



COSTA RICA

December 2023

2023 ARTICLE IV CONSULTATION, FIFTH REVIEW UNDER THE EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY, SECOND REVIEW UNDER THE RESILIENCE AND SUSTAINABILITY FACILITY AND REQUEST FOR MODIFICATION OF REFORM MEASURE

In the context of the Article IV Consultation, Fifth Review Under the Extended Arrangement Under the Extended Fund Facility, Second Review Under the Resilience and Sustainability Facility, and Request for Modification of Reform Measure, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on December 21, 2023, following discussions that ended on October 27, 2023, with the officials of Costa Rica on economic developments and policies underpinning the IMF Extended Fund Facility arrangement, and reform measures supporting the IMF Resilience and Sustainability Facility arrangement. Based on information available at the time of these discussions, the staff report was completed on December 6, 2023.
- **Informational Annex.**
- World Bank **Assessment Letter.**
- A **Statement by the Executive Director** for Costa Rica.

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

- **Selected Issues.**

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

Copies of this report are available to the public from
International Monetary Fund • Publication Services
PO Box 92780 • Washington, D.C. 20090
Telephone: (202) 623-7430 • Fax: (202) 623-7201
E-mail: publications@imf.org Web: <http://www.imf.org>
Price: \$18.00 per printed copy

International Monetary Fund
Washington, D.C.



IMF Executive Board Concludes the Fifth Review under the Extended Fund Facility and Second Review under the Resilience and Sustainability Facility and Concludes 2023 Article IV Consultation for Costa Rica

FOR IMMEDIATE RELEASE

- The IMF Executive Board concluded the fifth review under the Extended Fund Facility (EFF) for Costa Rica, allowing for a disbursement equivalent to about US\$ 276 million.
- The IMF Executive Board also concluded the second review under Costa Rica's Resilience and Sustainability Facility (RSF) arrangement, making available about US\$ 495 million in support of Costa Rica's ambitious climate change agenda.
- Costa Rica is reaping the benefits from the home-grown reform program. To institutionalize progress, it is critical to continue adhering to the existing fiscal framework, restrain foreign exchange intervention, ensure compliance with the Public Employment Law, and restart central bank autonomy and governance reform.

Washington, DC – December 21, 2023: The Executive Board of the International Monetary Fund (IMF) completed today the fifth review of Costa Rica's economic reform program supported by the IMF's extended arrangement under the Extended Fund Facility (EFF). Completion of this review makes available SDR 206.23 million (about US\$ 276 million), bringing total disbursements under the arrangement to SDR 1.03115 billion (about US\$ 1.4 billion). The Executive Board also completed the second review under Costa Rica's Resilience and Sustainability Facility (RSF) arrangement. The completion of this assessment makes available SDR 184.7 (about US\$ 247 million) associated with this review and again makes available another SDR 184.7 million, which the authorities did not request be disbursed within the required 30-day window following the first review. The Executive Board also concluded the 2023 Article IV consultation with Costa Rica.¹

Costa Rica's three-year extended arrangement under the EFF was approved on March 1, 2021, in the amount of SDR 1.23749 billion (335 percent of quota in the IMF or about US\$1.8 billion at the time of approval of the arrangement, see [Press Release No. 21/53](#)) and was extended by five months on March 25, 2022 (see [Press Release No. 22/91](#)).

Costa Rica's RSF arrangement was approved on November 14, 2022, in the amount of SDR 554.1 million (150 percent of quota in the IMF or about US\$ 725 million at the time of approval of the arrangement, see [Press Release No. 22/382](#)). Its duration coincides with the period remaining under the EFF – disbursements under the RSF being contingent on the conclusion

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

of relevant reviews under the EFF and implementation of scheduled reform measures. The Costa Rican Legislative Assembly's Ratification of the RSF, which occurred on October 17, 2023, will enable the authorities to request disbursements made available by completion of assessments.

Real GDP growth is expected to reach around 5 percent this year, supported by buoyant exports and recovering domestic demand. Growth is expected to moderate to 3½ percent in 2024, which is broadly in line with the medium-term potential growth rate. Headline inflation has been negative as global commodity prices fell and a stronger currency helped to reduce goods prices. Inflation is expected to rise back within the Central Bank of Costa Rica (BCCR)'s tolerance band by mid-2024. The value of the *colón* has stabilized near its historical average in real effective terms and international reserves buffers are strong. Banking sector capital and liquidity metrics are comfortable and provisioning is adequate, although dollarization remains high. The ratio of gross debt-to-GDP has continued to decline despite the government's efforts to build up liquidity buffers. Staff projects a primary surplus of 1.5 percent of GDP this year and of around 2 percent of GDP over the medium term.

Following the Executive Board's discussion on Costa Rica, Mr. Bo Li, Deputy Managing Director and Acting Chair of the Board, issued the following statement:

"Costa Rica is reaping the benefits from its home-grown reform program. Strong implementation of the Fund-supported programs has enabled the country to restore confidence in the strength of its policy frameworks, withstand multiple external shocks, push forward key reforms, and achieve robust growth. Fiscal outturns have exceeded expectations, and the institutional framework for fiscal policy has been particularly valuable in achieving these results. Monetary policy has demonstrated its ability to react to inflation shocks and anchor expectations and reserves are adequate.

"The central bank should return to a neutral stance by mid-2024 and the exchange rate allowed to respond flexibly to market conditions. The BCCR has appropriately lowered the policy rate and should continue to do so to ensure that inflation converges decisively to the target. A more flexible exchange rate and greater transparency in central bank FX operations would allow monetary policy to have its full effect on activity and inflation and would incentivize the deepening of the FX market. Further institutional and technical reforms should be targeted at improving the functioning of the FX market and strengthening market participants' ability to manage currency risks.

"The authorities should continue pursuing improvements to the central bank's governance and autonomy. While the central bank is conducting monetary policy in an independent manner, these practices should be institutionalized through legislation. It is critical that the central bank's autonomy and other areas of improvements recommended in the 2020 Safeguards Assessment that remain unaddressed be followed up in a steadfast manner.

"Ongoing spending restraint is expected to continue to reduce the debt and interest burden and should be continued. Passage of the income and value added tax bills would improve the equity and efficiency of the tax system and raise revenues that have been eroded in recent reforms. Broadening the CIT base and abolishing income tax exemptions would further these objectives, reduce debt faster, and create more space for spending to improve public services. The implementation of the public employment bill by the executive branch marks an important milestone.

“There are ongoing efforts to make productivity gains more broad-based and to green the economy. The authorities should deepen their efforts to boost female labor force participation and integrate migrants into the formal labor market as part of their package of reforms to make growth more equitable. Efforts to increase digital connectivity, reduce electricity costs, and improve educational outcomes will boost productivity throughout the economy. Building on progress on both climate adaptation and mitigation, reform measures to publish guidelines to assess the climate impact of public projects, introduce a vehicle feebate scheme, expand climate transition fiscal risk analysis, and better evaluate climate change-related credit risks are all important steps to make the Costa Rican economy greener and more resilient.”

Executive Board Assessment²

Executive Directors commended the authorities for their strong implementation of the Fund-supported programs, which has enabled the country to restore confidence in the strength of its policy frameworks, withstand multiple external shocks, and achieve robust growth. To build on this progress, Directors encouraged continued fiscal prudence while supporting social assistance, carefully calibrated monetary policy, and structural reforms to broaden employment and support the green transition.

Directors agreed that monetary policy has demonstrated its ability to react to inflation shocks and anchor expectations. They agreed that the central bank should return to a neutral stance by mid-2024 and that the exchange rate should be allowed to respond flexibly to market conditions. Further institutional and technical reforms targeted at improving the functioning, deepening, and transparency of the FX market and strengthening market participants' ability to manage currency risks were encouraged.

Directors encouraged the authorities to continue pursuing improvements to the central bank's governance and autonomy, including through legislation. They stressed that the central bank's autonomy and other recommendations in the 2020 Safeguards Assessment should be addressed in a steadfast manner.

Directors commended the authorities for the impressive fiscal performance. They supported the ongoing spending restraint, which will help reduce the debt and interest burden. Directors encouraged passage of the government's income and value added tax bills to improve the equity and efficiency of the tax system and restore revenues. Broadening the CIT base and abolishing tax exemptions would reduce debt faster and create space for enhanced social and infrastructure spending. They welcomed reforms to improve fiscal transparency and spending, including implementation of the public employment bill.

Directors were encouraged by ongoing efforts to make productivity gains more broad-based and to build a greener and more resilient economy. They supported the authorities' efforts to boost female labor force participation and integrate migrants into the formal labor market, increase digital connectivity, reduce electricity costs, and improve educational outcomes to boost productivity throughout the economy. Directors welcomed progress on both climate

² At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: <http://www.imf.org/external/np/sec/misc/qualifiers.htm>.

adaptation and mitigation and the reform measures in the context of the RSF, which should help catalyze much needed climate financing.

Costa Rica: Selected Economic and Financial Indicators

	2019	2020	2021	2022	Projections					
					2023	2024	2025	2026	2027	2028
Output and Prices										
	(Annual percentage change)									
Real GDP	2.4	-4.3	7.9	4.6	5.1	3.5	3.3	3.3	3.3	3.3
GDP deflator	2.6	0.8	2.4	6.3	1.0	2.9	3.2	3.2	3.2	3.2
Consumer prices (period average)	2.1	0.7	1.7	8.3	0.7	1.9	3.0	3.0	3.0	3.0
Savings and Investment										
	(In percent of GDP)									
Gross domestic saving	14.8	15.2	16.1	14.7	13.8	15.0	15.6	15.8	15.8	16.0
Gross domestic investment	16.1	16.2	18.6	18.3	16.2	17.1	17.5	17.5	17.4	17.5
External Sector										
Current account balance	-1.3	-1.0	-2.5	-3.6	-2.3	-2.1	-1.9	-1.7	-1.6	-1.5
Trade balance	-6.0	-3.2	-4.3	-6.6	-5.3	-5.9	-6.1	-6.0	-6.0	-6.1
Financial account balance	-2.0	-0.4	-1.2	-3.2	-2.3	-2.1	-1.9	-1.7	-1.6	-1.5
Foreign direct investment, net	-4.2	-2.6	-4.8	-4.4	-3.6	-3.6	-3.6	-3.6	-3.6	-3.5
Gross international reserves (millions of U.S. dollars)	8,937	7,232	6,921	8,724	11,944	11,693	12,015	12,746	13,319	14,006
-as percent of ARA metric	132.5	108.4	97.8	101.7	122.9	115.8	114.3	114.4	113.7	113.8
External debt	47.8	49.6	49.7	51.7	47.3	45.4	45.0	45.2	44.9	44.6
Public Finances 1/										
Central government primary balance	-2.6	-3.7	-0.3	2.1	1.5	1.9	2.0	2.0	2.0	2.0
Central government overall balance	-6.7	-8.4	-5.1	-2.8	-3.3	-3.0	-2.6	-2.3	-2.1	-1.9
Central government debt	64.5	66.9	67.6	63.0	60.8	60.2	59.2	58.0	56.6	55.1
Money and Credit										
Credit to the private sector (percent change)	-2.3	3.4	3.7	3.3	1.4	6.0	6.2	6.2	6.2	6.2
Monetary base 2/	7.1	8.3	7.8	8.0	8.1	7.8	7.8	7.8	7.8	7.8
Broad money	44.8	54.8	53.8	47.3	48.3	48.0	47.5	47.3	47.3	47.3
Memorandum Items										
Nominal GDP (billions of colones) 3/	37,832	36,495	40,327	44,810	47,588	50,681	54,026	57,592	61,393	65,445
Output gap (as percent of potential GDP)	0.2	-3.6	0.1	-0.3	0.7	0.2	0.0	0.0	0.0	0.0
GDP per capita (US\$)	12,691	12,164	12,539	13,240	16,552	17,813	18,705	19,590	20,530	21,466
Unemployment rate	12.4	20.0	13.7	11.7	8.1	8.7	9.3	9.3	9.3	9.3

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

1/ As of January 2021, the Central Government definition has been expanded to include 51 public entities as per Law 9524. Data are adjusted back to 2019 for comparability.

2/ We use a narrower definition of monetary base that includes only currency issued and required reserves.

3/ National account data reflect the revision of the benchmark year to 2017 for the chained volume measures, published in January 2021.



COSTA RICA

December 6, 2023

STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION, FIFTH REVIEW UNDER THE EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY, SECOND REVIEW UNDER THE RESILIENCE AND SUSTAINABILITY FACILITY AND REQUEST FOR MODIFICATION OF REFORM MEASURE

EXECUTIVE SUMMARY

Context. Costa Rica is reaping the benefits from the home-grown reform program that has been implemented since 2021 and enabled the country to restore confidence in its policy frameworks, withstand multiple external shocks, and push forward key reforms. Despite strong growth, inflation has fallen sharply. International reserves are on an upward path and public debt is falling.

Article IV discussion. The consultation focused on how to institutionalize the impressive progress that has been achieved over the past few years. It is critical to continue adhering to the existing fiscal framework while mobilizing more revenues. As fiscal space is rebuilt, social spending should be increased. The central bank should continue lowering the policy rate toward neutral by mid-2024. FX market reforms and a more restrained approach to FX intervention will help strengthen the inflation targeting and exchange rate regime. Improvements in the business environment, greater banking competition, and integrating more women and migrants into the formal labor market will lead to more inclusive growth. RSF-supported reforms are helping to advance an ambitious climate agenda and decarbonize the economy.

EFF and RSF performance and prospects. Performance under the Extended Fund Facility (EFF) and the Resilience and Sustainability Facility (RSF) arrangements remains strong. All quantitative performance criteria have been met for this review, although the June Indicative Target on public debt was exceeded as the government took advantage of favorable market conditions to build liquidity buffers. Inflation undershot the Monetary Policy Consultation Clause (MPCC) inner band in June and the outer band in September. The Public Employment Bill has been fully implemented across the executive branch but critical central bank governance and autonomy reform has stalled due to the lack of societal consensus. All reform measures for this RSF arrangement review have been completed.

Approved By
Nigel Chalk (WHD)
and Fabián Valencia
(SPR)

The team consisted of Ding Ding (head), Alberto Behar, Chao He, Charlotte Lundgren, and Daniel Wales (all WHD), Juan Carlos Benítez (FAD), Fumitaka Nakamura (MCM), Igor Zuccardi (SPR), Santiago Acosta-Ormaechea and Ivania García Cascante (Resident Representative Office), with assistance from Heidi Canelas and Rozi Lamprakaki (all WHD), and Orlando Carvajal (Resident Representative Office). Discussions were held during October 16-27, 2023 in San José, Costa Rica. The team held meetings with Costa Rica’s President Chaves Robles, Vice Presidents Brunner Neibig and Munive Angermüller, BCCR’s President Madrigal López, Minister of Finance Acosta Jaén, and other senior government and financial sector officials, members of the Legislative Assembly, academics, private sector, civil society, and other development partners. Alfonso Guerra and Valerie Lankester (OED) joined some of the meetings. World Bank, Inter-American Development Bank, and United Nations staff also joined some of the meetings and provided valuable inputs.

CONTENTS

RECENT DEVELOPMENTS	4
EFF PROGRAM AND RSF PERFORMANCE	7
OUTLOOK AND RISKS	7
POLICY DISCUSSIONS	8
A. Further Strengthening Monetary and Financial Stability	9
B. Sustaining Debt Reduction While Protecting the Poor	12
C. Promoting Equitable Growth	16
D. Making the Economy Greener and More Resilient	18
EFF PROGRAM AND RSF ISSUES	19
STAFF APPRAISAL	21
FIGURES	
1. Real Sector Developments	23
2. External Sector Developments	24
3. Fiscal Sector Developments	25
4. Monetary and Financial Sector Developments	26

TABLES

1. Selected Economic and Financial Indicators	27
2. Central Government Balance	28
3. Balance of Payments	29
4. Gross External Financing Needs and Sources	30
5. Monetary Survey	31
6. Financial Soundness Indicators	32
7. Indicators of Fund Credit	33
8. Access and Phasing Under the Extended Fund Facility	34
9. Access Under the Resilience and Sustainability Facility Arrangement	35
10. RSF Reform Measure Matrix	36

ANNEXES

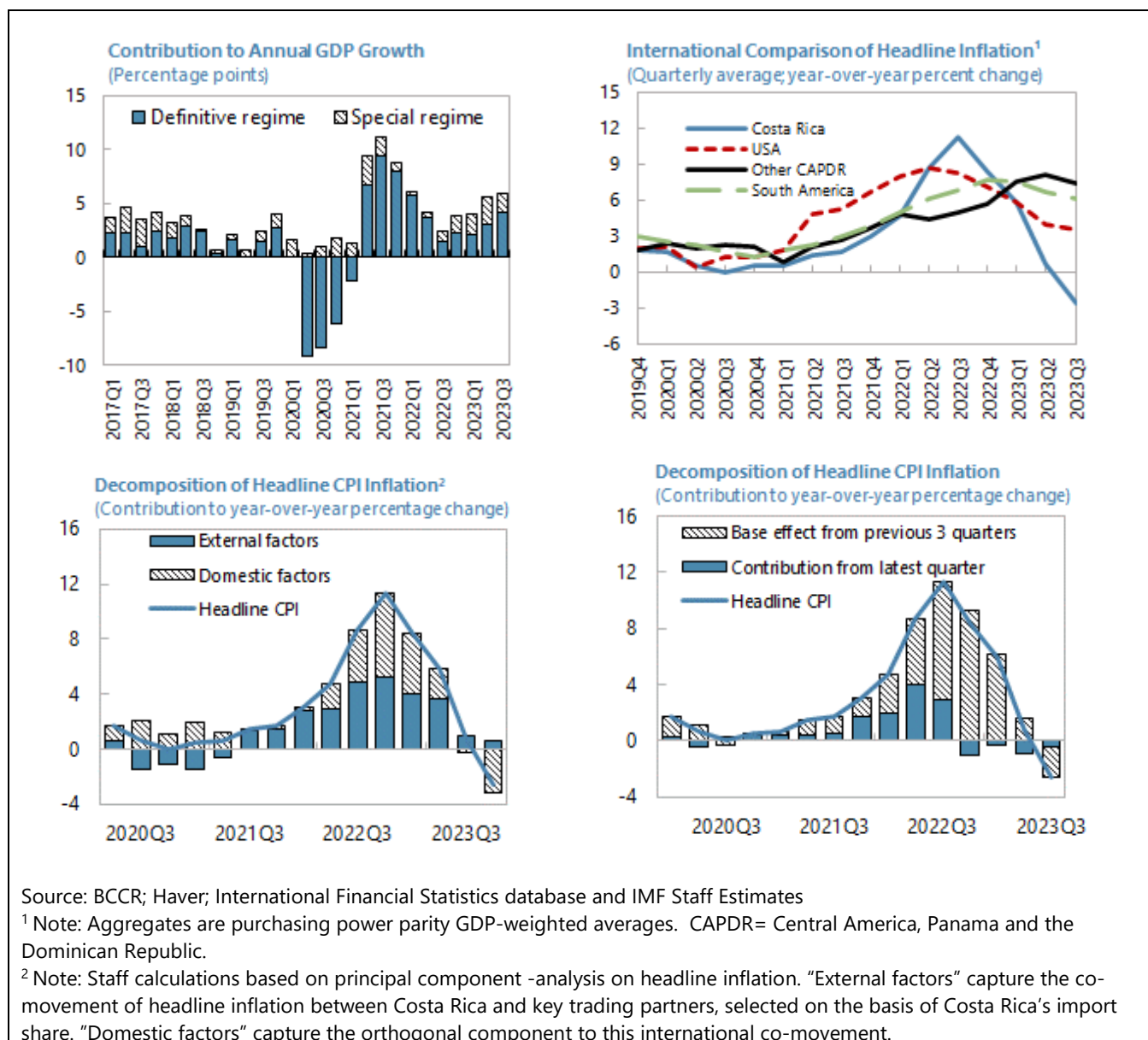
I. External Sector Assessment	38
II. Risk Assessment Matrix	41
III. Sovereign Risk and Debt Sustainability Assessment	43
IV. Foreign Exchange Intervention in Costa Rica through the Lens of the Integrated Policy Framework	54
V. Public Compensation Control and Public Employment Reform: Two Landmark Achievements	62
VI. Costa Rica's Free Trade Zones	66
VII. Implementation of Past Fund Policy Advice	71

APPENDICES

I. Letter of Intent	72
Attachment I. Memorandum of Economic and Financial Policies	75
Attachment II. Technical Memorandum of Understanding	127

RECENT DEVELOPMENTS

1. Robust output growth continues in 2023. Real GDP grew by 5.3 percent in the first three quarters of 2023, up from 4.6 percent in 2022. While growth in the first half of 2023 was driven by buoyant net exports, especially from companies operating within the special regime,¹ it has become more broad-based as activities in the domestic economy pick up steam. Unemployment has declined to below pre-pandemic levels. However, labor force participation is also lower than pre-pandemic, including for younger workers, which may indicate some remaining labor market slack.

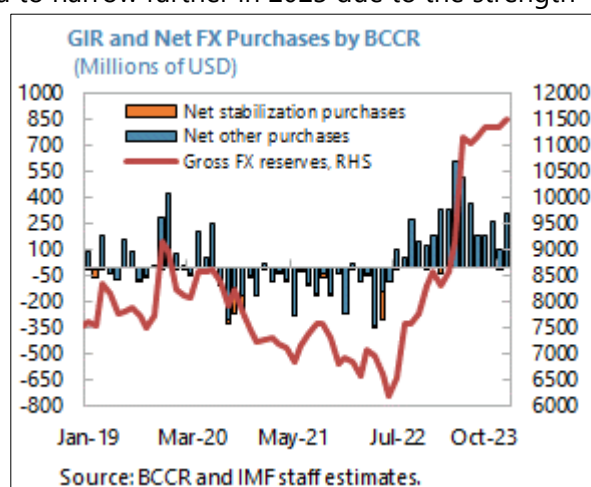


¹ The special regime includes the free trade zones (*zonas francas*) and companies operating under a separate incentive scheme for inward processing and re-exportation.

2. Inflation has fallen to below the lower limit of the Central Bank of Costa Rica (BCCR)'s tolerance band. Headline inflation fell to -3.3 percent (y-o-y) in August from the peak of 12.1 percent one year earlier, before picking up to -1.3 percent as of October. During the 2021-22 episode of surging global inflation, price pressures in Costa Rica increased later and more rapidly than in regional peers. These base effects have now unwound. In addition, monthly sequential inflation has been negative for most of this year, reflecting lower commodity prices and the effects of currency appreciation. Core inflation is low (0.5 percent y-o-y in October) and inflation expectations remain well anchored (market and survey measures are mostly within 0.5 p.p. of the 3 percent target).

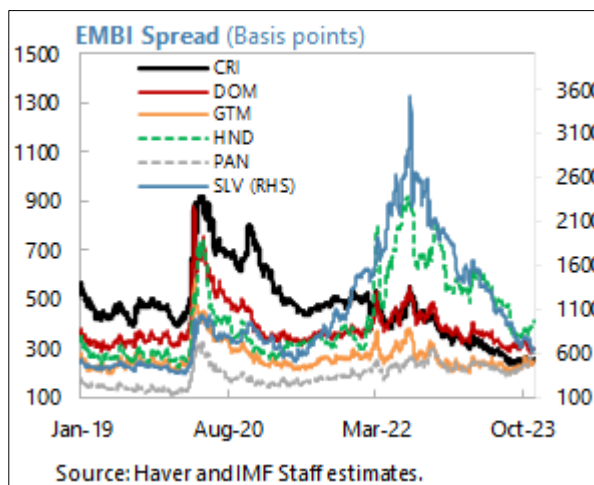
3. The banking sector remains well capitalized and systemic financial stability risks are contained. Credit growth was subdued in the first half of 2023, reflecting the impact of the high interest rates, but accelerated in Q3 due to rising demand for loans in the service sector and for imported goods. The NPL ratio remains low at 2 percent and provisioning is adequate. The BCCR's top-down stress tests indicate that the banking sector holds enough capital to withstand a severe macroeconomic shock.²

4. The external position in 2022 is assessed to be stronger than medium-term fundamentals and desirable policies (Annex I). The cyclically adjusted current account balance in 2022 was -1.4 percent of GDP (compared to the norm of -3.7 percent), implying a REER gap of -8 percent. The current account deficit is projected to narrow further in 2023 due to the strength of exports and improving terms of trade. FDI remains strong especially to the free trade zones, with services and manufacturing accounting for 85 percent of FDI net inflows in 2023H1. Following sustained FX purchases by the BCCR since 2022H2, gross international reserves reached US\$11.5 billion by October 2023 (118.2 percent of the IMF's Assessing Reserve Adequacy metric), exceeding the reserve accumulation goals envisaged at the time of the EFF request. Following a sharp appreciation between mid-2022 and March 2023, the real exchange rate has stabilized around its historical average.

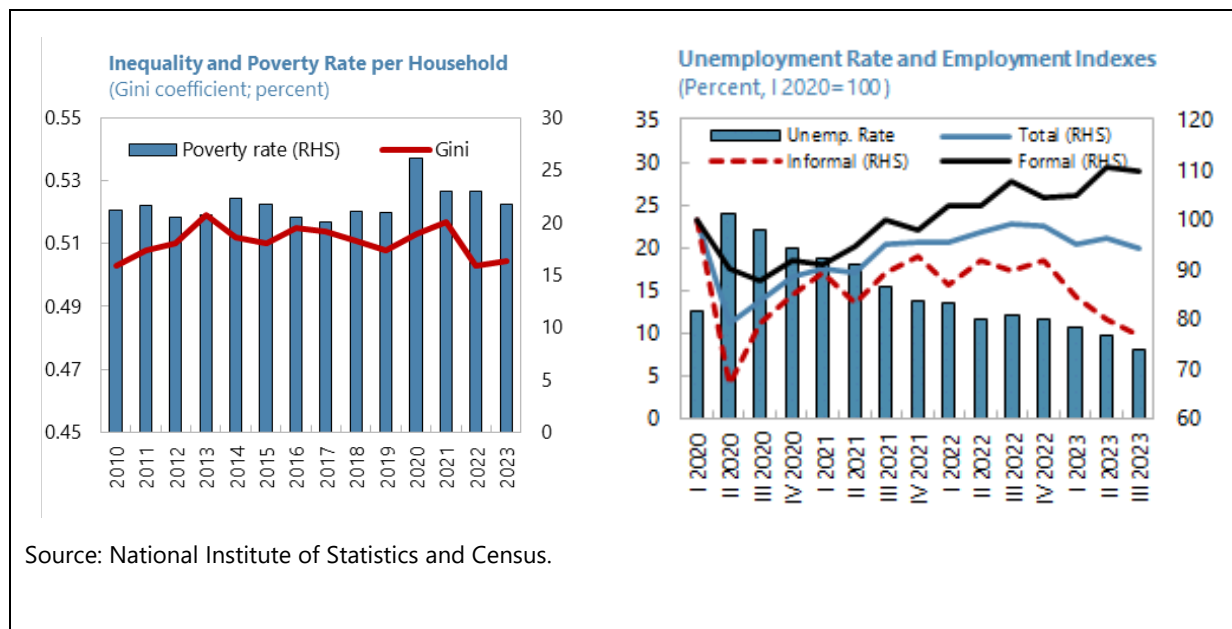


² The stress scenarios assume negative shocks comparable to the economic downturn and currency depreciation observed during the global financial crisis.

5. Fiscal outturns continue to overperform program targets. The cumulative primary surplus to September was 1.7 percent of 2023 GDP (comfortably exceeding the June QPC and September IT). The main driver has been the spending restraint imposed by the fiscal rule. However, revenue growth is weakening as some of the benefits from higher inflation are moving into reverse. The fiscal performance exceeds that envisaged at the time of the EFF request although interest costs remain high (at around one-third of fiscal revenue). Sovereign spreads have fallen abruptly since 2020. In November, the government issued a 31-year Eurobond of US\$1.5 billion.



6. Poverty and income inequality remain elevated. The poverty rate declined somewhat in 2023 thanks to lower inflation, a stronger labor market, and the better targeting of social benefits. Nonetheless, the gap between formal and informal employment has widened and income inequality has increased as past income gains have favored the formal sector and urban households.



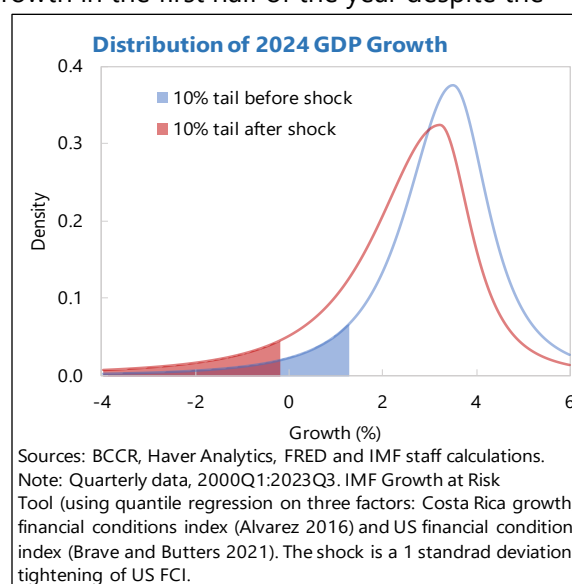
EFF PROGRAM AND RSF PERFORMANCE

7. All performance criteria (PCs) were met and the implementation of the Public Employment Bill, a key structural reform under the program, has been completed for executive branch employees. Both the primary fiscal balance and the NIR targets were met with large margins, and all June and September ITs were met except for the June debt IT (which was breached by 0.3 percent of GDP as the authorities took advantage of favorable market conditions to rebuild liquidity buffers). Inflation undershot the Monetary Policy Consultation Clause (MPCC) inner band in June and was below the outer band in September. The single pay spine was put in place for all executive branch employees in September and all institutions covered by the law are expected to adopt a single wage spine by early in 2024, which would address the unmet March 2023 SB. Progress on central bank governance and autonomy reform, a key recommendation of the 2020 Safeguards Assessment and an end-2022 SB, has unfortunately stalled.

8. The authorities have completed the four Reform Measures (RMs) scheduled for this review. The implemented RMs supported by the RSF arrangement will improve the integration of climate issues into fiscal and financial sector risk analysis (RM5 and RM8) and in project appraisal (RM6). The authorities have also submitted a bill to encourage the use of low-pollution vehicles through feebates (RM7).

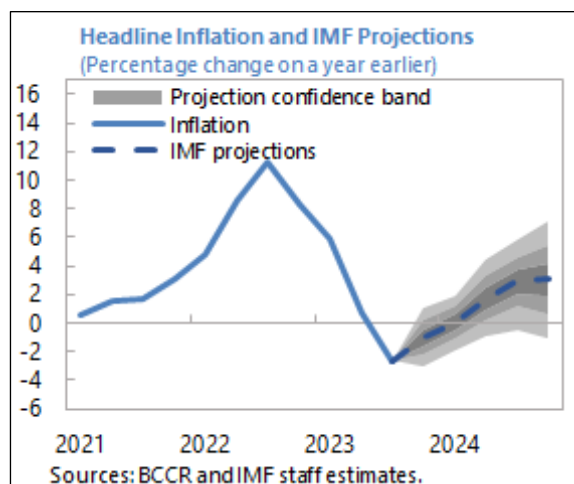
OUTLOOK AND RISKS

9. Growth is projected to reach 5.1 percent in 2023 before moderating towards potential in the medium term. This represents an upward revision relative to the fourth review, which is explained mainly by stronger-than-expected export growth in the first half of the year despite the sharp appreciation of the exchange rate. The economy is expected to decelerate in the final quarter of the year as net exports normalize and investment growth levels off. Growth is expected to moderate to 3½ percent in 2024 and converge toward the potential of about 3¼ percent thereafter, with monetary and fiscal policies normalizing as the output gap closes. The current account deficit is expected to narrow to 2.3 percent of GDP in 2023 and to around 1.5 percent over the medium term. External risks are tilted to the downside, notably from lower growth in the U.S., a sustained tightening of global financial conditions, and/or rises in global commodity prices. Domestically, El Niño presents a growing risk, while political fragmentation leading to delays or the weakening of reforms remains an important challenge (Annex II). On the upside, continued strong FDI inflows could lift potential growth.



Growth-at-risk analysis suggests that the probability of economic contraction in 2024 is around 5 percent and a material tightening of financial conditions in the U.S. could reduce the mode of the growth rate distribution by 0.3 percentage points and reduce the 10th percentile by 1.5 percentage points.

10. Inflation is expected to converge to the BCCR's tolerance band from below. Falling prices—due to the recent appreciation and lower global commodity prices—alongside contractionary monetary and fiscal policies are expected to result in negative headline inflation until end-2023. Nonetheless, inflation is expected to return to target by end-2024. Risks to this outlook are judged to be balanced. The possibility of prolonged weak domestic price pressures is offset by the risk of higher import prices.



11. Debt is sustainable in the medium term and the risk of sovereign debt distress is low (Annex III). Debt is projected to decline to 61 percent of GDP at end-2023 despite the government's initiatives to opportunistically build deposits in anticipation of debt service coming due in early 2024. Debt will fall below 60 percent of GDP by end-2025. However, the interest burden is expected to remain high (about 5 percent of GDP in 2023-24) and gross financing needs are projected to remain around 9 percent of GDP in 2023-24 (falling to 7 percent of GDP by 2028). Risks to the outlook include the potential realization of contingent liabilities (including a disputed claim from the social security fund of about 6 percent of GDP) or a weaker real exchange rate.

Authorities' Views

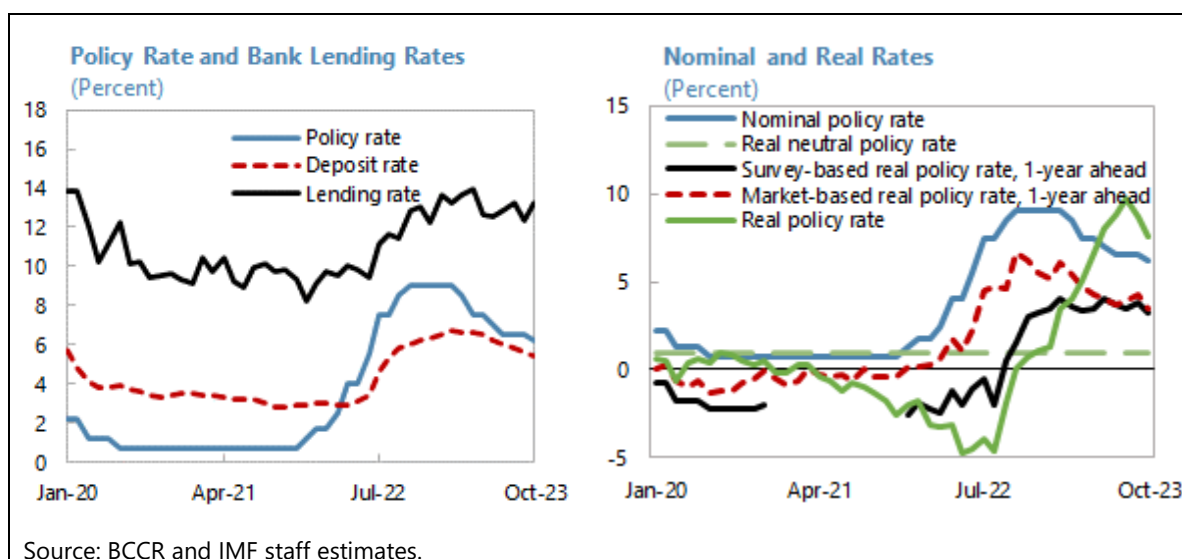
12. The authorities broadly agreed with staff's macroeconomic outlook, albeit with a more optimistic view on potential growth. They also see somewhat higher upside risks to inflation due to geopolitical tensions and potential impacts of natural disasters. For the medium term, the authorities estimate potential growth at 3¾-4 percent, about ½ a percentage point higher than staff's current estimate, on account of stronger labor force growth and faster capital accumulation.

POLICY DISCUSSIONS

Institutionalizing the progress achieved in the last few years across a range of areas will help foster sustained growth. This will require pressing ahead with central bank governance reforms, deepening the FX market, sustaining debt reduction, increasing social spending, improving debt management, increasing the effectiveness of government programs, enabling a better business environment, improving the quality of education, integrating women and migrants into the formal labor market, and expanding access to climate financing.

A. Further Strengthening Monetary and Financial Stability

13. If the economy evolves broadly as expected in staff’s baseline forecast, the central bank should return to a neutral stance by mid-2024. The BCCR’s monetary policy stance has played an important role in anchoring inflation expectations, which are currently close to the 3 percent inflation target. After raising the policy rate decisively to 9 percent to counter the global inflation shock, the BCCR has cut the policy rate by 275 basis points. Staff’s baseline forecast is conditioned upon the central bank’s gradual return to a neutral policy stance by end-2024. However, absent new shocks, staff assess that a return to a neutral stance—an *ex ante* real rate of around 1 percent (Selected Issues Paper)—by mid-2024 may better support the sustainable return of inflation to target. Policy decisions should, though, remain forward-looking and highly attuned to incoming data. Furthermore, monetary policy should be allowed to have its full effect, including by allowing the exchange rate to move flexibly in line with market conditions.



14. A deeper FX market and greater exchange rate flexibility would help disincentivize dollarization and strengthen monetary policy transmission. Under the Fund’s Integrated Policy Framework, Costa Rica’s shallow FX market and currency mismatches arising from dollarization argue in favor of deploying targeted foreign exchange interventions (FXI) in response to large shocks (Annex IV). This means that FXI should be infrequent. In most circumstances the exchange rate should be allowed to respond flexibly to market conditions. With FX reserves at comfortable levels, there is little need for the central bank to actively purchase additional reserves. Going forward, the BCCR’s FX market activities should be more restrained than in the recent past. The central bank’s impact in the FX market can be reduced by aligning the timing of BCCR purchases of FX on behalf of the non-financial public sector (NFPS) with the sale of FX to these entities, which would facilitate timely price formation in the market and enhance the transparency of FX

operations.³ A longer-term strategy should be developed for the NFPS to meet their FX needs through direct market transactions and to manage the currency risks. Planned reforms to improve the functioning and liquidity of the FX market will further reduce the underlying need for central bank FX operations. Such reforms should include revisiting macroprudential requirements (see below), introducing new market makers, extending MONEX trading hours, and developing FX derivative markets.

15. The deployment of targeted macroprudential measures has the potential to increase the financial system’s resilience to large movements of the exchange rate. The authorities have adopted a suite of macroprudential measures, including capital requirements for FX loans to unhedged borrowers, generic provisions to unhedged FX loans, applying the liquidity coverage ratio by currency, and limiting FX net open positions (NOP). Combined, these actions materially mitigate FX financial stability risks arising from currency mismatches on household, corporate and bank balance sheets.⁴ There is, though, scope to loosen the daily and monthly NOP limits.

16. Despite the current lack of societal consensus around central bank governance and autonomy reforms, the authorities should continue building support for these important institutional changes. The 2020 Safeguards Assessment recommended legal amendments to (i) clarify that the BCCR’s main objective is to maintain low and stable inflation; (ii) provide for a clear allocation of functions among its decision-making bodies; (iii) strengthen its institutional, functional, personal, and financial autonomy; and (iv) enhance its transparency and accountability practices. Although the authorities have submitted legislation that would address the transparency and accountability practices of the BCCR and make some progress on autonomy, more comprehensive legal reforms are needed. At the current juncture there is insufficient political support for these efforts. *De facto*, the BCCR is making its monetary policy decision independently. Nonetheless, institutionalizing its autonomy and clarifying the BCCR’s mandate and decision-making process are critical steps for aligning the legal framework with the recommendations under the 2020 Safeguards Assessment.

17. The authorities are proactively using their supervisory tools to address pockets of financial sector vulnerabilities. Capital, liquidity, and profitability indicators suggest that the banking system is resilient to downside shocks. However, high levels of dollarization and a large share of variable rate borrowing (making up over 80 percent of total bank loans) suggest that large swings of the exchange rate or tighter global financial conditions could have an important negative impact on credit quality. To mitigate such risks, the authorities are tightening macroprudential limits on FX loans to unhedged borrowers. They have also reactivated dynamic provisioning to prepare against adverse economic conditions and further strengthened top-down stress testing, in particular

³ The BCCR accounted for 68 percent of the turnover in the MONEX market in the first ten months for 2023, of which 52 percent were FX transactions on behalf of NFPS.

⁴ Capital requirements are scheduled for a further gradual increase to 150 percent by 2031. The requirement of generic provision to unhedged FX loans was introduced in 2016 but will be phased out by January 2024.

by incorporating contagion risks. The supervisory agency is also working to further enhance its oversight capabilities and incorporate climate risks into the bottom-up stress testing exercise.

18. There is scope to improve the institutional setup for financial oversight.

- **Strengthening the crisis management framework.** The proposed amendments to the bank resolution and deposit insurance law will allow the authorities to resolve non-viable banks in an orderly manner, while maintaining the continuity of those banks' vital economic functions. The authorities are preparing an arrangement that clarifies the roles of various stakeholders and ensures funding is readily available for effective resolution. The goal is to submit these legal amendments to the Legislative Assembly later this year (end-December 2023 SB).
- **Better managing climate risks.** In October, the authorities approved a regulation that requires supervised financial intermediaries to put in place policies to incorporate socioenvironmental and climate risks into banks' decision-making processes, specify the main risk areas to be covered, classify these risks in their credit operations, and meet specific disclosure requirements by end-2026 (RM8).

19. The authorities should continue to promote competition in financial services and level the playing field between public and private banks. Legislation is needed to align the regulatory treatment of all banks. This would involve replacing parafiscal contributions of state-owned banks with transfers of dividends to the budget and discontinuing the requirement that private banks contribute part of their short-term deposits to the *Sistema de Banca para el Desarrollo* (Development Bank System) for lending to underserved sectors. Insofar as the central bank establishes limits on fees in the card system, such limits should be established in a way that promotes efficiency and competition but also pays due attention to consumer protection (see Selected Issues Paper).

Authorities' Views

20. The authorities overall agreed with staff's assessment but emphasized the need for a more gradual approach in certain areas. The BCCR broadly agreed with staff's monetary policy advice. However, due to the upside risks to inflation and the risk of a sudden switch of deposits to the U.S. dollar by residents, they emphasized the need for a gradual and prudent approach, which may imply reaching a neutral stance only in the second half of 2024. Bearing in mind the external pressures faced in 2022H1 and the large FX debt repayment needs in 2024, the central bank plans to further bolster reserves by purchasing FX when market conditions are favorable. The authorities agreed with the objectives of less FX intervention, greater exchange rate flexibility, and reforms in favor of a deeper and more liquid FX market. They noted that recent FX purchases on behalf of NFPS have been largely passed to the market without a delay, but they also pointed to institutional and market structure impediments to more substantial changes in the near term. As for macroprudential measures, the authorities prefer to first assess the impact of measures currently coming into effect before implementing new regulations, but they agree there is scope to relax the NOP restrictions to facilitate FX market development. With regards to central bank governance and autonomy reforms, the authorities reiterated their strong commitment. In their view, the most viable

way to achieve the objective of the original SB is by obtaining constitutional autonomy for the central bank, which they intend to pursue as soon as the political context allows.

B. Sustaining Debt Reduction While Protecting the Poor

21. The 2018 tax reforms and spending restrictions imposed by the fiscal rule have been critical in maintaining the reduction in the debt-to-GDP ratio. Increases in the structural primary balance in 2022 and 2023 changed the debt trajectory and contributed to the disinflation process. The draft budget appropriately targets a further fiscal consolidation in 2024—largely through a reduction in primary current spending—with a headline primary balance of 1.9 percent of GDP. Staff’s baseline projects a primary balance of 2 percent of GDP over the medium term, which is lower than under the authorities’ medium-term fiscal framework (MTFF) but would be sufficient to bring debt below 50 percent of GDP before 2035. With the transition period from the 2018 tax reform coming to an end, fiscal revenues are expected to stabilize at 15¼ percent of GDP. However, the effects of tax exemptions, possible future tax reforms, and compliance improvements are uncertain. Primary spending is projected to stabilize at 13¼ percent of GDP as the fiscal rule’s unchanged limit on spending becomes less restrictive. Costa Rica is assessed to have growing fiscal space and would be well-placed to employ countercyclical measures if negative shocks were to materialize.

22. Bills recently approved by the Legislative Assembly (despite the government’s objections) may reduce revenues and make the tax system less equitable and less efficient. Changes to the taxation of vehicles (Law 10.381) have created greater certainty on taxpayers’ liabilities but have reduced progressivity and revenue collection. Establishing an economic substance criterion and amending the definition of Permanent Establishment in the corporate tax contains double-non taxation risks⁵ and, by reinforcing the territoriality principle, may narrow the corporate tax base, distort investment decisions, and favor taxpayers with offshore earnings (Law 10.390). These policy changes are estimated to reduce tax revenues by 0.1 percent of GDP per year and are incorporated in staff’s baseline.

23. The government’s proposed tax reforms would improve equity and efficiency and generate around 0.1 percent of GDP in additional revenues. Proposals include:⁶

- Implementing a dual personal income tax system, increasing progressivity, and taxing domestic and offshore capital income and capital gains at a flat rate, which are key steps to improving the income tax (bill 23.760). The bill does not eliminate tax exemptions for the Christmas bonus (*Aguinaldo*) and the 14th salary for public employees (*salario escolar*), which are inefficient, inequitable, and cost an estimated 0.4 percent of GDP per year.

⁵ The bill, nonetheless, was effective in removing Costa Rica from the EU’s Annex I List of Non-Cooperative Jurisdictions for Tax Purposes in October 2023.

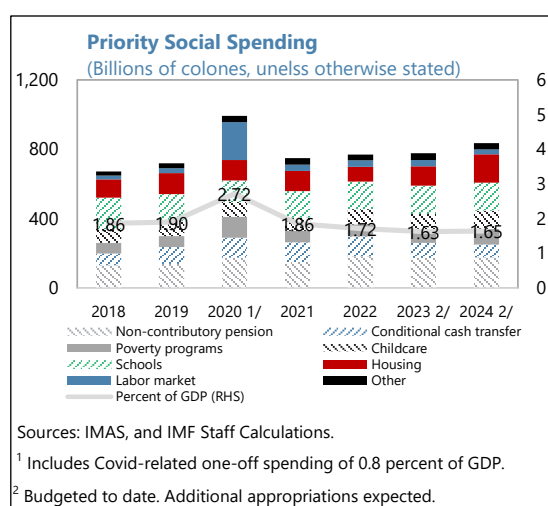
⁶ The baseline does not include yields from the proposals nor possible gains from improvements in tax and customs administration.

- Moving to a single tax rate for corporate income.
- Improving the simplified tax regime for small taxpayers.
- Strengthening the automatic exchange of tax information on non-residents (bill 23.088).
- Ensuring all tax incentives granted to firms in free trade zones are consistent with the OECD/G20 Pillar 2 minimum global tax to protect the domestic tax base.
- Eliminating ineffective VAT exemptions on airfares, medical equipment, and forestry products (bill 23.763), and reassessing the effectiveness of all tax exemptions (with a view to eliminating those that are ineffective).
- Introducing a revenue-neutral feebate scheme to accelerate private transportation's transition to electrical vehicles (RM7).⁷

24. Improvements in tax and customs administration are underway. The authorities have made important progress as part of their Tax Compliance Improvement Plan and continue to improve compliance on VAT, income tax, and international taxation, with a strategic focus on large taxpayers. Information technology has been improved and there is greater information sharing amongst different institutions. The authorities are also strengthening customs regulations to curb smuggling and evasion.

25. Over the medium term, greater resources will be needed for both social assistance and capital spending, building on institutional reforms that should make such spending more effective.

- During the last decade, **social spending** has helped compensate for declining labor incomes at the lower end of the income distribution. However, more recently, social spending has sagged as a share of GDP. The reversal of this trend in the draft 2024 budget is encouraging because the evidence suggests that well-targeted increases in social assistance coverage—for example through cash transfers targeted to poor children—can materially reduce poverty.⁸ The newly centralized and digitalized cash transfer system and the forthcoming launch of a single window for social assistance (a February 2024 SB, for which an online



⁷ Submittal of the feebate bill was initially envisaged for September 2023. However, the Executive delayed submission until it managed the agenda of bills being submitted.

⁸ See Annex VI. *The Inequality and Informality Challenge*. IMF Country Report No. 21/48. Also see OECD (2023). OECD Economic Surveys: Costa Rica. February 2023.

form and self-service module are already complete) should facilitate a scaling up of spending on such programs.

- Public **capital spending** is expected to rise to around 2 percent of GDP over the medium term. However, Costa Rica has persistently under-executed its capital budget (by an average of 40 percent during the last decade). This has worsened the quality of infrastructure and underlines the need to improve public investment management to increase execution and efficiency. This would facilitate the increase in investment needed to make the physical infrastructure more resilient to the effects of climate change (consistent with Public Investment Management Assessment (PIMA) and Climate PIMA recommendations). A bill to modernize public investment processes and reduce institutional fragmentation is under discussion in the Legislative Assembly. Efforts are also underway to strengthen project appraisal and selection and ensure projects are consistent with the MTF. Better investment planning would support decarbonization and ensure the social cost of carbon is incorporated into project appraisal (completed RM6) and climate-related criteria are systematically considered in project selection (RM9).

26. The aging of the population will have important long-term fiscal implications. The non-contributory pension regime plays an effective role in poverty reduction but coverage of the elderly poor is incomplete.⁹ The government intends to substitute its spending on the non-contributory pension with a contribution to a universal basic pension (UBP bill 23.625) that will be gradually phased in over the next several years. However, there is a risk that, if the statutory minimum pension is not simultaneously phased out, the actuarial position of the system will worsen. An alternative approach—that would have less financial impact and work within the current institutional framework—would be to take steps to increase coverage of the non-contributory pension in combination with steps to reduce informality more broadly.¹⁰ There is also a pressing need to have a more strategic assessment of the whole pension system to restore actuarial balance.

27. A range of reforms are underway to improve the institutional framework for fiscal transparency and spending.

- The Public Employment Bill modernizes the wage structure, improving performance incentives and reducing wage expenditure growth in the medium term (Annex V).
- In line with IMF CD, an amendment to the fiscal rule excluded financially sound public institutions that operate under market conditions or without government control. However, the other public institutions should not be excluded from the rule. The amendment maintains the coverage of spending categories subject to the rule and the formula for determining the ceiling but weakens the coverage of NFPS expenditure. The fiscal rule should have broad coverage and apply to aggregate spending (i.e., not to disaggregated entities within the consolidated central government), including externally-financed capital expenditure. This would allow a better

⁹ World Bank (2022). Opportunities for Reducing Poverty and Inequality in Costa Rica: World Bank Poverty and Inequality Assessment.

¹⁰ Recommendations from an IMF CD report.

prioritization of spending across all central government agencies through the annual budget process and facilitate ex-post compliance verification. Moreover, ex-post verification should compare fiscal outturns (not the final budget) with the previous year's initial budget and include externally financed capital expenditure.¹¹

- The ongoing implementation of the new public procurement regulations should reduce procurement costs and increase transparency but, to maximize gains, there is a need to improve the information system for public procurement consistent with *Hacienda Digital*.
- The adoption of International Financial Reporting Standards by State-Owned Enterprises will improve transparency. The authorities are steadily working towards the adoption of fiscal and debt data in accordance with the 2014 standards to produce consistent data for the non-financial public sector.
- Gender budgeting was incorporated into the 2024 budget submitted to the Assembly. As a next step, the government should expand the coverage to decentralized institutions.
- The authorities are establishing a Macro-Fiscal Unit to enhance analytical and forecasting capabilities.

28. The establishment of a single debt management office would significantly improve the government's ability to develop and implement a clear debt strategy. The government submitted a bill to establish the office in May (end-June 2023 SB). To facilitate implementation of the debt management strategy there should be greater flexibility for the Executive to issue external debt and the government's cash management strategy should more systematically decide the trade-off between maintaining liquidity and minimizing interest costs. In this regard, debt exchanges, reverse auctions, and plans to potentially convert FX financing to domestic currency are welcome. The authorities are also finalizing an investment strategy and will produce a sovereign asset and liability management roadmap, drawing on IMF CD.

Authorities' Views

29. The authorities expressed their firm commitment to sustaining the fiscally responsible policy and institutionalizing the macroeconomic, social, and climate-related progress achieved so far. They reiterated their intention to reduce debt quickly to create room for additional spending under the fiscal rule, targeting a ratio of 60 percent by 2025. In this regard, the government shares staff concerns regarding the passed bills that reduced tax revenue and weakened the institutional coverage of the fiscal rule. They are concerned that further tax cuts would imperil their ability to sustain the fiscal consolidation without further restricting social and other spending. Although greater efficiency and equity are the main aim of the income tax bill (23.760), restoring revenues by removing outdated and ineffective exemptions is also important. The authorities see upside risks to improving revenue collection through the implementation of

¹¹ Lam, R. et al. (2023) Costa Rica. Upgrading the Rule-Based Fiscal Framework. FAD TA report.

Hacienda Digital and they consider it important to target tax incentives in the special regime to ensure Costa Rica does not cede tax revenues to other jurisdictions. They consider their efforts to build liquidity buffers can improve market confidence by reducing rollover risks and signaling responsible macroeconomic management. Implementing the PEB and improving public investment management remain high priorities in their policy agenda, but ultimate compliance by all institutions with the PEB, as with many laws, requires strengthening the institutional capacity of the implementing ministry and enforcement by institutions other than the executive.

C. Promoting Equitable Growth

30. Costa Rica’s free trade zones have been an important growth engine. Activities in the free trade zones have become increasingly broad-based and knowledge-intensive, which has diversified exports and increased resilience to external shocks (Annex VI). During the past year the free trade zones have contributed more than a third of GDP growth, about 80 percent of FDI inflows and over 10 percent of total employment. Wages in the free trade zones are around 20 percent higher than in the rest of the economy. With an estimated 60 percent of free trade zone inputs being sourced domestically, there are also important linkages to the domestic economy. However, the free trade zones are mostly concentrated in the greater metropolitan area of San José, contributing to widening income inequality across regions.¹² The fiscal cost of various tax preferences associated with the zones is estimated at around 1.5 percent of GDP per year.¹³ Going forward, the OECD/G20 Pillar 2 minimum tax can be helpful in limiting this source of tax expenditure (protecting Costa Rica’s tax base by ensuring incentives are consistent with the minimum tax) without reducing Costa Rica’s attractiveness as an investment destination.

31. Efforts to improve the business environment will raise potential growth.¹⁴ The upcoming installation of a 5G network will improve digital connectivity, the planned increase in infrastructure investments will help mitigate regional disparities, and easier entry into power generation should reduce electricity costs. However, a broader range of product market reforms are needed to boost competition, productivity, and investor confidence.¹⁵ Efforts to strengthen the role of women in entrepreneurial activities should increase female labor force participation, reduce gender wage gaps, and boost productivity. These should be combined with a reduction in the number of minimum wage categories and reduced payroll contributions for part-time workers to reduce incentives to operate in the informal economy.

¹² A 2022 law introduced incentives for companies in certain strategic sectors to locate their investments outside of the metropolitan area.

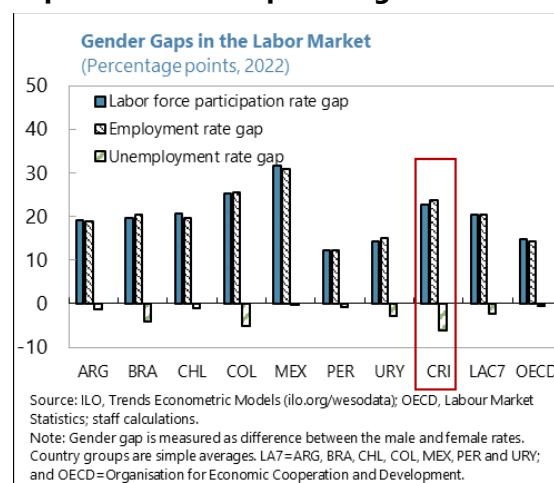
¹³ Dirección General de Hacienda, División de Política Fiscal, “Costa Rica: El Gasto Tributario (GT) 2021, Metodología y Estimación, Impuesto sobre la Renta, Impuesto al Valor Agregado y Otros Tributos, 2023 (forthcoming).

¹⁴ IMF (2023), “Structural Reforms to Accelerate Green Growth and Ease Policy Trade-Offs in EMDEs”, *Staff Discussion Note SDN/2023/007*.

¹⁵ According to the OECD’s Product Market Regulation indicator, Costa Rica has more stringent regulations than any other OECD country. *OECD Economic Surveys, Costa Rica*, OECD, February 2023.

