INTERNATIONAL MONETARY FUND

IMF Country Report No. 23/231

COSTA RICA

June 2023

FOURTH REVIEW UNDER THE EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY, FIRST REVIEW UNDER THE RESILIENCE AND SUSTAINABILITY ARRANGEMENT, REQUEST FOR MODIFICATION OF REFORM MEASURE UNDER THE RESILIENCE AND SUSTAINABILITY FACILITY, AND MONETARY POLICY CONSULTATION

In the context of the Fourth Review Under the Extended Arrangement Under the Extended Fund Facility, First Review Under the Resilience and Sustainability Arrangement, Request for Modification of Reform Measure Under the Resilience and Sustainability Facility, and Monetary Policy Consultation, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on June 26, 2023, following discussions that ended on April 28, 2023, with the officials of Costa Rica on economic developments and policies underpinning the IMF Extended Fund Facility arrangement, and reform measures supporting the IMF Resilience and Sustainability Facility arrangement. Based on information available at the time of these discussions, the staff report was completed on June 9, 2023.
- A **Staff Statement** updating information on recent developments.
- A **Statement by the Executive Director** for Costa Rica.

The documents listed below have been or will be separately released:

Letter of Intent sent to the IMF by the authorities of Costa Rica*****
Memorandum of Economic and Financial Policies by the authorities of Costa Rica*****
Technical Memorandum of Understanding*****

*****Also included in Staff Report

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.

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IMF Executive Board Concludes the Fourth Review of Costa Rica's Extended Fund Facility and the First Review under the Resilience and Sustainability Facility

FOR IMMEDIATE RELEASE

- The IMF Executive Board concluded today the fourth review under the Extended Fund Facility (EFF) for Costa Rica, allowing for a disbursement equivalent to about US$ 275 million.
- The IMF Executive Board also concluded the first review under Costa Rica's Resilience and Sustainability Facility (RSF) arrangement, making available about US$ 246 million in support of Costa Rica's ambitious climate change agenda.
- The authorities continue to make important progress on Costa Rica's economic reform agenda. Going forward, the overall policy stance should remain focused on durably bringing inflation back to target and keeping public debt on a firm downward path, while advancing reforms to achieve green, dynamic and inclusive growth.

Washington, DC – **June 26, 2023:** The Executive Board of the International Monetary Fund (IMF) completed today the fourth review of Costa Rica's economic reform program supported by the IMF's extended arrangement under the Extended Fund Facility (EFF). Completion of this review makes available SDR 206.23 million (about US$ 275 million), bringing total disbursements under the arrangement to SDR 825.0 million (about US$ 1.1 billion).

The Executive Board also concluded today the first review under Costa Rica's Resilience and Sustainability Facility (RSF) arrangement. Completion of this assessment makes available SDR 184.7 million (about US$ 246 million).

Costa Rica's three-year extended arrangement under the EFF was approved on March 1, 2021, in the amount of SDR 1.23749 billion (US$1.778 billion or 335 percent of quota in the IMF at the time of approval of the arrangement, see Press Release No. 21/53) and was extended by five months on March 25, 2022 (see Press Release No. 22/91).

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

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

"The Costa Rican authorities are making important progress on their economic reform agenda. Growth has been resilient despite global headwinds and inflation is on a strong downward trend. Program performance under both the Extended Fund Facility and the Resilience and Sustainability Facility remains strong.

“The Central Bank of Costa Rica (BCCR)’s data-dependent, forward-looking approach helped bring inflation back down. While there is scope for further monetary easing in 2023, policies should remain attentive to risks to the inflation outlook. The authorities are taking gradual steps to strengthen the BCCR’s autonomy, governance, and operational framework, and should persist in those efforts.

“Fiscal targets were met by large margins, further strengthening debt sustainability. Proposed tax reforms, including recently submitted legislation, will make the system more progressive, equitable, efficient, and environmentally friendly. The steady improvement in public debt management is also welcome. The implementation of the Public Employment Bill is taking longer than expected, but recent progress represents a crucial milestone toward a full implementation.

“The supervisory authorities’ continuous proactive monitoring of the financial system is important, as are the coming legal reforms to enhance the framework for bank resolution and deposit insurance, which will further strengthen the financial safety net.

“Important improvements to the targeting and efficiency of social programs are underway to help address relatively high poverty rates, and new incentives to formalize employment, support female labor force participation and entrepreneurship, and improve the business climate are key steps towards a more dynamic and equitable economy.

“The RSF arrangement is supporting Costa Rica’s ambitious climate change agenda. The authorities completed all RSF reform measures for this review, taking steps to incorporate climate considerations into fiscal planning and policy, infrastructure investments, financial sector supervision, and the investment of the country’s international reserves. The authorities are also intensifying efforts to attract climate financing from official and private sector sources.”

Costa Rica: Selected Economic and Financial Indicators

					Projections					
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
Output and Prices				(Annual percentage change)						
Real GDP	2.4	-4.3	7.8	4.3	3.0	3.2	3.2	3.3	3.2	3.2
GDP deflator	2.6	0.8	2.0	5.8	2.0	3.2	3.1	3.0	3.1	3.0
Consumer prices (period average)	2.1	0.7	1.7	8.3	1.9	3.0	3.0	3.0	3.0	3.0
Savings and Investment				(In percent of GDP)						
Gross domestic saving	14.8	15.1	16.3	14.7	16.7	17.3	17.9	17.9	17.9	18.1
Gross domestic investment	16.1	16.2	19.6	18.6	20.2	19.9	20.3	20.0	19.9	19.9
External Sector										
Current account balance	-1.3	-1.0	-3.3	-4.0	-3.4	-2.7	-2.4	-2.1	-1.9	-1.8
Trade balance	-6.0	-2.7	-4.4	-5.6	-5.7	-5.7	-5.9	-6.0	-6.0	-6.2
Financial account balance	-2.0	-1.9	-2.5	-3.2	-3.4	-2.6	-2.3	-2.1	-1.9	-1.8
Foreign direct investment, net	-4.2	-2.6	-4.8	-4.3	-3.4	-3.2	-3.3	-3.3	-3.2	-3.2
Gross international reserves (millions of U.S. dollars)	8,937	7,232	6,921	8,724	10,541	11,205	11,527	12,258	12,830	13,518
-as percent of ARA metric	132.5	108.4	96.7	100.9	110.5	110.1	108.7	108.5	107.7	107.7
External debt	47.8	49.6	50.0	52.4	47.5	48.4	48.4	49.0	49.1	49.1
Public Finances 1/										
Central government primary balance	-2.6	-3.7	-0.3	2.1	1.5	1.9	2.0	2.0	2.1	2.1
Central government overall balance	-6.7	-8.4	-5.1	-2.8	-3.4	-2.8	-2.4	-2.1	-1.9	-1.7
Central government debt	64.5	66.9	68.0	63.8	62.4	61.4	60.4	59.1	57.6	55.9
Money and Credit										
Credit to the private sector (percent change)	-2.3	3.4	3.7	3.3	3.8	6.0	6.1	6.1	6.2	6.2
Monetary base 2/	7.1	8.3	7.9	8.1	7.9	7.8	7.7	7.7	7.8	7.8
Broad money	44.8	54.8	54.1	47.9	47.9	47.9	47.3	47.2	47.2	47.2
Memorandum Items										
Nominal GDP (billions of colones) 3/	37,832	36,495	40,113	44,252	46,483	49,500	52,669	56,040	59,632	63,400

Output gap (as percent of potential GDP)	0.2	-3.6	-0.1	0.8	0.5	0.2	0.1	0.1	0.0	0.0
GDP per capita (US$)	12,691	12,164	12,473	13,075	16,250	17,016	17,779	18,560	19,402	20,225
Unemployment rate	12.4	20.0	13.7	11.7	10.7	10.1	9.8	9.6	9.5	9.3

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

June 9, 2023

FOURTH REVIEW UNDER THE EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY, FIRST REVIEW UNDER THE RESILIENCE AND SUSTAINABILITY ARRANGEMENT, REQUEST FOR MODIFICATION OF REFORM MEASURE UNDER THE RESILIENCE AND SUSTAINABILITY FACILITY, AND MONETARY POLICY CONSULTATION

EXECUTIVE SUMMARY

Recent developments. Growth has been resilient despite global headwinds and inflation is on a strong downward trend. The easing of external pressures has allowed the authorities to rebuild reserves, while the ongoing fiscal consolidation has strengthened debt sustainability and contributed to upgraded sovereign ratings.

Program performance. Program performance under both the Extended Fund Faciliy and the Resilience and Sustainability Facility remains strong. All performance criteria and indicative targets have been met for the fourth review of the EFF. Inflation exceeded the outer band of the Monetary Policy Consultation Clause in December 2022, triggering a Board consultation, but has been on a strong downward trend, returning to the central bank's tolerance band in April. Implementation of most structural reforms is on track. Progress on implementing the Public Employment Bill has been slower than anticipated but the single wage spine has been put in place for one quarter of executive branch positions, meeting the prior action for this review. Submission of amendments to the central bank law has been delayed but the authorities have submitted a subset of these amendments to the legislature and are preparing a separate law proposal to provide constitutional autonomy to the central bank. All reform measures scheduled under the RSF arrangement were completed.

Focus of the review. The review focused on accelerating structural reforms, and further improving social protection, the equity and efficiency of taxes, and the fiscal rule. There was broad agreement that the overall policy stance should remain focused on durably bringing inflation back to target and keeping public debt on a firm downward path.

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

The team consisted of Ding Ding (head), Charlotte Lundgren, Alberto Behar, Pedro Juarros, and Daniel Wales (all WHD), Juan Carlos Benítez (FAD), Piyabha Kongsamut and Fumitaka Nakamura (MCM), Igor Zuccardi (SPR), Santiago Acosta-Ormaechea and Ivania García Cascante (Resident Representative Office), with assistance from Heidi Canelas, Eliana Porras, and Rozi Lamprakaki (all WHD) and Orlando Carvajal (Resident Representative Office). Discussions were held during April 17-28 in San José, Costa Rica. The team held meetings with Costa Rica's President Chaves Robles, Vice Presidents Brunner Neibig and Munive Angermüller, BCCR's President Madrigal López, Minister of Finance Acosta Jaén, and other senior government and financial sector officials, members of the Legislative Assembly, academics, private sector, civil society, and union representatives as well as other development partners. Alfonso Guerra and Valerie Lankester (both OED) joined some of the meetings. World Bank and Inter-American Development Bank staff also joined some of the meetings and provided inputs.

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CONTEXT

1. The Costa Rican authorities continued to move their reform agenda forward, supported by the EFF and RSF arrangements. Faced with external pressures in the first half of 2022, the authorities took decisive actions to counter inflation and rebuild reserve buffers. Fiscal consolidation has continued to overperform the government's targets. Important progress is also being made on structural reforms, with capacity development support from the Fund and development partners (see Annex I and II).

RECENT DEVELOPMENTS

2. Growth has been resilient despite global headwinds.

- *Real GDP* growth decelerated to 4.3 percent in 2022 after a strong post-COVID rebound in 2021. Growth in the first quarter of 2023 was 4.0 percent (y-o-y), driven by strong exports especially in medical devices, which account for 35 percent of all goods exports.

- *Unemployment* fell to 10.6 percent in March, although the labor force participation rate remains below pre-pandemic levels. Informal employment represents 42 percent of total employment.

- *The current account deficit* was 4.0 percent of GDP in 2022, 0.7 percentage points higher than in 2021. BOP pressures have eased due to lower commodity prices, a strong export performance (including in tourism), lower outflows by local pension funds, and robust FDI inflows.

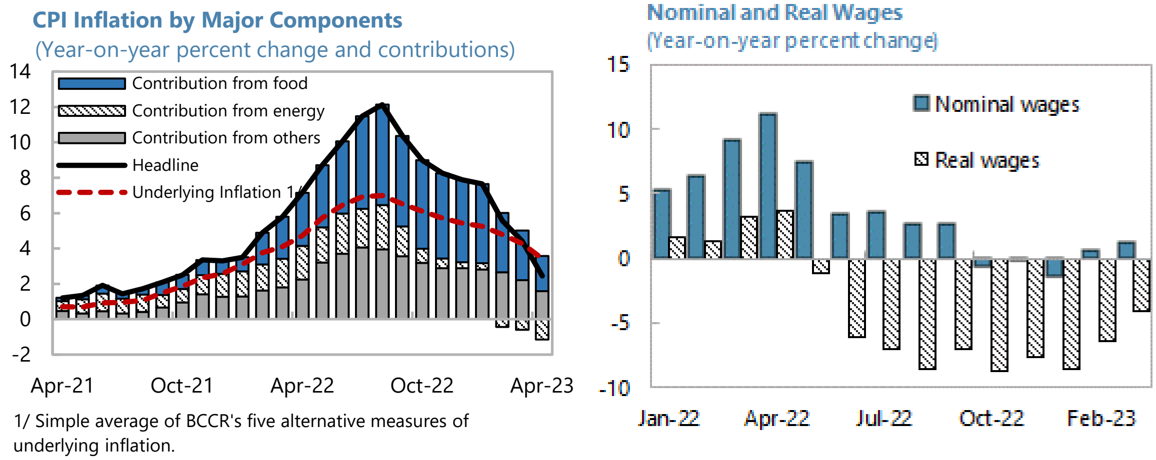
- During 2022, the *real effective exchange rate* appreciated 13 percent, followed by another 5.5 percent appreciation as of end-March 2023.

- *EMBIG spreads* fell 151 bps in the second half of 2022, even as global financial conditions tightened, and by a further 16 bps by end-April 2023. Costa Rica's sovereign debt rating was upgraded by rating agencies in early 2023, and local and international government bond yields have decreased.

- *Private sector credit* grew by 5.5 percent y-o-y (adjusted for exchange rate movements) in March, up from 2.5 percent at end-2021. Consumer credit and borrowing by the wholesale and retail sector accounted for much of the credit growth.

3. Inflation has been on a strong downward path. Headline inflation fell to 2.4 percent (y-o-y) in April from the peak of 12.1 percent in August, driven by falling energy prices. The composite indicator of core inflation fell to 3.4 percent. Disinflation in recent months has been broad-based and month-on-month inflation has turned negative since February. Real wage growth has been negative for most of the past year, in part owing to the public sector wage freeze that was triggered as a result of the fiscal rule.

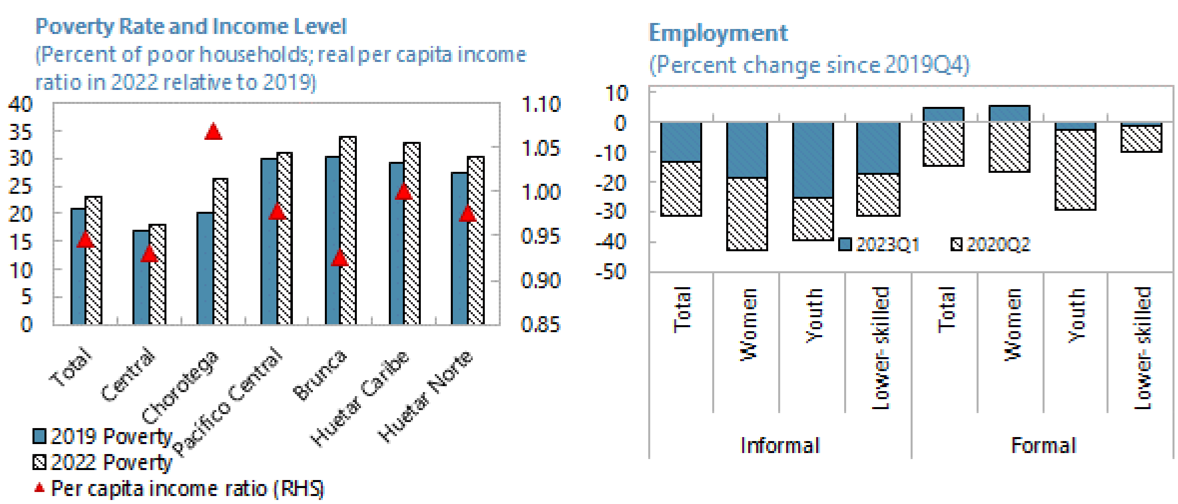
Costa Rica: Inflation and Wages



Sources: BCCR, INEC and; IMF staff estimates.

4. Social indicators continue to improve, albeit unevenly. The national unemployment rate has returned to its pre-pandemic level. However, poverty rates are high (23 percent for the country as a whole and up to 34 percent in the rural Brunca region) and real incomes have not yet recovered to pre-pandemic levels for most regions. Informal sector employment growth—especially for lower-skilled, young, and female workers—has been weak.

Costa Rica: Social and Labor Market Indicators



Sources: BCCR and IMF staff estimates.

OUTLOOK AND RISKS

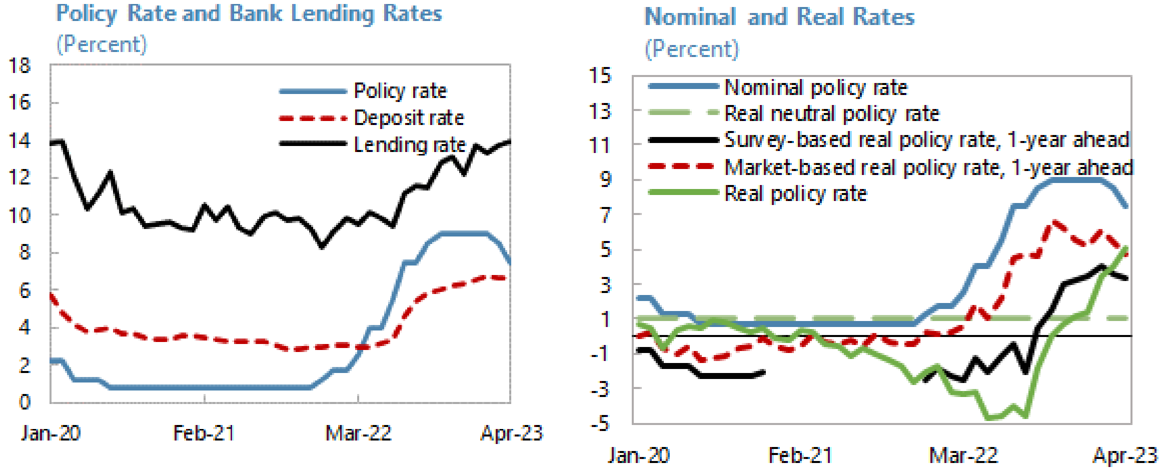
5. Growth is expected to moderate to 3 percent in 2023. Headline inflation is projected to remain below the Central Bank of Costa Rica (BCCR)'s target of 3 percent for the rest of the year as base effects from past increases in food and commodity prices fall out of the annual comparison while the impact of *colón* appreciation and monetary policy tightening continue to feed through. The current account deficit is expected to decline to 3.4 percent of GDP this year and to around 2 percent of GDP over the medium term as external demand, including tourism, continues to recover.

6. There are important downside risks to the outlook. Weaker-than-expected external demand, tighter global financial conditions, and commodity price volatility could add to BOP and inflationary pressures. Costa Rica's exposure to natural disasters presents an enduring risk. However, the government's ongoing reform program has the potential to create more fiscal space that can be used to bolster investment and job creation.

PROGRAM PERFORMANCE AND POLICY DISCUSSIONS

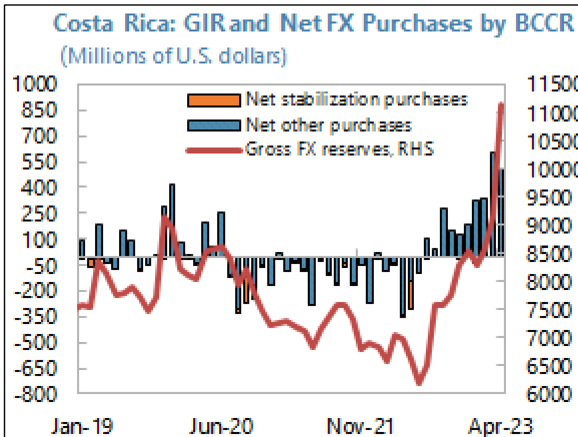
A. Safeguarding Monetary and Financial Stability

7. The BCCR's restrictive monetary policy stance has helped bring down inflation. Between December 2021 and October 2022, the BCCR increased the policy rate from 0.75 percent to 9 percent. This decisive monetary tightening was the right response to rising inflation and, combined with the ongoing fiscal consolidation, has helped maintain macroeconomic stabilty. While inflation was above the outer band of the Monetary Policy Consultation Clause (MPCC) in December (see Appendix I, Attachment III), it fell below the BCCR's 3 percent target in April. This more favorable inflation outlook has allowed the BCCR to lower its policy rate by 150 bps, while the ex ante real policy rate has remained above the neutral level. The BCCR's data-dependent, forward-looking approach, supported by clear and transparent communications, has helped anchor inflation expectations. Going forward, the weakening of inflation pressures provides scope for a further reduction in interest rates in 2023 (although policy decisions should remain data dependent).



Sources: BCCR and IMF staff estimates.
Note: The real policy rate is defined as the nominal policy rate less one-year ahead inflation expectations.

8. An improved external environment has allowed the central bank to rebuild international reserves. The end-December and end-March NIR targets were met by large margins (US$576 million and US$1511 million, respectively). At end-April 2023, gross international reserves were US$11.1 billion (116.8 percent of the IMF's Reserve Adequacy metric), up from US$6.2 billion as of end-June. Systematic FX purchases by the BCCR, the issuance of a US$1.5 billion Eurobond, and multilateral funding inflows have all boosted reserves.



Sources: BCCR and IMF staff estimates.

9. The BCCR is committed to allowing the exchange rate to be determined by market conditions. Recent interventions in the exchange market have been focused on ensuring an adequate level of reserves and addressing disorderly market conditions. To deepen the FX market and increase the predictability and transparency of the central bank's FX operations, the BCCR is working to reorganize its FX operations, including by extending Monex trading hours, developing FX derivatives, and reviewing banks' net open position limits.

10. The financial sector is well capitalized and liquid. The system's capital adequacy ratio was 18 percent in March, well above the regulatory minimum. Banks are also highly liquid. The NPL ratio remains low at 2 percent and provisioning is adequate. However, with over 80 percent of loans at variable rates, the increase in interest rates are weakening the repayment capacity of some borrowers. Dollarization of loans remains high at 32 percent and the appreciation of the exchange rate has lessened credit risks associated with foreign currency lending to unhedged borrowers.

11. Financial supervisors continue to closely monitor risks to the financial sector, while improving their toolkit.

- **Supervision.** Supervisors are proactively ensuring that provisioning is adequate and that any asset quality concerns do not develop into systemic threats. To strengthen supervisors' legal powers and protections, the authorities are developing a roadmap to address the recommendations from the recent Basel Core Principles assessment. Regulations that mandate adequate assessment of socioenvironmental and climate change risks in banks' credit portfolios are being developed.

- **De-dollarization.** To reduce the risks from financial dollarization, a tighter definition of an unhedged FX borrower has been introduced with reduced room for discretion in the assessment of currency mismatches. Additional capital requirements will be imposed on FX loans to unhedged borrowers starting in January 2024. The supervisory authorities have also begun to regularly publish data on unhedged FX borrowing.

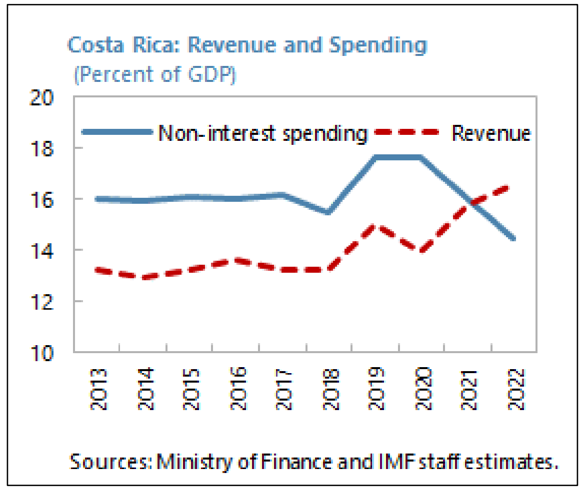
- **Bank resolution.** The legal framework for bank resolution and deposit insurance is being amended to strengthen the institutional arrangements for the deposit guarantee fund and for resolution authority (with stronger resolution powers and clear triggers). The proposed amendments are expected to be submitted to the national supervisory council for approval by end-September 2023.

- **Financial inclusion and cyber risk.** The government will develop a plan to modernize and broaden the coverage of the credit registry by end-July 2023. To address cyber risks, the authorities have prepared draft regulation, which is expected to be approved by end-November 2023.

12. While a comprehensive reform proposal has not been submitted, the authorities are taking gradual steps to further strengthen the BCCR's autonomy, governance, and operational framework. The authorities have submitted to the Legislative Assembly a limited subset of amendments to the central bank law. They also intend to submit a separate law proposal during the August-October legislative session to provide constitutional autonomy to the central bank. Following the legislative process of these proposals, the authorities should consider further measures to align the BCCR's governance reforms with the recommendations of the 2020 Safeguards Assessment, to be discussed in the context of the next program review.

B. Strengthening Fiscal Institutions and Preserving Fiscal Sustainability

13. Fiscal outturns continue to overperform the government's targets. The 2022 primary balance was 1.4 percent of GDP above the target. Tax revenues rose by 0.4 percent of GDP between 2021 and 2022, mostly due to stronger activity and the price effect (including strong increases in the price of imported goods). Also, there were one-off transfers from the consolidation of nonbudget entities into the primary balance. Primary spending fell by 1.6 percent of GDP due to wage freezes, lower transfers to public entities, and the underexecution of capital spending.



14. **The authorities are on track to exceed their 2023 primary surplus target of 1.3 percent of GDP.** As a result of the fiscal rule, the approved budget has frozen current primary spending in nominal terms. In order to protect coverage of the vulnerable from the fiscal consolidation amid high inequality,[1] the government aims to maintain priority social spending as a share of GDP constant, offset by lower spending on other transfers and on goods and services. An unwinding of cyclical revenues and a one-off payment to settle a debt to the social security fund (that was postponed from 2022 to 2023) will reduce the headline primary balance. However, continued structural gains through tax yields and tight spending control are expected to continue the underlying fiscal consolidation trend.[2] As an early indication of the likely fiscal performance in 2023, the March indicative target on the primary balance was met by a large margin.

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

	CR/21/48			CR/22/93			CR/22/345			Proj.		
	2021	2022	2023	2021	2022	2023	2021	2022	2023	2021	2022	2023
Revenue measures:	**0.4**	**0.8**	**1.4**	**0.2**	**0.3**	**0.4**	**0.2**	**0.3**	**0.4**	**0.2**	**0.3**	**0.4**
2018 tax reform yields	0.1	0.1	0.3	0.2	0.3	0.4	0.2	0.3	0.4	0.2	0.3	0.4
New permanent measures	0.4	0.7	1.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure measures:	**-1.3**	**-1.8**	**-2.3**	**-1.5**	**-2.9**	**-3.4**	**-1.5**	**-2.9**	**-3.2**	**-1.5**	**-2.7**	**-3.2**
Wage bill	-0.6	-0.8	-1.0	-0.6	-0.9	-1.3	-0.6	-1.1	-1.4	-0.6	-1.2	-1.5
Purchases of G&S	-0.1	-0.2	-0.3	-0.1	-0.2	-0.3	-0.1	-0.2	-0.2	-0.1	-0.1	-0.2
Current transfers	0.0	-0.5	-0.8	-0.3	-1.4	-1.7	-0.3	-1.2	-1.5	-0.3	-0.9	-1.2
o.w. Social assistance	0.1	0.1	0.1	0.0	0.0	0.1	0.0	-0.1	-0.1	0.0	-0.2	-0.2
Capital spending	-0.5	-0.3	-0.1	-0.5	-0.4	-0.2	-0.5	-0.4	-0.2	-0.5	-0.5	-0.3
Total structural measures	**1.7**	**2.5**	**3.7**	**1.7**	**3.2**	**3.8**	**1.7**	**3.2**	**3.6**	**1.7**	**3.0**	**3.6**
+ One-off measures	0.6	0.7	0.6	0.9	0.4	0.4	0.9	0.7	0.5	0.9	0.8	0.4
+ Cyclical impact/tax admin gains	0.1	0.4	0.6	0.8	0.9	0.9	0.8	1.0	1.0	0.8	2.0	1.3
Primary balance	**2.3**	**3.6**	**4.9**	**3.5**	**4.4**	**5.1**	**3.5**	**4.8**	**5.1**	**3.5**	**5.8**	**5.3**
Primary balance (Percent of GDP)	**-1.7**	**-0.3**	**1.0**	**-0.3**	**0.7**	**1.3**	**-0.3**	**1.1**	**1.3**	**-0.3**	**2.1**	**1.5**

Source: IMF staff estimates.

[1] See "The Inequality and Informality Challenge" in the [2021 Article IV Consultation and EFF Request Staff Report](#).

[2] The text table includes past projections at the time of the EFF request (CR/21/48), the First and Second Reviews (CR/22/93), and the Third Review (CR/22/345).

15. Proposed amendments to the fiscal rule are designed to preserve its role in anchoring spending. The nominal expenditure rule that came into force in 2020 has institutionalized spending discipline but was still able to be deployed with flexibility during the extraordinary COVID-19 shock. Since an initial proposal to amend the rule was submitted to the Legislative Assembly in September 2022, the proposal has been refined through the legislative process, consistent with IMF TA, in order to improve the rule's operation while preserving its credibility and crucial role in containing spending and reducing debt. The refined proposal would exclude from the rule's coverage those financially sound public institutions that are operating as market producers or without government control. However, the broad coverage of the types of spending and the spending growth formulas would be maintained.

16. Implementation of the Public Employment Bill (PEB) is taking longer than expected. The implementation of the reform is critical to revamp the highly fragmented public salary system and modernize the public administration, and will also help gradually lower the wage bill. The implementing regulation for the legislation entered into force in March 2023. The single wage spine was produced for one-quarter of executive branch positions, a prior action for this review and a crucial milestone that will facilitate wider implementation. Guidelines for data collection, job factor valuation, and the design of the wage spine were issued for those public institutions that are not under the Ministry of Planning's technical and legal purview. The new wage scheme will cover at least 90 percent of executive branch positions by end-September (a proposed new structural benchmark (SB)). Payments under the new wage scheme for all employees covered by the PEB will begin in line with the transitional provisions under the law and its regulation by end-November 2023.

17. The government submitted in May bills to the Legislative Assembly to further improve the equity and efficiency of the tax system. The changes include:

- Moving to an income tax system that taxes the income of the self-employed, pensioners, and employees under the same, more progressive, schedule;
- Equalizing the tax treatment of capital income and gains;
- Taxing passive income earned abroad;
- Simplifying the taxation of non-residents;
- Eliminating the progressive rate structure for the corporate income tax;
- Rationalizing VAT exemptions; and
- Increasing the progressivity of the property tax on vehicles.

Costa Rica: Estimated Tax Policy Reform Yields, 2025

Tax Measures	Percent of GDP
Income tax	
Taxing self-employed under a dual schedule	-0.13
Schedule recalibration (keeping the current exemption threshold)	0.07
Eliminating the reduced progressive schedule within the CIT	0.14
Equating the tax rate on all capital income and gains	0.01
Taxing dividends distributed by firms in Free zones 1/	>0
Taxing passive income earned abroad by residents 1/	>0
VAT and other indirect taxes	
Eliminating the reduced VAT rate on airfare purchases	0.05
Eliminating the reduced VAT rate on wood	0.00
Eliminating the exemption on car rentals 1/	>0
Eliminating the VAT exemption on medical equipment	0.03
Property taxes	
Improving the progressivity of the property tax on vehicles	0.00
Total tax reform yield	**0.17**

Source: IMF staff estimates.
1/ No data available to estimate yields.

The authorities have also updated the special regime for small businesses to align it with the general regime. The reforms would yield around 0.2 percent of GDP in additional revenues.

18. Efforts are underway to improve tax compliance. The backlog of unprocessed forms due to the cyber attacks in 2022 caused some delays in developing risk assessment plans by the tax and customs administrations. Nonetheless, an updated plan to improve compliance approved in December will develop tools to assess revenue risks (notably related to transfer pricing and cross-border payments). Updates to the tax code were submitted to the Legislative Assembly to improve enforcement and compliance in May. New regulations will expedite customs procedures, combat fraud, and impose fines on non-compliant taxpayers.

