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# Staff Country Reports

**Costa Rica: Report on Observance of Standards and Codes—  
Fiscal Transparency Module**

This Report on the Observance of Standards and Codes on Fiscal Transparency for Costa Rica was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on November 6, 2007. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of Costa Rica or the Executive Board of the IMF.

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INTERNATIONAL MONETARY FUND

COSTA RICA

**Report on The Observance of Standards and Codes (ROSC)  
Fiscal Transparency Module**

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November 6, 2007

**EXECUTIVE SUMMARY**

This report provides an assessment of fiscal transparency practices in Costa Rica in relation to the requirements of the IMF *Code of Good Practices on Fiscal Transparency* based on discussions with the authorities and other organizations, the authorities' response to the IMF fiscal transparency questionnaire, and other sources of information.

Costa Rica meets the requirements of the transparency code in several areas. Responsibilities across powers and levels of government are clearly specified, and the central bank is operationally independent. The legal framework underlying the public finance processes is sound, and significant progress has been made in centralizing and improving debt and cash management, updating accounting norms, and upgrading the data management systems. The budget process is well specified and publicized. The laws governing the regulation of the private sector are generally clear, tax legislation is well publicized, and taxpayers' rights are clearly spelled out in the law. The internal and external audit frameworks are sound, and the Comptroller's General office is independent and technically strong.

In other areas further efforts will be needed to improve transparency. These relate mainly to the need to enhance fiscal coordination mechanisms across general government institutions, improve the coverage and quality of budget documents, as well as of fiscal reporting, introduce a medium-term fiscal framework, and develop fiscal risk reporting and analysis. In particular:

- There is room to improve clarity of responsibilities across general government institutions to avoid duplication of functions and improve coordination.
- The budget formulation and presentation can be further improved, including by (i) integrating most general government autonomous institutions in the budget; (ii) adopting a medium-term budget framework; (iii) developing a public investment program and establishing clear principles for the evaluation and approval of investment projects; (iv) eliminating earmarked spending mandates; and (v) including a statement of fiscal risks in budget documents.
- Budget execution and reporting could be strengthened, including by (i) harmonizing the accounting standards and procurement processes across all public institutions; (ii) strengthening the monitoring and reporting of in-year execution of general government expenditure; and (iii) enhancing parliamentary oversight over budget execution.

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### ABBREVIATIONS AND LINKS

AOP	Annual Operating Plans
ARESEP	Regulatory Authority for Public Services, <a href="http://www.aresep.go.cr/">http://www.aresep.go.cr/</a>
CBCR	Central Bank of Costa Rica, <a href="http://www.bccr.fi.cr/">http://www.bccr.fi.cr/</a>
CCSS	<i>Caja Costarricense de Seguro Social</i> , the Social Security Fund, <a href="http://www.info.ccss.sa.cr/">http://www.info.ccss.sa.cr/</a>
CGR	Comptroller General of the Republic, <a href="http://cgrw01.cgr.go.cr/">http://cgrw01.cgr.go.cr/</a>
CoA	Chart of Accounts
DGABCA	General Directorate for Asset Management and Procurement, Ministry of Finance, <a href="https://www.hacienda.go.cr/">https://www.hacienda.go.cr/</a>
DGT	General Directorate for Taxation, , <a href="https://www.hacienda.go.cr/">https://www.hacienda.go.cr/</a>
FML	Financial Management and Public Budget Law
GDCCS	General Directorate of the Civil Service, <a href="http://www.sercivil.go.cr/">http://www.sercivil.go.cr/</a>
GFS	Government Finance Statistics
ICE	<i>Instituto Costarricense de Electricidad</i> , the state electricity and Telecommunication company, <a href="http://www.grupoice.com/">http://www.grupoice.com/</a>
INS	<i>Instituto Nacional de Seguros</i> , the state insurance company, <a href="http://portal.ins-cr.com/">http://portal.ins-cr.com/</a>
MOF	Ministry of Finance, <a href="https://www.hacienda.go.cr/">https://www.hacienda.go.cr/</a>
NCC	National Council for Concessions, <a href="http://www.mopt.go.cr">http://www.mopt.go.cr</a>
NDP	National Development Plan, <a href="http://www.mideplan.go.cr/">http://www.mideplan.go.cr/</a>
NFPS	Nonfinancial Public Sector
NISC	National Institute of Statistics and Census, <a href="http://www.inec.go.cr/">http://www.inec.go.cr/</a>
NSS	National Statistics System
RECOPE	The state oil importer and refinery, <a href="http://www.recope.go.cr/">http://www.recope.go.cr/</a>
SIGAF	Integrated Information System for Financial Administration
SICCNET	<i>Sistema de Consolidación de Cifras del Sector Público Costarricense</i> , the information system for consolidating public sector data
STA	Single Treasury Account
ROSC	Reports on the Observance of Standards and Codes
SDDS	Special Data Dissemination Standard

## I. DETAILED DESCRIPTION OF PRACTICE<sup>1</sup>

### A. Clarity of Roles and Responsibilities

#### Definition of Government Activities

**1. The general government is defined consistently with the Government Finance Statistics (GFS) principles, but its coverage in the budget process is limited.** (1.1.1)

The structure of the public sector and the definition of various levels of government are clearly described in an institutional classification table published on the website of the ministry of finance (MOF). It defines the general government consistently with the GFS principles (the units of general government are listed in Box 1). Within the general government, there are five concepts relevant to Costa Rica's public finance: (i) the budgetary central government (known in Costa Rica as just central government), which includes the ministries, autonomous powers and their dependencies; (ii) deconcentrated units, which are part of the administrative structure of ministries but have budgetary autonomy by law; (iii) the Government of the Republic, which consists of the above two sectors; (iv) decentralized institutions, which have full administrative and budgetary autonomy; and (v) the local governments (largely municipalities). There is also an increasing number of trust funds, which are usually set up as private entities that manage public funds, and hence not captured in the general government definition and statistics. As it is clear from the definitions, the budget covers only the budgetary central government, which accounts for some 56 percent of total general government spending.

**2. The clarity of roles and responsibilities within the general government are hampered by its fragmented administrative organization.** (1.1.1)

The Constitution allows for the establishment of public institutions with administrative autonomy, and these have proliferated as the central administration devolved many of its inherent functions—by way of gaining flexibility in the budgetary process—to satellite units that have been given budgetary and/or administrative autonomy through legislation. Excluding municipalities, there are about 120 decentralized and deconcentrated institutions in the general government. Their budgets are not subject to direct legislative oversight but, instead, must be approved by the Comptroller General of the Republic (CGR). There seems to be little policy coordination between the ministries and the decentralized units in their sector, with unclear responsibility for policy objectives and potential for duplication of functions.<sup>2</sup>

<sup>1</sup> Discussions on fiscal transparency were held in San José during March 14–29, 2007. The mission team comprised Ms. Cebotari and Mr. Velloso (both FAD), and Messrs. de la Torre and Estrella (both members of FAD's expert roster). The team met with Vice-President and Planning Minister Casas, Finance Minister Zúñiga, Central Bank of Costa Rica President Gutiérrez, Comptroller General of the Republic Aguilar, Congresswoman Charpentier, and other officials from various government ministries and departments, as well as officials and representatives of state-owned enterprises, such as ICE, RECOPE, and Banco Nacional, regulatory agencies, such as ARESEP, and the academic and business communities.

<sup>2</sup> For instance, there are 30 different public institutions involved in social policies and poverty reduction, 11 in the health sector, 12 in infrastructure and transportation, in addition to the respective line ministries (National Development Plan, 2006–10, p. 30).

**3. Government holdings of fully-owned corporations and equity are extensive, and there is no single entity that monitors ownership or coordinates policies.** (1.1.5, 2.1.4)

The government owns three commercial banks (accounting for some two-thirds of total banking system assets), over 20 other financial corporations, and 16 nonfinancial corporations. Many public corporations enjoy monopoly positions in important sectors of the economy, such as electricity and telecommunications (*Instituto Costarricense de Electricidad*, ICE), hydrocarbons (the oil importer and refinery, RECOPE), and insurance (*Instituto Nacional de Seguros* INS). These holdings are generally limited to sectors that have been historically associated with public service provision.<sup>3</sup> There is no single entity in the government that is responsible for monitoring ownership and coordinating policies, and equity participations are not clearly reported.<sup>4</sup> Information on equity holdings can only be found from the annual reports of the various public corporations, which in turn can be identified from the institutional classification of the public sector. There is no reporting on government equity holdings in the budget documentation.

<b>Box 1. General Government in Costa Rica, 2005</b>	<u>Number</u>	<u>Expenditures (percent of GDP)</u>
General government in Costa Rica comprises the following:	247	25.4
<b>Budgetary central government:</b> Ministries, President's office, Parliament and its dependencies, Judiciary, the Supreme Electoral Tribunal	24	14.3
<b>Deconcentrated Units:</b> including the National Road Council (Conavi), the National Council for Concessions, and the Social Development Fund (Fodesaf)	73	1.4
<b>Decentralized Institutions:</b> including the Social Security Fund (CCSS), universities, the public service regulator (ARESEP), institutes for tourism (ICT), learning (INA), agricultural development (IDA)	48	8.8
<b>Local Governments</b>	102	0.9

Sources: Annual Report of the CGR (2005) and MOF.

**4. The relationships between government and public nonfinancial and financial corporations are clear.** (1.1.4)

General government is clearly separated from public corporations operating in both the financial and nonfinancial sectors. The operation and management of the state-owned banks are governed by the banking law,<sup>5</sup> while those of the remaining financial and

<sup>3</sup> The most obvious exception is the monopoly on the production of alcohols, *Fábrica Nacional de Licores* (FANAL).

<sup>4</sup> Under international best practice, the management of government equity holding would usually be centralized in a specialized and independent holding and management company. The goals and activities of such a company would be defined by a legal framework and brought at arms-length of day-to-day government activities.

<sup>5</sup> *Ley Organica del Sistema Bancario Nacional*, No. 1644.



nonfinancial corporations are governed by special legislation, which, however, makes it challenging to ascertain fully the government's overall relations with the sector. Despite having their boards of directors appointed by the government, public corporations operate largely on a commercial basis, do not make transfers to the budget,<sup>6</sup> and do not enjoy special tax exemptions. Tariffs on public utilities are required by law to be set at least at cost recovery levels, although in practice cross-subsidization within sectors exists. The framework governing the budget process for the public corporations is clearly set in the legislation,<sup>7</sup> and public corporations are generally subject to the overall budget guidelines set by the budgetary authority,<sup>8</sup> which also monitors their finances and performance. The budget of public corporations is approved and performance audited by the CGR,<sup>9</sup> and their borrowing and procurement are subject to the same requirements as all public sector institutions.

