Concept Environmental and Social Review Summary

Concept Stage

*(ESRS Concept Stage)*

Date Prepared/Updated: 12/11/2019 | Report No: ESRSC00972
### BASIC INFORMATION

#### A. Basic Project Data

<table>
<thead>
<tr>
<th><strong>Country</strong></th>
<th><strong>Region</strong></th>
<th><strong>Project ID</strong></th>
<th><strong>Parent Project ID (if any)</strong></th>
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</thead>
<tbody>
<tr>
<td>Costa Rica</td>
<td>LATIN AMERICA AND CARIBBEAN</td>
<td>P172352</td>
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**Project Name**
Costa Rica Tax and Customs Administration Project

**Practice Area (Lead) - Financing Instrument**
- Governance: Investment Project Financing
- Estimated Appraisal Date: 2/21/2020
- Estimated Board Date: 3/26/2020

**Borrower(s)**
Government of Costa Rica

**Implementing Agency(ies)**
Ministry of Finance

**Proposed Development Objective(s)**
The project's objective is to improve the efficiency and effectiveness of tax and customs operations in Costa Rica.

**Financing (in USD Million)**

<table>
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<th>Amount</th>
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<td>100.00</td>
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**B. Is the project being prepared in a Situation of Urgent Need of Assistance or Capacity Constraints, as per Bank IPF Policy, para. 12?**
No

**C. Summary Description of Proposed Project [including overview of Country, Sectoral & Institutional Contexts and Relationship to CPF]**
The proposed project will support the modernization and enhancement the tax and customs administrations in Costa Rica. The project is a five-year IPF comprising three components: Enhancing the operational efficiency and effectiveness of the tax administration; Enhancing customs controls and services; Strengthening the institutional and operational environments of the tax and customs administrations and promoting their digital interoperability.

**D. Environmental and Social Overview**
D.1. Project location(s) and salient characteristics relevant to the ES assessment [geographic, environmental, social]
The project is national in scope. Activities aimed at improving operations and processes of tax collection and customs management will be implemented on a national scale, in a national context characterized by low compliance rates of personal and corporate income tax, and tax evasion and avoidance estimated at 8.22% of GDP in 2013. While poverty rates in Costa Rica are among the lowest in LCR, poverty reduction has stagnated in recent years and inequality is rising. Approximately 2.4 percent of the population is Indigenous; while this represents a small proportion of the national population, the cantons with the highest poverty rates are also those where most of the indigenous population lives. Lower employment and income opportunities for IPs has also translated into a higher rates of self-employment, which may imply higher rates of SME ownership among IPs relative to the general population.

Several important measures have already been implemented to improve tax collection. For instance, the passage of the fiscal reform bill (Law of Public Finance Strengthening) was a critical step, as it includes changes to two fundamental taxes: The General Sales Tax and the Income tax. This reform includes conversion of the sales tax into a value added tax (A new VAT went into effect on July 1, 2019), as well as higher income taxes. On this matter, the General Directorate of Taxation (DGT) passed a 2019-2021 plan against the evasion of the general sales tax and the VAT. On the expenditure side, it includes wage restraint and a fiscal rule that ties down spending growth. The expected total yield of the reform is estimated at 4 percent of GDP by 2023, with government debt peaking at about 62 percent of GDP that year and declining gradually thereafter. However, market reaction has been cautious and financing costs remain high. Shortly following passage, however, three rating agencies downgraded Costa Rica’s sovereign credit rating and placed the country on a negative outlook, citing continued worsening of debt dynamics and significant short-term funding challenges. To raise additional revenue, the bill introduces two new top brackets to personal income tax (PIT), with rates of 20% and 25%, at 5 and 10 times the average income, thereby also raising its progressivity. The Executive has also submitted a VAT reform, intending to increase the tax rate from 13% to 15% and enlarge the tax base by extending VAT collection to all services sectors. Additionally, as part of its tax reform, government is planning to reassess its current system of corporate tax incentives with the aim of streamlining the incentives and increasing transparency.

