FOR AGENDA

EBS/81/123

CONFIDENTIAL

June 4, 1981

To: Members of the Executive Board

From: The Secretary

Subject: Costa Rica - Request for Extended Arrangement

Attached for consideration by the Executive Directors is a paper on a request from Costa Rica for an extended arrangement equivalent to SDR 276.75 million. A draft decision appears on page 19.

This subject has been tentatively scheduled for discussion on Monday, June 17, 1981.

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

COSTA RICA

Request for Extended Arrangement

Prepared by the Western Hemisphere Department

(In consultation with the Exchange and Trade Relations,
Legal, and Treasurer's Departments)

Approved by S. T. Beza and Manuel Guitian

June 3, 1981

I. Introduction

In the attached letter dated May 29, 1981, the Second Vice President of the Republic, the Minister of Finance, and the Executive President of the Central Bank of Costa Rica request an arrangement under the extended Fund facility for a three-year period beginning in June 1981, in an amount equivalent to SDR 276.75 million, which is 450 per cent of Costa Rica's quota of SDR 61.5 million. If such request is granted, the Costa Rican authorities also request the cancellation at the same time of the existing two-year stand-by arrangement for an amount equivalent to SDR 60.5 million, approved on March 12, 1980. The proposed extended arrangement would involve resources under the supplementary financing facility and borrowed resources in the amount of SDR 190.65 million. A waiver of the limitation in Article V, Section 3(b)(iii), of the Articles of Agreement is required.

The Costa Rican authorities' request is intended to support the program described in the attached letter and reviewed in this paper. The extended arrangement includes macroeconomic targets for calendar years 1981-83 and performance clauses for the 12-month period beginning June 1981. Under the terms of the arrangement, up to SDR 92.25 million would be available to Costa Rica in the first year of the program phased as follows: purchases are not to exceed SDR 22.5 million until August 15, 1981, SDR 40 million until November 15, 1981, SDR 57.5 million until February 15, 1982, and 75 million until May 15, 1982. Costa Rica will consult with the Fund in accordance with the Fund's policies and the provisions of the attached EFF arrangement; performance criteria and the phasing of drawings for the remainder of the arrangement will be established in subsequent reviews with the Fund.

The last Article IV consultation discussions with the Costa Rican authorities were concluded in early 1980 (SM/80/56 and SM/80/57) and the consultation procedure was completed by the Executive Board on March 12, 1980 (EBM/80/43).1/ Since that time there have been numerous contacts between the Costa Rican authorities and Fund staff leading to the negotiation of the program in support of which the EFF arrangement is being requested. A staff mission visited San Jose in January 1981, and these talks were continued at headquarters in mid-February 1981. The round of discussions in Washington set the stage for a visit of a staff mission to Costa Rica in March 1981 for negotiation of the EFF program which the Costa Rican authorities have now submitted to the Fund.2/ These negotiations were concluded by the visit of a Costa Rican delegation to Washington in the period May 8-15, 1981.

II. Recent Developments and Performance Under the Present Stand-By Arrangement

Since the coffee boom years of 1976-77, the balance of payments position of Costa Rica has deteriorated markedly, with the current account deficit widening from the equivalent of 7-1/2 per cent of GDP in 1977 to over 14 per cent in 1979. The deterioration in the current account was accompanied by a weakening of private capital inflows, so that despite a larger amount of foreign borrowing by the public sector, the overall balance of payments shifted from a surplus of US$102 million in 1977 to a deficit of US$82 million in 1979. The deterioration in Costa Rica's external position has been due in part to an adverse change in its external terms of trade brought about by the decline in international coffee prices and the increase in world oil prices, but it also has reflected strong demand pressures stemming primarily from large public sector deficits.

In an effort to improve the balance of payments position, the Costa Rican authorities introduced in March 1980 a stabilization program which was supported by the Fund with the two-year stand-by arrangement mentioned earlier. The main objective of the stabilization program was to strengthen the external position of Costa Rica, mainly by reducing the deficit of the nonfinancial public sector. The program aimed at reducing the deficit in the current account of the balance of payments from over 14 per cent of the GDP envisaged for 1979 to 11-1/2 per cent in 1980, and to 10-1/2 per cent in 1981. The improvement in the current account was expected to be consistent with an overall balance of payments deficit of US$50 million in 1980 and equilibrium in 1981. To achieve these objectives, specific quantitative limits were established on the net domestic assets of the

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1/ Fund relations with Costa Rica are summarized in an Appendix to this report.
2/ This staff mission consisted of Messrs. Zayas (Head), Bonangelino, Cha, and Elson (all WHD), and Ms. Hill (Secretary-WHD), and was assisted by Mr. Lindgren, the Fund's resident representative in Costa Rica.

Central Bank, net Central Bank credit to the nonfinancial public sector, and net external borrowing by the public (financial and nonfinancial) sector.

Performance under the stand-by program fell short of expectations in 1980. Costa Rica exceeded the credit ceilings shortly after purchasing the first credit tranche (plus supplementary financing), and as of the end of 1980 the ceiling on the net domestic assets of the Central Bank was exceeded by about ₡ 1 billion and the ceiling on the Central Bank's net credit to the nonfinancial public sector was exceeded by ₡ 1.1 billion. As of the same date, the limit of US$300 million on the net use of foreign credit by the public sector was exceeded by US$40 million (Table 1).

Table 1. Costa Rica: Performance Under Stand-By Program

	December 31, 1980	
	Program	Actual
(Outstanding balances in millions of colones)		
Net domestic assets of the Central Bank	3,050	4,068
Net Central Bank credit to the nonfinancial public sector	6,150	7,259
(Flows in millions of U.S. dollars)		
Net external borrowing by the public sector 1/	300	340 2/

Source: Central Bank of Costa Rica.

1/ Cumulative.
2/ Excludes assumption of US$22.5 million external liability by a state-owned fertilizer company (FERTICA).

1. Fiscal and monetary developments

The Government's fiscal policy in 1980 was designed to slow the growth of aggregate demand and to improve the savings performance of the public sector. Specifically, the program called for a reduction in the deficit of the nonfinancial public sector from a then estimated ₡ 4.2 billion in 1979 to ₡ 3 billion in 1980, or from the equivalent of 11-1/2 per cent of GDP estimated for 1979 to about 7 per cent of GDP in 1980. Because of the reluctance of the Legislative Assembly to approve new revenue measures, the fiscal adjustment programed for 1980 was to be achieved largely through expenditure restraint, supported by certain revenue measures introduced by executive decree in December 1979 and estimated to yield approximately ₡ 500 million on a yearly basis. The authorities were to limit the growth of public sector expenditure in 1980 to less than 6 per cent, and no salary increase to public sector employees was to be granted unless additional tax revenue in an equivalent amount was approved. A Budgetary Authority was created by the Government to improve expenditure control, especially outside the Central Administration.

Although progress was made in 1980 in reducing the size of the public sector deficit in relation to GDP, the overall results of the Government's fiscal program diverged markedly from the plan. Public sector savings were further eroded in 1980 and were negative in an amount equivalent to 2 per cent of GDP. At the same time, the overall deficit of the nonfinancial public sector was ₡ 4.3 billion, or nearly 50 per cent higher than the target set in the program (Table 2). This deficit represented the equivalent of about 10-1/2 per cent of GDP, compared with close to 12-1/2 per cent of GDP in 1979 and a programed level of 7 per cent of GDP for 1980. About one third of the deficit of the public sector in 1980 was financed from foreign borrowing. Net foreign financing of the public sector deficit in 1980 was only marginally in excess of the level contemplated in the program, but net domestic financing was almost double the program level.

The performance of the public sector in 1980 reflected in particular a much larger than expected deficit at the central government level. The central government deficit amounted to ₡ 3 billion compared with a projection of ₡ 1.6 billion. This deviation stemmed not only from expenditure overruns but also from a shortfall in revenue. Central government expenditure increased by 21 per cent in 1980, compared with less than 6 per cent envisaged in the program. Not only were scheduled economies unrealized, but the Government failed to obtain additional revenue sufficient to finance supplementary expenditures of about ₡ 750 million authorized in July-August 1980 for salary increases and transfers to the universities. In August, the Government introduced an increase of 6 percentage points in the selective consumption tax for all products subject to the sales tax, but this measure is estimated to have yielded only about ₡ 200 million in 1980.

Despite the additional revenue from the tax measures of December 1979 and August 1980, total government revenue increased by only 14 per cent compared with an increase of 21 per cent projected in the program and a rise of 22 per cent in nominal GDP. The lower than expected revenue yield reflected in large part a decline in receipts from export taxes on coffee and bananas (such receipts dropped from ₡ 430 million in 1979 to ₡ 360 million in 1980) owing to a reduction in the volume of these exports. Moreover, income tax receipts increased by only a moderate amount last year (by 5 per cent or ₡ 50 million), due largely to administrative deficiencies in tax collection and slower real growth of the economy.

Within the public enterprise sector, deviations in the program occurred mainly in the operations of the State Production Council (CNP), the National Oil Refinery (RECOPE), and the Costa Rican Development

Table 2. Costa Rica: Summary Operations of Nonfinancial Public Sector

(In millions of colones)

	1978	1979	1980 Program 1/	1980 Actual 2/	1981 Program
Central Government	-1,078	-2,273	-1,565	-3,047	-2,500
Current revenue and grants	4,125	4,342	5,361	4,953	7,900
Expenditure	5,203	6,615	6,926	8,000	10,400
Current	(4,057)	(5,141)	(5,568)	(6,156)	(8,488)
Capital	(1,146)	(1,474)	(1,358)	(1,844)	(1,912)
Rest of general government	-92	120	334	205	-352
Revenue	3,572	4,598	4,967	5,661	6,792
Current	(3,414)	(4,412)	(4,707)	(5,337)	(6,392)
Capital	(158)	(186)	(260)	(324)	(400)
Expenditure	3,664	4,478	4,633	5,476	7,144
Current	(2,992)	(3,849)	(3,753)	(4,680)	(6,299)
Capital	(672)	(629)	(880)	(796)	(845)
State enterprises	-1,204	-1,801	-1,515	-1,971	-2,398
Current account surplus	356	-209	166	-56	784
Capital revenue	133	93	--	180	150
Capital expenditure	1,693	1,685	1,681	2,095	3,332
Consolidated public sector deficit	-2,374	-3,954	-2,746	-4,833	-5,250
Net residual 3/	-434	-245	-254	507	--
Overall financing	2,808	4,199	3,000	4,326	5,250
External	1,843	1,600	1,540	1,589	2,750
Domestic	965	2,599	1,460	2,737	2,500

Sources: Office of the Comptroller General; Ministry of Finance; and Fund staff estimates.

1/ As presented in EBS/80/39.
2/ Estimates.
3/ Includes adjustments from accrual to cash basis for different reporting periods, transactions of the nonconsolidated public sector, and statistical discrepancies.

Corporation (CODESA). The poorer than expected results for these enterprises were partly offset by the performance of the National Electricity Institute (ICE), which is by far the most important public enterprise (both in terms of total investment and the size of its overall deficit). In 1980, ICE's overall deficit was less than projected because of under-execution of its investment program and frequent adjustments of its tariffs.

Monetary policy in 1980 was dominated by the need to accommodate the borrowing requirements of the public sector. Although the financial resources accruing to the banking system nearly reached the value projected in the program, the total expansion of bank credit far exceeded the increase in these resources and the use of medium- and long-term foreign loans, and thus there was a sharp drawdown in the net international reserves of the banking system. The rapid expansion of total bank credit reflected the large increase in credit to the public sector, as credit to the private sector rose somewhat less than projected (Table 3). There was also a relatively large expansion in net unclassified assets, reflecting mainly exchange losses of the Central Bank.

The slower than projected increase in credit to the private sector was dictated mainly by the tight liquidity position of the commercial banks. In mid-1980, the commercial banks were required to transfer demand deposits held by the public sector entities to a special account in the Central Bank. The transfer of deposits under this requirement amounted to ₡ 340 million by July and ₡ 430 million by December 1980. As a result of this transfer of funds, the liquidity position of the commercial banks deteriorated sharply and their legal reserve position with the Central Bank was in deficit throughout the period July-November 1980. This deficiency was accommodated by the Central Bank by a decline of two points in the legal reserve requirement and by a temporary waiver of penalties under the legal reserve requirement.

