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IDB INVEST

**COSTA RICA**

**IDB GROUP STRATEGY WITH COSTA RICA  
2019-2022**

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## ABBREVIATIONS

BIM	Building information modelling
CAF	Development Bank for Latin America
CCSS	Caja Costarricense de Seguridad Social [Costa Rican Social Security Fund]
CELADE	Latin American and Caribbean Demographic Center
CGR	Contraloría General de la República [Office of the Comptroller General of Costa Rica]
CONAVI	Consejo Nacional de Vialidad [National Road Council]
EIB	European Investment Bank
FDI	Foreign direct investment
GDP	Gross domestic product
ICE	Instituto Costarricense de Electricidad [State-owned electricity and telecommunications company]
IMF	International Monetary Fund
INA	Instituto Nacional de Aprendizaje [National Learning Institute]
LAC	Latin America and the Caribbean
LANAMME	Laboratorio Nacional de Materiales y Modelos Estructurales [National Laboratory for Materials and Structural Models]
MOPT	Ministry of Public Works and Transportation
MSMEs	Micro, small, and medium-sized enterprises
NFPS	Nonfinancial public sector
OECD	Organisation for Economic Co-operation and Development
OVE	Office of Evaluation and Oversight
PPP	Public-private partnership
RVAC	Red Vial de Alta Capacidad [High Capacity Road Network]
RVC	Red Vial Cantonal [Cantonal Road Network]
RVN	Red Vial Nacional [National Road Network]
SINIRUBE	Sistema Nacional de Información y Registro Único de Beneficiarios del Estado [National Information and Single Registry System for State Beneficiaries]
SME	Small and medium-sized enterprises

## EXECUTIVE SUMMARY

### **Economic and social context**

Costa Rica's economic, social, and institutional development has been relatively successful in terms of the Latin American region, enabling the country to achieve high rates of wellbeing. Nonetheless, persistent structural challenges have limited productivity and delayed convergence toward higher-income countries, while at the same time contributing to continued poverty levels and increased inequality. Worth noting in this regard is the fiscal imbalance, which has dampened investment and affected the business climate. In addition, the poor quality and lack of resilience of the nation's infrastructure have hindered competitiveness, while in terms of production there are few examples of linkage between multinational and local companies. Human capital, a Costa Rican asset, faces challenges in education quality and relevance, which impede access to the labor market. These challenges are also present at the territorial level, where they coexist with the significant environmental goals outlined in the National Decarbonization Plan 2018-2050.

### **The IDB Group in Costa Rica**

During the 2015-2018 country strategy period, the strategy set out four priority areas aligned with Costa Rica's National Development Plan 2015-2018: (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. Sovereign-guaranteed loan approvals totaled US\$1.039 billion, while approvals from the private-sector window totaled US\$178 million. In addition, 34 nonreimbursable technical cooperation operations were approved for a total of US\$9.8 million.

### **Priority areas**

The Bank will support the Costa Rican government's efforts to move forward on its social welfare, low-carbon economic development, and environmental resilience goals. The country strategy for the 2019-2022 period<sup>1</sup> will focus on four strategic pillars: (i) strengthening of public finance; (ii) development of quality and resilient infrastructure; (iii) productivity gains and narrowing of production gaps; and (iv) human capital accumulation for inclusion and competitiveness. These pillars are aligned with the Bicentennial National Development and Public Investment Plan 2019-2022 and the Bank's Update to the Institutional Strategy 2020-2023.

### **Indicative lending framework for 2019-2022**

Sovereign-guaranteed approvals are projected at US\$1.800 billion, subject to the availability of Bank resources and continued macroeconomic stability. The Bank will endeavor to leverage private-sector resources through public-private partnerships and cofinancing with other donors.

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<sup>1</sup> The country strategy for 2019-2022 will be in effect from the date of its approval by the Boards of Executive Directors of the IDB Group until 31 December 2022.

**Risks**

The main risks for implementation of the country strategy for the 2019-2022 period are: (i) macroeconomic risks, associated with the implementation of fiscal reforms, which could lead to social tensions; (ii) execution and institutional capacity risks; and (iii) risk of natural disasters and unforeseen climate events having a social impact and affecting public finance.

## I. SOCIOECONOMIC CONTEXT

- 1.1 The economic, social, and institutional development of Costa Rica has been relatively successful in terms of the Latin American region. Annual economic growth has averaged 5.3% over the past 50 years, exceeding the average for both Latin America and the Caribbean (LAC) (4.4%) and the Organisation for Economic Co-operation and Development (OECD) countries (3.4%). The population has virtually universal access to primary education<sup>2</sup> and health services, a stable democratic system, solidly entrenched rule of law, low levels of violence and insecurity, and innovative environmental conservation policies. These elements have translated to high rates of wellbeing and life satisfaction for the population. This progress has allowed Costa Rica to move forward on the process of accession to the OECD,<sup>3</sup> and the country is expected to attain membership in 2020.
- 1.2 Costa Rica's growth strategy has been based on trade liberalization and integration and on attracting foreign direct investment (FDI) as means of transforming the country's production and exporting profile. The creation of free zones, along with international promotion, helped attract large foreign companies, resulting in a rise in exports and their increased diversification and sophistication. High-technology exports, which in the early 1990s accounted for less than 5% of total exports, now exceed 35%. Costa Rica is today the largest exporter of high-technology products in Latin America and the region's largest per-capita exporter of goods and services. At the same time, FDI has made it possible to supplement national savings, create opportunities for better-paid employment, train human resources, and introduce new technologies.<sup>4</sup>
- 1.3 Despite these advances, challenges persist, the most formidable of which is fiscal sustainability. Fiscal sustainability, necessary for greater economic growth and social welfare, has been compromised by low tax revenue collection and an accelerated rise in current expenditures, which have dampened public investment and limited private sector growth. After repeated attempts to pass legislation aimed at correcting these imbalances, in December 2018 the country approved the [Law on Strengthening Public Finance](#), which is estimated to create an impact equal to 3.9% of the gross domestic product (GDP) and which, if successfully implemented, would reduce the central government deficit and stabilize the debt trajectory in the medium term.<sup>5</sup>
- 1.4 The contribution of productivity to economic growth has been limited, preventing Costa Rica from converging more rapidly toward high-income countries. In fact, productivity accounted for 25% of the economy's growth over the past 50 years, while in developing countries that have achieved a more successful convergence with more advanced nations, productivity's share was in excess of 50%. Capital is the factor that has contributed the most to economic growth, but its size has diminished. Comparatively speaking, based on its income level, Costa Rica invests less than it should, and this shortfall is reflected in part in infrastructure coverage and quality. This affects the

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<sup>2</sup> Primary school attendance is almost universal, this goal having been achieved two decades earlier than the average date for LAC.

<sup>3</sup> To date, there has been approval in 14 of the 22 substantive committees.

<sup>4</sup> For example, highly sophisticated medical devices.

<sup>5</sup> The reform would make it possible to stabilize the debt at about 60% of GDP. Article IV (International Monetary Fund, 2019).

competitiveness of the economy, while at the same time exposing the country's infrastructure to extreme climate events that are being augmented by climate change, resulting in annual losses equal to 0.17% of GDP.

- 1.5 Furthermore, Costa Rica exhibits a pronounced disparity in productivity levels between sectors and between enterprises of different sizes, as manifested in, among other things, a dearth of linkages and limited innovation transfer, whether production is aimed at the domestic or the foreign market. Thus, while 2% of the country's enterprises account for more than 70% of total exports, 73% of the enterprises export less than 1% of the total. Enterprises with low productivity levels have not shown any gains in either industrial complexity or value added. This, in turn, reflects an uneven institutional development in the productive sector and a business climate that creates elevated costs and lengthy times for enterprises, particularly local ones. Costa Rica is 47<sup>th</sup> in the global competitiveness ranking; red tape and a paper-based culture in government agencies stand out as obstacles to the development of small and medium-sized enterprises (SMEs).<sup>6</sup>
- 1.6 This set of factors has had an impact on the social arena. Over the last decade, poverty has persistently remained at about 20% of households.<sup>7</sup> Although relatively low in the Latin American context, this rate is 1.7 times the average for OECD countries. The country's poverty is due to a combination of factors, notably including educational deficits in secondary school and poor academic performance, particularly in rural areas and in the indigenous population; adolescent pregnancy and its impact on the educational path of young people; lack of relevance in training for employment; and disparities in access to social services. Inequality in income distribution has increased,<sup>8</sup> a trend that is associated with greater informality, limited high-quality job opportunities, and persistence of high salaries in the public sector. Inequities are also present at the territorial level. The San José metropolitan area<sup>9</sup> is economically more dynamic and socially more developed, in contrast to the areas bordering neighboring countries and the coastal areas, which have a greater concentration of districts with a low or very low Social Development Index (SDI).<sup>10</sup> Moreover, while the country has one of the highest social expenditure proportions in LAC, the services reflect challenges in term of quality and relevance.
- 1.7 The [Bicentennial National Development and Public Investment Plan 2019-2022](#) and the [National Decarbonization Plan 2018-2050](#) aim to put Costa Rica on a path that will allow it to achieve accession to the OECD, converge toward the levels of countries with a higher degree of development, and move forward on its goals of social welfare, low-carbon economic development, and environmental resilience. This will require, firstly, addressing the fiscal challenge, a key factor for achieving a stable macroeconomic environment conducive to sustained and more inclusive growth. Building on these fiscal strengthening efforts, it will be important to foster investment in sustainable and climate-change resilient

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<sup>6</sup> In 2017 there were 130,388 SMEs and 3,377 large companies. Of this total (including large companies), 64.2% were in the services sector, 22.4% in the commercial sector, 6.6% in the agricultural sector, and 5.3% in the industrial sector. SMEs accounted for close to 345,000 jobs in 2017. It should be noted that the Ministry of Economy, Industry, and Commerce (MEIC) includes microenterprises in its definition of SMEs.

<sup>7</sup> In 2018, poverty in rural areas affected 25.1% of households.

<sup>8</sup> The Gini coefficient has risen from 0.497 in 2006 to 0.514 in 2018.

<sup>9</sup> The San José metropolitan area covers 1,967 km<sup>2</sup>, a landmass equivalent to 3.8% of the nation's territory, and is divided into 31 cantons and 164 districts.

<sup>10</sup> A tool based on administrative statistics encompassing education, health, citizen participation, economics, and security to better understand development status from a territorial perspective.

infrastructure to help advance the decarbonization goals and contribute to the fiscal objective by means of greater private sector participation through public-private partnerships (PPPs) and by leveraging cofinancing resources from other donors; improvement of the institutional and innovation environment for the development of competitive enterprises; and human capital accumulation.

## II. THE IDB GROUP IN COSTA RICA

### A. Implementation of the country strategy with Costa Rica 2015-2018

- 2.1 The Bank's country strategy with Costa Rica for the 2015-2018 period was principally aimed at contributing to the government's actions to achieve higher, more inclusive, and more sustainable growth and accelerate the pace of poverty reduction. To this end, the strategy prioritized four strategic lines of action: (i) support fiscal sustainability and efficient spending; (ii) improve the quality, efficiency, and sustainability of the productive infrastructure; (iii) make SMEs more competitive; and (iv) strengthen the human capital accumulation strategy. In addition, the strategy undertook to address institutional strengthening, gender equality and diversity, climate change, and environmental sustainability through crosscutting interventions. Implementation of the strategy emphasized management of the fiscal, institutional, and natural disaster risks. Accordingly, the Bank program was adjusted by balancing financial and nonfinancial instruments so as to properly respond to the context and achieve progress in the priority sectors. Consequently, the IDB Group maintained its position as Costa Rica's main multilateral partner and results were attained in all strategic areas.
- 2.2 **During the country strategy period,<sup>11</sup> the Bank approved seven sovereign-guaranteed loan operations<sup>12</sup> for US\$1.039 billion, including one policy-based loan operation for US\$350 million** that strengthens fiscal sustainability and public expenditure efficiency, and **six investment operations for US\$689 million.** Four of the latter focused on expanding the High Capacity Road Network in the San José metropolitan area, improving the quality of cantonal roads and the efficiency of border crossings, generating electric power through renewable sources,<sup>13</sup> and improving the electricity infrastructure; one investment operation supported infrastructure rehabilitation following the damage caused by tropical storm Nate; and one operation focused on improving police effectiveness and on actions to prevent youth violence.
- 2.3 **IDB Invest approved<sup>14</sup> 21 non-sovereign guaranteed operations for US\$178 million** to improve the educational offerings in science, technology, engineering, and mathematics, promote greater female participation in these professions, and expand access to finance for business investment projects, including support for SMEs, foreign

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<sup>11</sup> Number of operations and amounts from January 2015 to 30 September 2019.

<sup>12</sup> Border Integration Program of Costa Rica (CR-L1066); First Renewable Energy, Transmission and Distribution of Electricity Program (CR-L1070); Tropical Storm Nate Emergency Response Program (CR-L1135); Cantonal Road Network II Program (CR-L1065); Fiscal Sustainability Support Program (CR-L1081); Citizen Security and Violence Prevention Program (CR-L1137); and Road Infrastructure Program and Promotion of Public-Private Partnerships (CR-L1139).

<sup>13</sup> The program for electric power generation from renewable sources and improvement in electricity infrastructure was approved for US\$200 million in November 2015; however, the loan contract was signed for US\$134.5 million in February 2019.

<sup>14</sup> Data from 2015 to August 2019. Of total approvals, US\$36 million correspond to the Trade Finance Facilitation Program.



trade, housing access, and investment in machinery. For its part, IDB Lab approved nine technical cooperation projects for US\$6.0 million, emphasizing female entrepreneurship promotion, job markets, competitiveness of exporting SMEs, and strengthening of the public policy adoption process.

- 2.4 In addition, **34 nonreimbursable technical cooperation operations were approved for US\$9.8 million** in sustainable management of natural resources and addressing emergencies arising from natural disasters, as well as in transportation, energy, education, water and sanitation, competitiveness and innovation, health, social protection, and poverty reduction. Furthermore, there were two investment grants for US\$3.0 million to support the country's objectives in the context of the Salud Mesoamérica Initiative and the internationalization of agricultural SMEs.

## **B. Main outcomes of the country strategy<sup>15</sup>**

- 2.5 In a context of pronounced political fragmentation, high institutional complexity in implementing public investment projects, and fiscal uncertainty, the actions of the IDB Group paved the way for advances on the four pillars of the country strategy and the adoption of successful innovative approaches in the areas of women's entrepreneurship and reduction in adolescent pregnancy.

- 2.6 **Fiscal sustainability and the efficiency of public expenditure** were central issues on the agenda of the authorities and in the Bank's technical and operational dialogue with the country.<sup>16</sup> The Bank supported the technical guidelines of the fiscal reform approved in December 2018, providing the government with parameters to design and evaluate the performance of the reform and to facilitate discussions with the Legislative Assembly. On the expenditure side, the Bank evaluated the implementation of a fiscal rule making current expenditure growth conditional on output and debt growth, and of additional administrative measures to change the expenditure dynamics as well as the preparation of reforms in public-sector wage policy, public-sector employment, and the judiciary pension system. On the revenue side, the Bank developed the technical basis for introducing a generalized value-added tax and an income tax reform (more progressive).<sup>17</sup> To supplement these actions, initiatives were launched to facilitate the monitoring of public policies and the interagency coordination needed to ensure fulfillment of the objectives under the government plans. In this area, worth noting is the technical support provided in the social sector (paragraph 2.14), strengthening of the agencies responsible for the planning and execution of public investment at the sector level (paragraphs 2.7, 2.9, and 2.14), and introduction of results-based budget techniques.

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<sup>15</sup> Includes outcomes of the support provided through the portfolio in execution (legacy portfolio) as well as of the operations approved during the strategy period. As of 31 August 2015, the portfolio consisted of 12 sovereign-guaranteed loan operations for a total of US\$1,796.2 million, with an undisbursed balance of US\$1,190.6 million. In addition, there were 11 non-sovereign guaranteed operations for US\$319.7 million, with an undisbursed balance of US\$143.0 million.

