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March 14, 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

Attached for consideration by the Executive Directors is the staff report for the 1990 Article IV consultation with Costa Rica, its request for a stand-by arrangement in an amount equivalent to SDR 33.64 million and external contingency financing, and for a purchase under the compensatory and contingency financing facility. Draft decisions appear on pages 38-40.

This subject, together with the letter of intent and memorandum on economic policy from the Costa Rican authorities (EBS/91/34, 3/6/91), is proposed to be brought to the agenda for discussion on Monday, April 8, 1991.

Mr. E. S. Williams (ext. 8648) or Mr. Escobar (ext. 8506) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

INTERNATIONAL MONETARY FUND

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 CCF

Prepared by the Western Hemisphere Department

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

Approved by S. T. Beza, Eduard Brau, and Bijan B. Aghevli

March 12, 1991

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I. Introduction

The 1990 Article IV consultation discussions with Costa Rica were initiated in San José from May 16 to June 8, 1990, in conjunction with discussions on an economic program that could be supported by a stand-by arrangement. ^{1/} Subsequent discussions on the economic program were held in Washington in August-September, in San José in October, and again in Washington in December and January 1991. Representatives of the Government of Costa Rica in these discussions included the Ministers of Finance, Agriculture, Economy, Foreign Trade, Labor, Planning, and Restructuring of the Public Sector; the Executive President of the Central Bank; and senior officials from the ministries, the Central Bank, and other public institutions. The staff representatives were Messrs. Williams (Head), Bonilla-Leal, Brown, Cha, DeMilner (all WHD), Feldman (ETR), and Ms. Smith-Croxatto and Mrs. Tollaksen (Assistants-WHD). The mission was assisted by Mr. Tampe, the Fund resident representative in San José. Mrs. Filardo, then Executive Director for Costa Rica, participated in some of the policy discussions during the earlier missions.

Costa Rica has accepted the obligations under Article VIII, Sections 2, 3, and 4. On May 23, 1989, the Executive Board completed the 1989 Article IV consultation (EBM/89/62) and approved a 12-month stand-by arrangement for SDR 42 million (50 percent of quota). No purchases were made under the arrangement. The authorities elected not to make the purchase available upon Board approval, and subsequently there were deviations from quantitative performance criteria (Table 1) and the mid-term review was not completed. Since end-May 1989, Costa Rica has made repurchases equivalent to SDR 36.4 million (43.3 percent of quota), and by the end of January 1991 Fund credit to Costa Rica had been reduced to 9.5 percent of quota.

In the letter and accompanying memorandum (circulated as EBS/91/34 on March 6, 1991), the Costa Rican authorities request a 12-month stand-by arrangement in the amount of SDR 33.64 million (40 percent of quota); the initial purchase would amount to 25.7 percent of quota because of the availability of the first credit tranche and the remaining purchases would be made in three quarterly installments (Table 2). Conditions necessary for these purchases are described in Appendix IV. The program provides for a mid-term review to be completed before mid-July 1991. To help sustain the adjustment effort in the face of possible external shocks during the program period the Costa Rican authorities also have requested external contingency financing under the compensatory and contingency facility. External contingency financing

^{1/} The previous Article IV consultation with Costa Rica was concluded by the Executive Board on May 23, 1989 (EBM/89/62). Notifications of delay in concluding the 1990 Article IV consultation have been issued, the latest being issued on December 28, 1990.

Table 1. Costa Rica: 1989 Stand-By Performance

	1989		
	June 30	Sept. 30	Dec. 31
(In millions of U.S. dollars)			
<u>Net international reserves</u>			
Original target	-77	-64	-27
Adjusted target ^{1/}	-12	-1	11
Outcome	-13	23	26
Margin (+) or excess (-)	-1	24	15
<u>External payments arrears</u>			
Original target	100	72	44
Adjusted target ^{1/}	85	57	29
Outcome	114	51	54
Margin (+) or excess (-)	-29	6	-25
(In millions of colones)			
<u>Net domestic assets of the</u>			
<u>Central Bank</u>			
Original target	28,400	27,600	31,400
Adjusted target ^{1/}	22,875	22,245	28,170
Outcome	21,394	18,900	25,792
Margin (+) or excess (-)	1,481	3,345	2,378
<u>Change in net domestic financing of</u>			
<u>the nonfinancial public sector</u>			
Target	3,900	1,000	-1,300
Outcome	1,797	5,519	8,920
Margin (+) or excess (-)	2,103	-4,519	-10,220
<u>Central government expenditures</u>			
Original target	37,900	54,800	73,000
Adjusted target	37,900	54,800	73,000
Outcome	37,877	58,816	82,430
Margin (+) or excess (-)	23	-4,016	-9,430

^{1/} As provided in the stand-by arrangement, the international reserve targets were adjusted to take account of Paris Club rescheduling that differed from program assumptions.

Table 2. Costa Rica: Position with the Fund During Period of Arrangement

	Outstanding Jan. 31, 1991	1991			1992	
		Apr.- June	July- Sept.	Oct. Dec.	Jan.- Mar.	Apr.- June
<u>(In millions of SDRs)</u>						
<u>Transactions under tranche</u> <u>policies (net)</u>		18.58	4.00	1.87	3.12	-1.25
Purchases <u>1/</u>		21.64	4.00	4.00	4.00	—
Repurchases		3.06	—	2.13	0.88	1.25
Ordinary resources		0.94	—	—	—	—
Enlarged access resources		2.12	—	2.13	0.88	1.25
<u>Transactions under special</u> <u>facilities (net)</u>		33.64	—	—	—	—
Purchases <u>2/</u>		33.64	—	—	—	—
Repurchases		—	—	—	—	—
<u>Total Fund credit outstanding</u> <u>(end of period)</u>	7.94	60.16	64.16	67.03	69.15	67.90
Under tranche policies <u>3/</u>	7.94	26.52	30.52	33.39	35.51	34.26
Special facilities <u>2/</u>	—	33.64	33.64	33.64	33.64	33.64
<u>(In percent of quota)</u>						
<u>Total Fund credit outstanding</u> <u>(end of period)</u>	9.4	71.5	76.3	79.7	81.1	80.7
Under tranche policies <u>3/</u>	9.4	31.5	36.3	39.7	42.1	40.7
Special facilities	—	40.0	40.0	40.0	40.0	40.0

Source: IMF Treasurer's Department.

1/ From ordinary resources only.

2/ Compensatory and contingency financing facility.

3/ Includes outstanding use under EAR and EFF.

would cover adverse developments related to oil import prices and coffee export prices up to a maximum SDR 21 million (25 percent of quota) during the stand-by period.

The Costa Rican authorities also have requested compensatory financing under Section V of the Compensatory and Contingency Financing Facility (CCFF) in the amount of SDR 33.64 million (40 percent of quota) in respect of an excess in oil import costs and a shortfall in exports.

At the time of the mid-term review of the stand-by arrangement, a further request for compensatory financing could be made provided that a compensable shortfall/excess exists and that all relevant conditions are met.

II. Background

1. Performance under the 1989 stand-by arrangement

After a severe recession and financial crisis in 1981-82, Costa Rica made considerable progress in restoring economic growth, restructuring its economy, and reducing fiscal imbalances. However, despite the adjustment efforts carried out with the support of Fund stand-by arrangements, by 1988 inflation was still very high, the fiscal deficit was unsustainable, and the balance of payments remained weak, in part because of the existence of heavy foreign debt service obligations. At the end of 1988, Costa Rica's arrears to bilateral and commercial creditors were estimated at close to US\$900 million, the equivalent of 19 percent of GDP.

The economic adjustment program for 1989, which was supported by a one-year stand-by arrangement approved on May 23, 1989, aimed at maintaining the growth momentum of the economy, reducing inflation, and strengthening the balance of payments. These objectives were to be pursued through a reduction of the overall deficit of the public sector, credit restraint and a flexible exchange rate policy. The program was predicated on an agreement between Costa Rica and its creditor banks that would reduce significantly the country's debt-service burden facilitating the attainment of external viability.

As it turned out, real GDP growth accelerated from 3.5 percent in 1988 to 5.6 percent in 1989 on the strength of large increases in private investment, public sector consumption, and exports. At the same time, the rate of increase in consumer prices fell from 25 percent during 1988 to 10 percent during 1989, partly as a result of the recovery of food supplies following hurricane damage to crops in 1988, and partly through postponement of adjustments to public utility tariffs and administered prices (Table 3).

Table 3. Costa Rica: Selected Economic and Financial Indicators

	1986	1987	1988	1989		1990	1991
				Prog.	Actual	Prel.	Prog.
(Annual percentage changes, unless otherwise specified)							
<u>National income and prices</u>							
GDP at constant prices	5.5	4.8	3.5	4.3	5.6	3.5	3.5
Nominal GDP	24.6	15.3	25.2	22.0	21.7	21.7	17.5
Consumer prices (end of period)	15.4	16.4	25.3	14.0	10.0	27.3	12.0
(average)	11.8	16.8	20.8	18.0	16.5	19.0	19.0
<u>External sector (on the basis of U.S. dollars)</u>							
Total exports, f.o.b.	15.5	2.0	6.7	9.5	12.0	2.7	12.3
Total imports, c.i.f.	4.6	19.6	2.3	8.2	23.4	16.1	-11.8
Non-oil imports, c.i.f.	12.1	19.6	3.0	8.0	23.0	14.8	-11.6
Export volume	-4.2	13.9	1.3	7.5	15.8	2.7	5.5
Import volume	6.5	14.2	-2.6	3.9	19.5	9.5	-13.0
Terms of trade (deterioration -)	22.9	-14.5	0.3	-2.2	-6.3	-5.7	4.9
Real effective exchange rate (end of period; depreciation -)	-3.8	-17.7	0.5	—	3.0	-3.5	
<u>Central Administration</u>							
Revenue and grants	18.8	17.4	21.4	21.9	20.1	16.9	36.7
Total expenditure	28.7	8.8	25.1	19.4	30.8	20.1	17.6
<u>Banking system</u>							
Net domestic assets ^{1/2/}	16.2	15.1	25.8	14.5	15.1	33.3	6.2
Of which: public sector ^{1/3/}	-1.6	-9.3	2.4	-0.8	2.0	5.3	-10.9
private sector ^{1/}	17.4	13.1	6.9	4.2	4.5	7.4	5.7
Liabilities to private sector	22.2	27.3	29.8	15.6	24.1	18.0	11.8
Interest rate (annual rate for six-month deposits, end of period)	17.8	20.5	22.7	...	20.8	29.4	...
(In percent of GDP)							
Combined public sector deficit (-)	-5.4	-3.8	-3.6	-2.8	-5.5	-5.1	-0.5
Nonfinancial public sector deficit ^{4/}	-1.7	-0.3	-0.3	0.2	-2.8	-3.1	1.3
Domestic financing	—	-0.4	0.7	-0.3	1.9	3.3	-2.1
External financing	1.7	0.7	-0.4	0.1	0.9	-0.2	0.8
Central bank losses (commitment basis)	-3.8	-3.5	-3.3	-3.0	-2.7 ^{5/}	-2.0 ^{5/}	-1.8 ^{5/}
Nonfinancial public sector savings ^{4/}	4.4	4.7	4.8	4.7	3.1	2.0	5.2
Central administration	0.5	0.4	-0.1	0.6	-1.0	-2.3	-0.2
Rest of public sector	3.9	4.3	4.9	4.0	4.1	4.3	5.4
Gross domestic investment	21.6	24.8	21.9	22.8	23.0	23.0	20.8
Gross national savings	17.4	15.8	15.3	17.9	14.2	11.6	16.5
Trade balance	-1.7	-6.2	-5.1	-3.7	-8.1	-11.7	-4.3
Current account balance (excluding official transfers for balance of payments support)	-4.2	-9.0	-6.6	-4.9	-8.8	-11.4	-3.5
External debt (including use of Fund credit) ^{6/}	88.4	89.8	87.6	70.1	75.8	53.3	54.2
(In percent of exports of goods and nonfactor services)							
Debt service ratio ^{7/}	49.8	51.4	48.4	37.3	39.2	29.2	21.1
Interest payments ^{7/}	20.0	19.6	18.7	17.1	16.2	13.0	10.8
(In millions of U.S. dollars)							
Change in net international reserves (increase -)	36.0	194.0	16.5	-40.0	-82.8	513.6	-333.3
Gross liquid reserves	89.2	69.6	223.9	...	240.2	103.4	253.4
Gross liquid reserves (months of imports)	0.9	0.6	2.0	...	1.6	0.6	1.7
Gross liquid reserves (percent of GDP)	2.1	1.5	4.8	...	4.5	1.8	4.0
Total external payments arrears	186.8	559.4	892.8	72.0	1,028.1	391.8	60.3

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

^{1/} In relation to the stock of liabilities to the private sector at the beginning of the period.

^{2/} Excludes counterpart of external payments arrears included in net international reserves of the Central Bank.

^{3/} Excludes increases in credit arising from the assumption by the Central Bank of part of the external debt of the public sector.

^{4/} Includes in addition to the Central Government, eight decentralized agencies and ten public enterprises which together account for about 90 percent of total revenues and expenditure in the total nonfinancial public sector.

^{5/} Excludes profits from debt conversion and debt repurchase.

^{6/} Includes interest arrears.

^{7/} Before rescheduling; includes Fund charges and repurchases, and interest on short-term debt. Excludes in 1990 amortization payments related to the commercial bank debt reduction package.

The combined public sector deficit (including central bank losses) rose from 3.6 percent of GDP in 1988 to 5.5 percent of GDP in 1989, instead of declining to 2.8 percent of GDP as envisaged under the program. Central government revenue was close to the projected level, but expenditure exceeded program targets by 2.2 percentage points of GDP, reflecting court-ordered increases in wages and salaries ^{1/} (laudos), the rising cost of export subsidies, and higher-than-programmed interest payments. In addition, the overall surplus of the rest of the public sector was lower than programmed because of the delay in adjusting public sector prices, including the failure to raise petroleum product prices in line with the increase in import costs. As a result, the domestic financing requirement of the nonfinancial public sector rose to the equivalent of nearly 2 percent of GDP, whereas the program had envisaged some reduction in domestic indebtedness (Table 4).

The external current account deficit rose from 6.6 percent of GDP in 1988 to 8.8 percent in 1989, instead of declining to 5 percent of GDP as projected. Export earnings increased roughly in line with the program projections as a fall in coffee exports caused by a slump in international prices was more than compensated by a 22 percent increase in nontraditional exports; however, imports increased by 23 percent as against a projected increase of 8 1/4 percent. There was a strong increase in imports of capital goods and raw materials relating to the increase in investment and the expansion of nontraditional exports; imports of consumer goods also rose rapidly, induced by the sizable growth in personal incomes and the lowering of import tariffs.

