IMF Country Report No. 21/48

COSTA RICA

March 2021

2021 ARTICLE IV CONSULTATION AND REQUEST FOR AN EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR COSTA RICA

In the context of the Staff Report for the 2021 Article IV Consultation and Request for an Extended Arrangement Under the Extended Fund Facility, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its March 1, 2021 consideration of the staff report on issues related to the Article IV Consultation and the IMF arrangement.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on March 1, 2021, following discussions that ended on January 22, 2021, with the officials of Costa Rica on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on February 12, 2021.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Costa Rica.

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

Copies of this report are available to the public from

International Monetary Fund • Publication Services
PO Box 92780 • Washington, D.C. 20090
Telephone: (202) 623-7430 • Fax: (202) 623-7201
E-mail: publications@imf.org Web: http://www.imf.org
Price: $18.00 per printed copy

International Monetary Fund
Washington, D.C.

PRESS RELEASE

PR21/53

IMF Executive Board Approves a 36-month US$1.778 Billion Extended Arrangement under the Extended Fund Facility for Costa Rica and Concludes 2021 Article IV Consultation

FOR IMMEDIATE RELEASE

- The IMF Executive Board approved today a 36-month US$1.778 billion arrangement under the Extended Fund Facility (EFF) to help support Costa Rica's recovery and stabilize its economy.
- The home-grown program supported by the IMF focuses on implementing equitable fiscal reforms to ensure debt sustainability, while protecting the most vulnerable.
- Looking ahead, the government's reform agenda is designed to help promote inclusive and sustainable growth, including through innovative digitalization, climate-change mitigation and resilience building.

Washington, DC – March 1, 2021: The Executive Board of the International Monetary Fund (IMF) approved today a 36-month extended arrangement under the Extended Fund Facility (EFF) for Costa Rica, with access equivalent to SDR 1.23749 billion (335 percent of quota, equivalent to US$1.778 billion). The Board's approval allows for an immediate disbursement equivalent to US$296.5 million. The EFF arrangement follows Fund emergency support to Costa Rica in April 2020 (100 percent of quota, equivalent to US$521.7 million). The arrangement is expected to catalyze additional bilateral and multilateral financial support.

The Executive Board also concluded the 2021 Article IV consultation[1] with Costa Rica on the same day.

Costa Rica has made important strides in recent years in its fiscal and structural reform agenda as part of the OECD accession process. However, the pandemic has hit the economy hard and exacerbated pre-existing vulnerabilities, undermining the expected yields from the ambitious fiscal reform launched in late 2018 and generating a sizable financing gap. While the authorities' prompt response and well-established universal healthcare system have helped avoid a deeper crisis, the recovery is expected to be protracted, with the Costa Rican

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

economy projected to grow by 2.6 percent in 2021. Moreover, risks to the outlook remain elevated given the uncertainty surrounding the pandemic.

In addition to supporting the recovery, the IMF-supported program aims at securing macroeconomic stability and advancing the authorities' home-grown reform agenda. The authorities' policy efforts under the program will be anchored by three key pillars: (i) gradually implementing equitable fiscal reforms to ensure debt sustainability, while protecting the most vulnerable; (ii) maintaining monetary and financial stability, while continuing to strengthen the central bank's operational autonomy and governance and addressing structural financial vulnerabilities; and (iii) advancing key structural reforms to promote inclusive, green, and sustainable growth.

Following the Executive Board discussion on Costa Rica, Mr. Mitsuhiro Furusawa, Deputy Managing Director, and Acting Chair, issued the following statement:

"The Costa Rican authorities have responded promptly to the COVID-19 shock, helping avoid a deeper crisis. However, the socio-economic impact of the pandemic has been sizable, weakening its fiscal position and generating a large financing gap.

"Against this backdrop, the IMF's Extended Fund Facility will support the authorities' home-grown program aimed at securing macroeconomic stability, supporting a gradual recovery, and advancing the reform agenda.

"Building on a broad-based dialogue and the 2018 fiscal reform, the authorities are committed to achieving a primary surplus by 2023 to place debt on a downward path, while continuing to secure adequate pandemic-related spending for 2021 and critical social and capital spending over the medium term to support growth. Continued strengthening of social assistance programs and implementation of the reforms envisaged under the ambitious Public Employment Bill will also be critical to improve the equity and efficiency of government spending. Other fiscal structural reforms will support the authorities' fiscal strategy and mitigate fiscal risks.

"The monetary policy stance remains appropriately accommodative, while other monetary and financial sector measures have been transparent and well-targeted, providing timely support. Going forward, greater development of the foreign exchange market will support effective risk management and increased intermediation in local currency, while stepped-up monitoring and supervision will help ensure adequate bank capitalization.

"Implementation of the authorities' ambitious macro-structural agenda, including by promoting innovation and digitalization and fostering greater female labor force participation, will help lift potential growth, address inequality, and deliver broad-based improvements in living standards that benefit all Costa Ricans.

"Costa Rica's pioneer role in tackling climate change remains a key pillar of the authorities' macro-structural agenda. Ongoing efforts on climate change mitigation and adaptation can generate important opportunities for new jobs as well as sustainable and inclusive growth."

Executive Board Assessment[2]

Directors commended the authorities' prompt response to the pandemic but recognized that the economic shock has still been significant, further weakening the country's pre-existing fiscal vulnerabilities and generating large financing gaps.

Directors supported Costa Rica's request for an Extended Arrangement under the Extended Fund Facility, underscoring its potential role as a catalyst for additional financing, and commended the authorities for the broad-based political and social dialogue that has underpinned their home-grown program. They agreed that policy efforts should prioritize equitable fiscal reforms, maintaining monetary and financial stability, and advancing key structural reforms to promote inclusive, green, and sustainable growth. Directors emphasized the importance of strong program ownership to achieve these objectives.

Directors noted that the fiscal position has weakened considerably due to the COVID-19 crisis, despite the ambitious 2018 reform. They welcomed the authorities' commitment to achieve a primary surplus by 2023 to place debt on a downward path, while continuing to secure critical social and capital spending in response to the pandemic and over the medium term. Directors also welcomed the authorities' plans to further strengthen social assistance programs, and, in the context of the ambitious Public Employment Bill, help improve the equity and efficiency of government spending. They noted that efforts to enhance medium-term fiscal planning and debt management, revenue administration, and public sector governance are critical to support the fiscal strategy and mitigate risks.

Directors agreed that the accommodative monetary policy stance remains appropriate. They emphasized the need to address remaining impediments to monetary policy transmission and noted that greater development of the foreign exchange market will help support effective risk management and intermediation in local currency. Directors also strongly supported the plans to further enhance the central bank's autonomy and governance which should further support the inflation targeting regime.

Directors noted that the authorities' temporary and well-targeted financial sector measures have provided needed crisis relief. While noting that the financial sector seems resilient, they

---

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

emphasized that the credit portfolios in the banking sector will need to be carefully monitored and welcomed the ongoing efforts to step up monitoring and supervision.

Directors commended the authorities' ambitious macro-structural agenda to lift potential growth and address inequality, including by promoting innovation and digitalization. They noted that increasing formalization, notably through greater female labor force participation, will help deliver broad-based improvements in productivity and living standards. Directors applauded the authorities for their pioneering efforts to further improve resilience to climate change and fully decarbonize their economy, which will present tremendous opportunities for new jobs and sustainable growth.

Costa Rica: Selected Economic and Financial Indicators

	2019	2020	2021	2022	2023	2024	2025	2026
		Projections						
Output and Prices	(Annual percentage change)							
Real GDP	2.2	-4.8	2.6	3.3	3.1	3.1	3.2	3.3
GDP deflator	2.2	0.5	1.4	1.0	1.3	2.0	2.4	2.8
Consumer prices (period average)	2.1	0.7	1.2	1.1	1.4	2.1	2.5	2.9
Savings and Investment	(In percent of GDP)							
Gross domestic saving	13.6	12.8	13.3	14.5	15.2	15.7	16.1	16.3
Gross domestic investment	15.9	15.3	16.5	17.5	18.1	18.5	18.8	19.0
External Sector								
Current account balance	-2.3	-2.6	-3.2	-3.0	-2.9	-2.7	-2.7	-2.7
Trade balance	-5.9	-3.4	-4.8	-6.0	-6.4	-6.5	-6.5	-6.5
Financial account balance	-2.2	-2.5	-3.2	-2.9	-2.8	-2.7	-2.6	-2.6
Foreign direct investment, net	-4.1	-2.9	-3.2	-3.7	-4.1	-4.1	-4.1	-4.1
Gross international reserves (millions of U.S. dollars)	8,937	7,232	8,004	8,956	9,123	9,984	10,012	10,621
-as percent of ARA metric	131.2	108.3	111.7	114.3	114.0	117.1	113.9	113.1
External debt	47.9	52.6	59.1	61.5	61.6	61.9	59.9	58.7
Public Finances 1/								
Central government primary balance	-2.6	-3.9	-1.7	-0.3	1.0	1.7	2.3	2.8
Central government overall balance	-6.8	-8.7	-7.0	-5.9	-4.3	-3.4	-2.6	-2.0
Central government debt	56.8	68.3	72.5	75.0	76.0	75.6	74.2	71.9
Money and Credit								
Credit to the private sector (percent change)	-1.9	2.3	6.1	6.4	6.9	7.1	7.4	7.9
Monetary base 2/	7.1	8.4	8.6	8.8	9.0	9.1	9.2	9.3
Broad money	45.1	55.8	52.5	51.7	51.8	51.9	52.2	52.3
Memorandum Items								
Nominal GDP (billions of colones) 3/	37,561	35,944	37,388	39,004	40,718	42,834	45,266	48,085
Output gap (as percent of potential GDP)	-0.6	-4.7	-3.0	-1.4	-0.7	-0.4	-0.2	0.0
GDP per capita (US$)	12,600	11,981	11,803	12,315	12,829	13,386	13,998	14,714
Unemployment rate	12.4	19.9	16.0	14.0	12.0	10.5	9.5	9.0

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

1/ For comparison purpose, starting from 2019, central government figures include public entities that are consolidated under the central government from 2021 onwards as required by Law 9524.

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

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

INTERNATIONAL MONETARY FUND

COSTA RICA

February 12, 2021

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION AND REQUEST FOR AN EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY

EXECUTIVE SUMMARY

Context. Costa Rica has been hit hard by the COVID-19 pandemic, notwithstanding the authorities' proactive policy response and the country's well-established universal healthcare system. The socio-economic impact has been significant, exacerbating an already fragile outlook and pre-existing imbalances, with a significant toll on economic activity and unemployment—especially among women and the young. The shock has further weakened the country's fiscal position, undermining the expected yields from the ambitious fiscal reform launched in late 2018, and generated a large financing gap. Financial support through the Fund's Rapid Financing Instrument (RFI) in 2020 provided temporary relief to respond to the pandemic, including by catalyzing financial assistance from other official partners, but financing needs remain sizable over the medium term.

Request for an Extended Arrangement under the Extended Fund Facility (EFF). Against this backdrop, the authorities are requesting a 36-month extended arrangement under the EFF to support the response to the pandemic and gradual economic recovery, while anchoring their policy and reform efforts. Access is proposed at SDR 1,237.49 million (about US$1,750 million or 335 percent of quota) to help meet Costa Rica's sizable balance-of-payments and budget-support needs, including by catalyzing financial support from other official lenders and international capital markets.

Policy priorities. The Article IV and program discussions focused on supporting a recovery from the COVID-19 shock, while securing macroeconomic stability and advancing the authorities' reform agenda. The program's reform pillars have benefited from the authorities' broad-based political and social dialogue with key stakeholders and place emphasis on: (i) gradually implementing equitable fiscal reforms to ensure debt sustainability, while protecting the most vulnerable; (ii) maintaining monetary and financial stability, while continuing to strengthen the central bank's operational autonomy and governance and addressing structural financial vulnerabilities; and (iii) advancing key structural reforms to promote inclusive, green, and sustainable growth.

Key Risks. Risks to the program remain sizable, stemming from the uncertainty surrounding the COVID-19 crisis and the global outlook as well as potential delays in the implementation of the fiscal strategy and other key supporting reforms.

Approved by:
Krishna Srinivasan (WHD) and Björn Rother (SPR)

The mission team consisted of Manuela Goretti (head), Nan Geng, Martina Hengge, Huidan Lin, Jasmin Sin (all WHD), Miguel Pecho (FAD), David Grigorian and Piyabha Kongsamut (both MCM), Russell Green (SPR), with assistance from Heidi Canelas and Cristhian Vera Avellan (both WHD). Discussions were held remotely from Washington, DC during January 11-22, 2021. The team held virtual meetings with Costa Rica's President Alvarado, Central Bank President Cubero, Minister of Finance Villegas, Minister of Planning Garrido, other senior government and financial sector officials, members of the Legislative Assembly, academics, private sector, civil society, and union representatives, as well as other development partners. Gerardo Peraza, Luis Ibanez Thomae (Regional Resident Representative office), Raphael Anspach, Maria Candia (both COM), Pablo Moreno, and Edgar Cartagena (both OED) participated in some of the meetings. Krishna Srinivasan (WHD) joined the concluding meetings.

CONTENTS

FIGURES

TABLES

ANNEXES

APPENDICES

CONTEXT

1. **Despite an ambitious fiscal and structural reform agenda, Costa Rica entered the COVID-19 crisis with significant vulnerabilities.** Costa Rica has made important strides in its fiscal and structural reform agenda, in line with Fund advice (see Annex I) and as part of the OECD accession process. The country launched an ambitious fiscal reform in late 2018, in response to rising fiscal and debt vulnerabilities, which were already weighing on market sentiment and growth. Important progress was also being made in advancing a comprehensive structural agenda to lift productivity and potential growth, which will help tackle persistently high levels of unemployment, inequality and informality.

2. **The COVID-19 pandemic has taken a heavy toll on Costa Rica, adding to the country's economic and social challenges.** The authorities' timely and comprehensive response, leveraging Costa Rica's well-established universal healthcare system and widespread access to water and sanitation, has played a critical role in fighting the outbreak and mitigating fatality rates. Nevertheless, COVID-19 cases remain elevated and have taken a significant toll on economic activity and unemployment—especially among women and the young—due to the necessary containment measures and gradual reopening of the economy. The deteriorating fiscal position and tight financial conditions have created a sizable financing gap. Financial assistance from the Fund's RFI helped catalyze financing from other IFIs and provided temporary relief to the country in meeting critical spending needs in 2020 to respond to the pandemic.[1] Nevertheless, gross financing needs remain sizable over the medium term.

3. **Against this backdrop, the authorities are requesting an extended arrangement under the EFF to address their balance-of-payments needs and anchor their reform efforts.** Building on the Article IV discussions, the economic reform program aims at mitigating the socio-economic impact of the crisis, supporting the most vulnerable segments of the population, and fostering an inclusive and green recovery, while tackling entrenched structural challenges, notably to secure debt sustainability. The structural nature of the program objectives and the time required to achieve durable solutions amid the gradual recovery from the COVID-19 shock support the use of an extended arrangement under the EFF. The proposed 36-month duration of the arrangement and phased access will help bridge general elections due in early 2022, supporting policy continuity throughout the electoral cycle.

ECONOMIC DEVELOPMENTS AND OUTLOOK

A. The Pre-COVID-19 Landscape

4. **Macroeconomic conditions were already somewhat fragile prior to the COVID-19 shock.** Economic activity had slowed down in 2017-2019 (Figure 1), amid a challenging external

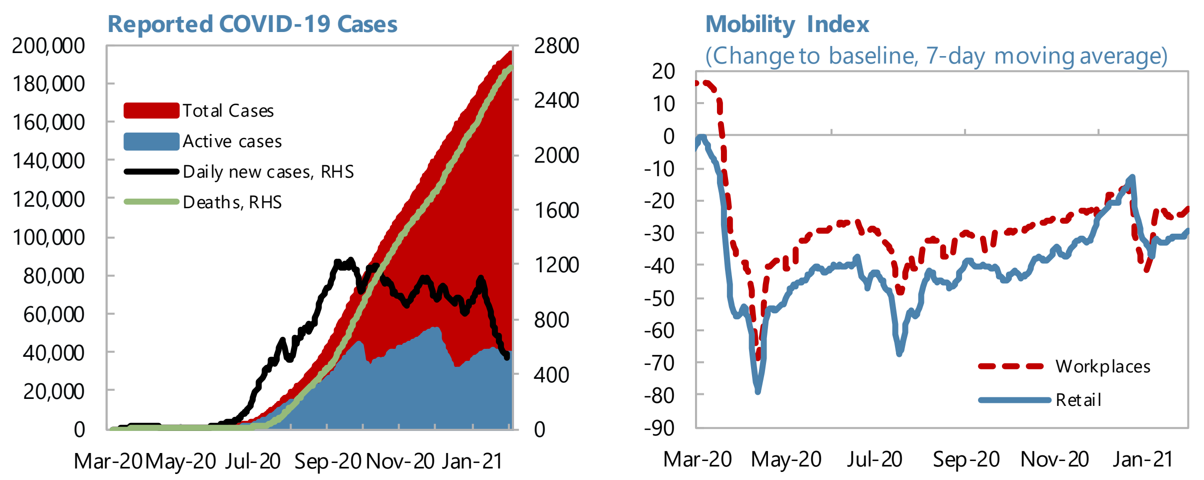
[1] See Costa Rica – Request for Purchase under the Rapid Financing Instrument.

environment, market stress from widening fiscal imbalances, and climate-related natural disasters, including a tropical cyclone and severe drought. While the economic outlook had started to improve in the second half of 2019, fiscal consolidation efforts, in the context of the authorities' ambitious 2018 fiscal reform (¶10), and tight financial conditions were expected to keep growth moderate at below 3 percent in 2019-20.[2] Inflation also remained contained in 2019, given still moderate growth and persistently high unemployment. The current account deficit, at 2.3 percent of GDP, was fully financed by FDI inflows, while reserves coverage was adequate at 6 months of imports or 131 percent of the Fund's Assessing Reserve Adequacy (ARA) metric as of end-2019. Although Costa Rica's credit rating remained below investment grade, the authorities were able to tap the Eurobond market for US$1.5 billion in November 2019, as the implementation of the 2018 fiscal reform helped improve market sentiment.

B. The Impact of the COVID-19 Shock

5. The authorities took swift and well-targeted actions to contain the pandemic, but a second wave of infections in mid-2020 has delayed the full reopening of the economy. Early containment measures at the onset of the pandemic included mandatory quarantines, closures of schools and public offices, and travel restrictions. A gradual reopening of the economy began in May 2020, as COVID-19 cases plateaued somewhat, but the full reopening has been delayed by a second and larger wave of infections. To balance the need to slow down community spread while supporting economic activity, the authorities have gradually relaxed restrictions at the national level, but stepped up prevention measures, including the introduction of a national mandatory face mask order in public enclosed spaces in September 2020 and of targeted containment measures at the cantonal level. As of end-January, there were 194,280 COVID-19 cases and 2,627 deaths.

Costa Rica: COVID-19 Developments



Sources: Ministry of Health; Google Community Mobility Report; and IMF staff estimates.
Note: Active cases = total confirmed - total recovered - total deaths.

[2] See Costa Rica - 2019 Article IV Consultation Staff Report.

6. Economic activity slowed down significantly in 2020, due to the global downturn and necessary containment measures.

- *Economic activity* declined sharply in 2020Q2-Q3 by 8.8 and 6.7 percent (y-o-y), respectively, due to the impact of domestic containment measures and weak external demand. The downturn was particularly pronounced in the hotels and restaurants, transportation, wholesale and retail, and construction sectors. *Inflation* was 0.7 percent on average in 2020—significantly below the Banco Central de Costa Rica (BCCR) target range of 2-4 percent—reflecting lower economic activity and oil prices. Average core inflation stood at 1.1 percent in 2020.

- *Unemployment* increased further due to the sharp contraction in activity, from 12.5 percent in 2020Q1 to 22.0 percent in 2020Q3, with particularly high rates among women and the young. *Poverty* also increased to 26.2 percent in July 2020, up from 21 percent a year earlier. *Private sector credit* remains stagnant with a recorded increase of 2.8 percent (y-o-y) in November 2020, up from -0.9 percent in April, mainly due to the impact of the exchange rate depreciation on FX-denominated loans (Figure 4).

- The *current account* recorded an annualized deficit of 2.5 percent of GDP through 2020Q3 (Figure 2). The tourism sector has been severely hit by the COVID-19 shock (Annex II), with arrivals at a near standstill in 2020Q2-Q3 and only a gradual recovery in 2020Q4. However, resilient exports from the free trade zone and the agriculture sector and sharp import compression have mitigated the impact on the current account deficit.

- *Reserves* declined by US$1.7 billion in 2020, while the colón-dollar exchange rate depreciated by 7.1 percent. The EMBI spread reached over 900 bps in April 2020 and, although market conditions have since improved, remains elevated at about 550 bps as of end-January 2021.

C. Outlook and Risks to the Recovery

7. The economy is projected to recover only gradually over the medium term, following a sizable contraction in 2020. Due to the prolonged impact of the pandemic, real GDP is expected to start recovering modestly in 2021, by 2.6 percent, and reach pre-COVID output levels only in late 2022. [3] Over the medium term, growth will converge to its potential of about 3 percent, supported by a recovery in credit growth and structural reforms. Weak demand and subdued import prices are expected to keep inflation around the lower end of the BCCR's target range in the near term, before it gradually converges to the midpoint over the medium term. The current account deficit is projected to widen to 3.2 percent of GDP in 2021, from 2.6 percent in 2020—as domestic activity and imports start recovering, while tourist arrivals resume only gradually—and to stabilize at around 2.7 percent over the medium term. A balance-of-payments financing gap of 6.4 percent of GDP is

[3] National account data reflect the revision of the benchmark year to 2017 for the chained volume measures, published in January 2021. The nominal GDP level increased by 3.5 percent in 2019 as a result of the revision.

projected over 2021-2023, in the context of twin deficits, tight financial conditions, and a slow recovery in FDI.

8. **Risks and uncertainty around the outlook are large.** The baseline assumptions are conservative and envisage a gradual recovery as the pandemic recedes and the economy reopens. Nevertheless, the pandemic could turn out more severe and protracted, including due to delays in vaccine distribution, which could prolong the global and domestic economic recovery (Annex III). This would lead to delays in the implementation of the fiscal consolidation strategy, owing to weaker-than-expected revenues and higher COVID19-related spending, portending greater macro-financial vulnerabilities amid rising private sector distress and scarring. These downside risks would further weigh on the debt and financing outlook. On the upside, a quick resolution of the pandemic, with stronger external demand and rebound in tourism, could allow for a speedier recovery. Faster-than-expected progress in fiscal consolidation and key structural reforms, with associated confidence effects, could also further lift investment and potential growth in the medium term.

9. **Based on preliminary data and EBA model results, the external position in 2020 was stronger than the level implied by fundamentals and desirable policies.** In 2020, the REER and NEER depreciated by 8.5 and 8.3 percent, respectively. The EBA-based current account gap of 2.3 percent of GDP (compared to a gap of 1 percent in 2019) suggests that the external position in 2020 was stronger than the level implied by fundamentals and desirable policies, although the assessment is subject to a high degree of uncertainty. Specifically, the assessment is driven by the larger deterioration in fundamentals of the EBA-model global comparator group of countries than in Costa Rica, as the sharp import compression and resilience of free trade zone exports contained the weakening of the country's external position (see Annex IV). As the health and economic crisis recedes domestically and globally, fiscal consolidation should resume, consistently with the fiscal rule, to prevent a deterioration in external sustainability. The authorities recognized that the assessment was driven by the relative performance of Costa Rica compared to the EBA comparator country group and is subject to a high level of uncertainty, given the major shock to the global economy in 2020. In particular, they noted that the adjustments for multilateral consistency masked the weakening of the country's external position in 2020, as indicated by the larger current account deficit, despite a sharp import compression and depreciation of the currency.

TOWARDS A MORE RESILIENT, INCLUSIVE, AND GREENER ECONOMY

A. Fiscal Policies: Supporting the Policy Response to the Pandemic while Ensuring Medium-Term Debt Sustainability

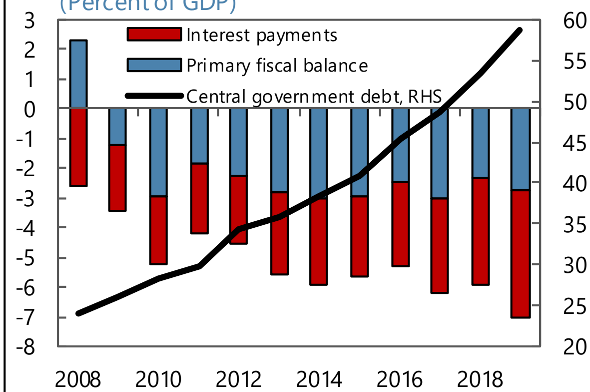
Background

10. **A major fiscal reform was approved in December 2018 to tackle the large imbalances built up over the past decade and anchor fiscal consolidation efforts.** Costa Rica entered the

COVID-19 crisis with an already weak fiscal position. The fiscal deficit and debt-to-GDP ratio had more than doubled since the Global Financial Crisis, amid permanent increases in current spending and rising interest payments. The weakening of the fiscal account was largely driven by a growing public sector wage bill, which also led to a widening wage premium and rising inequality between public and private sector employees (Figure 3). To tackle the rising fiscal imbalances, the authorities approved in December 2018 a comprehensive fiscal reform, which included a mix of tax reforms and spending measures as well as the introduction of a new fiscal rule with spending ceilings (Annex V). Despite initial yields from the implementation of the fiscal reform, the deficit widened further in 2019, reflecting a growing interest bill, backloaded transfers to public entities from 2018, a capital contribution to the Development Bank of Latin America (CAF), and weaker growth. The full implementation of the reform, including of the new fiscal rule, was expected to reduce the primary deficit from 2.6 percent in 2019 to 1.3 percent of GDP in 2020 (as projected in the BCCR's January 2020 Macro Program).

Costa Rica: Fiscal Balance and Government Debt

(Percent of GDP)



Sources: Ministry of Finance and IMF staff estimates.

Costa Rica: Fiscal Response to COVID-19

Revenue measures

- *3-month moratorium for VAT, business income taxes, and customs duties* (interest-free, payable by end-year and with the possibility to arrange for payment plan to defer tax payment until 2021).
- *25 percent temporary reduction (for six months) in the minimum tax base for health and pension contributions.*
- *Deferral of the roll-out of the VAT on construction and tourism services.*
- *A one-off tax relief on car registration tax in 2020, with the revenue loss to be compensated by the PAGAR bill (a one-off revenue collection from public entities in 2021).*
- *Transfer of CRC 75 billion excess capital from INS to CG*
- *Freeze in domestic retail price for premium petroleum* and transfer of the resulting additional revenue of CRC 16 billion from RECOPE to CG.

Spending measures

- *Activation of the escape clause under the fiscal rule* to allow higher COVID-related spending by four relevant public institutions.
- *Increase in public health spending*, including construction of a specialized hospital for COVID-19 treatment, financed by National Emergency Fund, and a COVID-19 vaccine downpayment of CRC 7.2 billion.
- *Transfer of CRC 74 billion to CCSS to compensate for the lower social security contribution.*
- *Launch of the Bono Proteger program* to provide a monthly subsidy of CRC 125,000 (≈US$205) for three months to about 375 thousand family economically affected by the crisis with a monthly income of less than CRC 750,000 (≈US$1,230) prior to COVID-19.
- *Freeze in public sector wage (except for police and healthcare workers) and 4953 public vacancies, and eliminated 2194 positions*.
- *Cut in non-critical spending on goods and services and capital*.

Sources: Costa Rican authorities and IMF staff.

11. The critical needs prompted by the COVID-19 crisis and sharp revenue shortfalls had a significant impact on the 2020 fiscal accounts. Following a strong budgetary outcome in January and February 2020 (with deficits half the size of the previous year), beginning March, the authorities had to swiftly adopt extensive revenue and expenditure measures, with four supplementary budgets, to respond to the pandemic and the worsening macroeconomic outlook. COVID-related spending in 2020 amounted to about 0.8 percent of GDP at the central government (CG) level and 1.3 percent of GDP at the general government level, of which the majority was devoted to the *Bono Proteger* cash transfer program to protect the most affected and the rest to transfers to the Social Security Fund and health-related spending. To mitigate the widening of the deficit, as tax revenues fell by 11 percent in 2020, the authorities reduced non-critical spending and tapped contingency funds and additional revenues from the freezing of retail fuel prices. Despite these efforts, the 2020 primary deficit for the CG, including newly consolidated public entities, is expected to have reached 3.9 percent of GDP, bringing debt to about 68 percent of GDP.[4]

Policy Discussions

12. The higher fiscal deficit in 2020 was justified by the need to adequately respond to the COVID-19 shock and allow automatic stabilizers to operate. The fiscal impact of the COVID-related measures introduced in 2020 was mitigated by the accruing yields from the 2018 tax reforms (0.6 percent of GDP) and offsetting revenue and spending measures introduced by the authorities. As a result, despite the widening in the headline deficit, the 2020 structural primary balance (net of cyclical impact and one-off measures triggered by the COVID-19 crisis) is projected to have improved by about 0.3 percent of GDP compared to 2019.

Costa Rica: Central Government Operations and Fiscal Package

Central Government Operations
(In percent of GDP)

	2019	2020	2021
		Proj.	Proj.
Total Revenue	15.1	14.3	14.7
o.w. Tax Revenue	13.2	12.2	12.7
Total Expenditure	21.9	22.9	21.7
Current Expenditure	19.6	21.0	20.2
o.w. Wage bill	7.0	7.5	6.9
o.w. Purchases of G&S	0.9	1.1	0.9
o.w. Current Transfers	7.6	7.7	7.0
Capital Expenditure	2.3	1.9	1.5
Primary Balance	-2.6	-3.9	-1.7
Overall Balance	-6.8	-8.7	-7.0
Memo items			
Structural Primary Balance	-2.7	-2.4	-0.8
Nominal GDP (CRC bn)	37561	35944	37388

Authorities' Fiscal Package, 2021-23
(Cumulative change from 2020 in percent of GDP)

	2021	2022	2023
	Proj.	Proj.	Proj.
Revenue measures:	**+0.4**	**+0.8**	**+1.4**
2018 tax reform yields	+0.1	+0.1	+0.3
Reduce tax exemptions	+0.2	+0.4	+0.5
Globalize PIT (territorial)			+0.4
Raise property tax		+0.1	+0.1
SOE dividends	+0.1	+0.2	+0.2
Expenditure measures:	**-1.3**	**-1.8**	**-2.3**
Wage bill	-0.6	-0.8	-1.0
Purchases of G&S	-0.1	-0.2	-0.3
Current transfers	0.0	-0.5	-0.8
o.w. Social assistance	+0.1	+0.1	+0.1
Capital spending	-0.5	-0.3	-0.1
Total structural measures	**+1.7**	**+2.5**	**+3.7**
+ One-off measures	+0.6	+0.7	+0.6
+ Cyclical impact	+0.1	+0.4	+0.6
Primary balance	**+2.3**	**+3.6**	**+4.9**
Primary balance (% of GDP)	**-1.7**	**-0.3**	**1.0**

Sources: Ministry of Finance and IMF staff estimates.

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

13. Building on a broad-based social dialogue and the 2018 fiscal reform, the authorities are gradually resuming their fiscal efforts, while supporting the recovery and most vulnerable. As the health emergency recedes and the recovery takes hold, the authorities plan to achieve a primary surplus of 1 percent of GDP by 2023, to place debt on a downward path, while maintaining space for adequate pandemic-related spending in 2021 and continuing to support the most vulnerable. To achieve this goal, the program targets a primary adjustment of nearly 5 percent of GDP over 2021-23 or 3.7 percent of GDP in structural terms —net of any cyclical impact and one-off measures.[5] The fiscal consolidation will be supported by a balanced mix of expenditure rationalization—underpinned by the fiscal rule (Annex V)—and equitable revenue mobilization, while strengthening the social safety net. The agreed measures were identified by the authorities in the context of a broad-based dialogue with social partners and political parties in late 2020 and early 2021 to ensure home-grown support and ownership of the reform program. The 2021 budget was approved by the Legislative Assembly last November, while supporting legislation on the revenue side was submitted last December-January and is currently under discussion. Specifically,

- ***Spending measures***. The authorities' 2021 budget envisages additional spending allocations for the one-off purchase and distribution of a COVID-19 vaccine to cover the entire eligible population, as well as supplementary resources to strengthen—on a structural basis—social assistance, including by expanding the coverage of low-income beneficiaries (¶15 and Annex VI). To meet these critical spending needs, while complying with the spending ceilings under the prudent fiscal rule (Annex V), the authorities are advancing their efforts to address some of the long-standing excesses in government spending, notably in the wage bill (of the CG as well as of the broader public sector—via current transfers).[6] The capital spending reduction is planned to be temporary due to COVID-related delays and reprioritization of capital projects. Overall, expenditure measures are expected to generate net savings of about 2.3 percent of GDP by 2023.

- ***Revenue measures***. Building on the 2018 tax reform, the authorities plan to further reduce tax expenditure—estimated at 4.9 percent of GDP in 2020—by 0.5 percent of GDP by 2023, including by removing the tax exemption on the 14th monthly salary for public employees, which will in turn help reduce the country's high public-private sector wage premium (Figure 3). The authorities' revenue package also envisages a more progressive luxury property tax and further globalization of the PIT, the latter through a reduction in the tax-exempted threshold.[7] Staff estimates, prepared with the World Bank (WB), suggest that the revenue measures put forth by the authorities would enhance progressivity and help reduce income inequality (Annex VI).

---

[5] One-off measures in 2021 include temporary higher tax rates on capital gains and revenues generated by the PAGAR bill (already approved by the Assembly), COVID19-related measures, including health spending for the vaccine and transfers to the Costa Rican Social Security Fund (CCSS), and capital contributions to CAF.

[6] Based on the authorities' estimates, salaries and social security account for about 80 percent of the central government transfers to the public sector.

[7] Costa Rica's immovable property tax revenue—currently at 0.3 percent of GDP—is low compared to the LAC and OECD averages of 0.4 and 1.1 percent of GDP, respectively, while the PIT tax-free threshold is high at 1.4 times per capita income, compared to 1.1 for LAC countries and 0.3 for OECD ones.

Moreover, a new policy which will allow for distribution of dividends by SOEs to the CG (for about 0.2 percent of GDP) is expected to generate efficiency gains, by replacing the current practice of SOEs' bond purchases and related interest costs. The total revenue package, including yields from the 2018 reform and net of COVID-related tax deferrals (e.g. for the roll-out of the VAT on construction and tourism), is expected to yield 1.4 percent of GDP by 2023.

14. The program incorporates contingency measures to augment COVID-related spending. Given the still high degree of uncertainty related to the COVID-19 crisis and economic recovery, the fiscal program builds flexibility to augment COVID-related emergency spending in 2021. Specifically, an adjustor to the fiscal primary target under the program allows for additional spending of up to 0.3 percent of GDP in 2021 (¶41), for health services, targeted support to households and businesses heavily affected by the pandemic, or additional allocations to social assistance programs to support the most vulnerable groups. To ensure the program objectives remain within reach, in the face of adverse shocks, the authorities also stand ready to reprioritize non-critical spending, as already planned in the President's order issued in early January which envisages a prudent level of spending execution, or propose to the Legislative Assembly temporary tax measures as needed. On the upside, should the economic recovery take hold faster than expected, the authorities are committed to locking in any revenue over-performance to accelerate their debt reduction plans.

15. Ongoing efforts to strengthen coverage and targeting of social assistance programs can provide critical support to the most vulnerable during and beyond the pandemic. While current spending levels on social assistance programs are broadly in line with countries at a similar development level, the authorities' planned structural increase in selected social assistance spending by 0.1 percent of GDP (about 5 percent of existing programs) starting in 2021, is expected to help expand coverage for the poorest income deciles and, according to model estimates by the WB, reduce income inequality by 0.4 Gini percentage points, lifting more than 12 thousand people out of poverty (Annex VI). This will be complemented by further enhancements to the social transfers' delivery system, through digitalization and centralization at the MOF's National Treasury, with support from IMF TA, to allow for more efficient channeling of resources. In parallel, the government's plans to upgrade the single social and beneficiary registry (*Sistema Nacional de Información y Registro Único de Beneficiarios del Estado*, *SINIRUBE*), with WB and IDB support, are expected to improve the targeting accuracy of social protection expenditure.

16. The public employment reform will be also instrumental in improving the equity and efficiency of government spending, bringing the public wage bill on a sustainable path. The ambitious Public Employment Bill—expected to be approved by the Legislative Assembly by end-May—will introduce, within twelve months, a single pay spine and eliminate other salary components such as annuities, bonuses, and incentives, in line with OECD recommendations.[8] A critical step to revamp the highly fragmented public salary system and modernize the public

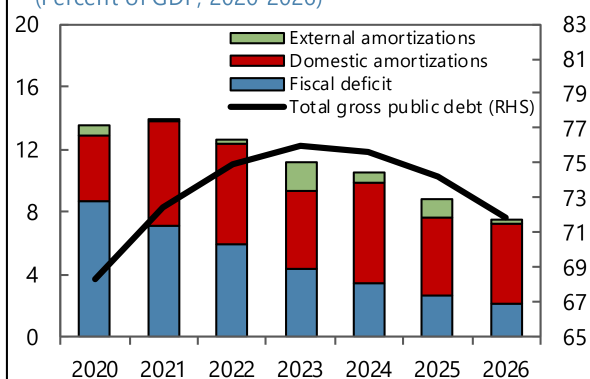
[8] The new regime will cover the central government, decentralized institutions, SOEs that do not compete in private markets, public universities, autonomous and semi-autonomous institutions, and municipalities.

administration, the reform will also entail a gradual rationalization of the wage bill over the medium to long term, supporting the implementation of the fiscal rule.

17. Further efforts to strengthen and improve the efficiency of the revenue administration are another key element of the fiscal strategy. Ongoing efforts to strengthen tax and customs administration are expected to support the authorities' fiscal consolidation plans (with potential yields of 0.3 percent of GDP already during the program period, although not yet reflected under the baseline). Building on the 2019 Tax Administration Diagnostic Assessment Tool, these include steps to enhance compliance risk management practices, revamp taxpayer services, overhaul information cross-matching programs, and improve collection of tax arrears. The MOF's digital transformation plan, *Hacienda Digital para el Bicentenario,* supported by the WB, is also expected to improve the efficiency of the revenue administration.

18. Despite the nascent recovery and planned fiscal reform efforts, debt vulnerabilities will remain elevated, with large financing needs over the medium term. Under the baseline scenario, debt is assessed as sustainable, but risks remain high (see the Debt Sustainability Analysis in Annex VII). Central government debt is projected to peak at about 76 percent of GDP in 2023—above the 70-percent debt distress threshold for emerging economies—before starting to gradually adjust over the medium term to reach the authorities' 50-percent target by 2035. Sustained implementation of the fiscal rule is imperative to support debt dynamics over the medium to long term. Moreover, the debt profile remains vulnerable to exchange rate, interest rate, and contingent liability shocks. Gross financing needs will remain elevated in coming years, peaking at nearly 14 percent of GDP in 2021. Over the projection period, about one third of financing needs are expected to be financed externally through multilateral credit, including Fund resources, as well as US$4 billion in Eurobond issuances (Table 4). Domestic debt, three quarters of which reflects rollovers of existing liabilities, would continue to be placed with a stable investor base, including pension funds and banks.

Costa Rica: Gross Fiscal Financing Needs and Debt
(Percent of GDP, 2020-2026)



Sources: Ministry of Finance; and IMF staff estimates.

19. Public financial and debt management practices are being modernized to better support debt dynamics. To anchor the fiscal consolidation strategy over the medium term, the authorities have started preparing a Medium-Term Fiscal Framework (MTFF) for the central government, with clearly defined deficit and debt objectives as well as an assessment of risks, with support from IMF TA. The MTFF coverage will be expanded by April 2022 to the entire non-financial public sector, with a more robust analysis of fiscal risks. In parallel, enhanced debt management practices will be underpinned by a well-articulated medium-term debt strategy (MTDS) and annual borrowing plans, with support from IMF and WB TA. These will be complemented by measures to develop the domestic debt market and facilitate non-resident participation.

20. Further efforts are also ongoing to improve governance and increase transparency in State-owned Enterprises (SOEs). Although SOEs play a dominant role in many key sectors of the economy, some of them present data reporting weaknesses, constraining a full assessment of their balance sheets and potentially hiding risks to fiscal finances and taxpayers. To foster greater transparency, full adoption of IFRS reporting standards by SOEs is being accelerated under the program, including by increasing the number of SOEs that publish their financial statements according to IFRS. Moreover, while Costa Rica's energy companies do not receive CG transfers, there is significant scope to improve their efficiency to support the country's productivity, notably through a reduction in electricity prices—among the highest in the region. Accordingly, the Government is making progress on an efficiency strategy to reduce the operative costs and restructure the debt of the Costa Rican Institute of Electricity (ICE) to achieve lower and more competitive tariffs. These efforts have already delivered important tariff reductions in generation, distribution, and transmission as of January 2021.

21. The authorities are further strengthening their fiscal governance and anti-corruption framework. Fiscal risk management is being improved as part of the MTFF and through the implementation of a new Public Procurement Law, which contains specific provisions related to the collection and publication of beneficial ownership information. Moreover, with reference to COVID-related emergency assistance, the authorities remain committed to ensuring all public procurement is fully transparent, including through the planned revamp of their Transparency Portal by end-December 2021, with IDB support. Data quality will be further enhanced by the authorities' plan to fully adopt 2014 GFSM accrual accounting standards for fiscal and budgetary information and international standards for non-financial public sector debt data by end-2022.