32. There is scope to improve educational outcomes. Compared to other OECD countries, Costa Rica’s spending on education as a share of GDP is high (especially at the tertiary level) but learning outcomes (captured by test scores) are mediocre and the take-up of vocational education is low, contributing to skills mismatches. There are also important inequalities in access to education and recent years have seen high learning losses due to strikes, the pandemic, and policy discontinuity. The authorities’ “Roadmap for Education” envisages reforming the school curriculum, improving testing for students and teachers, providing free meals and transport to all K-12 students, and expanding internet access for students. International experience suggests that prioritizing spending at the early stages of education would have high returns, in line with the authorities’ ongoing efforts to strengthen childcare networks.¹⁶ Ongoing efforts to better align the higher education curricula with labor market demand, complementing recent reforms to vocational training, will help address skills gaps while being critical to keep attracting FDI.

33. Removing barriers to female labor force participation would help boost growth and reduce income inequality. The large gender gap in the labor market—in participation and employment—is a key factor behind relatively high levels of income inequality (see [2021 Article IV](#)). Family care responsibilities constrain women from taking paid jobs making improvements in childcare critical to close this gap. Reductions in the minimum contribution for part-time workers, public funding for vocational training, technical assistance and financial aid to female entrepreneurs, and scholarship programs for women in STEAM fields would also be important to durably reduce the gender gap.



34. More effectively integrating migrants and refugees into the formal labor market would increase both growth and equity (Selected Issues Paper). Foreign-born employees account for 11 percent of Costa Rica’s labor force, one of the highest shares in Latin America. They bring to the country a diverse skill set that can complement that of native-born workers as well as mitigate the rapid aging of the labor force. Staff estimates suggest that foreign-born labor contributed to around 6.5 percent of GDP during 2017-21. The foreign-born population also contribute, on net, around 0.5 percent of GDP to the fiscal position (social security, income and consumption taxes exceed the costs of their use of public education, health services and social transfers). Most of these workers hold informal and low-paying jobs and experience relatively high rates of poverty.

¹⁶ OECD (2023). OECD Economic Surveys: Costa Rica. February 2023. *Programa Estado de La Nación* (2023) *Noveno Estado de la Educación*.

Government programs to provide health insurance and facilitate transportation services for seasonal migrants in the coffee sector have generated positive outcomes and should be expanded to other sectors. There is also scope to better integrate migrants and refugees into the formal labor market by simplifying procedures and shortening the time needed for acquiring legal resident status and facilitating migrants' access to social security benefits (e.g., by reducing minimum vesting periods for the contributory public pension).

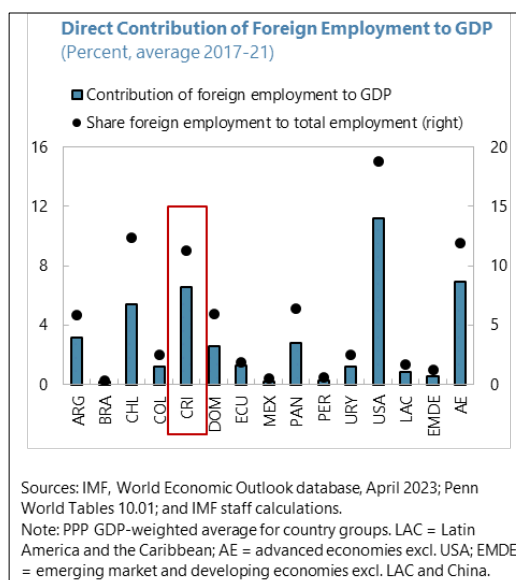
Authorities' Views

35. The authorities concurred with staff's recommendations on making growth more equitable.

Welcoming the analysis on the free trade zones, the authorities agreed that the OECD/G20 Pillar 2 minimum tax will be helpful in setting a floor for the tax level and confirmed that they are already working to improve monitoring of qualification for free trade zone concessions. They, however, cautioned that the contrafactual in terms of foregone revenues due to tax concessions is uncertain. The authorities appreciated staff's analysis of the economic and fiscal impact of migrants and refugees, which provided important inputs for their incipient work on a comprehensive migration strategy. The authorities concurred with proposals to increase female labor force participation by strengthening childcare networks and expanding coverage, alongside steps to bolster labor formalization and women's role in entrepreneurial activities, but noted that budget limitations are slowing the implementation of some of these efforts. The authorities highlighted ongoing initiatives to improve educational attainment through better use of technology and testing, and to foster employability by promoting bilingualism alongside early integration of students with companies through on-the-job learning (dual education system).

D. Making the Economy Greener and More Resilient

36. The authorities are making progress on both adaptation and mitigation.¹⁷ Climate change presents important risks to the economy, chiefly through the potential damage to transportation infrastructure and agriculture caused by flooding. Completed RMs are helping to integrate climate risks in fiscal planning, strengthen public investment and infrastructure resilience, support decarbonization, as well as green reserves and strengthen financial sector resilience. The National Decarbonization Plan targets emissions reductions that are more ambitious than Costa Rica's commitments under the Paris Agreement with a central role for decarbonization of transportation. Building a comprehensive charging network, incentivizing the adoption of electric vehicles, and reduced tax revenue from fuels is expected to cost around 2.4 percent of GDP over the



¹⁷ See *Annex III. Costa Rica's Climate Change Challenge*. Costa Rica Country Report CR/22/345. See *Annex IX. Costa Rica's Climate Change Response*. Costa Rica Country Report CR/21/48.

next 30 years according to IMF CD estimates. Decarbonization is also being incentivized through a review of tax incentives (RM11). Addressing skills mismatches and providing a strengthened social safety net during this transition will also be essential for the transition. The 2022-2026 National Adaptation Plan appropriately targets improvements in disaster risk management, for example by investing in climate-resilient infrastructure (supported by RM9), including climate change considerations in regulatory plans (supported by RM10), and increasing financial sector resilience (supported by RM8 and RM12).

37. The authorities are intensifying their efforts with development partners to attract green financing. They are exploring the issuance of sustainability-linked or Use of Resources Eurobonds, capitalizing on Costa Rica’s longstanding “green” credentials with support from the United Nations Development Programme (UNDP). Work has started on a project preparation facility, with support from the Inter-American Development Bank (IDB), aimed at creating a pipeline of sustainable projects for which private financing can be sought. The authorities are also strengthening the Private-Public Partnership capacity, with IDB support, and creating a single green taxonomy with the help of the Green Climate Fund and the UNDP.

Authorities’ Views

38. The authorities reaffirmed their commitment to the climate agenda. Costa Rica has an environmentally friendly economic model but is vulnerable to the effects of climate change, which presents fiscal and financial risks. The authorities noted their ambitious and multi-faceted efforts in advancing the climate agenda, including measures to improve the efficiency of budget planning and public investment, support decarbonization, mitigate financial risks, and strengthen public investment and infrastructure resilience. They also welcomed the RSF’s catalytic role in supporting the government’s ongoing efforts to mobilize climate finance.

EFF PROGRAM AND RSF ISSUES

39. All quantitative performance criteria were met for the fifth review under the EFF and all RMs were met for the second review under the RSF arrangement. ITs were met for September and the authorities are on track to meet end-December PCs. Inflation was below the inner band of the MPCC in June (a semi-annual test date)¹⁸ and the outer band of the MPCC in September, but the central bank’s reduction of the policy rate is expected to support the return of inflation toward the center of the MPCC in 2024. The SB for this review related to the Public Employment Bill was met. Furthermore, the government has expanded its climate risk analysis, published guidelines to assess the impact of public projects on climate change, submitted legislation to introduce a feebate scheme for vehicles, and approved regulation on managing banks’ climate change-related credit risks (RM5, RM6, RM7 and RM8). The authorities are on track to launch

¹⁸ As required by the MPCC, staff held consultation with the BCCR Board of Directors on the reasons for the breach of the inner band and the policy response.

a single window for social programs and submit amendments to the deposit insurance and bank resolution laws (both are SBs for the final review).

40. A modification to RM12 under the RSF arrangement on incorporating climate risks in stress testing is proposed. An ongoing legal process determining the central bank’s right to access micro data on banks’ credit portfolio may create delays in the implementation of climate risk stress testing (the information is needed to specify the geographic location of the financed activities to assess the credit risks of climate events). Given differences in banks’ business models and the geographic concentration of their lending, stress tests based on the incomplete information of bank credit, which the central bank has conducted, could be misleading. The authorities have, therefore, proposed modifying the RM requiring the finalization of the stress test methodology, which would then be applied once the requisite data is available. In combination with previously completed work to define and gather needed data, the finalization of the methodology would bring the authorities very close to the objective of the original RM, which the authorities are committed to accomplishing. It is therefore staff’s view that an unchanged level of access is warranted.

41. Costa Rica’s capacity to repay the Fund remains adequate and the program is fully financed. The EFF program remains fully financed with firm financing commitments over the next 12 months and good prospects thereafter (Table 4). Costa Rica has an adequate capacity to repay the Fund, with outstanding Fund credit peaking at 2.7 percent of GDP, 7.1 percent of exports, or 522.5 percent of quota (372.5 percent of quota without RSF arrangement financing) in 2024 (Table 7). The bill to ratify the RSF arrangement was approved by the Legislative Assembly in October (a requirement for all sovereign foreign borrowing).¹⁹ Access to the EFF is helping Costa Rica meet its existing balance-of-payments needs. Both the EFF and the RSF arrangement financing will continue to be used for direct budget support. RSF resources provide Costa Rica with financing at longer maturities, substituting shorter-term private financing and improving their capacity to repay. Financing from other multilateral creditors, particularly project financing, has been rescheduled from 2023 to 2024-2028. The program remains subject to downside risks, particularly from the external

Costa Rica: Program Financing (In millions of U.S. dollars)			
	2022	2023	2024
Financing need	2,911	405	2,121
Reserve accumulation (excl. RSF)	1,803	3,220	-993
Underlying BOP need 1/	1,109	-2,815	3,114
Official multilateral financing	2,675	405	2,121
IMF	554	275	553
EFF	554	275	553
Other multilateral creditors	2,121	130	1,568
World Bank	307	5	785
Inter-American Development Bank	385	96	498
CAF Development Bank for Latin America	0	0	0
Central American Bank for Economic Integration	329	29	285
Latin American Reserve Fund	1,100	0	0
Unidentified financing	236	0	0
RSF disbursement	0	0	743
Total change in official reserves (incl. RSF)	1,803	3,220	-251
<i>Memorandum items:</i>			
Capital market access	0	3,000	1,000
Gross international reserves (incl. RSF)	8,610	11,944	11,693
In percent of the ARA metric (incl. RSF)	102	123	116
In percent of the ARA metric (excl. RSF) 2/	102	123	108
Source: IMF staff estimates.			
Note: IMF financing in 2024 includes disbursements associated with the 5th and 6th reviews of the EFF and the 1st, 2nd and 3rd reviews of the RSF.			
1/ Net of private sector and bilateral financing.			
2/ Excludes cumulated RSF disbursements.			

¹⁹ Legislative Assembly approval was secured more than 30 days after the IMF Executive Board’s approval of the funding at the first RSF arrangement review. This funding can be requested following Executive Board approval of the second RSF arrangement review.

environment, but there are buffers in place to respond to shocks. If needed, additional financing could be mobilized from domestic financial institutions or regional partners.

STAFF APPRAISAL

42. Costa Rica is reaping the benefits from its home-grown reform program. Strong implementation of the EFF program since 2021 has enabled the country to restore confidence in the strength of its policy frameworks, withstand multiple external shocks, and push forward key reforms. Fiscal outturns have exceeded expectations and placed the authorities on track to overperform their end-2023 primary balance target. The institutional framework for fiscal policy has been particularly valuable in achieving these results. Monetary policy has demonstrated its ability to react to inflation shocks and anchor expectations. The external position in 2022 is assessed to be stronger than medium-term fundamentals and desirable policies, and reserves are adequate.

43. The central bank should return to a neutral stance by mid-2024 with the exchange rate being allowed to respond flexibly to market conditions. The BCCR has appropriately lowered the policy rate and should continue to do so in the coming months to ensure that inflation converges decisively to the target. Policy decisions should continue to be data-dependent, forward-looking, and supported by clear and transparent communications, with due attention to the two-sided risks to inflation. While Costa Rica's shallow FX market and existing currency mismatch could justify deploying targeted FX intervention to mitigate excessive exchange rate fluctuations, in most circumstances the exchange rate should be allowed to move freely in response to market conditions. A more flexible exchange rate and greater transparency in central bank FX operations would allow monetary policy to have its full effect on activity and inflation and would also incentivize the deepening of the FX market. To complement a more restrained approach to FX intervention, further institutional and technical reforms should be targeted at improving the functioning of the FX market and strengthening market participants' ability to manage currency risks.

44. The authorities should continue pursuing improvements to the central bank's governance and autonomy. While the central bank is conducting monetary policy in an independent manner, these practices should be institutionalized through legislation. It is critical that the central bank's autonomy and other areas of improvements recommended in the 2020 Safeguards Assessment that remain unaddressed be followed up on as soon as possible.

45. Due to the authorities' commendable fiscal efforts, the risk of sovereign debt distress is low. Ongoing spending restraint is expected to continue to reduce the debt and interest burden. Passage of the income and value added tax bills would improve the equity and efficiency of the tax system and raise revenues that have been eroded in recent reforms. Broadening the CIT base and abolishing the income tax exemption on the *aguinaldo* and *salario escolar* would further these objectives, thus reducing debt faster and creating more space for spending to improve public services and respond to shocks. The implementation of the Public Employment Bill by the executive branch marks an important milestone and ongoing public financial and debt management reforms will further strengthen the fiscal position.

46. There are ongoing efforts to make productivity gains more broad-based and to green the economy.

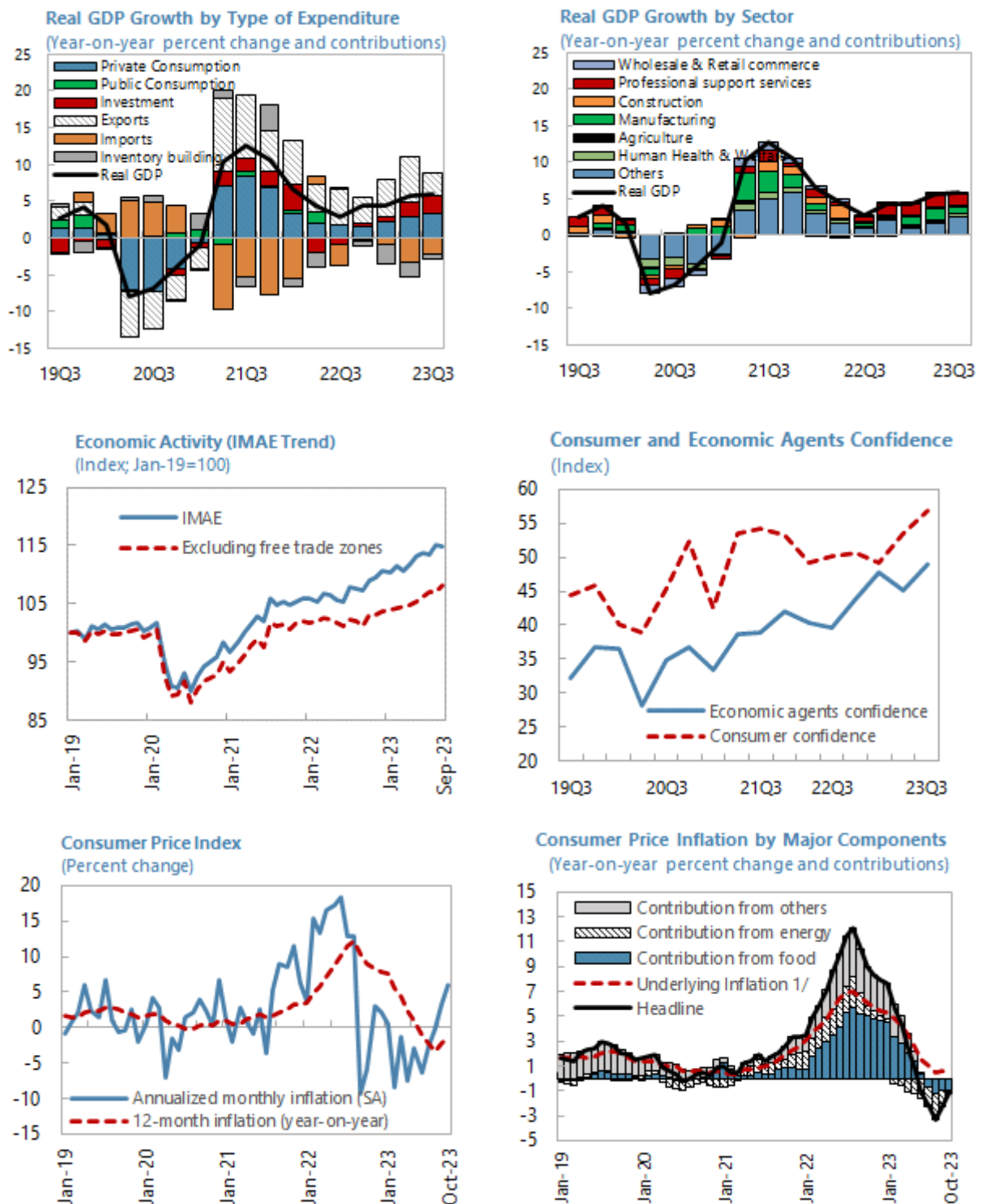
The authorities should deepen their ongoing efforts to boost female labor force participation in order to boost potential growth and reduce gender gaps in the labor market, which contribute to high income inequality. Simplifying the process for migrants to obtain residency and enroll in the social security system would also boost formal sector employment. Efforts to increase digital connectivity, reduce electricity costs, and improve educational outcomes will boost productivity throughout the economy. The authorities' efforts to publish guidelines to assess the climate impact of public projects, introduce a vehicle feebate scheme, expand climate transition fiscal risk analysis, and better evaluate climate change-related credit risks are all important steps forward.

47. Staff supports the authorities' request for completion of the fifth EFF review and the second review under the RSF arrangement.

Based on the strong macroeconomic performance, and important progress on structural reforms, staff supports disbursement of SDR 206.23 million under the EFF. Based on completion of RM1-RM8, staff supports disbursement of SDR 369.4 million under the RSF arrangement. Staff also supports the authorities' request for modification of RM12.

48. It is expected that the next Article IV consultation will be held on the 24-month cycle, in accordance with Decision No. 14747-(10/96).

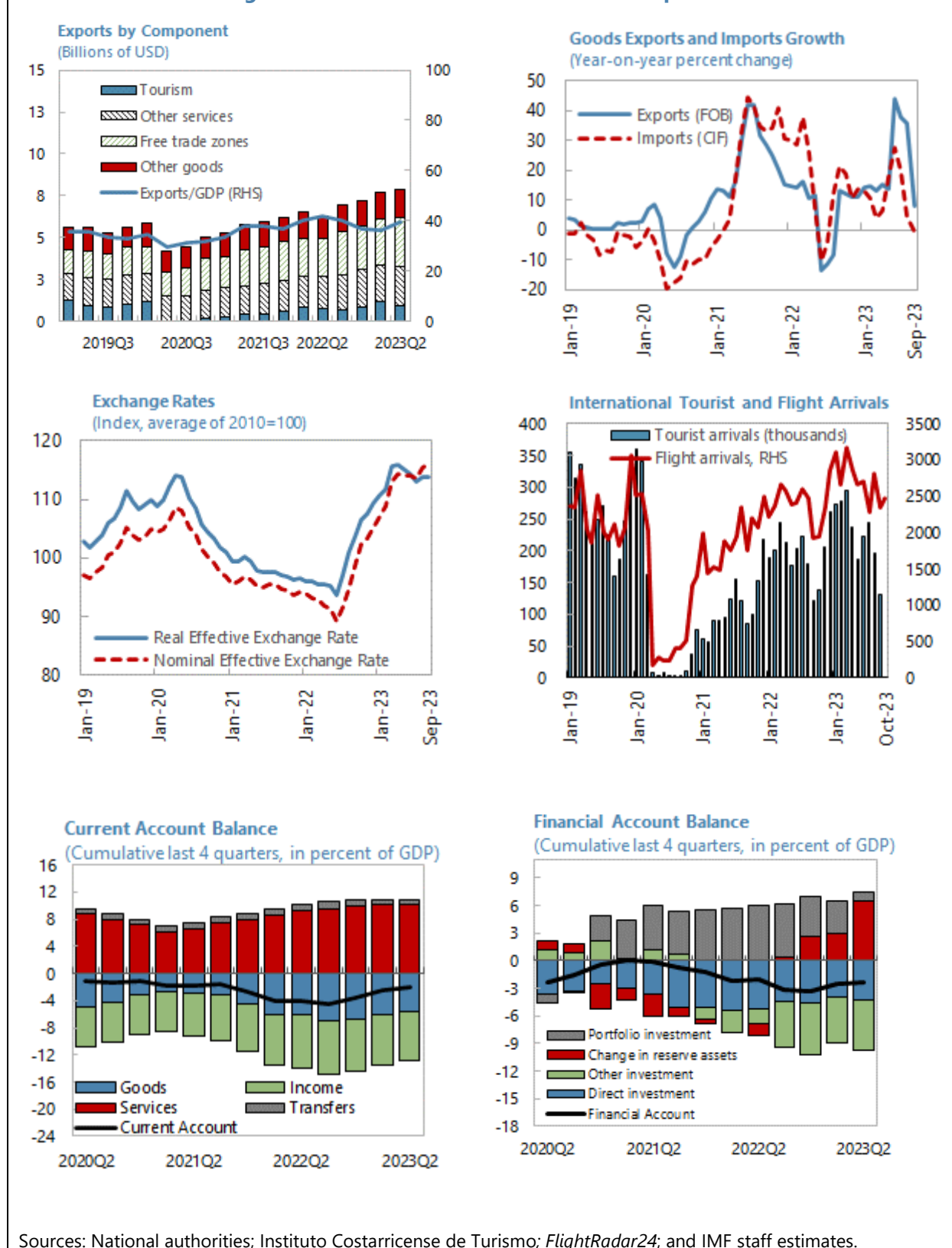
Figure 1. Costa Rica: Real Sector Developments



Sources: National authorities and IMF staff estimates.

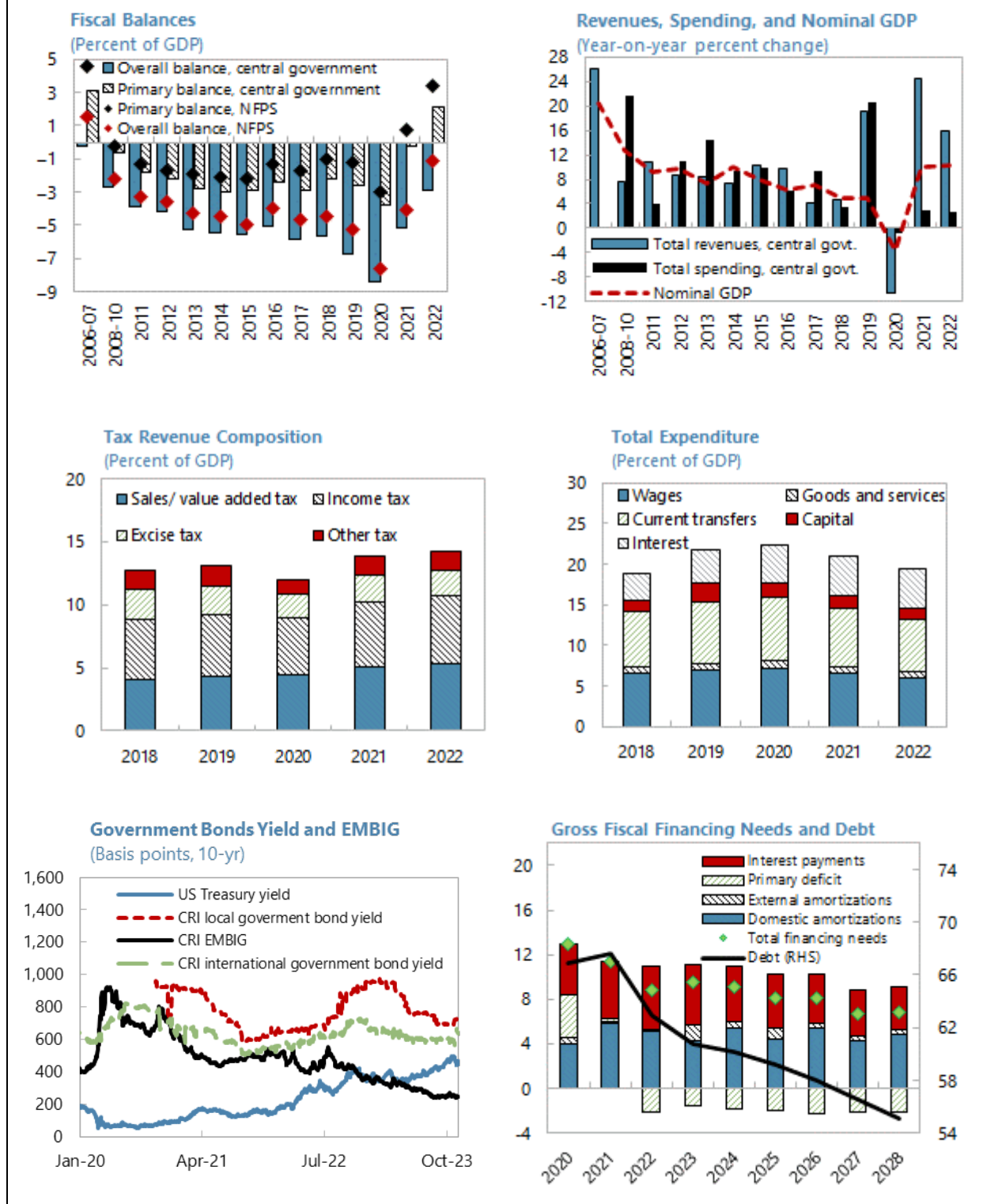
1/ Simple average of BCCR's five alternative measures of underlying inflation.

Figure 2. Costa Rica: External Sector Developments



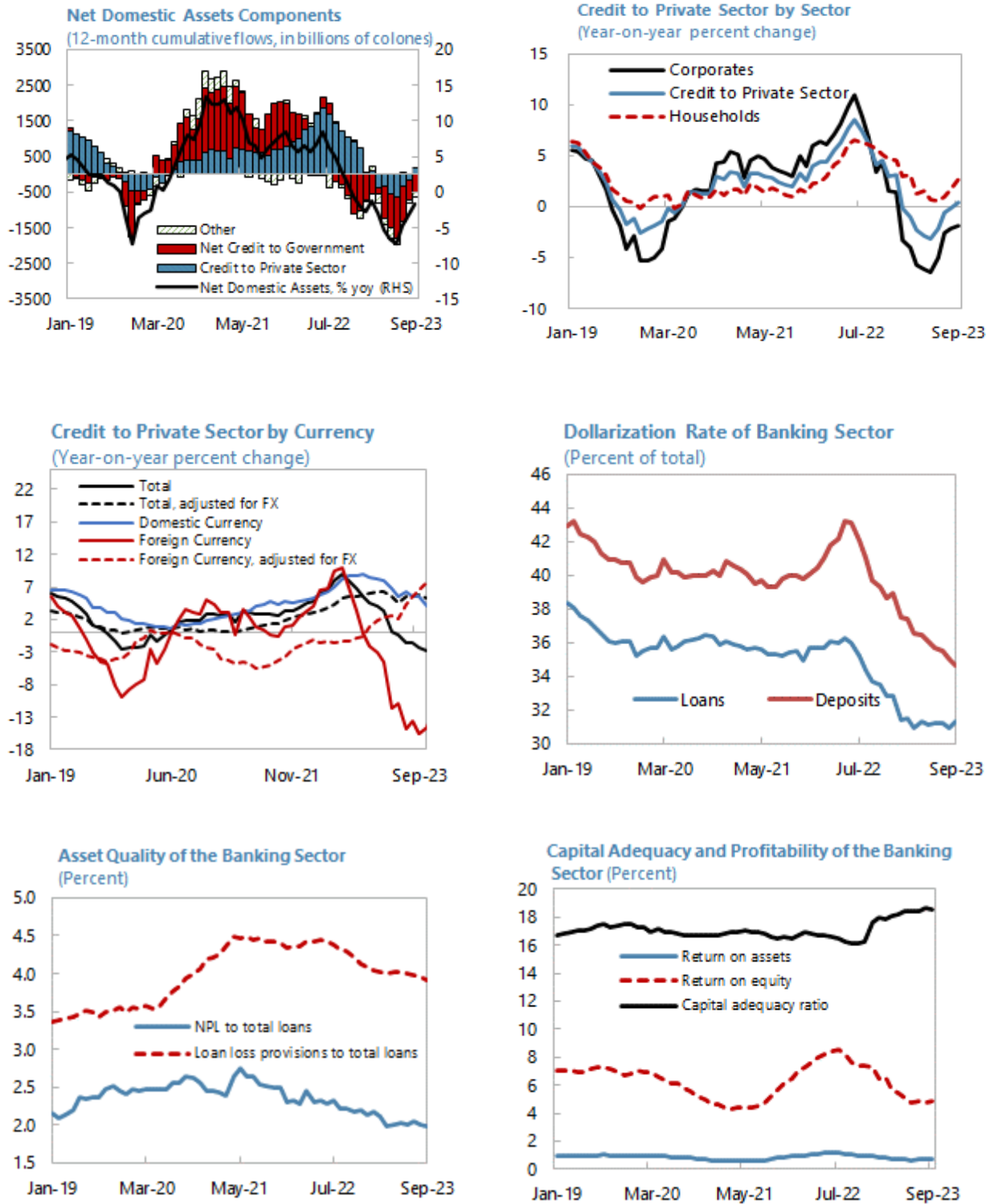
Sources: National authorities; Instituto Costarricense de Turismo; *FlightRadar24*; and IMF staff estimates.

Figure 3. Costa Rica: Fiscal Sector Developments



Sources: National authorities; World Bank; Bloomberg; and IMF staff estimates.

Figure 4. Costa Rica: Monetary and Financial Sector Developments



Sources: National authorities and IMF staff estimates.

Table 1. Costa Rica: Selected Economic and Financial Indicators

	2019	2020	2021	2022	Projections							
					2023	2023	2024	2024	2025	2026	2027	2028
					CR/23/231				CR/23/231			
National Income												
	(Annual percentage change)											
Real GDP	2.4	-4.3	7.9	4.6	3.0	5.1	3.2	3.5	3.3	3.3	3.3	3.3
Domestic demand	0.2	-4.8	8.6	2.0	2.7	2.6	2.7	3.0	3.0	3.0	3.1	3.1
Consumption	2.5	-5.3	6.9	3.2	2.8	3.5	2.7	3.0	2.8	2.8	2.9	2.9
Private	1.7	-6.9	8.3	3.4	3.2	4.1	3.0	3.3	3.2	3.2	3.2	3.2
Public	5.9	0.8	1.7	2.4	1.2	1.1	1.6	1.9	1.6	1.5	2.0	2.0
Gross fixed capital formation	-8.2	-3.4	7.8	1.5	5.3	4.7	2.4	4.2	1.7	3.8	3.5	3.5
Exports of goods and nonfactor services	4.3	-10.6	15.9	13.2	7.9	12.8	5.6	7.9	6.3	6.1	6.1	6.1
Imports of goods and nonfactor services	-2.3	-12.9	19.2	6.0	8.2	6.8	4.7	7.4	6.1	6.1	6.2	6.2
	(Contributions to real GDP growth)											
Domestic demand	0.2	-4.6	8.3	1.9	2.6	2.5	2.5	2.7	2.7	2.8	2.8	2.8
Consumption	2.0	-4.3	5.5	2.5	2.1	2.7	2.1	2.3	2.2	2.2	2.2	2.2
Gross domestic investment	-1.8	-0.3	2.8	-0.6	0.4	-0.2	0.4	0.4	0.5	0.6	0.6	0.6
of which: Inventory changes	-0.3	0.2	1.5	-0.9	-0.4	-1.0	0.0	-0.2	0.3	0.0	0.0	0.0
Net exports	2.2	0.4	-0.3	2.6	0.4	2.6	0.7	0.8	0.6	0.5	0.5	0.5
Prices												
	(Annual percentage change)											
GDP deflator	2.6	0.8	2.4	6.3	2.0	1.0	3.2	2.9	3.2	3.2	3.2	3.2
Consumer prices (period average)	2.1	0.7	1.7	8.3	1.9	0.7	3.0	1.9	3.0	3.0	3.0	3.0
Consumer prices (end of period)	1.5	0.9	3.3	7.9	2.1	-0.8	3.0	3.0	3.0	3.0	3.0	3.0
Savings and Investment												
	(In percent of GDP)											
Savings	16.1	16.2	18.6	18.3	20.2	16.2	19.9	17.1	17.5	17.5	17.4	17.5
Domestic savings	14.8	15.2	16.1	14.7	16.7	13.8	17.3	15.0	15.6	15.8	15.8	16.0
Private sector	17.4	20.9	17.9	13.7	17.8	12.9	17.8	13.6	13.9	13.8	13.6	13.7
Public sector	-2.6	-5.8	-1.8	1.0	-1.1	0.9	-0.5	1.4	1.7	2.0	2.2	2.3
External savings	1.3	1.0	2.5	3.6	3.4	2.3	2.7	2.1	1.9	1.7	1.6	1.5
Gross domestic investment	16.1	16.2	18.6	18.3	20.2	16.2	19.9	17.1	17.5	17.5	17.4	17.5
Private sector	13.2	14.1	16.3	16.1	18.2	14.0	17.8	14.8	15.1	15.0	14.8	14.8
Public sector	2.9	2.1	2.2	2.1	2.0	2.2	2.1	2.3	2.4	2.5	2.6	2.7
External Sector												
Current account balance	-1.3	-1.0	-2.5	-3.6	-3.4	-2.3	-2.7	-2.1	-1.9	-1.7	-1.6	-1.5
Trade balance	-6.0	-3.2	-4.3	-6.6	-5.7	-5.3	-5.7	-5.9	-6.1	-6.0	-6.0	-6.1
Services	9.8	7.2	7.5	9.7	7.6	8.1	8.5	8.8	9.0	9.0	9.1	9.3
Capital account balance	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account balance	-2.0	-0.4	-1.2	-3.2	-3.4	-2.3	-2.6	-2.1	-1.9	-1.7	-1.6	-1.5
Foreign direct investment, net	-4.2	-2.6	-4.8	-4.4	-3.4	-3.6	-3.2	-3.6	-3.6	-3.6	-3.6	-3.5
Gross international reserves (millions of U.S. dollars)	8,937	7,232	6,921	8,724	10,541	11,944	11,205	11,693	12,015	12,746	13,319	14,006
-as percent of ARA metric	132.5	108.4	97.8	101.7	110.5	122.9	110.1	115.8	114.3	114.4	113.7	113.8
-in months of next year's imports	6.1	4.0	3.1	3.4	4.0	4.2	3.9	3.8	3.7	3.7	3.7	4.0
External debt	47.8	49.6	49.7	51.7	47.5	47.3	48.4	45.4	45.0	45.2	44.9	44.6
Real effective exchange rate, avg. (percent change)	0.6	1.0	-9.2	1.8	...	...	...	...	...	...	...	...
Public Finances^{1/}												
Central government primary balance	-2.6	-3.7	-0.3	2.1	1.5	1.5	1.9	1.9	2.0	2.0	2.0	2.0
Central government overall balance	-6.7	-8.4	-5.1	-2.8	-3.4	-3.3	-2.8	-3.0	-2.6	-2.3	-2.1	-1.9
Central government debt	64.5	66.9	67.6	63.0	62.4	60.8	61.4	60.2	59.2	58.0	56.6	55.1
Money and Credit												
Credit to the private sector (percent change)	-2.3	3.4	3.7	3.3	3.8	1.4	6.0	6.0	6.2	6.2	6.2	6.2
Credit to the private sector (adjusted by exchange rate change)	0.1	1.0	2.4	6.1	4.6	5.5	5.8	5.9	6.0	6.0	6.1	6.0
Monetary base ^{2/}	7.1	8.3	7.8	8.0	7.9	8.1	7.8	7.8	7.8	7.8	7.8	7.8
Broad money	44.8	54.8	53.8	47.3	47.9	48.3	47.9	48.0	47.5	47.3	47.3	47.3
Memorandum Items												
Nominal GDP (billions of colones) ^{3/}	37,832	36,495	40,327	44,810	46,483	47,588	49,500	50,681	54,026	57,592	61,393	65,445
Output gap (as percent of potential GDP)	0.2	-3.6	0.1	-0.3	0.5	0.7	0.2	0.2	0.0	0.0	0.0	0.0
Unemployment rate	12.4	20.0	13.7	11.7	10.7	8.1	10.1	8.7	9.3	9.3	9.3	9.3

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

1/ As of January 2021, the CG definition has been expanded to include 51 public entities as per Law 9524. Data are adjusted back to 2019 for comparability.

2/ Includes currency issued and required reserves.

3/ National account data reflect the revision of the benchmark year to 2017 for the chained volume measures, published in January 2021.

Table 2. Costa Rica: Central Government Balance^{1/}

	2019	2020	2021	2022	Projections							
					2023	2023	2024	2024	2025	2026	2027	2028
					CR/23/231	CR/23/231						
	(In billions of colones)											
Revenue	5,676	5,077	6,326	7,341	7,320	7,277	7,766	7,732	8,267	8,814	9,387	9,995
Tax revenue	4,940	4,385	5,566	6,312	6,554	6,532	6,956	6,929	7,413	7,906	8,422	8,970
Nontax revenue ^{2/}	735	693	760	1,029	766	745	810	804	854	908	964	1,025
Expenditure	8,204	8,136	8,377	8,598	8,903	8,862	9,165	9,233	9,647	10,114	10,653	11,220
Current noninterest	5,803	5,781	5,839	5,803	5,827	5,855	5,952	5,990	6,302	6,625	7,015	7,430
Wages	2,613	2,612	2,624	2,627	2,666	2,654	2,739	2,724	2,783	2,862	3,001	3,150
Goods and services	327	337	342	356	376	380	382	402	421	452	491	531
Transfers	2,863	2,832	2,874	2,820	2,785	2,822	2,831	2,864	3,097	3,311	3,523	3,749
Interest ^{3/}	1,534	1,690	1,939	2,184	2,300	2,301	2,320	2,440	2,443	2,466	2,476	2,508
Capital	867	665	599	611	776	705	893	804	902	1,023	1,162	1,282
Primary balance	-994	-1,368	-112	927	717	716	921	939	1,063	1,166	1,209	1,283
Overall Balance	-2,529	-3,058	-2,051	-1,257	-1,583	-1,585	-1,399	-1,501	-1,380	-1,300	-1,266	-1,225
Total Financing	2,476	3,377	2,158	1,207	1,583	1,585	1,399	1,501	1,380	1,300	1,266	1,225
External (net)	1,119	724	645	1,051	1,809	1,213	1,574	1,941	752	960	840	487
of which RSF disbursement	0	0	0	0	...	0	...	397	0	0	0	0
Domestic (net)	1,358	2,654	1,513	156	-225	372	-175	-440	628	340	426	738
Central government debt	24,420	24,420	27,272	28,224	28,985	28,926	30,391	30,492	31,963	33,380	34,729	36,038
External	4,767	5,898	6,779	7,210	8,367	7,615	10,017	9,589	10,415	11,473	12,387	13,046
Domestic	19,653	18,522	20,493	21,014	20,618	21,311	20,374	20,902	21,549	21,906	22,342	22,992
	(In percent of GDP)											
Revenue	15.0	13.9	15.7	16.4	15.7	15.3	15.7	15.3	15.3	15.3	15.3	15.3
Tax revenue	13.1	12.0	13.8	14.1	14.1	13.7	14.1	13.7	13.7	13.7	13.7	13.7
Nontax revenue ^{2/}	1.9	1.9	1.9	2.3	1.6	1.6	1.6	1.6	1.6	1.6	1.6	1.6
Expenditure	21.7	22.3	20.8	19.2	19.2	18.6	18.5	18.2	17.9	17.6	17.4	17.1
Current noninterest	15.3	15.8	14.5	12.9	12.5	12.3	12.0	11.8	11.7	11.5	11.4	11.4
Wages	6.9	7.2	6.5	5.9	5.7	5.6	5.5	5.4	5.2	5.0	4.9	4.8
Goods and services	0.9	0.9	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8
Transfers	7.6	7.8	7.1	6.3	6.0	5.9	5.7	5.7	5.7	5.7	5.7	5.7
Interest ^{3/}	4.1	4.6	4.8	4.9	4.9	4.8	4.7	4.8	4.5	4.3	4.0	3.8
Capital	2.3	1.8	1.5	1.4	1.7	1.5	1.8	1.6	1.7	1.8	1.9	2.0
Primary balance	-2.6	-3.7	-0.3	2.1	1.5	1.5	1.9	1.9	2.0	2.0	2.0	2.0
Overall Balance	-6.7	-8.4	-5.1	-2.8	-3.4	-3.3	-2.8	-3.0	-2.6	-2.3	-2.1	-1.9
Total Financing	6.5	9.3	5.4	2.7	3.4	3.3	2.8	3.0	2.6	2.3	2.1	1.9
External (net)	3.0	2.0	1.6	2.3	3.9	2.5	3.2	3.8	1.4	1.7	1.4	0.7
of which RSF disbursement	0.0	0.0	0.0	0.0	...	0.0	...	0.8	0.0	0.0	0.0	0.0
Domestic (net)	3.6	7.3	3.8	0.3	-0.5	0.8	-0.4	-0.9	1.2	0.6	0.7	1.1
Central government debt	64.5	66.9	67.6	63.0	62.4	60.8	61.4	60.2	59.2	58.0	56.6	55.1
External	12.6	16.2	16.8	16.1	18.0	16.0	20.2	18.9	19.3	19.9	20.2	19.9
Domestic	51.9	50.8	50.8	46.9	44.4	44.8	41.2	41.2	39.9	38.0	36.4	35.1
Memorandum items:												
Non-interest expenditure growth (percent)												
in nominal terms	19.6	-3.4	-0.1	-0.4	2.9	2.3	3.7	3.6	6.0	6.2	6.9	6.5
in real terms	17.2	-4.1	-1.8	-8.0	1.0	1.6	0.6	1.6	3.0	3.1	3.8	3.4
Domestic financing without RSF (net)	1,358	2,654	1,513	156	...	372	...	-43	628	340	426	738
Nominal GDP (billions of colones)	37,832	36,495	40,327	44,810	46,483	47,588	49,500	50,681	54,026	57,592	61,393	65,445

Sources: Ministry of Finance and IMF staff estimates.

1/ As of January 2021, the CG definition has been expanded to include 51 public entities as per Law 9524. Data are adjusted back to 2019 for comparability.

2/ In 2022, includes a one-off transfer of surpluses from public entities accumulated before their CG consolidation and not used in 2021 and revenues that could not be identified due to the cyberattack.

3/ The inflation adjustment of the principal of TUDES (inflation indexed bonds) was recorded as interest expenditure.

Table 3. Costa Rica: Balance of Payments

	2019	2020	2021	2022	Projections							
					2023	2023	2024	2024	2025	2026	2027	2028
					CR/23/231		CR/23/231					
	(In millions of U.S. dollars)											
Current Account	-826	-632	-1,605	-2,469	-2,951	-2,036	-2,406	-2,017	-1,895	-1,821	-1,845	-1,822
Goods and services balance	2,424	2,477	2,096	2,091	1,603	2,476	2,512	2,817	2,975	3,187	3,549	3,757
Trade balance	-3,868	-2,018	-2,798	-4,597	-4,899	-4,642	-5,198	-5,580	-6,108	-6,365	-6,739	-7,260
Export of goods (f.o.b.)	11,831	12,067	14,873	16,706	18,185	19,214	19,473	20,769	22,368	24,095	25,543	26,948
Import of goods (f.o.b.)	15,700	14,085	17,671	21,303	23,084	23,855	24,671	26,348	28,476	30,461	32,282	34,208
Services balance	6,292	4,495	4,895	6,687	6,501	7,118	7,710	8,396	9,083	9,553	10,288	11,017
Primary Income	-3,832	-3,634	-4,251	-5,129	-5,131	-5,094	-5,516	-5,434	-5,500	-5,672	-6,092	-6,315
Secondary Income	582	526	550	570	577	582	599	601	630	664	698	735
Capital Account	32	18	19	20	23	23	25	25	28	30	33	37
Financial Account	-1,268	-272	-805	-2,212	-2,928	-2,014	-2,381	-1,991	-1,867	-1,790	-1,812	-1,786
Public sector	-1,002	421	-737	-1,279	-1,884	-771	-2,174	-2,905	-865	-1,181	-892	-194
Private sector	-1,658	1,061	195	-2,736	-2,862	-4,462	-871	1,164	-1,324	-1,340	-1,492	-2,279
Foreign direct investment, net	-2,695	-1,644	-3,146	-3,060	-2,895	-3,147	-2,925	-3,414	-3,598	-3,804	-3,996	-4,153
Other private sector flows	1,037	2,706	3,341	324	33	-1,315	2,054	4,577	2,274	2,464	2,504	1,874
Change in International Reserves (increase +)	1,393	-1,755	-263	1,803	1,817	3,220	664	-251	322	731	573	688
Errors and Omissions	-473	342	781	236	0	0	0	0	0	0	0	0
	(In percent of GDP)											
Current Account	-1.3	-1.0	-2.5	-3.6	-3.4	-2.3	-2.7	-2.1	-1.9	-1.7	-1.6	-1.5
Goods and services balance	3.8	4.0	3.2	3.0	1.9	2.8	2.8	3.0	3.0	3.0	3.2	3.2
Trade balance	-6.0	-3.2	-4.3	-6.6	-5.7	-5.3	-5.7	-5.9	-6.1	-6.0	-6.0	-6.1
Export of goods (f.o.b.)	18.4	19.3	22.9	24.1	21.2	22.0	21.5	21.9	22.2	22.6	22.7	22.7
Import of goods (f.o.b.)	24.4	22.6	27.2	30.8	26.9	27.3	27.2	27.8	28.3	28.6	28.7	28.8
Services balance	9.8	7.2	7.5	9.7	7.6	8.1	8.5	8.8	9.0	9.0	9.1	9.3
Of which: Travel balance	4.6	1.7	1.8	3.1	2.9	3.1	3.6	3.8	3.9	3.9	3.9	3.9
Exports of services	16.9	12.7	14.1	17.3	15.5	15.9	16.6	16.7	17.0	17.0	17.1	17.2
Imports of services	7.2	5.5	6.6	7.7	8.0	7.7	8.1	7.9	8.0	8.1	8.0	8.0
Primary Income	-5.9	-5.8	-6.5	-7.4	-6.0	-5.8	-6.1	-5.7	-5.5	-5.3	-5.4	-5.3
Secondary Income	0.9	0.8	0.8	0.8	0.7	0.7	0.7	0.6	0.6	0.6	0.6	0.6
Capital Account	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial Account	-2.0	-0.4	-1.2	-3.2	-3.4	-2.3	-2.6	-2.1	-1.9	-1.7	-1.6	-1.5
Public sector	-1.6	0.7	-1.1	-1.8	-2.2	-0.9	-2.4	-3.1	-0.9	-1.1	-0.8	-0.2
Private sector	-2.6	1.7	0.3	-4.0	-3.3	-5.1	-1.0	1.2	-1.3	-1.3	-1.3	-1.9
Foreign direct investment, net	-4.2	-2.6	-4.8	-4.4	-3.4	-3.6	-3.2	-3.6	-3.6	-3.6	-3.6	-3.5
Other private sector flows	1.6	4.3	5.1	0.5	0.0	-1.5	2.3	4.8	2.3	2.3	2.2	1.6
Change in International Reserves (increase +)	2.2	-2.8	-0.4	2.6	2.1	3.7	0.7	-0.3	0.3	0.7	0.5	0.6
Errors and Omissions	-0.7	0.5	1.2	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum Items:												
Non-oil current account (percent of GDP)	1.2	0.3	0.0	0.1	-1.2	0.1	-0.7	0.1	0.2	0.3	0.3	0.4
Terms of trade (annual percentage change)	-0.8	4.5	-3.0	-1.1	2.9	2.4	0.5	0.0	0.7	0.7	0.7	0.6
Gross international reserves (with RSF, millions of U.S. dollars)	8,937	7,232	6,921	8,724	10,541	11,944	11,205	11,693	12,015	12,746	13,319	14,006
Gross international reserves (without RSF, millions of U.S. dollars)	8,937	7,232	6,921	8,724	...	11,944	...	10,950	11,272	12,003	12,576	13,264
Net international reserves, program definition (millions of U.S. dollars) ^{1/}	6,099	3,712	2,884	3,871	4,623	6,354	4,638	4,981	5,240	5,788	6,218	6,896
External debt (percent of GDP) ^{2/}	47.8	49.6	49.7	51.7	47.5	47.3	48.4	45.4	45.0	45.2	44.9	44.6

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

1/ The program definition of NIR excludes FX deposits of residents other than the central government.

2/ Includes public and private sector debt.

Table 4. Costa Rica: Gross External Financing Needs and Sources

	2019	2020	2021	2022	Projections							
					2023	2023	2024	2024	2025	2026	2027	2028
					CR/23/231				CR/23/231			
	(In millions of U.S. dollars)											
Gross external financing needs	-8,143	-10,002	-10,427	-11,972	-16,220	-15,724	-14,125	-14,244	-13,854	-14,103	-14,340	-14,484
Current account balance	-826	-632	-1,605	-2,469	-2,951	-2,036	-2,406	-2,017	-1,895	-1,821	-1,845	-1,822
Amortization	-4,777	-4,885	-4,642	-5,473	-10,072	-10,137	-8,633	-8,703	-8,293	-8,052	-8,299	-8,437
Public sector, of which	-740	-1,145	-771	-358	-2,181	-2,181	-969	-967	-1,073	-638	-584	-424
Central government	-93	-340	-127	-148	-391	-391	-37	-36	-322	-368	-393	-226
Central bank	-377	-627	-2	-2	-275	-275	-550	-550	-275	0	0	0
Private sector	-4,036	-3,740	-3,871	-5,116	-7,891	-7,956	-7,664	-7,735	-7,220	-7,415	-7,715	-8,012
of which: short-term	-3,048	-2,709	-2,782	-3,977	-6,723	-6,723	-6,387	-6,387	-5,907	-6,059	-6,307	-6,535
Other net capital inflows 1/	-2,540	-4,485	-4,181	-4,030	-3,197	-3,551	-3,086	-3,525	-3,666	-4,230	-4,195	-4,225
Gross external financing sources	7,648	8,622	9,273	10,397	14,498	15,381	12,160	11,628	12,753	13,016	13,479	14,393
Capital transfers	32	18	19	20	23	23	25	25	28	30	33	37
Direct investment, net	2,695	1,644	3,146	3,060	2,895	3,147	2,925	3,414	3,598	3,804	3,996	4,153
Borrowing	6,313	5,206	5,845	9,119	13,398	15,431	9,874	7,939	9,449	9,913	10,022	10,890
Public sector, of which	2,262	524	576	500	3,149	3,415	1,984	2,062	1,643	1,538	1,422	1,333
Central government	1,539	215	-12	152	2,807	3,076	1,155	1,254	1,123	1,053	1,073	1,019
of which: Eurobonds	1,467	0	0	0	2,500	3,000	1,000	1,000	1,000	1,000	1,000	1,000
Central bank 2/	0	0	502	1,100	0	0	0	0	0	0	0	0
Private sector	4,051	4,682	5,270	8,619	10,249	12,016	7,890	5,877	7,806	8,375	8,600	9,558
Change in International reserves (increase -)	-1,393	1,755	263	-1,803	-1,817	-3,220	-664	251	-322	-731	-573	-688
Use of IMF credit	0	522	294	554	981	213	275	1,048	-187	-70	-140	-257
Purchases/disbursements	0	522	294	554	1,043	275	521	1,296	0	0	0	0
RFI	0	522	0	0	0	0	0	0	0	0	0	0
EFF	0	0	294	554	550	275	275	553	0	0	0	0
RSF	0	0	0	0	493	0	246	743	0	0	0	0
Repurchases/repayments	0	0	0	0	-62	-62	-246	-248	-187	-70	-140	-257
Other gross multilateral financing	495	858	861	1,021	741	130	1,690	1,568	1,288	1,157	1,000	349
World Bank	...	105	313	307	109	5	...	...	...	...	...	...
Inter-American Development Bank (IDB)	...	282	404	385	516	96	...	...	...	...	...	...
CAF	...	448	0	0	0	0	...	...	...	...	...	...
Central American Bank for Economic Integration (CABEI)	...	23	144	329	115	29	...	...	...	...	...	...
Debt rescheduling or refinancing	0	0	0	0	0	0	0	0	0	0	0	0
Other exceptional financing	0	0	0	0	0	0	0	0	0	0	0	0
Unidentified financing	0	0	0	0	0	0	0	0	0	0	0	0
Memorandum items:												
Gross multilateral support	495	1,380	1,154	1,575	1,783	405	2,211	2,864	1,288	1,157	1,000	349
In percent of GDP	0.8	2.2	1.8	2.3	2.1	0.5	2.4	3.0	1.3	1.1	0.9	0.3
Of which, committed	...	1,380	1,154	1,575	1,783	405	2,211	2,864	1,288	1,157	1,000	349
Of which, disbursed	...	1,380	1,154	0	0	0	0	0	0	0	0	0
IMF share of total gross multilateral financing (percent)												
Purchases and disbursements, flow basis	...	38	25	35	58	68	...	...	...	...	...	...
Purchases and disbursements, cumulative basis	...	38	32	33	41	36	...	...	...	...	...	...
Current account balance (percent of GDP)	-1.3	-1.0	-2.5	-3.6	-3.4	-2.3	-2.7	-2.1	-1.9	-1.7	-1.6	-1.5
Gross international reserves	8,937	7,232	6,921	8,724	10,541	11,944	11,205	11,693	12,015	12,746	13,319	14,006
In percent of the ARA metric	133	108	98	102	111	123	110	116	114	114	114	114
In percent of ST debt (remaining maturity)	183	156	126	85	117	132	123	136	146	149	153	153
In percent of gross external financing requirement	156	137	98	68	88	108	97	110	119	123	126	769
In months of next year's imports of G&S	6.1	4.0	3.1	3.4	4.0	4.2	3.9	3.8	3.7	3.7	3.7	4.0

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

1/ Also reflects the 2021 SDR allocation and changes in banks', corporates', and households' gross foreign assets.

2/ Includes FLAR credit line in 2022.