2. The external sector

In relation to GDP the current account deficit of the balance of payments in 1980 remained at about the same level as in 1979 rather than decline by 3-1/2 percentage points as called for in the program. In absolute terms the targeted level was exceeded by US$128 million. Net capital inflows were also substantially lower than projected and as a result, despite a very substantial buildup of arrears (US$283 million), the net international reserves of the Central Bank declined by an unprecedented US$173 million, compared with a targeted loss of US$50 million (Table 4). The unfavorable balance of payments outcome reflected mainly an erosion of private sector confidence caused by growing awareness of the deteriorating financial situation and possible repercussions on exchange rate policy.

Table 3. Costa Rica: Summary Operations of the Banking System

(In millions of colones)

	December 31				
				1980	
	1977	1978	1979	Program 1/	Actual
Net international reserves	1,619	1,389	528	100	-1,170
Central Bank	1,346	1,006	303	-125	-1,173
Commercial banks	273	383	225	225	3
Net credit to public sector	1,778	2,629	5,485	6,850	7,886
Central Bank 2/	1,421	2,065	4,983	6,150	7,259
Commercial banks	357	564	502	700	627
Credit to private sector 3/	7,008	8,678	10,388	12,270	11,821
Central Bank	60	63	173	449	213
Commercial banks	6,948	8,615	10,215	11,821	11,608
Interbank transactions	-3	-2	-9	--	29
Central Bank net claims on banks	-530	107	-1,076	-781	-831
Commercial banks' net claims on Central Bank	527	-109	1,067	781	860
Other assets (net)	977	1,685	2,115	2,507	3,220
Central Bank	859	1,099	1,332	1,177	1,806
Commercial banks	118	586	783	1,330	1,414
Counterpart unrequited foreign exchange	183	219	444	494	647
Central Bank	183	219	444	494	647
Medium- and long-term foreign liabilities	2,016	2,257	3,687	4,759	4,589
Central Bank	1,190	1,527	2,773	3,751	3,867
Commercial banks	826	730	914	1,008	722
Liabilities to private sector 4/	9,180	11,903	14,376	16,474	16,550
Central Bank	1,783	2,594	2,497	2,625	2,760
Commercial banks	7,397	9,309	11,879	13,849	13,790

Source: Statistical Appendix Table 11.

1/ As presented in EBS/80/39.
2/ Includes credit to commercial banks for on-lending to the Central Government.
3/ Includes credit to nonbank financial intermediaries.
4/ Includes liabilities to nonbank financial intermediaries.

Table 4. Costa Rica: Summary Balance of Payments

(In millions of U.S. dollars)

	1978	1979	Proj. 1980 1/	Prel. 1980	Proj. 1981
Current account	-363	-566	-533	-661	-460
Merchandise trade	-302	-455	-430	-512	-260
Exports, f.o.b.	(864)	(942)	(980)	(1,017)	(1,093)
Imports, c.i.f.	(-1,166)	(-1,397)	(-1,410)	(-1,529)	(-1,353)
Services (net)	-78	-123	-125	-167	-218
Of which: factor payments	(-110)	(-146)	(-160)	(-210)	(-270)
Transfers (net)	17	12	22	17	18
Capital account	320	459	477	182	454
Private 2/	86	69	177	-180	104
Official	234	390	300	362	350
Nonfinancial	(215)	(187)	(177)	(209)3/	(183)
Financial	(19)	(203)	(123)	(153)	(167)
SDR allocation and gold revaluation	3	25	6	23	6
Overall balance	-40	-82	-50	-456	--
Arrears	--	--	--	283	-96
Net official international reserves (increase -)	40	82	50	173	96

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

1/ As presented in EBS/80/39.
2/ Includes net errors and omissions.
3/ Includes assumption of US$22.5 million external liability by FERTICA.

In 1980 the value of exports rose by about 8 per cent, or by about the same rate projected under the program.1/ Although receipts for the major traditional exports (coffee and bananas) were below projected levels, mainly because of shortfalls in export volume, nontraditional (industrial) exports performed better than expected (Statistical Appendix Table 16). In part, this outcome was the result of strong regional demand

1/ The estimate for exports in 1979 has been revised from what was shown in EBS/80/39.

for Costa Rica's exports, especially from Nicaragua. However, the growth in exports last year was more than offset by the growth of imports and net interest payments on public external borrowing, so that the current account position did not improve as programed.

In addition to the large loss of net official foreign reserves and the accumulation of payments arrears, excess demand pressures in 1980 had a significant impact on the exchange and trade system of Costa Rica. In September 1980 the authorities introduced import restraints in the form of outright prohibitions, prior import deposits, and tariff surcharges, and allowed the spread between the official and parallel exchange markets to widen beyond 2 per cent. This effective splitting of the exchange market was achieved by transferring a substantial volume of foreign exchange transactions from the official to the parallel market operated by the Stock Exchange.1/ By December 1980, the average value of the colon for trade transactions had depreciated to approximately ₡ 10.90 per U.S. dollar, compared with ₡ 8.57 per U.S. dollar prior to the introduction of the dual market system in September 1980. During December 1980, the value of the colon in the free exchange market averaged around ₡ 14.50 per U.S. dollar, or 70 per cent above the midpoint exchange rate of the colon in the official market.

On December 26, 1980, the dual market arrangement was formally replaced with a unified flexible exchange rate system, according to which the value of the colon was to be determined largely by market forces. At the same time, all restrictions on the sale of foreign exchange and surrender requirements were lifted.2/ In addition, the Costa Rican authorities eliminated all temporary import surcharges (of variable amounts) on selected imports--including those established on September 26, 1980--and introduced a uniform 1 per cent surcharge applicable to all imports.

From January 5, 1981 (the first working day under the new exchange arrangement) until early February, the exchange value of the colon in the banking system appreciated from around ₡ 15 per U.S. dollar to ₡ 12.60 per U.S. dollar, as a result of heavy sales of foreign exchange by the Central Bank. Thus, the gross foreign reserves of the Central Bank were sharply reduced and on February 12, 1981, the Central Bank ceased selling foreign exchange to the public. By the end of February, the value of the colon had depreciated to around ₡ 17 per U.S. dollar. On March 9, 1981, the Costa Rican authorities re-established a dual exchange market system on a temporary basis with the Bank's buying rate pegged at ₡ 15 per U.S. dollar,

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1/ This change was reported to the Executive Board on October 14, 1980 (EBS/80/222).

2/ It was also announced that the Central Bank would continue to provide foreign exchange at the previous rate of ₡ 8.60 per U.S. dollar for central government payments abroad during 1981, and for student and medical expenses approved by the Central Bank prior to September 26, 1980. These changes were reported to the Executive Board on January 14, 1981 (EBS/81/4).

and a parallel market where the value of the colon fluctuated freely.1/ During March and April 1981, the exchange rate for the colon in the parallel market continued to fluctuate in the neighborhood of ₡ 20 per U.S. dollar. On April 24, 1981, the authorities reunified the exchange markets; initially the exchange rate was around ₡ 21 per U.S. dollar, but since that time the value of the colon has appreciated, and it is now around ₡ 17 per U.S. dollar.

3. Developments in output and prices

Parallel to the deterioration in the external position of Costa Rica in recent years, there has been a sharp decline in the rate of economic growth and an intensification of inflationary pressures. In 1980, real GDP is estimated to have increased by around 2 per cent, compared with over 3 per cent in 1979 and an average of 7-1/2 per cent a year in 1977-78 (Table 5). At the same time, the rate of inflation, as measured by the GDP deflator, accelerated to 19-1/2 per cent last year, compared with around 9 per cent a year in 1978-79. The slowdown in growth in 1980 reflected mainly a decline in the production of traditional agricultural exports (bananas, sugar, and meat) and a sharp deceleration in the growth of services, caused by a drop in value added in the commerce sector. Aggregate domestic expenditure in nominal terms increased more rapidly in 1980 than in 1979 because of a marked acceleration in the growth rate of consumption expenditure (Statistical Appendix Table 8). The rate of growth in fixed capital formation tapered off significantly in 1980, as public sector investment activity (mainly by CODESA and ICE) was slowed after the relatively rapid expansion during the period 1977-79. The growth in private sector investment spending also decelerated last year, in part as a result of growing uncertainties over financial and economic conditions in Costa Rica.

1/ It was also announced that all export proceeds had to be surrendered to the Central Bank within a period of 15 days from the date of approval of export licensing.

Table 5. Costa Rica: National Accounts Indicators

(Percentage change)

	1977	1978	1979	Prel. 1980	Proj. 1981
GDP at market prices	27.4	14.7	13.4	21.8	40.0
Real GDP	8.9	6.3	3.3	1.9	--
Agriculture	(2.2)	(6.6)	(-1.0)	(-1.2)	(2.3)
Manufacturing	(12.5)	(9.6)	(1.4)	(2.6)	(2.6)
Construction	(3.9)	(5.8)	(5.3)	(10.8)	(-5.0)
Services	(10.5)	(5.4)	(5.3)	(1.8)	(1.0)
GDP deflator	16.9	7.9	9.8	19.5	40.0

Sources: Statistical Appendix Tables 8 and 9; and Fund staff estimates.

III. Medium-Term Program

In view of the deviations which occurred in last year's stabilization program and the changes made in exchange policy, the Costa Rican authorities have decided to implement a new adjustment program with the aim of correcting existing external and internal imbalances over the medium term.

The adjustment program in support of which the EFF arrangement is being requested is geared to reducing the current account deficit of the balance of payments from the equivalent of somewhat more than 14 per cent of GDP in 1980 to 9 per cent of GDP by 1983, which is believed to be a level which can be sustained by normal inflows of long-term capital to the private and official sectors (Table 6). It is also expected that such an adjustment effort would facilitate a gradual restoration of the net international reserve position of the Central Bank, in the amount of some US$150-175 million, during the second and third years of the program. The Costa Rican authorities will seek to achieve these objectives through the application of both structural adjustment and demand management policies. During the first year of the program, the emphasis is to be on demand management, as restrained monetary and fiscal policies are required to contain inflationary pressures and to promote an orderly development of the exchange market. If such policies are applied successfully in the first year of the program, then the exchange rate adjustment that has taken place since the end of last year, together with the Government's structural adjustment measures in the energy, agriculture, and foreign trade areas, ought to help reorient the Costa Rican economy and provide incentives for investment, exports, and growth. In the process, the

Table 6. Costa Rica: Macroeconomic Flows

(As per cent of GDP)

	1979	1980	Program 1981	Program 1982	Program 1983
Current account of the balance of payments	-14.2	-14.3	-11.8	-10.5	-9.0
Trade balance	-11.4	-11.1	-6.7	-5.3	-4.2
Factor payments (net)	-3.7	-4.5	-6.9	-7.0	-6.9
Other services and transfers	0.9	1.3	1.8	1.8	2.1
Capital account	12.1	10.5	11.8	11.5	11.0
Private capital 1/	1.7	2.2 2/	2.7	3.5	3.8
Public capital	10.4	8.3	9.1	8.0	7.2
Nonfinancial	(4.7)	(4.5)	(4.7)	(4.7)	(5.5)
Financial 3/	(5.7)	(3.8)	(4.4)	(3.3)	(1.7)
Net official international reserves (increase -)	2.0	3.7	--	-1.0	-2.0
Public sector					
General government current account	-0.7	-1.9	-0.8	0.5	1.4
Revenue	(22.2)	(21.4)	(21.7)	(22.5)	(23.4)
Expenditure	(22.9)	(23.3)	(22.5)	(22.0)	(22.0)
State enterprises' operating surplus	-0.6	-0.1	1.3	1.7	2.1
Public sector savings	-1.3	-2.0	0.5	2.2	3.5
Fixed investment	8.9	8.4	8.5	8.7	9.0
Other capital expenditure 4/	2.1	--	1.0	0.5	--
Overall deficit	12.3	10.4	9.0	7.0	5.5
Net foreign financing	4.7	3.9 5/	4.7	4.7	5.5
Net domestic financing 6/	7.6	6.6	4.3	2.3	--
Savings and investment					
Fixed capital formation	25.1	23.0	22.5	23.0	24.0
Public sector	(8.9)	(8.4)	(8.5)	(8.7)	(9.0)
Private sector	(16.2)	(14.6)	(14.0)	(14.3)	(15.0)
Inventory changes	-0.6	1.1	--	0.7	0.5
Investment = savings	24.5	24.1	22.5	23.7	24.5
External savings	14.2	14.3	11.8	10.5	9.0
National savings	10.3	9.8	10.7	13.2	15.5
Public sector	(-1.3)	(-2.0)	(0.5)	(2.2)	(3.5)
Private sector	(11.6)	(11.8)	(10.2)	(11.0)	(12.0)

Sources: Costa Rican authorities; and Fund staff estimates.

