Justification Checklist (For internal Review)

1. Are the funds sufficient?
2. Are procedures for advances needed?
3. Can Grantee demonstrate financial accountability?
4. Can the Grantee legally sign the document?
5. Are AID/Grantee's responsibilities clear?

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ANEXO II

DISPOSICIONES GENERALES PARA MEMORANDOS DE ENTENDIMIENTO

1. Asignación de Recursos

Asignar, sin costo para el Proyecto, los recursos necesarios para el buen logro del propósito de este Convenio. Estas responsabilidades incluirán, pero no se limitarán a, la contabilidad, administración, coordinación, evaluación e información de todas las actividades que estén contemplados en el Convenio.

2. Documentación de la Cuenta Bancaria Separada Establecida

Brindar a la A.I.D. evidencia, en la forma y con el contenido satisfactorios a la A.I.D., con anterioridad a la transferencia a ______ de los fondos que se comprometen bajo este Convenio, que ______ ha establecido una cuenta bancaria separada para controlar el recibo y desembolso de todos los fondos descritos en este Convenio, que incluya capital e intereses.

3. Definición de Intereses Devengados

Colocar cualquier porción ociosa de los fondos en instrumentos del Gobierno de Costa Rica que produzcan intereses, o en Certificados de Depósito del Sistema Bancario Nacional. Cualquier y todo interés devengado por estos fondos deberá transferirse a la cuenta separada que se menciona en la sección 2. antes mencionada, utilizarse de acuerdo con el propósito específico de este Convenio.

ATTACHMENT II

STANDARD PROVISONS FOR MEMORANDUMS OF UNDERSTANDING

1. Assignment of Resources

To assign, without cost to the Project, the necessary resources for the successful accomplishment of the purpose of this Agreement. These responsibilities will include, but will not be limited to, the accounting, administration, coordination, evaluation and reporting of all activities which are contemplated by this Agreement.

2. Establishment of Separate Bank Account/Documentation

To provide evidence to A.I.D., in form and substance satisfactory to A.I.D., prior to the transfer to ______ of the funds obligated under this Agreement, that ______ has established a separate bank account to control the receipt and disbursement of all funds, including interest and principal, described in this Agreement.

3. Interest Earnings Definition

To place any unused portion of the funds into interest bearing instruments of the Government of Costa Rica or in Certificates of Deposit of the National Commercial Banking System. Any and all interest earned from these funds must be transferred to the separate account mentioned in section 2. above and used in accordance with the specific purpose of this Agreement.

4. Informe Financiero

Presentar a la A.I.D., una certificación de la procedencia y aplicación de los fondos a la AID, que refleje el monto real del dinero recibido (que incluya intereses) y los gastos en que se haya incurrido durante el período que se solicite, contabilizado de conformidad con los renglones presupuestarios correspondientes. Como Anexo I se adjunta un Plan Financiero (Presupuesto Ilustrativo) para este Convenio.

5. Mantenimiento de Libros y Registros

Presentar a la A.I.D., dentro de los treinta (30) días siguientes a la firma de este documento, evidencia en la forma y con el contenido satisfactorios a la A.I.D., de que mantendrán o harán que se mantengan, de acuerdo con principios y prácticas contables generalmente aceptados y consecuentemente aplicados, libros y registros en relación con a este Convenio, adecuados para mostrar sin limitaciones, el recibo y uso de todos los bienes y servicios adquiridos bajo esta actividad. Tales libros y registros se mantendrán por lo menos por un período de tres años después de la fecha del último desembolso hecho por_______ bajo este Convenio.

6. Variaciones de los Planes de Auditoría y Finanzas

La administración total y el uso de los fondos descritos en este Convenio será objeto de auditoría por parte de A.I.D., o de firmas aprobadas por A.I.D. Hasta un tres por ciento (3%) de los fondos proporcionados mediante este convenio, cuyo uso se define en el Anexo I, podrán ser separados por _______________

4. Financial Report

To present a source and application of funds statement to A.I.D., reflecting the actual amount of cash received (including interest) and expenses incurred for the period requested annotated against specific budget categories. A financial plan (Illustrative Budget) for this Agreement is attached as Attachment I.

5. Maintenance of Books and Records

To provide A.I.D., within thirty (30) days of signing this document, evidence in form and substance satisfactory to A.I.D., that it will maintain or cause to be maintained, in accordance with generally accepted accounting principles and practices, consistently applied, books and records relating to this Agreement, adequate to show, without limitation, the receipt and use of all goods and services acquired under this activity. Such books and records will be maintained for at least three years after the date of last disbursement by _______ under this Agreement.

6. Audit and Financial Plan Variations

All administration and use of the funds described in this Agreement will be subject to audit by A.I.D. or A.I.D. approved firms. Up to three (3) percent of the funds provided under this Agreement, with usage defined in Annex I, may be set aside by ________ for this purpose. Varitations between line items of up para este propósito. Se podrán producir variaciones en los renglones presupuestarios, de hasta un 15% por renglón, sin que se requiera la aprobación de la A.I.D.

to fifteen (15) percent of line item amount may occur without A.I.D. approval.

7. Informes

La institución suministrará a la A.I.D. copia de todos los informes y documentos legales que se originen mediante el uso de estos fondos. Se requerirán informes ____________ y un informe final.

7. Reports

The institution will provide to A.I.D. copies of all reports and legal documentation produced with the use of these funds. ____________ progress reports and a final report will be required.

8. Saldo Final

Si al finalizar este Convenio, los fondos cubiertos por el mismo, incluyendo capital y cualesquier intereses devengados, no se han agotado, la A.I.D. podrá solicitar a ______________ que reintegre dichos fondos, según la A.I.D. lo indique, dentro de los treinta (30) días siguientes a una solicitud por escrito en ese sentido.

