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

COSTA RICA

PROJECT PAPER

ECONOMIC STABILIZATION AND RECOVERY IX

AID/LAC/P-518

Project Number: 515-0245
Grant Number: 515-K-611

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CLASSIFICATION

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROGRAM ASSISTANCE APPROVAL DOCUMENT (PAAD)

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4. Date: MAY 1, 1990
5. To: AA/LAC, James Michel
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7. From: LAC/DR, Terrence J. Brown
8. OYB Increase: NONE
To be taken from: ECONOMIC SUPPORT FUNDS (ESF)
9. Approval Requested for Commitment of: $ 60,000,000
10. Appropriation Budget Plan Code: LES090-35515-KG31; 070-65-515-00-50-01
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15. Commodities Financed

16. Permitted Source		17. Estimated Source
U.S. only		U.S.
Limited F.W.		Industrialized Countries
Free World		Local
Cash	$60,000,000	Other

18. Summary Description

The purposes of the Program are to support economic stabilization efforts in Costa Rica and to encourage policy, structural and sectoral changes which will facilitate sustainable economic growth. Up to $33 million of the $60 million grant will be used in connection with an IMF-administered, commercial debt reduction program. The balance will be used to finance private sector imports from the United States of eligible raw materials, capital goods and other productive inputs. All ESF dollars will be initially deposited in a separate, non-commingled account or accounts in the U.S. Transfer to the IMF-managed contribution fund and payments for eligible foreign exchange transactions will be made from this account.

Before disbursement of the initial ($33 million) tranche, the GOCR will make a series of commitments to develop and execute an acceptable economic program for 1990. Prior to disbursement of the second ($27 million) tranche, the GOCR will meet specific performance objectives which will be included in the Program Agreement and will be based on the policy agenda outlined in the PAAD.

The Central Bank of Costa Rica will deposit in a separate, non-interest bearing account the colon equivalent of each dollar disbursement calculated at the highest rate of exchange which is not unlawful in Costa Rica on the date of the disbursement.

19. Clearances	Date
LAC/DR/CEN:MSilverman	5/3/90
ARA/ECP:DMarshall	5-3-90
PPC/EA:JLaPittus	5-4-90
GC/LAC:MVelazquez	5/4/90
M/PFM/A:RBonnaffon	5/4/90
LAC/DP:BSchouten	5/4/90
DAA/LAC:ESchieck	

20. Action

☒ APPROVED ☐ DISAPPROVED

Authorized Signature: James H Michel
Date: 5/7/90
Title: ASSISTANT ADMINISTRATOR, LAC

AID 1120-1 (5-82)

CLASSIFICATION

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 Verification Policy Implementation Guidance.

E. Cecile Adams, Controller, LAC

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I. SUMMARY AND CONCLUSIONS

A. Summary

This document requests authorization of $60.0 million in Economic Support Funds for the 1990 Economic Stabilization and Recovery IX program to be provided as a cash transfer to the Government of Costa Rica. While the Costa Rica ESF total is $63.544 million, USAID and the GOCR have agreed that $2.0 million will be used for the Central America Peace Scholarship program (CAPS) under the CLASP II Project and $1.544 million for the Policy and Training Support (PATS) Project. The ESF balance of payments assistance will be used to support the Costa Rican economic stabilization and structural adjustment program. It will disburse against appropriate program benchmarks in the implementation of a sound economic stabilization and structural adjustment program. We propose that the eligible uses of the funds disbursed include a debt buy-back at the cost of the debt reduction program recently concluded by the GOCR with its commercial bank creditors. The balance would be used for essential imports from the U.S. -- i.e., raw materials, spare parts, and intermediate and capital goods required by the Costa Rican productive private sector. An amount of local currency equivalent to the $60 million program will be made available by the GOCR for activities consistent with the U.S. and GOCR development strategies for Costa Rica. However, the local currency equivalent of the debt buy-back program will likely be applied for demonetized uses, such as retiring losses of the Central Bank. Local currency may also be used to assist the GOCR in reducing the public sector deficit and in activities designed to reduce expenditures on a permanent basis. Authorization to obligate the entire $60.0 million is requested. Disbursements are planned in two tranches based on the Costa Rican implementation benchmarks described in Section VIII of this document. As the IMF Agreement expires on May 21, 1990, this establishes the outer limit to complete implementation of the debt buy-back portion.

B. Recommendations

1. That this PAAD be approved, authorizing the $60.0 million ESR IX program and that obligation of a grant for the entire $60.0 million in Economic Support Funds for Costa Rica be authorized, to be provided as a cash transfer;

2. That the disbursment plan in Section VI.B be approved, including the disbursement of $20 million remaining under ESR VIII as described in Sections VIII and VI.A;

3. That the Mission be authorized to vary the disbursement plan contained in Section VI.B. as required to maintain an even and rational flow of foreign exchange into Costa Rica.

BACKGROUND

A. Overview--Past ESF Program Rationale

Past ESF resources administered by AID have played a decisive role in the progress toward stabilization and recovery described below. These resources have enabled Costa Rica to meet the real import requirements of sustaining higher growth rates than would otherwise have been attainable. Equally important, they have been disbursed against appropriate benchmarks in the implamentation of an economic program that have been sufficiently credible to merit broad support from the International Monetary Fund and World Bank among others. Beginning in 1982, AID has signed ESR Agreements with Costa Rica for a total of $876 million, all of which has been disbursed except the final disbursement of ESR VIII for $20 million.

ASSISTANCE UNDER ESR I-VIII ($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
ESR VII	1988	GOCR		85,000	85,000
ESR VIII	1989	GOCR		85,000	85,000
TOTAL			$168,000	$708,067*	$876,067

* $65 million has been disbursed

Each of the previous ESR programs has been intended to support the implementation of Costa Rica's economic reform program. The dollars that have been disbursed have increased 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.

A.I.D.'s development strategy has been 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 a tradition of democracy and social justice that is unique to Central America, Costa Rica's economic and political success has been properly viewed as an essential element for 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 real wages and living standards and the instability in 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 ESF programs, A.I.D., in conjunction with other international donors, has supported a major adjustment effort accompanied by macroeconomic and structural reforms essential to achieving sustainable long-term growth. Past reforms have included a major reduction in the number of GOCR agencies, substantial liberalization in the financial system including a unified, market-based exchange rate, maintenance of positive deposit and lending real interest rates, a substantial reduction in the public sector deficit, passage of a monetary reform law which improved the competitive position of private banks in a state bank-dominated system; and privatization and/or liquidation of state owned enterprises.

Central to A.I.D.'s strategy has been the need to shift the Costa Rican economy from an import substitution strategy to one that emphasizes policies that promote efficiency in resource allocation. This, in particular, has meant elimination of the anti-export bias implicit in Costa Rica's tax system and in its monetary and exchange rate regime. A.I.D. policy reform efforts focused on removing inefficient constraints to private sector investment and production. As a result, private sector exports, particularly new, non-traditional exports (NTE) have expanded sharply. Reflecting this, NTE grew by some 17% per year over the past five years and averaging over 30% to non-Central American Common Market (CACM) countries during the same period. AID has sought to support policies that would encourage broad-based growth. Moreover, local currency program have emphasized increasing employment opportunities, housing, and improving educational opportunities.

During the period 1982-1989 U.S. economic and financial assistance totaled about $1.2 billion including development assistance, PL 480 food aid and the ESF cash transfers. All elements of the assistance package have supported the restructuring effort. The $876 million ESF program has represented the largest portion of the assistance package and has been directed at policy reform objectives. The Costa Rican ESF program currently consists of three basic elements:

Provision of dollar grant funds: The ESF program has been used to permit the Costa Rican private sector to finance imports from the U.S. In a small, open economy such as Costa Rica, these 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. In 1990, this category will be extended to include dollar funds necessary for the GOCR's debt reduction program.

Policy reform conditionality: Costa Rica, like many other developing countries, has needed to make major policy reforms in order to do a better job in achieving high and sustainable growth rates. It has needed to institute policies to effectively increase productivity, exports, savings, investment and social services. These policies have been designed to curb inappropriate subsidies and inefficient public and private sector operations. In general, policies to develop an efficient, market-oriented private sector had to be designed and implemented. Encouraging these policy reforms has entailed economic and political costs. The ESF program has been an effective means to support policy reforms whose benefits are delayed and where initial impacts may be adverse from the perspective of special interest groups.

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 through the auspices of a Bipartite Commission. This cooperation and programming process ensures that the local currency is used to support the the policy reform program and development objectives of A.I.D. and the GOCR (See Section VI).

B. U.S. Interests

Costa Rica's longstanding democratic tradition and peaceful nature are well known and unique in Central America. Its army was abolished in 1949, and its respect for human rights continues to be outstanding when many of its close neighbors have been 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, over 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 January 1984 report to then 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 economic crisis and political turmoil in neighboring countries severely tested Costa Rican institutions and 50 years of democratic traditions; the country has in large measure been able to withstand the challenges, as described below, to undertake some of the difficult policy and structural changes required to reestablish growth and prosperity. Such changes have taken place within a democratic process, and have been accepted peacefully by the Costa Ricans.

However, many of the policy and structural changes undertaken since the beginning of the Monge administration in May, 1982, continuing with the Arias administration in 1986, and others which are still required at the beginning of the Calderon era in 1990, represent a 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. Despite continuing foreign assistance budget limitations and growing worldwide competition for scarce development financing, continued U.S. assistance is being provided to advance the economic recovery efforts, and to reaffirm U.S. commitment to Costa Rica's democratic process.

C. Relationship to Mission Strategy

The ESR IX program conforms both to the Mission Strategy of May 1988 and Action Plan submitted to AID/W in mid-January, 1990. As stated in the Action Plan, balance of payments support is appropriate for Costa Rica given the need to reinforce and continue economic policy reforms emphasizing broad based and sustainable economic growth.

The Mission's principal strategic goal therefore is sustainable economic growth. The strategy for achieving this focuses on using the policy dialogue and disbursing program resources to support Costa Rica's economic policy reforms.

By emphasizing the elimination of the anti-export bias implicit in Costa Rica's historical policy framework, the strategy seeks to increase significantly Costa Rica's ability to earn the foreign exchange needed to underwrite its productive capacity and socioeconomic infrastructure. A principal emphasis has been on exploitation of efficient growth in nontraditional agricultural crops and industrial products.

The results are encouraging. NTE gains in both the agricultural and manufacturing sectors in the last five years have been impressive, averaging 17 percent per year. Growth in NTE to non-CACM countries has been even more impressive, averaging over 30 percent per year during the same period. NTE also account for a growing percentage of Costa Rica's foreign exchange from exports of goods and services, 37 percent in 1989, compared to 27 percent in 1985. The prospects for additional and even greater gains over the medium term appear reasonable, particularly if the GOCR continues to improve the macroeconomic policy climate and continues to reduce the still strong anti-export bias in its economic policies.

These achievements in turn have contributed to the solid economic recovery which Costa Rica has experienced since 1983 and a resurgence in the country's belief in its possibilities for continued longer term growth and development. GDP growth averaged 4-1/2 percent over the period 1984-88, even as Costa Rica implemented its major economic restructuring program. National confidence has been further enhanced by the November 1989 agreement with the commercial banks on a comprehensive debt reduction program (See Section V) and the well-publicized 100th anniversary of Costa Rica's constitutional democracy.

Important Mission policy dialogue themes of macroeconomic policy, debt management, and public sector involvement in the economy are closely related to the goal of sustainable economic growth.

Costa Rica's large debt burden ($4.2 billion, including $1.8 billion owed to private commercial banks), one of the highest per capita debt burdens in the world, has somewhat clouded the economic environment. Allowing U.S. dollars that are disbursed against appropriate progress benchmarks in Costa Rica's economic reform to be utilized for debt reduction makes good sense. It will enhance Costa Rica's creditworthiness by eliminating the debt overhang that continues to affect confidence in the economy.

As stated above, the principal emphasis of U.S. economic assistance to Costa Rica is to lay the basis for sustained economic expansion, particularly by supporting policies designed to improve the efficiency with which resources are allocated. Various inefficiencies within the public and private sector serve to undermine progress in preserving macroeconomic gains, in export and investment promotion, and in maintaining Costa Rica's social services, particularly education and health care. Thus, a focus on improving efficiency is a logical continuation of the basic strategy to achieve sustainability through policy dialogue as discussed in Section VII.

Another important and related strategy emphasis of the Mission is on a wider sharing of the benefits of growth through the integration of more Costa Ricans into an expanded market-based economy. This will provide the additional public resources needed to assist the GOCR in maintaining a high level of social services.

In fact, Costa Rica is already demonstrably superior to most developing countries in passing the benefits of growth to the poor majority. During the boom between 1961 and 1971, for instance income of the lowest half of the population grew by 80%, and income of the richest tenth grew by only 19%. During the same period, absolute poverty, measured by cash income, dropped from 51% to 20%.

The pattern is even more striking when non-cash benefits from GOCR social programs (e.g. education and health care) are added to the picture. Every year, Costa Rica -- which has no army -- devotes 60-70% of its budget to social programs, a level unmatched by any other developing country in the world. The benefits of this social spending are naturally skewed toward the poor. In 1982, for example, GOCR social spending directed to the lowest 20% of the population was equivalent to 87% over and above the cash income of that group.

The 1990 ESF balance of payments program for Costa Rica will underwrite the movement toward economic expansion in three ways. First, it will provide foreign exchange to maintain import capacity for economically productive activities. Second, it will disburse against the implementation of reforms that will enable higher growth to be achieved. Third, it will help provide commercial debt relief. Basic human needs of the poor Costa Rican majority will continue to be protected and supported in the process.

The Mission has identified three principal areas where we will focus our policy dialogue efforts in the context of the ESR program. As described in Section VI, policy dialogue being carried out by the Mission with the GOCR is taking place under the auspices of, though not limited to, a "U.S.-Costa Rica Bipartite Commission". It is also being discussed through the Consultative Group forum through the initiative of Costa Rican officials. The sectors for ESR IX conditionality emphasis are:

-- Macroeconomic/Financial Concerns
-- Public Sector Efficiency
-- Export Investment and Promotion

These areas of ESR IX conditionality and policy dialogue are discussed in Section VII.

III. ECONOMIC BACKGROUND

A. General

Costa Rica has implemented an economic reform program designed to reactivate the economy through eliminating the anti export bias inherited from a long history of policies which fostered an import substitution process. This program combined important economic policy measures with large inflows of economic assistance from abroad, mostly from the USG. At this point, the USG is gradually reducing its ESF assistance levels to Costa Rica and will be focusing more on sectoral programs in the areas of public sector efficiency, continued rationalization of foreign trade policies, and natural resources management, three priority areas of the GOCR. At the same time, it is expected that other donors, principally the World Bank and the Inter-American Development Bank, will step-up their assistance programs in Costa Rica. Private risk capital inflows will need to supplement foreign savings. Donor coordination, particularly within the context of the Consultative Group, is a top Mission priority.

Costa Rica offers an excellent example of the benefits of economic liberalization. Not only has the GDP increased rapidly but this has resulted in tremendous gains in private sector employment. At this time, the labor market situation can be characterized as one of full employment, with a very low unemployment rate and rising real wages. (See Graph 1). Consolidating the financial stabilization and structural adjustment program in Costa Rica in the next three to four years is essential to assure that the benefits derived from the US assistance program will be self sustaining, and to provide an important demonstration to other countries in the region of the economic and social benefits of market-oriented growth policies.

A number of factors are introducing some uncertainty in the immediate term. Although recent events in Panama and Nicaragua may have increased political stability in the isthmus, the full beneficial effect of these developments will not be felt in Costa Rica for some time. If the forecasted economic slowdown in the industrialized countries materializes it could have an adverse impact given Costa Rica's considerable reliance on markets in those countries. Furthermore, the political platform of the winning party included the promise of a massive subsidized housing program and other populist measures, which could weaken the delicate fiscal situation. The value of coffee exports, still about 30% of total export earnings is expected to be $240-$270 million in 1990, or 10-20% lower than in 1989. The support of AID and other donors will be crucial as the new GOCR administration attempts to maintain the policy reform effort on track and avoid policy reversals.

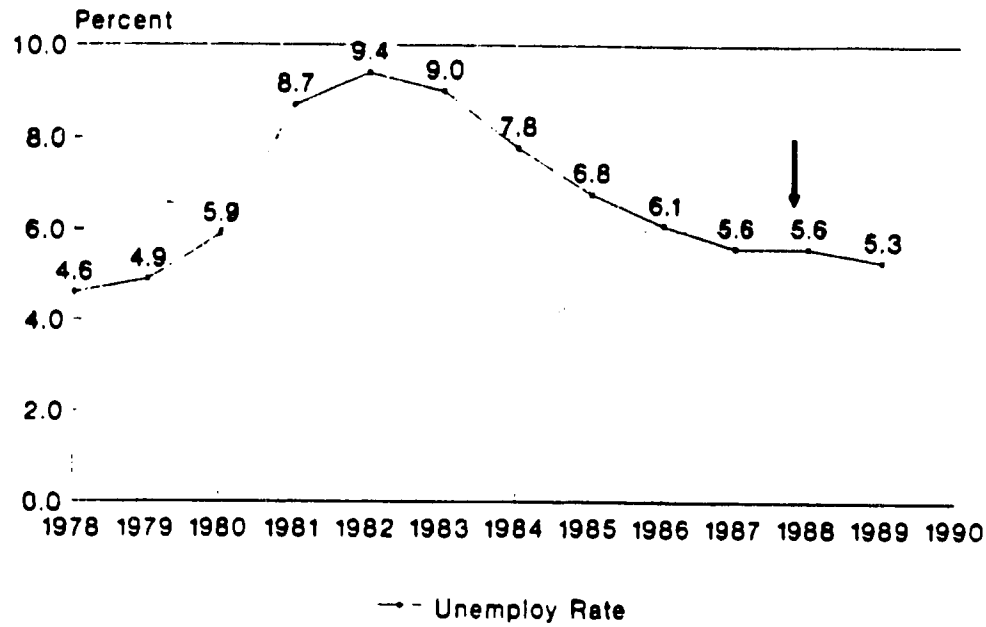
B. Output Trends

Long-Term Trends. In the period 1965 to 1973, GDP grew at an annual average growth rate of about 7%, one of the highest rates of growth of the region. The rate of growth slowed down in the period 1973-80, the consequence of the oil crisis and of the general slow-down of world economic activity. This lower rate of growth was fueled, moreover, through borrowing from commercial banks at hard terms. By 1980 the GDP stagnated and declined in 1981 and 1982 as foreign borrowing become increasingly costly and difficult to obtain. From 1983 onwards GDP growth rate has recovered. In no small measure, this has been a result of improved policies. Graph 2A summarizes the rates of growth of the GDP during the period 1965 to 1989.

The improvement in economic performance in the period 1983-89 was characterized by a substantial structural transformation of the economy. The most important features of that transformation are: the economy has become more open, with the ratio of exports of goods and non-factor services to total aggregate demand increasing from 0.25 in the period 1979-80 to 0.34 in the period 1988-89; private investment has increased steadily and has now reached in real terms a level similar to the level before the economic crisis (see Graph 2B); private employment has increased at a faster rate than public sector employment; and non-traditional exports have surpassed traditional exports in importance. In summary, Costa Rica has been highly succesful in reactivating the economy through the promotion of private sector activity, primarily for the production of non-traditional exports.

Graph 1

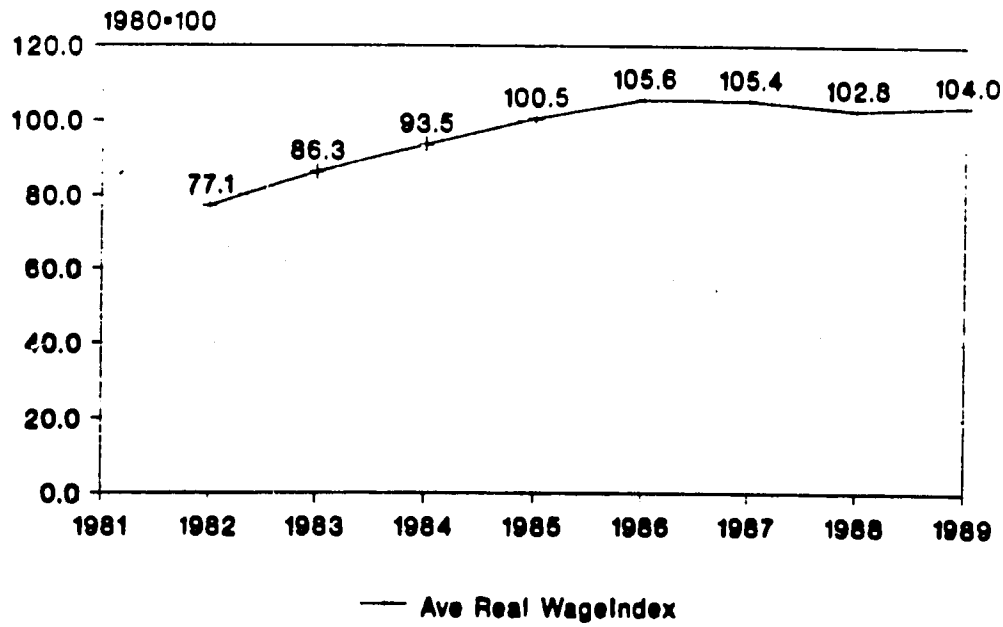
Unemployment Rate
1978-88



Source: La Academia de CentroAmerica

Note: The methodology changed in 1988

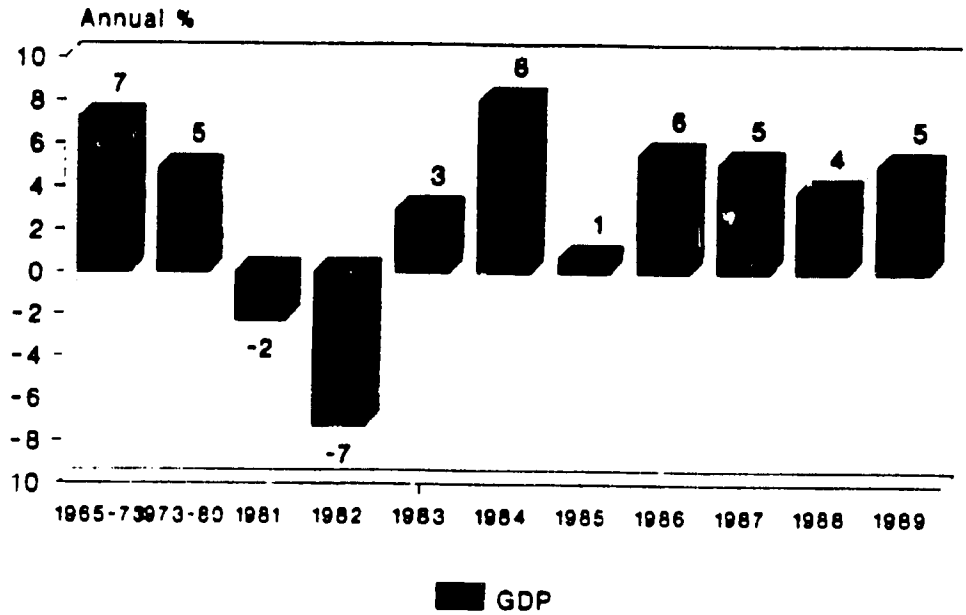
Private Sector Wage Index
1982-89



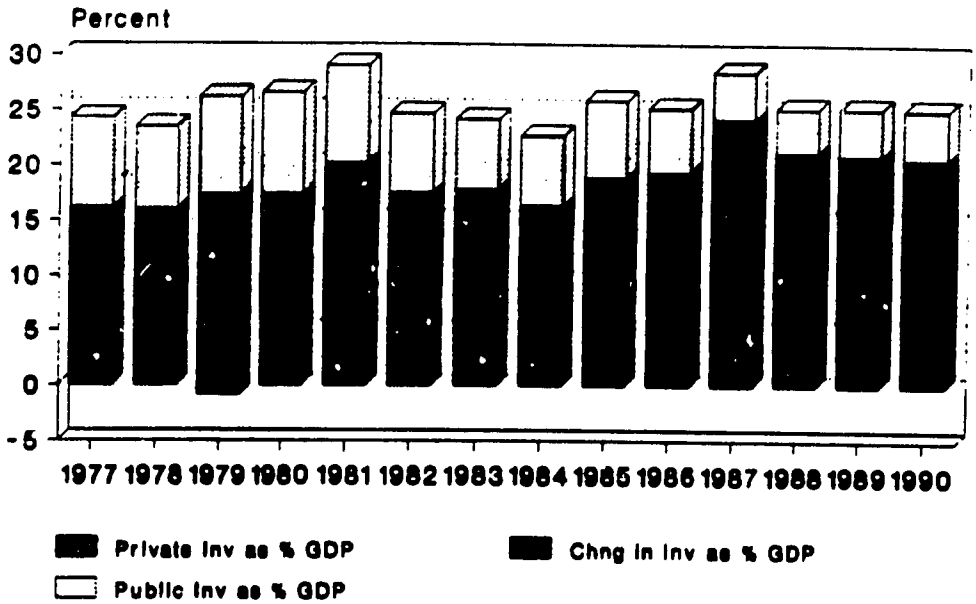
Source: La Academia de CentroAmerica

Graph 2

Annual GDP Growth Rates
1965-89



Investment
1977-1990



Source: National Accounts(BCCR)

Economic Growth in 1989. GDP grew by 5.0% compared to a target of 4.3% established in the economic program. Growth was well balanced across economic sectors: the only sectors which grew at less than 4% were real estate; electricity, gas and water; and general government. GDP per capita increased by 2.4%. The growth rates by sector were:

Agriculture	5.4
Manufacturing	4.5
Electricity and water	3.7
Construction	6.9
Government services	2.5
Other services	5.0

C. Financial Intermediation

During 1989 credit extended by the banking system to the private sector grew by 12% and total financed assets held by the private sector expanded by 21%. Most of the GOCR fiscal deficit was financed by heavy borrowing in the domestic capital market. Internal debt of the GOCR increased by 15,700 million colones. An indication of the magnitude of the internal debt is that it is almost as large as the expansion of deposits in local currency in the state-owned banks. Government participation in financial markets to such a degree reduces private sector access to credit, and has resulted in high real interest rates.