1/ Includes net errors and omissions.
2/ Includes payments arrears.
3/ Includes SDR allocation in 1979-81.
4/ Includes statistical discrepancy.
5/ Excludes FERTICA (US$22.5 million).
6/ Includes foreign financing channeled through the domestic banking system.

authorities hope to encourage a recovery in the overall investment ratio to about 24 per cent of GDP by 1983, which should contribute to the achievement of real economic growth of at least 4 per cent.

During the period of the program, the authorities will continue to promote investment in the energy and agricultural fields.1/ In the energy sector, particular emphasis is being given to the expansion of electricity generation from both hydro and geothermal sources. Substantial investments by the State Electricity Corporation (ICE) have already achieved the full substitution of hydroelectric for thermal power generation and it is expected that future electric power requirements will be satisfied by hydroelectric power projects now under construction or in the planning stage; it is also possible that some excess will be available for export to neighboring countries. The Arenal hydroelectric project (157 MW) was completed last year and the projects of Corobici (174 MW) and Ventanas-Garita (90 MW) will be ready for operation in 1982 and 1985, respectively. The authorities also intend to continue efforts in alcohol fuel production and oil and coal exploration in order to reduce further their dependence on imported energy sources. In the area of oil exploration, the Petroleum Company of Mexico (PEMEX) signed a contract in November 1980 with RECOPE to finance seismic studies along the Atlantic continental shelf and further financing for these studies is expected later this year from both the IBRD and IDB. In the agricultural sector, the authorities intend to continue the development of irrigation facilities and the construction of feeder roads which will expand the agricultural frontier of the country and increase the productivity of land which is now only marginally exploited. Under these programs, particular emphasis is being given to an expansion in production of sugarcane, meat and dairy products, basic grains, fruits, and vegetables.

The Government is also committed to a major strengthening of the public finances as a means of facilitating the balance of payments adjustment process outlined above. Through a combination of specific revenue and expenditure measures (described below), the Government intends to reduce the overall deficit of the nonfinancial public sector from the equivalent of 10-1/2 per cent of GDP in 1980 to 5-1/2 per cent of GDP by 1983. This effort would be reflected in an improvement of public sector savings of the same order of magnitude, which would be consistent with the maintenance of public investment at a rate of about 9 per cent of GDP per year and a reduction in the use of foreign commercial borrowing by the public sector.

IV. The Program for 1981-82

The attached letter of intent describes the financial program for the first year of the arrangement beginning June 1981. The program includes six quantitative performance clauses: (1) ceilings on the net

1/ The involvement of the World Bank in financing projects in these areas is presented in Statistical Appendix Table 19.

domestic assets of the Central Bank of Costa Rica applicable at all times; (2) ceilings on net Central Bank credit to the nonfinancial public sector applicable at all times; (3) limits on the overall deficit of the nonfinancial public sector subject to testing at the end of each calendar quarter; (4) limits on the net external borrowing of the public (financial and nonfinancial) sector subject to testing at the end of each calendar quarter; (5) minimum targets for the net international reserves of the Central Bank subject to testing at the end of each calendar quarter; and (6) a minimum target for the reduction of payments arrears applicable at the end of December 1981. Nonquantitative performance criteria are the understandings not to introduce any multiple currency practice or any restriction on payments or transfers for current international transactions, and not to introduce or intensify any import restriction for balance of payments reasons.

Fiscal policy has a crucial role in the stabilization program and the authorities intend to limit the overall deficit of the nonfinancial public sector to no more than ₡ 5,250 million in 1981, equivalent to 9 per cent of this year's projected GDP and compared with 10-1/2 per cent in 1980. The fiscal measures which have been adopted for this purpose are described in paragraphs 9, 10, and 13 of the attached letter of intent and include action to (a) increase taxes, (b) raise prices and rates of public enterprises, and (c) control expenditure growth.

The current revenues of the Central Government are projected to grow substantially in 1981, as a result of a significant increase in consumption tax yields related to the increase in rates decreed in August 1980, a higher yield from foreign trade taxes as a result of the adjustment of the exchange rate, and the introduction by executive decree on April 24, 1981 of a temporary increase for one year in export taxes equivalent to 5 per cent of the value of exports. The temporary increase in export taxes is expected to yield new revenues of approximately ₡ 500 million in 1981, or the equivalent of nearly 1 per cent of GDP.

Additional public sector revenue is also expected this year from tariff adjustments of the main public enterprises in the utility sector. In December 1980 and January 1981, domestic fuel prices, telephone rates, and electricity tariffs were raised substantially. Fuel prices were adjusted by an average of 27 per cent in March 1981 and by a further 19 per cent in May. Also, electricity and telephone rates were raised by 20 per cent and 18 per cent, respectively, in May 1981. The authorities have affirmed in paragraph 13 of the attached letter of intent that they will continue to adjust domestic fuel prices so as to pass on to consumers the full increase in costs resulting from higher oil prices, exchange rate adjustments, and other factors, such as subsidies for mass transport.

To provide for additional revenue on a permanent basis, the authorities proposed to the Legislative Assembly on April 9, 1981 a tax reform which they hope to have in place before the time the export tax mentioned above is phased out; the measures proposed in the tax reform package would be expected to yield an amount equivalent to at least 2 per cent of GDP on an annual basis. This tax reform proposal revises the income tax, establishes a new land tax, and rationalizes the application and administration of the sales tax and consumption duties. In the case of the corporate income tax the proposal is to create a new, uniform, proportional rate to replace the variable rate schedule now in effect. The new rate would apply only to distributed profits. In the case of individuals, the tax reform would extend the coverage of the income tax, establish a presumptive tax for professionals, and change the system of exemptions and deductions to one of tax credits. The tax reform also would introduce a new land tax with a uniform, proportional rate of 1 per cent, which would be based on a revised cadastral survey. Finally, the reform package would consolidate a number of specific duties on consumption, simplify the administration of the general sales tax, and would eliminate the earmarking of these revenues.

On the expenditure side, the Costa Rican authorities intend to pursue a policy of expenditure restraint at the level of the Central Administration. In order to keep central government outlays in 1981, in real terms, below the level of 1980, budgetary appropriations will be underspent and no additional appropriations will be requested beyond those for investment expenditure (financed with external development credits) and for a recent increase in public sector salaries which already have been taken into account in this year's fiscal program. In regard to public sector wages, the Government has granted an average increase of 15 per cent, which would represent additional budgetary expenditures of ₡ 600 million. No further salary increases in the public sector are contemplated for 1981. The Budgetary Authority has established expenditure ceilings for all public sector entities that are consistent with the global deficit on public sector operations mentioned earlier. The Budgetary Authority also has been charged with the responsibility of monitoring the performance of the public sector in terms of the quarterly quantitative limits set out in Table 2 of the attached letter of intent.

The financing of the overall deficit of the nonfinancial public sector is to be limited in 1981 to an amount equivalent to the net use of external borrowing by the overall public (financial and nonfinancial) sector. The dependence of the nonfinancial public sector on bank credit financed with domestic resources should be sharply reduced as compared with previous years. In Costa Rica the bulk of domestic deficit financing of the nonfinancial public sector has originated in the Central Bank, either directly or through credits channeled via commercial banks. All such Central Bank financing is subject to the limits described in paragraph 11 and Table 4 of the attached letter of intent. These limits have been phased quarterly to take into account the seasonality of receipts and outlays of the nonfinancial public sector.

The Government intends to limit the public sector's net use of external credit to US$350 million in 1981, to be phased quarterly as described in paragraph 12 and Table 5 of the attached letter of intent. Of this amount, US$183 million corresponds to the nonfinancial public sector and the remainder to borrowing by public financial intermediaries. It is also the intention to reduce significantly the share of foreign commercial sources within this limit.

In addition to limiting the amount of domestic bank financing of the public sector deficit, the monetary program of the Costa Rican authorities is designed to accommodate some acceleration in the growth of bank credit to the private sector and a significant reduction in payments arrears. Consistent with their objectives for net international reserves, the authorities have established quarterly ceilings on the net domestic assets of the Central Bank (defined as currency issue less net international reserves), which are described in paragraph 11 and Table 3 of the attached letter of intent. In order to ensure that these limits are complied with, the Central Bank is prepared to increase its sales of stabilization bonds as conditions require. The authorities also plan to pursue an interest rate policy that allows domestic interest rates to move toward levels which are positive in real terms in order to promote the attractiveness of domestic financial savings and efficient resource allocation. The Central Bank will continue to set the basic interest rate on six-month deposits to which all other bank rates are linked;1/ the interest rate subsidy on Central Bank credit to support basic grains production has been reduced.

For the purposes of the financial program, all payments arrears outstanding at the end of December 1980 (estimated at US$283 million) which have been validated by a 100 per cent counterpart claim in the Central Bank in colones are to be treated as reserve liabilities of the Central Bank. These claims are being recognized by the Central Bank by the issue of negotiable certificates of deposit denominated in U.S. dollars which bear interest equivalent to six-month LIBOR and will be redeemed on a semiannual basis over a period of three years from the date the claims were presented. Payments arrears have been targeted to decline by at least US$96 million by the end of 1981. It is projected that the reduction in payments arrears will be offset by an increase in other net official international reserves liabilities, and thus during 1981 the net international reserves of the Central Bank (including arrears) will show no change (see Table 4). During the first half of 1982, however, it is projected that the net international reserves of the Central Bank will improve by more than the projected reduction in payments arrears (Table 7).

1/ The basic rate on deposits is reviewed periodically by the Central Bank taking into consideration the rate of domestic inflation and the prevailing interest rate for six-month deposits in the United States and Panama. The basic rate for bank credit operations, including the Central Bank's rediscount rate for most operations, is set at 3 percentage points above the basic deposit rate.

Table 7. Costa Rica: Summary Accounts of the Central Bank 1/

(In millions of colones)

	1980 Dec.	Projection 1981 June	1981 Dec.	1982 June
Net international reserves	-6,299	-6,388	-6,299	-5,548
Official	-2,061	-2,494	-3,504	-3,313
Arrears	-4,238	-3,894	-2,794	-2,235
Net domestic assets	9,194	9,188	9,939	9,048
Public sector (net) 2/	7,233	8,500	10,000	10,700
Net position with banks	-1,710	-1,470	-1,603	-2,425
Medium- and long-term foreign liabilities	-6,791	-7,600	-8,636	-9,800
Exchange losses and interest payments on arrears	--	692	1,428	2,020
Counterpart of arrears	4,238	3,894	2,795	2,235
Arrear deposits	--	-2,080	-1,493	-1,194
Other 3/	6,224	7,252	7,448	7,512
Currency issue	2,895	2,800	3,640	3,500

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

1/ Foreign exchange accounts have been valued at ₡ 15 per U.S. dollar.
2/ Includes credit to commercial banks for on-lending to the Central Government.
3/ Includes valuation adjustment and SDR allocation.

During the financial program year, the Central Bank will incur interest payment obligations and exchange losses in colones equivalent to the difference between the exchange rate at which foreign exchange is sold to importers in arrears (i.e., ₡ 8.60 per U.S. dollar) and the rate of ₡ 15 per U.S. dollar established for the purpose of liquidating arrears. In line with the targeted reduction of US$96 million in payments arrears during 1981, exchange losses and interest payments amounting to ₡ 1,428 million have been projected within the net domestic assets of the Central Bank.1/

1/ Any exchange losses arising from the sale of foreign exchange to the Central Government at ₡ 8.60 per U.S. dollar for its payments abroad, as called for in the exchange reform of December 26, 1980, will be counted as credit to the public sector, as will any exchange losses of the Central Bank in respect of operations with the rest of the public sector.

