ACTION MEMORANDUM FOR THE ASSISTANT ADMINISTRATOR (LAC)

From : LAC/DR, Dwight B. Johnson

Subject: Costa Rica, Economic Stabilization and Recovery III Project (No. 515-0192), Amendment to Loan Agreement

Action: Your Approval is required to amend two covenants of the Loan Agreement for the Economic Stabilization and Recovery III Project in Costa Rica.

Background: Covenant 6.1.(e) of the first amendment (dated July 12, 1984) to the Loan Agreement provides for the establishment of regulations defining a system whereby the Central Bank of Costa Rica (BCCR) will discount the local currency equivalent of $15,000,000 in credit funds directly to private banks. The purpose of this Covenant, as amended, is to establish an orderly system whereby funds can be channeled into the private banking system and, thus, strengthen the competitive position of private banks in Costa Rica.

The amended loan agreement added a new covenant (6.1.(k)) which provides for the utilization of $20,000,000 in local currency to support the BCCR's program of unsubsidized lending to the private sector, through state commercial banks, for projects in agro-industry, agriculture, and construction.

Discussion: The President of the Central Bank recently approached the Mission with a request that A.I.D. provide additional monies for the special credit line which discounts funds directly to private sector banks. The President of the BCCR advised the Mission of "urgent funding needs" for agricultural and industrial projects which the state commercial banks could not, "by their own inertia" handle alone. Rather than increasing the amount of system credit to state entities, the BCCR would rather funnel the additional monies through private sector banks

To be able to respond to this initiative, the Mission would like to reallocate project funds and amend the Loan Agreement as follows:

1) Covenant 6.1.(e): Increase the amount thus designated for support of the private banking system by $10,000,000 from $15,000,000 to $25,000,000.

2) Covenant 6.1.(k): Decrease the amount of credit available for unsubsidized lending to the private sector

through state commercial banks by $5,000,000 from $20,000,000 to $15,000,000.

The proposed amendments will not change projected FY 85 nor life-of-project funding.

The additional $5,000,000 designated for private banks will be used only for high priority agricultural and industrial projects. The Mission has determined that these additional monies will not distort the "credit resource picture" in Costa Rica.

Redelegation of Authority No. 133.3, Section II, B, allows that the Mission may approve amendments to project and non-project assistance....provided, ..."that prior to the exercise of the authority to approve amendments, the A.I.D. Mission shall have communicated information to the LAC Bureau, satisfactory in form and substance..."

Recommendation: That you approve the attached cable authorizing the Mission to proceed with the proposed amendments.

Clearances:

LAC/DR:LKlassen	LK	Date: 10/24
LAC/CAP/CR:MSchwartz	(Draft)	Date:10/18/84
LAC/DP:JOleson	(Draft)	Date:10/18/84
LAC/DR/PS:ROtto	(Draft)	Date:10/18/84
GC/LAC:PJohnson		Date: 10/26/84
LAC/DR:CPeasley		Date: 10/26
LAC/DR:ILevy		Date:
LAC/DR:DBJohnson		Date: 10/26
DAA/LAC:MDBrown		Date:

LAC/DR:RBloom:(01870):10/22/84:ext. 28126

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UNITED STATES INTERNATIONAL DEVELOPMENT COOPERATION AGENCY
AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON D.C. 20523

SEP 26 4 15 PM '84

ASSISTANT
ADMINISTRATOR

EXECUTIVE SECRETARIAT

ACTION MEMORANDUM FOR THE ADMINISTRATOR

THRU : AA/PPC, Richard Derham (Acting)

FROM : AA/LAC, Victor M. Rivera

SUBJECT : Costa Rica Economic Stabilization and Recovery III PAAD Amendment 3 (Project 515-0192) 515K605

Action: Your approval is required to authorize a $60.0 million grant from Economic Support Funds (ESF) to Costa Rica for the Economic Stabilization and Recovery Program III.

Background: The Economic Stabilization and Recovery III Program for FY 1984 was approved by you on 27 April 1984. The original PAAD (Tab A) provided the background, rationale and description for the overall $70.0 million cash transfer ESF program for FY 1984 including details of conditionality and utilization of local currency resources for the $35.0 million loan portion of the assistance. A PAAD Supplement for the $35.0 million grant portion of the cash transfer, approved by you on 31 July, added further conditionality to induce needed fiscal and economic reforms. This ESR III PAAD Amendment 3 draws on both the original PAAD and amendments thereto, provides the rationale for additional assistance up to $100.0 million and requests approval and authorization at this time of $60 million in grant monies in ESF funds made available under the FY 1984 supplemental appropriation. The essential rationale and conditionality for this additional support was included in USAID/Costa Rica's ESF Concepts Paper approved by the LAC Bureau in January 1984 (Tab B).

The purposes of the ESR III program are to provide balance of payments support to Costa Rica and to promote the objectives of economic stabilization and USAID/Costa Rica's Caribbean Basin Implementation Plan by encouraging economic policy changes and structural reforms aimed at re-establishing dynamic economic growth through increased exports. The initial $70.0 million provided to date has been disbursed as a cash transfer to the Central Bank of Costa Rica (BCCR) to provide balance of payments support. The BCCR has made available from its own resources an amount of foreign exchange equivalent to the assistance to finance imports from the United States of raw materials, intermediate goods, construction materials and spare parts needed by the private sector in Costa Rica. The local currency equivalent of the $35.0 million loan, which was deposited into a special credit line, has been used to finance credit to the productive private sector. The local currency equivalent of the $35.0 million grant is being used for social and economic development purposes jointly agreed upon by AID and the GOCR.

The purpose of this PAAD supplement is to provide continued urgently needed balance of payments support to aid stabilization efforts already underway in Costa Rica within the parameters of the ESR III Program. The grant will be signed with the Government of Costa Rica (GOCR) and will be channeled through the Central Bank of Costa Rica (BCCR). The GOCR will make available for sale to private producers the foreign exchange equivalent of $60 million to allow for imports from the U.S. of essential raw materials, intermediate goods, construction materials and spare parts. Because of concerns regarding the effects of domestic credit ceilings negotiated by the GOCR and the IMF on the use of local currency, any local currency generated pursuant to this action will be held in a special blocked account at the BCCR. AID will examine the implications of any expenditure from the blocked account on Costa Rica's stabilization program in consultation with the IMF. AID will control release of funds from the blocked account until a determination is made as to the most appropriate use of these resources.

This PAAD (Tab C) provides updated information on the country's 1984 economic performance, justifying this request for additional assistance. The country's balance of payments gap has increased substantially from projections made in early 1984. A premature reactivation of the economy from the second half of 1983 and the lack of continuity in the GOCR's economic team are the principal explanatory factors. Some progress has been made by the GOCR; macroeconomic performance improved in 1983. Aggregate output grew by 1% as compared with a 9% decline in 1982; inflationary pressure subsided to about 11% as compared with the 40% projected in the 1983 program and the 1982 year-end rate of 82%; the overall public sector deficit was in 1983 equivalent to approximately 3% of GDP as compared with 9% in 1982 and 14% in 1981; and credit to the private sector increased by 44% in real terms in 1983. Also in 1983, private sector holdings of money and quasi-money grew by approximately 20% in real terms; this unusually high growth rate was caused by a return flow of liquid financial assets related to the emergence of positive real rates of interest in Costa Rica and also to a mild appreciation of the free market exchange rate.

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In 1984, GOCR economic policymakers responded to widespread dissatisfaction with declining real incomes by permitting nominal credit expansion at annualized rates in excess of 30% during the second half of 1983 and the first half of 1984. By June 1984, imports were growing at an annual rate of 20% while exports were growing at a more modest rate of 13%. Thus, by mid-1984, the Central Bank had growing foreign exchange arrearages. GOCR authorities have undertaken measures to tighten credit conditions, increase government revenues, and comply with the prior actions required to validate the April IMF Letter of Intent. An IMF Mission arrived in San Jose on 3 September to revise the Letter of Intent and adjust quantitative performance targets, and a revised Letter of Intent is expected to be forwarded to the IMF's Board of Directors by mid-October.

Even though the Standby Arrangement only provides modest resources in November (approximately $25 million), it constitutes an essential precondition for a $75 million commercial bank credit presently under negotiation and expected in November, for subsequent Paris Club and commercial bank negotiations on the rescheduling of the external debt, and for a prospective World Bank Structural Adjustment Loan. The $60 million ESF grant provides critically needed bridge resources to the anticipated IMF/commercial bank disbursements in November. Even with the disbursements, the Central Bank foreign exchange arrearages are projected to increase from $73 million at the end of August to $105 million at the end of October.

For 1984, present indications suggest GDP growth on the order of 3-4% but accompanied by a significant expansion of the balance of payments basic balance deficit. The Mission expects a steadfast application of tightened credit conditions will reduce imports absolutely by the early months of 1985, thereby improving the situation.

Discussion: The Mission has achieved considerable success in eliciting key economic policy reforms and actions from the GOCR this year, most notably the passage in August of the long debated and politically sensitive currency and banking law. The GOCR has also succeeded earlier this year in gaining approval by the IMF of a Letter of Intent. Therefore, the Mission plans to obligate the $60 million grant within the conditionality framework established for policy and structural reforms under earlier loan and grant tranches to the 1984 program; thus no new conditionality is contemplated. Rather,

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these ESF funds will provide emergency balance of payments assistance to serve as a bridge to the anticipated IMF/commercial bank disbursements dependent upon the signing of the IMF Letter of Intent currently being renegotiated. Pursuant to this approach, the Mission will continue to work with the GOCR on carrying out reforms set out as covenants in prior Agreements while it prepares a Concepts Paper setting forth its strategy for the use of FY 1985 ESF funding.

A Congressional Notification is not required as the $60 million in supplemental grant funds was included in the FY 1984 Congressional Presentation.

Recommendation: That you sign the Attached Program Assistance Approval Document (PAAD) authorizing $60.0 million in ESF grant funds for Costa Rica for the Economic Stabilization and Recovery Program III.

Attachments
TAB A - Original PAAD - April 17, 1984
TAB B - Concepts Paper - January 1984
TAB C - PAAD Amendment No. 3

Clearances:
PPC/PDPR:EHullander ______ Date 9/25/84
GC:HFry ______ Date 9/25/84

LAC/DR:MSDugan:aep:(1911B):09/19/84:ext. 29486

Project No. 0192, Amendment No. 3

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROGRAM ASSISTANCE APPROVAL DOCUMENT (PAAD)

2. Country: Costa Rica

3. Category: Cash Transfer

4. Date: September 10, 1984

To: A/AID, M. Peter McPherson

6. OYB Change Number: N/A

8. OYB Increase: $60,000,000

To be taken from: Economic Support Funds (ESF)

From: AA/LAC/ Victor M. Rivera

Approval Requested for Commitment of $ 60,000,000

10. Appropriation Budget Plan Code: 72-114/51037 LES 484-35-515-KG-31

Type Funding: ☐ Loan ☒ Grant

12. Local Currency Arrangement: ☒ Informal ☐ Formal ☐ None

13. Estimated Delivery Period: FY 1984/FY 1985

14. Transaction Eligibility Date:

15. Commodities Financed: N/A

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

18. Summary Description

The purposes of the ESR III Program are to provide balance of payments support to aid stabilization efforts in Costa Rica, and to promote the objectives of USAID/Costa Rica's Caribbean Basin Implementation Plan by encouraging policy and structural changes aimed at re-establishing dynamic growth in the economy through increased exports. The $60,000,000 increment to the grant will be signed with the government of Costa Rica and will consist of balance of payments support through a cash transfer to the Central Bank of Costa Rica (BCCR). The BCCR will make available for sale to private producers to finance imports from the United States of raw materials, intermediate goods, construction materials and spare parts an amount of foreign exchange at least equal to the grant. An equivalent amount in local currency will be deposited by the Central Bank into a special account pending determination of the most appropriate uses of these funds. Disbursements of local currency from the account will be made pursuant to AID implementation letters. The $60,000,000 grant will be subject to the covenants and special provisions of the $35,000,000 grant agreement signed August 1, 1984 between the GOCR and AID.

RECORD COPY

19. Clearances	Date
DAA/LAC:M.D.Brown	
ARA/ECP:R.Beckham	9/20
LAC/DP:J.Oleson	9/20
GC/LAC:R.Meighan	9/14
LAC/CEN:P.Askin	9/13/84
AAA/PPC:R.Derham	9/26/84
M/FM:C.Christensen	9/25/84
LAC/DR:D.B.Johnson	
GC:H.Fry	9/25/84

20. Action

☒ APPROVED ☐ DISAPPROVED

Authorized Signature: [signature]

Date: Sept 26, 1984

Title:

AID 1120-1 (5-82)

CLASSIFICATION:

ACTION AID-00

INFO FILE-01 ECP-01 OAS-01 DCEM-01 REG-01 ES-01 /007 A3 YC

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UNCLAS SECTION 01 OF 08 SAN JOSE 06479

AIDAC

E.O. 12356: N/A
SUBJECT: ECONOMIC STABILIZATION AND RECOVERY III
- PAAD AMENDMENT NO. 3

1. CABLE SUMMARY AND ACTION REQUESTED. THIS CABLE TRANSMITS THIRD AMENDMENT TO ESR III PAAD FOR AID/W REVIEW, AND AUTHORIZATION OF $60 MILLION GRANT SUPPLEMENT TO GOCR.

2. DRAFT AUTHORIZATION INFORMATION FOR PAAD FACESHEET ITEMS AS FOLLOWS:

- (1) PROJECT NO. 0192, AMENDMENT NO. 3
- (2) COSTA RICA
- (3) CASH TRANSFER
- (4) AUGUST 22, 1984
- (5) A/AID MR PETER MCPHERSON
- (6) N/A
- (7) AA/LAC, VICTOR M. RIVERA
- (8) OYE INCREASE - $60,000,000 FROM ECONOMIC SUPPORT FUNDS.
- (9) $60,000,000
- (10) BUDGET PLAN CODE
- (11) GRANT
- (12) INFORMAL
- (13) FY 1984/FY 1985
- (14) -
- (15) N/A
- (16) CASH - $60,000,000
- (17) U.S. - $60,000,000
- (18) SUMMARY DESCRIPTION: THE PURPOSES OF THE ESR III PROGRAM ARE TO PROVIDE BALANCE OF PAYMENTS SUPPORT TO AID STABILIZATION EFFORTS IN COSTA RICA, AND TO PROMOTE THE OBJECTIVES OF USAID/COSTA RICA'S CARIBBEAN BASIN INITIATIVE PLAN BY ENCOURAGING POLICY AND STRUCTURAL CHANGES AIMED AT RE-ESTABLISHING DYNAMIC GROWTH IN THE ECONOMY THROUGH INCREASED EXPORTS. THE $60,000,000 INCREMENT TO THE GRANT WILL BE SIGNED WITH THE CENTRAL GOVERNMENT OF COSTA RICA AND WILL CONSIST OF B/P SUPPORT THROUGH A CASH TRANSFER TO THE CENTRAL BANK OF COSTA RICA (BCCR), THE DOLLAR EQUIVALENT OF WHICH WILL BE MADE AVAILABLE FOR SALE TO PRIVATE PRODUCERS TO FINANCE IMPORTS FROM THE U.S. OF RAW MATERIALS, INTERMEDIATE GOODS, CONSTRUCTION MATERIALS AND SPARE PARTS IN AN AMOUNT AT LEAST EQUAL TO THE GRANT. AN AMOUNT IN LOCAL CURRENCY EQUIVALENT TO THE GRANT WILL BE DEPOSITED BY THE CENTRAL BANK INTO A SPECIAL ACCOUNT. DISBURSEMENTS OF LOCAL CURRENCY FROM THE ACCOUNT WILL BE MADE PURSUANT TO AID IMPLEMENTATION LETTERS. THE $60,000,000 GRANT WILL BE SUBJECT TO THE COVENANTS AND SPECIAL PROVISIONS OF THE $35,000,000 GRANT AGREEMENT (PAAD AMENDMENT NO. 1) SIGNED AUGUST 1, 1984 BETWEEN THE GOCR AND AID.

3. BEGIN PAAD AMENDMENT TEXT.

4. TABLE OF CONTENTS

5. CHAPTER I - INTRODUCTION

THE ECONOMIC STABILIZATION AND RECOVERY III PAAD PROVIDED THE BACKGROUND, RATIONALE AND DESCRIPTION FOR AN OVERALL SEVENTY MILLION DOLLAR ESF PROGRAM IN FY 1984, INCLUDING CONDITIONALITY REQUIREMENTS AND UTILIZATION OF LOCAL CURRENCY EQUIVALENTS UNDER THE PROGRAM. ON APRIL 17, 1984, $35 MILLION IN LOAN FUNDS WERE APPROVED UNDER THE PAAD. AMENDMENT NO.1 TO THE ESR III PAAD, SUBMITTED TO AID/W ON MAY 22, 1984 AND APPROVED ON JULY 31, 1984 AUTHORIZED THE REMAINING $35 MILLION AS A GRANT TO COSTA RICA. AMENDMENT NO. 2, PER 1984 SAN JOSE 04913, REVISED COVENANT E OF THE LOAN AGREEMENT. THIS THIRD AMENDMENT DRAWS ON BOTH THE ORIGINAL PAAD AND THE FIRST AMENDMENT THERETO. IT PROVIDES THE RATIONALE FOR ADDITIONAL ASSISTANCE OF UP TO $100 MILLION, AND REQUESTS APPROVAL AND AUTHORIZATION OF $60 MILLION IN ADDITIONAL GRANT FUNDS AT THIS TIME.

THIS PAAD AMENDMENT NO.3 DOES NOT PROPOSE

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UNCLAS SECTION 02 OF 06 SAN JOSE 06479

AIDAC

E.O. 12356: N/A
SUBJECT: ECONOMIC STABILIZATION AND RECOVERY III

CONDITIONALITY REQUIREMENTS BEYOND THOSE WHICH FORM THE STRATEGIES OF THE $33 MILLION ESR III LOAN AND $25 MILLION ESR III GRANT AGREEMENTS. RATHER, THE AMENDMENT PROPOSES TO TRANCHE DISBURSEMENTS OF THE ADDITIONAL ASSISTANCE IN SUCH A WAY THAT CRITICAL BALANCE OF PAYMENT NEEDS OF COSTA RICA CAN BE MET WITHOUT REDUCING THE GOCR INCENTIVE FOR STRUCTURAL AND POLICY REFORMS. THE MISSION WILL CONTINUE TO HAVE, AS UNDER THE ORIGINAL PAAD, FLEXIBILITY TO VARY THE DISBURSEMENTS AS REQUIRED. SUCH DISBURSEMENT FLEXIBILTY ALLOWS AID FUNDS TO BRIDGE AND REINFORCE PENDING AGREEMENTS BETWEEN THE GOCR, THE IMF AND THE COMMERCIAL BANKS, WHILE PROVIDING AID WITH ADEQUATE LEVERAGE TO MAINTAIN REALISTIC DIALOGUE WITH THE GOCR REGARDING ITS COMPLIANCE WITH PRIOR PAAD COVENANTS.

6. CHAPTER II - ECONOMIC ANALYSIS

THE THRUST OF COSTA RICA'S 1984 ECONOMIC PROGRAM AIMS TO CURTAIL FURTHER EROSION OF REAL INCOME AND TO CONTAIN FURTHER ECONOMIC RECESSION. AGAINST A BACKDROP OF MINIMAL FX RESERVES, WHICH WERE BRIDGED IN MARCH BY A $50 MILLION B/P LOAN FROM THE BANCO DE MEXICO, THE GOCR SENT A LETTER OF INTENT TO THE IMF WHICH SET OUT A POLICY TO LIMIT THE OVERALL DEFICIT OF THE NONFINANCIAL PUBLIC SECTOR TO 2 PERCENT OF GDP, AND AGREED TO MAINTAIN A FLEXIBLE EXCHANGE RATE POLICY FOR THE COLON IN ORDER TO MAINTAIN EXPORT COMPETITIVENESS AND REFLECT DEVELOPMENTS IN THE B/P SITUATION.

IMPLEMENTATION OF NEEDED ECONOMIC REFORMS SUFFERED DELAYS DUE TO CHANGES IN THE ADMINISTRATION'S ECONOMIC TEAM AND THE TIME REQUIRED TO REACH CONSENSUS ON ECONOMIC MATTERS. CONSEQUENTLY, COSTA RICA'S FX POSITION HAS WORSENED. ON AUGUST 2, THE PRESIDENT OF THE GOCR GAVE A PUBLIC PRESENTATION ON THE STATE OF COSTA RICA'S FX, NOTING THAT THE GOCR WAS $86 MILLION IN ARREARS IN ITS FX PAYMENTS. HE NOTED THAT COSTA RICA HAD NOT RECEIVED ANTICIPATED FX INFLOWS FROM BILATERAL (AID), MULTILATERAL (IMF) AND PRIVATE (COMMERCIAL BANK) SOURCES.