The Central Bank continued the financial liberalization process. It eliminated the ceiling on lending rates, allowing commercial banks to determine their own interest rates. Although a tight ceiling was imposed on the expansion of credit to private sector using domestic funds, (5%) there was no lending limit for commercial banks using external funds. Private credit increased by 6 percent in real tems, compared to a contraction of about 10 percent in 1988.

Reflecting the comparatively high interest rates offered on dollar deposits in Costa Rica, deposits in foreign currency rose by US$83 million. This can be explained by the Central Bank's policy objective to substitute private flows of foreign exchange for bank flows of foreign exchange. Dollar-denominated deposits have been increasing their participation in the total stock exchange transactions, from 23 percent in fiscal year 1987-1988 to 27 percent during 1988-1989.

The financial liberalization process has continued. The Central Bank announced that credit ceilings will not be established for 1990 and that money supply will be controlled by using open market operations and changes in reserve requirements.

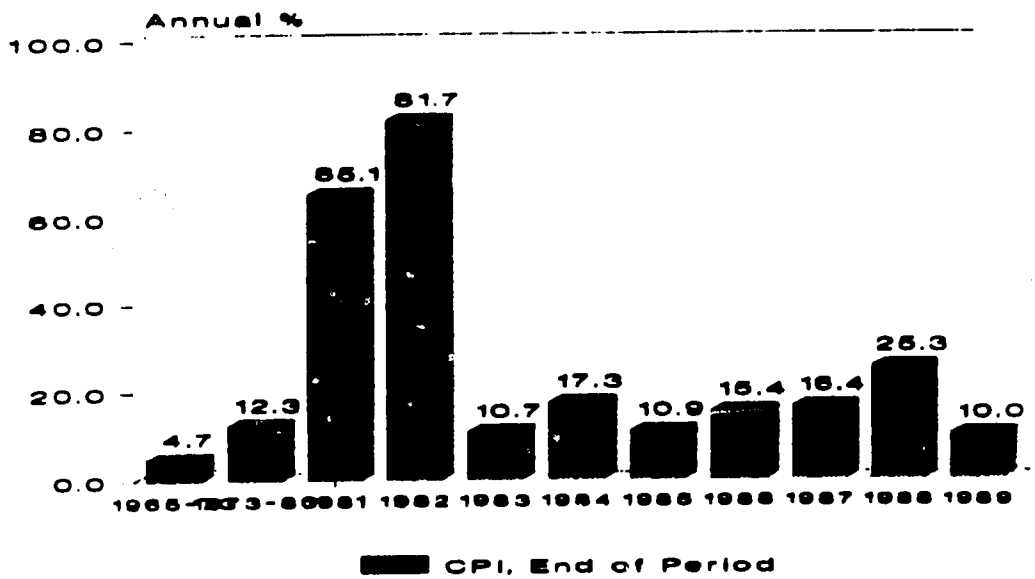
D. Inflation

After relative price stability in the period 1965-73, inflation accelerated to 12% per year in the period 1973-80. With the beginning of the economic crisis, inflation reached the unprecedented level for Costa Rica of 65% in 1981 and 82% in 1982. Since that time, inflation has been under 25%.

The buoyant performance in the real sector of the economy in 1989 was accompanied by moderate inflation as can be seen in Graph 3. The cost of living index increased by 10% from December 1988 to December 1989 while the average GDP implicit deflator increased by 14%. The moderate recorded inflation results partly from repressed inflation, as the prices of gasoline and other petroleum derivatives were not adjusted to account for changes in international prices, and some key public utility rates such an electricity and phone rates were not adjusted to compensate for cost increases. As these adjustments are made in 1990, they will be reflected in the cost of living index. Inflation could reach 20% in 1990.

Graph 3

Annual Inflation 1965-89



E. Exchange Rate Policy

Costa Rica devalued the exchange rate sharply in 1981 but from that year to 1983 the real effective exchange rate appreciated. In 1985 the authorities began to implement a crawling peg policy whereby the exchange rate generally is adjusted to compensate for the difference between the inflation rate in Costa Rica and that of its main trading partners. This policy was effective in maintaining and/or enhancing international competitiveness until 1988.

Mini-devaluations of the exchange rate continued during 1989 but have not been sufficient to compensate for domestic inflation vis-a-vis the inflation of Costa Rica's trading partners. Preliminary calculations of the real effective exchange rate show a slight loss of competitiveness (about 5%) by December 1989 as compared to December 1988. This situation will need to be addressed given the weakening in Costa Rica's external position in 1989. An adjustment of 20% in the exchange rate may be needed in 1990 given the expected deterioration in the terms of trade, and further reductions in tariffs through the 2nd World Bank Structural Adjustment Loan (SAL II).

F. Performance Under the IMF Stand-by Arrangement

We do not have the official data on performance under the IMF Stand-by Arrangement, but we have unofficial data which show that the ceilings generally were not met. As was expected, the limits on Central Government expenditures were exceeded by between 9,000 and 10,000 million colones, and this constituted the most significant deviation from the economic program. This will be discussed in detail in Section IV. Closely related to this, the domestic borrowing limits of the non-financial public sector were exceeded by about 8,000 million colones. Even though the arrears reduction fell short of target by about $40 million, the rise in capital inflows permitted an increase in net international reserves which was roughly in line with the target established in the economic program. This performance on net international reserves is even more remarkable if it is considered that the third tranche of FY89 ESF ($20 million) and the first tranche of the Japanese co-financing under SAL II (the equivalent of $35 million) were not disbursed in 1989 as had been programmed. Private capital inflows, including errors and omissions, were about $220 million, and this explains the strong international reserve position. Changes in net domestic assets of the Central Bank were roughly in line with the targets established under the economic program.

In summary, the program was characterized by a loose fiscal policy and a deficit that was financed largely by the non-bank public. The fairly tight monetary policy and the domestic finance of the deficit resulted in high interest rates, and these rates attracted significant foreign finance which enabled the GOCR to meet the net international reserve targets.

G. Evaluation of the Economic Adjustment Program.

The financial stabilization program used fiscal, monetary and exchange rate policies in a coordinated and coherent manner, and this is partially the reason why it was highly successful. Massive flows of assistance, mostly from the USG, were an important contributing factor to the success of the reform. As will be discussed in Section IV, public sector finances deteriorated in 1989 and constitute an important problem.

In the financial sector, private sector intermediaries enhanced their role, and became a major source of finance for exporters of non-traditional commodities. Interest rates are now highly positive and this has contributed to financial deepening. The administrative allocation of credit has diminished and the ceiling on interest rate spreads was eliminated. The level of subsidized credit has been maintained constant in nominal terms, and transfers must now be made from the Central Government to the financial institutions to compensate them for the costs of the subsidy, thus increasing transparency. On the negative side, the State-owned commercial banks maintain their monopoly on demand deposits and on access to Central Bank rediscount using domestic resources. Leveling the playing field between state-owned and private banks is important in order to increase competition and to reduce lending costs.

The unification of the exchange rate and the adoption a crawling peg system have increased the export competitiveness of Costa Rica. The nominal devaluation of the exchange rate has resulted in a devaluation in real terms which has been maintained even though there was a slight appreciation of the real effective exchange rate in 1989.

A program to rationalize commercial policy had as a target the reduction of the maximum rate of nominal protection to 40%, and the establishment of a tariff floor of 5%. Even if this is accomplished, effective protection would remain high, and Costa Rica could loose competitiveness vis-à-vis neighboring nations such as Honduras, El Salvador and Mexico, countries which have begun to implement a more rational commercial policy. The elimination of the anti-export bias which results from the protection of domestic industries must continue. Non-traditional exports have been encouraged through a system of subsidies (CATs), generous tax holidays, credit at below market interest rates, and subsidized investment promotion services. The non-traditional sector is the leading sector of the economy, and as it has a low tax burden, public sector finances will continue to be precarious. Although an infant industry type argument can be made to support a system of export subsidies, there is a need to limit the time that they are granted.

The structural adjustment program did not address the issues of public sector efficiency, and this remains one of the most important problems facing Costa Rica. The pension systems of the public sector and retirement system managed by the Caja Costarricense del Seguro Social have huge actuarial deficits and these represent a time bomb for the economy.

The structural adjustment program has not addressed the numerous microeconomic inefficiencies in the economy such as the ports system, transportation, etc. Some of these inefficiencies are the result of regulations which have been designed to provide high pecuniary benefits to a small group of individuals associated in the so called "gremios". As the costs of these privileges are diffused and borne by society at large, it is difficult to eliminate them. Costa Rica appears to be a quintissential rent seeking society, and this results in a misallocation of resources.

IV. MAIN ECONOMIC PROBLEMS

Economic performance in 1989 was characterized by rapid growth, low unemployment, moderate inflation, a larger than expected public sector deficit, and a marked deterioration in the balance of trade. The moderate inflation rate may reflect significant repressed inflation as the prices of key services and goods produced by the rate were not adjusted to reflect cost increases and the exchange rate was not adjusted to reflect fully the difference between the inflation in Costa Rica and the inflation of Costa Rica's trading partners. A sharp increase in imports, financed largely by private capital inflows, also helped to keep the inflation rate low.

The new administration is faced with the need to reduce the 1990 deficit and to make adjustments in public sector prices and in the exchange rate. These measures will probably result in an increase in inflation to about 20%, and will require a depreciation of the exchange rate during 1990 of up to 20%. While the effect might be to slow growth in 1990, it will prevent a sharp reduction in growth in the immediate future. The new administration faces four main problems: First, there is a need to address public finances to reduce the fiscal deficit in 1990,

implement a reform in the structure of public sector finances, and increase the efficiency of the public sector. Second, there is a need to restore international creditworthiness. The main objective is to conclude a debt reduction agreement with the commercial banks. Third, there is a need to rectify the deterioration in the balance of payments that occurred in 1989 and has become more pronounced during the first two months of 1990. Fourth, although the level and the dispersion of tariffs were reduced under the SAL I and the SAL II programs, there is a need to deepen this process in order to further reduce the anti-export bias, particularly now that other countries in the region which had lagged behind Costa Rica in the reform of commercial policy are now moving much faster.

A. Public Sector Finances

The public sector deficit increased in 1989 and unless adjustment measures are taken, the fiscal situation will worsen in 1990. This section analyzes trends in public sector finances from 1983 to 1988, it provides estimates of the deficit for 1989, presents projections of the deficit for 1990 if the government does not take measures to reduce spending (passive deficit), and quantifies the effects of different short term fiscal measures on the 1990 deficit. Possible medium term fiscal measures to improve the structure of public sector finances are then discussed. This includes the tax structure, and the elasticity of the tax system, and the issue of discretionary spending.

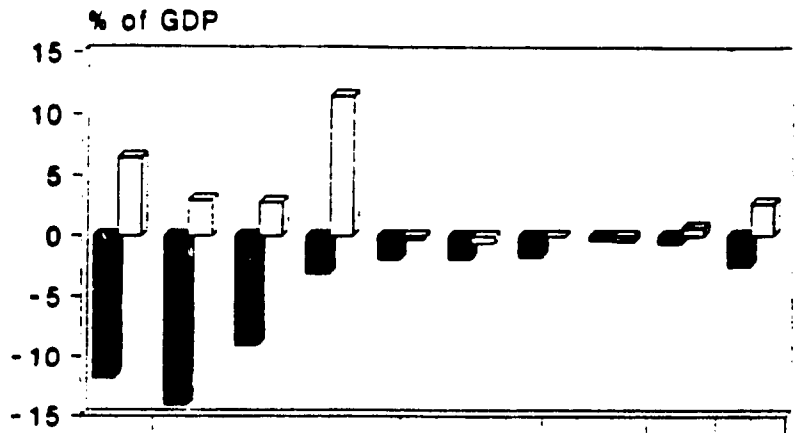
1. Public Finance Trends 1983 to 1988

The non-financial public sector (NFPS) of Costa Rica comprises the Central Government; about 100 decentralized agencies, of which the most important one is the social security system (CCSS); 84 municipalities; and 13 state-owned enterprises (SOEs), of which the most important are the state refinery (RECOPE), the electricity and telephone company (ICE), the state holding company (CODESA), the state marketing agency (CNP), and the social protection council (JPSSJ). The Central Bank, although not a part of the non-financial public sector, has carried out quasifiscal functions, financing the deficit of the public sector and acquiring some of the debt of the NFPS as part of the debt renegotiations with the commercial banks.

Overall Trends. The trends in the public sector deficit are summarized in Graph 4. The public sector deficit as a percent of the GDP declined steadily from 1981 until 1987, and there was a slight increase in the deficit in 1988. The general improvement reflected a decline in the ratio of expenditures to GDP, mainly the result of a decline in public investment. Current expenditures as a percent of GDP remained fairly constant. The decline in public investment and in maintenance expenditures has resulted in a marked deterioration of the physical infrastructure of the country.

Graph 4

Non-Financial Public Sector Deficit 1973-89



	73-80	81	82	83	84	85	86	87	88	89
Deficit	-11.8	-14.1	-9	-3.1	-1.9	-1.9	-1.7	-0.3	-0.6	-2.5
Domestic Borrowing	6.5	3	2.8	11.5	-0.3	-0.6	0	-0.4	0.7	2.7

Deficit Domestic Borrowing

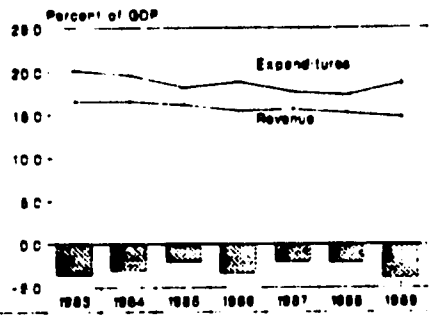
Central Government. The deficit of the Central Government declined from 3.6% of GDP in 1983 to 2.1% of GDP in 1988 (see Graph 5A). As will be discussed below, this trend was reversed sharply in 1989. The revenue of the Central Government, and particularly tax revenue, racorded a secular decline with respect to the GDP. Tax revenue as a percent of the GDP declined from 16.1 in 1983 to 14.2 in 1988. This relative decline in the tax burden is composed of two different trends: a sharp decline in taxes on foreign trade as a percent of GDP and a more or less stable relationship between domestic transaction taxes and GDP (see Graph 5B). While export taxes declined sharply, import duties as a percentage of GDP have increased (see Graph 5C). A reduction in the relative importance of foreign trade taxes is salutory as it reduces anti-export biases in the tax system. But the objective is not to do this at the expense of tax revenues necessary to provide public services in a non inflationary way.

Capital expenditures of the Central Goverment have declined from 3.9% of GDP in 1983 to 2.2% of GDP in 1988 as shown in Graph 5D. In contrast, Chile and Thailand have had levels averaging 6.5% and 3.7% GDP from 1982-1987 while sustaining high levels of GDP growth. Current expenditures in Costa Rica have remained at about 16% of GDP. The current expenditure categories which have shown the fastest rate of growth are interest payments on the domestic debt which increased from 5.5% of total expenditures in 1984 to 9.6% in 1988; and transfers to the private sector, which increased from 15% of total expenditures in 1984 to 25% of total expenditures in 1988. The fastest growing transfers to the private sector are the Certificados de Abono Tributario (CATs) and pension payments to retired public sector employees. Salaries remained a constant percent of expenditures (30%) during the period.

Graph 5

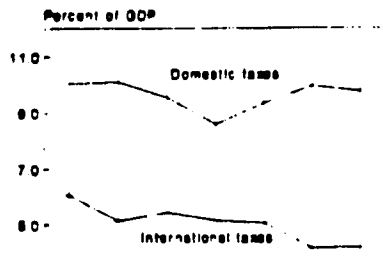
Central Government Finances

Central Government Operations



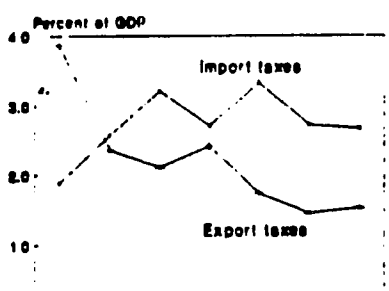
	1983	1984	1985	1986	1987	1988	1989
Revenue	18.6	18.6	18.2	15.6	16.7	18.2	14.6
Expenditures	20.1	18.6	18.2	18.8	17.7	17.3	18.6
Deficit	-3.6	-3.0	-2.0	-3.4	-2.0	-2.1	-3.9

Taxes on Domestic and International Transactions



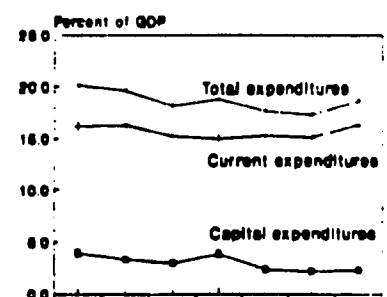
	1983	1984	1985	1986	1987	1988	1989
Domestic taxes	10.0	10.1	9.8	8.9	9.4	10.0	9.8
International taxes	6.1	5.1	6.4	6.2	6.1	4.2	4.2

Foreign Trade Taxes



	1983	1984	1985	1986	1987	1988	1989
Taxes on imports	1.8	2.6	3.2	2.7	3.3	2.7	2.7
Taxes on exports	3.9	2.4	2.1	2.4	1.7	1.4	1.6

Central Government Expenditures



	1983	1984	1985	1986	1987	1988	1989
Total expenditures	20.1	18.6	18.2	18.8	17.7	17.3	18.6
Current expenditure	18.2	16.3	16.2	16.0	16.3	15.1	16.3
Capital expenditure	2.9	2.3	2.0	2.8	2.4	2.2	2.3

Rest of the Non-financial Public Sector. The rest of the non-financial public sector is composed of the Caja Costarricense del Seguro Social (CCSS), the municipalities, about 100 decentralized agencies, and a number of state-owned enterprises (SOEs), of which the most important ones are the state owned oil refinery (RECOPE), the electricity and telephone company (ICE), the grain marketing agency (CNP), and an agency providing basic social services and which receives its financing from the proceeds of the national lottery (JPSSJ). These institutions of the rest of the non-financial public sector moved from a deficit position in the early 1980's to a surplus position by the end of the decade and they are presently an important source of finance of the Central Government, as several of those institutions "invest" their surpluses in Central Government bonds.

2. Fiscal Performance in 1989

Central Government. Official figures using the IMF methodology are not available at this time but the figures discussed in this section are based on the best data available as of February 28 1990. The deficit of the Central Government for 1989 has been estimated at 17,400 million colones. The data is summarized in Table 1.

The deficit is about double the amount agreed with the IMF as part of the Stand-by Arrangement. The revenue of the Central Government was fairly close to the estimates made by the IMF even though some revenues were significantly lower. For example, RECOPE transfers were 1,200 million colones less, transfers from public institutions to the Central Government were 400 million colones less, and the revenue from the coffee tax was 580 million colones less than forecasted. At the same time, the faster rate of real economic growth and the lower rate of inflation resulted in increased revenues from other sources and this compensated partially for the loss in revenue from RECOPE, from the public institutions, and the loss in coffee tax revenue.

The increase in the Central Government deficit in 1989 can be explained mostly by the high level of expenditures. Total Central Government expenditures were 9,000 million higher than was was envisaged in the IMF program. Fully two thirds of the difference can be explained by higher expenditures in interest payments on the domestic debt (2,400 million colones higher); wages and salaries (1,200 colones million higher); public sector employees pensions (1,200 million colones higher); and CATs (1,300 million colones higher).

Most of the institutions of the rest of the non-financial public sector performed poorly, with ICE being the most notable exception. Among these institutions, the one which performed the worse in relation to the IMF target was RECOPE, a result of not having adjusted local gasoline and other petroleum prices to reflect both externally and internally generated changes in costs. The RECOPE surplus was lower than what was envisaged and, in addition, it failed to transfer most of the 12% tax on gasoline to the Central Government. The rest of the non-financial public sector had a surplus of 6,900 million colones in 1989 compared to a surplus of 8,800 envisaged in the IMF program. Although the performance was not as good as expected, the deviation from the targets established in the Stand-by Arrangement was not as large as the deviation of the Central Government. Although some of

Table 1 - Public Sector Balance

	1988 act	1989 IMF	1989 est.	1990 proj.
Central Goverment				
TOTAL REVENUE	**53,750**	**65,530**	**64,600**	**72,700**
Expenditures				
Of which,				
Wages and salaries	18,765	22,540	23,735	28,360
CATs	1,790	n.a.	4,290	5,500
Pensions	n.a.	n.a.	7,850	10,300
Interes on domestic debt	4,900	n.a.	9,670	11,750
TOTAL Expenditures	**61.155**	**73,000**	**82,000**	**98,000**
Central Goverment Balance	**-7,405**	**-7,470**	**-17,400**	**-25,300**
Rest of Non-financial Public Sector				
CCSS	2,710	4,050	3,576	3,697
RECOPE	2,589	1,441	632	-1,808
ICE	2,228	2,500	2,500	1,473
CNP	-396	-273	-818	-473
JPSSJ	152	200	200	145
Subtotal of five agencies	7,283	7,918	6,090	3,034
Other NFPS	-1,791	858	858	1,040
TOTAL Rest of NFPS	5,492	8,776	6,948	4,074
Balance on Non-financial Public Sector	**-1,913**	**1,306**	**-10,452**	**-21,226**
Central Bank Balance	**-11,105**	**-12,866**	**-9,864**	**-11,960**
Of which, cash losses	-4,856	-10,381	-6,561	-7,191
PUBLIC SECTOR BALANCE	**-13,018**	**-11560**	**-20,316**	**-33,186**
PERCENTAGE OF GDP				
Central Goverment	-2.1	-1.7	-4.1	-4.9
Rest of non-financial public sector	1.5	2.0	1.6	0.8
TOTAL NFPS	-.05	0.3	-2.4	-4.1
Central Bank	-3.1	-3.0	-2.3	-2.3
TOTAL	-3.6	-2.7	-4.7	-6.4
Memorandum Item: GDP	358219	435100	428859	515000
GDP IMF program	358219	428859	428859	520000

these institutions face significant mid-term problems, principally the CCSS, the fiscal problem in Costa Rica in 1989 was essentially the result of rapid increases in Central Government expenditures, particularly in transfers to the private sector, rising domestic debt service, and increases in wages and salaries that exceeded inflation.

3. Fiscal Projections for 1990

Table 1 provides an estimate of the passive deficit for 1990, i.e. the deficit that would result if no additional revenue enhancement measures and expenditure reduction measures are undertaken. The deficit of the Cental Government would reach 25,000 million colones (4.9% of GDP), the surplus of the rest on the non-financial public sector would reach 4,000 million colones (0.8% of GDP), and the non-financial public sector deficit would then be 21,000 million colones (4.1% of the GDP). Including Central Bank losses, the deficit could reach ¢33 thousand million. The medium term projections of the IMF forecasted a surplus of 0.4% of GDP for the non-financial public sector for 1990. On this basis, Costa Rica needs a fiscal effort equal to 4.5% of GDP or 23,000 million colones. Such a fiscal effort in the short-run may now be unrealistic, particularly given the poor fiscal performance in 1989 and the lack of fiscal adjustment during the first three months of 1990. Possible masures to reduce the deficit are discussed below.

4. Potential Measures to Reduce the Deficit in 1990

Table 2 summarizes the different fiscal measures to reduce the deficit and improve the structure of public sector finances. They are classified by type according to whether they require administrative decisions (A) or whether they require legislation (L). Whenever appropriate, the fiscal effect of a low adjustment measure and a high adjustment measure are quantified.

These measures are: improved tax collections, particularly of the sales tax, which are quite possible without changes in legislation; raising the tariff floor from 5% to 10 or to 15% would reduce the dispersion of protection and will reduce effective protection, thus accelerating the structural adjustment program; raising the contribution to the pension plan by teachers was recommended by an actuarial study but may be diffcult to implement because of political considerations; the reduction in wages of 5% from the 1990 level basically means that the average wages of the public sector would remain constant in real terms, compared to the increase in real terms which took place in 1989; the reduction in other expenditures is possible, particularly if transfers are curtailed; the estimates of the revenue effect of public utility rate increases are based on the adjustment taking place April 1 1990, and delays would mean that the price increase would have to be higher; the cost reduction at CNP is deemed possible by the authorities; and the divestiture possibility is entirely speculative.