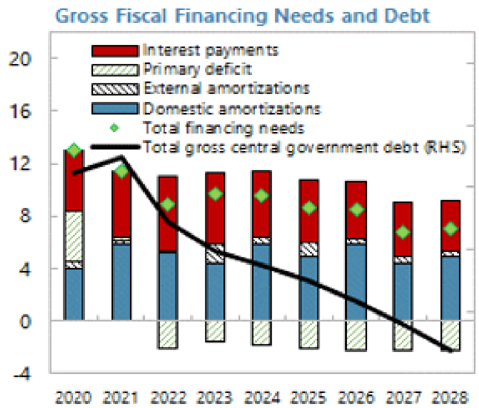
19. PFM reforms are advancing. Advancing submitted legislation will broaden the adoption of the National Public Investment Management System by autonomous institutions to ensure investments are aligned with the nation's medium- and long-term planning priorities. Legislation was proposed to the Legislative Assembly in September 2022 to help improve liquidity management of the Treasury Single Account and increase the transparency and traceability of public funds (through digitalization). To support the institutionalization of the Medium-Term Fiscal Framework (MTFF) and fiscal rule reforms, a macrofiscal unit is being formalized within the Ministry of Finance and the Fiscal Council is being operationalized.

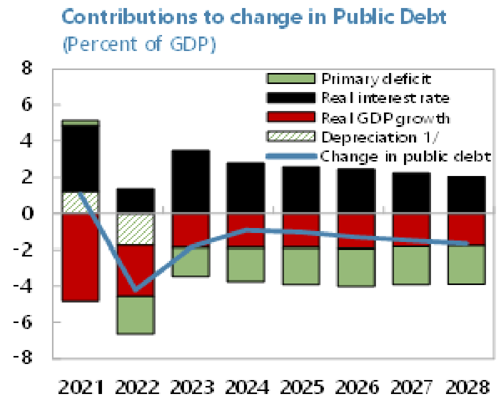
20. Public debt remains on a firm downward path. Fiscal overperformance, a stronger exchange rate, and inflation lowered debt to 64 percent of GDP at end-2022 and further this year so far. A continued downward path is expected to 56 percent of GDP by 2028, although debt levels and financing needs remain sensitive to the exchange rate and other risks.[3] The legislature has approved the issuance of up to US$5 billion in Eurobonds and legislation is being drafted to give the executive more discretion over external borrowing. A primary dealer pilot program is underway and a new law has been passed to reduce the obstacles for foreign investors to participate in domestic debt markets,[4] which should help develop the local market. Finally, legislation was submitted to centralize debt-related functions into a debt management office (a June 2023 SB) and the government is developing a strategic framework to govern its management of sovereign assets and liabilities.

[3] FX-denominated debt was 25 percent of GDP at end-2022 and estimated FX-denominated gross financing needs are almost 4 percent of GDP for 2023. Also see "Sovereign Risk and Debt Sustainability Analysis" Annex in the Third EFF Review Staff Report.

[4] Legal revisions, approved in December 2022, remove double taxation (previously 15 percent on interest on securities and 15 percent on repatriation abroad), clarify the term internal public debt, and add provisions to the Securities Market Regulatory Law on compensation, liquidation and custody of securities.

Costa Rica: Debt and Financing Needs
(Percent of GDP, 2020-2028)





Sources: Ministry of Finance and IMF staff estimates.
1/ For historical data only.

C. Supporting Climate Change Resilience and Decarbonization

21. 2022 was one of the rainiest years on record for Costa Rica, triggering flooding that affected 300,000 people and required emergency repairs. The impact of this event highlighted the need to better execute maintenance projects, incorporate climate resilience considerations into public investment decisions, and increase the fiscal resources available for emergencies.

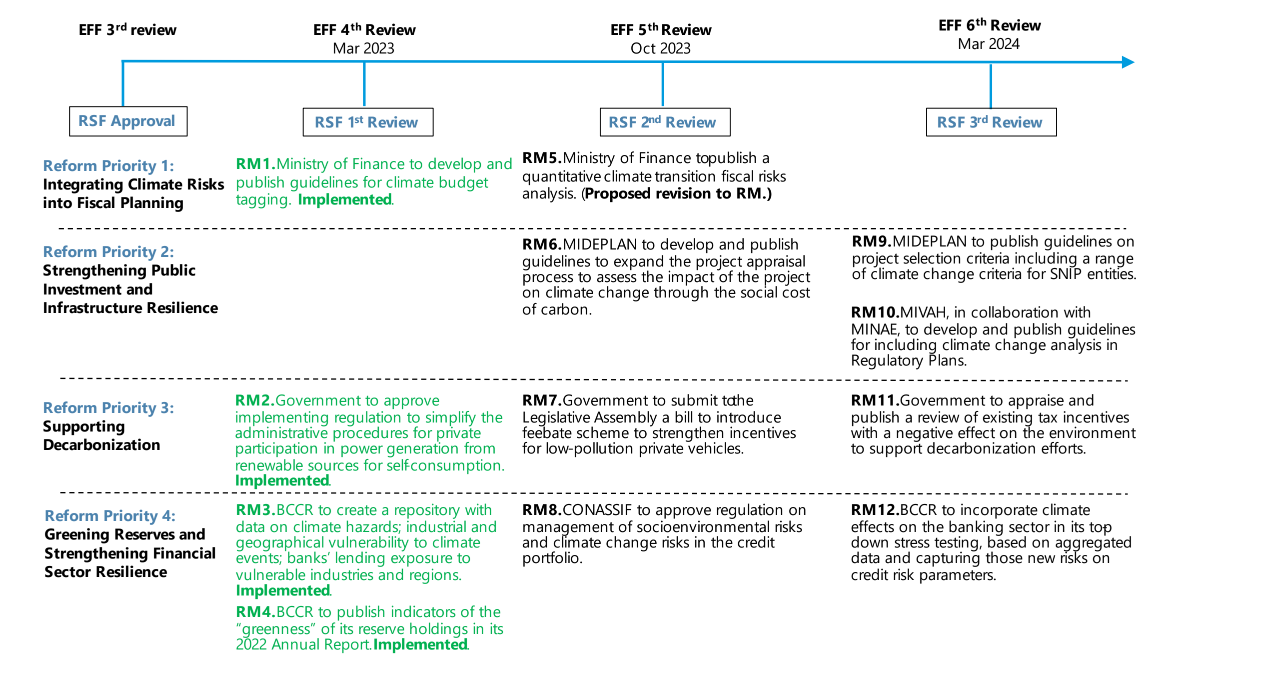
22. Costa Rica already has a low reliance on fossil fuels, which should facilitate a smooth transition to a low carbon economy. Electricity is generated almost exclusively from renewables and while transport and storage account for over half of greenhouse gas emissions they make up only around 5 percent of GDP and employment. Decarbonizing is expected to generate modest employment gains. However, agriculture, forestry, and fishing will face a negative impact.[5] As such, increasing labor mobility and investing in new skills (e.g. developing lower carbon and climate-resilient agricultural methods and maintaining electric vehicles) will be essential to smooth the transition for these workers. The authorities are formulating ways to adapt educational programs, especially for women and coastal area workers to meet these skills gaps. Furthermore, improvements are being made in the social safety net to protect vulnerable workers (¶28).

23. The authorities have implemented all the reform measures (RMs) expected for this review. They have published climate budget tagging guidelines (RM1) and are developing information systems to facilitate operationalization of climate expenditure classification in the budget, which will help prioritize investments in adaptation and resilience. They issued new regulations aligned with global best practice to facilitate private-sector participation in renewable energy for self-consumption (RM2). The BCCR completed RM3 by establishing a data repository on

[5] AFD and UCR (2021), *El Empleo en un Futuro de Cero Emisiones Netas en Costa Rica*; also see MINAE, RAND, and UNDP (2022), *A Green Costa Rica COVID-19 Recovery*.

climate hazards and vulnerabilities, including granular data on banks' exposure to vulnerable industries and regions, covering 35 percent of the banking system's credit portfolio. The BCCR is also incorporating green indicators into its international reserves portfolio decisions (RM4), while maintaining existing objectives on capital preservation, liquidity and rate of return.

Costa Rica: Progress on RSF Reform Measures



24. The authorities continue to move ahead with their climate-related reform agenda:

- Quantitative analysis of climate transition risks is being published and incorporated into the government's medium-term planning (proposed revision to RM5).[6] Project appraisal guidelines will examine the impact on climate change and legislation is being prepared to introduce feebates to incentivize lower emissions in transport (RM7). The authorities are continuing efforts to reduce the cost of electricity and increase its share in the energy matrix.

- Climate effects will be integrated into the BCCR's top-down stress testing (RM12) and a regulation is being developed to incorporate socio- and environmental risks into banks' risk management practices (RM8).

[6] At the time of the request for the RSF arrangement, the proposed RM was to publish the analysis in the September MTFF. The revised RM proposal has publication of a focused document and a slightly later indicative target date in order to allow more time to produce a richer analysis that is tailored to Costa Rica. Supporting reforms include an introduction to transition risks in the September MTFF and incorporation of the quantitative analysis in the March 2024 MTFF.

25. The authorities are also working to create an enabling environment for private climate financing, supported by measures included in the EFF and RSF arrangements. The government's ambitious fiscal reform program has compressed spreads and public investment reforms will increase the transparency of project appraisal and selection, and improve project quality and execution. These efforts should facilitate increased private financing. Private financing mechanisms are being explored to address projects that have high upfront costs and potentially long payback periods (e.g. the electrification of bus fleets). Legislation has been approved to promote thematic bonds and regulations that require supervised entities to incorporate sustainability in investment policies and ESG risks in risk management, allow the issuance of ESG bonds, and promote disclosure of ESG actions. A harmonized green taxonomy is to be developed with support from the Green Climate Fund and the United Nations Environment Programme. The planned removal of tax exemptions, for example in agriculture and transport, that have a negative environmental impact should incentivize private sector investments in greener projects. Finally, the authorities are working to improve project selection and the management of fiscal risks in order to incentivize Public-Private Partnerships for climate-related projects.

26. For 2023-2024, US$1.2 billion in climate-related financing is expected from official sources.[7] US$370 million[8] has been pledged by a World Bank adaptation and mitigation project while the IDB, French Development Agency, and Korean Infrastructure Funding Facility are expected to invest US$400 million in the conservation of ecosystems to capture greenhouse gases, the electrification of transport, renewable energy expansion, and improved gender equality in climate transition. The IDB also has US$100 million in ongoing projects in water and sanitation, renewable energy production, and transportation. Finally, the Central American Bank for Economic Integration is expected to lend US$350 million to rebuild infrastructure damaged by natural disasters and to make it resilient to future events.

27. Costa Rica's green credentials are partially priced in to its existing bonds. Even bonds without specific tags already attract ESG-focused investors. The authorities plan to build greater recognition as an ESG sovereign, possibly through ESG or sustainability-linked bonds.

D. Advancing the Agenda for Dynamic and Inclusive Growth

28. The authorities are enhancing their digital registry of social benefits recipients to improve the targeting, coverage and efficiency of social programs. A single window will be launched to consolidate social programs, improve targeting, and prioritize responses according to the urgency of need (proposed new SB for end-February 2024). Legislation has been submitted to consolidate social programs under the social benefits institute, IMAS. The UN is supporting the government in providing assistance to the considerable flow of in-transit migrants.

[7] Financing that has either been contracted or is under negotiation, and is included in the baseline financing assumptions.

[8] This amount excludes a Disaster Risk Management Policy Loan with a Catastrophe Drawdown Option signed in March 2023.

29. Improved childcare and long-term services are needed to support female labor force participation. Minimum quality standards for childcare are being established while coverage is being expanded to reach about 64,700 children by end-2023 (a four percent increase relative to pre-pandemic levels). Steps are also being taken to expand households' eligibility for long-term care. A roadmap to provide guidance and financial support for women entrepreneurs will be launched by end-October 2023. As part of the gender budgeting strategy, a pilot exercise was completed in December 2022 and the 2024 budget statement will identify gender-related spending.

30. The authorities are also taking steps to incentivize formal employment and improve the business climate. The Social Security Fund has begun to reduce the minimum contribution base for part-time workers in a phased manner (to reduce risks of contributions shortfalls). Low-income self-employed workers can voluntarily contribute to the health and pension scheme for 6 months (after which contributions become mandatory). Participation of seasonal workers in the social security system has been incentivized by eliminating the employee contribution of targeted groups such as coffee harvest workers. 132 obstacles identified by firms as preventing them from carrying out their businesses (such as excessive paperwork and regulations) were eliminated by end-March 2023. The authorities have also issued decrees and recently submitted a draft law to the Legislative Assembly to reduce the cost of specialized professional advice, through the elimination of mandatory minimum fees of 10 professional associations.

PROGRAM MODALITIES

31. All PCs and ITs and all Reform Measures for this review were met, and important progress is being made on structural reforms. Targets on the primary balance, government debt, and NIR were met with large margins. The MPCC outer band was exceeded in December (see Appendix I, Attachment III) but the authorities took corrective actions and inflation is now falling rapidly. Amendments to the BCCR Law were not submitted to the Legislative Assembly by December, but the authorities have subsequently submitted a subset of these amendments and are preparing legislation to provide the BCCR with constitutional autonomy. The March 2023 SB on implementation of the Public Employment Bill was not met but the authorities have made progress and a new SB has been established to ensure completion of these changes by November. The June 2023 SB to centralize debt management functions was met. The four reform measures under the RSF arrangement targeted for this review have been completed.

32. ITs for March 2024 and two new structural benchmarks are proposed to establish a single social assistance window and to ensure continued implementation of the Public Employment Bill (Appendix I, Tables 1 and 2). A modification of RM5 is also proposed, which integrates climate transition risks in fiscal planning.

33. Costa Rica's capacity to repay the Fund remains adequate and the program is fully financed. The program remains fully financed with firm financing commitments over the next 12 months and good prospects thereafter (Table 4). Costa Rica has an adequate capacity to repay to the Fund, with outstanding Fund credit peaking at 2.8 percent of GDP or 7.5 percent of exports in 2024 (Table 7). The authorities have submitted a bill to the Legislative Assembly to ratify the RSF arrangement.[9] Access to the EFF will help Costa Rica meet its existing balance-of-payments needs. Both the EFF and the RSF financing will continue to be used for direct budget support. RSF resources also provide Costa Rica with financing at longer maturities, substituting shorter-term private financing, improving their capacity to repay. The program remains subject to downside risks, particularly from the external environment, but there are buffers in place to respond to shocks. If needed, additional financing could be mobilized from domestic financial institutions or regional partners.

Costa Rica: Program Financing
(In millions of U.S. dollars)

	2022	2023	2024
Financing need	3,152	1,291	1,965
Reserve accumulation (excl. RSF)	1,803	1,324	418
Underlying BOP need 1/	1,349	-34	1,547
Official multilateral financing	2,673	1,291	1,965
IMF	552	550	275
EFF	552	550	275
Other multilateral creditors	2,121	741	1,690
World Bank	307	109	669
Inter-American Development Bank	385	516	416
CAF Development Bank for Latin America	0	0	0
Central American Bank for Economic Integration	329	115	604
Latin American Reserve Fund	1,100	0	0
Unidentified financing	479	0	0
RSF disbursement	0	493	246
Total change in official reserves (incl. RSF)	1,803	1,817	664
Memorandum items:			
Capital market access	0	2,500	1,000
Gross international reserves (incl. RSF)	8,610	10,541	11,205
In percent of the ARA metric (incl. RSF)	101	111	110
In percent of the ARA metric (excl. RSF) 2/	101	105	103

Source: IMF staff estimates.
1/ Net of private sector and bilateral financing.
2/ Excludes cumulated RSF disbursements.

STAFF APPRAISAL

34. The BCCR's data-dependent, forward-looking approach, supported by clear and transparent communications, has helped bring inflation back down to target. The decline in inflation provides scope for further monetary easing in 2023 but policy should remain attentive to the evolving distribution of risks to the inflation outlook. The BCCR has taken appropriate steps to strengthen its reserves position while allowing the exchange rate to be determined by market conditions. The authorities are taking steps to further strengthen the BCCR's autonomy, governance, and operational framework.

35. Financial supervisors continue to closely monitor risks to the financial sector. Supervisors should continue to pro-actively ensure that provisioning is adequate and that any asset quality concerns do not develop into systemic threats. The planned legal amendments to the bank resolution and deposit insurance framework will help strengthen the financial safety net.

36. The authorities met their 2022 fiscal targets by a large margin and are on track to exceed 2023 targets, further strengthening debt sustainability. Proposed changes to the fiscal

[9] As required by the Constitution for any financing that is deemed to be external borrowing by the government under domestic law. Ratification of the RSF arrangement by the Legislative Assembly will enable disbursement of financing under the arrangement.

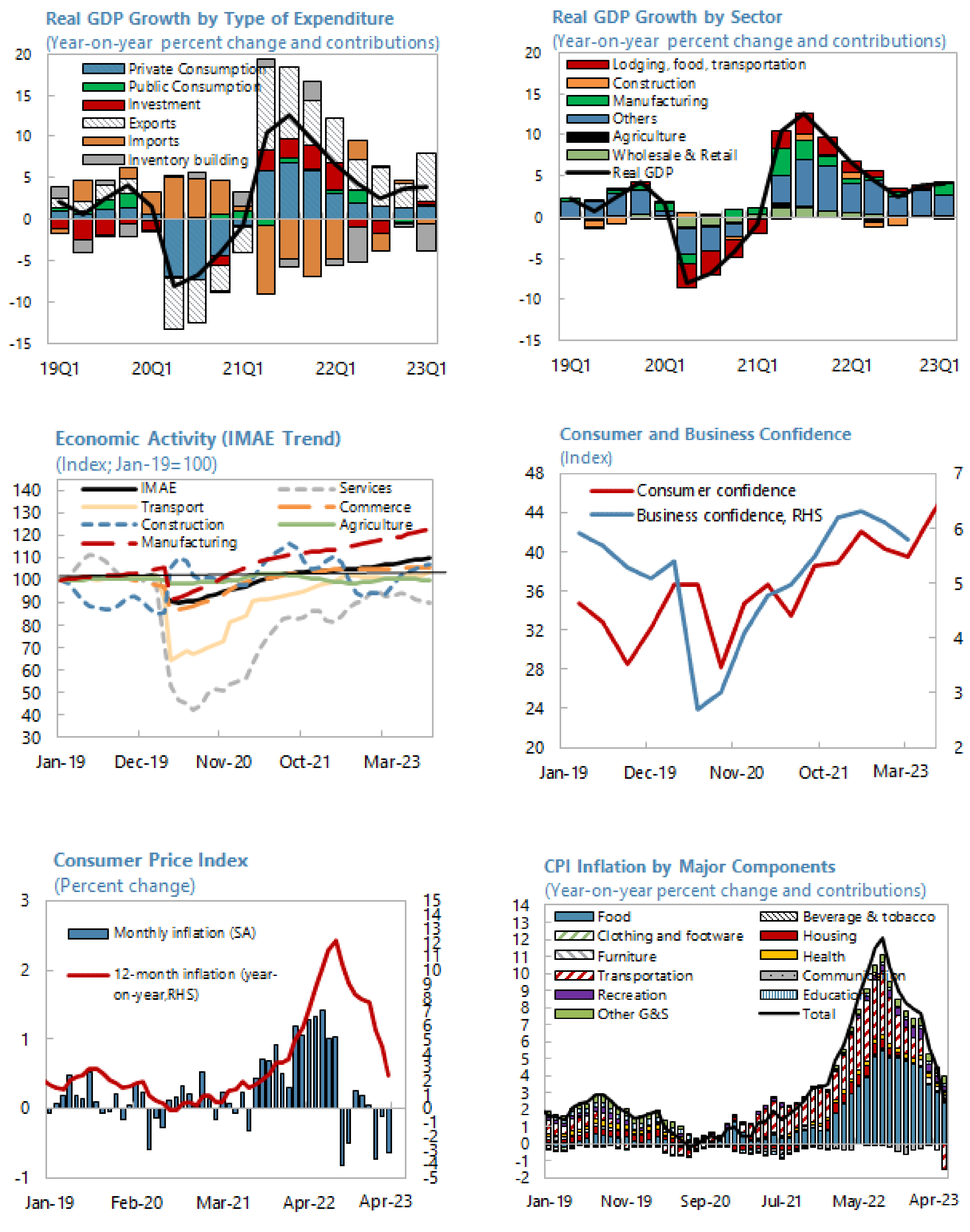
rule redefine the institutional coverage while preserving fiscal discipline. Tax reforms will help make the system more progressive, equitable, efficient, and environmentally-friendly, and debt management is being steadily strengthened. The SB on the Public Employment Bill was not met but the authorities are moving ahead to fully implement the reform by November. The authorities met the June 2023 SB to unify debt management functions.

37. The authorities are strengthening social protection and taking steps to foster a more dynamic and equitable economy. Improvements are underway to the targeting, coverage, timeliness, and efficiency of social programs. Incentives are being offered to formalize employment, support female labor force participation and entrepreneurship, and improve the business climate.

38. First steps are being taken to incorporate climate considerations into fiscal planning and policy, infrastructure investment, financial sector supervision, and the investment of the country's international reserves. The authorities are intensifying efforts to attract further climate financing from official and private sector sources, with the EFF and RSF arrangements helping to create an enabling environment. Staff supports the modification of the RM5, which integrates climate transition risks in fiscal planning.

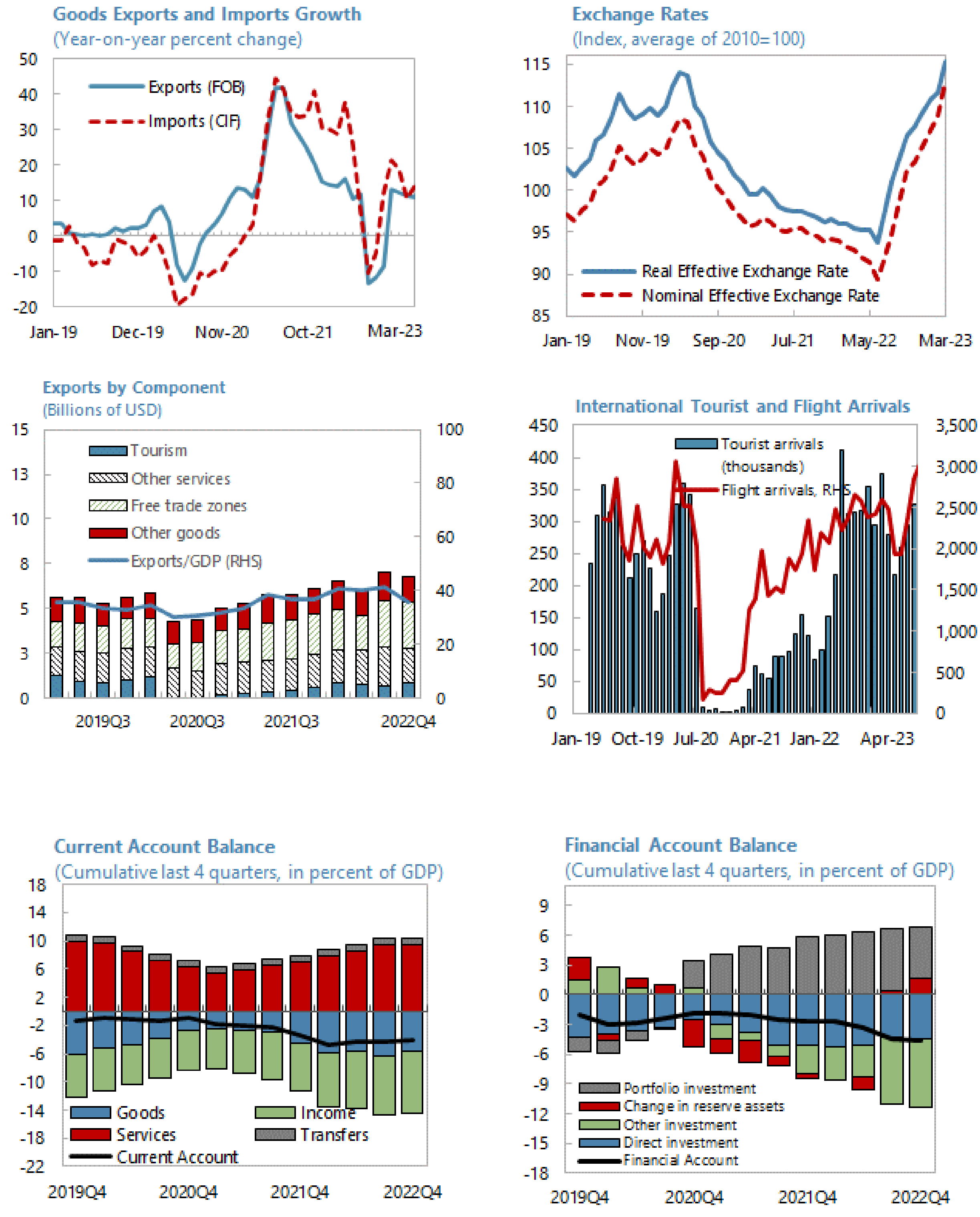
39. Staff supports the authorities' request for completion of the fourth EFF review and the first review under the RSF arrangement. Based on the strong macroeconomic performance, important progress on structural reforms, completion of Board consultation under the MPCC, and completion of RMs 1-4, staff support disbursements amounting to SDR 206.23 million and SDR 184.70 million.

Figure 1. Costa Rica: Real Sector Developments



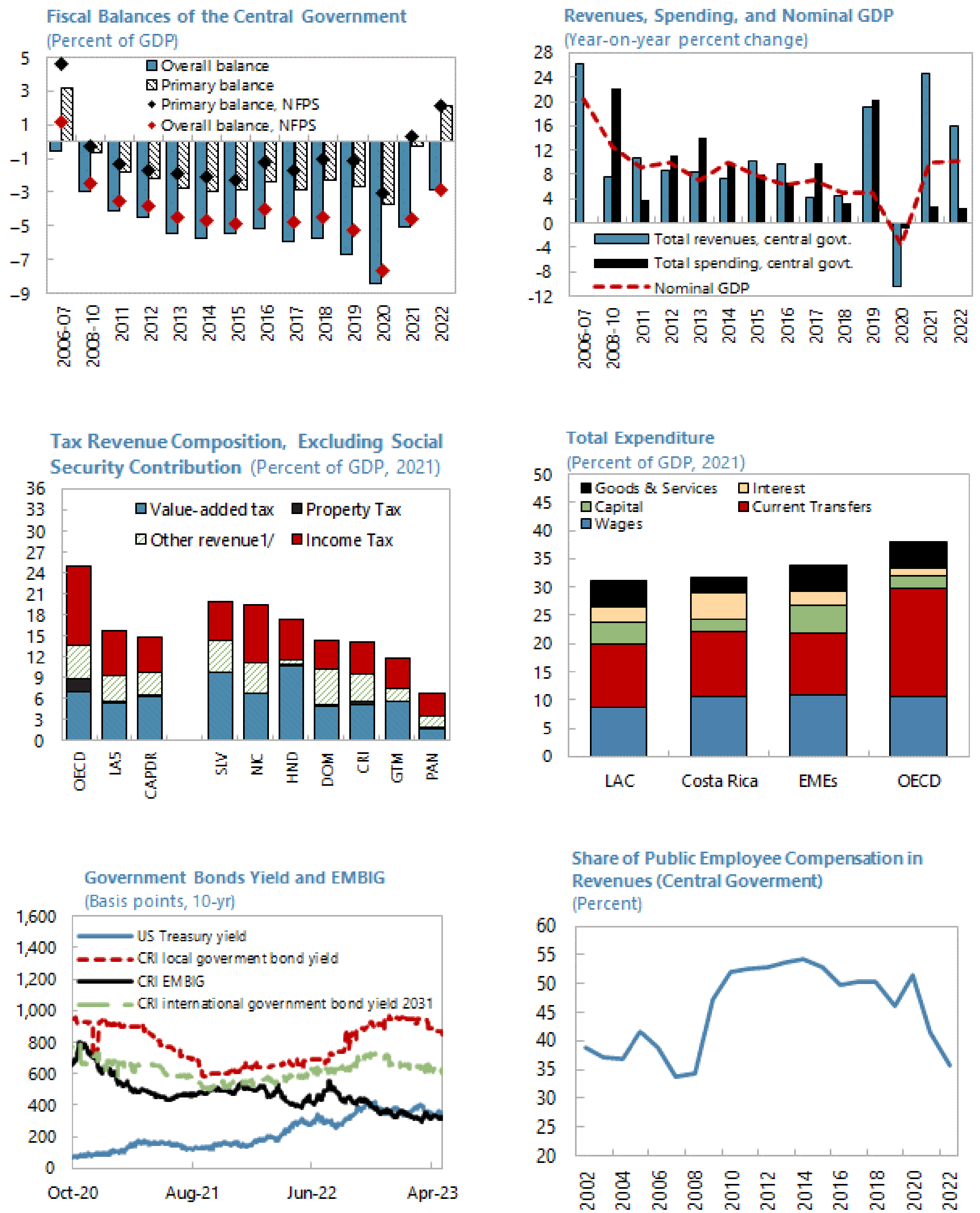
Sources: National authorities and IMF staff estimates.

Figure 2. Costa Rica: External Sector Developments



Sources: National authorities; FlightRadar24; and IMF staff estimates.

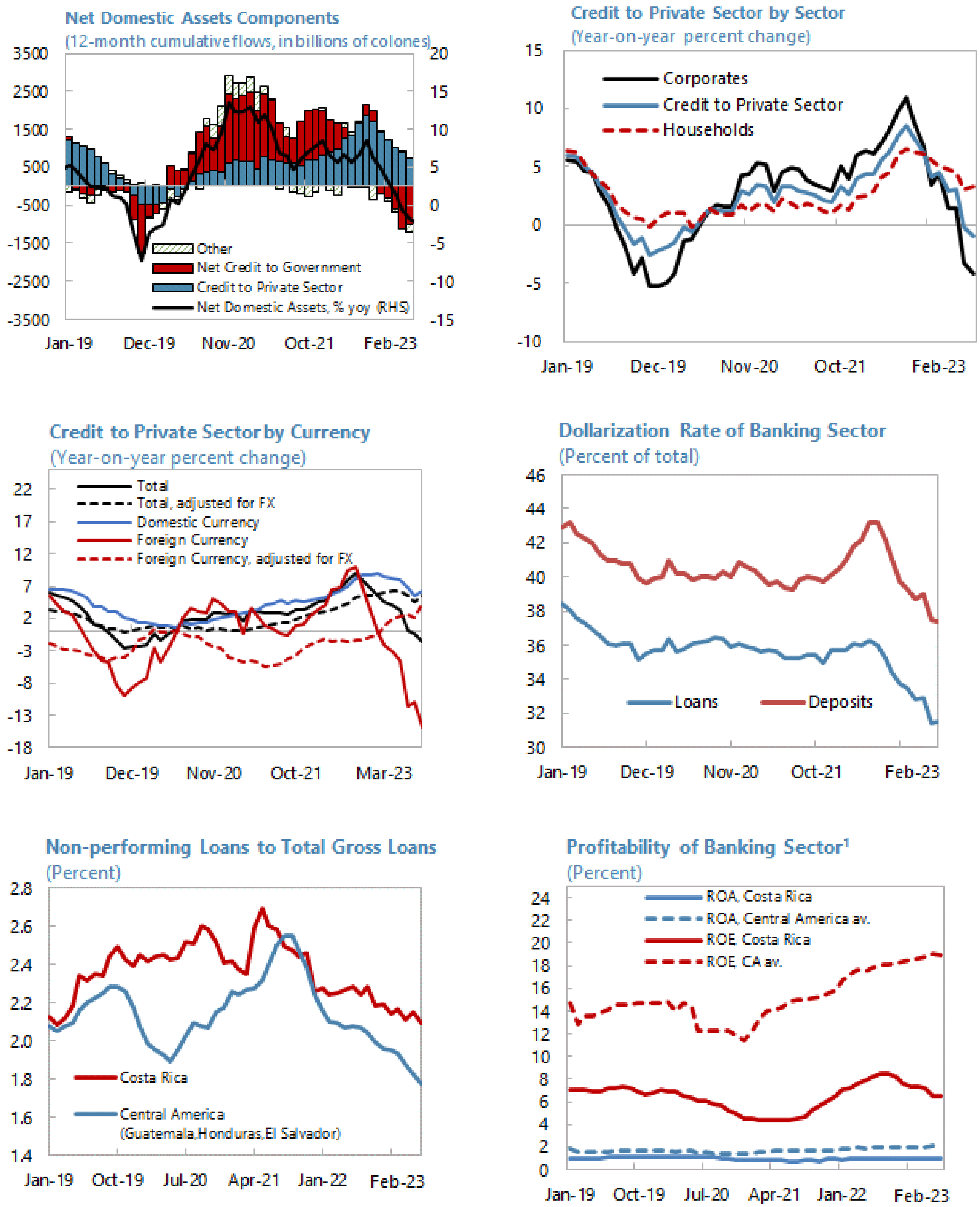
Figure 3. Costa Rica: Fiscal Sector Developments



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

1/ Includes property tax for Nicaragua.

Figure 4. Costa Rica: Monetary and Financial Sector Developments



Sources: National authorities and IMF staff estimates.

[1] Central America (CA average) includes Dominican Republic, El Salvador, Guatemala, and Honduras.