8. Final Balance

If, upon termination of this Agreement, the funds, including principal and any earned interest covered by this Agreement have not been exhausted, A.I.D. shall require ______ to refund such funds as A.I.D. may direct, within thirty (30) days of a written request to do so.

9. Notificación

Cualquier aviso, solicitud, documento u otra comunicación enviada por cualquiera de las Partes a la otra bajo este Convenio, será por escrito o por medio de telegrama o cable, y se considerará debidamente entregada o enviada cuando se envíe a dicha Parte a las siguientes direcciones:

A

9. Notification

Any notice, requests, document, or other communication submitted by either Party to the other under this Agreement will be in writing or by telegram or cable, and will be deemed duly given or sent when delivered to such Party at the following address:

TO

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A la A.I.D.:

USAID/Costa Rica
Embajada de los Estados Unidos
de América
Apartado Postal 10.053
1.000 San José, Costa Rica

10. Representación

Para todos los efectos relacionados con este Convenio, ___________ estará representada por la persona que ejerza el cargo en función o internamente en la Oficina del Director Ejecutivo y la A.I.D. estará representada por la persona que ejerza el cargo en función o internamente en la Oficina del Director de la USAID/Costa Rica, cada uno de los cuales, mediante notificación escrita, podrá designar representantes adicionales.

11. Idioma

Este Convenio ha sido preparado tanto en inglés como en español. En caso de ambigüedad o conflicto entre las dos versiones, la versión en inglés será la que rija.

To A.I.D.:

USAID/Costa Rica
United States Embassy
P.O. Box 10.053
1000 San José, Costa Rica

10. Representation

For all purposes relevant to this Agreement, _________ will be represented by the individual holding or acting in the office of Executive Director, and A.I.D. will be represented by the individual holding or acting in the Office of the Director, USAID/Costa Rica; each of whom by written notice, may designate additional representatives.

11. Language

This Agreement is made in both English and Spanish. In the event of ambiguity or conflict between the two versions, the English language version shall control.

Doc:0100H&0101H
DH:pm:as

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ATTACHMENT III

Prudent Management

1. Provision of adequate information to the prospective recipient on AID assistance procedures;

2. Ascertainment of technical and managerial competence and financial responsibility of the prospective recipient;

3. Reduction to writing of the purpose to be promoted by any assistance instrument and of all understandings betweeen AID and the recipient;

4. Maintenance of contact and liaison with recipient, including receipt, review and analysis of at least annual substantive reports on operations and accomplishments;

5. Establishment of any limitations on expenditure of AID's granted funds;

6. Provision for adequate record-keeping and financial reporting;

7. Audit;

8. Evaluation of program effectiveness;

9. Provision for claiming and receipt of refunds equivalent to amounts, if any, misapplied, or spent in violation of the conditions by recipient;

10. Provision for termination.

Care should, however, be taken to avoid the imposition of requirements for program approvals reports and/or restrictions that go beyond the needs of prudent management and that are inconsistent with reasonable program and management flexibility for the recipient.

ATTACHMENT 2

Page No.
04/10/87

LOCAL CURRENCY FILS

MOU No ORGANIZATION   NOTE IT

** PROJECT 194

ORGANIZATION	DATE	FIL No	AMOUNT
1.0 CODESA			
	01/17/86	13	775
	10/24/86	36	714
	02/12/87	47	119,262
2.0 CINDE/MIDEX	DATE	FIL No	AMOUNT
	03/05/86	21	11,747
	05/21/86	25	3,324
	07/18/86	28	6,566
	12/03/86	44	16,077
3.0 CINDE	DATE	FIL No	AMOUNT
	05/15/86	24	12,527
	09/23/86	37	10,987
4.0 MINEX/ICAF	DATE	FIL No	AMOUNT
	03/26/86	22	2,012
	05/19/86	23	793
	08/18/86	30	2,012
	11/25/86	40	1,874
5.0 BOOK CHAMBER	DATE	FIL No	AMOUNT
	03/06/86	20	47,543
6.0 COSB/CENDEISS	DATE	FIL No	AMOUNT
7.0 ASELEX	DATE	FIL No	AMOUNT
	03/27/86	19	3,000
8.0 CIAPA	DATE	FIL No	AMOUNT
	11/06/86	38	3,505
9.0 COLESA	DATE	FIL No	AMOUNT
	04/07/86	23	3,766
	02/12/87	50	3,535
10.0 INCAE	DATE	FIL No	AMOUNT
	09/12/86	32	1,400
11.0 INT. EXEC. SERVICE CORPS	DATE	FIL No	AMOUNT

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LOCAL CURRENCY FILS

MOU No ORGANIZATION	NOTE IT		
	11/26/86	41	450
12.0 MEP/BOOK CHAMBER	DATE	FIL No	AMOUNT
	10/10/86	35	4,000
13.0 CHAMBER OF INDUSTRIES	DATE	FIL No	AMOUNT
	12/05/86	43	133
	02/06/87	48	300
14.0 CINDE	DATE	FIL No	AMOUNT
	12/31/86	46	727
15.0 COOP. HOUSING FOUND./CHF	DATE	FIL No	AMOUNT
16.0 FEDECR./CHF/RC	DATE	FIL No	AMOUNT
	03/16/87	51	11,880
98.0 CINDE	DATE	FIL No	AMOUNT
98.0 CINDE.FIE	DATE	FIL No	AMOUNT
98.0 BOLSA DE CONSULTORES	DATE	FIL No	AMOUNT
98.0 SCHOOL REFURBISHING	DATE	FIL No	AMOUNT
98.0 SCHOLARSHIPS NAT. UNIV.	DATE	FIL No	AMOUNT
100.0 AID BUILDING (FY 1987)	DATE	FIL No	AMOUNT
	07/14/86	27	19,000
	10/24/86	37	24,900
	01/06/87	45	420,347
100.0 AID	DATE	FIL No	AMOUNT
	08/01/86	27	20,000
	08/18/86	31	20,000
100.0 AID	DATE	FIL No	AMOUNT
	10/10/86	34	30,000
	11/24/86	37	9,000
	12/04/86	42	20,000
	01/14/87	47	20,000
100.0 REAL PROPERTY	DATE	FIL No	AMOUNT