### **Government relations with nonfinancial public corporations and the private sector**

#### **5. Public nonfinancial corporations carry out limited quasi-fiscal activities (QFAs). (1.1.4)**

The legislation requires that all public tariffs (set by the regulatory authority for public services, ARESEP) cover reasonable costs.<sup>10</sup> The tariff-setting process appears clear and transparent. While tariffs are adjusted in line with costs, the system has inherited notable cross-subsidization of various products within the same enterprise. For instance, in the case of hydrocarbons, lower-than-market diesel prices are offset by higher prices for gasoline, LPG and asphalt; in telecommunications, cheaper fixed-line telephones have been subsidized by wireless and international call services; and, in electricity, low residential tariffs are offset by higher industrial tariffs. Cross-subsidization has so far not affected the overall performance of state-owned enterprises, which are profitable as a whole and do not rely on transfers from the budget.<sup>11</sup> The authorities recently took measures to correct the misalignment in hydrocarbon prices, and these are expected to be fully in line with international prices by end-2007.

#### **6. While there is no active privatization program, the government is committed to revamping the legal framework for concessions and opening up the insurance and telecommunications sectors. (1.1.5)**

<sup>6</sup> However, state-owned banks are required by law to transfer 18 percent of their profits to three public institutions promoting social development.

<sup>7</sup> Financial Management and Public Budgets Law, No. 8131, and its regulations.

<sup>8</sup> Financial corporations are not covered by the budget guidelines. Most recently, ICE has also been exempt from the guidelines by way of allowing it to undertake much needed infrastructure investment.

<sup>9</sup> Budget approval by CGR is largely limited to a check of its consistency with the budget guidelines issued by the budget authority and to the legality of various spending items, and does not involve policy or operational aspects.

<sup>10</sup> Law No. 7593 regulates the activity of ARESEP and the tariff-setting process. According to the law, the ARESEP Board is appointed by the government, but in the recent past ARESEP has shown independence from the government. Draft legislation currently in the Assembly seeks to strengthen the formal independence of ARESEP.

<sup>11</sup> No information is available publicly on the extent or financial impact of cross-subsidization.

There is no legal framework for privatization, but draft legislation in the Assembly envisages opening up the telecommunications and insurance sectors to competition, as required under the impending DR-CAFTA agreement. The current framework for concessions, including PPP-type arrangements, is detailed in the Law on Concessions.<sup>12</sup> The entity responsible for concessions is the National Council for Concessions (NCC), whose board comprises the minister of public works and transport, the minister of finance, the minister of planning, the president of the central bank, and three other members representing civil society. Several legal challenges, including of land expropriations and of the terms of the contracts, have adversely affected the actual implementation of the program of concessions; only one concession is so far fully operational.<sup>13</sup> The initial payment received under this concession was used for severance payments and was not accounted for in the central government's budget. The government has presented to the Assembly a draft law aimed primarily at simplifying the concession process and giving more operational independence to the NCC.

**7. Laws and processes governing the regulation of the nonfinancial private sector are generally clear.** (1.1.5)

Costa Rica has undertaken substantial reforms aimed at improving the procedures and regulatory environment in which the private sector operates. The Law on Consumer Protection and Competition (No. 7472) created the national deregulation commission, with the main goals of deregulating and simplifying procedures, and the Law on the Protection of Citizens from Excessive Requirements and Administrative Procedures (No. 8220) established important new instruments for protecting private sector activity, including the principle of “positive silence” in public administration decisions. However, in sectors with significant state presence, a coherent and clear legal framework needs to be further developed. For instance, according to a recent World Bank report on the investment climate in Costa Rica,<sup>14</sup> there appears to be a lack of clarity on legal rights for independent power generators, and there are legal gaps and preferential treatments in the allocation of rights for the use of hydro resources. In addition, rice producers currently benefit from a monopoly over the importation of rice (to meet demand in excess of what can be produced domestically), which hinders competition in this market and renders state support to rice producers nontransparent.<sup>15</sup>

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<sup>12</sup> *Ley General de Concesión de Obras Públicas con Servicios Públicos*, No. 7762. The law defines concessions quite broadly to include arrangements whereby third parties (public, private or mixed) execute and finance public investments, and provide associated services as applicable; these are consistent with PPP-type arrangements.

<sup>13</sup> The San José-Caldera and the San José-San Ramón road concessions were granted, respectively, in 2001 and 2002, but construction of those roads has yet to begin. The Calderas Port, the only successful concession granted under the Law on Concessions, was transferred to the private sector last year, almost six years after its concession process was initiated.

<sup>14</sup> Costa Rica Investment Climate Assessment, World Bank Report No. 35424-CR of November 15, 2006.

<sup>15</sup> Law No. 8285 of May 2002.

## Government relations with the central bank and public financial sector

### 8. **The Central Bank of Costa Rica (CBCR) is operationally independent, and its financial relationship with the government is clearly defined in law.** (1.1.4)

The CBCR Organic Law<sup>16</sup> establishes the administrative independence of the central bank and states that its main objective is to maintain the internal and external stability of the currency. However, the central bank's large quasi-fiscal losses have complicated the management of monetary policy<sup>17</sup> (Box 2). The CBCR board is composed of seven members, including the president of the central bank and the minister of finance. The CBCR president is appointed by the government for a period of four years, but could be removed at any time at the discretion of the president of the Republic. The other five members of the CBCR board are proposed by the executive branch and ratified by the Assembly to serve staggered periods of 90 months. The budget of the CBCR is approved by its board and ratified by the CGR. Article 10 of the CBCR Organic Law clearly spells out rules for the use of central bank profits, and no profit transfers to the budget are envisaged in the law. The central bank is forbidden to finance the government in amounts in excess of 5 percent of the national annual budget, and any such financing must be reported immediately to the Assembly. In practice, the CBCR has not financed the budget for at least a decade. The central bank provides remunerated treasury services to government, but single treasury account (STA) balances at the central bank are not remunerated.

### 9. **Public financial corporations do not carry out noteworthy QFAs.** (1.1.4)

As mentioned above, government presence in the financial sector is extensive. The state-owned banks, which account for some two-thirds of total bank assets, operate on a commercial basis and do not engage in QFAs, although they enjoy a privileged position in the market relative to the private banks.<sup>18</sup> Any limited lending at non-market rates is done only with full compensation by the public entities promoting the lending.

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<sup>16</sup> *Ley Organica del Banco Central*, No. 7558 of November 1995.

<sup>17</sup> Information about CBCR's net worth position and quasi-fiscal losses is available on its website on a monthly basis.

<sup>18</sup> There is a blanket deposit guarantee for state-owned banks; private banks are required to place 17 percent of their deposits in state-owned banks in the form of partially-remunerated deposits (at half of the average deposit rate in the banking system); and all public sector entities are required to use state-owned banks for their banking needs.

### **Box 2. Recapitalization Needs of the Central Bank**

The CBCR has a large negative net asset position, resulting in sizable quasi-fiscal losses. The central bank's negative net worth is estimated at US\$ 2.2 billion (more than 10 percent of GDP) as of end-2006, with quasi-fiscal losses of around 1.2 percent of GDP in 2006. The main factors behind the negative net worth include:

- a. a large accumulation of liabilities during the 1980s due to the issuance of debt to cover losses from foreign exchange subsidies for debt service and imports by public sector entities, and from the provision of subsidized credit to the government and the private sector;
- b. an accumulation of non-earning assets in the 1990s related to short-term credits to Nicaragua (3 percent of GDP) and the liquidation of a state-owned bank (1 percent of GDP); and
- c. the costs associated with sterilized intervention in the foreign exchange market through open market operations carried out with central bank bonds.

Large quasi-fiscal losses complicate the management of monetary policy. In particular, these losses tend to: (i) inhibit a lasting reduction in inflation because the inflation tax continues to be an important source of financing; (ii) complicate the policy response to adverse shocks because a tightening of credit conditions would worsen the quasi-fiscal balance; and (iii) prevent a full shift to open market operations (in an attempt to reduce sterilization costs, the central bank has raised nonremunerated reserve requirements up to 15 percent, the maximum allowed, de facto imposing an intermediation tax on banks).

Previous efforts to address the central bank's quasi-fiscal losses have proven insufficient, and the central bank still needs to be recapitalized in amounts sufficient to restore its long-term solvency in a low inflation environment. The current administration has been engaged in serious efforts to address the quasi-fiscal losses and has drawn up a comprehensive recapitalization plan; this had to be shelved, however, until congressional approval of a proposed tax reform package could provide adequate resources to finance it. In April 2007, the authorities announced a shorter-term recapitalization plan that envisages some transfer of resources during 2007–08, by way of ensuring that immediate inflation objectives are met.

## **Fiscal management relations among the branches of government**

### **10. The fiscal roles of the executive, legislative and judicial branches are clearly defined in law.**

(1.1.2)

The Constitution assigns to the Assembly the approval of the central government's budget, with the power to increase total budgeted spending only if offsetting revenues are identified. The Assembly also has the exclusive right to approve taxes and is required to approve all external loans of public sector institutions. All disputes related to the budget process as set out in the Constitution are resolved by the constitutional chamber of the supreme court of justice (*Sala Constitucional*),<sup>19</sup> which has been very active in the fiscal area.

<sup>19</sup> See the Organic Law of the Judicial Power, No.7333.

## Fiscal management relations among different levels of government

### 11. The responsibilities of different levels of government are relatively well defined. (1.1.2)

There are 102 local governments, but these are small and account for less than 4 percent of general government spending. Article 170 of the Constitution assigns 10 percent of national government revenue to municipalities, but in the absence of a law that would devolve expenditure responsibilities to them (as required by the Constitution) this provision is not in effect. Municipalities provide traditional municipal services, such as maintenance and development of local roads and parks, waste collection, local power provision, and police services, and obtain revenue from various charges for these services,<sup>20</sup> from own taxes they can introduce with the approval of the Assembly, and from earmarked shares of various taxes.<sup>21</sup> While these shares and their distribution among the municipalities are not clearly defined,<sup>22</sup> the amounts involved are small. The Constitution establishes that municipal governments approve their own budgets, with its subsequent endorsement and monitoring of execution by the CGR.