THIS PROLONGED ABSENCE OF IMF DRAWING RIGHTS AND THE QUOTE IN FORCE UNQUOTE IMF AGREEMENT RESULTS IN THE ADVOCATES OF POLICY REFORM HAVING NO EFFECTIVE LEVER TO COUNTER GOCR PERFORMANCE SHORTFALL.

- A. FISCAL

THE 1984 ECONOMIC PROGRAM CALLED FOR A REDUCTION OF THE PUBLIC SECTOR DEFICIT FROM 4.5 PERCENT OF GDP IN 1983 TO 2 PERCENT OF GDP IN 1984 AND OF THE CENTRAL ADMINISTRATION DEFICIT FROM 3 PERCENT OF GDP IN 1983 TO 1 PERCENT IN 1984. ACHIEVING THE LATTER TARGET WOULD REQUIRE AN INCREASE IN CENTRAL ADMINISTRATION REVENUES FROM 17 PERCENT OF GDP IN 1983 TO 19 PERCENT OF GDP IN 1984.

- TO ASSIST IN REACHING THIS OBJECTIVE (ALSO REQUIRED BY THE IMF TO NEGOTIATE A 1984 STANDBY), THE GOCR MOVED TO REDUCE THE CENTRAL ADMINISTRATION DEFICIT. IN FEBRUARY, THE LEGISLATIVE ASSEMBLY APPROVED SEVERAL TAX MEASURES INCLUDING TAX RATE INCREASES, TEMPORARY SUSPENSION OF REVENUE EARMARKING, AND AN INCREASE IN TRANSFERS FROM THE REST OF THE PUBLIC SECTOR TO THE CENTRAL ADMINISTRATION, AS WELL AS A 22.5 PERCENT GENERAL REDUCTION IN EXPENDITURES. (A SUBSTANTIAL INCREASE IN THE GASOLINE TAX, INCLUDED IN THE LIST OF ACTIONS REQUIRED BY THE IMF PRIOR TO FORWARDING THE LETTER OF INTENT TO THE IMF BOARD FOR APPROVAL, WAS DETERMINED TO BE POLITICALLY INFLEASIBLE BY THE EXECUTIVE BRANCH AND AN ALTERNATIVE PLAN TO CLOSE THE FISCAL GAP WAS UNDERTAKEN BY THE GOCR IN JULY.)

- DESPITE THESE MEASURES, DATA FOR THE FIRST FOUR MONTHS OF 1984 INDICATE THAT, WHILE THE GENERAL GOVERNMENT AND STATE ENTERPRISES HAD FINANCIAL BALANCES EQUAL TO OR BETTER THAN IN 1983, THE CENTRAL ADMINISTRATION'S FISCAL POSITION WAS 1.1 BILLION

ACTION AID-00

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TO SECSTATE WASHDC IMMEDIATE 6817

UNCLAS SECTION 03 OF 06 SAN JOSE 06479

AIDAC

E.O. 12356: N/A
SUBJECT: ECONOMIC STABILIZATION AND RECOVERY III

COLONES WORSE THAN THE SAME PERIOD IN 1983.

- FACED WITH THIS SITUATION THE EXECUTIVE BRANCH HAS INITIATED A 2.2 BILLION COLONES FISCAL CORRECTION PROGRAM APPLICABLE TO THE REMAINING MONTHS OF 1984. SEVERAL REVENUE MEASURES HAVE BEEN ENACTED UNDER EXECUTIVE BRANCH AUTHORITY INCLUDING SELECTIVE CONSUMPTION TAXES, PAYMENT OF THE SALES TAX BY PUBLIC SECTOR ENTITIES, AND DEFERRAL OF THE 20 PERCENT REVALUATION OF ASSETS INCLUDED IN THE FEBRUARY LEY DE EMERGENCIA FOR INCOME TAX PURPOSES. IN ADDITION, A TAX PACKAGE HAS BEEN SENT TO THE LEGISLATIVE ASSEMBLY WHICH INCLUDES USE OF THE HIGHEST LEGAL EXCHANGE RATE FOR CUSTOMS COLLECTION, AND EMPLACEMENT OF A TAX ON PREVIOUSLY EXONERATED IMPORTS. ALSO CONTRIBUTING TO ACHIEVING FISCAL BALANCE ARE DELAYS IN CAPITAL EXPENDITURES, TRANSFERS OF ADDITIONAL TAXES TO THE CENTRAL ADMINISTRATION, AND THE YIELD OF A 5 PERCENT TAX ON FINANCIAL ASSET EARNINGS.

- E. MONETARY

- THE CENTRAL BANK'S MONETARY PROGRAM FOR 1984 TARGETED A 14 PERCENT INCREASE IN NET DOMESTIC CREDIT WHICH IS COMPATIBLE WITH OTHER QUANTITATIVE PROGRAM TARGETS, I.E. BANKING SYSTEM NET CREDIT TO THE NON-FINANCIAL PUBLIC SECTOR, NET DOMESTIC ASSETS AND NET INTERNATIONAL RESERVES OF THE CENTRAL BANK. THIS RATE OF CREDIT EXPANSION WAS CONSIDERED COMPATIBLE WITH LOW RATES OF PRICE AND WAGE INFLATION AND ALLOWED A MODEST REAL INCREASE IN ECONOMIC OUTPUT AND IMPORTS. HOWEVER, IN HIS AUGUST 2 INTERVIEW, THE PRESIDENT OF THE CENTRAL BANK ACKNOWLEDGED THAT THE CREDIT PROGRAM FOR THE (STATE) COMMERCIAL BANKS HAD ALREADY REACHED THE DECEMBER 31, 1984, CEILING OF 26,395 MILLION COLONES. THE REASONS FOR THE HIGH RATE OF CREDIT EXPANSION DURING THE FIRST HALF OF 1984 ARE (A) THE LACK OF CEILINGS ON NET DOMESTIC CREDIT FOR THE TOTAL BANKING SYSTEM WHICH WOULD HAVE COMPELLED A SLOWER AND SMOOTHER EXPANSION OF CREDIT TO THE PRIVATE SECTOR, AND (B) THE FACT THAT PUBLIC SECTOR ENTITIES DID NOT PROMPTLY REIMBURSE THE CENTRAL BANK FOR ITS PAYMENT OF THEIR EXTERNAL DEBT SERVICE IN LATE 1983.

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- SELECTED MONETARY VARIABLES
- DECEMBER 1982 - MAY 1984

SAN JO 06479 03 OF 06 232302Z 3433 ARA5687

	DEC.31 1982	MAY 31 1983	DEC.31 1983	MAY 31 1984
	(IN MILLIONS OF CURRENT COLONES)			
NET DOMESTIC CREDIT	28,566	29,892	40,670	45,929
NET CREDIT TO THE NON-FINANCIAL PUBLIC SECTOR (A)	11,090	9,135	14,017(B)	15,949 (C)
CR. TO PRIVATE SECTOR	17,476	20,757	26,653	29,980
LIABILITIES TO PRIVATE SECTOR	41,013	45,945	52,616	53,679
MONEY SUPPLY (M1)	16,962	16,783	22,482	21,416
QUASI-MONEY	24,051	29,162	30,136	32,263

	DEC. 1982 DEC. 1983	DEC. 1982 MAY 1983	DEC. 1983 MAY. 1984
	(...PERCENTAGE CHANGE...)		
NET DOMESTIC CREDIT	(D)	4.6	12.9
NET CREDIT TO THE NON-FINANCIAL PUBLIC SECTOR	(D)	-17.6	13.8
CREDIT TO PRIVATE SECTOR	52.5	18.8	12.5
LIABILITIES TO PRIVATE SECTOR	28.3	12.0	2.0
MONEY SUPPLY (M1)	32.5	-1.1	-4.7
QUASI-MONEY	25.2	21.3	7.1

FOOTNOTES:
(A) ITEM INCLUDES EXCHANGE SUBSIDIES.
(B) AND (C) INCLUDES 5.7 AND 6.3 BILLION COLONES RESPECTIVELY ON ACCOUNT OF EXTERNAL PAYMENT ARREARS FOR WHICH NO COLONES COUNTERPART WAS RECEIVED BY THE CENTRAL BANK. DATA FOR PREVIOUS MONTHS DID NOT EXIST AND THEREFORE ANNUAL COMPARISON WOULD BE

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ACTION AID-00

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UNCLAS SECTION 04 OF 06 SAN JOSE 06479

AIDAC

E.O. 12356: N/A
SUBJECT: ECONOMIC STABILIZATION AND RECOVERY III

MISLEADING.
(D) ANNUAL COMPARISONS OMITTED FOR REASONS STATED IN (B) AND (C).

\- AS SHOWN IN THE MONETARY TABLE, NET DOMESTIC CREDIT EXPANDED BY 12.9 PERCENT IN THE FIRST FIVE MONTHS OF 1984, WITH CREDIT TO THE NON-FINANCIAL PUBLIC SECTOR INCREASING BY 13.8 PERCENT AND CREDIT TO THE PRIVATE SECTOR BY 12.5 PERCENT WHICH REPRESENT ANNUALIZED RATES IN EXCESS OF 30 PERCENT PER ANNUM. MUCH OF THE INCREASE IN CREDIT TO THE PUBLIC SECTOR HAS BEEN DUE TO CENTRAL BANK FINANCING OF LARGE DEFICITS AT CNP AND CODESA.

\- BY MARCH, CENTRAL BANK STAFF WERE AWARE OF THE RAPID EXPANSION OF BANKING SYSTEM CREDIT. HOWEVER, CORRECTIVE ACTION WAS NOT TAKEN UNTIL LATE JUNE WHEN THE CENTRAL BANK PUT MEASURES TO REDUCE CREDIT EXPANSION AND IMPORTS INTO EFFECT.

\- THESE MEASURES INCLUDE (A) AN INCREASE IN THE IMPORTERS LOCAL CURRENCY DEPOSIT REQUIREMENT TO 100 PERCENT FROM THE PREVIOUS LEVEL OF 50 PERCENT; (B) THE REQUIREMENT THAT ALL TRADE WITH CENTRAL AMERICAN COUNTRIES BE EFFECTED IN U.S. DOLLARS OR, IF THROUGH THE CACM CLEARING MECHANISM, THE EXPORTER WOULD RECEIVE ONLY 70 PERCENT IN CASH AND THE REST IN A SIX MONTH TIME DEPOSIT; (C) AN INCREASE IN THE COMMERCIAL BANK LEGAL RESERVE REQUIREMENT TO A 50 PERCENT MARGINAL RATE ON DEMAND DEPOSITS FROM A PREVIOUS 32 PERCENT AVERAGE REQUIREMENT; AND (D) THE REQUIREMENT THAT COMMERCIAL BANKS LIMIT CREDIT TO THE LEVELS ORIGINALLY CONTAINED IN THE CENTRAL BANK'S 1984 CREDIT PROGRAM. THESE MEASURES APPEAR TO BE WORKING. IN ADDITION, BY LATE JULY PUBLIC SECTOR ENTITIES HAD REPAID THE CENTRAL BANK APPROXIMATELY 2.1 BILLION COLONES OF THE DE FACTO CREDIT EXTENDED WHEN THE CENTRAL BANK PAID THE EXTERNAL DEBT OF THESE ENTITIES IN DECEMBER 1983 (ALTHOUGH SOME ENTITIES RESPONDED ONLY WHEN THE CONTROLLER GENERAL REFUSED TO APPROVE THEIR BUDGET).

\- C. BALANCE OF PAYMENTS

\- PRESENT EVIDENCE SUGGESTS THAT COSTA RICA'S 1984 B/P GAP IS SUBSTANTIALLY LARGER THAN THE [illegible] BASIC BALANCE DEFICIT PROJECTED BY THE CENTRAL BANK IN FEBRUARY. AS OF JULY, PAYMENT ARREARS OF $[illegible] MILLION PLUS DISBURSEMENT OF APPROXIMATELY $[illegible] MILLION IN B/P SUPPORT INFLOWS HAD CREATED A GAP OF $[illegible] MILLION WHICH IS EXPECTED TO MORE THAN DOUBLE

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BY THE END OF THE YEAR. USING THE LATEST AVAILABLE DATA THE MISSION NOW ESTIMATES THE GAP WILL BE ON THE ORDER OF $365 MILLION (SEE TABLE BELOW) WHICH, JUDGING FROM RECENT UNPUBLISHED DATA, IS LIKELY TO BE HIGHER, PERHAPS ON THE ORDER OF $384 MILLION (FYI, THE MISSION IS PREPARING A SEPARATE MESSAGE PROVIDING MORE DETAIL ON FOREIGN EXCHANGE CASH FLOW PROJECTIONS WHICH SHOULD BE REVIEWED IN CONJUNCTION WITH THIS PARA. END FYI).

\- COSTA RICA'S BALANCE OF PAYMENTS
\- (MILLIONS OF U.S. DOLLARS)

-	1983 PREL./CB	1984 FEB/CB	1984 (AUG/AID
EXPORTS	870	895	884
IMPORTS	-991	-1084	-1189
BALANCE OF TRADE	-121	-185	-285
NON-FACTOR SERVICES	105	76	75
INTEREST PROFIT REMIT.	-365	-364	-410
BALANCE ON SERVICES	-260	-287	-335
TRANSFERS	27	54	45
BALANCE ON CURRENT ACCOUNT	-354	-419	-495
PRIVATE CAPITAL AND ERRORS AND OMISSIONS	177	140	60
NET OFFICAL CAPITAL EXCLUDING B/P SUPPORT GRANTS, CREDITS	101	126	70
BASIC BALANCE DEFICIT	-76	-153	-365

\- SEVERAL FACTORS EXPLAIN THE ENLARGED BASIC BALANCE DEFICIT: (A) THE MOST RECENT 12-MONTH DATA

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E.O. 12356: N/A
SUBJECT: ECONOMIC STABILIZATION AND RECOVERY III

BASIS (THROUGH APRIL) SHOW EXPORTS (FOB) RUNNING 13 PERCENT HIGHER THAN IN 1983 AND IMPORTS (CIF, THROUGH JUNE) RUNNING 20 PERCENT HIGHER; (B) THE LATEST CENTRAL BANK PROJECTION HAS INTEREST PAYMENTS AT $410 MILLION VERSUS $364 MILLION IN FEBRUARY DUE TO THE RECENT INCREASE IN INTERNATIONAL INTEREST RATES; (C) TRANSFERS ARE MARGINALLY LOWER THAN PROJECTED IN FEBRUARY AT $45 MILLION; (D) THE NET INFLOW ON OFFICIAL CAPITAL HAS BEEN SCALED BACK BY THE CENTRAL BANK TO $70 MILLION; (E) EVEN THOUGH THE NET INFLOW ON PRIVATE CAPITAL AND ERRORS AND OMISSIONS IN COSTA RICA'S B/P ACCOUNTING IS FUNDAMENTALLY A RESIDUAL WITHOUT SUITABLE DATA CONFIRMATION, THE DECLINING RATE OF INCREASE IN MONEY AND QUASI-MONEY IN RECENT MONTHS SUGGESTS THAT A SUBSTANTIAL NET RETURN CAPITAL FLIGHT IS NOT PRESENT IN 1984.

- THE COMPOSITION OF PROSPECTIVE B/P SUPPORT ASSISTANCE FOR 1984 HAS ALSO CHANGED SINCE FEBRUARY. INFORMATION ON B/P SUPPORT GRANTS AND CREDITS CITED IN THE MAY LAC BUREAU REPORT ON B/P FOR SELECTED LAC COUNTRIES WAS AS FOLLOWS: A TOTAL OF $181 MILLION COMPOSED OF $55 MILLION FROM THE 1984 IMF STANDBY, $70 MILLION ESF (FY 1984), AND $56 MILLION FROM THE 1983-CREATED REVOLVER CREDIT FACILITY BUT DISBURSED IN 1984. PRESENT INFORMATION SUGGESTS THE FOLLOWING COMPOSITION OF 1984 B/P ASSISTANCE: A TOTAL OF $332 MILLION COMPOSED OF $15 MILLION FROM THE PROSPECTIVE 1984-1985 IMF STANDBY, $70 MILLION ESF (FY 1984), 60 MILLION ESF (1984 SUPPLEMENTAL), $52 MILLION FROM THE 1983-CREATED REVOLVER CREDIT FACILITY, $75 MILLION FROM A PROSPECTIVE 1984 ADD-ON TO THE REVOLVER CREDIT FACILITY, THE $30 MILLION DEPOSIT IN THE CENTRAL BANK FROM THE BANCO DE MEXICO (PRESENTLY IN ARREARS), AND A PROSPECTIVE $30 MILLION SWAP FROM EUROPEAN COUNTRIES TO THE CENTRAL BANK. THIS LEVEL OF B/P ASSISTANCE SUPPORT RESULTS IN AN UNFINANCED GAP OF AT LEAST $33 MILLION FOR 1984.

- D. PRODUCTION, EMPLOYMENT AND REAL INCOME

- THE MOST RECENT OFFICIAL REVISION OF NATIONAL ACCOUNTS PROJECTS A 3.2 PERCENT INCREASE IN 1984 GDP WITH SECTORAL RATES OF GROWTH AS FOLLOWS (PERCENT IN PARENTHESIS): AGRICULTURE (0.8), MANUFACTURING INDUSTRY (5.5), ELECTRICITY ([illegible]), CONSTRUCTION ([illegible]), COMMERCE (4.0), TRANSPORTATION ([illegible]), FINANCIAL SECTOR ([illegible]), HOUSING ([illegible]), GENERAL GOVERNMENT ([illegible]), AND OTHER SERVICES (2.0). AGRICULTURE AND MANUFACTURING ARE, BY SIZE, THE LARGEST OF THE PRODUCTIVE SECTORS, WITH THE MANUFACTURING INDUSTRY THE LEADING SECTOR FOR 1984 ECONOMIC EXPANSION. ACCORDING TO A SURVEY OF SOME 200 MANUFACTURERS, THE INCREASE OF OUTPUT DURING THE FIRST HALF OF 1984 WAS 6.6 PERCENT, EXCLUDING THE REFINING OF PETROLEUM PRODUCTS. THE MARCH-TO-MARCH INCREASE IN COSTA RICA'S EMPLOYED LABOR FORCE AMOUNTED TO 4.2 PERCENT IN 1984 AS COMPARED WITH 3.7 PERCENT INCREASE IN 1982 AND A 0.9 PERCENT DECLINE IN 1983. MOREOVER, THE EXPANSION OF EMPLOYMENT IN THE PRIVATE SECTOR AMOUNTED TO 3.3 PERCENT WITH THE BIGGEST INCREASE BEING IN THE HIGHER SKILLED CATEGORIES. REAL WAGES ALSO CONTINUED THE UPWARD MOVEMENT WHICH BEGAN IN MID-1982. THE AVERAGE REAL WAGE INCREASED BY 6.8 PERCENT IN THE PERIOD MARCH 1983-MARCH 1984, WITH A 7.4 PERCENT INCREASE IN THE PRIVATE SECTOR AND 2.3 PERCENT INCREASE IN THE PUBLIC SECTOR. THE AVERAGE REAL WAGE IN MARCH 1984 WAS 98.2 PERCENT OF THE LEVEL OF MARCH 1981, AND THE RESPECTIVE PERCENTAGES FOR THE PRIVATE AND PUBLIC SECTORS WERE 93.9 PERCENT AND 83.9 PERCENT.

- E. INFLATION

- THE CENTRAL BANK'S MONETARY MANAGEMENT POLICIES HAVE NOT YET PRODUCED SIGNIFICANT ACCELERATION IN THE PACE OF INFLATION. THE 12-MONTH RATE OF INCREASE IN THE CPI WAS 8.8 PERCENT IN JUNE 1984 AS COMPARED WITH 10.7 PERCENT IN DECEMBER 1983. HOWEVER, THE MONTHLY INFLATION RATE WAS 1.36 PERCENT DURING SECOND QUARTER 1984 AS

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AIDAC

E.O. 12356: N/A
SUBJECT: ECONOMIC STABILIZATION AND RECOVERY III

COMPARED WITH 1.01 PERCENT DURING FOURTH QUARTER 1983, AND 1.20 PERCENT DURING FIRST QUARTER 1984. IS TREND SUGGESTS THAT SOME GAINS IN REAL GROWTH MAY BE JEOPARDIZED.

7. CHAPTER III - PROGRESS UNDER PRIOR ESR AGREEMENTS

- A. ESR III FUNDS HAVE HAD, AS A PRIOR ACTION, THE GOCR PASSAGE OF MODIFICATIONS TO ITS CURRENCY LAW, THE DETAILS OF WHICH WERE SPELLED OUT IN SECTION IV.E.1.A. OF THE ORIGINAL PAAD. THESE MODIFICATIONS REPRESENT MAJOR POLICY CHANGES ON THE PART OF THE GOCR, INCLUDING DIRECT DISCOUNTING OF FUNDS BY THE BCCR TO PRIVATE SECTOR COMMERCIAL BANKS, AND REMOVAL OF LEGISLATION WHICH PREVIOUSLY ALLOWED FOREIGN CURRENCY DENOMINATED DEBTS TO BE RE-PAID IN COLONES AT THE OFFICIAL EXCHANGE RATE -- APPROXIMATELY HALF OF THE FREE BANK RATE. WITH THE CONTINUED SUPPORT OF PRESIDENT MONGE, THE COSTA RICA LEGISLATIVE ASSEMBLY APPROVED THE CURRENCY LAW MODIFICATIONS ON AUGUST 18, 1984. PRESIDENT MONGE IS EXPECTED TO SIGN THE BILL INTO LAW SHORTLY. THIS LEGISLATION IS A MAJOR STEP FORWARD ON THE PART OF COSTA RICA, AND AN INDICATION THAT AID CONDITIONALITY CAN AND HAS BEEN EFFECTIVE IN PROMOTING STRUCTURAL AND POLICY REFORMS.