Table 5. Costa Rica: Monetary Survey

	2019	2020	2021	2022	Projections					
					2023	2023	2024	2024	2025	
					CR/23/231		CR/23/231			
(In billions of colones, unless otherwise indicated)										
Central Bank										
Net foreign assets	5,035	4,474	4,007	3,800	4,462	5,015	4,864	4,958	5,197	
<i>Of which</i> : Gross international reserves										
(In millions of U.S. dollars)	8,937	7,232	6,921	8,724	10,541	11,944	11,205	11,693	12,015	
Net domestic assets	-2,367	-1,441	-852	-195	-804	-1,177	-998	-980	-996	
Net domestic credit	-2,166	-1,894	-1,592	-1,745	-1,805	-2,255	-1,898	-2,367	-3,094	
Credit to nonfinancial public sector (net)	-549	-35	-306	-605	-505	-962	-505	-982	-982	
Credit to other depository corporations (net)	-1,579	-1,832	-1,204	-1,114	-1,274	-1,267	-1,367	-1,358	-2,086	
Credit to other financial corporations (net)	-38	-26	-82	-26	-26	-26	-26	-26	-26	
Credit to the private sector (net)	0	0	0	0	0	0	0	0	0	
Monetary stabilization instruments (-)	-1,859	-1,564	-1,364	-1,282	-1,398	-2,375	-1,398	-2,375	-2,375	
Other items (net)	-710	-226	-112	416	-17	1,037	-118	1,346	2,057	
Capital account (-)	2,367	2,243	2,216	2,416	2,416	2,416	2,416	2,416	2,416	
Monetary base ^{1/}	2,667	3,033	3,155	3,605	3,658	3,838	3,866	3,978	4,201	
Currency	1,305	1,498	1,529	1,495	1,555	1,556	1,648	1,650	1,754	
Required reserves	1,362	1,535	1,626	2,110	2,103	2,282	2,218	2,328	2,447	
Other Depository Institutions										
Net foreign assets	-1,681	-720	-63	693	1,116	857	1,336	1,166	1,459	
Net domestic assets	24,885	27,100	29,012	28,383	29,435	30,085	31,234	31,728	33,606	
Net domestic credit	28,483	30,630	33,228	33,317	34,292	34,867	35,813	35,960	38,171	
Credit to nonfinancial public sector (net)	2,674	3,900	5,841	5,185	4,954	5,118	4,750	4,573	4,299	
Credit to nonfinancial private sector	20,896	21,601	22,405	23,146	24,016	23,473	25,454	24,877	26,411	
In national currency	13,249	13,583	14,212	15,343	16,263	15,954	17,583	17,240	18,642	
In foreign currency	7,647	8,019	8,193	7,804	7,753	7,519	7,870	7,638	7,769	
Credit to financial corporations (net)	4,913	5,129	4,982	4,986	5,322	6,276	5,609	6,510	7,460	
Other items (net)	1,352	1,602	1,322	677	953	1,404	1,609	2,357	2,458	
Capital account	-4,950	-5,131	-5,538	-5,611	-5,810	-6,186	-6,187	-6,589	-7,023	
Liabilities to nonfinancial private sector	23,204	26,380	28,949	29,077	30,551	30,941	32,571	32,894	35,064	
In national currency	15,059	16,593	17,469	17,859	18,992	19,252	20,319	20,504	21,918	
In foreign currency	8,146	9,787	11,480	11,218	11,559	11,689	12,252	12,390	13,146	
<i>Of which</i> : Deposits (including CDs)	23,025	26,201	28,743	28,849	30,055	30,914	32,421	32,840	34,718	
Consolidated Financial System										
Net foreign assets	3,354	3,753	3,944	4,494	5,577	5,872	6,200	6,124	6,656	
Net domestic assets	21,080	23,953	25,828	25,625	26,006	26,299	27,418	27,998	29,636	
Net domestic credit	23,021	25,465	27,939	27,726	28,465	27,629	29,699	28,468	29,728	
Other items (net)	643	1,376	1,210	1,093	936	2,441	1,491	3,703	4,516	
Capital account	-2,583	-2,888	-3,322	-3,195	-3,394	-3,770	-3,771	-4,173	-4,607	
Broad money	16,957	19,990	21,683	21,215	22,264	22,996	23,713	24,344	25,686	
Memorandum Items										
					(Annual percentage change)					
Monetary base ^{1/}	-5.2	13.7	4.0	14.3	1.5	6.5	5.7	3.6	5.6	
Broad money	4.0	17.9	8.5	-2.2	4.9	8.4	6.5	5.9	5.5	
Credit to the private sector	-2.3	3.4	3.7	3.3	3.8	1.4	6.0	6.0	6.2	
In national currency	1.8	2.5	4.6	8.0	6.0	4.0	8.1	8.1	8.1	
In foreign currency	-8.6	4.9	2.2	-4.7	-0.6	-3.6	1.5	1.6	1.7	
Credit to the private sector (adjusted by exchange rate changes)	0.1	1.0	2.4	6.1	4.6	5.5	5.8	5.9	6.0	
					(In percent of GDP)					
Monetary base ^{1/}	7.1	8.3	7.8	8.0	7.9	8.1	7.8	7.8	7.8	
Broad money	44.8	54.8	53.8	47.3	47.9	48.3	47.9	48.0	47.5	
<i>Of which</i> : Deposits denominated in foreign currency	14.2	18.5	20.4	18.7	19.0	17.8	18.7	17.3	17.1	
Credit to the private sector	55.2	59.2	55.6	51.7	51.7	49.3	51.4	49.1	48.9	
<i>Of which</i> : In foreign currency	20.2	22.0	20.3	17.4	16.7	15.8	15.9	15.1	14.4	
Central bank balance	-0.4	0.3	0.1	-0.4	0.0	0.0	0.0	0.0	0.0	

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

1/ Includes currency issued and required reserves.

Table 6. Costa Rica: Financial Soundness Indicators

	2017	2018	2019	2020	2021	2022	2023
	Dec	Dec	Dec	Dec	Dec	Dec	Sep
	(In percent)						
Capitalization							
Risk-adjusted capital ratio	16.8	16.7	17.5	16.8	16.5	17.7	18.6
Capital-to-assets ratio	13.9	14.2	15.2	14.4	14.4	14.4	15.4
Asset quality							
Nonperforming loans to total loans	2.0	2.1	2.4	2.5	2.3	2.1	2.0
Non-income generating assets to total assets	16.2	16.3	15.8	18.3	17.1	18.5	17.2
Foreclosed assets to total assets	0.8	1.0	1.1	1.1	1.0	1.0	1.0
Loan loss provisions to total loans	2.8	3.3	3.5	4.2	4.3	4.1	3.9
Credit in foreign currency to total credit	39.2	39.1	36.6	37.1	36.6	33.7	32.3
Management							
Administrative expenses to total assets	3.1	3.1	3.2	3.0	2.9	3.1	3.3
Noninterest expenses to gross income	73.7	77.6	83.1	82.0	79.1	88.4	89.1
Total expenses to total revenues	94.8	95.6	96.7	97.2	94.6	96.9	98.3
Profitability							
Return on assets (ROA)	0.9	0.9	1.0	0.6	0.9	1.0	0.7
Return on equity (ROE)	6.5	6.8	6.8	4.6	6.5	7.2	4.9
Interest margin to gross income	25.3	21.3	16.4	18.9	26.9	13.8	10.3
Liquidity							
Liquid assets to total short-term liabilities	102.7	98.6	96.8	93.9	89.9	89.9	92.1
Liquid assets to total assets	29.1	28.0	29.8	33.0	35.7	33.8	33.4
Loans to deposits ^{1/}	112.3	113.1	105.6	99.0	95.6	94.8	94.3
Liquid assets to deposits	45.5	43.7	44.6	50.0	52.4	48.6	47.5
Sensitivity to market risk							
Net open FX position to capital	22.7	21.1	23.5	25.1	25.6	24.4	20.9
Other							
Financial margin ^{2/}	6.6	7.1	7.1	6.7	7.0	7.0	5.8

Source: Superintendency of Banks (SUGEF).
1/ Loans (including contingent credits) divided by deposits held by the public.
2/ Difference between implicit loan and deposit rates.

Table 7. Costa Rica: Indicators of Fund Credit

	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	2036	2037	2038	2039	2040	2041	2042	2043	2044	2045			
Fund obligations based on existing credit																										
(millions of SDRs)																										
Principal	46.2	184.7	138.5	51.6	103.1	137.5	137.5	137.5	137.5	85.9	34.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Charges and interest ^{1/}	0.0	69.0	55.7	48.1	43.2	35.6	28.5	21.4	14.2	8.1	4.6	3.8	3.8	3.8	3.8	3.8	3.8	3.8	3.8	3.8	3.8	3.8	3.8	3.8		
Fund obligations based on existing and prospective credit																										
(millions of SDRs)																										
Principal	46.2	184.7	138.5	51.6	103.1	189.1	206.3	206.3	206.3	154.7	103.1	63.4	55.4	55.4	55.4	55.4	55.4	55.4	55.4	55.4	55.4	9.2	0.0	0.0		
GRA	46.2	184.7	138.5	51.6	103.1	189.1	206.3	206.3	206.3	154.7	103.1	17.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
RSF	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	46.2	55.4	55.4	55.4	55.4	55.4	55.4	55.4	55.4	55.4	9.2	0.0	0.0		
Charges and interest ^{1/2/}	2.9	115.5	113.8	107.6	105.4	94.8	78.5	64.1	53.3	43.7	36.6	32.2	29.2	26.4	23.5	20.7	17.9	15.0	12.2	9.3	6.5	4.1	3.8	3.8		
Total obligations based on existing and prospective credit																										
Millions of SDRs																										
Percent of exports of goods and services	0.2	1.1	0.9	0.5	0.6	0.8	0.8	0.7	0.6	0.4	0.3	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0	
Percent of gross international reserves	0.6	3.4	2.8	1.7	2.1	2.7	2.6	2.3	2.1	1.5	1.0	0.6	0.5	0.5	0.4	0.4	0.4	0.4	0.3	0.3	0.3	0.2	0.0	0.0	0.0	
Percent of government revenue	0.5	2.8	2.2	1.3	1.6	2.1	2.0	1.8	1.6	1.1	0.8	0.5	0.4	0.4	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.0	0.0	0.0	0.0	
Percent of public external debt service	1.8	14.1	10.9	8.2	10.0	12.9	12.2	10.8	9.8	7.0	4.6	3.0	2.5	2.2	2.0	1.8	1.7	1.5	1.3	1.2	1.1	0.2	0.1	0.1	0.1	
Percent of GDP	0.1	0.4	0.3	0.2	0.3	0.3	0.3	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Percent of quota	13.3	81.3	68.3	43.1	56.4	76.8	77.1	73.2	70.3	53.7	37.8	25.9	22.9	22.1	21.4	20.6	19.8	19.1	18.3	17.5	16.8	3.6	1.0	1.0	1.0	
Principal	12.5	50.0	37.5	14.0	27.9	51.2	55.8	55.8	55.8	41.9	27.9	17.2	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	2.5	0.0	0.0	0.0	
GRA	12.5	50.0	37.5	14.0	27.9	51.2	55.8	55.8	55.8	41.9	27.9	4.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
RSF	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	12.5	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	2.5	0.0	0.0	0.0	
Outstanding IMF credit based on existing and prospective drawings																										
Millions of SDRs																										
GRA	1,354.5	1,376.0	1,237.5	1,185.9	1,082.8	893.7	687.5	481.2	275.0	120.3	17.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
RSF	369.4	554.1	554.1	554.1	554.1	554.1	554.1	554.1	554.1	554.1	554.1	507.9	452.5	397.1	341.7	286.3	230.9	175.5	120.1	64.7	9.2	0.0	0.0	0.0	0.0	
Percent of exports of goods and services	7.0	7.1	6.1	5.6	5.0	4.1	3.3	2.6	2.0	1.5	1.2	1.0	0.8	0.7	0.5	0.4	0.3	0.2	0.1	0.1	0.1	0.0	0.0	0.0	0.0	
Percent of gross international reserves	19.3	22.1	20.1	18.5	16.7	14.0	11.3	8.8	6.6	5.1	4.0	3.3	2.8	2.3	1.9	1.5	1.1	0.8	0.5	0.3	0.0	0.0	0.0	0.0	0.0	
Percent of government revenue	17.3	17.9	15.7	14.5	12.9	10.8	8.7	6.8	5.1	3.9	3.1	2.6	2.2	1.8	1.4	1.1	0.9	0.6	0.4	0.2	0.0	0.0	0.0	0.0	0.0	
Percent of total public external debt	13.9	12.8	11.1	10.0	8.8	7.5	6.0	4.7	3.5	2.7	2.2	1.8	1.5	1.2	1.0	0.8	0.6	0.4	0.3	0.1	0.0	0.0	0.0	0.0	0.0	
Percent of GDP	2.6	2.7	2.4	2.2	2.0	1.7	1.3	1.0	0.8	0.6	0.5	0.4	0.3	0.3	0.2	0.2	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	
Percent of quota	466.7	522.5	485.0	471.0	443.1	391.9	336.1	280.3	224.4	182.6	154.7	137.5	122.5	107.5	92.5	77.5	62.5	47.5	32.5	17.5	2.5	0.0	0.0	0.0	0.0	
GRA	366.7	372.5	335.0	321.0	293.1	241.9	186.1	130.3	74.4	32.6	4.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
RSF	100.0	150.0	150.0	150.0	150.0	150.0	150.0	150.0	150.0	150.0	150.0	137.5	122.5	107.5	92.5	77.5	62.5	47.5	32.5	17.5	2.5	0.0	0.0	0.0	0.0	
Net use of IMF credit (millions of SDRs)																										
Disbursements	1,723.9	206.2	-138.5	-51.6	-103.1	-189.1	-206.3	-206.3	-206.3	-154.7	-103.1	-63.4	-55.4	-55.4	-55.4	-55.4	-55.4	-55.4	-55.4	-55.4	-55.4	-9.2	0.0	0.0	0.0	
Repayments and repurchases	1,770.1	390.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Memorandum items:																										
Exports of goods and services (millions of U.S. dollars)	33,068	36,636	39,466	42,225	44,820	47,433	50,563	53,900	57,458	61,250	65,293	69,602	74,196	79,093	84,313	89,877	95,809	102,133	108,873	116,059	123,719	131,884	140,589	140,589	140,589	
Gross international reserves (millions of U.S. dollars)	11,944	11,693	12,015	12,746	13,319	14,006	14,931	15,916	16,967	18,086	19,280	20,553	21,909	23,355	24,896	26,540	28,291	30,158	32,149	34,271	36,533	38,944	41,514	41,514	41,514	
Quota (millions of SDRs)	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4

Source: IMF staff estimates and projections.

1/ Based on the GRA rate of charge of 5.179 percent as of November 9, 2023.

2/ Costa Rica belongs to the RST Interest Group C. Based on the RST rate of interest of 5.129 percent as of November 9, 2023.

Table 8. Costa Rica: Access and Phasing Under the Extended Fund Facility

Availability Date	Millions of SDR	Percent of Quota	Conditions
March 1, 2021	206.34	55.86	Board approval of the Extended Arrangement under the Extended Fund Facility
October 15, 2021	103.115	27.91	First review and continuous and end-July 2021 performance criteria
March 15, 2022	103.115	27.91	Second review and continuous and end-December 2021 performance criteria
October 15, 2022	206.23	55.83	Third review and continuous and end-June 2022 performance criteria
March 15, 2023	206.23	55.83	Fourth review and continuous and end-December 2022 performance criteria
October 15, 2023	206.23	55.83	Fifth review and continuous and end-June 2023 performance criteria
March 15, 2024	206.23	55.83	Sixth review and continuous and end-December 2023 performance criteria
Total	1237.49	335	
<i>Memorandum item:</i>			
Quota	369.40		

Source: IMF staff calculations.

Table 9. Costa Rica: Access Under the Resilience and Sustainability Facility Arrangement

Availability Date	Millions of SDR	Percent of Quota	Conditions
March 15, 2023	46.175	12.50	Reform measure 1 implementation review
March 15, 2023	46.175	12.50	Reform measure 2 implementation review
March 15, 2023	46.175	12.50	Reform measure 3 implementation review
March 15, 2023	46.175	12.50	Reform measure 4 implementation review
October 15, 2023	46.175	12.50	Reform measure 5 implementation review
October 15, 2023	46.175	12.50	Reform measure 6 implementation review
October 15, 2023	46.175	12.50	Reform measure 7 implementation review
October 15, 2023	46.175	12.50	Reform measure 8 implementation review
March 15, 2024	46.175	12.50	Reform measure 9 implementation review
March 15, 2024	46.175	12.50	Reform measure 10 implementation review
March 15, 2024	46.175	12.50	Reform measure 11 implementation review
March 15, 2024	46.175	12.50	Reform measure 12 implementation review
Total	554.10	150.00	
<i>Memorandum item:</i>			
Quota	369.40		

Source: IMF staff calculations.

Table 10. Costa Rica: RSF Reform Measure Matrix

REFORM PRIORITY	REFORM MEASURE (RM)	TENTATIVE DATE	BACKGROUND ANALYSIS	RM EXPECTED OUTCOME
Integrating climate change risks into fiscal planning	RM1. Ministry of Finance to develop and publish guidelines for climate budget tagging.	End-February 2023 (completed)	<i>Agence Française de Développement</i> (AFD) and IDB TA.	Improved tracking of climate-related spending in the budget and financial reporting.
	RM5. Ministry of Finance to publish a quantitative analysis of climate transition fiscal risks.	End-November 2023 (completed)	IMF CD supporting the development of a methodology to quantify the fiscal risks from climate transition. IDB TA.	Integration of key possible fiscal effects of decarbonization efforts into fiscal planning (e.g., MTFE).
Strengthening Public Investment and Infrastructure Resilience	RM6. MIDEPLAN to develop and publish guidelines to expand the project appraisal process to assess the impact of the project on climate change through the social cost of carbon.	End-September 2023 (completed)	IMF PIMA and C-PIMA. World Bank TA.	Reduced greenhouse gas emissions from public investments. Helps improve project quality and execution, thus accelerating climate-related financing.
	RM9. MIDEPLAN to publish guidelines on project selection criteria including a range of climate change criteria for SNIP entities.	End-December 2023 (on track)	IMF PIMA and C-PIMA. World Bank TA (e.g., PEFA). IDB TA.	Methodology to score and prioritize to promote resilience in public infrastructure and decarbonization. Helps improve project quality and execution, thus accelerating climate-related financing.
	RM10. MIVAH, in collaboration with MINAE, to develop and publish guidelines for including climate change analysis in Regulatory Plans.	End-February 2024 (on track)	IMF PIMA and C-PIMA. World Bank and AFD TA.	Improved spatial planning to promote resilient infrastructure.
Supporting Decarbonization	RM2. Government to approve implementing regulation to simplify the administrative procedures for private participation in power generation from renewable sources for self-consumption.	End-December 2022 (completed)	IDB diagnostics.	Improved competition in the electricity sector, accelerating electrification.
	RM7. Government to submit to the Legislative Assembly a bill to introduce feebate scheme to strengthen incentives for low-pollution private vehicles.	End-September 2023 (completed)	IMF CD on feebate design, using the Climate Policy Assessment Tool.	Reduced emissions from private cars.
	RM11. Government to appraise and publish a review of existing tax incentives with a negative effect on the environment to support decarbonization efforts.	End-February 2024 (on track)	GIZ technical support to develop a methodology to assess tax expenditures through a climate lens.	Facilitated removal of incentives to engage in activities with negative environmental impact and reduction of tax expenditures.

Table 10. Costa Rica: RSF Reform Measure Matrix (Concluded)

Greening Reserves and Strengthening Financial Sector Resilience	RM4. BCCR to publish indicators of the “greenness” of its reserve holdings in its 2022 Annual Report.	End-February 2023 (completed)	Priority identified in the BCCR’s climate change roadmap, guided by recommendations of the Network of Central Banks and Supervisors for Greening the Financial System.	Prioritization of environmentally friendly investment of the reserve holdings.
	RM3. BCCR to create a repository with data on climate hazards; industrial and geographical vulnerability to climate events; banks’ lending exposure to vulnerable industries and regions.	End-February 2023 (completed)	Critical intermediate step to achieve RM12.	An integrated database needed to systematically capture climate-related financial sector risks.
	RM8. CONASSIF to approve regulation on management of socioenvironmental risks and climate change risks in the credit portfolio.	End-September 2023 (completed)	Priority identified by the authorities.	Improved management of socioenvironmental credit risks by regulated financial sector entities.
	RM12. BCCR to develop a methodology to incorporate climate effects on the banking sector in its top-down stress testing, based on data aggregated from granular information, and capturing those new risks on credit risk parameters.	End-February 2024 (on track)	Priority identified in the BCCR’s climate change roadmap. Methodology guided by recommendations of the Network of Central Banks and Supervisors for Greening the Financial System.	Diagnostic of climate-related credit risks, supporting the management of those risks.

Annex I. External Sector Assessment

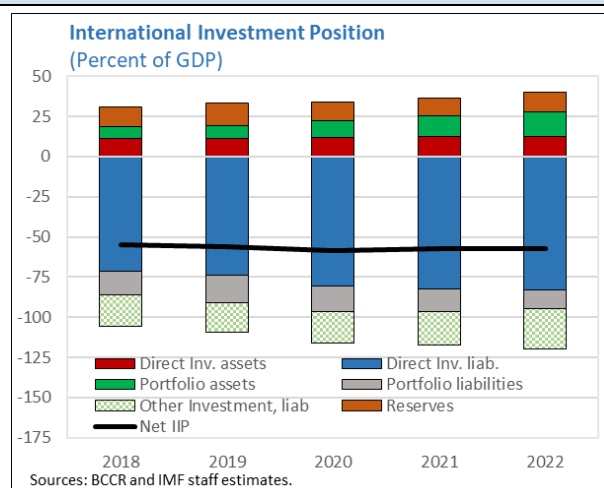
Overall Assessment: The external position of Costa Rica in 2022 was stronger than the level implied by fundamentals and desirable policies. Robust performance of exports, especially from free zones, continued recovery of the tourism sector, and lower commodity prices in 2022H2 eased BOP pressures, bringing the headline current account (CA) to -3.6 percent of GDP. This assessment takes a medium-term view, with desirable policies set at medium-term levels and temporary factors removed. After adjusting for the pandemic-related factors, staff finds a cyclically adjusted CA of -1.5 percent of GDP.

Potential Policy Responses: The authorities' fiscal consolidation and BCCR's data-dependent monetary policy approach should continue to support external sustainability. An adequate level of international reserve buffers will allow authorities to respond to adverse external shocks. The structural agenda will provide conditions for growth, which will support a robust external position in the medium-term.

Foreign Assets and Liabilities: Position and Trajectory

Background. The NIIP has been trending down slowly since 2020 and, for 2022, that trend reflects increments in portfolio assets and international reserves: the NIIP reached -57.1 percent of GDP in 2022. Liabilities mainly include FDI (69.3 percent of total) with non-portfolio (21.1 percent) and portfolio (9.6 percent) external debt comprising most of remainder. External debt was 51.7 percent of GDP in 2022. It is projected to stabilize at 44.6 percent of GDP. About 15.7 percent of external debt is at short-term maturity and nearly all external debt is denominated in foreign currency.

Assessment. The substantial share of FDI in Costa Rica's liabilities mitigate potential risks from its large net debtor position. Strong performance of FDI inflows have been observed between 2020 and 2022, reaching FDI liabilities equal 83 percent of GDP, and that trend has continued in 2023 y-t-d. Performance of public sector external debt in the medium-term would also indicate a trend towards sustainability. This is further indicated by the results of the ES model. The positive CA gap indicates the CA is higher than the level required to stabilize the NIIP.



2022 (% GDP): -3.6	NIIP: -57.1	Gross Assets: 62.8	Debt Assets: 27.3	Gross Liab.: 119.9	Debt Liab.: 36
-----------------------	-------------	--------------------	-------------------	--------------------	----------------

Current Account

Background. The current account deficit widened to 3.6 percent of GDP in 2022 (elevated above the five-year average of 2.3 percent). In 2022H1, Costa Rica faced high commodity prices and weak recovery of tourism sector. However, in 2022H2, BOP pressures eased due to lower commodity prices, a strong export performance (especially from free zones, which are mainly driven by external demand), a continued recovery of the tourism sector, and robust FDI inflows. Those drivers have been persistent in 2023H1, which might imply further improvement in the current account over the medium term.

Assessment. The EBA current account (CA) model suggests a current account gap of 2.3 percent of GDP in 2022, after including the adjustor to the current account for the temporary impact of the pandemic. In 2021, the gap was 0.5 percent of GDP. The main domestic driver of the policy gap in 2022 – the difference between current and desirable policies - has been the fiscal balance gap (in comparison to world average), coming from the fiscal consolidation under the EFF program. The EBA external sustainability (ES) model indicates a current account gap of 2.4 percent of GDP, meaning that the current account deficit is smaller than the level needed to stabilize net foreign assets at the 2022 level.

Costa Rica continues to pursue an ambitious free trade agenda: in March 2023 Costa Rica signed a free trade agreement with Ecuador, requested membership to both the Pacific Alliance and the CPTPP; and began negotiations of trade agreements with UAE and Israel. This agenda will expand opportunities for trade-based growth.

Costa Rica: EBA Model Estimates, 2022				
(In percent of GDP, unless otherwise indicated)				
	2022			
	CA	REER	REER	ES
	model	index	level	model
	model	model	model	model
CA-Actual	-3.6			-3.6
Cyclical Contributions (from model)	-0.3			-0.3
Temporary factors related to the pandemic 1/	-1.9			-1.9
Adjusted CA	-1.4			-1.4
CA Norm (from model) 2/	-3.7			-3.8
Adjustments to the norm	0.0			0.0
Adjusted CA Norm	-3.7			-3.8
CA Gap	2.3	2.2	-3.3	2.4
o/w Policy gap	1.0			
Elasticity	-0.29	-0.29	-0.29	-0.29
REER Gap (in percent)	-8.0	-7.5	11.3	-0.8

1/ These include adjustments for travel: 1.1, and transport: 0.8.
2/ Cyclically adjusted, including multilateral consistency adjustments.

Real Exchange Rate

Background. The REER and NEER appreciated 1.8 and 0.5 percent (average) during 2022, respectively. In 2022H1, the REER and NEER continued the trend observed in the last 5 years, with average depreciation of 2.7 and 3.4 percent, respectively. However, that trend changed in 2022H2 and the REER and NEER appreciated 9.3 and 7.9 percent, respectively vs. 2022H1. As of September 2023, the REER and NEER have further appreciated 14.1 and 18.1 percent, respectively, with respect to the average values observed in 2022.

Assessment. The EBA current account model estimates a REER gap of -8 percent using an elasticity of -0.29. The REER index and level models indicate a gap of -7.5 and 11.3, respectively. The fit of these models is not as good as the CA model, so the assessment is based on the CA model.

Capital and Financial Accounts: Flows and Policy Measures

Background. Costa Rica's capital flows have been dominated by FDI inflows for many years. In 2022, inward FDI continued the trend observed in 2021 with a rise of inflows relative to pre-pandemic levels. In 2022, inward FDI were 54 percent of net inward capital flows (debits), and net FDI (debit and credit) accounted for 123.9 percent of the CA. In addition, other investment inflows reached US\$4.1 billion (or 61.6 percent of net inward capital flows) driven by lending to the Central Bank (US\$1.1 billion from FLAR), the

government (US\$1.1 billion), and non-financial sector (US\$0.9 billion). However, net flows of other investments accounted to 66.5 percent of the CA. Net portfolio outflows increased US\$0.9 billion, associated with capital outflows from pension funds and reduction of portfolio inflows in government bonds.

Assessment. Costa Rica shows a robust structure of external financing with strong FDI inflows that can cover the current account balance. Portfolio investments abroad by pension funds slowed down since 2022H2 as domestic financial assets' yields increased, easing the pressure on the exchange rate. However, changes in external and/or domestic financial conditions might trigger the acceleration of those capital outflows.

FX Intervention and Reserves Level

Background. Gross international reserves (GIR) increased US\$1.8 billion in 2022, reaching US\$8.6 billion or 101.8 percent of the IMF's metric for assessing reserve adequacy (ARA metric) for countries with floating exchange rates. Until end-October 2023, the BCCR has bought about US\$3.1 billion on a net basis, in addition to changes in reserves from other sources like external debt disbursements and service. By end-October 2023, GIR stood at US\$11.5 billion.

The BCCR operates within a managed floating regime, limiting FX intervention to address episodes of exchange rate volatility. The BCCR also acts as intermediary for SOEs to smooth out their large FX transactions. In 2022, intervention to address volatility amounted to US\$192 million in net FX sales and intervention on behalf of SOEs amounted to US\$195 million in net purchases. In particular, during 2022H1 net FX sales reached US\$851 million and were mainly driven by the increase in the import energy bill and other financial requirements by SOEs, as well as a response to FX volatility due to pension fund outflows. During 2022H2 net FX purchases were US\$853 million as BOP pressures eased in that period.

Assessment. In 2022, Costa Rica's GIR returned above 100 percent of ARA adequacy metric. In 2023, it is expected that GIR will reach 123 percent of the ARA metric and stabilize around 114 percent of the ARA metric at the end of the projection period.

Adequacy Metrics		
Gross International Reserves, 2022		
(percent unless noted otherwise)		
Metric	Level	Benchmark
Million of US dollars	8577	
ARA metric (floating)	100.4	100-150
Short-term debt at remaining maturity	84.7	100
Broad money	24.6	20
Months of next year's imports	3.4	3

Source: IMF staff estimates

Annex II. Risk Assessment Matrix

Risks		Policy Response
External		
Intensification of regional conflict(s). Escalation of Russia's war in Ukraine or other regional conflicts and resulting economic sanctions disrupt trade (e.g., energy, food, tourism, and/or critical supply chain components), remittances, FDI and financial flows, and payment systems, and lead to refugee flows.	<p>High Likelihood</p> <p>Medium Impact</p>	Maintain adequate level of international reserve buffers to respond to adverse changes in international food and energy supply and, in case of increased global inflation. Maintain forward-looking data dependent approach in setting monetary policy to guard against inflation shocks. Maintain exchange rate flexibility to help absorb external shocks. Use created fiscal space to help protect social goals during fiscal consolidation, while securing debt sustainability.
<p>Abrupt global slowdown or recession. Global and idiosyncratic risk factors combine to cause a synchronized sharp growth downturn, with recessions in some countries, adverse spillovers through trade and financial channels, and market fragmentation causing sudden stops in EMDEs.</p> <p>U.S.: Amid tight labor markets and/or commodity price shocks, inflation remains elevated, prompting the Fed to keep rates higher for longer and resulting in more abrupt financial, housing and commercial real estate market correction, and "hard landing".</p>	<p>Medium Likelihood</p> <p>High Impact</p> <p>Medium Likelihood</p> <p>High Impact</p>	<p>Maintain flexibility of the exchange rate as absorber of external shocks. Consider monetary and fiscal policy mix to mitigate impacts on growth and inflation based on Costa Rica's cyclical position. Maintain adequate level of international reserve buffers to respond to potential capital outflows. Preserve financial sector's capital adequacy buffers to cushion the impact of global financial tightening conditions, increase in risk premia, financial assets repricing and, as a result, deteriorating asset quality.</p> <p>U.S.: given Costa Rica's strong trade and financial linkages, monetary policy should be calibrated to anchor inflation expectations, while flexible exchange rate and international reserve buffers help absorb shocks and potential capital flow reversals. Fiscal policy should support growth and protect vulnerable social sectors, while preserving sustainability of public debt.</p>
Commodity price volatility. A succession of supply disruptions (e.g., due to conflicts and export restrictions) and demand fluctuations (e.g., reflecting economic rebound) causes recurrent commodity price volatility, external and fiscal pressures, and social and economic instability.	<p>High Likelihood</p> <p>Medium Impact</p>	Maintain data-dependent forward-looking approach in setting monetary policy while maintaining exchange rate flexibility to absorb international price shocks. Maintain priority social spending during fiscal consolidation process.

Risks		Policy Response
Domestic		
Climate event El Niño 2023. This climate event might be present in 2023H2 and early 2024. Adverse impact on food production and prices, with pressure on higher inflation and weaker-than-expected growth.	High Likelihood High Impact	Maintain monetary policy stance that mitigates the impact of rise in food prices on domestic inflation. Use fiscal space to support growth, while prioritizing social spending towards vulnerable populations.
Political fragmentation leading to inability to pass key reform measures or adverse changes to the executive's proposals. The government only holds a small minority of seats. Costa Rica's government has shown capacity to build coalitions in the Legislative Assembly to approve key economic reforms, including several complex reforms during the EFF program. However, its ability to do so has recently been increasingly challenged.	Medium Likelihood Medium Impact	Rebuild coalitions across party lines in the Legislative Assembly and assess the macrocriticality of the ongoing reforms to elaborate strategies to get agreement in the approval process.
Vulnerability to cyber-attacks in key sectors of the economy. Costa Rica had an important cyber-attack in 2022 that targeted several government systems. While the authorities were able to contain the negative effects, future attacks, including, on the financial system, could have more serious consequences.	Medium Likelihood Medium Impact	Continue public sector training programs to minimize the risk of cyberthreats. In the financial sector, continued efforts to strengthen the supervisory capacity among financial sector supervisors and raise awareness in the financial sector. Approval of cybersecurity regulation by end-January 2024.
Sudden surge of migration flows. Higher-than-expected migration flows crossing Costa Rica's territory, which might generate unanticipated fiscal outlays and additional challenges in migrants' integration processes.	Medium Likelihood Medium Impact	Increase priority social spending while safeguarding the fiscal consolidation process to ensure that public debt firmly remains on a downward trend. Close coordination with key stakeholders and additional support from development partners can help Costa Rica cope with rising migration flows.

Annex III. Sovereign Risk and Debt Sustainability Assessment

Table 1. Costa Rica: Risk of Sovereign Stress

Horizon	Mechanical signal	Final assessment	Comments
Overall	...	Low	The overall risk reflects a relatively consistent level of vulnerability over the medium term and long term as well as the sustainability assessment.
Near term 1/	n.a	n.a.	Not applicable.
Medium term	Low	Low	The mechanical signal has declined since 2022 and the last assessment. It is on the threshold between a low and moderate risk signal and thus sensitive to changes in the assumptions. The final assessment is informed by the signals as well as the macroeconomic and contingent liability stress scenarios.
Fanchart	Moderate	...	
GFN	Moderate	...	
Stress test	...	...
Long term	...	Low	Climate-related long-term debt risks are limited. Debt risks from aging include an alternative baseline of slower GDP growth as well as scenarios illustrating pension and healthcare pressures in the absence of further reforms.
Sustainability assessment 2/	...	Sustainable	With the implementation of the envisaged policies under the program and Medium-term Fiscal Framework, debt will be on a downward path and financing needs will moderate.
Debt stabilization in the baseline			Yes

Source: Fund staff.

Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.

1/ The near-term assessment is not applicable in cases where there is a disbursing IMF arrangement. In surveillance-only cases or in cases with precautionary IMF arrangements, the near-term assessment is performed but not published.

2/ A debt sustainability assessment is optional for surveillance-only cases and mandatory in cases where there is a Fund arrangement. The mechanical signal of the debt sustainability assessment is deleted before publication. In surveillance-only cases or cases with IMF arrangements with normal access, the qualifier indicating probability of sustainable debt ("with high probability" or "but not with high probability") is deleted before publication.

DSA Summary Assessment

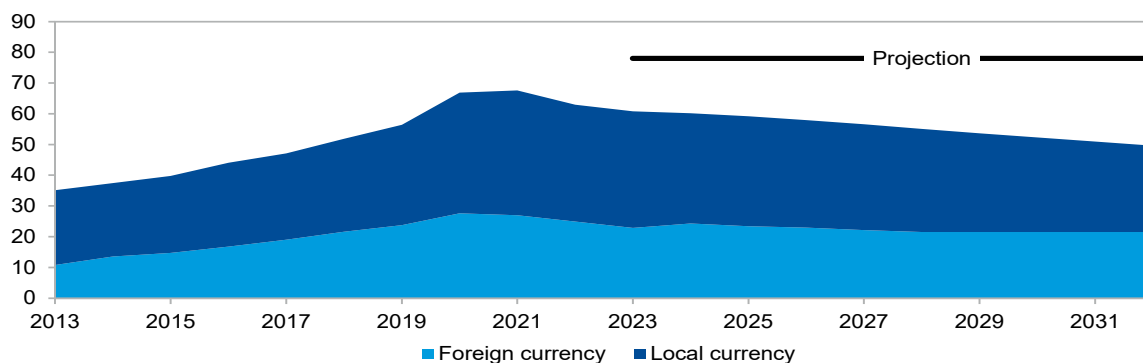
Commentary: Under the baseline scenario, Costa Rica's public debt is assessed to remain sustainable. Public debt is projected to decline to 60.2 percent of GDP in 2024, which is about 5½ percentage points lower than in the previous assessment, and reach 50 percent before 2035. The main driver of expected debt dynamics is the fiscal discipline that is expected to continue after the EFF program. Gross financing needs, estimated at about 9 percent in 2024, are expected to decline over the medium term, while the government has accelerated its build-up of cash deposits to meet obligations. Financing is expected to come from official external sources, domestic debt, and Eurobonds. Broader coverage beyond the central government would aid a more comprehensive assessment.

Table 2. Costa Rica: Debt Coverage and Disclosures

										Comments	
1. Debt coverage in the DSA: 1/			CG	GG	NFPS	CPS	Other				
1a. If central government, are non-central government entities insignificant?									No		
2. Subsectors included in the chosen coverage in (1) above:											
Subsectors captured in the baseline											Inclusion
CPS	NFPS	GG: expected	CG	1	Budgetary central government						Yes
				2	Extra budgetary funds (EBFs)						No
				3	Social security funds (SSFs)						No
				4	State governments						No
				5	Local governments						No
				6	Public nonfinancial corporations						No
				7	Central bank						No
				8	Other public financial corporations						No
3. Instrument coverage:			Currency & deposits	Loans	Debt securities	Oth acct. payable 2/	IPSGGs 3/				
4. Accounting principles:			Basis of recording		Valuation of debt stock						
			Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/				
5. Debt consolidation across sectors:			Consolidated		Non-consolidated						
Color code: ■ chosen coverage ■ Missing from recommended coverage ■ Not applicable											
Reporting on intra-government debt holdings											
		Holder	Budget. central govt	Extra-budget. funds	Social security funds	State govt.	Local govt.	Nonfin. pub. corp.	Central bank	Oth. pub. fin corp	Total
CPS	NFPS	GG: expected	CG	1	Budget. central govt						0
				2	Extra-budget. funds						0
				3	Social security funds						0
				4	State govt.						0
				5	Local govt.						0
				6	Nonfin pub. corp.						0
				7	Central bank						0
				8	Oth. pub. fin. corp						0
Total			0	0	0	0	0	0	0	0	
<p>1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.</p> <p>2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.</p> <p>3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.</p> <p>4/ Includes accrual recording, commitment basis, due for payment, etc.</p> <p>5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).</p> <p>6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.</p> <p>7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.</p>											
<p>Commentary: Coverage focuses on the central government due to data timeliness and quality concerns for the broader public sector. Supplementary data suggests unconsolidated domestic debts of other general government entities is about 0.5 percent of GDP and that consolidated debt is lower than for the central government alone partly due to social security fund holdings of government securities. The authorities have resumed progress in improving data timeliness, quality, and coverage with IMF TA including by expanding GFSM2014 standards to the general government</p>											

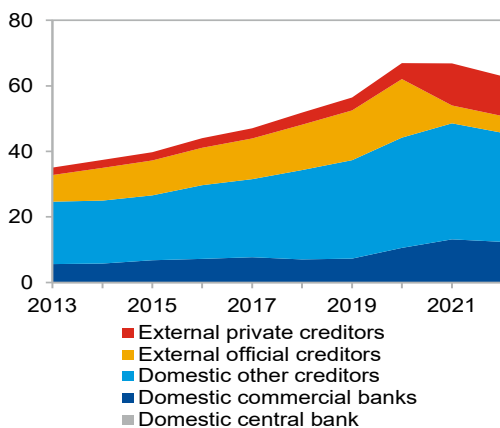
Figure 1. Public Debt Structure Indicators

Debt by Currency (percent of GDP)



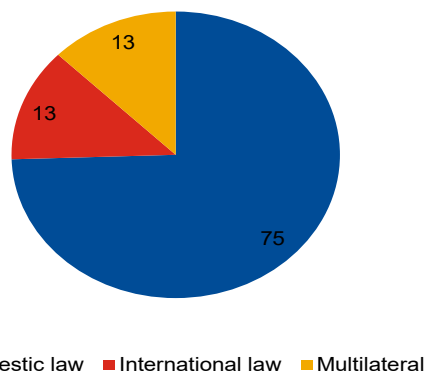
Note: The perimeter shown is central government.

Public Debt by Holder (percent of GDP)



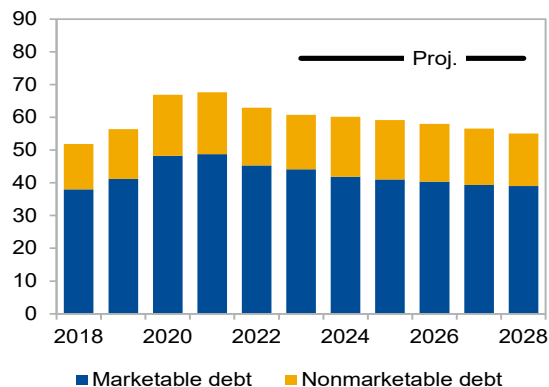
Note: The perimeter shown is central government.

Public Debt by Governing Law, 2022 (percent)



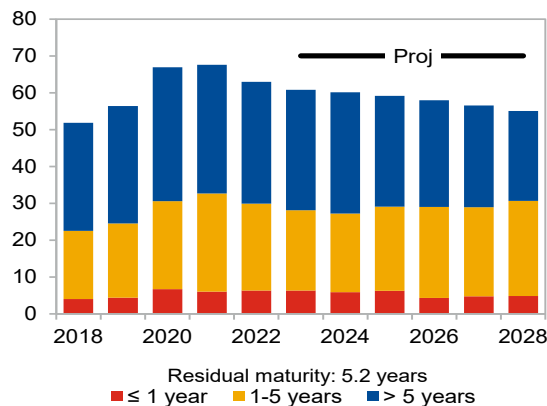
Note: The perimeter shown is central government.

Debt by Instruments (percent of GDP)



Note: The perimeter shown is central government.

Public Debt by Maturity (percent of GDP)



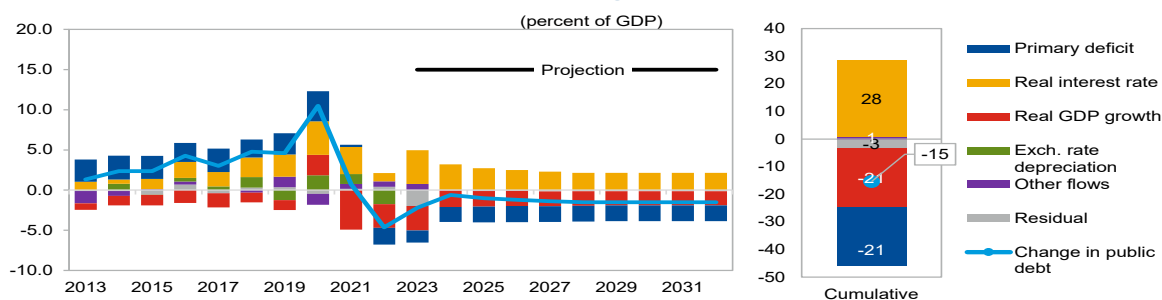
Note: The perimeter shown is central government.

Commentary: Consistent with the Medium-term Debt Strategy, the authorities are expected to continue to benefit from multilateral funding in the short term. The authorities returned to the Eurobond market in 2023 and have legislative approval for issuance in future years.

Table 3. Costa Rica: Baseline Scenario

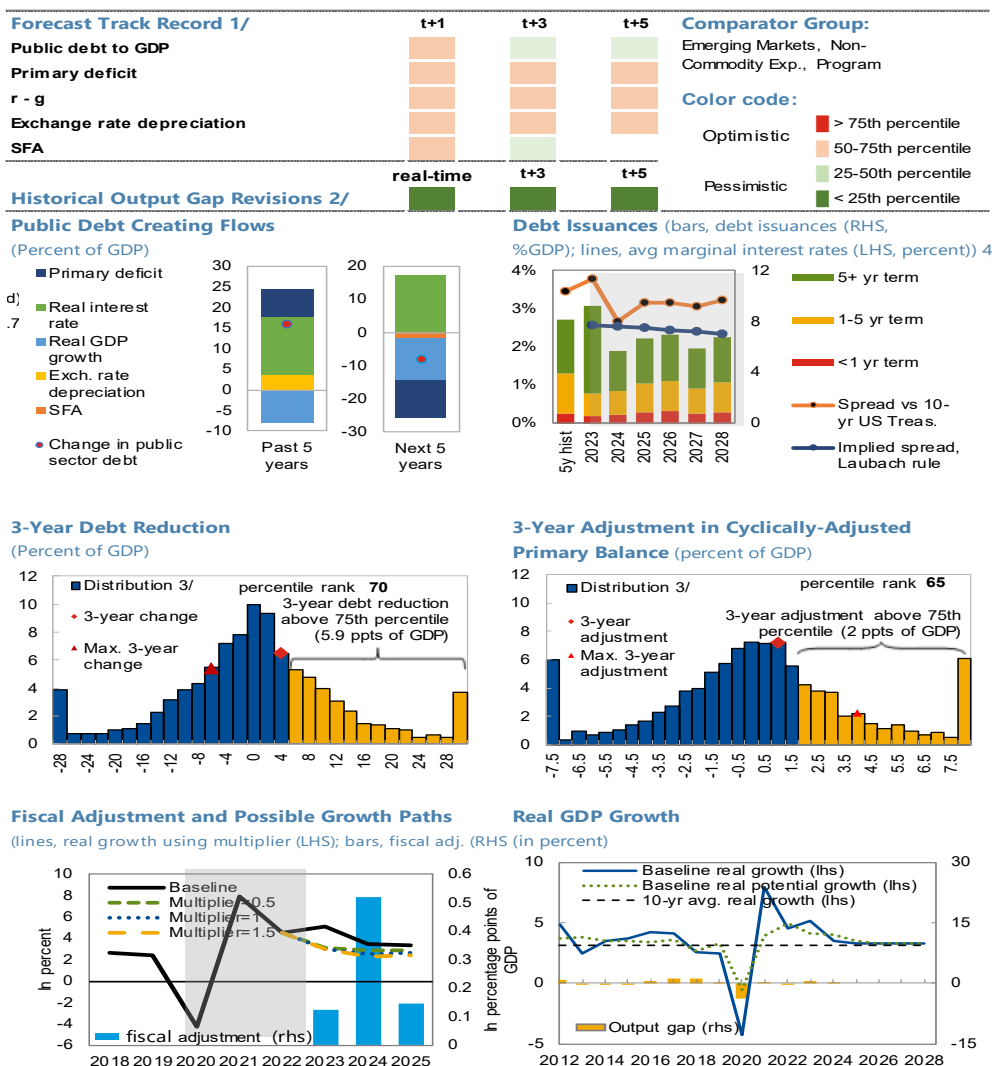
(percent of GDP unless indicated otherwise)

	Actual		Medium-term projection						Extended projection			
	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	
Public debt	63.0	60.8	60.2	59.2	58.0	56.6	55.1	53.6	52.3	50.9	49.6	
Change in public debt	-4.6	-2.2	-0.6	-1.0	-1.2	-1.4	-1.5	-1.4	-1.4	-1.3	-1.3	
Contribution of identified flows	-5.1	-0.2	-0.6	-0.9	-1.1	-1.2	-1.4	-1.4	-1.4	-1.3	-1.3	
Primary deficit	-2.1	-1.5	-1.9	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0	
Noninterest revenues	16.4	15.3	15.3	15.3	15.3	15.3	15.3	15.3	15.3	15.3	15.3	
Noninterest expenditures	14.3	13.8	13.4	13.3	13.3	13.3	13.3	13.3	13.3	13.3	13.3	
Automatic debt dynamics	-3.7	0.5	1.2	1.1	0.9	0.7	0.6	0.5	0.6	0.6	0.6	
Int. rate-growth differential	-1.9	1.2	1.1	0.8	0.6	0.4	0.3	0.3	0.4	0.4	0.4	
Real interest rate	1.1	4.2	3.2	2.7	2.5	2.3	2.1	2.1	2.0	2.0	1.9	
Real growth rate	-2.9	-3.1	-2.1	-1.9	-1.9	-1.9	-1.8	-1.8	-1.7	-1.6	-1.5	
Real exchange rate	-1.6	...	...	...	...	...	...	...	...	...	...
Relative inflation	-0.2	-0.6	0.1	0.3	0.3	0.3	0.3	0.2	0.2	0.2	0.2	
Other identified flows	0.7	0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other transactions	0.7	0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contribution of residual	0.4	-2.0	-0.1	-0.1	-0.1	-0.2	-0.1	0.0	0.0	0.0	0.0	
Gross financing needs	8.1	9.1	8.9	8.0	8.1	6.8	7.1	6.8	6.6	6.4	6.2	
of which: debt service	10.2	10.6	10.8	10.0	10.1	8.8	9.0	8.8	8.6	8.3	8.1	
Local currency	6.9	6.9	7.6	6.3	7.3	5.9	7.1	6.9	6.7	6.5	6.4	
Foreign currency	3.2	3.6	3.2	3.7	2.9	2.8	2.0	1.9	1.9	1.8	1.8	
Memo:												
Real GDP growth (percent)	4.6	5.1	3.5	3.3	3.3	3.3	3.3	3.3	3.3	3.1	3.1	
Inflation (GDP deflator; percent)	6.3	1.0	2.9	3.2	3.2	3.2	3.2	3.0	3.0	3.0	3.0	
Nominal GDP growth (percent)	11.1	6.2	6.5	6.6	6.6	6.6	6.6	6.4	6.4	6.4	6.4	
Effective interest rate (percent)	8.0	8.2	8.4	8.0	7.7	7.4	7.2	7.2	7.2	7.2	7.2	

Contribution to change in public debt

Commentary: A sizeable frontloaded fiscal consolidation and a stronger currency reduced debt in 2022 and in 2023 despite increases in cash balances and interest payments. The end-2024 debt forecast is about 5½ percentage points lower than in the last assessment. Under the baseline, debt is expected to continue to decline over the medium term. Following the existing parameters of the fiscal rule, which are expected to allow progressively more spending room, especially after debt falls below 60 percent of GDP, the primary balance is expected to stabilize at about 2 percent of GDP. Debt is expected to fall below 50 percent of GDP before 2035 and enter a range that provides a prudent safety buffer to respond to adverse shocks while keeping debt below standard stress thresholds with a high probability (See Costa Rica Technical Assistance Report- Upgrading the Rule-based Fiscal Framework, Country Report 23/97).

Figure 2. Realism of Baseline Assumptions Track Record



Source : IMF Staff.

1/ Projections made in the October and April WEO vintage. Program status not used in creating comparator group due to lack of data.

2/ Percentile rank of the country's output gap revisions (defined as the difference between real time/period ahead estimates and final estimates in the latest October WEO) in the total distribution of revisions across the data sample.

3/ Data cover annual observations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis.

4/ The Lauback (2009) rule is a linear rule assuming bond spreads increase by about 4 bps in response to a 1 ppt increase in the projected debt-to-GDP ratio.

Commentary: Realism analysis does not trigger major concerns. The structural improvement in the primary balance is underpinned by EFF program commitments, which have thus far been exceeded, and the fiscal rule. The baseline does not include yields from recently implemented tax compliance measures or savings from the Public Employment Bill's implementation. The spread is expected to decline in 2024 due to large use of more favorable multilateral financing sources and less pressure on local markets. GDP growth projections are in line with recent averages, implied fiscal multipliers, and potential growth estimates.

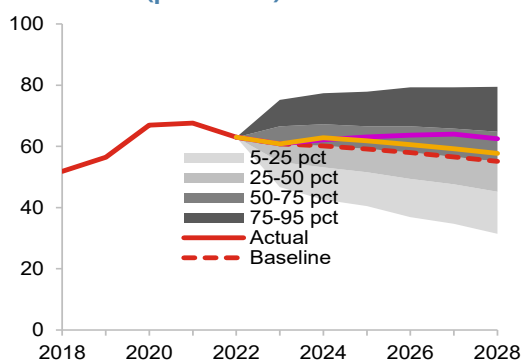
Figure 3. Medium-term Risk Analysis
Debt Fanchart and GFN Financeability Indexes

(percent of GDP unless otherwise indicated)

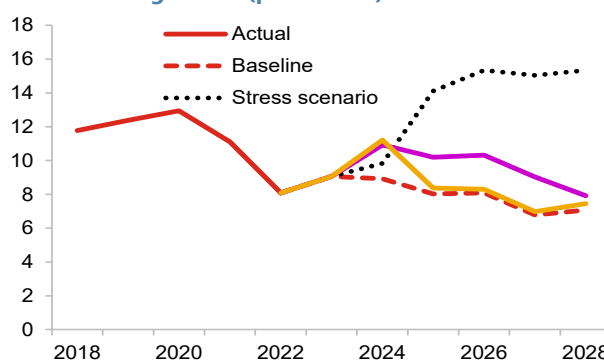
Module	Indicator	Value	Risk index	Risk signal	EMs., Non-Com. Exp, Program				
					0	25	50	75	100
Debt fanchart module	Fanchart width	48.0	0.7	...	[Progress bar]				
	Probability of debt not stabilizing (pct)	9.4	0.1	...	[Progress bar]				
	Terminal debt level x institutions index	27.6	0.6	...	[Progress bar]				
Debt fanchart index		...	1.4	Moderate					
GFN financeability module	Average GFN in baseline	8.0	2.7	...	[Progress bar]				
	Bank claims on government (pct bank assets)	10.8	3.5	...	[Progress bar]				
	Chg. in claims on govt. in stress (pct bank assets)	7.7	2.6	...	[Progress bar]				
GFN financeability index		...	8.8	Moderate					

Legend: [Interquartile range] Costa Rica

Final fanchart (pct of GDP)



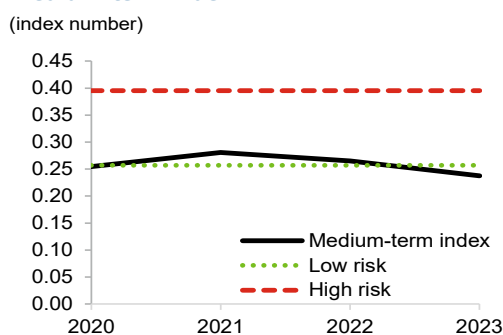
Gross Financing Needs (pct of GDP)



Triggered stress tests (stress tests not activated in gray)

Banking crisis Commodity prices Exchange rate Contingent liab. Natural disaster

Medium-term Index



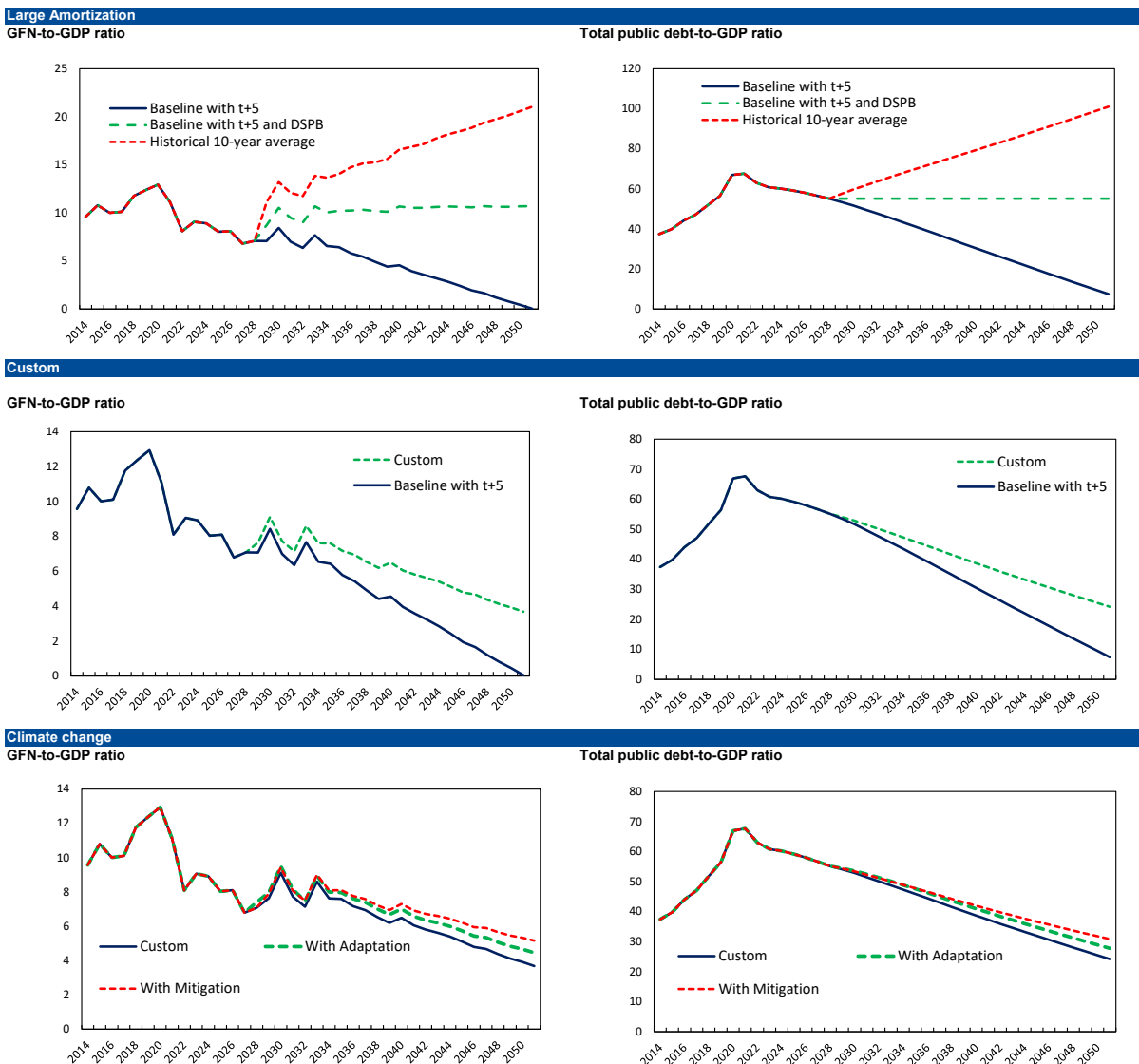
Medium-term Risk Analysis

	Low risk threshold	High risk threshold	Weight in MTI	Normalized level
Debt fanchart index	1.1	2.1	0.5	0.31
GFN financeability index	7.6	17.9	0.5	0.17
Medium-term index (MTI)	0.26	0.40	...	0.24, Low

Prob. of missed crisis, 2023-2028 (if stress not predicted): 9.1 pct.
 Prob. of false alarm, 2023-2028 (if stress predicted): 43.2 pct.

