FOR AGENDA

0451

EBS/91/40
Correction 1

CONFIDENTIAL

April 5, 1991

To: Members of the Executive Board

From: The Secretary

Subject: Costa Rica - Staff Report for the 1990 Article IV Consultation, Request for a Stand-By Arrangement and External Contingency Financing, and Request for a Purchase Under the CCFF

The following corrections have been made in EBS/91/40 (3/14/91):

Page 12, under "net official reserves": for "(+increase)" read "(-increase)"

Page 29, para. 1, last line: for "does not involve the early"
read "does not involve phasing under the early"

Page 39, Proposed Decisions, last line: for "set out in Annex I to the attachment"
read "set out in the attachment"

Page 40, Proposed Decisions, para. (ii), last line: for "the same Annex."
read "the same attachment."

Page 52, para. 1, line 5: for "May 5, 1991" read "May 5, 1990"

line 6: for "May 21, 1991" read "May 21, 1990"

Corrected pages are attached.

Att: (5)

uncertainties about exchange rate policy, the sharp increase in inflation, and some disintermediation following the freeze on bank credit in August. In these circumstances, the loss in net international reserves continued in the second semester, albeit at a lower rate than in the first semester, and for the year as a whole amounted to US$514 million.

The rate of monthly depreciation was raised to 2 colones per U.S. dollar in May and to 2.3 colones in August. In addition, the spread between buying and selling rates for the colon was increased from 1.15 percent in April to 2 percent in June. There was a small depreciation of the colon in real terms during 1990, which essentially reversed the appreciation registered in 1989 (Chart 1).

The external current account deficit is estimated to have increased from 8.8 percent of GDP in 1989 to 11.4 percent of GDP in 1990, as the U.S. dollar value of exports remained virtually unchanged and that of imports increased by 16 percent (Table 6). The outcome was heavily influenced by the decline in the terms of trade caused by a 23 percent decline in coffee export prices and a 27 percent increase in fuel import prices. The volume of coffee and banana exports rose by 5 percent and 9 percent, respectively, but the volume of nontraditional exports, which had grown by about 18 percent a year in 1988-89, stagnated. The volume of oil imports rose by 7 percent and that of non-oil imports by 10 percent.

The capital account shifted back to deficit in 1990, as there were delays in disbursements under a World Bank SAL-II loan and large payments related to the commercial bank debt-reduction agreement. Also, private capital inflows (including net errors and omissions) declined sharply from the exceptionally high level of 1989.

The decline in net international reserves of US$514 million in 1990 included an increase in arrears of US$210 million. About US$120 million of these arrears arose from delays of more than 15 days in processing applications for foreign exchange for current international transactions, US$60 million represented arrears to Paris Club creditors on commitments from the 1989 Paris Club agreement, and most of the remainder was due to non-Paris Club bilateral creditors (mainly Brazil) and the Central American Bank for Economic Integration (BCIE).

Preliminary data indicate that the growth in real GDP moderated to 3.5 percent in 1990, partly reflecting the slowdown in the growth of exports. The rate of increase in consumer prices accelerated to 27 percent during 1990, partly reflecting substantial corrective price adjustments.

