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

COSTA RICA

PROJECT PAPER

ECONOMIC STABILIZATION AND RECOVERY VIII

AID/LAC/P-517

Project Number: 515-0240
Grant Number: 515-K-610

UNCLASSIFIED

AID 1120-1

PAAD

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROGRAM ASSISTANCE APPROVAL DOCUMENT

1. PAAD NO.	515-K-610 (515-0240)
2. COUNTRY	Costa Rica
3. CATEGORY	Cash Transfer
4. DATE	April, 1989
5. TO	AAA/LAC, Frederick Schieck
6. OYB CHANGE NO.	N/A
7. FROM	LAC/DR, Terrence J. Brown (for)
8. OYB INCREASE	None
TO BE TAKEN FROM:	Economic Support Funds (ESF)
9. APPROVAL REQUESTED FOR COMMITMENT OF:	$ 85,000,000
10. APPROPRIATION -	72-119/01037 / LES9 89 35515 KG31 970 65 515 00 50 91
11. TYPE FUNDING	☐ LOAN ☒ GRANT
12. LOCAL CURRENCY ARRANGEMENT	☒ INFORMAL ☐ FORMAL ☐ NONE
13. ESTIMATED DELIVERY PERIOD	FY 1989
14. TRANSACTION ELIGIBILITY DATE	
15. COMMODITIES FINANCED	

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

18. SUMMARY DESCRIPTION

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

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

19. CLEARANCES		DATE
LAC/DP:WWheeler		4/11/89
GC/LAC:TGeiger		4/21/89
LAC/CEN:CCostello		4/12/89
PFM/FM:SOwens		
PPC/EA:ECostello		4/24/89
ARA/ECP:Walle		
PPC/PB:SRea		
LAC/CONT:GByllesby		

20. ACTION

☒ APPROVED ☐ DISAPPROVED

AUTHORIZED SIGNATURE: Frederick W. Schieck — DATE: 4/25/89

Frederick Schieck

Acting Assistant Administrator, LAC

TITLE

CLASSIFICATION:

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I. SUMMARY AND RECOMMENDATIONS

A. Summary

This document requests authorization of $85.0 million in Economic Support Funds for the 1989 Economic Stabilization and Recovery VIII program to be provided as a cash transfer to the Government of Costa Rica. While the Costa Rica ESF total is $90 million, USAID and the GOCR have agreed that $5 million will be used to finance projects. The ESF balance of payments assistance will be used to support the Costa Rican economic stabilization program by providing funds to finance essential imports from the U.S. -- i.e., raw materials, spare parts, and intermediate and capital goods required by the Costa Rican productive private sector. An equivalent amount of local currency made available by the GOCR under the program, equal to these dollar funds, will be used for activities consistent with the U.S. and GOCR development strategies for Costa Rica in accordance with agreements made with the GOCR. Illustrative uses of local currency funds include the following: export and investment promotion, natural resources, housing, public sector efficiency activities, AID operating expenses, program trust fund activities and training. Authorization to obligate the entire $85 million is requested. Disbursements are planned in three tranches based on the Costa Rican performance against the criteria and specific covenants described in Section V. of this document.

B. Recommendations

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

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

3. That the LAC Bureau clarify its guidance regarding documentation and approval requirements for on-going Trust Fund activities by allowing the Mission to increase incremental funding for activities based on AID/W approval of the PAAD which includes a discussion of these activities; and modify its guidance for approval of certain new Trust Fund activities as described in Section III.E.4.

II. BACKGROUND

A. The Costa Rica ESF Program

1. Overview--Past ESR Program Rationale

Past ESF resources administered by AID have played a decisive role in the progress toward stabilization and recovery described in Section II.B. below and in Annex A. Beginning in 1982, AID has signed ESR Agreements with Costa Rica for a total of $791 million, all of which has been disbursed.

ASSISTANCE UNDER ESR I-VII ($000)

	FY	Signatory	Loan	Grant	Total
ESR I	1982	BCCR	$15,000	$5,000	$20,000
ESR II	1983	BCCR	118,000	37,735	155,735
ESR III	1984	BCCR	35,000		
		GOCR		95,000	130,000
ESR IV	1985	BCCR		20,000	
		GOCR		140,000	160,000
ESR V	1986	GOCR		120,582	120,582
ESR VI	1987	BCCR		119,750	119,750
ESR VII	1988	GOCR		85,000	85,000
TOTAL			$168,000	$623,067	$791,067

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

1) The economic crisis of the early 1980s;

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

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

A devastating series of external shocks, beginning around 1979, led to an economic crisis. The terms of trade turned sharply against Costa Rica. Coffee prices fell sharply and petroleum prices doubled. Political unrest and falling incomes elsewhere in Central America reduced investor confidence. Trying to avoid a painful adjustment, Costa Rica attempted to maintain its growth performance through heavy internal and external borrowing. A policy of strong monetary expansion maintained existing levels of public and private consumption but caused inflation, an overvalued exchange rate, and a reduction of net foreign exchange reserves to negative levels. In July 1981, having run up one of the highest per capita debts in the world, the GOCR unilaterally suspended principal and interest payments on an external debt whose servicing requirements it could no longer meet. Cut off from external financing, Costa Rica's economy rapidly deteriorated. GDP fell by 9.6 percent between 1980 and 1982 while open unemployment reached 9.5 percent in 1982. Inflation exceeded 100 percent.

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

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

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

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

During the period 1982-1988 U.S. economic and financial assistance has totaled about $1.1 billion including development assistance, PL 480 food aid and the ESF cash transfers. All elements of the assistance package were designed to support the restructuring effort. The $791 million ESF program has represented the largest portion of the assistance package and has been the mainstay of the policy reform program. The Costa Rican ESF program currently consists of three basic elements:

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

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

Joint programming of local currency: Under the terms of the ESF cash transfer program, an equivalent amount of local currency is made available by the GOCR which A.I.D. and the GOCR jointly program through the auspices of a Bipartite Commission. This cooperation and programming process ensures that the local currency is used to support the the policy reform program and development objectives of A.I.D. and the GOCR (See Section III.E).

B. Economic Summary

A detailed analysis of Costa Rican economic trends and problems for the period 1982-1988 is attached as Annex A.

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

Since 1983 and through 1988, the Costa Rican economy has improved significantly. Positive economic growth has returned, capital formation has increased, and non-traditional exports to non-CACM markets have expanded substantially. In conjunction with international donor stabilization and structural adjustment programs (especially with AID, the IMF and IBRD), GOCR policy reform has achieved the following positive results over the past five years:

-- GDP growth, which was a negative 7.3% in 1982, has been positive since 1983, with the 1984-1988 average in constant prices at 4.5%. GDP growth in 1988 has been estimated at 4.0%.

-- Inflation, which reached 82% in 1982 as measured by the consumer price index, averaged 17.1% annually between 1984-1987 and increased to 25% in 1988.

-- The non-financial public sector deficit which stood at 9.0% of GDP in 1982 was reduced to zero % in 1988.

-- Inclusive of Central Bank losses, the public sector deficit has been reduced from 14.6% of GDP in 1982 to about 3.5% in 1988.

-- Statistics indicate that real income has essentially returned to 1975 levels and is close to 1977 levels (i.e. for 1988, real per capita GDP is estimated at 97% of the 1977 level).

-- Unemployment was reduced from 9.5% in 1982 to 5.6% in 1988.

Though Costa Rica's 1988 Gross Domestic Product (GDP) grew at a rate officially estimated at 3.4 percent, this is a preliminary estimate and may understate the rate of growth, particularly in view of a strong increase in nontraditional exports. In any event this rate is relatively high compared with the experience of the early 1980s but lower than the 5.5 percent and 5.1 percent growth rates of 1986 and 1987. For the basic productive sectors of the economy, the estimated rates of growth for 1988 are 3.9 percent for agriculture, 3.5 percent for manufacturing, and 4.2 percent for construction.

In 1988 total exports (FOB) including the value added of drawback exports reached $ 1,225 million, about $118 million (10.2 percent) higher than in 1987. Imports amounted to $1,225 million, about $18 million (1.3 percent) higher than in 1987. The value of traditional exports (coffee, bananas, sugar, and beef) increased by only 1.3 percent in 1988 with coffee earnings up $ 9 million and banana exports up $ 8 million. Nontraditional exports (including the value-added of drawback exports moved up from $ 517.6 million in 1987 to $ 626.6 million in 1988 (i.e., by 21.1 percent). Within this category, the preliminary estimate for nontraditional exports to markets outside of Central America indicates that such exports increased by $ 125 million in 1988 (i.e., by about 35 percent as stated above). Preliminary data also indicate strong growth of employment in 1988 as well as continuation of a low (5.6 percent) rate of open unemployment.

Monetary and fiscal policy continued on a reasonably steady course in 1988. Even so, the deficit of the public sector (including Central Bank losses) increased from 3.2% of GDP in 1987 to 3.5% in 1988. The deficit of the non-financial public sector was reduced from 0.3% in 1987 to zero in 1988. However, an increase in Central Bank losses (due to higher interest rates and continued exchange rate depreciation) offset this improvement. In the monetary sphere, net domestic credit of the banking system increased by 16.8% with credit to the private sector increasing by 11.2% and credit to the non-financial public sector increasing by 6.8%. Monetary growth was substantially higher, with money (M1) expanding by 20.0% and quasi-money by 37.5%. Monetary growth in 1988 was fed primarily by an increase in foreign exchange purchases by the banking system, i.e., a balance of payments surplus (including the accumulation of arrears) and secondarily by a higher-than-planned expansion of credit to the public sector.

Notwithstanding the progress that has been made in revitalizing the economy through export growth and in improving public sector finances, several problems remain:

-- The pace of inflation accelerated in 1988. The consumer price index registered an increase of 25.3 percent for the period

December 1987 to December 1988 as compared with an increase of 16.4 percent for one year earlier.

-- Scheduled external debt service (before rescheduling) remains on the order of 50 % of exports of goods and services. This situation produces continuing pressure on the GOCR and external creditors to negotiate debt relief.

-- Coverage of large balance of payments basic balance deficits in 1987 and 1988 has taken the form of accural of arrears on the service of external debt--particularly to bilateral and commercial bank creditors.

-- There is still a need for exceptional B/P support from ESF in 1989. The projected disbursement of ESF, IBRD SAL II, and Japanese co-financing to SAL II amounts to $ 155 million and, if implemented would bring the over-all balance of payments deficit to $ 43 million.

The IMF and GOCR project some $94 million of interest payment relief from commercial bank creditors to cover this deficit and produce a $ 51 million increase in official foreign exchange reserves.

In regard to external assistance and external debt, the Arias administration initiated negotiations with commercial bank creditors in the second half of 1986. Subsequently, Standby arrangements were negotiated with the IMF in 1987 and in 1988, and negotiations have been undertaken for a Standby to cover the period from March 1989 through March 1990. Regarding negotiations with commercial bank creditors, in 1987 the commercial bank Steering Committee refused to consider any agreement with Costa Rica prior to the completion of a rescheduling agreement with Brazil. Significantly in late 1987, the IMF agreed to proceed with the Standby in the absence of a rescheduing agreement with commercial bank creditors, providing that the GOCR make partial payment of interest to these creditors ($5 million per month of the full payment of $12 million per month due). Negotiations between the IMF and the GOCR on a 1989 Standby began in November 1988 and have involved two IMF missions to Costa Rica as well as conversations in Washington. We judge that substantial progress has been made in these negotations and that areas of policy disagreement are small. (See Section III.B.)

III. PROGRAM DESCRIPTION

A. U.S. Interests

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

In its January 1984 report to then President Reagan, the National Bipartisan Commission on Central America (Kissinger Commission) emphasized the high degree to which Central America is both vital to U.S. interests and particularly vulnerable. The Kissinger Commission clearly articulated how national interests are served by advancing the cause of democracy within the hemisphere. As historically the most successful social democracy in Latin America, Costa Rica is uniquely important to U.S. policy in Central America. The country serves as a paradigm of peaceful and democratic development for the region.

The economic crisis and political turmoil in neighboring countries severely tested Costa Rican institutions and ingrained democratic traditions; the country has in large measure been able to withstand the challenges, and, as described in Section II, above, to undertake some of the difficult policy and structural changes required to reestablish growth and prosperity. It is appropriate to note that such changes have taken place within a democratic process, and accepted peacefully by the Costa Ricans.

However, many of the policy and structural changes undertaken since the beginning of the Monge administration in May, 1982, and continuing with the Arias administration in 1986, and others which are still required, represent a shift in outlook and philosophy for Costa Rica, and quite naturally engender public and official concern. While changes have sometimes appeared to us to occur slowly, and may continue to do so, they have sometimes been hard won with resistance and skeptical attitudes still remaining to these and further changes. Thus, any serious deterioration in the economic situation would severely affect the credibility of the recovery effort and potentially undermine some of the achievements made to date. Despite continuing foreign assistance budget limitations and competing worldwide development priorities, continued U.S. assistance is required to advance the economic recovery efforts, and to reaffirm U.S. commitment to Costa Rica's democratic process and peaceful tradition.

Relationship to Mission Strategy

The ESR VIII program conforms both to the Mission Strategy of May 1988 and Action Plan submitted to AID/W in late January, 1989. As stated in the Strategy document, the continuation of balance of payments assistance to Costa Rica is appropriate given the need to reinforce and continue economic policy reforms and macroeconomic progress on a number of fronts, while continuing a shift to a program emphasizing economic growth level build upon the stabilization that has been achieved.

The Mission recognizes that the economic stabilization goal of former ESF programs was a necessary condition to sustained growth but was not an end in and of itself. Major economic progress has been achieved in that there has been a return to positive growth rates, reduced inflation (though rising to 25% in 1988) and improved fiscal performance. Indeed, stabilization remains an important area of concern because the progress achieved to date is fragile and can be reversed quickly. Our 1989 Action Plan recognizes that the continuation of macroeconomic concerns in the 1989 ESF program, while not entailing new initiatives, is necessary as a minimum precondition for long-term growth, though not a primary goal.

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

Another important and related strategy emphasis of the Mission is on a wider sharing of the benefits of growth through the integration of more Costa Ricans into an expanded economy and, as an effect of its balance of payments and local currency activities, assisting the GOCR in maintaining its high level of social services.

In fact, Costa Rica is already demonstrably superior to most developing countries in passing the benefits of growth to the poor majority. During the boom between 1961 and 1971, for instance, overall cash income grew by 58%, while income of the lowest half of the population grew by 80%, and income of the richest tenth grew by only 19%. During the same period, absolute poverty, measured by cash income, dropped from 51% to 20%.

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

But social programs must be paid for. Especially after the collapse of Costa Rica's international credit, the only viable source for these funds was taxation of local private production and income. The tax burden (as a percentage of Costa Rican GDP) has grown during the eighties, and is relatively high for a developing country and the proportional allocation of taxes to social programs is probably at its practical limit. Thus, social spending is tied to maintenance and growth of GDP. Analysis recently undertaken by the Mission suggests that, absent the package of ESF assistance and structural reform, social programs in Costa Rica would have had to be reduced by as much as 24% below actual levels in 1988.

Thus, the 1989 ESF balance of payments program for Costa Rica will support the movement toward economic expansion based on export-led growth by providing foreign exchange that will maintain import capacity for economically productive activities. As well, the basic human needs of the poor Costa Rican majority will continue to be protected and supported in the process. Further, such assistance will help Costa Rica comply with economic and fiscal performance targets negotiated with other external donors, thereby permitting the release of still further financing for productive activities. Conditionality associated with the ESF program will also result in continued attention to macroeconomic concerns while increasing emphasis on sectoral level policies that contribute to the goal of long term sustainable growth.

In that regard, the Mission has identified three principal areas where we will focus our policy dialogue efforts. As described in Section III.E., policy dialogue being carried out by the Mission with the GOCR is taking place under the auspices of, though not limited to, a "U.S.-Costa Rica Bipartite Commission". The three sectors for ESR VIII conditionality emphasis are:

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

These three areas of ESR VIII conditionality and policy dialogue are discussed in Section IV.

B. Relation to IMF Strategy and the GOCR Economic Plan

The Mission developed its past ESF (ESR) programs and conditionality packages in conjuction with and supportive of the macroeconomic and structural adjustments sponsored by the IMF and the World Bank. In this regard, the only programs which departed from this close association were the 1985 program (which aimed at the CODESA divestiture) and the 1986 program (in which no IMF Standby was negotiated and in which the second tranche of SAL I was disbursed). The 1987 and 1988 ESF programs were designed assuming that IMF Standbys would be in effect during those years. Moreover, the relatively good economic policy and performance by the GOCR of recent years can be traced to Standby negotiations and arrangments even when these did not lead to formalization of Standby arrangments, as in the period from May 1986 to October 1987. Negotiations between the IMF and the GOCR on a 1989 Standby began in November 1988 and have involved an IMF mission to Costa Rica in late November and a second mission in February 1989. It is the judgement of the Mission, the IMF, and the GOCR that substantial progress has been made in these negotations and that areas of policy disagreement are small.

The 1989 ESF program is based on the assumption there will be IMF Standby in 1989 and that the IMF will play an important role in macroeconomic policy. To date, the IMF and GOCR have made substantial progress in framing quarterly limits (ceilings or floors) for the following macroeconomic variables: (a) central government expenditures, (b) the cumulative over-all financial balances of the CCSS, RECOPE, ICE, CNP, and JPS, (c) net domestic assets of the Central Bank, (d) changes in banking system credit to the nonfinancial public sector, (e) the net international reserve position of the Central Bank, and (f) arrears on external payments. The GOCR's economic plan for 1989 therefore would necessarily conform to these limits in the event of agreement with the IMF on a Letter of Intent for a Standby arrangement. In the event that no agreement were reached, such an economic plan can be considered as a shadow IMF program as well as a valid economic plan for 1989 for purposes of the ESF program.

Agreement by the GOCR and IMF on a Standby arrangement is clearly preferred over a lack of such an agreement. The concluded Standby Agreement could allow the GOCR to reach debt rescheduling agreements with Paris Club (bilateral) creditors, with the Government of Japan as regards its $100 million co-financing of SAL II, and with commercial bank creditors as regards a two-phased program of debt rescheduling (including the buy-back of a portion of the debt and a menu of options to remaining commercial bank creditors). In the event that the GOCR and IMF do not reach agreement on a Standby, certain macroeconomic conditions in the ESR VIII program obtain stronger significance. These conditions relate to maintenance of a competitive exchange rate, reduction of the public sector deficit (by 0.5 % of GDP), limitation on central administration expenditures, and banking system credit to the nonfinancial public sector. With agreement by the GOCR and IMF on a Standby, we would generally defer to IMF guidance on these conditions.

Thus, the ESF program will continue to be supportive of the IMF and IBRD programs and conditionality. The IBRD's Structural Adjustment Loan II (SAL II), which was approved by the IBRD board in December, 1988 has now been submitted to the Costa Rican National Assembly and is anticipated for ratification by mid 1989. SAL II is focused on issues of financial sector efficiency and control, agricultural pricing and marketing policy, and international trade (tariff structures). (See Section IV. p 25 for a description of the SAL II program.) As discussed in Section III.A. above, it will not be the intention of the ESR VIII program to interject new policy dialogue efforts in these areas. 1988 ESF conditionality contained an increasingly important focus on sectoral topics such as investment and export promotion, public sector efficiency, promotion of non-traditional exports and housing. This trend toward sectorality will continue and receive more emphasis in this year's program (See Section IV).

However, stabilization remains an important element because the progress achieved to date in Costa Rica is still reversible, as evidenced by a projected $198 million financial gap in the 1989 balance of payments. ESR VIII will reinforce the macroeconomic progress that has been achieved to date in Costa Rica. The relationship of the ESF program to the IMF Standby and portions of the World Bank's SAL II, therefore, will be to remain supportive, not duplicative, of their programs, recognizing that the IMF has the lead role for macroeconomic conditionality. At the same time, the ESF program will pursue a more sectoral focus and concentrate on the necessary policy reform which must accompany such a focus.

C. The Program

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

The Mission is carrying out a series of negotiations with the GOCR's cabinet level Bipartite Commission, led by the Minister of the Presidency and including the Minister of Finance, the President of the Central Bank and the Minister of Planning. Intensive and on-going negotiations with the GOCR team have been underway since mid-January 1989, resulting in substantial understanding if not full agreement on terms and conditionality of the 1989 program.

The Mission proposes that the $85.0 million to be authorized by this PAAD be provided as a grant. Costa Rican public sector debt service, prior to debt relief, is projected to consume about 50% of all commodity export earnings from 1988-1990. Given Costa Rica's high debt servicing burden, maximum grant financing is consistent with U.S. interests in Costa Rica. Grant rather than loan financing reduces the debt service burden and the rate of debt accumulation, thereby supporting our stabilization and recovery objectives.

D. U.S. Dollar Resources and Disbursement Plan

1. Purpose and Terms for Dollar Resources

A total of $85.0 million will be provided to the Central Bank in the form of cash transfers as balance of payments support to Costa Rica. Annex A (Table V) shows a $198 million projected financial gap in Costa Rica's 1989 balance of payments.

In accordance with a FY 1987 Continuing Resolution requirement, a separate account was established by the GOCR for the ESR VI Program that permitted improved control and monitoring of the use of ESF dollars. The separate account is still in place and functioning well, and will be used for ESR VIII funds. Annex C provides details on the ESF dollar separate account and the uses proposed by the Mission for the dollar funds. The funds will facilitate imports from the U.S. of eligible commodities required by the Costa Rican private sector.

2. Disbursement of U.S. Dollar Resources

a. Justification for Cash Transfer

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

Net private capital inflows to Costa Rica for 1980-1988 were as follows:

1980	-$240.0 million
1981	-$ 69.0 million
1982	$ 16.0 million
1983	$ 68.0 million
1984	$ 24.0 million
1985	$119.0 million
1986	$170.0 million
1987	$102.3 million
1988	$140.0 million

This reflow of private capital to Costa Rica reflects a continuing trend toward stabilization of the economy and improvements in interest and exchange rate structure. Cash transfers and conditionality under the Mission's ESR programs have played key roles in successfully helping to restore economic stability.

Finally, Costa Rica is using the AID ESF funds to compensate for foreign exchange inflows lost as a result of factors leading to its current economic difficulties. Historically, Costa Rican imports from the U.S. have been well in excess of the dollar amounts made available under ESR Agreements. Total imports from the U.S. amounted to $406 million in 1984, $380 million in 1985, $438 million in 1986, $600 million in 1987. (A final figure for 1988 is not yet available but is estimated at about $650 million). Illustratively for 1985, eligible import commodities as prescribed by ESF conditionality totaled $288 million, of an overall U.S. import total of $380 million. This figure well exceeds the ESF total of that year ($160 million). The figures for 1987 totaled $183 million in eligible import commodities versus an ESF total of $119.75 million. A similar relationship existed in 1988 and will exist in 1989.

b. <u>Disbursement Plan</u>

An initial tranche of $40 million will be disbursed once the GOCR demonstrates successful initial implementation of an approved economic plan for 1989, as well as upon a determination by the Mission of acceptable GOCR compliance with the terms of ESR VIII conditionality. It is anticipated that this disbursement would be made early in the second-quarter of CY 1989.

A second tranche of $25 million will be made upon a determination by USAID/Costa Rica of satisfactory subsequent compliance by the GOCR in meeting the economic performance targets set forth in the economic plan referred to above and upon a determination by the Mission of continued satisfactory progress by the GOCR in implementing conditionality. It is anticipated that this disbursement can be made late in the third quarter of CY 1989.

The third and final tranche of $20 million will be disbursed, likely in the fourth quarter of CY 1989, upon a determination of continued GOCR compliance with its economic plan and ESR VIII conditionality.

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

<u>ESF VIII DISBURSEMENT PLAN</u>

Disbursements (projected)		Grant Funds (U.S. dollars)
First	$	40,000,000
Second		25,000,000
Third		20,000,000
TOTAL	$	85,000,000

The Mission requested, and was given, authorization to vary the disbursement plans under ESR II-VII as required to assure good management and regular availability of foreign exchange resources. In the same manner, the Mission requests authorization to include in the ESR VIII assistance agreement a plan for the disbursement of funds as detailed above, but with the provision that the Mission may vary this plan as required to maintain an even and rational flow of foreign exchange. However, any variation to the disbursement plan which would involve withholding part or all of a disbursement would be based on prior consultation with AA/LAC.

c. Use of Dollar Funds

As with the 1988 ESF Program, consistent with LAC guidance, dollar funds in the ESF Separate Account will be available to facilitate the importation of U.S. raw materials, spare parts and intermediate goods required by the Costa Rican private sector. Details of the Separate Account system have been established with the Central Bank (BCCR) (See Annex C) to ensure that ESF funds are used to reimburse the BCCR for eligible commodity imports from the U.S.

d. Audit Provisions

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

- ESF dollars and the LC trust fund for USAID operating expenses are the audit responsibility of the A.I.D. Inspector General.
- General budget support and sectoral support activities undertaken with HCOLC are the audit responsibility of the GOCR Controller General.
- Specific development activities will be audited by local CPA firms under host-country or implementing institution contracts (approved by USAID where appropriate) as required in all memoranda of understanding or other HCOLC programming documents.

E. Local Currency Resources

1. Background

USAID/Costa Rica has been involved for over a year in a complicated process related to several key host country owned local currency (HCOLC) issues. Discussions have been intensively pursued with the GOCR Commission within the Ministry of the Presidency charged with the negotiation and of programming the ESF agreements for the use of ESF local currency made available under existing agreements. The major tasks in this process have been the following:

- obtain explict acknowledgement from the GOCR that the ESF local currency made available under the program belonged to them;

- maintain the ability to program local currency in support of on-going and future program activities;

- in accordance with Costa Rican law, develop by January 1, 1989 a legal mechanism for programming local currency for a variety of uses including private sector, public sector and AID operating expenses;

- develop Mission local currency programming guidelines;

- continue and deepen Costa Rican involvement in local currency programming while enhancing the GOCR's capacity to design, manage and account for programs in support of joint development objectives; and

- negotiate with the GOCR, consistent with AID/W and LAC guidance, a viable and largely sectoral local currency program encompassing all remaining local currency made available under past ESF programs.

In response to LAC guidance in early 1988, a major issue in the Mission's negotiations with the GOCR was to achieve a 1988 ESF Agreement in which, for the first time, the GOCR would explicitly acknowledge ownership of the local currency available by the cash transfer program. As reported in 1988 San Jose 2549, this objective was met upon signature of the ESR VII Grant Agreement on June 13, 1988.

