(Translation)

PRELIMINARY PROJECT OF MONETARY LAW

AND OF

REGULATION OF INTERNATIONAL TRANSFERS

Prepared for the

National Bank of Costa Rica

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Preliminary Project of Monetary Law and of

Regulation of International Transfers

Introductory Report

Introduction:

A. Need for Reform:

Since the suspension of convertibility of the currency in the year 1931, Costa Rica has lived under a de facto monetary system, without any of the guarantees provided by organic monetary legislation.

Although some provisions of a monetary character are included in the law of 1936 regulating the National Bank, these provisions are excessively rigid and theoretical and, consequently, have never been put into practice during the eight years which have elapsed since the enaction of that legislation. Much more important in practice is the exchange control legislation. This legislation was adopted hastily under the pressure of emergency conditions and today appears extremely deficient, considering the nature of the present problems and the techniques which have become available with the evolution of modern monetary theory. Furthermore, the exchange control legislation establishes an exceedingly rigid system, the spirit of which is directly opposed to the equally rigid monetary provisions of the National Bank Law. The present exchange control has also the disadvantage of being completely divorced from the National Bank, regardless of the fact that monetary responsibility is placed upon the latter.

Finally, it would be very difficult to harmonize the fragmentary monetary provisions in existence as well as the antiquated exchange control legislation with the principles and ideals which inspire the Bretton Woods agreements and with the intent shown by so many nations to collaborate on that basis in a determined effort toward international monetary cooperation and stabilization.

B. General Remarks and Structure of the Project

The present project attempts to give the country a modern and realistic monetary system which will take into account the contemporary developments in monetary theory and techniques, the needs and characteristics of the national economy, and the obligations and opportunities which will result from the current effort at international monetary collaboration initiated at Bretton Woods.

The first three chapters discuss the three functions which economic theory assigns to the monetary system in a closed economy:

1. Unit of account or common measure of value;
2. Means of payment;
3. Unit of deferred payments and store of value.

Under the traditional gold standard system, these three chapters would cover all essential aspects of the monetary system of a country. The breakdown of the gold standard and the development of a new body of monetary theory have given rise, in practically all countries, to special provisions which limit the external convertibility of the currency. We have tried to integrate in the monetary law itself these provisions which in practice have come to assume such a major importance in the monetary system. Chapter IV defines the basic system of external convertibility and Chapter V discusses the qualifications and limitations which may modify this system in periods of emergency.

Chapter I. The Monetary Unit

The first chapter considers the role of money as an abstract unit of account or measure of value. The law retains the colón and the céntimo as the basic monetary units and reaffirms the principle of monetary sovereignty of the country by excluding, under the provisions of Article 2, the use of any other unit in contracts and transactions, with a few legitimate and unavoidable exceptions which arise from the international relations of the country. It should be noted in passing that the nullity of all clauses incompatible with the provisions of Article 2 does not necessarily invalidate the main contract if it can be reasonably reinterpreted in terms of the national monetary unit.

Chapter II. The Monetary Issue

The second chapter deals with money not as an abstract unit of account but as an effective means of payment, i.e., in its tangible aspect of notes and coins. Article 3 retains the exclusive privilege of issue of the Monetary Department of the National Bank of Costa Rica with respect to coins as well as to notes, and it refers to the basic law of the National Bank in all matters relating to the legal regulation of note issue and of coinage.

In most countries, the categories, types, materials, designs, legends, and other characteristics of notes and coins are the subject of more or less minute regulation, consideration of which fills a large part of the basic monetary law. This practice diverts attention from essential matters to those of secondary importance. The Issuing Institute should be given the necessary freedom to determine all these details--which affect neither the volume nor the monetary value of the issue--in accordance with the needs of trade as reflected by the demand of the public for various denominations and with changes in metal prices and techniques of coinage. The Costan Rican constitution requires the intervention of Congress in these matters. Nevertheless, in perfect agreement with this constitutional provision, it has been deemed preferable to leave such intervention to special laws of a regulatory character which may be modified whenever it appears desirable without forcing a revision of the basic monetary law.

Article 5 merely reaffirms the legal tender power of the notes and coins issued by the Monetary Department in accordance with Article 3. Any legal limitation on the legal tender power of subsidiary currency has been deemed superfluous since the danger against which such provisions are directed is somewhat illusory and hardly ever presents itself in practice.

Articles 6 and 7 establish, in a clear and precise form, the obligations of the Monetary Department with reference to the inter-exchange of notes and coins. In order more accurately to estimate the monetary issue actually outstanding, Article 8 authorizes the Monetary Board to retire all notes and coins which have been in circulation for more than a stated number of years, but at the same time it provides for the protection of the holders by the requirement of two transitory periods of six months each in which the old notes and coins can be exchanged at par for new ones. Finally, Article 9 earmarks the contingent profits which result from the exchange to defray coinage, note printing and replacement costs. These costs are, in practice, quite high and require adequate resources. Article 9 provides these resources in a very logical manner and at the same time eliminates the temptation to use the accounting profits of the exchange for unjustified and inflationary purposes.

Chapter III. The Gold Parity of the Colón

The third chapter treats of money as a unit of deferred payments and as a store of value. In reality, this problem is already resolved to a large extent by the limitation of the monetary issue, which is implicit in the system regulating the operations of the Monetary Department. Nevertheless, among other things, the regulation of the volume of the issue provided for in the National Bank Law authorizes the Monetary Department to issue money in payment of foreign exchange acquired by the Department and, as a consequence, the actual amount of the issue is very much influenced by the level of exchange rates.

Article 10 determines the gold parity of the colón at ...... grams of fine gold. This article is supplemented by Article 11 which represents the newest and possibly most important aspect of the proposed legislation.

The determination of the gold parity of the colón in Article 10 puts an end to the <u>de facto</u> monetary regime which has characterized the monetary organization of the country since 1931 and substitutes for it a basic legal regime closely integrated with the international monetary system outlined in the Bretton Woods conference.

Taken together, the two Articles, 10 and 11, introduce a new monetary regime which differs fundamentally from both the classic gold standard in its rigid interpretation and the monetary projects presented by Dr. Max in 1936.

We are in agreement with Dr. Max's criticism against any artificial determination and maintenance of exchange rates without consideration of the factors which may influence internal prices and the movements of the balance of payments. On the other hand, we diverge from Dr. Max's system for the following reasons:

1. The system proposed by Dr. Max in his project of monetary law of 1936 is as rigid and inflexible as the gold standard itself. It does not give any discretion to the monetary authorities of the country but merely substitutes for the automatism of the gold standard another automatism which under certain circumstances will be found as inconvenient and rigid as the former.

2. Dr. Max's system relies too naively on abstract price indices whose concrete and practical significance may be very doubtful insofar as they mix up and veil the divergent movements of various groups of prices whose incidence upon the economy may differ greatly. For example, we may witness simultaneously a rise in industrial prices, which most affect the country's imports, and a fall of agricultural prices--especially coffee prices--which most affect its exports. These movements will have a major impact upon the balance of payments and the monetary and economic situation of the country but will be reflected only in a very imperfect and artificial manner in a general price index.

