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COSTA RICA

IDB COUNTRY STRATEGY WITH COSTA RICA (2015-2018)

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ELECTRONIC LINKS

1. Bank portfolio report
2. Growth analysis
3. Social analysis in Costa Rica
4. Bank's strategic dialogue with civil society
5. National Development Plan (2015-2018)

SECTOR AND FIDUCIARY NOTES

1. Technical note: Fiscal
2. Technical note: Transportation
3. Technical note: Energy
4. Technical note: Science and technology
5. Technical note: Education
6. Technical note: Social welfare
7. Technical note: Fiduciary
8. Technical note: Private sector windows

ABBREVIATIONS

AECID	Agencia Española de Cooperación Internacional para el Desarrollo [Spanish Agency for International Development Cooperation]
BCCR	Central Bank of Costa Rica
BCR	Bank of Costa Rica
CABEI	Central American Bank for Economic Integration
CGR	Contraloría General de la República [Office of the Comptroller General of Costa Rica]
DGT	Dirección General de Tributación [Taxation Bureau]
ECLAC	Economic Commission for Latin America and the Caribbean
ICE	Instituto Costarricense de Electricidad [Costa Rican Electricity Authority]
IMF	International Monetary Fund
JICA	Japan International Corporation Agency
kWh	Kilowatt hour
MW	Megawatts
NSG	Nonsovereign guaranteed operations
OECD	Organization for Economic Cooperation and Development
OVE	Office of Evaluation and Oversight
PEFA	Public Expenditure and Financial Accountability Report
PND	National Development Plan
PPP	Public-private partnership
SG	Sovereign guaranteed operations
SMEs	Small and medium-sized enterprises
UNDP	United Nations Development Programme

EXECUTIVE SUMMARY

Country context:	After growing by 6% on average in 2002-2008, Costa Rica's economy contracted by 1% in 2009 as a consequence of the international financial crisis. Growth has recovered since 2010, averaging 4.3% a year between 2010 and 2014, which, nonetheless, is lower than the pre-crisis rate. The behavior of public accounts also changed in 2010. While fiscal surpluses of 0.6% and 0.2% were posted in 2007 and 2008, respectively, the fiscal accounts deteriorated, with deficits averaging 5% of GDP in 2010-2014. On the expenditure side, the economy has grown through consumption and private investment. Foreign direct investment has underpinned the economy in recent years, covering more than 95% of the current account deficit. The growth observed during the last decade has not created a spill-over effect in the entire economy, which can be seen from the scant contribution of productivity to growth, and poverty levels that have remained at close to 20% for more than two decades.
The IDB in Costa Rica:	The Bank's Country Strategy for 2011-2014 defined six priority sectors: (i) transportation; (ii) energy; (iii) citizen security and violence prevention; (iv) early childhood development; (v) health; and (vi) innovation. During the period covered by the Country Strategy, sovereign guaranteed (SG) loan approvals totaled US$1,034.9 million. The private sector windows approved an additional US$578.1 million in loans.
Priority areas 2015-2018:	The Country Strategy 2015-2018[1] has the objective of contributing to the government's actions to achieve higher, more inclusive and sustainable growth and speed up the pace of poverty reduction. The Bank will support the country in attaining the objectives set out in its National Development Plan (PND) 2015-2018 and in the IDB's Institutional Strategy. To that end, the Bank's activities will focus on four strategic objectives: (i) supporting fiscal sustainability and efficient spending; (ii) improving productive infrastructure quality, efficiency, and sustainability; (iii) boosting the competitiveness of small and medium-sized enterprises; and (iv) strengthening the human capital accumulation strategy.
Lending framework:	The lending framework contains two scenarios with levels of SG approvals ranging from US$736 million to US$1.031 billion for 2015-2018. The country's debt with the IDB would rise from 1.9% of GDP in 2015 to 2.4%-2.7% in 2018, depending on the scenario.
Risks:	The main risks for implementing the Country Strategy are: (i) institutional, relating to political fragmentation and the execution capacity of local counterparts; (ii) macroeconomic, linked to fiscal sustainability; and (iii) risks relating to potential natural disasters.

[1] The present Country Strategy will remain in effect from the time it is approved by the Board of Executive Directors until December 2018.

I. Country Context

1.1 **Costa Rica's economy has grown steadily over the last three decades at an average of 4.6%, which is higher than observed growth for Latin America and the Caribbean as a whole,[1] and its poverty and inequality levels are below the regional average.** This performance has been sustained by a social policy aimed at human capital accumulation, a policy of macroeconomic prudence with low debt until the start of the international financial crisis, openness to foreign investment, development of the high-technology export sector, and an environmental conservation and sustainability strategy that places it at the forefront of sustainable development.

1.2 **However, the figures for growth, poverty and inequality, public finances, and increased use of nonrenewable energy in the last decade, particularly since 2010[2] have shown signs of weakening.[3]** Although the 2008-2010 international crisis partly explains the slowdown in growth, pre-crisis levels have not been regained. 2014 closed with economic growth of 3.5%, and the estimated rates for 2015 and 2016 are 3.4% and 4.1%,[4] respectively.

1.3 **The incidence of poverty has remained at close to 20% for two decades,** despite average economic growth of nearly 5% a year during that time. The figures for post-crisis poverty show that it is tending to increase. Between 2010 and 2014, poverty rates rose from 21.3% to 22.4%, while extreme poverty grew from 5.8% to 6.7%.

1.4 **The fiscal position has deteriorated in recent years.** In 2014, the central government's deficit was 5.7% of GDP, which is the highest in the last two decades and is likely to remain unchanged in 2015. According to the Ministry of Finance, the central government's debt at the close of 2014 was 39.3% of GDP, which is higher than the average for the 2009-2013 period (31.6%). This figure is close to the average for countries with risk ratings similar to that of Costa Rica, but higher than the level for countries with an investment grade rating.[5]

1.5 **The environmental sustainability associated with the use of renewable energy sources has been declining in recent years.** The impact of climate change, which has affected precipitation levels, coupled with lack of investment in the energy sector and the increase in energy demand, mean that the use of nonrenewable sources to produce energy has increased from 1% in 2000, to 12% in 2014.

1.6 **To recoup growth and make headway in poverty reduction in a context of fiscal and environmental sustainability, the country needs to address a series of restrictions.[6]** The main obstacles identified are related to: (i) the political-institutional context which is marked by delays in policy decision-making and implementing investment initiatives, and by administrative processes that

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1 From the mid-1980s to 2014, Costa Rica grew by an average of 4.63% compared to 3.4% for Latin America.

2 Partly due to the reduction in the availability of hydropower resources as a result of lower precipitation.

3 Except for the early years of the last decade.

4 Central Bank of Costa Rica estimates.

5 Costa Rica lost its investment grade from Moody's in September 2014.

6 See Diagnóstico Social en Costa Rica [Social analysis in Costa Rica] and Diagnóstico de Crecimiento de Costa Rica [Growth analysis of Costa Rica] (2014).

make it difficult for the private sector to do business in the country;[7] (ii) shortcomings in transportation infrastructure and related services for trade in goods that impose a high cost on businesses, particularly small and medium-sized enterprises (SMEs); (iii) low SME productivity, associated with problems of access to financing[8] and limited incentives for innovation that result in scant integration with value chains;[9] (iv) shortages in the supply of trained human capital in technical areas and engineering for which there is growing demand as a consequence of the switchover by the Costa Rican industrial park to activities with higher value-added;[10] and (v) dropouts on the secondary school level[11] and shortcomings in school infrastructure and equipment[12] which, in turn, impact social progress indicators.

1.7 With regard to environmental sustainability, the energy supply and its sources **will continue to be a key factor in Costa Rica's sustainable growth strategy.** In the electricity subsector alone, demand is expected to double in the next 15 years which, if not covered by renewable sources, could lead to an increase in the use of nonrenewable ones in the energy mix and eventually become a constraint to competitiveness and growth.

1.8 **Costa Rica needs to invest more to overcome these restrictions, which will demand a major fiscal effort and private-sector participation.** The economic slowdown and growth in current spending have affected the country's fiscal situation, narrowing the scope for making the required investments in energy, transportation, and education, among other areas. In 2009, public investment accounted for approximately 4.0% of GDP, while in 2013 it was 2.5%.[13] The fiscal situation can affect the perception of risk related to the strength of the economy and become an obstacle to the growth of private investment.