In addition to its commitment on payments arrears, the Central Bank undertook in April 1981 to reimburse private importers, in respect of payments arrears paid off through the free market during the first quarter of 1981, for the difference between the actual exchange rate at which foreign exchange was purchased for this purpose (up to a maximum of ₡ 15 per U.S. dollar) and the previous selling rate of ₡ 8.60 per U.S. dollar. These guarantees will be granted in the form of five-year bonds (in colones) which will be amortized in three annual installments beginning two years after their date of issue; the interest rate on such bonds will be 12 per cent a year. It is estimated that the total value of transactions subject to this guarantee amounts to a maximum of US$244 million.1/

V. Staff Appraisal and Proposed Decision

The external position of Costa Rica weakened markedly in 1980 as a result of the intensification of excess demand pressures which had been building for several years. These pressures last year led to a sizable deterioration in the net international reserve position of the Central Bank, a large accumulation of payments arrears, and a sharp depreciation of the colon in the parallel exchange market. A growing deficit in the overall balance of public sector operations, caused chiefly by a rapid growth in central government expenditures, has been a major source of the demand management problem. During 1980, an effort was made to reduce the size of the overall public sector deficit in relation to GDP in the context of a Fund-supported stabilization program, but the results achieved fell short of expectations. The consequence was that the main targets of the financial program for 1980 were not attained.

In view of these developments, the Costa Rican authorities have initiated a new adjustment program designed to strengthen the balance of payments position of Costa Rica over the medium term. In the short run this program gives emphasis to demand management, centered basically on an improved fiscal performance, in order to contain inflationary pressures and to help promote orderly developments in the exchange market. Over the medium term, the program will call for significant structural adjustments in the agricultural, energy, and trade fields which should make possible the return to a higher rate of economic growth than that experienced in the recent past. The Management of the World Bank has informed the Fund that, in light of the fact that about 60 per cent of capital formation is expected to be in the private sector and that broadly appropriate incentives in this respect are expected to be provided, and that it considers the allocation of public investment to be generally appropriate, especially in the energy field (where the Bank and the IDB are directly and extensively involved in project financing), the Bank has no reservations regarding the proposed EFF.

1/ The Central Bank also has granted an exchange rate guarantee in respect of registered private sector net external obligations, estimated at about US$45 million, which will be issued in the form of bonds maturing in April 1987. These bonds will be non-negotiable and noninterest bearing until the repayment of the foreign liability, in respect of which they were issued, falls due.

Success in the implementation of the program will require the application of strict fiscal discipline. In this connection, the staff welcomes the intention of the authorities to strengthen the responsibility of the Budgetary Authority as a coordinator of public sector operations and to improve tax administration at the central government level. Achievement of the planned improvement of the public sector's position over the period of the extended arrangement will require concrete action on tax and administrative reforms. It is crucial in this respect that the Government begin as soon as possible the legal process of reducing the scope of revenue earmarking and compulsory spending which now characterize public sector operations in Costa Rica.

The staff believes that the substantial exchange rate adjustment that has taken place since late last year should contribute to a structural change in the balance of payments over the medium term. Moreover, the maintenance of a flexible exchange rate policy should help to ensure the achievement of the program's balance of payments objectives in the short run. Of course, the Central Bank's credit policy also has an important role to play in this regard. Limiting the growth of such credit to the volume planned will not be an easy task in view of the burden created by the exchange losses and interest payments accepted by the Central Bank in its treatment of payments arrears and exchange rate guarantees. The authorities will have to be prepared to react if necessary--e.g., by selling stabilization bonds--to ensure compliance with the credit limits of the Central Bank.

In the staff's view the economic program of the Costa Rican authorities supporting their request for an extended arrangement represents a significant effort to strengthen the external position of Costa Rica and warrants the support of the Fund. Accordingly, the following draft decision is proposed for the Board's approval:

1. The Government of Costa Rica has requested an extended arrangement for a period of three years in an amount equivalent to SDR 276.75 million.

2. The Fund approves the extended arrangement attached to EBS/81/123.

3. The Fund waives the limitation in Section V, Section 3(b)(iii), of the Articles of Agreement.

Table 8. Costa Rica: National Accounts at Current Prices

(In millions of colones)

	1977	1978	1979	Est. 1980
Consumption	21,440	25,489	29,642	35,875
General government	4,223	4,895	6,133	7,853
Private sector	17,217	20,594	23,509	28,022
Gross domestic investment	6,391	7,084	8,373	10,048
Fixed capital formation	5,889	6,952	8,593	9,581
Public sector	(2,275)	(2,687)	(3,037)	(3,512)
Private sector	(3,614)	(4,265)	(5,556)	(6,069)
Inventory changes	502	132	-220	467
Gross domestic expenditure	27,831	32,573	38,015	45,923
Exports of goods and nonfactor services	8,279	8,748	9,483	10,924
Imports of goods and nonfactor services	-9,779	-11,127	-13,265	-15,142
GDP at market prices	26,331	30,194	34,233	41,705
Net factor payments abroad	-633	-950	-1,257	-1,888
GNP at market prices	25,698	29,244	32,976	39,817
Depreciation	-1,352	-1,584	-1,846	-2,231
National income	24,346	27,660	31,130	37,586

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

Table 9. Costa Rica: Gross Domestic Product at Constant Prices

	1977	1978	Prel. 1979	Est. 1980
	(In millions of 1966 colones)			
Gross domestic product	8,587	9,125	9,422	9,605
Primary sectors	1,653	1,736	1,719	1,698
Agriculture and related areas	(1,629)	(1,736)	(1,719)	(1,698)
Mining	(24)	(...)	(...)	(...)
Secondary sectors	2,534	2,750	2,819	2,947
Manufacturing	(1,869)	(2,048)	(2,077)	(2,131)
Construction	(483)	(511)	(538)	(596)
Utilities	(182)	(191)	(204)	(220)
Services	4,400	4,639	4,884	4,960
Commerce	(1,653)	(1,723)	(1,759)	(1,713)
Government	(839)	(881)	(934)	(965)
Other services	(1,908)	(2,035)	(2,191)	(2,282)
	(Percentage distribution)			
Gross domestic product	100.0	100.0	100.0	100.0
Primary sectors	19.3	19.0	18.2	17.7
Agriculture and related areas	(19.0)	(19.0)	(18.2)	(17.7)
Mining	(0.3)	(...)	(...)	(...)
Secondary sectors	29.5	30.1	29.9	30.7
Manufacturing	(21.8)	(22.4)	(22.0)	(22.2)
Construction	(5.6)	(5.6)	(5.7)	(6.2)
Utilities	(2.1)	(2.1)	(2.2)	(2.3)
Services	51.2	50.8	51.8	51.6
Commerce	(19.3)	(18.8)	(18.7)	(17.8)
Government	(9.8)	(9.7)	(9.9)	(10.0)
Other services	(22.2)	(22.3)	(23.2)	(23.8)
	(Percentage change from previous year)			
Gross domestic product	8.9	6.3	3.3	1.9
Primary sectors	2.7	5.0	-1.0	-1.2
Agriculture and related areas	(2.2)	(6.6)	(-1.0)	(-1.2)
Mining	(41.2)	(...)	(...)	(...)
Secondary sectors	10.3	8.5	2.5	4.5
Manufacturing	(12.5)	(9.5)	(1.4)	(2.6)
Construction	(3.9)	(5.8)	(5.3)	(10.8)
Utilities	(7.1)	(4.9)	(6.8)	(7.8)
Services	10.6	5.4	5.3	1.6
Commerce	(17.9)	(4.2)	(2.1)	(-2.6)
Government	(5.0)	(5.0)	(6.0)	(3.3)
Other services	(7.4)	(6.6)	(7.7)	(4.2)

Source: Central Bank of Costa Rica.

Table 10. Costa Rica: Price Indices

(Annual percentage change)

	Weights	1977	1978	1979	1980
Wholesale prices (average)	100.0	7.5	7.8	17.4	23.8
Food and beverages	46.6	7.6	9.9	18.5	25.7
Textiles and hides	7.4	11.2	4.7	6.6	36.3
Construction material	13.0	5.3	8.8	19.3	11.4
Fuels, electricity, and ice	7.6	6.4	2.3	38.3	17.2
Chemicals and manufactures	25.4	7.3	6.1	11.8	23.8
Wholesale prices (end of period)		7.4	9.4	24.0	21.6
Consumer prices (average)	100.0	4.1	6.0	9.2	18.1
Food	40.8	4.8	10.3	12.7	21.7
Clothing	10.0	-5.6	-5.6	-3.7	6.8
Housing	27.1	7.2	4.2	5.6	16.8
Other	22.1	3.7	5.4	11.8	16.7
Consumer prices (end of period)		5.2	8.1	13.1	17.8
Export prices (average)		27.8	-3.9	3.6	10.9
Import prices (average)		5.3	5.8	14.8	14.0

Source: Central Bank of Costa Rica; General Directorate of Statistics and Census; and Fund staff estimates.

Table 11. Costa Rica: Accounts of the Banking System 1/

(In millions of colones)

	December 31				
	1976	1977	1978	1979	1980
I. Central Bank					
Net international reserves	474.5	1,346.0	1,005.6	302.6	-1,173.2
Assets	837.1	1,724.9	1,783.1	1,314.4	1,948.8
Short-term liabilities	-362.6	-378.9	-777.5	-1,011.8	-3,122.0
Net domestic assets	2,666.3	3,606.8	4,790.9	8,611.0	11,964.5
Credit to public sector (net)	823.1	1,421.2	2,065.4	2,902.9	3,482.2
Credit to Central Government (net)	(216.7)	(383.1)	(834.2)	(881.7)	(545.6)
Credit to rest of public sector (net)	(606.4)	(1,038.1)	(1,231.2)	(2,021.2)	(2,936.6)
Official capital and reserves	-13.1	-13.1	-13.1	-13.0	-12.6
Credit to banks	968.2	1,266.7	1,563.3	4,203.9	6,462.7
Credit to nonbank intermediaries	57.6	59.8	63.1	172.6	213.3
Subscriptions to international agencies (net)	166.3	179.3	193.8	205.2	214.5
Unclassified assets (net)	664.2	692.9	918.4	1,139.4	1,604.4 2/
Counterpart unrequited foreign exchange	109.0	182.9	219.4	444.0	647.4
Medium- and long-term foreign liabilities	818.0	1,190.2	1,526.7	2,773.2	3,866.6
Liabilities to banks	1,075.4	1,796.8	1,456.8	3,199.6	3,517.0
Liabilities to nonbank intermediaries	0.2	0.4	1.7	2.0	0.4
Liabilities to private sector	1,138.2	1,782.5	2,591.9	2,494.8	2,759.9
Currency in circulation	1,116.2	1,408.9	1,704.0	1,954.4	2,255.0
Demand deposits	18.4	29.4	61.4	39.0	153.1
Foreign currency deposits	3.6	47.3	409.5	130.6	33.1
Stabilization bonds	--	296.9	417.0	370.8	286.3
Import deposits	--	--	--	--	32.4

Table 11. Costa Rica: Accounts of the Banking System 1/ (Continued)

(In millions of colones)