- B. UNDER ESR II, AND THE ESR III LOAN AND GRANT AGREEMENTS NOW IN EFFECT, COSTA RICA COVENENTED NUMEROUS ACTIONS FOR INCREASING CREDIT AVAILABILITY TO THE PRODUCTIVE PRIVATE SECTOR, STRENGTHENING THE FINANCIAL SYSTEM, EXPANDING EXPORTS, IMPROVING PUBLIC-PRIVATE SECTOR COORDINATION AND POLICY FORMULATION.

- (1) ACTIONS AGREED UPON IN THE ESR III GRANT SIGNED AUGUST 1, 1984, HAVE YET TO BE IMPLEMENTED. THE MISSION IS, HOWEVER, PROGRESSING INTERNALLY WITH PREPARATION OF DOCUMENTS DESCRIBING THE PROCEDURES AND REQUIREMENTS OF GOCR INSTITUTIONS FOR SUCH LOCAL CURRENCY ACTIVITIES AS ROAD MAINTENANCE, WATER EXTENSION, TEXTBOOK PRINTING, ETC.

- (2) REGARDING ACTIONS REQUIRED OF THE BCCR UNDER THE ESR III LOAN AGREEMENT SIGNED MAY 7, 1984, AND THE AMENDMENT THERETO, THE CENTRAL BANK AND THE MISSION HAVE AGREED TO TIMETABLE CHANGES FOR REPORT PREPARATION, AND POSTPONED INITIAL REPORTING TO SEPTEMBER 1. NO SIGNIFICANT DEVIATION FROM THE LOAN AGREEMENT COVENANTS IS EXPECTED. IT

SHOULD BE NOTED THAT UNDER COVENANT (D) WHICH CONCERNS PRICE VERIFICATION ACTIONS, THE BCCR AND THE MISSION HAVE BEEN ACTIVELY ENGAGED IN STRUCTURING A PRICE CHECKING UNIT AT THE BCCR. ACTIVITIES THUSFAR INCLUDE ANALYSES BY THE FIRM OF PRICE WATERHOUSE, OF BCCR PROCEDURES; INFORMATIONAL VISITS BY BCCR AND AID CONTROLLER PERSONNEL TO EL SALVADOR TO REVIEW THE OPERATIONAL FORMAT OF A SIMILAR UNIT; AND A SIMILAR VISIT TO COLOMBIA BY BCCR PERSONNEL.

- COVENANT E OF THE LOAN AGREEMENT, AS REVISED BY AMENDMENT NO.1 TO THE AGREEMENT, PROVIDES FOR THE BCCR TO INCREASE THE RESOURCES AVAILABLE TO PRIVATE COMMERCIAL BANKS THROUGH THE AID SPECIAL CREDIT LINE IN THE AMOUNT OF $15,000,000 UPON A.I.D.'S APPROVING A REVISION TO THE REGULATION GOVERNING PROCEDURES FOR AND USE OF THE CREDIT LINE. THIS REVISION WILL, AMONG OTHER THINGS, PROVIDE FOR THE BCCR TO DISCOUNT THE FUNDS DIRECTLY TO THE PRIVATE BANKS, AND WILL THUS AVOID FURTHER USE OF CODESA, THE STATE HOLDING COMPANY, AS AN INTERMEDIARY. THE BCCR COULD NOT PROCEED WITH REVISING THE CREDIT LINE REGULATION UNTIL THE MONETARY LAW WAS MODIFIED TO PERMIT THE BCCR TO DISCOUNT DIRECTLY TO PRIVATE BANKS. WITH THE PASSAGE OF THE MONETARY LAW, BCCR AND MISSION REPRESENTATIVES HAVE ALREADY MET TO DISCUSS APPROPRIATE CHANGES TO THE REGULATION.

- REVIEW OF THE BCCR'S STATUS OF COMPLIANCE WITH THE REMAINING COVENANTS UNDER THE ESR III LOAN AGREEMENT, SUCH AS CREDIT TO CNP,

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AIDAC

E.O. 12356: N/A
SUBJECT: ECONOMIC STABILIZATION AND RECOVERY III

INDICATES THAT THE BCCR IS PREPARING A STRATEGY FOR IMPLEMENTATION OF THESE SENSITIVE ACTIONS.

- (3) THE BCCR'S TRACK RECORD ON ESR II COMPLIANCE, WHEREIN ONLY ONE COVENANT REMAINS UNFILLED BECAUSE OF AN ONGOING BCCR/INSURANCE INSTITUTE STUDY, STRENGTHENS THE MISSION'S ASSUMPTION THAT THE BCCR WILL PROPERLY EXERCISE ITS ROLE AND LEAD IN REDUCING ARTIFICIAL CREDIT ALLOCATION DEVICES AND IN MONITORING THE COLON'S VALUE IN INTERNATIONAL COMMERCE.

8. CHAPTER IV - MISSION STRATEGY

- A. THE MISSION STRATEGY TO ENSURE COMPLIANCE WITH MONETARY AND CREDIT REFORMS, IS TO BALANCE CRITICALLY NEEDED B/P SUPPORT DISBURSEMENTS WITH BCCR PROGRESS IN ACHIEVING THE CONDITIONALITY GOALS ALREADY ESTABLISHED. UNDER THE CURRENT BCCR CASH FLOW PROJECTIONS, SEPTEMBER AND OCTOBER ARE CRITICAL MONTHS FOR COSTA RICA. THE MISSION THUS PROPOSES TO CONTINUE TO TRANCHE DISBURSEMENTS, AS UNDER PREVIOUS AGREEMENTS, IN ORDER TO PROVIDE A BASIS FOR ENFORCING THE EXISTING CONDITIONALITY WHILE MAINTAINING COSTA RICA'S ABILITY TO COMPLY WITH OTHER DONOR REQUIREMENTS CONSIDERED BENEFICIAL, SUCH AS THE IMF TARGETS AND COMMERCIAL BANK CONDITIONALITY. THE COVENANTS AND SPECIAL PROVISIONS OF THE ORIGINAL GRANT AGREEMENT WILL APPLY TO THE ADDITIONAL FUNDS REQUESTED HEREIN, INCLUDING ARTICLE 6.5 WHICH PERMITS AID TO SUSPEND DISBURSEMENTS IF IT DETERMINES THAT THE GOCR IS NOT IN SUBSTANTIAL COMPLIANCE WITH THE CONDITIONALITY OF ESR III LOAN, ESR II, OR ANY AMENDMENTS TO THESE AGREEMENTS.

- A DISBURSEMENT PLAN WILL BE CONTAINED IN THE AMENDMENT TO THE GRANT AGREEMENT TO BE SIGNED WITH THE GOCR. (AN ILLUSTRATIVE VERSION OF THIS PLAN, CONFORMING TO GOCR FOREIGN EXCHANGE CASH FLOW NEEDS, WILL BE PROVIDED TO AID/W BY SEPTEL DISCUSSED IN PARA 6.C ABOVE.) THE ORIGINAL PAAD, SECTION IV.C.2.A, AUTHORIZED THE MISSION QUOTE TO VARY THE DISBURSEMENT SCHEDULE AS REQUIRED TO ASSURE GOOD MANAGEMENT AND REGULAR AVAILABILITY OF FOREIGN EXCHANGE RESOURCES. END QUOTE. MISSION FLEXIBILITY IN THE TIMING AND MAGNITUDE OF DISBURSING THIS SUPPLEMENTAL APPROPRIATION ACTS AS A SUBSTANTIAL COMPLIANCE LEVER EASILY UNDERSTOOD BY THE BCCR, WHICH THE BCCR CAN ALSO USE TO JUSTIFY ITS ACTIONS. THE MISSION THEREFORE REQUESTS AUTHORIZATION TO VARY DISBURSEMENTS OF THE PROPOSED

$60 MILLION ADDITION TO THE GRANT, AND ANY FURTHER ASSISTANCE WHICH MAY BE SUBSEQUENTLY AUTHORIZED UNDER ESR III, BASED ON NEED AND ON ADHERENCE TO EXISTING CONDITIONALITY REQUIREMENTS AS DETERMINED BY THE MISSION.

- B. THE GOCR HAS NOT MET THE TARGETS OF ITS 1984 MONETARY PROGRAM. THE BCCR HAS REQUESTED THAT AID HOLD ESR LOCAL CURRENCY EQUIVALENTS AT THE BCCR AND, WHERE ACTIVITIES DETERMINED BY AID TO BE NECESSARY ARE TO BE FUNDED, TO REFRAIN FROM PLACING CURRENCY IN THE MARKETPLACE IN LARGE, SUDDEN QUANTITIES BECAUSE 15-40 PERCENT OF AVAILABLE COLONES ARE EXPENDED FOR IMPORTED COMPONENTRY. THE MISSION THEREFORE PROPOSES TO MAINTAIN ALL LOCAL CURRENCY EQUIVALENT OF THE $60 MILLION GRANT INCREMENT IN A SPECIAL ACCOUNT AT THE BCCR WITHOUT PRESENTLY PROGRAMMING THE USE OF SUCH FUNDS, AND REQUESTS AUTHORIZATION FOR CONTINUED LOCAL CURRENCY PROGRAMMING AUTHORITY AT THE MISSION LEVEL. AS IN THE PAST, ESF LOCAL CURRENCY EQUIVALENTS WILL, OTHER THAN IN EXCEPTIONAL CASES SUCH AS MINEX, AND WITH LAC BUREAU CONCURRENCE, NOT BE USED FOR GOCR BUDGET SUPPORT. SOME ACTIVITIES MAY, ON OCCASION, BE IMPLEMENTED WITH PUBLIC SECTOR ENTITIES, HOWEVER, THESE WILL BE OF A LIMITED TIME FRAME AND OF A DEVELOPMENTAL NATURE. DISBURSEMENTS FROM THE ACCOUNT WILL CONTINUE TO BE MADE PURSUANT TO AID

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AIDAC

E.O. 12356: N/A
SUBJECT: ECONOMIC STABILIZATION AND RECOVERY III

IMPLEMENTATION LETTERS.

- C. FYI. AS NOTED IN PARAGRAPH 6.C ABOVE, EVEN IF ALL DONOR ASSISTANCE, INCLUDING $60 MILLION SUPPLEMENTAL IS MADE AVAILABLE TO COSTA RICA, AN UNFINANCED GAP, ESTIMATED AT A MINIMUM OF $33 MILLION EXISTS BY THE END OF 1984. IF, AS THE RESULT OF ANY END OF YEAR (EOY) REPROGRAMMING, ADDITIONAL FUNDS BECOME AVAILABLE, THE MISSION REQUESTS AID/W CONSIDERATION OF ADDITIONAL FUNDING TO CLOSE THAT 1984 UNFINANCED GAP. END FYI.

9. CHAPTER V - CONDITIONALITY

THE COVENANTS AND SPECIAL PROVISIONS CONTAINED IN THE GRANT AGREEMENT SIGNED AUGUST 1, 1984 WILL APPLY ALSO TO THE $60 MILLION INCREMENT PROPOSED HEREIN.

10. CHAPTER VI - IMPLEMENTATION

THE $60 MILLION SUPPLEMENTAL, ONCE AUTHORIZED BY AID/W, WILL BE OBLIGATED AS AMENDMENT NO. 1 TO THE $35 MILLION GRANT AGREEMENT SIGNED WITH THE GOCR IN AUGUST 1, 1984. THE DISBURSEMENT MECHANISM WILL BE A CASH TRANSFER TO THE BCCR ON A TRANCHED BASIS. AID WILL CONTINUE TO RESERVE THE RIGHT, AS PROVIDED FOR UNDER ARTICLE 4.4 OF THE ORIGINAL AGREEMENT, TO ESTABLISH THE CALENDAR FOR THE PLANNED DISBURSEMENTS, AND TO NOTIFY THE CENTRAL BANK WHEN EACH DISBURSEMENT MAY BE REQUESTED. THE LOCAL CURRENCY EQUIVALENT OF THE GRANT WILL BE PLACED IN A SPECIAL ACCOUNT MAINTAINED AT THE BCCR, WITH DISBURSEMENTS FROM THIS MADE PURSUANT TO A.I.D. IMPLEMENTATION LETTERS.
WINSOR

ACTION MEMORANDUM FOR THE ADMINISTRATOR

THRU : AA/PPC, Richard Derham (Acting)

FROM : AA/LAC, Victor M. Rivera /s/ Marshall D. Brown

SUBJECT : Costa Rica Economic Stabilization and Recovery III PAAD Amendment 3 (Project 515-0192) 515K605

Action: Your approval is required to authorize a $60.0 million grant from Economic Support Funds (ESF) to Costa Rica for the Economic Stabilization and Recovery Program III.

Background: The Economic Stabilization and Recovery III Program for FY 1984 was approved by you on 27 April 1984. The original PAAD (Tab A) provided the background, rationale and description for the overall $70.0 million cash transfer ESF program for FY 1984 including details of conditionality and utilization of local currency resources for the $35.0 million loan portion of the assistance. A PAAD Supplement for the $35.0 million grant portion of the cash transfer, approved by you on 31 July, added further conditionality to induce needed fiscal and economic reforms. This ESR III PAAD Amendment 3 draws on both the original PAAD and amendments thereto, provides the rationale for additional assistance up to $100.0 million and requests approval and authorization at this time of $60 million in grant monies in ESF funds made available under the FY 1984 supplemental appropriation. The essential rationale and conditionality for this additional support was included in USAID/Costa Rica's ESF Concepts Paper approved by the LAC Bureau in January 1984 (Tab B).

The purposes of the ESR III program are to provide balance of payments support to Costa Rica and to promote the objectives of economic stabilization and USAID/Costa Rica's Caribbean Basin Implementation Plan by encouraging economic policy changes and structural reforms aimed at re-establishing dynamic economic growth through increased exports. The initial $70.0 million provided to date has been disbursed as a cash transfer to the Central Bank of Costa Rica (BCCR) to provide balance of payments support. The BCCR has made available from its own resources an amount of foreign exchange equivalent to the assistance to finance imports from the United States of raw materials, intermediate goods, construction materials and spare parts needed by the private sector in Costa Rica. The local currency equivalent of the $35.0 million loan, which was deposited into a special credit line, has been used to finance credit to the productive private sector. The local currency equivalent of the $35.0 million grant is being used for social and economic development purposes jointly agreed upon by AID and the GOCR.

The purpose of this PAAD supplement is to provide continued urgently needed balance of payments support to aid stabilization efforts already underway in Costa Rica within the parameters of the ESR III Program. The grant will be signed with the Government of Costa Rica (GOCR) and will be channeled through the Central Bank of Costa Rica (BCCR). The GOCR will make available for sale to private producers the foreign exchange equivalent of $60 million to allow for imports from the U.S. of essential raw materials, intermediate goods, construction materials and spare parts. Because of concerns regarding the effects of domestic credit ceilings negotiated by the GOCR and the IMF on the use of local currency, any local currency generated pursuant to this action will be held in a special blocked account at the BCCR. AID will examine the implications of any expenditure from the blocked account on Costa Rica's stabilization program in consultation with the IMF. AID will control release of funds from the blocked account until a determination is made as to the most appropriate use of these resources.

This PAAD (Tab C) provides updated information on the country's 1984 economic performance, justifying this request for additional assistance. The country's balance of payments gap has increased substantially from projections made in early 1984. A premature reactivation of the economy from the second half of 1983 and the lack of continuity in the GOCR's economic team are the principal explanatory factors. Some progress has been made by the GOCR; macroeconomic performance improved in 1983. Aggregate output grew by 1% as compared with a 9% decline in 1982; inflationary pressure subsided to about 11% as compared with the 40% projected in the 1983 program and the 1982 year-end rate of 82%; the overall public sector deficit was in 1983 equivalent to approximately 3% of GDP as compared with 9% in 1982 and 14% in 1981; and credit to the private sector increased by 44% in real terms in 1983. Also in 1983, private sector holdings of money and quasi-money grew by approximately 20% in real terms; this unusually high growth rate was caused by a return flow of liquid financial assets related to the emergence of positive real rates of interest in Costa Rica and also to a mild appreciation of the free market exchange rate.

In 1984, GOCR economic policymakers responded to widespread dissatisfaction with declining real incomes by permitting nominal credit expansion at annualized rates in excess of 30% during the second half of 1983 and the first half of 1984. By June 1984, imports were growing at an annual rate of 20% while exports were growing at a more modest rate of 13%. Thus, by mid-1984, the Central Bank had growing foreign exchange arrearages. GOCR authorities have undertaken measures to tighten credit conditions, increase government revenues, and comply with the prior actions required to validate the April IMF Letter of Intent. An IMF Mission arrived in San Jose on 3 September to revise the Letter of Intent and adjust quantitative performance targets, and a revised Letter of Intent is expected to be forwarded to the IMF's Board of Directors by mid-October.

Even though the Standby Arrangement only provides modest resources in November (approximately $25 million), it constitutes an essential precondition for a $75 million commercial bank credit presently under negotiation and expected in November, for subsequent Paris Club and commercial bank negotiations on the rescheduling of the external debt, and for a prospective World Bank Structural Adjustment Loan. The $60 million ESF grant provides critically needed bridge resources to the anticipated IMF/commercial bank disbursements in November. Even with the disbursements, the Central Bank foreign exchange arrearages are projected to increase from $73 million at the end of August to $105 million at the end of October.

For 1984, present indications suggest GDP growth on the order of 3-4% but accompanied by a significant expansion of the balance of payments basic balance deficit. The Mission expects a steadfast application of tightened credit conditions will reduce imports absolutely by the early months of 1985, thereby improving the situation.

<u>Discussion</u>: The Mission has achieved considerable success in eliciting key economic policy reforms and actions from the GOCR this year, most notably the passage in August of the long debated and politically sensitive currency and banking law. The GOCR has also succeeded earlier this year in gaining approval by the IMF of a Letter of Intent. Therefore, the Mission plans to obligate the $60 million grant within the conditionality framework established for policy and structural reforms under earlier loan and grant tranches to the 1984 program; thus no new conditionality is contemplated. Rather,

these ESF funds will provide emergency balance of payments assistance to serve as a bridge to the anticipated IMF/commercial bank disbursements dependent upon the signing of the IMF Letter of Intent currently being renegotiated. Pursuant to this approach, the Mission will continue to work with the GOCR on carrying out reforms set out as covenants in prior Agreements while it prepares a Concepts Paper setting forth its strategy for the use of FY 1985 ESF funding.

A Congressional Notification is not required as the $60 million in supplemental grant funds was included in the FY 1984 Congressional Presentation.

Recommendation: That you sign the Attached Program Assistance Approval Document (PAAD) authorizing $60.0 million in ESF grant funds for Costa Rica for the Economic Stabilization and Recovery Program III.

Attachments
TAB A - Original PAAD - April 17, 1984
TAB B - Concepts Paper - January 1984
TAB C - PAAD Amendment No. 3

Clearances:
PPC/PDPR:EHullander ________ Date 9/25/84
GC:HFry ________ Date 9/25/84

9/25/84

LAC/DR:MSDugan:aep:(1911B):09/19/84:ext. 29486

Clearances:
LAC/DR:LKlassen ________ Date 9/20
LAC/DR:ILevy ________ Date ________
LAC/DR:DBJohnson ________ Date ________
LAC/DP:JOleson ________ Date 9/20
LAC/CEN:PAskin ________ Date 9/20
GC/LAC:RMeighan (draft) Date ________
ARA/ECP:RBeckham ________ Date 9/20
PPC/PB:MMuhammed ________ Date 9/25

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROGRAM ASSISTANCE APPROVAL DOCUMENT (PAAD)

Project No. 0192, Amendment No. 3

2. Country: Costa Rica

3. Category: Cash Transfer

4. Date: September 10, 1984

To: A/AID, M. Peter McPherson

6. OYB Change Number: N/A

From: AA/LAC/ Victor M. Rivera

8. OYB Increase: $60,000,000

To be taken from: Economic Support Funds (ESF)

Approval Requested for Commitment of $ 60,000,000

10. Appropriation Budget Plan Code: 72-114/51037 LES 484-35-515-KC-31

Type Funding: ☐ Loan ☒ Grant

12. Local Currency Arrangement: ☒ Informal ☐ Formal ☐ None

13. Estimated Delivery Period: FY 1984/FY 1985

14. Transaction Eligibility Date:

Commodities Financed

N/A

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

Summary Description

The purposes of the ESR III Program are to provide balance of payments support to aid stabilization efforts in Costa Rica, and to promote the objectives of USAID/Costa Rica's Caribbean Basin Implementation Plan by encouraging policy and structural changes aimed at re-establishing dynamic growth in the economy through increased exports. The $60,000,000 increment to the grant will be signed with the government of Costa Rica and will consist of balance of payments support through a cash transfer to the Central Bank of Costa Rica (BCCR). The BCCR will make available for sale to private producers to finance imports from the United States of raw materials, intermediate goods, construction materials and spare parts an amount of foreign exchange at least equal to the grant. An equivalent amount in local currency will be deposited by the Central Bank into a special account pending determination of the most appropriate uses of these funds. Disbursements of local currency from the account will be made pursuant to AID implementation letters. The $60,000,000 grant will be subject to the covenants and special provisions of the $35,000,000 grant agreement signed August 1, 1984 between the GOCR and AID.