Table 1. Costa Rica: Selected Economic and Financial Indicators

						Projections						
	2019	2020	2021	2022	2022	2023	2023	2024	2025	2026	2027	2028
				CR/22/345		CR/22/345						
National Income				(Annual percentage change)								
Real GDP	2.4	-4.3	7.8	4.3	4.3	2.9	3.0	3.2	3.2	3.3	3.2	3.2
Domestic demand	0.2	-4.8	7.8	3.1	1.2	2.4	2.7	2.7	3.0	3.0	3.1	3.2
Consumption	2.5	-5.3	5.8	3.6	3.0	2.5	2.8	2.7	2.8	3.0	2.9	2.8
Private	1.7	-6.9	7.0	4.0	3.3	2.9	3.2	3.0	3.2	3.3	3.2	3.1
Public	5.9	0.8	1.7	2.4	1.9	1.3	1.2	1.6	1.5	1.7	1.6	1.9
Gross fixed capital formation	-8.2	-3.4	11.0	3.7	0.8	4.2	5.3	2.4	4.2	2.9	4.0	4.8
Exports of goods and nonfactor services	4.3	-10.6	15.9	8.3	12.2	5.7	7.9	5.6	6.0	6.2	6.0	6.2
Imports of goods and nonfactor services	-2.3	-12.9	16.9	4.8	3.5	4.5	8.2	4.7	6.0	5.8	6.2	6.6
				(Contributions to real GDP growth)								
Domestic demand	0.2	-4.6	7.5	3.0	1.2	2.3	2.6	2.5	2.8	2.7	2.8	2.9
Consumption	2.0	-4.3	4.6	2.9	2.4	2.0	2.1	2.1	2.2	2.3	2.2	2.2
Gross domestic investment	-1.8	-0.3	2.9	0.2	-1.2	0.3	0.4	0.4	0.6	0.5	0.6	0.8
of which : Inventory changes	-0.3	0.2	1.1	-0.5	-1.3	-0.4	-0.4	0.0	-0.1	0.0	0.0	0.0
Net exports	2.2	0.4	0.3	1.3	3.1	0.6	0.4	0.7	0.4	0.6	0.4	0.3
Prices				(Annual percentage change)								
GDP deflator	2.6	0.8	2.0	5.4	5.8	4.4	2.0	3.2	3.1	3.0	3.1	3.0
Consumer prices (period average)	2.1	0.7	1.7	8.6	8.3	6.4	1.9	3.0	3.0	3.0	3.0	3.0
Consumer prices (end of period)	1.5	0.9	3.3	9.5	7.9	4.8	2.1	3.0	3.0	3.0	3.0	3.0
Savings and Investment				(In percent of GDP)								
Savings	16.1	16.2	19.6	20.5	18.6	20.2	20.2	19.9	20.3	20.0	19.9	19.9
Domestic savings	14.8	15.1	16.3	15.9	14.7	15.9	16.7	17.3	17.9	17.9	17.9	18.1
Private sector	17.5	20.9	19.1	18.3	15.8	17.4	17.8	17.8	18.0	17.7	17.5	17.6
Public sector	-2.7	-5.8	-2.9	-2.4	-1.2	-1.5	-1.1	-0.5	-0.1	0.2	0.4	0.5
External savings	1.3	1.0	3.3	4.6	4.0	4.3	3.4	2.7	2.4	2.1	1.9	1.8
Gross domestic investment	16.1	16.2	19.6	20.5	18.6	20.2	20.2	19.9	20.3	20.0	19.9	19.9
Private sector	13.2	14.1	17.8	18.6	16.9	18.1	18.2	17.8	18.0	17.7	17.5	17.5
Public sector	2.9	2.1	1.8	1.9	1.7	2.1	2.0	2.1	2.2	2.3	2.4	2.4
External Sector												
Current account balance	-1.3	-1.0	-3.3	-4.6	-4.0	-4.3	-3.4	-2.7	-2.4	-2.1	-1.9	-1.8
Trade balance	-6.0	-2.7	-4.4	-7.3	-5.6	-7.4	-5.7	-5.7	-5.9	-6.0	-6.0	-6.2
Services	9.8	6.4	6.7	8.4	9.2	9.0	7.6	8.5	8.7	8.8	9.1	9.2
Capital account balance	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account balance	-2.0	-1.9	-2.5	-4.6	-3.2	-4.3	-3.4	-2.6	-2.3	-2.1	-1.9	-1.8
Foreign direct investment, net	-4.2	-2.6	-4.8	-5.1	-4.3	-4.9	-3.4	-3.2	-3.3	-3.3	-3.2	-3.2
Gross international reserves (millions of U.S. dollars)	8,937	7,232	6,921	8,241	8,724	8,695	10,541	11,205	11,527	12,258	12,830	13,518
-as percent of ARA metric	132.5	108.4	96.7	98.9	100.9	100.2	110.5	110.1	108.7	108.5	107.7	107.7
-in months of next year's imports	6.1	3.9	3.2	3.4	3.5	3.4	4.0	3.9	3.8	3.8	3.8	4.1
External debt	47.8	49.6	50.0	54.6	52.4	55.5	47.5	48.4	48.4	49.0	49.1	49.1
Real effective exchange rate, avg. (percent change)	0.6	1.0	-9.2	…	1.8	…	…	…	…	…	…	…
Public Finances[1/]												
Central government primary balance	-2.6	-3.7	-0.3	1.1	2.1	1.3	1.5	1.9	2.0	2.0	2.1	2.1
Central government overall balance	-6.7	-8.4	-5.1	-4.3	-2.8	-4.0	-3.4	-2.8	-2.4	-2.1	-1.9	-1.7
Central government debt	64.5	66.9	68.0	67.2	63.8	66.3	62.4	61.4	60.4	59.1	57.6	55.9
Money and Credit												
Credit to the private sector (percent change)	-2.3	3.4	3.7	6.2	3.3	5.0	3.8	6.0	6.1	6.1	6.2	6.2
Monetary base[2/]	7.1	8.3	7.9	7.3	8.1	7.2	7.9	7.8	7.7	7.7	7.8	7.8
Broad money	44.8	54.8	54.1	48.9	47.9	48.5	47.9	47.9	47.3	47.2	47.2	47.2
Memorandum Items												
Nominal GDP (billions of colones)[3/]	37,832	36,495	40,113	43,992	44,252	47,275	46,483	49,500	52,669	56,040	59,632	63,400
Output gap (as percent of potential GDP)	0.2	-3.6	-0.1	0.8	0.8	0.3	0.5	0.2	0.1	0.1	0.0	0.0
GDP per capita (US$)	12,691	12,164	12,473	13,159	13,075	13,868	16,250	17,016	17,779	18,560	19,402	20,225
Unemployment rate	12.4	20.0	13.7	12.5	11.7	13.2	10.7	10.1	9.8	9.6	9.5	9.3

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

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

2/ Includes currency issued and required reserves.

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

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

	2019	2020	2021	2022	2022	2023	2023	2024	2025	2026	2027	2028
						Projections						
				CR/22/345		CR/22/345						
	(In billions of colones)											
Revenue	**5,676**	**5,077**	**6,326**	**6,908**	**7,341**	**7,229**	**7,320**	**7,766**	**8,268**	**8,788**	**9,324**	**9,888**
Tax revenue	4,940	4,385	5,566	6,006	6,312	6,485	6,554	6,956	7,411	7,882	8,366	8,876
Nontax revenue[2/]	735	693	760	902	1,029	744	766	810	857	906	958	1,012
Expenditure	**8,223**	**8,147**	**8,377**	**8,806**	**8,598**	**9,141**	**8,903**	**9,165**	**9,550**	**9,984**	**10,430**	**10,935**
Current noninterest	5,803	5,781	5,839	5,723	5,803	5,757	5,827	5,952	6,206	6,518	6,861	7,265
Wages	2,613	2,612	2,624	2,709	2,627	2,737	2,666	2,739	2,809	2,896	2,991	3,135
Goods and services	327	337	342	354	356	350	376	382	389	429	465	503
Transfers	2,863	2,832	2,874	2,659	2,820	2,670	2,785	2,831	3,007	3,194	3,405	3,626
Interest[3/]	1,553	1,701	1,939	2,375	2,184	2,521	2,300	2,320	2,328	2,340	2,337	2,358
Capital	867	665	599	708	611	862	776	893	1,017	1,125	1,231	1,312
Primary balance	**-994**	**-1,368**	**-112**	**478**	**927**	**609**	**717**	**921**	**1,045**	**1,144**	**1,232**	**1,312**
Overall Balance	**-2,547**	**-3,069**	**-2,051**	**-1,897**	**-1,257**	**-1,912**	**-1,583**	**-1,399**	**-1,282**	**-1,196**	**-1,106**	**-1,046**
Total Financing	2,494	3,388	2,158	1,897	1,207	1,912	1,583	1,399	1,282	1,196	1,106	1,046
External (net)	1,119	724	645	1,340	1,051	2,162	1,809	1,574	953	740	648	511
Domestic (net)	1,376	2,665	1,513	557	294	-250	-225	-175	330	456	457	535
Unidentified financing	0	0	0	0	-88	0	0	0	0	0	0	0
Central government debt	**24,420**	**24,420**	**27,272**	**29,566**	**28,224**	**31,338**	**28,985**	**30,391**	**31,799**	**33,129**	**34,327**	**35,466**
External	4,765	5,898	6,779	8,044	7,210	10,472	8,367	10,017	11,067	11,921	12,652	13,342
Domestic	19,655	18,522	20,493	21,522	21,014	20,866	20,618	20,374	20,732	21,208	21,675	22,124
Other debt (multilateral financing)	0	0	0	0	0	0	0	0	0	0	0	0
	(In percent of GDP)											
Revenue	**15.0**	**13.9**	**15.8**	**15.7**	**16.6**	**15.3**	**15.7**	**15.7**	**15.7**	**15.7**	**15.6**	**15.6**
Tax revenue	13.1	12.0	13.9	13.7	14.3	13.7	14.1	14.1	14.1	14.1	14.0	14.0
Nontax revenue[2/]	1.9	1.9	1.9	2.1	2.3	1.6	1.6	1.6	1.6	1.6	1.6	1.6
Expenditure	**21.7**	**22.3**	**20.9**	**20.0**	**19.4**	**19.3**	**19.2**	**18.5**	**18.1**	**17.8**	**17.5**	**17.2**
Current noninterest	15.3	15.8	14.6	13.0	13.1	12.2	12.5	12.0	11.8	11.6	11.5	11.5
Wages	6.9	7.2	6.5	6.2	5.9	5.8	5.7	5.5	5.3	5.2	5.0	4.9
Goods and services	0.9	0.9	0.9	0.8	0.8	0.7	0.8	0.8	0.7	0.8	0.8	0.8
Transfers	7.6	7.8	7.2	6.0	6.4	5.6	6.0	5.7	5.7	5.7	5.7	5.7
Interest[3/]	4.1	4.7	4.8	5.4	4.9	5.3	4.9	4.7	4.4	4.2	3.9	3.7
Capital	2.3	1.8	1.5	1.6	1.4	1.8	1.7	1.8	1.9	2.0	2.1	2.1
Primary balance	**-2.6**	**-3.7**	**-0.3**	**1.1**	**2.1**	**1.3**	**1.5**	**1.9**	**2.0**	**2.0**	**2.1**	**2.1**
Overall Balance	**-6.7**	**-8.4**	**-5.1**	**-4.3**	**-2.8**	**-4.0**	**-3.4**	**-2.8**	**-2.4**	**-2.1**	**-1.9**	**-1.7**
Total Financing	**6.6**	**9.3**	**5.4**	**4.3**	**2.7**	**4.0**	**3.4**	**2.8**	**2.4**	**2.1**	**1.9**	**1.7**
External (net)	3.0	2.0	1.6	3.0	2.4	4.6	3.9	3.2	1.8	1.3	1.1	0.8
Domestic (net)	3.6	7.3	3.8	1.3	0.7	-0.5	-0.5	-0.4	0.6	0.8	0.8	0.8
Unidentified financing	0.0	0.0	0.0	0.0	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Central government debt	**64.5**	**66.9**	**68.0**	**67.2**	**63.8**	**66.3**	**62.4**	**61.4**	**60.4**	**59.1**	**57.6**	**55.9**
External	12.6	16.2	16.9	18.3	16.3	22.2	18.0	20.2	21.0	21.3	21.2	21.0
Domestic	52.0	50.8	51.1	48.9	47.5	44.1	44.4	41.2	39.4	37.8	36.3	34.9
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	0.0
Memorandum items:												
Non-interest expenditure growth (percent)												
in nominal terms	19.6	-3.4	-0.1	-0.1	-0.4	2.9	2.9	3.7	5.5	5.8	5.9	6.0
in real terms	17.2	-4.1	-1.8	-8.0	-8.0	-3.3	1.0	0.6	2.4	2.7	2.8	2.9
Nominal GDP (billions of colones)	37,832	36,495	40,113	43,992	44,252	47,275	46,483	49,500	52,669	56,040	59,632	63,400

Sources: Ministry of Finance and IMF staff estimates.

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

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

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

Table 3. Costa Rica: Balance of Payments

						Projections						
	2019	2020	2021	2022	2022	2023	2023	2024	2025	2026	2027	2028
				CR/22/345		CR/22/345						
					(In millions of U.S. dollars)							
Current Account	**-826**	**-639**	**-2,136**	**-3,166**	**-2,706**	**-3,151**	**-2,951**	**-2,406**	**-2,256**	**-2,156**	**-2,065**	**-2,056**
Goods and services balance	2,424	2,294	1,463	707	2,488	1,193	1,603	2,512	2,653	2,908	3,234	3,370
Trade balance	-3,868	-1,708	-2,848	-5,052	-3,803	-5,413	-4,899	-5,198	-5,672	-6,012	-6,403	-6,916
Export of goods (f.o.b.)	11,831	11,991	14,823	17,016	16,302	18,076	18,185	19,473	20,932	22,548	23,825	25,074
Import of goods (f.o.b.)	15,700	13,699	17,671	22,067	20,105	23,489	23,084	24,671	26,603	28,560	30,227	31,990
Services balance	6,292	4,003	4,311	5,758	6,291	6,606	6,501	7,710	8,324	8,919	9,636	10,286
Of which: Travel balance	2,953	1,085	1,038	2,034	2,171	2,740	2,501	3,266	3,538	3,738	4,010	4,241
Exports of services	10,906	8,005	8,938	10,980	11,790	12,396	13,323	15,018	16,067	17,009	18,098	19,190
Imports of services	4,614	4,002	4,627	5,222	5,499	5,789	6,822	7,308	7,742	8,089	8,461	8,904
Primary Income	-3,832	-3,501	-4,150	-4,482	-5,763	-4,970	-5,131	-5,516	-5,536	-5,724	-5,993	-6,158
Secondary Income	582	568	551	609	569	625	577	599	627	660	695	732
Capital Account	**32**	**17**	**19**	**21**	**20**	**23**	**23**	**25**	**28**	**30**	**33**	**37**
Financial Account	**-1,268**	**-1,172**	**-1,622**	**-3,145**	**-2,207**	**-3,129**	**-2,928**	**-2,381**	**-2,228**	**-2,126**	**-2,031**	**-2,019**
Public sector	-1,002	421	-737	-2,794	-1,279	-2,291	-1,884	-2,174	-1,214	-759	-526	-228
Private sector	-1,658	161	-623	-1,670	-2,730	-1,291	-2,862	-871	-1,336	-2,098	-2,078	-2,479
Foreign direct investment, net	-2,695	-1,644	-3,110	-3,526	-2,941	-3,599	-2,895	-2,925	-3,110	-3,277	-3,403	-3,527
Other private sector flows	1,037	1,806	2,487	1,855	211	2,308	33	2,054	1,773	1,179	1,325	1,048
Change in International Reserves (increase +)	1,393	-1,754	-263	1,320	1,803	454	1,817	664	322	731	573	688
Errors and Omissions	**-473**	**-550**	**495**	**0**	**479**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
					(In percent of GDP)							
Current Account	**-1.3**	**-1.0**	**-3.3**	**-4.6**	**-4.0**	**-4.3**	**-3.4**	**-2.7**	**-2.4**	**-2.1**	**-1.9**	**-1.8**
Goods and services balance	3.8	3.7	2.3	1.0	3.6	1.6	1.9	2.8	2.8	2.9	3.0	3.0
Trade balance	-6.0	-2.7	-4.4	-7.3	-5.6	-7.4	-5.7	-5.7	-5.9	-6.0	-6.0	-6.2
Export of goods (f.o.b.)	18.4	19.2	22.9	24.7	23.8	24.7	21.2	21.5	21.9	22.4	22.4	22.4
Import of goods (f.o.b.)	24.4	22.0	27.4	32.1	29.4	32.0	26.9	27.2	27.8	28.3	28.4	28.6
Services balance	9.8	6.4	6.7	8.4	9.2	9.0	7.6	8.5	8.7	8.8	9.1	9.2
Of which: Travel balance	4.6	1.7	1.6	3.0	3.2	3.7	2.9	3.6	3.7	3.7	3.8	3.8
Exports of services	16.9	12.8	13.8	15.9	17.2	16.9	15.5	16.6	16.8	16.9	17.0	17.1
Imports of services	7.2	6.4	7.2	7.6	8.0	7.9	8.0	8.1	8.1	8.0	8.0	8.0
Primary Income	-5.9	-5.6	-6.4	-6.5	-8.4	-6.8	-6.0	-6.1	-5.8	-5.7	-5.6	-5.5
Secondary Income	0.9	0.9	0.9	0.9	0.8	0.9	0.7	0.7	0.7	0.7	0.7	0.7
Capital Account	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Financial Account	**-2.0**	**-1.9**	**-2.5**	**-4.6**	**-3.2**	**-4.3**	**-3.4**	**-2.6**	**-2.3**	**-2.1**	**-1.9**	**-1.8**
Public sector	-1.6	0.7	-1.1	-4.1	-1.9	-3.1	-2.2	-2.4	-1.3	-0.8	-0.5	-0.2
Private sector	-2.6	0.3	-1.0	-2.4	-4.0	-1.8	-3.3	-1.0	-1.4	-2.1	-2.0	-2.2
Foreign direct investment, net	-4.2	-2.6	-4.8	-5.1	-4.3	-4.9	-3.4	-3.2	-3.3	-3.3	-3.2	-3.2
Other private sector flows	1.6	2.9	3.8	2.7	0.3	3.1	0.0	2.3	1.9	1.2	1.2	0.9
Change in International Reserves (increase +)	2.2	-2.8	-0.4	1.9	2.6	0.6	2.1	0.7	0.3	0.7	0.5	0.6
Errors and Omissions	**-0.7**	**-0.9**	**0.8**	**0.0**	**0.7**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Memorandum Items:												
Non-oil current account (percent of GDP)	1.2	0.3	-0.9	-0.7	-0.3	-0.9	-1.2	-0.7	-0.6	-0.4	-0.2	-0.1
Terms of trade (annual percentage change)	-0.8	3.6	-2.5	-0.9	-1.1	1.5	2.9	0.5	0.6	0.7	0.6	0.5
Gross international reserves (millions of U.S. dollars)	8,937	7,232	6,921	8,241	8,724	8,695	10,541	11,205	11,527	12,258	12,830	13,518
Net international reserves, program definition (millions of U.S. dollars)[1/]	6,099	3,712	2,884	3,639	3,871	2,870	4,623	4,638	4,922	5,492	5,966	6,670
External debt (percent of GDP)[2/]	47.8	49.6	50.0	54.6	52.4	55.5	47.5	48.4	48.4	49.0	49.1	49.1

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

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

2/ Includes public and private sector debt.

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

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
					Projections					
	(In millions of U.S. dollars)									
Gross external financing needs	**-8,143**	**-10,001**	**-10,391**	**-11,853**	**-16,220**	**-14,125**	**-14,168**	**-14,408**	**-14,833**	**-15,223**
Current account balance	-826	-639	-2,136	-2,706	-2,951	-2,406	-2,256	-2,156	-2,065	-2,056
Amortization	-4,777	-4,885	-4,642	-5,473	-10,072	-8,633	-8,821	-8,587	-9,066	-9,460
Public sector, of which	-740	-1,145	-771	-358	-2,181	-969	-1,074	-638	-562	-425
Central government	-93	-340	-127	-148	-391	-37	-323	-368	-371	-228
Central bank	-377	-627	-2	-2	-275	-550	-275	0	0	0
Private sector	-4,036	-3,740	-3,871	-5,116	-7,891	-7,664	-7,747	-7,949	-8,505	-9,034
of which: short-term	-3,048	-2,709	-2,782	-3,977	-6,723	-6,387	-6,450	-6,591	-7,057	-7,493
Other net capital inflows 1/	-2,540	-4,477	-3,613	-3,674	-3,197	-3,086	-3,091	-3,665	-3,702	-3,707
Gross external financing sources	**7,648**	**8,621**	**9,236**	**10,280**	**14,498**	**12,160**	**12,672**	**13,808**	**14,355**	**15,112**
Capital transfers	32	17	19	20	23	25	28	30	33	37
Direct investment, net	2,695	1,644	3,110	2,941	2,895	2,925	3,110	3,277	3,403	3,527
Borrowing	6,313	5,206	5,845	9,122	13,398	9,874	9,856	11,232	11,491	12,236
Public sector, of which	2,262	524	576	502	3,149	1,984	1,597	1,602	1,416	1,349
Central government	1,539	215	-12	154	2,807	1,155	1,057	1,099	1,049	1,019
of which: Eurobonds	1,467	0	0	0	2,500	1,000	1,000	1,000	1,000	1,000
Central bank 2/	0	0	502	1,100	0	0	0	0	0	0
Private sector	4,051	4,682	5,270	8,619	10,249	7,890	8,259	9,630	10,076	10,888
Change in International reserves (increase -)	-1,393	1,754	263	-1,803	-1,817	-664	-322	-731	-573	-688
Use of IMF credit	**0**	**522**	**294**	**552**	**981**	**275**	**-185**	**-69**	**-162**	**-256**
Purchases/disbursements	0	522	294	552	1,043	521	0	0	0	0
RFI	0	522	0	0	0	0	0	0	0	0
EFF	0	0	294	552	550	275	0	0	0	0
RSF	0	0	0	0	493	246	0	0	0	0
Repurchases/repayments	0	0	0	0	-62	-246	-185	-69	-162	-256
Other gross multilateral financing	**495**	**858**	**861**	**1,021**	**741**	**1,690**	**1,682**	**670**	**640**	**366**
World Bank	...	105	313	307	109	...	...	...	...	...
Inter-American Development Bank (IDB)	...	282	404	385	516	...	...	...	...	...
CAF	...	448	0	0	0	...	...	...	...	...
Central American Bank for Economic Integration (CABEI)	...	23	144	329	115	...	...	...	...	...
Debt rescheduling or refinancing	0	0	0	0	0	0	0	0	0	0
Other exceptional financing	0	0	0	0	0	0	0	0	0	0
Unidentified financing	0	0	0	0	0	0	0	0	0	0
Memorandum items:										
Gross multilateral support	495	1,380	1,154	1,573	1,783	2,211	1,682	670	640	366
In percent of GDP	0.8	2.2	1.8	2.3	2.1	2.4	1.8	0.7	0.6	0.3
Of which, committed	...	1,380	1,154	1,573	1,783	2,211	1,682	670	640	366
Of which, disbursed	...	1,380	1,154	0	0	0	0	0	0	0
IMF share of total gross multilateral financing (percent)										
Purchases and disbursements, flow basis	...	38	25	35	58	...	...	...	...	...
Purchases and disbursements, cumulative basis	...	38	32	33	41	...	...	...	...	...
Current account balance (percent of GDP)	-1.3	-1.0	-3.3	-4.0	-3.4	-2.7	-2.4	-2.1	-1.9	-1.8
Gross international reserves	8,937	7,232	6,921	8,724	10,541	11,205	11,527	12,258	12,830	13,518
In percent of the ARA metric	133	108	97	101	111	110	109	109	108	108
In percent of ST debt (remaining maturity)	183	156	126	85	117	123	132	131	133	132
In percent of gross external financing requirement	156	137	91	67	88	97	105	107	109	658
In months of next year's imports of G&S	6.1	3.9	3.2	3.5	4.0	3.9	3.8	3.8	3.8	4.1

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

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

2/ Includes FLAR credit line in 2022.

Table 5. Costa Rica: Monetary Survey

	2019	2020	2021	2022	2022	Projections 2023	2023	2024	2025
				CR/22/345		CR/22/345			
	(In billions of colones, unless otherwise indicated)								
Central Bank									
Net foreign assets	5,035	4,474	4,007	4,695	3,800	5,171	4,462	4,864	5,132
Of which : Gross international reserves									
(In millions of U.S. dollars)	8,937	7,232	6,921	8,241	8,724	8,695	10,541	11,205	11,527
Net domestic assets	-2,367	-1,441	-852	-1,499	-195	-1,774	-804	-998	-1,103
Net domestic credit	-2,166	-1,894	-1,592	-1,939	-1,745	-2,103	-1,805	-1,898	-2,757
Credit to nonfinancial public sector (net)	-549	-35	-306	-426	-605	-426	-505	-505	-505
Credit to other depository corporations (net)	-1,579	-1,832	-1,204	-1,431	-1,114	-1,594	-1,274	-1,367	-2,226
Credit to other financial corporations (net)	-38	-26	-82	-82	-26	-82	-26	-26	-26
Credit to the private sector (net)	0	0	0	0	0	0	0	0	0
Monetary stabilization instruments (-)	-1,859	-1,564	-1,364	-1,364	-1,282	-1,364	-1,398	-1,398	-1,398
Other items (net)	-710	-226	-112	-413	416	-524	-17	-118	636
Capital account (-)	2,367	2,243	2,216	2,216	2,416	2,216	2,416	2,416	2,416
Monetary base 1/	2,667	3,033	3,155	3,196	3,605	3,397	3,658	3,866	4,030
Currency	1,305	1,498	1,529	1,407	1,495	1,604	1,555	1,648	1,752
Required reserves	1,362	1,535	1,626	1,789	2,110	1,793	2,103	2,218	2,278
Other Depository Institutions									
Net foreign assets	-1,681	-720	-63	748	693	804	1,116	1,336	1,475
Net domestic assets	24,885	27,100	29,012	29,926	28,383	31,852	29,435	31,234	33,120
Net domestic credit	28,483	30,630	33,228	35,557	33,317	36,509	34,292	35,813	38,755
Credit to nonfinancial public sector (net)	2,674	3,900	5,841	6,357	5,185	5,843	4,954	4,750	5,134
Credit to nonfinancial private sector	20,896	21,601	22,405	23,798	23,146	24,977	24,016	25,454	27,012
In national currency	13,249	13,583	14,212	15,417	15,343	16,468	16,263	17,583	19,022
In foreign currency	7,647	8,019	8,193	8,380	7,804	8,510	7,753	7,870	7,990
Credit to financial corporations (net)	4,913	5,129	4,982	5,402	4,986	5,689	5,322	5,609	6,610
Other items (net)	1,352	1,602	1,322	484	677	1,915	953	1,609	948
Capital account	-4,950	-5,131	-5,538	-6,115	-5,611	-6,571	-5,810	-6,187	-6,584
Liabilities to nonfinancial private sector	23,204	26,380	28,949	30,674	29,077	32,656	30,551	32,571	34,595
In national currency	15,059	16,593	17,469	17,640	17,859	18,780	18,992	20,319	21,620
In foreign currency	8,146	9,787	11,480	13,033	11,218	13,876	11,559	12,252	12,975
Of which: Deposits (including CDs)	23,025	26,201	28,743	29,622	28,849	32,087	30,055	32,421	34,122
Consolidated Financial System									
Net foreign assets	3,354	3,753	3,944	5,443	4,494	5,975	5,577	6,200	6,607
Net domestic assets	21,080	23,953	25,828	25,901	25,625	27,430	26,006	27,418	29,057
Net domestic credit	23,021	25,465	27,939	29,729	27,726	30,394	28,465	29,699	31,640
Other items (net)	643	1,376	1,210	71	1,093	1,391	936	1,491	1,584
Capital account	-2,583	-2,888	-3,322	-3,899	-3,195	-4,355	-3,394	-3,771	-4,168
Broad money	16,957	19,990	21,683	21,491	21,215	22,945	22,264	23,713	24,913
Memorandum Items	(Annual percentage change)								
Monetary base 1/	-5.2	13.7	4.0	1.3	14.3	6.3	1.5	5.7	4.2
Broad money	4.0	17.9	8.5	-0.8	-2.2	6.8	4.9	6.5	5.1
Credit to the private sector	-2.3	3.4	3.7	6.2	3.3	5.0	3.8	6.0	6.1
In national currency	1.8	2.5	4.6	8.5	8.0	6.8	6.0	8.1	8.2
In foreign currency	-8.6	4.9	2.2	2.3	-4.7	1.5	-0.6	1.5	1.5
Credit to the private sector (adjusted by exchange rate changes)	0.1	0.8	2.4	7.0	8.7	4.3	4.6	5.8	6.0
	(In percent of GDP)								
Monetary base 1/	7.1	8.3	7.9	7.3	8.1	7.2	7.9	7.8	7.7
Broad money	44.8	54.8	54.1	48.9	47.9	48.5	47.9	47.9	47.3
Of which: Deposits denominated in foreign currency	14.2	18.5	20.5	21.3	19.0	21.1	19.0	18.7	18.3
Credit to the private sector	55.2	59.2	55.9	54.1	52.3	52.8	51.7	51.4	51.3
Of which: In foreign currency	20.2	22.0	20.4	19.1	17.6	18.0	16.7	15.9	15.2
Central bank balance	-0.4	0.3	0.1	0.0	-0.5	0.0	0.0	0.0	0.0

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

1/ Includes currency issued and required reserves.