1.9 **The National Development Plan (PND) 2015-2018 presented by the government proposes to address these challenges.** The PND groups sector activities under three overarching objectives: (i) promoting economic growth and creating more and better jobs; (ii) reducing inequality and eliminating extreme poverty; and (iii) combatting corruption and strengthening a transparent and efficient State.

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7 In the survey by the World Economic Forum (2014-2015), the inefficiency of the government bureaucracy is the main stumbling block for doing business in the country (26.8% of votes) and inadequate infrastructure received 23.9% of negative responses, ranking it in second place.

8 The World Bank's Enterprise Survey 2010 named the main obstacle to doing business in that year as access to financing. Just 8.6% of the local credit market was targeted to SMEs in 2011.

9 Between 2009 and 2011, just 37% of exports were integrated into a global value chain. Source: Cadenas globales de valor y diversificación de exportaciones: el caso de Costa Rica [Global value chains and export diversification: The case of Costa Rica], ECLAC, 2014.

10 Companies in free zones are often looking for technicians and engineers, who are scarce in the country. In 2012, unemployment among engineering graduates was 3.5%, while the figure for unemployment as a whole was 9.2% (Observatorio Laboral de Profesiones [Job Observatory] (OLaP)), 2015.

11 The net enrollment rate was 70% in 2014, similar to the Latin American and Caribbean average (73%) but below the average for the OECD countries (88.4%) and lower than Costa Rica's net primary enrollment rate (94.2%).

12 According to the III Informe del Estado de la Educación [Third Report on the State of Education] (2011), one of the critical problems in the country's education system is the historical deficit of school infrastructure.

13 National Development Plan 2015-2018 (MIDEPLAN, 2014).

II. THE IDB IN COSTA RICA

2.1 **The Bank's Country Strategy for 2011-2014[14] was able to reposition the Bank in key sectors for the country's sustainable development,** specifically: (i) transportation; (ii) energy; (iii) citizen security; (iv) early childhood development; (v) health; and (vi) innovation. Given the weaknesses in public investment execution capacity, that strategy also proposed working to strengthen and improve the financial management and public procurement systems.

2.2 **This sector positioning led to the approval of five SG loans for US$1,034.9 million or one quarter of historical Bank approvals for Costa Rica.** The loans were in transportation (US$450 million), energy (US$250 million), citizen security and violence prevention (US$132.4 million), innovation (US$35 million), and education (US$167.5 million). A contingent credit line for US$100 million was also approved to respond to emergencies caused by natural disasters. Twenty-four technical-cooperation projects were approved for US$11.4 million to support dialogue and interventions in the fields of energy, transportation, fiscal management, innovation, early childhood development, education, urban development, disaster risk mitigation, and a better investment climate. The Bank helped to finance about 21% of Costa Rica's public investments, making it the country's main financial partner.

2.3 **The private sector windows** approved 26 loans for US$578.1 million in financial markets (12 operations for US$192.5 million), private enterprises and the development of SMEs (11 operations for US$145.6 million), housing (2 operations for US$40 million), and energy (1 operation for US$200 million). The latter featured the coordination of SG and NSG financing for the Reventazón hydroelectric plant. The Multilateral Investment Fund (MIF) approved US$5.9 million for early childhood development, agricultural development, and support for SMEs.

2.4 **Achievements.** The Country Strategy 2011-2014 revitalized the Bank's relationship with Costa Rica, approving a US$1.6 billion lending program to address the country's development challenges, namely, obstacles to competitiveness associated with inadequate transportation infrastructure and business's capacity to innovate, and the need to strengthen power generation from renewable sources, in line with the country's conservation and environmental sustainability objectives. All of these objectives were pursued in coordination with the private sector. With regard to transportation, support was provided for the rehabilitation and expansion of the Cañas-Liberia segment of the Pacific Corridor. Already 70% complete, this project will increase transportation capacity on a highway corridor of critical importance to the competitiveness of Costa Rica and of the Mesoamerican region. As concerns innovation, headway was made on strengthening and increasing coverage with financing instruments, through lines of credit for energy efficiency projects and new products, such as leasing and financial products targeted to women entrepreneurs. With respect to energy, support was provided for clean electric power generation, which included upgrading four of the five generating units at the Río Macho hydroelectric plant.

[14] The Country Strategy 2011-2014 is in effect from June 2011 to December 2014, plus a transition period to the date on which either (i) a new Country Strategy is approved, or (ii) one year after the original expiry date, i.e. December 2015.

Progress was also made in the construction of the Reventazón hydroelectric plant, which is expected to come online in 2016 and contribute approximately 10% of the country's total installed generation capacity. In addition, the Bank pursued fresh initiatives in social areas, including the development of a new multidisciplinary model to prevent youth violence and the consolidation of a social safety net from early childhood via a pilot with public-private partnerships (PPPs) for delivering quality early childhood development services to poor families. In the health sector, a results-based financing scheme was developed. During the current strategy period, Bank technical support and the dialogue in the above-mentioned areas will play an important role in addressing inclusion and gender considerations in the delivery of basic services. Lastly, the increase in Bank approvals during the period occurred against a backdrop of significant improvements in execution, owing to the adoption of monitoring systems that enabled disbursements to increase 28% per year between 2011 and 2014, reaching a historical peak of US$209.9 million in 2014.[15]

2.5 **Lessons learned.** With an eye to boosting the effectiveness of the Bank's lending program in the country, two important lessons were learned from the strategy's implementation. The first concerns the importance of implementing systems to minimize delays associated with Costa Rica's execution mechanisms and bidding processes, and continuing the dialogue with the authorities to improve the framework for the execution of public investments in general and Bank projects specifically. Many of these problems are related to the numerous steps required prior to execution and factors such as: (i) rigid vertical procurement decision-making processes; and (ii) shortcomings in procurement planning, programming, and management by executing agencies. These issues affect and will continue to affect infrastructure investments.[16] Accordingly, the current strategy will provide continuity to practices implemented under the previous strategy that have proven effective in streamlining the execution of Bank projects, such as the use of a specialized technical unit (UTIF) to support the executing units, and the creation of trust funds in the education sector. The second lesson learned concerns the delays in the Legislative Assembly ratifying external loans.[17] Accordingly, use of Conditional Credit Lines for Investment Projects (CCLIPs) has enabled that body to approve a series of projects in a given sector. This situation underscores the importance of maintaining a fluid dialogue with the various sectors in the country involved in public decision-making in order to communicate the objectives of Bank interventions.

2.6 **The Country Program Evaluation: Costa Rica 2011-2014 prepared by the Office of Evaluation and Oversight (OVE) contains the following recommendations:** (i) strive to deepen the Bank's support for the dialogue on the

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[15] Another achievement since 2012 is a substantial reduction in the length of execution periods, which shrank from an average of 72 months in 2012 to 30 months in 2014, through the use of a risk- and results-based control and monitoring system that was incorporated into management tools.

[16] For the Bank, this translated into an average ratio of disbursements to the available balance in the active portfolio in the 2012-2014 period of 13.8%, one of the lowest reported for the entire Bank.

[17] The average time required to obtain approval of an operation from the time the loan contract is signed exceeds the average observed in other countries in the region. The average number of days required for IDB loans to be declared eligible in Costa Rica in the 2001-2011 period was 199 days, placing the country in 22nd position of the 26 borrowing member countries.

formulation and implementation of public policies, potentially including the fiscal, innovation, and local productive development domains; (ii) support the country in seeking alternatives for attracting private investment through public-private partnerships, particularly in infrastructure; and (iii) help the country strengthen public governance capacities, particularly in areas related to project execution, procurement, and e-government. Management's implementation of these recommendations is summarized in Annex III.

2.7 **Portfolio available for the new Country Strategy.** The SG portfolio in execution consists of 11 projects for an approved total of US$1,766.2 million, with 80% concentrated in infrastructure (transportation 45.9%, energy 28.3%, water and sanitation 5.8%), education 9.5%, and reform and modernization of the State 7.5%.[18] Of the total approved, US$1,168.5 million is available, with 50% concentrated in the transportation sector, 17% in energy, 13% in education, 8% in institutional capacity of the State, 8% in water and sanitation, 3% in competitiveness and innovation, and 1% in the environment and natural disasters. The NSG portfolio in execution consists of 13 projects for total exposure of US$502.7 million, with 62.7% in infrastructure (transportation 7.7%; energy 55%); 31.8% in SME financing, 4.0% in financing for foreign trade, 0.9% in green lines, and 0.6% in tourism. The Inter-American Investment Corporation (IIC) has a portfolio in execution consisting of 15 projects for total exposure of US$96.9 million (92.1% in financial services and 7.9% in SMEs). The MIF has a portfolio in execution composed of seven technical-cooperation projects and three loans for a total of US$9.1 million, with about US$5.1 million still to be disbursed.

