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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 PROGRAM II
(AMENDMENT)

AID/LAC/P-123/1

Loan Number:515-K-040/A
Grant Number:515-K-602/A1

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CLASSIFICATION:

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROGRAM ASSISTANCE APPROVAL DOCUMENT (PAAD)

1. PAAD Number
Grant 515-K-602 Amend 1 Loan 515-K-040 A

2. Country
Costa Rica

3. Category
Cash Transfer

4. Date

5. To
A/A.I.D., M. Peter McPherson

6. OYB Change Number

7. From
AA/LAC, Otto J. Reich

8. OYB Increase

To be taken from:
Economic Support Funds (ESF)

9. Approval Requested for Commitment of
$ 30,515,000(loan); 19,485,000(grant)

10. Appropriation Budget Plan Code
LESA-83-35-515-KL-31 LESA-83-35-515-KG-31

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

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

13. Estimated Delivery Period
FY 1983

14. Transaction Eligibility Date

15. Commodities Financed

16. Permitted Source		17. Estimated Source	
U.S. only		U.S.	$50,000,000
Limited F.W.		Industrialized Countries	
Free World		Local	
Cash	$50,000,000	Other	

18. Summary Description

The $50 million ($30,515,000 loan; $19,485,000 grant) PAAD is an amendment to the ongoing Economic Stabilization and Recovery Program II, which is designed to provide Costa Rica with critical balance of payment support and to assist the GOCR carry out the changes in fiscal, monetary and foreign exchange policies contained in its Agreement with the IMF. The program continues to support the objectives of the Costa Rica CBI Implementation Plan for Private Sector Development. The amendment to the program places particular emphasis on the attainment of the export and investment expansion objectives of the plan.

The Borrower will be the Central Bank of Costa Rica (BCCR), which will administer the loan and dollar portions of the program through the National Banking System. Within three months of the termination of the program's disbursements, the BCCR will make available to private importers an amount of foreign exchange not less than that disbursed under the United States Government's economic stabilization program for the import of raw materials, intermediate goods and spare parts from the United States.

The colon equivalent of the $30,515,000 loan portion of the program will be used to support the BCCR credit program for the private sector and to establish a credit guarantee program.

The colon equivalent of the $19,485,000 grant portion of the program will be used to finance priority housing projects, to finance investment production credit for a land redistribution program, and for other high priority social and economic development activities to be jointly programmed by A.I.D. and the GOCR. The loan will be repaid in 30 years, including a ten year grace period. The interest rate will be 2% during the grace period and 3% thereafter. The $50.0 million program will be subject to the conditions and covenants specified on pages 34 - 36 of this document.

19. Clearances		Date
PPC/PDPR:EHullander		
GC:R.A.Derham		5/28/83
AA/PPC:J.Bolton		5/27/83
FM:C.Christensen		5/27/83
LAC/DR:D.B.Johnson		5/27/83
ARA/ECP:RBash		
LAC/CEN:P.Askin		5/19/83
GC/LAC:R.Meighan	RM	
LAC/DP:R.Oleson		
PPC/PB:H.Handler		

20. Action

[X] APPROVED [ ] DISAPPROVED

Authorized Signature

Date May 27, 1983

Title

AID 1120-1 (5-82)

CLASSIFICATION:

PROGRAM ASSISTANCE APPROVAL DOCUMENT AMENDMENT

COSTA RICA: ECONOMIC STABILIZATION AND RECOVERY PROGRAM II

I. SUMMARY AND RECOMMENDATION

A. Economic Background

As has been well documented in the past two years1/, Costa Rica's economy continues to deteriorate and will experience further decline before necessary structural adjustments are in place. Although the Costa Rican economy has reached a temporary, tenuous degree of stability within the last six months, with a revaluation of the currency in the "free" market and a significant drop in the internal rate of inflation, the analysis in this PAAD indicates that this stability is, at best, fragile. The economy in 1983 will continue to be plagued by continuing GDP decline and an unmanageable public debt. For many years to come Costa Rica will continue to experience sizeable balance of payments deficits due principally to high levels of debt service and projected slow export growth. The updated balance of payments analysis for 1983 contained in this PAAD indicates that even after including $241 million of compensatory financing from AID, the IMF, and the multilateral development banks, and assuming that $938 million of commercial bank principal and interest can be rolled-over, and taking into account Paris Club refinancing, that there will remain an unfinanced gap of $101 million. Current interest alone due on the