PAST ESR COVENANTS STATUS SUMMARY

DETAILED COVENANT REPORT USAID

Covenant : II 6.1(A) Type : B1 Status : Completed Closed

Document : ESR II, Amendment 3 (1983, Project 0186, Loan 040)

Description :

Provide FX allocation to private enterprises in an amount equivalent t to ESR II cash transfer.

Covenant : II 6.1(B) Type : G2 Status : Completed Closed

Document : ESR II (1983, Project 0186, Loan 040)

Description :

Deposit $11.25 million equiv. in CINDE acct.

Covenant : II 6.1(C) Type : B2 Status : Completed Closed

Document : ESR II (1983, Project 0186, Loan 040)

Description :

US commodity imports equal to ESF disbursements

Covenant : II 6.1(D) Type : C1 Status : Completed Closed

Document : ESR II (1983, Project 0186, Loan 040)

Description :

Preferential FX rates for exporters.

Covenant : II 6.1(E) Type : B3 Status : Completed Closed

Document : ESR II (1983, Project 0186, Loan 040)

Description :

Move during 83 toward unified exchange rate, to be completed by 12/31/85

Covenant : II 6.1(F) Type : GOB Status : Completed Closed

Document : ESR II (1983, Project 0186, Loan 040)

Description :

AID to get copies of reports to IMF

Covenant : II 6.1(G) Type : A3 Status : Completed Closed

Document : ESR II, Amendment 1 (1983, Project 0186, Loan 040)

Description :

Reestablish a $10 million equivalent special credit line for private enterprise thru private banks.

Covenant : II 6.1(H) Type : A4 Status : Current Closed

Document : ESR II, Amendment 3 (1983, Project 0186, Loan 040)

Description :

Establish $5 million equiv. credit line for low-income mortgage finance.

Covenant : II 6.1(I) Type : A2 Status : Completed Closed

Document : ESR II, Amendment 1 (1983, Project 0186, Loan 040)

Description :

Increase unsubsidized credit to private sector by $41,500,000 equivalent during '83

Covenant : II 6.1(J) Type : A3 Status : Completed Closed

Document : ESR II (1983, Project 0186, Loan 040

Description :

Establish reporting procedures on local currency credit resources.

Covenant : II 6.1(K) Type : G4 Status : Current Closed

Document : ESR II (1983, Project 0186, Loan 040)

Description :

Assure no injury to U.S. ag. interests from activities financed under this agreement

Covenant : II 6.1(L) Type : G1 Status : Current

Document : ESR II, Amendment 3 (1983, Project 0186, Loan 040)

Description :

$14,485,000 equivalent in local currency to AID special account

Covenant : II 6.1(M) Type : A4 Status : Current

Document : ESR II, Amendment 3 (1983, Project 0186, Loan 040)

Description :

Establish $3mil equiv small industry credit line, open to private banks, reglamento satisf. to AID, reflows from 028 go to this line, floor on interest rate.

Covenant : II 6.1(N) Type : A4 Status : Completed/alter

Document : ESR II, Amendment 3 (1983, Project 0186, Loan 040)

Description :

$10 mil equivalent to credit guarantee fund for private enterprise, and establish administrative unit.

Covenant : II 6.1(O) Type : A2 Status : Completed

Document : ESR II, Amendment 4 (1983, Project 0186, Loan 040)

Description :

Use $32,513,000 equivalent to support BCCR's unsubsidized private sector lending.

Covenant : II 6.1(P)   Type : A10   Status : Completed

Document : ESF II, Amendment 3 (1983, Project 0186, Loan 040)

Description :

Report on 1982 + 1983 BCCR credit programs

Covenant : II 6.1(Q)   Type : C4   Status : Completed

Document : ESF II, Amendment 3 (1983, Project 0186, Loan 040)

Description :

Maintain policy that doesn't weaken competitive position of D.R. exports in foreign markets.

Covenant : II 6.1(R)   Type : B3A   Status : Completed

Document : ESF II, Amendment 4 (1983, Project 0186, Loan 040)

Description :

Negotiate and implement 1984 IMF Standby Arrangement or extended Fund Facility.

Covenant : II 6.1(S)   Type : A2   Status : Completed

Document : ESF II, Amendment 4 (1983, Project 0186, Loan 040)

Description :

Maintain private sector credit level programmed in the '83 National Credit Program, insure banks have sufficient liquidity for same.

Covenant : II 6.1(T)   Type : A3   Status : Completed

Document : ESF II, Amendment 4 (1983, Project 0186, Loan 040)

Description :

Add $10 million equiv. to special private sector credit line, for use through private banks only.

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Covenant : II 6.1(U) Type : A3 Status : Completed

Document : ESR II, Amendment 4 (1983, Project 0186, Loan 040)

Description :

Assure that private banks can maintain during '83-84 the same level of operations under the special credit line as during the prior year.