<sup>16</sup> During the 2015-2018 strategy period, the Bank assisted in the design of the fiscal reform by means of technical cooperation operations and strategic dialogue (CR-T1097 and CR-T1127), as well as through a policy-based loan (CR-L1081).

<sup>17</sup> During the 2015-2018 strategy period, the Bank provided support through four technical cooperation operations. Of these, one was a legacy operation (Strengthening Fiscal Institutions in Costa Rica (CR-T1097)) and three were approved during the strategy period (Budget for Results (CR-T1127); Technical Support to the Ministry of the Presidency (CR-T1135); and Knowledge Exchange on Electronic Billing and Fiscal Risk (CR-T1171)).

- 2.7 In terms of **quality, efficiency, and sustainability of the productive infrastructure**, the most significant outcomes were in the areas of energy and transportation. In **energy**, the IDB Group emphasized helping to enhance generation capacity and service reliability based on renewable energy in a context of uncertainty due to climate change and the public transport decarbonization goals. In this regard, construction was completed on the Reventazón hydroelectric plant,<sup>18</sup> assuring electric power for more than 525,000 families and expanding Costa Rica's capacity to export energy to other countries in the region through the Regional Electricity Market. The New Energy Control Center became operational. The most modern facility of this kind in Central America, it will help to ensure the sustainability and reliability of electricity service for both residential and industrial customers. The share of electric power generation from renewable sources increased from 86.5% in 2014 to 98.6% in 2018, and support was provided for the procurement of electric vehicles to promote electromobility in the public sector. In terms of access, around 40 photovoltaic systems were installed, providing electricity service for isolated rural indigenous communities and rural schools.
- 2.8 In **transportation**, the Bank supported the country in elevating the quality of the national road network, enhancing the connectivity of rural areas, and designing a roadmap for a sustainable urban mobility model. The investments helped to build capacities in the sector, at both the national and cantonal levels, and to test results-based process management mechanisms. The most noteworthy outcomes include construction of the 50.6-km segment between Cañas and Liberia, which forms part of the Mesoamerican Pacific Corridor and thus assists in reducing the logistic costs of intraregional trade, facilitates tourism, and helps to enhance road safety.<sup>19</sup> In rural areas, 433 kilometers of roads and 31 bridges were built in all 81 cantons,<sup>20</sup> providing the population in these areas with better access to markets and services. In the context of the project that finances these works, the first program for routine road maintenance microenterprises was launched in four cantons. Each of these microenterprises consisted of 10 persons on average, including a total of 12 women in technical and/or leadership positions.<sup>21</sup> In the area of urban mobility, a Comprehensive Sustainable Urban Mobility Plan was completed with Bank financing for the San José metropolitan area. This gave rise to initiatives aimed at transforming the bus system in the city with a view to making this service more efficient and contributing to the decarbonization goals.<sup>22</sup> In the area of innovation, pilots have been implemented for the use of drones for works inspection, and the building information modelling (BIM)

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<sup>18</sup> Coordinated IDB and IDB Invest financing in operations CR-L1049 (Power Sector Development Program 2012-2016) and CR-L1056 (Reventazón Hydroelectric Project). In 2019, the International Hydroelectricity Association awarded the Blue Planet Prize 2019 to the Reventazón Hydroelectric Project, noting the good sustainability practices employed in the process of building the plant.

<sup>19</sup> High standards of quality, physical separation between directions, pedestrian bridges between communities, and shoulders of regulation width are some of the factors that have improved safety in this segment.

<sup>20</sup> As of May 2017, Río Cuarto de Alajuela became canton 82 in Costa Rica.

<sup>21</sup> In addition, work was completed on the "Paso Ancho" overpass and the expansion of the arterial road and bridge in the segment between Pozuelo and Jardines del Recuerdo. These works will help to streamline traffic and improve road safety in the capital city. Work was also completed on the Guacamaya overpass (part of the outer beltway in the metropolitan area). The design, bidding, and contract award process has been completed for the highway between Cañas and Barrancas, a 60-km segment that is part of the Pacific Corridor and provides continuity for the Cañas-Liberia highway. Other projects have been awarded, such as the project for improvement of the Caldera Port and the ferry terminals in the Gulf of Nicoya. These works are expected to be completed during the 2019-2022 country strategy period.

<sup>22</sup> Costa Rica is a beneficiary of operation RG-T3078 to support the adoption of hybrid and electric buses.

methodology has been put into use. In addition, the use of green pavements has been explored in collaboration with the National Laboratory for Materials and Structural Models (LANAMME).

- 2.9 In **SME competitiveness**, the actions of the IDB Group facilitated **access to finance for investment and foreign trade**, with an emphasis on women's entrepreneurship. The Bank supported the strengthening of innovation capacity and digital transformation and completed interventions aimed at promoting sustainable tourism, with a focus on participation by the local private sector. As a result, more than 23,000 micro, small, and medium-sized enterprises (MSMEs) obtained financing for investment projects and 28 businesses, including 21 SMEs, attained access to foreign trade financing services. These interventions also accelerated the business development process at more than 160 women-led SMEs,<sup>23</sup> and the participating banks developed financial and nonfinancial products to serve this market segment. These initiatives were scaled up, enabling 1,670 female beneficiaries to undertake economic empowerment initiatives.<sup>24</sup>
- 2.10 In **innovation**, an open innovation platform was developed to promote knowledge-intensive linkages between SMEs and driver companies, and pilots of financial instruments for innovation (seed capital and venture capital) were conducted with the development banking system, with scaling potential.<sup>25</sup> Lastly, the Bank supported the design and launch of the Strategy for Digital Transformation toward Costa Rica's Bicentennial as a first step in harnessing the potential of new technologies for increasing growth with equity.
- 2.11 In **tourism**, with the Bank's support,<sup>26</sup> the country developed a sustainable tourism strategy and introduced management tools informed by conservation and market criteria with a view to promoting sustainable development of the sector with the economic participation of the communities. As a result, 11 national parks now have adequate facilities for tourism, the parks have a better management system, and the municipios are better able to identify actions to bolster the local economic benefits of tourism expansion. The project also involved strengthening the capacity of microenterprises to address the flow of visitors to the area, as well as the mechanisms to ensure the financial sustainability of the protected area system and maintenance of the parks. In addition, construction methodologies were developed to provide access to individuals with disabilities, notably including the Caño Negro pier, the first in Central America to be certified by the National Council for Persons with Disabilities.<sup>27</sup>
- 2.12 Within the **human capital accumulation** pillar, the Bank's financing and technical assistance were aimed at strengthening the skills and assets of the vulnerable population groups through actions in the education, citizen security, social protection, and health sectors, combined with a strengthening of information and interagency coordination tools. In **education**, the Bank worked with the authorities to reduce the lag in education infrastructure, introducing components aimed at elevating the quality of the educational environment in the schools targeted for intervention. As of March 2019, 24 works had

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<sup>23</sup> IDB Lab: CR-M1023 The Business Case for Supporting the Growth of Women-led Enterprises.

<sup>24</sup> IDB Invest.

<sup>25</sup> IDB Lab: CR-T1153 Innovation for Internationalization.

<sup>26</sup> Loan 1824/OC-CR, CR-L1001 Tourism Program in Protected Areas.

<sup>27</sup> Project completion report for operation CR-L1001.

been completed, benefiting more than 14,500 students,<sup>28</sup> and the relevant mechanisms were defined to enable the sector financially and operationally to undertake construction of the schools provided by law. To align the content of classroom education with the needs of a production sector characterized by increasing technological sophistication, a model for development of mathematical-logical skills through programming was tested at a group of schools that offer preschool education,<sup>29</sup> and pilots were modeled with the aim of preparing vulnerable youth to successfully join the knowledge economy.<sup>30</sup> This was combined with initiatives to facilitate collaboration between the public and private sectors with a view to creating mechanisms for feedback between the education system and the demands of the job market.<sup>31</sup>

- 2.13 In ***citizen security***, the Bank supported a comprehensive and preventive approach to citizen security, the centerpiece of the government's security and violence prevention policy, through a combination of investments in police infrastructure and social prevention methodologies. The achievements include: (i) implementation of a social crime prevention model at the local level in 7 Centros Cívicos para la Paz [Civic Centers for Peace] (CCP), offering activities that include supervised free time for children and adolescents aged 6 to 18 and peer-to-peer peaceful dispute resolution under a preventive and community approach; (ii) modernization of police infrastructure through the design and construction of 11 police stations in 6 provinces of Costa Rica; and (iii) adoption of a correctional services model at 3 new comprehensive care units, where 1,600 inmates receive remedial education and vocational training, and deployment of a new curriculum for correctional officers that for the first time explicitly focuses on human rights.<sup>32</sup>
- 2.14 In ***social protection***, the Bank supported a series of initiatives that have become entrenched as essential components of social policy: (i) it provided technical assistance and technological infrastructure to develop the National Information and Single Registry System for State Beneficiaries (SINIRUBE),<sup>33</sup> which currently contains integrated information from several ministries for more than one million Costa Rican households and is used for selecting beneficiaries of social programs; and (ii) it financed the algorithm for selecting participants that forms part of SINIRUBE. In addition, the Bank supported studies and workshops for the design and implementation of the Puente al Desarrollo [Bridge to Development] strategy, including a medium-term evaluation of the strategy that helped in

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<sup>28</sup> CR-L1053 Building and Equipping of Education Infrastructure. An additional 31 works are in construction and will be completed in the first quarter of 2020.

<sup>29</sup> CR-T1134 Mathematical Logical Thinking Skills through Education Technology in Preschool. The final line of the experimental evaluation is being collected.

<sup>30</sup> Under the IDB Lab operation CR-T1151 Matching New Workforce Skills to Knowledge Economy Demands, the Bank created the first virtual reality/augmented reality game for the development of soft skills in Latin America. Its use among the student population is expected to be scaled up through the partnership between Fundación Monge and the Ministry of Public Education.

<sup>31</sup> Through IDB Lab initiative CR-T1174 The Crystal Ball for Jobs of the Future in Costa Rica, a roadmap was created for modifying the education system in view of the new digital transformation paradigms.

<sup>32</sup> Loan 2526/OC-CR20. As of this date, the Bank is using qualitative methods to conduct process and outcome evaluations that are appropriate given the level of maturity of the intervention. The early effects of these interventions notably include active involvement and appropriation of the new preventive services by the communities, as well as use of the facilities. For example, an average of 4,500 adolescents and young people are enrolled in one or more artistic or cultural activities available at the five Civic Centers for Peace currently in operation, and sports events conducted at these centers have drawn 20,000 spectators.

<sup>33</sup> SINIRUBE, supported by the Bank, was created in 2013 as an institution attached to the Instituto Mixto de Ayuda Social [Public-Private Social Assistance Institute].

making adjustments to improve it. At present, the strategy has been implemented as part of social policy aimed at reducing extreme poverty, establishing a flexible framework for multisector coordination of services for vulnerable families.

- 2.15 In **health**,<sup>34</sup> through the Salud Mesoamérica Initiative 2015 and the Bank's technical assistance, a results-based approach was introduced to prevent school dropout due to pregnancy or maternity by female students and discourage risky behavior in the adolescent population in terms of sexual and reproductive health. In the former case, the Bank promoted an inclusive policy in schools to reconcile school participation by pregnant girls and mothers with pregnancy and postpartum care, using curriculum adaptation measures to enable these students to remain in school and providing appropriate spaces for lactation in the schools. In the case of health centers, the care and guidance model for adolescents in the health units of the primary care and hospital network was modified, encompassing 75% of the adolescent population in the regions included in the project. In addition, actions were undertaken to narrow the gap in contraception coverage, offering adolescents guaranteed access to a menu of modern methods in their respective health centers, enabling young women to make informed decisions on sexuality, protection, and prevention. The interventions to reduce adolescent pregnancy have proven to be successful<sup>35</sup> and significant in terms of raising the secondary school graduation rate. In addition, the Bank carried out institutional strengthening actions to facilitate these outcomes and their sustainability, while also institutionalizing the evaluation of technologies aimed at improving expenditures in health.
- 2.16 **Crosscutting themes.** The three crosscutting themes included in the country strategy were integrated into the various areas. To improve **public sector governance**, the Bank carried out actions in the fiscal area (particularly results-based budgeting) as well as in infrastructure, education, health, and tourism. The **gender and diversity** theme was incorporated into the Bank's initiatives for SME financing, health, transportation, electric power and rural electrification, water and sanitation, and production development.<sup>36</sup> In terms of **climate change and environmental sustainability**, the Bank provided technical support to the government in preparing the Decarbonization Plan 2018-2050<sup>37</sup> and nationally appropriate mitigation actions (NAMAs) in cattle farming and in bananas and plantains. In addition, environmental sustainability and resilience considerations formed part of the guidelines for the design of interventions in energy, transportation, tourism, and SME support, and took on greater relevance in the context of the natural disasters that occurred during the strategy period<sup>38</sup> and the competitiveness challenges related to the urban environment and the country's decarbonization goals.

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<sup>34</sup> Four operations: CR-G1001, CR-G1004, CR-T1111, and CR-T1129.

<sup>35</sup> In 2017, the adolescent pregnancy rate was the lowest ever recorded (14.7%). In the 2012-2016 period, the rate had ranged between 19.4% and 20%. According to the Caja Costarricense de Seguridad Social [Costa Rican Social Security Fund] (CCSS), the Salud Mesoamérica project in the country's Atlantic coast and southern areas succeeded in changing the approach to the adolescent population.

<sup>36</sup> In diversity, investments were completed to expand electricity service (CR-L1049), in social protection and health (CR-G1001, CR-G1004, CR-T1111, and CR-T1129), in water and sanitation (CR-L1024 and CR-X1009), and in the operation Human and Productive Empowerment for Indigenous and Afro-descendant Peoples (CR-T1157).

<sup>37</sup> The plan encompasses four areas: sustainable transportation and mobility; sustainable energy, construction, and industry; integrated waste management; and agriculture, land-use and land-use change, and nature-based solutions.

<sup>38</sup> The Bank approved three technical cooperation operations to address natural disaster emergencies (CR-T1137, CR-T1161, and CR-T1175), as well as a loan—Tropical Storm Nate Emergency Response Program—aimed at restoring serviceability on highways and bridges and drinking water service in the affected areas.

## C. Portfolio in execution and lessons learned

- 2.17 **Portfolio.** As of 30 September 2019, the Bank's portfolio in Costa Rica is comprised of 11 sovereign-guaranteed operations for a total approved amount of US\$1,929.0 million, including the transportation (37%), energy (20%), fiscal strengthening (18%), integration and trade (5%), water and sanitation (4%), citizen security (5%), competitiveness and innovation (2%), and education (9%) sectors, with an undisbursed amount of US\$1,331.9 million. In addition, 26 nonreimbursable operations for US\$32.8 million are in execution, including 23 technical cooperation operations for US\$9.8 million and 3 investment grants for US\$23.0 million. IDB Invest has an active portfolio composed of 25 operations and an exposure of US\$469.6 million focused on financial institutions, with an emphasis on SME support, infrastructure and energy, and the corporate sector. The IDB Lab portfolio is comprised of 17 operations for a total approved amount of US\$13.4 million, including 2 loan operations for US\$2.0 million and 15 technical cooperation operations for US\$11.4 million in innovation, SME financing, labor market, and decarbonization.
- 2.18 **Lessons learned.**<sup>39</sup> At the *strategic* level, the priority areas turned out to be relevant and remain so for the country. For the new strategy cycle, it will be important to consider the following lessons learned: (i) technical support can create key inputs for sustainable development;<sup>40</sup> in this regard, it is important to identify a program of technical cooperation projects with a medium-term outlook that provides solutions to the main challenges and facilitates innovation; (ii) given the political and institutional context, it is essential to identify interventions that are politically viable in the medium term so as to ensure they will be confirmed and implemented by different administrations and legislatures; (iii) participation by strategic partners<sup>41</sup> in conceptualizing and implementing operations in innovation is essential for the success of the interventions; (iv) advisory services can be useful in supplementing IDB Invest support to bank and nonbank financial institutions with a view to maximizing the development impact of operations intended to lessen credit constraints for underserved segments; and (v) the use of IDB Lab to test solutions for specific problems can pave the way for larger-scale operations or address challenges in existing operations.
- 2.19 At the *operational* level, the Bank tested innovative execution models<sup>42</sup> which, while slow in taking off, proved successful for moving forward in the priority sectors. This experience, coupled with the emphasis on execution during implementation, provides the following lessons: (i) faced with institutional complexities, approval of the operations should include a high degree of preparation<sup>43</sup> that enables advising of risks and the critical path for timely execution; (ii) the design of the operations should consider reinforcing the management capacities for infrastructure works in all sectors and not only in those traditionally associated with works of this type (transportation and energy); (iii) in the design of new

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<sup>39</sup> Information based on the project completion reports finalized during the strategy period (CR-L1001, CR-0150, CR-L1009, CR-L1023, CR-L1135, and CR-L1031), the semiannual portfolio meetings, and the OVE 2015-2018 Country Program Evaluation, among other sources.