The Government has given priority to tax and customs administration modernization and therefore, is carrying out a series of policy measures that include: (i) a general tax reform that combines a current expenditure tax rule with the introduction of Value Added Tax (VAT) and the update of the income tax; (ii) the law of modernization of public employment; and (iii) an institutional administrative reform. The Government is not pursuing another hike in the tax rates and has requested the World Bank support through an IPF focused on improving tax administration to raise more revenues and reduce compliance gaps. The project would support medium- and long-term reforms related to tax and customs administration, especially regarding the interoperability, and other services related to trade facilitation.

As opposed to national level activities, the physical footprint of project activities will be limited from a social and environmental perspective. Some project activities, such as IT infrastructure enhancement and upgrading of customs equipment may involve a very limited scale of civil works. The nature and scale of civil works that may be supported under the project, together with the associated environmental and social risks and impacts, are not known at the time of the PCN and will be assessed during preparation.

D. 2. Borrower’s Institutional Capacity
The Project aims to improve Borrower efficiency and effectiveness of tax and customs operations through enhanced enforcement processes and improved data development and management. The Project will be implemented by the
Ministry of Finance (Ministerio de Hacienda), under the coordination of the Vice Ministry of Income (Viceministerio de Ingresos). A project implementation unit (PIU) will be established within the Ministry of Finance to oversee the activities implemented. It is expected at this stage that the PIU will take responsibility for overall project management, including environmental and social aspects.

The Ministry of Finance has implemented World Bank projects before; however, they do not have prior experience with the Bank’s Environmental and Social Framework. Nonetheless, Costa Rica’s national systems on environmental management are considered to be generally quite strong. With respect to environmental, health and safety (EHS) capacity, since the project environmental risk is expected to be low, and in light of generally strong national systems, there is not likely to be a need for a full time EHS specialist on the project; the optimal staffing and oversight arrangement will nonetheless be assessed further during project preparation, and appropriate staffing and training requirements, as well as detailed screening, management and monitoring procedures for any activities with potential EHS impacts or risks, will be specified and included in the ESCP.

II. SCREENING OF POTENTIAL ENVIRONMENTAL AND SOCIAL (ES) RISKS AND IMPACTS

A. Environmental and Social Risk Classification (ESRC)  Moderate

Environmental Risk Rating  Low

The environmental risk classification for the project is considered low. The project is not expected to generate any significant environmental impacts, as its activities are focused on improving operations and processes of tax collection and customs management. The project includes the financing of information systems equipment (software and hardware) and border/customs equipment that could entail some minor civil works that will be confirmed during project preparation. Some minor and indirect negative environmental risks and impacts could occur related to e-waste from electronic equipment replacement, as well as Occupational, Health and Safety (OHS) issues in the installation and use of equipment procured by the project. The project will ensure appropriate management of these issues and will seek to maximize positive environmental and OHS impacts through the development of procedures, guidelines and capacity building related to safe use of equipment as well as management of any minor EHS construction stage issues that may arise.

Social Risk Rating  Moderate

The social risk classification for the project is considered moderate. The proposed project is expected to generate mainly positive social impacts through: (i) improved fiscal position due to increased tax and customs revenue collected, which is expected to help protect past gains from reductions in poverty and inequality and support the sustainability of the country’s Social Compact, Green Trademark, and future progress overall, and; (ii) savings to taxpayers in terms of the reduction of time required to clear customs and pay taxes from more efficient and effective tax administration processes. Improvements in taxpayer services are expected to benefit certain types of firms that may currently face a disproportionate tax compliance burden, for example small-businesses and female-led businesses – by addressing and reducing the barriers they face as taxpayers. The main social risks associated with the proposed project include: (i) the possibility that enhanced tax compliance will imply short-term income impacts that would disproportionately affect poor or vulnerable taxpayers, such as indigenous and female-headed households and/or SMEs; (ii) potential job loss within the DGT and DGA as a result of improvement and automation of core tax
processes, and; (iii) resistance to proposed project activities from taxpayers currently not in compliance with the tax code, as well as push back from specific stakeholder groups, such as importers-exporters, auxiliary agents (customs brokers, bonded warehouses, etc.).