B. Monetary and Financial Sector Policies: Maintaining Stability, while Supporting the Recovery from the COVID-19 Shock

Background

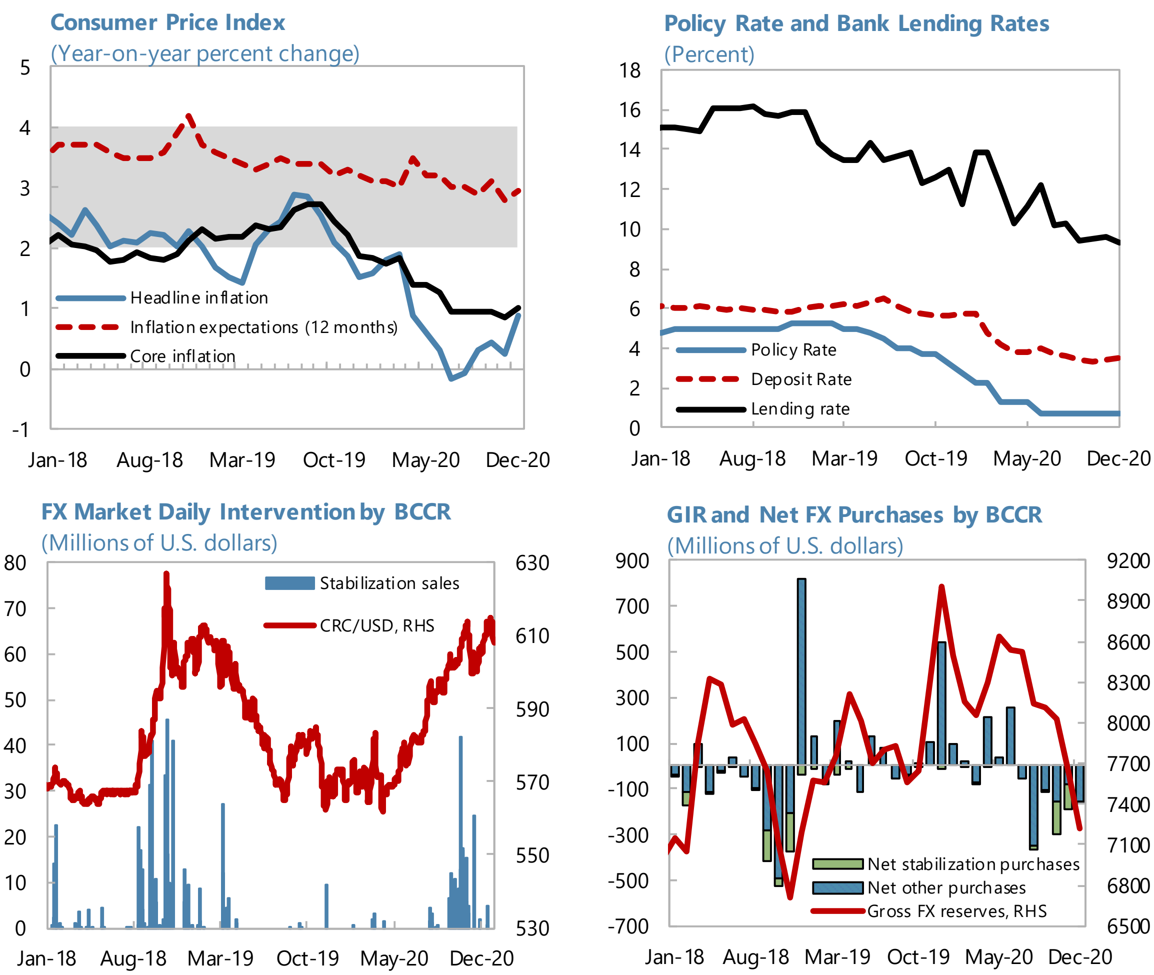
22. The BCCR has taken swift actions to mitigate the impact of the COVID-19 shock. Since the start of the pandemic, the central bank cut the policy rate twice from 2¼ percent in early March to a record low of ¾ percent in June 2020. Nevertheless, inflation has continued to hover below the BCCR's tolerance band (±1 percentage point) around the mid-point target of 3 percent. Deposit and lending rates have fallen gradually in response to the policy rate cut. To support liquidity, since April 2020, the BCCR has been authorized by law to purchase sovereign and other liquid securities in the secondary market in the event of systemic liquidity stress. Moreover, the BCCR expanded in January 2021 the long-term repo facility introduced last September.[9]

23. The BCCR has focused FX intervention on episodes of excessive volatility. Direct FX sales have been contained since the onset of the COVID-19 shock, aside from a period of high

[9] As of end-December 2020, secondary market purchases by the BCCR stood at less than CRC 1.7 billion, while CRC 575 billion had been approved for the repo facility.

volatility in the fall of 2020, amid market uncertainty about the country's outlook and reform plans, which triggered FX intervention of about US$260 million. In addition, the BCCR absorbed FX needs by the non-financial public sector for about US$371 million in 2020.

Costa Rica: Inflation, Interest Rate, and FX Market Developments



Sources: BCCR; and IMF staff estimates.

24. While the banking sector entered the crisis with adequate capital and liquidity buffers, it is being affected by the COVID-19 shock. The banking system's capital adequacy ratio remained above the 10-percent required threshold, with a liquidity-to-short-term-liabilities ratio of nearly 1, as of end-2020 (Table 6). Regulatory NPLs have risen somewhat, particularly in the construction and hospitality sectors, but remain below 3 percent, while forward-looking loan loss provisions have increased from 3.5 percent in 2019 to 4.2 percent in 2020. Reflecting weak economic conditions, banking system profitability (return on equity) declined from 6.8 percent in 2019 to 4.6 percent in 2020. However, credit quality could worsen and banks' profitability could be further compressed as loan restructuring measures expire and lagged effects of the crisis kick in (¶30, Annex VIII).

25. As the COVID-19 crisis unfolded in 2020, the authorities introduced temporary measures to ease credit conditions. These included the macroprudential measure of reducing to zero the minimum accumulation of countercyclical provisions for financial entities, the relaxation of regulations to support loan restructuring and offering moratoria, at the discretion of the creditor, for those worst hit by the pandemic, and the provision of emergency funding to SMEs. By end-November 2020, almost half of the loan portfolio had been restructured, taking advantage of these temporary measures, although some of these loans have already started to be repaid.

26. As conditions stabilize, the authorities have started to cautiously unwind some of the COVID-related measures, while continuing to provide targeted support. Starting in December 2020, banks have been required to update the credit ratings of borrowers for new restructured loans to adequately reflect the potential impact on credit risks. Banks' approach to restructuring has become more and more targeted, as the impact of the crisis on specific creditors becomes clearer, with proactive provisioning against specific exposures, benefiting from the use of already accumulated countercyclical buffers. The Legislative Assembly is also considering the establishment of a US$300 million fund to provide guarantees to companies and individuals affected by the pandemic, with limited contingent liabilities for the government.

Policy Discussions

27. The accommodative monetary policy stance by the BCCR remains appropriate amid a still weak inflation outlook. The cuts in the policy rate and other measures taken by the BCCR in response to the crisis, consistent with its inflation targeting and flexible exchange rate regime, have been transparent and well-communicated and are helping ease liquidity conditions and support the recovery. Going forward, the BCCR's monetary policy stance should continue to be data-dependent and forward-looking, in line with the inflation targeting framework.

28. The authorities continue to take steps to address remaining structural issues hindering monetary policy transmission, including due to high financial dollarization. The BCCR's ongoing efforts to refine and foster the availability of interest rate benchmarks to best reflect current market conditions, as per international standards, will help strengthen monetary policy transmission. Amid a still high level of dollarization (nearly 40 percent for both credit and deposit),[10] the authorities are advancing important initiatives, with support from IMF TA, to enhance effective management of FX risks, by developing the FX derivative market, and further discourage unhedged FX borrowing and lending through prudential regulation. FX intervention by the BCCR should continue to be limited to periods of excessive volatility, in line with its mandate.

29. Plans to further strengthen the BCCR's governance framework will help enhance the inflation targeting regime. The amendments to the BCCR Law in 2019—to tighten the dismissal rules for the BCCR Governor, delink the Governor's term from the political cycle, and remove the Minister of Finance's voting rights in the BCCR Board—have improved the personal autonomy provisions in the law. Moreover, the BCCR has taken important steps to enhance communication

[10] See "*Macro-Financial Stability Update*", Annex III, Staff Report, Costa Rica Article IV Consultation 2019.

and transparency in recent years, including with the release of the calendar of monetary policy meetings starting in January 2020 and the publication of the Financial Stability Report last July. Nevertheless, the 2020 Safeguards Assessment identified scope to further strengthen the BCCR's operational autonomy and governance, with support from IMF TA (see details in ¶43).

30. Staff welcomed the actions taken by the authorities to support the financial sector in response to the COVID-19 shock as well as the proactive monitoring and supervisory efforts. The introduction of temporary, transparent, and well-targeted measures has been appropriate given the severity of the shock and has helped provide important credit relief to affected businesses and households. While the financial system appears resilient to a range of sizable yet realistic shocks (Annex VIII), the authorities have appropriately stepped up monitoring and supervision of credit portfolios, given the large share of restructured loans and the high degree of uncertainty surrounding this crisis to ensure banks remain adequately capitalized. Such proactive supervision, together with sustained targeted support and use of available countercyclical buffers, should continue until conditions improve. Moreover, the authorities' phased-in adoption of Basel III over the next two years, including for specific risks and overall capital adequacy, is welcome.

31. The authorities are advancing the implementation of the 2018 Financial Sector Stability Review (FSSR) recommendations. The laws on consolidated supervision and banking resolution recently approved by the Legislative Assembly have helped address some of the shortcomings identified in the 2018 FSSR. Macroprudential monitoring of systemic risk is also being strengthened.

- ***Consolidated supervision***. Relevant regulations to implement the new law on consolidated supervision will be issued by end-2022, with support from IMF TA. Looking ahead, cross-border supervision can be further facilitated, including by expanding the supervisor's scope to financial companies that may be linked by common foreign ownership.

- ***Financial safety net***. Implementing regulations for banking resolution and deposit guarantee fund are under preparation. Moreover, additional efforts are planned, with support from IMF TA, to further strengthen the legal framework on bank resolution and deposit insurance, including through adequate institutional arrangements for the Deposit Guarantee Fund and the resolution authority, safeguards for resolution, and clear resolution triggers.

- ***Macroprudential framework***. The establishment of a new coordination group under the Financial Stability Committee to monitor macro-financial risks has enhanced collaboration across agencies. The authorities intend to further strengthen the macroprudential framework by developing a responsibility matrix between relevant groups, with support from IMF TA.

- ***Financial inclusion***. Further steps are also being taken to foster financial inclusion, starting with a national strategy for financial education that is being implemented.

Costa Rica: Implementation Status of Selected FSSR and Follow-Up TA Recommendations

	Completed	In progress
Financial Crisis Management	- Lender of Last Resort facility implemented - Law on banking resolution and deposit insurance passed	- Issue regulations for banking resolution and Deposit Guarantee Fund - Further enhance crisis management framework, as per international best practice
Prudential Regulatory and Supervisory Regime	- Law covering effective consolidated supervision passed - Improved monitoring of liquidity coverage ratio	- Enhance framework for regulation and supervision of financial groups, including cross-border - Formalize monitoring of net stable funding ratio - Refine credit-loss estimation and provisioning rules
Macroprudential Policy Framework	- Financial Stability Committee established, with a group monitoring macro-financial risks - Contingency plan implemented	- Continued strengthening of stress testing tools - Define matrix of responsibilities between BCCR, CONASSIF, and Superintendencies
Financial Dollarization	- Greater exchange rate flexibility allowed - Reserve requirement for deposits in colones reduced	- Refine the definition of "FX generator" - Further recalibrate prudential regulation to discourage dollarization - Develop FX derivative market to enable effective management of FX risks
Financial Inclusion	- Payment system access by Fintech - National financial education strategy being implemented	- Develop a national financial inclusion strategy - Regulate the currently non-regulated credit providers

Sources: CONASSIF and IMF staff. indicates IMF CD support received/requested.

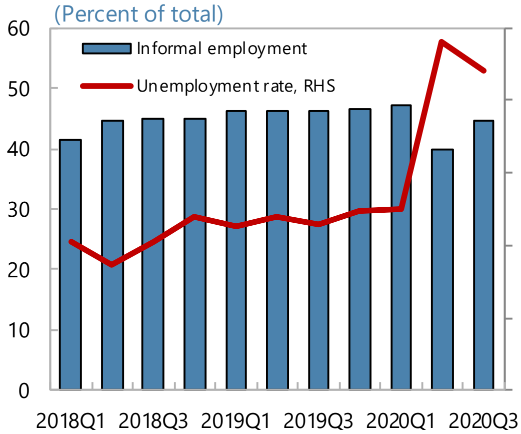
C. Growth-enhancing Structural Reforms: Fostering Economic Inclusion, Competitiveness, and Green Growth

Background

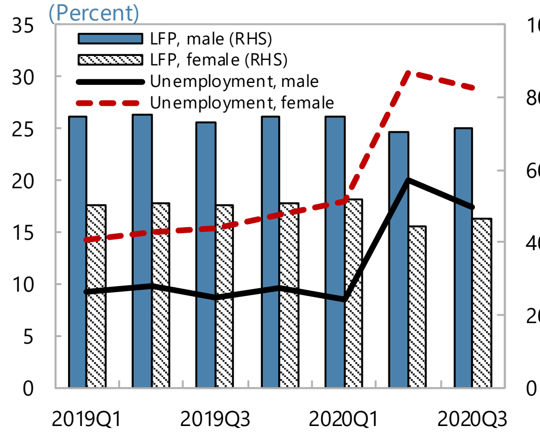
32. **Despite remarkable progress with structural reforms, high inequality, weak productivity, and climate change continue to pose important challenges.** Strong reform momentum in a wide range of areas has strengthened Costa Rica's macroeconomic environment and supported the economic recovery in 2019. In May 2020, the OECD invited Costa Rica to become its 38th member, recognizing the country's achievements. Nonetheless, as discussed below, compared to other OECD economies, informality and inequality remain very high in Costa Rica, amid weak productivity. Additional structural challenges arise from exposure to climate-related natural disasters to which the authorities have responded with an ambitious agenda.

Costa Rica: Labor Market Indicators

Informality and Unemployment
(Percent of total)



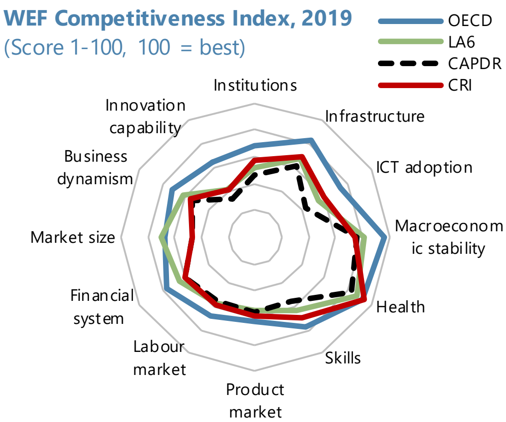
Unemployment and Labor Force Participation
(Percent)



Sources: INEC; and IMF staff estimates.

33. Costa Rica compares favorably in competitiveness rankings, although some obstacles to growth remain. Due to its social and political stability as well as relatively high human capital, Costa Rica has emerged as an attractive destination for FDI in the region. Nonetheless, Costa Rica has lost some ground in recent years to peers, e.g. in terms of the World Economic Forum's Global Competitiveness Index.[11] Important skill mismatches and infrastructure gaps—notably in transport and telecommunication—together with limited technological innovation and excessive red tape are identified as key obstacles to boosting productivity and competitiveness. Despite some improvement in recent years, low productivity still hampers the ability of domestic firms to integrate with firms in the country's free trade zone and participate in global value chains.

WEF Competitiveness Index, 2019
(Score 1-100, 100 = best)



Sources: World Economic Forum; and IMF staff estimates.

34. The economy features a high degree of informality, especially among low-skilled workers and women. About 40 percent of employment remains concentrated in the informal sector, with limited opportunities for workers to transition to more productive jobs with better pay and working conditions. Lack of access to the formal labor market is particularly prevalent for low-skilled workers and women. Despite women's high education attainment, female labor force participation and job opportunities are low compared to most OECD countries and regional peers.

[11] The World Economic Forum's Global Competitiveness Index combines official data and survey responses from business executives on several dimensions of competitiveness.

Staff analysis shows that informality and gender gaps are among the key drivers of Costa Rica's persistently high inequality (Annex VI).

35. Costa Rica has been a pioneer in promoting a green economy, given its vulnerabilities as a primary "hot spot" for climate change in the tropics. Costa Rica is prone to climate-related natural disasters, such as tropical storms, floods, and droughts, the frequency and severity of which have increased in recent decades. Recognizing the need for bold action, Costa Rica is the first country to have stopped and reversed deforestation and has achieved significant growth in sustainable tourism (Annex II) and zero-emission in electricity supply. Moreover, the country has set ambitious goals to transition to a zero net emission economy by 2050—anchored by its National Decarbonization Plan—and to adapt to climate change (Annex IX). Crisis preparedness and disaster risk management are also being strengthened through the National Commission for Risk Prevention and Emergency Care's Institutional Strategic Plan 2018-2022.

Policy Discussions

36. Lifting potential growth hinges on boosting productivity, with major opportunities from strengthening education, reducing infrastructure gaps, and cutting red tape. The authorities are committed to reducing skill mismatches by enhancing the quality of education, e.g. through updated curricula and teaching quality assurance—especially in scientific and digital fields—as well as by promoting dual vocational training (theoretical and practical) to address demand for specific technical skills and support employment opportunities. Measures to strengthen the integration between universities and firms can also foster innovation and knowledge transfer to the private sector. Ongoing efforts to close physical and digital infrastructure gaps, in collaboration with the IDB, as well as measures to facilitate firm registration and business license applications can further enhance the business environment and attract investment. Moreover, the recently revamped bankruptcy law—expected to be approved by the Legislative Assembly in 2021—will help facilitate liquidation and restructuring of distressed enterprises.

37. Promoting formalization, notably for low-skilled workers and women, would help deliver broad-based improvements in living standards. Efforts, in line with OECD recommendations, to make the social security system more job-friendly, including by introducing targeted reductions in contributions, will incentivize formalization for low-skilled workers and women who frequently work part time. Ongoing initiatives to expand childcare services, launch a long-term care system, and promote female education in STEM—with support from the IDB—will also be critical, together with further efforts to promote parental leave in the public and private sector, to strengthen female labor force participation and productivity growth. Current plans to further streamline the minimum wage structure would also allow for greater flexibility and support the National Strategy to Transition to a Formal Economy.

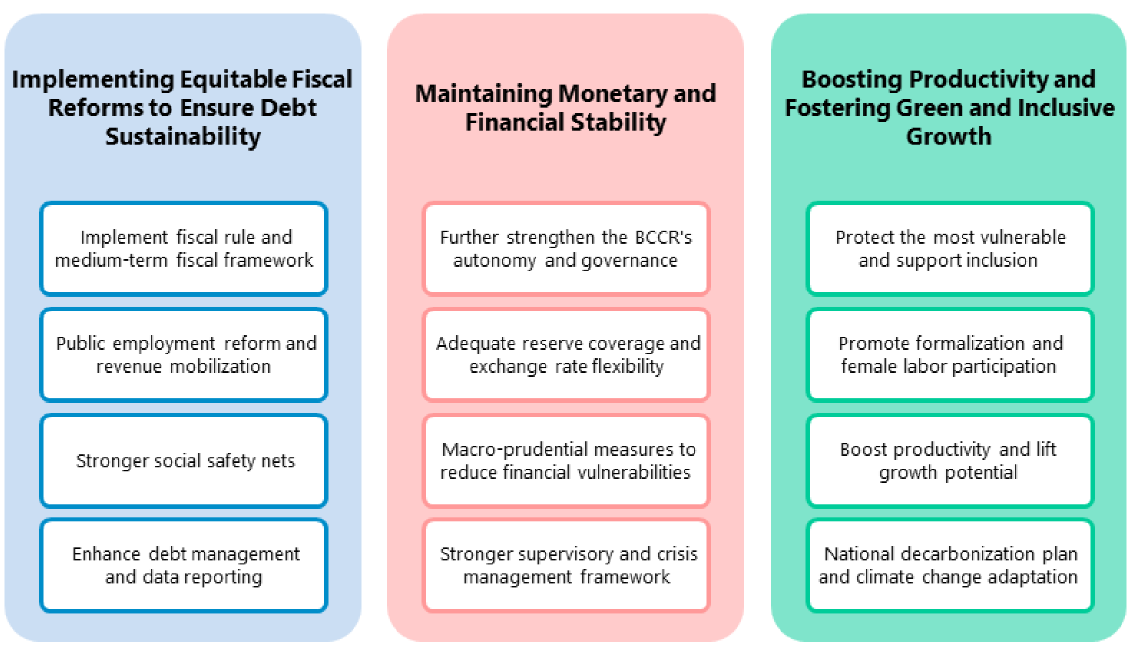
38. The authorities are taking ambitious steps to mitigate and adapt to climate change, including as part of their commitment to the National Decarbonization Plan. The plan sets important mitigation targets in a wide range of sectors—from public and private transport to industry and agriculture—to fully decarbonize the economy by 2050 (Annex IX). The authorities' cost-benefit evaluation of the plan, in collaboration with the IDB and WB, suggests substantial net benefits from transitioning to a zero net emission economy. In parallel, ongoing adaptation efforts are guided by the National Policy on Adaptation to Climate Change and include welcome actions, such as the creation of climate change risk maps. The development of a roadmap to enhance infrastructure resilience to climate change, including through a thorough assessment of the costs and financing options, with support from the WB, will further support adaptation to climate change. Staff welcomes additional measures to preserve Costa Rica's forests, with support from the WB, which play a vital role in mitigating the impact of hurricanes and generate important revenues through ecotourism (Annex II). In addition, measures currently under evaluation by the authorities to integrate climate change considerations into monetary and financial sector policies can help mitigate vulnerabilities and promote a more sustainable financial sector.

TAKING THE STRATEGY FORWARD UNDER A FUND-SUPPORTED PROGRAM

A. Program Objectives and Modalities

39. **The authorities are requesting financial support from the Fund to anchor their policy and reform program.** Building on the Article IV discussions, the Fund-supported program aims at supporting the recovery from the COVID-19 shock, while securing macroeconomic stability and advancing the authorities' reform agenda. The authorities' policy and reform efforts will be anchored around three main pillars: (i) gradually implementing equitable fiscal reforms to ensure debt

Costa Rica: Policy Pillars of the IMF-Supported Program



sustainability, while strengthening social protection; (ii) maintaining monetary and financial stability, while continuing to strengthen the central bank's autonomy and governance and addressing structural financial vulnerabilities; and (iii) advancing key structural reforms to promote inclusive, green, and sustainable growth.

40. Staff proposes a 36-month extended arrangement under the EFF, with semi-annual reviews. The program will provide a policy anchor to the authorities' fiscal reform plan for the period needed to gradually achieve a primary surplus and place debt on a downward path, while addressing upfront financing needs and supporting the economic recovery. The structural nature of the program objectives and the time required to achieve durable solutions, amid the gradual recovery from the COVID-19 shock, support the use of an EFF. The 36-month duration of the program will also help ensure policy continuity across the electoral cycle, given general elections in early 2022. The attached Letter of Intent, Memorandum of Economic and Financial Policies (MEFP), and Technical Memorandum of Understanding (TMU) describe the authorities' economic program and set out their commitments.

41. The program will be guided by the following policy conditionality:

- ***Quantitative conditionality***. Staff proposes performance criteria (PCs) for end-July and end-December 2021 as well as indicative targets (ITs) for end-September 2021 and end-March 2022 (Table 9). In addition to the continuous PCs under the program, as also listed in the attached TMU, quantitative conditionality will include floors on the BCCR's net international reserves, to ensure gross reserves remain comfortably above 100 percent of the ARA metric throughout the program period, and on the central government primary balance, consistent with the authorities' fiscal reform plan that anchors debt sustainability (¶13). The program builds additional flexibility, through an adjustor to the primary balance target, to augment COVID-related spending by up to 0.3 percent of GDP in 2021. In addition, the program envisages an indicative target on the debt stock of the central government. Program coverage of the fiscal and debt indicators will be adjusted in the context of future reviews and reflected in the TMU, in line with planned progress with data quality and availability.

- ***Monetary Policy Consultation Clause (MPCC)***. The program will include a MPCC to align conditionality with the BCCR's inflation-targeting framework. Progress in meeting the inflation targets will be monitored through an outer consultation band of ±3 percentage points and an inner consultation band of ±1.5 percentage points around interim targets, as defined in the TMU. If actual inflation falls outside the outer band, the BCCR will consult with the IMF Board to discuss the reasons for the deviation and the policy response. If actual inflation falls outside the inner band, the BCCR will consult with IMF staff.

- ***Structural conditionality***. The proposed structural benchmarks (SBs) under the program have been calibrated and phased in line with the authorities' plans and implementation capacity, including to alleviate pressure amid the COVID-19 pandemic (Table 10). Fiscal conditionality envisages SBs on the preparation and implementation of a MTFF, on needed enhancements to the MTDS (¶19), as well as on revenue administration (¶17). Measures to improve the targeting and delivery of social assistance programs are also defined in the MEFP, including a SB on the centralization and digitalization of all social program payment systems, with support from IMF TA (¶15). Measures to improve governance and transparency of SOEs include a SB on the publication of the 2020 financial statements according to IFRS standards, starting with three non-compliant SOEs (¶20). Based on the recommendations of the 2020 safeguards assessment (¶43 below), draft amendments to the BCCR law to strengthen the central bank's operational autonomy and governance are also included as a SB under the program. Reflecting the authorities' commitment to greener growth, the development of a roadmap to enhance infrastructure resilience to climate change is also a SB (¶38). The MEFP includes further commitments to safeguard financial stability and address pending FSSR recommendations as well as to advance the authorities' ambitious macro-structural agenda, in close collaboration with other development partners.

B. Program Financing and Safeguards

42. Access under the 36-month EFF arrangement is proposed at SDR 1,237.49 million (about US$1,750 million or 335 percent of quota). The proposed access, together with the planned fiscal consolidation efforts by the authorities, financial support from other IFIs, and market financing, would be adequate to help Costa Rica meet its financing needs, while ensuring foreign reserves remain comfortably above standard adequacy metrics to provide a buffer against downside risks (Table 4). Given the pressing fiscal needs, the authorities intend to use the financial assistance from the extended arrangement under the EFF for direct budget support, while fiscal consolidation efforts advance, and have updated the existing Memorandum of Understanding between the BCCR and MOF as warranted to clarify the responsibilities for timely servicing of the financial obligations to the Fund. The proposed access would be within the normal annual and cumulative access limits (benefiting from the temporary increase of the annual access limit approved by the IMF's Executive Board in July, given approval of the RFI for 100 percent of quota in April 2020). Access is proposed to be evenly spread over the program period, with the initial purchase expected to take place following the approval by Costa Rica's Legislative Assembly of the financial assistance by the Fund under the EFF arrangement (¶44). The Fund would represent about one-third of total

Costa Rica: Program Financing

(In millions of U.S. dollars)

	2020	2021	2022
Financing need	1,431	2,678	1,746
Reserve accumulation	-1,706	773	952
Underlying BOP need 1/	3,137	1,906	794
Official multilateral financing	1,431	2,678	1,746
IMF	522	581	581
RFI	522	0	0
EFF	0	581	581
Other multilateral creditors	910	2,098	1,165
World Bank	105	584	305
Inter-American Development Bank (IDB)	282	597	457
CAF	500	550	0
Central American Bank for Economic Integration (CABEI)	23	367	403
Unidentified financing	0	0	0
Memorandum items:			
Capital market access	0	0	1,000
Gross international reserves	7,232	8,004	8,956
In percent of the ARA metric	108	112	114

Source: IMF staff estimates

1/ Net of private sector and bilateral financing.

official financing over the program period. Financing assurances are in place with firm commitments by other multilaterals over the next twelve months and good prospects thereafter.[12]

43. An updated safeguards assessment of the BCCR was finalized in October 2020. Since the last assessment in 2009, the BCCR has enhanced safeguards in its external audit mechanism and financial reporting. In 2019, the BCCR's personal autonomy was improved through amendments to the BCCR Law, which tightened the dismissal rules for the BCCR governor and removed the Minister of Finance's voting rights in the BCCR Board. Nevertheless, some areas for improvement remain, particularly related to the BCCR's operational autonomy and governance arrangements. To this end, the authorities plan to further amend the BCCR Law and take necessary steps to fill the current vacancy in the BCCR Board.[13] In view of its significant negative equity, the BCCR also intends to develop a roadmap to strengthen its equity position over the medium to long term.

44. Capacity to repay the Fund is assessed to be adequate, although program risks are elevated amid high global and domestic uncertainty. Fund credit outstanding, including the RFI purchase and projected purchases under the proposed arrangement, will peak in 2023 at 3.3 percent of GDP, equivalent to around 9.3 percent of exports of goods and services and 24.6 percent of gross international reserves. Total debt service to the Fund will peak at 1.2 percent of exports of goods and services and 3.1 percent of gross international reserves in 2024 (Table 7). Nevertheless, while the program is built on conservative assumptions, a more protracted pandemic, by delaying the global and domestic recovery, could hinder the authorities' fiscal consolidation efforts and exacerbate balance-of-payments pressure and macro-financial vulnerabilities (¶8). The program has built in flexibility to allow for any needed recalibration in response to the COVID-19 crisis, through additional fiscal space and contingency measures, while preserving the integrity of the program objectives and ensuring capacity to repay the Fund remains adequate (¶14). Moreover, the authorities' commitment and ownership is supported by the important efforts over the past few months to build broad-based consensus on their economic reform program through a social and political dialogue as well as the progress already achieved in advancing the fiscal reform package, the 2021 budget approved last November and all the supporting legislation already under discussion. This is in turn expected to support a smooth ratification by the Legislative Assembly by May or June of the financial assistance by the Fund and other IFIs, as required by Costa Rica's Constitution for any financing that is deemed to be external borrowing by the government. That said, implementation risks remain significant and ultimately hinge on the resolve of the legislators to advance the country's reform program to secure macroeconomic stability, boost market confidence, and support a strong recovery.

[12] In the event downside shocks were to materialize, also due to a more protracted pandemic, additional financing could be mobilized, including available contingency lines from CAF (US$500 million) and CABEI.

[13] The 2019 amendments to the BCCR Law grant, as a transitional provision, the Minister of Finance voting rights while the vacancy on the BCCR Board is being filled.

STAFF APPRAISAL

45. Despite the authorities' swift and comprehensive response, the pandemic has inflicted significant social and economic costs on Costa Rica, exacerbating existing imbalances. While the authorities' prompt response and well-established universal healthcare system have helped avoid a deeper crisis, the economic recovery is expected to be protracted. Moreover, the shock has further weakened the country's fiscal position, undermining the expected yields from the ambitious 2018 fiscal reform and generating a large financing gap.

46. The authorities' home-grown reform program aims at supporting the recovery from the pandemic, while securing macroeconomic stability and advancing the reform agenda. The authorities' reform efforts envisage a gradual and equitable fiscal consolidation plan, built through a broad-based political and social dialogue with key stakeholders, to ensure debt sustainability, while protecting the poor and most vulnerable. Monetary and financial sector policies aim at maintaining stability, while continuing to strengthen the central bank's autonomy and governance and addressing structural financial vulnerabilities. These policies are complemented by comprehensive structural reforms to promote inclusive, green and sustainable growth.

47. As the pandemic recedes and the economic recovery takes hold, staff supports the authorities' goal of achieving a primary surplus by 2023 to place debt on a downward path. The fiscal reform plan is based on a balanced mix of expenditure rationalization, underpinned by a prudent fiscal rule, and revenue mobilization, while maintaining space for adequate pandemic-related needs in 2021 as well as critical social and capital spending over the medium term to support strong and inclusive growth. The authorities' ongoing efforts to strengthen the coverage and targeting of social assistance programs can help limit the economic fallout from the COVID-19 crisis, while, together with the reforms envisaged under the ambitious Public Employment Bill, improving the equity and efficiency of government spending. Further structural reforms to enhance medium-term fiscal planning and debt management, as well as to strengthen revenue administration and further enhance the governance and transparency of SOEs are also critical to support the authorities' fiscal strategy and mitigate fiscal risks.

48. The BCCR's monetary policy stance remains appropriately accommodative and should continue to be data-dependent and forward-looking. The cuts in the policy rate and other measures taken by the BCCR in response to the crisis, consistent with its inflation targeting and flexible exchange rate regime, have been transparent and well-communicated. Greater development of the foreign exchange market can help facilitate effective risk management and support increased intermediation in colones, while plans to further strengthen the central bank law can further enhance the BCCR's operational autonomy and governance.

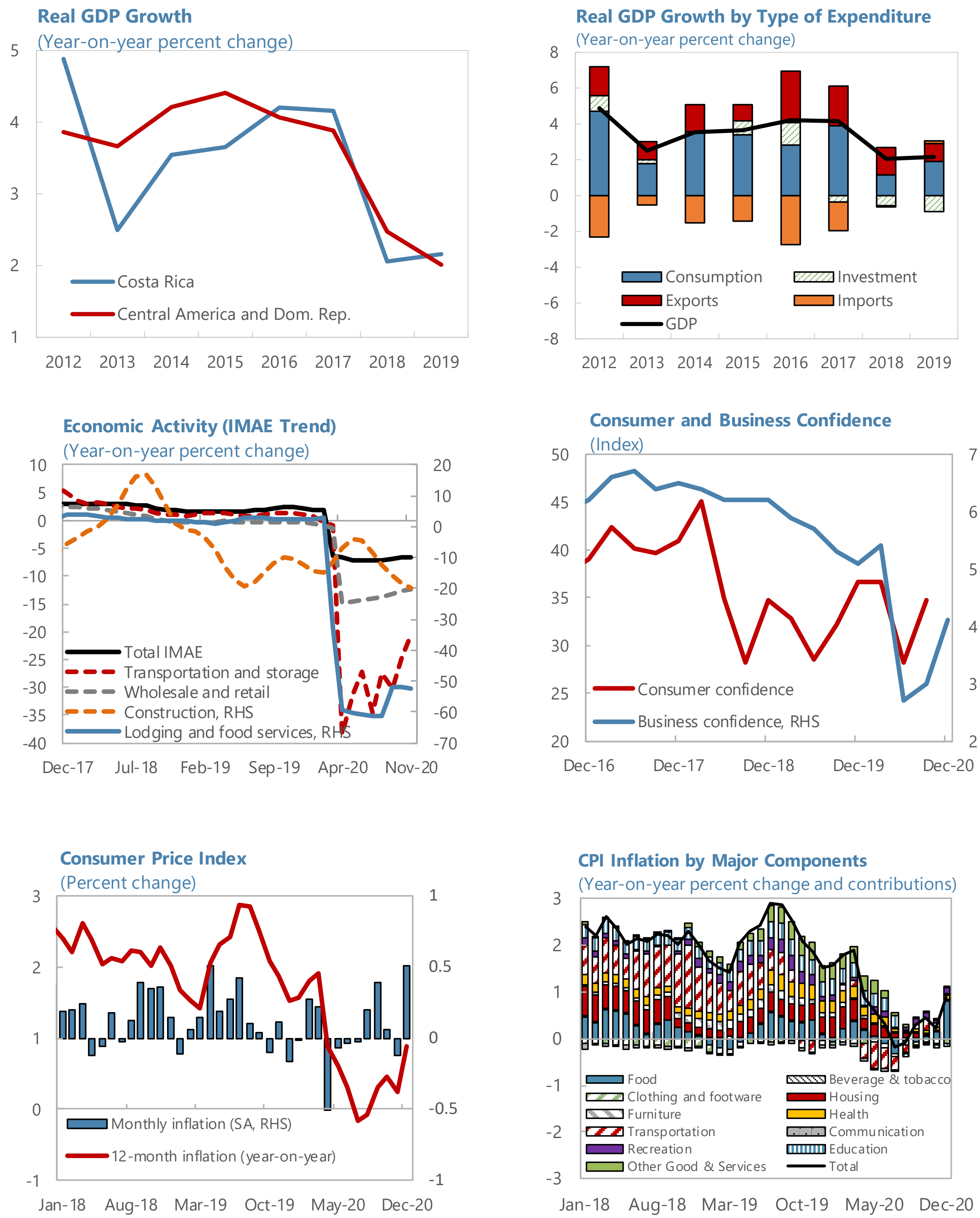
49. The banking sector entered the crisis in a relatively good position but will need continued close monitoring. The authorities' temporary, transparent, and well-targeted measures to support the financial sector in response to the COVID-19 shock have provided credit relief to affected businesses and households. While the financial system appears resilient to a range of shocks, the authorities have appropriately stepped up monitoring and supervision of credit portfolios, given the large share of restructured loans and the high degree of uncertainty surrounding this crisis, to ensure banks remain adequately capitalized. Financial stability can be further buttressed by strengthening the regulatory and supervisory framework, the financial safety net, and by fostering greater financial inclusion.

50. Staff welcomes the authorities' ambitious structural agenda geared towards lifting potential growth and addressing inequality, while advancing the fight against climate change. Its success hinges upon strengthening education, promoting innovation, cutting red tape, while leveraging the greater use of digitalization. Prompting formalization, including with stepped-up initiatives to support female labor force participation, would also help deliver broad-based improvements in productivity and living standards. Costa Rica's commendable efforts to further improve resilience to climate change and fully decarbonize its economy make it a trailblazer in the global arena and will help generate new and sustainable business and growth opportunities.

51. Staff supports the authorities' request for a 36-month arrangement under the EFF. While Costa Rica's capacity to repay is assessed to be adequate and financing assurances have been secured, risks to the program are large, given the heightened uncertainty surrounding the pandemic and economic recovery. Nevertheless, the program builds adequate flexibility to respond to an adverse shock, through fiscal buffers and contingency measures. Moreover, the authorities' ownership of the reform program is evidenced by the important efforts over the last months to build broad-based consensus through a social and political dialogue as well as the progress already achieved in advancing the fiscal reform package with the approval of the 2021 budget.

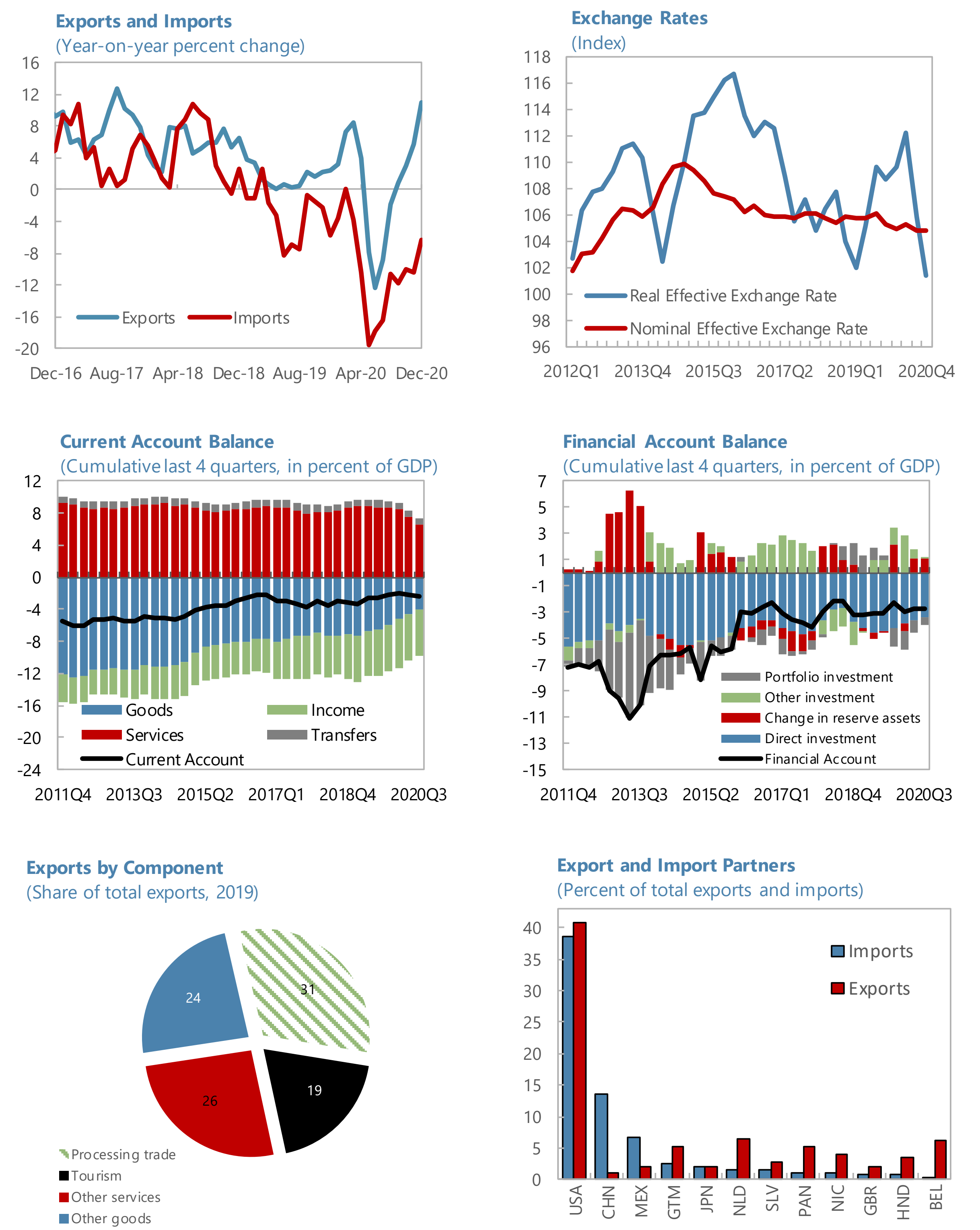
52. It is proposed that the next Article IV consultation with Costa Rica takes place on a 24-month cycle in accordance with the Decision on Article IV Consultation Cycles for members with Fund arrangements.