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

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

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

This proposed $50.0 million program is an amendment to the ongoing Economic Stabilization and Recovery Program II, which is designed to provide Costa Rica with critical balance of payment support, and to assist the GOCR in carrying out the changes in fiscal, monetary and foreign exchange policies contained in its Agreement with the IMF. In addition, this program continues support of the objectives of the Costa Rica CBI Implementation Plan for Private Sector Development. In this PAAD amendment particular emphasis will be placed on the attainment of the export and investment expansion objectives of the plan. The program also supports key socio-political objectives of the GOCR.

B. Program Summary

The proposed $50.0 million amendment to the ongoing Economic Stabilization and Recovery (ESR) Program II will consist of a cash transfer to the Central Bank of Costa Rica (BCCR), of which $30,515,000 will be loan and $19,485,000 million will be grant.

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

1/ See San José 1666 (classified)

The components of the PAAD amendment are:

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

Disbursements under the ESR II program to the BCCR may not exceed the following schedule:

(Million of U.S. Dollars)

	Original ESR II		Revised ESR II		
	Loan	Grant	Loan	Grant	TOTAL
First	6.5	8.0	6.5	8.0	14.5
Second	10.0	-	10.0	-	10.0
Third	10.0	3.25	10.0	3.25	13.25
Fourth	-	-	-	10.0	10.0
Fifth	10.0	-	10.0	-	10.0
Sixth	10.0	-	10.0	-	10.0
Seventh	10.0	-	10.0	-	10.0
Eighth	5.985	-	5.985	4.0	9.985
Ninth	-	-	4.515	5.485	10.0
Tenth	-	-	10.0	-	10.0
Eleventh	-	-	10.0	-	10.0
Twelfth	-	-	6.0	-	6.0
	62.485	11.250	93.000	30.735	123.735

Disbursements are scheduled and conditioned in such a manner as to encourage and support continued GOCR adherence to its Standby Agreement with the IMF, as well as to assure the formal adoption by the GOCR of a coherant export and investment strategy. Disbursements after July 31, 1983, will depend on the formal adoption by the GOCR of an export and investment expansion strategy and work plan which is acceptable to A.I.D.

The economic analysis performed for the original ESR II program indicates that no problem should exist on the demand side with respect to the amount of foreign exchange to be made available to the

1/ Total dollar resources under the ESR II program are $123,735,000.

private sector by the BCCR within the specified time period.

2. Local Currency Resources

a. The colon equivalent of the $30,515,000 loan portion of the program will be used to support the BCCR credit program for the private sector. The following is illustrative of the types of programs to be undertaken and the amounts to be allocated for each: (a) the colon equivalent of $17,515,000 to increase the liquidity of the unsubsidized credit programs budgeted for the productive private sector through the National Banking System (SBN); (b) the colon equivalent of $10.0 million to establish a guarantee fund which will guarantee an estimated $50.0 million of industrial and agro-industrial loans; (c) the colon equivalent of $3.0 million to continue a modified form of the highly successful industry credit program established under AID Loan 515-W-028 (Urban Employment and Community Improvement), accessible to both private and public banks.

b. The colon equivalent of the $19,485,000 grant portion of the program will be used to support a number of high priority social and economic development activities. These activities may include priority housing projects and investment production credit for a land distribution program. These funds will be held in a special account which AID would program jointly with the GOCR.

C. Borrower/Grantee

The Borrower and Grantee will be the Central Bank of Costa Rica (BCCR), which will administer the loan and dollar portions of the program through the National Banking System. The grant portion of the local currency program will be administered by various Costa Rican entities.