The capital account shifted from deficit to a small surplus in 1989 as private capital inflows in the form of foreign direct investment and short-term flows induced by changes in interest rate differentials, rose sharply. In addition, there was substantial debt relief from the Paris Club and from the commercial banks pending the completion of the debt-reduction package. Despite a further accumulation of payments arrears to bilateral creditors which for purposes of program monitoring were included as a foreign liability, net international reserves rose by US\$83 million, compared with a gain of US\$40 million envisaged in the program.

During 1989, contrary to the program objective, there was a small appreciation of the colon in real effective terms.

In November 1989 Costa Rica signed an agreement on a financing package with commercial bank creditors covering the purchase of about 62 percent of Costa Rica's commercial bank debt and past-due interest (approximately US\$990 million). The debt not purchased was to be

^{1/} Existing legislation prohibits strikes by public sector workers and provides for the settlement of labor disputes through court-appointed labor tribunals. Beginning in 1989, these tribunals became more actively involved in awarding wage increases to maintain wage differentials between groups of workers.

Table 4. Costa Rica: Operations of the Nonfinancial Public Sector ^{1/}

	1986	1987	1988	1989		Prel.	Prog.
				Prog.	Actual	1990	1991
(In millions of colones)							
Central Administration	-8,245	-5,713	-8,835	-7,470	-17,330	-22,865	-12,400
Revenue	38,030	44,642	54,200	65,530	65,100	76,100	104,000
Expenditures	46,275	50,355	63,035	73,000	82,430	98,965	116,400
Current	36,858	43,628	54,571	62,845	69,627	88,454	105,500
Fixed capital formation	2,834	2,395	2,599	2,500	3,040	3,763	4,670
Other capital and net lending	6,583	4,332	5,865	7,655	9,763	6,747	6,230
Rest of general government	3,534	3,472	3,802	4,039	3,330	5,400	8,766
Revenue	24,774	28,647	30,528	36,977	41,025	60,534	71,995
Current	24,292	28,349	30,665	36,974	40,986	59,600	71,285
Capital	483	298	-137	3	39	934	710
Expenditure	21,240	25,175	26,726	32,938	37,695	55,134	63,229
Current	18,783	22,033	22,707	28,271	31,197	46,854	59,203
Fixed capital formation	1,150	985	887	1,762	2,061	2,060	2,901
Other capital and net lending	1,307	2,157	3,132	2,905	4,437	6,220	1,125
Public enterprises	642	1,379	3,934	4,433	1,835	946	11,334
Revenue	43,269	47,455	61,400	73,167	72,254	88,954	115,629
Current	41,621	46,648	60,383	70,704	70,668	87,477	114,530
Capital	1,648	907	1,017	2,463	1,586	1,477	1,099
Expenditures	42,627	46,176	57,466	68,734	70,419	88,008	104,295
Current	37,358	40,717	50,764	61,802	62,543	77,205	93,226
Fixed capital formation	5,523	5,967	6,768	7,070	7,774	11,343	11,437
Other capital and net lending	-254	-508	-66	-138	102	-540	-368
Current account deficit (-)	10,943	13,261	17,206	20,290	13,387	10,664	31,886
Central Administration	1,172	1,014	-371	2,685	-4,527	-12,354	-1,500
Rest of general government	5,508	6,316	7,958	8,703	9,789	12,746	12,082
Public enterprises	4,263	5,931	9,619	8,902	8,125	10,272	21,304
Overall deficit (-)	-4,069	-862	-1,099	1,002	-12,165	-16,519	7,700
Net financing requirements	4,069	862	1,099	-1,002	12,165	16,519	-7,700
External (net)	4,139	1,901	-1,470	314	3,723	-1,090	5,255
Disbursements	8,187	4,681	3,405	11,050	6,804	7,285	23,425 ^{2/}
Amortization	-4,849	-4,153	-5,958	-4,270	-4,516	-8375	-15,628
Foreign interest arrears	801	1,373	1,083	-6,466	1,435	...	-2,542
Domestic	-70	-1,039	2,569	-1,316	8,442	17,609	-12,955
Bank credit (net)	-1,123	-789	2,862	-1,241	4,813	...	-21,618
Other (net)	1,053	-250	-293	75	3,629	...	8,663
(In percent of GDP)							
Overall deficit (-)	-1.7	-0.3	-0.3	0.2	-2.8	-3.1	1.3
Central Administration	-3.4	-2.0	-2.5	-1.7	-4.0	-4.3	-2.0
Revenue	15.7	15.7	15.2	16.8	15.0	14.5	16.9
Expenditure	19.1	17.7	17.7	15.1	19.0	18.8	18.9
Rest of general government	1.4	1.2	1.1	0.9	0.8	1.0	1.4
Public enterprises	0.3	0.5	1.1	1.0	0.4	0.2	1.9
External financing	1.7	0.7	-0.4	0.1	0.9	-0.2	0.8 ^{2/}
Domestic financing	--	-0.4	0.7	-0.3	1.9	3.3	-2.1

Sources: Ministry of Finance; and Fund staff estimates.

^{1/} As defined in Table 3.

^{2/} Includes disbursements of US\$80 million under IBRD SAL II and III.

exchanged for long-term bearer bonds carrying an interest rate of 6 1/4 percent while the past-due interest that was not bought back was to be exchanged for bonds carrying a commercial rate of interest after a 20 percent down payment. The operation took place in May 1990, with a payment by Costa Rica of US\$225 million financed by external grants (US\$43 million), medium-term loans (US\$40 million), short-term loans (US\$100 million), and use of official reserves. ^{1/}

2. Developments in 1990

The combined public sector deficit continued to rise in the first half of 1990. The overall deficit of the Central Government almost doubled, relative to the same period of 1989, as coffee export taxes fell due to declining international prices and expenditures continued to increase sharply in response to new arbitration wage awards and increases in interest payments. The finances of the public enterprises weakened further as adjustments to petroleum product prices and public utility tariffs continued to be postponed and the State Marketing Agency (CNP) incurred large losses on the sale of basic grains.

With reduced foreign financing available for the budget (as some external loans were used for the debt-reduction deal), the Central Government's recourse to domestic financing increased sharply putting pressure on short-term interest rates which increased by 4 percentage points in the first half of the year. In an attempt to hold down bank credit to the private sector and protect the balance of payments, the legal reserve requirement on the banks' sight deposits began to be increased by 1 percentage point a month starting March, at the same time that the rate of depreciation was increased from ¢ 0.45 per U.S. dollar to ¢ 1.05 per U.S. dollar a month. Notwithstanding these measures, there was a marked deterioration in the balance of payments in the first half of 1990 as net international reserves declined by US\$390 million, of which about US\$140 million was related to the debt-reduction deal with the commercial banks.

A new Administration assumed office in mid-May 1990, and soon after introduced measures to reduce the fiscal deficit and to ease balance of payments pressures. A revenue package was announced in mid-June (with an estimated yield of 3 percent of GDP on an annual basis) which included: (i) an increase to 10 percent in minimum import duties on raw materials and on intermediate and capital goods; (ii) an 80 percent increase in the tax on banana exports; (iii) an increase in the range of 17-22 percent in the prices of basic grains sold by the CNP; and (iv) adjustments in the range of 20-32 percent in the prices of petroleum products, electricity, and telephone tariffs. In response to increases in international fuel prices, there were further increases of

^{1/} See Appendix VI for details.

around 40 percent in petroleum product prices during the period August-December. ^{1/} Also in mid-June the Government announced a freeze on the creation of new posts in the central administration, and established a ceiling of 50 percent on the number of vacancies that should be filled. In addition, ministries and decentralized agencies were requested to cut expenditure by 2 percentage points of GDP on an annual basis.

Preliminary data indicate that the combined fiscal deficit was reduced from 7 percent of GDP in the first half of 1990 to around 3 1/2 percent of GDP in the second half. The reduction was somewhat smaller than had been envisaged because of a further decline in export taxes due to the continued weakening in international coffee prices, unanticipated wage increases in October as a consequence of rulings made by the labor court earlier in the year and slippages in the implementation of the planned expenditure cuts.

Notwithstanding the 1 percent a month increase in the legal reserve requirement which raised this requirement to 31 percent by August when it was discontinued, bank credit expansion continued at a strong pace on the basis of an increase in the commercial bank float with the Central Bank. In early September the Central Bank froze bank credit to the private sector at the level outstanding on August 31, 1990, except for credit financed by foreign resources. At the same time, commercial banks were prohibited from using the float as a basis for expanding credit but, to avoid forcing the banks to call existing loans, the Central Bank temporarily reduced the legal reserve requirement on sight deposits to 15 percent. Since October, the reserve requirement on these deposits is being increased by 3 percentage points a month with a view to raising it back to 31 percent.

Nominal short-term interest rates rose by between 7 (for central bank stabilization bonds) and 9 percentage points (for government securities) during the second half of 1990. Commercial bank interest rates moved in step with these official rates and by year-end stood at 36 percent for six-month time deposits and 41 percent for loans, i.e., in the range of 7-11 percent in real terms. ^{2/}

With the credit freeze imposed as from end-August, the expansion of bank credit to the private sector for 1990 as a whole was contained to 7.4 percent (Table 5). However, there was a fairly strong increase in net bank credit expansion to the public sector. Moreover, bank liabilities to the private sector fell in real terms, perhaps due to

^{1/} In August the authorities adopted a system for adjusting domestic fuel prices in response to increases in international oil prices. However, because of administrative problems there was a less than full pass-through of oil import price increases during the five-month period August-December.

^{2/} Rates on foreign exchange deposits are set by the Central Bank on the basis of LIBOR plus a margin. In December 1990 they averaged 8.4 percent on three-month deposits.

Table 5. Costa Rica: Summary Operations of the Central Bank and Banking System

	December		December		December		December	
	1987	1988	1988	1989	1989	1990	1990	Proj.
	(¢ 76/US\$)		(¢ 81.5/US\$)		(¢ 91.5/US\$)		(¢ 115/US\$)	1991
(In millions of colones)								
I. Central Bank								
Net international reserves	-23,484	-20,095	-5,550	866	20,916	-27,898	-35,064	3,266
Official reserves	-3,108	4,863	5,216	6,465	26,881 1/	-2,928	-3,680	10,201
Payments arrears	-20,376	-24,958	-10,766	-5,599	-5,765	-24,970	-31,383	-6,935
Net domestic assets	42,954	44,829	30,284	27,110	7,061	55,875	68,953	36,384
Public sector credit (net)	43,531	39,791	42,248	41,378	43,014	54,573	66,977	48,967
Rest of banking system								
credit (net)	-11,061	-15,627	-20,383	-19,675	-44,689	-44,019	-50,869	-74,126
Government trust funds	-15,676	-18,824	-18,824	-16,794	-16,794	-18,156	-18,156	-33,198
Counterpart arrears	20,376	24,958	10,766	5,599	5,765	24,970	31,383	6,935
Operational losses 2/	42,281	47,137	47,137	53,450	104,601	115,075	115,075	126,189
Medium- and long-term foreign								
liabilities	-125,111	-125,967	-135,083	-130,543	-169,970 1/	-129,582	-162,863	-167,174
Stabilization bonds	-7,648	-16,068	-16,068	-23,411	-23,411	-21,701	-21,701	-25,047
Other accounts net	96,252	109,429	120,491	117,106	108,545	74,715	109,106	153,838
Currency issue	19,470	24,734	24,734	27,977	27,977	33,889	33,889	39,650
II. Banking System								
Net international reserves	-18,746	-18,383	996	8,016	28,940	-21,077	-26,491	12,414
Net domestic assets	140,351	176,272	167,274	186,545	173,585	260,142	282,383	273,734
Public sector credit (net)	36,530	39,392	40,394	43,752	45,155	55,859	66,483	38,474
Credit to private sector	57,369	65,755	63,508	70,522	69,527	84,486	85,378	99,884
Medium- and long-term foreign								
liabilities	-126,863	-127,880	-137,137	-133,252	-173,013	-132,987	-166,943	-171,231
Other accounts (net) 3/	173,315	199,005	200,509	205,523	231,916	252,784	297,464	306,608
NDA-Arrears	119,975	151,314	156,508	180,946	167,820	235,172	251,000	266,799
Liabilities to private sector	121,605	157,889	168,270	194,561	202,525	239,065	255,892	286,148
Money	40,225	54,936	54,936	56,961	56,961	62,694	62,694	73,352
Quasi-money	81,380	102,953	113,334	137,600	145,564	176,371	193,198	212,796
Domestic currency	53,406	66,367	66,367	72,695	72,695	90,637	90,637	105,842
Foreign currency 4/	28,424	36,586	46,967	64,905	72,869	85,734	102,561	106,954
(Annual percentage change) 5/								
Banking system								
Net domestic assets 6/		25.8		14.5		33.3		6.2
Public sector credit		2.4		2.0		5.3		-10.9
Credit to private sector		6.9		4.2		7.4		5.7
Liabilities to private sector		29.8		15.6		18.0		11.8
Of which: domestic currency		22.6		6.9		18.3		16.9
(In percent of GDP) 7/								
Banking system								
Credit to private sector	20.2	18.5	17.8	16.3	16.1	16.0	16.2	16.2
Central bank losses	—	1.4	—	1.5	—	2.0	—	1.8
Liabilities to private sector	42.8	44.4	47.3	44.9	46.8	45.4	48.6	46.4
Money	14.2	15.4	15.4	13.2	13.2	11.9	11.9	11.9
Quasi-money	28.6	28.9	31.8	31.8	33.6	33.5	36.7	34.5

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

1/ Revision reflects reclassification of short-term liabilities to commercial banks as part of medium- and long-term foreign liabilities as a result of the debt reduction package.

2/ From 1989 onward on accrued basis. Prior to this date on cash basis.

3/ Includes government trust funds, counterpart arrears, and central bank losses.

