FOR AGENDA

SM/84/156
Supplement 1

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INFORMATION

July 25, 1984

To: Members of the Executive Board

From: The Acting Secretary

Subject: Costa Rica - Staff Report for the 1984 Article IV Consultation

The attached supplement to the staff report for the 1984 Article IV consultation with Costa Rica has been prepared on the basis of additional information.

If Executive Directors have technical or factual questions relating to this paper rior to the Board discussion, they should contact Mr. Elson (ext. (5)8500).

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INTERNATIONAL MONETARY FUND

COSTA RICA

Staff Report for the 1984 Article IV Consultation - Latest Developments

Prepared by the Western Hemisphere Department

(In consultation with the Exchange and Trade Relations and Legal Departments)

Approved by Eduardo Wiesner and Manuel Guitian

July 24, 1984

Since the time when the report for the 1984 Article IV consultation with Costa Rica (SM/84/156) was prepared, the staff has received additional information on economic developments and policy changes that is summarized below.

I. Recent Developments

During the first half of 1984, the net international reserves of the Central Bank (including arrears) declined by US$84 million, compared with a gain of US$50 million during the same period of last year (Table 1). The decline in reserves was the result of fiscal and monetary policies being more expansionary than had been planned, combined with a marked reduction in the disbursement of long-term concessional aid from bilateral sources.

During the first five months of 1984, the overall deficit on central government operations was an estimated ₡ 1.5 billion, compared with ₡ 0.7 billion for the same period of last year. Total government revenues rose at an annual rate of 27 percent in the first five months of the year, while the growth in overall expenditure was 34 percent. Most of the government deficit registered so far has been financed with bond placements outside the banking system. In fact, net banking system claims on the Central Government declined during the first half of 1984.

Notwithstanding a decline in net claims on the public sector, the net domestic assets of the Central Bank expanded significantly in the first half of the year, following a contraction last year. This change in trend was the result of a sharp increase in net Central Bank credit to the rest of the banking system, which appears to have been associated with a rapid growth in bank credit to the private sector and a marked deceleration in the growth of banking system deposits. The latter development can be attributed, in part, to the competition for private

Table 1. Costa Rica: Selected Economic and Financial Indicators

	1982	1983	1983	1984
1. Exchange Rate				
(colones per U.S. dollar;	Dec.	Dec.	June	June
end-of-month, selling)	40.50	43.65	41.50	44.25
2. Domestic Prices (twelve-month percentage change)				
	Dec.	Dec.	May	May
Consumer	81.8	10.7	50.1	7.8
Wholesale	79.1	5.9	37.1	5.7
3. Central Government Finances (in millions of colones)				
	Jan.- Dec.		Jan.-May	
Revenue	13,317	21,612	7,692	9,744
Expenditure	16,575	25,727	8,395	11,281
Deficit (-)	-3,258	-4,115	-703	-1,537
4. Summary Accounts of the Central Bank 1/ (in millions of colones)				
	Dec.	Dec.	June	June
Net international reserves	-10,143	-4,716	-7,897	-8,514
Net domestic assets	17,080	13,664	14,283	16,758
Public sector (net)	25,008	28,864	24,651	27,968
Banks (net)	-7,861	-8,099	-10,302	-6,694
Stabilization bonds	-4,755	-5,090	-7,050	-5,132
Medium- and long-term foreign liabilities	-62,468	-72,224	-65,868	-72,312
Other	67,156	70,213	72,852	72,928
Currency issue	6,937	8,948	6,386	8,244
5. Net International Reserves of the Central Bank (in millions of U.S. dollars)				
	Dec.	Dec.	June	June
Total	-225.4	-104.8	-175.5	-189.2
Assets	244.3	327.5	371.0	353.6
Liabilities	-115.7	-400.3	-192.5	-476.3
Arrears	-354.0	-32.0	-354.0	-66.5
6. Foreign Trade (in millions of U.S. dollars)				
	Jan.- Dec.		Jan.-Apr.	
Exports, f.o.b.	865.8	862.4	284.4	332.1
Imports, c.i.f.	893.4	993.5	285.6	349.7
Trade deficit (-)	-27.6	-131.1	-1.2	-17.6

Sources: Central Bank of Costa Rica; Ministry of Finance; and Fund staff estimates.