Table 6. Costa Rica: Financial Soundness Indicators

	2017	2018	2019	2020	2021	2022	2023
	Dec	Dec	Dec	Dec	Dec	Dec	Mar
			(In percent)				
Capitalization							
Risk-adjusted capital ratio	16.8	16.7	17.5	16.8	16.5	17.7	18.1
Capital-to-assets ratio	13.9	14.2	15.2	14.4	14.4	14.4	15.0
Asset quality							
Nonperforming loans to total loans	2.0	2.1	2.4	2.5	2.3	2.1	2.0
Non-income generating assets to total assets	16.2	16.3	15.8	18.3	17.1	18.5	17.7
Foreclosed assets to total assets	0.8	1.0	1.1	1.1	1.0	1.0	1.0
Loan loss provisions to total loans	2.8	3.3	3.5	4.2	4.3	4.1	4.0
Credit in foreign currency to total credit	39.2	39.1	36.6	37.1	36.6	33.7	31.9
Management							
Administrative expenses to total assets	3.1	3.1	3.2	3.0	2.9	3.1	3.2
Noninterest expenses to gross income	73.7	77.6	83.1	82.0	79.1	88.4	90.5
Total expenses to total revenues	94.8	95.6	96.7	97.2	94.6	96.9	98.1
Profitability							
Return on assets (ROA)	0.9	0.9	1.0	0.6	0.9	1.0	0.8
Return on equity (ROE)	6.5	6.8	6.8	4.6	6.5	7.2	5.7
Interest margin to gross income	25.3	21.3	16.4	18.9	26.9	13.8	10.8
Liquidity							
Liquid assets to total short-term liabilities	102.7	98.6	96.8	93.9	89.9	89.9	93.9
Liquid assets to total assets	29.1	28.0	29.8	33.0	35.7	33.8	34.2
Loans to deposits[1/]	112.3	113.1	105.6	99.0	95.6	94.8	93.4
Liquid assets to deposits	45.5	43.7	44.6	50.0	52.4	48.6	48.7
Sensitivity to market risk							
Net open FX position to capital	22.7	21.1	23.5	25.1	25.6	24.4	21.8
Other							
Financial margin[2/]	6.6	7.1	7.1	6.7	7.0	7.0	6.1

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

Table 7. Costa Rica: Indicators of Fund Credit

	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	2036	2037	2038	2039	2040	2041	2042	2043	2044	2045
Fund obligations based on existing credit (millions of SDRs)																							
Principal	46.2	184.7	138.5	51.6	103.1	103.1	103.1	103.1	103.1	51.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Charges and interest 1/	40.8	49.2	37.0	31.2	27.9	23.0	18.1	13.2	8.3	4.3	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7
Fund obligations based on existing and prospective credit (millions of SDRs)																							
Principal	46.2	184.7	138.5	51.6	120.3	189.1	206.3	206.3	206.3	154.7	95.2	63.4	55.4	55.4	55.4	55.4	55.4	55.4	55.4	55.4	46.2	9.2	0.0
GRA	46.2	184.7	138.5	51.6	120.3	189.1	206.3	206.3	206.3	154.7	85.9	17.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
RSF	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	9.2	46.2	55.4	55.4	55.4	55.4	55.4	55.4	55.4	55.4	46.2	9.2	0.0
Charges and interest 1/2/	53.7	110.7	104.6	98.9	97.0	86.5	70.9	57.6	47.8	38.9	32.4	28.2	25.5	22.9	20.2	17.6	15.0	12.4	9.8	7.2	4.6	2.9	2.7
Total obligations based on existing and prospective credit																							
Millions of SDRs	99.9	295.4	243.1	150.4	217.3	275.5	277.2	263.8	254.0	193.6	127.5	91.6	80.9	78.3	75.6	73.1	70.4	67.9	65.2	62.6	50.8	12.1	2.7
Percent of exports of goods and services	0.4	1.1	0.9	0.5	0.7	0.8	0.8	0.7	0.6	0.5	0.3	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.0
Percent of gross international reserves	1.3	3.5	2.8	1.6	2.3	2.7	2.6	2.3	2.1	1.5	0.9	0.6	0.5	0.5	0.4	0.4	0.4	0.3	0.3	0.3	0.2	0.0	0.0
Percent of government revenue	1.0	2.8	2.2	1.3	1.8	2.1	2.0	1.8	1.6	1.2	0.7	0.5	0.4	0.4	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.0	0.0
Percent of public external debt service	3.6	13.6	10.4	7.6	10.4	12.6	12.0	10.7	9.7	6.9	4.3	2.9	2.4	2.2	2.0	1.8	1.6	1.5	1.3	1.2	0.9	0.2	0.0
Percent of GDP	0.2	0.4	0.3	0.2	0.3	0.3	0.3	0.3	0.3	0.2	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Percent of quota	27.0	80.0	65.8	40.7	58.8	74.6	75.0	71.4	68.8	52.4	34.5	24.8	21.9	21.2	20.5	19.8	19.1	18.4	17.7	17.0	13.8	3.3	0.7
Principal	12.5	50.0	37.5	14.0	32.6	51.2	55.8	55.8	55.8	41.9	25.8	17.2	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	12.5	2.5	0.0
GRA	12.5	50.0	37.5	14.0	32.6	51.2	55.8	55.8	55.8	41.9	23.3	4.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
RSF	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	2.5	12.5	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	12.5	2.5	0.0
Outstanding IMF credit based on existing and prospective drawings																							
Millions of SDRs	1,723.9	1,930.1	1,791.6	1,740.0	1,619.7	1,430.6	1,224.4	1,018.1	811.9	657.2	562.1	498.7	443.3	387.9	332.5	277.1	221.6	166.2	110.8	55.4	9.2	0.0	0.0
GRA	1,354.5	1,376.0	1,237.5	1,185.9	1,065.6	876.5	670.3	464.0	257.8	103.1	17.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
RSF	369.4	554.1	554.1	554.1	554.1	554.1	554.1	554.1	554.1	554.1	544.9	498.7	443.3	387.9	332.5	277.1	221.6	166.2	110.8	55.4	9.2	0.0	0.0
Percent of exports of goods and services	7.3	7.5	6.5	5.9	5.2	4.4	3.5	2.7	2.1	1.6	1.3	1.0	0.9	0.7	0.6	0.5	0.3	0.2	0.2	0.1	0.0	0.0	0.0
Percent of gross international reserves	21.8	23.0	20.8	19.1	17.0	14.3	11.5	9.0	6.7	5.1	4.1	3.4	2.9	2.4	1.9	1.5	1.1	0.8	0.5	0.2	0.0	0.0	0.0
Percent of government revenue	17.0	18.1	16.0	14.8	13.1	11.1	8.9	6.9	5.2	4.0	3.2	2.7	2.2	1.8	1.5	1.1	0.9	0.6	0.4	0.2	0.0	0.0	0.0
Percent of total public external debt	13.0	12.5	10.7	9.8	8.7	7.4	5.9	4.6	3.5	2.6	2.1	1.8	1.5	1.2	1.0	0.8	0.6	0.4	0.3	0.1	0.0	0.0	0.0
Percent of GDP	2.7	2.8	2.5	2.3	2.1	1.7	1.4	1.1	0.8	0.6	0.5	0.4	0.3	0.3	0.2	0.2	0.1	0.1	0.1	0.0	0.0	0.0	0.0
Percent of quota	466.7	522.5	485.0	471.0	438.5	387.3	331.5	275.6	219.8	177.9	152.2	135.0	120.0	105.0	90.0	75.0	60.0	45.0	30.0	15.0	2.5	0.0	0.0
GRA	366.7	372.5	335.0	321.0	288.5	237.3	181.5	125.6	69.8	27.9	4.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
RSF	100.0	150.0	150.0	150.0	150.0	150.0	150.0	150.0	150.0	150.0	147.5	135.0	120.0	105.0	90.0	75.0	60.0	45.0	30.0	15.0	2.5	0.0	0.0
Net use of IMF credit (millions of SDRs)	1,723.9	206.2	-138.5	-51.6	-120.3	-189.1	-206.3	-206.2	-206.3	-154.7	-95.2	-63.4	-55.4	-55.4	-55.4	-55.4	-55.4	-55.4	-55.4	-55.4	-46.2	-9.2	0.0
Disbursements	1,770.1	390.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayments and repurchases	46.2	184.7	138.5	51.6	120.3	189.1	206.3	206.3	206.3	154.7	95.2	63.4	55.4	55.4	55.4	55.4	55.4	55.4	55.4	55.4	46.2	9.2	0.0
Memorandum items:																							
Exports of goods and services (millions of U.S. dollars)	31,508	34,491	36,998	39,557	41,922	44,264	47,101	50,120	53,333	56,751	60,389	64,259	68,378	72,761	77,425	82,387	87,668	93,287	99,267	105,629	112,400	119,604	127,270
Gross international reserves (millions of U.S. dollars)	10,541	11,205	11,527	12,258	12,830	13,518	14,384	15,306	16,287	17,331	18,442	19,624	20,882	22,221	23,645	25,160	26,773	28,489	30,315	32,258	34,326	36,526	38,867
Quota (millions of SDRs)	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	370.4

Source: IMF staff estimates and projections.

1/ Based on the GRA rate of charge of 4.775 percent as of May 18, 2023.

2/ Costa Rica belongs to the RST Interest Group C. Based on the RST rate of interest of 4.725 percent as of May 18, 2023.

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

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

Source: IMF staff calculations.

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

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

Source: IMF staff calculations.

Annex I. Capacity Development Integration: Updated Country Strategy Note[1]

Building on the progress to date, Costa Rica's capacity development (CD) efforts are aligned with the reform objectives under the Fund-supported EFF and RSF arrangements. CD priorities include improving fiscal institutions, strengthening the central bank's autonomy and governance as well as supervisory and crisis management, and advancing structural reforms to incentivize private investment and foster green and inclusive growth. The authorities' engagement and ownership on these issues remain strong. Given their heavy use of CD from the Fund and other partners, close integration between CD activities and program priorities as well as coordination with other technical assistance providers remain critical.

Context

1. **Despite the authorities' timely response, the COVID-19 pandemic took a heavy toll on Costa Rica, exacerbating pre-existing fiscal and social challenges.** Following the disbursement under the Rapid Financing Instrument in 2020, the Executive Board on March 1, 2021 approved the country's request for a three-year arrangement under the Extended Fund Facility (EFF) to further support the authorities' response and gradual economic recovery, while anchoring their policy and reform efforts. The program's reform priorities have benefited from the authorities' broad-based political and social dialogue with key stakeholders and are anchored by three key pillars: (i) implementing equitable fiscal reforms to ensure debt sustainability, while protecting the poor and 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 the government's strong commitment to fighting climate change. Under the new administration, which took office in May 2022, CD has continued and will continue to play a key role in the Fund's engagement with the authorities to advance the implementation of priority reforms under the EFF and is aiding reforms supported by the RSF arrangement, which was approved by the Executive Board on November 14, 2022.

Engagement Strategy

- **Fund's CD Engagement with Costa Rica.** Historically, the Costa Rican authorities have received extensive CD, with generally good traction and implementation record. Some of the CD implemented over the years has offered textbook cases of how CD can improve the quality of

[1] This country strategy note and the attached table matrices illustrate the integration of capacity development and program objectives guided by key recommendations in the IMF Board Paper *2018 Review of the Fund's Capacity Development Strategy*. The acronyms in the note refer to the following IMF and other CD providers: Central America-Panama-Dominican Republic Regional Technical Assistance Center (CAPTAC-DR); Fiscal Affairs Department (FAD), Finance Department (FIN), Institute for Capacity Development (ICD); Legal Department (LEG), Monetary and Capital Markets Department (MCM); Statistics Department (STA); Inter-American Development Bank (IDB); Organization of Economic Cooperation and Development (OECD); World Bank (WB); and United Nations (UN).

policy making, for example, with the punctual update of the base year of the national accounts (NA), which helps measure the informal sector, or the publication of tax expenditure reports as part of the budget process. Table AII.1 and AII.2 summarize the key CD priority areas and engagement since January 2019. Looking ahead, Costa Rica is expected to remain a heavy user of CD, consistent with the EFF and RSF agenda.

- **Integration of CD in the Fund's surveillance and lending.** CD delivery in Costa Rica has traditionally been closely integrated with the surveillance priorities identified in previous Article IV Consultations and has been following recommendations of the 2018 Financial Sector Stability Review and recent Basel Core Principles assessment conducted as part of the WB FSAP Development Module. This coordination effort is being stepped up under the EFF-supported program and the RSF arrangement with the country team and CD providers working closely together, including through mission participation, to ensure CD is consistently integrated in the authorities' reform priorities and effectively supports program implementation. Appropriate sequencing of CD across reform streams is coordinated by the country team, in consultation with the authorities and CD providers, including CAPTAC-DR, as appropriate. The Fund's resident representative office also plays a key role in these efforts.

- **Collaboration with other partners** remains strong, especially in the areas of debt management, targeting accuracy of the social safety net, and climate change, where efforts with the WB are being closely coordinated. To support the authorities' goal of improving public spending efficiency and transparency as well as fostering an inclusive and green recovery, staff continues to engage with multilateral and bilateral donors—including the WB on climate change adaptation, business climate, and FSAP follow-up; the IDB on public employment reform, climate change mitigation, FinTech, and development of road infrastructure through public-private partnership; the OECD on improving reporting standards of state-owned enterprises; and the UN on gender and education. Staff is engaging with other CD partners on a regular basis through joint meetings and/or missions and regularly debriefs donors to ensure consistency of policy advice and synergies in supporting the program's objectives.

CD Priorities

2. The main CD objectives for Costa Rica focus on consolidating the achievements to date and making further progress on the authorities' macro-critical reform priorities supported by the EFF and RSF arrangements. These include implementing fiscal reforms to boost private investment and support inclusive and green growth while ensuring debt sustainability and further strengthening the autonomy and governance of the Central Bank of Costa Rica (BCCR) as well as the supervisory and crisis management framework to maintain monetary and financial stability. Fund's CD is expected to support these main reform areas as follows:

3. Implement fiscal reforms to support inclusive and green growth while ensuring debt sustainability. To tackle the large fiscal imbalances built up over the past decades, the authorities approved a comprehensive fiscal reform in 2018, which included a mix of tax reforms and spending measures as well as the introduction of a new fiscal rule with spending ceilings to ensure debt sustainability. The authorities also plan to take steps to strengthen price incentives to support their National Decarbonization Plan through revenue instruments, based on the options for environmental tax reforms identified by past CD by FAD, and to upgrade their analysis of transition risks. Building on these efforts, the Fund-supported program aims at improving fiscal institutions, including through more efficient revenue administration and public financial management, strengthening the social safety net, as well as high-quality data reporting and analytical and forecasting capacity going forward.

- *Public Employment Reform*. The corrective actions, including the prior action, and revised timeline drew heavily on TA provided in February 2023.

- Revenue *administration and tax Policy: FAD/CAPTAC-DR*. To promote further tax reform gains, this workstream supports the authorities' revenue mobilization efforts through Tax Compliance Improvement Plans (SB), a Customs Law, and the implementation of the Hacienda Digital project. FAD is helping design a dual personal income tax to increase horizontal and vertical equity, and feebates to support emissions reduction.

- *Public financial management: FAD/CAPTAC-DR*. CD in this workstream supports the development of a comprehensive Medium-Term Fiscal Framework covering the entire NFPS (SB) as well as improvement of the Treasury's cash management. To foster inclusive growth, CD efforts also focus on an action plan on gender budgeting as well as the recent centralization and digitalization of the payment system for all cash transfer social assistance programs (SB) that can support parallel work by the WB to strengthen targeting accuracy of the social safety net. The 2022 PIMA will improve public investment efficiency and resilience to climate change in support of the authorities' ambitious climate change infrastructure agenda (SB) and related RSF-supported reform measures. The Public Expenditure Framework Assessment led by the WB provided complementary advice. FAD fiscal rule TA also assists the authorities' efforts to improve how the rule operates while preserving its critical role in reducing debt. FAD TA is facilitating the incorporation of climate-related transition risks in fiscal planning, complementing work by the IDB on risks to fuel revenues from decarbonization of the transport sector.

- *Debt management*: *MCM, in coordination with the WB*. CD efforts aim at deepening the domestic debt market and enhancing debt management in line with international best practices, including by updating the Medium-Term Debt Strategy (SB) and unifying existing debt functions within the same agency (SB).

- *Government finance statistics (GFS): STA/CAPTAC-DR/ICD*. Building on progress to date, CD by STA/CAPTAC-DR in the GFS area continue to support efforts to improve the quality and timeliness of fiscal reporting, expand coverage beyond the central government, and transition from GFSM 1986 to GFSM 2014.

- *Macroeconomic frameworks:* CD by ICD will also help enhance the analytical and forecasting capacity of the MoF with the development of a comprehensive macro-fiscal framework and delivery of customized training to support policy decisions.

4. Further strengthen the autonomy and governance of the BCCR and the supervisory and crisis management framework. The authorities have advanced the implementation of the 2018 FSSR recommendations, including by approving new laws on consolidated supervision and banking resolution, strengthening the macroprudential framework and monitoring of systemic risk, and implementing the national financial education strategy. Progress is underway in several critical areas to maintain monetary and financial stability and address remaining structural financial vulnerabilities.

- *Central bank operations: LEG/MCM/CAPTAC-DR*. This workstream by LEG supports the authorities' efforts to further strengthen the BCCR's operational autonomy and governance, as recommended by the 2020 Safeguards Assessment (SA), with draft amendments to the BCCR Law prepared in August 2021 (SB) and further revised in December 2022 for submission to the Legislative Assembly (SB). CD by MCM/*CAPTAC-DR* is also supporting the deepening the FX market to facilitate effective risk management and increased intermediation in local currency.

- *Financial Crisis Management*: *LEG/MCM*. CD by LEG/MCM supports the authorities' efforts to improve alignment of the legal framework on bank resolution and deposit insurance with international practices based on the already conducted gap analysis that will guide further reforms, including with regard to adequate institutional arrangements for the deposit insurance fund and the resolution authority, safeguards for resolution, and clear resolution triggers (SB).

- *Financial Supervision and Regulation: CAPTAC-DR/MCM*. Ongoing CD by CAPTAC-DR/MCM is also helping strengthen supervision and regulation, including by enhancing consolidated supervision and gradual adoption of Basel III. CD by CAPTAC-DR/MCM is engaging in dialogue with Costa Rican authorities on climate change issues and supporting the authorities' efforts to enhance FinTech regulation and cybersecurity, and to develop derivatives markets.

- *Macroeconomic Frameworks: ICD*. CD by ICD will enhance the analytical, forecasting, and policy analysis capacity of the BCCR through further development of macroeconomic frameworks and delivery of tailored training. ICD will also provide TA and training on semi-structural gap and DSGE models and help align the BCCR forecasting and policy analysis system with best international practices.

Table AI.1. Costa Rica: Capacity Development Integration Matrix Under the EFF and RSF Arrangements

Specific Area	Objectives	IMF, WB, and IDB TA/Training engagement	Achieved Outcomes	Future CD and Program Outcomes
Implementing Fiscal Reforms to Support Inclusive and Green Growth While Ensuring Debt Sustainability				
Ensuring debt sustainability by improving tax collections, fiscal institutions, and analytical capacity, while strengthening social protection				
Tax Policy	Improve tax policy under principles of efficiency, fairness, progressivity, and sufficiency.	• FAD: options for income tax reform; environmental feebate scheme; tax expenditures analysis and measurement.	• Publication of tax expenditure reports as part of the budget process.	• Introduce income tax reform to strengthen progressivity and support climate change. • Reduce profit shifting. • Evaluation of tax exemptions and incentives.
Revenue Administration	Mobilize revenue by strengthening core tax administration functions and improving tax compliance.	• FAD: Tax Administration and Diagnostic Assessment Tool (TADAT), Revenue Administration Gap Assessment, risk and tax liability management and Compliance Improvement Plans (CIPS). • CAPTAC-DR: risk-based post-clearance audits. • WB: upgraded tax and customs procedures and information systems.	• TADAT assessment completed. • New Custom Portal aligned with WTO TF Agreement. • Submission of a bill containing a new Custom Law. • Develop and implement Tax CIPs.	• Update estimates of VAT and CIT compliance gaps. • Implement Hacienda Digital project.

Table AI.1. Costa Rica: Capacity Development Integration Matrix Under the EFF and RSF Arrangements (continued)

Public Financial Management	Strengthen treasury and fiscal risk management, strengthen the medium-term fiscal framework (MTFF), review fiscal rule, introduce gender budgeting (GB), review pensions system, strengthen the social safety net, improve public spending efficiency, and promote climate change resilience and decarbonization.	• FAD: efficiency and improvement of the payment system for social programs, PIMA (including climate change criteria), development of a MTFF and GB, transition risks. • CAPTAC-DR: improve Treasury and fiscal risk management and coverage and quality of fiscal and financial reporting. • WB: improve targeting of the social safety net and centralize and digitalize payments systems. Disaster Risk Management and payment for ecosystems schemes. Public Expenditure Framework Assessment. • IDB public investment management including climate change criteria, transition risks, and climate-related budget tagging.	• First MTFF report for the central government (CG) and NFPS published. • Methodology for fiscal risk reporting formulated. • General assessment of the Treasury Single Account (TSA) operation and coverage completed. • Centralize and digitalize payment system for cash transfer social assistance programs. • Fiscal rule bill amended.	• Create and staff a macro-fiscal unit. • Additional fiscal rule modifications supplemented by MTFF. • Establish an independent fiscal council. • Expand coverage of the TSA. • Implement PIMA recommendations. • Develop GB. • Establish a social assistance single window. • Business continuity policies in place.

Table AI.1. Costa Rica: Capacity Development Integration Matrix Under the EFF and RSF Arrangements (continued)

Financial Integrity	Further promote transparency and accountability of public procurement processes.	• LEG: strengthen legal framework to enable collection and publication of beneficial ownership information. • WB: SOE procurement. • IDB: Transparency on Covid-related purchases.	• New public procurement law approved. • Transparency portal created.	• Draft and enact implementing regulations to enable collection and publication of beneficial ownership information for awarded contracts.
Debt Management	Enhance public debt management by undertaking institutional reforms, updating the medium-term debt management strategy (MTDS), and developing the domestic debt market.	• MCM: Assist with institutional reforms of debt management function and deepening of domestic debt markets. Update MTDS. • IDB: market development. • WB: Annual Borrowing Plan (ABP), market development, and legal reforms to attract non-resident investors.	• Publication of guidelines for public institutions debt management. • Debt Committee established on public debt management. • Pilot market-making / primary dealer program.	• Structure operational responsibilities of the Public Credit Directorate and the National Treasury. • Deepen domestic debt market and improve price formation and auction mechanism. • Update MTDS to also include government's contingent liabilities.

Table AI.1. Costa Rica: Capacity Development Integration Matrix Under the EFF and RSF Arrangements (continued)

Public Employment	Ensure equity of pay within and cross public sector institutions and reduce public-sector wage premium to enhance the equity and efficiency of public spending and promote private employment.	• IDB: Design of Public Employment Bill and Implementing Regulation. • FAD, IDB, and WB: Design of Single Wage Spine.	• Public Employment Bill passed. • Implementing Regulation published and law took effect. • Single wage spine produced for one-quarter of executive branch positions.	• Single wage spine fully in place to meet objectives of reform.
Macroeconomic Frameworks	Improve macro-fiscal projections and develop a comprehensive macro-fiscal framework at the MoF.	• ICD: Assist with the development of a macro-fiscal projection model.	• Creation of a core MoF team in charge of developing and updating the macroeconomic projection tool.	• Develop comprehensive macro-fiscal framework to support policy decisions and MTFF aligned with best practices.
Government Finance Statistics (GFS)	Strengthen compilation and dissemination of GFS and Publis Sector Debt Statistics (PSDS).	• CAPTAC-DR: Compile and reconcile high frequency CG GFS and PSDS and expand coverage. • STA: Support towards 2014 GFSM adoption.	• Higher frequency and improved coverage of GFS and PSDS complied and disseminated. • 51 public institutions consolidated under CG.	• Fully adopt 2014 GFSM accrual accounting standards for NFPS data.

Table AI.1. Costa Rica: Capacity Development Integration Matrix Under the EFF and RSF Arrangements (continued)				
Maintaining Monetary and Financial Stability				
Strengthening exchange rate flexibility, the central bank's autonomy and governance, and supervisory and crisis management framework, while addressing structural financial vulnerabilities				
Specific Area	**Objectives**	**TA/Training engagement**	**Achieved Outcomes**	**Future CD and Program Outcomes**
Central Bank Operations	Strengthen BCCR's operational autonomy and governance as well as its functions as a risk monitor, a lender of last resort (LOLR), and an inflation targeter.	• CAPTAC-DR: Design a LOLR facility. • MCM/CAPTAC-DR: Deepen FX market and develop derivatives markets. • LEG/FIN: Update SA, and clarify BCCR's legal mandate, and strengthen its decision-making structure, autonomy, and transparency and accountability mechanisms.	• Regulation on emergency liquidity assistance facility approved by the BCCR Board in July 2018. • Ongoing legal reforms to further strengthen the BCCR's mandate, autonomy, decision-making structures, and transparency and accountability mechanisms.	• Deepen FX market, increase daily variation in net open FX position limits, introduce BCCR FX swaps, develop interbank markets to increase liquidity, and promote legal reform to allow greater NFPS' FX activity with FX intermediaries.

Table AI.1. Costa Rica: Capacity Development Integration Matrix Under the EFF and RSF Arrangements (continued)

Financial Supervision and Regulations	Strengthen the resilience of the financial sector through enhancing consolidated supervision of financial groups, mitigating risks associated with high financial dollarization, as well as advancing risk-based prudential supervisory framework.	• MCM: FSSR follow-up. • WB: FSAP Development Module, identification of data for climate-related risks and green taxonomy. • CAPTAC-DR: Revamp credit risk management framework, improve liquidity risk monitoring; strengthen supervisor's stress testing capacities, and develop regulatory framework for consolidated supervision.	• Greater exchange rate flexibility, and prudential policies implemented to discourage dollarization. • Liquidity risk monitoring improved with the introduction of liquidity coverage ratio (LCR) and the expected introduction of a net stable funding ratio (NSFR). • Further discouraged financial dollarization: (i) revised the definition of "unhedged borrowers"; (ii) issued regulation imposing additional capital requirements on unhedged FX borrowing; and (iii) published data on unhedged FX borrowing.	• Implement recommendations from the Basel Core Principles detailed assessment report, based on road map to be prepared by August 2023.
		• MCM/CAPTAC-DR: regional training and country dialogue on integrating climate change	• Credit-risk regulation revamped. • Strengthened supervisory stress test models/tools of credit, market,	• Integrate climate change into financial policies. • Enhance FinTech and cybersecurity regulation.

Table AI.1. Costa Rica: Capacity Development Integration Matrix Under the EFF and RSF Arrangements (continued)

		consideration into financial policies; enhancing FinTech and cybersecurity regulation.	Liquidity and contagion risks. • Introduced regulations for consolidated supervision of financial groups.	
Macroprudential Policy Framework and Systemic Risk Analysis	Strengthen the resilience of the financial sector through enhancing macroprudential (MAP) frameworks and systemic risk monitoring.	• MCM: FSSR follow-up. • Develop a NSFR.	• Financial Stability Committee established to coordinate MAP policy. • A NSFR to take effect from 2024. • Crisis management protocols in place.	• Strengthen macro-financial stress testing tools, including on climate risks.
Financial Crisis Management	• Enhance financial safety net and crisis preparedness framework.	• MCM/LEG: Strengthen banking resolution and deposit insurance legal framework.	• A roadmap developed to close the gaps identified in the legal framework. • Legal amendments drafted for submission to CONASSIF.	• Submit the revised law on bank resolution and Deposit Guarantee Fund for Legislative Assembly's approval.
Real Sector Statistics	• Strengthen compilation and dissemination of macroeconomic and financial statistics for decision making according to internationally accepted statistical standards.	• CAPTAC-DR: compile a quarterly supply and use table (SUT) and improve monthly economic activity indicator (IMAE), annual accounts, and non-financial asset balance sheets.	• GDP rebased to 2017. • Rebased GDP published by industry and expenditure approach, in line with the 2008 SNA. • Main 2008 SNA recommendations implemented.	• Develop financial accounts, balance sheets, revaluation and other volume changes in asset accounts, and quarterly SUT for all sectors to meet national data and ISWGNA minimum requirements. • Update CPI weights with year 2025 as the reference year.

Table AI.1. Costa Rica: Capacity Development Integration Matrix Under the EFF and RSF Arrangements (concluded)

	• Development of High-frequency Indicators.			
Macroeconomic frameworks	• Develop further capacity at the BCCR in macroeconomic forecasting and policy analysis.	• ICD: Assist and train staff on model-based forecasting and policy analysis, including semi-structural and structural models. • IDB: Impact analysis of climate policies.	• Help develop further the BCCR model-based frameworks.	• Align the BCCR forecasting and policy analysis system with best international practices.

Table AI.2. Costa Rica: IMF Capacity Development Missions, 2019 to end-April 2023		
TA/Training Mission	**Provider**	**Mission Date (Completed)**
Implementing Equity-Enhancing Fiscal Reforms to Ensure Debt Sustainability		
Revenue Administration and Tax Policy		
Strengthening taxpayers' registry	CAPTAC-DR	February 2019, September 2022
Strengthening risk management	CAPTAC-DR	May, November 2019, February 2020, June 2022, November 2022, April 2023
Customs: improvement of risk analysis	CAPTAC-DR	March 2019
Improvement of clearance process	CAPTAC-DR	March 2019
Risk management for improving tax and customs compliance & improving registration process	CAPTAC-DR	June 2019
Process management	CAPTAC-DR	October 2019
Integral cargo control plan	CAPTAC-DR	June 2019
TADAT Assessment	FAD	June 2019
Improving management of declarations	CAPTAC-DR	August 2019, January 2020
Improving tax filing compliance	CAPTAC-DR	January 2020
Strengthening Strategic Planning	CAPTAC-DR	June 2020
Strengthening the identification, assessment, and quantification of compliance risks	CAPTAC-DR	July, October 2020, May 2021, July 2021
Improving tax services for tax compliance plan	CAPTAC-DR	September 2020
Improving import and export process	CAPTAC-DR	October 2020, February 2021
Workshop: Tax compliance risk management	CAPTAC-DR	December 2020
Enhancing cargo control program	CAPTAC-DR	March 2021
Strengthening auditing of large taxpayers	CAPTAC-DR	April 2021
New Customs Law	CAPTAC-DR	April 2021, May 2021
Definition of new functionalities and technology transfer for the new Customs Web Portal	CAPTAC-DR	May 2021
Development of Tax CIP	FAD	April 2021
Improvement in tax compliance risk management	CAPTAC-DR	May 2021
Strengthening of tax audit	CAPTAC-DR	October 2021, March 2023
Revenue administration gap assessment (RA-GAP)	FAD	May 2023
Implementation of Tax compliance improvement plan	CAPTAC-DR/FAD	September 2020, May 2021, June 2021, August 2021, October 2021, June-July 2022, September 2022, December 2022
Post clearance controls and audit Mission	CAPTAC-DR	October 2021, February-March 2022, July-August 2022, January-April 2023
Customs Modernization Strategy	CAPTAC_DR	April 2022
Design of a global personal income tax, feebates to support emissions reduction, and incentives to promote female labor force participation.	FAD	September 2022
Review of FY23 and FY24 workplans	CAPTAC-DR/FAD	August 2022, February 2023

Table AI.2. Costa Rica: IMF Capacity Development Missions since 2019 to end-April 2023 (continued)		
Public Financial Management		
Fiscal risk-specific risks	CAPTAC-DR	April, November 2019, November 2020, June 2021, November 2022
Treasury management and fiscal risks	CAPTAC-DR	April 2019, January, March, April 2021
Treasury management – coordination between Treasury and Crédito Público	FAD	June 2019
Hackathons on the payment system of social programs	FAD	June, July, November 2019, February 2021
Accounting – IPSAS & consolidation	CAPTAC-DR/FAD	July, November 2020, August 2021, October 2021, May 2022
Treasury Single Account	FAD	August-September 2021
Medium-term fiscal framework (MTFF)	FAD	July 2020, March 2021
Centralization and digitalization of cash transfer social assistance programs	FAD	August 2021
Management for the improvement of assets and liabilities	CAPTAC-DR	May, August, November-December 2021, March, May 2022
Public investment management assessment (PIMA)	FAD	November-December 2021
Gender budgeting	FAD	January-February 2022, September-November 2022, December 2022, April 2023
Improved budget execution and control through internal audit	CAPTAC-DR	April 2022
Evaluation of public expenditure and accountability	CAPTAC-DR	May 2022
Comprehensive, credible and policy-based budget preparation – MTFF & MTFF for NFPS	CAPTAC-DR	December 2021, May 2022
Fiscal rules	FAD	October-November 2022
Financial Integrity		
COVID financial integrity measures	LEG	March-December 2021
Debt Management		
Updating medium-term debt management strategy (MTDS), and institutional reform and deepening debt markets	MCM	November 2021, March-April 2022
Sovereign Assets and Liability Management	MCM	November 2022
Macro-Fiscal Capacity Building		
Macro-fiscal projection model	ICD	September 2021, October 2022, January 2023, February 2023
Government Finance Statistics		
Assessment of CG high frequency data	CAPTAC-DR	June 2019

Table AI.2. Costa Rica: IMF Capacity Development Missions since 2019 to end-April 2023 (continued)		
Compilation of high frequency CG GFS and PSDS, including data from Ods	CAPTAC-DR	September 2020
Reconciliation of high frequency CG GFS and PSDS, including data from Ods	CAPTAC-DR	October 2020
Adoption of GFSM 2014 for CG GFS and PSDS	CAPTAC-DR	June 2021
Improving compilation and coverage of GFS and PSDS – Including customized training for PSDS	CAPTAC-DR	July 2021, September 2021, March 2022, March 2023
GFS and PSDS – Compilation and consolidation of CCG, including Extrabudgetary Units; incorporation of accrued interest; debt stocks, and GFS implementation plan	CAPTAC-DR	October 2022, February 2023
GFS and PSDS – incorporation in *Hacienda Digital*	CAPTAC-DR	February 2023
Public Expenditure Reform		
Public Employment Bill implementation	FAD	February 2023
Maintaining Monetary and Financial Stability		
Central Bank Operations		
Safeguards assessment update	FIN/LEG	July 2020
Developing FX market framework	MCM	February 2021
Assisting the BCCR to prepare amendments to the Central Bank Law	LEG	March, July 2021, October-November 2022, March-April 2023
Monetary operations scoping mission	CAPTAC-DR	August 2021
Central Bank FX Swap Introduction	CAPTAC-DR	November 2021
Development of domestic liquidity markets	CAPTAC-DR	April 2022
BCCR Foreign Exchange Operations to Aid Reserves Accumulation	MCM	July-August 2022
Macroeconomic forecasting and policy		
Model-based economic frameworks (BCCR)	ICD	December 2022, January 2023
Financial Supervision and Regulation		
Regional TA: CCSBSO Accounting standardization	CAPTAC-DR	October 2019, August 2020
Credit risk regulation: strengthening management and provisioning regulations, including COVID-19 effects	CAPTAC-DR	January, April, May 2019, July-August 2020
FSSR follow-up: insurance and pensions (WAH)	MCM	February 2019
Regional TA: Cross-border consolidated supervision procedures	CAPTAC-DR	March 2019
Supervisory liquidity stress test	CAPTAC-DR	December 2019, September-December 2020
FSSR follow-up: insurance supervision	MCM	October 2020

Table AI.2. Costa Rica: IMF Capacity Development Missions since 2019 to end-April 2023 (concluded)		
Financial groups regulatory framework	CAPTAC-DR	February-March 2021
Derivatives Regulation Training	CAPTAC-DR	August 2022
Cybersecurity Regulation Training, review regulation	MCM/ CAPTAC-DR	July 2022, March 2023
Financial Crisis Management		
Roadmap for strengthening legal framework for banking resolution and restructuring	MCM	April 2021
Strengthen legal framework for deposit insurance and bank resolution	LEG	February 2022, May-June 2022, January-February 2023
Real Sector Statistics		
Preparation of quarterly SUT and sectoral accounts for rebasing national accounts to 2017	CAPTAC-DR	July 2019, August 2020
National accounts: define statistical samples for the monthly survey of non-financial services	CAPTAC-DR	October 2019
Annual sectoral accounts: compile non-financial balance sheets for the total economy and the non-financial corporations	CAPTAC-DR	December 2019
Implementation of 2008 SNA	CAPTAC-DR	March 2020
National accounts statistics: Source data for the volume of services index	CAPTAC-DR	January 2021
National Accounts Statistics: balance sheet	CAPTAC-DR	February, October 2021, November 2022
Webinar on Business Information and Macroeconomic Management	CAPTAC-DR	February 2021
Quarterly accounts and seasonal adjustment	CAPTAC-DR	July 2021
Price statistics	CAPTAC-DR	February 2022
National accounts statistics: Source data for the use of the digital fiscal invoice	CAPTAC-DR	December 2021, February 2023
Institutional Sectoral Accounts and flow of funds	CAPTAC-DR	November-December 2022
High Frequency Economic Activity Indicators	CAPTAC-DR	December 2022

Annex II. Collaboration with World Bank and Interamerican Development Bank Under the EFF and RSF Arrangements

1. **Close collaboration with the WB and IDB under the EFF arrangement has been leveraging comparative expertise and institutional knowledge.** Areas of WB-Fund collaboration under the EFF include social spending (most recently including on the proposed SB to produce a single window for social assistance), human resource management, debt management, and spending controls. Areas of IDB-Fund cooperation include social spending, electricity sector reforms, improvements in physical and digital infrastructure, education, childcare, and other gender equality issues. IDB expertise has been crucial to the authorities' PEB implementation efforts, and there has been particularly close IDB-Fund communication to align understandings on the authorities' progress, obstacles the authorities face, and follow-up on TA from both instututions. The IDB and WB have also complemented the IMF's TA in other areas. As detailed in the MEFP (Appendix I), other development partners have also provided the authorities with valuable technical and financial support.