The resolution of this issue has had a significant impact on the management of the local currency resources, explained in more detail below. In conjunction with revised Agency (1987 State 327494) and LAC (State 102677) guidance, the immediate result was to reinforce the Mission's efforts, begun in 1987, to expand the GOCR's role in the management of and accountability for the funds.

Resolution of the ownership issue raised a new question regarding the treatment of local currency available for programming and disbursement under earlier ESF Agreements (where the ownership question was not addressed). Of particular concern was the use of those funds for private sector activities, such as export promotion, long an integral part of the USAID program. A two part response proposed by the Mission and accepted by LAC (see State 96604) called for (1) a covenant in the 1988 ESF Agreeement which required that, by January 1, 1989, the GOCR establish a new mechanism for approving all activities (including for non-public sector entities and for AID OE costs) to be financed with local currencies, and (2) the use of funds available under agreements prior to 1988 in accordance with the terms of those agreements (while still requiring joint programming and maximum GOCR participation in the process). This solution continued the transition to an increased role for the GOCR in local currency management and also provided the means for financing specific priority activities during the interim period leading up to January 1, 1989.

2. Programming, Management and Accountability

The original system established by USAID/Costa Rica to program, manage and account for local currency under our ESF program had its origins in the ESR II program of 1983. A variety of adaptations were made in the local currency systems based on Mission implementation experience. One change, beginning in 1987, was to increase the degree of GOCR participation in the programming process -- one of the first steps taken in the transition to explicit GOCR acknowledgement of local currency ownership.

Another significant change affecting local currency management was the creation, at the Mission's suggestion, of a Bipartite Commission charged in part with representing the GOCR both in negotiating ESF agreements and in programming and assuming responsibility in the use of ESF-related local currency, including the programming of resources still available under prior agreements. For the GOCR, the Commission is headed by the Minister of the Presidency and includes the Ministers of Finance and Planning, as well as the President of the Central Bank.

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

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

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

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

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

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

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

Concurrent to these discussions with the Commission, the Mission justified a waiver of the requirement that local currency be deposited into an interest bearing account, given the negative impact of accumulated interest payments on GOCR monetary policy. Further, worldwide Agency and more specific LAC guidance on local currency programming was provided. The LAC supplemenal guidance provided for five programming alternatives: general budgetary support, sectoral or subsectoral support, projects or specific activities, special non-governmental activities, and trust fund projects. A transition period to January 1, 1989 for full compliance with the new guidance was provided, during which time the Mission undertook limited mutual programming under the prior Memoranda of Understanding system (for example, for AID project counterpart funds, export promotion activities, and USAID OE). Concurrently, USAID undertook extensive negotiations with the GOCR Commission to program all local currency made available under prior ESF programs (except ESR VII) and carry out this programming on a sectoral basis in accordance with LAC guidance.

The Commission, USAID and the LAC guidance recognized the importance of establishing a system for controlling approved local currency activities. Toward that end, an existing office within the Ministry of the Presidency is being expanded and staffed accordingly. It is organizing itself in conjunction with the existing local currency implementation unit for PL-480 funds located in the Ministry of Planning to take on its new responsibility for design, implementation, monitoring and accounting for sectoral activities. The office has also studied the former local currency control system developed by the Mission and found it to be comprehensive and responsive to its needs. Rather than create and test an entire new system, the unit has adopted much of the former USAID system for its own use.

LAC HCOLC guidance stated that AID must be satisfied that the HG has good quality sectoral activities, and technical and administrative capabilities to carry out the program -- and that the sector program content be consistent with AID Strategy. Thus during 1988, Mission staff worked closely with Commission staff to devise sectoral programs to be implemented through sound HG institutions. Discussions and negotiation culminated on December 9, 1988 with the programming of all existing HCOLC (prior to ESR VII) in the amount of 7 billion colons ($88 million) equivalent (See Local Currency Programming Agreement, Annex H). The funded activities were in the following sectors: water, transportation, education, child health, community development, agriculture, rural housing and public sector finance. The sectoral activities were consistent the USAID's development strategy for Costa Rica and otherwise developed in accordance with LAC and Agency HCOLC guidance. Further, our objective -- to gradually withdraw from a controlling role in HCOLC implementation matters -- has been accomplished.

3. Multipurpose Local Currency Programming

Once the GOCR acknowledged ownership of the ESF local currency and began to expand its role in its programming and management, questions arose on the part of the GOCR as to the legality of their programming these funds for other than public sector uses. The argument was, that as GOCR owned local currency, programs other than those operated by and for GOCR programs or entities, would have to be approved by the Costa Rican National Assembly. Such a possibility, however acceptable as a policy, was problematic in real terms to both USAID and the GOCR, as programs would have been submitted to an approval process that could take years, meanwhile jeopardizing on-going and future local currency activities vital to joint AID/GOCR development strategy. The Mission and the GOCR agreed in the ESR VII Agreement that the 1988 ESF local currency would not be programmed nor the 1989 ESF program put forward until such time as the legal mechanism was in place to allow full unrestricted programming for a variety of development purposes, including private sector activities as well as USAID operating expenses. In addition, both parties agreed in the ESR Agreement that this mechanism would be in place by January 1, 1989. The Minister of the Presidency in a June 6, 1988 letter to the U.S. Ambassador also committed the GOCR to take the necessary means no later than January 1, 1989 to permit this application of ESR resources to both public as well as private sector uses.

The complexity of the problem for the GOCR is illustrated by the following issue: As the GOCR overtly accepted ownership of the local currency in the 1988 ESR VII Program, the Agreement was properly termed a "Grant Agreement" or "Donaciçn" in Spanish. These terms contrasted with the term "Assistance", or "Ayuda" in Spanish, which is the operative term used in the Bilateral Agreement of 1962 to describe U.S. development assistance. In the process of solving its legal problem, the GOCR chose the Bilateral Agreement as the vehicle by which the GOCR could link its legal capacity to undertake multipurpose local currency programming. In other words, the Legislative Assembly ratified the 1962 Bilateral Agreement providing the Executive Branch authority, in essence, to execute agreements with AID and use funds provided under these agreements to assist AID in carrying out its development program, i.e. for public and private sector and OE uses without further legislative approval. For ESR VII, however, the use of the term "Grant" was inconsistent with the Bilateral Agreement, thus complicating further the application of the "legal mechanism" to ESR VII local currency. Yet, this problem had to be solved prior to the end of 1988 not only to fulfill the terms of the ESR VII Agreement and permit the advancement of the 1989 Program, but also to permit programming of the ESR VII local currency.

Still another problem in this process appeared upon termination of a prior Executive Decree which effectively served to bar even public sector use of donated funds from external sources as of January 1, 1989, without approval by the Legislative Assembly. Thus, a legal programming mechanism had to be developed by the end of 1988 which permitted application of ESF funds with few if any programming restrictions, i.e., to permit not only private sector programming of HCOLC as originally envisioned, but public sector uses as well. The GOCR, in their view, had to thus negotiate and sign an Implementation Agreement with AID for these purposes, propose uses of the 1988 ESF local currency funds, negotiate and finally program these funds with AID. This process culminated on December 23, 1988 with the signature of an "Implementation Agreement" which interprets the U.S.-GOCR Bilateral Agreement of 1962 to allow the programming of ESF local currencies for these purposes (See Annex I).

In other words, all of these efforts combined have permitted the GOCR to now represent to AID that the programming of funds for public and private sector uses and for AID OE and program expenses is permitted by applicable Costa Rican laws, rules and regulations. Therefore the ESR VII Agreement requirement has been met.

A final point is that the GOCR and USAID agreed early on in the HCOLC negotiation process that the use of ESR VII local currency, following approval of the "legal mechanism", would be in accordance with a 50-30-20 split (public sector/private sector/intermediate). This split between public and private sector and intermediate uses was respected in the programming of ESR VII HCOLC that followed approval of the legal mechanism on December 23, 1988, and will be applied to future ESF local currency programs. The GOCR and USAID/Costa Rica have thus satisfactorily achieved their objective of multipurpose local currency programming. According to the GOCR Commission, the end result of the signing of the legal "Implementation Agreement" represents a satisfactory resolution to the problem of ESF local currency programming and the establishment of a straight forward and flexible local currency programming system applicable to future Agreements.

Programming of local currency provided under the ESR VIII program will be finalized following obligation of the Agreement. An illustrative list of local currency uses is contained in Annex J.

4. <u>Program Trust Funds</u>

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

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

- Special Development Fund (SDF): This is a fund to finance small community self-help projects identified by Peace Corps Volunteers. Historically, Development Assistance funds have been used for this activity but, in view of the availability of local currency and the absence of any dollar costs associated with the projects, the Mission switched the funding to local currency in 1985. The equivalent of approximately $500,000 is budgeted per year for this activity through 1991.

- Civic Action: Under this program, approximately $40,000 in local currency is used each year to purchase materials for small community projects (e.g., school repairs, pharmaceuticals). Labor for these projects is provided by U.S. military personnel who operate at request of and under the control of local civilian authorities. We expect that FY 1990 will be the last year of funding for this program.

- Rural School Refurbishment: This program started in 1987 in response to a Ministry of Education (MEP) request for assistance in improving the physical state of elementary schools in rural areas. The program works in a similar fashion to the SDF program. Peace Corps Volunteers, in coordination with MEP officials, work with communities to develop projects on a matching grant basis. The budget for the program is the equivalent of $1,900,000 over a four year period, terminating in 1991.

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

- Agricultural College (EARTH): Under the terms of a local currency Memorandum of Understanding with the GOCR, it was agreed that, until EARTH had the capability to do so, the Mission would act as its agent for certain procurement and contracting purposes. EARTH staff have now acquired most of these functions and the majority of EARTH money formerly in the Trust Fund has been transferred to an EARTH controlled account and to monetary stabilization bonds. The Mission's role will continue to be phased out.

- Policy Planning and Administrative Improvement (PPAI): These funds provide counterpart to the Mission's DA project to finance the local currency costs of services financed with the dollar resources. After the DA project PACD of June 30, 1990, these funds will be utilized in the same fashion for the Policy and Technical Support Project (PATS), now under design. In certain limited cases where no dollar costs are required, these funds will be used without complementing dollar funds, but will still be charged as counterpart to the DA project.

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

- Support to AID Funded Projects: The local currency equivalent of $5 million has been programmed to provide local currency financing to support AID funded projects. The program covers the contracting of technical assistance, audits, studies, training costs and other support costs required for project implementation.

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

Bureau guidance regarding the programming of HCOLC was provided in 1988 State 313159, including guidance for the implementation of activities funded through Trust Funds. The cable allowed a transition period until December 31, 1988 for full application of the guidance, by which time AA/LAC approval as well as a PP-like document for Trust Funds activities was required. For Trust Funds activities that are on-going, i.e., funded under agreements signed prior to December 31, 1988, it is not entirely clear to the Mission whether proceeding with new increments of HCOLC programs funded from Trust Funds past the transition period is allowable without application of the new requirements. On one hand, the guidance states that full compliance (i.e., AA/LAC approval, etc.) is required for programs using HCOLC after December 31, 1988. On the other hand, the cable states that for the use of HCOLC made available under earlier agreements, the Mission can proceed by documenting the basis for not complying with these requirements.

In one recent case of applying prior Trust Fund local currency to a previously approved activity (the 1989 $40,000 equivalent Civic Action program), the Mission determined that grounds existed to justify proceeding without the PP-like document. A few other similar cases, such as adding funding to the OFDA advisor's contract, will arise in the future where resolution of this issue would be most helpful. The Mission proposes the Bureau approve USAID's plans to proceed to justify on a case by case basis the increased incremental funding of these activities without a PP.

In addition, though the Mission has no present plans to expand its Trust Funds activities, some new activities which are appropriate for the Trust Fund (again using Civic Action programs as an example), due to their small size, simplicity, short duration or lack of management implications for the Mission, are not conducive to PP-like analysis. The Mission feels that USAID's should be allowed to justify to the AA/LAC those cases where Trust Fund documentation requirements are not appropriate, and proposes that the Bureau so modify its HCOLC guidance accordingly.

IV. KEY CONDITIONALITY CONCEPTS AND POLICY REFORM

The 1989 ESF Program for Costa Rica is the major component of an overall U.S. supported balance of payments assistance program that includes the PL 480 Title I food commodities program, as well as the policy reforms negotiated as part of these programs. As discussed in Section II and in Annex A, assuming no dramatic negative change in economic trends and continued assistance from other external donors, it is anticipated that ESF levels will continue to decline at a steady moderate rate over the coming years -- to $57 million in 1990 and to $36 million in 1991. (Current plans call for the PL 480 Title I program to continue at the current level of $15 million per year.)

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

Thanks in part to the strong financial and policy support of the IMF, IBRD and AID, Costa Rica has essentially emerged from its economic crisis of the 1980-82 period. Major macroeconomic progress has been achieved in that there has been a return to positive, if modest growth rates; reduced inflation; improved exchange rate performance; and improved fiscal performance. Appropriately, earlier ESF programs concentrated on macroeconomic conditionality such as maintaining real positive interest rates, limiting net banking system net credit to the nonfinancial public sector, maintaining a unified exchange rate, etc. The policy reforms emphasized by this past ESF conditionality, while having had significant positive effect, need to be further institutionalized to better prepare the country for the end of ESF assistance. Measures to reinforce the macroeconomic progress obtained to date are discussed below.

As described in Section III. B., the Mission assumes that the current IMF Standby will be extended through 1989 and that the IMF will have the lead role for macroeconomic conditionality. Therefore, the Mission will include no new initiatives in this regard. However, if the IMF program for 1989 is delayed or not extended past March, 1989, the Mission will be ready to step in to request that the GOCR provide a satisfactory macroeconomic plan for 1989 prior to first disbursement or prior to making subsequent ESF disbursements, depending upon timing of this eventuality. This plan will include quarterly limits for the following: (1) central government expenditures, (s) cumulative financial balances of the CCSS, RECOPE, ICE, CNP, and JPS; (3) net domestic assets of the Central Bank; (4) changes in banking system credit to the non-financial public sector; (5) the net international reserve position of the Central Bank; and (6) arrears on external payments.

The Mission also assumes that the World Bank's SAL II Program will take effect during 1989 following ratification by the Costa Rican Legislative Assembly. The IBRD Board approved the loan in mid-December, 1988. The basic financial plan of SAL II is to have a $100 million loan from the World Bank and a potential cofinancing (without additional policy measures) for $100 million from Japan, though recent developments in Japan, according to IBRD sources, have begun to cast doubt on whether or not the Japanese will be willing to follow through on this commitment. The SAL II loan would be disbursed in three tranches with the first disbursement of $40 million being made upon taking effect, the second tranche of $35 million after the first performance review and the third tranche of $25 million being disbursed after a second performance review.

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

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

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

In the public sector component of the SAL II program, the Bank and the GOCR have negotiated three areas of agreement: (a) the size and composition of a public sector investment program, (b) a commitment to increase public sector savings (inclusive of Central Bank losses) to 4.0 percent of GDP in 1989 and 6.5 percent in 1990 (in 1986 this variable was about 4.5 percent), and (c) a reduction in the earmarking of tax revenues. While the Mission's policy dialogue with the GOCR will reinforce certain IBRD priorities (for example in reinforcing financial reforms on interest rates, credit allocation and subsidies), the Mission will not undertake major new initiatives in ESR VIII conditionality for the areas covered by the Bank.

State 386936, received in December 1987, describes in general terms the Bureau's ideas of moving toward a greater emphasis on sectoral ESF policy conditionality. The idea is that, given earlier emphasis and progress in attaining short-term stabilization objectives, ESF programs need to evolve toward sectoral reform objectives -- ones that represent a logical next step in the recovery and growth process and that show demonstrable results. Our understanding of the guidance for the ESR VII Program and continuing to a large extent for the ESR VIII program, stresses its transitional and flexible nature, i.e. macroeconomic conditionality should be continued and reinforced to the extent appropriate and necessary, and where possible, the focus should be shifted to identifying sector programs that are based on a solid analytical base and that can better accomplish economic growth objectives.

The covenants and the local currency programming contained in the 1987 ESF program initiated the Mission's focus on sub-sectoral topics such as investment promotion, public sector efficiency, promotion of non-traditional exports and support to the private manufacturing sector through increased credit availability. The 1988 ESR VII program continued in this vein to sharpen our focus and more clearly articulate a more sectoral approach, orienting conditionality to achieving sectoral policy reform rather than simply programming funds for sectoral initiatives. It should be noted too, that while past ESF conditionality is an obvious and effective forum for pursuing sectoral issues, the establishment of the Bipartite Commission and the local currency sectoral programming and negotiation process described in Section III above provided the Mission with an even more far reaching and effective avenue for pursuing sectoral reform priorities with the GOCR. While the proposed ESR VIII program as described below shows further evolution and movement toward a sectoral program and will be backed by continually more focused policy dialogue and conditionality, the Mission makes no claim that we have yet arrived at a well-defined sectoral program. Indeed, Mission plans call for a continued transition period of concentration on the areas where further work and policy dialogue are needed in order to permit an eventual sectoral approach in one or more sectors. Current plans call for the Mission to have developed at least a sectoral cash transfer program by 1991 that concentrates on the removal of constraints to further development of Costa Rica's export sector.

Other sections of this document stress our perspective that despite substantial progress, victory cannot be yet claimed on the macroeconomic front in Costa Rica -- the progress, while substantial, is still reversible. Illustratively, an increase in the public sector deficit could serve to drain credit from the private sector and fuel increased inflation. We must continue therefore our macroeconomic conditionality and policy dialogue, while at the same time deepening and clarifying our sectoral focus. The Mission's movement toward a more sectoral focus therefore is one that is evolving as a result of progress achieved and the growing maturity of the Costa Rica ESF program. This focus is and will continue to be firmly founded on Mission, GOCR and other donor analyses. With Costa Rica's large balance of payments gap and the still significant levels of ESF assistance, the cash transfer approach of the past remains valid. By FY 1991 however, the convergence of an improved balance of payments situation and lower ESF levels will make it appropriate to shift the ESF program to a sector orientation.

Section III.A. above describes the evolution of the Mission's strategy from "economic stabilization" to "laying the basis for long-term growth", with a concomitant orientation to areas where we believe significant progress can be achieved in furtherance of that goal. Accordingly, the Mission will concentrate on three principal areas which are complementary to the long-term growth strategy and which will form the parameters of the Mission's policy dialogue agenda with the GOCR. These are:

(1) Macroeconomic/Financial Concerns;

(2) Public Sector Efficiency; and

(3) Export and Investment Promotion

A. Financial/Macroeconomic Concerns

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

The Mission is therefore negotiating conditionality with the GOCR that will carry over aspects of prior macroeconomic conditionality. For example, the Central Bank will be required to maintain during 1989 a unified exchange rate and to revise this rate as necessary, essentially to maintain purchasing power parity with Costa Rica's trading partners. The Central Bank has followed a crawling peg, or minidevaluation, program since January 1985. In 1987 for example there were 25 mini-devaluations with a 17.7% increase in the exchange rate; and in 1988 there were 20 minidevaluations with a 14.7% increase in the exchange rate. The Mission will closely monitor this covenant as it is anticipated that the pace and amount of the minidevaluations will be held down in the first four months of 1989 in order to dampen inflationary expections.

Also, conditionality will be included to require no increase of net banking system credit to the non-financial public sector. A covenant will also require that banking system interest rates be guided by market forces so that they are positive in real terms. In 1988 the Central Bank continued its policy of allowing commercial banks and finance companies to freely set their interest rates on both deposits an loans with the provision that the spread between the highest and lowest rate on loans not exceed 9 percentage points. Interest rates on loans were positive in real terms, except for subsidized credit, which was limited to less than 16% of total credit to the private sector.

A further covenant will require that a program be followed for the provision of credit that avoids detailed allocative categories. In 1987, credit ceilings by banks and credit allocation categories were completely eliminated. However, in 1987 credit expanded faster than projected and certain groups of producers, notably cattlemen and basic grain farmers, complained about not receiving sufficient credit from the banking system. As a result of these pressures, in 1988 overall credit ceilings by banks were reinstated and a limit was set on the amount of credit that banks could extend to "other activities", i.e., commerce, services, electricity, transportation and consumer credit. As has been described in previous ESR PAADs, in 1981-82, all credit in Costa Rica was subsidized in that the real interest rate was negative. Moreover, credit was allocated to a set of 54 topes, or pre-determined categories. A return to overall credit ceilings in 1988 was not considered a serious case of reversion toward detailed credit categories.

Previously burdensome procedures, political interference and lack of competition impeded the banking sector's ability to respond efficiently to the growing credit needs of the productive sector. As well, in 1982 the public sector received a full 43% of banking system credit. The combination of an infusion of credit resources and policy dialogue by AID--including support to the private banks as an alternative to the state banks, supported by ESF conditionality--has resulted in considerable strides in ameliorating the credit situation. The last two covenants described above will serve to reinforce this progress.

An agricultural credit law (FODEA) was passed in 1987 by the Legislative Assembly that contained provisions for rescheduling loans made at negative real subsidized interest rates to different classes of agricultural producers. Fears were high on the part of USAID that FODEA would lead to wholesale loan defaults, legitimizing the non-payment of the old loans, with negative impacts on producers of non-traditional products. This did not come to pass as the nationalized banks themselves proved less than eager to reschedule the loans at subsidized rates. The rescheduling had the effect of decreased availability of credit for cattle and basic grains production, which were the bulk of the non-performing loans. Pressures are presently again on the rise within the National Assembly to provide another subsidized credit program, reviving old fears of the FODEA Law. To counter such moves, ESR VIII conditionality will require that subsidized credit be strictly limited during 1989. For the first time the Mission will include within this limit credit from internal (including subsized credit financed through the national budget) and external (i.e. donor) sources. This approach will improve the Mission's optic on this issue and establish a benchmark for negotiating future net reductions in overall subsized credit levels.

While the macroeconomic results of the ESF program in Costa Rica have been encouraging, USAID considers it important to continue and carryover an emphasis on economic stabilization. Such an emphasis complements efforts of other donors, particularly the IMF and IBRD, protects past progress that has been made, and continues movements toward future stabilization reform objectives.

B. Public Sector Efficiency

USAID/Costa Rica has long been concerned with overcoming the effects of inefficiencies in the Costa Rican public sector. A litany of various deficiencies in the operation of the public sector has served not only to limit the ability of the economy to move from relative equilibrium to sustained growth, but also has served and continues to undermine progress made in a number of vital policy concern areas. These include investment and export promotion, preserving macroeconomic policy gains by limiting Central Government expenditures, and significantly, in preserving and protecting the GOCR's capacity to provide its high level of support for social services, particularly education and health care.

A cross section of GOCR decision makers and international donors point to the need to restore fiscal discipline and administrative efficiency to the Costa Rican government bureaucracy as a central issue of public policy. The scope of the problem is enormous and frought with the sensitive political problems of reforming public policy and institutions within a most democratic of settings.

Illustratively, public sector employment in Costa Rica has increased from 36,200 in 1962 to 160,000 in 1988, distributed between 202 public institutions. The 1962 level represented 9.8% of the labor force, up to a full 20% in 1988. Spurred on by social democratic traditions and bolstered by a past epoque of high traditional export earnings and different demographics, public workers successfully secured a range of salary, employment and pension benefits that neither present nor future governments can realistically hope to finance. In the 80's the GOCR has been forced to drastically curtail capital expenditures in order to meet the entitlement-driven recurrent cost demands of public sector institutions. Omnipresent Costa Rican red tape and bureaucratic inertia confound and confuse citizens and foreigners alike, creating and perpetuating obstacles to a number of beneficial programs, for example, to Costa Rica's non-traditional export initiative. In fact, the burgeoning financial demands and bureaucratic inefficiencies threaten the continued growth of the private economy as well as the GOCR's much praised social services and welfare programs.

The public sector efficiency problem is more disturbing upon closer review. Of the 160,000 public sector employees, an internal GOCR report estimates many are redundant. A low level of technical training of the vast majority of these employees makes for low governmental productivity, creating a host of institutional, administrative and legal problems. There are nineteen generous pension systems for the public sector, ten of which are partially financed by the GOCR and nine of which are <u>fully</u> paid by the state. The 40% of public employees enrolled in these pension systems now absorb fully 3% of Costa Rica's GDP. Public agencies are plagued by a lack of planning, duplication of functions, and inefficient use of information in public administration. The situation is complicated by a rigid civil service system and a code of civil law that is sometimes inconsistent, contradictory and obsolete. End results of this state of affairs can hardly be expected to be positive-- one of the most serious results being (in addition to the general wasted productivity) a plethora of needlessly complex, overly bureaucratic and inordinately time consuming procedures of public administration ("tramites") that confound and frustrate one and all. This charterization applies to a number of important functions-- credit procedures, import licensing, customs, construction permits, social security procedures, immigration and so on. The "tramites" impact negatively on efforts to cut public sector costs and to remove impediments to economic growth objectives.

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

It is the intent of the Mission, in conjunction with the GOCR and major donors, to conceptualize, propose and begin implementing a more comprehensive program to address some of the staggering problems of the public sector. Due to the sensitivities involved (perhaps more sensitive than other areas of conditionality and policy dialogue), public sector efficiency programs must be perceived and operated as the GOCR's own program. We believe that the evolution of this program, done properly, has the potential of addressing the issue in a way that the GOCR can see as positive and supportive of its own policy objectives, aided by potential sources of financing to ease political sensitivities and provide incentives. While the initiation of the first steps toward a public sector efficiency program will be through the vehicle of ESR VIII conditionality, the Mission will work closely with the GOCR through policy dialogue and other forms of assistance, to put form and substance to a GOCR public sector efficiency program that must necessarily be carefully and incrementally developed.

Though the outline of the proposed program below represents a new Mission initiative to more effectively address an old problem, past conditionality and policy dialogue have sought to accomplish public sector reforms. Past Mission initiatives have been in the areas of privatization, public sector employment and customs reform.

The Costa Rican Development Organization (CODESA) founded in 1972, perpetrated a sad legacy of inefficient, ineffective, politically motivated and controlled, dubiously managed organizations totalling some 42 in all--all the while having free and unlimited access to Central Bank credit resources until the practice was ended with AID pressure in 1984. While the AID-supported privatization and divestiture of CODESA has made significant progress (See Annex B), the CODESA experience remains a textbook example of the public sector run amuck. The Arias administration has continued its support of CODESA divestiture though the tying up of loose ends has in some cases taken longer than expected. Given the political sensitivities of the subject, particularly in a pre-election year, progress on other privatization programs is likely to be slow though the interest of the present administration, based on the CODESA experience, has proven positive indeed. One practical lesson from the CODESA divestiture experience has been that much reform, even in politically sensitive areas, can be made when objectives are clearly defined, linked to policy goals, capitalized, and perhaps most importantly, when the government takes the lead in openly supporting the program.

