FOR AGENDA

EBS/85/31

CONFIDENTIAL

February 5, 1985

To: Members of the Executive Board

From: The Secretary

Subject: Costa Rica - Request for Stand-By Arrangement

Attached for consideration by the Executive Directors is a request from Costa Rica for a stand-by arrangement equivalent to SDR 54 million. Draft decisions appear on page 26.

This subject will be brought to the agenda for discussion on a date to be announced.

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

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

COSTA RICA

Request for Stand-by Arrangement

Prepared by the Western Hemisphere Department

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

Approved by Eduardo Wiesner and Manuel Guitian

February 4, 1985

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I. Introduction

Discussions on an economic program that could be supported by the Fund with a stand-by arrangement in the upper credit tranches were held in San Jose during September 6-21, 1984 and in Washington, D.C. during the Annual Meetings and in the period October 15-19, 1984.1/ In the attached letter dated January 11, 1985, the Minister of Finance and the Executive President of the Central Bank of Costa Rica request a thirteen-month stand-by arrangement in an amount equivalent to SDR 54 million, or 64 percent of Costa Rica's quota of SDR 84.1 million. The proposed stand-by arrangement would be financed by SDR 27 million from ordinary resources and SDR 27 million from borrowed resources. The phasing of purchases under the stand-by arrangement is set out in Table 1. A waiver of the limitation in Article V, Section 3(b)(iii) of the Articles of Agreement is proposed.

As of December 31, 1984, the Fund's holdings of Costa Rican colones amounted to SDR 243.1 million, equivalent to 289.1 percent of quota, of which 49 percent corresponded to purchases under the compensatory financing facility and 140.1 percent corresponded to purchases under the tranche policies. The proposed stand-by arrangement, if fully utilized and taking into account scheduled repurchases, would increase the Fund holdings of Costa Rican colones to 321.6 percent of quota by the conclusion of the period of the arrangement (295.2 percent of quota, if purchases under the compensatory financing facility are excluded). Further information on Costa Rica's relations with the Fund is presented in Appendix I.

Costa Rica's last stand-by arrangement in the upper credit tranches expired in December 1983. The 1984 Article IV consultation was conducted in San Jose in February-March 1984 and was concluded by the Executive Board on August 1, 1984 (EBM/84/119).

II. Summary of Recent Developments 2/

At the end of the last decade, Costa Rica's external position came under severe strain as a result of both external and internal factors. The external factors which affected Costa Rica adversely were the sharp fall in its terms of trade arising from the drop in world coffee prices after 1978 and the second round of oil price increases, the recession in the industrialized countries and the surge in interest rates in

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1/ The staff representatives were R. A. Elson (Head), M. Figuerola, T. Lehwing, J. Martelino (all WHD) and P. Edwards (Secretary-WHD). Mr. Tampe, the Fund resident representative in San Jose, assisted the mission and participated in the discussions at headquarters.

2/ Recent economic developments in Costa Rica and performance under the last stand-by arrangement were reviewed in detail in the staff reports for the 1984 Article IV consultation (SM/84/146 and SM/84/156).

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

	Outstanding Dec. 31, 1984	1985 Jan.-Mar.	1985 Apr.-June	1985 July-Sept.	1985 Oct.-Dec.	1986 Jan.-Mar.
			(In millions of SDRs)			
Transactions under tranche policies (net)	--	12.7	6.7	10.0	7.0	10.0
Purchases	--	14.0	10.0	10.0	10.0	10.0
Ordinary resources	(--)	(7.0)	(5.0)	(5.0)	(5.0)	(5.0)
Enlarged access resources	(--)	(7.0)	(5.0)	(5.0)	(5.0)	(5.0)
Repurchases	--	-1.3	-3.3	--	-3.0	--
Ordinary resources	(--)	(-1.3)	(-1.3)	(--)	(-0.9)	(--)
Enlarged access resources	(--)	(--)	(-2.0)	(--)	(-2.1)	(--)
Transactions under special facilities (net) 1/	--	-3.8	-3.8	-3.8	-3.8	-3.8
Purchases	--	--	--	--	--	--
Repurchases	--	-3.8	-3.8	-3.8	-3.8	-3.8
Total Fund credit outstanding (end of period)	159.0	167.9	170.8	177.0	180.2	186.4
Under tranche policies 1/	117.8	130.5	137.2	147.2	154.2	164.2
Special facilities 2/	41.2	37.4	33.6	29.8	26.0	22.2
			(As percent of quota)			
Total Fund credit outstanding (end of period)	189.1	199.6	203.1	210.5	214.3	221.6
Under tranche policies 1/	140.1	155.2	163.1	175.0	183.3	195.2
Special facilities 2/	49.0	44.5	40.0	35.4	30.9	26.4

Source: IMF Treasurer's Department.

1/ Includes outstanding use under EAR, SFF and EFF.
2/ Compensatory Financing Facility.

international markets, as well as the political turmoil and economic decline in the Central American region. The effects of these developments were compounded by expansionary financial policies in Costa Rica, which led to a progressive increase in the overall deficit of the nonfinancial public sector to the equivalent of 14 percent of GDP in 1981. The fiscal imbalance resulted in large deficits in the current account of the balance of payments in 1980-81, notwithstanding a large real depreciation of the colon. In addition, Costa Rica encountered serious difficulties in servicing its external debt, and it had to suspend service payments in August 1981. Real GDP declined sharply in 1981, while inflation accelerated to 65 percent.

After a further weakening of the overall financial situation during the first half of 1982, a new Administration began to adopt fiscal and other measures to redress the serious economic and financial deterioration. Major tax increases and large adjustments in public sector prices were put into effect in the second semester of 1982. This effort, supported by a policy of expenditure restraint, resulted in a decline of the overall deficit of the nonfinancial public sector of about 5 percentage points to around 9 percent of GDP in 1982. Moreover, in August 1982 the authorities reorganized and simplified the exchange system by establishing a dual market arrangement, consisting of a fixed exchange rate for most trade transactions and a fluctuating exchange rate for other transactions. The new Administration also opened talks with foreign commercial banks and resumed partial interest payments on its foreign debt. Despite a drop in the external current account deficit from around 16 percent of GDP in 1981 to 9 1/2 percent in 1982, the balance of payments registered a substantial overall deficit in the latter year, which was financed by a further accumulation of arrears on external debt service.

In the context of a one-year stand-by arrangement from the Fund, which was approved on December 20, 1982, Costa Rica made further progress toward economic stabilization and recovery in 1983. The economic program supported by that arrangement was designed to contain inflationary pressures, to bring about a gradual unification of the exchange markets and to facilitate the resumption of external debt service payments. Performance under the program was generally satisfactory. In particular, inflationary pressures subsided quickly as the rate of price increase came down to around 11 percent during the year ended December 1983, compared with a program target of 40 percent. The better than projected price performance appears to have been related to a sharper reduction in the overall fiscal deficit than expected in the program, a higher than projected import level, and an appreciation of the colon in the free market associated with a recovery of confidence and a favorable change in inflationary expectations. Virtually all external debt arrears (which had amounted to around US$1 billion) were eliminated by the end of 1983, and the overall balance of payments registered a surplus compared with a target of equilibrium in the program.

The overall deficit of the nonfinancial public sector was equivalent to 3 1/2 percent of GDP in 1983, compared with a program target of 4 1/2 percent,1/ on the strength of a better than expected performance of the main decentralized entities; the Central Administration's deficit turned out to be somewhat higher than projected. Central government revenues increased significantly in 1983, but expenditures rose at a faster rate than in the program, mainly as a result of salary increases in the second half of the year. The strong performance of the rest of the public sector reflected large increases in social security contributions, tariffs of the National Electricity Corporation (ICE), and prices charged by the State Petroleum Refinery (RECOPE). The operating surplus of the state enterprise sector fell somewhat short of the program target, in part because of a partial rollback of tariff adjustments by RECOPE and ICE at midyear in the wake of public protests, but this result was more than offset by a reduction in investment spending and a stronger than projected performance of the Social Security Institute.

Despite the improvement in the fiscal position of Costa Rica, the current account deficit of the balance of payments rose to around 10 1/2 percent of GDP in 1983, compared with a target of 8 percent under the program.2/ Export performance was weak, while imports rose more than had been projected, as there was a sharp increase in bank credit to the private sector financed in part by substantial net inflows of private capital (apparently including some reflow of savings held abroad). On the strength of these inflows and an increase in concessional aid and debt relief from foreign creditors, the overall balance of payments yielded a surplus of US$55 million in 1983. Also, the exchange markets were formally unified at ₡ 43.65 per U.S. dollar (selling) in mid-November 1983, and virtually all arrears were eliminated by the end of the year, mainly as a result of rescheduling agreements with the Paris Club and foreign commercial banks.

During 1984 Costa Rica made further progress toward economic stabilization and recovery, although not as much as had been expected during the consultation discussions of February-March 1984. On the positive side, the rate of inflation remained relatively low (13 percent on an average annual basis), and there was a further recovery in the growth of domestic output (3 1/2 percent in 1984), associated with a significant increase in exports (following two years of no growth) and investment spending.

1/ The fiscal targets were defined to exclude the net losses of the Central Bank, which are significant because of its heavy interest payments of foreign commercial liabilities. These losses amounted to roughly 5 percent of GDP in 1982-83.

2/ The targets for the current account deficit were defined to include official transfers and, therefore, are not strictly comparable with the definition used in Table 8 which excludes such transfers.

The overall deficit of the nonfinancial public sector is estimated to have declined to 2 1/2 percent from around 3 1/2 percent of GDP in 1983. The reduction in the overall deficit in 1984 reflected an improvement in the position of the Central Administration, particularly in the second half of the year (Table 2), while the rest of the public sector remained in approximate overall balance. The growth in government expenditure was moderated last year by means of budget cuts approved by the Legislative Assembly on the order of C$2.3 billion (around 1 1/2 percent of GDP). Also, tax measures were introduced in mid-1984, estimated to yield the equivalent of about 1 percent of GDP in 1984 and 2 percent on an annual basis. These measures included increases of 2 to 5 percentage points in the rates of selective consumption duties, a broadening of the tax base subject to sales tax to include purchases of goods and services of the public sector, a 10 percent reduction in import duty exemptions, a change in the provisions for the revaluation of assets for income tax purposes, and a 2 percentage point increase in import surcharges. In contrast with previous years, all of the overall public sector deficit in 1984 is estimated to have been financed with external resources, including an increase in external payments arrears, while net banking system credit to the public sector declined.

The tightening of fiscal policy in 1984 permitted a further deceleration in the growth of overall bank credit, primarily during the second half of the year. During the first half of 1984, overall bank credit expanded sharply because of a surge in credit demand by the private sector which was financed in large measure by the commercial banks through a drawdown of their excess reserves in the Central Bank. At the same time, deposit growth dropped sharply as a significant portion of private financial savings was channeled to the Central Government through large bond placements. The net domestic assets of the Central Bank rose sharply in the first half of the year, and the net international reserves fell. The growth of overall bank credit was curtailed in the second half of 1984, as a marginal reserve requirement of 50 percent was established in June 1984, interest rates were raised by two percentage points and Central Bank rediscounts were cut back.1/ The end result of these measures was virtually no growth in the net domestic assets of the Central Bank during the second half of 1984 and a small gain in its net international reserves.

Despite the correction of fiscal and monetary policies which occurred during the second half of 1984, the overall balance of payments result in the year as a whole was weaker than in 1983. Imports grew somewhat faster than exports, partly reflecting the real appreciation of the colon in effective terms during the first nine months of the year, notwithstanding three minor downward adjustments in the value of the colon in relation to the U.S. dollar during this period.2/ It is

1/ These measures were described in SM/84/156 (Supplement 1).

2/ On October 25, 1984, however, the colon was depreciated by 6 1/2 percent (in terms of local currency per U.S. dollar), or from ₡ 45 per U.S. dollar (selling) to ₡ 48 per U.S. dollar (selling).

Table 2. Costa Rica: Fiscal and Monetary Indicators, 1983-84

I. Central Government Operations

(Annual percentage change) 1/

	1983	1984	Est. 1984	
	Jan.-Dec.	Jan.-June	July-Dec.	Jan.-Dec.
Revenue	62.1	26.2	34.5	30.8
Expenditure	55.2	36.7	15.3	23.8

II. Summary Central Bank Accounts 2/

(In millions of colones)

	1983	1984	
	Dec.	June	Dec.
Net international reserves 3/	-6,084	-9,760	-8,837
Net domestic assets	15,032	18,004	18,722
Public sector (net)	29,000	28,779	30,348
Banks (net)	-8,058	-6,694	-10,636
Stabilization bonds	-5,090	-5,132	-4,848
Medium- and long-term foreign liabilities	-68,127	-70,049	-74,646 4/
Other	67,307	71,100	78,504
Currency issue	8,948	8,244	9,885

Sources: Costa Rican authorities; and Fund staff estimates.

1/ Measured with respect to the same time period of previous year.
2/ Accounts denominated in foreign currency are converted at ₡ 45 per U.S. dollar.
3/ Differs from balance of payments concept by amount of arrears assumed to be eligible for rescheduling.
4/ Includes U.S. AID grant assistance.

estimated that the external current account deficit last year was about the same in relation to GDP as in 1983. Net capital inflows in 1984 were significantly less than in the previous year and insufficient to cover the current payments deficit. In part, this outcome reflected smaller net inflows of private capital than in 1983, but it also reflected the failure of Costa Rica to obtain certain debt relief from bilateral creditors in the context of a financial arrangement with the Fund as had been planned.

An overall payments deficit of US$140 million is estimated for 1984, compared with a surplus of US$55 million in 1983. All of the deficit last year is accounted for by an increase in payments arrears, as there was an improvement in the net international reserve position of the Central Bank in 1984 (including its net position with the Fund). Payments arrears rose from US$41 million at the end of the 1983 to US$245 million at the end of 1984, mainly on account of delays in debt service payments to official bilateral creditors (Paris Club), and an accumulation of unpaid interest to foreign banks.

III. The Economic Program for 1985 and the Performance Criteria

The Government program for 1985 is a continuation of the policies which were implemented during the second half of 1984. These policies call for the containment of inflationary pressures, the promotion of economic recovery over the medium term and an improvement in Costa Rica's external position through fiscal and monetary restraint and the pursuit of flexible interest and exchange rate policies. In particular, the program calls for a further reduction in the overall deficit of the nonfinancial public sector by 1 percentage point of GDP excluding the net losses of the Central Bank, and by nearly 2 percentage points of GDP including these losses. In addition, the deficit in the current account balance of payments (excluding official transfers) is to be reduced from around 12 percent of GDP in 1983-84 to 9 percent of GDP in 1985, and all external payments arrears are to be eliminated during the program period.

Costa Rica's progress toward the goals of its 1985 financial program will be monitored by the following quantitative performance criteria that are incorporated in the proposed stand-by arrangement: (1) quarterly ceilings on the net domestic assets of the Central Bank; (2) quarterly ceilings on the net credit of the banking system to the nonfinancial public sector; (3) quarterly targets for the net international reserves of the Central Bank (including as reserve liabilities any external payments arrears); (4) quarterly targets on outstanding external payments arrears; (5) limits on the contracting by the public sector of foreign commercial borrowing of 1-12 years maturity and the net utilization by the nonfinancial public sector of short-term foreign credit. The usual clause on the exchange and trade system is included. In addition, a mid-term review of policies is to be completed by the Fund before the end of August 1985. There is also a performance criterion which restricts Costa Rica's right to make a final purchase under the arrangement, if rescheduling agreements currently under negotiation or in prospect for 1985 have not been completed by January 30, 1986. The quantitative performance criteria of the program are summarized in Table 3.

Table 3. Costa Rica: Quantitative Performance Criteria for the Stand-By Arrangement

	1984	1985				1986
	Dec.	Mar.	June	Sept.	Dec.	Mar.
		(In millions of colones)				
Net domestic assets of the Central Bank 1/	19,704	18,300	18,500	19,000	19,750	18,300
Domestic banking system net credit to the nonfinancial public sector 1/2/	17,100	17,300	17,300	17,100	17,100	17,300
		(In millions of U.S. dollars)				
Net international reserves	-196	-175	-165	-170	-140	-115
Payments arrears 1/3/	168	100	50	25	--	--
Public sector external indebtedness			March 1985 - March 1986			
Limits on commercial borrowing						
1 - 12 years			50			
1 - 5 years			25			
Net use of short-term indebtedness			3			

1/ Outstanding stocks.
2/ These ceilings will be reduced by any use by the Central Government of counterpart funds from the IBRD structural adjustment loan (SAL).
3/ Defined to exclude those arrears which are expected to be rescheduled.

1. Domestic policies

The Government's financial program for 1985 is designed to bring about a significant improvement in the balance of payments through a further strengthening of the public finances and a reduction in the rate of overall bank credit expansion. The degree of adjustment to be achieved in the program can be seen in the combined deficit of the nonfinancial public sector and the net operational losses of the Central Bank. This combined deficit is programmed to decline from the equivalent of 8 percent of GDP in 1983 and around 7 1/2 percent in 1984 to less than 6 percent in 1985 (Table 4).