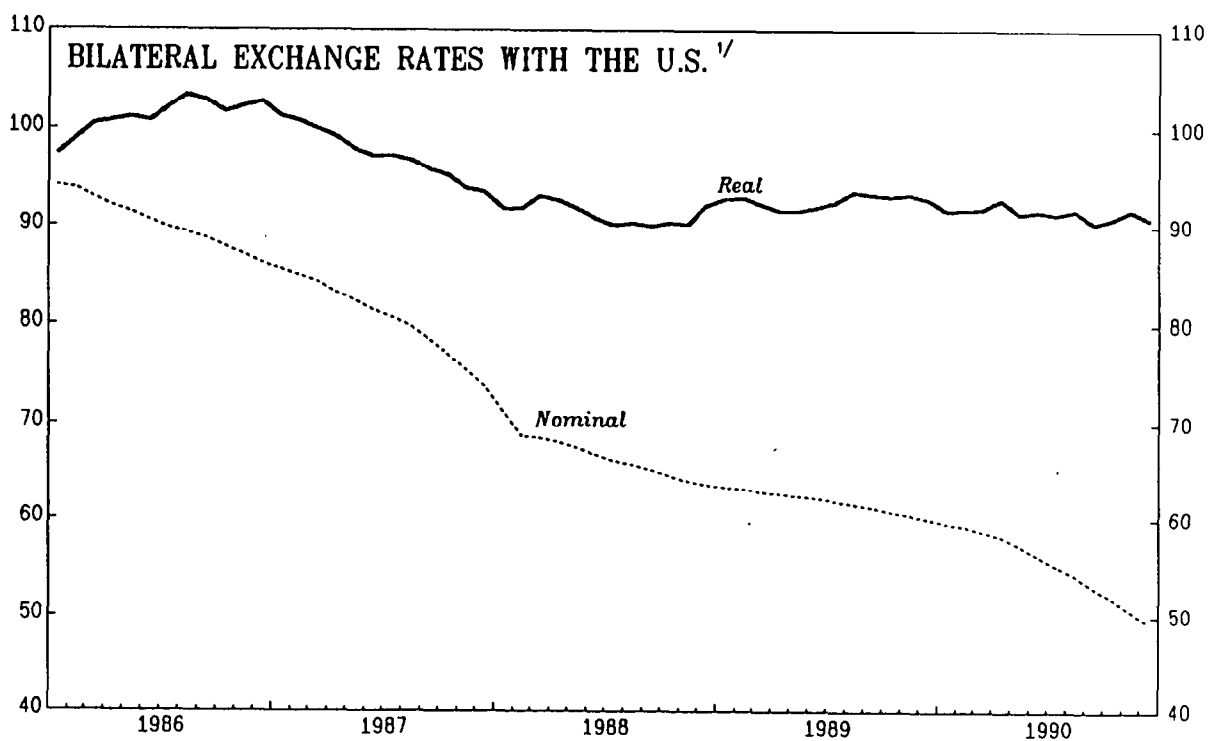
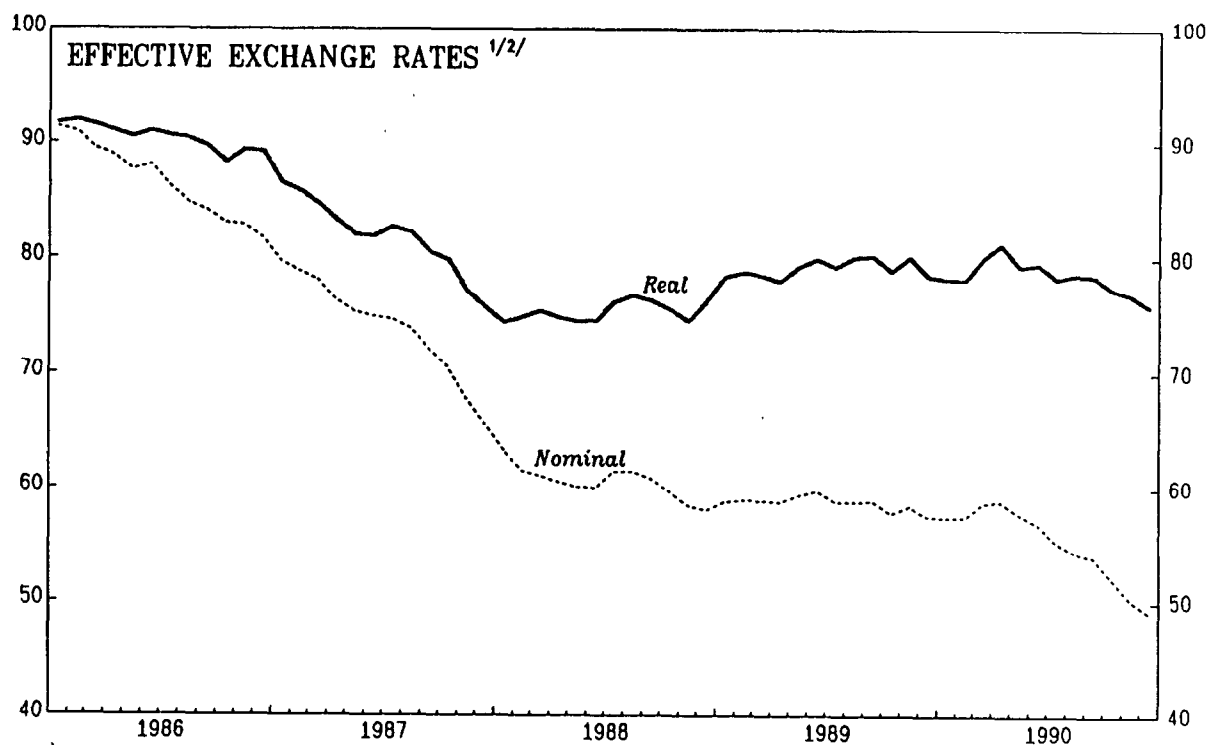
4/ From 1988 on, CDs relating to arrears are included in domestic foreign currency liabilities. Prior to this date they were classified as international liabilities.

5/ In relation to the initial stock of liabilities to the private sector.

6/ Excludes counterpart of external payments arrears.

7/ End-of-year stocks in relation to the GDP of the same year, except for the central bank losses for which the numerators of the ratios are yearly flows.

CHART 1
COSTA RICA
EXCHANGE RATE DEVELOPMENTS
(1985=100)



Source: IMF, International Financial Statistics, and staff estimates.

^{1/} A decline in the indices denotes a depreciation of the colon.

^{2/} 1980 trade weights exclude Nicaragua and oil.

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	--	--	--

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

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
(In percent change)										
Memorandum items										
Export volume growth	13.9	1.3	15.8	2.7	5.5	6.7	3.3	3.7	3.8	3.5
Import volume growth	14.2	-2.6	19.5	9.5	-13.0	2.0	4.8	4.8	4.8	4.8
Terms of trade index	-14.6	0.3	-6.3	-5.7	5.0	1.5	2.2	2.2	2.3	2.6
Of which: coffee	-41.7	9.3	-17.1	-22.9	9.5	4.1	9.5	11.6	12.0	12.0
bananas	0.6	-10.1	3.1	5.1	1.8	2.7	3.2	3.1	4.0	4.0
oil	19.8	-12.6	18.9	30.3	-19.8	-8.3	4.0	4.0	4.0	--
(In percent of GDP)										
Trade balance	-6.2	-5.1	-8.1	-11.7	-4.3	-2.7	-2.5	-2.2	-1.9	-1.6
Exports	24.4	25.2	24.9	23.6	24.3	24.9	25.1	25.4	25.7	25.9
Imports	-30.7	-30.3	-33.0	-35.3	-28.6	-27.6	-27.6	-27.6	-27.6	-27.5
Current account	-9.0	-6.6	-8.8	-11.4	-3.5	-1.7	-1.3	-0.4	0.3	1.0
Overall balance of payments after debt relief	-4.3	-0.4	1.6	-8.9	1.3	1.4	1.9	1.6	1.8	2.4

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

1/ Services data for 1989 onward were revised substantially in September 1990 to reflect improved measurement, coverage, and classification.

2/ Includes US\$40 million from Taiwan Province of China for the financing package with commercial banks.

3/ Includes gains from debt-equity conversion in 1987-90.

4/ Includes US\$225 million for the financing package with commercial banks.

5/ Includes US\$33 million for the financing package with commercial banks.

6/ Includes cofinancing.

7/ Includes US\$70 million to be used to unwind short-term borrowing from Mexico and Venezuela associated with the financing package with commercial banks.

8/ Takes into account \$100 million in short-term borrowing from Mexico, Venezuela and the offshore affiliate of the state banks for the financing package with commercial banks.

III. The Program for 1991

The Government has adopted an economic program for 1991-92, geared to reduce inflation, strengthen the balance of payments, and set the stage for sustained economic growth and external viability over the medium term. The program includes a significant tightening of financial policies, an exchange rate policy aimed at maintaining competitiveness, and structural policies designed to increase the efficiency of domestic production. For 1991 the program assumes a real GDP growth of around 3.5 percent and seeks a reduction in the rate of inflation (measured by the consumer price index) from 27 percent during 1990 to around 12 percent during 1991; on an average annual basis, the increase in consumer prices would remain at around 19 percent in 1991. The external current deficit is projected to decline from 11 percent of GDP in 1990 to around 3.5 percent of GDP in 1991 facilitating a major reduction in external arrears and a reconstitution of the foreign reserves position of the Central Bank.

For 1992 the aim is to raise the rate of economic growth to 4 percent, reduce inflation to a range of 8-10 percent on an end-of-year basis, and to consolidate the strengthening of the external payments position.

1. Fiscal policy

The centerpiece of the economic program is the reduction in the combined deficit of the public sector from 5.1 percent of GDP in 1990 (3.5 percent of GDP in the second half) to no more than 0.5 percent of GDP in 1991. The improvement is targeted to be almost entirely in the nonfinancial public sector, where a turnaround from a deficit of 3.1 percent of GDP to a surplus of 1.3 percent of GDP is envisaged, with central bank losses declining from 2 percent to 1.8 percent of GDP. ^{1/} This overall surplus, together with a turnaround in net external borrowing, would make it possible to reduce the net domestic indebtedness of the nonfinancial public sector by the equivalent of 2.1 percent of GDP.

The overall deficit of the Central Administration is programmed to be reduced by more than one half to 2 percent of GDP in 1991 through an increase in revenues to 16.9 percent of GDP from 14.5 percent of GDP in 1990. Total expenditures would remain at a little below 19 percent of GDP, but noninterest expenditure would decline by 1 percent of GDP, reflecting mostly a reduction in government transfers by 0.7 percent of GDP while the wage bill would remain unchanged.

^{1/} The losses of the Central Bank stem largely from interest obligations on external debt, some of which was assumed by the Bank in the context of earlier external debt reschedulings. Debt conversions and the external debt buyback operation with the commercial banks resulted in a reduction in central bank losses from an average of 3.5 percent of GDP in 1986-88 to 2 percent of GDP in 1990.

In late 1990 a tax reform package formulated with technical assistance from the Fund's Fiscal Affairs Department was presented to the National Assembly. In early January 1991 the Assembly approved the broadening of the base of the sales tax to cover electricity charges and petroleum sales and a temporary increase in the rate of this tax from 10 to 13 percent, with an estimated yield in 1991 of 1.2 percent of GDP. The remainder of the package (comprising a progressive tax on pensions paid by the public sector, an increase in the level of presumptive income of professionals for tax purposes, and steps to improve tax collections), which is projected to yield 0.2 percent of GDP on an annual basis, is expected to be considered by the Assembly in the second half of 1991.

In addition to the modifications of the sales tax, central government revenue in 1991 will be boosted by the full-year impact of the measures introduced in mid-1990 (the increase in the banana tax and in the minimum import duty on raw materials and intermediate and capital goods) and by the imposition of a 10 percent temporary import surcharge, estimated to yield 1.2 percent of GDP on an annual basis, but which is to remain in effect for only seven months (January-July).

On the expenditure side, the increase in the Central Government's wage bill in 1991 is not to exceed 18 percent in 1991 (compared with increases averaging 26 percent in 1989-90), and to this end the Government will implement a plan to cut employment and limit wage adjustments. During 1991 central government employment will be reduced by 2,300 (3.5 percent) as part of a scheme to reduce public sector employment by 9,000 (about 5 percent of total employment in the public sector). Of the planned reductions in public sector employment, some 2,000 would represent workers who would leave through retirement and attrition and who would not be replaced, while the remainder will come from a program of voluntary labor mobility (movilidad laboral) geared to encourage workers to move to the private sector (including self-employment). Under this program workers are being offered enhanced severance benefits, financed largely with grants provided by U.S. AID (in an amount equivalent to 0.2 percent of GDP). As of end-January, public sector employment had been reduced by 3,600 under the program and further cuts of 3,500 were expected to take place by end-March.

Beginning in 1989, wage policy in the Central Administration provided for full indexation for inflation. Increases were granted in the months of January and July based on projected inflation over the following six months, with a catch-up payment if actual inflation in the previous six months exceeded the projection (there was no corresponding adjustment if actual inflation was lower than projected). Under this policy, a general wage increase of roughly 16 percent would have been due with effect on January 1, 1991. In the light of the tight fiscal situation, the system of wage indexation was suspended and public sector workers received a wage increase of 5 percent with effect from January 1, 1991. An increase of another 5 percent to take effect from July 1 has been built into the fiscal program, but would be granted only

if the improvement in the public finances proceeds as expected. In order to keep the wage bill within programmed levels, one half of an arbitration award (laudo) scheduled to take effect in 1991 has been postponed to 1992.

As indicated earlier, the system of laudos has contributed significantly to the growth in the public sector wage bill over the past few years. The Government is convinced that before full control of public sector wage policy can be established, the system of laudos must be replaced by a new arrangement which takes fiscal objectives into account. Consequently, draft legislation to this effect has been presented to the National Assembly. Meanwhile, the Government has presented to the Supreme Court a constitutional challenge which has suspended temporarily the granting of new laudos. The program envisages that any wage increases beyond those budgeted for will be fully offset by additional reductions in public sector employment.

The increase in central government transfers, which has averaged 22 percent a year in the last two years, is to be held to less than 6 percent in 1991. To this end, presidential decrees have been issued to cut transfers for higher education, discretionary pension benefits, and a number of programs run by decentralized agencies below the amounts included in the budget.

To support the planned expenditure cuts, the Government has initiated reforms in several agencies, including the State Railroad Company (INCOFER) and the Social Assistance Agency (Asignaciones Familiares), has presented to the Supreme Court a petition to eliminate the payment of exceptional pension benefits provided through the budget law, and has reprogrammed several nonpriority investment projects.

The combined surplus of the public enterprises is projected to increase from 0.2 percent of GDP in 1990 to 1.9 percent of GDP in 1991, as a result of the wage restraint and employment-reduction policies described above as well as further increases in fuel prices, public utility tariffs and commodities sold by the state marketing agency (CNP).

