CONTEXT

1. **The new administration has reaffirmed its commitment to the Fund-supported program**. Following general elections in February and second-round presidential elections in April, a cyberattack affected several government systems. Around the same time, Russia's invasion of Ukraine worsened Costa Rica's terms of trade and drove up inflation. The government was able to restore operations to priority computer systems. To counter the surge of inflation, the Central Bank of Costa Rica (BCCR) has tightened monetary policy. Despite these volatile circumstances, the government has continued its program of fiscal consolidation, which has helped to anchor sovereign spreads.

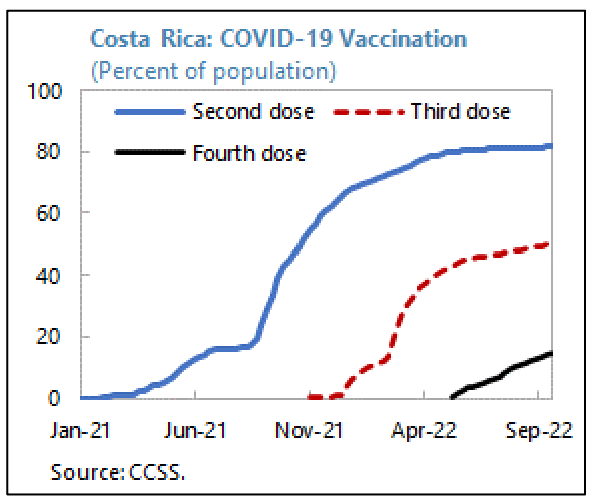
2. **Sustained policy efforts will be critical to maintain macroeconomic stability and debt sustainability while fostering green growth and job creation**. Prudent monetary and fiscal policy in line with the program objectives should proceed hand in hand with continued efforts to enhance the efficiency of government spending and strengthen the autonomy of the central bank. Sustained reforms to improve the social safety net and incentivize formal employment, especially for young and female workers, will help support the poor and reduce inequality. Costa Rica continues to pursue an ambitious agenda for climate resilience and decarbonization and the authorities are requesting a new RSF arrangement to support their efforts and catalyze further financing.

RECENT DEVELOPMENTS

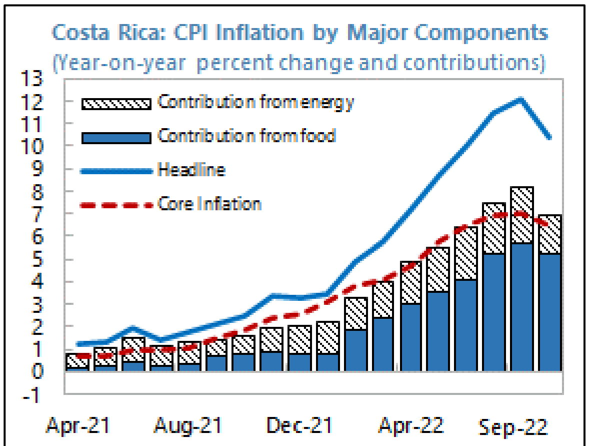
3. **After a strong rebound from the COVID-19 shock, the economic recovery is losing momentum.** The economy recovered strongly in 2021, with real GDP expanding by 7.8 percent. The country's high rate of vaccination continues to support domestic activity. However, global headwinds are weighing on growth:

- *Real GDP* growth decelerated from 8.4 percent (y-o-y) in 2022Q1 to 6.5 percent in Q2. High frequency leading indicators point to a broad-based slowdown in the remainder of this year.

- *Unemployment* fell from a peak of 24 percent to 11.8 percent in August, close to pre-pandemic levels. Participation and employment rates have, however, failed to return to 2019 levels.



- *Headline inflation* increased from 3.3 percent (y-o-y) in December 2021 to 12.1 percent in August 2022, driven mostly by higher global commodity prices. However, core and headline inflation started moderating recently, with headline and core inflation at 10.4 and 6.5 percent, respectively, in September.



Sources: BCCR and IMF staff estimates.

- *The current account* deficit widened to 3.1 percent of GDP in 2022H1 (annualized), compared to 1.8 in 2021H1, largely due to a higher energy and food import bill (Figure 2) and a weak recovery in tourism (international arrivals were 71 percent of 2019 levels in 2022H1).

- *Gross international reserves* fell to US$6.2 billion in the first half of 2022 (75 percent of the IMF's Reserve Adequacy (ARA) metric), a result of higher energy import costs and delays in the legislative approval of external financing. Reserves recovered during the third quarter to US$7.6 billion (91 percent of the ARA metric), with the central bank actively purchasing in the market and new multilateral funding being disbursed.

- As of end-September, the *exchange rate* had appreciated by about 2 percent y-t-d against the U.S. dollar, after depreciating by over 7 percent in 2022H1. The REER appreciated by 4.7 percent between December 2021 and August 2022.

- *Private sector credit* grew by 2 percent (y-o-y, foreign exchange (FX) adjusted) in July, with increased local currency borrowing in services and housing. FX borrowing (FX adjusted) continues to decline, reflecting regulatory disincentives and concerns about a potential weakening of the exchange rate.

- *EMBI spreads* fell as electoral-related uncertainty was resolved, helping mitigate the impact of tighter global financial conditions.

OUTLOOK AND RISKS

4. **Global headwinds are expected to continue to weigh on the outlook.** GDP growth is expected to slow to 4.3 percent in 2022 and 2.9 percent in 2023, amid tighter global and domestic financial conditions. Headline inflation is expected to continue to fall, returning towards the BCCR's target of 3 percent by late 2024.

5. **The external position in 2021 was assessed to be broadly in line with the level implied by medium term fundamentals and desirable policies**. The 2021 cyclically adjusted current account is assessed at -2.3 percent of GDP after accounting for temporary factors related to the COVID-19 pandemic and pension-fund outflows. This is close to the current account norm of -2.8

percent of GDP (Annex I). Higher import prices and weaker external demand are expected to lead to an increase in the current account deficit to 4.6 percent of GDP in 2022, falling back to around 3 percent of GDP over the medium term (as tourism recovers and commodity prices decline).

6. There are important downside risks to growth. Further supply shocks from commodity prices or a greater-than-expected global slowdown would weigh on activity. More entrenched domestic inflation and/or a sharper-than-expected global monetary tightening would lead to tighter financial conditions, restraining growth and weighing on the fiscal position. Costa Rica's exposure to natural disasters continues to pose important risks which are likely to increase over time. Finally, a resurgence in COVID-19 either at home or abroad could again curtail tourism. On the upside, recent and planned reforms could create greater fiscal space that can be deployed to increase investment, boost, job creation, and/or improve climate resilience.