Table 4. Costa Rica: Combined Deficit of the Nonfinancial Public Sector and Net Losses of the Central Bank

	1982	1983	Est. 1984	Prog. 1985
(In millions of colones)				
Total 1/	14,357	10,005	11,207	9,680
Public sector deficit	8,857	4,245	3,707	2,480
Net losses of Central Bank	5,500	5,760	7,500	7,200
(As a percent of GDP)				
Total 1/	14.6	8.0	7.6	5.8
Public sector deficit	9.0	3.4	2.5	1.5
Net losses of Central Bank	5.6	4.6	5.1	4.3

Sources: Costa Rican authorities; and Fund staff estimates.

1/ Both the public sector deficit and the net losses of the Central Bank are estimated on an accrual basis as they include interest payments in arrears.

The net losses of the Central Bank are large because of substantial interest payments abroad on its foreign indebtedness and the weak structure of its earning assets. As of end 1984, the external debt of the Central Bank amounted to US$2 billion, or about one half of the total external debt of the public sector (including all of the public sector's foreign commercial indebtedness). Also, the Central Bank pays high rates of interest on liabilities with the private sector in the form of stabilization bonds (₡ 5 billion), as well as on liabilities to the banking system originating in a 100 percent reserve requirement on foreign exchange deposits.

a. Fiscal policy

The improvement in fiscal performance under the program is expected to result mainly from an increase in public sector revenues, which are projected to rise from the equivalent of 26 percent of GDP in 1983 and an estimated 29 percent in 1984 to 31 percent in 1985 (Table 5). The overall deficit of the nonfinancial public sector would be financed mainly by long-term development credits from abroad which are being used to support a step up in public investment. In sharp contrast with previous years, the public sector is expected to improve substantially its net position with the domestic banking system in 1985 taking into account the buildup of deposits associated with disbursements of an IBRD structural adjustment loan (SAL).

Most of the projected improvement in fiscal performance is expected to take place in the Central Administration, the overall deficit of which would decline from 3.3 percent of GDP in 1982-83 and an estimated 2.6 percent of GDP in 1984 to 1.7 percent of GDP in 1985. Revenues would increase substantially owing mainly to the full impact on an annual basis of the new tax measures introduced during 1984. As mentioned earlier, tax measures projected to yield ₡ 3 billion (2 percent of GDP) on a full-year basis were introduced during the course of 1984. The revenue projections also take into account the continuation of measures adopted during 1984 to centralize certain earmarked revenues in the Central Government budget and to increase transfers from the rest of the public sector.

Central government expenditures are programmed to rise at a slower pace than revenue in 1985, or at a rate of about 14 1/2 percent. Although this growth rate is somewhat faster than the projected growth in nominal GDP, it continues the decelerating trend that was established during 1984. The slight increase in the ratio of government expenditure to GDP projected for 1985 is due entirely to higher capital outlays. In line with the expenditure targets just described, the authorities have set quarterly limits for total expenditure. The concept of expenditure used for these limits is a more comprehensive one than used in the program itself, as it includes not only cash outlays, but expenditure commitments as well. These limits are not a performance criterion, but any excess over the limits will trigger consultation between the Costa Rican authorities and the Fund staff on the measures needed to ensure that performance is brought back on track.

Of particular importance in the Government's fiscal program is the commitment expressed in the attached letter of intent to limit public sector wage adjustments during 1985 to the increase in absolute amounts in the value of a basic basket of essential goods and services for low-income workers ("canasta basica").1/ It is estimated that the strict

1/ Under this mechanism, which is to be implemented on a semi-annual basis, the absolute increase in the cost of the "basic basket" for the most recent six-month period will be applied to the monthly base wage for all salary levels of the public service.

Table 5. Costa Rica: Summary Operations of the Nonfinancial Public Sector

	1982	1983	Est. 1984	Prog.1/ 1985
(In millions of colones)				
Central Administration	-3,258	-4,137	-3,765	-2,890
Current revenue	13,317	21,585	28,085	33,891
Expenditure	-16,575	-25,722	-31,850	-36,781
Current	(-14,363)	(-20,631)	(-26,482)	(-29,966)
Capital	(-2,212)	(-5,091)	(-5,368)	(-6,815)
Rest of general government	704	1,787	1,139	1,098
Revenue	10,496	12,610	15,475	17,382
Current	(9,828)	(11,975)	(15,056)	(16,896)
Capital	(668)	(635)	(419)	(486)
Expenditure	-9,792	-10,823	-14,335	-16,284
Current	(-8,799)	(-9,984)	(-13,046)	(-14,696)
Capital and net lending	(-993)	(-839)	(-1,289)	(-1,588)
Public enterprises	-6,303	-1,895	-1,081	-688
Revenue	18,374	28,305	33,367	36,676
Current	(18,239)	(27,786)	(33,113)	(36,444)
Capital	(135)	(520)	(254)	(232)
Expenditure	-24,677	-30,200	-34,448	-37,364
Current	(-21,260)	(-26,300)	(-29,942)	(-31,990)
Capital and net lending	(-3,417)	(-3,900)	(-4,506)	(-5,279)
Public sector current account deficit (-)	-3,036	4,429	6,783	10,579
General government	-267	2,100	2,014	4,629
Public enterprises	-2,769	2,329	4,769	5,950
Public sector overall deficit (-)	-8,857	-4,245	-3,707	-2,480
External	1,789	2,219	3,420	6,350 2/
Domestic	3,002	2,026	-1,198	-3,870
Banking system	(2,332)	(1,161)	(-1,049)	(...)
Other	(670)	(865)	(-149)	(...)
Interest in arrears	4,066	--	1,485	--
Memorandum items				
Public sector revenue	16,798	32,408	42,062	50,677
Public sector expenditure	-26,093	-36,653	-45,769	-53,158
Current	(-19,836)	(-27,972)	(-35,518)	(-40,341)
Capital and net lending	(-6,257)	(-8,695)	(-10,251)	(-12,817)
(Annual percentage change)				
Public sector revenue	67.0	92.8	29.7	20.7
Public sector expenditure	44.4	40.5	24.9	16.1
Current	(62.1)	(41.0)	(27.0)	(13.6)
Capital and net lending	(-2.6)	(38.9)	(17.9)	(25.0)
(In percent of GDP)				
Public sector deficit	-9.0	-3.4	-2.5	-1.5
Revenue	17.3	25.9	28.8	30.6
Expenditure	26.3	29.3	31.3	32.1
Current	(20.1)	(22.4)	(24.1)	(24.2)
Capital	(6.2)	(6.9)	(7.2)	(7.9)
Central Administration deficit	-3.3	-3.3	-2.6	-1.7
Revenue	13.5	17.3	19.2	20.5
Expenditure	16.8	20.6	21.8	22.2
Current	(14.6)	(16.5)	(18.1)	(18.1)
Capital	(2.2)	(4.1)	(3.7)	(4.1)
Memorandum items				
Public sector current account deficit (-)	-3.1	3.5	4.6	6.4
General government	(-0.3)	(1.6)	(1.3)	(2.8)
State enterprises	(-2.8)	(1.9)	(3.3)	(3.6)
Public sector fixed capital formation	4.7	5.5	5.9	6.5

Sources: Ministry of Finance; and Fund staff estimates.

1/ Excludes U.S. AID grant disbursements which are channeled directly to the private sector.
2/ Includes IBRD/SAL disbursements (US$80 million).

application of this guideline should yield an increase in public sector wages and salaries during 1985 on the order of 5 to 6 percent, or significantly less than the projected rate of increase in consumer prices (i.e., 10 percent). Other actions which were implemented during 1984 to moderate the growth in government expenditure for wages and salaries are a freeze on total public sector employment and programs to accelerate the retirement of older workers and the transfer of employees to the private sector.

In the rest of the public sector, the aim is to achieve, as a minimum, overall equilibrium in 1985 as in 1984. The rest of the general government, which is dominated by the Social Security Institute, will continue to generate an overall surplus, whereas the deficit of the public enterprises is expected to be much smaller than in previous years. The improvement in the enterprise sector is to be accomplished by tariff increases in the main state enterprises, in particular ICE,1/ and certain other measures to reduce the deficits of the National Production Council (CNP) and the National Development Corporation (CODESA). The overall deficit of CNP, which regulates the production and marketing of basic grains, is projected to be reduced from ₡ 1.4 billion in 1984 to not more than ₡ 0.65 billion in 1985 as a result of cuts in overhead and investment expenditure, and reductions in its support prices for basic grains which will eliminate the existing subsidy on rice exports.

A program to divest CODESA of its subsidiaries, many of which are poorly managed, has been underway since mid-1984, on the basis of legislation approved in that year. The sale of two small enterprises to local investors already has been completed, and the sale of a number of CODESA's larger enterprises is expected to take place upon completion of financial evaluation studies. The proceeds generated by CODESA's divestment program would be used, in equal parts, to reduce CODESA's indebtedness with the Central Bank and to increase Treasury revenues. The program does not include any estimate of the sales value of CODESA's shareholdings; therefore, any proceeds generated by such sales should improve Costa Rica's performance with respect to the program targets.

The overall deficit of the nonfinancial public sector in 1985 is expected to be fully financed with long-term external resources, particularly in the form of financing for the investment programs of the Electricity Company (ICE), the Water Authority (ICAA) and the National Railways (FECOSA). The authorities have stated their intention not to increase the Government's floating debt or the outstanding stock of domestic bonds outside the banking system except for seasonal financing needs. Limits have been set on net credit from the domestic banking system to the nonfinancial public sector (Table 2 of the attached letter) which take into account only seasonal financing needs.

1/ An increase of 12 percent in ICE's utility rates was introduced on January 1, 1985.

b. Monetary policy

In the area of monetary policy, the aim of the authorities is to slow down the rate of overall bank credit expansion in order to achieve an increase in the net international reserve position of the Central Bank and to limit the rate of inflation to no more than 10 percent in 1985. Total bank credit is projected to increase by 18 percent in 1985, compared with an estimated 23 percent in 1984 and 40 percent in 1983 (measured in relation to liabilities to the private sector outstanding at the beginning of the period). As noted, there is to be no increase in net credit of the banking system to the public sector during the program period. In addition, the authorities intend to maintain the marginal reserve requirement of 50 percent which was introduced in June 1984 and have reduced sharply their rediscount operations with the rest of the banking system to control the growth of bank credit to the private sector. Bank credit to the private sector is programmed to increase by 14 percent, compared with 19 percent in 1984 and 52 percent in 1983.

As mentioned earlier, the losses of the Central Bank are large mainly because of the Bank's substantial interest payments abroad on its liabilities with foreign commercial banks. Such indebtedness increased significantly as a result of the rescheduling agreement with foreign commercial banks in 1983, in accordance with which the Central Bank assumed all the foreign commercial debt of the public sector. Accordingly, the payments in 1983 by the Central Bank of all principal and interest on the external debt of the public sector for which no local currency deposit was received in that year were registered during 1984 as counterpart claims against the public entities in question, in order to ensure that all past and future costs associated with the service of the foreign commercial debt assumed by the Central Bank would be recovered. In accordance with this procedure, the calculation of net central bank credit to the nonfinancial public sector for program purposes includes a separate account for the repayment of principal and interest on these obligations to the Central Bank (Table 6).1/

The central bank authorities also approved at the end of October 1984 changes in the level and structure of the Central Bank's lending rates with a view to increasing its interest earnings in 1985. These changes include increases in the commission charged to the banks on loans financed with foreign resources, and in the rates charged on short-term advances to the banks for liquidity purposes. Also, a 2 percentage point commission was established on central bank loans to CNP, the rate for which is fixed by law.

1/ The accounts of the Central Bank with the nonfinancial public sector summarized in Table 6 also show a separate account (called rescheduling) for the counterpart of the foreign loans assumed by the Central Bank in last year's rescheduling agreement. This account is treated outside the concept of net credit for the purposes of the program because of some uncertainty about when the operation will be formally accounted in the balance sheet of the Central Bank.

Table 6. Costa Rica: Summary Operations of the Banking System

	December 31						
	(US$1 = ₡ 50.00)			(US$1 = ₡ 45.00)		(US$1= ₡ 50.00)	
		1983		Reclass.	Prel.	Prel.	Prog.
	1982	Program	Actual	1983 1/	1984	1984	1985
	(In millions of colones)						
	I. Banking System						
Net international reserves 2/	-59,345	-59,345	-57,312	-4,380	-8,834	-9,819	-6,820
Net domestic assets	134,902	157,665	151,875	128,810	141,272	151,278	162,328
Net credit to public sector 3/	11,565	13,565	12,726 4/	26,712	25,387	26,927	29,620
Of which: subject to ceiling	(11,565)	(13,565)	(12,726)	(17,578)	(16,481)	(17,031)	(17,031)
Credit to private sector	18,195	27,345	27,569	27,549	32,792	32,792	37,367
Government trust funds 5/	--	--	--	--	-4,478	-4,478	-8,575
Other 6/	50,392	62,005	62,900	72,722	81,244	89,007	103,916
Counterpart arrears/rescheduling	54,750	54,750	48,680	1,827	6,327	7,030	--
Long-term foreign liabilities 7/	32,712	41,970	39,201	69,998	72,334	80,371	86,296
Liabilities to private sector 8/	42,845	56,350	55,362	54,432	60,104	61,088	69,212
	II. Central Bank						
Net international reserves 2/	-59,970	-59,970	-57,255	-6,084	-8,837	-9,819	-6,820
Official reserves (net)	-5,220	-5,220	-8,575	2,596	7,745	8,606	7,025
Payments arrears	-54,750	--	-2,030	-1,827	-7,497	-8,330	--
Rescheduling/revolving trade credit facility	--	-54,750	-46,650	-6,853	-9,085	-10,095	-13,845
Net domestic assets	66,907	70,870	66,203	15,032	18,722	19,704	19,720
Net credit to public sector 3/	11,885	13,885	14,994	29,000	30,348	31,856	34,549
Of which: rescheduling	(--)	(--)	(--)	(14,732)	(13,857)	(15,397)	(14,378)
Net credit to banks	-11,412	-8,412	-13,140	-8,507	-10,636	-10,456	-7,989
Of which: rescheduling	(--)	(--)	(--)	(4,119)	(1,619)	(1,799)	(2,660)
Government trust funds 5/	--	--	--	--	-4,478	-4,478	-8,575
Stabilization bonds	-4,755	-9,750	-5,090	-5,090	-4,848	-4,848	-4,848
Long-term foreign liabilities 7/	-28,020	-37,820	-34,542	-68,127	-70,168	-77,964	-84,889
Of which: rescheduled debt	(--)	(--)	(--)	(-21,330)	(-20,808)	(-23,120)	(-29,870)
Other 6/	44,459	58,217	55,301	65,479	72,177	78,564	91,472
Counterpart arrears/rescheduling	54,750	54,750	48,680	1,827	6,327	7,030	--
Currency issue	6,937	10,900	8,948	8,948	9,885	9,885	12,900
	(In percent change)						
Banking system							
Net domestic assets 9/	105.0 10/	51.9	39.6		22.9		18.1
Net credit to public sector	25.1 10/	17.3	10.0		-5.0		10.0
Credit to private sector	36.7 10/	48.5	51.5		19.0		14.0
Liabilities to private sector	50.1 10/	30.7	29.2		10.4		13.3
	(As percent of GDP)						
Net credit to public sector	11.5	8.8	10.2		17.4		17.9
Credit to private sector	18.6	17.7	22.0		22.4		22.6
Liabilities to private sector 11/	34.9	32.0	37.9		39.0		39.4

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

1/ Reflects the full effect of the rescheduling of payment arrears.
2/ Includes payments arrears and special financing. The first three columns also include US$50 million due to a consortium of Mexican banks (COMERMEX) which was converted from a short-term to a medium-term foreign liability in January 1981.
3/ Includes exchange subsidies and in 1982 and 1983 is adjusted for reclassification of public sector deposits with commercial banks previously classified as private sector and also those now classified as financial sector.
4/ Includes an implicit credit for the equivalent of US$38.3 million on account of external interest payments for which no colones counterpart was deposited.
5/ Includes U.S. AID grants and IBRD/SAL counterpart deposits.
6/ Includes valuation adjustment and net losses.
7/ Includes counterpart to SDR allocation.
8/ Includes liabilities to nonbank financial intermediaries, and in 1982 is adjusted for reclassification of public sector deposits with commercial banks previously classified as private sector and also those now classified as financial sector.
9/ In relation to liabilities to the private sector, including liabilities to nonbank financial intermediaries, at the beginning of the period.
10/ Changes based on foreign currency accounts valued at ₡ 40 per U.S. dollar.
11/ Ratio of two-year average of liabilities to the private sector, including liabilities to nonbank intermediaries, to GDP. Foreign currency deposits are valued at the actual end-of-year exchange rates.