D. Conditions and Covenants

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

E. Recommendation

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

II. CURRENT ECONOMIC SITUATION

A. Introduction

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

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

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

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

The IMF conditions are tough, but Costa Rican authorities have informed AID officials that the GOCR has every intent to meet them. Although there has been some question as to whether the GOCR will be considered to have met the March 31 tests, as of February 28, 1983, they were well within the limits[1/]. It is thought that questions as to whether the March 31, 1983 targets were met is merely a definitional problem which will be resolved shortly. No prognosis can be made at this point with respect to the Government's ability to comply with the targets set for subsequent quarters.

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

B. The Balance of Payments in 1982 and 1983

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

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

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

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

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

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

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

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

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1/ See San Jose 1666 (classified)

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

C. Net International Reserves

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

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

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

D. Debt Service Charges

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

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

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

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

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

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

2/ Assumes rescheduling of public debt.

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

E. Real GDP

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

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

The outlook for 1983 is not encouraging. The Central American Common Market is seriously depressed, banana and coffee prices are low and are not expected to recover significantly, the shortage of foreign exchange is likely to continue to hamper manufacturing industry, and internal inflation is discouraging exports and depressing real savings. Imports are projected to increase by only 6% in current prices, which means no increase in real terms. As a result of these various factors, the Central Bank anticipates another decline in the real GDP in 1983, perhaps in the order of 2 to 3 percent, and worse if anticipated compensatory financing is not forthcoming to finance the required levels of imports.

F. Fiscal Situation

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

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

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

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

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

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

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

G. Monetary and Price Situation

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

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

H. The IMF Agreement

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

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

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

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

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

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

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

BEST AVAILABLE

- o Avoid a further decline in net internationl reserves.

- o Increase social security contributions by 4%: 2% for the employer and 2% for the employee.

- o Adjustment of interest rates: the rate on six-month deposits is to rise to 25%, while interest charged on agriculture loans is also to rise to that level. Interest rates will continue to be adjusted to take into account the current and expected rate of inflation, interest rates abroad and the demand for credit from the private sector, in order to approach rates that are positive in real terms.

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

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

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

III. RESULTS AND CURRENT STATUS OF PRIOR ESF PROGRAMS

Since the Monge Administration took office in May of 1982, to February 28, 1983, USAID/Costa Rica has disbursed over $94 million in DA, ESF, PL 480, and ̄G resources. Our assistance has been an impo tant element in helping . sta Rica to achieve the precarious economic improvement it is no xperiencing and has also been key to significant policy redirection. two prior ESF-funded Economic Stabilization and Recovery Programs laying an important overall role in this, the initial stabilization phase.

A. Economic Stabilization and Recovery I (ESR I)

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

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

B. Economic Stabilization & Recovery II (ESR II)

This program which is being financed by the CBI supplemental presently totals $73,735,000[2/] of which $65,485,000 is loan funded and $11,250,000 is grant funded. On the dollar side, the entire $73,735,000 is in the form of a cash transfer to the Central Bank. Two disbursements to date under the program total $24.5 million of which $8.0 million is grant-financed.

1/ See San José 1666 (classified)

2/ The total amount o funds appropriated under the CBI supplemental for Costa Rica was $75.0 million. However, $1.265 million of the $75.0 million was authorized and obligated for three discrete grant projects.

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

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

(1) <u>Private Sector Export and Investment Promotion and Other PVO Activities ($11.25 million grant)</u>

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

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

Under the ESR II Assistance Agreement the BCCR agreed: "to establish prior to March 31, 1983[1/], in form and substance satisfactory to A.I.D., with local currency generated from the sale of transferred dollars, a special credit line, similar to that established under AID Loan No. 515-K-037 (ESR I), to be used exclusively by private banks through which the colon equivalent of at least ten million United States Dollars (U.S. $10,000,000) will be extended as credit to private producers and manufacturers." The Mission, with AID/W approval, changed the due date on this covenant to March 31, 1983, because the BCCR took considerable time in submitting to USAID the regulations governing this credit line. We are now in the process of reviewing those proposed regulations. It appears that some differences exist between the A.I.D. and BCCR approaches to this credit line and that negotiations will have to take place to overcome those differences.