1/ Accounts denominated in foreign currency are converted at ₡ 45 per U.S. dollar. The accounts for December 1982 and June 1983 are not strictly comparable with those shown in SM/84/146 and SM/84/156 because of adjustments used here to eliminate the effects of rescheduling.

financial savings arising from the placement of government bonds mentioned earlier. There also was a slowdown in the disbursement of foreign concessional resources to the Central Bank (mainly from U.S. AID). During the first half of 1984, such disbursements amounted to US$12 million, compared with US$67 million in the same period of last year.1/

The expansionary stance of monetary and fiscal policies in the first half of 1984 was reflected in a widening of the external trade deficit and a decline in the net international reserve position of the Central Bank, including an increase in arrears of US$35 million, mainly for external debt. During the first four months of 1984, imports rose at an annual rate of 22 percent, compared with a growth rate of 16 1/2 percent for exports. At the same time, the value of the colon in real effective terms appreciated by around 1 percent during the first half of 1984, notwithstanding two small downward adjustments of the colon in relation to the U.S. dollar at the end of May and June.

The combination of rapid import growth and relative steadiness in the external value of the colon has been reflected in a further deceleration in the rate of domestic price increases since the end of last year. During the year ended May 1984, consumer and wholesale prices rose by 7.8 percent and 5.7 percent, respectively.

II. Recent Policy Measures

Because of the deterioration in financial performance during the first half of this year, the Costa Rican authorities have recently adopted a number of monetary, fiscal, and exchange measures, and these are summarized below.

1. Monetary policy

On June 22, 1984, the Central Bank Directorate decided to increase the maximum interest rate which banks can pay on local currency deposits by 1 percentage point. Such rates now range from 19 percent to 21 percent, depending upon the term of the deposit. At the same time, a marginal reserve requirement of 50 percent was established on the increase in sight deposits and term deposits of 30 days or less after July 1, 1984. In addition, the minimum term requirement for the investment of excess reserve deposits of the banks in Central Bank stabilization bonds was raised from three months to six months.

1/ During the first half of July 1984, disbursements from U.S. AID amounted to US$23 million, thus reducing somewhat the difference with 1983.

2. Fiscal policy

In early July 1984, the Costa Rican authorities introduced a number of tax measures: (i) the rates for selective consumption duties were raised by 5 percentage points for goods on Lists I and II (mainly luxury goods)1/ and by 2 to 5 percentage points in the case of certain items on List III (mainly basic consumer goods); (ii) the corporate income tax was amended by reducing the allowance for depreciation used in the calculation of net income for tax purposes; (iii) the existing tax of 5 percent on interest earnings, which previously applied to bonds of private corporations listed on the Stock Exchange, was extended to all financial instruments; and (iv) the sales tax was extended to the purchases of all public enterprises, which were previously exempt. It is estimated that the yield of these measures during the remainder of 1984 will amount to approximately ₡ 1,070 million (around 0.7 percent of GDP).

3. Exchange policy

On June 22, 1984, the Central Bank Directorate introduced certain changes in its exchange regulations: (i) in an effort to increase liquidity absorption, the local currency deposit requirement which applies to all requests for foreign exchange was raised from 50 percent of the value of such requests to 100 percent;2/ (ii) proceeds from exports to the rest of Central America settled through the Central American Clearing House will now be paid in colones in an amount equivalent to 70 percent of the export value; the remainder will be converted into a negotiable bond of six-months maturity which pays interest at the prevailing bank rate for six-month deposits (the "basic indicator" rate); this provision was introduced because Costa Rica has been experiencing delays in the settlement of bilateral claims against other members of the regional clearing mechanism; and (iii) a guarantee deposit requirement of 100 percent was established for all payments of imports before arrival, with the intention of dampening potentially speculative demand for foreign exchange; this deposit, which is additional to that mentioned in item (i) above, must be constituted at the time foreign exchange for the prepayment of imports is requested and will be retained until the date of customs clearance. In the staff's view, the guarantee deposit requirement is an exchange restriction on import payments subject to the Fund's approval under Article VIII, Sections 2(a) and 3, of the Fund Agreement.