Table 6. Costa Rica: Summary Balance of Payments, 1987-96

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
	(In millions of U.S. dollars)									
Current account	-408.4	-311.7	-465.5	-657.8	-217.6	-116.8	-93.6	-29.8	-25.4	93.3
Trade balance	-282.3	-239.5	-429.7	-676.5	-269.6	-184.1	-187.8	-182.3	-170.0	-153.6
Exports, f.o.b.	1,106.4	1,180.7	1,322.7	1,358.3	1,525.0	1,700.3	1,866.8	2,057.7	2,272.3	2,501.4
Coffee	334.3	316.4	286.2	231.0	259.9	270.5	291.4	325.2	364.2	407.9
Banana	228.6	221.1	270.5	309.6	345.0	389.7	402.2	414.7	431.3	448.5
Nontraditional exports	466.0	575.2	701.9	741.5	848.9	967.7	1,092.0	1,226.5	1,371.2	1,533.0
Total import value	-1,388.8	-1,420.2	-1,752.4	-2,034.8	-1,794.7	-1,884.5	-2,054.5	-2,240.1	2,442.3	2,655.1
Non-oil	1,267.2	1,305.4	1,605.1	1,843.0	1,628.9	1,727.9	1,886.9	2,060.5	2,250.0	2,457.0
Oil	121.6	114.8	147.3	191.8	165.8	156.6	167.7	179.6	192.3	198.0
Factor payments	-295.4	-325.3	-356.0	-300.6	-289.6	-310.3	-317.3	-309.2	-318.4	-324.9
Official interest due	-284.7	-303.4	-298.3	-252.2	-234.1	-248.3	-250.8	-235.2	-233.4	-229.9
Other 1/	-10.7	-21.9	-57.7	-48.4	-55.5	-62.0	-66.5	-74.0	-85.0	-95.0
Other services and non-balance of payments transfers 1/	169.3	253.1	320.1	319.3	341.6	377.6	411.5	461.7	513.8	571.9
Capital account	-202.4	-150.4	10.6	-137.3	153.2	113.5	162.7	131.2	109.6	109.6
Public	-316.5	-330.3	-349.0	-340.5	-19.0	-31.5	22.7	-8.8	-30.4	-30.4
Disbursements	83.8	96.4	87.6	201.1 2/	211.7	181.0	205.8	183.8	158.8	158.8
Amortization due 3/	-400.3	-426.7	-436.6	-541.6 4/	-230.7	-212.5	-183.1	-192.6	-189.2	-189.2
Private 3/	114.1	179.9	359.6	203.2	172.2	145.0	140.0	140.0	140.0	140.0
Balance of payments support	120.0	125.0	105.0	120.0	230.0	100.0	75.0	25.0	25.0	25.0
U.S. AID (ESF)	120.0	125.0	65.0	80.0 5/	30.0	30.0	25.0	25.0	25.0	25.0
IBRD (SAL) 6/	—	—	40.0	40.0	200.0 7/	70.0	50.0	—	—	—
Overall balance of payments before debt relief	-490.8	-337.1	-349.9	-675.2	165.6	96.7	144.1	126.4	160.0	227.9
Rescheduling	42.9	108.6	229.7	1,023.4	135.4	—	—	—	—	—
Current obligations	21.8	25.0	15.1	115.3	—	—	—	—	—	—
Past obligations	21.1	83.6	214.6	908.1	135.4	—	—	—	—	—
Arrears subject to rescheduling (+ increase)	253.9	212.0	203.0	-861.8	-118.9	—	—	—	—	—
Overall balance of payments after debt relief	-194.0	-16.5	82.8	-513.6	182.1	96.7	144.1	126.4	160.0	227.9
Net international reserves	194.0	16.5	-82.8	513.6	-333.3	-131.7	-169.1	-126.4	-160.0	-227.9
Nonrefinanceable arrears (+ increase)	118.4	121.4	-67.7	209.5	-212.6	-60.3	—	—	—	—
Net official reserves (- increase)	75.6	-104.9	-15.1	304.1	-120.7	-71.4	-169.1	-126.4	-160.0	-227.9
Net use of Fund credit	-40.1	-60.9	-33.4	-25.6	82.0	1.1	—	-34.2	-46.5	-46.5
Other net official reserves 8/	115.7	-44.0	18.3	329.7	-202.7	-72.5	-169.1	-92.2	-113.5	-181.4
Financing gap	—	—	—	—	-151.2	-35.0	-25.0	—	—	—

VII. Compensatory Financing

The authorities of Costa Rica have also requested under Section V of the CCFF Decision compensatory financing of SDR 33.64 million (equivalent to 40 percent of quota) in respect of an excess in oil import costs and a shortfall in exports in calendar 1990. 1/ The data used in respect of the shortfall year were actual data for exports and ten months of actual data and two months of estimated data for oil imports. The request, therefore, does not involve phasing under the early drawing procedure.

1. Calculation of the net compensable amount

The net compensable amount is calculated to be SDR 54.8 million (equivalent to 65.2 percent of quota), which is the sum of an excess in oil import costs and a shortfall in exports (Table 10). Oil import costs, which declined by 9 percent in 1988 and increased by 35 percent in 1989, predominantly because of fluctuations in import unit values, increased by further 23 percent in 1990, the excess year. These costs are projected to decline by 18 percent in 1991 and 6 percent in 1992. On the basis of these figures, staff calculations indicate an oil import excess of SDR 27.9 million (about 33.2 percent of quota).