B. Environment and Social Standards (ESSs) that Apply to the Activities Being Considered

B.1. General Assessment

ESS1 Assessment and Management of Environmental and Social Risks and Impacts

Overview of the relevance of the Standard for the Project:

Based on the information available at the PCN stage, there are limited negative environmental impacts and moderate potential social impacts expected from the proposed Project. While most project activities relate to strengthening institutions, systems, and software for tax and customs management, under Component 2b, “Improve e-trade services and upgrade critical equipment”, the following activities are envisaged which may result in minor, site specific E&S risks and impacts: (i) the provision of technological equipment such as Radio frequency identification (RFID), electronic border gates, and gantries; (ii) hardware for the electronic border control management; (iii) equipment to improve the security of integrated border posts, such as security CCTV and non-intrusive equipment for peripheral customs (public-private); (iv) weight (truck scales) equipment for trucks; and (v) vehicles for mobile units.

To address any potential environmental, social, health and safety risks which may arise from such minor works as well as the ongoing use of equipment and hardware that is procured and installed under the project, a concise Environmental and Social Management Plan (ESMP) is proposed to be developed and included in the project Operational Manual, with relevant sub-sections also integrated into all corresponding bid documents for activities which may cause any such risks and impacts. The ESMP will be consistent with the WBG EHS Guidelines and is expected to cover, inter alia: OHS issues, waste disposal -- including in particular e-waste management in the event that the procurement of IT hardware under the project results in decommissioning of old equipment; good housekeeping measures for works sites; protocols for informing and minimizing disruptions to nearby office workers or other stakeholders when equipment installations or other minor physical works are underway; EHS requirements related to ongoing use of equipment, etc. In addition, the ESMP will specify that all project activities shall be carried out in compliance with Costa Rican environmental regulation.

A social assessment, including stakeholder engagement and consultation with indigenous representatives, will be undertaken during project preparation to assess the potential social risks associated with national-level investments, including any risks related to the relationship between the proposed project and the Government’s tax reform plan, including the abovementioned recently introduced laws. The social assessment and stakeholder engagement would also explore the current extent of tax evasion among poor, vulnerable households, including IPs, and among SMEs to assess the potential for project-supported reforms to imply negative income impacts for these households and businesses, as well as gaps in the current face-to-face tax services offered in field offices, from the perspective of gender, cultural relevance for indigenous communities, and gaps for other particularly poor or vulnerable groups, such as elderly and disabled taxpayers, etc. The social assessment will also explore the potential for resistance to change and pushback to reforms from taxpayers in general, as well as from particular stakeholder groups, such as SMEs, importers-exporters or auxiliary agents (e.g. customs brokers, bonded warehouses, etc.). The extent of negative employment impacts associated with the push towards automation of core tax administration functions of the DGT and DGA will also be assessed as part of the social assessment. These analyses and participatory processes will inform the development of measures to reduce and mitigate these and other potential social risks and impacts.
(subsidies, for example), to be included in project-level ESMP, IPPF, LMP and SEP, as well as a robust behavioral change and public awareness raising campaign, and a project-level GRM, with specific access points and procedures tailored for IPs, specific stakeholder groups, and with a standalone GRM for the LMP. An advanced draft of the social assessment will be prepared and disclosed prior to the beginning of appraisal. The social assessment will undergo consultations as per the SEP, which will include, for indigenous groups, compliance with Costa Rica’s General Mechanism for Consultation with Indigenous Peoples (Executive Decree 40.932).

Areas where “Use of Borrower Framework” is being considered:
None. Costa Rica has generally robust environmental laws and regulations. To the extent to which they are applicable to any of the proposed activities under the project, they will be followed; however, the project does not propose to rely on these systems for ESF compliance.

ESS10 Stakeholder Engagement and Information Disclosure
These activities will be used to inform the development of a robust Stakeholder Engagement Plan (SEP), which will include a communication plan, an IPP, and GRM, to be consulted and disclosed prior to appraisal. The GRM will be part of the SEP and will need to include its own estimated budget, source of funding, and personnel. The GRM is expected to be functional by the time consultations begin, so that stakeholders can be informed of its existence and make use of it, if needed, during project preparation. The SEP will be implemented following the General Mechanism for Consultation with Indigenous Peoples (Executive Decree 40.932) from Costa Rica. Results from stakeholder engagement processes and consultations will also inform the design of behavioral change, external and internal communications and public education campaigns, as well as client-facing applications, improvements to face-to-face services in field offices, design and implementation of taxpayer surveys and other CE mechanisms. The PCU will carry out meaningful stakeholder engagement and consultations throughout the project life cycle, paying particular attention to income impacts on poor and vulnerable households and SMEs from activities aimed at increasing compliance with domestic taxes, and effectiveness of tailoring of campaigns, communication strategies, client-facing applications, face-to-face services and Citizen Engagement (CE) mechanisms to intended audiences (e.g. specific stakeholder groups, Indigenous Peoples, taxpayers with particular needs, such as those with sensory disabilities, etc.).