3. Price movements and especially the fluctuations of the internal purchasing power of the currency are an important factor, but not the only factor, to be considered in the determination of monetary policy. Of equal or even greater importance may be fundamental movements in the balance of payments and their impact upon the national income. Actually, modern economic theory pays more and more attention to these latter factors and tends to complement the classical analysis of price fluctuations with an analysis of income fluctuations. In countries as dependent on the international economy as is Costa Rica, national income and monetary phenomena are influenced to a major degree by the movements of the balance of payments. These movements are, again, very poorly reflected in a general price index. For example, a reduction in coffee exports, even though due to a price decline, will have an insignificant influence on the cost of living or on the wholesale price index. Nevertheless, it may constitute a very disturbing element on the money market and on the Costa Rican economy and may provide ample justification for readjustment of the external parity of the currency.

4. Finally, Dr. Max's system cannot be harmonized with the present international plans of monetary stabilization. The ratification by Costa Rica of the Bretton Woods agreements would be incompatible with Dr. Max's project as well as with the present monetary system of the country.

The system established in Articles 10 and 11 of the present law avoids these difficulties; it determines in precise terms gold parity of the currency, but at the same time leaves the monetary authorities ample powers to modify that parity in certain well specified cases.

The first case refers principally to the possible application of Article IV, section 7 of the provisions of the International Monetary Fund, i.e., to uniform proportionate changes in the par values of the currencies of all members. These changes may be made by the Fund, but each country may prevent the application of this decision with respect to its own currency by notifying the Fund of its disapproval within 72 hours of the Fund's action. It is desirable, therefore, to authorize the Monetary Board to concur or disagree with the Fund's decision. This is the fundamental purpose of clause (a) of Article 11.

The second clause of Article 11 also allows modification of the parity when such action is considered indispensable in order to counteract the damaging effects of fluctuations of major amplitude--let us say 20 or 30 per cent--in those prices, computed in gold, which most affect the economy of the country. This criterion reformulates Dr. Max's theory in a more flexible and practical manner. It eliminates the arbitrary and artificial results of the rigid use of a general price index by authorizing readjustments of the exchange rate in order to stabilize the means of payment and the national income when the country is confronted, for example, with major fluctuations in coffee prices. The requirement that the fluctuations be of major amplitude eliminates the danger of constant or too frequent readjustments of exchange rates and places the system within the general philosophy of the Bretton Woods agreements.

Finally, the last case--and possibly the most important one--is that of fundamental disequilibria in the balance of payments, related to disparities between internal and external prices and costs of production. Transitory disequilibria do not justify recourse to so far-reaching and disturbing a measure as a modification of monetary parity. On the other hand, even if the disequilibria be of a fundamental nature, the modification of monetary parity would be neither appropriate nor, in many cases, effective in remedying disequilibria which do not arise from, and have not already been reflected in, disparities between internal and external prices. From the point of view of the balance of payments, readjustments in exchange rates, generally speaking, are equivalent to price readjustments. Disequilibria in the balance of payments which bear no relation to disequilibria in the international price system require measures suitable to the specific case at hand and cannot be eliminated by methods directed toward the relative level of internal and external prices. A concrete example of this problem would be the case in which a high level of income stimulated, in an exaggerated manner, the consumption of imported goods without causing an internal rise in prices. Finally, it must be observed that basic disequilibria in the balance of payments related to disparities between internal and external prices and costs of production do not necessarily call for a devaluation of the currency as a corrective. A disequilibrium of very recent occurrence and of moderate amplitude could be corrected by other methods of an internal character. Article 11 is merely optional, and allows the Monetary Board to choose, in any concrete case, between two courses of action and to select the one it considers most beneficial and least prejudicial to the national economy.

Article 12 imposes two distinct obligations on the Board. In case the Bretton Woods or other similar agreements are adopted, the decisions of the Board in the matter of exchange rates will have to conform with the international obligations assumed by the country. The very wording of Article 11 incorporates into the Costa Rican legislation some of the basic principles of the Bretton Woods agreement. Article 12 complements the preceding article and points out that modifications in the parity of the colón will have to be made in conformity with procedures and other obligations provided for in the international agreements accepted by the country. Moreover, they will have to be the subject of a detailed justificatory report which will receive wide publicity in the country.

Modifications of the gold parity of the colón or of other currencies, or of the legal exchange rates of other currencies may affect the valuation of the international reserves of the country in terms of the national currency, and thereby produce profits or losses in the assets of the Monetary Department and of the commercial banks (including the other departments of the National Bank). This presents three major disadvantages:

1. The consideration of such profits or losses tends unduly to influence the decisions of the Monetary Board with respect to changes in the gold parity of the colón. These profits or losses are of an accounting rather than of a real character, since the amount of gold and foreign exchange reserves is not affected in any way by a change in the parity rates of gold or foreign currencies with respect to the colón. Nevertheless, they inject into the Board's decisions an irrational bias in favor of devaluation, which will bring profits to the Department, and against currency appreciation, which will involve losses. In many countries considerations of this nature have often interfered with the adoption of a sound monetary and exchange policy guided solely by the real interests of the economy. It constitutes a purely artificial factor which works uniformally toward a gradual depreciation of the currency.

2. Upon being entered into the balances of the banks, these profits or losses then influence also internal monetary and credit policies. Profits or losses, primarily of an accounting nature, thus become an arbitrary factor of expansion or contraction, regardless of the real needs of the money and credit markets.

3. Anticipation of eventual exchange profits or losses stimulates a speculative spirit on the part of the banks, consequently hampering a sound administration of credit.

In order to curtail these dangers, Article 14 sterilizes all profits or losses of this nature in a purely bookkeeping account, i.e., the old debt of the Treasury to the Monetary Department. In this way the law assures the independence and serenity of the monetary, exchange, and credit policies of the Monetary Board, and protects the banks against temptations and risky speculations in the conduct of their operations.

The practical application of the provision in Article 14 referring to the banks could be made as follows. When modifications in exchange parities have taken place, the Monetary Department would acquire the foreign exchange held by the banks at the same rates at which it had been purchased and would resell this exchange to the same banks at new rates resulting from the modifications in the legal parity.

Chapter IV. The Exchange System and the External Convertibility of the Currency

In a modern economy, foreign exchange, together with gold, has come to form an integral part of the international reserves of a country. It should be available in times of emergency for purposes of national interest, and should not be dissipated in private speculations. Article 15 of the present law maintains the principle, therefore, that all the international reserves of the country and all transactions in gold or foreign exchange should be concentrated in the Monetary Department of the National Bank. However, this should not imply any monopoly by the Bank in the execution of exchange operations. On the contrary, the free execution of these operations by the commercial banks relieves the National Bank of congestion, lessens its risks, and is better suited to legitimate preferences of banking and commerce. In order to reconcile these two objectives, the law authorizes the banks qualified for this purpose by the Monetary Board to carry out all exchange operations. Such operations, however, will be made only for the account of the Monetary Department and at the buying and selling rates fixed by the Department in accordance with the present law. Moreover, the banks must communicate daily to the Department the details of all operations effected and credit the respective exchange margins to the Department, retaining only the commissions necessary to cover legitimate expenses and customary profits.