2. **Costa Rica's climate change agenda was developed and is being implemented with technical support from the IDB, WB, and other development partners.** The WB has been aiding emissions monitoring, promoting investment in green technologies, reducing emissions in transport as well as promoting conservation and decarbonization in agriculture, forestry, and fishing. The IDB has provided support on strengthening the management and monitoring of climate action, conservation of ecosystems that can capture greenhouse gases, electrification of transports, and promotion of gender equality along with decarbonization.

3. **RSF reforms are being closely coordinated.** The implementation assessment of the reform measures envisaged under the RSF arrangement continues to be conducted in close consultation with IDB and WB staff through desk review and participation in the IMFs' technical discussions with the authorities. For example, parallel and complementary conditionality across institutions benefits from close coordination between RSF RMs, prior actions (PAs) or indicative triggers (ITRs) in the WB's Third Fiscal and Decarbonization Management Development Policy Loan (DPL), and policy conditions (PCs) in the IDB's Support for Costa Rica's Decarbonization Plan II. For example:

- On public investment management, an IDB-supported reform to align projects submitted to the SNIP with the National Decarbonization Plan and WB-supported changes to the Public Investment Law to incorporate climate considerations in investment management complement RSF RMs 6, 9, and 10. These RMs are underpinned by climate Public Expenditure and Financial Accountability (PEFA) and C-PIMA as well as IDB technical work to aid prioritization of projects based on decarbonization and sustainability criteria.
- WB-supported reforms to promote electrification of buses and reduce taxes on electric vehicles as well as IDB-supported establishment of fares for electric buses are all efforts to decarbonize transport, as is the case with RSF RM7.
- To enhance fiscal planning, RSF RM11 reenforces a WB PA to remove tax exemptions, while an IDB PC on climate and biodiversity markers that include spending on disaster risk management complements RSF RM1.

Appendix I. Letter of Intent

San José, June 8, 2023

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

Dear Ms. Georgieva:

Amid ongoing external pressures and lingering challenges posed by the COVID-19 pandemic, our economic program, supported by the Extended Arrangement under the Extended Fund Facility (EFF), is playing a critical role in securing macroeconomic stability, supporting a continued economic recovery, and promoting a stronger, greener, and more inclusive growth over the medium term. The arrangement under the Resilience and Sustainability Facility (RSF) is supporting our ambitious climate change agenda and we expect it to catalyze financing from other sources to aid this effort.

Notwithstanding a challenging global environment, we have managed to make significant progress under the Fund-supported program. We met the end-December fiscal targets for the fourth review by a comfortable margin. We were able to proactively purchase FX from the market in the second half of 2022 and met the end-December target. Moreover, as a result of the global commodity shock, the inflation outer target band under the program's Monetary Policy Consultation Clause (MPCC) was breached in December 2022, triggering a Board consultation as part of this review cycle. We continue to comply with the continuous performance criteria. While we did not submit amendments to the BCCR Law to the Legislative Assembly as foreseen by the end-December 2022 structural benchmark, in June we submitted to the Legislative Assembly a subset of the previously foreseen changes to the BCCR law. We are also working on a proposal to award constitutional autonomy to the BCCR to be submitted to the Legislative Assembly during the next ordinary legislative session period in August-October. Although we could not meet the end-March 2023 structural benchmark on implementation of the public employment bill (PEB) owing to the complexities of ensuring the reform meets the law's objectives, our efforts towards this goal are back on track. For example, we achieved the prior action needed for this review and have committed to an additional structural benchmark. We submitted a bill to unify debt management (an end-June 2023 structural benchmark.)

We implemented four RSF reform measures (RMs) linked to this review: climate budget tagging, private participation in power generation, a data repository, and indicators of the greenness of international reserves.

In view of the macroeconomic policies implemented to achieve the main program objectives, our response to global economic challenges and ongoing actions to strengthen reserve buffers, our redoubled efforts on the PEB, as well as the progress on other structural reforms under the program, we request the completion of the Fourth Review of the Extended Arrangement under the EFF and the purchase of SDR 206.23 million. In view of our completion of RSF RMs, we request the purchase of SDR 184.70 million. We also request modification of the RM to incorporate climate transition risks in fiscal planning.

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

This Letter of Intent (LOI) and the attached Memorandum of Economic and Financial Policies (MEFP) and Technical Memorandum of Understanding (TMU) update the versions dated October 27, 2022 and set out the economic policies and reform measures that we intend to implement to achieve the objectives of our Fund-supported program under the EFF and the RSF.

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

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

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

Sincerely yours,

/S/	/S/
Róger Madrigal López President, Central Bank of Costa Rica Governor of the IMF	Nogui Acosta Jaén Minister of Finance

Attachments (3)
Memorandum of Economic and Financial Policies
Technical Memorandum of Understanding
Consultation with the IMF Executive Board on the Missed Inflation Target Under the MPCC

Attachment I. Memorandum of Economic and Financial Policies

1. The government of Costa Rica remains fully committed to the economic reform program supported by the extended arrangement under the EFF and the reform measures under the RSF arrangement. The extended arrangement was approved by the IMF Executive Board on March 1, 2021, and ratified by the country's Legislative Assembly on July 19, 2021. The RSF was approved by the IMF Executive Board on November 14, 2022. Having submitted the relevant bill to the Legislative Assembly, the authorities will strive for the RSF to be ratified by the Legislative Assembly as soon as possible during the extraordinary sessions. This memorandum outlines in detail the progress toward meeting the objectives of the Fund-supported program and our policy plans to advance these objectives as well as our progress and policy commitments under the RSF arrangement. Tables 1, 2, and 3 summarize performance to date and how we plan to update the quantitative targets going forward, progress on structural benchmarks and new structural conditionality under the EFF, as well as progress on reform measures supported by the RSF arrangement.

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

I. MACROECONOMIC DEVELOPMENTS AND OUTLOOK

3. Costa Rica's growth has moderated. Following the pandemic, which hit the Costa Rican economy hard in 2020, real GDP rebounded in 2021, growing by 7.8 percent. However, amid global headwinds, real GDP growth slowed to 4.3 percent in 2022. While exports grew solidly, the slowdown was due in particular to a moderation in domestic demand. Real GDP growth is forecast to moderate further to 3.3 percent in 2023, with growth expected to remain broadly in line with potential of just over 3 percent over the medium term. Inflation peaked in August and declined to 2.4 percent y-o-y in April, back within the BCCR's 2-4 percent tolerance band. In 2022H1, higher global commodity prices and a weak recovery in tourism were negatively weighing on the current account and international reserves, in the context of capital outflows from local pension funds. However, in 2022H2 those external pressures eased, which, along with a strong performance of exports (including tourism) allowed the BCCR to rebuild international reserve buffers. The current account deficit is expected to narrow from 4.0 percent of GDP in 2022 to 3.3 percent of GDP in 2023. The sovereign spread has continued to narrow, further supported by sovereign credit rating upgrades earlier this year. The outlook remains subject to downside risks, including further supply disruptions and commodity price volatility, further tightening of financial conditions, weaker-than-expected global demand, and possible natural disasters.

II. PROGRAM PERFORMANCE

4. Since taking office, we have made important progress on our reform agenda. The end-December 2022 Quantitative Performance Criterion (QPC) on the central government (CG) primary balance and Indicative Target (IT) for the debt stock were met by comfortable margins, reflecting continued robust revenue performance and our prudent approach to spending. We also met the end-March fiscal ITs by a good margin. The end-December QPC and the end-March IT on net international reserves were met by comfortable margins. The Monetary Policy Consultation Clause (MPCC) outer band—set in early 2022 under a more benign outlook for global food and energy prices—was breached by 2.4 percentage points in December. Attached is a letter from the BCCR explaining the deviation in accordance with the required Board consultation. We continue to observe the continuous PCs on non-accumulation of new external arrears, non-imposition/intensification of restrictions on the making of payments and transfers for current international transactions, non-imposition/modification of multiple currency practices (MCPs), non-introduction/intensification of import restrictions for BOP reasons, and no conclusion of bilateral payments agreements that are inconsistent with Article VIII obligations. While we did not submit amendments to the BCCR Law to the Legislative Assembly as foreseen by the end-December 2022 structural benchmark, in June we submitted to the Legislative Assembly a subset of the previously foreseen amendments to the BCCR law. We are also working on a proposal to award constitutional autonomy to the BCCR to be submitted to the Legislative Assembly during the next ordinary legislative session period in August-October. Depending on the outcome of the legislative process, we will consider further measures to align the BCCR governance and operational frameworks with the objectives of the reform, with a plan to be discussed in the context of the next program review. Although we made progress in implementing the public employment bill, we did not meet the structural benchmark owing to the complexities of implementing the wage spine in a manner that meets the law's objectives (¶13). We submitted a bill to unify debt management (an end-June 2023 structural benchmark).

III. FISCAL POLICY

Fiscal Stance

5. The main priorities of fiscal policy are to meet the critical social and health needs of the population, support the recovery, and secure debt sustainability. Costa Rica's fiscal balance deteriorated sharply over the previous decade, due to a permanent increase in current spending following the global financial crisis. Recognizing the pressing fiscal and financing challenges facing our country, a comprehensive fiscal reform bill was approved by the Legislative Assembly in December 2018 to rein in spending and strengthen revenue. The economic contraction caused by the pandemic made an additional fiscal adjustment necessary to keep debt manageable. This reform started to improve the fiscal balance in 2021 and put public debt on a declining trajectory, mostly by requiring a significant decline in spending as a share of GDP. Building on a strong revenue overperformance and spending restraint in 2021 and 2022, we are committed to pressing ahead with the required fiscal consolidation, while continuing to protect the vulnerable and supporting a sustainable economic recovery. Our efforts to date have contributed to an improved fiscal outlook and we are on track to exceed our primary balance target of 1.3 percent of GDP by end-2023 and to achieve a surplus of 1.85 percent of GDP by end-2024. We expect to reach a debt-to-GDP ratio of 50 percent by 2035. Additional progressive income and expenditure measures will foster more inclusive and sustainable growth and deliver a faster decline in debt.

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

- ***Fiscal rule.*** The reform introduced a fiscal rule tying down nominal spending growth and included tight restraints on public sector remunerations. The reform also enabled reallocation of earmarked revenues and legally mandated spending (except those mandated by the Constitution) if debt exceeds 50 percent of GDP. The rule has played a pivotal role in anchoring debt sustainability. However, recent experiences through the pandemic and Russia's invasion of Ukraine have identified opportunities to improve the rule. Following a change to the implementing regulation of the fiscal rule in June 2022, the spending ceilings for execution will no longer be based on the previous year's execution but exclusively on the previous year's original budget. The change addressed a structural shortcoming in the regulation that penalized under-execution by ministries and other agencies and reduced the flexibility to reallocate resources within the budget envelope to meet evolving or unanticipated needs. We are considering further options to improve the fiscal rule (¶15).

- ***Tax reform.*** The reform also included important enhancements to Costa Rica's taxation system. A VAT replaced the General Sales Tax. Income taxation was strengthened through the: (i) globalization and a phased-harmonization of capital income and gains tax at a 15 percent rate; (ii) phasing-in of new rules for corporate income taxation (CIT); and (iii) increase in the progressivity of the personal income taxation (PIT) with additional brackets of 20 and 25 percent for employment income.

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

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

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

8. We are on track to sustain our fiscal consolidation efforts in 2023. A primary balance of CRC 467 billion up to end-March 2023 exceeded the IT of CRC 152 billion and places us on track to achieve a primary surplus above CRC 609 billion (or about 1.3 percent of GDP) by end-December 2023. To deliver the needed structural adjustment, net of one-offs, and support a balanced and progressive fiscal consolidation going forward, we are committed to implementing the following revenue and expenditure measures, consistent with the 2023 budget approved by the Legislative Assembly in November 2022:

- ***Revenue measures***. The 2018 tax reform will provide additional income tax yields that were not realized earlier due to the delayed enforcement of thin capitalization rules between related parties; these are expected to generate a yield of 0.1 percent of GDP. In January 2023, we implemented measures to improve the efficiency of the tax system by taxing imports of certain goods with VAT throughout each stage of value production until sold to the final consumer, yielding 0.06 percent of GDP. We remain on track with the scheduled phase-out of reduced VAT rates to the tourism sector and construction services. We remain committed to improving revenue mobilization through a more equitable and efficient tax system (MEFP ¶11). In September 2022, we adopted a legal framework to periodically appraise tax expenditures and remove those no longer serving their intended purpose, aiding our efforts to broaden the tax base and improve its fairness. We also strengthened the pecuniary framework for taxpayers' wrongful use of exemptions. After a first appraisal of the tax expenditures, we expect to broaden the tax base and mobilize at least 0.07 percent of GDP in additional revenue by removing the lenient VAT treatment of airfares, medical equipment, and wood (after accounting for its negative environmental impact), and tax exemptions on car rentals through legislation submitted to the Legislative Assembly in May. We will continue to remove tax expenditure provisions with a higher social cost than their benefit going forward. In September 2022, we conducted a detailed review of our personal income tax (PIT), with support from IMF TA. Based on the findings of the analysis, we submitted in May 2023 to the Legislative Assembly a tax bill to reform the PIT to increase horizontal and vertical equity by taxing the income of employed, pensioners, and self-employed individuals under a single recalibrated schedule, thereby equalizing their tax burden. The reform fully harmonizes the PIT rate on capital income and gains, broadens the tax base by, among others, including dividends distributed by firms in free zones to Costa Rican residents, removing the progressive schedule within the CIT, while retaining and updating the existing regime for small and medium enterprises. Moreover, the bill will broaden the tax base by including capital income earned abroad by Costa Rican residents, and simplify the taxation of non-residents. The bill is expected to be approved by end-January 2024. Although the focus of the reform is on improving the efficiency and equity of the tax system and the intention is not to raise significant revenues, the annual yield of the above bill's reforms is estimated to be approximately 0.1 percent of GDP. To support and cooperate with international efforts to reduce profit shifting and base erosion, we amended the definition of permanent establishment to align to international standards and broadened our base by taxing previously out-of-scope profits from firms and clearly defined the taxable base for corporations. In addition, we also committed to improving the progressivity of our property tax on vehicles by submitting a bill to the Legislative Assembly in May. Finally, as part of our commitment to foster green growth, we will introduce a revenue neutral scheme of feebates to strengthen incentives to replace high-polluting private vehicles and further our decarbonization plans by end-September 2023 (MEFP ¶42). The overall net yields on the revenue side on an annual net basis is estimated at about 0.2 percent of GDP from 2025 onwards.

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

9. Given the lingering uncertainty related to the COVID-19 crisis and economic recovery, our program builds in flexibility to deal with unforeseen shocks. Ongoing improvements in tax and customs administration continue supporting revenue yields. Further progress in strengthening our tax system, with the approval of tax bills in the Legislative Assembly, would also secure our public finances on a firmer footing. Nevertheless, were revenues to underperform, we will propose to the Legislative Assembly temporary tax measures and we will reprioritize non-critical spending as needed to ensure that the primary target goal remains within reach. In the event of additional COVID-19 needs, due to a more protracted pandemic, the program targets will continue to allow for an adjustor to accommodate increased COVID-19 emergency spending, up to 0.2 percent of GDP in 2023, that might emerge from increased transfers to support health services, stronger targeted support to households and businesses heavily affected by the pandemic, or further enhanced social assistance programs to support the most vulnerable groups. We are, however, committed to saving any revenue over-performance or windfalls in 2023 and outer years to accelerate our debt reduction plans.

10. We will further advance our fiscal consolidation efforts in 2024 and over the medium term to reduce our debt to below 60 percent of GDP as soon as possible, while making space for critical infrastructure and social needs. We are targeting a primary balance of at least 1.85 percent of GDP in 2024, consistent with conditions set by the Legislative Assembly for further Eurobond issuance, as spending complies with the fiscal rule and continues to decline as a share of GDP. Additional measures will be underpinned by a planned income tax reform and additional efforts to rationalize tax expenditure (MEFP ¶11). In addition, the implementation of our ambitious reform of public-sector employment (MEFP ¶13) will further support our commitment to keeping nominal spending growth low. In line with the fiscal rule and the Public Employment Bill (PEB), the freeze in the basic wage will be extended beyond 2025. We will do these while we continue to modernize and strengthen our social safety net. Expected efficiency gains through consolidation of ministries and other institutions as part of our broader public sector reform; our planned asset sale program; and greater revenue mobilization from the modernization of the tax and customs administration (MEFP ¶12) and PFM reforms (MEFP ¶15) provide important upsides to our ability to tackle our current debt and financing challenges faster than expected under the program, thereby supporting macroeconomic stability and growth.

Structural Fiscal and Debt Management Reforms

11. We are developing a medium-term revenue strategy to move towards a more progressive and growth-friendly tax system that supports equitable growth. We are reviewing and redesigning the tax system through a comprehensive set of policies to support the government's priorities and meet revenue goals. This strategy includes (i) reforming the PIT for a more equitable, efficient and neutral tax system where wages earned by employees, profits from the self-employed, and pensions are taxed through a single recalibrated progressive tax schedule (MEFP ¶8); (ii) broadening the base by taxing dividends distributed by firms in Free Zones as well as passive capital income earned abroad by Costa Rican residents; (iii) rationalizing and simplifying income taxation of non-residents; (iv) further broadening the tax base by removing services taxed with reduced VAT rates and going forward through the systematic and regular cost-benefit analysis of tax exemptions, to remove outdated or ineffective exemptions, including a thorough review of those that have a negative environmental impact with the aid of IMF TA; (v) removing the progressive tax schedule within the corporate income tax (CIT) and amending the definition of permanent establishment, and broadening the tax base; (vi) revising our current incentives under the Free Zones to move in line with the new international taxation architecture (Pillar 2) with World Bank (WB) support; and (vii) supporting the environmental agenda by introducing and periodically recalibrating feebates to support the transition to low emission vehicles and safeguarding revenues consistent with IMF advice.

12. We are strengthening revenue administration to support our fiscal consolidation plans and medium-term revenue strategy. The Tax Compliance Improvement Plan, approved in December 2021 (structural benchmark) with IMF TA support and updated in December-2022, aims at strengthening compliance strategies through a more robust large-scale automated cross-matching of information to detect inaccurate reporting and revamped audit programs focused on VAT on services and erosion of CIT bases. While the rollout of the compliance plan was delayed due to the hacking of the tax and customs administration's main collection systems, we resumed the implementation of different compliance risk mitigation strategies in August 2022, with quarterly monitoring based on both quantitative and qualitative indicators for the selection of risk-based cases. From September-2022 to April-2023, our risk assessments of VAT and large corporate taxpayers allowed the tax administration to recoup approximately US$ 14.6 million in owed taxes, including interest and penalties. International taxation risk assessments are scheduled for end-June 2023. We developed a guideline (*ficha*) to undertake risk assessments of large net-wealth taxpayers by end-May 2023. We are also modernizing our tax code through another bill submitted in May to instate fiduciary responsibility, simplified enforcement procedures, updates on penalties, coercive collection and precautionary administrative measures. We continue to strengthen the integrity of the taxpayers' registry, with IMF TA, and are scheduling monthly thorough taxpayer registry cleansing processes during May-November 2023. We will use administrative and third-party information to enhance compliance, including the automatic exchange of information on financial accounts (CRS), Country-by-Country (CbC) reports, and effective use of corporation shareholders and beneficial owners' registers when warranted. We have also started to exploit data from samples of electronic invoices to detect unusual activity in specific sectors and taxpayer behaviors to improve enforcement capabilities and the efficiency of the tax administration. With IMF TA, we also updated our noncompliance estimations for VAT and CIT in May 2023. In addition, we continue to monitor and update the strategic indicators and targets in the Compliance Improvement Plan. On the customs side, the approval of the new Customs Law in May 2022, designed and approved with IMF TA support, will further promote trade facilitation to help increase productivity growth in trade-related sectors and improve revenue collection through more effective risk-based enforcement. The implementing regulation will be approved and published in June 2023. The Directorate of Customs is preparing an organizational change to better serve taxpayers and will formalize these changes through an executive decree by August 2023. We are modernizing points of entry for imported merchandise at the border with Panama and Nicaragua. Additionally, with the support of CAPTAC-DR, we continue developing analytical tools to improve our risk-based assessments and to reduce the under declaration of imported goods. To improve enforcement, we are employing non-intrusive scanners using risk-selection criteria of containers in the Moin Port. Additional revenue administration and customs efficiencies are expected from the MOF's digital transformation plan, *Hacienda Digital*, supported by the WB, which will upgrade tax and customs procedures and information systems, and replace the National Integrated Risk Management Systems, a tax and customs coordinated risk management approach, which was abandoned due to technical issues with the service provider. We have also deployed an aggressive strategy to minimize cyber risks through an extensive communication strategy and training programs on cyber risks geared toward all MOF staff. We have invested in updating security measures to reduce vulnerabilities.

13. Although the relevant structural benchmark was not met, we remain committed to rationalizing and improving the efficiency and quality of government spending through the full implementation of the public employment reform. Beyond what was already mandated by the December 2018 fiscal reform, there is significant scope to further rationalize the public wage bill, bringing it back on a sustainable path after its excessive expansion over the last 15 years.

- *The implementation of the landmark Public Employment Bill, approved in March 2022 (the related structural benchmark was not met by end-May 2021 as initially envisaged due to legislative delays)*, is underway in phases. The Ministry of National Planning and Economic Policy (MIDEPLAN), through the creation of a Public Employment Unit and in coordination with the Civil Service General Directorate (DGSC) and with support from the Inter-American Development Bank (IDB), finalized the methodology to create a single wage spine with all seven job families, consolidating within the single salary other wage supplements such as annuities, bonuses, incentives and others. The oversight over the design of the single wage spine is being shared between MIDEPLAN and autonomous institutions for their employees (Judiciary and Legislative Branches, Supreme Electoral Tribunal, public universities, municipalities, and CCSS), following the criteria and ceilings approved by the Bill. The Bill, including the introduction of a single pay spine, will be implemented by end-November 2023 (missed end-March 2023 **structural benchmark**). In particular, engagement with stakeholders including a public consultation in January 2023 facilitated the approval of the implementing regulation as envisaged by March 2023. As a result, new hiring in the public sector adheres to the new rules in line with the Public Employment Bill. A follow-up National Dialogue was set up in March and held for 10 days to better communicate the implementation of the PEB to stakeholders and iron out technicalities within the PEB. As a result, we will submit to the Legislative Assembly in June 2023 amendments to specific articles in the PEB to strengthen the certainty of the implementation by addressing these technicalities, including closing the current loopholes allowing institutions to carve out their staff from the PEB by declaring their job positions as exclusive. The full implementation was delayed due to the unanticipated methodological complexities in designing the single wage spine, including incomplete wage data resulting from the cyberattack to the Ministry of Finance last year.

- *With IMF TA support, we took corrective actions and established a strict schedule of activities to reaffirm our commitment to bringing the implementation of the single wage spine back on track while ensuring it meets the objectives of the law*. MIDEPLAN issued general methodological guidelines pertaining to job data collection, analysis of job classes by job family, and the formulation of the single wage spine in May 2023 to inform the implementation of the PEB by public institutions whether or not they are legally under the technical tutelage of MIDEPLAN. For institutions not under MIDEPLAN's tutelage, these guidelines are a non-binding reference for the correct application of the PEB and can be used as institutions see fit. For institutions under MIDEPLAN's legal purview, MIDEPLAN produced a single wage spine in compliance with the Public Employment Bill covering at least one-quarter of job positions in the executive branch in June 2023 (**a prior action for completing this review**), by producing a document detailing how factors are mapped into points, points are assigned to the job positions, monetary values are assigned to points, and developing (with the support of the Ministry of Finance) fiscal scenarios for the public administration to provide adjustment margins to the single wage spine if needed. These employees will gradually transition to a global salary according to the transitory articles established in the PEB and its regulations. We will assign points to teachers by end-June 2023 and we are taking the steps to complete their inclusion in the single wage spine. We will incorporate 90 percent of the executive branch's job positions in the single wage spine by end-September 2023 (**proposed structural benchmark**) by publishing the directive which will set the global salaries of new workers and the transitional provisions in the PEB and its regulations will be applied henceforth. We will begin administering payments for all employees covered by the law in line with the transitional provisions set by the PEB and its regulation by November 2023. To ensure the robustness of our methodological approach and with the support of the IDB, we will run a simulation on a small but representative sample of jobs by December 2023 and if necessary make adjustments to the single wage spine in the appropriate directive. 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. It will modernize and streamline the public administration, bringing the public wage bill on a sustainable path, in line with OECD recommendations. Due to the large wage premium in the public sector, the salaries that fall above the spine will be frozen until the single pay scheme reaches them. This, along with the gradual transition to the single wage spine for existing workers whose salaries fall below the reference wage (Transitory Disposition XI), will imply that savings can be immediately rendered from the effectiveness of the reform. Based on the new reference salaries, we estimate, with support from the IDB, that savings from the reform will range between 0.4 and 0.6 percent of GDP during the first five years for the entire public sector including savings of 0.3 to 0.5 percent of GDP for the central government. The implemented Bill has also introduced new rules for recruitment and selection, professional development, and performance evaluation, including for top-ranked officials; and new employee benefits including one-month parental leave, two-month extension of maternity leave (for special cases), and sick leave to take care of a family member.

14. We are committed to enhancing the targeting accuracy and delivery of our social protection programs, leveraging digitalization. Costa Rica devotes important resources in its budget to fighting poverty and reducing inequality. There are opportunities to build on recent improvements and further enhance the effectiveness of some of its social assistance programs through improved coverage, targeting, and delivery. The delivery system is also highly fragmented with different entities engaging in social assistance activities, with scope for improvement in institutional arrangements, transparency, and payment delivery. To consolidate the social protection system and provide more flexibility in social spending, we presented bill 23.436 in October 2022 to integrate the functions of various bodies within IMAS and we expect it to be available for discussion in the plenary by December 2023. Ongoing improvements include:

- ***Centralization and digitalization of the payment system.*** The payment system for all cash transfer social assistance programs at the MOF's National Treasury (SUPRES), in coordination with social assistance units, was centralized and digitalized in December 2021 (structural benchmark). Specifically, we signed agreements with responsible institutions, issued appropriate regulations, and incorporated the payment software solution into the Digital Treasury system. Despite the delays caused by the cyberattack, we have resumed the implementation of the new systems in the IMAS Avancemos Program and the necessary coordination and implementation have continued to include all the remaining programs that are financed with resources from the national budget by end-June 2023. As a next step, we will be supporting adoption by remaining institutions and programs that deliver cash benefits by tailoring the data interface and helping them overcome capacity constraints. We expect all the main institutions and programs that provide benefits in the form of cash to be fully compliant with the new system by end-December 2023. We estimate that introducing the system reduced the payment processing time needed to reach the final beneficiaries from 3-5 days to just 24 hours and improved service delivery to beneficiaries, fiscal operations efficiency, and financial inclusion of the low-income population (especially women) through the adoption of digital payment tools.

- ***Targeting and coverage of social programs.*** To continue enhancing the targeting accuracy of our social programs, we continue strengthening the role of SINIRUBE (*Sistema Nacional de Información y Registro Único de Beneficiarios del Estado*) as the main instrument to target social protection benefits and services, which will also contribute to a more harmonized framework for inter-institutional coordination. A study by *Programa Estado de la Nación* confirmed the robustness of the SINIRUBE algorithm for targeting beneficiaries. Major social assistance programs have already adopted SINIRUBE and the office in charge of its administration has prepared plans to support the adoption by remaining institutions, including the judiciary and higher education. The government is also encouraging municipalities to learn and adopt SINIRUBE as their targeting instrument. In addition to boosting inclusiveness, these efforts will improve spending efficiency by promoting interoperability with other sources of data to reduce costs of data validation and rationalize existing programs. In this context, building on IMAS Directive 0122-2022, we are increasing the use of information from SINIRUBE to have a better and up-to-date socio-economic profile of individuals and households, to inform benefit allocation decisions. For example, SINIRUBE will incorporate the *baremo* tool, which quantifies the intensity of a person's needs, to aid with prioritization. Additionally, IMAS is progressing in accordance with its roadmap to remove ineligible duplicate benefits, identified by SINIRUBE, outside of municipalities. Bill 23.436 will also facilitate the removal of duplicate benefits paid by multiple agencies.

- ***Social Assistance Single Window.*** With technical support from the WB, IMAS has started designing and developing a Social Assistance Single Window ("*ventanilla única*") to consolidate social programs and to move from a first-come-first-serve basis to prioritization based on the urgency of need, thus improving response times and targeting. We already launched an online form allowing changes in contact details and started to strengthen associated back-office systems. Building on these efforts, IMAS will launch a single window for social programs under its authority (except those related to emergency care, the group programs of the Area of Productive and Community Development, and the ones corresponding to the Area of Social Action and Administration of Institutions) by end-February 2024 (**proposed SB**); the window will automate the process from when a request is made to when an appointment is assigned. This will entail allowing the public to enter or update information relevant for assessing their situation and determining eligibility and integrating this online form with SINIRUBE, whose capacity to validate data and assess eligibility will be strengthened. In early 2024, we will have an inventory of programs from other institutions that could be linked to the services of the single window. When completed, the single window will: (i) serve as a one-stop-shop for potential beneficiaries to access information on social programs; (ii) consolidate information on benefits and programs that individuals and families are receiving; (iii) provide information on potential eligibility for new benefits to beneficiaries and social workers; (iv) facilitate the preparation of legal documents for beneficiaries such as certificates for appeals; (v) provide an online interface where individuals and families can more easily and regularly update personal and contact information; and (vi) facilitate coordination among public institutions that manage benefits and programs.

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

- ***Fiscal Rule Improvements.*** We are developing amendments to clarify the rule's regulatory perimeter and allow for a more flexible reallocation of resources within the existing spending ceilings while maintaining the rule's essential role in containing spending and reducing debt. Having submitted a first legislative proposal in September 2022 (bill 23.330), we, in line with IMF TA recommendations, discussed amendments through motions at the legislative committee level in March 2023. A modified proposal was submitted in April 2023 with expected approval in July 2023. The modified proposal preserves broad coverage of spending categories (e.g., capital when debt is above 60 percent, interest, and court rulings). To prevent ad hoc requests for exclusion, the modified proposal excludes institutions that operate as market producers or without government control. To facilitate resource allocation in line with the administration's priorities, the MOF will by end-October 2023 produce an assessment of legal changes needed to empower the STAP to make the expenditure limit applicable to the overall central government (including extrabudgetary entities) on aggregate instead of to individual entities. We will limit further changes to the rule to holistic periodic reviews.

- ***Medium-Term Fiscal Framework***. With support from IMF TA, the MOF published in April 2022 a Medium-Term Fiscal Framework (MTFF) covering the NFPS including the period 2022-2027, meeting the relevant structural benchmark. The revised MTFF, which improves the credibility of the budget process and presents a coherent fiscal strategy in line with the fiscal rule, includes analysis and reporting of fiscal risks with contingent liabilities, debt guarantees, and explicit fiscal contingency reserve schemes, and integrates into the fiscal strategy a medium-term public investment plan/framework. The MTFF was updated in September 2022, as part of the submission of the 2023 budget, and in March 2023, ensuring continuity in the analysis of macroeconomic shocks and further analysis of debt management. We plan to further strengthen the September 2023 MTFF by better aligning our fiscal policy with long-term national plans, explicitly stating the goal to reduce debt to 50 percent of GDP by 2035. To further enhance fiscal risk analysis, the MTFF will include climate transition risks (¶44).

