FOR AGENDA

EBS/88/60

CONFIDENTIAL

March 15, 1988

To: Members of the Executive Board

From: The Secretary

Subject: Costa Rica - Staff Report for the 1987 Article IV Consultation and Review Under Stand-By Arrangement

Attached for consideration by the Executive Directors is the staff report for the 1987 Article IV consultation with Costa Rica and the first review under its stand-by arrangement, which is proposed to be brought to the agenda for discussion on Wednesday, April 6, 1988. Draft decisions appear on pages 25-27. It is expected that the Executive Director elected by Costa Rica will be requesting the Board for a waiver of the circulation period.

Mr. Tandeciarz (ext. 8501) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

COSTA RICA

Staff Report for the 1987 Article IV Consultation and Review Under Stand-By Arrangement

Prepared by the Western Hemisphere Department

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

Approved by S. T. Beza and Eduard Brau

March 14, 1988

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I. Introduction

The 1987 Article IV consultation discussions with Costa Rica were held in San José in the periods November 10-December 3, 1987 and January 20-February 6, 1988, and at Fund headquarters in the period December 14-16, 1987, in conjunction with the first program review under the current stand-by arrangement. The staff met with the Ministers of Finance, Agriculture, Economy, Foreign Trade, Labor, and Planning; the Executive President of the Central Bank; and senior officials from the ministries, the Central Bank, and other public institutions. The staff representatives were Ignacio C. Tandeciarz (Head), Lawrence DeMilner, Marcelo Figuerola (all WHD), Joris Buyse and Karnit Flug (both ETR), Jaime Vázquez (FAD), and Amelia de Lucio and Rosa María Orpin (Secretaries-WHD). The missions were assisted by Héctor Avila, the Fund resident representative in San José through end-1987 and by his successor, Ignacio Tampe. Mr. Ayales, Advisor to the Executive Director for Costa Rica, participated in the main policy discussions.

Costa Rica has accepted the obligations under Article VIII, Sections 2, 3, and 4. The 1986 Article IV consultation was completed on October 30, 1986 (EBM/86/174). A 17-month stand-by arrangement for SDR 50 million (equivalent to 42 percent of quota on an annual basis) was approved by the Executive Board on October 28, 1987. Costa Rica did not make the purchase that became available upon approval of the arrangement. The second purchase would have become available at the end of January 1988, upon observance of quantitative performance criteria as of end-December 1987 and completion of the present program review. However, certain end-1987 performance criteria were not observed and no purchase under the arrangement has been made to date.

In the attached letter, the Costa Rican authorities describe the measures that are being implemented to achieve the program objectives for 1988 and to correct for part of the deviation in the external accounts that took place in 1987. They also state that they will not request any purchase until a satisfactory track record can be established, and propose that total access under the arrangement be reduced from SDR 50 million to SDR 40 million; purchases are to be made in four equal quarterly installments starting in the second quarter of 1988 (Table 1). Conditions necessary for these purchases are described in Appendix V. The second program review, to assess the adequacy of the external financing in the context of the negotiations with commercial banks and the progress made in the implementation of program policies, is now expected to be completed by end-June 1988.

II. Background and Performance Under the Stand-by Arrangement

In the early 1980s, Costa Rica experienced a deep recession and serious balance of payments difficulties arising from a series of external shocks and shortcomings in domestic policies. Progress was

Table 1. Costa Rica: Position with the Fund During Period of Arrangement

	Outstanding Dec. 31, 1987	1988 Jan.-Mar.	1988 Apr.-June	1988 July-Sept.	1988 Oct.-Dec.	1989 Jan.-Mar.
	(In millions of SDRs)					
Transactions under tranche policies (net)		-7.8	-1.2	4.4	1.2	5.9
Purchases 1/		--	10.0	10.0	10.0	10.0
Repurchases		-7.8	-11.2	-5.6	-8.8	-4.1
Ordinary resources		-5.8	-7.4	-3.6	-3.5	-2.1
Enlarged access resources		-2.0	-3.8	-2.0	-5.3	-2.0
Transactions under special facilities (net) 2/		-2.3	-2.3	-2.3	--	--
Purchases		--	--	--	--	--
Repurchases		-2.3	-2.3	-2.3	--	--
Total Fund credit outstanding (end of period)	93.2	83.1	79.5	83.6	84.8	90.7
Under tranche policies 2/	86.2	78.4	77.2	83.6	84.8	90.7
Special facilities 3/	7.0	4.7	2.3	--	--	--
	(As percent of quota)					
Total Fund credit outstanding (end of period)	110.8	98.8	94.5	99.4	100.8	107.8
Under tranche policies 2/	102.5	93.2	91.8	99.4	100.8	107.8
Special facilities 3/	8.3	5.6	2.7	--	--	--

Source: IMF Treasurer's Department.

1/ From ordinary resources only.
2/ Includes outstanding use under EAR, SFF, and EFF.
3/ Includes compensatory financing facility.

made over the following years in reducing the deficit of the nonfinancial public sector, improving interest rate and exchange rate management, and slowing inflation. However, Costa Rica's economy continued to be affected by structural constraints that have hampered the expansion of output on a sustained basis. In addition, heavy foreign debt obligations have burdened the country's external position.

Against this background, the authorities adopted an economic program for 1987-88 aimed at strengthening the external accounts within a framework of financial stability. In support of their program, the authorities requested a stand-by arrangement from the Fund in April 1987 (EBS/87/91, 4/27/87). Consideration of the arrangement by the Executive Board was postponed because of delays in concluding a financial package with commercial banks that would ensure adequate financing. Moreover, some problems developed with the implementation of the proposed measures. *Ultimately, the stand-by arrangement was approved by the* Executive Board in October 1987 on the basis of an updated program while negotiations on a financing package with commercial banks were in progress. 1/

During the first half of 1987 fiscal performance was on track, but bank credit expansion to the private sector turned out to be much larger than projected in the original program, notwithstanding efforts by the monetary authorities to absorb commercial banks' excess liquidity. As a result, the 12-month rate of inflation rose to around 20 percent by mid-1987 from 15 percent at the end of 1986, and the net international reserves (including arrears) at the end of June 1987 were substantially lower than originally projected. The latter deviation reflected a surge in imports and a shortfall in disbursements of project loans.

In response to these developments, in the third quarter the authorities adopted a number of measures aimed at dampening credit expansion to the private sector, including increases in the discount rate and in the deposit requirement for purchases of foreign exchange. Nevertheless, projections that incorporated the effect of these measures still pointed to deviations from program targets in both the current and the capital accounts of the balance of payments for 1987 as a whole.

The program that was approved by the Executive Board at the end of October provided for additional measures to correct the prospective deviation in the external current account in relation to the objective set in the original program of April 1987. Specifically, the authorities undertook to step up the rate of depreciation of the colon, to reduce the nonfinancial public sector deficit in 1987 by nearly 1/2 percent of GDP beyond the decline envisaged in the original program, and to bring about a sizable net monetary contraction during the last quarter of the year. The prospective shortfall in capital inflows with respect

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1/ Both the original program and the adjusted program approved by the Executive Board are described in Costa Rica - Request for Stand-By Arrangement (EBS/87/91, Supplement 1; October 16, 1987).

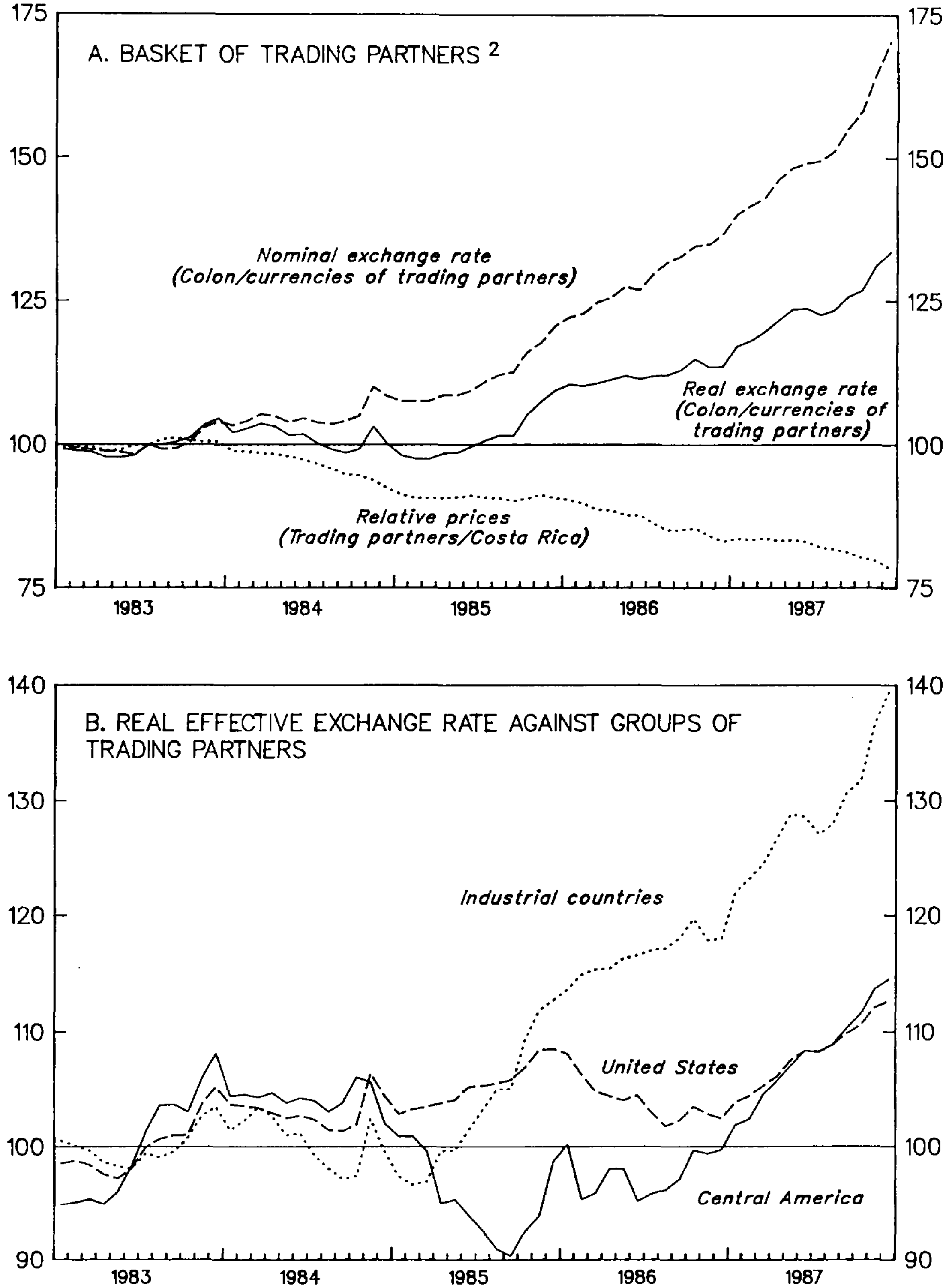
to the original program for 1987 was expected to be addressed through further adjustment measures in 1988, to the extent that in the first review of the program it was judged that the shortfall would not be made up within the program period.

In the event, the nominal depreciation of the colon was accelerated to an annual rate of about 30 percent during the last quarter of 1987, compared with 12 percent in the first half of the year and 17 percent in the third quarter. 1/ The public finances broadly performed along program guidelines, as the limit on the combined public sector deficit was observed, although the contraction in domestic borrowing requirements by the nonfinancial public sector was smaller than programmed because of the shortfall in disbursements of foreign loans (Table 2). This latter development, together with difficulties in private financial markets (explained below), resulted in slippages in the implementation of credit policy. Thus, the limit on the Central Bank's net domestic assets for end-1987 was exceeded and net international reserves fell short of the program target by about US$140 million. About one third of this deviation reflected a valuation adjustment in the Central Bank's position with the Fund (stemming from the appreciation of the SDR vis-a-vis the U.S. dollar) and revisions in the end-1986 data on external payments arrears.

As regards economic activity, in 1987 real GDP rose by 3 percent, down from an average rate of growth of 4 percent a year during 1983-86 (Table 3). By 1987 total output was 9 1/2 percent above the pre-recession level (1980), but on a per capita basis it was almost 10 percent lower. While the ratio of investment to GDP in 1987 remained at about the 21 percent observed in 1983-86, private consumption grew rapidly as it was boosted by personal income gains stemming from increased revenues from coffee exports in late 1986. Strong consumer demand contributed to an acceleration in the growth of imports and the rate of inflation in the first half of the 1987. In the latter part of the year the rate of inflation abated somewhat and, for the full year, the 16 percent rise in prices was only marginally faster than that experienced during 1986. On the basis of preliminary information, it appears that the strong recovery in real wages that began in 1983 was arrested in 1987.

1/ This brought the real effective depreciation of the colon since mid-1985--when Costa Rica embarked on a more active exchange rate policy under a crawling peg regime--to nearly 40 percent measured in terms of wholesale prices, with about one third of this depreciation reflecting the decline of the U.S. dollar against other major currencies (Chart 1). Measured in terms of consumer prices, the real effective depreciation of the colon over the same period was 22 percent. However, since 1980 both measures indicate a roughly similar real effective depreciation (on the order of 40 percent).

CHART 1
COSTA RICA
EFFECTIVE EXCHANGE RATES [1]



Sources: IMF, *International Financial Statistics;* and Fund staff estimates.