Figure 1. Costa Rica: Real Sector Developments



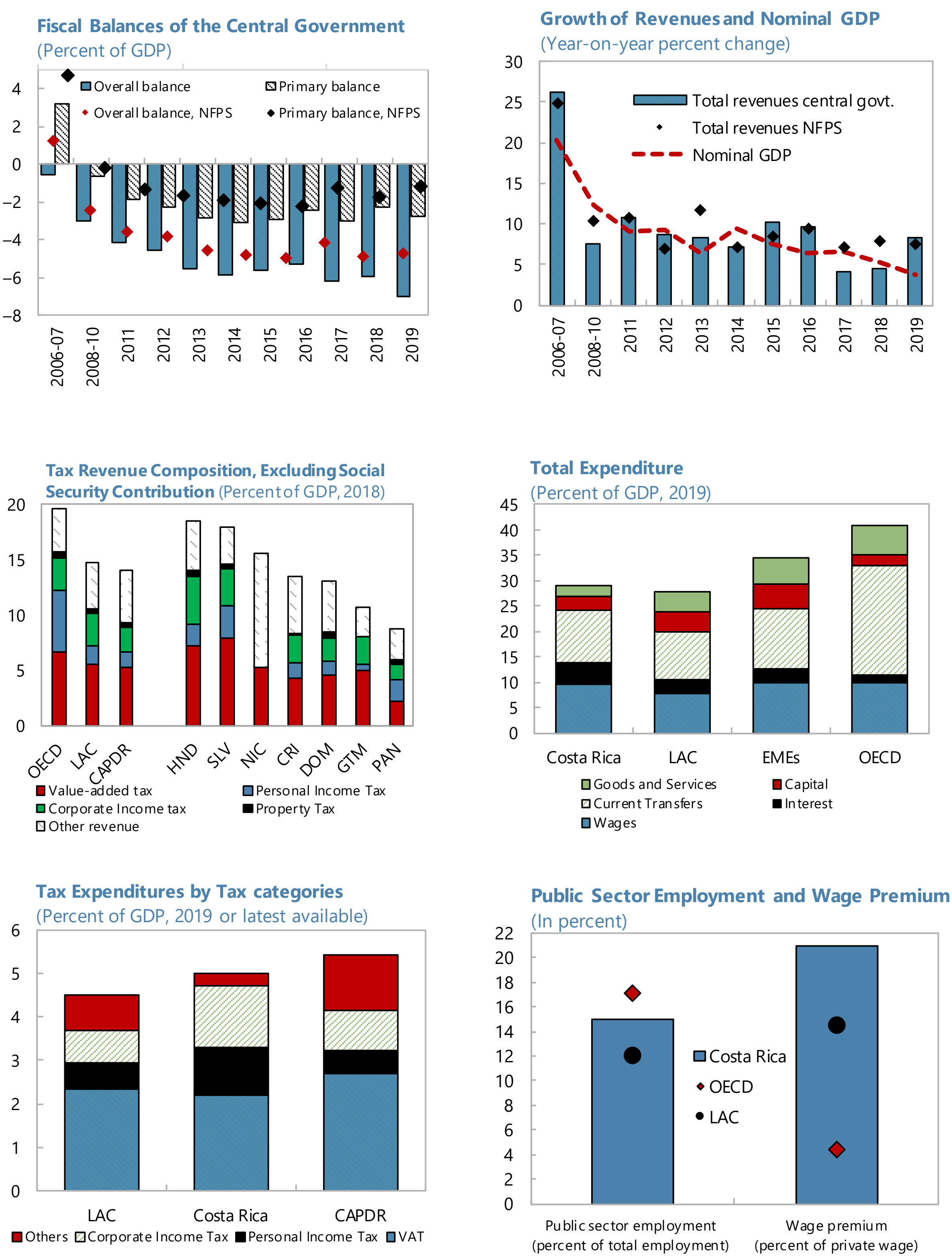
Sources: National authorities and IMF staff estimates.

Figure 2. Costa Rica: External Sector Developments



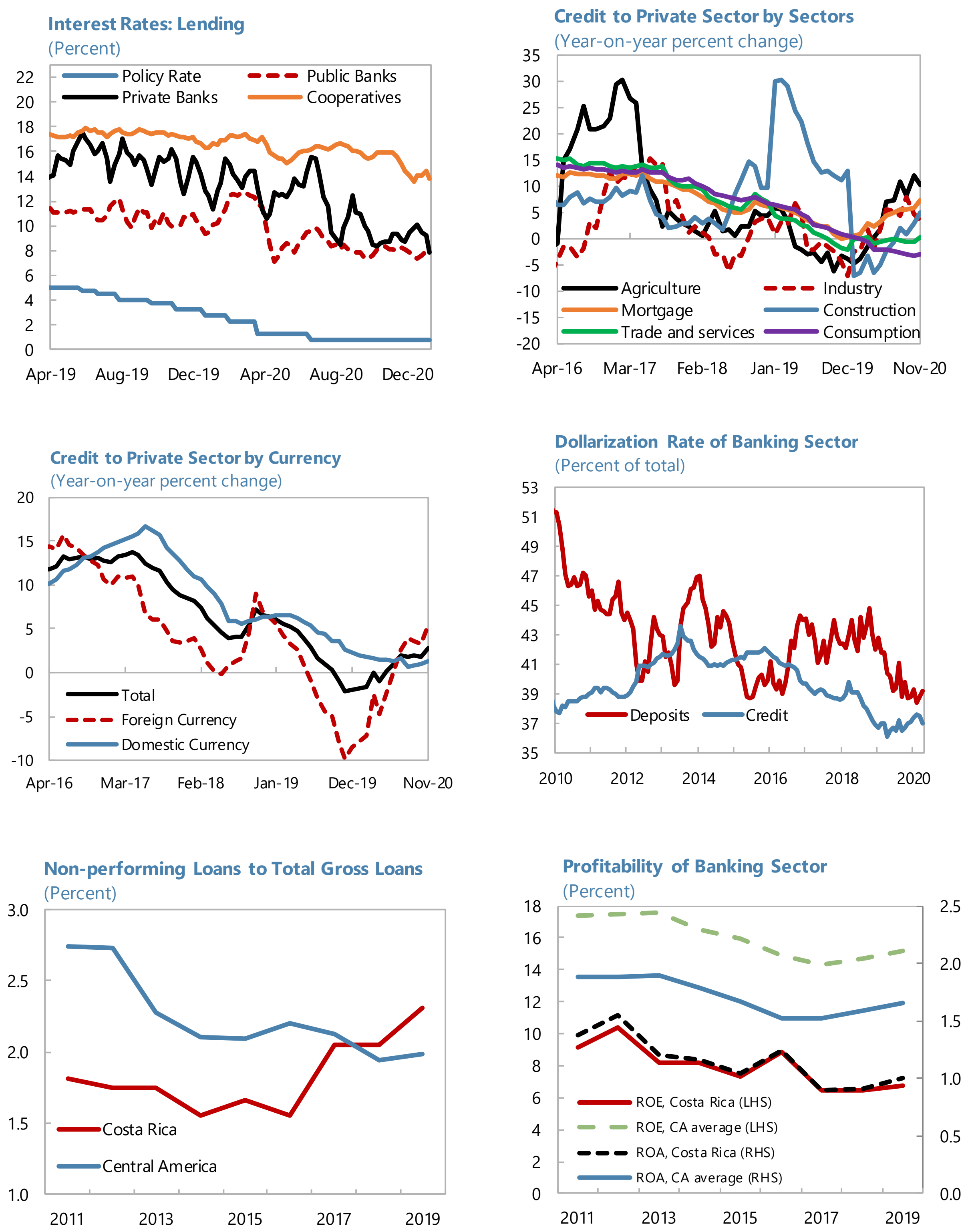
Sources: National authorities and IMF staff estimates.

Figure 3. Costa Rica: Fiscal Sector Developments



Sources: National authorities, World Bank April 2019 Costa Rica Public Finance Review, and IMF staff estimates.

Figure 4. Costa Rica: Monetary and Financial Sector Developments



Sources: National authorities and IMF staff estimates.

Table 1. Costa Rica: Selected Economic and Financial Indicators

	2016	2017	2018	2019	Projections 2020	2021	2022	2023	2024	2025	2026
National Income					(Annual percentage change)						
Real GDP	4.2	4.2	2.1	2.2	-4.8	2.6	3.3	3.1	3.1	3.2	3.3
Domestic demand	4.1	3.5	0.6	1.0	-3.6	2.4	2.8	2.8	3.0	3.1	3.1
Consumption	3.5	4.8	1.4	2.4	-3.1	1.4	1.6	2.0	2.4	2.5	2.5
Private	3.8	5.6	1.6	1.6	-4.3	2.0	2.3	2.8	3.1	3.3	3.2
Public	2.3	2.0	0.5	5.3	1.5	-0.8	-0.9	-0.8	-0.7	-0.7	-0.4
Gross fixed capital formation	6.0	0.1	0.8	-5.4	-3.4	3.8	4.5	6.2	6.0	5.5	5.2
Exports of goods and nonfactor services	9.4	7.0	4.7	3.0	-13.7	8.4	7.8	6.8	5.2	5.0	5.3
Imports of goods and nonfactor services	8.9	5.0	0.2	-0.5	-10.9	8.2	6.4	6.1	5.2	4.8	4.8
					(Contributions to real GDP growth)						
Domestic demand	4.1	3.5	0.6	1.0	-3.5	2.4	2.7	2.7	2.9	3.0	3.0
Consumption	2.8	3.9	1.1	1.9	-2.5	1.2	1.3	1.6	1.9	2.0	2.0
Gross domestic investment	1.3	-0.4	-0.6	-0.9	-1.0	1.3	1.4	1.1	1.1	1.0	1.0
Net exports	0.1	0.6	1.5	1.2	-1.3	0.2	0.6	0.4	0.2	0.2	0.3
Prices					(Annual percentage change)						
GDP deflator	2.0	2.9	2.6	2.2	0.5	1.4	1.0	1.3	2.0	2.4	2.8
Consumer prices (period average)	0.0	1.6	2.2	2.1	0.7	1.2	1.1	1.4	2.1	2.5	2.9
Consumer prices (end of period)	0.8	2.6	2.0	1.5	0.9	1.2	0.9	1.7	2.3	2.7	3.1
Savings and Investment					(In percent of GDP)						
Savings	18.9	18.1	17.4	15.9	15.3	16.5	17.5	18.1	18.5	18.8	19.0
Domestic savings	16.8	14.4	14.2	13.6	12.8	13.3	14.5	15.2	15.7	16.1	16.3
Private sector	18.2	16.4	16.7	16.3	17.9	17.2	16.9	16.0	15.8	15.5	15.2
Public sector	-1.4	-2.0	-2.5	-2.7	-5.1	-3.9	-2.4	-0.8	-0.1	0.6	1.1
External savings	2.1	3.6	3.2	2.3	2.6	3.2	3.0	2.9	2.7	2.7	2.7
Gross domestic investment	18.9	18.1	17.4	15.9	15.3	16.5	17.5	18.1	18.5	18.8	19.0
Private sector	16.2	15.3	15.3	13.0	12.8	14.4	15.1	15.6	16.0	16.3	16.4
Public sector	2.7	2.8	2.1	2.9	2.6	2.1	2.4	2.5	2.5	2.5	2.6
External Sector											
Current account balance	-2.1	-3.6	-3.2	-2.3	-2.6	-3.2	-3.0	-2.9	-2.7	-2.7	-2.7
Trade balance	-7.5	-7.2	-7.0	-5.9	-3.4	-4.8	-6.0	-6.4	-6.5	-6.5	-6.5
Services	8.7	7.9	8.5	8.7	5.7	6.6	7.9	8.6	8.6	8.6	8.6
Financial account balance	-2.6	-4.0	-3.2	-2.2	-2.5	-3.2	-2.9	-2.8	-2.7	-2.6	-2.6
Foreign direct investment, net	-3.6	-4.4	-3.7	-4.1	-2.9	-3.2	-3.7	-4.1	-4.1	-4.1	-4.1
Gross international reserves (millions of U.S. dollars)	7,574	7,150	7,501	8,937	7,232	8,004	8,956	9,123	9,984	10,012	10,621
-as percent of ARA metric	129.9	118.4	117.6	131.2	108.3	111.7	114.3	114.0	117.1	113.9	113.1
-in months of next year's imports	4.8	4.4	4.6	6.3	4.8	4.6	4.7	4.5	4.7	4.4	4.4
External debt	43.4	44.9	46.6	47.9	52.6	59.1	61.5	61.6	61.9	59.9	58.7
Real effective exchange rate, avg. (percent change)	-0.7	-4.6	-2.6	0.6	…	…	…	…	…	…	…
Public Finances 1/											
Central government primary balance	-2.4	-2.9	-2.2	-2.6	-3.9	-1.7	-0.3	1.0	1.7	2.3	2.8
Central government overall balance	-5.1	-6.0	-5.7	-6.8	-8.7	-7.0	-5.9	-4.3	-3.4	-2.6	-2.0
Central government debt	44.1	47.1	51.9	56.8	68.3	72.5	75.0	76.0	75.6	74.2	71.9
Money and Credit											
Credit to the private sector (percent change)	12.8	8.5	6.3	-1.9	2.3	6.1	6.4	6.9	7.1	7.4	7.9
Monetary base 2/	7.7	8.0	7.8	7.1	8.4	8.6	8.8	9.0	9.1	9.2	9.3
Broad money	49.0	46.5	45.3	45.1	55.8	52.5	51.7	51.8	51.9	52.2	52.3
Memorandum Items											
Nominal GDP (billions of colones) 3/	32,056	34,344	35,972	37,561	35,944	37,388	39,004	40,718	42,834	45,266	48,085
Output gap (as percent of potential GDP)	0.6	1.1	0.5	-0.6	-4.7	-3.0	-1.4	-0.7	-0.4	-0.2	0.0
GDP per capita (US$)	11,987	12,185	12,414	12,600	11,981	11,803	12,315	12,829	13,386	13,998	14,714
Unemployment rate	9.5	9.3	12.0	12.4	19.9	16.0	14.0	12.0	10.5	9.5	9.0

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

1/ As of January 2021, the CG definition has been expanded to include 51 public entities as per Law 9524. Data are adjusted back to 2019 for comparability.
2/ Includes currency issued and required reserves.
3/ National account data reflect the revision of the benchmark year to 2017 for the chained volume measures, published in January 2021.

Table 2. Costa Rica: Central Government Balance

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
								Projection[3/]			
					(In billions of colones)						
Revenue	**4,379**	**4,560**	**4,767**	**5,676**	**5,132**	**5,486**	**5,970**	**6,531**	**6,879**	**7,262**	**7,706**
Tax revenue	4,168	4,390	4,567	4,940	4,379	4,741	5,284	5,807	6,122	6,475	6,870
Nontax revenue[1/]	212	170	199	735	753	745	685	723	757	786	835
Expenditure	**6,024**	**6,610**	**6,829**	**8,223**	**8,245**	**8,121**	**8,268**	**8,279**	**8,346**	**8,457**	**8,688**
Current noninterest	4,563	4,907	5,096	5,803	5,844	5,562	5,422	5,379	5,364	5,366	5,401
Wages	2,178	2,290	2,395	2,613	2,702	2,589	2,610	2,632	2,654	2,675	2,744
Goods and services	198	217	224	327	379	351	324	300	278	257	273
Transfers	2,187	2,400	2,477	2,863	2,763	2,622	2,488	2,446	2,432	2,434	2,384
Interest[2/]	886	1,054	1,254	1,553	1,707	1,996	2,162	2,135	2,180	2,240	2,335
Capital	575	649	480	867	694	564	684	765	803	851	952
Primary balance	**-758**	**-996**	**-809**	**-994**	**-1,406**	**-640**	**-136**	**387**	**713**	**1,045**	**1,353**
Overall Balance	**-1,644**	**-2,050**	**-2,063**	**-2,547**	**-3,113**	**-2,635**	**-2,298**	**-1,748**	**-1,467**	**-1,196**	**-983**
Total Financing	1,733	2,066	1,997	2,494	3,113	2,635	2,298	1,748	1,467	1,196	983
External (net)	160	62	150	1,119	754	1,713	1,755	946	786	68	341
Domestic (net)	1,484	1,988	1,913	1,428	2,360	922	543	801	681	1,128	641
Unidentified financing	0	0	0	0	0	0	0	0	0	0	0
Central government debt	**14,122**	**16,163**	**18,670**	**21,347**	**24,567**	**27,100**	**29,241**	**30,926**	**32,393**	**33,588**	**34,571**
External	3,310	3,468	3,836	4,765	5,893	7,546	9,198	10,100	10,886	10,953	11,295
Domestic	10,812	12,695	14,834	16,582	18,674	19,554	20,043	20,826	21,507	22,635	23,276
Other debt (multilateral financing)	0	0	0	0	0	0	0	0	0	0	0
					(In percent of GDP)						
Revenue	**13.7**	**13.3**	**13.3**	**15.1**	**14.3**	**14.7**	**15.3**	**16.0**	**16.1**	**16.0**	**16.0**
Tax revenue	13.0	12.8	12.7	13.2	12.2	12.7	13.5	14.3	14.3	14.3	14.3
Nontax revenue[1/]	0.7	0.5	0.6	2.0	2.1	2.0	1.8	1.8	1.8	1.7	1.7
Expenditure	**18.8**	**19.2**	**19.0**	**21.9**	**22.9**	**21.7**	**21.2**	**20.3**	**19.5**	**18.7**	**18.1**
Current noninterest	14.2	14.3	14.2	15.5	16.3	14.9	13.9	13.2	12.5	11.9	11.2
Wages	6.8	6.7	6.7	7.0	7.5	6.9	6.7	6.5	6.2	5.9	5.7
Goods and services	0.6	0.6	0.6	0.9	1.1	0.9	0.8	0.7	0.6	0.6	0.6
Transfers	6.8	7.0	6.9	7.6	7.7	7.0	6.4	6.0	5.7	5.4	5.0
Interest[2/]	2.8	3.1	3.5	4.1	4.7	5.3	5.5	5.2	5.1	4.9	4.9
Capital	1.8	1.9	1.3	2.3	1.9	1.5	1.8	1.9	1.9	1.9	2.0
Primary balance	**-2.4**	**-2.9**	**-2.2**	**-2.6**	**-3.9**	**-1.7**	**-0.3**	**1.0**	**1.7**	**2.3**	**2.8**
Overall Balance	**-5.1**	**-6.0**	**-5.7**	**-6.8**	**-8.7**	**-7.0**	**-5.9**	**-4.3**	**-3.4**	**-2.6**	**-2.0**
Total Financing	**5.4**	**6.0**	**5.6**	**6.6**	**8.7**	**7.0**	**5.9**	**4.3**	**3.4**	**2.6**	**2.0**
External (net)	0.5	0.2	0.4	3.0	2.1	4.6	4.5	2.3	1.8	0.1	0.7
Domestic (net)	4.6	5.8	5.3	3.8	6.6	2.5	1.4	2.0	1.6	2.5	1.3
Unidentified financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Central government debt	**44.1**	**47.1**	**51.9**	**56.8**	**68.3**	**72.5**	**75.0**	**76.0**	**75.6**	**74.2**	**71.9**
External	10.3	10.1	10.7	12.7	16.4	20.2	23.6	24.8	25.4	24.2	23.5
Domestic	33.7	37.0	41.2	44.1	52.0	52.3	51.4	51.1	50.2	50.0	48.4
Other debt (unidentified financing)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:											
Non-interest expenditure growth (percent)											
in nominal terms	5.7	8.1	0.4	19.6	-2.0	-6.3	-0.3	0.6	0.4	0.8	2.2
in real terms	5.7	6.4	-1.8	17.2	-2.7	-7.4	-1.4	-0.8	-1.7	-1.6	-0.7
Nominal GDP (billions of colones)	32,056	34,344	35,972	37,561	35,944	37,388	39,004	40,718	42,834	45,266	48,085

Sources: Ministry of Finance and Fund staff estimates.

1/ Before 2019, transfers to the Social development and Family Transfers Fund (FODESAF) are recorded in net terms.

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

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

Table 3. Costa Rica: Balance of Payments

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
					Projections						
					(In millions of U.S. dollars)						
Current Account	-1,257	-2,189	-1,990	-1,439	-1,580	-1,976	-1,915	-1,967	-1,968	-2,035	-2,153
Goods and services balance	684	393	890	1,816	1,414	1,083	1,269	1,446	1,488	1,618	1,720
Trade balance	-4,426	-4,367	-4,389	-3,743	-2,085	-2,932	-3,847	-4,376	-4,655	-4,905	-5,223
Export of goods (f.o.b.)	10,100	10,811	11,474	11,604	11,708	12,253	12,896	13,579	14,386	15,245	16,195
Import of goods (f.o.b.)	14,526	15,178	15,863	15,347	13,793	15,185	16,743	17,955	19,041	20,150	21,418
Services balance	5,110	4,760	5,280	5,559	3,499	4,015	5,116	5,822	6,143	6,522	6,943
Of which: Travel balance	2,845	2,612	2,931	3,057	1,053	1,202	2,245	2,966	3,156	3,309	3,504
Exports of services	8,537	8,598	9,055	9,598	6,859	7,570	9,179	10,526	11,190	11,856	12,608
Imports of services	3,427	3,837	3,775	4,039	3,360	3,555	4,063	4,704	5,047	5,334	5,665
Primary Income	-2,452	-3,161	-3,344	-3,769	-3,471	-3,566	-3,703	-3,945	-4,016	-4,240	-4,489
Secondary Income	510	579	463	513	477	507	519	532	560	588	616
Capital Account	87	41	31	32	34	37	40	42	44	47	49
Financial Account	-1,547	-2,445	-1,967	-1,403	-1,546	-1,940	-1,875	-1,925	-1,924	-1,988	-2,104
Public sector	-392	-222	-687	-1,013	-40	-2,348	-2,011	-752	-1,154	121	-592
Private sector	-895	-1,799	-1,631	-1,827	200	-364	-816	-1,341	-1,631	-2,138	-2,122
Foreign direct investment, net	-2,127	-2,652	-2,283	-2,631	-1,781	-1,982	-2,388	-2,800	-2,952	-3,120	-3,314
Other private sector flows	1,232	853	652	805	1,981	1,618	1,572	1,459	1,322	982	1,192
Change in International Reserves (increase +)	-260	-424	351	1,436	-1,706	773	952	167	861	28	609
Errors and Omissions	-376	-297	-8	4	0	0	0	0	0	0	0
					(In percent of GDP)						
Current Account	-2.1	-3.6	-3.2	-2.3	-2.6	-3.2	-3.0	-2.9	-2.7	-2.7	-2.7
Goods and services balance	1.2	0.6	1.4	2.8	2.3	1.8	2.0	2.1	2.1	2.1	2.1
Trade balance	-7.5	-7.2	-7.0	-5.9	-3.4	-4.8	-6.0	-6.4	-6.5	-6.5	-6.5
Export of goods (f.o.b.)	17.2	17.9	18.4	18.1	19.1	20.0	20.0	20.0	20.1	20.1	20.1
Import of goods (f.o.b.)	24.7	25.1	25.4	24.0	22.4	24.8	26.0	26.4	26.6	26.6	26.6
Services balance	8.7	7.9	8.5	8.7	5.7	6.6	7.9	8.6	8.6	8.6	8.6
Of which: Travel balance	4.8	4.3	4.7	4.8	1.7	2.0	3.5	4.4	4.4	4.4	4.4
Exports of services	14.5	14.2	14.5	15.0	11.2	12.4	14.2	15.5	15.6	15.7	15.7
Imports of services	5.8	6.3	6.1	6.3	5.5	5.8	6.3	6.9	7.0	7.0	7.0
Primary Income	-4.2	-5.2	-5.4	-5.9	-5.6	-5.8	-5.7	-5.8	-5.6	-5.6	-5.6
Secondary Income	0.9	1.0	0.7	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8
Capital Account	0.1	0.1	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Financial Account	-2.6	-4.0	-3.2	-2.2	-2.5	-3.2	-2.9	-2.8	-2.7	-2.6	-2.6
Public sector	-0.7	-0.4	-1.1	-1.6	-0.1	-3.8	-3.1	-1.1	-1.6	0.2	-0.7
Private sector	-1.5	-3.0	-2.6	-2.9	0.3	-0.6	-1.3	-2.0	-2.3	-2.8	-2.6
Foreign direct investment, net	-3.6	-4.4	-3.7	-4.1	-2.9	-3.2	-3.7	-4.1	-4.1	-4.1	-4.1
Other private sector flows	2.1	1.4	1.0	1.3	3.2	2.6	2.4	2.1	1.8	1.3	1.5
Change in International Reserves (increase +)	-0.4	-0.7	0.6	2.2	-2.8	1.3	1.5	0.2	1.2	0.0	0.8
Errors and Omissions	-0.6	-0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum Items:											
Non-oil current account (percent of GDP)	-0.4	-1.4	-0.7	0.1	-1.3	-1.2	-1.1	-1.1	-1.0	-1.0	-1.0
Terms of trade (annual percentage change)	1.5	-5.8	-4.5	-1.5	4.7	-2.2	1.3	0.9	0.8	0.7	0.5
Gross international reserves (millions of U.S. dollars)	7,574	7,150	7,501	8,937	7,232	8,004	8,956	9,123	9,984	10,012	10,621
Net international reserves, program definition (millions of U.S. dollars)1/	5098	4529	4657	6099	3712	3768	4208	3700	4652	4674	5171
External debt (percent of GDP)2/	43.4	44.9	46.6	47.9	52.6	59.1	61.5	61.6	61.9	59.9	58.7

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

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

2/ Includes public and private sector debt.

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

	2018	2019	2020	2021	2022	2023	2024	2025	2026
			Projections						
			(In millions of U.S. dollars)						
Gross external financing needs	**-9,235**	**-9,091**	**-10,929**	**-10,245**	**-10,869**	**-11,986**	**-10,658**	**-10,872**	**-10,933**
Current account balance	-1,990	-1,439	-1,580	-1,976	-1,915	-1,967	-1,968	-2,035	-2,153
Amortization	-4,214	-5,338	-5,733	-5,149	-5,893	-7,128	-6,012	-6,711	-6,270
Public sector, of which	-285	-740	-1,445	-487	-911	-1,834	-428	-865	-229
Central government	-96	-93	-344	-130	-138	-1,170	-152	-738	-110
Central bank	-2	-377	-625	0	0	0	0	0	0
Private sector	-3,928	-4,598	-4,288	-4,661	-4,982	-5,294	-5,584	-5,846	-6,041
of which: short-term	-2,611	-3,169	-2,735	-2,987	-3,193	-3,392	-3,578	-3,746	-3,871
Other net capital inflows 1/	-3,032	-2,314	-3,616	-3,121	-3,061	-2,890	-2,678	-2,126	-2,510
Gross external financing sources	**8,934**	**8,576**	**9,497**	**7,567**	**9,124**	**10,501**	**10,264**	**10,564**	**10,817**
Capital transfers	31	32	34	37	40	42	44	47	49
Direct investment, net	2,283	2,631	1,781	1,982	2,388	2,800	2,952	3,120	3,314
Borrowing	6,971	7,349	5,977	6,321	7,648	7,826	8,128	7,426	8,062
Public sector, of which	1,670	2,210	327	531	1,570	1,514	1,623	895	1,190
Central government	13	1,570	201	255	1,294	1,263	1,072	544	564
of which: Eurobonds	0	1,500	0	0	1,000	1,000	1,000	500	500
Central bank	1,000	0	0	0	0	0	0	0	0
Private sector	5,301	5,139	5,649	5,789	6,078	6,311	6,505	6,531	6,872
Change in International reserves (increase -)	-351	-1,436	1,706	-773	-952	-167	-861	-28	-609
Use of IMF credit	**0**	**0**	**522**	**581**	**581**	**514**	**-266**	**-224**	**-124**
Purchases	0	0	522	581	581	581	0	0	0
RFI	0	0	522	0	0	0	0	0	0
EFF	0	0	0	581	581	581	0	0	0
Repurchases	0	0	0	0	0	-67	-266	-224	-124
Other gross multilateral financing	**332**	**464**	**910**	**2,098**	**1,165**	**971**	**660**	**532**	**240**
World Bank	…	…	105	584	305	…	…	…	…
Inter-American Development Bank (IDB)	…	…	282	597	457	…	…	…	…
CAF	…	…	500	550	0	…	…	…	…
Central American Bank for Economic Integration (CABEI)	…	…	23	367	403	…	…	…	…
Unidentified financing	0	0	0	0	0	0	0	0	0
Memorandum items:									
Gross multilateral support	332	464	1,432	2,679	1,746	1,552	660	532	240
In percent of GDP	0.5	0.7	2.3	4.4	2.7	2.3	0.9	0.7	0.3
Of which, committed	…	…	1,432	2,679	1,746	1,552	660	532	240
IMF	…	…	522	581	581	581	0	0	0
World Bank	…	…	105			…	…	…	…
Inter-American Development Bank (IDB)	…	…	282			…	…	…	…
Central American Bank for Economic Integration (CABEI)	…	…	23			…	…	…	…
CAF	…	…	500			…	…	…	…
French Development Agency (AFD)	…	…	150			…	…	…	…
Of which, disbursed	…	…	1,432	0	0	0	0	0	0
IMF share of total gross multilateral financing (percent)									
Purchases and disbursements, flow basis	…	…	36	22	33	37	…	…	…
Purchases and disbursements, cumulative basis	…	…	36	27	29	31	…	…	…
Current account balance (percent of GDP)	-3.2	-2.3	-2.6	-3.2	-3.0	-2.9	-2.7	-2.7	-2.7
Gross international reserves	7,500.9	8,937.1	7,231.5	8,004.3	8,956.3	9,123.3	9,984.3	10,012.3	10,621.3
In percent of the ARA metric	117.6	131.2	108.3	111.7	114.3	114.0	117.1	113.9	113.1
In percent of ST debt (remaining maturity)	140.5	155.9	139.9	135.4	124.1	144.9	143.5	156.1	146.9
In percent of gross external financing requirement	102.4	124.6	107.2	101.5	98.1	110.4	111.9	118.5	113.2
In months of next year's imports of G&S	4.6	6.3	4.8	4.6	4.7	4.5	4.7	4.4	4.4

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

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

Table 5. Costa Rica: Monetary Survey

	2016	2017	2018	2019	2020	2021	2022	2023
					Projections			
	(In billions of colones, unless otherwise indicated)							
Central Bank								
Net foreign assets	4,445	4,406	4,312	5,158	4,941	5,399	5,968	6,104
Of which : Gross international reserves	4,152	4,050	4,533	5,095	4,464	4,870	5,382	5,458
(In millions of U.S. dollars)	7,574	7,150	7,501	8,937	7,232	8,004	8,956	9,123
Net domestic assets	-1,963	-1,657	-1,499	-2,491	-1,908	-2,177	-2,538	-2,438
Net domestic credit	-1,580	-1,603	-1,735	-2,166	-1,894	-1,177	-1,230	-1,363
Credit to nonfinancial public sector	-238	-115	-16	-549	-35	-237	-237	-237
Credit to other depository corporations (net)	-1,318	-1,459	-1,682	-1,579	-1,832	-913	-966	-1,099
Credit to other financial corporations (net)	-22	-29	-36	-38	-26	-26	-26	-26
Credit to the private sector (net)	-1	0	-1	0	0	0	0	0
Monetary stabilization instruments (-)	-2,445	-2,034	-1,934	-1,859	-1,564	-1,645	-1,748	-1,763
Other items (net)	-109	-263	-36	-833	-693	-1,434	-1,465	-1,216
Capital account (-)	2,171	2,244	2,206	2,367	2,243	2,079	1,904	1,904
Monetary base 1/	2,482	2,749	2,813	2,667	3,033	3,222	3,429	3,666
Currency	1,109	1,197	1,238	1,305	1,498	1,648	1,813	1,958
Required reserves	1,373	1,553	1,575	1,362	1,535	1,574	1,617	1,708
Other Depository Institutions								
Net foreign assets	-2,719	-2,607	-2,430	-1,681	-719	-1,309	-1,560	-1,832
Net domestic assets	21,914	23,829	24,747	24,885	27,283	28,010	29,476	31,214
Net domestic credit	24,991	27,073	28,369	28,415	30,749	31,424	33,076	35,176
Credit to nonfinancial public sector (net)	2,314	2,385	2,330	2,531	4,185	4,385	4,397	4,540
Credit to nonfinancial private sector	18,540	20,112	21,381	20,970	21,451	22,758	24,215	25,891
In national currency	10,939	12,233	13,017	13,323	13,560	14,624	15,847	17,318
In foreign currency	7,602	7,879	8,364	7,647	7,891	8,134	8,368	8,573
Credit to financial corporations (net)	4,136	4,576	4,658	4,913	5,112	4,280	4,465	4,745
Other items (net)	945	1,065	985	1,421	1,649	1,907	1,950	1,832
Capital account (-)	-4,023	-4,309	-4,607	-4,950	-5,115	-5,320	-5,550	-5,794
Liabilities to nonfinancial private sector	19,195	21,223	22,317	23,204	26,564	26,702	27,916	29,381
In national currency	12,374	13,621	14,012	15,059	16,896	16,983	17,768	18,797
In foreign currency	6,820	7,602	8,306	8,146	9,669	9,719	10,148	10,584
Of which: Deposits (including CDs)	19,043	21,046	22,101	23,025	26,414	26,581	27,834	29,260
Consolidated Financial System								
Net foreign assets	1,726	1,800	1,882	3,477	4,222	4,090	4,408	4,272
Net domestic assets	19,951	22,173	23,248	22,394	25,375	25,833	26,938	28,776
Net domestic credit	23,411	25,470	26,634	26,249	28,855	30,247	31,847	33,813
Other items (net)	837	802	949	588	956	473	485	616
Capital account (-)	-1,852	-2,064	-2,401	-2,583	-2,871	-3,241	-3,646	-3,890
Monetary stabilization instruments (-)	-2,445	-2,034	-1,934	-1,859	-1,564	-1,645	-1,748	-1,763
Broad money	15,723	15,958	16,298	16,957	20,063	19,617	20,175	21,082
Memorandum Items	(Annual percentage change)							
Monetary base 1/	6.4	10.8	2.3	-5.2	13.7	6.2	6.4	6.9
Broad money	3.1	1.5	2.1	4.0	18.3	-2.2	2.8	4.5
Credit to the private sector	12.8	8.5	6.3	-1.9	2.3	6.1	6.4	6.9
In national currency	14.3	11.8	6.4	2.4	1.8	7.8	8.4	9.3
In foreign currency	10.7	3.6	6.2	-8.6	3.2	3.1	2.9	2.4
Credit to the private sector (adjusted by exchange rate changes)	11.5	7.6	3.8	0.5	-0.1	6.6	7.0	7.3
	(In percent of GDP)							
Monetary base 1/	7.7	8.0	7.8	7.1	8.4	8.6	8.8	9.0
Broad money	49.0	46.5	45.3	45.1	55.8	52.5	51.7	51.8
Of which: Deposits denominated in foreign currency	14.6	14.6	15.0	14.3	18.5	17.1	16.6	16.2
Credit to the private sector	57.8	58.6	59.4	55.8	59.7	60.9	62.1	63.6
Of which: In foreign currency	23.7	22.9	23.3	20.4	22.0	21.8	21.5	21.1
Central bank balance	-0.3	-0.2	0.1	-0.4	0.3	0.4	0.4	0.0

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

1/ Includes currency issued and required reserves.

Table 6. Costa Rica: Financial Soundness Indicators

	2016	2017	2018	2019	2020			
	Dec	Dec	Dec	Dec	Mar	Jun	Sep	Dec
				(In percent)				
Capitalization								
Risk-adjusted capital ratio	16.4	16.8	16.7	17.5	16.9	16.9	16.7	16.8
Capital-to-assets ratio	14.1	13.9	14.2	15.2	14.9	14.5	14.5	14.4
Asset quality								
Nonperforming loans to total loans	1.5	2.0	2.1	2.4	2.5	2.5	2.6	2.5
Non-income generating assets to total assets	15.7	16.2	16.3	15.8	17.0	16.9	17.3	18.3
Foreclosed assets to total assets	0.8	0.8	1.0	1.1	1.1	1.1	1.1	1.1
Loan loss provisions to total loans	2.2	2.8	3.3	3.5	3.6	3.7	3.9	4.2
Credit in foreign currency to total credit	41.0	39.2	39.1	36.5	37.2	37.0	37.6	...
Management								
Administrative expenses to total assets	3.3	3.1	3.1	3.2	3.2	3.2	3.1	3.0
Noninterest expenses to gross income	67.6	73.7	77.6	83.1	83.2	81.4	81.1	82.0
Total expenses to total revenues	91.3	94.8	95.6	96.7	96.7	96.6	96.7	97.2
Profitability								
Return on assets (ROA)	1.2	0.9	0.9	1.0	1.0	0.9	0.8	0.6
Return on equity (ROE)	8.8	6.5	6.8	6.8	6.9	6.1	5.6	4.6
Interest margin to gross income	32.4	25.3	21.3	16.4	16.4	18.4	19.0	18.9
Liquidity								
Liquid assets to total short-term liabilities	95.9	102.7	98.6	96.8	96.7	97.2	96.4	93.9
Liquid assets to total assets	28.2	29.1	28.0	29.8	30.7	33.0	33.4	33.0
Loans to deposits[1/]	115.8	112.3	113.1	105.6	103.4	99.7	100.1	99.0
Liquid assets to deposits	45.0	45.5	43.7	44.6	45.9	49.1	49.9	50.0
Sensitivity to market risk								
Net open FX position to capital	21.4	22.7	21.1	23.5	22.3	22.3	23.6	25.1
Other								
Financial margin[2/]	6.9	6.6	7.1	7.1	7.1	7.1	6.9	6.7

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

Table 7. Costa Rica: Indicators of Fund Credit

	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
Fund obligations based on existing credit														
(millions of SDRs)														
Principal	0.0	0.0	46.2	184.7	138.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Charges and interest[1/]	4.0	4.0	4.0	3.0	1.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Fund obligations based on existing and prospective credit (millions of SDRs)														
Principal	0.0	0.0	46.2	184.7	155.7	86.0	154.7	206.3	206.3	206.3	189.1	120.3	51.6	0.0
Charges and interest[1/]	7.7	16.5	29.1	32.6	27.2	26.6	23.3	16.2	8.4	5.3	3.2	1.4	0.4	0.1
Total obligations based on existing and prospective credit														
Millions of SDRs	7.7	16.5	75.3	217.3	182.9	112.6	178.0	222.4	214.7	211.6	192.2	121.7	51.9	0.1
Millions of U.S. dollars[2/]	11.1	23.7	108.4	312.9	263.4	162.1	256.3	320.3	309.2	304.7	276.8	175.3	74.8	0.1
Percent of exports of goods and services	0.1	0.1	0.4	1.2	1.0	0.6	0.9	1.1	1.0	0.9	0.8	0.5	0.2	0.0
Percent of gross international reserves	0.1	0.3	1.2	3.1	2.6	1.5	2.2	2.6	2.4	2.2	1.9	1.1	0.4	0.0
Percent of GDP	0.0	0.0	0.2	0.4	0.3	0.2	0.3	0.4	0.3	0.3	0.3	0.2	0.1	0.0
Percent of quota	2.1	4.5	20.4	58.8	49.5	30.5	48.2	60.2	58.1	57.3	52.0	32.9	14.1	0.0
Outstanding IMF credit based on existing and prospective drawings														
Millions of SDRs	782.0	1,194.4	1,560.7	1,376.0	1,220.3	1,134.4	979.7	773.4	567.2	360.9	171.9	51.6	0.0	0.0
Millions of U.S. dollars[2/]	1,126.2	1,720.3	2,247.9	1,981.8	1,757.6	1,633.8	1,411.0	1,113.9	816.9	519.8	247.5	74.3	0.0	0.0
Percent of exports of goods and services	5.7	7.8	9.3	7.7	6.5	5.7	5.0	3.7	2.6	1.5	0.7	0.2	0.0	0.0
Percent of gross international reserves	14.1	19.2	24.6	19.8	17.6	15.4	12.2	9.1	6.3	3.8	1.7	0.5	0.0	0.0
Percent of GDP	1.8	2.7	3.3	2.8	2.3	2.0	1.8	1.3	0.9	0.5	0.2	0.1	0.0	0.0
Percent of quota	211.7	323.3	422.5	372.5	330.3	307.1	265.2	209.4	153.5	97.7	46.5	14.0	0.0	0.0
Net use of IMF credit (millions of SDRs)	412.6	412.5	366.3	-184.7	-155.7	-86.0	-154.7	-206.3	-206.3	-206.3	-189.1	-120.3	-51.6	0.0
Disbursements	412.6	412.5	412.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayments and repurchases	0.0	0.0	46.2	184.7	155.7	86.0	154.7	206.3	206.3	206.3	189.1	120.3	51.6	0.0
Memorandum items:														
Exports of goods and services (millions of U.S. dollars)	19,822.5	22,075.0	24,104.6	25,575.8	27,101.0	28,802.6	28,277.9	30,058.3	31,950.8	33,962.4	36,100.7	38,373.6	40,789.6	43,357.7
Gross international reserves (millions of U.S. dollars)	8,004.3	8,956.3	9,123.3	9,984.3	10,012.3	10,621.3	11,532.1	12,258.2	13,030.0	13,850.3	14,722.3	15,649.3	16,634.5	17,681.9
Nominal GDP (millions of U.S. dollars)	61,177.8	64,502.6	67,909.9	71,603.8	75,670.7	80,381.4	78,956.9	83,928.0	89,212.1	94,828.9	100,799.3	107,145.7	113,891.5	121,062.2
Quota (millions of SDRs)	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4

Source: IMF staff estimates and projections.

