PD-AAZ-015
ISN 60253

UNCLASSIFIED

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

COSTA RICA

PROJECT PAPER

BALANCE OF PAYMENTS

AID/LAC/DR/P-427

Project Number: 515-0236
Grant Number: 515-K-609

UNCLASSIFIED

AID 1120-1

PAAD

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROGRAM ASSISTANCE APPROVAL DOCUMENT

1. PAAD NO: 515-K-609 515-0236

2. COUNTRY: Costa Rica

3. CATEGORY: Cash Transfer

4. DATE: May, 1988

5. TO: AA/LAC, Dwight Ink

6. OYB CHANGE NO.: N/A

7. FROM: LAC/DR, Terrence Brown

8. OYB INCREASE: None

TO BE TAKEN FROM: Economic Support Funds (ESF)

9. APPROVAL REQUESTED FOR COMMITMENT OF: $85,000,000

10. APPROPRIATION - LES888-35515-KG31 870-65-515-00-50-81

11. TYPE FUNDING: ☐ LOAN ☒ GRANT

12. LOCAL CURRENCY ARRANGEMENT: ☒ INFORMAL ☐ FORMAL ☐ NONE

13. ESTIMATED DELIVERY PERIOD: FY 1988

14. TRANSACTION ELIGIBILITY DATE:

15. COMMODITIES FINANCED

16. PERMITTED SOURCE		17. ESTIMATED SOURCE	
U.S. only:		U.S.:	$85,000,000
Limited F.W.:		Industrialized Countries:	
Free World:		Local:	
Cash:	$85,000,000	Other:	

18. SUMMARY DESCRIPTION

The purposes of the program are to provide balance of payments support to A.I.D. stabilization efforts in Costa Rica, and to encourage policy, structural and sectoral changes aimed at re-establishing dynamic growth in the economy through increased exports. The $85,000,000 grant which will be signed with the Government of Costa Rica will consist of a cash transfer to a separate Central Bank account to finance private sector imports from the United States of eligible raw materials, capital goods and other productive inputs. Local currency in an amount equivalent to the grant will be deposited by the Central Bank in a special account to finance economic development activities acceptable to A.I.D. and the Government of Costa Rica. The $85 million authorized hereby will be subject to the Conditions, Covenants and Special Provisions specified in Section V of the PAAD.

The Mission is authorized to vary the disbursment plan containea in Section III. D.2.b of the PAAD as required to maintain an even and rational flow of foreign exchange into Costa Rica, but with the provision that the Mission will consult with AA/LAC prior to taking any action to withhold or delay all or any part of a disbursement. The Central Bank of Costa Rica will provide the colon equivalent of each dollar disbursement calculated at the highest rate of exchange, at the date of the disbursement, which is not unlawful in Costa Rica.

19. CLEARANCES		DATE
LAC/DP:Wheeler	WBW	6/8/88
GC/LAC:GDavidson	[illegible]	6/8/88
LAC/CEN:CCostello	[illegible]	6/9/88
PFM/FM/PAFD:ESOwens	[illegible]	6/8/88
PPC/EA:KKauffman		
ARA/FCP:WBarmon	WB	6/8/88
DAA/LAC:MButler		

20. ACTION: ☒ APPROVED ☐ DISAPPROVED

Dwight Ink 6/10/88

AUTHORIZED SIGNATURE DATE

Assistant Administrator (LAC)

TITLE

Approval of Methods of Financing:

This PAAD complies with current Agency guidance on methods of financing and has provided for adequate audit coverage in accordance with the Payment Verificiation Policy Implementation Guidance.

Gary L. Byllesby, Controller, LAC

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I. SUMMARY AND RECOMMENDATIONS

A. Summary

This document requests authorization of $85.0 million in Economic Support Funds for the 1988 Economic Stabilization and Recovery VII 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 the U.S. and GOCR development strategies for Costa Rica in accordance with agreements made with the GOCR. Potential uses of local currency funds include the following: rural development, export promotion, natural resources, housing, agribusiness development, road maintenance, promotion of non-traditional agricultural exports and education. Authorization to obligate the entire $85 million is requested. Disbursements are planned in two tranches based on the Costa Rican performance against the criteria and specific covenants described in Section V. of this document.

B. Recommendations

1. That this PAAD be approved, authorizing the $85.0 million ESR VII program and that obligation of a grant for the entire $85 million in Economic Support Funds for Costa Rica be authorized, to be provided as a cash transfer.

2. That the Mission be authorized to vary the disbursement plan contained in Section III.D. 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. A. THE COSTA RICA ESF PROGRAM

1. Overview--Past ESR Program Rationale

Past ESF resources administered by AID have played a decisive role in the progress toward stabilization and recovery described in Section II.B. below and in Annex A. AID has previously signed ESR Agreements with Costa Rica for a total of $706 million, all of which has been disbursed.

ASSISTANCE UNDER ESR I-VI ($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
ESR VI	1987	BCCR		119,750	119,750
TOTAL			$168,000	$538,067	$706,067

Each of the previous ESR programs intended to support Costa Rica's international balance of payments and to increase the amount of foreign exchange available to the private productive sector. The design of the Costa Rican ESF program has been influenced mainly by:

1) the economic crisis of the early 1980s;

2) A.I.D.'s general Central American development strategy; and

3) U.S. political interests in Central America.

During the late 1970s, the terms of trade turned sharply against Costa Rica. Coffee prices fell sharply and petroleum prices doubled. Rather than taking the necessary restructuring actions, Costa Rica attempted to maintain its growth performance through heavy internal and external borrowing. A policy of strong monetary expansion maintained existing levels of public and private consumption but caused inflation, an overvalued exchange rate, and a reduction of net foreign exchange reserves to negative levels. In

July 1981, the GOCR unilaterally suspended principal and interest payments on an external debt whose servicing requirements it could no longer meet. Cut off from external financing, Costa Rica's economy rapidly deteriorated. GDP fell by 9.6 percent between 1980 and 1982 while open unemployment reached 9.5 percent in 1982. Inflation surpassed 80 percent.

A.I.D.'s development strategy is based on the four principal goals of the National Bipartisan Commission on Central America (the Kissinger Commission): economic stabilization; laying the basis for long-term growth; spreading the benefits of growth; and strengthening democracy. Central to this strategy were the needs to maximize the involvement of the private sector in the development process, allowing it to take the lead in fostering export-led growth, and to achieve structural change through policy dialogue.

With its strong tradition of democracy and social justice, Costa Rica's success was important to the U.S. goal of encouraging free, stable, democratic nations throughout Latin America. The country's dedication to democracy did not falter in the face of reduced living standards and the threat from neighboring Nicaragua, thus demonstrating that U.S. political interests could be achieved through a process of economic stabilization and sustained, broad-based economic growth.

Through its ESR programs, A.I.D., in conjunction with other international donors and agencies, has supported a major stabilization effort accompanied by macroeconomic reforms essential to achieving sustainable long-term growth. The reforms have included a major reduction in the number of GOCR agencies and programs which received subsidized credit; a unified, market-based exchange rate; the maintenance of positive real interest rates on both savings and loans; a substantial reduction in the public sector deficit; and passage of a monetary reform law which improved the competitive ability of private banks in a state bank-dominated system.

Central to A.I.D.'s strategy was the need to shift the Costa Rican economy from an orientation emphasizing import substitution to one of export-led growth. A.I.D. policy reform efforts focused on removing constraints to private sector investment and private sector exports, particularly to new, non-traditional exports. The final elements of the A.I.D. strategy concentrated on equity--the need to make sure that the process of restructuring also spread the benefits of growth. This equity focus included increasing the involvement of the private sector in areas where it could be more efficient than the government, such as through a state enterprises privatization program, increasing employment opportunities, improving housing, and improving educational opportunities. For a more detailed examination of past ESR programs' objectives and accomplishments, the interested reader is directed to review the ESR VI PAAD.

During the period 1982-1987 U.S. economic and financial assistance has totaled $953.1 million including development assistance, PL 480 food aid and the ESF cash transfers. All elements of the assistance package were designed to support the restructuring effort. However, the $706 million ESF program has represented the majority of the assistance package and has been the mainstay of the policy reform program. The Costa Rican ESF program currently consists of three basic elements:

The provision of dollar grant funds: The ESF program has been used to permit the Costa Rican productive private sector to finance imports from the U.S. Such imports have provided critical raw materials, intermediate goods, spare parts and capital equipment which have allowed Costa Rica to maintain an adequate rate of economic growth.

Policy reform conditionality: Costa Rica, like many other developing countries, has needed to make major policy reforms in order to reestablish growth. It has needed to institute policies to effectively increase productivity, exports, savings, investment and social services, and to curb inappropriate subsidies and inefficient public sector operations. In general, incentives to develop an efficient, market-oriented private sector had to be designed. Encouraging these policy reforms has generated economic and political costs, and the ESF program has been a means to encourage reform through appropriate economic policy conditionality, while buffering those costs through cash transfers.

Joint programming of local currency: Under the terms of the ESF cash transfer program, an equivalent amount of local currency is made available by the GOCR which A.I.D. and the GOCR jointly program, normally as part of the ESF negotiations. This cooperation ensures that the local currency is used to support the the policy reform program and development objectives of A.I.D. and the GOCR.

B. Economic Summary

A detailed analysis of Costa Rican economic trends and problems for the period 1982-1987 is attached as Annex A.

Costa Rica's reputation as a model developing country during the 1960s and 1970s was based on its performance in terms of economic growth, quality of life, equity considerations, traditional exports, and manufactured exports to the Central American Common Market (CACM). This performance was impressive, but concealed certain structural weaknesses which in conjuction with the increase in world petroleum prices, the decline in the prices of traditional exports, the disruption of the CACM and a sharp rise in debt service payments led to the economic crisis of 1980-1982. Those weaknesses included: (1) a heavy dependency on traditional agricultural exports and exports to the CACM; (2) a production structure oriented to import substitution; (3) a large and chronic public sector deficit; (4) excessive government intervention (including ownership) in private sector production; and (5) a nationalized, non-competitive banking system. During the 1980-1982 economic crisis, Costa Rica's output registered negative rates, unemployment increased sharply, inflation reached unprecedented levels and the public sector accumulated a huge external debt.

Since 1983 and through 1987, the Costa Rican economy has improved significantly in that positive economic growth has returned, new capital formation has increased, and non-traditional exports to non-CACM markets have grown. In conjunction with international donor stabilization and structural adjustment programs (especially from AID, the IMF and IBRD), GOCR policy reform has resulted in the following positive results over the past five years:

-- GDP growth, which was a negative 7.3% in 1982, has been positive since 1983, with the 1984-1987 average in constant prices at 4.7%.

-- Inflation, which reached 82% in 1982 as measured by the consumer price index, averaged 15% annually between 1984-1987.

-- The non-financial public sector deficit which stood at 9.0% of GDP in 1982 was reduced to 0.3% in 1987.

-- Inclusive of Central Bank losses, the public sector deficit has been reduced from 14.6% of GDP in 1982 to about 3.3% in 1987.

-- For the first time since the crisis, statistics indicate that real income has essentially returned to 1975 levels and is close to 1977 levels (i.e. for 1987, real per capita GDP is estimated at 94% of the 1977 level).

-- Unemployment was reduced from 9.5% in 1982 to 5.6% in 1987.

Notwithstanding the above, some serious problems still remain. The most immediate of these is the balance-of-payments problem (See Table 5, Annex A). In 1987, Costa Rica's b/p basic balance deficit (the current account deficit plus private capital, project loans to the public sector, and official amortization) rose to $613 million as compared with an average of $374 million in the 1984-86 period. This increase was due to a $222 million surge in imports in 1987 induced by the 1986 coffee price boomlet and by a sharp expansion of credit. (As a result of a tightened monetary policy begun in late 1987, imports in 1988 are projected to be about $75 million lower than in 1987.) To fill this basic financial gap in the balance of payments, Costa Rica relied not only on external balance of payments support amounting to $101 million, but also allowed payment arrears to bilateral and commercial bank creditors to increase by $374 million.

The external debt problem has reached a proportion whereby service on this debt is approaching 50% of export earnings. The Arias administration undertook negotiations with commercial bank creditors in the latter part of 1986 to reschedule that debt; however, the negotiations have not been successfully concluded. The reasons for this are several: The GOCR originally refused to pay interest on the debt without a rescheduling agreement. The commercial banks subsequently refused to consider an agreement with Costa Rica prior to completing a rescheduling agreement with Brazil. More recently, the banks themselves have disagreed on how to proceed. Significantly, the IMF agreed to proceed with a Standby Agreement for Costa Rica in the absence of a commercial bank agreement, though Costa Rica has agreed to continue paying interest to its commercial bank creditors at the rate of $5 million per month ($11 million per month would be full payment.) Though it is difficult to predict the timing of a commercial bank agreement, it is anticipated that such an agreement will involve debt relief of a significant portion of the scheduled interest, and a rolling over of principal maturities.

In 1987 Costa Rica's Gross Domestic Product (GDP) grew at a rate of 3.0%, which is high compared to the early years of the economic crisis, but lower than the 1986 growth rate. Exports grew by 2.6% in 1987 as an impressive increase in nontraditional exports to third country markets was tempered by a decline in traditional exports. A recent Mission projection is that for the period 1988-1992, non-traditional exports will grow by $228 million --an average of $57 million annually. Even with a projected 10% annual increase in non-traditional exports and overall export growth at 7.5% annually, the trade deficit is estimated to decline by only $63 million during this period due to the corresponding increase in imports that will accompany economic growth.

1987 began with the Central Bank continuing its credit liberalization program begun in 1983. Allocative credit categories had been removed and credit limits were replaced by more frequent use of indirect monetary instruments such as sales of stabilization bonds and changes in reserve requirements and rediscount rates. Reserve requirements on demand and term deposits were raised but did not effectively serve to dampen a strong credit expansion. By May 1987, inflation was running at 20% and imports were increasing at an annual rate of 24%. Realizing that monetary expansion was too high, the Central Bank raised importer deposits for foreign exchange applications and required non-financial public sector entities to withdraw large portions of deposits in state banks and purchase state bonds. The measures resulted in a considerable squeeze on private financial institutions and some private businesses. Several private finance companies went bankrupt late in the year, though it is unclear to what extent the failures were the result of the liquidity squeeze or of unsound financial practices. At present, confidence has been restored in the private banking sector with over ¢500 million being captured weekly by the private banks and, according to the Superintendency of Banks, with no private banks experiencing liquidity problems.

For the period 1988-1992, USAID/Costa Rica projects an economic growth rate on the order of 3-5% per year. The balance of payments projection (Table 5, Annex A) demonstrates Costa Rica's continued need for external balance of payments support. The indication is that Costa Rica's current deficit will average over $170 million annually through 1992. Even with partial coverage of this deficit through increased direct private investment and debt relief from commercial banks and bilateral creditors, balance of payments assistance from the external donors (including AID) will be necessary to fill the financial gap. It is projected that continued increases in exports, linked with the accompanying new investment, will result in a beneficial impact on the net inflow of capital. Assuming that continued balance of payments assistance will be available from the IMF and World Bank, along with continued project assistance from multilateral and bilateral donors, this should permit a downward trend in ESF levels for Costa Rica.

III. PROGRAM DESCRIPTION

A.1. U.S. Interests and Relationship to Mission Strategy

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 role in formulating the Central American peace initiative in 1987 has brought world-wide attention and recognition to Costa Rica. 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. To date, some 31,000 persons have officially entered Costa Rica as refugees from other Central American countries; 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. 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 and potentially undermine some of the achievements made to date. In view of the above, and despite severe foreign assistance budget limitations and competing worldwide development priorities that will likely continue to gradually reduce ESF assistance levels 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.

A.2. Relationship to Mission Strategy

The ESR VII program conforms to the Mission Strategy Update and Action Plan that were approved by AID/W in early April, 1988. As stated in the Strategy document, the continuation of balance of payments assistance to Costa Rica is appropriate given the need to reinforce and continue economic policy reforms and macroeconomic progress on a number of fronts, while allowing a shift to a program of longer term growth building upon the stabilization that has been achieved.

The Mission recognizes that the economic stabilization goal of former ESF programs was a necessary condition to sustained growth but was not an end in and of itself. Major economic progress has been achieved in that there has been a return to positive, though modest, growth rates, reduced inflation and improved fiscal performance. Indeed, stabilization remains an important area of concern because the progress achieved to date is fragile and can be reversed quickly. Our strategy update recognizes that the continuation of macroeconomic concerns in the 1988 ESF program, while not entailing new initiatives, is necessary and serves as support to the GOCR economic team that has advocated and implemented rational, coherent economic programs.

Nevertheless, the Mission's strategy, building on past progress, is evolving from economic stabilization to a primary emphasis over the next three to five years of laying the basis for sustained economic expansion by supporting export-led growth. This shift supports an "economic transformation" though an increase in non-traditional agricultural and industrial exports outside the CACM both in absolute terms, and in relation to total exports and a growing GDP.

The 1988 ESF balance of payments program for Costa Rica will support the movement toward economic expansion based on export-led growth by providing foreign exchange that will maintain import capacity for economically productive activities. Such assistance will also help Costa Rica comply with economic and fiscal performance targets negotiated with other external donors, thereby permitting the release of still further financing for productive activities. Conditionality associated with the ESF program will also result in continued attention to macroeconomic concerns while increasing emphasis on sectoral level policies that contribute to the goal of long term sustainable growth.

In that regard, the Mission has identified four principal areas where we will focus our policy dialogue efforts. As described in Section III.E., policy dialogue being carried out by the Mission with the GOCR is taking place under the auspices of a "U.S.-Costa Rica Bipartite Commission". The four sectors for ESR VII conditionality emphasis are:

-- Financial Stability
-- Foreign Trade, Investment and Export Promotion
-- Housing
-- Public Sector Efficiency

These four areas for ESR VII conditionality and policy dialogue are discussed in Section IV.

B. Relation to IMF Strategy and the GOCR Economic Plan

The Mission has developed its past ESF programs and conditionality packages in conjunction with and supportive of the macroeconomic and structural adjustments required by the IMF and the World Bank as part of their assistance to the GOCR's stabilization efforts. The 1987 ESF program, for instance, was designed assuming that an IMF Standby agreement would be in effect during the year and that it would provide the parameters and criteria by which GOCR economic performance could be measured. The Letter of Intent for this IMF agreement was signed in April 1987 for a Standby in the amount of SDR 50 million (approximately $65 million) to run for 18 months, or to the end of 1988. However, delay in activation of the IMF agreement was caused by the failure of the foreign commercial banks and the GOCR to reach agreement on a prerequisite debt rescheduling package with the GOCR. This negotiation impasse with the foreign commercial creditors arose from the unwillingness of the banks to set a precedent of more favorable terms for Costa Rica that could be used by other debtor countries.

Despite the problems with the commercial banks and the subsequent negative impact on the April 1987 Letter of Intent, the GOCR continued its consultations with the IMF. Agreement was reached on a revised Letter of Intent in October 1987, only the second time that the IMF has reached essential agreement on a Standby in the absence of an external arrears accord with commercial creditors. The IMF discussions included a formula whereby the GOCR would continue to pay interest to the foreign commercial bank creditors amounting to $5 million per month. Even though the IMF and GOCR agreed upon the principal economic targets for the end of 1987 and 1988 as a basis for the October Letter of Intent, deterioration of Costa Rica's balance of payments in 1987 impaired attainment of some of the IMF's targets for year end 1987 and the GOCR did not drawn upon this Standby. However the IMF and GOCR have been in close consultation in recent months to establish the basis for a sound economic program for 1988 and as of late February 1988 finalized quarterly performance targets for 1988. The IMF Board approved the Standby in early April and the GOCR is now able to activate drawings from the Standby.

It was an assumption of the 1987 ESF program that not only would there be an IMF Standby, but that the IMF would play the lead role in macroeconomic conditionality. The lack of an IMF agreement until late in the year required that additional economic performance targets be added to ESR VI to compensate for the absence of targets that would have been the focus of the IMF program. As a consequence, the GOCR provided AID with the parameters of an "Economic Plan" for 1987, that included limits on banking system net credit to the non-financial public sector, net domestic assets of the Central Bank, and Central Government cumulative expenditures as well as other performance targets adjusted to compensate for the lack of a commercial bank rescheduling accord on Costa Rica's external arrears. The GOCR complied with the targets agreed in the "Economic Plan", permitting the first two disbursements of ESR VI to take place in September and December 1987, respectively. The final disbursement took place in March, 1988, based upon an evaluation of overall performance and the submission of the GOCR's economic plan for 1988.