[1] 1983=100. Calculated on the basis of Costa Rica's wholesale price index. An increase (decrease) in the index indicates depreciation (appreciation) of the colon.

[2] 1980 trade weights excluding oil and Nicaragua.

Table 2. Costa Rica: Performance Under Stand-By Arrangement

(End 1987, unless otherwise specified)

	Program	Actual
(In millions of U.S. dollars)		
Net international reserve position	-170	-310
Stock of external payments arrears	200	268
Foreign indebtedness of the public sector		
Short-term debt outstanding	--	--
New commitments with maturities of up to 12 years	60	8
(In millions of colones)		
Cumulative central government expenditure (January-December)	49,755	50,347
Net domestic assets of the Central Bank	30,000	39,000
Net credit from the banking system to the nonfinancial public sector	36,480 1/	38,084

1/ Adjusted for revisions in end-1986 data and for departures from the assumed composition of domestic financing.

The external current account deficit, which had declined to 4 1/4 percent of GDP in 1986 owing to favorable terms of trade developments, rose to the equivalent of 9 1/4 percent of GDP in 1987. Notwithstanding a large rise in nontraditional exports to markets outside the Central American region, overall exports have been relatively sluggish in recent years, as their U.S. dollar value rose less than 2 percent a year in the period 1981-86. In 1987 the U.S. dollar value of exports increased by less than 3 percent, as coffee export receipts declined 16 percent despite a sharp rise in volume. At the same time, the U.S. dollar value of imports rose 19 percent, stimulated by the income gains of late-1986 and the expansion in credit

Table 3. Costa Rica: Selected Economic Indicators

	1982	1983	1984	1985	1986	1987 Oct. Prog.	1987 Prel. Actual	1988 Oct. Prog.	1988 Prop. Prog.
(Annual percent change, unless otherwise specified)									
National income and prices									
GDP at constant prices	-7.3	2.9	8.0	1.0	4.6	3.3	3.0	2.5	2.4
Nominal GDP	70.8	32.6	26.1	18.0	25.8	9.2	11.6	11.8	13.8
Consumer prices (end of period)	81.7	10.7	17.3	10.9	15.4	12.0	16.4	7.0	10.0
(average)	90.1	32.6	12.0	15.0	11.8	15.8	16.8	8.2	14.8
External sector (on the basis of U.S. dollars)									
Total exports, f.o.b.	-13.8	-2.0	17.0	-5.9	15.6	-0.2	2.6	8.2	5.7
Total imports, c.i.f.	-26.3	11.1	11.0	0.8	4.7	7.7	19.1	1.4	-5.4
Non-oil imports, c.i.f.	-30.0	14.8	16.0	0.6	12.3	8.1	19.2	1.0	-6.0
Export volume	-10.9	2.1	14.4	-7.3	-6.3	10.6	13.4	3.0	-0.7
Import volume	-25.8	19.1	12.8	7.4	7.7	2.5	13.0	-2.0	-10.1
Terms of trade (deterioration -)	-2.6	2.9	4.0	8.2	26.9	-14.1	-14.2	1.5	1.2
Real effective exchange rate (end of period; depreciation -)	37.5	-3.3	4.2	-9.4	-3.8	...	-17.4	...	-6.0
Central administration									
Revenue and grants	80.5	52.7	26.1	18.5	18.8	10.0	17.0	21.9	16.3
Total expenditure	60.5	50.7	22.8	12.4	28.7	2.9	8.8	17.7	14.7
Banking system									
Net domestic assets 1/2/	37.5	31.6	8.6	10.4	16.2	11.2	23.3	7.3	8.7
Of which: public sector 1/3/	8.7	0.9	-1.7	0.8	-1.6	-3.4	-1.0	-1.0	-3.0
private sector	37.5	51.7	17.9	16.1	17.4	14.1	23.7	12.4	9.3
Central Bank losses (cash basis)1/	...	...	6.8	24.0	6.6	6.5	2.1	21.6	23.7
Liabilities to private sector	50.5	30.3	10.5	12.9	22.2	12.0	18.4	10.9	12.9
Interest rate (annual rate for six-month deposits, end of period)	25.0	22.0	20.0	22.5	21.5	...	23.0	...	...
(In percent of GDP)									
Combined public sector deficit	-14.5	-8.0	-6.2	-7.2	-5.5	-3.7	-3.3	-3.0	-3.0
Nonfinancial public sector deficit	-8.9	-3.1	-1.9	-1.9	-1.7	-0.2	-0.2	--	0.8
Changes in floating debt and interest arrears	4.3	-5.3	1.5	-1.3	1.1	-0.4	-0.7	-0.2	-1.0
Domestic financing	2.5	11.1	-0.8	-0.3	-0.8	-0.6	0.5	-1.3	-0.7
External financing	2.0	-2.7	1.2	3.5	1.4	1.2	0.4	1.5	0.9
Central Bank losses (commitment basis)	-5.6	-4.9	-4.3	-5.3	-3.8	-3.5	-3.1	-3.0	-3.8
Nonfinancial public sector savings	-2.5	3.1	4.3	4.0	4.5	5.1	5.1	6.6	7.2
Central administration	-1.1	0.4	0.3	1.0	0.5	0.1	0.3	1.0	1.0
Rest of public sector	-1.4	2.7	4.0	3.0	4.0	5.0	4.8	5.6	6.2
Central administration deficit	-3.3	-3.6	-3.0	-2.0	-3.4	-2.2	-2.2	-1.7	-2.0
Gross domestic investment	16.6	22.5	21.1	20.7	21.9	22.5	21.2	23.3	20.2
Gross national savings	7.7	11.4	13.4	12.2	17.7	14.6	11.9	16.2	14.3
Trade balance 4/	-0.9	-4.9	-3.2	-5.1	-2.1	-4.6	-7.1	-2.7	-3.3
Current account balance (excluding official transfers for balance of payments support)4/	-8.9	-11.1	-7.7	-8.6	-4.2	-7.9	-9.3	-7.1	-4.9
External debt (including use of Fund credit)4/	106.5	118.0	109.0	110.1	106.6	102.4	102.0	99.3 5/	98.0 5/
(In percent of exports of goods and nonfactor services)									
Debt service ratio 6/	55.7	55.2	53.6	53.8	49.2	54.5	54.0	50.9	51.0
Interest payments 7/	29.4	28.6	24.5	22.9	19.9	20.7	19.5	19.6	18.1
(In millions of U.S. dollars)									
Overall balance of payments	-314	-800	-128	194	-81	-47	-165	251	330
Gross official reserves	244	307	441	513	553	519	501	557	...
Gross official reserves (months of imports)8/	3.3	3.7	4.8	5.5	5.7	4.8	4.3	5.1	...
External debt payments arrears outstanding	1,110	40	215	46	180 9/	197 9/	268 9/	--	--

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/ GDP in colones has been converted into U.S. dollars using a constant real exchange rate between the colon and the U.S. dollar at the 1988 level.
5/ Includes expected exceptional financing.
6/ Before rescheduling. Includes Fund charges and repurchases, interest on short-term debt, unpaid interest and amortization, and interest on resources to cover the financing gap in 1987 and 1988.
7/ Before rescheduling. Includes Fund charges, interest on short term debt, unpaid interest, and interest on resources to cover the financing gap in 1987 and 1988.
8/ A substantial portion consists of nonliquid reserve assets, mainly claims against other Central American central banks.
9/ Excludes revolving credit facility in arrears, which is treated as a renewable credit line in the net official reserves of the Central Bank. Also excludes arrears accumulated in 1987 that are refinanceable.

referred to above, as well as by a reduction in taxes on imported final goods. 1/

In the capital account, disbursements of public capital (excluding balance of payments support from U.S. AID and the World Bank) declined to US$80 million in 1987 from annual averages US$160 million in 1985-86 and of US$260 million in 1981-84. This development explains in part the decline in the ratio of external public debt (including use of Fund credit) to GDP since 1982-83.

III. Policy Discussions and the Program for 1988

The discussions centered on the developments under the economic program for 1987 and the objectives and policies for 1988. The authorities reaffirmed their commitment to the objectives of the economic program that is supported by the current stand-by arrangement from the Fund. Accordingly, since late 1987 they have adopted measures in the fiscal, monetary, and exchange rate areas to restore the momentum of adjustment. They noted, however, that it was not feasible to maintain the targets for net official international reserves included in the program for 1987-88 as a whole. Thus, they would strive to ensure that the balance of payments outcome for 1988 would be in line with program projections. In addition, out of the US$140 million deviation with respect to the 1987 target for the net international reserves, US$30 million would be made up in 1988 through adjustment measures, and US$50 million would be recovered through new long-term financing.

1. Fiscal policy

Available data suggest that implementation of the authorities' fiscal plan through end-1987 was basically on track (Table 4). The central administration's overall deficit declined, as projected, from 3.4 percent of GDP in 1986 to an estimated 2.2 percent of GDP in 1987. Central administration revenue was substantially higher than originally envisaged, despite a shortfall in coffee tax revenue equivalent to nearly 1/2 percent of GDP that was related to the decline in international prices. Large increases were recorded in receipts from

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1/ *The tariff reform that entered into effect in January 1986* included a reduction of the highest tariff rates from 220 to 100 percent. In the first half of 1986 import surcharges were reduced from a range of 12.5-100 percent to a maximum rate of 7.5 percent for regionally produced goods and 30 percent for goods not produced in Central America (except cars), and the 75 percent consumption tax on imported pick-up trucks was eliminated. This lowering of taxation on imports was followed by a reduction in consumption taxes on final goods in October 1986, by the elimination of the 75 percent consumption tax on small cars in July 1987, and by a 10 percent reduction in tariffs on final goods (excluding shoes and textile products) in October 1987.

selective consumption and import taxes reflecting a higher volume of transactions. Also, tax collections appear to have been bolstered by improvements in tax administration, both in the internal tax and customs offices, that included a tightening of regulations concerning tax exemptions and efforts to register non-filers.

Total expenditure by the central administration in 1987 was kept in line with the program objectives, declining by 1/2 percentage point to 18.6 percent of GDP. Capital expenditure (including capital transfers to the rest of the public sector) fell to 2 1/2 percent of GDP in 1987 from nearly 4 percent in 1986, whereas the ratio of current expenditure to GDP rebounded after two years of decline. Interest payments on an accrual basis rose sharply, and so did transfers (mainly because of larger export subsidies). The wage bill increased more moderately than in the previous year, as average real wages changed little in accordance with the stated government policy of keeping public sector base wages constant in real terms. A new formula had been established for this purpose in October 1986, according to which public sector base wages are to be raised at the beginning of each year by an absolute amount calculated essentially by applying the rate of inflation projected for the coming year to the average wage in the central administration (including seniority and other benefits), with an additional adjustment in July if inflation since the beginning of the year is higher than projected.

Preliminary information on the decentralized entities and the public enterprises indicates that their combined overall surplus rose marginally to 2 percent of GDP in 1987, as planned. This improvement largely reflected increases in prices charged for electricity, telephone, and some petroleum derivatives. Also, there was a substantial change in the composition of the financing of the nonfinancial public sector deficit with respect to program projections, as a shortfall in external financing (equivalent to close to 1 percent of GDP) was compensated by larger borrowing from the domestic banking system. As regards the Central Bank's net operating losses, the outcome was much better than expected: these declined from 3.8 percent of GDP in 1986 to 3.1 percent in 1987 as a result of lower foreign interest rates, relief provided by U.S. AID on interest due on local currency counterpart funds, and capital gains arising from the purchase of external debt at a discount.

For 1988 the authorities were confident that they would be able to achieve the planned reduction in the combined public sector deficit, including the losses of the Central Bank, to 3 percent of GDP. The program contemplates an improvement in the operations of the nonfinancial public sector of 1 percent of GDP (to a surplus equivalent to 3/4 of 1 percent of GDP) to cover a widening of the net operating losses of the Central Bank (see Table 3).