<sup>40</sup> This was the case with the fiscal, climate change, and social development areas.

<sup>41</sup> For example, the foreign direct investment promotion agency in Costa Rica (CINDE), the Information and Communication Technologies Chamber (CAMTIC), and local universities.

<sup>42</sup> Such as the combined notion of trust and manager in the management of transportation programs.

<sup>43</sup> Design of works (including the studies that support these designs), environmental and social safeguard plans (when these are critical based on the type of intervention), and progress on the procedures required under Costa Rican legislation (environmental permits, land expropriation, etc.).

projects, consider the experience of management mechanisms that introduce incentives to expedite execution; (iv) when analyzing infrastructure projects, consider the PPP mechanism and take governance, social, environmental, and territorial issues into account in the evaluation; (v) conduct a detailed review of the operating and maintenance costs of the works in social sector operations to ensure sustainability and evaluate the fiscal impact upon completion of the works; (vi) structuring conditional credit lines for investment projects (CCLIPs) for infrastructure can reduce the risk of long legislative ratification processes but requires more detailed preparation to enable legislative approval; (vii) review with the Ministry of Finance the content of the loan contract approval laws to prevent delays due to legal interpretations of the operations' content; and (viii) in the area of SME access to finance, endeavor to grant loans in lower amounts for each enterprise instead of attempting to achieve targets for both number and volume of loans simultaneously.

### III. PRIORITY AREAS

- 3.1 Building on the foundations of the preceding strategy, the country strategy with Costa Rica for 2019-2022 will support the policies of the Government of Costa Rica, as reflected in its [Bicentennial National Development and Public Investment Plan \(2019-2022\)](#), to create inclusive, sustainable, and environmentally friendly economic growth through four strategic pillars: (i) strengthening of public finance, which is the central pillar of this strategy due to its critical importance for the sustainability of growth and the wellbeing of the population, undergirding all advances on the other three pillars; (ii) development of quality and resilient infrastructure; (iii) productivity gains and narrowing of production gaps; and (iv) human capital accumulation for inclusiveness and competitiveness.<sup>44</sup> The government's commitment to the health and stability of public finance and the goals of the National Decarbonization Plan 2018-2050 will be key elements in deepening the Bank's actions under the pillars of this country strategy.
- 3.2 Implementation of the country strategy for the 2019-2022 period will rely on existing portfolio operations and new IDB Group interventions. It will be aligned with the Update to the Institutional Strategy 2020-2023 (document AB-3190-2), the IDB Invest Business Plan 2017-2019 and its Update (document CII/GA-77-8), and the IDB Lab Business Plan 2019-2021 (document MIF/GN-235-3). In addition, the three thematic documents of IDB Lab (climate-smart agriculture, inclusive cities, and knowledge economy) will be taken into account when promoting operational alignment. Taking into consideration the lessons learned in the 2015-2018 country strategy and the recommendations of the Office of Evaluation and Oversight (OVE), the Bank will seek to strengthen the participation of, and synergies with, the private sector.

#### A. Strengthening of public finance

- 3.3 Costa Rica exhibits a fiscal imbalance resulting from stagnated tax pressure and an accelerated increase in current expenditure. At roughly 13% of GDP, tax pressure is lower than in countries of similar income. This is due to the small tax base, the large number of preferential treatments and systems and exemptions from the main types of taxes, as well as to structural and organizational deficiencies in the tax administration. Furthermore, the implementation of expansive policies following the global financial crisis of 2008 led to an

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<sup>44</sup> These pillars are based on the challenges identified in the study "Costa Rica: Country Development Challenges" (Annex I).

increase in current expenditures (from 13.2% of GDP in 2008 to 18.8% of GDP in 2018), in particular wages and salaries, noncontributory pension systems, and current transfers.<sup>45</sup> A large part of the current expenditure is due to the growth in the government wage bill,<sup>46</sup> which is the second highest in LAC. In addition, spending is highly rigid<sup>47</sup> and is inefficient. These challenges reflect a weak fiscal institutional structure that has prevented both proper coordination between revenue and expenditures and austerity controls through tools such as the fiscal rule, budgetary process, and results-based management evaluations.

- 3.4 As a consequence of this fiscal imbalance, the central government balance went from a surplus of 0.2% of GDP in 2008 to a deficit of 5.9% of GDP in 2018, the second highest deficit in LAC. At the same time, the public debt doubled in the last decade (from 24.1% of GDP in 2008 to 53.7% of GDP in 2018) and is poised to exceed 60% of GDP in the coming years. These developments have eroded the space available for public investment, which went from 1.7% of GDP in 2008 to 1.4% in 2018, one of the lowest levels in LAC and the OECD. In addition to the high debt level, the country faces challenges in managing this debt (in terms of maturities, rates, and currency). This increases the refinancing, interest rate, and foreign exchange risks and hinders management of the central government's cash flow. In the medium term, the demographic shift will create pressures on public expenditure through the pension system. The population over 65 will expand, going from 8.2% in 2018 to 13.0% in 2030<sup>48</sup> and 23.7% in 2050.<sup>49</sup> The disability, old age, and death system under the Caja Costarricense de Seguridad Social [Costa Rican Social Security Fund] (CCSS) faces a delicate actuarial situation and, in the absence of reforms, its reserve fund will be exhausted in 2030.
- 3.5 To meet part of these challenges, a fiscal reform was approved after almost two decades<sup>50</sup> and, if fully implemented, would stabilize public finance and strengthen the fiscal institutional structure. The approval of this reform is a step in the right direction toward reducing the financing needs of the central government,<sup>51</sup> which would in turn improve the dynamics of the debt and the confidence of the markets. Similarly, the creation and implementation of a fiscal rule on current expenditure will help to introduce greater discipline into the spending decisions, while an independent fiscal board will monitor compliance with the rule. The government's fiscal strategy also envisages, in the medium term, approval of the Law on Public Employment to improve the civil service and an institutional re-engineering<sup>52</sup> that will eliminate duplication of responsibilities and unnecessary roles in public institutions.

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<sup>45</sup> Eighty-five percent of transfers are allocated to education, the CCSS, and social programs.

<sup>46</sup> Costa Rica has one of LAC's highest levels of central government expenditure in wages and salaries as a percentage of GDP, total expenditure, and tax revenues (7%, 36%, and 45%, respectively).

<sup>47</sup> The largest components of current expenditure—wages and transfers—are highly inflexible. In addition, 8.0% of the GDP is allocated to public education and, as a result, more than 90% of the expenditure is predetermined.

<sup>48</sup> Fiscal impact of the demographic shift (Office of the Comptroller General of Costa Rica, 2019).

<sup>49</sup> Latin America and the Caribbean: Population estimates and projections (CELADE, 2019).

<sup>50</sup> Consists of four sections: I. Law on Value-added Tax (VAT); II. Law on Income and Profits Tax; III. Amendment to Law on Government Salaries; and IV. Fiscal Responsibility.

<sup>51</sup> These amount to 12.3%, 13%, and 14.1% of GDP respectively for 2019, 2020, and 2021. Approximately 50% of the debt matures between 2019 and 2024.

<sup>52</sup> Costa Rica is the Central American country with the largest number of public institutions (330 vs. 145 on average). "Social Expenditure in Central America, Panama, and the Dominican Republic at a Glance: 2007-2013." (Prat & Beverinotti, 2016 and Mideplan, 2019.)



- 3.6 On the expenditure side, there are opportunities to strengthen public finance governance and its contribution to faster and more inclusive growth. The efficiency of expenditures in health and education, which account for 60% of the annual budget (more than twice the respective percentage in emerging markets and OECD countries), faces challenges in terms of results. In the education sector, which annually receives 8% of GDP, a mere 40% of the workforce completed secondary school and the results of the PISA test lag behind those in OECD countries. Furthermore, most of the students who continue to tertiary education graduate in fields that are not in demand in the most dynamic sectors of the economy. In the health sector, the indicators are favorable with respect to LAC and the OECD. However, it is estimated that total sector expenditures will rise by 86% in real terms between 2016 and 2030 due to faster aging of the population and the epidemiological transition.<sup>53</sup> In addition, Costa Rica has the second-highest level of leakages from targeted expenditures in Central America.<sup>54</sup> These leakages amount to 1.9% of GDP and are primarily from tax expenditures, although leakages in social programs are close to 0.5% of GDP.<sup>55</sup> Leakages in transfers and the burden in public employee wages and public procurement<sup>56</sup> total 4.7% of GDP, which exceeds the average for LAC.<sup>57</sup> Costa Rica is also one of LAC's four lowest-ranked countries in terms of public investment governance. This is the result of challenges in public investment planning and prioritizing that affect governmental effectiveness and the execution of resources, as well as the implementation of large-scale investment projects.
- 3.7 Under this central pillar of the strategy, the IDB Group will deepen its support to the country's efforts to control current expenditure and increase tax revenue collection through initiatives aimed at strengthening the fiscal institutional structure and improving public governance and spending efficiency. The reform having been approved, the Bank will assist in its implementation in terms of revenue (electronic billing), public expenditure (employment reform and expenditure re-engineering), and improvement of the macrofiscal institutional framework (compliance with the fiscal rule and creation of an independent fiscal board). To bolster these actions, the Bank's initiatives will seek to strengthen the medium-term expenditure framework, taking into consideration, in the fiscal planning processes, the climate impact on the prioritized public investments and integrating the goals of the National Decarbonization Plan 2018-2050 where relevant. Similarly, the Bank will support the implementation of results-based management (RBM) at several central government institutions.<sup>58</sup> In terms of public debt management, support will be provided for the implementation of technical recommendations through IDB Group operations, coordination with other international agencies, and technical support to the Directorate of Public Credit.

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<sup>53</sup> Fiscal impact of the demographic shift (Office of the Comptroller General of Costa Rica, 2019).

<sup>54</sup> They include social programs, energy, and tax expenditure.

<sup>55</sup> Leakages in social programs tend to be lower in Central American countries, averaging 0.27% of GDP. Better spending for better lives" (Izquierdo, Pessino & Vuletin, 2018).

<sup>56</sup> They account for approximately 15% of GDP. The fragmentation of demand among multiple governmental agencies generates low-value contracts that are often executed using noncompetitive methods. Article IV (International Monetary Fund, 2019).

<sup>57</sup> Better Spending for Better Lives (Izquierdo, Pessino & Vuletin, 2018).

<sup>58</sup> The Bank is supporting the planning, budget formulation, and monitoring processes to strengthen results-based management in the central government with a view to making the use of public resources more effective (CR-T1127). In addition, through the use of resources from the C and D windows, the scope is being expanded to encompass a larger number of institutions.

- 3.8 The Bank will seek to make public expenditure more efficient by providing technical support to: (i) improve the selection of SINIRUBE beneficiaries; (ii) help in the implementation of the Public Procurement Strengthening Plan, including improvements in the regulatory framework for procurement; and (iii) improve operational and strategic management of pension policy to reduce medium-term fiscal risks.
- 3.9 The support of the IDB Group in this area is aligned with the Update to the Institutional Strategy 2020-2023 in the areas of strengthening the capacity of the State, establishing suitable institutional frameworks, and creating a more effective fiscal policy, as well as with respect to the crosscutting strategic pillar of climate change.

## **B. Development of quality and resilient infrastructure**

- 3.10 Costa Rica is approximately 35 years behind in terms of infrastructure, and improving and maintaining this infrastructure poses challenges with a view to bolstering the country's productive development and competitiveness. The principal challenges revolve around: (i) deficient quality and low resilience of the road, port, airport, railroad, and logistics infrastructure; (ii) limited sustainable urban mobility and its carbon footprint; (iii) high cost of electric power; (iv) low sanitation, sewerage, wastewater treatment, and solid waste management coverage and quality; and (v) limited coverage of telecommunication services.
- 3.11 In the last 10 years, public investment in infrastructure was 1.0% of GDP,<sup>59</sup> which is far from sufficient to meet existing needs. To take just the road sector, the annual investment requirements identified for 2019 to 2035 are 3.1% of GDP. The 2018 Global Competitiveness Index ranks Costa Rica 78<sup>th</sup> out of 140 countries in the infrastructure pillar,<sup>60</sup> with lags in the components of road infrastructure quality (124<sup>th</sup>/140) and road connectivity (111<sup>th</sup>/140). Although Costa Rica has one of the densest road networks,<sup>61</sup> 72.7% of the entire public network is gravel and dirt. In terms of the quality of the paved National Road Network (RVN), 4.5% was rated as "good," 33.4% as "fair," and 62.1% as "deficient" or "very deficient."<sup>62</sup> The state of the logistics and transport infrastructure, coupled with the management of the border crossings,<sup>63</sup> raises transportation costs by 4% to 12%,<sup>64</sup> affecting the main value chains,<sup>65</sup> which require specific routes to travel from the production hubs to the main local consumer hub (San José metropolitan area) and the regional and international consumer hubs. An additional challenge is the resilience of this infrastructure to climate change in view of the intensification of extreme climate events

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<sup>59</sup> Central Bank of Costa Rica, 2019.

<sup>60</sup> 2018 Global Competitiveness Index (World Economic Forum, 2018).

<sup>61</sup> The density is 76 km/100 km<sup>2</sup>, as compared to an LAC average of 30 km/100 km<sup>2</sup>. The road network, which spans more than 42,800 km (of which 27.3% is paved) is divided into the RVN, serviced by the Ministry of Public Works and Transportation (MOPT) and consisting of primary, secondary, and tertiary roads, and the Cantonal Road Network (RVC), totaling 29,000 km, managed by the municipios, and consisting of minor roads, local streets, and unclassified roads. In addition, the country has a Strategic Road Network (RVE) that spans 2,207 km and is comprised of the High Capacity Road Network (RVAC) (904 km) and regional distributor roads (1,303 km). The High Capacity Road Network is a network of multilane highways in both directions with full or partial controls at accesses.

<sup>62</sup> International Roughness Index from the University of Costa Rica's LANAMME.

<sup>63</sup> Absence of control components and obsolescence of equipment and furnishings at the control agencies.

<sup>64</sup> Border Integration Program (IDB, 2014).

<sup>65</sup> Pineapples, bananas, medical devices, dairy products, and tourism. Study underway for the Inter-American Development Bank (Georgia Tech, 2018).

generating human, physical, and financial losses.<sup>66 67</sup> These losses amount on average to 0.17% of GDP per year and could rise to 2.5% of GDP by 2025.<sup>68</sup>

- 3.12 The infrastructure for sustainable urban mobility also lags behind in the face of urbanization demands and climate change, affecting the productivity and welfare of the population. Of all cities in Latin America, San José has the largest number of motorcycles and the sixth-largest number of vehicles per capita.<sup>69</sup> In the metropolitan area, 60% of residents travel by private vehicle, creating traffic congestion, extending travel times,<sup>70</sup> and increasing the carbon footprint of economic activity. The transportation sector is one of those principally responsible for carbon emissions, accounting for 53.5% of the total. Thus, modernizing this sector through efficiency and environmental sustainability standards is essential for achieving the national decarbonization goals.<sup>71</sup>
- 3.13 In the road subsector, institutional fragmentation generates delays and inefficiencies in the execution of resources, which has led to an execution level of less than 50% of the authorized budget.<sup>72</sup> The project management failures are mainly related to public bidding processes and contracts with design weaknesses, owing to limited preinvestment, cost overruns,<sup>73</sup> limited supervision of work quality,<sup>74</sup> and lengthy bidding processes due to intensive use of the appeals system<sup>75</sup> on the part of bidders. In addition, this subsector lacks an appropriate employment framework for attracting and retaining highly qualified professionals,<sup>76</sup> thereby compromising the capacity of the State to carry out projects. The process for achieving environmental feasibility<sup>77</sup> for projects has room for improvement in terms of speed and certainty regarding the requirements as well as in terms of the criteria for identifying the projects that should in fact be subject to this process. Improving the planning and management of infrastructure projects and adapting the designs to the

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<sup>66</sup> According to the International Road Federation, Costa Rica is the most affected country in the Mesoamerican region, and it is estimated that 80% of the road drainages lack the capacity needed to absorb these water flows.

