INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL FINANCE CORPORATION
AND MULTILATERAL INVESTMENT GUARANTEE AGENCY
COUNTRY PARTNERSHIP FRAMEWORK
FOR
THE REPUBLIC OF COSTA RICA
FOR THE PERIOD FY16-FY20
April 23, 2015

Central America Country Unit
Latin America and the Caribbean Region
The International Finance Corporation
Multilateral Investment Guarantee Agency

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CURRENCY EQUIVALENTS
(Exchange Rate Effective as of March 31, 2015)
Currency Unit= Costa Rican Colon (₡)
US$1.0=₡533

FISCAL YEAR
January 1 to December 31

ABBREVIATIONS AND ACRONYMS
CABEI Central American Bank for Economic Integration
CAF Development Bank of Latin America
CAT DDO Catastrophe Deferred Draw Down Option
CCSS Costa Rican Social Security Administration (Caja Costarricense de Seguro Social)
CPF Country Partnership Framework
CPS Country Partnership Strategy
DPF Development Policy Financing
DRM Disaster Risk Management
FDI Foreign Direct Investment
FY Fiscal Year
GDP Gross Domestic Product
IBRD International Bank for Reconstruction and Development
IDB Inter-American Development Bank
IFC International Finance Corporation
IMF International Monetary Fund
LAC Latin America and the Caribbean
MIGA Multilateral Investment Guarantee Agency
MSME Micro, Small and Medium Enterprises
NDP National Development Plan
OECD Organization of Economic Cooperation and Development
REDD+ Reducing Emissions from Deforestation and Forest Degradation
SCD Systematic Country Diagnostic
SMEs Small and Medium Enterprises
TA Technical Assistance
US United States
VAT Value-Added Tax
WBG World Bank Group

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<td>Karin Finkelston</td>
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<td>J. Humberto Lopez</td>
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I. INTRODUCTION

1. Costa Rica stands out for being one of the most politically stable, progressive, and prosperous nations in Latin America and the Caribbean (LAC). Since the first presidential elections under the new Constitution in 1953, the country has held 13 elections, the last in 2014. All have been considered peaceful and transparent. Beyond laying the foundation for Costa Rica to become one of the most politically stable countries in the region, the mid-1950s also introduced measures that helped define the Costa Rican Social Compact, including (i) abolition of the army and reliance on a police force to maintain order; (ii) establishment of a professional civil service; (iii) enactment of basic welfare legislation; and (iv) guaranteed public education for all. Subsequent governments have continued to prioritize the social welfare and development of the Costa Rican people.

2. The Social Compact has achieved many successes, particularly in the delivery of universal services. Costa Rica’s trademark universal and integrated health care system, managed by the Costa Rican Social Security Administration (Caja Costarricense de Seguro Social, CCSS) has provided access to health care to its entire population, including the poor and bottom 40 percent. As a result, life expectancy at birth improved from 61.6 years in 1960 to 79.7 years in 2012, similar to the Organization for Economic Co-operation and Development (OECD) average of 80.7 years. The country has also invested heavily in education, nearly reaching the 2010 spending targets of eight percent of GDP. The literacy rate for adults 15 years old and above is almost universal (97 percent), and the share of adults 25 years and above who had no formal education has declined from 21.2 percent in 1950 to 3.4 percent today.

3. Political stability and inclusive social policies have contributed to solid growth rates and the modernization of the country. GDP per capita (US$13,876 in Purchasing Power Parity terms) has tripled since 1960, compared to a 260 percent increase in LAC. Intel’s decision to set up a semiconductor assembly and test plant in Costa Rica (1996) was a turning point that contributed to its transition from an agrarian-based economy to one where high value-added industries are a trademark. In addition to Intel, other well-known multinationals began investing in the country, including Baxter Healthcare, Procter and Gamble, and Abbott Laboratories (now Hospira), and by the early 2000s, manufacturing and services had overtaken agriculture in their contribution to GDP. A vibrant and fast-growing industry has emerged around products such as medical device manufacturing, demonstrating the extent to which Costa Rica is integrated into global value chains.

4. The combination of political stability, the Social Compact, and steady growth, has resulted in one of the lowest poverty rates in LAC. Using the poverty and extreme poverty lines of US$4 per day and US$2.5 per day respectively, just 12 percent of the Costa Rican population is considered poor (less than half the LAC average), and 4.7 percent extremely poor (about one-third of the LAC average). Moreover, only 1.4 percent of the population lives under the US$1.25 poverty line. The country’s success over the past decades is also reflected in its strong human development indicators, which continue to rank higher than those of other countries in the region, and the size of the middle class1, which has been the largest group in society since 2010.

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1 Defined as the share of the population who lives with US$10 to US$50 per day.
5. **Costa Rica is also a global leader for its environmental policies and accomplishments, which have helped the country to build its Green Trademark.** The pioneering Payments for Environmental Services program has been successful in promoting forest and biodiversity conservation and Costa Rica is the only tropical country in the world that has reversed deforestation. It has also been active in seeking to mitigate climate change through a number of innovative initiatives, such as establishment of the domestic carbon market.

6. **Despite these impressive achievements, the country is showing symptoms of deeper structural problems that could threaten the sustainability of Costa Rica’s development model.** Two pressing development challenges stand out: the deteriorating fiscal situation and stubborn inequality. First, fiscal pressures threaten to undermine the sustainability of the country’s Social Compact and Green Trademark, and prevent it from undertaking much needed investments in public infrastructure. Second, despite reasonable growth and a strong commitment to the Social Compact, poverty reduction has stagnated and inequality is rising. These challenges cut across the fabric of Costa Rica’s development model and affect the basic pillars of development: inclusion, growth, and sustainability.

7. **The new Government seeks to address these problems and is committed to an inclusive society that guarantees the welfare of its people, supported by transparent and accountable public institutions.** The 2015-18 National Development Plan (NDP) outlines its priorities of boosting economic growth and creating quality jobs, increasing efficiency of public spending, reducing poverty and inequality, and creating an open, transparent and efficient Government to reduce corruption.

8. **The WBG’s new Country Partnership Framework (CPF) seeks to support Costa Rica’s objectives of reducing constraints to productive inclusion and bolstering fiscal, social and environmental sustainability.** These themes are priorities in both the Government’s 2015-2018 NDP and in the WBG’s Systematic Country Diagnostic (SCD).

**II. COUNTRY CONTEXT AND DEVELOPMENT AGENDA**

*Political and Social Context*

9. **Costa Rica has been one of the most stable democracies in LAC, with successive democratically-elected governments and peaceful transitions of power since 1949.** The Government is made up of executive, legislative, and judicial branches and has a strong system of constitutional checks and balances. The President holds executive power, and the Legislative Assembly is made up of 57 members. The 2014 election of President Solís of the *Partido Acción Ciudadana* marked the first time since 1949 that neither the *Partido Liberación Nacional* nor the *Partido de Unidad Socialcristiana* held the Presidency.

10. **Social rights are the backbone of Costa Rica’s notable Welfare State.** As far back as 1943, an article on social rights was written into the Constitution, including health, housing, social assistance, public services, taxes, minimum wages, among others. The Constitution also defines the objective of Social Security as the protection of “employers and employees against risks associated to illness, invalidity, maternity, death and other contingencies as determined by the laws.” Today, most of the population is covered by at least one program in the social security and
pension systems. These systems have been extended throughout the country and include workers' compensation and family assistance benefits, and cover a large share of the poor via non-contributory pensions.

**Growth, Poverty and Shared Prosperity**

11. **Costa Rica has enjoyed good growth performance over the past decades, despite the impact of the 2008 crisis.** Costa Rica’s GDP per capita has tripled since 1960 and its growth averaged 4.5 percent between 2000 and 2013, as compared to the LAC average of 3.8 percent for the same period. During the global crisis, real GDP growth slowed to 2.7 percent in 2008 and contracted by 1 percent in 2009. As pointed out in the SCD, the economy rebounded following the crisis, achieving an average real growth rate of 4.9 percent between 2010 and 2012. However, growth decelerated to 3.5 percent in 2013, and remained stable in 2014. Given the deteriorating fiscal balance and the rising public debt to GDP ratio, growth is not likely to change in 2015 but is expected to pick up in the following years, if steps are taken to address the current fiscal challenges.

12. **Sustained growth was supported by an open economy and a well-diversified export base.** The transition to higher value-added areas of the economy, including high-tech manufacturing, combined with trade liberalization, contributed to sustained growth. Signing the Dominican Republic-Central America Free Trade Agreement provided not only a more stable framework for trade with the United States, but also introduced changes to promote transparency, ensure a secure and predictable environment for investors, and put an end to Government telecommunications and insurance monopolies. Further trade agreements with China, Mexico, Peru, Singapore, Canada, and the European Union followed. With a diversified export base, Costa Rica currently contributes to at least five major high-tech global value chains: electronics, medical devices, automotive, aeronautic/aerospace, and film/broadcasting devices. The agricultural portfolio (bananas, pineapples, coffee, etc.) accounts for most other goods’ exports, while low value-added products, such as textiles, are losing their relevance. Services’ exports (tourism, business services) also play an important role in the economy, with business services accounting for almost half of all services’ exports.

13. **Costa Rica’s success in attracting foreign direct investment (FDI) has contributed to the diversification of exports of goods and services.** Following early investment attraction efforts in the 1980s aimed at low value-added sectors such as textiles, in the 1990s, Costa Rica began pursuing FDI growth in high value-added sectors, especially electronics and advanced manufacturing, medical devices and life sciences, and services for export. The country received US$407 million (3 percent of GDP) in FDI inflows in 1997, growing to nearly US$2.7 billion by 2013 (5.2 percent of GDP). Costa Rica is one of the world’s most FDI-intensive economies, with its FDI-to-GDP ratio above global averages from 1985 through 2010. Moreover, despite the global economic crisis, Costa Rica has continued to attract FDI, although the composition has shifted towards services, which increased from 8.3 percent of total FDI in 2002-05 to 20.6 percent in 2010-13 due, in part, to the liberalization of the telecommunication and insurance sectors. In 2013, Costa Rica attracted US$583 million of new investment in high-tech sectors across 43 projects, with over 7,000 direct jobs created. At the same time, the 2014 Intel announcement that it would close Costa Rican production facilities raises concerns that the country is losing its competitive edge in the high-tech industry.
### Box 1: Poverty Reduction and Shared Prosperity Trends

#### Figure 1: GDP per capita (constant 2005 US$, percent of U.S.)

![GDP per capita graph](image)

**Source:** World Development Indicators

#### Figure 2: Poverty rates (percent)

![Poverty rates graph](image)

**Source:** SEDLAC (CEDLAS and World Bank)

#### Figure 3: Annualized growth rate (percent)

![Annualized growth rate graph](image)

**Source:** SEDLAC (CEDLAS and World Bank)

#### Figure 4: Middle class (percent of population)

![Middle class graph](image)

**Source:** SEDLAC (CEDLAS and World Bank)

#### Figure 5: Gini coefficient

![Gini coefficient graph](image)

**Source:** EHPM/ENAHO, SEDLAC data, and OECD Stats for non-LAC OECD

#### Figure 6: Change in poverty (percentage points)

![Change in poverty graph](image)

**Source:** EHPM/ENAHO. Poverty line was C.96,565 (June 2014)

Poverty numbers are not comparable before and after 2010.
14. **Sustained growth has led to low poverty rates and strong human development indicators.** One of the greatest outcomes of Costa Rica’s sustained GDP growth and strong Social Compact is the poverty reduction that took place over the second half of the 20th century. By the early 2000s, the poverty headcount\(^2\) was 29 percent (Box 1), decreasing to 20 percent in 2007 and flattening out at around 12 percent after 2010. The trends for extreme poverty\(^3\) are similar: a decline from 15 percent in 2001 to 8 percent in 2007, slowing to an average of 5 percent after 2010. Even more striking than Costa Rica’s low poverty rates are its strong human development indicators: in 2014, it ranked 7\(^{th}\) in LAC and 68\(^{th}\) in the world.\(^4\) The country’s universal health care system, along with the expansion of safe water and sanitation, are considered the key reasons behind its impressive health outcomes. The infant mortality rate stands at 10.6 deaths per 1,000 live births, a vast improvement since 1960 (90 deaths per 1,000). Almost 100 percent of all births are attended at hospitals and according to recent estimates, close to 90 percent of the economically active population and their dependents have access to health insurance, as well as 62 percent of non-wage earners.

15. **Despite the solid growth over the past decades, Costa Rica’s per capita GDP has not converged to countries of higher income, such as the United States.** This is in contrast to other high performing LAC countries, such as Chile or Panama and Uruguay, which started to converge to the US respectively in the early-1990s (admittedly with a pause in the second half of the 1990s) and the early-2000s. Other than in the second half of the 2000s when Costa Rica’s GDP per capita increased from 10 to 12 percent of the US level, it has displayed a growth pattern that is more in line with the average LAC country, where the level of convergence is limited.

16. **Moreover, income inequality has been steadily rising for a number of years.** Costa Rica has gone from being the least unequal country in LAC after Uruguay in 2000, to being around the median country out of 17 countries for which internationally comparable data exist for 2012. In Costa Rica, changes in household survey methodologies create problems for the comparability of the measure of inequality over time. Nonetheless, long-term trends over different periods indicate that inequality has either risen or remained flat since the late 1980s. In recent years, inequality has risen from 0.51 in 2010 to 0.52 in 2014. The increase in inequality has not only significantly offset the poverty-reducing impact of growth in the late 2000s, but also reversed what should have been a decline in poverty of about 3 percentage points between 2010 and 2014 into a poverty increase of 0.4 percentage points. The changes in income distribution are also apparent when looking at income changes across both wealth quintiles and geographic regions. The bottom 40 percent experienced growth in income about 2 percentage points lower than average mean income growth between 2007 and 2012. Similarly, the Central region has the greatest weight in overall income inequality. Although the Central region has the lowest poverty incidence compared to other regions, it has the highest concentration of the poor (1.7 million), in large part because it is home to 62 percent of the population. In contrast, poverty incidence is highest in border areas and in those cantons where the indigenous population lives (Box 2). It is interesting to note that inequality fell since 2010 in all but the Central region. Thus, the Central region seems to have driven the overall increment of the Gini by one point.

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2 Measured using an internationally comparable US$4 per day threshold.

3 Defined in LAC as income under US$2.50 a day.

Box 2: A Note on Indigenous Peoples in Costa Rica

Costa Rica has a very small indigenous population, at just 2.4 percent of the total population (or 104,143 people). Legally-established indigenous territories cover about 7 percent of the Costa Rican territory, and 91 percent of the total indigenous population is concentrated in three cantons.

Indigenous populations have tended to have lower access to basic services than the non-indigenous, although access has improved since 2000. Despite broad coverage of basic services, indigenous people still lag behind in access to electricity, water supply, and sewage. According to the 2011 Census, 80 percent of indigenous households had an electricity connection, against 99 percent of non-indigenous. Similarly, only 67 percent had access to piped water against 94 percent of non-indigenous while 31 percent of the indigenous population had no access to sewage (public or private) against 4 percent of non-indigenous. However, these indicators have improved since 2000, when only 67 percent of households had electricity, 50 percent had access to some form of sewage, and 53 percent had access to clean water.

Human capital accumulation and income generating opportunities are also lower for indigenous populations. Indigenous people report lower educational attainment than non-indigenous: average years of education among the indigenous is 6.1, against 7.7 for non-indigenous while illiteracy is at 7.7 percent among indigenous and 2.2 among non-indigenous. This translates into lower employment and income opportunities among the indigenous, as they have a higher probability of working in self-employment or unpaid work.

17. **Costa Rica’s high level of social spending is not delivering the expected results for the population.** Social spending in Costa Rica is one of the highest in LAC and on par with OECD countries. Overall spending in education, health, and social protection amounted to 20.8 percent of GDP in 2012, by far the highest among its Central American neighbors. This stems from a strong commitment to social policy since the mid-20th century, which has delivered good results in terms of literacy, life expectancy and other health outcomes. However, the high level of social spending is not delivering expected results for secondary school completion and the sustainability of the universal health model is under question given concerns about deteriorating quality and the challenge of an aging population. Finally, social protection spending is not adequately protecting people against poverty, nor is it effective in moving people out of poverty.

**Recent Economic Developments**

18. **Macroeconomic stabilization policies put in place in the 1980s helped to foster sustained growth until the 2009 crisis.** In the 1980s, a series of macroeconomic policies were implemented, including increases to the value-added tax (VAT) rate and broadening of the tax base on the revenue side, as well as elimination of most agricultural subsidies, freezing of public sector salaries and reform of the public pension system, on the expenditure side. These policies proved successful in contributing to a high and sustainable growth rate, averaging nearly 5 percent per annum from 1983 to 2006. The fiscal deficit was virtually eliminated and public debt reduced by two thirds, of which less than 20 percent was external. While growth had already started to decelerate prior to the global economic and financial crisis, Costa Rica experienced a 1 percent contraction in 2009 and since has not been able to catch up to its previous growth trend (Table 1).

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5 This is social spending of the consolidated public sector.
19. The country’s fiscal response to the global economic crisis in 2009 set the country on an unsustainable path due to a permanent fiscal expansion. The adoption of countercyclical policies to cushion the impact of the crisis on domestic economic activity led to growing fiscal deficits. In particular, the wage bill and direct transfers rose steeply in 2009 and remained at the higher level thereafter. The wage bill increased from 5.5 percent of GDP in 2008 to 7.4 percent in 2014 as a result of a policy that aimed to increase remuneration in the Central Government to the 50th percentile of salaries for similar jobs in the rest of the public sector. Originally intended to adjust the wages of some categories of public sector workers, it expanded throughout most Central Government entities and some decentralized institutions. At the same time, Government revenues which had risen steeply prior to the crisis dropped back to the 2000-05 average levels. Thus, Costa Rica’s fiscal accounts shifted from an average surplus of 2.9 percent of GDP in 2006-08 to a deficit of the Central Government of 4.5 percent of GDP in 2009-2013. Failure to change the fiscal deficit dynamics will lead to an unsustainable build-up of public debt.

Table 1: Costa Rica Key Economic Indicators, 2008-2016

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Source: Ministry of Finance, Central Bank and IMF, European Intelligence Unit and World Bank staff estimates
Note: The consolidated public sector comprises the Central Government, decentralized government entities, public enterprises including the Central Institute of Electricity, and the Central Bank. Consolidated public debt nets out central government and central bank debt held by the CCSS and other entities of the nonfinancial public sector. The projections assume fiscal consolidation as currently planned.

20. Approval of a fiscal reform package, including measures on the revenue and spending side, is crucial to bring fiscal policy back to a sustainable path. The overall deficit of the Central
Government grew to 5.4 percent of GDP in 2013, and has stabilized at 5.7 percent of GDP in 2014. As a result, the stock of public debt grew from 24.8 percent in 2008 to 37 percent of GDP in 2013, of which about three quarters is domestic and one quarter external. If no corrective measures are taken, the overall deficit of the Central Government could be above 6.2 percent in 2016 and beyond and debt levels reach 63 percent of GDP by 2019. The Government is strongly committed to fiscal consolidation based on a reform package with revenue and expenditure measures. Approval of reforms, such as broadening of the tax base for VAT and increase in the rate, elimination of exemptions on personal income tax, introduction of pension ceilings, improved efficiency in the use of the single treasury account, and introduction of a fiscal rule are all expected to lead to a containment of the deficit in the medium-term. While there is consensus around the need for fiscal consolidation, approval and implementation of critical reforms in Costa Rica requires considerable time and effort to garner political support, particularly for complex areas, such as tax reform. With fiscal consolidation as currently planned by the authorities, the overall fiscal deficit of the Central Government is expected to be reduced to 4.2 percent of GDP by 2016 when the debt level is expected to stabilize around at 43 percent.