Clearances	Date
DAA/LAC:M.D.Brown	
ARA/ECP:R.Beckham	
LAC/DP:J.Oleson	
GC/LAC:R.Meighan RM	9/14
LAC/CEN:P.Askin	9/13/84
AAA/PPC:R.Derham	
M/FM:C.Christensen	
LAC/DR:D.B.Johnson	
GC:H.Fry	9/25/84

20. Action

☒ APPROVED ☐ DISAPPROVED

Authorized Signature

Date 9/26/84

Title /s/ Frank B. Kimball

set out in prior Agreements. In the ESF Concepts Paper for FY 1985, the Mission plans to discuss the issue of longer-term restructuring of Costa Rica's external debt.

A Congressional Notification is not required as the $60 million in supplemental grant funds was included in the FY 1984 Congressional Presentation.

Recommendation: That you sign the Attached Program Assistance Approval Document (PAAD) authorizing $60.0 million in ESF grant funds for Costa Rica for the Economic Stabilization and Recovery Program III.

Attachments
TAB A - Original PAAD - April 17, 1984
TAB B - Concepts Paper - January 1984
TAB C - PAAD Amendment No. 3

Clearances:
PPC/PDPR:EHullander ____________ Date ________
GC:HFry ____________ Date ________

LAC/DR:MSDugan:aep:(1911B):09/12/84:ext. 29486

Clearances:
LAC/DR:LKlassen LK Date 9/13
LAC/DR:ILevy ____________ Date ________
LAC/DR:DBJohnson ____________ Date ________
LAC/DP:JOleson ____________ Date ________
LAC/CEN:PAskin ____________ Date 9/13/84
GC/LAC:RMeighan Rm Date 9/14
ARA/ECP:RBeckham ____________ Date ________
PPC/PB:MMuhammad ____________ Date ________

In 1984, GOCR economic policymakers responded to widespread dissatisfaction with declining real incomes by permitting nominal credit expansion at annualized rates in excess of 30% during the second half of 1983 and the first half of 1984. By June 1984, imports were growing at an annual rate of 20% while exports were growing at a more modest rate of 13%. Thus, by mid-1984, the Central Bank had growing foreign exchange arrearages. GOCR authorities have undertaken measures to tighten credit conditions, increase government revenues, and comply with the prior actions required to validate the April IMF Letter of Intent. An IMF Mission arrived in San Jose on 3 September to revise the Letter of Intent and adjust quantitative performance targets, and a revised Letter of Intent is expected to be forwarded to the IMF's Board of Directors by mid-October.

Even though the Standby Arrangement only provides modest resources in November (approximately $25 million), it constitutes an essential precondition for a $75 million commercial bank credit presently under negotiation and expected in November, for subsequent Paris Club and commercial bank negotiations on the re scheduling of the external debt, and for a prospective World Bank Structural Adjustment Loan. The $60 million ESF grant provides critically needed bridge resources to the anticipated IMF/commercial bank disbursements in November. Even with the disbursements, the Central Bank foreign exchange arrearages are projected to increase from $73 million at the end of August to $105 million at the end of October.

For 1984, present indications suggest GDP growth on the order of 3-4% but accompanied by a significant expansion of the balance of payments basic balance deficit. The Mission expects a steadfast application of tightened credit conditions will reduce imports absolutely by the early months of 1985, thereby improving the situation.

Discussion: The Mission plans to use these ESF funds to continue to address ~~as~~ the broad ~~a~~ range of policy and structural reforms~~, as is deemed feasible to achieve the overall long-term objectives of the ESF program. This involves both continuing efforts~~ initiated by previous Agreements as well as important steps to be taken in 1984. The Mission has achieved success in eliciting key economic policy reforms from the GOCR this year, most notably the passage in August of the long debated and politically sensitive currency and banking reform law. The Mission will continue to work with the GOCR on further reforms

The purpose of these funds is to provide a balance of payments bridge ~~with~~ antic ~~IMF~~ pending

Substitute this section for the entire Discussion section in the action memo.

Discussion: The Mission has achieved considerable success in eliciting key economic policy reforms and actions from the GOCR this year, most notably the passage in August of the long debated and politically sensitive currency and banking law. The GOCR has also succeeded earlier this year in gaining approval by the IMF of a Letter of Intent. Therefore, the Mission plans to obligate the $60 million grant within the conditionality framework established for policy and structural reforms under earlier loan and grant tranches to the 1984 Program; ~~and~~ thus, no new conditonality is contemplated. Rather, these ESF funds will provide emergency balance of payments assistance to serve as a bridge to the anticipated IMF/commercial bank disbursements dependent upon the signing of the IMF Letter of Intent currently being renegotiated. Pursuant to this approach, the Mission will continue to work with the GOCR on carrying out reforms set out as covenants in prior Agreements while it prepares a Concepts Paper setting forth its strategy for the use of FY 1985 ESF funding.

UNITED STATES INTERNATIONAL DEVELOPMENT COOPERATION AGENCY
AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON D C 20523

JUL 31 3 12 PM '84
AID
EXECUTIVE SECRETARIAT

ASSISTANT
ADMINISTRATOR

ACTION MEMORANDUM FOR THE ADMINISTRATOR

JUL 31 1984

THRU : AA/PPC, Richard Derham (Acting)

FROM : AA/LAC, Marshall D. Brown (Acting)

SUBJECT : Costa Rica Economic Stabilization and Recovery III Program (Project No. 515-0192)

Action: Your approval is required to authorize a $35.0 million grant from Economic Support Funds (ESF) to Costa Rica for the Economic Stabilization and Recovery III Program.

Background: The Economic Stabilization and Recovery III Program for FY 1984 was submitted March 2, 1984, reviewed by the DAEC on March 16, and approved by you on April 27. The original PAAD (copy attached) provided background, rationale and description for the overall $70 million dollar ESF program for FY 1984, as well as a detailed description of conditionality requirements and objectives for local currency resources for the $35.0 million loan portion of assistance. At that time, the PAAD requested authorization of the loan portion of assistance only. The PAAD indicated that the $35.0 million grant portion of the cash transfer would be authorized based on a PAAD Supplement, which is the topic of this memo.

The purpose of the PAAD Supplement is to provide additional balance of payments support to AID stabilization efforts in Costa Rica, and to promote the objectives of USAID/Costa Rica's Caribbean Basin Implementation Plan by encouraging policy and structural reforms aimed at re-establishing dynamic growth in the economy through private sector export-led growth. The grant will be signed with the Government of Costa Rica (GOCR) and will provide balance of payments support via the Central Bank of Costa Rica. The GOCR will make an equivalent amount of dollars available for sale to private producers to allow for imports from the U.S. of raw materials, intermediate goods, construction materials, and spare parts. An equivalent amount of local currency will be deposited by the Central Bank in a special account. These funds will be used for development activities jointly agreed upon by the GOCR and AID.

8411865 24
258

Since the signing of the December 1982 one-year IMF Standby Arrangement, the Costa Rican economy has evidenced several important accomplishments.

These include successful rescheduling of the external debt in 1983 with commercial banks and bilateral donors at the Paris Club; a decrease in the public sector deficit from its peak of 14.5% of GDP in 1981 to less than 5% in 1983; achievement of exchange rate stability (by the end of 1983 the Central Bank unified and stabilized the flexible rate, currently at 44.25 colones to the dollar); achievement of relative price stability as evidenced by a reduction in the rate of inflation from 81.8% in 1982 to 10.7% in 1983; an increase of 42% in real terms of credit provided to the private sector by the National Banking System; the creation of the Program for Investments and Exports within MINEX to promote exports and to attract new investments; and a bottoming out of the recession (real GDP grew by 0.8% in 1983 and the official forecast for GDP growth in 1984 is 2%).

These accomplishments have moved Costa Rica towards economic stability. If, however, Costa Rica is to begin and sustain an economic recovery led by an export growth strategy, the GOCR will have to adopt and adhere to a new set of policies which have been outlined in both the PAAD and the Mission's CDSS for FY 1986.

Discussion: The Mission strategy for ESF funds is to address as broad a range of policy and structural reforms as is deemed feasible to achieve the overall long-term objectives of the ESF Program. This involves both continuing efforts begun under previous Agreements, and seeing that important steps are taken in 1984.

The strategy has thus shifted away from an emphasis on short-term stabilization and towards longer-term conditionality and activities pertaining to, in particular, improved policy formation and administrative reform, strengthening of the financial system, and administrative and operational support for expansion of exports and investment.

There is also a political factor involved in the Mission's strategy: 1986 is an election year in Costa Rica. Delay in initiating movement towards necessary policy and structural reforms beyond 1984 could result in these being postponed and not reconsidered until 1987. The Mission, therefore, has considered it important to attack these issues on a broad front before the end of CY 1984.

There are three prior actions to A.I.D. obligation of the $35 million grant. Meeting of the first prior action,(which was also a prior action to the $35 million loan portion of our ESF Program), took place in April 1984 when IMF management sent a message to the GOCR indicating acceptance of the GOCR's Letter of Intent. The GOCR has achieved some success in reaching IMF macroeconomic targets; the process, however, is continuing and approval of the Letter of Intent by the IMF Board of Directors is still pending.

Meeting of the second prior action took place in May, 1984, when President Monge formally issued a document titled "Economic Policy: Strategy and Actions 1984-86," which outlined the GOCR's export and investment policy strategy.

Meeting of the third prior action, which was also a prior action to the $35 million loan portion of our ESF Program, requires modifications of the monetary law (Ley de la Moneda). Reforms to the monetary law which will make external borrowing in dollars feasible and a change in Article 62 of the Banking Act, a provision of Costa Rica's monetary legislation, is also required in order to allow the Central Bank to lend dollars directly to private banks are required. The bill to meet these important conditions has passed out of committee and is currently being debated by the Costa Rican assembly. The Mission expects the legislation to be approved by mid-August; however, the exact date of passage cannot be predicted with certainty.

In addition to the three prior actions and in accordance with its "broad front" strategy, the Mission proposes 22 covenants/activities to be worked on throughout the time period envisaged for the ESF Program. The covenants include, among other things, provision of funds for activities as well as approval and/or publication of a number of action plans related to policy and structural reform. Funds will be provided to increase operating capital for the Free Zone Corporation, to improve Central Bank statistical and price verification capacities, and for Ministry of Planning studies and other contracting requirements. Action plans will be published with respect to divesting or reorientating the majority of the Costa Rican Development Corporation's current holdings to the private sector, reducing distortions in the pricing system, and modifying the Free Zone Law to make it more responsive to export and investment promotion policies. In line with the Mission's ESF strategy, these covenants/actions will be the subject of on-going A.I.D. conditionality.

Finally, the $35 million grant attaches two special provisions for suspending AID disbursements: (1) GOCR failure to remain in substantial compliance with the IMF Stand-by Arrangement; or (2) GOCR failure to substantially comply with the Covenants in this Grant Agreement or in the Loan Agreement signed on May 7, 1984, or in the Agreement signed between AID and the Central Bank on December 13, 1982 or any of the amendments thereto.

The Mission's conditionality for the $35 million grant sets the stage for a coordinated donor action program. The remaining $23 million from the $35 million loan funds was obligated on July 12, 1984. A portion of the grant funds is expected to be obligated and disbursed by the end of July or early August. This will assist the GOCR to maintain net domestic assets at a level sufficient to obtain approval by the IMF Board of Directors of the 1984 Standby Arrangement with the GOCR for SDR 50 million. The 1984 Standby Arrangement is in turn a condition required by the World Bank for a series of Structural Adjustment Loans planned to begin at the end of this calendar year.

The need for A.I.D. monies to foment a coordinated donor action program is pertinent given the GOCR's immediate cash crunch, brought on mainly by the huge debt service obligation. Payments on outstanding debt have increased from $276.5 million in 1982 (a debt-service ratio of 32%) to a forecasted $480 million in 1984 (a debt-service ratio of 53%). The GOCR faces a foreign exchange shortage of approximately $30 million at present; this figure is expected to rise (net of ESF and other disbursements)to $87.5 million by end-July, and to $150 million by end-December.

An Advice of Program Change along with a new Congressional Notification was sent to Congress on June 7th as this PAAD Supplement requests grant funding and only loan funding was included in the FY 1984 Congressional Presentation. The waiting period expired on June 22nd.

In light of Costa Rica's urgent balance of payments crisis , it may be necessary to postpone or eliminate the remaining prior requirement to permit immediate obligation and disbursement of the first tranche of grant funds. Further, given the fluid nature of the political and economic situation, it may be necessary to modify some of the covenants/activities during the course of negotiation and implementation.

Hence, it is requested that you: (1) authorize the Mission director in consultation with the Acting Assistant Administrator (LAC) to postpone or eliminate the remaining prior requirement if necessary; and (2) authorize the Acting Assistant Administrator (LAC) to approve any changes in the covenants which may be requested by the Mission.

Recommendation: (1) That you sign the attached Program Assistance Approval Document (PAAD) authorizing $35.0 million in ESF grant funds for Costa Rica for the Economic Stabilization and Recovery Program.

APPROVE FBKimball

DISAPPROVE ______

DATE 7·31·84

(2) That you authorize the Mission Director in consultation with the Acting Assistant Administrator, (LAC) to postpone or eliminate the remaining prior requirement to this $35.0 million grant tranche, should it become necessary.

APPROVE FBKimball

DISAPPROVE ______

DATE 7·31·84

(3) That you authorize the Acting Assistant Administrator, (LAC) to approve changes in the covenants to this $35.0 million grant tranche, should they become necessary.

APPROVE FBKimball

DISAPPROVE ______

DATE 7·31·84

Classification:

AID 1120-1		
PAAD	AGENCY FOR INTERNATIONAL DEVELOPMENT PROGRAM ASSISTANCE APPROVAL DOCUMENT	1. PAAD NO. Project No. 0192 515-K-604 2. COUNTRY Costa Rica 3. CATEGORY Cash Transfer 4. DATE June 20, 1984

5. TO: A/AID, M. Peter McPherson

6. OYB CHANGE NO. N/A

7. FROM: AA/LAC, Victor M. Rivera (Designate)

8. OYB INCREASE NONE

TO BE TAKEN FROM: Economic Support Funds (ESF)

9. APPROVAL REQUESTED FOR COMMITMENT OF: $ 35,000,000

10. APPROPRIATION – Budget Plan Code LESA-84-35515-KG31

11. TYPE FUNDING: ☐ LOAN ☒ GRANT

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

13. ESTIMATED DELIVERY PERIOD: FY 1984

14. TRANSACTION ELIGIBILITY DATE

15. COMMODITIES FINANCED

N/A

16. PERMITTED SOURCE		17. ESTIMATED SOURCE	
U.S. only:		U.S.:	$35,000,000
Limited F.W.:		Industrialized Countries:	
Free World:		Local:	
Cash:	$35,000,000	Other:	

18. SUMMARY DESCRIPTION

The purpose of this PAAD Supplement is to provide additional balance of payments support to AID stabilization efforts in Costa Rica, and to promote the objectives of USAID/Costa Rica's Caribbean Basin Implementation Plan by encouraging policy and structural reforms aimed at re-establishing dynamic growth in the economy through private sector investment-led growth. The grant will be signed with the Government of Costa Rica (GOCR) and will provide balance of payments support via the Central Bank of Costa Rica. The GOCR will make an equivalent amount of dollars available for sale to private producers to allow for imports from the U.S. of raw materials, intermediate goods, construction materials, and spare parts. An equivalent amount of local currency will be deposited by the Central Bank in a special account. These funds will be used for development activities jointly agreed upon by the GOCR and AID.

19. CLEARANCES	DATE
ARA/ECP: R. Bash	
~~LAC/DP J. Oleson~~	6/25
GC/LAC: R. Meighan	6/25
~~PPC/PDPR: R. Hullander~~	7/20
Acting AA/PPC: R. Derham	
~~M/FM: C. Christensen~~	
LAC/DR: D.B. Johnson	
GC: H. Fry	7/30/84
DAA/LAC: M.D. Brown	

20. ACTION

☒ APPROVED ☐ DISAPPROVED

AUTHORIZED SIGNATURE: Frank B. Kimball

DATE: July 31, 1984

TITLE

CLASSIFICATION:

29

ATTACHMENT
TAB A - PAAD Document

Clearances:
PPC/PDPR:EHullander ____ Date 7/23/84
GC:HFry ____ Date 7/30/84

LAC/DR:MSDugan:msd:07/17/84:(0561B):ext. 28126

30

ATTACHMENT
TAB A - PAAD Document

Clearances:
PPC/PDPR:EHullander RH Date 7/30/84
GC:RFry RFry Date 7/30/84

LAC/DR:MSDugan:sd:07/17/84:(0561B):ext. 28126

Clearances:
LAC/DR:LKlassen ____ Date 7/26/84
LAC/DR:SESmith ____ Date 7/26/84
LAC/DR:ILevy ____ Date 7/26/84
LAC/DR:DBJohnson ____ Date 7/27/84
LAC/DP:JOLeson ____ Date 7/26/84
LAC/CEN:PAskin ____ Date 7/26/84
GC/LAC:RMeighan ____ Date 7-26-84
ARA/ECP:RBash R Bechtum Date 7/30/84
PPC/PB:JWilkinson MM Date 7/30/84

ACTION MEMORANDUM FOR THE ACTING ASSISTANT ADMINISTRATOR (LAC)

From : LAC/DR, Dwight B. Johnson

Subject : Costa Rica Economic Stabilization and Recovery III Program (No. 515-0192) -- Amendment to Covenant

Action: Your approval is requested to amend a Covenant approved in conjunction with the FY 1984 $35.0 million ESF Loan which was authorized by the Administrator on April 17, 1984.

Discussion: As part of the conditionality package approved by the Administrator for the subject Program, the A.I.D. Mission in Costa Rica negotiated a Covenant with the Government of Costa Rica (GOCR) which called for the GOCR to make new local currency resources equivalent to $20.0 million available for use by state commercial banks for lending to the private sector. The same Covenant required the GOCR to increase local currency credit resources available to the private sector through private commercial banks by an amount equivalent to $15.0 million.

The GOCR now has become concerned that net domestic asset levels, which include funds lent by the Central Bank of Costa Rica (BCCR), will exceed limits agreed upon by the GOCR and the International Monetary Fund (IMF) as a requisite for a 1984 Standby Arrangement. After discussion with the GOCR, the Mission has proposed that the Covenant on local currency usage (shown as Covenant V in the PAAD approved on April 17; see Tab A) be revised to be shown as two Covenants as discussed in the Mission's incoming cable (Tab B).

Covenant (E) in Tab B now requires the establishment of a reglamento which defines a system whereby the BCCR directly discounts the local currency equivalent of $15,000,000 in credit funds to the private commercial banks. Local currency credit to the private sector banks is now being channeled via CODESA, a state owned holding company, in accordance with the Currency Control Law (Ley de la Moneda) which presently prohibits the direct passage of credit funds from the BCCR to the private banks. CODESA charges a fee for passing credit funds to the banks, so total flows to the sector suffer accordingly. The proposed Covenant is designed to deal with this problem.

It is important to note, however, that the proposed Covenant's effectiveness is dependent upon passage of a bill reforming the Ley de la Moneda, which is currently under consideration in the Costa Rican Congress. Were the reform bill not to pass (or at least that portion of it dealing with transfers of credit to private banks), the amended Covenant as worded would be invalid and would have to amended once again.

The new Covenant (M) in Tab B gives the GOCR the flexibility needed to allow it to program credit resources available in such a way as to maintain net domestic assets at levels acceptable to the IMF and still provide maximum credit support to the productive private sector.

Delegations of Authority: In accordance with an action taken by the Acting Administrator in authorizing the $35.0 million Loan increment to the subject Program on April 17, you have the authority to approve changes in Covenants related to the aforementioned Loan (Tab C).

Recommendation: That you approve the proposed changes to the Loan Covenants as set out in Tab B.