The approval of the Standby by the IMF Board in April has validated tne assumption of the 1988 ESF program that an IMF Standby will be operative. This implies that the IMF will reassume the lead role for macroeconomic conditionality. The IBRD's Structural Adjustment Loan II (SAL II), for which negotiations with the GOCR are virtually completed and is expected to go into effect by mid-year 1988, will be focused on issues of financial sector efficiency and control, agricultural pricing and marketing policy, and international trade (tariff structures). (See Section IV. p 23 for a description of the SAL II program.)

As in previous years, the ESF program will continue to be supportive of the IMF and IBRD programs and conditionality. As discussed in Section III.A. above, it will not be the intention of the ESR VII program to interject new policy dialogue efforts in the areas.

Prior to the delay in the 1987 Standby with the IMF, 1987 ESF conditionality contained an increasingly important focus on sectoral topics such as investment and export promotion, public sector efficiency, promotion of non-traditional exports and support to the private manufacturing through increased credit availability. This trend will continue and receive more emphasis in this year's program (See Section IV). While it is appropriate to continue to orient the 1988 ESF program toward sectoral concerns, stabilization remains an important element of concern because the progress achieved to date in Costa Rica is fragile and can be reversed quickly. It is important to preserve and reinforce the macroeconomic progress that has been achieved to date in Costa Rica.

The relationship of the ESF program to the IMF Standby and portions of the World Bank's SAL II, therefore, will be to remain supportive, not duplicative, of their programs, recognizing that the IMF has the lead role for macroeconomic conditionality. At the same time, the ESF program will pursue a more sectoral focus and concentrate on the necessary policy reform which must accompany such a focus.

C. The Program

The ESR VII program consists of a $85.0 million ESF grant to Costa Rica in the form of a cash transfer. The Mission proposes to obligate the entire $85 million in one single agreement.

The Mission has carried out a series of negotiations with the GOCR's cabinet level Bipartite Commission, led by the Minister of the Presidency and including the Minister of Finance, the President of the Central Bank and the Minister of Planning. Intensive and on-going negotiations with the GOCR team have been underway since December 1987, resulting in full agreement on terms and conditionality of the 1988 program.

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. 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.

D. U.S. Dollar Resources and Disbursement Plan

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 A (Table IV) shows a $200 million projected balance-of-payments gap for Costa Rica in 1988, assuming a rescheduling of principal owed to foreign commercial banks. 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 was established by the GOCR for the ESR VI Program that permitted improved control and monitoring of the use of ESF dollars. A similar mechanism will be used for ESR VII funds. Annex C provides details on the ESF dollar separate account and the uses proposed by the Mission for the dollar funds. The funds will facilitate 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 1987 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 VII program. A cash transfer program will allow a more flexible and responsive disbursement capability than a CIP. A quick injection of foreign exchange into the Costa Rican economy is necessary 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 1980-1987 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
1987	$102.3 million

This 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. 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 its current economic difficulties. 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, $438 million in 1986 and jumped to approximately $600 million in 1987. Illustratively for 1985, eligible import commodities as prescribed by ESF conditionality totaled $288 million, of an overall U.S. import total of $380 million. This figure well exceeds the ESF total of that year ($160 million), The figures for 1987 total $183 million in eligible import commodities versus an ESF total of $119.75 million. A similar relationship in 1988 is expected.

b. <u>Disbursement Plan</u>

An initial tranche of $45 million will be disbursed once the GOCR demonstrates successful initial implementation of an approved economic plan for 1988, as well as upon a determination by the Mission of acceptable GOCR compliance with the terms of ESR VII conditionality. It is anticipated that this disbursement can be made late in the second-quarter of CY 1988.

The second and final tranche of $40 million will be made upon a determination by USAID/Costa Rica of satisfactory subsequent 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 VII 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. It is anticipated that this disbursement can be made in the early part of the fourth quarter of CY 1988.

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

ESF VII DISBURSEMENT PLAN

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

The Mission requested, and was given, authorization to vary the disbursement plans under ESR II-VI 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 VII 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. Use of Dollar Funds

As with the 1987 ESF Program, consistent with LAC guidance, dollar funds in the ESF Separate Account will be available to facilitate the importation of U.S. raw materials, spare parts and intermediate goods required by the Costa Rican private sector. Details of the Separate Account system have been established with the BCCR (See Annex C) to ensure that ESF funds are used to reimburse the BCCR for eligible commodity imports from the U.S.

E. Local Currency Resources

1. Ownership

In response to LAC guidance, a major issue in the Mission's negotiations with the GOCR was to achieve a 1988 ESF Agreement in which, for the first time, the GOCR would explicitly acknowledge ownership of the local currency available by the cash transfer program. As reported in San Jose 2549, this objective has been met. The ESR VII Grant Agreement, therefore, will include appropriate language to reflect this achievement.

The resolution of this issue will have a significant long-term impact on the management of the local currency resources. In conjunction with revised Agency (1987 State 327494) and LAC (State 102677) guidance, the immediate result will be to reinforce the Mission's efforts, begun in 1987, to expand the GOCR's role in the management of and accountability for the funds. Doing so will permit a corresponding reduction in the role exercised by the Mission over the past several years.

The mechanism for undertaking the transition to an increased role for the GOCR has been under discussion with the GOCR for several months. A number of concerns were identified and resolved, and a system is taking form to ensure adequate accountability for the funds (a concern fully shared by the Mission) while, to the extent possible, also providing flexibility to respond to local conditions. The Mission is taking the steps necessary to incorporate the requirements of the new guidance into the system. Based on our experience thus far, however, the Mission believes that the transition to a more active GOCR role in managing the local currency resources will continue to be time consuming and, to assure compliance with the guidance and provide the level of accountability desired, also staff intensive for the Mission.

As also reported in San Jose 2549, resolution of the ownership issue raised a new question regarding the treatment of local currency available for programming and disbursement under earlier ESF Agreements (where the ownership question was not addressed). Of particular concern was the use of those funds for non-public sector activities. A two part response proposed by the Mission and accepted by LAC (see State 96604) calls for (1) a covenant in the 1988 ESF Agreeement which requires that, by January 1, 1989, the GOCR establish a new mechanism for approving all activities (including for non-public sector entities and for AID OE costs) to be financed with local currencies from the 1988 and subsequent ESF agreements that are explicitly acknowledged as being GOCR owned, and (2) the use of funds available under agreements prior to 1988 in accordance with the terms of those agreements (but still

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requiring joint programming and maximum GOCR participation in the process). This solution continues the transition to an increased role for the GOCR in local currency management while also providing the means for financing specific priority activities during the interim period leading up to January 1, 1989. Once the new mechanism is established, all local currency funds still available for programming, regardless of which ESR agreement initially made them available, will be programmed under the terms of the new mechanism.

2. Programming, Management and Accountability

a. Background

The system established by the Mission to program, manage and account for local currency under our ESF program had its origins in a proposal that was approved as part of the first amendment to the PAAD for the ESR II program. Over the past four years, a variety of changes were made based on Mission experience in implementing the system. Annex F to the ESR VI PAAD contains a description of the system as it was in use through mid-1987. (Annex H of this PAAD provides a listing of on-going local currency activities and the pipeline associated with each one.)

As part of the final negotiations on ESR VI, and following LAC guidance, the system was modified slightly in 1987 to increase the degree of GOCR participation in the process. This was one of the first steps taken in the transition to explicit GOCR acknowledgement of local currency ownership.

The most significant change over the past several months has been the creation, at the Mission's suggestion, of a Bipartite Commission charged with representing the GOCR both in negotiating the 1988 ESF agreement and in programming and assuming responsibility in the use of ESF related local currency, including the programming of resources still available under existing agreements. For the GOCR, the Commission is headed by the Minister of the Presidency and also includes the Ministers of Finance and Planning and the President of the Central Bank.

A key point in discussions with the Commission was reaching agreement on shifting a greater degree of responsibility in the management and accountability for these resources to the GOCR. In gradually accepting this responsibility, the Commission also recognized the implications in terms of potential public scrutiny on how this mandate is handled. With this in mind, our earliest discussions with the Commission focused on several parameters designed to facilitate its task, including:

- joint programming of all funds in writing by the Commission and the Mission;

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- use funds for development purposes, including sector budget support;

- approve activities that fit within the development priorities of the GOCR and the Mission;

- avoid a proliferation of activities by establishing a minimum funding requirement, with the objective of approving fewer but larger projects;

- all disbursements must be consistent with the GOCR's monetary program; and

- approved activities should not have an orientation toward a single political party or platform.

The Commission also recognized the importance of establishing a system for controlling approved activities. Toward that end, an existing office within the Ministry of the Presidency is being expanded and staffed accordingly. At the present time, it is organizing itself to take on this new responsibility. To minimize unnecessary bureaucratic growth, this office will explore the possibility of using contracted services (particularly for financial management) to carry out some of its functions. The office has also studied the control system developed by the Mission and found it to be comprehensive and responsive to its needs. Rather than create and test something new, therefore, the office intends to adopt that system for its own use.

b. Impact of Recent Agency and LAC Guidance

The Mission initiated the transition to increased GOCR responsibility for the management of ESF local currency funds prior to the issuance of the most recent Agency and Bureau guidance. As noted above, the Mission fully concurs with the objective of assuring adequate accountability for the funds, and, based on the guidance, is now taking necessary action to adjust what has been developed so far to conform to that guidance. We believe that relatively little will be required since the system being developed placed priority on the same concerns as those in the new guidance.

In this regard the Mission will continue to work closely with the office in the Ministry of the Presidency as it takes responsibility for managing the local currency resources. Our objective is to gradually withdraw from this role as the staff gains experience and demonstrates that the accountability issue is being satisfied. It is too early to establish a timetable for this withdrawal; however, it will be a top priority for the Mission.

Because the local currency funds to be available under the ESR VII program will not be used until January 1, 1989, when the new GOCR system will be in place, the Mission will work during the interim period to modify what has already been negotiated with the GOCR. It is our hope that some flexibility will be permitted so that the development potential of the local currency can be maximized through specific interventions. Our preliminary reaction, however, is that because of the staff implications of such an approach, we expect to see a substantial portion of the resources go to uses that will minimize intensive staff management -- i.e., general budget and sectoral support.

c. Illustrative Uses of Local Currency

Consistent with the new guidance, the Mission envisions four uses for the local currency made available through the ESR VII program. Basic criteria such as those listed in Section III. E. 2. a., above, will be established to provide general parameters to control the programming of available funds. This Mission has already recommended these criteria as the minimum required in order to maximize the long-term benefits of the local currency resources, and we will continue to incorporate them in our negotiations related to the establishment of the GOCR's new management system.

The four areas of local currency use will be the following:

- General Budget Support: This will not be a top priority for the Mission since any potential development impact will be minimal. One area that is of interest since it would contribute to the GOCR's overall economic stabilization program is direct transfers to the Central Bank to help write down its losses and thus reduce the contribution it makes to the total public sector fiscal deficit. Use of local currency funds for this purpose was first carried out under the ESR VI program.

- Sectoral Support: Under this area, funds will be targeted to the priority sectors most closely related to the Mission's recently approved strategy including export promotion, rural development, natural resources, housing and transportation. GOCR priorities will also be factored into the programming process.

- Specific Development Projects: All programming under this area will be done within the ability of existing Mission staff resources to comply with the new guidance. Neither the Mission nor the GOCR have adequate staff to propose a large number of projects; nonetheless, it is expected that instances will exist where specific project level interventions -- for both public and private sector activities -- will be desirable for strategic or programmatic purposes.

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Included in this area would be counterpart for AID and other donor financed projects as well as activities that are financed only with local currency.

- Trust Funds: This area will be to support certain program related activities implemented directly by the Mission (see discussion in next section for more detail) as well as for Mission Operating Expenses.

At this time, specific amounts of funding for each of these areas have not been negotiated in final with the GOCR. The Mission's preliminary position, however, is that no less than 50% will be programmed for general budget and sectoral support. The majority of the remainder of the funds will be for specific activities, including projects involving the private sector, and a small amount (perhaps up to 10%) will be for OE and Program Trust Fund purposes. As the funds to be available under the ESR VII program will not be used until the GOCR's new system has been developed and installed (i.e., January 1, 1989), there will be time to finalize negotiations on the amounts to be committed to each of these areas.

3. Program Trust Funds

The Mission's Program Trust Fund was negotiated with the GOCR and an agreement was signed in February, 1984. Since then, the Mission has used this mechanism to manage ESF local currency-financed project activities for which it assumed day to day implementation responsibilities (the Mission also has an OE Trust Fund that is covered by a separate agreement).

Currently, the following activities are receiving funding through the Trust Fund:

- Special Development Fund (SDF): This is a fund to finance small community self-help projects that are identified by Peace Corps Volunteers. Historically, Development Assistance funds had been used for this activity but, in view of the availability of local currency and the absence of any dollar costs associated with the projects, the Mission switched the funding to local currency in 1985. The equivalent of approximately $300,000 to $400,000 is budgeted per year for this activity.

- Civic Action: Under this program, approximately $40,000 in local currency is used each year to purchase materials for small community projects (e.g., school repairs). Labor for these projects is provided by U.S. military personnel who visit Costa Rica (usually as a port call on a Navy vessel).

- Rural School Rehabilitation: This program started in 1987 in response to a Ministry of Education (MEP) request for assistance in improving the physical state of elementary schools in rural areas. The program works in a similar fashion to the SDF program, with Peace

Corps Volunteers, in coordination with MEP officials, working with communities to develop projects, and the communities providing at least 50% of the cost of the project. The budget for the program is the equivalent of $700,000 over a three year period.

- Central American Peace Scholarships (CAPS): Implementation of the CAPS program involves a variety of in-country costs -- primarily English language training and purchase of airline tickets. Although considered a counterpart contribution to the dollar funds, these resources are managed directly by the Mission so as to facilitate the coordination of the myriad of activities associated with selection and preparation of long and short-term participants for travel to the U.S.

- Agricultural College (EARTH): Under the terms of a local currency Memorandum of Understanding with the GOCR, it was agreed that, until EARTH had the capability to do so, the Mission would act as its agent for certain procurement and contracting purposes. Pursuant to the agreement, funds are transferred from the MOU to the Mission's program Trust Fund from which the Mission then directly controls the funds. As soon as sufficient staff is hired by the school (now in process), the Mission will cease to serve in this role.

- Policy Planning and Administrative Improvement (PPAI): These funds provide counterpart to the Mission's DA project and are used to finance the local currency costs of services financed with the dollar resources. In certain limited cases where no dollar costs are required, these funds will be used without complementing dollar funds, but will still be charged as counterpart to the DA project.

During this year's Action Plan review, the Mission's proposal to implement an urban school rehabilitation project via the Trust Fund was rejected by AID/W because of the staff implications associated with the new local currency guidance. The Mission is now reviewing the design of the project to devise a non-Trust Fund mechanism for implementation.

Given the Action Plan decision on the urban school project, as well as the new local currency guidance, the Mission will carefully review all plans for activities that, in the past, would have been implemented via the Trust Fund with a view toward keeping such activities to a minimum. However, the Mission does plan to continue with the SDF and Civic Action programs and, as in the past, will provide reports in conjunction with the Action Plan and Congressional Presentation that will indicate implementation status. Also, in an effort to further reduce the demand on Mission staff that these programs require, the Mission will explore alternative funding mechanisms (e.g., transfer funds directly to the Peace Corps so that they can assume full financial responsibility for the SDF program) over the coming months and, if feasible, will make adjustments accordingly.

Although new Agency guidance requires a PP-like document for projects financed through a Trust Fund, the last three projects in the above list were approved before the new guidance took effect. Nonetheless, since the funds provided are local currency counterpart to dollar projects, full PPs were prepared and approved and, thus, these activities comply with the guidance. Also, although it is fully funded with local currency and was approved prior to the issuance of the new guidance, the Rural School Rehabilitation project was justified in a document the Mission considers to be PP-like. The remaining projects have been active for several years and receive annual increments to continue financing what are in essence very small (less than $5,000) community self-help activities. As such they are not conducive to PP-like analysis.

As noted above, the Mission plans only limited use of the Program Trust Fund and, in those cases, will comply with all documentation requirements. In addition to these limited project specific activities, the Mission will also continue financing PD&S-like activities (evaluations, audits, short-term technical advisors, etc.) via the Trust Fund when only local currency costs are involved. In those cases, FAR procurement procedures will be employed.

4. Interest Earned on ESF Local Currency

AID policy favors that ESF local currency be placed in an interest bearing account with interest earned programmed as if it were principal, so long as such arrangements conform to Host Country law and do not undermine sound monetary policy and internationally-supported stabilization arrangements. 1987 State 327494 allows for the Mission Director to determine whether or not to follow AID's preference for an interest bearing account.

Since ESR II, USAID/Costa Rica has required the BCCR to pay interest on the local currency deposits related to the grant portion of ESF cash transfers. These deposits total the local currency equivalent of $538 million (all local currency funds have been deposited in the Central Bank of Costa Rica). To date interest earnings on those deposits have totalled the equivalent of $115 million, and have been programmed for the same development purposes as principal. The rationale for the interest payments was to provide an incentive for the GOCR to give priority to implementing the approved local currency activities (and, thus, to rapidly draw down on the local currency deposits), and to maintain the value of the devaluing colon.

The requirement for paying interest on the local currency account has been a sensitive political issue at high levels of the GOCR since 1986. The sensitivities have become more acute now, given the Mission's insistence that the GOCR acknowledge local currency ownership and by January 1, 1989, devise a mechanism for programming local currency for both public and private sector uses. In the ESR VI program, the Mission diffused the interest issue by agreeing to program an amount of local currency equivalent to the interest earned in 1987 to be applied against Central Bank losses. Hence, the Mission negotiated a theoretical maintenance of interest while applying this same amount in support of a demonetized use consistent with the GOCR priorities and its stabilization program.

In the negotiations on the ESR VII program, the GOCR advised the Mission that it is not the Government's policy to pay interest on funds that it owns and, thus, with the explicit acknowledgement of ownership of these local currencies, it intends to cease the past practice. That the interest payments add to Central Bank losses is another compelling factor the GOCR raised in its argument to stop such payments. Also, when viewed in the context of a continuing stabilization and structural reform program, the role the Central Bank plays in that program, and the fact that interest payments on these funds contribute to Central Bank losses, it is no longer possible for the Mission to argue pursuasively for continuation of interest payments. We have therefore concluded that interest generation on the local currency deposited in the Central Bank pursuant to our ESF agreements will no longer be required.

5. Audit Provisions

Audit coverage will be provided for the various ESF dollar and local currency (LC) elements of this program as follows:

- ESF dollars and LC trust fund for USAID operating expenses are the audit responsibility of the A.I.D. Inspector General.

- General budget support and sectoral support LC are the audit responsibility of the GOCR Controller General.

- Specific development projects will be audited by local CPA firms under host-country contracts (approved by USAID where appropriate) as required in all memoranda of understanding.

IV. KEY CONDITIONALITY CONCEPTS AND POLICY REFORM

The 1988 ESF Program for Costa Rica is part of an overall balance of payments assistance program that includes the PL 480 Title I food commodities program, as well as the policy reforms negotiated as part of these programs. As discussed in Section II and in Annex A, assuming no dramatic negative change in economic trends and continued assistance from other external donors, it is anticipated that ESF levels will continue to decline at a moderate rate over the coming years. (It is also envisioned that PL 480 Title I will continue at the current level of $15 million per year.)

Declining levels of ESF resource assistance is consistent with what makes programmatic sense in light of the economic progress achieved by Costa Rica and USG budgetary constraints. Declines are also consistent with the principles of the Central America stretch out plan submitted to Congress in March 1987. As agreed at the Mission's Strategy and Action Plan reviews, by FY 1991 it will be appropriate to shift from a cash transfer justification to a program that focuses on the one or two sectors most critical to achieving the Mission's strategic objectives.