III. Priority Issues

3.1 The objective of Country Strategy 2015-2018 is to contribute to the government's actions to bring about higher, more inclusive, and sustainable growth and speed up the pace of poverty reduction. The specific objectives that will guide Bank actions were selected on a dialogue with the authorities that discussed the priorities of the PND, the Bank's evaluation of the economic and social development challenges and their linkage to the government's objectives, the effective use of the portfolio in execution, and of the lessons learned to support these objectives, and other areas in which the Bank could support the development and implementation of the government's development agenda.

3.2 The Country Strategy proposes four strategic objectives: (i) support fiscal sustainability and efficient spending; (ii) improve productive infrastructure; (iii) make SMEs more competitive; and (iv) strengthen the human capital accumulation strategy. These objectives will be supported by crosscutting interventions on institutional strengthening, gender equality and diversity, climate change, and environmental sustainability.

3.3 The proposed objectives seek to create synergies for supporting the government's priorities and advance the tenets of the Bank's Institutional Strategy of heightening productivity and reducing inequality in a sustainable way. Based on the analyses performed, productive infrastructure, particularly in transportation and energy, is

[18] Operations in these sectors have major infrastructure components and are therefore affected by the country's general works execution framework.

key to achieving higher growth, thereby favoring fiscal and environmental sustainability. Improvements in these areas also have a positive impact on competitiveness by reducing the burden of transportation and fuel costs and facilitating the country's integration with the regional market. Human capital accumulation is a determining factor in the objective of more inclusive development and poverty reduction, while favoring the growth of the most dynamic sectors and higher productivity in the sectors lagging farthest behind. Owing to the importance of SMEs in job creation, boosting their productivity is an objective that cuts across the growth, poverty reduction, and inclusion objectives. Also, the proposed emphasis on fiscal sustainability could bring multisectoral benefits by opening up room to make the investments that the country needs and enhancing the climate to increase private investment.

3.4 The IDB Group will support these strategic objectives through financial and nonfinancial instruments and the execution of programs already in the portfolio, which will serve as a starting point and provide continuity for the Bank's work in the country. Furthermore, the lessons learned from projects will be drawn upon in order to sustain a pace of execution that will yield better results. These objectives will also promote support from the private sector windows, which will be particularly important given the country's narrow fiscal leeway for making priority investments.

A. Supporting fiscal sustainability and efficient spending

3.5 To achieve sustainable and inclusive growth, Costa Rica requires a series of public and private investments that can only be carried out in a context of fiscal solvency. Therefore, the existing gap between income and expenditure must be narrowed and the efficiency of public spending improved.

3.6 The imbalance in public finances has become the country's main macroeconomic challenge. At the close of 2014, the fiscal deficit was 5.7% of GDP, with this value being significantly higher than the average for the last 40 years (3.3%). This fiscal problem has been dragging on since 2009 on account of the increase in central government current spending as the main fiscal policy instrument for responding to the financial crisis. According to the Central Bank of Costa Rica (BCCR), the fiscal deficit could reach 6.5% of GDP by 2016 unless corrective measures are taken.

3.7 As a result, total public debt rose from 39.4% of GDP in 2008 to 56.7% in 2014, with 39.3% corresponding to the central government and about 10% to the BCCR. If the recent trend continues, the situation could compromise the country's macroeconomic stability in the medium term, the social gains made to date, its capacity to attract private investment, and its competitiveness.

3.8 On the **spending** side, the main challenge is to control growth in the least flexible and weightiest components, such as outlays for wages and current transfers. The wage component rose from an average of 5.7% of GDP in the period 2006-2009 to 7.2% in 2010-2014; while current transfers grew from 5.2% of GDP to 7.3% of

GDP in the same period.[19] As a result, total central government spending grew from 15.7% of GDP in 2008 to 19.6% in 2014. Furthermore, the country has one of the highest levels of social spending in the region (22.6% of GDP)[20] which, although it has enabled mortality rates and chronic malnutrition to be lowered in children under 5, has high leakage rates[21] that need to be stemmed to make it more efficient.

3.9 On the **revenue** side, receipts have not grown apace with spending. Between 2006 and 2008, total central government revenue as a percentage of GDP averaged 15.2%, to then fall by nearly one percentage point between 2009 and 2013. Despite the fact that the Taxation Bureau (DGT) has been making efforts to improve collection, structural and organizational problems persist that weaken management, collection capacity, taxpayer service, and oversight.

3.10 As for administration, aspects of international taxation have been strengthened through progress in fiscal transparency. However, these gains have not been sufficient to reduce the fiscal deficit, and tax policy needs to be reviewed and reformed, with emphasis on improving collection and the equity, progressiveness, and simplicity of the system.[22] The reform should include strengthening the autonomy of the DGT by improving its model for organization, human resources and, in particular, information systems.

3.11 In this context a sweeping fiscal reform that fills the voids, closes the gap between income and expenditure, and improves efficiency by identifying sectors with the potential to generate receipts, is a centerpiece in the government's objective of creating sustainable growth with equity and prosperity.

3.12 For that reason, the PND has included as one of its strategic sector proposals the implementation of policy measures to narrow the gap between income and expenditure, the primary and overall deficit, and the economy's vulnerability to interest rate fluctuations. The government's main actions are expected to focus on comprehensive fiscal reform, attacking the shortfall and easing the tax burden, modernizing the tax administration, and improving its technological systems.

3.13 Given these challenges, the Bank will provide technical and financial support for the government's fiscal reform initiatives with the objectives of making public spending more efficient and increasing receipts so as to reduce the fiscal deficit. Along that line, the Bank will work with the authorities to establish institutional planning mechanisms and a fiscal rule. It will support strengthening the autonomy of the tax administration and reviewing public spending, with the goal of obtaining results in tax revenues and spending efficiency. These priorities are aligned with

[19] On the remuneration side, the 50th percentile policy, which consists of equalizing the wages of central government professionals with the 50th percentile salaries of the autonomous nonfinancial public sector, led to an increase of approximately 50% in the average wage paid by the central government between 2008 and 2010. As for transfers, they were led by the increase in the Fondo de Desarrollo Social y Asignaciones Familiares [Social Development and Family Allowance Fund] (FODESAF) and the Fondo Especial para la Educación Superior [Special Higher Education Fund] (FEES). Together the two grew from 68.9% of total spending in 2006-2009 to 76.1% in 2010-2014.

[20] United Nations Development Programme (UNDP), 2014.

[21] Idem.

[22] The options include turning the general sales tax into a value-added tax and simplifying and eliminating exemptions and special treatment from the income tax.

the social exclusion and inequality challenge of the Bank's Institutional Strategy and its objectives of creating a more distributive fiscal policy and enhancing the capacity of the State.

B. Improving productive infrastructure quality, efficiency, and sustainability

3.14 To return to the path of higher sustained growth and boost competitiveness, the country must upgrade its infrastructure so that it can contribute to those objectives. According to the World Economic Forum, one of the main limitations on doing business in the country is inadequate infrastructure. The country ranks 119th out of 144 in the quality of roads subindex, with just 66% of the national road system paved, and just 17% of local roads paved. The inadequacies in this area increase transportation costs and the use of fuel, restricting the country's potential for benefitting from the openness of its economy and its market access.[23]

3.15 The infrastructure deficits affect Costa Rica's capacity to benefit from regional integration.[24] The current condition of infrastructure at border crossings stands out, where there is no interagency coordination to allow for adequate operation from the standpoints of national control and trade facilitation.

3.16 In the energy sector, the country faces challenges due to rising demand and climate change. Given the forecasts for growth in electric power consumption,[25] within a decade Costa Rica could become much more dependent on imports of diesel and bunker fuel, unless it makes a series of much-needed investments without which its progress in environmental sustainability could be reversed. Between 2000 and 2014, nonrenewable energy's share in electricity production rose from 1% to 12%.

3.17 Climate change brings challenges associated with hydroelectric generation, a source that has been key in Costa Rica's energy strategy. Climate change has caused heavier but less frequent rainfall whose volatility affects the reliability of service. Although Costa Rica still has significant unexploited renewable resources, such as geothermal sources that could diversify its renewables, they are located in conservation areas where their exploitation is prohibited.[26]

3.18 Although increased participation by private generators coupled with energy trading on the Regional Electric Market (MER) have helped to contain costs, electricity prices have risen steadily in recent years, which undermines the country's competitiveness.[27] Greater openness and competition would encourage

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[23] Today, 43% of the cost of exporting pineapples to the United States can be put down to delays in overland transport and deteriorated roads, and just 5% of the cost goes for shipping by sea. *Logistics in Central America: Path to competitiveness*. World Bank, 2012.

