April 2002
IMF Country Report No. 02/88

Costa Rica: 2001 Article IV Consultation—Staff Report; Staff Statement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Costa Rica

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2001 Article IV consultation with Costa Rica, the following documents have been released and are included in this package:

- the staff report for the 2001 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **April 23, 2001,** with the officials of Costa Rica on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on June 25, 2001.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff statement of **July 30, 2001** updating information on recent developments.

- a Public Information Notice (PIN) summarizing the **views of the Executive Board as expressed during its July 30, 2001 discussion** of the staff report that concluded the Article IV consultation.

- a statement by the Executive Director for Costa Rica.

The document listed below has been or will be separately released.

Selected Issues Paper

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to Publicationpolicy@imf.org.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org Internet: http://www.imf.org

Price: $15.00 a copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

COSTA RICA

Staff Report for the 2001 Article IV Consultation

Prepared by the Staff Representatives for the
2001 Consultation with Costa Rica

Approved by Claudio M. Loser and Jesús Seade

June 25, 2001

Contents

Figure

Appendices

EXECUTIVE SUMMARY

Economic performance in 2001 weakened. Real GDP growth slowed, while inflation remained high at 10 percent. The overall public sector deficit rose from 3.5 percent of GDP in 1999 to 4.2 percent of GDP in 2000, and total public debt rose to 48 percent of GDP by end-2000, which helped keep lending interest rates in domestic currency at about 28 percent a year. With much lower costs on U.S. dollar loans, foreign currency lending rose by 52 percent, with much of the loans for mortgage refinancing and consumer credit. The external current account deficit rose to 5½ percent of GDP, as the terms of trade declined, and the net international reserve position weakened further. The real effective exchange rate appreciated by 5 percent during the year.

The authorities' economic program for 2001 envisaged a recovery in real GDP growth to 3 percent, with inflation staying at 10 percent and net international reserves remaining constant. The fiscal plan was to reduce the overall public sector deficit in relation to GDP, while credit policy would support a gradual decline in interest rates.

In the policy discussions, the authorities and the staff agreed that it would be possible for the economy to grow by 3 percent in 2001, while inflation might turn out slightly higher than planned. Nonetheless, the staff projected that the overall public sector deficit would rise to 4.5 percent of GDP in 2001, which would lead to a further increase in public debt. The fiscal stance would also result in a further increase in the external current account deficit to over 6 percent of GDP a significant loss of net international reserves, unless the central bank chose to tighten credit policy and slow economic growth. The authorities viewed the rapid growth in U.S. dollar lending as a potential risk, and had begun to adopt measures to discourage this type of lending. They had also proposed legislation to strengthen the independence of the central bank, improve financial supervision, and establish partial deposit insurance for all financial institutions.

The policy discussions also centered on how to improve the mix of economic policies to reduce the economy's vulnerability over the medium term. The authorities and the staff agreed that continued sizable overall public sector deficits and limited progress on structural reform would weaken the economy over time. The staff presented an active medium-term scenario that pointed to the benefits of raising the primary surplus from 0.2 percent of GDP in 2000 to 1.6 percent of GDP in 2001, with a view to reducing public debt by 10 percentage points of GDP by 2006. This policy, together with structural reforms to improve infrastructure in electricity, telecommunications, and roads, would support an increase in real GDP growth and lower inflation. With a stronger fiscal position, the authorities would be in a position to consider moving away from their current crawling peg exchange rate regime, which was vulnerable to swings in capital inflows.

I. Introduction

1. A mission visited San José in the period March 14–24 and on April 23, 2001 to hold discussions for the 2001 Article IV consultation and to review the Fund's technical assistance program with Costa Rica.[1] The staff team consisted of Messrs. Rennhack (Head), Bailén, Giustiniani, and Martin, and Mmes. Coronel and Frantischeck (all WHD). The mission met with the minister of finance, the president of the central bank, other senior government officials, and representatives of the private sector.

2. At the conclusion of the last Article IV consultation in October 1999, Executive Directors welcomed the strong real GDP growth in 1998–99 and the progress in reducing inflation. However, they emphasized the need for fiscal consolidation to reduce public sector debt, relieve pressures on domestic interest rates, and lower the vulnerability of the economy. They also recommended the strengthening of the financial sector and urged the authorities to build political support for structural reforms. Directors observed that the crawling peg exchange rate had been successful in avoiding an erosion of external competitiveness.

3. Costa Rica's statistical database is weak in several areas, which interferes with proper surveillance of macroeconomic developments (Appendix IV). In particular, the coverage of the monetary statistics and prudential indicators is incomplete because of sizable unrecorded activity in offshore branches and the off-balance-sheet accounts of domestic banks, although the authorities recently improved reporting requirements in this area. In the fiscal sector, a large statistical discrepancy exists in the measurement of the overall public sector deficit. The measurement of the balance of public enterprises, domestic debt, private sector external debt, and exports of services could also be improved.

II. Background and Recent Developments

A. Background

4. **During the previous decade,** Costa Rica made significant progress in opening its trade system, and social conditions, especially for education and health, remained among the best in the region (Table 1). These factors, together with a long history of political stability, attracted foreign direct investment, led to more diversified exports, and sustained real GDP growth of 4½ percent a year in the period 1990–99, while inflation declined from 27 percent in 1990 to 10 percent in 1999 (Table 2). However, successive governments met strong

---

[1] Costa Rica has no outstanding obligations to the Fund. Details of Costa Rica's relations with the Fund are provided in Appendix I and with the World Bank and the Inter-American Development Bank in Appendices II and III.

political resistance to their efforts to reduce the overall public sector deficit on a sustained basis, and total public debt reached 45 percent of GDP by end-1999, contributing to high real lending interest rates in domestic currency and an external current account deficit of 4½ percent of GDP. Progress in implementing structural reforms, besides trade liberalization, also was limited. According to the reported prudential indicators, the banking system appeared healthy at end-1999, but domestic banks engaged in a significant amount of unreported financial activity in offshore branches and off-balance-sheet accounts.

B. Developments in 2000

5. **In 2000, economic performance weakened.** Real GDP growth slowed to 1.7 percent, from over 8 percent a year in 1998–99, reflecting in part a deterioration in the terms of trade, the end of the construction phase of a large foreign direct investment project by INTEL, and the effect of high real interest rates on domestic demand.[2] Inflation remained high at 10 percent during the year, in line with the objectives of credit and exchange rate policy. The decline in the terms of trade contributed to a loss of net international reserves of about US$150 million. At end-2000, gross international reserves amounted to 1.7 months of imports of goods and nonfactor services and 22 percent of broad money, a relatively low level by regional standards (Table 3).

6. **The overall public sector deficit rose from 3.5 percent of GDP in 1999 to 4.2 percent of GDP in 2000**, as the primary surplus virtually disappeared (Table 4).[3] Net external financing (including a US$250 million Eurobond issue) amounted to about 1½ percent of GDP, with the balance covered through further domestic borrowing; total public debt rose to 48 percent of GDP by end-2000. In the central government, transfers to the private sector declined in relation to GDP, reflecting the policy to phase out the export subsidies on nontraditional exports by 2001 (Table 5). However, while the higher world oil prices raised indirect tax revenues (the import duties and value-added taxes on petroleum products are ad valorem), the earmarking system channeled the additional revenues to public social programs. Central bank operating losses rose to 1.8 percent of GDP, reflecting interest on the large stock of open market instruments that had been issued in recent years (Selected Issues Table 19). In September the government began to absorb some of the central bank's losses by repaying part of its debt to the central bank, on which it was not paying interest. The overall surplus of the rest of the public sector fell slightly to 0.6 percent of GDP

---

[2] A wide gap has emerged between GDP and GNP, because the foreign direct investment in the 1990s has led to profit remittances equivalent to 8 percent of GDP. The growth in real GNP rose to 9 percent in 1998 and showed no growth in 1999 and 2000 as profit remittances picked up.

[3] Measured from the financing side, the overall deficit rose to 5.3 percent of GDP. The authorities are trying to clarify the sources of this discrepancy.

(Table 6). This estimate of the enterprise surplus includes an estimated 0.6 percent of GDP of expenditure by a trust fund set up in early 2000 by the state electricity and telecommunications enterprise (ICE). The authorities believed that this trust fund was a private sector operation, because private investors provided the financing and bore all the risk. After consulting with the Fund's Fiscal Affairs and Statistics Departments, the staff explained this expenditure should be recorded as public spending, because the trust fund was simply a financing mechanism.

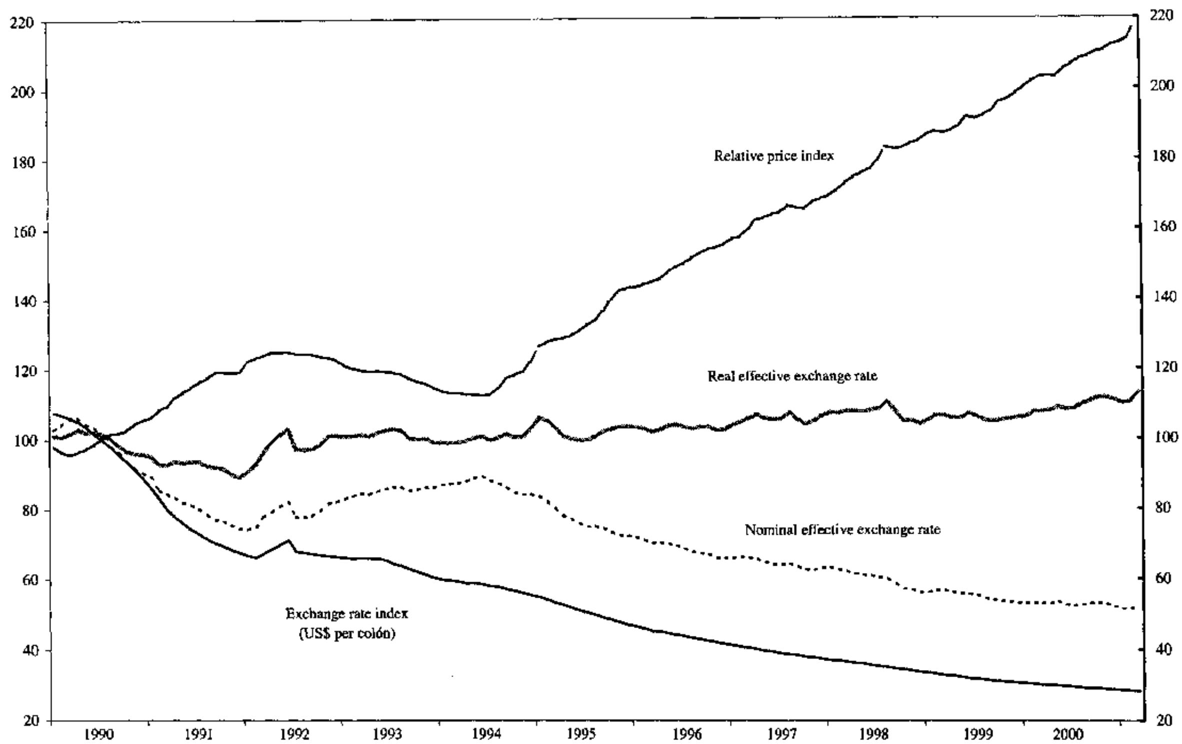
7. **The central bank sought to hold inflation stable at 10 percent a year.** The central bank's net domestic assets contracted slightly in 2000 (Table 7).[4] In March 2000, reserve requirements on domestic currency deposits were lowered by 2 percentage points to 12 percent to try to narrow the intermediation spread (the difference between deposit and lending interest rates) and encourage lower interest rates on domestic currency loans. (The reserve requirement on U.S. dollar deposits stayed at 5 percent.) The central bank held the interest rate on its open market instruments steady at 17 percent (for 6-month paper) through September, and then reduced the rate to 15 percent following the repayment by the central government. Lending interest rates in domestic currency declined from 29 percent at end-1999 to 27.8 percent at end-2000, although the intermediation spread held steady at about 13 percent. Exchange rate policy aimed to depreciate the colón to offset the differential between the domestic inflation target and estimated foreign inflation. During 2000, the central bank slowed the rate of crawl to 6.6 percent, from 9.9 percent during 1999, as it expected higher foreign inflation. However, the colón appreciated by 5 percent in real effective terms during the year, owing largely to the unexpected strength of the U.S. dollar (Figure).

8. **Bank credit to the private sector rose by 31 percent during the year, led by a 52 percent rise in foreign currency lending.** Moreover, a growing share of the foreign currency loans went to mortgage refinancing, consumer credit and other activities without income in foreign currency. Borrowers were taking advantage of the significantly lower cost of U.S. dollar loans, which carried an interest rate of 12.3 percent on average during 2000 plus expected currency depreciation of about 6½ percent. The rapid credit expansion was financed partly by the use of net foreign assets, as broad money rose by 20 percent during the year. By end-2000, foreign currency loans amounted to 46 percent of total loans, compared with 36 percent at end-1999, while foreign currency deposits rose from 42 percent to 45 percent of broad money. Reported nonperforming loans rose from 2.9 percent of total loans at end-1999 to 3.6 percent of total loans at end-2000, reflecting mostly problem loans at the National Bank (the largest state bank) (Table 8). The risk-weighted capital asset ratio amounted to 19.5 percent at end-2000.

---

[4] Currency issue declined during 2000, as the demand for currency picked up at end-1999, owing to concerns about Y2K.