Commentary: The MTI has fallen to just below the low-risk threshold. The fanchart estimates risks, including those from forecast uncertainty, to be moderate. The GFN module indicates lower risks than for comparators, and cash buffers have been rebuilt. The contingent liability test includes debts of local government and the CCSS (1/2 percent of GDP) as well as central government contingent liabilities (8 1/2 percent). Contingent liabilities include 6 percent of GDP that is the subject of a disputed claim by the CCSS (which is within general government) on the central government. The test, in which 9 percent of GDP is paid over four years, postpones further debt reduction but does not increase GFNs as much as the default stress scenario (growth reduced by 1 standard deviation for 2 years, interest rates rise by up to 300 bps, a depreciation equal to the largest of the last 10 years, shorter borrowing maturities, as well as incomplete rollover and no new financing by foreign private creditors). The natural disaster shock is customized to a fiscal cost of 2.3 percent of GDP and a 0.7 percent GDP reduction

Figure 4. Long-term Risk Analysis



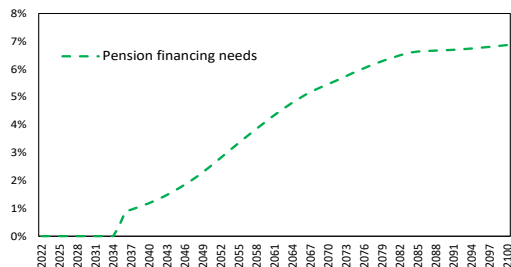
Commentary: The default large amortization module calculates gross financing needs (GFNs) and debt based on amortization from existing debt under three illustrative scenarios. The custom scenario has a more conservative baseline, which has a primary balance averaging 1.4 percent of GDP over the long term (consistent with the fiscal rule, which allows higher spending as debt falls) and GDP growth slowing by 0.04 percent per year, mainly due to a declining labor force, to about 2 percent in 2060 (about half the deceleration modelled by the OECD in the absence of any growth-enhancing reforms). Debt and financing needs are projected to keep falling over the long run under the customized baseline. The lower interest rate and long maturity of RSF financing reinforce this trend. The standardized climate change adaptation module adds costs of associated investments of 0.4 percent of GDP in the medium term and declining thereafter. Such costs are consistent with those in the macroeconomic framework and can yield long-term fiscal savings, so these results should instead be interpreted as an adverse scenario of unexpected additional net costs. The standardized mitigation module adds costs averaging about 0.3 percent of GDP over the projection period, although these are expected to be frontloaded. The scenarios, which critically assume investments are sufficient to offset adverse effects on GDP growth, suggest that unanticipated additional mitigation and adaptation costs do not pose a large risk to the debt trajectory.

Figure 5. Long-term Risk Analysis

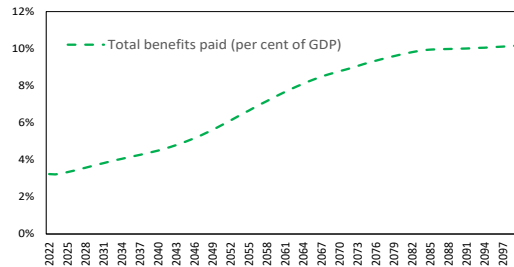
Demographics: Pension

Permanent adjustment needed in the pension system (pp of GDP per year)	To keep pension assets positive for:		
	30 years	50 years	Until 2100
	0.92%	2.40%	4.09%

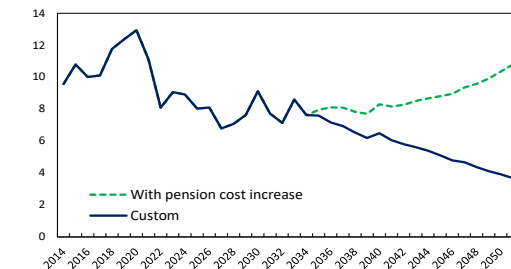
Pension Financing Needs



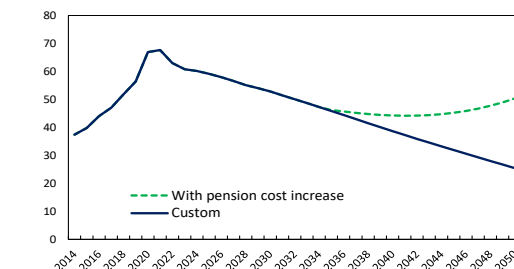
Total benefits paid



GFN-to-GDP ratio

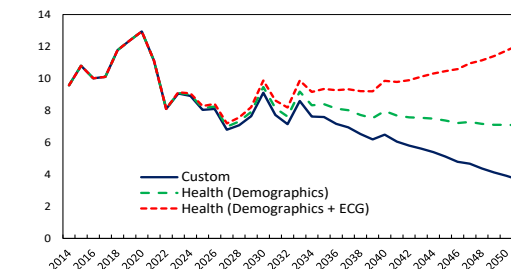


Total public debt-to-GDP ratio

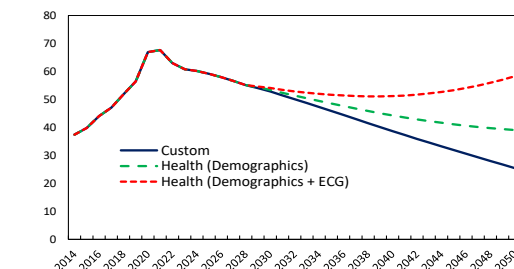


Demographics: Health

GFN-to-GDP ratio



Total public debt-to-GDP ratio



Commentary: The pensions module considers how aging could increase budgetary pressures, focusing on the old-age, death, and disability pension managed by the CCSS. In 2022, benefits exceeded contributions (excluding claims from the central government), requiring the use of interest income. Modelled¹ demographic pressures run down assets in 2034, generating fiscal pressures and debt risks. Results do not imply forecasts but can help illustrate the effect of parametric changes. Indexation to inflation instead of wages and linking retirement age to life expectancy could reduce costs by 2 percent of GDP by 2050. The healthcare modules estimate how aging can increase fiscal pressures using data on spending by the CCSS. A scenario of higher spending per capita by 0.6 percent per year suggests contingent fiscal pressures that could prevent sustained declines in debt.

¹ Toolkit developed by Acosta-Ormaechea et. al. (2017). Demographic Changes in Latin America—The Good, the Bad and ... IMF Working Paper WP/17/94. Results are consistent with IMF CD, which projects reserves exhaustion in 2034 and has a slightly lower funding gap, in part because expenditure growth is cushioned by tightening of early retirement options from 2024 onward and phased increases in contribution rates until 2029.

Table 4. Costa Rica: External Debt Sustainability Framework, 2018-28
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						Debt-stabilizing non-interest current account 6/ -4.1	
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028		
Baseline: External debt	46.7	47.8	49.6	49.7	51.7	47.3	45.4	45.0	45.2	44.9	44.6		
Change in external debt	2.2	1.1	1.8	0.1	2.0	-4.4	-1.9	-0.4	0.2	-0.3	-0.3	0.0	
Identified external debt-creating flows (4+8+9)	-2.4	-4.4	-0.2	-4.5	-4.1	-3.5	-3.1	-3.2	-3.4	-3.4	-3.5	0.0	
Current account deficit, excluding interest payments	1.4	-0.3	-0.7	1.0	1.6	0.7	0.4	0.1	0.0	-0.2	-0.3	4.1	
Deficit in balance of goods and services	-1.5	-3.8	-4.0	-3.2	-3.0	-2.8	-3.0	-3.0	-3.0	-3.2	-3.2		
Exports	34.4	35.3	32.1	37.0	41.4	37.8	38.6	39.2	39.7	39.8	39.9		
Imports	32.9	31.5	28.1	33.8	38.4	35.0	35.6	36.3	36.7	36.7	36.8		
Net non-debt creating capital inflows (negative)	-4.0	-4.3	-2.7	-5.0	-4.6	-3.8	-3.7	-3.7	-3.7	-3.7	-3.6	-3.6	
Automatic debt dynamics 1/	0.2	0.1	3.3	-0.5	-1.1	-0.4	0.2	0.4	0.3	0.4	0.5	-0.5	
Contribution from nominal interest rate	1.6	1.6	1.7	1.5	2.0	1.7	1.7	1.8	1.7	1.8	1.9	1.9	
Contribution from real GDP growth	-1.1	-1.1	2.1	-3.8	-2.1	-2.1	-1.5	-1.4	-1.4	-1.4	-1.4	-1.4	
Contribution from price and exchange rate changes 2/	-0.2	-0.3	-0.6	1.8	-1.0	...	...	...	...	...	...	-1.0
Residual, incl. change in gross foreign assets (2-3) 3/	4.5	5.6	1.9	4.6	6.1	-0.9	1.2	2.8	3.6	3.2	3.2	0.0	
External debt-to-exports ratio (in percent)	135.6	135.4	154.7	134.4	124.8	125.0	117.6	114.6	113.9	112.8	111.8		
Gross external financing need (in billions of US dollars) 4/	5.9	5.6	5.5	6.2	7.9	12.3	11.1	10.5	10.0	10.4	10.6		
in percent of GDP	9.5	8.7	8.8	9.6	11.5	10-Year	10-Year	14.1	11.7	10.4	9.4	9.2	8.9
Scenario with key variables at their historical averages 5/						47.3	47.9	49.0	51.0	52.6	54.2	-4.7	
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation					For debt stabilization	
Real GDP growth (in percent)	2.6	2.4	-4.3	7.9	4.6	3.1	3.1	5.1	3.5	3.3	3.3	3.3	3.3
GDP deflator in US dollars (change in percent)	0.5	0.8	1.2	-3.5	2.0	0.8	2.7	20.1	5.0	2.6	2.4	2.4	2.2
Nominal external interest rate (in percent)	3.6	3.4	3.4	3.1	4.2	3.3	0.4	4.1	3.9	4.3	4.1	4.2	4.4
Growth of exports (US dollar terms, in percent)	10.7	5.9	-12.1	20.2	19.4	7.0	9.1	15.3	10.8	7.7	7.0	6.1	5.8
Growth of imports (US dollar terms, in percent)	8.1	-1.2	-13.8	25.2	21.2	5.4	11.2	15.0	10.5	7.9	7.0	5.7	5.8
Current account balance, excluding interest payments	-1.4	0.3	0.7	-1.0	-1.6	-1.6	1.5	-0.7	-0.4	-0.1	0.0	0.2	0.3
Net non-debt creating capital inflows	4.0	4.3	2.7	5.0	4.6	4.3	0.7	3.8	3.7	3.7	3.7	3.7	3.6

1/ Derived as $[r - g - r(1+g) + ea(1+r)] / (1+g+r+gr)$ times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as $[-r(1+g) + ea(1+r)] / (1+g+r+gr)$ times previous period debt stock. r increases with an appreciating domestic currency ($e > 0$) and rising inflation (based on GDP deflator).

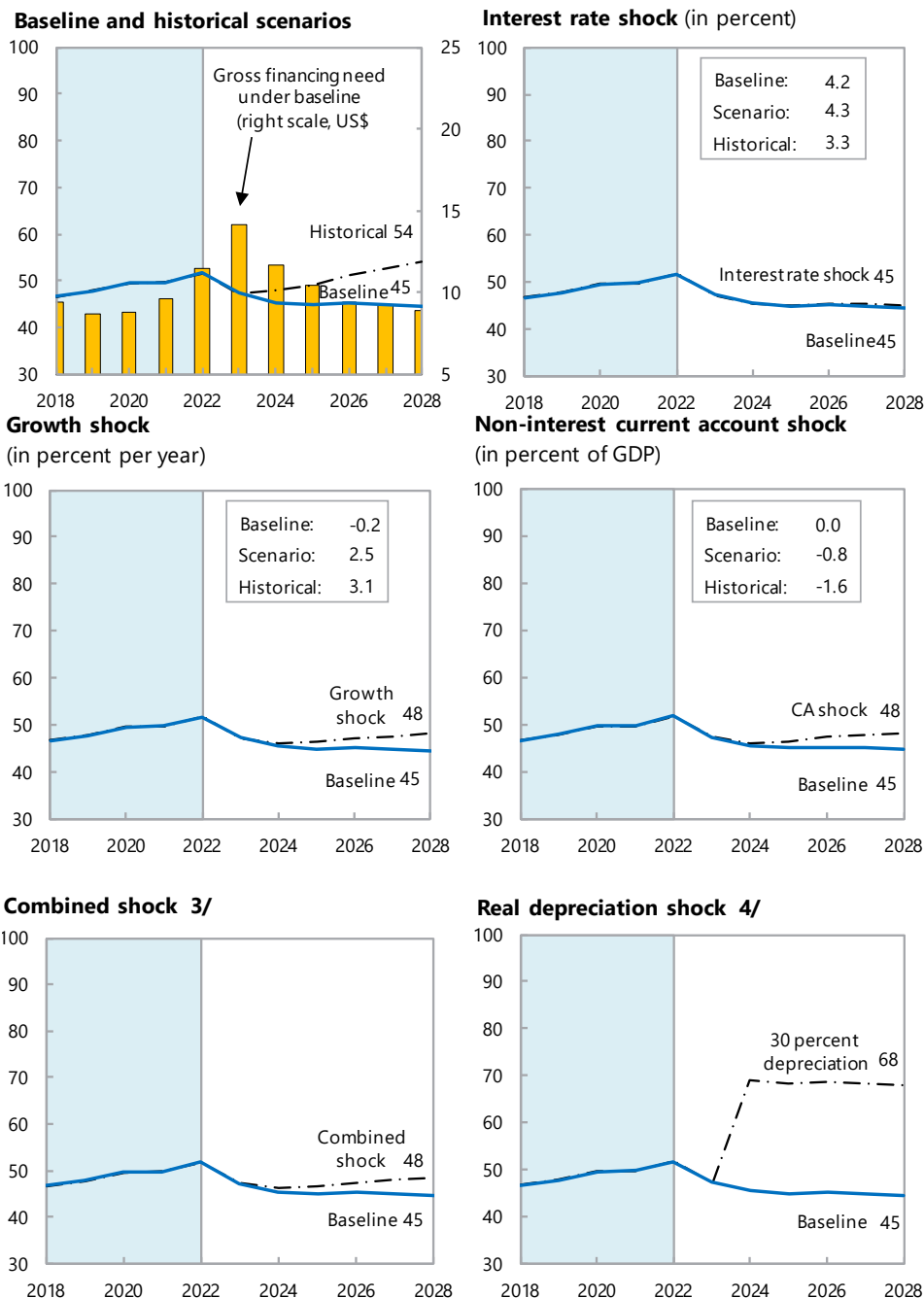
3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Figure 6. External Debt Sustainability: Bound Tests^{1,2}
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
 1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
 2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
 3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
 4/ One-time real depreciation of 30 percent occurs in 2024.

Table 5. Costa Rica: Decomposition of Public Debt and Debt Service by Creditor, 2022-24¹

	Debt Stock (end of period)			Debt Service ³			
	2022			2022	2023	2024	2022
	(Millions of US\$)	(Percent total debt)	(Percent of GDP)	(In millions of US\$)			(Percent of GDP)
Total	47,225.0	100.0	63.8	7,438.0	9,272.0	9,799.0	10.0
External	12,063.7	25.5	16.3	623.75	2,052.46	1,567.8	0.8
Multilateral creditors ²	5,985.4	12.7	8.1	270.8	655.2	927.9	0.4
IMF	1,315.1	2.8	1.8				
World Bank	1,561.6	3.3	2.1				
ADB/AfDB/IADB	1,888.5	4.0	2.6				
Other Multilaterals, o/w:	1,220.2	2.6	1.6				
CAF	523.0	1.1	0.7				
Central American Bank for Economic Integration (CABEI)	697.3	1.5	0.9				
Bilateral Creditors	578.3	1.2	0.8	23.9	40.3	49.2	0.0
Paris Club, o/w:	301.6	0.6	0.4	9.8	24.0	35.93	0.0
French Development Agency (AFD)	242.9	0.5	0.3				
Japan International Cooperation Agency (JICA)	52.3	0.1	0.1				
Non-Paris Club, o/w:	276.7	0.6	0.4	14.1	16.3	13.3	0.0
Exim Bank of China	276.7	0.6	0.4	14.1	16.3	13.3	0.0
Bonds	5,500.0	11.6	7.4	329.1	1,356.9	590.8	0.4
Commercial creditors	0	0.0	0.0	0	0	0	0.0
Other international creditors	0	0.0	0.0	0	0	0	0.0
Domestic	35,161.26	74.5	47.5	6,814.2	7,219.6	8,231.2	9.2
Held by residents, total	34,762.1	73.6	46.9				
Held by non-residents, total	399.2	0.8	0.5				
T-Bills	0	0.0	0.0	0	0	0	0.0
Held by:							
central bank							
local banks							
local non-banks							
non-residents							
Bonds	34,892.9	73.9	47.1	6,728.3	7,035.4	8,204.9	9.1
Loans	268.4	0.6	0.4	85.9	184.2	26.4	0.1
Held by:							
central bank							
local banks							
local non-banks							
non-residents							
Memo items:							
Collateralized debt ⁴	0	0.0	0.0				
Contingent liabilities	6,453.7	13.7	8.7				
o/w: Public guarantees	817.5	1.7	1.1				
o/w: Other explicit contingent liabilities ⁵	5,636.1	11.9	7.6				
Nominal GDP	74,044.1						

1/As reported by Country authorities according to their classification of creditors, including by official and commercial. Debt coverage is the same as the DSA.

2/ "Multilateral creditors" are simply institutions with more than one official shareholder and may not necessarily align with creditor classification under other IMF policies (e.g. Lending Into Arrears).

3/ Debt service figures reflect budgetary execution, which is not forecast beyond the current year at the creditor level.

4/ Debt is collateralized when the creditor has rights over an asset or revenue stream that would allow it, if the borrower defaults on its payment obligations, to rely on the asset or revenue stream to secure repayment of the debt. Collateralization entails a borrower granting liens over specific existing assets or future receivables to a lender as security against repayment of the loan. Collateral is "unrelated" when it has no relationship to a project financed by the loan. An example would be borrowing to finance the budget deficit, collateralized by oil revenue receipts. See the joint IMF-World Bank note for the G20 "Collateralized Transactions: Key Considerations for Public Lenders and Borrowers" for a discussion of issues raised by collateral.

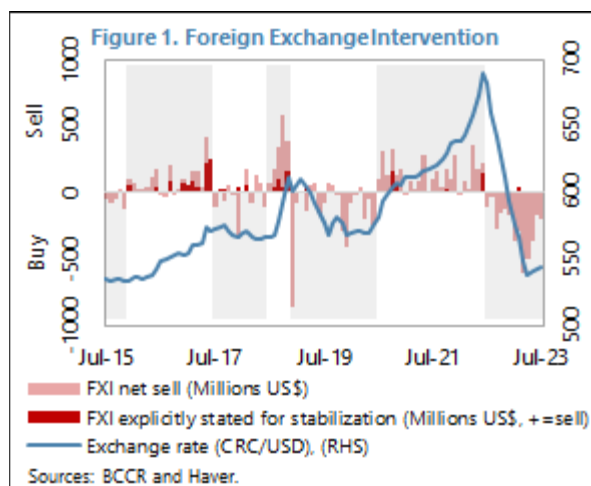
5/ Includes other-one off guarantees not included in publicly guaranteed debt (e.g. credit lines) and other explicit contingent liabilities not elsewhere classified (e.g. potential legal claims, payments resulting from PPP arrangements).

Annex IV. Foreign Exchange Intervention in Costa Rica through the Lens of the Integrated Policy Framework¹

Under the Fund's Integrated Policy Framework, Costa Rica's shallow FX market and currency mismatches arising from dollarization argue in favor of deploying targeted foreign exchange interventions (FXI) in response to large shocks. However, a dominant role of the central bank in the FX market can hinder FX market development and financial sector de-dollarization, while weakening the shock-absorbing role of the flexible exchange rate. Going forward, the central bank's FX market activities should be more restrained than in the recent past. The proper use of macroprudential policies can help enhance the financial system's resilience to large movements of the exchange rate.

1. Since Costa Rica's transition to a managed floating exchange regime in February 2015, its foreign exchange interventions have remained frequent.² Under this regime, the Central Bank

of Costa Rica (BCCR) "allows the exchange rate to be freely determined by foreign currency supply and demand, but it may participate in the market to meet its own foreign currency requirements and those of the non-financial public sector and, at its discretion, to prevent drastic fluctuations in the exchange rate".³ While foreign exchange intervention (FXI) explicitly designated for stabilization purpose has been rare and concentrated in times of sharp *colón* (CRC) depreciation against the U.S. dollar, such as in late-2020 and mid-2022, the BCCR participates in the FX market almost every month for



transactions with and on behalf of the non-financial public sector (NFPS), and to a much lesser extent reserve accumulation (Figure 1). The direction of intervention is highly correlated with the exchange rate: the BCCR sells FX when the exchange rate depreciates and purchases when the opposite is true.

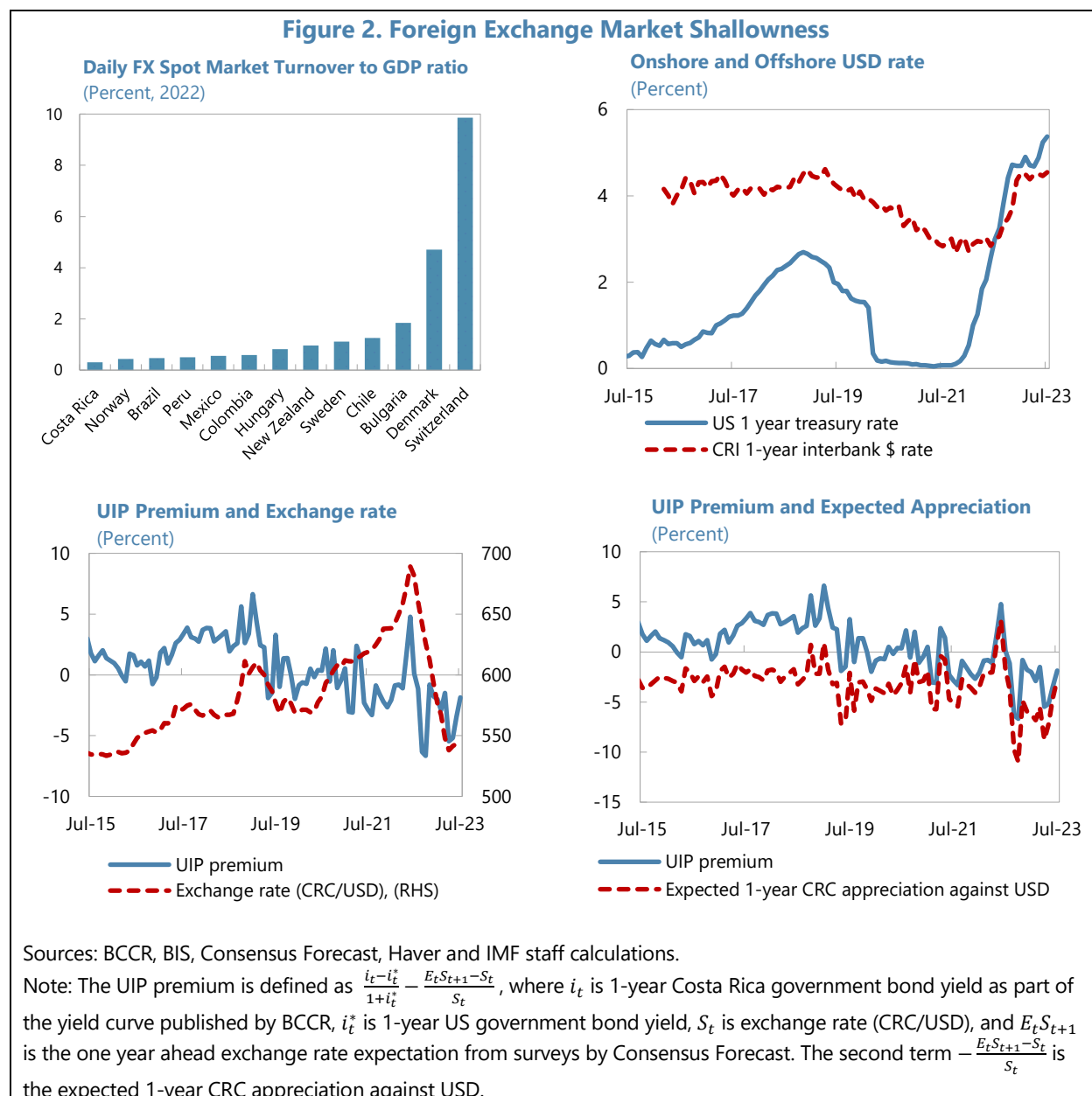
2. The volume of FX transactions is thin. There are two main FX markets in Costa Rica: the Electronic Foreign Exchange Market (MONEX) and the Over-the-Counter windows provided by intermediaries, both spot markets. While the latter is around 9 times the former in terms of turnover, price making is done in the centralized MONEX. The daily spot market turnover as a share of GDP is about 0.25 percent in 2022, much lower than in other small OECD countries (not using the euro) and

¹ Prepared by Chao He.

² The exchange rate regime was fixed up to the 1980s, a crawling peg from 1984–2006, and a crawling band from 2006–2015. Transition towards an inflation targeting monetary policy regime began in 2006. For further discussion on Costa Rica's experience in the transition, see Cubero, R. V. Lankester, and E. Muñoz, 2019. "Costa Rica: Learning to Float", Chapter 10 in "Foreign Exchange Intervention in Inflation Targeters in Latin America", ed., D. Hoffman, N. Magud, and A. Werner.

³ Central Bank of Costa Rica (2015). "Artículo 5 del Acta de la sesión 5677–2015 de la Junta Directiva del Banco Central de Costa Rica, celebrada el 30 de enero del 2015." Central Bank of Costa Rica, San José.

major Latin American countries (Figure 2 panel 1). Moreover, unlike in those countries, the FX derivatives market is almost non-existent in Costa Rica.



3. The premium between onshore and offshore dollar markets has narrowed since 2021.

While the premium of the 1-year interbank dollar rate in Costa Rica against the 1-year US treasury rate has historically been stable, this premium dissipated since 2021 when the Federal Reserve began hiking its policy rate, and it has remained negative since late 2022. The more modest movement of the onshore dollar rate compared to the offshore rate possibly reflects under-development in the interbank market in Costa Rica and a high cost for market participants to arbitrage.

4. The Uncovered Interest Parity (UIP) premium has shown a downward trend in recent years with large volatility. The premium measures the excess return of holding a Costa Rica 1-year government bond in CRC over a 1-year US treasury security in USD, after adjusting for the expected exchange rate change from surveys by the Consensus Forecast. The UIP premium displays a downward trend and turned negative recently (Figure 2 panel 3). Conventional wisdom suggests the UIP premium should be positive as investors command a premium to hold less liquid and more risky CRC assets. While the downward trend reflects a reduction of the premium for holding Costa Rica assets over time, likely due to the improvement of Costa Rica's fiscal and economic fundamentals, the decline further into negative territory can also reflect rising shadow costs of holding USD assets for Costa Ricans, possibly due to the shallow and illiquid domestic FX and bond markets limiting arbitrage opportunities by market participants. The volatility of the UIP premium has been large, and the premium required to hold CRC against USD after removing the trend is high when CRC is weak vis-à-vis USD. This time-varying premium likely results from the under-developed FX market interacting with fluctuations of capital flows and risk appetites. Put another way, the volatility of the UIP premium is driven mainly by the expected CRC appreciation against USD (Figure 2 panel 4). The misalignment between the spot exchange rate and the expected rate suggests either a shallow spot FX market or lack of hedging instruments in the thin and inactive forward market.⁴

5. Sectoral balance sheets show a structural imbalance in FX positions. Other depository corporations (mainly banks), other financial corporations (mainly pension and insurance companies), and households all have structurally long FX positions (Table 1). The corporate sector, on the other hand, has large net FX liabilities of 63 percent of GDP, though these are mainly from foreign direct investment into Costa Rica. The government is a net issuer of USD denominated debt by 20 percent of GDP, but its risk of debt distress is low as assessed in Annex III.

Table 1. Costa Rica: Balance Sheet in FX by Sector
(Percent of GDP, 2022)

	Government		Central Bank		Other Depository Corporations		Other Financial Corporations		Nonfinancial Corporations		Households		External		Total	
	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
Government			0	1	3	0	3	0	0	0	0	0	15	0	22	2
Central Bank	1	0			4	0	0	0	0	0	0	0	2	13	8	13
Oth. Dep. Corporations	0	3	0	4	2	3	0	0	1	9	24	9	4	6	32	35
Oth. Fin Corporations	0	3	0	0	0	0	0	0	0	1	0	0	0	5	1	9
Nonfinancial Corporations	0	0	0	0	9	1	1	0					90	34	99	36
Households	0	0	0	0	9	24	0	0					...	...	9	24
External	0	15	13	2	6	4	5	0	34	90	...	...			58	112
Total	2	22	13	8	34	32	9	1	36	99	24	9	112	58	195	194

Sources: IMF Balance Sheet Approach Matrix Tool.

Note: Columns show the assets and liabilities of a particular sector. The assets and liabilities are claims of/claimed by the sector shown in the row.

6. The banking sector has made progress in de-dollarization supported by the authorities' macroprudential policy and capital flow management (Box 1) but the level of dollarization

⁴ Predominantly non-deliverable forwards.

remains high. Over the last two decades, USD denominated assets as a share of total assets, as well as USD denominated liabilities as a share of total liabilities and equity, has fallen by more than 10 percentage points to about 35 percent⁵ (Figure 3 panel 1). The 2023 dip is mainly associated with valuation effects of the large CRC appreciation. The de-dollarization over time can be attributed to active prudential regulations such as capital charge, provision requirement, foreign exchange position limit, and currency-based liquidity coverage requirement, against the backdrop of a more flexible exchange rate. On the asset side, the de-dollarization of loans roughly follows the same pattern as the whole balance sheet. On the liability side, the de-dollarization of deposits is more muted. USD deposits growth actually outpaced those of CRC from mid-2021 until early 2023 (Figure 3 panel 2), coinciding with the sharp CRC depreciation until the second half of 2022. The still elevated deposit dollarization poses liquidity risks. A bank run on USD deposits is more difficult to stop or prevent than a run on CRC deposits as BCCR's lender of last resort ability for USD is limited to its FX reserves. While prudential policies such as currency-based liquidity coverage ratio regulations and sound macro policy framework could help, further de-dollarization takes time.

Box 1. Costa Rica: Selected Prudential Policies

Macropprudential

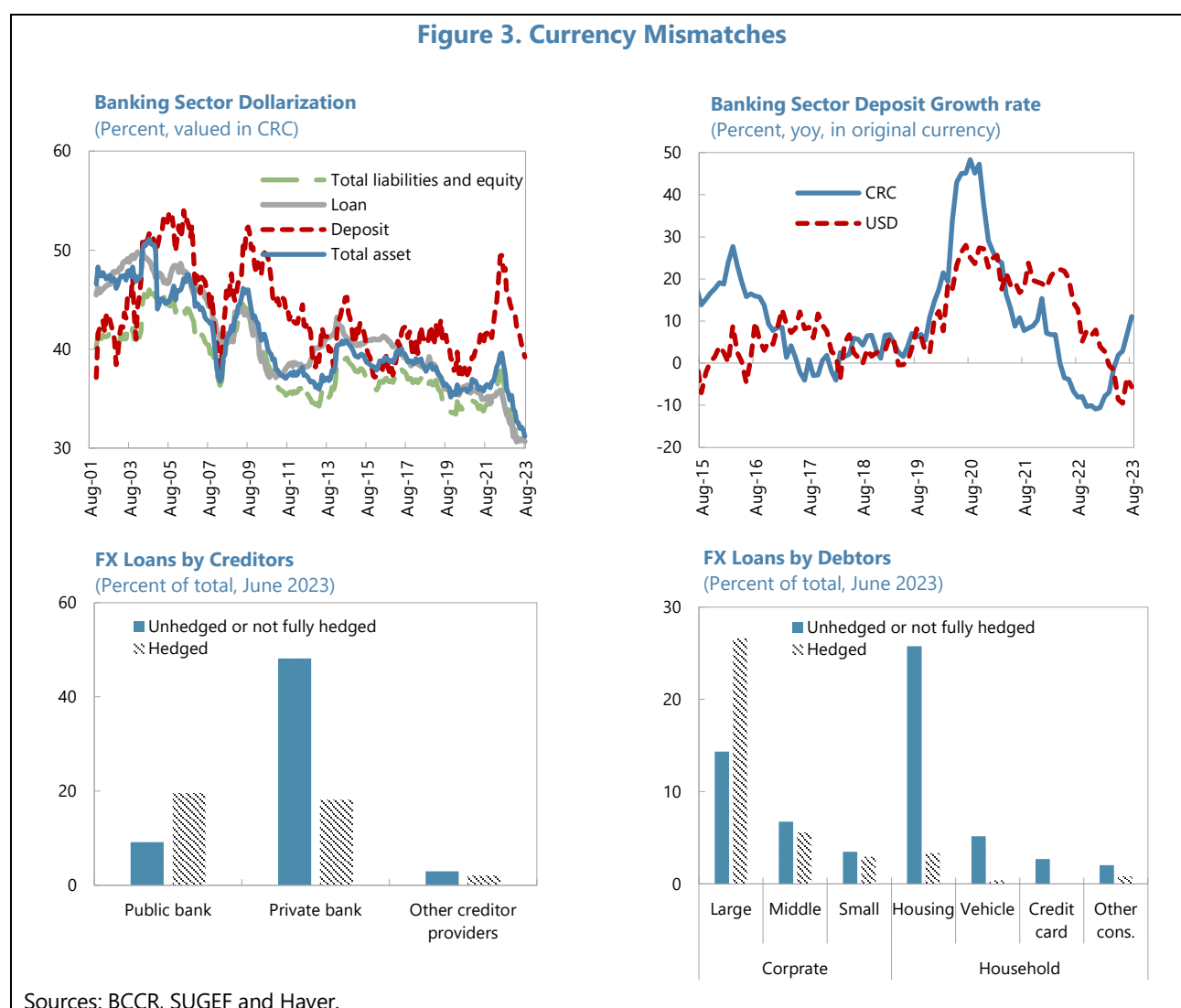
- Credit risk weight of unhedged FX loans: for mortgage, increased to 62.5 percent in 2013 and revised to differentiate by loan-to-value ratios in 2016 up to 100 percent; for non-mortgage, increased from 100 percent in 2013 to 125 percent in 2015 and cut back to 100 percent in 2018. Both will be increased to 150 percent by 2030.
- Loan loss provisions to unhedged FX loans: introduced in 2016, generic provisions of 1.5 percent on FX loans to unhedged borrowers, applicable on top of other provisions; reduced to 1 percent in 2018. It will be phased out in January 2024.
- Liquidity coverage ratio by each major currency: announced in 2013 and phased in from 2015 at 60 percent to 2019 at 100 percent.
- FX Net Open Position (NOP) limit: introduced in 2016 and revised in 2017 to be within ± 100 percent of bank's core capital; the daily NOP changes cannot exceed ± 3 percent of core capital; the monthly average NOP must be within a narrow band (1 percent of core capital to the upside and 3 percent to the downside) from a bank-specific target level agreed with BCCR (e.g. the state owned Banco Nacional's target is 12 percent of core capital).
- Reserve requirement for FX deposits: 15 percent (currently at the cap).

Capital Flow Management

- External debt issuance restrictions: authorization requirement for the government and selected nonbank public sector.
- Contracting credit abroad restrictions: banks must inform the BCCR in advance and credit unions must obtain approval.
- Outbound portfolio investment restrictions: pensions can invest up to 50 percent of assets overseas (currently not binding).

⁵ The total assets of the banking sector are about the same as one year of GDP. Total loans are about 60% of GDP and total deposits are about 40% of GDP.

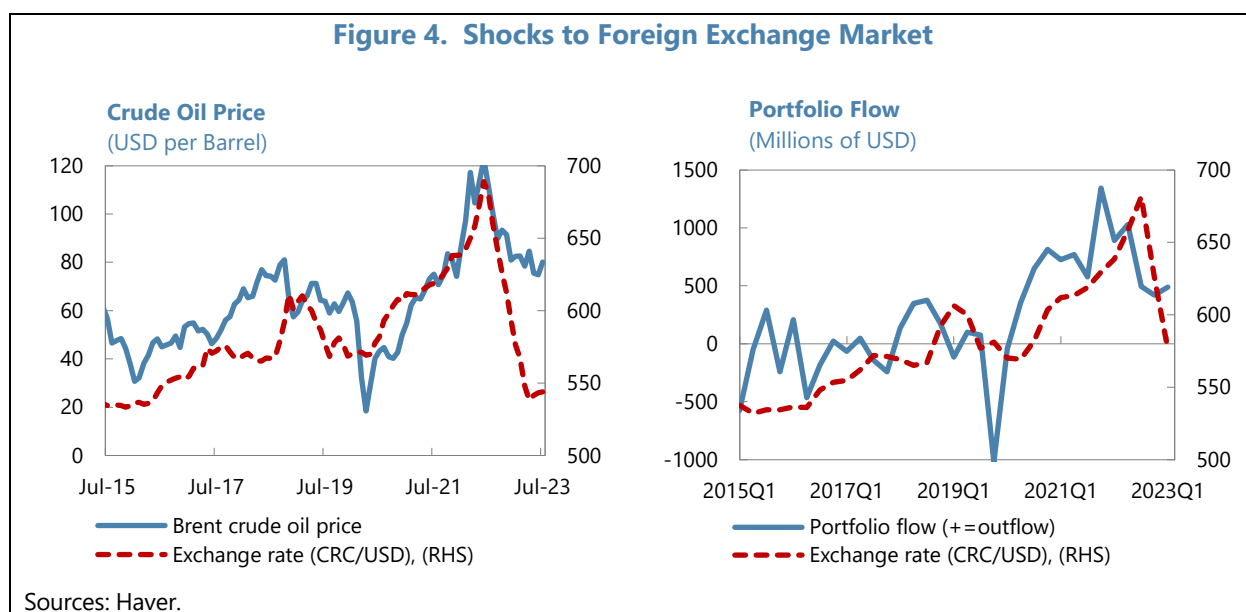
7. Unhedged FX loans remain high, especially for private banks, households and small and medium firms.⁶ Within USD denominated loans, about 60 percent is extended to unhedged (or not fully hedged) borrowers, which is about 10 percent of GDP. Private banks dominate in FX lending and extend 66 percent of total FX loans, with a majority unhedged (Figure 3 panel 3), while public banks' exposure to unhedged borrowers is more limited. About 60 percent of FX loans are obtained by the corporate sector, of which small- and medium-size firms have a higher share of unhedged borrowers (Figure 3 panel 4). Households tend to be more unhedged than corporates, with unhedged FX debt particularly high for mortgage loans. Policies have been in place to discourage FX lending and the risks that come with it (Box 1). The risk weight for FX credit to unhedged borrowers will be further increased starting January 2024. The definition of an unhedged borrower has also been made more stringent effective 2023.



⁶ Lacks natural or financial hedges against exchange rate risk, or the natural, financial or both coverages available cover less than 100% of the service of credit operations.

8. While essential in addressing financial stability risks arising from currency mismatches, some macroprudential policies may have constrained market development. For example, Costa Rica is rather unique among the OECD and relevant Latin American countries to deploy multiple requirements on banks' FX net open positions (NOP), which limit banks' daily variation of NOP to 3 percent of their capital and the monthly average NOP to a predetermined bank-specific target. These restrictions hamper banks' ability to quote and execute large FX orders in a day, particularly for smaller banks, and create risk-aversion in taking orders as the position has to be unwound within a month. Therefore, the restrictions can exacerbate the shallowness of the FX market and make the UIP premium more volatile.

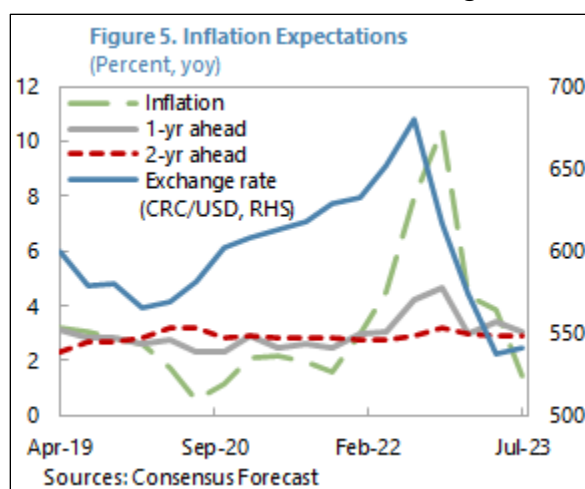
9. As a small open economy, Costa Rica is susceptible to large shocks driving large swings of the exchange rate. The high correlations between the exchange rate and commodity prices and portfolio movements are shown in Figure 4. The NFPS, mainly the oil-importing national oil company and national electricity company, are the dominant buyer of FX in the market (through BCCR). Because of legal constraints these companies have limited capacity to hedge against extreme price movements, which often results in a full transmission from an increase in international oil to an increase in domestic FX demand. The portfolio flows are increasingly driven by the portfolio allocation of local pension funds, which have large (compared to turnover of the FX market) and growing assets and are still far from the 50 percent regulatory limit on the share of assets allocated overseas.⁷ They are the second largest group of buyers of FX, and their FX positions are typically not hedged. A change in market conditions could lead to large capital flows by these pension funds, causing large swings in the exchange rate. Moreover, residents can convert their CRC deposits to USD and vice versa relatively easy. A sudden switch of deposits would exacerbate the illiquidity of the FX market and exchange rate swings.



⁷ Pensions have invested about 15-40 percent of assets abroad as of 2022.

10. A targeted use of FXI to guard against excessive FX shocks is appropriate given Costa Rica's shallow FX market and unhedged FX liabilities in some sectors. The IMF's Integrated

Policy Framework⁸ provides support for FXI in response to large shocks given well-identified frictions. In Costa Rica's case, the FX market is shallow, as suggested by the thin trading volumes, onshore-offshore USD rate differentials, and the volatile UIP premium. Capital flows and risk appetite shocks, therefore, induce large inefficient overshooting of exchange rates, key prices in the economy. In this case, FXI can be used to address premia from arbitrage frictions in shallow FX markets. The unhedged FX liabilities in some sectors are large, leading to

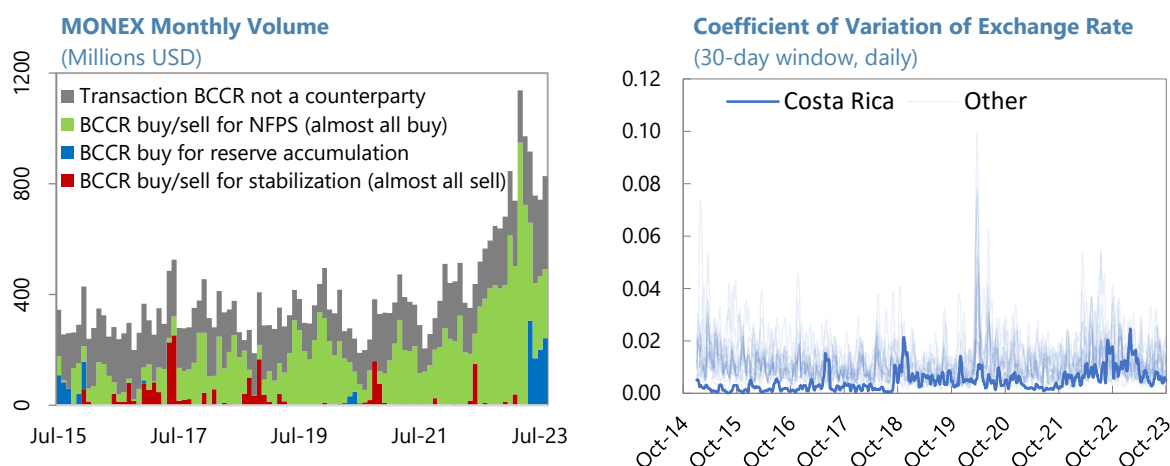


solvency risk from large exchange rate depreciation. Large swings in the exchange rate also induce capital losses and gains, due to net positions of currency mismatches. Those with unhedged FX liabilities can be forced to deleverage with large currency depreciation, their fire-sale of domestic currency assets in exchange of FX to service the debt then can further exacerbate the depreciation pressure and create vicious feedback loops. In this case, FXI can be used to mitigate financial stability risks from FX mismatches. In Costa Rica, there have been a few episodes with particularly sharp exchange rate movements over a short period of time, roughly coinciding with the occasions when the BCCR explicitly stated that its FXIs were for stabilization. The IPF also provides a use case when sharp changes in exchange rates threaten to de-anchor inflation expectations. This use case is less applicable to Costa Rica given its well-anchored inflation expectations including during the recent episode of surging imported inflation and large swing of the exchange rate (Figure 5).

11. However, the central bank's FX market activities should be more restrained than in the recent past going forward. The central bank's dominant role in FX operations, mostly because of daily transactions with and on behalf of NFPS, can hinder the development of the FX market and create incentives for dollarization as perceived exchange rate risk is low (Figure 6). It also weakens exchange rate movement as a shock absorber and as a monetary policy transmission channel. Costa Rica's daily exchange rate volatility is very low compared to other small open OECD countries (not using the Euro) and major Latin American countries. By contrast, the benefit of FXI for stabilization purposes is non-linear. It can be relatively small for small shocks that do not create large swings of exchange rates or balance sheet pressures, but it can be large when the unhedged FX borrowers are forced to deleverage under greater exchange rate pressure. The trade-off between uncertain benefits and significant costs from frequent FXI suggests that FXI should be more targeted to address large and relevant shocks.

⁸ IMF (2020). Toward an Integrated Policy Framework. Policy Paper No. 2020/046.

Figure 6. Scale of Foreign Exchange Intervention



Sources: BCCR, Haver and IMF staff calculations.

Note: NFPS = Non-financial public sector. In the right-hand side chart, coefficient of variation is standard deviation divided by mean. "Other" includes Brazil, Bulgaria, Chile, Czechia, Denmark, Hungary, Iceland, Israel, Mexico, New Zealand, Norway, Peru, Switzerland, and Uruguay.

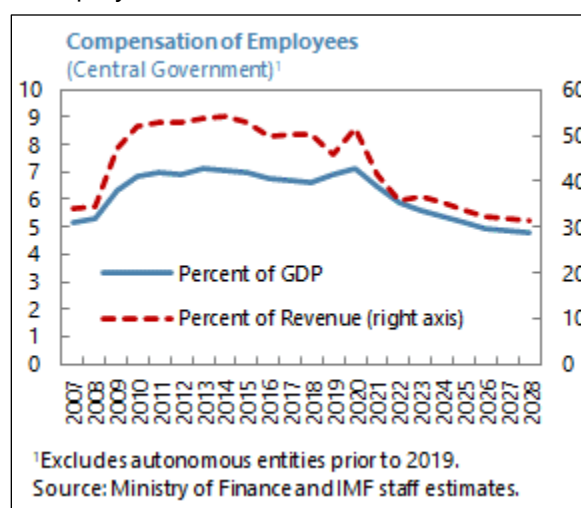
12. A more developed FX market and well-calibrated macroprudential tools can enhance the financial system's resilience to FX shocks. The authorities are planning to phase in active FX market deepening policies, such as revisiting the banks' FX NOP limits, introducing market makers, extending MONEX trading hours, and, building on an improved spot market, developing the FX derivatives market. The authorities have been aligning the timing of their FX purchase on behalf of NFPSs with their sales of FX to NFPSs in recent months, which makes its FX market activities more transparent. This good practice should continue. Ex-ante macroprudential policies that internalize the financial stability cost of dollarization in the banking system have helped reduce the level of dollarization and can play an important role in mitigating financial stability risks potentially triggered by excessive exchange rate volatility. But some of the measures, such as FX NOP mentioned earlier, should be revisited to not excessively reduce FX market depth.

13. Strengthening market participants' incentives and capacity to manage international oil price and FX risks can reduce shocks to the FX market. Further institutional and technical reforms would be needed to create the right incentives for public oil companies and pension funds to better manage risks. In particular, hedging instruments can help market participants mitigate the risks, thereby reducing the shocks to the FX market and enhancing the stability of the financial system as a whole.

Annex V. Public Compensation Control and Public Employment Reform: Two Landmark Achievements¹

Containing the government's compensation bill has been key to the fiscal turnaround and has also had beneficial effects on inflation, private employment, and income inequality. The implementation of the Public Employment Bill represents a landmark reform under the authorities' home-grown reform program.

1. The government's compensation of employees has been an important factor in Costa Rica's fiscal performance. Between 2007 and 2010, the central government including autonomous entities increased the number of employees by about 15 percent and increased wages. This pushed the central government's spending on compensation of employees as a share of revenues to the highest in the OECD² and contributed to a deteriorating primary balance. The fiscal rule and other reforms introduced in the Law 9.635 from 2018 onwards restrained such spending by freezing hiring, suspending overtime, and capping salary supplements. When debt exceeded 60 percent of GDP in 2020, the fiscal rule mandated a nominal pay freeze starting in 2022. Together with tax yields from a 2018 reform and savings on transfers to the rest of the public sector, which have a large compensation component, restraint on employee compensation has been an important contributor to the recent improvement in the fiscal balance.³



Contributions to Change in Primary Balance, 2019-2023 (Central Government, percent of GDP)	
Employee compensation decrease	1.3
Public transfers decrease	0.5
Other primary spending decrease	2.0
Revenues increase	0.3
Total	4.1

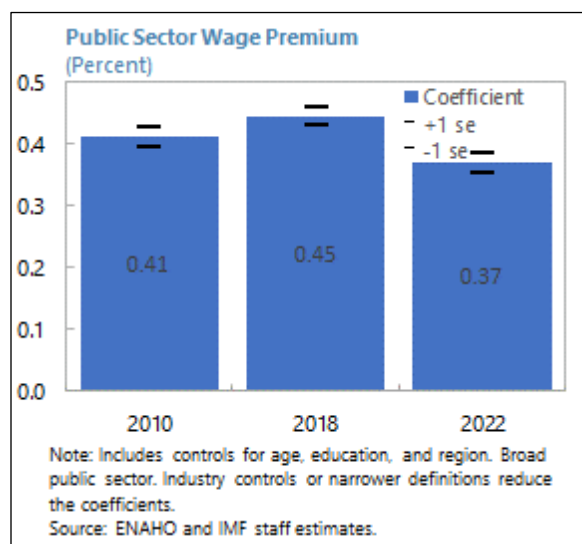
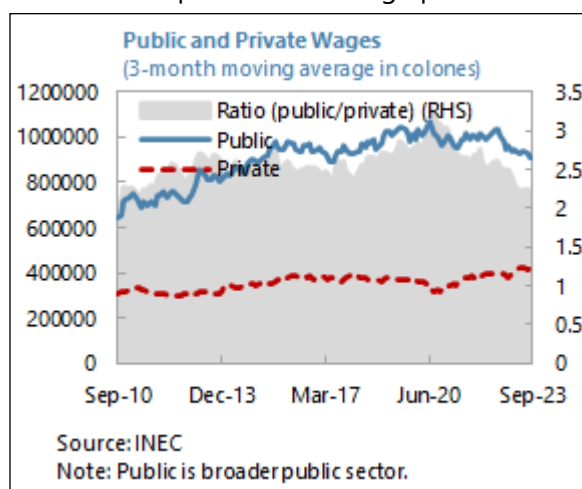
Source: Ministry of Finance and IMF staff estimates.

¹ Prepared by Alberto Behar and Juan Carlos Benitez with inputs from Alberto Tumino.

² OECD (2023), *OECD Economic Surveys COSTA RICA*.

³ For the non-financial public sector, the wage bill was 7 percent of GDP in 2007, 9.6 percent in 2011, 8.7 percent in 2019, and 7.9 percent in 2022.

2. The trend of increasing public-sector pay premia has gone into reverse. Average public-sector pay continued to outpace private-sector pay for much of the 2010s but the 2018 reforms set this into reverse. This pattern is reflected in estimated public-sector wage premia relative to private salaried employees after controlling for observable worker characteristics. Nonetheless, wage premia remain high by global and regional standards and should arguably be negative owing to non-pecuniary benefits.⁴ The wage premium for men is lower in the public sector and the premium for older workers is higher, which is consistent with a system that favored compensation based on seniority above all that had been in place prior to the PEB reform. Premia are similar across the income distribution, but the distribution of public employment is skewed towards the top: public employment comprises about 60 percent of formal employment in the top decile and 3 percent in the bottom decile. There is considerable heterogeneity by occupation.



Wage Premia Determinants, 2022 (Percent)	
Public employment ¹	0.37
Secondary education ¹	0.31
Tertiary education ¹	0.89
Female ¹	-0.14
(Public employment)*(Secondary education) ²	0.15
(Public employment)*(Tertiary education) ²	0.16
(Public employment)*female ²	0.06
(Public employment)*age ³	0.01

Source: ENAHO and IMF staff estimates.

¹ Coefficient on dummy variable from regression with no interaction terms.

² Coefficient on interacted dummy variable terms. For narrower public employment definition, premium does not increase with education.

³ Coefficient on dummy variable interacted with age in years.

3. Lower wage bills can increase the efficiency and equity of spending, reduce inflation, and facilitate private-sector employment. By contributing to the fiscal consolidation, a lower wage bill is reducing inflation.⁵ Although lower public-sector pay does not affect the price of government-provided services, it can restrain private-sector wages, which also fell in real terms in 2022, thus

⁴ Gindling, Hasnain, Newhouse & Shi (2019), "Are Public Sector Workers in Developing Countries Overpaid?", *World Development*. Abdallah, Coady & Jirasavetakul (2023), *Public-Private Wage Differentials and Interactions Across Countries and Time*, IMF Working Paper WP/23/64. World Bank (2021). *Public Sector Employment and Compensation: An Assessment Framework*. EFI-Insight-Governance.

⁵ A 1 percent-of-GDP fall in government spending translates to approximately half a percentage point fall in inflation (see *April 2023 Fiscal Monitor*). Specifically, public wages also translate to higher inflation (Abdallah et. al., *ibid.*).

promoting private-sector employment⁶ and reducing inflation. Although the share of public-sector employees in total employment (12 percent for general government) is not high, cross country evidence suggests the hiring freeze likely promotes private-sector employment as well, for example by increasing the likelihood of accepting a private employment offer.⁷ Besides aiding labor market efficiency, reducing wage premia from excessive levels increases public spending efficiency and reduces deadweight losses from distortions. Under recently tight limits on spending imposed by the fiscal rule, wage measures prevented the crowding out of other priority social spending, where the burden could have been borne more heavily by the poor. Continued restraint would accelerate debt reduction and reduce pressures to do so via additional taxes.

4. The Public Employment Bill (PEB) is modernizing and simplifying the public sector's wage expenditure. It consolidated public sector compensation supplements such as annuities, bonuses, incentives, and others within a wage spine. The bill changed rules for recruitment, selection, development, and evaluation and provides new benefits such as additional parental leave and sick leave to care for family. This landmark reform was approved by congress in March 2022 after two constitutional reviews. Following the PEB's entry into force in March 2023, a transitional global wage for new hirings in the executive branch was introduced. As of September 2023, a definitive wage spine has been designed and adopted for 7 job families considering the complexity each class of job requires. In compliance with the law, autonomous institutions are in the process of designing and implementing their own wage spines following the principles defined by the PEB.

5. Costa Rica's PEB reform features structural compensation changes which are associated with positive fiscal planning outcomes. Simplifying non-wage compensation improves transparency of government pay without affecting service delivery.⁸ Centralization of wage bill management have shown strong associations with fiscal outcomes in advanced and emerging market economies. Furthermore, position based-employment, a system akin to Costa Rica's current recruiting based on their fit for specific positions, can facilitate lower public-private wage premia. On the other hand, international experience shows automatic inflation wage indexation, which is not widespread, poses risks to fiscal objectives.⁹ This risk is somewhat mitigated by the fiscal rule, which contains divergence between wage bills and spending limits by tying spending growth to nominal GDP growth and freezing wages when debt is high.

⁶ Afonso & Gomes (2014), "Interactions between private and public sector wages", *Journal of Macroeconomics*. Abdallah et. al. (ibid) show that the effect of public on private wages is correlated with the size of the public sector and with overall inflation.

⁷ Behar & Mok (2019), "Does public-sector employment fully crowd out private-sector employment?", *Review of Development Economics*.