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

The ESR II program also called for the establishment "...prior to March 31, 1983[1/], in form and substance satisfactory to A.I.D., with local currency generated from the sale of transferred dollars, a special credit line of the colon equivalent of at least five million United States Dollars (U.S. $5,000,000) to be utilized exclusively for the provision of mortgage financing for families below or at the median income level through the Sistema Nacional de Ahorro y Préstamo (National Savings and Loan System);". As a result of the DAEC review of ESR II the Mission agreed to undertake an update of the SNAP's financial condition. This study, which was sent to AID/W, will be revised so as to present a more comprehensive recovery plan for the SNAP which will demonstrate how and why the mix of HG and ESF local currency resources will keep the system afloat. The study which was submitted did point out that the SNAP was in worse condition than had been previously recognized, that emergency measures were justified, and that the below the median income level restriction was partially at odds with perserving the private sector nature of the SNAP.

1/ On February 10, 1983, the AA/LAC approved an amendment to the covenant which extended the covenant compliance dates from January 31, 1983 to March 31, 1983. The justification of the extension was that the first disbursement of the program was later than anticipated and therefore did not permit sufficient time to develop the necessary procedures to establish the credit lines.

IV. PROGRAM RATIONALE AND OBJECTIVES

A. U. S. Interests

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

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

The tenuous stability, especially with regard to the exchange rate, that the Costa Rican economy has regained is deceptive in that it is not totally based on fundamental factors, and it is dangerous in that it is lulling many Costa Ricans, especially the more affluent, into the illusion that the worst is over and that they can soon get back to previous levels of consumption[1/]. The temporary stability is deceptive because of two factors:

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

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

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

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

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

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

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

B. Program Objectives

1. Overall ESR Objectives

As stated in the original ESR II PAAD, USAID/Costa Rica's economic stabilization program supports the goals and objectives presented in the approved CBI Implementation Plan for Costa Rica. The goals of this plan are as follows:

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

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

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

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

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

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

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

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

2. Specific Objectives of PAAD Amendment

a. Economic Stabilization and Recovery

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

Section II, Current Economic Situation, analyzes and describes the acute nature of the balance of payments problem which Costa Rica faces in 1983. Even counting CBI supplemental disbursements during the year of $73,735,000 and the $50,000,000 of resources to be provided under this program, as well as all expected multilateral bank disbursements and assuming $228 million in new commercial bank import financing (partial interest average roll-over), an unfinanced gap of some hundred million dollars still exists at a zero growth GDP target.[1/] Thus, an important objective of this program, as is true for almost all of USAID/CR's efforts, is its effect on the balance of payments.

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

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

Additional ESF resources of $35.0 million will have to be appropriated by Congress to reach these levels. Assuming that these resources in fact materialize, the additional ESF could be disbursed in the last quarter of 1983 to compensate for multilateral shortfalls, which at present appear probable.

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

1/ This is the target of the original IMF program and does not take into account more recent adverse factors discussed in Section IIE.

(2) Justification for Cash Transfer

The reasons for using the cash transfer mechanism, which were described at length in the PAADs for ESR I and ESR II, remain essentially unchanged, and the Mission has concluded that the cash transfer mechanism is also applicable to the PAAD amendment.

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

b. Expansion of Exports and Investments

As a result of the DAEC review of the PAAD for ESR II which had the A.D. Little Study[1/] as an Annex, it was decided that prior to authorizing this program, the GOCR should develop a coherent export and investment promotion strategy. The socio-political objectives of this program, which are discussed below have made the full-blown development of that strategy prior to authorization and initial disbursement an impossible task. In spite of the foregoing, considerable progress has been made by the GOCR towards the development of an export and investment strategy. After an in-depth briefing on the results of the A. D. Little study at the highest levels of the Costa Rican Government, many of the report's major thrusts have been adopted as policy. The report's most important recommendation, that the GOCR name an authority at the highest level to develop and implement a coordinated export and investment strategy has been fully implemented. On March 9, 1983, after a careful

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

process of consultation with key advisors and cabinet members, President Monge named Dr. Mario Carvajal H. as Minister (without portfolio) for Exports and Investments. Minister Carvajal has already become an effective advocate both within the councils of government and in public for change in the export policy environment. Minister Carvajal has set for himself as his first task the development a coherent export and investment strategy and detailed work plan within ninety days. Grant local currency resources from this program's first disbursement will assist Minister Carvajal in the fuller development of the strategy, the formal adoption of which we propose to make a subsequent condition precedent for disbursements beyond July 31, 1983.