Covenant : II 6.1(V) Type : B1 Status : Current

Document : ESR II, Amendment 4 (1983, Project 0186, Loan 040)

Description :

$7 million equivalent into AID special account

Covenant : III 6.1(A) G Type : F3 Status : Completed

Document : ESR III GRANT (1984, Project 0192)

Description :

Approval and funding ($5 million equiv.) of demonstration private sector road program.

Covenant : III 6.1(A)(01) Type : A5 Status : Completed

Document : ESR III LOAN (1984, Project 0192, Loan 043)

Description :

Limit activities subject to credit control during '84

Covenant : III 6.1(A)(02) Type : E1 Status : Completed

Document : ESR III LOAN (1984, Project 0192, Loan 043)

Description :

CODESA Credit Program will provide only operational credit, and no direct BCCR credit, during '84

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Covenant : III 6.1(A)(03) Type : A9 Status : Completed/sup

Document : ESR III LOAN (1984, Project 0192, Loan 043)

Description :

No credit to Consejo Nacional de Produccion to cover losses due to subsidies.

Covenant : III 6.1(A)(04) Type : A6 Status : Completed

Document : ESR III LOAN (1984, Project 0192, Loan 043)

Description :

Basic "passive" (interest) rate to remain positive in real terms during '84

Covenant : III 6.1(A)(05) Type : A8 Status : Completed

Document : ESR III LOAN (1984, Project 0192, Loan 043)

Description :

Revise interest rates in '84 so that rates for agriculture and livestock (other than breeding) are higher than the tasa basica pasiva.

Covenant : III 6.1(A)(06) Type : A5 Status : Completed

Document : ESR III LOAN (1984, Project 0192, Loan 043)

Description :

No more than 2 interest rates higher than tasa basica pasiva during 1984.

Covenant : III 6.1(A)(07) Type : A8 Status : Completed

Document : ESR III LOAN (1984, Project 0192, Loan 043)

Description :

Limit the recipients of interest rates lower than the tasa basica pasiva.

Covenant : III 6.1(A)(08) Type : A8 Status : Completed

Document : ESR III LOAN (1984, Project 0192, Loan 043)

Description :

Soft loans by national banking system to be financed at least 50% from resources other than those captured from the general public by commercial banks.

Covenant : III 6.1(A)(09) Type : A7 Status : Completed

Document : ESR III LOAN (1984, Project 0192, Loan 043)

Description :

Interest rates to be revised during 1984 as often as necessary to reflect various factors, reports to A.I.D.

Covenant : III 6.1(A)(10) Type : F5 Status : Superceded Closed

Document : ESR III LOAN (1984, Project 0192, Loan 043)

Description :

Prepare program to improve efficiency of national banking system, report to AID.

Covenant : III 6.1(B) Type : B3 Status : Completed

Document : ESR III LOAN (1984, Project 0192, Loan 043)

Description :

Maintain unified exchange rate during 1984, revised continually to reflect various factors.

Covenant : III 6.1(B) G Type : D2 Status : Current

Document : ESR III GRANT (1984, Project 0192)

Description :

Approve and fund ($7 million equiv.) demo. private sector water and sewage project.

Covenant : III 6.1(C) Type : F6 Status : Current

Document : ESR III LOAN (1984, Project 0192, Loan 043)

Description :

Finalize action plan by 6/30/84 to improve quality of economic information available, report to AID.

Covenant : III 6.1(C) G Type : C2 Status : Current

Document : ESR III GRANT (1984, Project 0192)

Description :

Council of Government to publish plan to improve C.R. ports. MIDEPLAN to execute policy studies.

Covenant : III 6.1(D) Type : F4 Status : Completed

Document : ESR III LOAN (1984, Project 0192, Loan 043)

Description :

Prepare action plan for price checking unit by 6-30-84

Covenant : III 6.1(D) G Type : C2 Status : Complete/Non-co

Document : ESR III GRANT (1984, Project 0192)

Description :

MOPT will publish decree reducing user tarriffs at Atlantic and Pacific ports, and eliminating through 1990 transfers to Central Government from such tariffs.

Covenant : III 6.1(E) Type : A3 Status : Completed

Document : ESR III LOAN, Amendmt. 2 (1984, Project 0192, Loan 043)

Description :

Add $25 million equiv. to special credit line, allocated between private and public banks, revise regulations.

Covenant : III 6.1(E) G Type : C2 Status : Current

Document : ESR III GRANT (1984, Project 0192)

Description :

MOPT to plan and BCCR to fund (from AID Spec. Acct.) $2,250,000 equiv. capital improvements at ports.

Covenant : III 6.1(F) Type : D1 Status : Current

Document : ESR III LOAN (1984, Project 0192, Loan 043)

Description :

Support creation of secondary mortgage bank.

Covenant : III 6.1(F) G Type : E2 Status : Complete/Non-co

Document : ESR III GRANT (1984, Project 0192)

Description :

CODESA to adopt divestiture plan by 9-30-84

Covenant : III 6.1(G) Type : B1 Status : Completed

Document : ESR III LOAN (1984, Project 0192, Loan 043)

Description :

Provide FX for private businesses during 1984 equivalent to amount of ESR cash transfer, report to AID.

Covenant : III 6.1(G) G Type : F1 Status : Current

Document : ESR III GRANT (1984, Project 0192)

Description :

Council of Gov't to publish action plan to promote meat and sugar exports, MIDEPLAN to conduct analytical studies.

Covenant : III 6.1(H) Type : B2 Status : Completed

Document : ESR III LOAN (1984 Project 0192, Loan 043)

Description :

Provide in 1984 FX equivalent to ESR transfers, for import of selected U.S. commodities by private sector, report to AID

Covenant : III 6.1(H) G Type : C3 Status : Completed

Document : ESR III GRANT (1984, Project 0192)

Description :

Ministries of Finance and of Industry, Energy and Mines to publish reglamento for the Free Zone law.