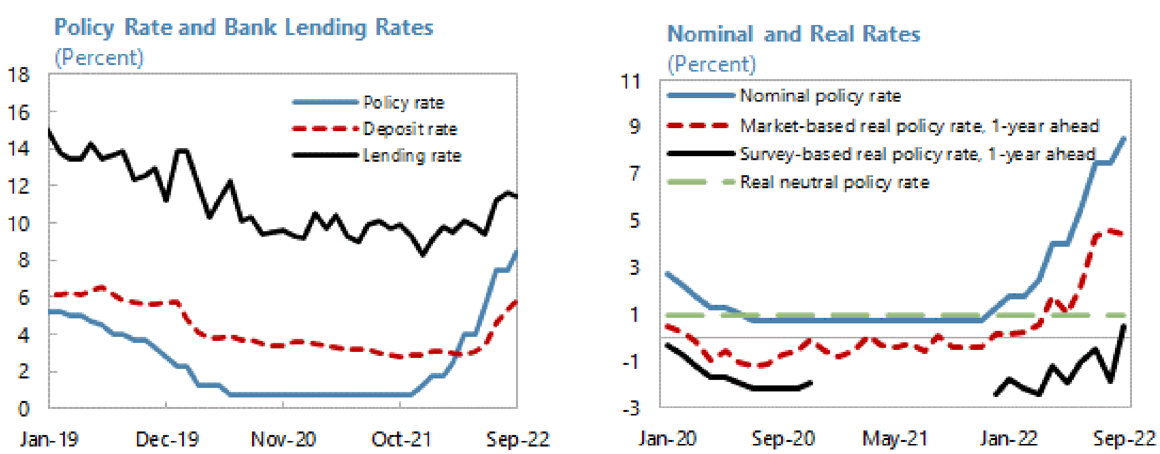
PROGRAM PERFORMANCE AND POLICY DISCUSSIONS

A. Safeguarding Monetary and Financial Stability

Background

7. As inflation picked up and became more entrenched, the BCCR accelerated its monetary policy tightening. Between December 2021 and October 2022, the BCCR increased the policy rate from 0.75 percent to 9 percent and continues to signal its readiness to raise rates further as needed. In July, the BCCR also increased reserves requirements by 3 percentage points. These actions have significantly tightened the monetary stance with the ex ante real policy rate rising 300-500 bps (depending on the end-September measure of inflation expectations). Despite these efforts, inflation exceeded the outer band of the program's Monetary Policy Consultation Clause (MPCC) in June and September, triggering a Board consultation (see Appendix I, Attachment III).

Costa Rica: Interest Rates

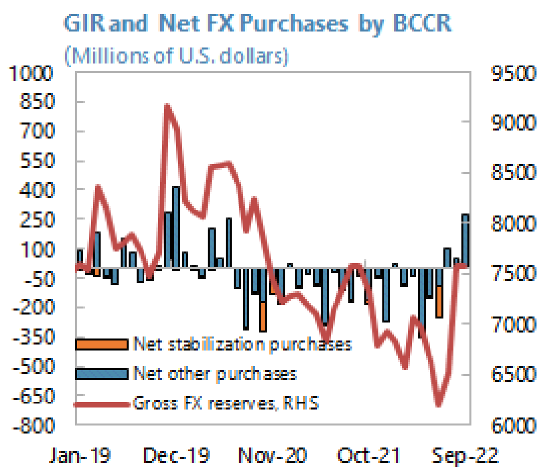


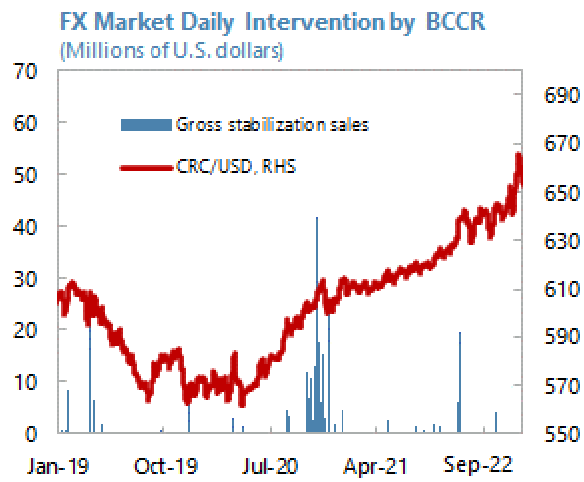
Sources: BCCR and IMF staff estimates.

Note: The real policy rate is defined as the nominal policy rate less one-year ahead inflation expectations.

8. The worsening external environment has weighed on the exchange rate and international reserves. Higher-than-expected FX demand from imports of the Non-Financial Public Sector (NFPS)—mostly for the oil company—was only partially offset by BCCR purchases in the first half of the year, resulting in reserves falling below the NIR floor in the program at end-June, despite continued exchange rate flexibility. BOP pressures eased in the third quarter, including through a slowdown in pension fund outflows. The BCCR began to rebuild reserves through systematic FX purchases from the market and substantially narrowed the breach of the end-September indicative target (IT) to US$48.6 million. In August, the BCCR also drew on a US$1.1 billion credit line from the Latin American Reserves Fund.

Costa Rica: FX Market Developments





Sources: BCCR and IMF staff estimates.

9. The banking system has weathered well the unwinding of emergency COVID-19 forbearance but a slowing economy and higher interest rates are expected to impact loan performance. The economic rebound in 2021H2-2022Q1 helped contain NPLs to below 3 percent and high investment income has allowed banks, especially private ones, to increase their capital.[1] The weaker economic outlook is expected to lead to a deterioration of loan performance, not yet observed due to lagged effects, but loan loss provisions remain high (at 195 percent of non-performing loans). Both liquidity and capital are well above regulatory minima.

Policy Discussion

10. The BCCR's accelerated move to a contractionary monetary stance is helping to anchor inflation expectations. Its data-dependent, forward-looking approach remains appropriate, in the context of heightened global and domestic uncertainty, and continues to be supported by clear and transparent communication. Based on staff's assessment of the outlook, further increases in the

[1]A broader indicator of credit quality, which includes arrears greater than 90 days and in judicial collection and the balance of credits liquidated and foreclosed in the past 24 months, stood at 5.6 percent in August.

policy rate will likely be needed at coming meetings to ensure that inflation returns to the MPCC band by the second half of 2023 (the outer band is expected to be exceeded in December 2022) and to the center of the band by 2025.

11. The BCCR is taking steps to reorganize its FX operations, deepen the FX market, and rebuild international reserves. The BCCR is developing a package of reforms to incentivize nonfinancial public sector entities to manage their FX needs more efficiently and to rely more on market-based transactions, rather than purchases from the BCCR, to meet their FX needs. Efforts are underway to increase the predictability and transparency of BCCR FX transactions and deepen the FX market (e.g. by revisiting Monex operating parameters, developing FX derivatives, reviewing banks' net open position limits, and taking supervisory actions to disincentivize dollarization (¶13)).

12. The authorities are finalizing amendments to legislation to strengthen the BCCR's governance and operational framework. In line with the 2020 Safeguards Assessment recommendations, the changes are designed to (i) clarify that the BCCR's main objective is to maintain low and stable inflation; (ii) provide for a clear allocation of functions among its decision-making bodies; (iii) strengthen its institutional, functional, personal, and financial autonomy; and (iv) enhance its transparency and accountability practices. The authorities expect to submit these amendments to the Legislative Assembly by end-December 2022.

13. Supervisors are closely monitoring systemic risks to the financial sector and enhancing their toolkit. With the unwinding of the COVID-19 emergency measures and the tightening of financial conditions, the supervisory authorities are proactively monitoring the financial system to anticipate new sources of stress. This includes regular updates to their credit, market, and liquidity risks stress tests. Overall, the banking system remains resilient to shocks.[2] The authorities have tightened the definition of unhedged borrower and approved a regulation to increase transparency and require gradually higher capital requirements on FX lending to unhedged borrowers, replacing the general provisioning requirement on FX loans to non-FX generators. The legal and regulatory framework for consolidated supervision is largely complete and the focus is now shifting to effectively implementing that framework. New regulations to address cyber risks and increase the resilience to cyber incidents are also being prepared. Following a recent World Bank Financial Sector Assessment Program development module, the authorities are now working to address key recommendations from the Basel Core Principles assessment, including legal changes to strengthen the powers of and protections for supervisors.