Another previous aspect of public sector improvement has been the area of customs. The customs service is renown among Costa Rican and foreigners alike as inefficient, slow and bureacratic. Its many problems include an unclear organizational mandate; untrained technical personnel; an aura of operational incompetence; and manual and repetitious processing of paperwork. The Arias administration early-on attempted to deal with the problem by beginning a customs reorganization, but the effort stalled due to a lack of political support and a number of legal problems. AID conditionality in ESR VI required that a number of mostly non-controversial short term reforms be adopted during 1987. These were for the most part carried out as required, raising hopes that more substantive and far reaching reform could be planned in the near future. In ESR VII some longer term changes were required -- implementation of a mechanization program, simplification of administrative an operational procedures, improvements in the operation of the customs laboratory and development of a training plan for customs personnel -- changes which responded directly to the expressed priorities of the Director General of Customs.

The 1988 ESR VII program contained conditionality, where for the first time AID focused directly on the public sector employment problem. The Mission underlined its interest in public sector employment limitations in 1988 ESF conditionality by requiring the GOCR to reaffirm its commitment to achieve realistic employment targets by freezing public sector employment levels as of September 30, 1987 (the date of the last GOCR public sector employment report) through calendar year 1988. Given domestic pressures on certain employment categories (for example education and public health) and political realities, the Mission felt that this was the most realistic and achievable employment target. Regarding this sector, the World Bank decided not to pursue public sector employment reduction targets in SAL II due to their belief that the goal was basically unachievable. Reports from the GOCR report compliance with this 1988 AID covenant freezing public sector employment levels and the covenant will be carried over in the ESR VIII Agreement.

On the customs front, the shift of conditionality will be from the shorter term reforms implemented under ESR VI to longer term changes. Progress by the GOCR in addressing these customs reforms has resulted in the issuance of a detailed customs reform plan that includes, among others, reorganizaton of the central customs administration and technical training for customs personnel.

We have attempted above to point out in summary fashion the importance of the public sector efficiency problem and past Mission programs and policy dialogue efforts. Following, therefore, is the outline of a Mission sectoral initiative that will evolve over the following year, backed by ESR VIII conditionality, well researched policy dialogue, sound and incremental design undertaken primarily by the GOCR with AID assistance, and potentially local currency and dollar financing.

At the suggestion of the First Vice President of Costa Rica, the program will be pursued initially by the formation of a high-level, bipartisan study group which will develop a master plan for addressing deficiencies in the operation of the public sector. Though there is a consensus among Costa Rican decision makers that public sector reform is essential, there has not existed to date a forum to systematically analyze the structural problems confronting the sector or to formulate a strategy and plan for carrying out required reforms. Given the nature of the task in a pre-election year, the development of the master plan could permit a new GOCR administration to begin implementing portions of the plan soon after assuming office.

Discussions with the GOCR to date on public sector efficiency have centered around two general topics:

(1) Public Sector Labor Mobility; and

(2) Improved Administrative Efficiency

a. Public Sector Labor Mobility: A distortion of efficient labor allocation between public and private sectors has the effect of diminishing the maximum productivity of both sectors. What is necessary are specific policies, incentives and programs to draw certain numbers of public employees into private employment, thereby increasing labor mobility and simultaneously increasing efficiency in both sectors. Such a program would begin with the GOCR undertaking a national employment efficiency study to identify more specific labor allocation problem areas, determine priority actions and institutions for focus, design a methodology for effecting transfer of a portion of the public sector labor force to a coordinated set of actions such as private sector employment. The program would emphasize financial incentive packages, recommend an administrative structure to implement the program, examine administrative and/or legal constraints to the program, and make recommendations as to the practical scope of such a program over time.

It should be emphasized that the this study and related subsequent activities must be at the initiative of and carried out by the GOCR -- albeit with appropriate AID technical and policy support. Conversations with a wide variety of GOCR officials and local businessmen, while noting the sensitive nature of the undertaking, have been positive and helpful in advancing the concept. Without fail, the importance of creating incentives, and positing the program as a GOCR one and in the demonstrable best interest of all involved has been stressed.

The study, the object of ESR VIII conditionality, would be followed up by the presentation of a program developed as a result of the labor allocation study. The GOCR, possibly aided by ESF local currency and other donor contributions, will aid the implementation of the program by the design and hopefully the establishment of a fund that will address the inevitable incentive and compensation issues related to salary levels, GOCR pensions, severance pay ("prestaciones") and technical training to improve transferee skills and marketability.

It must be noted that while AID policy dialogue and negotiations with various GOCR officials to date have been positive and encouraging, no realistic assessment of the proposed concept can at this time guarantee the establishment and operation of a sound public sector program and the proposed transition fund. Given the "first step" nature of the proposal and the approach that allows the GOCR to pursue its own program in practical increments there is however room for optimism.

The issue of GOCR pensions is one that transcends the scope of the public sector employment program described above. However, the need for reform of the system is accepted by Costa Rican decision makers, though again, the subject is frought with sensitivity. ESR VIII conditionality will require the GOCR to develop recommendations for an improved and economically feasible pension system and a plan for implementing the recommendations.

b. Improved Administrative Efficiency: This area is closely related to Public Sector Labor Mobility discussed above and two aspects, entitlements (pensions and severance pay) and labor allocation, directly overlap. Serious efforts at solving public sector inefficiency problems must particularly be directed at those inefficiencies that undercut Costa Rica's considerable progress in supporting sustained economic growth. For example, the Mission plans to continue supporting efforts to streamline export and import procedures. (ESR VII conditionality urged successfully for the establishment of a one-stop window for exporters.)

The area of customs improvement is an obvious area where the Mission needs to and will continue its focus. The efforts of the GOCR to seriously deal with previous ESR VII customs conditionality for mechanization, procedure simplification and technical training caused them to produce a detailed proposal for customs reform and ask AID for technical assistance in implementing the program. While major Customs changes will not come overnight, the Mission assessment is that the GOCR is serious in its reform efforts and we will therefore make available the technical assistance as requested. ESR VIII conditionality will reinforce the GOCR's commitment to carry out their own customs proposal.

Another area of administrative efficiency that the Mission will explore at some length is one of organizational efficiency, i.e., in particular the relationship between central and local government. It is ironic that Costa Rica, one of the world's most vibrant democracies, is also one of the most centralized. Theoretically, an optimum level of public sector efficiency is approached between a division of responsibilities between a central government and local authorities. Costa Rican authorities have recognized the basic incompatibility between a centralized authority and a strong democratic tradition, and have initiated the process to enact decentralization legislation. This constitutional reform which, if approved by the legislature, will represent the most far reaching step towards decentralization of responsibility and authority from the central government to municipal governments since the Constitution's adoption in 1949. This reform proposes to:

- Shift 10% of central government revenues to the 85 municipal governments over a ten year period, thus tripling municipal resources;

- Transfer responsibility for certain basic services from the central government to local municipal governments;

- Create a uniform civil service system for municipalities; and

- Fund a training and technical assistance program for municipal staff during a two year transition period.

Though GOCR efforts in this area to date are just beginning, USAID will seek through policy dialogue and other opportunities to promote appropriate programs and policies to improve the provision of public services through administrative and fiscal decentralization.

The Mission proposes to use the remainder of FY 1989 and subsequent year ESF negotiations to frame the public sector efficiency issue particularly around the two substantive themes outlined above. Our intent is to link policy dialogue with ESF and DA dollars, local currency and technical assistance to assist the GOCR put into place the policies and programs to enable it to meaningfully increase the efficiency of the public sector in the targeted areas. Despite the acknowledged difficulty of the task as outlined, the GOCR itself is seriously discussing the issues and already grappling with possible solutions. As initiatives evolve, the GOCR will also better place itself in position to attract multi-donor support within the context of the Costa Rican Consultative Group.

ESR VIII conditionality will touch on three additional areas of public sector efficiency, two new and one continuing. The continuing area of conditionality is privatization, where a prior covenant will be carried over permitting no CODESA access to Central Bank investment credit. Further, two covenants will carry over GOCR commitments to complete actions in process for the disposition of three remaining CODESA companies.

One new area of emphasis is in the area of private power generation. Costa Rica now expects serious shortfalls in the production of domestic power resources in the period 1990-1992. Though not a major thrust <u>per se</u> of the Mission, AID has financed a series of excellent studies that clearly demonstrate the potential of private Costa Rica power producers, particularly from bagasse-burning sugar mills and small hydo, to produce about 120 MW of the shortfall, or about 15% of Costa Rica's total demand, within the coming 2-3 years. The GOCR, sugar industry officials and the national electrical authorities all agree that the production of private power in small commercial excess quantities to the national grid represents an idea with great promise for Costa Rica. The initial major issues in permitting this production is a legal one to permit private power production in commercial quantities, and an administrative one, to determine by decree an adequate price structure for the grid's purchase of the produced excess power. Both of these issues are actively being pursued by the Ministry of Natural Resources, particularly the Minister (an ex-USAID employee) with assistance from AID/W, and resolution of both is reasonably expected by mid-1989. AID conditionality in this area not only serves to support a positive policy initiative in which AID has been instrumental since inception, it also serves to reinforce and protect Mission investment and export production goals, as well as to protect balance of payments objectives (optional imported power is paid in precious foreign exchange). From the public sector efficiency perspective, there is no reason to promote the expansion of a public utility company when private power producers are presently able to begin to make up the projected shortfall at the same or lower production costs than the utility options.

An additional aspect of public sector efficiency addressed in ESR VIII conditionality is in the area of public sector audits. A lack of GOCR capacity in carrying out effective and comprehensive audits of its public sector programs and activities has jointly been identified by USAID and the GOCR. A covenant will require the GOCR Controller General to proposed a time phased plan to improve audit coverage, including provision for training and a revamped audit organizational structure. A further covenant will provide further definition at the policy level of periodic audit requirements of DA projects and HCOLC activities. These provisions are expected to assist the GOCR in improving an important aspect of its public sector management and accountability operations.

C. Export and Investment Promotion

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

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

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

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

On the policy side, previous ESF, IBRD and IMF conditionality have encouraged the GOCR to reduce protection of the manufacturing sector in favor of developing and expanding non-traditional exports. The AID-encouraged policy of minidevaluations and the unified exchange rate have had the effect of maintaining the profitability of exports. This policy continues as evidenced by a January 1988 colon devaluation of 6% and overall 16% devaluation during calendar year 1988. In addition, over the long run tariff reduction should encourage risk adverse Costa Ricans to turn away from their protected environment and produce for export. The IBRD has taken the lead on this issue, and the Mission's role will be limited to supporting rapid passage and implementation of SAL II in our policy dialogue efforts with the Bipartite Commission and by encouraging support among the private sector groups with whom we deal.

USAID/Costa Rica has put much emphasis since 1982 on the provision of term credit for the productive, including exporting, private sector. Producers have had access to almost $250 million in credit in special dollar and local currency credit lines established after 1981, of which some $180 million has been term credit. At present, some $27 million in AID dollar credit is undisbursed. Producers have access to this credit through the private banks which offer exporters a more efficient and responsive alternative to state banks. IBRD and AID conditionality discussed in the previous section should reinforce, protect and strengthen past gains of the private financial sector's vital role in promoting exports.

Direct investment promotion activities in Costa Rica are being carried out by the Costa Rican Coalition for Development Initiatives (CINDE), a private, non-profit association founded in 1983 by a group of prominent Costa Rican businessmen and professionals with financial support form ESF local currency resources. CINDE's investment promotion program for the industrial sector (PIE) is implementing an intensive plan to identify investors and sell them on the advantages of Costa Rica as a place for doing business. Currently funded at about $3.5 million per year CINDE/PIE has attracted about $130 million in non-traditional export investments during the period 1986 through 1988. This has resulted in the creation of about 20,000 direct new jobs for the investment period.

At least half of the foreign investors interested in Costa Rica want to establish operations in free trade zones. Responding to the need for additional free zone space, the Mission has implemented a series of programs to accelerate free zone development. Our major dollar and colon credit lines were liberalized to permit free zone investments. Technical assistance was donated to the GOCR agency (CZF) regulating free zones to assist in the drafting of an improved law designed to facilitate the growth of improved free zones and make it more attractive for the foreign investor to locate in a free zone; the Mission also engaged in direct policy dialogue to encourage the incorporation of consultant's recommendations in a bill submitted to the legislature. In addition, we will be assisting the CZF to privatize the free zones they are now operating. Most recently, the Mission approved additional technical assistance to assist private free zone to develop improved satellite communication systems and to improve the administration and operation of their export processing zones. Because efficient free zones are an important component of CINDE's investment promotion program in providing a location free of taxes and bureaucratic red tape, the Mission is supporting a series of actions to encourage private free zone development.

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

A variety of DA, local currency and PL 480 funded measures are presently addressing sector wide constraints to trade, investment and export promotion. The role for the accompanying policy dialogue talks on the subject being carried out with the Bipartite Commission in general, and with respect to ESR VIII conditionality specifically, is to promote an institutional and policy framework that maximizes the ability of the productive private sector to produce for export. In that regard, the Mission's principal policy target is to ensure the sustainability of an efficient export and investment promotion operation in Costa Rica.

The Mission has to date with the cooperation of a number of influencial GOCR Ministers and businessmen, pushed to achieve such an operation through a reorganization plan to rationalize and consolidate export and investment promotion operations. A proposed covenant would require the GOCR to advance a reorganization of the GOCR's export and foreign investment promotion activities so that they will be part of a single GOCR agency, capable of paying sufficient salaries to attract and retain high quality staff, and including the participation of private sector representatives.

Recent ESF negotiations have indicated, however, a lack of consensus among the GOCR Cabinet and Bipartite Commission that this sustainable export and investment role can best be accomplished through a reorganization, i.e., specifically, through a combination of CINDE and the GOCR's CENPRO (the GOCR's official investment promotion agency). If continuing negotiations on this subject prove inconclusive, the Mission will partially alter the conditionality as presently written, and pursue the goal of organizational sustainability through seeking to guarantee the availability of funds for export and investment promotion over the long and medium term -- for example via initiation of local currency endowment or trust funded from 1989 ESF local currency resources. The Mission plans to require the GOCR to pledge the programming of these local currency funds at the same time as signing the ESR VIII Agreement. The issue is further described in Annex F.

V. CONDITIONS AND COVENANTS

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

The ESR VIII Agreement will be signed by AID and the GOCR following PAAD authorization, likely in early April. Detailed discussions on the 1988 ESF program have been underway with the GOCR-AID Bipartite Commission since mid-January and well before as regards a number of related policy dialogue topics. Though substantial progress has been achieved in most areas, the issue of nine unresolved investment disputes involving U.S. individuals or companies, has resulted in pressure by non-AID USG authorities to withhold part of 1989 ESF program funds pending satisfactory progress by the Costa Ricans in moving to resolve these cases. Mission officials have repeatedly stressed with leading GOCR officials the importance of making progress in the resolution of these cases. This issue remains most troublesome to a satisfactory conclusion of the ESR VIII negotiations and will have unknown consequences on other ESR VIII related initiatives. Notwithstanding, Mission officials will seek to conclude negotiations with the GOCR Commission very soon after PAAD authorization and will incorporate additional guidance, particularly on the investment dispute issue, received during the PAAD review.

1. Conditions Precedent to Disbursement

The Mission plans to require as a condition for the first disbursement of ESR VIII dollars, that the GOCR submit for AID approval an economic program for calendar year 1989 which contains, inter alia, quarterly limits for the following variables: (a) central government expenditures, (b) the cumulative over-all financial balances of the CCSS, RECOPE, ICE, CNP, and JPS, (c) net domestic assets of the Central Bank, (d) changes in banking system credit to the nonfinancial public sector (e) the net international reserve position of the Central Bank, and (f) arrears on external payments.

Further, the Mission plans to require that the GOCR be in compliance with repayment terms of all AID loan and HIG Agreements, and that thus the GOCR end its current practice of waiting until statute 620(q) is nearly triggered prior to undertaking repayments to the USG. Negotiations on this subject to date have achieved the GOCR's agreement to make current during the course of the current year their outstanding AID loan obligations.

In addition, the standard statutory conditions for designating authorized representatives for the project (including specimen signatures) and an opinion from GOCR legal counsel that the Agreement is a binding commitment will be required.

Second and third disbursements will be made according to evidence provided by the GOCR that they are in substantial compliance with terms of the 1989 economic plan, by continued compliance with AID repayment provisions, and upon a determination by the Mission that GOCR compliance with ESR VIII conditionality is satisfactory.

2. Covenants

The GOCR will covenant as follows:

-- To maintain during calendar year 1989 a unified exchange rate; and to review the appropriateness of the exchange rate on a continuing basis, and revise it when necessary, in accordance with the following factors: relationship of actual domestic prices to prices in the principal countries with which Costa Rica has commercial relations, the status of the current account in the balance of payments, service of foreign debt, and non-compensatory net capital inflows.

-- To reduce the public sector deficit in 1989 by 0.5 percent of the 1988 GDP level and to comply with the limits stated in the economic plan for central government expenditures, the cumulative over-all financial balances of the CCSS, RECOPE, ICE, CNP, and JPS, and changes in banking system credit to the nonfinancial public sector.

-- To continue with the policy that banking system interest rates respond to the domestic financial market realities in a manner that they are positive in real terms, stimulate financial savings and avoid capital flight, and to supply A.I.D. with quarterly reports on interest rates in the organized financial markets.

-- To implement and maintain during calendar year 1989 a credit program that eschews detailed allocative categories for the provision of credit.

-- To maintain outstanding balances of subsidized credit during calendar year 1989 at levels no higher than 1988 levels, or 7.7 billion colones, and which do not exceed that level by more than 5% on a purely seasonal basis during the course of 1989; and to report to A.I.D., within three months of the end of each calendar quarter, information sufficient to demonstrate compliance with this condition. Subsidized credit is defined as credit extended by domestic financial institutions from all domestic and external sources at interest rates lower than the six-month deposit rates, including credit at subsidized rates when subsidies granted by the government or other organizations raise the return to banks to a level equal to the six month deposit rate.

-- To provide to A.I.D. from the signing of this Agreement until the end of calendar year 1990, copies of all reports to the International Monetary Fund as required under present or future agreements with the Fund; to provide each such reports to A.I.D. at the same time that they are provided to the Fund; and, in the event that at any time during such period no agreement with the Fund is in effect, to provide to A.I.D. during such period, reports whose timing and content shall be sustantially similar to those currently provided to the Fund.

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

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

2) BANHVI adopts credit policies to reasonably guarantee full cost recovery of loans by authorized on-lending financial entities.

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

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

-- To undertake the necessary measures to (1) clearly define the roles of all housing sector institutions, particularly INVU, IMAS and CEV, to avoid duplication of effort and reliance on emergency procedures, increase management efficiency and (2) focus public sector housing institutions projects exclusively on families at low and moderate income levels.

-- To affirm its commitment to maintain public sector employment levels to the levels of September 30, 1987, through calendar year 1989, excluding those positions created in the 1988 budget for education, and those necessary for the expansion of public health services, and to provide quarterly reports to A.I.D. through March of 1990 regarding the number of Costa Rican public sector employees, number of vacant positions and salaries paid, that demonstrate satisfactory progress in complying with this goal.

If the information mentioned above for the entire public sector is not available in a timely manner, provide the information for the sample of institutions included in data prepared for the International Monetary Fund.

-- To establish no later than May 1, 1989 a high level study group to study and address limitations and inefficiencies of the Costa Rica public sector. Once established, the group will develop a national employment efficiency study that analyzes on a macro basis relative redundancies or inefficiencies between the Costa Rican public and private sectors, including the identification of public sector institutions and numbers of positions for elimination or transfer to the private sector; and, based upon this plan, by November 1, 1989, design, officially create and publicize a plan of action and a fund that will, as soon as is practical and feasible, facilitate the integration of public sector employees into the private sector.

-- To propose by March 31, 1989, using as a basis the IBRD/MIDEPLAN report "Economic Analysis of Pension Systems in Costa Rica and Recommendations for their Reform" of March, 1988, a series of recommendations for an improved, more efficient, and economically feasibly national pension system(s) (including control systems to guarantee regular salary deductions for public sector pension and retirement plans), and an implementation plan for carrying out these recommendations.

-- To undertake measures by May 1, 1989 to permit the cogeneration of electricity in commercial quantities by private power producers.

-- To issue by May 1, 1989 an Executive Decree determining an adequate price structure for the purchase of cogenerated power from private power producers to the national electrical grid and undertake whatever further measures required for the adoption of this price structure.

-- To implement the customs reform program as proposed by the Vice-Minister of Finance in a letter to AID of November 3, 1988.

-- To have prepared by the Controller General by June 1, a study to identify impediments and propose a time phased plan for improving audit coverage of public sector programs, including identification of an organizational structure and training required for an effective, comprehensive audit program.

-- To present to USAID by June 1, 1989 and annually thereafter, a schedule for the completion of financial and compliance audits for the following 12 months, of U.S. dollar funded and local currency funded agreements; and further, to provide USAID with copies of the completed financial and compliance audit reports.

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

To complete the sale of 100% of the shares of CATSA by June 1, 1989.

To sign agreements with FINTRA transferring 100% of the shares of FERTICA and CEMPASA in trust to FINTRA by April 1, 1989, providing for management of the two companies by FINTRA at least until 40% of their shares are sold.

To exert its best efforts to complete the sale of 40% of the shares of CEMPASA by December 31, 1989.

To exert its best efforts to complete the sale of 40% of the shares of FERTICA by March 31, 1990.

-- To exert its best efforts to secure permanent financial resources for and advance a reorganization of the GOCR's export and foreign investment promotion operations, such that these operations are lodged in a single GOCR agency with the following characteristics:

i. Its operations will be responsive to foreign trade policy as established by the GOCR;

ii. It will not be subject to Servicio Civil or the Autoridad Presupuestaria;

iii. A majority of its governing body will be designated by private sector organizations.

ECONOMIC TRENDS AND PROBLEMS: FEBRUARY 1989
Economic Analysis Office: 2-24-89

1. The Economic Crisis (1980-1982)

The economic crisis that Costa Rica experienced in the early 1980s had adverse implications for income growth and for the service of external debt obligations. Gross Domestic Product (GDP) declined by 2.3 % and 7.3 % respectively in 1981 and 1982. High inflation in 1981 and 1982, fueled by strong exchange rate depreciation and rapid growth of domestic credit, eroded purchasing power. Even as the economy began to recover in 1983, with GDP increasing at 2.9 %, per capita investment and consumption were 35 % and 79 % of their respective 1977 levels. Imports which had grown from $ 1.02 billion in 1977 to $ 1.52 billion in 1980 were reduced to $ 0.99 billion in 1983. The government had borrowed heavily from foreign commercial banks in the late 1970s to cover the increasing import bill and to forestall exchange rate devaluation. The Costa Rican experience prior to and during this period conforms to the usual case of an open economy in which the destabilizing growth of domestic credit increases imports and depletes foreign exchange reserves. With the exhaustion of foreign exchange reserves in 1981, the GOCR suspended payment of external debt service, and runaway currency depreciation served to reduce imports and domestic real income. In addition to the inability of Costa Rican policymakers to maintain a net inflow of capital, the balance of payments crisis of 1980-1982 was heightened by cyclical highs in prices of imported petroleum and interest rates and by erosion of incomes and, hence, exports in Central American markets. Placed in longer-term perspective, Costa Rica's severe economic crisis came after expansionary monetary/fiscal policies and excessive external borrowing had been used to provide for usual growth of consumption that could no be supported due to a declining growth of export volume. That is, the growth of exports earnings were constrained by a few commodities with world markets, i.e., coffee, bananas, beef, sugar, and manufactured goods sold in a protected, but depressed, Central American market.

In July 1982, shortly after coming to office, the Monge administration resumed partial payments on external debt service and initiated an economic stabilization program. A one-year IMF Standby was approved on December 20, 1982 which provided approximately $ 100 million (SDR 92.5 million). In addition, US ESF assistance amounted to $ 175.7 million in 1982-1983. The ESF and IMF resources closed the balance of payments gap, and by the end of 1983 the Government of Costa Rica had concluded commercial bank and Paris Club rescheduling agreements. Apart from increased supporting assistance, improvement in Costa Rica's balance of payments was also brought about through the reduction of real incomes and aggregate demand. In this regard, the nominal dollar values of imports (CIF) declined from $ 1,528 million in 1980 to $ 993 million in 1983 and exports (FOB) declined from $ 1,001 million in 1980 to $ 862 million in 1983, and, in real terms (as measured by national accounting estimates), import volume declined by about 30 percent from 1980 to 1983, and export volume increased slightly. Real wages declined by 25-30 % from 1980 to 1983 and open unemployment rose from 4.9 % of the labor force in 1979 to 9.4 % in 1982 and 9.0 % in 1983.

2. Economic Stabilization: Monge Administration (1982-1986)

Debt Negotiations. After the suspension of public sector debt service in August 1981, the Monge administration negotiated two successive rounds of B/P support packages. The first round was linked to the IMF Standby of December 20, 1982. In January 1983, the GOCR signed a debt rescheduling agreement with ten bilateral creditor countries under the aegis of the Paris Club.1/ In regard to commercial bank creditors, in April 1983 the GOCR signed a memorandum of understanding covering 95 % of principal in arrears and falling due in 1983 and 1984, which were rescheduled to a period beginning in 1987 and ending in 1991. In addition, the agreement provided a Revolving Credit Facility in favor of Costa Rica (of self-liquidating and diminishing character) composed of fifty percent of interest payable and due in 1983. These arrangements and the restructuring of suppliers' credits and dollar-denominated certificates of deposit (issued by the Central Bank) provided relief amounting to $ 941 million in 1983 and $ 154 million in 1984. In 1984 the GOCR initiated a second round of negotiations with external creditors.2/ A Standby arrangement with a period of 13 months and a value of SDR 54 million (about $ 55 million), approved by the IMF on March 13, 1985, was a key prior condition for the rescheduling of debt with external bilateral creditors, for a $ 75 million loan from foreign commercial bank creditors, and as prior action for an $ 80 million World Bank Structural Adjustment Loan (SAL I). In early 1985 the GOCR reached debt relief agreements with bilateral creditors (the ten creditor countries in the Paris Club) and with foreign commercial banks. The 1985 Paris Club agreement (April 22, 1985) rescheduled official credits contracted before July 1, 1982 and falling due from January 1, 1985 to March 31, 1986 (the consolidation period) or in arrears at December 31, 1984.3/ In January 1985, Costa Rica's foreign commercial bank creditors agreed to reschedule 100 % of maturities falling due to participating commercial banks in 1985 and 1986 and to the provision of $ 75 million in new credit. This heavily-conditioned agreement was finalized in May 1985.4/ Even though the 1985 B/P support package (debt relief, IMF Standby, and ESF) approximated $ 600 million, delays undermined compliance with the IMF program and also held Central Bank foreign exchange holdings to low levels in 1985.