Table 2 - Potencial Fiscal Measures

Measures	Type	Low	High
Central Goverment			
Increase collection of sales tax	A	1,500	2,000
Raise the tariff floor from 5% to 10% July 1990	L	2,000	
Raise the tariff floor from 5% to 15% July 1990	L		4,000
Raise contributions to pension plan by teachers from 5% to 10% July 1990	L	500	500
Reduce wages and salaries of Central Goverment by 5%	A	1,400	1,400
Reduction in non-salary expenses (principally BANVI and other transfers)	A	2,000	4,000
Total Central Goverment		**7,400**	**11,900**
Of which, Revenue enhacement measures		4,000	6,500
Expenditure reduction measures		3,400	5,400
Rest of Non-financial Public Sector			
RECOPE prices increased by 30% April 1, 1990	A		4,500
ICE rates increased by 20% April 1, 1990	A	2,850	
ICE rates increased by 30% April 1, 1990	A		4,275
Cost reduction at CNP	A	400	400
ICAA rates increased by 20% April 1, 1990	A	200	
ICAA rates increased by 30% April 1, 1990	A		300
CODESA divestiture	A	500	1,000
Total rest of NFPS		**6,950**	**10,475**
Of which, Revenue enhancement measures		6,050	9,075
Expenditure reduction measures and divestiture		900	1,400
TOTAL PUBLIC SECTOR		**14,350**	**22,375**
Of which, Revenue enhancement measures		10,050	15,575
Expenditure reduction measures and divestiture		4,300	6,800
PERCENTAGE OF GDP			
Revenue enhancement measures		2.0%	3.1%
Expenditure reduction measures and divestiture		0.8%	1.3%

The effect on the deficit of implementing these measures is summarized in Table 3. The implementation of the Central Government measures could reduce the 1990 deficit of the Central Government from 25,300 million to between 13,400 to 17,900 million colones. The implementation of measures on the rest of the non-financial public sector would increase the surplus from 4,000 million colones to between 11,000 to 14,500 million colones. The non-financial public sector deficit would be reduced with the low measures to a deficit of 6,900 million colones (1.3% of GDP). With the higher measures, the deficit would be converted to a surplus of 1,100 million colones (0.2% of GDP) which would be very close to the IMF medium term projections.

Table 3 - Effect of the Measures on the Public Sector

	1989 IMF	1989 est.	1990 passive	1990 low	1990 high
		Million Colones			
Central Goverment	-7,470	-17,400	-25,300	-17,900	-13,400
Rest of NFPS	8,776	6,948	4,074	11,024	14,549
TOTAL NFPS	1,306	-10,452	-21,226	-6,876	1,149
Central Bank	-12,866	-9,864	-11,960	-11,960	-11,960
Total Public Sector	**-11,560**	**-20,316**	**-33,186**	**-18,836**	**-10,811**
		Percentage of GDP			
Central Goverment	-1.7	-4.1	-4.9	-3.5	-2.6
Rest of NFPS	2.0	1.6	0.8	2.1	2.8
Total NFPS	0.3	-2.4	-4.1	-1.3	0.2
Central Bank	-3.0	-2.3	-2.3	-2.3	-2.3
Total Public Sector	**-2.7**	**-4.7**	**-6.4**	**-3.7**	**-2.1**

5. Medium Term Outlook Considerations

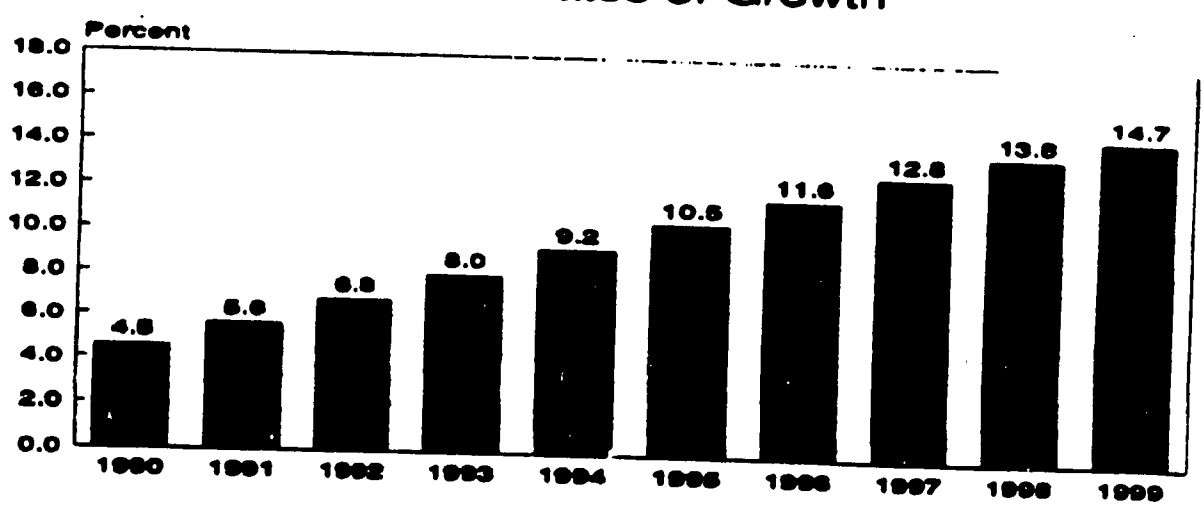
Costa Rica has faced periodic fiscal crises which have been normally solved through emergency type measures, almost guaranteeing the resurgence of a fiscal crisis soon after each crisis is resolved. The measures discussed above are generally of an emergency nature. It is encouraging that the President-elect is seeking assistance from the IMF within the context of an Extended Fund Facility (EFF) as this may be the best mechanism to address the structural problems of public sector finances. AID can play a key role through the support of measures designed to enhance the efficiency of the public sector.

The secular decline in the tax to GDP ratio will continue unless the tax system is modified. At the same time, tax expenditures from CATs will increase in real terms at an annual compound rate of 15% unless the system is modified, public sector pensions will increase at an increasing annual rate (see graph 6), and the interest on the domestic debt will continue its rapid increase unless domestic finance of the public sector deficit is curtailed. Obviously, this situation is not sustainable, and measures designed to address the structural weaknesses will have to be implemented in order for Costa Rica to maintain financial stability.

The medium term measures which need to be considered to improve the structure of public sector finances are: a reduction of the CATs that goes beyond the agreement reached between the Arias administration and the private sector; substitution of exchange rate adjustment for CATS in order to preserve competition in a CAT-free world; reduction in the net costs of pensions through an increase in employee contributions and/or a reduction in benefits; privatization of state-owned enterprises; reductions in the public sector workforce; improvements in the public sector budget process; and a tax reform that would increase the elasticity of the tax system, perhaps through a consolidation of the sales tax and the consumption tax into a value added tax. A value added tax at a rate of 15-20% could replace the sales and consumption taxes, and a myriad of other taxes that collect negligible amounts of revenue and would permit further reductions of taxes on foreign transactions.

Graph 6

Expenditures for Special Regime Pension
Real Rates of Growth



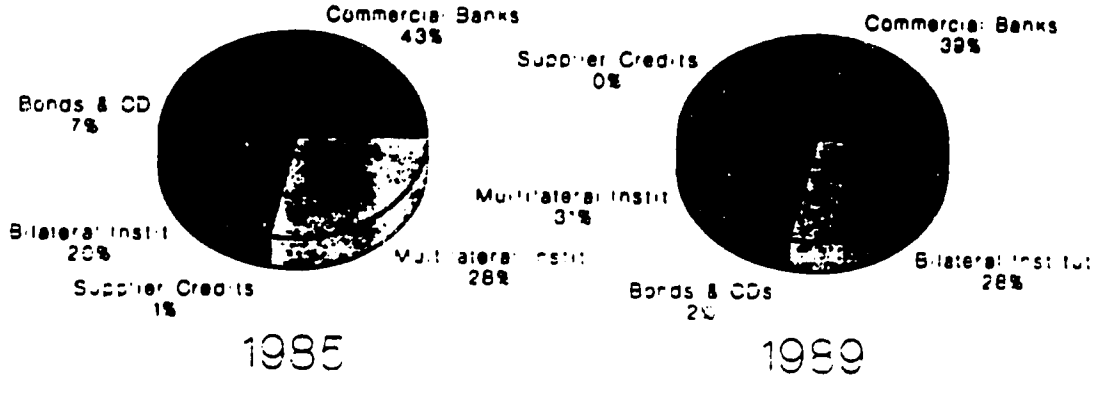
Source: Carmelo Mesa. Lago : Análisis comparativo de los sistemas de pensiones en C.R. y...

B. External Debt

The external debt crisis reached Costa Rica about one year before it reached other countries of the region. The public external debt is now about $4.0 billion, of which $1.8 billion is owed to the commercial banks. Commercial bank share of total debt dropped from 43% in 1985 to 39% in 1989, as is shown in Graph 7. Since 1983 successive administrations have engaged in commercial debt reschedulings and debt renegotiations, but these have resulted in a situation where Costa Rica makes partial payments on interest due, and the difference between interest due and interest actually paid increases the stock debt. In 1989, for example, the GOCR paid $44 million in interest to its external commercial creditors, while interest due was close to $170 million. We have calculated that if Costa Rica made full interest payments to the commercial banks, its GDP would be about 8% lower.

After more than two years of arduous negotiations, the GOCR has concluded a debt reduction program with its commercial creditors. This program consists of three elements. First, a debt buy-back of 60% of the commercial debt at a price of 16% of par value. Second, an exchange of the remaining debt for 20 year bonds with an interest rate fixed at 6.25%. Banks which sell 60% or more of their debt will receive bonds ("A" Series) that will have a guarantee for the payment of interest during 12 months through a fund established for that purpose. Banks which sell less than 60% of their debt will receive bonds ("B" Series) which do not have a guarantee for the payment of interest. Third, 20% of past due interest (PDI) that is not repurchased will be paid in cash and the balance will be refinanced over 15 years at an interest rate of LIBOR plus 13/16. Banks which sell 60% or more of their debt will have an interest guarantee for 36 months while the banks that sell less than 60% of their debt will not have that guarantee.

Graph 7
Public Sector External Debt
1985 and 1989



The debt reduction program is highly favorable to Costa Rica and represents a clear recognition that the debt burden of commercial debt is too onerous, and that the economic program of Costa Rica can not succeed without major debt relief. The debt reduction program for Costa Rica is highly favorable in comparison with other plans already concluded (Mexico and the Philippines) as well as with plans under consideration. This plan is the result of close collaboration between the banks, the GOCR, and the USG, and may be the best example of what can be achieved under the Brady Plan. The implementation of the debt reduction plan will contribute to an eventual return to Costa Rica of international capital markets.

The debt buy-back is the most essential component of the debt reduction program. The funds required for the buy-back are about $170 million. This does not include the down payment on past due interest ($25 million) and funds to collateralize interest payments. Annual payments to commercial bank creditors will be about $60 million. There is a recapture clause that increases the interest rate on the bonds and on refinanced interest if Costa Rica's GDP exceeds 120% of the real level in 1989. The proposal also includes a debt conversion plan of $100 million over 5 years for which bonds and interest refinanced are eligible. The agreement does not include new money. The potential sources of finance are as follows:

Japan	$35 million
Taiwan	$40 million
Canada	$10-15 million
Spain	$10-15 million
Mexico	$10-15 million
World Bank	$40 million
IMF	$55 million
USAID	$33 million
Total	$233-245 million

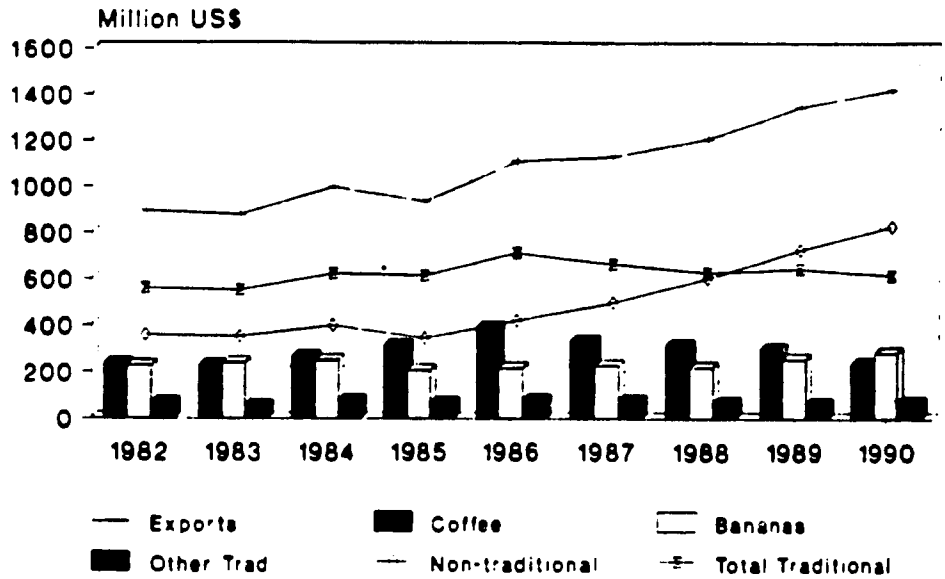
The US Government has provided the leadership which was necesary to reach the debt reduction agreement with the banks and has encouraged other donors to participate in the buy-back operation. Obviously, the success of the buy-back operation depends on U.S. participation. Accordingly, USG participation in debt reduction will be a major aspect of ESR IX.

C. The Balance of Payments

Trends 1982-88. Since the economic crisis of 1981, Costa Rica has implemented policies designed to enhance the role of competitive market forces in resource allocation. This has had major positive effects on export growth, particularly non-traditional exports. This strategy has been highly successful, as non-traditional exports have grown rapidly. In 1986, the value of exports of non-traditional commodities surpassed the value of coffee, and in 1988 it surpassed the value of all traditional exports combined. Non-traditional exports in 1988 were about $600 million (see graph 8A). In spite of this, the trade deficit began to widen after 1986 (Graph 8B).

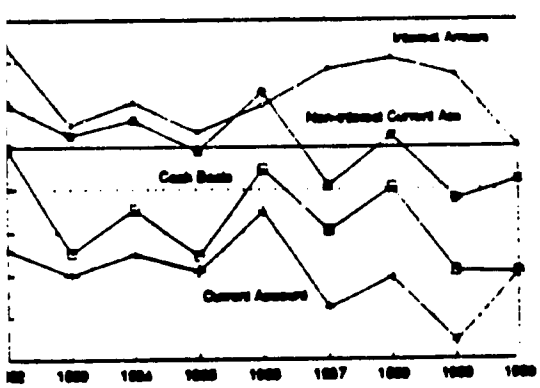
Graph 8

Merchandise Trade
1982-90

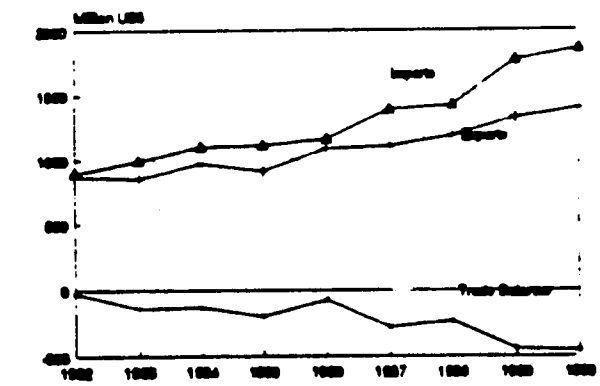


Source BCCR & IMF

Current Acount
1982-1990



Balance of Trade
1982-90.



Since 1982, the current account deficit has fluctuated widely but has widened steadily from $250 million in that year to over $300 million in 1988. While exports have increased rapidly, imports have increased at a slightly faster rate. The non-interest current account has performed in a similar fashion. (Graph 8C.) It is interesting to note that the non-interest current account has been negative in 1987 and in 1989, indicating that the country received real resources from abroad on a net basis, something which is rare among the highly indebted countries of Latin America.

The financing of the current account has evolved considerably during this period. The data of inflows of new capital, excluding rescheduling, are as follows: (in US$ million)

Table 4. Capital Inflows

	Annual Average 1982-86	Annual Average 1987-88
Private Capital	48	148
Official		
Official Project Assistance	204	90
Balance of Payments Assistance	94	123
AID	78	123
IBRD/Japan	16	0
Total Official	298	213
Total Capital	346	361

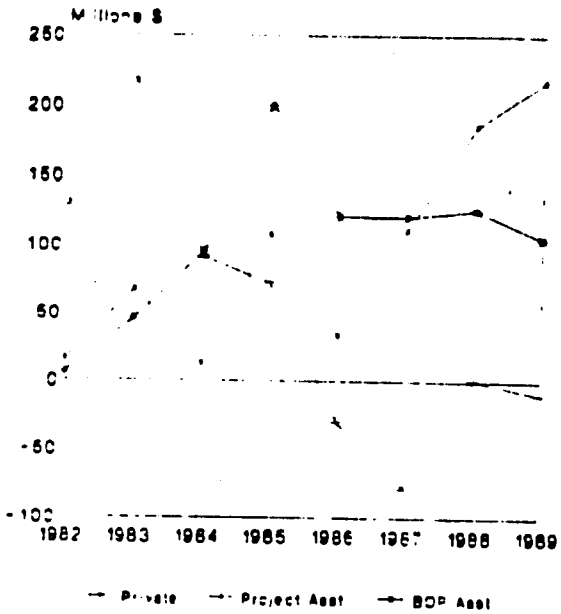
The annual average private capital inflow increased from $48 million in 1982-86 to $148 million in 1987-88, and this compensated for the reduction in official capital inflows, which declined from an annual average of $204 million in 1982-86 to an annual average of $90 million in 1987-88. (Graph 9A). Balance of payment support also compensated for the reduction in project assistance.

Another important element in the balance of payments in Costa Rica has been the exceptional financing related to debt relief (see Graph 9B). Costa Rica received an average of $165 million a year in debt relief betwen 1983 and 1988, mostly from rescheduling of debt. Two major agreements were reached with Paris Club creditors and commercial bank creditors in 1983 and 1985. The rescheduling in 1983 reduced arrears by $1070 million. In 1985 and 1986 the debt relief reduced arrears by $170 million and rescheduled $360 and $145 million in 1985 and 1986 (see Graph 9C). Commercial banks also made available a new revolving credit facility in 1985. During this period (1982-88), net international reserves declined in five of the seven years (see Graph 9D).

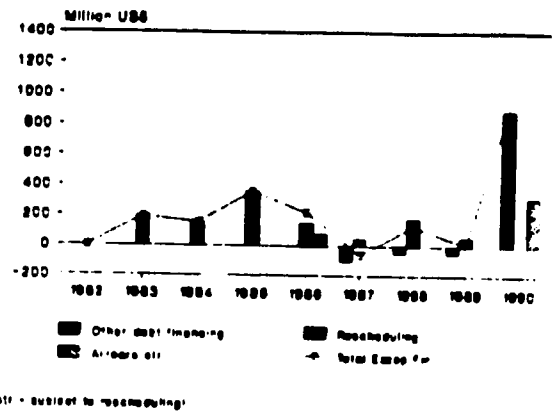
Graph 9

Financing of BOP

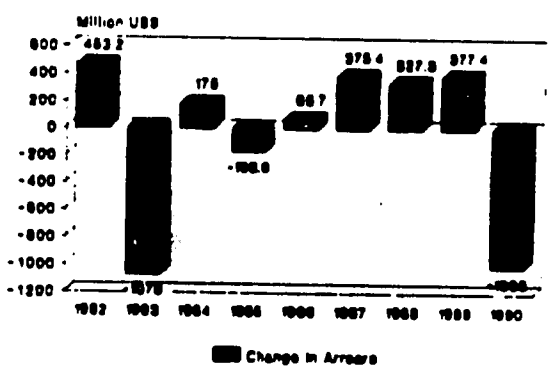
Capital Inflows
1982-1989



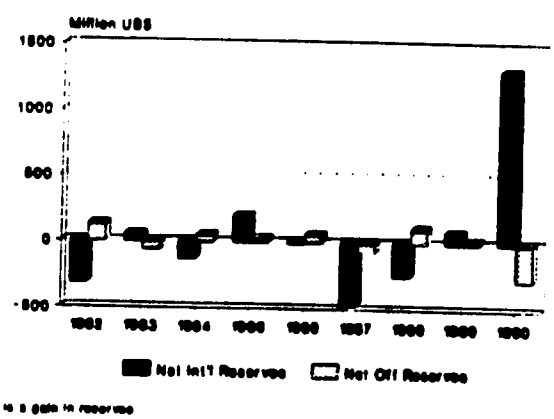
Exceptional Financing



Arrears



Reserves



Performance in 1989. Non-traditional exports continued to increase rapidly, reaching $700 million in 1989. Nevertheless, there was a major deterioration in the balance of trade which began in the second semester of that year (see Graph 8B). The balance of trade deficit increased from $240 million in 1988 to $432 million in 1989 (Table 5). This deterioration resulted from the rapid increase in imports which increased from $1420 million in 1988 to $1768 million in 1989, a rate of growth of 24%. The rapid increase in imports is the result of a combination of at least four factors, namely: the deterioration of the fiscal situation; the appreciation of the real effective exchange rate; rebuilding of inventories after 1988, a year where imports increased slowly; and expectations of a sharp devaluation in 1990.

The year ended with an increase in net international reserves of about $40 million, in spite of import growth of 24%. This performance was due to rapid increase in tourism receipts, the Paris Club rescheduling which provided financing of about $180 million, and most importantly, the result of private capital inflows which, including errors and omissions, reached $218 million. This performance is even more remarkable if it is considered that the third tranche of ESF ($20 million) and the Japanese co-financing of SAL II (the equivalent of $35 million) did not take place in 1989 as had been planned.

Performance in 1990. Performance in 1990 will depend on the fiscal and monetary policy stance, as well as an exogenous factors such as international prices, that are yet to be determined. The debt reduction plan, which was approved by the Legislative Assembly in Costa Rica in March 1990, will influence the balance of payments in a major way. The agreement would reduce interest and amortization payments and provide capital inflows to reduce arrears. A second factor contributing to uncertainty is that performance during the first two months of 1990 has been extremely poor. The merchandise trade deficit during the first two months of the year reached $120 million, a somewhat larger trade deficit than the deficit during the first six months of 1989. During the first two months of 1990 the Central Bank lost $65 million in net official reserves. If the Government of Japan had not disbursed $35 million from the co-financing of SAL II, reserve losses would have been $100 million.

If the trend in the merchandise trade balance continues, the trade deficit will be greater than our forecast. The projected level of $450 million trade deficit was based on a 5% increase in exports and imports and assumes that strong fiscal and exchange rate adjustments are undertaken. The Central Bank has been trying to reduce liquidity in the economy by increasing reserve requirements and interest rates. Projections after 1990 depend on the effectiveness of measures taken this year.

Table 5. Balance of Payments

	1988	1989	With Debt Reduction Plan 1990	Without Debt Reduction Plan 1990
Current Account(1)	-304.4	-458.4	-294.1	-475
Merchandise Trade Balance	-236.2	-431.9	-458	-458
Net Factor Services	-389.4	-401.4	-289.1	-470
Net Official Interest	-331.4	-335.3	-214.1	-395
Capital Account (2)				
Official Capital (3)	-381.2	-283.8	-77.4	-286.4
Private Capital	185.4	217.7	268.6	268.6
Basic Balance	-500.2	-524.5	-102.9	-102.9
Balance of Payment Support	125	105	210	210
Debt Relief	133.7	461.1	1230.1	0.0
Overall Balance	-248.9	41.6	1306.6	-313.4
Net International Reserves	248.9	-41.6	-1306.6	347.6

(1) Excludes transfers from AID (See BOP Support)
(2) Includes, Official Disbursements, Amortization Due and Private Capital.
(3) Excludes World Bank SAL (See BOP Support)

In 1990, the trade deficit and the current account will be financed by continued increases in tourism, which are expected to grow by 16%, private capital flows, which are expected to increase about 10% and foreign assistance, including balance of payments support. As long as the debt reduction plan is carried out, the GOCR will increase net official reserves by about $250 million in 1990 and will reduce arrears by more than $1 billion. The

gain in reserves is primarily from the debt financing for the repurchase of commercial bank debt which will be written down to 16% of its face value rather than from a trade surplus. Loans and grants for this purpose have been estimated at $169 million, which includes the $33 million grant from AID. This amount does not include funds to establish the collateral accounts for interest payments for Series A bonds referred to earlier in the report nor the does it include the down payment on past interest due. (Note that the Central Bank's calculation is based on a debt level of $1.15 billion in contrast to the $1.48 that is often used.) Debt financing for 1990 also includes gains from the repurchase of about $920 million of commercial bank debt for about $170 million, giving Costa Rica a gain of about $750 million. (See Table 6.)

Without the debt reduction plan, net international reserves will decline by almost $350 million. The net capital inflow would be reduced by almost $200 million because amortization payments increase, and payments in the current account would increase by about $180 million. The reserve loss also takes into account the loss of debt financing and capital gains from the buy-back.

Table 6. Debt Relief

	1989	1990 (1)
Debt Relief	461.1	1230.1
Rescheduling	52.2	0.0
Arrears Subject to Rescheduling	445.0	318.0
Other Debt Financing		
Buy-back Loans	0.0	169.0
Debt Conversion	-46.3	-35.4
Capital Gains from Buyback	0.0	748.0

Note

(1) Includes debt reduction plan.

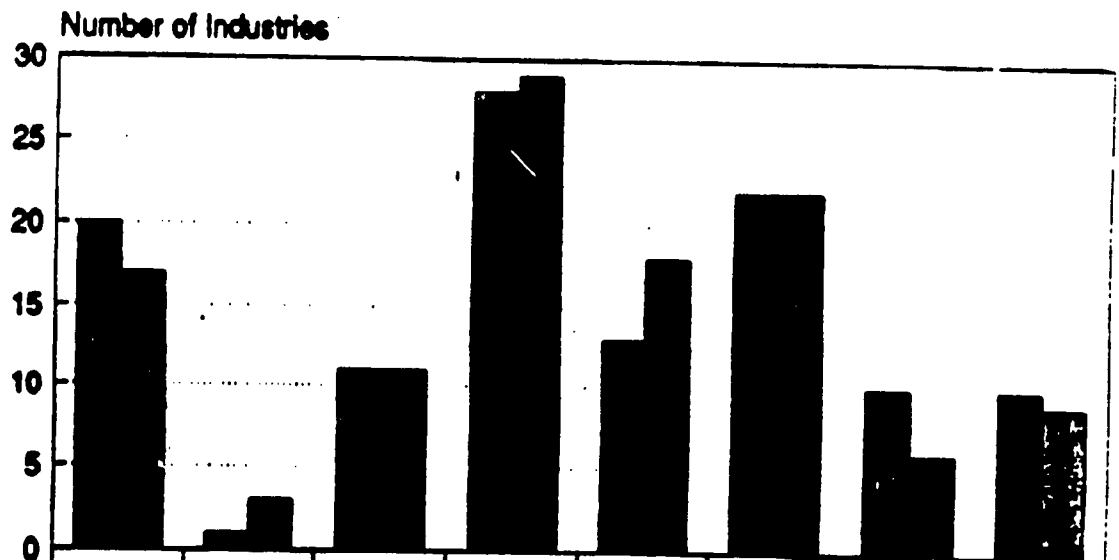
The coming year could bring more difficulties than had been expected in the balance of payments even if the debt reduction agreement proceeds. The domestic fiscal situation is expected to worsen in 1990 putting more pressure on the balance of payments. Foreign assistance through balance of payments support increased in 1990 mostly because of the SAL II and ESF support, but what happens in the medium term? Already one sees a trend in the increase in bilateral and multilateral debt in Costa Rica, increasing from 48% of the total in 1985 to 59% in 1989.