Commercial banks, in their capacity as agents of the Monetary Department, are allowed to maintain foreign exchange funds up to a maximum amount to be fixed by the Board with relation to their paid-in capital and surplus. The banks will administer these funds and will be allowed to sell drafts against them, but they will remain the property of the Monetary Department and be subject to the regulations which the Monetary Board may dictate in accordance with Chapter V of the present law.

The power given the Monetary Board to permit the functioning of a free exchange market under the conditions established in the following chapter constitutes an exception to the general principle explained above and is based on the desire to liberalize as much as possible the control system now in force. It will permit a more flexible and realistic application of exchange controls the advantages of which will appear when the legal provisions pertaining to it are commented upon.

Article 16 allows the Monetary Department to collect an exchange margin of 1 per cent on each purchase or sale of foreign exchange. This margin is in conformity with Article IV, section 3, of the Bretton Woods agreement and will facilitate the solution of a fundamental problem in the monetary organization of the country: to free the policy of the Monetary Department from any profit consideration. The Department should be free to follow a policy of contraction or expansion, whichever is in the national interest. At the present time, however, the Department derives its only earnings from the interest yielded by its credit injections into the market. When rediscounts decrease, profits are not sufficient to cover expenses, much less allow the assumption of the additional charges that would result from a policy of absorption through the issuance of bonds or certificates. In order that the Department may follow a truly national monetary policy with the necessary strength and independence, it must be provided with stable sources of income which do not depend on a policy of monetary expansion. The simplest way to do this, within the traditional organization of the monetary and banking system, is by a moderate increase of exchange margins within the limits approved at Bretton Woods. The margins proposed in Article 16 conform to this idea and cannot be considered excessive in such a narrow exchange market as that of Costa Rica.

This amplification, nevertheless, should be limited to serving the purposes of national welfare specified above and should not lead to unjustified increases in the profits of private banks. Accordingly, the provision in Article 15 assigns all exchange benefits to the Monetary Department, including profits made by commercial banks in their direct exchange transactions with the public. In all these operations, the banks will be considered as agents of the Monetary Department and will be allowed to retain only the commissions necessary to cover their expenses with a small margin for legitimate profits.

Article 18 expresses in concrete terms the obligation of the Monetary Department to maintain the external convertibility of the colón in conformity with the legal provisions explained above. This convertibility, however, should not and cannot in practice be imposed in an absolute and unlimited form without seriously and unnecessarily compromising the internal and external stability of the currency. The experience of the last fifteen years has proved that a rigid regime of convertibility may become intolerable or extremely harmful for countries fundamentally dependent on international trade and subject to sudden, excessive, and often erratic fluctuations in their balance of payments. Faced with emergency situations almost all the Latin American countries, in the past, have had occasionally to suspend convertibility and impose some restrictions on exchange. Article 19 and Chapter V endeavor to substitute, in lieu of exceptional measures hurriedly conceived under the pressure of accidental circumstances, an organic regime of international transfers which foresees eventual needs and prepares their logical solution, eliminating or reducing in every possible way trade restrictions, administrative arbitrariness and all kinds of abuses usually associated with exchange control.

Chapter V. The Regulation of International Transfers

The establishment of exchange control in the past decade gave rise in almost all countries to abuses of every kind which perverted its objectives, obstructed adjustments indispensable to the national economies, and greatly aggravated the international crisis by poisoning economic and political relations among nations. The regulation of international transfers established in this chapter differs decidedly in every respect from previous exchange control legislation. It limits the controls, in purpose as well as in application, to what is strictly indispensable for the success of a sound monetary policy. It establishes a highly flexible system, adapted to the problems resulting from an excessive and inflationary increase in foreign exchange as well as to those which arise from a dangerous scarcity of the country's international reserves. It eliminates, as much as possible, discriminatory measures harmful to the international trade and foreign relations of the country and it explicitly subordinates all controls to the obligations arising from treaties or international agreements accepted by the country. The introduction of a free and an auction market liberalizes, in a fundamental manner, the administration of the controls and guards against the complexity and arbitrariness which characterize traditional exchange control. Finally, the law itself contains some peremptory and precise provisions to ensure the country against the use or permanency of exchange restrictions not required by a dangerous level of the country's monetary reserves.

Section I. Purpose and Administration

Articles 20 to 22 correspond to the ideas just explained. They indicate the ends which can and those which cannot be served by the provisions of the present chapter.

Of special importance is Article 21, clause (a), which prohibits the use of exchange control "as a permanent means to avoid basic economic readjustments called for by lasting changes in the comparative levels of prices and costs of production in the country and abroad". This prohibition springs from a realistic evaluation of what can and of what cannot be expected from exchange control measures. We must not forget that these measures have no corrective action. They simply allow the monetary authorities to postpone indispensable readjustments in the economy, and may thus perpetuate the basic disequilibria of which exchange difficulties are merely a symptom. If the controls assume such a permanent character, they impose increasingly damaging and intolerable sacrifices on the economy. Temporary controls can restrict, for example, indispensable but deferrable imports. Permanent controls cannot do this and, in order to be sufficiently effective, they must gradually expand toward restrictions that will affect not only luxuries, but also the basic consumption of the population and the importation of products indispensable for the development of the economy.

Fundamental and lasting disequilibria in the balance of payments cannot, therefore, be solved by means of exchange control. They definitely require other suitable measures of readjustment, one of which might be a modification in monetary parity in conformity with Article 11.

Article 22 subordinates the application and administration of exchange regulations to the international treaties and agreements of the country. Upon joining the International Monetary Fund, some of the measures of this chapter will, once the initial transition period has passed, be subject to the Fund's approval. On the other hand, the general structure of this chapter and the guarantees included against abuses of the control already integrate the present law with the spirit of the Bretton Woods monetary agreements.

Article 23 is a direct and logical consequence of Article 20. Since the regulation of international transfers has an exclusively monetary purpose, its general administration should be entrusted to the Monetary Board, which is the organization charged with the monetary policy of the country and the one most competent for adapting the concrete regulations of the present law to the fluid needs of that policy.

Section 2. Statistical Control of Exchange Transactions and Concentration of the International Monetary Reserves of the Country

Articles 24 to 27 have the sole purpose of establishing a permanent, but purely statistical, control over purchases and sales of foreign exchange. The information collected will make possible the maintenance of current estimates on the balance of payments--information which is indispensable for the guidance of monetary policy--and will facilitate the introduction and immediate application, when needed, of an effective control of transactions.

Articles 28 and 29 liberalize the exchange control system now in force with respect both to deposits in foreign currency and to the obligatory sale to the Monetary Department of the foreign exchange proceeds arising from exports. They substitute for unnecessarily rigid obligations a flexible regime which may be adapted at all times to the conditions of the money market.