APPROVE Marshall Brown

DISAPPROVE ______________

DATE 7/12/84

ATTACHMENT
TAB A - Pg 28 from PAAD approved April 17, 1984
TAB B - San Jose Cable 04913
TAB C - Action Memorandum signed April 17, 1984

APR - 6 1984

ACTION MEMORANDUM FOR THE ADMINISTRATOR

THRU : AA/PPC, Richard Derham (Acting)

FROM : AA/LAC, Marshall D. Brown (Acting) /s/ Marshall D. Brown

SUBJECT : Costa Rica Economic Stabilization and Recovery PAAD (Project No. 515-0192)

Action: Your approval is required to authorize a $35.0 million loan from Economic Support Funds (ESF) to Costa Rica for the Economic Stabilization and Recovery Program.

Discussion: The purposes of this Program are to provide balance of payments support to aid stabilization efforts in Costa Rica, and to promote the objectives of USAID/Costa Rica's Caribbean Basin Implementation Plan by encouraging policy and structural reforms which help to re-establish dynamic growth in the economy through increased exports. This $35.0 million Loan will be made to the Central Bank of Costa Rica (BCCR) for balance of payments support, and will be disbursed as a cash transfer. Within CY 1984, the BCCR will make available through its own funds an amount of foreign exchange equivalent to the Loan to finance imports from the U.S. of raw materials, intermediate goods, spare parts, and construction materials. The Mission, in consultation with the IMF, has proposed that the local currency equivalent of $35.0 million be used to finance credit to the productive private sector, $15.0 million through the private commercial banks, and $20.0 million through the state commercial banks. The local currency is intended to go into an existing special credit line. A.I.D. will monitor and assist in establishing regulations for the use of the funds.

The PAAD justifies a disbursement of $35.0 million, or half of the currently programmed FY 1984 level of ESF resources, as a loan to the Central Bank. The Mission will present a PAAD for the balance (a grant to the Central Government) later in the FY. This $35.0 million will be lent by the Mission on terms which require repayment in 40 years, with a ten year grace period. Interest rates will be 2% during the grace period, and 3% thereafter. These terms are justified by the Mission on the basis of the serious external debt problems of the Costa Rican government.

No Advice of Program Change is required, as this funding was included in the FY 1984 Congressional Presentation.

There are two Conditions Precedent to A.I.D. obligation of these monies: (1) submission by the Government of Costa Rica (GOCR) of a Letter of Intent, which is acceptable to Management of the IMF, indicating agreement has been reached on an IMF Stand-by Arrangement; and (2) a revision of the Currency Law to facilitate dollar-denominated lending by Costa Rican credit institutions and access by private banks to BCCR funds of external origin. One other Condition Precedent, which was originally contemplated by the Mission and approved by AID/W in its recent review of USAID/Costa Rica's ESF Strategy Paper, relates to modification of the Free Zones Law. The GOCR has already complied with this condition.

With regard to the second Condition Precedent for this Loan, the ESF Concepts Paper, presented by the Mission in January, proposed that this Condition state that the private banks have access to all Central Bank credit. However, we have accepted the revised language suggested by the Mission which permits access by private sector banks to Central Bank credit only where the origin of funds is external. While the compromise agreed to by A.I.D./Washington would enable the private banks to be able to utilize a large percentage of BCCR funds, the lack of access to all central bank credit operations places the private banking sector at a disadvantage. It is, in fact, one of the fundamental structural problems of the Costa Rican economy, which the Mission intended to help correct through the covenant as originally written. Therefore, because this is a highly sensitive political issue which cannot be fully resolved at this time, the Bureau requested that the Mission continue to press on this problem with the GOCR and provide a progress report in the proposed PAAD amendment for the $35.0 million Grant.

Several covenants are also to be included in this Agreement, which require policy and structural reforms in the following areas: (1) credit and interest rate policy; (2) exchange rate policy; (3) improved data relating to external debt, foreign commerce and other international transactions, and economic indicators; and (4) credit resources for the private sector. The Mission had requested guidance on one covenant which would allow the National Banking System to provide credit funds up to a total of 4.6 billion colones at interest rates lower than the six-month certificate of deposit (CD) rate. The decision of the Bureau was that this was too high a level, given that the amount of subsidized credit made available* the previous year was 3.5 billion colones (or 16% of total credit in real

* small farmer
micro-business
artisan
rural women

terms). The Mission, therefore, was instructed to alter the covenant to require that the amount of credit provided at interest rates lower than the six-month CD rate not exceed 16% of total credit during CY 1984.

Given the highly dynamic situation in Costa Rica, and in light of the urgent balance of payments crisis and the fact that the exact terms of the IMF arrangements are not known, it may be necessary to modify some of these covenants during the course of negotiation and implementation. Hence, it is requested that you authorize the Acting Assistant Administrator (LAC) to approve any changes in the covenants.

Recommendation: (1) That you sign the attached Program Assistance Approval Document (PAAD) authorizing $35.0 million in ESF loan funds for Costa Rica for the Economic Stabilization and Recovery Program.

(2) That you authorize the Acting Assistant Administrator, (LAC) to approve changes in the covenants to this $35.0 million loan tranche, should they become necessary.

Frank B. Kimball

APPROVE ______________

DISAPPROVE ______________

DATE 17 [illegible] 1984

ATTACHMENT
TAB A - PAAD Face Sheet

Clearances:
PPC/PDPR:EHullander Date 4/6/84
GC:HFry Date 4/9/84

LAC/DR:SMerrill:04/05/84:(0561B):ext. 29152

Clearances:
LAC/DR:LKlassen LK Date 4/2
LAC/DR:SESmith (draft) Date 4/4
LAC/DR:ILevy Date
LAC/DR:DBJohnson Date 4-4-84
LAC/DP:JOLeson(draft) Date 4/3
LAC/CEN:PAskin (draft) Date 4/2
GC/LAC:PJohnson (draft) Date 3/30
GC/LAC:RMeighan (draft) Date 4/4
ARA/ECP:RBash (draft) Date 3/29
PPC/PB:HHandler (sub) Date 3/22

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROGRAM ASSISTANCE APPROVAL DOCUMENT (PAAD)

1. PAAD Number: Project No. 0192 - Loan 515-K-043

2. Country: Costa Rica

3. Category: Cash Transfer

4. Date: March 2, 1984

5. To: A/AID, M. Peter McPherson

6. OYB Change Number: N/A

7. From: AA/LAC, Marshall D. Brown

8. OYB Increase: None

To be taken from: Economic Support Funds (ESF)

9. Approval Requested for Commitment of: $ 35,000,000

10. Appropriation Budget Plan Code: Budget Plan Code

11. Type Funding: [X] Loan [ ] Grant

12. Local Currency Arrangement: [ ] Informal [ ] Formal [ ] None

13. Estimated Delivery Period: FY 1984

14. Transaction Eligibility Date:

15. Commodities Financed

N/A

16. Permitted Source		17. Estimated Source	
U.S. only		U.S.	$35,000,000
Limited F.W.		Industrialized Countries	
Free World		Local	
Cash	$35,000,000	Other	

18. Summary Description

The purposes of the program are to provide balance of payments support to aid stabilization efforts in Costa Rica, and to promote the objectives of USAID/Costa Rica's Caribbean Basin Implementation Plan through encouraging policy and structural changes which help to re-establish dynamic growth in the economy through increased exports. The $35 million loan will consist of B/P support through a cash transfer to the Central Bank of Costa Rica, which, with its own funds will make available an equivalent amount of dollars for sale to private producers. Imports from the U.S. of raw materials, intermediate goods, construction materials and spare parts in an amount at least equal to the Loan will be required. The local currency equivalent of $15,000,000 of the loan will be used to finance credit to the productive private sector through a special credit line from the Central Bank to the private commercial banks; the equivalent of $20,000,000 of the loan will be used through the same special credit line for similar credit operations conducted through the State Commercial Banks.

The loan will be for 40 years, with a ten year grace period during which interest will be 2% and 3% thereafter. The $35 million program will be subject to the prior actions, Conditions and Covenants specified in Section V.E.1 of this PAAD.

19. Clearances	Date
ARA/ECP: R. Bash (draft)	3/29
LAC/DP: J. Oleson (draft)	3/29
GC/LAC: R. Meighan (draft)	3/30
PPC/PDPR: R. Hullander	4/6/84
AA/PPC: R. Derham	
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Date: 17 APR 1984

Title:

AID 1120-1 (5-82)

CLASSIFICATION:

COSTA RICA

PROGRAM ASSISTANCE APPROVAL DOCUMENT

FOR

ECONOMIC STABILIZATION AND RECOVERY III 515-0192

USAID/Costa Rica
March 21, 1983

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LIST OF ACRONYMS

AID	Agency for International Development
AIFLD	American Institute for Free Labor Development
BANCOOP	Banco Cooperativo S. A.
BCCR	Banco Central de Costa Rica
CACM	Central American Common Market
CBI	Caribbean Basin Initiative
CDSS	Country Development Strategy Statement
CENPRO	Centro de Promoción de Exportaciones
CINDE	Coalición Costarricense de Iniciativas de Desarrollo
CIP	Commodity Import Program
CODESA	Corporación Costarricense de Desarrollo
COFISA	Corporación Costarricense de Financiamiento Industrial
DA	Development Assistance
DAEC	Development Assistance Executive Committee
EFF	Extended Fund Facility
ESF	Economic Stabilization and Recovery
ESR	Economic Stabilization & Recovery Program
FY	Fiscal Year
GDP	Gross Domestic Product
GOCR	Government of Costa Rica
HIG	Housing Investment Guarantee
IBRD	International Bank for Reconstruction and Development
IDB	Interamerican Development Bank
IMF	International Monetary Fund
INVU	Instituto Nacional de Vivienda y Urbanismo
PAAD	Program Assistance Approval Document
PCGP	Productive Credit Guaranty Program
PL 480	Public Law 480
PPAI	Policy Planning and Administrative Improvement
ROCAP	Regional Office for Central American Programs
S & Ls	Savings and Loan Associations
SBN	Sistema Bancario Nacional
SNAP	Sistema Nacional de Ahorro y Préstamo

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COSTA RICA: ECONOMIC STABILIZATION AND RECOVERY PROGRAM III

I. SUMMARY AND RECOMMENDATION

A. Economic Background

As has been well documented in the past two years[1/], Costa Rica's economy continues to deteriorate and will experience further decline before necessary structural adjustments are in place. Although the Costa Rican economy has reached a temporary, tenuous degree of stability within the last six months, with a revaluation of the currency in the "free" market and a significant drop in the internal rate of inflation, the analysis in this PAAD indicates that this stability is not based on fundamental factors. The economy in 1983 will continue to be plagued by continuing GDP decline and an unmanageable public debt. For many years to come Costa Rica will continue to experience sizeable balance of payments deficits due principally to high levels of debt service and because of projected slow export growth. The updated balance of payments analysis for 1983 contained in this PAAD indicates that even after including $241 million of compensatory financing from AID, the IMF, and the multilateral development banks, and assuming that $938 million of commercial bank principal and interest can be rolled-over, as well as, taking into account Paris Club refinancing, that there will remain an unfinanced

1/ These studies include Clarence Zuvekas, Jr., Costa Rica: A Review of Macro-Economic Conditions, with Projections to 1985, September 12, 1981; Academia de Centroamérica, Costa Rica: Una Economía en Crisis, December 1981; Clark Joel's macro-economic assessments of February 1982 (for CDSS) and October 19, 1982, as well as his update of the October, 1982 assessment which is Section II of this PAAD. Academia de Centroamérica, Costa Rica: Problemas Económicos para la Década de los 80, December 1980; IBRD, Costa Rica: Current Economic Position and Prospects, November 1980; IBRD, Costa Rica: Trade Incentives and Export Diversification, November 1980; University of Costa Rica, Evolución de la Industria en Costa Rica durante el año 1981 y Perspectivas para 1982, December 1981, Costa Rica: Country Development Strategy Statements, FY 1983 and FY 1984; and Costa Rica Private Sector Study, 1982.

gap of $101 million. Current interest alone due on the external public debt in 1983 will total some $442 million, or 49% of anticipated merchandise export;private external debt service will also require foreign exchange. It makes no sense to even discuss amortization of principal or arrearages. Costa Rica is in a "black hole" of debt, and debt renegotiations with commercial lenders remain a difficult piece of the overall stabilization puzzle which is not yet in place.

There are brighter sides to the Costa Rica picture, however. First, the GOCR's IMF-supported stabilization program was approved on December 20, 1983. The IMF conditions are tough, but Costa Rican authorities have informed AID officials that the GOCR has every intent to meet them. The Central Bank is confident that it will be able to meet the March 31, 1983 tests and has submitted data showing that as of February 28, 1983, they were well within the limits1/. Secondly, the recent naming of a new, dynamic Minister for Export and Investment who will develop and implement the GOCR's strategy and program in these areas. Finally, the Costa Rican populance, in general, has so far responded without major civil strife to a forced and drastic reduction in their standard of living.

This Economic Support Fund program is designed to provide Costa Rica with critical balance of payment support, and to assist the GOCR in carrying out the changes in fiscal, monetary and foreign exchange policies contained in its Agreement with the IMF. In addition, this program continues support of the objectives of the Costa Rica CBI Implementation Plan for Private Sector Development. In this program particular emphasis will be placed on the attainment of the Export and Investment Expansion objectives of the plan. The program also supports key socio-political objectives of the GOCR.

B. Program Summary

The proposed $50 million program will consist of a cash transfer to the Central Bank of Costa Rica (BCCR), of which $30,515,000 will be loan and $19,485,000 million will be grant.

Grant funding is desirable because of Costa Rica's overall debt situation and is required because of the increase in GOCR expenditures induced by recently approved higher levels of ESF and PL 480 local currency-financed public sector expenditures which were not anticipated by the IMF Agreement. The general nature of these high social impact expenditures were agreed upon by Presidents Monge and Reagan. If these expenditures were to be loan-financed, they would constitute 23.8% of the GOCR fiscal deficit allowed under the IMF program and would endanger Costa Rica's ability to meet IMF targets.

1/ See San José 1666 (classified)

The components of the program are:

1. Dollar Resources ($50.0 million) - Within three months of the termination of 1983 cash transfer disbursements, the BCCR will make available to private importers an amount of foreign exchange not less than that disbursed under 1983 cash transfers from the United States Government for the import of raw materials, intermediate goods, and spare parts from the United States. The BCCR will sell the dollars it makes available through the public and private banks of the National Banking System, as well as through private financieras, in accordance with the priorities and systems established by the BCCR, which favor the imports of such items. The BCCR will document imports of eligible commodities by the private sector and provide the Mission with a report of these transactions.

Disbursements to the BCCR may not exceed the following schedule:

(Million of U.S. Dollars)

	Loan	Grant	Total
Initital Disbursement	-	10.0	10.0
Second Disbursment	-	4.0	4.0
Third Disbursement	4.515	5.485	10.0
Fourth Disbursement	10.0	-	10.0
Fifth Disbursement	10.0	-	10.0
Sixth Disbursement	6.0	-	6.0
	30.515	19.485	50.0

Disbursements are scheduled and conditioned in such a manner as to encourage and support continued GOCR adherence to its Standby Agreement with the IMF as well as to assure the formal adoption by the GOCR of a coherant export and investment strategy. The first disbursement, expected to take place in April, will have no special conditionality attached and will replace a scheduled disbursement under Economic Stablization and Recovery II (ESR II). Subsequent disbursements will depend on the formal adoption by the GOCR of an export and investment expansion strategy and work plan which is acceptable to A.I.D.

The economic analysis performed for ESR II indicates that no problem should exist on the demand side with respect to the amount of foreign exchange to be made available to the private sector by the BCCR within the specified time period.

2. Local Currency Resources

a. The colon equivalent of the $30,515,000 generated by the loan portion of the cash transfer will be used to support the BCCR credit program for the private sector in three ways: (a) the colon equivalent of $17,515,000 will be used to increase the liquidity of the unsubsidized credit programs budgeted for the productive private sector through the National Banking System (SBN); (b) the colon equivalent of $10.0 million will be used to establish a guarantee fund in the Central Bank, to which both public and private banks will have access, and which will guarantee an estimated $50.0 million of industrial and agro-industrial loans; (c) the colon equivalent of $3.0 million will be used to continue a modified form of the highly successful industry credit program established under AID Loan 028 (Urban Employment and Community Improvement), accessible to both private and public banks.

b. The colon equivalent of $19,485,000 generated by the grant portion of the cash transfer will be used as follows: (a) the equivalent of $5.0 million will be used to finance priority housing projects for low income groups; (b) $6.1 million equivalent will be used to finance investment production credit for a land redistribution program, involving United Brands, which will increase the production of palm oil for domestic consumption; (c) the equivalent of $7.385 million will go to a GOCR trust fund for which A.I.D. will be trustee and which A.I.D. will jointly program with the GOCR. These funds would provide counterpart funding to A.I.D. projects and support other high priority GOCR activities, especially the local costs of the new Office of the Minister for Exports and Investments and for the establishment of a one-stop Investment Center and for the strengthening of Free Trade Zones; (d) the colon equivalent of $1.0 million would be placed by the grantee in a trust fund for which A.I.D. would also be the trustee. The grantee will agree that the proceeds of this trust fund would be used by A.I.D. to reinforce the A.I.D. Mission's capability to handle the dramatically expanded A.I.D. program in Costa Rica.

C. Borrower/Grantee

The Borrower will be the Central Bank of Costa Rica (BCCR), which will administer the loan and dollar portions of the program through the National Banking System. The grant portion of the program will be administered by various Costa Rican entities including the Minister for Export and Investments, the National Housing Institute (INVU), and various private bank and finance companies.

D. Conditions and Covenants

The conditions and covenants proposed for the loan are discussed in Section V of the PAAD.

E. Recommendation

USAID/Costa Rica and the U.S. Embassy recommend authorization of an Economic Support Fund Loan of $30,515,000 and an Economic Support Fund Grant of $19,485,000. The dollar loan will be repaid in 40 years, including a ten year grace period. The interest rate will be 2% during the grace period and 3% thereafter.

II. CURRENT ECONOMIC SITUATION

A. Introduction

An up-date of the Costa Rican macro-economic situation undertaken by ROCAP Regional Economic Advisor Joel with the assistance of the Central Bank's Research Department revealed no major change since the previous economic assessment (of October 19, 1982), and arrived at a balance of payments gap only slightly below that projected by the IMF in its November 1982 report. The IMF found that, Costa Rica would need $1,177 million in 1983 to finance interest and principal payment in arrears, plus another $112 million to re-finance payments on principal falling due in 1983, a total of nearly $1.3 billion. The current Joel/Central Bank projection indicates a total remaining unfinanced balance of payments gap of $1,039 million after allowing for $100 million in IMF assistance, the $50 million additional ESF requested in this PAAD and a $30 million rescheduling of interest arrears negotiated at the January Paris Club meeting. Since the IMF estimate (made last October) excluded the latter of these amounts, the two estimates are essentially consistent.

There can be no doubt that most of this remaining financial requirement will have to take the form of rescheduling of both principal and interest payments on the total debt outstanding, including all amortization payments and interest arrearages. Should Costa Rica's commercial bank debt not be rescheduled, its debt service charges would rise to the unsustainable level of 73% of exports.

Costa Rica's real GDP is estimated to have declined by over 6% in 1982, and is expected to fall by at least another 2% in 1983. This will mean a cumulative per capita decline of 20% in real terms between 1979 and 1983. National Income per capita has dropped even more drastically; salaries, especially, have lagged.

A major point to be noted is the extent of the fiscal readjustment to which the GOCR has committed itself in reaching agreement with the IMF. The Central Government's total expenditures are projected to increase by only 27% after allowance has been made for the projected colon 3,200 million increase in total expenditures to make partial allowance for inflation (expected to be about 50% in 1983). On the revenue side, a number of measures have been adopted to increase tax collections (summarized in Part II-F).

The IMF conditions are tough, but Costa Rican authorities have informed AID officials that the GOCR has every intent to meet them. The Central Bank is confident that it will be able to meet the March 31 tests, and has submitted data showing that, as of February 28, 1983,

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they were well within the limits[1/]. No prognosis can be made at this point with respect to the Government's ability to comply with the targets set for subsequent quarters.

The following sections summarize the major conclusions of the economic analysis.

B. The Balance of Payments in 1982 and 1983

Conclusions of the balance of payments analysis (presented in Annex I, Table 1) are as follows:

1. The overall balance of payments deficit (the "basic balance") increased very substantially between 1981 and 1983 — from $279 million to $646 million in 1982 and $1,280 million in 1983. This deficit was obtained by including only official capital non-compensatory inflows in the capital account. All "compensatory" loans obtained were treated as ways of financing the deficit and placed "below the line".

2. The main reason for the sharp increase in the balance of payments deficit in recent years is the substantial increase in interest and amortization payments. Debt service charges on unpaid prior year debt servicing (excluding interest and amortization charges accruing during the current year) increased from zero in 1981 to $1.1 billion in 1983 (item V in Table 1, Annex I). Other factors accounting for the balance of payment difficulties include:

- An adverse shift in the terms of trade as coffee and sugar prices have fallen and banana prices remained depressed, while import prices, particularly petroleum, rose through 1981.