The authorities intend to maintain domestic interest rates in the banking system at levels which are significantly positive in real terms. At the end of October 1984, the basic annual rate for six-month deposits, to which most other rates in the banking system are tied, was raised from 18 percent to 20 percent. This adjustment is consistent with the commitment expressed in the attached letter to adjust interest rates from time to time in the light of foreign and domestic market conditions and domestic price trends.

The monetary program of the Central Bank for 1985 has been designed to bring about an improvement in the net foreign reserves of the Central Bank of US$60 million. The program assumes that private sector claims on the banking system will increase during 1985 about in line with the growth of nominal GDP (i.e., 13 percent). The loanable resources of the banking system are to be supplemented by significant inflows of concessional assistance from U.S. AID in the form of loans and grants amounting to US$190 million in 1985, compared with US$130 million in 1984.1/ During 1985 counterpart funds generated by U.S. AID grants are expected to be drawn down to finance private sector activity; but no use of these funds is envisaged by the public sector. Consistent with the targets and assumptions just mentioned, the program specifies quarterly ceilings on the net domestic assets of the Central Bank as shown in Table 3 of the attached letter of intent, in addition to the ceilings on net banking system credit to the nonfinancial public sector mentioned earlier.

2. External sector policies

In the external sector, the main objectives of the authorities are to reduce the current account deficit of the balance of payments, (excluding official transfers) from 12 percent of GDP in 1983-84 to 9 percent of GDP in 1985, to restore debt service payments to a current basis, and to improve the net foreign reserve position of the Central Bank (Table 8).2/ In addition to the pursuit of cautious demand management policies, the authorities intend to follow a flexible exchange rate policy whereby the colon is adjusted from time to time according to developments in the balance of payments, the rate of inflation in

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1/ Loans from U.S. AID are reflected in medium- and long-term foreign liabilities of the Central Bank, whereas grants are recorded as increases in government trust funds, in Table 7. The disbursement of US$80 million under an IBRD Structural Adjustment Loan also is reflected as an increase in government trust funds.

2/ The targets for the current payments deficit have been defined to exclude official transfers because of the significant changes from one year to the next in the size of grant assistance and because of some uncertainty about the compositon of concessional aid from the United States between loans and grants.

Table 7. Costa Rica: Quarterly Central Bank Operations

(In millions of colones at ₡ 50 per U.S. dollar)

	1984	1985				1986
	Dec.	Mar.	June	Sept.	Dec.	Mar.
Net international reserves	-9,819	-7,960	-8,060	-8,160	-6,820	-5,210
Net official reserves 1/	-1,489	-2,960	-5,560	-7,535	-6,820	-5,210
Arrears	-8,330	-5,000	-2,500	-625	--	--
Net domestic assets	19,704	18,216	18,448	18,986	19,720	16,960
Public sector (net)	31,856	34,549	34,549	34,549	34,549	34,549
Subject to ceiling	(21,960)	(21,960)	(21,960)	(21,960)	(21,960)	(21,960)
Current operations (net)	/16,459/	/18,383/	/18,979/	/19,575/	/20,171/	/20,767/
Arrears/Service	/5,501/	/3,577/	/2,981/	/2,385/	/1,789/	/1,193/
Rescheduling	(9,896)	(12,589)	(12,589)	(12,589)	(12,589)	(12,589)
Banking system (net)	-10,456	-8,536	-8,402	-8,365	-7,989	-8,972
Current operations (net)	(-12,255)	(-11,196)	(-11,062)	(-11,025)	(-10,649)	(-11,632)
Arrears/Service	(146)	(--)	(--)	(--)	(--)	(--)
Rescheduling	(1,653)	(2,660)	(2,660)	(2,660)	(2,660)	(2,660)
Government trust funds	-4,478	-5,175	-7,475	-7,665	-8,575	-9,575
Stabilization bonds	-4,848	-4,848	-4,848	-4,848	-4,848	-4,848
Medium- and long-term foreign liabilities	-77,964	-82,714	-82,374	-84,124	-84,889	-85,639
Regular 2/	(-54,844)	(-52,844)	(-52,504)	(-54,254)	(-55,019)	(-55,769)
Rescheduling	(-23,120)	(-29,870)	(-29,870)	(-29,870)	(-29,870)	(-29,870)
Other (net)3/	85,594	84,940	86,998	89,439	91,472	91,445
Currency issue	9,885	10,256	10,388	10,826	12,900	11,750

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

1/ Includes the Revolving Trade Credit Facility.
2/ Includes the counterpart of SDR allocations.
3/ Includes net losses and counterpart of external payments arrears.

Table 8. Costa Rica: Balance of Payments

	1981	1982	1983	Prel. 1984	Prog. 1985
(In millions of U.S. dollars)					
Current account 1/	-426.4	-236.0	-355.6	-390	-300
Merchandise trade	-210.7	-25.2	-120.8	-130	-68
Exports, f.o.b.	(1,002.6)	(869.0)	(870.4)	(960)	(1,055)
Imports, c.i.f.	(-1,213.3)	(-894.2)	(-991.2)	(-1,090)	(-1,123)
Services, net	-242.7	-240.4	-257.8	-285	-262
Nonfactor	(76.6)	(100.2)	(104.5)	(85)	(94)
Factor	(319.3)	(-340.6)	(-362.3)	(-370)	(-356)
Direct investment and private interest	/-11.4/	/1.3/	/-6.3/	/-10/	/-14/
Official interest	/-307.9/	/-341.9/	/-356.0/	/-360/	/-342/
Paid	[-160.3]	[-106.0]	[-316.0]	[-268]	[-312]
Scheduled/unpaid	[-147.6]	[-235.9]	[-40.0]	[-92]	[-30]
Private transfers, net	27.0	29.6	23.0	25	30
Capital account 2/	-49.2	-77.8	410.6	250	92
Private and net errors and omissions	-69.3	5.2	129.8	45	47
Public (net inflow)	231.3	128.0	208.0	174	188
Disbursements	(330.3)	(191.0)	(302.0)	(257)	(346)
Nonfinancial	/266.4/	/91.0/	/117.0/	/136/	/218/
Financial	/63.9/	/100.0/	/185.0/	/121/	/128/
Amortization (paid)	(-99.0)	(-63.0)	(-94.0)	(-83)	(-158)
Nonfinancial	/-49.7/	/-39.0/	/-63.0/	/-43/	/-81/
Financial	/-49.3/	/-24.0/	/-31.0/	/-40/	/-77/
Public (net refinancing of current obligations)	-211.2	-217.3	31.0	-75	-238
Rescheduling of principal	(--)	(--)	(146.0)	(147)	(...)
Rescheduling of interest	(--)	(--)	(40.0)	(--)	(...)
Amortization (scheduled/unpaid)	(-211.2)	(-217.3)	(-155.0)	(-222)	(-238)
Official transfers	--	6.3	41.8	106	95
SDR allocation counterpart	5.4	--	--	--	--
Overall balance (deficit -)	-470.2	-313.8	55.0	-140	-208
Financing gap = exceptional financing 3/	--	--	--	--	268
Of which: rescheduling of principal	--	--	--	--	238
rescheduling of interest	--	--	--	--	30
Net international reserves	-470.2	-313.8	55.0	-140	60 4/
Accumulation (+) or reduction (-) of arrears	358.8	453.2	-1,054.0	204	-245
Principal	(211.2)	(217.3)	(-686.0)	(86)	(-112)
Interest	(147.6)	(235.9)	(-368.0)	(92)	(-107)
Imports	(--)	(--)	(--)	(26)	(-26)
Rescheduling of arrears 3/	--	--	732.0	--	84
Principal	(--)	(--)	(639.0)	(--)	(51)
Interest	(--)	(--)	(93.0)	(--)	(27)
Imports	(--)	(--)	(--)	(--)	(6)
Conversion of CDs (P+I)	--	--	49.0	--	--
Revolving trade credit facility	--	--	152.0	50	75
Net official reserves (increase -)	106.4	-128.8	58.0	-114	26
Net use of Fund resources	(45.7)	(-9.7)	(99.0)	(-23)	(21)
Other net official reserves	(60.7)	(-119.1)	(-41.0)	(-91)	(5)
Valuation adjustment	5.0	-10.6	8.0	--	--
(As percent of GDP)					
Current account 1/	-16.4	-9.3	-11.8	-12.0	-9.1
Trade balance	-8.1	-1.0	-4.0	-4.0	-2.1
Net factor services	-12.3	-13.4	-12.0	-11.4	-10.8
Other services and private transfers	4.0	5.1	4.2	3.4	3.8
Capital account	-1.9	-3.0	13.6	7.7	10.9
Private	-2.7	0.2	4.3	1.4	1.4
Public (net inflow)2/	8.9	5.3	8.3	8.6	8.6
Public (net refinancing)3/	-8.1	-8.5	1.0	-2.3	0.9

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

1/ Excluding official grants.
2/ Including official grants.
3/ In 1985 represents working assumptions on amounts to be rescheduled.
4/ Concept used for balance of payments test in stand-by program.

Costa Rica relative to that of its trading partners and changes in the net international reserves of the Central Bank (including payments arrears).1/

Most of the projected improvement in the current account in 1985 would be accounted for by a reduction of the trade deficit arising from a further recovery of exports and a containment of the growth of imports stemming from tighter demand management policies. Moreover, a shift is expected in the structure of imports away from consumer goods in response to last year's increases in selective consumption duties. Net factor payments (mainly interest payments on official debt), which were in the neighborhood of 11-12 percent of GDP in 1983-84, are projected to be marginally lower in 1985 because of a decline in interest rates in international financial markets.2/

Most of the current account deficit in prospect for 1985 is to be financed by net official inflows associated with the public investment effort and concessional aid from the U.S. Government. It has been assumed that all repayments of principal to the commercial banks falling due in 1985 and 1986 will be rescheduled in a new agreement which is to be finalized during the first few months of 1985.3/ Finally, it was assumed (for working purposes) that Costa Rica would negotiate a Paris Club agreement in 1985 on terms similar to those obtained in January 1983, in which payments of principal and interest to official bilateral creditors estimated at US$90 million in arrears for 1984, and a similar amount falling due in 1985, will be rescheduled.

In view of Costa Rica's severe external debt problem, and consistent with projected capital inflows, the authorities intend to limit strictly the contracting of new foreign commercial loans during the program period. In an effort to improve the maturity structure of Costa Rica's external debt, the authorities will limit to US$50 million any new borrowing by the public sector (including guarantees) with maturities of one year up to and including 12 years. Within this limit, new foreign commercial borrowing of one year up to and including five years will be limited to US$25 million. Excluded from this limitation are reschedulings of existing obligations (both principal and interest), disbursements under the Mexico-Venezuela oil facility, and foreign reserve liabilities of the Central Bank which are covered under the

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1/ During the course of 1984, it is estimated that the colon depreciated by about 1 percent in real effective terms (see Chart in Appendix V).

2/ For purposes of the program, interest rate levels of 11 1/2 percent, in the case of the U.S. prime rate, and 10 percent, in the case of the three-month LIBOR, were assumed.

3/ In January 1985, the Bank Steering Committee for Costa Rica and the Costa Rican authorities agreed in principle to reschedule all maturities falling due in 1985 and 1986 over a period of ten years (including a three-year grace period).

program's balance of payments test. It is also the intention of the authorities not to increase during the program period the outstanding stock of short-term foreign indebtedness of the nonfinancial public sector (excluding trade-related credits) above the level outstanding at the end of September 1984 (US$3 million).

Consistent with the objectives of the monetary program, the targets established for the net international reserves of the Central Bank call for an increase during the program period of US$60 million, as indicated in Table 4 of the attached letter. For the purpose of these targets, the net international reserves are defined to include all payments arrears (excluding those assumed to be rescheduled) and any disbursements by the foreign banks under a new credit facility amounting to US$75 million which was agreed in principle between the Bank Steering Committee for Costa Rica and the Costa Rican authorities in January 1985. The proceeds from this loan are to be used to help reduce Costa Rica's external payments arrears and/or to bolster Costa Rica's gross foreign reserves. A first disbursement equivalent to 25 percent of the facility is to be made simultaneously with Costa Rica's first purchase from the Fund under the requested stand-by arrangement; the remainder would be disbursed with the first disbursement of the IBRD structural adjustment loan (SAL) (expected to be in May or June 1985).

The program also includes targets for the gradual elimination of arrears on external debt service and commercial payments by the last quarter of 1985, as set out in Table 5 of the attached letter. During the period of the arrangement, it is envisaged that arrears on external debt may accumulate in respect of payments of principal and interest in 1985 with members of the Paris Club, in anticipation of negotiations for a rescheduling of such obligations.1/ The definition of the variables to be used in both the balance of payments test and the arrears targets include an amount equivalent to 15 percent of these payments which is the amount that (for working purposes) the staff has assumed will not be rescheduled.2/ In order to satisfy the balance of payments test, these amounts must be offset by an equivalent increase in other net international reserves of the Central Bank.

1/ There is also a restriction arising from a claim with respect to a bank loan of US$738,000 and accrued interest, which was involved in the rescheduling negotiations that led to the September 1983 agreement with all members of a bank syndicate but one. The Costa Rican authorities have offered to this bank the same terms as have been accepted by the other members of the syndicate, but the bank has not accepted the offer and the matter has been in litigation.

2/ Thus both the balance of payments test and the arrears targets exclude 85 percent of the amount of the arrears with members of the Paris Club, which is the amount assumed eligible for rescheduling.

The program also calls for a mechanism to monitor the emergence of any arrears on commercial payments in the form of a deposit requirement equivalent to 100 percent of the value of foreign exchange requested from the Central Bank. If such deposits are held for a period of more than 15 working days, which is the normal period for the proper administrative verification of the bona fide nature of foreign exchange requests, they will be treated as a foreign liability for purposes of the balance of payments test and will be included in the definition of arrears subject to limits under the program.

IV. Medium-Term Outlook

The financial program for 1985 was conceived within essentially the same medium-term framework as that presented in the staff paper for the 1984 Article IV consultation. Given the difficult external situation which Costa Rica faces, it is clear that economic policies must be geared to alleviating the burden of external debt service on Costa Rica's balance of payments. At the end of 1984, Costa Rica's external public debt (including financial obligations to the Fund) was equivalent to nearly 120 percent of GDP and its debt service payments (before rescheduling) amounted to 55 percent of exports of goods and services (Table 9). Interest payments on external public debt alone are estimated at about one third of exports of goods and services, or 11 percent of GDP, in 1984.

As mentioned above, Costa Rica was able to secure a rescheduling of its arrears and some relief of contractual obligations falling due in 1983 and 1984, in negotiations with the Paris Club and the foreign commercial banks during 1983. However, contractual debt service obligations are projected to remain at around 55 percent of projected exports of goods and services through 1987, before declining gradually to 33 percent by 1990. In these conditions, it is clear that Costa Rica will need rescheduling of its large commercial debt obligations for the rest of the decade. On the assumption that about one half of its principal repayments falling due over the next several years can be rescheduled, as was the case in 1983-84, Costa Rica's debt service ratio would rise to around 40 percent through 1987 and then decline to 25 percent by 1990. Its outstanding public external debt would decline gradually from around 120 percent of GDP in 1983-85 to less than 100 percent of GDP by the end of the decade. Although this ratio is still comparatively high, it is projected that the nonconcessional component of the public external debt would fall from about one half at present to two fifths by the end of the decade.