14. The crisis management framework is being upgraded. The National Council of Financial System Supervision (CONASSIF) is reviewing amendments to the deposit insurance and bank resolution law to reduce legal uncertainties in the resolution process, provide for adequate institutional arrangements for the Deposit Guarantee Fund and the resolution authority, increase safeguards, and ensure clear resolution triggers. A consultation with the private sector on the

[2] Under a macroeconomic stress scenario with a combined severe shock to exchange rates, interest rates, and growth, conducted in mid-2022, existing buffers would be eroded but only one small bank would fall below the 10 percent minimum capital requirement, with a capital shortfall of less than 1 percent of GDP.

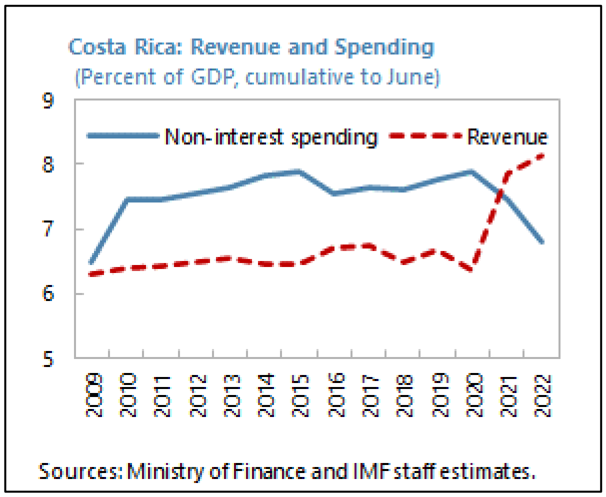
proposed changes will be launched with the goal of submitting legislation to the National Assembly by end-2023 (a proposed SB under the program).

15. The new administration is considering legal changes to increase competition in the banking sector. Long-standing regulatory asymmetries between public and private banks create unnecessary distortions and hamper banks' ability to effectively support growth and job creation. In line with OECD recommendations, the authorities are planning to remove these differences in regulatory treatment to level the playing field between private and public banks (including by eliminating the quasi-fiscal contributions of state-owned banks and the requirement that private banks transfer part of their deposits to the Development Bank System). The authorities are also working to identify alternative ways to prudently channel resources to underserved sectors, including SMEs.

B. Strengthening Fiscal Institutions and Preserving Fiscal Sustainability

Background

16. The fiscal targets were comfortably met despite the cyberattack disruption (Box 1). The end-June primary surplus exceeded the program target by 1 percent of GDP. Taxes on income and imports were boosted by growth in economic activity, high inflation and greater-than-expected yields from the 2018 tax reform. Spending was restrained by the fiscal rule, falling as a percent of GDP. At end-June, public debt was well below the program target. Aside from delays in data reporting,[3] there appears to have been little measurable after-effects of the cyberattacks that temporarily disabled government systems during the second quarter of the year.



Policy Discussions

17. The authorities are expected to exceed their end-2022 primary balance target. Higher international food and energy prices were allowed to pass through to retail prices and an additional 0.1 percent of GDP of social spending—including conditional cash transfers and temporary food vouchers—was allocated to support the most vulnerable. Primary spending is projected to decline due to lower-than-expected capital spending (including an unused guarantee fund to support credit to businesses affected by the pandemic) and despite a one-off debt payment to the social security fund of 0.2 percent of GDP. Stronger-than-expected tax collection and one-off transfers (0.4 percent

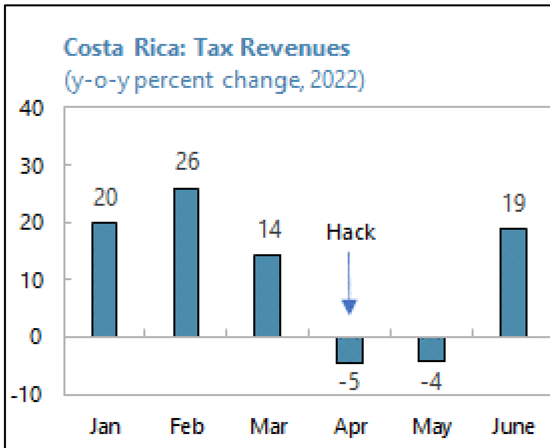
[3] While final data are being delayed, the authorities are confident to have also met the end-September indicative fiscal targets by a good margin.

of GDP) from recently consolidated entities are expected to result in a primary surplus of 1.1 percent of GDP by end-2022 (above the 0.7 percent of GDP target).[4]

Box 1. Cyberattack Targeting Costa Rica's Government

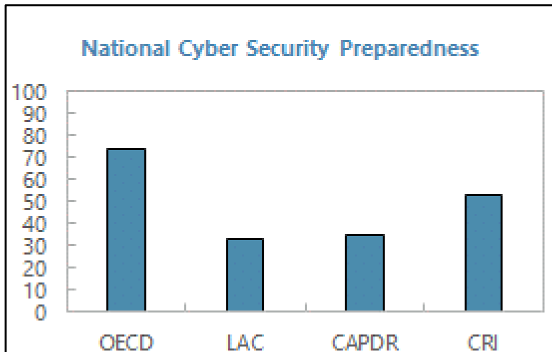
In April and May 2022, multiple government institutions were victims of ransomware attacks. The revenue and customs systems were both affected, as well as the social security system. The government did not pay the ransom and shut down many information systems to limit any damage and risk of further attacks. Other standard operations such as the use of cloud-based software were also disabled, so routine data collection and control were not possible. After being checked for vulnerabilities, critical taxpayers' systems were fully restored with assistance from international governments and private companies. However, work is still ongoing to restore some of the back-end systems. Considerable time and resources were needed to reestablish routine data reporting and processes and handle backlogs.

As disabled systems slowed tax collection and data provision, the Ministry of Finance implemented contingency solutions. Large taxpayers had to self-assess taxes and use a form that was integral to the former manual process. Smaller taxpayers resumed payments through an alternative digital payment system that was set up. Together with contingency solutions for VAT, these plans allowed much of the losses incurred in April and May to be recouped in the following months. Government liquidity was sufficient to meet obligations and the authorities minimized technical difficulties in paying wages and transferring payments on time. The customs information system was also replaced by a manual process to mitigate the risk of import bottlenecks.



Sources: Ministry of Finance and IMF staff estimates.

While the authorities' response managed to limit the damage, the attack highlighted the value and urgency of cyber preparedness. Cybersecurity indicators suggest Costa Rica is relatively well prepared but is still below the OECD average. The administration has been reinforcing Information Technology security through the National Cybersecurity Strategy and the Information Crime Incident and Response Center. While the BCCR and the financial system were not affected, work is also ongoing to strengthen the security of the payments system and improve the regulatory framework for cyber risk.



Sources: National Cyber Security Index and IMF staff estimates.
Note: Measures the preparedness of countries to prevent cyber threats and manage cyber incidents, out of 100.