	December 31				
	1976	1977	1978	1979	1980
II. Commercial Banks					
Net international reserves	219.4	272.5	383.1	225.6	3.3
Assets	245.6	345.2	477.7	403.3	417.7
Short-term liabilities	-26.2	-72.7	-94.6	-177.7	-414.4
Claims on Central Bank	1,071.5	1,791.0	1,434.2	3,183.8	3,558.3
Net domestic assets	5,460.1	6,823.4	9,008.8	12,865.8	16,708.4
Credit to public sector (net)	-6.3	379.2	600.7	2,578.9	4,465.9
Credit to Central Government (net)	(391.5)	(613.8)	(939.2)	(2,990.0)	(5,400.6)
Credit to rest of public sector (net)	(-397.8)	(-234.6)	(-338.5)	(-411.1)	(-934.7)
Official capital and reserves	-297.8	-289.1	-296.8	-303.7	-307.5
Credit to private sector	5,115.0	6,034.1	7,483.5	8,950.7	10,200.3
Credit to rest of banking system	122.1	125.0	168.8	307.1	242.1
Credit to nonbank intermediaries	5.9	--	--	21.0	130.0
Unclassified assets (net)	521.2	574.2	1,052.6	1,311.8	1,977.6 2/
Medium- and long-term foreign liabilities	539.3	741.0	656.4	851.0	671.6
Liabilities to Central Bank	798.6	1,056.3	1,269.9	3,892.2	6,162.9
Liabilities to rest of banking system	9.8	29.3	20.6	31.8	38.3
Liabilities to nonbank intermediaries	3.3	--	--	--	4.6
Liabilities to private sector	5,400.0	7,060.3	8,879.2	11,500.2	13,392.6
Demand deposits	2,259.9	3,035.7	3,836.6	4,198.7	4,824.8
Savings deposits	682.0	956.3	1,273.4	1,310.0	1,267.4
Time deposits	1,555.1	1,923.5	2,391.8	3,408.4	4,550.8
Foreign currency deposits	739.1	938.1	1,127.5	2,190.0	2,222.5
Other	163.9	206.7	249.9	393.1	527.1

Table 11. Costa Rica: Accounts of the Banking System 1/ (Continued)

(In millions of colones)

	December 31				
	1976	1977	1978	1979	1980
III. Rest of Banking System					
Claims on Central Bank	0.5	0.2	0.4	0.5	0.2
Net domestic assets	625.8	753.2	945.4	1,055.4	997.1
Credit to public sector (net)	-9.0	-22.3	-37.4	3.0	-62.6
Credit to Central Government (net)	(7.1)	(2.2)	(2.2)	(2.2)	(7.8)
Credit to rest of public sector (net)	(-16.1)	(24.5)	(-39.6)	(0.8)	(-70.4)
Official capital and reserves	-125.9	-123.2	-128.7	-133.5	-135.5
Credit to commercial banks	9.8	29.3	20.6	33.4	37.4
Credit to private sector	797.4	914.3	1,131.6	1,244.1	1,277.5
Unclassified assets (net)	-46.5	-44.9	-40.7	-91.6	-119.7
Medium- and long-term foreign liabilities	63.5	84.4	73.6	62.3	50.8
Liabilities to Central Bank	175.4	207.3	273.2	307.3	311.7
Liabilities to commercial banks	122.1	125.0	168.8	307.1	242.1
Liabilities to nonbank intermediaries	86.2	125.4	143.4	180.6	212.4
Liabilities to private sector	179.1	211.3	286.8	198.6	180.3
Demand deposits	1.1	1.8	4.5	--	--
Bonds	162.6	184.3	246.6	184.2	160.0
Other	15.4	25.2	35.7	14.4	20.3

Table 11. Costa Rica: Accounts of the Banking System 1/ (Concluded)

(In millions of colones)

	December 31				
	1976	1977	1978	1979	1980
IV. Consolidated Banking System					
Net international reserves	693.9	1,618.5	1,388.7	528.2	-1,169.9
Assets	1,082.7	2,070.1	2,260.8	1,717.7	2,366.5
Short-term liabilities	-388.8	-451.6	-872.1	-1,189.5	-3,536.4
Net domestic assets	7,642.9	9,759.9	12,990.4	17,978.5	22,956.7
Credit to public sector (net)	807.8	1,778.1	2,628.7	5,484.8	7,885.5
Credit to Central Government (net)	(615.3)	(999.1)	(1,775.6)	(3,873.9)	(5,954.0)
Credit to rest of public sector (net)	(192.5)	(779.0)	(853.1)	(1,610.9)	(1,931.5)
Official capital and reserves	-436.8	-425.4	-438.6	-450.2	-455.6
Credit to nonbank intermediaries	63.5	59.8	63.1	193.6	343.3
Credit to private sector	5,912.4	6,948.4	8,615.1	10,194.8	11,477.8
Subscriptions to international agencies (net)	166.3	179.3	193.8	205.2	214.5
Unclassified assets (net)	1,138.9	1,222.2	1,930.3	2,359.6	3,462.3 2/
Interbank float	-9.2	-2.5	-2.0	-9.3	28.9
Counterpart unrequited foreign exchange	109.0	182.9	219.4	444.0	647.4
Medium- and long-term foreign liabilities	1,420.8	2,015.6	2,256.7	3,686.5	4,589.0
Liabilities to nonbank intermediaries	89.7	125.8	145.1	182.6	217.4
Liabilities to private sector	6,717.3	9,054.1	11,757.9	14,193.6	16,333.0
Money	3,395.6	4,475.8	5,606.5	6,192.1	7,233.1
Quasi-money	2,979.8	3,865.2	5,202.2	7,039.1	8,073.8
Bonds	162.6	481.2	663.6	555.0	446.3
Other	179.3	231.9	285.6	407.5	579.8

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

1/ All accounts denominated in foreign currency have been converted at ¢ 8.57 per U.S. dollar.
2/ Includes valuation adjustment.

Table 12. Costa Rica: Summary Operations of the Consolidated Nonfinancial Public Sector

	1978	1979	1980
(In millions of colones)			
Total revenue	6,755	7,377	8,874
Current account surplus or deficit of public enterprises	356	-209	-56
Current revenue of general government	6,399	7,586	8,930
Total expenditure and net lending	9,129	11,331	13,707
Current expenditure of general government	6,084	7,826	9,737
Fixed capital formation	2,687	3,037	3,512
Other capital expenditure (net) 1/	358	468	458
Residual 2/	-434	-245	507
Deficit = financing (net)	2,808	4,199	4,326
External	1,843	1,600	1,589
Domestic	965	2,599	2,737
(Annual percentage change)			
Total revenue	26.9	9.2	20.3
Current revenue of general government	24.5	18.5	17.7
Total expenditure and net lending	21.4	24.1	21.0
Current expenditure of general government	23.0	28.6	24.4
Fixed capital formation	17.4	13.0	15.6
Other capital expenditure (net)	24.7	30.7	-2.1
(In per cent of GDP)			
Total revenue	22.4	21.6	21.3
Current account surplus or deficit (-) of public enterprises	1.2	-0.6	-0.1
Current revenue of general government	21.2	22.2	21.4
Total expenditure and net lending	30.2	33.2	32.9
Current expenditure of general government	20.1	22.9	23.4
Fixed capital formation	8.9	8.9	8.4
Other capital expenditure (net)	1.2	1.4	1.1
Residual	-1.5	-0.7	1.2
Deficit = financing (net)	9.3	12.3	10.4
External	6.1	4.7	3.8
Domestic	3.2	7.6	6.6

Sources: Office of the Comptroller General; Ministry of Finance; RECOPE; CODESA; ICE; and Fund staff estimates.

1/ Includes net lending and capital revenue.
2/ Includes discrepancy between accrual and cash basis and for reporting periods that differ from the calendar year.

Table 13. Costa Rica: Operations of the Central Administration

(In millions of colones)

	1977	1978	1979	1980
Current revenue and grants	3,548	4,125	4,342	4,953
Direct taxes	849	1,043	1,082	1,189
Income tax	(748)	(897)	(937)	(993)
Payroll taxes	(69)	(84)	(90)	(125)
Other direct taxes	(32)	(62)	(55)	(71)
Indirect taxes	2,532	2,882	3,065	3,636
General sales tax	(374)	(475)	(512)	(619)
Consumption tax	(495)	(581)	(551)	(933)
Taxes on imports	(542)	(652)	(761)	(827)
Tax on coffee exports	(257)	(248)	(223)	(170)
Tax on banana exports	(204)	(198)	(208)	(188)
Other indirect taxes	(660)	(728)	(810)	(899)
Other current revenue	167	200	195	128
Current expenditure 1/	3,559	4,057	5,141	6,156
Wages and salaries	1,907	1,948	2,478	2,819
Goods and services	291	222	311	316
Interest	286	418	622	820
Transfers	1,075	1,469	1,730	2,201
Current account surplus or deficit (-)	-11	68	-799	-1,203
Capital expenditure 1/	908	1,146	1,474	1,844
Fixed capital formation	584	640	915	1,102
Transfers	273	454	463	712
Other capital expenditure	51	52	96	30
Overall deficit (-)	-919	-1,078	-2,273	-3,047
Residual 2/	171	-207	-248	227
Financing	748	1,285	2,521	2,820
Domestic financing (net)	524	418	1,737	2,414
External financing (net)	224	867	784	406

Sources: Ministry of Finance; and Fund staff estimates.

1/ Adjusted for checks unpaid.
2/ Includes discrepancy between accrual and cash basis.

Table 14. Costa Rica: Net International Reserves of the Central Bank

	December 31				
	1976	1977	1978	1979	1980
	(In millions of U.S. dollars)				
Net international reserves	55.6	157.6	117.8	35.4	-137.3
Assets	98.0	202.0	208.8	153.9	228.2
Gold	(2.5)	(11.7)	(15.5)	(36.1)	(54.0)
SDRs	(1.4)	(6.4)	(3.7)	(5.7)	(--)
IMF position	(--)	(--)	(10.1)	(10.1)	(--)
Contribution to the Central American Stabilization Fund	(7.5)	(10.0)	(10.0)	(10.0)	(10.0)
Assets with multilateral clearing arrangements	(3.4)	(5.0)	(2.5)	(4.2)	(17.4)
Other	(83.2)	(168.9)	(167.0)	(87.8)	(146.8)
Liabilities	-42.5	-44.4	-91.0	-118.5	-365.5
Liabilities to IMF	(-37.4)	(-34.0)	(-30.5)	(-56.6)	(-57.0)
Liabilities with multilateral clearing arrangements	(--)	(--)	(-0.2)	(-0.3)	(-10.7)
Other	(-5.1)	(-10.4)	(-60.3)	(-61.6)	(-297.8)
	(In months of imports)				
Net international reserves	0.9	1.8	1.2	0.3	...
Gross international reserves	1.5	2.4	2.1	1.3	1.8

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

Table 15. Costa Rica: Balance of Payments

(in millions of U.S. dollars)