These projections are based on the assumptions that over the remainder of the decade there is a gradual recovery in the growth in real GDP to rates close to those prevailing in the second half of the 1970s (around 5 percent). Exports are projected to grow by 10 percent in 1985 (in U.S. dollar terms)--which would bring them back to the record level registered in 1981--and at an average annual rate of

Table 9. Costa Rica: Medium-Term Outlook

	1983	Prel. 1984	Proj. 1985	1986	1987	1988	1989	1990
	(In millions of U.S. dollars)							
Current account	-356	-390	-300	-243	-208	-207	-228	-222
Trade balance	-121	-130	-68	9	55	60	65	89
Exports, f.o.b.	(870)	(960)	(1,055)	(1,170)	(1,288)	(1,430)	(1,587)	(1,762)
Imports, c.i.f.	(-991)	(-1,090)	(-1,123)	(-1,161)	(-1,233)	(-1,370)	(-1,522)	(-1,673)
Factor payments	-406	-416	-405	-425	-436	-450	-478	-498
Interest (official)	(-356)	(-360)	(-342)	(-357)	(-364)	(-375)	(-380)	(-390)
Other	(-50)	(-56)	(-63)	(-68)	(-72)	(-75)	(-98)	(-108)
Other services and private transfers	171	156	173	173	173	183	185	187
Capital account 1/	411	250	360	309	285	290	317	321
Private	130	45	47	73	76	83	136	143
Public	281	205	313	236	209	207	181	178
Of which:								
Official grants	(42)	(106)	(95)	(80)	(70)	(65)	(60)	(60)
Exceptional financing 1/	(...)	(...)	(268)	(255)	(245)	(256)	(217)	(199)
Net international reserves	55	-140	60	66	77	82	89	99
Memorandum items								
External public debt outstanding (year-end)	3,613	3,862	4,194	4,350	4,484	4,626	4,747	4,865
Noncommercial debt as percent of total debt	48.0	49.5	51.7	53.5	54.9	56.3	57.4	58.5
Average interest rate of total debt (percent)	9.9	9.4	8.4	8.3	8.2	8.2	8.1	8.1
Net utilization	208	174	178	156	134	142	121	118
Disbursements	302	257	336	378	348	353	305	300
Amortization	94	83	158	222	264	211	184	182
Debt service	609	704	761	843	894	884	813	780
Amortization	240	344	419	486	530	509	433	390
Interest	356	360	342	357	364	375	380	390
Of which:								
IMF	26	35	34	40	59	45	24	21
Repurchases	12	23	23	29	49	35	13	10
Charges	13	12	11	11	10	10	11	11
	(As percent of GDP)							
Current account	-11.8	-12.0	-9.1	-7.0	-5.5	-5.0	-5.0	-4.5
Trade balance	-4.0	-4.0	-2.1	0.3	1.4	1.4	1.4	1.8
Factor payments	-13.4	-12.8	-12.2	-12.2	-11.5	-10.9	-10.5	-10.1
Other	5.6	4.8	5.2	5.0	4.4	4.3	4.1	3.8
Capital account	13.6	7.7	10.9	8.9	7.5	7.0	7.0	6.5
Private	4.3	1.4	1.4	2.1	2.0	2.0	3.0	3.0
Public	9.3	6.3	9.5	6.8	5.5	5.0	4.0	3.6
Of which:								
Official grants	(1.4)	(3.3)	(2.9)	(2.3)	(1.8)	(1.6)	(1.3)	(1.2)
Exceptional financing	(--)	(--)	(8.1)	(7.3)	(6.5)	(6.2)	(4.8)	(4.0)
Net international reserves	1.8	-4.3	1.8	1.9	2.0	2.0	2.0	2.0
Outstanding debt	119.4	119.0	126.7	125.2	118.2	111.6	104.9	98.5
	(As percent of exports of goods and services)							
Debt service								
Excluding IMF	48.8	52.4	52.7	53.3	50.8	44.2	36.7	32.1
Including IMF	50.9	55.1	55.2	55.9	54.2	46.6	37.8	33.0
Debt service after debt relief								
Excluding IMF	32.1	27.8	33.6	37.0	36.5	30.8	26.4	23.6
Including IMF	34.6	30.5	36.1	39.5	40.0	33.1	27.5	24.5

Sources: IBRD/Debt Reporting Service; Costa Rican authorities; and Fund staff estimates.

1/ Starting in 1985, includes working assumptions on the amounts of exceptional financing (i.e., amounts of principal and interest rescheduled).

11 percent thereafter. It is also assumed that the effective interest rate on external public debt will decline gradually from 10 percent in 1983 to 8 percent in 1990, as a result of a decline in interest rates in international financial markets, as well as a change in the structure of Costa Rica's external indebtedness toward concessional credits.

In the financial program for 1985, and in the medium-term outlook, it has been assumed that Costa Rica's need for external resources (excluding debt relief) will be satisfied largely, if not exclusively, by means of concessional credits and grant assistance. At the same time, an overall surplus has been projected each year, consistent with an improvement in Costa Rica's gross reserve position and its repurchase obligations to the Fund.1/

Given the availability of concessional financing, the assumed financing in the form of debt relief, and the need for an improvement in the net international reserve position of the Central Bank, a sustainable current account deficit over the medium term would be on the order of 5 percent of GDP. Thus, the adjustment effort initiated in 1982-83 will have to be maintained for several years during which the Fund is likely to be called upon to play a catalytic role vis-a-vis other creditors.

The medium-term adjustment of the Costa Rican economy will involve a number of structural reforms which are being discussed with the World Bank as the basis for negotiating a series of structural adjustment loans (SAL).2/ In the external sector, the export promotion strategy would call for a revision of the protectionist policy established in the Central American Common Market. Recently, discussions at the regional level have cleared the way for a phased reduction in the level of the Common External Tariff as a means of encouraging efficiency in the region's industrial sectors. In negotiations with the World Bank, Costa Rica has indicated its intention to initiate a process of tariff reform within this regional framework no later than July 1, 1985.

At the same time, domestic reforms will be initiated by the Costa Rican Government to improve the efficiency of the domestic financial system and to strengthen the centralized control of public sector operations. In the first area, the Government has established a commission on financial reform, which is due to report its findings early in 1985, and which is charged with the responsibility of proposing changes in the legal and institutional framework of the commercial banking system. One possibility under consideration is the removal of operating restrictions which now limit the private commercial banks from competing on an equal footing with the state commercial banks. In September 1984,

1/ Although Costa Rica's gross foreign reserves amounted to US$421 million at the end of December 1984 (four and a half months of estimated 1984 imports), most of these reserves were in the form of nonliquid claims against other Central American countries.

2/ The main features of the SAL program are described in Appendix II.

a first step in this direction was made by legislative approval of a reform to the Monetary Law whereby the private commercial banks would be granted access to rediscount facilities of the Central Bank financed with foreign lines of credit.

In the area of fiscal reform, the authorities intend to introduce certain institutional and structural changes in the public finances as a means of enhancing the effectiveness of fiscal policy over the medium term. Early in 1984, a special commission of former Ministers of Finance recommended changes in budgetary procedures and institutional arrangements, as well as legal revisions to the complex system of revenue earmarking and compulsory spending which has evolved in Costa Rica over many years. These proposals are now being studied by a special commission of the Legislative Assembly which is expected to propose legal or constitutional changes to the Legislative Assembly as a whole by March 31, 1985.

V. Staff Appraisal

Costa Rica's economic and financial performance has improved following a period of economic decline, rapid inflation, and severe external disequilibrium. Gains were made under a stand-by arrangement in 1983, notwithstanding some slippages in public sector wage policy during the latter half of the program. In particular, substantial progress was made towards the reduction of inflation, the elimination of external arrears and the achievement of exchange rate unification.

Early in 1984 the authorities formulated policies to consolidate the gains already made and to create the basis for sustained economic growth. Policies were directed toward a further compression of the public sector deficit, a cutback in the rate of bank credit expansion, and a reduction in the current payments deficit accompanied by an improvement in the net foreign reserve position of the Central Bank. Delays were incurred in implementing the relevant measures, and the results last year fell short of the targets set originally. Although policies of fiscal and monetary restraint were put into effect during the second half of 1984, they were not sufficient to reverse the deterioration in Costa Rica's external position in the first half of the year. In particular, the deficit in the external current account remained unchanged as a ratio of GDP in 1984, and the overall balance of payments registered a large deficit financed by a significant increase in external payments arrears.

Costa Rica's economic program for 1985 centers on fiscal and monetary restraint, together with exchange rate flexibility, as a means of achieving a significant improvement in the balance of payments position and a reduction in the rate of inflation.

In the fiscal area, the authorities intend to reduce further the overall deficit of the nonfinancial public sector and to finance this deficit with long-term external credits of a concessional nature.

The fiscal tightening underway is being achieved primarily by revenue action, as evidenced by a series of tax measures and public enterprise tariff adjustments which have been implemented since early last year. However, the key to success in the fiscal program will depend to a large extent on the achievement of effective control over government expenditures. To this end, the program calls for a deceleration in the growth of government expenditure, through curbs on wage payments and transfers to the rest of the public sector. The Government's wage policy is of particular importance, and a firmer policy will be required in this area than in the past. The staff notes that the Costa Rican authorities intend to adjust public sector wages in the period of the program only to the extent justified by increases in the cost of a basic basket of essential goods and services.

The success of the fiscal program also depends upon actions to deal with the financial problems of the National Production Council (CNP) and the National Development Corporation (CODESA). In the case of CNP, efforts are underway to reduce substantially its losses by changes in its relative price structure. In the case of CODESA, progress has been made to date in the divestment of its subsidiaries, but additional steps are needed to facilitate the sale of CODESA's major enterprise holdings.

The staff also would highlight the critical importance of institutional reforms in the public sector, such as dismantling the present complex system of revenue earmarking and compulsory spending, as a means of strengthening expenditure control. It is important that the authorities press forward with specific proposals in this area without delay, once the special legislative commission on fiscal reform has reported its findings.

In regard to monetary policy, the program calls for a reduction in the rate of growth of total bank credit consistent with the price and balance of payments objectives of the program. To this end, the authorities have sterilized a portion of the excess reserves of the banking system and have adjusted both the level and structure of interest rates. Action on interest rates should help to reduce the operational losses of the Central Bank, although the staff would stress that this problem cannot be resolved by monetary means alone. Further adjustments in fiscal policy will be needed in the coming years to help offset the effects of these losses.

Achievement of the balance of payments objectives of the program will depend critically upon the maintenance of a flexible exchange rate policy. Such a policy, in conjunction with the proposed customs tariff reform, will help to foster the improvement in export performance needed to service the external debt in the coming years, and the staff would urge the authorities to ensure that exchange rate policy be geared to the achievement of the external objectives of the program. The staff welcomes the intention of the authorities to eliminate the existing payments arrears before the end of 1985, in order to re-establish an exchange system which is free of restrictions on payments and transfers for current international transactions.

In summary, the staff considers that the program for which the Costa Rican authorities have requested Fund assistance is one which will continue the efforts supported by the last Fund arrangement in strengthening the economy and improving Costa Rica's external position over the medium term and is, therefore, worthy of Fund support. Accordingly, the staff recommends that the Executive Board approve Costa Rica's restrictions on payments and transfers for current international transactions that result from payments arrears and the process of rescheduling until the conclusion of the next Article IV consultation, or August 31, 1985, whichever is earlier. The staff believes that the amount of the requested stand-by arrangement (59 percent of quota on an annual basis) is justified by Costa Rica's balance of payments need in the short run and by the size of its adjustment effort. It would also appear that the amount is consistent with Costa Rica's likely need for Fund assistance over the medium term, given its present position with the Fund under the tranche policies.

VI. Proposed Decisions

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

I. Stand-By Arrangement

1. The Government of Costa Rica has requested a stand-by arrangement for the period March , 1985 - March , 1986, for an amount equivalent to SDR 54 million.

2. The Fund approves the stand-by arrangement attached to EBS/85/31, and waives the limitation in Article V, Section 3(b)(iii).

II. Approval of Exchange Restrictions

1. Costa Rica maintains restrictions on payments and transfers for current international transactions as described in EBS/85/31. In light of the implementation by Costa Rica of policies for balance of payments adjustment, which are supported by a stand-by arrangement (EBS/85/31), the Fund grants approval for the retention of these restrictions until the conclusion of the 1985 Article IV consultation, or August 31, 1985, whichever is earlier.

Costa Rica - Fund Relations
(As of December 31, 1984)

(Amounts in millions of SDRs, unless otherwise indicated)

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:			243.1	289.1
(c) Fund credit:	Total		159.0	189.1
	Of which:	Credit Tranche	(47.6)	(56.6)
		CFF	(41.2)	(49.0)
		EAR	(45.9)	(54.6)
		Extended facility	(11.3)	(13.4)
		Supplementary facility	(13.0)	(15.5)
(d) Reserve tranche position:			--	--
(e) Current operation budget:			--	--
(f) Lending to the Fund:			--	--

III. Current Stand-by Arrangement and Special Facilities

(a) Current stand-by arrangement: None

(b) Previous stand-by and extended arrangements:

Type of Arrangement	Amount: SDR Million	Amount: Percent of Quota	Duration	Amount Drawn (SDR million)	Status
SBA	92.25	150.0	Dec. 1982-Dec. 1983	92.25	Expired
EFF	276.75	450.0	June 1981-May 1984	22.5	Cancelled December 1982
SBA	60.50	147.6	Mar. 1980-Feb. 1982	15.4	Cancelled June 1981
SBA	11.60	36.2	July 1976-July 1977	--	Expired

(c) 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:	23.7	100.0
(b) Holdings:	0.1	0.4
(c) Current designation plan:	--	--

V. Administered Accounts None.

VI. Overdue Obligations to the Fund None.

(B) Nonfinancial Relations

VII. Exchange rate arrangement: The representative exchange rate for the Costa Rican colon is the unified banking rate which is presently quoted at ₡ 48 (selling) per U.S. dollar. All transactions take place at this rate with the exception of the equivalent of 1/5 of 1 percent of export proceeds which are surrendered at the official rate of ₡ 20.00 per U.S. dollar, however, this does not give rise to a multiple currency practice under Article VIII, Section 3.

VIII. Last Article IV consultation: February-March 1984, completed by the Executive Board on August 1, 1984 (EBM/84/119), after a 12-month cycle. At present, Costa Rica's exchange restrictions are not approved by the Fund.

IX. Technical Assistance:

(a) CBD	None
(b) Fiscal	A FAD panel expert was assigned to the Ministry of Finance from August 1980 to December 1983, providing assistance principally in the area of budgetary procedures.
(c) Other	None

X. Resident Representative/Advisor: Mr. Ignacio Tampe assumed the post of Resident Representative in March 1984.

Costa Rica: Financial Relations With the World Bank Group
as of December 31, 1984

(In millions of U.S. dollars)

		Number of Credits	Disbursed to Date	Undisbursed	Total	Repaid
	A. IBRD/IDA/IFC Operations					
1.	IBRD/IDA loans	29	333.9	77.7	411.6	103.0
	Agriculture	3	29.2	0.7	29.9	10.2
	Education	1	6.0	--	6.0	0.2
	Export	1	4.3	20.9	25.2	--
	Industry	3	15.5	4.4	19.9	6.6
	Power	7	120.8	6.5	127.3	41.0
	Telecommunications	4	57.6	0.5	58.1	18.1
	Transport	7	92.1	20.6	112.7	19.3
	Water supply	1	1.9	24.1	26.0	1.1
	Program loan	2	6.5	--	6.5	6.5
2.	IFC investments	5	6.7	--	6.7	...

B. IBRD Loan Disbursements

	Actual				Est.	Proj.
	1980	1981	1982	1983	1984	1985
Net disbursements	22.7	13.7	7.5	5.8	20.9	94.0
Disbursements	29.4	22.3	19.7	23.5	42.7	116.4 1/
Repayments	-6.7	-8.6	-12.2	-17.7	-21.8	-22.4

Sources: IBRD; IDA; and IFC.

1/ Includes Structural Adjustment Loan (SAL).

Summary of Structural Adjustment Loan Program with the World Bank

In January 1985 the World Bank staff completed negotiations with Costa Rica on the terms of a Structural Adjustment Loan (SAL) of US$80 million for 1985 and Board approval of the loan is expected around the end of March 1985. It is expected that this will be the first in a sequence of SALs.

The focus of the SAL program is on structural issues aimed at setting the basis for sustained economic growth over the medium term. Export growth through diversification of products and markets is a central objective. The program involves institutional reforms of both the public sector and the financial system, as well as the redefinition and establishment of priorities for the public investment program. In addition, the program seeks to dismantle price controls and subsidies, mainly for agricultural products, and to correct inefficiencies in production, principally in industry.

The approval of a stand-by arrangement by the Fund, together with the negotiation of the terms of a regional tariff reform and the timetable for its implementation, are the main preconditions for World Bank approval of the SAL.

1. Tariff reform

The tariff reform will involve a changeover from the Central American classification (NAUCA) to the Brussels Trade Nomenclature (BTN), the substitution of ad valorem for specific rates, and a phased reduction of both nominal and effective protection.

During a ministerial meeting on December 14, 1984, a new legal framework for the reform of the common external tariff (CET) of the Central American Common Market (CACM) was agreed which will be put into effect by all members of the CACM no later than October 1, 1985.1/ In accordance with this regional agreement, Costa Rica will introduce a new CET which is intended to reduce the level and dispersion of effective protection rates from the present range of 50 to 1,600 percent to a range of 50 to 150 percent by means of the following changes in nominal tariffs: (1) the tariff rates on competing final goods will be reduced from a range of 40 to 220 percent to a range of 35 to 70 percent, with certain exceptions; (2) the following new tariff levels will be established: 20 percent and 30 percent for competing intermediate goods, depending on the degree of elaboration; 10 percent for noncompeting intermediate goods produced outside the region; 10 percent for noncompeting, nonessential finished consumer goods and their respective inputs; and 5 percent for essential, noncompeting finished goods and their respective inputs; (3) the elimination of all exonerations on raw

1/ Costa Rica is committed under the SAL program to take certain measures to advance the starting date of its trade reform to July 1, 1985.

materials, intermediate and capital goods, as well as the San Jose Protocol surcharges; and (4) the introduction of the Brussels nomenclature and transformation of the system to an ad valorem basis.