D. Commercial Policy

Costa Rica began to implement a tariff reduction program designed to reduce the rates of effective protection ahead of other countries in the region. The maximum rate of nominal protection has been set at 40%, while the tariff floor is about 5%. The result of this has been a slight reduction in the extreme cases of effective protection. (Graph 10). At this time, however, other countries in the region such as El Salvador and Honduras are beginning to implement a tariff regime with maximum rates of nominal protection of about 25%, and floors of 10%. In order for Costa Rica to compete, it will be necesary to continue to reduce the tariff ceiling and continue to raise the tariff floor.

Other factors reduce Costa Rica's ability to compete internationally. High transportation and port charges, and bureaucratic impediments are some of the most important ones.

Graph 10
Effective Protection Coefficients



	0-.99	1.00	1.01-1.20	1.21-1.60	1.61-2.00	2.01-4.00	4.01+	Negative
1986	20	1	11	28	13	22	10	10
1989	17	3	11	29	18	22	6	9

1986 1989

V. RATIONALE FOR ESF ASSISTANCE

The debt crisis has affected economic development negatively since 1980. At this time, the proposed debt reduction program provides the best opportunity to make the problem manageable. This program is based on Secretary Brady's debt initiative, and it is quite favorable to Costa Rica. About $250 million are required for the debt-buy back, for the "down payment" on past due interest, and to establish the interest payment guarantee funds. The participation of the USG through the provision of financial resources for the buy-back is absolutely necessary if the debt reduction program is to succeed not only because of the resources that will be provided but because it offers a clear signal to other multilateral and bilateral donors of the USG commitment to this program.

Additional balance of payments support will be needed because of the loss of coffee export revenue but most importantly to provide leverage to a reform effort designed to improve structural aspects of public sector finances. While it is expected that the IMF will continue to pressure for a reduction in the deficit, AID conditionality could give greater emphasis to the composition of the deficit. Further reductions in the anti-export bias would reduce the need to rely on subsidies to encourage exports, and this is of course closely related to the structural problems of public sector finances. Assistance conditioned on measures designed to improve public sector finances and to reduce the anti-export bias would help to consolidate the economic reform effort in Costa Rica at a time when the levels of US assistance are being reduced.

VI. THE PROPOSED PROGRAM

A. The Program

The ESR IX program consists of a $60 million ESF grant to Costa Rica in the form of a cash transfer. The Mission proposes to obligate the entire amount in a single agreement.

ESR IX is a single program to support economic stabilization efforts in Costa Rica. Dollars provided under the program will be used: (1) to support the GOCR commercial debt buy-back agreement in the amount of $33 million, and (2) for balance of payments support consisting of the provision of foreign exchange to finance essential imports for the productive private sector, $27 million.

The Mission proposes that the $60.0 million be authorized by this PAAD entirely as a grant. Prior to debt relief as negotiated under the debt reduction plan with the commercial banks, Costa Rica's public sector debt service is projected to consume about 13% of commodity export earnings in 1990. Given as well the direct application of half the ESR IX total to the Costa Rica debt reduction program, grant financing is consistent with overall stabilization and recovery objectives.

Debt Buy-Back Support

The first disbursment total of $33 million will be provided to the Central Bank of Costa Rica in the form of a cash transfer to be used in support of the GOCR's "Debt Repurchase Offer Relating to Certain External Debt of Costa Rican Public Sector Obligors" dated March 1, 1990. This Offer is to be implemented in accordance with the Brady Plan under the auspices of the International Monetary Fund (IMF).

As this PAAD is being written, some of the procedural details for executing the debt repurchase offer are still being negotiated and may change somewhat. However, most of the major elements of those procedures are now known and are described below.

This first disbursement ($33 million) of the cash transfer would not be subject to substantial conditionality. It is anticipated that this disbursement will take place almost immediately after the Agreement is signed. AID would disburse the funds into the Separate Account established by the Banco Central de Costa Rica (BCCR) at the Federal Reserve Bank of New York (FRB). Funds would be disbursed directly into that account by AID via electronic funds transfer.

On the same day, or shortly thereafter, the BCCR would instruct the FRB to disburse the funds to the multidonor contribution account managed by the IMF. As soon as that disbursement is made, the intermediate project objective of supporting the Brady Plan for Costa Rica will have been met since the presence of the funds in an account with irrevocable instructions to pay the banks is a necessary condition of the agreement with the participating banks.

The contribution account is an accounting entity controlling the donations to fund the debt repurchase offer for Costa Rica. The cash donations to this fund would be kept in an account which would be opened in the name of the IMF, at the FRB, for U.S. Dollar donations such as AID's. (There may be an account in a Swiss bank for non-U.S. Dollar donations, but AID funds would not be placed there.) The account at the FRB will enjoy the privileges and immunities, for example, immunity from attachment, generally accorded IMF funds. The IMF will account for the transactions of the contribution fund.

The contribution account may total as much as approximately $250 million, of which AID's contribution would be $33 million.

Because the buy-back is a direct disbursement for an ESF objective, it will not be a reimbursement for foreign exchange used for eligible import transactions and the usual import documentation supporting the transfer will not be present. The only documentation required will be a confirmation from the FRB that the dollar funds for debt reduction were fully disbursed to the IMF debt reduction account, also at the FRB, and a certification from the GOCR through the IMF that these funds were used to support reduction of GOCR debt.

When AID funds are disbursed by the BCCR from the separate account at the FRB to the IMF contribution account at the FRB, they will be commingled with the funds of the other donors. If all goes according to plan, all transactions related to the AID-provided funds will have been completed before the end of May, 1990. Funds not used, if any, will be returned to the Separate Account to be used for reimbursement for eligible imports as described below.

With respect to the IMF account and the commingling, although this is not ideal, it is considered to be the only way to assist Costa Rica in reducing and refinancing its public sector external indebtedness to nonofficial creditors. The involvement of the IMF as depository of donor resources provides confidence to those donors, as well as assurances to Costa Rica and to its nonofficial creditors, that such resources will in fact be available for use in accordance with the purposes of the debt reduction program. Further, because the IMF plays a central role in the strengthened debt strategy and provides appropriate support to debt and debt-service reduction efforts, it is an appropriate institution to manage the resources. Any other mechanism would not provide Costa Rica's creditors with the necessary confidence that funds are available. Accordingly, USAID will not attempt to track the AID donation to any particular type of repurchase of debt to any particular creditor, nor is it feasible to do so.

It should also be noted that the GOCR repurchase program is a multi-donor, multilateral effort in which the procedures and requirements are specific, time-sensitive, and require the donors to deposit funds into either an IMF account in the FRB or an equivalent bank in Switzerland. The only option available to the donors is advice of place of their deposit. The IMF will provide a contribution of the date and the amount of disbursement and interest earned, if any. The IMF will also confirm that the GOCR has confirmed to the IMF that the disbursal of the AID contribution, and any interest, was used in accordance with the terms and conditions in the Republic of Costa Rica, 1989 Financing Package. The IMF will also confirm any unused funds and will transfer those funds back to the Separate Account if they are not used on or before May 31, 1990. This will assure that the AID contribution is promptly used, but if not, redeposited. The Agreement will require that such redeposited funds will be automatically subject to the requirement pertaining to eligible import transactions.

USAID will also require the BCCR to request the FRB to provide directly to the USAID Controller a FRB statement verifying that the AID provided funds were fully disbursed from the separate account to the contribution account

Procedural Requirements (to be approved by AID/W): In order to assure that the AID funds are used as requested, the following conditions and requirements would be included in the agreement with the BCCR. (Note that the usual requirement of a legal opinion of counsel acceptable to AID as a precondition to the first disbursement is not being required -- nor is there time to permit one to be provided -- before the first disbursement takes place. That opinion will be required as a condition precedent to the second disbursement.)

The GOCR will provide evidence:

(1) that a Separate Account has been opened with the Federal Reserve Bank of New York into which all dollar disbursements under the Agreement shall be deposited;

(2) that disbursements from the Separate Account will be made to the IMF - Administered Contribution Account - Costa Rica, established by the IMF to assist Costa Rica in reducing and refinancing its public sector indebtedness to nonofficial creditors under the terms and conditions set forth in The Republic of Costa Rica, 1989 Financing Package; and,

(3) that the IMF has been instructed to promptly confirm in writing to AID (a) the date and amount of the AID contribution received and (b) the receipt of instructions to promptly use the AID contribution pursuant to instructions by Costa Rica and certified by Costa Rica to be in accordance with the terms and conditions set forth in The Republic of Costa Rica, 1989 Financing Package.

Requirements for Notification:

Unless AID otherwise agrees in writing, the GOCR will provide evidence, in form and substance satisfactory to AID, of the following:

(1) That the FRB of New York has been instructed to provide to AID a written confirmation, within three days after the requested transfer, that the dollar funds deposited in the Separate Account were fully disbursed from that account into the Voluntary Contribution Account established by the IMF for use in accordance with the terms and conditions of the May 7, 1990 Debt Repurchase Offer;

(2) With respect to the AID contribution to the Voluntary Contribution Account noted above, that the IMF has been instructed to undertake the following within three days after the disbursement of the AID contribution or May 31, 1990, whichever comes first:

(a) to provide AID a written confirmation of the date and amount of disbursement and interest earned, if any, and the amount of any unused funds remaining of the AID contribution, and that Costa Rica has certified to the IMF that the disbursed portion plus interest thereon, if any, of the AID contribution was used in accordance with the terms and conditions set forth in The Republic of Costa Rica, 1989 Financing Package;

(b) to return any unused funds of the AID contribution and any interest earned to the Separate Account of the GOCR in the Federal Reserve Bank of New York; and,

(c) to confirm in writing to AID the transfer of the unused funds to the Separate Account and the amount of funds transferred.

If any of the dollar funds provided under this Agreement and deposited into the Account with the FRB of N.Y. opened by the IMF on behalf of Costa Rica for use in the debt repurchase effort are not used to repurchase debt on or before May 31, 1990, unless AID agrees otherwise in writing:

(1) The GOCR shall cause to be promptly redeposited that amount of dollar funds together with any interest earned thereon into the Separate Account; and

(2) Use those funds to provide foreign exchange for essential imports for the private sector.

Balance of Payments Disbursements

As further detailed in Section VIII.A. the Mission proposes to disburse half of the remaining $20 million from ESR VIII as a second tranche upon receipt of an acceptable economic plan for 1990 from the GOCR. The second tranche from ESR IX (the third overall tranche) in the amount $27 million would be undertaken upon a determination by USAID/Costa Rica of satisfactory compliance by the GOCR in meeting the economic performance targets set forth in the plan and upon a determination by the Mission of acceptable GOCR compliance with the terms of ESR IX conditionality. It is anticipated that this disbursement can be made in the third quarter of CY 1990.(See Sections VII.E and VIII). A fourth tranche of $10,000,000 (from ESR VIII) will be disbursed upon satisfactory progress in resolving outstanding expropriation cases. (See Section VII.E.)

The second, third and fourth tranches totaling $47 million will be provided to the Central Bank in the form of cash transfers. The disbursements will be made into the dollar separate account established under the 1987 FAA Continuing Resolution in the Central Bank in accordance with Agency guidance and procedures. (See Annex C.)

USAID will authorize the release of dollars from the separate account to the general accounts of the GOCR as reimbursement for the purchase of eligible imports, after presentation to AID of evidence that such purchases have taken place. (See Annex C.)

Therefore, the disbursement plan to be incorporated into the ESR IX assistance agreement is as follows.

B. ESR IX DISBURSEMENT PLAN

Disbursements (projected)	Grant Funds (U.S. dollars)
First	$ 33,000,000
Second (ESR VIII)	$ 10,000,000
Third	$ 27,000,000
Fourth (ESR VIII)	$ 10,000,000
TOTAL	$ 80,000,000

The Mission requested, and was given, authorization to vary the disbursement plans under ESR II-VIII as required to assure good management of foreign exchange resources. In the same manner, the Mission requests authorization to include in the ESR IX assistance agreement 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.

C. Local Currency Resources

Programming, Management and Accountability

Since 1987, USAID/Costa Rica has been involved in a sometimes complicated process to shift a greater degree of responsibility for the management and accountability of local currency resources to the GOCR. This process, which began with obtaining an explicit acknowledgement that ESF local currency belonged to the GOCR, has now, barring new local currency guidance, been largely completed. The primary tasks in this process have been (1) to maintain the ability to jointly program host country owned local currency (HCOLC) for AID/ GOCR development priorities, (2) allow for programming HCOLC to support private sector activities as well as public sector and AID operating expenses, (3) develop Mission HCOLC programming guidelines, (4) enhance the GOCR's ability to design, manage, and account for HCOLC programs, and (5) in concert with AID guidance, develop and negotiate with the GOCR a largely sectoral HCOLC program. For a fuller background explanation of these tasks and the history of local currency management in USAID/Costa Rica, the reader is directed to Section III.E. of the ESR VIII PAAD (1989).

A key development in the management of HCOLC was the creation in 1987, at the Mission's suggestion, of a joint AID/GOCR Bipartite Commission charged with negotiating the ESF assistance agreements and, for the GOCR, for programming and assuming responsibility for the implementation of ESF HCOLC activities. For the GOCR, the Commission is headed by the Minister of the Presidency and includes the Ministers of Finance and Planning, as well as the President of the Central Bank.

Mindful of the implications of increased GOCR responsibilities for HCOLC management, the Commission developed parameters to facilitate its task, including:

- joint programming of all funds in writing by the Commission and the Mission;
- use of HCOLC for development purposes, including sector support;
- approve activities that fit within the development priorities of the GOCR and the Mission;
- avoid a proliferation of activities with the objective of approving fewer but larger activities;
- 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.

Until 1988, USAID had required that all ESF HCOLC be deposited into an interest bearing account. On September 30, 1988 the Mission justified a waiver of this requirement given the negative impact accumulated interest payments were having on GOCR monetary policy and the negative effect on the balance of payments rationale. This rationale continues for the ESR IX program and interest payments on the HCOLC made available under the program will not be required.

The Commission, USAID and new LAC HCOLC guidance recognized the importance of establishing a system for controlling approved local currency activities. The Commission and USAID agreed that this end could best be met by expanding an existing office within the Ministry of the Presidency and staffing it accordingly to assume responsibilities for the HCOLC programming and monitoring process. This office, the Office of Control and Follow-Up (OCS), organized itself in coordination with the existing implementation unit for PL-480 funds located in the Ministry of Planning in order to develop procedures for HCOLC activity design, implementation, monitoring and accounting. In developing its procedures, the OCS studied the former local currency control system developed by the Mission and, rather than create and test an entirely new system, found much of that system to be comprehensive and responsive to its needs, and therefore adopted much of it for their own use.

Prior to January 1, 1989, LAC allowed for a transition period prior to attaining full compliance with new Bureau local currency programming guidelines. During this period the Mission undertook some limited local currency under the former Memorandum of Understanding system in order to assure programming of AID operating expenses, counterpart to USAID projects and export promotion programs. The latter was important at the time, given a temporary GOCR legal problem (explained further below) that prevented the programming of HCOLC for private sector programs.

LAC HCOLC supplemental guidance established five local currency programming alternatives: general budget support, sectoral support, projects or specific activities, special non-governmental activities (though not completely defined), and trust fund projects. Concurrently with the issuance of this guidance, USAID undertook extensive negotiations with the GOCR Commission to program all remaining HCOLC made available under prior ESF programs and carry out this programming on a sectoral basis in accordance with the guidance. For the sectoral programming option, the guidance stated that AID must be satisfied that the HG has good sectoral activities and the technical and administrative capability to carry them out. Further, AID should assure that the sectoral programs are consistent with the FAA and AID development strategy but not select sectoral programs based upon a quantitative analysis of the specific activities within the sector.

Thus, for the first year's programming under the new guidance (1988), Mission staff worked closely with the Commission and the OCS to devise sectoral programs that could be implemented through sound institutions. Ultimately, sectoral programs were programmed in the amount of 7 billion colons ($88 million equivalent) in the following sectors: water, transportation, education, community development, child health, agriculture, rural housing and public sector finance. The sector activities selected were consistent with USAID's Costa Rican development strategy and otherwise consistent with LAC and Agency HCOLC guidance. Further, our objective of withdrawing from a controlling role in HCOLC implementation matters had been accomplished.

Multipurpose HCOLC Programming

One of the ironies of achieving GOCR acknowledgement of their ownership of the local currency and expanding their role in its programming and management, was the fact that it became impossible for the GOCR to program HCOLC for anything other than public sector uses. The argument set forth by the GOCR was that, as GOCR-owned local currency, programs other than those operated by and for government entities, would require approval by the Costa Rican National Assembly. Such a possibility, however acceptable in theory, was problemmatic in real terms to both the GOCR and USAID, as programs would have been submitted to an approval process that could have taken years and would have jeopardized on-going and future local currency activities vital to joint U.S./GOCR development strategy. Clearly the challenge for the GOCR was to devise a legal mechanism to allow HCOLC programming for a variety of development purposes, including private sector programs as well as USAID operating expenses. To this end, USAID and the GOCR agreed that such a mechanism would be in place prior to the programming of the $85 million equivalent in HCOLC made available under the ESR VII program, and that the ESR VIII program of 1989 would not be put forward until such time as this legal mechanism for unrestricted programming was in place.

The GOCR ultimately succeeded in developing the required "legal mechanism" by linking the multipurpose HCOLC programming to the Bilateral Agreement of 1962 which had been ratified by the Legislative Assembly and which provided authority, in essence, for the Executive Branch to execute agreements with AID and to use the funds provided under these agreements for furthering the development program. The written agreement arrived at with AID (signed on December 23, 1988) and ratified by the GOCR legal authorities, interpreted this provision to allow the programming of local currency provided under AID programs for a variety of development purposes, i.e. private as well as public sector programs and USAID operating expenses.

In other words, the GOCR could now represent to AID that the programming of funds for public and private sector uses and for USAID OE and program expenses was permitted by Costa Rican laws and regulations. This permitted therefore the programming of ESR VII funds to proceed which included the equivalent of $25.5 million (30% of the ESR VII total) for a private sector-oriented credit line. As well, the ESR VIII program was put forward, negotiated and signed with the GOCR as agreed. Local currency made available under ESR VIII (also the equivalent of $85 million) was programmed successfully with the GOCR, including $27.7 million in colons for a private sector export fund. The "legal mechanism" therefore is accomplishing its purpose of protecting multipurpose HCOLC programming, and protecting the integrity of private sector programs of great importance to the GOCR and AID.

Present Status of Local Currency Programming

Programming of the HCOLC under the 1988 ESR VIII program was not completed until late February, 1990. This delay was via mutual agreement with the OCS given the time necessary for them to more fully develop operational procedures and monitoring systems for HCOLC programmed earlier, to allow programs to develop within the Central

Bank monetization limits, and due in part to delays in the final disbursement of the ESR VIII dollars (See Section VII.E). Also, neither USAID nor the GOCR wished to finalize programming absent assurance that a pillar of the ESR VIII HCOLC, the Export Fund (the $27.5 million referred to above), would be approved by AID/W. Following AID/W approval of the Export Fund concept document on February 22, 1990 and resolution of final details with the OCS, the ESR VIII programming agreement was signed on March 14, 1990.

HCOLC programming under ESR VIII follows the principle of multipurpose programming described above. continues and expands the role of the GOCR in the programming, control, design, management and monitoring of the activities, and continues the sectoral orientation of HCOLC programs. Of the $85 million equivalent, $61.25 million are for sectoral programs fully under the operational control of the GOCR. These sectors are the following: public sector efficiency, natural resources, education, justice, exports, community development, and housing.

A further $13.0 million is for counterpart to AID projects (FORESTA and Financial Services) and the remaining $10.75 million will divided between USAID operating expenses ($6.0 million), Central America Peace Scholarship local currency ($3.1 million) and counterpart to the Policy and Training Support Project (PATS) $1.65 million). AID OE will be provided through the AID OE Trust Fund. HCOLC for CAPS and PATS will be provided under the AID Program Trust Fund as described in the ESR VIII PAAD and approved by AID/W during its review in 1989.

Programming of local currency provided under the ESR IX program will be finalized following obligation of the Agreement. It is anticipated that the sectoral focus of past recent agreements will be continued with a major focus being demonetized uses of HCOLC such as to retire losses of the Central Bank, as well as some additional increments of HCOLC for AID project counterpart (Financial Services, etc.) and USAID operating expenses. Present plans are that an amount of HCOLC roughly equal to the debt buy-back dollar portion will be applied to retire Central Bank losses and/or reducing public sector employment. Given present GOCR and USAID plans for funding the recently approved Export Fund activity, it is possible that a portion could be devoted for this export sector activity. Given the transition to a new GOCR administration, it has been impossible and impractical to be more precise on ESR IX HCOLC programming at this point. The Mission will inform AID/W of proposed HCOLC uses under the program once specific discussions take place with the incoming Calderon team.

The transition to the administration of President-Elect Calderon must require a certain amount of flexibility in HCOLC programming in 1990, as the new GOCR administration learns more about USAID programs, strategy and activities underway with the present administration. As some members of the Calderon transition team have already stated that they would attempt to convince USG authorities to restore reduced ESF dollar levels for 1990, flexibility in HCOLC programming is a more practical and realistic alternative that the Mission feels must be provided.

Program Trust Funds

The USAID/Costa Rica Program Trust Fund was established by written agreement with the GOCR in February, 1984. The Mission has used this mechanism since that time to manage ESF local currency-financed activities for which it assumed day-to-day management and implementation responsibilities.

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 identified by Peace Corps Volunteers. Historically, Development Assistance funds have 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 $500,000 is budgeted per year for this activity through 1991.

- Rural School Refurbishment: 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. Peace Corps Volunteers, in coordination with MEP officials, work with communities to develop projects on a matching grant basis. The budget for the program is the equivalent of $1,900,000 over a four year period, terminating in 1991.

- 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 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 1987 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. EARTH staff have now acquired these functions and all EARTH money formerly in the Trust Fund has been transferred to an EARTH controlled account and to monetary stabilization bonds. The Trust Fund for EARTH has now been phased out.

- Policy and Training Support (PATS) (formerly Policy Planning and Administrative Improvement (PPAI)): These funds provide counterpart to the Mission's DA project to finance the local currency costs of services

financed with the dollar resources. As the PPAI project is approaching its PACD, this fund has been renamed PATS and is being utilized in the same fashion as PPAI. 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.

Emergency Preparedness Technical Assistance: This fund finances local currency counterpart costs for technical assistance provided under contract with the Office of Foreign Disaster Assistance (OFDA) for such items as salary, per diem, transportation, housing, communications and support services.

Support to AID Funded Projects: The program provides local currency financing for the provision of PD&S-like activities required for project implementation.

The Mission is proposing no new Trust Fund activities, however, the activities listed above are on-going and may receive incremental funding under the ESF program. USAID will continue to manage and account for these activities as if they were dollar-financed AID projects. The Mission plans to continue with the SDF, Rural School Refurbishment, PATS, CAPS, and Emergency Preparedness programs and, as in the past, will provide reports in conjunction with the Action Plan and Congressional Presentation that will indicate implementation status. In addition to these limited project specific activities, the Mission will also continue financing PD&S-like activities through the Support to AID Projects activity via the Trust Fund when only local currency costs are involved. In those cases, FAR procurement procedures will be employed.

D. Audit Provisions

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

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

- General budget support and sectoral support activities undertaken with HCOLC are the audit responsibility of the GOCR Controller General.

- Specific development activities will be audited by local CPA firms under host-country or implementing institution contracts as required in all HCOLC programming documents. The Mission will monitor the quality of the firms and the results of the audits. Follow-up responsibilities will be shared between the Mission and AID/W as appropriate.

VII. KEY CONDITIONALITY CONCEPTS AND POLICY AGENDA

A. General

The 1990 ESF Program for Costa Rica is the major component of a U.S. supported economic assistance program that includes the PL 480 Title I Food Commodities program, as well as the policy reforms negotiated as part of these programs. ESR IX is a program of economic recovery whose funds will have two essential applications -- $33 million to be provided as a contribution to Costa Rica's commercial debt buy-back as forseen under the Brady Plan, and $27 million for balance of payments assistance. As discussed above, assuming no dramatic unraveling of Costa Rican economic trends and continued assistance from Costa Rica's other external donors, it is anticipated that ESF funding levels will continue to fall for Costa Rica at a moderate and steady rate over the coming years -- to a planned $45 million in 1991. As the scope of the ESF structural adjustment program becomes more sectoral in focus, 1990 should be the final year in which ESF cash transfers are included for general balance of payments assistance purposes, i.e., to fund the importation of essential goods for the productive private sector as in previous years.