## The legal and administrative framework for budget management

### 12. The overall budget framework is clear but fragmented: (1.2.1)

- The Constitution provides the basis for the budgetary process by: (i) establishing the deadlines for the presentation of the budget to the Assembly and its approval; (ii) giving the Assembly responsibility for approving the budgets of the ministries, autonomous powers (Assembly, supreme court of justice and the election tribunal) and their dependencies (i.e., budgetary central government), which are prepared by the executive; (iii) requiring that budgetary allocations to education be at least 6 percent of GDP, to municipalities 10 percent of government revenue, and to the judiciary 6 percent of government revenue; (iv) allowing the Assembly to modify overall spending limits only if offsetting revenues are identified; (v) setting deadlines for final account submission to the CGR and to the Assembly. The Constitution also sets a separate budget track for the institutions outside the budgetary central government: it gives the CGR responsibility for approving the budgets of the municipalities, autonomous institutions (state-owned banks and insurance companies, state universities, the Social Security Fund (*Caja Costarricense de Seguro Social*, CCSS) and other institutions to whom autonomy is granted by law), whose budgets are not approved by the Assembly. Finally, the Constitution gives CGR responsibility for the external audit of all public sector institutions, establishes the principles of the STA under the management of the Treasury and of the use of public tenders for all

<sup>20</sup> As set in the Law on Municipalities, No. 7794.

<sup>21</sup> For example, municipalities receive up to 7.5 percent of the fuel tax (Law No. 8114), and a share of the fees on banana exports (Law No. 7317), exit tax (Law No. 8316), and transit penalties (Law No. 7331).

<sup>22</sup> The *Ley de Simplificación y Eficiencia Tributaria*, No. 8114, assigns up to 7.5 percent of the fuel tax to municipalities, but the actual share is determined as a residual after road spending is accommodated. Although the same law defines how the share of the fuel tax should be divided up among municipalities, in practice transfers are made directly to a council of municipalities, which then distributes the proceeds among the municipal governments.

purchases by public institutions (with exceptions established in law), and establishes the financing of the CCSS through mandatory contributions of employees and employers, and through residual budget financing of its deficit.<sup>23</sup>

- The framework for public financial management is further developed in the Financial Management Law (FML)<sup>24</sup> and its regulations.<sup>25</sup> These guide public sector financial management with regard to the budget process, cash management and the STA, public sector debt, government accounting, and public sector assets. Each of these systems is managed by a general directorate in the MOF, whose functions are clearly defined and regulated. While the provisions of the law apply to all public sector institutions, the FML limits the oversight of the MOF to the central government, autonomous powers, and their dependencies (i.e., budgetary central government). Oversight responsibility for the institutions outside the budgetary central government is given to CGR, which oversees accounting, procurement, and budgeting procedures of these institutions, and approves their budgets.
- With a view to coordinating policies across budgetary and nonbudgetary institutions, the FML gives the budgetary authority—a collegiate body consisting of the minister of finance, the planning minister, and a third minister chosen by the President of the Republic, whose technical secretariat operates from the MOF—the power to oversee overall public sector spending and issue annual budget guidelines to the public sector, although a large number of institutions (universities, municipalities, CCSS, banks, and some nonfinancial corporations) are exempt from these guidelines. The annual budget guidelines set the overall spending envelope for the public sector institutions and are issued by end-March of each year. Overall, the legal framework for fiscal management is oriented toward the fulfillment of financial objectives and legal compliance.

### **13. Extrabudgetary activities are extensive and the mechanisms for the coordination and management of budgetary and extrabudgetary activities are partially in place. (1.1.3)**

Extrabudgetary activities are largely those related to the deconcentrated and decentralized institutions that have budgetary autonomy and are not included in the Assembly-approved budget, as well as some trust funds that are not captured in the public sector statistics. Although these autonomous institutions are responsible for preparing their own budgets, they are in principle subject to the annual budget guidelines issued by the budgetary authority. In practice, however, many institutions have been exempt from these guidelines, including the CCSS.<sup>26</sup> Apart from the overall budget envelope set by the

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<sup>23</sup> The Constitution regulates constitutionally-mandated earmarking for education, municipalities, and the judiciary in Articles 78, 170, and 177, respectively; government budgeting in Articles 176–81; the provisions with regard to the CCSS in Articles 73 and 177; and treasury operations in Articles 185–87.

<sup>24</sup> *Ley de Administración Financiera de la Republica y Presupuestos Públicos*, No. 8131 of October 16, 2001.

<sup>25</sup> Decree No. 30058-H-MP-PLAN of April 9, 2002; amended by Decree No. 32988-H-MP-PLAN of April 18, 2006.

<sup>26</sup> For instance, the CCSS, a decentralized institution, is the main part of the general government outside the Assembly-approved budget process. It manages resources amounting to 8 percent of GDP, mainly collected

(continued

... )

budgetary authority, there seems to be little coordination of policies across budgetary and extrabudgetary institutions.

**14. There is significant revenue earmarking in the budget.** (1.1.3)

Legal spending mandates (*destinos específicos*) are estimated to earmark some three-quarters of available revenue. Together with nondiscretionary spending, this would bring mandatory spending in the budget to over 100 percent of revenue. Apart from contributing to substantial budget rigidity, this renders the budgetary process nontransparent and gives misleading assurances to the public that legal spending mandates can be undertaken (see Box 3 for a more detailed discussion). It also forces a discretionary scaling-down of mandates and puts the fiscal authorities in a difficult legal position. Draft legislation has been prepared by the government to phase out unfunded spending mandates created by legislation, to help restore the budget process as the proper place for defining spending priorities subject to available resources.

**The legal and administrative framework for tax policy and administration**

**15. The legislative basis for taxation is generally clear and comprehensive, but tax exemptions are extensive and tax expenditures are not reported.** (1.2.2)

Article 121 of the Constitution establishes that only the Assembly can create taxes, and Article 5 of the Tax Code<sup>27</sup> specifies that the Assembly can create, modify, or repeal taxes. Four major categories of taxes are collected: (i) on income (both personal and corporate); (ii) on goods and selected services (general sales tax and excises); (iii) on property; and (iv) on imports. In addition, the CCSS collects mandatory contributions for pension and health. The income tax has several exemptions (including to enterprises in free trade zones,<sup>28</sup> industrial cooperatives, and labor associations), and firms are subject to different rates (according to their level of gross income). The general sales tax is an imperfect VAT in that: (i) its tax credit system is based on the physical (rather than financial) usage of intermediate products in the production process; and (ii) many goods and most services are not subject to the general sales tax.<sup>29</sup> The government has organized better the system of tax exemptions with the creation of Exonet, an online software that taxpayers must use to apply for tax exemptions, and currently more than 150 types of exemptions are covered by Exonet. The tax administration does not have a global estimate of foregone revenue due to tax exemptions, and partial estimates are available for the cost of income tax exemptions (neither these estimates nor the methodology used in the calculation is published).

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through mandatory social contributions, and its budget is prepared by the CCSS board and approved by the CGR.

<sup>27</sup> Code on Norms and Tax Procedures, Law No. 4755.

<sup>28</sup> The exemption is 100 percent for the first eight years and 50 percent for the next four years. In nondeveloped areas, the exemption is 100 percent for 12 years and 50 percent for the next four years. Exemption periods can be extended according to minimum reinvestment requirements.

<sup>29</sup> General sales tax exemptions include items in the basic basket of consumption, medicines, veterinary products, agricultural inputs and machinery, and fishing inputs.

### Box 3. Earmarking in Costa Rica's Budget

The transparency and efficiency of the budgetary process in Costa Rica is hampered by pervasive earmarking. It is estimated that earmarked spending mandates account for some ¾ of available revenues in 2007. Together with nondiscretionary spending on wages, pensions and interest, this brings mandatory spending in the budget to potentially 160 percent of available revenues <sup>1/</sup> (Table A). Apart from contributing to substantial budget rigidity, this introduces significant opacity into the budget because it gives misleading assurances that the spending mandates could be undertaken. The implementation of these mandates is clearly unfeasible, and in practice the government has accommodated about half of the total spending earmarked by legislation, forced to exercise discretion in the allocation of the scarce resources.

There are two main sources of earmarking—the constitution and the tax legislation—that together assign some 10 percent of GDP to specific spending objectives:

- The Constitution requires that (i) at least 6 percent of GDP be spent on education every year (Article 78); and (ii) at least 6 percent of budgeted revenues (equivalent to about 0.8 percent of GDP) be transferred to the judiciary (Article 177).
- There are, in addition, 33 laws that create 56 spending mandates without always identifying their funding sources. The total size of such mandates is estimated at some 3 percent of GDP (Table A).

Given the infeasibility of meeting these mandates within the envelope of available resources, these could only be partially included in the annual budget. Some of the executive's decisions to scale down the mandates have been appealed in the constitutional court, whose decisions—until about 2004—were supportive of the executive's right to only budget the amounts within existing resources. More recent decisions, however, have tended to insist on the executive's legal obligation to fully budget the mandates.

The authorities have prepared a draft "Law on Fiscal Transparency" for submission to the assembly that seeks to eliminate all unfunded spending mandates created by legislation.

**Table A. Mandated Earmarking in the 2007 Budget**

	Percent of GDP	N <sup>o</sup> of mandates
<b>Total Earmarked Mandates</b>	<b>9.9</b>	<b>58</b>
<b>Earmarking in legislation</b>	<b>3.1</b>	<b>56</b>
Sales tax	1.2	2
Fuel tax	0.6	3
Housing Bank 1/	0.6	1
Income tax	0.4	6
Other	0.4	44
<b>Earmarking in constitution</b>	<b>6.8</b>	<b>2</b>
Education	6.0	1
Judiciary	0.8	1
<b>Memorandum Items:</b>		
Nondiscretionary spending	12.5	...
Wages	5.9	...
Pensions	2.7	...
Interest	3.9	...

Source: Ministry of Finance and staff estimates.

1/ Assigned 3 percent of total budget spending.

<sup>1/</sup> This estimate exaggerates the true extent of earmarking, as it double-counts the nondiscretionary spending that counts towards satisfying the earmarked mandates (for example, a large share of earmarked mandates for education and the judiciary is met through wage spending). The data were not readily available, however, to eliminate the double-counting.



**16. The tax and customs administrations are clearly defined and well coordinated with overall fiscal management.** (1.2.2)

The general directorate for taxation (DGT) is in charge of the collection of domestic taxes, and the general directorate for customs (*Aduanas*) of foreign trade taxes. The heads of both institutions report directly to the MOF's vice-minister for revenue. DGT and *Aduanas* are organized functionally and share a common taxpayer identification number, but there seems to be a lack of coordination in the process of auditing taxpayers. Tax and customs administration officials do not seem to have discretion in the determination of tax liabilities and exemptions, which are defined in legislation approved by the Assembly. Case-by-case negotiation of tax liabilities is not allowed, but there is room for negotiation in the settlement of tax arrears, including through the determination of installment payment schedules. There is a code of conduct for tax and customs officials,<sup>30</sup> and other norms also establish ethical principles in the civil service, including the civil service statute,<sup>31</sup> the MOF's autonomous regulation,<sup>32</sup> and the recently-issued ethical principles for public servants (see below).<sup>33</sup> The CCSS and DGT share information on taxpayers.