Taking into account the projected employment reductions, the increase in the combined wage bill of the public enterprises is programmed not to exceed 12 percent, compared with an increase of 26 percent in 1990. In January petroleum product prices were increased by 13 percent, and the existing system for adjusting fuel prices was streamlined to permit a more automatic adjustment for increases in import costs and exchange rate changes. These measures, along with a cut in investment spending, will increase the overall surplus of the state-owned oil company (RECOPE) by close to 1 percent of GDP. To strengthen the financial situation of the state-owned public utility company (ICE), electricity tariffs are being increased by 1.8 percent a month in 1991; these increases are in addition to the adjustments being

made to reflect changes in the cost of imported petroleum prices. Moreover, the basic telephone tariffs, as well as charges for other telephone services, are to be increased by at least 10 percent effective April 1, 1991. After many years of controlled, often subsidized, prices for basic grains, CNP is now operating at market prices and private importers will be allowed to compete freely in the market for these products; as a result, CNP's deficit is expected to be halved.

2. Fiscal adjustment beyond 1991

In 1992 the sales tax rate will be reduced by 1 percentage point (0.4 percent of GDP) as part of a plan to return to a rate of 10 percent by 1994. In addition, the elimination of the temporary import surcharge as from August 1991 will imply an annual revenue loss of 0.7 percent of GDP. To ensure fiscal consolidation beyond 1991, the Government is introducing legislation to limit sharply the growth of central government expenditure, including through a public sector reform program involving further reductions in employment, an overhaul of the government-administered pension schemes, and modifications to the system of fiscal subsidies for nontraditional exports (CATs). These policies, which are summarized in Section 4 below, are being supported by structural adjustment programs (SAL-II and III) financed by the World Bank and the IDB. Also, the Government is committed to continue its policy of wage restraint.

3. Monetary policy

The monetary program establishes a path for the net domestic assets of the Central Bank during 1991 which is expected to be consistent with the inflation and balance of payments objectives referred to above. The program involves a major reduction in net credit to the public sector, consequent on the projected improvement in the public finances and allows for a net drawdown of U.S. AID trust funds of \$ 1.7 billion to finance severance payments under the labor mobility scheme. Under the program there is room for an increase in total bank credit to the private sector during 1991 of around 17 percent, in line with the projected growth of nominal GDP.

The freeze on bank credit to the private sector introduced in early September 1990 was lifted at the end of the year. In 1991 credit control will be exercised through the use of instruments such as legal reserve requirements and open market operations.

The authorities are of the view that the current level of interest rates is having a dampening effect on business activity. They are, however, committed to the existing system of market-determined interest rates which they consider essential to the stabilization process and to efficient resource allocation.

In 1989, in the context of the second structural adjustment loan from the World Bank, the Government initiated a series of financial sector reforms, including the introduction of legislation to strengthen the supervision and regulation of the financial system and steps to increase competition in the banking system by reducing the minimum-term requirement for deposits with private banks from 180 days to 90 days. Also, with financial assistance from the World Bank, the quality of the loan portfolio of the state banks was improved. The Government will be discussing with the World Bank, in the context of SAL-III, further measures to increase competition in the banking system such as allowing private banks to offer shorter maturity deposits, standardizing debt-equity ratios for public and private banks and granting private banks, equal access to central bank rediscounts.

4. External policies

Since 1985, Costa Rica has pursued a policy of mini-devaluations geared to maintain external competitiveness. In general, the system generated confidence for producers and investors and, together with generous fiscal incentives, has facilitated a substantial growth in nontraditional exports. The real effective value of the colon was lowered by about one third in the period 1985-88 but thereafter has remained more or less unchanged, while import tariffs have been reduced significantly, and there has been a major deterioration in the terms of trade.

In the light of these developments and to support the tight financial policies (described above), the authorities believe that exchange rate policy over the program period should be geared toward achieving some real depreciation of the colon to compensate for the factors noted above as well as the reduction in fiscal subsidies for exports (discussed later in this section). Given the nature of labor relations in Costa Rica and the experience of 1988 when a step depreciation unleashed significant wage pressures, the authorities have opted to continue the crawling peg system. The rate of depreciation was ₡ 4.48 per U.S. dollar in January 1991 and ₡ 3.47 per U.S. dollar in February. The authorities intend to continue reducing the monthly rate of depreciation taking into consideration the program's balance of payments objectives.

Exchange rate policy is to be reinforced by wage restraint. Over the past few years wage increases in the private sector have lagged behind those in the public sector and also behind the increase in consumer prices. The Government will seek to maintain a moderate growth of the minimum wage, which serves as a guideline for private sector wage adjustments. ^{1/} The Government also plans to emphasize the central role of productivity changes in wage determination in order to minimize the inflationary pressure arising from wage adjustments.

^{1/} The minimum wage is normally adjusted annually by a tri-partite commission consisting of representatives of the Government, labor, and the business sector.

Since 1986, with a view to fostering export-led growth, Costa Rica has lowered its maximum import tariff rates for most goods from around 70 percent to 40 percent. The trade reform program under SAL-II had provided for a minimum import tariff of 5 percent on most imports of raw materials, intermediate and capital goods but in the context of the tax package announced in June 1990 this was increased to 10 percent. Discussions on a schedule for a further reduction in the dispersion and maximum level of import tariffs have begun in the context of the new structural adjustment loan (SAL-III) with the World Bank. The Government's present proposal calls for a reduction in the maximum tariff for most goods to 20 percent by 1992.

The system of export incentives--Certificados de Abono Tributario (CATs)--has been an important policy instrument to promote nontraditional exports. However, the budgetary cost of the program has risen from an average of ¢ 2.1 billion (0.7 percent of GDP) in 1987/88 to ¢ 5.9 million (1.2 percent of GDP) in 1990. Following discussions with the World Bank, the authorities have decided to modify the scheme to reduce its fiscal impact and to force export industries to increase efficiency. The modified scheme provides for a new benefits schedule applicable to new export contracts, under which the subsidy level would be tied to domestic value added and would decline over the length of the contract which would run for five years or through September 30, 1996, whichever is earlier. The benefits under old export incentive contracts are to be adjusted in one of two ways: exporters may opt for a 30 percent cut in benefits but with the maturity period being extended by three years (to September 30, 1999), or will have the benefits taxed at a rate of 25 percent.

5. Balance of payments in 1991

The external current account deficit is projected to narrow to 3.5 percent of GDP in 1991 from an estimated 11.4 percent of GDP in 1990. The decline is predicated on a 12 percent growth in U.S. dollar value of exports (compared with 3 percent in 1990), a 12 percent decline in imports, and an improvement in the services account reflecting a continued expansion of tourism. The capital account also would strengthen, and the overall balance would shift (by more than 10 percent of GDP) into surplus. However, taking into account the need to replenish the official reserve position and to deal with external arrears, Costa Rica is faced with a financing gap on the order of US\$150 million, which the authorities expect to cover through debt relief from official creditors and loans currently being negotiated as cofinancing of the World Bank SAL-III.

Traditional exports are projected to increase by 9 1/2 percent in 1991 mainly due to higher coffee export prices and an expected increase in banana export volume as a result of increases in the area planted and improved yields. Bolstered by the exchange rate policy described above, nontraditional exports are projected to increase by 14 1/2 percent, a sizable improvement over the performance of 1990 but well below the annual increase in 1987-89.

Based on the latest CCFF baseline projections of oil prices (implying an average import price for Costa Rica of US\$20.56 a barrel in 1991 compared with an average of US\$25.63 a barrel in 1990) the oil import bill is projected to decline by 14 percent in 1991. Non-oil imports are projected to decline by 11 1/2 percent in nominal U.S. dollar terms, with the aid of tight financial policies, some rundown of inventories accumulated in 1989-90, the temporary import surcharge, and the increase in domestic currency deposits associated with foreign exchange requests (from 1 percent to 50 percent of the corresponding value of imports).

A turnaround in the capital account by nearly US\$300 million in 1991 results, in part, from the sharp decline in amortization payments after the debt-reduction deal with the commercial banks. Moreover, official balance of payments support is expected to increase sharply, and would include US\$100 million from the World Bank with cofinancing of a similar amount, and US\$30 million from the U.S. AID; other official disbursements are assumed to be at about the level of 1990.

The program provides for an increase in net international reserves of US\$333 million, which includes a build-up of gross liquid reserves of US\$150 million and a reduction in arrears of US\$213 million through cash payments and rescheduling. Arrears to be eliminated through cash payments consist of US\$54 million to the Paris Club (including the release of about US\$30 million from the special account at the Banque de France related to the 1989 Paris Club rescheduling) and commercial arrears amounting to US\$80 million. Rescheduling agreements with Brazil and BCIE, reached in March, reduced arrears by US\$55 million and another US\$18 million of arrears to other bilateral creditors are expected to be rescheduled. The authorities are committed to a complete elimination of remaining arrears by 1992.

6. Exchange restrictions

Costa Rica's exchange system contains restrictions as evidenced by external payments arrears by public enterprises to official creditors. In addition, as mentioned above, there are commercial arrears arising from delays of more than 15 days in the settlement of applications for foreign exchange purchases for current international transactions (previously these applications were processed in less than five days). At prevailing interest rates, this delay raises the effective cost of foreign exchange for some transactions to more than 2 percent above the spot exchange rate, giving rise to a multiple currency practice. The authorities intend to eliminate this multiple currency practice during the program period by shortening the wait for foreign exchange and reducing the domestic currency deposit requirement.

Although Costa Rica has for all practical purposes a unified exchange market, remittances to students who had registered with the Central Bank prior to 1981 are still settled at a rate of ¢ 20 per U.S. dollar. There are currently only a few such students and it is envisaged that all of them will complete their studies abroad by the end of 1991.

7. Structural reforms

Costa Rica has been implementing for some time a program of structural reforms geared toward improving resource allocation and raising potential output. Under an ongoing divestment program, most of the subsidiaries of the state-owned development corporation (CODESA) have either been liquidated, absorbed by the other public entities, or sold to the private sector. CODESA now owns only two large companies--a fertilizer company (FERTICA) and a cement company (CEMPASA)--and the Government has requested congressional approval for their sale. Moreover, with the assistance of U.S. AID, the Government is in the process of formulating a plan for the divestment of state enterprises not affiliated with CODESA. In the context of the employment reduction plan, the Government has taken steps to privatize services previously provided in-house by the social security agency, eliminate several unprofitable routes of the state railway corporation (INCOFER), and sell off some of the marketing outlets of the state marketing agency.

The public sector reform will involve the elimination of widespread institutional duplication and the streamlining of several agencies. The reform of the pension systems will aim at improving their actuarial soundness and reducing their fiscal cost. With effect from January 1, 1991, the minimum retirement age under the social security scheme was increased from 57 years (55 years for women) to 62 years (60 years for women). As regards government-administered pension schemes, proposals now before the National Assembly call for a similar increase in the retirement age, a reduction in the maximum pension, and an increase in the minimum number of contributions that a participant must make to qualify for pension benefits.

8. Social safety net

The Government has established a Social Compensation Fund (FCS) to assist the most disadvantaged social groups. In August 1990 FCS began a special program of food and income support that benefited 250,000 people. However, the program had a negative impact on the supply of labor during the harvest season, and the Government is currently redefining it for specific target groups (single mothers, the disabled, etc.).

FCS also has begun a new training and employment program geared to generate employment in the country's 27 poorest municipalities and has adopted a housing subsidy program for low-income families. Resources for these programs are now being provided from the budget, but the Government is seeking additional concessional assistance from external donors.

9. Performance criteria

The economic program included a number of significant prior actions in the fiscal area: (i) the expansion of the coverage and an increase in rates of the sales tax; (ii) the imposition of the temporary import

surcharge; (iii) the implementation of the 1991 wage policy and the initiation of the public sector employment reduction program; and (iv) the issuance of presidential orders giving effect to the agreed expenditure cuts. Other prior actions included the release of resources accumulated in the special account in the Banque de France related to the 1989 Paris Club agreement and the finalization of rescheduling arrangements with Brazil and BCIE.

The program contains the following indicative targets for March 31, 1991 and performance criteria for the three following quarters: (a) a ceiling on the net domestic financing of the nonfinancial public sector; (b) a ceiling on cumulative central government expenditures; (c) a ceiling on the stock of domestic assets of the Central Bank; (d) a floor for the stock of net international reserves; and (e) a schedule for the reduction of external payments arrears (Table 7). In addition, there are limits on the contracting or guaranteeing by the public sector of new foreign loans, excluding the rescheduling of obligations with Paris Club creditors, as follows: (a) a limit on loans with maturities of over one and up to and including twelve years; (b) a sublimit on loans of less than five years; and (c) a ceiling on short-term external public debt.

The customary performance clauses on exchange restrictions, multiple currency practices, bilateral payments agreements inconsistent with Article VIII, and import restrictions for balance of payments purposes are applicable during the program period.

Progress made in implementing the program will be assessed in a review to be completed by mid-July, which would cover developments in the public finances as well as the evolution of the balance of payments.

IV. The Medium-Term Balance of Payments Outlook ^{1/}

The medium-term balance of payments scenario presented in Table 6 assumes the continued implementation of adjustment policies geared toward a sustainable rate of economic growth with reasonable price stability and external viability. The scenario assumes a steady reduction in the public sector's net use of domestic savings and the implementation of interest rate, exchange rate, and credit policies aimed at promoting national savings and encourage the inflow of capital from abroad. The projections suggest that with the benefits of the debt-reduction package with commercial banks concluded in May 1990, which reduced Costa Rica's external debt service by roughly US\$600 million through 1993, Costa Rica should be able to achieve balance of payments viability in 1992-93 and continue to build up international reserves through 1996.

^{1/} The scenario is based on the discussions with the Costa Rican representatives and is broadly in line with the price projections from the Fund's Research Department as of end-January 1991.

Table 7. Costa Rica: Quantitative Performance Criteria 1/

Variables and Periods	Amounts
	(millions ₡)
I. Ceilings on the stock of net domestic assets of the Central Bank December 31, 1990 (actual) March 31, 1991 (indicative) June 30, 1991 September 30, 1991 December 31, 1991	68,953 51,000 38,195 44,078 36,384
II. Limits for cumulative changes in Central Government expenditures Cumulative change from December 31, 1990 March 31, 1991 (indicative) June 30, 1991 September 30, 1991 December 31, 1991	26,000 52,000 81,000 116,400
III. Limits for the cumulative change in the net domestic financing of the nonfinancial public sector Cumulative change from December 31, 1990 March 31, 1991 (indicative) June 30, 1991 September 30, 1991 December 31, 1991	-4,300 -14,000 -12,900 -12,900
	(millions US\$)
IV. Targets for the stock of the net inter- national reserves of the Central Bank December 31, 1990 (actual) March 31, 1991 (indicative) June 30, 1991 September 30, 1991 December 31, 1991	-304.9 -135.9 -12.6 -52.0 28.4
V. Limits for the stock of external payments arrears December 31, 1990 (actual) March 31, 1991 (indicative) June 30, 1991 September 30, 1991 December 31, 1991	272.9 111.1 67.6 61.5 60.3

1/ Definitions of the concepts to be measured and adjustments that may be invoked are included in the footnotes to the tables attached to the Letter of Intent.