	1977 Credit	1977 Debit	1977 Balance	1978 Credit	1978 Debit	1978 Balance	1979 Credit	1979 Debit	1979 Balance	Preliminary 1980 Credit	Preliminary 1980 Debit	Preliminary 1980 Balance
Goods and services	976.0	1,217.1	-241.1	1,040.7	1,420.4	-379.7	1,122.1	1,700.3	-578.2	1,231.3	1,909.7	-678.4
Merchandise trade 1/	827.8	1,027.3	-199.5	863.9	1,166.0	-302.1	942.1	1,396.9	-454.8	1,017.1	1,528.7	-511.6
Freight and merchandise insurance	10.6	--	10.6	11.6	--	11.6	13.4	--	13.4	16.0	--	16.0
Other transportation	30.1	30.2	-0.1	24.8	33.9	-9.1	24.2	28.0	-3.8	26.5	29.6	-3.1
Travel	62.3	51.4	10.9	72.5	61.7	10.8	73.8	63.4	10.4	86.5	62.1	24.7
Factor services	12.9	86.4	-73.5	16.3	126.6	-110.3	11.7	157.8	-146.1	17.5	227.2	-209.7
Direct investment income	(--)	(26.5)	(-26.5)	(--)	(27.1)	(-27.1)	(0.8)	(17.4)	(-16.6)	(4.0)	(22.5)	(-18.5)
Interest	(12.9)	(59.9)	(-47.0)	(16.3)	(99.5)	(-83.2)	(10.9)	(140.4)	(-129.4)	(13.5)	(204.7)	(-191.2)
Other	32.3	21.8	10.5	51.6	32.2	19.4	56.9	54.2	2.7	67.4	62.1	5.3
Transfers	26.4	11.0	15.4	28.0	11.4	16.6	30.1	17.9	12.2	31.1	14.0	17.1
Private	24.6	9.6	15.0	26.1	10.3	15.8	27.8	11.3	16.5	28.4	12.0	16.4
Public	1.8	1.4	0.4	1.9	1.1	0.8	2.3	6.6	-4.3	2.7	2.0	0.7
Current account balance	1,002.4	1,228.1	-225.6	1,068.7	1,431.8	-363.1	1,152.2	1,718.2	-566.0	1,257.1	1,923.6	-661.3
Private capital	...	...	164.3	...	...	86.3			69.1			-178.9
Direct investment	63.1	--	63.1	1.6	48.7	47.1	...	...	42.3	...	...	19.8
Medium- and long-term loans	162.9	100.2	62.7	212.6	121.9	90.7	...	...	-18.3	...	...	20.0
Short-term loans (including net errors and omissions)	...	...	38.5	...	...	-51.5	...	...	45.1	...	...	-218.7
Official capital	116.6	35.1	81.5	266.5	51.1	215.4	299.4	112.2	187.2	270.5	61.9	208.6
Central Government	39.4	13.3	26.1	120.0	17.0	103.0	140.4	48.9	91.5	64.0	16.4	47.6
Public enterprises	70.8	21.1	49.7	127.0	33.6	93.4	120.6	60.8	59.8	158.4	35.4	123.0
Rest of public sector	2.3	0.7	1.6	4.7	0.5	4.2	2.2	2.5	-0.3	10.8	1.3	9.5
Short-term loans	4.1	--	4.1	14.8	--	14.8	36.2	--	36.2	37.3	8.8	28.5
Financial intermediaries	111.5	36.8	74.7	81.6	61.0	20.6	264.7	60.9	203.8	214.1	60.5	153.6
Central Bank	53.1	9.5	43.6	61.0	21.6	39.4	175.2	29.3	145.9	136.5	3.4	133.1
Commercial banks 2/	55.4	26.7	28.7	16.3	38.7	-22.4	81.4	28.4	53.0	74.2	50.5	23.7
Long term	(50.0)	(15.0)	(35.0)	(13.7)	(23.2)	(-9.5)	(62.9)	(28.4)	(34.5)	(20.2)	(22.5)	(-2.3)
Short term	(5.4)	(11.7)	(-6.3)	(2.6)	(15.5)	(-12.9)	(18.5)	(--)	(18.5)	(54.0)	(28.0)	(26.0)
Other public intermediaries 3/	3.0	0.6	2.4	4.3	0.7	3.6	8.1	3.2	4.9	3.4	1.6	1.8
Transactions with nonmonetary international agencies	--	1.5	-1.5	5.1	6.8	-1.7	1.8	3.1	-1.3	4.5	5.6	-1.1
SDR allocation and gold revaluation			8.6			2.7			24.8			23.4
Overall balance			102.0			-39.8			-82.4			-455.7
Arrears			--			--			--			283.0
Net international reserves -BCCR			-102.0			39.8			82.4			172.7
Assets (increase -)			-104.0			-6.8			54.9			-74.5
Liabilities			1.9			46.6			27.5			247.2

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

1/ Exports, f.o.b.; imports, c.i.f.
2/ Including short term.
3/ Including INFOCOOP, INS and INVU.

Table 16. Costa Rica: Value, Volume, and Unit Value of Principal Exports

(Values in millions of U.S. dollars; volumes in thousands of units as indicated; and unit values in U.S. dollars)

	1977	1978	1979	Prel. 1980
Exports, f.o.b.	827.8	863.6	942.1	1,017.1
Coffee	319.2	313.7	315.4	246.4
Volume (quintal)	1,470	1,877	2,117	1,551
Unit value (per quintal)	217.2	167.1	149.0	158.9
Bananas	150.3	169.9	190.5	201.2
Volume (metric ton)	1,003	1,058	1,025	960
Unit value (per ton)	149.9	160.6	185.9	209.6
Meat	44.1	60.3	81.7	70.4
Volume (metric ton)	31.9	34.6	31.6	25.9
Unit value (per ton)	1,380.0	1,740.0	2,590.0	2,718.1
Sugar	15.6	15.9	17.5	40.6
Volume (quintal)	1,479	1,488	1,502	1,552
Unit value (per quintal)	10.6	10.7	11.7	26.2
Cocoa	17.1	15.1	9.7	4.2
Volume (quintal)	122	127	92	47
Unit value (per quintal)	140.4	119.0	105.6	89.3
Fertilizer	13.7	11.0	9.3	10.3
Volume (metric ton)	108.0	83.1	61.1	56.7
Unit value (per ton)	127.0	132.4	152.2	181.6
Other products	268.1	279.1	310.3	444.8
Agricultural	(52.1)	(66.3)	(60.3)	(83.0)
Industrial	(216.0)	(212.8)	(250.0)	(361.7)
Adjustment	-0.3	-1.4	7.7	-0.7

Sources: Directorate General of Statistics and Census; and Central Bank of Costa Rica.

Table 17. Costa Rica: Outstanding External Public Debt 1/

(In millions of U.S. dollars)

	1976	1977	1978	1979	Est. 1980
Total debt	605.6	790.1	1,018.2	1,353.2	1,660.9
By borrower					
Central Government	181.5	216.6	322.2	412.4	460.0
Public enterprises	220.4	280.5	367.4	427.0	550.0
ICE	(174.3)	(224.9)	(263.4)	(322.9)	(413.4)
ICAA	(21.3)	(19.7)	(30.4)	(17.2)	(21.6)
RECOPE	(8.7)	(12.1)	(18.9)	(5.0)	(6.8)
CODESA	(6.9)	(9.2)	(16.8)	(13.7)	(33.7)
FECOSA	(4.3)	(4.3)	(19.5)	(45.3)	(50.1)
Other	(4.9)	(10.3)	(18.4)	(22.9)	(24.4)
Public financial institutions	200.5	284.2	314.7	500.1	627.7
Central Bank	(95.8)	(139.4)	(178.8)	(324.7)	(452.8)
Commercial banks 2/	(95.8)	(133.4)	(121.1)	(155.8)	(153.5)
Other	(8.9)	(11.4)	(14.8)	(19.6)	(21.4)
Rest of public sector	3.2	8.8	13.9	13.7	23.2
By lender					
Multilateral agencies	268.8	340.1	405.0	468.4	546.9
IBRD	(106.9)	(128.5)	(144.8)	(157.7)	(174.5)
IDB	(76.3)	(103.6)	(128.2)	(157.2)	(207.4)
CABEI	(84.9)	(106.1)	(127.9)	(146.3)	(154.3)
Other	(0.7)	(1.9)	(4.1)	(7.2)	(10.7)
Foreign public lenders	117.4	134.0	196.5	236.0	271.2
USAID	(60.0)	(60.6)	(62.3)	(66.7)	(65.7)
VIF	(33.0)	(39.7)	(57.8)	(64.7)	(79.6)
Other	(24.4)	(33.7)	(76.4)	(104.6)	(125.9)
Foreign private lenders	216.0	316.0	412.1	635.8	827.8
Banks	(185.0)	(283.0)	(377.3)	(609.0)	(...)
Suppliers	(31.0)	(31.0)	(34.8)	(26.8)	(...)
Unallocated	3.4	--	4.6	13.0	15.0

Sources: National Planning Office (OFIPLAN); Central Bank of Costa Rica; and Fund staff estimates.

1/ Public external debt with a maturity of more than one year.
2/ Includes DECAP.

Table 18. Costa Rica: External Public Debt Operations 1/

	1977	1978	1979	Est. 1980
	(In millions of U.S. dollars)			
Outstanding debt (at year end)	790.1	1,018.2	1,353.2	1,660.9
Nonfinancial public sector	505.9	703.5	853.1	1,033.2
Public financial intermediaries	284.2	314.7	500.1	627.7
Net drawing	158.5	234.5	336.3	307.7
Disbursements	218.6	330.7	509.4	393.3
Amortization	-60.2	-96.2	-173.1 2/	-85.6
Debt service payments	102.3	162.2	261.8 2/	227.6
Interest payments	42.1	66.0	88.7	142.0
New loans contracted	313.8	506.2	423.3	...
	(In per cent)			
Outstanding public debt/GDP	25.7	28.9	33.9	35.8
Net drawings/GDP	5.2	6.7	8.4	6.6
Debt service/exports of goods and nonfactor services	10.6	15.8	23.6 2/	18.8
Interest payments/outstanding public debt	5.3	6.5	6.5	8.5

Sources: National Planning Office (OFIPLAN); Central Bank of Costa Rica; and Fund staff estimates.

1/ External public debt with a maturity of more than one year.
2/ Includes early repayment of US$68.1 million.

Table 19. Costa Rica: Financial Relations with the World Bank Group

(In millions of U.S. dollars)

	Disbursed	Undisbursed
A. IBRD/IDA/IFC Operations (as of April 30, 1981)		
IBRD/IDA loans		
Agriculture	27.1	2.7
Education	6.0	0.2
Industry	4.9	15.0
Power	89.5	34.8
Telecommunications	53.6	4.5
Transport	55.7	57.0
Water supply	--	26.0
Program loan	6.5	
Total	243.3	140.2
Of which: repaid	55.6	
outstanding	187.7	
IFC investment		
Total	4.1	0.5

B. IBRD loan disbursements

	Actual		Est.	Projected	
	1979	1980	1981	1982	1983
Net disbursements	14.6	23.6	31.5	40.7	33.2
Disbursements	20.5	30.1	40.6	52.1 1/	54.1 1/
Repayments	5.9	6.5	9.1	11.4	20.9

Source: IBRD.

1/ Includes about US$27 million for nonproject lending during 1982-83.

Fund Relations with Costa Rica

Status:	Article VIII.
Quota:	SDR 61.5 million.

Fund holdings of Costa Rican colones:

As of April 30, 1981	Millions of SDRs	Per Cent of Quota
Total	103.8	168.8
Under tranche policy	71.8	116.7
From ordinary resources	66.7	108.4
From supplementary financing facility	5.1	8.3
Under oil facility	11.5	18.8
Under compensatory financing facility	20.5	33.3

SDR Department:

As of April 30, 1981	Millions of SDRs	Per Cent of Allocation
Net cumulative allocation	23.7	100.0
Holdings	0.7	2.9

Gold distribution:	Costa Rica has received gold distributions in the amount of 27,387.0 ounces.
Direct distribution of profits from gold sales:	Costa Rica has received US$5.1 million.
Exchange rate:	As of December 27, 1980, the dual exchange system was abolished and since that time the exchange rate for the colon has fluctuated. In May 1981 the average exchange rate for the colon was around ₡ 18 per U.S. dollar compared with the previous official parity of ₡ 8.57 per U.S. dollar.
Last consultation (Article IV):	November 1979, concluded in January 1980, and completed by the Executive Board on March 12, 1980 (EBM/80/43).

Costa Rica--Extended Arrangement

Attached hereto is a letter dated May 29, 1981 from the Second Vice President of the Republic, the Minister of Finance, and the Executive President of the Central Bank of Costa Rica requesting an extended arrangement and setting forth:

(a) the objectives and policies that the authorities of Costa Rica intend to pursue for the period of this extended arrangement;

(b) the policies and measures that the authorities of Costa Rica intend to pursue for the first year of this extended arrangement; and

(c) understandings of Costa Rica with the Fund regarding reviews that will be made of progress in realizing the objectives of the program and of the policies and measures that the authorities of Costa Rica will pursue for the second and third years of this extended arrangement.

To support these objectives and policies the International Monetary Fund grants this extended arrangement in accordance with the following provisions:

1. For a period of three years from June , 1981, Costa Rica will have the right to make purchases from the Fund in an amount equivalent to SDR 276.75 million, subject to paragraphs 2, 3, and 4 below, without further review by the Fund.

2. (a) Until June , 1982 purchases under this arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 92.25 million, provided that purchases shall not exceed the equivalent of SDR 22.50 million until August 15, 1981, the equivalent of SDR 40 million until November 15, 1981, the equivalent of SDR 57.5 million until February 15, 1982, and SDR 75 million until May 15, 1982.

(b) Until June , 1983 purchases under this arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 184.5 million.

(c) The right of Costa Rica to make purchases during the second and third years shall be subject to such phasing as shall be determined.