**17. Taxpayers' legal rights are well defined, but there are delays in the resolution of complaints.** (1.2.2)

Taxpayers' legal rights are set forth in the Tax Code and the Customs Law.<sup>34</sup> Taxpayers have, inter alia, the right of confidentiality and hearings to express their views on decisions taken by the tax and customs authorities. In the case of domestic taxes, taxpayers are given 30 days to appeal for a reversal or reconsideration of a decision. The DGT has three months to study the case further and, after this period has elapsed and the decision not reversed, the taxpayer has 15 days to insist on the appeal. The DGT then has one month to issue a final decision, which can be appealed to the fiscal court (the last administrative instance) within 15 days. In the case of foreign trade taxes, the law establishes a clear timetable for appeal (23 days), study of the case (10 days), further appeal (three days), final decision by *Aduanas* (three days), and appeal to the customs court (10 days). These timetables, however, are not usually met, and there are delays in the resolution of tax disputes. Taxpayers have the right to judicial recourse at any stage of the administrative appeals process.

**Public servants' code of behavior and anti-corruption activity**

**18. Public servants are subject to a well-defined code of behavior.** (1.2.3)

Legislation to fight corruption has improved significantly during the last decade. Costa Rica signed the Inter-American Convention Against Corruption in 1996, and in 2004 issued the Anti-Corruption Law (No. 8422) and guidelines to strengthen public administration control. A relatively large number of high-profile embezzlement, fraud

<sup>30</sup> Decree No. 9264 – H of February 2001.

<sup>31</sup> Law No. 1581 of May 1953, Article 39.

<sup>32</sup> Decree No. 25271-H of June 1996.

<sup>33</sup> Decree No. 33146 of May 2006.

<sup>34</sup> *Ley General de Aduanas*, Law No. 7557.

and corruption cases have been submitted to the prosecution in recent years, with a free and assertive press playing an instrumental role in investigating corruption cases. In a show of strong political support in the fight against corruption, the current administration issued a code of behavior for public servants in May 2006, establishing the key principles of integrity, objectivity, accountability, transparency, honesty, rationality, leadership for public servants, as well as the procedures for the general public to make a formal complaint against public servants. It is too early to assess, however, how well the code will perform in fighting corruption and abuse of office.

## **B. Open Budget Preparation, Execution, and Reporting**

### **The budget preparation process: clarity and consistency of process and presentation**

#### **19. The annual budget preparation process is open but fragmented.** (3.2.1)

The budgetary central government follows a separate process from that of the rest of the general government:

- For the budgetary central government, the budget is on a calendar-year basis and its timetable is well-established (Box 4). Budget preparation begins with the budgetary authority defining broad guidelines on public expenditure growth, financial investment, debt, monitoring and evaluation, and public sector employment policy.<sup>35</sup> On the basis of these guidelines and a circular released in April by the MOF, ministries and budget units in turn prepare their budget proposals and submit them to the MOF. After negotiation and the approval of the council of ministers, the budget is submitted to the Assembly by September 1, with a certification of the adequacy of the revenue forecasts and of the government's additional debt capacity, by the CGR and the CBCR, respectively. The Assembly debates and approves the budget by end-November. Expenditure figures in the budget documents are presented in gross terms and according to institutional, economic, functional and program classifications. The budget for each institution contains information on its mission, expenditure priorities, and performance indicators.

The budgetary process for the rest of the general government has also been defined in the law (Box 5).<sup>36</sup> The process begins with the budgetary authority defining broad budget guidelines that set the overall targets for fiscal policy and the levels of government expenditure, where applicable.<sup>37</sup> On the basis of these guidelines and a circular released in April by CGR, the budgets of these spending units are first approved internally by their respective boards and then submitted for approval to CGR by end-September.

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<sup>35</sup> The guidelines of budgeting policy and employment for public entities, ministries and other institutions, where applicable, under the mandate of the budgetary authority for 2007, issued on March 30, 2006. These guidelines are followed by detailed procedures.

<sup>36</sup> The Municipal Code (Law No. 7794) regulates the budget process for municipalities.

<sup>37</sup> Under budgetary authority guidelines, some or all aspects of the expenditure of ICE, RECOPE, INS, and others are exempt.

<b>Box 4. The Budget Preparation Process for the Budgetary Central Government</b>		
<b>Due dates</b>	<b>Activities</b>	<b>Legal basis</b>
The fiscal year is set on a calendar-year basis by the constitution and budget process legislation. The main steps in the process are as follows:		
March 30	Public sector expenditure guidelines are issued by the budgetary authority	Art. 21 and 23, Law 8131 and Art. 12 and 13 of Regulation
April 15	Budget circular is issued by MOF	Art. 37 of Regulation, Law 8131
June 15	Budget proposals are submitted to the MOF	Art. 34 of Regulation, Law 8131
September 1	Cabinet-wide decision-making on remaining budget issues; submission of budget draft to the Assembly	Art. 38 of Regulation, Law 8131
September 30	The Comptroller General sends to the Assembly a technical evaluation of budget prepared by executive	Art. 40, Law 8131
October 20	Budget approval in the budget committee for fiscal affairs	Art. 178 of Regulation of National Assembly
November 1	First discussion in full session of the Assembly	Art. 179 of Regulation of National Assembly
November 30	Approval of budget by the Assembly.	Art. 125 of Constitution

<b>Box 5. The Budget Preparation Process for Deconcentrated Units, Decentralized Institutions and Municipalities</b>		
<b>Due dates</b>	<b>Activities</b>	<b>Legal basis</b>
The main steps in the process are as follows:		
March 30	Public expenditure guidelines are issued by the budgetary authority, where applicable	Art. 21 and 23, Law 8131 and Art. 12 and 13 of Regulation
April	CGR sends out the budget circular	
May-September	Preparation of budgets and annual operational plans according to CGR guidelines	CGR Manual Art 554
September 30	Draft budget presented to CGR for legal approval	Art. 19, CGR Organic Law; Municipal Code (Law 7794)
Not indicated	Formal approval of budget by CGR	

## **The macroeconomic framework and policy basis for the budget**

### **20. The budget document focuses narrowly on the budgetary central government and discusses its primary and overall balances.** (3.2.3)

The budget presentation discusses policy objectives in terms of the primary and overall balance of the budgetary central government, although these are not presented in any of the accompanying tables. Budget documents do not provide any information about the direction of fiscal policies at the general government level. Budget execution data for all public sector institutions are in principle available at the CGR with monthly frequency, but these are not consolidated or analyzed. Budget execution data are also available at the MOF on a monthly basis for the budgetary central government and on an annual basis for the entire public sector, albeit with some limitations on institutional coverage; these are the data disseminated to the public.

### **21. Budget forecasts and underlying macroeconomic assumptions are clearly presented in the budget documents.** (3.1.3)

Macroeconomic forecasts underpinning the budget are prepared by the CBCR in the context of its annual monetary program, although forecast models are not disclosed. The budget documents clearly present the assumptions and discuss how these affect budget projections. Budget revenue projections need to be certified by the CGR (in an accompanying document), and revenue projections are usually vetted and agreed upon between the MOF and CGR prior to the presentation of the budget to the Assembly.

## **Medium-term planning and analysis of fiscal risks**

### **22. Medium-term fiscal policy objectives and fiscal sustainability analysis are not included in the budget documents.** (3.1.1)

The preparation of the budget focuses on the fiscal year. Annual fiscal policy objectives and priorities are defined in the budget proposal submitted to the Assembly. Medium-term macroeconomic and fiscal projections are not included, nor does the budget documentation include any analysis of the sustainability of fiscal policy.<sup>38</sup> No work has been done to prepare a quantitative and detailed medium-term expenditure framework, taking into account the impact on recurrent expenditure of the investment initiatives described in the National Development Plan (NDP). However, the MOF has plans to frame the 2008 budget in a medium-term context.

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<sup>38</sup> Article 36 of the FML requires that the draft budget documents to be presented to the Assembly include a medium-term qualitative and quantitative assessment of revenue, expenditure, and financing. In addition, Article 38 of the same law states that the draft budget documents must include an annex on multi-year commitments and an analysis of macroeconomic and financial issues for at least five years.

**23. The golden rule is established in the budget legislation,<sup>39</sup> but has only become effective last year.** (3.1.2)

Transition Article V of the FML establishes that the golden rule—which prohibits borrowing to meet recurrent expenditures—must be adhered to only from 2006 onward. CGR annual reports indicate that little progress has been made toward meeting the rule between 2002 and 2005, but no information is yet available for 2006.<sup>40</sup>

**24. Estimates of new initiatives and ongoing costs of government policies are not clearly distinguished in the budget documents.** (3.1.4)

Budget documents sent to the Assembly do not clearly distinguish between ongoing costs of activities from new spending proposals introduced in each year's budget.

**25. The sensitivity of budget estimates to changes in economic variables is not assessed, and fiscal risks are not quantified nor discussed in the budget documents.** (3.1.5)

**Clarity of control of budget execution**

**26. Internal control and accounting procedures are in place.** (3.3.1)

The overall framework for internal control is set by the Internal Control Law (No. 8292) and by the overall guidelines issued by the CGR, which oversees the internal control and audit system.<sup>41</sup> The implementation of controls is the responsibility of the internal control units of each public institution. Accounting principles support the accrual and cash recording for revenue and expense. The accounting office in the MOF is in charge of preparing and elaborating a chart of accounts (CoA) to be applied by all public entities. Currently, the accounting office has only prepared a CoA for the budgetary central government and some formats for collecting financial information for the rest of public entities. There is no unified CoA for the rest of the general government. Budgetary central government units are part of the STA, and nonbudgetary institutions receive transfer payments from the central government through the STA. The CGR has the authority to review and report on accounting procedures, and to regulate and evaluate internal control and internal audit systems.<sup>42</sup>

**27. Debt and cash management practices are well coordinated.** (3.3.1, 2.1.4)

The framework for financial management is set out in the FML and other regulations, and both debt and cash management are under the treasury department of the MOF. The treasury prepares annual and quarterly cash plans, but cash planning could be improved through the provision by line agencies of better information on their forward expenditure plans. The public debt directorate of the treasury is responsible for the issuance and management of debt, and produces regular reports on the stocks and profile of public

<sup>39</sup> Article 6 of the FML. However, the use of cash accounting may lead in practice to the application of a modified golden rule in that the financing of gross (rather than net) investment by borrowing is permitted.

<sup>40</sup> CGR annual report for 2005, p. 78–79.

<sup>41</sup> Article 7 of Law No. 8292.

<sup>42</sup> The CGR's internal control and audit oversight is established in the CGR Organic Law and the Internal Control Law.

debt. Domestic debt issuances are coordinated closely with the central bank. Data management systems, such as the securities management system (STAV) for domestic debt and the financial analysis and debt management system for external debt, provide relevant but partial information for GFS compilation in line with the *GFSM 2001* requirements.