Stabilization. The 1983 stabilization effort, which included strong measures to reduce the public sector deficit, obtained rapid recovery of price and exchange rate stability. By the end of 1983 the consumer and wholesale price indices were increasing at annual rates of only 10.7 % and 5.9 %, respectively, and the inter-bank and "free" market exchange rates that had existed at the outset of 1983 were unified by November 1983. The Monge administration also reduced the public sector financial deficit. Public sector finances improved strongly in 1983 and 1984 with a reduction of the total deficit from 14.6 % of GDP in 1982 to 6.6 % of GDP in 1984. The deficit of the nonfinancial public sector, which had increased from 6.7 % of GDP in 1977 to a high of 14.1 % of GDP in 1981, was reduced to 3.1 % of GDP in 1983 and to less than 2.0 % of GDP in 1984 and 1985. This reduction can be attributed, in large measure, to revenue generation policies, i.e., to higher prices for petroleum products and public utilities, to increased social security contributions, and to higher taxes. In regard to trade policy, in late 1983 an export incentive program was implemented which included exemption from income tax of profits generated by nontraditional exports to markets outside of Central America. After several small step devaluations in 1984, a minidevalution mode of exchange rate management was adopted in early 1985.

Growth. Recovery from the economic crisis during the Monge administration was uneven. After large absolute declines of GDP in 1981 (-2.3 %) and 1982 (-7.3 %), and the low growth of 1983 (2.9 %), real GDP grew by 8.0 % in 1984 and by 0.7 % in 1985. The strong growth of 1984 can be attributed to an upswing in agricultural production due to favorable climatic conditions and rising domestic demand fueled by the expansionary monetary, fiscal, and wage policies pursued in late 1983 and early 1984. Growth rates for sectors leading the 1984 recovery were as follows: agriculture (10.1 %), manufacturing (10.4 %), construction (23.6 %), and other services (6.2 %). In 1985 the decline in the rate of growth was due to more restrictive demand management and to weaker performance of the basic productive sectors. Notably, agricultural output declined by 5.5 % due to reduced coffee and banana production, and the growth rate for the manufacturing sector was also lower in 1985 (2.0 %)—due in part to a decline in exports to the Central American Common Market (CACM) region related to the trade debt problems afflicting the region. Nontraditional exports moved down from the $ 400 million registered in 1984 to $ 348 million in 1985 with strong decline in such exports to Central America.

3. Economic Adjustment: Arias Administration (1986-1990)

Economic Policies. The Arias administration generally continued the key economic policies of the Monge administration, including the following: the policy of minidevaluation to adjust the exchange rate in line with the differential in inflation rates with trading partners; a monetary policy which attempted to prevent inflation but was not so restrictive as to choke off economic growth; and a fiscal policy which aimed not only at a low financial deficit but also at facilitating a level of public sector expenditures that are nearly constant as a ratio of GDP with recourse to additional taxes as necessary. In addition, the tougher stance toward Central American trading partners and a willingness to have reduced trade instead of accumulating unpaid deficits, which had been adopted by the Central Bank in 1985, was also continued. However, some polices were changed, as in the following areas. The Government took a stronger stance toward external creditors demanding lower, concessional interest rates instead of accepting new credits to cover the contractual interest payments. In agricultural policy, heavy subsidies to domestic rice producers were curtailed and the tax on banana exports was reduced in order to increase production and exports. In addition, there also appears to have been less rigidity in the governmental management of price controls and wage adjustments.

Economic Growth. The Costa Rican economy moved strongly upward with increases in GDP of 5.5 % in 1986 and 5.1 % in 1987. This growth was propelled by a 15.6 % increase in export earnings in 1986 followed by a 3.1 % increase in 1987; see Table VI. Coffee export earnings were an important factor in this growth; such earnings increased from $ 267 million in 1984 to $ 392 million in 1986, mainly from higher world market prices, with a decline to $ 335 million in 1987. However, total export earnings did not decline with coffee earnings in 1987 due to the continued growth of nontraditional exports--which increased by $ 84 million in 1987. By 1986 the earnings of nontraditional exports had recovered to the 1984 level due to the strong growth of such exports to markets outside of Central America. In 1986 and 1987 the real income of Costa Ricans increased as a function of higher prices for coffee exports, lower prices for imported petroleum, and of an increased volume of nontraditional exports. As an example, Gross Domestic Expenditure, i.e., the sum of Total Consumption and Gross Domestic Investment, increased by 14.7 % in the two-year period 1986-1987 and allowed simultaneous increases in consumption and investment; see Table II. Consumption increased by 13.3 % in this period and Gross Domestic Investment increased by 19.2 %. In 1986 and 1987 arrears on external debt service were allowed to grow as part of a negotiation strategy aimed at obtaining new debt relief arrangements with foreign commercial banks and governments. The growth of payment arrears also compensated for the lack of debt relief and net inflows from the IMF, foreign commercial banks, and the Paris Club.

Monetary/Fiscal Policy. In 1986 monetary management moved to replace bank-specific credit limits with more orthodox indirect instruments, i.e., open market operations, changes in reserve requirements, and changes in rediscount rates. In the first half of 1987 reserve requirements were raised to compensate for a lowering of the mandatory local currency deposits for importers. However, the increase in reserve requirements was less effective than expected, thereby permitting strong credit expansion in 1987. Later in the year, several unregulated private finance companies failed, inhibiting monetary authorities from taking stronger restrictive action. Thus, in 1987 net domestic credit increased by 25.4 % and credit to the private sector increased by 24.4 % as compared with rates of growth below 20 % for these variables in 1984, 1985, and 1986. (The public sector deficit was not a cause of this expansion; banking system credit to the nonfinancial public sector declined by 2.2 % in 1987.) The increased pace of credit expansion in 1987 as well as the reduction of import taxes on some motor vehicles brought a 19.7 % increase in commodity imports in 1987. Turning to fiscal performance, 1987 brought improvement. The central administration was able to hold expenditure growth to 8.8 % against a 17.3 % increase in revenues (which also increased partly due to higher imports). A tax package to raise about 4 billion colones in revenues was the subject of debate in the Legislative Assembly from February until passage in November 1987.

4. 1988 Economic Performance

Production, Consumption, and Investment. In 1988 Costa Rica's Gross Domestic Product (GDP) grew at a rate officially estimated at 3.4 %. Several local economists believe that 1988 GDP growth was on the order of 4.0 % and that the official national accounts are not reflecting adequately the strong increase in nontraditional exports. A rate of growth on the order of 3.4 % to 4.0 % is relatively high compared with Costa Rica's GDP growth in the early 1980s, but lower than the 5.5 % and 5.1 % growth rates registered in 1986 and 1987. In regard to the basic productive sectors of the economy, the estimated rates of growth for 1988 are 3.9 % for agriculture, 3.5 % for manufacturing, and 4.2 % for construction; see Table I. However, the sub-sectors of agriculture and manufacturing linked to nontraditional exports to markets outside of Central America undoubtedly had substantially higher rates of growth than the sectoral averages, which are closer to the rate of increase in domestic consumption. National accounting data also indicate changes in the volume of production, consumption, investment, imports, and exports; see II. According to these estimates, the physical volume of exports of goods and services increased by 4.0 % in 1988 while the physical volume of imports increased by 3.7 % in 1987. Turning to consumption and investment, global absorption, or Gross Domestic Expenditure, grew by 3.4 % in 1988. Consumption grew by 5.2 % mainly as related to a 5.9 % growth of Private Consumption. Gross Fixed Investment increased by 1.8 %, but Gross Domestic Investment declined by 2.7 % in 1988 due mainly to lower inventory accumulation.

Balance of Payments--Current Account. Costa Rica's 1988 balance of payments current account deficit is estimated at $ -243 million, which is substantially lower than the $ -384 million deficit of 1987; see Table V. In 1988 total exports (FOB) reached $ 1,226 million while imports (CIF) were $ 1,410 million. In 1988 imports were only about $ 20 million (1.3 %) higher than in 1987, but 1988 export earnings (including the value added of drawback exports) were 10.2 % higher than in 1987; see Table VI. The value of traditional exports (coffee, bananas, sugar, and beef) increased by only 1.3 % in 1988 with coffee earnings up $ 9 million and banana exports up $ 8 million. Nontraditional exports (including the value-added of drawback exports moved up from $ 517.6 million in 1987 to $ 626.6 million in 1988, i.e., an increase of 21.1 %. Within this category, the preliminary estimate for nontraditional exports to markets outside of Central America indicates that such exports increased by $ 125 million in 1988 to $ 436 million—an increase of about 35 % in 1988 and an increase of 148 % from the 1985 level. Net tourism receipts (see net travel in Table V) increased by $ 41 million in 1988—an increase of 61 %.

Inflation. The December 1987 to December 1988 consumer price index registered an increase of 25.3 % as compared with 16.4 % for one year earlier. The rate of increase in the wholesale price index also accelerated to a rate of 19.6 % for December 1988 as compared with a rate of 10.9 % for December 1987. Possible causal factors explaining the accelerating inflation include disturbance of expectations linked to the 6 % step devaluation of January 1988, monetization of the increase in foreign exchange reserves, continued expansion of nontraditional exports and the bidding of resources to this dynamic sector, a relatively liberal wage adjustment policy, and the exceptional impact of bad weather in creating shortages in the second half of 1988.

Real Wages and Employment. In 1988 two wage increases were approved for private sector employees, one in January and a second in July. According to payroll data (for workers subject to social security, health and pension benefits) real wages declined by 2.4 % for public sector employees and by 2.5 % for private sector employees. However, these calculations do not include the impact of the wage increase made in November. In regard to employment, preliminary data indicate strong growth of employment in 1988 and an apparent growth rate of 7.0 % from July 1987 to July 1988. However, we judge that these statistics are not fully comparable. Employment surveys also indicate continuation of a low (5.6 %) rate of open unemployment.

Public Sector Finances. The deficit of the public sector increased from 3.2 % of GDP to 3.5 % of GDP due to a strong increase in Central Bank net operating losses (from 2.9 % of GDP to 3.5 % of GDP). The plan for 1988 public sector financial operations projected an over-all public sector deficit at 3.0 % of GDP. In this plan Central Bank losses would approximate 3.8 % of GDP, but this would be offset by a surplus of the nonfinancial public sector amounting to 0.8 % of GDP. In regard to realization, an improvment in the situation of the nonfinancial public sector took place in 1988 but amounted to about 0.3 % of GDP, thereby bringing its surplus to less than 0.1 % of GDP. This improvement was less than was needed to hold the line on public sector deficit, which increased from 3.2 % of GDP in 1987 to 3.5 % of GDP in 1988. In regard to performance of the central administration, revenues increased by 20.4 % in 1988 and expenditures increased by 21.4 %. The deficit of the central administration increased from 5.7 billion colones ($ 81.9 million) in 1987 to 7.4 billion colones ($ 92.6 million) in 1988. The surplus of the rest of general government (the Costa Rica social security institute and decentralized agencies) declined by approximately 0.1 billion colones to 3.5 billion colones in 1988. The state enterprise sector increased its surplus from 1.3 billion colones in 1987 to 4.1 billion colones in 1988. The over-all result for the nonfinancial public sector was a 138 million colon surplus ($ 1.7 million). Central Bank losses amounted to 12.3 billion colones ($ 153.2 million).

Monetary Performance. The Central Bank was not successful in reducing inflation in 1988 even though this was one of the main goals of the monetary program. Monetary explanations for the acceleration of inflation in 1988 include the following: (a) the easing of monetary policy in late 1987 and early 1988 in order to stop the runs on and failure of private financial entities; (b) the lagged effect of a sharp expansion of credit in 1987 into 1988; and (c) the strong expansion of Costa Rica's international reserves in 1988, particularly in the second half of the year and the related increase in the stock of domestic money.

Non-monetary variables may also explain a portion of the higher rate of inflation in 1988. Strong inflationary expectations were generated by the 6 % step devaluation of January 1988. In addition, a wage policy can be considered as feeding inflation inasmuch as wage increases aimed to compensate fully for past inflation. Turning to monetary data (see Table IV), credit to the private sector expanded in 1988 by 11.2 % in nominal terms, almost in line with the 10 % targeted in the monetary program at the outset of the year. However, banking system net credit to the nonfinancial public sector increased by 6.8 %, in contrast with a planned 3 % decline. In total, net domestic assets of the banking system, exclusive of counterpart arrears, expanded by 16.8 % in nominal terms. In regard to banking system liabilities to the private sector, money (i.e., currency in circulation and demand deposits in commercial banks) expanded by 20.0 % (i.e., about 7 percentage points higher than projected) and quasi-money rose by 37.5 % in nominal terms (quasi-money includes stabilization bonds and dollar denominated deposits). Dollar-denominated deposits rose by 26 % (i.e., by about $ 99 million). Placements of stabilization bonds also increased by 52 % due mainly to swaps of "Presa" CDs and conversion of external debt.

Credit Policy. In 1988 the Central Bank continued its policy of allowing commercial banks and finance companies to freely set their interest rates on both deposits an loans with the provision that the spread between the highest and lowest rate on loans not exceed 9 percentage points. Apart from subsidized credit, which was limited to less than 16 % of total credit to the private sector, interest rates on loans were positive in real terms. However, as a result of rising inflation and of idle liquid balances in state-owned banks, interest rates on term deposits in state-owned banks declined in real terms during the second half and were only slightly positive in the last quarter. In general, in 1988 the Central Bank backed off from the liberalization program initiated in 1983. By 1987, the Central Bank had moved to an indirect control of credit, relying upon more active use of conventional monetary policy instruments, e.g. changes in reserve requirements on deposits in banks, and open market operations (sales/purchases of Central Bank stabilization bonds). In addition, credit ceilings by banks and credit allocation categories were completely eliminated. However, in 1987 credit expanded faster than projected and certain groups of producers, notably cattlemen and basic grain farmers, complained about not receiving sufficient credit from the banking system. As a result of these pressures, in 1988 overall credit ceilings by banks were reinstated and a limit was set on the amount of credit that banks could extend to "other activities", i.e., commerce, services, electricity, transportation and consumer credit.

B/P—Capital Account and Reserves. The deficit on the basic balance of Costa Rica's external payments, which is the sum of the current account balance plus autonomous capital inflows (private capital, official amortization, and disbursements of project loans), amounted to $ -443 million in 1988 as compared with $ -642 million in 1987. The major sources of finance for the basic balance deficit were a $ 378 million increase in external payment arrears, $ 36 million of debt relief, and a net B/P support inflow of $ 110 million; see Table V. The over-all balance for 1988, per Table V, is a $ 80 million surplus. At year-end 1988, Central Bank holdings of freely-disposable foreign exchange assets amounted to $ 254 million--an increase of $ 140 million in 1988. The increase in Central Bank foreign exchange assets in 1988 exceeded the B/P surplus due to the growth of foreign exchange deposits in commercial banks in Costa Rica--which increased by $ 93.8 million during the year. The Central Bank has a 100 % reserve requirement on these deposits (i.e., these deposits are Central Bank liabilities). The IMF adjusts the presentation of Central Bank official FX reserves to eliminate the increase in these deposits from year-end 1986 in order to recognize the uncertainty concerning these deposits and their potential for withdrawl on short notice. Table VII includes this adjustment.

Debt Arrears and Settlement Prospects. As is indicated in Table VII, Costa Rica's official reserve position has increased rapidly as a negative number during the past three years due to a strong increase payment arrears on external debt. These arrears increased from about $ 180 million at year-end 1986 to $ 561 million at year-end 1987 and to $ 933 million at year-end 1988. As is shown in Table VIII, the largest share of these payment arrears are to foreign commercial banks (about $ 606 million) and foreign governments (about $ 206 million). As is indicated in Table V, the IMF/Central Bank have separated arrears into two categories: refinancible and nonrefinancible. Refinancible arrears include all of the principal owed to commercial bank creditors and a sizeable portion of the arrearages to foreign governments inasmuch as most of these arrears would undoubtedly be rescheduled in any formal debt rescheduling agreement. At year-end 1988, the nonrefinancible arrears amounted to $ 325 million. Within this category, overdue interest to commercial bank creditors amounted to $ 248 million. In 1987, in the case of Costa Rica, the IMF departed from previous practice of requiring settlement with external bank creditors as a condition for a Standby, but required good faith payment of a portion of the interest to commercial bank creditors, i.e., $ 5 million per month when full payment would have been about $ 12 million per month. Various settlement proposals have been considered by the GOCR and its commercial bank creditors as follows: (a) a plan built around below market interest rates which did not prosper due to lack of favorable tax treament for creditors; and (b) a plan for a two-stage operation involving a voluntary buy-back of debt financed by grants and concessional credits from friendly governments followed by a menu of options to the remaining bank creditors.

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5. Outlook for 1989

A 1989 Program. Elements of a macroeconomic and financial program for 1989 are emerging. At present the prospects for an IMF Standby to begin in the second quarter of 1989 (after termination of the existing program) are uncertain. The fundamental objectives of an economic program for 1989 would be to continue the export-led growth strategy that has already shown good objective results and has improved Costa Rica's balance of payments. Reduction of the rate of inflation and containment of the public sector deficit are also important objectives for 1989. Obviously an IMF program entails specification of quarterly quantitative ceilings on certain key test variables, e.g. domestic banking system credit to the non-financial public sector, net domestic assets and the net international reserve position of the Central Bank, and the stock of payment arrears. The key policy instruments for any program are the exchange rate, interest rates, and fiscal operations. An acceptable economic program for 1989 would, in our view, contain the following: (a) an understanding regarding management of the exchange rate in order to prevent erosion of export competitiveness; (b) an understanding concerning the expansion of banking system credit aimed at reducing the rate of inflation along with a tight restriction on the use of banking system credit by the nonfinancial public sector and a limit on the growth of expenditures of the central administration; and (c) an agreement to maintain positive real interest rates along with a limit on the volume of subsidized credit and a covenant to maintain a flexible interest rate policy so as to encourage the holding of domestic monetary instruments.

Projected Balance of Payments. The projected balance of payments for 1989, presented in Table V, was prepared by the Central Bank and IMF in early December 1988. In 1989 exports (FOB) are projected to grow by 10.7 % in nominal US dollars and imports (CIF) are projected to grow by 8.8 %. Nonfactor service income, transfers, and the net ouflow on investment income are expected to change only slightly from the 1988 levels. These assumptions generate a current account balance deficit of $ -253 million, which is about $ 10 million (i.e., more negative) higher than in 1988. The projected net basic balance deficit for 1989 is $ -474 million, which is $ -31 million higher than in 1988. As is indicated in Table V, an increase of refinancible arrears amounting to $ 276 million is assumed for 1989 with no increase in nonrefinancible arrears. Of course, this inflow could also take place as debt relief (see Table V) if a rescheduling agreement were accomplished. The projection for 1989 includes exceptional B/P assistance in the form of $ 85 million of U.S. Economic Support Funds and $ 70 million in disbursement from the second Structural Adjustment Loan. Conforming to the assumptions noted above, the over-all balance of payments deficit is $ 43 million. This gap does not include provision for an increase in Central Bank (official) FX reserves. Central Bank/IMF projection states the gap as $ 94 million because a target increase of $ 51 million in official reserves is also assumed. Coverage of this gap would have to come as an increase in nonrefinancible arrears or, in the event of settlement with commercial bank creditors with a "buy-back," as debt relief arising from a lower interest charge on this debt.

The 1989 Monetary/Credit Program. A restrictive credit program for the private sector, consistent with other measures designed to reduce inflation, was approved by the Central Bank in late December 1988. According to this program the expansion of credit funded from domestic resources will be limited to 5 % over the oustanding balance of such credit as of November 30, 1988 (this limit applies to each of the state-owned and private banks individually). Credit funded from external resources is not subject to a specific limit, however, overall credit expansion should not exceed 13 %. In addition, a 10 % limit was also set on credit extended by private finance companies. In regard to the allocation of credit, commercial banks and finance companies are required to observe during 1989 the same portfolio composition outstanding as of end November 1988 as regards preferential activities (i.e., agriculture, livestock, manufacturing, contruction, housing and tourism) and other activities (i.e., commerce, services, transportation, electricity generation and consumer credit). Net credit to the public sector is projected to decline by 3.0 % and net domestic credit (to public and private sectors) is projected to expand by 6.3 %. The Central Bank projects that the stock of money (M1) will increase by 17 % in 1989 and that quasi-money will increase by 18 %.

Reduction of Inflation. The reduction of inflation from 25.3 % in 1988 to 12 % in 1989 is now one of the main goals of the GOCR. To this end, the GOCR announced recently the following measures: (a) implementation of a restrictive credit program; (b) reduction of losses of the CNP and ICE (0.6 billion colones and 4 billion colones, respectively) by means of increases in the price of wheat and in electricity rates; (c) expenditure cuts in public sector entities amounting to 4 billion colones; (d) a slow down in the pace of minidevaluations; (e) price controls (unspecified); (f) support to the agricultural sector (aimed at eliminating shortages of farm products) ; (g) support for the SAL II program; and (h) a national agreement to fight against inflation.

Exchange rate policy. The Central Bank has announced that a strong step devaluation such as that of January of 1988 will not be made during 1989. The system of minidevaluations of the colon to compensate for differences in inflation rates between Costa Rica and its main trading partners will continue during 1989. As of December 1988, the IMF calculation of the index number for the real effective exchange rate (based upon a trade-weighted index of 1980 with real depreciation as a number over 100) was 137.8 as compared with 138.7 for December 1987 and a high of 141.0 for May 1988. In January, only two devaluations (of 0.15 colones each) were undertaken. We expect that the pace and amount of the minidevaluations will be held down in the first four months of 1989 in order to dampen inflationary expectations. The Central Bank has followed a crawling peg, or minidevaluation, program since January 1985. In 1985 there were 21 minidevaluations with a 12.4 % increase in the exchange rate; in 1986 there were 17 minidevaluations with a 9.8 % increase in the exchange rate; in 1987 there were 25 mini-devaluations with a 17.7 % increase in the exchange rate; and in 1988 there were 20 minidevaluations with a 14.7 % increase in the exchange rate.

Public Sector Finances. The public sector financial program is presently the object of discussion between the IMF and the GOCR, and a definitive projection is not yet available. Initial projections of the public sector deficit for 1989 indicated a deficit equivalent to 5.2 % of GDP. Current information indicates that the government has firm plans for expenditure cuts/revenue enhancement approximating 7.85 billion colones and that with these actions the projected over-all public sector deficit for 1989 would approximate 3.4 % of GDP. In regard to composition, projected Central Bank losses amount to 2.8 % of GDP and the deficit of the nonfinancial public sector amounts to 0.6 % of GDP. Each 1.0 % of GDP approximates 4.4 billion colones. Thus, a reduction of the deficit to 3.0 % of GDP, which would be only a slight improvement as compared with the 3.2 % deficit of 1987, would require additional expenditure cuts and revenue enhancement of 1.8 billion colones. The principal difficulty in the area of revenue enhancement is the official pledge not to increase taxes (at least via Legislative Assembly action) during the remainder of the Arias administration.

Economic Growth. The Central Bank expects (per its projection of early January) that GDP will grow by 3.6 % in 1989. Even with relatively restrictive monetary and fiscal policies in 1989, success in the program to reduce inflation will tend to increase real income in 1989, lifting real demand, GDP, and imports. Therefore, we expect that 1989 economic growth will be 4 % as a minimum. (In addition, in recent years, the tendency in the preparation of official national accounting estimates and projections has been toward initial understatement of GDP and sectoral growth rates with subsequent revisions toward higher growth rates.) Turning to the supply side, the obvious dynamic element in Costa Rica's current economic growth is nontraditional exports and they are likely to continue expanding in 1989. Even though detailed data on particular supply and market constraints are not available, businessmen report that the labor constraint is now important. However, we doubt that this constraint will choke off the growth of the nontraditional and drawback exports in 1989.

TABLE I : SELECTED ECONOMIC INDICATORS, 1985-1989

	1985	1986	1987	1988(A)	1989(B)
GDP in Current Prices (C)	197,920	245,958	285,145	350,244	406,395
GDP in U.S. Dollar Equivalent (D)	3,922	4,388	4,541	4,608	4,809
GDP in Constant Prices 1977=100	114	120	126	131	135
GDP Per Capita in Constant Prices, 1977=100 (E)	92	94	97	97	98
Growth of GDP in Constant Prices (Percent Change)					
Gross Domestic Product	0.7	5.5	5.1	3.4	3.6
Basic Productive Sectors	-1.0	5.8	4.3	3.7	3.7
-Agriculture	-5.5	4.8	4.0	3.9	2.9
-Manufacturing	2.0	7.2	5.5	3.5	3.9
-Construction	5.6	3.1	-0.3	4.2	6.6
Government	0.5	2.0	2.5	2.0	2.5
Other Sectors	2.6	5.9	6.5	3.4	3.7
Prices (Percent Change)					
GDP Deflator (Annual Average)	20.5	17.8	10.3	18.8	12.0
Consumer Prices (Dec. to Dec.)	10.9	15.4	16.4	25.3	N/A
Wholesale Prices (Dec. to Dec.)	7.6	11.9	10.9	19.6	N/A
Unemployment (Percent) (F)	6.8	6.1	5.6	5.6	N/A
Employed Labor Force (Thousands)(F)	826.7	854.2	923.3	987.6	N/A
Real Average Wages (1977=100)					
From DGES/MinLab. Employ. Survey(F)	100	102	122	N/A	N/A
-Public Sector	88	88	109	N/A	N/A
-Private Sector	107	111	132	N/A	N/A
From Payroll reports to Soc.Sec.(G)	101	105	106	103	N/A
-Public Sector	86	88	89	87	N/A
-Private Sector	112	117	118	114	N/A
Exchange Rate (Colons per U.S.$) (Selling Price, Dec. 31)					
Official Market (H)	20.50	20.50	20.50	20.50	N/A
Banking or Unified Market	53.95	59.25	69.75	80.00	N/A

Notes:

(A) Preliminary. (B) Projected data. (C) Millions of Colones.

(D) Millions of U.S. Dollars.