⁸ OECD (2015), "Special feature: Compensation reforms since 2008", in *Government at a Glance 2015*, OECD Publishing, Paris, https://doi.org/10.1787/gov_glance-2015-31-en.

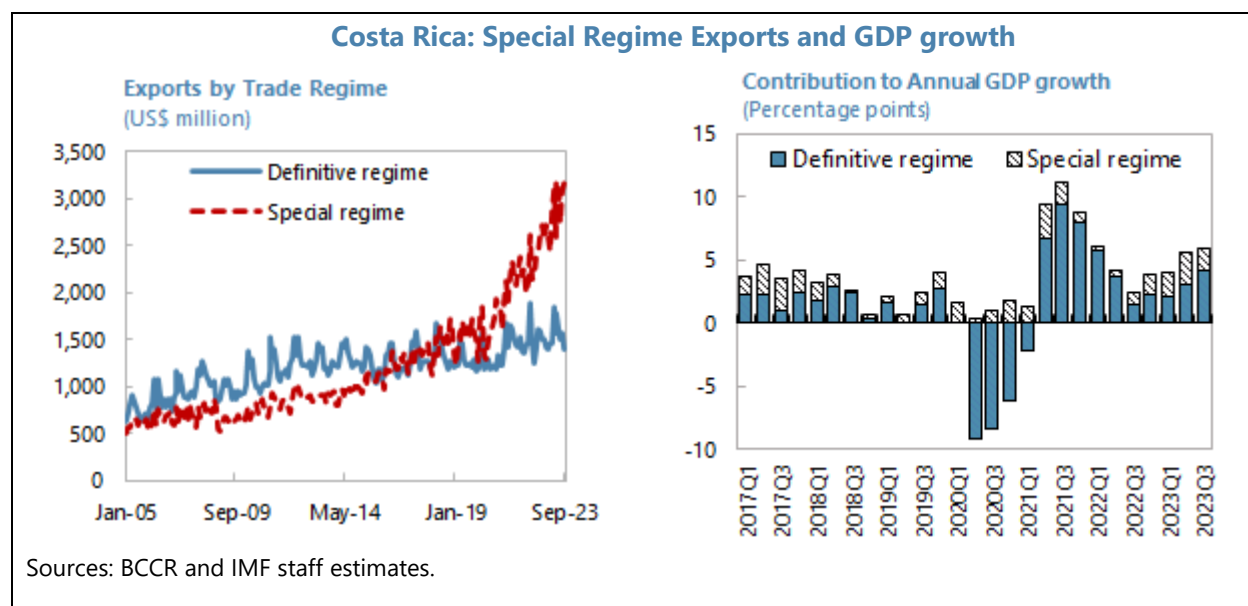
⁹ IMF (2016), "Managing Government Compensation and Employment – Institutions, Policies and Reform Challenges". IMF, Washington DC. Balasundharam, V., A Kayastha and M Poplawski-Ribeiro (forthcoming), "Inflation Indexation: Current International Practices", IMF Working Paper.

6. The PEB is being implemented gradually to safeguard fiscal gains. Compensation for employees hired after March 2023 adheres to the final single wage spine. However, employees whose compensation is below the spine will receive the same composite increases as before the PEB reform was put into effect until the reference wage within the single wage spine is reached, reducing fiscal risks. For employees whose compensation is above the spine's reference wage, their wages will remain frozen until the wage spine reaches them, thus generating fiscal savings relative to a setting in which everyone would enjoy the same increase. In practice, this results in three groups of employees' whose compensation increases at different rates, and which will take some time to increase at an equal pace. The PEB will help contain wage bills over time if the value of the point is only modified to reflect labor market needs and not subject to arbitrary changes. Regarding fiscal savings, the effects of Law 9.635 are currently binding and will only end after the debt-to-GDP ratio is below 60 percent. The savings from the PEB are therefore expected to be relatively modest at first and increase over the medium term. The PEB transition will require building administrative capacity to handle this complexity, careful monitoring, and managing wages to avoid inflexibility in hiring, especially where specific skills are in high demand and the public-private wage premia is low or non-existent.

Annex VI. Costa Rica's Free Trade Zones¹

Costa Rica's free trade zones have been critical in attracting FDI, creating a dynamic and diversified export sector, and generating formal job opportunities. They also played an important role in supporting growth during the COVID-19 pandemic and the latest global slowdown in growth. As the importance of the free trade zones continues to grow, more attention to the implications from the dual economy – both in terms of macro policies and efforts to ensure inclusive growth- is warranted.

1. During the recent years of global headwinds, Costa Rica's free trade zones have been an engine for exports and growth. While the free trade zones have been a feature of the Costa Rican economy for a long time, their growth became even more dynamic in the second half of the 2010s. Since 2017, exports under the special regime² have exceeded those from the rest of the economy and the gap continues to widen. Accordingly, the contributions to GDP growth from the special regime have increased and played an important role in supporting growth during the COVID-19 pandemic and the most recent slowdown in global demand. In 2022, real GDP under the special regime increased by 7.1 percent (y-o-y) vs. 4.1 percent for the rest of the economy. So far in 2023, real GDP growth under the special regime was 16.0 (y-o-y) vs. 3.9 percent in the rest of the economy.



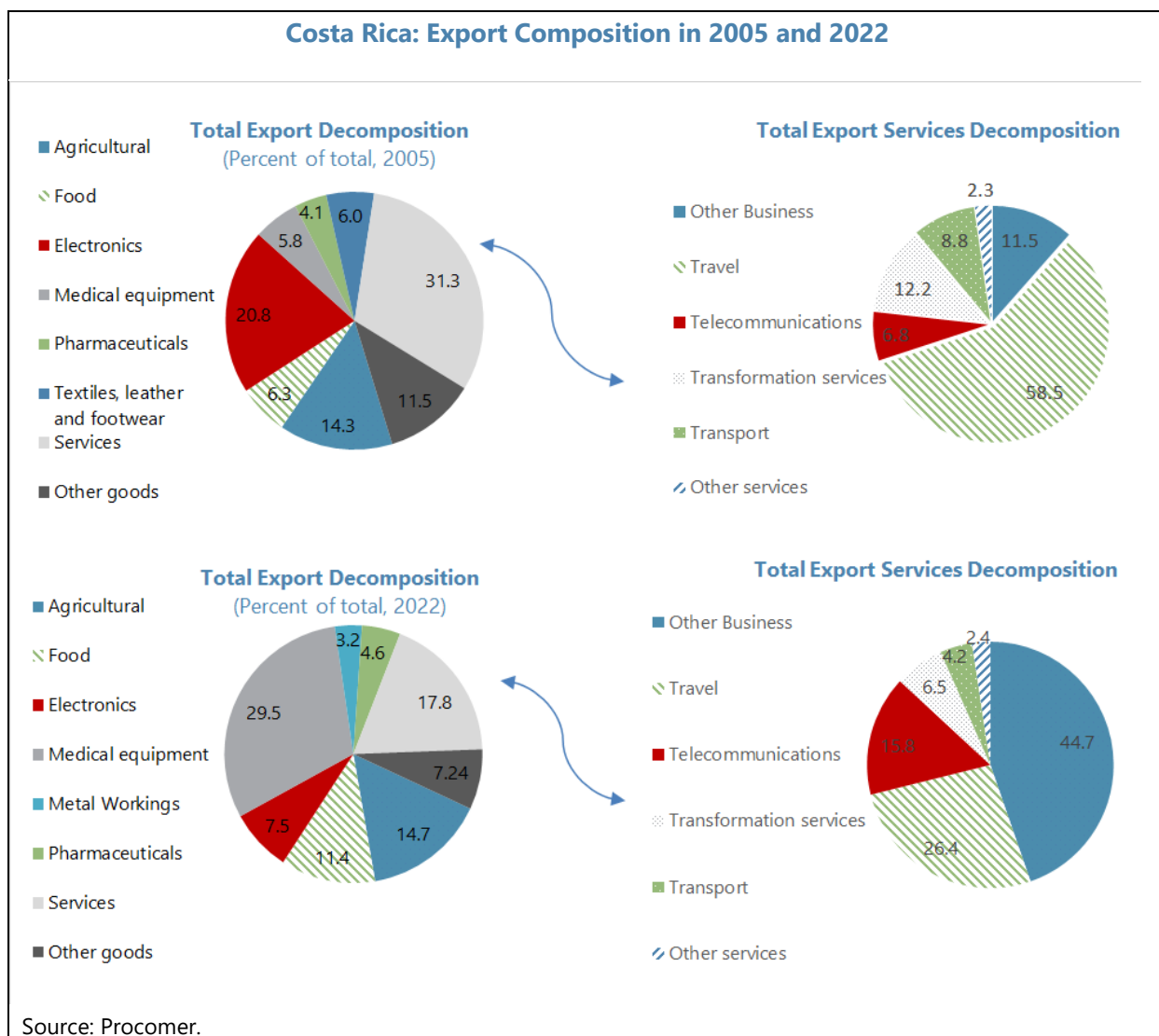
2. The share of FDI to the free trade zones in total FDI to Costa Rica has increased dramatically since 2017. The average share in total annual FDI during 2017-2022 was 66 percent vs. 36 percent during 2000-2016. In 2021 and 2022 the share increased even further to 74 percent and 81 percent, respectively. Not surprisingly given the geographic proximity, the lion's share of FDI to

¹ Prepared by Charlotte Lundgren.

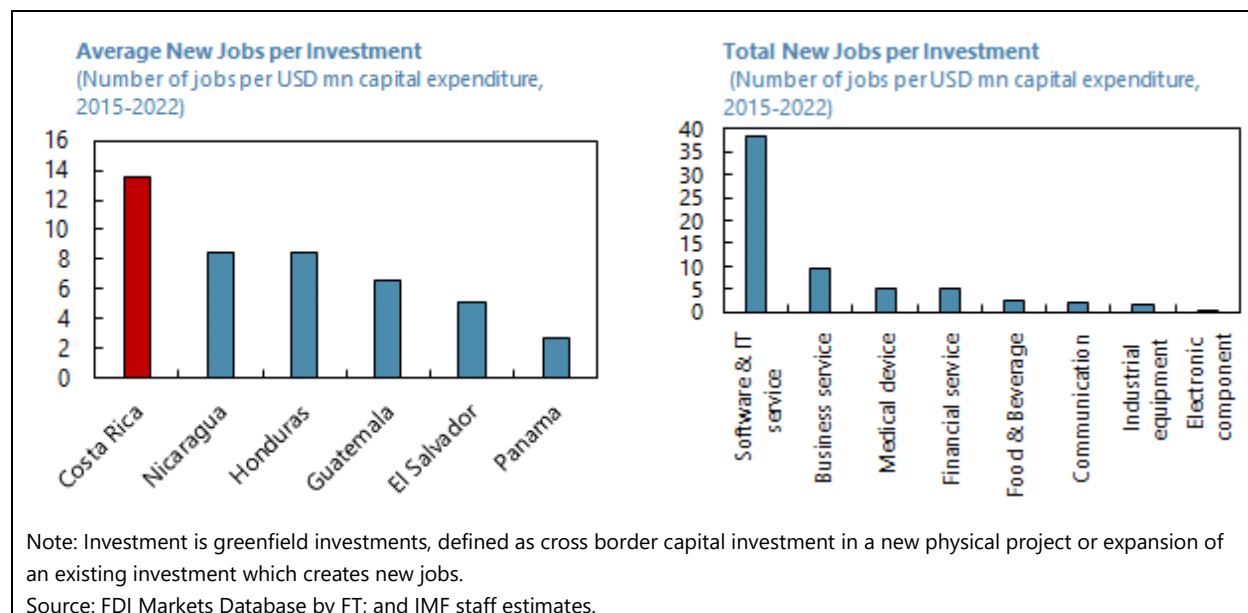
² The Special Regime includes the free trade zones (*zonas francas*); and companies operating under another incentive scheme for inward processing and re-exportation. Depending on the definition of various data sources, this annex uses data covering only the free trade zones and the Special Regime interchangeably.

Costa Rica is coming from the United States, from which the contribution to total FDI to Costa Rica averaged 54 percent in 2005-2022. The increase in total FDI since 2017 was also largely driven by U.S. investments; the average U.S. share of total FDI during 2017-2022 increased to 69 percent.

3. Activities in the free trade zones are increasingly diversified and knowledge intensive, contributing to the diversification of exports for the country as a whole. From 2017 to 2021, the number of free trade zone companies grew on average by 6 percent per year, with growth driven in particular by establishments in the service sector. About half of the companies are now in this sector, including software engineering, leasing services, outsourced business processes, logistics, and technical support centers. Moreover, the medical- and dental devices sector is an example of important export diversification, which has been a key driver of the strong export growth in the most recent years.



4. The free trade zones contribute to over 10 percent of Costa Rica’s employment. The authorities estimate that the free trade zones contributed 221,295 direct- and indirect jobs in 2021. 164,212 (74 percent of total) were direct employment, of which 60 percent in the services sector. 44 percent of the employed were women. In 2021, the average salary in the free trade zones was about 20 percent higher than in the private sector nationwide.³ Looking at greenfield investments to Costa Rica as a whole, data suggests that FDI to Costa Rica generates a significantly higher number of jobs per USD invested than in other countries in the region. This seems to be the case in particular for investments in the software and IT services sector.



5. There are important backward linkages and signs of catalytic effects on the rest of the economy, as an estimated 60 percent of free trade zone purchases are from the local economy.

A recent study by IDB staff and previous work by staff of the BCCR⁴ conclude that the multinational companies present in Costa Rica generate intangible benefits both for the domestic supplier companies in the form of productivity spillovers and for the workers who they employ in the form of salary premiums. An important observation is that, in general, these benefits are significantly greater when considering the multinational companies that are part of the free trade zones than for those

³ This number compares average free trade zone wages with wages outside the free trade zones reported to social security. If comparing with the entire economy, including informal employment, the ratio is 1.7.

⁴ Monge-González, Ricardo; Rivera, Luis; [Importancia relativa de los beneficios intangibles de la inversión extranjera directa en zonas francas: el caso de Costa Rica](#), IDB, 2022; Alfaro Ureña, A; Badilla Maroto, M. A.; Manelici, I; and Vasquez, J.P.; [Beneficios intangibles de la Inversión Directa \(ID\) en Zonas Francas en Costa Rica: Resumen de resultados](#), BCCR Nota técnica N.º 01 | 2022.; Alfaro Ureña, A; Badilla Maroto, M. A.; Manelici, I; and Vasquez Carvajal, J.P.; [Importancia relativa de los beneficios intangibles de la Inversión Extranjera Directa \(IED\) en Zonas Francas en Costa Rica](#), BCCR, DOCUMENTOS DE TRABAJO, N.º 008 | 2021.

that are outside of this regime. Moreover, it was found that local suppliers to the multilateral companies were 8 percentage points more likely to become exporters themselves.

6. The free trade zones contribute to increasing the overall wealth of the economy and existing cost-benefit analyses are positive. In addition to the contributions to export growth and employment creation in the free trade zones, backward linkages help share some of the gains with the rest of the economy. Cost-benefit analyses conducted by the authorities, and more recently by IDB staff,⁵ weigh the benefits, such as additional local purchases of goods and services, employees wage premium and benefits, and contributions to the social security system (all quantified as relative to what would have been the case outside of the free trade zones), against the costs in the form of tax exonerations. These estimates have resulted in important net positive contributions to the economy, benefits being more than double the costs.

7. However, these analyses do not question whether the fiscal incentives are long-term the most cost-efficient way to achieve the same results. According to the authorities' own estimates, the fiscal incentives to the free trade zone companies amounted to CRC 597 bn in 2021 or 1.5 percent of GDP.⁶ This is the equivalent of CRC 2.7 mn (appr. US\$ 4.350) per direct- or indirect job stemming from the free trade zones, or 3.6 mn (appr. US\$ 5.860) per direct job per year. In addition to the fiscal cost, tax exemptions could distort competition, incentivize resource misallocation, result in tax evasion or avoidance opportunities, and lead to rent-seeking behavior. Importantly, there is an opportunity cost since the costs associated with maintaining the free trade zones, combined with the foregone tax revenue, might be better spent on other priorities, such as better infrastructure, education, or healthcare, which are all relevant criteria to FDI decisions. Previous empirical analyses on the relationship between taxes and investment have found that taxes can have a significant effect on investment, in particular tax holidays on FDI⁷. However, there are also surveys that show that other factors, notably a country's overall economic characteristics, may be just as, if not more important.⁸ Therefore, a valid question to ask is whether a similar amount of FDI could be attracted by means of Costa Rica's attractive geographic location, stable democracy and its skilled labor force, combined with improved infrastructure and streamlined red tape for foreign investments; and whether there is a case for a gradual phasing out of fiscal incentives, especially since the upcoming implementation of the global minimum tax will render some tax incentives redundant.

⁵ Esencial Costa Rica, Procomer, Ministerio de Comercio Exterior, and Cinde, [Balance de Zona Franca, Costa Rica 2017-2021](#); and Monge-González, Ricardo; Rivera, Luis; [Importancia relativa de los beneficios intangibles de la inversión extranjera directa en zonas francas: el caso de Costa Rica](#), IDB, 2022.

⁶ Dirección General de Hacienda, División de Política Fiscal, *Costa Rica: El Gasto Tributario (GT), 2023, Metodología y Estimación, Impuesto sobre la Renta, Impuesto al Valor Agregado y Otros Tributos*, (forthcoming).

⁷ Klemm, A. and S. Van Parys, 2009, [Empirical Evidence on the Effects of Tax Incentives](#), IMF Working Paper 09/136, (Washington: International Monetary Fund); and S. Van Parys & S. James, 2010. *The Effectiveness of Tax Incentives in Attracting FDI: Evidence from the Tourism Sector in the Caribbean*, Working Papers of Faculty of Economics and Business Administration, Ghent University, Belgium 10/675, Ghent University, Faculty of Economics and Business Administration.

⁸ Chai, J. and Goyal, R., 2008, *Tax Concessions and Foreign Direct Investment in the Eastern Caribbean Currency Union*, IMF Working Paper 08/257, (Washington: International Monetary Fund).

8. The OECD/G20 Pillar 2 minimum tax will be helpful in setting a floor for the tax level under the Special Regime.

By ensuring that tax incentives granted to firms in the free trade zones are consistent with the tax policy implications of the OECD/G20 Pillar 2 minimum global tax, the authorities will be able to reduce the costs of tax exemptions, without a commensurate effect on competitiveness. It will also be an opportunity to revisit and reevaluate the overall fiscal incentives package to optimize the cost-benefits. In the more immediate term, it will also be important to follow up on the observations in the recent report by the Comptroller's office to ensure adequate control and follow-up of free trade zone concessions.⁹

9. Further efforts are needed to ensure that the benefits from the export-led growth are benefitting the population at large.

Unless productivity and real GDP growth in the non-free trade zone economy keep pace with that of the free trade zones, there is a risk that the dual economy translates into increased inequality, especially from a regional perspective. FDI has been heavily concentrated to the greater metropolitan area (during 2018-2022, more than 90 percent). In response, the Legislative Assembly approved a new law in May 2022, including eleven new incentives, to strengthen territorial competitiveness to attract FDI outside of the greater metropolitan area (Law No. 10234), in sectors such as the food processing industry, agricultural input companies, specialized health centers and sustainable recreational and adventure activities. The degree to which this initiative is successful may provide an indication of the relative importance of tax incentives versus other factors in attracting FDI. However, to reap the full benefits in terms of catalytic effects from the free trade zones, and for the rest of the economy to close the gap in the long term, further efforts will be needed to create the right conditions for businesses also outside of the free trade zones to raise their productivity and competitiveness. This would include moving towards a more competition-friendly regulatory framework,¹⁰ facilitating entry and reducing costs for starting a company, continuing ongoing efforts to reduce regulations, and improving physical and digital infrastructure. To maintain Costa Rica's edge in terms of a skilled labor force long term, pressing ahead with the ongoing educational reform efforts will also be critical, including by adapting higher education curricula with labor market demand.

⁹ [Informe de auditoría sobre los otorgamientos y la revisión de requisitos de permanencia para empresas en el régimen de zonas francas](#), 27 de setiembre de 2023, Informe N° DFOE-FIP-IAD-00003-2023, Contraloría General de la República.

¹⁰ According to the OECD's Product Market Regulation indicator, Costa Rica has more stringent regulations than any other OECD country. *OECD Economic Surveys, Costa Rica*, OECD, February 2023.

Annex VII. Implementation of Past Fund Policy Advice

2021 Article IV Staff Recommendations	Implementation
Ensure Debt Sustainability While Protecting The Most Vulnerable	
Pursue balanced consolidation through a mix of spending restraint underpinned by the fiscal rule and revenue measures beyond those of the 2018 tax reform.	<ul style="list-style-type: none"> • Consolidation has exceeded expectations. • The fiscal rule has anchored spending discipline despite a minor breach in 2021. • Robust revenues reduced the priority of additional measures. A periodical review of tax incentives and exemptions was institutionalized to broaden the tax base going forward.
Improve the efficiency of spending.	<ul style="list-style-type: none"> • Public Employment Bill approved. • Reforms to improve targeting and efficiency of social spending undertaken.
Enhance public financial and debt management.	<ul style="list-style-type: none"> • MTFFs and Medium-term Debt Strategy published.
Ensuring Monetary and Financial Stability	
Keep monetary policy data-dependent and forward-looking.	<ul style="list-style-type: none"> • Monetary policy has been appropriate and continued to be transparent and well-communicated.
Improve the BCCR's autonomy and governance.	<ul style="list-style-type: none"> • Ongoing. Draft amendments were prepared in consultation with IMF staff, but only a limited set of amendments were submitted to the Legislative Assembly.
Continue to limit FX intervention to periods of excessive volatility, in line with the BCCR's mandate.	<ul style="list-style-type: none"> • Interventions in the exchange market have been focused on ensuring an adequate level of reserves and addressing disorderly market conditions.
Develop the foreign exchange market.	<ul style="list-style-type: none"> • Limited progress.
Strengthen the regulatory and supervisory framework and the financial safety net. Foster greater financial inclusion.	<ul style="list-style-type: none"> • Consolidated supervision took effect in January 2023 with transition arrangements, and risk-based supervision is being phased in starting January 2024. Amendments to the banking resolution and deposit guarantee framework are in progress. Implementation of a national strategy for financial education has started.
Structural Reforms to Promote Inclusive Green Growth	
Improve productivity and inclusiveness.	<ul style="list-style-type: none"> • Measures to incentivize formalization enacted. • Steps taken to implement education roadmap. • Regulations streamlined to reduce red tape. • Childcare and long-term care support increased. • Gender budgeting reports published.
Climate change adaptation and mitigation.	<ul style="list-style-type: none"> • Roadmap to enhance infrastructure resilience to climate change produced.

Appendix I. Letter of Intent

San José, December 5, 2023

Ms. Kristalina Georgieva
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Ms. Georgieva:

Our economic program, supported by the Extended Arrangement under the Extended Fund Facility (EFF), is playing a critical role in solidifying macroeconomic stability, and promoting a stronger and more inclusive growth over the medium term. The arrangement under the Resilience and Sustainability Facility (RSF) is supporting our ambitious climate change agenda and we expect it to catalyze financing from other sources to aid this effort.

We continue to make persistent progress under the Fund-supported program. We met the end-June fiscal and international reserves targets for the fifth review by large margins. All June and September indicative targets (IT) were met except for the June debt IT, which was breached by 0.3 percent of GDP, as we seized the opportunity offered by favorable market conditions to pre-finance coming debt service payments. As a result of the unwinding of the global commodity shock and a decrease in the overall price level, largely reflecting monetary tightening, lower commodity prices and the lagged effects of currency appreciation, the lower inner target band for inflation under the program's Monetary Policy Consultation Clause (MPCC) was breached in June and the lower outer band was breached in September. We continue to comply with the continuous performance criteria. We completed the implementation of the landmark Public Employment Bill for the executive branch, meeting the requirements agreed as part of the EFF-supported program. We remain committed to completing the outstanding measures to align the BCCR's governance and operational frameworks with the objectives of the end-December 2022 structural benchmark. However, the current political environment prevents us from doing so. As soon as the situation improves, we will resume our efforts to ensure that the proposal to the Legislative Assembly to provide constitutional autonomy to the central bank can be submitted.

We implemented four RSF reform measures (RMs) linked to this review: we published a quantitative analysis of climate transition fiscal risks, expanded the appraisal process for government investment projects to assess the impact on climate change, submitted to the Legislative Assembly a bill to introduce a feebate scheme to strengthen incentives for low-pollution private vehicles, and approved regulation on management of socio-environmental risks and climate change risks in banks' credit portfolio.

In view of the strong macroeconomic policies implemented to achieve the main program objectives, further progress on PEB implementation, as well as the progress on other structural reforms under the program, we request the completion of the fifth review of the Extended Arrangement under the EFF and the purchase of SDR 206.23 million. In view of our completion of four RMs under the first RSF review, for which the associated disbursement was not previously requested due to our Legislative Assembly's delayed ratification of the RSF arrangement, and four RMs under the second RSF review, we request the disbursement of SDR 369.40 million. We also request a modification to RM12 on incorporating climate risks into BCCR's top-down stress testing.

Our fiscal consolidation efforts delivered a strong overperformance in 2021 and 2022 and we are on track to achieve a primary surplus exceeding 1.3 percent of GDP by end-2023 and of 1.85 percent of GDP in 2024. These represent a cumulative overperformance relative to our original program objectives and important steps towards achieving a debt-to-GDP ratio of 50 percent of GDP by end-2035. Additional progressive income and expenditure measures will yield further declines in debt to secure macroeconomic stability and foster inclusive and sustainable growth, in line with international best practices. Monetary policy will, using its data-dependent and forward-looking approach, continue to bring inflation back to within the Central Bank of Costa Rica (BCCR)'s tolerance band and anchor expectations, in line with the BCCR's inflation targeting and flexible exchange rate regime. As reiterated in our new National Development and Investment Plan for 2023-2026, which we published in December 2022, we remain committed to advancing our ambitious reform agenda to support a dynamic and inclusive economy, tackling the structural challenges posed by still high informality and inequality (including through a structural benchmark to establish a social assistance single window) and fostering greater economic empowerment of women. We are also resolved to advance our pioneering efforts to adapt to climate change, given our country's important exposure to natural disasters, and transition to a low carbon and resilient economy, generating growth and new job opportunities.

This Letter of Intent (LOI) and the attached Memorandum of Economic and Financial Policies (MEFP) and Technical Memorandum of Understanding (TMU) update the versions dated June 8, 2023, and set out the economic policies and reform measures that we intend to implement to achieve the objectives of our Fund-supported program under the EFF and of the RSF arrangement.

The government and the BCCR will continue to provide the Fund with the data and information necessary to monitor performance under the EFF and RSF arrangements, including those specified in the TMU. We believe that the policies set forth in the attached MEFP, together with the previously issued MEFP and LOI, are adequate to meet the objectives of our economic program, but we stand ready to take additional measures as appropriate. We will maintain close communication and consult in advance with the Fund on the adoption of new measures or revisions of the policies contained in the MEFP and in this letter, in accordance with the Fund's policies on such consultations.

In keeping with our transparency policy, we authorize the publication of this letter and its attachments as well as the associated staff report.

We are grateful to the IMF for the ongoing support to Costa Rica and we look forward to continuing our close cooperation under the EFF and RSF arrangements.

Sincerely yours,

/S/

Róger Madrigal López
President, Central Bank of Costa Rica
Governor of the IMF

/S/

Nogui Acosta Jaén
Minister of Finance

Attachments (2)

Memorandum of Economic and Financial Policies

Technical Memorandum of Understanding

Attachment I. Memorandum of Economic and Financial Policies

1. The government of Costa Rica remains fully committed to the economic reform program supported by the extended arrangement under the EFF and the reform measures under the RSF arrangement. The extended arrangement was approved by the IMF Executive Board on March 1, 2021, and ratified by the country's Legislative Assembly on July 19, 2021. The RSF arrangement was approved by the IMF Executive Board on November 14, 2022, and ratified by the Legislative Assembly on October 17, 2023. This memorandum outlines in detail the progress toward meeting the objectives under the EFF arrangement and our policy plans to advance these objectives as well as our progress and policy commitments under the RSF arrangement. Tables 1, 2, and 3 summarize performance to date and the quantitative targets going forward, progress on structural benchmarks under the EFF, as well as progress on reform measures and modification of one reform measure supported by the RSF arrangement.

2. Our economic reform program aims at securing macroeconomic stability, while fostering an inclusive, green, and sustainable recovery from the pandemic. Our policy and reform efforts remain anchored around three main pillars: (i) gradually implementing equitable fiscal reforms to protect the most vulnerable, while ensuring debt sustainability; (ii) maintaining monetary and financial stability, strengthening the central bank's autonomy and governance, and addressing financial vulnerabilities; and (iii) advancing structural reforms to facilitate inclusion, boost labor productivity, and address the implications of climate change. These broad-based efforts will help support more inclusive, green, and sustainable growth in Costa Rica over the medium term.

I. MACROECONOMIC DEVELOPMENTS AND OUTLOOK

3. Costa Rica's growth remains resilient. Following the strong post-pandemic rebound in 2021, real GDP growth moderated to 4.6 percent in 2022. GDP growth remained robust in the first three quarters of 2023 at 5.3 percent (y-o-y). While strong exports, in particular from the free trade zones, have been the main driver, growth has gradually become more broadbased. Real GDP growth is forecast to continue to grow at 5.0 percent in 2023, following which it is expected to gradually moderate to 4.3 percent in 2024 and in line with potential of 3½-4 percent over the medium term. Inflation peaked in August 2022 and subsequently declined rapidly—thanks to the monetary tightening, the unwinding of base effects, lower commodity prices, and the currency appreciation—to -3.3 percent (y-o-y) in August, well below the BCCR's 2-4 percent tolerance band. The disinflation gradually moderated to -1.3 percent y-o-y in October. Starting in 2022H2 the previous external pressures eased, supported by the strong export performance (including tourism) and FDI inflows, which allowed the BCCR to rebuild international reserve buffers. The current account deficit is expected to narrow from 3.6 percent of GDP in 2022 to 2.1 percent of GDP in 2023. The sovereign spread has continued to narrow, supported by sovereign credit rating upgrades this year. The outlook remains subject to downside risks, including weaker-than-expected global demand, geopolitical tensions, commodity price volatility, tightening of global financial conditions, and climate events such as El Niño.

II. PROGRAM PERFORMANCE

4. Since taking office, we have made important progress on our reform agenda. The end-June 2023 Quantitative Performance Criterion (QPC) and end-September Indicative Targets (IT) on the central government (CG) primary balance and on net international reserves were met with comfortable margins. Although the end-June IT for the debt stock was breached by 0.3 percent of GDP as we took advantage of the favorable market conditions to rebuild liquidity buffers, we met the end-September IT. Amid sizeable liquidity needs to meet debt service obligations in early 2024, we are committed to meeting the remaining debt targets. The Monetary Policy Consultation Clause (MPCC) lower inner band was breached by 0.8 percentage points in June and the lower outer band by 2.6 percentage points in September. We continue to observe the continuous PCs on non-accumulation of new external arrears, non-imposition/intensification of restrictions on the making of payments and transfers for current international transactions, non-imposition/modification of multiple currency practices (MCPs), non-introduction/intensification of import restrictions for BOP reasons, and no conclusion of bilateral payments agreements that are inconsistent with Article VIII obligations. The single pay spine was put in place for all executive branch employees in September, thus exceeding the requirements for the end-September 2023 structural benchmark set in the fourth review. Payments for most institutions covered by the law was administered based on the new pay spine following the gradual approach envisaged in the law starting in November. We remain committed to completing the outstanding measures to align the BCCR's governance and operational frameworks with the objectives of the end-December 2022 structural benchmark. However, the current political environment prevents us from doing so. As soon as the situation improves, we will resume our efforts to ensure that the proposal to the Legislative Assembly to provide constitutional autonomy to the central bank is submitted. The constitutional autonomy will then allow us to implement measures envisaged in the original structural benchmark.

III. FISCAL POLICY

Fiscal Stance

5. The main priorities of fiscal policy are to meet the critical social and health needs of the population, support the recovery, and secure debt sustainability. Costa Rica's fiscal balance deteriorated sharply over the previous decade, due to a permanent increase in current spending following the global financial crisis. Recognizing the pressing fiscal and financing challenges facing our country, a comprehensive fiscal reform bill was approved by the Legislative Assembly in December 2018 to rein in spending and strengthen revenue. The economic contraction caused by the pandemic made an additional fiscal adjustment necessary to keep debt manageable. This reform started to improve the fiscal balance in 2021 and put public debt on a declining trajectory, mostly by requiring a significant decline in spending as a share of GDP. Building on a strong revenue overperformance and spending restraint in 2021 and 2022, we are committed to pressing ahead with the required fiscal consolidation, while continuing to protect the vulnerable and supporting a sustainable economic recovery. Our efforts to date have contributed to an improved fiscal outlook and we are on track to exceed our primary balance target of 1.3 percent of GDP by end-2023 and to achieve a surplus of 1.85 percent of GDP by end-2024. We expect to reach a debt-to-GDP ratio of

60 percent in 2025 and 50 percent by 2035. Additional progressive income and expenditure measures will foster more inclusive and sustainable growth and deliver a faster decline in debt.

6. In this context, the 2018 reform represented a major milestone towards debt sustainability through strict and comprehensive spending limits and a more efficient and fair taxation system.

- **Fiscal rule.** The reform introduced a fiscal rule tying down nominal spending growth and included tight restraints on public sector remunerations. The reform also enabled the reallocation of earmarked revenues and legally mandated spending (except those mandated by the Constitution) if debt exceeds 50 percent of GDP. The rule has played a pivotal role in anchoring debt sustainability. However, the pandemic and Russia's invasion of Ukraine helped identify opportunities to improve the rule. Following a change to the implementing regulation of the fiscal rule in June 2022, the spending ceilings for execution are no longer based on the previous year's execution but exclusively on the previous year's original budget. The change addressed a structural shortcoming in the regulation that penalized under-execution by ministries and other agencies and reduced the flexibility to reallocate resources within the budget envelope to meet evolving or unanticipated needs. More recently, we enacted further modifications to the fiscal rule (¶115).
- **Tax reform.** The reform also included important enhancements to Costa Rica's taxation system. A VAT replaced the General Sales Tax. Income taxation was strengthened through the: (i) globalization and a phased-harmonization of capital income and gains tax at a 15 percent rate; (ii) phasing-in of new rules for corporate income taxation (CIT); and (iii) increase in the progressivity of the personal income taxation (PIT) with additional brackets of 20 and 25 percent for employment and pension income.

7. In 2022, we entrenched further improvement in the fiscal accounts, in line with the program targets. Despite the challenges posed by a cyberattack that targeted several government systems and the rising external pressures on the economy, we comfortably met all primary balance and debt targets under the program. In particular, the end-September primary balance was CRC 1,003 billion compared to a program target of CRC 215 billion. The end-December primary balance was CRC 927 billion compared to a program target of CRC 287 billion. We implemented the following measures:

- **Revenue measures.** Despite being forced to shut down our main tax collection systems in late April 2022 due to a breach into our information systems, revenue performance remained strong in 2022, especially for corporate income, VAT, and import-related taxes, thanks to the prompt deployment of contingency plans to ensure the continuity of basic services to large taxpayers. Moreover, the implementation of the 2018 tax reform continues to generate durable and incremental yields through the scheduled rate increases of VAT on construction-related services and tourism as well as the capital income tax. To mitigate the impact of the global commodity price shock, we delayed the scheduled inflation adjustment to the fuel tax for six months until December 2022. We used one-off revenues—from transferring surpluses accumulated by

decentralized entities before incorporation into the central government—to accelerate debt reduction.

- Spending measures.** Because of the sharp contraction in GDP in 2020 and the debt ratio exceeding 60 percent of GDP, our fiscal rule envisages tighter spending constraints for 2022–2025 to accelerate debt reduction. Accordingly, total spending grew by 1.4 percent in 2022. Total and current spending grew well within the limits established by the fiscal rule after accounting for relevant exclusions. Primary spending fell in nominal terms and by 1.6 percent of GDP in 2022. The spending restraint is based on continued wage constraints imposed by the 2018 fiscal reform (freeze in base salaries, annuities, and new hiring; and elimination of all vacancies). Moreover, until September 2022, we implemented (i) annual nominal reductions of temporary wage components (such as overtime) by 8.5 percent; (ii) freezes in pensions of public sector retirees and current transfers to the public sector excluding transfers to the Social Security Fund (CCSS); (iii) cuts in non-pension private transfers, non-CCSS public transfers, and transfers with external resources; and (iv) annual nominal reduction in spending on goods and services. While the regulation related to these constraints was abrogated in September 2022 to provide more flexibility to the budget process, the Ministry of Finance’s (MOF) circular issued in November 2021 as envisaged by law 8131 continues to ensure tight spending controls remain in place in line with the budget and fiscal rule. Moreover, we closely monitored spending execution and adjusted appropriations to line ministries monthly. Delays and reprioritization of capital projects as well as unused resources from a guarantee fund led to an under execution of capital spending. Moreover, despite the rigidities imposed by the fiscal rule on some agencies, we issued supplementary budgets, excluded *Fondo de Desarrollo Social y Asignaciones Familiares* (FODESAF) resources from the fiscal rule, identified operational efficiencies, and deployed higher-than-anticipated revenues from the Joint Institute for Social Welfare’s (IMAS) commercial activities to reallocate additional resources to mitigate the effects of higher prices on the most vulnerable. Compared to the budget, we provided an additional 0.2 percent of GDP including additional cash transfers for poverty reduction (including temporary food support for new beneficiaries) and additional support for childcare. In 2022, when faced with considerable social and political pressure, a temporary scheme to limit the increase in gasoline prices was under consideration by the Legislative Assembly. However, the measure became less urgent amid reduced external pressures from energy prices and did not advance further through the legislative process. Nonetheless, if such pressures were to reemerge, we are committed to amending the measure before it is sent for debate to ensure its duration does not exceed 9 months, the fiscal cost is capped at CRC 3 billion (or less than 0.01 percent of GDP), and it is covered by the fiscal rule spending ceiling.

8. We are on track to sustain our fiscal consolidation efforts in 2023. A primary balance of CRC 646 billion up to end-June 2023 exceeded the QPC of CRC 305 billion and we also overperformed relative to the end-September IT, placing us on track to exceed our primary surplus target of CRC 609 billion (or about 1.3 percent of GDP) by end-December 2023. To deliver the needed structural adjustment, net of one-offs, and support a balanced and progressive fiscal consolidation going forward, we are committed to implementing the following revenue and

expenditure measures, consistent with the 2023 budget approved by the Legislative Assembly in November 2022:

- Revenue measures.** The 2018 tax reform provided additional income tax yields in 2023 due to the delayed enforcement of thin capitalization rules between related parties; these generated a yield of 0.1 percent of GDP. In January 2023, we implemented measures to improve the efficiency of the tax system by taxing imports of certain goods with VAT throughout each stage of value production until sold to the final consumer, yielding 0.06 percent of GDP. We fully phased-out the reduced VAT rates to the tourism sector and construction services. We remain committed to improving revenue mobilization through a more equitable and efficient tax system (¶11). In September 2022, we adopted a legal framework to periodically appraise tax expenditures and remove those no longer serving their intended purpose, aiding our efforts to broaden the tax base and improve its fairness. We also strengthened the pecuniary framework for taxpayers' wrongful use of exemptions. After a first appraisal of the tax expenditures, we expect to broaden the tax base and mobilize at least 0.07 percent of GDP in additional revenue by removing the lenient VAT treatment of airfares, medical equipment, and wood (after accounting for its negative environmental impact), and tax exemptions on car rentals through legislation submitted to the Legislative Assembly in May 2023. We will continue to remove tax expenditure provisions with a higher social cost than their benefit going forward; we aim to produce our next appraisal of redundant tax exemptions by April 2024. In September 2022, we conducted a detailed review of our personal income tax (PIT), with support from IMF TA. Based on the findings of the analysis, we submitted in May 2023 to the Legislative Assembly a tax bill (23.760) to reform the PIT to increase horizontal and vertical equity by taxing the income of employed, pensioners, and self-employed individuals under a single recalibrated schedule, thereby equalizing their tax burden. The reform intends to fully harmonize the PIT rate on capital income and gains, broaden the tax base by, among others, including dividends distributed by firms in free zones to Costa Rican residents, removing the progressive schedule within the CIT, while retaining and updating the existing simplified tax regime to provide targeted support to small and medium enterprises. Moreover, the bill seeks to broaden the tax base by including capital income earned abroad by Costa Rican residents and simplify the taxation of non-residents. To support and cooperate with international efforts to reduce profit shifting and base erosion and remove Costa Rica from the EU's list of non-cooperative jurisdictions for tax purposes, the Legislative Assembly passed law 10.381, which removed Costa Rica from the EU's Annex I list of noncooperative jurisdiction by amending the definition of permanent establishment to align it to international standards, taxing non-resident firms without economic substance and reinforcing the territoriality principle for resident firms. The President partially vetoed the bill because it narrows our tax base, generates revenue losses, distorts investment decisions and erodes the horizontal equity of the tax system but the Legislative Assembly overrode the partial veto instead of accepting the revised bill or alternatives previously proposed by the executive, which would have safeguarded revenues and equity. As Costa Rica remains on the EU State of Play document (Annex II) which reflects ongoing work needed in the field of taxation, to ensure we are not deemed as a non-cooperative jurisdiction for tax purposes in future rounds, we submitted bill 23.088 to ensure that financial institutions adequately comply

with the due diligence process regarding financial information of non-residents required for the automatic exchange of information, cooperating with international efforts to fight against tax evasion and safeguarding the integrity of tax systems. We intend to resume the discussion of the bill proposal number 23.760 to address the current income tax structural shortcomings. The Legislative Assembly also approved in September 2023 an extension and expansion of the tax exemption on small and medium enterprises, representing a setback in our efforts to achieve a more efficient tax system. The tax yield of the recurrent property tax on vehicles was also reduced through a bill introduced and approved by the Legislative Assembly in September 2023. As part of our commitment to foster green growth, we submitted to the Legislative Assembly a revenue neutral scheme of feebates to strengthen incentives to replace high-polluting private vehicles and further our decarbonization plans in November 2023 (1142).

- Spending measures.** The 2023 budget approved by the Legislative Assembly envisages total spending growth of 3 percent in 2023 (consistent with the fiscal rule limit of 2.6 percent after accounting for emergency spending). Given budgeted increases in the interest bill, this implies zero growth in budgeted primary current spending. As of September 2023, primary current spending grew by 1 percent. Moreover, we continue to prudently manage budget execution to fully meet the program's primary surplus target, adjusting appropriations to line ministries monthly as warranted. Despite the constraints on spending, the 2023 budget represents an increase in social spending of more than CRC 30 billion (4 percent) compared to the initial 2022 budget, including by providing new non-contributory pensions to elderly people in poverty. As we did in 2022, we have, through extraordinary budgets, reallocated underexecuted resources of CRC 55 billion to social spending to safeguard social spending. We will channel these resources to the main cash transfer, non-contributory pension, and childcare programs with identified coverage and funding gaps while stepping up efforts to verify eligibility. As approved under the 2018 fiscal reform, we are also effectively reallocating spending away from legally mandated uses (with the exemption of those mandated by the Constitution) when the debt-to-GDP ratio is above 50 percent of GDP. We remain committed to staying current on all our payment obligations and not accumulating any spending arrears. Approval in November 2022 by the Legislative Assembly of external loans by our multilateral partners and multi-year Eurobond issuance, together with continued improvement in market conditions and ongoing debt management efforts, will help contain interest expenditure, which will reduce the headline deficit and create additional space for priority spending. Importantly, after verifying a portion of money claimed by the CCSS, we made additional payments this year.

9. The draft 2024 budget targets a primary balance of at least 1.85 percent of GDP. This target is consistent with conditions set by the Legislative Assembly for further Eurobond issuance. The budget permits nominal primary current spending growth of 2.4 percent, as current and overall spending comply with the fiscal rule and continue to decline as a share of GDP despite higher interest costs. Despite these constraints, there is an increase in priority social spending of 16 percent relative to the ordinary 2023 budget and we expect to increase budget allocations through extraordinary budgets. Ongoing improvements in tax and customs administration continue supporting revenue yields. Further progress in strengthening our tax system, with the approval of

tax bills the government presented to the Legislative Assembly, would also secure our public finances on a firmer footing. Although the primary aim of bill 23.760 (¶18) continues to be the improvement of the equity and efficiency of the tax system, we will through revisions to the bill pursue means to minimize the yields lost through the recent passage of legislation on CIT and property taxes on vehicles (¶18) in addition to enhanced compliance measures. Nevertheless, were revenues to underperform, we will propose to the Legislative Assembly compensating tax measures and we will reprioritize non-critical spending as needed to ensure that we reach our primary targets under the program and required for Eurobond issuance. In the event of additional COVID-19 needs, the program targets will continue to allow for an adjustor to accommodate increased COVID-19 emergency spending, up to 0.2 percent of GDP in 2023, that might emerge from increased transfers to support health services, stronger targeted support to households and businesses heavily affected by the pandemic, or further enhanced social assistance programs to support the most vulnerable groups. We are, however, committed to saving any revenue over-performance or windfalls to accelerate our debt reduction plans.

10. We will further advance our fiscal consolidation efforts over the medium term to reduce our debt to below 60 percent of GDP as soon as possible, while making space for critical infrastructure and social needs. We are aiming to reach the 60 percent threshold in 2025 and continue reducing the debt thereafter. Additional measures will be underpinned by a planned income tax reform and additional efforts to rationalize tax expenditure (¶111). In line with the fiscal rule and our current debt forecasts, the freeze in the basic wage will be extended until 2027. At that point, we expect fiscal savings from the implementation of our ambitious reform of public-sector employment (¶113) to begin to materialize. These factors will further support our commitment to keeping nominal spending growth low. Meanwhile, we will continue to modernize and strengthen our social safety net (¶114) and allocate additional resources to improve coverage. Expected efficiency gains through consolidation of ministries and other institutions as part of our broader public sector reform; our planned asset sale program; and greater revenue mobilization from the modernization of the tax and customs administration (¶112) and PFM reforms (¶115), provide important upsides to our ability to tackle our current debt and financing challenges faster than expected under the program, thereby supporting macroeconomic stability and growth. We will verify and as appropriate settle additional CCSS claims in a systematic fashion, thus reducing contingent liability risks to the central government while putting the CCSS on an even firmer financial footing for the provision of health and pensions.

Structural Fiscal and Debt Management Reforms

11. We are developing a medium-term revenue strategy to move towards a more progressive and growth-friendly tax system that supports equitable growth. We are improving the tax system through a comprehensive set of policies to support the government's priorities and meet revenue goals. This strategy includes (i) redesigning the PIT for a more equitable, efficient and neutral tax system where wages earned by employees, profits from the self-employed, and pensions are taxed through a single recalibrated progressive tax schedule (¶18); (ii) broadening the base by taxing dividends distributed by firms in free trade zones as well as passive capital income earned

abroad by Costa Rican residents; (iii) rationalizing and simplifying income taxation of non-residents; (iv) further broadening the tax base by removing services taxed with reduced VAT rates and going forward through the systematic and regular cost-benefit analysis of tax exemptions, to remove outdated or ineffective exemptions, including a thorough review of those that have a negative environmental impact; (v) removing the progressive tax schedule within the corporate income tax (CIT) while protecting small firms through the revamping of the special tax regime, and broadening the tax base and correcting non-neutralities; (vi) revising our current incentives under the free trade zones to protect our domestic base in line with the new international taxation architecture (Pillar 2) with World Bank (WB) support; and (vii) supporting the environmental agenda by introducing and periodically recalibrating feebates to support the transition to low emission vehicles and safeguarding revenues consistent with IMF advice. Because the individual elements have varying implications for yields, we will aim for the comprehensive package to compensate for the revenue losses of the CIT and the property tax on vehicles (¶18).

12. We are strengthening revenue administration to support our fiscal consolidation plans and medium-term revenue strategy.

The Tax Compliance Improvement Plan, approved in December 2021 (structural benchmark) with IMF TA support and updated in December-2022 and December 2023, aims at strengthening compliance strategies through a more hands on approach to recovering delinquent tax arrears, utilization of robust large-scale automated cross-matching of information to detect inaccurate reporting, and revamped audit programs focused on VAT on services and erosion of CIT bases. While the rollout of the compliance plan was delayed due to the hacking of the tax and customs administration's main collection systems, we resumed the implementation of different compliance risk mitigation strategies in August 2022, with quarterly monitoring based on both quantitative and qualitative indicators for the selection of risk-based cases. From September-2022 to November-2023, our risk assessments of VAT, large corporate taxpayers, and cross-border taxation allowed the tax administration to recoup approximately US\$ 38.5 million in owed taxes, including interest and penalties. We developed and implemented a guideline (*ficha*) to undertake risk assessments of large net-wealth taxpayers in November 2023. We are also modernizing our tax code through another bill (23.759) submitted in May 2023 to instate fiduciary responsibility, simplified enforcement procedures, updates on penalties, coercive collection, and precautionary administrative measures. Through bill 23.088, we have proposed changes to our general tax code to ensure that financial institutions adequately comply with the due diligence process regarding financial information of non-residents required for the automatic exchange of information for tax purposes. We continue to strengthen the integrity of the taxpayers' registry, with IMF TA, and are on track with the monthly debugs of the taxpayer registry scheduled for May-November 2023. We developed the international taxation risk assessment guideline (*ficha*) to identify Common Reporting Standards (CRS) non-compliance and began a pilot in August 2023 to assess whether the identified risk criteria translate in actual non-compliance. We will use administrative and third-party information to enhance compliance, including the automatic exchange of information on financial accounts (CRS), Country-by-Country (CbC) reports, and effective use of corporation shareholders and beneficial owners' registers when warranted. We have also started to exploit data from samples of electronic invoices to detect unusual activity in specific sectors and taxpayer behaviors to improve enforcement capabilities and the efficiency of the tax

administration. We are requiring large cross-border service providers to register for VAT to enhance tax compliance on cross-border services consumed in Costa Rica. In addition, with IMF TA, we are also updating our framework to estimate non-compliance estimations for VAT and CIT by end-March 2024. In addition, we continue to monitor and update the strategic indicators and targets in the Compliance Improvement Plan. On the customs side, the approval of the new Customs Law in May 2022, designed and approved with IMF TA support, will further promote trade facilitation to help increase productivity growth in trade-related sectors and improve revenue collection through more effective risk-based enforcement. The implementing regulation was approved and published in June 2023. The Directorate of Customs has prioritized the operational and procedural changes mandated by the law and delayed the organizational changes until the new operational and procedural guidelines are in place. Through an executive decree by end-January 2024, we are curbing abuses and improving our oversight of service logistics firms in the free trade zones by requiring them to share their inventories and limiting some activities which can be carried out within the zones. We are modernizing points of entry for imported merchandise at the border with Panama and Nicaragua. Additionally, with the support of CAPTAC-DR, we continue developing analytical tools to improve our risk-based assessments and to reduce the under declaration of imported goods. To improve enforcement, we are employing non-intrusive scanners using risk-selection criteria of containers in the Moin Port. Additional revenue administration and customs efficiencies are expected from the MOF's digital transformation plan, *Hacienda Digital*, supported by the WB, which will upgrade tax and customs procedures and information systems, and replace the National Integrated Risk Management Systems, a tax and customs coordinated risk management approach, which was abandoned due to technical issues with the service provider. The discussion with the firms for the development of the Commercial-Off-The-Shelf modules for tax and customs are ongoing. We expect these modules to be fully interoperable improving risk-management and enforcement capabilities. We have also deployed an aggressive strategy to minimize cyber risks through an extensive communication strategy and training programs on cyber risks geared toward all MOF staff. We have invested in updating security measures to reduce vulnerabilities.

13. We are rationalizing and improving the efficiency and quality of government spending through the full implementation of the public employment reform. In particular, we have met the revised milestones we committed to during the Fourth EFF Review.

- *The landmark Public Employment Bill was approved in March 2022 (the related structural benchmark was not met by end-May 2021 as initially envisaged due to legislative delays).* The reform enhances fairness and productivity by replacing the composite salary system, which indiscriminately rewarded seniority and civil-service exclusivity, generating perverse incentives for public servants, with a single pay spine. It modernizes and streamlines the public administration, bringing the public wage bill on a sustainable path, in line with OECD recommendations. Beyond the fiscal consolidation efforts envisaged by the 2018 fiscal reform, the PEB puts the public wage bill on a sustainable path after its excessive expansion over the previous 15 years. Due to the large wage premium in the public sector, the public employment reform freezes salaries that fall above the spine until the single pay spine reaches them. This, along with the gradual transition to the single wage spine for existing workers whose salaries fall

below the reference wage (Transitory Disposition XI), will generate savings. The reform introduces new rules for recruitment and selection, professional development, and performance evaluation, including for top-ranked officials; and new employee benefits including one-month parental leave, two-month extension of maternity leave (for special cases), and sick leave to take care of a family member.

- Our implementation timeline has been achieved through a phased approach.* The implementation process had to overcome unanticipated methodological complexities in designing the single wage spine, including incomplete wage data resulting from the cyberattack to the MOF last year. The Ministry of National Planning and Economic Policy (MIDEPLAN), through the creation of a Public Employment Unit and in coordination with the Civil Service General Directorate (DGSC) and with support from the Inter-American Development Bank (IDB), finalized the methodology to create a single wage spine with all seven job families, consolidating within the single salary other wage supplements such as annuities, bonuses, incentives and others in June 2023. The oversight over the design of the single wage spine was shared between MIDEPLAN and autonomous institutions for their employees (Judiciary and Legislative Branches, Supreme Electoral Tribunal, public universities, municipalities, and CCSS), following the criteria and ceilings approved by the Bill. The implementation of the single wage spine was achieved by engaging with stakeholders, including a public consultation in January 2023, to facilitate the approval of the implementing regulation as envisaged by March 2023. As a result, new hiring in the public sector adhered to the new rules in line with the Public Employment Bill since then. A follow-up National Dialogue was set up in March 2023 and held for 10 days to better communicate the implementation of the PEB to stakeholders and iron out technicalities within the PEB. MIDEPLAN issued general methodological guidelines pertaining to job data collection, analysis of job classes by job family, and the formulation of the single wage spine in May 2023 to inform the implementation of the PEB by public institutions whether or not they are legally under the technical tutelage of MIDEPLAN. For institutions not under MIDEPLAN's tutelage, these guidelines are a non-binding reference for the correct application of the PEB and can be used as institutions see fit.
- With IMF TA support, we took corrective actions and established a strict schedule of activities to meet our program commitments to implement the single wage while ensuring it meets the objectives of the law.* MIDEPLAN produced a single wage spine in compliance with the Public Employment Bill covering at least one-quarter of job positions in the executive branch in June 2023 (a met prior action for completing the previous review), by producing a document detailing how factors are mapped into points, points are assigned to the job positions, monetary values are assigned to points, and developing (with the support of the MOF) fiscal scenarios for the public administration to provide adjustment margins to the single wage spine if needed. We incorporated 100 percent of the executive branch's job positions in the single wage spine in early-September 2023 (structural benchmark) by publishing the wage spine and its directives, which will set the global salaries of new workers and the transitional provisions in the PEB and how its regulations will be applied henceforth. We updated our payroll system, Integra, and began administering payments for all employees covered by the law in line with the transitional

provisions set by the PEB and its regulation in November 2023. All institutions covered by the PEB will have complied with the design and enforcement of a global wage spine by January 2024, thus meeting the requirements for the missed end-March 2023 structural benchmark.

- *We are taking further steps to ensure implementation meets our reform's objectives.* To ensure the robustness of our published wage spine and with the support of the IDB, we are running a simulation on a small but representative sample of jobs. By end-December 2023, we will contrast the resulting wage spine from the sample with the published global spine and, only if necessary, make adjustments to the published wage spine in the appropriate annual directive by March 2024 in coordination with the MOF and the STAP as mandated by the PEB. To ensure fiscal savings are preserved and to ensure the public sector can attract qualified human capital, we will publish detailed guidelines on how to revalue points within the global wage spine over time. The drafting and approval of other guidelines and regulations related to human resource management envisioned in the law and its regulation will be completed by March-2024. As a result of our earlier consultations held in the National Dialogue, we identified and drafted amendments to specific articles in the PEB to strengthen the certainty of the implementation by addressing technicalities, including closing the current loopholes allowing institutions to carve out their staff from the PEB by declaring their job positions as exclusive.