3. Purchases under this extended arrangement shall be made from ordinary resources and with supplementary financing in the ratio of 1 to 1 until purchases under this arrangement reach the equivalent of SDR 49.15 million, then each purchase under this arrangement shall be made with ordinary resources and borrowed resources in the ratio of 1 to 1 until purchases under this arrangement reach the equivalent of SDR 172.2 million, and then each purchase shall be made with borrowed resources, provided that any modification by the Fund of the proportions of ordinary and borrowed resources shall apply to amounts that may be purchased after the date of modification.

4. Costa Rica will not make purchases under this arrangement:

(a) throughout the first year, during any period in which

(i) the limit on the net domestic assets of the Central Bank of Costa Rica referred to in paragraph 11 and Table 3 of the annexed letter, or

(ii) the limit on the net credit of the Central Bank of Costa Rica to the nonfinancial public sector referred to in paragraph 11 and Table 4 of the annexed letter

is not observed; or

(b) throughout the first year, during any period in which the data at the end of the preceding period indicate that

(i) the target for the net international reserves of the Central Bank of Costa Rica, including the target for reducing payments arrears, referred to in paragraph 14 and Table 6 of the annexed letter, or

(ii) the limit on the overall deficit of the nonfinancial public sector referred to in paragraph 9 and Table 2 of the annexed letter, or

(iii) the limit on the net foreign borrowing by the public sector referred to in paragraph 12 and Table 5 of the annexed letter

has not been observed; or

(c) throughout the second and third years, if before the beginning of the second year and the beginning of the third year of the arrangement suitable performance clauses have not been established in consultation with the Fund as contemplated in paragraph 6 of the attached letter or such clauses, having been established, are not being observed; or

(d) throughout the duration of the arrangement, if Costa Rica

(i) imposes or intensifies restrictions on payments and transfers for current international transactions, or

(ii) maintains a dual exchange rate system or introduces other multiple currency practices, or

(iii) concludes bilateral payments agreements which are inconsistent with Article VIII, or

(iv) imposes or intensifies import restrictions for balance of payments reasons.

When Costa Rica is prevented from purchasing under this arrangement because of this paragraph 4, purchases will be resumed only after consultation has taken place between the Fund and Costa Rica and understandings have been reached regarding the circumstances in which such purchases can be resumed.

5. Costa Rica's right to engage in the transactions covered by this arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of Costa Rica. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 5, purchases under this arrangement will be resumed only after consultation has taken place between the Fund and Costa Rica and understandings have been reached regarding the circumstances in which such purchases can be resumed.

6. Purchases under this extended arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, and may be made in SDRs if, on the request of Costa Rica, the Fund agrees to provide them at the time of the purchase.

7. The value date of a purchase under this extended arrangement involving borrowed resources will be normally either the fifteenth day or the last day of the month, or the next business day if the selected day is not a business day. Costa Rica will consult the Fund on the timing of purchases involving borrowed resources.

8. Costa Rica shall pay a charge for this extended arrangement in accordance with the decisions of the Fund.

9. (a) Costa Rica shall repurchase the amount of its currency that results from a purchase under this extended arrangement in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those relating to repurchase as Costa Rica's balance of payments and reserve position improve.

(b) Any reductions in Costa Rica's currency held by the Fund shall reduce the amounts subject to repurchase under (a) above in accordance with the principles applied by the Fund for this purpose at the time of the reduction.

(c) The value date of a repurchase in respect of a purchase financed with borrowed resources under this extended arrangement will be normally either the 6th day or the 22nd day of the month, or the next business day if the selected day is not a business day, provided that repurchase will be completed not later than seven years from the date of purchase.

10. During the period of the extended arrangement, Costa Rica shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to Costa Rica or of representatives of Costa Rica to the Fund. Costa Rica shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Costa Rica in achieving the objectives and policies set forth in the attached letter.

11. In accordance with paragraph 16 of the attached letter, Costa Rica will consult the Fund on the adoption of any measures that may be appropriate at the initiative of the Government or whenever the Managing Director requests consultation because any of the criteria under paragraph 4 above have not been observed or because he considers that consultation on the program is desirable. In addition, after the period of the extended arrangement and while Costa Rica has outstanding purchases under this extended arrangement, the Government will consult with the Fund from time to time, at the initiative of the Government or at the request of the Managing Director, concerning Costa Rica's balance of payments policies.

San Jose, Costa Rica
May 29, 1981

The Managing Director
International Monetary Fund
Washington, D. C. 20431
U.S.A.

Dear Mr. de Larosiere:

1. In 1976 and 1977 the real growth rate of GDP in Costa Rica accelerated, spurred by an improvement in the terms of trade as world coffee prices reached unprecedented levels. Output, which had increased by only 2 per cent in 1975, rose by 5-1/2 per cent in 1976 and by 9 per cent in 1977. However, this expansion in production was not sufficient to keep pace with the rising domestic demand, and consequently had to be satisfied increasingly from imports. Despite the coffee boom, neither a significant improvement in the public finances nor a reduction in the current account deficit of the balance of payments was achieved.

2. The present Administration, which took office in May 1978, had to face the problems resulting from a decline in coffee prices and sharply lower export income. Efforts to reduce excessive aggregate demand through significant cuts in central government outlays have been limited severely by the institutional rigidities of the expenditure system. Thus, in 1978 public outlays rose by about 30 per cent with respect to the previous year as the incoming Administration found that its powers to reduce expenditure in the middle of the budget year were limited. The 1979 budget, sent by the Executive to the Legislative Assembly, contemplated an increase in authorized outlays of less than 10 per cent in respect of the 1978 budget. However, the approved budget was much larger and it could not have been executed without undermining the efforts to stabilize the economy. The Government, therefore, announced its intention to substantially underexecute the authorized budget in order to promote a degree of financial stability as a first step toward overcoming the country's balance of payments and domestic inflationary problems. The Government agreed, in the first half of 1979, to grant an increase in salaries to public employees but requested the Legislative Assembly to provide the tax revenue to meet this additional expenditure. In September 1979 the Assembly ordered the increase in expenditure to be met with the resources freed by the underspending relative to budget authorization. Consequently, a part of the Government's stabilization effort during 1979 was nullified. The lack of adjustment in spending to Costa Rica's new income levels resulted in a considerable increase in the current account deficit of the balance of payments in both 1978 and 1979. This deficit was mostly financed by public sector borrowing abroad, and also by a loss of net international reserves. This deterioration in the external accounts was accompanied by a sharp deceleration in the rate of growth of real GDP to around 3-1/3 per cent in 1979.

3. In view of these developments, the Government early last year introduced an adjustment program designed to deal with both internal and external imbalances, mainly through a tightening of fiscal policy. This program was supported by the International Monetary Fund with a two-year stand-by arrangement in an amount equivalent to SDR 60.5 million. The program aimed at reducing the deficit in the current account of the balance of payments primarily by means of a reduction in the overall deficit of the nonfinancial public sector. The improvement in the current account balance was expected to be consistent with an overall balance of payments deficit of US$50 million in 1980 and equilibrium in 1981. The programed fiscal adjustment for 1980 was to be achieved largely through expenditure restraint, supported by revenue measures introduced by executive decree in December 1979 and by a tax package to be approved by the Legislative Assembly. To facilitate achievement of these fiscal objectives, a new Budgetary Authority was created to centralize and improve expenditure control, especially for public sector entities outside the Central Administration.

4. In spite of a further decline in the terms of trade, the Government managed to fulfill, in part, the objectives of its financial program for 1980. Substantial progress was made in 1980 in reducing the deficit of the nonfinancial public sector, by about 2 percentage points in relation to GDP, but the deficit was still in excess of the programed level of 7 per cent of GDP. Thus, both the ceiling on net central bank credit to the public sector (as well as that on the net domestic assets of the Central Bank) and the limit on public external borrowing were exceeded. Deviations from the 1980 program occurred mainly because of expenditure overruns, reflecting chiefly salary increases in the Central Government and in public sector entities dependent on government transfers. These additional expenditures were to be financed by raising tax revenues. However, only part of the tax proposal was approved by midyear. Consequently, additional tax measures were taken in August 1980 by executive decree which, on an annual basis, are estimated to have yielded the equivalent of about 12 per cent of central government revenues in 1980.

5. The progress made in improving the fiscal performance and in moderating the expansion of credit to the private sector resulted in a deceleration in the rate of import growth in early 1980, which was further reinforced by the changes in the exchange system toward the end of the year. As a result, imports declined in real terms for the year as a whole. In nominal terms, however, imports were higher than programed and there was a sharp increase in factor payments abroad, which was only partly offset by a faster than programed growth in exports. Therefore, owing in part to a worsening in the terms of trade, it was not possible to achieve the targeted reduction in the current account deficit of the balance of payments in 1980, and it remained at about the same level in relation to GDP as in 1979. Net private capital inflows fell short of what had been projected in the stand-by program. Thus, despite a larger than projected amount of foreign official borrowing, the net foreign reserves of the Central Bank declined by US$173 million in 1980. In addition, the Central Bank accumulated overdue foreign exchange obligations on a large scale in

the second half of the year. In response to growing pressures in the official foreign exchange market, in September 1980 the authorities introduced a dual exchange market and imposed import restraints in the form of outright prohibitions, prior import deposits, and tariff surcharges.

6. In view of these actions in the exchange and trade fields, and the results of last year's financial program, the Government has decided to develop and implement a new medium-term adjustment program. As an essential part of this program, steps were taken to unify the exchange market on the basis of a flexible exchange rate. In support of this effort, the Government of Costa Rica requests the use of Fund resources under a three-year extended Fund facility arrangement with supplementary financing and borrowed resources in an amount equivalent to SDR 276.75 million. Accordingly, the Government hereby requests cancellation of the existing stand-by arrangement as of the date of the Fund's approval of the new arrangement. Costa Rica will consult with the Fund in accordance with the Fund's policies and the provisions of the EFF arrangement, in order to reach understandings with the Fund on the quantitative aspects of the programs for the second and third years of the arrangement on the basis of the annual reviews jointly with the Fund staff.

7. The macroeconomic objectives of the programs for 1981-83, expressed in terms of GDP, are presented in attached Table 1. The main aim of the program is to achieve a major reduction by the end of 1983 of the deficit in the current account of the balance of payments through a combination of demand management and structural adjustment policies. As regards the former, the Government will continue to give emphasis to achieving a substantial reduction in the overall deficit of the nonfinancial public sector. At the same time, on the basis of the exchange reform initiated at the end of last year and other structural adjustment measures in the energy, agriculture, and foreign trade areas, the Government intends to promote a strengthening of investment and exports as a means of achieving a satisfactory and sustained rate of growth. The program envisages that the economy will achieve a real growth rate of at least 4 per cent by 1983, up from an average of about 1 per cent in 1980-81.

8. More specifically, to increase the productive base of the Costa Rican economy, the Government will implement over the next three years a comprehensive development plan involving the execution of investment projects, many of them already under way. For example, in the energy field, investment projects in electricity generation (hydro and geothermal sources), alcohol fuel production, and oil and coal exploration are designed to achieve a considerable reduction in the country's dependence on imported energy sources. In the agricultural sector, the development of irrigation facilities and the construction of feeder roads should expand significantly the agricultural frontier and increase sharply the productivity of land which is now only marginally exploited. Finally, in order to facilitate the growth of exports, the Government is improving port facilities, building new roads and railroads, and expanding its export promotion efforts abroad.

9. The Government believes that the immediate aim of its economic and financial policies during 1981 should be to limit inflationary pressures and to foster stability in the exchange market. To this end, the Government, has designed a fiscal program, which will limit the overall deficit of the nonfinancial public sector to no more than ₡ 5,250 million or the equivalent of 9 per cent of projected GDP in 1981. For the Central Government, this outcome takes into account the full year's effect of the consumption tax increases decreed in August 1980, the increased yield of foreign trade taxes as a result of the adjustment of the exchange rate, and the introduction by Executive action on April 24, 1981 of a temporary increase in export taxes equivalent to 5 per cent of the value of exports. This measure will be in effect for a period of one year. It is anticipated that by then the Legislative Assembly will have approved the comprehensive tax reform proposal described in paragraph 10 below. The Government also intends to reinforce tax administration, especially for the collection of income tax. Notwithstanding existing inflexibilities in expenditure management and cost pressures originating in the exchange rate adjustment, the authorities will keep central government outlays in 1981, in real terms, below the level of 1980, mainly by an underexecution of budgetary appropriations. With the exception of investment expenditure financed with development credits from abroad and a salary increase for civil servants, which have already been taken into account in the fiscal program described herein, the Government will not seek additions to the budget in the Assembly in the course of 1981. Also, the Budgetary Authority has established expenditure ceilings for all public sector entities outside the Central Administration. In particular, the Social Security Institute has taken steps to hold down the growth of its expenditure and to strengthen its revenue sources in order to ensure that its overall deficit is kept at a manageable level in 1981. To monitor the financial performance of the public sector, the authorities have established quarterly limits on the overall deficit of the nonfinancial public sector as indicated in attached Table 2.