21. **Monetary and exchange rate policies have evolved, and although inflation has decreased, the real effective exchange rate has appreciated.** In 2006, the Central Bank of Costa Rica abandoned the crawling peg in favor of an exchange rate band. During the 1990s and 2000s, as FDI flows increased, the Central Bank intervened in the foreign exchange market - first as per the crawling peg, and then to maintain the exchange rate within the band. The accumulation of international reserves was evidence of the strength of the economy, but the sterilization bonds that the Central Bank had to issue to prevent excessive monetary expansion generated growing quasi-fiscal deficits. Inflation remained in double digits levels until 2009, when it finally dropped to below 10 percent. However, domestic inflation is persistently above than that of the United States (its major trading partner), and large capital inflows have put appreciating pressure on the exchange rate. The real effective exchange rate index appreciated by 12.3 percent in 2011-13, negatively affecting Costa Rica’s international competitiveness. During that period, the Central Bank actively intervened in the foreign exchange market, buying foreign currency to keep the exchange rate above the lower bound of the target range. As a result, net international reserves rose from US$4.8 billion at end-2011 to US$7.3 billion at end-2013. The Central Bank then sterilized the resulting monetary expansion with domestic bonds, which pay a substantially higher interest rate than the returns it gets on international reserves. Consequently, in 2013, the quasi-fiscal deficit of the Central Bank rose to 0.9 percent of GDP, and its debt stood at about 10 percent of GDP. In early 2015, the Central Bank abandoned the exchange rate bands and moved to a managed floating exchange rate regime as a further step towards full-fledged inflation targeting. The increased exchange rate flexibility is expected to dampen dollarization in the financial sector and help absorb external shocks.

22. **To further complicate monetary issues, dollarization has become widespread in Costa Rica.** The perception of relative stability of the exchange rate in recent years and ample US dollar liquidity, has encouraged dollarization. The widespread dollarization of the economy adds vulnerability to the financial system and undermines the effectiveness of monetary policy. In response, Costa Rica has put in place prudential measures to discourage lending in dollars to non-foreign exchange generators and to reduce the banks’ open foreign exchange positions. The
authorities granted a four-year implementation period in 2013 to allow the banks to gradually rebalance their loan portfolios and adapt to new regulations.

Environmental Sustainability

23. **Costa Rica is regarded as a world leader in conservation and has made significant achievements in reforestation.** Over the last 30 years, forest cover has increased from 26 percent to 52 percent through the use of economic incentives for conservation (under the 1996 Forest Law and its Payments for Environmental Services framework). These achievements have proven critical to Costa Rica’s development strategy, given the country’s recognition as an international ecotourism destination.

24. **However, the country’s ability to continue these efforts is limited physically and financially and thus its Green Trademark and its commitment to carbon neutrality by 2021 are at risk.** Being green and carbon neutral at the same time requires not only maintaining the current levels of forest cover, but also reducing the current levels of greenhouse gas emissions from all sectors. This is a challenging task given the trade-offs built into the current economic incentive structure for forest conservation and reforestation, which are dependent on revenues generated from tax on gasoline. While reduction of a large share of greenhouse gas emissions can be achieved through better management of forested and agricultural land, Costa Rica also needs to reduce carbon emissions from fossil fuels coming from transport, construction, and, increasingly, from general electricity consumption. In the long-run, efforts to promote Costa Rica as a carbon neutral country will reduce tax revenues as the consumption of fossil fuels decreases. Scarce fiscal resources are also likely to be redirected to other more urgent needs, calling for reform of the current incentive structure.

25. **Moreover, the current environmental regulatory framework favors a strong conservation approach that has limited productive opportunities.** During the last four decades, the focus on conservation has led to the development of a nature-based tourism sector, on the one hand, and a significant contraction of the domestic timber industry, on the other. But efforts to maintain, or further increase, the forest cover are undermined by rising opportunity costs. The fiscal weight of the conservation and reforestation program of Costa Rica may prove too heavy to sustain in the longer term, with the pressing social and economic issues that the country faces in the short term and an increasing opportunity cost of alternative land-use options.

26. **The country is also highly exposed to natural hazards and faces significant challenges from climate change.** Costa Rica is one of the countries with the highest exposure to hazards, including hydro-meteorological (floods, cyclones, and landslides) and geophysical (earthquakes and volcanoes). It is the second most exposed country to multiple hazards based on land area, with 36.8 percent of the total area exposed to three or more natural hazards. It is estimated that 77.9 percent of the population and 80.1 percent of GDP are subject to high risk from multiple hazards. While Costa Rica has been spared by major disasters in recent years, it is not immune to the potential of a catastrophic event. In 2010, Hurricane Thomas caused an estimated at US$292 million in damages; Tropical Depression 12E in 2011 caused US$60 million in damages; and in 2012, the Samara-Guanacaste earthquake resulted in US$100 million in damages to public
buildings and infrastructure. Furthermore, certain climate change projections for Costa Rica indicate up to a 32 percent decrease in overall rainfall precipitation by 2050.

**Key Development Challenges**

27. **Costa Rica aims to become one of the most developed countries in LAC; however, it faces challenges on the inclusion, growth, and sustainability fronts.** Indeed, its development model is under threat from the deteriorating fiscal situation and persistent inequality. Decades of steady economic growth, stable democracy, significant environmental achievements, and a strong commitment to the Social Compact have contributed to Costa Rica’s current status as an upper-middle income country on the cusp of acceding to the OECD. However, the deteriorating fiscal situation and persistent inequality threaten Costa Rica’s development model. As discussed previously, the fiscal situation has deteriorated substantially since the global crisis, with the overall deficit of the Central Government growing to around 6 percent. In tandem, public debt increased from almost 25 percent of GDP in 2008 to 37 percent in 2013, and current projections would put it at 63 percent by 2019 unless corrective measures are implemented. Without fiscal consolidation, the deficit could push public debt to unsustainable levels and threaten the country’s economic, social, and environmental gains. Growth has been uneven, with lower growth and job creation in sectors that are more likely to employ unskilled workers (e.g., construction and agriculture). Not surprisingly, inequality has increased, with the widening gap between the earnings of rich and poor workers mirroring large disparities in human capital and educational attainment. Moreover, despite high spending on social protection benefits and the broader Social Compact, taxes and transfers have not proven to be effective in redistributing income to compensate for these disparities. Competitiveness is hampered by investment-climate related factors, such as rising electricity costs, weak infrastructure, and burdensome regulations. And governance challenges constrain both growth and inclusion.

28. **Thus, maintaining the achievements of the past several decades and successfully addressing the development challenges ahead will require tackling three key areas:** inclusion and income inequality; bottlenecks to growth; and managing fiscal, social and environmental sustainability risks.

**Inclusion and income inequality**

29. **High wages and modest education outcomes resulting in excess demand for high-skilled workers could explain the evolution of inequality over the past decades and the more recent rise in unemployment.** As the SCD outlines, high income levels, the increasing cost of living and generous social benefits, have resulted in relatively high reservation wages, even for low-skilled labor. Together with rising costs of energy and logistics, this has made Costa Rica less competitive in low value-added sectors. While the transition to high value-added sectors has been successful, there is increasing and unmet demand for high-skilled workers, which has boosted the salaries of this group of workers. Surprisingly, even though Costa Rica has long prioritized investment in public education, achievements at secondary and higher levels have been poor, with less than half of those aged 25-29 having completed secondary or higher education. Furthermore, since 2007, job creation in low-skilled sectors has been low or negative, with unemployment on the rise since the global crisis. The poor have been disproportionately affected in their inability to
find jobs, as the sectors where job creation has been minimal are those mainly employing low-skilled workers. Conversely, sectors employing high-skilled workers (e.g. financial services, real estate) are growing quickly.

30. While the impact of economic inequality and unemployment are felt throughout the Costa Rican economy, women suffer disproportionately more relative to their male counterparts, despite gender parity in many social areas. Compared to its neighbors, Costa Rica shows much better gender outcomes in a number of indicators: maternal mortality is low, with just 38 deaths per 100,000 live births in 2013, against 83 in LAC and 57 in other upper middle income countries; and gender parity in primary school enrollment and more females than males enrolled at both secondary and tertiary levels. However, despite women’s achievements in education, challenges persist with respect to women’s economic opportunities. For instance, the wage gap between women and men remains stable at 0.84 and women spend disproportionate amounts of hours in domestic tasks, which prevents their full integration into the labor market. When they do gain entry to the labor market, they tend to be segregated into less productive sectors. Costa Rican women are also more likely to be both unemployed and underemployed. In 2013, the gender gap in unemployment was 4 percentage points (with 10 percent female unemployment and just 6 percent male unemployment). Notably, young women are particularly affected, as the unemployment rate among females aged 15 to 24 years old reached 24 percent, 9 percentage points above the male unemployment rate of 15 percent. Similarly, underemployment rates of women were far higher than men in 2012, at 17.4 percent against 9.3 percent for men. Efforts to lift women’s time constraints, such as for instance the provision of affordable and accessible childcare services that enable women to balance their work and domestic responsibilities, and strategic support to enable them to access sectors with higher wages, are essential to improving their economic opportunities.

31. The state has also shown a limited ability to effectively redistribute income through taxes and transfers. Since 1953, the Assembly has approved 1,259 tax exemptions (nearly half of them with unclear definitions of the taxes exempted), amounting to 5.6 percent of GDP. Hence, the country has a limited ability to counterbalance income inequality through tax policies. At the same time, most social assistance programs in Costa Rica have fairly low coverage among the poor and are poorly targeted. Even the most widespread program (school feeding) reaches only half of the population in the lowest quintile, and the targeting accuracy of programs is low compared to other countries. For example, 74 percent of cash transferred in the Red de Oportunidades of Panama go to the poorest quintile, against only 44 percent in Avancemos in Costa Rica.

32. To tackle these issues, the SCD concluded that it would be important to take action on a number of fronts. First and foremost, Costa Rica needs to improve education outcomes of secondary and higher education, as it will be difficult to sustain a productive structure similar to the OECD countries with the current education outcomes. Second, given the difficulties of the country to compete on the basis of low wages, even for low-skilled workers, it will be critical to ensure that firms can offset the relatively higher wages with even higher productivity. This, in turn, will call for progress with the competitiveness agenda.
Bottlenecks to growth

33. **Costa Rica’s economic convergence to rich-country income levels faces constraints in the areas of business climate and regulation, education and skills, infrastructure, and governance.** As already discussed, Costa Rica’s labor supply quality and composition is not well-adapted to the current needs of the labor market and critical skill shortages could slow down the country’s trajectory towards a high value-added economy. At the same time, numerous investment-climate related factors, such as rising electricity costs, high logistics costs due to an outdated stock of infrastructure, burdensome regulations and the appreciation of the real exchange rate over the past eight years, are eroding the country’s external competitiveness. Costa Rica’s historical efforts to build an extensive network of infrastructure in nearly all productive service areas are clear from its infrastructure stock: the country has two times the road and three times the rail density of the average middle-income country; access to electricity is nearly universal; and mobile penetration is higher than the OECD average. Yet the near freeze in public infrastructure investment since the 1990s, as well as recent fiscal constraints, have taken a toll on the country’s ability to upgrade and maintain its infrastructure. Today, roads and ports have among the lowest quality marks in the LAC region. The necessity of continuing to invest in infrastructure, and the reality of fiscal constraints, mean that Costa Rica must look for options for private sector participation in the construction and maintenance of its infrastructure.

34. **Business regulations and red tape also affect competitiveness.** Costa Rica ranks poorly on many investment climate areas, such as the protection of investors, enforcement of contracts, facility to pay taxes and start a business, and resolving insolvencies. Cumbersome regulations, particularly for small and medium enterprises, make the process of starting new businesses particularly challenging. This suggests that a number of micro issues need to be addressed to improve productivity and unleash faster rates of economic growth. The complex organization of the Government and lack of coordination among agencies result in a lack of clarity around the steps, agencies and time to process regulatory requirements. For example, when the telecommunication sector was liberalized, new private entrants reported delays in installing their systems due to the slow approval of tower building permits by the municipalities.\(^6\) Capacity constraints, related to weak sectoral planning and bureaucratic inefficiencies, also affect the ability of the public sector to implement policies and execute public investment projects. Environmental, health, and construction are the areas mostly affected by these factors.

Managing fiscal, social and environmental sustainability risks

35. **Fiscal consolidation is Costa Rica’ primary policy challenge.** As mentioned, the Central Government’s fiscal deficit increased significantly from the pre-crisis levels to 5.6 percent of GDP in 2014. If imbalances in the public accounts are not addressed, the deficit would grow to more than 9 percent of GDP, and debt would rise to 60 percent by 2019. A consequence of the weaker fiscal stance has been the deterioration of the investment rating. In September 2014, Standard & Poor's Ratings Services downgraded the country's rating due to fiscal trends and the foreseen difficulties in passing a comprehensive tax reform that could put the debt on a sustainable path. The fiscal consolidation agenda needs to address important challenges on both the revenue and expenditure sides. On the revenue side, the Government is hoping to put in place policies that

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\(^6\) World Bank (2013a).
would generate an additional 2.5 percent of GDP, given Costa Rica’s tax collection levels compared to countries with similar level of GDP per capita and social indicators. Options could include broadening the tax base of the VAT to include services and basic goods, reducing tax exemptions, and increasing the tax rates. On the expenditure side, measures include a hiring freeze, pension ceilings, introduction of a fiscal rule, and more efficient use of the single treasury account, among others. Additional ways to boost revenue could come from strengthening tax compliance given that tax evasion is estimated at 4 percent of GDP for income tax and 1.3-1.8 percent for sales tax.

36. With respect to social sustainability, the effectiveness and coverage of social programs as well as the deteriorating quality of public health services require attention. On the social protection front, it will be critical to address the institutional complexity and fragmentation of programs which undermine the effectiveness and coverage of these programs. Mandating the common use of beneficiary registries, improving monitoring and evaluation practices, and consolidating social policy under the leadership of a Ministry of Social Development are all key actions that with relatively little investment could reap large rewards. Likewise, improving the quality of health services requires modernizing the health system. Among other things, a more efficient allocation of resources would enable health centers to cope with rising demand from chronically ill and elderly patients and reduce waiting times.

37. Finally, on the environmental front, preserving Costa Rica’s “Green Trademark” and strengthening disaster response capacity are of utmost importance. This will call for a reconciliation of conservation efforts with sustainable economic activities, and for the management of increasing urban pressure on resources. Likewise, on the disaster risk management (DRM) front, this will call for stronger institutional and legal frameworks as well as for mainstreaming disaster risk in the national development and investment programs.

III. WORLD BANK GROUP PARTNERSHIP FRAMEWORK

A. Lessons Learned

38. WBG support to areas of strategic importance with broad stakeholder buy-in is one of the key lessons from the WBG’s previous engagement in Costa Rica. Experience from the previous Country Partnership Strategy (CPS) highlighted a few key lessons. First, fully taking into account political economy is key to ensuring achievement of CPS objectives. The strongly democratic nature of Costa Rica requires time and effort for the ruling party to garner political support for the approval of reforms and development projects. For example, WBG investment projects take on average eighteen months to be approved by the Legislative Assembly. Thus, going forward, a focus on fewer, larger projects that have high strategic importance to a multitude of stakeholders could speed up the legislative approval procedures, as was the case for the Higher Education Improvement Project (P123146), which was approved in ten months.

39. Secondly, the use of alternative financing instruments and non-traditional project design, such as results-based financing, could yield better results. A second critical lesson stemming from implementation experience is that use of alternative financing instruments and non-traditional project design may work better to finance complex reforms and produce concrete results on the ground. An example of the former is the use of Development Policy Financing (DPF)
which focuses on supporting formulation and implementation of Government’s policy reforms that may be complex and require broader consensus. Another example is that of results-based financing which links payments to the achievement of key milestones and results of a broad sectoral program. The WBG is currently financing payments based on results for reduction of emissions under the Reducing Emissions from Deforestation and Forest Degradation (REDD+) mechanism. This approach can also be supported by the WBG’s new Program for Results instrument.

40. **Finally, the WBG’s knowledge and advisory services engagement should be more strategic and fully aligned with the CPF program to ensure greater impact.** Under the previous CPS, many large analytical reports never saw any follow up and were disjointed from the overall strategic direction of the WBG program. For example, a report on geothermal development and costs of urban pollution was well received but no follow up or relation to the CPS program was established. Thus, to avoid limited and/or fragmented impact going forward, the WBG analytical program could be consolidated around TA activities that have capacity building components and support the immediate application of analytical work, thereby potentially yielding better results in Costa Rica and ensuring impact on policy formulation. Further details on lessons can be found in the Completion and Learning Review in Annex 7.

### B. Selectivity Filters

41. **To design the WBG engagement in Costa Rica, three selectivity filters were applied, as follows:** (i) alignment with the Government’s own program and requests for WBG support to date; (ii) focus on priority areas identified by the SCD; and (iii) context-specific WBG comparative advantage, including track record in Costa Rica, lessons learned, global experience on a specific issue, as well as the role of other development partners.

#### Figure 7: Developing the CPF: Filtering Process to Define Objectives

42. **Selectivity Filter 1: Alignment with Government Program.** The Government program is based on its own diagnostic of the country’s key development challenges. During its first six months in office, the Government developed its 2015-2018 NDP, with three pillars: (i) boost economic growth and create quality jobs; (ii) reduce poverty, in particular extreme poverty and social and territorial inequality; and (iii) create an open, transparent Government to reduce corruption. Further, the NDP provides strategic proposals across 16 sectors with recommendations
on how to achieve specific objectives. During its first year in office, the Government has focused on articulating strategies and social programs to reduce extreme poverty, as well as strengthening the capacity of the poor to access the labor market and other income-generating opportunities. Other proposed structural changes are expected in the coming years, including fiscal consolidation reform, addressing the country’s deteriorating infrastructure, and improving the efficiency of social spending. The Government may, however, have difficulty moving forward in all of these areas simultaneously, due in part to a fragmented Legislative Assembly and limited fiscal space. Further details on Costa Rica’s NDP can be found in Annex 6.

43. **Selectivity Filter 2: Focus on SCD Priority Areas.** The SCD identifies a number of priority areas linked to inclusion, growth and sustainability in Costa Rica. These areas include: (i) education and skills; (ii) competitiveness, including infrastructure, business climate and governance; and (iii) sustainability, including fiscal, social and environmental.

![Figure 8: SCD Priority Areas](image)

44. **The SCD also highlights several knowledge gaps.** Although there is an extensive body of policy analysis on Costa Rica, there are a few issues where further research and data collection would be helpful to design more concrete policy reforms to tackle the issues outlined in the SCD. For example, the specific factors driving secondary dropout are still not well understood. Taking into consideration gender gaps in secondary and primary school enrollment and completion\(^7\), a gender lens will be employed in carrying out this work. In the labor market, it is not clear whether the contraction of employment in agriculture, manufacturing and construction is of a cyclical or structural nature. This has important implications for low-skilled unemployment. Likewise, though there are strong signs that reservation wages are high, further study could quantify this better. In particular, analysis of gender-specific constraints to entering and succeeding in the labor market, such as lack of access to childcare, could provide important insights. To improve the efficiency of the public sector, on one hand, it is crucial to identify the specific governance bottlenecks in

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\(^7\) 97 percent of female children completed primary education compared to 94 percent of boys in 2012.
executing infrastructure projects, as well as their cost implications. On the other hand, a thorough institutional mapping of social programs would be an important pre-requisite to improving the effectiveness of social programs. Finally, environmental conservation could be better linked with economic activity, such as sustainable production and rural landscapes. The elements of this emerging knowledge agenda are included in each of the pillars as relevant.