[24] The country has border crossings with Panama (Paso Canoas and Sixaola) and Nicaragua (Peñas Blancas and Las Tablillas).

[25] In its Electricity Generation Expansion Plan, the Instituto Costarricense de Electricidad [Costa Rican Electricity Authority] (ICE) estimates that over the period 2014-2035, installed capacity will need to rise from 2,600 MW in 2014 to about 5,000 MW in 2030.

[26] So long as restrictions exist, the ICE can only exploit geothermal energy outside the national parks, which limits the options for increasing the part played by this resource in the energy mix.

[27] For example, the average price of industrial electricity has almost doubled, rising from ¢39/kWh to ¢67.7/kWh between 2008 and 2013. The prices of residential and commercial energy have also risen by 52% and 60%, respectively, in the last five years. However, with some exceptions, the impact of the cost of electricity on the total average costs of the country's industrial sector is about 3%.

companies that have traditionally been operating in the market to step up their efforts to introduce efficiencies for cost reduction.

3.19 To address these challenges, the country needs to mobilize investments in the transportation and energy sectors in amounts that the public sector would have difficulty in coming up with on its own. Therefore, private sector participation is key to moving the country's infrastructure agenda forward.

3.20 The PND prioritizes actions to cover the main transportation and energy deficits that curb economic activity today and stresses the importance of better planning of future investments so they do not become an obstacle to sustainable growth. The Bank has been the country's partner in both sectors for many years in developing infrastructure and strengthening its energy profile.

3.21 In this Country Strategy, the Bank's activities in **transportation** seek the objectives of maintaining and improving overland connections through feeder roads that link value chains and strengthening freight logistics at land border crossings.

3.22 The Bank has an active portfolio of US$810 million in road infrastructure to support this objective.[28] Furthermore, an SG loan was recently approved for US$100 million to modernize border crossings[29] in a joint effort with other countries of the region to enhance regional integration.

3.23 Private sector support is important in this area given the delays in making the investments needed to attain the objectives of the National Transportation Plan 2011-2035 and the current fiscal situation. The Plan mentions the need for private sector participation to cover approximately 30%-35% (US$20.000 billion) of the required investments (US$59.000 billion) between now and 2035. Attracting the private sector requires improvements in the regulatory framework to implement public-private partnerships (PPPs). Since the Public Works Concession Act was passed, just two projects have been implemented. The country would benefit if it had an independent agency with solid technical expertise to arrange the PPPs needed to close the gaps in infrastructure. The IDB Group will support the country in the institutional strengthening necessary to develop the PPPs and in promoting the use of this instrument in specific projects. New types of PPPs are also needed to cover hybrid contracts and administrative systems should be explored for franchises and concessions that ought to be accompanied by risk mitigation tools and contingent liability calculations.

3.24 As for **energy**, the Bank will continue working with the country to establish a cleaner energy mix, supporting generation that uses unconventional renewable sources and expanding existing ones. It will also support institutional modernization of the energy sector to promote the incorporation of new energy sources and the renewal of infrastructure.

3.25 The Bank has an active portfolio of US$500 million in SG loans[30] and US$276.9 million in NSG loans.[31] The private sector has been relevant in implementing Costa Rica's energy strategy and could continue contributing in

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[28] CR-L1022, CR-L1023, and CR-L1032.

[29] CR-L1066.

[30] CR-L1009 and CR-L1049.

[31] CR-L1012 and CR-L1056.

conjunction with SG financing, along the lines of the loan for the Reventazón hydroelectric plant. Opportunities will also be explored to support private sector initiatives to improve efficiency in energy use.

3.26 The support is aligned with the challenges of *social exclusion and inequality, low productivity and innovation, and limited regional integration* established in the Bank's Institutional Strategy and with the strategic objectives of offering inclusive infrastructure and infrastructure services, offering urban planning and rural infrastructure, improving regional infrastructure, aligning integration instruments and policies, and upgrading regional infrastructure.

C. Boosting SME competiveness

3.27 Over the last decade, productivity has made no contribution whatsoever to the country's growth,[32] despite the fact that very dynamic, highly productive sectors linked to global value chains have been developed. The stagnation of productivity reflects the shortcomings in competitiveness of the bulk of Costa Rica's business fabric, 95% of which consists of SMEs. Despite providing 46% of jobs, contributing 31.9% of GDP, and making up 80% of the country's exporters, SMEs only contribute 14% of the total value of exports, or one sixth of the value of exports by large companies.[33]

3.28 Exports by SMEs lag substantially behind in the complexity that marks the exporting structure of large companies and the free zone regime.[34] Although high-technology companies report high levels of investment in innovation and, consequently, in productivity, the vast majority of establishments show the opposite, with lower aggregate levels of productivity and low levels of innovation.[35]

3.29 Difficulties in gaining access to financing have been pointed to as one explanation for the low investment in innovation and the lag in SMEs' productive complexity. Despite accounting for the majority of businesses, in 2010 this segment only obtained 8.6% of total credit in the financial system, which is focused mainly on real estate and consumer loans.[36] In addition, owing to scant capacity in technology, volume, or quality, there is very little integration between local companies and global value chains, in which they could act as suppliers. This lack of linkage of the productive fabric is one of the main factors hindering growth in national productivity.

3.30 The PND envisages the strengthening of higher-value-added chains linking local suppliers and exporters as a way to increase productivity and growth. Under the

[32] While the breakdown of growth for Latin America and the Caribbean in the period 2004-2011 was: productivity (45%), labor (23%), and capital (32%), for Costa Rica the figures were productivity (-1%), labor (50%), and capital (51%) (Fernández Arias 2014).

[33] Ministry of Economic Affairs, Industry, and Trade (MEIC), 2013.

[34] Eighty-four percent of SMEs are in the commerce (41%) and services (43%) sectors. The agricultural sector is the only one where SMEs have a larger relative share of total value exported (57%). In chemicals, plastics, and machine tools, SMEs represent about one third of exported value despite making up 85% of companies in these sectors. In the remaining sectors, SMEs' share of value exported is less than 15%.

[35] In Costa Rica, investments in research and development account for 0.5% of GDP, while in countries with similar levels of development and productive structure, investment averages close to 0.9% (IDB, 2010). See also Monge-González and Torres-Carballa (2014).

[36] Consulting Group of Assistance to the Poor, Financial Access Report 2010.

objective of strengthening the competitiveness of SMEs, the Bank's emphasis will be on supporting actions to facilitate the availability of credit for this business segment so that these companies can finance innovation and the incorporation of technologies into their productive processes and join more dynamic value chains in the economy as suppliers of goods and services. Support may also be provided for financial inclusion programs for unbanked companies and for developing insurance instruments to mitigate the effects of climate change on the productive sectors that are most vulnerable to that phenomenon.

3.31 The Bank supports this strategic objective with an SG loan in the portfolio for US$35 million[37] and six NSG projects for US$159.4 million,[38] as well as technical cooperation operations. These interventions seek to improve the technological profile of SMEs and the country's business climate. Initiatives in the areas of productive infrastructure and education quality put forward by the Bank during implementation of the Country Strategy will also support this objective.

3.32 The private sector could support this objective by providing venture capital financing, developing financial products to promote projects linking businesses in the local market with those operating in duty-free or productive development zones, and offering financing for foreign trade to facilitate the internationalization of the country's SMEs.

3.33 The Bank's prioritization of this objective for SMEs is aligned with the challenges in the Institutional Strategy of *low productivity and innovation and limited regional integration*, and with its strategic objectives of offering suitable knowledge and innovation ecosystems, and incorporating enterprises into value chains.

D. Strengthening the human capital accumulation strategy

3.34 Over the last 20 years and despite annual growth rates of close to 5%, the country has been unable to steadily reduce poverty levels,[39] which stand at 22.4% of the population (2014). Nor has extreme poverty retreated,[40] which disproportionately affects female heads of households.[41] Inequality, as measured by the Gini coefficient,[42] remained on the order of 0.50[43] over the 1994-2014 period. As well, 21.3% of youths ages 15 to 24 neither work nor study,[44] a phenomenon that is accentuated by gender (25.6% for women versus 17% for men) and contributes to higher rates of juvenile delinquency.