While it is not possible at this time to describe fully the entire GOCR export and investment strategy, the strategy will have to address the following issues:

- the overall competitiveness of Costa Rica in attracting investment for export, including GOCR's tax policy and special tax incentives for exporters. Non-tax incentives and disincentives will also have to be addressed.
- the competitiveness of Costa Rica's exports in world markets and the effect of GOCR export taxes and exchange rate policy.
- the relative exphasis that will be placed on expanding traditional vs. non-traditional exports as well as similar definitions of the relative emphasis to be given to attracting assembly industries in the short-term and agro-industry in the longer term. The emphasis to be placed on tourism and conventions as a foreign earner will also require discussion.
- the institutional issues in the export and investment areas, among which are are the proper role of CENPRO, the activities and institutional location of a "one-stop investment center", the modification of the free zone legislation, and the need for investment promotion offices abroad. A strategy for simplifying public sector procedural obstacles to investment and export activities will also have to be developed.
- financial constraints and transportation obstacles to exporters will also have to be addressed.

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

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

d. Socio-Political Objectives

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

It was in part in order to be responsive to President Monge's request that President Reagan recently announced an increase, subject to Congressional approval, of $60.1 million in USAID/Costa Rica's overall assistance package. This increase consists of a mixture of DA, ESF, and PL 480 resources. In President Reagan's reply to President Monge's request for increased assistance he stated that he was committed to providing substantial U.S. economic assistance, part of it on a grant basis and the rest on highly concessional terms."

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

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

C. Rationale for Grant Funding and Loan Terms

1. The External Debt

Costa Rica's crushing debt service burden, which requires the rescheduling of both its private and public debt, has been amply documented in this and other documents. At present, this debt is estimated to total some $4.0 billion. As has been pointed out previously, current interest on the external public debt alone totals some 49% of merchandise exports; and amortization in the next ten years of commercial bank debt will prove impossible. Therefore, although the infusion of new concessional multilateral and bilateral resources will improve the term structure of Costa Rica's public debt, that debt can still be expected to increase massively and could easily be in the $6-8 billion range five years from now. Although the bulk of this new debt can be expected to be on "concessional" terms, the multilaterals are charging 8-10% interest and their policies do not permit rescheduling. Although this Mission does not know of studies of the long-term consequences of Costa Rica's indebtedness[1/], debt service ratios in excess of 50% for the next decade or two are easily envisioned as is a "black hole" of debt phenomenon. Admittedly, these considerations do not support a specific grant target under this program. They do, however, justify the conclusion that every effort must be made to provide Costa Rica with economic assistance on the most concessionary terms possible.

2. The IMF Agreement

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

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

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

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

- The approximately $5.0 million colon equivalent increase in public expenditures resulting from the

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

local currency housing program, which is described in Section V;

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

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

- Expenditures in 1983, estimated at the equivalent of \$300,000-\$400,000 for activities which are to be undertaken by the new Minister of Exports and Investments and other local currency expenditures of \$400,000-\$500,000 also related to the PPAI project.

3. The Local Currency Program

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

V. PROGRAM DESCRIPTION

A. Program Components

The components of the proposed program are as follows:

1. The $50.0 million in assistance to the Central Bank of Costa Rica consists of a $30,515,000 million loan and $19,485,000 grant.

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

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

b. The local currency equivalent of the grant portion of the program will finance high priority social and economic impact projects.

B. U. S. Dollar Resources

1. Disbursement of U. S. Dollar Resources

Disbursements under the ESR II program to the BCCR may not exceed the following schedule:

(millions of U.S. Dollars)

Dibursement	Loan	Grant	TOTAL
Initial	6.5	8.0	14.5
Second	10.0	-	10.0
Third	10.0	3.25	13.25
Fourth	-	10.0*	10.0
Fifth	10.0	-	10.0
Sixth	10.0	-	10.0
Seventh	10.0	-	10.0
Eighth	5.985	4.0*	9.985
Ninth	4.515*	5.485*	10.0
Tenth	10.0*	-	10.0
Eleventh	10.0*	-	10.0
Twelfth	6.0*	-	6.0
	93.000	30.735	123.735

* Denotes additional disbursements to ESR II program as a result of this PAAD amendment.