**28. Internal audit could be more effective.** (3.3.3)

Government regulations on internal control and audit establish a system of internal audit for budget units.<sup>43</sup> These regulations provide for the functional independence of internal auditors<sup>44</sup> and their reporting responsibilities,<sup>45</sup> stipulate what is expected from each budget unit, and specify the rules of procedure governing the internal audit function. However, there appears to be a need to develop more formal work plans and to establish effective internal audit committees in a range of areas (including accountability and governance arrangements, and risk-based internal audit planning and implementation) to improve the effectiveness of internal controls.<sup>46</sup>

**29. Procurement rules are clear and publicly available, but implementation is fragmented and there is no system-wide coordination or monitoring.** (3.3.2)

The FML and the Procurement Law<sup>47</sup> provide a sound basis for open and competitive, albeit cumbersome, procurement practices. Until recently, all procurement contracts required ex-ante CGR approval before being awarded,<sup>48</sup> taxing considerably CGR's administrative capacity. A new regulation issued in March 2006 limits ex-ante approval to public tenders (still accounting for some 80 percent of procurement) and to direct contracting that invokes the "public interest" clause in the procurement legislation.<sup>49</sup> Responsibility for implementing the overall procurement framework, nevertheless, is devolved to individual institutions, and oversight of the procurement system is shared between the MOF and CGR. In particular, the MOF's general directorate for asset management and procurement (DGABCA) oversees central government procurement (about 8 percent of all public sector procurement) and the CGR oversees the rest, where the bulk of purchases are done. The two systems use different procedures, information systems, and reporting requirements, with seemingly limited coordination, which hampers a comprehensive evaluation of procurement practices.

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<sup>43</sup> Internal audit has a legal basis in Articles 20–38 of Law No. 8292.

<sup>44</sup> Articles 21 and 25 of Law No. 8292.

<sup>45</sup> Under Article 24 of Law No. 8292, the internal audit units report directly to the highest authority in each entity, who appoints the head of the audit unit.

<sup>46</sup> Estado de la Nación Report No. 12, 2005, p. 292.

<sup>47</sup> *Ley de Contratación Administrativa*, No. 7494.

<sup>48</sup> According to an interpretation provided in 1998 by the *Sala Constitucional*.

<sup>49</sup> The procurement legislation allows for direct contracting under specific condition related to the size of the contract and to situations for which direct contracting would serve "public interest." In light of the open nature of this latest provision, CGR approval is required for the use of direct contracting invoking this provision.

**30. Civil service employment procedures are clear and well understood for entities of the budgetary central government.** (3.3.2)

All statutory employment decisions at the budgetary central government are handled by the general directorate of the civil service (GDCS). The statute of the civil service<sup>50</sup> regulates the selection, entry, career development, and scale of salaries in this part of the public sector. It clearly establishes the mechanism to fill vacancies, which includes four options: (i) bringing an employee from another office; (ii) promoting an employee; (iii) internal competition; and (iv) open competitions, which have to be publicly advertised. In the latter case, the government entity must submit the employment requirement to the GDCS, which then oversees the screening of applicants and submits to the entity a list of three names. There are positions that are not subject to this process, particularly the top executives of ministries and advisors. The rest of the public sector has more flexible rules of selection and the capacity to offer better salaries.

**Clarity of internal control and independence of tax administration**

**31. Tax administration has effective internal monitoring and control mechanisms.** (3.3.3)

The MOF has an internal audit unit which is responsible for supervising and auditing the integrity and professionalism of tax administration officials. Its objective is to verify that management procedures are carried out in accordance with the law, internal rules, and general civil service regulations. There has been a recent improvement in the extent of computerization of the system: *Aduanas* has been working since last year with a modern information system, the information technology for customs control (TICA), that has reduced further the discretion of tax officials in determining tax liabilities and has yielded considerable customs revenues. The DGT has also improved its information systems, and medium and large taxpayers must now declare and pay taxes by internet.

**32. The tax and customs administrations are not given legal protection from political interference.** (3.3.4)

Both *Aduanas* and DGT depend administratively on the MOF's vice-ministry for revenue and do not enjoy budgetary nor administrative independence. Their budgets are part of the budget of the MOF, and they do not have administrative discretion in managing them. However, limitations on the firing of tax and customs officials are set forth in the civil service statute, the MOF's internal labor regulation, and the Tax Code. The administrative fiscal court and the customs fiscal court, which are the last administrative appeal instances, are legally autonomous in their decisions, which helps ensure transparency.

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<sup>50</sup> Law No. 1581 of 1953.

## Accounting and reporting on budget execution

### 33. The accounting system is capable of producing accurate within-year reports on central government cash budget execution. (3.3.1)

Monthly cash budget execution reports are prepared by the end of the following month and information on commitments to monitor payment arrears is also available.<sup>51</sup> The MOF uses the integrated system of financial administration management (SIGAF) for budgetary central government operations, and the budgetary authority uses the data consolidation system of the Costa Rican public sector (SICCNET) for consolidating financial information from the central administration, autonomous powers, decentralized agencies, deconcentrated institutions, and public sector enterprises. The SICCNET was created to manage budgetary information on a cash basis and is utilized as a reporting mechanism by the budgetary authority. The SIGAF needs to be adjusted to incorporate the recording of nonfinancial assets and the valuation of assets and liabilities for a complete harmonization with *GFSM 2001* methodology.

### 34. Fiscal reporting covers the budgetary central government on a monthly basis and consolidated public sector on an annual basis. (3.3.1, 2.1.1)

Monthly data on the budgetary central government are produced by the accountant's office of the MOF, are relatively reliable, and are disseminated to the public through the monthly reports of the CBCR. Consolidated accounts for the public sector are produced by the same office, which is also responsible for sending consolidated data on budget execution to the CGR by March 1.<sup>52</sup> However, the quality and coverage of consolidated fiscal data may be adversely affected by the fact that: (i) several institutions do not report data; (ii) different accounting methodologies are used; (iii) the legislation establishes a quick turnaround for the consolidation of data (15 days);<sup>53</sup> and (iv) there is a lack of proper information systems to consolidate data automatically.

### 35. The Assembly does not undertake a mid-year budget review, and is not presented with in-year budget execution reports. (3.4.1)

### 36. Audited final accounts are available within six months of the end of the fiscal year. (3.4.2)

Article 184 of the Constitution and Article 32 of the Organic Law of the CGR require that the CGR submit to the Assembly a report on the final accounts of the previous year by May 1.<sup>54</sup> The most recent CGR report had a negative opinion on the 2005 final accounts,

<sup>51</sup> The information on a commitment or accrual basis is somewhat less reliable, with weaknesses persisting especially in the recording of interest accrued on zero-coupon bonds. This interest is recorded above the line when the bond matures and the payment is due, and is not allocated over the accounting periods throughout the life of the bond, as envisaged in the *GFSM2001*. This understates the central government accrual deficit by  $\frac{1}{2}$  to  $\frac{3}{4}$  percent of GDP.

<sup>52</sup> Article 52 of the FML and Article 124 of its regulation.

<sup>53</sup> Public institutions present data to the accountant's office by February 16, and consolidated data need to be presented to the CGR by March 1.

<sup>54</sup> CGR annual reports contain a statistical supplement with information on public sector revenue, expenditure, financing, and debt for the central government, general government, and public enterprises.



identifying several shortcomings in budget execution, accounting results, public sector asset management, public sector consolidated financial statements, and treasury and debt statements.<sup>55</sup>

### **Results-oriented budgeting and reporting**

**37. The objectives and expected results from government activities are presented in the budget documents, but the evaluation process of annual spending indicates that deficiencies remain in determining what was actually achieved.** (3.2.2, 3.4.3)

A national system of performance evaluation has been developed and implemented in the operating plans of spending units, and the objectives of major budget programs are presented to the Assembly in the budget documents (Box 6). According to the law, spending units must submit biannual reports on execution (against expected results) to the MOF, the budgetary authority, and the ministry of planning,<sup>56</sup> with an annual report on execution and results being submitted to the Assembly.<sup>57</sup> In 2005, however, several deficiencies were reported in linking expected results with information provided by general government institutions.<sup>58</sup>

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<sup>55</sup> CGR Annual Report, 2005, p. 112.

<sup>56</sup> Articles 71–77 of the regulation of the FML.

<sup>57</sup> Article 73 of the regulation of the FML.

<sup>58</sup> CGR Annual Report, 2005, p. 118.

### **Box 6. The National Development Plan and the Budget Process**

Each incoming government develops a four-year national development plan (NDP) that guides medium-term economic policies and that underlies the operational planning and budgetary process of all public institutions. The key legislation behind the development of the NDP are the Planning Law (No. 5525) and the FML.

- The Planning Law establishes that the planning ministry is responsible for putting together the NDP and for ensuring that the investment plans of all public sector institutions are consistent with the priorities established in the NDP.
- The FML further links the NDP with the budget process and the annual operational plans of the public institutions. It states that the NDP is the overall framework that should guide the annual operating plans (AOP) of the public institutions, which in turn are the basis for their annual budgets. To ensure consistency with the NDP, budgetary central government institutions need to develop their investment plans taking into account the objectives and priorities established in the NDP, and these need to be subsequently endorsed by the planning ministry. Further, the budgetary central government institutions need to present their AOP to the planning ministry by April 30, and the rest of the public sector institutions, whose budgets are approved by the CGR, need to present their AOP to the CGR by July 16; these plans should be consistent with the AOP guidelines set forth by the planning ministry, MOF, and the budgetary authority.
- The FML also requires that by March 1 of every year the planning ministry present to the CGR a report evaluating budget execution over the previous year, especially with regard to the implementation of the goals envisaged in the NDP, and including explanatory notes discussing performance vis-à-vis the NDP targets, the effectiveness of spending, the unitary costs of services provided, and the efficiency of use of public resources. Semiannual reports on the implementation of the NDP are to be submitted by the public institutions to planning ministry, MOF, and the Assembly.

In the past, however, the NDP has not been an effective tool for strategic planning and policy-making, as it did not have a unified vision across and within economic sectors and there was little coordination across public institutions. The NDP tended to include an excessive number of performance indicators (over 1,600), many of which were neither measurable nor had relevance to the spending programs; this made a meaningful monitoring and evaluation of performance difficult. As a result, the NDP and performance orientation of the budget process lost relevance, the public institutions have not adopted performance budgeting as a planning tool, and the system of national investment planning collapsed.