1/ Based on the GRA rate of charge of 1.06 percent as of January 28, 2021.

2/ Based on the SDR rate as of December 31, 2020.

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

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

Source: IMF staff calculations

Table 9. Costa Rica: Quantitative Performance Criteria (PC) and Indicative Targets (IT) 1/

(Cumulative from the beginning of the year, in billions of colones, unless otherwise noted)

	2021			2022
	End-Jul	End-Sep	End-Dec	End-Mar
	PC	IT	PC	IT
I. Quantitative Performance Criteria				
Floor on cash primary balance of the central government (-= borrowing)	-390	-480	-640	-34
Floor on net international reserves of the Central Bank (stock, in millions of U.S. dollars)	3,660	4,336	3,768	4,123
II. Continuous Performance Criteria 2/				
Ceilling on accumulation of new external arrears (in millions of U.S. dollars)	0	0	0	0
III. Monetary Policy Consultation Clause (MPCC) 3/				
Year-on-year inflation in the consumer price index 4/				
Upper outer band limit (3 percent above center point)	4.4	4.4	4.3	4.1
Upper inner band limit (1.5 percent above center point)	2.9	2.9	2.8	2.6
End-of-period inflation center point (percent)	1.4	1.4	1.3	1.1
Lower inner band limit (1.5 percent below center point)	-0.1	-0.1	-0.2	-0.4
Lower outer band limit (3 percent below center point)	-1.6	-1.6	-1.7	-1.9
IV. Quantitative Indicative Targets				
Ceiling on debt stock of the central government	26,625	26,833	27,100	28,747
V. Memorandum Items				
External program financing (in millions of U.S. dollars)	540	1,390	2,511	0
External project financing (in millions of U.S. dollars)	57	73	97	49
External commercial loans (in millions of U.S. dollars)	0	0	0	1,000
Domestic FX-denominated debt issuance (in millions of U.S. dollars)	888	888	888	0
Proceeds from commercialization of public assets to non-residents (in millions of U.S. dollars)	0	0	0	0
Amortization of official external debt by the central government (in millions of U.S. dollars)	55	74	103	20
Interest payments of official external debt by the central government (in millions of U.S. dollars)	273	416	537	190
Domestic FX-denominated debt service (in millions of U.S. dollars)	684	793	1,797	480

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

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

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

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

Table 10. Costa Rica: Structural Benchmarks	
Structural Benchmarks	**Target Date**
Efficiency of government spending	
Legislative Assembly to approve Public Employment Bill.	End-May 2021
Revenue mobilization	
The Tax Commissioner to approve a new Tax Compliance Improvement Plan, in line with IMF staff recommendations.	End-December 2021
Fiscal governance and transparency	
Publication of financial statement under IFRS standards for fiscal year 2020 for three SOEs (ICE, AyA, CNP).	End-December 2021
Cabinet to approve and publish a Medium-Term Fiscal Framework for the entire Non-Financial Public Sector for 2023-2026.	End-April 2022
Cabinet to approve and publish a Medium-Term Debt Strategy (MTDS) for 2023-2026.	End-April 2022
Social safety nets	
MOF's National Treasury to centralize and digitalize the payment system for all the cash transfer social assistance programs, in coordination with social assistance units.	End-December 2021
Monetary and financial sector reforms	
The BCCR to submit to the Ministry of Finance draft amendments to the BCCR Law, prepared in consultation with IMF staff, to strengthen the central bank's operational autonomy and governance framework.	End-August 2021
Macro-structural reforms	
Authorities to develop a roadmap to enhance infrastructure resilience to climate change, including cost assessment and financing options.	End-September 2022

Annex I. Implementation of Past Fund Policy Advice

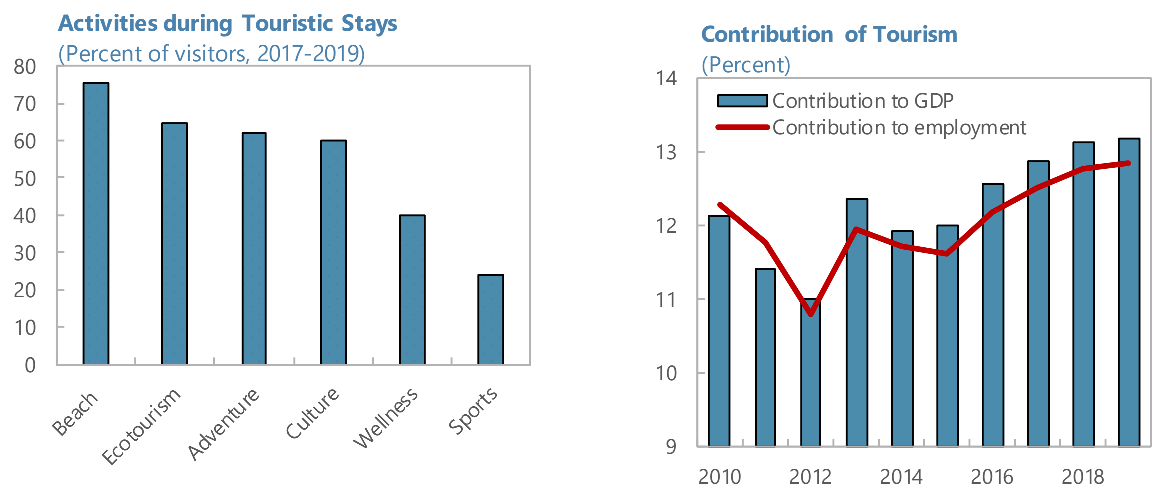
2019 Article IV Staff Recommendations	Implementation
Fiscal Policy	
Full and timely implementation of the 2018 fiscal reform	• Before the COVID-19 shock, the fiscal reform implementation (e.g. conversion of sales taxes into VAT, higher income taxes, wage restraint, and the fiscal rule) was having a significant impact on fiscal finances, with a fiscal deficit half the size, as of end-February 2020, compared to the same period in 2019. • The fiscal rule was applied from January 2020. In April 2020, the emergency escape clause under the rule was activated in response to the pandemic. In May 2020, the Legislative Assembly excluded municipalities from the fiscal rule.
Further fiscal consolidation to reduce debt and ease financial pressures	• The government proposed additional fiscal measures to the Legislative Assembly in early February 2020, including to improve tax administration, consolidate public institutions, streamline public wage scales, and reduce debt through asset sales and financial surpluses of decentralized public entities. However, plans for 2020 were derailed by the urgent needs generated by the COVID-19 pandemic. • As the pandemic recedes and the recovery takes holds, the authorities plan to resume their fiscal consolidation efforts to reach a primary balance of 1 percent of GDP by end-2023.
Monetary and Foreign Exchange Policy	
Data-dependent monetary policy, with enhanced transparency	• As inflation pressures remain low, with the headline inflation falling below the BCCR's tolerance band since November 2019, the BCCR has lowered its policy rate in several steps, from 5.25 percent in March 2019 to 0.75 percent in June 2020. • Monetary policy transparency has been further improved since 2020 with the ex-ante publication of the calendar of monetary policy meetings.
Exchange rate flexibility	• The BCCR has maintained a flexible exchange rate policy since 2019. FX intervention has focused on addressing episodes of excessive exchange rate volatility.
Financial Sector Reforms	
Implementation of high- and medium-priority FSSR recommendations	• The law on consolidated supervision was approved in 2019, and the law on banking resolution and the creation of a deposit guarantee fund in February 2020. Further enhancements to the resolution framework are needed. • The risk-based supervisory framework continues to be strengthened with support from IMF's capacity development. • To help reduce dollarization, the BCCR differentiated the reserve requirements by currency and reverted the provisioning rate applied to FX loans to unhedged borrowers from 1.0 percent back to 1.5 percent. • Progress in deepening debt markets and improving public debt management has been limited.
Structural reforms	
Structural reforms to improve competitiveness and foster inclusive growth	• Costa Rica was invited to become an OECD member in May 2020. 14 new laws and/or administrative reforms were passed during the OECD accession, with recommendations implemented in a broad array of areas, including public finances, environment, education, customer protection, and competition. • A comprehensive package of measures is planned to further boost productivity and promote inclusive and green growth, including, among others, reforms that incentivize formalization and promote the decarbonization of the economy.

Annex II. The Impact of the Pandemic on the Tourism Sector

1. Since the late 1980s, Costa Rica has established itself as a prime destination for green and sustainable tourism. Many tourists are drawn to Costa Rica's varied national parks and protected areas—which cover around 25 percent of the national landmass—and provide opportunities for a wide range of activities, including beach holidays, ecotourism, and adventure trips. In 2019 the country attracted more than 3 million international visitors, mainly from North America (53.1 percent), Central America (22.3 percent), and Europe (15.9 percent). While leisure accounts for the largest share of tourism revenues (66 percent), tourism for health (13.4 percent), business (12.7 percent), and education purposes (7.7 percent) also play an important role, as of 2016 survey data by the Costa Rican Tourism Institute (ICT).

2. Tourism contributes significantly to employment and economic activity. The tourism sector is a leading source of jobs and—directly and indirectly—supported an estimated 12.9 percent of total employment in Costa Rica in 2019. Informal employment in the tourism sector has been increasing, accounting for 59 percent of all jobs in 2019 (compared to around 46 percent in other sectors of the economy). More than half of the sector's employees are women. Tourism's direct and indirect contribution to GDP has increased over the past decade, from 12.1 percent of GDP in 2010 to an estimated 13.2 percent in 2019. It is also a large component of trade, accounting for about 20 percent of the country's annual exports.

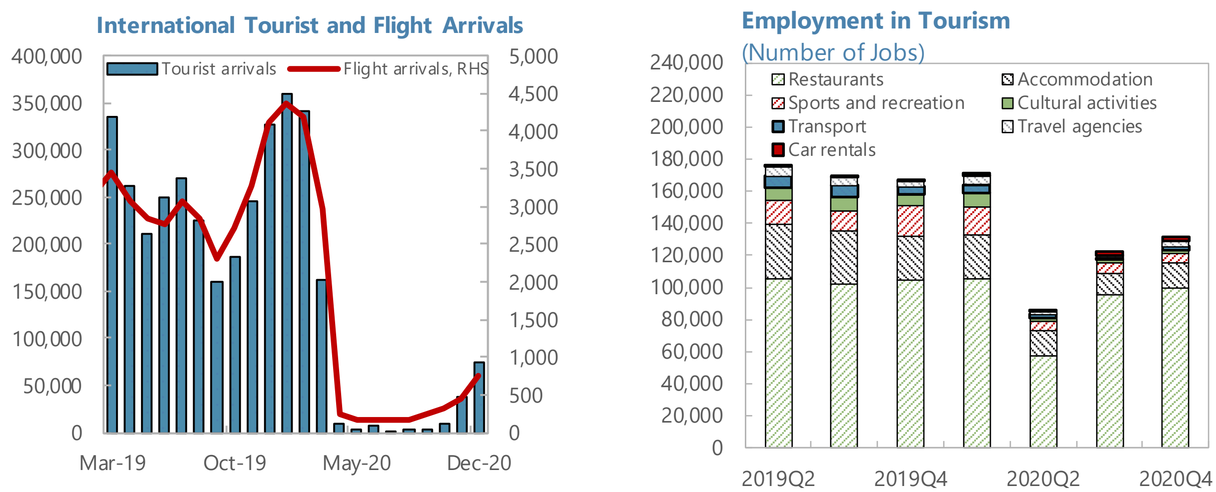
Costa Rica: Type of Tourism and Contribution to Economic Activity



Sources: BCCR; Instituto Costarricense del Turismo; World Travel and Tourism Council; and IMF staff estimates.

3. The COVID-19 pandemic and necessary containment measures have caused an unprecedented decline in tourism activity. International tourist arrivals contracted by 85.4 percent y-o-y in 2020Q4, following an even sharper drop of 98.7 percent y-o-y in 2020Q3. As a result, direct employment in the tourism sector declined by 21.3 percent y-o-y in 2020Q4 (compared to a decline of 51.6 percent y-o-y in 2020Q2), driven by restaurants and hotels, which generate the largest share of jobs in the sector. Overall, economic activity in the tourism sector is estimated to decline by 40 percent y-o-y in nominal terms in 2020. The impact of the pandemic on the tourism sector is amplified by the sector's structure, as the majority of businesses, often informal, are SMEs (94 percent of hotel and lodging firms are micro and small enterprises), with limited access to credit.

Costa Rica: Impact of the Pandemic on the Tourism Sector



Sources: BCCR; FlightRadar24; Instituto Costarricense del Turismo; and IMF staff estimates.

4. **Costa Rica has begun to open its borders to international visitors, but restrictions remain in place.** Following the closure of its borders in March 2020 to contain the spread of the virus, Costa Rica has gradually relaxed entry restrictions for foreign visitors. As of last November, tourists from 44 countries, including from the U.S., have been authorized to visit. While entry requirements for health insurance coverage from local or international providers as well as domestic containment measures remain in place, quarantine restrictions have been removed to support the reactivation of the tourism sector.

5. **Costa Rica's tourism sector is well-positioned to accommodate new travel habits and protocols.** Considerable natural attractions and accommodation in resort destinations—rather than urban centers—provide an opportunity to attract visitors with preferences for outdoor activities and social distancing. Costa Rica's growing high-end ecotourism and wellness niche can benefit from post-COVID travel habits favoring outdoor activities and increasing demand for sustainable travel. In this context, the country has been able to create crucial synergies between its efforts to preserve forests to promote climate change mitigation and adaptation (Annex X) and the ecotourism sector. Another factor that might draw tourists to Costa Rica, compared to other destinations in the tropics, is its high-quality healthcare system, which can cater to visitors in need of medical assistance and thereby partly mitigate health concerns during the pandemic.

6. **Costa Rica has launched a roadmap to reactivate the sector and adjust to the new normal.** The roadmap contains several initiatives to restore travelers' confidence and attract visitors:

- The Costa Rican Tourism Institute (ICT), in collaboration with the private sector, has launched 16 health and hygiene protocols for tourism-related activities. Adopting these protocols allowed Costa Rica to earn the World Travel and Tourism Council's Safe Travels Seal in July 2020. The ICT has also provided tourists with good practice guides and a mobile app to share relevant information and enhance contact tracing on a voluntary basis.
- To initiate the reactivation of the sector, the ICT launched national and international campaigns. The national campaign *Vamos a Turistear* (Let's Go Sightseeing) was launched in July 2020 and aims at incentivizing domestic tourism through attractive offers, discounts, and financing options. In July, the Legislative Assembly approved a law that moved several national holidays to Mondays to extend weekends during 2020-2024 and thereby boosts domestic tourism. To promote international tourism, Costa Rica continued its marketing efforts in line with "Only the Essentials" in the U.S. and Canada and launched "Costa Rica: A Sanctuary of Sustainable Tourism in Europe", embodying the country's "*pura vida*" or "full of life" mindset.
- The *"ICT Capacita"* platform provides a virtual training tool to enhance the skills of entrepreneurs and workers in the tourism sector. The platform delivers training by experts on a comprehensive range of topics, including on tourism during and after the pandemic, sectoral protocols, sustainable tourism, and legislation, among other topics.
- Other measures concentrate on improving the tourism experience, for example, through offering services for small groups with a mandatory local guide and a focus on sustainable tourism. In addition, the authorities' roadmap reinforces efforts to attract FDI in the tourism sector, transform the Guanacaste area into a tourism hub, and promote maritime tourism.

Annex III. Risk Assessment Matrix[1]

Risks		Policy Response
	External	
Unexpected shift in the Covid-19 pandemic. Extended need for containment measures or slow vaccine distribution exacerbates stretched asset valuations, fueling financial vulnerabilities, or policy support is insufficient. Equally, quick pandemic containment boosts confidence and economic activity.	**High Likelihood** **High Impact**	Advance fiscal consolidation and reform plans to secure debt sustainability, while making space for extended COVID-19 measures; maintain expansionary and countercyclical monetary policy, with exchange rate flexibility to help absorb external shocks.
Widespread social discontent and political instability. Social tensions erupt as the pandemic and inadequate policy response cause socio-economic hardship (job loss, poverty or higher prices of essentials) or due to unequal access to vaccines. Growing political polarization and instability weaken policymaking and confidence.	**High Likelihood** **High Impact**	Implement structural agenda to boost inclusive growth, support informal sector, and foster labor productivity; provide support to the most vulnerable, including by enhancing targeting and delivery of social assistance.
Oversupply and volatility in the oil market. Supply increases or demand shocks could lead to renewed weakness in energy prices. Uncertainty about production demand contribute to continued high price volatility.	**Medium Likelihood** **Medium Impact**	Use created fiscal space to help protect social goals during fiscal consolidation and accelerate debt reduction; maintain flexible exchange rate.
Intensification of geopolitical tensions and security risks in the Central American region (e.g., in response to pandemic) cause socio-economic and political disruption and lower confidence. Immigration flows could intensify due to the sharp economic contraction in the neighboring countries from the COVID-19 crisis.	**Medium Likelihood** **Low Impact**	Coordinate closely with regional authorities on sanitary protocols to avoid interruptions of trade flows; and continue enhancing COVID-19 tracing capabilities, including among migrant workers to contain community transmission.
	Domestic	
Hysteresis from the pandemic downturn. The severity or uniqueness of the downtum could cause unexpected private sector distress and scarring of the economy. This could heighten macro-financial vulnerabilities, slow the pace of recovery, and result in persistently high unemployment.	**Medium Likelihood** **High Impact**	Further strengthen financial sector supervision and contingency framework; maintain data-dependent and forward-looking monetary policy; implement active labor market policies to facilitate labor reallocation and job creation.
Failure to attain political consensus around reforms. With a coalition government and elections in early 2022, there is a risk that critical fiscal and institutional measures may not pass or be excessively delayed.	**Medium Likelihood** **High Impact**	Secure broad-based consensus on reform program; timely and consistent implementation of the 2018 fiscal reform and fiscal rule, prioritizating growth-friendly and equitable measures.
Domestic supply shocks caused by climate change. Climate shocks could have a negative impact on agricultural activity and road infrastructure, among others, and affect the growth of the economy.	**Medium Likelihood** **Medium Impact**	Build a consistent framework with investment in resilience and appropriate ex-ante financing, including fiscal buffers.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

Annex IV. External Sector Assessment

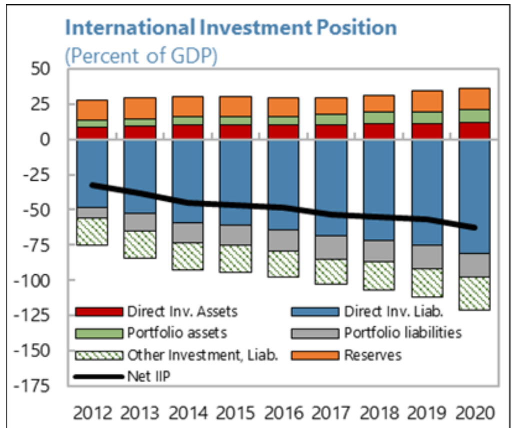
Overall Assessment: *Based on preliminary data and EBA model results, the external position in 2020 was stronger than the level implied by fundamentals and desirable policies, though the assessment is subject to a high degree of uncertainty. This assessment is driven by a larger deterioration of fundamentals in the model's global comparator group of countries than in Costa Rica, where the COVID shock, including a sharp collapse in tourism, has been partly offset by a sizable import compression amid a drop in domestic demand, and relatively resilient exports.*

Potential Policy Responses: *As the health and economic crisis recedes domestically and globally, fiscal consolidation should resume gradually, consistently with the fiscal rule, to prevent a deterioration in external sustainability.*

Foreign Assets and Liabilities: Position and Trajectory

Background. The NIIP has been trending down since 2011 reflecting the CA deficits and is projected at -59.6 percent of GDP in 2020. Non-resident portfolio equity holdings are negligible, leaving liabilities divided between FDI (68 percent of total) and external debt (31 percent). About 9 percent of external debt is at short-term maturity, and nearly all external debt is denominated in foreign currency. About 15 percent of external liabilities are on the balance sheet of the financial sector.

Assessment. The substantial share of FDI in Costa Rica's liabilities mitigate potential risks from its growing net debtor position. The expected reduction in the current account deficit as fiscal consolidation takes hold would slow the decline in the NIIP.



Sources: BCCR and IMF staff estimates.

2020 (% GDP)	NIIP: -59.6	Gross Assets: 55.1	Debt Assets: 24.2	Gross Liab.: 114.8	Debt Liab.: 29.6

Current Account

Background. The current account deficit is projected to widen to 2.6 percent of GDP in 2020 from 2.3 percent in 2019 (compared with the five-year average of 2.9 percent) mainly due to a sharp contraction in tourism, which produces about 20 percent of exports in normal years. A significant compression of imports and resilience in some agricultural goods and free trade zone exports are projected to contain the widening of the current account deficit. The tourism sector is expected to recover slowly, supporting an improvement in the current account over the medium term.

Assessment. The EBA current account (CA) model suggests a current account gap of 2.3 percent of GDP in 2020 after including adjustors to the current account for the temporary impact of the pandemic on tourism and oil imports.[1] The gap is another way to say that Costa Rica's current account deficit is smaller than predicted by the model when policies are set at desirable medium-term levels. In 2019, the gap was 1.0 percent of GDP. The policy gap in 2020—the difference between current and desirable policies—is mostly driven by the relatively stronger fiscal expansion globally in response to the COVID shock. Domestically, higher public savings from the gradual fiscal consolidation under the program should ease crowding out and facilitate higher domestic investment.[2]

[1] An auxiliary regression of the effects of tourism and oil shocks on the cyclically adjusted current account indicates that the current account ultimately reflects 60 percent of the shock.

[2] Multilateral consistency requires balanced adjustment towards desirable policies. For even larger fiscal deficits in major countries to decline—raising their current accounts in the process—other countries' current accounts must decline.

Costa Rica: EBA Current Account Model Estimates
(in percent of GDP, unless otherwise indicated)

	2019	2020
CA-Actual	**-2.3**	**-2.6**
Cyclical Contributions (from model)	0.3	0.5
Temporary factors related to the pandemic	0.0	-1.7
Adjusted CA	**-2.7**	**-1.4**
CA Norm (from model) 1/	**-3.7**	**-3.7**
Adjustments to the norm	0.0	0.0
Adjusted CA Norm	**-3.7**	**-3.7**
CA Gap	**1.0**	**2.3**
o/w Policy gap	-1.1	0.9
Elasticity	-0.26	-0.24
REER Gap (in percent)	**-4.0**	**-9.6**

1/ Cyclically adjusted, including multilateral consistency adjustments.

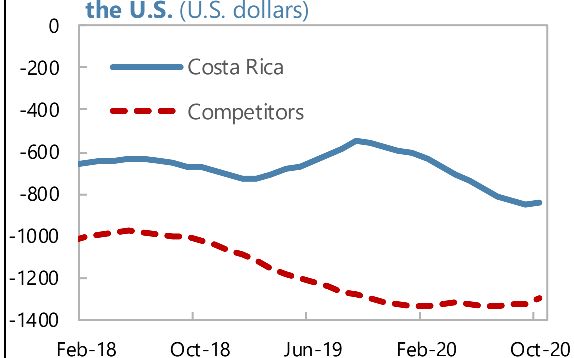
Real Exchange Rate

Background. The colón has been relatively stable over the last five years, partially due to the BCCR's practice of taking care of all SOE FX transactions outside the FX market. In 2020, the REER and NEER depreciated by 8.5 and 8.3 percent, respectively.

As regards the tourism sector, Week-at-the-Beach tourism costs—an indicator of competitiveness—have remained stable during the pandemic.[3]

Costa Rica's supporting policy and structural reforms, including as part of the OECD's accession process, are expected to support competitiveness, although further initiatives are needed for the country to converge to the OECD averages, including measures to support formalization, address skill mismatches, and reduce red tape and infrastructure gaps.

Cost of a Week at the Beach Relative to the U.S. (U.S. dollars)



Sources: World Development Indicators and IMF staff estimates.
Note: Weak-at-the-Beach cost minus the U.S. cost, 12-month moving average. Competitors are countries in the dataset with a Caribbean Sea coastline, weighted by 2018 tourist arrivals.

Assessment. The EBA current account model estimates a REER gap of -9.6 percent using an elasticity of -0.24. This is based on the model's conclusion explained above that the current account deficit is smaller than predicted by the model, given relative domestic and global developments.

---

[3] See Laframboise et al. 2014. Data reliability is affected by extremely low volumes during the pandemic.

Capital and Financial Accounts: Flows and Policy Measures

Background. Costa Rica's capital flows have been dominated by FDI inflows for many years. In 2020, even with a decline due to the shock, net FDI (debit and credit) represented 113 percent of the current account. Costa Rica maintains relatively low restrictions on FDI relative to OECD peers, and FDI is expected to recover in the medium term.[4] For portfolio capital, on the other hand, low size and liquidity of the local currency bond market constrain non-resident participation and hence flows. The projected portfolio and other net outflows in 2020 are mainly due to the pandemic shock. Net inward debt portfolio flows represented 20 percent of net inward capital flows on average during 2013-17, and total net debt portfolio flows accounted for 33 percent of net capital flows.

Assessment. The external financing structure has been a source of resilience for Costa Rica, with FDI fully covering the current account deficit in normal years.

FX Intervention and Reserves Level

Background. Gross international reserves (GIR) fell significantly—by about US$ 1.7 billion—in 2020. At year-end reserves amounted to US$ 7.2 billion or 108 percent of the IMF's metric for Assessing Reserve Adequacy (ARA metric) for countries with floating exchange rates.

Costa Rica: Gross International Reserves, 2020 Adequacy Metrics

(in percent of metric, unless noted otherwise)

Metric	Level	Benchmark
Millions of US dollars	7,232	
ARA metric (floating)	108	100-150
Short-term debt at remaining maturity	139	100
Broad money	22	20

Source: IMF staff estimates

Since 2015, the BCCR operates within a managed floating regime, limiting FX intervention to address episodes of exchange rate excessive volatility. The BCCR also acts as an intermediary for state-owned enterprises (SOEs) to smooth out their large FX transactions. In 2020, FX intervention amounted to net direct FX sales of US$650 million, with US$280 million to address volatility and net sales on behalf of SOEs of US$ 371 million.

The early repayment in January of a US$ 625 million reserves loan by the Latin American Reserve Fund (FLAR) had a sizable impact on reserves. In addition, a few external loans expected in 2020 did not receive approval by the Legislative Assembly, a step required by the Costa Rican Constitution, and most of them have been rescheduled to 2021.

Assessment. Costa Rica's FX reserves remain broadly adequate despite the 2020 decline. GIR meets the standard benchmark levels for a country with a floating exchange rate and an open capital account. The still-high rate of dollarization, the high fiscal financing needs amid market risks, and BCCR's limited tolerance for large exchange rate swings are factors that might suggest holding an extra buffer above 100 percent of the ARA metric.

[4] Meehan, L. (2018), "Structural policies to boost productivity and inclusion in Costa Rica", OECD Economics Department Working Paper, No. 1485, OECD Publishing, Paris.

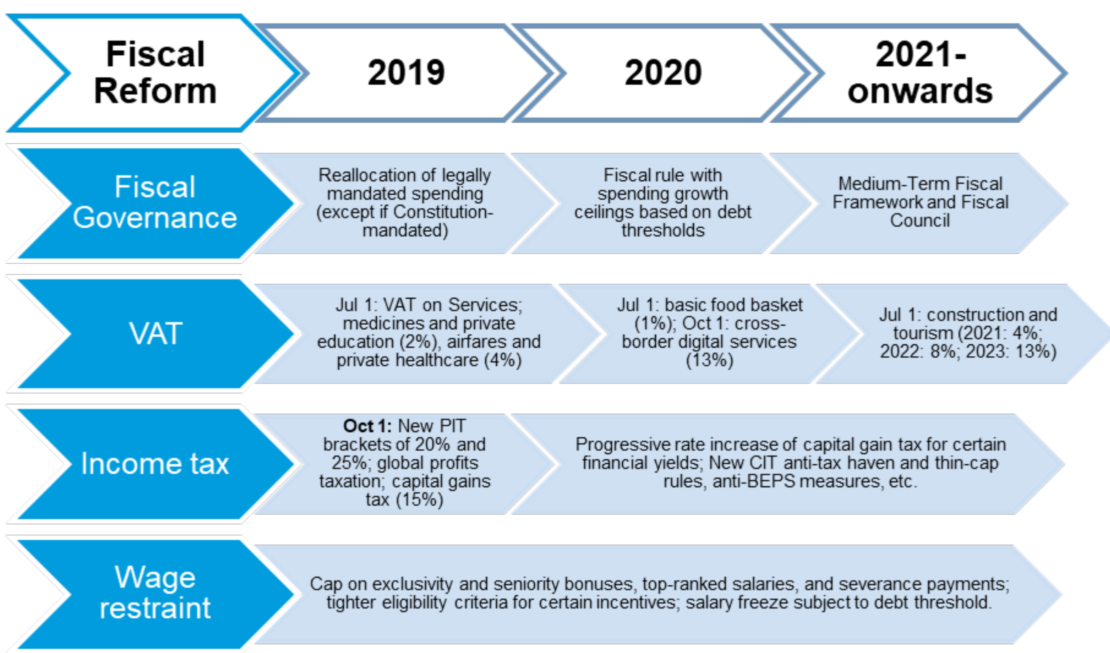
Annex V. Key Elements of the 2018 Fiscal Reform

An ambitious fiscal reform bill was passed into law on December 3, 2018. The reform, which included the introduction of a fiscal rule and envisaged the creation of a fiscal council and the adoption of a Medium-Term Fiscal Framework, was expected to yield savings of about 4 percent of GDP over 2018-23, as estimated in the 2019 Article IV Report. Specifically,

- **The tax reforms were projected to generate additional revenue of 1.6 percent of GDP annually by 2023.** These included (i) the conversion of the sale tax into a full-fledged VAT, including full taxation of services and full deduction of taxes paid on imports and purchases from July 2019; (ii) the strengthening of income taxation by harmonizing capital income and gains at a 15 percent tax rate and adding additional brackets of 20 and 25 percent for employment income as of October 2019.

- **A new fiscal rule and wage restraints were projected to lower spending by 2.4 percent of GDP by 2023**. The fiscal rule, operating as of 2020, limits current expenditure growth to 100, 85, and 75 percent of the average GDP growth over the previous four years when debt (t-2) is below 30, between 30 to 45, and between 45 to 60 percent of GDP, respectively, and total spending growth to 65 percent of the same benchmark when debt (t-2) is above 60 percent of GDP. The reform also mandates a freeze in the base wage when debt exceeds 60 percent of GDP and imposes caps on extra remunerations as of 2019. Reallocation of legally mandated spending (except those mandated by the Constitution) is also envisaged if debt exceeds 50 percent of GDP.

Costa Rica: Key Elements of the 2018 Fiscal Reform and Implementation Timetable



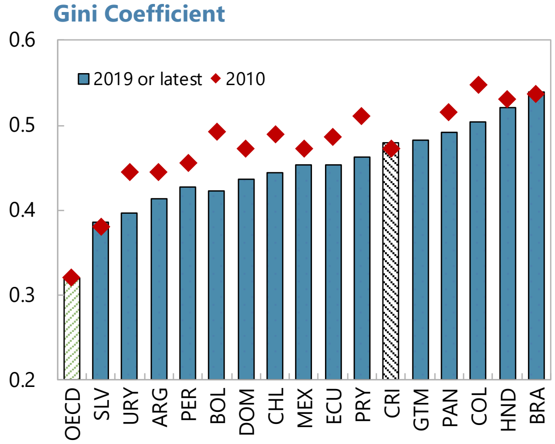
Sources: Ministry of Finance and IMF staff.

Annex VI. The Inequality and Informality Challenge[1]

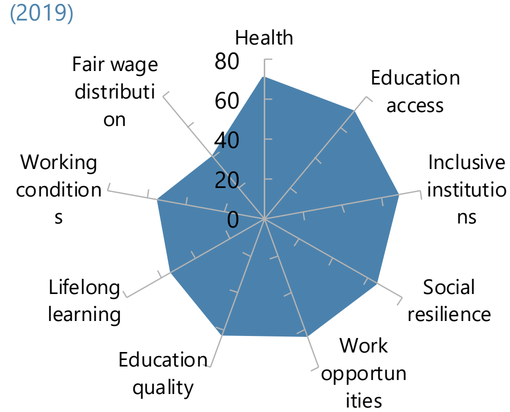
1. In contrast to the declining trend observed in the region, income inequality in Costa Rica has been persistently high. Despite good economic performance, income inequality has increased slightly over the past decade and remains high compared to OECD and LAC standards. In 2019, the Gini coefficient stood at 0.48, well above the OECD average of 0.32. While universal access to education and health have contributed to providing equal opportunities, differences in the quality of education, school attendance and completion, and labor market conditions translate into wide income gaps and limited social mobility.

Costa Rica: Inequality

Gini Coefficient



Social Mobility Index Subcomponents
(2019)



Sources: World Bank WDI Database; and World Economic Forum.

2. Based on macro-level evidence, several reasons seem at the root of Costa Rica's high-income inequality:

- ***Labor market opportunities are distributed unequally, especially for informal workers and women.*** High unemployment and informality, together with a widening pay gap between informal and formal employment, have resulted in an unequal wage distribution. Disproportionally high social security minimum contributions for low-income and part-time workers and a complex minimum wage system deter formalization and contribute to this trend. Female labor force participation remains particularly low, partially reflecting limited provision of public childcare services, although efforts to close gender gaps could significantly boost economic growth (with cumulative losses estimated at over 20 percent for Costa Rica).[2] A high

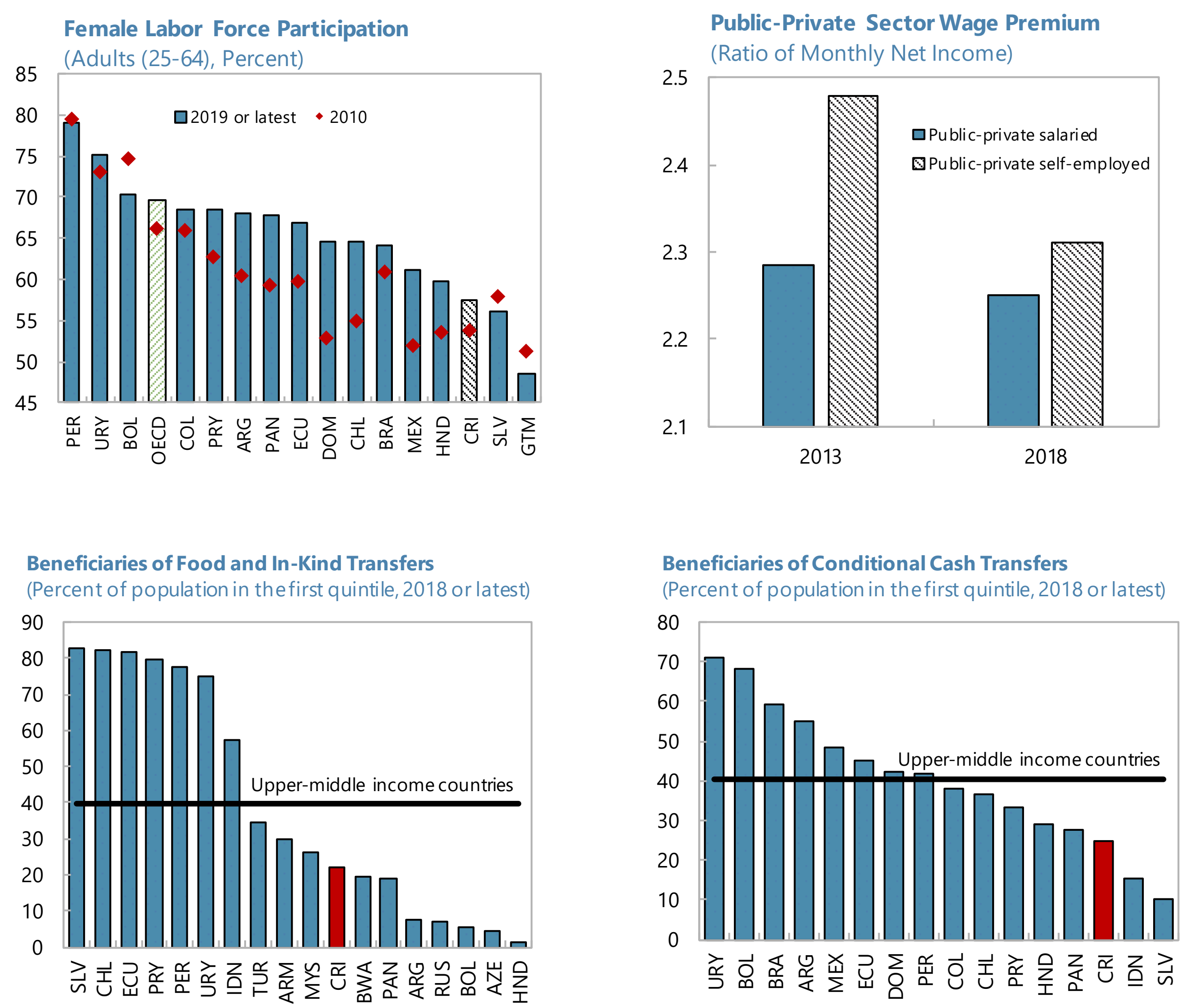
[1] Prepared in collaboration with Gervasio Agustín Arakaki (WB) and Juan Pablo Baquero Vargas (WB).

[2] See Cuberes, Newiak and Teigner (2017). Chapter 3: Gender Inequality and Macroeconomic Performance in *Women, Work, an Economic Growth: Leveling the Playing Field*, Washington, D.C as well as Cuberes and Teigner (2016). Aggregate Effects of Gender Gaps in the Labor Market: A Quantitative Estimate, *Journal of Human Capital*, 10(1).

wage premium for public sector employees and divides along educational dimensions further exacerbate labor income inequality.

- ***Well-targeted social spending and fiscal redistribution is limited.*** Spending on social assistance and active labor market policies is in line with other countries in the region with a similar development level but remains low compared to other OECD countries. While the delivery of social assistance programs has improved in recent years, including via the transition to bank payments, challenges related to the coverage of the main social assistance programs and the targeting of conditional cash transfers remain. Targeting for in-kind transfers programs and social pensions, in contrast, is better in Costa Rica than for the average upper-middle-income country. Overall, redistribution through taxes and transfers play a limited role in lowering income inequality due to low progressivity, as highlighted in the OECD 2020 Economic Survey for Costa Rica.

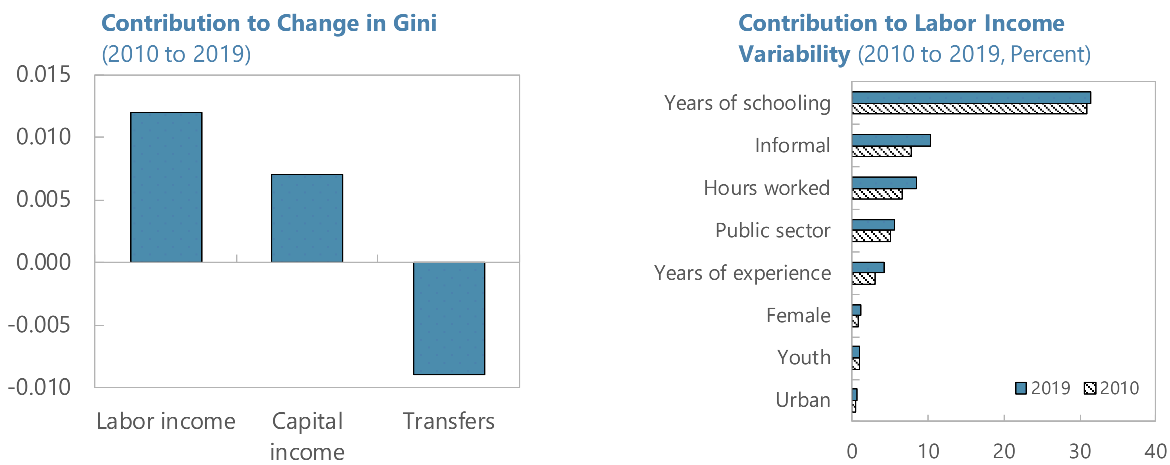
Costa Rica: Female Labor Force Participation, Public Sector Wage Premium, and Social Assistance Coverage



Sources: SEDLAC; INEC; and World Bank.