1/ These increases are in addition to those reported in SM/84/146 and SM/84/156 which took effect in early March 1984.

2/ This requirement was established in late 1982 as an administrative procedure for the purpose of monitoring payments arrears. Such deposits are to be held for no longer than 15 days which is the time period considered necessary to ensure the bona fide nature of exchange requests. In the event a deposit is held for more than 15 days, it is considered to be a payments arrear.

As of the same date, the Central Bank Board also recommended that the official exchange rate 1/ be adjusted from ₡ 20 per U.S. dollar to ₡ 40 per U.S. dollar, which is close to the value of the colon in the unified exchange market. This change requires the approval of the Legislative Assembly, and a bill to this effect is to be presented by the Government shortly.

On June 28, 1984, the value of the colon in the unified exchange market was depreciated from ₡ 44 per U.S. dollar (selling) to ₡ 44.25 per U.S. dollar (selling). This is the second adjustment of the colon since the exchange markets were unified at ₡ 43.65 per U.S. dollar (selling) on November 11, 1983 and brings the cumulative depreciation of the colon since then to 1.4 percent (in local currency terms).

III. Staff Appraisal

In the first half of 1984, there have been significant delays in the implementation of the economic program which was discussed with Fund staff in February-March 1984. In fact, available indicators in the fiscal, monetary, and external sectors for the first half of 1984 suggest that the stabilization effort carried out last year has begun to be reversed. The rapid growth of government expenditure and overall bank credit thus far in the year are of particular concern.

The recently announced measures, particularly in the fiscal and monetary fields, should move the economy back towards the adjustment path set by the authorities earlier in the year. Some of these measures had been envisaged originally, but others have been made necessary to compensate for slippages in the implementation of the Government's economic program. The authorities are considering additional revenue and expenditure measures to strengthen the fiscal position as needed to meet the Government's stabilization objectives, and the staff would urge the authorities to implement these measures without delay.

The staff notes with concern that restrictions have been intensified in the form of payments arrears and a deposit requirement for accelerated import payments and urges the authorities to eliminate these restrictions as quickly as possible. For the reasons explained in SM/84/156, no approval of Costa Rica's exchange measures is being recommended.

1/ This rate applies only to the surrender of 1 percent of export proceeds and to the calculation of certain specific import duties.

Costa Rica - Statistical Issues 1/

1. Coverage, Currentness, and Reporting of Data in IFS

		Latest Data in July 1984 IFS
Real Sector	- National Accounts	1981
	- Prices	January 1984
	- Production	n.a.
	- Employment	n.a.
	- Earnings	n.a.
Government Finance	- Deficit/Surplus	January 1984
	- Financing	January 1984
	- Debt	January 1984
Monetary Accounts	- Central Bank	November 1981
	- Deposit Money Banks	November 1981
	- Other Financial Institutions	November 1981
External Sector	- Merchandise Trade: Values	December 1983 (exports) February 1984 (imports)
	- Merchandise Trade: Prices	December 1983
	- Balance of Payments	1982
	- International Reserves	May 1984
	- Exchange Rates	May 1984

During the past year, the reporting record of the IFS correspondent has been excellent for international reserves and general economic data; however, no report forms were received at all for data on the financial system or national accounts.

2. Outstanding Statistical Issues

Monetary Accounts: The monetary accounts shown in IFS have not been updated because of problems associated with the recording of foreign currency denominated accounts and exchange subsidies and losses. These problems have arisen during a period of time in which the value of the colon experienced a significant depreciation.

Government Finance: The analytical usefulness of government finance data would be enhanced through improvements in the coverage of data. In particular, there is a need for timely and accurate data on extrabudgetary operations. With respect to the central government sector, there is a need to develop consistent data on the composition of government financing and external government debt.

1/ This appendix is an update of Appendix IV in SM/84/156.

3. Technical Assistance in Statistics

a. A mission in May 1981 discussed problems related to the provision of data for the GFS Yearbook.

b. A mission to Costa Rica is expected to take place within the next few months to resolve problems relating to the updating of money and banking data for IFS.