[4] One-off factors contribute only 0.1 percent of GDP towards the fiscal overperformance.

Costa Rica: Authorities' Fiscal Package, 2021-23 (Cumulative change from 2020 in percent of GDP)	CR/21/48			CR/22/93			Proj.		
	2021	2022	2023	2021	2022	2023	2021	2022	2023
Revenue measures:	**0.4**	**0.8**	**1.4**	**0.2**	**0.3**	**0.4**	**0.2**	**0.3**	**0.4**
2018 tax reform yields	0.1	0.1	0.3	0.2	0.3	0.4	0.2	0.3	0.4
New permanent measures	0.4	0.7	1.1	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure measures:	**-1.3**	**-1.8**	**-2.3**	**-1.5**	**-2.9**	**-3.4**	**-1.5**	**-2.9**	**-3.2**
Wage bill	-0.6	-0.8	-1.0	-0.6	-0.9	-1.3	-0.6	-1.1	-1.4
Purchases of G&S	-0.1	-0.2	-0.3	-0.1	-0.2	-0.3	-0.1	-0.2	-0.2
Current transfers	0.0	-0.5	-0.8	-0.3	-1.4	-1.7	-0.3	-1.2	-1.5
o.w. Social assistance	0.1	0.1	0.1	0.0	0.0	0.1	0.0	-0.1	-0.1
Capital spending	-0.5	-0.3	-0.1	-0.5	-0.4	-0.2	-0.5	-0.4	-0.2
Total structural measures	**1.7**	**2.5**	**3.7**	**1.7**	**3.2**	**3.8**	**1.7**	**3.2**	**3.6**
+ One-off measures	0.6	0.7	0.6	0.9	0.4	0.4	0.9	0.7	0.5
+ Cyclical impact/tax admin gains	0.1	0.4	0.6	0.8	0.9	0.9	0.8	1.0	1.0
Primary balance	**2.3**	**3.6**	**4.9**	**3.5**	**4.4**	**5.1**	**3.5**	**4.8**	**5.1**
Primary balance (Percent of GDP)	**-1.7**	**-0.3**	**1.0**	**-0.3**	**0.7**	**1.3**	**-0.3**	**1.1**	**1.3**

Source: IMF staff estimates.

18. **The 2023 budget targets a primary surplus of 1.3 percent of GDP**. Non-interest nominal spending is flat relative to 2022 and wage constraints remain in place, in line with the fiscal rule. Nevertheless, the budget includes a 9 percent increase on social spending relative to the previous budget and the authorities plan to reallocate unexecuted resources to social assistance throughout the year. Spending has also been increased on higher-priority capital investments (including emergency repairs to infrastructure following heavy rains). The phasing in of rules for corporate taxation and phasing out of reduced VAT rates for tourism and construction will add to revenues in 2023.[5]

19. **Costa Rica's fiscal rule continues to play a pivotal role in anchoring debt sustainability but there is scope for improvements.** To address operational constraints in its implementation and make some fiscal space, the authorities amended the fiscal rule regulation in July 2022 to base the spending ceilings on the original budget for the previous year, rather than execution. The change addresses a structural shortcoming in the regulation that penalized under-execution by ministries and other agencies and disincentivized savings for fear of future constraints. The execution basis also had the unintended shortcoming of tightening nominal spending limits more than warranted during the pandemic, given significant underexecution due to COVID-19 restrictions. The authorities are also considering, with support from IMF TA, reforms to the fiscal rule legislation that would clarify its regulatory perimeter and facilitate reallocation of resources within the spending ceilings, while maintaining its broad coverage and essential role in reducing debt.

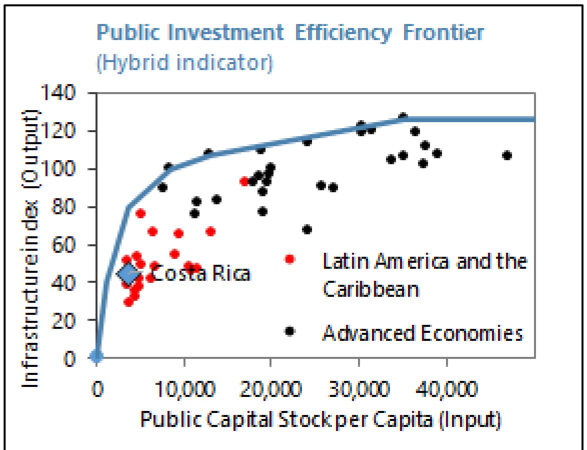
20. **A medium-term revenue strategy is being designed to increase progressivity and make the tax system more growth-friendly.** Some regressive VAT exemptions will be removed and the

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

personal income tax will be simplified by reducing exemptions and equalizing the tax burden between employees and the self-employed through a single, more progressive tax schedule. The authorities are developing a feebate scheme to accelerate the transition towards low-emission vehicles (¶28). The Legislative Assembly has approved a new law to require a periodic review of tax expenditures with the goal of eliminating those that no longer serve their intended purpose. A new Customs Law should help increase revenue, facilitate trade, and deter fraud through risk-based enforcement.

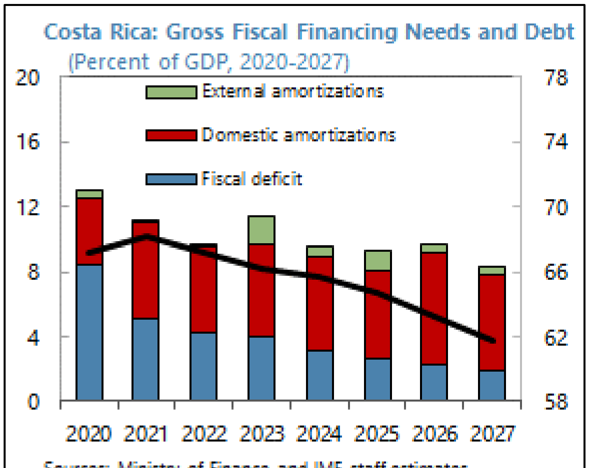
21. The government is prioritizing improving the equity and efficiency of government spending. In April, the authorities published a revamped Medium-Term Fiscal Framework for the entire nonfinancial public sector, including a statement of fiscal risks (a SB in the program). The framework was updated in September ahead of the 2023 budget. The Public Employment Bill is expected to be fully implemented by end-March 2023, which will help improve fairness and efficiency. The new public procurement law will strengthen transparency and accountability in public purchases. Efforts are underway to consolidate public services within fewer institutions and restructure line ministries. Finally, new gender budgeting initiatives (¶25) will further support equity in government spending.

22. The urgency to address climate change vulnerabilities has prompted broader efforts to improve public investment management. The Public Investment Management Assessment (PIMA) identified lower efficiency scores in Costa Rica compared to peers, especially in terms of capital budget allocation and execution. This has led to weaker quality infrastructure. The authorities intend, therefore, to strengthen capital project appraisal and selection including by incorporating climate change and resiliency considerations (¶28).



Source: Making Public Investment More Efficient.