The Monetary Board has the power either to prohibit or to authorize the holding of deposits in foreign exchange by individuals; in granting this authorization, the Monetary Board may subject it to conditions which avoid possible repercussions injurious to monetary stability. It may, for example, reserve the right of the Monetary Department in emergency cases to buy the foreign exchange deposits at the rate of exchange of the day. It may also, if the foreign exchange is utilized by the depositor, impose payment of the same exchange margins and rates on exchange permits as prevail on that date in other transactions of the same type.

Article 29 introduces the same flexibility with regard to foreign exchange proceeds of exports or of other international transactions. The Board may require the sale of the foreign exchange to the Monetary Department, but it may also authorize the operation of a free exchange market. This power of the Board permits it to limit control measures to whatever is necessary and practicable. In periods when there is an abundance of foreign exchange, free market operations can be expanded without inconvenience and, on the contrary, with considerable advantage. On the other hand, even in times of scarcity of foreign exchange, a free market has proved to be an escape valve of incalculable value, in the experience of other countries, for the effective application of measures of control. It permits the reduction to a minimum of illegal but uncontrollable evasions which demoralize honest businessmen and place a premium on fraud.

There would enter into the free market that foreign exchange whose control is not worth the trouble or is impracticable or, in a period of abundance, is not necessary. Therefore, the Board is permitted to establish valuations or percentages (which might be nil for certain kinds of foreign exchange proceeds, such as those arising from tourist or other transactions uncontrollable in practice) which limit the obligation of selling the foreign exchange to the Department. The system of valuations will be used, in preference to percentages, for exports of merchandise or products whose real selling price cannot be exactly verified, as in the case of the operations of the Compañía Bananera.

The foreign exchange thus supplied to the free market would be sold to those buyers who do not have access either to the official market or to the auction market. It would be used for purposes not recognized in those markets, such as dividend or amortization remittances above certain limits, capital exports in periods of foreign exchange scarcity, trips abroad of purely luxury character, etc. Such an escape valve relieves congestion of demand for exchange on the other markets and greatly simplifies the practical functioning of exchange regulations, while at the same time it restricts these operations, but in a less rigid manner, by means of the penalty of an elevation of the exchange rate.

If it is deemed necessary, the operations of the free market could be controlled still further by allowing only operations through exchange certificates that could be declared invalid if they are not used within a specified period. This system has been used in Colombia with some success, but it has the disadvantage again of demanding a control, in some cases impossible, of all purchases of foreign exchange.

Article 30 imposes on customs and postal authorities the obligation of cooperating with the Exchange Division in order to ensure exact observance of the law.

Section 3. Anti-inflationary Controls

The traditional exchange control legislations are emergency legislations conceived in periods of extreme scarcity of foreign exchange. They are ill-adjusted to the changing needs of monetary administration but, on the contrary, tend to maintain, more or less permanently, restrictions that are entirely self-defeating once the transitory difficulties which gave rise to the controls are surmounted.

The provisions of this section pertain not to scarcity of foreign exchange but to the opposite condition of excessive and inflationary inflows of foreign exchange, the importance of which has been revealed in recent years in all Latin American countries. Unlimited convertibility of foreign exchange into national currency can produce, and has in practice produced, inflationary movements as dangerous for the economy of the country as the deflationary monetary pressures which have resulted at other times from the unlimited convertibility of national currency into foreign currency. Nevertheless, in conformity with Article 21, clause (a), control measures are excluded as inadequate when the country has to cope with fundamental and lasting disequilibria related to disparities between internal and external prices and costs of production. In these cases, the readjustment of the balance of payments should be sought either through internal expansion or through a revaluation of the currency in accordance with Article 11, clause (b), of the present law.

The measures enumerated in Article 32 suggest various methods of defense against disequilibria originating in transitory fluctuations in the balance of payments. The most radical and most difficult to apply are found in the last two clauses, (g) and (h).

Clause (g) allows the Board to force the sellers of foreign exchange to accept partial payment of their drafts in the form of registered certificates which would sterilize part of the exchange inflow during the period of emergency. Large surpluses in the balance of payments will reflect, in general, a very favorable situation for exporters and extraordinary profits that would allow them to support this forced investment. The portion of the drafts to be paid in certificates will be established by the Monetary Board after consideration of the absorption capacity of the various groups affected. Ideally, it would be preferable to relate the obligation to purchase certificates directly to the level of the extraordinary profits of the sellers of foreign exchange, but the present state of fiscal statistics precludes this procedure. The Board, nevertheless, will be guided by the same criterion and will approximate its results as far as possible.

In order to reduce to the most indispensable minimum the compulsory aspect of investments in certificates, the Board may authorize the substitution of other equivalent investments which would equally sterilize the internal expansive impact of the foreign exchange inflow.

Clause (h) would be applied only in extreme cases of disequilibrium and could, at times, constitute the first step toward a general revaluation of the currency, in conformity with Article 11. It would direct part of the foreign exchange toward the free market -- whose rates in this case would be lower than the official rates. The amount so directed would be determined on the same basis as in the preceding clause. In reality, the currency would already have been revalued automatically by the free play of supply and demand if the Bank had not arbitrarily interfered in the market to prevent a reduction of exchange rates. Clause (h) permits the authorities to confine this protection to the foreign exchange acquisitions which correspond to a normal situation. The excess might be maintained in foreign exchange, or converted into colones only at rates established through the free play of the market.

Besides the methods specified in Article 32, the Bank has at its disposal the other, and more traditional, weapons of control resulting from its organic charter. These weapons should be used preferably to, or in conjunction with, those of the present article. Fiscal policy can also play a role, perhaps a leading one, in the stabilization of the currency against the shocks resulting from the disequilibria forming the subject of the present section of the law. The success of monetary policy will depend on the coordination of all these instruments of action in the best interests of the national economy.

An active policy of monetary stabilization on the part of the Bank involves sacrifices and expenses that could not be borne within the present regime of the National Bank. These costs could be reduced by the exercise of the power granted in Article 34, which, by making the purchase of the bonds, certificates, and deposits referred to in Article 32 more attractive, would permit the Bank to issue them with relatively low interest rates. The use of this procedure, however, entails serious disadvantages that may militate against its adoption and, in any case, would not entirely eliminate the expenses contemplated. Article 33 provides a logical solution of the financial problem of the stabilization policy and at the same time avoids the creation of a fiscal interest in the maintenance of controls unnecessary and burdensome for the economy.

Section 4. Anti-deflationary Controls

Section 4 of the present chapter considers a situation directly opposite to the one discussed in Section 3: a dangerous scarcity of reserves or excessive outflows of foreign exchange, which result from abnormal and transitory disequilibria in the balance of payments. It enumerates some appropriate methods of defense not provided for in the organic law of the National Bank.

Article 36 is the parallel to Article 32 and requires no new explanatory comments.

