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FOR
AGENDA

EBS/85/31
Supplement 1

CONFIDENTIAL

March 12, 1985

To: Members of the Executive Board
From: The Secretary
Subject: Costa Rica - Request for Stand-By Arrangement

The attached supplement to the paper on Costa Rica's request for a stand-by arrangement has been prepared on the basis of additional information. Revised draft decisions appear on page 3, and a revised text of the proposed stand-by arrangement is set forth in Attachment I.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion on Wednesday, March 13, 1985, they should contact Mr. Elson (ext. 8500) or Mr. Silard (ext. 7715).

Att: (1)

INTERNATIONAL MONETARY FUND

COSTA RICA

Request for Stand-By Arrangement--Supplement

Prepared by the Legal, Exchange and Trade Relations and
Western Hemisphere Departments

Approved by George P. Nicoletopoulos,
Eduardo Wiesner and Manuel Guitian

March 11, 1985

The purpose of this supplement is to give effect to the wish of the Costa Rican authorities on a particular point in connection with the proposed approval of Costa Rica's exchange restrictions and to modify the text of the proposed stand-by arrangement (Attachment I of EBS/85/31) in the light of Executive Board Decision No. 7908-(85/26), February 20, 1985.

I. Exchange System

As mentioned in EBS/85/31, Costa Rica maintains restrictions on payments and transfers for current international transactions in the form of payments arrears and an unsettled claim with respect to a bank loan which was involved in the rescheduling negotiations that led to the September 1983 general agreement with members of a bank syndicate. The agreement has since been ratified bilaterally by all members of the syndicate but one. The bank in question has not accepted Costa Rica's offer to settle the claim on the same terms as those accepted by the other members of the bank syndicate, and the matter has been in litigation in the United States (Allied Bank International case).

In connection with the disputed bank claim just mentioned, the Costa Rican authorities have informed the Fund that they do not wish to request approval of the restriction to which it gives rise because of the implications of such approval for the financing package with the banks assumed in the program supported by the Fund. As noted in EBS/85/31, Costa Rica's economic program for 1985 assumes a substantial participation by the foreign commercial banks in the form of (1) refinancing of certain principal repayments in arrears and maturities falling due in 1985 and (2) a new money facility of US\$75 million. The banks have informed the Costa Rican authorities that they did not feel they could proceed to a satisfactory agreement with Costa Rica on rescheduling of that country's external debt and on the necessary new financing if the Fund were to approve the restriction involved in the Allied Bank International case, in view of their concern regarding the effect that approval by the Fund of the exchange restriction might have on the outcome in that case.

The concern of the creditor banks is based on Article VIII, Section 2(b) of the Fund Agreement, the first sentence of which provides that:

"Exchange contracts which involve the currency of any member and which are contrary to the exchange control regulations of that member maintained or imposed consistently with this Agreement shall be unenforceable in the territories of any member."

This provision was interpreted by the Fund by Decision No. 446-4, June 10, 1949 (Selected Decisions, Tenth Issue, pp. 233-34), on which the Fund's practice relating to this matter is based. Section 1 of this decision states that:

"Parties entering into exchange contracts involving the currency of any member of the Fund and contrary to exchange control regulations of that member which are maintained or imposed consistently with the Fund Agreement will not receive the assistance of the judicial or administrative authorities of other members in obtaining the performance of such contracts. That is to say, the obligations of such contracts will not be implemented by the judicial or administrative authorities of member countries, for example by decreeing performance of the contracts or by awarding damages for their non-performance."

The decision also provides that "the Fund is prepared to advise whether particular exchange control regulations are maintained or imposed consistently with the Fund Agreement."

The Costa Rican authorities have continued to indicate that they are prepared to enter into new contractual arrangements incorporating the same repayment terms to all the creditor banks, in accordance with the rescheduling agreements worked out with them. The Fund staff supports the firm intention of the authorities to proceed in this manner. It is, indeed, on the basis of the implementation of the financing agreement with the banks, and consistent with the total financial requirements of the program, that this program has been submitted to the Board. In view of the request from the authorities, approval is not being proposed now for the relevant restriction.

The bank coordinating committee has assured the Costa Rican authorities and the Fund staff that payment by Costa Rica pursuant to a judgment in the Allied Bank International case in the courts of the United States would not be a basis for accelerating payments to other banks under the 1983 rescheduling agreement. The bank coordinating committee has also indicated that, regardless of the outcome of the case, it expects continuing support by banks for the rescheduling on the basis of the understandings with Costa Rica set out in this paper.

II. Stand-by Arrangement

The revised text of the stand-by arrangement attached to this supplement takes account of a recent decision of the Executive Board on overdue payments to the Fund (Decision No. 7908-85/26).

III. Proposed Decisions

In accordance with the above, the following revised draft decisions are proposed for adoption by the Executive Board:

I. Approval of Exchange Restrictions

Costa Rica maintains restrictions on payments and transfers for current international transactions that result from payments arrears and the process of rescheduling, as described in EBS/85/31 and EBS/85/31, Supplement 1. 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, Supplement 1), and in view of the considerations referred to in EBS/85/31, Supplement 1, the Fund grants approval for the retention of these restrictions, other than the restriction described in footnote 1 on p. 19 of EBS/85/31, until the conclusion of the 1985 Article IV consultation, or August 31, 1985, whichever is earlier.

II. Stand-By Arrangement

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

2. The Fund approves the stand-by arrangement attached to EBS/85/31, Supplement 1, and waives the limitation in Article V, Section 3(b)(iii).

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 April , 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, 5, and 6 below, without further review by the Fund.
2. (a) Purchases under this stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 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, 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 will not make purchases under this stand-by arrangement during any period of the arrangement in which the member has an overdue financial obligation to the Fund or is failing to meet a repurchase expectation pursuant to the Guidelines on Corrective Action in respect of a noncomplying purchase.

6. Costa Rica's right to engage in the transactions covered by this stand-by arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of Costa Rica. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 6, purchases under this arrangement will be resumed only after consultation has taken place between the Fund and Costa Rica and understandings have been reached regarding the circumstances in which such purchases can be resumed.

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

8. 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).

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

10. (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.

11. 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.

12. 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.