(E) Per Capita GDP was calculated based upon the population series from the Central Bank (official) National Accounts 1977-1986. For 1987, 1988 and 1989 a 2.67 % growth rate was used to project population.

(F) July of each year. In 1987 the survey methodology was changed, therefore, data are not fully comparable.

(G) Average of March, July and November; except 1988, inasmuch as data for November are not available.

(H) A constitutional requirement; not used for any transactions.

TABLE II : PERFORMANCE OF GROSS DOMESTIC PRODUCT, 1984-1989

	1984	1985	1986	1987	1988 (Prelim.)	1989 (Proj.)
A. As Percent of 1977 Real Value						
Gross Domestic Product	113.1	113.9	120.2	126.4	130.7	135.4
Imports of Goods & Services	82.6	87.5	102.9	117.5	121.9	121.9
Exports of Goods & Services	125.3	120.3	124.6	146.1	152.0	166.1
Gross Domestic Expenditures	96.7	101.1	111.7	116.0	119.9	119.6
Consumption	102.5	106.4	116.4	120.6	126.9	129.4
Private Consumption	102.0	106.4	117.8	122.6	129.8	132.5
Public Consumption	105.1	106.2	109.2	110.6	112.3	114.0
Gross Domestic Investment	79.8	86.0	98.0	102.5	99.7	91.0
Per Capita Basis:						
Gross Domestic Product	93.7	91.8	94.3	96.6	97.2	98.9
Total Consumption	84.9	85.7	91.4	92.2	94.5	93.8
Private Consumption	84.4	85.8	92.5	93.7	96.6	96.0
Gross Domestic Investment	66.0	69.3	76.9	78.4	74.2	65.9

B. Aggregates and Sectors as Percentage of Gross Domestic Product in 1986-1987

Gross Domestic Product	100.0	Agriculture	19.0
Net Foreign Balance	0.9	Manufacturing	22.3
Imports of Goods & Services	38.8	Construction	4.3
Exports of Goods & Services	39.7	Basic Productive Sectors	45.6
Gross Domestic Expenditure	99.1	Commerce	17.5
Total Consumption	76.8	Transportation	7.6
Private Consumption	65.1	Financial Services	5.9
Public Consumption	11.7	Housing	7.0
Gross Domestic Investment	22.4	Personal Services	4.1
Gross Fixed Investment	20.1	Electricity	3.0
Change in Inventories	2.3	Other Service Sectors	45.1
		Government	9.3
		Total: Gross Domestic Product	**100.0**

Source: Central Bank of Costa Rica.

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

	1985	1986	1987	1988(A)
Central Administration	-3,941	-8,248	-5,713	-7,405
Revenue	32,005	38,029	44,642	53,750
Expenditure	35,946	46,277	50,356	61.155
Current	(30,144)	(36,859)	(43,629)	(52,650)
Capital and net lending	(5,802)	(9,418)	(6,727)	(8,505)
Rest of General Government	2,704	3,534	3,549	3,454
Revenue	19,336	24,774	29,625	37,082
Current	(18,765)	(24,291)	(29,303)	(36,668)
Capital	(571)	(483)	(322)	(414)
Expenditure	16,632	21,240	26,077	33,629
Current	(14,535)	(18,783)	(22,950)	(29,323)
Capital and net lending	(2,097)	(2,457)	(3,126)	(4,306)
State Enterprises	-2,479	642	1,327	4,089
Revenue	36,950	43,269	48,269	59,816
Current	(36,659)	(41,621)	(47,362)	(58,799)
Capital	(291)	(1,648)	(907)	(1,017)
Expenditure	39,429	42,627	46,942	55,727
Current	(35,065)	(37,358)	(41,484)	(50,100)
Capital and net lending	(4,364)	(5,269)	(5,459)	(5,627)
Public Sector Current Account Deficit (-)	7,685	10,941	13,244	17,144
General Government	6,091	6,678	7,366	8,445
State Enterprises	1,594	4,263	5,878	8,700
Nonfinancial Public Sector Overall Deficit (-)	-3,716	-4,072	-838	138
Statistical Discrepancy (E)			1,766	
Deficit Financing	3,715	4,069	-927	-138
External net	699	-2,066	1,868	3,347
Domestic	-1,055	-70	-2,796	-3,485
Banking System	(505)	(-1.123)	(-2,654)	(1,562)
Other	(-1,560)	(1,053)	(-142)	(-5,047)
Change in external arrears	**-3,096**	**2,845**	**N/A**	**N/A**
Rescheduling	**7,167**	**3,360**	**N/A**	**N/A**
(As Percent of GDP)				
Central Administration				
Deficit	**-2.0**	**-3.4**	**-2.0**	**-2.1**
Revenue	**16.6**	**15.7**	**15.7**	**15.3**
Expenditure	**-18.7**	**-19.1**	**-17.7**	**-17.4**
Rest of General Government Deficit (-)	**1.4**	**1.5**	**1.2**	**1.0**
State Enterprises deficit (-)	**-1.3**	**0.3**	**0.5**	**1.2**
Nonfinancial Public Sector Overall Deficit (-)	**-1.9**	**-1.7**	**-0.3**	**0.04**
Central Bank Net Operating Losses(D)	**-5.3**	**-3.8**	**-2.9**	**-3.5**
Total Public Sector Deficit (-)	**-7.2**	**-5.5**	**-3.2**	**-3.5**

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TABLE III (CONTINUED)

Source: 1985-1986, Central Bank of Costa Rica and IMF; 1987-1988
Ministry of Finance and IMF

Notes:

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

(A) IMF and Ministry of Finance projection.

(B) Statistical discrepancy between budget liquidations and deficit financing.

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

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

	1985	1986	1986	1987	1987	1988(A)
Exchange rates used for conversion of FX to Colons:	(56.50/US$)		(63.00/US$)		(76.00/US$)	
Central Bank						
Net International Reserves	-3747	-8202	-9147	-19530	-41200	-54356
Official Reserves	-1154	1979	2206	-2627	1398	16552
Payments Arrears	-2593	-10181	-11353	-16903	-42598(H)	-70908(H
Net Domestic Assets	17003	25509	26454	39000	60669	79090
Net Credit to Public Sector(C)	34244	44712	48056	41563	43521	39456
Net Credit to Banks	-12443	-11106	-12070	-6190	-14697	-26592
Government Trust Funds	-10985	-18263	-18263	-15676	-15676	-18084
Stabilization Bonds	-4900	-5079	-5079	-7885	-7495	-11422
Long-term Foreign Liabilities	-93983	-102979	-114826	-112867	-125111	-125967
Counterpart Arrears	2593	10165	11353	16903	42203	70893
Other Accounts Net	102477	108059	117283	123152	137924	150806
Currency Issue	13256	17307	17307	19470	19470	24734
Banking System						
Net International Reserves(B)	-1504	-4761	-5310	-15340	-36159	-48002
Net Domestic Assets	73223	92419	93375	119726	144402	189786
Net Credit to Public Sector(C)	26161	35690	38956	31992	36777	39385
-Adjusted Net Credit (D)	26161	25038	38956	38084	38043	40625
-Central Government	11897	13240	18956	21265	21230	28787
-Rest of Public Sector	14264	11798	20000	16819	16813	11839
Credit to Private Sector	38183	44824	42855	53301	54644	60746
Long-Term Foreign Liabilities	-98181	-104209	-116197	-114314	-126883	-127958
Other Accounts Net (E)	107060	116114	127761	148747	179864	217613
Liabilities to Private Sector	71719	87658	88065	104386	108243	141784
Money	28970	39901	39901	40467	40225	48229
Quasi-money	42749	47757	48164	63919	68019	93554

Source: 1985-1986 and 1986-1987 Central Bank and IMF; 1987-1988 Central Bank

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TABLE IV (CONTINUED)

Percentage Change (F)

Banking System	1985	1986	1987	1988
Net Domestic Assets (G)	10.3	16.5	25.4	16.8
Net Credit to Public Sector (D)	0.8	-4.3	-2.2	6.8
Credit to Private Sector	16.1	17.4	24.4	11.2
Liabilities to Private Sector	12.9	22.2	18.5	31.0
- Money	12.7	37.7	1.4	20.0
- Quasi-Money	13.1	11.7	32.7	37.5

Notes:

(A) Central Bank estimate.

(B) Includes external payments arrears

(C) The definition of net credit to the public sector conforms to Central Bank monetary accounts. Debt assumed by the Central Bank on behalf of the public sector related to the rescheduling of external debt is included. This reflects only an accounting entry in which the increase in Central Bank external liabilities is offset by an equivalent increase in Central Bank credit to the nonfinancial public sector.

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

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

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

(G) Excludes counterpart of external payments arrears.

(H) In the 1987-1988 columns all arrears (both refinanciable and nonrefinanciable) are included.

TABLE V : BALANCE OF PAYMENTS: COSTA RICA 1984-1989
(millions of U.S. dollars)

	1984	1985	1986	1987	1988	1989
Balance of Trade	-104.7	-172.0	-77.4	-285.2	-184.1	-195.0
—Commodity Exports, FOB	997.5	939.0	1,085.8	1,107.0	1,225.9	1,339.0
--Commodity Imports, CIF	-1,102.2	-1,110.9	-1,163.2	-1,392.2	-1,410.0	-1,534.0
Nonfactor Services	122.5	105.5	136.6	122.8	173.2	180.0
--Freight,Insurance, net	10.4	10.2	10.6	11.7	13.8	n.a.
—Travel, net	66.1	64.3	71.4	67.6	108.5	n.a.
--Transportation, net	21.5	1.1	6.9	6.1	12.2	n.a.
--Other Services, net	24.5	29.9	47.7	36.8	38.7	n.a.
Investment Income, net	-313.6	-282.2	-280.7	-297.1	-320.1	-320.0
—Private Profit, Interest	0.4	-1.9	1.0	-12.4	-13.2	-13.0
--Official Interest	-314.0	-280.3	-281.7	-284.7	-306.9	-307.0
(Unpaid: memo.)	(-105.3)	(-35.3)	(-97.8)	(-182.0)	(-153.1)	—
Unrequited Transfers	45.9	58.8	69.4	75.9	87.6	82.0
--Official Sector, net	14.0	16.2	34.7	37.2	36.1	—
--Private Sector, net	31.9	42.6	34.7	38.7	41.5	—
Current Account Balance	-249.9	-289.9	-152.1	-384.2	-243.4	-253.0
(Autonomous Capital Flows)						
Private Capital & E&O	11.9	98.7	49.3	112.8	140.0	87.0
Official Amortization	-339.0	-357.6	-379.6	-453.6	-437.3	-409.0
(Unpaid: memo.)	(-229.4)	(-283.5)	(-212.0)	(-291.1)	(-339.8)	
Project loans	165.8	185.3	135.7	83.3	97.7	101.0
Basic Balance (C)	-411.2	-363.5	-346.7	-641.7	-443.0	-474.0
Reduction (-) or increase (+) of Arrears (D)	(175.3)	(-169.5)	(135.7)	(402.1)	(377.5)	(276.0
—Nonrefinancible (E)	175.3	-169.5	135.7	105.5	49.7	—
—Refinancible	—	—	—	296.6	327.8	276.0
Debt Relief	**(153.7)**	**(357.8)**	**(145.9)**	**(42.9)**	**(36.0)**	**—**
—Resch. Current Oblig	**153.7**	**300.8**	**133.0**	**21.8**	**—**	
—Resch. of Arrears	**—**	**57.0**	**12.9**	**21.1**	**36.0**	
Financial Gap (- sign)(F)	**-82.2**	**-175.2**	**-65.1**	**-196.7**	**-29.5**	-198.0
(B/P Support Inflows)	**(145.9)**	**(305.0)**	**(84.1)**	**(57.8)**	**(109.9)**	**(155.0**
—ESF Loans & Grants	**130.0**	**160.0**	**80.6**	**120.0**	**125.0**	**85.0**
—Revolver Credit Facility	**49.9**	**75.0**	**—**	**—**	**—**	**—**
--IMF Net Inflow	-34.0	30.0	-36.0	-62.2	-15.1	n.a.
—IBRD Struc. Adjust. Loans	—	40.0	39.5	—	—	70.0
Over-all balance (G)	63.7	129.8	19.0	-138.9	80.4	-43.0

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TABLE V (Continued)

Source: Central Bank of Costa Rica and IMF.

Notes:

(A) Preliminary.

(B) Projected.

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

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

(E) The estimate shown for each year corresponds to the net change in payment arrears. The concept of nonrefinancible versus refinancible debt service rests upon what can normally be expected to refinanced in negotiations with external creditors, e.g., the nonrefinancible arrears include unpaid debt service to external multilateral creditors, and interest to commercial bank creditors. For 1988, the estimate of a \$ 49.7 million increase in nonrefinancible arrears includes the following: (a) an increase of \$ 130.1 million in unpaid interest obligations due in 1988, (b) an increase of \$ 45.9 million in unpaid amortization due in 1988, (c) the payment of \$ 45.7 million in interest unpaid in previous years, (d) the payment of \$ 41.0 million in amortization unpaid in previous years, and (e) an adjustment with a negative sign of \$ 3.6 million to account for the last two months of 1988.

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

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

TABLE VI: EXPORTS BY PRINCIPAL PRODUCTS, 1984-19[illegible]
(Value in millions of U.S. dollars,
volume in thousands of units indicated,
unit value in U.S. dollars)

	1984	1985	1986	1987	1988(A)	1989(B)
Traditional Exports	597.3	591.0	689.6	640.7	649.3	699.2
Coffee	267.3	315.8	391.9	334.5	343.2	371.0
--Volume (quintals, 100 lb.)	2457	2683	2053	3004	2776	2920
--Unit value (per quintal)	108.8	117.7	190.9	111.3	123.6	127.1
Bananas	251.0	208.0	216.8	228.6	237.0	242.0
--Volume (metric tons)	1020	851	941	986	1000	1040
--Unit value (per ton)	246.1	244.4	230.4	231.9	237.0	232.3
Beef	43.5	53.7	69.8	62.5	58.1	68.4
--Volume (metric tons)	20.5	27.2	35.2	27.3	24.0	30.4
--Unit value (per metric ton)	2123	1974	1980	2290	2400	2250
Sugar	35.3	13.5	11.1	15.1	11.0	17.8
--Volume (quintals, 100 lb.)	2231	968	1660	1644	1040	1413
--Unit value (per quintal)	15.9	14.0	6.7	9.2	10.6	12.6
Nontraditional exports	400.2	348.0	396.2	473.4	576.6	640.0
--to Central American CM	193.0	143.5	98.9	109.4	118.0	127.4
--to Panama	36.3	28.9	41.7	47.6	23.0	25.0
--to Rest of the world	170.9	175.6	255.6	316.4	435.6	487.6
(to United States) (C)	(n.a.)	(n.a.)	(n.a.)	(158.0)	(250.0)	(n.a.)
Total Commodity Exports (D)	997.5	939.0	1,085.8	1,114.1	1,225.9	1,339.2
Drawback Value Added (included in Other Services)	26.1	35.0	37.3	44.2	50.0	55.0
Total Exports (Inc. Drawback)	**1,023.6**	**974.0**	**1,123.1**	**1,158.3**	**1,275.9**	**1,394.2**

Source: Central Bank of Costa Rica and IMF.

Notes:

(A) Preliminary; excludes $ 24.1 million of exports corresponding to the value of the sale and exportation of monetary gold (to nonmonetary purchase).
(B) Projected. (C) Data on nontraditional exports to the United States excludes drawback goods, which are also exported nearly exclusively to the United States. (C) Data for the years 1984 through 1986 are from the FY 1988 PAAD. The preliminary data in the B/P for 1987 exports FOB is $ 1,107.0 million instead of $ 1,114.1 million per notation by the Central Bank as adjustment for volume.

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

	1986	1987	1988
1. Net Official Reserves	35.7	-41.0	64.2
Assets	558.6	503.2	635.4
Freely Disposable	134.6	113.9	254.1
Gold	26.4	23.8	8.0
Bank Deposits	11.9	86.7	243.1
Foreign Exchange	1.8	i.e.	i.e.
Securities	92.3	i.e.	i.e.
Special Drawing Rights	2.2	3.4	3.0
Other	i.e.	i.e.	i.e.
Other Assets	424.0	389.3	381.3
Time Deposits in CA Central Banks)	365.4	344.2	350.1
C. Amer. Clearing Arrang.	31.1	17.0	4.0
Contrib. to CA Stab. Fund	22.5	23.8	25.1
Other	5.0	4.3	2.1
Liabilities	-522.9	-484.8	-417.9
Net Position with IMF	-172.4	-132.3	-71.3
Revolver Credit Facility	-276.8	-276.4	-272.5
Other Short Term	- 73.7	-76.1	-74.1
Drawing on CA Stab. Fund	-33.7	N.A.	N.A.
Banco de Mexico (& clearing)	0	N.A.	N.A.
Banco Republic de Colombia	-0.8	0	0
Other	-39.2	N.A.	N.A.
Adjustment of Short Term Liabilities (by IMF)	0	-59.4	-153.2
2. Payment Arrears	**-180.2**	**-560.5**	**-933.0**
Over 15 working days (imports)	**-0.3**	**-5.2**	**-0.2**
Other (D, 1988)	**-179.9**	**-555.3**	**-932.8**
3. Total	**-144.5**	**-601.5**	**-868.8**

Source: Central Bank of Costa Rica.

Note: i.e. signifies included elsewhere.

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TABLE VIII : COMPOSITION OF FOREIGN EXCHANGE PAYMENT ARREARS
October 31, 1988
(In millions of U. S. Dollars)

Creditor	Principal	Interest	Total
Commercial Banks (A)	371.3	235.1	606.4
Foreign Governments	135.5	70.1	205.6
Multilateral Institutions	26.0	11.6	37.6
Bonds	0.4	0	0.4
CDs "Presa" (B)	-	-	-
Suppliers Credits	5.0	0.8	5.8
Subtotal	538.2	317.6	855.8
Arrears of over 15 working days to importers			0.3
TOTAL			856.1

Source: Central Bank of Costa Rica

Notes:
(A) Principal in arrears related to the Revolving Credit and New Money Facility is not included, inasmuch as it is treated as a reserve liability. However, Interest in arrears related to these liabilities is included.
(B) CDs of the "Presa" are not included, inasmuch as they are treated as liabilities to residents.

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TABLE IX : PUBLIC SECTOR EXTERNAL DEBT
(on a Disbursed Basis, December 31, 1985
September 30, 1987 and September 30, 1988,
in millions of U.S. dollars)

	12-31-85	09-30-87	09-30-88
By lending institution			
Commercial banks	1,601.3	1,368.4	1,471.0
Multilateral institutions	1,035.9	1,366.7	1,287.5
Bilateral loans	748.4	943.4	981.9
--Paris Club		(358.2)	(364.4)
--Other		(585.2)	(617.5)
Bonds and Float. Rate Notes	73.9	69.5	73.6
"Presa" CDs	184.0	148.6	0(A)
Suppliers credits	50.0	27.0	14.3
---Total	3,693.5	3,923.6	3,828.3

Source: Central Bank of Costa Rica.

Notes:
(A) Beginning in 1988 "Presa CDs" are treated as liabilities to residents.

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FOOTNOTES

1/This agreement rescheduled 85 % of the principal and interest in arrears at June 30, 1982 and falling due between July 1, 1982 and December 31, 1983 to a seven-year period beginning December 1985. The total debt relief provided under this agreement is estimated at $ 136 million.

2/Inasmuch as negotiations for the 1985 Standby agreement lasted for over one year, Tranche II of the 1983 agreement with commercial banks did not go into effect until early 1985, and total debt relief in 1984 was less than had been expected. In addition, new arrears, principally to bilateral creditors and commercial banks, were accumulated in the second half of 1984.

3/Debt service resulting from Costa Rica's 1983 Paris Club agreement was not eligible for restructuring. In the 1985 agreement, 90 % of the debt service in the consolidation period was rescheduled with a five-year grace period (to 1991) followed by a five-year repayment period. The arrears at the end of 1984 were rescheduled with a three-year grace period and eight-year repayment period. Each of the two 10 % residual amounts were scheduled to be paid in three installments--from 1985 to 1988.

4/The principal due in 1985 and 1986 was rescheduled over a ten-year period with a three-year grace period followed by a seven-year repayment period. The 1985 agreement with the Bank Steering Committee was conditioned upon Costa Rica being in compliance with the 1985 Standby, to approval by the World Bank and GOCR of a Structural Adjustment Loan, and upon the GOCR seeking comparable debt relief from other creditors for debt of similar maturities.

5/Even though detail on the composition of nontraditional exports (NTE) is not availabe for any part of 1988, we expect that over half of the $ 119 million increase in non-drawback NTE to markets outside of Central America are from the agricultural sector. Local observers report strong increases in exports of pineapple, macademia nuts, and ornamental plants.

STATUS OF PRIVATIZATION

A. CODESA Divestiture

Background:

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

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

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

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

Results to Date:

Financially speaking, the most significant result of the process was achieved almost immediately, when CODESA's access to credit for new investment was cut off in 1984. During the prior four years, CODESA's operating assets had grown each year by about C1.5 billion (equivalent to abour $30 million at an average rate of 50:1). Subsequent history has demonstrated that most of these investments went for overpriced and uneconomic operations, so that most of their value was lost to the country on the day the investments were made.

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

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

-- CATSA (sugar) was transferred in trust from CODESA to FINTRA in September, 1987, under a contract which provides for onward sale to private cooperatives. As of January 31, 1989, 72% of CATSA shares were sold and the remainder are expected to be sold by March 1989.

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

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

-- Under current law, only 40% of the shares of FERTICA (fertilizer) and CEMPA (cement) may be sold. The GOCR is actively considering transfering 100% of these companies in trust to FINTRA for management by FINTRA until 40% of their shares have been sold.

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

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

Future Privatization Activities: CODESA

The biggest change to occur thus far during the four years of the CODESA divestiture program has been the GOCR administration's conclusion that privatization can yield significant political advantages, especially where a company is sold on favorable terms to a wide group of local buyers. Thus the GOCR has pursued privatization more aggressively in the last two years. The sale of CATSA (sugar to private co-ops) is almost completed.

Under the banner of "economic democratization", the GOCR will probably sell the legal maximum of 40% of FERTICA (fertilizer) and CEMPA (cement) to broad-based groups of Costa Rican citizens. The government has indicated willingness to place these companies in trust with FINTRA to facilitate responsible management and sale of 40% of these companies. Once 40% of these companies has been transferred successfully, the government will probably be willing to consider an eventual privatization of the remainder, though legislative approval would be necessary.

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

Of course, no present action by AID or the GOCR can completely preclude such a possibility in the future. The best that could be done right now would be to dissolve CODESA. A second-best alternative would be a legislative restructuring of CODESA which prohibited it from acquiring new subsidiaries. In substance, this latter alternative would be similar to a dissolution of CODESA, in that either action would result in legislative approval being required for any further parastatal acquisitions. However, the Arias administration has indicated definitively that it will undertake neither of these steps, which would be highly offensive to a powerful wing on the incumbent party which was associated with CODESA's creation and growth.

The GOCR has agreed to precluding further CODESA borrowing or investment by administrative decree. If CODESA is left alive as a corporate shell, but substantially without subsidiaries, then the GOCR will have to define a (face-saving) role for the holding company. It has been suggested that CODESA might be transformed into an agency to implement industrial restructuring policy and provide administrative, technical and marketing guidance to affected companies.

Future Privatization Activities Other Than CODESA:

The present administration made an attempt last year to pursue the privatization of ICE, the power and light company, and Radiogr§fica, the Telegram/telext company. This was dropped after clumsy first steps provoked heavy political opposition.

It its last year in office, the administration is unlikely to pursue any politically conflictive privatization activities.

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

Notwithstanding the above suggestion of a low-profile approach on further privatization, USAID expects to cooperate with the GOCR in making resources available whenever requested for this effort. The nature and amount of funding requirements have yet to be defined. It might include a fund to pay special severance incentives to encourage the resignation of government employees. However, we would not envisage the inclusion of large amounts of local currency to finance the sale of companies (as was done in the case of CODESA).

THE ESF SEPARATE ACCOUNT

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

ESF dollars not be comingled with other GOCR/BCCR funds; ESF dollars finance eligible transactions which are carefully identified by AID; the cash transfer nature of the ESF program not be altered; and the mechanism be flexible enough to permit changes based on experience and developments which may affect its efficiency.

In collaboration with the Central Bank, USAID/Costa Rica developed the following procedures for disbursement to the Separate Account and the reimbursement of eleigible import transactions:

Dollars under ESR agreements are disbursed through the Treasury's Electronic Funds Transfer system (EFT) to a separate account maintained by the Central Bank in the Federal Reserve Bank which has provided assurances that the sub-account established to receive these funds will preclude comingling of ESF dollar funds with other resources. Any interest earned by the fund will be credited to and deposited in the separate sub-account.

The BCCR has submitted confirmation that the separate sub-account has been established and the Mission has certified that this account is a separate non-comingled sub-account, established solely to receive ESF dollar funds.

Reimbursement for specific import transactions financed with the GOCR's foreign exchange reserves will be made from the separate account. The use of foreign exchange for all imports must be approved by the Central Bank. The BCCR's computerized import approval system uses a NAUCA code system to produce a listing of imports from the United States by a date range, in accordance with predetermined eligible NAUCA codes. The Mission has reviewed and determined that the Central Bank's system for approving foreign exchange and maintaining documentation supporting their approval has been reliable and is expected to continue to be reliable assuming compliance with established procedures.

To request reimbursement from the separate account, the Central Bank will provide the USAID with a request for reimbursement supported by a certified report of eligible imports. The imports listed in the report will total at least 110% of the value of funds for which reimbursement is being sought -- this is to facilitate the review process should ineligible items be discovered during USAID's review of transactions.

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

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

The Mission plans to contract for a review of the supporting documentation and stratify the total population of transactions to be reviewed. All "Large" transactions (approximately $15,000 and over) will be reviewed by direct inspection of supporting documentation. Small transactions will be reviewed on a statistically valid sample basis using the "monetary unit sampling" method. The Mission has obtained successful results on two occasions using this system and does not anticipate any difficulty utilizing it in the future.

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

After Mission confirmation of import transactions eligible for reimbursement under the agreement, the Mission authorizes release of Dollars from the Separate Account to the GOCR general accounts as reimbursement for imports by the Costa Rican private sector of raw materials, intermediate goods, spare parts, etc. from the United States.