Based on this experience, the government that took office in 2006 sought to revamp the NDP process, and turn it into an authentic policy instrument. The preparation of the 2006–10 NDP, which was issued in January 2007, was based on a coordinated effort across all public sector institutions, which were grouped by economic sectors, with each sector asked to contribute to a more focused list of about 10 strategic goals for each sector. These goals were supported by a number of spending programs and projects, as well as performance tracking indicators, which will help evaluate their effectiveness. The 2008 budget process will be guided by the 2006–10 NDP.

### C. Public Availability of Information

**38. Annual fiscal information is fairly comprehensive and readily available to the public, and there is a clear commitment to provide information at scheduled times.** (2.1.1)

Budget execution data for the budgetary central government are available on a monthly basis, and are disseminated according to a clear schedule, but cover a limited share of total public spending. More comprehensive reports for the general government and the public sector as a whole are available to the public and the Assembly only on an annual basis, with less than a six-month delay, although institutional coverage is not complete. The requirements for presenting the final accounts are clearly specified in the law.

#### The coverage and quality of budget documents

**39. The budget documents cover the budgetary central government only, and no data are provided on the general government in the budget documents.** (2.1.1)

The annual budget covers some 60 percent of general government spending, leaving out deconcentrated and decentralized units that have budgetary autonomy granted by law, as well as local governments. The draft budget is accompanied by: (i) a narrative discussion of the macroeconomic assumptions underlying the budget (real growth, inflation, interest rates, exchange rates, imports, and nominal GDP), broad considerations behind the revenue projections, strategic sectoral objectives of spending, and the growth of spending relative to last year's budget; (ii) annexed tables detailing revenue projections, budgeted spending according to functional, economic, and institutional classifications, and financing and employment data; (iii) CGR's certification of the adequacy of the revenue projections as required by law; and (iv) central bank's certification of the government's capacity to take additional debt as required by law. The budget does not provide any information on the budgets of the rest of the general government, which account for close to half of public spending and are approved by the CGR.

**40. There is no defense expenditure in the absence of permanent armed forces.** (2.1.1)

Permanent defense forces are prohibited by Article 12 of the Constitution.

#### Fiscal data in the budget

**41. The budget documents disclose fiscal aggregates for past budget years, but only partially in the case of revenue.** (2.1.2)

The annexes that accompany the draft budget include revenue collections during the first six months of the previous three years (with no full-year data on past collections), and annual spending for two previous years (outcomes for the year prior to budget presentation, and appropriations for the year of budget presentation).

#### Budget treatment of off-budget fiscal activity

**42. Statements on contingent liabilities are not included in budget documents, but are partially included in the final accounts.** (2.1.3)

The consolidated government accounts include references to the potential liabilities due to administrative and tax litigation, with input from the attorney general's office and the

administrative and customs fiscal courts. In addition, technical studies at the NCC have quantified government contingencies for some infrastructure projects.

**43. Statements of tax expenditures and quasi-fiscal activities are not reported in the budget documents.** (2.1.3)

The DGT undertook a quantification of the cost of the exemptions from the income tax in free trade zones, industrial cooperatives, and labor associations, which are estimated to amount to 30 percent of the income tax collections. There is otherwise no comprehensive study of the cost of tax exemptions.

**Publication of data on debt and financial assets**

**44. Information on gross public debt is published.** (2.1.4)

Data on gross debt stocks for the public sector are released on a monthly basis (albeit with a three–four month lag) on the website of the MOF.<sup>59</sup> These data show internal and external debt stocks for the central government, central bank, and the rest of the nonfinancial and financial public sectors. External debt information is broken down by broad creditor groups, and the domestic debt of the central government is broken down by instrument (in the case of bond debt) and by creditor (in the case of debt with the financial sector). More timely and detailed information on the bond debt issued is available in the monthly reports of the CBCR.<sup>60</sup> Information on projected debt service payments for the medium term is not published.

**45. Information on public sector’s financial and physical assets is published annually, but is partial.** (2.1.4)

The MOF’s accounting office publishes annually, on the website of the MOF, the consolidated public sector balance sheet. Financial assets are included in the balance sheet, but at an aggregated level, and the information on nonfinancial assets is incomplete (with the inventory of physical assets in the central government alone covering less than two-thirds of the budgetary central government);<sup>61</sup> serious problems with asset valuation persist. Overall, the quality of the balance sheet information for both financial and physical assets does not appear to be adequate for budgeting and reporting purposes.

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<sup>59</sup> See table “*Deuda Publica Bruta Total*” at <https://www.hacienda.go.cr>.

<sup>60</sup> See table “*Deuda interna bonificada del sector público, por tipo de tenedor*” at <http://indicadoreseconomicos.bccr.fi.cr>.

<sup>61</sup> Efforts are currently underway to finalize the inventory for the budgetary central government by end-2007.

## Commitment to timely publication of fiscal data

### 46. Formal commitments for regular publication of fiscal data have been made and advance data release calendars are announced. (2.2.1, 2.2.2)

The FML and its regulations establish clear deadlines for the submission to the Assembly of final budget execution reports for the consolidated public sector.<sup>62</sup> No such requirements for in-year budget execution exist, and the legislation does not require data to be disseminated to the public.<sup>63</sup> Nonetheless, final budget execution reports are posted on the MOF's website and monthly fiscal data for the budgetary central government are published within a month, with regular press conferences held to disseminate the data. Costa Rica subscribes to the IMF's Special Data Dissemination Standard (SDDS).

## D. Assurances of Integrity

### Integrity of data processes

### 47. Data on the budgetary central government are generally reliable, and differences between budgeted and actual outturn are disclosed to the public. (4.1.1)

The difference between budgeted amounts and budget outturns has been moderate on the whole, but with some significant differences across items (Table 1). Revenue collections have exceeded budgeted amounts by about 5 percent on average during 2003–05, reflecting both better-than-anticipated macroeconomic outcomes and a conservative approach to projections. Primary spending has been underexecuted by some 9 percent on average during this period, especially on purchases of goods and services and investments, while the interest bill has been generally underbudgeted (exceeding original budgets by an average of 10 percentage points). The deviations of spending outcomes from budgeted amounts have declined over time, however. There are usually one or two supplementary budgets a year (increasing original budget appropriations by some 4 percentage points in the last two years) and numerous executive decrees, transferring appropriations within programs as allowed by the legislation.<sup>64</sup> The difference between budget appropriations and outcomes is reported, but only at the level of the ministry. There are no contingency or reserve appropriations in the budget.

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<sup>62</sup> Article 52 and Article 126f of the FML.

<sup>63</sup> However, biannual reports evaluating performance vis-à-vis the performance targets included in the budget need to be submitted to the congressional committee for the control of public revenue and spending.

<sup>64</sup> In 2005, two supplementary budgets and 23 executive decrees modifying the budget were issued. These executive decrees involve changes at the program and sub-program level and are regulated under Article 61 of the FML regulations.

**Table 1. Revenues and Expenditures of the Budgetary Central Government**  
(execution relative to the original and modified budgets, in percent)

	2003		2004		2005		Average	
	Original	Modified	Original	Modified	Original	Modified	Original	Modified
Revenues	3.0	3.0	3.5	3.5	9.1	9.1	5.2	5.2
Primary current spending, o/w:	-3.5	-8.2	-7.3	-8.2	-7.5	-5.4	-6.1	-7.3
<i>Wages</i>	3.8	-2.5	-3.2	-2.7	-4.4	-4.4	-1.3	-3.2
<i>Goods and services</i>	-26.3	-35.7	-14.1	-21.2	-18.9	-18.9	-19.8	-25.3
<i>Transfers</i>	-7.1	-9.9	-10.0	-11.5	-9.2	-4.9	-8.8	-8.8
Capital spending	-7.0	-25.0	-7.5	-21.6	-14.2	-11.5	-9.5	-19.3
Interest	-6.6	-27.4	8.8	-3.7	26.4	-1.8	9.5	-11.0

**48. Statements on accounting policy are not included in the budget and final accounts documents.** (4.1.2)

The accounting principles, CoA, and accounting manuals are available at the MOF's website. The CGR and MOF approve the principles and general rules of government accounting and modifications, as necessary.

**49. The information management system (SIGAF) allows for routine and timely reconciliation of budgetary central government accounts.** (4.1.3)

Reconciliations relate to expenditure made with budgetary appropriations, accounting data on revenues and payments with debits and credits to bank accounts, and both above- and below-the-line data.

**Independent oversight**

**50. External audit is independent of the executive branch and covers all public sector activities.** (4.2.1)

The CGR's external audit function of all public sector activities is well established in the Constitution.<sup>65</sup> In exercising this function, CGR staff have unfettered access to all information and documentation they may need for carrying out their work. The head of the CGR is appointed by the Assembly for a period of eight years and can only be removed for legally justified reasons. The CGR prepares its draft budget, which is then submitted to the government for inclusion in the central government budget.

<sup>65</sup> These functions are defined in Article 184 of the Constitution.

**51. The CGR has a strong external audit capacity supported by well-qualified and trained staff.** (4.2.1)

In 2005, 152 external audit reports were issued.<sup>66</sup> CGR's external audit reports are available on its website. The qualification and experience of staff, as well as the high quality of annual reports, suggest that the CGR is carrying out its external audit responsibilities well.<sup>67</sup>

**52. The legislature discusses external audit reports, but with significant delays, and does not systematically follow up on audit findings.** (4.2.1)

The Assembly receives the reports prepared by the CGR, but its findings are discussed at the Assembly's permanent commission for the control of public revenue and expenditure with significant delay (of a few years), and with even greater delay in the full Assembly. There is generally little follow-up on the CGR's annual report recommendations.

**53. No external scrutiny of macroeconomic models and assumptions is carried out.** (4.2.2)

The macroeconomic forecasts underpinning the budget are those of the CBCR's monetary program. The model used in the projections is not made publicly available, and no detailed description of the model exists at present. However, information about key assumptions utilized in the projections is available.

**54. The National Institute of Statistics and Census (NISC) is given legislative assurances of independence.** (4.2.3)

The Law on the National Statistics System<sup>68</sup> establishes that the NISC is an autonomous institution, with administrative independence. The NISC executive council is comprised of five expert members designated by the government for six-year terms. The manager of the NISC is selected by the executive council. To strengthen further the technical configuration of the NISC executive council, two of its five members must be chosen from a list of three names submitted to the government by the national council of university chancellors, and another member must be selected from a list of three names submitted by the economic science professional college. The NISC elaborates the consumer and construction price indices and conducts household and poverty surveys, while the CBCR is responsible for national accounts and balance of payment statistics, and the MOF for fiscal statistics.

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<sup>66</sup> CGR Annual Report, 2005, p. 259.