Article 39 guarantees the effective application of the legal selling rates of foreign exchange to all operations essential to the maintenance of the basic standard of living of the population and to the development of production. It extends the same guarantee to contractual payments abroad which result from obligations incurred with the approval of the Monetary Board, and to other capital transfers up to reasonable percentages, sufficient and indispensable for attracting desirable foreign investments. In the extreme hypothesis, in which the Board would authorize only the transfers guaranteed by Article 37, 105 per cent of the capital originally invested could be withdrawn in 10 years. Additional transfers moreover could be made through the free market. Theoretically, it would be more logical to guarantee official rates for all transfers of profits, interest, and dividends, and to limit the extent of the guarantee only with respect to amortization transfers. In practice, however, it would be very difficult for the Board to discriminate realistically between servicing and amortization, and an imperfect control would favor what the present law endeavors to avoid: fraud and evasions of the law.

The auction market established in Article 39 has two objectives:

1. To eliminate a major part of the complexities and red tape which characterize traditional exchange control procedures, at the same time avoiding the administrative arbitrariness, the favoritism, and the complaints, whether justified or not, of businessmen against discrimination and partiality in the granting of exchange permits.

2. To recapture for purposes of general interest, the extraordinary and artificial profits that exchange control grants to the middlemen who obtain foreign exchange. The scarcity of imports which results from the rationing of foreign exchange tends to raise prices automatically, regardless of the exchange rate paid by the importer. Grants of foreign exchange at the official rates, together with the restriction of imports, have in the past supplied businessmen with abnormal and entirely unjustified profits. It is desirable to organize the control in a way which avoids these abuses and these erratic results of state interventionism. Inasmuch as a general control of internal prices would be impractical, it is preferable to concentrate this control on essential merchandise which enjoys the stability of exchange guaranteed by the official market, and to accept the inevitable increase in prices of other merchandise, recapturing, however, the windfall profits for purposes of common good through the increase in the auction rates.

Article 40 protects the auction market against arbitrary manipulation by the Bank. In principle, all foreign exchange currently acquired by the Bank should also be sold currently, either on the official market or on the auction market, thus assuring the effective play of supply and demand. Three exceptions to this principle are admitted, however:

1. In order to normalize the market during the course of the year and to avoid the erratic fluctuations in quotations which would be associated with normal seasonal movements in purchases and sales of exchange;

2. In order to permit a rational utilization of the proceeds of foreign loans;

3. In order to reconstitute an adequate level of reserves in case the Regulation Fund has reached abnormally low levels.

Article 41 allows the Board to distribute the foreign exchange of the auction market among several categories -- say 3 or 4 -- with the exclusive purpose of equilibrating the distribution of exchange permits in accordance with the basic needs of the economy. In order to avoid a monopoly of foreign exchange by a few strong buyers, the Board is also permitted to limit the maximum amount that may be obtained by any one person or entity. This would be done by establishing maximum individual quotas proportionate to the value of normal purchases in former years.

Articles 42 and 45 have as their object a nearly automatic elimination of the controls as soon as the monetary situation permits. They protect the country against unnecessary restrictions and constitute a practical affirmation of the will to collaborate in the international plans for monetary stabilization and the liberalization of trade. To this end, Article 42 establishes precise criteria which leave no room for arbitrary or biased interpretation. Articles 43 and 44 do not in reality constitute exceptions to this system but adapt it to ineluctable exigencies originating in a possible breakdown of the exchange market into isolated compartments as a result of the previous action of other countries. Article 44 is inspired directly by Article VII, Section 3, of the Bretton Woods agreements.

Section 5. Control of Capital Movements

In spite of the extensive exposition required by Articles 31 to 45 of the present law, Sections 3 and 4 constitute a regime of exception whose normal duration should be very brief. In the majority of cases, the restrictive provisions, of section 4 especially, could be avoided with all propriety by temporary borrowing abroad or by recourse to the International Monetary Fund, once that institution is functioning.

The only restrictions of a possibly permanent character established by this law are those of Article 46, referring to capital movements. If these movements totally escape the control of the monetary authorities, they may assume a magnitude that would defy any policy of monetary stability, internal as well as external. This is precisely what happened in the years 1924-32 in the majority of Latin

American countries. It would be very difficult to sustain the thesis that these movements constitute an automatic factor of readjustment in the international equilibrium of every country, although this thesis has been defended at times by the most extreme theories of the classical doctrine of the gold standard. Actually, an intense economic crisis would be generally accompanied by movements of capital repatriation from debtor to creditor countries. These movements check the deflationary pressures in the latter countries but accentuate them in the former. On the other hand, in times of prosperity, capital movements in an inverse sense aggravate the inflationary problem of debtor countries and mitigate in in the creditor countries. In both cases, therefore, large uncontrolled capital movements can bring additional disorder, rather than automatic readjustment, to the very weak economies of the debtor countries.

The controls laid down by Article 46 are, for the most part, indispensable to the success of a sound monetary policy and are perfectly integrated with the Bretton Woods agreements (see Article V, Section 3, of the agreements). Nevertheless, to avoid rigid controls, inapplicable in practice, Article 47 provides an escape valve for any transfer not authorized by the Monetary Board. These transfers could be effected in the free market, without the Bank's guarantee in regard to the exchange rates at which conversions will be made from foreign exchange to colones or vice versa.

Section 6. Penalties

See the report of the Bank's Counsel.

Chapter VI. General Provisions

No comment necessary.

Chapter VII. Transitory Provisions

Article C simplifies the lengthy official designation of the "Board of Directors of the Issue Department" by substituting the name of "Monetary Board". The other change from "Issue Department" to "Monetary Department" introduces a more exact and correct terminology. The power of issue is only one aspect of the general task of monetary direction entrusted to the Monetary Department, which also includes, for example, the administration of monetary reserves and the multiple operations of monetary sterilization and stabilization introduced in the present law.

Conclusion

The present law returns the country to monetary normality, in accordance with a modern and flexible system of monetary administration, adapted to its own needs and to the new international circumstances reflected in the Bretton Woods conference and which give hope for the establishment in the near future of an international monetary standard.

The new law liberalizes, at the same time, the antiquated exchange control legislation, and adapts it to the permanent needs of monetary policy.

Finally, it provides the Monetary Department with new weapons of monetary administration, the lack of which has been made abundantly clear during the wartime crisis and the use of which will be required, perhaps even more urgently, in the course of postwar readjustments.

Preliminary Project of Monetary Law and of the Organic Regulation of International Transfers

Chapter I. The Monetary Unit

Article 1.- The monetary unit of Costa Rica is the colón. The colón is divided into 100 equal parts called "céntimos". The symbol of the colón is the letter "C" crossed diagonally by two parallels.

Article 2.- All prices, taxes, assessments, fees, wages, salaries, contracts, and obligations of any class or kind that must be paid, collected, or executed in the Republic, shall be expresssed and liquidated exclusively in colones.

Any qualifying or restricting clause that imposes payment in silver or gold metal, foreign moneys or devisen, or any monetary unit other than the colón shall be null and void.

Excepted are:

a) Obligations requiring payments from Costa Rica abroad or from abroad to Costa Rica;

b) Remunerations to persons or entities with actual residence abroad, for services given temporarily in the country;

c) Obligations to institutions of public law which, in application of special laws, must be paid in foreign currency or exchange or in specie.

