

LOAN COMMITTEE

DECLASSIFIED

MAR 04 2022

WBG ARCHIVES

December 19, 1986

LC/M/ 86-41

Minutes of the Loan Committee Meeting to consider
COSTA RICA - Proposed Banking Sector Adjustment Loan
held on December 16, 1986 in Conference Room E-1208

A. Present

Committee:

Chairman:	Mr. Stern
Finance:	Mr. Wood
Legal:	Mr. Scott
ERS:	Mr. Michalopoulos
OPS:	Mr. Husain
Region:	Mr. Knox

Other:

Messrs./Mes. Clements
 Picciotto
 Steckhan
 Pfeffermann
 Landau
 Knotter
 Schultz
 Larrain
 Park
 Baran
 Fox
 MacMullan
 Coutinho
 Umana

DISTRIBUTION

COMMITTEE
 Senior Vice President, Operations (Chairman)
 Senior Vice President, Finance
 Vice President & General Counsel
 Vice President, Operations Policy
 Regional Vice President concerned*
 Vice President, Energy & Industry (for lending
 in these sectors and SALs)
 Vice President, Economics and Research (for non-
 project lending)

OTHERS
 Standard (see LC/M/ 86-41 page 7)

*Copy to all other Regional Vice Presidents

B. Issues

1. The Meeting was called to discuss the proposals in the Initiating Memorandum attached to Mr. Knox's memorandum of November 26, 1986 for a Banking Sector Adjustment Loan to Costa Rica. The discussion focused on the main issues raised in the Country Policy Department's memorandum of December 12, 1986.

C. Discussion

Country Strategy and Pace of Adjustment

2. The meeting noted the difficulties experienced in implementing SAL I and the uneven country performance. The Region stated that given this background, appraisal of the proposed operation had been made contingent on satisfactory progress by the Government in carrying out the commitments agreed at the time of the Second Tranche release of the SAL, as well as on reaching an agreement with the IMF on a stand-by and making progress in negotiations with the commercial banks. The Government had recently expressed its determination to move forward in each of these areas. The Region also reported that the Government has just prepared a strategy document covering its overall adjustment objectives, which provided a reasonable basis for developing a detailed program. A Ministerial Committee had been established to prepare a detailed plan focussing on export and trade policy and on the financial, public and productive sectors. While past experience dictated caution, the Region felt that it might be possible to proceed with the proposed operation separately within the context of the Government's overall adjustment strategy, or to include the banking sector operation as part of a larger adjustment program.

3. The Committee concluded that, while this matter could be decided when the Government's detailed program was available, it would seem preferable in the light of past country performance to incorporate the operation as a component of a second SAL.

Reserve Requirements and the Banking Sector

4. The meeting reviewed the question of whether the proposed operation should address the issue of the level of reserve requirements and the possible payment of interest on reserves. The Region pointed out that, although the reserve requirements affected banks' profitability, the level of reserves in comparison with other countries in the region was not unusually high. Moreover, the payment of interest would exacerbate already high Central Bank losses. The Region felt that reserve requirements were predominantly an instrument of monetary policy and that the IMF should continue to take the lead in handling this issue in the context of the overall public sector deficit.

5. The Committee noted that Government policy regarding reserve requirements significantly influenced the operations of the banking system. This policy, therefore, needed to be reconsidered in any program to develop a more competitive and dynamic financial sector. The Committee also believed that measures to reduce the budget deficit under a government stabilization program should be accompanied by complementary action to contain this major indirect source of government financing.

Public Bank Portfolio Management

6. The meeting discussed the large public bank arrears. The Chairman enquired whether a change in the accounting mechanism to force the banks to show actual losses would by itself be sufficient to solve this problem without a specific plan on how to eliminate the arrears, taking into consideration the capacity of the borrowers to repay. The Region noted that the key step was to change the signals and prevailing attitudes, both by forcing the banks to show actual losses and convincing borrowers that it was necessary to pay. The Region was satisfied that borrowers' capacity to pay was not a serious general problem and could, where necessary, be dealt with on a case-by-case basis.

7. The Committee noted that the proposed reforms would require major adjustments (including staff reductions) by the public banks. The Region confirmed that the Government was prepared for this consequence.

D. Conclusion

8. In view of the Government's decision to prepare a broader adjustment program the Committee agreed that a decision on the proposed operation would be postponed until the Region has had an opportunity to review the Government's adjustment plans in more detail. As part of a broader approach to adjustment, the proposal was important; as a free-standing operation, it seemed inadequate to support a quick-disbursing loan of the size proposed.