Costa Rica has essentially emerged from its economic crisis of the 1980-82 period with strong financial and policy support from the donor community. Major macroeconomic progress has been achieved in that there has been a return to positive, if modest growth rates; reduced inflation; improved exchange rate performance; and improved fiscal performance. Quite properly, earlier ESF programs emphasized macroeconomic conditionality such as maintaining real positive interest rates, limiting net banking system net credit to the nonfinancial public sector, maintaining a unified exchange rate, etc. The policy reforms emphasized by this past ESF conditionality are now taking hold and need to be further institutionalized to better prepare the country for the days when ESF assistance ends. Measures to reinforce the macroeconomic progress obtained to date are discussed below.

As described in Section III. B., the Mission assumes that the current IMF Standby will continue to be operative in 1988 and that the IMF will have the lead role for macroeconomic conditionality. Therefore, the Mission will include no new initiatives in this regard. However, if as in 1987 there is no 1988 IMF program, the Mission will be ready to step in to request that the GOCR provide an acceptable macroeconomic management program prior to first disbursement or prior to making subsequent ESF disbursements, depending upon timing of this eventuality.

The Mission also assumes that the World Bank's SAL II Program, negotiations for which are already in an advanced state, will be approved by the Costa Rican Legislative Assembly around mid-year 1988. The basic financial plan of SAL II is to have a $100 million loan from the World Bank and cofinancing (without additional policy measures) for $100

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million from Japan. The loan would be disbursed in two equal tranches with the first disbursement hopefully during the first half of 1988, and the second tranche after mid-term review in the second half of 1988.

The SAL II program concentrates on such areas as agricultural pricing and marketing policy, financial sector efficiency and control issues, and international trade issues (as they relate to tariff structures.) More specifically, in the financial sector, SAL II includes legal changes giving the Superintendency of Banks more power to audit and control commercial banks, and a program to recognize and reduce the operating losses of state banks. This program would require that loan maturities in arrears for more than 180 days and interest in arrears more than 90 days be treated as losses. The program aims to reduce the bad loan portfolio of state banks from about 30 percent to 3 percent over a three year period.

In the trade sector, the main aim in SAL II is to reduce nominal tariffs on final goods to 40 percent over a three year period. This tariff reform would be implemented in proportional cuts in six semiannual installments beginning in October 1988.

In the agricultural sector, the main element is retraction of the CNP from marketing of domestic and imported agricultural products with some exceptions in regard to the produce of small farmers and the convergence of domestic and international prices of agricultural prices. The CNP has been the principal marketer of domestically produced rice, corn, beans, sorghum and of imported wheat, and under SAL II the CNP would retire from the marketing except for work related to helping small farmers produce exportable crops.

In the public sector component of the SAL II program, the Bank and the GOCR have negotiated three areas of agreement: (a) the size and composition of a public sector investment program, (b) a commitment to increase public sector savings (inclusive of Central Bank losses) to 4.0 percent of GDP (in 1986 this variable was about 1.0 percent), and (c) a reduction in the earmarking of tax revenues. While the Mission's policy dialogue with the GOCR will reinforce certain IBRD priorities (for example in reinforcing financial reforms on interest rates, credit allocation and subsidies), the Mission will not undertake major new initiatives in ESR VII conditionality for the areas covered by the Bank.

State 386936, received in December 1987, describes in general terms the Bureau's ideas of moving toward a greater emphasis on sectoral ESF policy conditionality. The idea here is that, given earlier emphasis and progress in attaining short-term stabilization objectives, ESF programs should begin a transition toward sectoral reform objectives--ones that represent a logical next step in the recovery and growth process and that show demonstrable results. Our understanding of the guidance stresses its transitional and flexible nature, i.e. macroeconomic conditionality

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should be continued and reinforced to the extent necessary, and where appropriate, the focus should be shifted to identifying sector programs that are based on a solid analytical base and can better accomplish equitable growth objectives.

Other sections of the PAAD stress our perspective that victory cannot be yet claimed on the macroeconomic front in Costa Rica--the progress, while substantial, is fragile and can be reversed. We must continue therefore this macroeconomic conditionality and policy dialogue, while at the same time, deepening and clarifying our sectoral focus. In the 1987 ESF program, the Mission began its first move toward an emphasis on sectoral issues. The covenants and the local currency programming contained in the 1987 program initiated a focus on sectoral topics such as investment promotion, public sector efficiency, promotion of non-traditional exports and support to the private manufacturing sector through increased credit availability. The ESR VII program will continue, sharpen the focus and more clearly articulate this sectoral approach, orienting conditionality to achieving sectoral policy reform rather than simply programming funds for sectoral initiatives. (It should be repeated that while ESF conditionality is an obvious and effective forum for pursuing sectoral issues, the Bipartite Commission presents the Mission with an even more far reaching and constantly available avenue for pursuing sectoral reform priorities with the GOCR.)

The Mission's sectoral focus is one that is evolving as a result of progress achieved and the growing maturity of the Costa Rica ESF program. This focus is firmly founded on Mission, GOCR and other donor analyses (that will continue to be updated) that present feasible development opportunities. However, as discussed and agreed to at its strategy review, the Mission feels that it is premature at this point to shift to a purely sectoral approach. With Costa Rica's large balance of payments gap and the still significant levels of ESF assistance, the cash transfer approach of the past remains valid. It is expected, however, that by FY 1991 the convergence of an improved balance of payments situation and lower ESF levels will make it appropriate to shift to a sector orientation for the ESF program.

The Mission's updated strategy paper, submitted to AID/Washington in early March and approved in April 1988, describes the evolution of our strategy from "economic stabilization" to "laying the basis for long-term growth", with a concomitant orientation to four specific areas where we believe significant progress can be achieved in furtherance of that goal. These four areas of emphasis have been selected due to their complementarity with the strategy focus on long term growth, their strong potential for protecting and consolidating past gains, and their sectoral orientation toward equitable and sustainable economic growth. These four areas for the focus of our efforts in the ESR VII Program are: (1) Financial Stability; (2) Foreign Trade, Investment and Export Promotion; (3) Housing; and (4) Public Sector Efficiency.

A. Financial Stability

The focus on financial stability serves to reinforce past ESF efforts aimed at economic stabilization, complements IMF and IBRD conditionality in this area, and protects the progress made since 1982. Financial stability, too, is a minimum condition for strengthening the underpinnings of long term economic growth in Costa Rica, including export growth. Specifically, as related to exports, the country's balance of payments situation impacts on the export sector's ability to import needed productive inputs, while public sector deficits limit the amount of credit available to the productive private sector. An emphasis on financial stability is appropriate in order not only to back hard-won reforms that can be easily undone, but also to support the Costa Rican economic decision makers who often risk strong political pressures in order to implement sound economic programs.

ESR VII will thus continue to stress some of the significant aspects of prior macroeconomic conditionality. For example, the Central Bank will be required to maintain during 1988 a unified exchange rate and to revise this rate as necessary, essentially to maintain purchasing power parity with Costa Rica's trading partners. Also, conditionality will be included to require no increase of net banking system credit to the non-financial public sector, and to limit Central Government cumulative expenditures as well as banking sector credit to the public sector. Covenants will require that banking system interest rates be guided by market forces so that they are positive in real terms and that a program be followed for the provision of credit that avoids detailed allocative categories.

As has been described in previous ESR PAADs, in 1981-82, all credit in Costa Rica was subsidized in that the real interest rate was negative. Moreover, credit was allocated to a set of 54 <u>topes</u>, or pre-determined categories. Burdensome procedures, political interference and lack of competition impeded the banking sector's ability to respond efficiently to the growing credit needs of the productive sector. As well, in 1982 the public sector absorbed a full 43% of banking system credit. The combination of an infusion of credit resources and policy dialogue by AID--including support to the private banks as an alternative to the state banks, supported by ESF conditionality--has resulted in considerable strides in ameliorating the credit situation. The two covenants described above will serve to reinforce this progress.

In 1987, an agricultural credit law (FODEA) was passed by the Legislative Assembly that contained provisions for subsidized interest rates for rescheduled loans made in the past to different classes of agricultural producers. Fears were high on the part of USAID, and other proponents of unsubsidized credit, that FODEA would lead to wholesale loan defaults, legitimizing the non-payment of the old loans, and negative impacts on producers of non-traditional products. This did not come to pass as the nationalized banks themselves proved less than eager to reschedule the loans at in essence subsidized rates, translating the situation into one of decreased availability of credit for the agricultural sector. In response, the GOCR pushed hard during the negotiations for the ESR VI Agreement to allocate ESF local currency to provide agricultural export credit channeled through the National Banking System. The terms of such a credit program have yet to be detailed and are awaiting the results of a USAID-sponsored study (carried out by Ohio State University) which is analyzing rural credit demand, costs and administration in Costa Rica. An ESR VII covenant will commit the GOCR to formulate a rural credit program based on an analysis of rural credit demand, costs and administration in Costa Rica, that will be responsive to market forces in mobilizing savings, controlling costs and improving the administration of rural financial services provided by the National Banking System.

Notwithstanding the above, ESR VII conditionality will require that subsidized credit during 1988 be limited so as not to exceed the level of such credit outstanding as of December 31, 1986 and carried over from ESR VI.

As described in Section II and Annex A, a liquidity crisis beginning in December 1987 in Costa Rica has clouded at least temporarily the progress made in strengthening the private banking sector. Several private non-bank financial institutions ("financieras"), including a major regulated one, have recently failed due to a tightening of the national money supply--a move undertaken by the Central Bank to recess the economy and reduce pressures on the overall balance of payments. Unfortunately, the resulting confidence crisis in the private financial sector fueled the arguments of those who dogmatically support the nationalized banks and oppose moves to promote the competitiveness of the private banks. While the crisis did not extend to all private banking institutions and the damage was limited, the Mission is focusing on the problem on several fronts. First, the Mission has agreed to a GOCR proposal to set up a special fund (financed with ESF local currency) to meet the temporary liquidity problems of qualifying private banks and their corporate clients in honoring maturing bond issues which have been sold on the national securities exchange. Second, in ESR VII conditionality, the Mission will require the GOCR to support the development of a guarantee system for deposits received by the private banks belonging to the National Banking System. Such a measure is already supported by the GOCR and Central Bank and, together with the liquidity fund, should help restore and preserve investor confidence and strengthen the stability of the financial system as a whole. SAL II conditionality should strengthen the authority of the Superintendency of Banks, further aiding this goal.

Another recent worrisome move afoot by Costa Rican legislators opposed to the private banks has been an effort to restrict access of the private banks to Central Bank credit made available from external sources. This policy was adopted under ESR I conditionality and represented one of the earliest accomplishments by AID in support of the competitive private banking sector. Fortunately, the GOCR executive has announced its intention to oppose any legislation or other measures to reduce current authorities of the private banks, including access to externally funded Central Bank rediscount facilities.

B. Foreign Trade, Investment and Export Promotion

As described in previous sections, the primary strategic emphasis of USAID assistance over the next three to five years will be to help lay the basis for sustained economic expansion by supporting export led growth. The rationale for this approach is well known--in a small, open economy such as Costa Rica, the country cannot efficiently produce all of the goods it needs for productive activity, and therefore imports goods paid for in foreign exchange. As foreign exchange has been in chronic short supply in Costa Rica (with the financial gap in its balance of payments averaging $385 million in the period 1984-87), the country must increase its foreign exchange earnings if it hopes to achieve sustained long term growth.

A shift in the country's structural underpinnings is necessary to permit an increase in non-traditional agricultural and industrial exports outside the CACM both in absolute terms, and in relation to total exports and to a growing GDP. Promotional programs for increased foreign and domestic investment, as well as capital market assistance, increased productivity and marketing ability are also necessary ingredients in the establishment of sustainable growth in non-traditional exports.

It is imperative for several reasons that export earnings, particularly from non-traditional products, be increased. First, massive infusions of donor assistance will not last forever, debt relief negotiations will have finite results, and savings from reduced imports will eventually have negative impacts on productivity and are probably about to be exhausted anyway. (This is the conclusion of a recent World Bank study.) Further, non-traditional products represent the best potential for increased earnings since the traditionals--bananas, coffee and sugar--are already produced relatively efficiently and are constrained by market conditions and international quotas.

Increased investment in non-traditional export products is resulting from a combination of factors, including continued economic stability. These factors also include improvements in trade policy, access to credit and the results achieved from dynamic export promotion efforts that will continue to have payoffs in the future.

On the policy side, previous ESF, IBRD and IMF conditionality have encouraged the GOCR to reduce protection of the manufacturing sector in favor of developing and expanding non-traditional exports. The AID-encouraged policy of minidevaluations and the united exchange rate have had the effect of maintaining the profitability of exports. This policy continues as evidenced by a January 1988 colon devaluation of 6%. In addition, over the long run tariff reduction should encourage risk adverse Costa Ricans to turn away from their protected environment and produce for export. The IBRD has taken the lead on this issue, and the Mission's role will be limited to supporting rapid passage and implementation of SAL II in our policy dialogue efforts with the Bipartite Commission and by encouraging support among the private sector groups with whom we deal.

USAID/Costa Rica has put much emphasis since 1982 on the provision of term credit for the productive, including exporting, private sector. Producers have had access to almost $250 million in credit in special dollar and local currency credit lines established after 1981, of which some $180 million has been term credit. At present, some $32 million in AID dollar credit is undisbursed. Producers have access to this credit through the private banks which offer exporters a more efficient and responsive alternative to state banks. IBRD and AID conditionality discussed in the previous section should reinforce, protect and strengthen past gains of the private financial sector's vital role in promoting exports.

Direct investment promotion activities in Costa Rica are being carried out by the Costa Rican Coalition for Development Initiatives (CINDE), a private, non-profit association founded in 1983 by a group of prominent Costa Rican businessmen and professionals with financial support form ESF local currency resources. CINDE's investment promotion program for the industrial sector is implementing an intensive plan to identify investors and sell them on the advantages of Costa Rica as a place for doing business. Funded at about $2.5 million per year, in the period 1986 through mid-1987, CINDE has attracted an estimated $38 million in non-traditional export investments. This has resulted in the creation of about 8,000 direct new jobs for the investment period.

At least half of the foreign investors interested in Costa Rica want to establish operations in free trade zones. Due to inadequate free zone operations, however, a significant number of potential investors are being lost. Until recently, there has only been one fully functional zone located in Cartago, near San Josê. A second free zone, recently started operations near the San Josê International Airport. Three other private free zone operations have been approved and are in various stages of development. The Free Zone Corporation, a semi-autonomous government organization, owns and operates two other free zones: one on the Atlantic, and one on the Pacific coasts. The publicly operated free zones have not been successful and should be sold and/or turned over to private developers as soon as possible. (The Mission is currently discussing such a possibility with the GOCR.)

Because efficient free zones are an important component of CINDE's investment promotion program in providing a location free of taxes and bureaucratic red tape, the Mission is supporting a series of actions to encourage private free zone development. At the same time we are attempting to discourage the GOCR from continuing to subsidize public industrial free zones which are a drain on government finances and unattractive to investors. Further, through imposing a 12% tax on successful private zones, the Zona Franca Corporation increases the cost of Costa Rican industrial free zones and reduces Costa Rica's competitive position in the market to attract international industrial investors. Efforts have begun to improve the Free Zone Corporation (ZFC), though a move of ownership from GOCR to private hands is only partially accomplished and policies adopted by the ZFC have not been fully positive.

CINDE is also addressing foreign and domestic investment in the agricultural sector in much the same way as the industrial sector. Overseas offices will target new investment and job generations with a concomitant target of shifting domestic agricultural investment into non-traditional crops by $7 million per year. A pilot office opening in Miami will act to coordinate the marketing of non-traditional products in the United States and act also as a conduit for investment.

On the GOCR side, the Ministry of Foreign Trade has been hampered by a variety of intitutional problems, including a lack of coordination with various government organizations and policies that restrict the paying of sufficient salaries necessary to attract qualified personnel. The Ministry has been incapable to date of mounting effective promotional programs, though it has undertaken under IDB financing a study for a proposed reorganization of all aspects of the GOCR's foreign trade functions. One reform decision has already been made--the creation of a one-stop center for processing export and investment approvals, though implementation depends upon legislative approval.

A variety of DA, local currency and PL 480 funded measures are presently addressing sector wide constraints to trade, investment and export promotion. The role for the accompanying policy dialogue talks on the subject being carried out with the Bipartite Commission in general, and with ESR VII conditionality specifically, is to promote an institutional and policy framework that maximizes the ability of the productive private sector to produce for export. In that regard, one of the conditions established in ESF VII is that the GOCR make its best effort to achieve privatization of the Free Zone Corporation at the ports of Moin and Puntarenas by April 30, 1990. Such action would include reducing the role of the Free Zone Corporation to a policy-making and regulatory body and to refrain from making new capital investments in free zones, except to facilitate transfer to the private sector. Also, a covenant will require the adoption of various GOCR public administration procedures, such as the one-stop window for exporters and simplified credit and import procedures. Finally, an ESR VII covenant will require that the GOCR undertake an effort to reorganize its Ministry of Foreign Trade export and investment promotion activities in order to permit a more efficient operation, free of the political machinations that have plagued the organization to date. This reorganization will also include provisions to include private sector representatives and participation in the activities of the organization.

C. Shelter

Building on its past commitments, the Mission will continue to emphasize the shelter sector in the ESR VII program. A large number of Costa Ricans continue to live in substandard or overcrowded housing and new housing starts have not been able to overcome the existing gap. In addition, significant linkages exist between shelter and other sectors of the economy. Also, the opportunity for progress in the shelter sector because of the high priority it receives from the Arias administration makes it particularly attractive.

The Mission has in recent years devoted considerable effort to addressing the policy and production delivery constraints to overcoming Costa Rica's housing shortage. Between 1980 and 1985, AID's housing sector strategy included two emphasis areas. First, the strategy aimed at demonstrating how to lower housing costs so as to be affordable to targeted lower income groups with minimum dependence on GOCR subsidy supports. Second, the strategy aimed to strengthen the capacity of Costa Rica's primary public and private shelter institutions, INVU and the National Savings and Loan system (SNAP), and its regulatory agency (DECAP).

This strategy achieved significant accomplishments, such as demonstrating through the Housing Guaranty program that many low and moderate income families were willing and able to pay for an urbanized lot and construction loan without the need for subsidies. The strategy also demonstrated the acceptability of a modified turn-key approach involving private sector construction company contracting and the a "progressive" (expandable) housing solution where additions are made to a house as family income permits. During this period also, an ESF local currency program helped overcome the problems of a decapitalized Savings and Loan system.

Today the most serious constraint facing the shelter sector is the difficulty of mobilizing sufficient financial inflows to finance the more than 25,000 housing units and supporting infrastructure improvements per year that is considered necessary by the GOCR's housing authorities. AID's strategy to alleviate this problem has been to assist in the creation of a private-sector controlled National Housing Mortgage Bank (BANHVI). As a secondary mortgage facility designed to provide long-term flows required by the sector officially established in late 1986, BANHVI is authorized to issue bonds or mortgage certificates and to rediscount mortgages generated by the on-lending housing finance institutions. With BANHVI settling into place, a unified set of credit terms and operational standards are now filtering through the marketplace.

Other constraints to the shelter sector in Costa Rica are:

-- fragmented lines of authority and delegation of responsibility for housing affairs at the national level;

-- institutional confusion among the excessive number of public and private housing institutions (36) involved in shelter policy, financing, and construction delivery systems without sufficient specialization and adequate regulatory controls;

-- a persistent philosophical commitment in some political circles for continued direct government involvement in the sector; and

-- a lack of supportive GOCR participation in policy, planning and regulatory activities.

1987 State 385052 presented AID/W's views on the Mission's shelter policy dialogue objectives at the level of BANHVI and beyond. Specific mention was made of economic/finance areas in support of overall USAID-supported macroeconomic policy, for example, market determined credit allocation, increased private sector participation, reinforcement of BANHVI's mandated role as a secondary lender, etc. The AID/W cable also stressed that the Mission should address the private sector's capacity to produce low-income shelter, i.e. helping new and existing organizations develop and package shelter programs oriented to the lowest income groups. As well, the Mission was advised to address the need for urbanization strategy in Costa Rica as housing production increases. The Mission has no problem with the advice, the question is only one of emphasis and timing. USAID has chosen to concentrate at this stage on the firm establishment of BANHVI, a new institution whose proper development will prepare the stage for further sector reforms. While ESR VII conditionality for housing, described below, firmly addresses many of the economic/finance and production issues raised by AID/W, our policy dialogue priority will be focused first on BANHVI's consolidation and then on a variety of broader issues that logically follow and are achievable within the constraints of time and resources.