In addition to the above, the Government has agreed to go beyond the regional agreement by increasing the tariff rates to 10 percent for all raw materials and to 20 percent for capital goods. These changes will further reduce the level of effective protection below the range agreed at the regional level.

The proposed tariff changes are significant, particularly since they constitute the first concrete effort to reform the CACM structure since the common market was established over 20 years ago. To facilitate further adjustments, the new regime includes a mechanism enabling such adjustments to be agreed through joint executive action at the regional level. In addition, the Government has agreed with the World Bank to carry out a detailed analysis of the impact of the new regime during its first year of operation, in order to lay the basis for a further reduction of all nominal tariff rates.

The Government has also agreed that exporters of nontraditional goods outside the CACM will be given rebates equivalent to the value of customs duties on imported inputs actually paid. The rebate mechanism is designed to ensure that domestic producers are reimbursed promptly and that their competitive position in third markets is not adversely affected by the new tariff regime.

2. Fiscal reform

The scope of the reform of public sector operations embodied in the SAL program is broad-based and would affect both the administration and control of revenue and expenditure; wages and employment practices in the public sector; and the dismantling of the system of administered price controls and subsidies. It is anticipated that actions in these areas will bring about a significant reduction in the size of the public sector within the economy. Action in respect of public sector operations will depend upon the recommendations of a special commission of the Legislative Assembly which is to report its findings by March 31, 1985. These recommendations center on the elimination of revenue earmarking and compulsory spending practices; the need to strengthen the Budgetary Authority in order to improve budgeting procedures and expenditure control; and the development of an effective system to monitor the external indebtedness of the public sector.

3. Financial reform

The SAL program also envisages actions to improve the efficiency of the banking system. For this purpose, it is intended to increase the role of private banks in financial intermediation which has been restricted since the nationalization of commercial banks in 1948. Some improvement in the system was achieved in September 1984 with the amendment to the Monetary Law permitting the private banks to have access to foreign credit lines extended to the Central Bank. Further action will depend upon the report, to be finalized early in 1985, of a special commission which is charged with recommending ways to modernize the operations of the state banks, to improve their financial condition and, in particular, to reduce their large portfolio of nonperforming loans.

4. Other issues

The SAL program will establish specific guidelines for the dismantling of price controls and subsidies mainly in the area of agricultural commodities which have given rise to substantial deficits of the National Production Council (CNP) in recent years. The establishment of a mechanism to provide for periodic adjustment of public enterprise prices in line with their costs and investment plans also is intended. Finally, the SAL program will provide specific technical assistance for revamping the operational scope of the State Development Corporation (CODESA), which administers several loss-making corporations, and for facilitating the sale of its shares in many of these corporations.

The main objectives in the area of wage and employment policy in the public sector are based on the provisions contained in the so-called Emergency Law approved in February 1984,1/ which aimed at reducing the size of the public sector labor force over time. The Emergency Law established a three-year freeze in the level of public sector employment, the compulsory retirement of all employees over 65 years of age, and the acceleration of early retirement for civil servants willing to transfer to the private sector. In the area of wage policy, the SAL program will seek to reinforce the Government's existing practice of adjusting wages, in absolute amounts, according to increases in the cost of a basic basket of essential goods and services for low income workers.

1/ The contents of this law were described in Appendix I of SM/84/146.

Costa Rica: Summary of Stand-By Program 1/

1. Principal targets

a. To consolidate the gains under the 1982-83 stabilization program so as to lay the basis for continued economic growth and medium-term balance of payments viability.

b. To reduce the deficit in the current account of the balance of payments (excluding official transfers) from around 12 percent of GDP in 1983-84 to 9 percent in 1985; to bring external debt service back to a current basis; and to achieve an overall payments surplus of US$60 million in 1985.

c. To increase the current account balance of the nonfinancial public sector by the equivalent of 3 percentage points of GDP to 6 1/2 percent of GDP from 1983 to 1985, while reducing the overall deficit by the equivalent of 2 percentage points to 1 1/2 percent of GDP. The overall fiscal deficit in 1985 would be fully financed with foreign borrowing on concessional terms.

d. To reduce the net operational losses of the Central Bank to the equivalent of 4 1/2 percent of GDP in 1985 from an average of 5 percent of GDP in 1982-84.

e. To maintain the increase in consumer prices at a rate of around 11 percent, on an average annual basis, in 1985.

2. Main assumptions

a. Nominal GDP is projected to increase 13 1/4 percent in 1985 (3 percent in real terms), compared with a 27 percent increase in 1983 (2 1/2 percent in real terms) amd 16 3/4 percent in 1984 (3 1/2 percent in real terms).

b. On the assumption of little change in income velocity, the banking system's liabilities to the private sector are projected to rise by 13 percent in 1985, compared with an estimated 10 percent in 1983. Domestic financial resources are to be supplemented by foreign resources, mainly through disbursements of US$190 million from U.S. AID and US$80 million from an IBRD structural adjustment loan (SAL).

c. Exports in U.S. dollar terms are projected to grow by 10 percent in 1985 (6 3/4 percent in volume terms).

d. The growth in the U.S. dollar value of total imports is projected to decline from around 10 percent in 1983-84 to 3 percent in 1985, reflecting a decline in the growth in import volume from 6 percent in 1983 and an estimated 2 3/4 percent in 1984 to 1 percent in 1985.

1/ Actual (1981-84) and projected (1985) data on selected economic and financial indicators are provided in Appendix IV.

3. Principal elements and instruments

a. Fiscal policy

A key element of the program is a prudent fiscal stance, geared to a significant improvement in the current account of the nonfinancial public sector and a further reduction in its overall deficit.

(i) Tax measures were introduced in mid-1984, estimated to yield the equivalent of about 1 percent of GDP in 1984 and an additional 2 percent of GDP in 1985. These measures included increases of 2 to 5 percentage points in the rates of selective consumption duties, a broadening of the tax base subject to sales taxes to include purchases of goods and services of the public sector, a 10 percent reduction in import duty exemptions, a change in the provisions for the revaluation of assets under the income tax, and a 2 percentage point increase in import surcharges.

(ii) The principal policy guidelines incorporated in the fiscal projections for 1985 call for limiting public sector wage adjustments to the increase in the cost of a basic basket of goods and services (estimated at 5 percent); a target of 6 1/2 percent of GDP (6 percent in 1984) for fixed capital formation; a reduction in the overall deficit of the National Production Council (CNP) of one half in relation to its level in 1984 through changes in the relative prices for its basic grain operations; and the adjustment of domestic fuel prices in line with the increase in import costs of the National Petroleum Refinery (RECOPE).

(iii) It is the intention of the authorities to finance the nonfinancial public sector with long-term foreign loans. To monitor fiscal performance, the program has established quarterly cumulative limits on Central Administration expenditure commitments. Any excess over these limits will trigger consultation with the Fund staff for the purpose of developing corrective measures that would assure the attainment of the programmed targets.

b. Monetary policy

The expansion in net bank credit is to be limited to 7 percent in 1985, compared with an estimated 17 percent in 1984 and 23 1/2 percent during 1983.1/ Net bank credit expansion to the private sector is to be limited to 7 1/2 percent in 1985, compared with an estimated 9 1/2 percent in 1984 and 22 percent during 1983. No increase in net banking system credit is programmed for the nonfinancial public sector.2/ A flexible interest rate policy will be continued, with domestic interest

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1/ In relation to banking system's liabilities to the private sector at the beginning of the year.

2/ Except for the equivalent of the 1984 maturities on external debts assumed by the Central Bank under the 1983 rescheduling agreement.

rates remaining significantly positive in real terms. Adjustments also have been introduced to the structure of Central Bank lending rates to reduce its net operational losses. The program includes periodic ceilings on the net domestic assets of the Central Bank and on the net credit of the banking system to the nonfinancial public sector (both of which are performance criteria).

c. External sector policy

The authorities intend to maintain a flexible exchange rate policy whereby the value of the colon will be adjusted from time to time, taking into account developments in the balance of payments, the rate of inflation in Costa Rica relative to that of its trading partners abroad, and changes in the net international reserves of the Central Bank (including payments arrears). External debt servicing is to be kept current and foreign commercial borrowing is to be strictly limited. The program includes quarterly targets on net international reserves of the Central Bank, a schedule for the elimination of payments arrears, and a ceiling on the net use of short-term foreign credit of the nonfinancial public sector and limits on medium- and long-term foreign borrowing of the public sector (all of which are performance criteria). The remaining two performance criteria also relate to the external sector--namely, a mid-term review by the Fund before August 31, 1985, which will focus on exchange rate policy, among other things, and the customary clause on exchange and import restrictions.

Costa Rica: Selected Economic and Financial Indicators

	1981	1982	1983	Prel. 1984	Prog. 1985
(Annual percent changes, unless otherwise specified)					
National income and prices					
GDP at constant prices	-2.3	-7.5	2.4	3.4	3.0
GDP deflator	41.1	86.4	24.0	12.9	10.0
Consumer prices (end of period)	65.1	81.8	10.7	15.0	10.0
(average)	37.1	90.1	32.7	13.0	11.0
External sector (on the basis of U.S. dollars)					
Exports, f.o.b.	0.2	-13.6	-0.5	10.3	9.9
Imports, c.i.f.	-20.6	-26.3	11.2	10.0	3.0
Non-oil imports, c.i.f.	22.4	-33.0	13.3	3.0	4.6
Export volume	9.5	-13.0	2.1	7.3	6.8
Import volume	-25.7	-30.6	5.9	2.7	1.1
Terms of trade (deterioration -)	-13.0	-6.3	-7.2	-1.0	0.6
Nominal effective exchange rate (end of period; depreciation -)	-304.1	-6.1	-4.5	-6.5	...
Real effective exchange rate (end of period; depreciation -)	-109.4	37.0	-6.0	-1.0	...
Government budget					
Revenue and grants	47.2	81.6	62.1	30.1	20.7
Total expenditure	24.7	60.4	55.2	23.8	15.5
Money and credit (banking system)					
Net domestic assets 1/	60.7	96.0	23.5	17.2	7.2
Public sector 1/	(9.1)	(8.5)	(2.7)	(--)3/	(--)2/
Private sector 1/	(6.4)	(17.8)	(21.9)	(9.6)	(7.5)
Medium- and long-term foreign liabilities 1/	(2.2)	(9.0)	(15.1)	(12.5)4/	(16.4)3/
Counterpart arrears and others 1/	(47.7)	(78.7)	(14.0)	(23.9)	(12.9)
Liabilities to private sector (M_3)	27.3	50.1	29.2	10.4	13.3
Velocity (GDP relative to M_3)4/	2.7	2.9	2.6	2.5	2.5
Interest rate (annual rate, six-month time deposit)	21.5	25.0	22.0	20.0	20.0
(In percent of GDP)					
Overall public sector deficit 5/	14.3	9.0	3.4	2.5	1.5
Central government savings	-1.6	-1.1	0.8	1.1	2.4
Central government budget deficit 5/	5.2	3.4	3.3	2.6	1.7
Domestic financing	(2.6)	(1.0)	(1.6)	(0.5)	(0.8)
Foreign financing 5/	(2.6)	(2.4)	(1.7)	(2.1)	(0.9)
Gross domestic investment	22.4	14.4	20.9	21.8	22.4
Gross national savings	6.0	5.4	10.5	13.1	16.2
Current account balance (deficit -)	-16.4	-9.0	-10.4	-8.7	-6.2
Current account (excluding official transfers)	-16.4	-9.3	-11.8	-12.0	-9.1
Trade balance (deficit -)	-8.1	-1.1	-4.0	-4.0	-2.1
External debt inclusive of use of Fund credit	95.1	104.7	119.4	117.4	125.2
(In percent of exports of goods and services)					
Debt service ratio 6/	51.7	55.0	51.0	55.1	55.2
Interest payments 6/	25.6	31.0	29.8	28.2	26.5
(In millions of U.S. dollars)					
Overall balance of payments	-470	-314	55	-140	60
Gross official reserves (months of imports)7/	1.5	3.3	3.7	4.6	4.2
External payments arrears	359	453	-1,054	204	-245

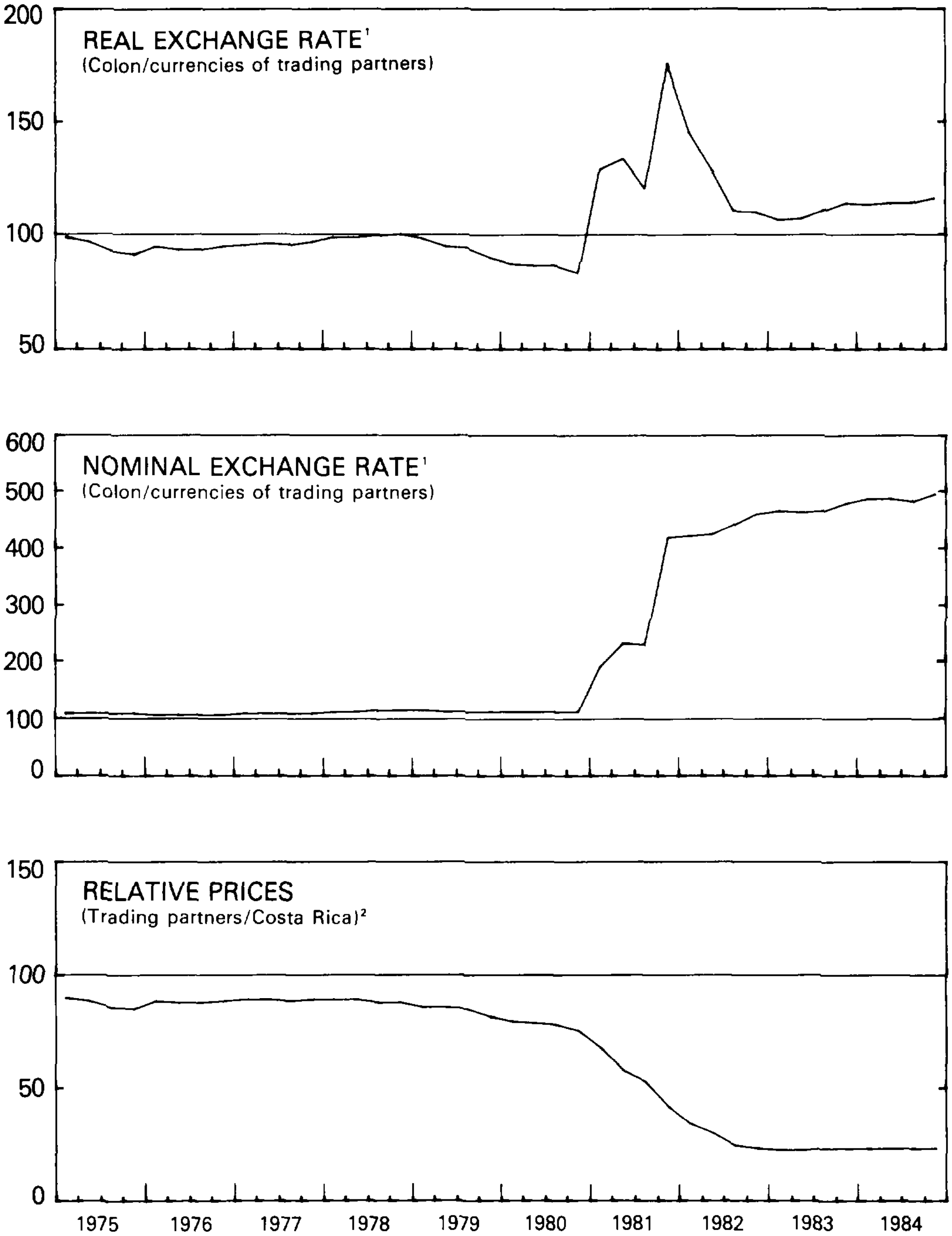
Sources: Central Bank of Costa Rica; Ministry of Finance; and Fund staff estimates.

1/ Against the stock of liabilities to the private sector at the beginning of the period.
2/ Excludes credit growth arising from 1983/84 debt rescheduling and counterparts to U.S. AID grants and IBRD/SAL.
3/ Includes liabilities assumed under the 1983/84 debt rescheduling and counterparts to U.S. AID grants and IBRD/SAL.
4/ GDP relative to the average of M_3 of the end of previous and current years.
5/ Includes accumulation of arrears.
6/ Inclusive of Fund charges and repurchases as well as interest on short-term debt. Includes unpaid interest and amortization (1981/82); excludes the effect of debt rescheduling (1983-85).
7/ Includes nonliquid reserve assets, mainly claims against other Central American central banks.

COSTA RICA

EFFECTIVE EXCHANGE RATE

(1974 = 100)



Sources: IMF, *International Financial Statistics;* and Fund staff estimates.
[1]An increase (decrease) in the index indicates a depreciation (appreciation) of the colon.
[2]Wholesale price index for Costa Rica and consumer price index for trading partners.