A round of consultations will be carried out by the Borrower during project preparation, which may include a combination of face-to-face events and virtual socialization activities. These consultations will be based on the mapping of the key stakeholders for the project, which are expected to include government agencies, importers-exporters, auxiliary agents (customs brokers, bonded warehouses, etc.), chamber of commerce, national-level indigenous peoples organizations, women’s associations, and consumer associations, among others. This round of consultations is expected to be completed before the end of appraisal. Information from the consultations will be documented and appended as annexes to the updated SEP, to be completed by Board approval. The updated SEP will be periodically reviewed by the borrower, to ensure its proper implementation, monitoring and evaluation.

B.2. Specific Risks and Impacts
A brief description of the potential environmental and social risks and impacts relevant to the Project.
ESS2 Labor and Working Conditions

This standard is relevant. The project will involve government civil servants as well as primary suppliers and contracted workers who will work in the project full-time or part-time. The project also includes various activities aiming to reform and strengthen the human resources management within the tax collection and borders system. Should minor civil works be required, the Occupational, Health and Safety (OHS) procedures will also apply and will be developed in line with the World Bank Group EHS Guidelines to ensure health and safety of workers. No major OHS hazards associated with the project activities are expected, but there could be minor risks related to handling of heavy loads, risks of electrical shock, etc. Relevant requirements will be outlined in Labor Management Procedures (LMP) that will be developed during the initial stages of project implementation in conjunction with the Operations Manual and the ESMP and updated as needed throughout the life of the project. To the extent that the project will imply redundancies and the development and implementation of new HR and hiring procedures in the DGT and DGA, these processes, as well as access to training, job assignments and promotions will be managed transparently and will be based on the principles of equal opportunity, fair treatment and non-discrimination. The LMP will also include a dedicated grievance redress mechanism (GRM) separate from the Project level GRM, with budget and source of funding, to be provided to any direct and contracted workers. This GRM will be easily accessible and will contain measures to protect such workers against any reprisal for its use. Full information on this GRM will be provided to all direct and contracted workers at the time of recruitment.

ESS3 Resource Efficiency and Pollution Prevention and Management

The standard is relevant. The project is not expected to result in any significant impacts related to pollution management or energy efficiency. However, the ESMP to be included in the project Operations Manual will address electronic waste (e-waste) management requirements, as well as specify the objective of maximizing energy efficiency wherever feasible in the design and procurement of systems and equipment. Should the project include specific activities to improve the Custom export and import procedures at borders, specific environmental measures will be included in the ESMP (OM) to address potential negative impacts related to handling, use and management of hazardous substances, as applicable, during operations. In addition, high fuel efficiency standards will be encouraged for any vehicles to be procured under the project.

ESS4 Community Health and Safety

The standard is not currently relevant since no health and safety risks or impacts on communities are expected at this time. However, potential community health and safety issues will be further assessed with the client during project preparation, including the potential need to develop requirements for security personnel who may be monitoring newly installed CCTV cameras, as well as the possible need for traffic safety issues related to equipment delivery and installation. If deemed necessary, the ESMP will outline requirements for security personnel as well as traffic management measures, such as speed limits, acceptable hours for delivery, etc. for suppliers that would be included in procurement documents.

ESS5 Land Acquisition, Restrictions on Land Use and Involuntary Resettlement

The standard is not currently relevant since no health and safety risks or impacts on communities are expected at this time. However, potential community health and safety issues will be further assessed with the client during project
preparation, including the potential need to develop requirements for security personnel who may be monitoring newly installed CCTV cameras, as well as the possible need for traffic safety issues related to equipment delivery and installation. If deemed necessary, the ESMP will outline requirements for security personnel as well as traffic management measures, such as speed limits, acceptable hours for delivery, etc. for suppliers that would be included in procurement documents.