23. Costa Rica's risk of sovereign stress is moderate (Annex II). Central government debt is projected to decline to 62 percent of GDP in 2027 and gross financing needs are estimated to decline from about 11½ percent of GDP in 2023 (including a 1½ percent of GDP repayment on a maturing Eurobond) to about 8 percent in 2027. The authorities have updated their Medium-Term Debt Management Strategy to incorporate contingent liabilities and will centralize all public debt management within a single entity by end-June 2023 (a proposed SB). They also plan to extend the Treasury Single Account to decentralized and



Sources: Ministry of Finance and IMF staff estimates.

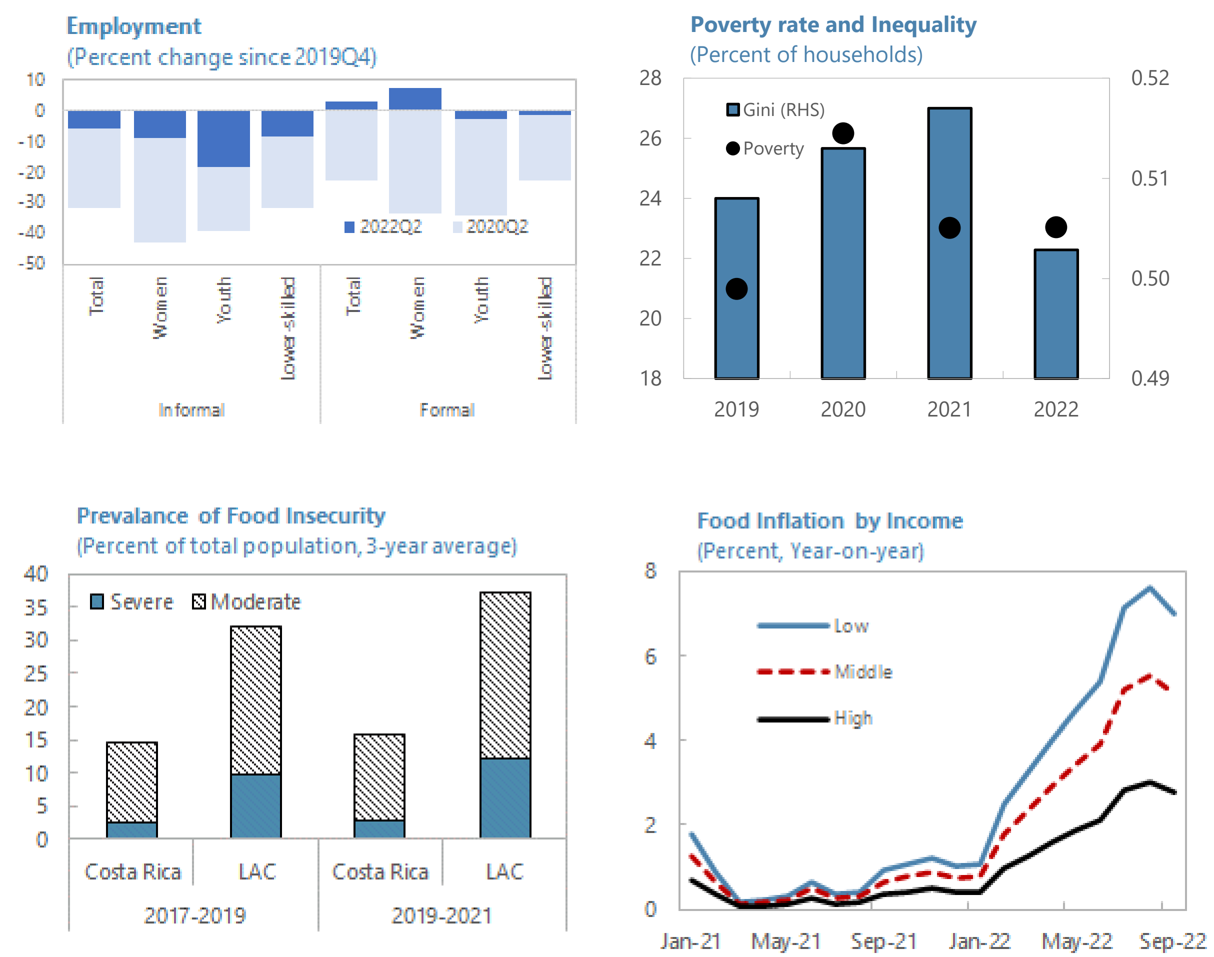
autonomous public entities. Legislative approval of a multi-year borrowing plan through Eurobond issuances will also give the government greater flexibility in debt management.

C. Advancing the Agenda for Inclusive Growth

Background

24. The pandemic has worsened social indicators. Informal employment remains 6 percent below pre-pandemic levels (particularly for young, female, and lower-skilled workers) and labor force participation has fallen. Despite universal access to publicly provided healthcare and education, Costa Rica entered the pandemic with high income inequality and poverty. While the GINI coefficient improved to 0.50 in 2022, after peaking in 2021, the share of the population in poverty remains elevated at 23 percent, and food insecurity has increased by 1.4 p.p. (particularly for

Costa Rica: Labor and Social Indicators



Sources: INEC; FAO; BCCR; and IMF staff estimates.
Note: The poorest households (bottom three deciles) spend 33.9 percent of their consumption basket on food items, compared to 13.4 percent by the high income ones (top two deciles).

women), with the recent food price shock especially weighing on the poorest segments of the population. The education system results in relatively poor learning outcomes despite high spending levels, and social assistance programs have limited coverage.[6]

Policy Discussion

25. The authorities are committed to strengthening social protection and fostering a more dynamic and equitable economy. Key priorities include:

- ***Strengthening the social safety net***. Spending on key social assistance programs is being increased alongside efforts to improve targeting and delivery. The newly-available, centralized digital information on recipients is being deployed to conduct an impact assessment of existing cash-transfer and in-kind programs. This analysis will be used to eliminate ineffective programs, improve targeting, and create a more accurate picture of how best to meet coverage goals.

- ***Incentivizing formal employment***. To encourage formal part-time or flexible employment, the Social Security Fund approved in September 2022 a plan to reduce the minimum contribution base for part-time workers, starting with workers younger than 35 (with a plan to expand to the entire workforce by 2025). The authorities also aim to differentiate social security contributions for independent workers by age, years in the job market, and for seasonal employment to encourage enrollment. A plan is also under consideration to make social security contributions tax deductible.

- ***Empowering women***. To reduce family care requirements and support female labor force participation, the authorities plan to strengthen the quality of existing public childcare services and offer co-payment schemes for privately provided childcare. The government is targeting an expansion of long-term care services and money transfers will be provided to caregivers that are living in extreme poverty. A pilot project on gender budgeting is expected to be completed by end-December 2022 and the 2024 budget will include a statement identifying gender-related spending for selected entities inside and outside the national budget.

- ***Enhancing the quality of education***. Based on an extensive review of school curricula by competencies, the authorities plan to develop a proposal for a new performance-based evaluation model for teachers by early 2024. Efforts are ongoing to increase digitalization in schools, support remote education, and expand access to technology by vulnerable groups. Vocational training curricula are being redesigned with the goal of exploiting synergies between universities and the business world to address skill mismatches.