3.35 The standstill in the reduction of poverty and inequality can be partly attributed to the lack of income-generating capacity in poor households,[45] which is the result of

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[37] CR-L1043.

[38] CR-L1058, CR-L1059, CR-L1061, CR-L1064, CR-L1068, and CR-L1069.

[39] Cyclically, poverty was reduced to 16.7% in 2007 but increased again during the 2009 crisis.

[40] It currently affects 6.7% of the population.

[41] Although women head 34.6% of all households, extreme poverty affects 41.4% of them. National Household Survey (ENAHO) 2012.

[42] The Gini coefficient is a measure of inequality. Normally it is applied to gauge income inequality. It ranges from 0 to 1, where 0 is perfect equality and 1 is maximum inequality.

[43] The data on poverty and inequality were taken from State of the Nation Reports for different years.

[44] Data from 2013.

[45] Azevedo, Inchauste, and Sanfelice, 2013.

educational deficits and problems with the targeting and efficiency of social welfare programs that limit their coverage. There is also a lack of linkage between the vocational skills learned and job opportunities that also affects the reduction of poverty and inequality.[46]

3.36 The scant improvement in poverty and inequality coupled with the situation of vulnerable youths highlights the imbalance that exists between the growth of investments in sectors linked to world markets that demand human resources with relatively high levels of skills that have sustained the country's recent development, and relevance and the speed at which Costa Rica has accumulated human capital. Despite its achievements in education in recent decades, Costa Rica is lagging behind changes in production, which prevents broader segments of the population from gaining access to niches with higher productivity and wages.

3.37 These mismatches can be observed in specific links in the education cycle that have affected households' capacity to participate in the growth and, in the case of the most vulnerable segments, limit their future possibility of rising out of poverty. Specifically, there are shortcomings in early childhood coverage[47] and secondary school coverage,[48] and in the percentage of students who graduate from that level. At the tertiary level, the university system is not producing the professionals that the most dynamic sectors of the economy require, which affects employment opportunities in the country.[49]

3.38 In the PND, the government identifies the need for an education policy that keeps pace with the life cycle and enables people to successfully join the workforce in line with the evolution of the productive sectors, and improvement in social welfare programs that facilitates universal access to education and health care services by groups living in extreme poverty, to break the cycle of poverty.

3.39 Under the objective of strengthening the human capital accumulation strategy, the Bank will support improvements in the targeting and coverage of social welfare programs and strengthening the coverage and quality of education, with a view to reducing existing gaps by shoring up factors that help to increase attendance and graduation rates and improve learning and skills in secondary school. It will also support the coverage, efficiency, and effectiveness of social programs intended to strengthen human capital accumulation in extremely poor households.[50] As a complement, the Bank will promote better human resource training in the most dynamic areas of the economy with the highest productivity,[51] seeking to surmount

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[46] For a more detailed analysis see UNDP *Reducir la Pobreza en Costa Rica es possible* [Poverty can be reduced in Costa Rica] (2014) and Diagnóstico Social en Costa Rica [Social analysis in Costa Rica].

[47] In all, 98% of two-year-olds, 95% of three-year-olds, and 75% of four-year-olds in income quintiles I and II do not have access to early childhood development services. There is virtually no public education offered for two-year-olds (crèches) or three-year olds (interactive education) (Trejos, 2014).

[48] The net enrollment rate on this educational level rose from 54.1% in 2000 to 70% in 2014. However, the indicator was 74.4% in urban areas and 64.4% in rural ones. A similar disparity was also observed in the rate for boys and girls (66.1% and 73.5%, respectively).

[49] For example, over the last decade, the country has been unable to significantly increase the number of engineering graduates, which only grew from 7.5% of public university graduates in 2003 to 8.6% in 2011.

[50] For more information on support in these working areas, see the respective sector notes and the document Diagnóstico Social en Costa Rica [Social analysis in Costa Rica].

[51] For example, manufactures, information and communication technologies, telecommunications, and others.

a significant limitation on growth in these sectors and to generate high-quality jobs. The support is aligned with the Institutional Strategy challenges of *social exclusion and inequality, and low productivity and innovation* and with the strategic objectives of eradicating extreme poverty and developing high-quality human capital.

3.40 The PND is aware of the need to coordinate social policy with different sectors and activities and therefore the Bank will monitor and facilitate coordination agreements among the relevant agencies. The Bank will also help to bring about improvements in spending efficiency, in line with the objective of supporting fiscal sustainability.

3.41 The Bank currently has an education infrastructure program for US$167.5 million,[52] which seeks to address deficits in the infrastructure of Costa Rica's education system, which are estimated at more than US$1 billion.[53] [54]

3.42 To close the existing gap in education infrastructure and between the supply and demand for science and engineering graduates, the private sector will explore opportunities for financing technical education institutes and expanding infrastructure through trust funds or, alternatively, PPPs for education infrastructure applied to all levels of instruction. Support of this kind will rely on the country developing private management models or PPPs in social services. The Bank may support the country in structuring this financing through loans or guarantees to mobilize private sector resources for projects.

E. Crosscutting action areas

3.43 In its dialogue and operations, the Bank will incorporate crosscutting areas that are crucial in the Costa Rican context. They include public sector governance. The Bank will support implementation of a series of practices that the country has begun to evaluate with a view to its future entry into the Organization for Economic Cooperation and Development (OECD), for example the adoption of a Government Center model to improve the management of PND priorities, public intervention monitoring and evaluation, the strengthening of budgeting practices, management of public employment, etc. The institutional support will also build the confidence of investors in the country by reducing the bureaucratic costs.[55]

[52] CR-L1053.

[53] Report on the State of Education, 2011.

[54] Information taken from IDB (2012). "Education infrastructure construction and equipment in Costa Rica." Loan proposal CR-L1053. Inter-American Development Bank. Washington DC, USA.

[55] See footnote 7.

3.44 Gender and diversity considerations will continue to be incorporated.[56] The Bank is executing a series of projects in these areas such as the Mesoamerican Health initiative[57] and support for SMEs in gender aspects.[58] During implementation of the Country Strategy, these subjects will be addressed as part of support for the country in developing its poverty-reduction strategy,[59] in addition to initiatives to deal with violence against women.

F. Dialogue areas

The country's water and sanitation sector has significant needs, especially as regards wastewater treatment. Costa Rica has the lowest rate of sanitary sewerage system coverage in the Central American region. Under the Country Strategy, the dialogue with the authorities will continue with a view to streamlining execution of the active portfolio in the sector, which amounts to US$93 million (US$73 million in an Ordinary Capital loan and US$20 million in grants). As significant advances are made in the execution of these resources, the development of new initiatives in the sector can be explored. The private sector could contribute through green investment programs, e.g. financing water treatment plants.

IV. LENDING FRAMEWORK

4.1 Costa Rica's gross financing requirements are estimated at approximately US$7.080 billion per year during the 2015-2018 period. Bank support for the country's financial program could range from US$736 million to US$1.031 billion, depending on progress in the macroeconomic stability area. In the base case scenario, which assumes no changes in the current fiscal deficit path and continuing growth of the central government's debt, estimated approvals and disbursements would be on the order of US$736 million and US$860 million, respectively. Under this scenario, the country's debt with the IDB as a percentage of GDP would increase from 1.9% in 2015 to 2.4% in 2018. During this same period, the debt with the IDB as a percentage of public foreign debt would rise from 14.2% to 14.6%. Average annual approvals and disbursements would be US$184 million and US$215 million, respectively (see Annex V).

4.2 In the event that measures are adopted to promote macroeconomic stability and fiscal sustainability, the Bank will assess the possibility of increasing its financing to US$1.031 billion in new approvals and US$1.160 billion in total disbursements. Under this scenario, average annual approvals and disbursements could increase

[56] For more information on work in this crosscutting area, refer to the corresponding section of the document Diagnóstico Social en Costa Rica [Social analysis in Costa Rica].

[57] The program's objectives for Costa Rica are to: (i) raise the quality of maternal, neonatal, and child health care for adolescents in the poorest parts of the country; (ii) improve the quality, use of, and access to sexual and reproductive health services for adolescents; and (iii) test best practices through a comprehensive inter-sector strategy with a collective impact on the prevention of teen pregnancies. The Mesoamerican Health initiative seeks to ensure access to basic health care services for more than 8 million poor women and children in Belize, El Salvador, Guatemala, Honduras, Nicaragua, Panama, and the Mexican state of Chiapas.