Chapter II. The Monetary Issue

Article 3.- Only the Monetary Department of the National Bank of Costa Rica may issue notes and coins in the territory of the Republic, with the guarantees and limitations established in the pertinent legal provisions and especially in the law of the Monetary Department. No other entity or person, public or private, may put into circulation notes, coins, or any other documents which, in the opinion of said Department, might circulate as money.

Article 4.- The Monetary Board shall determine the categories, types, composition, designs, legends and other characteristics of the notes and coins, in accordance with the Constitution and in conformity with the special laws which Congress may dictate on the subject.

All expenses of printing, coinage, and replacement shall be defrayed by the Department.

Article 5.- The notes and coins of the Monetary Department of the National Bank of Costa Rica, issued or coined in accordance with Article 3, shall be unlimited legal tender throughout the territory of the Republic.

Article 6.- The Monetary Department shall exchange on demand and without charge notes and coins of any denomination for notes and coins of any other denomination. If, for reasons beyond its control, the Department is temporarily unable to provide certain denominations of notes or coins, it shall substitute for them the available denominations which are closest to those demanded.

Article 7.- The Department shall retire and replace by new notes or coins any notes and coins so deteriorated through normal use thay they have become inadequate for monetary circulation.

Nevertheless, the Department shall not exchange notes and coins whose identification is impossible, notes which have lost more than two-fifths of their surface, and coins which show traces of filing, clipping, or perforation. The Department shall retire these notes and coins without compensation and shall demonetize them. Appeal may be made to the Monetary Board, whose decision in the case shall be final.

Article 8.- The Monetary Board is permanently empowered to call in for exchange the notes of any series issued more than 15 years previously and coins after 30 years from the date of coinage. The notes and coins called in for exchange shall remain legal tender for a period of six months after the initiation of the retirement operations, but the Bank shall not return to circulation those that have been retired. When this period is over, they shall cease to be legal tender and shall be exchangeable at par and without charge, for another period of six months, only in the Monetary Department and in the banks qualified for that purpose by the Board. When this second period is over, the exchange shall be suspended and the notes and coins not yet exchanged shall be entirely demonetized.

Article 9.- The amount of any ascertained reduction in the note and coin liabilities of the Department due to loss, destruction or demonetization shall be applied to the establishment or to the increase of special reserves of the Department which shall be utilized to defray the expenses of issue, coinage, and replacement of the notes and coins.

Chapter III. The Gold Parity of the Colón

Article 10.- The colón shall have a gold parity of .... grams of fine gold.

Article 11.- The gold parity of the colón may be modified only by concurrent decision of four members of the Monetary Board in full session of titular members and alternates and only in the following cases:

a) in application of decisions emanating from international agreements for monetary stabilization;

b) to counteract the harmful effects of wide fluctuations in those prices, computed in gold, which most affect the economy of the country;

c) to correct fundamental and lasting disequilibria in the balance of payments, related to disparities between internal and external prices and costs of production.

Article 12.- The modifications mentioned in the preceding article must be made in conformity with the obligations accepted by the country through international treaties or conventions and must be accompanied by a detailed justificatory report which shall be published within three days in the Diario Oficial and in two newspapers of wide circulation in the country.

Article 13.- The legal exchange rates of foreign currencies freely and effectively convertible into gold shall be calculated on the basis of the gold parity of these currencies. In all other cases, the legal exchange rate shall be calculated on the basis of the respective current quotations on the New York or London market.

Article 14.- Profits or losses arising from any revaluation of the international reserves of the Monetary Department, of the other departments of the National Bank, and of the other banks in the country, as a consequence of changes in the gold parity either of the colón or of other currencies, or in the legal exchange rates of other foreign currencies, shall be offset, immediately upon their appearance, through equivalent amortization or increase in the old debt of the Treasury to the Monetary Department and shall not enter into the calculation of the net profits or losses of the year.

Chapter IV. The Regulation of Exchange and the

External Convertibility of Currency

Article 15.- Only the Monetary Department may buy and sell gold and foreign exchange, except for the authority given the Monetary Board to permit the operation of a free exchange market under the conditions established in the following chapter. When these operations take place with non-banking persons or entities, the Department shall act exclusively through the medium of the Commercial Department and of the other commercial

banking institutions which the Monetary Department qualifies to act as its agents. Nevertheless, the Board may authorize the Commercial Department and these banking institutions to maintain, in their capacity of agents of the Monetary Department, funds in foreign exchange up to a maximum that the Board shall fix in relation to their paid-in capital and surplus, and to sell drafts against these funds.

All exchange operations of the Banks must be reported daily to the Monetary Department, which shall be empowered to control their accuracy through whatever inspections it deems necessary. These operations shall take place at the buying and selling rates established by the Department in accordance with Articles 16 and 17 and the exchange differences shall be credited to the Department, the agent banks being allowed, however, to retain a commission the maximum amount of which shall be fixed by the Board but which may not in any case exceed one-tenth of one per cent of the amount of the transaction.

Article 16.- The Exchange Commission of the National Bank of Costa Rica shall quote daily the prices in colones which shall govern the buying and selling of sight drafts on the principal markets which are of importance for the country. These buying and selling rates may vary up to 1 per cent in either direction from the legal rates established in Article 13.

Article 17.- In other exchange operations, such as the buying and selling of foreign notes or coins, cable transfers, time drafts, etc., the Monetary Board shall determine the maximum commissions that may be collected in order to defray the additional expenses involved, including interest on documents in transit. Furthermore, the purchase or sale of time drafts shall be governed by special regulations laid down by the Board in such a way as to avoid speculative risks for the Department on future and unforeseeable fluctuations in international exchange rates.

Article 18.- The National Bank of Costa Rica shall meet all demands for or offers of foreign exchange at the rates mentioned in Articles 16 and 17. It shall act through the Monetary Department when these operations emanate from banking institutions, and through the Commercial Department when they come from the public or the Treasury.

Article 19.- The application of Articles 15 to 18 shall be limited and qualified by the provisions of the following chapter on the regulation of international transfers.

Chapter V. The Regulation of International Transfers

Section I. Purpose and Administration

Article 20.- The regulation of international transfers established in this chapter has the exclusive purpose of protecting the internal and external stability of the currency against the dangers and disturbances of excessive inflows and outflows of foreign exchange, due to disequilibria in the country's balance of payments which do not reflect fundamental economic trends related to disparities between internal and external prices and costs of production.

Article 21.- The exchange restrictions provided in this chapter shall not be used for purposes alien to those specified in the previous articles and especially not:

a) as a permanent measure tending to elude basic economic readjustments required by lasting changes in the comparative levels of prices and costs of production at home and abroad;

b) as an instrument of protectionist policy;

c) as a means of economic or political pressure, except in the case of concerted international action.

Article 22.- The application and administration of the present system shall conform to the international treaties and conventions of the country and shall avoid all discriminatory measures prejudicial to its political or economic relations with other nations and to its permanent interests in the development of trade and international cooperation. This last prohibition does not refer to legitimate differentiations in the treatment of distinct categories of merchandise, services, and capital movements, on generally recognized bases, nor to inevitable discriminations imposed by the previous action of other countries and its effects on the monetary situation of Costa Rica.