14. We are committed to enhancing the targeting accuracy and delivery of our social protection programs, leveraging digitalization. Costa Rica devotes important resources in its budget to fighting poverty and reducing inequality. There are opportunities to build on recent improvements and further enhance the effectiveness of some of its social assistance programs through improved coverage, targeting, and delivery. The delivery system is also highly fragmented with different entities engaging in social assistance activities, with scope for improvement in institutional arrangements, transparency, and payment delivery. To consolidate the social protection system and provide more flexibility in social spending, we presented bill 23.436 in October 2022 to integrate the functions of various bodies within IMAS. The bill is advancing through the legislative process and we expect it to be available for discussion in the plenary by May 2024. Ongoing improvements include:

- **Centralization and digitalization of the payment system.** The payment system for all cash transfer social assistance programs at the MOF's National Treasury (SUPRES), in coordination with social assistance units, was centralized and digitalized in December 2021 (structural benchmark). Specifically, we signed agreements with responsible institutions, issued appropriate regulations, and incorporated the payment software solution into the Digital Treasury system. Despite the delays caused by the cyberattack, by July 2023, the system included all IMAS programs and numerous other institutions' programs, representing 97 percent of cash payments financed with resources from the national budget. To achieve 100 percent payment of such resources through the budget, we are developing round-the-clock real-time payments and the ability to compensate third parties for in-kind services. As a next step, we will be supporting adoption by remaining institutions and programs that deliver cash benefits by tailoring the data interface and helping them overcome capacity constraints. We expect all the main institutions

and programs that provide benefits in the form of cash to be fully compliant with the new system by end-December 2023. We estimate that introducing the system reduced the payment processing time needed to reach the final beneficiaries from 3-5 days to less than 24 hours (often in real time) and improved service delivery to beneficiaries, fiscal operations efficiency, savings on transactions costs, and financial inclusion of the low-income population (especially women) through the adoption of digital payment tools.

- **Targeting and coverage of social programs.** To continue enhancing the targeting accuracy of our social programs, we continue strengthening the role of SINIRUBE (*Sistema Nacional de Información y Registro Único de Beneficiarios del Estado*) as the main instrument to target social protection benefits and services, which will also contribute to a more harmonized framework for inter-institutional coordination. A study by *Programa Estado de la Nación* confirmed the robustness of the SINIRUBE algorithm for targeting beneficiaries. Major social assistance programs have already adopted SINIRUBE and the office in charge of its administration has prepared plans to support the adoption by the 2 (out of 17) remaining autonomous social sector institutions, namely the judiciary and higher education. The government is also persuading municipalities to learn and adopt SINIRUBE as their targeting instrument. In addition to boosting inclusiveness, these efforts will improve spending efficiency by promoting interoperability with other sources of data to reduce costs of data validation and rationalize existing programs. In this context, building on IMAS Directive 0122-2022, we are increasing the use of information from SINIRUBE to have a better and up-to-date socio-economic profile of individuals and households, to inform benefit allocation decisions. For example, SINIRUBE incorporates the *baremo* tool, which quantifies the intensity of a person's needs, to aid with prioritization. Additionally, IMAS is progressing in accordance with its roadmap to remove ineligible duplicate benefits, outside of municipalities. In particular, possible duplicates have been identified by SINIRUBE and relayed to institutions for review. Through regulations and directives, we have included measures to prevent duplication in key institutions. Bill 23.436 will safeguard our powers to do so. As targeting improves and more resources become available, we will increase coverage of priority programs over the medium term, including those targeting children and the elderly in poverty. We are also, with UN support, assessing our legal options for increasing or decreasing the conditionality of cash transfers.
- **Social Assistance Single Window.** With technical support from the WB, IMAS has started designing and developing a Social Assistance Single Window (*ventanilla única*) to consolidate social programs and to move from a first-come-first-serve basis to prioritization based on the urgency of need, thus improving response times and targeting. We already launched an online form allowing changes in contact details and started to strengthen associated back-office systems. Building on these efforts, IMAS is on track to launch a single window for social programs under its authority (except those related to emergency care, the group programs of the Area of Productive and Community Development, and the ones corresponding to the Area of Social Action and Administration of Institutions) by end-February 2024 (**structural benchmark**); the window will automate the process from when a request is made to when an appointment is assigned. This will entail allowing the public to enter or update information

relevant for assessing their situation and determining eligibility and integrating this online form with SINIRUBE, whose capacity to validate data and assess eligibility will be strengthened. We recently completed the user self-service module, improved interoperability across databases, and automated prioritization of beneficiaries (including through real-time validation of data using SINIRUBE, and expect to extend access rights beyond registered social workers by the end of 2023). In early 2024, we will have an inventory of programs from other institutions that could be linked to the services of the single window. When completed, the single window will: (i) serve as a one-stop-shop for potential beneficiaries to access information on social programs; (ii) consolidate information on benefits and programs that individuals and families are receiving; (iii) provide information on potential eligibility for new benefits to beneficiaries and social workers; (iv) facilitate the preparation of legal documents for beneficiaries such as certificates for appeals; (v) provide an online interface where individuals and families can more easily and regularly update personal and contact information; and (vi) facilitate coordination among public institutions that manage benefits and programs. We are working to secure the financing needed to make the single window as effective as possible.

15. We are taking further actions to improve public financial management (PFM) and the functioning of our fiscal rule.

- Fiscal Rule Amendments.** In September 2023, we passed amendments on the rule's regulatory perimeter excluding public institutions operating under market conditions or without government control consistent with budgetary classifiers, in line with IMF TA recommendations. The amendments, however, also excluded other non-IMF advised institutions such as the national security sector, donations to the non-financial public sector, and royalties paid to ARESEP among other transitory arrangements, which complicates the verification of compliance with the fiscal rule. The amendment preserves broad coverage of spending categories (e.g., capital when debt is above 60 percent, interest, and court rulings), in line with IMF TA, but reduces the institutional coverage and thus the amount of spending covered by the rule by 5.8 percent of non-financial public sector spending. Overall, the rule retains the spending ceilings and maintains the rule's essential role in containing spending and reducing debt at the central government level but the influence of the fiscal rule on non-financial public sector expenditure has been considerably weakened. Going forward, we will continue to strongly oppose ad hoc requests for additional institutional exclusions. To facilitate resource allocation in line with the administration's priorities, the MOF produced an assessment of legal changes needed to empower the STAP to make the expenditure limit applicable to the overall central government (including extrabudgetary entities) on aggregate instead of to individual entities in September 2023. The assessment concluded that including extrabudgetary entities in the aggregate would require constitutional and other supporting reforms. We will limit further changes to the rule to holistic periodic reviews.
- Medium-Term Fiscal Framework.** With support from IMF TA, the MOF published in April 2022 a Medium-Term Fiscal Framework (MTFF) covering the NFPS including the period 2022-2027, meeting the relevant structural benchmark. The revised MTFF, which improves the credibility of

the budget process and presents a coherent fiscal strategy in line with the fiscal rule, includes analysis and reporting of fiscal risks with contingent liabilities, debt guarantees, and explicit fiscal contingency reserve schemes, and integrates into the fiscal strategy a medium-term public investment plan/framework. The MTFF was updated in September 2022 as part of the submission of the 2023 budget, and in March 2023, ensuring continuity in the analysis of macroeconomic shocks and further analysis of debt management. We further strengthened the September 2023 MTFF by better aligning our fiscal policy with long-term national plans, explicitly stating the goal to reduce debt to 50 percent of GDP by 2035. To further enhance fiscal risk analysis, the MTFF includes climate transition risks (¶44).

- **Public Investment Management Assessment.** To improve the planning, allocation, and implementation of public investment among the numerous entities currently responsible for infrastructure development, the MOF and MIDEPLAN undertook the IMF Public Investment Management Assessment (PIMA), including a new Climate Change Module, in November-December 2021, with support from the WB and IDB. Based on the assessment, we have defined a plan aimed at strengthening public investment efficiency while making fiscal space for our climate change-related and other critical infrastructure needs (¶41). As part of this plan, we submitted a bill (No. 22.470) to the Legislative Assembly to extend the process and procedures of the national public investment management system (*Sistema Nacional de Inversion Publica (SNIP)*) to all the decentralized entities attached to the different ministries, the Legislative Branch, the Judicial Branch, the Supreme Electoral Tribunal, and their dependencies and auxiliary entities, as well as to the decentralized administration: autonomous and semiautonomous state-owned enterprises and municipalities. The bill has been viewed favorably by the relevant legislative committee, MIDEPLAN is conducting extensive outreach with legislators, and we expect the bill to be approved by the Legislative Assembly by end-February 2024. We incorporated the climate impact of projects by integrating the social cost of carbon in our project appraisal. In September-2023, we published guidelines for the appraisal of projects with specific illustrations in the transport sector considering the climate impact of the project through the social cost of carbon (¶41). To seamlessly implement the appraisal process, we have started requesting other public sector institutions to start training their planning unit staff so they are able to apply them. To give continuity to the work initiated with the support of IDB and private consultants, we will publish by end-December 2023 a set of clear and transparent project selection criteria including climate change criteria (¶41). We already issue quarterly and half-year reports on the physical and financial progress of externally funded projects. To streamline capital project portfolio monitoring, we plan to extend the process to domestically funded projects. We also plan to develop a comprehensive asset register including information on the stock of public assets and their condition as a necessary precondition to inform investment planning, selection, and maintenance.
- **Gender budgeting.** We introduced gender budgeting to better operationalize the gender equality policy agenda in our 2024 national budget proposal. With IMF capacity development support, we incorporated a gender lens into the budget preparation process by publishing a gender budget statement that identifies gender-related spending for the Ministry of Justice,

Ministry of Education, Ministry of Agriculture and Livestock, the Judicial Branch, National Institute of Learning, Rural Development Institute, National Institute of Cooperative Development, and IMAS as an annex to their respective 2024 budgets (completed in October 2023). Intermediate steps in the preparation of the budget included: (i) a pilot exercise to identify gender-related expenditures (completed by end-December 2022); (ii) adjusting budget call circulars for the 2024 budget to give instructions to identify gender-related spending in the pilot ministries (completed by end-April 2023); (iii) establishing coordination between the MOF, the STAP and the Comptroller's Office, so the CGR considers the adoption of the technical budgeting standards to identify gender-related spending and mandatorily applies it in the decentralized sector. The execution of gender-related spending, in line with the budget statement, will be monitored during 2024.

- **Fiscal Council.** We are resourcing and fully operationalizing the Fiscal Council to enable it to publish its first public assessment of the government's fiscal strategy, fiscal rule compliance, debt sustainability, and macro-fiscal projections included in the March 2024 MTF. We will support the Fiscal Council in developing its own communication tools as well as a memorandum of collaboration with the MOF to clarify the separation of functions and information sharing.
- **Macro-fiscal Unit.** In line with IMF TA recommendations, we have initiated the process needed to formalize a unit at the MOF permanently in charge of macro-fiscal issues by end-December 2023.
- **Other key PFM institutional reforms.** The MOF and the Comptroller's Office will continue working together throughout the entire budget cycle to ensure compliance with the fiscal rule, despite the additional complexity created by recent changes. We have recently resumed our efforts to reduce budget fragmentation. Following the consolidation under the CG budget from 2021 of all public entities, as required by Law 9524 of April 2018, we plan to consolidate public services within fewer public institutions, as part of our planned public sector reform. Specifically, we submitted legislation to consolidate the responsibilities of multiple entities within the Ministry of Public Works and Transportation (MOPT), a new Ministry of Housing, and a new Social Ministry to abate redundancies within the public sector. We are also restructuring several ministries to strengthen their oversight of other decentralized entities and eliminating the Ministry of Governance, reallocating some of its directorates under other public institutions. In addition, with IMF TA support, we will continue improving the management of public sector liquidity by extending the Treasury Single Account (TSA) to the entire public sector, including decentralized and autonomous entities. Specifically, we submitted a revised bill (No. 22.661) in September 2022, with expected approval by end-December 2023, that requires the phased transfer of all cash held by decentralized and autonomous entities in commercial bank accounts to the TSA, which will reduce idle cash in the financial system and reduce the central government's borrowing costs. Additional expenditure administration efficiencies are expected from the MOF's digital transformation plan, *Hacienda Digital*, supported by the WB, which will modernize and integrate our PFM information systems to better align expenditure policies across core PFM entities, planning, and spending units.

16. We modernized our public procurement processes. In line with the Social Dialogue's agreements, we enforced the use by all procuring entities of the electronic platform *Sistema Integrado de Compras Públicas* (SICOP) to lower transaction costs and improve capacity and expertise. The Public Procurement Law (No. 9986) approved in May 2021 introduced a sound regulatory and institutional framework for managing and implementing umbrella contracts for goods and services, eliminating past exceptions to public bidding processes and increasing competition for government contracts. This new procurement legal framework entered into force in December 2022 and requires bidders' registration in the e-procurement system, 'Electronic Registry of Official Suppliers and Subcontractors of the Unified Digital System', to be incorporated into the *Sistema Integrado de Compras Públicas* (SICOP). The regulation was published in November 2022. The regulation requires all competing bidders to submit accurate and current beneficial ownership information through affidavits as part of the bidding process. The required information includes information to identify the beneficial owner, including their full name, and type and number of official identification document(s) for legal persons. Although SICOP is accessible to the public, beneficial ownership information will be held within MOF's supplier registry for consultation by the Comptroller General of the Republic, Office of the Attorney General of the Republic or other judicial authority upon request. It will also allow the authorities to cross-check information with the Transparency and Final Beneficiary Registry, administered by the BCCR to combat tax fraud and money laundering (¶135). Moreover, the enforcement of the Public Procurement Law updates, streamlines, and modernizes the public procurement processes ensuring greater efficiency savings through bulk purchases of certain goods and it will allow differentiating by public works, goods, and services, and set different thresholds and processes for each procurement category, doing away with a great deal of complexity in the public procurement process. We will continue striving to upskill procurement offices within the public sector to improve public procurement planning in line with the National Procurement Plan for 2024.

17. We continue to foster transparency and adhere to best practices in the procurement and contract awards of any COVID-related spending. The Comptroller's Office developed a Fiscal Transparency Portal for COVID-19, with published information on public purchases and audit results on the use of emergency assistance, while the Ministry of Labor and Social Security created a transparency portal on the *Bono Proteger* program, which includes the list of beneficiaries, statistics, and reports. Moreover, with IDB support, MIDEPLAN launched a revamped the Transparency Portal (*Rendir Cuentas*) with the intention of disseminating the CG's COVID-19-related public purchases, subsidies and donations, including data from SICOP, IMAS, MTSS, MINSAs, CNE, CCSS and SINIRUBE. On public purchases, the data published in the Portal include information on awarded vendors, including their legal ownership (if tenders required it). The Comptroller's Office continues carrying out specific audits on emergency cash transfers to ensure related funds are used properly and publish them in its Portal.

18. We are committed to improving governance and increasing transparency in SOEs. Although SOEs play a dominant role in many key sectors of the economy, such as electricity, telecommunications, transportation, banking and insurance services, and petroleum products, some of them present data reporting weaknesses, constraining full assessments of their balance sheets

and potentially hiding risks to public finances and taxpayers. To foster greater transparency in line with international standards, we are committed to accelerating the full adoption of International Financial Reporting Standards (IFRS) by SOEs. As regards the publication of the 2020 financial statements for three SOEs according to IFRS (end-December 2021 structural benchmark), ICE (*Instituto Costarricense de Electricidad*) was fully compliant and AyA (*Instituto Costarricense de Acueductos y Alcantarillados*) became compliant with a delay in June 2022. To fully comply with IFRS, CNP (*Consejo Nacional de Producción*) continues to work on implementing a new accounting system for FANAL, a very small company under its purview. The remaining SOEs already published their 2020 financial statements per IFRS standards. An updated 2021 aggregate report on SOE performance was published in February 2022. With support from the OECD and WB, SOEs' public procurement process is fully consistent with the SICOP as required by the Public Procurement Law, limiting the use of exceptions for direct public procurement and gradually eliminating regulations that grant them the right to withhold confidential information.

19. We are strongly committed to boosting productivity through greater efficiency and competitiveness in the electricity sector and the modernization of electricity tariffs. Since 2021, the Costa Rican Institute of Electricity has been implementing an efficiency strategy to reduce electricity prices in the context of its strategic plan. This strategy includes actions such as reducing operational costs, restructuring debt, and completing the implementation process of the IFRS. As a result of these efforts, the cumulative price reductions in ICE's generation, transmission and distribution systems are estimated to be 10 percent, 13 percent and 5 percent, respectively, from December 2020 to December 2023. The Government is committed to advancing this efficiency strategy through further debt restructuring and cost reduction in order to achieve lower and more competitive tariffs. ICE will continue the execution of its Financial Sustainability Roadmap to reduce fixed costs and renegotiate debt conditions in its financial statements and the regulatory accounting used for tariff setting by reclassifying operating leases as finance leases; this last step was concluded in March 2023 and it will be reflected in the reduction of tariffs as of 2024. ICE will assess its cost structure in each segment of the electricity supply chain (generation, transmission, distribution) to identify efficiency opportunities and launch a roadmap with detailed actions to increase the efficiency of the state-owned company by end-December 2023. In September 2023, ICE requested ARESEP to carry out an ordinary tariff study to reduce prices in the generation and distribution systems (14 and 3 percent, respectively), which is expected to take effect in January 2024. ICE is renewing and/or renegotiating at affordable terms the private generator contracts as they expire to leverage installed capacity to meet increasing electricity demand and guarantee investment efficiency, as well as achieve benefits in end-user tariffs. To optimize the use of installed infrastructure, a bill (No. 22.561) authorizing private energy generators, public companies, and cooperatives to sell their surplus energy (after supplying local demand) to the regional market was submitted to the Legislative Assembly in June 2021 and is expected to be approved by end-June 2024. *Autoridad Reguladora de Servicios Públicos* (ARESEP) will expand its efforts to analyze tariff competitiveness in generation, distribution, and transmission and the adoption of a new efficient tariffs benchmark, with IDB support. To achieve this, under ARESEP's leadership, three companies (ICE, ESPH and COOPELESCA) started to implement the first part of the tariff modernization program in 2021 and, building on this pilot, the remaining five companies started implementation in 2022. As

the next step, starting in 2024, ARESEP is working with each distribution company to develop a roadmap for the introduction of the modernization of the tariff structure. ARESEP will continue monitoring distribution companies' financial costs to ensure their investment projects' financing terms fit with the underlying assets' useful lifespan. Efforts are also ongoing to promote the harmonization of the energy sector. The implementing regulation for Law No. 10086 to simplify the administrative procedures for private participation in power generation from renewable sources for self-consumption, approved in October 2021, was officially established in February 2023 (¶142). Moreover, ICE and the Costa Rican Chamber of Distributed Generation will simplify the procedures for the interconnection of distributed generators in ICE's network through an internal protocol. We submitted a bill (No. 23.414) to the Legislative Assembly in October 2022 to promote the development of new technologies and business schemes for the provision of public electricity service, optimize physical infrastructure, and ignite the commercialization of electricity, all of which will be an effort to lower electricity costs. The bill also seeks to integrate the public policy for electricity and fuels, which will accelerate decarbonization and is under discussion in the legislative committee.

20. We have launched a comprehensive reform of debt management. To contain the risk of rising debt levels, the President of Costa Rica and the Minister of Finance approved in 2019 a Debt Policy for the Public Sector (Executive Decree 41935-H), which establishes solid guidelines for public institutions to put debt on a sustainable path in the long term. The rises in public debt and financing risks amid the COVID-19 crisis and more recent rises in global interest rates have highlighted the urgent need to diversify sources of fiscal financing and better manage the outstanding debt stock and liquidity. Our debt management agenda comprises:

- ***Eurobond issuance.*** In November 2022, the Legislative Assembly authorized the Ministry of Finance to issue up to US\$ 5 billion in Eurobonds. In our first issuance since 2019, we successfully secured US\$ 1.5 billion in March 2023 and followed this with another US\$ 1.5 billion in November 2023 (at face value). We have authorization for up to US\$ 1 billion in 2024, and up to US\$ 1 billion in 2025, subject to prudent fiscal targets being met to accelerate debt reduction. The general authorization will provide us with some flexibility for international issuances. In February 2024, we will pursue a constitutional reform that would grant the executive greater flexibility in international borrowing according to best practices. This will allow the MOF to optimize the balance and timing of internal and external debt issuance. It will also allow the budget debate in the Legislative Assembly to have a more holistic approach that moves beyond discussions of expenses to include discussions on financing (including debt) needed to close any gaps in the budget.
- ***Institutional debt management reforms.*** We submitted an amendment to law 8131 to the Legislative Assembly to centralize all debt-related functions of the government, in line with best international practices, to improve transparency and reporting of public debt, within the purview of a new standalone Public Debt Management Office reporting directly to the Minister of Finance, in May 2023 (an end-June 2023 structural benchmark). The bill is advancing through the appropriate legislative processes. The established Assets and Liabilities Committee, comprising

the Treasury, the Public Credit Department (DCP), the macro-fiscal unit of the MOF, and the BCCR will continue to provide strategic guidance and inter-agency coordination of high-level policy decisions related to government debt.

- Medium-term debt strategy (MTDS).** We published an updated MTDS covering 2022-27 in April 2022, meeting the relevant structural benchmark. The report covered the government's contingent liabilities, especially guarantees provided to state-owned companies. Going forward, we will publish and adhere to Annual Borrowing Plans and Quarterly Issuance calendars in line with the MTDS and strengthen the accounting and budget execution processes for public debt payments.
- Domestic market development.** With WB support, we are taking steps to improve the functioning of the debt markets. We are focusing our issuance on standard fixed-rate bullet bonds of select maturities while open bond windows and bilateral bond sales are being gradually phased out, and the overall size of the issuance was discussed in the executive committee of the market makers in June 2023. We will reform the auction mechanism for the Treasury to become a price-taker in bond auctions (which will improve the price discovery process) and we will form a technical pricing committee to develop guidelines for pricing methodologies. We are promoting non-resident participation in our debt market by easing regulatory barriers and harmonizing the tax regime for non-resident investors, subject to macroprudential considerations. The Legislative Assembly approved in December 2022 a law to promote and open the Costa Rican public debt market to foreign participants by easing regulatory barriers and harmonizing tax treatment. We are also in consultations with different international platforms to allow clearing and settlement of our debt securities in accordance with international standards. Finally, in December 2022, with support from the IDB, we rolled out a pilot market-making / primary dealer program with a small group of participants with well-defined rights and responsibilities, which is expected to be ready in the first half of 2024. We produced a report for consultation with market participants and regulators. Moreover, we are preparing workshops towards the end of 2024 with Euroclear, local central securities depositories and regulators to fulfill the requirements from Euroclear, which allows the domestic debt instruments to be linked to the international securities depositories.
- Liquidity Management.** Over the last decade, the government has had cash balances of much less than 1 percent of GDP. For example, in 2020, balances were insufficient for one month of obligations. We have been steadily building up cash buffers in order to reduce rollover risks and increase market confidence. In light of unexpectedly favorable appetite for government securities and of very high financing needs anticipated in the first half of 2024, we have accelerated our build-up of cash balances. Our approach trades off (i) comfortable coverage of needs in domestic and foreign currency, (ii) increased use of foreign financing consistent with our MTDS, and (iii) our goals to contain interest costs and the headline debt. To improve the tradeoffs and meet our targets, we increased the use of liability management operations in line with our MTDS, rescheduled some disbursements, and used opportunities to conduct FX sales/purchases to/from the BCCR (without unduly directly affecting the exchange rate).

21. We stand ready to adopt a sovereign asset and liability management (SALM) at an operational level to effectively analyze and manage overall risk exposures. We agreed to publish the recent Technical Assistance report on SALM to facilitate a broader discussion on a new framework among stakeholders. The Committee for Sovereign Assets and Liabilities was established to coordinate public debt management, cash management, and financial programming of the budget, which facilitates managing the liquidity surplus properly. We have drafted a decree to facilitate implementation of an investment strategy, which will allow us to reduce the cost of carry, and expect the decree to be issued by December 2023. We plan to develop a roadmap to implement key recommendations proposed in the report by June 2024. This roadmap should cover broadening data collection on all sovereign assets and liabilities, consistent with international accrual accounting standards, and establishing a framework to analyze system-wide liquidity risk, rollover risk, contingent liabilities, and other shocks to the budget.

22. We are advancing our efforts to improve data quality and transparency in fiscal reporting. We are committed to improving the timeliness, quality, and comprehensiveness of the fiscal, financial and debt accounting for the public sector, with support from IMF TA. Despite some delays due to the hacking attacks on several government systems, we resumed efforts to adopt the GFSM 2014 accrual accounting standards for fiscal and debt information. We finalized and published the compilation of monthly revenue and expenditure (above-the-line) data excluding accrued interest for 2019-2022 for the Consolidated Central Government (CCG), including for extrabudgetary units (*unidades descentralizadas*) representing 90 percent of extrabudgetary units' spending by end-March 2023. We have produced Budgetary Central Government (BCG) debt stocks, including loans and debt securities at nominal value (including accrued interest) according to the GFSM 2014 framework for August 2023 and are producing monthly data before the end of the following month. To allow for a year's worth of observations, facilitate inter-year comparison, and carefully communicate the implications of the methodological changes to the public, we will publish a report detailing and explaining the CCG debt and accrued interest data in October 2024. We will progressively extend this effort to expand institutional coverage of GFS and PSDS to the general government (GG) and its subsectors (CCG, CCSS, and local governments). We will publish monthly GG above the line data (excluding accrued interest) from 2019-2023 by end-March 2024. We will compile monthly debt data (including accrued interest) for the CCSS for December 2023 to February 2024 consistent with 2014 GFSM accrual accounting standards by end-April 2024. We will publish at least a year's worth of monthly consolidated GG fiscal data consistent with GFSM 2014 standards in January 2025, and debt data (including accrued interest) in September 2025. We will expand institutional coverage to include nonfinancial public corporations' GFS above-the-line and PSDS quarterly data by end-March 2025. In this context, we initiated the compilation, consolidation, and dissemination of 2022, 2023 and 2024 data on assets and liabilities for all subsectors of CCG, and gradually that from local governments, the social security fund, and the nonfinancial public corporations, and developed the reporting of fiscal risks (in the context of the MTFE), to include contingent liabilities, guarantees, concession contracts, and the indebtedness of municipal governments and nonfinancial public corporations by end-March 2025. These improvements include the comprehensive collection and reconciliation of financing (below-the-line) data, the harmonization of both methodology and data coverage among national accounts, government

finance and public sector debt statistics, as well as coordinated improvements on public sector accounting to guarantee stock-flow consistency, allow balance sheet enhanced analysis, and provide improved data for decision making. These improvements form part of our efforts to harmonize statistics with those of other countries in the region.

IV. MONETARY AND EXCHANGE RATE POLICY

23. Monetary policy continues to be underpinned by our firm commitment to low inflation within an inflation targeting framework. Maintaining low and stable inflation, under a flexible exchange rate, is critical to secure domestic and external stability, consistent with the BCCR's mandate. Given rising inflationary pressures in the wake of the COVID-19 pandemic and upside risks to the inflation forecast, the BCCR began to raise the policy rate in December 2021. As a result of the protracted commodity shock from the war in Ukraine, inflationary pressures became more entrenched and started to impact inflation expectations. In response, the BCCR accelerated its tightening pace, bringing the policy rate to 9 percent by October 2022. In addition, the minimum legal reserve requirement rate for deposits and obligations in national currency was raised from 12 percent to the typical maximum level of 15 percent in July 2022. Together with the decline in global fuel prices, this monetary tightening led to a decline in inflation and inflation expectations starting in September 2022. Starting in the second quarter this year, the removal of strong base effects revealed weak underlying inflationary pressure, primarily associated with lower commodity prices alongside past appreciation, and inflation bottomed out at -3.3 percent y-o-y in August. This led to a breach of the inner lower MPCC band by 0.8 percentage points in June 2023 and the outer lower MPCC band by 2.6 percentage points in September 2023. In light of the accelerated decline in headline and core inflation, the decline in inflation expectations, and the downward revision to the inflation projection, the BCCR saw room to move towards a less restrictive monetary policy stance since March and lowered the policy rate by 2.75 percent by October 2023.

24. Monetary policy will remain data dependent and forward-looking to meet the inflation target of 3 percent, with a tolerance band of ± 1 percentage point. The BCCR will continue to monitor inflation developments closely and communicate clearly and transparently the drivers of inflation, the inflation outlook, and the implications for monetary policy. Barring new shocks and if conditions allow, the BCCR will continue its gradual and prudent move towards a neutral monetary policy stance in the second half of 2024. Progress in meeting the inflation target under the program will continue to be monitored through a MPCC around quarterly targets (Table 1), as described in the attached TMU.

25. We are committed to allowing the exchange rate to flexibly adjust, in line with market conditions, and to maintain international reserves at adequate levels. Costa Rica operates a flexible exchange rate regime, intervening only to avoid disorderly market conditions and to maintain adequate reserves levels. During the first half of 2022, the BCCR faced significantly higher FX demands from energy imports by the NFPS and from pension funds. This was only partially offset through the BCCR's FX purchases from the market, resulting in the end-June 2022 and end-September 2022 NIR targets being missed by US\$612.2 million and US\$48.6 million, respectively. As external pressures eased in the second half of 2022 and the first three quarters of 2023, the BCCR proactively purchased foreign currency from the market and exceeded the end-December 2022 and

March 2023 NIR targets. The June 2023 and end-September 2023 NIR targets were exceeded by US\$3311 million and US\$4124 million, respectively. We intend to maintain levels of reserves in line with the IMF's Assessing Reserve Adequacy (ARA) metric and above the net international reserves floor set under the program (Table 1). The Internal Audit Office of the BCCR will regularly review the NIR and underlying data, in line with the definition in the TMU, and, as needed, reconcile them with the audited financial statements as of the end of the fiscal year.

26. A calibrated series of operational reforms are underway to deepen the FX market and further enhance exchange rate flexibility. The BCCR is taking steps to strengthen the predictability and transparency of its FX transactions and create incentives for greater reliance on market-based transactions. To improve visibility on large orders and better manage FX demands from the NFPS, since April 2022, NFPS entities must give advance notice of at least one month to the BCCR for FX requests. We intend to further accumulate reserves by purchasing FX when market conditions are favorable, until we reach a more comfortable level of reserves. We also aim to pass the NFPS's demand for FX to the market as quickly as possible, so as to facilitate price discovery in the FX market and greater exchange rate flexibility. We will target the use of FX intervention to addressing excessive exchange rate volatility, given Costa Rica's shallow FX market and currency mismatches arising from dollarization. Recommendations by the BCCR staff for reforms of the FX market are being considered by the BCCR Board. The BCCR is improving the functioning of the spot foreign exchange market in order to favor better price formation and liquidity, including the introduction of market makers that will enhance liquidity in the market. Specifically, we have identified potential candidates for a market makers scheme, who would have an obligation to regularly quote prices based on minimum trading lots and maximum bid/ask spread, and we are in the process of defining the appropriate incentives for entities to take on the market maker role. Once we have achieved better market functioning and liquidity, we will re-extend Monex's trading hours starting with a gradual expansion that aims to cover at least the hours of heavy trading at the commercial banks' windows. To improve efficiency and price formation, the BCCR is looking for ways to balance the participation of different parties with different order sizes. In addition, to promote ethical, responsible and transparent behavior of participants in Monex, we introduced in December 2022 an obligation to adhere to the FX Global Code, which will be implemented by January 2024. We also plan to revise the FX intermediaries' net open FX position requirements in line with international best practices, including by loosening the daily NOP limit, to enhance their market making ability. With better liquidity in the spot market, we will also work to develop the FX derivative market, which would improve FX liquidity, hedging potential, and price formation. A master agreement is being developed (in coordination with foreign exchange intermediaries) for the negotiation of FX derivatives in the country by end-June 2024. We also see the need for NFPS to enhance their ability to manage currency risks and reduce their reliance on the BCCR as an intermediary for FX transactions. All the envisaged reforms will be conducted in a manner consistent with our Article VIII commitments and The IMF's Institutional View on Liberalization and Management of Capital Flows. All these actions to deepen the FX market and allow for greater flexibility of the exchange rate would complement other measures being taken to reduce financial dollarization (¶30), which in turn should reduce financial vulnerabilities and strengthen monetary policy transmission.

27. We stand ready to further strengthen the BCCR’s independence, transparency, and accountability in the implementation of the flexible inflation targeting regime. The amendments to the BCCR Law in 2019—to tighten the dismissal rules for the BCCR Governor, delink the Governor’s term from the political cycle, and remove the Minister of Finance’s voting rights in the BCCR Board—have improved the personal autonomy provisions in the law. To further strengthen the BCCR law, and in line with the recommendations of the IMF’s 2020 Safeguards Assessment, we submitted to the MOF draft amendments to the BCCR law, prepared in consultation with IMF staff, by end-August 2021, meeting the relevant structural benchmark. The final amendments, however, were not submitted to the Legislative Assembly by end-December 2022, missing the structural benchmark. Therefore, taking into account the particularly challenging political environment, we decided to adjust the implementation process of this reform. In June, we submitted to the Legislative Assembly a subset of the previously foreseen changes to the BCCR law, which are now with the Commission of Economic Affairs. We remain committed to addressing remaining Safeguards Assessment recommendations to strengthen the BCCR’s autonomy, governance and operational structure, and believe that the most viable way to achieve this is by the award of constitutional autonomy to the BCCR. We have already prepared such legislation and intend to facilitate its submission to the Legislative Assembly as soon as the political context so allows. The constitutional autonomy will then allow us to implement measures envisaged in the original structural benchmark. The BCCR has completed nine of the twelve recommendations from the Safeguards Assessment. The Executive Branch will take the necessary steps in order to fill the current vacancy in the BCCR Board, after the needed Constitutional Court decision. In addition, we will develop a long-term roadmap to continue to strengthen the BCCR’s equity position.

V. FINANCIAL SECTOR POLICIES

28. We have made significant progress in financial sector reforms. Over the last years, we have approved and implemented several important financial sector reforms, building on the IMF’s 2018 Financial Sector Stability Review (FSSR) and OECD recommendations as well as the WB’s recent FSAP Development Module. As a result of sound prudential policies, the banking system has strong capital and liquidity buffers, as evidenced by the stress test results. Nevertheless, high levels of unhedged FX borrowing and indebtedness in the household and corporate sectors are important sources of vulnerabilities in the financial system. To increase transparency, since March 2023, SUGEF began to publish the names of the domestic systemically important financial entities, the quarterly Capital Adequacy Ratio of each supervised financial entity, and information on the bottom up stress test (BUST) results. The first publication of the BUST results only covered aggregated results of systemically important financial entities but, starting January 2024, the publication will cover individual results of the participating entities.

29. The banking sector remains stable despite the still high interest rates. To help borrowers in financial difficulty during the period of high inflation and increased interest rates, CONASSIF and SUGEF created a transitional loan classification category—to soften the effect on the risk rating when financial entities make modifications (extensions, restructurings, refinancings) in their credit operation— on January 1, 2023. This measure also incentivizes borrowers to report their

true conditions, which helps financial entities to modify credit operations in response to the true situation of the borrower. We are keeping this measure transparent by recording all the historical changes in classification. To prepare against adverse economic conditions, SUGEF has also reactivated counter cyclical provision from January 2023, which was reduced in 2020 to mitigate negative effects coming from the COVID-19 crisis. In addition, CONASSIF approved a new regulation and guidelines for credit provisioning effective from January 1, 2024, which uses an updated methodology, risk parameters, credit segmentation, and similar treatment to credit restructurings, extensions or refinancing. In parallel, we have strengthened reporting and monitoring efforts, as laid out in the attached TMU, and we will continue to monitor the situation closely, including through the Financial Stability Committee's (FSC) Monitoring and Coordination Group (MCG) comprising senior representatives of the BCCR, CONASSIF, the Superintendencies, and the MOF. The technical group supporting the MCG will continue to meet frequently to follow up on key systemic developments and financial risks and to detect and anticipate sources of stress, including interest rates and FX movements. Over the years, we have also made significant progress in systemic risk assessment by strengthening our credit, market and liquidity risks' stress test models and contagion risk tools. We will continue updating our bottom-up and top-down stress test results and publishing them in our annual Financial Stability Report. In line with the BCCR's roadmap to integrate climate considerations into monetary and financial policies, we have been working to enhance our capabilities in climate risk management, including through an integrated climate and economic model, and developing stress testing methodologies (¶45). Also, SUGEF has developed a roadmap to incorporate key recommendations to enhance the resilience of the financial system in the 2022 World Bank Financial Sector Assessment report. The regulations to tighten authorization requirements was approved in November 2023, and the amendments to the law aimed to underpin the legal power of superintendents are expected to be submitted to the Legislative Assembly by December 2024.

30. We have taken further actions to reduce the risks from financial dollarization, in line with international standards. Since 2018, the BCCR has allowed for greater exchange rate flexibility, helping agents internalize exchange rate risks (¶25-26). However, this effect may be reduced by the strong appreciation of the exchange rate since mid-2022, generating incentives for economic agents to once again take risk in foreign currency. To complement these efforts, the FSC is closely monitoring the risks from dollarization, and SUGEF and CONASSIF have taken further measures to recognize this risks in prudential parameters, including (i) establishing a higher general provision requirement for loans to non-FX generators; (ii) calculating liquidity coverage requirements by currency; (iii) requiring additional capital requirements for foreign currency mortgages to unhedged borrowers, based on LTV thresholds; and (iv) requiring banks to assess the sensitivity of debtors' payment capacity to exchange rate changes. SUGEF and CONASSIF have (i) revised the definition of an unhedged borrower, which took effect from January 1, 2023; and (ii) issued a new regulation imposing additional capital requirements on foreign currency loans to unhedged borrowers, in replacement of the general provision mentioned above. In the new regulation, the definition of unhedged borrowers is based on information on whether borrowers currently have a natural hedge or financial hedge against exchange rate risk, and thereby reduces the room for discretion in the assessment of currency mismatches between their income and loan

currency. These natural or financial hedges are only considered when they cover at least 100 percent of the loan instalment, regardless of the number of hedges. Also, the regulation establishes a gradual increase in the risk weight for credits to unhedged borrowers, starting on January 1, 2024, and ending on January 1, 2031. The risk weight will apply gradually to both the loan balance by end-December 2023 and to the marginal loans from the corresponding effective date. To increase transparency, SUGEF has also begun to publish data quarterly on unhedged FX borrowing since March 2023, and end-September data was uploaded to our website in October 2023.

31. We are advancing efforts to strengthen the prudential regulatory and supervisory regime. The reforms to the laws on consolidated banking supervision and on securities market regulation passed in 2019 (Law no. 9768) marked important milestones towards effective supervision by strengthening the powers of supervisors, including sanctioning ones, in line with international best practices.

- **Implementing consolidated supervision.** In May 2022, CONASSIF approved a regulation to strengthen the governance of supervised financial entities, holding companies, and affiliated companies of financial groups and conglomerates, which took effect on January 1, 2023, with transition arrangements towards full implementation. In September 2022, CONASSIF introduced regulations to implement consolidated supervision of financial groups, including issuing guidelines to strengthen regulatory provisions and information sharing, and to update the solvency and capital requirements for financial groups, with different aspects taking effect in a phased manner starting January 1, 2023. With support from the ongoing IMF TA mission, we are identifying further room for improvement and will take additional steps to strengthen the supervisory framework for domestic financial conglomerates depending on their size, risk and profile.
- **Phasing in risk-based supervision.** We are taking further steps to advance our risk-based supervision framework, including by adopting Basel III standards in a phased manner: (i) SUGEF enhanced its liquidity risk management supervision through improvements in the monitoring of the liquidity coverage ratio, and the net stable funding ratio is expected to come into effect with transitional arrangements from September 1, 2024; (ii) SUGEF is also revamping its credit risk management framework by introducing forward-looking assessment of losses and provisioning requirements, with new regulation and guidelines for provisioning finalized in November 2021, to come into effect from January 1, 2024; (iii) we have revised banks' capital definition, established conservation and systemic importance capital buffers, and the definition of systemically important institutions, in line with Basel III, with the regulation issued in August 2021, to come into effect from January 1, 2025; (iv) we have also reviewed the regulation on capital requirements for market risk and credit risk, and included the measurement of interest rate risk in the balance sheet of the banking sector, all of which is expected to be approved at the end of 2023 with effective date on January 1, 2025. These effective dates will allow for a sufficient adjustment period in the context of the combined effect of the new regulations on the financial system. During the adjustment period, the financial entities have been required to assess operational and financial impacts from some of the aforementioned regulations and send

these results to SUGEF on a quarterly basis, starting in the last quarter of 2022. Based on available resources, we will continue to strengthen practices toward fully risk-based supervision, such as broadening the risk assessment of banks beyond specific business lines and bringing in more specialized expertise to assess and validate their risk management practices. In June 2023, SUGEF launched a functional re-organization to reallocate supervisory resources in response to new responsibilities for resolution and consolidated supervision, and to modernize the structure as required by the risk-based supervisory approach. The structure we envision will have an area that will bring together risk specialists who will provide transversal support to the supervision process. The challenge will be to have the budget and agile processes to attract and maintain qualified professionals or external experts, strengthen analytical and statistical capabilities, and continue developing supervisory skills on emerging risks. The organizational change proposal was sent to the BCCR and is pending approval.

- **Strengthening supervisors' legal powers and protection.** Drawing on the Basel Core Principles assessment from a recent FSAP developmental module, we intend to pursue critical legislative reforms to strengthen supervisors' legal powers and protection. Specifically, we intend to grant to supervisors the legal powers to (i) dismiss members of the Board and senior management of banks for engaging in unsafe and unsound practices, (ii) ease the legal conditions for the exercise of supervisory powers (giving more discretion to the supervisor), and (iii) establish a separate appeal procedure for (at least) the most serious supervisory measures, and to establish that the intervention agreement or the effects of the measures adopted prior to the declaration of non-viability of the entity can never result in the reversal of its legal effects. Moreover, we will work to recalibrate the sanctioning framework to provide the proper incentives. In addition, we intend to strengthen the legal protection for supervisors with respect to coverage of legal costs, and protection against good faith errors. Finally, we included in the regulatory roadmap for 2024 the new regulations and the corresponding development of supervisory capabilities to impose additional capital requirements under Basel Pillar II on individual banks.
- **Responding to cyber risks.** In addition, with support from IMF TA, we are preparing draft regulations to address governance and risk management of cyber risk, including with respect to information sharing, immediate incident reporting and testing frameworks, as well as how to address third-party risks and response to and recovery from cyber incidents. Moreover, the supervisory authorities will follow up with implementation plans prepared by financial institutions. We have completed the draft, which was reviewed by the IMF TA mission in April, with the regulations expected to be approved no later than January 2024.

32. We will continue to strengthen our financial safety net by enhancing our banking resolution and deposit guarantee framework in line with best practices. We have advanced our crisis preparedness framework considerably, with the approval by the Legislative Assembly in February 2020 of the law on banking resolution and the creation of a deposit guarantee fund (DGF) (law no. 9816). Implementing regulations have been in effect since May 2021, and quarterly payments into the DGF started in October 2021. In May 2023, CONASSIF approved the regulation on recovery and resolution plans, which establishes a period of 12 months, at SUGEF's request, to

present the recovery plan and the report to support the resolution plan. With support from IMF TA, we are further strengthening the legal framework on bank resolution and deposit insurance, including adequate institutional arrangements for the DGF and the resolution authority, sufficient resolution powers, and clear resolution triggers. This will include strengthening the legal regime for resolution and recovery plans. Accordingly, we are finalizing draft amendments to Law 9816 and other relevant laws, in coordination with CONASSIF and the BCCR, and we shared the draft bill to the MOF. Once the legal amendments are approved by the Executive Branch, we will continue with the consultation with the industry and other stakeholders. We will submit the final legal amendments, once approved by the MOF and the President of the Republic, in line with program understandings, to the Legislative Assembly by end-December 2023 (**structural benchmark**). In parallel, the MoF will form a commission in coordination with SUGEF, CONASSIF and the BCCR to propose a plan for the back-up resolution financing, clarifying the roles and contributions by the various stakeholders. The financial safety net and the crisis preparedness framework have also been strengthened by the continuous monitoring of macro-financial risks by the MCG (¶129), including through an updated early warnings system; an updated contingency plan for episodes of financial stress, with the inclusion of a communications protocol; and the BCCR's recent enhancement of its Lender of Last Resort mechanism. We will assess the scope for improvements to the Lender of Last Resort mechanism for it to perform its function in a timely and effective manner. As a contingent measure in situations of stress, the BCCR increased the tenure of the emergency liquidity facility from 24 hours to 84 days.

33. The Executive Branch is committed to levelling the playing field between public and private banks to foster competition. Several distortions and regulatory asymmetries hamper both private- and state-owned banks, and hence their ability to support growth and job creation in Costa Rica. To remove these asymmetries, we understand that in the future it is necessary to prepare a proposal for the Legislative Assembly including the following: (i) conversion of parafiscal contributions by state-owned banks into a single commensurate transfer to the CG budget, adjusting the fiscal rule spending accordingly; (ii) removal of the requirement on state-owned financial institutions to comply with public procurement requirements; (iii) gradual phasing out of the requirement for private banks, which have not opened agencies or branches in certain areas listed in the law, to transfer a part of their short-term deposits as a loan to state-owned banks (the *peaje*), while identifying alternative ways to channel resources to underserved sectors, limiting any fiscal contingent liabilities. The asymmetry generated by the existing legal requirement for NFPS to do their banking with state-owned banks will be also corrected with the approval of the legislation on the Single Treasury Account (¶115) that is being discussed by the Legislative Assembly. As the deposit guarantee covering the entire banking sector becomes fully effective, we will explore options to gradually phase out the existing blanket guarantee for state-owned banks. We will work to improve the BCCR and MEIC database that compares credit products across the financial system, to enhance information for financial consumers and foster bank competition.

34. We are pressing ahead with our efforts to promote financial inclusion. During the pandemic, a sharp increase in the use of electronic transactions and the allocation of *Bono Proteger* have led to a significant increase in bancarization and financial inclusion. However, structural issues,

such as limited banking competition and partial coverage of the credit registry, push up lending rates and hinder financial inclusion. In line with the IMF's FSSR recommendations, the Ministry of Economy, Industry and Commerce (MEIC) has developed and started implementing a national strategy for financial education, in coordination with the BCCR, CONASSIF, and the Superintendencies. To broaden access to our payment system and promote digital banking, we have simplified requirements for opening a bank account and launched an electronic payment system for public transport nationwide. We are committed to improving the design and scope of the public credit registry, *Centro de Información Crediticia* (CIC), with information from supervised financial entities and non-supervised credit providers. We will send to CONASSIF the draft bill to define the next steps no later than December 2023. CONASSIF and the four Superintendencies finalized the draft legislation for financial consumer protection, following which the Executive Branch decided to revise the draft bill so that in the future this matter, for both regulated or non-regulated entities, will be in the hands of the MEIC. Moreover, with support from the IDB, CONASSIF, BCCR and the Superintendencies, we inaugurated in April 2022 a Financial Innovation Center to support and provide guidance to fintech startups. The Center is acting as an advisor to our ongoing efforts to strengthen and develop new regulations on fintech. We will ensure that our regulations strike a good balance between fostering innovation and protecting financial stability.

35. We remain fully committed to further strengthen the AML/CFT regime and disclosure of beneficial ownership information.

- Costa Rica is currently under enhanced follow-up by the *Grupo de Acción Financiera de Latinoamérica* (GAFILAT), a regional FATF-style body, and continues to strengthen its technical compliance with the FATF standards to address remaining shortcomings. We submitted four FATF Recommendations (8, 17, 22, and 28) for re-rating, which will be decided at the next GAFILAT Plenary in December 2023. To strengthen compliance with Recommendation 15 on new technologies, which was downgraded to Non-Compliant due to the changes to the FATF standard, a draft amendment law (Bill No. 22.837) subjecting virtual assets (VAs) and virtual asset service providers (VASPs) to AML/CFT supervision by SUGEF had been presented to the Legislative Assembly on December 9, 2021. The draft was sent for consultation to SUGEF and the financial sector in October 2022 and is currently under review in the Legislative Assembly.
- In order to support reporting entities' know-your-customer (KYC) and monitoring obligations, we also adopted regulations in July 2022, requiring financial institutions to upload to CICAC (*Centro de Información Conozca a su Cliente*) the information from customers that explicitly authorize the financial entity. As of August 31, 2023, CICAC is holding over 70,299 active files with customer information from 49 financial institutions.
- To strengthen disclosure of beneficial ownership information, the BCCR's centralized beneficial ownership registry RTBF (Transparency and Beneficial Ownership Registry), has commenced to collect shareholder and beneficial ownership information for all legal entities except third-party resource managers and non-profit organizations. The information is accessible to the Ministry of Finance and the Costa Rican Institute on Drugs. A beneficial ownership declaration form for non-profit organizations is available since August 2023, and they will have to declare for the period

of 2024 by April 2024. We have also developed technology to enable financial institutions' legal entity clients to share the beneficial ownership information provided to the RTBF with the CICAC repository.

VI. STRUCTURAL REFORMS TO BOOST PRODUCTIVITY AND PROMOTE GREEN AND INCLUSIVE GROWTH

36. We are resolved to further advance our growth-enhancing reform agenda, supporting a resilient recovery from the COVID-19 crisis to help achieve our medium- and long-term vision. In May 2021, Costa Rica officially became an OECD member, following a successful accession process, which saw the introduction of 14 landmark legal and administrative reforms. As underscored in our new National Development and Investment Plan, we remain fully committed to further advancing our reform agenda. Specifically, our strategy hinges on three key objectives: (i) protecting the most vulnerable and supporting inclusion, including by promoting greater female labor force participation; (ii) boosting productivity growth, including by eliminating barriers to business formalization, investment, and job creation; and (iii) promoting a green recovery, anchored by our National Decarbonization Plan and the goal of becoming a zero net emission economy by 2050.

A. Protecting the Most Vulnerable and Boosting Productivity Growth

37. We are taking steps to foster productivity growth to attract investment and create jobs. Our efforts focus on reducing skill mismatches and promoting innovation, closing infrastructure gaps, cutting red tape, and attracting FDI:

- **Formalization.** To incentivize formalization, since 2017, the CCSS has adopted plans to reduce social security contributions, targeting populations where informality is prevalent. To ensure the burden of social security payments is lower for vulnerable workers, in 2020 the CCSS created a specific mechanism to provide coverage for coffee harvest workers, including migrants and their families. This model changed the tripartite contribution mechanism involving worker, employer and state to a two-party modality where contributions are covered by the state and ICAFE, Costa Rica's coffee institute, eliminating employees' contributions and thus the burden for workers. In addition, in October 2023, the National Insurance Institute (INS) and ICAFE, in collaboration with the Ministry of Agriculture, launched a new mechanism to further protect coffee harvesters through an occupational risk insurance scheme. To encourage formal part-time or flexible employment, the CCSS Board of Directors formulated in June 2022 a plan to adjust the minimum contribution base of the mandatory pension and health insurance schemes for part-time workers and submitted it for public consultation. While the related structural benchmark was not met by end-June as originally envisaged, the CCSS approved the final plan in September 2022. For health insurance, the reduced minimum contribution base (MCB) is being implemented in three phases to minimize the shortfall of contributions, starting in January 2023 as planned for workers below the age of 35; January 2024 for workers below the age of 50; and January 2025 for all workers. For pension insurance, the plan allows part-time workers who earn

less than the MCB to accumulate fractional quotas, counted to receive a pension benefit, proportional to their contributions. For instance, contribution brackets are set from, less than 25 percent, 25-50 percent, 50-75 percent, to over 75 percent of the MCB; and workers are credited with 0.25, 0.50, 0.75 and 1 quotas, respectively (a total of 180 quotas are required to receive a minimum pension). Furthermore, since May 2022, to ease independent workers' entry to the social security system, the CCSS allows them to contribute voluntarily to the health and pension schemes for 6 months provided their income is below the MCB, but after the 6-month period, the health and pension contributions to the CCSS become automatically mandatory. The MCB for health and pension insurance is being implemented as expected and has reached more than 19,000 and 27,000 workers, respectively, in August 2023. The CCSS is implementing law No. 10232, approved in December 2022, which authorizes the relief of social security debts in order to encourage the formalization of independent workers and employers. The CCSS is also preparing the regulation of the law (No. 10.363), approved in May 2023, to reduce the cost of settling independent workers' unpaid debts with the CCSS from 10 to 4 years. To reduce the administrative burden for firms, we reduced the number of minimum wages across job categories for the private sector from 26 to 16 over the last four years, and we intend to further reduce the number of categories to 11 by end-December 2023, in line with OECD recommendations.

- Education.** To improve the quality of the education system, we launched a Roadmap for Education (*Ruta de la Educación 2022-2026*) in February 2023. The Roadmap is progressing as expected and we have provided regular updates to the public. A report that summarizes the progress in implementing the Roadmap for Education will be available in May 2024. To improve the transparency and efficiency of the public education system, with the WB and IDB support, the Ministry of Public Education will develop an internal reorganization and decentralization plan, following Mideplan guidelines, by end-December 2024. With UN support, we are working to transform the current budget structure to a results-based one, for which an information system of indicators will be developed by end-May 2024. We have also developed 13 guidelines for teachers to strengthen students' competences in school curricula for: i) citizenship; ii) life; and iii) employability and entrepreneurship. As of February 2023, it is mandatory that all children in first grade know how to read and write to enter the next school year, for which we have implemented the strategy *La Aventura de Leer y Escribir*. Support for teachers to accelerate the learning process will be provided, for instance, in the case of English as a second language, through *ABC Mouse* and *My Math Academy* accelerators, which are available for teachers of 489 educational centers as of October 2023. Through these programs, we are offering free training opportunities for teachers to further improve digital, methodological, and English competencies. We are developing a preliminary proposal for a new teachers' performance-based evaluation model, which will include: i) defining a desired profile for teachers with reference to the National Qualification Framework by end-June 2024; ii) supporting teachers to identify their real profile by end-July 2024; iii) providing courses and online/offline support materials for teachers to close skill gaps during 2024; and iv) evaluating teachers based on desired profiles in 2025. The Ministry of Education administered a standardized digital test for grades 6 (end of primary school) and grades 11 and 12 (end of secondary school) to measure students' performance at

the beginning and the end of the year (*Prueba Nacional Estandarizada*) starting in April 2023. In addition, a comprehensive test was applied to students from all grades, where 766,000 students completed the test at the initial and mid-year terms in order to prepare educational recovery plans. Test results were shared with teachers, school principals and other stakeholders to better understand areas requiring further strengthening. To reallocate teachers' time away from administrative responsibilities to focus on teaching and support to students that lag behind, we introduced the new Agile Evaluation System (SEA) to replace the time-consuming registration systems in place. We assessed the SEA and found high rates of acceptance among 11,878 interviewed teachers. We will work on the SEA improvements identified by teachers. To close the digital gap, as of October 2023, we have provided internet and increase connectivity speed in 2,645 centers, including 587 centers from rural areas. In collaboration with the Ministry of Health, we have identified 1,004 schools with sanitary orders. We are addressing the infrastructure gap by: i) allocating budget resources to provide maintenance to 400 centers during 2023 and 2024; ii) investing in school infrastructure (leveraging Public-Private Partnerships (PPPs)) and building 26 educational centers under the program *Adopte un Centro Educativo*, including two in indigenous territories; iii) including \$125 million in a broader infrastructure CABEL loan for the construction and repair of 133 centers; and iv) developing a comprehensive inventory of educational centers, in collaboration with experts and local governments, to determine educational infrastructure gaps by location. To help youth in low-income families, we are increasing food support at school with the universalization of the provision of meals benefiting 526,826 preschool and primary students. Food assistance was also provided to nearly 300,000 secondary school students. As of June 2023 (compared to June 2022), food provision was offered to nearly 28,621 new students in schools located in low-income areas. In addition, 23,862 poor students living far from education centers started to receive school transportation during the 2023 school year. We are working with IMAS to ensure that the *Avancemos* scholarship program is achieving its purpose of maintaining students in the classrooms. To address this, we issued a directive requiring school principals to report when an *Avancemos* scholarship student drops out the school to ensure early detection and re-enrolling, while improving the targeting of social spending. In February 2021, a Bilingualism Education Policy was introduced, with an Action Plan to improve proficiency in a second language by 2040, including students in rural areas. We administered English and French tests to 70,000 secondary school students and we are processing the results to place them according to the Common European Framework of Reference for Languages (CEFR). We are also providing English lessons to 22,044 preschoolers and piloted a plan to test the oral and written English skills of primary and secondary students (8,333 and 7,954, respectively) using artificial intelligence. We are strengthening the implementation of the vocational curricula of technical careers in the context of Industry 4.0, to begin implementation in February 2024. We launched 4 new study programs in 2023, and we aim to launch 6 more programs under dual education in February 2024. In 2023, we assumed the official leadership of the technology education agenda, and approved the inclusion in the national curriculum of technological courses starting in 2024 from kindergarden to adult education. We also worked on linking public universities' funding to labor market needs by including targets and commitments in the 2024 university budget negotiation agreement. We

reformed a regulation to streamline the approval and monitoring processes for private higher education.