Figure. Costa Rica. Exchange Rate Developments
(1990=100)



Source: IMF, Information Notice System.

1/ Trade-weighted index of nominal exchange rates deflated by seasonally adjusted relative consumer prices. An increase (decrease) indicates appreciation (depreciation).

9. **The external current account deficit** reached 4.8 percent of GDP, from 4½ percent of GDP in 1999, reflecting lower world coffee and banana prices as well as the surge in world oil prices (Table 9). General merchandise exports in U.S. dollar terms declined for the second consecutive year, as world coffee and banana exports remained weak and the decline in subsidies and the strength of the U.S. dollar affected nontraditional exports. INTEL decided to retool the plant built in 1998-99, which led to almost equal declines in exports of goods for processing and profit remittances. Net capital inflows dropped by over 50 percent, partly because foreign direct investment declined, as the construction of INTEL's plant ended in 1999. Other private capital inflows also fell sharply, reflecting largely the decline in domestic interest rates, while net borrowing by the public sector remained steady at about 1 percent of GDP.

10. **In the structural area**, the assembly approved legislation to open up the **telecommunication and electricity** sectors to private investment, but subsequently strong

popular opposition and an unfavorable supreme court ruling stopped this reform. In early 2000, the **superintendent of financial institutions** introduced regulations that required banks to place off-balance-sheet operations on their balance sheets, report regularly on their offshore operations, and apply stricter norms for loan classification. **Trade liberalization** continued, with a reduction in tariffs on imports from outside Central America in January, the abolition of a small tax on trade with Central America, and the approval of a free trade agreement with Chile.

III. Policy Discussions

11. **Since taking office in 1998, the authorities have sought to promote more rapid economic growth by adopting structural reforms and maintaining macroeconomic stability.** Their economic program for 2001 (which was published in December 2000)[5] envisaged a recovery in real GDP growth to 3.2 percent, on the assumption that lower domestic interest rates would stimulate a recovery in investment. Inflation was to be held at 10 percent during the year. The external current account deficit was projected to remain constant in relation to GDP, but with increased net capital inflows, net international reserves would remain constant. The fiscal plan was to reduce the overall public sector deficit in relation to GDP, financed by another international bond issue and domestic borrowing. The government planned to repay the remainder of its debt to the central bank, which would allow the central bank to redeem a significant amount of open market instruments without expanding credit. This policy was expected to permit a reduction in interest rates on open market instruments of about 50 basis points. Consistent with the inflation target, the central bank planned to depreciate the colón by 6.6 percent during the year.

12. **So far in 2001**, preliminary information suggests that real economic activity declined by about 2 percent (year on year) in the first four months, as INTEL had not yet finished retooling its plant. (Excluding INTEL operations, economic activity rose by an estimated 2 percent year on year in the same period). Price increases in housing and food raised 12-month inflation to 13.3 percent in May. In the first quarter, the central government deficit amounted to 3.2 percent of quarterly GDP. Although the government repaid the remainder of its debt to the central bank, net domestic assets of the central bank contracted through end-May. The central bank lowered interest rates on its open market instruments by 50 basis points to 14.5 percent in late April, much less than the decline in interest rates on U.S. treasury bills since end-2000, and continued to sell open market securities. Owing to stagnant exports, the external current account deficit widened to about 3 percent of quarterly GDP in the first quarter, considerably higher than in the same period in 2000. Through end-May, net international reserves rose by US$32 million, benefiting from the proceeds of a US$250 million bond issue by the government in March.

---

[5] By law, the authorities must publish their monetary program in December and July.

13. **The discussions reviewed the prospects for achieving the objectives of the 2001 economic program.** The authorities felt that it would be possible for the economy to grow by 3 percent in 2001, but noted that they might update this projection when they revised their economic program in midyear. The staff commented that inflation for the year might overshoot the target, but the authorities stressed that credit and exchange rate policy would aim to keep inflation close to 10 percent. The staff noted that the overall public sector deficit was likely to be larger than projected by the authorities and that this would generate more public debt than expected. This would lead to higher interest rates and slower economic growth or increased demand pressures which would spillover into a wider external current account deficit and a further loss of net international reserves.

14. **Most of the discussions centered on how to improve the mix of economic policies to reduce the economy's vulnerability over the medium term.** The authorities and staff agreed that continued sizable overall public sector deficits and limited progress on structural reform would weaken the economy over time. The authorities explained that, since taking office in May 1998, the current government's efforts to advance structural reforms and to maintain a strong fiscal policy had frequently been thwarted by strong political resistance, as this government lacks a simple majority in the assembly. Nonetheless, the government intended to continue trying to strengthen fiscal policy and advance structural reforms where possible. For example—while dropping the plans to increase private participation in electricity and telecommunications—it recently introduced legislation to increase the independence of the central bank, strengthen financial supervision, and extend limited deposit insurance to all banks. Also, the authorities have asked to be included in the Financial Sector Assessment Program (FSAP), although they felt that the offshore banks and off-balance-sheet accounts contained few problems. The authorities agreed, however, that the prospects for adopting stronger policies in the remainder of 2001 were limited, because political pressures would probably intensify ahead of the general elections in February 2002.

A. Fiscal Policy

15. **The authorities expected the overall public sector deficit to decline to 3.8 percent of GDP in 2001,** with an improvement in the primary surplus to 0.6 percent of GDP.[6] The central government deficit was expected to widen to 3½ percent of GDP, reflecting the absorption of part of the central bank's losses and a further increase in the wage bill. Central government revenues are projected to decline slightly in relation to GDP, as lower world oil prices reduce the taxes on petroleum products. Part of this revenue loss was to be offset by the tax simplification package expected to be approved in June, which has an estimated

[6] This includes an estimated 0.7 percent of GDP of spending by the ICE trust fund.

revenue yield of 0.3 percent of GDP in 2001.[7] Central bank operating losses were to decline to 1.4 percent of GDP, as the central bank redeemed open market securities. The central government projected the surplus of the public enterprises to improve to 1 percent of GDP in 2001, mainly because it assumed that the state electricity and telecommunications enterprise (ICE) was assumed to benefit from strong increases in sales of electricity and cellular telephones.

16. **However, the staff projected that the overall public sector deficit would rise to 4½ percent of GDP in 2001, with no primary surplus.** While the staff agreed with the projected deficit for the central government, it noted that the central government exercised only indirect control over major public enterprises such as ICE and that the government's projections of ICE's revenue and expenditure (besides the trust fund) were too optimistic. On this basis, it estimated that the overall surplus of the public enterprises would fall from 0.6 percent of GDP in 2000 to 0.4 percent of GDP in 2001, instead of rising as expected by the authorities. With an overall public sector deficit of 4½ percent of GDP, public debt would rise to over 50 percent of GDP by end-2001. The authorities agreed that they lacked direct control over major public enterprises, but said they would make an effort to secure an increase in the enterprise surplus to limit the overall public sector deficit to 3.8 percent of GDP (including the trust fund spending).

17. **The staff urged the authorities to improve expenditure management by simplifying the complex wage structure and scaling back revenue earmarking.** The wage bill of the nonfinancial public sector is expected to reach over 9 percent of GDP in 2001, from 7.7 percent of GDP in 1997, reflecting in part strong growth in teachers' salaries and additional employment in education and security. While base salaries tended to rise in line with inflation, actual salaries included additional elements—based on the employees' job, educational level, seniority, and other characteristics—that effectively multiplied the base salary increase by a factor of 1.5 for central government employees and up to 2.5 for employees of the state refinery. The staff commented that revenue earmarking applied to a significant share of the central government's tax revenues (perhaps on the order of 33 percent), limiting the ability to reduce the deficit through revenue measures. The authorities agreed that the wage structure and revenue earmarking complicated fiscal management, and recently proposed legislation to eliminate all revenue earmarking.

---

[7] The main elements of the tax simplification package are: (i) creation of an adjustable specific tax on oil products to replace the sales, excise, consumption, and import taxes currently in force; (ii) elimination of some exemptions to the VAT tax; (iii) elimination or reduction of selective consumption taxes applied to a variety of goods; (iv) minor reforms to the income tax system; and (v) reduction in the time period to present income and sales tax declarations.

B. Credit Policy

18. **An overall public sector deficit of 4½ percent of GDP would generate an increase in public debt that is inconsistent with the planned credit policy.** The staff estimated that the increased public sector borrowing requirement would put pressure on domestic interest rates as well as the international reserve position. If the central bank were to try to keep its interest rates at 14.5 percent, net domestic assets would expand more than expected, and net international reserves would decline by about US$180 million. With broad money projected to rise somewhat faster than nominal GDP, bank credit to the private sector would rise by 22 percent during the year. Fiscal measures to reduce the overall public sector deficit to 3½ percent of GDP would probably eliminate the loss of net international reserves without forcing the central bank to raise domestic interest rates. Alternatively, the central bank could adopt a tighter credit policy, which would drive up domestic interest rates, slow growth in credit to the private sector, and impede the recovery in real economic growth.

19. **The authorities agreed that a wider fiscal deficit would force a shift in credit policy** and said they would consider whether to modify the economic program to be published in July 2001. They mentioned that—in the past—the central bank has raised interest rates if necessary to protect the reserve position. So far this year, the central bank's interest rates had declined much less than interest rates in the United States, which had led to an increase in net international reserves so far this year.

20. **The authorities viewed the rapid growth in U.S. dollar lending as a potential risk that needed close monitoring.** They explained that the private sector preferred U.S. dollar loans because of both the lower interest rates in U.S. dollars as well as confidence in the central bank's exchange rate policy. The authorities agreed with the staff that reducing public debt was the best way to lower domestic currency interest rates and diminish the advantage to borrow in foreign currency. Nonetheless, with limited prospects for an immediate shift in fiscal policy, they were taking other steps to discourage lending in U.S. dollars. Thus, in January and May 2001, the reserve requirement on local currency deposits was lowered in steps to 9 percent and a further reduction to 5 percent by mid-2002 is planned. Other possible actions might include equalizing the tax treatment on deposits regardless of currency or increasing provisioning or capital requirements on these types of loans. The staff supported these measures.

C. External Sector Policies

21. **The staff estimated that—with an overall public sector deficit of 4½ percent of GDP and no change in credit policy—the external current account deficit would widen to about 5½ percent of GDP in 2001**, despite some relief from lower international oil prices. While domestic demand was expected to sustain imports, general merchandise exports are unlikely to recover, owing to slower growth in the United States and other key trading partners and to depressed markets for coffee and banana exports. INTEL was expected to

finish retooling its plant and resume exporting at full capacity in the second half of 2001. Profit remittances were projected to decline for the year as a whole, as the INTEL plant was expected to generate lower profits.

22. The staff projected that net capital inflows could rise significantly but could finance only part—not all—of the wider current account imbalance. Reflecting strong investment in the tourism sector, FDI inflows would remain a stable source of financing, amounting to about 2½ percent of GDP, while declining international interest rates may attract more portfolio investment inflows. However, net external borrowing by the public sector would fall sharply to 0.3 percent of GDP since the proceeds from the international bond placement and the expected disbursements from multilateral organizations would be offset by significant amortization payments. The public sector's external debt would decline slightly to 19 percent of GDP at the end of 2001.

23. **The staff raised the issue of the appropriateness of the crawling peg exchange rate regime.** The authorities noted that the poor performance of nontraditional exports in recent years raised questions about external competitiveness, but felt that wages and the exchange rate were not the source of the problem. Instead they preferred to strengthen competitiveness through structural reforms to improve infrastructure (especially telecommunications, roads, and ports), cut administrative inefficiency and lower the high financial intermediation spread in local currency. The staff supported this assessment, noting that Costa Rica's relative unit labor costs in manufacturing in U.S. dollars had declined since 1995. However, the staff recommended that the central bank accelerate somewhat the rate of depreciation in 2001, as the WEO projected foreign inflation at 1.4 percent, compared with the central bank's estimate of 3.2 percent.

24. **The staff suggested that Costa Rica consider a move to another exchange rate regime in the medium term**, because the crawling peg helped sustain high inflation and could be undermined by swings in private capital inflows, especially with significant macroeconomic imbalances. The authorities agreed that the crawling peg was vulnerable, but noted that this regime had helped protect external competitiveness from the effects of an inflation rate of 10 percent a year. They felt it would be essential for Costa Rica to strengthen its fiscal and external positions, lower inflation and improve financial supervision before considering a move towards a harder peg, such as in the case of El Salvador, or towards a more flexible exchange rate regime.

25. **Costa Rica has a generally liberal trade regime, and has no significant restrictions on capital account transactions.**[8] Average tariffs are relatively low, as the effective weighted average tariff rate fell from 5.9 percent in 1999 to 5.5 percent in 2000, and

[8] Costa Rica has a rating of 4 on the Fund's trade restrictiveness index (on a scale ranging from 1 for the most open trade regime to 10 for the most restrictive regime).

there are few nontariff barriers. In a recent WTO trade policy review, the authorities were encouraged to reduce the discrepancy between actual import tariffs and the maximum tariff rates (which are 45 percent for most goods except for a few products) with a view to leading to more predictable market access conditions.

26. **The authorities reiterated their commitment to provide Costa Rica's share of debt relief under the HIPC Initiative for Nicaragua.** They commented that—depending on the modality—Costa Rica would have to provide relief in net present value terms equivalent to over 2 percent of GDP, which is high compared with other HIPC creditors.[9] They added that the relief would most likely require legislative approval. For these reasons, they wanted to find a modality that minimized the financial cost and gained the broadest domestic political support. In their view, it would be important for Costa Rica to participate, preferably as a signatory, in a multilateral debt agreement for Nicaragua. They also wanted to explore the possibility of securing financial support from other bilateral creditors.