45. **Selectivity Filter 3: WBG Comparative Advantage.** Comparative advantage needs to be looked at as specific to the context, both in time and of the country. Thus a number of factors were used to assess WBG comparative advantage, including areas where the WBG has developed a track record of delivering results over time, global experience on a critical issue and the role of other development partners. For example, the WBG has had a long engagement in environment and DRM, providing International Bank for Reconstruction and Development (IBRD) financing to support Costa Rica’s reforestation agenda through in part, attracting greater numbers of poor small- and medium-sized land owners into the innovative Payments for Environmental Services program. The International Finance Corporation (IFC) has also had experience in Costa Rica in environment and renewable energy, promoting use of mandatory standards in commercial and residential buildings for more efficient energy and water use, and investing US$100 million in the renewable energy Reventazón Hydro-power Project (CR-L1056) to both address the country’s growing demand for electricity and comply with its goal of reducing carbon emissions. Likewise, the WBG has been a close partner on DRM helping to strengthen the Government’s capacity to plan and reduce risk as well as respond to disasters through the DRM DPF with Catastrophe Deferred Draw Down Option (CAT DDO) (P111926), offering a source of immediate liquidity. Conversely, implementation experience and track record in infrastructure projects has been mixed across the WBG. While the Multilateral Investment Guarantee Agency (MIGA) provided a guarantee for a toll road between the capital and the Pacific Coast, increasing the volume of traffic to the country’s second port beyond what was originally envisaged, a recent IBRD investment in the Port-City of Limon Integrated and Infrastructure Project (P085539) closed without completing any of the intended activities after seven years of implementation and with negligible results. Indeed, IFC is probably the best placed within the WBG to support the Government in partnering with the private sector to finance the improvement of infrastructure, which is in dire need of rehabilitation. This depends, however, on the country improving its institutional conditions and the political will to create and manage public-private partnerships. MIGA also could provide additional guarantees in the infrastructure and energy areas.

46. **The WBG's ability to mobilize global knowledge on a specific issue is a factor in determining its comparative advantage as well as how a proposed WBG engagement interacts with the work of other development partners.** For example, given WBG experience supporting the design and implementation of universal health schemes around the world (e.g., Argentina, Ghana, India, among others), it is well placed to provide the CCSS with advice on best practices for increasing efficiency and quality of services. Finally, given that there are relatively few active development partners in Costa Rica, such as the Central American Bank for Economic Integration (CABEI), the Development Bank of Latin America (CAF), the European Investment Bank (EIB), the Inter-American Development Bank (IDB), the Japanese Bank for International Cooperation (JBIC), and the United Nations (UN), it is crucial to ensure close coordination and complementarity of WBG interventions in support of the Government’s development agenda. Traditionally, there has been an efficient division of labor among key development partners in
Costa Rica and this is expected to continue. For example, the WBG is the only major partner currently supporting the higher education agenda, while IDB, CABEI and CAF are all financing infrastructure projects. Given the Government’s financing needs and the inability of one single partner to address these, IBRD and IDB are working closely on the Government’s fiscal consolidation agenda. The WBG has been closely coordinating with the Pan American Health Organization and the International Labor Organization during the preparation of the new health operation to ensure complementarity of interventions and build a joint strategic dialogue with the CCSS.

47. The proposed CPF was developed following a consultative process with the Costa Rican Government and confirmed alignment with Government’s priorities. CPF preparation was launched following a two-day roundtable discussion with the new Government in September 2014 on the country’s challenges and how the WBG could best support Costa Rica to overcome them. A series of visits and discussions took place over a six-month period around the elaboration of the SCD and definition of the CPF. Upon presentation of the draft CPF in March 2015, Government stakeholders noted that it was well structured, aligned with the needs of the country and the NDP, and sufficiently ambitious given the current needs and challenges of the Government and Costa Rican population. Looking ahead to future CPF periods, the WBG was encouraged to explore a few areas for possible engagement. Specifically, the WBG could expand work with micro, small and medium enterprises (MSMEs) to determine how to effectively engage smaller, sometimes informal MSMEs, particularly in urban areas, as this could have a greater impact on improving livelihoods of the bottom 40 percent. In addition, the WBG could play a critical role in helping Costa Rica address the growing urban needs and mitigate environmental impacts, in areas such as urban trash management and waste water treatment, both of which are significant challenges for the bottom 40 percent. Following these consultations, the CPF was revised to reflect these challenges and, to the extent possible, incorporate the suggestions provided.

48. Consultations were also held with different stakeholders in Costa Rica during both CPF and SCD preparation, highlighting three issues. Some stakeholders noted that, despite the existence of a NDP, the Legislative Assembly lacked clear priorities at times, making it difficult to move forward policy dialogue and planning. Secondly, partners encouraged the WBG to continue working closely with line ministries and local institutions to try to anticipate potential stumbling blocks and proactively define strategies to reduce risks to program implementation. Similarly, the WBG was also encouraged to consider longer periods for program implementation, taking into account the local context and challenges.

C. Proposed WBG CPF

49. The WBG’s proposed CPF FY16-FY20 supports the Government’s objective of greater inclusion and is aligned with SCD priority areas under Inclusion and Sustainability. This four-year CPF features a highly selective program focused on: (i) inclusion and income inequality, focused on education/skills and competitiveness; and (ii) sustainability, focused on fiscal, social and environmental sustainability.

50. The CPF will support two complementary pillars, with six objectives:
1. Reducing Constraints to Productive Inclusion
2. Bolstering Fiscal, Social and Environmental Sustainability
51. The proposed areas of engagement are linked to the twin goals through ensuring sustainability of Costa Rica’s growth model and Social Compact for continued gains in poverty reduction, while addressing the income inequality gap. Addressing barriers to the sustainability of growth will ensure that Costa Rica is able to continue delivering on its Social Compact and maintain its gains in poverty reduction. At the same time, focusing on productive inclusion for the bottom 40 percent is key to addressing the rising inequality gap and generating more balanced opportunities for the different segments of society.

52. Not all SCD priority areas will be fully addressed by this WBG CPF, namely business and investment climate as well as aspects of public sector institutions and regulatory frameworks. The CPF will not tackle issues related to business and investment climate given that there has been no demand from Government for WBG support in this area. Although the WBG engagement will seek to build capacity in the public institutions implementing its program, the CPF does not include any particular intervention related to strengthening public sector institutions and regulatory frameworks in general, given the overall objective of remaining selective.

53. The selectivity of the CPF is also reflected in a realistic results framework. In addition to relying on the selectivity filters to pragmatically focus on key development areas for WBG support, the CPF tries to maximize its development impact by exploiting the synergies of the WBG’s different instruments: lending, economic and sector work, technical assistance, and dialogue. For example, in order to enhance the sustainability of the health sector, IBRD is building on previous dialogue and advice on critical sector reforms while it is relying on lending and TA to support increased efficiency in the social sectors. At the same time, the expected results of the program are commensurate to WBG-supported interventions relative to Government's overall program and the country’s development challenges described in the SCD.

54. The design of the proposed CPF also takes into account the existing portfolio and recent analytical work (Box 3). Currently, IBRD only has two operations: the Higher Education Improvement Project and the DRM DPF with CAT DDO for response to disasters. Support to environmental and climate change interventions continue to be supported through trust funds. IFC’s portfolio focuses on energy and financial services, while MIGA’s portfolio is concentrated in the transport sector. An array of analytical work has been completed in recent years, among
others, a social sector expenditure and institutional review, work on green and inclusive growth, a low carbon strategy, a 2015 Gender Assessment, which together with the SCD provide the analytical underpinnings for the choice of interventions featured in the CPF.

Box 3: WBG On-going Portfolio and Technical Assistance, as of March 31, 2015

**IBRD’s** active portfolio is highly selective and includes two lending operations, for a net committed amount of US$265 million, of which US$220 million remain undisbursed. The portfolio is focused on improving access, quality and relevance of tertiary education, and providing immediate liquidity in case of a disaster through a DRM DPF with CAT DDO, along with TA to enhance the Government’s capacity to respond to disasters. IBRD is also supporting the Government’s efforts to enhance environmental sustainability through a number of trust funds, such as the Forest Carbon Partnership Facility and Partnership for Market Readiness, among others. The quality of the IBRD portfolio has been affected by persistently low disbursement rates, a trend that is expected to continue. In the past two years, the situation worsened as older project exited the portfolio. In FY14 and FY15, the disbursement rate was only 5 percent, well below Central America averages (23 percent in FY14 and 18 percent in FY15) and LAC averages (19 percent in FY14 and 17.1 percent in FY15). The low disbursement rates are mostly attributed to the complex design of investment projects, weak implementation capacity of public institutions and the strong oversight role of the Comptroller General’s Office which often leads to prolonged procurement processes.

**IFC’s** activities focus on supporting development of Costa Rica’s renewable energy and financial markets as well as investments oriented to mitigating climate change and helping low-income groups. As of March 31, 2015, IFC’s total commitments stand at US$235.5 million, with an outstanding portfolio of US$135 million. IFC committed US$100 million to support the development of a 305.5 MW hydropower plant in the Limon Province (**Reventazón** Project). Under the regional program promoting a green building market in LAC, IFC recently launched its operations in Costa Rica. The program will establish a green building certification system for the mass market (such as track housing, schools, and hospitals) utilizing IFC’s EDGE tool, and assist the Government in drafting and enacting a mandatory national green building code, expected to lead to a reduction in energy and water consumption in new buildings. In the financial sector, IFC is already engaged in MSME financing through commercial banks, reaching close to 2,300 small and medium firms with an overall loan volume of US$280 million, in addition to more than 800 microenterprises with a loan volume of US$2.5 million. Through an IFC Advisory project, the WBG further supports the Government in creating a National Collateral Registry aimed to facilitate access to finance for MSMEs and women entrepreneurs in particular. By 2019, the web-based registry for security interests in movable property is expected to generate US$2 billion in financing to firms and benefit 17,000 Small and Medium Enterprises (SMEs) and 4 microenterprises.

**MIGA** has US$113 million in Gross Exposure in one project (**Autopista del Sol**) in the transport sector.

**PILLAR 1: REDUCING CONSTRAINTS TO PRODUCTIVE INCLUSION**

55. **Despite its advanced social policies, income inequality is on the rise in Costa Rica.** Historically, Costa Rica experienced shared prosperity, with the incomes of the bottom 40 percent of the population growing faster than the incomes of the rest of the population. However, the global financial crisis reversed this phenomenon, resulting in steady income growth among higher wage

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8 World Bank Gender Assessment and Policy Note, February 2015
9 Please see Annex 7 (Completion and Learning Review) for more information on portfolio implementation challenges.
earners and a slowdown among the bottom 40 percent. As a result, inequality grew and Costa Rica’s poverty rates stagnated around 21 percent. Today, the profile of the poor is increasingly urban, featuring larger households, with higher dependency and lower education. A key contributor to the increase in income inequality is the under-supply of highly-skilled labor for a growing demand and over-supply of low-skilled labor for a decreasing demand.

56. **Costa Rica’s labor market and education system are currently unable to produce the highly-skilled labor that is in increasing demand for a modernized economy.** As the economy has diversified into increasingly high value-added sectors, the demand for skilled labor has soared. And yet, Costa Rica has not sufficiently increased its stock of high-skilled workers. Surprisingly, despite the long-standing commitment to invest in public education, less than half of the cohort 25-29 years-old (42.3 percent) had achieved a secondary or higher education by 2010, further adding to the stock of low-skilled adult workers. Given that less than half of the secondary school cohorts completes secondary education, and that tertiary education has been historically biased towards social sciences over more technical disciplines, particularly among women, the Costa Rican labor force is not well-adapted to the transitioning labor market that increasingly requires highly skilled, technical work. This human capital deficit will continue to increase the disparity in access to jobs and other income-generating opportunities. Gender disparities and stereotypes also play a key role in education and labor market decisions, as such, understanding their role and addressing gender specific constraints and barriers is key to effectively increasing productive inclusion in Costa Rica. In particular, closing knowledge gaps on the constraints for low labor force participation among women (51 percent, below LAC average of 58 percent) and higher rates for participation in informal sector (44.3 percent compared to 34.7 percent among men) is needed.

57. **In parallel to producing more skilled labor, which is a long term endeavor, productive opportunities need to be created for the existing large pool of low-skilled labor.** Demand for low-skilled labor has decreased significantly since the crisis given the contraction in construction and agriculture, which, together with domestic services, previously employed over 50 percent of low-skilled workers. MSMEs provide opportunity for self-employment and wage labor for this now largely unemployed pool of people, but MSME viability is dependent on access to financial services. MSMEs can also address important gender-specific barriers and work to improve outreach and inclusion. The development of inclusive and efficient financial markets will help MSMEs grow and create productive opportunities for poor households in order to improve their livelihoods by enabling them to save, invest and cope with economic uncertainties.

58. **Inclusion, as well as growth, would also benefit from the many complementarities involved in improving education and bolstering competitiveness.** Closing the education gap between the poor and non-poor is highly relevant for productive inclusion as it would allow those in the bottom 40 percent to access more opportunities. However, a well-educated workforce with relevant skills is also fundamental for sustaining economic growth and increasing productivity while lowering the costs of doing business can boost competitiveness across various sectors. In parallel, increasing infrastructure spending stimulates construction, creating more jobs for the large stock of low-skilled workers. Thus sustainable investments in energy and transport would both lower costs and improve the operating environment for firms, thereby supporting competitiveness, and generate jobs for workers with different levels of skills.
59. CPF support under Pillar I seeks to address the constraints to productive inclusion through tackling the skills issue, fostering opportunities for those that are excluded by virtue of lack of skills, and contributing to enhanced competitiveness through energy and transport investments. Thus, Pillar I’s objectives are to: (i) enhance higher education to improve skills; (ii) increase access to finance to generate productive opportunities; and (iii) promote sustainable investments in energy and transport to support competitiveness.

Objective 1: Enhance higher education to improve skills

60. The competitiveness of Costa Rica hinges on the existence of a skilled labor force to support its trajectory towards a high value-added economy and reduce the skills-income gap. With fewer than half of young adults graduating from secondary school, and with performance on test scores falling, Costa Rica’s labor supply is not able to furnish the skills needed for a labor market supporting a high value-added economy. Tackling these challenges requires a multi-pronged approach: (a) strengthening quality, retention, and relevance of the education system to build the skills of “tomorrow’s workers”; (b) improving the quality and relevance of tertiary education; and (c) strengthening the technical training system for the workforce.

61. The country faces a number of bottlenecks in higher education, including limited access, poor quality, lack of relevance of programs, and lack of accountability of providers. Access to public universities is contingent upon successfully passing an entrance examination and is limited by quotas due to limitations in physical infrastructure and human resources, most impacting the poor. The quality of institutions and programs (especially among the numerous private universities) is uneven due to lack of accredited programs and low quality of university faculty. As of 2012, only 64 programs in 18 universities were officially accredited by the National System for Accreditation of Higher Education. Thus, more needs to be done to ensure that university programs are systematically accredited. Furthermore, few university programs and curriculum are relevant for labor market needs, with only 16.7 percent of university programs focusing on basic sciences, engineering, and computing. Also, among those men and women (18 and older) with university and professional degrees, significant gender segregation exists according to field of study. Efforts intensified to attract students to areas of study relevant to the future of the economy, such as science, technology, and mathematics. These areas currently produce less than 20 percent of public university graduates, and just 10 percent of private university graduates. Finally, universities are granted full autonomy but with little accountability for results, despite high levels of expenditures.

62. The Government seeks to improve the overall learning environment as a foundation for the modernization of the national economy and the achievement of high-quality educational outcomes. The Government is committed to improving results to improve access, quality and relevance through results-oriented management. In response to the gaps in quality and relevance of university programs, the Government seeks to promote the study of subjects relevant to the national economy, introduce linkages of university programs and research to ongoing work of industry leaders, and invest in the professional development of university professors. Finally,

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10 Large gender gaps exist favoring men exist in the fields of information technology and telecommunications, accounting, engineering, architecture/construction, electricity/electronics and agriculture, while women earn more degrees in education, medical services, secretarial work, and social and behavioral sciences than men.
by identifying (and subsequently responding to) drivers of secondary drop-outs, the Government hopes to not only increase secondary completion, but also increase access to, and improve the quality of tertiary education, so as to bring educational outcomes closer to the standards of OECD member states.

63. **The WBG’s legacy engagement will continue to support Government’s efforts to improve access to, and quality, and relevance of higher education.** The WBG program seeks to contribute to enhancing higher education to improve the quality and skills of graduates in Costa Rica by: (i) improving access, particularly for indigenous youth, and quality of public higher education; (ii) developing more programs designed to develop skills required by Costa Rica’s labor market; (iii) increasing accountability of public universities for quality through performance-based agreements; and (iv) identifying the drivers of low secondary completion and developing options for improving retention using a gender lens. The WBG’s on-going Higher Education Improvement Project is providing support for (i) increasing access by expanding facilities and equipment and reaching out to indigenous youth; (ii) improving quality of faculty through training; (iii) strengthening the National System for Accreditation of Higher Education; (iv) developing system-wide information and monitoring; and (v) allocating investment resources through innovative performance agreements with public universities. The Project provides financing for sub-projects, through Institutional Improvement Agreements with participating universities. These agreements, the first of their kind in Costa Rica, were signed between the Government (the Ministries of Public Education, Science and Technology, National Planning and Economic Policy, and Finance) and each of the four participating public universities, and outline activities and targets. Types of sub-projects include financing of laboratory and computer equipment; infrastructure (e.g. new schools, dormitories, etc.); scholarships and internships for improving faculty qualifications; visiting professorships; and institutional management systems. Moreover, a comprehensive Indigenous Peoples Plan has been adopted to overcome the myriad of barriers that indigenous youth face in tertiary education. This plan has already started to produce important results for improved inclusion and could potentially be expanded to target other vulnerable populations. Finally, universities will benefit from increased investments in areas of innovation, scientific, and technological development to promote the study of disciplines with a growing relevance for the national economy, such as engineering, mathematics, telecommunications, and natural sciences.

64. **In addition to work in tertiary education, the WBG will deepen its knowledge base on the issue of low secondary completion rates and on skills development programs and their links to the labor market.** More than half of children who complete primary education fail to complete secondary school. Although some general factors are known, such as lack of motivation and distance (in rural areas), the specific factors that push children out of secondary school (and their level of importance) are still unclear. Moreover, some determinants of dropping out of school may be gender specific, such as expectations of the future roles and responsibilities, household chores and/or adolescent pregnancy. Thus, the WBG will carry out analytical work to better understand the underlying causes of secondary drop-outs and provide TA to assess the efficiency of existing school retention incentives and financial support mechanisms, as well as market dynamics that may contribute to early exit from secondary schooling. In addition, diagnostic work on the availability of skills development programs in Costa Rica will be undertaken, including assessing the links between educational and vocational training systems (such as the National Training Institute) in terms of program design and implementation. The WBG has a comparative
advantage in this area given its long-term engagement in the sector and global experience, and is the Government’s primary development partner in this sector.

65. **The expected outcome of this objective is improved access, quality and relevance of tertiary education in Costa Rica.** Indicators to measure the success of the WBG engagement include increased number of students enrolled in priority areas (namely science, technology and mathematics) in four public universities (disaggregated by gender and with a subset on indigenous students), increased number of indigenous students completing the university entrance exam (disaggregated by gender), and increased number of officially accredited programs.

### Objective 2: Increase access to finance to generate productive opportunities

66. **To ensure greater inclusion, the bottom 40 percent of the population needs greater access to more productive opportunities.** Labor income and self-employment are the largest contributors to poverty alleviation while MSMEs play an important role in providing income and employment opportunities for low skilled workers and the poor. Although MSMEs have been a significant driver of the Costa Rican economy to-date, accounting for 38 percent of total formal employment in the country, access to finance to expand operations is limited, given the MSME segment is generally underserved by state- and foreign-owned banks in Costa Rica: approximately 40 percent of the country’s estimated 300,000 MSMEs cite access to credit as a major constraint to growth. Women and poor are most disadvantaged: just 40 percent of women and 35 percent of people in the bottom two wealth quintiles have access to formal financial services. In this context, the Government’s NDP (2015-18) commits to providing credit and increasing access to financing for MSMEs in order to support their role as contributing forces to reducing inequality and social exclusion and improving the overall quality of life for many Costa Ricans.