The Mission's immediate primary concern in our policy dialogue with the GOCR on shelter will be to get the GOCR to define and publicize the roles, responsibilities, and linkages between the Ministry of Housing and other entities in the shelter sector. As this occurs, we will encourage the public sector to maintain a policy role and leave production to the private sector, which is more cost efficient and effective.

In ESR VII conditionality for the shelter sector, the Mission will act to reinforce the long term viability of BANVHI operations--that BANHVI discount mortgages only to authorized financial institutions and not engage in direct lending, that its credit policies guarantee full cost recovery of its loans, and that GOCR contributions to BANHVI are paid without delay. In addition, a covenant will require the GOCR adopt policies which will support financial mechanisms that guarantee self-financing of infrastructure investments for housing construction, including full cost recovery of capital expenditures (water, sewerage and storm drainage) and operations and maintenance costs. This covenant thus applies the same principle of self financing of housing infrastructure through sufficient financial flows, that BANHVI applies to housing. Finally, an ESR VII covenant will require that the GOCR clearly define the role of housing sector institutions to avoid duplication of effort and that INVU (the National Institute for Housing and Urbanism) focus its projects exclusively on low/moderate income families.

D. Public Sector Efficiency

Inefficiencies in the Costa Rican public sector considerably limit the ability of the economy to move from a status of relative economic equillibrium to one of sustained growth. Indeed, public sector inefficiencies cut across all of the sectors previously described, and act to effectively undermine some of the progress obtained and sought in these sectors.

A key concern in this area is the level of public sector employment. A recent AID funded study indicates that in 1985, the level of public sector employment approximated 19.1% of the labor force. (By comparison, U.S. public sector employment, excluding the military, approximates 14.2%). The study goes on to conclude that public sector employment growth is the key factor in explaining why the real growth of public sector expenditures exceeds that of GDP. Indeed, as the GOCR tries to limit its expenditures (and its deficit), public sector employment levels are not only holding, but increasing at the expense of investment and non-salary operating costs.

GOCR data on recurrent-cost and investment expenditures reveals that in 1985 only 16.6% of those expenditures were for investment; (of the investment expenditures, a full 93% fell within the purview of the Ministry of Transportation and Public Works.) At the same time, the personal services (salaries) category accounts for 80% of recurrent costs. The situation is even more striking within individual Ministries. In the Ministry of Education, which has the highest recurrent cost/investment expenditure total, the personal services category accounts for 98.7% of the expenditure total.

Public sector inefficiencies are by no means limited to questions of employment. The Costa Rican Development Organization

(CODESA) founded in 1972, perpetrated a sad legacy of inefficient, ineffective, politically motivated and controlled, dubiously managed organizations totaling some 42 in all--all the while having free and unlimited access to Central Bank credit resources until the practice was ended with AID pressure in 1984. While the AID-supported privatization and divestiture of CODESA has made significant progress (See Annex C), the CODESA experience remains a textbook example of the public sector run amuck. The Arias administration has been supportive of CODESA divestiture and has expressed interest in continuing the process in other areas (under the label of "economic democracy"). Given the political sensitivities of the subject, progress is likely to be slow though the interest of the present administration, based on the CODESA experience, is positive indeed.

Another obvious area for public sector improvement is the area of customs. The customs service is renown among Costa Rican and foreigners alike as inefficient, slow and bureaucratic. Its many problems include an unclear organizational mandate; untrained personnel at the technical level; an aura of operational incompetence; and manual and repetitious processing of paperwork. The Arias administration attempted to deal with the problem by beginning a customs reorganization, but the effort stalled due to a lack of political support and a number of legal problems. AID conditionality in ESR VI required that a number of mostly non-controversial short term reforms be adopted during 1987. These were for the most part carried out as required, raising hopes that more substantive and far reaching reform could be planned in the near future.

A final aspect of public sector efficiency is the needlessly complex, overly bureaucratic, and inordinately time consuming procedures of public administration that confront and confound the Costa Rica citizen. This characterization applies to customs (described above), credit procedures, import licensing, export procedures, construction permits, social security procedures, immigration and so on. These "trâmites" impact negatively on efforts to cut public sector costs and remove impediments to economic growth.

Last year in ESR VI, AID focused directly on the public sector employment problem for the first time. A side letter to the Agreement from the GOCR reinforced the GOCR's stated commitment to reduce public sector employment. Detailed reports were required to demonstrate progress toward this goal. The Mission entered into this sector to demonstrate our support for implementation of these reductions and to support what had been a focus of IBRD conditionality in SAL I. In ESR VII, the Mission will underline its interest in public sector employment limitations by asking that the GOCR reaffirm its commitment to achieve realistic employment targets as a covenant rather than as a side letter to the Agreement. The Mission feels that given a covenant requiring a freeze in public sector employment levels as of September 30, 1987 (the

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date of the last GOCR public sector employment report) through calendar year 1988, is the most realistic and achievable employment target, given domestic pressures on certain employment categories (for example education and public health) and political realities. Modest increases in for teacher positions, created in the 1988 budget will be excluded. Regarding this sector, the World Bank has decided not to pursue public sector employment reduction targets in SAL II due to their belief that the goal was basically unachievable. As well, and as a near final step in the CODESA divestiture process, the Mission will require that the GOCR continue to limit CODESA's operations through the end of the Arias administration so as not to permit it Central Bank investment credit or to guarantee new investments. The GOCR will also covenant to use its best efforts to accelerate the sale of one subsidiary, CATSA, and the sale to the private sector of 40% of the shares of two other subsidiaries, FERTICA and CEMPA. (See Annex C.)

On the customs front, the shift of conditionality will be from the shorter term reforms implemented under ESR VI to longer term changes--e.g. implementation of a mechanization program, simplification of administrative and operational procedures, improvements in the operation of the customs laboratory and development of a training plan for customs personnel. These changes respond directly to the expressed priorities of the Director General of Customs and should support him in his efforts.

Finally, ESR VII conditionality will reinforce a stated GOCR interest in simplifying certain public administration procedures that impact on the productive private sector--creating a one-stop window for exporters, and simplifying credit and import procedures.

V. CONDITIONS AND COVENANTS

Conditionality proposed for the ESR VII program will support the sectoral priorities and accompanying policy dialogue issues discussed in Section IV above. Conditionality on financial stability issues, public sector efficiency, shelter and investment and export promotion will assure that the policy objectives of the balance of payments program are achieved.

The ESR VII Grant Agreement will be signed by AID and the GOCR following PAAD authorization, likely in May. Detailed discussions on the 1988 ESF program have been underway with the GOCR-AID Bipartite Commission since December 1987. Given the substantial progress achieved on the issue of local currency ownership, changes in the programming system for local currencies available under the ESR VII and later programs, and collaborative discussions with the Bipartite Commission and at the working group level on conditionality (See Section III.E.), the Mission has identified to date no further substantive issues that will delay obligation. Negotiations with the Bipartite Commission will be concluded very soon after PAAD authorization in order to incorporate additional guidance, if any, received during the PAAD review.

1. Conditions Precedent to Disbursement

The Mission plans to require as a condition for the first disbursement of ESR VII dollars, that the GOCR present evidence that it has approved and is successfully implementing an economic program for 1988. In addition, the statutory conditions for designating authorized representatives for the project (including specimen signatures) and an opinion from GOCR legal counsel that the Agreement is a binding commitment will be required. Second disbursement will be made according to evidence provided by the GOCR that they are successfully complying with terms of the 1988 Economic Program and upon a determination by the Mission that GOCR compliance with ESR VI conditionality is satisfactory.

2. Covenants

-- To maintain during calendar year 1988 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: relationship of actual domestic prices to prices in the principal countries with which Costa Rica has commercial relations, the status of the current account in the balance of payments, external debt arrears, and non-compensatory net capital inflows.

-- To comply with quantitative macroeconomic limits for 1988, as set forth in a GOCR economic plan, as regards domestic banking system net credit to the non-financial public sector, net domestic assets of the Central Bank and Central Government cumulative expenditures, and to supply A.I.D. with a report at the end of each quarter on the status of compliance under such limits.

-- To continue with the policy that banking system interest rates are guided by market forces in a manner that they are positive in real terms, and to supply AID with quarterly reports on interest rates in the organized financial markets.

-- To implement and maintain during calendar year 1988 a credit program that eschews detailed allocative categories for the provision of credit.

-- To maintain average outstanding balances of subsidized credit for agriculture and industry during calendar years 1988 and 1989 (defined as credit which is extended through the state owned banks at interest rates lower than the six-month deposit rates) at levels no higher than the level of such credit outstanding as of December 31, 1986, or by 5,354 million colons, and which do not exceed that level by more than 5% on a purely seasonal basis during the course of 1988; and to report to AID, within three months of the end of each calendar quarter, information sufficient to demonstrate compliance with this section. For 1989, the Parties will review the level of outstanding balances of subsidized credit as of December 31, 1988 and, based on that figure, will establish a new limit for such credit.

For the purposes of this agreement, subsidized credit will be defined so as not to include credit at subsidized rates funded from external resources, including counterpart funds and loans extended with the reflows of these programs. Likewise exempted from subsidized credit limits will be credit extended through the state-owned banks at subsidized rates when subsidies granted by the Government or other organizations raise the return to banks at least to a level equal to the six month deposit rate.

-- To support, in short-term contingency situations, especially in the initial phases, programs of authorized private financial institutions in areas in which the institutions develop a guarantee system that protects funds on deposit.

-- To prepare by December 1, 1988 recommendations for a rural credit program based on an analysis of rural credit demand, costs and administration in Costa Rica, that will be responsive to market forces in mobilizing savings, controlling costs and improving the adminis- tration of rural financial services provided by the National Banking System.

-- To provide evidence to A.I.D. that the GOCR is supporting and reinforcing the measures stipulated in Law 7052 which created the National Mortgage Housing Bank (BANHVI), specifically that:

1) BANHVI discounts mortgages only to authorized financial institutions and does not engage in direct project lending.

2) BANHVI adopts credit policies to reasonably guarantee full cost recovery of its loans.

3) GOCR contributions to BANHVI are paid without undue delay.

-- To adopt policies which will support financial mechanisms that guarantee self-financing of infrastructure investments for housing construction, including full cost recovery of capital expenditures (water, sewerage, and storm drainage) and operations and maintenance costs.

-- To promote the necessary measures to, before October 31, 1988, (1) clearly define the roles of all housing sector institutions to avoid duplication of effort and increase management efficiency and (2) focus INVU projects exclusively on families at the lowest income levels.

-- To affirm its commitment to maintain public sector employment levels to the levels of September 30, 1987, through calendar year 1988, excluding the positions created in the 1988 budget for education, and those necessary for the expansion of public health services, and to provide quarterly reports to A.I.D. through March of 1989 regarding the number of Costa Rican public sector employees, number of vacant positions and salaries paid that demonstrate satisfactory progress in complying with this goal.

-- To limit CODESA's activities such that through April 30, 1990 it will be permitted neither to access Central Bank investment credit nor to guarantee new investments, except for commitments previously acquired and ratified by the Cabinet.

· To exert its best effort to accelerate the completion of the sale of CAISA and the sale of 40% of the shares of FERTICA and CEMPASA.

-- To require the General Director of Customs to undertake and implement long-term managerial and administrative improvements by April 30, 1990, specifically:

1) to implement a customs mechanization program;
2) to execute routine and systematic inspections in order to produce simplified customs administrative and operational procedures, including those for import certificates;

3) to improve the operation of the customs laboratory; and

4) develop a training plan for customs personnel.

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-- To use its best efforts to continue privatization of the Zona Franca Corporation (ZFC) operations in Moin and Puntarenas while focussing on policy and regulatory functions; to achieve full private operation of both export processing zones by April 30, 1990; and to abstain from new capital investments in free zones, except as necessary to facilitate transfer to the private sector.

-- To use its best efforts to secure a reorganization of GOCR's export and investment promotional operations, that will permit the achievement of technically-based management objectives, and allow the participation of highly qualified personnel and private sector representatives.

-- To adopt measures to improve and simplify various public administration procedures which impact on the productive private sector, including specifically the creation of a one-stop window for exporters, simplification of credit procedures in the National Banking System, and simplification of regulations governing imports.

-- To provide to A.I.D. from the signing of this agreement until the end of calendar year 1989, copies of all reports to the International Monetary Fund as required under present agreements or programs with the Fund; and to provide each such report to A.I.D. at the same time that it is provided to the Fund; and, in the event that at any time during such period no agreement with the Fund is in effect, to provide to A.I.D. during such period reports whose timing and content shall be substantially similar to those currently provided to the Fund.

-- To develop a mechanism by January 1, 1989, by which it will be possible for the GOCR owned local currency deposited pursuant to the ESR VII Agreement to be used for a broad range of development purposes.

ANNEX A

ECONOMIC TRENDS AND PROBLEMS: MARCH 1988
Economic Analysis Office: 4-08-88

1. The Economic Crisis (1980-1983)

The economic crisis that Costa Rica experienced in the early 1980s had adverse implications for income growth and debt service obligations. Gross Domestic Product (GDP) declined by 2.3% and 7.3% respectively in 1981 and 1982. While the economy began to recover in 1983, with GDP increasing at 2.9%, per capita investment and consumption were 35% and 79% of their respective 1977 levels. High inflation in 1981 and 1982, fueled by strong exchange rate depreciation and rapid growth of domestic credit, continued to erode purchasing power. Imports grew from $1.02 billion in 1977 to $1.52 billion in 1980. The government borrowed heavily from foreign commercial banks in the late 1970s to cover the increasing import bill and to forestall exchange rate devaluation. The Costa Rican experience prior to and during this period conforms to the usual case of an open economy in which the destabilizing growth of domestic credit increases imports and depletes foreign exchange reserves. With the exhaustion of external creditworthiness, in 1981 the GOCR suspended payment of external debt service, and runaway currency depreciation served to reduce imports and domestic real income. In addition the inability of Costa Rican policymakers to maintain a net inflow of capital, the balance of payment crisis of 1980-1982 was heightened by cyclical highs in prices of imported petroleum and interest rates and by erosion of incomes and hence exports in Central American markets.

In July 1982, shortly after coming to office, the Monge administration resumed partial payments on external debt service and initiated an economic stabilization program. 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. The ESF and IMF resources closed the balance of payments gap, and by the end of 1983 the Government of Costa Rica had concluded commercial bank and Paris Club rescheduling agreements. Apart from increased supporting assistance, improvement in Costa Rica's balance of payments was also 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, and, in real terms (as measured by national accounting estimates), import volume declined by about 30 percent from 1980 to 1983, and export volume increased slightly. The 1983 stabilization effort, which included strong measures to reduce the public sector deficit, 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, and the inter-bank and "free" market exchange rates that had existed at the outset of 1983 were unified by November 1983. The Monge administration also reduced the the public sector financial deficit. Excluding Central Bank losses, the public sector 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. This reduction can be attributed, in large measure, to higher prices for petroleum products and public utilities and to increased social security contributions and taxes.

2. Economic Recovery 1984-1986.

B/P Support Package I. At year-end 1982 Costa Rica's 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 the suspension of public sector debt service in August 1981, the Monge administration negotiated two successive rounds of B/P support packages. The first round was linked to the IMF Standby of December 20, 1982. In January 1983, the GOCR signed a debt rescheduling agreement with ten bilateral creditor countries under the aegis of the Paris Club; this agreement 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 creditors, in April 1983, the GOCR signed a memorandum of understanding 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. These arrangements and the restructuring of suppliers' credits and dollar denominated certificates of deposit (issued by the Central Bank) provided relief amounting to $ 941 million in 1983 ($ 749 million in regard to arrears and $ 192 million in regard to debt service falling due in 1983) and $ 154 million in 1984.

B/P Support Package II. In 1984 the GOCR initiated a second round of negotiations with external creditors. The Standby, which was approved by the IMF on March 13, 1985, had a period of 13 months and amounted to SDR 54 million (about $ 55 million) and was a key prior condition for the rescheduling of debt with external bilateral creditors, for a $ 75 million loan from foreign commercial bank creditors, and as prior action for an $ 80 million World Bank Structural Adjustment Loan (SAL I). Inasmuch as negotiations for this new Standby agreement lasted for over one year, 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. In addition, new arrears, principally to bilateral creditors and commercial banks, were accumulated in the second half of 1984. Nevertheless, in early 1985 the GOCR reached debt relief agreements with bilateral creditors (the ten creditor countries in the Paris Club) and with 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, 1984.1/ In January 1985, Costa Rica's foreign commercial bank creditors agreed to reschedule 100 % of maturities falling due to participating commercial banks in 1985 and 1986 and to the provision of $ 75 million in new credit, and this agreement was finalized in May 1985.2/ Even though the 1985 B/P support package approximated $ 0.6 billion (with ESF), four separate episodes of delays 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), causing noncompliance at the end of June 1985 on the arrearage reduction test in the Standby. In addition, the requirement by IMF staff for a supplementary Letter of Intent (based upon its August 1985 review and related to fiscal management, wage policy, exchange rate policy, and foreign exchange deposits) 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. During most of 1985, Central Bank holdings of freely-disposable foreign exchange reserves were low. In December 1985, the the delay of the World Bank in releasing the second tranche of the SAL prevented compliance with the year-end performance limits and precluded drawing of the related tranche of the Standby.

Production. Real GDP grew by 8.0 % in 1984, by 1.0 % in 1985, and by 4.6 % in 1986; see Table I. The high rate of growth of 1984 has to be set against the large absolute declines of GDP of 1981 (-2.3 %) and 1982 (-7.3 %) and the low growth of 1983 (2.9 %). It can also be attributed to an upswing in agricultural production due to favorable climatic conditions and rising 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 %). In 1985 the decline in the rate of growth was due to more restrictive demand management and to weaker performance of the basic productive sectors. Notably, agricultural output declined by 2.9 % due to reduced coffee and banana production, and the growth rate for the manufacturing sector was also lower in 1985 (3.2 %)--due in part to a decline in exports to the Central American Common Market (CACM) region related to the trade debt problems afflicting the region. Even though nontraditional exports to markets outside of Central America continued to increase in 1985, this growth was offset by the decline in exports to the Central American market. Economic growth resumed in 1986 with agricultural production expanding by 3.0 % and manufacturing production expanding by 7.1 %. The areas of weakness in 1986 related to a continued decline in exports to the Central American market (from $ 144 million to $ 99 million) and a growth rate of only 1.3 % for construction activity (which accounts directly for 4.3 % of GDP by value-added). As described below, the main area of strength in 1986 was in Costa Rica's external accounts.

The Coffee Price Boomlet. Coffee export earnings, which had moved up from $ 230 million in 1983 to $ 267 million in 1984 and $ 316 million in 1985, increased further to $ 392 million in 1986 as a result of higher world market prices; see Table VI. The increase in coffee earnings in 1986 carried through to the net trade deficit, which declined from $ 172 million in 1985 to $ 77 million in 1986, to the current account deficit, which declined from $ 290 million in 1985 to $ 152 million in 1986, and to the B/P financial gap, which declined from $ 175 million in 1985 to $ 65 million in 1986; see Table V. The coffee price boomlet had two effects discernible in 1986. The perceived burden on policymakers of refinancing of debt service was lessened. In 1986 arrears on external debt service were allowed to grow as part of a negotiation strategy aimed at obtaining new debt relief arrangements with foreign commercial banks and governments, and the growth of payment arrears also compensated in 1986 for the lack of new arrangements with the IMF, foreign commercial banks, and the Paris Club. The real incomes of Costa Ricans also increased in 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, increased by 20.5 % in the three-year period 1984-1986, i.e., from 89.9 % of the level of 1977 in 1983 to 108.3 % of that level in 1986. The favorable performance of Gross Domestic Expenditure allowed sustained and simultaneous increases in consumption and investment. Gross Domestic Investment increased by 42.0 % in the period 1984-1986 amounting to 97.7 % of the 1977 level in 1986 as compared with levels that were lower than 75 % during the years 1981, 1982, and 1983. Private consumption also grew by 18.5 in the period 1984-1986, amounting to 112.7 % of the 1977 level in 1986, thereby surpassing the level of the last pre-crisis year (1979). Even so, on a per capita basis, 1986 private consumption was lower than the 1977 level, at 88.4 % of that level, and Gross Domestic Investment was also lower than the 1977 level, at 76.7 % of that level.