<sup>67</sup> Between 1998 and 2012, the country invested US\$680 million in repairing roads affected by hydrometeorological phenomena.

<sup>68</sup> Information taken from the Office of the Comptroller General of Costa Rica.

<sup>69</sup> Desarrollo Urbano y Movilidad en América Latina (Development Bank of Latin America, 2011).

<sup>70</sup> In San José, the average travel time by public transportation is 1.46 times the average travel time by automobile and one quarter of the population spends two hours a day traveling to its destination. The loss of time due to vehicular congestion totals 2% of GDP.

<sup>71</sup> The goals include for 70% of buses and taxis to be zero emission and for the Rapid Passenger Train to operate 100% electrically by 2035. MINAE (2018), [Decarbonization Plan 2018-2050](#).

<sup>72</sup> Three-year period 2014-2016. "Análisis de los bloqueos para la gestión eficiente de la infraestructura vial y de saneamiento ambiental en Costa Rica" (IDB, 2019).

<sup>73</sup> Of a total of 59 projects in the LANAMME database, 79% experienced an increase from the original amount during the implementation of the works ("*Análisis de los bloqueos para la gestión eficiente de la infraestructura vial y de saneamiento ambiental en Costa Rica*") (IDB, 2019)).

<sup>74</sup> Due to a lack of procedures and capabilities for evaluating changes in the contracts, duplication of roles between CONAVI staff and companies subcontracted to perform supervision, and lack of well-defined responsibilities resulting in difficulties with accountability and establishment of penalties. Loría et al. (2013).

<sup>75</sup> In Costa Rica, protests by participants in bidding processes are governed by the national Law on Administrative Procurement and its implementing regulations rather than solely by the Bank's procurement policy.

<sup>76</sup> Seventy-three point four percent of the MOPT positions are for traffic police officers, machinery operators, and workers performing miscellaneous activities that require a low skill level.

<sup>77</sup> The Secretaría Técnica Nacional Ambiental [National Environmental Technical Secretariat] (SETENA), a decentralized agency attached to the Ministry of Environment and Mining (MINAE), is responsible for harmonizing the environmental impact with the production processes as well as analyzing environmental impact assessments.

challenges of climate change would elevate the quality, efficiency, and sustainability of public investment and open up greater opportunities for evaluating a more active participation by the private sector.

- 3.14 Business competitiveness is affected by the high cost of electric power. In all, 72.5% of industrial companies assert that the cost of electric power adversely affects competitiveness, particularly for large companies.<sup>78</sup> In recent years, Costa Rica has produced the highest rates<sup>79</sup> for the industrial sector<sup>80</sup> of any Central American country. The cost of electricity also limits the ability to attract FDI, since companies pay up to 3.5 times more for electricity than in countries such as Mexico.<sup>81</sup> In terms of the environment, while Costa Rica has a high rate of penetration and diversification of renewable energy sources in its energy matrix, 75% of it depends on hydroelectric power. This increases the seasonal vulnerability of the matrix to the availability of water and to the long-term impact of climate change. However, the nation's energy consumption is mostly based on oil,<sup>82</sup> primarily used in transportation, making it necessary to boost the efficiency of the (commercial and passenger) transportation systems and introduce electric vehicles. On the institutional side, the Instituto Costarricense de Electricidad<sup>83</sup> has been exhibiting a gradual decline in its financial condition, which jeopardizes the future sustainability of the sector, hinders the setting of competitive rates, and creates a contingent liability for public finance.<sup>84</sup>
- 3.15 With regard to the brown agenda challenges,<sup>85</sup> the country performs well in terms of water and basic sanitation coverage, but the outlook is negative in terms of sewerage and wastewater treatment.<sup>86</sup> Sewerage services cover only 21.5% of the population, while 76.4% of the population has a septic tank.<sup>87</sup> The financial sustainability of the sector is affected by the current rates, which are insufficient for generating resources for the operating and investment budget. Similarly, planning, preinvestment, and execution face challenges that hinder investments to improve coverage. With regard to wastewater treatment, it is estimated that more than 85% of discharges into surface sources are made without any type of treatment.<sup>88</sup> For its part, solid waste is the third-largest source of

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<sup>78</sup> (Costa Rican Chamber of Industries, 2017).

<sup>79</sup> Factors such as a quasi-monopoly structure, fragmented markets, barriers to entry, and oversized investment expenditures raise the cost of rates. "El sector eléctrico en Costa Rica" (Academia de Centroamérica, 2016).

<sup>80</sup> Statistics on the electricity subsector of the countries in the Central America Integration System (ECLAC 2017).

<sup>81</sup> Costo de electricidad, inglés y déficit fiscal amarran competitividad de Costa Rica (Rodríguez, 2017).

<sup>82</sup> In 2014, 63% of total consumption was supplied by hydrocarbons (State of the Nation Program in Sustainable Human Development, 2015).

<sup>83</sup> ICE (public-sector company), together with its subsidiary Compañía Nacional de Fuerza y Luz [National Power and Light Company] (CNFL), holds 72.5 % of the installed power generation capacity; distributes and sells 78% of the electricity; manages and operates the transmission network; and through its Kolbi brand holds a 63.7% share in the mobile telephony market. In 2015, 65.5% of the energy was generated by ICE, while 21.4% was generated by private-sector companies. "El sector eléctrico en Costa Rica" (Academia de Centroamérica, 2016).

<sup>84</sup> This situation is primarily the result of a substantial reduction in revenues from the sale of electricity due to a lower growth in demand for electric energy, which in turn is due to a number of factors, including the economic slowdown, structural changes in the patterns of economic growth, greater efficiency in the use of energy, and high electricity rates.

<sup>85</sup> Sanitation, atmospheric pollution, water pollution, industrial waste, etc. (ECLAC, 2009).

<sup>86</sup> After Nicaragua, Costa Rica has the lowest sewer system coverage in Central America.

<sup>87</sup> National Policy on Wastewater Treatment (AyA, MINAE, and Ministry of Health, 2016).

<sup>88</sup> National Policy on Wastewater Treatment (AyA, MINAE, and Ministry of Health, 2016).

emissions.<sup>89</sup> In Costa Rica, close to 4,000 metric tons of solid waste is generated daily, primarily by the residential and industrial sectors. While 80% of this total<sup>90</sup> is accounted for by recyclable waste, only 15% of this volume reaches collection centers.<sup>91</sup> Approximately 30% of the waste is not treated and 20% is left in open-air sites.<sup>92</sup>

- 3.16 The current state of the telecommunications infrastructure<sup>93</sup> and broadband penetration impedes digital transformation, improvement of the business climate, and innovation as well as efficiency gains based on the digital economy in both the private and public sectors.<sup>94</sup> Fixed broadband penetration is slightly higher than 10%, in line with the LAC average but below the figure for Uruguay (leader in Latin America with close to 25%) and the OECD (28%).<sup>95</sup> The coverage of fixed and mobile last-mile networks is characterized by low connection speeds when compared to those in OECD countries.<sup>96</sup>
- 3.17 Modernizing the infrastructure of Costa Rica in terms of both quality and coverage while paying attention to modern environmental standards requires a significant flow of resources. The complex fiscal outlook will limit public investment in infrastructure works in the coming years. In view of this, the introduction of new public-private arrangements through public works concessions becomes a necessity in order to address the persistent gap in the country. Costa Rica has had scant experience with PPPs and, in most of the projects that were undertaken, the concessions have not achieved the expected outcomes in terms of time frames and costs.<sup>97</sup> There are coordination challenges between the actors involved in the concession process, in addition to a limited capacity for structuring and supervising projects under this modality. While

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<sup>89</sup> Nationally Determined Contributions, 2015.

<sup>90</sup> National Integrated Waste Management Plan 2016-2021 (Ministry of Health, 2016).

<sup>91</sup> The United States has a 34.3% recycling rate (United States Environmental Protection Agency, 2017).

<sup>92</sup> State of the Nation Program in Sustainable Human Development, 2012.

<sup>93</sup> The market consists of 135 authorized operators and providers of telecommunication services.

<sup>94</sup> Of the 1,614 procedures managed by the central government, only 15% can be initiated and completed online (IDB study to be published in 2019). Similarly, growth is slow and there are limitations in terms of designing and implementing platforms and systems to interconnect the public entities and provide user-oriented services, leading to an inefficient use of public resources and higher costs for the business sector. "Broadband policies for Latin America and the Caribbean: A digital economy toolkit" (OECD-IDB, 2016).

<sup>95</sup> Broadband policies for Latin America (OECD-IDB, 2016).

<sup>96</sup> Such as those based on VDSL, DOCSIS 3.0, or even FTTH. "*Las telecomunicaciones y la banda ancha en Costa Rica*." IDB (García-Zaballos, González-Herranz & Iglesias-Rodríguez, 2014).

<sup>97</sup> Investments in infrastructure in LAC through PPPs increased from US\$8 billion in 2005 to US\$39 billion in 2015. This was due in part to improvements in the institutional framework and the degree of preparation for PPP activity, including the establishment of agencies and regulations solely for this type of partnership in many countries in the region. Evaluation of Public-Private Partnerships in Infrastructure (OVE, IDB 2017). In 20 years, only 5 projects have been carried out: San José-Caldera Highway Concession, Construction of New Passenger Terminal at the Daniel Oduber Airport, Caldera Port Bulk Terminal, Moín Port Container Terminal, and Juan Santamaría Airport (Infrascope 2019). In addition, the San José-Caldera Highway Concession project experienced cost overruns of up to 60%. In the case of both this project and the San José – San Ramón Concession project (canceled in the past), only one bid was submitted in the bidding process. Development Bank of Latin America, 2015.

Costa Rica has improved the institutional framework for concession arrangements<sup>98</sup> as well as its position in terms of measures related to a facilitating environment for the implementation of projects under PPPs (being ranked 7<sup>th</sup> out of 21 LAC countries),<sup>99</sup> it continues to face challenges in operationalizing specific initiatives and improving technical capacity<sup>100</sup> in the public sector.

- 3.18 Under this pillar, the actions of the IDB Group will be aligned to support the country in initiatives that lead to the structuring of new PPPs, an increase in the length and quality of the road network in good condition, greater development of the logistics infrastructure, a reduction in the emissions generated by the transportation system and in travel times, a comprehensive design of the electricity rate structure, and an increase in sanitary sewerage coverage.
- 3.19 In this regard, the IDB Group will continue to support the country in increasing the coverage, quality, and sustainability of the national road network (with an emphasis on the Strategic Road Network) and the cantonal road network and improving sustainable urban mobility, with a view to fostering economic activity and competitiveness as well as the quality of life of the Costa Rican population. In this strategy cycle, the Bank will deepen its support in strengthening the capacities to structure and manage PPP arrangements and will leverage initiatives to enable the country to move forward toward a more efficient, more resilient, and cleaner public transportation system in line with the national decarbonization goals. Similarly, the IDB Group will continue to help improve the logistics and regional integration infrastructure through Coordinated Border Management,<sup>101</sup> rehabilitate border crossings, and improve the national customs systems. Through the Digital Central American Trade Platform and interventions in border processes, it will seek to ensure that the region adopts common international trade standards.
- 3.20 The IDB Group will also direct its efforts to making the electricity sector more efficient and competitive by supporting financial reinforcement of ICE and the Public Utilities Regulatory Authority to redesign the rate structure toward a model that sends the necessary signals for attracting investment in the sector and for fostering efficiency.<sup>102</sup> Through coordinated actions, the IDB Group will continue to promote diversification of the electricity matrix, including the development of nonconventional renewable sources, financing of private-sector projects, and introduction of innovative long-term financing instruments to facilitate access to the capital markets for private developers.
- 3.21 To improve the quality and reliability of the water, sanitation, and solid waste management services and bolster the sector's resilience to the effects of climate

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<sup>98</sup> The legal framework for concessions consists of several sets of provisions: the General Law on Public Works and Services Concessions of 1998 (Law 7762), the 2008 amendment to Law 7762 (Law 8643), and the Statute for Private Initiative in Concessions of 2004 (Decree 31836). In 2016, a public policy for PPPs was established and the use of this type of contract became regulated under the Law on Administrative Procurement. On 17 July 2019, President Alvarado signed Law 9701 on Strengthening Efficient Models for Partnership between the Public and Private Sectors (PPPs), which amends and restates the General Law on Concessions of 1988 with a view to combating the weaknesses in the concept of a concession as set forth in that law.

<sup>99</sup> Infrascopes 2019.

<sup>100</sup> In airports and ports, the experience with concessions has been more positive, in large part due to the technical capacity of the entities involved.

<sup>101</sup> This is the basis for the Regional Strategy for Trade Facilitation and Competitiveness agreed upon by the Council of Ministers of Economic Integration of Central America.

<sup>102</sup> For example, a methodology based on a cost comparison with the costs of an efficient company.

change, the IDB Group will continue to provide technical support to the authorities, will prioritize the execution of the current operation,<sup>103</sup> and will explore opportunities to introduce PPP arrangements into the sector.

- 3.22 To address the shortcomings in the telecommunications infrastructure, the IDB Group will support initiatives aimed at achieving better utilization of the spectrum through a technological shift toward more advanced and higher-quality networks (5G testbed) with a view to narrowing the digital and connectivity gap, particularly in the most remote areas.
- 3.23 Spaces have been identified for joint intervention by the IDB Group windows with regard to the introduction of innovative approaches. Examples include intelligent transportation systems in urban and logistic transport, the use of BIM methodology to scale to build and manage infrastructure projects, and the protection of critical infrastructure from digital risks (cybersecurity).<sup>104</sup> With regard to gender, the IDB Group will explore women's participation in infrastructure.
- 3.24 The IDB Group's support in this area is aligned with the Update to the Institutional Strategy 2020-2023 in terms of achieving an inclusive infrastructure and expanded economic integration through infrastructure, as well as with the crosscutting strategic pillar of climate change. Similarly, the above-described priorities are aligned with the IDB Invest Business Plan 2017-2019, particularly with respect to support for the development of infrastructure. This area addresses the themes of inclusive cities and the knowledge economy, which are a priority for IDB Lab.

### **C. Productivity gains and narrowing of production gaps**

- 3.25 Costa Rica not only faces challenges in terms of boosting its productivity; there is a pronounced disparity<sup>105</sup> among the various productive sectors as well as among enterprises within each sector based on size. The productive apparatus is characterized by a dual structure, in which large, highly productive companies (both local and multinational) exist side by side with small domestic companies with low and dispersed productivity.<sup>106</sup> While this is not a fully binary situation, the less productive sectors tend to have a greater capacity to create jobs, albeit lower-skill and lower-paying. On the other hand, the more productive sectors, which are generally engaged in nontraditional agriculture and new services and are located in free zones, offer better jobs but have a lesser capacity to create employment. The link between the two groups in terms of commerce and innovation transfer is limited, making it difficult for the less productive sectors to join the major value chains.<sup>107</sup> At the same time, there are territorial imbalances. Thus, the regions closest to the San José metropolitan area are characterized by having

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<sup>103</sup> CR-L1024, Water and Sanitation Program.

<sup>104</sup> See pillar C for a better understanding of the challenges being faced in cybersecurity.

<sup>105</sup> There is a high level of productivity dispersion by business size in sectors such as agriculture, manufacturing, services, and commerce. Particularly in the services sector, the difference between the productivity median of microenterprises and that of large companies is 63% (Monge-González & Torres-Carballo, The dynamics of entrepreneurship in Costa Rica: An analysis of firm entry, exit and growth rates, 2014).