With the considerable financial and policy support of the IMF, IBRD, and AID, Costa Rica has emerged essentially very well from its economic crisis of the 1980-82 period, though the country's present fiscal deficit points to the economy's continuing fragility. Major economic progress has been achieved with a return to positive and steady growth rates, reduced inflation, improved exchange rate performance , and until 1990 an improved fiscal situation. Appropriately, earlier ESF programs concentrated on macrceconomic conditionality such as maintaining positive real interest rates, limiting banking system net credit to the nonfinancial public sector, maintenance of a unified exchange rate, etc. These policy reforms (not limited solely to macroeconomic policy) have had significant positive effect. An AID evaluation "The Effectiveness and Economic Development Impact of Policy-Based Cash Transfer programs: The Case of Costa Rica" of November, 1988 states:

> "... AID, as a part of a joint international organization/GOCR effort, has made substantial positive impact on Costa Rican economic policies. Comparison of IMF, World Bank, and AID covenants and conditions indicates a coherent and comprehensive policy reform process aimed at correcting Costa Rica's unstable economic structure, but implemented 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. Generally, AID has encouraged and enabled policy reform that the Government of Costa Rica wanted to implement but lacked the international reserves and/or political will to accomplish."

The Mission feels that much of the focus of past conditionality should be further institutionalized, especially as ESF levels decline and a new Costa Rican administration assumes power. Measures to reinforce, and in some cases refine, the macroeconomic progress obtained to date and measures to support initiatives in the vital area of increased public sector efficiency are discussed below.

As described in previous sections of the PAAD, we assume that an IMF Standby will be in effect during 1990, most likely through the development of an Extended Fund Facility (EFF) arrangement. Indeed, this scenario is important in order to affect the debt buy-back according to the present agreement between the GOCR and its commercial bank creditors. Given the assumption of an agreement with the IMF, the Mission assumes that the IMF will have the lead role for macroeconomic conditionality, and we will include no major new initiatives in this regard. However, whether or not the 1990 IMF program is renegotiated, the Mission will require that the GOCR provide a satisfactory economic plan for 1990. The GOCR's economic plan will include quarterly limits for the following: (1) Central government expenditures; (2) cumulative financial balances of the CCSS, RECOPE, ICE, CNP, and JPS; (3) net domestic assets of the Central Bank; (4) changes in banking system credit to the non-financial public sector; (5) the net international reserve position of the Central Bank; and (6) arrears on external payments.

The Mission also assumes that the World Bank's SAL II Program will continue in effect for 1990. The IBRD Board approved the loan in mid-December, 1988 and Costa Rican Legislative Assembly ratified it in September 1989. The basic financial plan of SAL II includes a $100 million loan from the World Bank and cofinancing (without additional policy measures) for $100 million from Japan. The SAL II loan consists of three tranches. The first disbursement of $40 million from the World Bank was made in December 1989 and from Japan in January 1990. The second tranche of $35 million each and the third tranche of $25 million each are pending.

The SAL II program concentrates on 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 is being implemented in proportional cuts in six semi-annual installments beginning in October 1988.

In the agricultural sector, the main element is retraction of the National Production Council (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 basic grains. Under SAL II the CNP would retire from 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 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 1989 and 6.5 percent in 1990 (in 1986 this variable was about 4.5 percent), and (c) a reduction in the earmarking of tax revenues. The Mission's policy dialogue with the GOCR has served to reinforce certain IBRD priorities (for example financial reforms on interest rates, credit allocation and subsidies), and the Mission will not undertake major new initiatives in ESR IX conditionality for the areas covered by the Bank. In ESR IX conditionalities, for example, the Mission will reinforce SAL initiatives by limiting the role of the CNP in grain marketing.

Since 1987, the Mission has been reflecting the Bureau's expressed priority of moving toward ESF policy conditionality with a more sectoral focus. This idea is based upon the justification that, given earlier ESF programs' emphasis and progress in attaining shorter term stabilization objectives, ESF programs should evolve toward sectoral objectives--i.e. ones that represent a logical next step toward economic growth objectives and that show demonstrable results. Our vision of this movement to sectoral objectives and conditionality has been transitional and flexible in nature. This means that given the continuing fragility of the economy, macroeconomic conditionality should be reinforced and in some cases deepened as necessary, and where appropriate, sector programs should be identified, and based upon a solid analytical base, introduced to better accomplish economic growth objectives.

Conditionality, policy dialogue topics and HCOLC programmings associated with earlier ESF programs, beginning with ESR VI in 1987, have attempted to focus on the themes of investment promotion, public sector efficiency, promotion of non-traditional exports, privatization and the like. ESR VII in 1988 and ESR VIII in 1989 sharpened further the Mission's conditionality and policy dialogue focus by continuing an emphasis on macroeconomic issues, but more systematically beginning a concentration on issues of public sector efficiency and export promotion (explained further below.) Having these themes more focused has resulted in clearer conditionality, clearer communication of the accompanying policy dialogue with the GOCR, and no small amount of success in policy reform. It is hoped that continued progress with the 1990 ESF policy dialogue will allow evolution to a full sectoral approach in one or perhaps more sectors. There are many unknowns in dealing with a new GOCR administration which assumes power in May. However, dealings to date with Ministers designate have been encouraging and very positive, giving rise to optimism that present areas of policy dialogue concentration will continue as priorities in a Calderon administration. If this proves to be true, current plans call for the Mission to have developed a sectoral cash transfer program in 1991 that concentrates on the further removal of constraints to Costa Rica's export sector.

The debt buy-back portion of ESR IX offers a perhaps unique opportunity for Costa Rica to address the overhanging problem of its commercial debt-- still one of the highest per capita in the world. At the same time, the country's fiscal deficit, 4.4% of GDP and a full 4% higher than had been anticipated under Costa Rica's agreement with the IMF and AID, demonstrates that it is inappropriate to declare total victory on the macroeconomic front--the progress has been substantial and impressive (especially by regional standards), but is still fragile and reversible. The GOCR must address soon the negative implication of this fiscal defict in order to avoid further inflation pressures, drains on the availablity of private sector credit and a large trade deficit and pressure on international reserves.

We must therefore continue our focus on macroeconomic conditionality and policy dialogue and deepen and clarify as in previous years our sectoral focus. It is the Mission view that such a movement to a more sectoral focus is one that is evolving as a result of progress achieved to date and the growing maturity of the program. The development of an ambitious policy agenda and its discussion with the new economic team was facilitated greatly by the Economic Policy Conference wich took place at the end of March, and which was co-sponsored by USAID/Costa Rica. Top Costa Rican economists of both parties were asked to prepare papers on the most important policy issues and these papers were reviewed by experienced policy makers and academicians from other countries, and by the World Bank and IMF officers. This allowed us to participate in a very intense policy dialogue where key policy issues were discussed in a totally open forum. A number of the policy measures discussed below (for example in public sector finances and fiscal issues) were presented at the Conference by the future President of the Central Bank, and this was the first public definition of his personal views of an economic adjustment program. The closing speech by the President-elect reinforced some of those themes. The Conference also identified areas of reform where opposition was strongest, and this has been invaluable for the Mission in assessing the political viability of the reforms. In discussions with the members of the economic team, they have used some of the arguments which were articulated in the Conference, and this also has contributed to an acceleration of the policy dialogue.

Review of the USAID/Costa Rica Action Plan in January, 1990 in A D/W resulted in an affirmation of the Mission's strategy of supporting long-term economic growth. Accordingly, the Mission will concentrate on three principal areas of policy dialogue and conditionality that complement this long-term growth strategy. These are:

(1) Macroeconomic and Financial Concerns;

(2) Public Sector Efficiency; and

(3) Export and Investment Promotion

B. Macroeconomic/Financial Concerns

ESR IX conditionality and policy dialogue in the macroeconomic/financial area will reinforce and protect past ESF efforts aimed at economic stabilization and growth. Of particular concern will be efforts to underpin IMF and IBRD conditionality in this area, particularly as befits export-led economic growth. This emphasis is appropriate in order not only to back up hard-won reforms that could be reversed, but also to support Costa Rican economic decision makers who often risk strong political pressures in order to implement sound economic programs. This latter rationale will be particularly important in this transitional political year as well as to offer measures of sound macroeconomic policy to the new team.

In addition to further reductions of Costa Rica's anti-export bias, structural problems of Costa Rica's public sector finances will be addressed as a means to consolidate economic reform efforts as overall asistance levels are reduced. Two Mission-financed studies of public sector finances are presently being prepared: one, a study of Central Bank losses and two, a comprehensive study which analyzes the Central Government expenditures, revenues, and domestic debt. Results of the studies shall be used in policy dialogue efforts toward the definition of medium term policies designed to diminish the structural problems of public sector finances.

ESR IX conditionality will necessarily include aspects of prior macroeconomic and financial conditionality carried over from prior programs. Political interference in the form of the provision of subsidized interest rates for various groups, for example cattle and basic grains producers, is a perennial issue in Costa Rica. As in the past, ESR IX conditionality will counter such pressures by conditionality that subsidized credit be strictly limited in 1990. As in 1989, the Mission will include within this credit limit from internal (including subsidized credit financed through the national budget) and external (donor) sources.

It is important to note that previous USAID infusions of credit and policy dialogue in the financial area have resulted in considerable progress and support to the private banking system and in ameliorating tight credit available to the private sector. A previous history of burdensome procedures, lack of private bank competition, and political interference had impeded an efficient response to the credit needs of the productive private sector. In this regard, the Mission will seek to support key decision-makers in the new Calderon Administration as they seek to further reduce the inequality of treatment between public and private banks. We will discuss measures to permit private bank access to rediscount lines through the Central Bank, and to allow private bank issuance of certificates of deposit of short maturities.

Especially considering the present fiscal concern in Costa Rica and the change in GOCR administrations, we feel it essential to reinforce and in some cases carryover an emphasis on economic stabilization in ESR IX. This approach acts to support the other major international donors and continues movement toward future reform objectives.

C. Public Sector Efficiency

Past USAID/Costa Rica PAAD's and Action Plans have sought to underline the importance of overcoming the effects of inefficiencies within the Costa Rican public sector. The importance of public sector efficiency and its direct impact on the long-term viability of the Costa Rican economy cannot be overemphasized. Deficiencies within public sector operation serve to limit the economy's movement from relative equilibrium to sustained growth and serve to directly undermine the progress attained in vital policy areas. These include preserving macroeconomic policy gains by limiting Central Bank losses and the fiscal deficit, export and investment promotion, and supporting the GOCR's capacity to continue its social services, particularly education and health care.

The importance of public sector efficiency comes into sharper focus as it relates both to the, firstly, largely successful structural adjustment program undertaken by the Costa Ricans to date, and secondly, to the chronic fiscal deficit problem that has become so

obviously a challenge to be confronted in 1990. From the point of view of structural adjustment, public sector efficiency is a central area of public policy that represents the next phase of a successful and thorough structural adjustment program. The restoration of fiscal discipline and administrative efficiency is necessary in order to reduce Costa Rica's unacceptably high level of current expenditures, that reduce in turn the capital account and contribute to the chronic fiscal deficit. From the perspective of the 1990 fiscal problem, the problem becomes more severe and underlines the veracity of claims that while Costa Rica's economic recovery is impressive, it is also fragile and incomplete.

Public sector employment in Costa Rica grew from 36,200 in 1962 to an estimated 160,000 in 1988. These numbers represent 9.8 and 20 percent of the labor force, respectively. Further, the GOCR itself report estimates that some 24,000 of these positions are redundant. Over the years public sector employees operating through their unions successfully secured a range of salary, other employment and pension benefits that neither the present nor future governments can realistically hope to finance. Consequently, in the 1980s the GOCR has been forced to drastically curtail capital expenditures to meet the recurrent cost demands of public sector institutions. This process routinely crowds out private sector borrowing. The problems go on an on, including redundancy in the public sector labor force, lack of adequate operational, maintenance and investment funds, and labor shortages in sprouting private sector firms which cannot compete under Costa Rica's present full employment conditions with the security and benefits packages of public sector employment.

The scope of the problem is enormous, complex and fraught with the political sensitivity of reforming public policy and institutions within a most democratic of settings. However, prospects for reform are not bleak, and 1989 saw the beginning of a growing consensus among Costa Rican political leaders and opinion makers and leaders in the donor community, that the problem must be addressed. This is considered by Mission observers as a significant positive and necessary development. Indeed, at the IBRD-sponsored Consultative Group meeting in Paris in November, 1989, GOCR representatives presented public sector efficiency and the restoration of public sector investment levels as one of the five top GOCR develoment priorities. This recognition by the GOCR is at least in part due to the low volume yet constant policy dialogue carried on by the Mission over the last three years. Over the past year, the Mission has, using ESF conditionality and intense policy dialogue as a lever and HCOLC and dollar-financed studies, technical assistance and seminars as an aid, assisted in the following actions:

-- Public sector employment levels have been frozen at 1987 levels;

-- A high level, bipartisan commission for the reform of the Costa Rican state has been formed and is working; (the new GOCR administration will provide State Reform with cabinet-level status);

-- Stage one of a customs reform sub-project is underway to modernize customs operational procedures and administration, and stage two, to support the development of an improved central customs terminal, is in the planning stages;

-- Actuarial studies for unifying Costa Rica's nineteen public sector pension systems have been funded and are underway;

-- One cabinet-level Commission and one Technical Commission have been formed within the GOCR to deal with pension reform. The commissions have drafted, reviewed, approved, and forwarded to the Legislative Assembly bills to reform both public and private sector pension programs;

-- A bipartisan, public/private sector group was sent to observe pension reform efforts in Chile, resulting in a draft legislation for a new private sector complementary pension savings plan;

-- The GOCR has designed and is implementing its first labor mobility program to move some 500 redundant public sector employees off the roles to the private sector. The first program within the Costa Rican Railroad should be completed by May, 1990;

-- The Ministry of Agriculture has requested USAID and IBRD assistance in the development of a restructuration plan of the Ministry to improve the efficiency of its operation.

-- The GOCR has approved the production of electrical power by the private sector in commercial quantities and its sale to the national grid (a first for Central America), and developed a rate structure for these sales;

-- The GOCR has approved the production of electrical power by the private sector in commercial quantities and its sale to the national grid (a first for Central America), and developed a rate structure for these sales;

In 1989, the Mission began a process aimed at assisting the GOCR to conceptualize and formulate a program to begin to address public sector efficiency issues. Earlier ESF conditionality on the subject --public sector employment freezes, CODESA privatization and the like-- were less a part of a comprehensive public sector efficiency plan than important targets of opportunity. It remained to convince the GOCR of the scope of the problem, help them begin to formulate the start of an action plan, and then, based on progress, go forward with specific programs.

The strategy is beginning to work. In mid-1989, the GOCR formed a high level and bipartisan commission ("Commission for the Reform of the Costa Rican State") to address public sector efficiency issues. The Commission has tried to define issues and has undertaken various studies, but perhaps more importantly, by its very existence has signaled that the Costa Ricans recognize and are beginning to grapple with the problem. This development was underlined as mentioned above in November, 1989 when the Costa Rican

delegation to the IBRD-sponsored Consultative Group meeting in Paris presented Public Sector Investment and Efficiency as one of their five priority development goals to this group. That this topic appeared in this public and high-level forum was further testimony to the subject's growing importance in Costa Rican minds.

USAID will continue the policy dialogue to assist this process and the development, hopefully in 1990, of a more comprehensive GOCR efficiency package. Signs are good that the process will continue and intensify during the Calderon Administration. The President Elect has elevated State Reform to a cabinet level post, and has appointed a PUSC member of the State Reform Commission as its Minister. This Minister-to-be is extremely motivated as evidenced by constant meetings with USAID on various public sector efficiency topics beginning the week after Calderon's election.

Pensions

Some of the most broad-based PSE progress has been made in the area of pension reform. Understanding that the overentitled an under funded public pension system was a loaded gun at the GOCR temple (funds run short at present rates in mid-1991), the GOCR, at USAID urging, formed a cabinet-level and technical level pension commission to consider pension system solutions and alternatives. Actuarial studies are underway (USAID financed) to allow rationalization of the present 19 public sector pension systems. TA financed by USAID from the U.S. Social Security Administration has further moved this process forward. A USAID-sponsored trip by GOCR, private sector and Costa Rican political party representatives to Chile to study pension reform there, resulted in the group devising upon their return draft legislation for a new complementary private sector pension saving plan, the first introduction of such a scheme in Costa Rica. The legislation has been approved by the pension commissions and submitted to the Legislature for approval. Further legislation has been developed by the pension Commission that radically reforms private sector pension operating procedures for example requiring increased automatic salary deductions and an increase in the minimum retirement age. This development was a subject of ESR VIII conditionality. The reform, though sure to be controversial, will likely be submitted to the Legislature in 1990. As controversial as pension reform is, a constant spate of articles in the local press in 1989 and early 1990 demonstrate that the issue is becoming better understood in Costa Rica and part of the public consciousness. USAID will continue our policy dialogue and financial support to GOCR and private sector pension reform efforts in the coming year, while urging in ESR IX conditionality the adoption of the reforms developed and proposed to date. Discussion with the Calderon team on the subject have been productive and positive, with a number of new Ministers-to-be requesting a briefing on the subject from USAID.

Customs Reform

The Mission has attempted since 1985 to assist the GOCR in improving its Customs Service, despite political sensitivities and vacillations of political will. Until 1989, the Customs Service had done little to alter its reputation as inefficient, slow and bureaucratic. Its problems have included an unclear organizational mandate, untrained personnel, an aura of incompetence, and manual and repetitious processing of paperwork. Some limited and non-controversial reforms were accomplished through ESR VI conditionality, but it was not until 1988 that the GOCR finally appeared ready to begin a serious customs reform effort. With

funding from USAID Policy, Planning and Administrative Improvement Project (PPAI), the Mission provided funds for stage one of a customs reform sub-project to improve and simplify administrative procedures and develop a customs software and information system. Though delayed in start-up by Central Bank contracting procedures, progress to date appears satisfactory giving rise to hopes that stage two, to proceed to an IDB and possibly USAID-assisted effort to establish a streamlined central customs processing center, may be realized. USAID will continue close scrutiny of its customs sub-project and advance the cause of continued GOCR customs reform through ESR IX conditionality.

Privatization

Past Mission efforts in privatization have been concentrated on facilitating the divestiture, privatization or dissolution of the holdings of Costa Rican Development Organization (CODESA). This process, underway since 1984, has been thoroughly documented and explained in past PAADs. Given the availability of HCOLC devoted to divestiture from past ESF HCOLC, the cutoff of CODESA access to Central Bank credit in 1985, political will to carry the program forward during the Monge and Arias administrations, and the organizational structure to implement the program, CODESA privatization/divestiture has largely been completed. A summary of the status is contained in Annex E. What remains is for the GOCR to complete the sale of 40% of the shares of two companies, FERTICA and CEMPSA. This process should be completed by the end of 1990. At its peak, CODESA contained some 42 dubiously managed and ineffective companies with free and unlimited access to Central Bank credit --a textbook example of the public sector run amuck. The perhaps major lesson from the CODESA experience has been that reform, even of politically sensitive areas, can be accomplished when the objectives are clearly defined and linked to policy goals, capitalized, and when the government takes the lead in supporting the program.

Beyond CODESA, the Mission has undertaken a number of exploratory initiatives in privatization with a number of GOCR organizations. For example, the Social Security Administration has requested Mission technical assistance in establishing new private sector organizations to take over current in-house support and service functions, separating personnel in these functions from the CCSS and transferring them to the new organizations. Talks are progressing with the Minister of Public Works on Mission involvement in a similar privatization program. At the request of GOCR, the Mission has arranged for the development of a Separation Incentives Program for the Railways, National Production Board and the Ministry of Agriculture that has as a target the separation of over one thousand redundant employees. (See Labor Mobility section below)

The next administration, with control of the Legislative Assembly, can be expected to initiate additional privatization activities in which the Mission can play a role. These could include privatization of the remaining 60% of FERTICA and CEMPASA, CODESA's 40% holdings in the National Securities Exchange, Radiográfica Costarricense (possibly together with international telecommunications), the National Liquor Factory and the National Insurance Company.

The incoming Minister of Tourism seems receptive to the Mission's offer of technical assistance in restructuring and streamlining the National Tourism Institute which will in effect become the new Ministry of Tourism. He also seems interested in indirect Mission involvement through FINTRA (a Mission created and funded fiduciary entity) in developing the infrastructure for a planned large scale tourist complex at Papagayo.

The Mission will continue to pursue, therefore, targets of opportunity in privatization, through policy dialogue with the GOCR and USAID-financed support (TA, studies and specific programs).

Labor Mobility

As stated above, the GOCR acknowledges that of its 160,000 public sector employees, many are redundant. The low level of technical training of the vast majority of these employees makes for low governmental productivity, creating a host of institutional, administrative and legal problems. The nineteen generous pension systems for the public sector which now absorb fully 3% of Costa Rica's GDP. Public agencies are plagued by a lack of planning, duplication of functions, and inefficient use of information in public administration. The situation is complicated by a rigid civil service system and a code of civil law that is sometimes inconsistent, contradictory and obsolete.

Spurred on by social democratic traditions and bolstered by a past epoque of high traditional export earnings and different demographics, public workers successfully secured a range of salary, employment and pensions benefits that neither present nor future governments can realistically hope to finance. By the 80's the GOCR was being forced to drastically curtail capital expenditures in order to meet the entitlement-driven recurrent cost demands of public sector institutions.

A related problem created by public sector inefficiencies, particularly overstaffing and overentitlement, is a structural rigidity that prevents easy movement of the work force between public and private sectors. On one hand, increased private business investment on the Meseta Central, particularly in draw-back industries and other non-traditional export operations, is pushing the economy in the direction of full employment. On the other hand, overstaffed and overendowed public sector agencies lock in large numbers of public employees that could, in principle, be used more efficiently and productively in the private sector work force.

Beginning in 1989, serious discussion began with the GOCR regarding the design and funding of labor mobility programs to move excess GOCR employees to the private sector. The 1989 PAAD described the tentative first steps in dialogue process with the GOCR, and how the Mission would pursue the design and implementation of labor mobility programs using local currency programming. The Mission recognized then and now the considerable issues of labor mobility. First, the programs are obviously politically very sensitive in Costa Rica. As well, there are complex design issues of pension benefits, severance pay, salary levels, and technical training to improve transferee skills and marketability.

The GOCR became interested in labor mobility in mid-1989, mainly through the Office of Control and Follow-Up (OCS) in the Ministry of the Presidency, and the Ministry of Agriculture. Immediate GOCR concern centered on three institutions --the National Railroad (INCOFER), the National Production Council (CNP), and the Ministry of Agriculture. The GOCR was concerned about the inefficient organizations' drain on the already weakened system of public finance as well as ties by the IBRD of future sector loans to GOCR progress in dealing with various agriculture and transport inefficiencies. The GOCR has completed a plan to remove, as a first stage, 500 INCOFER employees and move them to the private sector. Following extensive talks with the OCS, the equivalent of $1.0 million in ESR VIII HCOLC has been sectorally programmed to carry out the program, which should be completed by May, 1990. Somewhat ironically, the February election results put at least a temporary hold on present GOCR plans to design and implement the CNP and MAG labor mobility programs (ironic in the sense the present GOCR became convinced of the need of such programs only soon before being voted out of office). A further $5.0 million in HCOLC has however been programmed from ESR VIII for labor mobility and will be held in reserve until policy dialogue with the new administration allows further progress. The Mission remains optimistic that this initiative will bear more fruit in 1990.

The Mission believes that labor mobility, despite the sensitivities, represents a vital opportunity for the GOCR that must and should be pursued. Given public sector efficiency as a very high Mission priority, we are prepared to mutually program more HCOLC in 1990 for labor mobility program incentives, design and implementation. Such programs would be based on studies to identify priority needs and institutions, the design of replicable incentive packages, and an administrative structure to carry out the programs, preferably outside the GOCR. Mission preference for such a management organization would be FINTRA, the private sector group that has so successfully carried out the CODESA divestiture program, though this must be negotiated with the GOCR. The Mission is including a covenant in the ESR IX agreement which requires the GOCR to develop a labor mobility plan in 1990.

Improved Administrative Efficiency

Serious efforts at solving public sector inefficiency problems must particularly be directed at those inefficiencies that undercut Costa Rica's considerable progress in supporting sustained economic growth. For example, the Mission plans to continue supporting efforts to streamline export and import procedures. (ESF conditionality has urged successfully for the establishment of a one-stop window for exporters, for example.)

In a related area, the GOCR budgeting process could improve enormously by shifting to budgeting by program rather the present system of incremental budgeting. The latter assumes that wages, transfers and debt service are fixed costs items, and then allows the same percentage increase per Ministry on the shrinking category of "good and services". This approach introduces a major degree of inertia and inflexibility into the system, generating situations like those of agricultural extension workers "grounded" because there is no money to buy gasoline for the cars parked outside the offices. Obviously, for the new system to be effective, it has to be be complemented by: (1) more flexibility and discretionary power to executing agencies to shift allocations according to changing needs; (2) shifting from cumbersome and time consuming ex-ante to ex-post controls design to deter and detect mal performance; (3) measuring success predetermined and well defined objectives; and (4)

evaluating overall implementation of programs, with feedback to the budget preparation management. Procedures for contracting and paying expeditures should be streamlined, eliminating duplicate functions carried out the Ministry of Finance and the Controller's office. This area will be addressed in ESR IX conditionality.