- Large public sector deficits in prior years covered by foreign borrowing and credit expansion; these have resulted in the unbearable debt servicing requirement.

- A sharp decline in exports to the CACM due to the depressed condition of the whole region.

- A cut-off of foreign lines of credit from both banks and suppliers.

3. There has been a substantial increase in compensatory financing between 1982 and 1983 — from $32 million to $241 million. In calculating "compensatory" financing, we made full allowance for the

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1/ See San Jose 1666 (classified)

IMF stand-by (estimated at about $100 million in 1983) and for $127 million in ESF and PL 480 assistance (the former includes the $50 million requested under this PAAD). Even with this substantial assistance, the GOCR will not only be unable to repay any part of the principal sum on loans due, but will also prove unable to meet interest payments that fell due prior to December 31, 1982. The GOCR will have to reschedule principal payments estimated at $710 million; and will, in addition, require additional loans or rescheduling (of prior-year interest payments) equal to about $329 million (Table 1)1/. Thus, it will require a total of about $1.0 billion to cover its debt servicing after full allowance has been made for all ESF2/ and IMF assistance expected in 1983.

C. Net International Reserves

The trend in net international reserves of the consolidated banking system since December 31, 1980 is as follows:

	(Million of Dollars)
December 31, 1980	$138.6
December 31, 1981	-185.3
June 30, 1982	-122.0
December 31, 1982	-125.8

Note the deterioration of $324 million ($139 plus $185 million) in 1981. Reserves recovered by $63 million in 1982 owing to bank loans secured for that purpose. They are still sharply negative, and they do not include the substantial accumulation of debt servicing arrears that has occurred since 1980.

D. Debt Service Charges

Debt service charges on the external public debt are shown below. Note that they have risen from $343 million in 1979 to an estimated $659 million in 1983. As a proportion of merchandise exports, the debt service ratio has gone up from 36% to 73%. No country can service a debt equal to three-fourths of its export earnings. Moreover, these debt service charges refer to the external public debt only. Private external debt is excluded.

1/ Of this amount the banks have only offered to finance $228 million.

2/ Inclusive of the $50 million requested in this PAAD, but exclusive of the $35 million yet to be appropriated.

DEBT SERVICE CHARGES ON THE EXTERNAL PUBLIC DEBT
(In million of dollars)

	(1) Interest	(2) Principal	(3) Total	(4) Merchandise Exports	(5) Debt Service Ratio (3) as % of (4)
1979	129.5	213.8	343.3	942.1	36.4
1980	159.0	253.7	412.7	1,000.9	41.2
1981	315.5	282.2	597.7	1,003.0	59.6
Projected					
1982	365.0	325.0 1/	690.0	875.0	78.9
1983	442.0	217.0 2/	659.0	900.0	73.2

1/ Includes both short term debt and the "presa" (unpaid Central Bank foreign exchange obligations).

2/ Assumes rescheduling of public debt.

Source: Unofficial estimates of the Research Dept. of the Central Bank as of March 11, 1983.

E. Real GDP

In an estimate made in August of 1982, the Central Bank projected the 1982 real GDP to decline by a 5.9%. The Central Bank now expects the decline to have been even more severe. While the August projection optimistically expected value added by agriculture to increase by 3.4% in real terms, the Central Bank now expects zero growth in the agricultural sector as a result of low banana prices and the drought which adversely affected rice and livestock production.

The GDP components which experienced the largest declines are construction, (down by 40%), commerce (down by 18%) and manufacturing industry (down by 7%). Total gross capital formation (public and private) is estimated to have declined by 38% and exports by 20%.

The outlook for 1983 is not encouraging. The Central American Common Market is seriously depressed, banana and coffee prices are low and are not expected to recover significantly, the shortage of foreign exchange is likely to continue to hamper manufacturing industry, and internal inflation is discouraging exports and depressing real savings. Imports are projected to increase by only 6% in current prices, which means no increase in real terms. As a result of these various factors, the Central Bank anticipates another decline in the real GDP in 1983,

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perhaps in the order of 2 to 3 percent, and worse if anticipated compensatory financing is not forthcoming to finance the required levels of imports.

F. Fiscal Situation

The GOCR has committed itself to a drastic reduction of the public sector deficit as part of an overall package of targets and policy changes agreed to with the IMF. Analysis of the fiscal program highlights the following points:

1. The total consolidated public sector deficit which already declined substantially in real terms in 1982, is projected to decline even more drastically in 1983. That year, the overall public sector deficit is projected to decline from colon 9.6 billion (in 1982) to colon 6.7 billion, a decline of 30% in current colones. This means a reduction of about 55% in real terms, given the projected rate of inflation.

2. The Central Government's 1983 deficit (Annex I, Table 2) is projected to remain approximately constant in 1983 in current colones, even after addition of colon 3.2 billion in supplementary budget funds (needed because the original budget did not make allowance for inflation). Current revenues are also projected to increase by colon 3.2 billion (over the amount originally budgeted) as a result of inflation. In real terms, the Central Government's budget deficit is expected to decline by 30 to 35 percent.

3. A particularly drastic reduction is projected in the deficits of the state enterprises which are committed to raise the rates for their services. The combined deficit of the state enterprises are expected to decline from colon 5.7 billion to colon 2.6 billion between 1982 and 1983, a reduction of 54% in current colones and 70% in real terms. Numerous rate increases have been realized over the past several months in several key areas such as electricity, which has been raised by 70% to date, with a further 45% raise planned over the next few months; gasoline, which has been raised by 69%; and water which was raised by 90% in March 1982, with a further 109% raise planned over the next several months. Railroad, telephone, postage and public transportation fees have also been raised substantially in recent months with the prospect for additional hikes in the future. It has been agreed with the IMF that cost increases in current state enterprises will be passed automatically to the public.

4. The degree to which the overall public sector deficit is expected to contract is best reflected in its proportion to the GDP. According to the IMF's projections, that proportion is projected to decline from 15% in 1981 to 9.2% in 1982 and 4.4% in 1983. For the Central Government alone, the proportion is projected to decline from 8% in 1980 to 3.6% in 1982 and 2.8% in 1983.

5. A key feature in the public sector's austerity program is the restraint that it must exercise in the area of salary increases and in the adjustment of the prices of gasoline and other basic public services. Government salaries can be increased only in proportion to the increase in living costs of the lowest income groups. These are expected to obtain a salary increase of approximately 40%. No more than the same increase in absolute terms can be granted to middle and upper echelon government officials. The latter will thus be getting salary increases in the range of only 5-10%.

6. The Government has adopted a series of tax reform measures as part of its stabilization program. The principal ones include a temporary surcharge of 15-30% on the corporate income tax; an increase in the general sales tax from 8 to 10%, along with an increase of the tax base (to include services); a tripling of the vehicles license tax; and higher taxes on selected consumer goods. A proposal to increase the rates of the property tax (agreed to with the IMF) is currently before the Assembly.

G. Monetary and Price Situation

The monetary program for 1983 (see Annex I, Table 3) calls for a significant slowdown in the rate of increase of money supply and for a slight reduction in the total rate of bank credit expansion. The money supply which increased by 78% in 1982, is projected to rise by only 37% in 1983; while total credit extended by the consolidated banking system increased by 39% in 1982, and is projected to increase by 34% in 1983. Note, however, that a substantial redistribution of credit expansion is to take place between the public and private sectors: credit to the public sector, which increased by 35% in 1982, is scheduled to increase by only 14% in 1983; while credit to the private sector, which increased by 42% in 1982, is projected to increase by 49% in 1983 (Annex I, Table 3). This redistribution of credit is the result of the various measures adopted to reduce the deficits of the Central Government and the state enterprises; and is designed to assist in reviving the private productive sector.

The rate of inflation accelerated sharply between 1980 and 1982, but there is evidence of a deceleration since last August. Thus, the general consumer price index for lower and middle income groups of the San José Metropolitan Area, increased by 18% during the twelve-month period ending on December 31, 1980; by 65% in 1981; and by 82% in 1982. The general wholesale price index increased by 19% in 1980, 117% in 1981 and 79% in 1982. A slowdown clearly occurred in 1982: the wholesale price index declined from an annual rate of increase of 81% during the first semester to 55% during the second. The Central Bank expects a further slowdown (to about 50%) in 1983.

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H. The IMF Agreement

The IMF/GOCR agreement approved in late November 1982, contained the usual stiff conditions to assure the success of the stabilization program. Its main features include:

- Heavy emphasis on reducing the overall public sector budget deficit, which is to decline from 9-1/2% to 4-1/2% of the GDP between 1982 and 1983 (down from a level of 15% in 1981). Revenues are to be increased through the various tax measures summarized above (Section F). On the expenditure side, the Government will pursue a very conservative salary policy and will carry out significant adjustments in current transfers for social security and higher education. Capital expenditures are projected to drop by about 7% in real terms and to be financed largely by long-term foreign loans. The finances of state enterprises will be strengthened by significant upward adjustments in the prices and rates charged.

- Changes in the use of foreign loans: increasingly, foreign credit is to be shifted from use in unproductive purposes to productive investment projects in the public sector and in complementing domestic financial resources to provide credit to the private sector.

- Discontinue the extension of exchange rate guarantees by the monetary authorities.

- Achieve the gradual unification of the exchange rate (the spread is not to exceed 2% by the end of 1983), and bring about the decline of outstanding external payments arrears, the bulk of which consists of delays in meeting the public sector's foreign debt service obligations. The authorities will achieve this objective within the framework of a flexible exchange rate system, which will take account of the need to assure the competitiveness of Costa Rican exports in foreign markets.

- Refrain from introducing new restrictions on payments and transfers for current international transactions.

- Reschedule payments due on the principal of foreign loans both to commercial banks and official bilateral creditors. However, the authorities will resume current contractual debt service payments on the public external debt during 1983.

- o Avoid a further decline in net internationl reserves.
- o Increase social security contributions by 4%: 2% for the employer and 2% for the employee.
- o Adjustment of interest rates: the rate on six-month deposits is to rise to 25%, while interest charged on agriculture loans is also to rise to that level. Interest rates will continue to be adjusted to take into account the current and expected rate of inflation, interest rates abroad and the demand for credit from the private sector, in order to approach rates that are positive in real terms.

To achieve these various objectives, the Agreement specifies a number of targets or ceilings involving the Net Domestic Assets of the Central Bank, the Net Domestic Assets of the Banking System, Net Credit to the Non-Financial Public Sector and the Net International Reserve position of the Central Bank. It also sets limits on the amount of external loans that can be contracted by the public sector with maturities of less than ten years, with another sub-ceiling set on loans with maturities of less than five years.

Compliance with these terms will not be easy politically. It will call for an unusual degree of self-discipline and for a significant cut-back in living standards for many people, particularly public sector employees. The goals are ambitious, particularly those related to the tax reform package, the rate increases of essential public services and gasoline prices, and the restraint on salary increases for public sector employees.

Central Bank officials and government authorities are determined to comply with the conditions of the IMF Agreement and to meet the various tests. According to data provided by the Central Bank to the ROCAP Economic Advisor (presented in Annex II, Table 4), the Central Bank believes it is in a good position to pass the March 31 tests. They claim to have a safety margin. Thus, the Net Internal Assets of the Central Bank stood at colon 64.8 billion at the end of February, compared with the limit of colon 69.5 billion for March 31. Total Net Credits by the national banking system to the Public Sector stood at colon 9.9 billion at the end of February, compared with the limit of colon 13.4 billion as of March 31; while no additional external loans with maturities of less than five or even 10 years have been contracted since the end of 1982, as against permissible limits of $50 million and $100 million, respectively, for these two types of loans (see Annex I, Table 4).

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III. RESULTS AND CURRENT STATUS OF PRIOR ESF PROGRAMS

Since the Monge Administration took office in May of 1982 to February 28, 1983, USAID/Costa Rica has disbursed over $94 million in D.A., ESF, PL 480, and HIG resources. Our assistance has been an important element in helping Costa Rica to achieve the precarious economic improvement it is now experiencing and has also been key to significant policy redirection. The two prior ESF-funded Economic Stabilization and Recovery Programs are playing an important overall role in this, the initial stabilization phase.

A. Economic Stabilization and Recovery I (ESR I)

This program for the amount of $20 million cash transfer was signed on July 14, 1982. All dollar resources under this program have been disbursed. Of the local currency, $5.0 million were granted to CINDE, a Costa Rican private association, for relending to COFISA. COFISA will not be able to relend these resources until such time as a definitive rescheduling agreement is signed with its creditors and an inter-creditor agreement is signed between AID and COFISA's other creditors. The foregoing is now expected to occur during April of 1983. The $15.0 million of loan-generated local currency fed an especially innovative banking system credit line to non-traditional exporters which for the first time permitted the financing of new stock purchases to finance working capital for enterprises which were not otherwise credit worthy. Those resources were quickly lent out.

Two major policy objectives were met by ESR I. First, the Central Bank agreed to negotiate and implement an IMF Standby. Such an agreement was accepted by the IMF on December 20, 1983 and is now being implemented[1/]. Secondly, an arrangement was made which, for the first time since the 1948 bank nationalization, permitted private bank participation, albeit indirectly, in a Central Bank credit program. More specifically, private banks, using a public sector holding company, CODESA, as an intermediary, were able to place 35% of the $15 million colon equivalent more quickly and efficiently than were state banks.

B. Economic Stabilization & Recovery II (ESR II)

This program which is being financed by the CBI supplemental presently totals $70 million, of which $58 million is loan funded and $12 million is grant funded. On the dollar side, the entire $70 million is in the form of a cash transfer to the Central Bank. Two disbursements to date under the program total $24.5 million of which $8.0 million is grant-financed. On December 13, 1982, $64.5 million of

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1/ See San José 1666 (classified)

the program was obligated. During the month of March the Mission will obligate the remainder of the CBI $70 million plus an additional $5 million of previously unallocated CBI loan resources.

There are three key conditions and special provisions in the program. First, a condition precedent to the program's second disbursement was the formalization of a standby by the IMF. A second, related special provision is that AID reserves the right to suspend scheduled monthly disbursements in the event that the GOCR is not in substantial compliance with the IMF program. As the discussion in the previous section on the Current Economic Situation indicates, the GOCR appears, at present, to be in substantial compliance with the IMF program which was formalized in last December. Thirdly, a condition precedent to disbursements from the program after February 28, 1983 is that there be submitted to the Costa Rican Legislative Assembly an amendment to the Central Bank's law to permit the participation of private banks in the Central Bank's rediscount and other lending programs on an equal basis with public banks. The Central Bank has prepared and its Board of Directors approved the necessary changes in the wording of Article 62 of its law. The Central Bank has forwarded the amendment to the Executive, which in turn will have to submit it to the Legislative Assembly prior to the end of March if the program's third disbursement is to proceed as scheduled. We fully expect that this legislation will have been forwarded prior to the review of this PAAD.

On the local currency side, in addition to supporting the expansion of unsubsidized lending to productive private sector, ESR II has three special features:

(1) <u>Private Sector Export and Investment Promotion and Other PVO Activities ($12.0 million grant)</u>

The principal component of this program is the private sector activities to be funded by CINDE (see ESR II PAAD for detailed description of CINDE). CINDE is still organizing itself but is off to a good start. It has hired as top management two of the country's most able professionals, and two private organization proposals, those of the IESC and the Chamber of Industries have already been approved. More importantly, CINDE has already had significant policy impact; for example, it played a key role in getting President Monge to name a Minister-Counselor for Exports and Investment.

Under this component the USAID is also making direct grants to AIFID ($250,000) to assist Costa Ricans in promoting democratic labor unions and to ACDI ($500,000) to provide technical assistance to the new private cooperative bank (BANCOOP S. A.).

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(2) Private Bank Credit Line Set Aside ($10 million)

Under the ESR II Assistance Agreement the BCCR agreed: "to establish prior to January 31, 1983, in form and substance satisfactory to A.I.D., with local currency generated from the sale of transferred dollars, a special credit line, similar to that established under AID Loan No. 515-K-037 (ESR I), to be used exclusively by private banks through which the colon equivalent of at least ten million United States Dollars (U.S. $10,000,000) will be extended as credit to private producers and manufacturers." The Mission, with AID/W approval, changed the due date on this covenant to March 31, 1983 because the BCCR took considerable time in submitting to USAID the regulations governing this credit line. We are now in the process of reviewing those proposed regulations. It appears that some differences exist between the A.I.D. and BCCR approaches to this credit line and that negotiations will have to take place to overcome those differences. It seems probable that a further extension to April 30, 1983 will be required for this covenant.

(3) Special Credit Line to the SNAP ($5 million)

The ESR II program also called for the establishment "...prior to January 31, 1983, in form and substance satisfactory to A.I.D., with local currency generated from the sale of transferred dollars, a special credit line of the colon equivalent of at least five million United States Dollars (U.S. $5,000,000) to be utilized exclusively for the provision of mortgage financing for families below or at the median income level through the Sistema Nacional de Ahorro y Préstamo (National Savings and Loan System);". As a result of the DAEC review of ESR II the Mission agreed to undertake an update of the SNAP's financial condition. This study, which was sent to AID/W, concluded that the SNAP was in worse condition than had been previously recognized, that emergency measures were justified, and that the below the median income level restriction was partially at odds with perserving the private sector nature of the SNAP. This Mission has requested AID/W approval to modify the covenant, and we are presently waiting for AID/W reply.

IV. PROGRAM RATIONALE AND OBJECTIVES

A. U. S. Interests

Costa Rica's economic crisis poses serious challenges to the country's political and economic system, particularly when considered in the context of the disruption affecting all of Central America. The new Costa Rican administration which took office in May of 1982, will continue to have to face the economic difficulties head-on, and undertake further difficult and far-reaching measures. It will also have to convince the country that its severe economic problems are being dealt with effectively, that the austerity measures will pay off, and that the necessary sacrifices will be shared equitably. This is likely to be an extremely difficult task. It is clear that a long period of stringent financial and fiscal discipline will be required of Costa Rica's government and people, and that the economy must undergo a far-reaching structural adjustment. It is not certain how Costa Ricans will react to a protracted period of high unemployment, eroded purchasing power, periodic food shortages, and cut-backs in public services.

Since the approval of Costa Rica's one year stabilization program by the IMF board on December 20, 1982, and the adoption of the current foreign exchange management regime in August 1982, the Costa Rican economy has temporarily recovered a certain degree of stability. The free rate of exchange had dropped from 63:1 to under 45:1 as of March 21, 1983, and the interbank rate has remained constant at 40:1 since October. A number of factors account for the certain degree of stability which has been achieved. First, Costa Ricans perceive the current GOCR's commitment to stabilization as a serious one. This has resulted in a reversal of earlier tendencies to capital flight; in fact, some capital repatriation apparently has taken place. Secondly, a significant contraction in the public sector deficit, the result of large rate increases for public services, significant tax increases, and a retrenchment in public sector expenditure, has led to a lessening of internal inflation; from July 1982 to January, 1983 monthly inflation (wholesale price index) averaged 2.4 percent compared to a monthly average of 6.6 percent during the previous six months. Thirdly, the successful bilateral (Paris Club) debt renegotiations concluded on January 11, 1983 have also given a temporary respite. Fourthly, Costa Rica has not been fully servicing its massive commercial bank debt nor the large arrears on it. Finally, and importantly, disbursements of USG assistance have made a critical difference; since the present GOCR administration took office last year these disbursements from Development Assistance, Economic Support Funds and PL 480 have totalled in excess of $94 million.

The tenuous stability, especially with regard to the exchange rate, that the Costa Rican economy has regained is deceptive in that it is not totally based on fundamental factors, and it is dangerous in that it

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is lulling many Costa Ricans, especially the more afluent into the illusion that the worst is over and that they can soon get back to previous levels of consumption[1/]. The temporary stability is deceptive because of two factors:

- o Costa Rica has only been making token payments on its public debt and because of accumulating arrearages that debt is growing rapidly and will be more difficult to service in the future.

- o Because of prior mismanagement, both the free exchange rate at 63:1 and the interbank exchange rate at 38:1 may have been undervalued in August of last year when the new exchange management regime came into effect.

Token debt service and some slack in the exchange rates gave the Monge Administration some breathing space—a grace period. Now, just as public confidence is recovering, the fundamentals are much different. Substantial service on the public debt will increase the demand for dollars. More basically, the interbank exchange rate at 40:1, coupled with significant export taxes is now, or will soon be, overvalued because internal inflation continues to be much higher than world inflation. In order to service its debt and to generate the foreign exchange that renewed growth requires, Costa Rica's exports will have to increase substantially. To achieve the foregoing, among other things, export taxes will have to be reduced or eliminated and the interbank exchange rate increased. If the GOCR decreases export taxes, either other revenues will have to be found, or public spending will have to be cut further. An increasing interbank rate will result in further increases in public service rates and in the prices of fuels and other essentials as well as increased taxes or cutbacks in public services. Significant new sacrifice will be required by the Costa Rican people.