D. Structural Reforms

27. **The authorities viewed the proposed financial legislation as an important part of their ongoing efforts to strengthen the financial system**. The legislation includes several reforms that strengthen the independence of the central bank, including by lengthening the term of the president from four years to eight years and separating the beginning of the term from the change in government. The legislation seeks to improve financial supervision through several changes, including by requiring annual inspections of financial institutions and allowing the supervisor to share information with his counterparts in other countries. The legislation would establish deposit insurance for all financial institutions. Currently, public banks—which together account for about two-thirds of banking system assets—have a full deposit guarantee, while private banks have no deposit insurance. The insurance would cover deposits up to 2.5 times the previous year's per capita national income per person, and financial institutions would finance the insurance through premia that varied with each bank's risk. The legislation would also allow foreign banks to set up branches in Costa Rica (the existing law only allows the establishment of fully owned subsidiaries).

28. **The staff and the authorities agreed on the need to create incentives to lower the spread between domestic currency deposit and lending interest rates**, which was especially high in private banks. The authorities noted that the proposal to extend limited deposit insurance to all banks would help reduce deposit and lending interest rates in private banks. Both public banks pay substantially lower deposit interest rates, because of the full

[9] At end-2000 Costa Rica's claims on Nicaragua amounted to over US$500 million, and the staff estimated that Costa Rica would have to provide relief in net present value terms of US$350 million to US$400 million.

deposit guarantee, and charge lower lending interest rates than private banks. The staff added that efforts to improve the efficiency of the National Bank—which accounts for 40 percent of banking system assets—could reduce its very high financial intermediation spread.[10] It would also be useful to remove the other forms of preferential treatment enjoyed by the state banks, such as the requirement that private banks maintain minimum balances with state banks.

29. **The staff expressed concern** that the existence of unsupervised banking in the offshore branches, as well as the off-balance-sheet activity, created doubts that the banking system was as healthy as indicated by the reported prudential indicators, such as the risk-weighted capital asset ratio. It mentioned that an MAE report prepared in early 2000 pointed to significant departures in the implementation of the Basel Core Principles and serious weaknesses in the state banks. The authorities replied that nonperforming loans were relatively low and almost fully covered by provisions and that banks were well capitalized. They believed that the offshore banks and off-balance-sheet accounts contained few problems. However, they were looking forward to the results of the upcoming financial sector assessment.

IV. Medium-Term Outlook

30. **The mission explained that the continuation of current policies would make the economy increasingly vulnerable over time**. Wide public sector deficits would sustain upward pressure on domestic real interest rates, keep the international reserve position weak, and curtail real economic growth. Limited progress on structural reforms, together with high interest rates, would not allow the country to reduce its costs and strengthen competitiveness on world markets.

31. **The mission discussed with the authorities an active medium-term scenario** that illustrated the benefits of tightening fiscal policy starting in 2001 and advancing structural reforms. This scenario assumed a fiscal policy that aimed to reduce public debt by about 10 percentage points of GDP by 2006 (Table 10). To achieve this, the government would need to increase substantially the primary surplus from 0.2 percent of GDP in 2000 to 1.6 percent of GDP in 2001. Subsequently the primary surplus could decline to 1.1 percent of GDP by 2006, as public debt and interest payments decline.[11] This would imply a gradual reduction in the overall public sector deficit from 4.2 percent of GDP in 2000 to about 2 percent of GDP in 2006, consistent with a reduction of the central government deficit of

---

[10] The spread of the National Bank is 450 basis points higher than the spread of the other public bank, the Bank of Costa Rica.

[11] These projections are sensitive to the assumptions about the pace and size of the decline in public debt in relation to GDP and interest rates.

about 2 points of GDP over the period. The staff commented that substantial fiscal action would be required under this scenario, in the form of revenue measures, expenditure restraint, and adoption of structural reforms in the areas of telecommunications, electricity and roads. Furthermore, the scenario is consistent with a healthy and well-supervised financial system.

32. **The fiscal adjustment, together with structural reforms, would encourage a gradual improvement in overall macroeconomic performance.** The decline in public debt would help reduce real interest rates, while steps to improve infrastructure would reduce costs. The staff projected that these actions would contribute to a gradual rise in real GDP growth to 5 percent a year by 2005–06, while inflation would fall to 4 percent a year.[12] The external current account deficit would decline gradually to 4 percent of GDP by 2006, financed largely by foreign direct investment, and net international reserves would rise to about 2 months of imports of goods and services (Tables 11 and 12). Gross domestic investment would rise from 17 to 19 percent of GDP, while the strong increase in public savings will contribute to higher gross national savings.

V. Technical Consultation

33. **The discussions also covered the strategy for the Fund's technical assistance in the coming years (Appendix V).** The authorities felt that past technical assistance, particularly to improve economic statistics, had been useful. The staff and the authorities agreed that a lack of transparency complicated the design and implementation of economic policy. In the coming years, the Fund's technical assistance should focus on improving transparency, with an emphasis on strengthening fiscal transparency and continuing to improve economic statistics. The upcoming financial sector assessment would likely generate recommendations for technical assistance to improve transparency in the financial sector.

VI. Staff Appraisal

34. **Looking at the past decade**, Costa Rica made good progress in trade liberalization and maintained social indicators, especially in education and health, which compared favorably with the rest of the region. It experienced a reasonable economic performance, with steady growth and declining inflation, even though political factors prevented a sustained improvement in the fiscal position and limited progress on structural reforms.

35. **In 2000 the weak fiscal and structural policies appeared to take their toll on economic performance.** The decline in the terms of trade widened the external current

---

[12] The scenario assumes that the current exchange rate regime would remain in effect and that the currency would depreciate to offset the inflation differential.

account deficit, yet economic policies could not adjust to stem the loss in net international reserves, which were relatively low at end-1999. Facing strong political resistance, it was difficult for the authorities to turn to a tighter fiscal policy. With the overhang of public debt, a tighter credit policy would have driven domestic real interest rates even higher, and added to the incentive to borrow in U.S. dollars. Moreover, the central bank probably trimmed the rate of currency depreciation to limit inflation, which contributed to the moderate erosion of competitiveness. In the end, the international reserve position weakened further, inflation remained relatively high and real economic growth slowed to less than 2 percent.

36. **Looking forward, the economy is likely to become increasingly vulnerable over time if the fiscal imbalances persist and structural reforms remain stalled**. Real economic growth will probably remain slow, as continued growth in public debt will sustain the upward pressure on domestic interest rates. The external position is likely to remain weak, with wide external current account deficits and relatively low international reserves. Moreover, economic policies seem to be losing their ability to respond to the effects of an adverse external shock.

37. **The most urgent policy requirement is to increase in the public sector's primary surplus to reduce the public sector's debt burden significantly over the next five years**. A significant fiscal adjustment would support faster economic growth by helping to achieve a significant reduction in inflation to single digit levels and by lowering real interest rates. The best approach would be to implement a significant up-front fiscal adjustment, which could allow for a gradual decline in the primary surplus over time, as public debt and interest payments decline. A delay in the fiscal adjustment would probably require a larger primary surplus over time simply to cover the higher interest payments. Steps to increase the primary surplus would include measures to raise revenues, cut unproductive expenditure and improve expenditure management by scaling back revenue earmarking and adopting a more transparent wage structure. In this regard the staff welcomes the tax simplification package, the phasing out of the export subsidies, and the proposed legislation to remove revenue earmarking as steps in the right direction. The government's decision to repay its debt to the central bank is an important step that makes fiscal policy more transparent. Structural reforms to modernize the public sector would help strengthen the fiscal position. It will be important to continue to try to open up the electricity generation and telecommunications sectors to private sector participation to reduce costs and satisfy the projected increase in demand for these services.

38. **A stronger fiscal position would enable credit policy to protect net international reserves and limit inflation**, without having to crowd out the private sector and put economic growth at risk. The rapid growth in U.S. dollar lending presents a serious risk that underscores the need for a lower overall public sector deficit. In the meantime, it would be useful to remove distortions that favored lending in U.S. dollars, such as differential tax treatment of deposits in different currencies, or to increase provisioning or capital requirements on these types of loans.

39. **For the time being, the crawling peg exchange rate regime appears adequate, until fiscal reforms are more firmly in place**. A faster rate of depreciation in 2001 seems warranted, based on the WEO projection of foreign inflation for Costa Rica. Nonetheless, weaknesses in external competitiveness are probably best addressed through structural reforms to improve infrastructure, cut administrative inefficiency, and lower the high financial intermediation spread in local currency. Over time, the authorities should improve the fiscal and external positions and reduce inflation and then give serious consideration to adopting a less vulnerable exchange rate regime.

40. **The staff welcomes the authorities' commitment to provide debt relief to Nicaragua under the HIPC Initiative** and notes their interest in finding a modality that minimizes the financial cost of this relief and that gains broad domestic political support.

41. **The financial legislation recently introduced to the assembly contains important reforms that will strengthen the financial system**. The measures will strengthen the central bank's independence from political interference and improve supervision of domestic financial institutions, especially by authorizing information sharing with supervisors in other countries. The proposed limited deposit insurance will help reduce the intermediation spread in domestic currency by leveling the playing field for private and public banks. It will be important to make the National Bank operate more efficiently. The staff welcomes the authorities' strong interest in the upcoming financial sector assessment, which should help clarify whether the offshore branches and off-balance-sheet accounts pose any risks.

42. **In the coming years, the Fund's technical assistance to Costa Rica should focus on improving transparency**, with an emphasis on continuing the efforts to improve economic statistics. Efforts to strengthen fiscal transparency, especially to include all public spending in the fiscal accounts, is key to improve the surveillance of macroeconomic developments.

43. It is recommended that the next Article IV consultation with Costa Rica be held on the standard 12-month cycle.

Table 1. Costa Rica: Comparative Social Indicators

	Costa Rica	Guatemala	Nicaragua	Honduras	El Salvador	Average for Latin America and the Caribbean
	(In percent of population; unless otherwise indicated)					
Rank in UNDP Human Delopment Index (out of 174 countries) (2000)	48	120	116	113	104	...
GDP per capita in U.S. dollars (2000)	4,127	1,680	470	990	2,150	3,820
People not expected to survive to age 40 (1998)	3.9	15.3	12.2	11.3	10.7	9.7
Life expectancy at birth (years) (1998)	76.2	64.4	68.1	69.6	69.4	69.7
Infant mortality (per 1000 live births) (1998)	14.0	41.0	39.0	33.0	30.0	32.0
Population without access to safe water (1990-98)	4.0	32.0	22.0	22.0	34.0	22.0
Population without access to health services (1981-93)	3.0	40.0	n.a.	38.0	n.a.	n.a.
Population without access to sanitation (1990-98)	16.0	13.0	15.0	26.0	10.0	29.0
Adult illiteracy (1998)	4.7	32.7	32.1	26.6	22.2	12.3
Primary school net enrollment (1997) (percent of relevant age of the population)	91.8	73.8	78.6	87.5	89.1	93.3
Secondary school net enrollment (1997) (percent of relevant age of the population)	55.8	34.9	50.5	36.0	36.4	65.3
Ratio of the per capita income of the richest 20 percent to the per capita income of the poorest 20 percent of the population (1987-98)	13.0	30.0	13.1	17.1	16.6	n.a.
Percentage of population below the poverty line (1989-98) 1/	11.0	58.0	n.a	53.0	38.0	n.a.

Source: UNDP Human Development Report 2000.

1/ Uses the national poverty line of individual countries based on a local basket of basic goods and services.