2. Use of U. S. Dollar Resources

A $50 million cash transfer to the Central Bank of Costa Rica (BCCR) is proposed, of which $30,515,000 would be a loan and $19,485,000 would be a grant. The loan portion of the transaction will be a 30 year loan with a 10 year grace period, 2% interest during the grace period, and 3% thereafter[1/].

Within three months of the termination of disbursement of the 1983 ESR II program, the BCCR will make available for private sector use an amount of foreign exchange at least equal to that disbursed under the cash transfer for the import of raw materials, intermediate goods, [illegible] spare parts from the United States. In the event that not all this program's cash transfer disbursements are completed in 1983, the BCCR will make available within three months after the termination of those disbursements an amount not less than that disbursed after 1983. The BCCR will sell the dollars it makes available through the public and private banks of the National Banking System, as well as through private financieras, in accordance with the priorities and systems established by the BCCR. Assuming that the planned cash transfer disbursement schedule is adhered to, the [illegible]CR would have to make available an average of approximately $10 million a month for such imports. Data provided by the Central Bank show that in 1980, the last "normal" year, Costa Rica's imports of raw materials and intermediate goods from the U.S. alone totalled $251 million, or approximately $20 million per month. Moreover, the BCCR's present foreign exchange allocation system and priorities favor the import of raw materials, intermediate goods, and spare parts. No problem should therefore exist on the demand side with respect to the BCCR meeting this requirement.

3. Management of U. S. Dollar Resources

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

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

C. Local Currency Resources

Immediately following dollar disbursements of each tranche of grant funds under the program, the colon equivalent of the grant will be placed in a special account. The Mission will require the submission of a formal proposal from an implementing agency prior to approving funding for an activity from this account. A standardized format for the presentation of proposals will be developed which will include a description of the proposed activity including necessary feasibility analyses, specific outputs to be achieved, an implementation plan and a budget. USAID approval will be given via a numbered letter of agreement or project implementation letter. Once approved, funds will be placed in a activity-specific account, fund, or credit line. Post-audits of disbursements for the activities to verify compliance with approved financial and implementation plans will be required.

Local currency deriving from loan funded assistance will be programmed and disbursed pursuant to subsequent memoranda of understanding or other documents which will be prepared and executed to give effect to the provisions of pertinent covenants to the assistance agreement.

The activities described below are illustrative of the types of projects that will be financed under the local currency program. Activities actually implemented, with the exception of the BCCR credit program, will be developed and approved in accordance with the procedures described above.

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

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

a. The BCCR Credit Program

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

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

b. Credit Guarantee Program

As a result of economic uncertainties, and because of exchange losses, many Costa Rican enterprises are not bankable given traditional accounting and banking criteria. As a result, most banks are seeking guarantees from these enterprises in excess of their capabilities to offer them. The guarantees that are being requested by the banking system from private productive enterprises are constraining the flow of credit to even financially sound enterprises. Thus increases in liquidity in the banking system do not translate into real improved credit availability for firms that cannot provide the types or amounts of guarantees demanded by the banks. To help address this problem, the establishment of a guarantee fund for credit provided by the banking system to industrial, agro-industrial, and construction enterprises, and, particularly, to firms involved in export activities is under consideration. The colon equivalent of up to $10 million would be held in a BCCR account or in another financial institution for this purpose. The users of this fund would pay a commission which will cover the fund's administrative costs and expected losses. The BCCR estimates that such a fund could guarantee a portfolio at least five times the size of the fund. If further analysis indicates that appropriate restrictions on the application of the guarantee would warrant a smaller guarantee fund, the balance not required for this purpose would be used as in section (a) above.