Economic Welfare: Inflation, Real Wages, and Employment. Throughout the three year period 1984-1986 the annual inflation rate was 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, 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; see Table I. Survey data for July 1985 indicate a further increase in real wages in 1985 amounting to 5.4 %. Payroll data (of workers subject to social security and health benefits) indicate an 8.7 % increase in average real wages in 1985 and 4 % in 1986. 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, 6.8 % in July 1985 and 6.2 % in July 1986. The employed labor force grew by 4.2 % during the year ending July 1984, 3.4 % during the year ending July 1985, and 3.3 during the year ending July 1986. In regard to underemployment, according to data from the July 1986 household survey, people who had part-time jobs and wanted to work longer hours amounted to a standardized 5.1 % of the labor force, and people who worked full-time but received less than the legal minimum wage amounted to a standardized 3.0 % of the labor force.

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3. 1987 Economic Performance

Production. In 1987 Costa Rica's Gross Domestic Product (GDP) grew at a rate of 3.0 %, which is relatively high compared with the experience of the early 1980s, but lower than the 4.6 % growth rate of 1986. In regard to productive sectors, those tied to house construction and to exports of nontraditional products were robust, but other sectors stagnated. For example, if one excludes agriculture, the rate of growth of GDP in 1987 amounted to 4.5 %. Agricultural production fell by 5 % due to poor performance of livestock, sugar, and basic grains even though the production of coffee and bananas increased. The volume of coffee production increased by 15.8 % and banana production increased by 4.9 % (to 54 million boxes). The area sown to rice was down by 30 % and that of sorghum by 80 % in 1987 due to lower prices and reduced credit, and, in addition, yield per hectare was also reduced by drought. Beef production also declined due to the reduction of herds caused by heavy off-takes in past years, i.e., the slaughter of reproductive herds. Construction sector activity expanded by 10 % even though few new public sector projects were undertaken. Private sector construction, particularly housing, responded strongly to credit and other incentives. Manufacturing output expanded in the first half of 1987, showing strength in food products, chemical products, and construction materials. However, in the second half the rate of expansion declined with weakness in demand for consumer durables.

Exports, Imports, Consumption, and Investment. National accounting data indicate changes in the volume of production, consumption, investment, imports, and exports; see Tables I and II. The volume of exports and imports of goods and services grew at rates significantly higher than the 3.0 % growth of GDP. In real terms, imports grew by 10.3 %. This high rate of increase appears related to several factors that were strongly evident in the first half of 1987, as follows: increased real income generated by sale of coffee inventories, the increase in the stocks of domestic money and credit, legal reforms (import duties and surcharges) that made some imports cheaper, and a devaluation that, in some months, did not fully compensate for inflation. Export volume grew by 20.7 % in 1987 due to the increased volume of coffee exports (up almost 60 % from 1986 and which included a liquidation of a good portion of the domestic inventory of coffee beans), the increase in banana exports (related to the Banana Development Program), and the dynamism of nontraditional exports. In contrast, beef export earnings declined and the Central American market was stagnant. Turning to consumption and investment, global absorption, or Gross Domestic Expenditure, the sum of consumption and gross investment, declined by 1.2 % in 1987. Consumption grew by 3.4 % in 1987 mainly related to the 4.0 % growth rate of private consumption, and Gross Fixed Investment grew by 8.8 % due to the housing program and to the establishment of new firms as nontraditional exporters. Gross Domestic Investment (which is the sum of Gross Fixed Investment and Change of Inventories) declined by 17 % in 1987, and this decline was mainly due to the reduction of inventories which was the counterpart of the export of coffee stocks. 3/

Inflation, Real Wages and Employment. Inflation, as measured by the consumer price index, was 16.4 % for the twelve month period ending December 1987. By May 1987 the CPI was running at 20.5 % (on an annual basis), however, a tightening of credit and other monetary measures adopted by the GOCR in the third and fourth quarters were effective in dampening inflationary pressures in the last half of 1987. According to the wage policy established by the GOCR in 1987, minimum wages for private sector employees are revised at the beginning of the year to compensate for inflation and additional revisions (increases) are authorized if during the year the consumer price index exceeds 7 % on a cumulative basis from December of the previous year. In 1987 two wage adjustments were approved for both private sector and public sector employees, one in January and a second in July. According to payroll data (for workers subject to social security health and social benefits), real average wages declined by 1.4 % in 1987 (based on data for March and July 1987), as compared with average real wages for full year 1986, (based on data for March, July and November 1986). Average real wages for private sector employees and for public sector employees based on the same data, declined by 0.8 % and 1.6 %, respectively. In regard to employment, preliminary data from the household survey shows an 8 % increase in the employed labor force in July 1987, as compared with July 1986 and a decline in open unemployment to 5.6 % by July 1987, from 6.2 % a year earlier; see Table I. (We are informed that the methodological changes account for part of the improvement recorded by these statistics.)

Public Sector Finances. The deficit of the nonfinancial public sector moved toward equilibrium in 1987. According to preliminary data presented in Table III, the deficit of the nonfinancial public sector as a percent of GDP declined from 1.7 % in 1986 to 0.3 % in 1987. The latter figure is the result of a 2.2 % deficit of the central government and a 1.9 % surplus of the rest of general government and state enterprises (i.e., a surplus of 5.2 billion colones). Central Bank operating losses (on accruals basis) declined to 3.0 % of GDP from 3.8 % in 1986. The consolidated public sector deficit (inclusive of Central Bank losses) as a percent of GDP declined from 5.5 % in 1986 to 3.3 % in 1987.

In regard to the performance of the central government, the April 1987 Standby set quarterly limits on cumulative expenditures, which restrained central government expenditures in 1987. The government met the first three quarterly tests, but failed to meet the end of December limit by about 600 million colones, which represents approximately 0.2 of one percent of 1987 GDP. Expenditures increased in nominal terms by 8.8 % which is equivalent to a decline in real terms. It should be noted, however, that current expenditures increased by 18 % and that capital expenditures and net lending decreased by 28 %. Fiscal revenues increased by 17 % in nominal terms, and the largest component of this, tax revenues, increased by 22 %. All tax categories show increases in 1987 with the exception of export taxes, namely taxes on exports of coffee and bananas, which declined due to lower coffee export prices and

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projected to raise about 4 billion colones in revenues for the central government was submitted to the Legislative Assembly in February 1987. This package included among other measures, an extension of the sales tax to professional services and public entertainment, a tax on high-value houses, and a steep increase in automobile license fees. However, intense resistance from the oppostion party deputies delayed enactment of the tax package until November 1987 and, for this reason, its full impact on revenues is not expected until 1988. In regard to the rest of the public sector (decentralized agencies and state enterprises), increases in utility charges and in the price of gasoline and other petroleum derivatives approved during 1987 contributed to a 5.2 billion colon surplus.

Monetary Performance. In 1987 the Central Bank continued the credit liberalization program initiated in 1983. By January 1987 all credit allocative categories and overall credit ceilings specified by banks had been eliminated, and bank managers were free to allocate credit according to demand and perceived risk. In regard to monetary management, over-all credit limits were replaced by more frequent use of indirect monetary instruments such as open market operations (sales of stabilization bonds), changes in reserve requirements on deposits, and rediscount rates. In the first half of 1987, the Central Bank reduced local currency deposits backing importers applications for foreign exchange from 100 % and 50 % to 10 %. As a compensating measure, reserve requirements on demand deposits and on term deposits (over 30 and less than 180 days) were raised from 32 % to 35 % and from 20 % to 23 %, respectively. However, the increase in reserve requirements was less effective than expected, and the reduction of importers' deposits (in local currency), jointly with the removal of over-all credit limits and the cyclical high of commercial banks' deposits in Central Bank allowed strong credit expansion in the first half of 1987. By May 1987, banking system credit to the private sector had expanded to 22 % on an annual basis, inflation was running at 20 % per annum, and imports were increasing at a 24 % annual rate. This situation contrasted sharply with the 13 % credit expansion and a 10 % inflation rate projected for the full year in the 1987 monetary program.

In the third quarter of 1987 it was clear to the monetary authorities that the monetary expansion was too high. For this reason, the Central Bank approved stringent measures to restrain credit and dampen imports. Importer deposits for foreign exchange applications were raised to 50% and nonfinancial public sector entities were required to withdraw a substantial portion of their deposits in state-owned banks to purchase fiscal bonds and/or stabilization bonds (i.e., issued by the Treasury and Central Bank, respectively). In addition, public sector entities were not allowed to purchase fiscal bonds and stabilization bonds at the secondary market, i.e., at the National Securities Exchange. As a result of these measures, private financial entities holding public sector bonds as transitory liquid investments had difficulty in selling this paper and, therefore, in honoring their maturing bond issues placed with private investors on a timely basis.

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During the fourth quarter, several private finance companies failed, and their officers blamed the Central Bank for these failures. However, it is not clear how many failures were a result of these measures or as a consequence of unsound financial practices because, with one exception, all the finance companies that failed were not under the authority and supervision of the Superintendency of Banks.

During 1987, banking system credit to the private sector increased by 23.7 % in nominal terms and net domestic assets of the banking system (exclusive of counterpart external arrears) increased by 25 % in nominal terms; see Table IV. The expansion of credit and net domestic assets was financed by a decrease of net international reserves (including the accumulation of external payments arrears) and by an 18.4 % increase in banking system liabilities to the private sector. Quasi-money increased by 31.9 % in nominal terms and this increase included a 55 % (2.8 billion <u>colones</u>) increase in holdings of stabilization bonds and a 23 % ($ 71 million) increase in foreign exchange deposits in state-owned banks. Money (M1) increased by only 1.4 % in nominal terms. Domestic banking system credit to the nonfinancial public sector declined (according to the definitions under the Standby Program) by 1.6 % and Central Bank losses, which are an important source of credit expansion, stood at only 1.9 billion colons (on a cash basis), inasmuch as a large portion of external debt payments was not made.

In regard to interest rates, in 1987 the Central Bank continued its policy of allowing commercial banks to set their own rates, both on deposits and loans subject to the following two constraints: (1) that the minimum lending rate can not be lower than their six month deposit rate and (2) that the maximum lending rate can not exceed the six month deposit rate by more than 9 percentage points. During 1987 interest rates on both deposits and loans were positive in real terms. However, as a result of the liquidity shortage of the last quarter, mentioned above, interest rates paid by state-owned banks rose by 2-3 percentage points, and the Central Bank and the Ministry of Financed intervened with state-owned banks to check this increase.

<u>Balance of Payments.</u> The key element in the deterioration of Costa Rica's 1987 balance of payments was the trade deficit. In 1986 it had been reduced to about $ 80 million due to the coffee price boomlet, but in 1987 it surged back to $ 271 million because exports grew (in nominal U.S. dollar value) by 2.6 percent as imports grew (in nominal U.S. dollar value) by 19.0 percent. Related to the enlarged trade deficit, the current account deficit also increased by approximately $ 200 million and the basic balance deficit increased from $ 347 million in 1986 to $ 613 million in 1987. Even though the GOCR obtained an agreement with the IMF in April 1987 on to a Standby of 18-month duration in amount of SDR 50 million, GOCR policymakers were unable to obtain agreements with foreign commercial bank and major bilateral creditors in 1987, and for that reason official debt relief amounted to only $ 43 million in 1987. Arrears on the service of external debt approximating

$ 375 million in 1987 were a major source of financing for the balance of payments. It is expected that $ 286 million of the arrears accumulated to year-end 1987 will be refinanced in debt rescheduling agreements in 1988.

Debt Rescheduling. As is noted above, in 1983 and 1985, the GOCR negotiated agreements for debt relief with its bilateral and commercial bank creditors. In view of prospective debt service on the order of 50 percent of exports (of goods and services), the Arias administration also undertook negotiations with commercial bank creditors in the second half of 1986. These negotiations have been prolonged for several reasons, e.g. initial refusal of GOCR authorities to pay interest without an agreement, subsequent refusal of commercial banks to consider the case of Costa Rica until a settlement with Brazil, and, more recently, disagreement amoung participating banks. In departing from previous practice, the IMF has been willing to proceed with a Standby agreement for Costa Rica (at least until June 1988) based upon payment of interest to commercial bank creditors of $ 5 million per month (as compared to approximately $ 11 million as full payment). Even though the timing of a new agreement with commercial bank creditors is uncertain, we expect that such an agreement will involve debt relief approximating a significant fraction (on the order of one-half) of scheduled interest or the equivalent in fresh money and a rolling-over of principal maturities.

4. Outlook for 1988

The 1988 Program. The macroeconomic and financial program of the GOCR was designed as an 18 month program to begin at mid-year 1987. The program for 1987 was outlined in the April Letter of Intent to the IMF. Due to refusal of foreign commercial bank creditors to negotiate debt rescheduling in the third quarter of 1987 and to departure of the external accounts from the program projection, the 1987 program was revised in the GOCR October 1987 Letter of Intent and initial targets were formulated for 1988 by IMF Staff and GOCR policymakers. Quarterly targets for 1988 were formulated in the GOCR Letter of Intent of February, 1988. The objective of the 1988 economic program is to continue the export-led growth strategy, to improve the balance of payments and international reserves, to reduce the public sector deficit, to reduce inflation, and to increase domestic savings. As is usual with such arrangements, quarterly quantitative ceilings are specified for central government expenditures, domestic banking system credit to the non-financial public sector, net domestic assets of the Central Bank, net international reserves of the Central Bank, and the stock of payment arrears. The exchange rate and interest rate are key policy instruments aiming at these objectives. The program promises that the exchange rate will be adjusted to maintain the real rate achieved after the step devaluation in January, 1988 for the purpose of increasing export competitiveness and improving the balance of payments and reserves. Positive real interest rates and a flexible interest rate policy will be maintained to encourage the holding of domestic monetary instruments.

<u>Projected Balance of Payments</u>. The GOCR-IMF program for 1988 calls for exports to grow (in nominal dollar value) by 5.7 percent and for imports to decline by about \$ 75 million along with a \$ 30 million increase in the net inflow of private capital. This program also calls for debt relief from commercial bank and bilateral creditors in 1988 amounting to \$ 786 million of which \$ 286 million relates to arrears accumulated to the end of 1987 (but not including arrears on interest due commercial bank creditors), \$ 300 million relates to obligations maturing in 1988, and \$ 200 million relates to additional relief (and this relief is roughly equivalent to unpaid interest to commercial bank creditors for 1986, 1987, and the unpaid remnant with payment at \$ 5 million per month in 1988). The 1988 program also includes exceptional B/P assistance in the form of \$ 125 million in U.S. Economic Support Funds and, \$ 100 million in the second Structural Adjustment Loan from the World Bank (which is assumed to be half of the total loan from the World Bank plus cofinancing). On February 13, 1988, the GOCR Vice President, Jorge Manuel Dengo, announced that the World Bank staff had approved the SAL II loan. The SAL II agreement must be approved by the World Bank Board and the Legislative Assembly before it becomes operative, and it is hoped that these steps will be taken so that disbursement of a first tranche can take place in the fourth quarter of 1988. We understand that the terms of SAL II include various legal changes necessary for financial sector reform, a phased reduction of import tariffs to reduce the predominant tariff level to 40 percent, and a GOCR commitment to a long-term price policy for domestic agricultural products subject to governmental intervention. We note that a projection of Costa Rica's balance of payments through 1992 was included in the Mission's Stategy Plan.4/

<u>The Monetary Program</u>. The monetary program for 1988 is an important component of the Standby Program. According to this program, monetary policy in 1988 is aimed at reducing inflation and improving the net international reserve position of the Central Bank. Consistent with these objectives, net domestic assets of the Central Bank, exclusive of counterpart external arrears, are projected to decrease by 9.5 %, banking system credit to the private sector is projected to increase by about 9.3 %, which means no growth in real terms, inasmuch as the rate of inflation is projected at 10 percent, and domestic banking system credit to the nonfinancial public sector is projected to decline by 3.0. These measures are expected to restrain credit and to offset Central Bank losses which are projected at 25.9 billion <u>colones</u> in 1988 (on cash basis), inasmuch as a substantial portion of external payments arrears are projected to be paid in 1988 (i.e., this assumes payment of interest in arrears to foreign commercial banks).

In regard to banking system credit to the private sector, for 1988 the Central Bank reinstated credit limits by banks. This measure is supposed to reinforce orthodox monetary instruments. The program limits the expansion of credit funded with domestic resources in 1988 to 5 % above the outstanding balance of such credit as of November 30, 1987. Credit funded with external resources is not included in the limit, however, Central Bank will monitor credit expansion to hold overall growth under 10 %. Banking system credit for "other activities" which include commerce, services, consumption, transportation and electricity is limited to no more than 30 % above the outstanding balance of such credit as of December 30, 1986, which means a net reduction of about 2.2 billion colons in 1988. This measure is a step backward from the freedom in credit allocation achieved in 1987. In regard to interest rates, the Central Bank has continued its policy of allowing commercial banks to set interest rates on both deposits and loans as described above.

Exchange Rate Policy. On January 18, 1988, the Central Bank devalued the Colon by 6.0 percent, and this sharper devaluation aimed at constraining imports by making them more costly. However, the Central Bank President stated that the minidevaluation system of exchange rate management would not be changed during the remainder of 1988 and that the pace of minidevlaution would be set, as in the past, by estimating the difference between domestic and international inflation. The Central Bank has followed a crawling peg or minidevaluation program since January 1985. In 1985 there were 21 minidevaluations with a 12.4 % increase in the exchange rate; in 1986 there were 17 minidevaluations with a 9.8 % increase in the exchange rate, and in 1987 there were 25 minidevaluations with a 17.7 % increase in the exchange rate.

The Public Sector Financial Program. The main elements of the public sector financial program are contained in the Standby Program. According to this program, the consolidated public sector deficit (inclusive of Central Bank operating losses) is projected at 3 % of 1988 GDP. To achieve this dificit, the nonfinancial public sector is projected to run a surplus equal to 0.8 of one percent of GDP. Within the nonfinancial public sector, central government is projected to run a

2 % deficit and the rest of general government and state enterprises combined are projected to achieve a surplus of 2.8 percent. Central Bank losses on accruals basis are projected at 3.8 % of GDP. In regard to the central government, expenditures are projected to grow by 18.7 % in nominal terms and revenues by 20.8 %. Approximately 40 % of the increase in revenues is expected to be raised by the tax package enacted by the Legislative Assembly in November 1987. In regard to the rest of general government and state enterprises, increases are projected for utility rates (electricity, water and telephone rates) and the price of gasoline and petroleum derivatives. In addition, several measures have been adopted by the GOCR to narrow the deficits of CNP (the state agricultural purchasing agency) and INCOFER (the state railroad), and the expenditures of RECOPE (the state petroleum refinery) are to be reduced by curtailment of programs such as petroleum exploration.

Economic Growth. Based upon the Standby program, growth of GDP in 1988 for Costa Rica is expected to be 2.4 %. Restrictive fiscal and credit policies should constrain the growth of domestic demand with the result that growth can mainly be attributed to production for export. Because of this, performance of the agricultural and manufacturing sectors will be mixed. In the agricultural sector, coffee, beef, sugar and grains face prospects for reduced growth due to the circumstances affecting each of these. However, banana production and production of non-traditional exports are expected to grow. In the manufacturing sector, production linked to exports is expected to grow. Manufacturing for the domestic market is not expected to expand strongly. Construction activity continues to be robust due to house construction and public works projects for sewers, water, and roads.

FOOTNOTES

1/ 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.

2/ 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 for debt of similar maturities.

3/ In national accounting terminology, this disinvestment is caused by the reduction (and export) of inventories of coffee which were accumulated in prior years and, hence, included in the GDP of those prior years. For this reason, consumption was not affected adversely in 1987 because the decrease in inventories (disinvestment) permitted consumption to grow by 3.4 % and exports of goods and services to grow by nearly 21 %, that is, at rates higher than the 3.0 % growth of GDP.

4/ The Mission projection of B/P for 1988 and future years, presented in the Strategy Plan and conforming to a scenario of economic growth on the order of 3-5 % per year, projects the growth of nontraditional exports (in nominal prices) at 10.0 % annually, and over-all export growth at 7.5 % annually. The projection demonstrates Costa Rica's continued need for external balance of payments support. In this projection, the current account deficit averages over $ 170 million annually through 1992 and coverage is projected in the form of increased private direct investment (foreign investment and the return flow of private capital), debt relief from commercial banks and bilateral creditors as well as B/P support assistance (from ESF, the IMF, and the World Bank). As a general conclusion, the projection includes strong export performance, but as exports increase, bringing growth of income and employment, imports also increase, and the combined effect reduces the B/P current account deficit only slowly.