- ***Public Investment Management Assessment***. To improve the planning, allocation, and implementation of public investment among the numerous entities currently responsible for infrastructure development, the MOF and MIDEPLAN undertook the IMF Public Investment Management Assessment (PIMA), including a new Climate Change Module, in November-December 2021, with support from the WB and IDB. Based on the assessment, we have defined a plan aimed at strengthening public investment efficiency while making fiscal space for our climate change-related and other critical infrastructure needs (MEFP ¶41). As part of this plan, we submitted a bill (No. 22.470) to the Legislative Assembly to extend the process and procedures of the national public investment management system (*Sistema Nacional de Inversion Publica (SNIP)*) to all the decentralized entities attached to the different ministries, the Legislative Branch, the Judicial Branch, the Supreme Electoral Tribunal, and their dependencies and auxiliary entities. As well as the decentralized administration: autonomous and semiautonomous state-owned enterprises and municipalities. The bill is advancing and we expect it to be approved by the Legislative Assembly by end-June 2023. We plan to complement our work on project appraisal by including in the appraisal process the climate impact of the project through the social cost of carbon by end-September 2023 (MEFP ¶41). To seamlessly implement the appraisal process, we have started requesting other public sector institutions to start training their planning unit staff so they are able to apply them. To give continuity to the work initiated with the support of IDB and private consultants, we will publish by end-December 2023 a set of clear and transparent project selection criteria including climate change criteria (MEFP ¶41). We already issue quarterly and half-year reports on the physical and financial progress of externally funded projects. To streamline capital project portfolio monitoring, we plan to extend the process to domestically funded projects. We also plan to develop a comprehensive asset register including information on the stock of public assets and their condition as a necessary precondition to inform investment planning, selection, and maintenance.

- ***Gender budgeting***. We are taking action to introduce gender budgeting to better operationalize the gender equality policy agenda. With IMF capacity development support, we are gradually incorporating a gender lens into the budget preparation process to publish a gender budget statement that identifies gender-related spending for the Ministry of Justice, Ministry of Education, Ministry of Agriculture and Livestock, the Judicial Branch, National Institute of Learning, Rural Development Institute, National Institute of Cooperative Development, and IMAS as an annex to their respective 2024 budgets by end-October 2023. Intermediate steps in the preparation of the budget included: (i) a pilot exercise to identify gender-related expenditures (completed by end-December 2022); (ii) adjusting budget call circulars for the 2024 budget to give instructions to identify gender-related spending in the pilot ministries (completed by end-April 2023); (iii) establishing coordination between the MOF, the STAP and the Comptroller's Office, so the CGR considers the adoption of the technical budgeting standards to identify gender-related spending and mandatorily applies it in the decentralized sector. The execution of gender-related spending, in line with the budget statement, will be monitored during 2024.

- ***Fiscal Council.*** We are resourcing and fully operationalizing the Fiscal Council to enable it to publish its first public assessment of the government's fiscal strategy, fiscal rule compliance, debt sustainability, and macro-fiscal projections included in the March 2024 MTFF. We will support the Fiscal Council in developing its own communication tools as well as a memorandum of collaboration with the MOF to clarify the separation of functions and information sharing.

- ***Macro-fiscal Unit.*** In line with IMF TA recommendations, we will formalize a unit at the MOF permanently in charge of macro-fiscal issues by end-December 2023.

- ***Other key PFM institutional reforms.*** The MOF and the Comptroller's Office will continue working together thoughout the entire budget cycle to ensure compliance with the fiscal rule. We have recently resumed our efforts to reduce budget fragmentation. Following the consolidation under the CG budget from 2021 of all public entities, as required by Law 9524 of

April 2018, we plan to consolidate public services within fewer public institutions, as part of our planned public sector reform. Specifically, we submitted legislation to consolidate the responsibilities of multiple entities within the Ministry of Public Works and Transportation (MOPT), a new Ministry of Housing, and a new Social Ministry to abate redundancies within the public sector. We are also restructuring several ministries to strengthen their oversight of other decentralized entities and eliminating the Ministry of Governance, reallocating some of its directorates under other public institutions. In addition, with IMF TA support, we will continue improving the management of public sector liquidity by extending the Treasury Single Account (TSA) to the entire public sector, including decentralized and autonomous entities. Specifically, we submitted a revised bill (No. 22.661) in September 2022, with expected approval by end-December 2023, that requires the phased transfer of all cash held by decentralized and autonomous entities in commercial bank accounts to the TSA, which will reduce idle cash in the financial system and reduce the central government's borrowing costs. Additional expenditure administration efficiencies are expected from the MOF's digital transformation plan, *Hacienda Digital*, supported by the WB, which will modernize and integrate our PFM information systems to better align expenditure policies across core PFM entities, planning, and spending units.

16. We modernized our public procurement processes. In line with the Social Dialogue's agreements, we enforced the use by all procuring entities of the electronic platform *Sistema Integrado de Compras Públicas* (SICOP) to lower transaction costs and improve capacity and expertise. The Public Procurement Law (No. 9986) approved in May 2021 introduced a sound regulatory and institutional framework for managing and implementing umbrella contracts for goods and services, eliminating past exceptions to public bidding processes and increasing competition for government contracts. This new procurement legal framework entered into force in December 2022 and requires bidders' registration in the e-procurement system, 'Electronic Registry of Official Suppliers and Subcontractors of the Unified Digital System', to be incorporated into the *Sistema Integrado de Compras Públicas* (SICOP). The regulation was published in November 2022. The regulation requires all competing bidders to submit accurate and current beneficial ownership information through affidavits as part of the bidding process. The required information includes information to identify the beneficial owner, including their full name and type and number of official identification document(s) for legal persons. Although SICOP is accessible to the public, beneficial ownership information will be held within MOF's supplier registry for consultation by the Comptroller General of the Republic, Office of the Attorney General of the Republic or other judicial authority upon request. It will also allow the authorities to cross-check information with the Transparency and Final Beneficiary Registry, administered by the BCCR to combat tax fraud and money laundering (MEFP¶35). Moreover, the enforcement of the Public Procurement Law updates, streamlines, and modernizes the public procurement processes ensuring greater efficiency savings through bulk purchases of certain goods and it will allow differentiating by public works, goods, and services, and set different thresholds and processes for each, doing away with a great deal of complexity in the public procurement process.

17. We continue to foster transparency and adhere to best practices in the procurement and contract awards of any COVID-related spending. The Comptroller's Office developed a Fiscal

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

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

19. We are strongly committed to boosting productivity through greater efficiency and competitiveness in the electricity sector and the modernization of electricity tariffs.
Since 2021, the Costa Rican Institute of Electricity has been implementing an efficiency strategy to reduce electricity prices in the context of its strategic plan. This strategy includes actions such as reducing operational costs, restructuring debt, and completing the implementation process of the IFRS. These efforts were reflected in ICE's cumulative average price reductions in 2022 of 8.8 percent, 8.0 percent, and 10.7 percent in generation, distribution, and transmission, respectively, compared to December 2020. The Government is committed to advancing this efficiency strategy through further debt restructuring and cost reduction in order to achieve lower and more competitive tariffs. ICE will continue the execution of its Financial Sustainability Roadmap to reduce fixed costs and renegotiate debt conditions in its financial statements and the regulatory accounting used for tariff setting by reclassifying operating leases as finance leases; this last step was concluded in March 2023 and it is expected to be reflected in tariffs as of 2024. ICE will assess its cost structure in each segment of the electricity supply chain (generation, transmission, distribution) to identify efficiency opportunities

and launch a roadmap with detailed actions to increase the efficiency of the state-owned company by end-December 2023. ICE is renewing and/or renegotiating at affordable terms the private generator contracts as they expire to leverage installed capacity to meet increasing electricity demand and guarantee investment efficiency, as well as achieve benefits in end-user tariffs. To optimize the use of installed infrastructure, a bill (No. 22.561) authorizing private energy generators, public companies, and cooperatives to sell their surplus energy (after supplying local demand) to the regional market was submitted to the Legislative Assembly in June 2021 and is expected to be approved by end-July 2023. *Autoridad Reguladora de Servicios Públicos* (ARESEP) will expand its efforts to analyze tariff competitiveness in generation, distribution, and transmission and the adoption of a new efficient tariffs benchmark, with IDB support. To achieve this, under ARESEP's leadership, three companies (ICE, ESPH and COOPELESCA) started to implement the first part of the tariff modernization program in 2021 and, building on this pilot, the remaining five companies started implementation in 2022. As the next step, ARESEP will work with each distribution company to develop a roadmap for the introduction of the modernization of the tariff structure during 2023. ARESEP will continue monitoring distribution companies' financial costs to ensure their investment projects' financing terms fit with the underlying assets' useful lifespan. Efforts are also ongoing to promote the harmonization of the energy sector. The implementing regulation for Law No. 10086 to simplify the administrative procedures for private participation in power generation from renewable sources for self-consumption, approved in October 2021, was officially established in February 2023 (MEFP¶42). Moreover, ICE and the Costa Rican Chamber of Distributed Generation will simplify the procedures for the interconnection of distributed generators in ICE's network through an internal protocol. We submitted a bill (No. 23.414) to the Legislative Assembly in October 2022 to promote the development of new technologies and business schemes for the provision of public electricity service, optimize physical infrastructure, and ignite the commercialization of electricity, all of which will be an effort to lower electricity costs. The bill also seeks to integrate the public policy for electricity and fuels, which will accelerate decarbonization.

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

- ***Eurobond issuance.*** In November 2022, the Legislative Assembly authorized the Ministry of Finance to issue up to US$ 5 billion in Eurobonds. In our first issuance since 2019, we successfully secured US$ 1.5 billion in March 2023. The authorization allows for up to another US$ 1.5 billion in the second half of 2023, up to US$ 1 billion in 2024, and up to US$ 1 billion in 2025, subject to prudent fiscal targets being met to accelerate debt reduction. The general authorization will provide us with some flexibility for international issuances. In August 2023, we will pursue a constitutional reform that would grant the executive greater flexibility in international borrowing according to best practices. This will allow the Ministry of Finance to optimize the balance and timing of internal and external debt issuance. It will also allow the budget debate in the Legislative Assembly to have a more holistic approach that moves beyond discussions of expenses to include discussions on financing (including debt) needed to close any gaps in the budget.

- ***Institutional debt management reforms.*** We submitted an amendment to law 8131 to the Legislative Assembly to centralize all debt-related functions of the government, in line with best international practices, to improve transparency and reporting of public debt, within the purview of a new standalone Public Debt Management Office reporting directly to the Minister of Finance, in May 2023 (an end-June 2023 **structural benchmark**). The established Assets and Liabilities Committee, comprising the Treasury, the Public Credit Department (DCP), the macro-fiscal unit of the MOF, and the BCCR will continue to provide strategic guidance and inter-agency coordination of high-level policy decisions related to government debt.

- ***Medium-term debt strategy (MTDS).*** We published an updated MTDS covering 2022-27 in April 2022, meeting the relevant structural benchmark. The report covered the government's contingent liabilities, especially guarantees provided to state-owned companies. Going forward, we will publish and adhere to Annual Borrowing Plans and Quarterly Issuance calendars in line with the MTDS and strengthen the accounting and budget execution processes for public debt payments.

- ***Domestic market development.*** With WB support, we are taking steps to improve the functioning of the debt markets. We are focusing our issuance on standard fixed-rate bullet bonds of select maturities while open bond windows and bilateral bond sales are being gradually phased out. We will reform the auction mechanism for Treasury to become a price-taker in bond auctions (which will improve the price discovery process) and we will form a technical pricing committee to develop guidelines for pricing methodologies. We 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. The Legislative Assembly approved in December 2022 a law to promote and open the Costa Rican public debt market to foreign participants by easing regulatory barriers and harmonizing tax treatment. We are also in consultations with different international platforms to allow clearing and settlement of our debt securities in accordance with international standards. We will continue to make active use of liability management operations to reduce rollover risks and to smooth the impact of maturing benchmark bonds, in line with our MTDS. Finally, in December 2022, with support from the IDB, we rolled out a pilot market-making / primary dealer program with a small group of participants with well-defined rights and responsibilities.

21. We stand ready to adopt a sovereign asset and liability management (SALM) at an operational level to effectively analyze and manage overall risk exposures. We agreed to publish the recent Technical Assistance report on SALM to facilitate a broader discussion on a new framework among stakeholders. We plan to develop a roadmap to implement key recommendations proposed in the report, including broadening data collection on all sovereign assets and liabilities and establishing a risk-analyzing framework.

22. We are advancing our efforts to improve data quality and transparency in fiscal reporting. We are committed to improving the timeliness, quality, and comprehensiveness of the fiscal, financial and debt accounting for the public sector, with support from IMF TA. Despite some delays due to the hacking attacks on several government systems, we resumed efforts to adopt the GFSM 2014 accrual accounting standards for fiscal and debt information. We finalized and published the compilation of monthly revenue and expenditure (above-the-line) data excluding accrued interest for 2019-2022 for the Consolidated Central Government (CCG), including for extrabudgetary units (*unidades descentralizadas*) representing 90 percent of extrabudgetary units' spending by end-March 2023. We intend to compile BCG quarterly debt stocks from the first quarter of 2022 to the third quarter of 2023, including loans and debt securities at nominal value (including accrued interest) according to the GFSM 2014 framework, by end-December 2023. We will progressively extend this effort to expand institutional coverage of GFS and PSDS to the general government (GG) and its subsectors (consolidated GG, including the CCSS and local governments). This will allow the compilation and publication of quarterly GG fiscal and debt data for 2022 and 2023 consistent with 2014 GFSM accrual accounting standards by end-March 2024. We will expand institutional coverage to include nonfinancial public corporations' GFS and PSDS above-the-line quarterly data by end-March 2025. In this context, we initiated the compilation, consolidation, and dissemination of 2022, 2023 and 2024 data on assets and liabilities for all subsectors of CCG, local governments, the social security fund, and the nonfinancial public corporations, and developed the reporting of fiscal risks (in the context of the MTFF), to include contingent liabilities, guarantees, concession contracts, and the indebtedness of municipal governments and nonfinancial public corporations by end-March 2025. These improvements include the comprehensive collection and reconciliation of financing (below-the-line) data, the harmonization of both methodology and data coverage among national accounts, government finance and public sector debt statistics, as well as coordinated improvements on public sector accounting to guarantee stock-flow consistency, allow balance sheet enhanced analysis, and provide improved data for decision making. These improvements form part of our efforts to harmonize statistics with those of other countries in the region. 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.

IV. MONETARY AND EXCHANGE RATE POLICY

23. Monetary policy continues to be underpinned by our firm commitment to low inflation within an inflation targeting framework. Maintaining low and stable inflation, under a flexible exchange rate, is critical to secure domestic and external stability, consistent with the BCCR's mandate. In response to the COVID-19 shock, the strong credibility afforded by the inflation targeting framework allowed the BCCR to run a strongly countercyclical policy stance, reducing the policy rate to a record low of 0.75 percent by June 2020 and supporting liquidity and bank credit. Given rising inflationary pressures and upside risks to the inflation forecast, the BCCR began to raise the policy rate in December 2021. As a result of the protracted commodity shock from Russia's invasion of Ukraine, inflationary pressures became more entrenched and started to impact inflation expectations. In response, the BCCR accelerated its tightening pace, bringing the policy rate to 9 percent by October 2022. In addition, the minimum legal reserve requirement rate for deposits and obligations in national currency was raised from 12 percent to the maximum level of 15 percent in July 2022. Together with the decline in global fuel prices, this monetary tightening led to a steady decline in inflation and inflation expectations since last September. Notwithstanding, the outer MPCC band was breached by 2.4 percentage points in December 2022. The attached letter explains the factors behind this overshoot of the target as part of the consultation with the IMF Executive Board (Attachment III). In light of the accelerated decline in headline and core inflation, the decline in inflation expectations, and downward revision to the inflation projection, the BCCR saw room to move towards a less restrictive monetary policy stance and lowered the policy rate by 0.5 percent in March and 1.0 percent in April.

24. Monetary policy will remain data dependent and forward-looking to meet the inflation target of 3 percent, with a tolerance band of ±1 percentage point. The BCCR will continue to monitor inflation developments closely and communicate clearly and transparently the drivers of inflation, the inflation outlook, and the implications for monetary policy. While a continued disinflation trend would provide scope for further policy rate cuts in 2023, there is high uncertainty around inflation developments and risks from a challenging external environment. The BCCR will act cautiously and reinforce the message in our communications about the need to be forward-looking and mindful of the risks with changing external circumstances. Progress in meeting the inflation target under the program will continue to be monitored through a MPCC around quarterly targets (Table 1), as described in the attached TMU.

25. We are committed to allowing the exchange rate to flexibly adjust, in line with market conditions, and to maintain international reserves at adequate levels. Costa Rica operates a flexible exchange rate regime, intervening only to avoid disorderly market conditions. During the first half of 2022, the BCCR faced significantly higher FX demands from energy imports by the NFPS and from pension funds. This was only partially offset through the BCCR's FX purchases from the market, resulting in the end-June and end-September NIR targets being missed by US$612.2 million and US$48.6 million, respectively. As external pressures eased in the second half of 2022 and the first quarter of 2023, the BCCR proactively purchased foreign currency from the market and exceeded the end-December 2022 and end-March 2023 NIR targets by US$576 million and US$1511 million, respectively. We intend to maintain levels of reserves in line with the IMF's Assessing Reserve Adequacy (ARA) metric and above the net international reserves floor set under the program (Table 1). The Internal Audit Office of the BCCR will regularly review the NIR and underlying data, in line with the definition in the TMU, and, as needed, reconcile them with the audited financial statements as of the end of the fiscal year.

26. A calibrated series of operational reforms are underway to deepen the FX market. The BCCR is taking steps to strengthen the predictability and transparency of its FX transactions and create incentives for greater reliance on market-based transactions. To improve visibility on large orders and better manage FX demands from the NFPS, since April 2022, NFPS entities must give an advance notice of at least one month to the BCCR for FX requests. Recommendations by the BCCR staff for reforms of the FX market are being considered by the BCCR Board. This includes a review of the way in which the foreign exchange needs of the NFPS are managed, with a view to strengthening the efficiency of these transactions. Options under consideration are to require FX purchases by NFPS to be pre-announced and a gradual elimination of central bank purchases for the NFPS, delegating this function to the state-owned banks as an intermediate step. To further improve transparency and market function, we are considering separating the BCCR's FX operations intervention between (i) transactions for reserve accumulation and replenishment from NFPS sales, which will occur via a preannounced schedule of daily FX auctions; and (ii) intervention to address market dysfunction, which will occur via Monex as needed. Moreover, the BCCR is improving the functioning of the spot foreign exchange market in order to favor better price formation and liquidity, including the introduction of market makers that will enhance liquidity in the market. Specifically, we have identified potential candidates for a market makers scheme, who would have an obligation to regularly quote prices based on minimum trading lots and a maximum bid/ask spread, and we are in the process of defining the appropriate incentives for entities to take on the market maker role. Following this, we are planning to re-extend Monex's trading hours, with a gradual expansion that aims to cover at least the hours of heavy trading at the commercial banks' windows. To improve efficiency and price formation, the BCCR is looking for ways to balance the participation of different parties with different order sizes. In addition, to promote ethical, responsible and transparent behavior of participants in Monex, we introduced in December 2022 an obligation to adhere to the FX Global Code, which will be implemented by December 2023. We also plan to revise the FX intermediaries' net open FX position requirements in line with international best practices. Once we have improved liquidity in the spot market, we will work to develop the FX derivative market, which would improve FX liquidity, hedging potential, and price formation. A master agreement is being developed (in coordination with foreign exchange intermediaries) for the negotiation of FX derivatives in the country by end-April 2024 and FX swaps will be introduced as an instrument for the BCCR's participation in this market by end-June 2024. All the envisaged reforms will be conducted in a manner consistent with our Article VIII commitments and The IMF's Institutional View on Liberalization and Management of Capital Flows. All these actions to deepen the FX market and allow for greater flexibility of the exchange rate would complement other measures being taken to reduce financial dollarization (MEFP ¶30), which in turn should reduce financial vulnerabilities and strengthen monetary policy transmission.

27. We stand ready to further strengthen the BCCR's independence, transparency, and accountability in the implementation of the flexible inflation targeting regime. The amendments to the BCCR Law in 2019—to tighten the dismissal rules for the BCCR Governor, delink the Governor's term from the political cycle, and remove the Minister of Finance's voting rights in the BCCR Board—have improved the personal autonomy provisions in the law. To further strengthen the BCCR law, and in line with the recommendations of the IMF's 2020 Safeguards Assessment, we submitted to the MOF draft amendments to the BCCR law, prepared in consultation with IMF staff, by end-August 2021, meeting the relevant structural benchmark. The final amendments, however, were not submitted to the Legislative Assembly by end-December 2022, missing the structural benchmark. Therefore, we have decided to adjust the implementation process of this reform. In June, we submitted to the Legislative Assembly a subset of the previously foreseen changes to the BCCR law. Also, we submitted to the MOF a proposal to award constitutional autonomy to the BCCR, which will be presented to the Legislative Assembly during the ordinary legislative sessions in August-October. We will then prepare a plan to assess the remaining parts of the original amendments in consultation with IMF staff during the next program review with a view to aligning the BCCR governance and operational structure with the recommendations of the Safeguards Assessment. The BCCR has completed nine of the twelve recommendations from the Safeguards Assessment. The Executive Branch will take the necessary steps in order to fill the current vacancy in the BCCR Board, after the needed Constitutional Court decision. In addition, we will develop a long-term roadmap to continue to strengthen the BCCR´s equity position.

V. FINANCIAL SECTOR POLICIES

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

29. The banking sector remains stable after the expiration of most of the extraordinary regulatory measures introduced in response to the COVID-19 crisis, and the increase in the monetary policy rate. Pre-pandemic settings have been restored. To help borrowers in financial difficulty during this period of high inflation and increased interest rates, we created a transitional loan classification category—to soften the effect on the risk rating when financial entities make modifications (extensions, restructurings, refinancings) in their credit operation— on January 1, 2023. This measure also incentivizes borrowers to report their true conditions, which helps financial entities to modify credit operations in response to the true situation of the borrower. We are keeping this measure transparent by recording all the historical changes in classification. We will introduce a new regulation and guidelines for provisioning effective from January 1, 2024, which uses an updated methodology, risk parameters, credit segmentation, and similar treatment to credit restructurings, extensions or refinancing. In parallel, we have strengthened reporting and monitoring efforts, as laid out in the attached TMU, and we will continue to monitor the situation closely, including through the Financial Stability Committee's (FSC) Monitoring and Coordination Group (MCG) comprising senior representatives of the BCCR, CONASSIF, the Superintendencies, and the MOF. The technical group supporting the MCG will continue to meet frequently to follow up on key systemic developments and financial risks and to detect and anticipate sources of stress, including increases in interest rates and FX movements. Over the years, we have also made significant progress in systemic risk assessment by strengthening our credit, market and liquidity risks' stress test models and contagion risk tools. We will continue updating our bottom-up and top-down stress test results and publishing them in our annual Financial Stability Report. In line with the BCCR's roadmap to integrate climate considerations into monetary and financial policies, we have been working to enhance our capabilities in climate risk management, including through an integrated climate and economic model, and developing stress testing methodologies (MEFP ¶45). Also, SUGEF is setting up a working group to consider key recommendations to enhance the resilience of the financial system in the 2022 World Bank Financial Sector Assessment report, and to develop a roadmap for implementation.

30. We have taken further actions to reduce the risks from financial dollarization, in line with international standards. Since 2018, the BCCR has allowed for greater exchange rate flexibility, helping agents internalize exchange rate risks (MEFP ¶25-26). To complement these efforts, the FSC is closely monitoring the risks from dollarization, and SUGEF and CONASSIF have taken further measures to recognize this risks in prudential parameters, including (i) establishing a higher general provision requirement for loans to non-FX generators; (ii) calculating liquidity coverage requirements by currency; (iii) requiring additional capital requirements for foreign currency mortgages to unhedged borrowers, based on LTV thresholds; and (iv) requiring banks to assess the sensitivity of debtors' payment capacity to exchange rate changes. SUGEF and CONASSIF have (i) revised the definition of an unhedged borrower, which took effect from January 1, 2023; and (ii) issued a new regulation imposing additional capital requirements on foreign currency loans to unhedged borrowers. In the new regulation, the definition of unhedged borrowers is based on information on whether borrowers currently have a natural hedge or financial hedge against exchange rate risk, and thereby reduces the room for discretion in the assessment of currency mismatches between their income and loan currency. These natural or financial hedges are only considered when they cover at least 100 percent of the loan instalment, regardless of the number of hedges. Also, the regulation establishes a gradual increase in the risk weight for credits to unhedged borrowers, starting on January 1, 2024, and ending on January 1, 2031. The risk weight will apply gradually to both the loan balance by end-December 2023 and to the marginal loans from the corresponding effective date. To increase transparency, SUGEF has also begun to regularly publish data on unhedged FX borrowing since March 2023.

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

- ***Implementing consolidated supervision***. In May 2022, CONASSIF approved a regulation to strengthen the governance of supervised financial entities, holding companies, and affiliated companies of financial groups and conglomerates, which took effect on January 1, 2023, with transition arrangements towards full implementation. In September 2022, CONASSIF introduced regulations to implement consolidated supervision of financial groups, including issuing guidelines to strengthen regulatory provisions and information sharing, and to update the solvency and capital requirements for financial groups, with different aspects taking effect in a phased manner starting January 1, 2023.

- ***Phasing in risk-based supervision***. We are taking further steps to advance our risk-based supervision framework, including by adopting Basel III standards in a phased manner: (i) SUGEF is enhancing its liquidity risk management through recent improvements in the monitoring of the liquidity coverage ratio, and the net stable funding ratio is expected to come into effect with transitional arrangements from January 1, 2024; (ii) SUGEF is also revamping its credit risk management framework by introducing forward-looking assessment of losses and provisioning requirements, with new regulation and guidelines for provisioning finalized in November 2021, to come into effect from January 1, 2024; (iii) we have revised banks' capital definition, established conservation and systemic importance capital buffers, and the definition of systemically important institutions, in line with Basel III, with the regulation issued in August 2021, to come into effect from January 1, 2025. These effective dates will allow for a sufficient adjustment period in the context of the combined effect of the new regulations on the financial system. During the adjustment period, the financial entities have been required to assess operational and financial impacts and send these results to SUGEF on a quarterly basis, starting in the last quarter of 2022. Based on available resources, we will continue to strengthen practices toward fully risk-based supervision, such as broadening the risk assessment of banks beyond specific business lines and bringing in more specialized expertise to assess and validate their risk management practices.

- ***Strengthening supervisors' legal powers and protection.*** Drawing on the Basel Core Principles assessment from a recent FSAP developmental module, we intend to pursue critical legislative reforms to strengthen supervisors' legal powers and protection. Specifically, we intend to grant to CONASSIF, SUGEF and the other Superintendencies the legal powers to (i) dismiss members of the Board and senior management of banks for engaging in unsafe and unsound practices, (ii) to impose additional capital requirements under Pillar II on individual banks; (iii) to ease the legal conditions for the exercise of supervisory powers (giving more discretion to the supervisor) and to establish a separate appeal procedure for (at least) the most serious supervisory measures and intervention or resolution decisions in which the annulment of the decision can only result in a monetary indemnification of damages, but never in the reversal of its legal effects. Moreover, we are working to recalibrate the sanctioning framework to provide the proper incentives. In addition, we intend to strengthen the legal protection for supervisors with respect to coverage of legal costs, and protection against good faith errors. We aim at finalizing by end-August 2023 a road map on the necessary steps to take these reforms forward.

- ***Responding to cyber risks***. In addition, with support from IMF TA, we are preparing draft regulations to address governance and risk management of cyber risk, including with respect to information sharing, incident reporting and testing frameworks, as well as how to address third-party risks and response to and recovery from cyber incidents. We have completed the draft, which was reviewed by the IMF TA mission in April, with the regulations expected to be approved in January 2024.

32. We will continue to strengthen our financial safety net by enhancing our banking resolution and deposit guarantee framework in line with best practices. We have advanced our crisis preparedness framework considerably, with the approval by the Legislative Assembly in February 2020 of the law on banking resolution and the creation of a deposit guarantee fund (DGF) (law no. 9816). Implementing regulations have been in effect since May 2021, and quarterly payments into the DGF started in October 2021. In May 2023, CONASSIF approved the regulation on recovery and resolution plans, which establishes a period of 12 months, at SUGEF's request, to present the recovery plan and the report to support the resolution plan. With support from IMF TA, we are further strengthening the legal framework on bank resolution and deposit insurance, including adequate institutional arrangements for the DGF and the resolution authority, sufficient resolution powers, and clear resolution triggers. This will include strengthening the legal regime for resolution and recovery plans. Accordingly, we are finalizing draft amendments to Law 9816 and other relevant laws, in coordination with CONASSIF and the BCCR. Following a consultation with the industry and other stakeholders, we plan to submit the proposed amendments to the national supervisory council for approval by end-September 2023. We will submit the final legal amendments, once approved by the MOF and the President of the Republic, in line with program understandings, to the Legislative Assembly by end-December 2023 **(structural benchmark)**. The financial safety net and the crisis preparedness framework have also been strengthened by the continuous monitoring of macro-financial risks by the MCG (MEFP ¶29), including through an updated early warnings system; an updated contingency plan for episodes of financial stress, with the inclusion of a communications protocol; and the BCCR´s recent enhancement of its Lender of Last Resort mechanism. As an additional measure in situations of stress, the BCCR recently increased the tenure of the emergency liquidity facility from 24 hours to 84 days.

33. The Executive Branch is committed to levelling the playing field between public and private banks to foster competition. Several distortions and regulatory asymmetries hamper both private- and state-owned banks, and hence their ability to support growth and job creation in Costa Rica. To remove these asymmetries, we plan to submit a proposal to the Legislative Assembly to (i) convert parafiscal contributions by state-owned banks into a single commensurate transfer to the CG budget, adjusting the fiscal rule spending accordingly; (ii) remove the requirement on state-owned financial institutions to comply with public procurement requirements; (iii) gradually phase out the requirement for private banks, which have not opened agencies or branches in certain areas listed in the law, to transfer a part of their short-term deposits as a loan to state-owned banks (the *peaje*). In parallel, we will identify alternative ways to channel resources to underserved sectors, limiting any fiscal contingent liabilities. We will develop a first legislative draft by end-October 2023. The asymmetry generated by the existing legal requirement for NFPS to do their banking with state-owned banks will be also corrected with the approval of the legislation on the Single Treasury Account (MEFP ¶15). As the deposit guarantee covering the entire banking sector becomes fully effective, we will explore options to gradually phase out the existing blanket guarantee for state-owned banks. 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.

34. We are pressing ahead with our efforts to promote financial inclusion. During the pandemic, a sharp increase in the use of electronic transactions and the allocation of *Bono Proteger* have led to a significant increase in bancarization and financial inclusion. However, structural issues, such as limited banking competition and partial coverage of the credit registry, push up lending rates and hinder financial inclusion. In line with the IMF's FSSR recommendations, the Ministry of Economy, Industry and Commerce (MEIC) has developed and started implementing a national strategy for financial education, in coordination with the BCCR, CONASSIF, and the Superintendencies. To broaden access to our payment system and promote digital banking, we have simplified requirements for opening a bank account and launched an electronic payment system for public transport nationwide. We are committed to improving the design and scope of the public credit registry, *Centro de Información Crediticia* (CIC). We will develop a plan, covering the technical design of the system, a legal feasibility study for its implementation and the corresponding draft bill by July 2023, to build a modern credit registry, with information from supervised financial entities and non-supervised credit providers. CONASSIF and the four Superintendencies finalized draft legislation for financial consumer protection, which is currently being reviewed by the MEIC, before submission to the Legislative Assembly. Moreover, with support from the IDB, CONASSIF, BCCR and the Superintendencies inaugurated in April 2022 a Financial Innovation Center to support and provide guidance to fintech startups. The Center will act as an advisor to our ongoing efforts to strengthen and develop new regulations on fintech. We will ensure that our regulations strike a good balance between fostering innovation and protecting financial stability.