10. On April 9, 1981 the Administration presented to the Legislative Assembly a comprehensive tax reform proposal, including modifications of the land tax, income tax, and other changes to the tax system aimed at both strengthening the tax base and improving the distribution of the tax burden. This proposal is expected to yield additional revenues equivalent to at least 2 per cent of GDP on an annual basis. Also, during the first year of the EFF program, the Government will propose to the Legislative Assembly legal and administrative reforms for the purpose of reducing substantially the earmarking of revenue and the spending patterns dictated by special laws which have created rigidities in the allocation of fiscal resources. In addition, the authorities will continue to strengthen the function of the Budgetary Authority. These actions should facilitate the achievement of a better control over expenditure and, together with the proposed tax measures to be approved by the Assembly, ought to make it possible to reduce the public sector deficit further in 1982 and 1983.

11. The strengthening of the financial position of the public sector should allow a reduction in its dependence on domestic credit, thus making room for a more satisfactory expansion of bank credit to the private sector with fewer risks of pressures on domestic prices and the exchange rate. The monetary program for 1981 specifies quarterly ceilings on the net domestic assets of the Central Bank, as detailed in Table 3, and quarterly limits on net central bank credit to the nonfinancial public sector, in line with the fiscal policy outlined above, as presented in attached Table 4. This program also takes into account the monetary impact of exchange guarantees granted in consideration of the exchange rate adjustment which has taken place since September 1980. It is the Central Bank's policy not to accept any additional exchange rate guarantees and to limit through close scrutiny the impact of those already presented. It is also the Government's intention not to extend any form of exchange rate guarantees to nonfinancial public sector entities. All exchange rate subsidies related to transactions of the nonfinancial public sector will be included as credit to this sector. To enhance the prospects of compliance with the credit program and to improve the allocation and availability of loanable resources, the Government intends to maintain domestic interest rates at competitive levels.

12. During the period of the EFF arrangement, the Governmment intends to reduce its use of foreign commercial borrowing and to use foreign credit increasingly in the financing of productive investment projects of the public sector. In accord with this policy, the public sector, including the public financial institutions, will make a net use of foreign credit of not more than US$350 million in 1981. The Government has established quarterly limits on the net use of such credit as shown in attached Table 5.

13. The Government believes that market forces should be the main determinant of prices and that direct price controls and subsidies should be limited to a minimum number of basic consumer products, which mainly benefit low-income groups. Prices charged by state enterprises and other public tariffs will be adjusted as needed to preclude the emergence of distortions and operational deficits. In this connection, domestic fuel prices, telephone rates, and electricity tariffs were raised substantially in December 1980 and in January 1981. Subsequently, on March 26 and May 1, 1981 fuel prices were further adjusted by an average of 27 per cent and 19 per cent, respectively, and an additional increase of 25 per cent in telephone rates is expected to be approved shortly. More generally, it is the Government's policy that RECOPE, the state-owned oil refinery, will continue to pass on to consumers the full increase in costs resulting from higher oil import prices, exchange rate adjustments, and other causes, so that RECOPE will incur no deficit. The success of this stabilization program depends crucially on the understanding by all interest groups that special treatment to any group will necessarily have to result in sacrifices for other groups and eventually in a less than successful outcome of the program. In this context, the Government will apply wage policies geared to reducing inflationary pressures while minimizing the effect on low-income groups.

14. Consistent with the adoption of a flexible exchange rate, the authorities do not intend to intervene in the exchange market to counter fundamental market trends. For 1981, the Government has adopted a minimum target of no change in the net international reserves of the Central Bank (including its overdue foreign exchange obligations as of the end of 1980). Quarterly targets for the net official international reserves, incorporating seasonal factors, have been established by the Government as shown in attached Table 6. During the period of the EFF arrangement, the Government is also committed to the elimination of the Central Bank's overdue foreign exchange obligations accumulated during 1980 which amounted to US$283 million, and which are backed by counterpart deposits in the Central Bank. The Government intends to reduce these foreign exchange obligations by at least US$96 million during 1981. The Government does not intend to introduce any new multiple currency practice or any new restrictions on payments and transfers for current international transactions during the period of the EFF arrangement. The establishment of a flexible exchange rate is of a temporary nature; however, the Government will not modify this regime except after consultation with the Fund, in accordance with Article IV, Section 3(b) of its Articles of Agreement.

15. In conjunction with the new exchange rate regime, the requirement of advance import deposits, which was introduced in September 1980, was eliminated and the system of temporary import surcharges of varying amounts on selected imports was replaced with a uniform surcharge of 1 per cent applicable to all imports. During 1981 the Government of Costa Rica intends to continue discussions with other members of the Central American Common Market on the reduction of tariff barriers. In addition, an important objective of the Government is to obtain a productive base which allows for the rationalization of fiscal incentives to exports without jeopardizing their competitiveness. The Costa Rican authorities have no intention of introducing any new import restrictions or intensifying any existing ones for balance of payments reasons.

16. The Government believes that the policies set forth in this letter are adequate to achieve the objectives of its program but will take any further measures that may become appropriate for this purpose. Costa Rica will consult with the Fund on the adoption of any measures that may be appropriate, in accordance with the policies of the Fund on such consultation.

Sincerely yours,

Jose Miguel Alfaro
Second Vice President of
the Republic and Minister
of Economy, Industry, and
Commerce

Emilio Garnier
Minister of Finance

Manuel Naranjo Coto
Executive President
Central Bank of Costa Rica

Table 1. Costa Rica: Macroeconomic Flows

(As per cent of GDP)

	1979	1980	Program 1981	Program 1982	Program 1983
Current account of the balance of payments	-14.2	-14.3	-11.8	-10.5	-9.0
Trade balance	-11.4	-11.1	-6.7	-5.3	-4.2
Factor payments (net)	-3.7	-4.5	-6.9	-7.0	-6.9
Other services and transfers	0.9	1.3	1.8	1.8	2.1
Capital account	12.1	10.5	11.8	11.5	11.0
Private capital 1/	1.7	2.2	2.7	3.5	3.8
Public capital	10.4	8.3	9.1	8.0	7.2
Nonfinancial	(4.7)	(4.5)	(4.7)	(4.7)	(5.5)
Financial 2/	(5.7)	(3.8)	(4.4)	(3.3)	(1.7)
Net official international reserves (increase -)	2.0	3.7	--	-1.0	-2.0
Public sector					
General government current account	-0.7	-1.9	-0.8	0.5	1.4
Revenue	(22.2)	(21.4)	(21.7)	(22.5)	(23.4)
Expenditure	(22.9)	(23.3)	(22.5)	(22.0)	(22.0)
State enterprises' operating surplus	-0.6	-0.1	1.3	1.7	2.1
Public sector savings	-1.3	-2.0	0.5	2.2	3.5
Fixed investment	8.9	8.4	8.5	8.7	9.0
Other capital expenditure 3/	2.1	--	1.0	0.5	--
Overall deficit	12.3	10.4	9.0	7.0	5.5
Net foreign financing	4.7	3.9 4/	4.7	4.7	5.5
Net domestic financing 5/	7.6	6.6	4.3	2.3	--
Savings and investment					
Fixed capital formation	25.1	23.0	22.5	23.0	24.0
Public sector	(8.9)	(8.4)	(8.5)	(8.7)	(9.0)
Private sector	(16.2)	(14.6)	(14.0)	(14.3)	(15.0)
Inventory changes	-0.6	1.1	--	0.7	0.5
Investment = savings	24.5	24.1	22.5	23.7	24.5
External savings	14.2	14.3	11.8	10.5	9.0
National savings	10.3	9.8	10.7	13.2	15.5
Public sector	(-1.3)	(-2.0)	(0.5)	(2.2)	(3.5)
Private sector	(11.6)	(11.8)	(10.2)	(11.0)	(12.0)

1/ Includes net errors and omissions.
2/ Includes SDR allocation in 1979-81.
3/ Includes statistical discrepancy.
4/ Excludes FERTICA (US$22.5 million).
5/ Includes foreign financing channeled through the domestic banking system.

Table 2. Costa Rica: Limits on the Overall Net Deficit of the Nonfinancial Public Sector 1/

(Cumulative flows from January 1, 1981 in millions of colones)

Dates	Limits
June 30, 1981	2,550
September 30, 1981	3,750
December 31, 1981	5,250
March 31, 1982	6,350

1/ This limit is defined as the sum of (1) net external borrowing by the nonfinancial public sector, (2) net credit from the domestic banking system, (3) net financing from other domestic nonbank financial intermediaries and (4) net credit from the domestic private sector.

Table 3. Costa Rica: Ceilings on Net Domestic Assets of the Central Bank 1/

(Outstanding balances in millions of colones)

Periods	Ceilings
April 1, 1981 - June 30, 1981	9,200 2/
July 1, 1981 - September 30, 1981	9,300
October 1, 1981 - December 31, 1981	10,000
January 1, 1982 - March 31, 1982	9,600
April 1, 1982 - June 30, 1982	9,100

1/ Defined as the difference between (1) currency issue and (2) net international reserves of the Central Bank. Net reserves will include all reserve liabilities of the Central Bank with less than one year's maturity, all liabilities to the IMF, and outstanding payments arrears.

2/ This ceiling will be increased by the amount of any shortfall in the outstanding stock of medium- and long-term foreign liabilities of the Central Bank on June 30, 1981 with respect to the projected level of ₡ 7,600 million (=US$506.7 million).

Table 4. Costa Rica: Ceilings on Central Bank's Net Credit to the Nonfinancial Public Sector 1/

(Outstanding balances in millions of colones)

Periods	Ceilings
April 1, 1981 - June 30, 1981	8,500
July 1, 1981 - September 30, 1981	9,050
October 1, 1981 - December 31, 1981	10,000
January 1, 1982 - March 31, 1982	10,450
April 1, 1982 - June 30, 1982	10,700

1/ Defined as the difference between the Central Bank's gross credit to the nonfinancial public sector (including rediscounts to the rest of the banking system for relending to the public sector) and the latter's deposits in the Central Bank. For this purpose the nonfinancial public sector includes the Central Government, municipalities, decentralized agencies, and state enterprises.

Table 5. Costa Rica: Limits on Net External Borrowing by the Public Sector 1/

(Cumulative flows from January 1, 1981 in millions of U.S. dollars)

Dates	Limits
June 30, 1981	225
September 30, 1981	280
December 31, 1981	350
March 31, 1982	440

1/ This limit includes all net foreign borrowing of the public sector (including financial institutions) regardless of maturity, and excludes only the short-term foreign liabilities of the Central Bank and any proceeds from an IBRD program or structural adjustment loan that may become available in the period through March 31, 1982. Any excess over these limits at each testing date matched by an equal excess over the targets for net official international reserves for the same date (Table 6) will not be counted under the limit on net external borrowing.

Table 6. Costa Rica: Targets on Net International Reserve Position of the Central Bank 1/

(Outstanding balances in millions of U.S. dollars)

Dates	Targets
June 30, 1981	-430 2/
September 30, 1981	-430
December 31, 1981	-420
March 31, 1982	-405

1/ Defined as the difference between the Central Bank's gross foreign assets and short-term foreign liabilities including net position with the Fund and outstanding payments arrears.

2/ This target will be reduced by the amount of any shortfall in the outstanding stock of medium- and long-term foreign liabilities of the Central Bank on June 30, 1981 with respect to the projected level of US$506.7 million.