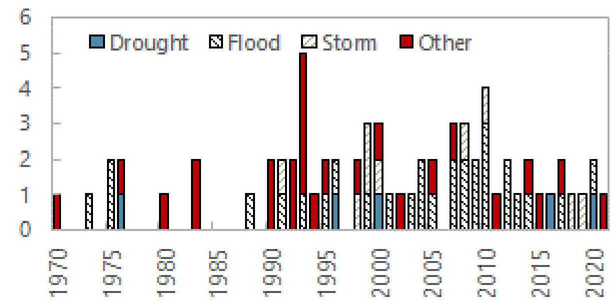
[6] See “The inequality and Informality Challenge” in the 2021 Article IV Consultation and EFF Request Staff Report.

D. Supporting Climate Change Resilience and Decarbonization

Background

26. Costa Rica faces increasing vulnerability to climate change. Costa Rica is exposed to higher temperatures and sea levels as well as more frequent and severe droughts, storms, and floods. Tropical storms have caused significant damage to roads and houses this year, prompting declarations of national emergency. Damage from natural disasters has averaged 0.5–0.7 percent of GDP per year but could rise over the medium term. Greater investment in infrastructure resilience will have a high pay-off, reducing the volatility of activity and, over time, saving fiscal resources (Annex III).

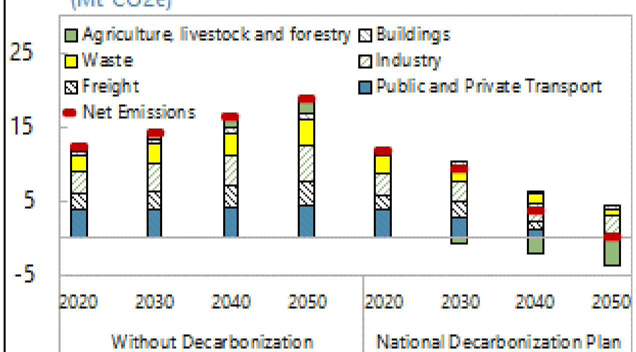
Costa Rica: Key Natural Hazard Statistics
(Number of occurences)



Source: EM-DAT, The International disasters database.

27. Decarbonization and conservation are integral to the government's economic plan. Nearly 100 percent of Costa Rica's electricity is generated from renewables and ambitious programs have enabled the country to nearly double the size of its forests in a generation. The government has a National Decarbonization Plan to reach net-zero emissions by 2050 with targets for 2030 that are more ambitious than the commitments under the Paris Agreement. Costa Rica's commitment to environmental sustainability is a key selling point for tourism (creating a significant source of income, jobs, and FX receipts).

Costa Rica: Greenhouse Gas Emissions
(Mt CO2e)



Source: RAND Climate Resilience Center.

Policy Discussion

28. The authorities are committed to advancing their ambitious climate change agenda under the RSF arrangement in four key areas:

- ***Integrating Climate Risks into Fiscal Planning.*** Natural disaster risks are already well integrated into the analysis of fiscal risks but fiscal planning can be enriched by an analysis of transition risks. Accordingly, the Ministry of Finance plans to expand their quantitative analysis in the MTFF to incorporate transition risks (proposed Reform Measure (RM) for end-September 2023). To attain a better overall picture of climate-related resource allocation and prioritization, the authorities will issue guidelines for climate budget tagging (proposed RM for end-February

2023) and then develop the associated financial management information systems for such tagging.

- ***Strengthening Public Investment and Infrastructure Resilience.*** Building on Costa Rica's National Adaptation Plan, the authorities have finalized a roadmap to scale up environmentally conscious investment, reduce climate-related infrastructure loss, and support public service continuity. Annual costs are estimated at around 0.5–0.7 percent of 2021 GDP in 2022–26, which will be financed within the existing budget envelope through a mix of public and private resources. Building on the PIMA recommendations and the authorities' existing methodology, which already includes climate adaptation considerations, new appraisal guidelines are being developed to assess the impact of new projects on climate change by incorporating the social cost of carbon (proposed RM for end-September 2023) and clear and transparent climate criteria will be incorporated into new project selection (proposed end-December 2023 RM). Given the importance of spatial planning for climate resilience, the authorities will integrate climate change adaptation considerations into their urban planning using a common methodology (proposed RM for end-February 2024).

- ***Supporting Decarbonization.*** The National Decarbonization Plan continues to guide the authorities' goal to fully decarbonize the economy by 2050. Electrification of transport is a major component of this effort, capitalizing on the fact that Costa Rica already has a large share of renewables in electricity generation. In addition to recently renewed incentives to purchase electric vehicles, the authorities will submit a bill to introduce a feebate scheme tied to emissions (proposed RM for end-September 2023) and review existing tax incentives that have a negative effect on the environment (proposed RM for end-February 2024). Charging centers for electric buses at subsidized prices are being expanded and bus concessions are being renegotiated to incentivize electrification. A cost reduction strategy has been introduced by the national electricity company and benchmark tariffs are being lowered for electricity providers. Greater competition is also being introduced in private-sector power generation by simplifying the administrative procedures for private participation in power generation from renewables (a proposed RM for end-December 2022). With 30 percent of its marine ecosystems already under conservation, Costa Rica is participating in a multi-country initiative to preserve swim-ways and biological corridors.

- ***Greening Reserves and Strengthening Financial Sector Resilience***.[7] The BCCR is committed to strengthen the "greenness" of its reserve holdings, increasing exposures to issuers with the best environmental credentials, and will publish environmental indicators of its investment portfolio in their 2022 Annual Report (proposed RM for end-February 2023). The BCCR is building a data repository to outline the effects of climate hazards on banks' lending exposures with a goal of covering 35 percent of their total credit portfolio by end-February 2023 (proposed RM) and expanding it over time. Using this data, the BCCR will incorporate climate effects on banks' credit risk in its "top-down" stress test (proposed RM for end-February 2024). Also, to ensure

[7] See also Box 2 on "Greening the Financial Sector in Costa Rica" in First and Second EFF Reviews Staff Report.

banks adequately internalize climate change in their risk management practices, CONASSIF will require socioenvironmental and climate change risks to be incorporated into banks' assessments of their credit portfolios (proposed RM for end-September 2023).

PROGRAM MODALITIES

29. The authorities request a Resilience and Sustainability Facility (RSF) arrangement. Costa Rica is eligible for RST financing.[8] The RSF arrangement is proposed to coincide with the period remaining under the EFF arrangement. The proposed disbursements are aligned with the three remaining semi-annual reviews of the EFF arrangement. To support Costa Rica's prospective balance-of-payments stability, the authorities have requested access under the RSF for SDR 554.1 million (150 percent of quota, Table 9). As highlighted in the previous section and Annex III, damage from past natural disasters has been significant, resulting in sizable economic, fiscal, and balance-of-payments costs, creating pressures on the currency and reserves. Costa Rica has ambitious adaptation and decarbonization plans to tackle its climate change challenges, as also highlighted by the breath and strength of the proposed RSF reform package (¶31). Nevertheless, their plans also entail significant costs, including to support the transition to a lower carbon economy, within a tight spending envelope, with most of the projected gains accruing over the medium to long term. Taken together, these considerations justify a larger-than-normal RSF access. The RSF arrangement will provide resources to reduce vulnerabilities as well as additional buffers to face future shocks and support the reform agenda. Importantly, RSF resources would substitute for more expensive financing, generating much needed fiscal space and easing balance-of-payment needs. Implementation of the authorities' far-reaching RMs proposed under the RSF arrangement are expected to improve the efficiency of budget planning and public investment, creating further fiscal space, mitigate financial risks, strengthening public debt dynamics and prospective balance-of-payments stability.