67. **The CPF seeks to catalyze productive opportunities for greater employment, especially for the bottom 40 percent among the large pool of unskilled labor force, through increased access to finance for the country’s MSME.** WBG engagement will facilitate access to credit and improve availability of finance through IFC credit lines tailored to MSMEs, including women-owned enterprises. The IFC is currently providing support to three financial intermediaries, reaching close to 2,300 small and medium firms with an overall loan volume of US$280 million, in addition to more than 800 microenterprises with a loan volume of US$2.5 million. Specifically, IFC provides financing to **Banco Improsa** and **Banco General** for credit lines tailored to the needs of SMEs, including women-owned businesses, and supports **Coopenae** in expanding access to finance for MSMEs. Looking forward, it will continue to provide support and advisory services to help identify areas for improvement in current MSME credit operations and strengthen institutional capabilities to better serve this market, aimed at contributing to employment opportunities and economic growth, particularly for the unskilled and poor. In line with these access-to-finance efforts, targeted WBG TA is being provided on good practices in development finance to contribute to improving access to finance for MSMEs, entrepreneurs (particularly women and youth) and small agricultural producers. The TA is supporting the development of secondary regulation related to operational and prudential topics, drawing upon the WBG’s global experiences with best practices of development finance institutions and adapted to a Costa Rican context. In some cases, access to finance may not simply be a problem of businesses or individuals being under-banked, but rather they may lack sufficient liquid capital to
bank in the first place. To address this challenge, the WBG, through an IFC Advisory project, will also continue to support the Government in implementing the Secured Transactions law by helping them to create the National Collateral Registry, which is a system that will allow MSMEs that are not eligible for financing under the current system to use movable collateral to access credit. Throughout the CPF period, IFC will further continue seeking opportunities with larger companies in the manufacturing and services sector including agribusiness as well as new sectors that are underserved and require equity such as telecom, technology and energy efficiency.

68. **The expected outcome of this objective is that access to finance to MSMEs would be increased.** This in turn would be expected to lead over time to more productive opportunities, especially for the bottom 40 percent of the population and the unskilled labor pool. The main indicator of success is increased microenterprises and SMEs reached with financial services. The expected outcome and indicator may be revised at the time of the Performance and Learning Review based on IFC’s investments in the first two years of the CPF.

**Objective 3: Promote sustainable investments in energy and transport to support competitiveness**

69. **Boosting inclusion and growth in the labor market requires confronting the dual challenge of maintaining competitiveness of high value-added sectors, while improving the viability of low value-added sectors.** For instance, improving the integration of export-oriented and domestic firms through backward linkages could sustain the growth among SMEs, generating jobs in mid and low-skilled occupations. This can be done by lowering operation costs to improve the productivity of labor and counterbalance the high labor costs in Costa Rica vis-à-vis its neighbors, for example by lowering the costs of doing business through regulatory simplification.

70. **Moreover, reducing the infrastructure deficit would increase competitiveness, growth, and environmental sustainability.** A critical priority identified by the SCD is that of infrastructure, including quality of transport infrastructure and rising electricity costs. Costa Rica’s historical efforts to build an extensive network of infrastructure in nearly all productive service areas are clear from the infrastructure stock: the country has two times the road and three times the rail density of the average middle-income country; access to electricity is nearly universal; and mobile penetration is higher than the OECD average. Yet, the near freeze in public infrastructure investment until the 1990s, as well as recent fiscal constraints have taken a toll in the country’s ability to upgrade and maintain its infrastructure, resulting in poor quality roads and transport services when compared to international standards. Electricity prices have doubled since 2007 due to weather related variable hydroelectric output, causing increased use of thermal units and high operating costs, among other factors. This increase reflects challenges in the sector, including energy mix and governance. Further, the Government has faced significant challenges in executing infrastructure investment in a timely manner. The deficiencies in productive infrastructure raise concerns about the level of investment needed and the long-term competitiveness of the country. This infrastructure deficit reduces the potential of local firms to grow and create jobs, in particular for firms that operate outside Free Trade Zones. In addition, the country needs to improve its waste management and clean energy production capabilities to be able to reduce greenhouse gas emissions, and water and soil pollution. Infrastructure improvement poses a number of tradeoffs, including the need to intervene in protected areas (in the case of clean energy production), as well
as the need to control the current fiscal deficit. Given the necessity of continuing to invest in infrastructure, and the reality of fiscal constraints, Costa Rica must look for options for private sector participation in the maintenance and upgrading of its infrastructure.

71. **The WBG engagement in the CPF reflects the legacy support of IFC and MIGA to the energy and transport sectors.** To improve the country’s medium-term energy security, IFC is investing US$100 million in the construction and operation of a hydroelectric power plant (*Reventazón*) with approximately 305.5 MW of installed capacity in the province of Limón. Through this investment, IFC jointly with IDB catalyzed an additional US$400 million in investment finance to support this US$1.4bn project. Once commissioned in 2016, the project will be Central America's largest hydropower plant and most significant renewable energy generator, representing close to 15 percent of the country’s total annual electricity demand expected to grow by an average of 4.5 percent per annum in the medium- to long-term. This highly strategic investment provides the country with a sizeable, competitive (relative to the currently available alternatives), long-term, stable and reliable renewable power source expected to underpin Costa Rica's future economic growth. Once operational in 2017, an additional 1,400 GWh will be generated on average per annum, representing about 10 percent of Costa Rica’s generation capacity and serving almost 350,000 individual residential customers. The project is expected to provide employment opportunities for approximately 3,300 workers during the three-year construction phase, and an average of 80 workers during operations. In addition to residential households, the increase in energy supply is expected to benefit MSMEs as well as other commercial users, thereby supporting private sector development and economic growth in one of Costa Rica’s poorest regions. The project will further contribute to climate change mitigation by displacing fossil fuel based power stations and thereby reducing greenhouse gas emissions by approximately 162,000 tC02 per annum on a net basis. With respect to transport, MIGA has a US$113 million in Gross Exposure in one transport project, which supported the design, rehabilitation, operation and maintenance of the San José-Caldera toll road through a 25-year concession agreement. The investment rationale made the case for a direct road link between San José and the Pacific Coast at Caldera, the country’s second port after Puerto Limón, so as to reduce travel time, lower vehicle operating costs, reduce accident rates, and provide demonstration of public private partnership benefits. Both CABEI and IDB are actively financing infrastructure, including transport, urban infrastructure, water and sanitation and energy.

72. **The expected outcome of these investments include increased power generation from renewable resources**. The main indicators of success is the people provided with new or improved access to electricity and additional capacity in the system. Should conditions be favorable and the opportunity arises, IFC and MIGA could potentially continue this engagement in facilitating public-private partnerships and providing guarantees respectively in infrastructure related areas, including energy and transport. The expected outcome and indicators may be adjusted at the time of the Performance and Learning Review based on IFC’s investments in the first half of the CPF.

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**PILLAR 2: BOLSTERING FISCAL, SOCIAL AND ENVIRONMENTAL SUSTAINABILITY**

73. **Challenges to the sustainability of Costa Rica’s development successes are on the fiscal, social and environmental fronts.** A key challenge to sustainability is the overall fiscal situation of the country, as it struggles to deal with worsening debt dynamics, weak public revenue
mobilization capacity, and inefficient expenditures. To address these issues, the SCD proposed options for increasing revenue and improving the efficiency of public spending, notably in the health and social sectors. In addition to fiscal vulnerabilities, there are growing social tensions due to rising inequality and deteriorating quality of services leading to worsening results in the social sectors despite high levels of public spending. Social protection spending, which includes social security and social assistance, is high by regional standards, but most of it funds pension benefits. At the same time, social assistance transfers have had limited effects on poverty and have not proven to be effective in redistributing income to the most vulnerable. In this context, the sustainability of social programs is a challenge given that there are signs that some segments of the population are opting out of public services and paying for private ones. Over time, this will seriously undermine the commitment of these segments to finance universal services that they no longer use, further eroding the quality and legitimacy of the system. Fiscal sustainability is further threatened by Costa Rica’s high vulnerability to a variety of potential natural and emerging environmental challenges, including climate change, which threaten Costa Rica’s green trademark. While it has been successful in mitigating the impacts of climate change by encouraging reforestation and reducing carbon emissions, adaptation to climate change and other emerging environmental challenges will be critical to shift towards a more climate-smart development approach, ensuring that continued efforts to invest in its green trademark are sustainable and consistent with increased resilience to climate risks and while providing improved livelihoods for the population.

74. The new Government is facing these challenges head-on. A comprehensive fiscal reform seeks to overhaul the current tax system by expanding the base for value-added and income taxes and enhancing the enforcement capacity of the State. The Government is also committed to containing the growth trajectory of key public expenditures and improving efficiency in targeted sectors. Social spending in Costa Rica is one of the highest in LAC and on par with OECD countries. Overall spending in education, health, and social protection (including pensions) amounted to 20.8 percent of GDP in 2012. However, in recent years, the high level of social spending is not delivering expected outcomes, for example low secondary school completion and graduates with skills mismatched to the demands of the economy, and the sustainability of the universal health model is being threatened by concerns about declining quality and the challenge of an aging population. Social assistance spending is not adequately protecting people against poverty, nor is it effective in moving people out of poverty. Thus, the Government seeks to introduce measures and mechanisms to enhance the efficiency gains in public spending, which will not necessarily lead to reduced allocations, especially to social sectors, but should contribute to better results per dollar spent. Finally, the Government’s continued work to prepare for and manage natural shocks should also help improve short-term resilience and insulate the impact of such shocks on the economy while long-term resilience will be built through improving the sustainable use of productive landscapes. Moreover, by strengthening and expanding the Payments for Environmental Services program beyond reforestation to include productive landscapes, more livelihood options will be available to the rural poor. The carbon neutrality agenda also continues to provide opportunities for the country to boost its green trademark, while offering local economic benefits in priority sectors.

75. Against this backdrop, this Pillar supports the Government’s efforts to tackle critical fiscal, social and environmental sustainability challenges. The Pillar’s objectives are to: (i)
strengthen fiscal management to enhance efficiency; (ii) improve efficiency and quality of the health insurance system to improve results; and (iii) expand capacity to promote climate-smart and environmentally sustainable development. The CPF will provide support in these areas through a variety of mechanisms, including mobilization of private financing by IFC where appropriate, IBRD lending and TA.

**Objective 4: Strengthen fiscal management capacity to enhance efficiency**

76. **Improving Costa Rica’s fiscal sustainability is necessary for alleviating poverty and fostering an environment conducive to growth in the medium term.** Despite sustained growth rates above the regional average and recent improvements to tax and fiscal transparency, Costa Rica continues to face a number of fiscal challenges. A growing deficit and large public debt, combined with limited Government revenue have contributed to worsening debt dynamics. The confluence of these events may also negatively impact investor confidence, especially given that Costa Rica lost its investment grade rating in September 2014 and is at risk for another downgrade\(^\text{11}\), thereby slowing the country’s progress on its development path as it seeks to move to a higher level of sustained economic growth. Thus, on the economic front, fiscal consolidation is Costa Rica’s primary policy challenge.

77. **Delivering on the Government’s commitment to fiscal consolidation requires a dual approach of increasing public revenues and limiting the level of expenditures.** The SCD highlights the growing deficit and public debt as barriers to growth and poverty alleviation, with increasing tax collection as an important pre-requisite for fiscal sustainability. The Government’s NDP (2015-18) seek to increase public revenue beyond the current level of 13 percent of GDP through such fiscal measures as transforming the existing sales tax into a full-fledged VAT and eliminating income tax exemptions. According to Government estimations, the inclusion of services in the existing sales tax to transform it into a VAT is expected to raise 1 percentage point of GDP in additional revenue in the first year of approval, and half a percentage point over the two following years. The elimination of exemptions to the income tax is expected to generate around 0.7 percentage points of GDP in additional revenue. Draft legislation to implement these initiatives are in public consultation and is expected to be sent to the Legislative Assembly in May 2015. Given the political landscape, the Government is carefully preparing to ensure that it has the simple majority needed for the approval of that legislation. Moreover, the Government also submitted legislation at the end of 2014 to support efforts against money laundering and smuggling. Once approved, these measures are expected to generate about a half percentage point of additional tax revenues over the next three years. These tax policy initiatives are also being complemented with tax administration measures to improve the efficiency of tax collection and management. For example, the Government is moving towards a virtual tax administration, including rolling out electronic invoices and facilitating income tax payment through use of credit and debit cards. Equally important, the Government is committed to reforms on the expenditure side to support consolidation. These reforms include use of results-based budgeting, introduction of ceilings on pensions, improvement in cash management, and implementation of hiring freezes. The impact of these measures is estimated to amount to be at least half a percentage point of GDP.

78. **The CPF will support the efforts of the Government to increase the efficiency of its fiscal management and strengthen its capacity mainly through the provision of TA.** To strengthen Government’s fiscal management capacity and thus efficiency, the WBG will provide TA to guide the Government in the implementation of the various revenue generation and expenditure limiting measures. The WBG is also in dialogue with the Government on providing a possible DPF to support a number of policy reforms should the Government efforts materialize. Given that some of the supported measures in this highly relevant area depend upon legal approval, any support in this area implies considerable risks to the overall WBG program. The WBG is also providing TA on (i) development of inclusive and sound financial systems in Central America (including Costa Rica); (ii) preparation of a framework for the analysis of systemic risks to increase the Government’s response capacity to threats to financial stability; and (iii) strengthening financial market integrity. Finally, the Government has also requested support to enhance public debt management, strengthen the public procurement system, and improve monitoring and tracking of spending under the national budget. Given that the WBG has just recently initiated dialogue in these areas in response to Government’s request, there is still a need to further define the focus and scope of this assistance.

79. **The WBG is collaborating closely with the International Monetary Fund (IMF) and the IDB on this agenda.** The WBG is jointly advising the Government on its fiscal reform agenda with the IMF, although no direct financial support from the IMF is expected. IDB is also actively involved in the dialogue on fiscal consolidation given that the Government’s financing needs over the next few years are so large that several multilateral or bilateral agencies will cover them.

80. **The expected outcome of this objective is that Government’s fiscal management capacity would be strengthened over time, resulting in greater efficiency.** Indicators to measure success of the WBG engagement include increased tax-to-GDP ratio and increased share of revenue collected electronically through credit or debit cards. The indicators related to this objective may have to be revisited at the time of the Performance and Learning Review in the event that approval of certain legislation does not materialize.

### Objective 5: Improve efficiency and quality of the health insurance system to improve results

81. **Sustainability of Costa Rica’s strong Social Compact requires addressing tensions between high levels of social spending and the country’s ability to deliver high-quality, efficient services and improve results and outcomes.** To bring quality of service back to its previous high level, both efficiency of service delivery and management as well as effectiveness of social programs should be enhanced. Despite Costa Rica’s long-standing commitment to universal health coverage, important “cracks in the system” reduce the effectiveness and efficiency of this cornerstone of the Social Compact. The current organization of the system has led to increasing waiting times and patient frustration. Out-of-pocket spending has increased alongside rising public spending on health, and budget allocations do not take into account demographic and demand changes, leading to inefficiencies and inequities of health care. Furthermore, an outdated infrastructure and information management system decreases transparency and efficiency of resource management. Finally, despite high coverage of the social protection system, social
assistance programs are fragmented and weakly targeted, resulting in limited impacts on poverty and inequality.

82. To continue to deliver high-quality health services to all Costa Ricans in an efficient and sustainable manner, the country’s public universal health insurance requires strengthening. This requires a three-pronged approach. First, the organization of health services requires adaptation to better tackle new demographic and epidemiological challenges to ensure quality and timeliness of service delivery. With reduced mortality and fertility rates and increasing life expectancy, the share of Costa Rica’s population over the age of 65 is expected to account for nearly 21 percent of the population by 2050, as compared to just over 5 percent in 2008. This demographic shift will further intensify the current epidemiological transition. For example, between 1995 and 2005 the burden of disease increased by more than 25 percent for a number of non-communicable conditions, including diabetes, coronary artery disease, and chronic kidney diseases, to name a few. Over the same period, the disease burden for lower respiratory infections, pre-term birth conditions and congenital anomalies decreased by more than 25 percent. These shifts present challenges to the financial sustainability of the current health care model, given the high costs associated with a narrow approach on individual and curative technologies. The international experience of OECD countries suggests that there are two key areas of intervention needed to ensure quality and sustainability of universal health coverage: (i) the reorganization of health care services within the framework of integrated health care networks of providers that improve timeliness and continuity of care; and (ii) the strengthening of institutional financial and administrative capacity to foster suitable incentives to reduce the burden of disease of non-communicable conditions while boosting efficiency and using out-of-pocket expenditures with transparency and clear lines of accountability. Finally, to support these two objectives, the health sector’s financial model of budget and resource allocation should be revisited. The CCSS is developing a new strategic vision for the universal health insurance system, seeking to improve the healthy years of life by improving the institutional capacity to prevent, diagnose, and treat non-communicable conditions, strengthening the continuity of care, setting up quality control mechanisms, streamlining central management, and improving budgetary and resource allocation practices.

83. Social assistance programs in Costa Rica also need upgrading so as to increase their effectiveness and impact given that coverage of major program reaches half the poor, at best. Social policy is fragmented across numerous institutions in Costa Rica, and consequently, more than two dozen social programs operate in parallel, often with similar target groups. These programs are uncoordinated and are not well targeted, resulting in low coverage of the most vulnerable. Even in better targeted Costa Rican programs, such as the non-contributory pension, only around half of beneficiaries are from the bottom income quintile. On the other end of the spectrum, programs such as school feeding and National Learning Institute training programs tend to benefit mainly the non-poor. Thus, there is significant room for improving the targeting accuracy of these programs and harmonizing eligibility criteria, as well as strengthening program management and performance monitoring and evaluation. Moreover, to improve both targeting and management of these programs, the various social information systems and beneficiary rosters should be harmonized and/or integrated while tools for strategic planning, program management and monitoring results should be developed. Finally, a significant challenge for the efficiency and effectiveness of the social protection system is its fragmentation and institutional complexity.
Institutional arrangements in the management and financing of social programs are highly complex. Funds flow from the central government to various programs, based on an allocation formula set by law. As a result earmarking makes the budget allocation inflexible, in turn making it difficult to track financial flows, and assess the cost-effectiveness of programs.

84. **The CPF will support the efforts of the Government to improve the efficiency and quality of the universal health insurance system.** The WBG will finance a part of CCSS’s reform of the Social Health Insurance system to deliver improved health outcomes per dollar invested to limit its dependence on the national budget in the future. The Program will include components aimed at (i) strengthening the system’s capacity to respond to the rise in non-communicable/chronic conditions, while ensuring that quality and timeliness gaps are reduced for those living in poverty, indigenous peoples, and other vulnerable groups; (ii) improving budget and resource allocation and expanding and diversifying revenue collection sources; and (iii) enhancing governance and accountability, with an emphasis on moving from controlling inputs to managing risks and results. New management practices will also be introduced to improve strategic decision-making. Overall, the emphasis is on shifting the focus from managing inputs to managing results. The WBG is also providing some support to the Government on enhancing efficiency and ensuring better results in the social sectors more broadly through an analytical review and TA. First, the WBG is carrying out a Social Sector Expenditure and Institutional Review to: (i) benchmark Costa Rica’s social spending (and select outcomes) to OECD aspirational peers; (ii) present a systematic analysis of spending efficiency across sub-national units; and (iii) identify options for achieving higher levels of efficiency in public spending. Second, the WBG is currently providing TA for the design of a strategy to (i) increase coverage of social safety nets and social protection programs among the extreme poor; and (ii) improve delivery of social programs and services to the moderate and extreme poor, through better coordination of social programs and services.

85. **The expected outcome of this objective is that the efficiency and quality of the health insurance system improves, leading over time to better results for the population.** Indicators to measure success of the WBG engagement include increased quality of services as measured by decreased patient hospital readmissions and increased efficiency as measured by reduced unnecessary hospitalizations for procedures eligible to be performed in an outpatient setting (both indicators will be disaggregated by gender). Given that the dialogue on the social protection systems is still in early stages, an indicator on social protection has not yet been defined. This will be revisited at the time of the Performance and Learning Review.