<sup>106</sup> Monge-González, Crespi, Beverinotti, and Torrentes. Confrontando el reto del crecimiento: Productividad e Innovación en Costa Rica, IDB 2019, pending publication.

<sup>107</sup> "The sales of local enterprises as suppliers of free zone companies do not exceed 20%-30% of the total purchases of these companies (OECD, 2018) and are mostly comprised of nontradable services and standard inputs that are ultimately not part of the final product (or service) of the multinational companies or, thus, of their production chains." Monge-González, Crespi, Beverinotti, and Torrentes. Confrontando el reto del crecimiento: Productividad e Innovación en Costa Rica, IDB 2019, pending publication.

greater density, better urban services, and sources of remunerative employment, making them more advantageous places to reside in, in contrast to more remote regions, which lack proper infrastructure and are characterized by lower education levels and more limited economic opportunities. Reducing these imbalances and boosting the growth of productivity (paragraph 1.4) requires multisector interventions that can reinforce: (i) improvement of the business climate and competition; (ii) a fostering of innovation in local businesses; (iii) the design of relevant financial products for the production sector; and (iv) deeper linkage of businesses to the export markets.

- 3.26 Improving the business climate is essential for boosting competitiveness. Costa Rica ranks 55<sup>th</sup> for global competitiveness, and governmental bureaucracy is the most problematic component of the business climate for business development.<sup>108</sup> Starting a business takes 2.7 times as long and is 3 times as expensive as the average in OECD countries. Both the disparity in the digitization of public agencies<sup>109</sup> and the time it takes to complete complex procedures are the result of regulatory and institutional weaknesses in digital governance and the limited interoperability of systems across agencies.<sup>110</sup> The direct consequences affect not only the public and businesses but also the quality of government expenditures.
- 3.27 In addition, while the country has an adequate legal framework and a national cybersecurity strategy, there are execution vulnerabilities in this regard. The areas with the most room for improvement include the cyber defense strategy, collective awareness of cybersecurity, education in this respect, responsible disclosure of information, protection of national critical infrastructure, and crisis management.<sup>111</sup>
- 3.28 Similarly, Costa Rica has institutional frameworks that inhibit competition and the emergence of new enterprises. A large number of markets and sectors are exempted from the Competition Law, resulting in numerous exemptions to the detriment of consumers.<sup>112</sup>
- 3.29 In addition, the reasons for low business productivity include insufficient investment in innovation, which is associated with lack of human capital training, limited investment in generic knowledge,<sup>113</sup> and scarcity of financial products for this purpose. The country devotes 0.6% of GDP to research and development, compared to an average of 2.4% of GDP<sup>114</sup> in the OECD. Furthermore, 57% of credit has been concentrated in commerce and services and only 0.3% in innovation and development.<sup>115</sup> The Costa Rican private sector lags behind that of other countries as a driver of innovation. Of Costa Rica's total spending in research and development, the private sector

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<sup>108</sup> 2018 Global Competitiveness Index (World Economic Forum, 2018).

<sup>109</sup> The Índice de Experiencia Pública Digital [Public Digital Experience Index] shows that a group of institutions offers advanced digital services while another significant group does not even have a website. The results of this index also indicate that the municipal sector lags in the delivery of digital services.

<sup>110</sup> Directory of agencies, codified catalogue of procedures, single identification and signature system, payment and collection gateway, one-stop portal, and others.

<sup>111</sup> The Bank and the Organization of American States issued the 2016 Cybersecurity Report, which analyzed the preparedness of 32 countries based on 49 cybersecurity indicators: <http://observatoriociberseguridad.com>. The evaluation of the 49 indicators yielded a score of 36 out of 100 for Costa Rica (88 points out of a possible 245).

<sup>112</sup> Peer review Costa Rica (OECD-IDB, 2015).

<sup>113</sup> Dualidad productiva y espacio para el crecimiento de las PYMEs en Costa Rica (Beverinotti, Coj-Sam & Solís, 2015).

<sup>114</sup> OECD Economic Surveys: Costa Rica 2018 (OECD, 2018).

<sup>115</sup> Dualidad productiva y espacio para el crecimiento de las PYMEs en Costa Rica (Beverinotti, Coj-Sam & Solís, 2015).



finances a mere 2.5%, as compared to 44.9% in Brazil and 17.2% in Argentina. However, Costa Rica has one of the highest percentages of individuals using Internet and the highest mobile broadband penetration in Latin America (95.5%).<sup>116</sup> These are favorable conditions for exploring the development of strategies and policies that can trigger a transformation toward a digital society.

- 3.30 The technology to support the productive transformation of SMEs and enable their articulation with export markets is essential with a view to boosting economic sophistication,<sup>117</sup> strengthening the productive linkages and clusters,<sup>118</sup> and contributing to a more balanced<sup>119</sup> and decarbonized growth. Costa Rica has the means to foster this growth both in tourism<sup>120</sup> and in agriculture. The country's natural capital creates the conditions to encourage the emergence of new entrepreneurs in these two sectors, aligned with the country's goals in terms of decarbonization, biodiversity management,<sup>121</sup> environmental protection, innovation, and digitization. Nonetheless, agriculture, which is the main economic activity in many rural areas,<sup>122</sup> continues to face technological challenges to its decarbonization<sup>123</sup> and contribution to the delivery of ecosystem services. In addition, while tourism has accounted for 5% of GDP and more than 40% of service exports in recent years, there is room for increasing its contribution to sustainable growth<sup>124</sup> and improving the management of the value chain to boost its impact on employment, inclusion, and generation of social benefits.<sup>125</sup>
- 3.31 Paving the way for the emergence of these innovation processes will also require more financing and specialized instruments. The challenges preventing MSMEs from boosting their productivity include access to and cost of credit for growth and limited ability to create bankable projects. The cost of credit to finance productive assets and for working capital is high, and there is a mismatch in time frames between the

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<sup>116</sup> State of broadband in Latin America and the Caribbean 2016 (ECLAC, 2016).

<sup>117</sup> Economic complexity is a measure of a society's body of knowledge as reflected in the goods it produces, helping to explain the differences in income between countries and to predict future economic growth. "The Atlas of economics complexity. Mapping paths to prosperity" (Hausmann & Hidalgo, 2011).

<sup>118</sup> A cluster is comprised of enterprises in one or more interrelated sectors, specialized providers, enterprises in ancillary and related sectors, distribution companies and customers, educational and research institutions (universities, laboratories, technology centers, etc.), and other institutions (governments, business associations) whose purpose is to work toward a continuous improvement in competitiveness, productivity, and continuous development of long-term competitive advantages. "The Competitive Advantage of Nations" (Porter, 1990).

<sup>119</sup> Countries that are economically more complex than expected for their income level tend to grow faster than those that are less complex than expected. In 2016, Costa Rica's economic complexity index was the second highest in LAC, after Mexico's, and put the country in 44<sup>th</sup> place globally.

<sup>120</sup> In 2016, according to the Adventure Tourism Development Index, the country was in 14<sup>th</sup> place globally and in 2<sup>nd</sup> place in LAC, after Chile.

<sup>121</sup> The management of biodiversity through payments for environmental services and the creation of new protected areas, both land and marine, enables an increase in productivity in the agricultural, tourism, and fishing sectors as well as greater infrastructure resilience. Costa Rica is an example to the world in terms of recovery of forest cover (52%, having had only a 25% cover in 1980) through the creation of protected areas, payment for environmental services, and a [biodiversity strategy](#).

<sup>122</sup> Where the poverty rate is double that of the urban areas, affecting 31.3% of the households.

<sup>123</sup> Twenty-five percent of the greenhouse gas emissions come from agriculture, forestry, and other land use. This figure is the difference between what the agricultural sector emits and what the forest captures (net sink).

<sup>124</sup> Technical cooperation document, Urban regeneration of the four central districts of San José (Chona, Bayona, Barragan & et al., 2017).

<sup>125</sup> Technical cooperation document, Urban regeneration of the four central districts of San José (Chona, Bayona, Barragan & et al., 2017).

products available on the market and the needs of business owners.<sup>126</sup> Less than 10% of the credit in the financial system is directed to SMEs,<sup>127</sup> which is a lower percentage than the average for both Latin America (12.4%) and the OECD (25.5%). With regard to information asymmetries, the financial entities detect a high risk in financing SMEs, which exhibit weaknesses in terms of equity, collateral, financial quality, and management. These factors contribute to the comparatively low entrepreneurial activity in the country.

- 3.32 Under this pillar, the IDB Group will coordinate its actions to contribute to the simplification and digitization of procedures and to help increase the proportion of the population with access to more advanced and better-quality networks. In addition, it will target actions to strengthen productive development based on high-potential and high-value-added linkages and clusters through better access to credit and improved exporting capacity by SMEs, as well as through a reduction in net carbon emissions. To this end, the IDB Group will seek to support: (i) simplification, digitization, and automation of procedures that affect business activities, logistics, and competitiveness; and (ii) strengthening of cybersecurity, by developing cybernetic security capacities for the various actors, reinforcing the relevant legal framework, and managing the risk; (iii) assistance with the reforms to strengthen the system of competition; (iv) intermediation of financial resources for productive investment, fostering new business models that create more efficient and inclusive products and services based on the use of digital technologies (fintech), benefiting SMEs and the most underserved segments;<sup>128</sup> (v) coordination among the various actors in the innovation system and strengthening of the agencies responsible for public policies in this area and for promoting clusters, including the orange economy cluster; and (vi) development of a service offering that facilitates the internationalization of businesses, through initiatives that foster an environmentally sustainable transformation of the exportable agricultural and agroindustrial supply and support resilience and emissions reduction in the sector.
- 3.33 The interventions under this pillar will incorporate a territorial vision, a vision of environmental sustainability and climate resilience, and a gender approach aimed at narrowing the gaps in the areas lagging furthest behind, where the various links of the main value chains are present and where there is a concentration of women and youth living in poverty. On a preliminary basis, synergies are identified between the different IDB Group windows in terms of support to SMEs, the development of business models that include digital technologies (fintech), and through measures that support decarbonization.
- 3.34 The IDB Group's support in this area is aligned with the Update to the Institutional Strategy 2020-2023 by seeking inclusive development, financial inclusion for the most disadvantaged groups, greater and more sustainable productivity and innovation, and support in the face of climate change. The above-described priorities are aligned with

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<sup>126</sup> In Costa Rica, only 3.3% of the population aged 18 to 64 owns established enterprises, compared to 19.1% in Chile. The components lagging furthest behind are: human capital, internationalization, venture capital, product innovation, technology sector, process innovation, and acceptance of risk. *Entrepreneurship in Costa Rica: Stagnation in the transition to innovation* (Chávez & Fonseca, 2015).

<sup>127</sup> *Acceso de la MiPyme a los servicios financieros a partir de la implementación de la Ley 8634 del Sistema de Banca de Desarrollo* (Corrales & Sancho, 2013).

<sup>128</sup> The IDB Group and IDB Lab can coordinate the development of innovative credit solutions for the sectors facing the greatest restrictions in the credit market; support partial credit guarantee programs and strengthen foreign trade finance through financial institutions. Providing support for financing in the early stages of enterprises will be particularly important.

the IDB Invest Business Plan 2017-2019, particularly with regard to support for infrastructure development, including social infrastructure,<sup>129</sup> and are consistent with two thematic areas of IDB Lab: climate-smart agriculture and knowledge economy.

#### **D. Human capital accumulation for inclusion and competitiveness**

- 3.35 Costa Rica has made significant strides in the social area and is considered a high human development country. However, in terms of human capital accumulation, it faces challenges that should be addressed to support the objectives of equity and growth. The aging<sup>130</sup> of the population, coupled with problems that are affecting the acquisition of skills by the school-age population and the younger segment of the workforce, are beginning to create an imbalance that is impacting the productivity of companies, the growth of new enterprises in the formal sector, and the adoption of new technologies and making it difficult to reduce poverty and inequality.
- 3.36 Few young people reach the diversified level and only 20% of those who enroll in secondary school graduate. This means that most of those who complete the education cycle and seek to join the labor market lack the skills to succeed in this process. In addition, 60% of those who obtain a university degree do so in disciplines associated with the humanities or education and only 10% earn a degree in engineering or basic science, which are the disciplines most in demand in the high-growth sectors. The youth unemployment rate is almost four times higher than the adult unemployment rate, affecting women in particular.<sup>131</sup> Informality<sup>132</sup> has been rising (40% to 60% of the economy is informal)<sup>133</sup> and close to 70% of the labor force works at low-complexity jobs. These problems tend to become exacerbated by the rapid advance of new technologies such as automation, the gig economy, and/or artificial intelligence. It is estimated that automation in Costa Rica could affect 52% of the occupations in the private sector, commerce being the most affected.
- 3.37 This situation reflects challenges existing throughout the population's formative period: low coverage and quality of preschool education (especially in low-income households),<sup>134</sup> high dropout rates<sup>135</sup> and limited quality<sup>136</sup> in secondary education, low

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<sup>129</sup> These proposals are aligned with the Update to the Business Plan approved in 2018 (document CII/GA-77-8).

<sup>130</sup> The country is at an advanced stage of demographic transition. It is estimated that, by 2030, the 65-year-and-older age group will go from 8.2% to 13% of the population. Office of the Comptroller General of Costa Rica.

<sup>131</sup> As of the 2<sup>nd</sup> quarter of 2019, the total female unemployment rate was 15%, 5.1 percentage points higher than the male unemployment rate (Instituto Nacional de Estadística y Censo [National Statistics and Censuses Bureau] (INEC)).

<sup>132</sup> Among other factors, the burdens of social security contributions are high, imposing a high labor cost and encouraging informality. Revenues from social security contributions in Costa Rica are the second highest in LAC, only exceeded by Uruguay's, and represent close to 30% of wages.

<sup>133</sup> As of June 2019, the INEC survey counted 1 million informally employed persons, of whom 593,000 were men and 419,000 were women. The informality rate among those living in extreme poverty and in poverty was 65.6% and 46.7% respectively. It is worth noting that the high rate of informality also affects tax revenues, exacerbating the fragility of public finances. To address this challenge, as indicated in pillar A, the country strategy will support the efforts to establish electronic billing, aiming for greater formalization of both individuals and legal entities.

<sup>134</sup> The access gaps between the lowest and highest income quintiles are in excess of 10% for children between five and six years of age.

<sup>135</sup> The secondary school completion rate is 40% and coverage at the diversified level has shown a drop in enrollment, which is now close to 40% and is thus lower than the regional average of 50%. The determining factors for secondary school dropout include the role of over-age and cumulative educational lag, learning difficulties, lack of student interest, and financial needs. Lack of student interest is associated with memorization-based teaching practices and a perceived lack of usefulness of the subjects' content.

graduation rates in the diversified<sup>137</sup> and tertiary education level, and limited relevance of the school curriculum and job training.<sup>138</sup> Added to this is adolescent pregnancy, which is associated with factors ranging from a lack of information and means to prevent the pregnancy to violence against women<sup>139</sup> and affects female participation in the labor market. Costa Rica has the second largest gap in Latin America between men and women in terms of labor force participation and employment.<sup>140</sup>

- 3.38 Compared to the OECD, Costa Rica has one of the lowest rankings in students' digital skills,<sup>141</sup> hindering the country's commitment to attracting high-value-added investments and preparing for jobs of the future with a high technological content. This is due to the high institutional dispersion and limited coordination in the job training sector, which prevents taking advantage of synergies among the entities engaged in the sector. Moreover, there is an absence of systems for identifying productive sector needs,<sup>142</sup> curriculum development, and training quality assurance systems. At the same time, there is a lack of information as to the labor market returns of the main career tracks offered and the quality of the available offering.<sup>143</sup> In addition, young people lack adequate information on job vacancies in the formal sector.
- 3.39 The accumulation of these disadvantages not only adds to the economic vulnerability and limited use of production opportunities in low-income households, but also results in a greater risk of criminal involvement by youth.<sup>144</sup> In 2017, 90% of homicide victims were men, 40% of whom were 18 to 29 years of age. However, the police force is limited, in terms of technical level and of management and infrastructure (technological and physical), in its ability to generate, manage, and analyze criminal evidence so as to address the growing risk of criminal involvement in the youth population.