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

	1981	1982	1983	1984	1985	1986	1987 October Program	1987 Prel. Actual	1988 Proposed Program
				(In millions of colones)					
Central administration	-2,999	-3,258	-4,627	-4,966	-3,941	-8,245	-5,780	-5,843	-6,000
Revenue	7,770	14,026	21,417	27,012	32,005	38,030	41,820 2/	44,504	51,750
Expenditures	10,769	17,284	26,044	31,978	35,946	46,275	47,600 3/	50,347	57,750
Current	8,663	15,072	20,953	26,586	30,144	36,858	41,536	43,604	50,625
Fixed capital formation	1,169	1,181	2,931	3,662	3,390	2,834	2,580	2,386	2,750
Other capital and net lending	937	1,031	2,160	1,730	2,412	6,583	3,484	4,357	6,375
Less: safeguard adjustment	--	--	--	--	--	--	--	--	2,000
Rest of general government 4/	-711	320	2,393	1,870	2,704	3,534	3,687	3,922	4,798
Revenue	6,549	10,782	12,628	15,176	19,336	24,774	28,295	29,350	36,593
Current	6,323	10,114	12,082	14,909	18,765	24,292	27,715	29,044	35,548
Capital	226	668	546	267	571	483	580	306	1,045
Expenditures	7,260	10,462	10,235	13,306	16,632	21,240	21,240	25,428	31,796
Current	5,768	9,085	10,190	11,916	14,535	18,783	20,526	22,075	26,500
Fixed capital formation	959	907	335	219	474	1,150	1,292	1,286	1,743
Other capital and net lending 4/	533	470	-290	1,171	1,623	1,307	2,790	2,067	3,552
Public enterprises	-4,407	-5,696	-1,783	7	-2,479	642	1,508	1,389	3,662
Revenue	11,039	18,374	28,473	34,152	36,950	43,269	46,993	47,992	62,320
Current	10,280	18,239	27,879	33,860	36,659	41,621	45,922	47,136	60,967
Capital	759	135	594	292	291	1,648	1,071	856	1,353
Expenditures	15,446	24,070	30,256	34,145	39,429	42,627	45,485	46,603	58,658
Current	12,119	20,653	26,230	30,217	35,065	37,358	40,165	41,288	51,068
Fixed capital formation	3,094	3,186	3,408	3,811	4,414	5,523	5,785	5,853	7,533
Other capital and net lending	233	231	618	117	-50	-254	-465	-538	57
Current account deficit (-)	-2,177	-2,431	4,005	7,062	7,685	10,943	13,230	13,717	22,073
Central Administration	-893	-1,046	464	426	1,861	1,172	284	900	3,125
Rest of general government	555	1,029	1,892	2,993	4,230	5,508	7,189	6,969	9,048
Public enterprises	-1,839	-2,414	1,649	3,643	1,594	4,263	5,757	5,848	9,900
Overall deficit (-) 4/	-8,117	-8,634	-4,017	-3,089	-3,716	-4,069	-585	-532	2,460
Change in floating debt and interest arrears	1,786	4,210	-6,850 5/	2,425	-2,536	2,597	-1,079	-1,820	-2,960
Of which: Interest on foreign debt	1,655	4,066	-7,290 5/	1,599	-1,959	801	-679	-- 6/	-3,460
Net financing requirements	6,331	4,423	10,867	664	6,251	1,472	1,664	2,352	500
External (net)	4,724	1,944	-3,540	1,971	6,730	3,338	3,256	947	2,775
Disbursements	5,807	3,403	4,981	4,343	7,405	8,187	5,613	4,448	7,258
Amortization due	-4,314	-4,862	-5,322	-2,884	-6,706	-10,253	-8,738	-10,074	-11,195
Principal in arrears (net change)	3,231	3,403	-6,476 5/	512	-1,136	2,044	-795 6/	676	-10,373
Debt relief	--	--	3,277	--	7,167	3,360	7,176 6/	5,897	...
Expected rescheduling	--	--	--	--	--	--		--	17,085 7/
Domestic	1,607	2,479	14,407 5/	-1,307	-479	-1,866	-1,592	1,405	-2,275
Bank credit (net)	1,664	1,872	13,889 5/	-959	505	-1,123	-3,242	-877	-3,325
Other (net)	-57	607	518	-348	-984	-743	1,650	2,282	1,050
				(In percent of GDP)					
Current account deficit (-)	-3.8	-2.5	3.1	4.3	4.0	4.5	5.1	5.1	7.2
Central Administration	-1.6	-1.1	0.4	0.3	1.0	0.5	0.1	0.3	1.0
Rest of general government	1.0	1.1	1.5	1.8	2.2	2.3	2.8	2.6	2.9
Public enterprises	-3.2	-2.5	1.3	2.2	0.8	1.8	2.2	2.2	3.2
Fixed capital formation	9.1	5.4	5.2	4.7	4.3	3.9	3.7	3.6	3.9
Overall deficit (-) 4/	-14.2	-8.9	-3.1	-1.9	-1.9	-1.7	-0.2	-0.2	0.8
Central Administration	-5.3	-3.3	-3.6	-3.0	-2.0	-3.4	-2.2	-2.2	-2.0
Rest of general government 4/	-1.2	0.3	1.8	1.1	1.4	1.5	1.4	1.5	1.6
Public enterprises	-7.7	-5.8	-1.4	--	-1.3	0.3	0.6	0.5	1.2
Changes in floating debt and interest arrears	3.1	4.3	-5.3	1.5	-1.3	1.1	-0.4	-0.7	-1.0
External financing	8.3	2.0	-2.7 5/	1.2	3.5	1.4	1.2	0.4	0.9
Domestic financing	2.8	2.5	11.1 5/	-0.8	-0.2	-0.8	-0.6	0.5	-0.7

Sources: Ministry of Finance; and Fund staff estimates.

1/ Reduced coverage of the nonfinancial public sector for program purposes.

2/ Excludes the effect of the tax package that had been submitted to the Legislative Assembly in January 1987 but passed only in November and of administrative efforts to improve tax collections.

3/ This ceiling was revised upward to ₡ 49,755 million as a result of actual revenue exceeding projected revenue by ₡ 2,684 million.

4/ Includes statistical discrepancies arising from reporting on an accrual and cash basis, from reporting periods that differ from the calendar year, and from public sector operations not included in this consolidation.

5/ Includes the effect of the assumption by the Central Bank of part of the external debt of the nonfinancial public sector in connection with the 1983 rescheduling agreement with foreign commercial banks.

6/ Includes expected rescheduling of current amortization and interest payments as well as rescheduling of arrears; derived from balance of payments data.

7/ Includes interest payments to commercial banks to be covered by rescheduling agreement expected to be concluded in 1988.

An important factor behind the prospective strengthening of the nonfinancial public sector position in 1988 has been the passage of the November 1987 tax package, which is expected to raise revenue equivalent to 1.3 percent of GDP. However, it is estimated that about one fourth of this increase would be offset by the effect of an impending reform of the income tax and of a projected decline in the volume of coffee exports and non-oil imports. The authorities have restored partially the taxes on motor vehicles that were eliminated in 1986-87 (as explained above). In addition to the tenfold increase in the road tax (included in the November 1987 tax package), the authorities have recently raised consumption taxes on small cars and imposed a temporary import surcharge on all vehicles with a view to restraining the foreign exchange cost of auto imports in 1988 to the level of 1986. The Costa Rican representatives also indicated that the government was giving priority to a tax bill now in the final stages of the legislative process that dealt with modifications in the procedural code intended to improve tax administration.

The program for 1988 limits the growth of central administration expenditure to 15 percent; this limit is to be adjusted upward, by up to ₡ 2 billion, to the extent that actual revenue during 1988 exceeds projected revenue. Although a 15 percent increase would exceed the projected rise of nominal GDP, the authorities observed that the expansion of central administration expenditure over the two-year period 1987-88 would be somewhat slower than inflation as measured by the consumer price index, even if the additional ₡ 2 billion just mentioned were spent. Moreover, they noted that the higher capital expenditure for 1988 included the effect of an increase in foreign loan disbursements for other public institutions (of about one third of 1 percent of GDP) that would be channeled through the central administration.

Outside the central administration, improvements are expected in the financial position of the Social Security Institute, as a result of a continued broadening of the number of wage earners covered under the scheme and higher returns on the Institute's investments, and in the state oil refinery, owing to an increase in prices of petroleum derivatives. In addition, the structure of producer and consumer prices for corn and beans has been modified to lessen the costs of handling basic grains, which in the past have adversely affected the finances of the national grain marketing agency.

The program provides for renewed efforts to ensure that wage increases in the public enterprises and decentralized agencies conform to the general guidelines for the central administration (described above). The Costa Rican representatives explained that in the past year the wage bill of some enterprises had risen substantially in real terms, but this departure from government policy was the result of judicial decisions affecting the interpretation of seniority rights and the effect of personnel reclassifications and promotions; also, wage determination in some enterprises was based on collective bargaining and could thus exceed government guidelines. To address this problem, the government intends to submit a bill to the Legislative Assembly that would regulate collective bargaining in the public enterprises. In the meantime, no new collective bargaining agreements in the public enterprises would be ratified by the Ministry of Labor.

The Costa Rican representatives noted that the Central Bank's losses had declined substantially over the past two years. Looking ahead, the authorities intend to allow the Central Bank to retain the gains that might result from any refinancing of the nonfinancial public sector's external debt at interest rates lower than those of the original loans. However, the Central Bank's losses are projected to rise in 1988 because of heavier interest payments associated with the accelerated depreciation of the colon in recent months and with the large placement of stabilization bonds that began in the latter part of 1987.

2. Monetary management

The authorities explained that bank credit to the private sector rose very rapidly in the first half of 1987, in part reflecting a strong expansion in housing and consumer credit. In addition, following the bankruptcy of a major coffee exporter, part of the financing needs of the coffee sector--which traditionally had been met from abroad--had to be satisfied by the domestic banking system. The rate of credit expansion also appears to have been influenced by the elimination of overall credit ceilings for individual banks and of sectoral credit allocation requirements--two measures that had been designed to improve efficiency in the allocation of credit. To curb credit expansion, the Central Bank raised reserve requirements in monthly steps in April-June, but the effect of this measure was largely offset by a lowering in May of the deposit requirement for the purchase of foreign exchange from an average of somewhat above 50 percent to 10 percent.

Additional measures were adopted in the third quarter to control credit expansion. Specifically, the discount rate was raised from 28 1/2 to 30 1/2 percent and the deposit requirement for the purchase of foreign exchange was increased from 10 to 50 percent. Moreover, the authorities undertook to increase the placement of stabilization bonds and to transfer public sector deposits from the commercial banks to the Central Bank by year-end in an amount equivalent to a little more than 1 percent of 1987 GDP.

The Costa Rican representatives said that implementation of the policy of credit restraint in the closing months of 1987 had been hindered by liquidity problems in the Costa Rican stock market (which deals primarily with bonds and financial paper) and by the subsequent failure of some unregulated finance companies. The main factor behind these failures appeared to be mismanagement in the matching of the maturities of assets and liabilities. These developments, in combination with the measures to restrain credit taken by the Central Bank, led to an increase in interest rates offered by state banks from an average of 21 percent to 25 percent in late October. In an effort to re-establish confidence and assist troubled financial institutions, in early November the authorities negotiated a coordinated rollback of those interest rate increases, although later in that month rates paid by state banks rose again by 2 percentage points. The Costa Rican representatives said that, in view of the fragile position of some financial institutions, it was not feasible to carry out the programmed sterilization of public sector deposits in the Central Bank, which had been expected to be the key credit policy instrument in the last quarter of the year. As a result, the net domestic assets of the Central Bank continued to increase rapidly, and bank credit to the private sector is now estimated to have expanded by 24 percent during the whole of 1987, compared with an increase of 14 percent contemplated in the program (Table 5).

The authorities' monetary program for 1988 aims at strengthening the net official reserve position of the Central Bank by US$60 million--after allowing for a reduction of about US$110 million in external arrears through cash payments--1/ and at reducing inflation to about 10 percent. The Costa Rican representatives said that the program had been designed with a view to achieving the needed curtailment in the rate of credit expansion while limiting as much as possible any additional pressures on private financial intermediaries. To this effect, the Central Bank had reinstated the practice of setting ceilings on individual banks' credit to the private sector. They observed that this had been the traditional instrument to control the expansion of credit to the private sector in Costa Rica, and were of the view that the use of other instruments, such as increases in the interest paid on public sector bonds and state bank deposits, would have exacerbated the drain of resources from the troubled private financial sector.

The credit ceilings on individual banks set in January limit the expansion of credit to the private sector financed with domestic resources to 5 percent for 1988. At the same time, the Central Bank (which controls the commercial banks' access to foreign resources, including the use of counterpart funds) will limit the amount of external funds channeled to the commercial banks to about ₡ 1,000 million in 1988, down from about ₡ 3,500 million in 1987, thus sharply curtailing the expansion of bank credit financed from abroad. In all, the rate of growth of total credit to the private sector, after allowing for any assistance to troubled financial institutions outside the banking system, will decline from 24 percent during 1987 to about 10 percent during 1988.

The authorities were concerned that credit ceilings might give rise to excess reserves in the commercial banks and, therefore, might discourage banks from attracting additional private sector deposits. To deal with this problem, one option under consideration is that the Central Bank issue short-term paper at market interest rates to be placed with commercial banks, to provide an outlet for the banks excess

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1/ The remaining US$160 million in arrears as of end-1987 are expected to be covered by a financing package from commercial banks.