Table 2. Costa Rica: Macroeconomic Flows

	1996	1997	1998	1999	2000	Proj. 2001
			(Annual percentage change)			
Nominal GDP	16.9	21.5	21.5	23.3	8.9	13.8
Real GDP	0.7	5.7	8.4	8.3	1.7	3.2
GDP deflator	16.1	14.9	12.1	13.9	7.0	10.3
Real GNP	-0.4	7.4	8.7	-1.4	0.3	3.2
Consumer prices						
End of period	13.9	11.2	12.4	10.1	10.2	10.0
Period average	17.5	13.2	11.7	10.0	11.0	10.0
			(In percent of GDP, unless otherwise indicated)			
Balance of payments						
Current account balance	-3.7	-4.9	-5.2	-4.6	-5.6	-6.1
Trade balance	-3.6	-5.1	-4.3	4.0	-1.5	-2.9
Exports	30.4	31.7	37.8	42.3	37.0	34.6
Imports	-34.0	-36.8	-42.1	-38.3	-38.5	-37.6
Services balance	0.2	1.1	1.7	2.4	3.1	3.1
Income and current transfers (net)	-0.3	-1.0	-2.5	-11.0	-7.1	-6.2
Capital and financial account	3.2	6.6	4.1	7.7	4.6	5.0
Public sector	-1.5	0.1	0.4	1.0	1.0	0.3
Private sector	4.7	6.5	3.7	6.7	3.6	4.7
Net official reserves (increase -)	0.5	-1.7	1.1	-3.1	1.0	1.1
Savings and investment						
Gross domestic investment	15.9	18.1	19.6	16.5	17.1	17.2
Public sector	2.9	3.2	3.5	3.4	3.5	3.2
Private sector	13.0	14.9	16.1	13.1	13.6	14.0
National savings	12.2	13.2	14.4	11.9	11.5	11.1
Public sector	-0.2	1.7	2.3	0.7	0.4	-0.2
Private sector	12.4	11.5	12.1	11.2	11.1	11.3
External savings	3.7	4.9	5.2	4.6	5.6	6.1
Public sector accounts						
Overall public sector balance (deficit -)	-4.1	-2.5	-2.0	-3.5	-4.2	-4.5
Overall primary balance	1.3	2.0	1.5	0.8	0.2	0.0
Net interest	5.4	4.6	3.5	4.3	4.4	4.6
Of which						
Central Bank	1.2	1.1	1.0	1.5	1.6	1.2
External financing	-0.2	1.1	0.5	1.5	1.4	1.2
Domestic financing	4.6	1.4	1.9	2.2	4.0	3.4
Statistical discrepancy	-0.3	0.0	-0.4	-0.2	-1.2	0.0
Nonfinancial public sector debt	47.8	43.8	44.6	45.3	48.0	50.4
Domestic	23.6	23.2	24.2	25.8	28.1	31.4
Foreign	24.2	20.6	21.6	19.5	19.9	19.0
Memorandum items:						
Nominal GDP						
In millions of U.S. dollars	11,823	12,822	14,090	15,637	15,784	16,847
In billions of colones	2,456	2,982	3,624	4,467	4,864	5,534

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

Table 3. Central America: Indicators of External Vulnerability

	1996	1997	1998	1999	Prel. 2000
Costa Rica					
Merchandise exports (12-month percent change) 1/	4.5	6.9	21.8	26.0	-15.7
Merchandise imports (12-month percent change)	7.6	12.9	16.8	-6.5	3.4
Terms of trade (percentage change)	-6.2	4.8	3.1	1.7	-13.2
Current account balance, after grants (in percent of GDP)	-3.7	-4.9	-5.2	-4.6	-5.6
Central bank net international reserves					
In months of imports of next year's goods and services 2/	1.8	2.0	1.8	2.7	2.3
In percent of M2	19.7	24.6	18.5	27.7	21.8
In percent of short-term debt on a remaining maturity basis 3/	85.4	125.5	96.3	109.4	96.0
Public sector external debt (in percent of GDP)	24.2	21.6	20.4	19.5	19.9
NFPS external debt service ratio	13.6	12.8	15.9	13.0	12.3
REER appreciation (+) (12-month percentage change)	-0.9	3.7	-2.2	1.7	4.7
El Salvador					
Merchandise exports (12-month percent change) 1/	5.0	33.3	-2.9	-2.1	15.6
Merchandise imports (12-month percent change)	-6.5	11.3	4.6	0.9	20.9
Terms of trade (percentage change)	-8.7	8.2	-0.1	-6.3	-5.6
Current account balance, after grants (in percent of GDP)	-1.6	0.9	-0.7	-2.3	-3.2
Central bank net international reserves					
In months of imports of next year's goods and services	5.3	4.9	5.1	5.7	4.6
In percent of M2	24.8	29.7	31.7	33.3	31.3
In percent of short-term debt on a remaining maturity basis 3/	177.7	166.1	200.9	174.5	177.4
Public sector external debt (in percent of GDP)	24.4	24.1	22.0	22.5	23.3
REER appreciation (+) (12-month percentage change)	4.7	4.8	1.3	1.1	2.9
Guatemala					
Merchandise exports (12-month percent change)	3.4	16.4	9.6	-2.3	10.9
Merchandise imports (12-month percent change)	-4.4	22.4	20.7	-2.0	7.1
Terms of trade (percentage change)	-9.8	6.8	6.0	-11.5	-5.0
Current account balance, after grants (in percent of GDP)	-2.9	-3.5	-5.3	-5.6	-4.5
Central bank net international reserves					
In months of imports of next year's goods and services	2.0	2.2	2.8	2.3	3.6
In percent of M2	18.3	21.9	26.4	26.3	35.0
In percent of short-term debt on a remaining maturity basis 3/	78.8	87.5	87.9	81.7	133.0
Public sector external debt (in percent of GDP)	15.2	14.7	14.9	18.1	17.5
REER appreciation (+) (12-month percentage change)	12.8	8.1	-4.5	-6.0	4.9
Honduras					
Merchandise exports (12-month percent change)	9.2	8.2	5.1	-24.4	13.1
Merchandise imports (12-month percent change)	11.9	15.9	16.3	5.9	7.5
Terms of trade (percentage change)	-5.9	10.0	3.8	-9.5	-2.8
Current account balance, after grants (in percent of GDP)	-4.8	-3.9	-2.8	-3.7	-3.5
Central bank net international reserves					
In months of imports of next year's goods and services	1.3	2.4	3.2	4.4	4.4
In percent of M2	15.2	26.2	29.9	39.4	35.2
In percent of short-term debt on a remaining maturity basis 3/	24.2	49.2	52.7	76.3	78.1
Public sector external debt (in percent of GDP)	84.6	68.9	64.9	79.1	77.8
REER appreciation (+) (12-month percentage change)	0.5	15.4	6.2	7.6	8.0
Nicaragua					
Merchandise exports (12-month percent change)	27.3	-6.6	-8.5	-4.7	18.3
Merchandise imports (12-month percent change)	16.8	12.8	2.6	24.8	-5.8
Terms of trade (percentage change)	-6.9	6.8	6.7	-18.1	-12.6
Current account balance, after grants (in percent of GDP)	-31.2	-31.8	-29.7	-39.2	-30.7
Central bank net international reserves					
In months of imports of next year's goods and services	1.2	2.8	2.0	2.4	2.1
In percent of M2	45.3	83.2	67.9	68.4	64.8
In percent of short-term debt on a remaining maturity basis 3/	59.1	44.7	42.0	58.5	35.7
Public sector external debt (in percent of GDP)	308.7	296.5	295.6	288.8	278.3
REER appreciation (+) (12-month percentage change)	1.0	3.5	2.0	1.7	8.8

Sources: National authorities; Joint BIS-IMF-OECD-World Bank Statistics on External Debt; and Fund staff estimates.

1/ Includes net maquila exports.

2/ Excluding imports of goods for processing.

3/ Debt due within a year.

Table 4. Costa Rica: Summary Public Sector Operations, 1996-2001

(In percent of GDP)

	1996	1997	1998	1999	Prel. 2000	Auth. 2001	Staff 2001
Current primary balance	**5.2**	**6.3**	**5.9**	**5.1**	**4.8**	**4.8**	**4.4**
Nonfinancial public sector primary balance	5.6	6.5	6.0	5.2	5.1	5.0	4.6
Central government	2.1	2.5	2.1	2.3	2.2	2.0	2.1
Current revenue	12.8	12.7	12.7	12.2	12.7	12.5	12.6
Current noninterest expenditure	10.7	10.2	10.6	9.8	10.4	10.5	10.5
Rest of nonfinancial public sector	3.5	4.0	3.9	2.9	2.9	3.0	2.5
Social security agency	0.2	0.5	0.5	0.3	0.3	0.3	0.2
Public enterprises	3.3	3.5	3.4	2.6	2.5	2.7	2.3
Cental bank primary balance	-0.4	-0.3	-0.2	-0.1	-0.2	-0.2	-0.2
Net interest obligations 1/	**5.4**	**4.6**	**3.5**	**4.3**	**4.4**	**4.4**	**4.6**
Central government	4.6	3.8	3.2	3.7	3.6	4.0	4.1
Rest of nonfinancial public sector	-0.5	-0.4	-0.7	-0.8	-0.8	-0.7	-0.7
Social security agency	-0.7	-0.5	-0.7	-0.8	-0.8	-0.7	-0.7
Public enterprises	0.2	0.2	0.0	0.0	0.0	0.0	0.0
Central Bank	1.2	1.1	1.0	1.5	1.6	1.1	1.2
Current account balance	**-0.2**	**1.7**	**2.3**	**0.7**	**0.4**	**0.4**	**-0.2**
Nonfinancial public sector	1.4	3.1	3.5	2.3	2.2	1.7	1.2
Central government	-2.6	-1.3	-1.1	-1.4	-1.4	-1.9	-2.0
Social security agency	1.0	1.0	1.2	1.1	1.1	1.0	0.9
Public enterprises	3.0	3.4	3.4	2.6	2.5	2.6	2.3
Central Bank	-1.6	-1.4	-1.2	-1.6	-1.8	-1.4	-1.4
Net capital expenditures and transfers	**3.9**	**4.2**	**4.3**	**4.2**	**4.6**	**4.2**	**4.4**
Fixed capital formation	2.9	3.2	3.5	3.4	3.5	3.1	3.2
Central government	0.5	0.7	0.5	0.5	0.5	0.4	0.4
Social security agency	0.2	0.2	0.2	0.3	0.3	0.1	0.1
Public enterprises	2.2	2.4	2.8	2.5	2.7	2.6	2.7
Capital transfers	1.0	1.0	0.8	0.9	1.1	1.1	1.1
Overall primary balance	**1.3**	**2.0**	**1.5**	**0.8**	**0.2**	**0.6**	**0.0**
Overall public sector balance	**-4.1**	**-2.5**	**-2.0**	**-3.5**	**-4.2**	**-3.8**	**-4.5**
Nonfinancial public sector	-2.4	-1.2	-0.8	-1.9	-2.4	-2.5	-3.1
Central government	-4.0	-2.9	-2.5	-2.7	-3.0	-3.5	-3.5
Social security agency	0.7	0.8	1.1	0.8	0.8	1.0	0.8
Public enterprises	0.9	1.0	0.6	0.0	-0.2	0.0	-0.4
Central Bank	-1.6	-1.4	-1.2	-1.6	-1.8	-1.4	-1.4
Financing 2/	**4.4**	**2.5**	**2.4**	**3.7**	**5.3**	**3.8**	**4.5**
External	-0.2	1.1	0.4	1.5	1.4	1.2	1.2
Domestic	4.6	1.4	1.9	2.2	4.0	2.6	3.4
Statistical discrepancy	**-0.3**	**0.0**	**-0.4**	**-0.2**	**-1.1**	**0.0**	**0.0**
Memorandum item:							
Overall public sector balance (excluding ICE Trust)	...	...	...	...	**-3.6**	**-3.1**	...

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

1/ Negative sign indicates net revenue.

2/ Excludes accumulation of debt due to capitalization of interest payments on some government debt.

Table 5. Costa Rica: Operations of the Central Government, 1996-2001

(In percent of GDP)

	1996	1997	1998	1999	Prel. 2000	2001 Auth.	2001 Staff
Total revenue	**12.8**	**12.7**	**12.7**	**12.2**	**12.7**	**12.5**	**12.6**
Tax revenue	12.6	12.5	12.6	12.1	12.5	12.3	12.4
Direct taxes	2.8	2.8	2.9	3.4	3.2	3.2	3.2
Indirect taxes	9.8	9.7	9.7	8.7	9.3	9.1	9.2
On imported goods	5.6	5.6	5.8	5.1	5.4	4.3	4.3
On domestic goods	3.5	3.5	3.1	3.0	3.3	4.3	4.3
Other	0.7	0.7	0.7	0.5	0.6	0.6	0.6
Other current revenue	0.2	0.1	0.1	0.1	0.2	0.2	0.2
Capital revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure	**16.9**	**15.6**	**15.1**	**14.9**	**15.7**	**16.0**	**16.1**
Current expenditure	15.4	14.0	13.8	13.5	14.1	14.4	14.6
Of which							
Noninterest current expenditure	10.7	10.2	10.6	9.8	10.4	10.5	10.5
Wages and salaries	4.4	4.3	4.3	4.3	4.6	4.9	4.9
Social security	0.6	0.5	0.6	0.5	0.6	0.7	0.7
Goods and services	0.6	0.6	0.6	0.5	0.5	0.5	0.5
Interest	4.6	3.8	3.2	3.7	3.6	4.0	4.1
Domestic	4.1	3.5	2.9	3.2	3.1	3.2	3.3
External	0.7	0.5	0.3	0.5	0.5	0.7	0.8
Transfers	5.1	4.8	5.1	4.6	4.7	4.4	4.4
To public sector	2.0	1.8	1.9	1.5	1.9	1.9	1.9
To private sector	3.1	3.0	3.2	3.0	2.8	2.5	2.5
Capital expenditure	1.5	1.6	1.4	1.4	1.6	1.5	1.5
Fixed investment	0.5	0.7	0.5	0.5	0.5	0.4	0.4
Transfers	0.9	1.0	0.8	0.8	1.1	1.1	1.1
Other capital expenditure	0.0	0.0	0.0	0.1	0.0	0.0	0.0
Current account balance	**-2.6**	**-1.3**	**-1.1**	**-1.4**	**-1.4**	**-1.9**	**-2.0**
Overall primary balance	**0.6**	**0.9**	**0.7**	**0.9**	**0.6**	**0.5**	**0.5**
Overall balance	**-4.0**	**-2.9**	**-2.5**	**-2.7**	**-3.0**	**-3.5**	**-3.5**
Financing 1/	**4.2**	**2.9**	**2.5**	**2.7**	**4.1**	**3.5**	**3.5**
External	-0.6	0.9	0.1	1.4	1.4	1.3	1.3
External borrowing	-0.7	0.0	1.0	1.4	1.4	1.3	1.3
Other	0.1	1.0	-0.9	0.0	0.0	0.0	0.0
Domestic	4.8	2.0	2.4	1.2	2.7	2.1	2.2
Central Bank	-3.2	1.6	0.2	-0.8	-0.6	-2.9	-2.9
Commercial banks	2.2	0.9	0.4	0.2	0.4	0.0	0.0
Bonds	5.8	-0.5	1.8	1.8	2.9	5.1	5.2
Statistical discrepancy	-0.2	0.0	-0.1	0.1	-1.1	0.0	0.0

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

1/ Excludes accumulation of debt due to capitalization of interest payments on some government debt.