The external current account deficit is projected to narrow from 3.5 percent of GDP in 1991 to 1.5 percent of GDP in 1992-93 and to 0.4 percent of GDP in 1994, before giving way to small surpluses in 1995-96. This scenario is based on an improvement in the terms of trade of around 1 1/2 to 2 1/2 percent per year, reflecting increases in coffee and banana prices averaging 8 1/2 percent and 3 percent a year, respectively, through 1994, and with international oil prices falling by 8 percent in 1992 before rising by 4 percent a year in 1993-94. For 1995-96 the projections assume increases in coffee prices of 12 percent a year, and in banana and oil prices of 4 percent a year.

Export volume growth is projected to average 4 percent a year in 1992-96 (about the same as in 1990-91), with traditional exports increasing by about 4 1/2 percent in 1992 and remaining about level thereafter and nontraditional exports growing at an average annual rate of 8 1/4 percent. Exports would be boosted by the trade reform in progress and the exchange rate policy being pursued by Costa Rica. The medium-term scenario calls for import volume to grow by 2 percent in 1992 and 5 percent a year thereafter, consistent with the financial and external policies described above. Net receipts on account of other current account items are expected to show moderate growth, led by tourism.

With the capital account staying in surplus, the prospect is for an increase of net international reserves of over US\$400 million in 1992-94. The capital account projections assume (i) a steady decline in balance of payments support from the U.S. AID, the World Bank, and the IDB; (ii) small increases (averaging US\$10 million a year) in project disbursements from multilateral agencies (based on existing commitments as well as new commitments currently being discussed); and (iii) other inflows from bilateral creditors at about the same level as in the past few years (averaging about US\$40 million a year). For 1995-96, a period for which less detail is available, it is assumed that balance of payments support loans will fall off sharply while other inflows are less than scheduled amortization payments.

V. Capacity to Repay the Fund

As discussed above, the balance of payments projections indicate a sizable financing gap in 1991 and small gaps in 1992-93, which are expected to be covered by additional debt relief and new loans. Total obligations falling due to the Fund in 1991 ^{1/} amount to SDR 10.9 million, compared with average annual payments of SDR 41.2 million in 1986-90. In the latter period, payments were made on a timely basis, despite, at times, a difficult external situation. ^{2/}

^{1/} Repurchases in 1991 are equal to SDR 5.2 million and estimated charges (including interest on the use of SDRs) are SDR 5.7 million.

^{2/} During this period payments were no more than six days late except on one occasion when a payment was eleven days late.

In making payments to the World Bank Costa Rica has frequently been late and from time to time by more than 60 days. Specifically, in the World Bank's fiscal years 1986-90, there were five months (falling in the period 1987-89) in which there were overdue payments of over 60 days. 1/ There also have been delays in making payments to the IDB.

With regard to policy implementation, it may be noted that in the last two programs supported by the Fund in (1988-89) there were policy slippages, particularly as regards fiscal policy. While this experience suggests that the possibility of slippages cannot be ruled out, the prior actions under the program to be supported by the proposed stand-by arrangement underscore the commitment of the current Administration to the adjustment process and serve to reduce the risk of slippages.

To assess the sensitivity of the external sector to changes in some of the underlying assumptions of the program, two alternative scenarios have been prepared (Table 8) based on more (Scenario A) and less (Scenario B) favorable assumptions regarding coffee, banana and petroleum prices, as well as on some sensitivity analysis for the effects of changes in the assumptions for other economic variables. The results indicate that under particularly adverse developments--for example, a permanent 10 percent decline from the baseline in coffee and banana prices starting in 1991, a similarly permanent increase in petroleum prices, and policy slippages leading to a 1 percentage point higher-than-programmed annual non-oil import volume growth--nearly the entire accumulation of net official reserves projected in the medium-term scenario discussed above (about US\$360 million) could be wiped out.

Such a scenario cannot be dismissed altogether as the prices of the commodities in question historically have posted large annual changes and as past policy slippages have tended to raise import volume. However, it needs to be viewed as a somewhat polar example in the sense that it assumes that the adverse shock to each of the individual variables is not only simultaneous but also permanent.

The sensitivity analysis, however, suggests that the impact of adverse exogenous developments could be sufficiently large that payments to the Fund, the World Bank, and other creditors could be put at risk if the authorities do not stand ready to take strong and decisive adjustment measures. By the same token, the analysis implies that favorable

1/ Under the World Bank's current lending practices, when arrears reach 60 days the country is informed that if the payment is not received on all overdues, disbursements will be suspended on all loans within 15 days.

Table 8. Costa Rica: Sensitivity Analysis of
Balance of Payments Scenario, 1991-93

(Deviations from baseline caused by indicated
changes in assumptions) 1/

	Deviations from baseline in			
	Current account as		Rise in financing	
	a percent of GDP <u>2/</u>		gap(-) or fall in	
	Average <u>3/</u>	1993	gap/rise in reserves(+)	Cumulative 1993
Assumptions:				
Scenario A (favorable) <u>4/</u>	+1.3	+1.4	+270	+100
Of which: oil	(+0.3)	(+0.3)	(+56)	(+21)
Scenario B (unfavorable) <u>5/</u>	-1.3	-1.4	-270	-100
Of which: oil	(-0.3)	(-0.3)	(-56)	(-21)
One percentage point higher annual nontraditional export volume growth <u>6/</u>	+0.3	+0.4	+57	+32
One percentage point higher annual nonoil import volume growth <u>6/</u>	-0.5	-0.8	-112	-60

Source: Fund staff estimates.

1/ Direct effects only, which exclude changes in GDP and other variables that may result from the indicated change in assumptions.

2/ "+" indicates lower current account deficit.

3/ Simple average of observations for each of the three years in the 1991-93 period.

4/ Coffee and banana export prices 10 percent higher and petroleum prices 10 percent lower in each of the three years from what is assumed in the baseline projections. Excludes any change in volume resulting from the price changes.

5/ Opposite of scenario A.

6/ Compared to the baseline. The effects of a similar decline in growth rates would be about symmetrical.

shocks would help reduce financing gaps and/or permit a more substantial build-up of international reserves. ^{1/}

The projected evolution of the indicators of debt-servicing capacity shown in Table 9 show favorable trends. Virtually all of the ratios (except those related to the use of Fund credit) are declining from 1991 on and would seem to be at manageable levels. In 1994-96, when all but SDR 0.4 million of the repurchases associated with the use of Fund resources under the proposed arrangement fall due, the debt-service ratio for obligations to the Fund would peak at 1.7 percent in 1995 and thereafter fall once again to less than 1 percent; the projected overall debt-service ratio for the period is around 14 percent.

VI. External Contingency Financing

Costa Rica has requested that the Fund provide, in association with the stand-by arrangement, contingency financing for up to SDR 21 million under the compensatory and contingency financing facility (CCFF), should adverse external shocks occur during the baseline period. The proposed contingency mechanism covers unanticipated deviations from program projections for oil import prices and coffee export prices. The baseline figures for oil and coffee prices are in line with CCFF baseline projections as of the end of January 1991. These prices have been particularly volatile on world markets, registering average absolute deviations of about 30 percent a year in the 1986-90 period.

A detailed presentation of the procedures for the contingency mechanism and its technical aspects is given in the Annex to the letter of intent. In the event of unfavorable deviations which trigger the contingency mechanism, the authorities will consult with the Fund on the necessary policy adjustments to attain the objectives of the program supported by the stand-by arrangement and on the appropriate adjustments to performance criteria. They have indicated that they stand ready to raise domestic oil prices by an amount equivalent to the higher costs of imported crude oil and products should that external contingency arise, and, more generally in the face of unfavorable deviations, tighten financial policies beyond what is envisaged in the program.

^{1/} Assuming no change in nonliquid reserve assets and short-term liabilities of the monetary authorities (other than to the Fund) from end-1991, gross liquid reserves would be around 2 months of imports at the end of 1992 and almost three months at the end of 1993 compared with about 2 1/2 weeks at the end of 1990.

Table 9. Costa Rica: Indicators of Debt-Servicing Capacity, 1988-95

	1988	1989	1990	1991	1992	1993	1994	1995
(In percent of GDP)								
External public debt	88	70	52	54	51	48	44	40
Of which: IMF	2	1	—	1	1	1	1	—
Of which: multilaterals <u>1/</u>	28	22	22	25	25	24	23	20
(In percent of exports of goods and nonfactor services)								
Debt service payments <u>2/</u>	48.4	39.2	41.0	<u>3/</u> 21.1	19.1	16.5	15.0	13.5
Of which: IMF	3.9	2.2	1.7	0.7	0.7	0.4	1.6	1.7
Of which: multilaterals <u>1/</u>	15.1	12.7	11.4	9.6	9.0	8.6	8.8	8.3
Outstanding Fund credit	4.4	1.9	0.6	4.2	3.9	3.6	2.1	0.4
(In units indicated)								
Outstanding Fund credit in percent of quota	63.1	32.0	9.6	78.4	80.1	80.1	51.1	11.6
Debt service obligations to the Fund in percent of net official reserves <u>4/</u>	21.8	15.1	-102.4	17.2	9.9	3.6	10.0	8.9
<u>Memorandum items</u>	Debt service obligations to the Fund (US\$ millions)			(In percent of exports of goods and nonfactor services)				
1994	45.5			1.6				
1995	54.6			1.7				
1996	17.1			0.5				
1997 <u>5/</u>	3.5			0.1				

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

1/ Includes mainly IMF, IBRD, IDB, and BCIE.

2/ Accrual basis, before possible future rescheduling. IMF comprises purchases under the stand-by arrangement and compensatory financing.

3/ Includes upfront payments associated with the financing package with commercial banks.

4/ Reserves are adjusted in 1988-89 to be on a comparable basis with the later years when reserves reflect the effects of the financing package with commercial banks on reserve liabilities. At the end of 1990 net official reserves were negative.

5/ After a repurchase of US\$0.4 million in the first quarter of 1997, outstanding debt to the Fund goes to zero.

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 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/ Short- fall 2/
	1988	1989	1990	1991	1992	
				Proj. 1/		
<u>Oil import costs</u>	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
<u>Merchandise exports</u>	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
<u>Net compensable amount</u>				54.8		
<u>Excess in import costs</u>				27.9		
<u>Shortfall in exports</u>				26.9		
<u>Proposed purchase</u>			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).

The volume of petroleum imports, which increased in the range of 8-9 percent per annum during 1988-89, remained unchanged in 1990 (Table 11). In contrast to 1988-89, when stocks remained virtually unchanged, in 1990 stocks were rundown partly because of refinery interruptions and expectations of a decline in world prices. Owing to movements in international prices, average petroleum import unit values displayed considerably more volatility. Compared with a decline of 16 percent in 1988 and an increase of 25 percent in 1989, average petroleum import unit values increased further by 23 percent in 1990, largely because of the sharp increase in international prices following the outbreak of the Middle East crisis. 1/

The volume of petroleum imports are expected to increase by 8 percent in 1991 and 3 percent in 1992, in line with forecasts of economic activity, some rebuilding of stocks, and measures taken to encourage energy conservation. These moderate rates of increase, combined with projections of a decline in import prices of 24 percent in 1991 and a further 9 percent in 1992 in line with the latest staff forecasts, would lead to progressive declines in the petroleum import bill. With a return to normalcy in domestic refining activities, the share of crude oil in total real imports is expected to recover to nearly two thirds.

3. Causes of the export shortfall

The calculated export shortfall is attributable principally to a shortfall in coffee exports. Excesses were registered for bananas and nontraditional exports. 2/ A more detailed analysis of the developments underlying the export shortfall is found in Appendix VII.

The weak performance of exports in 1990 was largely due to factors beyond the member's control. Exports of coffee declined by 24 percent, entirely on account of a decline in unit values, following the suspension of the International Coffee Agreement in mid-1989. After a sharp increase in banana exports in 1989, mainly on account of volume increases, exports rose in 1990 by just 8 percent in a climate of flat international prices. In addition, climatic difficulties constrained production. Costa Rica's minor traditional exports moved in opposite directions. Meat exports declined by 17 percent, largely because of an easing in world market prices, intense competition from other meat producing countries, marketing difficulties, and a rebuilding of herds. Sugar exports doubled, as domestic production of alcohol declined with the increase in international prices for sugar. Nontraditional exports,

1/ These fluctuations in import unit values are broadly in line with the movements of the simple average of spot prices for three benchmark crudes (U.K. Brent, Alaska North Slope, and Dubai), which in SDR terms declined by 23 percent in 1988, increased by 27 percent in 1989, and increased further by 21 percent in 1990.

2/ It may be noted that the sum of the five-year geometric averages of export components do not add up to the five-year geometric average of the sum of export components.

Table 11. Costa Rica: Crude Petroleum and Products Imports, 1989-93

	Years Ending December								Arithmetic Excess in 1991	
	1985	1986	1987	1988	1989	1990	1991	1992	Amount	Percent of Quota
I. Calculation of excesses										
	(In millions of SDRs)									
Total	163.7	86.9	94.0	85.4	114.9	141.3	116.2	109.0	27.9	33.2
Crude petroleum	86.5	58.1	64.5	51.3	68.3	49.1	74.3	70.3	-13.6	-16.1
Petroleum products	77.2	28.8	29.5	34.1	46.6	92.2	41.9	38.7	41.5	49.3
Diesel	43.7	18.2	19.6	20.7	25.3	46.6				
Gasoline	22.9	6.0	7.6	10.9	17.0	29.6				
Aviation fuel	2.6	1.1	0.5	0.8	2.4	6.8				
Asphalt	1.7	1.7	0.4	...	...	0.5				
Other products	6.3	1.9	1.5	1.6	1.9	8.7				
	(Percentage change)									
Total		-47	8	-9	35	23	-18	-6		
Crude petroleum		-33	11	-20	33	-28	51	-5		
Petroleum products		-63	2	16	37	98	-55	-8		
Diesel		-58	8	6	22	84				
Gasoline		-74	27	44	56	74				
Aviation fuel		-57	-51	51	190	186				
Asphalt		2	-77	...	...	...	
Other products		-70	-22	11	17	352				
II. Movement in volume and unit values										
	(Indices: excess year=100)									
Value	116	62	67	60	81	100	82	77		
Crude petroleum	176	118	131	104	139	100	151	143		
Petroleum products	84	31	32	37	51	100	45	42		
Diesel	94	9	42	44	54	100				
Gasoline	77	20	26	37	57	100				
Aviation fuel	38	16	8	12	35	100				
Asphalt	65	371	84	...	...	100				
Other products	73	22	17	19	22	100				
Volume	74	86	85	93	100	100	108	111		
Crude petroleum	102	153	151	150	158	100	185	191		
Petroleum products	56	41	41	53	60	100	55	56		
Diesel	62	51	53	63	65	100				
Gasoline	54	31	37	59	72	100				
Aviation fuel	24	22	11	15	43	100				
Asphalt	153	357	80	...	...	100				
Other products	44	18	19	25	28	100				
Unit values	156	71	77	65	81	100	76	69		
Crude petroleum	173	78	87	70	88	100	82	75		
Petroleum products	151	77	77	69	84	100	83	75		
Diesel	152	77	79	70	83	100				
Gasoline	143	66	69	62	79	100				
Aviation fuel	157	74	70	81	81	100				
Asphalt	238	104	105	...	...	100				
Other products	166	117	91	76	79	100				

Sources: Data provided by the authorities of Costa Rica.

which consist mainly of other agricultural products, seafood, value-added from assembly activities, and light manufactures registered no growth in 1990 after two years of rapid increases. This stagnation owed mainly to weakening demand in major industrial trading partners, particularly the United States.