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

	December 31										
								(₡ 63/US$1)			
								1987		(₡ 76/US$1)	
	(₡ 45/US$1)		(₡ 50/US$1)		(₡ 56.5/US$1)			October	Prel.	Prel.	Proj.
	1983	1984	1984	1985	1985	1986	1986	Program	Actual	1987	1988
I. Central Bank											
(In millions of colones)											
Net international reserves	-5,994	-11,800	-13,111	-3,317	-3,747	-8,202	-9,146	-10,650	-19,530	-23,560	1,520
Official reserves	-4,180	-2,030	-2,256	-1,022	-1,154	1,979	2,207	1,765	-2,627	-3,169	1,520
Payments arrears	-1,814	-9,770	-10,855	-2,295	-2,593	-10,181	-11,353	-12,415	-16,903	-20,391	--
Net domestic assets	14,942	21,685	22,996	16,573	17,003	25,509	26,453	29,913	39,000	43,030	20,480
Public sector credit (net) 1/	29,328	30,339	31,874	32,896	34,244	44,712	48,061	47,493	41,563	47,322	44,495
Rest of banking system credit (net)	-7,537	-9,597	-10,454	-11,108	-12,443	-11,106	-12,072	-8,726	-6,190	-8,173	-9,856
Government trust funds	-1,098	-4,478	-4,478	-10,985	-10,985	-18,263	-18,263	-24,420	-15,676	-15,676	-31,176
Counterpart arrears	1,814	8,588	9,542	2,295	2,593	10,165	11,334	12,415	16,903	20,390	--
Operational losses (cash basis)	18,781	22,523	22,523	37,359	37,359	42,118	42,118	47,908	44,013	44,013	69,887
Medium- and long-term foreign liabilities	-66,845	-69,125	-76,806	-83,171	-93,983	-102,979	-114,826	-110,448	-112,867	-136,157	-144,562
Stabilization bonds	-5,041	-4,895	-4,895	-4,900	-4,900	-5,079	-5,079	-10,880	-7,885	-7,885	-10,234
Other accounts net	45,540	48,330	55,690	54,187	65,118	65,941	75,180	76,571	79,139	99,196	101,926
Of which: valuation adjustments	20,756	20,756	28,118	28,118	38,050	38,050	47,289	47,292	47,289	67,346	67,346
Currency issue	8,948	9,885	9,885	13,256	13,256	17,307	17,307	19,263	19,470	19,470	22,000
II. Banking System											
(In millions of colones)											
Net international reserves	-3,415	-10,328	-11,475	-1,331	-1,504	-4,761	-5,309	-5,680	-15,340	-18,505	6,575
Net foreign assets	-1,601	-558	-620	964	1,089	5,420	6,044	6,735	1,563	1,886	6,575
Payment arrears	-1,814	-9,770	-10,855	-2,295	-2,593	-10,181	-11,353	-12,415	-16,903	-20,390	--
Net domestic assets	58,407	71,109	73,354	71,205	73,223	92,419	94,431	110,070	121,500	129,536	118,764
Public sector credit (net) 1/	27,098	25,444	26,985	23,848	26,161	35,690	389961	40,442	31,992	37,686	34,361
Of which: Adjusted net credit 2/	17,508	16,549	17,073	17,578	26,161	25,038	38,961	35,781	3/38,084	37,686	34,361
Credit to private sector 4/	27,541	32,470	32,490	37,733	38,183	44,824	45,081	51,437	55,785	56,349	61,593
Medium- and long-term foreign liabilities	-68,716	-71,825	-79,806	-86,881	-98,181	-104,209	-116,198	-111,700	-114,314	-137,903	-146,186
Other accounts (net) 5/	72,484	85,020	93,685	96,505	107,060	116,114	127,152	129,891	148,037	173,404	168,996
Liabilities to private sector 4/	54,992	60,781	61,879	69,874	71,719	87,658	89,688	104,390	106,160	111,031	125,339
Money	22,481	25,710	25,710	28,970	28,970	39,901	39,901	42,500	40,467	40,467	45,700
Quasi-money	32,511	35,071	36,169	40,904	42,749	47,757	49,787	61,890	65,693	70,564	79,639
(Annual percentage change)											
Net domestic assets 6/7/		8.6		8.2		16.2		11.2 8/	23.3		8.7
Public sector credit 2/6/		-3.0		0.8		-1.6		-3.4 8/	-1.0		-3.0
Credit to private sector		17.9		16.1		17.4		14.1	23.7		4.7
Liabilities to private sector		10.5		12.9		22.2		12.0 8/	18.4		12.9
(In percent of GDP) 9/											
Credit to private sector		18.4		18.2		17.1		17.9	18.7		19.2
Central Bank losses (cash basis)		2.3		7.7		2.0		2.1	0.7		8.4
Liabilities to private sector		35.5		34.2		32.9		35.9	36.2		38.4
Money		14.8		14.2		14.2		15.2	14.9		14.0
Quasi-money		20.7		20.0		18.7		20.7	21.4		24.4

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

1/ Includes counterpart of external debt assumed during the year.
2/ For program purposes, excludes counterpart of external debt assumed during the year.
3/ Reflects reclassification of 1986 base data.
4/ Includes rest of financial system.
5/ Includes Government trust funds, counterpart arrears, and Central Bank operational losses.
6/ In relation to the initial stock of liabilities to the private sector.
7/ Excludes counterpart of external payments arrears.
8/ Changes as originally envisaged in the program. Do not allow for changes in the data for the base period.
9/ Average of the stocks at the beginning and end of year 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.

reserves. In addition, the Central Bank will monitor the interest differential between savings deposits denominated in domestic currency and those denominated in foreign currency, with a view to avoiding any adverse shift in the composition of private financial savings.

A key element of the monetary program is the sterilization in the Central Bank of the prospective surplus of the nonfinancial public sector. To this end, an agreement will be signed shortly with the state oil company (RECOPE) that will allow the Central Bank to collect a substantial part of the past due obligations of this institution. Another agreement, negotiated with the Social Security Institute (CCSS), is expected to result in the transfer of a significant part of the CCSS's deposits in the commercial banks to the Central Bank.

In order to support the private financial system, following the failure of three more financial institutions in late January, the Central Bank adopted some measures in early February including a temporary reduction from 10 to 6 percent in legal reserve requirements on time deposits of at least six months. The resources being released are available for lending to troubled private commercial banks or to financial intermediaries operating under the supervision of the monetary authorities, as well as to borrowers of these institutions to facilitate an orderly recovery of their loans. The potential expansionary impact of these measures was estimated at around ₡ 1,200 million; however, the authorities stressed that any credit extended by banks will be included within the ceilings contemplated in the monetary program. The authorities have announced that starting July 1988, reserve requirements on deposits of at least six months maturity will be raised by 1 percentage point a month so as to restore the previous rate of 10 percent by October 1988.

Other measures adopted in February 1988 include the creation of a Contingency Fund in the Central Bank with resources provided by the financial intermediaries operating in the Stock Market, to be used by these institutions in case of liquidity problems. The creation of a similar contingency fund is being considered for the savings and loan cooperatives. The Central Bank also has announced that a deposit insurance scheme will be implemented in the near future.

3. External policies

Given Costa Rica's weak external position and limited access to foreign capital, a major goal of the authorities is to foster export growth. An export-led growth strategy is seen as the best way to reconcile the government's objective of sustained growth of output, employment, and incomes with progress toward the normalization of relations with Costa Rica's external creditors. Accordingly, the authorities place emphasis on the maintenance of a unified and flexible exchange rate system with a view to ensuring export competitiveness. They also attach a great deal of importance to reforms of the trade regime to reduce its anti-export bias and to the establishment of an efficient system of export incentives.

In accordance with the objectives just mentioned, the authorities' considered that there was a need to provide further signals to markets of their determination to improve the country's competitive position. Accordingly, in mid-January 1988 they made a step devaluation of 6 percent, and announced that this action would be followed by frequent adjustments to maintain the real exchange rate at the level reached after that step. The Costa Rican representatives expected that this policy would be consistent with a lower level of interest rates than the policy of seeking a real depreciation through the working of a crawling peg regime.

The Costa Rican representatives were of the view that the exchange rate adjustment, together with the direct incentives for exports introduced by the government in the past few years, constituted the basis for the rapid expansion of nontraditional exports outside the Central American region that had taken place in the past two years. Following a 46 percent increase in 1986, such exports increased by an estimated 32 percent in U.S. dollar terms in 1987, and a substantial further expansion was in prospect for 1988. The behavior of traditional exports had been less favorable, but this reflected in some cases a tightening of restrictions in Costa Rica's foreign markets (sugar and beef) or developments in world market prices (particularly coffee).

The Costa Rican representatives explained that the failure to achieve the overall balance of payments objective for 1987 largely reflected the rapid increase in imports associated with the expansion of credit to the private sector. They stressed the efforts being made to tighten credit and noted that information on the requests for foreign exchange for the payment of private sector imports showed that there had been a decline since October, although to some extent this might reflect seasonal factors.

The mission agreed that a tightening of demand management policies would certainly be crucial to sustain the change in cost-price relationships that was being sought through exchange rate policy and that was needed to improve the pattern of aggregate expenditure and the structure of production. At the same time, the mission drew attention to the substantial reduction of import duties and consumption taxes on imported goods since the beginning of 1986. While the reduction of import duties was an important step to improve resource allocation, it had implications for the balance of payments that had to be dealt with through exchange rate action. Thus, future steps toward import liberalization would have to be accompanied by exchange rate adjustments so as to furnish an appropriate framework for efficient import substitution.

The authorities observed that given the high level of Costa Rica's interest obligations (about 7 percent of GDP in 1988) and the need to maintain a level of imports consistent with satisfactory economic growth, they had not only to develop policies aimed at fostering export growth but also to secure adequate financing. Thus, it was their aim to normalize relations with external creditors as soon as possible. The authorities were committed to the pursuit of economic policies that would permit them to settle all external arrears in the course of 1988, either through cash payments or through rescheduling. 1/ Moreover, they were confident that the financing assumed in the program would be obtained in their forthcoming discussions with commercial banks and official creditors under the Paris Club; Costa Rica was committed to proceed quickly with these negotiations, with a view to completing them by mid-1988. 2/ In the meantime, Costa Rica intended to continue making partial payments of interest to commercial banks at the rate of US$5 million a month.

The Government of Costa Rica, in collaboration with the World Bank, has been developing policies aimed at reducing the anti-export bias of import restrictions and providing direct incentives for exports. These policies have been supported by a structural adjustment loan from the World Bank (SAL-I), and negotiations on another such loan (SAL-II) are well advanced. The authorities intend to make every effort to obtain timely approval from the Legislative Assembly of this loan and of the expected cofinancing from the Government of Japan, so that they can be disbursed before the end of 1988.

The Government has been steadily reducing taxes on imported goods with a view to lowering effective protection. Looking to the medium term, the government intends to implement a second stage of the tariff reform that would reduce the highest tariff rate to 40 percent and rationalize the system of import duty exemptions (which, in addition to being costly from a fiscal viewpoint, appears to include a bias against labor-intensive activities).

1/ In addition to the exchange restrictions evidenced by payments arrears, Costa Rica maintains a multiple currency practice on a transitional basis related to remittances to students registered with the Central Bank prior to 1981, to whom foreign exchange is sold at the official rate of ₡ 20 per U.S. dollar. This practice has been approved through April 30, 1988.

2/ Following the meeting between the Costa Rican authorities and commercial banks held in New York on February 19, 1988, the Coordinating Committee informed creditor banks that they would consider the consents and waivers to be provided under the existing credit agreements to authorize a debt/equity conversion program proposed by the government delegation. The Committee considered the progress made by Costa Rica in the negotiations with the Fund, the World Bank, and Paris Club creditors to be encouraging, and noted that it agreed to continue discussions regarding Costa Rica's public sector external debt during March 1988.

Under the current regime of "export contracts" established in 1985, exporters of nontraditional goods outside Central America are entitled to exemption from import duties, and from sales, consumption, and income taxes, and to a subsidy of up to 15 percent of the f.o.b. value of exports. The government is discussing with the World Bank ways to streamline this system, including in particular the elimination of the export subsidy; this subsidy may pose problems as Costa Rica becomes a member of the GATT. 1/ In addition, an effort would be made to simplify administrative procedures involving exports, including those associated with the obtention of export incentive benefits.

4. Other policies

As part of their focus on improving the economy's growth potential, the authorities also have been developing policies in areas other than those discussed above with the aim of reducing disincentives to savings and investment and improving efficiency in the use of resources.

The government's involvement in price determination includes the setting of producer prices for a number of domestically produced basic foods. Over the years, the state grain marketing agency (CNP) has bought basic grains at prices sufficiently high to support local production and sold them at a loss, mostly in the domestic market but on occasion abroad, with adverse effects for the public finances. Implementation of this policy has required import protection for products such as basic grains, sugar, flour and milk. In the past two years, CNP has stopped buying rice and sorghum at support prices, but has continued to incur losses in the marketing of other products, mainly corn and beans. The Costa Rican representatives said that, in addition to the recent adjustments in the producer and consumer prices of these two products, CNP would continue reducing subsidies with a view to encouraging a shift towards production of tradeables at internationally competitive prices. Furthermore, it would impose user charges on all handling and processing services that up to now have been provided free.

The Costa Rican representatives explained that a new procedure to set wages in the private sector had been introduced in October 1986. The new procedure replaced the system that had been in place since 1983, under which adjustments were made in accordance with movements in the value in colones of a basic basket of goods and services. Under the new system, minimum wages for different categories of private sector employees are set by a tripartite council representing the government, labor and management. Minimum wages are adjusted at the beginning of each year by the increase in consumer prices over the previous 12 months; whenever inflation exceeds 7 percent in the course of the year, negotiations are opened and wages may be adjusted again.

1/ Costa Rica's membership to the GATT is expected to become effective in 1988.

The Costa Rican representatives were of the view that the new system had helped arrest the rise in the real value of minimum wages in 1987 following its rapid increase from 1983 to 1986.

Under the terms of World Bank's SAL-I, the government established a medium-term plan to cut public sector employment to the level prevailing in March 1984. In fact, employment in the central government has continued to increase, but employment in public enterprises has declined, mainly because of the divestiture of CODESA's enterprises. In all, from September 1986 to June 1987 there was a small increase in public sector employment.