The value of merchandise exports declined by 3 percent in 1990, after increasing by 3 percent in 1988 and 17 percent in 1989. The weak export performance in 1990 was caused mainly by a decline in the price of coffee, slower growth in the volume of banana exports, and the stagnation of nontraditional exports. Export earnings are projected to rise by 7 percent in 1991 and 11 percent in 1992. This pattern of earnings, which does not invoke the rule in paragraph 15 of the CCFF decision limiting the growth rate of projected earnings in the post-shortfall years, results in a calculated shortfall of SDR 26.9 million (32 percent of quota).

2. Causes of the excess in oil import costs

Costa Rica imports partially refined crude oil and petroleum products, mainly diesel, gasoline, and aviation fuel. Though crude oil usually comprises just under two thirds of these imports, in 1990 the mix substantially changed in favor of petroleum products mainly because of interruptions in the operations of the domestic refinery on account of repairs and maintenance activities. As a result, the share of crude in total oil imports declined to 35 percent. Costa Rica exports a relatively small quantity of petroleum products, mainly relating to the refueling of aircraft and ships.

1/ In this section, references to values and unit values are converted from U.S. dollars to SDR terms. This conversion could affect the size and sign of movements.

Table 10. Costa Rica : Compensatory Financing--
Determination of the Amount of Compensation

(In millions of SDRs)

	Year Ending December					Excess/
				Proj. 1/		Short-
	1988	1989	1990	1991	1992	fall 2/
Oil import costs	85.4	114.9	141.3	116.2	109.0	27.9
Petroleum	51.3	68.3	49.1	74.3	70.3	-13.6
Petroleum products	34.1	46.6	92.2	41.9	38.7	41.5
Merchandise exports	878.5	1,032.0	1,001.1	1,068.7	1,183.5	26.9
Coffee	235.4	223.3	170.3	182.1	188.3	28.0
Bananas	164.5	211.0	228.2	241.7	271.3	-19.5
Meat	41.4	38.1	31.5	30.6	31.2	2.8
Sugar	9.2	12.0	24.7	19.3	19.2	-11.3
Nontraditional exports	428.0	547.6	546.5	594.8	673.6	-13.0
Net compensable amount			54.8			
Excess in import costs			27.9			
Shortfall in exports			26.9			
Proposed purchase			33.6			

Sources: Data provided by the Costa Rica authorities; and Fund staff estimates and projections.

1/ Based on judgmental forecasts of oil import costs and export earnings.
2/ Arithmetic averages of oil import costs for the five-year period centered on the excess year are used to calculate oil import excess (shortfalls); geometric averages of export earnings for the same period are used to calculate export shortfalls (excesses).

B. Stand-By Arrangement and External Contingency Financing

1. The Government of Costa Rica has requested:

(a) a stand-by arrangement in an amount equivalent to SDR 33.64 million for the 12-month period beginning April --, 1991, and

(b) a decision that, should adverse external contingencies occur during the period of the stand-by arrangement, the Fund will provide, in association with the arrangement, external contingency financing under Section III the Compensatory and Contingency Financing Facility (Decision No. 8955-(88/126), adopted August 23, 1988, as amended), up to a maximum amount equivalent to SDR 21.0 million.

2. (a) The Fund approves the stand-by arrangement attached to EBS/91/40.

(b) The Fund decides that:

(i) should adverse external contingencies occur during the period of the arrangement, the Fund will provide, in association with the arrangement, external contingency financing under Section III of the Compensatory and Contingency Financing Facility (Decision No. 8955-(88/126), adopted August 23, 1988, as amended) up to a maximum amount equivalent to SDR 21.0 million, in accordance with the factors set out in the attachment to EBS/91/34, and

(ii) should favorable external contingencies occur during the period of the arrangement, adjustments of up to SDR 21.0 million will be made by the Fund at that time under paragraph 27 of Decision No. 8955-(88/126), adopted August 23, 1988, as amended, in accordance with the factors set out in the same attachment.