TABLE I : SELECTED ECONOMIC INDICATORS, 1984-1988

	1984	1985	1986	1987(A)	1988(B)
GDP in Current Prices (C)	163,011	192,425	242,117	270,271	307.565
GDP in U.S. Dollar Equivalent (D)	3,671	3,813	4,320	4,290	4,047
GDP in Constant Prices 1977=100	113	114	119	123	126
GDP Per Capita in Constant Prices, 1977=100 (E)	94	92	94	94	94
Growth of GDP in Constant Prices (Percent Change)					
Gross Domestic Product	8.0	1.0	4.6	3.0	2.4
Basic Productive Sectors	11.3	0.3	4.8	1.3	2.8
-Agriculture	10.1	-2.9	3.0	-5.0	0.7
-Manufacturing	10.4	3.2	7.1	5.2	3.2
-Construction	23.6	1.3	1.3	10.0	8.6
Government	1.5	0.5	1.5	1.0	0.7
Other Sectors	6.2	1.7	5.1	5.1	2.3
Prices (Percent Change)					
GDP Deflator (Annual Average)	16.7	16.9	20.3	8.4	11.2
Consumer Prices (Dec. to Dec.)	17.3	10.9	15.4	16.4	10.0
Wholesale Prices (Dec. to Dec.)	12.2	7.6	11.9	10.9	N/A
Unemployment (Percent) (F)	7.8	6.8	6.2	5.6	N/A
Employed Labor Force (Thousands)(F)	800.1	826.7	854.2	922.7	N/A
Real Average Wages (1977=100)					
From DGES/MinLab. Employ. Survey	98	103	N/A	N/A	N/A
-Public Sector	84	88	N/A	N/A	N/A
-Private Sector	102	108	N/A	N/A	N/A
From Payroll reports to Soc.Sec.	97	106	110	108	N/A
-Public Sector	87	97	99	98	N/A
-Private Sector	105	113	118	117	N/A
Exchange Rate (Colons per U.S.$) (Selling Price, Dec. 31)					
Official Market (G)	20.50	20.50	20.50	20.50	N/A
Banking or Unified Market	48.00	53.95	59.25	69.75	N/A

Notes:

(A) Preliminary (B) Projected data (C) Millions of Colones.
(D) Millions of U.S. Dollars
(E) Per Capita GDP was calculated based upon the population series from the Central Bank (official) National Accounts 1976-1985 and data provided by Central Bank for 1986 and 1987. For 1988, a 2.67 % growth rate for population was used in the projection.
(F) July of each year. Inasmuch as data for July 1984 is not available, we have used the increase from March 1983 to March 1984 applied to data for July 1983 to obtain a proxy for July 1984.
(G) A constitutional requirement; not used for any transactions.

TABLE II : PERFORMANCE OF GROSS DOMESTIC PRODUCT, 1984-1988

	1984	1985	1986	1987 (Prelim.)	1988 (Proj.)
A. As Percent of 1977 Real Value					
Gross Domestic Product	113.1	114.2	119.4	123.0	126.0
Imports of Goods & Services	82.6	82.6	96.5	106.4	101.8
Exports of Goods & Services	125.3	118.2	125.2	151.1	142.6
Gross Domestic Expenditures	96.7	101.7	108.3	106.9	110.6
Consumption	102.5	106.4	112.0	115.8	118.2
Private Consumption	102.0	106.5	112.7	117.2	120.0
Public Consumption	105.1	106.2	108.4	109.0	109.0
Gross Domestic Investment	79.8	87.8	97.7	81.0	88.6
Gross Fixed Investment	83.6	87.7	95.6	104.0	109.0
Per Capita Basis:					
Gross Domestic Product	93.7	92.1	93.8	94.0	93.8
Total Consumption	84.9	85.8	87.9	88.5	88.0
Private Consumption	84.4	85.8	88.4	88.2	91.7
Gross Domestic Investment	66.0	70.8	76.7	62.0	67.3
Gross Fixed Investment	69.2	70.7	75.0	79.4	81.1

B. Aggregates and Sectors as Percentage of Gross Domestic Product in 1985-1986

Gross Domestic Product	100.0	Agriculture	19.3
Net Foreign Balance	3.6	Manufacturing	22.4
Imports of Goods & Services	34.0	Construction	4.5
Exports of Goods & Services	37.6	Basic Productive Sectors	46.2
Gross Domestic Expenditure	96.4	Commerce	16.7
Total Consumption	74.6	Transportation	7.3
Private Consumption	62.6	Financial Services	5.9
Public Consumption	12.0	Housing	7.2
Gross Domestic Investment	21.9	Personal Services	4.2
Gross Fixed Investment	19.6	Electricity	3.0
Change in Inventories	2.3	Other Service Sectors	44.2
		Government	9.6
		Total: Gross Domestic Product	100.0

Source: Central Bank of Costa Rica and IMF.

TABLE III : OPERATIONS OF THE NONFINANCIAL PUBLIC SECTOR 1985-1988
(In millions of Colons)

	1985	1986	1987(A)	1988(B)
Central Administration	-3,941	-8,248	-5,843	-6,000
Revenue	32,005	38,029	44,504	53,750
Expenditure	35,946	46,277	50,347	59,750
Current	(30,144)	(36,859)	(43,604)	(50,625)
Capital and net lending	(5,802)	(9,418)	(6,743)	(9,125)
Rest of General Government	2,704	3,534	3,777	4,798
Revenue	19,336	24,774	29,350	36,593
Current	(18,765)	(24,291)	(29,044)	(35,548)
Capital	(571)	(483)	(306)	(1,045)
Expenditure	16,632	21,240	25,573	31,795
Current	(14,535)	(18,783)	(22,075)	(26,500)
Capital and net lending	(2,097)	(2,457)	(3,498)	(5,295)
State Enterprises	-2,479	642	1,389	3,662
Revenue	36,950	43,269	47,992	62,320
Current	(36,659)	(41,621)	(47,136)	(60,967)
Capital	(291)	(1,648)	(856)	(1,353)
Expenditure	39,429	42,627	46,603	58,658
Current	(35,065)	(37,358)	(41,288)	(51,068)
Capital and net lending	(4,364)	(5,269)	(5,315)	(7,590)
Public Sector Current Account Deficit (-)	7,685	10,941	13,717	22,072
General Government	6,091	6,678	7,869	12,173
State Enterprises	1,594	4,263	5,848	9,899
Nonfinancial Public Sector Overall Deficit (-) (C)	-3,716	-4,072	-677	2,460
Deficit Financing	3,715	4,069	677	-2,460
External net	699	-2,066	-5,481	-3,937
Domestic	-1,055	-70	-415	-1,776
Banking System	(505)	(-1.123)	(-877)	(-3,325)
Other	(-1,560)	(1,053)	(462)	(1,549)
Change in external arrears	-3,096	2,845	6,113	-13,832
Rescheduling	7,167	3,360	460	17,085

(As Percent of GDP)

	1985	1986	1987(A)	1988(B)
Central Administration				
Deficit	-2.0	-3.4	-2.2	-2.0
Revenue	16.6	15.7	16.5	17.5
Expenditure	-18.7	-19.1	-18.6	-19.4
Rest of General Government Deficit (-)	1.4	1.5	1.4	1.6
State Enterprises deficit (-)	-1.3	0.3	0.5	1.2
Nonfinancial Public Sector Overall Deficit (-)	-1.9	-1.7	-0.3	0.8
Central Bank Net Operating Losses (D)	-5.3	-3.8	-3.0	-3.8
Total Public Sector Deficit (-)	-7.2	-5.5	-3.3	-3.0

TABLE III (CONTINUED)

Source: Central Bank of Costa Rica and IMF

Notes:

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 and Ministry of Finance projection.

(C) Includes statistical discrepancies from reporting on an accrual and a cash basis, from reporting periods that differ from the calendar year and from operations not included in the consolidation.

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

TABLE IV : MONETARY ACCOUNTS 1985-1988
(December 31 of each year;
millions of Colons)

	1985	1986	1986	1987	1987	1988(A)
Exchange rates used for conversion of FX to Colons:	(56.50/US$)		(63.00/US$)		(76.00/US$)	
Central Bank						
Net International Reserves	-3747	-8202	-9146	-19530	-23560	1520
Official Reserves	-1154	1979	2207	-2627	-3169	1520
Payments Arrears	-2593	-10181	-11353	-16903	-20390(H)	0
Net Domestic Assets	17003	25509	26453	39000	43030	20480
Net Credit to Public Sector(C)	34244	44712	48061	41563	47322	44495
Net Credit to Banks	-12443	-11106	-12072	-6190	-8173	-10274
Government Trust Funds	-10985	-18263	-18263	-15676	-15676	-31176
Stabilization Bonds	-4900	-5079	-5079	-7885	-7885	-10234
Long-term Foreign Liabilities	-93983	-102979	-114826	-112867	-136157	-144562
Counterpart Arrears	2593	10165	11334	16903	20390	0
Operational Losses (cash basis)	37359	42118	42118	44013	44013	69887
Other Accounts Net	65118	65941	75180	79139	99195	102344
Currency Issue	13256	17307	17307	19470	19470	22000
Banking System						
Net International Reserves(B)	-1504	-4761	-5309	-15340	-18505	6575
Net Domestic Assets	73223	92419	94996	121500	129536	118764
Net Credit to Public Sector(C)	26161	35690	38961	31992	37686	34361
-Adjusted Net Credit (D)	26161	25038	38961	38084	37686	34361
-Central Government	11897	13240	18961	21265	---	---
-Rest of Public Sector	14264	11798	20000	16819	---	---
Credit to Private Sector	38183	44824	45081	55785	56349	61593
Long-Term Foreign Liabilities	-98181	-104209	-116198	-114314	-137903	-146186
Other Accounts Net (E)	107060	116114	127152	148037	173404	168996
Liabilities to Private Sector	71719	87658	89688	106160	111031	125339
Money	28970	39901	39901	40467	40467	45700
Quasi-money	42749	47757	49787	65693	70564	79639

Source: Central Bank of Costa Rica and IMF

TABLE IV (CONTINUED)

Percentage Change (F)

Banking System	1985	1986	1987	1988
Net Domestic Assets (G)	10.3	16.5	25.0	8.8
Net Credit to Public Sector (D)	0.8	-1.6	-1.6	-3.0
Credit to Private Sector	16.1	17.4	23.7	9.3
Liabilities to Private Sector	12.9	22.2	18.4	12.9
- Money	12.7	37.7	1.4	12.9
- Quasi-Money	13.1	11.7	31.9	12.9

Notes:

(A) Central Bank and IMF projection.

(B) Includes external payments arrears

(C) The definition of net credit to the public sector conforms to Central Bank monetary accounts. Debt assumed by the Central Bank on behalf of the public sector related to the rescheduling of external debt is included. 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.

(D) The definition of net credit to the public sector is adjusted to conform to the definition under the Standby Program limit. Debt assumed by the Central Bank on behalf of the public sector related to the rescheduling of external debt does not affect annual comparisons.

(E) Includes Government Trust Funds, counterpart of external payment arrears and Central Bank operational losses.

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

(G) Excludes counterpart of external payments arrears.

(H) Arrears not subject to rescheduling.

TABLE V : BALANCE OF PAYMENTS: COSTA RICA 1983-1988
(millions of U.S. dollars)

	1983	1984	1985	1986	1987(A)	1988(B)
Balance of Trade	-140.7	-104.7	-172.0	-77.4	-271.4	-133.0
--Commodity Exports, FOB	852.5	997.5	939.0	1,085.8	1,113.6	1,177.0
--Commodity Imports, CIF	-993.2	-1,102.2	-1,110.9	-1,163.2	-1,385.0	-1,310.0
Nonfactor Services	121.8	122.5	105.5	136.6	131.3	141.9
--Freight, Insurance, net	8.2	10.4	10.2	10.6	12.5	13.9
--Travel, net	80.6	66.1	64.3	71.4	65.6	76.8
--Transportation, net	13.1	21.5	1.1	6.9	7.5	9.1
--Other Services, net	19.9	24.5	29.9	47.7	45.7	42.1
Investment Income, net	-333.7	-313.6	-282.2	-280.7	-285.3	-281.8
--Private Profit, Interest	13.9	0.4	-1.9	1.0	-1.6	-2.8
--Official Interest	-347.6	-314.0	-280.3	-281.7	-283.7	-279.0
(Paid)	(-295.3)	(-208.7)	(-245.0)	(-183.9)	(-102.7)	(-254.0)
(Unpaid)	(-52.3)	(-105.3)	(-35.3)	(-97.8)	(-181.0)	(-25.0)
Unrequited Transfers	31.9	45.9	58.8	69.4	67.7	73.7
--Official Sector, net	9.0	14.0	16.2	34.7	31.2	34.7
--Private Sector, net	22.9	31.9	42.6	34.7	36.5	39.0
Current Account Balance	-320.7	-249.9	-289.9	-152.1	-355.4	-197.0
(Autonomous Capital Flows)						
Private Capital & E&O	97.4	11.9	98.7	49.3	102.3	133.7
Official Amortization	-266.7	-339.0	-357.6	-379.6	-439.9	-449.0
(Paid)	(-92.8)	(-109.6)	(-74.1)	(-167.6)	(-162.5)	(-174.4)
(Unpaid/Rescheduled)	(-173.9)	(-229.4)	(-283.5)	(-212.0)	(-277.4)	(-274.6)
Project loans :	193.1	165.8	185.3	135.7	79.6	117.5
Basic Balance (C)	-296.9	-411.2	-363.5	-346.7	-613.4	-394.8
Reduction (-) or increase (+) of Arrears (D)	-1,018.2	175.3	-169.5	135.7	373.8	-554.0
Debt Relief :	940.9	153.7	357.8	145.9	42.9	785.5
--Resch. Current Oblig	191.6	153.7	300.8	133.0	21.8	299.7
----Amortization Relief (E)	157.2	153.7	278.3	130.6	21.8	274.6
----Interest Relief	34.4	--	22.5	2.4	--	25.1
--Resch. of Arrears	749.3	--	57.0	12.9	21.1	285.8
--Proposed Rescheduling						200.0
Financial Gap (- sign)(F)	-374.2	-82.2	-175.2	-65.1	-196.7	-163.3
(B/P Support Inflows)	(407.0)	(145.9)	(305.0)	(84.1)	(57.8)	(210.0)
--ESF Loans & Grants	155.7	130.0	160.0	80.6	120.0	125.0
--Revolver Credit Facility	152.3	49.9	75.0	--	--	--
--IMF Net Inflow	99.0	-34.0	30.0	-36.0	-62.2	-15.0
--IBRD SALs & Sector Loans	--	--	40.0	39.5	--	100.0

TABLE V (Continued)

Source: Central Bank of Costa Rica and IMF.

Notes:

(A) Preliminary

(B) Projected

(C) The basic balance is defined as the current account balance plus autonomous capital flows, i.e. the sum of private capital (and errors and omissions), official amortization and disbursements of project loans (including PL 480).

(D) A change in payment arrears with a positive sign is an accumulation of arrears, and with a negative sign a change in payment arrears is a net disaccumulation (repayment).

(E) The \$ 130.6 million of amortization relief from the rescheduling of current obligations in 1986 contains \$ 107.0 million from foreign commercial bank creditors and \$ 8.4 million from Paris Club. Supplementary information on the 1988 projection indicates expectation of rescheduling of arrears and current obligations with commercial banks amounting to \$ 384.3 million and with Paris Club creditors amounting to \$ 96.4 million.

(F) The financial gap is the sum of the basic balance, the change in arrears, and debt relief operations.

(G) The over-all balance with a positive sign is an increase in the official net international reserve position, and with a negative sign it is a decrease.

TABLE VI: EXPORTS BY PRINCIPAL PRODUCTS, 1984-1988
(Value in millions of U.S. dollars,
volume in thousands of units indicated,
unit value in U.S. dollars)

	1984	1985	1986	1987(A)	1988 (B)
Traditional Exports	597.3	591.0	689.6	641.8	636.1
Coffee	267.3	315.8	391.9	330.0	333.4
--Volume (quintals, 100 lb.)	2457	2683	2053	2950	2778
--Unit value (per quintal)	108.8	117.7	190.9	111.9	120.0
Bananas	251.0	208.0	216.8	237.7	252.5
--Volume (metric tons)	1020	851	941	980	1010
--Unit value (per ton)	246.1	244.4	230.4	242.6	250.0
Beef	43.5	53.7	69.8	57.2	37.6
--Volume (metric tons)	20.5	27.2	35.2	26.0	16.0
--Unit value (per metric ton)	2123	1974	1980	2200	2350
Sugar	35.3	13.5	11.1	16.9	12.6
--Volume (quintals, 100 lb.)	2231	968	1660	1677	970
--Unit value (per quintal)	15.9	14.0	6.7	10.1	13.0
Nontraditional exports	400.2	348.0	396.2	471.8	540.9
--to Central American CM	193.0	143.5	98.9	98.0	101.0
--to Panama	36.3	28.9	41.7	37.0	39.9
--to Rest of the world	170.9	175.6	255.6	336.8	400.0
Total Commmodity Exports, FOB	997.5	939.0	1,085.8	1,113.6	1,177.0
Drawback Value Added (included in Other Services)	26.1	35.0	37.3	40.0	47.5
Total Exports (Inc. Drawback)	1,023.6	974.0	1,123.1	1,153.6	1,224.5

Source: Central Bank of Costa Rica and IMF.

Notes:

(A) Preliminary

(B) Projected

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

	1985	1986	1987
1. Net Official Reserves	-79.2	34.7	-37.0
Assets	492.7	552.1	501.2
Freely Disposable	111.7	134.5	113.7
Gold	19.1	26.1	23.7
Bank Deposits	81.7	11.9	86.6
Foreign Exchange	0.9	1.8	i.e.
Securities	9.5	92.5	i.e.
Special Drawing Rights	0.5	2.2	3.4
Other	--	--	i.e.
Other Assets	381.0	417.6	387.5
Time Deposits in CA Central Banks)	238.8	365.4	344.1
C. Amer. Clearing Arrang.	113.7	13.1	0.9
Contrib. to CA Stab. Fund	19.2	22.5	23.7
Other	9.3	16.6	18.8
Liabilities	-539.1	-517.5	-478.7
Net Position with IMF	-188.6	-172.4	-132.3
Revolver Credit Facility	-276.8	-276.9	-272.3
Other Short Term	- 73.7	-68.2	-74.1
Drawing on CA Stab. Fund	-30.0	-33.7	n.a.
Banco de Mexico (& clearing)	-3.2	0	n.a.
Banco Republic de Colombia	-3.7	-0.8	--
Other	-36.8	-33.7	n.a.
Adjustment of Short Term Liabilities (by IMF)	-32.8	--	-59.5
2. Payment Arrears	-32.6	-183.0	-559.3
Over 15 working days (imports)		-0.3	-5.2
Other (D, 1988)	-32.6	-182.7	-554.1
3. Total	-111.8	-148.3	-596.3

Source: Central Bank of Costa Rica and IMF Staff.

Note: I.E. signifies included elsewhere.

TABLE VIII : COMPOSITION OF FOREIGN EXCHANGE PAYMENT ARREARS
December 31, 1987
(In millions of U. S. Dollars)

Creditor	Principal	Interest	Total
Commercial Banks			
Medium and long term	179.7	156.5	336.2
Foreign Governments	116.8	60.3	177.1
Paris Club	60.6	36.7	97.3
(Previously refinanced)	(15.4)	(17.2)	(32.6)
Others	56.2	23.6	79.8
(Previously refinanced)	(16.7)	(8.4)	(25.1)
Multilateral Institutions	20.9	12.3	33.2
Bonds	0.4	1.3	1.7
CDs of the "Presa"	0	4.4	4.4
Suppliers Credits	9.3	1.2	10.5
Subtotal	327.2	236.0	563.2
Arrears of over 15 working days to importers			5.2
TOTAL			568.4

Source: Central Bank of Costa Rica

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TABLE IX : PUBLIC SECTOR EXTERNAL DEBT
(on a Disbursed Basis, December 31, 1985
and September 30, 1987,
in millions of U.S. dollars)

	12-31-85	9-30-87
By lending institution		
Commercial banks	1,601.3	1,368.4
Multilateral institutions	1,035.9	1,366.7
Bilateral loans	748.4	943.4
--Paris Club		(358.2)
--Other		(585.2)
Bonds and Float. Rate Notes	73.9	69.5
"presa" CDs	184.0	148.6
Suppliers credits	50.0	27.0
---Total	3,693.5	3,923.6

Source: Central Bank of Costa Rica.