**ESS6 Biodiversity Conservation and Sustainable Management of Living Natural Resources**

The standard is not relevant since the project’s proposed activities are not expected to have any direct or indirect negative impact on the biodiversity or the sustainable management of living resources. The locations of any equipment installation related minor works are expected to be fully within existing customs and tax offices or facilities; no greenfield sites would be utilized.

**ESS7 Indigenous Peoples/Sub-Saharan African Historically Underserved Traditional Local Communities**

This standard is relevant given that 2.4 percent of the national population of Costa Rica is Indigenous. While this represents a small proportion of the national population, the cantons with the highest poverty rates in the country are also those where most of the indigenous population lives. Additionally, historically lower employment and income opportunities among indigenous communities has translated into higher relative rates of self-employment, which may also imply higher rates of SME ownership.

During project preparation, the borrower will undertake a social assessment involving consultation with national-level indigenous representative organizations. Among other factors, and potential negative risks and impacts, the social assessment will explore the current extent of evasion/non-payment and capacity to pay by Indigenous households and SMEs, to assess the level of impact from project activities aimed at bringing Costa Ricans into compliance with the tax code, as well as opportunities for inclusion of IP taxpayers and SMEs in culturally appropriate benefits. This will inform the development of an IPPF, rather than an IPP, given that IP groups have not yet been identified. The IPPF will identify broad potential risks and impacts on indigenous taxpayers and will elaborate guidelines for culturally appropriate consultation and for the preparation of IPPs during implementation to minimize and mitigate any adverse impacts and to enhance opportunities and benefits for Indigenous taxpayers and SMEs...The preparation of the social assessment and the IPPF will follow a sequential approach whereby an advanced draft of the social assessment will be prepared and disclosed prior to the beginning of appraisal, and will guide the development of the IPPF. The IPPF would be prepared, consulted and disclosed prior to Board approval.

**ESS8 Cultural Heritage**

The standard is not expected to be relevant, given that any minor works related to equipment installation will take place within existing customs and tax offices or facilities, and would not impact or otherwise affect any cultural heritage resources.
The standard is not relevant. FI's are not part of this project.

**C. Legal Operational Policies that Apply**

| OP 7.50 Projects on International Waterways | No |
| OP 7.60 Projects in Disputed Areas | No |

**III. WORLD BANK ENVIRONMENTAL AND SOCIAL DUE DILIGENCE**

**A. Is a common approach being considered?**

No

**Financing Partners**

N/A

**B. Proposed Measures, Actions and Timing (Borrower’s commitments)**

**Actions to be completed prior to Bank Board Approval:**

The following instruments will be prepared and/or disclosed prior to the beginning of appraisal:

1. Preparation, consultation and disclosure of an advanced draft of the Social Assessment;
2. Preparation, consultation and disclosure of an advanced draft of the SEP, including a finalized Project Grievance Redress Mechanism (GRM), with culturally relevant mechanisms for Indigenous stakeholders;
3. Preparation, consultation and disclosure of the ESCP;

The following will be disclosed prior to Board approval:

1. Revised SEP;
2. IPPF, with culturally relevant GRM;

**Possible issues to be addressed in the Borrower Environmental and Social Commitment Plan (ESCP):**

- Preparation, consultation and disclosure of Labor Management Procedures which will be included in the project operational manual
- Development and inclusion in the project operational manual of a concise Environmental and Social Management Plan (ESMP) for minor impacts related to equipment installation and use
- Inclusion of relevant provisions of the LMP and ESMP in bidding documents

**C. Timing**

**Tentative target date for preparing the Appraisal Stage ESRS**

13-Jan-2020
**IV. CONTACT POINTS**

**World Bank**

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**Borrower/Client/Recipient**

Borrower: Government of Costa Rica

**Implementing Agency(ies)**

Implementing Agency: Ministry of Finance

**V. FOR MORE INFORMATION CONTACT**

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**VI. APPROVAL**

Task Team Leader(s): Mayra Del Carmen Alfaro De Moran, Ruxandra Burdescu

Practice Manager (ENR/Social) Maria Gonzalez de Asis Recommended on 25-Nov-2019 at 20:43:2 EST

Safeguards Advisor ESSA Maria Da Cunha (SAESSA) Cleared on 11-Dec-2019 at 02:08:53 EST