ANNEX D

Ministro de la Presidencia

23 de febrero de 1989
DM-066-89

Señor
Deane R. Hinton
Embajador de los Estados
Unidos de América
SU DESPACHO

Estimado señor Embajador:

Tengo el gusto de dirigirme a usted, para solicitarle la continuación de los programas de asistencia económica con el Gobierno de los Estados Unidos de América para el año 1989.

El Programa de Estabilización y Recuperación Económica de 1989 es un apoyo importante a los esfuerzos del Gobierno de Costa Rica por sentar bases firmes para un crecimiento económico sostenido.

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

Es intención del Gobierno continuar los esfuerzos por aumentar la eficiencia del Sector Público y mejorar la asignación de recursos humanos dentro del Sector, mejorar el funcionamiento del Sistema Aduanero y del Sector Vivienda, completar la venta de CATSA y avanzar significativamente en el traspaso de FERTICA y CEMPASA, así como apoyar las gestiones del Ministerio de Recursos Naturales, Energía y Minas que permitan aumentar la producción de energía cogenerada.

Los recursos que se obtengan a través de este acuerdo de asistencia económica serán utilizados por el Gobierno de Costa Rica, tomando en consideración las recomendaciones de la Comisión creada por Decreto Ejecutivo No. 18.108-P, dentro del marco del Plan Nacional de Desarrollo.

Aprovecho la oportunidad para informarle que el Proyecto de Préstamo de Ajuste Estructural II se encuentra para su estudio en la Asamblea Legislativa y que con el Fondo Monetario Internacional, el Gobierno ha presentado su programa económico, el cual se estará negociando en Washington a finales del mes de febrero.

Atentamente,

Rodrigo Arias Sánchez
Ministro de la Presidencia

ANNEX E

INITIAL ENVIRONMENTAL EXAMINATION

Project Location: Costa Rica

Project Title: Economic Stabilization and Recovey VIII

Funding: $85,000,000

Project Description: The Project consists of a cash transfer to provide balance of payments assistance to support economic stabilization and recovery in Costa Rica during CY 1989.

Action: Handbook 3, Chapter 2, Appendix 2D, Section 216.2.(c)(2)(vi) states that "contributions to ... National Organizations by the United States which are not for the purpose of carrying out a specifically identifiable project or projects" are not subject to A.I.D.'s environmental procedures.

The USAID/Costa Rica FY 89 PAAD provides for cash transfers to the Costa Rican Central Bank for balance of payments support. An amount of foreign exchange equivalent to that provided under the cash transfer is used by the Central Bank to finance imports for use by Costa Rica's private sector in manufacturing and other productive activities. Pesticides will not be procured with these funds without first doing an Environment Assessment and having it approved by AID/W. Also, an amount of local currency equivalent to the cash transfer will be deposited by the Central Bank for mutually agreed-upon development purposes. The PAAD does not authorize A.I.D. funds for identifiable projects, rather providing appropriated funds for an economic stabilization and recovery program.

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

IEE prepared by: Heriberto Rodriguez
General Engineer

Concurrence: Carl H. Leonard
Mission Director
USAID/Costa Rica

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CONCEPT PAPER:

A Costa Rican Institute For The Promotion Of Non-Traditional Exports

This paper will (1) review the recent history of public and private export promotion programs in Costa Rica, (2) outline a proposed reorganization and consolidation of these programs into a new agency, and (3) discuss funding options for this agency in the context of USAID's 1989-1991 ESF programs.

I. BACKGROUND

The Policy Environment. There is a consensus within the GOCR, and among the international donor community as well, that the only viable long-term solution to Costa Rica's balance of payments problem lies in sustained increases in non-traditional exports (NTE's).

In achieving such a structural transformation of the economy, the essential prerequisite has been a series of policy reforms to "level the playing field", correcting an anti-export bias which had developed during the '60s and '70s, when Costa Rica was pursuing an import-substitution strategy of development.

In the course of the '80s, Costa Rica has achieved export-oriented policy reforms which look all the more impressive when their high political cost is considered. A badly-overvalued exchange rate was rationalized, even though this contributed to a burst of inflation which temporarily peaked above 100%, and a drop of about 40% in real wages (most of which has since been recouped). Elimination of taxes on NTE's, and promulgation of a competitive package of export and investment incentives, required a serious fiscal commitment. Deregulation of credit markets led to a steep rise in interest rates; but this step has reversed a pattern of capital flight, ending the capital starvation which was strangling new export investments. The GOCR is making continued progress in reducing the tariff barriers which had provided permanent shelter for inefficient import-substitution industries. An effective regime for the encouragement of private free trade zones has been put in place.

One might expect that a decade would be required for some of these reforms to have their full impact, but already the results have been striking:

Exhibit 1:
NTE's to Non-Central-American Markets
($000,000)

1983	1984	1985	1986	1987	1988 (est.)
142	210	216	298	361	486

(Average Annual Growth Rate: 28%)

Promotional Programs: Problems to Date. Once a sound policy framework has been put in place, a series of effective "operational" programs (export and investment promotion, etc.) is required in order to maximize the rate of NTE growth.

Over the years, a number of GOCR agencies have been charged with such tasks. The Center for Promotion of Exports (CENPRO) was given responsibility to promote foreign and local investment in NTE businesses, as well as to facilitate exports by existing local companies through marketing services, data bases, training, etc. The National Investment Council was to administer the package of NTE incentives. The Free Zone Corporation was established to administer GOCR-owned Free Zones and regulate privately-owned zones.

However, a recurring pattern of problems has hobbled these agencies. In all of them, the principal staff members are expected to work closely with sophisticated private investors (especially foreign investors). However, it has proved impossible to hire and retain adequately qualified personnel for such jobs, because of Costa Rica's low civil service salary limits. Likewise, managers have repeatedly found that under the civil service regime they lack the necessary flexibility to motivate and manage their employees. Hiring, firing, and operational decisions have sometimes been subject to political, rather than technocratic, considerations.

CINDE. Since the early 1980's, USAID has assisted the GOCR in carrying out export promotion programs. However, high-level GOCR officials agreed with the USAID Mission that, because of the above limitations, the existing public agencies were inadequate vehicles for mounting effective programs. It was decided that, as a temporary expedient, support would be provided to private sector groups, outside the government, to mount some of the necessary programs, at least until such time as the GOCR was able to accomplish the necessary restructuring of its promotional institutions.

Most of the USAID support for export promotion programs was channelled through CINDE, a private sector non-profit organization. After a slow start, CINDE is now achieving excellent results. The most dramatic of CINDE's accomplishments have come in its PIE program, which concentrates on promotion of foreign investment in new NTE businesses in Costa Rica. PIE's extraordinary record is summarized in Exhibit 2 on the following page.

Exhibit 2:

CINDE/PIE RESULTS

	NTE Investments Committed In 1986	1987	1988	Total
Number of Companies Investing	16	21	28	65
Total Investment ($000,000)	18	29	83	130
Currently Projected Direct Jobs at Full Production	3,925	4,768	11,164	19,767
Actual Direct Jobs to Date	3,100	3,194	3,673	9,967
Projected Annual Exports at Full Production ($000,000)	21	22	82	125
Promotional Cost per Direct Job Created ($)	703	490	305	430

The vast majority of the investments reported in this table resulted from "cold calls" by PIE's overseas offices, so that it is safe to assume that the investment would not have occurred absent PIE's efforts.

The promotion officers who are producing these results are being paid salaries which are quite high by Costa Rican standards — well above civil service limits. Yet the cost-effectiveness of the program is exceptional: promotional costs are running about $430 per direct job created, a small fraction of the costs typical in similar programs in other countries. (There are reasonable grounds to estimate that two new indirect jobs arise from each direct job created.)

CINDE's export training program, PROCAP, has provided courses in a wide range of practical subjects for about 10,000 upper and mid-level managers of local export-related businesses. A recent AID/W independent evaluation found that the participants had uniformly high praise for the usefulness of the courses, and that the program was exceptionally well-managed.

CAAP is a relatively young CINDE program which identifies new agricultural export opportunities, provides technical assistance to develop those opportunities, promotes agricultural investment, and provides marketing assistance. While CAAP received strong praise in a recent AID/W independent evaluation, it is still too early to quantify CAAP's results in terms of new investments, jobs, or exports.

Beginning in 1989, CINDE is implementing a new Industrial Development Program to assist local industries in making the conversion from import-substitution to exporting.

Despite its successes, CINDE in its present institutional form has never been thought to be a permanent solution to the promotional challenge. As a purely private body, it lacks official status, and some government officers have occasionally complained that CINDE is not responsive enough to GOCR policy interests. There has been duplication of function, along with predictable turf wars, between CINDE and CENPRO, the main GOCR promotional agency. Finally, and most importantly, CINDE's financial future is insecure. Its activities in recent years have been funded almost entirely by periodic USAID grants (of ESF-generated local currency) for annual operating expenses: declining ESF levels make this a dubious source of funding after 1991.

All actors -- government, private, and donor -- are coming to a consensus that a rationalization and consolidation of operational programs related to NTE promotion is necessary, along with establishment of sustainable financing for the future.

II. PROPOSED REORGANIZATION

At the behest of Vice President Jorge Manuel Dengo, a study was conducted in late 1987 to recommend a restructuring of Costa Rica's foreign trade sector, including both policy and operational functions. That study's proposal has been further refined in discussions among the GOCR, the private sector, and USAID.

The institution proposed in the following pages relates only to operational (i.e. promotional) functions, not to policy-setting and trade negotiation functions. There is fairly wide consensus on its basic outline, though some of its details will require further resolution.

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The "New CENPRO". A single new institution would be established by law,* charged with execution of all publicly-funded programs related to export promotion. It would be an official GOCR agency, but "autonomous" in the sense that it would be outside of civil service and other GOCR administrative restrictions. Its board of directors would include representation from the relevant GOCR ministries, but a heavy majority would be designated by private sector bodies, including the various chambers. The New CENPRO would of course be governed by GOCR-defined trade policy; but to the maximum extent possible, its charter would provide protection against political influence in its staffing or operations.

There is precedent in Costa Rica for such a "non-political" entity under GOCR aegis: for instance, ICE, the electric power company, has been left fairly free of political interference in operations and staffing for many years, with the result that it is characterized by a relatively high degree of technocratic efficiency.

Functions. Final determination of the programs to be carried out by the New CENPRO would require further consultation between the GOCR and the sectors involved. But the tentative list includes the following:

-- Promotion of foreign NTE investment;

-- Technical and marketing assistance for local industrial and agricultural exporters (or potential exporters);

-- Assistance to, and monitoring of, private development of free trade zones and industrial parks;

-- Maintenance of commercial and technical data bases and libraries;

-- Technical administration of governmental NTE incentives; and

-- Administration of the "one-stop" export processing center.

The New CENPRO would not have to begin from scratch. Its point of departure would be the incorporation of the successful or promising programs which are already up and running in a disparate group of public and private institutions. These existing institutions would disappear, or would at least pass over all their promotional activities to the New CENPRO.

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* It has been suggested that the most convenient way to establish the new institution's legal framework would be to amend the existing CENPRO law.

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Political Climate. The proposed reorganization will require legislative action. When USAID first began discussions on the subject in 1987, it was anticipated that legislative approval of the reorganization would be difficult, and in any event unlikely to occur before the new administration and legislature take office in May of 1990. Among the factors which militated against an expectation of quick action were (1) the political sensitivity of a proposal calling for private sector domination of the board of the new agency, (2) the general pattern of legislative inertia in Costa Rica, and (3) the particular difficulty of pushing a controversial initiative during the year before an election.

However, there are recent political developments which may justify somewhat more optimism. Late in 1988 the President named a new Foreign Trade Minister, Luis Diego Escalante. Escalante, one of the founders of CINDE, has placed the proposed reorganization high on his list of priorities for his term of office. Further, Escalante braved considerable opposition to name an American consultant, Carlos Torres, as the interim director of CENPRO. Torres is a former director of CINDE's PIE program who was instrumental in PIE's design and successful implementation. One of Torres' principal tasks will be preparing the way for the reorganization outlined in this paper. His presence at CENPRO has effected a truce in the turf wars which prevailed in earlier years between CENPRO and CINDE.

Despite these encouraging indications, the political horizon is still very unclear. If the proposed reorganization turns out to be impossible over the short or longer term, then the second-best alternative would be to continue as at present, with the bulk of the proposed activities being carried out by a purely private organization (CINDE). In any event, the long-term financial viability of these activities must be addressed.

III. FINANCING THE "NEW CENPRO"

Funding Requirements. Based on experience with existing programs, and rough estimates for new ones, Exhibit 3 on the following page projects an annual cost for the New CENPRO equivalent to $8,500,000 per year, adjusted for inflation.*

*Even though most of the New CENPRO's costs and resources will be denominated in colones, Exhibit 3 is denominated in U.S. dollars, to avoid the indeterminacies related to colon interest and devaluation rates. In recent years, colon interest and devaluation rates have moved pretty much in tandem; as long as this pattern continues, doing projections in dollars will not result in substantial distortions.

RR 2-15-8

Exhibit D (All Amounts Are In US $000)

File: CINDE

COSTA RICAN EXPORT/INVESTMENT PROMOTION FUNDING

ASSUMPTIONS

-- Dollar Inflation Rate	4.0%
-- Real Dollar Interest Rate on Balances	3.0%
-- Colon/Dollar Devaluation Rate	16.0%

	1989	1990	1991	1992	1993	1994	1995	1996	1997
OPENING FUND BALANCE (Note 1)	16,162	39,765	68,929	99,858	101,720	103,541	104,860	105,672	105,962
EXPENDITURES									
-- COST OF OPERATIONS (Note 2)	8,500	8,840	9,194	9,561	9,944	10,342	10,755	11,185	11,633
Less: User Fees & Private Contrib's	(85)	(442)	(919)	(1,434)	(1,989)	(2,068)	(2,151)	(2,237)	(2,327)
(As % of Cost of Operations)	1%	5%	10%	15%	20%	20%	20%	20%	20%
Subtotal: NET COST TO BE FUNDED	8,415	8,398	8,274	8,127	7,955	8,273	8,604	8,948	9,306
RECEIPTS									
-- ESF CONTRIBUTIONS	26,000	10,000	10,000						
-- OTHER DONOR CONTRIBUTIONS		20,000	20,000						
-- CENTRAL BANK CONTRIBUTIONS (Note 3)	3,211	2,977	2,566	2,212	1,907	1,644	1,417	1,222	1,053
-- SALE OF P.I.C. SHARES (Note 4)	500	500	500	500	500	500	500	500	500
-- BANEX-COFISA LOAN PROCEEDS (Note 5)	376	316	266	223	187	156	131	109	91
-- INTEREST ON FUND BALANCES (Note 6)	1,930	3,770	5,571	7,057	7,182	7,292	7,368	7,417	7,409
Subtotal: RECEIPTS	32,017	37,563	39,203	9,988	9,776	9,593	9,416	9,238	9,053
NET CASH FLOW	23,602	29,165	30,929	1,861	1,821	1,319	812	289	(253)
CLOSING FUND BALANCE	39,765	68,929	99,858	101,720	103,541	104,860	105,672	105,962	105,708

Note 1: The opening fund balance shown for 1989 represents a lump-sum disbursement under a 12/88 MOU for 1989-1990 operations

Note 2: Operating levels projected here are equivalent to CINDE's present ESF-funded operations, adjusted for inflation. Not included are two DA-funded projects with CINDE, which will disburse about $1.5 million per year in 1989 and 1990. Costs associated with certain activities now in CENPRO (e.g. one-stop window) should be offset by dropping certain CINDE activities which won't be transferred to the new entity (e.g. lobbying).

Note 3: The Central Bank has agreed to donate to CINDE and its successor an amount of interest equal to about 290 million colones per year for twenty years, generated from an export-oriented credit line.

Note 4: CINDE owns shares in the Private Investment Corporation whose face value is about $5 million. It should be possible to sell them on an instalment basis.

Note 5: This item reflects principal and interest proceeds from a 1983 Trust Agreement.

Note 6: Interest is calculated on average fund balances, using the sum of the assumed inflation and real interest rates.

About two thirds of this cost will be in local currency. Thus far, the Central Bank (BCCR) has been willing to convert colones to foreign exchange to pay for the hard-currency costs associated with export promotion.

User Fees and Private Contributions. The bulk of New CENPRO's activities, initially at least, will be programs taken over from CINDE. In the past, CINDE's programs have not generated substantial "internal" revenues from user fees or private sector donations. In the Five-Year Plan which CINDE submitted to AID/Washington in August, 1988, the CINDE Board committed itself to substantially increased efforts in this direction. However, for reasons discussed in considerable detail in that Five-Year Plan, these revenues would take several years to reach maximum levels, and it would be imprudent to depend on their ever exceeding perhaps 20% of annual program costs (the peak level assumed in Exhibit 3).

Public Funding Alternatives. Given the realistic limits on user fees and private contributions, it is clear that the financial sustainability of the new institution would depend primarily on public or international donor funding. This should come as no surprise: to the best of our knowledge, the government finances most or all of the cost in every country in the world which has established such export promotion programs on a long-term basis.

In other words, experience indicates fairly clearly that the notion of a national export promotion program funded primarily by voluntary payments from the business community is not realistic. Such programs are a classic "public good" in the economists' sense.

However, funding this institution through the GOCR's annual budget process would present serious problems at the present time, given the country's precarious fiscal position and heavy pressure to cut, rather than expand, central government expenditures. More importantly, USAID is convinced that in the Costa Rican political environment, the New CENPRO would be unable to protect itself from damaging political interference if it had to go back to the legislature each year for an annual appropriation.

As an alternative, some local business leaders have suggested that export promotion operations be financed out of a dedicated tax on NTE's, whose proceeds would pass automatically to the New CENPRO. This idea has a certain logic to it. But such a tax would be a targeted disincentive to NTE's; it would be especially unattractive because, despite some successful policy reforms, Costa Rican NTE's still suffer from some structural disincentives such as abnormally high transport costs etc. Moreover, passage of any dedicated tax would probably be very difficult politically.

An Endowment. A remaining practical alternative, which is being proposed here, is the gradual accumulation of a permanent endowment. Exhibit 3 assumes endowment contributions equivalent to a total of $86 million during 1989-91, about half of which would come from ESF-gerated colones, while the other half would be parallel or joint financing from other international donors.

Last year's AID/W evaluation of CINDE recommended consideration of an endowment as the preferred way to fund export promotion in Costa Rica.*

However, it was with considerable reluctance that USAID came to accept this recommendation. Such an endowment, especially when it is as large as the one proposed here, might tend to lessen the external pressure on the institution to justify its programs and demonstrate its results on a regular basis. Major resources will be tied up in a program which USAID will not be able to monitor and influence after its first few years.

The Mission has finally come to settle on the endowment concept, not because it is free of problems, but because the realistic alternatives present worse dangers, as indicated above (and as discussed at greater length in the CINDE Five-Year Plan). The most dangerous alternative of all would be to allow Costa Rican export and investment promotion to languish through lack of dependable funding.

USAID views the New CENPRO as a development investment which promises exceptionally high returns, for reasons which can be summarized as follows:

-- Costa Rica's ample comparative advantages, in terms of political stability, workforce, and geography, make export promotion here a much more promising avenue than in many other LDC's (as evidenced by this country's initial successes over the past five years).

-- The GOCR has already demonstrated its commitment to this structural transformation by implementing, at considerable political cost, a sound package of policy reforms.

-- Several core programs to be integrated into the New CENPRO are already up and running, and have demonstrated excellent prospects.

-- The new institution would have the advantage of taking over CINDE administrative systems (financial controls, personnel, procurement, etc.) which, after years of work by AID and CINDE, are considerably stronger than those of most comparable Costa Rican institutions.

-- In Costa Rica, as contrasted with many other developing countries, it is demonstrable that the macroeconomic benefits stemming from export growth will be shared proportionally by the poorer levels of the population. (This subject is discussed at greater length in a recent paper submitted to AID/W for the presidential transition team.)

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* Checchi & Co., May 1988: see, for example, Executive Summary, p. 8.

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-- Due to intense inflationary pressures, the GOCR and USAID are exceedingly anxious to limit the monetization of ESF-generated local currency. The endowment proposed here will have the advantage of "de-monetizing" large amounts of colones: the principal of the endowment would be invested in GOCR monetary stabilization bonds, and nothing would be added to the money supply each year except the interest on these bonds, which will be spent for program operations.

In Chile, an endowment of the sort proposed here was the platform upon which Fundación Chile built an extraordinarily agile and successful export promotion program, which is continuing to have major positive impact on Chile's balance of payments and national income.

Current Status of Negotiations. In accordance with AID/LAC guidance, last year's CINDE Five-Year Plan showed a gradual reduction in annual operating funding by means of USAID-CINDE MOU's (memoranda of understanding):

1989	100% of program costs
1990	100%
1991	75%
1992	50%
1993	25%
1994	0%

At the same time, the Plan recognized clearly that other public or donor funding would be essential, even after making the most optimistic estimates of receipts from user fees and private donations.

In December, 1988 an agreement was signed between the GOCR, USAID, and CINDE, to allocate to export promotion activities about $16 million worth of GOCR-owned local currency generated under the 1987 ESF program. (This amount is equivalent to most of CINDE's 1989-90 requirements.) These funds were disbursed to a CINDE account, but on a "temporary" basis: it was agreed that as soon as a satisfactory reorganization could be accomplished, the remaining funds could be transferred (along with most of CINDE's programs) to the New CENPRO.

Also at the end of 1988, the GOCR and Central Bank agreed to dedicate ¢298 million (equivalent to about $3 million in 1989) to export promotion every year for twenty years. These annual infusions will be drawn from the interest spread on an export-oriented credit line in the Central Bank which has been funded by ESF local currency generations. Like the funds described in the paragraph above, these Central Bank contributions will be deposited with CINDE's separate investment account, but will be transferred to the New CENPRO upon its establishment.

In terms of future USAID contributions, Exhibit 3 above assumes further infusions of ESF-generated colones equivalent to a total of $46 million between 1989 and 1991.

The Mission views this activity as being particularly suited for co-financing with one or more other donors, and has proposed it in a recent cable to AID/W as a candidate for cooperation with the Japanese. Conversations have also been initiated with the Taiwanese and certain EEC countries. While it is too early to make any prediction as to the outcome of these discussions, Exhibit 3 assumes $40 million from other international donors.

In the event that the New CENPRO fails to attract this level of support from other donors, the USAID Mission would probably want to fund some or all of that shortfall with additional allocations of ESF-generated colones.*

In terms of negotiating posture, the Mission expects that its willingness to fund a large part of the New CENPRO's requirements from ESF-generated colones would give us the leverage necessary to insist on a proper (i.e. politically insulated) structure for the new agency. The current arrangement of temporarily depositing these funds with CINDE also has a negotiating advantage: in the event that serious delays are encountered in the legislature, programs can continue to function in the interim, and we will not be forced to accede to an unsatisfactory compromise on structure in order to get funds moving and programs under way.

Other Issues. (1) The Mission is assuming that, however an endowment is structured, it should not include any requirement of long-term USAID monitoring or oversight. Fundamentally, the New CENPRO would be accountable to the groups who appoint its directors. As the structuring moves ahead, we will consider whether it is desirable to add another line of accountability by separating management of the endowment from management of the programs. Under such an arrangement, the Trustees of the Endowment would be separate from the Directors of the New CENPRO, and would have some discretion as to disbursements from the endowment.

(2) Care will have to be exercised to structure the endowment contributions in a way which would not dampen the new agency's incentive to maximize user fees and private contributions.

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*The Mission's recently-submitted Action Plan proposed an Export Sector Development program for FY 1991, under which local currency equivalent to $32 million would be used for export and investment promotion. Exhibit 3 above reflects a 1991 contribution to the New CENPRO equivalent to $10 million. The balance, equivalent to $22 million, could be available for the New CENPRO in the event that other donor contributions fall short of the levels projected in Exhibit 3.

(3) Much of the New CENPRO's endowment will be denominated in local currency. Thus, the principal value of the endowment would be at risk in the event of a sudden and unexpected devaluation. This risk can be reduced by keeping the colon portfolio invested in relatively short-term instruments, trading off slightly reduced current income against improved protection from devaluation losses. An obvious advantage of participation by other donors is that their contributions in hard currency would cushion this devaluation risk.

Conclusion. The Mission is well aware that, at least at first blush, the amounts involved in this proposal seem breathtaking, in terms of the annual operating costs as well as the size of an endowment needed to permanently fund them.

Our willingness to allocate such heavy resources to this activity stems principally from the expected return on investment. Even if one were to ignore all the other benefits of the New CENPRO except for the historically-demonstrated results of the foreign-investment promotion activity, those results alone would represent a cost-benefit ratio which compares very favorably with similar programs elsewhere in the world. Moreover, past experience satisfies us that the return on an investment in a New CENPRO would probably be better than the return from a typical alternative activity on which the GOCR and USAID might spend the same ESF-generated colones.

5C(2) - NONPROJECT ASSISTANCE CHECKLIST

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

CROSS-REFERENCES: IS COUNTRY CHECKLIST UP TO DATE?. HAS STANDARD ITEM CHECKLIST BEEN REVIEWED?

A. GENERAL CRITERIA FOR NONPROJECT ASSISTANCE

1. FY 1988 Continuing Resolution Sec. 523; FAA Sec. 634A. Describe how authorization and appropriations committees of Senate and House have been or will be notified concerning the project.

Congress has been notified through the FY 89 Congressional Presentation.

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

No further pre-conditions for obligations are necessary.

3. FAA Sec. 209. Is assistance more efficiently and effectively provided through regional or multilateral organizations? If so, why is assistance not so provided? Information and conclusions on whether assistance will encourage developing countries to cooperate in regional development programs.

No.

4. FAA Sec. 601(a). Information and conclusions on whether assistance will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and

The assistance will increase international trade foster private initiative and competition, and improve 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 efficiency of industry, agriculture and commerce.

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

Via this balance of payment assistance, U.S. markets for Costa Rican products will be expanded and U.S. private investment and trade in Costa Rica will be enhanced.

6. FAA Secs. 612(b); Sec 636(h); FY 1987 Continuing Resolution Secs. 507, 509. Describe steps taken to assure that, to the maximum extent possible, foreign currencies owned by the U.S. are utilized in lieu of dollars to meet the cost of contractual and other services.

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

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

No.

8. FAA Sec. 601(e). Will the assistance utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise?

N/A

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

N/A

B. FUNDING CRITERIA FOR NONPROJECT ASSISTANCE

1. Nonproject Criteria for Economic Support Fund

a. FAA Sec. 531(a). Will this assistance promote economic and political stability? To the maximum extent feasible, is this assistance

Yes

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consistent with the policy directions, purposes, and programs of Part I of the FAA?