[58] Loan CR-L1069 (US$75 million) with Banco Nacional to support women's banking, and loan CR-L1074 (US$50 million) with BAC San José to support women entrepreneurs, both of which have been approved.

[59] The Bank supported the design and will also support implementation of the development bridge strategy.

to US$257 million and US$290 million, respectively. The country's debt with the IDB would increase from 1.9% of GDP in 2015 to 2.7% in 2018.

4.3 The Bank will closely monitor the country's fiscal position and, with respect to the objectives set out in this Strategy, will maintain a dialogue with the authorities on developments in the country's macroeconomic situation and how it could impact the level of financing and types of instruments that make up the Bank's lending program.

V. IMPLEMENTATION OF THE STRATEGY

5.1 **Actions to speed up parliamentary ratification.** The Bank will promote dialogue with the Legislative Assembly about the planned operations to better clarify its work in the country and facilitate legislative processes for ratification of the programs carried out under the Country Strategy.

5.2 **Actions to improve project execution.** To sustain the gains in the pace of disbursements made in recent years steps, such as those specified in paragraph 2.5 to shorten execution times, will continue to be taken. The formulation of a medium-term action plan is also being discussed with the authorities that includes improvements in the public procurement system.

5.3 The Bank will continue to work taking the following specific priorities into account for the Costa Rican context: (i) bring project startup activities into line with the capacity of the local counterparts and undertake strengthening exercises in project planning, execution, supervision, and spending processes; (ii) coordinate with the borrower to anticipate possible fiscal or administrative constraints; (iii) continue its close cooperation with the Ministry of Finance's Public Credit Division in reviewing progress and proposing solutions to speed up financial execution; and (iv) offer alternative financial execution mechanisms.

5.4 **Private sector.** Owing to the key role that the sector can play in the country's investment plan, the Bank will maintain a dialogue with the authorities on critical factors that could promote private contributions to the objectives proposed in the Country Strategy. This could be particularly relevant for the development of projects under way or in preparation on energy efficiency, green lines, renewable energy, PPPs in transportation and social services (housing, education, and health), and credit for SMEs.

5.5 **Use of country systems.** The 2010 Public Expenditure and Financial Accountability Report (PEFA)[60] concluded that Costa Rica's management of public finances is satisfactory overall, underlining the budgeting process and treasury management. However, it also identified areas that require adjustments, such as general accounting and internal audits. Loan operations use the country budgeting and treasury subsystems in their financial management. The Bank has participated actively in implementing the recommendations for the 2015-2018 period and plans to continue its support for these subsystems and possibly to fortify the Integrated Financial Management System (SIGAF).

[60] Work is currently being done with the national government to update the PEFA.

5.6 An agreement for partial use of Costa Rica's country procurement system was formalized in 2015, as part of the Board of Executive Director's acceptance of the following subsystems (document GN-2538-11/12): (i) information system; (ii) framework agreements; (iii) abbreviated bidding procedure and direct contracting for the purchase of off-the-shelf goods and services, equivalent to the shopping method established in the Bank's policies; and (iv) contracting of individual consultants. The government is also committed to implementing the Public Procurement Information System (SICOP). Accordingly, awareness of the need to reform the country procurement system will continue to be raised, particularly with actions to reinforce merging of the electronic procurement systems. During 2015, the assessment using the OECD's Methodology for Assessing Procurement Systems (MAPS) will be updated, which will lead to a plan of action and certain activities to support the country public procurement system.

5.7 In the area of financial management, the Bank will continue its support for building the audit capacity of the Contraloría General de la República [Office of the Comptroller General of the Republic] (CGR) and will support the National Accounting Division in implementing International Accounting Standards which, by executive decree, are to be introduced in 2016. In the treasury subsystem, payments through the national banking system for projects with decentralized agencies will continue to be evaluated.

Table 5.1 Country systems

Use of country systems[61]	Baseline 2014	Estimated use 2016	Actions planned
Financial management			
Budget	100%	100%	Implementation of the government's budgeting structure
Treasury	91%	91%	Evaluation of making payments to decentralized agencies through the national banking system and the use of trusts
Accounting and reporting	0%	0%	Implementation of the International Public Sector Accounting Standards (IPSAS) in 2016 by the central government as a minimum
Internal budget auditing	0%	5%	CGR performs external audits of Bank-financed projects
Procurement			
Information system	20%	50%	Signature of an agreement with the Ministry of Finance to use country procurement subsystems and implementation plan
Shopping	0%	7%	
Individual consulting services	0%	7%	
Partial national competitive bidding	0%	0%	
Advanced national competitive bidding	0%	0%	

5.8 **Coordination with other donors.** The Bank expects to continue working in coordination with different multilateral organizations and cooperation agencies during the Country Strategy period. In the fiscal field, the Bank cooperates closely

[61] Percentage of the active portfolio of Bank loans (operations) managed by country systems.

with the IMF, the World Bank, the OECD, and the UNDP. In the field of energy, it has worked in coordination with the Japan International Cooperation Agency (JICA). In the water and sanitation sector, the Bank cooperates with JICA, the Spanish Agency for International Development Cooperation (AECID), the German Reconstruction Loan Corporation (KfW), and the Central American Bank for Economic Integration (CABEI). Under the Mesoamerican Health initiative and in the social sector, partnerships have been established with the World Bank, Eurosocial, the Bill and Melinda Gates Foundation, the Carlos Slim Foundation, and AECID. In transportation, the Bank has worked with the Economic Commission for Latin America and the Caribbean (ECLAC), CABEI, and the Permanent Secretariat of the General Treaty on Central American Economic Integration (SIECA). It has also coordinated with other institutions that offer programs in the country such as the United States Treasury Department, USAID, and the European Union and will support coordination with other donors to devise strategies for poverty reduction and the coordination of projects in common subjects and areas.

VI. RISKS

6.1 **Institutional risk.** The country faces institutional challenges that affect the entire spectrum of Costa Rican society. The main ones include political fragmentation.[62] The country has migrated from a two-party system able to reach consensus and prevail over the veto power of minorities to a multiparty system[63] that is not conducive to reaching consensus in the legislative branch. Legislative delays caused by a series of institutional stumbling blocks have made it very difficult to reach consensus on reforms. To partly mitigate this risk, the Bank is already working with the government to reinforce the Government Center and to apply the management-by-results methodology to public budgeting. This will make it possible to continually monitor the institutional risk and take steps to mitigate its impact on Bank programs in preparation and execution.

6.2 **Fiscal risk.** The deterioration of public finances, with a deficit that could reach 6.9% of GDP in 2016 unless comprehensive reform is undertaken, has led to increases in public debt (56.7% of GDP in 2014), which has undermined sustainability.[64] This could lead to interest rate hikes, a reduction in public investment, and the loss of confidence by foreign investors. Comprehensive reforms of both expenditure and revenue will be needed to address this situation, reduce macroeconomic risk, and boost the country's growth. To mitigate the risk, the Bank will support the government's dialogue on fiscal reforms with the Legislative Assembly. To monitor this risk, macroeconomic sustainability reports will continue to be produced periodically, and joint work will continue with the World Bank and IMF technical teams.

6.3 **Risk of natural disasters and environmental risks.** Costa Rica is exposed to the risk of natural disasters. It has high vulnerability indexes for volcanic activity, and there are no programs to mitigate these risks. They could affect the Country

[62] OECD Public Governance Review of Costa Rica - Good Governance: from Process to Results (2015).

[63] The Legislative Assembly currently has 57 members from 9 political parties.

[64] The debt sustainability analyses point to medium-term risks.

Strategy objectives. The impact of climate change on the energy sector could affect growth and, therefore, the fiscal and growth objectives. The Bank will continue its dialogue with the authorities to support measures to identify and mitigate the risks. This is particularly relevant for productive infrastructure programs. Contingent credit lines could be prepared for emergencies and preventive programs to address the risks identified.