Table 6. Costa Rica: Summary Operations of the Rest of the Nonfinancial Public Sector, 1996-2001

	1996	1997	1998	1999	Prel. 2000	Auth. 2001	Staff 2001
	I. Total Rest of Nonfinancial Public Sector						
Total revenue	18.7	17.9	17.2	16.1	17.6	17.4	17.1
Current revenue	18.3	17.5	17.0	15.9	17.6	17.3	17.0
Capital transfers	0.4	0.4	0.2	0.1	0.1	0.1	0.1
Total expenditure	17.1	16.1	15.5	15.2	17.1	16.4	16.7
Current expenditure	14.3	13.1	12.4	12.2	13.9	13.6	13.8
Current noninterest expenditure	13.9	12.7	12.0	11.9	13.6	13.3	13.5
Interest	0.4	0.4	0.3	0.3	0.3	0.3	0.3
Capital expenditure and net lending	2.8	3.0	3.2	3.0	3.1	2.8	2.9
Overall primary balance	2.0	2.2	2.0	1.2	0.9	1.3	0.7
Current balance	4.0	4.4	4.6	3.7	3.6	3.7	3.2
Overall balance	1.6	1.8	1.6	0.8	0.6	1.0	0.4
	II. Public Enterprises						
Total revenue	12.2	11.7	10.6	9.6	10.9	10.6	10.4
Current revenue	11.9	11.3	10.4	9.5	10.8	10.5	10.4
Capital transfers	0.3	0.4	0.2	0.1	0.1	0.1	0.1
Total expenditure	11.4	10.7	10.0	9.6	11.1	10.6	10.8
Current expenditure	8.9	7.9	7.1	7.0	8.3	7.9	8.1
Current noninterest expenditure	8.5	7.5	6.7	6.6	8.0	7.5	7.7
Interest	0.4	0.4	0.3	0.3	0.3	0.3	0.3
Capital expenditure and net lending	2.5	2.8	3.0	2.7	2.8	2.7	2.8
Overall primary balance	1.3	1.4	0.9	0.4	0.1	0.3	-0.1
Current balance	3.0	3.4	3.4	2.6	2.5	2.6	2.3
Overall balance	0.9	1.0	0.6	0.0	-0.2	0.0	-0.4
	III. Social Security Agency (CCSS)						
Total revenue	6.5	6.3	6.5	6.5	6.8	6.8	6.7
Current revenue	6.4	6.2	6.5	6.4	6.8	6.8	6.7
Capital transfers	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Total expenditure	5.7	5.5	5.5	5.6	6.0	5.9	5.9
Current expenditure	5.4	5.2	5.3	5.3	5.7	5.8	5.7
Current noninterest expenditure	5.4	5.2	5.3	5.3	5.7	5.8	5.7
Capital expenditure and net lending	0.3	0.3	0.2	0.3	0.3	0.1	0.2
Overall primary balance	0.7	0.8	1.1	0.8	0.8	1.0	0.8
Current balance	1.0	1.0	1.2	1.1	1.1	1.0	0.9
Overall balance	0.7	0.8	1.1	0.8	0.8	1.0	0.8
Memorandum item:							
Overall public sector balance (excluding ICE Trust)	...	...	...	...	1.2	1.7	...

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

Table 7. Costa Rica: Summary of Monetary Accounts

	1996	1997	1998	1999	2000	Proj. 2001
	Public sector and central bank financing (flows; billions of colones)					
Overall balance	-99.5	-75.8	-71.9	-155.6	-205.0	-251.6
Financing	106.4	77.2	77.7	163.1	258.2	251.6
External	-6.7	32.3	9.9	66.7	65.9	66.1
Domestic	113.2	44.9	67.8	96.4	192.3	185.6
Central Bank (net)	-76.3	47.5	-22.5	206.3	-43.5	-133.3
Commercial banks (net)	10.3	-18.1	-0.4	3.3	-6.2	21.4
Private sector bonds	139.7	-25.9	48.3	-184.5	124.8	179.5
ICE Trust	0	0	0	0	29.5	40.5
Other (Central Bank losses)	39.5	41.4	42.4	71.2	87.7	77.5
Statistical discrepancy	-6.9	-1.4	-5.8	-7.4	-53.2	0
	(End-of-period stocks; in billions of colones)					
Private financial assets	997.7	1,171.7	1,389.7	1,774.9	2,130.9	2,461.9
Currency held by public	91.7	106.8	124.2	144.3	143.0	164.1
Bank deposits	633.7	746.7	931.0	1,136.6	1,391.6	1,628.2
Public securities	272.3	318.1	334.5	494.1	596.4	669.6
Government	257.5	226.3	231.6	263.8	384.7	564.2
Central Bank 1/	14.8	91.9	102.8	230.2	211.7	105.5
Banking system						
Credit to the private sector	334.3	426.1	647.2	764.8	1,004.1	1,222.7
Net credit to the nonfinancial public sector	164.1	76.3	58.1	97.0	21.9	-84.2
Central Bank						
Net foreign assets	-84.0	-15.5	-64.9	90.0	67.7	60.3
Net interntional reserves	143.9	210.8	195.3	354.1	334.6	297.2
Medium- and long-term foreign liabilities	-227.9	-226.3	-260.2	-264.1	-267.0	-236.9
NDA	199.8	162.3	230.2	139.8	135.0	173.1
Of which						
Stabilization bonds with private sector	14.8	91.9	102.9	230.2	211.7	106.1
Currency issue	115.8	146.8	165.3	229.8	202.7	233.4
	(Annual percentage changes)					
Private financial assets	25.4	17.4	18.6	27.7	20.1	15.5
Currency held by public	13.7	16.4	16.2	16.2	-0.9	14.7
Bank deposits	29.5	17.8	24.7	22.1	22.4	17.0
Public securities	20.7	16.8	5.1	47.7	20.7	12.3
Bank credit to the private sector	25.2	27.5	51.9	18.2	31.3	21.8
Currency issue	17.0	26.8	12.6	39.0	-11.8	15.1
	(In millions of U.S. dollars)					
Change in NIR	-61.4	215.6	-148.9	479.8	-153.6	-181.0
	(In percent)					
NIR/base money	89.9	107.5	80.4	129.3	114.4	96.6
NIR/central bank monetary liabilities	80.5	72.1	54.3	62.8	57.7	71.9

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

1/ Includes certificate of deposits in U.S. dollars.

Table 8. Costa Rica: Key Prudential Indicators of the Banking Sector

	1996	1997	1998	1999	2000
1. Risk-weighted capital/asset ratio	...	20.9	17.9	20.0	19.5
2. Nonperforming loans, substandard or lower quality (as percent of total loans)	6.4	4.3	4.5	2.9	3.6
3. Total provisions for loans (as a percent of nonperforming loans)	94.0	121.0	84.7	119.2	95.1
4. Average pretax return on total assets (in percent) 1/	1.5	1.9	1.3	2.5	2.2
5. Contingent and off-balance sheet accounts (as percent of total assets)	151.3	172.8	170.8	171.7	157.8
Of which					
Foreign currency denominated (as percent of total assets)	35.1	46.4	52.2	64.9	73.7
6. Total assets as a percent of GDP	43.3	41.8	46.7	44.6	51.0
6.a. Foreign currency-denominated					
6.a.i. Assets (as percent of total assets)	34.1	37.3	38.6	39.6	42.0
6.a.ii. Liabilities (as percent of total assets)	29.5	31.7	33.9	34.9	36.5

Source: Superintendency of Financial Institutions.

1/ Total assets include: cash, precious metals, deposits at the central bank and other financial institutions; other liquid assets; temporary and permanent investments; loan portfolio; real state assets and other nonfinancial assets.

Table 9. Costa Rica: Summary Balance of Payments

(In millions of U.S. dollars, unless otherwise indicated)

	1996	1997	1998	1999	Prel. 2000	Proj. 1/ 2001
Current account	**-443**	**-632**	**-730**	**-692**	**-758**	**-949**
Trade balance	**-425**	**-650**	**-609**	**619**	**-182**	**-831**
Export of goods (f.o.b.)	3,599	4,068	5,328	6,611	5,850	4,882
General merchandise	2,561	2,735	2,932	2,628	2,446	2,305
Traditional	1,103	1,049	1,143	969	878	706
Non traditional	1,458	1,685	1,790	1,659	1,568	1,600
Goods for processing	1,022	1,319	2,381	3,963	3,385	2,557
Others	16	15	15	19	19	20
Import of goods (f.o.b.)	-4,023	-4,718	-5,937	-5,992	-6,032	-5,713
General merchandise	-3,234	-3,652	-4,267	-3,989	-4,077	-4,197
Goods for processing	-762	-1,036	-1,629	-1,966	-1,901	-1,471
Others	-27	-31	-42	-37	-55	-45
Services	**20**	**140**	**234**	**408**	**556**	**695**
Transportation	-251	-189	-214	-194	-183	-182
Travel	374	394	505	648	724	819
Other services	-103	-65	-57	-46	15	58
Income	**-185**	**-248**	**-467**	**-1,822**	**-1,227**	**-903**
Compensation of employees	2	6	-7	-15	-18	-18
Investment income	-117	-192	-410	-1,795	-1,238	-905
Other investment	-82	-158	-370	-1,717	-1,134	-771
Current transfers	**147**	**126**	**113**	**102**	**96**	**90**
General government	43	38	40	54	56	58
Other sectors	104	88	73	48	40	32
Capital and financial account	**68**	**537**	**552**	**936**	**389**	**767**
Financial account	**39**	**537**	**552**	**936**	**389**	**767**
Direct investment	421	402	607	614	392	451
Portfolio investment	-22	77	-80	85	-46	194
Other investment	-360	58	25	236	42	121
Errors and omissions	**314**	**310**	**28**	**236**	**216**	**0**
Reserve assets	**61**	**-216**	**149**	**-480**	**154**	**182**
Change in net reserves (- = increase)	61	-216	149	-480	154	182
Memorandum items:						
Current account (in percent of GDP)	-3.7	-4.9	-5.2	-4.4	-4.8	-5.6
Non oil current account (in percent of GDP)	-1.2	-2.8	-3.5	-2.6	-1.9	-2.7
Volume of export of goods (in percentage change)	5.7	9.0	29.0	21.7	-4.2	-13.6
Volume of import of goods (in percentage change)	1.5	18.6	27.7	0.6	-4.4	-4.7
Public sector capital flows (net)	-180	19	59	161	172	44
Disbursments to the public sector	177	487	478	498	554	400
Amortization of public sector external debt	356	468	419	337	382	356
Private capital flows (net) 2/	533	829	522	1,012	432	723
FDI	421	402	607	614	392	451
Other capital flows 2/	112	427	-85	397	40	271
Gross reserves	694	910	760	1,240	1,087	905
In months of import of goods and services	1.5	1.5	1.3	2.0	1.8	1.5
In months of domestic imports and services 3/	1.8	2.0	1.8	2.8	2.4	1.8
Net international reserves	693	909	760	1,240	1,086	904
External public sector debt (in percent of GDP)	24.2	21.6	20.4	19.5	19.9	18.9
Debt service ratio 4/	12.8	15.9	13.0	12.7	13.7	13.7
Of which						
Interest	3.0	3.8	3.3	4.7	4.8	5.5

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

1/ Staff projection based on public sector deficit of 4.5 percent of GDP.
2/ Including errors and omissions.
3/ Excluding imports of goods for processing.
4/ In percent of exports of general merchandise and services.

Table 10. Costa Rica: Medium-Term Macroeconomic Framework

	Prel.	Staff Projection					
	2000	2001	2002	2003	2004	2005	2006
	(Annual percentage change)						
Real GDP	1.7	2.0	3.5	4.0	4.5	5.0	5.0
Inflation rate (end of period)	10.4	10.0	8.0	7.0	6.0	5.0	4.0
	(In percent of GDP)						
Overall primary public sector balance	**0.2**	**1.6**	**1.2**	**1.1**	**1.1**	**1.0**	**1.1**
Net interest payments	**4.4**	**4.4**	**4.1**	**3.7**	**3.4**	**3.2**	**3.0**
Overall public sector deficit (-)	**-4.2**	**-2.8**	**-2.9**	**-2.7**	**-2.3**	**-2.2**	**-1.9**
Nonfinancial public sector	-2.4	-1.4	-1.5	-1.3	-0.9	-0.8	-0.5
Central Bank	-1.8	-1.4	-1.4	-1.4	-1.4	-1.4	-1.4
Overall financing 1/	**4.2**	**2.8**	**2.9**	**2.7**	**2.3**	**2.2**	**1.9**
External	1.4	1.2	1.5	1.2	1.2	1.1	1.1
Domestic	4.0	1.5	1.4	1.4	1.0	1.0	0.7
Statistical discrepancy	-1.2						
Total public debt	**48.0**	**46.2**	**44.2**	**42.8**	**40.9**	**39.2**	**37.4**
External	19.9	19.2	18.9	18.7	18.2	17.7	17.0
Domestic	28.1	27.0	25.3	24.1	22.7	21.5	20.4
External current account deficit (-)	-4.8	-5.2	-4.9	-4.8	-4.5	-4.2	-4.0
Gross domestic investment	17.1	17.9	17.8	18.1	18.5	18.8	19.0
Public sector	3.5	3.5	3.1	3.3	3.6	3.7	3.8
Private sector	13.6	14.4	14.7	14.8	14.9	15.1	15.2
Gross national savings	12.3	12.7	12.9	13.3	14.0	14.6	15.0
Public sector	0.4	1.8	1.8	1.8	2.5	2.7	3.1
Private sector	11.9	10.9	11.1	11.5	11.5	11.9	11.9
	(In months of imports of goods and services)						
Net international reserves	1.9	1.5	1.5	1.6	1.7	1.9	2.1

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

1/ Excludes intrapublic sector debt.