Table I. Costa Rica: National Account Indicators

	1982	1983	Est. 1984	Prog. 1985
	(In millions of colones)			
GDP at market prices	98,457	125,069	146,049	165,473
Real GDP	8,727	8,934	9,242	9,519
GDP deflator (1966=100)	1,129	1,400	1,580	1,738
GDP in U.S. dollars	2,551	3,025	3,246	3,309
Accounting ER (₡/US$)	38.6	41.35	45	50
	(Percentage change)			
GDP at market prices	72.4	27.0	16.8	13.3
Real GDP	-7.5	2.4	3.4	3.0
GDP deflator	86.4	24.0	12.9	10.0
	(In millions of colones)			
Nominal GDP	98,457	125,069	146,049	165,473
Net resource balance 1/	2,895	-674	-2,025	1,300
Gross domestic expenditure	95,562	125,743	148,074	164,173
Investment	14,215	26,148	31,838	37,066
Public	(5,274)	(7,367)	(8,661)	(10,642)
Private 2/	(8,941)	(18,781)	(23,177)	(26,424)
Consumption	81,347	99,595	116,236	127,107
	(As a percent of GDP)			
Investment	14.4	20.9	21.8	22.4
Public	(5.3)	(5.9)	(5.9)	(6.4)
Private 2/	(9.1)	(15.0)	(15.9)	(16.0)
Savings	14.4	20.9	21.8	22.4
External 1/	(-2.9)	(0.5)	(1.4)	(-0.8)
Internal	(17.3)	(20.4)	(20.4)	(23.2)
Public 3/	/0.6/	/7.8/	/8.9/	/10.9/
Private	/16.7/	/12.6/	/11.5/	/12.3/

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

1/ Current account balance of goods and nonfactor services.
2/ Includes inventory change.
3/ Net of interest payments abroad.

Table II. Costa Rica: Operations of the Nonfinancial Public Sector

(In millions of colones)

	1981	1982	1983 1/	Prel. 1984	Prog. 1/ 1985
I. Central Administration					
Current revenue	7,333	13,317	21,585	28,085	33,891
Tax revenues	7,080	13,008	21,040	25,251	31,283
Direct taxes	(1,701)	(3,215)	(5,166)	(5,862)	(6,647)
Indirect taxes	(5,379)	(9,793)	(15,874)	(19,389)	(24,636)
Sales of goods and services	36	48	58	55	62
Property income	52	48	257	443	458
Transfers	52	86	36	2,105	1,808
Other current revenue	113	127	194	231	280
Current expenditure	8,226	14,363	20,631	26,482	29,966
Wages and salaries	3,501	5,044	7,730	9,675	10,230
Goods and services	426	669	1,163	1,415	1,618
Interest	1,427	2,615	3,412	3,994	4,643
Transfers to	2,512	5,942	8,326	11,398	13,475
Rest of general government 2/	(1,402)	(3,271)	(2,421)	(3,346)	(3,869)
Public enterprises	(59)	(14)	(14)	(220)	(146)
Other	(1,051)	(2,657)	(5,891)	(7,832)	(9,460)
Exchange subsidies 3/	360	93	--	--	--
Current surplus or deficit (-)	-893	-1,046	954	1,603	3,925
Capital expenditure	2,106	2,212	5,091	5,368	6,815
Fixed capital formation	1,169	1,181	2,931	3,925	4,815
Transfers to	844	816	2,033	1,287	1,810
Rest of general government	(75)	(398)	(600)	(313)	(436)
Public enterprises	(623)	(80)	(456)	(134)	(87)
Other	(146)	(338)	(977)	(840)	(1,287)
Other capital expenditure	93	215	127	156	190
Overall surplus or deficit (-)	-2,999	-3,258	-4,137	-3,765	-2,890

Table II. Costa Rica: Operations of the Nonfinancial Public Sector (Continued)

(In millions of colones)

	1981	1982	1983 1/	Prel. 1/ 1984	Prog. 1/ 1985
II. Rest of the General Government 4/					
Current revenue	6,148	9,828	11,975	15,056	16,896
Direct taxes	3,045	4,697	8,332	10,330	12,056
Of which: social security					
payments from	(2,915)	(3,846)	(7,202)	(9,027)	(10,752)
Central Administration	/153/	/469/	/582/	/940/	/1,436/
Public enterprises	/191/	/226/	/287/	/668/	/822/
Other	/2,571/	/3,151/	/6,333/	/7,418/	/8,495/
Indirect taxes	951	1,594	437	563	635
Sales of goods and services	414	633	220	369	425
Property income	245	293	590	1,034	1,028
Transfers from	1,582	2,648	2,361	2,792	2,842
Central Administration	(1,399)	(2,407)	(1,839)	(2,406)	(2,433)
Public enterprises	(20)	(23)	(293)	(350)	(351)
Other	(163)	(218)	(229)	(36)	(58)
Other current revenue	201	289	33	2	4
Adjustment 5/	-290	-325	2	-34	-93
Capital revenue	226	668	635	419	486
Transfers from	177	664	600	352	486
Central Administration	(131)	(637)	(600)	(313)	(436)
Public enterprises	(33)	(--)	(--)	(39)	(50)
Other	(13)	(27)	(--)	(--)	(--)
Other capital revenue	27	8	35	67	--
Adjustment 5/	22	-4	--	--	--
Current expenditure	5,593	8,799	9,984	13,046	14,696
Wages and salaries	3,152	4,460	4,060	5,649	6,184
Goods and services	1,501	2,691	2,219	3,038	3,745
Interest	34	148 6/	39	44	48
Transfers to	731	1,195	3,667	4,315	4,700
Central Administration	(30)	(36)	(223)	(664)	(452)
Public enterprises	(11)	(5)	(--)	(89)	(100)
Other	(690)	(1,154)	(3,444)	(3,562)	(4,148)
Other current expenditure	--	--	--	--	19
Exchange subsidies 3/	175	305	--	--	--
Capital expenditure	1,182	1,218	839	1,290	1,588
Fixed capital formation	959 7/	907	335	376	727
Transfers to	85	83	78	118	142
Central Administration	(36)	(11)	(--)	(--)	(--)
Public enterprises	(42)	(49)	(78)	(118)	(142)
Other	(7)	(23)	(--)	(--)	(--)
Net lending	57	140	268	132	222
Other capital expenditure	81	88	158	664	497
Overall surplus or deficit (-)	-401	479	1,787	1,139	1,098

Table II. Costa Rica: Operations of the Nonfinancial Public Sector (Continued)

(In millions of colones)

	1981	1982	1983 1/	Prel.1/ 1984	Prog.1/ 1985
III. General Government					
Current revenue	11,974	19,838	30,916	39,131	46,467
Tax revenue	10,923	18,829	29,227	35,204	42,538
Direct taxes	(4,593)	(7,443)	(12,917)	(15,252)	(17,267)
Indirect taxes	(6,330)	(11,386)	(16,310)	(19,952)	(25,271)
Sales of goods and services	450	681	278	424	487
Property income	222	341	847	1,477	1,486
Transfers from	192	265	548	1,881	1,771
Public enterprises	(21)	(26)	(294)	(1,240)	(1,045)
Other	(171)	(239)	(254)	(641)	(726)
Other current revenue	314	416	227	233	284
Adjustment 5/	-127	-694	-210	-88	-99
Capital revenue	115	259	36	106	50
Transfers from	46	27	--	39	50
Public enterprises	(33)	(--)	(--)	(39)	(50)
Other	(13)	(27)	(--)	(--)	(--)
Other capital revenue	27	8	36	67	--
Adjustment 5/	42	224	--	--	--
Current expenditure	12,312	19,855	27,972	35,518	40,341
Wages and salaries	6,653	9,504	11,789	15,324	16,414
Goods and services	1,927	3,360	3,382	4,452	5,363
Interest	1,386	2,763	3,450	4,038	4,691
Transfers to	1,811	3,830	9,350	11,703	13,854
Public enterprises	(70)	(19)	(14)	(309)	(246)
Other	(1,741)	(3,811)	(9,336)	(11,394)	(13,608)
Other current expenditure	--	--	--	--	19
Exchange subsidies 3/	535	398	--	--	--
Capital expenditure	3,177	3,021	5,331	6,344	7,967
Fixed capital formation	2,128	2,088	3,266	4,300	5,542
Transfers to	818	490	1,512	1,092	1,516
Public enterprises	(665)	(129)	(535)	(252)	(229)
Other	(153)	(361)	(977)	(840)	(1,287)
Net lending	57	140	268	132	222
Other capital expenditure	174	303	235	818	687
Adjustment 5/	--	--	--	--	--
Overall surplus or deficit (-)	-3,400	-2,779	-2,350	-2,625	-1,792

Table II. Costa Rica: Operations of the Nonfinancial Public Sector (Continued)

(In millions of colones)

	1981	1982	1983 1/	Prel.1/ 1984	Prog.1/ 1985
IV. Nonfinancial Public Enterprises					
Current revenue	10,280	18,239	27,786	33,112	36,444
Sales of goods and services	9,846	17,737	26,746	31,842	35,531
Property income	66	145	158	1,011	791
Transfers from	52	97	14	309	246
General government	(52)	(28)	(14)	(309)	(146)
Other	(--)	(69)	(--)	(--)	(100)
Other current revenue	274	663	833	39	--
Adjustment 5/	42	-403	35	-89	-124
Capital revenue	759	135	520	254	231
Transfers from general government	670 8/	102	537	252	231
Other capital revenue	27	33	--	2	--
Adjustment 5/	62	--	-17	--	--
Current expenditure	12,119	21,260	26,301	29,942	31,990
Wages and salaries	1,358	2,061	2,633	3,240	3,776
Social security payments	191	228	564	668	822
Goods and services	7,213	11,680	14,585	16,919	17,564
Interest	1,966 9/	5,316 9/	6,124 9/	5,663 9/	6,126
Transfers to	692	238	2,395	3,452	3,702
General government	(115)	(52)	(294)	(1,240)	(1,044)
Other	(577)	(186)	(2,101)	(2,212)	(2,658)
Exchange losses 3/	351	1,038	--	--	--
Other current expenditure	348	699	--	--	--
Capital expenditure	3,327	3,417	3,899	4,506	5,374
Fixed capital formation	3,094 10/	3,186	3,587	4,261	5,209
Transfers to	108	53	--	39	50
General government	(1)	(52)	(--)	(39)	(50)
Other	(107)	(1)	(--)	(--)	(--)
Net lending to	76	160	270	170	95
General government	(--)	(--)	(--)	(--)	(--)
Other	(76)	(160)	(270)	(170)	(95)
Other capital expenditure	49	18	42	37	20
Adjustment 5/	--	--	--	--	--
Current account surplus or deficit (-)11/	-1,839	-3,021	1,485	3,170	4,454
Overall surplus or deficit (-)	-4,407	-6,303	-1,895	-1,082	-688

Table II. Costa Rica: Operations of the Nonfinancial Public Sector (Concluded)

(In millions of colones)

	1981	1982	1983 1/	Prel.1/ 1984	Prog.1/ 1985
V. Consolidated Nonfinancial Public Sector					
Current revenue	10,060	16,798	32,387	41,993	50,674
Tax revenue	10,732	18,603	28,663	34,535	41,717
Direct taxes	(4,402)	(7,217)	(12,352)	(14,584)	(16,445)
Indirect taxes	(6,330)	(11,386)	(16,311)	(19,951)	(25,272)
General government nontax revenue	1,152	1,438	1,352	2,134	2,257
Central Administration	(208)	(223)	(509)	(729)	(800)
Rest of general government	(944)	(1,215)	(843)	(1,405)	(1,457)
Public enterprises current account surplus or deficit (-)	-1,839	-3,021	2,294	4,858	6,074
Adjustment 5/	15	-222	78	466	653
Capital revenue	208	213	21	69	3
Transfers	13	27	--	--	--
Other capital revenue	54	41	36	69	3
Adjustment 5/	141	145	-15	--	--
Total expenditure and net lending	18,075	26,093	36,653	45,769	53,158
General government current expenditures	12,237	19,836	27,972	35,518	40,341
Capital expenditures and net lending	5,838	6,257	8,695	10,251	12,817
Fixed capital formation	(5,222)	(5,274)	(6,853)	(8,561)	(10,751)
Transfers	(260)	(362)	(977)	(840)	(1,287)
Net lending)	(133)	(300)	(538)	(303)	(317)
Other)	(223)	(321)	(327)	(855)	(708)
Adjustment 5/	(--)	(--)	(-25)	(-308)	(-246)
Overall surplus or deficit before adjustment (-)	-7,807	-9,082	-4,245	-3,707	-2,480
Net residual 12/	-354	225	--	--	--
Financing = overall deficit	8,161	8,857	4,245	3,707	2,480
External (net)	4,767	2,094	2,219	3,420	6,350
Domestic	1,739	2,697	2,026	-1,198	-3,870
Banking system	(1,664)	(1,872)	(1,161)	(-1,049)	
Nonbank financial intermediaries	(20)	(99)	(--))		
Private sector	(-76)	(582)	(490))	(-149)	
Change in floating debt and others	(131)	(144)	(375))	)	
Interest in arrears (change)	1,655	4,066	--	1,485	

Sources: Ministry of Finance; Comptroller General's Office; Central Bank of Costa Rica; and Fund staff estimates.

1/ The coverage of the public sector for program purposes differs from that used in previous years.
2/ Includes social security payments.
3/ Exchange subsidies granted by the the Central Bank.
4/ National lottery (Junta de Proteccion Social de San Jose) is included through 1980 when, by executive decree, it was transformed into a public financial institution.
5/ The adjustment for the difference between transfers made and transfers received. In general, the adjustment was made to the consolidated revenues assuming that the donor's classification is correct, except in those cases in which the donor's transfer is higher than the corresponding total revenues of the recipient; in the latter case, the adjustment was made to the consolidated expenditures.
6/ Includes ₡ 100 million in accumulation of unpaid interest on external debt.
7/ Increased by ₡ 240 million to account for the difference with external debt disbursements as reported by the Central Bank.
8/ Includes ₡ 199 million of an assumption of CNP debt and ₡ 335 million of a transfer of government bonds to CODESA.
9/ Includes ₡ 1,136 million in 1981 and ₡ 2,984 million in 1982 in accumulation of unpaid interests on external debt.
10/ Increased by ₡ 860 million to account for the difference with the external debt disbursements as reported by the Central Bank.
11/ Net of transfers and other transactions made and received from the rest of the nonfinancial public sector.
12/ Includes discrepancies arising from reporting on accrual and cash basis, from reporting periods that differ from the calendar year, and from the operations of the nonconsolidated public sector.