3. Micro-level evidence confirms the key role of informality, education, and the public-private sector wage divide in driving inequality over time. Shapley estimates, based on Costa Rican household-level data, show that labor income accounts for the largest share of income and contributed the most to the increase in the Gini coefficient from 2010 to 2019. Education, informality, hours worked, and the public sector wage premium have played an important role in driving the increase in inequality and together explain almost half of labor income variability.

Costa Rica: Drivers of Inequality



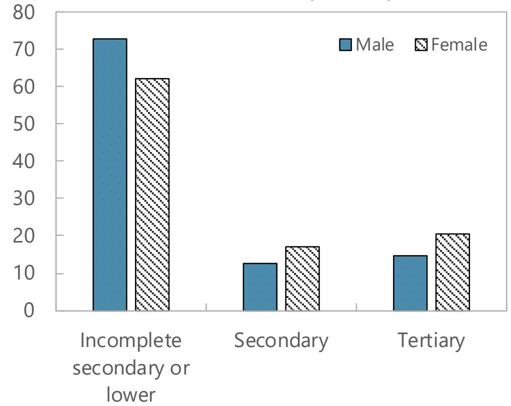
Sources: INEC; and staff estimates.

4. The impact of COVID-19 is exacerbating pre-existing sources of inequality. Owing to the pandemic, unemployment increased from already high levels to 22 percent in 2020Q3 (29 percent for women). The impact on employment is proving sharper for low-skilled and informal workers who are less likely to benefit from telework arrangements and less resilient to negative income shocks. An evaluation of the Bono Proteger program, which provided temporary subsidies to workers who are affected by the pandemic and vulnerable, shows that two out of three recipients have incomplete secondary or lower education, confirming that low-skilled workers are being disproportionately affected. Likewise, informal workers experienced particularly sharp job losses, in line with cross-country evidence for Latin America.[3] Relative to 2019Q4, informal employment declined by 33.3 percent at the height of the pandemic in 2020Q2, compared to 10 percent for formal workers.

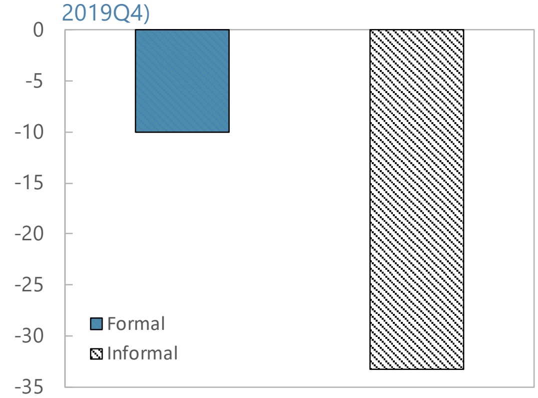
[3] Bottan, A., Vera-Cossio D.A. and Hoffmann, B. (2020). *The Unequal Impact of the Coronavirus Pandemic: Evidence from Seventeen Developing Countries.* IDB Discussion Paper No. 785.

Costa Rica: Unequal Impact of the Pandemic

Recipients of Bono Proteger by Education and Gender (Percent)



Employment Change by Sector, 2020Q2 (Percent change relative to 2019Q4)



Sources: INEC; Ministerio de Trabajo y Seguridad Social; and staff estimates.

5. **The measures envisaged under the program aim at facilitating inclusive and sustained growth.** Persistent income inequality, uneven access to opportunities, and low social mobility undermine growth by reducing consumption, human capital accumulation, and investment. The Fund-supported program will seek to address inequality and protect vulnerable groups despite the important fiscal reform efforts being envisaged. An analysis of the impact of the fiscal package on income distribution and poverty suggests that the planned fiscal reform together with an expansion of the social safety net by 0.1 percent of GDP would improve income distribution and reduce poverty:[4]

- The relative tax incidence, i.e. the share of taxes on gross market income, is expected to grow for the higher deciles of the income distribution. Compared to the baseline situation, which considers the current parameters of the tax system, the direct tax relative incidence would rise from 8.0 to 8.2 percent for the eighth decile, from 9.0 to 9.4 percent for the ninth decile, and from 12.5 to 13.5 percent for the tenth decile. As a result, income inequality would decrease by 0.26 Gini percentage points.

- The current level of social assistance spending in Costa Rica is broadly on par with countries with a similar development level. Nonetheless, the coverage of all major types of social assistance programs in Costa Rica is below the upper-middle income country average.[5] This suggests that

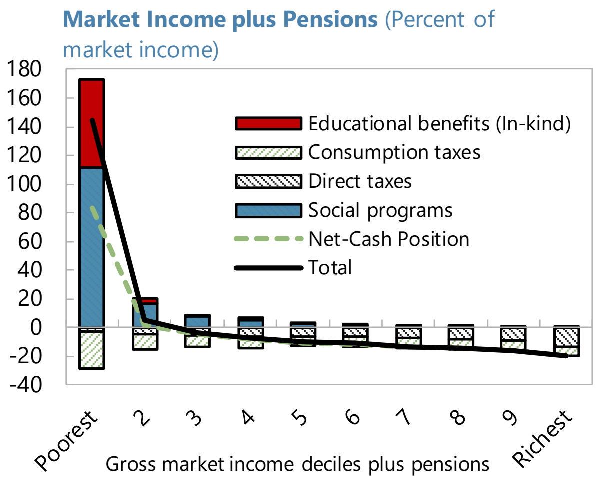
[4] The analysis was performed using the microsimulation tool developed and implemented by the Poverty and Equity Team of the World Bank for Costa Rica. This tool is based on microdata from the National Survey on Household Income and Expenditure (ENIGH), which was collected in 2018, and official data on tax and benefit regimes. The tool allows the user to perform simulations of changes to both taxes and (cash and in-kind) transfers. Due to data constraints, the analysis focuses on three aspects of the fiscal package, namely removal of income tax exemption on school salary, anticipation in the harmonization of taxation of all forms of financial returns to 15 percent, and integration of employment, professional and business income into a single PIT progressive rate structure.

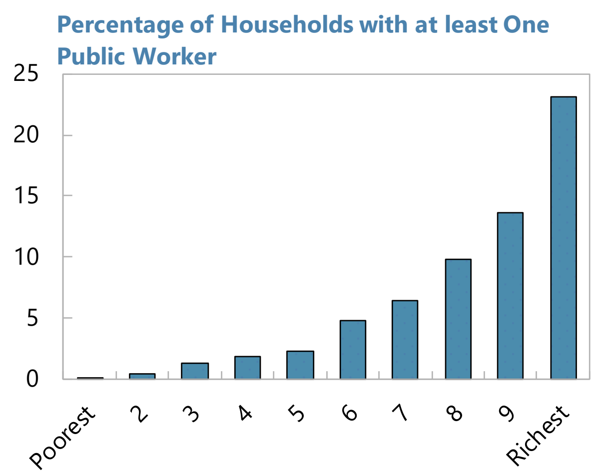
[5] Coverage is defined as the number of beneficiaries in the lowest quintile divided by the population in that quintile.

additional allocations could be used to expand the number of beneficiaries in the poorest decile of the income distribution. The simulations suggest that the additional allocation of 0.1 percent of GDP in social assistance spending under the fiscal reform package—which is expected to be channeled via three programs, namely non-contributory pensions, the National Childcare and Development Network (REDCUDI), and Education, Nutrition, and Child Comprehensive Care Centers (CEN-CINAI)—could reduce income inequality by 0.4 Gini percentage points, while the poverty ratio would decreases by 0.25 percentage points –lifting at least 12,184 people out of poverty. For the first decile, the share of cash transfers would increase from 108 to 112 percent and the share of cash and in-kind benefits would rise from 51 to 61 percent of market income plus pensions.

- Additional simulations also show that a reduction in the public sector wage bill, reflecting the authorities' plans to freeze base salaries and accrual of annuities, and elimination of all vacancies, among other measures, would not have an impact on the poverty rate as public sector employment is concentrated in the higher deciles of the income distribution.

Costa Rica: Distributional Impact of Tax Measures and Transfers





Sources: World Bank and IMF staff estimates.

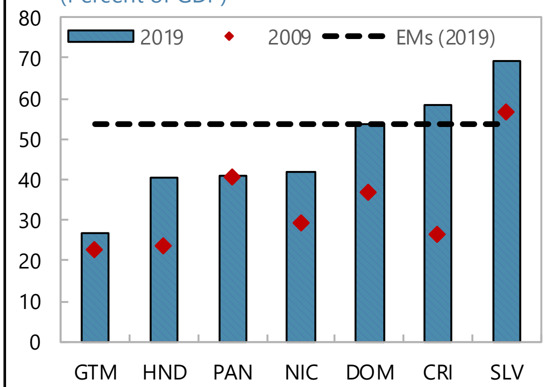
Annex VII. Debt Sustainability Analysis

Costa Rica's debt vulnerabilities remain elevated, with significant financing needs over the medium term. Under the baseline scenario, debt is assessed to remain sustainable, as the gradual economic recovery and fiscal consolidation plans under the program help strengthen debt dynamics. Public debt is projected to start declining over the medium term after peaking at 76 percent of GDP in 2023. Risks remain high, including from weaker growth, a slower-than-expected fiscal adjustment, materialization of contingent liabilities, and interest rate and currency shocks.

A. Background and Key Assumptions

1. Public debt has increased significantly over the last decade, with a recent spike due to the COVID-19 shock. Since the global financial crisis, public debt increased by about 40 percent of GDP amid loose fiscal spending, relatively weak growth dynamics, and increasing interest costs. After rising by about 5 percentage points in 2019, the public debt ratio increased further from 56¾ percent of GDP at end-2019 to about 68 percent of GDP at end-2020, reflecting COVID-related pressures as well as a growing interest bill. Based on preliminary disaggregated data, as of end-2020, domestic debt (mostly bonds issued in colones or U.S. dollars) accounts for about 52 percent of GDP or about three quarters of total public debt. External public debt consists of multilateral and bilateral loans (about 7 percent of GDP or 10 percent of total) as well as Eurobonds (9.4 percent of GDP or 13.8 percent of total). Foreign-currency denominated debt accounts for about 42 percent of total. As of end-2019, Costa Rica's debt-to-GDP ratio stands higher than most peers and the emerging market (EMs) average (54 percent).

Central Government Debt
(Percent of GDP)



Sources: WEO Database and IMF staff estimates.

2. The public debt sustainability analysis (DSA) focuses on the central government (CG), due to data availability constraints for the broader public sector. The CG definition has been expanded, with support from IMF TA, to include 51 public entities that, starting in 2021, are required to be consolidated under central government (CG) by Law 9524 (accounting for about 0.3 percent of GDP in debt as of end-2019). The CG accounts have been consolidated retroactively back to 2019, to ensure data comparability. The rest of the public sector, not included under the DSA, has been broadly in balance in recent years as the cash surplus of the social security system and other decentralized government entities broadly offsets the small central bank deficit—resulting from its past liquidity management operations—while public enterprises are broadly in balance. However, different reporting standards and weak data reporting of state-owned enterprises do not allow for consistent data availability, constraining staff's ability to monitor the entire public sector.

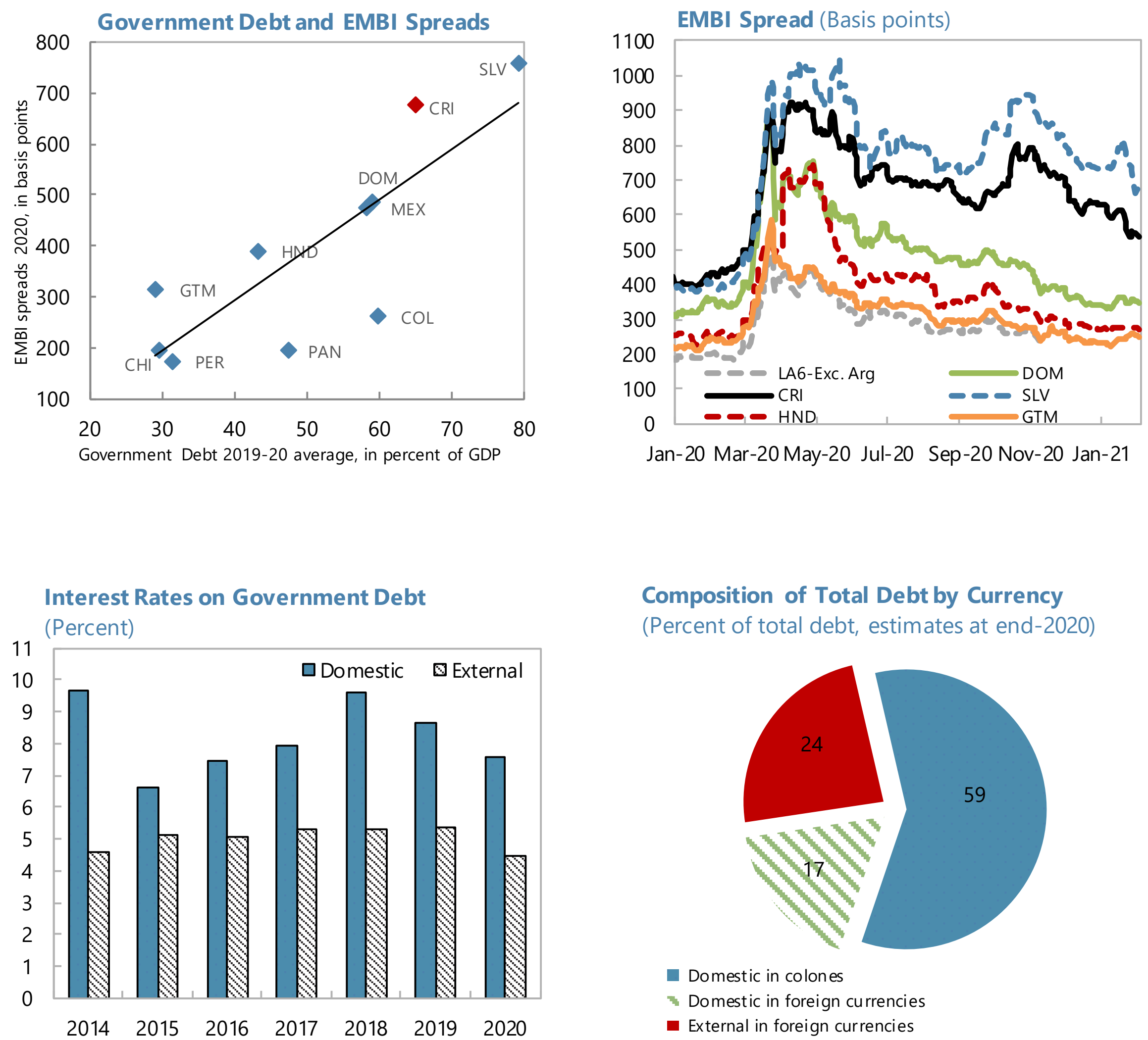
3. The baseline scenario of the DSA reflects the medium-term macroeconomic projections and policies under the proposed extended arrangement under the EFF. The baseline envisages a gradual recovery over the next two years, with real GDP growing by a modest 2.6 percent, after contracting by 4.8 percent in 2020, and slowly converging to its potential growth of about 3 percent. Weak demand and subdued import prices are expected to keep inflation around the lower end of the BCCR target range in the near term, before it gradually converges to the midpoint as the recovery takes hold. The primary balance is projected to strengthen from a 3.9 percent of GDP deficit in 2020 to a surplus of around 2.8 percent of GDP in 2026, based on consistent implementation of the fiscal rule and further expenditure and revenue measures under the program. Interest payments are expected to remain sizable, due to the rising public debt, with projections based on actual interest payments for existing debt and prevailing interest rates in the primary market for newly issued debt, adjusted in line with expected medium-term developments in domestic and global financial conditions.

B. Public Debt Sustainability

4. The authorities' fiscal consolidation plans would help strengthen debt dynamics over the medium term. Under the baseline scenario, central government debt is projected to peak at 76 percent of GDP in 2023—above the 70-percent high risk of debt distress threshold for emerging economies—before starting to gradually decline to 71.9 percent of GDP by 2026. The debt adjustment will be supported by structural measures of about 5¼ percent of GDP over 2021-25, including sustained implementation of the fiscal rule over the medium term. Average gross financing needs will remain elevated averaging about 12 percent of GDP in 2021-24, before starting to decline below 10 percent of GDP in 2025. The baseline assumes access to external financing in the form of official financing and US$4 billion in Eurobond issuances over 2022-26.

5. Nevertheless, risks to debt sustainability remain high, as signaled by the heat map and stress scenario analysis. The heat map analysis indicates a high risk to debt sustainability given that debt exceeds the high risk of debt distress threshold of 70 percent of GDP for EMs in 2021 and over the projection period already under the baseline scenario. If fiscal consolidation efforts were to fall short of the program targets, failing to strengthen the primary balance beyond its historical level (- 2.7 percent of GDP), the debt-to-GDP ratio would continue to rise to about 94 percent by 2026. Gross financing needs would remain below the benchmark of 15 percent of GDP in all standardized macro-fiscal stress tests, except for the contingent liability shock scenario. When all these shocks are combined, the debt to GDP ratio would reach 92.6 percent in 2026 and gross financing needs would remain elevated at around 15 percent of GDP until 2023. In terms of the realism of the baseline assumptions, the envisaged maximum three-year improvement in the structurally adjusted primary balance by around 3.7 percent of GDP over 2020–23 is higher than in 83 percent of international experiences, highlighting the ambition of the fiscal consolidation plan. The debt profile analysis indicates a moderate degree of vulnerabilities related to market perception, external financing requirement, debt held by non-residents, and debt denominated in foreign currency. Specifically, foreign-currency denominated debt as share of total debt is estimated to have reached about 42 percent in 2020, and continue to rise thereafter until 2024, although largely reflecting financial assistance from the Fund and other IFIs to respond to the COVID-19 shock and support the recovery efforts, although the share will remain below the high-risk of debt distress threshold of 60 percent.

Costa Rica: Vulnerability to Interest Rate and Exchange Rate Shocks



Sources: Bloomberg, MoF, and IMF staff estimates.

C. External Debt Sustainability

6. **The ratio of total external debt (public and private) to GDP is projected to peak in 2024 and then decline over the medium term.** External debt is projected to increase by 6.5 percent in 2021 to 59.1 percent of GDP, due to the widening current account deficit and weak growth as the COVID-19 shock recovery begins. It is projected to peak in 2024 at 61.9 percent of

GDP and then decrease to around 58.7 percent by 2026 as GDP growth and the trade balance normalize.

7. The main risk to external debt sustainability is a sharp depreciation of the exchange rate. Currency risks, notably vis-à-vis the U.S. dollar, are high. The stress test analysis suggests that a 30 percent real depreciation in 2020 could lead to a sizable increase in the external debt-to-GDP ratio to 90 percent by 2024. Nevertheless, the stress tests show that other common risk factors—from interest rates, growth, and the current account primary balance—pose relatively low risk. Robustness was further evidenced by the fact that, despite the magnitude of the COVID shock and the fiscal challenges in 2020, exchange rate pressure abated by year-end and FDI more than covered the current account. Nevertheless, further tightening in global liquidity conditions as well as country-specific shifts in investor confidence, for example related to a weakening of the fiscal and debt trajectory, could raise rollover risks and interest costs.

Figure AVII. 1. Costa Rica: Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario

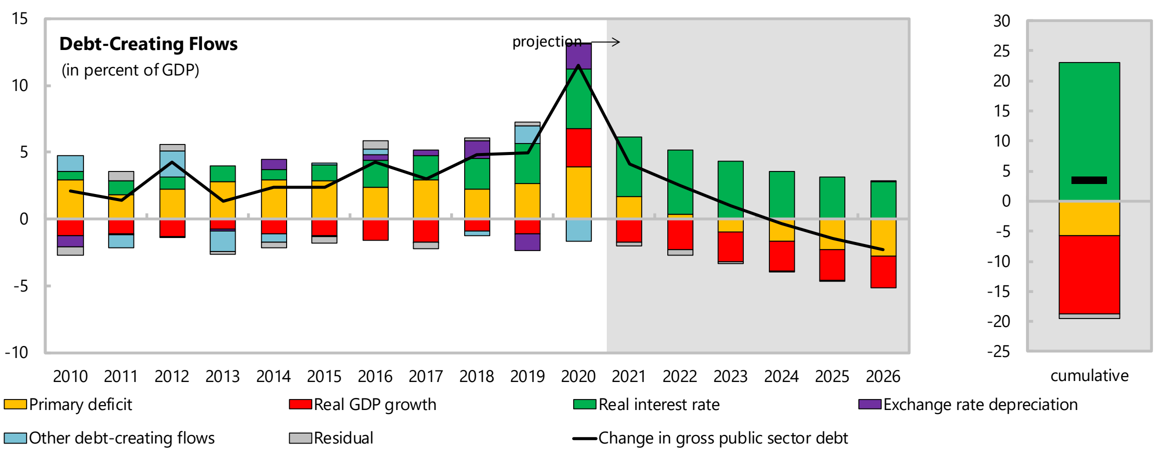
(In percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators 1/

	Actual		Prel.	Projections						As of January 15, 2021		
	2010-2018 2/	2019	2020	2021	2022	2023	2024	2025	2026	Sovereign Spreads		
Nominal gross public debt	38.5	56.8	68.3	72.5	75.0	76.0	75.6	74.2	71.9	EMBIG (bp) 3/		606
Public gross financing needs	11.8	12.6	13.5	13.9	12.5	11.2	10.5	8.8	7.5	5Y CDS (bp)		583
Real GDP growth (in percent)	3.9	2.2	-4.8	2.6	3.3	3.1	3.1	3.2	3.3	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	4.2	2.2	0.5	1.4	1.0	1.3	2.0	2.4	2.8	Moody's	B2	B2
Nominal GDP growth (in percent)	8.3	4.4	-4.3	4.0	4.3	4.4	5.2	5.7	6.2	S&Ps	B	B
Effective interest rate (in percent) 4/	8.3	8.3	8.0	8.1	8.0	7.3	7.0	6.9	7.0	Fitch	B	B

Contribution to Changes in Public Debt

	Actual			Projections							
	2010-2018	2019	2020	2021	2022	2023	2024	2025	2026	cumulative	debt-stabilizing primary balance 9/
Change in gross public sector debt	2.9	4.9	11.5	4.1	2.5	1.0	-0.3	-1.4	-2.3	3.5	
Identified debt-creating flows	2.9	4.6	11.5	4.4	2.9	1.1	-0.3	-1.4	-2.3	4.4	
Primary deficit	2.6	2.6	3.9	1.7	0.3	-1.0	-1.7	-2.3	-2.8	-5.7	0.5
Primary (noninterest) revenue and grants	13.2	15.1	14.3	14.7	15.3	16.0	16.1	16.0	16.0	94.1	
Primary (noninterest) expenditure	15.8	17.8	18.2	16.4	15.7	15.1	14.4	13.7	13.2	88.5	
Automatic debt dynamics 5/	0.3	0.7	9.2	2.7	2.5	2.1	1.3	0.9	0.5	10.1	
Interest rate/growth differential 6/	0.1	1.9	7.3	2.7	2.5	2.1	1.3	0.9	0.5	10.1	
Of which: real interest rate	1.3	3.0	4.5	4.4	4.8	4.3	3.6	3.2	2.8	23.1	
Of which: real GDP growth	-1.2	-1.1	2.8	-1.7	-2.3	-2.2	-2.2	-2.3	-2.3	-13.1	
Exchange rate depreciation 7/	0.2	-1.3	1.9	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	1.3	-1.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Use of Deposits (negative)	0.0	1.3	-1.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (2)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes 8/	0.0	0.3	0.1	-0.3	-0.4	-0.2	0.0	0.0	0.0	-0.8	



Source: IMF staff calculations.

1/ Public sector is defined as central government, which includes deconcentrated public agencies as of 2019.

2/ Based on available data.

3/ EMBIG.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

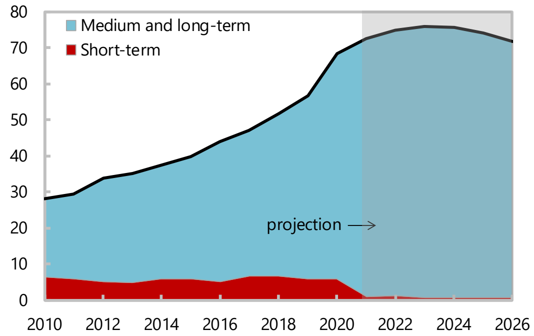
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

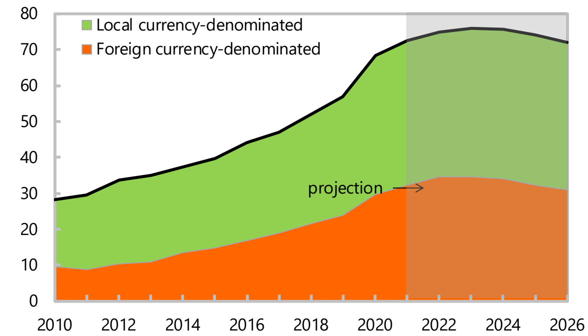
Figure AVII. 2. Costa Rica: Public DSA - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



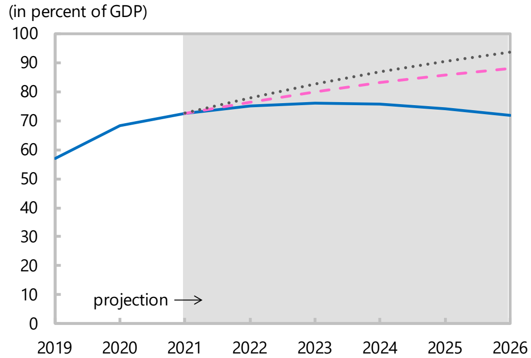
By Currency
(in percent of GDP)



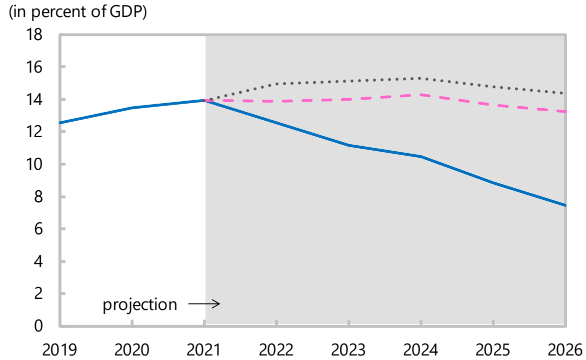
Alternative Scenarios

Baseline   Historical   Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



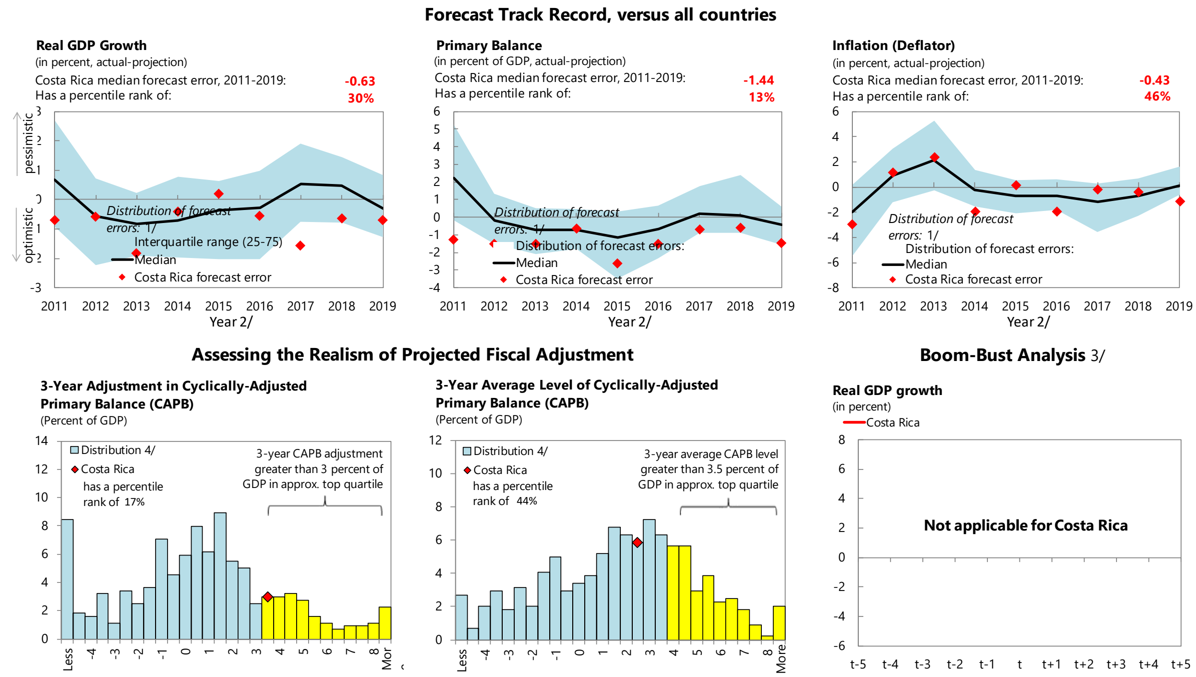
Underlying Assumptions
(in percent)

Baseline Scenario	2021	2022	2023	2024	2025	2026
Real GDP growth	2.6	3.3	3.1	3.1	3.2	3.3
Inflation	1.4	1.0	1.3	2.0	2.4	2.8
Primary Balance	-1.7	-0.3	1.0	1.7	2.3	2.8
Effective interest rate	8.1	8.0	7.3	7.0	6.9	7.0
Constant Primary Balance Scenario						
Real GDP growth	2.6	3.3	3.1	3.1	3.2	3.3
Inflation	1.4	1.0	1.3	2.0	2.4	2.8
Primary Balance	-1.7	-1.7	-1.7	-1.7	-1.7	-1.7
Effective interest rate	8.1	8.0	7.3	7.0	6.8	6.8

Historical Scenario	2021	2022	2023	2024	2025	2026
Real GDP growth	2.6	2.7	2.7	2.7	2.7	2.7
Inflation	1.4	1.0	1.3	2.0	2.4	2.8
Primary Balance	-1.7	-2.7	-2.7	-2.7	-2.7	-2.7
Effective interest rate	8.1	8.0	7.1	6.6	6.3	6.2

Source: IMF staff calculations.

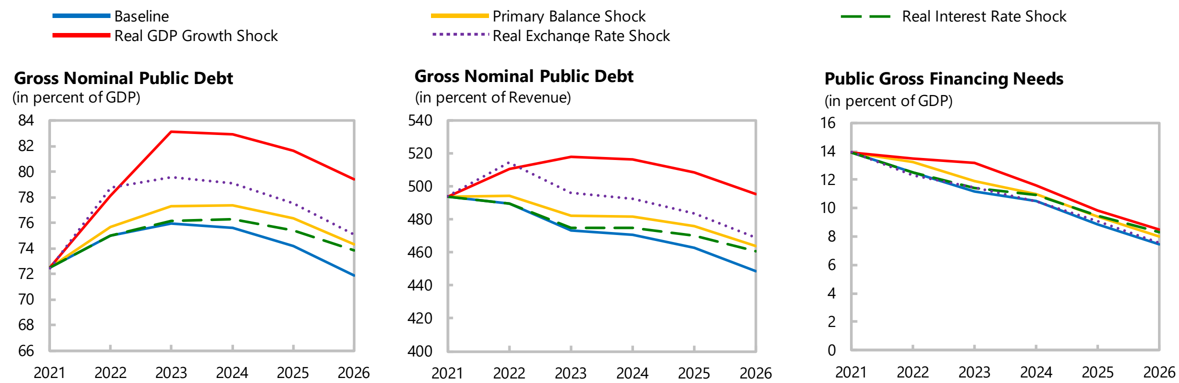
Figure AVII. 3. Costa Rica: Public DSA - Realism of Baseline Assumptions



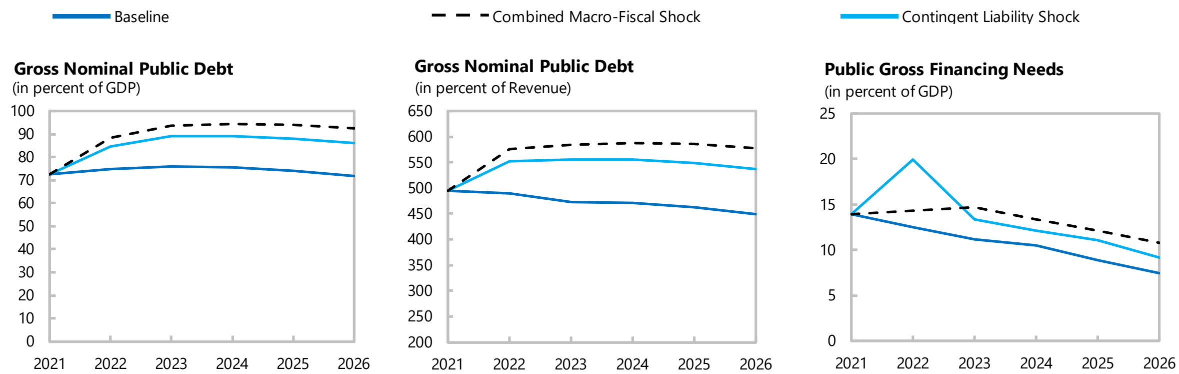
Source : IMF Staff calculations.
1/ Plotted distribution includes all countries, percentile rank refers to all countries.
2/ Projections made in the spring WEO vintage of the preceding year.
3/ Not applicable for Costa Rica, as it meets neither the positive output gap criterion nor the private credit growth criterion.
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Figure AVII. 4. Costa Rica: Public DSA - Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

	2021	2022	2023	2024	2025	2026
Primary Balance Shock						
Real GDP growth	2.6	3.3	3.1	3.1	3.2	3.3
Inflation	1.4	1.0	1.3	2.0	2.4	2.8
Primary balance	-1.7	-1.0	0.3	1.3	2.0	2.6
Effective interest rate	8.1	8.0	7.3	7.1	7.0	7.0
Real Interest Rate Shock						
Real GDP growth	2.6	3.3	3.1	3.1	3.2	3.3
Inflation	1.4	1.0	1.3	2.0	2.4	2.8
Primary balance	-1.7	-0.3	1.0	1.7	2.3	2.8
Effective interest rate	8.1	8.0	7.6	7.6	7.7	7.9
Combined Shock						
Real GDP growth	2.6	0.5	0.3	3.1	3.2	3.3
Inflation	1.4	0.3	0.6	2.0	2.4	2.8
Primary balance	-1.7	-1.0	-0.1	1.3	2.0	2.6
Effective interest rate	8.1	8.6	7.3	7.3	7.5	7.7

	2021	2022	2023	2024	2025	2026
Real GDP Growth Shock						
Real GDP growth	2.6	0.5	0.3	3.1	3.2	3.3
Inflation	1.4	0.3	0.6	2.0	2.4	2.8
Primary balance	-1.7	-0.9	-0.1	1.7	2.3	2.8
Effective interest rate	8.1	8.0	7.3	7.1	7.0	7.0
Real Exchange Rate Shock						
Real GDP growth	2.6	3.3	3.1	3.1	3.2	3.3
Inflation	1.4	8.5	1.3	2.0	2.4	2.8
Primary balance	-1.7	-0.3	1.0	1.7	2.3	2.8
Effective interest rate	8.1	8.6	7.0	6.8	6.7	6.7
Contingent Liability Shock						
Real GDP growth	2.6	0.5	0.3	3.1	3.2	3.3
Inflation	1.4	0.3	0.6	2.0	2.4	2.8
Primary balance	-1.7	-6.9	1.0	1.7	2.3	2.8
Effective interest rate	8.1	8.5	7.5	7.3	7.1	7.1

Source: IMF staff calculations.

Figure AVII. 5. Costa Rica: Public DSA Risk Assessment

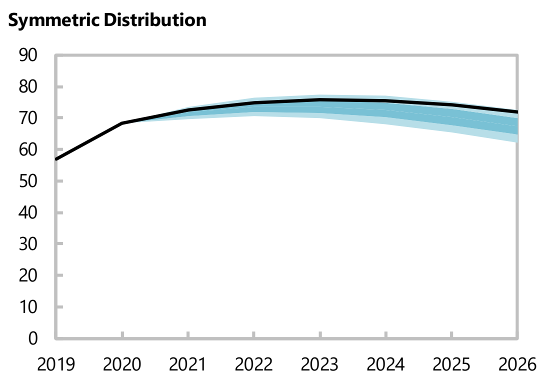
Heat Map

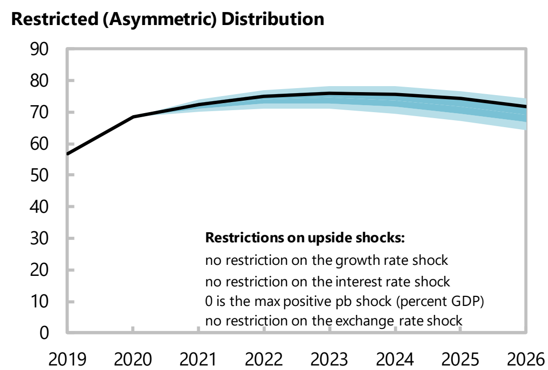
Debt level 1/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs 2/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile 3/	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)

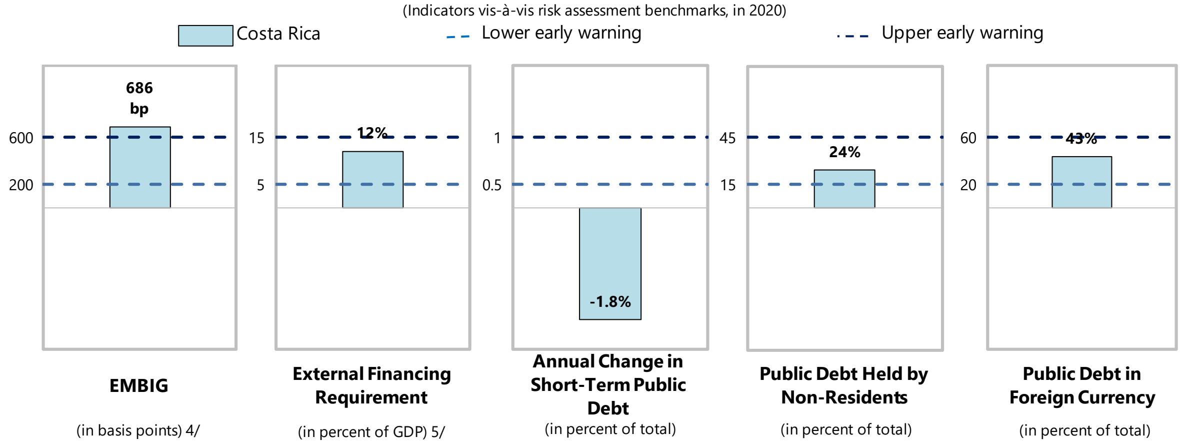
Baseline   Percentiles: 10th-25th   25th-75th   75th-90th





Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2020)



Source: IMF staff calculations.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.

Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ EMBIG, an average over the last 3 months, 17-Oct-20 through 15-Jan-21.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Table AVII. 1. Costa Rica: External Debt Sustainability Framework, 2016-26

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2016	2017	2018	2019	2020			2021	2022	2023	2024	2025	2026	Debt-stabilizing non-interest current account 6/
Baseline: External debt	43.4	44.9	46.6	47.9	52.6			**59.1**	**61.5**	**61.6**	**61.9**	**59.9**	**58.7**	**-6.1**
Change in external debt	1.7	1.4	1.7	1.4	4.7			6.5	2.3	0.1	0.3	-2.0	-1.2	
Identified external debt-creating flows (4+8+9)	-3.3	-2.1	-1.9	-3.1	1.5			-1.5	-2.7	-3.1	-3.3	-3.4	-3.4	
Current account deficit, excluding interest payments	0.8	2.3	1.6	0.7	0.8			1.4	1.1	1.1	1.1	1.1	1.2	
Deficit in balance of goods and services	-1.2	-0.6	-1.4	-2.8	-2.3			-1.8	-2.0	-2.1	-2.1	-2.1	-2.1	
Exports	31.7	32.1	32.9	33.2	30.2			32.4	34.2	35.5	35.7	35.8	35.8	
Imports	30.5	31.4	31.5	30.3	27.9			30.6	32.3	33.4	33.6	33.7	33.7	
Net non-debt creating capital inflows (negative)	-3.7	-4.5	-3.7	-4.2	-3.0			-3.3	-3.8	-4.2	-4.2	-4.2	-4.2	
Automatic debt dynamics 1/	-0.4	0.2	0.2	0.4	3.8			0.5	0.0	0.0	-0.1	-0.3	-0.3	
Contribution from nominal interest rate	1.3	1.4	1.6	1.6	1.8			1.8	1.9	1.8	1.7	1.6	1.5	
Contribution from real GDP growth	-1.7	-1.8	-0.9	-1.0	2.4			-1.4	-1.8	-1.8	-1.8	-1.9	-1.9	
Contribution from price and exchange rate changes 2/	0.0	0.6	-0.4	-0.2	-0.4			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	4.9	3.5	3.6	4.5	3.1			8.0	5.0	3.2	3.6	1.4	2.2	
External debt-to-exports ratio (in percent)	137.2	139.9	141.4	144.6	174.1			182.4	179.6	173.4	173.2	167.1	163.8	
Gross external financing need (in billions of US dollars) 4/	5.2	6.3	6.2	6.8	7.3			7.1	7.8	9.2	8.3	9.0	8.6	
in percent of GDP	8.8	10.4	10.0	10.6	11.9	10-Year	10-Year	11.7	12.1	13.5	11.5	11.9	10.7	
Scenario with key variables at their historical averages 5/								**59.1**	**62.5**	**64.0**	**66.0**	**65.9**	**66.8**	**-5.5**
						Historical	Standard							
Key Macroeconomic Assumptions Underlying Baseline						Average	Deviation							
Real GDP growth (in percent)	4.2	4.2	2.1	2.2	-4.8	2.7	2.8	2.6	3.3	3.1	3.1	3.2	3.3	
GDP deflator in US dollars (change in percent)	0.1	-1.3	1.0	0.4	0.9	2.4	3.4	-3.0	2.1	2.1	2.3	2.4	2.8	
Nominal external interest rate (in percent)	3.4	3.2	3.6	3.5	3.6	3.2	0.3	3.5	3.4	3.0	2.9	2.8	2.7	
Growth of exports (US dollar terms, in percent)	8.7	4.1	5.8	3.3	-12.4	4.2	6.5	6.8	11.4	9.2	6.1	6.0	6.3	
Growth of imports (US dollar terms, in percent)	4.7	5.9	3.3	-1.3	-11.5	3.1	7.6	9.2	11.0	8.9	6.3	5.8	6.3	
Current account balance, excluding interest payments	-0.8	-2.3	-1.6	-0.7	-0.8	-2.5	1.5	-1.4	-1.1	-1.1	-1.1	-1.1	-1.2	
Net non-debt creating capital inflows	3.7	4.5	3.7	4.2	3.0	4.3	0.8	3.3	3.8	4.2	4.2	4.2	4.2	

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

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

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

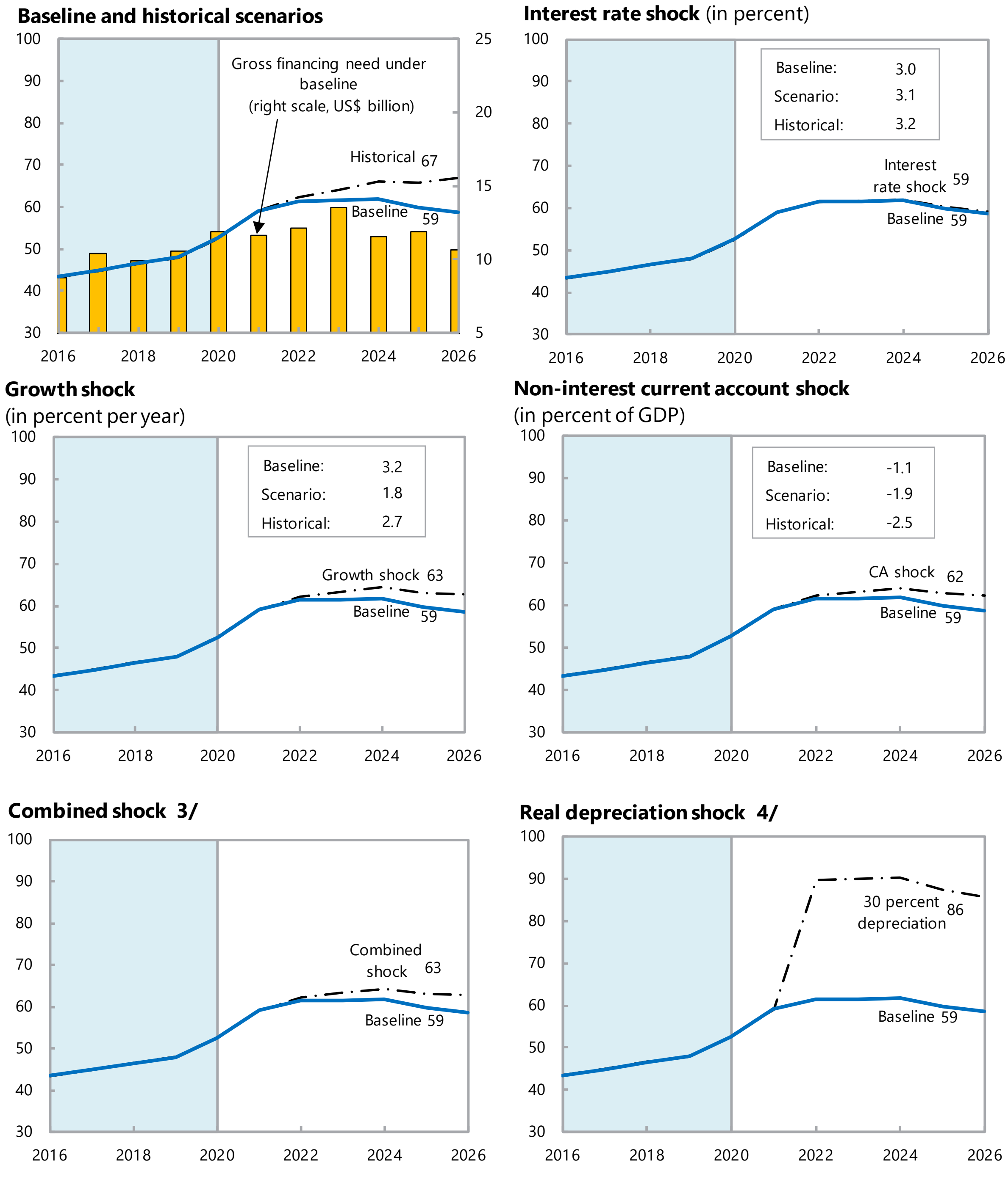
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

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

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

Figure AVII. 6. Costa Rica: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2020.

Annex VIII. Bank Stress Tests

The Costa Rican banking sector has so far been able to absorb the COVID-19 shock, with an overall capital adequacy ratio (CAR) of 13½ percent as of end-May 2020 (the base for the stress tests given data availability), still above the 10-percent minimum regulatory requirement. Staff's top-down stress test results show that the banking sector should be able to withstand a more severe shock under a downside scenario, with the overall CAR falling to 10.1 percent just above the regulatory minimum.

1. The top-down solvency stress test covers some of the main risks facing the banking sector:

- ***Credit risk***, where an additional 5.8 percent of non-performing loans (NPLs) is assumed, with a provisioning rate of 40 percent, to bring post-shock NPLs to 8.5 percent of total loans. The estimated shock is twice the size of the increase in extended NPLs ("*mora ampliada*", which include written-off loans) observed during the 2008-09 global financial crisis, when real GDP growth fell by about 5 percentage points. In the downside scenario, real GDP growth is estimated to fall by 10 percentage points over 2020-21 compared to the pre-COVID 2019 level.

- ***Interest rate risk***, where sovereign bond yield is assumed to further increase by 300 bps, causing the repricing of banks' sovereign bond holdings.[1] This shock resembles the increase in the government bond yield in October 2018, amid uncertainties surrounding the fiscal reform and concerns about debt sustainability. In 2020, despite some temporary volatility in the fall, government bond yields declined by 150 bps.

- ***Exchange rate risk***, where the colón is assumed to depreciate by an additional 10 percent in 2021. The direct impact of the depreciation is positive, because most banks have a long net open FX position. However, the indirect channel, through currency-induced credit risk of non-hedged borrowers, leads to an additional 6.8 percent of FX loans to become non-performing.

2. The biggest potential losses would result from the NPL shock. The system-wide increase in NPLs is estimated to cause a fall in CARs by 1.8 percentage points. The depreciation of the colón would cause some unhedged FX borrowers to default and have a sharper impact on private banks due to their higher share of FX-denominated loans (73 percent versus 24 percent for public banks). An increase in sovereign yields, on the other hand, would have a larger impact on public banks through repricing, given their higher share of sovereign bond holdings.

3. Under an adverse scenario where all these risks materialize, the system-wide CAR would fall just above the regulatory minimum. Under the combined shock, five banks—collectively accounting for less than 30 percent of market share—would have their CARs falling below the 10-percent threshold, thus requiring some recapitalization. Nevertheless, the combined capital shortfalls would only amount to 0.24 percent of GDP.

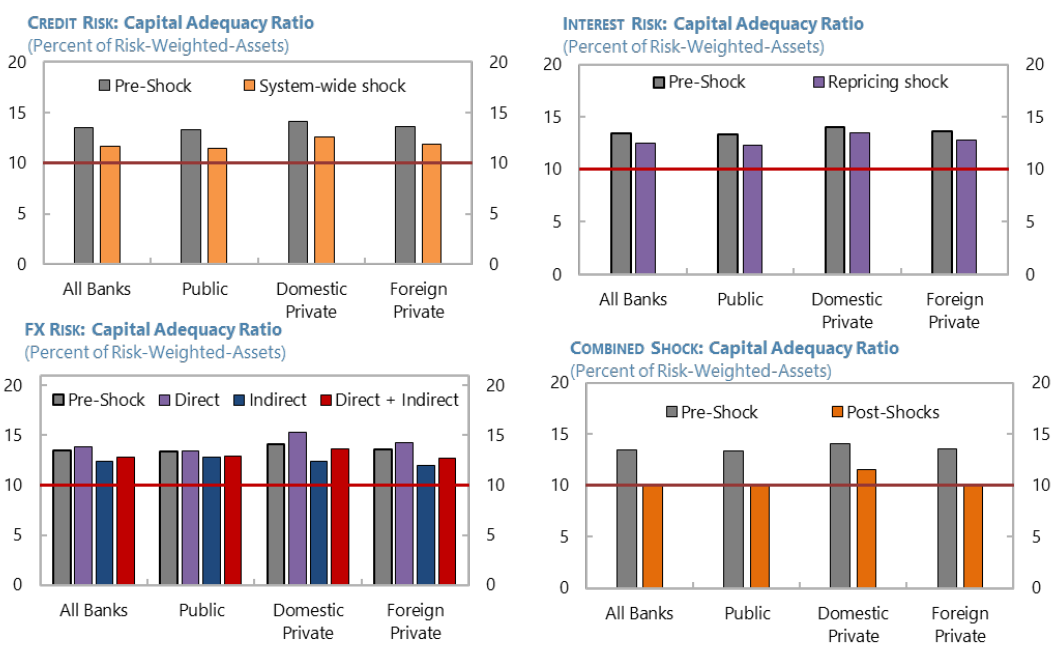
[1] The potential loss arising from the flow impact of a positive interest rate shock is small, as most banks have more short-term interest rate-sensitive assets than liabilities (i.e., assets can be repriced faster than liabilities).

Costa Rica: Summary of Banks' Solvency Stress Test Results

	All Banks	Public	Domestic Private	Foreign Private
Summary of Results				
Pre-shock CAR	13.5	13.3	14.1	13.6
Impact of: (in percentage points of the original RWA)				
Increase in NPLs	-1.8	-1.8	-1.5	-1.8
Increase in sovereign bond yields	-0.9	-1.1	-0.6	-0.8
Exchange rate depreciation	-0.6	-0.4	-0.5	-0.9
o/w: direct impact on banks' net open FX positions	0.4	0.1	1.2	0.7
o/w: indirect impact on NPLs	-1.1	-0.6	-1.7	-1.6
Change in CAR (combining all shocks)	**-3.4**	**-3.3**	**-2.5**	**-3.5**
Post-shock CAR (percent of post-shock RWA)	10.1	10.0	11.5	10.1

Sources: SUGEF and IMF staff estimates.
Notes: Tests conducted using data as of May 2020. Public banks include Banco Popular.

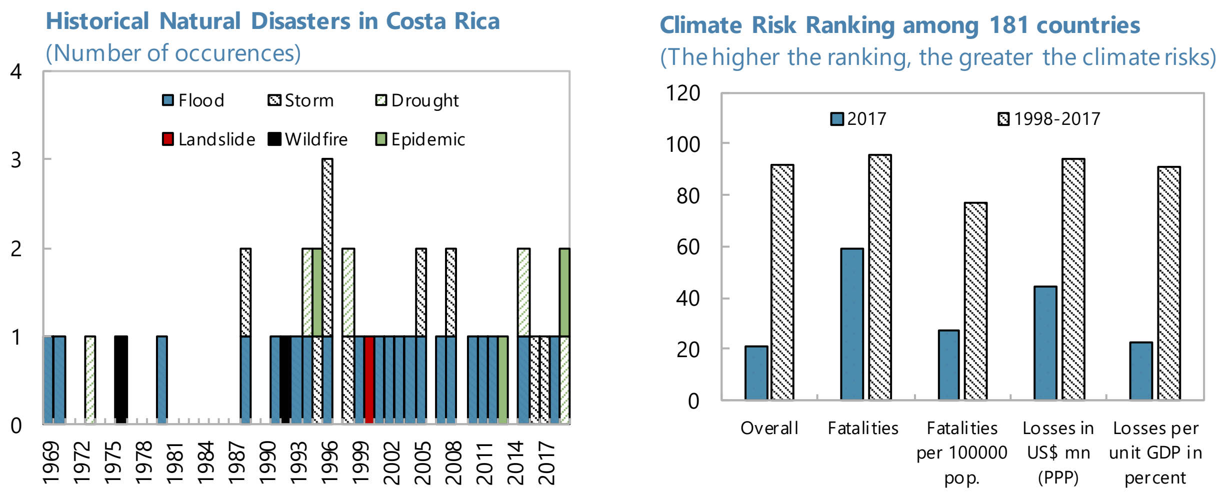
Costa Rica: Stress Test Results of Different Shocks



Annex IX. Costa Rica's Climate Change Response[1]

1. Located between two oceans, Costa Rica is highly vulnerable to climate change induced natural disasters. The UN Intergovernmental Panel on Climate Change identified Costa Rica as a hot spot for climate change with severe effects on ecosystems and livelihoods through a rise in sea levels, higher temperatures, and more frequent storms, droughts and floods, among other consequences. Climate-related natural disasters have occurred more frequently in recent decades, especially floods and tropical storms, with a significant bearing on the population and the economy.[2] As of 2017, Costa Rica is the 21st country with the highest risks from climate change worldwide, according to Germanwatch, much worse than in the previous two decades.

Costa Rica: Climate Change Risks



Sources: EM-DAT; Germanwatch; and IMF staff estimates.
Notes: Please refer to the *EM-DAT International Disaster Database* for the classification of natural disasters.

2. Significant climate change vulnerabilities translate into sizable human, social, and economic costs. According to the International Disasters Database, during 1969-2019, natural disasters, especially floods, droughts, and storms, have led to significant fatalities as well as social and economic costs in Costa Rica, with annual losses from these events averaging 0.4 percent of GDP and total people affected reaching about 35,000 per year, on average.[3] In a 2017 report, the Office of the Comptroller General warned about the impact of climate-induced extreme events on public finances; the estimated annual costs due to hydrometeorological and climate-induced events amounted to 0.3-1.7 percent of GDP over 1988-2010 and could reach up to 2.5 percent of GDP by

[1] Prepared in collaboration with Adrien Vogt-Schilb (IDB) and Diji Chandrasekharan Behr (WB).

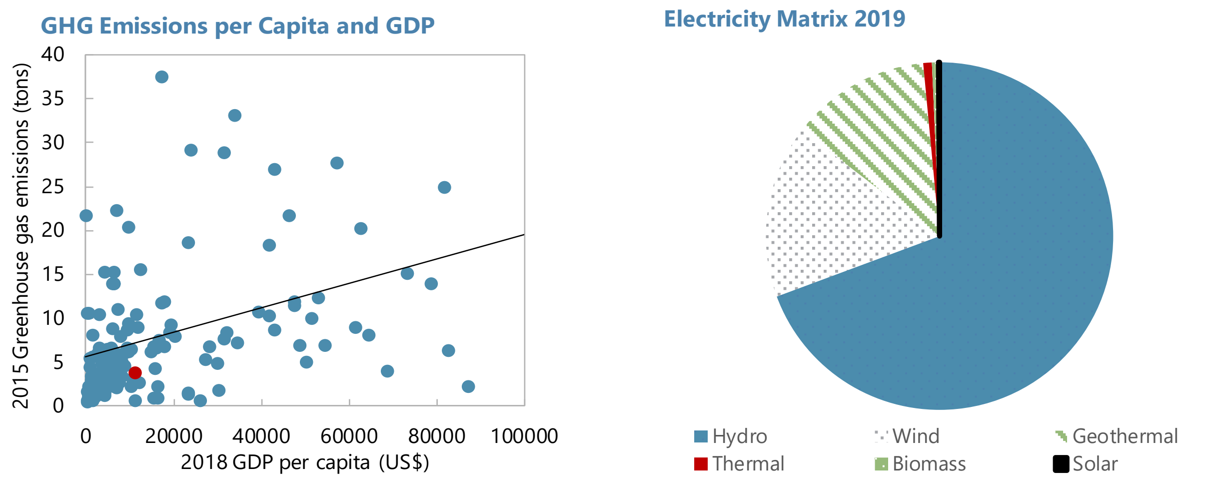
[2] *Climate Change Knowledge Portal: Costa Rica*, WB. Hydrometeorological events have also occurred with greater magnitude.

[3] The total cost may be higher as disasters occur mainly in places where the population is economically vulnerable.

2025.[4] Similarly, the National Commission of Risk Prevention and Emergencies (CNE) emphasized that 78.2 percent of the losses from hydrometeorological and geotectonic events over 2005-2011 related to public infrastructure.[5] Road infrastructure is the most affected sector, followed by electricity-generating infrastructure, and agriculture. Going forward, staff estimates based on the ENVISAGE model calibrated for Costa Rica suggest that global warming of +3°C, which is within the expected median global warming of 2.6°C to 3.1°C by 2100 considering current pledges globally, could reduce Costa Rica's GDP by more than 6 percent, primarily through the channels of tourism, heat effects on labor productivity, and agriculture.

3. Costa Rica has continuously facilitated climate change adaptation and strengthened disaster risk management. The National Adaptation Policy 2018-2030 and the Institutional Strategic Plan 2018-2022 aim at improving resilience in key areas, including infrastructure, tourism, and water resources management. In this context, the authorities are currently developing a roadmap to strengthen infrastructure resilience to climate change, considering both implementation costs and financing options, and disaster risk management, jointly with the WB. In the agricultural sector, Costa Rica launched an insurance scheme, which enhances financial resilience and promotes adaptation by allowing agricultural producers to insure their harvest against climate change risks, with lower premia for producers implementing adaptation measures. In addition, the authorities are collaborating with the WB to strengthen adaptation by increasing forest biomass and thereby enhancing resilience to tropical storms. Opportunities to further enhance disaster risk management arise from the possibility to strengthen financial risk protection, disaster recovery planning, and risk identification.[6]

Costa Rica: Greenhouse Gas Emissions and Gross Electricity Production



Sources: European Commission; Sistema Eléctrico Nacional; and IMF staff estimates.

[4] *Presión sobre la Hacienda Pública en un contexto de variabilidad y cambio climático: desafíos para mejorar las condiciones presentes y reducir los impactos futuros*, Contraloría General de la República.

[5] *Política Nacional de Prevención de Riesgos y Atención de Emergencias*. National Commission of Risk Prevention and Emergencies.

[6] *Index of Governance and Public Policy in Disaster Risk Management (iGOPP): National Report of Costa Rica*, IDB.

4. As regards Costa Rica's own mitigation efforts, greenhouse gas emissions in the country are low by international standards, although they have increased over time. At 2.6 tons per capita, Costa Rica has lower annual greenhouse gas emissions than other countries with a similar development level. The relatively low level of emissions can be attributed to the environmentally friendly economic model, with significant growth in sectors like sustainable tourism and hydropower generation, whereby almost 100 percent of the country's electricity stems from renewable sources. In addition, Costa Rica is the first tropical country to have stopped and reversed deforestation, with over half of its landmass covered by forest. Nonetheless, greenhouse gas emissions have been rising, particularly in the transport sector, which is responsible for over 40 percent of the country's gross greenhouse gas emissions according to the Ministry of the Environment and Energy (MINAE). Higher emissions in the transport sector can mainly be attributed to a large increase in the vehicle fleet, especially private vehicles, with an average age of 15 years.

5. Costa Rica's efforts to decarbonize its economy by 2050 make it a trailblazer in the global arena. In 2019, Costa Rica was named "Champion of the Earth" by the United Nations for its leadership in natural resource conservation and its ambitious National Decarbonization Plan 2018-2050[7], which lays out steps to transition to a zero net emission economy over the next three decades, in line with the Paris Agreement. The plan is structured along ten lines of actions and eight cross-cutting strategies in the economic areas with the highest greenhouse gas emissions in the country. It provides detailed short-, medium-, and long-term targets (Table). In addition, the national decarbonization strategy creates synergies with the Strategic Plan Costa Rica 2050 and the Territorial Economic Strategy for an Inclusive and Decarbonized Economy 2020-2050, which envisage a deep transformation towards a more competitive, equitable, and green economy. Several multilateral institutions support Costa Rica in the implementation of its ambitious decarbonization strategy, including CAF, the IDB, and the WB.

6. Decarbonization presents an economic opportunity, despite large upfront costs. Implementation of the National Decarbonization Plan requires large upfront investments, especially into infrastructure. A recent cost-benefit evaluation of the plan by the IDB considers 3,000 potential scenarios and consistently finds net economic benefits, amounting to US$40.9 billion over 2020-2050.[8,9] For the transport sector alone—which constitutes three of the ten lines of action under the plan—estimated financial net benefits over 2020-2050 amount to US$2.9 billion and to US$20.6 billion when positive effects in terms of reduced congestion, accidents, and local air pollution

[7] *National Decarbonization Plan*, Ministerio de Ambiente y Energía.

[8] Groves, David G., James Syme, Edmundo Molina Perez, Carlos Calvo, Luis Victor-Gallardo, Godinez-Samora, Guido, Jairo Quiros-Tortos, et al. (2020). *The Benefits and Costs of Decarbonizing Costa Rica's Economy*. Inter-American Development Bank and RAND Corporation.

[9] The estimated costs and benefits are discounted back to 2015 at an annual rate of 5 percent. If net benefits were discounted back to 2020, they would amount to $54.7 billion. In addition, the preferred scenario assumes a high and increasing level of decarbonization of forests over time. Thus, if forest decarbonization levels were to be lower than expected, net benefits would be lower.

Table AIX. 1. Costa Rica: Key Targets of the National Decarbonization Plan

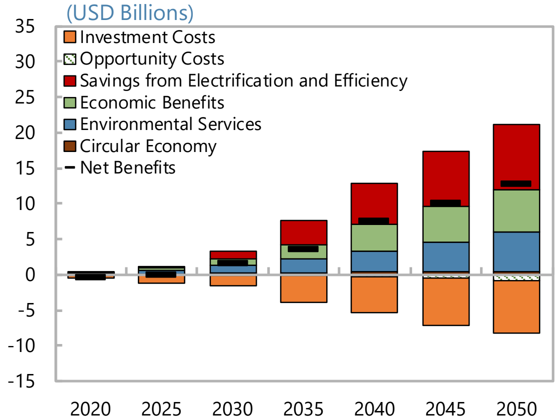
Line of action	2022	2025	2030	2035	2050
Public transport	- 8 main trunk lines in operation - At least one public transport mode operates with a system of integrated electronic payment			- 30% of public transport is zero-emissions	- 85% of public transport is be zero-emissions - Public transport replaces private vehicles as principal mobility option
Private transport	- Operate at least 69 fast recharge centers	- Stabilize growth of motorcylce fleet		- 30% of vehicle fleet is electric	- 95% of vehicle fleet is zero-emissions - There is an extensive network of electric charging and hydrogen fueling stations
Cargo transport	- At least one logistics pilot project operates under low-emission parameters		- 20% of cargo fleet operates with liquified peteroleum gas	- Adopt sustainable logistics models in principal ports and urban areas	- Cargo transport reduces emissions by 20% compared to 2018
Electric energy	- Develop 2 sectoral electrification strategies - Develop plan to promote investment in the electricity system		- National electricty mix 100% renewable		- Electricty is primary energy source for transport, residential, commercial, and industrial sectors
Construction		- 10% increase in use of wood, bambus, and other local materials in construction of buildings	- 100% of new buildings comply with emission standards and are climate-resilient		- 50% of residential, commercial, and institutional buildings comply with emission standards
Industry	- Publish 2 roadmaps for the reduction of emissions		- Develop cradle-to-grave strategy, encompassing production, distribution, and disposal of products for industrial sector		- Industrial sector consumes low-emission energy
Waste management	- Launch national composting strategy - Implement 4 pilot projects on a circular economy	- 10 municipalities implement national composting strategy			- Waste collection, recycling, reutilizacion, and disposal available for entire country - Restore 20% of rivers in GAM
Crop cultivation	- Implement 2 programs to reduce emissions - Offer 2 financial instruments to facilitate the transformation of producers		- Value chains for coffee, livestock, sugar cane, rice, and banana use emision-reducing technologies		- National production adopts advanced, low-emission technology
Livestock	- Launch education campaign - Implement pilot for utilization of agricultural residuals in the industrial sector		- Adopt low-emission technologies for 70% of livestock and 60% of areas dedicated to livestock		- National production adopts advanced, low-emission technology
Biodiversity and ecosystems	- Restore 3km of urban corridors - Implement programs to prevent illegal deforestation		- Increase national forest coverage to 60%		- 4,500 hectares of green areas function as recreational parks in the GAM

Source: *National Decarbonization Plan,* Ministerio de Ambiente y Energía.
Note: This table provides an overview of the key targets. More detailed information is available from the full National Decarbonization Plan.

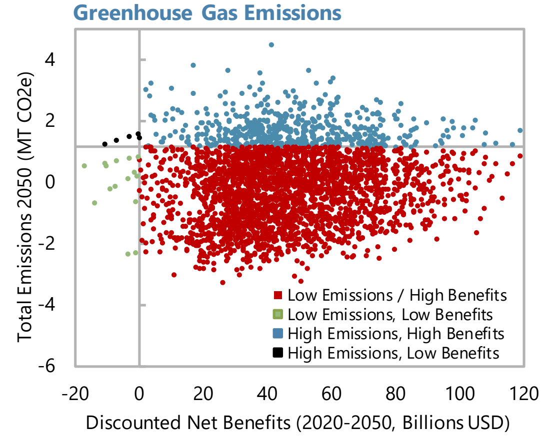
are considered.[10] Similarly, a recent assessment by the World Bank—based on an integrated model covering the energy, land (AFOLU), and water sectors—concludes the decarbonization target is achievable and would generate even larger cumulative net economic benefits of US$54.5 billion over 2020-2050.[11] To maintain fiscal sustainability and compensate for the loss of tax revenues related to the expected future reduction in gasoline and diesel consumption—currently accounting for about 10.7 percent of fiscal revenues— reforms of the taxation on fuels, vehicles and trucks could play an important role.[12] Likewise, decarbonizing the agriculture, livestock, and forestry sectors would result in larger yields and an increase in ecosystem services provided by forests, such as renewable forest products, water and soil benefits, and support for tourism and cultural heritage, with estimated net benefits of US$21.9 billion.[13]

Costa Rica: Benefits of Decarbonization and 2050 GHG Emissions Across Possible Future Scenarios

Undiscounted Benefits and Costs
(USD Billions)



Discounted Net Benefits and and 2050 Greenhouse Gas Emissions



Sources: Groves, et al. (2020).

7. **Costa Rica has also started integrating climate change considerations into other policy areas.** To ensure that trade policy supports the country's decarbonization goals, Costa Rica is currently negotiating an Agreement on Climate Change, Trade and Sustainability (ACCTS) with Fiji,

---

[10] Godinez, Guido, Luis Victor-Gallardo, Jam Angulo-Paniagua, Eunice Ramos, Mark Howells, Will Usher, Felipe De Leon, Andrea Meza, and Jairo Quirós-Tortós (2020). *Decarbonising the Transport and Energy Sectors: Technical Feasibility and Socioeconomic Impacts in Costa Rica*..

[11] When uncertainty is factored in, using Robust Decision Making, the current findings at the sectoral level show positive net economic benefits in the AFOLU sector, positive net economic benefits in the energy sector for most scenarios, and net costs under several scenarios in the water sector due to the cost associated with an increase in wastewater disposal infrastructure.

[12] Rodriguez Zúñiga, Mónica, Luis Victor-Gallardo, Jairo Quiros-Tortos, Edmundo Molina Perez, Silvia Charpentier, Martin Ardanaza, Marcela Jaramillo, and Adrien Vogt-Schilb (2020). *Evaluación Del Impacto Fiscal de Descarbonizar El Sector Transporte En Costa Rica y Opciones de Política Para Manejarlo – reporte interino (mimeo).* Inter-American Development Bank; International Energy Agency (2019). *Global EV Outlook 2019*.

[13] Groves, et al 2020.

Iceland, New Zealand, Norway, and Switzerland. The ACCTS' key areas cover market access for environmental goods and services, commitments to eliminate harmful fossil fuel subsidies, and the development of guidelines to inform the implementation of voluntary eco-labelling programs and mechanisms. The agreement will comply with WTO rules and will be open to adhesion for all WTO members that can meet the standards initially agreed on. In 2018 Costa Rica also launched a Green Growth Platform to promote the adoption of more sustainable practices in the export sector, a project which was awarded the "Best Initiative for Inclusive and Sustainable Trade" by the International Trade Centre, a joint WTO-UN agency. In addition, Costa Rica is currently taking steps to green its financial sector. In 2016 Costa Rica tapped the green bond market for the first time to finance climate-friendly infrastructure projects. Moreover, in 2019 the BCCR joined the Network for Greening the Financial System, which brings together a group of central banks and supervisors aimed at managing environment and climate risk in the financial sector. Likewise, the BCCR is exploring ways to consider climate change risks and opportunities in the design of monetary and financial policy, for example through greening international reserves, evaluating the financial sector's exposure to climate change risks, and supporting the transition to a decarbonized economy.

Appendix I. Letter of Intent

San José, February 10, 2021

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

Dear Ms. Georgieva:

As a result of long-standing policies focusing on economic openness, strong institutions, and investment in human capital, the Costa Rican economy has moved up the value chain and transformed itself from an agricultural-based economy to a knowledge-intensive service-oriented one. More recently, Costa Rica has undertaken wide-ranging structural reforms to align our public governance structure and policies to international best practices and foster transparency, efficiency, and growth. Many of these reforms were adopted as part of the accession process to the Organization for Economic Cooperation and Development (OECD). Our structural reform agenda has also been underpinned by a strong commitment to fighting climate change. Recognizing the large fiscal imbalances facing our country, we deployed strong efforts to restore fiscal sustainability, including through the passage of a comprehensive fiscal reform bill in December 2018. We have also made significant progress in strengthening the monetary and exchange rate policy frameworks and improving financial sector regulation and supervision.

However, the COVID-19 crisis has hit the Costa Rican economy hard. In our letter of intent dated April 22, 2020, where we requested emergency assistance from the IMF under the Rapid Financing Instrument, we explained how the Government of Costa Rica had taken proactive measures to protect our population's health and support our economy, including strict containment measures, a tax moratorium, and targeted subsidies to the vulnerable. The rapid support from the IMF, of SDR 369.4 million (100 percent of quota) approved on April 29, 2020, provided emergency relief to our population and helped ease the strain on our health sector. Since then, we have continued to take measures to protect lives and livelihoods and limit the impact of the crisis on our economy. Nevertheless, the COVID-19 crisis has generated a large economic impact and balance of payments gap, amid a sharp drop in global activity and tight financial conditions for emerging markets with high debt levels. The shock has put further stress on our already-stretched public finances, despite the introduction of compensatory fiscal measures to contain the increase in public debt. Moreover, the crisis has led to sizable job losses, against an already-high level of unemployment, especially among women and the young.

Against this background, we have put together an economic program to secure macroeconomic stability and deliver an inclusive and sustainable recovery from the COVID-19 shock.

Our policy and reform efforts are anchored around three main pillars: (i) gradually implementing equitable fiscal reforms to ensure debt sustainability, while protecting the most vulnerable; (ii) maintaining monetary and financial stability, while continuing to strengthen the central bank's autonomy and governance and addressing structural financial vulnerabilities; and (iii) advancing key structural reforms to promote inclusive, green, and sustainable growth. Our program strategy builds on a broad-based political and social dialogue focused on the reform agenda.

In support of Costa Rica's economic program, we request a 36-month Extended Arrangement under the Extended Fund Facility (EFF) from the IMF totaling SDR 1,237.49 million (335 percent of quota and equivalent to about US$1,750 million) to be provided for direct budget support. Together with financial assistance from other international financial institutions, the arrangement under the EFF will help address our financing needs and support a smooth economic recovery, while providing a policy anchor to our fiscal consolidation plans for the period needed to achieve a primary surplus and place debt on a secure downward path.

The attached Memorandum of Economic and Financial Policies (MEFP) sets out the specific plans and economic policies that we intend to implement under our Fund-supported program. The implementation of the program will be monitored through semi-annual quantitative performance criteria and structural benchmarks and quarterly indicative targets, as described in the MEFP and in the attached Technical Memorandum of Understanding (TMU). There will be five semi-annual reviews of the arrangement by the Fund to assess progress in implementing the program and reach understandings on any additional measures that may be needed to achieve its objectives. The government and the Central Bank of Costa Rica (BCCR) will provide the Fund with the data and information necessary to monitor performance under the program, including those specified in the TMU.

We believe that the policies set forth in the attached MEFP are adequate to meet the objectives of our economic program. However, we stand ready to take additional measures as appropriate. We will maintain close communication and consult in advance with the Fund on the adoption of new measures or revisions of the policies contained in the MEFP and in this letter, in accordance with the Fund's policies on such consultations.

We completed a safeguards assessment in October 2020 and we are committed to implementing the associated recommendations, as specified in the MEFP. We have also updated the existing Memorandum of Understanding between the BCCR and Ministry of Finance that clarifies the responsibilities for timely servicing of the financial obligations to the IMF.

We are profoundly grateful to the IMF for the strong and timely support to Costa Rica during the pandemic, and look forward to continued close cooperation under the EFF.

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

Sincerely yours,

/s/

Rodrigo Cubero
President, Central Bank of Costa Rica
Governor of the IMF

/s/

Elian Villegas
Minister of Finance

Attachments (2)
Memorandum of Economic and Financial Policies
Technical Memorandum of Understanding

Attachment I. Memorandum of Economic and Financial Policies

1. **Our economic program aims at securing macroeconomic stability, while fostering an inclusive and sustainable recovery from the pandemic.** Our policy and reform efforts will be anchored around three main pillars (i) gradually implementing equitable fiscal reforms to ensure debt sustainability, while protecting the most vulnerable (ii) maintaining monetary and financial stability, while continuing to strengthen the central bank's autonomy and governance and addressing structural financial vulnerabilities, and (iii) advancing structural reforms to support inclusion, while boosting labor productivity, under our strong commitment to fighting climate change. These broad-based efforts will help support inclusive, green, and sustainable growth in Costa Rica over the medium term.

I. MACROECONOMIC OUTLOOK

2. **The pandemic has taken a heavy toll on our economy.** Prior to the COVID-19 shock, macroeconomic conditions were broadly stable, although the fiscal situation remained fragile, with a high fiscal deficit and rising public debt, which had contributed to slow growth since 2016. Against that context, the pandemic hit the Costa Rican economy hard. The global economic slowdown and the necessary domestic containment measures have severely impacted growth and the already weak fiscal accounts, generating sizable balance-of-payments needs. The economic recovery is expected to be gradual, due to the lasting economic impact of the pandemic, including through lower tourism inflows, weakened private sector balance sheets, and precautionary saving behavior due to large uncertainties, as well as the fiscal consolidation needed to secure public debt sustainability. As a result, real GDP is projected to grow by 2.6 percent in 2021 and return to its pre-COVID level only in late 2022. Over the medium term, economic growth is expected to reach its potential of around 3 percent. Weak demand and subdued import prices are expected to keep inflation at the lower end of the target band in the near term. Despite the phased reopening of the economy, tourism receipts, an important source of income in the balance of payments, are expected to recover only slowly in the coming years, widening the current account deficit, amid weak foreign direct investment.

II. FISCAL POLICY

Fiscal Stance

3. **The main priorities of fiscal policy are advancing our efforts to secure debt sustainability, while meeting critical social and sanitary needs and supporting the recovery.** Costa Rica's fiscal balance deteriorated sharply over the past decade, due to a permanent increase in current spending following the global financial crisis. Recognizing the pressing fiscal and financing challenges facing our country, the Government promoted a comprehensive fiscal reform bill to rein in spending and strengthen revenue. This reform, approved by the Legislative Assembly in December 2018, put public debt on a declining trajectory over the medium term, mostly by forcing a significant decline in spending as a share of GDP. The economic contraction caused by the pandemic, however, has made an additional fiscal adjustment necessary to keep debt at manageable levels. We are committed to pressing ahead with the required fiscal consolidation, while

continuing to protect the vulnerable and supporting a sustainable economic recovery. Accordingly, we cut non-critical primary spending in 2020, and will implement additional income and expenditure measures in the next three years, with a view to reaching a primary balance of 1 percent of GDP by end-2023 and reach a debt-to-GDP ratio of 50 percent by 2035.

4. The 2018 reform represented a major milestone towards debt sustainability through strict and comprehensive spending limits and a more efficient and fair taxation system. The 2018 fiscal reform included tight restraints on public sector remunerations taking effect in 2019 and a fiscal rule tying down spending growth starting in 2020. Also, from July 2019, the reform introduced a full-fledged VAT to replace the General Sales Tax. The new VAT taxes services fully while allowing for a proper crediting system. Income taxation was also strengthened mainly through: (i) globalization and harmonization of capital income and gains tax at a 15 percent rate since October 2019; (ii) phasing-in of new rules for corporate income taxation (CIT), including anti-tax haven rules, anti-BEPS measures, thin-cap rules, and loss carry-forward among others as of January 2020; and (iii) further progressivity in personal income taxation (PIT) with additional brackets of 20 and 25 percent for employment income, since October 2019.

5. The COVID-19 shock hit the country as our fiscal adjustment efforts were just starting to bear fruits, benefiting from the 2018 fiscal reform. Despite some initial adjustment efforts in 2019, the fiscal deficit continued deteriorating to 6.8 percent of GDP (calculated using the rebased GDP), weighing on our debt and financing outlook. To reassure markets of our commitment to fiscal discipline, we proposed to the Legislative Assembly additional fiscal measures in early February 2020. These included measures to improve tax administration and collection, consolidate public institutions and streamline public wage scales, and reduce debt through asset sales and financial surpluses of decentralized public entities. Nevertheless, the deep decline in revenues prompted by the COVID-19 crisis, amid increased critical medical, social, and economic needs, has significantly impacted the 2020 fiscal accounts.

6. In 2020, our fiscal stance was a balancing act between addressing the health, social, and economic effects of the crisis and maintaining fiscal sustainability:

- ***2020 budget.*** The 2020 budget adopted by the Legislative Assembly in November 2019 envisaged a central government (CG) deficit of 7.8 percent of GDP based on conservative revenue projections, without considering the impact of the tax reforms approved in 2018. At the time of the budget approval, we already expected to overperform on the original budget, with an updated fiscal deficit projection of 5.9 percent of GDP, as published in the BCCR's January 2020 Macro Program. The projection reflected expected under-execution of expenditure and the impact of the tax reforms approved in 2018 and taking effect from mid-2019. The 2020 budget was the first budget to apply the new spending limits under the fiscal rule. Thanks to the initial phase of implementation of the fiscal reform, our fiscal deficit more than halved in February 2020, compared to the same period in 2019.

- ***2020 first supplementary budget.*** The macro-economic outlook worsened dramatically since mid-March due to the outbreak of the COVID-19 virus, accompanied by sharp revenue shortfalls, requiring approval of a supplementary budget in April. In response to the critical needs prompted by the pandemic, we: (i) approved a three-month moratorium on the payment of VAT, business income taxes, and customs duties; (ii) granted a temporary reduction (for six months) of 25 percent in the minimum tax base for health and pension contributions; (iii) triggered the escape clause under the fiscal rule to allow higher spending by the Institute of Social Assistance (IMAS), the Ministry of Labor and Social Security (MTSS), the Costa Rican Research Institute in Health and Nutrition (INCIENSA), police and firefighters corps; (iv) launched the Bono Proteger program to provide a monthly subsidy of CRC 125,000 (about US$205) for three months to about 375 thousand families economically affected by the crisis with a monthly income of less than CRC 750,000 prior to COVID-19; and (v) deferred the roll-out of the VAT on construction and tourism services. The above-mentioned temporary measures were partly offset by the freezing of the basic wage for public employees in 2020, except for law enforcement and healthcare workers. This implied a fiscal deficit of 8.1 percent of GDP, as envisaged in the budget at the time.

- ***2020 second, third, and fourth supplementary budgets.*** In July and November 2020, the Legislative Assembly approved three additional extraordinary budgets, in view of the sharper (than initially expected) revenue shortfalls and the need for additional social spending and transfers to the social security fund to compensate for lower contributions. The budgets envisaged a package of offsetting revenue and spending measures to contain the widening of the fiscal deficit and risks to debt sustainability, including: (i) freezing the domestic retail price for premium gasoline as of March 4, 2020 and transferring the higher proceeds of CRC 16 billion from RECOPE to the CG; (ii) transferring to the budget about CRC 75 billion of excess capital from the National Insurance Institute (INS); (iii) freezing 4,953 public sector vacancies along with the initiation of new public investment projects and eliminating 2,194 positions; (iv) transferring CRC 74 billion to the Social Security Fund to compensate for the lower social security contributions and higher expenses due to the COVID-19 crisis (of which, about CRC 31 billion was delayed to 2021); (v) paying a COVID-19 vaccine down payment of CRC 7.2 billion; and (vi) spending cuts in goods and services and capital. In addition, in November, the Legislative Assembly approved a temporary reduction of up to 50 percent in the ownership tax on transport vehicles depending on their taxable value as a COVID-19 relief measure, which was expected to lead to a revenue loss of CRC 52 billion in 2020 and CRC 18 billion in 2021. CG revenue collection declined by 11 percent (or 1.6 percent of GDP, using rebased GDP hereafter) compared to 2019 levels. This revenue shortfall was partly offset by spending compression at the CG level by 2.5 percent (or 0.6 percent of GDP) compared to 2019. The primary deficit is estimated to have reached 3.9 percent of GDP and the headline fiscal deficit to reach 8.7 percent of GDP in 2020 for the consolidated CG, including public entities that are consolidated under the CG from 2021 onwards, as required by Law 9524.