35. We remain fully committed to combating money laundering and countering terrorism.

- ***Complying with FATF standards***. Costa Rica continues to strengthen its technical compliance with the FATF standards on AML/CFT to help the fight against money laundering and terrorist financing. Our application to the Financial Action Task Force of Latin America (GAFILAT) for the re-rating of four FATF recommendations (8, 17, 22, and 28), was discussed at the GAFILAT Plenary Meeting in December 2022. All ratings were maintained or postponed until the next Plenary in July 2023. In addition, six other recommendations were re-evaluated due to changes in the FATF standard, of which five were maintained. Recommendation 15 on new technologies was downgraded from Compliant to Non-Compliant due to changes to the FATF standard. We provided a progress update on effectiveness and technical compliance at the Plenary and published the 7th Enhanced Follow-Up Report in January 2023. To strengthen compliance with recommendation 15, a new draft amendment law subjecting virtual assets (VAs) and virtual asset service providers (VASPs) to AML/CFT supervision by SUGEF had been presented to the Legislative Assembly for consultation in October 2022 and is currently under review.

- ***Strengthening the AML/CFT framework and disclosure of beneficial ownership***. 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 beneficial ownership, including in revised SUGEF Regulation 12-21 of September 2020. CONASSIF has also updated regulations (in force as of January 1, 2022) to strengthen the due diligence measures that financial entities are required to apply to politically exposed persons, the financing of political parties, and the receipt of cash especially in foreign currency. In January 2021 CONASSIF approved SUGEF regulation 35-21 that established the *Centro de Información Conozca a su Cliente* (CICAC) as a centralized repository of customer information that will promote transparency, efficiency, and cost reduction concerning Know-Your-Customer (KYC) monitoring and supervision. This regulation became effective in January 2022. All regulated entities in the financial system are required to ask for the customer's authorization to record their information in CICAC as of July 2022. Approval of proposed amendment regulations to require the upload of all customers' information to CICAC is expected to come into force in June 2023. With respect to designated non-financial businesses and professions (DNFBPs), more than 5,000 legal entities and individuals are registered in SUGEF, and as of December 2022 they are required to upload information to CICAC in order to register. We have also developed technology to enable financial institutions' legal entity clients to share the beneficial ownership information provided to the centralized Transparency and Beneficial Ownership Register with the CICAC repository. Furthermore, the regulation also allows SUGEF to "suspend" the registration of legal entities and individuals that do not comply with regulatory requirements, which prevents regulated financial intermediaries to provide services to them. As of March 2023, 620 registered legal persons and natural persons have been suspended. Moreover, in accordance with Law 9416 and Decree No. 41040-H, to strengthen information and transparency on beneficial ownership, the BCCR also created in 2019 a centralized registry (Transparency and Beneficial Ownership Registry) and started collecting shareholder and beneficial ownership information for all legal entities except trusts, third-party resource managers and non-profit organizations. The registry is accessible to the MOF and the Costa Rican Institute on Drugs. As of October 2021, trusts have been included, and concerning non-profit organizations, the application form will be ready in August 2023 and its registry will be at the request of the MOF and the Costa Rican Institute on Drugs. CONASSIF and the Financial Intelligence Unit will continue to dedicate resources to AML/CFT supervision and collaboration between competent authorities and carry out inspections with the required frequency.

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

36. We are resolved to further advance our growth-enhancing reform agenda, supporting a resilient recovery from the COVID-19 crisis to help achieve our medium- and long-term vision. In May 2021, Costa Rica officially became an OECD member, following a successful accession process, which saw the introduction of 14 landmark legal and administrative reforms. As underscored in our new National Development and Investment Plan, we remain fully committed to further advancing our reform agenda. Specifically, our strategy hinges on three key objectives: (i) protecting the most vulnerable 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.

A. Protecting the Most Vulnerable and Boosting Productivity Growth

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

- ***Formalization.*** To incentivize formalization, since 2017, the CCSS has adopted plans to reduce social security contributions, targeting populations where informality is prevalent. To ensure the burden of social security payments is lower for vulnerable workers, in 2020 the CCSS created a specific mechanism to provide coverage for coffee harvest workers, including migrants and their families. This model changed the tripartite contribution mechanism involving worker, employer and state to a two-party modality where contributions are covered by the state and ICAFE, Costa Rica´s coffee institute, eliminating employees' contributions and thus the burden for workers. To encourage formal part-time or flexible employment, the CCSS Board of Directors formulated in June 2022 a plan to adjust the minimum contribution base for part-time workers and submitted it for public consultation. While the related structural benchmark was not met by end-June as originally envisaged, the CCSS approved the final plan in September 2022. The reduced minimum contribution base (MCB) is being implemented in three phases to minimize the shortfall of contributions, starting in January 2023 as planned for workers below the age of 35; January 2024 for workers below the age of 50; and January 2025 for all workers. Furthermore, since May 2022, to ease independent workers' entry to the SS system, the CCSS allows them to contribute voluntarily to the health and pension scheme for 6 months provided their income is below the MCB, but after the 6-month period, the health and pension contributions to the CCSS become automatically mandatory. To reduce the administrative burden for firms, over the last four years we reduced the number of minimum wages across job categories for the private sector from 26 to 16 and further reduced it to 11 by end-May 2023, in line with OECD recommendations.

- ***Education.*** To improve the quality of the education system, we launched a Roadmap for Education (*Ruta de la Educación 2022-2026)* in February 2023. A report that summarizes the progress in implementing the Roadmap for Education will be available in May 2024. To improve the transparency and efficiency of the public education system, the Ministry of Public Education will develop an internal reorganization and decentralization plan, following Mideplan guidelines, by end-December 2024. We will also develop guidelines for teachers to strengthen students' competences in school curricula by end-December 2023 for: i) citizenship; ii) life; and iii) employability and entrepreneurship. As of February 2023, it is mandatory that all children in first grade know how to read and write to enter the next school year. Support for teachers to accelerate the learning process will be provided, for instance, in the case of English as a second language, through *ABC Mouse* and *My Math Academy* accelerators, which will be available for teachers as of August 2023. Through these programs, we will offer free training opportunities for teachers to further improve digital, methodological, and English competencies. We are developing a preliminary proposal for a new teachers' performance-based evaluation model, which will include: i) defining a desired profile for teachers with reference to the National

Qualification Framework by end-December 2023; ii) supporting teachers to identify their real profile by end-July 2024; iii) providing courses and online/offline support materials for teachers to close skill gaps during 2024 and; iv) evaluating teachers based on desired profiles in 2025. Using the newly-defined competencies, the Ministry of Education administered a standardized digital test to measure students' performance at the beginning and the end of the year (*Prueba Nacional Estandarizada*) starting in April 2023. Students will be tested again in November 2023 to review the progress made during the current scholar year. To reallocate teachers' time away from administrative responsibilities to focus on teaching and support to students that lag behind, we introduced the new Agile Evaluation System (SEA) to replace the time-consuming registration systems in place. The SEA will be assessed by end-January 2024. To close the digital gap by the end of 2024, we plan to provide internet and increase connectivity speed in about 2,500 centers. We are also investing in school infrastructure (leveraging Public-Private Partnerships (PPPs)) and building three educational centers in indigenous territories under the program "*Adopte un Centro Educativo*". By end-2024, we will launch a plan to build and provide maintenance to 528 schools with sanitary orders. To help youth in low-income families, we are increasing food support at school with the universalization of the provision of meals in preschool and primary. Food provision will be offered to nearly 28,000 new students in schools located in low-income areas. In addition, 24,000 poor students living far from education centers will start receiving school transportation during the 2023 school year. In February 2021, a Bilingualism Education Policy was introduced, with an Action Plan to improve proficiency in a second language by 2040, including students in rural areas. We are strengthening the implementation of the vocational curricula of four technical careers in the context of Industry 4.0, to be implemented by end-December 2024, with support from the IDB. We are already offering 24 new study programs, and we aim to implement 8 more programs by end-2023. We will also work on linking public universities' funding to labor market needs.

- ***Investment climate.*** To attract investment, we are identifying spending priorities and promoting PPPs, with support from CABEI and IDB, to reduce existing physical and digital infrastructure gaps, consistent with our fiscal consolidation plans under the program. With IDB support, we launched the Program of Road Infrastructure and Promotion of PPPs and will provide critical training on PPP development across central and local governments during 2022-2024. In February 2023, we issued a methodological guide to evaluate the appropriateness of PPPs. We also identified a portfolio of infrastructure projects that could be developed through PPPs, including a new airport and highways. In parallel, we will work with the non-government sectors to address the challenges, build confidence in the PPP model, and develop the required structural reforms. Another critical step in promoting investment is our ongoing effort to reduce electricity tariffs (MEFP ¶19). To further promote high quality, innovative and affordable telecommunication services in all our territory and develop digital skills, we launched in December 2022 a new National Telecommunications Plan 2022-2027. This plan aims to generate the necessary conditions to encourage the timely deployment of robust, scalable, resilient, and sustainable telecommunications network infrastructure (regulated by Law N° 10216 and derived regulations, which are expected to be issued by end-December 2023). The target is to increase competition among mobile technology operators, including 5G networks, for which we will conduct a tender process in 2023. In collaboration with the private sector, we have launched the program *Le Dejamos Trabajar*, which eliminated 132 obstacles for businesses by end-March 2023. As part of our smart deregulation strategy, we implemented *Costa Rica Fluye* commitments with 11 public institutions to enact 21 regulatory enhancements. We also implemented a single-window system (VUI), where businesses can apply for licenses and permits. To further cut red tape, the VUI is being implemented in 42 local governments, while efforts are ongoing to simplify 125 procedures across the public sector to start a business, integrate environmental permits, and centralize procedures at the national level to provide a single point of contact, in line with OECD recommendations, by end-September 2023. In September 2022, we issued 11 decrees to eliminate minimum fees to increase competition in 10 professional associations. Since some of the decrees were not operational, given legal issues, we also submitted a bill (No. 23.357) to eliminate mandatory fees for all 10 professional associations to the Legislative Assembly in September 2022. In addition, we are expediting the implementation of a new bankruptcy law (Ley 9957), with the approval of the necessary regulation by end-December 2023. The law simplifies the bankruptcy process to reduce the duration and cost of liquidation proceedings and promote the restructuring of affected firms. To foster FDI attraction, already one of Costa Rica´s strengths, we will promote innovation clusters to remove information barriers and facilitate the integration of domestic firms in global value chains. In March 2023, we amended the Development Banking System Regulations to ease financing for entrepreneurs in rural areas, women, youth, vulnerable populations and SMEs, and halved the time it takes to formalize guarantees. We also approved a regulation to promote investment in the renewable energy sector (MEFP ¶42).

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

- ***Workplace discrimination and sexual harassment.*** We continue to work on the program that certifies gender equality in the workplace at private companies and the public sector. In addition, we appointed inspectors from the Ministry of Labor and Social Security in each region to monitor and sanction gender discrimination, including pay gaps, in private companies. During the first two months of the year, the gender focus inspections were done in agriculture, commerce, industry, services and transportation sectors. Infractions on gender discrimination, wage differentials and lack of breastfeeding rooms have been issued, and labor judges are taking courses on this matter. Moreover, in November 2022 we launched a strategy to combat sexual harassment (Decree 43771-MSP-MTSS-MCM), providing emotional and legal support to victims, increasing resources for first-response centers, developing early warning devices to prevent harassment in public transportation, and increasing awareness through a broad communication campaign.

- ***Childcare.***The 2018 fiscal reform expanded the definition of public education to include early education centers, with a view to helping reallocate funds to increase the supply of public childcare services. In 2021, childcare services were increased by 15,000 additional children (relative to 2017), with a focus on children up to 5 years old, improving access for low-income households. We aim to reach about 64,700 children below 12 by end-2023 (a four percent increase relative to pre-pandemic levels). To improve the quality of services and expand coverage, we have completed a review of the supply of existing childcare services standardizing the costing framework and the basic certification for the supply of services. We are reviewing the governance of the childcare network *Red de Cuido* to propose changes to increase coverage and improve services in the future. Stronger childcare facilities can in turn support educational outcomes and female labor force participation. The Public Employment Bill (MEFP ¶13) has also introduced for public sector workers one month of paternity leave, a two-month extension of maternity leave (in specific cases), and paid leave to take care of a family member.

- ***Long-term care.*** In March 2022, the SINCA (*Sistema Nacional de Cuidados y Apoyos para personas adultas y personas adultas mayores en situación de dependencia*) was created (Law No. 10192) to improve the quality and access to long-term care. We will issue the SINCA's regulation by end-July 2023 to implement the governance of the long-term care system, as established in the law. A plan will be progressively implemented along five pillars: governance, data intelligence, strengthening of care supply and benefits, generation of conditions for closing gender gaps in labor markets, and quality assurance. With support from the IDB, in an effort to unify access to long-term care by August 2023, we plan to issue a decree to make mandatory the allocation of benefits through the tool *baremo,* which defines a single dependency scale. We are aiming for 4,000 vulnerable caregivers (according to the baremo) to receive long-term care support by end-December 2026 (1,000 per year). Furthermore, effective May 2023, we are implementing a cash transfer ("cash for care") to 3,000 households with a female head living in impoverished conditions and headed by a severely dependent person. The Ministry of Health will design accreditation standards to strengthen the quality of long-term care home services. In addition, the *baremo* will be integrated into SINIRUBE to identify the dependent population, as well as the supply of services of the national care system for dependent adults and senior adults. INA is working on updating the training available and providing training in long-term caregivers' services, with IDB support. To further increase the supply of care services, INA is developing, with IDB support, a pilot to connect care service providers with those in demand of such services through a mobile application. Moreover, we are working with the IDB on developing a pilot of home care services to support caregivers (*Cuidadores a domicilio*), as well as on a methodology to quantify the cost of a minimum set of care services (*Canasta de dependencia*).

- ***Education and entrepreneurship.*** The ongoing efforts to strengthen our education system and vocational training as well as to deepen financial inclusion (MEFP ¶34) will be critical to support women's economic empowerment. We have developed a plan to boost at regional level the program FOMUJERES, which finances women-owned businesses and provides support to formalize them. We plan to start its implementation in July 2023. This plan will make the entrepreneurship process more user-friendly for women, provide technical assistance during the formulation phase of business projects, granting financing in the planning and development phases. Additionally, state institutions including public banks and private entities jointly completed pilot programs to strengthen financial inclusion and women's empowerment, a project financed by CAF, by focusing on the design of financial products based on women's specific needs. INAMU will launch a roadmap to guide women from entrepreneurship up to the export stage of their products by end-October 2023. To this end, MEIC and INAMU will amend the regulations of Law 8262 to facilitate women's access to comprehensive financial services. The objective is to provide institutional support and develop a special financing program for vulnerable women to strengthen their economic independence through INAMU, Banco Popular and FODEMIPYME. In collaboration with the IDB, in 2022 we completed the incorporation of all regions in the country into the STEAM education strategy to continue fostering the participation of women in these fields. 56 new public institutions were added in 2022 to the 166 public educational institutions already implementing the STEAM education strategy, and we plan to incorporate 27 new public institutions in 2023 to reach a total of 249 public institutions implementing the STEAM strategy. We will also continue to implement our national action plan for gender equality in scientific and technological fields, which will strengthen female labor force participation and productivity growth. As part of this policy, a new scholarship program is being developed to promote STEAM careers by reformulating incentives to attract women to technical education through the INA's program *Rompiendo moldes*. As part of the dual education program, INA will create new alliances with 32 companies impacting regional employability and new options for the young workforce as of 2023. Moreover, since 2022 the INA has been revamping 46 percent of outdated technical programs to modernize 3,734 educational services, including STEAM.

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

39. We are strongly committed to responding to the challenges of climate change and fostering the transition to a resilient and low-carbon economy. Our ambitious strategy centers on: (i) adapting to climate change, with a strong emphasis on crisis preparedness, climate-resilient infrastructure, as well as our agriculture and agroindustry; (ii) reaching net-zero emissions by 2050 while ensuring a just transition in terms of jobs and growth; (iii) greening the financial sector, monitoring the risks posed by climate change and updating our modeling and regulatory tools; (iv) mobilizing official and private financing to meet the significant short to long term costs to confront the long-term challenges from climate change within our budget envelope. In this context, we are fully committed to implementing the reform measures supported by the Resilience and

Sustainability Facility, which are important elements of our broader comprehensive climate strategy and complementary to reforms supported by other development partners. This instrument is critical to our efforts, together with the additional climate finance resources it is expected to catalyze.

40. To support our strategy, we are enhancing our institutional readiness to respond to the climate change challenge. The Ministry for Energy and the Environment (MINAE) has overall responsibility for climate change issues. To mainstream and consolidate governance of the ecosystems, we submitted a bill (23.213) in June 2022 to integrate relevant decentralized bodies into MINAE. The legislative committee approved it in February 2023 and we expect the bill to be approved in July 2023. MINAE produced our National Adaptation Plan with the support of MIDEPLAN and our National Decarbonization Plan with the support of other ministries. The National Commission of Risk Prevention and Emergencies (CNE) coordinates actions and articulates the overall disaster management framework. MINAE's National Directorate of Climate Change oversees our Carbon Neutrality Country Program (PPCN 2.0), which supports the country's mitigation efforts by providing a mechanism for the voluntary adequate management of greenhouse gas emissions for public and private organizations. Moreover, we will establish a data-driven, highly inclusive process to update NDCs and long-term climate action plans including the new National Development Plan for the environmental sector, which was launched in October 2022. MINAE, through the Secretariat of Planning's Environmental Sector (*Secretaria de Planificacion del Sector Ambiente* (SEPLASA)) is coordinating with MIDEPLAN and ministries and entities that are part of the environmental sector to ensure the sustainability of the modeling and analysis capabilities that have been developed over the last six years. The BCCR is part of the Network of Central Banks and Supervisors for Greening the Financial System (NGFS) and established the Group for Strategic Analysis of Climate Change (GAECC), which is instrumental in coordinating national efforts to green the monetary and financial sector (MEFP¶48).

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

- ***Disaster Risk Management***. With support from the WB, we are strengthening our National System for Disaster Risk Management—which has been in force since 2006—in line with the Institutional Strategic Plan 2018-2022 of the National Commission for Risk Prevention and Emergency Care. We will decentralize and increase access to early warning, preparedness, and response services, including in coastal areas. We will have business continuity policies in all providers of public services by August 2023. We have already developed climate risk maps for extreme hydrometeorological events for 23 country cantons and expect to cover all remaining cantons by end-June 2024. We also plan to address the significant gaps in integrating climate-related risks into spatial planning and regulations. Currently only about 50 percent of Costa Rica's land area is regulated by land-use/spatial plans, and the Regulatory Plans (urban and coastal) and Regional Development Plans do not take into account climate change considerations. Considering the importance of spatial planning for resilient infrastructure, the

Ministry of Housing and Human Settlements (MIVAH) in collaboration with MINAE will develop and publish guidelines for including climate change considerations in Regulatory Plans by end-February 2024 (**RSF reform measure**). We will start to implement the new guidelines into all the new urban and coastal regulatory plans and gradually adjust the existing ones. In complementary work, the National Commission for Risk Prevention and Emergency Care is providing information to the municipalities on climate-related risks. To support the most vulnerable productive sectors, we also introduced a new insurance scheme in 2019, which allows agricultural producers to insure their harvest against climate change risks and offers lower premia for producers implementing adaptation measures.

- ***Climate-resilient infrastructure and public investment management.*** We developed a roadmap to enhance infrastructure resilience to climate change in September 2022 (structural benchmark) with a view to guiding the technical planning and implementation, including through an assessment of the medium-term investment needs and associated costs, beyond what is already in the pipeline, as well as available private and public sector financing options to support them. In line with the road map, we have identified several priority actions to reduce infrastructure loss due to climate change and the associated interruption of public goods provision, fiscal costs of rebuilding and retrofitting existing infrastructure, and damage to transport and water sectors. To meet the fiscal costs amid tight fiscal space, we are exploring new opportunities for green finance from official and private sources (MEFP ¶46), while at the same time seeking ways to improve the efficiency of public investment. In this context, we are committed to strengthening our institutional capacity to plan and manage efficiently green and resilient investment projects, building on the recommendations of the PIMA (MEFP ¶15) and its climate change module, with support from IMF TA. In 2020, we issued a Decree (N°42465-MOPT-MINAE-MIVAH) on incorporation of resilience measures in infrastructure. With WB support, we have continued building climate change considerations into public investment management, by updating the methodological guidelines for preparing and appraising public investment projects to incorporate principles to handle exposure and resilience of public works to natural disasters. As the next step in project appraisal and as part of our planned enhancements to the operation of the SNIP (MEFP ¶15), we will develop and publish guidelines to expand the project appraisal process to assess the impact of the project on climate change through the social cost of carbon by end-September 2023 (**RSF reform measure**). We are also advancing our work to strengthen project selection criteria. With the support of the IDB and a private company we are developing a methodology to score and prioritize capital projects according to a set of criteria and weights. Building on the piloting of this new methodology, we will publish guidelines setting clear and transparent project selection criteria including a range of climate change criteria for SNIP entities by end-December 2023 **(RSF reform measure)**. Given the increased prevalence of climate-related disasters, we are also resolved to have a more efficient and proactive approach to capital maintenance to strengthen infrastructure resilience. With support from the German Development Agency (GIZ), we produced a Methodology for the Evaluation of Climatic Risks in the Public Infrastructure of Costa Rica (MERCI), which could be applied to other countries. In this context, guidelines were issued to assess needs and allocate adequate amounts of resources to routine and capital repairs. For example, with the support of

CABEI and the WB, we are starting to strengthen infrastructure under imminent threat from natural disasters and identifying what other infrastructure could be at risk.

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

- ***Electrification of transport.*** To support the electrification of private vehicles, the Legislative Assembly approved a bill to extend tax incentives for electric vehicles to 2034. Moreover, we are developing a feebate scheme to promote the transition to low-emission vehicles (MEFP ¶8). The scheme comprises a sliding scale of fees to vehicles with above-average emission rates and a sliding scale of rebates to light-duty private passenger vehicles with below-average emission rates levied at the time of purchase or import of new or used vehicles that are up to 5 years old. The design will aim to be revenue-neutral, with safeguards to reduce risks of revenue loss. With support from IMF TA, we will complete the technical design of the feebate scheme. We will submit to the Legislative Assembly the bill on the introduction of the feebate scheme to strengthen incentives for low-pollution private vehicles by end-September 2023 (**RSF reform measure**). As part of our systematic cost-benefit analysis of tax exemptions (MEFP ¶11), we will also appraise and publish a review of existing tax incentives with a negative effect on the environment to support decarbonization efforts by end-February 2024 (**RSF reform measure**), with a view to streamlining them over time. In parallel, we will continue encouraging fleet electrification processes in the transport sector—the largest contributor to greenhouse gas emissions. For public transport, we developed new promotional electric tariffs, building on the experience of existing pilots, for the use and supply of electricity associated with charging centers for electric buses and incorporate the tariff into the current tariff schedules of electricity distribution companies. With support from the IDB, we installed 55 fast charging centers nationwide by end-December 2022. The scheme will require that new busses follow the guidelines of the National Decarbonization Plan, Nationally Determined Contributions, and the National Electric Transportation Plan, and is expected to take effect in September, 2023, thus steadily increasing the share of zero-emissions vehicles in the fleet. We are determined to revamp public transportation. To this end, we are analyzing self-sustainable financing options to electrify public transport buses, and will launch a plan by end-March 2024. In addition, by end-May 2024, we will launch the public transport sectorization plan, which includes a cost-efficient route redesign, electronic payment, and the integration of the urban train into the public transport routes. All these measures will also encourage the use of public transport instead of private transport.

- ***Renewable energy.*** Our efforts to increase competition in the energy sector and reduce electricity prices from renewable sources will support decarbonization. We published the implementing regulation of Law No. 10086, as approved by the Legislative Assembly in October 2021, to simplify the administrative procedures for private participation in power generation from renewable sources for self-consumption in February 2023 (**RSF reform measure**). This regulation is in line with best practice as it boosts competitiveness and investment for market participants by: i) defining responsibilities for owners to promote the safe and reliable interconnection of the electricity grid; ii) securing the economic sustainability of generation projects by authorizing the sale of energy surpluses and encouraging the use of price signals or different tariffs depending on the time; and, iii) declaring certain activities, such as energy storage and electric vehicle charging, as "services of general interest", which allows public services to be provided by private players. To complement this action, we completed efforts (i) by the Costa Rican Institute of Electricity to enact tariff reductions by reducing operational costs, restructuring debt, and implementing IFRS; (ii) by the *Autoridad Reguladora de Servicios Públicos* (ARESEP) to reduce electricity prices charged by other generators beyond ICE with IDB support, applying new tariff methodologies; and (iii) to introduce measures to remove barriers to foreign participation in the energy sector through legislation currently under consideration by the legislative assembly (MEFP ¶19). We are also developing the legal framework to allow the private sector to use geothermal energy in industrial processes, agriculture, and tourism. Currently only ICE is allowed to use low-enthalpy geothermal energy, and we will submit to the Legislative Assembly a bill to facilitate expanded use of this renewable energy in December 2023.

- ***Agriculture and forestry.*** The agriculture and forestry sectors play a major role in carbon sequestration and are therefore key to reaching our zero net emission target. With assistance from the GIZ, we will further support farmers in adopting resilient and low-carbon technologies and practices by providing technical assistance, promoting agricultural research on low-carbon and resilient solutions, and further developing financing instruments. We are also scaling up adaptation and mitigation actions such as nationally appropriate mitigation actions (NAMAs) for coffee, livestock, rice, sugarcane, and bananas, with support from the IDB, AFD, and GIZ-EU and the participation of CONARROZ, CORBANA, FEDECANA and other private-sector actors. The scaling up entails a stocktake of capacity in each sector to design the adaptation and mitigation actions, sectoral mitigation scenarios and targets, operationalization through financing and innovation, and monitoring. We are advanced on the pilot in the rice sector and have started the sugar pilot. We completed an assessment of the costs of such a scaling up and identified suitable financing, starting with priority sectors, by end-March 2023. We will refine our payment for ecosystems schemes to cover the entire landscape including agriculture, livestock, and forestry, with support from the WB and the Global Environmental Facility, as envisaged in our PSA 2.0 directive to be published in July 2023. To support this, the 2022 National Development and Investment Plan envisages additional training and land coverage. We also established initiatives to promote job creation through such schemes, including in the wood industry.

- ***Marine ecosystems.*** We are also committed to supporting the "blue" economy through sustainable and innovative approaches to the use of coastal areas while ensuring their conservation. We exceeded our goal to protect 30 percent of our marine territory under conservation schemes by end-December 2022 early. To this end, in December 2021, we signed the decree 43368-MINAE to expand the protection of Coco Island National Park and Montes Submarinos Marine Area to consolidate the protection of important marine ecosystems as well as endangered species and high commercial value ones and promote sustainable tourism and other economic activities while preserving the health and resilience of the ocean. This is part of a broader regional conservation and management strategy in the Eastern Tropical Pacific, which aims to establish a transboundary biosphere reserve to consolidate swim-ways or underwater biological corridors that will connect Cocos Island (Costa Rica), Galapagos (Ecuador), Malpelo (Colombia) and Coiba (Panama), with the relevant technical papers ready and interim governance structures established for jointly managing financial support received by the four countries. We aim to file the application in March 2024. We are also piloting programs to strengthen wetlands and mangroves while improving the lives of the local populations, with donor support, in order to leverage these ecosystems' ability to reduce net emissions. We are also seeking opportunities to extend the payment for environmental services model to the marine sectors, starting with the fisheries, with WB support.

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

43. We are further developing our strategy for transition mitigation. In March 2021, we released the Territorial Economic Strategy for an Inclusive and Decarbonized Economy 2020-2050, with support from the IDB. The Strategy aims to gradually transition to an inclusive and decarbonized economy by 2050, with 12 development poles, six corridors—that will facilitate the interaction between these poles—and 12,750 km^2 of territorial management areas. The strategy involves policy measures on economic growth, social inclusion, human capital, gender, infrastructure and connectivity, and natural capital. Among the fifty priority actions, key just transition actions include expanding coverage of early English education and implementing training programs on the green and blue economy. Our modeling work, with support from the IDB and UN, has estimated that our National Decarbonization Plan has economic benefits of US$41 billion in net present value terms and a net positive effect on jobs by 2050. With ILO support, we conducted a pilot study of new green jobs (including tasks that directly green the economy and reduce pollution and jobs that indirectly support those tasks) and blue jobs (in activities related to the oceans, seas, and coasts) focused on the North East coast. The study found that, although women's jobs tend to be more green and more blue than men's jobs, women are expected to account for a minority of new green and blue jobs created, and that there will be a growing gap between the demand for jobs and graduates. We are working on policies to promote enrollment in relevant programs, especially by women. Our 2022 National Development and Investment Plan includes a pilot program to help women transition to a green urban economy. In May 2023, we issued a decree and accompanying strategy to promote gender equality in climate action to comply with our Paris Agreement commitments, with UN support. With AFD support, we are conducting additional analytical work to study the technical profiles for new green and blue jobs by end-September 2023. We expect to incorporate the analysis and policy plans in our just transition strategy in 2024. We are also promoting electricity and biomethane (produced from agricultural waste) as substitutes for bunker oil, LPG, and diesel fuel. To help different industries decarbonize, we will publish a long-term green hydrogen strategy in September 2023.

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

45. The BCCR and the supervisory authorities are pressing ahead with efforts to address climate change effects on the financial sector. In 2019, the BCCR joined the Network of Central Banks and Supervisors for Greening the Financial System (NGFS). The BCCR also established within the central bank the Group for Strategic Analysis of Climate Change (GAECC), comprising representatives of different departments, to address the impacts and risks related to climate change on the central bank's main objectives. With support from GAECC, the BCCR developed a roadmap to integrate climate change considerations into the design of monetary, financial, and macro-prudential policies. The roadmap is centered around four blocks: (i) establishing reliable and comparable data with identification of systematic data gaps; (ii) strengthening modeling and analytical capacity for scenario analysis; (iii) promoting climate change risk management in the financial system; (iv) and greening international reserves. Over the past few years, the CONASSIF and the Superintendencies have also worked to raise awareness and train the industry on the risks and opportunities associated with climate change, efforts that create strong synergies with the BCCR road map. They have aligned their agendas with the National Strategic Plan 2050. The GAECC now regularly coordinates efforts on climate change issues with the CONASSIF and the Superintendencies. The BCCR has taken the decision to dedicate permanent staff resources to the GAECC, which will ensure continuity and allow further strengthening and broadening of its coordination function.

- ***Data and modeling to assess financial sector climate risks.*** The BCCR is continuing to take stock of the required data to adequately analyze the impact of climate change and to identify suitable indicators that can serve as a reference to measure and monitor climate-related risks. An important part of monitoring such risks is to document the main climate risks faced by Costa Rica at a more granular level, combining information from various sources, and identifying systemic data gaps. Supervisory agencies will coordinate efforts to obtain firm-level disclosures of climate-related risks to inform the design of regulatory and supervisory approaches to manage these risks, within their respective mandates. Complementary to these efforts, the BCCR has compiled and made public two new environmental accounts—Material Flow Accounts for 2014-2019 and Environmental Protection Expenditure Accounts—for the private sector for 2018-2020. However, an integrated database, with more granular information, is needed to systematically capture risks at the national level. To this end, the BCCR is creating a data repository, including indicators of (i) main climate hazards, notably hydro-meteorological ones; (ii) degree of vulnerability to climate-related events at sectoral and geographical levels; (iii) exposure of banks´ credit portfolios to vulnerable industries and regions. We completed the **RSF reform measure** of creating a data repository, as a first step, covering 35 percent of the credit portfolio. With support from the IDB, the BCCR has developed an integrated economic and environmental model to conduct impact analysis of climate and environmental policies. The BCCR aims to advance in the analysis of different climate scenarios combined with various mitigation and adaptation policies by end-December 2024.

- ***Climate change risk management***. The BCCR is assessing the interlinkages between climate-related and macro-financial variables as well as the risks to the financial system from climate change. The BCCR is guided by the recommendations of the Network of Central Banks and Supervisors for Greening the Financial System in its "top-down" stress-testing methodologies. We will continue to expand coverage of the data repository, to support our ability to map the main transmission channels of climate-related shocks to financial institutions and improve stress testing methodologies for macro-financial risk surveillance. Based on this data, the BCCR will incorporate climate effects on the banking sector, focused on physical risks, in its "top-down" stress test, based on aggregated data and capturing those new risks on credit risk parameters by end-February 2024 (**RSF reform measure**). We will aim at including preliminary information on the new stress test methodology in the Financial Stability Report in May 2024. The BCCR will further develop its methodologies and climate risk macro-financial scenario building to address the specific risks faced by Costa Rica, with a view to publish climate stress test results in future Financial Stability Reports and ultimately support the design of macro- and micro-prudential policies that effectively mitigate the impact of climate-related shocks. SUGEF has also started early work, supported by GIZ, to develop methodological guidelines and, as a pilot project, identify risk exposure in one bank.

- ***Greening international reserves.*** The BCCR aims at leading the search of investments for its international reserves that is environmentally friendly and increases exposures to issuers with the best environmental performance. To this end, the BCCR published a final selection of indicators of the "greenness" of its reserve holdings together with its 2022 Annual Report published in April 2023 (**RSF reform measure**). The indicators are used to increase the investment limits for the issuers that perform well from an environmental perspective, using a "best in class strategy", and without compromising the primary objectives of capital preservation, liquidity and return.