Note: The data as of 9-30-87 are the latest available. They were prepared by the Section of Register and Control of External Debt of the Central Bank of Costa Rica, November 9, 1987.

ANNEX B

STATUS OF PRIVATIZATION

A. CODESA Divestiture

Background. The Corporación Costarricense de Desarrollo, S.A. (CODESA) was established in 1972 to serve as a development bank and venture capital partner, cooperating with private enterprise to develop new industries in Costa Rica. CODESA was originally expected to play a short term role in each venture, turning its interest over to the private sector once the business established its viability.

In actual experience, however, CODESA (which is owned almost entirely by the GOCR) has taken a majority or sole ownership position in many enterprises. The public sector thus took on management of a range of commercial activities including aluminum milling, cement production, sugar refining, fertilizer mixing, cotton processing, and others.

Non-commercial and non-economic factors often predominated in the design, staffing, and management of these enterprises. Political interference and some outright corruption led to a pattern of unproductive investments generating consistent losses. CODESA repeatedly tapped its free access to Central Bank credit. In the early 1980's it was consuming one-third of all public sector credit, while generating less than 1.5% of the GDP and less than 0.5% of national employment.

In 1984, the GOCR agreed with the Mission on covenants to the ESR III program which cut off CODESA's access to BCCR credit for new investments, and the legislature enacted a legal framework for the divestiture. During 1985, the Mission worked with the GOCR to develop a specific procedure for divesting or liquidating CODESA's holdings, based on the 1984 law. This complex procedure, whose design and implementation have been detailed in the PAAD's for 1985-87 (ESR IV - VI), included large transfers to ESF-generated local currency back to the BCCR to reduce CODESA debt there. These transfers (equivalent roughly to $175 million) far exceeded the real commercial value of the subsidiaries which CODESA was divesting. The decision to transfer such large amounts was driven by two principal considerations. (1) The Mission concluded that it was desirable to "denometize" or "sterilize" these funds, since actually spending them in the local economy (e.g. for development projects) would entail unacceptable consequences in terms of inflation and additional import demand. (2) On a cosmetic level, these transfers would minimize political embarrassment and opposition to the divestiture, by protecting the GOCR from a charge that it was giving away priceless national assets without receiving sufficient compensation.

Results to Date. Financially speaking, the most significant result of the process was achieved almost immediately, when CODESA's access to credit for new investment was cut off in 1984. During the prior four years, CODESA's operating assets has grown each year by about ₡1.5 billion (equivalent to abour $30 million at an average rate of 50:1). Subsequent history has demonstrated that most of these investments went for overpriced and uneconomic operations, so that most of their value was lost to the country on the day the investments were made.

At the beginning of the process, over 90% of CODESA's operating assets consisted in seven companies.

-- ALUNASA (aluminum) was bought by FINTRA, a private-sector trust set up by AID, in December, 1985, and was sold by FINTRA to a private buyer as a going concern in July 1987.

- CATSA (sugar) was transferred from CODESA to FINTRA in September, 1987, under a contract which provides for onward sale to private cooperatives in March, 1988.

-- CEMVASA (cement) is not viable. It has been inactive since 1983. CODESA is well along in the complex legal process of liquidating CEMVASA assets.

-- FECOSA (railroad) and TRANSMESA (bus company) were transferred out of CODESA into other GOCR agencies, as required by law.

-- Under current law, only 40% of the shares of FERTICA (fertilizer) and CEMPA (cement) may be sold. The GOCR is still considering various options for handling these politically sensitive companies. Decisions are expected in early 1988.

CODESA has sold or liquidated its interests in most of its 35 other subsidiaries and affiliates.* None of these represent more than 1% of CODESA's net operating assets; the majority were empty corporate shells. Progress on cleaning up these minor loose ends has been slow, but reasonably satisfactory.

Future Privatization Activities: CODESA. The biggest change to occur thus far during the three years of the CODESA divestiture program has been the new GOCR administration's conclusion that privatization can yield significant political advantages, especially where a company is sold on favorable terms to a wide group of local buyers. Thus the GOCR has pursued privatization more aggressively in the last year, and is assuming primary implementation responsibility for the remaining major subsidiaries (CATSA, FERTICA, and CEMPA). While the sale of CATSA (sugarO to private co-ops is well on its way, OPS expects that close monitoring will be necessary until its conclusion, since a couple of remaining steps in the process are still at some risk.

Under the banner of "economic democratization", the GOCR will probably sell the legal maximum of 40% of FERTICA (fertilizer) and CEMPA (cement) to broad-based groups of Costa Rican citizens. OPS is cooperating in the GOCR's definition of mechanisms. Once 40% of these companies has been transferred successfully, the government will probably be willing to consider an eventual privatization of the remainder, though legislative approval would be necessary. As an interim step, the government is exploring the possibility of placing its 60% of these companies in trust with a private body to facilitate responsible management. FINTRA might be an attractive candidate for such an arrangement only if that organization were completely "unplugged" from AID. (Heretofore, given the close identification between FINTRA and the Mission, and the political sensitivity associated with many CODESA subsidiaries, we have always insisted that no company go into FINTRA unless there were a predetermined, foolproof mechanism for passing the company out of FINTRA in a reasonable time period.)

Once CODESA's subsidiaries and affiliates have been divested or liquidated, the fate of the holding company remains an open question. The divestiture process will hardly have been a great success if the GOCR were to turn around a couple of years later and fill up the CODESA stable with new parastatal companies.

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* "Subsidiaries" are companies in which CODESA has controlling interest, while "affiliates" represent minority positions.

Of course, no present action by AID of the GOCR can completely preclude such a possibility in the future. The best that could be done right now would be to dissolve CODESA. However, the Arias administration has indicated definitively that it will not take this step, which would be highly offensive to a powerful wing on the incumbent party which was associated with CODESA's creation and growth. A second-best alternative would be a legislative restructuring of CODESA which prohibited it from acquiring new subsidiaries. In substance, this latter alternative would be similar to a dissolution of CODESA, in that either action would result in legislative approval being required for any further parastatal acquisitions.

If CODESA is left alive as a corporate shell, but substantially without subsidiaries, then the GOCR will have to define a (face-saving) role for the holding company. It has been suggested that CODESA might be transformed into a development bank, but the Mission is not enthused about this suggestion, because we do not see a need for another development bank in Costa Rica, and because we doubt that CODESA would exercise such a function effectively. Alternatively, if certain Ministry of Foreign Trade export promotion functions were spun off into an autonomous entity (as discussed above), CODESA might be restructured as the promotional agency.

Resolution of this matter will have to be addressed in the ongoing policy dialogue between the Mission and the GOCR.

Future Privatization Activities Other Than CODESA. The Minister of Planning and certain other leaders in the present administration are pursuing privatization of non-CODESA activities. Among the candidates are companies (such as Radiográfica de Costa Rica, the telegram/telex company) and services (such as road maintenance or collection of telephone bills). Their efforts thus far have been characterized by minor successes and considerable political opposition.

Both the GOCR and the Mission believe that AID's role in further privatization (beyond CODESA) ought to be a relatively passive one. The GOCR feels that a highly visible foreign-donor presence would aggravate political opposition to the program. After some years of a high Mission profile and intense controversy over various Mission programs, there is something of a consensus in the Mission that we might direct more of our program and policy dialogue into areas which are less inflammatory. In any event, the practical experience of the CODESA divestiure has made it abundantly clear that satisfactory results are obtained only when it is the government that is pulling the privatization cart.

Notwithstanding the above suggestion of a low-profile approach on further privatization, OPS expects to cooperate with the GOCR in making resources available for this effort. The nature and amount of funding requirements have yet to be defined. We expect to receive soon a preliminary request from the planning ministry to approve modest amounts of local currency for feasibility studies of privatization targets, as well as assistance for public sector employees to organize themselves as private companies or co-ops which would provide certain services on a contract basis. Initially these new companies would receive contracts on a non-competitive basis, for a limited number of years. Thereafter, award of the contracts would be fully competitive.

Beyond this preliminary request, a more comprehensive program will have to be defined during the first half of 1988. In addition to the above elements, this program might include a fund to pay special severance incentives to encourage the resignation of government employees. However, we would not envisage the inclusion of large amounts of local currency to finance the sale of companies (as was done in the case of CODESA).

The British are the most experienced and successful practitioners of privatization in the world today. OPS has already brokered some limited British technical assistance for the GOCR, which has been very well-received. We will pursue an expansion of British assistance: this will not only bring additional expertise to bear, but will also have the political advantage of lessening the identification or privatization with U.S. policy pressure. Ideally, the British government would cover all the costs associated with such assistance, but ESF-generated local currency may be needed as well.

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* "Subsidiaries" are companies in which CODESA has a controlling interest, while "affiliates" represent minority positions.

ANNEX C

THE ESF SEPARATE ACCOUNT

In conformance with a requirement in the 1987 Continuing Resolution, the GOCR was required to open a separate account in which all dollar disbursements under the ESF program were to be deposited. In carrying out the directives for the separate account, USAID had 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.

In collaboration with the Central Bank, USAID/Costa Rica developed the following procedures for the functioning of the Separate Account and the accounting of ESF dollar disbursements:

Dollars under ESR agreements are disbursed through the Treasury's Electronic Funds Transfer (EFT) to a separate account maintained by the Central Bank.

The dollars deposited into the special account are to be used by the private sector for essential imports (raw materials, intermediate goods, spare parts, etc.) from the United States. The ESR VII Agreement will include a list of items that cannot be imported with financing from ESR monies.

Reimbursement for specific import transactions financed with the GOCR's foreign exchange reserves will be allowable from the separate account. Foreign exchange is approved for all imports by the Central Bank and their computerized import approval system uses NAUCA codes that is capable of producing a listing of imports from the United States by a date range and eligible NAUCA codes. The Mission is allowing TCIP guaranteed transactions so long as the GOCR has paid off the line of credit at the commercial bank and has eliminated the contingent liability of double financing. Moreover, the Mission has reviewed and determined that the Central Bank's system for approving foreign exchange and maintaining documentation supporting their approval is reliable.

To request reimbursement from the separate account, the Central Bank will provide the USAID with a request for reimbursement supported by a certified report of eligible imports. The imports listed in the report will total at least 110% of the value of funds for which reimbursement is being sought to facilitate the review process should ineligible items be discovered during the USAID's review. Upon receipt of the report from the Central Bank, the Mission will satisfy itself through a review of documentation on file at the bank that the report contains eligible transactions equal to the disbursement plus estimated interest earned on funds deposited in the separate account for which we can reimburse the GOCR.

Documentation reviewed at the Central Bank to determine eligibility of the reimbursement includes, (1) the application and approval of foreign exchange, (2) supplier's invoice, (3) Bill of Lading, (4) póliza of customs indicating the commodity's entry into the country, and (5) evidence of payment. This documentation will be retained by the Central Bank for a period of three years and will be avilable to USAID, or its representative, for purposes of audit.

ANNEX D

Ministerio de la Presidencia

DM-290-88
6 de junio de 1988

Señor
Deane R. Hinton
Embajador
Embajada de los Estados
Unidos de América
S. M.

Estimado señor Embajador:

Tengo el gusto de dirigirme a usted para solicitarle la continuación de los programas de asistencia económica con el Gobierno de los Estados Unidos de América para el año 1988. El Programa de Estabilización y Recuperación Económica de 1988 es un apoyo importante a los esfuerzos del Gobierno de Costa Rica por sentar bases firmes para un crecimiento económico sostenido.

Los recursos que se obtengan mediante este acuerdo posibilitarán la expansión de la economía al proporcionar divisas que permitirán mantener la capacidad de importación de los sectores productivos. Al mismo tiempo, fortalecerán las acciones del Gobierno a nivel macro-económico, que tienen por objeto, en cuanto al Sector Público, introducir los cambios necesarios que conduzcan a una mejora sustancial en la eficiencia y la calidad de los servicios públicos, y en cuanto al Sector Privado, fortalecer y modernizar la capacidad de los sectores productivos para responder adecuadamente a un crecimiento de la economía nacional basado en el incremento de la productividad y de su capacidad competitiva en los mercados internacionales.

Es intención del Gobierno fortalecer el proceso de inversión y promoción de exportaciones, promover la eficiencia y desarrollo del Sistema Bancario Nacional, tanto en la banca estatal como privada y continuar con el mejoramiento de la eficiencia del sector público, especialmente en el sistema aduanero y en el sector vivienda.

Los recursos que se obtengan a través de este acuerdo de asistencia econón serán utilizados por el Gobierno de Costa Rica tomando en consideración recomendaciones de la Comisión creada por Decreto Ejecutivo N° 18108-P, dentro marco del Plan Nacional de Desarrollo.

Nuestra intención es tomar las medidas necesarias para asegurar aprovechamiento de la ayuda que sea proporcionada en el VII Programa de Estabilizac y Recuperación Económica a más tardar el 1° de enero de 1989, para apoyar en for significativa tanto los esfuerzos y programas del sector público como del sector priva para consolidar el cambio estructural y el desarrollo de Costa Rica. Con el mismo fin asegurar el aprovechamiento de la ayuda, y en el ámbito de los compromisos adquiri por Costa Rica en el marco del Convenio General, estamos dispuestos a procurar al A.I. las facilidades que sean indispensables para desarrollar sus programas y actividades, to de acuerdo con el artículo II del referido Convenio.

Aprovecho la oportunidad para señalarle que como apoyo al programa económi del Gobierno, el directorio del Fondo Monetario Internacional revisó y ratifi nuevamente el programa con Costa Rica el pasado 4 de abril de 1988, programa que ri de 28 de octubre de 1987 a 31 de marzo de 1989.

Con el Banco Mundial, el Gobierno está haciendo todos los esfuerzos posibles pa que sean aprobadas las Leyes del Sistema Financiero en la Asamblea Legislativa, despu de lo cual el Sal II se someterá al conocimiento del Directorio de este organismo para discusión y aprobación.

Atentamente,

Rodrigo Arias Sánchez
Ministro de la Presidencia

ANNEX E

INITIAL ENVIRONMENTAL EXAMINATION

Project Location:	Costa Rica
Project Title:	Economic Stabilization and Recovey VII
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 1988.
Action:	Handbook 3, Chapter 2, Appendix 20, 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 86 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: ______________________
Carl H. Leonard
Mission Director
USAID/Costa Rica

ANNEX F

ESF Conditionality Compliance Status

Past conditionality included in the ESR II-VI agreements has consisted of one hundred and five 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 1987 detailed report on ESR conditionality the Mission concluded that compliance by the GOCR was generally very satisfactory. Sixty-six covenants which had been completed were formally closed. Compliance with the outstanding covenants continues to be satisfactory. There are no significant cases of GOCR non-compliance at the present time. The covenant of most concern is one from ESR VI that states that the Central Bank should continue the policy of allowing market forces to determine banking system interest rates in 1987 and 1988 and to supply AID with a quarterly report on banking system interest rates. In the second half of 1986, the Central Bank began to allow banks, both state-owned and private, as well as private finance companies to freely set their rates on both deposits and unsubsidized loans subject to the following two constraints: (1) the minimum lending rate could not be lower than their six-month deposit rate; and (2) the maximum lending rate could not exceed their six-month deposit rate by more than 10 percentage points. This spread was reduced to 9 percent in 1987. The Central Bank continued with this policy and banks have been setting interest rates according to this mechanism. In late 1987, however, the Minister of Finance announced that the four state-owned banks, the Central Bank and the Ministry of Finance had "agreed" to reduce their interest rates on term deposits, stabilization bonds and fiscal bonds, e.g. interest rates on six month deposits were reduced from about 23-25% to 21%; and interest rates on six month stabilization bonds and fiscal bonds were reduced from about 23% to 21.5%. The Mission interpreted this action as a violation of the spirit of this covenant; however, the Central Bank President subsequently assured USAID that interest rates in Costa Rica were positive in real terms and that the Central Bank was not setting the interest rates, but that there is some coordination. Given this explanation and subsequent reports from the GOCR, this is not considered a case of substantive non-compliance. The covenant has been altered slightly in ESR VII to say that the state banking system interest rates in 1988 will be positive in real terms.

The Mission's detailed semi-annual report on ESR covenant compliance was submitted to AID/W in early April, 1987.

The following text regarding ESF conditionality and GOCR compliance is exerted from an October 1987 report, "Costa Rica Cash Transfer Evaluation", carried out by Robert R. Nathan Associates, Inc.: "Table

Table III-2. ESR Policy Covenants by Policy Category
(Number of covenants)

	ESR I	ESR II	ESR III	ESR IV	ESR V	Totals
<u>Production and Private Sector Development</u>			<u>3</u>	<u>6</u>	<u>7</u>	<u>16</u>
Price structure			1			1
CODESA divestiture			2	6	7	15
<u>International Trade Performance</u>		<u>5</u>	<u>8</u>	<u>3</u>	<u>5</u>	<u>21</u>
Foreign exchange availability		2	2	2	2	8
Exchange rate		1	1	1	2	5
Export promotion		2	5		1	8
<u>Fiscal Sector</u>		<u>10</u>	<u>15</u>	<u>8</u>	<u>12</u>	<u>45</u>
International capital flows			1	1	1	3
BCCR-Credit availability		10	9	5	9	33
Interest rates		5	2	2	2	9
<u>Employment and Equity</u>		<u>1</u>	<u>2</u>	<u>1</u>	<u>1</u>	<u>5</u>
Housing		1	2	1	1	5
<u>Other</u>		<u>6</u>	<u>4</u>	<u>2</u>	<u>5</u>	<u>17</u>
Infrastructure			1			1
IMF related		2		1	2	5
Administrative req.		4	3	1	3	11
Totals	0	22	32	21	30	105

policy category. Nearly one-half of the covenants are in the financial sector, with 33 of the total of 105 covenants relating to Central Bank of Costa Rica (BCCR) credit allocations and ceilings. The covenants either increase or maintain credit levels available to private sector enterprises by specifying dollar equivalent credit amounts for private credit lines or the BCCR credit program. Some of the credit-related covenants deal with reporting requirements to AID or exclude specific entities from receiving credit to cover subsidy losses. Completing the financial sector category are 9 covenants on interest rate levels and 3 covenants relating to the implementation of the Price Checking Unit established to prevent capital flight from Costa Rica.

There have been 21 ESR covenants supporting international trade performance, approximately equally divided between the objectives of (1) allocation of foreign exchange to the private sector in the amount of ESR resources, (2) progress toward exchange unification, and (3) the encouragement of exports through various promotion efforts.

Another important group of covenants, 15 in total, established target dates for divestiture of CODESA interests in specifically-named public sector enterprises. ESRs II through V have each had a covenant directing credit to low-income housing. There was an additional covenant issued under ESR III requiring municipal water and sewage systems to be constructed or improved in order to supplement credit to the housing sector.

Other covenants, 16 in total, are administrative in nature. They direct local currency deposits to particular accounts or specify reports to be supplied to AID. Of the 16 covenants, 4 are related to providing AID copies of reports sent to the IMF. One covenant under ESR II required that Costa Rica negotiate and implement an IMF standby arrangement.

Record of Compliance

The GOCR's overall record of compliance with the conditions and covenants of the Cash Transfer Program has been good, in part because USAID/CR has been flexible enough to modify them as changes in economic conditions have made it necessary. The GOCR's performance is now closely monitored by a computerized system, which reports that the great majority of conditions have been satisfied. More importantly, those with highest priority, including the unification and correct valuation of the exchange rate, promotion of private sector banking, maintenance of positive real interest rates, and diverstiture of public sector entities, have been met and maintained. The relatively few cases of non-compliance center mainly on a failure to meet deadlines or to provide reports. For example, meeting conditionality deadlines of divestiture for CODESA public sector enterprises is still a problem.

Some conditions have been modified because of a lack of practicality or feasibility, and have been complied with in most cases.