### Objective 6: Expand capacity to promote climate-smart and environmentally sustainable development

86. **Costa Rica is renowned for its ability to simultaneously pursue economic and social improvements while reaping local and global environmental benefits.** Costa Rica has been able to establish itself as a leader in environmental conservation and green development. Through its pioneering Payments for Environmental Services program and the subsequent establishment of the Biodiversity Endowment Fund, Costa Rica has been highly successful in promoting forest and biodiversity conservation. Costa Rica has also made significant progress on the climate mitigation agenda and reduction of greenhouse gas emissions, having been an early adopter of the REDD+...
concept (formalized in 2005) and the first country to put REDD+ onto the agenda of international climate negotiations. In addition, through the Partnership for Market Readiness program, Costa Rica is planning to assess greenhouse gas mitigation programs and actions in key sectors and enabling policy instruments, such as a domestic carbon offset market, to foster a lower emissions development pathway and ultimately contribute to its aspirational goal of carbon neutrality. It is further working to integrate the valuation of natural assets in the budget system through the Wealth Accounting and the Valuation of Ecosystem Services program. In addition to environmental gains, Costa Rica’s ‘green’ initiatives have strong local co-benefits in terms of community participation and local livelihoods, particularly for Indigenous People and other rural communities, as well as efficiency in resource use and fostering the environmental trademark that underpins Costa Rica’s image as a green travel destination. Finally, Costa Rica continues to look for opportunities to increase domestic clean energy sources, such as hydropower.

87. **Yet, Costa Rica is at significant risk for disasters, some of which are likely to increase in frequency as a result of climate change.** The country is prone to a number of disasters, including geophysical hazards and occurrence of extreme weather events. Should such extreme disasters occur, the country currently lacks access to substantial contingent funds to address the needs of the population, which could increase macroeconomic instability. It is, therefore, critical that Costa Rica improve its ability to respond promptly to these possible eventualities by expanding its menu of financing options. Over the medium-term, climate change is likely to increase the frequency of occurrence of extreme weather events, as well as the recurrence of low-onset climate risk, such as droughts, calling for a need to build resilience capacity to adapt to climate change across different sectors and levels.

88. **And the ability for Costa Rica to sustain its current model of conservation and reforestation is limited both financially and physically, requiring an approach that is better adapted to the broader productive landscape.** With nearly 30 percent of the population living in rural settings and deriving much of its income from agriculture and rural livelihood sources, there are increasing tensions between providing for income growth, while both preserving the achievements of increasing or sustaining the forest cover and enhancing the resilience of the community to increasing climate change and extreme events. To improve medium- and long-term outcomes for the poor, innovative approaches to income generation that allow for cultural and environmental sustainability need to be explored. The Government seeks to build off of the successful Payments for Environmental Services program and promote a broader, resilient, productive landscape vision that will contribute to sustainable livelihoods of the rural population. At the same time, there is the need to diversify funding sources for the payment system, put in place sustainable incentive structures, and be less reliant on a fuel tax in the long-term.

89. **Growing urbanization and its accompanying challenges are also putting increasing pressure on existing resources.** As noted in the SCD, insufficient waste water treatment, a growing solid waste challenge, air pollution, contamination of beaches, and an overall lack of planning for increased urbanization jeopardize Costa Rica’s development model and status as a green destination. Therefore, failure to deliver on environmental goals to-date present a dual threat in the forms of potential backsliding on conservation efforts, as well as decreased appeal to foreign tourism. Costa Rica also needs to consider the extent to which, and how, it will begin to engage in these more complicated aspects of environmental sustainability as its economy continues to grow.
90. **The CPF will support the Government efforts in promoting climate-smart and environmentally sustainable development through a two-pronged approach that combines increased resilience to disasters and climate risks with low carbon growth options.** To promote increased resilience to disasters, the WBG will continue to provide contingency financing to the Government through a DRM DPF with a CAT DDO (legacy operation), a tool that provides immediate access to liquid capital following a disaster. The availability of such contingency financing would alleviate the need to draw down on already limited funds from the public budget and provide bridge-funding while other financing is mobilized in the aftermath of a disaster. In addition, the WBG will support Costa Rica’s implementation of a DRM financing strategy and mainstreaming disaster risk in the national and subnational development and investment programs. The WBG also stands ready to support the Government in joining the Caribbean Catastrophe Risk Insurance Facility. This Facility is a multi-country risk-pooling insurance that offers policies in the event of earthquakes, tropical cyclones, and excess rainfall in order to mitigate short-term cash flow problems. In terms of long-term climate resilience, the WBG engagement will also continue to support the Government’s efforts to sustain and expand the Payments for Environmental Services program from forest ecosystems toward rural productive areas with a strong view of integrating adaptation options. As a first step, the WBG will provide TA to identify the opportunities and costs of providing sustainable livelihood improvements in the rural landscape and enhance the Government’s ability to undertake sustainable landscape and territorial planning. As productive land is limited, the approach will emphasize agricultural production of high-value products and climate resilience, while seeking to improve market linkages of rural farmers. Support under the productive landscape approach will focus on (a) agriculture broadly defined (including livestock and plantation forestry) with an emphasis on productivity, competitiveness and value chains; and (b) natural resources management, including conservation and an improved/reformed Program for Environmental Services. In addition, the work would be complemented by climate smart planning and decision support systems covering both adaptation (to enhance resilience of systems) and mitigation (to maximize low carbon production/conservation options).

91. **The WBG engagement will also support the country’s aspiration to maintain a low carbon and environmentally sustainable development path that assures benefits for local communities and access to renewable energy resources for economic growth.** The WBG will continue to support the REDD+ strategy to reduce greenhouse gas emissions through enhanced forest management. As part of this work, the Government and the WBG have agreed to negotiate an Emission Reductions Payment Agreement, the first globally, with the Forest Carbon Partnership Facility worth up to US$63 million. The Partnership for Market Readiness processes outlined above will help the Government and private sector establish a domestic carbon offset market to promote low carbon development alternatives in promising sectors. The WBG is also supporting Costa Rica’s efforts to expand renewable energy generation sources through the IFC’s *Reventázón* investment in hydro-power, which will not only respond to the economy’s growing energy needs but also contribute to the country’s goal of reducing its carbon emissions. While environmental urbanization challenges are not included under this CPF based on the selectivity filters, there is potential to consider targeted pollution problems, such as support to improving sewerage and drainage capacity on the Caribbean Coast. Through analytical support, including links to ongoing regional studies, the CPF could help to better understand these growing challenges and,
accordingly, consider additional areas for assistance and support to the Government.

92. The WBG maintains a comparative advantage in this area, given its global and regional knowledge and experience in natural resource management and climate change and its long term engagement in the environment sector. Over the past two decades, IBRD has been a close partner to Costa Rica on the environmental agenda, collaborating on frontier areas such as the first Payment for Environmental Services program. Going forward, it is collaborating closely with a number of other development partners active in the environment sector, including the German Development Bank, the German Agency for International Cooperation, EIB, EU, the Japanese International Cooperation Agency, the International Union for the Conservation of Nature, the Tropical Agricultural Research and Education Center, and the United Nations Development Programme.

93. The expected outcome of this objective is expanded Government capacity to promote climate-smart and environmentally sustainable development options. Indicators to measure success of the WBG engagement include increased Government capacity to promote low carbon development and maintained capacity to respond to disasters.

D. Implementing the CPF

94. The proposed CPF is highly selective given its four-year implementation period and features a mix of instruments to provide Costa Rica with a package of assistance to best address the country’s most critical development needs. The CPF is focused on achieving results in a few priority areas, given past experience in the country and the implementation timeframe, which is aligned with the four-year political cycle. Lending volumes in FY16-FY17 will depend on country demand, overall performance in the course of the CPF period, and global economic developments, which affect IBRD’s financial capacity and demand by other WBG borrowers. In FY16, the WBG plans to support the Enhancing Performance of Universal Health Insurance Project in the amount of US$417 million, either through an investment lending or a Program for Results, depending on feasibility. During the remainder of the CPF period, the WBG may support a DPF to promote fiscal consolidation, and an investment financing project to increase sewerage and drainage services on the Caribbean Coast. The timing and amounts of these two projects are not yet determined. No lending is foreseen in the second half of the CPF, given the high risk of projects not being approved by the Legislative Assembly at the end of the political cycle. Instead, in the outer years of the CPF, the WBG will focus on implementing newly approved operations and the existing portfolio, as well as provide TA to support and maximize the impact of investments and engage with the Government on key priority areas. Where appropriate, the program will draw on trust funds to increase impact, in particular for ensuring environmental sustainability. IFC will remain an active partner in the private sector, although also with selective engagement. Its portfolio in Costa Rica is small due to the small market size, and lack of institutional conditions. Given these constraints, IFC plans to provide up to US$160 million in investments and US$5 million in TA over the CPF period, working alongside IBRD. If opportunities arise for large scale transformational programs and conditions allow, it will scale up its engagement. MIGA has no pre-determined envelope for guarantees over the CPF period, but will actively seek opportunities to meet requests from foreign investors. To support the engagement and further improve implementation, the WBG will continue to maintain a presence
on the ground and lead the dialogue with Government, development partners, private sector and civil society.

95. **While Costa Rica has made good progress in strengthening its country systems and public financial management, challenges remain in the use of country systems for WBG operations.** The establishment of the Integrated Financial Administration System and the Single Treasury Account have led to improved financial programming, prudent and disciplined cash flow management, and decentralization of the treasury function. Currently, WBG operations are included in the national budget, but the use of the Single Treasury Account and the Integrated Financial Administration System is still limited, at times requiring the use of supplementary records and processes for the preparation of project financial reports. Mostly, the challenges derive from the legal control framework in terms of financial management and public procurement. In particular, the control framework for the approval of contracts by the Comptroller’s General Office often delays implementation and disbursements of projects. During preparation of investment lending, the WBG will assess the possibility of using those well-functioning elements of the country systems (e.g. integrated financial management system and Treasury Single Account for the processing of payments) and try to limit the use of additional or supplemental requirements so as to further simplify implementation arrangements. The Program for Results instrument would also aim to support the strengthening and modernization of these existing systems and build capacity within CCSS for a more efficient budget management. Looking ahead, the WBG will continue working on strengthening country systems, in an effort to overcome some of the challenges encountered in project implementation, including: (i) strengthening the national financial management information systems to facilitate timely and reliable accounting and budgeting records, control and reporting of projects; (ii) promoting use of the Single Treasury Account; and (iii) supporting alignment with international legal and regulatory standards.

**IV. MANAGING RISKS TO THE CPF PROGRAM**

96. **Risk in Costa Rica is assessed as substantial, with four potential risks that could have an overall substantial impact on the implementation of the CPF.** These risks include: a fragmented political environment, which could impact sensitive elements of the Government’s planned fiscal reforms; uncertain macroeconomic environment; weak institutional and implementation capacity; and fragile fiduciary environment.

97. **With respect to political and governance risks, the Government faces challenges in implementing its fiscal reform agenda, especially some of the more sensitive elements, due to lack of majority in the Legislative Assembly.** Given that the ruling party holds just around 20 percent of seats in the Legislative Assembly, it is dependent on alliances to advance its proposed reform agenda. Moreover, the Government is attempting to tackle some sensitive and difficult issues related to increased taxation. While it is working to build broad support in the Legislative Assembly and among other non-state actors (civil society and the business community) through extensive consultations, there is a high risk that the relevant laws may not be approved or, even if approved, that they could be overturned later by the Supreme Court, as was the case in 2014. Thus, any engagement in such core policy areas could be subject to this risk and the WBG’s proposed program may be impacted over the coming years. To the extent possible, the WBG has already attempted to mitigate this risk by applying the selectivity filters and focusing on fewer, larger
operations with significant Government support and of high strategic importance to the country. However, this risk remains high and the CPF may need to be modified at the Performance and Learning Review stage.

Table 2: Risk in Costa Rica

<table>
<thead>
<tr>
<th>Risk Categories</th>
<th>Rating (H, S, M, L)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Political and governance</td>
<td>H</td>
</tr>
<tr>
<td>2. Macroeconomic</td>
<td>S</td>
</tr>
<tr>
<td>3. Sector strategies and policies</td>
<td>M</td>
</tr>
<tr>
<td>4. Technical design of project or program</td>
<td>L</td>
</tr>
<tr>
<td>5. Institutional capacity for implementation and sustainability</td>
<td>S</td>
</tr>
<tr>
<td>6. Fiduciary</td>
<td>S</td>
</tr>
<tr>
<td>7. Environment and social</td>
<td>M</td>
</tr>
<tr>
<td>8. Stakeholders</td>
<td>L</td>
</tr>
<tr>
<td>Overall</td>
<td>S</td>
</tr>
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</table>

98. Continued economic growth in the last decade, a rising debt to GDP ratio, an increasing deficit, and stagnant and low revenues could impact Costa Rica’s future macroeconomic stability. Costa Rica needs to urgently restore its fiscal balance and remedy the imbalance between expenditure and debt to ensure continued progress on reducing inequality and expanding shared prosperity. The WBG is supporting the Government’s efforts to submit to the Legislative Assembly draft legislation to transform the sales tax into a full-fledged value added tax by including the services sector and legislation to reduce exemptions to the income tax to the Legislative Assembly in May 2015. Moreover, it is exploring mechanisms to improve the efficiency of both its spending and its tax revenue collection. Costa Rica also has contingent lines of credit in the case of disasters, which could help cushion the impact on the overall economy. While requiring spending restraint in the short-run, a fiscal consolidation is necessary to ensure the sustainable provision of public services. In case of a further deterioration of the fiscal situation, WBG projects could be impacted through scarce resources for operating budgets that are needed to accompany programs as for example in education or health. A number of the proposed CPF activities respond to this risk by working to create contingencies for the Government in the case of negative macroeconomic shocks. The WBG will also continue to monitor the evolution of the macroeconomic situation and advise the Government on necessary measures to respond to vulnerabilities. As such, this risk is rated substantial.

99. Finally, Costa Rica also faces significant institutional and fiduciary risks related to the weak capacity of public institutions. Experience has shown that WBG interventions, whether project financing or TA, have not produced expected results due, in part, to low implementation capacity of public institutions. Moreover, given the role of the Comptroller General’s Office in reviewing and, when necessary, challenging decisions (particularly on procurement), achieving results under the past CPS took longer than originally expected. With this in mind, this CPF has set more realistic targets and implementation timelines and the WBG will continue to work with the Government to ensure that the design of operations fully take into account lessons learned and implementation experience. Furthermore, the WBG will work closely with the Government and
implementing institutions to provide early and regular capacity building. Fiduciary risks also relate mainly to ex-ante controls by the Comptroller General’s Office for contract signing, which appear to be cumbersome, and weak institutional capacity. To mitigate these risks, the WBG will continue supporting the strengthening of public financial management systems to facilitate timely and reliable accounting and budgeting records, control, and reporting of projects. It will also work closely with the Comptroller General’s Office to strengthen its control framework and approach and seek opportunities to pursue further simplification of required procedures in addition to capacity building. Notwithstanding these mitigation measures, the risk to the impact of the WBG engagement due to these risks are substantial.
Annex 1: CPF Results Framework

<table>
<thead>
<tr>
<th>Pillar 1: Reducing Constraints to Productive Inclusion</th>
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<tr>
<td>Despite its advanced social policies, income inequality is on the rise in Costa Rica. A key contributor to the increase in income inequality is the under-supply of highly-skilled labor for a growing demand and over-supply of low-skilled labor for a decreasing demand. Costa Rica’s labor market and education system are currently unable to produce the highly-skilled labor that is in increasing demand for a modernized economy. As the economy has diversified into increasingly high value-added sectors, the demand for skilled labor has soared. And yet, Costa Rica has not sufficiently increased its stock of high-skilled workers. This human capital deficit will continue to increase the disparity in access to jobs and other income-generating opportunities. In parallel to producing more skilled labor, which is a long term endeavor, productive opportunities need to be created for the existing large pool of low-skilled labor. Demand for low-skilled labor has decreased significantly since the crisis given the contraction in construction and agriculture, which, together with domestic services, previously employed over 50 percent of low-skilled workers. Micro, small and medium enterprises (MSME) provide opportunity for self-employment and wage labor for this now largely unemployed pool of people, but MSME viability is dependent on access to financial services. Inclusion, as well as growth, would also benefit from the many complementarities involved in improving education and bolstering competitiveness. Closing the education gap between the poor and non-poor is highly relevant for productive inclusion as it would allow those in the bottom 40 percent to access more opportunities. However, a well-educated workforce with relevant skills is also fundamental for sustaining economic growth and increasing productivity while lowering the costs of doing business can boost competitiveness across various sectors. In parallel, increasing infrastructure spending stimulates construction, creating more jobs for the large stock of low-skilled workers. Thus sustainable investments in energy and transport would both lower costs and improve the operating environment for firms, thereby supporting competitiveness, and generate jobs for workers with different levels of skills. Pillar I seeks to address the constraints to productive inclusion through tackling the skills issue, fostering opportunities for those that are excluded by virtue of lack of skills, and contributing to enhanced competitiveness through energy and transport investments. Pillar I’s objectives are to: (i) enhance higher education to improve skills; (ii) increase access to finance to generate productive opportunities; and (iii) promote sustainable investments in energy and transport to support competitiveness.</td>
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<table>
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<tr>
<th>Objective 1: Enhance higher education to improve skills</th>
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<tr>
<td><strong>Intervention Logic:</strong> The competitiveness of Costa Rica hinges on the existence of a skilled labor force to support its trajectory towards a high value-added economy and reduce the skills-income gap. Currently, Costa Rica’s labor supply is not able to furnish the skills needed for a labor market supporting a high value-added economy. The country faces a number of bottlenecks in higher education, including limited access, poor quality, lack of relevance of programs, and lack of accountability of providers. Access to public universities is contingent upon successfully passing an entrance examination and is limited by quotas due to limitations in physical infrastructure and human resources, most impacting the poor. The quality of institutions and programs (especially among the numerous private universities) is uneven due to lack of accredited programs and low quality of university faculty. Furthermore, few university programs and curricula are relevant for labor market needs, with only 16.7 percent of university programs focusing on basic sciences, engineering, and computing. Finally, universities are granted full autonomy but will little accountability for results, despite high levels of expenditures. In response to the gaps in quality and relevance of university programs, the Government seeks to promote the study of subjects relevant to the national economy, increase accreditation of university programs, introduce linkages of university programs and research to ongoing work of industry leaders, and invest in the professional development of university professors. In addition, by identifying (and subsequently responding to) drivers of secondary drop-outs, the Government hopes to not only increase secondary completion, but also increase access to, and improve the quality of tertiary education, so as to bring educational outcomes closer to the standards of OECD member states. The expected outcome of this objective is improved access, quality and relevance of higher education in Costa Rica.</td>
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<tr>
<td>CPF Indicators</td>
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### Objective 2: Increase access to finance to generate productive opportunities

**Intervention Logic:** To ensure greater inclusion, the bottom 40 percent of the population needs greater access to more productive opportunities. Labor income and self-employment are the largest contributors to poverty alleviation while MSMEs play an important role in providing income and employment opportunities for low skilled workers and the poor. Although MSMEs have been a significant driver of the Costa Rican economy to-date, accounting for 38 percent of total formal employment in the country, access to finance to expand operations is limited, given the MSME segment is generally underserved by state- and foreign-owned banks in Costa Rica: approximately 40 percent of the country’s estimated 300,000 MSMEs cite access to credit as a major constraint to growth. The Government has committed to providing credit and increasing access to financing for MSMEs in order to support their role as contributing forces to reducing inequality and social exclusion and improving the overall quality of life for many Costa Ricans. The CPF seeks to catalyze productive opportunities for greater employment, especially for the bottom 40 percent among the large pool of unskilled labor force, through increased access to finance for the country’s MSME. The expected outcome of this objective is that access to finance through MSMEs would be increased.