Covenant : III 6.1(I) Type : A10 Status : Completed

Document : ESR III LOAN (1984, Project 0192, Loan 043)

Description :

Report on national credit programs for '82, '83, and '84.

Covenant : III 6.1(I) G Type : F2 Status : Current

Document : ESR III GRANT (1984, Project 0192)

Description :

Plan of action and studies toward reducing pricing distortions.

Covenant : III 6.1(J) Type : G5 Status : Completed

Document : ESR III LOAN (1984, Project 0192, Loan 043)

Description :

Provide AID various reports at various times.

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Covenant : III 6.1(J) G Type : A3 Status : Completed

Document : ESR III GRANT (1984, Project 0192)

Description :

Modify special credit line to allow loans equal to separation pay for certain public sector retirees, for investment in private enterprises.

Covenant : III 6.1(K) Type : A2 Status : Completed

Document : ESR III LOAN, AMENDMT. 2 (1984, Project 0192, Loan 043)

Description :

Use $20 million equiv. to support BCCR's unsubsidized lending to private sector

Covenant : III 6.1(K) G Type : D3 Status : Completed Closed

Document : ESR III GRANT (1984, Project 0192)

Description :

BCCR to propose modification of Savings and Loan law.

Covenant : III 6.1(L) G Type : G1 Status : Current

Document : ESR III GRANT, AMENDMENT 1 (1984, Project 0192)

Description :

Colon equiv. of dollar disbursements to go into AID Special Account

Covenant : IV 5.1(A) Type : B1 Status : Current

Document : ESR IV (1985, Project 0194)

Description :

FX available to private enterprise equal to ESR disbursements. Reports due w/in 3 mos. of last disbursment or by 3-31-86.

Covenant : IV 5.1(B) Type : B2 Status : Completed Closed

Document : ESR IV (1985, Project 0194)

Description :

Make available FX equal to ESR disbursement for private sector imports of selected U.S. commodities. Report by 6/30/86 or 6 months from last transfer.

Covenant : IV 5.1(C) Type : A3 Status : Completed

Document : ESR IV (1985, Project 0194)

Description :

$20 million increase in Special Credit Line.

Covenant : IV 5.1(D) Type : G3 Status : Completed

Document : ESR IV (1985, Project 0194)

Description :

Give AID copies of reports to IMF.

Covenant : IV 5.1(E) Type : A10 Status : Completed

Document : ESR IV (1985, Project 0194A)

Description :

BCCR to maintain the credit program announced 1/2/85

Covenant : IV 5.1(F) Type : A1 Status : Completed Closed

Document : ESR IV (1985, Project 0194A)

Description :

BCCR to report on 1983, 1984 and 1985 credit programs.

Covenant : IV 5.1(G) Type : A6 Status : Completed

Document : ESR IV (1985, Project 0194A)

Description :

Tasa basica pasiva to remain positive in real terms.

Covenant : IV 5.1(H) Type : A7 Status : Completed

Document : ESR IV (1985, Project 0194A)

Description :

Interest rates to be revised as necessary to reflect various factors, quarterly reports to AID.

Covenant : IV 5.1(I) Type : A8 Status : Completed

Document : ESR IV (1985, Project 0194A)

Description :

Subsidized credit limited to defined categories, net balance not to exceed credit program.

Covenant : IV 5.1(J) Type : A8 Status : Complete/non-co

Document : ESR IV (1985, Project 0194A)

Description :

50% of subsidized credit will be funded from resources other than those captured from public by commercial banks.

Covenant : IV 5.1(K) Type : A9 Status : Superceded

Document : ESR IV (1985, Project 0194A)

Description :

No credit to cover subsidy-caused losses of CNP.

Covenant : IV 5.1(L) Type : G5 Status : N/A

Document : ESR IV (1985, Project 0194A)

Description :

Interprets Covenant G through K

Covenant : IV 5.1(M) Type : B3 Status : Completed

Document : ESR IV (1985, Project 0194A)

Description :

Unified exchange rate in 1985, adjusted periodically to reflect various factors quarterly reports to AID.

Covenant : IV 5.1(N) Type : F4 Status : Completed

Document : ESR IV (1985, Project 0194A

Description :

Implement BCCR price-checking unit

Covenant : IV 5.1(O) Type : A2 Status : Completed

Document : ESR IV (1985, Project 0194A

Description :

Reductions in CODESA debt funded by ESR IV will be reflected in equal reductions in public sector debt ceiling.

Covenant : IV 5.1(P) Type : E2 Status : Current

Document : ESR IV (1985, Project 0194A)

Description :

BCCR will make credit available to CODESA to convert 3rd-party debt

Covenant : IV 5.1(Q) Type : E1 Status : Current

Document : ESR IV (1985, Project 0194A)

Description :

No new CODESA credit except short-term working capital, capitalization of interest, and conversion of 3rd party debt.

Covenant : IV 5.1(R) Type : E1 Status : Complete

Document : ESR IV (1985, Project 0194A)

Description :

No new CODESA investments or guarantees beyond limits of 2-6-85 Cabinet resolution.

Covenant : IV 5.1(S) Type : E2 Status : Current

Document : ESR IV (1985, Project 0194A)

Description :

BCCR will make available FX required for CODESA divestiture.

Covenant : IV 5.1(T) Type : A3 Status : Completed Closed

Document : ESR IV (1985, Project 0194A)

Description :

CODESA to have no further role in AID Special Credit Line.