COUNTRY STRATEGY RESULTS MATRIX

Government priority	IDB strategic objective	Expected outcomes	Indicators	Baseline
Improve the country's macroeconomic conditions	Support fiscal sustainability and spending efficiency	Tax revenues increase	Tax revenues over GDP	13.2% of GDP (2014) Ministry of Finance, annual
		The efficiency of poverty-reduction programs improves	Fiscal cost of leakage in poverty-reduction programs[66]	0.5% of GDP (2013), Ministry of Finance, annual
Generate higher economic growth marked by more and better jobs	Improve the quality, efficiency, and sustainability of the productive infrastructure	Road quality improves[67]	Road quality index	2.8 (119th out of 144) Global Competitiveness Index (2014-2015), World Economic Forum, annual
		The efficiency of border crossings improves	Maximum freight processing capacity at land border crossings (transportation units/day)	Imports: 362 Exports: 476 Georgia Tech Report (2014),[68] annual
		More energy is generated from conventional and nonconventional renewable sources	Percentage of renewable energy production[69]	88% renewable, 12% thermal (2014) ICE, annual.
	Boost the competitiveness of SMEs	Credit to SMEs rises steadily	Annual growth (Dec.-Dec.) in the portfolio of bank loans to SMEs	BNCR: 1.8% BCR: 6% Bancrédito 9.7% (2014), banks.[70]
Reduce poverty in general and extreme poverty in particular and lessen social and territorial inequality	Strengthen the human capital accumulation strategy	Gross secondary-school graduation rate increases	Gross grade 9 graduation rate	54.2%[71] State of the Nation Report (2012), annual
		The coverage and efficiency[72] of poverty-reduction programs increases	Percentage of extremely poor households covered by poverty-reduction programs	40% Government estimate Regional Policy Dialogue Presentation (2014), annual

[66] Leakage or inclusion errors are defined as the number of beneficiaries who do not belong to the target population as a percentage of total program beneficiaries.

[67] Refers to the portion of the national and local road system that is paved.

[68] IDB report.

[69] The denominator of this indicator is total energy generated.

[70] A baseline will be established with private banks during the Country Strategy period. However, it should be clarified that the three public banks mentioned have 40% of total assets in the financial system and a shift of their assets towards SMEs would be a robust indicator of trends in assistance for this segment.

[71] Report on the State of Education 2013.

[72] Efficiency is captured by the "Fiscal cost of leakage in poverty-reduction programs" indicator included in the objective "Support fiscal sustainability and spending efficiency."

COUNTRY SYSTEMS MATRIX

Country objectives	IDB strategic objectives	Expected outcomes	Indicators	Baseline
Combat corruption and strengthen a transparent, efficient, and effective State	Increase planning, financial auditing, and performance capacity in the Directorate General of Accounting, with the adoption of International Public Sector Accounting Standards (IPSAS)	CGR's performance is evaluated on the basis of a framework that measures international parameters	Performance Measurement Framework applied to the CGR	1 (2015)
		IPSAS implemented	% of IPSAS adopted	0% (2015)
	Reform the country procurement system	Electronic procurement systems are unified	% convergence of the main electronic procurement systems	0% (2015)
		A plan of action exists that identifies short- and medium-term objectives to improve the efficiency and transparency of Costa Rica's procurement system	Action plan validated by the government	0 (2015)
	Increase the use of country fiduciary/financial management systems	The external control system is used for Bank-financed loans	Number of projects audited by the CGR	0 (2015)
	Increase the use of country fiduciary/procurement management systems	An agreement is signed by the IDB and the government to use country subsystems	Signature of implementation agreements	0 (2015)
		Subsystems for framework agreements, direct contracting, and abbreviated bidding process equivalent to shopping, and individual consulting services are used	% of the portfolio using the subsystem	0% (2015)

Main economic and social indicators

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Social indicators										
Population (thousands)	4215	4279	4340	4404	4469	4534	4592	4652	4713	4773
Poverty rate	21,2	20,2	16,7	17,7	18,5	21,3	21,6	20,6	20,7	22,4
Extreme poverty rate	5,6	5,3	3,3	3,5	4,2	6,0	6,4	6,3	6,4	6,7
Unemployment rate	6,6	6,0	4,6	4,9	7,8	7,3	7,7	7,8	8,5	9,7
Per capita GDP (PPP- US$)	9.699,2	10.713,8	11.702,8	12.081,0	11.873,2	12.434,1	13.095,9	13.838,2	14.340,0	14.864,3
Real sector indicators										
Real GDP (% growth)	5,89	8,78	7,94	2,73	-1,02	4,95	4,52	5,17	3,44	3,50
Nominal GDP (US$ millions)	19.961,03	22.528,75	26.322,10	29.837,89	29.382,69	36.298,31	41.237,29	45.300,67	49.236,71	49.552,58
Fiscal indicators 1/ (% GDP)										
Fiscal revenue	13,26	14,23	15,48	15,86	14,03	14,37	14,50	14,35	14,26	14,23
Total expenditure	15,7	15,28	14,91	15,67	17,43	19,51	18,56	18,74	19,65	19,96
Capital expenditure	-	0,928	1,299	1,756	1,790	2,350	1,456	1,453	1,615	1,742
Overall balance	-2,47	-1,05	0,57	0,19	-3,40	-5,14	-4,05	-4,39	-5,38	-5,73
Central government public debt	37,50	33,32	27,54	24,74	27,20	29,14	30,75	35,34	36,07	39,50
External debt	11,86	10,30	8,66	6,87	5,88	6,13	4,87	6,01	7,14	8,85
External indicators (% GDP unless otherwise indicated)										
Current account balance	-4,91	-4,54	-6,25	-9,34	-1,96	-3,53	-5,40	-5,31	-5,05	-4,90
Foreign direct investment	4,31	6,52	7,20	6,96	4,58	4,04	5,28	5,15	5,44	4,25
Net international reserves (US$ millions)	2.312,6	3.114,5	4.113,6	3.799,1	4.066,3	4.627,2	4.755,8	6.856,7	7.330,9	7.211,4
Monetary and exchange indicators										
Inflation rate (end of period)	14,07	9,43	10,81	13,90	4,05	5,82	4,74	4,55	3,68	5,13
Growth of monetary aggregates (M2)	33,32	29,84	32,32	9,24	3,83	9,46	8,12	16,06	14,10	14,96
Nominal exchange rate (average Dec., L/US$)	477,88	511,25	516,62	526,24	573,29	525,83	505,66	502,90	499,77	538,32
Real effective exchange rate (% change + dep.)	-3,03	0,04	-6,54	-3,79	3,81	-13,51	-1,39	-3,27	-2,13	0,11

1/ Fiscal data and debt refer to the central government.

Sources: Central Bank of Costa Rica (BCH), Ministry of Finance (SEFIN), National Statistics and Censuses Bureau (INEC), and IDB.

MAP OF DONORS AND MAIN AREAS OF INTERVENTION

Country	Agency	Support Sector																			
		Environment and climate change	Natural disaster prevention	Education	Energy	Health	Water and sanitation	Rural infrastructure	Infrastructure	Local development	Social welfare and food security	Economic development (job creation)	Public finance	Agricultural sector	Private sector (competitiveness)	Regional integration	Security	Violence prevention	Rule of law	Governance	Civil society
BILATERAL																					
Germany	GIZ																				
Japan	JICA																				
Canada	Embassy																				
France	Embassy																				
Spain	AECID																				
Switzerland	COSUDE																				
USA	USAID																				
MULTILATERAL																					
World Bank	Multilateral																				
IDB	Multilateral																				
European Union	Multilateral																				
OAS	Multilateral																				
United Nations	Multilateral																				
CABEI	Multilateral																				