4. Energy policies

Costa Rica's electricity needs are met mainly from hydroelectric sources but most other energy requirements are met from imported oil. Electricity is also generated in thermal plants that operate at peak demand times. The Costa Rican Government has at various times contracted with foreign companies for exploration of the continental shelf, but oil has not been found in commercial quantities so far. The Government has undertaken studies on the production of gasohol but the project cannot be justified financially at current oil prices.

From 1982 through 1988, the Costa Rican Government generally followed a policy of maintaining domestic energy prices above those prevailing in international markets, although at times price adjustments were not made on a timely basis. As a condition of SAL II the Government was required to adopt a pricing policy that would narrow the gap between domestic prices of petroleum products and international levels while still generating a small overall surplus for the state oil company (RECOPE). The reason for this policy was that it was felt that the then prevailing domestic prices for petroleum derivatives were hurting the competitiveness of Costa Rican exports. However, during 1989 and 1990 the previous administration did not adjust domestic prices of oil products in line with exchange rate movements and increase in domestic costs, allowing these prices to decline in real terms.

In June 1990 the new Government increased petroleum product prices by 20-32 percent, to correct for previous delays in adjusting domestic prices of these products. In the period August-December the Government increased prices by an additional 40 percent, but this increase failed to reflect fully the increase in international crude prices. As a result, government tax receipts from this source declined. In August 1990 the Government adopted a pricing formula for all petroleum product prices that implied full pass-through of import oil costs increases. The electricity company, which uses petroleum products in its thermal plants, also bills clients separately for the use of petroleum derivatives so as to be able to pass on fully the costs of imported oil.

In January 1991, as part of the tax package adopted by the Government, the sales tax was broadened to include petroleum products and electricity. The current sales tax rate is 13 percent but will be lowered by 1 percentage point a year starting in 1992 until it reaches 10 percent. As of late February the price of a U.S. gallon of regular gasoline stood at US\$1.74 and the price for diesel, widely used in

agriculture and public transportation, was US\$1.37 per U.S. gallon. In addition to an aggressive pricing policy, the Government has also introduced a daylight saving system to reduce energy consumption.

5. Cooperation with the Fund

During the 1980s Costa Rica had several programs supported by the Fund, the last two of which (in 1988-89) went off track because of policy slippages, particularly in the area of fiscal policy. In the 1988 program, after a somewhat satisfactory performance in the first half of the year, central government expenditure rose rapidly in the second semester and the year-end limit for the combined public sector deficit was missed by the equivalent of about 3/4 percent of GDP. The larger fiscal deficit combined with shortfalls in net foreign loans resulted in a deviation in domestic credit to the public sector equivalent to 1 1/2 percent of GDP. In the balance of payments field, the December target for the reduction of payments arrears was not realized, and even after adjusting for shortfalls in external financing the year-end target for net international reserves was missed by about 1 percent of GDP.

Under the 1989 program, real GDP grew by 5 1/2 percent, nontraditional exports continued to expand strongly, and inflation was more than halved, albeit, partly as a result of the postponement of adjustments to public sector prices. However, mainly because of expenditure overruns (of about 2 percent of GDP), the combined public sector deficit rose by 2 percentage points of GDP, instead of declining by 1 percentage point of GDP as envisaged in the program, and the ceiling on net domestic financing of the public sector was exceeded by a wide margin. Also, the balance of payments outturn was much weaker than expected in the program (an external account deficit of 8.8 percent of GDP as against a program projection of 4.9 percent of GDP) and arrears were accumulated on commitments under the 1989 Paris Club agreement. Costa Rica elected not to make the purchase available upon Board approval of the stand-by arrangement and was not eligible for subsequent purchases because of deviations from performance criteria and the noncompletion of the program review.

In the light of this background, the staff believes that Costa Rica's record of cooperation falls under paragraph 49(d)(ii).

Soon after it assumed office in mid-1990, the current Administration began discussions with the staff on an economic program. These discussions, which lasted over six months, have culminated in the formulation of the program which is being proposed as the basis for the stand-by arrangement.

VIII. Staff Appraisal

Costa Rica's last two economic programs supported by Fund stand-by arrangements (1988-89) experienced difficulties mainly because of fiscal policy slippages. Under the 1989 program, real GDP increased by 5 1/2 percent, the rate of price increase was more than halved to 10 percent during the year, and nontraditional exports expanded rapidly. However, the overall fiscal deficit rose significantly instead of declining as had been envisaged and the balance of payments came under strong pressure. In the absence of strong corrective measures, there was a sizable loss of net international reserves in the first half of 1990, including rising external arrears. During the program period Costa Rica completed a debt-reduction package with the commercial banks, but given the shortcomings in policies, the Fund was not in a position to give financial support to the package.

A new Administration took office in May 1990, and soon after began to take measures to correct imbalances and stem the reserve loss. During the second half of 1990 the authorities raised taxes, made corrective adjustments to petroleum product prices and public utility tariffs, tightened credit, and more than doubled the monthly rate of depreciation of the colon. The combined public sector deficit was halved from the first to the second half of 1990, but there continued to be heavy reliance on domestic credit as the rise of external financing slackened. Moreover, there was a weakening in the demand for money. In all, the international reserves continued to decline, albeit at a slower pace than earlier in the year, and the 12-month rate of price increase picked up to 27 percent at the end of 1990.

Building on the measures taken in the second half of 1990, the Government has recently adopted an economic program for 1991 which aims at lowering inflation by more than one half and sharply reducing the external current account deficit with a view to facilitating a reconstitution of the net international reserve position of the Central Bank.

A key feature of the economic program is the reduction in the combined public sector deficit from more than 5 percent of GDP in 1990, and an estimated 3 1/2 percent in the second half of the year, to 1/2 of 1 percent of GDP in 1991. To this end, taxes have been raised, public sector employment is being reduced, wage increases are to be restrained, and government transfers and export subsidies are being cut back. Experience has shown the extreme difficulty of staying the course in these areas, and given the central role of fiscal adjustment the Government will need to avoid actions that weaken the program and to act quickly to correct any deviations that may emerge. Some of the tax measures introduced in 1991 are temporary and to ensure that the present efforts lead to a lasting solution of the fiscal problem, the Government will need to pursue forcefully the structural reforms now being discussed with the World Bank, including the public sector reform and the

overhaul of the government administered pension schemes. The abolition of the system of court-ordered wage awards and the development of a framework for a restrained wage policy in the public sector also are essential.

Consistent with the inflation and balance of payments objectives of the authorities, the monetary program provides for a tight overall credit policy. However, with the expected reduction in the net domestic indebtedness of the nonfinancial public sector, there is room for an increase in bank credit to the private sector in line with the projected growth of nominal GDP. Under a system of free determination of interest rates, rising inflation and the growing credit needs of the public sector have led to higher interest rates, giving rise to pressures for official intervention to lower them. These pressures must be resisted because such action could be detrimental from the viewpoint of both stabilization and resource allocation. A lasting decline in interest rates can be expected only as the public sector deficit is reduced and inflation subsides.

The present exchange rate policy is geared toward maintaining export competitiveness, taking into account the need to compensate for the recent deterioration in the terms of trade, the continuing lowering of import tariffs, and the reduction in export subsidies. The authorities have opted to pursue this objective within the existing system of mini-devaluations, and the staff accepts their judgment that the system provides the best chance of achieving the necessary wage restraint. The authorities have indicated their intention to keep exchange rate policy under review in the light of balance of payments and wage developments.

A significant strengthening of the balance of payments is expected in 1991 with a resumption of growth of nontraditional export and compression of non-oil imports. The staff is of the view that this improvement will be attained through the vigorous pursuit of the financial, exchange rate, and wage policies envisaged in the program. Costa Rica's debt-reduction agreement with the commercial banks has facilitated the attainment of medium-term balance of payments viability. However, achievement of this goal will require continued implementation of sound economic policies.

In view of the projected strengthening in its balance of payments and Costa Rica's past payments performance to the Fund (to whom it has always accorded preferred creditor status), Costa Rica could be expected to meet its obligations to the Fund in a timely manner in the future. The staff notes the delays that several creditors have experienced in receiving payment from Costa Rica and urge the authorities to make debt-service payments promptly.

The authorities have requested compensatory financing in an amount of SDR 33.64 million in respect of an excess in oil import costs and an export shortfall under the compensatory and contingency financing facility (CCFF). This amount (equivalent to 40 percent of Costa Rica's

quota) would be available upon Executive Board approval of the request. Costa Rica's compensatory request meets all the relevant requirements set forth in the CCFE Decision. The staff is satisfied that the excess in oil import costs and the shortfall in exports are largely due to circumstances beyond the control of the member and is temporary in character and that the requirements with respect to energy policy under paragraph 49(g) of the CCFE Decision are met. Against the background of Costa Rica's record of performance under the last two stand-by arrangements, and in the light of the policies described in the authorities' letter of intent in support of which an upper credit tranche arrangement is requested, the staff believes that Costa Rica has fulfilled the requirement of cooperation under paragraph 49(d)(ii).

The adjustment program that the authorities have adopted is ambitious, but the objectives are achievable if the policies are implemented resolutely. To reduce the risks of policy slippage, the program contained strong prior actions and include indicative targets for the first quarter. The program incorporates an external contingency mechanism which will help sustain the adjustment effort in the face of adverse shocks. However, the authorities must be prepared to take additional measures as needed to ensure that the program remains on track.

In the light of the measures already adopted and the commitments for further policy action, the staff believes that the authorities' program justifies the support of the Fund and proposes that the requests for a stand-by arrangement and compensatory financing be approved.

Costa Rica retains restrictions on the making of payments and transfers for current international transactions and multiple currency practices as described in III-6 of this report. Given the temporary nature of Costa Rica's multiple currency practices, and the authorities' program for the reduction and eventual elimination of the restrictions, including those evidenced by external payments arrears, the staff recommend approval of Costa Rica's exchange restrictions and multiple currency practices until a review under the stand-by arrangement or July 15, 1991, whichever is earlier.

It is proposed that the next Article IV consultation be held on the regular 12-month cycle.

IX. Proposed Decisions

Accordingly, the following decisions are proposed for adoption by the Executive Board:

A. 1990 Consultation

1. The Fund takes this decision relating to Costa Rica's exchange measures subject to Article VIII, Sections 2(a) and 3, in the light of the 1990 Article IV consultation with Costa Rica conducted under Decision No. 5392-(77/63), adopted April 29, 1977, as amended (Surveillance over Exchange Rate Policies).
2. Costa Rica maintains restrictions on payments and transfers for current international transactions as evidenced by external payments arrears by public enterprises to official creditors and undue delays in the approval of applications for foreign exchange purchases for certain current payments, and engages in multiple currency practices for certain current payments as described in EBS/91/40. The Fund notes the temporary nature of the multiple currency practices and the authorities' program to reduce and eventually eliminate the above restrictions, and grants approval of the retention by Costa Rica of the restrictions on the making of payments and transfers for current international transactions and of the multiple currency practices until a review under the stand-by arrangement or July 15, 1991, whichever is earlier.

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 Annex I to 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 Annex:

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.

Fund Relations with Costa Rica
(as of January 31, 1991)

I. Membership Status

- (a) Date of Membership: January 8, 1946
(b) Status: Article VIII

(A) Financial Relations

II. General Department

- (a) Quota: SDR 84.1 million

	<u>Millions of SDRs</u>	<u>Percent of Quota</u>
(b) Total Fund holdings of colones:	92.1	109.5
(c) Fund credit: Total	7.94	9.4
Of which: EAR	7.00	8.3
Extended facility	0.94	1.1
(d) Reserve tranche position:	--	--

III. Recent Stand-By or Extended Arrangements and Special Facilities

- (a) Stand-by and extended arrangements:

<u>Type of Arrangement</u>	<u>Amount (SDR million)</u>	<u>Percent of Quota</u>	<u>Duration</u>	<u>Amount Drawn (SDR million)</u>	<u>Status</u>
SBA	42.00	50.0	5/23/89-		
			5/22/90	--	Expired
SBA	40.00	47.6	10/28/87-	--	Expired
			3/31/89		
SBA	54.00	64.2	3/13/85-	34.0	Expired
			4/30/86		
SBA	92.25	150.0	12/82-12/83	92.25	Expired
EFF	276.75	450.0	6/81-5/84	22.5	Canceled Dec. 1982
SBA	60.50	147.6	3/80-2/82	15.4	Canceled June 1981

(b) Special facilities:
Compensatory financing.

<u>Date of Approval</u>	<u>Amount Drawn</u>	
	<u>SDR Million</u>	<u>Percent of Quota</u>
Sept. 1983	18.60	30.2
June 1981	30.10	48.9

<u>IV. SDR Department</u>	<u>Millions of SDRs</u>	<u>Percent of Allocation</u>
(a) Net cumulative allocation:	23.73	100.0
(b) Holdings:	0.7	2.9
(c) Current designation plan:	--	--

V. Administered Accounts: None.

VI. Financial Obligations Due to the Fund (millions of SDRs)

As shown in the attached table:

(B) Nonfinancial Relations

VII. Exchange Arrangements: The representative exchange rate for the Costa Rican colon is the unified banking rate which was quoted at ₡ 108.30 (selling) per U.S. dollar as of January 31, 1991. All transactions take place at this rate except for remittances to students registered with the Central Bank prior to 1981, to whom foreign exchange is sold at the official rate of ₡ 20.00 per U.S. dollar; this special exchange rate gives rise to a multiple currency practice under Article VIII, Section 3.