Further, public utility rates and the price of gasoline and diesel are established by the Servicio Nacional de Electricidad (SNE), and autonomous institutions. State-owned enterprises submit their request for prices changes to SNE, the SNE analyses the request, and then it desides whether or not will be approved. Often SOEs do not submit requests for tariff/price modifications because of political considerations. A clear example of this took place in 1989, an election year, when utility rates and the price of gasoline and diesel were not adjusted to reflect higher costs of inputs, and this was an important factor that contributed to the large fiscal deficit. There is a need to establish a system that would adjust prices automatically when exogenous factors change, thus moving the tariff modification process outside the political arena. The establishment of such system is a subject of ESR IX conditionality.

The Mission in 1989 explored another area of administrative efficiency at some length, i.e., the relationship between central and local government. It is ironic that Costa Rica, one of the world's most vibrant democracies, is also one of the most centralized. Theoretically, an optimum level of public sector efficiency is approached between a division of responsibilities between a central government and local authorities. Costa Rican authorities have recognized the basic incompatibility between a centralized authority and a strong democratic tradition, and have initiated the process to enact decentralization legislation. This constitutional reform did not advance through the Legislative Assembly in 1989 due to the subject's sensitivity in an election year. The reform movement is still very much alive and should be pursued by the Assembly and political parties in 1990. The reform, if approved by the legislature, would represent the most far reaching step towards decentralization of responsibility and authority from the central government to municipal governments since the Constitution's adoption in 1949. This reform proposes to shift a portion of central government revenues to the 85 municipal governments over a ten year period, transfer responsibility for certain basic services from the central government to local municipal governments, create a uniform civil service system for municipalities, and fund a municipal staff training and technical assistance program.

In 1989, the Mission contracted for a comprehensive municipal development study. The study, recently completed, concludes that efficiencies gained in Costa Rica from centralizing services such as electricity, water and so forth have reached the point of diminishing returns and that decentralization of services, and central government authority in general, must begin to devolve to municipalities or regional organizations. There is a concensus within the GOCR that this is the case, though there is considerable disagreement on how to do it. The Mission will carry forth the issue of effective decentralization with the new administration as part of its policy dialogue agenda.

USAID will seek through policy dialogue and other opportunities to promote appropriate programs and policies to improve the provision of public services through administrative and fiscal decentralization as well as through the aforementioned means of privatization and labor mobility. For example, the Mission recently submitted a successful

proposal for the "private provision of social services" competition of the late former AID Administrator. This proposal, now a DA project design effort, will involve development of sanitary landfill and garbage services by the private sector --a function presently handled exclusively and inadequately, by government authorities. Further, using either HCOLC or funds under the PATS project, the Mission will be prepared to fund selected management reorganization appraisals of public sector ministries and organizations to enhance their effectiveness, in many cases through devolving or privatization of functions or other means. A present reorganization study has been requested by the Ministry of Agriculture which will involve, likely, a labor mobility program as well as development of a fees-for-services plan.

Private Power Generation

Private power generation is an area of emphasis that has emerged as a significant issue in Costa Rica and one that has received important, though modest, Mission support. Costa Rica now expects serious shortfalls in the production of domestic power resources in the period 1990-1992. Though not a major thrust per se of the Mission, AID has financed a series of excellent studies and consultancies that clearly demonstrate the potential of private Costa Rica power producers, particularly from bagasse-burning sugar mills and small hydro, to produce about 120 MW of the shortfall, or about 15% of Costa Rica's total demand, within the coming 2-3 years.

The GOCR, sugar industry officials and the national electrical authorities all agree that the production of private power in small commercial excess quantities to the national grid represents an idea with great promise for Costa Rica. In 1989, the major issues to permit this production were legal, one to permit private power production in commercial quantities, and administrative, to determine an adequate price structure for the grid's purchase of the produced excess power. Both of these issues were actively pursued by the Minister of Natural Resources, with assistance from AID/W. The Mission helped orchestrate these issues' resolution by sending a GOCR, private sector, banking, etc. group to Hawaii and California to observe a private power generation from sugarcane, and see the pricing, administrative, and regulatory measures undertaken in the U.S. to facilitate private power production. AID conditionality in ESR VIII for these two reforms was successfully complied with by mid-1989.

Private power sales to the Costa Rican grid began at modest levels in September, 1989 (a first for Central America) and further investment in cogeneration infrastructure continues. Significantly, the first large scale production of private power by a sugar mill and sale to the national grid is slated to begin in May, 1990. USAID will continue to support private power production in Costa Rica. An ESR IX covenant will require continued support for the legality of such production and sales by the private sector to head off what could possibly be intentions by a few members of the National Assembly to put power production back in the exclusive hands of the public sector. Such a move is not considered likely and the covenant therefore is precautionary.

Support for private power production serves to support a positive policy initiative in which AID has been instrumental since inception, reinforces and protects Mission investment and export production goals, as well as balance of payments objectives (optional imported power is paid in precious foreign exchange). From the public sector efficiency

perspective, there is no reason to promote the expansion of a public utility company when private power producers are presently able to begin to make up the projected shortfall at the same or lower production costs than the utility options.

D. Export and Investment Promotion

USAID's primary strategic emphasis in Costa Rica has been and will continue to 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, the country must increase its foreign exchange earnings if it hopes to achieve sustained long term growth.

A continued shift in the country's structural underpinnings is necessary to permit increases 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.

Though non-traditional exports increased by 17% in 1989, it is imperative for several reasons that export earnings, particularly from non-traditional products, continue to increase. 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. 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 conditionalities 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 unified exchange rate have had the effect of maintaining the profitability of exports though we estimate a present need to devalue a further 20% by the end of 1990. 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 implementation of SAL II in our policy dialogue efforts with the Bipartite Commission and private sector groups.

USAID/Costa Rica has provided over $250 million of term credit for the productive, including exporting, private sector since 1982 in special dollar and local currency credit lines. 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 previous sections 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 from ESF local currency resources. CINDE's investment promotion program for the industrial sector (PIE) is implementing an intensive plan to identify investors and sell them on the advantages of Costa Rica as a place for doing business. Currently funded at about $4 million per year CINDE/PIE has attracted over $300 million in non-traditional export investments during the period 1986 through 1989. This has resulted in the creation of about 30,000 direct new jobs for the investment period.

CINDE is also addressing foreign and domestic investment in the agricultural sector in much the same way as the industrial sector. Overseas offices have targeted new investment and job generations with concommitant targets of shifting domestic agricultural investment into non-traditional crops. An office has opened in Miami and is acting to coordinate the marketing of non-traditional products in the United States and as a conduit for investment.

CINDE's extraordinarily successful export and investment promotion programs have depended on annual infusions of ESF-related local currency funding. Given the decline in Costa Rica's ESF levels, this pattern is not sustainable in the future. A major focus of the policy dialogue with the GOCR this year has been the design and negotiation of a sustainable funding mechanism to allow continuation of these programs while protecting their technical independence in operations and staffing.

Agreement was reached on the establishment of an Export Fund which will house an endowment whose annual income will support continuation of export and investment promotion programs. At last November's Consultative Group meeting in Paris, the GOCR proposed the Fund and solicited participation by other donors.

The BCCR has already committed itself to annual contributions of C298 million (currently about $3.5 million) for twenty years, drawn from its spread on an export-oriented credit line funded under ESR VII. In February, AID/W approved a design document which detailed the Mission's proposed participation in the Fund. HCOLC equivalent to $27.15 million provided under ESR VIII will be allocated to the Fund. It is presently expected that the bulk of the local currency connected with the 1991 ESF program will also be programmed for the Fund. Although it is too soon to predict the level of participation by other donors, the GOCR has already received favorable indications from the Taiwanese.

A brief summary of the Fund and its rationale is attached as Annex H. For further details, the reader is encouraged to consult the February design document which is available in LAC/DR.

E. Special Concern-Expropriations

Beginning with the negotiations of the ESR VIII program and continuing to the present. USAID as part of the Country Team, has continued to express its concern to the GOCR regarding some nine expropriation cases involving U.S. citizens in Costa Rica. As a side letter to the ESR VIII Agreement, the GOCR agreed that it would make its best legal efforts to resolve the expropriation cases (mostly involving land holdings expropriated for inclusion into Costa Rican parks and protected areas) expeditiously as well as report quarterly on progress achieved. As of April, 1990, one of the cases (Bandelin) was completely solved with the claimant receiving nearly full compensation. Two more cases have been successfully negotiated. As a response to this less than ideal progress, as well as our concern regarding the fiscal situation, USAID has not (as of April, 1990) disbursed the third and final tranche of ESR VIII ($20 million).

GOCR authorities indicate that they are pursuing resolution of the cases to the extent permitted by Costa Rican law. While there has been some progress, and a recent flurry of activity by the GOCR provides some temporary ground for optimism, it is clear that much more remains to be done. (See status report contained as Annex D).

The Mission has continued to push the Arias administration to solve the cases but given their little time left in office, sees it highly unlikely that further progress will be made by them. We have briefed the incoming Calderon administration about the problem and the depth of our concern. Given this, the Mission proposes to continue to hold a portion of the final tranche of ESR VIII until we judge that the GOCR has made adequate progress in resolving the remaining cases . Given the USG interest in proceeding with the debt buy-back to be supported with the first tranche of ESR IX, we propose that ESR IX should not be conditioned per se on resolution of the expropiation cases. As detailed in Section VI.A, we proposed that the first ESR IX tranche of $33 million be disbursed without conditions for the debt buy-back. We propose further that $10 million of the remaining $20 million of ESR VIII be disbursed as a second tranche once the GOCR presents an acceptable economic plan for 1990. The GOCR would also provide with the economic plan a side letter that obligates the new Calderon administration to apply its best legal efforts to solve the remaining cases. In return for satisfactory progress, the final $10 million under ESR VIII would be disbursed, likely as the final tranche. Such an approach will permit the new Calderon team a fair chance to deal with the problem, while not obviating the unique debt buy-back opportunity for which the first ESR IX tranche will be dedicated. The third disbursement of $27 million from ESR IX will be disbursed upon satisfactory GOCR performance under the economic plan and conditionality. Otherwise, USAID will continue its strong support of country team efforts to resolve the remaining cases during 1990.

VIII. CONDITIONS AND COVENANTS

General

ESR IX conditionality will support the priorities and accompanying policy dialogue issues discussed in Section VII above. Conditionality on financial/macroeconomic concerns. public sector efficiency and investment and export promotion will help assure that the policy objectives of the balance of payments program are achieved.

The ESR IX Agreement will be signed by AID and the GOCR following PAAD authorization, likely in May. Discussions on the 1990 ESF program have been underway with members of the present GOCR and newly elected economic team on the debt buy-back and on related policy dialogue topics. Discussions intensified in April, allowing the Mission to assess very positively the prospect of concluding ESR IX negotiations very soon after PAAD review and authorization though some modification in final conditionality language is inevitable.

As explained in Section VII.E. above, the Mission has yet to disburse the final $20 million tranche of ESR VIII due to unsatisfactory progress in resolving a defined set of nine outstanding expropriation cases involving U.S. citizens. Further, events of late April, 1990 indicate that the first ESR IX tranche of $33 million will need to be disbursed for the debt buy-back very quickly perhaps no later than May 7. The USG needs to be positioned to support this multi-donor effort. Furthermore, in order to encourage the new GOCR administration to adopt a sound economic program, the Mission proposes that $10 million of the remaining $20 million of ESR VIII be disbursed to the new GOCR upon delivery of the required acceptable economic plan for 1990. (The final ESR VIII $10 million will be held until satisfactory progress is made by the GOCR on the expropriation cases described in the previous section.)

The GOCR's economic plan will include quarterly limits for the following: (1) Central government expenditures; (2) cumulative financial balances of the CCSS, RECOPE, ICE, CNP, and JPS; (3) net domestic assets of the Central Bank; (4) changes in banking system credit to the non-financial public sector; (5) the net international reserve position of the Central Bank; and (6) arrears on external payments.

The remaining $27 million of ESR IX would be disbursed as a third tranche, likely by the end of the third calendar quarter of 1990, following a Mission evaluation of satisfactory GOCR performance under the plan and ESR IX conditionality.

This scenario would somewhat resweeten the pot with the Calderon administration, would help restore some leverage lost if the buy-back were completely separated from the economic program, and would allow substantial support for implementation of a sound economic program to the tune of the remaining $27 million. It also retains an appropriate incentive ($10 million) for addressing outstanding investment disputes.

Indicative conditionality to be negotiated with the GOCR is as follows:

Macroeconomic/Financial

1. To maintain outstanding balances of subsidized credit during calendar year 1990 no higher than 1988 levels, or 7.7 billion colones; and which do not exceed that level by more than 5% on a purely seasonal basis during the course of 1990; and to report to AID within three months of the end of each calendar quarter, information sufficient to demonstrate compliance with this condition. Subsidized credit is defined as credit extended by domestic financial institutions from all domestic and external sources at interest rates lower than the six-month deposit rates, including credit at subsidized rates when subsidies granted by the government or other organizations raise the return to banks to a level equal to the six-month deposit rate.

2. To provide to AID from the beginning of this Agreement until the end of calendar 1991, copies of all reports to the International Monetary Fund as required under present or future agreements with the Fund and other information that AID considers relevant to assessment of the economic program; to provide these reports to AID at the same time they are provided to the IMF; and in the event that at any time during such period no agreement with the Fund is in effect, to provide to AID reports whose timing and content shall be substantially similar to those provided to the Fund.

3. In order to reduce the inequality of treatment between public and private banks, introduce legislation to permit private bank access to domestic funds rediscounted through the Central Bank, and to allow private bank issuance of certificates of deposit of short maturity.

Public Sector Efficiency

4. To plan and develop a program for public sector labor mobility by December 31, 1990 that includes detailed institutional, operational and financial feasibility targets. Institutions for inclusion in the labor mobility program may include but not be limited to CNP, INCOFER, CODESA, and MOPT.

5. To affirm its commitment to maintain public sector employment levels at levels below or no higher than that of December 31, 1989 through calendar year 1990 and to provide quarterly reports to AID through March of 1991 regarding the numbers of public sector employees, numbers of vacant positions and salaries paid, that demonstrates compliance with this goal.

6. To continue implementation of the modernization of the National Customs Service to improve services to exporters and importers, and to improve collections for the National Treasury.

7. To undertake a study for the development of a new national budgeting process and submit a draft budget reform law to the National Assembly by December 31, 1990 which, among other things, makes the budget process more responsive to performance and other budgetary goals.

8. To develop and implement a system for the automatic adjustment of public utility and fuel prices on the basis of objective criteria (international prices, etc.).

9. Guided by actuarial studies being prepared under the auspices of the Ministry of Finance and reform efforts advanced by the CCSS and the GOCR Technical Pension Commission, to propose a calendar and exert its best efforts for the implemention of a pension reform program which will result in a unified, more efficient and economically feasible public sector pension system.

10. To submit legislation for the adoption of the complimentary private savings system recomended by the GOCR Technical Pension Commission, and presented to the GOCR Pension Commission in February, 1990, to the National Assembly no later than July 1, 1990.

11. To continue support for the private production of co-generated electricity in commercial quantities and its sale to the national electrical grid.

12. To present to AID a schedule for financial and compliance audits of AID-related projects on a quarterly basis, and to complete such audits, as agreed to separately by the USAID Controller and appropriate GOCR representatives.

13. To design and implement no later than December 31, 1990 a system to measure the efficiency of public sector enterprises with particular emphasis on investment versus current expenditure levels and the adequate provision of services.

14. To limit CODESA's activities such that it will be permitted neither to access Central Bank investment credit nor to guarantee new investments;

    To exert its best efforts to maximize the sale of the shares of FERTICA, CEMPASA and STABAPARI by December 31, 1990.

    To continue supporting the planning and implementation of privatization activities of GOCR-owned enterprises including complete or partial divestitures, liquidations, and contracting for services to the private sector.

15. To continue to reduce the role of the CNP in the commercialization of basic grains, and to eliminate import licensing and all other non-tariff restrictions on imports of beans, corn, and rice.

Export Promotion

16. To continue the process of reduction of tariff ceilings and raising of the tariff floor to reduce effective protection.

17. To continue support for the creation and operation of the "Export Fund" in reorganization of Costa Rica's export and investment promotion operations, and exert its bests efforts to assure permanent resources for this Fund.

STATISTICAL APPENDIX

Annex A

Table 1

Selected Economic Indicators

	1982	1983	1984	1985	1986	1987	1988	1989	1990
GDP - Current Prices (Mil Colones)	97505	129314	163011	197920	246579	284853	358219	428859	509714
GDP - US$ Equivalent	2607	3146	3665	3927	4403	4536	4726	5230	5510
GDP - Constant 1966 Prices	8743	8993	9715	9784	10526	10833	11243	11805	12321
Growth of GDP - Constant Prices									
GDP	-7.3	2.9	8.0	0.7	5.5	4.9	3.8	5.0	4.4
Basic Productive Sectors	-10.8	3.0	11.3	-1.0	5.8	4.8	3.8	5.1	4.1
- Agriculture	-4.7	4.0	10.1	-5.5	4.8	5.0	6.2	5.4	2.1
- Manufacturing	-11.4	1.8	10.4	2.0	7.2	5.5	2.2	4.5	6.0
- Construction	-31.9	4.7	23.6	5.6	3.1	-0.1	1.6	6.9	3.1
Government	-2.9	-1.6	1.5	0.5	2.0	2.5	2.5	2.5	2.5
Other Sectors	-4.5	3.8	6.2	2.6	5.9	5.6	4.0	5.4	5.1
Prices									
GDP Deflator (Annual Average)	84.2	28.9	16.7	20.5	18.0	10.1	21.2	18.0	14.0
Consumer Prices (End of Period)	81.5	10.7	17.3	10.9	15.4	16.4	25.3	10.0	20.0
Wholesale Prices (End of Period)	90.1	32.6	11.9	15.1	11.8	16.8	20.8	10.7	18.7
Labor									
Unemployment (%)	23.8	19.9	6.4	6.8	6.2	5.6	5.6	5.3	5.0
Employed Labor Force (000)	760.0	788.3	800.1	826.7	854.2	923.3	972.6	1025.0	1049.0
Real Average Wages (1980=100)	77.1	86.3	93.5	100.5	105.6	105.4	102.8	104.0	106.0
Exchange Rate (Ave Colones per US$)	37.4	41.1	44.5	50.4	56.0	62.8	75.8	82.0	92.5
(End of Period)	40.5	43.7	48.0	54.0	59.3	69.8	80.0	84.9	100.0

Table 2. PERFORMANCE OF GROSS DOMESTIC PRODUCT BY EXPENDITURE ITEMS

	1982	1983	1984	1985	1986	1987	1988	1989	1990
B. Index (1977=100)									
GDP	101.8	104.7	113.1	113.9	120.3	126.2	130.9	137.5	143.5
Net Foreign Balance	-179.5	-111.9	-127.1	-73.3	-3.7	-25.5	-108.1	-107.8	-136.1
Imports of Goods & Services	64.4	74.6	82.6	87.5	102.9	121.0	120.0	136.9	143.2
Exports of Goods & Services	114.1	112.6	125.3	120.3	124.6	150.8	166.4	186.6	200.0
GDExpenditures	82.6	89.9	96.7	101.1	111.8	115.8	114.6	120.7	121.3
Consumption	92.4	96.1	102.5	106.4	111.5	115.6	118.9	124.8	129.9
Private Consumption	90.1	95.1	102.0	106.4	112.1	116.5	119.7	126.3	131.9
Public Consumption	104.2	101.1	105.1	106.2	108.7	111.1	114.5	117.3	120.3
GDInvestment	54.1	71.9	79.8	86.0	112.5	116.4	102.2	108.7	99.7
GFInvestment	61.2	66.3	83.6	88.1	98.6	108.3	105.4	114.2	111.8
Public	64.0	72.3	77.5	94.2	97.0	97.3	78.1	80.6	72.0
Private	59.8	63.1	86.8	84.9	99.4	114.1	119.7	131.7	132.7
Change in Inventories	-16.6	127.4	42.1	64.8	249.7	196.1	70.2	55.0	-20.3
Private + Inventories	49.6	71.8	80.8	82.2	119.5	125.1	113.1	121.5	112.2
GDE	82.6	89.9	96.7	101.1	111.8	115.8	114.6	120.7	124.3
GDE(C+I)	82.6	89.9	96.7	101.1	111.8	115.8	114.6	120.7	122.2
C. As percentage of GDP									
Gross Domestic Product	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Net Foreign Balance	13.0	7.8	8.3	4.7	0.2	1.5	6.1	5.8	7.0
Imports of Goods & Services	27.5	31.0	31.7	33.4	37.2	41.7	39.8	43.3	43.4
Exports of Goods & Services	40.5	38.8	40.0	38.1	37.4	43.2	45.9	49.0	50.3
Gross Domestic Expenditure	87.0	92.2	91.7	95.3	99.8	98.5	93.9	94.2	93.0
Consumption	72.4	73.2	72.3	74.5	74.0	73.1	72.4	72.5	72.3
Private Consumption	59.0	60.6	60.1	62.3	62.2	61.6	61.0	61.3	61.3
Public Consumption	13.4	12.7	12.2	12.2	11.9	11.6	11.5	11.2	11.0
Gross Domestic Investment	14.6	18.9	19.4	20.8	25.8	25.4	21.5	21.8	19.1
Gross Fixed Investment	15.0	15.8	18.5	19.3	20.5	21.5	20.1	20.5	19.5
Public	5.4	5.9	5.9	7.1	6.9	6.6	5.1	5.0	4.3
Private	9.6	9.9	12.6	12.2	13.5	14.8	15.0	15.7	15.2
Change in Inventories	-0.4	3.1	0.9	1.4	5.3	3.9	1.4	1.0	-0.4
Private + Inventories	9.2	13.0	13.5	13.7	18.8	18.5	16.4	16.7	14.8
Gross Domestic Expend. (GDP+NFB)	87.0	92.2	91.7	95.3	99.8	98.5	93.9	94.2	97.1
Gross Domestic Expend.(C+I)	87.1	92.2	91.7	95.3	99.8	98.5	93.9	94.2	95.4

Table 3. **PERFORMANCE OF GROSS DOMESTIC PRODUCT BY PRODUCTIVE SECTOR**

Percentage of GDP	1982	1983	1984	1985	1986	1987	1988	1989	1990
Agriculture(+Forestry,Hunting,Fishing)	19.9	20.1	20.5	19.2	19.1	19.1	19.5	19.6	19.2
Manufacturing(+Mining,Quarrying)	21.4	21.2	21.6	21.9	22.3	22.4	22.0	21.9	22.3
Construction	3.7	3.7	4.3	4.5	4.4	4.2	4.1	4.2	4.1
Electricity(+Water)	2.9	3.4	3.2	3.0	3.0	3.1	3.0	3.0	3.0
* Construction Elect & Water	6.6	7.1	7.5	7.5	7.4	7.2	7.1	7.1	7.1
Commerce(+Restaurants,Hotels)	15.7	15.8	16.3	16.9	17.1	17.1	16.8	16.9	17.2
* Commerce & Other Services	20.2	20.2	20.5	21.2	21.3	21.3	20.9	21.0	21.1
Transport(+Warehousing,Communications)	7.6	7.5	7.2	7.3	7.5	7.7	8.0	8.2	8.4
Financial Services	5.7	5.8	5.7	5.9	6.0	6.2	6.5	6.5	6.6
Housing	7.8	7.7	7.2	7.3	7.0	6.9	6.8	6.7	6.6
Services(Other personal services)	4.4	4.4	4.2	4.3	4.2	4.1	4.1	4.0	4.0
Government	10.9	10.5	9.8	9.8	9.5	9.3	9.1	8.9	8.8
Gross Domestic Product (Sum of above)	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Basic Productive Sectors(A+M+C)	44.9	45.0	46.4	45.6	45.7	45.7	45.7	45.7	45.6
Government	10.9	10.5	9.8	9.8	9.5	9.3	9.1	8.9	8.8
Other Sectors	44.1	44.5	43.8	44.6	44.8	45.1	45.2	45.4	45.6

Table 4

Costa Rica Monetary Authorities Account 1984-89

	(50 colons/$US1)		(56.5 colons/$US1)		(63 colons/$US1)		(76 colons/$US1)		(85 colons/$US1)	
	1984	1985	1985	1986	1986	1987	1987	1988	1988	1989
	(End of period. In Costa Rican Colones)									
Net International Reserves	-13111	-3317	-3747	-8202	-9146	-19467	-23485	-24168	-5661	-2261
Official Reserves (net)	-2256	-1022	-1154	1979	2207	-2577	-3109	4864	5440	1462
Payment Arrears	-10855	-2295	-2593	-10181	-11353	-16890	-20376	-29032	-11101	-3723
Net Domestic Assets	22996	16573	17003	25509	26453	38957	42974	48918	30395	23757
Public Sector Credit (net)	31874	32896	34244	44712	48061	38698	43532	39791	43852	43000
Rest of Banking System Credit	-10454	-11108	-12443	-11106	-12072	-6627	-8724	-12776	-14248	-13225
Govt Trust Funds	-4478	-10985	-10985	-18263	-18263	-15656	-15656	-23736	-23736	-23681
Counterpart arrears (nfps debt)	9542	2295	2593	10165	11334	16495	19890	29032	11101	3723
Oper losses of Central Bank (Cash basis)	22523	37359	37359	42118	42118	43982	43982	46193	46193	-8207
Med & Long-term Foreign Liabilities	-76806	-83171	-93983	-102979	-114826	-101821	-125111	-125967	-140884	-85787
Stabilization Bonds	-4895	-4900	-4900	-5079	-5079	-7648	-7648	-11204	-11204	-14621
Other Items (net)	55609	54187	65118	65941	75180	71534	92709	107585	119321	122555
(of which valuation adj)	28118	28118	38050	38050	47289	47289	68464	68464	80200	80200
Currency Issue	9885	13256	13256	17307	17307	19469	19469	24734	24734	29062