<table>
<thead>
<tr>
<th>CPF Indicators</th>
<th>Supplementary Progress Indicators / Milestones</th>
<th>WBG Program</th>
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</table>
| 2.1 Increased microenterprises, and SMEs reached with financial services | Volume of micro and SME loans outstanding increased  
*Baseline:* US$2.5 million (micro) + US$332 million (SME) (2013)  
**On-going IFC**  
• Banco Improsa (35132)  
• Banco General (31846)  
• Banco Davivienda (32965)  
• Cooperativa Nacional de Educadores (Coopenae) (30325)  
• IFC Secure Transactions and Collateral Registry (600301)  
• WBG TA on Development Finance Good Practices (under Central America Financial Sector Programmatic Approach - P152455)  
**Potential New**  
• Possible IFC Investments in SMEs and microenterprises |

| Baseline: 805 (micro) + 2,420 (SME) (2013)  
| Target: 2,091 (micro) + 25,329 (SME) (2019) |

### Objective 3: Promote sustainable investments in energy and transport to support competitiveness

**Intervention Logic:** Boosting inclusion and growth in the labor market requires confronting the dual challenge of maintaining competitiveness of high value-added sectors, while improving the viability of low value-added sectors. Moreover, reducing the infrastructure deficit would increase competitiveness, growth, and environmental sustainability. A critical priority identified by the SCD is that of infrastructure, including quality of transport infrastructure and rising electricity costs. Further, the Government has faced significant challenges in executing infrastructure investment in a timely manner. The deficiencies in productive infrastructure raise concerns about the level of investment needed and the long-term competitiveness of the country. This infrastructure deficit reduces the potential of local firms to grow and create jobs, in particular for firms that operate outside Free Trade Zones. Infrastructure improvement poses a number of tradeoffs, including the need to intervene in protected areas (in the case of clean energy production), as well as the need to control the current fiscal deficit. Given the necessity of continuing to invest in infrastructure, and the reality of fiscal constraints, Costa Rica must look for options for private sector participation...
in the maintenance and upgrading of its infrastructure. The expected outcome of these investments under this objective include increased power generation from renewable resources.

<table>
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<tr>
<th>CPF Indicators</th>
<th>Supplementary Progress Indicators / Milestones</th>
<th>WBG Program</th>
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| 3.1 People provided with new or improved access to electricity | Additional capacity in the system (from IFC hydro projects)  
Baseline: 0 annual GWh (2015)  
Target: 1,400 annual GWh (2017) | On-going  
• IFC Reventazon Hydropower Project (31383)  
• MIGA Transport Guarantee: San José-Caldera Toll Road |

**Pillar 2: Bolstering Fiscal, Social, and Environmental Sustainability**

Costa Rica faces challenges to the sustainability of development successes on the fiscal, social and environmental fronts. Costa Rica struggles with sound fiscal health - it is dealing with worsening debt dynamics, weak public revenue mobilization capacity, and inefficient expenditures. The SCD proposed options for increasing revenue and improving the efficiency of public sectors. In addition to fiscal issues, there are growing social tensions, high unemployment (particularly among the lowest quintiles and women), and deteriorating quality of services. Thus, sustainability of social programs is a challenge given that there are signs that some segments of the population are opting out to substitute public services in health and education with private ones. Finally, fiscal sustainability is further threatened by Costa Rica’s vulnerability to potential natural and environmental challenges, which threaten Costa Rica’s Green Trademark. While it has been successful in climate change mitigation, adaptation to climate change and other emerging environmental challenges will be critical to ensuring sustainability of its green trademark and consistency with increased resilience to climate risks, all while providing improved livelihoods for the population. This Pillar supports the Government’s efforts to tackle critical fiscal, social and environmental sustainability challenges. The Pillar’s objectives are to: (i) strengthen fiscal management capacity to enhance efficiency; (ii) improve efficiency and quality of the health insurance system for better results; and (iii) expand capacity to promote climate-smart and environmentally sustainable development.

**Objective 4: Strengthen fiscal management capacity to enhance efficiency**

**Intervention Logic:** Improving Costa Rica’s fiscal sustainability is necessary for alleviating poverty and fostering an environment conducive to growth. Despite sustained growth rates above the regional average and recent improvements to tax and fiscal transparency, Costa Rica continues to face a number of fiscal challenges. A growing deficit and large public debt, combined with limited Government revenue have contributed to worsening debt dynamics. The confluence of these events may also negatively impact investor confidence, thereby slowing progress towards a higher level of sustained economic growth. Delivering on the Government’s commitment to fiscal consolidation requires a dual approach of increasing public revenues and limiting the level of expenditures. The Government is committed to increasing public revenue through such fiscal measures as transforming the existing sales tax into a full-fledged VAT, eliminating income tax exemptions, and improving efficiency of tax collection and management. In addition, it is also committed to reforms on the expenditure side to support consolidation. These reforms include use of results-based budgeting, introduction of ceilings on pensions, improvement in cash management, and implementation of hiring freezes. The expected outcome of this objective is that Government’s fiscal management capacity would be strengthened over time, resulting in greater efficiency.
<table>
<thead>
<tr>
<th>CPF Indicators (2019)</th>
<th>Supplementary Progress Indicators / Milestones</th>
<th>WBG Program</th>
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<tr>
<td></td>
<td></td>
<td>• WB Programmatic Development of Inclusive and Sound Financial Systems in Central America (P152455)</td>
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<td></td>
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<td>• WB Analytical Framework Systemic Risk (146774)</td>
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<td>• WB Financial Market Integrity TA</td>
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**Objective 5: Improve efficiency and quality of the health insurance system to improve results**

**Intervention Logic:** Sustainability of Costa Rica’s strong Social Compact requires addressing tensions between high levels of social spending and the country’s ability to deliver high-quality, efficient services and improve results and outcomes. To continue to deliver high-quality health services to all Costa Ricans in an efficient and sustainable manner, the country’s public universal health insurance requires strengthening. This requires a three-pronged approach. First, the organization of health services requires adaptation to better tackle new demographic and epidemiological challenges to ensure quality and timeliness of service delivery. These shifts present challenges to the financial sustainability of the current health care model, given the high costs associated with a narrow approach on individual and curative technologies. The international experience of OECD countries suggests that there are two key areas of intervention needed to ensure quality and sustainability of universal health coverage: (i) the reorganization of health care services within the framework of integrated health care networks of providers that improve timeliness and continuity of care; and (ii) the strengthening of institutional financial and administrative capacity to foster suitable incentives to reduce the burden of disease of non-communicable conditions while boosting efficiency and using out-of-pocket expenditures with transparency and clear lines of accountability. Finally, to support these two objectives, the health sector’s financial model of budget and resource allocation should be revisited. The CCSS is developing a new strategic vision for the universal health insurance system, seeking to improve the healthy years of life by improving the institutional capacity to prevent, diagnose, and treat non-communicable conditions, strengthening the continuity of care, setting up quality control mechanisms, streamlining central management, and improving budgetary and resource allocation practices. The expected outcome of this objective is that the efficiency and quality of the health insurance system improves, leading over time to better results for the population. Given that the dialogue on the social protection systems is still in early stages, an indicator on social protection has not yet been defined.
<table>
<thead>
<tr>
<th>CPF Indicators (2019)</th>
<th>Supplementary Progress Indicators / Milestones</th>
<th>WBG Program</th>
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</table>
| 5.1 Increased quality of services, as measured by decreased patient hospital readmissions (disaggregated by gender)  
Baseline: TBD (2015)  
Target: TBD (2019) | Beneficiary satisfaction survey in place  
Baseline: No (2015)  
Target: Yes (2017)  
Streamlined mechanisms to address patient complaints under implementation  
Baseline: No (2015)  
Target: Yes (2018) | On-going  
• Central America Social Protection and Labor systems (P153468)  
• Central America Social Sector Expenditure and Institutional Review (P146907)  
• Costa Rica Pensions Reform: Risk-Based Supervision (P148780; TF016015) |
| 5.2 Increased efficiency, as measured by reduced unnecessary hospitalizations for surgical procedures eligible to be performed in an outpatient setting (disaggregated by gender)  
Baseline: TBD (2015)  
Target: TBD (2019) | List of surgical procedures eligible to be performed in an outpatient setting agreed upon  
Baseline: No (2015)  
Target: Yes (2017)  
Resource allocation for specialized hospitals executed using output-based measurements  
Baseline: No (2015)  
Target: Yes (2018) | Potential/Planned New  
• Costa Rica Enhancing Performance of Universal Health Insurance (P148435) |

**Objective 6: Expand capacity to promote climate-smart and environmentally sustainable development**

**Intervention Logic:** Costa Rica is renowned for its ability to simultaneously pursue economic and social improvements while reaping local and global environmental benefits. It has managed to position itself as a leader in environmental conservation efforts, reversing deforestation trends over the past decades based on the successful Payment for Environmental Services system, and enabling it to focus its strong image as a green travel destination. Costa Rica has also made significant progress on the climate mitigation agenda and reduction of greenhouse gas emissions, as an early adopter of the REDD+ and the first country to put REDD+ onto the agenda of international climate negotiations. Yet, Costa Rica is at significant risk for disasters, some of which are likely to increase in frequency as a result of climate change. The country is prone to a number of disasters, including geophysical hazards and occurrence of extreme weather events. Should such extreme disasters occur, the country currently lacks access to substantial contingent funds to address the needs of the population, which could increase macroeconomic instability. And the ability for Costa Rica to sustain its current model of conservation and reforestation is limited both financially and physically, requiring an approach that is better adapted to the broader productive landscape. With nearly 30 percent of the population living in rural settings and deriving much of its income from rural sources, there are increasing tensions between providing for income growth, while both preserving the achievements of increasing or sustaining the forest cover and enhancing the resilience of the community to increasing climate change and extreme events. To improve medium- and long-term outcomes for the poor, innovative approaches to income generation that allow for cultural and environmental sustainability need to be explored. Growing urbanization and its accompanying challenges are also putting increasing pressure on existing resources. The CPF will support the Government efforts in promoting climate-smart and environmentally sustainable development through a two-pronged approach that combines increased resilience to disasters and climate risks with low carbon growth options. The WBG engagement will also support the country’s aspiration to maintain a low carbon and environmentally sustainable development path that assures benefits for local communities and access to renewable energy resources for economic growth. The expected outcome of this objective is expanded Government capacity to promote climate-smart and environmentally sustainable development options.
<table>
<thead>
<tr>
<th>CPF Indicators (2019)</th>
<th>Supplementary Progress Indicators / Milestones</th>
<th>WBG Program</th>
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| 6.1 Increased Government capacity to promote low carbon development, as measured by forest GHG emission reductions achieved Baseline = 0 (2015) Target = 2 million tons* of CO2 (2019) *final amount depends on price of carbon negotiated | Low Emissions Development Scenarios prepared  
*Baseline: 0 sectors (2015)  
*Target: 4 sectors (2018)  
Water and forest accounts mainstreamed into fiscal policy  
*Baseline: 0 (2015)  
*Target: 2 (2019) | On-going  
• Costa Rica Catastrophe Deferred Draw Down Option (P111926)  
• Costa Rica Forest Carbon Partnership Facility Reducing Emissions from Deforestation and Forest Degradation Readiness (P123702)  
• CR Green and Inclusive Growth through a multi-sectoral Landscape Approach (P147664)  
• Costa Rica Partnership for Market Readiness (P129352)  
• Wealth accounting and valuation of ecosystem services partnership in Costa Rica (P143484)  
• IFC Advisory Services on Green Building Regulations |
| 6.2 Maintain Government capacity to respond to disasters, as measured by availability of policy and financial instruments for disaster risk management  
*Baseline: 2 (2015)  
*Target: At least 2 (2019) | National Disaster Risk Management Financing Strategy developed  
*Baseline: No (2015)  
*Target: Yes (2017)  
Mapping tool for climate-smart National Resource Management options established  
*Baseline: No (2015)  
*Target: Yes (2018)  
Disaster risk information and resilience/response mechanisms integrated into sub-national land-use plans  
*Baseline: 25 (2015)  
*Target: 35 (2019)  
National Emergency Fund remains well-funded and functional | Potential/Planned New  
• Caribbean Catastrophe Risk Insurance Facility (P108058)  
• Possible TA or investment lending on productive landscape support  
• Possible support for Caribbean Coast sewerage program  
• Possible additional or new financing for DRM DPF with CAT DDO |
Annex 2: Monitoring and Evaluation of the CPF Results Framework

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<tr>
<th>INDICATORS</th>
<th>OPERATIONAL DEFINITIONS AND SOURCES OF DATA</th>
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| 1.1 Increased number of students enrolled in priority areas in four public universities | This includes enrolment in (i) undergraduate and (ii) graduate programs in each of the priority areas: engineering, basic sciences (math, physics, chemistry, biology and geology), natural resources, agriculture and food sciences, arts, education, and health sciences. The four participating universities are: Universidad de Costa Rica, Universidad Nacional, Instituto Tecnológico de Costa Rica and Universidad Estatal a Distancia. The targets for this indicator are not cumulative.  
**Baseline:** 49,638 (undergrad) + 4,265 (grad) (2014); 24,684 (female, undergrad) + 2,004 (female, grad) (2015)  
**Target:** 57,492 (undergrad) + 4,600 (grad) (2019); 29,250 (female, undergrad) + 2,162 (female, grad) (2019)  
**Source of data:** Registry offices of the four participating universities. Data collected annually. |
| 1.2 Increased number of officially accredited programs at four public universities | This includes undergraduate academic degree programs. In order for a program to obtain accreditation, a self-evaluation has to be undertaken, a formal application for accreditation has to be filed, and an external evaluation has to take place. For accreditations to remain valid, the program must fulfill the corresponding requirements (e.g. submitting annual reports). The four participating universities are as in 1.1. Targets for each of the four universities will be monitored through the Institutional Improvement Agreements, which were signed between each university and the four participating Ministries – Ministerio de Educación Pública, Ministerio de Ciencia y Tecnología, Ministerio de Planificación Nacional y Política Económica, and Ministerio de Hacienda.  
**Baseline:** 68 (2015)  
**Target:** 85 (2019)  
**Source of data:** Vice-rectory of Teaching/Academic Vice-rectory of each of the four participating universities. Data collected annually. |
| 2.1 Increased microenterprises and SMEs reached with financial services | Number of microenterprises, and SMEs reached with financial services supported by WBG-financed operations. IFC counts a broad range of financial services with data disaggregated between MSMEs, including:  
- **Individuals/Micro Finance:** This category includes deposit accounts, the number of outstanding micro, housing, and retail loans, as well as clients reached with insurance and pensions. IFC counts the year-end number of outstanding loans, clients insured, and deposit accounts. Microfinance loan is defined as a commercial loan with amount at origination up to US$10,000. Retail loans include consumer credit cards, store cards, motor (auto) finance, personal loans (installment loans), consumer lines of credit, retail loans (retail installment loans).  
- **SME Finance:** SME finance includes SME loans, leasing, as well as enterprise insurance. An SME loan is defined as a commercial loan with amount at origination between US$10,000 to US$1,000,000 (or to US$2,000,000 in more advanced economies). Enterprise insurance includes the number of non-life commercial lines and agribusiness.  
**Baseline:** 805 (micro) + 2,420 (SME) (2013)  
**Target:** 2,091 (micro) + 25,329 (SME) (2019)  
**Source of data:** Development Outcome Tracking System, SME Reach survey |
| 3.1 People provided with new or improved access to electricity | Number of individual residential customers reached with additional energy generated from the *Reventazón* Hydropower Plant.  
*Baseline:* 0 (2015)  
*Target:* 348,000 (2019)  
*Source of data:* Development Outcome Tracking System |
|---|---|
| 4.1 Increased tax-to-GDP ratio | Total value of taxes collected against the national GDP.  
*Baseline:* 13.2% (2014)  
*Target:* 14.7% (2019)  
*Source of data:* Central Bank of Costa Rica |
| 4.2 Increased share of revenue collected electronically through credit or debit cards | Proportion of tax revenue collected from electronic transactions (credit and debit cards) divided by total revenue collected.  
*Baseline:* 0% (2015)  
*Target:* 25% (2019)  
*Source of data:* Central Bank of Costa Rica |
Currently, Costa Rica has access to two retention disaster risk financing instrument - the National Emergency Fund to address risk response and to invest in risk prevention and mitigation (as stipulated by Law 8488, Article 43); and a contingent line of credit, i.e. the DRM DPF with CAT DDO. In order to maintain the current financial capacity to respond to disasters, it will be necessary to preserve access to these types of disaster risk financing instruments and, if appropriate, consider expansion to others disaster risk financing instruments, including risk transfer tools (e.g the Caribbean Catastrophe Risk Insurance Facility).

Baseline: 2 (2015)
Target: 2 (2019)

Source of data: Dirección de Credito Publico (within the Ministerio de Hacienda)
Annex 3: Selected Indicators* of Bank Portfolio Performance and Management  
As of 3/31/2015

<table>
<thead>
<tr>
<th>Indicator</th>
<th>2014</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td><em>Portfolio Assessment</em></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number of Projects Under Implementation a</td>
<td>5</td>
<td>2</td>
</tr>
<tr>
<td>Average implementation Period (years) b</td>
<td>7</td>
<td>4.5</td>
</tr>
<tr>
<td>Percent of Problem Projects by Number c</td>
<td>20.0</td>
<td>0</td>
</tr>
<tr>
<td>Percent of Problem Projects by Amount c</td>
<td>22.4</td>
<td>0</td>
</tr>
<tr>
<td>Percent of Projects at Risk by Number d</td>
<td>20.0</td>
<td>0</td>
</tr>
<tr>
<td>Percent of Projects at Risk by Amount d</td>
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<td>0</td>
</tr>
<tr>
<td>Disbursement Ratio (%)*</td>
<td>5.1</td>
<td>5</td>
</tr>
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<table>
<thead>
<tr>
<th>Memorandum Item</th>
<th>Since FY 80</th>
<th>Last Five FYs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proj Eval by OED by Number</td>
<td>28</td>
<td>2</td>
</tr>
<tr>
<td>Proj Eval by OED by Amt (US$ millions)</td>
<td>1,119.7</td>
<td>513.3</td>
</tr>
<tr>
<td>% of OED Projects Rated U or HU by Number</td>
<td>7.7</td>
<td>0.0</td>
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<tr>
<td>% of OED Projects Rated U or HU by Amt</td>
<td>5.8</td>
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</tr>
</tbody>
</table>

*As shown in the Annual Report on Portfolio Performance (except for current FY).

b. Average age of projects in the Bank’s country portfolio.

c. Percent of projects rated U or HU on development objectives (DO) and/or implementation progress (IP).

d. As defined under the Portfolio Improvement Program.

e. Ratio of disbursements during the year to the undisbursed balance of the Bank’s portfolio at the beginning of the year. Investment projects only.

*All indicators are for projects active in the Portfolio, with the exception of Disbursement Ratio, which includes all active projects as well as projects which exited during the fiscal year.
Annex 4: Operations Portfolio (IBRD and Grants)
As of 3/31/2015
(in US$ millions)

**IBRD/IDA * **
Total Disbursed (Active) 46.27
of which has been repaid 2.23
Total Disbursed (Closed) 772.4
of which has been repaid 132.3
Total Disbursed (Active + Closed) 818.67
of which has been repaid 134.53

Total Undisbursed (Active) 219.73
Total Undisbursed (Closed) 69.2
Total Undisbursed (Active + Closed) 68.33

<table>
<thead>
<tr>
<th>Active Projects</th>
<th>Last PSR Supervision Rating</th>
<th>Original Amount in US$ Millions</th>
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<td>Project ID</td>
<td>Development Objectives</td>
<td>Implementation Progress</td>
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<tr>
<td>P111926</td>
<td>S</td>
<td>S</td>
</tr>
<tr>
<td>P123146</td>
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<tr>
<td>Overall Result</td>
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Annex 5. Statement of IFC Committed and Outstanding Portfolio
As of 3/31/2015
(in US$ millions)

<table>
<thead>
<tr>
<th>Commitment Fiscal Year</th>
<th>Institution Short Name</th>
<th>LN Cmdt - IFC</th>
<th>LN Repayment - IFC</th>
<th>ET Cmdt - IFC</th>
<th>QL + GE - IFC</th>
<th>GT Cmdt - IFC</th>
<th>RM Cmdt - IFC</th>
<th>ALL Cmdt - IFC</th>
<th>ALL Part</th>
<th>LN Out - IFC</th>
<th>ET Out - IFC</th>
<th>QL + GE out - IFC</th>
<th>GT Out - IFC</th>
<th>RM Out - IFC</th>
<th>ALL Out - IFC</th>
<th>ALL Out - Part</th>
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<tr>
<td>2012/2011/2010/2009/2008</td>
<td>Banco Impresa</td>
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<td>10.00</td>
<td>0</td>
<td>0</td>
<td>4.00</td>
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<td>24.00</td>
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<td>0</td>
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</tr>
<tr>
<td>2011/2012/2013/2014/2015</td>
<td>Banco LAFISE CR</td>
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<td>0</td>
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<td>19.11</td>
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<tr>
<td>2013</td>
<td>Banco General CR</td>
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<tr>
<td></td>
<td>CH Alaguada</td>
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<td>2011</td>
<td>Cooperasa</td>
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<td>2014/2015</td>
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<td>2012</td>
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<tr>
<td>2009/2010/2008/2007/2006</td>
<td>Promerica CR</td>
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<tr>
<td>2012</td>
<td>Sac Bic CR</td>
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<tr>
<td>Total Portfolio</td>
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<td>30.41</td>
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<td>118.16</td>
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<td>30.41</td>
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<td>153.01</td>
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</tbody>
</table>

The overall aim of the NDP is to promote sustainable, innovative, equitable and participatory development rooted in ethical and effective governance. The NDP is based on three pillars: (i) promotion of economic growth and creation of quality jobs; (ii) reducing poverty and inequality; and (iii) ensuring a transparent, efficient, and effective Government. These pillars are interdependent, requiring that substantial progress is made across the pillars.