3. Should the Government of Costa Rica notify the Fund after the date of this decision that it no longer wishes to avail itself of the benefit under paragraph 2(b)(i) above in association with the stand-by arrangement, the provisions of paragraph 27 of Decision No. 8955-(88/126), adopted August 23, 1988, as amended shall continue to apply for the remainder of the baseline period.

C. Compensatory Financing

1. The Fund has received a request by the Government of Costa Rica for a purchase equivalent to SDR 33.64 million for the compensation of an excess in the cost of oil imports and a shortfall in export earnings under Section V of the Decision on the Compensatory and Contingency Financing Facility (Decision No. 8955-(88/126), adopted August 23, 1988, as amended).

2. The Fund finds that Costa Rica is eligible for a purchase under Section V of Decision No. 8955-(88/126), adopted August 23, 1988, as amended, for an excess in oil import cost and a shortfall in export earnings, and approves the purchase in accordance with the request.

Costa Rica: Schedule of Purchases During Period of the Stand-By Arrangement

Scheduled Availability Date	Amount	Conditions Necessary for Purchase 1/
April 1991	SDR 21.64 million	Executive Board approval of arrangement.
	SDR 33.64 million	Executive Board approval of CCFF drawing.
After August 15, 1991	SDR 4.00 million	Observance of quantitative performance criteria as of June 30, 1991, and completion of mid-term review.
After November 15, 1991	SDR 4.00 million	Observance of quantitative performance criteria as of September 30, 1991, and any other conditions to be decided upon in the mid-term review.
After February 15, 1992	SDR 4.00 million	Observance of quantitative performance criteria as of December 31, 1991, and any other conditions to be decided upon in the mid-term review.

1/ Other than generally applicable conditions under the arrangement and nonquantitative performance criteria, including the performance clauses on the exchange and trade system.

Costa Rica: Financing Arrangement with Commercial Banks

On November 16, 1989, Costa Rica and the coordinating committee of its commercial bank creditors reached agreement on an outline of a financing package. After the necessary waivers were granted by participating banks and after approval by Costa Rica's Legislative Assembly, the accord was signed on May 5, 1990 and the related transactions completed on May 21, 1990.

The terms of the package followed closely the outline of the term sheet as described in EBS/89/243 (December 27, 1989). The amount of debt involved in the transaction was somewhat smaller than originally envisaged (US$1,598 million of which US$366 was past-due interest (PDI) because in the interim some debt had been dealt with through debt-equity conversions and other types of swaps. The purchase involved roughly 62 percent of Costa Rica's commercial bank debt (US$767 million) and PDI (US$223 million) at a price of US$0.16 to the U.S. dollar.

Of the US$465 million debt remaining after the buyback, US$237 million was exchanged for type A bonds, paying a fixed rate of interest of 6 1/4 percent. These bonds, available to creditors who tendered at least 60 percent of their debt for the buyback, have a grace period of 10 years, a maturity of 20 years, and carry a rolling interest guarantee of 18 months. Creditors who tendered less than 60 percent of their debt for the buyback exchanged US$228 million for type B bonds, also paying 6 1/4 percent, but having a grace period of 15 years, a maturity of 25 years, and no interest guarantee.

The PDI (US$143 million) not tendered in the buyback, after a 20 percent downpayment, was exchanged for bonds with a 15-year maturity and an interest rate of LIBOR plus 13/16. Creditors who had tendered 60 percent of their PDI for the buyback received a 3-year interest guarantee (covering US$53 million of PDI).

Interest payments on the refinanced bank debt will be about US$40 million a year. This compares with the annual interest that was accruing on the outstanding principal of bank debt of about US$150 million. The current payments schedule therefore represents a saving of US$110 million a year. 1/

Principal payments on bonds exchanged for PDI would be less than US$1/2 million in 1990 rising to nearly US$4 million by 1995 and averaging US$37 million over the remaining 9 1/2 years. 2/ Payments could

---

1/ Excludes cost on financing for the package which in 1991 would roughly be US$10 million.

2/ The principal paid as a percentage of the remaining balance rises steadily from 1.5 percent at the beginning of 1996 to 3.6 at the beginning of 2005.