Covenant : UNNUMBERED Type : D4 Status : Current

Document : ESR II, Amedment 2 (1983, Project 0186, Loan 040)

Description :

$5 million equiv. into a special account to be used per AID/INVU MOU

Covenant : V 5.1(A) Type : B1 Status : Current

Document : ESR V (1986, Project 0222, Grant)

Description :

Provide FX allocation to private enterprises in an amount equivalent to ESR V cash transfer.

Covenant : V 5.1(B) Type : B2 Status : Current

Document : ESR V 1986, Project 0222, Grant)

Description :

Make available FX equal to ESR V disbursement for private sector imports of selected U.S. commodities. Report by June 30, 1987 or 6 months from last transfer.

Covenant : V 5.1(C) Type : A3 Status : Current

Document : ESR V (1986, Project 0222)

Description :

BCCR to maintain Special Credit Line in operation until December 31, 1996

Covenant : V 5.1(D) Type : B1 Status : Completed

Document : ESR V (1986, Project 0222)

Description :

Deposit colon equivalent of each disbursement into AID Special Account by up to $20 million, ($5 million for housing), strengthen loanable assets of private banks.

Covenant : V 5.1(E) Type : A8 Status : Completed

Document : ESR V (1986, Project 0222)

Description :

BCCR will restrict net credit outstanding through the national banking system to the non-financial public sector during CY 86 to IMF 85 levels minus reductions in CODESA debt, report due quarterly within 3 months of prior quarter.

Covenant : V 5.1(F) Type : AIO Status : Current

Document : ESR V (1986, Project 0222)

Description :

Subsidized credit limited in CY 1986 to defined rates no higher than the level of such credit outstanding as of 12/31/84, no more than 5% seasonal variation.

Covenant : V 5.1(G) Type : Status : Completed Closed

Document : ESR V 1986, Project 0222)

Description :

During 1986 a unified exchange rate will be maintained.

Covenant : V 5.1(H) Type : A6 Status : Completed Closed

Document : ESR V (1986, Project 0222)

Description :

During 1986, the basic rate, which is the interest rate set by the Central Bank for six-month certificates of deposit, will remain higher than the inflation rate.

Covenant : V 5.1(I) Type : AIO Status : Completed Closed

Document : ESR V (1986, Project 0222)

Description :

During 1986 the credit program made by the Central Bank's Board of Directors on February 19, 1986, will not be altered, and will be fully implemented.

Covenant : V 5.1(J) Type : F4 Status : Completed Closed

Document : ESR V (1986, Project 0222)

Description :

The Central Bank will provide satisfactory evidence no later than 30 days after the signing of this agreement that the import and export Price Checking Unit is functional and after that to provide acceptable reports each quarter until 12/31/88, on the prog.program

Covenant : V 5.1(K) Type : G3 Status : Current

Document : ESR V 1986, Project 0222)

Description :

From the signing of this agreement until the end of 1987, the Central Bank will provide to AID copies of all reports to the Interntl Monetary Fund, that are required by agreement.

Covenant : V 5.1(L) Type : G1 Status : Current

Document : ESR V (1986, Project 0222)

Description :

Central Bank will promptly deposit an equivalent amount of colones or into Spec.Account originally established under Covenant 6.1(L) of the ESR II Agreement.The account will pay the same interest as that set by BCCR for 6 month certificates of deposit.

Covenant : V 5.1(M) Type : E2 Status : Current

Document : ESR V (1986, Project 0222)

Description :

By December 31, 1986 CODESA will have divested Atunes de Costa Rica SANSA, LACSA, SANBAFARI, MACASA, NAMUCAR, CEMVASA, Tempisque Ferry Boat, and any other company it has interest in.

Covenant : V 5.1(N) Type : E2 Status : Current

Document : ESR V (1986, Project 0222)

Description :

By September 30, 1987, at the latest, CODESA will have sold its shares in CATSA, and 40% of CEMPASA and FERTICA

Covenant : V 5.1(O) Type : E2 Status : Current

Document : ESR V (1986, Project 0222)

Description :

By March 31, 1987, at the latest CODESA will have developed a plan for the disposition of its interests in ALCORSA, and that it will be implemented no later than September 30, 1987.

Covenant : V 5.1(P) Type : E2 Status : Current

Document : ESR V (1986, Project 0222)

Description :

By December 31, 1986, changes in the By-Laws of Cementos del Pacifico, SA.(CEMPASA) and Fertilizantes de C.A. (FERTICA) will be approved, for guarantees to protect buyers of the 40% of shares of these enterprises including a management contract.

Covenant : V 5.1(Q) Type : E2 Status : Current

Document : ESR V (1986, Project 0222)

Description :

By no later than 12/31/86 the Nat.Commission for Reorg.of CODESA will complete the transfer of subsidiaries: TRANSMESA to the Ministry of Public Works, and Transport. FECOSA to Nat.Railroad Inst.MINASA to the M.Industry, Energy and Mines.Free Zone to Cent.for Exp.Inv.Prom

Covenant : V 5.1(R) Type : E2 Status : Current

Document : ESR V (1986, Project 0222)

Description :

The President of Costa Rica with the Central Bank and the Nat.Comm. will contract studies and work to define the future reorganization of CODESA while also maintaining original development purpose, and not creating any new subsidiary. The plan should be ready 11/30/86

Covenant : V 5.1(T) Type : D5 Status : Current

Document : ESR V (1986, Project 515-0222)

Description :

GOCR to implement reforms to consolidate and specialize public institutions involved in housing construction and finance.