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<sup>136</sup> Of 15-year-old students within the educational system, 46% perform poorly in science, 62% in math, and 40% in reading. Furthermore, roughly 66% of 15-year-olds both within and outside the educational system lack basic mathematics skills. "Latin America and the Caribbean in PISA 2015: How many students are low performers?" (Bos, Elías, Vegas & Zoido, 2016).

<sup>137</sup> Upon completing Cycle III, students may elect to continue with diversified studies, which last two to three years.

<sup>138</sup> Defined as including diversified education as well as higher education, both university and non-university, and the education offered by companies to their workers.

<sup>139</sup> In the 2015-2017 period, there were 164 intentional homicides perpetrated against women, and 22% of the victims were young women murdered mostly with knives or firearms. "Infografía violencia contra las mujeres 2015-2017" (COMESCO, 2019).

<sup>140</sup> The main reason why women are not actively looking for employment is the limitations in the child and senior adult care system, which make it inaccessible. "Better Jobs Index" (IDB, 2017).

<sup>141</sup> According to the OECD, digital skills, especially high-level skills, "allow innovation to prosper in a digital economy."

<sup>142</sup> Current and future skills are identified by the National Learning Institute (INA) in several industrial sectors, but this is done only every two to three years and the processes of converting the research findings to a study plan are slow. (OECD, 2017).

<sup>143</sup> According to the State of Education (2015), "accurate identification and quantification of the demand gaps in vocational and university training is difficult because the country lacks published prospective studies of needs at the sector level. In addition, the limited data available lack a robust methodological support and are not sufficient to determine the number of professionals and technicians that should be trained, much less the skills they should be taught."

<sup>144</sup> In Costa Rica, 1 of every 5 young people ages 15 to 24 neither studies nor works (State of the Nation Program, 2016) and only 4.5% of inmates have completed secondary school (Prison Survey, 2017). This group, which is vulnerable to dangerous activities, also faces a growing risk of low integration into the labor market. "Social Pulse in Latin America and the Caribbean: Realities and Perspectives" (Duryea & Robles, 2016).

- 3.40 Addressing these challenges involves additional complexities in the migrant population and the recipient communities.<sup>145</sup> Historically, Costa Rica has been a host and transit country for migrants, and it has one of LAC's largest proportions of migrant population relative to the total population (approximately 13%).<sup>146</sup> Recently, the social and economic conditions of some nearby countries have triggered a significant rise in migration,<sup>147</sup> putting pressure on the capacity of the State to provide basic services, particularly education.<sup>148</sup>
- 3.41 Under this pillar, the actions of the IDB Group will be aimed at supporting outcomes prioritized by the country with regard to expanding preschool enrollment in households in the lowest income quintile, lowering the secondary school dropout rate, increasing the productive sector's participation in developing the National Learning Institute (INA) curriculum, and reducing the homicide rate. The IDB Group will endeavor to work with the authorities and the private sector,<sup>149</sup> particularly in areas lagging furthest behind and with at-risk population, to: (i) increase the coverage and quality of preschool education; (ii) address the problem of secondary school dropout; (iii) boost the quality and relevance of the education system with a view to promoting the development of relevant skills for labor market and social integration consistent with a digital and decarbonized economy; (iv) address the quality and relevance of job training and the development of services that provide information on formal job vacancies; (v) strengthen the policy for prevention of adolescent pregnancy; and (vi) prioritize a preventive approach to crime,<sup>150</sup> addressing the social and emotional capacities of at-risk youth and giving the law enforcement agencies<sup>151</sup> the tools needed to make them more effective. In addressing **migration** and the host communities, the IDB Group will endeavor to reduce barriers related to school dropout in early education and secondary school with a view to boosting inclusion and sociocultural diversity. Spaces will be explored for coordination between the different IDB Group windows to identify potential synergies with the private sector for the implementation of projects in education and health<sup>152</sup> with an emphasis on inclusion and on sustainability and innovation.

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<sup>145</sup> Nicaraguans comprise a majority of the migrant community in Costa Rica (75%), while other migrants come from South America (8%), North America (5%), Panama (3%), and other Central American countries, the Caribbean, Europe, Asia, Africa, and Oceania (10%) (2011 Census).

<sup>146</sup> Primarily concentrated in the Huetar Atlantic, Central Pacific, Huetar North, and Chorotega regions and in some cantons in the Central region.

<sup>147</sup> While 67 asylum applications were received from Nicaraguans in 2017, more than 18,235 such applications were received between June and October 2018, in addition to more than 1,400 from Venezuelans.

<sup>148</sup> The education system has a total of 1,007,825 students, 4% of whom are of foreign origin (MEP, 2017). Between 2015 and 2018, the number of migrants attending school rose by 17% and the number of migrant children aged 4 to 6 attending preschool increased by 135% (National Household Survey). Similarly, secondary school dropout affects the migrant population, necessitating the implementation of an approach that takes into account the needs of this population group as well as inclusion and sociocultural diversity (National Statistics and Censuses Bureau, 2018).

<sup>149</sup> Finishing schools can help to build skills in line with a changing and dynamic labor demand that is growing in both size and quality. Several countries have implemented these programs to close the gap between formal education and industry requirements.

<sup>150</sup> "Conceptual Framework for Youth Development" (Duryea & Vivo, 2011) and "Citizen Security: Conceptual Framework and Empirical Evidence" (Abizanda, Serra-Hoffman, Marmolejo, Duryea, 2012).

<sup>151</sup> Attached to the Ministry of Public Security, exercising preventive and first response functions.

<sup>152</sup> IDB Invest will focus on interventions to reinforce the infrastructure for strengthening human capital, particularly in health and education.

- 3.42 The support of the IDB Group in this area is aligned with the Update to the Institutional Strategy 2020-2023 in the challenge of social exclusion and inequality and in its objective of developing quality human capital. It also reflects the knowledge economy theme of IDB Lab (from the standpoint of preparing young people for the jobs of the future).
- 3.43 **Crosscutting themes.** The IDB Group will endeavor to incorporate the following dimensions into the priority areas, as applicable: (i) adaptation to climate change, through designs to make the infrastructure more resistant to climate events, and support to the priorities under the National Decarbonization Plan 2018-2050. In particular, the Bank will work on urban mobility, transport electrification, land-use planning, resilient and low-carbon agriculture, environmental governance, and waste treatment actions; (ii) innovation, through actions that contribute to Costa Rica's digital agenda; and (iii) gender and diversity approach, particularly in the areas of infrastructure, entrepreneurship, financing, and education. The Bank will continue to work in the context of the Salud Mesoamérica Initiative and the Gender Parity Initiative<sup>153</sup> to reduce barriers preventing women from having access to opportunities on an equal footing with men and from being empowered in decision-making.
- 3.44 **Dialogue areas.** The execution of public investment projects will continue to be a central area of dialogue with the country. The Bank will seek coordination at various decision-making levels (political, technical, and consultation) and at the interagency level to anticipate problems, agree on solutions, and monitor actions. Sustainable and inclusive territorial development will be a dialogue area through which the Bank will seek to coordinate interventions aimed at promoting a metropolitan area and medium-sized cities that are sustainable, efficient, safe, inclusive, and resilient to climate change.<sup>154</sup>

#### IV. INDICATIVE LENDING FRAMEWORK

- 4.1 According to the Medium-term Budget Framework 2018-2022 and the projections in the Central Bank's Revised Macroeconomic Program 2019-2020, the central government's gross financing needs in the medium term will average 11.9%<sup>155</sup> of GDP, and they will be funded primarily (approximately 68%) through internal debt.
- 4.2 In view of the strides made by the country in terms of fiscal sustainability, enabling the use of all the Bank's instruments; considering the increased commitment to the execution of Bank projects on the part of the local counterparts; and subject to the allocation exercises for the Bank's Ordinary Capital resources, indicative annual approvals are projected to be approximately US\$450 million. Thus, the IDB financing for the 2019-2022 period is estimated at US\$1.8 billion in new approvals. According to this indicative scenario, the Bank's exposure in the country will remain at around 4.6% of the total debt and will account for 18%<sup>156</sup> of the nonfinancial public sector's (NFPS) external debt at the end of

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<sup>153</sup> Public-private plan that will be implemented in coordination with the Bank and the World Economic Forum.

<sup>154</sup> These issues relate to the challenges in knowledge economy and inclusive cities prioritized by IDB Lab, as well as to the rural development challenges prioritized in the Bank's Agriculture Sector Framework Document 2019-2022.

<sup>155</sup> The data provided by the Ministry of Finance assume an annual issuance of Eurobonds and consider the GDP revision by the Central Bank of Costa Rica.

<sup>156</sup> The estimate of the nonfinancial public sector's external debt is based on the (unpublished) projection of the external central government debt provided by the Ministry of Finance, which for 2019 includes the approval of US\$1.5 billion in Eurobonds and the approval of IDB and CAF loans. For 2020, it assumes approval of US\$1 billion in Eurobonds plus multilateral financing for a similar amount.

the strategy period (see Annex III), consolidating the Bank's position as Costa Rica's main source of multilateral financing.<sup>157</sup> During implementation of the strategy, the Bank will continue to support Costa Rica in the design and adoption of measures that contribute to macroeconomic stability, environmental sustainability, and improved project execution.

## V. IMPLEMENTATION OF THE STRATEGY

- 5.1 **Policy dialogue.** The IDB Group will maintain a high-level dialogue with the government and other significant actors (donors, civil society, etc.) on key issues for the country such as fiscal sustainability, efficiency of public expenditure, attracting private investment, access to finance, and goals for decarbonization and digitization of the economy.
- 5.2 **Continued emphasis on portfolio management and innovation in execution.** In line with the lessons learned, the Bank will work to: (i) promote results-oriented management; (ii) seek to establish a mechanism for coordination between the Bank and the Ministry of Finance regarding the content of the loan contract approval laws to prevent delays due to legal interpretations capable of affecting the launch of the operations; (iii) maintain a technical dialogue with the Office of the Comptroller General of Costa Rica to explore improvements in the procedures related to the management of Bank-financed projects in the country and to strengthen the information that feeds the monitoring system for technical cooperation operations; and (iv) work in preparing mature operations at the time of approval.
- 5.3 **Coordination within the IDB Group.** Based on the lessons learned, coordination among the Bank, IDB Invest, and IDB Lab makes it possible to test intervention arrangements that can be scaled or be a source of relevant information for the success of operations in execution or in preparation. To facilitate coordination, the following is proposed: (i) joint formulation and implementation of this country strategy, from policy dialogue to identification, preparation, and monitoring of operations that are guided by common objectives and maximize operational synergies; (ii) planning of joint missions for engagement with the authorities, especially in areas that require policy reforms and/or where there are evident synergies for working in a complementary manner; and (iii) organization of joint dissemination activities.
- 5.4 **Coordination with donors and leveraging of external resources.** The Bank envisages close collaboration with other donors in the areas of infrastructure (China, Japan, Spain, and European Investment Bank (EIB)), fiscal sustainability (International Monetary Fund (IMF), World Bank, Development Bank of Latin America (CAF)), social sector (World Bank), citizen security (United States Embassy), environmental sustainability and decarbonization (Agence Française de Développement (AFD), World Bank, EIB), and innovation (Korea and others). In addition, the Bank will continue with initiatives on exchanges of good south-south experience in various areas prioritized under the country strategy.
- 5.5 **Country fiduciary systems.** For the fiduciary management of operations, the Bank relies on execution supervision in the following country systems: (i) public procurement system: information, national competitive bidding, shopping, and individual consultants; and (ii) public financial administration system: budget, treasury, accounting, and external control. During the strategy, the Bank will continue to support strengthening the governmental control function through: (i) technical assistance to narrow the gaps

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<sup>157</sup> Excluding the Latin American Reserve Fund, the Bank accounts for 37% of the multilateral debt.

identified in the evaluation of the Office of the Comptroller General of Costa Rica (CGR) based on the SAI Performance Measurement Framework (SAI PMF) methodology developed by the International Organization of Supreme Audit Institutions; (ii) technical assistance to the CGR in the initiative to transform comprehensive oversight and institutional governance based on business intelligence; and (iii) evaluation of the quality of CGR audits of Bank-financed projects. In addition, through technical assistance, the Bank will continue to support the Ministry of Finance's Dirección General de Contabilidad Nacional [National Accounting Bureau] (DGCN) in implementing the International Public Sector Accounting Standards (IPSAS) and in designing and implementing a data analytics and strategic information management pilot that supports strategic decision-making at the DGCN. With regard to the governmental procurement system, the Bank will support the Ministry of Finance and the CGR in: (i) the use of the Sistema Integrado de Compras Públicas [Integrated Public Procurement System] (SICOP) in some of the procurement modalities included in the Acceptance of Partial Use of the Country Procurement System; (ii) implementation of the public procurement strengthening plan; (iii) introduction of improvements to the procurement provisions in the new General Law on Public Procurement and in the applicable appeals process for management of protests; and (iv) dissemination of events for public procurement knowledge transfer in national or regional networks.

- 5.6 **Environmental and social governance country systems.** Consistent with the provisions set forth in the Update to the Strategy for the Strengthening and Use of Country Systems (document GN-2538-31), and in view of the relevance of environmental and social issues in the region, the Bank is working to include strengthening of the environmental and social governance country systems in the Bank's dialogue with the country and in the strategy documents. The Bank's support will focus on improving the performance of the environmental and social governance systems at the national, subnational, and sector levels to implement environmental and social rules and regulations for the protection of natural resources and the population. The Bank thereby seeks to ensure consistency between the economic objectives and the environmental and social sustainability objectives. In the case of Costa Rica, which is one of the region's leaders on environmental issues, the Bank will support the country in strengthening the environmental and social governance systems in terms of the regulatory, institutional, and budgetary framework for environmental and social management required for the National Decarbonization Plan 2018-2050 and the goals of the National Biodiversity Strategy 2016-2025.

## VI. RISKS

- 6.1 **Macroeconomic risks.** The potential risks that may affect the implementation of the strategy notably include: (i) a partial implementation of the fiscal reform that fails to fully comply with the fiscal rule due to a volatile political context<sup>158</sup> precluding the approval of additional laws to make public finance more sustainable, such as the Public Employment Law; (ii) a slowdown in growth in the strategy period due to increased uncertainty among economic agents as to the implementation of the reform and the economic performance of the country's main trading partners, with the implications on trade, investment, and migration flows; (iii) the occurrence of adverse climate events that could exert greater

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<sup>158</sup> Increased fragmentation in the Legislative Assembly is emerging as a risk to the current administration's agenda. The governing party has 10 out of a total of 57 legislators. Seven parties are represented, and there is a block of seven independent representatives.



pressure on public finance while also affecting economic activity and the social situation of the most vulnerable population groups; (iv) more restrictive global financial conditions, raising the cost of financing for sovereign entities and economic agents; and (v) commodity price volatility, since Costa Rica is a net oil importer and is highly dependent on commodity exports such as banana, pineapple, and coffee. As a mitigation measure, the Bank will continue to support the sustainability of public finance in both technical and financial terms, coordinating with the government and other financial institutions on the design and implementation of measures to improve the fiscal balance and sustainability of the debt, while focusing its strategy on actions aimed at achieving a more inclusive and sustainable growth.