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

c. FAA Sec. 531(d). Will ESF funds made available for commodity import programs or other program assistance be used to generate local currencies? If so, will at least 50 percent of such local currencies be available to support activities consistent with the objectives of FAA sections 103 through 106? — Yes/Yes

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

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

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

2. Nonproject Criteria for Development Assistance N/A

a. FAA Secs. 102(a), 111, 113, 281(a). Extent to which activity will (a) effectively involve the poor in development, by expanding access to economy at local level, increasing labor-intensive production and the use of appropriate technology, spreading investment out from cities to small towns and rural areas, and insuring wide participation of the poor in the benefits of development on a sustained basis, using the appropriate U.S. institutions; (b) help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help themselves toward better life, and otherwise encourage democratic private and local governmental institutions; (c) support the self-help efforts of developing countries; (d) promote the participation of women in the national economies of developing contries and the improvement of women's status; and (e) utilize and encourage regional cooperation by developing countries?

b. FAA Secs. 103, 103A, 104, 105, 106, 120-21. Is assistance being made available: (include only applicable paragraph which corresponds to source of funds used; if more than one fund source is used for assistance, include relevant paragraph for each fund source):

(1) (103) for agriculture, rural

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

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

(3) (105) for education, public administration, or human resources development; if so, (a) extent to which

activity strengthens nonformal education, makes formal education more relevant, especially for rural families and urban poor, and strengthens management capability of institutions enabling the poor to participate in development; and (b) extent to which assistance provides advanced education and training of people of developing countries in such disciplines as are required for planning and implementation of public and private development activities.

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

(i)(a) concerned with data collection and analysis, the training of skilled personnel, research on and development of suitable energy sources, and pilot projects to test new methods of energy production; and (b) facilitative of research on and development and use of small-scale, decentralized, renewable energy sources for rural areas, emphasizing development of energy resources which are environmentally acceptable and require minimum capital investment;

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

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

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

(v) for special development problems, and to enable proper

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utilization of infrastructure and related projects funded with earlier U.S. assistance;

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

(5) (120-21) for the Sahelian region; if so, (a) extent to which there is international coordination in planning and implementation; participation and support by African countries and organizations in determining development priorities; and a long-term, multi-donor development plan which calls for equitable burden-sharing with other donors; (b) has a determination been made that the host government has an adequate system for accounting for and controlling receipt and expenditure of projects funds (dollars or local currency generated therefrom)?

c. FAA Sec. 107. Is special emphasis placed on use of appropriate technology (defined as relatively smaller, cost-saving, labor using technologies that are generally most appropriate for the small farms, small businesses, and small incomes of the poor)?

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

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

ANNEX H

ACUERDO DE PROGRAMACION DE MONEDA LOCAL

ENTRE

EL GOBIERNO DE LOS ESTADOS UNIDOS DE AMERICA

Y

EL GOBIERNO DE COSTA RICA

Y

EL BANCO CENTRAL DE COSTA RICA

FECHA: 9 de diciembre de 1988

LOCAL CURRENCY PROGRAMMING AGREEMENT

BETWEEN

THE GOVERNMENT OF THE UNITED STATES OF AMERICA

AND

THE GOVERNMENT OF COSTA RICA

AND

THE CENTRAL BANK OF COSTA RICA

DATE: December 9, 1988

POR CUANTO, los Gobiernos de Costa Rica y Estados Unidos de América celebraron un Convenio General para la Ayuda Económica, Técnica y para propósitos Afines ("Convenio General"), el cual fue aprobado por la Ley 3011 del 18 de julio de 1962, según el cual el Gobierno de los Estados Unidos proporcionará ayuda de conformidad con acuerdos por escrito y firmados por representantes de ambos Gobiernos;

POR CUANTO, el Convenio General establece que la ayuda que los Estados Unidos proporcione será para el progreso social nacional y programas de desarrollo económico;

POR CUANTO, el Gobierno de los Estados Unidos, actuando por medio de la Agencia para el Desarrollo Internacional ("AID"), y el Gobierno de Costa Rica, actuando por medio del Ministerio de la Presidencia ("GOCR") desean comprometer el total de los fondos disponibles en la Cuenta No.215-03-031/0 ("Cuenta Especial") en el Banco Central de Costa Rica ("BCCR"), para ser usados en programas de desarrollo económico y social;

POR CUANTO, la AID y el GOCR son citados en conjunto como "las Partes", para los propósitos de este Acuerdo;

AHORA, POR LO TANTO, las Partes por este medio acuerdan la programación de los Fondos para programas sectoriales y para fondos que el GOCR usará como contrapartida para los proyectos financiados por la AID, de conformidad con los términos y condiciones establecidos a continuación; y el BCCR está de acuerdo con los términos y condiciones que se aplican al mismo.

WHEREAS, the Governments of Costa Rica and the United States of America entered into a General Agreement for Economic, Technical and Related Assistance ("General Agreement") which was approved by Law 3011 of July 18, 1962, under which assistance from the Government of the United States would be provided in accordance with agreements written and signed between the representatives of both Governments;

WHEREAS, the General Agreement establishes that the assistance provided by the United States will be for national social progress and economic development programs;

WHEREAS, the Government of the United States, acting through the Agency for International Development ("AID"), and the Government of Costa Rica, acting through the Ministry of the Presidency ("GOCR"), desire to commit to economic and social development programs the total amount of funds available in Account No. 215-03-031/0 ("Special Account") in the Central Bank of Costa Rica ("BCCR");

WHEREAS, AID and the GOCR are, for purposes of this Agreement, collectively referred to as "the Parties";

NOW, THEREFORE, the Parties do hereby agree to the programming of the Funds for sector programs and for GOCR counterpart to AID-financed projects, in accordance with the terms and conditions set forth below; and the BCCR agrees to the terms and conditions that apply to it.

ARTICULO I. Financiamiento

Sección A. Resumen del Programa. El total de los fondos disponibles en la Cuenta Especial es de cuatro mil ciento treinta y cinco millones setecientos cuarenta y un mil quinientos colones (C4,135,741,500) ("Fondos"). Por este medio se comprometen y distribuyen estos fondos entre los programas de acuerdo con las siguientes categorías generales:

Asistencia sectorial	C3,335,741,500
Contrapartida del GOCR a proyectos en dólares de la AID	C 800,000,000

Estas categorías generales se especifican con más detalle en los Artículos II y III de este Acuerdo y en el Anexo I titulado "Presupuesto del Programa en Moneda Local" el cual se adjunta a este Acuerdo.

Sección B. Compromiso y Asignación de Fondos. Para los fines de este Acuerdo, "Compromiso" se define como un aporte irrevocable de fondos, tanto por parte de la AID como del GOCR, a las actividades que se especifican en este Acuerdo, que puede ser cambiada únicamente por mutuo acuerdo de estas mismas partes expresado en una enmienda escrita a este Acuerdo. La "Asignación" de Fondos se define como la colocación de fondos subsiguiente a este acuerdo que efectúe el GOCR en las instituciones ejecutoras individuales mediante el uso de documentación congruente con las prácticas y procedimientos internos del GOCR. Tal documentación especificará el uso que se le dará a los fondos así como los términos y condiciones que se aplicarán al uso de fondos por parte de las instituciones ejecutoras.

ARTICLE I. Financing

Section A. Program Summary. The total amount of funds available in the Special Account is four billion one hundred thirty-five million seven hundred forty-one-thousand, five hundred colones (C4,135,741,500) ("Funds"). These Funds are hereby committed and allocated among programs according to the following general categories:

Sector Assistance	C3,335,741,500
GOCR Counterpart to AID $ Projects	C800,000,000

These general categories are more specifically detailed in Articles II and III of this Agreement and in Annex I entitled "Local Currency Program Budget", attached to this Agreement.

Section B. Commitment and Assignment of Funds. For purposes of this Agreement, "Commitment" is defined as the definitive allocation of funds by AID and the GOCR to the activities specified in this Agreement, that can be changed only by mutual agreement of these same parties in a written amendment to this Agreement. "Assignment" of funds is defined as the allocation of funds by the GOCR subsequent to this Agreement to individual implementing institutions through documentation consistent with GOCR internal practices and procedures. Such documentation will specify the use of the funds and the terms and conditions applying to the use of the funds by the implementing institutions.

Sección C. Monetización. La Monetización, que es el momento en que los fondos pasan a ser parte de las existencias monetarias del país, la cual ocurrirá cuando los fondos programados al tenor de este Acuerdo sean desembolsados de las cuentas individuales establecidas dentro del BCCR conforme a los Artículos II y III de este Acuerdo (1) hacia cuentas específicas de las unidades ejecutoras abiertas en bancos comerciales, a menos que los fondos sean inmediatamente devueltos al Banco Central como reintegro de deuda u otros mecanismos que eviten efectivamente que los fondos ingresen a la corriente económica; o (2) directamente a las entidades ejecutoras, según se describe con más amplitud en el Artículo II, Sección D detallado más abajo. No se considerará que ha habido monetización cuando los Fondos solamente se transfieran de la Cuenta Especial en el BCCR a las cuentas individuales de las instituciones ejecutoras o de los programas sectoriales en el BCCR.

La AID y el GOCR convienen en que la tasa de monetización será establecida por el BCCR y que los criterios y procedimientos para cumplir con esa tasa de monetización serán establecidos mediante un convenio escrito adicional suscrito por el GOCR y la AID.

ARTICULO II. Programación Sectorial

Sección A. Resumen del Programa Sectorial. **Un total de C3,335,741,500 se compromete al tenor de este Acuerdo para la programación sectorial del GOCR. El monto comprometido será asignado por el GOCR tal como sigue:**

1. Sector: Agua. 850 millones de colones se asignarán al Instituto Costarricense de Acueductos y Alcan-

Section C. Monetization. Monetization, the point at which funds become part of the nation's money supply, will be deemed to have occurred when funds programmed under this Agreement are disbursed from individual accounts established within the BCCR in accordance with Articles III and IV of this Agreement (1) into the accounts of the individual GOCR implementing institutions in commercial banks, unless the funds will immediately be returned to the BCCR through debt repayments or other mechanisms which, in effect, prevent funds from entering the economy, or (2) directly to the implementing entities, as further described in accordance with Article II, Section D below. Monetization will not be deemed to have occurred when the Funds are only transferred from the Special Account in the BCCR to the individual accounts of the implementing institutions or sector programs established within the BCCR.

AID and the GOCR agree that the rate of monetization will be established by the BCCR and the criteria and processes for compliance with the rate of monetization will be established through further written agreement between the GOCR and AID.

ARTICLE II. Sector Programming

Section A. Sector Program Summary. A total of C3,335,741,500 is committed under this Agreement for GOCR sector programming and the amount committed shall be assigned by the GOCR as follows:

1. Sector: Water. C850 million will be assigned to the Costa Rican Institute of Water and

tarillado (ICAA) para apoyar sus programas de agua potable en la zonas rurales y urbanas. Las actividades incluirán la construcción de acueductos rurales y municipales y una encuesta de necesidades de agua. Los objetivos programáticos del GOCR son:

a. Fortalecer el sector de agua potable, que es esencial en el mejoramiento de la salud y calidad de vida de los costarricenses;

b. Orientar el apoyo del sector de agua potable principalmente para beneficiar a los grupos más postergados de la población; y

c. Contruir 180 acueductos menores o rurales, 9 acueductos mayores, y 25 acueductos municipales.

2. Sector: Infraestructura para el Transporte. 740 millones de colones se asignarán al Instituto de Fomento y Asesoría Municipal (IFAM) para la construcción y mantenimiento de carreteras y puentes, y a la Dirección General de Aviación Civil para la construcción y mantenimiento de aeropuertos. El GOCR conseguirá la colaboración del IFAM, Aviación Civil, y el Ministerio de Obras Públicas y Transportes en la ejecución del programa de infraestructura para el transporte. Los objetivos programáticos del GOCR son:

a. Mejorar la red nacional de caminos y comunicaciones del país, así como impedir su deterioro;

b. Promover la incorporación a la economía nacional de cada una de las regiones del país; y

c. Construir y mejorar unos 1.400 kms de caminos (basándose en un costo promedio de alrededor de C240,000 por kilómetro).

Sewerage (ICAA) in support of its potable water programs in rural and urban areas. Activities will include construction of rural and municipal aqueducts and a water-needs survey. GOCR program objectives are:

a. To strengthen the potable water sector, which is essential to improvement of health and the quality of life of Costa Ricans;

b. To orient potable water sector support principally to benefit the the most disadvantaged segments of the population; and

c. To construct 180 small or rural aqueducts, 9 major aqueducts, and 25 municipal aqueducts.

2. Sector: Transportation Infrastructure. C740 million will be assigned to the National Institute for Municipal Development (IFAM) for the construction and maintenance of roads and bridges, and to the Director General for Civil Aviation for airport construction and maintenance. The GOCR will enlist the collaboration of IFAM, Civil Aviation, and the Ministry of Public Works and Transportation (MOPT) in implementation of the transportation infrastructure program. GOCR program objectives are:

a. To improve the national roads and communications network of the country, as well as preventing its deterioration;

b. To promote the integration of individual regions of the country into the national economy; and

c. To construct and improve some 1,400 of roads and bridges (based on an average cost of approximately C240,000 per kilometer.

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3. Sector: Infraestructura para Educación. 345 millones de colones se asignarán al Instituto Nacional de Vivienda y Urbanismo (INVU) para la construcción y mantenimiento de centros escolares en comunidades rurales y urbanas. El GOCR procurará la colaboración del INVU y el MOPT en la ejecución del programa, de conformidad con las prioridades que determine el MEP. Los objetivos programáticos del GOCR son:

a. Apoyar los Ministerios de Educación Pública y de Obras Públicas y Transportes, con la participación directa de los centros educativos y sus comunidades respectivas, para disminuir el déficit de aulas y atender las más urgentes necesidades de infraestructura educativa;

b. Llevar a cabo un programa de construcción y ampliación de escuelas en zonas marginales y zonas rurales;

c. Lograr las siguientes metas de construcción y mejoramiento: construcción de aproximadamente 240 aulas en zonas rurales, renovación y mantenimiento de aproximadamente 50 escuelas urbanas, reconstrucción, rehabilitación y reubicación de aproximadamente 144 aulas afectadas por el Huracán Juana, y construcción y ampliación de aproximadamente 45 escuelas.

4. Sector: Bienestar y Salud Infantil. 300 millones de colones se asignarán a la Oficina de Cooperación Internacional para la Salud (OCIS) para la construcción de centros de bienestar infantil. Los objetivos programáticos del GOCR son:

3. Sector: Education Infrastructure. C345 million will be assigned to the National Urban Housing Institute (INVU) for construction and maintenance of rural and urban community primary schools. The GOCR will secure the cooperation of INVU and MOPT in implementing the program in conformance with priorities determined by the Ministry of Education (MEP). GOCR program objectives are:

a. To support the Ministries of Public Education and of Public Works and Transport, with the direct participation of the schools and their respective communities, to reduce the classroom deficit and to attend to the most urgent education infrastructure needs;

b. To implement a school construction and expansion program in marginal communities and rural areas.

c. Achieve the following construction and improvements targets: construction of approximately 240 classrooms in rural zones, renovation and maintenance of approximately 50 urban schools, reconstruction/ rehabilitation and relocation of approximately 144 classrooms affected by Hurricane Joan, and construction and expansion of approximately 45 schools.

4. Sector: Child Welfare and Health. C300 million will be assigned to the Office for International Cooperation in Health (OCIS) for the construction of child welfare centers. GOCR program objectives are:

a. Proporcionar servicios básicos de salud a grupos humanos postergados mejorando las condiciones sanitarias;

b. Reducir los índices de desnutrición proteico-calórica entre niños menores de cinco años de edad;

c. Construir, ampliar y mejorar aproximadamente 67 centros de cuidado infantil, 20 de los cuales están junto a puestos de salud.

5. Sector: Desarrollo Comunal. 100 millones de colones se asignarán para asistencia financiera a proyectos pequeños de desarrollo comunal y/o pequeños proyectos productivos. Antes de la asignación de los fondos a la institución ejecutora, la AID y el GOCR acordarán por escrito la selección de la institución ejecutora apropiada y los objetivos específicos para el programa.

6. Sector: Agricultura. 320 millones de colones se asignarán al Consejo Nacional de Producción (CNP) para su reestructuración y modernización y para actividades de apoyo al pequeño agricultor. Los objetivos programáticos del GOCR son:

a. Modernizar, reestructurar y descentralizar el CNP;

b. Lograr la autosuficiencia operativa y financiera del programa de estabilización de precios y evitar los subsidios.

c. Mejorar la productividad de los pequeños y medianos agricultores y mejorar los sistemas de mercadeo y manejo de los productos agrícolas mediante actividades de asistencia técnica, mejor

a) To provide basic health services to disadvantaged groups by improving sanitary conditions;

b) To reduce protein/caloric malnutrition indices among children under five years of age;

c) To construct, expand, and improve approximately 67 child-care centers, 20 of which are attached to health posts.

5. Sector: Community Development. C100 million will be assigned for financial assistance to small community development projects and/or to small production projects. Prior to the assignment of funds to the implementing institution, AID and the GOCR shall further agree in writing on the selection of the appropriate implementing institution and on the specific objectives for the program.

6. Sector: Agriculture. C320 million will be provided to the National Production Council (CNP) for its restructuring and modernization, and for activities in support of the small farmer. GOCR program objectives are:

a. To modernize, restructure and decentralize the CNP;

b. To achieve operational and financial self-sufficiency of the price stabilization program and avoid subsidies.

c. To improve productivity of small and medium farmers and improve the marketing systems and handling of the farmers' produce through technical assistance activities, improved administración de los inventarios y establecimiento de un archivo modelo de información, y mejoras en la planta de recibo que reducirían los costos de procesamiento en un 40 por ciento.

7. Sector: Vivienda Rural. 345 millones de colones se asignarán al Instituto Mixto de Ayuda Social (IMAS) para financiar viviendas rurales de bajo costo. El programa será llevado a cabo de manera tal que garantize la completa recuperación de los gastos de capital, y gastos de operación. Los objetivos programáticos del GOCR son:

a. Contribuir en la solución del problema de vivienda en las zonas rurales;

b. Proporcionar, a través de la autoconstrucción, ayuda mutua u otro sistema establecido de de financiamiento para vivienda, la construcción de viviendas para familias de escasos recursos económicos.

c. Proporcionar alrededor de 1.000 soluciones de vivienda.

8. Sector: Financiamiento al Sector Público. C335,741,500 se asignarán al BCCR para reducir sus pérdidas de operación. Los objetivos programáticos del GOCR son:

a. Reducir el déficit consolidado del sector público y

b. Fortalecer el proceso de estabilización y recuperación económica.

Sección B. Uso de los Fondos para la Administración Financiera. El GOCR está autorizado para hacer uso de hasta el cinco por ciento de los

inventory management and establishment of a master information file, and receiving-plant improvements that should reduce processing costs by 40 percent.

7. Sector: Rural Housing. C345 million will be provided to the Social Assistance Institute (IMAS) for low-cost rural housing finance. The program will be implemented so as to guarantee full cost recovery of capital expenditures and operating costs. GOCR program objectives are:

a. To contribute to a solution to the housing problem in rural zones;

b. To provide, through self-help construction, mutual assistance, or established housing-finance systems, housing construction for low-income families.

c. To provide for approximately 1,000 shelter solutions.

8. Sector: Public Sector Finance. C335,741,500 will be provided to the BCCR to reduce its operating losses. The GOCR program objectives are:

a. To reduce the consolidated public sector deficit and

b. To strengthen the economic stabilization and recovery process.

Section B. Use of Funds for Financial Management. The GOCR is authorized to use of up to five percent of the funds provided for fondos proporcionados para cada uno de los programas anteriormente descritos para (1) desarrollar o mejorar los sistemas y procedimientos utilizados tanto por las entidades ejecutoras como por el GOCR , y/o (2) realizar auditorías financieras y de cumplimiento necesarias para los programas.

Sección C. Asignación de Fondos por Parte del GOCR. Al suscribir este Acuerdo, AID conviene en que que el GOCR podrá asignar fondos para los programas descritos y hasta por los montos designados en la Sección A. anterior, de acuerdo con sus requisitos de documentación internos sin que medie un acuerdo escrito adicional con la AID, excepto para el programa de apoyo al sector de Desarrollo Comunal descrito en la Subsección 4 anterior, el cual requiere acciones adicionales específicas antes de asignar fondos. Las transferencias y desembolsos efectuados después de la asignación serán hechos conforme a los procedimientos establecidos en la Sección D siguiente.

Sección D. Responsabilidades de las Partes

1. Responsabilidades del GOCR. El GOCR, por medio del Ministerio de la Presidencia (el cual contará con la ayuda de la Oficina de Control y Seguimiento y la Unidad de Ejecución del PL 480 del Ministerio de Planificación), verificará que el diseño, ejecución, seguimiento y evaluación de los programas sea completo:

a. Aprobando actividades sectoriales específicas basadas en la revisión de su solidez programática, administrativa y financiera y en una consideración adecuada del impacto ambiental;

each of the above-described programs to (1) develop or improve the financial systems and procedures used by either the implementing entities or the GOCR, and/or (2) conduct necessary financial and compliance audits of the programs.

Section C. GOCR Assignment of Funds. In signing this Agreement, AID agrees that the GOCR may proceed to assign funds for the programs described and up to the amounts designated in Section A above, according to its internal documentation requirements without further written agreement with AID, except for the Community Development sector support program described in Subsection 4 above, which requires specific additional actions prior to assignment of funds. Transfers and disbursements after assignment will be in accordance with procedures set for in Section D below.

Section D. Responsibilites of the Parties.

1. GOCR Responsibilities. The GOCR, through the Ministry of the Presidency (which will be assisted by the Office of Control and Follow-up and the Ministry of Planning's PL 480 Implementing Unit), will ensure sound design, implementation, monitoring and evaluation of the programs by:

a. Approving individual sector activities based on review of programmatic, administrative, and financial soundness, and adequate consideration of environmental impact;

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b. Dando seguimiento a las actividades referentes a la administración financiera y progreso global de los programas;

b. Monitoring activities with regard to financial management and overall progress of the programs;

c. Verificando que los programas y mecanismos de ejecución sean congruentes con las cláusulas de política de los Acuerdos ESR, con especial atención a las cláusulas relativas a programas de vivienda;

c. Ensuring that programs and implementation mechanisms are consistent with policy covenants under the ESR agreements, with special attention to covenants related to housing programs;

d. Asegurándose de que los fondos programados se usen para apoyar las categorías sectoriales que se acuerdan por este medio;

d. Ensuring that the funds programmed are used to support the sector categories agreed upon;

e. Realizando evaluaciones de los programas;

e. Conducting evaluations of the programs;

f. Poniendo a disposición de la AID o su representante, para que la examine, la documentación relativa al uso de los fondos en moneda local, según se detalla en la Sección E abajo;

f. Making available for examination by AID or its representative documentation relating to local currency use, as detailed in Section E of this Article; and

g. Manteniendo registros contables de acuerdo con regulaciones establecidas por las leyes costarricenses, suficientes para administrar la programación y desembolso de los fondos para apoyo sectorial y mostrar en su totalidad el estado en que se encuentra la ejecución de los programas. (Cada entidad ejecutora mantendrá registros contables detallados de conformidad con el Artículo IV, Sección B.).

g. Maintaining accounting records in accordance with the regulations established by the Costa Rican laws, sufficient to manage the programming and disbursement of the sector support funds and to fully disclose the status of implementation of the programs. (Detailed accounting records will be maintained by each implementing entity in accordance with Article IV, Section B.)

h. Verificar que se realicen las auditorías de los programas de conformidad con el Artículo IV., Sección D.)

h. Ensuring that audits of the programs are undertaken in accordance with Article IV., Section D.

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2. Responsabilidades del BCCR. El Banco Central será responsable de:

a. Abrir cuentas separadas en el BCCR de acuerdo con la Sección D.1. descrita abajo;

b. Transferir y desembolsar los fondos, a solicitud escrita de la AID y el GOCR, de acuerdo con las disposiciones de transferencia y desembolso incluídas en la Sección D descrita abajo, o de otro modo, según lo convengan por escrito el GOCR y AID; y

c. Mantener documentación adecuada que demuestre la transferencia y desembolso de fondos.

3. Responsabilidades de la AID. La responsabilidad de AID se limita a revisar la documentación para determinar que la moneda local fue transferida o desembolsada a cuentas acordes con la programación sectorial presentada en este Acuerdo.

Sección E. Transferencia y Desembolso de Fondos

1. Transferencia de Fondos

a. El BCCR abrirá cuentas separadas, que no devenguen intereses en el mismo BCCR, a nombre de las instituciones ejecutoras o bien del sector específico o contrapartida que se financiará a más tardar treinta días después de firmarse este Acuerdo; dentro del mismo lapso el BCCR proporcionará a la AID una lista de las cuentas a satisfacción de la AID. El BCCR también proporcionará una copia de la lista al GOCR.

b. Dentro de los quince días siguientes al recibo de la lista, la AID emitirá documentación con instrucciones al BCCR para transfe-

2. BCCR Responsibilities. The BCCR will be responsible for:

a. Opening separate accounts in the BCCR accordance with Section D.1. below;

b. Transferring and disbursing funds upon written request from AID and the GOCR, in accordance with the transfer and disbursement provisions included in Section D below or as otherwise agreed to in writing by AID and the BCCR; and

c. Maintaining adequate documentation demonstrating the transfer and disbursement of the funds.

3. AID Responsibilities. AID's responsibility is limited to reviewing documentation to determine that local currency was transferred or disbursed to accounts consistent with the sector programming presented in this Agreement.

Section E. Transfer and Disbursement of Funds.

1. Transfer of Funds

a. The BCCR will open a separate, non - interest - bearing account in the BCCR in the name of the implementing institutions or the specific sector or counterpart to be financed not later than thirty days after the signing of this Agreement; and within that time, the BCCR shall provide to AID a list of the accounts satisfactory to AID. The BCCR shall also provide a copy of the list to the GOCR.

b. Within fifteen days after receipt of the list, AID will issue documentation instructing the BCCR to transfer funds from the

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rir los fondos de la Cuenta Especial a las cuentas individuales.

c. El BCCR contrafirmará el documento presentado por la AID y efectuará la transferencia.