Costa Rica also engages in a multiple currency practice related to delays in settling foreign exchange requests and corresponding import deposits requirements. Costa Rica maintains restrictions on payments and transfers for current international transactions as evidenced by certain external payments arrears, undue delays in the approval of applications for foreign exchange purchases for certain current payments and advance deposit requirements for certain current payments.

VIII. Last Article IV Consultation: Consultation discussions were held in January-February 1989 and the consultation was concluded the Executive Board on May 23, 1989 (EBM/89/62). Consultations are conducted on a 12-month cycle.

IX. Technical Assistance:

(a) CBD: A staff mission reviewed the Central Bank and financial sector legislation in February 1986. From April to November 1986 an advisor was assigned to the Central Bank in the area of organization and methods. From April 1986 to March 1989 an advisor assisted the Central Bank in the area of accounting procedures. A panel expert was assigned to the Central Bank in September 1986 as an advisor on external debt management. In November 1986 a CBD mission visited San Jose to advise the authorities on procedures and techniques used in the formulation of monetary policy. In September 1990 a panel expert was assigned to the Central Bank as research advisor to help the Bank improve its programming and policy capabilities.

(b) Bureau of Statistics: In September 1987 Costa Rica was included in a technical assistance mission on the five countries of the Central American Monetary Council (CMAC) to promote methodological consistency in the preparation and formulation of monetary and financial accounts. Follow-up missions took place in September 1988 and January 1989. In October 1988 a mission visited San Jose to discuss improvements in procedures and coverage of data on international banking and external debt transactions. In January 1989 a mission visited the five countries of the CMAC to investigate the availability of balance of payments data on a quarterly basis.

(c) FAD: A Fund team visited Costa Rica in March-April 1990 to survey the tax system. An aide memoire describing recommended changes in the structure of the tax system and its administration was left with the authorities.

X. Resident Representative/Advisor: Mr. Ignacio Tampe has been the Fund's resident representative in San Jose since January 1988.

Projected Payments to the Fund (in SDR millions) for COSTA RICA
As at February 28, 1991

	Overdue	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	Beyond	Total
A. Obligations from Existing Drawings													
1. Principal													
a. Repurchases	-	5.2	2.8	-	-	-	-	-	-	-	-	-	7.9
b. ESAF/SAF Repayments	-	-	-	-	-	-	-	-	-	-	-	-	-
c. TF Obligations	-	-	-	-	-	-	-	-	-	-	-	-	-
2. Charges and Interest 1/													
a. Total	-	1.7	2.2	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9	.5	19.8
Total Obligations 2/	-	6.9	4.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9	.5	27.8
(percent of quota)	-	8.2	5.9	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	.6	33.0
B. Obligations from Prospective Drawings													
1. Principal													
a. Repurchases	-	-	-	-	14.3	33.1	19.3	5	-	-	-	-	67.3
b. ESAF/SAF Repayments	-	-	-	-	-	-	-	-	-	-	-	-	-
c. TF Obligations	-	-	-	-	-	-	-	-	-	-	-	-	-
2. Charges and Interest 1/													
a. Total	-	2.6	5.6	5.7	5.5	3.3	7	0	-	-	-	-	23.5
Total Obligations	-	2.6	5.6	5.7	19.8	36.5	20.0	5	-	-	-	-	90.8
(percent of quota)	-	3.1	6.6	6.8	23.6	43.4	23.8	.6	-	-	-	-	108.0
C. Cumulative (Existing and Prospective)													
1. Principal													
a. Repurchases	-	5.2	2.8	-	14.3	33.1	19.3	5	-	-	-	-	75.2
b. ESAF/SAF Repayments	-	-	-	-	-	-	-	-	-	-	-	-	-
c. TF Obligations	-	-	-	-	-	-	-	-	-	-	-	-	-
2. Charges and Interest 1/													
a. Total	-	4.4	7.8	7.7	7.4	5.3	2.6	1.9	1.9	1.9	1.9	.5	43.3
Total Obligations 2/	-	9.6	10.5	7.7	21.8	38.4	22.0	2.4	1.9	1.9	1.9	.5	118.6
(percent of quota)	-	11.4	12.5	9.1	25.9	45.7	26.1	2.9	2.3	2.3	2.3	.6	141.0

- 1/ Projections are based on current rates of charge, including burden-sharing charges where applicable, for purchases in the GRA, and on current interest rates for SAF, ESAF and Trust Fund. The current SDR interest rate is assumed for net use of SDRs.
2/ Overdue obligations (if applicable) will be settled in full at close of business March 1, 1991

Relations with the World Bank Group

Costa Rica has received to date 33 Bank loans, 1 IDA credit, and financing through IFC of 6 investment projects, totaling US\$674.9 million (see table below). Of this amount, US\$140.6 million remains to be disbursed.

Prior to 1981, World Bank lending to Costa Rica was concentrated primarily on developing basic infrastructure. In the early 1980s, the Bank's strategy regarding Costa Rica was redesigned to encourage long-term structural changes needed to restore dynamism to the economy, while also assisting the more directly productive sectors. In this context, the Bank's approach supports three key goals: (a) revamping the incentive framework to promote new sources of growth in the economy, with particular emphasis on developing exports to new markets outside the region; (b) improving public sector efficiency and resource use to increase the availability of resources for productive investments; and (c) strengthening Costa Rica's creditworthiness.

As a first phase of this effort, an Export Development Loan was approved in May 1983, which was fully disbursed by mid-1985. This operation was followed by a Structural Adjustment Loan (SAL) of US\$80 million, that was approved in April 1985 and disbursed by mid-1986. The SAL aimed at supporting the Government's structural adjustment program, with the objective of promoting renewed export-led growth, with particular emphasis on expanding nontraditional exports to markets outside Central America. The main areas covered by the first phase of the Government's medium-term program included: (a) trade reform geared to a lowering of effective protection; and (b) fiscal reform directed to a reduction of the size of the public sector and improvement in the efficiency of public sector institutions and programs. In the area of trade policy, Costa Rica took initiatives for the reform of the regional tariff regime of the Central American Common Market. These initiatives included tariff reductions, a shift of specific tariffs to an ad valorem basis, introduction of a modern nomenclature, and reduction of import surcharges. Regarding public sector management, the program aimed at limiting the growth of the public sector, including curtailing certain public sector investments, reducing public sector employment, and initiating actions to improve the cost effectiveness of certain loss-making institutions.

More recently, in October 1986 the Bank approved a US\$26 million loan for the Atlantic Agriculture Development Project which aims at expanding agricultural exports. The loan was signed in April 1987 and approved by the Legislative Assembly in February 1988.

The Costa Rican authorities have reached agreement with the World Bank on a second structural adjustment program to be supported by a US\$100 million SAL which came into effect in November 1989. The first tranche of SAL II (US\$40 million) was disbursed shortly thereafter. The main components of the program include: (i) trade reform, including the

further reduction of import tariffs and reform of the export incentive system; (ii) banking reform; (iii) management of the public sector and public savings targets; and (iv) measures to increase efficiency in the production and import of basic grains. The loan is being cofinanced by Japan's OECF with US\$100 million.

The following tabulation describes Costa Rica's financial relations with the World Bank group.

(In millions of U.S. dollars, as of December 31, 1990)

A. IBRD/IDA/IFS Operations

	<u>Number of Credits</u>	<u>Disbursed to Date</u>	<u>Undisbursed</u>	<u>Total</u>	<u>Repaid</u>
1. <u>IBRD loans</u>	<u>33</u>	<u>534.3</u>	<u>140.6</u>	<u>674.9</u>	<u>255.1</u>
Agriculture	4	35.3	20.4	55.7	25.0
Education	1	6.0	--	6.0	1.3
Export	1	25.2	--	25.2	6.8
Imports	2	6.5	--	6.5	6.5
Industry	3	19.9	--	19.9	14.1
Power	7	126.9	--	126.9	83.0
Technical assistance	1	3.4	0.1	3.5	0.3
Telecommunications	4	57.9	--	57.9	43.9
Transport	7	107.3	60.0	167.3	53.5
Water supply	1	26.0	--	26.0	14.1
SAL	2	119.9	60.1	180.0	6.6
2. <u>IDA credit</u>	<u>1</u>	<u>5.5</u>	<u>--</u>	<u>5.5</u>	<u>2.0</u>
Transport	1	5.5	--	5.5	2.0
3. <u>IFC investments</u>	<u>6</u>	<u>8.2</u>	<u>--</u>	<u>8.2</u>	<u>...</u>

B. IBRD Loan Transactions 1/

	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>1991</u> 2/
<u>Net disbursements</u>	<u>62.4</u>	<u>31.0</u>	<u>-18.0</u>	<u>-27.5</u>	<u>-29.6</u>	<u>1.0</u>	<u>-18.6</u>
Gross							
Disbursements	84.1	55.2	13.6	6.6	4.6	42.0	2.9
Principal							
Repayments	-21.7	-24.2	-31.6	34.1	34.2	41.0	21.5

Source: IBRD.

1/ Data are for fiscal years which end on June 30.

2/ First half of fiscal year only (July 1-December 31, 1990).

Costa Rica--Statistical Issues

1. Outstanding statistical issues

a. Real sector

The weights of the consumer price index (base 1975) and the whole-sale price index (base 1978) are outdated. The authorities plan to introduce a new CPI sometime in 1991 based on the results of the 1987 household survey on income and expenditure. A new WPI would also be introduced in 1991 with 1990 as the base year.

b. Government finance

While the annual data in IFS cover consolidated central government operations, monthly and quarterly data in IFS include neither social security nor extrabudgetary transactions.

c. Monetary accounts

The Costa Rican authorities are presently engaged in a program aimed at the modernization of the accounting systems of the financial institutions. The new accounting system for the Central Bank was introduced in January 1990.

2. Coverage, currentness, and reporting of data in IFS

The table below shows the currentness and coverage of data published in the country page for Costa Rica in the March 1991 issue of IFS. The data are based on reports sent to the Fund's Bureau of Statistics by the Central Bank of Costa Rica which, during the past year, have been provided on a timely basis.

Status of IFS Data

Sector	Series	Latest Data in March 1991 IFS
Real Sector	- National Accounts	1990
	- Prices: WPI	December 1990
	CPI	December 1990
Government Finance	- Deficit/Surplus	October 1990
	- Financing	October 1990
	- Debt: by currency	September 1990
	by residency of lender	1983
Monetary Accounts	- Monetary Authorities	June 1990
	- Deposit Money Banks	June 1990
	- Other Banking Institutions	June 1990
Interest Rates	- Discount Rate	October 1990
	- Bank Deposit/Lending Rates	October 1990
	- Bond Yields	n.a.
External Sector	- Merchandise Trade: Values Prices	October 1990
		September 1990
	- Balance of Payments	December 1989
	- International Reserves	January 1991 (partial data)
	- Exchange Rates	January 1991

Costa Rica: Summary Description of the Economic Program for 1991-92

1. Principal objectives and targets

a. To secure economic conditions conducive to a higher rate of growth, a sustainable balance of payments position, and a stable price environment. The program is designed to be consistent with real GDP growth of 3.5 percent in 1991 and 4 percent in 1992, a reduction of the rate of inflation from 27 percent during 1990 to around 12 percent during 1991 and to a range of 8-10 percent during 1992.

b. Net international reserves are targeted to increase by US\$333 million in 1991 with net official reserves rising by US\$120 million and arrears being reduced by US\$213 million. Gross liquid reserves are programmed to increase by US\$148 million in 1991.

1. Instruments of the economic program

a. Fiscal policy

(i) The combined public sector deficit (including central bank losses) is programmed to decline from 5.1 percent of GDP in 1990 (3.5 percent of GDP in the second half of the year) to 0.5 percent of GDP in 1991, with most of the improvement occurring in the nonfinancial public sector.

(ii) The deficit of the Central Government would decline from 4.3 percent of GDP in 1990 to 2.0 percent in 1991 with the improvement coming from an increase in the coverage and rate of the sales tax, a temporary import surcharge, wage restraint, a cut in employment, and a reduction in transfers in relation to GDP.

(iii) In the rest of the nonfinancial public sector, the surplus would increase from 1.2 percent of GDP in 1990 to 3.3 percent of GDP in 1991, mainly as the result of increases in regulated prices for energy, public services, and basic grains. Nonpriority public sector investment expenditures will be postponed or eliminated.

b. Monetary policy

Credit ceilings for individual banks have been removed. Net domestic assets of the Central Bank is to be reduced substantially, consistent with the attainment of the balance of payments and inflation targets. The credit program leaves room for an increase in bank credit to the private sector of about 17 percent. Interest rate movements will continue to reflect market forces.

c. External sector policy

(i) The system of crawling peg adjustments will continue in 1991, geared toward maintaining external competitiveness.

(ii) The program of fiscal incentives for exports (CATs) has been modified so that for new contracts, the subsidy level would now be tied to domestic value added and decline over the length of the contract.

d. Structural policies

(i) Reductions in the dispersion and maximum level of import tariffs are to be continued.

(ii) A program of public sector reform involving the elimination of institutional duplication and the streamlining of several government agencies is to be initiated.

(iii) Government-administered pension schemes are to be overhauled through an increase in the retirement age, a reduction in the maximum pension, and an increase in the minimum number of contributions needed to qualify for a pension.

(iv) The ongoing divestment program will be broadened to cover state enterprises outside the state-owned development corporation (CODESA).

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

Scheduled Availability Date	Amount	Conditions Necessary for Purchase <u>1/</u>
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, 1991 and the related transactions completed on May 21, 1991.

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.

increase by an estimated average of US\$14 million per year beginning 1995 through 2005 because of the value recovery clause included in the agreement. 1/

As part of the package, Costa Rica has begun to implement a US\$100 million, five-year debt-equity conversion program with a minimum amount of US\$20 million in transfer value each year. Possible noncommercial conversions (such as debt for nature swaps) would be additional to these annual amounts.

The financing required for the entire package was US\$225 million: US\$159 million for the buyback, US\$29 million for the 20 percent down-payment on PDI, and US\$38 million for interest guarantees. These funds were obtained from the following sources:

<u>Total financing</u>	<u>US\$225.0 million</u>
External grants	43.0
USAID	(33.0)
Canada	(4.5)
The Netherlands	(5.5)
Medium-term loan (Taiwan Province of China)	40.0
Short-term loans	100.0
Mexico	(35.0)
Venezuela	(35.0)
BISCA <u>1/</u>	(30.0)
Use of official reserves	42.0

The short-term loans received from Mexico and Venezuela are expected to be amortized from proceeds of disbursements from the World Bank SAL-II and cofinancing from Japan.

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1/ See EBS/89/243, #?p. 3 for details of this provision.
1/ An off-shore affiliate of Costa Rica's National Bank.