<sup>67</sup> Costa Rica received the highest mark in a recent survey of supreme audit institutions that included Argentina, Colombia, Costa Rica, Guatemala, El Salvador, Mexico, Nicaragua, and Peru. The criteria used in the ranking were: (i) trustworthiness of the external comptroller's office; (ii) its effectiveness in the fight against corruption; (iii) the external comptroller's office capacity to verify whether the executive branch complies with the physical goals of budget programs; and (iv) its capacity to exercise effective oversight over federal spending. (Latin American Index for Budget Transparency: A Comparison of Eight Countries, Estado de la Nación., October 2005.)

<sup>68</sup> Law No. 7839 of November 1998.

## II. IMF STAFF COMMENTARY

**55. Costa Rica meets the requirements of the fiscal transparency code in several areas.** The separation of powers between the executive and legislature, and the responsibilities of different levels of government, are clearly specified. The CBCR is operationally independent and provides technical support on macroeconomic projections for the budget. The relations between the government and public corporations are based on clear arrangements, and laws and regulations governing private sector activity are generally transparent. Laws and processes governing the regulation of the nonfinancial private sector are generally clear. Tax legislation is complex, but well publicized, and taxpayers' rights are clearly spelled out in the law. The budget process is well specified and publicized. The cornerstone of public financial management is the Law on Financial Administration and Public Budgets adopted in 2001, which clarified and modernized the budget process, giving it a performance orientation, and prescribed clear rules governing debt, cash and asset management, and the accounting system. On the basis of this framework, significant progress has been made in centralizing and improving debt and cash management, updating accounting norms to align them to international standards, and upgrading the data management systems. The internal and external audit frameworks are sound and provide adequate safeguards for the integrity of the public financial processes: the CGR is independent and responsive to inquiries of the Assembly, and provides crucial feedback on the financial management of the public sector.

**56. A number of initiatives currently underway would further advance fiscal transparency.** These include legislative proposals to enhance the formal independence of the regulatory agency for public services, open the telecommunications and insurance sectors to competition, improve the framework for concessions, and move to a full-fledged VAT, as well as efforts to transform the National Development Plan into a more efficient policy-making instrument—all of which will contribute to enhanced transparency. Other initiatives include efforts to develop a medium-term budget framework, develop guidelines for medium-term debt management, widen the coverage of the single treasury account, and finalize the inventory of physical assets.

**57. In several other areas further efforts will be needed to improve transparency.** These relate to the need to recapitalize the central bank, enhance fiscal coordination mechanisms across general government institutions, improve the coverage and quality of budget documents and fiscal reporting, introduce a medium-term fiscal framework, and develop fiscal risk analysis. More specifically:

### Clarity of roles and responsibilities

- **A clearer division of responsibilities for monetary and fiscal policies would require a strong commitment to recapitalizing fully the central bank.** The authorities have already made advances in this area, and have recently announced plans to cover part of central bank's quasi-fiscal losses this year with a view to minimizing their inflationary pressures. To increase transparency in this area:
  - a medium-term strategy for recapitalizing the central bank and bringing its capital to adequate levels should be developed and disclosed to the public, to give a clear



signal to the market that the government is committed to eliminating central bank's quasi-fiscal losses;

- the need to maintain an adequate level of central bank capital should be addressed in the legislation;
  - to emphasize the commitment to a clear separation of monetary and fiscal policies, the legal provision allowing for limited central bank financing of the government should be eliminated.
- **Policy responsibilities across general government institutions should be clarified and coordination improved.** The considerable institutional fragmentation and the multi-track budgetary system for the general government have made responsibilities for policy formulation and implementation opaque. Consideration may need to be given to undertaking an in-depth survey of responsibility assignment across general government institutions (especially between line ministries and autonomous institutions in their sectors) with a view to identifying any duplication of functions, determining whether decentralized institutions perform inherently central government functions, and streamlining assigned functions across institutions.

#### **Budget formulation and approval**

- **To enhance transparency in public resource allocation, the activities of decentralized and deconcentrated units should be integrated into the Assembly-approved budget.** Many of these entities provide services intrinsic to central government activities, and their budgets should be approved, along with the central government budget, by the Assembly (the social security fund (CCSS) and universities, whose autonomy is prescribed in the Constitution, could be exceptions from this rule). This would go a long way toward avoiding duplication of functions, forging policy coordination across institutions, and enhancing the role of the Assembly-approved budget in setting transparently public spending priorities. It would also obviate the need for a separate agency to coordinate the budgets of several general government institutions (budgetary authority), a role that could be assumed by the MOF.
- **The government should adopt a credible medium-term budget framework that is well integrated with the National Development Plan (NDP).** The annual budget should be presented to the Assembly in a multi-year framework, spanning a three- to five-year horizon, that would include: (i) a clear statement of fiscal policy objectives and a discussion of how they will contribute to medium-term public debt sustainability; (ii) a medium-term macroeconomic forecast; (iii) realistic revenue estimates for the planning period; (iv) a medium-term path for specific expenditure aggregates; and (v) a sensitivity analysis of the main fiscal variables to changes in the main macroeconomic variables. Such medium-term orientation would also permit to identify more clearly future recurrent costs of new projects, helping guide decisions on project selection. The authorities are already planning to include medium-term macroeconomic and fiscal projections in the 2008 budget, and these efforts should be pursued further with the view to making the medium-term budget framework an effective tool for planning, allocating, and controlling public spending.

- **The government should develop a medium-term public investment program and establish clear principles for the evaluation and approval of investment projects.** Although the procedures for approving project requests from public institutions are clear, the economic criteria guiding their prioritization are not. To improve transparency of the budget process, the project selection process for the annual budget (and, in future years, for the multi-year investment plan and budget) should be strengthened, including by developing the capacity in the planning ministry to utilize quantitative methods for evaluating and prioritizing projects.
- **Earmarked spending mandates should be phased out and spending priorities should be determined in the budget process.** Pervasive earmarking (*destinos específicos*) has resulted in overcommitment of scarce resources and made it impossible to comply with the legislated mandates. In addition to limiting budget flexibility, it has rendered the budget process largely nontransparent by giving misleading assurances that the spending mandates could be undertaken. The earmarking mandated through the legislation (whether funded or unfunded) should be phased out and spending priorities should be decided in the context of the budget discussions.
- **A statement of fiscal risks should be included in the budget documents.** Budget documents could provide: (i) an overview of all government contingent liabilities; (ii) a summary table of concession and trust fund (*fideicomiso*) operations, their total expected cost, and the estimated impact of associated availability fees; (iii) information on debt and other government guarantees, including the maximum liability under the blanket deposit guarantee for state banks; (iv) legal claims against the government; and (v) fiscal risks stemming from quasi-fiscal activities of public financial and nonfinancial corporations.
- **Budget presentation to the Assembly should be improved**, by including in the budget documents:
  - a discussion of the fiscal policy objectives at the *general government* level and a table on the consolidated general government past performance and projections for the budget year;
  - a medium-term fiscal framework, a discussion of fiscal and debt sustainability, and a statement of fiscal risks, as discussed above;
  - a clear identification in the budget tables of the primary and overall balances;
  - a clear presentation of the revenue and expenditure performance on an *annual* basis, to facilitate comparison with the budget;
  - a clear delineation of the estimates of the cost of new initiatives (on spending and revenue) and of ongoing government policies;
  - an overview of existing tax expenditures and their quantification (tax expenditures should in essence be regarded as regular expenditure on a multi-year basis).

## Budget execution and reporting

- **The accounting framework across public institutions should be harmonized and its ability to produce consolidated data improved.** The fragmented accounting standards applied across the public sector hamper proper and timely consolidation of the accounts, especially of in-year budget execution, and reduce the reliability of public financial information. The accounting office of the MOF should be in charge of elaborating the chart of accounts for all public entities and should use its legal entitlement to collect financial information from public institutions. In light of this, as well as of the tight turnaround the legislation affords for the consolidation of final accounts for the public sector, the technical capacity of the MOF's accounting office should be reinforced.
- **Transparency of the procurement process could be enhanced by applying standard procedures and registry to all public sector institutions.** This could be achieved by expanding the coverage of central government's electronic procurement system (CompraRed) to the rest of the public sector where the bulk of procurement occurs, and by centralizing or coordinating better regulatory oversight of all public sector procurement.
- **Budget execution monitoring and reporting should be strengthened:**
  - *The MOF should strengthen its capacity to monitor in-year execution of general government expenditures.* For this, it should require at least quarterly financial reporting by all general government entities to its accounting office, as allowed by the FML. Such reports would inform the MOF analysis and provide the public with more frequent information on budget execution.
  - *The MOF should disseminate to the public quarterly and annual reports* that not only provide data on budget execution, but also discuss fiscal developments, compare them to the original and modified budget, and discuss factors that contributed to the deviations from the initial and modified budget, focusing particularly on the consolidated accounts. These reports could first cover the budgetary central government and then be extended to the general government as data collection for the latter improve.
  - *Similar mid-year reports on budget execution should be presented to the Assembly on a timely basis.*
  - *Consideration should be given to introducing a legislative requirement to disseminate fiscal data to the public.* While the MOF publishes, on its website, final accounts for the consolidated public sector and monthly accounts for the budgetary central government, no such requirement exists in the legislation.
  - *The website of the MOF could be revamped to make it more user-friendly.* The site should be easier to navigate, public sector statistics should be organized more clearly, and all legislation pertaining to the budget process and public financial management more generally should be made available.
- **Parliamentary oversight over budget execution should be strengthened.** This would require: (i) timely discussion of the final budget execution accounts, both in the

economic and budget commissions of the Assembly as well as in full session; and (ii) more rigorous follow-up on the implementation of the CGR recommendations.

Legislative oversight over the use of public funds would also improve if the decentralized and deconcentrated institutions are fully integrated into the budgetary process, with their budgets approved and performance monitored by the Assembly.

As a minimum, general government accounts should be presented for the Assembly's information in the budget and budget execution documents.

- **To facilitate a better understanding of government spending objectives and their evaluation, the system of performance indicators should be streamlined.**

Significant progress has been made in this regard in the context of the new government's national development plan. This should be followed up in the 2008 budget process by streamlining the number of performance indicators in each ministry, making them more meaningful and measurable, and providing some past information in the budget documents on the targeted indicators. A streamlined system of performance indicators would also permit the government to develop more meaningful program evaluation reports.

#### **Tax policy and private sector regulation**

- **The planned transition to a VAT will increase the transparency of the tax system and should be pursued.** The current system of crediting physical, rather than financial, inputs and the numerous exemptions gives rise to discretion and renders the system opaque. A move to a VAT, with minimum exemptions, would be welcome.
- **Consideration should be given to providing additional legal protection to tax and customs administration officials.** While the current legal framework already provides for some degree of protection, it would be useful to consider adding special provisions to formally shield these officials from political pressure. This could take the form of the protection already given to the heads of the internal audit units.
- **The importation of rice monopoly should be eliminated.** The current prohibition of rice imports (other than by the corporation of rice producers, when there is insufficient domestic production) is a nontransparent and inefficient way of supporting producers. This support, should the government choose to continue it, should be provided transparently through budgetary subsidies discussed in the Assembly.