c. Small Industry Credit Fund

The Small Industry Credit Program, a BCCR discount line, established under the Urban Employment and Community Improvement Loan (515-W-028) has fully disbursed the $3.255 million allocated to it under that loan. After some initial start-up problems, the program is a resounding success and has resulted in the creation of many jobs for people who might otherwise be unemployed. Many new enterprises have been assisted by the fund, some of which export non-traditional products. Reflows from the A.I.D. loan are inadequate to meet present demand. Interest rates to final borrowers through the program have been 12%. In order to satisfy the unmet credit demand of this group of small-scale, dynamic entrepreneurs, to help create jobs in this sector, and to do so at interest rates which more nearly reflect commercial interest rates in

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

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

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

a. Urban Housing

Drastically reduced real wages in Costa Rica and continued austerity measures have destroyed the hopes of homeownership for large segments of the population that previously could have aspired to eventually acquire a housing solution, especially Costa Rica's lower middle class, for many of whom HG-financed solutions are not accessible because their incomes exceed the median. Presently, affordable housing solutions do not exist for this target group from any source. It is precisely this group of wage earners who have been most adversely affected by the decreased value of their earnings. Sensing that this target group is ripe for leftist extremist organization around the housing issue, President Monge has specifically requested a special housing program for this target group during this, the worst part of the economic crisis. To address this problem, various formulations of housing programs are under consideration to provide the colon equivalent of $5.0 million of local currency for mortgage financing through INVU, the Savings and Loan System, or other private sector channels.

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

b. Land Distribution

Just as the GOCR is faced with the need to respond to housing demands in urban areas, in the rural areas the pressure is for land ownership. Contrary to generally held beliefs, Costa Rica's democracy and egalitarianism has not extended to the ownership of agricultural land1/. The high degree of political organization in rural areas makes it difficult for the GOCR to ignore this issue. Accordingly, the colon equivalent of approximately $6.1 million will be allocated to permit the GOCR to respond to this problem.

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

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

Feasibiltiy questions exist regarding the use of market interest rates for agricultural loans (26.5%) in this activity which requires four years until cash flow starts and fifteen year financing, especially at a time when world market prices for palm oil are depressed. But programs of this type should be planned for the very long-run and such arrangements as a variable interest rate related to world market prices

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

and capitalization of interest during a four year grace period have to be examined. Grant funding through BANCOOP and COFISA could make such arrangeme workable if the project is fundamentally economically sound in the long-run, a question the USAID will examine prior to finalizing this activity.

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

c. Selective Development Activities

The funds remaining in the local currency account in the BCCR will be jointly programmed by the GOCR and AID to support high priority social and economic development activities in Costa Rica. For example, funds could be programmed to assist the newly appointed Minister of Exports and Investments in the implementation of the export and investment strategy. By freeing the Minister of Exports and Investment from dependence upon GOCR appropriated funds, the export and investment programs that he will oversee will not be subject to the salary, contracting and other bureaucratic restrictions that are the common cause of failures of similar programs in Costa Rica and elsewhere.

VI. CONDITIONS, COVENANTS AND SPECIAL PROVISIONS

The proposed program has been discussed with officials of the BCCR. With the possible exception noted in the footnote on p. 31, which may affect Covenant 3, we expect no difficulties in negotiating this program quickly. The Mission believes that the program, as described in the PAAD amendment, responds to the needs of Costa Rica. The following conditions and covenants will be in addition to those outlined in the original PAAD for ESR II.

A. Conditions

Proposed conditions precedent to the signing of the Assistance Agreement for the additional funds for the ESR II program:

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

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

The following is a proposed condition precedent to disbursements of the loan and grant after July 31, 1983 :

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

B. Covenants

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

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

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

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

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

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

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

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

7. To move progressively, in the course of 1983, towards the unification of the inter-bank and free exchange rates in accordance with the targets outlined in the IMF Agreement; and

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

C. Special Provision

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

(Millions of U.S. Dollars)

Disbursements	Loan	Grant	Total
Initial	6.5	8.0	14.5
Second	10.0	-	10.0
Third	10.0	3.25	13.25
Fourth	-	10.0	10.0
Fifth	10.0	-	10.0
Sixth	10.0	-	10.0
Seventh	10.0	-	10.0
Eighth	5.985	4.0	9.985
Nineth	4.515	5.485	10.0
Tenth	10.0	-	10.0
Eleventh	10.0	-	10.0
Twelth	6.0	-	6.0
	93.0	30.735	123.735