Table 11. Costa Rica: Balance of Payments Medium-Term Projections, 2000-2006

(In millions of U.S. dollars, unless otherwise indicated)

	Prel.	Staff's Active Scenario					
	2000	2001	2002	2003	2004	2005	2006
Current account	**-758**	**-864**	**-865**	**-901**	**-909**	**-934**	**-973**
Trade balance	**-182**	**-752**	**-442**	**-439**	**-412**	**-409**	**-431**
Export of goods (f.o.b.)	5,850	4,882	5,881	6,259	6,693	7,127	7,564
General merchandise	2,446	2,305	2,416	2,583	2,773	2,958	3,130
Traditional	878	706	757	814	877	933	966
Non traditional	1,568	1,600	1,659	1,769	1,895	2,025	2,164
Goods for processing	3,385	2,557	3,444	3,657	3,900	4,149	4,414
Others	19	20	20	20	20	20	20
Import of goods (f.o.b.)	-6,032	-5,635	-6,322	-6,698	-7,105	-7,536	-7,995
General merchandise	-4,077	-4,118	-4,344	-4,602	-4,873	-5,166	-5,478
Goods for processing	-1,901	-1,471	-1,938	-2,056	-2,192	-2,330	-2,477
Others	-55	-45	-40	-40	-40	-40	-40
Services	**556**	**701**	**729**	**800**	**876**	**959**	**1,050**
Transportation	-183	-175	-215	-229	-244	-261	-278
Travel	724	819	880	959	1,044	1,137	1,239
Other services	15	58	64	70	76	83	89
Income	**-1,227**	**-903**	**-1,236**	**-1,341**	**-1,451**	**-1,564**	**-1,671**
Compensation of employees	-18	-18	-22	-27	-33	-39	-47
Investment income	-1,238	-905	-1,225	-1,310	-1,397	-1,500	-1,600
Other investment	-1,134	-771	-1,072	-1,139	-1,216	-1,294	-1,378
Current transfers	**96**	**90**	**84**	**79**	**79**	**79**	**79**
General government	56	58	61	64	64	64	64
Other sectors	40	32	23	15	15	15	15
Capital and financial account	**389**	**767**	**935**	**1,015**	**1,096**	**1,166**	**1,260**
Capital account	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Financial account	**389**	**767**	**935**	**1,015**	**1,096**	**1,166**	**1,260**
Direct investment	392	451	505	557	629	702	769
Portfolio investment	-46	194	194	194	201	190	179
Other investment	42	121	236	264	266	273	312
Errors and omissions	**216**	**0**	**0**	**0**	**0**	**0**	**0**
Reserve assets	**154**	**97**	**-70**	**-115**	**-187**	**-232**	**-287**
Change in net reserves (- = increase)	154	97	-70	-115	-187	-232	-287
Memorandum items:							
Current account (in percent of GDP)	-4.8	-5.2	-4.9	-4.8	-4.5	-4.2	-4.0
Non oil current account (in percent of GDP)	-1.9	-2.3	-2.3	-2.4	-2.3	-2.1	-2.0
Volume of export of goods (in percentage change)	-4.2	-13.6	14.8	3.4	4.5	4.4	4.8
Volume of import of goods (in percentage change)	-4.4	-5.2	11.7	5.2	5.2	5.1	5.0
Public sector capital flows (net)	172	44	160	180	192	189	206
Disbursments to the public sector	554	400	450	632	477	513	557
Amortization of public sector external debt	382	356	290	452	285	324	351
Private capital flows (net) 1/	432	723	775	836	903	977	1,054
FDI	392	451	505	557	629	702	769
Other capital flows 1/	40	271	270	279	275	275	285
Gross reserves	1,087	990	1,060	1,174	1,361	1,593	1,880
In months of import of goods and NFS	1.8	1.5	1.5	1.6	1.7	1.9	2.1
In months of domestic imports and services 2/	2.4	2.0	2.1	2.1	2.3	2.6	2.8
External public sector debt (in percent of GDP)	19.9	19.2	18.9	18.7	18.2	17.7	17.0
Debt service ratio 3/	13.7	13.7	11.7	14.4	10.4	10.8	10.8
Of which							
Interest	4.8	5.5	5.4	5.3	5.1	5.2	5.1

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

1/ Including errors and omissions.

2/ Excludes imports of goods for processing.

3/ In percent of exports of general merchandise and services.

Table 12. Costa Rica: Medium-Term Public External Debt and Debt-Service Indicators

	1999	Est. 2000	Projections 1/ 2001	2002	2003	2004	2005	2006
		(In millions of U.S. dollars)						
Total external debt (end of period)	**3,057**	**3,148**	**3,192**	**3,352**	**3,531**	**3,724**	**3,912**	**4,118**
Of which IMF	0	0	0	0	0	0	0	0
Debt service	**538**	**591**	**596**	**542**	**716**	**558**	**622**	**664**
Amortization	337	382	356	290	452	285	324	351
Of which IMF	0	0	0	0	0	0	0	0
Interest	200	209	240	252	264	273	298	313
		(In percent of GDP)						
Total external debt (end of period)	**19.5**	**19.9**	**19.2**	**18.9**	**18.7**	**18.2**	**17.7**	**17.0**
Of which IMF	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt service	**3.4**	**3.7**	**3.6**	**3.1**	**3.8**	**2.7**	**2.8**	**2.7**
Amortization	2.2	2.4	2.1	1.6	2.4	1.4	1.5	1.5
Of which IMF	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Interest	1.3	1.3	1.4	1.4	1.4	1.3	1.3	1.3
		(In percent of exports of goods and services)						
Debt service	12.7	13.7	13.7	11.7	14.4	10.4	10.8	10.8
Amortization	7.9	8.9	8.2	6.3	9.1	5.3	5.6	5.7
Of which IMF	0	0	0	0	0	0	0	0
Interest	4.7	4.8	5.5	5.4	5.3	5.1	5.2	5.1
		(In millions of U.S. dollars)						
Memorandum items:								
GDP	15,637	15,783	16,588	17,702	18,850	20,415	22,104	24,160
Exports of goods and services 2/	4,244	4,305	4,364	4,626	4,965	5,352	5,752	6,163
Disbursements	498	554	400	450	632	477	513	557

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

1/ Consistent with staff's active scenario.
2/ Exports of general merchandise and services.

Costa Rica: Fund Relations
(As of April 30, 2001)

I. Membership Status:

Joined: January 8, 1946
Status: Article VIII

II. General Resources Account:

	SDR Million	Percent of Quota
Quota	164.10	100.0
Fund holdings of currency	144.11	87.8
Reserve tranche position	20.00	12.2

III. SDR Department:

	SDR Million	Percent of Allocation
Net cumulative allocation	23.73	100.0
Holdings	0.20	0.8

IV. Outstanding Purchases and Loans: None

V. Latest Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR million)
Stand-by	11/29/95	2/28/97	52.00	0.00
Stand-by	4/19/93	2/18/94	21.00	40.00
Stand-by	4/08/91	9/30/92	33.64	25.64

VI. **Projected Obligations to the Fund (SDR million):** Based on existing use of resources and present holdings of SDRs):

	Overdue	Forthcoming				
	12/31/00	2001	2002	2003	2004	2005
Charges/interest	--	0.7	0.9	0.9	0.9	0.9
Total	**--**	**0.7**	**0.9**	**0.9**	**0.9**	**0.9**

The estimates of amounts of charges and their due dates are estimates and subject to change.

VII. Exchange Rate Arrangements:

Costa Rica has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement and maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions. The central bank adjusts the exchange rate daily on the basis of the differential between inflation in Costa Rica and its main trading partners. Buying and selling exchange rates were 322.88 and 323.45, respectively, for April 30, 2001.

VIII. Last Article IV Consultation:

The 1999 Article IV consultation was concluded by the Executive Board on October 6, 1999 (SM/99/224). Costa Rica is on the standard 12-month Article IV consultation cycle.

Costa Rica: Relations with the World Bank Group

I. Financial Relations

(In millions of U.S. dollars)

A. IBRD/IDA/IFC Operations (as of April 30, 2001)[1]

	Total	Disbursed	Debt Outstanding
IBRD/IDA loans	**756.7**	**715.0**	**122.7**
Agriculture	56.8	56.8	3.6
Education	29.0	28.6	15.1
Electric Power and Other Energy	117.4	117.4	0.0
Environment	32.6	0.0	0.0
Finance	15.0	15.0	0.0
Health, Population, and Nutrition	22.0	18.8	14.2
Industry	4.9	4.9	0.0
Oil and Gas	3.0	3.0	0.0
Public sector management	3.5	3.5	0.4
Telecommunications	57.9	57.9	0.0
Transportation[2]	167.3	165.0	23.3
Water supply and sanitation	42.0	39.2	10.3
Multisector	205.3	205.3	55.8
IFC investments	**103.3**	**90.3**	**46.5**
Total	**860.0**	**805.7**	**169.2**

B. IBRD/IDA/IFC Loan Disbursements

	1996	1997	1998	1999	2000	2001
Net disbursements	**31.9**	**-34.3**	**-20.7**	**-22.7**	**-27.4**	**-3.1**
Gross disbursements	9.7	19.6	19.8	11.6	5.8	3.4
Amortization	41.6	53.9	40.5	34.4	33.3	6.6

[1] Net of cancellations.

[2] Includes one IDA project (US$6.4 million).

II. Recent IBRD Activities

The Bank has four active projects in Costa Rica (ecomarkets, health, water supply, and transportation), with about US$41 million undisbursed. All projects are rated satisfactory in both development objective and implementation progress. The last loan approved was the Ecomarkets project (US$33 million), which aims to increase the production of environmental services by supporting the development of markets and services supplied by privately owned forests. It became effective on February 20, 2001. Also, preparation of the Costa Rica Health project is underway and should be ready for Board approval by end-2001.

The Bank has also provided grants for technical assistance on pension reform, public sector reform, privatization, and environmental issues, including innovative work on joint implementation and Costa Rica's carbon bond initiative. The last Costa Rican Country Assistance Strategy Report (CAS) was in 1993. In FY 2002 a new CAS will be prepared, in which the new assistance program for Costa Rica will be defined. The Regional Unit for Technical Assistance office (RUTA) remains located in San José.

Costa Rica: Relations with the Inter-American Development Bank

I. Financial relations
(In millions of U.S. dollars)

A. Operations (as of May 28, 2001)

	Approved	Disbursed	Available
Loans in execution	**559.4**	**183.6**	**375.8**
Energy	320.0	98.3	220.3
Education	56.0	22.2	33.8
Health and sanitation	93.0	52.7	40.3
Social investment and microenterprise	65.0	0.0	65.0
Reform and public sector modernization	23.9	10.2	13.7
Preinvestment	1.6	0.2	1.4
Non reimbursable technical cooperation	**34.2**	**13.2**	**21.0**
Total	**593.6**	**196.8**	**396.8**

B. Loan Disbursements

	1996	1997	1998	1999	2000	2001[1]
Disbursements	**62.5**	**125.4**	**58.3**	**62.1**	**83.3**	**42.6**
Amortization	50.7	57.8	55.9	85.1	75.7	87.4
Interest and charges	58.4	58.6	57.8	57.7	58.4	65.7
Net cash flow	**-46.8**	**9.0**	**-55.4**	**-80.7**	**-50.8**	**-110.5**

[1] Projected.

C. Lending Program for 2001-2003

Competitiveness support program	200.0
Judicial administration reform II	21.0
Tertiary education accreditation program	10.0
Decentralization framework	10.0
Social expenditure efficiency improvement	5.0
Total	**246.0**

II. Recent Activities

The third and last tranche of the Public Sector Reform Loan, as well as the third and last tranche of the Investment Sector Loan, were disbursed in 2000. In addition, during 2000 the IDB approved a new loan for US$65 million to finance a reform to the official land register.

III. Future Plans

The government has been working with IDB staff on the design of a large Competitiveness Support Program, but the nature of structural reforms is still being discussed by the authorities with the opposition. A mission is programmed for the second semester of 2001 to produce a dialogue policy paper, that will be used as a framework for discussing with the main presidential candidates' teams needed structural reforms for Costa Rica.

Costa Rica: Statistical Issues

General

Although some progress has been made with the money and banking and balance of payments statistics, the overall quality of macroeconomic statistics needs improvement. Areas of concern include the consistency of data on the financing of the public sector, statistics on public and private sectors debt, timeliness and coverage of the national accounts by use, delays in the availability of commercial bank accounts, and weaknesses in the compilation of some components of the balance of payments. The authorities are cooperating fully in providing available data to the Fund through electronic means. The authorities also aim at subscribing to the SDDS.