30. RSF resources are expected to replace more expensive domestic budget financing and catalyze new official and private sector climate financing. Identified concessional financing for climate adaptation includes more than US$115 million in grants and approximately US$1.5 billion in loans from development partners. The authorities have also passed legislation to support issuance of securities focused on sustainability. Supervised entities are (i) incorporating sustainable or responsible components in their investment policies, (ii) integrating ESG into their risk management, (iii) planning to issue ESG bonds, and (iv) voluntarily disclosing ESG actions. Also, to catalyze more private financing, the IDB and UN are exploring the use of special purpose vehicles and guarantee schemes to promote ESG investments by the private sector, including domestic pension funds. Finally, Costa Rica is aiming to be recognized as an ESG-indexed sovereign and considering the issuance of thematic bonds to international investors with key performance indicators related to forestry coverage, ecological integrity and biodiversity.

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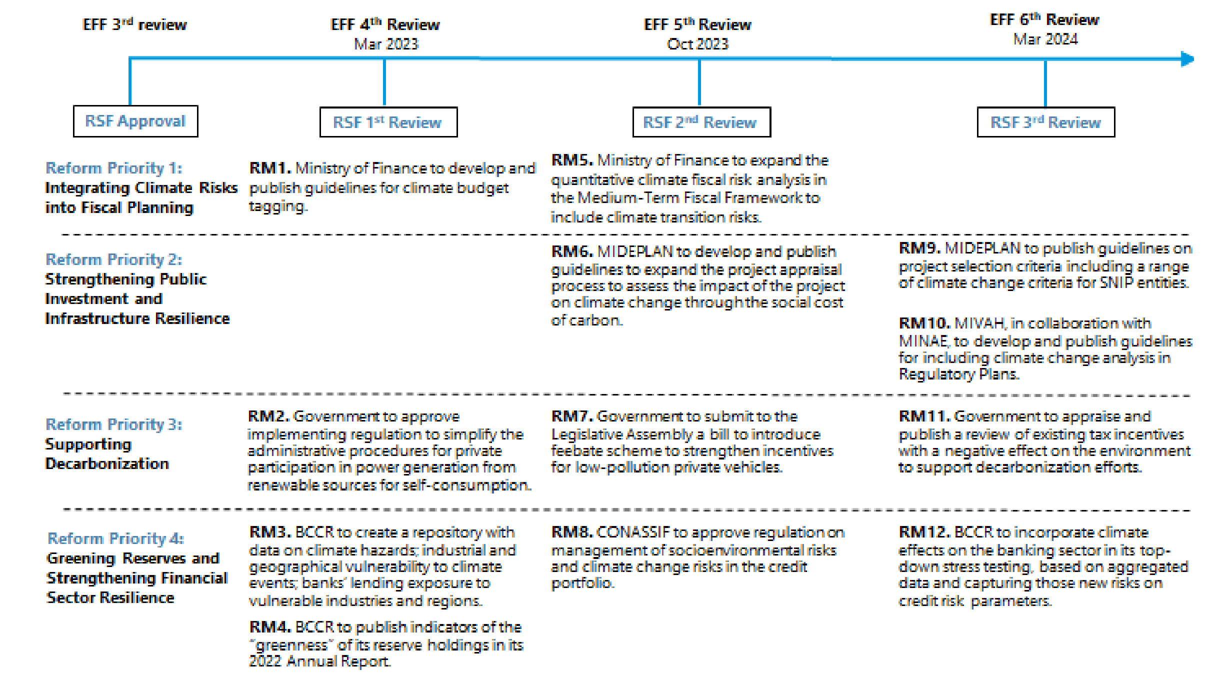
[8] Costa Rica belongs to the RST interest group C, as per [IMF Policy Paper No. 2022/013 Proposal To Establish A Resilience and Sustainability Trust](), Appendix III.

31. Program conditionality under the EFF and RSF arrangements is being set as follows:

- **EFF Quantitative Targets and Structural Benchmarks.** In light of the commodity price shock, and based on the ongoing corrective actions to rebuild reserves buffers by the BCCR, the authorities requested a waiver of nonobservance of the end-June QPC on the NIR. The indicative targets on CG debt for end-December 2022 and March 2023 are being reset to accommodate an expected front-loading of debt issuance to build up liquidity buffers. The MPCC has been left unchanged since it is aligned with the central bank's inflation target. New PCs and ITs have been proposed for June-December 2023 (MEFP, Table 1). Two new SBs have also been proposed (MEFP, Table 2): (i) to improve crisis resolution, the government is to submit legal amendments of the framework on bank resolution and deposit insurance to the Legislative Assembly; (ii) to strengthen debt management, the government will submit a bill to centralize debt-related functions.

Costa Rica: Reform Measures Supported by the RSF Arrangement



- **RSF Reform Measures.** Twelve RMs have been proposed under the RSF arrangement (MEFP, Table 3) to cover four reform priority areas: (i) integrating climate issues into fiscal planning through climate budget tagging and an expansion of the fiscal risk analysis in the MTFF to include transition risks; (ii) strengthening public investment and infrastructure resilience to climate change through enhancements to project appraisal, project selection, and urban regulatory plans; (iii) supporting decarbonization by facilitating more private-sector power generation from renewables, introducing feebates to incentivize the purchase of low-pollution vehicles, and reviewing tax incentives that have negative environmental effects; and (iv) publishing indicators of the "greenness" of BCCR reserves, creating a data repository of

climate hazards and banking sector vulnerabilities, incorporating climate information in banks' stress tests, and approving regulations on best practices for banks' management of socioenvironmental and climate change risks. The scope and timeline of the reforms are ambitious but feasible for a country like Costa Rica with an already strong climate change track record.

32. **Capacity to repay remains adequate even over the medium to long run and the program is fully financed.** Access under the EFF is helping Costa Rica meet its existing balance-of-payments needs and will continue to be used for direct budget support. The program remains fully financed with firm financing commitments over the next 12 months and good prospects thereafter. Proposed access under the RSF arrangement will be used for direct budget support and provide Costa Rica with more affordable financing at longer maturities, further improving their capacity to repay. Capacity to Repay indicators show that Costa Rica has an adequate capacity to repay to the Fund with RSF resources (Annex IV and Table 7): (i) Total Fund Credit Outstanding is mostly inside the interquartile range for GRA-only borrowing countries, peaking at 3.4 percent of GDP, 8.0 percent of exports (of goods and services), or 523 percent of quota (323 percent of quota excluding the RSF credit outstanding)[9] in 2024 and with a downward sloping trend over time (Table 7 and Panel A); (ii) the inclusion of RST resources does not strongly increase Costa Rica's total debt service to the Fund, with the near-term increase due to repurchases of the 2020 Rapid Financing Instrument (RFI) purchase (Panel B); (iii) Costa Rica's largest peaks for both credit outstanding (as percent of GDP) and debt service to the Fund with RST resources are at or below the 25th percentile of comparators (Panel C).