- ***Regulation of socioenvironmental risks.*** To lay the foundations for ensuring that the regulated financial sector entities adequately take into account climate change risks and consistent with interim guidance from the Financial Stability Board's Task Force on Climate-related Financial Disclosures, CONASSIF will approve a regulation on management of socioenvironmental risks and climate change risks in the credit portfolio by end-September 2023 (**RSF reform measure**). This regulation, of which a draft will be sent for consultation in June, aims to strengthen risk management by requiring banks to put in place policies and processes to manage such risks and incorporate them into decision-making processes, including specifying roles for the Board and senior management, the main risk areas to be covered for credit risk management purposes (including physical and transition risks), classification of credit operations according to socioenvironmental and climate change risks assestment, and disclosure requirements. We will also strengthen internal training for supervisors and processes to determine that banks are in compliance with the expectations above. As national and international practice in this area develops and we improve information collection and taxonomies, we will be better able to take further steps towards the establishment of capital and liquidity requirements and requirements for market risk, operational risk, and other material climate-related risks.

46. We are taking further steps to develop green financing. Our overall reform agenda, including fiscal consolidation to reduce debt; PFM reforms to improve monitoring, transparency, and accountability of green public investment projects; enhanced financial sector risk management; and efforts to develop deeper and more open capital markets for foreign investors creates an enabling environment for attracting further green public and private financing. A study conducted with the support of GIZ identified activities with particular potential to attract foreign direct green investments, such as components for green hydrogen (¶43), green data centers for digitization, and development of materials from waste recovery. FDI in these sectors will be supported by our overall agenda to improve the investment climate (¶37). We are also taking specific actions to attract other forms of green financing:

- The Legislative Assembly approved in October 2021 Law 10051 to Promote Financing and Investment for Sustainable Development, through the use of Thematic Public Offering Securities, to promote such financing for investment in activities aimed at achieving the national goals for a sustainable development and a green economy.

- CONASSIF approved updates to a series of associated regulations in May 2022 according to which supervised entities are (i) required to incorporate the sustainable or responsible component in their investment policies; (ii) required to incorporate ESG risk management into their risk management framework; (iii) allowed to issue ESG bonds; and (iv) recommended to include voluntary disclosures on their ESG actions in their annual reports. The first two of these measures were approved with a transitional period that ends in December 2023.

- To further support the development of green financing, the CONASSIF and the Superintendencies have formed a working group with the objective of developing a single green taxonomy for the financial sector. Following initial technical assistance from the WB to develop general guidelines for a new taxonomy, the authorities, including MINAE, are starting a two year project supported by the Green Climate Fund, with the United Nations Environment Programme as delivery partner, to create the taxonomy.

- Our sovereign bonds are already included in indices that recognize our green credentials. Together with those assisting us with planned Eurobond placements, we are exploring Costa Rica's ability to be further recognized as an Environmental Social Governance (ESG) sovereign to catalyze further financing from private investors by leveraging our ambitious climate actions, including through the possible issuance of sustainability-linked Eurobonds (SLBs) or ESG bonds. These bonds could reference key performance indicators related to forestry coverage, ecological integrity, and biodiversity. To support the extensive monitoring and reporting requirements associated with such issuances, we are strengthening internal collaboration between ministries, including through a new interagency committee to facilitate collaboration between the Debt Management Office, the relevant units in the MOF, MINAE and other line ministries whose inputs are required for issuance. Beyond the central government, the Costa Rican Institute for Electricity is exploring the issuance of a second sustainable bond with WB assistance.

- We are also exploring the option of PPPs as a vehicle to finance green investments. We are taking steps to strengthen our institutional PPP framework by improving our capacity for project selection and management of fiscal risks (including the thorough analysis of contingent liabilities from PPPs through a centralized database), supported by WB and IMF technical assistance.

VII. RISKS AND CONTINGENCIES

47. The largest risks to the program come from an array of external factors. Intensified regional conflicts and resulting further supply disruptions, renewed global financial market turmoil and tightening in global financial conditions, and a greater-than-expected global downturn, all carry the potential to adversely impact Costa Rica's economy. These shocks and the required policy response to persistent inflationary and resuming external pressures would likely entail a further slowdown in domestic activity. This could in turn lead to increased domestic financial vulnerabilities and weaker-than-expected revenue performance that would impact our fiscal consolidation strategy. Our exposure to natural disasters continues to pose important risks, which are likely to increase over time. 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 domestic or external developments to support a stronger economic performance, we stand ready to accelerate the adjustment and reform process, strengthening the resilience of our economy to future shocks.

VIII. PROGRAM MONITORING

48. Progress in the implementation of our policies, which are supported by the IMF, is monitored through semi-annual reviews, performance criteria (PCs), indicative targets (ITs), structural benchmarks (SBs), and Reform Measures (RMs). Progress in meeting the inflation target under the program will continue to be monitored through a MPCC. These are detailed in Tables 1, 2, and 3 with definitions and data requirements provided in the attached TMU. The fifth and sixth reviews will take place on or after October 15, 2023, and March 15, 2024, respectively. Purchases under the EFF and RSF will be used for direct budget support during the program period consistent with the Memoranda of Understanding on the responsibilities for servicing financial obligations to the IMF under the EFF and RSF.

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

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

	2022																2023							2024
	End-Mar				End-Jun				End-Sep				End-Dec				End-Mar				End-Jun	End-Sep	End-Dec	End-March
	Prog.	Adj. Prog.	Act.	Met / not met	Prog.	Adj. Prog.	Act.	Met / not met	Prog.	Adj. Prog.	Act.	Met / not met	PC	Adj. Prog.	Act.	Met / not met	IT	Adj. Prog.	Act.	Met / not met	PC	IT	PC	IT
I. Quantitative Performance Criteria																								
Floor on cash primary balance of the central government (-= borrowing)	-34		362	met	144		577	met	215			1,013	287		927	met	152		467	met	305	457	609	230
Floor on net international reserves of the Central Bank (stock, in millions of U.S. dollars)	4,123	2,712	2,634	not met	3,007	2,301	1,689	not met	2,791	3,238	3,189	not met	3,830	3,295	3,871	met	2,314	2,890	4,401	met	3,771	2,860	2,815	3,884
II. Continuous Performance Criteria[2/]																								
Ceiling on accumulation of new external arrears (in millions of U.S. dollars)	0		0	met	0		0	met	0		0	met	0		0	[met]	0		0	met	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)	6.0		...		6.0		...		6.0		...		6.0		...		6.0		...		6.0	6.0	6.0	6.0
Upper inner band limit (1.5 percent above center point)	4.5		...	inner	4.5		...	outer	4.5		...	outer	4.5		...	outer	4.5		...	inner	4.5	4.5	4.5	4.5
End-of-period inflation center point (percent)	3.0		4.7	band	3.0		8.6	band	3.0		11.3	band	3.0		8.4	band	3.0		5.9	band	3.0	3.0	3.0	3.0
Lower inner band limit (1.5 percent below center point)	1.5		...	breach	1.5		...	breach	1.5		...	breach	1.5		...	breach	1.5		...	breach	1.5	1.5	1.5	1.5
Lower outer band limit (3 percent below center point)	0.0		...		0.0		...		0.0		...		0.0		...		0.0		...		0.0	0.0	0.0	0.0
IV. Quantitative Indicative Targets																								
Ceiling on debt stock of the central government	28,747		27,572	met	28,791		28,108	met	28,855		28,483	met	29,566		28,927	met	29,710		29,035	met	30,254	30,598	30,942	31,317
V. Memorandum Items																								
External program financing (in millions of U.S. dollars)[5/]	0		270		932		540		1,439		840		1,601		942		0		0		890	890	1,360	534
External project financing (in millions of U.S. dollars)	49		62		121		96		264		183		313		211		61		33		141	212	286	72
External commercial borrowing (in millions of U.S. dollars)	1,000		0		0		0		0		1,056		1,000		1,056		0		0		1,500	1,500	1,500	0
Domestic FX-denominated debt issuance (in millions of U.S. dollars)	0		384		634		563		884		1,181		1,098		1,514		0		646		220	220	220	60
Proceeds from commercialization of public assets to non-residents (in millions of U.S. dollars)	0		0		0		0		0		0		0		0		0		0		0	0	0	0
Amortization of official external debt by the central government (in millions of U.S. dollars)	20		49		84		79		157		125		191		159		64		76		95	158	256	163
Amortization of external commercial loans (in millions of U.S. dollars)	0		0		0		0		0		0		0		0		1,000		1,000		1,000	1,000	1,138	138
Interest payments of official external debt by the central government (in millions of U.S. dollars)	190		145		248		198		423		379		567		462		180		214		450	734	966	385
Domestic FX-denominated debt service (in millions of U.S. dollars)	480		434		782		801		1,269		1,317		1,394		1,523		123		159		441	912	1,014	545

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

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

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

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

5/ Excluding IMF financing.

Table 2. Costa Rica: Prior Actions and Structural Benchmarks

Action	Target Date	Status	Comment
Prior Action			
MIDEPLAN to produce a single wage spine in compliance with the Public Employment Bill covering at least one-quarter of job positions in the executive branch.	**Prior Action**	**Met**	June 3, 2023
Structural Benchmarks			
Efficiency of government spending			
Legislative Assembly to approve Public Employment Bill.	End-May 2021	**Not Met**	Approved on March 7, 2022.
Implementation of Public Employment Bill, including introduction of a single pay spine.	End-March 2023	**Not met**	Implementing regulation published in March; partial progress on wage spine.
MIDEPLAN to incorporate 90 percent of the executive branch's job positions in the single wage spine.	End-September 2023		**Proposed new SB**
Revenue mobilization			
The Tax Commissioner to approve a new Tax Compliance Improvement Plan, in line with IMF staff recommendations.	End-December 2021	**Met**	
Fiscal governance and transparency			
Publication of financial statement under IFRS standards for fiscal year 2020 for three SOEs (ICE, AyA, CNP).	End-December 2021	**Not met**	Pending for a small firm under CNP.
Cabinet to approve and publish a Medium-Term Fiscal Framework for the entire Non-Financial Public Sector for 2023-2026.	End-April 2022	**Met**	
Cabinet to approve and publish a Medium-Term Debt Strategy (MTDS) for 2023-2026.	End-April 2022	**Met**	

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

Table 3. Costa Rica: Reform Measures Under the Resilience and Sustainability Facility Arrangement

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

Table 3. Costa Rica: Reform Measures Under the Resilience and Sustainability Facility Arrangement (concluded)

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

Attachment II. Technical Memorandum of Understanding

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

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

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

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

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

d) a monetary policy consultation clause;

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

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

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

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

c) no introduction or modification of multiple currency practices;

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

- These four performance criteria will be monitored continuously.

4. For program monitoring purposes, all foreign currency-related assets, liabilities, and flows will be evaluated at "program exchange rates" as defined in Table 1 below, except for items related to fiscal operations which will be measured at current exchange rates. Going forward, the program rates are those that prevailed on September 13, 2022. Monetary gold will be valued at US$1,703 per troy ounce, which was the price prevailing on September 13, 2022.

Table 1. Costa Rica: Program Exchange Rates (September 13, 2022)	
Colones to the U.S. dollar	635.725
U.S. dollar to the SDR	1.3068
U.S. dollar to the Yen	0.0070
U.S. dollar to the Euro	1.0179
U.S. dollar to the Canadian dollar	0.7620
U.S. dollar to the Chinese RMB	0.1443
U.S. dollar to the British Pound	1.1730
Gold price per troy ounce (U.S. Dollar)	1,703

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

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

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

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

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

I. PERFORMANCE CRITERIA

A. Performance Criterion on Central Government Primary Balance

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

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

B. Performance Criterion on Net Official International Reserves

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

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

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

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

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

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

II. CONTINUOUS PERFORMANCE CRITERIA

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

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

III. MONETARY POLICY CONSULTATION CLAUSE

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

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

where

t = the month within which the test date is included

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

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

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

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

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

IV. INDICATIVE TARGETS

A. Indicative Target on Debt Stock of the Central Government

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

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

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

V. DATA REPORTING REQUIREMENTS

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

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

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

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

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

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

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

- Financial soundness indicators of banks and cooperatives, bank by bank, group (public and private), and system level. Data will be reported monthly, no later than four weeks after the end of each month.

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

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

(In billions of colones)

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

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

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

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

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

(In billions of colones)

Financing
Net Domestic Financing
Net BCCR Financing
BCCR Renegotiated debt
Deposits BCCR
Deposits BCCR Initial Balance
Deposits BCCR Final Balance
BCCR Net loans
Banking System Financing
Banking System Financing Loans
Banking System Financing Amortization
Banking System Financing Deposits
Banking System Financing Var. Securities
Banking System Financing Var. Securities Initial Balance
Banking System Financing Var. Securities Final Balance
Banking System Financing Cash and Banks
Banking System Financing Cash and Banks Initial Balance
Banking System Financing Cash and Banks Final Balance
Banking System Financing Net Loans
Central Government Financing
Central Government Financing Amortization of government
Central Government Financing Change in Government Securities
Central Government Financing Change in Government Securities Initial Balance
Central Government Financing Change in Government Securities Final Balance
Other domestic financing
Other domestic financing Credit providers
Other domestic financing Disbursements
Other domestic financing 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 TMU ¶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/]					
2.2. 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 [3/]					
2.6. Housing subsidies					
2.6.1. Housing improvement					
2.6.2. Housing grants					
2.7. Food security and nutrition programs					
2.7.1. Prestación alimentaria					
2.8. Active labor market programs					
2.8.1. Employment National Program (PRONAE)					
2.8.2. Small enterprises' support program (PRONAMYPE)					
2.8.3. Productive ideas					
2.8.4. Training aid					
2.8.5. Training voucher program [4/]					
2.9. Other targeted programs					
2.9.1. Subsidies for elderly persons					
2.9.2. Subsidies for persons with disabilities					
2.9.3. Subsidies for violence female victims					
2.9.3. Subsidies for teenage mothers					
3. Capital transfers to social assistance programs					
3.1. Community infrastructure and socio-productive projects					
TOTAL					

1/ As agreed for the purpose of monitoring the program.
2/ Crecemos program will be merged under Avancemos program starting in 2022.
3/ Since 2020, the program reports only tertiary education scholarship information, with primary education scholarships information (that used to be reported under this program) consolidated under Crecemos.
4/ Starting in 2022, this program will provide support to students enrolled in private institutions' training programs when the National Institute of Apprenticeship (INA) cannot provide the service directly.

Attachment III. Consultation with the IMF Executive Board on the Missed Inflation Target Under the Monetary Policy Consultation Clause (MPCC)

In December 2022 and March 2023, inflation stood at 7.9 and 4.4 percent (y-o-y), respectively. Despite the downward trend relative to the September target date, the upper outer band limit agreed in the Monetary Policy Consultation Clause and defined in the Technical Memorandum of Understanding (TMU) was breached by 2.4 percentage points (p.p) in December, and the upper inner band limit was breached by 1.4 p.p. in March.

A. Inflation Trajectory

1. **The increase in inflation began in the second half of 2021, but manifested itself more strongly in 2022, especially since the second quarter, reaching 12.1 percent in August, compared to 3.3 percent in December 2021.** During February 2022-March 2023, inflation stayed above the BCCR's tolerance band (2-4 percent), and during May 2022-February 2023 it was above the upper outer and limit established in the MPCC.

2. **The inflation shock observed from the second half of 2021 and the first three quarters of 2022 has been rapidly dissipating across all available measures of inflation, core inflation, imported inputs, while having a direct effect on the reduction of inflation expectations.** During the first quarter of 2023, both headline and core inflation kept their downward trend. In April, both headline inflation at 2.4 percent and core inflation at 3.4 percent returned within the BCCR's tolerance band. Inflation expectations have also adjusted downwards, albeit more slowly.

3. **The sustained deceleration of inflation reflects the reversal process of external supply shocks, as well as the effect of restrictive monetary policy measures.** External factors that have favored the reduction of local inflation include the decline in transportation costs, the continued normalization of supply chains, and the reduction in the price of raw materials, as also evidenced by the downward trend in food and fuel prices in the international market.

4. **The Producer Price Index (IPP-MAN) has also decelerated since the second half of 2022, with a year-on-year average variation of 4.3 percent in the first quarter of 2023.** This is consistent with a smaller contribution from manufactured final consumer goods to the increase in the overall CPI. Internal factors, such as the cumulative effect of monetary policy measures and the appreciation of the colón, also contributed to the fall in inflation since September 2022.

5. **Monetary policy actions have contributed to reduce aggregate demand pressures and contain second-round inflationary effects.**

B. Policy Response

6. Since December 2021 until October 2022 the Central Bank of Costa Rica increased its monetary policy rate by 825 basis points to 9 percent. In July 2022, in an additional effort to reinforce its restrictive monetary policy stance, the BCCR raised the minimum legal reserve requirements rate for deposits and obligations in national currency from 12 percent to 15 percent.

7. After a pause in the policy rate hikes, the BCCR decided to reduce its policy rate by 50 basis points (bps) in March, and an additional 100 bps in April, moving to a less restrictive monetary stance. The BCCR board has indicated that the fast decrease in the inflation rate, the continued decrease in inflation expectations, and the presence of base effects due to the inflation shock in 2022 make it very likely that inflation will go below the BCCR's tolerance band in the next two quarters. Nevertheless, once base effects dissipate, it is likely that inflation will increase again to above the lower limit of the tolerance band by the end of 2023. Also, given an upward balance of risks, the monetary policy stance needs to remain restrictive.

8. The Central Bank has publicly reiterated its commitment to the continuous monitoring of the evolution of different macroeconomic indicators, which allows it to take the necessary monetary policy actions in the required direction in a timely fashion, in response to changes to the inflation forecast and inflation expectations. To achieve the long-term inflation target of 3 percent, the monetary policy stance will continue to be data-dependent and forward-looking, in line with the inflation targeting framework.

C. Inflation Projections

9. BCCR models project that the process of reduction of inflation would continue during 2023. The projections of headline inflation for the next two quarters will reflect a base effect due to the 2022 inflationary shock, which will, most likely, lead to values below the lower limit of the BCCR's tolerance band. According to the same models, it is expected that inflation will later return within the tolerance band towards the end of 2023 and remain within said range through the rest of the projection horizon.

10. In order to achieve its target in the medium term, the BCCR will adjust its policy stance when is needed as new information is available and forecasts are updated.

11. As all forecasts, inflation projections are conditional on risk factors. Even though inflation expectations recently registered a downward correction, there is a risk of a slower convergence to the target. Upward risks to inflation include higher prices of raw materials in international markets, and depreciation pressures on the exchange rate motivated by faster than expected increases in external interest rates, which may encourage capital outflows and the demand for foreign currency by residents. Downside risks include slow growth in our main trading partners and international food and oil prices lower than the ones expected in our baseline scenario.

Statement by the Staff Representative on Costa Rica
June 20, 2023

This statement provides information that has become available since the staff report was issued to the Executive Board. This information does not alter the thrust of the staff appraisal.

1. **The Central Bank of Costa Rica lowered the policy interest rate by 50 basis points to 7 percent on June 14th.** The decision came amid a further decline of the headline inflation to 0.9 percent y-o-y in May.

Statement by Mr. Guerra and Ms. Lankester Campos on Costa Rica
Executive Board Meeting
June 26, 2023

Our authorities want to thank management and staff for their close and active engagement to conclude the fourth review under the Extended Fund Facility (EFF) arrangement and the first review under the Resilience and Sustainability Arrangement (RSF). They would like to extend their appreciation to Mr. Ding Ding, the Mission Chief, and his team for their remarkable work, commitment, and open discussions with the government and civil society. Also, they welcome the valuable engagement with the Fund's capacity development and the collaborative work with the World Bank and the Interamerican Development Bank's staff. Costa Rica has widely used the Fund's technical assistance and would like to thank staff for their close engagement. Also, they want to highlight the importance of capacity development as an instrument for a program's progress and success.

The economic program laid out by the Costa Rican authorities, and supported by the EFF, has been critical to safeguarding macroeconomic stability and anchoring fiscal consolidation efforts in a context of ongoing global challenges, tighter financial conditions, and commodity price volatility. Moreover, it has been instrumental in catalyzing additional financial support from other multilateral institutions and improving negotiations on the international capital markets.

For the fourth review, Costa Rica continues to perform strongly. Overall, fiscal consolidation has overperformed the government's targets, and the Central Bank has taken decisive actions to counter inflation and rebuild reserve buffers. Targets on the primary balance, government debt, and net international reserves (NIR) were met with large margins. The authorities report a robust implementation of macroeconomic policies to achieve the main program objectives and significant progress on structural reforms. All performance criteria (PC) and indicative targets (IT) were met. Going forward, the policy stance will remain focused on bringing inflation back to target and keeping public debt on a firm downward path.

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

Our authorities stand ready to take the necessary actions in case geopolitical tensions are channeled via higher commodity prices and lower global growth, and to mitigate the risks associated with climate change developments over the medium and long run.

Economic Outlook

Amid a challenging international context, the Costa Rican economy has been resilient. During the last three years, the COVID-19 pandemic and the war against Ukraine have had a significant impact on its economy. Still, in 2021, growth rebounded to 7.8 percent; in 2022, growth exceeded expectations with a 3.7 percent outturn; and there was a 3.9 percent increase in the first quarter of 2023. In April 2023, the monthly index of economic activity was 4.9 percent y-o-y. The economy's dynamism is explained by higher external demand and the recovery of gross fixed capital formation as multinational firms are choosing Costa Rica for their relocation. Total exports were the most dynamic component. For 2023 and 2024, the Central Bank (BCCR) forecasts real GDP growth of 3.3 and 3.6 percent, respectively. This outlook considers a larger external demand for medical devices and business and IT services, and a greater internal demand given a higher disposable income because of improved terms of trade.

The labor market has recovered, but at a slower pace than economic activity. The unemployment rate reached its peak of 24.4 percent and has decreased to 9.7 percent when considering the quarters of February, March, and April 2023 (13.3 percent for the same period in 2022), below pre-pandemic levels (12.2) and past average levels (9.9 percent from 2010 until 2019). This result is the lowest in the last 54 months (about four and a half years).

Monetary policy

The BCCR has proactively responded to the shocks faced by the economy, evidencing its independence and vigilant behavior towards low and stable inflation and financial stability; its monetary policy decisions, as an inflation targeter, are data-dependent and forward-looking.

By mid-2022, inflation in Costa Rica had reached 10.1 percent, one of the highest levels among the inflation targeters in Latin America. Accordingly, the BCCR was one of the first countries to raise its monetary policy interest rate. From December 2021 (0.75 percent) until October 2022 (9.0 percent), the monetary policy rate was increased by 825 b.p. Annual inflation peaked at 12.13 percent in August 2022, but since then, inflation and core inflation have shown a downward trend.

In March 2023, the BCCR became the second in Latin America to lower its policy rate (in 50 bp) given the clear downward trend already observed in February in both inflation and its core component (5.6 and 4.8 percent, respectively). By then, the median inflation expectations for 12 and 24 months were 5.0 and 4.0 percent, respectively. Also, the forecast models indicated a return to target (3.0 percent ± 1 p.p.) by the end of 2023. Since then, there have been two other monetary policy decisions to reduce the interest rate, in April (100 bp) and June (50 bp). With these changes, the policy rate is now 7 percent. In general, for its policy decisions, the BCCR considers the recent behavior of inflation, its forecasts, and macroeconomic determinants, along with the risks that may affect the foreseen trajectory.

In May 2023, annual inflation was 0.9 percent, while the core component was 2.5 percent. Lower inflation reflects international price shock reversal, the cumulative monetary policy rate increases, the local currency appreciation, and base effects. The 12-month inflation expectation reached 4.0 percent in May (9.5 percent in August 2022) on average, while the 24-month expectation was 3.7 percent after six consecutive months of being at 4.0 percent.

In its June communiqué, the BCCR explained the reasoning behind the decision, reiterated its commitment to achieve the inflation target, and explained its outlook for inflation, the risks around the outlook, and the implications for monetary policy. The BCCR is vigilant about the tightening of global financial conditions and the risks posed by global price pressures, and it will continue to decide on its policy rate changes considering the macroeconomic circumstances and inflation projections.

In line with the less restrictive monetary policy, liquidity has been ample, mainly due to the expansive effect of foreign currency purchases by the BCCR. Such operations were done in the context of abundant foreign currency availability in the FX market, which is explained by real sector operations such as the tourism sector´s recovery, an increase in exports, and direct investment. On the other hand, FX demand has remained steady given commodity price stability and fewer requirements by pension funds.

Overall, the BCCR's exchange rate policy is implemented through FX market operations, with three main motives: reserve accumulation, operations on behalf of the non-financial public sector, NFPS, and to mitigate abrupt fluctuations that may have negative implications for financial stability. During the first four months of 2023, the BCCR bought US$2,751 million as administrator of the NFPS´s needs and to restitute reserves. Even with the active participation of the BCCR, the increased supply has been translated into an appreciation of the nominal exchange rate, which accumulated for April at 8.4 percent and 18.1 percent y-o-y.

Mainly because of the systematic FX purchases by the BCCR, the issuance of a US$1.5 billion Eurobond, and multilateral funding inflows, gross international reserves were boosted. By end-May, they were US$11,023 million, well above the IMF's Reserve Adequacy metric.

Fiscal policy

The fiscal reform approved by the end of 2018 comprised income and expenditure measures and a fiscal rule that limits expenditure growth in accordance with debt level intervals. Since then, multiple shocks have impacted Costa Rica, but the authorities have maintained their commitment to the fiscal rule and to fiscal discipline more broadly. As a result, fiscal consolidation has overperformed the government's and the EFF program's targets.

The accomplishment of these fiscal targets has translated into changes in risk perception from international markets, as Moody's, Fitch, and S&P have improved Costa Rica's sovereign rating and outlook, the sovereign spread is lower when compared to the GLOBAL and the LATAM EMBI; and the government received a 4.8 bid to offer in the latest issuance of external debt bonds (March 2023).

In 2022, fiscal performance was strong. The fiscal targets were met despite the cyberattack disruption between March and June. The primary balance was 2.1 percent of GDP (-0.3 percent in 2021), the lowest of the last thirteen years, and a financial deficit of 2.5 percent of GDP (5 percent in 2021). By the end of 2022, total income represented 16.6 percent of GDP, 0.8 percent more than the same period last year, while tax revenue was the highest in more than a decade, at 14.3 percent of GDP. Public debt remains on a firm downward path; the debt to GDP ratio was 63.8 percent. Preliminarily, in April, the accumulated primary balance was 1.0 percent of GDP, while the financial deficit was 0.7 percent of GDP. The fiscal balance overperformance has benefited from the robust economic recovery and from a reduction in primary expenditure as a share of GDP under the fiscal rule.

Going forward, the authorities have reaffirmed their commitment to the required fiscal consolidation, as evidenced in the 2023 budget. In fact, they are on track to exceed their 2023 primary surplus target of 1.3 percent of GDP. For 2023 and 2024, public finances are expected to continue this sustainable path with positive primary results of 1.6 and 1.8 percent, respectively, and financial deficits of 3.5 and 3.0 percent of GDP. To maintain these positive results, the Finance Ministry´s strategic proposal for decision making focuses on three main pillars: control and reduction of public expenditure, a more equal and effective tax system, and a long run financial strategy.

Structural reforms

On the structural front, the third pillar of the program aims to advance key reforms to promote inclusive, green, and sustainable growth in Costa Rica. The authorities' efforts are committed to continuing to advance on the path already set with the OECD accession (which introduced 14 landmark legal amendments) with additional reforms to align public governance and policies with international best practices, foster transparency, efficiency, and growth while reducing inequality and protecting the most vulnerable. Broadly, the aim is to protect the most vulnerable from the impact of shocks and support inclusion, including by promoting greater female labor force participation and boosting productivity growth, including by eliminating barriers to business formalization, investment, and job creation.

Against this backdrop, one of the most ambitious reforms of recent years, the public employment bill (PEB), a SB under the program, was approved in March 2022. Its purpose is to improve efficiency and equity in the public sector by modernizing and streamlining the public administration while containing the wage bill. From the start of the discussion, the bill encountered strong opposition from the public sector unions as it creates a single wage spine across the public sector, eliminating salary components such as bonuses and annuities.

This reform entered into force in March 2023, but preparations for the introduction of the single pay pillar and related reforms have been ongoing since its approval. It was expected that the introduction and implementation of the single wage spine would be finished by then, but the implementation of the PEB has taken longer than expected due to the unanticipated methodological complexities in its design, including incomplete wage data resulting from the cyberattack on the Ministry of Finance last year.

With IMF TA support, the authorities took corrective actions and established a strict schedule of activities to reaffirm their commitment to bringing the implementation of the single wage spine back on track while ensuring it meets the objectives of the law. As a result, the Ministry of National Planning and Economic Policy (MIDEPLAN) produced a single wage spine in compliance with the PEB covering at least one-quarter of job positions in the executive branch (prior action for this review) and is committed to incorporate 90 percent of the executive branch's job positions by end-September 2023. Also, this ministry will begin administering payments for all employees covered by the law in line with the transitional provisions set by the PEB and its regulations by November 2023.

The structural fiscal program also envisages gains from reforms to public procurement, modernization of the tax and customs administration, and public financial management reforms. In 2022, the cabinet approved and published a Medium-Term Fiscal Framework (MTFF) for the entire Non-Financial Public Sector for 2023-2026, along with a Medium-Term Debt Strategy for the same period. To support its institutionalization and fiscal rule reforms, a macro fiscal unit is being formalized within the Ministry of Finance and the Fiscal Council is being operationalized.

To foster inclusive growth, CD efforts have focused on an action plan to operationalize gender budgeting (pilot completed in December 2022) as well as the recent centralization and digitalization of the payment system for all cash transfer social assistance programs (proposed SB to produce a single window). The execution of gender-related spending, in line with the budget statement, will be monitored during 2024 as part of the initiatives to reduce the gender economic gap.

The BCCR has worked to strengthen its independence, transparency, and accountability. In 2019, amendments to its law were approved 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. Afterwards, and in line with the recommendations of the IMF's 2020 Safeguards Assessment, it worked closely with the Fund's legal experts on some additional amendments. The final draft, however, was not submitted to the Legislative Assembly by end-December 2022, missing the structural benchmark. This decision was carefully thought out by the authorities, who balanced the risks and benefits of presenting to the Legislative Assembly an *integral* reform of the Central Bank law. It was decided that given the political situation, global turmoil, and explicit intentions from some parliamentarians to change the BCCR's main objective, the downward risks outweighed the benefits. Submitting a proposal to amend the BCCR's organic law now would result in the opposite of the intended objectives.

Still, the BCCR remains committed to strengthening its autonomy, governance, and operational framework, which is why it submitted to the Legislative Assembly a project to amend some articles of its law (a subset of the foreseen changes). These proposals have limited scope for modifications and do not involve the main objectives and functions of the BCCR. Specifically, the selection includes articles important to transparency, autonomy, and accountability practices. In parallel, the BCCR drafted the law project to award constitutional autonomy to the BCCR, to be submitted in the following months.

The RSF

Even when Costa Rica has made significant advances in its comprehensive green agenda, it is still a country exposed to higher temperatures and rising sea levels, as well as more frequent and severe droughts, storms, and floods. Through the years, it has taken measures to strengthen its adaptation capacity and reduce greenhouse gas emissions, but still, the RSF fills a much-needed gap to unlock critical resources as these plans entail significant costs within a tight spending envelope.

Costa Rica's compromise, reflected in the proposed reform measures within this facility, is ambitious and multi-faceted. This set of measures aims to improve the efficiency of budget planning and public investment, create further fiscal space, mitigate financial risks, strengthen public debt dynamics, and provide prospective balance-of-payments stability. Specifically, it comprises four reform priorities: (i) integrating climate risks into fiscal planning; (ii) strengthening public investment and infrastructure resilience; (iii) supporting decarbonization; and (iv) greening reserves and strengthening financial sector resilience.

For this first RSF review, all scheduled reform measures were completed. The Ministry of Finance published the guidelines for budget tagging and is developing the information systems to facilitate its operationalization. Also, the government approved the implementation of the regulations aligned with global best practices to facilitate private-sector participation in renewable energy for self-consumption. The BCCR's Group for Strategic Analysis of Climate Change (GAECC) established a data repository on climate hazards and vulnerabilities, while the Superintendency of Financial Entities included granular data on banks' exposure to vulnerable industries and regions, covering 35 percent of the banking system's credit portfolio. Finally, the BCCR published the indicators of the "greenness" of reserve holdings, while maintaining existing objectives on capital preservation, liquidity, and rate of return.

Going forward, the authorities continue to move ahead with their strong climate-related reform agenda and have the aim to keep on building on the RSF's catalyzing effect, including through continued work with the World Bank and other IFIs. Also, the facility will support the issuance of securities focused on sustainability. Costa Rica's efforts to further improve resilience to climate change and fully decarbonize its economy are financially costly, but the authorities strongly believe they will help generate new and sustainable business and growth opportunities.