Costa Rica: Developments in the Export Sector
Underlying the Export Shortfall

Coffee and bananas have traditionally composed a substantial share in Costa Rica's exports. These exports, along with fresh meat and sugar, have been subject to large fluctuations in volumes and unit values. Since 1986, Costa Rica has intensified its program of export diversification and achieved a large measure of success. Nontraditional exports, consisting mainly of other agricultural goods, seafood, processed agricultural products and light manufactures, have steadily grown, surpassing in 1989 the value of traditional exports (Appendix Table 1). As noted in Section VII above, an export shortfall of SDR 26.9 million has been calculated for 1990. 1/

While coffee has been replaced by bananas as the single most important export commodity of Costa Rica, coffee remains a major source of foreign exchange and provider of rural employment. Terrain and climate are highly suitable for coffee production and productivity in terms of yield is the highest in the world. Costa Rica has been a member of the successive International Coffee Agreements (ICA) and received an export quota of about 2.1/5 percent of the market of member countries when quotas have been in effect. Since early 1986, when international coffee prices began to follow a declining trend, Costa Rica has endeavored to sell to nonmember countries supplies in excess of its quota to member countries so as to limit inventory accumulation. 2/

The ICA quota system was suspended in July 1989, following disagreements on the distribution of quotas among exporting countries and on the discounts given to exports to nonmembers. As a result, world coffee prices dropped steeply. While all of Costa Rica's 1988/89 crop had been sold by then, realized export unit values for the whole of 1989 declined by 17 percent in SDR terms (Appendix Table 2). The brunt of the impact on Costa Rica of the steep decline in world prices was felt mainly in 1990, when coffee export unit values declined by 23 percent. In response, the Government reduced coffee export taxes to cushion its impact on exporters. Given the slow growth of world demand for coffee, the slow adjustment of supply to lower prices, and the low probability that the ICA quotas would be reintroduced shortly, unit values in 1991 and 1992 are expected to rise only moderately in the absence of large supply shocks. Export volumes are expected to record also moderate increases, as productivity growth and an appropriate exchange rate would continue to maintain the competitiveness of export sector. With the

1/ The values and unit values in this section are converted to SDR terms, which could change the size and sign of movements expressed in terms of U.S. dollars.

2/ Stocks at the close of the crop year (ending September 30) declined from 1.163 million 60-kilo bags in 1988/89 to 1.011 million bags in 1989/90. A further decline to 0.860 million bags is forecast for 1990/91.

resulting pattern of earnings, a shortfall in coffee earnings of SDR 28 million (33.3 percent of quota) is calculated for 1990. The shortfall for coffee exceeds the calculated shortfall for exports as a whole.

Exports of bananas, which have progressively grown in importance in recent years, composed about a fifth of total exports in 1990. Despite a generally declining trend in realized unit values, export volume has steadily increased on account of incentives, including lower export taxes. In 1989, export volume increased by 19 percent while unit values increased moderately. The fairly large increase in volume owed partly to favorable weather, an expansion into new markets, and supply disruptions in other fruit exporting countries (strikes by banana plantation workers in Honduras and Colombia and the temporary ban on Chilean fruit exports imposed by the United States, Japan, and Saudi Arabia in March 1989). In 1990, mainly on account of less favorable weather, the growth of Costa Rica's export volume decelerated to 9 percent, while unit values remained virtually unchanged. In the post-shortfall years, unit values are expected to ease somewhat, because of ample world export availability. A projected expansion of the area of cultivation about 1,000 hectares per annum is projected to lead to an increase in export volume of about 10 percent per annum on average. An export excess of SDR 19.5 million (23.2 percent of quota) is calculated for bananas.

Exports of fresh meat and sugar compose a relatively small part of total exports, about 6 percent in 1990. In recent years, exports of fresh meat, which are destined mainly to the United States, have followed a declining trend. Underlying this development was a steady decline in export volumes, reflecting intense competition from other meat producing countries and marketing difficulties. In 1990, in particular, the scarcity of beef in the local market led farmers to increase their herds, partly contributing to the further 12 percent decline in export volumes. It is projected that the volume of meat exports would begin increasing moderately from 1991 onwards, though in a climate of lower though broadly stable prices. A small shortfall of SDR 3 million is calculated for meat exports.

A major factor affecting Costa Rica's sugar exports has been the reductions in its quota to the United States market. ^{1/} Costa Rica has sought to offset these reductions by expanding exports in new markets, particularly the U.S.S.R, Trinidad and Tobago, and Nicaragua. In 1988 and 1989, the annual sugar export volume declined to about two thirds of the previous two years annual export volume, reflecting adverse weather and reductions in area of cultivation in favor of coffee and other products. In 1990, export volume nearly doubled to a level exceeding

^{1/} Costa Rica's sugar quota allocation was reduced from 2 percent of the total in 1984/85 (14 months ending November 1985) to 1.5 percent in 1990/91 (12 months ending September 1991). The implied absolute amounts declined from 57,653 metric tons in 1984/85 to 24,887 metric tons in 1990/91.

the 1986 and 1987 figures, as more favorable unit values led to a shift of sugar from alcohol production to exports. In 1991-92 export volume and unit value are projected to decline to a lower plateau. An excess of SDR 11 million is calculated for sugar.

During 1986-90 the value of nontraditional exports increased by 62 percent. In large part, this development owed to measures taken since 1986 towards export diversification. These measures included income tax relief on profits gained from nontraditional exports, exemptions from import duties on imports of raw materials and capital goods, tax credits, and the establishment of five free trade zones. Exports from the free trade zones rose from a negligible amount in 1985 to an estimated US\$90 million in 1990. Nontraditional exports have also been boosted by the Caribbean Basin Initiative under which only the value added of assembled exports (maquila) is subject to import duties in the United States. More recently, foreign investment in Costa Rica increased substantially under debt-equity conversion programs, further expanding the base for nontraditional exports.

After growing by an average of 24 percent per annum in 1988-89, the growth of nontraditional exports stagnated in 1990, reflecting mainly a slowdown in sales to industrial trading partners, particularly the United States. In 1990, negative rates of growth were registered for several important categories, including value-added in assembly activities (which composed nearly 10 percent of nontraditional exports), garments, fish, shrimps, pineapples, medicines, gold jewelry, furniture, tires, and handbags. This was offset by increases in the growth of ornamental plants and flowers and other nontraditional exports. Nontraditional exports are expected to increase at about 9 percent in 1991 and 13 percent in 1992; about two thirds of annual growth in these years would be accounted for by volume increases, mainly reflecting a projected recovery in demand from industrial trading partners. An excess of SDR 13 million is calculated for nontraditional exports.

Table 1. Costa Rica: Export Earnings, 1986-92 and Shortfalls of Major Commodities for Year Ending December 1990

	Year Ending December							Geometric Shortfall	
	1986	1987	1988	1989	1990	1991	1992	Unadjusted	Adjusted
(In million of SDRs)									
Total	924.6	855.6	878.5	1,032.0	1,001.1	1,068.7	1,183.5	26.9	26.9
Coffee	334.1	258.5	235.4	223.3	170.3	182.1	188.3	28.0	28.0
Bananas	184.8	176.8	164.5	211.0	228.2	241.7	271.3	-7.9	-19.5
Meat	59.4	48.3	41.4	38.1	31.5	30.6	31.2	2.8	2.8
Sugar	9.5	11.7	9.2	12.0	24.7	19.3	19.2	-8.8	-11.3
Nontraditional exports	336.9	360.4	428.0	547.6	546.5	594.8	673.6	5.6	-13.0
Fish	11.2	12.6	15.1	30.7	26.3				
Shrimp	13.7	10.1	13.2	9.4	4.7				
Ornamental plants, foliage and flowers	20.3	24.5	28.1	33.7	43.2				
Pineapples	12.7	16.7	23.2	31.0	27.7				
Medicines	20.2	18.7	16.3	19.3	18.1				
Bags	4.1	5.3	6.8	9.0	7.1				
Tires	7.4	8.5	8.8	10.3	8.1				
Garments	17.1	26.5	29.6	33.4	22.2				
Gold jewelry	3.6	5.7	8.5	18.2	8.4				
Furniture	4.1	4.7	4.9	11.2	9.7				
Value added from assembly plants	29.7	34.2	45.1	58.4	52.0				
Others	192.8	192.8	228.6	282.8	319.1				
(Percentage change)									
Total		-7	3	17	-3	7	11		
Coffee		-23	-9	-5	-24	7	3		
Bananas		-4	-7	28	8	6	12		
Meat		-19	-14	-8	-17	-3	2		
Sugar		23	-21	30	106	-22	-1		
Nontraditional exports		7	19	28	—	9	13		
Fish		13	20	103	-14				
Shrimp		-26	31	-29	-50				
Ornamental plants, foliage and flowers		21	15	20	28				
Pineapples		31	39	34	-11				
Medicines		-7	-13	18	-6				
Bags		29	28	32	-21				
Tires		15	4	17	-21				
Garments		55	12	13	-34				
Gold jewelry		58	49	114	-54				
Furniture		15	4	129	-13				
Value added from assembly plants		15	32	29	-11				
Others		—	19	24	13				
Memorandum items									
U.S. sugar quota allocation for Costa Rica (in metric tons)									
US\$/SDR 1		38,265 ^{1/}	19,680 ^{2/}	14,451 ^{3/}	28,433 ^{4/}	21,325 ^{5/}	24,887 ^{6/}	...	
		1.1732	1.2931	1.3439	1.2818	1.3567	1.4271	1.4367	

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

^{1/} December 1, 1985-December 31, 1986.^{2/} Calendar 1987.^{3/} Calendar 1988.^{4/} Twelve month's prorated value of the allocation of 49,758 metric tons for January 1, 1989 to September 30, 1990.^{5/} Nine month's prorated value of the allocation of 49,758 metric tons for January 1, 1989 to September 30, 1990.^{6/} October 1, 1990-September 30, 1991.

Table 2. Costa Rica: Export Value, Volume, and Unit Value
for Major Commodities, 1986-92
(1990=100)

(In terms of SDRs)									
(1990 = 100)									
		Value Share in Total Exports in 1991 (in percent)	1986	1987	1988	1989	1990	1991	1992
Year Ending December									
Value	100.0	92	85	88	103	100	107	118	
Coffee	17.0	196	152	138	131	100	107	111	
Bananas	22.8	81	77	72	92	100	106	119	
Meat	3.1	189	153	131	121	100	97	99	
Sugar	2.5	38	47	37	49	100	78	78	
Nontraditional exports	54.6	62	66	78	100	100	109	123	
Volume	73	80	84	99	100	106	114		
Coffee	69	101	88	96	100	103	103		
Bananas	69	72	77	92	100	109	120		
Meat	196	152	131	114	100	103	106		
Sugar	94	93	61	57	100	85	85		
Nontraditional exports	68	72	84	103	100	106	116		
Unit value	126	107	104	105	100	101	104		
Coffee	284	150	158	137	100	104	108		
Bananas	118	108	93	101	100	97	99		
Meat	96	101	100	106	100	95	94		
Sugar	41	51	61	86	100	92	91		
Nontraditional exports	90	91	93	97	100	103	106		
Memorandum item:									
US\$/SDR 1	1.1732	1.2931	1.3439	1.2818	1.3567	1.4271	1.4367		

Costa Rica: Stand-By Arrangement

Attached hereto is a letter with attached Memorandum on Economic Policy and annex on External Contingency Mechanism dated March 5, 1991 from the Minister of Finance and the Executive President of the Central Bank of Costa Rica, and attached Memorandum on Economic Policy, requesting:

(a) A stand-by arrangement, and setting forth (i) the objectives and policies that the authorities of Costa Rica intend to pursue for the period of this stand-by arrangement; and (ii) understandings of Costa Rica with the Fund regarding a review that will be made of the progress in realizing the objectives of the program and of the policies and measures that the authorities of Costa Rica will pursue for the remaining period of this stand-by arrangement; and

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

To support these objectives and policies, the International Monetary Fund grants this stand-by arrangement, subject to any decision adopted pursuant to paragraph 27 of Decision No. 8955-(88/126), adopted August 23, 1988, as amended, in accordance with the following provisions:

1. For a period of 12 months from April --, 1991, Costa Rica will have the right to make purchases from the Fund in an amount equivalent to SDR 33.64 million, subject to paragraphs 2, 3, 4, 5 and 6 below, without further review by the Fund.

2. (a) Purchases under this stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 21.64 million until August 15, 1991, the equivalent of SDR 25.64 million until November 15, 1991, the equivalent of SDR 29.64 million until February 15, 1992.

(b) None of the limits in (a) above shall apply to a purchase under this stand-by arrangement that would not increase the Fund's holdings of Costa Rica's currency in the credit tranches beyond 25 percent of quota.

3. Purchases under this stand-by arrangement shall be made from ordinary resources only.

4. Costa Rica will not make purchases under this stand-by arrangement that would increase the Fund's holdings of Costa Rica's currency in the credit tranches beyond 25 percent of quota:

(a) during any period in which

(i) the limit on cumulative central government expenditures described in paragraph 16 of the attached memorandum and its Table 1; or

(ii) the ceiling on the net domestic financing of the nonfinancial public sector described in paragraph 16 of the attached memorandum and its Table 2; or

(iii) the ceiling on the net domestic assets of the Central Bank described in paragraph 24 of the attached memorandum and its Table 3; or

(iv) the target for the stock of net international reserves of the Central Bank described in paragraph 24 of the attached memorandum and its Table 4; or

(v) the limit on the stock of external payments arrears described in paragraph 24 and 26 of the attached memorandum and its Table 5; or

(vi) the limits on new foreign borrowing by the public sector and its short-term borrowing described in paragraph 31 of the attached memorandum are not observed; or

(b) during any period after July 31, 1991, until the review referred to in paragraph 5 of the attached letter has been completed and appropriate understandings have been reached on suitable performance criteria for the subsequent period of the stand-by arrangement, or after such performance criteria have been established, while they are not being observed; or

(c) if Costa Rica

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

(ii) introduces or modifies multiple currency practices,
or

(iii) concludes bilateral payments agreements that 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 stand-by 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 will not make purchases under this stand-by arrangement during any period of the arrangement in which Costa Rica has an overdue financial obligation to the Fund or is failing to meet a repurchase expectation pursuant to the guidelines on Corrective Action in respect of a noncomplying purchase pursuant to Decision No. 9331-(89/167).

6. Costa Rica's right to engage in the transactions covered by this stand-by 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 6, 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.

7. Purchases under this stand-by 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.

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

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

(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 timing of the reduction.

10. During the period of the stand-by 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 5 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 in 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 arrangement and while Costa Rica has outstanding purchases in the upper credit tranches, 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.