For example, ESR III included major conditionality with respect to credit and interest rates, limiting credit allocation to a maximum of three subsidized rates as opposed to five, as in previous years. As a result, the GOCR reduced the number of credit limits to 23, as opposed to some 53 subclassifications in 1983. By February 1985 there were only three broad categories; allocation of subsidized credit, productive activities and unproductive activities (i.e. commerce, utilities, personal credit). With these exceptions, detailed credit allocations have been substantially eliminated.

Following is an analysis of GOCR policy reforms by policy category as related to AID CT conditionality.

Private Sector Development

The AID ESF program is supporting the transfer of ownership of some major budget-draining state enterprises of CODESA (a state-owned holding company) to the private sector. Major subsidiaries of CODESA are being sold, dissolved or liquidated. They include ALUNASA, an aluminum plant, recently acquired by the private sector; CATSA, a sugar refinery to be transferred to a cooperative in March 1988; and 40% of CEMPASA, a cement plant, which has been put up for bid. This divestiture is expected to be concluded by June 1988. The government is also examining ways to cut public sector employment by transferring some activities and services to cooperatives formed by employees currently performing these services.

CINDE, a private sector industrial promotion agency, was created by ESR I. It has been quite successful in terms of promoting new investment in and exportation from Costa Rica. In terms of public sector policy dialogue, however, CINDE has not been able to accomplish much.

Price subsidies for rice, corn, beans and sorghum account for about 10 % of the value of agricultural production. These subsidies led to rice production in excess of domestic market demand. 1/ Basic grains were sold at prices below cost and large financial losses incurred by the state marketing agency (CNP) were funded by the Central Bank. Price supports still exist for numerous crops, and they generally favor large farmers. 2/ Public authorities still control the market prices of many agricultural and industrial commodities.

1/ Removal of rice from the CNP was a major step towards removing subsidies.

2/ Public sector expenditures in agriculture indicate a sharp rise in relation to GDP, from 4% in 1975 to 22% in 1985. Subsidies make up a substantial portion of the rise.

In general, the liberalization of the Costa Rican economy and the promotion of private sector activities on the part of the GOCR are due largely to policy dialogue with AID.

International Trade

In October 1983, the Central Bank unified the exchange rate and implemented a crawling peg system, with the degree of devaluation derived from a formula relating rates of inflation in Costa Rica with those of its major trading partners. From December 31, 1984 through September 25, 1987, the colon was devalued 59 times and the exchange rate increased by 50% from 43.65 colons to the dollar to 65.35. The official exchange rate remains fixed at 20.0 colons to the dollar, but it is used only for a tiny fraction of all foreign exchange transactions. This policy reform was taken after extensive dialogue with AID and IBRD representatives.

A reduction of nominal import tariffs in January 1986 brought down the average tariff to 65%, with effective protection ranging from 50 to 150 percent. Continued reduction of import tariffs is currently under negotiation for the World Bank SAL II. Efforts are being made to lower nominal tariffs to a 40% average and the effective rate of protection to 75% average, over a three-year period. Costa Rica is currently negotiating to become a full member of GATT.

In addition, Costa Rica is actively working to expand non-traditional exports to markets outside the Central American Common Market (CACM). Special policy changes include establishment of an "export contract" under which the investor receives an agreed set of incentives including negotiable tax credits, exoneration from income tax and exemptions of import duties and some taxes on locally purchased inputs. Costa Rica, under a condition of the current ESF agreement, is presently reclassifying its tradeable to achieve consistency with the Brussels nomenclature in order to open its non-traditional exports to more world markets. It has also set up a price-checking unit to prevent overinvoicing of imports and underinvoicing of exports.

Fiscal Reform

The major element of AID CT conditionality aimed at progressively reducing public sector deficits has been achieved, in that the deficit as a proportion of GDP has dropped for the past five years. The GOCR has reduced the total public sector deficit from 14.6% of GDP in 1982 to 5.3% in 1986. Excluding Central Bank losses, the public sector deficit stood at only 1.5% of GDP in 1986. This reduction represents a major accomplishment toward achieving economic stability. The IMF's efforts to curtail the growth of public sector employment, with its high wages, have not been as successful, however. In other areas, AID-led efforts for the privatization of CODESA represent a continued effort to curtail the drain of non-financial public institutions. While the CODESA scheduling deadlines have often not been met, divestitures are taking place.

Failure to meet the dealines is probably due to unrealistic scheduling in the first place.

Monetary Policy and Financial Market Reform

Since 1984 the Central Bank has been liberalizing the financial system. Nonmarket credit allocation (e.g. credit ceilings and allocative credit categories) has been replaced with more market-oriented mechanisms (e.g. changes in reserve requirements on bank deposits, open market operations and, most importantly, positive market-determined interest rates). Private and state-owned banks are now free to allocate credit and set interest rates on most deposits and loans. Some credit (less than 15% of the total) is still allocated by state-owned banks at subsidized rates, with the requirements that the highest rate charged on loans cannot exceed the lowest rate by more than 8 percentage points. Limits are being placed on expanding subsidized credit.

The availability of funds to the private sector banks has enhanced the competition among state-owned and private banks, and there is a movement to make the system more competitive by expanding the types of financial instruments which the private banks can issue. USAID/CR has also supported passage of legislation authorizing the creation of the National Housing Mortgage Bank.

Employement, Equity and Basic Needs Reform

Public policy toward employment, equity and basic needs has not been addressed directly by the AID CR program, though the actual economic trends impacted by the program certainly show improvements in those areas. See Chaper V and Appendix B.

Policy Dialogue

The above discussion indicates that AID, as a part of a joint international/GOCR effort, has made substantial positive impact on Costa Rican economic policies. Comparison of IMF, World Bank and AID covenants and conditionalities indicates a coherent and comprehensive policy reform process aimed at correcting an unstable economic structure, but in such a way as to minimize the adjustment costs. The Government of Costa Rica has been a full partner in this process at the level of policy dialogue. In fact, the evaluation team was able to directly confirm the level of GOCR participation in the process by interviewing many of the major Costa Rican participants. In great part, AID has encouraged and enabled policy reform that the GOCR would have liked to implement in any event, but may have lacked the international reserves and/or political will to do so.

3(A)2 - NONPROJECT ASSISTANCE CHECKLIST

The criteria listed in Part A are applicable generally to FAA funds, and should be used irrespective of the program's funding source. In Part B a distinction is made between the criteria applicable to 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? HAS STANDARD ITEM CHECKLIST BEEN REVIEWED?

A. GENERAL CRITERIA FOR NONPROJECT ASSISTANCE

1. FY 1988 Continuing Resolution Sec. 523; FAA Sec. 634A. Describe how authorization and appropriations committees of Senate and House have been or will be notified concerning the project.	Congress has been notified through the FY 88 Congressional Presentation.
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 pre-conditions for obligation are necessary.
3. FAA Sec. 209. Is assistance more efficiently and effectively provided through regional or multilateral organizations? If so, why is assistance not so provided? Information and conclusions on whether assistance will encourage developing countries to cooperate in regional development programs.	No

4.	FAA Sec. 601(a). Information and conclusions on whether assistance will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use of cooperatives, credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture, and commerce; and (f) strengthen free labor unions.	The assistance will increase international trade, foster private initiative and competition, and improve the efficiency of industry, agriculture and commerce.
5.	FAA Sec. 601(b). Information and conclusions 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).	Via this balance of payments assistance, U.S. markets for Costa Rican products will be expanded and U.S. private investment and trade in Costa Rica will be enhanced.
6.	FAA Secs. 612(b), 636(h); FY 1988 Continuing Resolution Secs. 507, 509. Describe steps taken to assure that, to the maximum extent possible, foreign currencies owned by the U.S. are utilized in lieu of dollars to meet the cost of contractual and other services.	Agreements with GOCR encourage use of local currencies for local needs.
7.	FAA Sec. 612(d). Does the U.S. 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 procedures for the awarding of contracts, except where applicable procurement rules allow otherwise?	N/A
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

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(e). 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 at least 50 percent of such local currencies be available to support activities consistent with the objectives of FAA sections 103 through 106? — Yes/Yes

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

e. FY 1988 Continuing Resolution. If assistance is in the form of a cash transfer: (a) are all such cash payments to be maintained by the country in a separate account and not to be commingled with any other funds? (b) will all local currences that may be generated with funds provided as a cash transfer to such a country also be deposited in a special account to be used in accordance with FAA Section 609 (which requires such local currencies to be made available to the U.S. governnent as the U.S. determines necessary for the requirements of the U.S. Government, and which requires the remainder to be used for programs agreed to by the U.S. Government to carry out the purposes for which new funds authorized by the FAA — Yes would themselves be available)? (c) Has Congress received prior notification providing in detail how the funds will be used, including the U.S. interests that will be served by the assistance, and, as appropriate, the economic policy reforms that will be promoted by the cash transfer assistance? Yes

f. FY 1988 Continuing Resolution. Have local currencies generated by the sale of imports or foreign exchange by the government of a country in Sub-Saharan Africa from funds appropriated under Sub-Saharan Africa, DA been deposited in a special account established by that government, and are these local currencies available only for use, in accordance with an agreement with the United States, for development activities which are consistent with the policy directions of Section 102 of the FAA and for necessary administrative requirements of the U. S. Government? N/A

2. Nonproject Criteria for Development Assistance N/A

a. FAA Secs. 102(a), 111, 113, 281(a). Extent to which activity will (a) effectively involve the poor in development, by expanding 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 countries and the improvement of women's status; and (e) utilize and encourage regional cooperation by developing countries?

b. FAA Secs. 103, 103A, 104, 105, 106, 120-21. Is assistance being made available (include only applicable paragraph which corresponds to source of funds used; if more than one fund source is used for 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, 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 programs explicitly addressing the problem of malnutrition of poor and vulnerable people; and (c) extent to which activity increases national food security by improving food policies and management and by strengthening national food reserves, with particular concern for the needs of the poor, through measures encouraging domestic production, building national food reserves, expanding available storage facilities, reducing post harvest food losses, and improving food distribution.

(2) [104] for population planning under Sec. 104(b) or health under Sec. 104(c); if so, 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 outrearch.

(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, and 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 of developing countries in such disciplines as are required for planning and implementation of public and private development activities.

(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 research on and development and use of small-scale, decentralized, renewable energy sources for rural areas, emphasizing development of energy resources which are environmentally acceptable and require minimum capital investment;

The fol'owing analysis is provided as requested during the strategy update review of March 28/29, 1988.
The pipeline balance is as of 3/31/83.

ACTIVE LOCAL CURRENCY (MOUs)
PROJECT 515 - 0166
(₡000) 1/

MOU No.	Implementing Institution	Description	Mortgage	Pipeline	Comments
6	INCAE	INCAE Endowment Fund.	-	-	Although all funds are disbursed, Mission continues with intensive mgmt.
17A	INCAE	Endowment Fund.	-	-	All funds have been disbursed to a Trust Fund which is now financing oil palm cooperative development project. Mission is intensively managing that project.
17B	UACA	Endowment Fund.	-	-	All funds have been disbursed to a Trust Fund which is now financing oil palm cooperative developmen project. Mission is intensively managing that project.

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?. Implementing Institution	Description	Mortgage	Pipeline	Comments
Escuela Para Todos AEPT	Endowment Fund.	–	–	All funds have been disbursed to a Trust Fund which is now financing oil palm cooperative developme[illegible] project. Mission is intensively managing that project.
Salvation Army (ESCR)	Endowment Fund.	–	–	All funds have been disbursed to a Trust Fund which is now financing oil palm cooperative developme project. Mission is intensively managing that project.
MINEX/PNUD	MINEX's invest.& export promotion.	–	–	PACD 5/31/88.
ogram Trust Funds				
nt USAID	WBinford services.	–	1,525	PSC advisor to Training for Private Sector Development Project.
.C.Ag. USAID	Support to USAID Activities.	–	3,883	To be fully disburse[illegible] in 1988.

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MOU No.	Implementing Institution	Description	Mortgage	Pipeline	Comments
P.I.L. No. 7	Northern Zone Infrastructure	Housing and offices construction.	-	781	Additional Counterpart to Loan 041.

1/ Figures are provided in local currency units because they were deposited in the Special Account at varying times and at different exchange rates. Converting the funds at the current exchange rate does not give the correct sense of the amounts of money originally involved; however, if desired the reader should use an exchange rate of ¢43.10/$ to have a general idea of the dollar equivalent involved.

ACTIVE LOCAL CURRENCY (MOUs)
PROJECT 515 - 0192
(¢000) 1/

o. Implementing Institution	Description	Mortgage	Pipeline	Comments
ABC	BCCR's computer system.	1,500	4,027	Activity has been completed and is awaiting final disbursement.
MOPT/INCOP	INCOP Capital Invest.	-	-	Final audit in proces
MOPT/JAPDEVA	JAPDEVA Capital Invest.	-	300	Final audit in draft.
IFAM	Water & Sewage Systems.	-	87,437	Activity will be completed in Sept. 1988.
UNDP/MIDEPLAN	Econ. and social studies.	-	19,042	Being implemented by MIDEPLAN.
USAID/GOCR/	EARTH School.	-	2,880,694	Majority of funds wil be transferred to EAR by mid CY 1988. Primarily endowment funds.
FEDECOOP/COFISA	Trust Funds financing Coffee diversification project.	-		Although funds have been fully disbursed, activity with participating cooperatives require intensive Mission management.

MOU No.	Implementing Institution	Description	Mortgage	Pipeline	Comments
17	ABC/BCCR	Price Checking Unit.	-	11,963	Activity being analyzed with BCCR to revise design based on experiences to date.
21	CATIE	Beneficiary of Trust established by MOU 16.	-	-	ROCAP managing this Activity.
21.1	FZC	Operating expenses.	-	2	Final audit in process.
24	ABC	ABC activit. in the BCCR.	-	1,162	Technical support to BCCR; will terminate in late CY 1988.
26	Centro Estudiantil Miravalles (CEM)	Beneficiary of Trust established in COFISA to finance housing construction.	-	-	Mission involved in oversight of housing activities.
25.1	CINDE	PROCAP.	-	43,366	Counterpart to DA funded Training for Private Sector Development.
34	USAID/UACA	Democracy books.	-	8,186	Request to extend PACD under review by Mission.
37	Fund. Omar Dengo	School Computers.	-	50,000	GOCR responsible for monitoring implementation.

9. Implementing Institution	Descript[illegible]	Mortgage	Pipeline	Comments
Funds Program				
g. USAID/SDF	To fund community projects.	–	4,009	USAID/Peace Corps Self help projects; funds will be disbursed in 1988.
Ag. USAID	Support to USAID Activities.	–	28,333	Local Currency PD&S-type activities funded with these resources.
Ag. USAID	Support to USAID Activities.	–	28,333	Local Currency PD&S-type activities funded with these resources.
Ag. USAID/ODC	Civic Action Activities.	–	354	Small community self-help activities; will be disbursed in 1988.
.Ag. USAID/TD	CAPS Program.	–	14,347	Counterpart to dollar project.
:.Ag. USAID/GDD	Disaster Preparedness Assistance.	–	4,641	Counterpart OFDA to dollar project.
:.Ag. USAID/PRD	Counterpart to PPAI.	–	2,794	Funds local currency costs to complement dollar resources.

Figures are provided in local currency units because they were deposited in the Special Account at varying times and at different exchange rates. Converting the funds at the current exchange rate does not give the correct sense of the amounts of money originally involved; however, if desired the reader should use an exchange rate of ₡45.25/$ to have a general idea of the dollar equivalent involved.

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ACTIVE LOCAL CURRENCY (MOUs)
PROJECT 515 - 0194A
(¢000) 1/

MOU No.	Implementing Institution	Description	Mortgage	Pipeline	Comments
6	CENDEISSS/CCSS	Construction activities.	-	5,000	Activity completed; final disbursement pending.
7	ASELEX/CAMARAS	Legislative information.	1,500	-	Funds are to extend ongoing democracy initiative program.
8	USAID/CIAPA	Econ.and social studies.	-	318	Will be completed in 1988.
9	NATIONAL COMMISSION	CODESA policy action.	1,250	3,709	Commission activities ended 4/30/88; funds represent final disbursements.
14	CINDE/PINDECO	Papaya Research Project.	-	3,372	Counterpart to T.A. project with USDA.
15	COOP.HOUSING FOUND.	Technical assistance.	13,000	18	Supports rural housing project financed under MOU 16.
16	MIDEPLAN/FEDEC./CHF/	Rural housing project.	-	11,880	PACD is 01/16/89.
19	MEP/PEACE CORPS	School Refurbishment.	-	49,265	Project started in 1987 with two year implementation schedule.

o. Implementing Institution	Description	Mortgage	Pipeline	Comments
CINDE	PROCAP.	–	17,335	Counterpart to Training for Private Sector Development Project.
am Trust Funds				
Ag. USAID/PPDE	Support to USAID Activities.	–	17,585	Local Currency PD&S type activities.

Figures are provided in local currency units because they were deposited in the Special Account at varying times and at different exchange rates. Converting the funds at the current exchange rate does not give the correct sense of the amounts of money originally involved; however, if desired the reader should use an exchange rate of ₡50.85/$ to have a general idea of the dollar equivalent involved.

ACTIVE LOCAL CURRENCY (MOUs)
PROJECT 515 - 0222
(¢000) 1/

MOU No.	Implementing Institution	Description	Mortgage	Pipeline	Comments
1(0194)	FINTRA/CODESA	CODESA divestiture.	-	2,030,550	Balance of funds expected to be disbursed by end of C 1988 or early CY 1989
1(0231)	BANHVI	BANHVI's housing program.	-	-	Initial disbursement made; two additional disbursement from future year funds are planned. Mission monitoring implementation closel
2	CINDE/CAAP/MIDEPLAN	CAAP program.	-	41,404	Operating budget for CAAP to be disbursed CY 1988.
3	COFISA	Housing project.	-	138,500	Long-term mortgages t be transferred to BANHVI by mid CY 198
5	UNDP/MIDEPLAN/GOCR	Export promotion.	-	18,510	Funds TA support to program in CINDE.
7	USAID/GOCR/ACORDE	ACORDE's program.	-	-	Umbrella PVO program Receives intensive Mission management.
8	CNE/UNA/UCR/ICE/CFIAA	Volcanic-Seismic Hazards.	-	6,540	Counterpart for AID/ (OFDA) funded projec

o. Implementing Institution	Description	Mortgage	Pipeline	Comments
MOPT/CNE	Bailey bridge in Limon.	-	3,500	To be completed in CY 1988.
MOPT/CNE	Bailey bridges in Cachi.	-	11,000	To be completed in CY 1988.
IESC	IESC technical assist.	-	16,160	Funds travel and per diem for IESC volunteers. Ongoing Mission activity.
USAID/GOCR/	EARTH School.	-	2,063,709	Funds for construction activities and other local currency costs. To be transferred to EARTH in CY 1988.
USAID/BCCR/	Special Line of Credit.	-	-	Ongoing credit line No new funds planned, but Mission monitors existing funds.

gram Trust Funds

.Ag. USAID/SDF	To fund community projects.	-	15,976	USAID/Peace Corps self-help activities with communities.

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MOU No.	Implementing Institution	Description	Mortgage	Pipeline	Comments
L.C.Ag.	USAID/ ODC	Civic Action Activities.	-	525	Small self help projects; will be disbursed in 1988.

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ACTIVE LOCAL CURRENCY (MOUs)
PROJECT 515 - 0231
(¢000) 1/

No. Implementing Institution	Description	Mortgage	Pipeline	Comments
BANHVI	BANHVI's housing program.	-	-	Balance of funds expected to be disbursed by end of [illegible] 1988 or early CY 1989
BCCR/GOCR	Transfer cover to BCCR losses.	-	732,350	Final transfer to tak[e] place in 2nd quarter [of] CY 1988.
CINDE/CAAP	CAAP Program.	76,422	-	Operating cost of program for 1988.
CINDE/PIE	PIE Program.	282,044	-	CY 1988 operating cost of the program.
[Pro]gram Trust Funds				
[illegible].Ag. [U]SAID/TD	CAPS Program.	-	70,979	Counterpart for dollar scholarship funds. Managed directly by the Mission.

1/ Figures are provided in local currency units beca[use they w]ere deposited [in] the Special Account at varying times and at differ[ent] exchange rates. Converting the funds at the current exchange rate does not give the [c]orrect sense of the amounts of money originally involved; however, if de[sired] the reader should use an exchange rate of ¢67.7[illegible] to have a ge[neral] idea of the dollar equivalent involved.

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