The Government will continue to promote economic growth and attract FDI. Specifically, it will work to attract foreign investments in productive, high value-added sectors which will generate more high-quality jobs. The goal of such strategy is to create a strong value chain that will reinforce the linkages across the economy and serve as a vehicle for sustained future growth. At the same time, the Government will also make concerted efforts to build capacity for providing goods and services to the domestic and regional markets. Furthermore, it will continue to support alternative business models, such as cooperatives and MSMEs by working to expand access to financing and providing incentives for innovation with the overall goal to improve competitiveness and establish productive domestic and regional supply chains. Finally, the Government is committed to improve the overall business environment by reforming monetary and fiscal policies and investing in infrastructure improvements as key components of Costa Rica’s economic recovery.

With respect to reducing poverty and inequality, the Government is committed to reinforcing the main tenets of the Costa Rican Social Compact. The NDP focuses on the need to implement social programs that are better targeted to reach those living in extreme poverty. To achieve this, the Government will need to increase efficiency and effectiveness of government programs and reduce inefficient spending. The Government prioritizes the need for universal access to education and health services, which are critical to ending the cycle of poverty. Further, the NDP also recognizes the need to facilitate greater access to productive employment and to ensure enforcement of minimum wage and other labor regulations. Lastly, the Government will develop a record of beneficiaries and a variety of social maps, which show higher concentrations of poor and extreme poor households to facilitate better geographic targeting, based on the 2011 National Census.

Finally, fighting corruption and strengthening government transparency and accountability are a critical component of the Government’s efforts to respond to the needs of the Costa Rican people. To this end, the Government is committed to increasing access to public information through an ‘open government’ model to encourage greater citizen participation and oversight of the governing process. Furthermore, it is also committed to managing for better results and improving Government implementation of the public budget. In order to deliver on this commitment, it is necessary to tackle issues of corruption with all areas of the Government, including passing reforms to anti-corruption legislation and establishing a comprehensive framework for accountability at sectoral and regional levels.

The NDP 2015-2018 consists of 164 programs or projects across 16 different sectors. This will require significant collaboration and cross-sectoral efforts at the national, regional, and local levels. Therefore, it is critical that steps be taken to encourage synergies across sectors and with civil society.
Annex 7: Costa Rica Country Partnership Strategy
Completion and Learning Review FY12-15

Date of Country Partnership Strategy: June 10, 2011 (Report No. 60980-CR)
Date of CPS Progress Report: January 31, 2014 (Report No. 82511-CR)
Completion and Learning Review prepared by: Jovana Stojanovic (LCC2C) with inputs from Frank Sader (IFC), Angela Maria Fonseca (IFC), and the Costa Rica Country Team.

Acronyms and Abbreviations

AAA Analytic and Advisory Activities
CAT DDO Catastrophe Deferred Draw Down Option
CPF Country Partnership Framework
CLR Completion and Learning Review
CPS Country Partnership Strategy
CPSPR CPS Progress Report
DRM Disaster Risk Management
EIB European Investment Bank
EU European Union
FY Fiscal Year
GDB German Development Bank
IBRD International Bank for Reconstruction and Development
IEG Independent Evaluation Group
IFC International Finance Corporation
JICA Japan International Cooperation Agency
LAC Latin America and the Caribbean
MIGA Multilateral Investment Guarantee Agency
MIDEPLAN Ministry of National Planning and Political Economy
MSMEs Micro, Small and Medium Enterprises
OECD Organisation for Economic Cooperation and Development
PES Payment for Environmental Services
PPPs Public Private Partnerships
RAS Reimbursable Advisory Services
<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>REDD+</td>
<td>Reducing Emissions from Deforestation and Forest Degradation</td>
</tr>
<tr>
<td>SMEs</td>
<td>Small and Medium Enterprises</td>
</tr>
<tr>
<td>TA</td>
<td>Technical Assistance</td>
</tr>
<tr>
<td>UNDP</td>
<td>United Nations Development Programme</td>
</tr>
<tr>
<td>WBG</td>
<td>World Bank Group</td>
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I. Introduction

1. This Completion and Learning Review (CLR) evaluates the performance of the Costa Rica Country Partnership Strategy (CPS) for FY12-15 and describes the relevance, achievements and effectiveness of World Bank Group (WBG) support, as well as alignment with the Twin Goals. In addition, the CLR seeks to draw lessons to guide the design and preparation of the forthcoming Country Partnership Framework (CPF). The CPS provided a framework for a flexible partnership, with selective lending and increased knowledge engagement. While the CPS Progress Report (CPSPR) reaffirmed the WBG support to the three original pillars, it also adjusted the strategy to better reflect the outcomes supported by the WBG program. The CLR evaluation of results is based on the updated FY12-15 Results Matrix of the CPSPR.

2. This report assesses overall progress toward achieving CPS outcomes as Moderately Satisfactory, and WBG performance as Good. The CPS program achieved all six planned outcomes as revised in the Results Matrix of the CPSPR. Activities under the social sector pillar focused on equity by targeting services to rural communities and indigenous people. The environment and disaster risk management (DRM) pillar made notable progress on readiness to manage disasters and sustain forest and biodiversity conservation. Achievements under the competitiveness pillar were limited, but the foundation was laid for addressing one of the main challenges facing Costa Rica, the need to build a skilled labor force and the continued role of education in maintaining an equitable society. On WBG performance, the clear alignment of the CPS design with the Government’s priorities, effective use of various instruments to engage in a timely manner, and targeted program delivery were strong achievements. The International Finance Corporation (IFC) program, although small compared to other countries in the region, continued to be relevant, responding to country challenges, such as the growing demand for clean energy. Building synergies between the International Bank for Reconstruction and Development (IBRD) and the IFC program was limited.

II. Progress towards Long-term Development Outcomes

3. During this CPS period, Costa Rica continued to be a well performing upper middle income country with overall positive economic growth, although with limited poverty reduction and impact on shared prosperity. Costa Rica experienced robust economic growth, at an annual average rate of 4.9 percent between 2010 and 2012, compared to a LAC average of 4 percent. Costa Rica’s growth is estimated at around 3.5 percent in 2013 and 2014. Despite positive economic performance, fiscal policy challenges emerged with rising central Government public debt and deteriorating fiscal deficit.12 The Government attempted to pass a significant tax reform, but failed mainly due to a fragmented Congress and lack of consensus around structural measures. Costa Rica continued to have one of the lowest poverty rates in the Latin American and Caribbean Region (LAC), although since the global economic crisis in 2008, poverty rates have stagnated and the growth of the income of the bottom 40 is now lagging behind the growth of the median income13. For many decades, the country was an outstanding example of efficient and egalitarian delivery of public services. Recently, however, the system and quality of services have

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12 Government public debt expanded from 24.7 percent of GDP in 2008 to 35.3 percent in 2012. It is expected to increase to 40 percent by 2015 unless structural measures are implemented.
13 For more information on poverty data please refer to the Costa Rica Systematic Country Diagnostic, 2014 (WB).
deteriorated, leading to growing dissatisfaction of users who are increasingly turning to private service providers. The authorities have acknowledged the need to revamp public services to avoid weakening of Costa Rica’s service delivery needed under its exemplary Social Contract.

4. **Costa Rica’s social indicators continue to rank higher than those of other countries in the region.** Basic education and health indicators are above the regional standards; gender indicators also compare favorably. While Costa Rica has achieved universal primary education, attainment in secondary education is poor, with only 46 percent finishing secondary school. Also, the country is closing the education gender gap: the female-male primary gross enrollment ratio is roughly equal (0.99 in 2011), while the secondary level female-male ratio is 1.05. Outcomes in health are outstanding. In 2009, skilled health staff attended 99 percent of all births, above the averages for upper middle-income countries (96 percent) and LAC (89 percent). The contraceptive prevalence rate of 82 percent is higher than the average for upper middle-income countries and LAC (75 percent). Other important health achievements include life expectancy of 79 years and low infant mortality rates (8 deaths per 1,000 live births in 2012). Despite these important successes, improving the living standards of the indigenous peoples (2.4 percent of the population) remains a challenge. The majority of the indigenous population lives in poverty and lacks access to health services and clean water. Average years of schooling and illiteracy rates within the indigenous territories are 3.4 years and 30.2 percent, respectively, and very few indigenous people attend university.

5. **Progress on important development challenges identified by the Chinchilla Administration (2010-2014) fell short of expectations.** Despite past successes and a continued positive outlook, in 2010 it became evident that maintaining the achievements of the past several decades would require exploring more effective ways of providing public services. To that end, the administration put forward an ambitious public investment program that identified a number of priorities for the country’s growth and development, including improving the country’s aging infrastructure, enhancing the country’s competitiveness, continuing to improve equity in the social sectors (particularly for secondary education and health), and implementing an ambitious environmental agenda. However, limited fiscal space and use of Public Private Partnerships (PPPs), and a fragmented Congress made it difficult to move forward in all these fronts. The most noteworthy achievement of the administration was reining in and decreasing the crime rates, which were the primary concern for most Costa Ricans in 2011, as homicide rates and property crimes were increasing at a steady pace.

6. **Costa Rica continued to position itself as a global pioneer, exploring innovative ways to sustain its green development path.** The country further promoted forest and biodiversity conservation through its pioneering Payments for Environmental Services (PES) program, funded mainly from tax revenues (3.5 percent) and water tariff revenues (25 percent), as well as donor financing. To ensure long-term financial sustainability of the program, Costa Rica established a Biodiversity Endowment Fund. In its effort to sustainably address climate change, the country has been actively developing Nationally Appropriate Mitigation Actions 14 for a number of key sectors, including energy, forestry, and agriculture, focusing on specific products, such as coffee and livestock. Other “green laboratory” initiatives that Costa Rica continued to pioneer include the

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14 A set of policies and actions the country will undertake as part of its pledge under the United Nations Framework Convention on Climate Change to contribute to global efforts to reduce greenhouse gas emissions.
implementation of Reducing Emissions from Deforestation and Forest Degradation (REDD+), Wealth Accounting and the Valuation of Ecosystem Services, and the Partnership for Market Readiness Program.

7. **Costa Rica focused on forging deeper ties with the Organisation for Economic Co-operation and Development (OECD).** OECD membership enjoys wide and strong support amongst the majority of political parties, the business sector, academia, and other stakeholders. So far, the country has focused on identifying gaps with OECD countries and has made some important advances in the area of fiscal affairs. Most notably, Costa Rica signed the Convention on Mutual Administrative Assistance in Tax Matters and became a member of the Global Forum on Transparency and Exchange of Information for Tax Purposes, signed 13 tax information exchange treaties, and passed tax and financial transparency legislation in 2012 that took the country off the OECD’s tax haven list. Costa Rica continues to work on bringing its public institutions in line with OECD standards. The OECD signaled its intention to open accession talks and Costa Rica is expected to submit its application in June 2015. The prospect of becoming an OECD member creates an incentive to advance institutional reforms, modernize national laws and the business environment to meet the relevant international standards.

III. Program Performance

**Pillar 1: Improving Equity in Social Sectors**

8. **To help Costa Rica increase secondary level completion rates the WBG focused on:** (i) improving equitable access to education in targeted poor and indigenous areas; and (ii) increasing the graduation ratio between targeted areas and the national level. Both outcomes were achieved and the pillar is rated **Satisfactory**. Additional achievements under the pillar are discussed below.

9. **Access to education for indigenous population in rural communities improved.** Through the Equity and Efficiency of Education Project (P057857), the WBG supported the Government to improve equity by reducing gaps in graduation rates between indigenous territories and the national level. Between 2008 and 2013, the ratio of the graduation rate in indigenous territories to the graduation rate at the national level increased from 60 percent to 94 percent, compared to a target of 67 percent. Some 230 classrooms in 75 schools were built, renovated and furnished in indigenous territories, compared to a target of 186. Targeted scholarships, and food and transportation programs ensured more indigenous students remained in schools. In addition, WBG support helped Costa Rica in its efforts to preserve indigenous cultures and encourage the participation of community representatives in curriculum development, teaching and management of schools. School infrastructure built in targeted areas helped transform the educational model through collaborative networks that respect autonomy and cultural identity of the indigenous communities. The organization of the networks fostered a sense of community and cultural identity among teachers, students, and parents, and helped provide continuity in the educational process to increase access to secondary education. Furthermore, the Department for Intercultural Education initiated, with support of the WBG, a vast program to collect (through a participatory approach) the traditions, customs and languages of indigenous cultures in order to update curriculum and elaborate didactic materials with local cultures. Based on this information, the Department for
Intercultural Education produced and disseminated documents for use by teachers, pedagogic advisors and supervisors. Finally, a Decree was issued in 2013 to regulate indigenous and intercultural education. The current Government remains committed to further advancing the integration of the indigenous community, while respecting cultural autonomy.

10. **WBG support was instrumental in implementing the Ministry of Education policy that transformed **Telesecundarias**, schools providing a low-quality secondary education, into **Liceos rurales**, schools providing the full curriculum to allow students to complete their “bachillerato.” In the period from 2008 to 2013, 139 **telesecundarias** in rural areas were replaced by 109 **Liceos rurales** (of which 25 in indigenous territories) and enrollment in **Liceos rurales** tripled from 3,113 students to 9,501. The passing rate to complete the “bachillerato” in indigenous territories improved from 11.4 percent in 2008 to 46.5 percent in 2013. In the same period, the passing rate at national and rural level increased by 7 percent.

11. **Progress was made in improving efficiency and equity in the management of education equity and transfer programs.** The administrative cost per beneficiary of managing the equity and transfer programs declined by 30 percent in the period from 2008 to 2013. WBG support focused on: (i) improving allocation procedures and enhancing management information systems, which expedited and computerized system processes to leverage staff time and capacity; and (ii) reorganizing the Ministry of Education and consolidating under one Directorate the dispersed services previously in charge of the equity and transfer programs. To improve equity in the allocation of resources, the WBG helped develop an integrated targeting model using the poverty index, education vulnerability, and individual specific situations. As a result, the number of indigenous beneficiaries of scholarships, food and transportation programs increased significantly.

12. **The WBG supported the development of an institutional health care system reform.** The Government sought to address emerging sustainability challenges to the health system and engaged the WBG in identifying reform options through a Reimbursable Advisory Service (RAS). The WBG helped develop a roadmap to increase efficiency and quality of health services over the short- and medium-term. The results of this RAS will be used by the Government to develop a medium- and long-term strategy to enhance sustainability and equitable access to services provided through social health insurance.

**Pillar 2: Supporting the Environment and Disaster Risk Management**

13. **To enhance the environment and DRM, the WBG supported the country’s development objectives to:** (i) maintain global leadership in sustainable environmental practices; (ii) generate all new electric power from renewable sources; and (iii) integrate disaster risk assessments in Ministry of National Planning and Political Economy’s (MIDEPLAN) selection process of investment projects. All three objectives were achieved using a diverse set of instruments, including investment lending, a Development Policy Financing with a Catastrophe Deferred Draw Down Option (CAT DDO), IFC investments, trust funds and knowledge services. The pillar is rated *Satisfactory* and represents the cornerstone of WBG support under this CPS.

14. **Costa Rica continued its success in the global reforestation agenda through the use of**
the PES program. Over the last 30 years, the country has increased its forest cover from 26 percent to a staggering 52 percent today. This has been possible through public and private commitment and use of economic incentives as drivers of behavioral change for promoting forest conservation. The WBG has been supporting these efforts since 2000 through two projects, the second of which was implemented under this CPS — the Mainstreaming Market-Based Instruments for Environmental Management Project II (P093384). The WBG helped develop and expand the local market for environmental services by promoting conservation and drawing poorer small- and medium-sized landowners into the PES scheme, including a greater share from indigenous groups. As a result, the amount of land covered by the PES increased from 230,000 to 296,294 hectares and the number of small- and medium-size landowners participating in the PES increased from 1,900 in 2006 to 4,700 in 2014. WBG support also facilitated entering into contracts with the Indigenous Integral Development Associations. Between 2008 and 2013, more than 67,500 hectares in indigenous territory were included in the PES program. To create sustainable, long-term financing of the PES program, the WBG helped establish a Sustainable Biodiversity Fund that achieved a capitalization of about US$19 million and returns on investments of around 5 percent, which is a significant first step in putting in place sustainable funding for the program.

15. Important steps have been taken on the definition of concrete climate change mitigation actions and the carbon agenda. Costa Rica has put strong emphasis on mitigating and reducing greenhouse gas emissions and continues to position itself as a global pioneer, exploring innovative ways to further its green development path. Supported by the WBG through the Forest Carbon Partnership Facility, Costa Rica’s REDD+ strategy, currently under implementation, envisions selling carbon certificates to promote forest conservation. In 2013, Costa Rica signed an intent to negotiate an Emissions Reduction Payment Agreement worth up to US$63 million. If successful, this would make Costa Rica the first country in the world to access large-scale performance-based payments for conserving its forests, regenerating degraded lands, and scaling up agro-forestry systems for sustainable landscapes and livelihoods. In addition, Costa Rica will provide guidelines for the generation, issuance, and exchange of carbon credits from activities originating in Costa Rica, thus effectively establishing a domestic carbon offset market. To make this market operational, the WBG is supporting Costa Rica through a Partnership for Market Readiness grant.

16. The WBG is supporting Costa Rica to expand renewable energy. To improve the country’s medium-term energy security, IFC invested US$100 million in the renewable energy Reventazón Hydro-Power Project. This project will not only help Costa Rica address its growing demand for electricity, but will also contribute to the country’s goal of reducing its carbon emissions. In addition, to expand the supply of long-term finance for energy efficiency, IFC invested US$6 million in a local financial institution, Banco Promerica. The WBG has also been supporting the Government’s efforts to promote minimum mandatory sustainable building standards in commercial and residential buildings for more efficient energy and water use, and the use of clean technologies in new buildings.

17. Costa Rica’s preparedness to respond to disasters has further improved with risk reduction and prevention programs. The regulatory and institutional DRM framework was strengthened with the introduction of a legal framework that requires all new public investments to follow DRM best practices and include a hazards assessment. The Government mainstreamed
DRM considerations in its 2011-2014 National Development Plan, specifically in the area of public investments, environment and land planning. Additionally, the 2012–2040 National Land Use Planning Policy incorporates DRM and climate change as a cross-cutting theme. This enhanced capacity of Costa Rica to implement its DRM program was supported by the WBG’s CAT DDO (P111926), which continues to provide a source of immediate liquidity in case of a disaster.

**Pillar III: Supporting Competitiveness**

18. **To support competitiveness, the WBG focused on the country’s development objective to reduce red tape and strengthen business regulation to promote and attract investment.** The original results expected under this pillar were overly ambitious. Indeed, the CPSPR dropped nine outcomes under this pillar as it became evident that no results would materialize by the end of the CPS period. This is largely due to the failure of Port-City of Limon Integrated and Infrastructure Project\(^\text{15}\) (P085539) that closed without completing any of the intended activities. This operation accounted for most of the outcomes under this pillar. In addition, the pillar supported improving private sector involvement in infrastructure and strengthening human capital and skills development. The CPS was ambitious in expecting to transform the country’s institutional environment for using PPPs and underestimated the time needed for the Higher Education Improvement Project (P123146) to begin implementation and start achieving results. At the CPSPR, only one original outcome remained supported by the WB-IFC Investment Climate advisory services. Given the limited achievements in supporting competitiveness, this pillar is rated *Moderately Unsatisfactory*, although the one outcome measuring the success of this pillar in the results matrix was achieved. Further IFC support, which was not captured in the results matrix, is discussed below.