Costa Rica Monetary Survey, 1984-89

	(50 colons/$US1)		(56.5 colons/$US1)		(63 colons/$US1)		(76 colons/$US1)		(85 colons/$US1)	
	1984	1985	1985	1986	1986	1987	1987	1988	1988	1989
	(End of period. In millions of Colones)									
Net International Reserves	-11475	-1331	-1504	-4761	-5309	-15288	-18443	-19015	103	3639
Foreign Assets (net)	-625	964	1089	5420	6044	1602	1933	10017	11204	7362
Foreign Assets										
Foreign Liabilities										
Payment Arrears	-10855	-2295	-2593	-10181	-11353	-16890	-20376	-29032	-11101	-3723
Net Domestic Assets	73354	71205	73223	92419	95044	98874	139472	163300	160444	185502
Public Sector Credit (net)	26985	23845	26161	35690	38956	31762	36530	39820	43443	42202
-Adjusted Net Credit	17073	17578	26161	25038	38956	30807	36530	36279	43443	42202
(Note: Counterpart of public sector debt assumed by Central Bank)	9912	6270	0	10652	0	955	0	3141	0	0
-Central Govt										
-ROPS										
Private Sector	32490	37733	38183	44824	45081	56806	57369	63400	63859	71587
Med & Long-term Foreign Liabilities	-79806	-86881	-98181	-104209	-116198	-103273	-126863	-127880	-143006	-163474
Other Items (net)	93685	96505	107060	116114	127205	113579	172436	188360	196148	235187
Govt Trust Funds										
Counterpart arrears (nfps debt)										
Oper losses of Central Bank										
Liabilities to Private Sector										
Broad Money (M2)	61879	69874	71719	87658	89784	114394	121029	144285	160548	189141
Money	25710	28970	28970	39901	39901	40225	40225	54936	54936	64542
Quasi-money	36169	40904	42749	47757	49883	74169	80804	89349	105612	124599

Table 5. BALANCE of PAYMENTS, 1982-1990

								Proj	with debt reduction plan	without debt reduction plan
	1982	1983	1984	1985	1986	1987	1988	1989	1990	1990
Current Account (1)	-241.5	-300.0	-250.4	-289.9	-150.2	-376.4	-304.4	-458.4	-294.1	-475.0
Non-Interest Current Account	100.4	27.0	63.6	-9.6	129.4	-91.7	27.0	-123.1	-80.0	-80.0
Merch Trade Balance	-25.2	-140.7	-130.8	-173.9	-76.6	-281.7	-236.2	-431.9	-458.0	-458.0
Exports, fob	869.0	852.5	971.4	937.0	1084.8	1107.0	1184.1	1335.6	1396.2	1396.2
Coffee	236.9	230.0	267.3	315.8	391.9	334.5	316.4	300.4	237.8	237.8
Bananas	228.1	240.4	251.0	208.0	216.6	228.6	219.9	256.1	284.0	284.0
Other Traditional	69.7	55.7	79.0	79.7	80.1	77.6	68.2	64.4	71.4	71.4
Nontraditional	0.0	0.0	374.1	334.4	396.2	473.4	579.5	703.0	803.0	803.0
Imports, cif	-894.2	-993.2	-1102.2	-1110.9	-1161.4	-1388.7	-1420.3	-1767.5	-1854.2	-1854.2
Official Interest Net	-341.9	-327	-314	-280.3	-279.6	-284.7	-331.4	-335.3	-214.1	-395
Paid	-106	-275.4	-208.7	-245	-181.8	-102.7	-123.2	-166.4	-214.1	-395
Unpaid	-235.9	-52.3	-105.3	-35.3	-97.8	-182	-197.5	-168.9	0	0
Other Services & Private Transfers	125.6	167.7	194.4	164.3	206	190	263.2	308.8	378	378
of which NFS	96.6	115.9	181.3	152.8	169.8	185.4	190.8	239.8	247.1	247.1
of which Travel, net			66.1	64.3	71.4	67.7	105.3	129.4	150.6	150.6
of which Private Interest Net	-5.3	14	-32.8	-44.3	-35.1	-101.4	-58	-66.1	-75	-75
of which Private Transfers	34.3	37.8	45.9	55.8	71.3	106	130.4	135.1	205.9	205.9
Capital Account (2)	-73.3	112.9	-125.2	-74.5	-201.4	-155.3	-195.8	-66.1	160.6	-48.4
Official Capital	-89.3	45.1	-138.2	-182.5	-235.3	-266	-381.2	-283.8	-77.4	-286.4
Disbursements (3)	191	311.8	200.8	175.1	144.3	83.7	96.1	79.3	96.6	96.6
Amortization due from-to	-280.3	-266.7	-339	-357.6	-379.6	-349.7	-477.3	-363.1	-174	-383
Paid	-63	-92.8	-109.6	-102.4	-174.5	-162.5	-95	-89.1	-174	-383
Unpaid	-217.3	-173.9	-229.4	-292	-219.7	-187.2	-382.3	-274	0	0
Private	16	67.8	13	108	33.9	110.7	185.4	217.7	238	238
Balance of Payments Support	6.3	46	95	200	120.6	120	125	105	210	210
A.I.D. ESF	6.3	46	95	160	80.6	120	125.0	65	50.0	50.0
SAL IBRD/Japan	0	0	0	40	40	0	0.0	40	160.0	160.0
Overall BOP before Debt Relief	-308.5	-141.1	-280.6	-164.4	-231.0	-411.7	-375.2	-419.5	76.5	-313.4
Exceptional Financing	0	191.2	153.7	357.8	221.3	-61	126.3	461.1	1230.1	0
Rescheduling	0.0	191.2	153.7	357.8	145.9	42.9	175.8	62.4	30.6	0
Current obligations	0	191.2	153.7	300.8	133	21.8	0	0	0	0
Resch of Prin	0	157.2	153.7	300.8	0	0	0	0	0	0
Refin of Interest	0	34	0	0	0	0	0	0	0	0
Amort not paid	0	0	0							
Past obligations	0	0	0	57	12.9	21.1	0	0	0	0
Arrears subj. to resch.(+ incr.)	0	0	0		75.4	0	0	445	317.9	0
Principal	0	0	0		-	0	0	-	212.5	0
Interest	0	0	0		-	0	0	-	105.4	0
Other debt financing	0	0	0	0	0	-103.9	-49.5	-46.3	881.6	0
Debt Conversion	0	0	0	0	0	-103.9	-49.5	-46.3	-35.4	0
Buy-back Loans	0	0	0	0	0	0	0	0	169	0
Capital Gains from Buy-back	0	0	0	0	0	0	0	0	748	0
Overall BOP after debt relief	-308.5	50.1	-126.9	193.4	-9.7	-472.7	-248.9	41.6	1306.6	-313.4

Table 5. BALANCE of PAYMENTS. 1982-1990 - Continuation

								Proj	with debt reduction plan	without debt reduction plan
	1982	1983	1984	1985	1986	1987	1988	1989	1990	1990
Net international reserves	313.8	-50.5	127.5	-193.4	10.7	472.3	248.9	-41.6	-1306.6	347.6
Nonrefinanceable arrears (+ inc)	453.2	-1070	175	-168.6	65.7	375.4	327.3	-63	-1008.0	377.0
Principal	217.3	-722.9	.	.	.	.	.	.	.	.
Interest	235.9	-347.1	.	.	.	.	.	.	.	.
Rescheduling of Arrears	0	801.1	0	0	0	21.3	26.5	38.8	-20.2	0
Principal	0	671.9	0	0	0	.	.	.	28.3	0
Interest	0	77.4	0	0	0	.	.	.	-48.5	0
Other	0	51.8	0	0	0	.	.	.		
Revolving Trade Credit Facility	0	152.3	0	0	0	0	0	0	0	0
Net official reserves (-increase)	-128.8	58.1	-47.5	-24.8	-55	75.6	-104.9	-17.4	-278.4	-29.4
Net use of Fund credit	-9.7	99	-34	30	-36	-40.1	-60.9	-35.9	-35.9	-35.9
Other net official reserves	-119.1	-40.9	-13.5	-54.8	-19	115.7	-44.0	18.5	-242.5	6.5
	-128.8	58.1	-47.5	-24.8	-55	75.6	-104.9	-17.4	-278.4	-29.4
Adjustment	-10.6	8								
Financing Gap	5.3	-0.4	0.6	-0.0	1.0	-0.4	-0.0	-0.0	-0.0	34.2

(1) Excludes Transfers from AID and World Bank.
(2) Capital Account includes Private, Official Disbursements & Amortization.A
(3) Excludes SAL credit which is presented separately

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Table 6

Exports by Principal Groups: Estimated for 1987 and 1988
----and Projected for 1989 (Value in Mil US$ Vol in 000 Units
----and unit value in US$)

---------- Date of Estimate Source	1982	1983	1984	1985	1986	1987	1988	projected	1990
Traditional Exports	534.74	526.11	597.34	591.02	689.38	640.65	604.54	620.88	593.18
Coffee (Value)	236.91	230.04	267.32	315.79	391.85	334.47	316.37	300.43	237.84
–Volume (quintals, 100 lb.)	2040	2357	2457	2683	2056	3004.00	2600.00	2929	2973.00
–Unit value (per quintal)	116.13	97.6	108.8	117.7	190.6	111.3	121.7	102.6	80
Bananas (Value)	228.1	240.4	251.0	208.0	216.6	228.6	219.9	256.1	284.0
–Volume (Metric Tons)	1013	1012	1020	851	941	986	1055	1191	1285
–Unit Value (Per MT)	225.21	237.5	246.1	244.4	230.18	231.8	208.5	215	221.0
Beef (Value)	53.15	31.90	43.52	53.69	69.83	62.50	55.82	45.03	43.61
–Volume (Metric Tons)	24.3	13.9	20.5	27.2	35.213	27.33	23.552	19	18.4
–Unit Value (Per MT)	2190	2295	2123	1974	1983	2286.9	2370.0	2370.0	2370.0
Sugar (Value)	16.55	23.81	35.47	13.55	11.10	15.12	12.40	19.36	27.75
–Volume (quintals, 100 lb.)	1191	1173	2231	968	1664	1644	1072	1115	1500
–Unit value (per ton)	13.9	20.3	15.9	14	6.67	9.2	11.6	17.36	18.5
Nontraditional Exports (Value)	334.3	326.4	374.1	319.9	396.2	473.448	579.52	703	803
–to Central American CM	167.2	198.2	193	143.5	100.5	109.4	129.87	148.5	na
–to Panama		33.5	36.3	28.9	43	47.6	34.9	40.3	803
–to Rest of the World	167.1	94.7	144.8	147.5	252.7	316.4	414.75	514.2	na
– (To the U.S.)					145	197.9	250.3	339.2	na
TOTAL COMMODITY EXPORTS FOB	869.0	852.5	971.4	910.9	1085.6	1114.1	1184.1	1323.9	1396.2
Adjustments (Note a)						-7.1	0.0	11.7	
TOTAL ADJ COMMODITY EXPORTS, FO	869.0	852.5	971.4	910.9	1085.6	1107.0	1184.1	1335.6	1396.2
Drawback Value Added (included in other services)	na	na	26.1	35	34.8	44.2	60.5	80	80
Total Commodity Exports Plus Drawback	869.0	852.5	997.5	945.9	1120.4	1158.3	1244.6	1403.9	1476.2

a - Adjusted by the Central Bank for volume.

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Table 7
Composition of International Reserves of the Central Bank of Costa Rica
as of december 31 of each year. (Mil of US$)

----------	1986	1987	1988	1989
Date of Estimate				
Source				
I. NET OFFICIAL RESERVES	35.7	-41	64.3	80.8
Assets	558.6	503.2	635.4	678.2
--Freely Disposable	134.6	113.9	254.1	317.6
----Gold	26.4	23.8	8	3.1
----Bank Deposits	11.9	86.7	243.1	31.4
----Foreign Exchange	1.8	i.e.	i.e.	2.7
----Securities	92.3	i.e.	i.e.	228.8
----Special Drawing Rights	2.2	3.4	3	2
----Other	i.e.	i.e.	i.e.	49.6
--Other Assets	424	389.3	381.3	360.6
----Time Deposits in CA Central Banks	365.4	344.2	350.1	311.3
----CA Clearing Arrang.	31.1	17	4	0
----Contrib to CA Stab. Fund	22.5	23.8	25.1	25.1
----Other	5	4.3	2.1	24.2
Liabilities	-522.9	-484.8	-417.9	-361.5
--Net Position with IMF	-172.4	-132.3	-71.3	-35.4
--Revolver Credit Facility	-276.8	-276.4	-272.5	-255.8
--Other Short Term Credit	-73.7	-76.1	-74.1	-70.3
----Drawing on CA Stab. Fund	-33.7	n.a.	n.a.	
----Banco de Mexico (& clearing)	0	n.a.	n.a.	
----Other	-0.8	n.a.	n.a.	
	-39.2			
Adjustment of Short Term ---Liabilities (By IMF)	0	-59.4	-153.2	-235.9
II. PAYMENT ARREARS (BCCR)	-180.2	-560.5	-894.4	-1293.4
(IMF definition (1))			-131.2	-68
--Over 15 working days (imports)	-0.3	-5.2	-0.2	0
--Other (BCCR)	-179.9	-555.3	-894.2	-1293.4
--Other (IMF (1))			-131	-68
III. TOTAL (BCCR)	-144.5	-601.5	-830.1	-1212.6
(IMF (1))			-66.9	12.8

Note: I.E. signifies included elsewhere.

(1) The IMF excluded arrears that were expected to be rescheduled.

Table 8
Composition of External Arrears
------by Category of External Creditor at Dec 30, 1989

----------	Principal	Interest	Total
To Commercial Banks --Medium and Long Term	873.9	293.8	1167.7
To Foreign Governments	65.5	36.3	101.8
To Multilateral Institutions	18.6	4.2	22.8
Bonds	0.3	0	0.3
CDs of the Presa	--	--	--
Suppliers Credits	1.3	0.5	1.8
Subtotal	959.6	334.8	1294.4
Arrears of Over 15 Working Days To Importers	--	--	0.3
TOTAL	--	--	1294.7

Table 9
Public Sector External Debt (On a Disbursed Basis)
------at December 31, 1985 and September 30, 1987, 1988 and 1989
------(Mil of US$)

----------	12-31-85	09-30-87	12-31-88	09-30-89
Date of Estimate				
Source				
BY LENDING INSTITUTION				
Commercial Banks	1601.3	1368.4	1470.3	1472.2
Multilateral Institutions	1035.9	1366.7	1291.7	1148.2
Bilateral Institutions	748.4	943.4	991.6	1050.4
--Paris Club		358.2	364.4	429.6
--Other		585.2	627.2	620.8
Bonds and Float. Rate Notes	73.9	69.5	67.6	61.4
Presa CDs	184	148.6	0	0
Suppliers Credits	50	27	12.7	14.6
TOTAL	3693.5	3923.6	3833.9	3746.8

ANNEX B

INITIAL ENVIRONMENTAL EXAMINATION

Project location:	Costa Rica
Project Title:	Economic Stabilization and Recovery IX
Project Number:	515-0246
Funding:	$60,000,000
Life of Project:	One year (FY 1990)
Project Description:	The project consists of a cash transfer to support a economic stabilization and recovery in Costa Rica during CY 1990. The USAID/Costa Rica FY 90 PAAD provides for cash transfers to the Costa Rican Central Bank for balance of payments support and for application to a debt buy-back program. A portion of the foreign exchange equivalent provided under the cash transfer is used by the Central Bank to finance imports for use by Costa Rica's private sector in raw materials, capital goods and other productive inputs. The remaining portion will be applied to the GOCR's debt reduction program. 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 to finance economic development activities acceptable to AID and the Government of Costa Rica. The PAAD does not authorize A.I.D. funds for identifiable projects, rather providing appropriated funds for an economic stabilization and recovery program.
Action:	Handbook 3, Chapter 2, Appendix 2D, Section 216.2 (c)(2)(vi) states that "contributions to international, regional or 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. Based on A.I.D. regulations in Handbook 3, Chapter 2, the A.I.D. Mission to Costa Rica recommends that no further environmental study be undertaken for this PAAD and that a "Categorical Exclusion" be approved.

IEE Prepared by:

Heriberto Rodríguez
General Engineer
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Concurrence:

Carl H. Leonard
Mission Director
USAID/Costa Rica

Date: March, 1990

THE ESF SEPARATE ACCOUNT

In conformance with a requirement in the 1987 Continuing Resolution, the GOCR was initially required to open a separate account for dollar disbursements to be deposited under the ESF program. The Mission has continued to impose this requirement on the GOCR. In carrying out the directives for the separate account, USAID has as its objectives that:

(1) ESF dollars not be commingled with other GOCR/BCCR funds; (2) ESF dollars be used for direct payment to an IMF account for purposes of buying back GOCR debt and related interest; (3) ESF dollars be used to reimburse the GOCR for discretely identifiable eligible imports from the United States, already financed with GOCR resources; (4) the cash transfer nature of the ESF program not be altered; and (5) 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 disbursement to the Separate Account:

In accordance with Economic Stabilization and Recovery (ESR) agreements signed with the GOCR, dollars are disbursed, in the form of a cash transfer, through an Electronic Funds Transfer (EFT) effected by the U.S. Treasury to a separate account established for this purpose in the Federal Reserve Bank (FRB), which has provided assurances that the sub-account established to receive these funds will preclude commingling of ESF dollar funds with other resources. Any interest earned by the fund will be credited to and deposited in the separate sub-account.

The BCCR will submit confirmation that the separate sub-account has been established and the Mission will certify that this account is a separate non-commingled sub-account, established solely to receive ESF dollar funds.

The separate account is monitored closely by the Mission. The BCCR is instructed to request the depository bank to advise AID of any movement in the account, including interest earned via telex, fax or letter as the circumstances may dictate. Cable traffic between the depository bank and the BCCR is also provided to AID.

In addition, copies of the bank statements from the depository bank for the separate account are obtained, directly from the depository bank, at least once a month, as long as the ESR agreement is not fully disbursed or there are funds remaining in the account. After each cash transfer has been fully released from the separate account, a copy of a statement for the separate account is requested from the depository bank. The statement following release of the last cash transfer should clearly show that there are no remaining funds in the account.

The agreement requires the dollars to be used (1) in support of the Brady Plan, by depositing funds in an IMF account which will in turn be used to repurchase GOCR debt in accourdance with the GOCR's debt repurchase offer of March 7, 1990 included in The Republic of Costa Rica, 1989 Financing Package, and (2) to reimburse the Costa Rican private sector for essential imports.

In the case of the debt buy-back, the BCCR would instruct the FRB to transfer the funds to a "contribution account" immediately after funds are deposited in the separate account. The "contribution account" is an account which would be opened in the name of the International Monetary Fund (IMF) at the FRB, into which donations to fund the debt repurchase would be deposited. This account enjoys the privileges and immunities accorded IMF funds. Before disbursing the funds to the separate account, AID will request that the BCCR obtain evidence from the IMF that the "contribution account" has been opened and copy of the instructions given by the BCCR to the IMF with relation to the debt repurchase. The IMF will fully account for the transactions of the contribution fund; assuring, in accordance with BCCR instructions, that funds are only used in accordance with the GOCR's debt repurchase offer of March 7, 1990.

AID funds will be commingled with the funds of other donors as soon as they are transferred to the contribution fund account at the FRB, however this is considered the end-use for these funds, i.e. contributing to the GOCR's debt repurchase effort. All of the funds in the contribution account will be used in accordance with the repurchase agreement. As instructed by the BCCR, the IMF will transfer money to closing agents who, acting on the instructions of the BCCR, will execute the final repurchase transactions.

The Mission will also require the BCCR to request the IMF to provide directly to the USAID Controller a written confirmation that a given amount of funds, including AID funds, were fully disbursed from the contribution account in support of the GOCR's debt repurchase effort..

In the case of reimbursement to the GOCR for essential imports, the following shall be considered eligible imports: raw materials, intermediate goods, spare parts, and capital goods from the United States. The following list of ineligible items cannot be imported with financing from ESF dollar funds.

PL-480 commodities (wheat and corn)
Fine Furs
Explosives and ammunition
Passenger cars
Fire arms/Military equipment
Police equipment
Weather modification equipment
Alcoholic beverages
Jewelry
Surveillance equipment
Pesticides
Gold, silver, and Coins/stamps
Abortion equipment
Non-durable consumer goods

The Central Bank (BCCR) approves the payment of foreign exchange from existing reserves for imports into Costa Rica. Reimbursement for eligible import transactions financed with the GOCR's foreign exchange reserves will be made from the separate account.

The computerized system for approval of imports by the BCCR uses the NAUCA II code system to produce, for a date range, two listings: a NAUCA II listing for eligible products and a second NAUCA II listing for ineligible products. Before each disbursement, both listings are received and reviewed by the Mission in accordance with the acceptance criteria for eligible import transactions previously approved by USAID. The listingss are also periodically updated by the Mission and the BCCR, according to modifications of the "Central American Tariff of Imports" made by Costa Rican law. The Mission has reviewed and determined that the BCCR's system for approving foreign exchange and maintaining documentation supporting the listing provided is reliable and is expected to continue to be reliable assuming compliance with established procedures. The BCCR will retain supporting documentation for a period of three years and it will be available to AID, or its representative, for the purpose of periodic audits.

In order to obtain reimbursement for the payment from existing GOCR foreign reserves for eligible imports into Costa Rica, the BCCR presents the Mission with the private sector import transaction listing from the United States, which is generated by the NAUCA II listings, totalling at least 110% of the dollar funds for which disbursement (release) is being requested from the separate account.

Upon receipt of the import transaction listing from the BCCR, the Mission will satisfy itself that the listing contains eligible transactions equal to the proposed ESF dollar disbursement, plus estimated interest earned on funds deposited in the separate account for which we can reimburse the GOCR. For the ESR IX program, only transactions taking place after the last review of documentation on file at the BCCR for the ESR VIII program will be eligible for financing.

The review of the import transactions submitted by the BCCR is performed, on behalf of the Mission, by a recognized Public Accounting (CPA) firm in accordance with the criteria set forth in the ESR agreement. In general the CPA firm will be asked to review only transactions above $15,000 in an effort to try to minimize the number of transactions which must be reviewed. Only if the amount arrived at is not enough to cover the planned release will transactions under $15,000 be reviewed. The Misssion has obtained successful results in the past using this system and does not anticipate any difficulty utilizing it in the future.

Specifically, the CPA firm will be asked to review the following in order to determine a particular import transaction's eligibility:

1) That the NAUCA code is part of the Mission's approved list.

2) Product origin is the United States.

3) The BCCR's file has the application and approval of foreign exchange.

4) The BCCR's file has copy of the supplier's invoice.

5) The BCCR's file has the Bill of Lading.

6) The BCCR's file has the customs' declaration ("poliza") indicating the commodity's entry into the country.

7) Evidence of payment by the BCCR. It should be noted that the Mission allows TCIP guaranteed transactions so long as the GOCR has paid off the line of credit at the commercial bank and eliminated the contingent liability of double financing.

The public accounting firm which reviews the supporting documentation also provides recommmendations on improving BCCR internal controls. The Mission encourages the BCCR to implement these recommendations. Moreover, the implementation of these recommendations is verified in subsequent reviews.

After Mission confirmation of import transactions eligible for reimbursement under the agreement, the Mission authorizes release of Dollars from the Separate Account to the GOCR general accounts as reimbursement for imports by the Costa Rican private sector. Prior to the release, the BCCR must indicate in what banks and in which accounts it wants to deposit the funds. The BCCR must have previously submitted a certification by the "Bank Auditor General" of Costa Rica, or other competent entity, that these accounts are recognized by and legitimate GOCR accounts. Finally, the Mission requests that the BCCR instruct the banking institution(s) to which the funds are to be released, to directly advise AID of the account number, date and amount of the deposit(s).

SUMMARY OF OUTSTANDING LAND DISPUTES

April 10, 1990

1. BANANITO TREE FARMS (GLEN BANDELIN)

PROPERTY IN QUESTION: 13,360 HECTARES OF FOREST LAND

VALUE: SETTLEMENT BETWEEN BANDELIN AND THE GOVERNMENT OF COSTA RICA FOR 120 MILLION COLONES. THE FIRST INSTALLMENT OF 30-YEAR BONDS WORTH 46 MILLION COLONES WAS PAID BY THE GOVERNMENT; THE REMAINDER WAS PAID BY THE NATIONAL PARKS FOUNDATION.

CIRCUMSTANCES: LAND WAS INCLUDED IN THE TALAMANCA INDIAN RESERVE AND THE PARQUE INTERNACIONAL DE LA AMISTAD.

CURRENT STATUS: MR. BANDELIN IS OWED APPROXIMATELY 8.1 MILLION COLONES TO COMPENSATE FOR THE DISCOUNT LOSS HE SUFFERED WHEN HE SOLD THE BONDS THAT COMPRISED THE FIRST PAYMENT. HE HAS NOT REQUESTED FURTHER EMBASSY ASSISTANCE.

2. COMPANIA MADERERA DEL ATLANTICO (TOM FYOCK)

PROPERTY IN QUESTION: 8000 HECTARES OF FOREST LAND

VALUE: ORAL AGREEMENT BETWEEN FYOCK AND THE GOVERNMENT OF COSTA RICA FOR 10,600 COLONES PER HECTARE HAS BEEN PENDING SINCE MARCH 1989.

CIRCUMSTANCES: LAND WAS INCLUDED IN THE TALAMANCA INDIAN RESERVE AND THE SIBUJU NORTE INDIAN RESERVE

LEGAL HISTORY: COURT CASE NO. 830-86 IN JUZGADO 4 CONTENCIOSO ADMINISTRATIVO Y CIVIL DE HACIENDA

CURRENT STATUS: A WRITTEN SETTLEMENT WAS SIGNED BY THE NATIONAL PARKS FOUNDATION ON MARCH 22, 1990, WITH A COMMITMENT TO PAY WITHIN 3 MONTHS OF DATE.