7. Our fiscal consolidation efforts in 2021 target a primary deficit of 1.7 percent of GDP. The 2021 budget, approved by the Legislative Assembly in November, with our commitment to a 94 percent execution rate of current non-interest expenditure, implies a CG primary deficit of 2.2 percent of GDP, broadly consistent with what is envisaged by law under the fiscal rule. To support debt sustainability and underpin the program targets for 2021-23, we have also submitted to the Legislative Assembly two comprehensive fiscal reform packages in December 2020 and January 2021, which benefited from a broad-based political and social dialogue, including additional measures for 2021 and outer years as detailed in this section. Accordingly, as tax revenues gradually recover in 2021, our structural adjustment in 2021, net of one-offs, will be underpinned by the following revenue and expenditure measures:

- ***Tax measures***. The implementation of the 2018 tax reform will continue to generate yields for about 0.1 percent of GDP in 2021 through: (i) the half-year impact of the 4 percent VAT on construction-related and tourism services, whose implementation was postponed from mid-2020 to mid-2021; (ii) the full-year impact of the new 1 percent VAT on the basic food basket and of the 13 percent VAT on cross-border digital services; (iii) the first CIT annual return under new anti-avoidance rules (e.g. anti-tax haven rules, anti-BEPS measures); and (iv) the scheduled rate increase in the capital income/gains tax for interests from Banco Popular y de Desarrollo Comunal, yields from Cooperatives' securities and profit distributions from Cooperatives. In addition, the fiscal reform package submitted in December to the Legislative Assembly will introduce new revenue measures expected to take effect in mid-2021 with cumulative annual yields of 0.5 percent of GDP by end-2023, by (i) removing the income tax exemption for prizes from the national lottery and the 14th month salaries for public sector employees; (ii) bringing forward the harmonization of capital gains and income tax at 15 percent; and (iii) increasing withholding tax rates on non-resident incomes by 5 percentage points (family and personal remittances are exempted). Additional fiscal measures with cumulative annual yields of 0.7 percent of GDP by end-2023 has been submitted in late January and early February (i) amending existing legislation to allow for distribution of dividends by SOEs to the CG; (ii) further globalizing personal income tax including by reducing the tax-exempted threshold from CRC 10 million to CRC 8.2 million; and (iii) replacing the current solidarity property tax (with a tax rate of 0.25-0.55 percent on properties with value over CRC 133 million) with a new luxury immovable property tax (with a single rate of 0.5 percent on properties with value over CRC 150 million), together with (iv) compensatory social transfers to the poorest deciles of the population (see the next bullet).

- ***Spending measures***. To gradually advance debt reduction while meeting critical spending needs, in line with the fiscal rule and the 2021 budget approved last November, we are further containing the expenditure envelope in 2021. Accordingly, the expected annual growth of current spending will be 4.1 percent (against the 2020 spending base after excluding emergency spending), in line with the fiscal rule requirements. The savings in non-interest expenditures are estimated at 1.3 percent of GDP in 2021, net of additional allocations to social programs, and include (i) continued wage constraints imposed by the 2018 fiscal reform; freeze in base salaries, annuities, and new hiring; and elimination of all vacancies; (ii) annual nominal reduction of temporary wage components (overtime etc.) by 8.5 percent; (iii) freeze in pensions of public sector retirees and current transfers to the public sector excluding CCSS transfers; (iv) cut in non-pension private transfers, non-CCSS public transfers, and transfers with external resources; (v) annual nominal reduction in spending on goods and services by 7.5 percent; and

(vi) temporary cuts in capital spending due to delays and reprioritization of capital projects. All these spending measures will be applied over 2021-25. Given that the debt to GDP ratio exceeded 60 percent in 2020, in line with the fiscal rule, our expenditure projections also consider bringing forward the freeze in basic wage and accrual of annuities foreseen beyond 2025. Moreover, the Legislative Assembly approved in January resource allocations for the one-off purchase and distribution of a COVID-19 vaccine for 0.1 percent of GDP. The fiscal reform package also proposes targeted compensatory measures to avoid the budgeted decline in social assistance spending in 2021 due to lower earmarked revenue (0.1 percent of GDP) and support the poorest and most vulnerable for an additional 0.1 percent of GDP, with this latter amount to be channeled through the social assistance programs with the best targeting, i.e., non-contributory pensions, childcare network, and CENCINAI. The 2021 compensatory transfer to social programs will be financed by a one-off reduction in election spending (about 0.1 percent of GDP). We remain committed to staying current on all our payment obligations and not accumulating any spending arrears.

- **Given the high degree of uncertainty related to the COVID-19 crisis and economic recovery, our program has built in flexibility to deal with unforeseen shocks.** Ongoing improvements in tax and customs administration are expected to support revenue yields in the course of 2021. Nevertheless, were revenues to underperform, we will propose to the Legislative Assembly temporary tax measures, and reprioritize non-critical spending as needed to ensure the primary target goal remains within reach, as already planned in the President's order issued in early January which envisages a prudent level of spending execution, with a maximum annual growth limit of 0.51 percent of CG current transfers, net of COVID-19 emergency spending. However, in the event of additional COVID needs, due to a more protracted pandemic, the program targets also allow for an adjustor to accommodate increased COVID-19 emergency spending for up to 0.3 percent of GDP in 2021—that might emerge from increased transfers to attend health services, stronger targeted support to households and businesses heavily affected by the pandemic, or further enhanced social assistance programs to support the most vulnerable groups. On the upside, should the economic recovery take hold faster than expected, we are committed to locking in any revenue over-performance to accelerate our debt reduction plans.

8. We will further advance our fiscal consolidation efforts over the medium term to secure debt sustainability, while making space for critical infrastructure and social needs. Additional structural measures will be needed over the medium term, in line with our primary fiscal targets under the program. These adjustment will be underpinned by the full-year impact of the new revenue measures included in the fiscal reform packages submitted in December and January to the Legislative Assembly as well as the continued yields of the already approved expenditure measures that will remain in place over the medium term (MEFP ¶7), which are broadly consistent with what is envisaged by law under the fiscal rule. In addition, our ambitious reform of public-sector employment (MEFP ¶11) will further support our commitment to keeping nominal spending growth low, while modernizing and strengthening our social safety net. Expected efficiency gains and greater revenue mobilization from the modernization of the tax and custom administration (MEFP

¶10) and PFM reforms (MEFP ¶12), together with our planned asset sale program, provide important upsides to our ability to tackle our current debt and financing challenges faster than expected under the program, thereby supporting macro stability and growth.

Structural Fiscal and Debt Management Reforms

9. We plan to take further steps to strengthen price incentives to support our climate change response through revenue instruments. Costa Rica has pledged to reduce greenhouse gas emissions to a net absolute maximum of 9.11 million tons of carbon dioxide equivalent (CO_2e) for 2030, a maximum net emissions budget in the period 2021 to 2030 of 106.3 million tons of carbon dioxide equivalent (CO_2e). It has also pledged to achieve zero net emissions by 2050 (MEFP ¶32). As part of our efforts to strengthen price incentives, we will start developing a revenue-neutral feebate scheme to promote low-emission vehicles comprising a sliding scale of fees to vehicles with above average emission rates and a sliding scale of rebates to vehicles with below average emission rates, and re-structuring annual taxes on used vehicles to include a revenue-neutral feebate component related to local air emission rates for accelerating retirement of older, more polluting vehicles (excluding farm vehicles), in conjunction with the current tax on vehicle value. These measures will aim to ensure the least impact on the lowest quintiles of the population. Other efforts to strengthen price incentives include updating and expanding the current Payment for Environmental Services scheme to support payment for ecosystem services beyond carbon sequestration, to support more types of carbon sequestration (including blue carbon and organic carbon in soils) and the launching of the Costa Rican Offset Mechanism (MCCR) to replace its existing "Mercado Doméstico de Carbono."

10. We are committed to stepping up our efforts to strengthen revenue administration to support our fiscal consolidation plans. Since 2018, we have taken steps to strengthen tax collection by enforcing electronic invoicing, deploying new audit programs, and improving our framework for tax information exchange with other jurisdictions. Building on the 2019 Tax Administration Diagnostic Assessment Tool (TADAT) assessment, we are committed to adopting a compliance risk management approach, revamping taxpayer services, and improving the collection of tax arrears. On the customs side, apart from proposing a new Customs Law, we expect to continue promoting trade facilitation to help increase productivity growth in trade-related sectors and sustain revenue collection through the implementation of risk-based post-clearance audits. To reduce VAT and CIT compliance gap levels below 30 and 60 percent of potential collections, respectively, we plan to refocus our anti-tax evasion efforts towards enforcement of recently approved tax reforms. The Tax Commissioner will approve a new Compliance Improvement Plan by end-December 2021 (**structural benchmark**), with compliance strategies underpinned by more robust large-scale automated-information cross-matching to detect inaccurate reporting and revamped audit programs focused on VAT on services and erosion of CIT bases through cross-border transactions (BEPS). We will further enhance our information-driven enforcement capabilities by end-December 2022 through a tax and customs coordinated risk management approach and an effective use of corporation shareholders and beneficial owners' registers, automatic exchange of information on financial accounts (CRS) and Country-by-Country (CbC) reports. Additional revenue administration efficiencies are expected from the MOF's digital transformation plan "Hacienda Digital para el Bicentenario", supported by the WB, which will upgrade tax and customs procedures and information systems.

11. We will rationalize and improve the efficiency and quality of government spending. Beyond what was already mandated by the December 2018 reform, there is significant scope for further rationalizing the public wage bill, bringing it back on a sustainable path after its excessive expansion over the last 15 years. We are also committed to enhancing the targeting accuracy and delivery of our social protection programs, leveraging on digitalization. As approved under the 2018 fiscal reform, we will effectively reallocate spending away from legally mandated destinations (with the exemption of those mandated by the Constitution), if the debt-to-GDP ratio is above 50 percent of GDP.

- ***Public employment reform.*** In addition to the efforts to contain the wage bill (MEFP ¶9), we will implement the structural reform of public employment envisaged under the Public Employment Bill, which is currently under discussion and expected to be approved by the Legislative Assembly by end-May 2021 (**structural benchmark**). This bill seeks to modernize and streamline the public administration, bringing the public wage bill on a sustainable path, in line with OECD recommendations. The reform will enhance fairness and productivity by replacing the current salary system, which indiscriminately rewards seniority and civil-service exclusivity, generating perverse incentives for public servants. The new regime adopts a single pay spine with eight job families, consolidating within the single salary other wage supplements such as annuities, bonuses, incentives, and others. It applies to all public sector institutions: central government, decentralized institutions, SOEs that do not compete in private markets, public universities, municipalities, as well as autonomous and semi-autonomous institutions. The new regime will apply directly to new hires. It also foresees a mandatory transitional rule for existing workers with salaries below their corresponding job family's salaries to converge gradually to the single pay spine. The reform will entail a gradual rationalization of the wage bill over the medium to long term, with average annual savings during the first 10 years estimated at around 0.5 percent of GDP for the central government and at 0.1 for the rest of the public sector. The Public Employment Bill foresees that new hiring under the new rules will start no later than twelve months after its entry into force. The law also introduces a limit of 20 days for vacations and establishes principles for separation and non-salary incentives for good performance.

- ***Social assistance***. Although Costa Rica devotes important resources in its budget to fighting poverty, social assistance programs continue to suffer from weak coverage and targeting. The delivery system is highly fragmented with different entities engaging in social assistance activities, with weak public financial management and transparency. Following the results of the 2019 hackathon, co-organized with the IMF, we will centralize and digitalize the payment system for all the cash transfer social assistance programs at the MOF's National Treasury by end-December 2021 (**structural benchmark**), in coordination with social assistance units. This measure is expected to reduce the payment processing time needed to reach the final beneficiaries from 3-5 days to just 24 hours, while contributing to improved beneficiaries´ experience and government efficiency. To enhance the targeting accuracy of our social safety nets, with the support of the WB, we will also strengthen by end-December 2021 the role of SINIRUBE (Sistema Nacional de Información y Registro Único de Beneficiarios del Estado) as the main instrument to target social protection benefits and services, which will also contribute to a more harmonized framework for inter-institutional coordination. In addition to boosting inclusiveness, these two measures will improve spending efficiency, supporting other fiscal consolidation efforts.

12. We will continue to improve public financial management (PFM) to ensure proper implementation of our fiscal rule. We will publish by April 2021 a first Medium-Term Fiscal Framework (MTFF)— before the approval of budget ceilings—covering initially only the CG. It will provide macro-fiscal forecasts for 2022-2025, improving the credibility of the budget process and presenting a coherent fiscal strategy in line with the fiscal rule. Its preparation will be centralized under a macroeconomic analysis team in the MOF, with support from IMF TA. After some pilot studies, we will publish a MTFF covering the entire Non-Financial Public Sector by end-April 2022 (**structural benchmark**), one year ahead of the deadline established by the Fiscal Responsibility Law. That MTFF will also include a more robust analysis of fiscal risks, including detailed information on public debt, SOEs, debt guarantees, contingent liabilities, concession contracts, risks from natural disasters, financial institutions, municipal governments and social security and health. The MOF and the Comptroller's Office will continue working together along the entire budget cycle to ensure compliance with the fiscal rule. The new Fiscal Council, whose competences were established by Executive Decree N. 41937-H in August 2019 as an independent observer of the state of public finances, will become fully operational, with the publication of the first public assessment of the government's fiscal strategy in 2022. We have recently resumed our efforts to reduce budget fragmentation, with the consolidation under the CG budget from 2021 of all public entities, as required by Law 9524 of April 2018. Further enhancements on budget consolidation will be analyzed as part of the public sector reform. Additional expenditure administration efficiencies are expected from the MOF's digital transformation plan "Hacienda Digital para el Bicentenario", supported by the WB, which will modernize and integrate our PFM information systems to better align expenditure policies across core PFM entities, planning and spending units.

13. We are modernizing our public procurement processes. In accordance with the Social Dialogue's agreements, we will enforce use by all procuring entities of the electronic platform Sistema Integrado de Compras Públicas (SICOP). The reform aims at generating potential fiscal savings through better prices, lower transaction costs and improved capacity and expertise. Our efforts will benefit from the Public Procurement Bill recently submitted to the Legislative Assembly, developed by the Comptroller's Office, with inputs from the OECD, which introduced a sound regulatory and institutional framework for managing and implementing umbrella contracts for goods and services, eliminating past exceptions to public bidding processes and increasing competition for government contracts. To promote further transparency and accountability, the bill contains specific provisions related to the collection and publication of beneficial ownership information. Upon its approval, we plan to implement this reform by updating appropriate administrative regulations by end-December 2021, to require that any bidder also disclose its beneficial owners when submitting the certified (by notary public) statement of its shareholders composition as part of its registration process.

14. We will also continue to foster transparency and adhere to best practices in the procurement and contract awards of any COVID-related spending. The Comptroller's Office has developed a Fiscal Transparency Portal for COVID-19, with published information on public purchases and audit results on the use of emergency assistance, while the Ministry of Labor and Social Security also manages a transparency portal on the Bono Proteger program, which includes the list of beneficiaries, statistics, and reports. Moreover, MIDEPLAN will launch by end-December 2021, with IDB support, a revamped Transparency Portal with the intention of disseminating CG's COVID-related spending, including data on public purchases by SICOP, IMAS, MTSS, CNE, and SINIRUBE, among others. The data published in the Portal will include information by vendors, including beneficial owner information, as well as the final amount of each procurement process. We will also continue carrying out specific audits on emergency cash transfers to ensure related funds are used properly and publish them in the Portal. Beyond COVID-related spending, we are also enhancing SICOP's functionalities to offer open data on public procurement.

15. We are committed to improving governance and increasing transparency in SOEs. Although SOEs play a dominant role in many key sectors of the economy, such as electricity, telecoms, transportation, banking and insurance services and petroleum products, many of them present data reporting weaknesses, constraining full assessments of their balance sheets and potentially hiding risks to fiscal finances and taxpayers. To foster greater transparency in line with international standards, we are committed to accelerating full adoption of International Financial Reporting Standards (IFRS) by SOEs, starting with the publication of the 2020 financial statements of ICE (Instituto Costarricense de Electricidad), AyA (Acueductos y Alcantarillados) and CNP (Consejo Nacional de Producción) according to IFRS, by end-December 2021 (**structural benchmark**). We also plan to gradually publish financial statements according to IFRS standards for the rest of the non-financial SOEs, with three additional SOEs by end-December 2022. We will also continue publishing an aggregate report on SOEs performance now on an annual basis. Starting with the FY2020 report to be published by December 2021, we will expand its coverage to include updates on the implementation of state ownership policy, dividends policy, overall financial performance and values, total employment, cost and funding of public policy objectives, and other SOE-related issues. With support from the OECD and WB, we are committed to bringing their public procurement within the SICOP, limiting the use of exceptions for direct public procurement, and gradually eliminating regulations that grant them the right to withhold confidential information. While Costa Rica's energy companies do not receive transfers from the central government, there is significant scope to improve their efficiency to support the country's productivity, notably through a reduction in electricity prices. During the last year, the Costa Rican Institute of Electricity has been implementing an efficiency strategy to reduce electricity prices. This strategy includes actions such as reducing operative costs, restructuring debt, and implementing the IFRS. These efforts were reflected in tariff reductions of 17.86 percent, 14.05 percent, and 1.48 percent in generation, distribution, and transmission, respectively. The Government is committed to advance this efficiency strategy through further debt restructuring and cost reduction in order to achieve lower and more competitive tariffs.

16. We have launched a comprehensive reform of debt management. To contain the risk of rising debt levels, the President of Costa Rica and the Minister of Finance approved in 2019 a Debt Policy for the Public Sector (Executive Decree 41935-H), which establishes solid guidelines for public institutions to put debt on a sustainable path in the long term. The rising levels of public debt and financing risks amid the COVID-19 crisis have highlighted the urgent need to diversify sources of fiscal financing and better manage the outstanding debt stock. Going forward, our reform agenda will center on three pillars: institutional reforms, medium-term strategy, and domestic market development. Specifically:

- ***Institutional debt management reforms***. We have recently established a Debt Committee, comprising the Treasury, the Public Credit Department (DCP), and the Macroeconomic Analysis Unit of the Ministry of Finance as well as the BCCR, to provide strategic guidance and oversee inter-agency coordination of policy decisions related to government debt. Going forward, we will structure the operational responsibilities of the DCP and the National Treasury along the front, middle, and back-office functions in line with best international practice and further improve transparency and reporting of public debt by end-June 2021. Finally, as the individual approval of external loans creates additional burden on debt management, we will liaise with the Legislative Assembly to seek a general authorization for external borrowing consistent with the approved annual budgetary and borrowing limits and debt management strategy (see below). As in the case of Laws 7970 and 9070 of 1999 and 2012, respectively, the general authorization will provide the government with greater flexibility for international issuances or official loans.

- ***Medium-term debt management strategy (MTDS).*** We will update our MTDS, with support from the IMF and WB, and publish it by end-April 2022 (**structural benchmark**). For the first time, the report will also cover government's contingent liabilities, especially guarantees provided to state-owned companies. Furthermore, we will publish and adhere to Annual Borrowing Plans and Quarterly Issuance calendars consistent with the MTDS. Meanwhile, we will strengthen the accounting and budget execution processes of public debt payments at the MOF to improve debt data monitoring and budget control.

- **Domestic market development**. We will improve the functioning of the primary market and markets operating under the principle of market concentration (Article 23 of Law of the Securities Market) by focusing our issuance on standard fixed-rate bullet bonds of select maturities. Open bond windows and bilateral bond sales will be gradually phased out. We will reform the auction mechanism for Treasury to become a price-taker in bond auctions to improve the price discovery process and form a technical pricing committee to develop guidelines for pricing methodologies. We will further encourage non-resident participation in our debt market by easing regulatory barriers and harmonizing the tax regime for non-resident investors, subject to macroprudential considerations. We will continue to make active use of liability management operations to reduce the rollover risks associated with debt maturing in the next 12-24 months and to smooth the impact of maturing benchmark bonds, in line with our

MTDS. Finally, by end-December 2021, we will roll out a pilot market-making/primary dealer program with a small group of participants with well-defined rights and responsibilities.

17. We will continue our efforts to improve data quality and transparency in fiscal reporting. We are committed to improving the timeliness, quality, and comprehensiveness of public sector fiscal, financial and debt accounting, with support from IMF's TA. Although the country meets the basic requirements for fiscal risk disclosure under the new IMF's fiscal transparency code, the 2013 Fiscal Transparency Assessment identified areas for further improvement. As previously mentioned, we will continue working to reduce the fragmentation and duality of the budgetary system (MEFP ¶12) and to strengthen the analysis and reporting of fiscal risks (in the context of the MTFF), including contingent liabilities, guarantees, concession contracts, and the indebtedness of municipal governments and SOEs. On the quality of the fiscal data, we will resume efforts to fully adopt 2014 GFSM accrual accounting standards for fiscal and budgetary information, initially at the CG level by end-December 2021, and progressively extending them to the rest of the public sector. Likewise, we will make efforts to fully adopt international standards for non-financial public sector debt data by end-December 2022. These improvements include the comprehensive collection and reconciliation of financing (below-the-line) data, the harmonization of both methodology and data coverage among national accounts, government finance and public sector debt statistics, as well as coordinated improvements on public sector accounting to guarantee stock-flow consistency, allow balance sheet enhanced analysis and provide improved data for decision making. We will update the program coverage and definitions in line with progress in these areas in subsequent reviews and reflect them in the attached TMU.

III. MONETARY AND EXCHANGE RATE POLICY

18. Monetary policy will continue to be underpinned by our firm commitment to low inflation within an inflation targeting framework. Maintaining low and stable inflation, under a flexible exchange rate, is critical to secure domestic and external stability, consistent with the BCCR's mandate. In the context of strong disinflationary pressures and actual and forecast inflation well below target, since March 2020 the BCCR has cut the policy rate by 1.5 percentage points to a record low of 0.75 percent to respond to the impact of the pandemic. This has deepened the BCCR´s countercyclical monetary policy stance adopted in March 2019. The BCCR has also reduced the gross interest rates on overnight deposits and on the permanent credit and deposit facility in the Integrated Liquidity Market (MIL) to almost zero. Monetary policy will remain data dependent and forward looking, underpinned by our commitment to maintain inflation consistent with BCCR's target of 3 percent, with a tolerance band of ±1 percentage point, over the medium term. Progress in meeting the inflation target under the program will be monitored through a consultation band around interim quarterly targets (Table 1). If actual inflation falls outside the band, the BCCR will have a consultation with IMF staff to discuss the reasons for the deviation and policies to return inflation to within the band, as described in the attached TMU.

19. The Central Bank has taken other measures to support liquidity and facilitate credit conditions. To support liquidity in episodes of stress, a legal reform passed in April 2020 allowed the BCCR to purchase capped amounts of sovereign securities in the secondary market. The BCCR

Board designed these interventions so that: (i) they take place only under conditions of liquidity stress; and (ii) all the purchases are conducted at market prices and in a well-communicated, transparent way, without jeopardizing BCCR's independence and in pursuit of its mandate. Moreover, the BCCR introduced in September 2020 a four-year repo facility of CRC700 billion (around 2 percent of GDP) for financial intermediaries at the monetary policy rate plus 5 basis points, conditional on their onlending the funds at favorable conditions to debtors affected by the pandemic. The facility was expanded in January 2021 by an additional CRC143 billion. The aim is to support the economic recovery.

20. We are taking further actions to reduce the risks from financial dollarization and strengthen monetary policy transmission. Since 2018, we allowed for greater exchange rate flexibility, which helps agents internalize exchange rate risk. Also, in 2019 we introduced reserve requirements differentiated by currency (with a higher rate for FX liabilities), with the aim of discouraging financial intermediation in foreign currency. We are also considering the adoption of an operation to facilitate the conversion of dollar loans into domestic currency loans. In line with IMF's TA recommendations, we have adopted, and plan to deepen, prudential measures to reduce the dollarization of our economy (MEFP ¶27). We continue to foster the availability of interest rate benchmarks that reflect current market conditions to strengthen monetary policy transmission.

21. We are committed to maintaining adequate international reserve buffers, while allowing the exchange rate to adjust in line with economic fundamentals and market conditions. Costa Rica operates under a flexible exchange rate regime, intervening only to moderate excessive market volatility. Our foreign-exchange reserve assets, bolstered by financial support from the IMF's RFI and credit lines from other IFIs, have played a critical role to buffer the impact of the pandemic on our balance of payments. Going forward, we will aim at maintaining adequate levels of reserves to cover our short term and maturing liabilities as well as the IMF's Assessing Reserve Adequacy (ARA) metric, in line with the net international reserves floor set under the program (Table 1). The Internal Audit Office of the BCCR will regularly review the net international reserves and underlying data, in line with the definition in the TMU, and reconcile them with the audited financial statements as of the end of the fiscal year. With support from IMF's TA, we will develop a policy roadmap for the development of the FX derivative market to enhance effective management of FX risks.

22. We stand ready to further strengthen the BCCR's independence, transparency, and accountability in the implementation of the flexible inflation targeting regime. The amendments to the BCCR Law in 2019—to tighten the dismissal rules for the BCCR Governor, delink the Governor's term from the political cycle, and remove the Minister of Finance's voting rights in the BCCR Board—have improved the personal autonomy provisions in the law. To further strengthen the BCCR's operational autonomy and governance, and in line with the recommendations of the IMF's 2020 Safeguards Assessment, we plan to prepare draft amendments to the BCCR law by end-August 2021 (**structural benchmark**), with a view to having them approved by the Ministry of Finance and the President of the Republic and submitted to the Legislative Assembly by end-August 2022. The Executive Branch will take the necessary steps in order to fill the current vacancy in the BCCR Board. In addition, we will develop a long-term roadmap to strengthen the BCCR´s equity position.

IV. FINANCIAL SECTOR POLICIES

23. We have made significant progress in financial sector reforms. Over the last years, we have approved several important financial sector reforms, building on the IMF's 2018 Financial Sector Stability Review (FSSR) and OECD recommendations. Also, as a result of sound prudential policies, the banking system entered the COVID-19 crisis with strong capital and liquidity buffers, as evidenced by the stress test results published in our 2019 Financial Stability Report. Nevertheless, high levels of unhedged FX borrowing and indebtedness in the household and corporate sectors are sources of important vulnerabilities in the financial system.

24. In response to the COVID-19 crisis, we temporarily opened the regulatory space for credit relief provision by financial intermediaries to households and businesses. In March 2020, CONASSIF approved transitional measures to provide space for financial entities to restructure loans, such as by allowing a temporary moratorium on loan servicing for affected borrowers without affecting their credit history and reducing the minimum accumulation of counter-cyclical provisions for financial entities to zero. This has led to comprehensive loan restructuring by banks, particularly to the most affected sectors. Emergency credit facilities are provided to SMEs through public banks and the Development Banking System (SBD) to fund their urgent needs for working capital. The BCCR also introduced the special facility to support credit to the private sector (MEFP ¶19).

25. We have gradually and cautiously started to unwind the temporary prudential measures, while continuing working on providing targeted support. Starting in December 2020, CONASSIF has required banks to update the credit ratings of borrowers for new restructured loans. At the same time, we have approved the use of already accumulated countercyclical provisions and softened the regulatory capital thresholds that define banks' "irregularity" until December 2021. We are also proposing to the Legislative Assembly to establish a 15-year government-funded US$300 million program to provide guarantees to businesses and individuals affected by the pandemic. For this and other measures, we are ensuring that they are transparent, temporary, targeted to the most affected sectors, and in line with regulatory best practices to avoid moral hazard. Any relaxation of regulations will be reversed once the recovery from the COVID-19 crisis takes hold.

26. We are committed to continuing to strengthen our macroprudential policy framework and stress testing capabilities. To coordinate macroprudential policy across agencies, we established in 2016 the Financial Stability Committee (FSC), comprising the President of the BCCR, the President of the National Council for Supervision of the Financial System (CONASSIF) and the Minister of Finance. In May 2019, the FSC strengthened its framework by creating the Monitoring and Coordination Group (MCG), made up of senior representatives of the BCCR, CONASSIF, the Superintendencies, and the Ministry of Finance. The MCG meets at least monthly and follows up on key systemic developments and financial risks. In January 2020, we changed the presidency of the FSC from a six-month rotation to a permanent basis and appointed the BCCR President as the FSC

President. In 2021, we will continue to strengthen the FSC by developing a responsibility matrix between the BCCR, CONASSIF and the Superintendencies, with technical support from the IMF. We have strengthened communications with the public, including through publishing our annual Financial Stability Report for the first time in July 2020. Over the years, we have made significant progress in systemic risk assessment by strengthening our credit, market and liquidity risks' stress test models and contagion risk tools. Bottom-up and top-down stress test results have been included in our Financial Stability Report. Going forward, we will continue updating our stress results on an annual basis and publish them in the Financial Stability Report, with an interim semiannual update of the top-down results. We will continue to strengthen our stress testing capacity with support from IMF's technical assistance.

27. We are taking further actions to reduce the risks from financial dollarization. Since 2018, we have allowed for greater exchange rate flexibility, and in 2019 introduced differentiated reserve requirements by currency, with the aim to reduce the dollarization of our economy. In addition, the Financial Stability Committee is closely monitoring the risks from dollarization, and SUGEF has taken further measures to discourage dollarization, including (i) establishing a higher general provision requirement for loans to non-FX generators, (ii) calculating liquidity coverage requirements by currency, and (iii) requiring banks to assess the sensitivity of debtors' payment capacity to exchange rate changes. In line with IMF TA recommendations, we plan to (i) review the definition of an unhedged borrower, (ii) work to implement a debt-to-income reporting requirement, and (iii) categorize as "high risk" the non-FX generators who have automobile loans or mortgages in FX and establish higher capital requirements for these loans. The BCCR is also considering introducing an operation to facilitate the colonization of loans by financial intermediaries (MEFP ¶20).

28. We plan to take further actions to strengthen the prudential regulatory and supervisory regime. The reforms to the laws on consolidated banking supervision and on securities market regulation passed in 2019 (Law no. 9768) marked important milestones towards effective supervision by strengthening the powers of supervisors, including sanctioning ones, in line with international best practices. With support from IMF TA, SUGEF will introduce by October 2022 regulations to implement the revamped legislation on supervising financial groups. This includes issuing guidelines to strengthen regulatory provisions and information sharing, and to update the solvency and capital requirements for financial groups. To facilitate effective cross-border supervision, we will also consider expanding SUGEF's scope of supervision to include financial companies that may be linked by common foreign ownership. We are taking further steps to advance our risk-based supervision framework, including by adopting Basel III standards in a phased manner. SUGEF is enhancing its liquidity risk management through recent improvements in the monitoring of the liquidity coverage ratio, and the planned introduction of the net stable funding ratio starting in August 2021. SUGEF is also revamping its credit risk management framework by introducing forward-looking assessment of losses and provisioning requirements, with the new regulation and guidelines for provisioning expected to be finalized in the first semester of 2021, to come into effect from January 2023. Moreover, we are revising banks' capital adequacy requirements in line with Basel III, with the regulation to be finalized in the first semester of 2021, to come into effect from January 1, 2023. The effective date of some of these new requirements may be subject to revision, depending on economic and financial conditions in the context of the pandemic and the combined effect of the new regulations on the financial system.

29. We will continue strengthening our financial safety net by implementing our banking resolution and deposit guarantee framework in line with best practices. We have advanced our crisis preparedness framework considerably, with the approval by the Legislative Assembly in February 2020 of the law on banking resolution and the creation of a deposit guarantee fund (DGF) (law no. 9816). We intend to have the implementing regulations in place by end-February 2021. By end-June 2021, we will adopt a roadmap, with support from IMF staff, to further strengthen the legal framework on bank resolution and deposit insurance, including adequate institutional arrangements for the DGF and the resolution authority, safeguards for resolution, and clear resolution triggers. The continuous monitoring of macro-financial risks by the MCG (MEFP ¶26), assisted by the recent implementation of an early warnings system; the implementation by the FSC of a contingency plan for episodes of financial stress; and the BCCR´s recent enhancement of its (Lender of Last Resort) LOLR mechanism, have also contributed to the strengthening of the financial safety net and the crisis preparedness framework.

30. We will press ahead with our efforts to promote financial inclusion and banking competition. With the onset of COVID-19, a sharp increase in the use of electronic transactions and the allocation of Bono Proteger (MEFP ¶6) have led to a significant increase in bancarization and financial inclusion. However, structural issues, such as limited banking competition and partial coverage of the credit registry, push up lending rates and hinder financial inclusion. In line with the IMF's FSSR recommendations, we have developed a national strategy for financial education, coordinated by the Ministry of Economy, Industry and Commerce (MEIC), which is currently being implemented. To enhance information on debtors, we are also working to require 4000 non-regulated credit providers (in addition to the 45 supervised entities) to report to the public credit registry, *Centro de Información Crediticia* (CIC). We are committed to strengthening the operations and governance of the SBD as well as developing alternative instruments to strengthen synergies between private banks and SMEs, including through the proposed guaranteed fund (MEFP ¶29). This should facilitate access to credit by SMEs and under-served sectors. The BCCR and MEIC have also recently launched a database that compares credit products across the financial system, to enhance information for financial consumers and foster bank competition.

31. We remain fully committed to combating money laundering and countering terrorism. Costa Rica has strengthened its compliance with the international standards on AML/CFT, as well as its framework on transparency and information exchange to help the fight against money laundering and terrorist financing, in line with FATF standards. CONASSIF has approved regulations to make our sanctioning framework more effective, proportionate and dissuasive, incorporate new regulated subjects, and adopt a new regulatory and legal framework related to the beneficial owner, including in revised SUGEF Regulation 12-10 of September 2020. In accordance with Law 9416 and

Decree no. 41040-H, to strengthen information and transparency, we created a centralized registry and started collecting shareholder and beneficial owner information in 2019 for all legal entities except trusts, third-party resource managers and non-profit organizations. We intend to include trusts by April 2021 and the rest of the entities by April 2022. We will continue to dedicate resources to AML/CFT supervision and collaboration between competent authorities and carry out inspections with the required frequency.

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

32. We are resolved to further advancing our growth-enhancing reform agenda, supporting a resilient recovery from the COVID-19 crisis. In May 2020, Costa Rica was invited to become an OECD member. In the context of our OECD accession, we have introduced 14 landmark legal reforms, in addition to many administrative reforms. Going forward, we remain fully committed to further advancing our reform agenda. Specifically, our strategy hinges on three key objectives: (i) protecting the most vulnerable from the impact of the crisis and supporting inclusion, including by promoting greater female labor force participation; (ii) boosting productivity growth, including by eliminating barriers to business formalization, investment and job creation; and (iii) promoting a green recovery, anchored by our National Decarbonization Plan and the goal of becoming a zero net emission economy by 2050.

33. We are implementing a comprehensive package of measures to protect the most vulnerable from the COVID-19 shock and support the reopening of our economy. Since the onset of the pandemic, we have promoted and enforced compliance with health protocols, expanded hospital capacity, and more recently deployed a large-scale vaccination campaign to control the pandemic and support the reopening of the economy. In addition, we have introduced temporary tax relief as well as targeted subsidies to households affected by the pandemic through the Bono Proteger (MEFP ¶16). Building on earlier efforts to increase labor market flexibility, we enacted a new legislation to protect employment through temporarily reduced working hours, made social security contributions proportional to the time worked and deferred their payments until the end of the year, and lowered minimum social security contributions for a period of six months (MEFP ¶16). In addition, we intend to support businesses and individuals affected by the pandemic via a temporary US$300 million credit guarantee fund (MEFP ¶25). We have also launched measures to support small-and medium-sized agricultural businesses and exporters via the Alivio program and are exploring opportunities to further catalyze the economic recovery, including by attracting near-shoring-oriented FDI and creating incentives for employment in the tourism sector.

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

- We have taken measures to improve the quality of the education system to address skill mismatches and increase human capital, including by increasing the provision of public childcare services (MEFP ¶35). To strengthen primary and secondary education, and discover skill shortages early on, we have ramped up support for vulnerable students and teachers' training. Going forward, we will implement updated curricula for 175 schools by end-December 2022, conduct regular student performance tests—including in digital and scientific fields—by end-December 2021, and update the performance-based evaluation system for teachers by end-December 2021. We will also introduce a Bilingualism Education Policy by end-December 2021 to assure students are proficient in a second language by 2040. To mitigate the impact of the pandemic on educational outcomes, we plan to reduce the digital gap by providing the necessary infrastructure and ensuring students have access to hardware, among other measures. We will also launch measures to address limitations in learning continuity to achieve higher efficiency and resilience with support from the WB. In addition, we intend to enhance the equity of our education system and attract more investment in education, in collaboration with the UN. To address the demand for specific technical skills, we passed a dual vocational training law in 2019 and improved the access, quality, and innovation capability of the public higher education system, in collaboration with the WB. Building on these efforts, we are committed to modernizing the National Apprenticeship Institute (INA) and will continue linking public universities' funding to labor market needs. Furthermore, we will step up efforts to strengthen the link between universities and the business world through their integration in the National Science and Technology Information System to promote innovation and allow firms to benefit from access to state-of-the art knowledge and skills, in line with recommendations from the IDB and the OECD.

- To attract investment, we will identify spending priorities and promote PPPs, with support from CABEI and the IDB, to reduce existing physical and digital infrastructure gaps, consistent with our fiscal consolidation plans under the program. In this context, a planned reduction in electricity tariffs will increase competitiveness and contribute to incentivizing investment (MEFP¶15). In addition, we will continue to strengthen our digital infrastructure via the Digital Transformation Strategy 2018-2020 and related initiatives to enhance cybersecurity and set up a digital government portal. To reduce red tape, we have designed a national strategy to promote administrative reforms and strengthen regulatory reform efforts of the central government. We have also launched Costa Rica Fluye—a project aimed at intelligent deregulation in 25 public institutions—and implemented a single-window system (VUI) where businesses can apply for licenses and permits. We will also reform the Law for the Protection of Citizens from Excess Requirements and Administrative Procedures to reduce the administrative burden for businesses, including by promoting the use of sworn declarations, by end-December 2021. In addition, a new bankruptcy law, expected to be approved by end-December 2021, will reduce the duration and cost of liquidation proceedings and promote restructuring of affected firms—a key toolkit to support the post-COVID recovery. We will further cut red tape by promoting the online system for registering a firm. To ensure FDI will be retained during the recovery, we will monitor risks and their impact on investors and explore new investment incentive plans, with a focus on non-tax related measures, such as promoting innovation clusters to remove information barriers and foster the integration of firms in global value chains.

- To incentivize formalization, in 2019 we adopted legislation to temporarily lower employer and employee social security contributions for new microenterprises during their first four years of operation. In 2017, we launched sectoral pilot programs with reduced minimum rate contributions for domestic and some agricultural workers. We plan to expand these programs to the fishing sector and part-time workers by end-December 2021 to ensure the burden of social security payments is lower for vulnerable workers. In addition, we will continue to strengthen our employment services agency to help workers move to formal sector jobs and lower unemployment through the nationwide single-window scheme. To reduce the administrative burden for firms, over the last three years we reduced the number of minimum wages from 26 to 20. We plan to further simplify the system by reducing the number to 16 by end-June 2021 and 11 over the medium term, in line with OECD recommendations. We will further support these efforts through implementing our national strategy for transitioning to the formal economy, with technical assistance from the ILO.

35. As part of our efforts to promote inclusive growth, we continue to focus on increasing female labor force participation. Costa Rica's long-standing provision of universal healthcare, pensions, and general education has supported greater inclusiveness and equality of opportunities. We aim at further promoting inclusive growth by strengthening female labor force participation, which is considerably lower than for men, despite women's better education outcomes. The 2018 fiscal reform expanded the definition of public education to include early education centers, which allowed us to reallocate funds to increase the supply of public childcare services. We will work on expanding childcare services by providing 40,000 additional places, with a focus on children up to 5 years old, as well as improving access for low-income households and implementing a co-payment scheme for middle-class families by end-December 2022. Stronger childcare facilities can in turn also support educational outcomes and labor productivity (MEFP ¶34). To further reduce women's family care requirements, we will launch in early 2021 a national policy to establish a long-term care system by end-June 2021. In addition, we will continue to foster the participation of women in STEM fields, in collaboration with the IDB, and implement our national action plan for gender equality in scientific and technological fields, which will strengthen female labor force participation and productivity growth (MEFP ¶34). To support these efforts, we are also considering additional measures to promote parental leave in the public and private sector.