Table III. Costa Rica: Summary Accounts of the Banking System

(In millions of colones)

	December 31							
	₡ 15.00 = US$1		₡ 40.00 = US$1		₡ 50.00 = US$1		₡ 45.00 = US$1	
							Recl.	Proj.
	1980	1981	1981	1982	1982	1983	1983 1/	1984
I. Central Bank								
Net international reserves	-2,061	-2,905	-7,748	-2,591	-3,239	-13,286	-4,257	-1,489
Assets	3,423	2,204	5,876	9,773	12,216	21,090	13,756	18,928
Short-term liabilities	-5,484	-5,109	-13,624	-12,364	-15,455	-34,376	-18,013	-20,417
Net domestic assets	17,810	22,670	45,497	50,974	59,533	81,461	102,553	107,864
Credit to public sector (net) 2/	7,341	8,765	8,765	9,628	9,613	9,892	26,288	27,634
Credit to Central Government (net)3/	(4,430)	(5,278)	(5,278)	(3,484)	(3,468)	(2,836)4/	(6,274)	(6,085)
Of which: rescheduling	/--/	/--/	/--/	/--/	/--/	/--/	/3,412/	/3,511/
Credit to rest of public sector (net)	(2,911)	(3,487)	(3,487)	(6,144)5/	(6,144)5/	(7,056)5/	(20,014)	(21,549)
Of which: rescheduling	/--/	/--/	/--/	/--/	/--/	/--/	/11,320/	/10,346/
Official capital and reserves	-13	-15	-15	-15	-15	-15	-15	-15
Credit to commercial banks 6/	2,276	1,710	1,710	1,801	1,801	2,866	6,985	6,370
Of which: rescheduling	(--)	(--)	(--)	(--)	(--)	(--)	(4,119)	(1,619)
Credit to rest of banking system	303	355	355	437	437	447	447	447
Credit to nonbank intermediaries	213	318	318	383	383	726	726	825
Subscriptions to international agencies (net)	-67	-554	-1,841	-1,798	-2,280	-1,328	-1,074	-341
Unclassified assets (net)	1,604	5,938	5,938	10,271	10,271	29,550	48,440	52,188
Valuation adjustment	6,153	6,153	30,267	30,267	39,323	39,323	20,756	20,756
Counterpart unrequited foreign exchange	1,137	427	1,140	1,140	1,425	1,424	1,122	1,057
Government trust funds	--	--	--	--	--	--	--	4,478
Medium- and long-term foreign liabilities	6,791	7,949	21,196	23,274	29,095	35,325	67,005	69,111
Regular	6,791	7,949	21,196	23,274	29,095	35,325	45,675	48,303
Rescheduled	--	--	--	--	--	--	21,330	20,808
Liabilities to banks	5,036	6,185	10,182	13,358	15,151	18,461	17,497	17,259
Liabilities to nonbank intermediaries	--	--	--	255 5/	255 5/	357 5/	357	357
Liabilities to private sector	2,785	5,204	5,231	10,356	10,368	12,315	12,315	14,113
Currency in circulation	2,255	3,500	3,500	5,436	5,436	6,940	6,940	9,085
Demand deposits	153	145	145	118	118	277	277	172
Foreign currency deposits	58	17	44	43	55	4	4	4
Stabilization bonds	286	1,542	1,542	4,755	4,755	5,090	5,090	4,848
Import deposits	32	--	--	4	4	4	4	4

Table III. Costa Rica: Summary Accounts of the Banking System (Continued)

(In millions of colones)

	December 31							
	₡ 15.00 = US$1		₡ 40.00 = US$1		₡ 50.00 = US$1		₡ 45.00 = US$1	
							Recl.	Proj.
	1980	1981	1981	1982	1982	1983	1983 1/	1984
II. Commercial Banks								
Net international reserves	6	179	480	501	625	-57	1,704	--
Assets	734	984	2,624	2,573	3,215	3,008	2,707	1,161
Short-term liabilities	-728	-805	-2,144	-2,072	-2,590	-3,065	-1,003	-1,161
Claims on Central Bank	5,077	6,109	10,105	13,217	15,010	18,016	17,052	16,988
Net domestic assets	13,492	14,287	15,990	21,779	22,565	31,601	31,231	36,660
Credit to public sector (net)	556	-139	-342	-252	-313	-2,260	-2,280	-4,918
Credit to Central Government (net)6/	(1,507)	(1,732)	(1,732)	(2,643)	(2,640)	(3,351)	(3,350)	(3,570)
Credit to rest of public sector (net)	(-951)	(-1,871)	(-2,074)	(-2,895)5/	(-2,953)5/	(-5,611)5/	(-5,630)	(-8,488)
Official capital and reserves	-308	-315	-315	-359	-359	-678	-678	-912
Credit to private sector	10,243	11,191	11,406	16,067	16,168	24,847	24,827	29,743
Credit to rest of banking system	242	379	379	404	404	647	647	790
Credit to nonbank intermediaries	130	165	165	170	170	170	170	170
Unclassified assets (net)	2,143	2,520	2,838	3,890	4,041	6,421	6,421	9,663
Valuation adjustment	486	486	1,859	1,859	2,454	2,454	2,124	2,124
Medium- and long-term foreign liabilities	1,180	1,167	3,112	3,532	4,415	4,389	1,628	1,943
Liabilities to Central Bank 6/	2,278	1,649	1,649	1,804	1,804	2,814	6,932	6,239
Liabilities to rest of banking system	38	21	21	42	42	29	29	101
Liabilities to nonbank intermediaries	5	23	23	452 5/	452 5/	1,223 5/	1,223	1,629
Liabilities to private sector	15,074	17,715	21,770	29,667	31,487	41,105	40,175	43,736
Demand deposits	4,825	6,963	6,963	11,408	11,408	15,264	15,264	16,836
Savings deposits	1,267	1,444	1,444	2,097	2,097	2,394	2,394	2,800
Time deposits	4,551	6,032	6,032	6,978	6,978	13,074	13,074	13,350
Foreign currency deposits	3,904	2,433	6,488	7,268	9,087	9,300	8,370	8,850
Other obligations	461	749	749	1,700	1,700	648	648	1,000
Private capital	66	94	94	217	217	425	425	900

Table III. Costa Rica: Summary Accounts of the Banking System (Continued)

(In millions of colones)

	December 31							
	₡ 15.00 = US$1		₡ 40.00 = US$1		₡ 50.00 = US$1		₡ 45.00 = US$1	
	1980	1981	1981	1982	1982	1983	Recl. 1983	Proj. 1984
III. Rest of Banking System								
Claims on Central Bank	--	10	10	53	53	124	124	124
Net domestic assets	1,035	1,110	1,265	1,291	1,346	1,594	1,567	1,605
Credit to public sector (net)	-63	-15	-15	-2	-2	-8	-8	-11
Credit to Central Government (net)	(8)	(--)	(--)	(16)	(16)	(2)	(2)	(47)
Credit to rest of public sector (net)	(-71)	(-15)	(-15)	(-18)	(-18)	(-10)	(-10)	(-58)
Official capital and reserves	-136	-137	-137	-139	-139	-139	-139	-139
Credit to commercial banks	38	22	22	42	42	29	29	62
Credit to private sector	1,278	1,352	1,352	1,474	1,474	1,826	1,826	2,054
Unclassified assets (net)	-120	-150	-150	-277	-277	-362	-362	-582
Valuation adjustment	38	38	193	193	248	248	221	221
Medium- and long-term foreign liabilities	89	93	248	222	277	270	243	223
Liabilities to Central Bank	312	354	354	437	437	445	445	445
Liabilities to commercial banks	242	377	377	402	402	641	641	791
Liabilities to nonbank intermediaries	212	230	230	209	209	235	235	211
Liabilities to private sector	180	66	66	74	74	127	127	59
Demand deposits	--	--	--	--	--	--	--	--
Bonds	160	37	37	30	30	59	59	13
Other obligations	20	29	29	44	44	68	68	46

Table III. Costa Rica: Summary Accounts of the Banking System (Concluded)

(In millions of colones)

	December 31							
	₡ 15.00 = US$1		₡ 40.00 = US$1		₡ 50.00 = US$1		₡ 45.00 = US$1	
	1980	1981	1981	1982	1982	1983	Recl. 1983 1/	Proj. 1984
	IV. Consolidated Banking System							
Net international reserves	-2,055	-2,726	-7,268	-2,090	-2,614	-13,343	-2,553	-1,489
Assets	4,157	3,188	8,500	12,346	15,431	24,098	16,463	20,089
Short-term liabilities	-6,212	-5,914	-15,768	-14,436	-18,045	-37,441	-19,016	-21,578
Net domestic assets	29,508	35,600	60,284	71,276	80,671	110,406	126,983	138,406
Credit to public sector (net) 2/	7,833	8,611	8,408	9,374	9,298	7,624	24,000	22,705
Credit to Central *Government (net)3/*	*(5,944)*	*(7,010)*	*(7,010)*	*(6,143)*	*(6,124)*	*(6,189)*	*(9,626)*	*(9,702)*
Credit to rest of public sector (net)	(1,889)	(1,601)	(1,398)	(3,231) 5/	(3,174) 5/	(1,435) 5/	(14,374)	(13,003)
Official capital and reserves	-456	-467	-467	-513	-513	-832	-832	-1,066
Credit to nonbank intermediaries	343	483	483	553	553	896	896	995
Credit to private sector	11,521	12,543	12,758	17,541	17,642	26,673	26,653	31,797
Subscriptions to international agencies (net)	-67	-554	-1,841	-1,798	-2,280	-1,328	-1,074	-341
Unclassified assets (net)	3,627	8,308	8,626	13,889	13,890	35,609	54,499	61,269
Interbank float	29	-2	-2	-89	-89	-261	-260	-54
Valuation adjustment	6,678	6,678	32,319	32,319	42,176	42,025	23,101	23,101
Counterpart unrequited foreign exchange	1,137	427	1,140	1,140	1,425	1,424	1,122	1,057
Government trust funds	--	--	--	--	--	--	--	4,478
Medium- and long-term foreign liabilities	8,060	9,209	24,556	27,028	33,787	40,277	68,876	71,277
Liabilities to nonbank intermediaries	217	253	253	916 5/	916 5/	1,815 5/	1,815	2,197
Liabilities to private sector	18,039	22,985	27,067	40,097	41,929	53,547	52,617	57,908
Currency	2,255	3,500	3,500	5,436	5,436	6,940	6,940	9,085
Demand deposits	4,978	7,108	7,108	11,525	11,526	15,541	15,541	17,008
Savings deposits	1,267	1,444	1,444	2,097	2,097	2,394	2,394	2,800
Time deposits	4,551	6,032	6,032	6,978	6,978	13,074	13,074	13,350
Foreign currency deposits	3,962	2,450	6,532	7,311	9,142	9,304	8,374	8,854
Bonds	446	1,579	1,579	4,785	4,785	5,149	5,149	4,861
Other	482	778	778	1,748	1,748	720	720	1,050
Private capital	98	94	94	217	217	425	425	900

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

1/ Reclassified; reflects the effect of the rescheduling of public sector payments arrears.
2/ Does not include exchange subsidies.
3/ Includes all credit of the Central Bank to the commercial banks for relending to the Central Government.
4/ Includes a reduction of ₡ 545 million in deposits on account of payments made in 1983 but only registered in January 1984.
5/ Adjusted for the reclassification of financial public sector deposits from rest of nonfinancial public sector to nonbank intermediaries. In 1983 also adjusted for CIDA credits to FERTICA and CODESA, through the Central Bank, which were only registered in May 1984 (₡ 257 million).
6/ Excludes all credit of the Central Bank to the commercial banks for relending to the Central Government.

Table IV. Costa Rica: Exports by Principal Groups

	1981	1982	1983	Est. 1984	Proj. 1985
(Value in millions of U.S. dollars; volume in thousands of units indicated; and unit value in U.S. dollars)					
Exports, f.o.b.	1,002.6 1/	865.8	870.4	960.0	1,055.0
Traditional exports	580.8	535.8	517.9	578.3	623.4
Coffee	240.1	236.7	230.0	283.1	291.0
Volume (quintal)	(2,094)	(2,038)	(2,345)	(2,452)	(2,695)
Unit value (per quintal)	(114.6)	(116.1)	(97.7)	(115.5)	(108.0)
Bananas	224.8	229.4	234.0	239.4	260.6
Volume (metric ton)	(1,002)	(1,017)	(1,012)	(1,050)	(1,095)
Unit value (per ton)	(224.4)	(225.6)	(231.4)	(228.0)	(238.0)
Meat	73.9	53.1	30.0	29.9	43.0
Volume (metric ton)	(33.2)	(24.3)	(13.2)	(13.0)	(17.2)
Unit value (per ton)	(2,228.9)	(2,185.5)	(2,380.0)	(2,300.0)	(2,500.0)
Sugar	42.0	16.6	23.9	25.9	28.8
Volume (quintal)	(1,567)	(1,191)	(1,173)	(1,600)	(1,800)
Unit value (per quintal)	(26.8)	(13.9)	(20.4)	(16.2)	(16.0)
Nontraditional exports	427.3	330.0	352.5	381.7	431.6
Agricultural products	66.5	61.4	295.5	320.0	352.8
Industrial products	360.8	286.6	57.0	61.7	78.8
(In percent of total value)					
Total exports	100.0	100.0	100.0	100.0	100.0
Traditional exports	57.9	61.9	59.5	60.2	59.1
Nontraditional exports	42.6	38.1	40.5	39.8	40.9
(Annual percentage change of total value)					
Total exports	0.2	-13.6	0.5	10.3	9.9
Traditional exports	2.5	-7.8	-3.3	11.7	7.8
Nontraditional exports	-1.8	-22.8	6.8	8.3	13.1

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

1/ Includes a statistical discrepancy between the central bank data and customs records of US$5.5 million.

Table V. Costa Rica: Exchange Rates

(Colones per U.S. dollar; period averages)

	Official		Banking		Free	
	Buying	Selling	Buying	Selling	Buying	Selling
1980	8.54	8.60	9.52	9.59	10.52	10.56
December	8.54	8.60	14.30	14.23	14.50	14.50
1981	9.28	9.56	21.36	21.48	23.89	24.42
December	17.40	19.92	35.85	36.01	37.70	38.27
1982	20.00	20.25	38.34	38.58	49.41	49.99
December	20.00	20.50	40.00	40.50	45.20	45.70
1983	20.00	20.50	40.84	41.34	43.60	44.10
January	20.00	20.50	40.00	40.50	44.87	45.37
February	20.00	20.50	40.00	40.50	44.66	45.16
March	20.00	20.50	40.00	40.50	44.43	44.93
April	20.00	20.50	40.00	40.50	44.17	44.67
May	20.00	20.50	40.00	40.50	44.10	44.60
June	20.00	20.50	40.14	40.64	43.96	44.46
July	20.00	20.50	41.00	41.50	43.10	43.60
August	20.00	20.50	41.00	41.50	43.10	43.60
September	20.00	20.50	41.07	41.57	42.81	43.31
October	20.00	20.50	41.25	41.75	42.10	42.60
November	20.00	20.50	42.45	42.95	42.77	43.27 1/
December	20.00	20.50	43.15	43.65	...	...
1984	20.00	20.50	44.29	44.79		
January	20.00	20.50	43.15	43.65		
February	20.00	20.50	43.15	43.65		
March	20.00	20.50	43.15	43.65		
April	20.00	20.50	43.15	43.65		
May	20.00	20.50	43.17	43.67		
June	20.00	20.50	43.52	44.02		
July	20.00	20.50	43.75	44.25		
August	20.00	20.50	43.75	44.25		
September	20.00	20.50	44.45	44.95		
October	20.00	20.50	45.18	45.68		
November	20.00	20.50	47.50	48.00		
December	20.00	20.50	47.50	48.00		

Source: Central Bank of Costa Rica.

1/ The banking and free market rates were unified in November 1983.

Stand-By Arrangement - Costa Rica

Attached hereto is a letter, dated January 11, 1985, from the Executive President of the Central Bank and Minister of Finance of Costa Rica requesting a stand-by arrangement and setting forth the objectives and policies that the Government of Costa Rica intends to pursue. To support these objectives and policies, the International Monetary Fund grants this stand-by arrangement in accordance with the following provisions:

1. For the period from March , 1985 to 1986, Costa Rica will have the right to make purchases from the Fund in an amount equivalent to SDR 54 million, subject to paragraphs 2, 3, 4, and 5 below, without further review by the Fund.

2. (a) Purchases under this stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 14,000,000 until April 30, 1985, the equivalent of SDR 24,000,000 until July 31, 1985, the equivalent of SDR 34,000,000 until October 31, 1985, and the equivalent of SDR 44,000,000 until January 31, 1986.

(b) None of the limits in (a) above shall apply to a purchase under this stand-by arrangement that would not increase the Fund's holdings of Costa Rica's currency in the credit tranches beyond 25 percent of quota, or increase the Fund's holdings of that currency resulting from purchases of supplementary financing or borrowed resources beyond 12.5 percent of quota.

3. Purchases under this stand-by arrangement shall be made from ordinary and borrowed resources in the ratio of 1 to 1, provided that any modification by the Fund of the proportions of ordinary and borrowed resources shall apply to amounts that may be purchased after the date of modification.

4. Costa Rica will not make purchases under this stand-by arrangement, other than the initial purchase of SDR 14,000,000 that it may request not later than within 15 days of the effective date of this arrangement, that would increase the Fund's holdings of Costa Rica's currency in the credit tranches beyond 25 percent of quota or increase the Fund's holdings of that currency resulting from purchases of supplementary financing or borrowed resources beyond 12.5 percent of quota:

(a) during any period in which the data at the end of the last reporting period not more than three weeks earlier show that

(i) the limit on the domestic banking system's net credit to the nonfinancial public sector set forth in Table 2 annexed to the attached letter;

(ii) the limit on the net domestic assets of the Central Bank of Costa Rica set forth in Table 3 annexed to the attached letter;

(iii) the target for the net international reserve position of the Central Bank set forth in Table 4 annexed to the attached letter;

(iv) the limit on the outstanding stock of payments arrears set forth in Table 5 annexed to the attached letter is not observed; or

(b) during any period in which the data at the end of the last reporting period not more than seven weeks earlier show that the limit on the amount of new foreign loans contracted or guaranteed by the public sector, and the net short-term foreign indebtedness of the nonfinancial public sector, as set forth in paragraph 10 of the attached letter is not observed; or

(c) during any period after August 31, 1985 if the review contemplated in paragraph 16 of the annexed letter has not been completed or, if further understandings have been reached pursuant to the review, while such understandings are not being observed; or

(d) during any period after January 30, 1986, in which there remain any external payments arrears relating to the rescheduling of external public debt currently under negotiation, until understandings have been reached between the Fund and Costa Rica on the completion of individual rescheduling agreements; or

(e) during the entire period of the stand-by arrangement, while Costa Rica has any overdue financial obligation to the Fund, or if Costa Rica:

(i) imposes or intensifies restrictions on payments and transfers on current international transactions other than as described in paragraph 13 of the attached letter; or

(ii) introduces multiple currency practices; or

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

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

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

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

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

7. The value date of a purchase under this stand-by arrangement involving borrowed resources will be determined in accordance with Rule G-4(b) of the Fund's Rules and Regulations. Costa Rica will consult the Fund on the timing of purchases involving borrowed resources in accordance with Rule G-4(b).