COMMENTS ON THE COUNTRY PROGRAM EVALUATION: COSTA RICA 2011-2014

Recommendation	**Management's response**
Recommendation 1: Strive to deepen the Bank's support for the dialogue on the formulation and implementation of public policies, potentially including the fiscal, innovation, and local productive development domains. The Bank could intensify its current support for the public policy dialogue. Depending on the interest expressed by the country, the Bank could provide support by using tools such as dialogue roundtables, interaction with presidential councils, and technical work with the Legislative Assembly. This should also include exploring with the government the possible use of policy-based loans.	**Partly agree.** In the policy dialogue and during the preparation of the notes and studies that are part of the process of preparing a new Bank Country Strategy, the Bank has placed different instruments at Costa Rica's disposal, including those suggested by OVE.[1] During implementation of the 2015-2018 strategy, this policy dialogue will continue to be deepened, including the fiscal, innovation, and productive domains. The form of financing to support these sectors will be selected as part of the process of determining programing with the Costa Rican government. Although Management agrees with OVE about exploring the possible use of policy-based loans, it considers it important to underscore the need to maintain the Bank's role in investment operations, which is why Management partly agrees with this recommendation. This is particularly relevant given that the main constraint on the country's growth is transportation infrastructure, because the poor condition of roads and problems with port capacity undermine the country's competitiveness. Given Costa Rica's infrastructure investment requirements and since the Bank has comparative advantages in financing investments, particularly with the use of a programmatic investment tool such as the Conditional Credit Line for Investment Projects (CCLIP), the importance of this type of lending modality is worth highlighting.
Recommendation 2: Support the country in seeking alternatives for attracting private investment through public-private partnerships, particularly in infrastructure. Although the recent experience of concessions in Costa Rica has been uneven, the IDB Group has played a positive role in putting these processes back on track. OVE believes the IDB Group could draw on its experience to help overcome the poor reputation that concessions currently suffer from. This might involve piloting new private participation arrangements; or using agencies specialized in implementing public-private partnerships that are capable of having a demonstration effect.	**Agree.** As part of implementing the Country Strategy 2015-2018, the Bank will continue to cooperate with the country in seeking options for attracting private investment. Technical cooperation will be used to continue support for the design and implementation of different kinds of public-private partnerships (PPPs), including concessions, and to identify viable projects, particularly in infrastructure. As one aspect of its participation in preparing the Country Strategy, the Vice Presidency for Private Sector and Non-Sovereign Guaranteed Operations (VPP) is drafting a private sector note that will include an analysis of the private investment context in the county and identify future opportunities for intervention, including support for the structuring of PPPs and attracting private investment for the transportation sector.
Recommendation 3: Help the country strengthen public governance capacities, particularly in areas related to project execution, procurement, and e-government. The Bank could help the country extend successful schemes deriving from the execution of its own projects to the rest of the public administration, including at the subnational level. For example, the use of programmatic schemes could be strengthened by targeting them on the consolidation of best practices. These practices could serve as a model for subsequent phases in which they will be applied to an increasing share of	**Agree.** In the period of the Country Strategy 2015-2018, the Bank will help to strengthen public governance capacities, particularly related to project execution and the strengthening of country financial management and procurement systems. Through its support for project execution, the Bank will continue to build up the governance capacities of executing agencies and will offer technical assistance for institutions responsible for execution. This will be enhanced by results-based portfolio review exercises that help to identify bottlenecks and possible solutions. Management agrees with OVE that the Bank could extend successful execution systems. For example, the results of the

[1] Studies were conducted on the following subjects: SME productivity, urban development, social welfare spending efficiency, education, telecommunications, justice, and water and sanitation.

Recommendation	**Management's response**
the public investment program. Similarly, support could be provided for the use of technological tools such as an effective public procurement system, or the extension of e-government initiatives to other areas of the public administration.	Bank's intervention through the Technical Infrastructure Unit (UTIF) to support project execution have led to government to wish to extend it by implementing similar mechanisms in different institutions that execute funds, with both own resources and funds from other multilateral agencies. The UTIF was able to streamline processes for obtaining building permits and shorten the times taken to contract works, which results in better portfolio performance. As for strengthening country systems, in the period 2015-2018, the Bank will continue to support public financial management, including strengthening of the Integrated Financial Management System (SIGAF) that supports the administrative and financial management of central government ministries and the leadership and oversight functions that correspond to the Ministry of Finance and the Office of the Comptroller General. It will promote dialogue to study possible improvements to strengthen the public procurement system through a comprehensive reform that includes leadership, control, and transactional efficiency.

SOVEREIGN DEBT SCENARIOS 2015-2018 (US$ MILLIONS)

	Base scenario				Alternative scenario			
	2015	**2016**	**2017**	**2018**	**2015**	**2016**	**2017**	**2018**
Approvals	**300,0**	**214,1**	**221,9**	**0,0**	**300,0**	**500,0**	**231,2**	**0,0**
Disbursements	**172,9**	**250,5**	**223,7**	**213,7**	**172,9**	**400,5**	**373,7**	**213,7**
Repayments	**40,1**	**54,6**	**56,5**	**68,4**	**40,1**	**54,6**	**56,5**	**68,4**
Net loan flows (disbursements minus repayments)	132,8	195,9	167,2	145,3	132,8	345,9	317,2	145,3
Debt to the IDB	**1046,9**	**1242,8**	**1410,0**	**1555,3**	**1046,9**	**1392,8**	**1710,0**	**1855,3**
IDB debt/GDP (%)	1,9%	2,2%	2,3%	2,4%	1,9%	2,4%	2,7%	2,7%
IDB debt/public external debt (%)	14,4%	14,9%	15,0%	14,6%	14,4%	17,6%	20,2%	20,7%
IDB debt/multilateral external debt (%)	40,1%	41,4%	41,8%	40,5%	40,1%	48,9%	56,2%	57,4%

DEVELOPMENT EFFECTIVENESS MATRIX

Costa Rica Country Strategy 2015-2018

STRATEGIC ALIGNMENT *This measures two dimensions: (i) the extent to which the objectives of the strategy are consistent with the country's development challenges and with the government's priorities and plans; and (ii) use of a mix of products (financial, knowledge, technical assistance) to attain the objectives, and identification of other cooperation agencies and their areas of action.*

Consistency of strategic objectives: *The CS identifies four strategic objectives and priority areas. 1) Support fiscal sustainability and improving the efficiency of public spending, 2) Improve the quality, efficiency and sustainability of productive infrastructure, 3) Strengthen the competitiveness of SMEs, and 4) Strengthen the strategy of human capital accumulation. The cross-cutting issues that are going to be mainstreamed in this CS are reinforcing Costa Rica´s evaluation and monitoring framework, strengthening the country´s budgeting process and its mechanisms, and gender and diversity. The country strategy priority areas are aligned with the country's development challenges and with IDB Institutional Strategy.*

Mix of products and participation by other donors: *The strategy proposes to use different Bank instruments such as sovereign guaranteed operations, NSG operations, and technical cooperation. The Strategy considers the involvement of other donors, such as: European Union, Central American Bank for Economic Integration and the World Bank, among others.*

EFFECTIVENESS *(This measures whether the country strategy is likely to achieve its intended objectives, through an examination of four dimensions: (i) the quality of the diagnostics on which Bank action is based in each area of work; (ii) the quality of the results matrix for the strategy; (iii) the use and build up of country systems; and (iv) the analysis of the lending framework.*

Effectiveness dimensions	
I. Sector diagnostics	%
- Identifies the main problems based on empirical evidence	100
- Identifies the main beneficiaries	100
- Identifies and measures the factors that contribute to the problems identified	100
- Presents the policy framework and a sequence for Bank intervention	100
- The diagnostic corresponds to the objectives presented in the strategy	100
II. Results matrix	%
- The expected outcomes are clearly defined	100
- The indicators are outcome indicators and are SMART	100
- The indicators have baselines	88

As part of the country strategy 6 sector notes were presented
-100% of the notes clearly identifies the main sector problems based on empirical evidence.
-100% of the notes identifies the potential beneficiaries in each area of intervention.
-100% of the notes identifies or measures the factors that contribute to the problems identified.
-100% of the notes of the notes identify the policy framework and a sequence for Bank actions.
-In 100% of the notes, there is consistency between the note and the proposed strategic objectives.

Results matrix: The section of the results matrix corresponding to the new strategic area includes 4 strategic objectives for Bank action, 8 expected results and 8 indicators to measure progress.
- 100% of the strategic objectives clearly identify expected outcomes.
- 100% of the indicators used are SMART.
- 88% of the indicators have baselines.

Country Systems: During this strategy period, the Bank will work with the country in strengthening the following subsystems: (i) information system; (Ii) framework agreements; (Iii) system abbreviated bidding and direct contracting for the purchase of common goods and services, equal to the method of comparison of the Bank's policies; and (iv) individual consultants. In addition, it will continue with reforms awareness of national procurement system, especially measures to strengthen the unification of electronic procurement systems.
In terms of financial management, the Bank will continue its support in strengthening the capacities of audit by the Comptroller General of the Republic (CGR) and with the support of National Accounting for the implementation of International Accounting Standards.

Lending framework: Bank support to the country could range between $736 million and US $1.031 billion. The base scenario is US$ 736 billion. In the base lending scenario the expected average annual approvals and disbursements are estimated to be $184 million and $215 million, respectively. In the high lending scenario, the expected average annual approvals and disbursements are estimated to be $257 million and $290 million, respectively.

RISKS. *This measures three dimensions: (i) identification of factors that actually do or might affect attainment of the proposed objectives; (ii) definition of mitigation measures; and (iii) monitoring mechanisms.*

The strategy identifies three risks that might jeopardize the country strategy implementation: the institutional risk, the fiscal risk and the risk of natural disasters and climate change. The CS identifies mitigation actions for all the risks, and monitoring actions for two of them.