36. We are strongly committed to promoting environmentally sustainable medium-term growth. In recent years, Costa Rica has accomplished significant advances in its efforts to accelerate, innovate, and scale up climate change mitigation and adaptation measures. Going forward, our agenda in this area remains ambitious and encompasses a comprehensive set of measures:

- Recognizing the need for prompt and bold action, in 2019, we launched a National Decarbonization Plan, which aims at transitioning to a zero net emission economy by 2050, in line with the Paris Agreement. With almost 100 percent of the electricity matrix currently sourced from renewables, we start off from a strong position. To reach our goal, we will continue to encourage fleet electrification processes in the transport sector—the largest contributor to greenhouse gas emissions. Specifically, we will strengthen the charging infrastructure by installing 67 charging centers by end-December 2022 and include unit (fleet) electrification considerations in the operators' concession contracts. Decarbonization measures will also focus on the agriculture and forestry sector, which plays a major role in carbon sequestration and is therefore key to reaching our zero net emission target. We also commit to protecting 30 percent of our marine territory under conservation schemes by end-December 2022. Additional initiatives will aim at reducing emissions in the construction and industrial manufacturing sectors as well as improving wastewater management. Our Carbon Neutrality Country Program (PPCN 2.0) supports these mitigation efforts by providing a mechanism for the adequate management of greenhouse gas emissions for public and private organizations. To complement the PPCN 2.0, with support from the WB, we intend to further support farmers in adopting low-carbon technologies and practices by providing technical assistance, promoting agricultural research on low-carbon solutions, and further developing financing instruments. We are also currently negotiating an Agreement on Climate Change, Trade and Sustainability (ACCTS) with five other countries to ensure that our trade policy supports the goals set forth by the National Decarbonization Plan. Moreover, we are developing price incentives to support this transformation to a zero net emission economy (MEFP ¶9).

- To establish adaptation goals for 2018-2030 and bring together efforts from different sectors of the economy, we launched the National Policy on Adaptation (PNA) to climate change in 2018. Key actions are the development of a National Adaptation Plan as well as current and future climate risk maps for every canton of the country by end-December 2022, among others. In addition, with support from the WB, we will continue to strengthen our National System for Disaster Risk Management—which has been in force since 2006—in line with the Institutional Strategic Plan 2018-2022 of the National Commission for Risk Prevention and Emergency Care. To support the most vulnerable productive sectors, we also introduced a new insurance scheme in 2019, which allows agricultural producers to insure their harvest against climate change risks and offers lower premia for producers implementing adaptation measures. In 2020, we started AGROINNOVA 4.0, a national program which promotes the application of technology to increase productivity and sustainability in the agricultural sector. Going forward, we will continue to support adaptation initiatives, including by climate-proofing our infrastructure, which is crucial to mitigating the fiscal impact of climate-related natural disasters and protecting coast lines. Specifically, we will set up an expert group and develop a roadmap, with support from the WB, to enhance infrastructure resilience by end-September 2022 (**structural benchmark**) with a view to guiding the technical planning and implementation, including through an assessment of the medium-term investment needs and associated costs, beyond what is already in the pipeline, as well as available private and public sector financing options to support them. In this context, we will also promote the "blue economy" through sustainable and innovative approaches to the use of coastal areas while ensuring their conservation. In collaboration with the IDB, we also aim at increasing the resilience of transport infrastructure, which will facilitate adaptation to climate change, contribute to closing infrastructure gaps, and boost productivity growth (MEFP ¶34). In addition, with support from the WB, we will allocate grants to reduce deforestation and forest degradation, which will foster ecosystem services and improve communities' resilience and livelihoods.

- We also released the Economic Strategy for an Inclusive and Decarbonized Economy 2020-2050 in January 2021. This proposal aims to make a gradual transition to an inclusive and decarbonized economy by 2050, with 12 development poles, 6 corridors—that will facilitate the interaction between these poles—and 12,750 km^2 of territorial management areas. The strategy involves policy measures on economic growth, social inclusion, human capital, infrastructure and connectivity, and natural capital, and will be reflected in the National Strategic Plan 2050, the country's main long-term planning instrument to be launched in July 2021.
- In addition, with a view to promoting the greening of the financial sector, the BCCR joined the Network for Greening the Financial System in 2019 and is currently developing a roadmap to integrate climate change considerations into the design of monetary and financial policy, to be launched by end-2021.

VI. RISKS AND CONTINGENCIES

37. The high degree of uncertainty due to the pandemic poses economic and financial risks to our program. Underpinning our economic reform program, we have conservatively assumed that the recovery is a gradual one, extending over the next years, as the health crisis recedes and economic activity resumes. Nevertheless, the pandemic could turn out even more severe and protracted, including due to delays in vaccine distribution, which could lead to a more prolonged global and domestic economic downturn. Accordingly, the main risks to the program include: (i) lower-than-expected growth and/or new balance-of-payments pressures; (ii) weaker-than-expected revenue performance and higher COVID19-related spending, resulting in delays in the implementation of our fiscal consolidation strategy; (iii) higher macro-financial vulnerabilities, amid rising private sector distress and scarring of the economy. These downside risks could challenge and renew concerns about debt sustainability. Should any of these risks materialize, the government of Costa Rica stands ready to adjust promptly its policies, in close consultation with IMF staff. On the upside, were the recovery to take hold faster than expected, thanks to either domestic or external developments, we stand ready to accelerate the adjustment and reform process, strengthening the resilience of our economy to future shocks.

VII. PROGRAM MONITORING

38. Progress in the implementation of our policies, which are supported by the IMF, will be monitored through semi-annual reviews, performance criteria (PCs), indicative targets (ITs), and structural benchmarks (SBs). These are detailed in Tables 1 and 2, with definitions and data requirements provided in the attached TMU. Purchases under the EFF will be used for direct budget support during the program period. The BCCR and the Ministry of Finance have updated their Memorandum of Understanding on the responsibilities for servicing financial obligations to the IMF.

Table 1. Costa Rica: Quantitative Performance Criteria (PC) and Indicative Targets (IT)[1/]

(Cumulative from the beginning of the year, in billions of colones, unless otherwise noted)

	2021			2022
	End-Jul	End-Sep	End-Dec	End-Mar
	PC	IT	PC	IT
I. Quantitative Performance Criteria				
Floor on cash primary balance of the central government (-= borrowing)	-390	-480	-640	-34
Floor on net international reserves of the Central Bank (stock, in millions of U.S. dollars)	3,660	4,336	3,768	4,123
II. Continuous Performance Criteria[2/]				
Ceilling on accumulation of new external arrears (in millions of U.S. dollars)	0	0	0	0
III. Monetary Policy Consultation Clause (MPCC)[3/]				
Year-on-year inflation in the consumer price index[4/]				
Upper outer band limit (3 percent above center point)	4.4	4.4	4.3	4.1
Upper inner band limit (1.5 percent above center point)	2.9	2.9	2.8	2.6
End-of-period inflation center point (percent)	1.4	1.4	1.3	1.1
Lower inner band limit (1.5 percent below center point)	-0.1	-0.1	-0.2	-0.4
Lower outer band limit (3 percent below center point)	-1.6	-1.6	-1.7	-1.9
IV. Quantitative Indicative Targets				
Ceiling on debt stock of the central government	26,625	26,833	27,100	28,747
V. Memorandum Items				
External program financing (in millions of U.S. dollars)	540	1,390	2,511	0
External project financing (in millions of U.S. dollars)	57	73	97	49
External commercial loans (in millions of U.S. dollars)	0	0	0	1,000
Domestic FX-denominated debt issuance (in millions of U.S. dollars)	888	888	888	0
Proceeds from commercialization of public assets to non-residents (in millions of U.S. dollars)	0	0	0	0
Amortization of official external debt by the central government (in millions of U.S. dollars)	55	74	103	20
Interest payments of official external debt by the central government (in millions of U.S. dollars)	273	416	537	190
Domestic FX-denominated debt service (in millions of U.S. dollars)	684	793	1,797	480

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

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

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

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

Table 2. Costa Rica: Structural Benchmarks	
Structural Benchmarks	**Target Date**
Efficiency of government spending	
Legislative Assembly to approve Public Employment Bill.	End-May 2021
Revenue mobilization	
The Tax Commissioner to approve a new Tax Compliance Improvement Plan, in line with IMF staff recommendations.	End-December 2021
Fiscal governance and transparency	
Publication of financial statement under IFRS standards for fiscal year 2020 for three SOEs (ICE, AyA, CNP).	End-December 2021
Cabinet to approve and publish a Medium-Term Fiscal Framework for the entire Non-Financial Public Sector for 2023-2026.	End-April 2022
Cabinet to approve and publish a Medium-Term Debt Strategy (MTDS) for 2023-2026.	End-April 2022
Social safety nets	
MOF's National Treasury to centralize and digitalize the payment system for all the cash transfer social assistance programs, in coordination with social assistance units.	End-December 2021
Monetary and financial sector reforms	
The BCCR to submit to the Ministry of Finance draft amendments to the BCCR Law, prepared in consultation with IMF staff, to strengthen the central bank's operational autonomy and governance framework.	End-August 2021
Macro-structural reforms	
Authorities to develop a roadmap to enhance infrastructure resilience to climate change, including cost assessment and financing options.	End-September 2022

Attachment II. Technical Memorandum of Understanding

1. This Technical Memorandum of Understanding (TMU) sets out a framework for monitoring the performance of Costa Rica under the program supported by the Extended Arrangement under the Extended Fund Facility (EFF). It specifies the performance criteria and indicative targets (including adjustors) under which Costa Rica's performance will be assessed through semiannual reviews. Monitoring procedures and reporting requirements are also specified.

2. The quantitative performance criteria and indicative targets specified in Table 1 attached to the Memorandum of Economic and Financial Policies (MEFP) are listed as follows.

a) a quantitative performance criterion on central government primary balance (floor);

b) a quantitative performance criterion on net official international reserves (floor);

c) a continuous quantitative performance criterion on new external payment arrears by the nonfinancial public sector and the BCCR (ceiling);

d) a monetary policy consultation clause;

e) an indicative target on debt stock of the central government (ceiling);

3. In addition to the performance criteria listed in Table 1, the arrangement will include the performance criteria standard to all Fund arrangements, namely:

a) no imposition or intensification of restrictions on the making of payments and transfers for current international transactions;

b) no imposition or intensification of import restrictions for balance of payments reasons;

c) no introduction or modification of multiple currency practices;

d) no conclusion of bilateral payments agreements that are inconsistent with Article VIII of the IMF Articles of Agreement.

- These four performance criteria will be monitored continuously.

4. For program monitoring purposes, all foreign currency-related assets, liabilities, and flows will be evaluated at "program exchange rates" as defined in Table 1 below, except for items related to fiscal operations which will be measured at current exchange rates. The program rates are those that prevailed on December 31, 2020. Monetary gold will be valued at US$ 1,891.10 per troy ounce, which was the price prevailing on December 31, 2020.

Table 1. Program Exchange Rates (December 31, 2020)	
Colones to the U.S. dollar	613.915
U.S. dollar to the SDR	1.45
U.S. dollar to the Yen	0.0096
U.S. dollar to the Euro	1.23
U.S. dollar to the Canadian dollar	0.78
U.S. dollar to the Chinese RMB	0.15
U.S. dollar to the British Pound	1.37
Gold price per troy ounce (U.S. Dollar)	1,891.10

5. Throughout this TMU, the central government figures comprises all branches of the government (executive, legislative, and judiciary), including the Comptroller's Office and the Ombudsman's Office; the Supreme Electoral Court; the budget lines "Servicio de la Deuda Pública", "Regímenes de Pensiones con cargo al Presupuesto de la República" and "Obras Específicas"; and the public entities that is required to be consolidated under central government (CG) from 2021 by Law 9524 (see below). The Central Bank of Costa Rica (BCCR), the state-owned enterprises and other public sector agencies are excluded from the definition of central government. Debt is defined in accordance with paragraph 8 of the Guidelines on Public Debt Conditionality in Fund Arrangements attached to Executive Board Decision No. 15688-(14/107), adopted December 5, 2014.

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

1. Agencia de Protección de Datos de los Habitantes (PRODHAB), 2. Casa de Cultura de Puntarenas, 3. Centro Costarricense de Producción Cinematográfica, 4. Centro Cultural e Histórico José Figueres Ferrer, 5. Centro Nacional de la Música, 6. Comisión Nacional para la Gestión de la Biodiversidad (CONAGEBIO), 7. Comisión Nacional de Prevención de Riesgos y Atención de Emergencias (CNE), 8. Comisión Nacional de Vacunación y Epidemiología, 9. Comisión de Ordenamiento y Manejo de la Cuenca Alta del Río Reventazón (CONCURE), 10. Consejo Nacional de Clubes 4-S, 11. Consejo Nacional de Concesiones (CNC), 12. Consejo Nacional de la Persona Adulta Mayor (CONAPAM), 13. Consejo Nacional de la Política Pública de la Persona Joven (CPJ), 14. Consejo Nacional de Vialidad (CONAVI), 15. Consejo de Salud Ocupacional (CSO), 16. Consejo de Seguridad Vial (COSEVI), 17. Consejo Nacional de Investigación en Salud (CONIS), 18. Consejo Nacional de Personas con Discapacidad (CONAPDIS), 19. Consejo Superior de Educación (CSE), 20. Consejo Técnico de Asistencia Médico Social (CTAMS), 21. Consejo Técnico de Aviación Civil (CTAC), 22. Consejo de Transporte Público (CTP), 23. Dirección Nacional de Centros de Educación y Nutrición y de Centros Infantiles de Atención Integral (Dirección de CEN-CINAI), 24. Dirección Nacional de Notariado, 25. Fondo de Desarrollo Social y Asignaciones Familiares (FODESAF), 26. Fondo Nacional de Becas (FONABE), 27. Fondo Nacional de Financiamiento Forestal (FONAFIFO), 28. Instituto sobre

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

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

I. PERFORMANCE CRITERIA

A. Performance Criterion on Central Government Primary Balance

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

7. The performance criterion on the central government cash primary balance will have one adjustor for 2021. The floor on central government cash primary balance will be adjusted downward by the full amount of any increase in COVID-19 emergency spending compared to budgeted amounts such as transfers to the health system, transfers for targeted support to families, workers, and firms heavily affected by the pandemic, or social assistance programs to the most vulnerable groups. Such additional expenditure should be clearly identified and reflected in an appropriate document (e.g., supplementary budget, government resolution, a circular of the ministry of finance). The adjustor is capped at CRC 112 billion.

B. Performance Criterion on Net Official International Reserves

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

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

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

- At end-2020, the Program NIR, evaluated at market exchange rates, stood at US$3,712 million. Targets for the Program NIR are set for cumulative flows from the end of the previous year. To calculate the cumulative flows, the Program NIR at the test dates and the end of the previous year are evaluated at the program exchange rates and gold price specified in paragraph 4.
- The following adjustment will apply:

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

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

II. CONTINUOUS PERFORMANCE CRITERIA

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

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

III. MONETARY POLICY CONSULTATION CLAUSE

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

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

where

t = the month within which the test date is included

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

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

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

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

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

IV. INDICATIVE TARGETS

D. Indicative Target on Debt Stock of the Central Government

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

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

15. The performance criterion on debt stock of the central government will have one adjustor for 2021. The ceiling on debt stock of the central government will be adjusted upward by the full amount of any increase in COVID-19 emergency spending compared to budgeted amounts such as transfers to the health system, transfers for targeted support to families, workers, and firms heavily affected by the pandemic, or social assistance programs to the most vulnerable groups. Such additional expenditure should be clearly identified and reflected in an appropriate document (e.g., supplementary budget, government resolution, a circular of the ministry of finance). The adjustor is capped at CRC 112 billion.

V. DATA REPORTING REQUIREMENTS

16. Costa Rica shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Costa Rica in achieving the objectives and policies set forth in the Memorandum of Economic and Financial Policies and Letters of Intent. All the program monitoring data will be provided by the Ministry of Finance, IMAS, FODESAF, and the BCCR. For the purpose of monitoring the fiscal performance under the program, data will be provided in the format as shown in Tables 2, 3, and 4. For the purpose of monitoring the external sector performance under the program, data will be provided in the format shown in Tables 5 and 6. For the purpose of monitoring the performance against the indicative target on treasury guarantees, data will be provided in the format shown in Table 7.

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

- Data on the cash primary balance of central government will be provided on a monthly basis, no later than three weeks after the end of the month to which the cash balance is calculated.

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

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

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

Table 2. Costa Rica: Central Government Operations[1/]

(In billions of colones)

Total Revenue
Current Revenue
Income Tax
Tax on Income and Profits
Income and to natural and legal per:
Income and to Individuals
Revenue and Profit Corporations
Dividends and interest s / Securities
Remittances Abroad
Banks and non-domiciled Financ
Property Tax
Owned vehicles
Supportive Housing Imp
Import Tax
Tariff:
1% Customs Value:
Export Tax
Exported Banana Case
Der.de Exp.ad / valorem
Sales Tax
Internal
Customs
Consumption Tax
Internal
Customs
Undistributed Customs
Indirect Tax
Single tax fuels
Tax soft drinks
Tax soap
Alcohol tax
Transfer used vehicles
Transfer property
Fiscal Stamp
Exit fees Homeland
Consular Rights
Tax Law on Migration and Aliens
Tax on Tobacco
Other tax revenue
Social Security Contributions
Non Tax
Current transfers
Capital Income
Recovery of Loans
Capital Transfers
Donation
Admin.Finan Act. (Cash only)

Table 2. Costa Rica: Central Government Operations (concluded)[1/]
(In billions of colones)

Total Expenditure
No Interest Expense Total
Current expenses
Salaries
Wages and salaries
Social Security Contributions
Social Security Contributions CCSS
Social Security Contributions Worker Prot
Social Security Contributions Others
Purchase of Goods and Services
Interest Expenditure
Internal Interest Expenditure
Interest Expenditure External
Transfers
Transfers Private Sector
Pensions (including CCSS)
Transfers Others
Transfers Public Sector
Transfers External Sector
Transfers Ctes with external resources
Capital Expenditure
Investment
Capital Transfers
Capital Transfers Private Sector
Capital Transfers Public Sector
Capital Transfers External Sector
Capital with external resource transfers
Capitalization banks
Primary Balance
Overall Balance
Residual
Total Financing
Net Domestic Financing
Net Foreign Financing
Privatization

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

Table 3. Costa Rica: Central Government Financing[1/]

(In billions of colones)

Financing
Net Domestic Financing
Net BCCR Financing
BCCR Renegotiated debt
Deposits BCCR
Deposits BCCR Initial Balance
Deposits BCCR Final Balance
BCCR Net loans
Banking System Financing
Banking System Financing Loans
Banking System Financing Amortization
Banking System Financing Deposits
Banking System Financing Var. Securities
Banking System Financing Var. Securities Initial Balance
Banking System Financing Var. Securities Final Balance
Banking System Financing Cash and Banks
Banking System Financing Cash and Banks Initial Balance
Banking System Financing Cash and Banks Final Balance
Banking System Financing Net Loans
Central Government Financing
Central Government Financing Amortization of government
Central Government Financing Change in Government Securities
Central Government Financing Change in Government Securities Initial Balance
Central Government Financing Change in Government Securities Final Balance
Other domestic financing
Other domestic financing Credit providers
Other domestic financing Disbursements
Other domestic financing Amoritizations
Other domestic financing Var. Dep in other entities
Other domestic financing Var. Dep in other entities Initial Balance
Other domestic financing Var. Dep in other entities Final Balance
Other domestic financing Other financ. internal
Other domestic financing Exchange Losses
Other domestic financing Net loans
Net Foreign Financing
Net Foreign Financing Disbursements
Net Foreign Financing Amortization
Net Foreign Financing Var. Dep abroad
Net Foreign Financing Var. Dep abroad Initial Balance
Net Foreign Financing Var. Dep abroad Final Balance

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

Table 4. Costa Rica: Central Government Debt[1/]
(In billions of colones)

Debt stock
Domestic
- Bonds
Tasa basica
Zero coupon colones
Zero coupon dolares
Fixed coupon colones
Fixed coupon dolares
Floating coupon colones
Floating coupon dolares
Inflation-linked bond (TUDES)
- Other liabilities
External
- Bilateral
- Bonds
- Multilateral
Unidentified financing
Domesticdebt stock by maturities
o.w.: OD domestic debt by maturities
External debt stock by maturities
o.w.: OD external debt by maturities
Total borrowing requirement
Financial deficit of CG
CG debt amortization
Domestic
o.w.: OD domestic debt amortization
External
o.w.: OD external debt amortization
- Bilateral
- Bonds
- Multilateral
Source of funds
Domestic placement or disbursement
External placement or disbursement
- Bilateral
- Bonds
- Multilateral
Use of government deposits

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

Table 5. Costa Rica: Foreign Exchange Cashflows of the Central Bank and the Government[1/]

(In millions of U.S. dollars)

1. Total Inflows
Official sector disbursement
Program loans
IMF
World Bank
IDB
CABEI
ADF
CAF
Project loans and grants, of which
World Bank
IDB
CABEI
bilateral: KFW/JICA/China Eximbank
Commercial loans
Syndicated loans
Sovereign bond, incl Eurobonds
Domestic FX debt issuance
Other inflows
BCCR Interest receipts and other net items
Change in balances in public accounts
o/w proceeds from public asset sale
2. Total outflows
External debt service
Amortization (excl. to IMF), of which:
Official loans, of which:
World Bank
IDB
CABEI
CAF
Bilaterals: AFD/KFW/JICA/Eximbank
Commercial loans
Syndicated loans
Sovereign bonds
Interest payment (incl. to IMF)
Domestic FX debt service
Residents
Non-residents
Net capital transfers and miscellaneous
3. Net FX intervention, of which
Net intervention for volatility management
Programmed reserve accumulation
Net FX purchases for rest of public sector
4. Other net flows
Net Central Government<-->BCCR transactions[1/]
Change in short-term liabilities with non-residents
Change in liabilities w/ residents
Net International Reserves (at market exchange rates)[2/]
Net International Reserves (at program exchange rates)[2/]
Gross International Reserves (at market exchange rates)

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

2/ As defined in ¶8.

Table 6. Costa Rica: Gross Official Reserve Position[1/]

(In millions of U.S. dollars)

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

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

Table 7. Costa Rica: Priority social spending[1/]

(In billions of Colons)

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

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

INTERNATIONAL MONETARY FUND

COSTA RICA

February 12, 2021

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION AND REQUEST FOR AN EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY—INFORMATIONAL ANNEX

Prepared by: The Western Hemisphere Department (in consultation with other departments)

CONTENTS

FUND RELATIONS

(As of December 31, 2020)

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

General Resources Account:	**SDR Million**	**% Quota**
Quota	369.40	100.00
Fund holdings of currency	667.47	180.69
Reserve Tranche Position	71.34	19.31

SDR Department	**SDR Million**	**% Allocation**
Net cumulative allocation	156.53	100.00
Holdings	82.99	53.02

Outstanding Purchases and Loans:		
Emergency Assistance [1/]	369.40	100.00

[1/] Emergency Assistance may include ENDA, EPCA, and RFI.

Latest Financial Arrangements

Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By	04/11/2009	07/10/2010	492.30	0.00
Stand-By	11/29/1995	02/28/1997	52.00	0.00
Stand-By	04/19/1993	02/18/1994	21.04	0.00

Outright loans:

Type	Date of Commitment	Date Drawn	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
RFI	04/29/2020	09/15/2020	369.40	369.40

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

	Forthcoming				
	2021	**2022**	**2023**	**2024**	**2025**
Principal	0.00	0.00	46.18	184.70	138.53
Charges/Interest	4.07	4.05	4.05	3.04	1.04
Total	4.07	4.05	50.23	184.74	139.56

Exchange Rate Arrangement. Costa Rica's de jure current exchange rate arrangement classification is "managed floating." The central bank is committed to allowing the exchange rate to be freely determined by foreign currency supply and demand but reserves the right to participate in the market to meet its own foreign currency requirements and those of the nonbank public sector and, at its discretion, to prevent sharp fluctuations in the exchange rate. The de facto exchange rate is classified as "crawl-like," as of February 2019. Costa Rica maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions.

Article IV Consultation. The last Article IV consultation was concluded on March 27, 2019 (Country Report No. 19/101).

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

Safeguards Assessment. An update safeguards assessment of the BCCR was finalized in October 2020. Since the last assessment in 2009, the BCCR has enhanced safeguards in its external audit mechanism and financial reporting, but some areas for improvement remain in the legal framework and governance arrangements. Specifically, the BCCR Law, which was last amended in 2019 to improve personal autonomy provisions, requires further amendments to safeguard the central bank's institutional, functional, and financial autonomy. There is also a need to further strengthen the decision-making structure of the BCCR, filling a current vacancy on the BCCR Board, clearly distinguishing between executive and oversight functions, and safeguarding the independence of internal audit. In view of the significant negative equity of the BCCR, the central bank should also develop a recapitalization roadmap over the medium to long term. Staff will continue monitoring the implementation of these recommendations per the safeguards policy for as long as Fund credit remains outstanding.

Technical Assistance (since Last Article IV Consultation).

Department	Time of Delivery	Purpose
STA, CAPTAC-DR	June 2019	Government Finance Statistics (GFS): Compilation of central government high frequency data
	September 2020	GFS: Compilation of high frequency central government GFS and PSDS data, including from entities required to be consolidated under central government starting in 2021
	October 2020	GFS: Reconciliation of high frequency central government GFS and PSDS data, including from entities required to be consolidated under central government starting in 2021
	July 2019	Real Sector Statistics (RSS): Quarterly SUT
	November 2019	RSS: Monthly service survey
	December 2019	RSS: Annual Sectoral accounts, flows and stocks
	March 2020	RSS: 2008 SNA implementation
	August 2020	RSS: Sectoral accounts: Captive Financial Corporations
	January 2021	RSS: Review of new national accounts series (2017=100)
MCM, CAPTAC-DR	April/May 2019	Banking supervision (SBF): Credit risk regulation: management & provisioning
	December 2019	SBF: Liquidity stress test
	June 2020	SBF: Supervisory liquidity stress
	July/August 2020	SBF: Credit risk regulation follow-up
	October 2020	FSSR follow-up: Solvency II and IFRS17
	February 2021	FX market framework development

FAD, CAPTAC-DR	March 2019 June 2019 June, October 2019 June 2019 October 2020	Customs Administration (AAA): Improving risk analysis AAA: Risk Management Strategy AAA: Process Management AAA: Integral Cargo Control Plan AAA: Improve import and export process
	April 2019 May, November 2019 June 2019 August 2019 January 2020 June 2020 July, October 2020 September 2020	Tax administration (ATT): Strengthen the Taxpayers Registry ATT: Strengthen Risk Management ATT: Tax Administration Diagnostic Assessment Tool ATT: Improve management of declarations ATT: Improve tax filling compliance ATT: Strengthen Strategic Planning ATT: Strengthen the identify, asses, rank and quantity compliance risks ATT: Improve Tax Compliance Plan
	July 2019 November 2019	Hackathon on social program payments Hackathon on social program payments – follow up and action plans
	April 2019 April, November 2019 June 2019 July, November 2020 July/August 2020	Public Financial Management (PFM): Treasury PFM: Fiscal Risks and Fiscal Risks – Specific Risks PFM: Treasury -Debt treasury coordination PFM: Accounting - IPSAS & Consolidation PFM: Medium-term fiscal framework

RELATIONS WITH OTHER FINANCIAL INSTITUTIONS

A. World Bank

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

B. Inter-American Development Bank

https://www.iadb.org/en/countries/costa-rica

C. Development Bank of Latin America (CAF)

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

D. Central American Bank for Economic Integration (CABEI)

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

STATISTICAL ISSUES

(As of January 2021)

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

National accounts: National accounts are compiled generally in accordance with the *System of National Accounts 2008* (*2008 SNA*). The Central Bank disseminated the annual national accounts data for the years 1991-2019 and quarterly estimates up to 2020 Q3. Quarterly estimates are released with around a 90-day lag and TA is assisting the authorities to reduce the lag to 60 days. The benchmark year was revised to 2017 (from 2012) for the chained volume measures in late 2020, and national account data reflecting this revision were published in January 2021. Estimation of real estate activities including owner-occupied housing has been improved. In the new system, deflation methods have been improved to obtain annual value added in constant prices. Changes in inventories are largely obtained following the *2008 SNA* recommendations for those products for which enough information is available, though TA recently recommended improvements to estimates for cattle and poultry. The informal activity of households as producers of goods and services is included in GDP levels (but not separately estimated).

Price statistics: Consumer price index (CPI) compilation generally follows the concepts and definitions of the CPI Manual. Its structure, scope, and coverage were updated in March 2017. The index reference period is June 2015. However, the CPI weights are based on the 2012/2013 Income and Expenditure Survey so are now out of date. The index only covers resident urban households. These comprise approximately 73 percent of the total population and 82 percent of the total consumption expenditures of Costa Rica. Atypical movements in the data are investigated and corrected when necessary. During 2018, a new Income and Expenditure Survey was collected.

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

Government Finance Statistics: The concepts and definitions used in compiling GFS generally follow the guidelines of the GFSM 1986. However, financing data and government debt, which use national concepts that combine instruments and holders, are not in accordance with international standards. Monthly fiscal statistics are only compiled and disseminated for budgetary central government (although these data are not reported to STA), while annual statistics are compiled and disseminated for the entire public sector and its subsectors. Annual data for the *GFS Yearbook* are reported on a regular basis, most recently for 2019.[1] The recent incorporation of 51 public entities as part of the budgetary central government as required by Law 9524 starting in 2021 was supported by CAPTAC-DR's TA to reconcile the fiscal and debt data. Data in the IMF staff report are adjusted back to 2019 for comparability. On PSDS, the market of issuance (Costa Rica or abroad) criterion is followed to classify domestic and foreign debt, instead of the internationally recommended holder residency criterion. Fiscal data discrepancies among national compilers on specific items are not regularly reconciled, although large fluctuations or discrepancies are investigated. Fiscal statistics are not regularly reconciled with monetary statistics, or other macroeconomic statistics.

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

Financial sector surveillance: Costa Rica reports all core financial soundness indicators (FSIs) and one of the 13 encouraged FSIs for deposit takers on a monthly basis for posting on the IMF's FSI website with less than one quarter lag. The authorities recently started reporting seven additional encouraged FSIs for deposit takers.

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

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

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

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

Costa Rica: Table of Common Indicators Required for Surveillance

(As of January 31, 2021)

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]
Exchange Rates	1/28/2021	1/29/2021	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Dec 20	Jan 21	M	M	M
Reserve/Base Money	Dec 20	Jan 21	M	M	M
Broad Money	Dec 20	Jan 21	M	M	M
Central Bank Balance Sheet	Dec 20	Jan 21	M	M	M
Consolidated Balance Sheet of the Banking System	Dec 20	Jan 21	M	M	M
Interest Rates[2]	Dec 20	Jan 21	M	M	M
Consumer Price Index	Dec 20	Jan 21	M	M	M
Revenue, Expenditure, Balance, and Composition of Financing[3]– Central Government[4]	Dec 20	Jan 21	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[4, 5]	Dec 20	Jan 21	M	M	M
External Current Account Balance	2020 Q3	Jan 21	Q	Q	Q
Exports and Imports of Goods and Services[6]	2020 Q3	Jan 21	Q	Q	Q
GDP/GNP	2020 Q3	Jan 21	Q	Q	Q
Gross External Debt	2020 Q3	Jan 21	Q	Q	Q
International Investment Position	2020 Q3	Jan 21	Q	Q	Q

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discounts rates, money market rates, rates on treasury bills, notes, and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] Data for 2020 and earlier years do not cover the public entities that, starting in 2021, are required to be consolidated under central government by Law 9524.
[5] Including currency and maturity composition.
[6] Goods trade data release is monthly with a one-month lag; services trade data release is quarterly at the time of current account balance release.
[7] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

Statement by Mr. Moreno and Mr. Cartagena Guardado on Costa Rica
March 1, 2021

Our authorities want to express most gratitude to management and staff for the timely response to Costa Rica's request of a three-year Extended Fund Facility (EFF) for SDR 1,237.49 million (335 percent of quota). We also extend our especial appreciation to Ms. Manuela Goretti, the Mission Chief, and her team, for their excellent work and fruitful discussions with the authorities, as well as for their efforts to bring this request to the Board in a timely manner. The EFF will help fulfill part of the balance of payments gap and support budget needs derived from the exogenous COVID-19 shock, and it will be instrumental in catalyzing additional financial support from other official lenders and international capital markets. The EFF follows a disbursement of SDR 369.4 million (100 percent of quota) under the Rapid Financial Instrument (RFI), approved by the Board in April 2020. The combined RFI and EFF resources, in response to the pandemic, signal a historical step for the country, which last drew Fund resources in 1991 under an SBA.

Background information

Costa Rica is recognized for its strong institutions and long-standing democracy. For decades, its policies have focused on economic openness and investment in human capital. They have laid the foundation for a profound transformation from an agriculture-based economy to a knowledge-intensive, service-oriented one. Costa Rica is one of three countries in Latin America ranked as full democracy by the Economist Intelligence Unit´s Democracy Index (21st in the world by same index). It also enjoys one of the highest human development indices in the region.

Since 2018, the authorities have adopted wide-ranging structural reforms, in line with the OECD accession process. The roadmap for structural reforms since 2018 has aimed to boost the economy's growth potential, reduce inequality and improve the living conditions of the population, with a strong commitment to decarbonization and building resilience to climate change. Acknowledging this process, OECD invited Costa Rica to become its 38th member in May 2020. Alongside the accession process, Costa Rica has taken decisive steps to align its legislation and public policies with international best practices and OECD standards in areas such as competition, statistics, anti-corruption, corporate governance, financial markets, and tax transparency. The accession agenda enjoys broad political support and has also provided the building blocks for the dialogue with the IMF, particularly on the structural front.

The authorities took decisive steps to strengthen macroeconomic policies. Costa Rica´s fiscal situation deteriorated sharply over the last decade. Recognizing the need to restore sustainability, the authorities promoted a comprehensive fiscal reform, approved in December 2018, to increase revenue, rein in spending, and put debt on a declining trajectory over the medium term. The reform included broadening the base for the value-added tax, higher income taxes, and a fiscal rule limiting expenditure growth underpinned by provisions to put a lid on public sector wages, one of main drivers of the fiscal deficit. The authorities also made substantive progress in strengthening the monetary and exchange rate policy framework and improve financial sector regulation and supervision.

The impact of the pandemic

The Costa Rican economy has been hit hard by the COVID-19 pandemic. According to preliminary estimates from the Central Bank (BCCR), 2020 ended with a 4.5 percent drop in GDP, the deepest economic contraction since 1982. The tourism industry, which accounts directly and indirectly for about 13 percent of GDP and employment, has been severely affected, but other sectors such as transportation and commerce have also taken a heavy toll. The unemployment rate doubled to over 24 percent, disproportionately affecting women and the young.

The economic and health crisis also led to a drastic deterioration in public finances, just when the benefits from the December 2018 reform were materializing. Tax collections tumbled due to the contraction of economic activity and the targeted moratoria on income and VAT taxes. The authorities increased health-related spending to address the pandemic, and introduced a special transfer program (Bono Proteger) to support households most affected by the crisis. To limit the fiscal impact, the authorities also contained non-priority primary spending, including current transfers to the public sector. However, the economic fallout from the pandemic entails that a new fiscal adjustment program, additional to the reform passed in 2018, will be necessary to keep debt at manageable levels over the medium term.

Monetary and financial authorities have taken support measures to mitigate the impact of the crisis. They have adopted a mix of monetary and prudential policies to lower interest rates, improve credit conditions, and ensure adequate functioning of financial markets. These measures have helped support cash flows to households and businesses, thereby protecting employment and the productive fabric.

Costa Rica's strong health system and sanitary measures were instrumental to reduce covid-related fatalities. At 1.37 percent, the fatality rate ranks one of the lowest in Latin America. It was the first country in Central America and among the first in the entire region to begin vaccinations against COVID-19, and the process is advancing well with over 100k doses administered so far and supplies secured for the entire adult population.

The outlook signals a sustained recovery through 2022. BCCR projects GDP growth at

2.6 percent in 2021 and 3.6 percent in 2022. While subject to the unprecedented uncertainties of the pandemic, the outlook is anchored on better external conditions and reopening of economies globally. Supportive credit conditions and improvement in consumer and business confidence as vaccination continues will also aid the economic recovery to take hold.

Costa Rica has remained closely engaged with the Fund during the pandemic. At the outset of the crisis, the country requested Fund support through the RFI , which helped ease the economic consequences. The Letter of Intent (LOI) for the RFI, signed in April 2020, expressed the authorities' desire to explore a longer-duration arrangement given the protracted impact of the pandemic and the need for additional fiscal consolidation. A close dialogue ensued and culminated with the formal request for an EFF program, intended for budget support purposes. The EFF will also help address the balance of payments and government financing needs, support the economic recovery, and provide a policy anchor to ensure macroeconomic stability.

The EFF Program

The program is structured around three pillars. As expressed in the authorities´ LOI, the program's three key objectives are: (i) gradually implementing equitable fiscal reforms to ensure debt sustainability while protecting the most vulnerable; (ii) maintaining monetary and financial stability while continuing to strengthen central bank autonomy and governance, and addressing structural financial vulnerabilities; and (iii) on the structural front, advancing on key reforms to promote inclusive, green, and sustainable growth.

The program is designed with strong ownership, including a wide political and social engagement. The authorities carried out a broad public consultation process between October and November 2020. A report titled "Plan to Overcome the Fiscal Impact Caused by the COVID-19 Pandemic: Proposal to Start Negotiations with the IMF" was made publicly available as a basis for discussion. It also became the authorities' baseline to start formal negotiations with the Fund's staff mission in January 2021. Public dialogue continues, with authorities engaging with the private sector, civil society organizations and Congress to advance key reforms contained in the Fund staff-level agreement.

On the fiscal front, the required consolidation will be based on continued implementation of the fiscal rule as well as additional tax and expenditures measures to ensure a gradual reduction in the fiscal deficit and put debt on a downward trajectory over the medium term. The fiscal program is anchored on two targets: a primary balance of 1 percent of GDP by 2023 and a debt-to-GDP ratio of 50 percent by 2035. To achieve these goals, the authorities are firmly committed to continue strict implementation of the fiscal rule, along with measures to contain expenditure beyond the mandate of the fiscal rule. A key element of the fiscal program on the expenditure side is a public employment bill, an ambitious reform to modernize and streamline the public administration while containing the wage bill, all in line with OECD recommendations. On the revenue side, measures include reduction of tax expenditures, adjustment of capital income rates, personal income tax reform, special tax on lottery prizes, overhaul of the tax on luxury homes, and mandated dividend distributions from state-owned enterprises. The fiscal program also envisages gains from reforms to public procurement, modernization of the tax and customs administration, and public financial management reforms. Finally, it contemplates protection of capital expenditure and welltargeted social spending to address critical infrastructure needs and support the most vulnerable.

Work with Congress on approval of the fiscal reforms contemplated in the EFF has started. The Goverment has already submitted to Congress all of the draft bills contained in the EFF policy commitments. To ensure adequate and timely progress with the fiscal reform package, the authorities are actively working with members of Congress to address any questions and secure support.

Monetary policy will continue to be underpinned by the authorities´ commitment to low inflation under the inflation targeting framework. Maintaining low and stable inflation (with a target of 3 percent ± 1 percentage point) under a flexible exchange rate is critical to secure domestic and external stability. In the context of the current and forecast inflation well below target, and strong disinflationary pressures from a negative output gap and high unemployment, BCCR has cut its policy rate to a record low. The authorities are committed to maintaining this counter-cyclical stance for as long as necessary to bring inflation gradually back to target as conditions allow. They have also introduced a policy of greater exchange rate flexibility, which is proving effective in absorbing shocks and helping reduce financial dollarization. To further support this strategy, the authorities have put in place reserve requirements differentiated by currency, as well as prudential regulation measures to discourage foreign-currency lending to unhedged borrowers. In 2019, the authorities promoted reform to strenghten the autonomy of the central bank through amendments to the BCCR Law. These amendments tightened dismissal rules for the BCCR's Governor, delinked the Governor´s term from the political cycle, and removed the Minister of Finance's voting rights in the BCCR Board.

The authorities are committed to continuing with the structural reform agenda, including on climate change. As previously highlighted, Costa Rica has laid out a comprehensive roadmap for structural reform to align public governance and policies with international best practices, and foster transparency, efficiency, and growth while reducing inequality and protecting the most vulnerable. Many of these reforms have already been completed as part of the accession process to OECD. The remaining ones are being implemented. Focus areas for the EFF include reducing skill mismatches, promoting innovation, incentivizing formalization, closing infrastructure gaps, cutting red tape, and continuing to attract FDI. Also, as part of the EFF, the authorites have reiterated their commitment to climate change reforms, with measures to reduce greenhouse gas emissions, for instance by promoting the electrification of the transport fleet, and to strengthen Costa Rica´s adapting capacity, for example by assessing the medium-term investment needs for enhancing resilience of the country´s physical infrastructure.

Fund capacity development will be a key element to support the program success. As outlined in the staff report's Informational Annex, Costa Rica has actively engaged in the use of Fund technical assistance, including on fiscal and national accounts statistics, financial regulation and supervision, customs efficiency, and revenue mobilization. Capacity building has been instrumental in the EFF design, and will continue to be critical for success of the policy agenda under the program.

We would like to emphazise the authorities´ strong commitment to the requested EFF, which will help support a smooth economic recovery, boost green and inclusive growth over the medium term, and provide a strong policy anchor for macroeconomic stability while protecting the poor. They are confident that the policies outlined in the LoI, and further detailed in the Memorandum of Economic and Financial Policies, will ensure an effective use of the requested disbursement. The authorities will remain in close dialogue with the Fund, as mentioned in the LoI and its annexes, to ensure the successful implementation of the program.