2. Desembolso de Fondos

a. El GOCR y la AID acordarán un procedimiento para el desembolso de fondos de las cuentas específicas del BCCR a las unidades ejecutoras o a sus cuentas en el sistema bancario nacional. Este procedimiento reflejará los mejores esfuerzos del GOCR y de la AID para cumplir con los requisitos de ejecución del programa manteniéndose dentro de los límites de monetización. El BCCR verificará que se cumpla con los límites de monetización.

b. Una vez que el procedimiento haya sido aprobado, el BCCR podrá, a solicitud del GOCR, desembolsar fondos de las cuentas individuales del BCCR a las unidades ejecutoras o a sus cuentas en el sistema bancario nacional conforme a los procedimientos acordados.

Sección F. Informes. El GOCR acuerda proporcionar a la AID los siguientes informes durante la vigencia del Acuerdo:

1. Informes trimestrales de los desembolsos de las cuentas específicas del BCCR hacia las unidades ejecutoras o sus cuentas en el sistema bancario nacional; y

2. Informes semestrales del progreso global de los programas sectoriales.

Special Account into the individual accounts.

c. The BCCR will countersign the document presented by AID and effect the transfer.

2. Disbursement of Funds.

a. The GOCR and AID will agree upon a procedure for disbursement of funds from the individual BCCR accounts to the implementing institutions or their accounts in the national banking system. The procedure will reflect GOCR and AID best efforts to meet program implementation requirements while complying with monetization limits. The BCCR will ensure adherence to monetization limits.

b. Once the procedure has been approved, the BCCR may, at the request of the GOCR, disburse funds out of the individual BCCR accounts to the implementing institutions or to their accounts in the national banking system in conformance with the agreed procedures.

Section F. Reports. The GOCR agrees to provide AID with the following reports during the life of the Agreement:

1. Quarterly reports on disbursements from individual BCCR accounts to the implementing institutions or their accounts in the banking system; and

2. Semi-annual reports on the overall progress toward objectives of the sector programs.

Sección G. Disposiciones Especiales.

1. Fundamento de la Aprobación de la AID. La aprobación por parte de AID de estas actividades sectoriales refleja su conformidad con los programas sectoriales globales, basándose en que ellos son coherentes con el Acta de Asistencia Exterior y con el Convenio General. La aprobación no se basa en una valoración técnica o cualitativa de las actividades individuales.

2. Redepósito de Fondos. Si suceden eventos que den a la AID bases razonables para creer que el GOCR o cualquiera de las unidades ejecutoras han fallado en el cumplimiento de este Acuerdo, la AID podrá solicitar que se redepositen en la Cuenta Especial cualesquiera montos gastados contra las normas de este Acuerdo.

ARTICULO III. Contrapartida del GOCR a Proyectos Financiados por la AID

Sección A. Resumen de Programación de la Contrapartida del GOCR. El total de 800 millones de colones disponibles bajo este Acuerdo como fondo de contraparte para la programación de los Proyectos de AID se compromete bajo el Proyecto de Consolidación de la Zona Norte conforme al Acuerdo firmado el 22 de agosto de 1988 por la AID y el GOCR en el que el GOCR conviene en proveer 1.058 millones de colones como contrapartida para el proyecto.

Sección B. Responsabilidades de las Partes. Las responsabilidades delineadas en esta sección son relativas únicamente a la administración de los recursos de contrapartida en moneda local comprometidos al tenor de este Acuerdo.

Section G. Special Provisions.

1. Basis of AID Approval. AID's approval of these sector programs reflects concurrence in the overall sector programs on the basis that they are consistent with the purposes of the Foreign Assistance Act, and with the General Agreement. The approval is not based upon a technical nor qualitative assessment of the individual activities included in the sector program.

2. Redeposit of Funds. If events have occurred that give AID reasonable grounds to believe that the GOCR or any GOCR implementing entity has failed to comply with this Agreement, AID may require the redeposit into the Special Account of any amounts expended in violation of this Agreement.

ARTICLE III. GOCR Counterpart to AID-financed Projects

Section A. GOCR Counterpart Programming Summary. The Total C800 million made available under this Agreement for counterpart to AID projects programming is committed to the Northern Zone Consolidation Project pursuant to the agreement signed on August 22, 1988, between AID and the GOCR in which the GOCR agreed to provide C1.058 billion for counterpart to the project.

Section B. Responsibilities of the Parties. The responsibilities outlined in this section relate only to management of the counterpart local currency resources committed under this Agreement.

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1. Responsabilidades del GOCR. El GOCR es responsable de la administración financiera de la contribución de contrapartida comprometida según la Sección A anterior.

1. GOCR Responsibilities. The GOCR, through the Ministry of Planning (MIDEPLAN), is responsible for the financial management of the counterpart contribution committed under Section A above.

2. Responsabilidades de AID. La responsabilidad de la AID se limita a la revisión de la documentación para determinar que los fondos en moneda local fueron transferidos o desembolsados a cuentas congruentes con la programación de proyectos del GOCR presentados en este Acuerdo como contrapartida de los proyectos financiados por la AID.

2. AID Responsibilities. AID's responsibility is limited to reviewing documentation to determine that local currency was transferred or disbursed to accounts consistent with GOCR counterpart to AID-financed projects programming presented in this Agreement.

3. Responsabilidades del BCCR. Las responsabilidades del BCCR se establecen en el Artículo II, Sección C.3. detallado anteriormente.

3. BCCR Responsibilities. The BCCR responsibilities are set forth in Article II, Section C.3. above.

Sección C. Transferencia y Desembolso de Fondos. Los procedimientos para la transferencia y desembolso de Fondos se establecen en el Artículo II, Sección D.

Section C. Transfer and Disbursement of Funds. Procedures for the transfer and disbursement of Funds are set forth in Article II, Section D.

ARTICULO IV. Disposiciones Generales

ARTICLE IV. General Provisions

Sección A. Prohibición. Ninguno de los fondos de este Acuerdo se usará para capacitación policial o con propósitos militares o paramilitares.

Section A. Prohibition. No funds under this Agreement will be used for police training or for military or paramilitary purposes.

Sección B. Contabilidad y Registros. El GOCR verificará que las entidades ejecutoras responsables designadas, mantengan, según sea apropiado, libros, registros, documentos, y otra evidencia documental de acuerdo con prácticas contables generalmente aceptadas, adecuadas para respaldar totalmente los gastos y el recibo de bienes y servicios al tenor de este Acuerdo. Igualmente, El GOCR se asegurará de que los registros financieros, documentación de apoyo y toda otra documentación pertinentes a este Acuerdo sean mantenidos por la unidad ejecutora correspondiente

Section B. Accounting and Records. The GOCR shall assure that its designated responsible implementing entities, as appropriate, will maintain books, records, documents, and other documentary evidence in accordance with generally accepted accounting practices to fully substantiate expenditures and receipt of goods and services under this Agreement. Similarly, the GOCR shall assure that financial records, supporting documents, and all other records pertinent to this Agreement shall be maintained by the responsible entity for a period por un período de tres años a partir de la fecha del último desembolso realizado bajo este Acuerdo. La AID a solicitud suya tendrá acceso oportuno a la documentación de apoyo y podrá visitar los lugares en donde se lleven a cabo las actividades, según sea apropiado, con el fin de verificar que se cumplan los términos de este Acuerdo.

of three years from the date of the last disbursement hereunder. AID shall have timely access to supporting documentation and shall be able to visit activity sites, as appropriate, in order to verify compliance with the terms of this Agreement.

Sección C. Auditorías. Exámenes de los programas financiados bajo este Acuerdo en forma de auditorías se llevarán a cabo al menos una vez dentro de un período de 12 meses luego de haberse iniciado cada programa de asistencia sectorial y después de esto al menos una vez cada dos años. También habrá una auditoría de cierre para cada uno de los programas. Tales auditorías serán hechas por la Contraloría General de la República de acuerdo con sus facultades legales o por firmas contables públicas establecidas en Costa Rica según prácticas contables aceptables. Se proporcionará a la AID una copia de todos los informes de auditoría.

Section C. Audits. Examination of the programs financed under this Agreement in the form of audits shall be made at least once within the 12-month period following the initiation of each sector assistance program and thereafter at least once every two years. There shall also be a closing audit for each of the programs. The audits will be made by the Controller General of the Republic in accordance with its legal authorities, or by independent public accounting firms organized to do business in Costa Rica in accordance with normal accounting practices. A copy of all audit reports shall be furnished to AID.

Sección D. Uso de los Fondos. A menos que las partes convengan de otra forma for escrito:

Section D. Use of Funds. Except as the Parties may otherwise agree in writing:

1. Salarios y Suplementos. El GOCR se asegurará de que cualquiera de los fondos proporcionados bajo este Acuerdo que se use para pagar salarios y asignaciones a empleados del GOCR será pagado a una tasa no más alta que la permitida bajo las leyes, reglas y regulaciones del GOCR que regulan los pagos solicitados, y que de otra fuente no se están proporcionando pagos duplicados o suplementarios.

1. Salaries and Supplements. The GOCR shall ensure that any funds provided under this Agreement used to pay salaries and allowances to GOCR employees shall be paid at a rate no higher than that permitted under the laws, rules and regulations of the GOCR governing the payments requested, and that no duplicate or supplement payments are being provided from another source.

2. Costos Locales. Los fondos proporcionados bajo este Acuerdo se usarán principalmente para financiar

2. Local Costs. Funds provided under this Agreement will be used principally to finance

costos locales (en colones) de bienes y servicios. Los bienes importados al país mediante canales comerciales, pero no específicamente importados para un proyecto o programa de desarrollo, son elegibles, en tanto sean pagados en colones en Costa Rica y que su fuente y origen sea los Estados Unidos y naciones del mundo libre.

3. Viajes y Viáticos. Para todas las actividades que se realicen al tenor de este Acuerdo que requieran de viajes y viáticos, los montos máximos que un viajero individual reciba en reembolso serán fijados conforme a los procedimientos establecidos en la unidad ejecutora. El total pagado por viáticos no deberá exceder las tasas de viáticos fijadas por el Gobierno de los Estados Unidos, a menos que la AID convenga de otra forma por escrito.

Sección E. Precios Razonables. Las unidades ejecutoras no pagarán más que los precios razonables por la adquisición de bienes y servicios financiados parcial o totalmente bajo este Acuerdo. Tales bienes y servicios se procurarán mediante el empleo de prácticas comerciales justas y correctas. Para todo trabajo se obtendrán cotizaciones competitivas de acuerdo con las leyes de Costa Rica.

ARTICULO V. Vigencia del Acuerdo

A menos que las Partes convengan de otra forma por escrito, la fecha de terminación de la financiación sectorial y de contrapartida cubiertas por este Acuerdo, será 8 de Diciembre de 1993, fecha en la cual todos los servicios financiados al tenor de este Acuerdo ya habrán sido realizados y todos los bienes financiados bajo este Acuerdo habrán sido entregados para los programas y contrapartida contemplados bajo este Acuerdo.

local (colon) costs of goods and services. Goods imported into the country through commercial channels, but not specifically imported for a project or development program, are eligible, so long as they are paid for in colones in Costa Rica and their source and origin is the United States and free-world nations.

3. Travel and Per Diem. For all activities under this Agreement that require travel and per diem, the maximum amounts that an individual traveler may be reimbursed shall be the amount provided for in the implementing entity's established procedures. The total paid for per diem may not exceed Government of the United States per diem rates, unless AID otherwise agrees in writing.

Section E. Reasonable Prices. Implementing institutions shall pay no more than reasonable prices for the procurement of goods and services financed in whole or in part under this Agreement. Such goods and services will be procured by employing fair and good commercial practices. Competitive quotations for all work will be obtained as required under Costa Rican law.

ARTICLE V. Effective Life of the Agreement

Except as the Parties may otherwise agree in writing, the completion date for sector program and counterpart financing covered by this Agreement, which is December 8, 1993, is the date by which all services financed under this Agreement will have been performed and all goods financed under the Agreement will have been furnished for the programs and counterpart contemplated under this Agreement.

ARTICULO VI. Idioma del Convenio.

Este Acuerdo está preparado tanto en Inglés como en Español. En caso de ambigüedad o conflicto entre las dos versiones, regirá la versión en Español.

EN FE DE LO CUAL, la República de Costa Rica, el Banco Central de Costa Rica, y los Estados Unidos de América, cada uno actuando por medio de sus representantes debidamente autorizados, han hecho que este Acuerdo se firme en su nombre y rige a partir de la fecha y año del mismo.

ARTICLE VI. Language of Agreement.

This Agreement is prepared in both English and Spanish. In the event of ambiguity or conflict between the two versions, the English-language version will prevail.

IN WITNESS WHEREOF, the Republic of Costa Rica, the Central Bank of Costa Rica, and the United States of America, each acting through its duly authorized representative, have caused this Agreement to be signed in their names and delivered as of the day and year of this Agreement.

REPUBLICA DE COSTA RICA

Rodrigo Arias Sánchez
Ministro de la Presidencia

UNITED STATES OF AMERICA

Carl H. Leonard
Director
USAID/Costa Rica

BANCO CENTRAL DE COSTA RICA

Eduardo Lizano Fait
Presidente Ejecutivo
Banco Central de Costa Rica

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ANNEX I
ANEXO I

LOCAL CURRENCY PROGRAM BUDGET
PRESUPUESTO DEL PROGRAMA DE MONEDA LOCAL
(colones)

Program Programa	Amount Monto
Sector Support **Apoyo Sectorial**	
Water Agua	850,000,000
Transportation Infrastructure Infraestructura para el Transporte	740,000,000
Education Infrastructure Infraestructura para Educación	345,000,000
Child Welfare and Health Binestar y Salud Infantil	300,000,000
Community Development Desarrollo Comunal	100,000,000
Agriculture Agricultura	320,000,000
Rural Housing Vivienda Rural	345,000,000
Public Sector Finance Financiamiento al Sector Público	335,741,500
Subtotal	**3,335,741,500**
Counterpart to GOCR/AID Projects **Contrapartida a Proyectos GOCR/AID**	
Northern Zone Consolidation **Consolidación de la Zone del Norte**	**800,000,000**
TOTAL	4,135,741,500

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LOCAL CURRENCY AGREEMENT

Drafted by PRO:LSimard 12/9/88

Clearances: CONT:PAmos

RLA:ISmyer (draft)

PDO:LLucke

DDIR:DTinsler

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<u>ACUERDO DE EJECUCION</u> fechado el 23 de diciembre, 1988, entre el Gobierno de Costa Rica ("GOCR"), representado por el Ministro de la Presidencia, y el Gobierno de los Estados Unidos de América, representado por la Agencia para el Desarrollo Internacional ("A.I.D."), en conjunto llamados las "Partes".

POR CUANTO, los Gobiernos de Costa Rica y Estados Unidos de América celebraron un "Convenio para la Ayuda Económica, Técnica y para Propósitos Afines" (Convenio General), aprobado por la ley costarricense No. 3011 del 18 de julio de 1962, que continúa en vigor, según el cual la ayuda del Gobierno de los Estados Unidos se proporciona conforme a acuerdos escritos y firmados entre los representantes de ambos gobiernos;

POR CUANTO, el Artículo I del Convenio General estipula que a fin de ayudar al Gobierno de Costa Rica en lo que respecta al desarrollo nacional y a sus esfuerzos por alcanzar el progreso social y económico por medio de la utilización efectiva de sus propios recursos y otras medidas de ayuda propia, el Gobierno de los Estados Unidos de América proporcionará la Ayuda económica, técnica y para asuntos afines que soliciten los representantes de organismos competentes del Gobierno de Costa Rica y que aprueben los representantes del organismo u organismos designados por el Gobierno de los Estados Unidos de América para la administración de sus compromisos bajo el Acuerdo General. Dicha ayuda se proporcionará conforme a acuerdos escritos y firmados entre los representantes anteriormente indicados;

POR CUANTO, el GOCR creó una Comisión del Gobierno de Costa Rica, por el Decreto Ejecutivo No. 18108-P del 29 de abril de 1988, publicado en el Diario Oficial, "<u>La Gaceta</u>", el 20 de junio

<u>IMPLEMENTATION AGREEMENT</u> dated December 23, 1988 between the Government of Costa Rica ("GOCR"), represented by the Ministry of the President, and the Government of the United States of America, represented by the Agency for International Development ("A.I.D."), together referred to as the "Parties".

WHEREAS, the Governments of Costa Rica and the United States of America entered into a "General Agreement for Economic, Technical and Related Assistance" (General Agreement), which was approved by Law No. 3011 on July 18, 1962, which continues in effect, under which assistance from the Government of the United States may be provided in accordance with agreements written and signed between representatives of both Governments.

WHEREAS, Article I of the General Agreement provides that to assist the Government of Costa Rica in its national development and in its efforts to achieve economic and social progress through effective use of its own resources and other measures of self-help, the Government of the United States of America will furnish such economic, technical and related assistance as may hereafter be requested by representatives of appropriate agencies of the Government of Costa Rica and approved by representatives of the agency or agencies designated by the Government of the United States to administer its responsibilities within the General Agreement. Such assistance shall be made available in accordance with written arrangements agreed upon between the above-mentioned representatives;

WHEREAS, the GOCR created the Government Commission of Costa Rica by Executive Decree No. 18108-P of April 29, 1988, that was published in the official publication, "<u>La Gaceta</u>", on June de 1988, ("Comisión del GOCR"), con el propósito de atender los asuntos relacionados con el Convenio General, y con acuerdos escritos que se llegaren a firmar entre ambos gobiernos en el marco de ese Convenio; y

POR CUANTO, las Partes desean suscribir el presente Acuerdo para la adecuada ejecución del Convenio General y a fin de establecer mecanismos eficientes para aprovechar los propósitos comunes de cooperación, definiendo las formas de esa cooperación, los programas y actividades hacia los que se destinará

AHORA, POR TANTO, con el espíritu de cooperación hacia el fomento del progreso económico y social de Costa Rica conforme al Artículo I del Convenio General, las Partes acuerdan lo siguiente:

ARTICULO I Para los fines de este Acuerdo se entenderá que la "Ayuda" está constituida por las sumas en colones que resulten de los dólares estadounidenses suministrados por A.I.D. a través de los Programas de Estabilización y Recuperación Económica, que se colocarán en una Cuenta Especial en el BCCR.

ARTICULO II El Gobierno de Costa Rica solicitará la Ayuda del Gobierno de los Estados Unidos, a través de A.I.D., dentro del marco del "Convenio General", por medio de la Comisión del GOCR.

ARTICULO III La Comisión del GOCR y la A.I.D., directamente o a través de sus respectivos funcionarios . técnicos autorizados, llevarán a cabo consultas para analizar las solicitudes de Ayuda.

ARTICULO IV A.I.D., actuando en representación del Gobierno de los Estados Unidos, revisará las solicitudes de la Comisión del GOCR y, si se

20, 1988, ("GOCR Commission") for the purpose of addressing subjects related to the General Agreement and the written assistance agreements that may be signed between the Governments under that Agreement; and,

WHEREAS, the Parties wish to ensure the satisfactory implementation of the General Agreement to establish efficient mechanisms in their common interest, defining those forms of cooperation and the programs and activities to which the assistance under the General Agreement is destined.

NOW THEREFORE, in the spirit of cooperation toward furthering the economic and social progress of Costa Rica pursuant to Article I of the General Agreement, the Parties agree as follows:

ARTICLE I For purposes of this Agreement the "Assistance" is constituted only of the funds in colones generated from U.S. dollars provided by A.I.D. through Economic Stabilization and Recovery Programs and which are deposited in a Special Account in the Central Bank of Costa Rica ("BCCR").

ARTICLE II The Government of Costa Rica requests for Assistance falling within the framework of the General Agreement will be made through the GOCR Commission to A.I.D., acting on behalf of the Government of the United States.

ARTICLE III The GOCR Commission and A.I.D., directly or through their authorized technical officers, will meet to review the requests for Assistance.

ARTICLE IV A.I.D. will review the GOCR Commission's requests and, if approved, will enter into written Joint aprueban, se establecerán por escrito Acuerdos de Programación Conjuntos para disponer el desembolso de los fondos de las solicitudes de asistencia aprobadas. A.I.D. consultará con la Comisión del GOCR antes de efectuar una determinación final con respecto a las solicitudes.

Programming Agreements providing for the disbursement of funds from approved Assistance requests. A.I.D. will consult with the GOCR Commission before making a final determination regarding approval of the requests.

<u>ARTICULO V</u> El GOCR cuidará de que los programas y actividades para los que solicite Ayuda bajo este Acuerdo estén conformes con las leyes, reglas y regulaciones de Costa Rica.

<u>ARTICLE V</u> The GOCR represents that the programs and activities for which Assistance is requested and which are set forth in this Agreement are permitted by applicable Costa Rican laws, rules, and regulations.

<u>ARTICULO VI</u> Los programas y actividades para los que se apruebe la Ayuda, serán compatibles con la dirección de la cooperación y los objetivos esbozados en el Convenio General y se diseñarán para contribuir al desarrollo nacional de Costa Rica. Estos programas y actividades pueden ser ejecutados por medio de órganos públicos u otras entidades públicas de cualquier naturaleza, por medio de entidades privadas, o mediante organismos internacionales no gubernamentales de carácter regional que tengan su sede en Costa Rica. En el caso de las entidades privadas, pueden ser escogidas como unidades ejecutoras las asociaciones y fundaciones, y, además, otras entidades privadas que como receptores directos no deriven ventajas comerciales de su condición de unidades ejecutoras, ni realicen esa actividad con propósitos lucrativos propios.

<u>ARTICLE VI</u> The programs and activities financed through the Assistance will be compatible with the aims of cooperation and goals outlined in the General Agreement and will be designed to contribute to the national development of Costa Rica. These programs and activities may be implemented by public organizations or other public entities of whatever nature, by means of private entities of whatever nature, or through nongovernmental international organizations, regional in character, headquartered in Costa Rica. In the case of private entities, associations and foundations may function as implementing organizations. Further, other private entities that serve as direct recipients of funds will not derive commercial benefit through their position as an implementing organization, nor undertake this function for their own profit-making purposes.

<u>ARTICULO VII</u> Los programas y actividades cuya ejecución se realice por medio de organismos del sector público serán compatibles con el fin y ámbito de competencia de esos organismos. La ayuda económica que se suministre para los programas y actividades que esos organismos ejecuten, se incorporará a los respectivos presupuestos, según lo que establezcan las leyes costarricenses, y se subordinará además

<u>ARTICLE VII</u> The programs and activities whose execution is carried out by public sector organizations will be compatible with the goals and capabilities of those organizations. The Assistance made available for those programs and activities to be carried out by those agencies and entities shall be incorporated into their respective budgets according to established laws of Costa Rica, and shall be subject, as well,

a los procedimientos, controles y modos de evaluación adicionales que sean compatibles con lo previsto en las leyes de Costa Rica y que sean requeridos por A.I.D. según los Acuerdos de Programación Conjuntos. Los programas y actividades que se realicen por medio de entidades del sector privado o por organismos internacionales no gubernamentales estarán subordinadas a los procedimientos, controles y modos de evaluación que las Partes establezcan en los Acuerdos de Programación Conjuntos.

ARTICULO VIII Para facilitar la operación de este Acuerdo y del Convenio General, y la realización de los programas y actividades que se financien con la Ayuda, las Partes convienen en que en los futuros Acuerdos de Programación Conjuntos, se asignarán fondos a la A.I.D., adecuados a sus tareas. Los bienes que A.I.D. adquiera con esos fondos pasarán al GOCR, para los fines que éste quiera darles, una vez que la A.I.D. manifieste que no los requiere. Además, en los Acuerdos de Programación Conjuntos se asignarán a A.I.D. fondos adecuados para emplearse en los programas y actividades ejecutados por A.I.D. para los propósitos establecidos en el Convenio General.

ARTICULO IX Las Partes, por medio de Acuerdos Conjuntos de Programación, de conformidad con este Acuerdo y el Convenio General, establecerán los detalles específicos de ejecución necesarios para el desempeño de los programas y actividades individuales que son objeto de la Ayuda.

ARTICULO X: A.I.D. y la Comisión del GOCR cooperarán para asegurar que el propósito de este Acuerdo se lleve a cabo y, ante la petición de cualquiera de los dos, intercambiar puntos de vista sobre el Acuerdo y las actividades financiadas bajo el mismo. Este acuerdo puede enmendarse bajo cualquier forma escrita de conformidad entre el GOCR y la A.I.D.

to the additional procedures, controls and means of evaluation compatible with that provided by the laws of Costa Rica and required by A.I.D. in accordance with the Joint Programming Agreements. The programs and activities carried out by entities of the private sector or by nongovernmental international organizations will be subject to the procedures, controls and means of evaluation established by the Parties in the Joint Programming Agreements.

ARTICLE VIII To facilitate the success of this Agreement and the General Agreement, and the programs and activities financed through the Assistance, the Parties agree that in future Joint Programming Agreements adequate funds will be provided to A.I.D. for the accomplishment of its tasks. The non-expended physical property and real property that A.I.D. aquired with those funds will be conveyed to the GOCR, for whatever uses that it wishes, once A.I.D. determines that it no longer requires such property. Furthermore, Joint Programming Agreements will provide adequate funds to A.I.D. to be used in programs and activities administered by A.I.D. for the purposes established in the General Agreement.

ARTICLE IX. The Parties, by means of Joint Programming Agreements, in accordance with this Agreement and the General Agreement, will establish specific implementation details necessary for the proper execution of the individual programs and activities that are the object of the Assistance.

ARTICULE X A.I.D. and the GOCR Commission will cooperate to assure that the purpose of this Agreement is carried out and will, at the request of either, exchange views on the Agreement and the activities financed under the Agreement. The Agreement may be amended by any form of written agreement between A.I.D. and the GOCR.

EN FE DE LO CUAL, los Gobiernos de Costa Rica y de los Estados Unidos de América, cada uno actuando a través de su representante debidamente autorizado, han hecho que este Acuerdo se firme y se ejecute a partir de la fecha y año que lo encabezan.

IN WITNESS WHEREOF, the Governments of Costa Rica and the United States of America, each acting through its duly authorized representatives, have caused this Agreement to be signed and delivered as of the day and year first written above.

Rodrigo Arias Sánchez
Ministro de la Presidencia

Carl H. Leonard
Director USAID/COSTA RICA

ILLUSTRATIVE LOCAL CURRENCY USES
($000)

		($ equivalent)
CAPS		1,500
Natural Resources Counterpart		10,000
BANHVI		10,000
CINDE		26,000
Northern Zone Counterpart		3,000
AID Operating Expenses		5,000
Public Sector Efficiency		5,000
Supplemental Sector Support		5,000
Program Trust Funds		4,500
Sub-Total	$	70,000
GOCR Sectoral Support		15,000
TOTAL	**$**	**85,000**