- Investment climate.** To attract investment, we are identifying spending priorities and promoting PPPs, with support from CABI and IDB, to reduce existing physical and digital infrastructure gaps, consistent with our fiscal consolidation plans under the program. With IDB support, we launched the Program of Road Infrastructure and Promotion of PPPs and will provide critical training on PPP development across central and local governments during 2022-24. In February 2023, we issued a methodological guide to evaluate the appropriateness of PPPs. We also identified a portfolio of infrastructure projects that could be developed through PPPs, including a new airport and highways. In parallel, we will work with the non-government sectors to address the challenges and build confidence in the PPP model, along with the development of the required structural reforms. Another critical step in promoting investment is our ongoing effort to reduce electricity tariffs (¶19). To further promote high quality, innovative and affordable telecommunication services in all our territory and develop digital skills, we launched in December 2022 a new National Telecommunications Plan 2022-2027. This plan aims to generate the necessary conditions to encourage the timely deployment of robust, scalable, resilient, and sustainable telecommunications network infrastructure (regulated by Law N° 10216 and derived regulations, which are expected to be issued by end-December 2023). The target is to increase competition among mobile technology operators, including 5G networks, for which we will conduct a tender process by end-March 2024. To strengthen public sector cybersecurity, we launched the Cybersecurity Strategy for public consultation and the final version was published in November 2023. In collaboration with the private sector, we have launched the program *Le Dejamos Trabajar*, which eliminated 140 obstacles for businesses by end-September 2023. As part of our smart deregulation strategy, we implemented *Costa Rica Fluye* commitments with 11 public institutions to enact 21 regulatory enhancements. We also implemented a single-window system (VUI), where businesses can apply for licenses and permits. To further cut red tape, the VUI was implemented in 44 local governments, while measures to simplify 163 procedures across the public sector to start a business, integrate environmental permits, and centralize procedures at the national level to provide a single point of contact, in line with OECD recommendations, were completed in September 2023. In September 2022, we issued 11 decrees to eliminate minimum fees to increase competition in 10 professional associations. Since some of the decrees (six) were not operational due to legal issues, we also submitted a bill (No. 23.357) to eliminate mandatory fees for all 10 professional associations to the Legislative Assembly in September 2022. In addition, the regulations for the implementation of a new bankruptcy law (Ley 9957) were published in September 2023. The law simplifies the bankruptcy process to reduce the duration and cost of liquidation proceedings and promote the restructuring of affected firms. To foster FDI attraction, already one of Costa Rica's strengths, we will promote innovation clusters to remove information barriers and facilitate the integration of domestic firms in global value chains. In line with this, we foresee that multinational companies will expand their operations in Costa Rica as a result of the partnership with the United States to explore semiconductor supply chain opportunities. In March 2023, we amended the Development Banking System Regulations to ease financing for

entrepreneurs in rural areas, women, youth, vulnerable populations and SMEs, and halved the time it takes to formalize guarantees. We also approved a regulation to promote investment in the renewable energy sector (¶42).

38. As part of our efforts to promote inclusive growth, we continue to focus on increasing female labor force participation. Costa Rica’s long-standing provision of universal healthcare, pensions, and general education has supported greater inclusiveness and equality of opportunities. We aim to further promote inclusive growth by strengthening female labor force participation, which is considerably lower than for men, despite women having better educational outcomes. In this context, we launched in September 2020 the Gender Parity Initiative (IPG), with support from the IDB, WB, and AFD, to reduce women’s care burden—the top obstacle to female labor force participation—and promote their participation in the labor market, particularly in leadership positions. Under the IPG, we plan to implement, over a minimum period of three years, an action plan with measures ranging from regulatory changes to awareness-raising initiatives that involve the public and private sectors. We will issue a decree in November 2023 to revamp the IPG to strengthen governance and coordination between the public and private sector. We are also advancing our gender budgeting agenda to support the implementation of IPG and other initiatives to reduce the gender economic gap (¶15).

- **Workplace discrimination and sexual harassment.** We continue to work on the program that certifies gender equality in the workplace at private companies and the public sector. In addition, we appointed inspectors from the Ministry of Labor and Social Security in each region to monitor and sanction gender discrimination, including pay gaps, in private companies. During the first two months of the year, the gender focus inspections were done in agriculture, commerce, industry, services and transportation sectors. Infractions on gender discrimination, wage differentials and lack of breastfeeding rooms have been issued, and labor judges are taking courses on this matter. Moreover, in October 2022 we launched a strategy to combat sexual harassment (Decree 43771-MSP-MTSS-MCM), dubbed *Ruta de Género*. The strategy was revamped in October 2023 and includes the provision of emotional and legal support to victims, the increase of resources for first-response centers, *Puntos Violeta*, and secure spaces (such as businesses and stores — including in tourist sites — that provide assistance in case of harassment), and the development of an app to report violence cases, including protocols to prevent harassment in public transport by issuing a drivers' handbook. To increase awareness on harassment, a broad communication campaign is being developed.
- **Childcare.** The 2018 fiscal reform expanded the definition of public education to include early education centers, with a view to help reallocate funds to increase the supply of public childcare services. In 2021, childcare services were increased by covering 15,000 additional children (relative to 2017), with a focus on children up to 5 years old, improving access for low-income households. We also aim to increase the coverage of children below 12 relative to pre-pandemic levels by end-2023. To improve the quality of services and expand coverage, we have completed a review of the supply of existing childcare services standardizing the costing framework and the basic certification for the supply of services. We have reviewed the governance of the childcare

network *Red de Cuido* and we will submit a bill to the Legislative Assembly to: i) define governance and centralize the responsibility in one single institution, ii) increase coverage by reducing average cost per child with IDB support; iii) unify several financing sources; iv) establish childcare services depending on demand and service offered by private entities; and v) better target the population. This bill will be submitted to the Legislative Assembly in November 2023. Stronger childcare facilities can in turn support educational outcomes and female labor force participation. The Public Employment Bill (113) has also introduced for public sector workers one month of paternity leave, a two-month extension of maternity leave (in specific cases), and paid leave to take care of a family member.

- **Long-term care.** In March 2022, the SINCA (*Sistema Nacional de Cuidados y Apoyos para personas adultas y personas adultas mayores en situación de dependencia*) was created (Law No. 10192) to improve the quality and access to long-term care. We issued the SINCA's regulation in November 2023 to implement the governance of the long-term care system, as established in the law. A plan will be progressively implemented along five pillars: governance, data intelligence, strengthening of care supply and benefits, generation of conditions for closing gender gaps in labor markets, and quality assurance. With support from the IDB, in an effort to unify access to long-term care in November 2023, we issued a decree to make mandatory the allocation of benefits through the tool *baremo*, which defines a single dependency scale. We are aiming for 4,000 vulnerable households (according to the *baremo*) to receive long-term care support by end-December 2026 (1,000 per year). Furthermore, effective February 2024, we will implement a benefit (care subsidy for people in a dependency situation) to 3,000 households with a female head living in impoverished conditions and headed by a severely dependent person. The Ministry of Health will design accreditation standards to strengthen the quality of long-term care home services by end-March 2024. In addition, by end-March 2024, the *baremo* will be integrated into SINIRUBE to identify the dependent population, as well as level of dependency and the supply of services of the national care system for dependent adults and senior adults. INA is working on updating the training available and providing training in long-term caregivers' services, with IDB support. To further increase the supply of care services, INA is developing, with IDB support, a pilot to connect care service providers with those in demand of such services through a mobile application. Moreover, we are working with the IDB on developing a pilot of home care services to support caregivers (*Cuidadores a domicilio*), as well as on a methodology to quantify the cost of a minimum set of care services (*Canasta de dependencia*), which will be implemented by end-April 2024.
- **Education and entrepreneurship.** The ongoing efforts to strengthen our education system and vocational training as well as to deepen financial inclusion (1134) will be critical to support women's economic empowerment. We have re-designed the plan to boost at regional level the program *FOMUJERES*, which finances women-owned businesses and provides support to formalize them. We started its implementation in August 2023. This plan will make the entrepreneurship process more user-friendly for women, provide technical assistance during the formulation phase of business projects, granting financing in the planning and development phases. Additionally, state institutions including public banks and private entities jointly

completed pilot programs to strengthen financial inclusion and women’s empowerment, a project financed by CAF, by focusing on the design of financial products based on women’s specific needs. INAMU launched a roadmap to guide 178 women from entrepreneurship up to the export stage of their products by end-November 2023 and the broader gender roadmap to strengthen women’s economic autonomy by end-March 2024. To this end, MEIC and INAMU amended in April 2023 the regulations of Law 8262 to facilitate women’s access to comprehensive financial services. The objective is to provide institutional support and develop a special financing program for vulnerable women to strengthen their economic independence through INAMU, Banco Popular and FODEMIPYME. In collaboration with the IDB, in 2022 we completed the incorporation of all regions in the country into the STEAM education strategy to continue fostering the participation of women in these fields. 56 new educational public institutions were added in 2022 to the 166 institutions already implementing the STEAM education strategy, and we incorporated 27 new public institutions in 2023 to reach 249 public institutions implementing the STEAM strategy. We will also continue to implement our national action plan for gender equality in scientific and technological fields, which will strengthen female labor force participation and productivity growth. As part of this policy, a new scholarship program is being developed to promote STEAM careers by reformulating incentives to attract women to technical education through the INA’s program *Rompiendo moldes*, as well as a new student grant approved in 2023 to financially support women in STEAM careers. As part of the dual education program, INA has created new alliances with 60 companies impacting regional employability and new options for the young workforce during 2023. Furthermore, since 2022 the INA has been revamping its services by transitioning from a previous objective-based curriculum model to a new competency-based one. This shift has enabled the discontinuation of 46 percent of services, which were not aligned with the current model, and has led to the creation of 509 competency-based services aligned with the National Qualifications Framework’s standards. This diversification of INA’s offerings is achieved through services related to training, education, and labor competency-based certification, including STEAM. In September 2023, the Ministry of Education launched an employability and entrepreneurship-focused program that will enable 25,000 adults who are lagging behind to obtain their secondary education diploma.

- **Employability.** We launched Costa Rica’s first National Employability Strategy (*Estrategia Brete*) in July 2023 to promote the employability of vulnerable groups, targeting women, the young population and people with disabilities. We also published a plan to improve working conditions of female migrant workers (which take a large share of paid housekeeping jobs), with ILO support.

B. Adapting to Climate Change, Decarbonizing the Economy, and Promoting Green Growth

39. We are strongly committed to responding to the challenges of climate change and fostering the transition to a resilient and low-carbon economy. Our ambitious strategy centers on: (i) adapting to climate change, with a strong emphasis on crisis preparedness, climate-resilient infrastructure, as well as our agriculture and agroindustry; (ii) reaching net-zero emissions by 2050

while ensuring a just transition in terms of jobs and growth; (iii) greening the financial sector, monitoring the risks posed by climate change and updating our modeling and regulatory tools; (iv) mobilizing official and private financing to meet the significant short- to long term costs to confront the long-term challenges from climate change within our budget envelope. In this context, we are fully committed to implementing the reform measures supported by the Resilience and Sustainability Facility, which are important elements of our broader comprehensive climate strategy and complementary to reforms supported by other development partners. This instrument is critical to our efforts, together with the additional climate finance resources it is expected to catalyze.

40. To support our strategy, we are enhancing our institutional readiness to respond to the climate change challenge. The Ministry for Energy and the Environment (MINAE) has overall responsibility for climate change issues. To mainstream and consolidate governance of the ecosystems, we submitted a bill (23.213) in June 2022 to integrate relevant decentralized bodies (for example, *Comisión Nacional para la Gestión de la Biodiversidad*, *Fondo Nacional de Financiamiento Forestal*, and *Sistema Nacional de Áreas de Conservación*) into MINAE. The legislative committee approved it in February 2023, we are addressing 400 amendment requests, and we expect the bill to be approved by the Legislative Assembly in July 2024. MINAE produced our National Adaptation Plan with the support of MIDEPLAN and our National Decarbonization Plan with the support of other ministries. The National Commission of Risk Prevention and Emergencies (CNE) coordinates actions and articulates the overall disaster management framework. MINAE's National Directorate of Climate Change oversees our Carbon Neutrality Country Program (PPCN 2.0), which supports the country's mitigation efforts by providing a mechanism for the voluntary adequate management of greenhouse gas emissions for public and private organizations, and is working to include more sectors in the program's management. Moreover, we will establish a data-driven, highly inclusive process to update NDCs and long-term climate action plans including the new National Development Plan for the environmental sector, which was launched in October 2022. MINAE, through the Secretariat of Planning's Environmental Sector (*Secretaria de Planificación del Sector Ambiente (SEPLASA)*) is coordinating with MIDEPLAN and ministries and entities that are part of the environmental sector to ensure the sustainability of the modeling and analysis capabilities that have been developed over the last six years. The BCCR is part of the Network of Central Banks and Supervisors for Greening the Financial System (NGFS) and established the Group for Strategic Analysis of Climate Change (GAECC), which is instrumental in coordinating national efforts to green the monetary and financial sector (¶45).

41. We are pushing ahead with our adaptation efforts, given the considerable vulnerability of our people and economy to climate change. We launched a National Adaptation Plan (NAP) in April 2022 to set climate adaptation milestones for 2022-2026 consistent with the National Policy on Adaptation across different sectors of the economy.

- **Disaster Risk Management.** With support from the WB, we are strengthening our National System for Disaster Risk Management—which has been in force since 2006—in line with the Institutional Strategic Plan 2018-2022 of the National Commission for Risk Prevention and Emergency Care. Based on the National Risk Management Policy for the period 2016–2030, the

National Risk Management Plan is currently in force for the period 2021–2025. Costa Rica has served as a pilot for the application of the Global Risk Assessment Framework (GRAF), with which the following products have been generated: An inventory of information sources to evaluate risk in sectors in charge of critical infrastructure, a risk modeling system for various threats including those linked to climate, and methodological guides for evaluating the impact of disasters in critical sectors. Costa Rica has served as the setting for the execution of the project “Principles for a resilient infrastructure” developed by the United Nations Office for Disaster Risk Reduction, which applies a stress test of critical service infrastructure, which must conclude with the design of sectoral strategies to ensure the continuity of services. We will have business continuity policies in all providers of public services by November 2024. We will decentralize and increase access to early warning, preparedness, and response services, including in coastal areas. We have already developed climate risk maps for extreme hydrometeorological events for 23 country cantons and expect to cover all remaining cantons by end-June 2024. We also plan to address the significant gaps in integrating climate-related risks into spatial planning and regulations. Currently only about 50 percent of Costa Rica’s land area is regulated by land-use/spatial plans, and the Regulatory Plans (urban and coastal) and Regional Development Plans do not take into account climate change considerations. Considering the importance of spatial planning for resilient infrastructure, the Ministry of Housing and Human Settlements (MIVAH) in collaboration with MINAE will develop and publish guidelines for including climate change considerations in Regulatory Plans by end-February 2024 (**RSF reform measure**). We will start to implement the new guidelines into all the new urban and coastal regulatory plans and gradually adjust the existing ones. In complementary work, the National Commission for Risk Prevention and Emergency Care is providing information to the municipalities on climate-related risks. To support the most vulnerable productive sectors, we also introduced a new insurance scheme in 2019, which allows agricultural producers to insure their harvest against climate change risks and offers lower premia for producers implementing adaptation measures. We are working to provide producers with an online tool for accessing competitive insurance premiums and expect to submit the relevant bill in April 2024.

- ***Climate-resilient infrastructure and public investment management.*** We developed a roadmap to enhance infrastructure resilience to climate change in September 2022 (structural benchmark) with a view to guiding the technical planning and implementation, including through an assessment of the medium-term investment needs and associated costs, beyond what is already in the pipeline, as well as available private and public sector financing options to support them. In line with the road map, we have identified several priority actions to reduce infrastructure loss due to climate change and the associated interruption of public goods provision, fiscal costs of rebuilding and retrofitting existing infrastructure, and damage to transport and water sectors. To meet the fiscal costs amid tight fiscal space, we are exploring new opportunities for green finance from official and private sources (¶146), while at the same time seeking ways to improve the efficiency of public investment. In this context, we are committed to strengthening our institutional capacity to plan and manage efficiently green and resilient investment projects, building on the recommendations of the PIMA (¶15) and its climate

change module, with support from IMF TA. In 2020, we issued a Decree (N°42465- MOPT-MINAE-MIVAH) on incorporation of resilience measures in infrastructure. With WB support through the Public Expenditure and Accountability Framework for assessing climate responsive PFM (PEFA Climate), we have continued building climate change considerations into public investment management, by updating the methodological guidelines for preparing and appraising public investment projects to incorporate principles to handle exposure and resilience of public works to disasters. As the next step in project appraisal and as part of our planned enhancements to the operation of the SNIP (¶15), we developed and published guidelines to expand the project appraisal process to assess the impact of the project on climate change through the social cost of carbon by end-September 2023 (**RSF reform measure**). The guidelines indicate an estimate of the social cost of carbon and a detailed application to the transport sector, which we produced with the support of the Economic Commission for Latin America and the Caribbean. As a next step, we are helping institutions to apply them. We are also advancing our work to strengthen project selection criteria. With the support of the IDB and a private company we are finalizing a methodology to score and prioritize capital projects according to a set of criteria and weights. Building on the piloting of this new methodology, we are on track to publish guidelines setting clear and transparent project selection criteria including a range of climate change criteria for SNIP entities by end-December 2023 (**RSF reform measure**). Given the increased prevalence of climate-related disasters, we are also resolved to have a more efficient and proactive approach to capital maintenance to strengthen infrastructure resilience. With support from the German Development Agency (GIZ), we produced a Methodology for the Evaluation of Climatic Risks in the Public Infrastructure of Costa Rica (MERICI), which could be applied to other countries. In this context, guidelines were issued to assess needs and allocate adequate amounts of resources to routine and capital repairs. For example, with the support of CABEL and the WB, we have started to strengthen infrastructure under imminent threat from disasters and identify what other infrastructure could be at risk.

42. We are strongly committed to promoting environmentally sustainable growth by implementing the mitigation strategies in our ambitious National Decarbonization Plan.

Recognizing the need for prompt and bold action to mitigate climate change, in 2019, we launched a National Decarbonization Plan, pledging to reduce greenhouse gas emissions to a net absolute maximum of 9.11 million tons of carbon dioxide equivalent (CO₂e) by 2030 and achieve zero net emissions by 2050. The Plan is among the few assessed to be consistent with limiting global warming to 1.5°C, in line with the Paris Agreement. With almost 100 percent of the electricity matrix currently sourced from renewables, we start off from a strong position.

- **Electrification of transport.** To support the electrification of private vehicles, the Legislative Assembly approved a bill to extend tax incentives for electric vehicles to 2034. Moreover, we are developing a feebate scheme to promote the transition to low-emission vehicles (¶18). The scheme comprises a sliding scale of fees to light-duty vehicles with above-average emission rates and a sliding scale of rebates to light-duty private passenger vehicles with below-average emission rates levied at the time of purchase or import of new or used vehicles up to 5 years

old. The design will aim to be revenue-neutral, with safeguards to reduce risks of revenue loss. With support from IMF TA, we completed the technical design of the feebate scheme. We submitted to the Legislative Assembly the bill on the introduction of the feebate scheme to strengthen incentives for low-pollution private vehicles in November 2023 (**RSF reform measure**). As part of our systematic cost-benefit analysis of tax exemptions (¶111), we will also appraise and publish a review of existing tax incentives with a negative effect on the environment to support decarbonization efforts by end-February 2024 (**RSF reform measure**), with a view to streamlining them over time. In parallel, we will continue encouraging fleet electrification processes in the transport sector—the largest contributor to greenhouse gas emissions. For public transport, we developed new promotional electric tariffs, building on the experience of existing pilots, for the use and supply of electricity associated with charging centers for electric buses and incorporate the tariff into the current tariff schedules of electricity distribution companies. With support from the IDB, we installed 55 fast charging centers nationwide by end-December 2022. The scheme will require that new buses follow the guidelines of the National Decarbonization Plan, Nationally Determined Contributions, and the National Electric Transportation Plan, and is expected to take effect in March 2024, thus steadily increasing the share of zero-emissions vehicles in the fleet. We are determined to revamp public transportation. To this end, we are analyzing self-sustainable financing options to electrify public transport buses, and will launch a plan by end-March 2024. We expect to have 500 zero-emissions buses by end-2025. In addition, by end-May 2024, we will launch the public transport sectorization plan, which includes a cost-efficient route redesign, electronic payment, and the integration of the urban train into the public transport routes. All these measures will also encourage the use of public transport instead of private transport.

- **Renewable energy.** Our efforts to increase competition in the energy sector and reduce electricity prices from renewable sources will support decarbonization. We published the implementing regulation of Law No. 10086, as approved by the Legislative Assembly in October 2021, to simplify the administrative procedures for private participation in power generation from renewable sources for self-consumption in February 2023 (RSF reform measure). This regulation is in line with best practice as it boosts competitiveness and investment for market participants by: i) defining responsibilities for owners to promote the safe and reliable interconnection of the electricity grid; ii) securing the economic sustainability of generation projects by authorizing the sale of energy surpluses and encouraging the use of price signals or different tariffs depending on the time; and iii) declaring certain activities, such as energy storage and electric vehicle charging, as "services of general interest", which allows public services to be provided by private players. To complement this action, we completed efforts (i) by the Costa Rican Institute of Electricity to enact tariff reductions by reducing operational costs, restructuring debt, and implementing IFRS; (ii) by the *Autoridad Reguladora de Servicios Públicos (ARESEP)* to reduce electricity prices charged by other generators beyond ICE with IDB support, applying new tariff methodologies; and (iii) to introduce measures to remove barriers to foreign participation in the energy sector through legislation currently under consideration by the legislative assembly (¶119). We are also developing the legal framework to allow the private sector to use geothermal energy in industrial processes, agriculture, and tourism. Currently only

ICE is allowed to use low-enthalpy geothermal energy, and we will submit to the Legislative Assembly a bill to facilitate expanded use of this renewable energy in January 2024.

- **Agriculture and forestry.** The agriculture and forestry sectors play a major role in carbon sequestration and are therefore key to reaching our zero net emission target. With assistance from the GIZ, we will further support farmers in adopting resilient and low-carbon technologies and practices by providing technical assistance, promoting agricultural research on low-carbon and resilient solutions, and further developing financing instruments. We are also scaling up adaptation and mitigation actions such as nationally appropriate mitigation actions (NAMAs) for coffee, livestock, rice, sugarcane, and bananas, with support from the IDB, AFD, and GIZ-EU and the participation of CONARROZ, CORBANA, FEDECANA and other private-sector actors. The scaling up entails a stocktake of capacity in each sector to design the adaptation and mitigation actions, sectoral mitigation scenarios and targets, operationalization through financing and innovation, and monitoring. We are advanced on the pilot in the rice sector and have started the sugar pilot. We completed an assessment of the costs of such a scaling up and identified suitable financing, starting with priority sectors, by end-March 2023. We will refine our payment for ecosystems schemes to cover the entire landscape including agriculture, livestock, and forestry, with support from the WB and the Global Environmental Facility, as envisaged in our PSA 2.0 directive to be published in December 2023. To support this, the 2022 National Development and Investment Plan envisages additional training and land coverage. We also established initiatives to promote job creation through such schemes, including in the wood industry.
- **Marine ecosystems.** We are also committed to supporting the “blue” economy through sustainable and innovative approaches to the use of coastal areas while ensuring their conservation. We exceeded our goal to protect 30 percent of our marine territory under conservation schemes by end-December 2022 early. To this end, in December 2021, we signed the decree 43368-MINAE to expand the protection of Coco Island National Park and Montes Submarinos Marine Area to consolidate the protection of important marine ecosystems as well as endangered species and high commercial value ones and promote sustainable tourism and other economic activities while preserving the health and resilience of the ocean. This is part of a broader regional conservation and management strategy in the Eastern Tropical Pacific, which aims to establish a transboundary biosphere reserve to consolidate swim-ways or underwater biological corridors that will connect Cocos Island (Costa Rica), Galapagos (Ecuador), Malpelo (Colombia) and Coiba (Panama), with the relevant technical papers ready and interim governance structures established for jointly managing financial support received by the four countries. We aim to file the application in March 2024. We are also piloting programs to strengthen wetlands and mangroves while improving the lives of the local populations, with donor support, in order to leverage these ecosystems’ ability to reduce net emissions. To this end, we have issued 300 permits, and expect to issue another 300, to community members to protect and sustainably use mangrove resources keeping the biological cycle of this ecosystem

in balance. We are also seeking other opportunities to extend the payment for environmental services model to the marine sectors, starting with the fisheries, with WB support.

- **Environmental trade.** We are making progress in negotiating an Agreement on Climate Change, Trade and Sustainability (ACCTS) with five other countries (Fiji, Iceland, New Zealand, Norway, Switzerland) to ensure that our trade policy supports the goals set forth by the National Decarbonization Plan. We and other ACCTS members have agreed to work towards eliminating tariffs on environmental goods trade, barriers to environmental services trade, and environment-damaging subsidies and commitments. Relevant government institutions have agreed a roadmap to publish by December 2023 our sustainable agro-landscapes strategy, which with IDB support will help position our agro products as sustainable and carbon neutral on global markets under a unified brand (Essential Costa Rica), and MINAE is supporting the Ministry of Foreign Trade in negotiations with trading partners.

43. We are further developing our strategy for transition mitigation. In March 2021, we released the Territorial Economic Strategy for an Inclusive and Decarbonized Economy 2020-2050, with support from the IDB. The Strategy aims to gradually transition to an inclusive and decarbonized economy by 2050, with 12 development poles, six corridors—that will facilitate the interaction between these poles—and 12,750 km² of territorial management areas. The strategy involves policy measures on economic growth, social inclusion, human capital, gender, infrastructure and connectivity, and natural capital. Among the fifty priority actions, key just transition actions include expanding coverage of early English education and implementing training programs on the green and blue economy. Our modeling work, with support from the IDB and UN, has estimated that our National Decarbonization Plan has economic benefits of US\$41 billion in net present value terms and a net positive effect on jobs by 2050. With ILO support, we conducted a pilot study of new green jobs (including tasks that directly green the economy and reduce pollution and jobs that indirectly support those tasks) and blue jobs (in activities related to the oceans, seas, and coasts) focused on the North East coast. The study found that, although women’s jobs tend to be more green and more blue than men’s jobs, women are expected to account for a minority of new green and blue jobs created, and that there will be a growing gap between the demand for jobs and graduates. We are working on policies to promote enrollment in relevant programs, especially by women. Our 2022 National Development and Investment Plan includes a pilot program to help women transition to a green urban economy. In May 2023, we issued a decree and accompanying strategy to promote gender equality in climate action to comply with our Paris Agreement commitments, with UN support. With AFD and ILO support, we are conducting additional analytical work to study the technical profiles for new green and blue jobs by end-March 2023. We expect to incorporate the analysis and policy plans in our just transition strategy in 2024. We are also promoting electricity and biomethane (produced from agricultural waste) as substitutes for bunker oil, LPG, and diesel fuel. To help different transport and domestic industries decarbonize, with IDB support we published a long-term green hydrogen strategy in July 2023. The strategy also seeks to make Costa Rica a regional hub for green hydrogen innovation and to explore export opportunities. The strategy estimates an annual reduction of 225 000 tons of CO₂e by 2030 and the creation of

18,000 jobs over the period 2022-2030. Financing is being provided through the NAMA facility and the Green Climate Fund.

44. To proactively assess the macro-fiscal implications of our climate change strategy, we are integrating climate risks into our budget planning. In May 2022 we approved the functional budget classification system in line with the 2014 IMF Government Finance Statistics Manual and the international concepts and definitions of climate change and disaster risk expenditure. With the support of the IDB and the AFD we developed a methodology for tagging climate-related expenditure in budget and financial reporting, and the MOF published guidelines for climate budget tagging in January 2023 (RSF reform measure). We will enhance the capacities of ministries and agencies on green budget tagging and modify the financial management information systems to operationalize the new climate change expenditure classification in time for the 2025 budget. In September 2022, we published a National Strategy for Financial Management of Disaster Risks, which quantifies financial losses and identifies possible financial instruments that could be mobilized *ex ante* (e.g., budget provisions, the National Emergency Fund, and insurance) or *ex post* (e.g., budget reallocations, new loans) to respond to such losses. The MOF, in collaboration with the National Commission for Risk Prevention and Emergency Care, will develop and publish an implementation plan of the strategy to select an optimal combination of instruments by end-July 2024. For example, our new National Development and Investment Plan has a target to increase emergency funds available for managing risks to 0.25 percent of GDP. We are seeking funding sources, including external sources, to achieve this goal, and conducting an actuarial valuation of the fund with WB support. In 2023, with support from the WB, we started an evaluation of the contingent liability, which determines future spending related to care and recovery from disaster events, including those associated with climate. This study determines which sectors have the most impact on the determination of this contingent liability and costs assignable to the State and the private sector are being estimated. In March 2023, we signed a Disaster Risk Management Policy Loan with a Catastrophe Drawdown Option with the WB, which will allow us to have immediate access to financial resources in the event of major disasters. While disaster risks are well integrated into the fiscal risks analysis, with IMF assistance, we included a preliminary introduction for transition risks in the September 2023 Medium-Term Fiscal Framework. With IMF support, we published a quantitative analysis of climate transition fiscal risks associated with the implementation of the National Decarbonization Strategy in November 2023 (**RSF reform measure**) and will integrate those findings in the risk analysis of the April 2024 Medium-Term Fiscal Framework.

45. The BCCR and the supervisory authorities are pressing ahead with efforts to address climate change effects on the financial sector. In 2019, the BCCR joined the Network of Central Banks and Supervisors for Greening the Financial System (NGFS). The BCCR also established within the central bank the Group for Strategic Analysis of Climate Change (GAECC), comprising representatives of different departments, to address the impacts and risks related to climate change on the central bank's main objectives. With support from GAECC, the BCCR developed a roadmap to integrate climate change considerations into the design of monetary, financial, and macro-prudential policies. The roadmap is centered around four blocks: (i) establishing reliable and comparable data with identification of systematic data gaps; (ii) strengthening modeling and

analytical capacity for scenario analysis; (iii) promoting climate change risk management in the financial system; (iv) and greening international reserves. Over the past few years, the CONASSIF and the Superintendencies have also worked to raise awareness and train the industry on the risks and opportunities associated with climate change, efforts that create strong synergies with the BCCR road map. They have aligned their agendas with the National Strategic Plan 2050. The GAECC now regularly coordinates efforts on climate change issues with the CONASSIF and the Superintendencies. The BCCR has taken the decision to dedicate permanent staff resources to the GAECC, which will ensure continuity and allow further strengthening and broadening of its coordination function. In line with this efforts, on October 4, 2023, the Superintendencies signed a Statement of Commitment to promote a resilient financial sector against climate change risks.

- Data and modeling to assess financial sector climate risks.** The BCCR is continuing to take stock of the required data to adequately analyze the impact of climate change and to identify suitable indicators that can serve as a reference to measure and monitor climate-related risks. An important part of monitoring such risks is to document the main climate risks faced by Costa Rica at a more granular level, combining information from various sources, and identifying systemic data gaps. Supervisory agencies will coordinate efforts to obtain firm-level disclosures of climate-related risks to inform the design of regulatory and supervisory approaches to manage these risks, within their respective mandates. SUGEF has identified improvements in the identification and location of real collateral guarantees and the understanding of the destination of resources. Concerning real collateral, new variables based on the political-administrative division of the country will be included in the reporting structures, including georeferencing. About destinations of the resources, valuable information is currently being reported by the financial entities. To make the most of the information, SUGEF will carry out specific actions on data mining, in-depth monitoring and data quality. In addition, the BCCR has compiled and made public two new environmental accounts—Material Flow Accounts for 2014-2019 and Environmental Protection Expenditure Accounts—for the private sector for 2018-2020. However, an integrated database, with more granular information, is needed to systematically capture risks at the national level. To this end, we completed the RSF reform measure of creating a data repository, as a first step, covering 35 percent of the credit portfolio, which includes indicators of (i) main climate hazards, notably hydro-meteorological ones; (ii) degree of vulnerability to climate-related events at sectoral and geographical levels; (iii) exposure of banks' credit portfolios to vulnerable industries and regions. With support from the IDB, the BCCR has developed an integrated economic and environmental model to conduct impact analysis of climate and environmental policies and is further advancing in the analysis of different climate scenarios combined with various mitigation and adaptation policies.
- Climate change risk management.** The BCCR is assessing the interlinkages between climate-related and macro-financial variables as well as the risks to the financial system from climate change. The BCCR is guided by the recommendations of the Network of Central Banks and Supervisors for Greening the Financial System in its "top-down" stress-testing methodologies. The BCCR remains committed to further expanding coverage of the data repository, to support our ability to map the main transmission channels of climate-related shocks to financial

institutions and improve stress testing methodologies for macro-financial risk surveillance. The objective remains to incorporate climate effects on the banking sector, focused on physical risks, in BCCR's "top-down" stress test, based on aggregated data built upon granular data and capturing those new risks on credit risk parameters. However, due to an ongoing legal process to determine the BCCR's right to access the needed detailed information about the credit portfolio, the expansion of the data repository has been delayed. Without this detailed information, the credits cannot be properly matched with the geographic location of the economic activity being financed, as the loan dataset sometimes references the bank branch instead. Given the differences in the banks' business models and in the geographic concentration of the activities financed, stress tests based only on the partial credit portfolio, which the BCCR has conducted, is likely to be misleading. While the legal process is ongoing, the BCCR will finalize the new stress test methodology by February 2024 (**revised RSF reform measure**) and aim at including preliminary information on the methodology in the Financial Stability Report in May 2024. Once full coverage of the data has been obtained, the BCCR will use the methodology to incorporate climate effects in its top-down stress tests as previously planned. The BCCR will further develop its methodologies and climate risk macro-financial scenario building to address the specific risks faced by Costa Rica, with a view to publish climate stress test results in future Financial Stability Reports and ultimately support the design of macro- and micro-prudential policies that effectively mitigate the impact of climate-related shocks. SUGEF has also started early work, supported by GIZ, to develop methodological guidelines and, as a pilot project, identify risk exposure in one bank. Additionally, technical assistance in several areas is in progress to support SUGEF in integrating climate-change related risks into its functions: supervision guidelines and practices, training for financial entities and supervisors, and the definition of a roadmap on the next steps in the agenda on climate-change risk for the financial sector, including developing the definition of green taxonomy, developing the data analysis capacities, and follow-up with supervised entities about regulatory changes.

- **Greening international reserves.** The BCCR aims at leading the search of investments for its international reserves that is environmentally friendly and increases exposures to issuers with the best environmental performance. To this end, the BCCR published a final selection of indicators of the "greenness" of its reserve holdings together with its 2022 Annual Report published in April 2023 (RSF reform measure). The indicators are used to increase the investment limits for the issuers that perform well from an environmental perspective, using a "best in class strategy", and without compromising the primary objectives of capital preservation, liquidity and return.
- **Regulation of socioenvironmental risks.** To lay the foundations for ensuring that the regulated financial sector entities adequately take into account socioenvironmental risks, including climate change risks, in a way that is consistent with the principles for the effective management and supervision of climate-related financial risks from the Basel Committee on Banking Supervision, CONASSIF approved a regulation on management of socioenvironmental risks and climate change risks in the credit portfolio in October, 2023 (**RSF reform measure**). This regulation, which had been subject to industry consultation in July 2023 and then revised based on the comments received, aims to strengthen risk management by requiring banks to put in place

policies and processes to manage socioenvironmental risks, to incorporate them into decision-making processes, and to promote actions to identify, assess and mitigate such risks. In particular, the regulation specifies roles for the Board and senior management, the main risk areas to be covered for credit risk management purposes (including physical and transition risks), classification of credit operations according to socioenvironmental and climate change risk assessment, and disclosure requirements in the Annual Risk Report of the financial entity. The scope of the regulation includes all supervised financial intermediaries except for some of the small and less complex cooperatives. Environmental and social risk management frameworks must be implemented no later than December 31, 2026, and financial institutions are required to report these environmental and social risk categories by January 31, 2027. We are also strengthening internal training for supervisors and processes to determine that banks are in compliance with the expectations above. As national and international practice in this area develops and we improve information collection and taxonomies, we will be able to take further steps towards the establishment of capital and liquidity requirements and requirements for market risk, operational risk, and other material climate-related risks. In the same way, the financial sector will gain the capacity to meet the requirements of the Task Force on Climate-related Financial Disclosures (TCFD), concerning governance, strategy, risk management, metrics and targets.

46. We are taking further steps to develop green financing. Our overall reform agenda, including fiscal consolidation to reduce debt; PFM reforms to improve monitoring, transparency, and accountability of green public investment projects; enhanced financial sector risk management; and efforts to develop deeper and more open capital markets for foreign investors, creates an enabling environment for attracting further green public and private financing. A study conducted with the support of GIZ identified activities with particular potential to attract foreign direct green investments, such as components for green hydrogen (T143), green data centers for digitization, and the development of materials from waste recovery. FDI in these sectors will be supported by our overall agenda to improve the investment climate (T137). We are also taking specific actions to attract other forms of green financing:

- The Legislative Assembly approved in October 2021 Law 10.051 to Promote Financing and Investment for Sustainable Development, through the use of Thematic Public Offering Securities, to promote such financing for investment in activities aimed at achieving the national goals for a sustainable development and a green economy.
- CONASSIF approved updates to a series of associated regulations in May 2022 according to which supervised entities are (i) required to incorporate the sustainable or responsible component in their investment policies; (ii) required to incorporate ESG risk management into their risk management framework; (iii) allowed to issue ESG bonds; and (iv) recommended to include voluntary disclosures on their ESG actions in their annual reports. The first two of these measures were approved with a transitional period that ends in December 2023, and were complemented by regulation on management of

socioenvironmental risks and climate change risks in the credit portfolio approved in October, 2023.

- To further support the development of green financing, the CONASSIF and the Superintendencies are developing a single green taxonomy for the financial sector. Following initial technical assistance from the WB to develop general guidelines for a new taxonomy, the authorities, including MINAE, are starting a two year project supported by the Green Climate Fund, with the United Nations Environment Programme as delivery partner, to create the taxonomy, expected to be finalized by December 2024.
- Our sovereign bonds are already included in indices that recognize our green credentials. Together with those assisting us with planned Eurobond placements and the UNDP, we are exploring Costa Rica's ability to be further recognized as an Environmental Social Governance (ESG) sovereign to catalyze further financing from private investors by leveraging our ambitious climate actions, including through the possible issuance of Use of Resources bonds or sustainability-linked Eurobonds (SLBs). These bonds could reference key performance indicators related to forest coverage, ecological integrity, and biodiversity. To support the extensive monitoring and reporting requirements associated with such issuances, we are strengthening internal coordination between ministries to facilitate collaboration between relevant units of the MOF (including the Debt Management Office), MINAE and others, whose contributions are necessary for their potential issuance. Beyond the central government, the Costa Rican Institute for Electricity is exploring the issuance of a second sustainable bond with WB assistance.
- We have also started preparatory work to develop a project preparation facility (PPF) with support from the IDB, aimed at creating a pipeline of sustainable projects to catalyze private financing. Initial operational costs of the PPF would be jointly covered with development partners, but once fully operational it would be self-financed. The PPF would help with the screening, appraisal and structuring of projects, which are currently important constraints to scale up investment in Costa Rica. Along with this, we are taking steps to strengthen our institutional PPP framework by improving our capacity for project selection and management of fiscal risks (including the thorough analysis of contingent liabilities from PPPs through a centralized database), supported by IDB technical assistance.

VII. RISKS AND CONTINGENCIES

47. Risks to the program come from an array of external and domestic factors. Intensified regional conflicts and resulting further supply disruptions, renewed global financial market turmoil and sustained tightening of global financial conditions, and weaker-than-expected global downturn, all carry the potential to adversely impact Costa Rica's economy. These shocks and the required policy response to renewed inflationary and external pressures would likely entail a slowdown in domestic activity. This could in turn lead to increased domestic financial vulnerabilities and weaker-than-expected revenue performance that would impact our fiscal consolidation strategy. Legislative pressures risk weakening the fiscal consolidation. Our exposure to natural disasters continues to

pose important risks, which are likely to increase over time. These downside risks could renew concerns about debt sustainability. Although we are committed to reducing those risks over which we have influence, should any of these risks materialize, the government of Costa Rica stands ready to adjust promptly its policies, in close consultation with IMF staff. On the upside, were domestic or external developments to support a stronger economic performance, we stand ready to accelerate the adjustment and reform process, strengthening the resilience of our economy to future shocks.

VIII. PROGRAM MONITORING

48. Progress in the implementation of our policies, which are supported by the IMF, is monitored through semi-annual reviews, performance criteria (PCs), indicative targets (ITs), and structural benchmarks (SBs). Progress in meeting the inflation target under the program will continue to be monitored through a MPCC. These are detailed in Tables 1, 2, and 3 with definitions and data requirements provided in the attached TMU. The sixth review will take place on or after March 15, 2024. Purchases and disbursements under the EFF and RSF arrangements will be used for direct budget support during the program period consistent with the Memoranda of Understanding on the responsibilities for servicing financial obligations to the IMF under the EFF and RSF arrangements.

Table 1. Costa Rica: Quantitative Performance Criteria (PC) and Indicative Targets (IT)^{1/}
(Cumulative from the beginning of the year, in billions of colones, unless otherwise noted)

	2022						2023						2024					
	End-Dec			End-Mar			End-Jun			End-Sep			End-Dec	End-March				
	PC	Adj. Prog.	Met / not met	IT	Adj. Prog.	Met / not met	PC	Adj. Prog.	Met / not met	IT	Adj. Prog.	Met / not met	PC	IT				
I. Quantitative Performance Criteria																		
Floor on cash primary balance of the central government (= borrowing)	287		927	met	152	467	met	305		646	met	457	810	met	609	230		
Floor on net international reserves of the Central Bank (stock, in millions of U.S. dollars)	3,830	3,295	3,871	met	2,314	2,872	4,401	met	3,771	3,219	6,530	met	2,860	2,256	6,381	met	2,815	3,884
II. Continuous Performance Criteria^{2/}																		
Ceiling on accumulation of new external arrears (in millions of U.S. dollars)	0		0	met	0	0	met	0		0	met	0	0	met	0		0	0
III. Monetary Policy Consultation Clause (MPC)^{3/}																		
Year-on-year inflation in the consumer price index ^{4/}																		
Upper outer band limit (3 percent above center point)	6.0		...		6.0	...		6.0		...		6.0	...		6.0		6.0	6.0
Upper inner band limit (1.5 percent above center point)	4.5		outer		4.5	inner		4.5		inner		4.5	outer		4.5		4.5	4.5
End-of-period inflation center point (percent)	3.0		8.4	band	3.0	5.9	band	3.0		0.7	band	3.0	-2.6	band	3.0		3.0	3.0
Lower inner band limit (1.5 percent below center point)	1.5		...	breach	1.5	...	breach	1.5		...	breach	1.5	...	breach	1.5		1.5	1.5
Lower outer band limit (3 percent below center point)	0.0		...		0.0	...		0.0		...		0.0	...		0.0		0.0	0.0
IV. Quantitative Indicative Targets																		
Ceiling on debt stock of the central government	29,566		28,927	met	29,710	29,035	met	30,254		30,394	not met	30,598	30,218	met	30,942		31,317	
V. Memorandum Items																		
External program financing (in millions of U.S. dollars) ^{5/}	1,601		942		0	0		890		0		890	0		1,360		534	
External project financing (in millions of U.S. dollars)	313		211		61	33		141		77		212	122		286		72	
External commercial borrowing (in millions of U.S. dollars)	1,000		1,056		0	0		1,500		1,500		1,500	1,500		1,500		0	
Domestic FX-denominated debt issuance (in millions of U.S. dollars)	1,098		1,514		0	646		220		680		220	731		220		60	
Proceeds from commercialization of public assets to non-residents (in millions of U.S. dollars)	0		0		0	0		0		0		0	0		0		0	
Amortization of official external debt by the central government (in millions of U.S. dollars)	191		159		64	76		95		111		158	174		256		163	
Amortization of external commercial loans (in millions of U.S. dollars)	0		0		1,000	1,000		1,000		1,000		1,000	1,000		1,138		138	
Interest payments of official external debt by the central government (in millions of U.S. dollars)	567		462		180	232		450		375		734	680		966		385	
Domestic FX-denominated debt service (in millions of U.S. dollars)	1,394		1,523		123	159		441		558		912	1,085		1,014		545	

^{1/} Definitions as specified in the Technical Memorandum of Understanding (TMU).

^{2/} The Standard Continuous Performance Criteria will also apply: (i) Not to impose new or modify existing restrictions on the making of payments and transfers for current international transactions; (ii) Not to introduce new or intensify existing multiple currency practices; (iii) Not to conclude bilateral payments agreement that are inconsistent with the IMF's Articles of Agreement (Article III); and (iv) Not to impose new or intensify existing import restrictions for balance of payments reasons.

^{3/} The Monetary policy consultation clause bands consist of two types of thresholds. The inner band triggers a staff consultation and the outer band triggers a Board consultation as detailed in the TMU.

^{4/} See the TMU for how to measure year-on-year inflation.

^{5/} Excluding IMF financing.

Table 2. Costa Rica: Structural Benchmarks

Action	Target Date	Status	Comment
Efficiency of government spending			
Legislative Assembly to approve Public Employment Bill.	End-May 2021	Not Met	Approved on March 7, 2022.
Implementation of Public Employment Bill, including introduction of a single pay spine.	End-March 2023	Not met	
MIDEPLAN to incorporate 90 percent of the executive branch's job positions in the single wage spine.	End-September 2023	Met	September 8, 2023.
Revenue mobilization			
The Tax Commissioner to approve a new Tax Compliance Improvement Plan, in line with IMF staff recommendations.	End-December 2021	Met	
Fiscal governance and transparency			
Publication of financial statement under IFRS standards for fiscal year 2020 for three SOEs (ICE, AyA, CNP).	End-December 2021	Not met	Pending for a small firm under CNP.
Cabinet to approve and publish a Medium-Term Fiscal Framework for the entire Non-Financial Public Sector for 2023-2026.	End-April 2022	Met	
Cabinet to approve and publish a Medium-Term Debt Strategy (MTDS) for 2023-2026.	End-April 2022	Met	
Government to submit law amendments to the Legislative Assembly to centralize all debt-related functions of the government within the purview of a standalone Public Debt Management Office, reporting to the Minister of Finance.	End-June 2023	Met	Submitted in May, 2023.

Table 2. Costa Rica: Structural Benchmarks (Concluded)

Table 2. Costa Rica: Structural Benchmarks (Concluded)			
Social safety nets			
MOF's National Treasury to centralize and digitalize the payment system for all the cash transfer social assistance programs, in coordination with social assistance units.	End-December 2021	Met	
IMAS to launch a single window for social programs under its authority.	End-February 2024		Ongoing.
Monetary and financial sector reforms			
The BCCR to submit to the Ministry of Finance draft amendments to the BCCR Law, prepared in consultation with IMF staff, to strengthen the central bank's operational autonomy and governance framework.	End-August 2021	Met	
The government to submit amendments to the BCCR Law to the Legislative Assembly, prepared in consultation with IMF staff, to strengthen the central bank's operational autonomy and governance framework.	End-December 2022	Not met	Selected BCCR Law amendments submitted to the Legislative Assembly in June 2023.
Government to submit amendments to the bank resolution and deposit insurance law and related legislation, in line with program understandings, to the Legislative Assembly, to strengthen the crisis management framework.	End-December 2023		Ongoing.
Macro-structural reforms			
CCSS to formulate and approve a plan to adjust the minimum contribution base for part-time workers.	End-June 2022	Not met	Approved on September 1, 2022.
Authorities to develop a roadmap to enhance infrastructure resilience to climate change, including cost assessment and financing options.	End-September 2022	Met	

Table 3. Costa Rica: Reform Measures Under the Resilience and Sustainability Facility Arrangement			
Reform Measures (RMs)	Indicative Date	Expected Corresponding Review under the EFF Arrangement	Update
Integrating Climate Risks into Fiscal Planning			
RM1. Ministry of Finance to develop and publish guidelines for climate budget tagging.	End-February 2023	Fourth EFF Review	Completed
RM5. Ministry of Finance to publish a quantitative analysis of climate transition fiscal risks.	End-November 2023	Fifth EFF Review	Completed
Strengthening Public Investment and Infrastructure Resilience			
RM6. MIDEPLAN to develop and publish guidelines to expand the project appraisal process to assess the impact of the project on climate change through the social cost of carbon.	End-September 2023	Fifth EFF Review	Completed
RM9. MIDEPLAN to publish guidelines on project selection criteria including a range of climate change criteria for SNIP entities.	End-December 2023	Sixth EFF Review	Ongoing
RM10. MIVAH, in collaboration with MINAE, to develop and publish guidelines for including climate change analysis in Regulatory Plans.	End-February 2024	Sixth EFF Review	Ongoing

Table 3. Costa Rica: Reform Measures Under the Resilience and Sustainability Facility Arrangement (Concluded)			
Supporting Decarbonization			
RM2. Government to approve implementing regulation to simplify the administrative procedures for private participation in power generation from renewable sources for self-consumption.	End-December 2022	Fourth EFF Review	Completed
RM7. Government to submit to the Legislative Assembly a bill to introduce feebate scheme to strengthen incentives for low-pollution private vehicles.	End-September 2023	Fifth EFF Review	Completed
RM11. Government to appraise and publish a review of existing tax incentives with a negative effect on the environment to support decarbonization efforts.	End-February 2024	Sixth EFF Review	Ongoing
Greening Reserves and Strengthening Financial Sector Resilience			
RM3. BCCR to create a repository with data on climate hazards; industrial and geographical vulnerability to climate events; banks' lending exposure to vulnerable industries and regions.	End-February 2023	Fourth EFF Review	Completed
RM4. BCCR to publish indicators of the "greenness" of its reserve holdings in its 2022 Annual Report.	End-February 2023	Fourth EFF Review	Completed
RM8. CONASSIF to approve regulation on management of socioenvironmental risks and climate change risks in the credit portfolio.	End-September 2023	Fifth EFF Review	Completed
RM12. BCCR to develop a methodology to incorporate climate effects on the banking sector in its top-down stress testing, based on data aggregated from granular information, and capturing those new risks on credit risk parameters.	End-February 2024	Sixth EFF Review	Proposed revision. Currently "BCCR to incorporate climate effects on the banking sector in its top-down stress testing, based on aggregated data and capturing those new risks on credit risk parameters."

Attachment II. Technical Memorandum of Understanding

1. This Technical Memorandum of Understanding (TMU) sets out a framework for monitoring the performance of Costa Rica under the program supported by the Extended Arrangement under the Extended Fund Facility (EFF). It specifies the performance criteria and indicative targets (including adjustors) under which Costa Rica's performance will be assessed through semiannual reviews. Monitoring procedures and reporting requirements are also specified.
2. The quantitative performance criteria and indicative targets specified in Table 1 attached to the Memorandum of Economic and Financial Policies (MEFP) are listed as follows.
 - a) a quantitative performance criterion on central government primary balance (floor);
 - b) a quantitative performance criterion on net official international reserves (floor);
 - c) a continuous quantitative performance criterion on new external payment arrears by the nonfinancial public sector and the BCCR (ceiling);
 - d) a monetary policy consultation clause;
 - e) an indicative target on debt stock of the central government (ceiling);
3. In addition to the performance criteria listed in Table 1, the arrangement will include the performance criteria standard to all Fund arrangements, namely:
 - a) no imposition or intensification of restrictions on the making of payments and transfers for current international transactions;
 - b) no imposition or intensification of import restrictions for balance of payments reasons;
 - c) no introduction or modification of multiple currency practices;
 - d) no conclusion of bilateral payments agreements that are inconsistent with Article VIII of the IMF Articles of Agreement.
 - These four performance criteria will be monitored continuously.
4. For program monitoring purposes, all foreign currency-related assets, liabilities, and flows will be evaluated at "program exchange rates" as defined in Table 1 below, except for items related to fiscal operations which will be measured at current exchange rates. Going forward, the program rates are those that prevailed on September 13, 2022. Monetary gold will be valued at US\$1,703 per troy ounce, which was the price prevailing on September 13, 2022.

Colones to the U.S. dollar	635.725
U.S. dollar to the SDR	1.3068
U.S. dollar to the Yen	0.0070
U.S. dollar to the Euro	1.0179
U.S. dollar to the Canadian dollar	0.7620
U.S. dollar to the Chinese RMB	0.1443
U.S. dollar to the British Pound	1.1730
Gold price per troy ounce (U.S. Dollar)	1,703

5. Throughout this TMU, the central government figures comprise all branches of the government (executive, legislative, and judiciary), including the Comptroller's Office and the Ombudsman's Office; the Supreme Electoral Court; the budget lines "*Servicio de la Deuda Pública*", "*Regímenes de Pensiones con cargo al Presupuesto de la República*" and "*Obras Específicas*"; and the public entities that is required to be consolidated under central government (CG) from 2021 by Law 9524 (see below). The Central Bank of Costa Rica (BCCR), the state-owned enterprises and other public sector agencies are excluded from the definition of central government. For program purposes, the definition of debt is set out in paragraph 8(a) of the Guidelines on Public Debt Conditionality in Fund Arrangements attached to Executive Board Decision No. 16919-(20/103) adopted October 28, 2020.

Specifically, the following entities are required to be consolidated under CG by Law 9524:

1. *Agencia de Protección de Datos de los Habitantes (PRODHAB)*, 2. *Casa de Cultura de Puntarenas*, 3. *Centro Costarricense de Producción Cinematográfica*, 4. *Centro Cultural e Histórico José Figueres Ferrer*, 5. *Centro Nacional de la Música*, 6. *Comisión Nacional para la Gestión de la Biodiversidad (CONAGEBIO)*, 7. *Comisión Nacional de Prevención de Riesgos y Atención de Emergencias (CNE)*, 8. *Comisión Nacional de Vacunación y Epidemiología*, 9. *Comisión de Ordenamiento y Manejo de la Cuenca Alta del Río Reventazón (CONCURE)*, 10. *Consejo Nacional de Clubes 4-S*, 11. *Consejo Nacional de Concesiones (CNC)*, 12. *Consejo Nacional de la Persona Adulta Mayor (CONAPAM)*, 13. *Consejo Nacional de la Política Pública de la Persona Joven (CPJ)*, 14. *Consejo Nacional de Vialidad (CONAVI)*, 15. *Consejo de Salud Ocupacional (CSO)*, 16. *Consejo de Seguridad Vial (COSEVI)*, 17. *Consejo Nacional de Investigación en Salud (CONIS)*, 18. *Consejo Nacional de Personas con Discapacidad (CONAPDIS)*, 19. *Consejo Superior de Educación (CSE)*, 20. *Consejo Técnico de Asistencia Médico Social (CTAMS)*, 21. *Consejo Técnico de Aviación Civil (CTAC)*, 22. *Consejo de Transporte Público (CTP)*, 23. *Dirección Nacional de Centros de Educación y Nutrición y de Centros Infantiles de Atención Integral (Dirección de CEN-CINAI)*, 24. *Dirección Nacional de Notariado*, 25. *Fondo de Desarrollo Social y Asignaciones Familiares (FODESAF)*, 26. *Fondo Nacional de Becas (FONABE)*, 27.

Fondo Nacional de Financiamiento Forestal (FONAFIFO), 28. Instituto sobre Alcoholismo y Farmacodependencia (IAFA), 29. Instituto Costarricense sobre Drogas (ICD), 30. Instituto Costarricense de Investigación y Enseñanza en Nutrición y Salud (INCIENSA), 31. Instituto Nacional de Innovación y Transferencia en Tecnología Agropecuaria (INTA), 32. Instituto de Desarrollo Profesional Uladislao Gámez Solano, 33. Junta Administrativa del Archivo Nacional (JAAN), 34. Junta Administrativa de la Dirección General de Migración y Extranjería, 35. Junta Administrativa de la Imprenta Nacional (JAIN), 36. Junta Administrativa del Registro Nacional, 37. Laboratorio Costarricense de Metrología (LACOMET), 38. Museo de Arte Costarricense, 39. Museo de Arte y Diseño Contemporáneo (MADC), 40. Museo Histórico Cultural Juan Santamaría, 41. Museo Nacional de Costa Rica (MNCR), 42. Museo Dr. Rafael Ángel Calderón Guardia, 43. Oficina de Cooperación Internacional de la Salud (OCIS), 44. Patronato de Construcciones, Instalaciones y Adquisiciones de Bienes, 45. Servicio Fitosanitario del Estado, 46. Servicio Nacional de Salud Animal (SENASA), 47. Sistema Nacional de Áreas de Conservación (SINAC), 48. Sistema Nacional de Educación Musical (SINEM), 49. Teatro Nacional (TNCR), 50. Teatro Popular Melico Salazar (TPMS), and 51. Tribunal Registral Administrativo (TRA).