- 6.2 **Execution and institutional capacity risks.** The main risks faced by the sovereign-guaranteed portfolio, which are subject to continuous management, are related to delays in: (i) the start of operations due to the fact that preinvestment (including studies and designs, bidding documents, procurement execution strategy, expropriations and taking of possession of land, easements, and socioenvironmental management plans) is not at an advanced stage of preparation; (ii) execution of infrastructure projects in social sectors due to weaknesses in executing agencies or in the operational structure of the projects; (iii) the process of legislative approval<sup>159</sup> of the operations; and (iv) the procurement processes due to objections and appeals permitted under the local legislation. Some of the mitigation measures to be implemented are: (i) expedite preinvestment, using funds from current projects and ensuring that operations are more mature at the time they are approved; (ii) provide technical assistance in strategic fashion to shore up the identified weaknesses and strengthen this area through the design of the operations; (iii) encourage a continuous dialogue with the country's government and congress through the design of the operations to disseminate their development impact with a view to streamlining their legislative approval; and (iv) provide technical coordination with the authorities for joint review of bidding documents prior to their publication and of objections or appeals filed during the process; in addition, the Bank will maintain contact with the Office of the Comptroller General to identify avenues for improving the procedures associated with the procurement processes.
- 6.3 **Disaster risks.** The country is ranked 91<sup>st</sup> on the Global Climate Risk Index and exhibits a high likelihood of occurrence of extreme events such as floods, storms, or drought of considerable magnitude. A variety of extreme meteorological risks affect the country's infrastructure, including floods, landslides, droughts, and coastal flooding.<sup>160</sup> In addition, Costa Rica's productive matrix is vulnerable to these events,<sup>161</sup> as close to 27% of the country's exports originate in the agricultural sector.<sup>162</sup> As a mitigation measure, the Bank will include adaptation measures in its interventions in a crosscutting manner to help develop resilience to the impact of climate change, while at the same time continuing to support the country's decarbonization goals. In addition, the Bank will maintain a dialogue to identify mitigation measures through financial mechanisms such as contingent credit lines.

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<sup>159</sup> This situation could affect the approval and execution of the Bank programs envisaged under this strategy, including fiscal, decarbonization, education, and job training reforms.

<sup>160</sup> In addition, floods and landslides are more prevalent in Costa Rica than in other countries in the region, affecting business operations, especially in urban areas.

<sup>161</sup> Economist Intelligence Unit, 2017.

<sup>162</sup> Simoes & Hidalgo, 2011.

## ANNEX I: COUNTRY STRATEGY RESULTS MATRIX

Government priority	Priority area	Strategic objective	Expected outcome	Indicators	Baseline (source and year)
Economy for stability and growth	Strengthening of public finance	Improve the institutions for public expenditure control	Public expenditure control	Average growth rate of public expenditure in the last five years (%)	8% Average in the last five years Ministry of Finance-BCCR, 2018
		Improve the country's revenue collection levels	Tax revenue collection increases	Tax revenue as a percentage of GDP	13.2% Ministry of Finance, 2018
Infrastructure, mobility, and land-use planning	Development of quality and resilient infrastructure	Strengthen the institutional architecture of public-private partnerships (PPPs)	The structuring of new PPPs in the country materializes	Number of new active PPP contracts in the last four years	5 (2019) Medium-term Budgetary Fiscal Framework Ministry of Finance, 2019
		Improvement in the coverage, quality, and resilience of the transportation services and infrastructure for regional integration	The length and quality of the road network in good condition increases	Percentage of the Paved National Road Network in excellent or good condition <sup>163</sup>	11% National Laboratory for Materials and Structural Models (LANAMME), 2019
				Percentage of the Paved Cantonal Road Network in excellent or good condition	61% Ministry of Public Works and Transportation, 2017
			Greater development of the logistics infrastructure	Logistic Development Index	2.79 Logistic Performance Index Score, 2018 <sup>164</sup>
		The emissions generated by the transportation system are reduced along with travel times	Economic cost <sup>165</sup> of traffic congestion in the San José metropolitan area as a percentage of GDP	3.8% State of the Nation Report on Sustainable Human Development, 2018	

<sup>163</sup> LANAMME conducts a measurement along the paved surface, using a laser profilometer (which in turn measures length), resulting in the International Roughness Index (IRI) ranges. IRI ranges below 1 m/km are rated excellent, while those between 1 and 1.9 m/km are rated good. These results are consistent with the Falling Weight Deflectometer sections.

<sup>164</sup> From 1=low to 5=high.

<sup>165</sup> Estimated calculation based on the time it takes a person to travel to work with traffic from one canton to another. The calculation took into account the duration of these trips, the professional profile, and the value of work per hour for the inhabitants of each canton. That cost was then measured in free traffic flow (no congestion) situations and a monetary value was assigned to the difference.

Government priority	Priority area	Strategic objective	Expected outcome	Indicators	Baseline (source and year)
				Carbon emissions by the transportation sector	4.955 billion tons of CO <sub>2</sub> equivalent National Inventory of Greenhouse Gases and Carbon Absorption, 2012
		Strengthen the financial structure and competitiveness of the electricity sector	Comprehensive redesign of the electricity rate structure	Roadmap to Financial Sustainability and Competitiveness of the Instituto Costarricense de Electricidad (ICE) and its companies (ICE Group)	0 ICE
		Address the main “brown agenda” challenges in the water and sanitation sector	Sanitary sewerage coverage is expanded	Percentage of the population with access to sanitary sewerage	23.3% Acueductos y Alcantarillados [State-owned water and sewer company] (AyA); MINAE; Ministry of Health, 2016
Innovation, competitiveness, and productivity	Productivity gains and narrowing of production gaps	Improve the business climate based on the country’s digital agenda	Procedures affecting business activity and competitiveness are simplified and digitized	Ease of Doing Business score	68.9 (of a possible 100), Doing Business 2019
			The percentage of the population with access to more advanced, better-quality networks increases	Percentage of the population with access to 4G	41% International Telecommunications Union, 2015
		Improve the supply of, and access to, relevant financial products for the production sector, with an emphasis on SMEs, women-led SMEs, and SMEs in the export sector	The number of exporting SMEs increases	Percentage of SMEs that directly or indirectly export (at least 10% of sales)	12.2% Enterprise Surveys, 2010
			Credit penetration in SMEs increases	Percentage of SMEs that identify a lack of financing as the main obstacle in the business environment	39.7% small businesses and 45% medium-sized enterprises Enterprise Surveys, 2010
		Percentage of women-led SMEs with access to credit		45.4% Enterprise Surveys, 2010	
		Reduce the disparity in productivity between SMEs and large companies	SME productivity increases	Annual growth in labor productivity <sup>166</sup> (%)	-14.4%, -12.9%, and -4.9% for small, medium-sized, and large enterprises Enterprise Surveys, 2010

<sup>166</sup> Annualized labor productivity growth, where labor productivity is actual sales divided by full-time permanent employees.

Government priority	Priority area	Strategic objective	Expected outcome	Indicators	Baseline (source and year)
		Reduce net emissions in agriculture, forestry, and other land use (AFOLU) <sup>167</sup>	Emissions in agriculture, forestry, and other land use are reduced	Net AFOLU emissions (total emissions - absorption) <sup>168</sup>	1.2 million tons of CO <sub>2</sub> equivalent National Inventory of Greenhouse Gases and Carbon Absorption, 2012 <sup>169</sup>
			Emission absorption in agriculture, forestry, and other land use increases		
Education for sustainable development; human security; health; and social security	Human capital accumulation for inclusion and competitiveness	Increase the coverage of preschool education, with an emphasis on vulnerable and at-risk areas	The percentage of children aged 4 and 5 from households in the lowest income quintile who attend preschool increases	Preschool (ages 4 and 5) coverage for the lowest income quintile	55% National Household Survey, 2017
		Reduce dropout rate in secondary school	The dropout rate in secondary school is reduced	Percentage of intra-year dropout in secondary school <sup>170</sup>	7.2% Ministry of Public Education, 2017
		Improve the quality and relevance of training for 21 <sup>st</sup> -century jobs	National Learning Institute (INA) curricula are developed with the participation of a more competitive production sector	Percentage of implemented INA curricula that are based on job skills aligned with the National Qualifications Framework	0% INA
		Reduce homicides in the country's 40 most affected districts	The homicide rate is reduced	Homicide rate per 100,000 inhabitants	19.1 Annual Report of the Organismo de Investigación Judicial [Judicial Investigation Agency], 2018

<sup>167</sup> "Agriculture, forestry and other land use." This definition is given by the Intergovernmental Panel on Climate Change (IPCC): <https://www.ipcc-nggip.iges.or.jp/public/2006gl/vol4.html> and is used worldwide to create greenhouse gas inventories.

<sup>168</sup> Total emissions and absorption are reported, yielding the net result.

<sup>169</sup> This inventory is prepared every four years; the inventory for 2015 is under development.

<sup>170</sup> Obtained by dividing the number of dropouts in year t by the number of those initially enrolled for school year t. Students who do not complete the school year are considered dropouts. The calculation is made for each level and then for all secondary school students.

### MATRIX OF COUNTRY SYSTEMS

Use of country systems	Baseline 2018	Estimated use 2022	Actions envisaged during the country strategy period
Budget	100%	100%	Monitoring of new developments or improvements to the SIGAF that could affect the budget or treasury processes
Treasury	75%	100%	Monitoring of new developments or improvements to the SIGAF that could affect the budget or treasury processes
Accounting and reporting	0%	17%	<ol style="list-style-type: none"> <li>1. Support to the DGCN in preparing and implementing an action plan for the adoption of IPSAS</li> <li>2. Support to the DGCN in the development of a tool for identifying gaps in IPSAS adoption</li> <li>3. Support in the design and implementation of a data analytics and strategic information management pilot that provides support for strategic decision-making at the DGCN.</li> <li>4. Support for an executing agency pilot to develop a tool that makes it possible to issue consolidated reports on externally financed projects, taking the information available in the SIGAF as a basis</li> </ol>
Internal audit	0%	0%	No actions are envisaged.
External control	25%	25%	<ol style="list-style-type: none"> <li>1. Support to the CGR on the initiative to transform comprehensive oversight and institutional management based on business intelligence</li> <li>2. Support to the CGR in applying the SAI PMF and in implementing recommendations that may arise from the evaluation</li> <li>3. Quality evaluation of the CGR audits of Bank-financed projects</li> </ol>
Information system	83%	100%	Monitoring of the operation of, and adjustments to, the SICOP platform affecting the procurement processes financed by the Bank.
Shopping	0%	20%	The Bank will support the DGABCA and RACSA in making adjustments to the SICOP and the General Law on Public Procurement and its implementing regulations, providing technical advice on issues prioritized by the Bank for implementation of the changes and for agreement on a roadmap.
Individual consultants	0%	0%	
Partial NCB	0%	0%	
Advanced NCB	0%	0%	

## ANNEX II: MAIN ECONOMIC AND SOCIAL INDICATORS

	2013	2014	2015	2016	2017	2018
<b>Social indicators</b>						
Population (millions)	4.73	4.79	4.85	4.91	4.97	5.02
General poverty rate (% households)	20.7	22.4	21.7	20.5	20.0	21.1
Gini coefficient	0.52	0.51	0.51	0.52	0.51	0.51
Open unemployment rate	8.3	9.7	9.6	9.5	9.3	12.0
Nominal GDP (US\$ millions)	49,745.1	50,577.8	54,776.0	57,158.0	58,174.6	60,126.0
Nominal GDP per capita (US\$)	10,517	10,559	11,294	11,641	11,705	11,977
<b>Real sector (%Δ)</b>						
Real GDP	2.3	3.5	3.6	4.2	3.4	2.7
<b>Public finance (% of GDP)</b>						
<i>TOTAL REVENUE</i>	14.2%	14.0%	14.3%	14.7%	14.4%	14.3%
Current revenue	14.2%	13.9%	14.3%	14.6%	14.4%	14.2%
<i>Tax revenue</i>	13.2%	12.9%	13.2%	13.4%	13.3%	13.2%
Nontax revenue	0.2%	0.2%	0.4%	0.4%	0.6%	0.6%
<i>TOTAL EXPENDITURE</i>	19.6%	19.6%	20.0%	19.9%	20.5%	20.2%
Current expenditure	18.0%	17.9%	18.2%	18.1%	18.5%	18.8%
<i>Wages and salaries</i>	7.3%	7.2%	7.2%	7.0%	6.9%	6.9%
<i>Goods and services</i>	0.6%	0.7%	0.7%	0.6%	0.7%	0.6%
<i>Interest</i>	2.5%	2.6%	2.7%	2.8%	3.1%	3.5%
<i>Transfers</i>	7.5%	7.4%	7.5%	7.6%	7.8%	7.7%
Capital expenditure	1.6%	1.7%	1.8%	1.8%	2.0%	1.4%
<b>Fiscal balance</b>						
Central government	-5.4%	-5.6%	-5.7%	-5.3%	-6.1%	-5.9%
<i>Primary balance</i>	-2.8%	-3.1%	-3.0%	-2.4%	-3.0%	-2.3%
Rest of NFPS	0.1%	1.1%	0.7%	1.1%	1.2%	1.5%
BCCR	-0.8%	0.7%	0.8%	0.6%	-0.4%	-0.4%
Overall public sector	-6.1%	-5.2%	-5.7%	-4.8%	-5.3%	-4.8%
<b>Public debt (% of GDP)</b>	<b>54.6%</b>	<b>55.6%</b>	<b>57.9%</b>	<b>63.1%</b>	<b>64.5%</b>	<b>70.6%</b>
Internal	42.5%	41.7%	42.9%	47.9%	49.5%	53.4%
External	12.1%	13.9%	14.9%	15.3%	14.9%	17.2%
<b>Central government debt (% of GDP)</b>	<b>35.9%</b>	<b>38.5%</b>	<b>41.0%</b>	<b>45.2%</b>	<b>49.2%</b>	<b>53.6%</b>
<b>External sector (% of GDP)</b>						
Current account	-4.9%	-4.9%	-3.5%	-2.2%	-3.0%	-3.1%
Balance of goods and services	-2%	-2%	0%	1%	1%	1%
Foreign direct investment	5.5%	5.8%	5.0%	3.9%	4.9%	4.5%
Net international reserves (US\$ millions)	7,330.9	7,211.4	7,834.1	7,573.8	7,149.8	7,495.0
<b>Monetary indicators</b>						
Inflation rate (period-end)	3.7%	5.1%	-0.8%	0.8%	2.6%	2.0%

Source: Central Bank of Costa Rica (BCCR), Ministry of Finance, National Statistics and Censuses Bureau (INEC), and International Monetary Fund (IMF).  
 Note: Nonfinancial public sector (NFPS).

### ANNEX III: INDICATIVE FINANCIAL SCENARIO FOR SOVEREIGN DEBT 2019-2022

US\$ millions

	Country strategy 2015-2018				Country strategy 2019-2022				<i>Total 2019-2022</i>
	2015	2016	2017	2018	2019	2020	2021	2022	
<b>Approvals</b>	<b>300.0</b>	<b>0.0</b>	<b>20.0</b>	<b>144.0</b>	<b>575.0</b>	<b>500.0</b>	<b>475.0</b>	<b>250.0</b>	<b>1,800.0*</b>
Disbursements	173.4	154.4	164.6	259.4	445.9	505.6	610.6	186.6	1,748.7
Repayments	39.1	53.8	55.8	64.3	72.9	83.6	106.2	105.1	367.8
Net flows	-134.3	-100.6	-108.8	-195.1	-373.0	-422.0	-504.4	-81.5	-1,380.9
Subscriptions	1.7	1.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net capital flow	-132.6	-98.9	-108.8	-195.1	-373.0	-422.0	-504.4	-81.5	-1,380.9
Interest and fees	13.2	22.2	25.3	41.2	53.3	75.0	86.0	95.4	309.7
<b>Net cash flow</b>	<b>-119.4</b>	<b>-76.7</b>	<b>-83.5</b>	<b>-153.9</b>	<b>-319.7</b>	<b>-347.0</b>	<b>-418.4</b>	<b>13.9</b>	<b>-1,071.2</b>
									<b>Average</b>
Outstanding IDB debt balance**	<b>824.8</b>	<b>927.1</b>	<b>1,038.5</b>	<b>1,233.5</b>	<b>1,606.5</b>	<b>2,028.5</b>	<b>2,533.0</b>	<b>2,614.5</b>	<b>2,195.6</b>
IDB / Total debt (%)	2.6%	2.6%	2.8%	2.8%	3.4%	4.0%	4.6%	4.6%	4%
IDB / External public debt (%)	10.1%	10.9%	12.0%	11.6%	13.1%	13.7%	17.6%	18.0%	16%
IDB / Multilateral (%)	33.1%	33.0%	35.6%	28.4%	36.8%	42.7%	48.9%	46.3%	44%

Note: The total and external debt projections are based on the projections of the Public Credit Directorate, taking the central government as a basis. The NFPS external public debt assumes a difference of 16 percentage points over the central government public debt in the 2019-2022 period. The NFPS public debt assumes an average weight of 20.9% on the total public debt of the NFPS. The multilateral debt projections assume no changes in the average growth of the last decade, which is equivalent to 10% (excluding 2018 due to the loan from the Latin American Reserve Fund).