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COVENANT TYPE REFERENCE SHEET

A. Credit & Interest

A1 Increase credit available to private sector banks
A2 Maintain/increase credit for private sector
A3 Special Credit Line
A4 Specific Credit Lines
A4a. Guaranty fund
A4b. Small Industry
A4c. Low-income mortgages
A5 Limit Credit Controls
A6 Real positive interest rates
A7 Periodic adjustment of interest rates
A8 Reduce subsidization of credit
A9 Limit credit to CNP
A10 Maintain & report on BCCR credit program

B. Foreign Exchange Availability and Rates

B1 FX for the private sector
B2 FX for US commodity imports
B3 Unification & review of exchange rates

C. Export and Investment Promotion

C1 Preferential access to FX for exporters
C2 Ports: tariffs, capital improvements
C3 Free zones
C4 Export policy

D. Housing

D1 Secondary Mortgage Bank
D2 Water/sewer improvements
D3 Modify Savings & Loan law
D4 INVU

E. CODESA Divestiture

E1 Limit Codesa borrowing and investment
E2 Divestiture

F. Other Policy Reform Studies, Plans, Projects

- F1 Meat and sugar exports
- F2 Pricing policy
- F3 Private Sector Road Maintenance
- F4 BCCR Price Checking Unit
- F5 Banking system efficiency improvement
- F6 Improve economic information

G. Miscellaneous Covenants

- G1 A.I.D. Special Account (counterpart funds)
- G2 CINDE funds to Special Account
- G3 IMF
  - G3a. Agreement
  - G3b. Reports
- G4 Non-injury to U.S. agricultural exports
- G5 (Specify or interpret other covenants)

INITIAL ENVIRONMENTAL EXAMINATION

Project Location:	Costa Rica
Project Title:	Economic Stabilization and Recovery VI
Funding:	$85,000,000
Project Description:	The Project consists of a cash transfer to provide balance of payments assistance to support economic stabilization and recovery in Costa Rica during CY 1987 and 1988.
Action:	Handbook 3, Chapter 2, Appendix 2D, Section 216.2.(c)(2)(vi) states that "contributions to ... National Organizations by the United States which are not for the purpose of carrying out a specifically identifiable project or projects" are not subject to A.I.D.'s environmental procedures.

The USAID/Costa Rica FY 87 PAAD provides for cash transfers to the Costa Rican Central Bank for balance of payments support. An amount of foreign exchange equivalent to that provided under the cash transfer is used by the Central Bank to finance imports for use by Costa Rica's private sector in manufacturing and other productive activities. Pesticides will not be procured with these funds without first doing an Environment Assessment and having it approved by AID/W. Also, an amount of local currency equivalent to the cash transfer will be deposited by the Central Bank in a special account to be used for mutually agreed-upon development purposes specified in the PAAD. The PAAD does not authorize A.I.D. funds for identifiable projects, rather it provides funds for an economic stabilization and recovery program.

Based on A.I.D. regulations in Handbook 3, Chaper 2, the A.I.D. Mission to Costa Rica recommends that no further environmental study be undertaken for this PAAD (as amended) and that a "categorical exclusion" be approved.

IEE prepared by: ______________________
Heriberto Rodríguez
General Engineer

Concurrence: ______________________
Daniel A. Chaij
Mission Director
USAID/Costa Rica

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 sources. In Part B a distinction is made between the criteria applicable to Economic Support Fund assistance and the criteria applicable to Development Assistance. Selection of the criteria will depend on the funding source for the program.

CROSS-REFERENCES: IS COUNTRY CHECKLIST UP TO DATE? IDENTIFY. HAS STANDARD ITEM CHECKLIST BEEN REVIEWED? Standard Item Checklist has been reviewed

A. GENERAL CRITERIA FOR NONPROJECT ASSISTANCE

1. FY 1986 Continuing Resolution Sec. 524; FAA Sec. 634A.

   Describe how authorizing and appropriations committees of Senate and House have been or will be notified concerning the project.

   Congress has been notified through AID FY 1987 Congressional Presentation. A Congressional Notification will be provided for Congressional review.

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 obligation are necessary. Prior Costa Rica compliance is satisfactory.

3. FAA Sec. 209. 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.

   No

4. FAA Sec. 601(a). Information and conclusions whether assistance will encourage

   Assistance will increase international trade, foster private initiative and competition, and improve technical

	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) strenghten free labor unions.	efficiency of industry, agriculture and commerce.
5.	FAA Sec. 601(b). Information and conclusion on how assistance will encourage U.S. private trade and investment abroad and encourage private U.S. 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); FY 1986 Continuing Resolution Sec. 507. 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 in lieu of dollars.	Agreements with GOCR encourage use of local currencies for local needs.
7.	FAA Sec 612(d). Does the United States own excess foreign currency of the country and, if so, what arrangements have been made for its release?	No
8.	FAA Sec. 601(e). Will the assistance utilize competitive selection	Yes

procedures for the awarding of contracts, except where applicable procurement rules allow otherwise?

9. FAA 121(d). If assistance is being furnished under the Sahel Development Program, has a determination been made that the host government has an adequate system for accounting for and controlling receipt and expenditure of A.I.D. funds? N/A

10. FY 1986 Continuing Resolution Sec. 533. Is disbursement of the assistance conditioned solely on the basis of the policies of any multilateral institution? No

B. FUNDING CRITERIA FOR NONPROJECT ASSISTANCE

1. Nonproject Criteria for Economic Support Fund

a. FAA Sec. 531(a). Will this assistance promote economic and political stability? To the maximum extent feasible, is this assistance consistent with the policy directions, purposes, and programs of part I of the FAA? Yes

b. FAA Sec. 531(c). Will assistance under this chapter be used for military, or paramilitary activities? No

c. FAA Sec. 531(d). Will ESF funds made available for commodity import programs or other program assistance be used to generate local currencies? If so, will such Yes/Yes