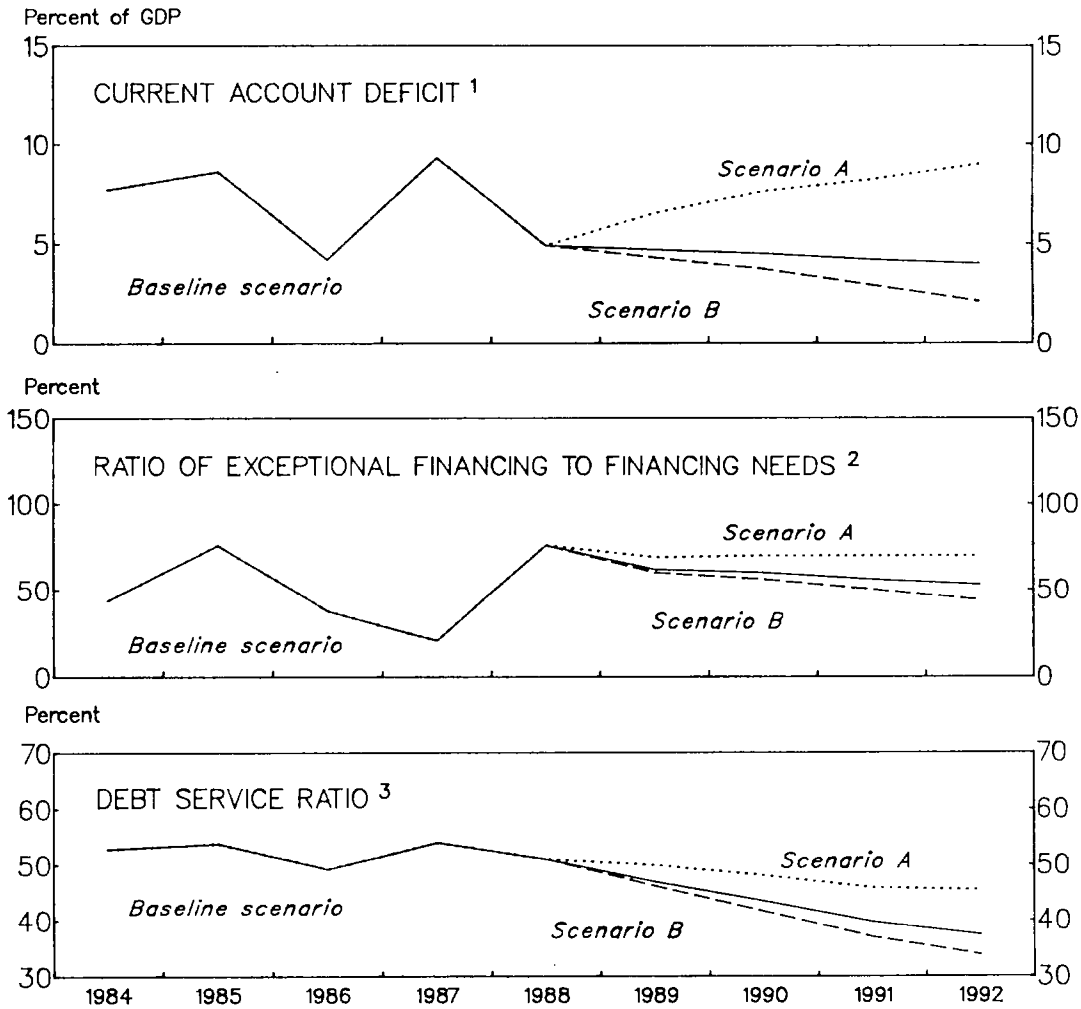
The government has continued to implement the 1985 agreement with U.S. AID to privatize CODESA's enterprises. U.S. AID is supporting this process by transferring some of the local counterpart of U.S. assistance to a private sector trust which has purchased some of CODESA's subsidiaries that were not being sold through public bidding. The divestiture plan has proceeded satisfactorily and is expected to be completed in 1988. Some of CODESA's enterprises already have been sold, with several others in the process of being sold; moreover, many enterprises have been, or are being, liquidated. The proceeds from these sales have been used to reduce substantially CODESA's net indebtedness with the Central Bank.

For some time, the government has been concerned about the high operational costs of the state banks, which are reflected in a large spread between lending and deposit rates. The problems of the financial system have been the subject of studies conducted in collaboration with the World Bank, and financial reform is expected to be part of the SAL-II program. Important elements of this reform would be the avoidance of generalized debt rescheduling programs, the establishment of stricter bank accounting rules for delinquent loans, and reductions over a three-year period in the state bank's overdue portfolio. As a first step, the government is to implement a program that includes a major reduction in the state banks' overdue portfolio, a reduction in interest rate subsidies, increased competition between state and private banks, and strengthening of the Central Bank's supervisory and monitoring powers. However, in response to high delinquency rates on agricultural loans, the Legislative Assembly passed a law in May 1987 that provides for the compulsory rescheduling, at below market interest rates and maturities of up to 16 years, of all agricultural bank loans overdue more than 180 days; implementation of this provision would exacerbate the difficulties of state banks.

IV. Medium-Term Outlook

The staff has updated the medium-term scenario presented in EBS/87/91, Supplement 1 (10/16/87), with the following main changes: (1) the latest estimates for 1987 and the program projections for 1988 have been incorporated; (2) exports of goods and nonfactor services in

CHART 2
COSTA RICA
MEDIUM-TERM SCENARIOS



ASSUMPTIONS	1988	1989	1990	1991	1992
Coffee prices (U.S. cents per pound)					
Scenario A		120.0	120.0	120.0	120.0
Baseline scenario	120.0	126.0	130.0	134.0	137.0
Scenario B		130.0	135.0	140.0	145.0
Petroleum prices (U.S. dollar per barrel) [4]					
Scenario A		20.0	21.0	22.0	23.0
Baseline scenario	16.5	17.0	17.5	18.0	18.6
Scenario B		16.3	16.8	17.2	17.5
Foreign interest rates (In U.S. dollar terms)					
Scenario A		8.1	8.6	9.0	9.5
Baseline scenario	7.0	7.2	7.2	7.2	7.2
Scenario B		7.0	6.6	6.3	6.0

[1] Excluding official transfers for BOP support.
[2] Exceptional financing includes balance of payments support. Financing needs are defined as principal and interest due plus reductions in arrears.
[3] In relation to exports of goods and nonfactor services and before debt relief; includes IMF and interest on additional borrowing to cover the prospective financing gaps.
[4] Average prices paid by Costa Rica, including oil derivatives.

Source: Table 6; and Fund staff estimates.

the projection period have been revised in accordance with the latest price forecasts from the WEO and the Fund's Commodities Division; and (3) interest payments have been modified on the basis of the changes to the data on the stock of debt.

The updated scenario, presented in Table 6, involves little change in the trade and capital flows, but debt service would be somewhat higher, mostly because of the higher level of debt outstanding at end-1987 and of the assumption that debt conversion for about US$50 million would take place in each of the following years within the forecasting period. After an initial compression in 1988, imports are projected to increase by close to 4 percent a year in real terms. The current account deficit would decline from 9 1/4 percent of GDP in 1987 to 4 percent in 1992. Costa Rica's financing gap would decline from 7 percent of GDP in 1989 to 5.8 percent in 1992, averaging the equivalent of about three fourths of principal falling due through the end of the projection period. It would therefore seem possible to cover most of the financing gap by means of rescheduling principal obligations with commercial banks and bilateral creditors. Costa Rica's debt service (before debt relief and including Fund transactions) would decrease from slightly over 50 percent of exports of goods and nonfactor services in 1988 to less than 40 percent in 1991-92. At about 2 percent of exports, Costa Rica's repurchase obligations to the Fund in this period would be relatively modest.

This scenario provides for an increase in output of 3 percent a year. While significantly better than the 1 percent a year increase recorded in the period 1981-87, this performance would result in a fairly small improvement in per capita income over the projection period. The Costa Rican representatives stressed that the economic reforms being implemented could be expected to improve economic efficiency and raise income levels but only over a period of time. Meanwhile, they were of the view that additional external assistance beyond that assumed in the scenario would be needed to improve Costa Rica's growth prospects and facilitate the process of structural change.

To assess the effect of changes in some of the underlying assumptions, two alternative scenarios were prepared, based on less (Scenario A) and more (Scenario B) favorable assumptions regarding coffee and petroleum prices and international interest rates. The results (Chart 2) show a relatively high degree of vulnerability of Costa Rica's external position to external developments and suggest that, even under an optimistic scenario, by the end of the forecast period there would be a need for balance of payments support and debt restructuring equivalent to almost half of principal and interest due.

Table 6. Costa Rica: Medium-Term Balance of Payments and External Debt Projections

	1985	1986	1987 October Program	1987 Prel. Actual	1988 October Program	1988 Proposed Program
(In millions of U.S. dollars)						
Current account 1/	-289.7	-152.1	-302.0	-355.4	-228.0	-197.0
Trade balance	-171.8	-77.4	-178.0	-271.4	-108.0	-133.0
Exports	939.1	1,085.8	1,072.0	1,113.6	1,160.0	1,177.0
Imports	-1,110.9	-1,163.2	-1,250.0	-1,385.0	-1,268.0	-1,310.0
Factor payments	-282.2	-280.7	-308.0	-285.3	-315.2	-281.8
Of which: public sector interest due	-280.3	-281.7	-290.0	-283.7	-295.8	-279.0
Other services and transfers	164.3	206.0	184.0	201.3	195.2	217.8
Capital account	-73.8	-195.1	-226.0	-257.9	-187.9	-197.8
Public 2/	-172.4	-244.4	-293.6	-360.3	-275.9	-331.5
Disbursements	185.2	135.2	105.0	79.6	144.0	117.5
Amortization due	-357.6	-379.6	-398.0	-439.9	-419.9	-449.0
Private, and errors and omissions	98.6	49.3	67.0	102.4	88.0	133.7
Balance of payments support	200.0	120.6	120.0	120.0	145.0	225.0
U.S. AID (ESF)	160.0	80.6	120.0	120.0	105.9	125.0
IBRD (SAL)	40.0	40.0	--	--	40.0	100.0
Overall balance before exceptional financing (deficit -)	-163.5	-226.6	-408.0	-493.3	-270.9	-169.8
Debt relief	357.8	145.9	--	42.9	--	--
Rescheduling of current obligations	300.8	133.0	--	21.8	--	--
Rescheduling of past obligations	57.0	12.9	--	21.1	--	--
Financing gap	--	--	361.0	285.8	521.9	499.7
Expected rescheduling of current obligations 3/	--	--	298.0	--	323.1	299.7
Expected rescheduling of past obligations 3/	--	--	63.0	--	--	285.8
Arrears subject to rescheduling	--	--	--	285.8	--	-285.8
Residual financing gap	--	--	--	--	198.8	200.0 4/
Overall balance after exceptional financing (deficit -)	194.3	-80.7	-47.0	-164.7	251.0	329.9
Net international reserves	-194.3	80.7	47.0	164.7	-251.0	-329.9
Net official reserves (increase -)	-99.8	-55.0	7.0	76.7	-54.0	-61.7
Net use of Fund resources	30.0	-36.0	-50.0	-62.2	-9.2	-15.1
Other net official reserves 5/	-129.8	-19.0	57.0	138.9	-44.8	-46.7
Change in arrears (reduction -)	-169.5	135.7	40.0	88.0	-197.0	-268.2
Outstanding public debt (including exceptional financing)	3,708.8	3,855.6	3,927.4	3,914.0	4,019.0	4,018.7
Debt service (including IMF)	-659.6	-697.3	-752.9	-785.8	-766.4	-784.6
Amortization	-379.3	-415.6	-464.2	-502.1	-470.6	-505.6
Of which: IMF	-21.7	-36.0	-61.1	-62.2	-56.6	-56.6
Interest	-280.3	-281.7	-288.7	-283.7	-295.8	-279.0
Of which: IMF	-14.5	-17.5	-13.5	-13.2	-11.1	-11.1
(As percent of GDP, unless otherwise specified)						
Exports	27.9	30.0	27.9	29.0	28.7	29.1
Imports	-33.0	-32.2	-32.6	-36.1	-31.3	-32.4
Trade balance	-5.1	-2.1	-4.6	-7.1	-2.7	-3.3
Current account balance 1/	-8.6	-4.2	-7.9	-9.3	-5.6	-4.9
Capital account 2/	-2.2	-5.4	5.9	-6.7	-4.6	-4.9
Exceptional financing 6/	16.6	7.4	12.5	4.2	16.5	17.9
Overall balance after exceptional financing	5.8	-2.2	-1.2	-4.3	6.2	8.2
External debt (including use of Fund credit)	110.1	106.6	102.4	102.0	99.3	98.0
Debt service ratio (before rescheduling) 7/	-53.8	-49.2	-54.5	-54.0	-50.9	-51.0
Debt service ratio (after rescheduling) 7/	-29.3	-39.8	-29.7	-52.5	-16.2	-31.5
Memorandum items						
GDP (in millions of U.S. dollars) 8/	3,370	3,617	3,837	3,837	4,047	4,047
Foreign interest rates (in percent)	7.4	7.3	7.4	7.2	7.4	7.0

Table 6. Costa Rica: Medium-Term Balance of Payments and External Debt Projections (Concluded)