ANNEX I , TABLE 1

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

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

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ANNEX I, TABLE 2

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

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

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

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

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

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ANNEX I, TABLE 3

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

	Diciembre 1981	Diciembre 1982*	Diciembre 1983**	VARIACIONES 1982 / 1981 Absoluta	VARIACIONES 1982 / 1981 Porcentual	VARIACIONES 1983 / 1982 Absoluta	VARIACIONES 1983 / 1982 Porcentual
Reservas monetarias internacionales netas	-9.420,0	-4,420,0	-4,420	5,000,0	53,1	-	-
Crédito Total	24.010,9	33.297,1	44.546,1	9.286,2	38,7	11.249,0	33,8
Al Gobierno (neto)	6.467.1						
Entidades Oficiales	4.162,8	14.323,2	16.323,2	3.693,3	34,7	2.000,0	14,0
Sector privado	13.249,6	18,842,5	28,091.9	5.592,9	42,2	9.249,0	49,1
Al exterior	131,4	131,4	-	-	-	-	-
Otros Activos Netos	54.499,2	57.034,6	68.424,0	2.535,4	4,6	11.389,4	16,6
TOTAL	69.090,0	85.911.5	108.550,1	16.821,5	24,3	22.638.6	26,4
Liquidez Total	33.717,3	47.114,3	60.317,9	13.397,0	39,7	13.203,6	28,0
Medio Circulante	10.808,9	19.198,0	26.288,0	8.389,1	77,6	7.090,0	36,9
Numerario en poder del público	3.500,9	6.300,0	8.630,0	2.799,1	79,9	2.330,	37,0
Depósitos cuenta corriente	7.308,0	12.898,0	17.658,0	5.590,0	76,5	4.760,0	36,9
Cuasidinero	22.908,4	27.916,3	34.029,9	5.007,9	21,9	6.136,6	21,9
Endeudamiento externo	35.372,7	38.797,2	48.232,2	3.424,5	9,7	9.435,0	24,3
TOTAL	69.090,0	85.911,5	108.550,1	16.821,5	24,3	22.638,6	26,4

* Estimado

** Programado

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

ANNEX I, TABLE 4

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

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

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

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Table 4, p.2

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

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

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

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

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

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

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

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

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3A(2) - NONPROJECT ASSISTANCE CHECKLIST

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

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

A. GENERAL CRITERIA FOR NONPROJECT ASSISTANCE

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

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

   CN will be forwarded 15 days prior to obligation.

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

   Yes.

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

   No such action is required

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

   No.

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

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

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

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

N/A

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

N/A

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

N/A

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

N/A

3. Nonproject Criteria for Development Assistance (Loans only)

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

N/A

A.

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

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

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

N/A

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

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

B. FUNDING CRITERIA FOR NONPROJECT ASSISTANCE

See PAAD Section IV; N/A

1. Nonproject Criteria for Security Supporting Assistance

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

2. Nonproject Criteria for Development Assistance

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

N/A

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

N/A

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

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

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

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

(a) to help alleviate energy problem;

(b) reconstruction after natural or manmade disaster;

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

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

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

b. FAA Sec. 201(b)(2); 201(d). Information and conclusion on (1) capacity of the country to repay the loan, including reasonableness of repayment prospects, and (2) reasonableness and legality (under laws of country and United States) of lending and relending terms of the loan.	N/A
c. FAA Sec. 201(e). If loan is not made pursuant to a multilateral plan, and the amount of the loan exceeds $100,000, has country submitted to AID an application for such funds together with assurances to indicate that funds will be used in an economically and technically sound manner?	N/A
d. FAA Sec. 202(a). Total amount of money under loan which is going directly to private enterprise, is going to intermediate credit institutions or other borrowers for use by private enterprise, is being used to finance imports from private sources, or is otherwise being used to finance procurements from private sources?	N/A
4. Additional Criteria for Alliance for Progress	Title VI of the FAA was repealed in 1978.

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

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

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