19. **Costa Rica made important steps to improve the business environment, including access to finance.** Starting a business has been made easier by introducing an online platform for business registration, reducing the time to register with social security, and simplifying the legalization of company books. Registering a business now takes 20 days, down from 60 days in 2011. Costa Rica also made paying taxes easier for companies by implementing an electronic system for filing corporate income tax and value added tax. To improve access to finance for Small and Medium Enterprises, the Government enabled the use of movable assets as collateral through approval of a new Law on Secured Transactions. These reforms were supported by a Technical Assistance (TA) cooperation agreement between IBRD, IFC, and Costa Rica. In addition, to improve access of Micro, Small and Medium Enterprises (MSMEs) to bank loans, IFC broadened access to long-term financing. IFC provided credit lines in the amount of US$45.5 million to one cooperative and two banks, focusing, among other, on mortgages for low-income individuals and creating opportunities for women entrepreneurs in the agribusiness and the services sectors. Since 2011, the number of new loans provided by these financial institutions to MSMEs has grown to over 11,500 reaching close to 3,100 MSMEs. The IFC has successfully supported the mid-tier hotel sector in San Jose and Alajuela, contributing to the improvement of the country’s business hotel infrastructure and expansion of local trade and business development.

\(^{15}\) For more information please refer to the Implementation Completion and Results Report for the Port-City of Limon Integrated and Infrastructure Project, December 2014, World Bank.
20. To support the Government’s efforts to strengthen the financial sector, the WBG provided technical assistance funded by the FIRST\textsuperscript{16} initiative. WBG support focused on further developing capital markets through primary market regulations for non-government fixed income securities, facilitating the issuance process, and encouraging greater participation in the bond market. As a result, a new Securities Markets Law was approved. The Law is expected to boost stock and bond trading for local and foreign investors. In addition, the WBG helped develop practical tools to efficiently manage financial distress and potential crisis, and revamp a systemic risk framework for the financial sector.

21. The WBG has commenced supporting Government’s efforts to strengthen human capital and skills development through a Higher Education Improvement Project. The Project supports the Government’s efforts to increase the number of the students obtaining tertiary education, including indigenous populations, and improve quality and relevance of programs. The implementation of the project is only just beginning due to the time needed to achieve congressional approval, meet the effectiveness conditions, and launch the first bidding documents. The Project will deliver the bulk of the intended results during the next strategy period, although steps have been already made towards building awareness among the indigenous populations by introducing Educatores whose responsibility, in addition to raising awareness, is to identify potential indigenous students.

IV. WBG Performance

22. Overall, WBG performance during the FY12-15 CPS period was Good. Positive aspects of WBG performance included a flexible and focused design, which successfully contributed to the pursuit of the key CPS objectives in supporting equity in social sector, and environment and DRM. Given the difficult country context in which any decision may be challenged by Contraloría General (the Comptroller General) and weak implementation capacity, the implementation of the program was challenging and slow. Nevertheless, the WBG commitment and effort to improve implementation was evident.

Design and Relevance

23. The CPS was relevant, aligned with the Government’s National Development Plan and flexible. Costa Rica’s human capital strategy recognized that building a skilled labor force is a basis for a competitive economy. The WBG responded in a timely manner by preparing a Higher Education Improvement Project. The CPS was flexible in the use of instruments and consolidated activities in a few priority areas. The CPSPR reordered the pillars de-emphasizing competitiveness, because of delivery concerns, and shifted attention towards environment and social sectors. In doing so, the CPSPR dropped eleven outcomes and revised four original outcomes to better align the achievements of the CPS with the WBG program. The IFC program remained relevant, in particular in the energy and competitiveness sector. The CPSPR could have explored synergies with the IBRD program and included IFC activities in the results matrix. The non-lending program was strong, although its impact raises some concerns. The Multilateral Investment Guarantee Agency (MIGA) did not provide any guarantees in this CPS period. Its

\textsuperscript{16} The FIRST Initiative is part of the WBG and offers small scale and short-term grants for Technical Assistance projects that contribute to more stable, more efficient and more inclusive financial systems.
portfolio in Costa Rica continues to include only one project in the transport sector for a total exposure of US$71.6 million.

24. **The Government took the lead in promoting efficient division of labor among key development partners.** The Government, at the beginning of its mandate, presented the country’s development challenges and outlined financing priorities for various multilateral organizations. To avoid duplications, a division of labor leveraged each institutions’ comparative advantage and experience working in Costa Rica. Complementarity between the WBG and other major donors was high, in particular in the environment sector with United Nations Development Program (UNDP) Japanese International Cooperation Agency (JICA), European Investment Bank (EIB), European Union (EU) and German Development Bank (GDB). The IFC maintained a fruitful cooperation with other key development partners in supporting the country’s renewable energy development. The Reventazon project, an investment of US$1.45 billion dollars, garnered investments from IFC, the EIB, the Costa Rican Electricity Institute, the Inter-American Development Bank, the Central American Bank for Economic Integration, and other local banks and institutional investors.

**Program Implementation**

25. **During this CPS, WBG support to Costa Rica was selective.** IBRD committed US$200 million in the Higher Education Improvement Project early in the CPS period to minimize the risk of delays given the lengthy approval process in Congress. A Health project (US$400) did not materialize because the Government decided to first engage the support of the WBG through a RAS in developing options for reform of the Social Security Agency. The IFC’s engagement had limited growth and its total outstanding commitments as of January 31, 2015 totaled US$188 million. The IFC’s selective approach and limited growth is due to several reasons, including the small market size (which in itself limits IFC’s business opportunities), dominance of the Government in many of the sectors (including banking and energy), and lack of institutional conditions and political will to create and manage PPPs. In addition, expansion of IFC activities, particularly in the financial sector, has been negatively affected by Off Shore Financial Centers, due to the fact that Costa Rican financial institutions use Panama as an intermediate jurisdiction, which is contrary to the WBG Off Shore Financial Centers Policy.17

26. **The CPS gave a prominent role to the non-lending program.** The WBG provided a substantial non-lending program mainly focused on health, environment, and competitiveness. The WBG delivered 13 non-lending activities, more than double compared to the previous CPS, and established itself as a knowledge partner by providing the first RAS in the country focusing on health sector reform. To address the Government’s need to develop a strategic and innovative approach to using rural landscapes productively in an environmentally sustainable manner, the WBG provided support under the Programmatic Approach Green and Inclusive Growth. The WBG also carried out a number of technical assistance activities, *inter-alia*, to identify best global practices and solutions to recognize foreign higher education degrees and facilitate labor integration, review relevant international experiences and programs that promote productive linkages between domestic Small and Medium Enterprises (SMEs) and multinational corporations,

and contribute to the improvement of the PPP legal and regulatory environment. Overall, however, it is difficult to establish the impact of the Analytical and Advisory Services (AAA) program, in part due to the lack of systematic evaluation of AAA work and at times, fragmented activities.

27. **The pace of implementation of investment projects was slow.** As of February 28, 2015, the active portfolio consisted of two operations, the Higher Education Improvement Project and the CAT DDO, totaling US$265 million in net commitments, of which 17 percent has been disbursed. Three projects closed during this CPS period and were rated *Moderately Satisfactory* in achieving their development objectives. The disbursement ratio worsened during the CPS period as older projects exited the portfolio, decreasing from 12 and 16 percent in the first two years to 6.5 percent in FY14, a trend that has continued in FY15 and is well below Central America and LAC averages (at end FY14, 25 percent and 20 percent, respectively). The low disbursements may be attributed to the fact that 70 percent of undisbursed (US$260 million) commitments were tied to the Higher Education Improvement Project (US$200 million) that only recently begun its implementation and to the Port-City Limon Integrated Infrastructure Project (P085539; US$72.5 million) that closed without disbursing more than 80 percent of the committed amount. Implementation was often difficult and prolonged given the strong oversight role of the Comptroller General in that it may challenge any decision. This particularly affected procurement processes for investment operations. In addition, implementation was further hindered by weak implementation capacity, limited experience with WBG operations, and the restrictive environment for restructurings that requires any substantial change to be resubmitted to Congress for approval.

28. **The Government of Costa Rica and the WBG have been working together to strengthen portfolio implementation.** For many years, the Costa Rica program was supported by WBG staff based in Washington D.C. Recognizing the need to strengthen the dialogue with the authorities and other local stakeholders, the WBG Country Office in El Salvador was mandated to support the Costa Rica program beginning in 2012. The WBG’s capacity for supervision and implementation support in Costa Rica has been further strengthened through the recruitment of an Operations Officer in May 2013 – the first staff member to be based in Costa Rica in many years. The WBG held monthly portfolio meetings with the Ministry of Finance advising Government officials on specific issues related to project execution, tracking implementation milestones, and monitoring the preparation and processing of procurement packages in a timely manner. These mitigation measures helped implement and successfully close three investment projects.

**Alignment with the WBG Corporate Goals**

29. **The WBG program was mostly aligned with the Twin Goals**, although the overall impact on eradicating extreme poverty and boosting shared prosperity is difficult to measure. Four of the five operations targeted poor, rural and indigenous communities, namely the Equity and Efficiency of Education Project, the Mainstreaming Market-Based Instruments for Environmental Management Project, the Port-City of Limon Integrated and Infrastructure Project, and the Higher Education Improvement Project. However, during this CPF period, only two

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18 The WBG’s Twin Goals are (i) to reduce the percentage of people living under US$1.25 per day to 3 percent globally by 2030, and (ii) to increase the income growth rate for the bottom 40 percent relative to average growth, within each country.
operations\textsuperscript{19}, the Equity and Efficiency of Education Project and the Mainstreaming Market-Based Instruments for Environmental Management Project, were successfully implemented and achieved measurable results albeit only in targeted areas, thus limiting the evaluation of any meaningful or sustainable impact on Twin Goals at a country level.

30. **Nevertheless, the WBG program positively impacted marginalized groups.** In particular, the Equity and Efficiency of Education Project focused on reducing the gap in the secondary education in rural areas and improving targeting of transportation and food programs. The Mainstreaming Market-Based Instruments for Environmental Management Project targeted poor small and medium landowners. Targeted indigenous communities benefitted most from direct payments. According to a consultancy report\textsuperscript{20} commissioned by the WBG to evaluate the socioeconomic impact of the PES program, between 2008 and 2013, an average of 12,000 hectares of forests were protected in indigenous territories. The PES was not used individually, but through community consensus for the acquisition of agricultural machinery, medical equipment and educational material, among others, furthering the development impact.

V. **Key Lessons from the CPS FY12-15 and Recommendations for the new CPF**

31. **Program and project design must take into account political economy and institutional constraints to ensure achievement of CPS objectives.** The IEG Review of the CPSCR (Report No. 63199) identified that implementation of investment projects in Costa Rica has always been difficult, mainly due to complex institutional arrangements and presence of a strong oversight body such as the Comptroller General. Going forward, a focus on fewer, larger projects that have high strategic importance to a multitude of stakeholders could speed up the usually lengthy legislative approval procedures, as was the case for the Higher Education Improvement Project. Likewise, alternative non-traditional options for the design of investment operations, such as the new Program for Results instrument, may lead to swifter and more successful implementation, allowing the country to improve the design and implementation of its development program and at the same time, achieve lasting results by strengthening institutions and building capacity.

32. **A realistic results matrix and efficient monitoring is needed to support CPS implementation.** The CPS results matrix should set realistic objectives that are achievable during the CPS period and include indicators that are relevant and material to the Objectives. At the time of the FY12-15 CPSPR, eleven outcomes were dropped, as it was evident that they would not be achieved by the end of the CPS period.

33. **A more consolidated approach to knowledge and advisory program could have a greater impact.** The proliferation of small trust funds financing knowledge and advisory services led to limited or fragmented impact. Moreover, many large analytical reports never saw any follow up. Thus, the WBG analytical program could be more strategic in addressing predefined issues and objectives. The program should also be consolidated around technical assistance activities that

\textsuperscript{19} See para 18 for more information on two projects that did not achieve intended results during this CPF (the Port-City of Limon Integrated and Infrastructure Project closed without completing any of the intended activities and the Higher Education Improvement Project only just begun with implementation).

have capacity building components and support the immediate application of the analytical work, thereby potentially yielding better results.
# Summary of CPS Program Self-Evaluation

<table>
<thead>
<tr>
<th>CPS Outcome and Outcome Indicators</th>
<th>Status and Evaluation Summary</th>
<th>Lending and Non Lending Services that Contributed to the Outcome</th>
<th>Lessons and Suggestions for the New CPS</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Outcome 1. Improve equitable access to education in targeted poor and indigenous areas as measured by:</strong></td>
<td>Achieved.</td>
<td>Equity and Efficiency of Education Project (P057857)</td>
<td>Project implementation took close to 9 years. After six years of poor implementation the project was substantially restructured (at the time of the restructuring the project had disbursed only US$5 million out of US$30m). The poor performance during the first six years can be attributed to a number of factors, including lack of client involvement early in project preparation, overly complex design and weak implementation capacity.</td>
</tr>
<tr>
<td>Increase in graduation rate in targeted areas (measured as the ratio between 11th and 7th grade enrollment) Baseline (2008): 22% Target (2014): 27.5% Actual (2014): 32%</td>
<td>230 classrooms in 75 schools were built, renovated and furnished compared to target of 186 but equipment has not yet been provided. As of December 2014, the graduation rate in targeted areas is 32%.</td>
<td></td>
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<tr>
<td>Increase in the graduation ratio between targeted areas and the national level (reduction in gap) Baseline (2008):60% Target (2014): 67% Actual (2014): 94%</td>
<td>As of December 2014, the graduation ratio stands at 94%.</td>
<td></td>
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</tbody>
</table>

### Pillar I: Improving Equity in Sectors Social

### Pillar II: Supporting the Environment and Disaster Risk Management

<p>| Outcome 2. Land incorporated into the PES increased Baseline (2007): 230,000 Ha Target (2014): 288,000 Ha Actual (2014): 292,000 Ha | Achieved (original target). As of December 2014, achieved an average of 292,000 Ha under contract annually. | Mainstreaming Market-Based Instruments for Environmental Management Project (PP111926)/GEF grant (P098838) | Several factors worked well for sustaining the Project’s benefits over time: i) strong ownership; ii) high capacity, implementing agency FONAFIFO is a strong institution with qualified staff, capable of coordinating the implementation of PES; and (iii) simpler design of the project. |
| Outcome 3. The number of small and medium land owners (&lt;100 Ha) participating in the program increased by 50 percent Baseline (2007): 1,900 Target (2014): 2,850 Actual (2014): 3,300 | Achieved. As of December 2014, PES benefitted an annual average of about 3,300 small and medium land owners | | |</p>
<table>
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</thead>
</table>
| **Outcome 4. Capitalization of the Biodiversity Endowment Fund**  
Baseline (2007): US$7.5 million  
Target (2010): at least US$15 million (total)  
As of December 2014, the Fund’s capitalization is around US$19 million.  
In addition to the achieved outcomes, Costa Rica designed its national Readiness Package and Letter of Intent for Emissions Reduction Payment Agreement valued at US$63 million signed (September 2013). Payment will be made upon delivery of emission reductions in 2020 and Costa Rica will use these funds to scale up the existing PES scheme. |  |  |
| **Outcome 5. Enhance the Government’s capacity to implement its disaster risk management program for natural disasters as measured by:**  
An increase in the number of projects recorded in the public investment projects (BPIP) that include a hazards assessment component  
Baseline (2011): 22.9%  
Target (2014): 75%  
Actual (2014): 100% | Achieved.  
Today, 100% of all new approved investment projects registered in MIDEPLAN's Investment Projects database incorporates DRM considerations.  
Executive Decree enacted ordering the adoption of “Technical Norms, Guidelines and Procedures for Public Investments” applicable to government agencies members of the National System of Public Investments.  
Ten methodological training guides produced for project preparation and assessment by sectors, including: drinking water and sanitation; solid waste management facilities; hospital facilities; | CAT DDO (P085539)  
Institutional Development Fund Mainstreaming DRM in the Costa Rica Investment Process | Very strong ownership of the DRM agenda. |
<table>
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<tbody>
<tr>
<td>educational facilities; irrigations; safety; and transport infrastructure projects.</td>
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</table>

**Pillar III: Supporting Competitiveness**

**Outcome 6. Improvement in business environment as measured by a reduction in red tape:**

**Days to start a business**
Baseline (2011): 60
Target (2014): 35
Actual (2014): 20

**Achieved.**
Days to start a business: 20 days (DB 2014).
Red Tape reduction Action Plan prepared, including a timetable for implementation of reforms.

**WBG Investment Climate Advisory engagements**
**IFC financing for corporate with regional integration and export-led strategies**

**Despite results in reducing red tape, a slow process for changing outdated laws precludes rapid improvement of the regulatory environment.**
## CPSCLR ANNEX 2 – PLANNED LENDING PROGRAM AND ACTUAL DELIVERIES (IBRD)

<table>
<thead>
<tr>
<th>CPS Lending Program (IBRD in US$ million)</th>
<th>Status at CPSCLR</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY12-13 Plan</td>
<td>FY11 Actual</td>
</tr>
<tr>
<td>Higher Education Improvement Project</td>
<td>US$200</td>
</tr>
<tr>
<td>National Health Insurance System project</td>
<td>US$400</td>
</tr>
<tr>
<td><strong>Total Planned FY12-FY15</strong></td>
<td><strong>US$600</strong></td>
</tr>
</tbody>
</table>
## CPSCLR Annex 3 – Planned Non-Lending Activities and Actual Delivery

<table>
<thead>
<tr>
<th>CPS Program</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>FY12 Plan</strong></td>
<td><strong>Status at the CPSCLR</strong></td>
</tr>
<tr>
<td>Institutional Strengthening for PPPs (P131654)</td>
<td>Delivered</td>
</tr>
<tr>
<td>Low Carbon Development Strategy (P128238)</td>
<td>Delivered in FY13</td>
</tr>
<tr>
<td>Financial Crisis Simulation Technical Assistance (P130914)</td>
<td>Delivered in FY13</td>
</tr>
<tr>
<td><strong>FY13 Plan</strong></td>
<td></td>
</tr>
<tr>
<td>Report on the Observance of Standards and Codes Accounting and Auditing (P108410)</td>
<td>Delivered</td>
</tr>
<tr>
<td><strong>FY14 Plan</strong></td>
<td></td>
</tr>
<tr>
<td>National Health Insurance RAS (P148435)</td>
<td>Delivered in FY15</td>
</tr>
<tr>
<td>Analytical Framework for Assessing Systemic Risk (P146774)</td>
<td>Delivered in FY15</td>
</tr>
<tr>
<td><strong>FY15 Plan</strong></td>
<td></td>
</tr>
<tr>
<td>Green and Inclusive Growth (P147664)</td>
<td>Delivered</td>
</tr>
<tr>
<td>Five Years after CAFTA-DR (Trade and Logistics) (P146939)</td>
<td>Delivered</td>
</tr>
<tr>
<td>Recognition of Foreign Degrees (P149157)</td>
<td>Delivered</td>
</tr>
<tr>
<td>Firm Integration into Global Value Chains (P147207)</td>
<td>Delivered</td>
</tr>
<tr>
<td>Social Expenditure and Institutional Review (P146907)</td>
<td>Delivered</td>
</tr>
<tr>
<td>Development of Capital Markets (P132212)</td>
<td>Delivered</td>
</tr>
</tbody>
</table>
This map was produced by the Map Design Unit of The World Bank. The boundaries, colors, denominations and any other information shown on this map do not imply, on the part of The World Bank Group, any judgment on the legal status of any territory, or any endorsement or acceptance of such boundaries.