	1988 Proposed Program	Projections 1989	1990	1991	1992
	(In millions of U.S. dollars)				
Current account 1/	-197.0	-202.5	-207.8	-207.1	-211.2
Trade balance	-133.0	-130.8	-136.5	-143.2	-154.5
Exports	1,177.0	1,269.8	1,362.3	1,462.0	1,567.7
Imports	-1,310.0	-1,400.6	-1,498.8	-1,605.2	-1,722.1
Factor payments	-281.8	-296.0	-304.6	-308.9	-314.0
Of which: public sector interest due	-279.0	-291.0	-294.6	-298.9	-304.0
Other services and transfers	217.8	224.3	233.3	245.0	257.2
Capital account	-197.8	-231.7	-210.2	-172.9	-137.6
Public 2/	-331.5	-331.7	-315.2	-282.9	-252.6
Disbursements	117.5	118.0	130.1	143.1	157.4
Amortization due	-449.0	-449.7	-445.3	-426.0	-410.0
Private, and errors and omissions	133.7	100.0	105.0	110.0	115.0
Balance of payments support	225.0	185.0	118.0	105.0	94.0
U.S. AID (ESF)	125.0	85.0	68.0	55.0	44.0
IBRD (SAL)	100.0	100.0	50.0	50.0	50.0
Overall balance before exceptional financing (deficit -)	-169.8	-249.2	-300.0	-275.0	-254.8
Debt relief	--	--	--	--	--
Rescheduling of current obligations	--	--	--	--	--
Rescheduling of past obligations	--	--	--	--	--
Financing gap	499.7	300.1	344.4	314.9	302.8
Expected rescheduling of current obligations 3/	299.7	...	...	...	...
Expected rescheduling of past obligations 3/	285.8	--	--	--	--
Arrears subject to rescheduling	-285.8	--	--	--	--
Residual financing gap	200.0 4/	...	...	...	...
Overall balance after exceptional financing (deficit -)	329.9	51.0	44.4	39.9	48.0
Net international reserves	-329.9	-51.0	-44.0	-39.9	-48.0
Net official reserves (increase -)	-61.7	-50.9	-44.4	-39.9	-48.0
Net use of Fund resources	-15.1	-22.1	-24.4	-17.9	-24.0
Other net official reserves 5/	-46.7	-28.8	-20.0	-22.0	-24.0
Change in arrears (reduction -)	-268.2	--	--	--	--
Outstanding public debt (including exceptional financing)	4,018.7	4,065.0	4,119.8	4,183.9	4,260.1
Debt service (including IMF)	-784.6	-775.9	-765.6	-746.0	-750.0
Amortization	-505.6	-484.9	-471.0	-447.1	-446.0
Of which: IMF	-56.6	-35.2	-25.7	-21.1	-36.0
Interest	-279.0	-291.0	-294.6	-298.9	-304.0
Of which: IMF	-11.1	-10.3	-8.3	-6.6	-5.2
	(As percent of GDP, unless otherwise specified)				
Exports	29.1	29.4	29.6	29.8	30.0
Imports	-32.4	-32.5	-32.6	-32.7	-32.9
Trade balance	-3.3	-3.0	-3.0	-2.9	-2.9
Current account balance 1/	-4.9	-4.7	-4.5	-4.2	-4.0
Capital account 2/	-4.9	-5.4	-4.6	-3.5	-2.6
Exceptional financing 6/	17.9	11.2	10.1	8.6	7.6
Overall balance after exceptional financing	8.2	1.2	1.0	0.8	0.9
External debt (including use of Fund credit)	98.0	94.2	89.6	85.3	81.5
Debt service ratio (before rescheduling) 7/	-51.0	-46.4	-43.0	-39.3	-37.1
Debt service ratio (after rescheduling) 7/	-31.5	...	...	...	...
Memorandum items					
GDP (in millions of U.S. dollars) 8/	4,047	4,314	4,599	4,903	5,226
Foreign interest rates (in percent)	7.0	7.2	7.2	7.2	7.2

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

1/ Excludes official transfers for balance of payments support (U.S. AID).
2/ Excludes disbursements of IBRD's structural adjustment loans.
3/ In 1988 assumes rescheduling of current and past due obligations on terms similar to those agreed upon in 1985.
4/ Consists of the financing of interest in arrears to banks at the end of 1987 plus the amount not paid in 1988.
5/ Includes revolving credit facilities and valuation adjustment.
6/ Includes balance of payments support and financing gap.
7/ As percent of exports of goods and nonfactor services.
8/ GDP in colones has been converted into U.S. dollars using a constant real exchange rate between the colon and the U.S. dollar at the 1988 level.

V. Staff Appraisal

Costa Rica experienced a deep recession and serious balance of payments difficulties in the early 1980s as a result of adverse external developments and shortcomings in domestic policies. The Government has made efforts in the past several years to lay the basis for sustained economic growth. The position of the nonfinancial public sector has been strengthened, interest rate and exchange rate management has been improved, inflation has been reduced, and steps have been taken to open up the economy and to reduce distortions. However, the external position remains weak, partly reflecting the country's heavy debt burden, and the outlook is for relatively modest economic growth over the medium term.

The economic program that the authorities developed for 1987-88 involves a tightening of financial policies and exchange rate action together with other measures aimed at improving overall economic efficiency. The program was expected to achieve a strengthening of the overall balance of payments position despite a decline in coffee prices, while maintaining a moderate rate of output growth and bringing about a further reduction of inflation. Performance under the program in 1987 was mixed. While fiscal policy was on track, there were slippages in the implementation of credit policy and the balance of payments outcome fell short of the program's objectives by a wide margin, as imports rose strongly. The surge in imports, which to a considerable extent was in consumer goods, may have reflected not only the rapid expansion of credit to the private sector but also relative price changes resulting from reductions in duties and consumption taxes on imported final goods.

Looking to 1988, the authorities have stated that they are committed to restoring the momentum of adjustment and have taken measures to this end. In addition to the step devaluation of the colon in mid-January, the program for 1988 contemplates a further reduction in the combined public sector deficit, to the equivalent of no more than 3 percent of GDP, and a major tightening of credit to the private sector. Also, additional structural changes are contemplated.

Passage of the government's tax package in November 1987 augurs well for achieving the planned improvement in the operations of the nonfinancial public sector in 1988. To this end, however, efforts to improve tax administration and to restrain the growth of expenditure will need to be maintained. Moreover, the prices charged by state enterprises will have to be kept under review. As regards the losses of the Central Bank, it would be important to establish arrangements under which the nonfinancial public sector would provide relief to the Central Bank to achieve a more transparent fiscal picture with a view to facilitating further fiscal adjustment.

A key element of the program for 1988 is a sharp tightening of private sector credit through the setting of ceilings on individual banks' credit expansion. Use of this instrument had been abandoned in

1987 because of efficiency considerations, but the authorities have chosen to reinstate such ceilings as the most effective instrument of credit control in view of the liquidity problems currently affecting private financial intermediaries. In this regard, the staff attaches importance to the authorities' intention to accommodate within the credit ceilings for individual banks any relief that may need to be provided to deal with the problems of financial institutions in difficulty. Also, it would be desirable to rely more on instruments of monetary control other than credit ceilings for individual banks once the situation in the private financial sector returns to normal.

The strengthening of the balance of payments requires that the authorities keep credit and exchange rate policies under close review, to enable them to react promptly to changing circumstances. While calculations of the real exchange rate suggest that there was a sizable real depreciation of the colon in the past few years, these calculations do not make allowance for the reductions in import duties and taxes in 1986-87 that lowered relative prices of imported consumer goods. Against this background, the authorities decided early in 1988 to make a step devaluation of the colon, to be followed by crawling adjustments aimed at maintaining the real exchange rate at the level reached after the initial step. This approach was chosen by the authorities in view of the possible implications for exchange rate expectations and interest rates of depreciating in real terms under a crawling peg regime.

The structural reform measures that have been designed by Costa Rica in the context of SAL negotiations with the World Bank need to be pursued with determination to ensure an improvement in economic performance over the medium to longer run. In this respect, special attention should be given to the establishment of a stable policy framework for the development of exports (including the reduction of import restrictions and the rationalization of the tariff schedule), the strengthening of the financial system, and the elimination of distortions stemming from pricing policies.

The authorities have reaffirmed their commitment to re-establish normal relations with Costa Rica's external creditors, an objective that will be facilitated by a return to the adjustment path of the program supported by the stand-by arrangement from the Fund. Conclusion of the first review under the stand-by arrangement would provide a basis for the completion of negotiations with commercial banks and official creditors under the aegis of the Paris Club. The financing arrangements will be reassessed at the time of the second program review to be concluded by mid-1988. In the meantime, Costa Rica's continuing partial payment of interest to commercial banks helps maintain an environment conducive to a cooperative solution to Costa Rica's debt problems.

Costa Rica maintains exchange restrictions evidenced by external payments arrears. In addition, Costa Rica engages in a multiple currency practice for certain remittances for study abroad. At the time of the Board discussion of the stand-by arrangement, the Fund granted temporary approval for the retention of the multiple currency practice for certain remittances, but no approval was granted for the retention of exchange restrictions evidenced by external payments arrears. The discussion at EBM/87/150 (10/28/87), in which that decision was taken, led to the preparation of EBS/88/13 (1/28/88), Legal Effects of Approval or Nonapproval of Exchange Restrictions by the Fund. Pending the Board's discussion of this paper, approval of the exchange restriction that is evidenced by external payments arrears is not being requested by Costa Rica or proposed by the staff. The staff is proposing the extension of the approval of Costa Rica's remaining multiple currency practice through the revised date of the second review under the stand-by arrangement.

The authorities have presented a program that is expected to strengthen Costa Rica's external position and improve economic performance more generally. The efforts of the authorities need to be complemented by external cooperation if the program is to be implemented successfully, with maintenance of orderly payments arrangements. In light of the measures already adopted and those which are being implemented, the staff is of the view that the authorities' program for 1988 justifies continued support from the Fund and proposes that the first review of the stand-by arrangement be completed.

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

Proposed Decisions

The following draft decisions are proposed for approval by the Executive Board:

A. Review of Stand-by Arrangement

1. Costa Rica has consulted with the Fund in accordance with Paragraph 4(b) of the stand-by arrangement for Costa Rica (EBS/87/91, Supp. 2) and Paragraph 2 of the supplementary letter dated October 9, 1987 from the Minister of Finance and the Executive President of the Central Bank of Costa Rica, in order to review the implementation of the measures described in that letter and the letter of April 25, 1987, and to establish performance criteria for 1988.

2. The letter dated March 14, 1988, from the Minister of Finance and the Executive President of the Central Bank of Costa Rica, shall be annexed to the stand-by arrangement for Costa Rica, and the letters dated April 25, 1987 and October 9, 1987 shall be read as modified and supplemented by the letter dated March 14, 1988.

3. Paragraph 1 of the stand-by arrangement is amended to read:

"For the period from October 28, 1987 through March 31, 1989, Costa Rica will have the right to make purchases from the Fund in an amount equivalent to SDR 40 million, subject to paragraphs 2, 3, 4, 5, and 6 below, without further review by the Fund."

4. Paragraph 2(a) of the stand-by arrangement is amended to read:

"Purchases under this stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 10 million until July 29, 1988, the equivalent of SDR 20 million until October 31, 1988, and the equivalent of SDR 30 million until January 31, 1989."

5. Accordingly, Costa Rica will not make purchases that would increase the Fund's holdings of Costa Rica's currency in the credit tranches beyond 25 percent of quota during any period in which:

(i) the limit on central administration expenditures described in paragraph 11 and Table 1 of the letter of March 14, 1988; or

(ii) the ceiling on net banking system credit to the nonfinancial public sector described in Table 1 of the letter of March 14, 1988; or

(iii) the ceiling on the net domestic assets of the central bank described in paragraph 7 and Table 1 of the letter of March 14, 1988; or

(iv) the target for the net international reserves of the central bank described in paragraph 7 and Table 1 of the letter of March 14, 1988; or

(v) the limit on the stock of external payments arrears described in Table 1 of the letter of March 14, 1988;

are not observed."

6. Paragraph 4(c) of the stand-by arrangement is amended to read:

"during any period after July 28, 1988 until the second review referred to in paragraph 2 of the attached supplement to the Letter of Intent has been completed and understandings have been reached on any necessary changes in performance criteria, or after such performance criteria have been changed, while the revised performance criteria are not being observed; or"

7. The Fund decides that the review contemplated in paragraph 4(b) of the stand-by arrangement has been completed, and that Costa Rica may proceed to make purchases subject to the observance of performance criteria in accordance with paragraph 4 of the stand-by arrangement.

B. Approval of Exchange Restrictions

The approval in Decision No. 8717-(87/150) of Costa Rica's multiple currency practice regarding certain remittances is extended until the earlier of the completion of the second review under the stand-by arrangement or June 30, 1988.

Fund Relations with Costa Rica
(as of January 31, 1988)

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

		Millions of SDRs	Percent of Quota
(b) Total Fund holdings of colones:		175.08	208.18
(c) Fund credit:	Total	90.69	108.16
Of which:	Credit tranches	28.53	33.93
	CFF	6.98	8.29
	EAR	47.49	56.47
	Extended facility	6.56	7.80
	Supplementary facility	1.41	1.67
(d) Reserve tranche position:		--	--

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

(a) Stand-by and extended arrangements:

Type of Arrangement	Amount (SDR million)	Percent of Quota	Duration	Amount Drawn (SDR million)	Status
SBA	50.00	59.5	10/28/87-3/31/89	--	Active
SBA	54.00	64.2	3/13/85-4/30/86	34.0	Expired
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

Date of Approval	Amount Drawn: SDR Million	Amount Drawn: Percent of Quota
Sept. 1983	18.60	30.2
June 1981	30.10	48.9

IV. SDR Department	Millions of SDRs	Percent of Allocation
(a) Net cumulative allocation:	23.73	100.00
(b) Holdings:	0.01	0.03
(c) Current designation plan:	--	--

V. Administered Accounts: None.

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

	Overdue Financial Obligations (Jan. 31, 1988)	Principal and Interest Due Feb.-Dec. 1988	1989	1990	1991
Repurchases	--	37.9	26.1	19.0	5.2
Charges and interest including SDR (provisional)	--	5.5	5.1	3.3	2.0
Total	--	43.4	31.2	22.3	7.2

(B) Nonfinancial Relations

VII. Exchange Rate Arrangements: The representative exchange rate for the Costa Rican colon is the unified banking rate which was quoted at ₡ 73.95 (selling) per U.S. dollar as of January 31, 1988. 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.