Article 23.- The system of international transfers established in this chapter shall be administered by the Exchange Division of the National Bank of Costa Rica under the general direction of the Monetary Board. The Monetary Board shall regulate its application and shall decide all appeals made against the resolutions, either executive or interpretive in character, taken by that Division.

Section 2. Statistical Control of Exchange Transactions

and Concentration of the International Monetary Reserves of the Country

Article 24.- Every exporter, person, or entity who possesses or comes into possession of foreign currencies or coins, or deposits in foreign moneys, either in the country or abroad, is obliged to declare their amount, in writing, to the Exchange Division or to banks authorized to that effect by the Monetary Board. These declarations must be made within eight days from the date of acquisition by persons or entities domiciled in the capital and within fifteen days by those domiciled outside of it. The declarations shall be strictly confidential.

The banks operating in the country shall inform the Exchange Division daily about the movement of all their accounts in foreign currencies, in or outside the country, whether they be held for the bank itself or for its customers.

The Monetary Board may except from the provisions of this article the foreign exchange of free negotiation referred to in Article 29.

Article 25.- The use of the moneys or deposits mentioned in the preceding article shall require previous declaration to the Exchange Division, with the exception of ordinary operations of current character by the banks themselves, which shall be governed by the preceding article.

Article 26.- The declarations required by Articles 24 and 25 shall be accompanied by such data and evidence as the Exchange Division may require concerning the amount, nature, and other conditions of the operation.

Article 27.- The Exchange Division shall classify the declarations mentioned above for the purpose of preparing current estimates of the country's balance of payments, investigate their accuracy by means at its disposal, and apply the pertinent penalties in case of false declarations or failure to make declarations.

Article 28.- The Monetary Board may at any time prohibit, totally or partially, or regulate the maintenance of deposits abroad or in foreign currencies by individuals, as well as the circulation of foreign currency and coin outside banks. In all cases in which the Board authorizes the maintenance of such deposits, coin or currency, it may require the payment of the corresponding taxes and exchange margins and, in general, subject such authorization to whatever other requirements or conditions are considered necessary in the interest of monetary stability.

Article 29.- The Monetary Board may, at any time, demand the sale to the Monetary Department, through the Commercial Department or the authorized banks, of all foreign exchange proceeds from exports or from any other source. This requirement may be extended to include all the foreign exchange acquired, or to percentages or *ad hoc* valuations established by the Board and these may vary according to the class of operation in which the acquisition originates. Foreign exchange the sale of which to the Monetary Department is not required by the Board may be negotiated freely in accordance with the regulations which the Board shall dictate to that effect.

Article 30.- Customhouses and postal offices shall give their full collaboration to the Exchange Division in order to assure the fulfillment of the provisions of this chapter. They shall require proof of the respective declarations and of the acquisition or negotiation of the foreign exchange before authorizing the dispatch of import or export merchandise, and shall send weekly statistical records to the Exchange Division of merchandise dispatched, except that the Board may establish special regulations for the shipment of exports on consignation.

Section 3. Anti-inflationary Controls

Article 31.- The Monetary Board shall combat the inflationary impact of excessive inflows of foreign exchange which are not a result of fundamental and lasting disequilibria in the balance of payments, related to disparities in internal and external prices and costs of production, through the use of the powers conferred on it by the organic law of the National Bank of Costa Rica and by the provisions of this chapter.

Article 32.- The Board is specially empowered:

a) To liberalize regulations pertaining to the holdings of cash and deposits abroad or in foreign currency;

b) To reduce the *ad hoc* valuations and percentages mentioned in Article 29;

c) To liberalize the system of exchange sales by means of reclassification of transactions among the official, the auction, and the free markets, and by supplying larger quantities of exchange to these markets until the official selling rates are made effective in all these markets, with no extra charge;

d) To restrict the inflow of foreign exchange in the form of capital movements and to liberalize its outflow, in accordance with the powers conferred on the Board by Article 46;

e) To issue stabilization bonds with interest rates, maturities, and other conditions which the Board may establish, reserving the right of the Monetary Department to redeem the bonds in advance at par and by lot. The stabilization bonds

shall be freely negotiable and may be issued, if it be advisable, in gold or foreign currencies. In this latter instance, the gold or foreign exchange necessary for the future service of the bonds issued shall be immediately deducted from the resources of the Monetary Regulation Fund and earmarked as a guarantee of that service;

f) To authorize the Monetary Department to receive time deposits, in either national or foreign currency, under the special conditions which the Board may establish, and to pay interest on these deposits. The Board shall retain the right to refund these deposits in advance;

g) To order that a percentage, not exceeding 20 per cent of the foreign exchange entering the country on various classes of transactions, be paid for by the issue of registered stabilization certificates denominated in national currency, with maturities not exceeding two years and bearing an interest rate which the Board shall fix. The certificates shall not be negotiable before their maturity nor acceptable as collateral against loans or advances, but the Monetary Department shall reserve the right to redeem them in advance in the order in which they were issued. Under conditions which it shall establish, the Board may authorize persons or entities domiciled in the country to free themselves from the obligation to receive certificates in partial payment of their drafts by substituting instead equivalent investments in extraordinary imports of machinery or other elements of production, advance payment of foreign debts abroad, repatriation of titles to the external debt of Costa Rica, purchase of enterprises or other national assets in the hands of persons or entities domiciled abroad, or other operations of the same kind which permit the use abroad of the foreign exchange in ways advantageous to the national interests;

h) At times of extreme disequilibrium in the exchange market, to restrict the purchase of foreign exchange in the official market to certain percentages or ad hoc valuations which shall be established by the Board and may vary according to the type of transaction in which the acquisition of exchange originates. Foreign exchange not acquired by the Bank in the official market may be sold in the free market by its holders.

Article 33.- The bonds, deposits, and certificates mentioned in clauses (e), (f), and (g) of the preceding article shall constitute obligations of the Monetary Department which shall finance their servicing and other pertinent costs, using to that effect the profits which result from exchange margins and from the charges collected in the auction market in accordance with Article 39 of the present law. The proceeds of the issues of bonds and certificates and of time deposits shall be sterilized in the Department itself through corresponding reductions in the monetary issue or in the sight deposits of the Department, according to the case.

Article 34.- In its future sales of exchange the Board may establish preferential treatment for the holders of the above-mentioned bonds, certificates, and time deposits, up to the amount of the investment.

Section 4. Anti-deflationary Controls

Article 35.- In periods of scarcity or excessive outflows of foreign exchange which are not due to fundamental disequilibria in the balance of payments arising from disparities in internal and external prices and costs of production, the Monetary Board shall adopt suitable measures of defense through the use of the powers conferred on it by the organic law of the National Bank of Costa Rica and by the provisions of the present chapter.