\* 2019 is the year of transition from the country strategy for 2015-2018, and the approvals for US\$575 million refer to the approvals of operations up to 30 September, namely: Fiscal Sustainability Support Program (CR-L1081), Citizen Security and Violence Prevention Program (CR-L1137); and Road Infrastructure Program and Promotion of Public-Private Partnerships (CR-L1139). No additional approvals are expected for the remainder of 2019.

\*\* The outstanding debt balance for the years 2015 to 2017 was obtained from the internal reports by the Bank's Finance Department. The differences between the figures published in the report and the calculation resulting from the debt in t-1 plus the net flows in t could be due to differences in the exchange rate used, among other factors. Starting in 2018, the formula Debt stock from the preceding year + net flows was indeed used.

## ANNEX IV: DEVELOPMENT EFFECTIVENESS MATRIX

<b>COUNTRY STRATEGY: DEVELOPMENT EFFECTIVENESS MATRIX</b>	
<p>In August 2008, the Board of Executive Directors approved the Development Effectiveness Framework (document GN-2489) to increase the evaluability of all Bank development products. The Development Effectiveness Matrix for Country Strategies (DEM-CS) is a checklist of the elements that are necessary to evaluate a country strategy. It is based on the evaluation criteria developed by the Evaluation Cooperation Group of the Multilateral Development Banks in the "Good Practice Standards for Country Strategy and Program Evaluation."</p>	
<b>COUNTRY STRATEGY: COSTA RICA</b>	
<p><b>STRATEGIC ALIGNMENT</b>  <i>Refers to the extent to which the strategy's objectives are consistent with the country's development challenges and the government's priorities and plans.</i></p>	
<p><b>EFFECTIVENESS</b> <i>(measures the extent to which the country strategy is likely to achieve its objectives, through an examination of four dimensions: (i) the quality of the diagnostic assessments that undergird the Bank's actions in each area of work; (ii) the quality of the results matrix for the country strategy; (iii) the use and reinforcement of the country systems:</i></p>	
Dimensions of effectiveness	
<b>I. Country diagnostic assessment – Country Development Challenges (CDC)*</b>	Yes/No
- Is comprehensive/holistic/complete	Yes
- Clearly identifies the main development challenges	Yes
- Shows magnitude of the main development challenges based on empirical evidence	Yes
<b>II. Diagnostic assessment of the priority areas</b>	%
- Clearly identifies and dimensions the specific constraints and challenges for the priority areas based on empirical evidence	100%
- Clearly identifies and dimensions, based on empirical evidence, the main factors or causes contributing to the specific constraints and challenges	100%
- Provides the appropriate policy recommendations	100%
<b>III. Results matrix**</b>	%
- The strategic objectives are clearly defined	100%
- The expected outcomes are clearly defined	100%
- The strategic objectives and the expected outcomes are directly related to the main challenges identified in the diagnostic assessment	100%
- The indicators are outcome indicators and are SMART	95%
- The indicators have baselines	100%
<b>IV. Vertical logic</b>	Yes/No
- The country strategy has vertical logic	Yes

\* This analysis includes any potential diagnostic document used to inform.

\*\* The results matrix is comprised of indicators that are meaningful to, and capture progress towards, the expected outcomes. The expected outcomes stem from the strategic objectives.



**Country diagnosis:**

As part of the Bank's country strategy with Costa Rica for 2019-2022, a diagnostic assessment of the country development challenges was presented under the title "Costa Rica: Country Development Challenges 2018." The diagnostic assessment is comprehensive and based on empirical evidence. Based on this diagnostic assessment and the dialogue process with the country, the country strategy will focus on four development challenges: (i) strengthening of public finance; (ii) development of quality and resilient infrastructure; (iii) productivity gains and narrowing of production gaps; and (iv) human capital accumulation for inclusion and competitiveness.

- The diagnostic assessment clearly identifies and dimensions 100% of the specific constraints and challenges for the priority areas based on empirical evidence.
- The diagnostic assessment clearly identifies and dimensions, based on empirical evidence, the main factors or causes contributing to the specific constraints and challenges for 100% of the priority areas.
- The diagnostic assessment sets out the policy framework and a sequence for Bank actions, based on empirical evidence, for 100% of the priority areas.

**Results matrix:**

The results matrix contains 14 strategic objectives for Bank action and 21 indicators to measure progress toward the intended strategic objectives.

- 100% of the strategic objectives are clearly defined.
- 100% of the expected outcomes are clearly defined.
- 100% of the strategic objectives are directly related to the main challenges identified in the diagnostic assessment.
- 95% of the indicators are outcome indicators and are SMART.
- 100% of the indicators have baselines.

**Country systems:**

For the fiduciary management of operations, the Bank relies on execution supervision in the following country systems: (i) public procurement system: information, national competitive bidding, shopping, and individual consultants; and (ii) public financial administration system: budget, treasury, accounting, and external control. During the strategy, the Bank will continue to support strengthening the governmental control function through: (i) technical assistance to narrow the gaps identified in the evaluation of the Office of the Comptroller General of Costa Rica (CGR) based on the SAI Performance Measurement Framework (SAI PMF) methodology developed by the International Organization of Supreme Audit Institutions; (ii) technical assistance to the CGR in the initiative to transform comprehensive oversight and institutional governance based on business intelligence; and (iii) evaluation of the quality of CGR audits of Bank-financed projects. In addition, through technical assistance, the Bank will continue to support the Ministry of Finance's Dirección General de Contabilidad Nacional [National Accounting Bureau] (DGCN) in implementing the International Public Sector Accounting Standards (IPSAS) and in designing and implementing a data analytics and strategic information management pilot that supports strategic decision-making at the DGCN. With regard to the government procurement system, the Bank will (i) support the Ministry of Finance in achieving improvements in and/or increased use of the Sistema Integrado de Compras Públicas [Integrated Public Procurement System] (SICOP) in some of the procurement modalities included in the Acceptance of Partial Use of the Country Procurement System of Costa Rica; (ii) support the Ministry of Finance in the implementation of the country's public procurement strengthening plan; (iii) support the CGR in improving the procurement provisions in the new General Law on Public Procurement and in the applicable appeals process for management of protests; and (iv) support the dissemination of events for public procurement knowledge transfer in national or regional networks.

**Vertical logic:** The country strategy has vertical logic.

**RISKS** (measures three dimensions: (i) identification of the factors affecting or capable of affecting achievement of the proposed objectives; (ii) definition of mitigation measures; and (iii) monitoring mechanisms):

The country strategy identifies three risks: (i) macroeconomic risks; (ii) execution and institutional capacity risks; and (iii) disaster risks. The country strategy proposes mitigation measures for these risks.

**ANNEX V: MANAGEMENT’S RESPONSE TO THE COUNTRY PROGRAM EVALUATION:  
COSTA RICA 2015-2018**

OVE recommendation	Management’s response
<p><b>Recommendation 1.</b>  <b>Work with the government to determine how best to support the country in its efforts to achieve fiscal sustainability by focusing on full implementation of the fiscal reform and on the structural changes needed to boost revenue and improve efficiency in the delivery of public services.</b> Accordingly, in the country strategy the IDB should emphasize support for implementation of the reform, and agree on the specific areas in which the IDB could lend its support (such as institutional strengthening, financial support, and helping to establish clear measures to improve efficiency and level the playing field between State-run and private entities to spur competition. Collaboration with other development banks and the IMF would reinforce the Bank’s efforts). The Bank should also consider adding clear measures to improve efficiency in the delivery of public services along its entire range of products.</p>	<p><b>Agree</b></p> <p><b>Actions proposed by Management</b></p> <p>Management concurs with OVE on the importance of the Bank’s continuing to prioritize fiscal sustainability in its relationship with the country, continuing the efforts made in the 2015-2018 strategy. The IDB supported the development of fiscal reform with technical assistance, particularly in the case of the design of the fiscal rule, which was finally passed by the Legislative Assembly in December 2018. The Bank’s support is currently focused on regulations for the reform, for which it has facilitated the exchange of good experience in the area of fiscal institutions, such as fiscal boards, to oversee compliance with the fiscal rule.</p> <p>Management is currently working with the authorities on the new country strategy and strengthening of public finance continues to be a major area of collaboration, with an emphasis on implementation of the recently approved fiscal reform. In terms of implementing the recommendation, specifically with regard to structural changes and/or efficiency in the delivery of public services, the sector scope and range of the Bank’s actions as well as the use of financial and nonfinancial products will be determined by the IDB Group’s dialogue with the government. This process takes into account factors such as the authorities’ agenda of reforms, the fiscal and political room available to undertake the reforms indicated by OVE, the actions of other partners, the institutional capacity of the relevant agencies, and the availability of Ordinary Capital resources.</p>

OVE recommendation	Management's response
<p><b>Recommendation 2.</b>  <b>Continue to support the country as it seeks to attract private investment through PPPs, particularly in infrastructure, and better integrate the IDB Invest operations into the country program.</b> The recommendation on PPPs in the last OVE CPE remains relevant, particularly given the limited fiscal space. The IDB Group has analyzed the PPP environment in Costa Rica. Depending on the country's priorities, the IDB can provide advice on the necessary legal and regulatory changes to improve the investment climate, strengthen institutions, and implement "model" transactions for replication. The IDB Group should build a broader role for the country representative so as to better integrate the IDB Invest operations into the country program and ensure that operations address key development needs in the country as well as strengthen value chains, increase competition in the financial sector, and provide finance in local currency.</p>	<p><b>Agree.</b></p> <p><b>Actions proposed by Management</b></p> <p>The IDB Group concurs with OVE on the importance of continuing to identify opportunities to support the private sector and to promote synergies between the different IDB Group windows. With regard to specific projects in execution, during implementation of the 2015-2018 strategy, the two windows coordinated actions in the energy sector in particular for generation from renewable energy sources.</p> <p>With respect to PPPs, the IDB Group promoted actions to foster a more conducive environment for the use of this modality in the country. Specifically, it facilitated PPP evaluation workshops and, through technical cooperation operations, sought to identify opportunities in infrastructure and urban development projects that were discussed with national and municipal authorities. It is worth noting that, as part of this effort, IDB Invest has been supporting the development of PPPs in the water and sanitation, solid waste, and transportation sectors. However, to date these efforts have not translated into financeable projects due to weaknesses in the regulatory framework and in the institutional structure in terms of managing PPPs. It is worth noting that IDB Invest will continue to work on the generation of bankable infrastructure projects in close collaboration with the Bank's PPP team in the context of IDB Group actions to improve the regulatory framework and the institutional structure.</p> <p>At present, the IDB Group is collaborating with the authorities in identifying road infrastructure projects that envisage PPPs and continues to offer technical advice to promote PPP projects aimed at improving the urban environment. The specific sectors and types of intervention to be covered by the new IDB Group strategy (financial and nonfinancial instruments) will reflect the priorities to be identified in the dialogue process and the opportunities that the authorities and the</p>

OVE recommendation	Management's response
	<p>IDB Group identify based on the country's institutional structure and the context for undertaking substantive reforms, such as in the financial sector.</p> <p>With regard to the role of the country representative in coordinating the actions of the IDB Group, IDB Invest Management acknowledges that this is a key factor for contributing to the operational cycle and facilitating synergies within the IDB Group and is in fact a general guideline for the work of IDB Invest in all countries. In the particular case of Costa Rica, the country representative has been essential in integrating the Bank and IDB Invest under a single vision in the discussions with the authorities that will give rise to the country strategy. For the implementation phase of the new strategy, the first to be carried out with Costa Rica under the new guidelines that strengthen public-private synergies, the role of the country representative will ensure that the new IDB Invest operations are aligned with the strategic priorities and that integrity issues of the counterparts are taken into account. In addition, the country representative will be crucial for the implementation of projects under PPP arrangements by facilitating the coordination of interventions that make it possible to address matters related to the institutional and regulatory fragmentation posed by this financing modality in Costa Rica.</p>
<p><b>Recommendation 3.</b>  <b>Continue with the focus on improving implementation of the IDB projects.</b>            Accordingly, the Bank will have to ensure better preparation of projects. It should collaborate with the government to find the best way to reduce delays in the confirmation process or at least take into account the long delays in the time frames and design of its projects, while ensuring that the PEUs have the proper experience and incentives for efficient implementation of the projects. In particular, given the large proportion of technical cooperation operations in the</p>	<p><b>Agree</b></p> <p><b>Actions proposed by Management</b></p> <p>Management agrees with OVE on the strategic value of the Bank's portfolio in the country and will therefore maintain the emphasis on execution under the new strategy. As pointed out in the OVE report, execution improved during this strategy cycle as a result of efforts to very closely monitor the operations with the execution units and of strong support to execution through technical cooperation operations. These initiatives yielded important lessons learned that informed the design of new operations. In</p>

OVE recommendation	Management's response
<p>country program, it will also be essential to introduce a better supervision system to evaluate the progress and outcomes of the technical cooperation projects.</p>	<p>particular, the Bank will seek: (a) to establish project management mechanisms geared towards results; (b) closer coordination with executing agencies and finance authorities in order to ensure agreement on regulations applicable to the execution framework for each operation, and (c) technical dialogue with the Office of the Comptroller General of Costa Rica to explore scope for improvements in procedures relating to IDB projects.</p> <p>With regard to the monitoring of technical cooperation operations, the Bank has had a monitoring and reporting system in place for technical cooperation operations (Technical Cooperation Monitoring, TCM) since 2016. This system includes, for each such operation, a results matrix for monitoring planned and achieved outputs and a findings and recommendations section with qualitative information on progress in execution and lessons learned, among others. In 2018, the Bank's Office of the Executive Auditor (AUG) performed an advisory service on the TCM which concluded that no other international financial institution has a system capable of capturing and disseminating the amount and quality of information that the Bank has with TCM. At present, it is mandatory to include the declaration of outcomes in TCM and it is optional to include the outcome indicators. Starting in August 2019, it will be mandatory to include the outcome indicators for operations of US\$1 million or more.</p> <p>With respect to Costa Rica, it should be noted that, due to the cutoff values for the migration of operations to the TCM in 2016, only 17 of the 33 technical cooperation operations considered by OVE in its evaluation were entered into TCM. At the moment, all technical cooperation operations in execution for the countries are in TCM. During the implementation of the new country strategy with Costa Rica, Management will seek to improve the level of detail of the outcome-related information feeding the TCM system.</p>

OVE recommendation	Management's response
<p><b>Recommendation 4.</b>  <b>Continue supporting the country in its environmental leadership, while also helping it to address some challenges and efficiency concerns.</b> The IDB could consider partnering with the country on initiatives or projects based on the experience gained using the natural resources capital for sustainable economic development; addressing "brown" environmental challenges in traditional IDB support sectors (sanitation, transportation, urban development); and promoting environmental efficiency and sustainable development considerations in private sector operations.</p>	<p><b>Agree</b></p> <p><b>Actions proposed by Management</b></p> <p>The IDB Group has supported Costa Rica in major environmental objectives and, in the context of implementation of the country strategy, these objectives were a constant in many of the financial and nonfinancial products approved. More recently, the Bank was instrumental in launching the decarbonization plan and, through the new country strategy, it will support its implementation.</p> <p>However, the scope and range of interventions will be the result of the dialogue with the country, the fiscal space, participation with other donors, and the country's progress in executing projects in specific sectors, such as water and sanitation and transportation. In urban development, the Bank has been working with the authorities on identifying investment priorities for sustainable development of the San José greater metropolitan area, and an advisory service is in process to enable the materialization of PPP projects.</p> <p>With regard to the private sector, IDB Invest will continue to promote environmental efficiency and sustainable development considerations through advisory services providing blended finance to mobilize private sector investment. Priorities in this area include resilient infrastructure and renewable energy, along with the incorporation of knowledge on climate change (for example, through energy efficiency appraisals, innovative clean energy financing models, and climate-smart agriculture solutions). This will be pursued through synergies with the IDB Group's interventions in the country.</p>