VIII. Exchange Restrictions: Costa Rica maintains a restriction on payments and transfers for current international transactions evidenced by external payments arrears and engages in a multiple currency practice for certain remittances for study abroad. On October 28, 1987, the Executive Board approved the retention of the multiple currency practice for certain remittances until the earlier of the completion of the second review of the stand-by arrangement approved that date or April 30, 1988 (EBM/87/150). Costa Rica's exchange restriction, evidenced by arrears on external debt obligations, was not approved by the Fund at that time.

IX. Last Article IV Consultation: Consultation discussions were held in May-July 1986 and completed by the Executive Board on October 30, 1986 (EBM/86/241). Consultations are conducted on a 12-month cycle.

X. 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. Since April 1986 an Advisor has been assisting 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 José to advise the authorities on procedures and techniques used in the formulation of monetary policy.

(b) FAD: A panel expert was assigned to the Ministry of Finance from August 1980 to December 1983, to provide assistance principally in the area of budgetary procedures.

(c) Bureau of Statistics: Technical assistance missions to improve the reporting of monetary data were fielded in December 1984 and May 1985. In January 1985 a technical assistance mission on balance of payments accounting visited Costa Rica. In May 1986 a STAT economist assisted the authorities in the implementation of procedures to improve the classification and monitoring of the Central Bank's net unclassified assets. A government finance statistics mission visited the country in July 1986. In September 1987 Costa Rica was included in a technical assistance mission on the five countries of the Central American Monetary Council to promote methodological consistency in the preparation and formulation of monetary and financial accounts.

XI. Resident Representative/Advisor: In January 1988 Mr. Ignacio Tampe replaced Mr. Hector Avila as the Fund's resident representative in San José.

Relations with the World Bank Group

Costa Rica has received to date 31 Bank loans, 1 IDA credit, and financing through IFC of 5 investment projects, totaling US$515 million (see table below). Of this amount, less than US$35 million remains to be disbursed.

Prior to 1981, World Bank lending to Costa Rica was concentrated primarily on developing basic infrastructure. With the growing financial and economic deterioration in Costa Rica that occurred in the early 1980s, the Bank's strategy 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 the principal elements of the next phase of a structural reform program. These include: (i) trade reform policies; (ii) banking reform policies; (iii) management of the public sector and public savings targets; (iv) incentive policies and organizational reforms in the productive sectors to promote exports; and (v) external debt management. The above reform program would be supported by a second World Bank structural adjustment loan which was appraised in September 1987; the overall package is expected to be cofinanced by the Government of Japan. The following tabulation describes Costa Rica's financial relations with the World Bank group.

(In millions of U.S. dollars, as of December 31, 1987)

A. IBRD/IDA/IFC Operations

	Number of Credits	Disbursed to Date	Undisbursed	Total	Repaid
1. IBRD loans	31	481.6	33.3	514.9	163.9
Agriculture	4	29.7	26.0	55.7	16.7
Education	1	6.0	--	6.0	0.7
Export	1	25.2	--	25.2	1.0
Imports	2	6.5	--	6.5	4.6
Industry	3	19.9	--	19.9	9.9
Power	7	126.4	0.5	126.9	62.0
Technical assistance	1	1.5	2.0	3.5	--
Telecommunications	4	57.9	--	57.9	26.5
Transport	6	107.3	--	107.3	34.9
Water supply	1	21.2	4.8	26.0	7.6
SAL	1	80.0	--	80.0	--
2. IDA credit	1	5.5	--	5.5	1.5
Transport	1	5.5	--	5.5	1.5
3. IFC investments	5	6.7	--	6.7	...

B. IBRD Loan Transactions 1/

	1981	1982	1983	1984	1985	1986	1987
Net disbursements	13.7	7.5	5.8	17.0	62.4	31.0	-18.0
Gross Disbursements	22.3	19.7	23.5	36.2	84.1	55.2	13.6
Pincipal Repayments	-8.6	-12.2	-17.7	-19.2	-21.7	-24.2	-31.6

Source: IBRD.

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

Costa Rica--Basic Data

Social and demographic indicators	
Area	51,100 sq. kilometers
Population density (1987)	51.3 per sq. km.
Income distribution (1973)	
Highest quintile	55.0 percent
Lowest quintile	3.0 percent
Population (1987)	2.7 million
Rate of population growth (1975-84)	2.9 percent
Life expectancy at birth (1986)	73 years
Infant mortality rate (aged under 1, 1986)	19 per thousand
Population per physician	1,400
Population per hospital bed	345
Population with access to safe water (1986)	
Urban	100.0 percent
Rural	68.0 percent
Population with access to electricity (1973)	69.0 percent
Calorie intake (1984)	2,800 calories per day
Adult literacy rate	93.1 percent
Primary school enrollment rate (1983)	100.0 percent

	1982	1983	1984	1985	1986	1987
Nominal GDP						
Colones (million)	97,505	129,314	163,011	192,425	242,118	270,271
US$ (million) 1/	2,700	2,887	3,233	3,370	3,617	3,837
SDR (million)	2,445	2,526	2,995	3,268	3,083	2,968
GDP per capita (US$)	1,121	1,165	1,268	1,266	1,340	1,381
Unemployment rate (percent)	8.0	7.4	6.4	6.0	6.3	6.0
Origin of GDP						
Agriculture	25	22	21	20	22	18
Manufacturing	20	22	22	22	22	22
Construction	3	3	4	4	3	3
Utilities	2	4	3	4	3	4
Commerce	22	20	19	19	18	19
Other	28	29	31	31	32	34
Ratios to GDP						
Exports of goods and nonfactor services	44	36	35	32	35	33
Imports of goods and nonfactor services	42	37	34	34	33	37
Central administration revenue	14	17	17	17	16	17
Central administration expenditure	18	20	20	19	19	19
Banking system credit to private sector	16	18	18	18	17	19
Money and quasi-money 2/	35	37	35	34	33	37
Banking system 3/			(billions of colones)			
Net international reserves	-44.8	-3.9	-10.3	-1.3	-4.8	-15.3
Of which: payments arrears	-42.7	-1.7	-9.8	-2.3	-10.2	-16.9
Net domestic assets	85.5	57.7	71.1	71.2	92.4	121.5
Net credit to public sector	11.6	26.5	25.4	23.8	35.7	32.0
Credit to private sector	18.1	27.5	32.5	37.7	44.8	55.8
Long-term foreign liabilities	-27.1	-64.4	-71.8	-86.9	-104.2	-114.3
Other 4/	82.9	68.1	85.0	96.6	116.1	148.0
Liabilities to private sector	40.7	53.8	60.8	69.9	87.7	106.2

	1982	1983	1984	1985	1986	1987
			(millions of colones)			
Nonfinancial public sector 5/						
Central Administration	-3,258	-4,627	-4,966	-3,940	-8,245	-5,845
Revenue	14,026	21,417	27,012	32,005	38,030	44,500
Expenditure	17,284	26,044	31,978	35,945	46,275	50,345
Rest of general government	320	2,347	1,909	2,605	3,281	3,690
Revenue	10,782	17,555	21,755	27,354	33,888	38,923
Expenditure	10,462	15,208	19,846	24,749	30,607	35,233
Public enterprises	-5,696	-1,737	-32	-2,380	895	1,623
Revenue	18,374	29,545	35,324	38,695	44,715	49,582
Expenditure	24,070	31,282	35,356	41,075	43,820	47,959
Current account	-2,431	5,020	8,041	8,177	12,232	14,965
Central Administration	-1,046	464	426	1,862	1,172	898
Rest public sector	-1,385	4,556	7,615	6,315	11,060	14,067
Overall deficit	-8,634	-4,017	-3,089	-3,715	-4,069	-532
External financing	-1,459	-341	1,460	699	-2,066	-5,626
Domestic financing	2,623	14,848	-471	-1,054	731	-415
External arrears (change)	7,470	-13,767	2,100	-3,096	2,044	676
Rescheduling	--	3,277	--	7,166	3,360	5,897
Balance of payments			(millions of U.S. dollars)			
Merchandise exports, f.o.b.	869	852	998	939	1,086	1,114
Merchandise imports, c.i.f.	-894	-993	-1,102	-1,111	-1,163	-1,385
Investment income (net)	-347	-334	-314	-282	-281	-285
Other services and transfers (net)	132	191	263	324	287	321
Balance on current and transfer accounts (including official transfers)	-240	-284	-155	-130	-71	-235
Official capital (net)	-89	237	16	168	-71	-339
Private capital and errors and omissions (net)	16	97	12	99	49	102
SDR allocations	--	--	--	--	--	--
Overall balance (deficit -)	-314	50	-127	137	-94	-472
Change in net official international reserves (increase -) 6/	-139	219	-48	-25	-55	77
Arrears, net (accumulation +)	453	-269 7/	175	-112 7/	149	395 8/

	December 31					
	1982	1983	1984	1985	1986	1987
International reserve position			(millions of SDRs)			
Central Bank (gross)	221	293	450	467	452	353
Central Bank (net)	-1,065	-127	-268	-60	-119	-219
Of which:						
payments arrears	-1,006	-38	-222	-42	-147	-189
Rest of banking system (net)	11	55	33	36	50	47

1/ GDP in colones has been converted into U.S. dollars using a constant real exchange rate between the colon and the U.S. dollar at the 1988 level.
2/ Ratio to GDP of average of liabilities to the private sector at the end of current and previous year.
3/ End of year; foreign currency balances are valued at accounting exchange rates.
4/ Includes government trust funds, counterpart arrears, and central bank operational losses.
5/ Expanded coverage of public sector, differs from program definition.
6/ Includes special lending facilities of foreign commercial banks.
7/ Reduction in arrears, net of rescheduling.
8/ Includes arrears subject to rescheduling and rescheduling of previous arrears.

Costa Rica: Statistical Issues

1. Outstanding Statistical Issues

a. Prices

The weighting patterns of the wholesale price index (base 1970) and the consumer price index (base 1975) are somewhat outdated. New surveys to reweight and rebase these indices would seem to be appropriate. In 1987 the authorities began a feasibility study for constructing a new index of producer prices.

b. Government finance

The 1987 Government Finance Statistics Yearbook (GFSY) includes data for budgetary central government and social security funds through 1986 and for local governments through 1985. There is a need to compile data on the extrabudgetary units (decentralized agencies) of the central government and to improve data on central government financing and debt. Annual data on central government in IFS are as reported in the 1986 GFSY.

c. Monetary accounts

Although monetary statistics for the Central Bank and commercial banks are reported regularly, there is a need for more regular reporting of data for other banking institutions.

Costa Rica was included in a September 1987 technical assistance mission on the five countries of the Central American Monetary Council which focused on the preparation and formulation of monetary and financial accounts, with emphasis on achieving methodological consistency. The mission evaluated the methodology used in the compilation of data, the mechanisms used for the collection and transmission of information, institutional coverage, sectorization of the economy, and problems of currentness, presentation and publication of monetary statistics. It focused primarily on the central bank's accounting and statistical systems and recommended that the accounting system currently used be modernized. To this end, the mission produced a new accounts code for the Central Bank, and suggested that the work carried out in Costa Rica serve as a model for the other countries. Subsequent work will be needed to deal with deposit money banks, other banking institutions and other financial institutions.

d. External debt

This is one of the weakest statistical areas. A CBD expert is providing assistance to the Central Bank, and a new system to update and compile external debt data is expected to be implemented toward the end of 1988

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 1988 issue of IFS. The data are based on reports sent to the Fund's Bureau of Statistics by the Banco Central de Costa Rica, which during the past year have been provided on a timely basis.

Status of IFS Data

		Latest Data in March 1988 IFS
Real Sector	- National Accounts	1986
	- Prices: Home and imported goods	December 1987
	- CPI	December 1987
	- Production	n.a.
	- Employment	n.a.
	- Earnings	n.a.
Government Finance	- Deficit/Surplus	September 1987
	- Financing	September 1987
	- Debt	June 1987
Monetary Accounts	- Monetary Authorities	December 1987
	- Deposit Money Banks	December 1987
	- Other Financial Institutions	Q3 1986
Interest Rates	- Discount Rate	December 1987
	- Bank Lending/Deposit Rate	December 1987
	- Government Bond Yield	n.a.
External Sector	- Merchandise Trade:	
	Values	September 1987 1/
	Prices (unit values of principal export commodities)	December 1987
	- Balance of Payments	1986
	- International Reserves	December 1987
	- Exchange Rates	December 1987

1/ Exports through August 1987.

