



# **HIGH-LEVEL SUMMARY TECHNICAL ASSISTANCE REPORT**

## **COSTA RICA**

**Sovereign Asset and Liability Management –  
Scoping Mission**

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### **High-Level Summary Technical Assistance Report** Monetary and Capital Departments

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**The *High-Level Summary Technical Assistance Report* series provides high-level summaries of the assistance provided to IMF capacity development recipients, describing the high-level objectives, findings, and recommendations.**

**ABSTRACT:** Costa Rica has embarked on an ambitious reform of its public debt management function and has made significant progress to date. On the institutional front, it includes the establishment of the Commission for Sovereign Assets and Liabilities for the coordination of public debt management, cash management, and financial programming of the budget. An IMF Technical Assistance mission visited San Jose in November 2022 to assist the Ministry of Finance in preparation of a framework for Sovereign Asset and Liability Management. This note summarizes the mission's findings and recommendations.

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## Background

At the request of the Ministry of Finance (MoF) of Costa Rica, a Monetary and Capital Markets Department mission visited San Jose from November 15–22, 2022, to support the authorities' efforts in preparing a framework for consolidated Sovereign Asset and Liability Management (SALM). The authorities have already taken steps toward building an SALM framework by inter alia establishing in April 2021 a Commission for Sovereign Assets and Liabilities (CSAL) for the coordination of public debt management, cash management, and financial programming of the budget. The team drafted a Report that should facilitate the discussion on the scale and scope of SALM in Costa Rica and its implementation.

## Summary of Findings

**Aided by a 36-month Extended Fund Facility (EFF) in place since March 2021, Costa Rica's reform efforts toward strong, inclusive, and sustainable growth are showing tangible results.** In public debt management, the authorities' commitment includes reforms of institutional arrangements, debt management strategy, and domestic market development. In parallel, efforts are underway to create a framework for consolidated management of the state's assets and liabilities, and to reform the functioning of various building blocks of the consolidated public sector balance sheet, such as state-owned enterprises and banks.

**A comprehensive SALM framework can have significant advantages over separate management of sovereign assets and liabilities.** It allows for analysis of the financial characteristics of the whole balance sheet of the sovereign, identification of sources of costs and risks, and quantification of the correlations among these sources. Thus, when an SALM approach is applied to the consolidated public sector portfolio, overall sovereign risk exposures can effectively be analyzed and managed.

**Implementing a full SALM framework can be challenging, but countries have applied it with a range of scope and policy objectives.** Challenges are twofold: first, obtaining data on all sovereign assets and liabilities; and second institutional coordination, given that assets and liabilities are managed by a range of entities, some of which enjoy significant independence. Nevertheless, the framework has been applied by numerous countries to manage currency risk, liquidity risk, asset allocation, and debt composition more effectively.

**An effective SALM framework is important for a country like Costa Rica with a complex balance sheet.** In addition to sizable liabilities, and a highly dollarized economy that is reflected in the BCCR balance sheet, its sovereign balance sheet includes ownership stakes in the financial and real sectors with extensive interlinkages among them. The mission analyzed the balance sheets of five types of entities: (i) the budgetary central government; (ii) the social security system; (iii) the central bank (BCCR); (iv) the four largest state-owned enterprises (SOEs); and (v) the state-owned banks (SOBs).

**This balance sheet analysis is a first step to developing a consolidated sovereign balance sheet.** The BCCR's balance sheet has negative equity and significant USD assets and liabilities. Most SOEs are in reasonably good financial health and can fund some investment from their retained earnings, and the SOBs are profitable and liquid, and reflect dollarization in the economy.

**Combining these balance sheets into a consolidated sovereign balance sheet allows for several observations to be drawn, and for follow up to this scoping exercise.** First, the consolidated balance sheet remains incomplete, largely due to gaps in knowledge of financial position of the central government (e.g., property, plant, and equipment). This contrasts with the SOEs, SOBs, and BCCR, which provide financial statements in line with international reporting standards. Second, the consolidated balance sheet highlights the risks to the sovereign's net worth, given the wide range of entities it owns, and the potential for transmission of shocks among them in time of stress. Third, the balance sheet highlights the presence of two sovereign debt issuers in the local market: the central government and the BCCR. This fragments local currency issuance and impedes the emergence of a government yield curve, which plays an important role in overall financial sector development. Addressing this would also allow for a single public debt management strategy and aid monetary policy implementation.

## Summary of Recommendations

The mission has made the following recommendations:

**The scope of CSAL should be broadened to include the BCCR as a permanent member, given the need for policy and operational coordination with monetary authorities within a SALM framework.**

**The government should consider broadening its financial reporting to include a statement of financial position, consistent with international accrual accounting standards.** This would improve risk management, support transparency, provide a useful input to long-term fiscal policy, and promote more effective stewardship of the government's sizable asset base.

**In collaboration with the National Treasury, CSAL should establish and monitor a framework for cash and liquidity management, including a liquidity buffer.** This would build on the initiative to establish a Treasury Single Account (Caja Unica) for the budgetary public sector. Among other system-wide risks that SCAL could begin to analyze are: rollover risk, contingent liabilities, and other shocks to the budget.

**The MoF and BCCR should consider a realignment of their balance sheets for the government to be the sole issuer of sovereign debt securities in Costa Rica.** This would support securities market development, allow a unified public debt management strategy, and support the implementation of monetary policy. This issue has been considered before in Costa Rica; a renewed focus could build on these efforts, and work through potential transition pathways and timeframes. Such a move would be neutral from the perspective of a public sector balance sheet and net worth.

**Consistent with Medium Term Debt Management Strategy and domestic debt market development, the MoF should continue reducing the FX exposure of sovereign debt.** Some SOEs are also aiming to reduce FX risk in the medium term. Maintaining such exposures without opportunities for hedging could be costly.

**Measures should be taken to develop a deep and liquid FX market as a basic precondition for providing hedging opportunities for market participants.** The planned liberalization of SOEs' access to foreign exchange (via transactions with the private sector) and expected improvement in transparency (by informing the market of all FX transactions, including OTC, carried out daily) are welcome developments.