Real sector

New series of national accounts compiled in accordance with the SNA 1993 and based on a 1991 benchmark year have been published in 2000, thus replacing the old series with a 1966 base year. Although the new series represent and important improvement in the quality of the national accounts estimates, a STA mission that visited the country in November 1999 found that weaknesses remain in the source data. That mission also noted weaknesses in private consumption, gross fixed capital formation, and changes in inventories components of GDP estimates by expenditure. Further improvements of the national accounts require improved source data by strengthening the statistical system, establishing and maintaining a statistical register, and regularly conducting economic surveys and censuses. Further developments of the national accounts include the compilation of quarterly GDP estimates, which the authorities have reported to be available in their latest communication with STA expressing their interest and readiness to subscribe to the SDDS.

Government finance statistics

The staff has noted some problems in the compilation of data on the operations of the central government, which derived from combining inappropriately information on a cash and an accrual basis. Moreover, there are significant discrepancies between the above-the-line fiscal figures and estimates of the deficit from the financing side. Costa Rica reports data for publication in IFS and the GFS yearbook. The ministry of finance has requested technical assistance to improve fiscal accounts either on cash or accrual basis.

Monetary statistics

After assistance provided by STA in 1996 and 1998, improvements were made to the classification, coverage, and timeliness of the money and banking statistics, in particular those pertaining to the Central Bank of Costa Rica. However, problems remain regarding the reports of other depository corporations, which lack the degree of detail to clearly identify the sources of deposits and users of loans to facilitate the sectorization of accounts of banks. There is also a need to collect information on offshore operations of bank conglomerates. A recent STA mission compiled enhanced monetary data, which include balance sheets of cooperatives, savings and loans institutions, and private financing corporations for publication in *IFS*. The mission also noted inconsistencies in the sectorization principles applied in the compilation of data for the central bank, other depository corporations, and other macroeconomic statistics. The mission made several recommendations, including the standardized sectorization of institutional units, and the development of a unified reporting system for monetary data that would meet the needs of STA and WHD. There are some advances in this direction that could improve the state of monetary accounting in the short term.

Balance of payments statistics

Substantial progress in the application of appropriate methodology and procedures in the compilation of balance of payments statistics has been achieved after the two technical assistance missions on balance of payments statistics (1999 and 2000), including the estimation of quarterly balance of payments statistics and the preparation of a provisional statement on international investment position. However, shortcomings relating to incomplete coverage of direct investment, other investment and services transactions , and insufficient validation of data from surveys remain to be addressed in the near future. There are no reliable data on the external debt of the private sector.

Costa Rica: Core Statistical Indicators
(As of mid-June 2001)

	Exchange Rates	International Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/ GNP	External Debt/ Debt Service
Date of Latest Observation	5/15/01	5/15/01	5/15/01	3/31/01	3/31/01	4/30/01	3/31/01	4/30/01	3/31/01	3/31/00	2000	12/31/00
Date Received	4/22/01	4/22/01	4/22/01	4/8/01	4/8/01	5/14/01	4/5/01	6/5/01	4/10/01	4/9/01	3/31/01	2/10/01
Frequency of Data	W	W	M	D	M	M	M	M	Q	M	A	M
Frequency of Reporting	D	D	M	M	M	M	M	M	Q	M	A	M
Source of Update	A	A	A	A	A	A	A	A	A	A	A	A
Mode of Reporting	E/C	E/C	E/C	E/C	E/C	E/C	E/C	E/C	E/C	E/C	E/C	E/C
Confidentiality	C	C	C	C	C	C	C	C	C	C	C	C
Frequency of Publication	D	W	M	M	W	M	M	M	M	M	A	M

Costa Rica—Technical Assistance Consultation

The consultation aimed to assess effectiveness of past technical assistance (TA) with the authorities, and identify priorities for future assistance. In the past, technical assistance provided to Costa Rica has been in the Fund's core areas of specialization (Table). However, the assistance requests have been ad hoc and have not formed part of a strategy linked to economic policies. The track record of implementation has been good in statistics and payments systems, but weaker in other areas, such as tax reform, monetary operations and bank soundness. The authorities asked for future technical assistance to strengthen transparency and are particularly interested in participating in the financial sector assessment program.

Past technical assistance

Fiscal Affairs Department

In recent years, Costa Rica has resorted only sparingly to technical assistance from FAD. FAD has provided advice on tax reform (1997), draft laws on tax policy and administration (1998), tax reform (1999), and public expenditure management (1999).

Monetary and Exchange Affairs Department

In recent years MAE has sent nine technical assistance missions to Costa Rica to give advice on monetary policy and operations, payment system modernization, reserve and debt management and, most recently, bank soundness issues. Recommendations to improve the payments system, especially to strengthen the check clearance process and to introduce Real Gross Time Settlement, have been largely followed, although there are a few remaining issues. The authorities accepted the advice on monetary policy and monetary operations, including public debt management, but little progress in implementation has been observed. The mission on bank soundness presented its report in July 2000.

Statistics Department

The Statistics Department has provided technical assistance missions to review the macroeconomic statistical systems, balance of payments statistics, government finance statistics, money and banking statistics, and real sector statistics. The central bank made substantial progress in implementing many of the recommendations to improve balance of payments statistics, but several areas still need to be addressed. The advice on money and banking statistics improved several aspects of the analytical accounts for the CBCR and helped update the definition of different monetary aggregates. Most of the real sector recommendations have been implemented.

Future technical assistance needs

The staff and the authorities agreed that better transparency would improve the implementation of fiscal policy and strengthen financial supervision. A ROSC data dissemination module will be prepared for Costa Rica in FY2001. Continuing to improve the dissemination practices and the quality of economic statistics, especially in the fiscal area, will also be important to improve surveillance and allow Costa Rica to subscribe to the Special Data Dissemination Standard (SDDS).

Table. Costa Rica: Technical Assistance

Department	Dates	Purpose
FAD	May 1997	Advice on tax reforms structure to a Costa Rican team at headquarters.
	Jan.28–Feb.1999	Assist the authorities in strengthening the financial management and procurement systems.
	November 1999	Advice on tax policy.
INS	April 1996	Regional course in Guatemala on financial programming.
MAE	Oct.–Nov. 1996	Review the functioning of the market for government securities, monetary instruments in general, and monetary programming and liquidity forecasting.
	April 1997	Pre-diagnostic assessment of the payments system.
	May 1997	Assist the Central Bank of Costa Rica to improve its monetary programming and liquidity forecasting.
	October 1997	Assist the Central Bank of Costa Rica to develop the interbank market.

Department	Dates	Purpose
	March 1998	Assessment of progress in reforming the payments system.
	September 1998	Assist the authorities on monetary programming and liquidity forecasting, the use of monetary instruments, and the development of a secondary market for government securities.
	March 2000	Assess the condition of the banking system and the regulatory and prudential framework.
STA	July 1996	Multisector mission to assess the strengths and weaknesses of the statistical system and make recommendations to strengthen the data base.
	March–April 1998	Improve the classification and presentation of the analytical accounts of the banking system.
	December 1998	Improve money and banking statistics.
	July–August 1999	Improve balance of payments statistics.
	December 1999	Assess the fiscal database and develop a working plan to improve statistics.
	November 2000	Follow-up mission to improve balance of payments statistics.
	February 2001	Assessment of Costa Rica's macroeconomic data dissemination practices, and assistance in preparing metadata for the SDDS, and improving compilation of monetary data.

Statement by the IMF Staff Representative
July 30, 2001

1. This statement presents information that became available after the staff report was issued on June 27. This information does not change the broad thrust of the staff appraisal.

2. At end-June, the authorities revised their 2001 economic program to incorporate the effect of the deterioration in the external environment since December 2000, when they first prepared the 2001 program. The authorities now expect **real GDP** in 2001 to rise by 0.6 percent, compared with the rate of 3 percent they had projected earlier, owing to weak demand for computer chips made by INTEL. **Inflation** is now targeted to rise slightly to 11 percent during the year (10 percent in the staff report), owing to larger than expected increases in electricity prices earlier in 2001. The authorities project the **external current account deficit** at 5.3 percent of GDP (5.5 percent of GDP in the previous program), as lower exports are offset partly by weaker import demand and a sharp cut in profit remittances by INTEL. **Net international reserves** are targeted to decline by US$75 million, compared with an original target of no loss in reserves, reflecting the repayment of a loan to Taiwan Province of China. In the staff report it was envisaged that this loan would be rolled over. The authorities expect the slower economic growth to have a limited effect on fiscal revenues, which are closely linked to GDP excluding INTEL, and project the **overall public sector deficit** to amount to about 4 percent of GDP, broadly as expected in the original program.[1] The central bank does not expect to increase its open market interest rates above their current level of 14.5 percent, and intends to keep its **net domestic assets** target virtually unchanged for the year as a whole. The central bank has announced that it will accelerate the rate of crawl of the colón in the second semester to achieve a depreciation of 7.2 percent for the year, compared with a rate of 6.6 percent in the original program. If inflationary pressures are greater than envisaged, the central bank will stand ready to tighten its credit policy as needed.

3. On July 2, the National Assembly approved the tax simplification package, as envisaged in the report.

4. The staff report identified a statistical discrepancy of 1.1 percent of GDP in the measurement of the overall public sector deficit in 2000. The authorities have now eliminated such discrepancy, so the financing also shows that the overall deficit amounted to 4.2 percent of GDP in 2000.

---

[1] This includes an estimate of trust fund spending by the state electricity enterprise of 0.7 percent of GDP.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 02/47
FOR IMMEDIATE RELEASE
April 24, 2002

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes 2001 Article IV Consultation with Costa Rica

On July 30, 2001, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Costa Rica.[1]

Background

During the 1990s, Costa Rica made significant progress in opening its trade system, and social conditions, especially for education and health, remained among the best in the region. These factors, together with a long history of political stability, attracted foreign direct investment, led to more diversified exports, and sustained real GDP growth of 4½ percent a year in the period 1990–99, while inflation declined to 10 percent in 1999. However, successive governments met strong political resistance to their efforts to reduce the overall public sector deficit on a sustained basis, and total public debt reached 45 percent of GDP by end-1999, contributing to high domestic interest rates and a weak net international reserve position.

In 2000, economic performance weakened. Real GDP growth slowed to 1.7 percent, from over 8 percent a year in 1998–99, reflecting in part a deterioration in the terms of trade, the end of the construction phase of a large foreign direct investment project by INTEL, and the effect of high real interest rates on domestic demand. Inflation remained at 10 percent during the year. Net international reserves declined by about US$150 million, leaving gross international

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. This PIN summarizes the views of the Executive Board as expressed during the July 30, 2001 Executive Board discussion based on the staff report.

reserves at end-2000 at a relatively low level by regional standards. The external current account deficit reached almost 5 percent of GDP, reflecting lower world coffee and banana prices as well as the surge in world oil prices.

The overall public sector deficit rose from 3.5 percent of GDP in 1999 to 4.2 percent of GDP in 2000, as the primary surplus virtually disappeared. Net external financing amounted to about 1½ percent of GDP, with the balance covered through further domestic borrowing, and total public debt rose to 48 percent of GDP by end-2000.

The central bank's net domestic assets contracted slightly in 2000. In March 2000, reserve requirements on domestic currency deposits were lowered by 2 percentage points to 12 percent to try to narrow the intermediation spread (the difference between deposit and lending interest rates) and encourage lower interest rates on domestic currency loans. (The reserve requirement on U.S. dollar deposits stayed at 5 percent.) Exchange rate policy aimed to depreciate the colón to offset the differential between the domestic inflation target and estimated foreign inflation. During 2000, the central bank slowed the rate of crawl to 6.6 percent, from 9.9 percent during 1999, as it expected higher foreign inflation.

Bank credit to the private sector rose by 31 percent during the year, led by a 52 percent rise in foreign currency lending. Moreover, a growing share of the foreign currency loans went to mortgage refinancing, consumer credit and other activities without income in foreign currency. The rapid credit expansion was financed partly by the use of net foreign assets, as broad money rose by 20 percent during the year. By end-2000, foreign currency loans amounted to 46 percent of total loans, compared with 36 percent at end-1999, while foreign currency deposits rose to 45 percent of broad money.

In the structural area, the assembly approved legislation to open up the telecommunications and electricity sectors to private investment, but subsequently strong political opposition stopped this reform. In early 2000, the superintendent of financial institutions introduced regulations that, inter alia, required banks to place off-balance sheet operations on their balance sheets and to report regularly on their offshore operations. Trade liberalization continued, with a reduction in tariffs on imports from outside Central America and the approval of a free trade agreement with Chile.

In the first four months of 2001, preliminary information suggested that real economic activity declined by about 2 percent (year on year) as exports by INTEL remained low. (Excluding INTEL operations, economic activity rose by an estimated 2 percent year on year in the same period.) Price increases in housing and food raised 12-month inflation to 13.3 percent in May. In the first quarter, the central government deficit amounted to 3.2 percent of quarterly GDP. The central bank lowered interest rates on its open market instruments by 50 basis points to 14.5 percent in late April, much less than the decline in interest rates on U.S. treasury bills since end-2000, and continued to sell open market securities. Owing to stagnant exports, the external current account deficit widened to about 3 percent of quarterly GDP in the first quarter. Through end-May, net international reserves rose by US$32 million, benefiting from the proceeds of a US$250 million bond issue by the government. In March 2001, the authorities introduced legislation to improve the independence of the central bank, strengthen financial supervision and introduce partial deposit insurance for both public and private banks.