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

Scheduled Availability Date	October Program 1/		Proposed Program	
	Amount	Conditions Necessary For Purchase 2/	Amount	Conditions Necessary For Purchase 2/
October 29, 1987	SDR 8.33 million	Executive Board approval of program.		
After January 28, 1988	SDR 8.33 million	Observance of quantitative performance criteria as of December 31, 1987 and completion of the first program review.		
After April 28, 1988	SDR 8.34 million	Observance of quantitative performance criteria as of March 31, 1988 and completion of the second program review.	SDR 10 million	Observance of quantitative performance criteria as of March 31, 1988.
After July 28, 1988	SDR 8.33 million	Observance of quantitative performance criteria as of June 30, 1988 and any other conditions to be decided upon in the program reviews.	SDR 10 million	Observance of quantitative performance criteria as of June 30, 1988 and completion of the second program review.
After October 30, 1988	SDR 8.33 million	Observance of quantitative performance criteria as of September 30, 1988 and any other conditions to be decided upon in the program reviews.	SDR 10 million	Observance of quantitative performance criteria as of September 30, 1988 and any other conditions to be decided upon in the second program review.
After January 30, 1989	SDR 8.34 million	Observance of quantitative performance criteria as of December 31, 1988 and any other conditions to be decided upon in the program reviews.	SDR 10 million	Observance of quantitative performance criteria as of December 31, 1988 and any other conditions to be decided upon in the second program review.

1/ As presented in EBS/87/91, Supplement 1; October 16, 1987. No purchase has been made to date under the program.
2/ Other than generally applicable conditions under the arrangement and nonquantitative performance criteria, including the performance clauses on the exchange and trade system.

San José, Costa Rica
March 14, 1988

Mr. Michel Camdessus
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Camdessus:

1. In our letters of April 25 and October 9, 1987, we outlined the main elements of an economic and financial program for the two-year period 1987-88 that is being supported by a stand-by arrangement from the Fund. As you will recall, in our second letter we described supplemental action aimed at compensating for a prospective deviation in the external current account in relation to the original program of April 1987. This action included a more active exchange rate policy, a reduction of the nonfinancial public sector deficit of nearly 1/2 percent of GDP in 1987 beyond that envisaged in the original program, and measures to bring about a net monetary contraction during the last quarter of the year equivalent to slightly more than 1 percent of 1987 GDP.

2. In accordance with the program guidelines, the depreciation of the colon was accelerated to an annual rate of about 30 percent in the last quarter of 1987, compared with 12 percent in the first half of the year and 17 percent in the third quarter. At the same time, there was a large widening of trade deficit in 1987, as imports were higher than programmed by the equivalent of 3 percent of GDP. Import growth was stimulated by the large income gains from coffee exports that took place in late 1986, by a lower taxation on imported final goods, and by a rapid expansion of bank credit to the private sector.

3. We encountered difficulties in implementing our monetary policy during the closing months of 1987, related in part to uncertainties in private financial markets, and credit as well as imports continued to expand rapidly. As a consequence, the limit on the Central Bank's net domestic assets, the target for the net international reserves, and the limit on the stock of external payments arrears for end-1987 were not observed. However, about one third of the deviation from the international reserves target was due to valuation adjustments stemming from large swings in foreign exchange rates and to revisions in the end-1986 data on payments arrears. On the fiscal side, the target for the combined public sector deficit was met, although central government expenditure slightly exceeded the program ceiling.

4. Since the beginning of this year, the Government has adopted a set of measures aimed at achieving the objectives contemplated in the program for 1988, as well as correcting a substantial part of the deviation in the net international reserves that took place in 1987. These measures, which are described below, are expected to result in an improvement in our net official reserve position of about US$60 million during 1988, after having eliminated all external payments arrears.

Quarterly performance criteria for the monitoring of the progress made in the implementation of the program for 1988, which incorporate the effect of seasonal factors, are presented in the attached Table 1.

5. Taking into account that the purchase available upon the Fund's Executive Board approval of the program in October 1987 was not made, and that it is our intention not to make any purchase until a satisfactory track record has been established, we hereby request that the amount of the present stand-by arrangement be reduced from SDR 50 million to SDR 40 million, and that the new amount be made available in four equal quarterly purchases starting with a first purchase, subject to the observance of end-March quantitative performance criteria, in the second quarter of 1988. It is now expected that the second review, to assess the adequacy of external financing in the context of the financial package that we intend to negotiate with commercial banks and the progress made in the implementation of the program, would be completed by end-June 1988.

6. The Government is determined to strengthen the external accounts as part of its export-led growth strategy. Efforts already made in this area include the sizable depreciation of the colon that has taken place in recent years, which has resulted in a rapid expansion of nontraditional exports to markets outside the Central American region. This depreciation, however, does not seem to have been large enough to compensate for the effect of recent reductions in duties and taxes on imported consumer goods, as evidenced by last year's sharp rise in imports. Thus, in mid-January we made a step devaluation of 6 percent vis-à-vis the U.S. dollar, in the belief that this would provide a clear signal of our determination to improve the country's competitive position. This action will be followed by crawling adjustments in the exchange rate according to price movements in Costa Rica and in its trading partners so as to maintain the real exchange rate at the level reached after the initial step devaluation. We expect that this policy will be consistent with a lower level of real interest rates than the policy followed in 1987 when we sought a real depreciation through the working of a crawling peg system. In addition, we have taken tax measures to curb imports of automobiles, whose rapid growth in 1987 contributed substantially to the weakening of the balance of payments. These measures include a tenfold increase in the road tax, a rise in consumption taxes on small cars, and a temporary import surcharge applying to all vehicles.

7. To ensure the desired improvement in the balance of payments, the exchange rate action will be accompanied by a tightening of monetary policy. Thus, monetary policy will aim at slowing down inflation to about 10 percent and improving the net international reserves of the Central Bank to US$20 million by the end of 1988. Consistent with these objectives, the net domestic assets of the Central Bank (excluding the counterpart of external debt arrears and including the cash losses of the Central Bank) will decline by 9 1/2 percent in 1988. The intended contraction incorporates the effect of the special financial support being extended to stabilize the private financial sector, following the recent failure of a number of financial intermediaries. This support

includes a temporary reduction in legal reserve requirements from 10 to 6 percent on time deposits of more than six months. The freed resources would be allowed to be lent to financial intermediaries with liquidity needs as well as to borrowers of these institutions to facilitate an orderly recovery of their loans.

8. Consistent with this policy, the recent sharp rise in credit to the private sector will have to be curtailed. To this end, the Central Bank has established ceilings on lending by individual banks to the private sector. Under these ceilings, which apply to both state and private banks, the 1988 increase in private sector credit financed with domestic resources will be limited to 5 percent over the level outstanding at end-November 1987. The credit financed with external resources will also be controlled by the Central Bank so that total banking system credit to the private sector will not rise by more than 10 percent during 1988, including any support extended to the nonbank financial intermediaries. Nevertheless, for the two-year period 1987-88 as a whole, private sector credit would grow faster than nominal GDP.

9. Notwithstanding some reduction in interest rates offered by private banks during the early weeks of 1988, the spread between these rates and the yields on public sector bonds remains large by historical standards; no action has been taken at this time because we felt that any rise in bond rates would serve to attract resources into the public sector, thus adding stress to private financial markets. Nevertheless, the Government is determined to continue the pursuit of a flexible interest rate policy in order to maintain the attractiveness of saving in domestic currency, particularly in view of the adverse impact on our credit program of a shift in the composition of private sector liabilities. Accordingly, we will continue monitoring closely the behavior of our financial markets and stand ready to reduce the interest rate spread to past standards once the situation in the private financial sector returns to normal.

10. To achieve the original target of limiting the combined public sector deficit to no more than 3 percent of GDP in 1988, we have taken steps to ensure that the nonfinancial public sector will register a surplus in its operations of about 3/4 of 1 percent of GDP, to compensate for a widening of the net operating losses of the Central Bank from 3.1 percent in 1987 to 3.8 percent in 1988. Most of the increase in the operating losses reflects the real depreciation of the colon in recent months, as the main component of these losses is the interest due on the Central Bank's external debt. The larger burden of the adjustment in the operations of the nonfinancial public sector will be on revenue measures.

11. The central government is expected to narrow its deficit by close to one fourth of 1 percent of GDP in 1988 on the basis of higher tax revenue. The tax package that was submitted to the Legislative Assembly early last year was approved in November, and it is estimated that it will raise additional revenue equivalent to about 1 1/3 percent of GDP. This increase in revenue, however, will be partly offset by a reform of the income tax that would reduce tax rates and raise minimum

exemptions, and by the effects of a prospective decline in the volume of coffee exports and non-oil imports. The Government intends to limit the expansion of central administration expenditures (gasto reconocido) to 15 percent in 1988, including the effect of a substantial increase in the proportion of disbursements of foreign loans for other public sector institutions that is channeled through the central administration. This limit could be adjusted upward by up to ₡ 2 billion, to the extent that actual revenue exceeds projected revenue.

12. The operations of the nonfinancial public sector outside the central administration are expected to show an improvement of close to 1 percent of GDP, largely on the strength of a better performance of the public enterprises. Electricity charges and the prices of petroleum derivatives have been increased in recent months, and the structure of producer and consumer prices for corn and beans has been modified so as to improve the finances of CNP (the national grain marketing agency). Furthermore, CNP has begun to impose user charges on some of the handling and processing services that up to now have been provided free; this process will continue so that in 1989 user charges will completely cover CNP's cost of providing these services.

13. It is expected that the measures described above will result in an improvement in the external current account equivalent to nearly 4 percent of GDP. Despite this effort, external support will be needed to achieve the target for the net international reserves. The financing of our program largely relies on reaching early understandings with our creditors, and on obtaining a timely approval from the Legislative Assembly of a Structural Adjustment Loan from the World Bank and associated cofinancing from the Government of Japan. Negotiations with commercial banks are progressing satisfactorily and we expect that they will be concluded by the end of April 1988; in the meantime, we intend to continue making monthly interest payments of US$5 million to commercial banks. We also have requested that official creditors under the aegis of the Paris Club consider the rescheduling of Costa Rica's debt after the Fund Executive Board's consideration of the program described in this letter.

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

Sincerely yours,

/s/
Fernando Naranjo Villalobos
Minister of Finance

/s/
Eduardo Lizano Fait
Executive President
Central Bank of Costa Rica

Table 1. Costa Rica: Limits, Ceilings, and Targets Under the Program for 1988-89 1/

Variables and Periods	Amounts
Ceiling on Cumulative Central Government Expenditure 2/	
January 1, 1987-March 31, 1988	63,380
January 1, 1987-June 30, 1988	78,450
January 1, 1987-September 30, 1988	91,040
January 1, 1987-December 31, 1988	108,100
Ceiling on net Credit to the Nonfinancial Public Sector from the Banking System 3/	
March 31-June 29, 1988	36,700
June 30-September 29, 1988	34,700
September 30-December 30, 1988	31,900
December 31, 1988-March 31, 1989	34,400
Ceiling on the Net Domestic Assets of the Central Bank 4/	
March 31-September 29, 1988	39,500
September 30-December 30, 1988	21,700
December 31, 1988-March 31, 1989	20,500
Target for the Net International Reserve Position of the Central Bank 5/	
March 31-September 29, 1988	-300
September 30-December 30, 1988	-65
December 31, 1988-March 31, 1989	20
Limit on the Stock of Payment Arrears 6/	
March 31-June 29, 1988	260
June 30-September 29, 1988	245
September 30-December 30, 1988	30
December 31, 1988-March 31, 1989	--

1/ The ceilings on foreign borrowing by the public sector will remain as described in paragraph 22 of the letter of April 27, 1987.

2/ Defined as the sum of budgetary expenditures (gasto reconocido) plus pending commitments (compromisos pendientes) plus extrabudgetary expenditures of the Central Government plus unpaid current interest. These limits shall be increased by the amounts that actual revenues exceed projected revenues as follows: (a) in the period January 1, 1987-March 31, 1988, by up to ₡ 400 million if revenues exceed ₡ 56,310 million; (b) in the period January 1, 1987-June 30, 1988, by up to ₡1,150 million if revenues exceed ₡ 68,850 million; (c) in the period January 1, 1987-September 30, 1988, by up to ₡ 1,360 million if revenues exceed ₡ 81,300 million; and (d) in the period January 1, 1987-December 31, 1988, by up to ₡ 2,000 million if revenues exceed ₡ 96,250 million.

3/ Defined to include the net credit extended by the Banco Internacional to the nonfinancial public sector. For this purpose, the nonfinancial public sector includes the central government, decentralized agencies, state enterprises, and the "Oficina del Arroz". This ceiling excludes foreign loans from the Canadian International Development Agency (CIDA) to the nonfinancial public sector channeled through the Central Bank. This ceiling will be reduced by the amount of counterpart funds from transfers of the Central Bank to the Central Administration, and any reduction in CODESA's indebtedness with the Central Bank arising from the sale of CODESA's subsidiaries. This ceiling will also exclude credit arising from additional assumption of external debt of the nonfinancial public sector by the Central Bank during the program period. Departures from the assumed net placement of government bonds (no change in the first and second quarters, ₡ 300 million in the third quarter, and ₡ 1,700 million in the fourth quarter) will require an offsetting adjustment of this ceiling.

4/ Defined as the difference between currency issue and net international reserves of the Central Bank.

5/ Defined as the difference between the Central Bank's gross foreign assets and short-term foreign liabilities, including its net position with the Fund and arrears on commercial payments and external debt service (excluding amounts assumed to be rescheduled). Interest in arrears to banks is to be included in short-term foreign liabilities.

6/ Defined as the stock of arrears on medium- and long-term external public debt outstanding at the end of 1986, plus the increase in arrears not subject to rescheduling, plus the outstanding balance of deposits for foreign exchange requests held by the Central Bank of Costa Rica in excess of 15 working days. Interest in arrears to banks is to be included.