Data from *Unidad Ejecutora del Proyecto* (UEP) was included in the historical series presented in the program document in 2019. From 2020 onwards, data related to UEP is already included in the budgetary central government.

I. PERFORMANCE CRITERIA

A. Performance Criterion on Central Government Primary Balance

6. The overall balance of the Central Government is defined as the difference between budgetary revenue and total expenditure. Cash primary balance is defined as the overall balance excluding net interest payment. Revenue data are registered on a cash basis, whilst expenses are accruals except in the case of interest, which are recorded when disbursements are made. Capital expenditure reflects the accrued amounts recorded under investment projects, not fully reconciled with the concept of the transactions categorized as net acquisition of nonfinancial assets. This system is internationally known as modified cash. The proceeds from privatization or commercialization of public assets to residents or non-residents will not be recorded as part of central government revenues. The consolidation of the data from entities contained in paragraph 5 and the other entities of the central government as well as the consolidation of data within the entities included above consider funds granted as both current and capital transfers. The consolidation process is done entity by entity and never aggregated. Whenever consolidation adjustments are necessary to maintain primary and overall balance unalterable, following international best practices, these residuals affect capital transfers (income and/or expense). Financing (below the line) data are not currently used for the calculation of primary or overall balance. Any variable or definition that is omitted but is relevant for primary balance is defined in accordance with the Fund's statistical manuals and shall be aligned with the framework of a modified cash approach. Figures until 2018 do not comprise the entities included in paragraph 5. For the purpose of program monitoring, the cash primary balance of the central government will be monitored from above the line data as described in the previous paragraph.

7. The performance criterion on the central government cash primary balance will have one adjustor for 2022 and 2023. The floor on the central government cash primary balance will be adjusted downward by the full amount of any increase in COVID-19 emergency spending compared to budgeted amounts such as transfers to the health system, transfers for targeted support to families, workers, and firms heavily affected by the pandemic, or social assistance programs to the most vulnerable groups. Such additional expenditure should be clearly identified and reflected in an appropriate document (e.g., supplementary budget, government resolution, a circular of the MOF). The adjustor is capped at CRC 95 billion for 2023 (about 0.2 percent of GDP) cumulatively.

B. Performance Criterion on Net Official International Reserves

8. For the purpose of program monitoring, net official international reserves (NIR) will be measured as the U.S. dollar value of the difference between (a) and (b) below, and will be called the "Program NIR":

a) Gross international reserves of the BCCR. They include monetary gold; foreign exchange balances (foreign currency cash, deposits with foreign correspondents, and holding of foreign securities); the reserve position at the IMF and SDR holdings. Excluded from gross foreign reserve assets are participation in international financial institutions; holdings of nonconvertible currencies; holdings of precious metals other than monetary gold; claims on residents (e.g., statutory reserves on foreign currency deposits of commercial banks and central bank foreign currency deposits with resident commercial banks); pledged, non-liquid, collateralized or otherwise encumbered foreign assets; and claims in foreign exchange arising from derivative transactions (such as futures, forwards, swaps and options).

b) Gross reserve-related liabilities of the BCCR. They include: all short-term liabilities to nonresidents denominated in convertible foreign currencies with an original maturity of one year or less; all short-term liabilities to residents denominated in convertible foreign currencies; the stock of IMF credit outstanding; the nominal value of all short-term derivative positions (including swaps, options, forwards, and futures), implying a sale of foreign currency or other reserve assets. Excluded from these liabilities are foreign exchange liabilities to the general government or related to deposit guarantees.

- At end-2021, the Program NIR, evaluated at market exchange rates, stood at US\$2,884 million. Targets for the Program NIR are set for cumulative flows from the end of the previous year. To calculate the cumulative flows, the Program NIR at the test dates and the end of the previous year are evaluated at the program exchange rates and gold price specified in paragraph 4.
- The following adjustment will apply:

9. If (i) the amount of foreign program financing by the central government and the BCCR net of IMF purchases (GRA and RST resources) and all debt service; (ii) the amount of external commercial borrowing (including international sovereign bonds and syndicated loans) by the central

government net of debt service; (iii) the amount of project loans and grants disbursed to the central government net of debt service; (iv) the amount of foreign exchange-denominated domestic debt issued by the central government net of debt service; and (v) proceeds from commercialization of public assets to non-residents;—as set out in Table 1 of the MEFP—are higher/lower in U.S. dollar terms than assumed under the program, the floor on the program NIR will be adjusted upward/downward by the cumulative differences on the test date. The proceeds from commercialization of public assets are defined as cash receipts from the sale or lease of publicly held assets. Such assets will include, but not be limited to, publicly held land, public holdings of infrastructure or commercial real estate, and public or quasi-public enterprises. These adjustors will apply to the NIR floor for end-July 2021 and thereafter.

10. If the sum of amortization of official external debt and interest payments on official external debt by the central government or the BCCR in U.S. dollar terms—as set out in Table 1 of the MEFP—is higher/lower than assumed under the program, the floor on the program NIR will be adjusted downward/upward by the cumulative differences on the test date. Official external debt refers to external debt owed to multilateral and official bilateral creditors, as defined in the *2013 External Debt Statistics: Guide for Compilers and Users*. These adjustors will apply to the NIR floor for end-July 2021 and thereafter.

II. CONTINUOUS PERFORMANCE CRITERIA

A. Performance Criterion on New External Payment Arrears by the Nonfinancial Public Sector and the BCCR

11. A continuous performance criterion applies to the non-accumulation of new external payments arrears on external debt contracted or guaranteed by the nonfinancial public sector and the BCCR. The nonfinancial public sector is defined following the 1986 Government Finance Statistics Manual and the 2008 System of National Accounts. It includes (but is not limited to) the central government as defined in paragraph 4 and nonfinancial public enterprises, i.e., boards, enterprises and agencies in which the government holds a controlling stake. External payments arrears consist of debt-service obligations (principal and interest) to nonresidents falling due after the date of Board approval of the arrangement that have not been paid at the time they are due, as specified in the contractual agreements, subject to any applicable grace period. However, overdue debt and debt service obligations that are in dispute by the authorities with respect to their amount and/or validity will not be considered as external payments arrears for the purposes of program monitoring. This PC also excludes arrears on external financial obligations of the government subject to rescheduling. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

III. MONETARY POLICY CONSULTATION CLAUSE

12. The inflation target bands are specified in Table 1 attached to the MEFP. For this purpose, the year-on-year inflation, as measured by the headline Consumers Price Index (CPI) published by the National Institute of Statistics and Census (INEC), for each test date is measured as follows:

$$\{CPI^*(t) - CPI^*(t-12)\} / CPI^*(t-12) * 100$$

where

t = the month within which the test date is included

CPI(t) = CPI index (all items) for month t

CPI(t-k) = CPI index (all items) as of k months before t

$CPI^*(t) = \{CPI(t-2) + CPI(t-1) + CPI(t)\} / 3$

$CPI^*(t-12) = \{CPI(t-14) + CPI(t-13) + CPI(t-12)\} / 3$

If the observed year-on-year inflation falls outside the outer band limits of +/- 3 percentage points around the targets as specified in Table 1 attached to the MEFP for the relevant semi-annual test dates, the authorities will complete a consultation with the IMF Executive Board, which would focus on (i) the stance of monetary policy and whether the Fund-supported program remains on track; (ii) the reasons for deviations from the specified band, taking into account compensating factors; and (iii) on proposed remedial actions, as deemed necessary. When the consultation with the IMF Executive Board is triggered, access to Fund resources would be interrupted until the consultation takes place and the relevant program review is completed. If the observed year-on-year inflation falls outside the inner band limits of +/- 1.5 percentage points around the targets for the relevant semi-annual test dates, the authorities will conduct a consultation with IMF staff on the reasons for the deviation and the proposed policy response.

IV. INDICATIVE TARGETS

A. Indicative Target on Debt Stock of the Central Government

13. The term “debt”, as defined in the Guidelines on Public Debt Conditionality in IMF Arrangements, Decision No. 15688-(14/107), will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debt can take a number of forms, the primary ones being loans, debt securities, bonds, commercial loans, buyers’ credits and off-budget project loans.

14. All foreign currency denominated debt will be converted into colones using the program exchange rates set out in Table 1. All domestic debt denominated in inflation-indexed units (TUDES) will be converted into colones using the program rate set out in Table 1.

15. The performance criterion on debt stock of the central government will have one adjustor for 2023. The ceiling on debt stock of the central government will be adjusted upward by the full amount of any increase in COVID-19 emergency spending compared to budgeted amounts such as transfers to the health system, transfers for targeted support to families, workers, and firms heavily affected by the pandemic, or social assistance programs to the most vulnerable groups. Such additional expenditure should be clearly identified and reflected in an appropriate document (e.g., supplementary budget, government resolution, a circular of the Ministry of Finance (MOF)). The adjustor is capped at CRC 95 billion.

V. DATA REPORTING REQUIREMENTS

16. Costa Rica shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Costa Rica in achieving the objectives and policies set forth in the Memorandum of Economic and Financial Policies and Letters of Intent. All the program monitoring data will be provided by the MOF, IMAS, FODESAF, BCCR, and SUGEF. For the purpose of monitoring the fiscal performance under the program, data will be provided in the format shown in Tables 2, 3, and 4. For the purpose of monitoring the external sector performance under the program, data will be provided in the format shown in Tables 5 and 6. For the purpose of monitoring priority social spending, data will be provided in the format shown in Table 7. For the purpose of monitoring financial sector performance under the program, data will be provided as described in paragraph 20.

17. Data relating to the fiscal targets (Tables 2, 3, and 4) will be furnished within the following timelines:

- Data on the cash primary balance of the central government will be provided on a monthly basis, no later than three weeks after the end of the month to which the cash balance is calculated.
- Data relating total stock of debt of the central government will be provided on a monthly basis, no later than three weeks after the end of the month, with breakdowns listed in Table 4.

18. Data relating to the external targets (Table 5) and monetary consultation band will be furnished within no more than three weeks after the end of each month, except for data on official reserve assets (Table 6), which will be furnished within one week after the end of each week.

19. Data regarding the level of social safety net spending (program spending only, not including wage and salaries and administrative costs of relevant agencies; see Table 7) will be provided on a quarterly basis, no later than four weeks after the end of the quarter.

20. Data relating to the financial sector will be reported as follows:

- Financial soundness indicators of banks and cooperatives, bank by bank, group (public and private), and system level. Data will be reported monthly, no later than four weeks after the end of each month.
- Anonymized bank-by-bank asset quality indicators, according to various disaggregations such as asset classification and provisioning by currency and type of credit, currency and economic sector. Data will be reported on a monthly basis, no later than four weeks after the end of each month. Such data on individual banks will be treated as strictly confidential and will not be published except in aggregate form.

Table 2. Costa Rica: Central Government Operations^{1/}
(In billions of colones)

Total Revenue

Current Revenue

Income Tax

Tax on Income and Profits
Income and to natural and legal per
Income and to Individuals
Revenue and Profit Corporations
Dividends and interest s / Securities
Remittances Abroad
Banks and non-domiciled Financ

Property Tax

Owned vehicles
Supportive Housing Imp

Import Tax

Tariff:
1% Customs Value:

Export Tax

Exported Banana Case
Der.de Exp.ad / valorem

Sales Tax

Internal
Customs

Consumption Tax

Internal
Customs

Undistributed Customs

Indirect Tax

Single tax fuels
Tax soft drinks
Tax soap
Alcohol tax
Transfer used vehicles
Transfer property
Fiscal Stamp
Exit fees Homeland
Consular Rights
Tax Law on Migration and Aliens
Tax on Tobacco
Other tax revenue

Social Security Contributions

Non Tax

Current transfers

Capital Income

Recovery of Loans

Capital Transfers

Donation

Admin.Finan Act. (Cash only)

Table 2. Costa Rica: Central Government Operations (concluded)^{1/}
(In billions of colones)

Total Expenditure

No Interest Expense Total
 Current expenses
 Salaries
 Wages and salaries
 Social Security Contributions
 Social Security Contributions CCSS
 Social Security Contributions Worker Protection Act
 Social Security Contributions Others
 Purchase of Goods and Services
 Interest Expenditure
 Internal Interest Expenditure
 Interest Expenditure External
 Transfers
 Transfers Private Sector
 Pensions (including CCSS)
 Transfers Others
 Transfers Public Sector
 Transfers External Sector
 Transfers Ctes with external resources
 Capital Expenditure
 Investment
 Capital Transfers
 Capital Transfers Private Sector
 Capital Transfers Public Sector
 Capital Transfers External Sector
 Capital with external resource transfers
 Capitalization banks

Primary Balance

Overall Balance

Residual

Total Financing

Net Domestic Financing
 Net Foreign Financing
 Privatization

1/ As agreed for the purpose of monitoring the program.

Table 3. Costa Rica: Central Government Financing^{1/}
(In billions of colones)

Financing

Net Domestic Financing

Net BCCR Financing

BCCR Renegotiated debt

Deposits BCCR

Deposits BCCR Initial Balance

Deposits BCCR Final Balance

BCCR Net loans

Banking System Financing

Banking System Financing Loans

Banking System Financing Amortization

Banking System Financing Deposits

Banking System Financing Var. Securities

Banking System Financing Var. Securities Initial Balance

Banking System Financing Var. Securities Final Balance

Banking System Financing Cash and Banks

Banking System Financing Cash and Banks Initial Balance

Banking System Financing Cash and Banks Final Balance

Banking System Financing Net Loans

Central Government Financing

Central Government Financing Amortization of government

Central Government Financing Change in Government Securities

Central Government Financing Change in Government Securities Initial Balance

Central Government Financing Change in Government Securities Final Balance

Other domestic financing

Other domestic financing Credit providers

Other domestic financing Disbursements

Other domestic financing Amortizations

Other domestic financing Var. Dep in other entities

Other domestic financing Var. Dep in other entities Initial Balance

Other domestic financing Var. Dep in other entities Final Balance

Other domestic financing Other financ. internal

Other domestic financing Exchange Losses

Other domestic financing Net loans

Net Foreign Financing

Net Foreign Financing Disbursements

Net Foreign Financing Amortization

Net Foreign Financing Var. Dep abroad

Net Foreign Financing Var. Dep abroad Initial Balance

Net Foreign Financing Var. Dep abroad Final Balance

1/ As agreed for the purpose of monitoring the program.

Table 4. Costa Rica: Central Government Debt^{1/}

(In billions of colones)

Debt stock

Domestic

- Bonds

Tasa basica

Zero coupon colones

Zero coupon dolares

Fixed coupon colones

Fixed coupon dolares

Floating coupon colones

Floating coupon dolares

Inflation-linked bond (TUDES)

- Other liabilities

External

- Bilateral

- Bonds

- Multilateral

Unidentified financing

Domestic debt stock by maturities

o.w.: OD domestic debt by maturities

External debt stock by maturities

o.w.: OD external debt by maturities

Total borrowing requirement**Financial deficit of CG****CG debt amortization**

Domestic

o.w.: OD domestic debt amortization

External

o.w.: OD external debt amortization

- Bilateral

- Bonds

- Multilateral

Source of funds

Domestic placement or disbursement

External placement or disbursement

- Bilateral

- Bonds

- Multilateral

Use of government deposits

1/ As agreed for the purpose of monitoring the program.

Table 5. Costa Rica: Foreign Exchange Cashflows of the Central Bank and the Government^{1/}

(In millions of U.S. dollars)

1. Total Inflows

- Official sector disbursement
 - Program loans
 - IMF
 - World Bank
 - IDB
 - CABEI
 - ADF
 - CAF
 - Project loans and grants, of which
 - World Bank
 - IDB
 - CABEI
 - bilateral: KFW/JICA/China Eximbank
- Commercial loans
 - Syndicated loans
 - Sovereign bond, incl Eurobonds
- Domestic FX debt issuance
- Other inflows
 - BCCR Interest receipts and other net items
 - Change in balances in public accounts
 - o/w proceeds from public asset sale

2. Total outflows

- External debt service
 - Amortization (excl. to IMF), of which:
 - Official loans, of which:
 - World Bank
 - IDB
 - CABEI
 - CAF
 - Bilaterals: AFD/KFW/JICA/Eximbank
 - Commercial loans
 - Syndicated loans
 - Sovereign bonds
 - Interest payment (incl. to IMF)
- Domestic FX debt service
 - Residents
 - Non-residents
- Net capital transfers and miscellaneous

3. Net FX intervention, of which

- Net intervention for volatility management
- Programmed reserve accumulation
- Net FX purchases for rest of public sector

4. Other net flows

- Net Central Government<-->BCCR transactions^{1/}
- Change in short-term liabilities with non-residents
- Change in liabilities w/ residents

Net International Reserves (at market exchange rates)^{2/}

Net International Reserves (at program exchange rates)^{2/}

Gross International Reserves (at market exchange rates)

1/ As agreed for the purpose of monitoring the program.

2/ As defined in TMU ¶18.

Table 6. Costa Rica: Gross Official Reserve Position^{1/}
(In millions of U.S. dollars)

Date	Central Bank		Reserve Position at IMF & SDR holdings	Total (1)+(2)	Government	Gross Official Reserves (3) + (4)	Liabilities			Net International Reserves (5) - (9)
	Reserves managed by BCCR				Foreign Reserve Asset Balances		Short-term Liabilities with Residents	Short-term Liabilities with Non-Residents	Drawings from the IMF		Total (6)+(7)+(8)
	Foreign Assets (FA) (Without DA)	Domestic Assets (DA)								
	1	2	3	4	5	6	7	8	9	10

^{1/} As agreed for the purpose of monitoring the program.

Table 7. Costa Rica: Priority Social Spending^{1/}
(In billions of Colons)

	FODESAF	Central Govt transfers	Other sources of financing	Total public sector spending	Number of beneficiaries
1. Non-contributory pensions and healthcare					
1.1. Non contributory pensiones regime (RNC)					
2. Targeted social assistance programs					
2.1. Conditional cash transfer <i>Creceemos</i> ^{2/}					
2.2. Conditional cash transfer <i>Avancemos</i>					
2.3. Poverty reduction and income support					
2.3.1. Basic needs (Atención a Familias)					
2.3.2. Family allowance (Asignación Familiar)					
2.3.3. Emergencies					
2.3.4. Fishing subsidies (Veda)					
2.4. Childcare					
2.4.1. Childcare transfer					
2.4.2. Childcare transfer CIDAI					
2.4.3. Childcare services (API intramuros)					
2.5. School programs					
2.5.1. School lunch program					
2.5.2. School transportation					
2.5.3. Social scholarship program ^{3/}					
2.6. Housing subsidies					
2.6.1. Housing improvement					
2.6.2. Housing grants					
2.7. Food security and nutrition programs					
2.7.1. Prestación alimentaria					
2.8. Active labor market programs					
2.8.1. Employment National Program (PRONAE)					
2.8.2. Small enterprises' support program (PRONAMYPE)					
2.8.3. Productive ideas					
2.8.4. Training aid					
2.8.5. Training voucher program ^{4/}					
2.9. Other targeted programs					
2.9.1. Subsidies for elderly persons					
2.9.2. Subsidies for persons with disabilities					
2.9.3. Subsidies for violence female victims					
2.9.3. Subsidies for teenage mothers					
3. Capital transfers to social assistance programs					
3.1. Community infrastructure and socio-productive projects					
TOTAL					

^{1/} As agreed for the purpose of monitoring the program.

^{2/} Creceemos program will be merged under Avancemos program starting in 2022.

^{3/} Since 2020, the program reports only tertiary education scholarship information, with primary education scholarships information (that used to be reported under this program) consolidated under Creceemos.

^{4/} Starting in 2022, this program will provide support to students enrolled in private institutions' training programs when the National Institute of Apprenticeship (INA) cannot provide the service directly.



COSTA RICA

December 6, 2023

STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION, FIFTH REVIEW UNDER THE EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY, SECOND REVIEW UNDER THE RESILIENCE AND SUSTAINABILITY FACILITY AND REQUEST FOR MODIFICATION OF REFORM MEASURE—INFORMATIONAL ANNEX

Prepared by:

The Western Hemisphere Department (in consultation with
other departments)

CONTENTS

FUND RELATIONS	2
RELATIONS WITH OTHER FINANCIAL INSTITUTIONS	4
STATISTICAL ISSUES	5

FUND RELATIONS

(As of October 31, 2023)

Membership Status: Joined: January 8, 1946; Article VIII

General Resources Account:	SDR Million	% Quota
Quota	369.40	100.00
IMF's Holdings of Currency (Holdings Rate)	1,492.50	404.03
Reserve Tranche Position	71.34	19.31

SDR Department	SDR Million	% Allocation
Net cumulative allocation	510.59	100.00
Holdings	438.57	85.89

Outstanding Purchases and Loans:		
Emergency Assistance ^{1/}	369.40	100.00
Extended Arrangements	825.03	223.34

^{1/} Emergency Assistance may include ENDA, EPCA, and RFI.

Latest Financial Commitments

Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
EFF	Mar 01, 2021	Jul 31, 2024	1,237.49	825.03
RSF	Nov 14, 2022	Jul 31, 2024	554.10	0.00
Stand-By	Apr 11, 2009	Jul 10, 2010	492.30	0.00

Outright loans:

Type	Date of Commitment	Date Drawn	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
RFI	Apr 29, 2020	Sep 15, 2020	369.40	369.40

Projected Payments to Fund

(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2023	2024	2025	2026	2027
Principal	46.18	184.70	138.53	51.58	103.13
Charges/Interest	18.65	68.45	55.14	47.54	42.62
Total	64.82	253.15	193.66	99.11	145.75

Exchange Rate Arrangement. Costa Rica's currency is the Costa Rican *Colón*. Costa Rica's de jure current exchange rate arrangement classification is managed floating, and the de facto exchange rate is classified as floating. All foreign exchange transactions are conducted at the market-determined exchange rate. The central bank is committed to allowing the exchange rate to be freely determined by foreign currency supply and demand but reserves the right to participate in the market to meet its own foreign currency requirements and those of the nonbank public sector, and to address sudden movements in the exchange rate without changing the trend in this macro price. Costa Rica maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions.

Article IV Consultation. The last Article IV consultation was concluded on March 1, 2021 ([Country Report No. 21/48](#)).

FSAP/FSSR Participation and ROSCs. The Financial Sector Assessment Program (FSAP) took place in 2001 and was updated in 2008. A Financial Sector Stability Review (FSSR) mission was conducted in 2017. A data ROSC took place in 2002 with a reassessment in 2010. A fiscal ROSC took place in 2007, with a reassessment in 2013.

Safeguards Assessment. An update safeguards assessment of the BCCR was finalized in October 2020. Since the last assessment in 2009, the BCCR has enhanced safeguards in its external audit mechanism and financial reporting, but some areas for improvement remain in the legal framework and governance arrangements. The authorities have submitted a proposal for limited legal amendments to the Legislative Assembly that would address transparency and accountability of the BCCR and make some progress on autonomy by removing the Minister of Finance from the Board of Directors. These legal amendments are still to be considered by the Legislative Assembly. However, comprehensive legal reforms are still needed to strengthen the BCCR's autonomy and decision-making structures, clearly distinguish between executive and oversight functions, and fill a current vacancy on the BCCR Board. Staff will continue monitoring the implementation of these recommendations per the safeguards policy for as long as Fund credit remains outstanding.

Technical Assistance (TA) and Capacity Development CD.

Costa Rica's capacity development (CD) efforts since the 2021 Article IV Consultation are aligned with the reform objectives under the EFF and RSF arrangements. CD priorities include improving fiscal institutions, strengthening the central bank's autonomy and governance, financial sector supervision and crisis management, and advancing structural reforms to incentivize private investment and foster green and inclusive growth. The authorities' engagement and ownership of these issues remain strong. Given the heavy use of CD from the Fund and other partners, integration between CD activities and program priorities as well as coordination with other technical assistance is ongoing and is facilitated through regular publications (see for example Annex 1 of [IMF Country Report No. 23/231](#), published in June 2023).

RELATIONS WITH OTHER FINANCIAL INSTITUTIONS

A. World Bank

<https://www.worldbank.org/en/country/costarica>

B. Inter-American Development Bank

<https://www.iadb.org/en/who-we-are/country-offices/costa-rica>

C. Development Bank of Latin America (CAF)

<https://www.caf.com/en/countries/costa-rica>

D. Central American Bank for Economic Integration (CABEI)

<https://www.bcie.org/en/member-countries/founders/republic-of-costa-rica>

STATISTICAL ISSUES

(As of October 2023)

General: Data provision is broadly adequate for surveillance. The quality of macroeconomic data has continued to improve in recent years. Further statistical improvements are being pursued, including in the real, fiscal, monetary, and balance of payments sectors. The Central Bank, the Ministry of Finance, and the National Institute of Statistics and Census make data available to the public through regular official publications on their websites (www.bccr.fi.cr, www.hacienda.go.cr, and <https://inec.cr>).

National accounts: National accounts are compiled generally in accordance with the *System of National Accounts 2008 (2008 SNA)*. The Central Bank disseminated the annual national accounts data for the years 1991-2022 and quarterly estimates up to 2023 Q3 (preliminary). Quarterly estimates are released with around a 90-day lag and a 30-day lag for the preliminary estimate. The benchmark year was revised to 2017 (from 2012) for the chained volume measures in late 2020, and national account data reflecting this revision were published in January 2021. Estimation of real estate activities including owner-occupied housing has been improved. In the new system, deflation methods have been improved to obtain annual value added in constant prices. Changes in inventories are largely obtained following the *2008 SNA* recommendations for those products for which enough information is available, though TA recently recommended improvements to estimates for cattle and poultry. The informal activity of households as producers of goods and services is included in GDP levels (but not separately estimated).

Price statistics: Consumer price index (CPI) compilation generally follows the concepts and definitions of the CPI Manual. Its structure, scope, and coverage were updated in January 2021. The index reference period is December 2020. The CPI weights are based on the 2018/2019 Income and Expenditure Survey. The index only covers resident urban households. These comprise approximately 71 percent of the total population and 80 percent of the total consumption expenditures of Costa Rica. Atypical movements in the data are investigated and corrected when necessary.

The Producer Price Index (PPI) generally follows the concepts and definitions of the PPI Manual, and is calculated both by product and economic activity (for manufacturing and selected services activities). The base year of the PPI for domestic manufacturing and for services (transportation, accommodation and food services, and professional services) is 2012.

Government Finance Statistics: The concepts and definitions used in compiling GFS for surveillance generally follow the guidelines of the Government Finance Statistics Manual 1986. For Article IV and program purposes, cash balances of the budgetary central government are used, consistent with the authorities' widely disseminated fiscal outturn updates and medium-term fiscal framework. However, CAPTAC-DR together with STA are supporting the authorities to compile and report GFS following the Government Finance Statistics Manual 2014 (GFSM 2014). The implementation of the GFSM 2014 framework was slowed by a cyberattack in April 2022, but

significant milestones have been achieved. Notably, since March 2023, the authorities have compiled and published monthly GFS statistics for consolidated central government revenues and expenditures (above the line) aligned with the GFSM 2014 but excluding accrued interest. Costa Rica subscribes to the Special Data Dissemination Standards (SDDS) and these monthly central government finance statistics can be accessed through their National Summary Data Page (NSDP). The authorities regularly report annual data for the *GFS Yearbook* to STA, with partial general government coverage using GFSM 2014 standards, most recently for 2021.¹ Annual statistics are compiled and disseminated for the entire public sector and its subsectors but not using GFSM 2014 standards and at times with a delay.

On Public Sector Debt Statistics (PSDS), the market of issuance (Costa Rica or abroad) criterion is followed to classify domestic and foreign debt, instead of the internationally recommended holder residency criterion. The authorities compile and disseminate quarterly PSDS for the general government to the joint World Bank/IMF database with the latest data for 2023 Q1. The authorities together with the Fund (CAPTAC-DR, STA and WHD country team) are advancing towards improving the quality and broadening the compilation and disseminating GFS and PSDS beyond central government as guided by GFSM 2014.

Fiscal data discrepancies among national compilers on specific items are not regularly reconciled, although large fluctuations or discrepancies are investigated. Fiscal statistics are not regularly reconciled with monetary or other macroeconomic statistics. Fiscal outturns are queried by the Comptroller of the Republic, in part because the government does not record third-party claims that are not budgeted, which is a necessary condition for payment. The Comptroller also reports difficulties in assessing fiscal rule compliance beyond the central government.

Earlier, the incorporation of 51 decentralized institutions into budgetary central government starting in 2021 was supported by CAPTAC-DR's TA; data in the IMF staff report are adjusted back to 2019 for comparability.

Monetary and Financial Statistics: The Central Bank of Costa Rica (BCCR) reports the Standardized Report Forms (SRFs) for the central bank, other depository corporations, other financial corporations, and for monetary aggregates for publication in the IMF's *International Financial Statistics (IFS)* on a monthly basis with a lag of one month. The reported monetary statistics are broadly in line with the methodology of the *Monetary and Financial Statistics Manual (MFSM)*. The BCCR has expanded the coverage of the monetary statistics to include money-market investment funds (MMF) in the 2SR, non-MMF investment funds, pension funds, and insurance companies in the 4SR. The BCCR reports data on some key series and indicators of the Financial Access Survey (FAS), including the two indicators (commercial bank branches per 100,000 adults and ATMs per 100,000 adults) adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals (SDGs).

¹ Costa Rica regularly reports to STA annual data using the format of GFSM 2014. The institutional coverage for Revenues and Expenses is General Government, but for Transactions and Stocks of assets and liabilities, it is Budgetary Central Government plus the Social Security Fund.

Financial sector surveillance: Costa Rica reports 15 out of 18 core financial soundness indicators (FSIs), 11 additional FSIs for deposit takers, and 2 additional FSIs for real estate markets on a monthly basis for posting on the IMF's FSI website with less than one quarter lag. Costa Rica has implemented the new FSI templates in line with the 2019 FSIs Guide.

External sector statistics: The BCCR compiles and disseminates quarterly balance of payments and international investment position (IIP) statistics, which are produced on a sixth edition of the Balance of Payments and International Investment Position Manual (BPM6) basis. Source data are generally adequate and derived from sound collection programs and work is still ongoing to improve the coverage of financial transactions of the nonfinancial private sector (such as those related to trade credit and advances), and remuneration of employees.

The BCCR also compiles and disseminates on a monthly basis the Data Template on International Reserves and Foreign Currency Liquidity, reports semi-annual data to the Coordinated Portfolio Investment Survey (CPIS) and annual inward and outward Coordinated Direct Investment Survey (CDIS), and submits quarterly external debt statistics to the Quarterly External Debt Statistics (QEDS) database.

Data Standards and Quality: Costa Rica is in observance with the Special Data Dissemination Standards (SDDS). Data Module Report on the Observance of Standards and Codes (ROSC) was published in February 2010.

Costa Rica: Table of Common Indicators Required for Surveillance

(As of October 31, 2023)

	Date of latest observation	Date received	Frequency of Data ⁷	Frequency of Reporting ⁷	Frequency of Publication ⁷
Exchange Rates	10/30/2023	10/31/2023	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	Sep 23	Oct 23	M	M	M
Reserve/Base Money	Sep 23	Oct 23	M	M	M
Broad Money	Aug 23	Oct 23	M	M	M
Central Bank Balance Sheet	Sep 23	Oct 23	M	M	M
Consolidated Balance Sheet of the Banking System	Aug 23	Oct 23	M	M	M
Interest Rates ²	Sep 23	Oct 23	M	M	M
Consumer Price Index	Sep 23	Oct 23	M	M	M
Revenue, Expenditure, Balance, and Composition of Financing ³ – Central Government ⁴	Sep 23	Oct 23	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt ^{4, 5}	Sep 23	Oct 23	M	M	M
External Current Account Balance	2023 Q2	Sep 23	Q	Q	Q
Exports and Imports of Goods and Services ⁶	2023 Q2	Sep 23	Q	Q	Q
GDP/GNP	2023 Q3	Oct 23	Q	Q	Q
Gross External Debt	2023 Q2	Sep 23	Q	Q	Q
International Investment Position	2023 Q2	Sep 23	Q	Q	Q

¹ Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

² Both market-based and officially-determined, including discounts rates, money market rates, rates on treasury bills, notes, and bonds.

³ Foreign, domestic bank, and domestic nonbank financing.

⁴ Data for 2020 and earlier years do not cover the public entities that, starting in 2021, are required to be consolidated under central government by Law 9524.

⁵ Including currency and maturity composition.

⁶ Goods trade data release is monthly with a one-month lag; services trade data release is quarterly at the time of current account balance release.

⁷ Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).



COSTA RICA

December 6, 2023

STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION, FIFTH REVIEW UNDER THE EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY, SECOND REVIEW UNDER THE RESILIENCE AND SUSTAINABILITY FACILITY AND REQUEST FOR MODIFICATION OF REFORM MEASURE

WORLD BANK ASSESSMENT LETTER FOR THE RESILIENCE AND SUSTAINABILITY FACILITY

A. Climate Change Implications for Costa Rica

1. Costa Rica’s economic progress over the last two decades allowed it to become more resilient to exogenous shocks, including climate events. Costa Rica doubled its income per capita during this period, relying on relatively solid institutions, an outward-oriented growth model and investments in human capital. The country upgraded and diversified its exports, increasing resilience to external shocks, and invested in preparedness against domestic shocks, including related to natural disasters. Improvements in institutional capacity with respect to multi-sectoral coordination and implementation of sector-specific policies have been critical for preparedness. However, fiscal vulnerabilities built up during this period, as spending increased while revenues stayed flat. Fiscal space is currently limited, reducing the potential for increasing public investment in the short run. In this context, it is critical to continue pursuing a fiscal consolidation and rebuilding fiscal buffers for implementing decarbonization related investments as well as navigating climate related shocks.

2. Climate change affects Costa Rica through intensification of extreme climate events and natural hazards and through key economic sectors. Despite recent achievements, Costa Rica still ranks 61 out of 182 countries in the 2022 ND-GAIN Index¹. Approximately 6.8 percent of its total area is exposed to three or more adverse natural events. Around 80 percent of Costa Rica’s population reside in areas at high risk of multiple hazards. In 1998-

¹ The Notre Dame Global Adaptation Initiative (ND-GAIN) Index ranks 182 countries using a score which calculates a country’s vulnerability to climate change and other global challenges as well as their readiness to improve resilience.

2018, infrastructure damage from rains and droughts averaged 0.7 percent of GDP². Studies suggest that climate change could increase the frequency of occurrence of weather-related events and the intensity of these phenomena. In a high-risk scenario, damage could rise to 1.6 to 2.5 percent per year over the medium term. Natural disasters have complex, interrelated effects on Costa Rica's people through death, disease, displacement, loss of physical assets, and disruptions in income and key services such as health and education. This could lead to long lasting impacts on growth, fiscal, poverty and vulnerability. Natural disasters disrupt the country's buoyant tourism sector, for example through coastal flooding from rising seas and storms. Agriculture is vulnerable to extreme events, including floods and droughts, as well as rising temperatures and desertification driven by poor land use practices. Key crops such as coffee beans, and bananas will be negatively affected. Changing rainfall patterns can also affect hydroelectric powerplants which account for most of the energy produced in Costa Rica. These could have significant fiscal and financial implications and affect long-term growth.

3. Costa Rica's efforts to fight climate change and restore ecosystems have resulted in a significant reduction of greenhouse gas (GHG) emissions per capita over the last decade, but this trend could reverse. Placing the sustainable use of natural resources at the core of its development strategy, Costa Rica has become the only tropical country in the world that has reversed deforestation, more than doubling its area covered by forests from 26 percent of its territory in 1983 to 59 percent today. National parks and protected areas comprise 26 percent of land area and contribute to a successful eco-tourism industry. The share of renewables in the energy sector is among the largest in the world. Wind technologies contributed significantly to electricity generation, allowing a drastic reduction in the use of oil during the last decade. Finally, Costa Rica has attracted multinational corporations with sustainable investments. Emissions amounted to a low 11.5 megatons in 2020 - below most upper middle-income countries. Emissions come mainly from transport (43 percent), agriculture (21 percent), industrial processes and production (9.6 percent). In the past, improvements in land and energy use have more than Executive branch but critical central bank governance and autonomy reform has stalled due to the lack of societal consensus. All reform measures for this RSF arrangement review have been completed.

B. Costa Rica's Policies and Strategies

4. Costa Rica has continuously strengthened disaster risk management and advanced policies in support of climate change adaptation. It has managed to limit vulnerabilities from climate change by: i) building an efficient disaster response system, ii) enforcing building codes, environmental standards, and land use planning³; iii) strengthening its institutional and legal framework, and iv) mainstreaming disaster risk management in its national development program. Costa Rica's National Adaptation Plan was launched in April, with key milestones for 2022-2026 across different sectors of the economy. The plan is aligned with the National Risk Management policy (2016-2030) and seeks to improve resilience in infrastructure, tourism, and water resources

² *Controlaría General de la República*, cited by Ministerio de Ambiente y Energía (ibid.)

³ Costa Rica Climate Risk Profile, World Bank 2022

management, including by incorporating climate consideration into public investment decisions. An insurance scheme for agriculture enhances financial resilience by allowing agricultural producers to insure their harvest against climate change risks. The authorities are also increasing forest biomass against impacts from tropical storms, such as landslides. Costa Rica also recently launched a disaster financing strategy⁴. Finally, the country's ongoing effort to rebuild fiscal buffers will be critical for dealing efficiently with climate events in the future.

5. Costa Rica's National Decarbonization Plan (NDP) outlines paths and actions to reach net-zero emissions by 2050⁵. The plan includes short, medium, and long-term goals related to emissions reductions in strategic sectors, such as transport, energy, and agriculture, among others. For the transport sector, the NDP focuses on enabling conditions and measures to promote the use of both public and private electric transportation, including through rebates and tariff schemes. For the agriculture sector, the NDP promotes technical and financial programs to help rural communities and small enterprises better manage land resources and access financing. For the energy system, the NDP foster system capacity for the electrification of the economy. The plan aims at increasing the flexibility and "intelligence" of energy infrastructure, allowing for the integration of distributed generation and demand management strategies, along with new technologies. These approaches also enable Costa Rica to maintain its high share of renewable energy as it meets increasing energy demand. Initial estimates suggest that the plan could generate a net economic benefit somewhere in the range of US\$50 billion derived from energy savings, reduced congestion, reduced accidents, improved air and water quality, increased productivity, and the benefits of ecosystem services for tourism, water, and soil health.

6. Going forward, continued progress towards decarbonization goals will require large investments and come with fiscal, economic, and social implications as well as opportunities. The cumulative investment (both private and public) needed to reach the set objective is estimated somewhere in the range of US\$30 billion until 2050.⁶ Yet, fiscal space to scale up public investment is currently limited. Decarbonization would also lead to economic-wide adjustments. Those could be triggered by shifts in relative prices of inputs, or policies to encourage the faster adoption of new (cleaner) technologies, shifting economic activity and job across sectors and regions. While the decarbonization process should be consistent with long term-growth objectives the transition can produce winners and losers and require mitigation measures, such as investments in human capital and skills needed in emerging segments to facilitate the transition or tailored social protection responses. At the same time, Costa Rica's global leadership in decarbonization also creates important opportunities, for example, allowing the country position itself as a low carbon exporter and a destination for sustainable investment, including by improving the readiness of its financial sector, for which Costa Rica is implementing the Greening the Financial System (NGFS) initiative. Costa Rica has succeeded in attracting sustainable FDIs.

⁴ Enacted by Executive Decree No. 43663-H, La Gaceta No 182, San Jose, Monday, September 26th, 2022.

⁵ Executive Decree no.41581- February, 2019.

⁶ World Bank TA associated with Fiscal Management and Decarbonization DPL (2021).

C. World Bank Engagement

7. The World Bank has been actively supporting a broad range of policies and initiatives implementing Costa Rica’s decarbonization and climate adaptation strategy through a combination of lending, technical assistance, and knowledge instruments and expect to continue this strategic engagement in the medium term. Activities include:

- **Climate adaptation:** Costa Rica was the first country to ever receive a Catastrophe Deferred Draw Down Option loan⁷ (CAT DDO) from the World Bank in 2008. This loan marked the beginning of a long-standing technical engagement with Costa Rica on DRM and climate adaptation activities⁸, including support to National Adaptation Plans, disaster financing strategy, assessment of contingent liabilities associated with natural disasters, among others. This program of knowledge and technical assistance has built the foundations for two lending operations: the Climate Change Resilience Recovery and Territorial Development (P178049), under preparation, which supports resilient infrastructure across the territory, and the Second Costa Rica CAT DDO (P179861), which recognize recent improvements in disaster risk management and complements Costa Rica disaster financing strategy.
- **Decarbonization Strategy:** The Fiscal and Decarbonization Management Development Financing series (2020-2023 – [P171912](#), [P174786](#), [P177029](#)) provided an umbrella for policy dialogue and technical assistance on decarbonization. The operation was informed by a knowledge program for Costa Rica and Central America more broadly⁹. The third pillar of the operation supports the implementation of reforms that assist a greener and more low-carbon post-COVID recovery. In particular, it supports the information infrastructure for monitoring, reporting, verifying, and registering GHG emissions to inform policy and investment decisions and enable carbon-market mechanisms. The operation also supports initiatives to motivate greater investments in, and faster deployment of, green and low-carbon technologies and practices, including inclusion of climate considerations in the assessment of financial sector risks, policies to facilitate electric mobility and climate friendly practices in agriculture. Finally, it helps advance a dialogue on strengthening the governance and transparency of institutions in the energy sector to enhance efficiency and help level the playing field for investments in renewable energy. The lending series has also provided a platform for integrating climate consideration in public finances. The World Bank participated in a joint climate-Public Expenditure and Financial Accountability (PEFA) and supported the inclusion of climate considerations in public investment management, integrating climate into appraisal methodologies. Costa Rica decarbonization efforts enable the country to be the first Latin America

⁷ Costa Rica CAT DDO (P111926, approved in August 2008)

⁸ Central America Disaster Risk Financing Technical Assistance (P172169), Sustainable urban & regional development: unlocking post-COVID transformational opportunities in Costa Rica (P175084)

⁹ Options for a Blue, Green and Climate Smart recovery in Costa Rica (P177951), Green Resilient and Inclusive Landscapes in Central America (P176670), Partnership for Market Readiness (P158795), Supporting a sound energy transition for an efficient Central America (P169052)

country to meet the conditions to access the first tranche (16 million) of the World Bank's Forest Carbon Partnership Facility (FCPF).¹⁰

¹⁰ The country's Emission Reductions Payment Agreement (ERPA -P160368) with the FCPF unlocks up to \$60 million across three scheduled payments, for reducing a total of 12 million tons of carbon emissions through to 2025, in line with the country's NDC commitment.

Statement by Mr. Guerra and Ms. Lankester Campos on Costa Rica
December 21, 2023

Our authorities want to thank staff for their close and active engagement to conclude the fifth review under the Extended Fund Facility (EFF) arrangement and the second review under the Resilience and Sustainability Arrangement (RSF). They would like to extend their appreciation to Mr. Ding Ding, the Mission Chief, and his team for their outstanding work, dedication, and open discussions with the authorities and civil society. Also, they welcome the valuable engagement with the Fund's capacity development and the collaborative work with the World Bank and the Interamerican Development Bank's staff.

The programs laid out by the Costa Rican authorities, and supported by the EFF and RSF, have been key tools to safeguard macroeconomic stability, anchor fiscal consolidation efforts, and strengthen the climate agenda in a context of ongoing economic and geopolitical uncertainty. As well, they have been instrumental in catalyzing financial and technical support from other multilateral institutions.

For the fifth review, Costa Rica's performance remains strong. Overall, fiscal consolidation has overperformed the government's and program's targets. The Central Bank has taken decisive actions to counter inflation and rebuild reserve buffers. Targets on the primary balance, government debt, and net international reserves (NIR) were met with sizable margins. The authorities report robust implementation of macroeconomic policies to achieve the main program objectives and significant progress on structural reforms. All performance criteria (PC) and indicative targets (IT) were met. Going forward, the policy stance remains focused on debt sustainability, with debt on a firm downward trend, and on being vigilant with inflation pressures to act in a timely manner.

On top of a very strong economic performance, all reform measures (RMs) of the RSF's second review were implemented. The RSF arrangement has built up over the country's already advanced efforts to promote a greener, more inclusive, and sustainable economy and has been instrumental in the continuity of the country's climate agenda. Also, it has been an anchor to further developments; specifically, our authorities are grateful to the IMF and its Climate Finance Task Force for facilitating a roundtable with other IFIs and private sector stakeholders about scaling up climate financing to support Costa Rica's climate agenda. As a result, during the COP28, the authorities announced their engagement with multilateral partners to launch a sustainable project preparation facility and crowd in climate investments to identify and prepare a pipeline of bankable projects.

From its track record, it is evident that our authorities stand ready to implement the necessary policy actions in response to external shocks such as geopolitical tensions (higher commodity prices and lower global growth), domestic challenges, and to mitigate the risks associated with climate change developments over the medium and long run.

Macroeconomic Performance

Amid a challenging international context, the Costa Rican economy has been resilient. In 2022, growth exceeded expectations with a 4.6 percent outturn, while the BCCR projects 5.0 and 4.3 percent for 2023 and 2024, respectively. In October 2023, the monthly index of economic activity was 6.6 percent y-o-y, 3.1 p.p. over last year's result. At this moment, the economy has grown over 6.0 percent for the past six months. The economy's dynamism is explained by construction, higher external demand, and the recovery of gross fixed capital formation as multinational firms choose Costa Rica for their relocation.

The labor market has also recovered significantly from pre-pandemic levels. The unemployment rate has decreased from its peak of 24.4 percent to 7.7 percent (11.4 percent a year before) when considering the moving quarter of August, September, and October 2023; still, there is a caveat as the participation rate has diminished to 53.7 percent from 60.3 percent a year before.

On inflation, the BCCR has remained vigilant and has responded in a timely manner to the shocks faced by the economy, evidencing its independence. In the latest world-inflationary chapter, the BCCR was one of the first central banks to raise and then lower its monetary policy interest rate (TPM) as inflationary pressures receded. Its decisions are data-dependent and forward-looking, which consider the risks that may affect the foreseen price trajectory of a small open economy. It is an Institution fully committed to its main objective as an inflation targeter. In ten months, from December 2021 until October 2022, the TPM was increased by 825 b.p.; annual inflation peaked at 12.13 percent in August 2022 and started a downward trend six months later. In March 2023, the BCCR lowered its policy rate, and since then it has decreased by 275 b.p. In November, there was a deflation rate of 1.64 percent y-o-y (1.77 accumulated deflation for 2023), while core inflation was 0.35 percent y-o-y. The median inflation expectation for 12 and 24 months was 2.0 and 3.0 percent, respectively (6.0 and 4.0 a year before). Broadly, these results reflect international price shock reversal, the cumulative effect of timely monetary policy decisions, local currency appreciation, and base effects. Inflation is expected to return to target, from below, by end-2024.

In line with the less restrictive monetary policy, liquidity has been ample, mainly due to the expansive effect of foreign currency purchases by the BCCR. Such operations were done in the context of abundant foreign currency availability in the FX market, which is explained by real sector operations such as economic activity growth, an increase in exports, and tourism in a context of commodity price stability. Given the high availability of foreign exchange, the BCCR has acted as a net buyer on behalf of the non-financial public sector, NFPS, and to strengthen its reserves. Because of the FX purchases by the BCCR, the issuance of a US\$1.5 billion Eurobond, and multilateral funding inflows, gross international reserves by end-November were US\$12,877 million, well above the IMF's Reserve Adequacy metric. Even with the active participation of the BCCR, the increased supply has been translated into a 10.2 percent appreciation of the nominal exchange rate until end-November.

Regarding fiscal policy, even when the economy has been subject to multiple shocks, the authorities have maintained their commitment to the fiscal rule and to fiscal discipline more broadly. As a result, fiscal consolidation has overperformed the government and the EFF program targets.

In 2022, fiscal performance was strong: the primary balance was 2.1 percent of GDP (-0.3 percent in 2021), the lowest of the last thirteen years, and the financial deficit was 2.5 percent of GDP (5 percent in 2021). Total income was 16.6 percent of GDP, 0.8 percent more than the same period last year, while tax revenue was the highest in more than a decade, at 14.3 percent of GDP. As staff has reported, public debt has been on a decreasing path, reaching 63.8 percent of GDP in 2022. The cumulative primary surplus to September 2023 was 1.7 percent of GDP (comfortably exceeding the June QPC and September IT). Preliminarily, in October 2023, the financial deficit was 2.4, and debt decreased further to 59.8 percent of GDP (from 67.6 percent by end 2021). Even when the expectation is for public debt to end the year at 61 percent of GDP, these results evidence the Treasury's effort to bring the debt-to-GDP ratio below 60 percent by 2025 and 50 percent before 2035. Broadly, the fiscal balance overperformance has benefited from the robust economic recovery and from a reduction in primary expenditure as a share of GDP under the fiscal rule. Going forward, fiscal consolidation is expected to continue. The authorities have reaffirmed their commitment, as evidenced in the draft budget for 2024, which appropriately targets further fiscal consolidation. For 2024, public finances are expected to continue this sustainable path with a positive primary result of 1.85 percent of GDP and a financial deficit of 3.0 percent of GDP.

To maintain these positive results, the Minister of Finance's strategic proposal for decision-making focuses on three main pillars: control and reduction of public expenditure, a more equal and effective tax system, and a long-term financial strategy. Recent improvements in debt management should help lower Costa Rica's financing costs, alongside additional reforms that have been announced. Efforts will continue to remove tax expenditure provisions, reform the PIT to increase horizontal and vertical equity by taxing the income of employed, pensioners, and self-employed individuals under a single recalibrated schedule, and resume the discussion to address the current income tax structural shortcomings. On spending, even when budget execution fully meets the program's primary surplus target, the 2023 budget represents an increase in social spending of more than 4 percent compared to the initial 2022 budget. Also, as done before, the Treasury will channel under-executed resources to the main cash transfer, non-contributory pension, and childcare programs. These, among other reforms, reinforce Costa Rica's fiscal consolidation and create buffers against shocks while protecting the poor.

These results in the monetary and fiscal sectors have been noted by international capital markets. Moody's, Fitch, and S&P have improved Costa Rica's sovereign rating and outlook twice this year, and sovereign spreads have fallen abruptly since 2020; for 2023, they have been below the GLOBAL and the LATAM EMBI. Moreover, in early November, the government issued an external debt bond for USD1.5 billion, maturing in November 2054 with a yield of 7.75 percent, for which there was a 3.4 bid to offer.

The third pillar of the program complies with broader structural reforms to promote inclusive, green, and sustainable growth in Costa Rica, which interrelate and complement the authorities' efforts to advance on the path already set by the OECD accession process. The main policy objectives are to protect the most vulnerable, promote greater female labor force participation, and boost productivity growth, including by eliminating barriers to business formalization, investment, and job

creation. Within these reforms, the public employment bill (PEB), a SB under the program, was approved in March 2022 and fully implemented for the executive branch's job positions in the single-wage spine in early September 2023.

The structural fiscal program also envisages gains from reforms to public procurement, modernization of the tax and customs administration, and public financial management reforms such as improving targeting accuracy and delivery of the social protection programs. In 2022, the cabinet approved and published a Medium-Term Fiscal Framework (MTFF) and Medium-Term Debt Strategy for 2023-2026. Also, a macro fiscal unit is being formalized within the Ministry of Finance, and the Fiscal Council is being operationalized. CD efforts have focused on an action plan to operationalize gender budgeting. The execution of gender-related spending, in line with the budget statement, will be monitored during 2024 as part of the initiatives to reduce the gender economic gap. Also, leveraging digitalization, the authorities are working to improve and enhance the effectiveness of some of their social assistance programs through improved coverage, targeting, and delivery. The payment system for all cash transfer social assistance programs was centralized and digitalized, and the main platform (SINIRUBE - Sistema Nacional de Información y Registro Único de Beneficiarios del Estado) to target social protection benefits and services has been enhanced to quantify specific individual's needs, to aid with prioritization in a robust manner. Moreover, by end-February 2024 (SB), there will be a Social Assistance Single Window ("ventanilla única") to consolidate social programs and to move from a first-come-first-serve basis to prioritization based on the urgency of need, thus improving response times and targeting.

Climate change agenda

Notwithstanding that Costa Rica is a country of 51,100 km², it hosts diverse ecosystems and about 6 percent of the world's species. The country has become a global leader for its environmental policies and accomplishments for programs such as the Payments for Environmental Services (PES), which was innovative and has shown effectiveness in promoting forest and biodiversity conservation, making Costa Rica the only tropical country in the world to have reversed deforestation. The country has also extended its forest cover to nearly 60 percent of land and is on track to achieve most of the 100 targets of the National Biodiversity Strategy 2016-25. Additionally, it has expanded its officially protected areas to cover 25 percent of land and 30 percent of marine areas, well above the respective OECD averages, and produces all of its electricity from renewable sources.

Even though the country has made some significant progress in the climate agenda to diminish environmental pressures over its economic growth, more is needed given the challenges posed by climate change. With the aim of becoming a resilient and low-carbon economy, Costa Rica is strongly committed to enhancing its crisis preparedness, climate-resilient infrastructure, greening the financial sector, reaching net zero emissions by 2050, and mobilizing official and private financing to meet the significant short- to long-term costs to confront the long-term challenges from climate change within the budget envelope. In this sense, the RSF fills a much-needed gap to unlock critical resources, as these plans entail significant costs. Against this backdrop, the authorities are dedicated to implementing the reform measures supported by the RSF, which are important elements of the

broader comprehensive climate strategy and complementary to reforms supported by other development partners.

For its second review, all RMs were completed. They aimed to improve the integration of climate issues into fiscal and financial sector risk analysis (RM5 and RM8) and in project appraisal (RM6). The authorities also submitted a bill to encourage the use of low-pollution vehicles through feebates (RM7). More broadly, in October, the authorities approved a regulation that requires supervised financial intermediaries to put in place policies to incorporate socioenvironmental and climate risks into banks' decision-making processes, specify the main risk areas to be covered, classify these risks in their credit operations, and meet specific disclosure requirements by end-2026 (RM8). These outcomes build upon the completed RMs of the first review, which involved publishing guidelines for budget tagging (for which the authorities are developing the information systems to facilitate its operationalization), the implementation of regulations to facilitate private-sector participation in renewable energy for self-consumption, the establishment of a data repository on climate hazards and vulnerabilities, and the publication of the "greenness" of reserve holdings of the BCCR.

The BCCR established within the central bank the Group for Strategic Analysis of Climate Change (GAECC), which developed a roadmap to integrate climate change considerations into the design of monetary, financial, and macro-prudential policies. In line with these efforts, in October 2023, the superintendencies signed a Statement of Commitment to promote a resilient financial sector against climate change risks. From January 2024, the supervised entities are required to incorporate the sustainable or responsible component into their investment policies and to incorporate ESG risk management into their risk management framework. Additionally, by December 2024, a single green taxonomy to support the development of green financing is expected to be in place.

The authorities recognize the urgent need to complete spatial planning and have taken initiatives to mainstream biodiversity in it. There is a roadmap to enhance infrastructure resilience that identifies priority actions to reduce infrastructure loss due to climate change and the associated interruption of public goods provision, fiscal costs of rebuilding and retrofitting existing infrastructure, and damage to transport and water sectors. Aware of the need to improve the efficiency of public investment, the authorities are committed to strengthening institutional capacity to efficiently plan and manage green and resilient investment projects, building on the recommendations of the PIMA and its climate change module.

To strengthen project selection criteria, the authorities are working with the IDB and a private company to develop a methodology to score and prioritize capital projects according to a set of criteria. Building on the piloting of this new methodology, they are on track to publish guidelines setting clear and transparent project selection criteria, including a range of climate change criteria for SNIP (Sistema Nacional de Inversion Publica) entities by end-December 2023. Along with this, the IDB will coordinate the establishment of the Project Preparation Facility (PPF), a multi-donor facility with the participation of other stakeholders, following international best practices for sustainable project preparation. The Public-Private Partnership (PPP) PPF will provide both financial, on a contingent recovery basis, and technical support that will help to create capacity and in-house technical expertise to achieve the Sustainable Development Goals (SDGs).

Going forward, the authorities continue to move ahead with their strong climate-related reform agenda and have the aim to keep on building on the RSF's catalyzing effect. This strategy includes potentially issuing sovereign bonds that are recognized for the country's overall climate and social credentials. Costa Rica's efforts to further improve resilience to climate change and fully decarbonize its economy are financially costly, hence, the authorities believe the RSF is critical to supporting their efforts, together with the additional climate finance resources it is expected to catalyze.