#### **Integrity of financial information**

- **Internal audit processes should be strengthened to ensure the integrity of the financial management systems.** The legislation provides a strong basis for internal controls, but the capacity of the internal audit units needs to be strengthened. This would help eventually shift the orientation of the CGR to ex post assessment and performance evaluation work, especially in regard to procurement. Coordination between the internal audit units and the CGR should be strengthened, with a view to minimizing overlap in their work programs and sharing common data and analysis.

### III. SUMMARY TABLES

**Table 1. A Summary Assessment of Practices**

Code Reference	Summary Assessment	Comment
<p><b>Overall summary</b></p> <p>Costa Rica meets the requirements of the transparency code in several areas. Responsibilities across powers and levels of government are clearly specified, and the central bank is operationally independent. The legal framework underlying the public finance processes is sound, and significant progress has been made in centralizing and improving debt and cash management, updating accounting norms, and upgrading the data management systems. The budget process is well specified and publicized. The laws governing the regulation of the private sector are generally clear, tax legislation is well publicized, and taxpayers' rights are clearly spelled out in the law. The internal and external audit frameworks are sound, and the Comptroller's General office is independent and technically strong.</p> <p>In other areas further efforts will be needed to improve transparency. These relate mainly to the need to enhance fiscal coordination mechanisms across general government institutions, improve the coverage and quality of budget documents, as well as of fiscal reporting, introduce a medium-term fiscal framework, and develop fiscal risk reporting and analysis. In particular:</p> <ul style="list-style-type: none"> <li>• There is room to improve clarity of responsibilities across general government institutions to avoid duplication of functions and improve coordination.</li> <li>• The budget formulation and presentation can be further improved, including by (i) integrating most general government autonomous institutions in the budget; (ii) adopting a medium-term budget framework; (iii) developing a public investment program and establishing clear principles for the evaluation and approval of investment projects; (iv) eliminating earmarked spending mandates; and (v) including a statement of fiscal risks in budget documents.</li> <li>• Budget execution and reporting could be strengthened, including by (i) harmonizing the accounting standards and procurement processes across all public institutions; (ii) strengthening the monitoring and reporting of in-year execution of general government expenditure; (iii) enhancing parliamentary oversight over budget execution.</li> </ul>		
<p><b>Clarity of roles and responsibilities</b></p>		
1.1.1	The general government is defined consistently with the Government Finance Statistics (GFS) principles, but its coverage in the budget process is limited. The clarity of roles and responsibilities within the general government are hampered by its fragmented administrative organization.	
1.1.2	The fiscal roles of the executive, legislative and judicial branches are clearly defined in law, and the responsibilities of different levels of government are also relatively well defined.	
1.1.3	Extrabudgetary activities are extensive and the mechanisms for the coordination and management of budgetary and extrabudgetary activities are partially in place. There is significant revenue earmarking in the budget.	Draft legislation has been prepared to eliminate all unfunded spending mandates created by legislation.
1.1.4	The relationships between government and public nonfinancial and financial corporations are clear. In particular, the Central Bank of Costa Rica (CBCR) is operationally independent and its financial relationship with the government is clearly defined in law, and public financial and nonfinancial corporations do not carry out noteworthy quasi-fiscal activities (QFAs).	

1.1.5	Government holdings of fully-owned corporations and equity are extensive, and there is no single entity that monitors ownership or coordinates policies. While there is no active privatization program, the government is committed to revamping the legal framework for concessions and opening up the insurance and telecommunications sectors. Laws and processes governing the regulation of the nonfinancial private sector are generally clear.	Draft legislation is currently in congress to open up the telecommunication and insurance sectors, and to reform the concession process.
1.2.1	The overall budget framework is clear but fragmented.	
1.2.2	The legislative basis for taxation is generally clear and comprehensive, but tax exemptions are extensive and tax expenditures are not reported. The tax and customs administrations are clearly defined and well coordinated with overall fiscal management. Taxpayers' legal rights are well defined, but there are delays in the resolution of complaints.	Draft legislation to move to a full-fledged VAT, currently in congress, will help enhance transparency. Existing estimates for the cost of income tax exemptions should be extended to all taxes, and published.
1.2.3	Public servants are subject to a well-defined code of behavior.	
<b>Public availability of information</b>		
2.1.1	Fiscal reporting covers the budgetary central government on a monthly basis and consolidated public sector on an annual basis. Annual fiscal information is fairly comprehensive and readily available to the public, and there is a clear commitment to provide information at scheduled times. However, the budget documents cover the budgetary central government only, and no data are provided on the general government. There is no defense expenditure given the absence of permanent armed forces.	
2.1.2	The budget documents disclose fiscal aggregates for past budget years, but only partially in the case of revenue.	
2.1.3	Budget documents do not include statements on contingent liabilities, tax expenditures or quasi-fiscal activities, but information on contingent liabilities is partially included in the final accounts.	
2.1.4	Government holdings of fully-owned corporations and equity are extensive, and there is no single entity that monitors ownership or coordinates policies. Debt and cash management practices are well coordinated, information on gross public debt is published, and information on public sector's financial and physical assets is published annually, but is partial.	
2.2.1	Formal commitments for regular publication of fiscal data have been made.	
2.2.2	Advance data release calendars are announced.	
<b>Open budget preparation, execution, and reporting</b>		
3.1.1	Medium-term fiscal policy objectives and fiscal sustainability analysis are not included in the budget documents.	The 2008 budget is expected to be framed in a medium-term context.
3.1.2	The golden rule is established in the budget legislation, but has only become effective last year.	
3.1.3	Budget forecast and underlying macroeconomic assumptions are clearly presented in the budget documents.	
3.1.4	Estimates of new initiatives and ongoing costs of government policies are not clearly distinguished in the budget documents.	
3.1.5	The sensitivity of budget estimates to changes in economic variables is not assessed, and fiscal risks are not quantified nor discussed in the budget documents.	
3.2.1	The annual budget preparation process is open but fragmented.	

3.2.2	The objectives and expected results from government activities are presented in the budget documents, but the evaluation process of annual spending indicates that deficiencies remain in determining what was actually achieved.	Recent efforts to streamline the system of performance objectives in the 2006-10 National Development Plan should guide the 2008 budget process.
3.2.3	The budget document focuses narrowly on the budgetary central government and discusses its primary and overall balances.	
3.3.1	Internal control and accounting procedures are in place. The accounting system is capable of producing accurate within-year reports on central government cash budget execution. Fiscal reporting covers the budgetary central government on a monthly basis and consolidated public sector on an annual basis.	
3.3.2	Procurement rules are clear and publicly available, but implementation is fragmented and there is no system-wide coordination or monitoring. Civil service employment procedures are clear and well understood for entities of the budgetary central government.	
3.3.3	Internal audit could be more effective. Tax administration has effective internal monitoring and control mechanisms.	
3.3.4	The tax and customs administrations are not given legal protection from political interference.	
3.4.1	The Assembly does not undertake a mid-year budget review, and is not presented with in-year budget execution reports.	
3.4.2	Audited final accounts are available within six months of the end of the fiscal year.	
3.4.3	The objectives and expected results from government activities are presented in the budget documents, but the evaluation process of annual spending indicates that deficiencies remain in determining what was actually achieved.	Recent efforts to streamline the system of performance objectives in the 2006-10 National Development Plan should guide the 2008 budget process.
<b>Assurances of integrity</b>		
4.1.1	Data on the budgetary central government are generally reliable, and differences between budgeted and actual outturn are disclosed to the public.	
4.1.2	Statements on accounting policy are not included in the budget and final accounts documents.	
4.1.3	The information management system (SIGAF) allows for routine and timely reconciliation of budgetary central government accounts.	
4.2.1	External audit is independent of the executive branch and covers all public sector activities. The Comptroller General of the Republic has a strong external audit capacity supported by well-qualified and trained staff. The legislature discusses external audit reports, but with significant delays, and does not systematically follow up on audit findings.	
4.2.2	No external scrutiny of macroeconomic models and assumptions is carried out.	
4.2.3	The National Institute of Statistics and Census (NISC) is given legislative assurances of independence.	

**Table 2. Public Availability of Information—A Summary**

	<b>Budget and fiscal report element</b>	<b>Included in budget/report documents</b>	<b>Available to the public</b>	<b>Para. ref.</b>	<b>Code ref.</b>
1.	Central government (CG) budget estimates	Yes	Yes, at <a href="https://www.hacienda.go.cr/">https://www.hacienda.go.cr/</a>	Para.39	2.1.1
2.	CG Defense Expenditures	No (there are no defense expenditures)	No (there are no defense expenditures)	Para. 40	2.1.1
3.	CG EBFs	No	Yes, annual data published by MOF at <a href="https://www.hacienda.go.cr/">https://www.hacienda.go.cr/</a>	Paras. 13, 38	2.1.1
4.	CG Budget outturns	Yes (half-year revenues for past 3 years and full-year expenditures for past 2 years)	Budget execution data available monthly for budgetary central government at MOF <a href="https://www.hacienda.go.cr/">https://www.hacienda.go.cr/</a>	Paras. 41, 46, 34	2.1.2
5.	CG Budget forecasts	Yes (in budget presentation to congress)	Yes, once budget submitted to parliament <a href="http://www.asamblea.go.cr/">http://www.asamblea.go.cr/</a>	Para. 39	2.1.2
6.	CG Contingent liabilities	No	Partial references in the final consolidated accounts	Para. 42	2.1.3
7.	CG Tax Expenditures	No	No	Para. 43	2.1.3
8.	CG QFAs	No	No	Para. 43	2.1.3
9.	Macroeconomic assumptions	Yes (in budget presentation to congress)	Yes, once budget submitted to parliament <a href="http://www.asamblea.go.cr/">http://www.asamblea.go.cr/</a>	Para. 39	3.1.3
10.	Analysis of fiscal risks/sensitivity analysis	No	No		3.1.5
11.	CG Debt	No	Yes, monthly data published by MOF at <a href="https://www.hacienda.go.cr/">https://www.hacienda.go.cr/</a>	Para. 44	2.1.4
12.	CG Financial Assets	No	Partial data published annually on the MOF website <a href="https://www.hacienda.go.cr/">https://www.hacienda.go.cr/</a>	Para. 45	2.1.4
13.	Sustainability Analysis	No	No		3.1.1
14.	General government budget estimates	No	No		2.1.5
15.	General government and public sector reports on fiscal outturns	No	Annual outturns for the general government and consolidated public sector published by MOF at <a href="https://www.hacienda.go.cr/">https://www.hacienda.go.cr/</a>	Para. 46	3.4.1