Article 36.- The Board shall be specially empowered:

a) To amortize or redeem the bonds and stabilization certificates and to refund the time deposits in the Monetary Department by replacing the currency or sight deposits previously sterilized through the issue of bonds and certificates and the acceptance of time deposits. All the bonds and certificates acquired, refunded, or amortized, ordinarily or extraordinarily, shall be retired immediately and shall not be considered as assets of the Department. Accrued interest and the principal of matured bonds and certificates which have not been presented for collection within 10 years from the date of maturity, shall be cancelled in favor of the Department;

b) To tighten the regulations relating to holdings of cash and deposits in foreign currency or abroad;

c) To liberalize the inflow of foreign exchange in the form of capital movements and to restrict their outflow, in accordance with the powers conferred on the Board by Article 46, except for the guarantees specified in Article 37, clauses (a) and (c);

d) To increase the ad hoc valuations and percentages mentioned in Article 29;

e) To tighten the regulations on the sale of foreign exchange, through reclassification of transactions among the official, the auction and the free markets and through supplying smaller quantities of exchange in the last two markets, in accordance with Articles 40 to 44.

Article 37.- Available gold and foreign exchange of the Monetary Department shall be used preferably for the sale, at rates fixed in accordance with Articles 16 and 17 of the present law and without extra charge, of foreign exchange necessary for the following purposes:

a) Contractual payments abroad originating in obligations incurred in conformity with Article 46;

b) Payments for indispensable services and for necessary and non-deferrable imports of elements of production and merchandise for general consumption;

c) Transfers of dividends, profits, or amortization of capital invested in the country by persons or entities actually domiciled abroad, up to a percentage of verified investments which shall never be lower than 6 per cent in any year nor lower than 15 per cent in at least 5 years of each 10-year period.

Article 38.- Declarations of debts and applications for remittances made by commercial and industrial firms which do not carry a complete legal accounting of their operations shall not be admitted to the benefits of the preceding article.

Article 39.- The balance of the available foreign exchange shall be sold at the same rates of exchange, and shall be distributed among the other buyers through public auction of exchange permits by the Bank. Alternatively, the Monetary Board may directly determine the charge to be collected for the granting of permits, such charge to be based on the available resources and current demands for exchange in such a way as to approximate the results of an auction and to equilibrate demand and supply.

In both cases, the payment of the charge fixed by the Board or by auction shall constitute the only condition for obtaining the exchange permit.

Article 40.- Whenever the net reserves in the Monetary Regulation Fund are more than 40 per cent of the average of annual sales of exchange of the three previous years, the Bank must offer currently for sale at least the total of the foreign exchange that it currently acquires, except for seasonal adjustments necessary to take account of the normal fluctuations of the balance of payments from month to month. This obligation shall not extend to foreign exchange acquired through loans; in this case, the Monetary Board shall reserve the right to retain the whole or part of this foreign exchange so as to assure its optimum utilization over the period of the loan. If the net reserves in the Monetary Regulation Fund are less than the percentage mentioned, the Bank may also withdraw from sale the foreign exchange necessary for the reconstitution of this percentage over a period of not less than a year.

Article 41.- The foreign exchange put on sale in application of Article 39, may be distributed among certain categories established by the Board, on generally accepted bases, with the exclusive purpose of equilibrating the distribution of permits in

accordance with the real needs of the economy. If the Board deems it necessary, it may also limit the foreign exchange that may be granted to any one person or entity, on the basis of a percentage of the value of normal purchases in previous years.

Article 42.- The exchange restrictions mentioned in this section may be put in force only by motivated decision of the Monetary Board and only when the net reserves in the Monetary Regulation Fund fall below 35 per cent of the annual average of foreign exchange sales in the three preceding years or when the current deficit in the balance of payments, taking seasonal movements into account, threatens to reduce these reserves to 30 per cent within a year.

Neither can these restrictions be retained for more than one year after the date of their initiation if net reserves are maintained for more than four months above 40 per cent of the average mentioned above, except if the current deficit of the balance of payments, taking seasonal movements into account, threatens to reduce these reserves to 35 per cent within a year.

Article 43.- If the Bank's reserves are composed in part of blocked foreign exchange or exchange not freely usable in other markets, this foreign exchange shall not be considered in the application of the provisions of this section. In these cases, the Monetary Board shall establish the system best adapted to the circumstances of the case and to the objectives stated in Articles 20 to 22.

Article 44.- Notwithstanding the provisions of Article 42, the Board may, at any time, apply the exchange restrictions provided in this section for sales of foreign currencies which are scarce in the reserves of the Monetary Regulation Fund, in accordance with the same criteria of Article 40 applied to reserves and transactions in these currencies, and which cannot be obtained through the normal conversion of other assets of the Fund into these currencies.

Article 45.- While the exchange restrictions authorized in this section are in force, the Monetary Board shall submit an annual report to the Secretary of the Treasury, analyzing the measures adopted, their necessity and their effects, and suggesting any other complementary legal measures which it deems necessary.

Section 5. Control of Capital Movements

Article 46.- Prior advice of the Monetary Board shall be required previous to all foreign credit operations by the Government and for operations of the same kind by official and semi-official institutions and entities. These latter operations shall, in addition, be subject to the prior authorization of the Secretary of the Treasury.

Prior authorization of the Monetary Board shall be required for the contraction or concession by individuals or banks -- including the Commercial Department and the Mortgage Department of the National Bank of Costa Rica -- of any credit operation abroad and for foreign capital investments in Costa Rica or Costa Rican capital investments abroad. The Board shall exempt from this requirement, in a general way and by regulations, operations of a current character or of minor amount and it may also delegate to the Director of the Exchange Division, separately or together with the Manager of the Monetary Department, the power to grant this authorization within the limits which the Board shall establish.

Article 47.- Notwithstanding the preceding article, the Board may authorize in a general way any capital movement provided that it be carried out in the free market. Capital coming into the country in this way, without having obtained the authorization mentioned in the preceding article, shall not enjoy, with regard to remittances abroad of interest, dividends, reimbursements, or amortization, the guarantees specified in Article 37, clauses (a) and (c), and these remittances shall be made through the free market or, in the case of authorization by the Board, through the auction market.

Section 6. Penalties

These articles should be drawn up in consultation with the Bank's Legal Counsel. Therefore, the last articles of this preliminary project do not have their definite numbering.

Chapter VI. General Provisions

Article A.- Government departments shall provide the Monetary Department of the National Bank of Costa Rica with the data and reports which it requests in order to obtain better compliance with the present law. Similarly, banks, exporters, and importers are obliged to give the inspectors commissioned by the Monetary Board or the Exchange Division, access to their books and accounting vouchers; if this access is denied them, it will be presumed that an attempt at fraud exists and the corresponding penalties shall be applied.

Article B.- Reforms to the present law shall be carried out only after consultation with the Monetary Board or upon its initiative.

Chapter VII. Transitory Provisions

Article C.- The designation of "Issue Department" of the National Bank of Costa Rica is changed to "Monetary Department" and the designation of "Directing Council of the Issue Department" to "Monetary Board".

Article D.- This law shall enter into effect on the date of its promulgation, and shall abrogate all laws and regulations opposed to its execution and especially the monetary law No..... of .... of ....,. and the exchange control laws No.......... and .... of ....