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local currencies be available to support activities consistent with the objectives of FAA sections 103 through 106?

d. ISDCA of 1985 Sec. 205. Will ESF funds made available for commodity import programs be used for the purchase of agricultural commodities of United States-origin? If so, what percentage of the funds will be so used? — No

e. ISDCA of 1985 Sec. 801. If ESF funds will be used to finance imports by an African country (under a commodity import program or sector program), will the agreement require that those imports be used to meet long-term development needs in those countries in accordance with the following criteria? — N/A

(i) spare parts and other imports shall be allocated on the basis of evaluations, by A.I.D., of the ability of likely recipients to use such spare parts and imports in a maximally productive, employment generating, and cost effective way;

(ii) imports shall be coordinated with investments in accordance with the recipient country's plans for promoting economic development. A.I.D. shall assess such plans to determine whether they will effectively promote economic development;

(iii) emphasis shall be placed on imports for agricultural activities which will expand agricultural production, particularly activities which expand production for export or production to reduce reliance on imported agricultural products;

(iv) emphasis shall also be placed on a distribution of imports having a broad development impact in terms of economic sectors and geographic regions;

(v) in order to maximize the likelihood that the imports financed by the United States under the ESF chapter are in addition to imports which would otherwise occur, consideration shall be given to historical patterns of foreign exchange uses;

(vi)(A) seventy-five percent of the foreign currencies generated by the sale of such imports by the government of the country shall be deposited in a special account established by that government and, except as provided in subparagraph (B), shall be available only for use in accordance with the agreement for economic development activities which are consistent with the policy directions of section 102 of the FAA and which are the types of activities for which assistance may be provided under sections 103 through 106 of the FAA;

(B) the agreement shall require that the government of the country make available to the United States Government such portion of the amount deposited in the special account as may be determined by the President to be necessary for requirements of the United States Government.

f. ISDCA of 1985 Sec. 207. Will ESF funds be used to finance the construction of, or the operation or maintenance of, or the supplying of fuel for, a nuclear facility? If so, has the President certified that such country is a party to the Treaty on the Non-Proliferation of Nuclear Weapons or the Treaty for the Prohibition of Nuclear Weapons in Latin American (the "Treaty of Tlatelolco"), cooperates fully with the IAEA, and pursues nonproliferation policies consistent with those of the United States?

No

g. FAA Sec. 609. If commodities are to be granted so that sales proceeds will accrue to the recipient country, have Special Account (counterpart) arrangements been made?

2. Nonproject Criteria for Development Assistance

a. FAA Sec. 102(c); Sec. 111; Sec. 281(a). Extent to which activity will (a) effectively involve the poor in development, by extending access to economy at local level; increasing labor-intensive production and the use of appropriate technology, spreading investment out from cities to small towns and rural areas, and insuring wide participation of the poor in the benefits of development on a sustained basis, using the appropriate U.S. institutions; (b) help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help themselves toward better life, and otherwise encourage democratic private and local governmental institutions; (c) support the self-help efforts of developing countries; (d) promote the participation of women in the national economies of developing contries and the improvement of women's status; and (e) utilize and encourage regional cooperation by developing countries? N/A

b. FAA Sec. 103, 103A, 104, 105, 106, 107. Is assistance being made available: (include only applicable para- N/A

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graph which corresponds to source of funds used. If more than one fund source is used for assistance, include relevant paragraph for each fund source.) N/A

(1) (103) for agriculture, rural development or nutrition; if so (a) extent to which activity is specifically designed to increase productivity and income of rural poor; (103A) if for agricultural research, full account shall be taken of the needs of small farmers, and extensive use of field testing to adapt basic research to local conditions shall be made; (b) extent to which assistance is used in coordination with efforts carried out under Sec. 104 to help improve nutrition of the people of developing countries through encouragement of increased production of crops with greater nutritional value, improvement of planning, research, and education with respect to nutrition, particularly with reference to improvement and expanded use of indigenously produced foodstuffs; and the undertaking of pilot or demonstration of poor and vulnerable people; and (c) extent to which activity increases national food security by improving food policies and management and by strengthening national food reserves, with particular concern for the needs of the poor, through measures encouraging domestic N/A

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production, building national food reserves, expanding available storage facilities, reducing post harvest food losses, and improving food distribution.

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

(3) (105) for education, public administration, or human resources development; if so, (a) 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; and (b) extent to which assistance provides advanced education and training of people in developing countries in such disciplines as are required for planning and implementation of public and private development activities. N/A

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(4) (106) for technical assistance, energy, research, reconstruction, and selected development problems; if so, extent activity is: (i) (a) concerned with data collection and analysis, the training of skilled personnel, research on and development of suitable energy sources, and pilot projects to test new methods of energy production; and (b) facilitative of geological and geophysical survey work to locate potential oil, natural gas, and coal reserves and to encourage exploration for potential oil, natural gas, and coal reserves. N/A

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

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

(iv) reconstruction after natural or manmade disaster;

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

(vi) for special development, especially small labor-intensive enterprises, marketing systems, and financial or other institutions to help urban

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poor participate in economic and social development.

(5) (107) is appropriate effort placed on use of appropriate technology? (Relatively smaller, cost-saving, labor using technologies that are generally most appropriate for the small farms, small businesses, and small incomes of the poor.) N/A

c. FAA Sec. 118(c) and (d). Does the assistance comply with the environmental procedures set forth in AID Regulation 16. Does the assistance take into consideration the problem of the destruction of tropical forests? N/A

d. FAA Sec. 281(b). Describe extent to which the activity 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. 122(b). Does the activity give reasonable promise of contributing to the development of economic resources, or to the increase of productive capacities and self-sustaining economic growth? N/A

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