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

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

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

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

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

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

San Jose, Costa Rica
January 11, 1985

Mr. J. de Larosière
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. de Larosière:

1. In the last two years, Costa Rica has made great strides in recovering from the economic and financial crisis which was experienced during the period 1980-82. That crisis had its origin in a series of shocks to Costa Rica's external environment which included a substantial decline in the terms of trade associated with a sharp fall in coffee prices and the second round of oil price increases, the world recession and the unprecedentedly high interest rates which accompanied it, and the political and economic upheaval in the Central American region. The failure to adjust domestic economic policies to these developments led to unsustainably large deficits in the public sector and the current account balance of payments, the suspension of debt service payments in mid-1981 and a rapid depreciation of the internal and external value of the colon.

2. During the second half of 1982, the Costa Rican Government set in motion a sequence of adjustment measures which laid the basis for a successful stabilization of the economy during 1983. This program was supported by a one-year stand-by arrangement which was approved by the Fund in December 1982. The main objectives of the program were to regain relative price stability, to strengthen the balance of payments and to restore confidence through the elimination of external debt arrears and the resumption of service payments on external public debt. Substantial increases in public enterprise tariffs and central government taxes were introduced in order to bring about a significant reduction in the overall public sector deficit which had been a major cause of Central Bank credit expansion in the preceding years. At the same time, the exchange markets were reorganized with the objective of achieving a unification of the banking market and free market exchange rates on a gradual basis by the end of 1983. Finally, negotiations were begun with foreign governments and commercial banks on a rescheduling of Costa Rica's external debt arrears and loan repayments falling due in 1983 and 1984.

3. The results of the program in 1983 turned out to be better than expected. As a result of decisive action on the fiscal front and the stabilization of the free market exchange rate, domestic inflationary pressures subsided quickly; the rate of consumer price increases dropped to about 10 percent at the end of 1983, compared with a rate of 82 percent in 1982 and a target of 40 percent in the program. The improvement in the financial position of the rest of the public sector, in particular the Social Security Institute, the National Electricity Company (ICE),

and the State Oil Refinery (RECOPE) was stronger than expected, with the result that the current account balance of the nonfinancial public sector shifted from a deficit of 3 percent of GDP in 1982 to a surplus of 3 1/2 percent of GDP in 1983, while its overall deficit was reduced to the equivalent of around 3 1/2 percent of GDP, compared with one of 9 percent in 1982 and a program target of 4 1/2 percent. In the external sector, the trade account weakened, and consequently the current account deficit increased to around 10 1/2 percent of GDP in 1983, instead of declining to 8 percent as called for in the program. Nevertheless, partly reflecting a reflow of private capital, there was a substantial improvement in the overall balance of payments which led to the formal unification of the exchange markets in mid-November 1983. In addition, as a result of rescheduling agreements with the Paris Club and the foreign commercial banks, virtually all external debt arrears were eliminated at the end of the program.

4. During 1984-85, the Government of Costa Rica is determined to consolidate the gains achieved under its stabilization program to date by continuing to strengthen its fiscal performance and balance of payments position so as to provide the basis for a sound economic recovery. Accordingly, the Government has developed a program which is designed to bring about a significant reduction in the current account balance of payments deficit and a replenishment of the foreign reserve position of the Central Bank. In support of this effort, the Government of Costa Rica would like to count on the continued support of the International Monetary Fund, and hereby requests a thirteen month stand-by arrangement in the amount of SDR 54 million. The key elements in the Government's adjustment program in the area of fiscal, monetary, incomes and external sector policies are explained below.

5. As a primary objective of fiscal policy, the Government has the intention of moving the nonfinancial public sector over the next few years towards a position of overall equilibrium. Consistent with this medium-term objective, the Government intends to limit the overall deficit of the nonfinancial public sector in 1985 to no more than 1 1/2 percent of GDP, compared with an estimated 2 1/2 percent in 1984 and 3 1/2 percent of GDP in 1983. The deficit in prospect will be reflected at the level of central government operations, as the rest of the nonfinancial public sector is expected to be in approximate equilibrium. As a result of a number of tax measures introduced during the course of 1984, central government revenues are projected to rise from the equivalent of 17 percent of GDP in 1983 to 20 1/2 percent in 1985. These measures included increases in selective consumption duties, a modification of the corporate income tax and a reduction in import duty exemptions. At the same time, the earmarking of revenues to the rest of the public sector has been reduced and centralized in the budget in 1984 and 1985.

6. On the expenditure side, the Government is committed to the pursuit of a policy of restraint in 1985. To this effect, a freeze on government employment was instituted last year and programs were established to accelerate the retirement of older workers and facilitate the shift of public employees to the private sector labor force. Also, transfers to the rest of the public sector are being held below budgeted levels, and only those investment projects will be implemented which can be financed with long-term foreign borrowing, mainly of a concessional nature. As a result, the growth of central government expenditure, in relation to GDP, is estimated to have moderated sharply in 1984 and is to remain unchanged in 1985. The tax and spending patterns outlined above will bring about a reduction in the overall government deficit from 3 1/2 percent of GDP in 1982-83 and an estimated 2 1/2 percent in 1984 to around 1 1/2 percent in 1985. In order to monitor compliance with the fiscal program, the Government has established quarterly limits for cumulative expenditure commitments in 1985, as set out in Table 1, which are consistent with the target for the overall central government deficit mentioned above. In the event that these limits are exceeded, the Government will consult immediately with the Fund staff on the remedial measures needed to bring performance into line with the program.

7. The further strengthening of the public finances in 1985 also will depend on an improvement in the financial position of the rest of the public sector. As in the last program with the Fund, a series of adjustments in local utility rates have been implemented to strengthen the current account position of the main state enterprises. Early in 1984, adjustments in ICE's electricity and telephone rates amounting to, on average, 9 percent and 70 percent, respectively, and an increase of 70 percent in the case of the rates charged by the State Water Authority (ICAA) were introduced. ICE's utility rates were further increased by 12 percent on January 1, 1985. These tariffs will be revised periodically to ensure that they are adequate to cover operating costs and to generate sufficient domestic resources to support the investment program of these enterprises. Also, the prices for basic grain operations of the National Production Council (CNP) are being adjusted in order to reduce its domestic financing requirements to a minimum level. In the case of RECOPE, the prices of its domestic fuel products will be adjusted to reflect increases in the cost of petroleum imports. The improvement in the savings performance of the rest of the public sector in 1984-85 will be reflected in an increase in transfers to the Central Government. The Government has also initiated a process, based on the authorization of the Legislative Assembly, of selling some of the major enterprises controlled by the state-owned development corporation (CODESA). These sales will permit the reorientation of CODESA's future operations and the reduction of its net indebtedness to the Central Bank.

8. In order to further strengthen public sector operations in the future, the Government intends to reduce substantially and permanently the scope of revenue earmarking and compulsory spending. To this effect, a proposal for the constitutional reform of the public finances has been presented to the Legislative Assembly, which will be reviewed by the Special Commission on Fiscal Reform which is to report its recommendations by March 31, 1985. Until a reform bill is approved, the Government does not intend to introduce any new revenue earmarking. Furthermore, the temporary reduction of earmarked taxes in the 1984 budget has been extended and increased in the 1985 budget. The Government's reform proposal, together with a strengthening of the Budgetary Authority, will facilitate the achievement of a better control of public expenditure and will make it possible to continue to reduce the public sector deficit in future years.

9. The programmed financial improvement during 1985 will mean that the nonfinancial public sector will have no recourse to domestic financing for the period of the program, as the overall fiscal deficit will be financed mainly by the use of foreign long-term borrowing, mostly on concessional terms. Consistent with this result, limits on domestic bank financing of the nonfinancial public sector have been established for the period of the stand-by program, as presented in Table 2, which take into account only seasonal financing needs. It is also the intention of the Government not to increase its domestic bond placements outside the domestic banking sector and floating debt (arrears) during the period of the financial program above the levels outstanding as of the end of December 1984, except for seasonal financing needs through domestic bonds placements.

10. As mentioned above, the Government intends to finance the operations of the public sector in the future mainly with the proceeds of foreign long-term concessional borrowing. In view of the rescheduling in 1983 of substantial arrears on foreign commercial debt service and of repayments of principal falling due during 1983 and 1984, the Government intends to limit its recourse to foreign commercial borrowing in the future to minimal amounts. Much of the present debt servicing difficulties has arisen from inappropriate external borrowing policies in the past, particularly the heavy utilization of short-term loans. In accordance with the Government's policy of improving the external debt profile over the medium term, the contracting by the public sector (including public financial institutions) of new foreign loans with maturities of over one year up to and including twelve years will be limited to US$50 million during the period of the program. Within this overall ceiling, new commitments with maturities of over one year and up to and including five years will be limited to US$25 million. This ceiling will also apply to officially guaranteed private sector loans and suppliers' credits, but will exclude any new loans directly related to the refinancing or rescheduling of existing external public debt, and credits under the Mexico-Venezuela oil facility. The Government also intends not to increase its recourse to short-term foreign borrowing; accordingly, during the program period, the net short-term foreign commercial indebtedness of the nonfinancial public sector, excluding normal trade credits, will not increase over the balance outstanding at the end of September 1984 (US$3 million).

11. The reduction in the domestic financing requirements of the non-financial public sector, together with the Central Bank's policies of credit control, will ensure that the rate of overall bank credit expansion is consistent with the Government's price and balance of payments objectives. The projected increase in domestic bank credit in the program is intended to ensure that sufficient financial resources are available to support the continued, gradual reactivation of private sector production and investment. In this connection, the interest rate policy of the Government is intended to achieve a balance between the need to provide adequate incentives to the growth of financial savings and the need to avoid hampering the productive efforts of the country. The authorities intend to maintain a flexible interest rate policy whereby the basic rate on six-month deposits, to which most rates in the system are related, will be adjusted from time to time to reflect the domestic rate of inflation, movements in interest rates abroad, the demand for private sector credit and the growth of domestic financial savings. At present, most interest rates in the banking system are positive in real terms and will be maintained as such during the program period. At the same time, the structure of Central Bank lending rates has been revised and subsidized credit operations are being reduced in order to lower the losses of the Central Bank. It is also the Government's policy not to increase the existing nominal tax rate of 5 percent on interest earnings. Consistent with the credit needs of the private and public sectors and the objective of increasing the net foreign reserve position of the Central Bank, ceilings have been established for the net domestic assets of the Central Bank over the program period, as set out in Table 3.

12. The Government is determined to ensure that the burden of economic adjustment is distributed equitably. This will be done in a manner consistent with the conviction of the authorities that in the present circumstances and for the foreseeable future, market forces should be the main determinant of prices, and that administrative controls and subsidies should be limited to a minimum number of basic consumer products, mainly benefitting low-income groups. Wage policy will be geared to reducing inflationary pressures, while minimizing the effects of price increases on low-income groups. Therefore, during 1985, public sector salaries and private sector minimum wages will be adjusted in absolute amounts in accordance with the increased cost of a basic basket of goods and services ("canasta basica").

13. In the external sector, the Government intends to pursue a flexible exchange rate policy whereby the value of the colon will be adjusted from time to time to reflect developments in the balance of payments and price changes in the domestic market and among its trading partners abroad. Consistent with this stance, the authorities also intend to avoid the accumulation of any arrears in the future for payments and transfers for current international transactions, including external debt

service payments, except in the case of arrears that may materialize on external public debt currently under negotiation for rescheduling with foreign commercial banks and bilateral creditors. In order to test compliance with this objective, the Government has established quarterly targets for the net international reserves of the Central Bank, as set out in Table 4, which incorporate seasonal factors and are defined to include payments arrears. The existing arrears, other than those related to rescheduling agreements under negotiation, will be eliminated before the end of 1985 according to the schedule set out in Table 5. Any arrears that may arise in respect of external public debt presently under negotiation with foreign banks and bilateral creditors in 1985 will be matched by an equivalent increase in the net official international reserves of the Central Bank for the amount not assumed to be rescheduled. To monitor the emergence of any arrears in the future, other than those on public sector debt service, the authorities are now requiring that all applications for foreign exchange purchases be backed by a counterpart deposit in local currency equivalent to 100 percent of the amount requested. It is also the firm intention of the Government to continue its policy of not issuing exchange guarantees on external obligations which could give rise to losses for the Central Bank.

14. During the period of the program, the Government of Costa Rica does not intend to introduce or intensify restrictions on payments and transfers for current international transactions, introduce any multiple currency practices, conclude any bilateral payments agreement which is inconsistent with Article VIII of the Articles of Agreement, or introduce any new or intensify any existing restriction on imports for balance of payments reasons.

15. As part of its external sector policies, the Government also intends to restructure its external tariff and system of export incentives with a view to reorienting domestic production towards export promotion and diversification. To this effect, the Government has recently revised the system of export incentives and has enacted legislation which will shift promotion efforts toward sectors with a high component of domestic value added. The authorities also intend to revise the customs tariff on July 1, 1985 by substituting the Brussels nomenclature for the existing NAUCA classification and by replacing specific duty rates with ad valorem ones. In addition, the Government intends to change the tariff structure, in the context of a structural adjustment loan (SAL) with the World Bank, with a view to reducing the dispersion of tariff rates and the effective level of protection in accordance with its export promotion goals.

16. The Government believes that the policies set forth in this letter are adequate to achieve the objectives of the 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 measure that may be appropriate, in accordance with the policies of the Fund on such consultation. Progress made in the implementation of the program, especially in the area of exchange rate and fiscal policies, CODESA's divestment program and fiscal reform, will be reviewed with the Fund before August 31, 1985.

Sincerely yours,

/s/
Porfirio Morera Batres
Minister of Finance

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

Table 1. Costa Rica: Limits for Cumulative Central Government Expenditure 1/

(Cumulative amounts in millions of colones)

Periods	Limits
Jan. 1, 1985 - Mar. 31, 1985	7,640
Jan. 1, 1985 - June 30, 1985	17,710
Jan. 1, 1985 - Sept. 30, 1985	28,685
Jan. 1, 1985 - Dec. 31, 1985	40,741

1/ Defined as the sum of budgetary expenditures (gastos comprometidos y reconocidos) plus pending commitments (compromisos pendientes) plus extrabudgetary expenditure of the Central Government.

Table 2. Costa Rica: Ceilings on Domestic Banking System's Net Credit to the Nonfinancial Public Sector 1/

(Outstanding balances in millions of colones)

Periods	Ceilings
Jan. 1, 1985 - Mar. 31, 1985	17,300
Apr. 1, 1985 - June 30, 1985	17,300
July 1, 1985 - Sept. 30, 1985	17,100
Oct. 1, 1985 - Dec. 31, 1985	17,100
Jan. 1, 1986 - Mar. 31, 1986	17,300

1/ Defined as the difference between the banking system's gross credit to the nonfinancial public sector and the latter's deposits in the banking system. For this purpose, the nonfinancial public sector includes the Central Government, decentralized agencies and state enterprises. These ceilings exclude foreign loans from the Canadian International Development Agency (CIDA) to the nonfinancial public sector channeled through the Central Bank (up to US$4 million). Also, these ceilings will be reduced by the amount of counterpart funds from the IBRD structural adjustment loan (SAL) used by the Central Government.

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

(Outstanding balances in millions of colones)

Periods	Ceilings
Jan. 1, 1985 - Mar. 31, 1985	18,300
Apr. 1, 1985 - June 30, 1985	18,500
July 1, 1985 - Sept. 30, 1985	19,000
Oct. 1, 1985 - Dec. 31, 1985	19,750
Jan. 1, 1986 - Mar. 31, 1986	18,300

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

Table 4. Costa Rica: Targets for the Net International Reserve Position of the Central Bank 1/

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

Periods	Targets
Jan. 1, 1985 - Mar. 31, 1985	-175
Apr. 1, 1985 - June 30, 1985	-165
July 1, 1985 - Sept. 30, 1985	-170
Oct. 1, 1985 - Dec. 31, 1985	-140
Jan. 1, 1986 - Mar. 31, 1986	-115

1/ Defined as the difference between the Central Bank's gross foreign assets and short-term foreign liabilities including its net position with the Fund. Also included are any arrears on commercial payments and external debt service.

Table 5. Costa Rica: Limits for the Stock of Payments Arrears 1/

(In millions of U.S. dollars)

Periods	Limits
Jan. 1, 1985 - Mar. 31, 1985	100
Apr. 1, 1985 - June 30, 1985	50
July 1, 1985 - Sept. 30, 1985	25
Oct. 1, 1985 - Dec. 31, 1985	--
Jan. 1, 1986 - Mar. 31, 1986	--

1/ Defined as the stock of arrears on medium- and long-term external public debt (excluding amounts assumed to be rescheduled in 1985) plus the outstanding balance of deposits for foreign exchange requests held by the Central Bank of Costa Rica in excess of 15 days.