In short, the GOCR will soon have to make some difficult choices, the political costs of which will be high. Trade-offs are involved, and long-term and short-term objectives will often conflict. As discussed below, an environment which favors exports and investments must be created. The measures which will have to be taken to do so will be in partial conflict with factors affecting short-term political and social stability. All of the foregoing will have to take place in the seething cauldron which is Central America today.

The U. S. interest is to assist Costa Rica in carrying out the required adjustment in a manner which preserves the basic tenents of a

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1/ This is of course only an illusion. In 1978-79, this Mission commissioned studies which indicated that only 25% of the population could not afford a minimum diet. The GOCR now estimates that figure at somewhere near 75%.

democratic society and a free market economy. U. S. Economic Support Fund assistance can help Costa Rica ease the strain of the austerity measures it must take over the next several years. There is considerable risk that Costa Rica's institutions might not survive the current crisis without the substantial assistance proposed by A.I.D. and other donors. In addition, A.I.D.'s assistance provides the GOCR with further incentives to undertake difficult policy changes; and economic assistance is, perhaps, the principal means by which the U.S. can attain its interests in Costa Rica. The program proposed in this PAAD is part of that effort; it has balance of payments, economic policy, and socio-political objectives.

B. Program Objectives

1. Overall ESR Objectives

USAID/Costa Rica's overall program, of which this program, ESR III, is a part, supports the goals and objectives presented in the approved CBI Implementation Plan for Costa Rica. The goals of this plan are as follows:

- to help reestablish dynamic growth in the Costa Rican economy; and
- to assist in the reorientation of the Costa Rican economy from its present industrial import substitution bias, to one in which the industrial sector contributes to export-led growth.

These goals, and the objectives which support them, are based on the conclusion that the current Costa Rican economic problems have deep structural roots. The overall USAID program is designed to address the various facets of the Costa Rican economy's structural problems by pursuing the following five principal strategy objectives:

- Economic Stabilization and Recovery - to relieve Costa Rica's economic crisis by improving its balance of payments situation by: alleviating the shortages of imported goods required for production; increasing credit available to the productive private sector; and restoring international confidence in Costa Rica and its currency. The program will be coordinated with, and support the economic stabilization and recovery aims of the present IMF Standby Agreement, as well as, a planned subsequent IMF EFF Program.
- Strengthening of the Financial System - to encourage the further development of private banks and other private financial entities in Costa Rica, in order to

expand and improve services to the productive private sector beyond that currently available through the nationalized banking system.

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

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

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

The program described in this PAAD responds to some degree to all of the above strategy objectives, but especially the objectives of economic stabilization and recovery, and export and investment expansion which merit further discussion in this document. In addition, the program's socio-political objectives, which respond to GOCR priorities and to U.S. interests, also merit elaboration.

2. Specific ESR III Objectives

a. Economic Stabilization and Recovery

(1) Program Timing and Relationship to Overall AID and other Donor Assistance

Section II, Current Economic Situation, analyzes and describes the acute nature of the balance of payments problem which Costa Rica faces in 1983. Even counting CBI supplemental disbursements during the year of $70 million and the $50 million of resources to be provided under this program, as well as all expected multilateral bank disbursements and assuming $228 in new commercial bank import financing (partial interest average roll-over) an unfinanced gap of some hundred million dollars still exists at a zero growth GDP target. Thus, an important objective of this program, as is true for almost all of USAID/CR's efforts, is its effect on the balance of payment.

The disbursement schedule for the resources to be provided under this program is presented in Section V. Except for the first $10 million disbursement which will be made in April or May1/, the cash transfer is planned to be disbursed monthly, from August to December of 1983. Disbursements after the first one would commence after ESR II was fully disbursed.

In recognition of the gravity of the Costa Rican balance of payments problem and in response to a special request made by President Monge (see Section IV.B.2.c, below), President Reagan recently announced the administration's intention to increase the allocation of foreign assistance to Costa Rica in FY 83 by $60.1 million over the planned continuing resolution level. This addition would bring our overall assistance level for FY 83 (excluding $70 million of the CBI supplemental) to $145.1 million, which is broken down as follows:

Development Assistance	27.1
Economic Support Funds	90.0
PL 480, Title I	28.0

Additional ESF resources of $35.0 million will have to be appropriated by Congress to reach these levels. Assuming that these

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1/ The reasons for the timing of the first disbursement are explained in Sections IV.C. and IV.D. of this PAAD. This program's first disbursement will replace the monthly scheduled disbursement under ESR I.

resources in fact materialize, the additional ESF could be disbursed in the last quarter of 1983 to compensate for multilateral shortfalls, which at present appear probable.

The $50 million to be provided under this program will provide a significant and even flow of funds to help support the balance of payments in the short-run. It will also have a positive impact on the balance of payments in the longer run because of the economic policy objectives which it will help support.

(2) Justification for Cash Transfer

The reasons for using the cash transfer mechanism which were described at length in the PAAD's for ESR I and ESR II remain essentially unchanged, and the Mission has concluded that the cash transfer mechanism is also the only means to achieve the objectives of this program.

In addition to the obviously favorable immediate balance of payments effects of an orderly cash transfer program, three of the principal objectives of this program are: (1) to encourage the GOCR to adhere to the IMF standby; (2) to encourage the GOCR to develop and implement a viable export and investment expansion strategy; and (3) to encourage the GOCR to maintain an exchange and export tax regime which provides adequate incentives to exporters. The Program Agreement will contain a subsequent Conditions Precedent and Special Provisions which will permit A.I.D. to suspend scheduled disbursements should the above mentioned principal policy objectives be in jeopardy. Furthermore, the cash transfer disbursement schedule has been designed to maximize the probability of achieving success with regard to the program's objectives. The "leverage" of the program's subsequent condition precedent and having the right to suspend scheduled disbursements, as well as, the support given of well-timed dollar inflows to the IMF program would be lost with a commodity import program.

b. Expansion of Exports and Investments

As a result of the DAEC review of the PAAD for ESR II which had the A.D. Little Study[1/] as an ANNEX, it was decided that prior to authorizing this program, the GOCR should develop a coherent export and investment promotion strategy. The socio-political objectives of this program, which are discussed below have made the full-blown development of that strategy prior to authorization and initial disbursement an impossible task. In spite of the foregoing, considerable progress has

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1/ CENPRO: In the Context of an Export Development Strategy for Costa Rica.

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been made by the GOCR towards the development of an export and investment strategy. After an in-depth briefing on the results of the A. D. Little study at the highest levels of the Costa Rican Government, many of the report's major thrusts have been adopted as policy. The report's most important recommendation, that the GOCR name an authority at the highest level to develop and implement a coordinated export and investment strategy has been fully implemented. On March 9, 1983, after a careful process of consultation will key advisors and cabinet members, President Monge named Dr. Mario Carvajal H. as Minister (without portfolio) for Exports and Investments. Minister Carvajal has already become an effective advocate both within the councils of government and in public for change in the export policy environment. Minister Carvajal has set for himself as his first task the development a coherent export and investment strategy and detailed work plan within ninety days. Grant local currency resources from this program's first disbursement will assist Minister Carvajal in the fuller development of the strategy, the formal adoption of which we propose to make a subsequent condition precedent beyond the initial disbursement.

At the present time the Mission is unable to demonstrate that the existing Costa Rican exchange rate and export tax regime are making Costa Rican exports uncompetitive in foreign markets[1/]. However, there are strong indications that if the interbank exchange rate is not now effectively overvalued, it soon will be. To provide a basis for future policy dialogue on this question the Mission proposes that a covenant be included in the program in which the Central Bank agrees to maintain an exchange rate system which will keep Costa Rican exports competive in foreign markets.

c. Socio-Political Objectives

On November 4, 1982, President Monge wrote a letter to President Reagan in which he requested that: (1) that this $50 million program be a grant and not a loan, and (2) that an additional $30 million dollars be made available to finance an "aggressive social compensation and development plan" to complement the structural adjustment to the economy.

It was in part in order to be responsive to President Monge's request that President Reagan recently announced an increase, subject to Congressional approval, of $60.1 million in USAID/Costa Rica's overall assistance package. This increase consists of a mixture of DA,

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1/ As one of the first activities to be funded under the PPAI, the Mission is sponsoring a study to be undertaken by Production Sharing, Ltd. on the competitiveness of Costa Rica for assembly industries. Other competitiveness analyses will also be supported either by the PPAI project or CINDE.

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ESF, and PL 480 resources. In President Reagan's reply to President Monge's request for increased assistance he stated that he was committed to "providing substantial U.S. economic assistance, part of it on a grant basis and the rest on highly concessional terms."

Given President Monge's concern, it is necessary that portions of the increased assistance be directed to areas of priority social concern such as housing and land redistribution. In order for these expenditures to have their desired effects it is also necessary that they be quickly and effectively spent.

The foregoing has had certain consequences for the programming of DA resources ($10 million health loan), PL 480: Title I local currency generations ($8 million increment, in part for rapid land purchases in the Northern Zone) and for the local currency uses of this program as well as its loan/grant split and disbursement schedule. The increased public sector expenditures which will be induced also has complications for the IMF program which are discussed in the following section.

C. Rationale for Grant Funding and Loan Terms

1. The External Debt

Costa Rica's crushing debt service burden, which requires the rescheduling of both its private and public debt, has been amply documented in this and other documents. At present, this debt is estimated to total some $4.0 billion. As has been pointed out previously, current intrest on the external public debt alone totals some 49% of merchandise exports; and amortization in the next ten years of commercial bank debt will prove impossible. Therefore, although the infusion of new concessional multilateral and bilateral resources will improve the term-structure of Costa Rica's public debt, that debt can still be expected to increase massively and could easily be in the $6-8 billion range five years from now. Although bulk of this new debt can be expected to be on "concessional" terms, the multilaterals are charging 8-10% interest and their policies do not permit rescheduling. Although this Mission does not know of studies of the long-term consequences of Costa Rica's indebtedness1/, debt service ratios in excess of 50% for the next decade or two are easily envisioned as is a "black hole" of debt phenomenon. Admittedly, these considerations do not support a specific grant target under this program. They do, however, justify the conclusion that every effort must be made to provide Costa Rica with economic assistance on the most concessionary terms possible.

1/ It is for this reason that a study of this topic will be shortly undertaken under PPAI.

2. The IMF Agreement

A second and more specific reason for grant financing relates to the correspondence between presidents discussed in Section IV. Even the partial implementation of a social program of the type envisioned by President Monge, and partially financed by the grant assistance to be provided under this program involves additional government expenditures i.e., expenditures over and above the amount contemplated at the time the IMF agreement was negotiated. President Reagan has responded favorably to President Monge's request, thus commiting additional U.S. assistance to finance expanded public expenditures. It behooves us to provide the GOCR with the means to do so without violating the IMF Agreement which was negotiated before this expansion was approved and the external financing secured. The provision of the additional resources in the form of a loan would fail to keep the GOCR's budget deficit from rising. A loan, even one on the most concessionary terms, would not prevent the deficit from increasing because a loan is not treated as a "revenue" in standard budget accounting. On the other hand, a grant would be treated as ordinary revenue. Thus, a grant-financed expenditure would not expand the budgetary deficit.

The IMF Agreement regarded U.S.G. ESF disbursements as "compensatory financing" and the agreement specifically provides that ceilings on domestic banking system credit to the non-financial public sector "will be reduced by the amount of any U.S. economic support loans directly disbursed to the non-financial public sector" (see P.70, Table 2 of IMF Document EBS/82/214).

If it is the position of the United States Government that Costa Rica's complaince with the IMF agreement should be encouraged, and if this position is being backed up by provisions in program agreements that allow for the suspension of ESF assistance in the event of non-compliance, then it would be inconsistent and counterproductive to contribute to non-compliance by adding further to the GOCR deficit.

The increase in the GOCR deficit, were there not $19.5 million of grant funding in this package, is accounted for by the following:

- The $5.0 million colon equivalent increase in public expenditures resulting from the local currency housing program, which is described in Section V;

- The $6.1 million colon equivalent land redistribution program, also described in Section V, which would have to be channelled through the GOCR if loan-funded;

- The $8.0 million colon equivalent increase in 1983 PL 480 local currency expenditures which result from the recently approved increase in that program.

- Expenditures in 1983, estimated at the equivalent of $300-400 thousand for activities which are to be undertaken by the new Minister of Exports and Investments and other local currency expenditures of $400-500 thousand also related to the PPAI project.

3. The Local Currency Program

Finally, but not unimportantly, it should be noted that the local currency program associated with the grant component would require approval of the Legislative Assembly if the source of the generations were from the loan rather than the grant. This would most likely result in considerable delays in any activities planned requiring early financing. In addition, activities such as the export and investment program would become more difficult to carryout due to legal and/or bureaucratic restrictions that would apply if the source of the local currency generations were loan funds.

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V. PROGRAM DESCRIPTION

A. Program Components

The components of the proposed program are as follows:

1. A $50.0 million cash transfer to the Central Bank of Costa Rica, of which $30,515,000 million will be a loan and $19,485,000, a grant.

2. A local currency program equivalent to the $50.0 million cash transfer with the following sub-components:

a. The local currency equivalent of the loan portion of the cash transfer will provide productive credit to the private sector through the banking system and establish a Central Bank credit guarantee fund.

b. The local currency equivalent of the grant portion of the cash transfer will finance social impact projects and the local cost of A.I.D. projects and activities.

B. U. S. Dollar Resources

1. Disbursement of U. S. Dollar Resources

Cash transfer disbursements will be made in monthly tranches starting with the month of authorization and ending in December 1983. A three month gap will occur between the first disbursement and the second disbursement, during which time the ESR II (Loan 515-K-040) funds will continue to be disbursed. This will allow for a fairly even flow of ESF resources. As in the case of Loan ESR II, A.I.D. could suspend disbursement in case of non-compliance with the IMF agreement. Disbursement would be held up if A.I.D. determines that non-compliance resulted primarily from factors within the control of the GOCR. Disbursements from ESR III, after the first disbursement, will also be conditioned upon the satisfactory completion of an export development strategy. The planned period between the first and second disbursements is considered to be sufficient to complete the strategy.

The following schedule shows the estimated disbursement calendar for ESR II and ESR III during 1983.

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(millions of U.S. Dollars)

1983	ESR II Loan	ESR II Grant 1/	ESR III Loan	ESR III Grant	TOTAL
January	6.5	8.0	-	-	14.5
February	10.0	-	-	-	10.0
March	10.0	3.25 2/	-	-	13.25
April	-	-	-	10.0	10.0
May	10.0	-	-	-	10.0
June	10.0	-	-	-	10.0
July	10.0	-	-	-	10.0
August	5.985	-	-	4.0	9.985
September	-	-	4.515	5.485	10.0
October	-	-	10.0	-	10.0
November	-	-	10.0	-	10.0
December	-	-	6.0	-	6.0
	62.485	11.250	30.515	19.485	123.735

1/ Excludes CBI ESF grants of $1.265 million for Costa Rica not included in cash transfer.

2/ Originally planned as part of initial ESR II disbursement.

2. Use of U. S. Dollar Resources

A $50 million cash transfer to the Central Bank of Costa Rica (BCCR) is proposed, of which $30,515,000 would be a loan and $19,485,000 would be a grant. The loan portion of the transaction would be at A.I.D.'s most concessional rates: a 40 year loan with a 10 year grace period, 2% interest during the grace period, and 3% thereafter 1/.

Within three months of the termination of disbursement of the cash transfer, the BCCR will make available for private sector use an amount of foreign exchange at least equal to that disbursed under the cash transfer for the import of raw materials, intermediate goods, and spare parts from the United States. In the event that not all this program's cash transfer disbursement are completed in 1983, the BCCR will make available within three months after the termination of those disbursements an amount not less than that disbursed after 1983. The BCCR will sell the dollars it makes available through the public and private banks of the

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1/ This recommended variance from A.I.D.'s normal lending terms for Costa Rica is discussed in Section IV.C.

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National Banking System, as well as through private financieras, in accordance with the priorities and systems established by the BCCR. Assuming that the planned cash transfer disbursement schedule is adhered to, the BCCR would have to make available an average of approximately $10 million a month for such imports. Data provided by the Central Bank show that in 1980, the last "normal" year, Costa Rica's imports of raw materials and intermediate goods from the U.S. alone totalled $251 million, or approximately $20 million per month. Moreover, the BCCR's present foreign exchange allocation system and priorities favor the import of raw materials, intermediate goods, and spare parts. No problem should therefore exist on the demand side with respect to the BCCR meeting this requirement.

3. Management of U. S. Dollar Resources

Dollar disbursements of the cash transfer will be made identically for both the loan and grant portion of the program. Disbursements will be made into a BCCR account, in accordance with its instructions. It is anticipated that electronic transfer of funds to a U.S. Bank will be employed. However, because of the possibility of embargo of such an account by GOCR creditors, other mechanisms may also be employed.

C. Local Currency Resources

1. Local Currency Equivalent of the Loan ($30,515,000)

The colon equivalent of the loan portion of the cash transfer will: 1) support the BCCR's program of credit expansion to the private sector in line with the IMF agreement; 2) improve the flow of credit to productive enterprises through the establishment of a fund to guarantee such credit; and 3) ensure the continued provision of credit to the small industry sector.

a. The BCCR Credit Program

The BCCR will utilize the colon equivalent of at least $17 million to permit an increase in 1983 over the 1982 levels of unsubsidized lending by the public commercial banks to the private sector for industry, agro-industry, agriculture, and construction. In 1982, credit allocations by the BCCR for these programs totalled nearly 12.4 billion colones. The cash transfer will permit an increase in these credit allocations in 1983 by the colon equivalent of at least $64,485,000, of which a $47,485,000 increase was permitted because of ESR II.

Documentation of the increased credit availability will be satisfied by BCCR reports of the National Banking System unsubsidized

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lending for industries, agro-industry, agriculture and construction through the BCCR Credit Program. The A.I.D. requirement that the credit be extended exclusively to the private sector will be satisfied by virtue of the IMF program prohibition on increases in banking system credit to public (CODESA) enterprises.

b. Credit Guarantee Program

As a result of economic uncertainties, and because of exchange losses, many Costa Rican enterprises are not bankable given traditional accounting and banking criteria. As a result, most banks are seeking guarantees from these enterprises in excess of their capabilities to offer them. The guarantees that are being requested by the banking system from private productive enterprises are constraining the flow of credit to even financially sound enterprises. Thus increases in liquidity in the banking system do not translate into real improved credit availability for firms that cannot provide the types or amounts of guarantees demanded by the banks. To help address this problem, the BCCR will establish a guarantee fund for credit provided by the banking system to industrial, agro-industrial, and construction enterprises, and, particularly, to firms involved in export activities. The colon equivalent of up to $10 million will be held in a BCCR account for this purpose. The users of this fund would pay a commission which will cover the fund's administrative costs and expected losses. The BCCR estimates that the fund can guarantee a portfolio at least five times the size of the fund. If further analysis indicates that appropriate restrictions on the application of the guarantee would warrant a smaller guarantee fund, the balance not required for this purpose would be used as in section (a) above. The guarantee program would be approved by A.I.D. The Central Bank will agree, that this fund will absorb the operation of the existing delinquency-ridden PCGP program and portfolio (about colones 19,000,000), as well as A.I.D.'s exposure in that program and that the new program will receive adequate staffing within the BCCR.

c. Small Industry Credit Fund

The Small Industry Credit Program, a BCCR discount line, established under the Urban Employment and Community Improvement Loan (028) has fully disbursed the $3.255 million allocated to it under Loan 028. The program after some initial start-up problems is a resounding success and has resulted in the creation of many jobs for people who might otherwise be unemployed. Many new enterprises have been assisted by the fund, some of which export non-traditional products. Reflows from the A.I.D. loan are inadequate to meet present demand. Interest rates to final borrower through the program have been 12%. In order to satisfy the unmet credit demand of this group of small-scale, dynamic entrepreneurs, to help create jobs in this sector, and to do so at interest rates which more nearly reflect commercial interest rates in

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Costa Rica, the colon equivalent of $3.0 million will be made available by the BCCR for discounting small industry loans through commercial banks. The Small Industry Credit Program will undergo two major modifications: (1) the proposed interest rate for these new funds, as well as, the reflows of other SBN small industry loans will be increased from 12% to three points below the deposit rate paid on 6 months certificates by the public banks of the SBN which is presently 25%1/; (2) private commercial banks will be permitted to participate in the discount line, either directly if the legal reform prospers, or through other financial intermediaries such as CODESA should the pending reform to Article 62 of the BCCR law be delayed.

2. Local Currency Equivalent of the Grant ($19,485,000)

The local currency equivalent of the grant will be used to support high priority social programs of the GOCR and the local costs associated with selected A.I.D. activities in Costa Rica. An Illustrative breakdown of the uses of these funds is provided below.

a. Urban Low-income Housing

Drastically reduced real wages in Costa Rica and continued austerity measures have destroyed the hopes of homeownership for large segments of the population that previously could have aspired to eventual by acquire a housing solution, especially Costa Rica's lower middle class, for many of whom HG-financed solutions are not accessible because their incomes exceed the median. Presently, affordable housing solutions do not exist for this target group from any source. It is precisely this group of wage earners who have been most adversely affected by the decreased value of their earnings. Sensing that this target group is ripe for leftist extremist organization around the housing issue, President Monge has specifically requested a special housing program for this target group during, this, the worst part of the economic crisis.