Executive Board Assessment

Executive Directors noted that Costa Rica had experienced steady economic growth and declining inflation in the 1990s, reflecting in part advances in trade liberalization and resulting in favorable social indicators. Nonetheless, Directors commented that the authorities have encountered difficulties in securing a sustained reduction in the overall public sector deficit, and that this has led to high domestic real interest rates and, in conjunction with a reduction in technology-related exports given the slowdown in the world economy, to a weak international reserve position. They cautioned that the economy is likely to become increasingly vulnerable over time if the fiscal imbalances persist and structural reforms remain stalled.

Directors emphasized that the most urgent policy requirement is to increase the public sector's primary surplus in a sustained manner in order to reduce the public sector's debt burden significantly over the next five years. The best approach would be to implement a sizable up-front fiscal adjustment through increasing revenues, cutting unproductive expenditure, scaling back revenue earmarking, and adopting a more prudent and transparent wage policy. In this regard, Directors welcomed the tax simplification package, the phasing out of the export subsidies, and the proposed legislation to remove revenue earmarking as steps in the right direction. They saw the government's decision to repay its debt to the central bank as an important step that makes fiscal policy more transparent.

Directors viewed the rapid increase in bank lending in U.S. dollars as a serious risk, and encouraged the authorities to remove distortions that favored this type of lending, such as differential tax treatment of deposits in different currencies, and to increase provisioning or capital requirements on these types of loans.

Directors observed that the crawling peg exchange rate regime appeared adequate for the time being, while inflation remained high. They felt that serious consideration should be given to adopting a more flexible exchange rate regime, once fiscal and external imbalances are reduced and inflation is brought down further.

Directors noted that the financial legislation recently introduced to the assembly contains important reforms to strengthen the central bank's independence, improve supervision of domestic financial institutions, and introduce limited deposit insurance. It will also be important to make the state-owned banks operate more efficiently and help reduce high intermediation costs in the economy. Directors welcomed the authorities' strong interest in the upcoming financial sector assessment, which should help clarify whether the offshore branches and off-balance sheet accounts pose any risks.

Directors stressed the importance of making progress on other key structural reforms, especially to improve infrastructure, cut administrative inefficiency, and lower the high financial intermediation spread in local currency. In addition, they thought that high priority should be given to opening up the electricity generation and telecommunications sectors to private sector participation in order to reduce costs and satisfy the projected increase in demand for these services. These steps would help reduce the overall public sector deficit and strengthen external competitiveness.

Directors very much welcomed the authorities' commitment to provide debt relief to Nicaragua under the Initiative for Heavily Indebted Poor Countries. They took note of the authorities' conversations with relevant parties to find a modality that reduces the financial cost of this relief and gains broad domestic political support.

Directors agreed that the Fund's technical assistance in the coming years to Costa Rica should focus on improving transparency, with an emphasis on continuing the efforts to improve economic statistics. Better fiscal transparency, especially to include all public spending in the fiscal accounts, is key to improve the surveillance of macroeconomic developments.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board. The Staff Report for the 2001 Article IV Consultation with Costa Rica is also available.

Costa Rica: Selected Economic Indicators

	1997	1998	1999	Prel. 2000
(Annual percent changes, unless otherwise indicated)				
National accounts and prices				
Real GDP	5.7	8.4	8.3	1.7
Real GDP per capita	5.4	6.8	7.8	-1.9
GDP deflator	14.9	12.2	13.8	7.0
Consumer price index (average)	13.2	11.7	10.0	11.0
Consumer price index (end of period)	11.2	12.4	10.1	10.2
Unemployment rate (in percent)	5.7	5.6	6.0	5.2
Gross domestic investment (In percent of GDP)	18.1	19.6	16.5	17.1
Gross national savings (An percent of GDP)	13.2	14.4	11.9	12.3
(Ratios to GDP)				
Public finances				
Consolidated public sector	-2.6	-2.0	-3.5	-4.2
Nonfinancial public sector deficit (-)	-1.2	-0.8	-1.9	-2.4
Central bank losses (-)	-1.4	-1.2	-1.6	-1.8
Central government domestic bonded debt	23.7	24.4	26.9	26.7
(12-month percentage changes, unless otherwise indicated)				
Money and credit				
Net domestic assets of the banking sector	16.4	23.3	14.5	14.9
Of which				
Credit to private sector	10.8	21.4	8.2	13.7
Private financial assets 2/	17.4	18.6	27.7	20.1
Interest rates (average)				
Six-month deposit interest rate	14.6	16.4	27.9	14.5
Six-month government bonds interest rate	19.3	20.8	20.3	15.9
Prime lending interest rate	25.5	26.0	27.9	26.5
External Sector (in percent of GDP)				
Exports (in percent of GDP)	31.7	37.8	42.3	37.1
Imports (in percent of GDP)	-36.8	-42.1	-38.3	-38.2
Current account (in percent of GDP)	-4.9	-5.2	-4.4	-4.8
Real effective exchange rate (12-month percentage change)	3.7	-2.2	1.7	4.7
International reserve position and external debt (as of December 31)				
Gross official reserves 3/	909	760	1,240	1,086
(in months of imports of goods and services)	1.5	1.3	2.0	1.8
Outstanding external debt, in percent of GDP				
Public	21.6	20.4	19.5	19.9

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

1/ IMF staff projections.
2/ Includes holdings of central bank and government bonds.
3/ Excludes bilateral claims under negotiation with neighboring countries which in the official statistics are classified as part of the international reserves.

Statement by Hernán Oyarzábal, Executive Director and Orlando Garner, Advisor to the Executive Director for Costa Rica
July 30, 2001

On behalf of our Costa Rican authorities, we would like to convey their appreciation for the continued support and helpful policy advise offered by the staff during the discussion related to the 2001 Article IV Consultation.

Background

Costa Rica is one of the most stable and robust democracies in Latin America with long standing commitment to economic growth and social development. Maintaining an outward-oriented, export-led development has allowed the economy to grow to a healthy level, enabling the government to devote public funds to social security and social programs. The share of national wealth allocated to social expenditure in Costa Rica, at 15-18 percent of GDP, has been among the highest in Latin America and the Caribbean region over the last 20 years. Furthermore, Costa Ricans enjoy some of the best indicators of social well being in the developing world. According to the World Bank, life expectancy at birth (74.9 years) is as high as that of some industrialized countries.

Economic Performance in 2000

During the year 2000, as was also the case in 1998 and 1999, economic performance was heavily determined by the activity of the high tech-electronic industry. As a result of a slowdown in this sector and the deterioration of the terms of trade resulting from the increases of international oil prices and the evolution of the coffee and banana markets, real GDP growth was 1.7 percent in 2000, in contrast with the previous 4.5 percent yearly increases of GDP observed during the last decade.

This deterioration of terms of trade prompted a fall of around US$ 150.0 millions in net international reserves. Still, the government was able to pay its foreign debt in full and made significant debt rescheduling: US$120 million with the Central American Bank for Economic Integration (CABEI) and US$105 million with Taiwan-China. In addition, in order to attract foreign investors, reciprocal agreements aimed at protecting foreign investment were reached with Korea, Switzerland and Bolivia, and talks have started with Venezuela, Paraguay, Czech Republic, Italy and The Netherlands.

The fiscal deficit of the overall public sector grew to 3.8percent of GDP[1] in the year 2000, an increase of about 0.3 percent from 1999. This deficit was the result of lower growth

[1] This figure does not include spending by the ICE Trust Fund. This explains the difference with the staff estimates of 4.2 percent

in government revenues due to the elimination of selective taxes on building materials and clothing, a reduction of 20 percent on the alcoholic beverages tax, and the elimination of both the one percent tax over assets, and the value added tax on exports. Furthermore, the government began to repay part of its debt to the Central Bank.

To compensate in part for lower revenues, the authorities started to implement the tax reforms passed by Congress in 1999. Also, they eliminated subsidies to the export sector that led to an expansion of the tax base subject to the income tax. Another positive development was the increase in indirect tax revenues due to higher international oil prices.

In spite of the boost in oil prices, the inflation rate in 2000 reached 10.3 percent—on a year-to-year basis—almost the same level of 1999, which was 10.1 percent. The average price per barrel in Costa Rica went from US$19 in 1999 to US$32 in 2000. Policy actions were effective in mitigating the impact of oil price increases, and maintaining inflation at the lowest level since 1993.

Policy Discussions

Following a midterm review of the economic program for 2001, the authorities considered that the original growth target of 3 percent was not feasible due to changes in the underlying program assumptions, hence, it was adjusted downwards. The new growth target for 2001 is 0.6 percent. The contribution of INTEL to GDP, which was expected to be almost 6 percent in 2001, has been revised to 3.6 percent to reflect the expected decrease in production. Furthermore, the slowdown of the world economy has prompted a reduction in the rest of the export sector in the first semester of the year, with an impact in the overall growth rate of the year.

It is important to note that excluding the high technology industry sector, GDP growth would have been 2.6 percent for 2001, in contrast to the 0.6 percent growth projected for total GDP.

The inflation rate is expected to be 11 percent in 2001. Although similar to that of the last five years, this level is higher than originally estimated because of an adjustment in public sectors tariffs, other regulated public services, as well as the effect of oil prices. No further increases on tariffs are envisaged for the moment, therefore no additional impact on inflation is considered.

The overall deficit of the public sector is expected to drop to 3.3[2] percent of GDP in 2001, given that public sector enterprises are projected to register a surplus of 1.2 percent of GDP during the year. The state owned telecommunication and electricity companies expect

[2] This does not include an estimated 0.3 percent of GDP in spending by the ICE Trust Fund. This figure differs from the staff estimates but reflects the actual level of spending which has been only 0.1 percent in the first semester of 2001.

higher earnings as a result of the above-mentioned tariff increase. As part of the effort to reduce the deficit, a tax simplification law was recently approved by Congress and new legislation was submitted in order to eliminate all revenue earmarking, which will enhance transparency and flexibility of the fiscal policy.

As the overall public sector deficit will be in line with the policy target, the Central Bank does not anticipate significant pressures on interest rates for the rest of the year. It must be noted that domestic rates have not been adjusted downward following declines in international rates.

The current account deficit widened because of a reduction in exports, as a consequence of the slowing of the US economy, lower coffee prices, a drop in volume of banana exports and falling exports of electronic components. This latter factor is important since exports of high-tech electronic goods are projected to reach only US$1.0 billion in 2001, continuing the decreasing tendency of 1999 and 2000 (US$2.5 billion and US$1.6 billion respectively)

However, the authorities consider that due to higher than expected tourism revenues and other services exports, the current account deficit will reach 5.3 percent of GDP, instead of 5.5 percent of GDP originally projected.

Notwithstanding the widening of the trade deficit and timely payment of the external debt service, reserves increased by US$83.0 million through the end of June. In addition, approval by the US Senate of the Caribbean Basin Initiative, together with free trade agreements with Dominican Republic, Chile and Canada (effective January 2002) and an accord signed with Panama in March last year to work toward a trade agreement, may bring about a positive effect on the balance of payments in the medium term.

With regard to exchange rate policy, our authorities consider appropriate for the time being to continue with the policy of adjusting the exchange rate daily, based on the trade-weighted inflation rate differentials between the local economy and its principal trading partners. Since the mid eighties, this policy has been successful in avoiding loss of competitiveness and maintaining external stability.

In order to address the appreciation of the exchange rate observed during 2000 (close to 2 percent), resulting from the authorities' perception of the expected dollar-euro exchange rate, the daily devaluation of the colon went from 8 to 10 cents or from 6 percent to 8 percent on an annual basis. The authorities requested Fund's technical assistance to review the current exchange rate methodology and it is envisaged that if there is any modifications, they will be incorporated in the 2002 monetary program.

Regarding the financial system, the authorities are confident that the banks' portfolios are properly outfitted, with low levels of nonperforming loans and adequate collaterals. Off-balance sheet accounts have been regulated and efforts continue to improve access to offshore bank operations. An agreement was signed with the supervisory authorities of

Panama that will allow detailed cross examination of relevant banking information between the two countries.

The Central Bank and the Superintendency of Financial Institutions are monitoring closely local US dollar lending operations and are trying to discourage this activity by lowering reserve requirements in local currency deposits. They are prepared to take stricter actions, if necessary, such as specific capital requirements on these loans. In the meantime, some of the major state banks have already taken measures to restrict dollar lending.

Structural Reforms & Other Issues

With regard to structural reforms, our authorities have proposed to the National Assembly important legislation to strengthen the financial system and give more independence to the monetary authority. This legislation covers the following reforms:

- Double the term of the President of the Central bank from four to eight years, so that he will serve under different presidential terms, which would enhance stability and independence.

- Reinforce the Superintendency of Financial Institutions to share information with their counterparts in other countries.

- Establish a deposit insurance system covering up to 2.5 times the previous year's GDP per capita for each individual depositant, in all financial institutions, not only in public banks as it is the practice now.

We would like to inform that Costa Rica is prepared to give debt relief under the HIPC initiative to its neighboring Nicaragua. Given the importance of the Nicaraguan debt, equivalent to more than 2 percent of GDP, support has been solicited from potential donors in order to alleviate its effects on the country's finances. On behalf of our authorities, we thank those countries that have already pledged their support.

Finally, our Costa Rican authorities want to reaffirm their commitment toward economic growth and macroeconomic stability. They look forward to a constructive and continued dialogue with the IMF.