3. TITISA, S.A. (BOB STONE)

PROPERTY IN QUESTION: 500 HECTARES OF BEACHFRONT PROPERTY ON THE BURICA PENINSULA, INCLUDING SIX KILOMETERS OF ROADS AND A PARTIALLY COMPLETED AIRPORT. TITISA HAD OPERATING PERMITS FOR A HOTEL COMPLEX, AND HAD PAID FOR AN ARCHITECTURAL DESIGN AND A FEASIBILITY STUDY.

VALUE: THE COSTA RICAN GOVERNMENT'S LAST OFFER (3/15/90) WAS 16 MILLION COLONES. MR. STONE HAD REQUESTED APPROXIMATELY 1 MILLION DOLLARS TO COVER HIS ACTUAL COSTS, BUT IS WILLING TO SETTLE FOR APPROXIMATELY 34 MILLION COLONES.

CIRCUMSTANCES: LAND WAS INCLUDED IN THE GUAYMI CONTE BURICA INDIAN RESERVE.

LEGAL HISTORY: MR. STONE HAS NOT BROUGHT THE CASE TO COURT BECAUSE OF THE 20 PERCENT BOND THAT COSTA RICAN LAW REQUIRES FOR THESE KINDS OF CASES. HE HAS DISCUSSED AND NEGOTIATED FOR A SETTLEMENT WITH FOUR DIFFERENT ADMINISTRATIONS. IN 1989, THE COMMISSION ON EXPROPRIATIONS ASKED THE ATTORNEY GENERAL FOR AN OPINION ON THE KINDS OF COSTS THAT WOULD BE REIMBURSEABLE; AN OPINION WAS NEVER RENDERED.

CURRENT STATUS: MR. STONE LAST MET WITH THE COSTA RICAN GOVERNMENT ON MARCH 15 (AFTER A LAPSE OF ALMOST NINE MONTHS). HE WAS OFFERED 16 MILLION COLONES AND COUNTEROFFERED 34 MILLION COLONES. HIS ATTORNEY IS NOW IN DISCUSSIONS WITH THE NATIONAL PARKS FOUNDATION.

4. TORO ROJO (REPRESENTED BY RICHARD BELL)

PROPERTY IN QUESTION: RANCH COMPRISING 6,400 HECTARES OF LAND (FOREST LAND, FARMLAND AND PASTURELAND), BUILDINGS AND ROADS, SOUTH OF DOMINICAL, PUNTARENAS.

VALUE: MR. BELL'S LAST REQUEST TO THE GOVERNMENT WAS 85 MILLION COLONES.

CIRCUMSTANCES: LAND WAS INCLUDED IN PARQUE INTERNACIONAL DE LA AMISTAD.

LEGAL HISTORY: THE CASE WAS INITIALLY IN JUZGADO 2 CONTENCIOSO ADMINISTRATIVO CIVIL DE HACIENDA, N. 517-85. ON JULY 21, 1989, THE FILE WAS TRANSFERED TO THE TRIBUNAL CONTENCIOSO ADMINISTRATIVE (EXP. 1255-89).

CURRENT STATUS: MR. BELL LAST MET WITH THE STAFF OF THE COMMITTEE ON EXPROPRIATIONS IN EARLY MARCH 1990. THE GOVERNMENT ASKED FOR ADDITIONAL INFORMATION AND A BETTER OFFER.

5. COMPANIA ADMINISTRADORA COMERCIAL (WILLIAM BAILEY)

PROPERTY IN QUESTION: 3,740 HECTARES OF FOREST LAND

VALUE: THE LATEST OFFER BY THE GOVERNMENT OF COSTA RICA WAS 58 MILLION COLONES. MR. BAILEY HAD THE LAND ASSESSED AT ONE TIME FOR 200 MILLION COLONES. HE HAS INDICATED HE WOULD ACCEPT THE GOVERNMENT'S OFFER FOR THE LAND, IF THE GOVERNMENT WOULD ALSO PAY HIM FOR THE VALUE OF THE TIMBER ON THE LAND. HE IS WILLING TO HAVE THIS LATTER AMOUNT DETERMINED BY LOCAL ARBITRATION.

CIRCUMSTANCES: LAND WAS INCLUDED IN THE TALAMANCA INDIAN RESERVE.

CURRENT STATUS: MR. BAILEY LAST MET WITH THE GOVERNMENT IN JANUARY 1990; NO PROGRESS WAS MADE. HE HAS A COURT CASE PENDING IN JUZGADO 2 CONTENCIOSO ADMINISTRATIVEO Y CIVIL DE HACIENDA (EXPEDIENTE NO. 826-86), BUT HAS BEEN NOTIFIED THAT THE MORTGAGE HE PUT UP FOR THE FIANZA IN 1986 HAS BEEN REJECTED. BAILEY ALSO CHALLENGED COSTA RICA'S GSP ELIGIBILITY IN THE UNITED STATES, BUT THE CHALLENGE WAS REJECTED BY THE GSP COMMITTEE (DECISION STILL TO BE ANNOUNCED PUBLICLY).

6. COMPANIA DE DESARROLLO SANTA ELENA, S.A. (JOSEPH HAMILTON)

PROPERTY IN QUESTION: 15,000 HECTARES AND 18 KILOMETERS OF BEACH FRONTAGE.

VALUE: APPRAISAL IN 1978 OF 2.9 MILLION DOLLARS. THE GOVERNMENT OFFERRED 1.9 MILLION DOLLARS AT THAT TIME. IN LATE JANUARY 1990, THE MINISTRY OF NATURAL RESOURCES OFFERED 900,000 DOLLARS.

CIRCUMSTANCES: LAND WAS INCLUDED IN THE SANTA ROSA NATIONAL PARK.

LEGAL HISTORY: AN EXPROPRIATION DECREE WAS SIGNED ON MAY 5, 1978 BY PRESIDENT ODUBER.

CURRENT STATUS: MR. HAMILTON IS CONTINUING NEGOTIATIONS WITH THE MINISTRY OF NATURAL RESOURCES.

7. FINCA EL COCAL O LIVINGSTON (JAMES GOULET)

PROPERTY IN QUESTION: 232.5 HECTARES OF FARMLAND (COCONUT AND CACAO) NEAR SIQUIRRES, LIMON. THE PROPERTY HAD AT LEAST THREE HOUSES AT THE TIME IT WAS TAKEN OVER BY SQUATTERS; THEY HAVE SINCE BEEN DESTROYED.

VALUE: UNCLEAR.

CIRCUMSTANCES: LAND WAS INVADED BY SQUATTERS.

LEGAL HISTORY: BECAUSE ITCO HAD DETERMINED THAT THE INVADERS DID NOT QUALIFY AS SQUATTERS, THE CASE WENT TO COURT. IN 1984, JUZGADO 1 DE INSTRUCCION DE LIMON ORDERED THE GUARDIA RURAL TO EVICT THE SQUATTERS, BUT THE ORDER WAS NOT EXECUTED. AN AMPARO WAS ENTERED AND THE SUPREME COURT RULED IN GOULET'S FAVOR ON JANUARY 11, 1985, ORDERING THE MINISTRY OF GOVERNMENT TO EXECUTE THE ORDER. HOWEVER, THE MINISTER REFUSED TO DO SO AGAIN.

CURRENT STATUS: THE COMMISSION ON EXPROPRIATIONS NEVER MADE AN OFFER TO THE GOULET FAMILY (THE ORIGINAL OWNER OF THE LAND, EDMOND GOULET, IS DECEASED).

8. RANCHO GESLING

PROPERTY IN QUESTION: 7,700 HECTARES OF FARMLAND AND PASTURELAND IN GUANACASTE.

CIRCUMSTANCES: EXPROPRIATION DECREE ISSUED IN 1982, FOR THE PURPOSE OF GIVING CATSA ADDITIONAL LAND TO GROW SUGAR CANE.

LEGAL HISTORY: CASE NO. 1230-85 DEL JUZGADO 1 CONTENCIOSO ADMINISTRATIVO Y CIVIL DE HACIENDA.

CURRENT STATUS: AFTER LENGTHY NEGOTIATIONS AND TRANSFER OF TITLE TO PORTIONS OF THE LAND, MR. GESLING IS WAITING FOR IDA TO LIFT THE EXPROPRIATION DECREE ON THE REMAINDER OF THE LAND. THE GOCR AND THE EMBASSY HAVE BEEN UNABLE TO REACH MR. GESLING. HE NEEDS TO CEASE HIS SUIT AGAINST THE GOVERNMENT BEFORE THE GOCR WILL LIFT THE EXPRO DECREE.

9. QUALLS FAMILY

PROPERTY IN QUESTION: 1,439 HECTARES OF FARMLAND IN OSA, PUNTARENAS.

VALUE: MR. QUALLS VALUED HIS LAND IN 1988 AT 86 MILLION COLONES. HE ALSO HAS SAID THAT HE HAD RECEIVED OFFERS OF $165,000 IN 1968 AND $275,000 IN 1975, BUT WAS NOT ABLE TO SELL THE LAND BECAUSE OF THE PRESENCE OF SQUATTERS.

CIRCUMSTANCES: LAND WAS INVADED BY SQUATTERS.

LEGAL HISTORY: SQUATTERS ARRIVED IN 1964. ITCO (NOW IDA) DECLARED AN AGRARIAN CONFLICT BUT NEVER EXPROPRIATED.

CURRENT STATUS: THE COMMISSION ON EXPROPRIATIONS HAS NEVER MADE AN OFFER TO QUALLS.

PRJ NAME: CODESA DIVESTMENT/FINTRA TRUST CAT: A PROJ MGR: IVAR BUCH OFF: OPS POSTED ON: 12/31/89

PRJ	515K194.09G	AGRDT:	01/18/85	LEVDT:	05/88	OBLIG:	9,065	CUM EXP:	7,644	PIPELINE:	1,421	FY EXP TD:	1,000
TDDA:	N/A	IPACD:	12/31/99	NEVDT:	12/90	AUTH:	9,065	CUM DIS:	7,644	FY TGT:	2,220	FY TGT TD:	1,500
TDD:	N/A	PACD:	12/31/99			COMM:	9,065	ACCRUED:	0	% FY TGT:	45	% FY TGT:	67

PARTIES TO AGR.: AID/GOCR/CODESA
MAJ. GOCR AGENCY: CODESA
IMPLEMENTING AGENCIES: FINTRA/CODESA
COUNTERPART PLANNED: N/A
COUNTERPART ACTUAL: N/A
CONTRACTORS: N/A
% LOP ELAPSED NA
% TOT OBLIG EXP 84

A. PROJECT PURPOSE AND DESCRIPTION:
To assist the GOCR in its divestiture of the equity interests of its holding company, CODESA. In 1985, an AID/GOCR agreement provided for AID to establish and fund a private sector trust, FINTRA, from an ESF-generated local currency account to buy, or hold in trust, holdings of CODESA for packaging and resale to the private sector. In addition to the ESF special currency account shown above, FINTRA has funds totalling about C 900 million earmarked for privatization.

B. IMPLEMENTATION PROGRESS:

LOP	Cumulative	Planned for Period	Actual in Period	Comments if less than planned	Next Period Plans
1. CODESA originally had 30 subsidiaries (owned 51% or more) and 10 affiliates (owned less than 50%) elegible for privatization. One affiliate (the Securities Exchange, 40% CODESA) is by law to be retained by CODESA.	1. Thirty one companies have been sold, liquidated or transferred to other government agencies, and six are now being liquidated. FINTRA bought and resold two of them (ALUNASA and ATUNES) and, while holding and managing CATSA in trust, restructured it and sold 82% of its shares to cooperatives, as provided by law.	1. Sale of 100% of CATSA. 2. Signing trust agreements for FINTRA to take over 100% of each of FERTICA and CEMPASA for later sale of 40% of their shares (by law the GOCR will retain 60% of their shares.) 3. Sale of CODESA's 23% holding of STABAPARI.	1. Sales agreements covering 75% of CATSA's shares were signed with 8 cooperatives. 7% sold directly to cooperative members. The new owners took over management on July, 1989. A new trust agreement limited to sales of remaining shares was signed with CODESA. 2. Trust agreement to take over FERTICA now signed. C 1 billion was credited from the Special Account against CODESA debt reduction with Central Bank. Negotiations on agreement covering CEMPASA well advanced.	1. In both the case of CATSA and FERTICA/CEMPASA, delays were mostly due to Government slowness in reacting to FINTRA proposals. 2. FINTRA has decline taking over CODESA's 23% holding of STABAPARI on basis that shares are not saleable at Controller General's valuation and only potential client at low price would be a former minister who owns 77% of the shares.	1. Remaining 18% of CATSA shares will be sold. 2. Restructuring of FERTICA will begin.

C. OTHER ACCOMPLISHMENTS:
1. At Min. of Planning's request to AID, FINTRA contracted a study on ways of using Employee Stock Ownership Plans in Costa Rica and legislation needed to make them effective. In progress.
2. At Ministry of Agriculture request, FINTRA contracted a study aimed at designing an incentive plan for voluntary separation of government employees. Study completed.

D. ISSUES:
CEMPASA negotiations are proving difficult due to Controller General's insistence on revaluing assets.

E. STATUS OF CP'S AND COVENANTS:
All CP's and covenants have been met, except that the GOCR is late in the divestiture timetable agreed in ESR VI.

F. STATUS OF AUDITS
Audits on FINTRA are done semi-annually.

G. STATUS OF EVALUATIONS:
Center for Privatization evaluation completed in May 1988. Findings were complimentary to AID.

H. MISSION DIRECTOR'S ASSESSMENT:
A category "B" project.

ANNEX E
SECTION OF PROJECTS

STANDARD CHECKLIST

3A(2) - NONPROJECT ASSISTANCE CHECKLIST

The criteria listed in Part A are applicable generally to FAA funds, and should be used irrespective of the program's funding source. In Part B a distinction is made between the criteria applicable to 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 90 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?

   Legislative approval of provisions applicable to the commercial bank debt buy-back is expected NLT April, 1990.

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 in- dustry, agriculture, and commerce; and (f) strenghten 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 conclusion on how assistance will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).	Via this 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); Sec 636(h); FY 1987 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. The local currency is not owned by the U.S.
7. FAA Sec 612(d). Does the United States own excess foreign currency of the country and, if so, what arrangements have been made for its release?	No.
8. FAA Sec. 601(e). Will the assistance utilize competitive selection 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 currencies 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. government 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 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/NA/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 contries 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):

(I) (I03) for agriculture, rural development or nutrition; if so (a) extent to which activity is specifically designed to increase productivity and income of rural poor; (I03A) 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. I04 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 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) (I04) for population planning under Sec. I04(b) or health under Sec. I04(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 outreach.

(3) (I05) 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) (I06) 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;

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

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

(iv) reconstruction after natural or manmade disaster and programs of disaster preparedness;

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

(vi) for urban development problems, especially small, labor-intensive enterprises, marketing systems for small producers, and financial or other institutions to help urban poor participate in economic and social development.

(5) (I20-2I) for the Sahelian region; if so, (a) extent to which there is international coordination in planning and implementation; participation and support by African countries and organizations in determining development priorities; and a long-term, multi-donor development plan which calls for equitable burden-sharing with other donors; (b) has a determination been made that the host government has an adequate system for accounting for and controlling receipt and expenditure of projects funds (dollars or local currency generated therefrom)?

c. FAA Sec. I07. Is special emphasis placed on use of appropriate technology (defined as relatively smaller, cost-saving, labor using technologies that are generally most appropriate for the small farms, small businesses, and small incomes of the poor)?

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

e. FAA Sec. 101(a). Does the activity give reasonable promise of contributing to the development of economic resources, or to the increase of productive capacities and self-sustaining economic growth?

EXPORT PROMOTION FUND CONCEPT: SUMMARY AND ISSUES

Growth of non-traditional exports (NTEs) to non-CACM markets is the only viable long-term solution to Costa Rica's balance-of-payments problems. Though further work remains to be done, the GOCR has already demonstrated its commitment to this structural transformation by adopting a broad range of politically difficult policy reforms, including exchange rate rationalization, financial liberalization, and reform of tariff, tax, and incentive structures. The private sector has responded with extraordinary NTE increases, averaging 32% per year since 1983.

Once a sound policy framework was in place, a series of effective "operational" programs (export and investment promotion, etc.) was required in order to take maximum advantage of the new NTE environment.

The GOCR's promotional programs have generally been ineffective. Under the civil service regime, salaries were too low to attract high-quality staff able to deal effectively with sophisticated investors, and program directors repeatedly found that they lacked the flexibility necessary to motivate and manage their personnel. Moreover, given the nature of Costa Rican democracy, hiring, firing, and operational decisions have frequently been subject to political, rather than technocratic, considerations.

Recognizing these problems, the GOCR agreed with USAID that non-governmental promotion programs were needed. CINDE began promotional operations in 1983. Its programs now include foreign investment promotion, agricultural export promotion, industrial reconversion for export, and export-oriented training. Despite a slow start, CINDE has been producing extraordinary results since late 1985 (cf. details below).

The annual cost of CINDE's programs is about $9 million, almost completely financed by AID grants*. The problem is how to secure the future financial sustainability of these programs (or such other export-promotion programs as may become appropriate in the future), given the probable decline in the level of AID resources.

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* ESF-generated local currency has funded most of the grants to CINDE

The Proposal

The solution being proposed by the Foreign Trade Ministry is the establishment of an Export Fund. Donor contributions equivalent to about $100 million over several years would generate annual income sufficient to fund the promotional programs at existing levels, assuming that 20% of total costs would be covered by private contributions and user fees.

(The Costa Rican Central Bank (BCCR) has already committed itself to annual contributions of 298 million colones (about $3.5 million) for twenty years, drawn from its interest spread on an export-oriented credit line. The GOCR is now presenting the endowment proposal to local representatives of a wide range of donors, and the proposal will be formally tabled at the November meeting of the Consultative Group in Paris.)

To assure accountability, the fund would not be lodged in CINDE. Rather, the endowment would be placed in an Export Promotion Fund: the trust would decide on periodic funding for programs of CINDE (or other operating entities) based on performance against agreed targets. No recipient of these funds would ever be assured of long-term access to them.

During an initial four-year "implementation" phase, the participating donors would have effective control of the board of trustees. Thereafter, the donors and the GOCR would jointly appoint trustees.

Every five years, the GOCR and the participating donors would review the trust in the light of program performance and national needs. If appropriate, the trust could be dissolved or its resources reallocated after any of these reviews.

To avoid an undesirable impact on the country's money supply, the trust corpus would be placed in BCCR monetary stabilization bonds. At a later time, if monetary prudence permits, the trust principal could be placed with private banks, thus allowing them to keep pace with the long-term finance requirements of the growing export sector.

(The general lines of this proposal were laid out in Annex F of the Mission's latest ESF PAAD, which was approved in April, 1989.)

Two Major Issues

1. The proposed capitalization of the fund represents a large sum of money. If one were talking about export promotion in the abstract, taking a flyer of this financial size would make little sense. However, the programs which would consume these resources are already in place. Their results are, in large part, a matter of demonstrated track record rather than hopeful speculation. Most of the administrative and managerial bugs in the programs have already been worked out.

We feel that a donor commitment of this size is simply justified in terms of demonstrated return on investment. In less than four years, CINDE's foreign investment program (PIE) has generated over $300 million in new NTE investment, new annual export capacity of about $230 million, and over 28,000 new direct jobs.** Since most of these investment decisions began with a "cold call" by a CINDE overseas promoter, these results can be attributed to CINDE's efforts with more confidence than is usually the case with such programs. So far, the average promotional cost has been under $403 per direct job created, a small fraction of the cost typical in similar programs elsewhere.

mid- and upper-level export managers. While it is impossible to directly measure the economic impact of this training, a recent independent evaluation gave this

CINDE's agricultural export unit (CAAP) is a younger program: among its accomplishments are a major improvement in the perishable air cargo system, establishment of Costa Rican strawberries as a significant factor in the U.S. off-season market and the development of a promising asparagus industry in Costa Rica. Experience thus far in 1989 indicates that CAAP will have generated 1,500 hectares of new NTE production this year, representing $5 million in new investment and $12 million in annual export earnings. Establishment of these crop programs requires long lead times: thus, there is every reason to believe that these impacts will grow each succeeding year as the new programs swing into full operation. Recent independent evaluations by AID/W and others have been glowing.

The Industrial Development Program (Impulso Industrial) is a thirty-month experimental program of integrated diagnostic, technical, and marketing assistance to enable local industries to make the difficult switch to NTEs. After less than a year of start-up operations, it is too soon to pronounce on the experiment's success, though implementation experience has been promising so far.

** While it is difficult to measure indirect job generation, experience in the Mexican border zones indicates that each new direct export job may generate two additional indirect jobs.

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Another candidate for (minor) funding would be CENPRO, the government agency whose recently-implemented "one-stop" window for processing of export documentation has substar .allyy reduced red tape and delays.

In addition to demonstrated results so far, three other factors argue for a maior investment in Costa Rican export promotion. Costa Rica's ample comparative advantages, in terms of political stability, educated and healthy workforce, and geography, make export advantages, in terms of political stability, workforce, and geography, make export promotion here a more promising avenue than in many other LDCs. And, as mentioned above, the GOCR has already demonstrated its commitment to this structural transformation by implementing, at considerable political cost, a sound package of policy reforms. Finally, it is demonstrable that the Costa Rican --as contrasted with many other developing countries-- economy benefits stemming from export growth will be shared proportionally by the poorer levels of its population.

2. Why can't the GOCR or the Private Sector pay for these programs? The notion of an endowment was one that the Mission was originally very reluctant to support, for a couple of reasons: (1) we felt that giving any program a guaranteed lease on life would blunt the healthy pressure to justify future funding by continued results; (2) we thought that programs generating such substantial benefits for private exporters and the economy at large ought to be able to attract sufficient support from the private sector and/or the GOCR.

The first concern -- accountability -- is largely obviated by the trust structure proposed above. The second concern remains valid, but we have nevertheless come to be convinced that there is no practical alternative to the trust/endowment.

As to private contributions or user fees, CINDE is now taking more serious measures to increase revenues by these means. Under the proposed financial structure of the trust, about 20% of the aggregate program costs would have to come from the private sector. For reasons discussed in detail in the Five-Year Plan which CINDE submitted to AID/W last year, that 20% probably represents the upper limit of what is attainable. It is a percentage which is much higher than what is being generated by any substantial AID-supported export program in the region right now.

Direct GOCR budget support of these programs might seem logical -- many other countries fund their export promotion programs this way. However, given the way the Costa Rican democracy (especially the Legislative Assembly) operates, we are convinced that the recourse to the GOCR budget process would inevitably lead to political inroads against the technocratic independence which has been crucial to the programs' success thus far. Besides, GOCR funding would entail application of the same civil service and other bureaucratic constraints which have crippled the effectiveness of almost all of the GOCR's recent efforts to mount promotional programs.

For precisely these reasons, last year's AID/W evaluation of CINDE recommended consideration of an endowment to fund these programs.

Agency for International Development
Washington, D.C. 20523

LAC-IEE-90-07

ENVIRONMENTAL THRESHOLD DECISION

Project Location	:	Costa Rica
Project Title	:	Economic Stabilization and Recovery IX
Project Number	:	515-0246
Funding	:	$60 million (ESF)
Life of Project	:	1 year (FY 90)
IEE Prepared By	:	Heriberto Rodriguez USAID/Costa Rica
Recommended Threshold Decision	:	Categorical Exclusion
Bureau Threshold Decision	:	Concur with Recommendation
Comments	:	Concurrence based on condition that Program will not provide support for import, purchase, or use of pesticides without first doing an Environmental Assessment and having it approved by the LAC Chief Environmental Officer.
Copy to	:	Carl H. Leonard, Director USAID/Costa Rica
Copy to	:	Heriberto Rodriguez, USAID/Costa Rica
Copy to	:	Frank Cadroga, REMS/CEN
Copy to	:	Mark Silverman, LAC/DR/CEN
Copy to	:	IEE File

John O. Wilson Date APR 30 1990

John O. Wilson
Deputy Environmental Officer
Bureau for Latin America
and the Caribbean

Best Available Document

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INITIAL ENVIRONMENTAL EXAMINATION

Project location:	Costa Rica
Project Title:	Economic Stabilization and Recovery IX
Project Number:	515-0246
Funding:	$60,000,000
Life of Project:	One year (FY 1990)
Project Description:	The project consists of a cash transfer to support a economic stabilization and recovery in Costa Rica during CY 1990. The USAID/Costa Rica FY 90 PAAD provides for cash transfers to the Costa Rican Central Bank for balance of payments support and for application to a debt buy-back program. A portion of the foreign exchange equivalent provided under the cash transfer is used by the Central Bank to finance imports for use by Costa Rica's private sector in raw materials, capital goods and other productive inputs. The remaining portion will be applied to the GOCR's debt reduction program. 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 to finance economic development activities acceptable to AID and the Government of Costa Rica. The PAAD does not authorize A.I.D. funds for identifiable projects, rather providing appropriated funds for an economic stabilization and recovery program.
Action:	Handbook 3, Chapter 2, Appendix 2D, Section 216.2 (c)(2)(vi) states that "contributions to international, regional or 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. Based on A.I.D. regulations in Handbook 3, Chapter 2, the A.I.D. Mission to Costa Rica recommends that no further environmental study be undertaken for this PAAD and that a "Categorical Exclusion" be approved.

IEE Prepared by:

Heriberto Rodríguez
General Engineer
USAID/Costa Rica

Concurrence:

Carl H. Leonard
Mission Director
USAID/Costa Rica

Date: March, 1990