To address this problem, INVU will receive $5.0 million of local currency as a contribution to its capital. In order to have the quick impact that President Monge desires, the housing will have to be made available quickly. INVU's recent adoption of a new reglamento

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1/ Note: The banking system at this time is not issuing 6 month Certificates of Deposit, but rather 1 and 2 month instruments which yield 21-22%, the rate at which this credit line would move. Because this change has not been fully negotiated at the level of the Central Bank's Board of Directors, substantial difficulty may exist in getting this policy change. The Mission believes that we will be able to get some movement on the rates governing this line. However, if we are unsuccessful, we will be back to AID/W with an alternate formulation.

permits it to finance "turn-key" housing projects planned and built by the private sector in accordance with INVU specifications. These funds will provide INVU with its first opportunity to test the "turn-key" approach which promises to be a mechanism which will provide the rapid response President Monge desires.

The houses that INVU will finance with these resources will be fully serviced, expandable core units. It is anticipated that the mortgages to be acquired by INVU with these resources will be of the variable rate variety made at market interest rates. It is not anticipated that subsidies will be required to make these solutions afforable; in any case, such subsidies as might be required would be selective through the lowering of mortgage principal and to those who really need them and not through an artificial lowering of construction costs or through indiscriminate subsidies through the interest rate.

b. Land Distribution

Just as the GOCR is faced with the need to respond to housing demands in urban areas, in the rural areas the pressure is for land ownership. Contrary to generally held beliefs, Costa Rica's democracy and egalitarianism has not extended to the ownership of agricultural land[1/]. The high degree of political organization in rural areas makes it difficult for the GOCR to ignore this issue. Accordingly, the colon equivalent of approximately $6.1 million will be allocated to permit the GOCR to respond to this problem.

A proposal is under discussion between USAID Costa Rica, the GOCR, and United Brands which would involve the transfer of ownership of 2,000 hectares of African Palm plantation to United Brands agricultural workers. United Brands would finance the land and some existing infrastructure, and local currency from the cash transfer would finance the three year investment costs of renovating the plantation lands with new African Palm. The loans would have a fifteen year period. United Brands would also sign a purchasing contract to guarantee the processing of the fruit and the marketing of the palm oil in the domestic market. As Costa Rica is a net importer of vegetable oils, the proposal would have a positive impact on the foreign exchange situation while also providing a highly visible response to those pressuring the government in favor of land distribution; it would also be a non-public sector solution to the land tenure problem.

1/ See p.7 of Agrarian Settlement and Productivity PP. Costa Rica actually ranks 13th among 16 Latin American republics for which data exist in degree of inequality of land ownership. Even pre-reform El Salvador had a more equal land tenure distribution than does Costa Rica.

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It is presently contemplated that local currency grants would be made to BANCOOP for relending to a group of potential producers organized into a cooperative and to COFISA for two groups organized into producer associations. Both BANCOOP and COFISA would benefit from the eventual nurturing of their capital by reflows which through a trust arrangement they would agree to utilize to finance similar land redistribution operations for the next twenty years.

Feasibiltiy questions exist regarding the use of agricultural market interest rates (26.5%) in this activity which requires four years until cash flow starts and fifteen year financing, especially at a time when world market prices for palm oil are depressed. But programs of this type should be planned for the very long-run and such arrangements as a variable interest rate related to world market prices and capitalization of interest during a four year grace period have to be examined. Grant funding through BANCOOP and COFISA could make such arrangements workable if the project is fundamentally economically sound in the long-run, a question the USAID will examine prior to finalizing this activity.

The Commonwealth Development Corporation (CDC) is also examining a similar United Brands proposal that would involve 1,600 hectares. The results of feasibility studies to be conducted by CDC palm oil experts beginning in April will determine whether the allotted $6.1 million in local currency equivalent from this program will be used to support this palm oil project. An alternative activity to address the land issue will be funded in the event the results of the feasibility study are not favorable.

c. <u>Economic Stabilization and Recovery Trust Fund</u>

The colon equivalent of $7,385,000 will be deposited by the BCCR into this trust fund. A.I.D. will be the trustee and administrator for these GOCR-owned funds, and the use of these funds will be jointly programmed by the GOCR and A.I.D. to provide counterpart funding for A.I.D. projects and support for other high priority GOCR activities.

During CY 1983 it is expected that the only disbursements from this fund will be to finance the local costs of the Development Assistance-funded Policy Planning and Administrative Improvement (PPAI) project, which has been prepared concurrently with this PAAD. This three year project will require approximately $2.5 million in local currency financing, of which approximately $1.0 million will be expended in CY 1983. The first priority of the PPAI project is the development of an export and investment strategy, which is a condition precedent to the second disbursement of this cash transfer (see Part IV.B.2.b.). The newly appointed Minister of Exports and Investment has been charged by President Monge with the preparation and subsequent

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implementation of the export and investment strategy. By freeing the Minister of Exports and Investment from dependence upon GOCR appropriated funds, the export and investment programs that he will oversee will not be subject to the salary, contracting and other bureaucratic restrictions that are the common cause of failures of similar programs in Costa Rica and elsewhere.

In order to relieve both the Mission and the new Minister of the administrative burden of financial management of the trust fund monies used in the export program, an independent management agent, such as a CPA firm, will be contracted to carry out this function. Whether this model would be used for other programs or activities utilizing trust fund monies would depend upon the particulars of each case.

d. A.I.D. Program Support Trust Fund

The colon equivalent of $1.0 million will be deposited by the BCCR in a second trust fund for which A.I.D. will be trustee and administrator but which will not be subject to joint programming with the GOCR. The principal purpose of this trust fund will be to reinforce the A.I.D. Mission's capability to handle the dramatically expanded A.I.D. program in Costa Rica and to provide for contingencies for which A.I.D. appropriated project or operating funds are not available. As is required for all A.I.D. trust agreements, A.I.D. will provide the GOCR and AID/W with periodic reports to show that expenditures of both trust funds are in accordance with the A.I.D.-GOCR trust agreement. The Mission is reviewing the option of simply adding to or modifying its existing trust fund with the GOCR. This trust fund which was established in 1968 in conjunction with Program Loan 018 still supplies this Mission with a small amount (about colones 350,000) of resources annually. Among the problems we have experienced with this trust fund are that its source is the GOCR treasury which often has cash flow probelms and that therefore payments to the Mission are often erratic or late. A new trust fund might have to be estabiished to overcome these problems.

VI. CONDITIONS, COVENANTS AND SPECIAL PROVISIONS

The proposed program has been discussed with officials of the BCCR. With the possible exception noted in the footnote on P. 31 on Covenant 3, we expect no difficulties in negotiating this program quickly. The Mission believes that the program, as described in the PAAD, responds to the needs of Costa Rica.

A. Conditions

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

1. An opinion of counsel acceptable to A.I.D. stating that this Agreement has been duly authorized, and/or ratified by, and executed on behalf of the Central Bank, which pursuant to the Laws of Costa Rica enjoys the complete cooperation and guarantee of the Costa Rican State, and that the Agreement constitutes a valid and legally binding obligation of the Central Bank in accordance with all of its terms; and

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

There is one proposed condition precedent to subsequent disbursement of the loan and grant:

- The formal adoption by the Government of Costa Rica of a strategy and work plan, acceptable to A.I.D., which will promote exports from and investment in Costa Rica.

B. Covenants

In addition to these conditions, the Mission proposes that the Assistance Agreement include various covenants relating to the implementation of the program and to policy changes which are necessary for the country's economic recovery effort to be successful; several of these covenants were also included in ESR II. Except as A.I.D. may otherwise agree in writing, the Central Bank shall agree to the following covenants:

1. To provide during 1983 foreign exchange resources to the National Banking System and other authorized agents, the total amount of which shall be no less than the amount of all cash transfers received from the United States Government during 1983 under this or other Assistance Agreements, in order to permit the importation from the United States of raw materials, intermediate goods, construction materials and spare parts needed by private enterprises in Costa Rica, and to report to USAID/Costa

Rica within three months of the termination of 1983 cash transfers that such imports were made; in the event that not all of this program's cash transfer disbursements are completed in 1983, the BCCR will make available within three months of the termination of such disbursements no less than the amount of such cash transfer disbursements for the importation from the United States of raw materials, intemediate goods, construction materials, and spare parts needed by private enterprises in Costa Rica and report to USAID/Costa Rica within six months after the termination of such disbursements that such imports were made;

2. To exchange for colones at the free exchange rate all disbursements of the $19,485,000 non-loan portion of the cash transfer and promptly deposit the proceeds, in accordance with instructions provided by A.I.D. in conjunction with each disbursement, into one or more, of the trust funds and special accounts established pursuant to the subsidiary memorandum of agreement governing this article;

3. To establish within six months after the signing of this Agreement, establish using the colon equivalent of $3.0 million of the loan portion of the cash transfer, or from the loan resources provided under AID Loan 515-K-040, a small industry credit discount line, similar in operations and purposes to that established under AID Loan 515-W-028, but open to private banks and with sub-lending terms and procedures to be established under the subsidiary memorandum of agreement governing this article; to incorporate reflows from the Loan 028 Small Industry Credit Program into the discount line; and to fix the lending rate to the final borrower of all BCCR small industry credit lines at a level which is not more than three points below the six month deposit rate paid by public commercial banks;

4. To promptly establish a new credit guarantee program within the BCCR, which is acceptable to A.I.D., and which guarantees loans to be made by member banks of the National Banking System and authorized finance companies for industry, agro-industry, export activities and related services, and construction; to promptly deposit the colon equivalent of $10 million of the loan portion of the cash transfer, or from resources provided under AID Loan 515-K-040, into the credit guarantee fund to be administered under this program; to establish an administrative unit for the program within the BCCR which is adequately and appropriately staffed; to incorporate the operations and guaranteed portfolio of the Productive Credit Guarantee Program (PCGP) into the new guarantee program; and to assume under the new program such contingent liabilities as A.I.D. may have under the PCGP Agreement executed on February 26, 1979;

5. To utilize the colon equivalent of that loan portion of the cash transfer not designated for other purposes, to support the Central Bank's Credit Program's unsubsidized lending through the commercial banks to the private sector for industry, agro-industry, agriculture and construction;

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6. To submit to A.I.D. a report on the execution of the Central Bank's 1982 Credit Program, which compares actual results with an analysis of actual as compared to planned targets; and to submit to A.I.D. similar evaluations of the 1983 credit program as these become available.

7. To move progressively, in the course of 1983, towards the unification of the inter-bank and free exchange rates, and to unify these rates by December 31, 1983;

8. To maintain an exchange rate which will keep Costa Rican exports competitive in foreign markets;

9. To provide A.I.D. with copies of all reports to the IMF, as they are issued, on compliance with the stabilization program.

10. To not request the scheduled monthly disbursement under AID Loan 515-K-040 in the month that the initial disbursement under this program is made; and to not request disbursements under this program, after the initial disbursement, until Loan 515-K-040 is entirely disbursed.

C. Special Provisions

Two special provisions pertaining to disbursements are also proposed:

1. A.I.D. reserves the right to suspend scheduled monthly disbursements in the event that the GOCR is not in substantial compliance with the IMF Agreement as determined by A.I.D.

2. Cash transfer disbursements may not exceed the monthly disbursements indicated in the following schedule:

(Millions of U.S. Dollars)

	Loan	Grant	Total
Initial Disbursement	-	10.0	10.0
Second Disbursement	-	4.0	4.0
Third Disbursement	4.515	5.485	10.0
Fourth Disbursement	10.0	-	10.0
Fifth Disbursement	10.0	-	10.0
Sixth Disbursement	6.0	-	6.0
TOTAL	30.515	19.485	50.0

ANNEX I, TABLE 1

COSTA RICA: BALANCE OF PAYMENTS
(In millions of dollars)

	1981	1982	1983
I. Current Account	-409	-230	-329
1. Exports FOB	1003	875	900
2. Imports CIF	-1211	-875	-930
3. Services, Net	-	-264	-337
Tourism	47	80	85
Transportation	26	31	34
Interest & Dividends	-304	-380	-462
Interest on Public Debt[1]	(-293)	(-365)	(-442)
Other, Net	(-11)	(-15)	(-20)
Other Services	4	5	6
4. Unilateral Transfers	27	34	38
II. Official Capital Non Compensatory[2/]	148	-88	100
1. Disbursements[2/]	274	130	317
2. Amortization Payments, Current (exclusive of amort. of prior year debt & of short-term debt)	-126	-218	-217
III. Private Capital, Net	-48	-15	0
IV. Adjustment of Reserve Valuation & Other short-term official capital movements, net	30	23	10
V. Interest & Amortization on Prior Year Debt[3/]	0	-336	-1061
1. Interest	-	-	-345[4/]
2. Amortization of all debt (including short-term & "Presa")	-	-336	-716
VI. Overall Deficit	-279	-646	-1280
VII. Financing of Deficit			
1. Compensatory Financing	121	32	241
AID/ESF	-	15	107
PL 480	-	17	20

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ANNEX I, TABLE 2

FISCAL OPERATIONS OF THE CENTRAL GOVERNMENT
(In million of colones)

	1981 1/	1982 1/	1983 2/
Total Expenditures	9,911	16,399	17,714
Current Expenditures	7,938	12,188	14,360
Capital Expenditures	1,973	4,211	3,354
Current Revenues	7,453	12,948	13,382
Deficit (Total)	-2,458	-3,451	-4,332
Financing			
External, net	887	1,354	442
Internal, net	1,571	2,097	3,890

1/ Preliminary estimates of actual (or realized) situation.

2/ Budgeted and amounts exclusive of supplementary budget which is expected to add 3.2 billion colones to both total expenditures and current revenues, thus leaving projected deficit unchanged.

Source: Informal and preliminary estimates of Central Bank's Research Department as of March 11, 1983.

ANNEX I, TABLE 3

KEY MONETARY VARIABLES FOR 1981-82, AND AMOUNTS PROGRAMMED FOR 1983
Saldos en millones de colones
(Tipo de cambio 50 colones por dólar)

	Diciembre 1981	Diciembre 1982*	Diciembre 1983**	VARIACIONES 1982 / 1981 Absoluta	1982 / 1981 Porcentual	1983 / 1982 Absoluta	1983 / 1982 Porcentual
Reservas monetarias internacionales netas	-9.420,0	-4,420,0	-4,420	5,000,0	53,1	-	-
Crédito Total	24.010,9	33.297,1	44.546,1	9.286,2	38,7	11.249,0	33,8
Al Gobierno (neto)	6.467,1						
Entidades Oficiales	4.162,8	14.323,2	16.323,2	3.693,3	34,7	2.000,0	14,0
Sector privado	13.249,6	18,842,5	26,091.9	5.592,9	42,2	9.249,0	49,1
Al exterior	131,4	131,4	-	-	-	-	-
Otros Activos Netos	54.499,2	57.034,6	68.424,0	2.535,4	4,6	11.389,4	16,6
TOTAL	69.090,0	85.911.5	108.550,1	16.821,5	24,3	22.638.6	26,4
Liquidez Total	33.717,3	47.114,3	60.317,9	13.397,0	39,7	13.203,6	28,0
Medio Circulante	10.808,9	19.198,0	26.288,0	8.389,1	77,6	7.090,0	36,9
Numerario en poder del público	3.500,9	6.300,0	8.630,0	2.799,1	79,9	2.330,	37,0
Depósitos cuenta corriente	7.308,0	12.898,0	17.658,0	5.590,0	76,5	4.760,0	36,9
Cuasidinero	22.908,4	27.916,3	34.029,9	5.007,9	21,9	6.136,6	21,9
Endedudamiento externo	35.372,7	38.797,2	48.232,2	3.424,5	9,7	9.435,0	24,3
TOTAL	69.090,0	85.911,5	108.550,1	16.821,5	24,3	22.638,6	26,4

* Estimado
** Programado

Sources: Excerpted from Central Bank/IMF MOnetary Progra, for 1983

ANNEX I, TABLE 4

CEILINGS IN IMF/GOCR AGREEMENT AND ACTUAL GOCR POSITION AS OF FEBRUARY 28, 1983
(Million of colones)
(50 colones = $1)

	Situación al 28/2/83	PROGRAMADO 3/1/83	6/30/83	9/30/83	12/31/83
Activos internos netos del Banco Central		69,470	69,610	71,110	72,610
Límite	69,470				
Situación actual	64,783				
Disponibilidad (sobregiro)	4,687				
Crédito neto del Sistema Bancario Nacional al Sector Privado		13,400	13,700	14,700	15,200
Límite	13,400				
Situación actual	9,932				
Disponibilidad o (sobregiro)	3,468				
Préstamos externos contratados por el sector público con vencimiento de 1 a 10 años (acumulado desde el 21 de diciembre de 1982)					
Límite	$100	$100	$100	$100	$100
Situación actual					
Disponibilidad o (sobregiro)					
Préstamos externos contratados por el sector público con vencimiento de 1 a 5 años (acumulado desde el 21 de diciembre de 1982)					
Límite	$ 50	$ 50	$ 50	$ 50	$ 50
Situación actual					
Disponibilidad o (Sobregiro)					

Source: Research Department of Central Bank, (Sección Programación Financiera).

	1981	1982	1983
Multibanco/Mexico	50	-	-
BID (Export Financing)	-	-	4
BIRF (Export Financing)	-	-	4
BIRF (Structural Adjust. Loan)	-	-	6
IMF	63	-	100
Banco de America for Basic Grain	8	-	-
2. Rescheduling or non-payment of Interest due on Loans Outstanding	121	254	-
3. Rescheduling or non-payment of Principal due on Loans Outstanding	-	498 5/	710
VIII. Remaining Unfinanced Gap (-)	-37	138	-329 6/ 4/

1/ For 1982 and 1983, includes only interest due in these year. Excludes interest due on prior year debt, but includes interest on this interest.

2/ Excludes all compensatory balance of payments financing which is entered "below the line" (under VII). Also excludes all Central Bank short-term loans (less than one year).

3/ Interest and amortization payment on prior year debt. Those on the current debt are included under I-2.

4/ Includes adjustment of past interest due to governments agreed in recent Paris Club negotiations.

5/ Amount is $336 million for 1981 plus $162 million that occured in 1982.

6/ To be financed in part by $228 million in commercial bank credits (under negotiation) and in part by rescheduling of interest due.

Source: ROCAP Economic Advisor and Central Bank (projection as of March 9, 1983).

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3A(2) - NONPROJECT ASSISTANCE CHECKLIST

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

CROSS-REFERENCES: IS COUNTRY CHECKLIST UP TO DATE? IDENTIFY. HAS STANDARD ITEM CHECKLIST BEEN REVIEWED? Except as noted below country ckecklist in AID/LAC/P-123 is up to date;* Yes

A. GENERAL CRITERIA FOR NONPROJECT ASSISTANCE

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

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

CN will be forwarded 15 days prior to obligation.

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

Yes.

2. FAA Sec. 611(a)(2). If further legislative action is required within recipient country, what is basis for reasonable expectation that such action will be completed in time to permit orderly accomplishment of purpose of the assistance?

No such action is required

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

No.

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

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

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* As of March 18, 1983, Costa Rica was in violation of 620 Q of the FAA; the Secretary of State has made an exception.

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

N/A

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

N/A

e. FAA Sec. 201(b)(2)-(4) and -(8); Sec. 201(e); Sec. 211(a)(1)-(3) and -(8). Does the activity give reasonable promise of contributing to the development of economic resources, or to the increase of productive capacities and self-sustaining economic growth; or of educational or other institutions directed toward social progress? Is it related to and consistent with other development activities, and will it contribute to realizable long-range objectives?

N/A

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

N/A

3. Nonproject Criteria for Development Assistance (Loans only)

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

N/A

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A.

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

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

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

N/A

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

The U.S. does not own excess foreign currency.

B. FUNDING CRITERIA FOR NONPROJECT ASSISTANCE

See PAAD Section IV; N/A

1. Nonproject Criteria for Security Supporting Assistance

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

2. Nonproject Criteria for Development Assistance

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

N/A

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

N/A

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

(2) [104] for population planning or health; if so, extent to which activity extends low-cost, integrated delivery systems to provide health and family planning services, especially to rural areas and poor; extent to which assistance gives attention to interrelationship between (A) population growth and (B) development and overall improvement in living standards in developing countries. Is activity designed to build motivation for small families in programs such as education in and out of school, maternal and child health services, agriculture production, rural development, and assistance to urban poor? N/A

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

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

(a) to help alleviate energy problem;

(b) reconstruction after natural or manmade disaster;

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

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

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

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

N/A

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

N/A

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

N/A

4. Additional Criteria for Alliance for Progress

Title VI of the FAA was repealed in 1978.

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

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

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