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

	2022	2023	2024
Financing need	3,040	2,904	953
Reserve accumulation	1,320	454	664
Underlying BOP need 1/	1,720	2,450	289
Official multilateral financing	3,040	2,904	953
IMF	555	1,040	523
EFF	555	549	276
RSF	0	491	247
Other multilateral creditors	2,485	1,864	430
World Bank	368	372	119
Inter-American Development Bank	693	439	186
CAF Development Bank for Latin America	0	500	0
Central American Bank for Economic Integration	323	553	125
Latin American Reserve Fund	1,100	0	0
Unidentified financing	0	0	0
Memorandum items:			
Capital market access	0	1,500	1,500
Gross international reserves	8,241	8,695	9,359
In percent of the ARA metric	99	100	102

Source: IMF staff estimates.
1/ Net of private sector and bilateral financing.

33. **The program remains subject to downside risks, particularly from a more challenging external environment.** External risks include further increases in commodity prices, a global slowdown, and tighter financial conditions. The program, however, has the flexibility to accommodate negative spillovers from global developments. A return to financing through international bonds is planned, but additional financing could be mobilized domestically and from regional partners in the event downside risks materialize. The program has built in buffers to respond to external shocks while meeting program objectives and ensuring capacity to repay the Fund remains adequate. Nevertheless, were revenues to underperform, the authorities stand ready

[9] The exceptional access frameworks that apply to GRA and PRGT credit do not apply to RST financing.

to reprioritize non-critical spending and propose temporary tax measures as needed to ensure that the program goals remain within reach. While the government's minority in the Legislative Assembly poses implementation risks for legislative reforms, continued efforts by the authorities to build a broad-based consensus on their economic reform program are expected to mitigate these risks. Climate change poses an important risk but the authorities' ongoing policy efforts are expected to strengthen Costa Rica's resilience to future climate-related shocks.

STAFF APPRAISAL

34. Despite multiple shocks, the authorities are taking important steps to strengthen Costa Rica's economic reform program. After a strong rebound in 2021, global headwinds have started to slow economic activity, amid elevated inflationary pressures. The outlook remains subject to important downside risks. Nevertheless, the new administration has reiterated their commitment to the program objectives and is making important advances on their reform agenda.

35. Monetary policy needs to continue to proactively respond to the shocks facing the economy. The BCCR's decisive move to tighten the monetary policy stance was warranted, and it should continue adjusting monetary policy in line with its data-dependent and forward-looking approach, supported by clear and transparent communication. Against a difficult external environment, the BCCR is taking appropriate steps to strengthen its reserve position and deepen the FX market, while promoting exchange rate flexibility. Important legal amendments are underway to strengthen the BCCR's governance, autonomy, and operational framework.

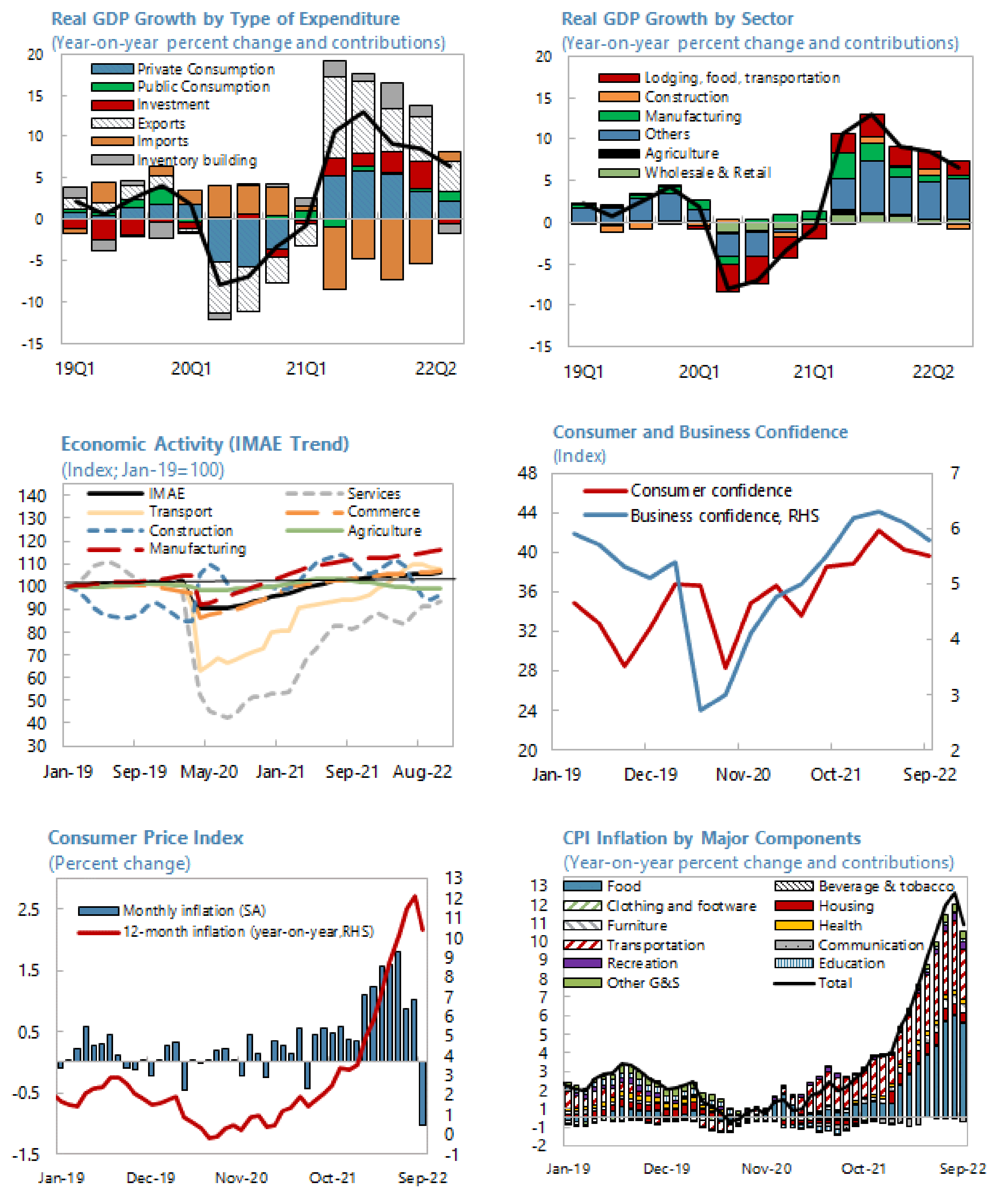
36. A steady fiscal consolidation should continue through revenue gains and prudent spending. The authorities are on track to exceed their end-2022 primary balance target and have submitted a prudent 2023 budget to further strengthen debt sustainability. They should press ahead with reforms to increase the fairness and progressivity of the tax system, improve the equity and efficiency of government spending, and strengthen debt management. There is also scope to re-examine the fiscal rule, while preserving its essential role in containing spending and reducing debt.

37. The authorities are committed to strengthen social protection and foster a more dynamic and equitable economy. The authorities have appropriately provided targeted support to alleviate the impact of inflation on the most vulnerable. Additional resources for the most effective social assistance programs, alongside actions to enhance targeting and delivery, are being supported by measures to incentivize formal employment, improve the quality of education, and boost female labor force participation.

38. The supervisory authorities are proactively monitoring the financial system. Ongoing efforts to strengthen bank supervisory and regulatory powers and to enhance the legal framework for bank resolution and deposit insurance are critical. The authorities should also press ahead with reforms to level the playing field between public and private banks, enhance bank competition, and improve access to finance.

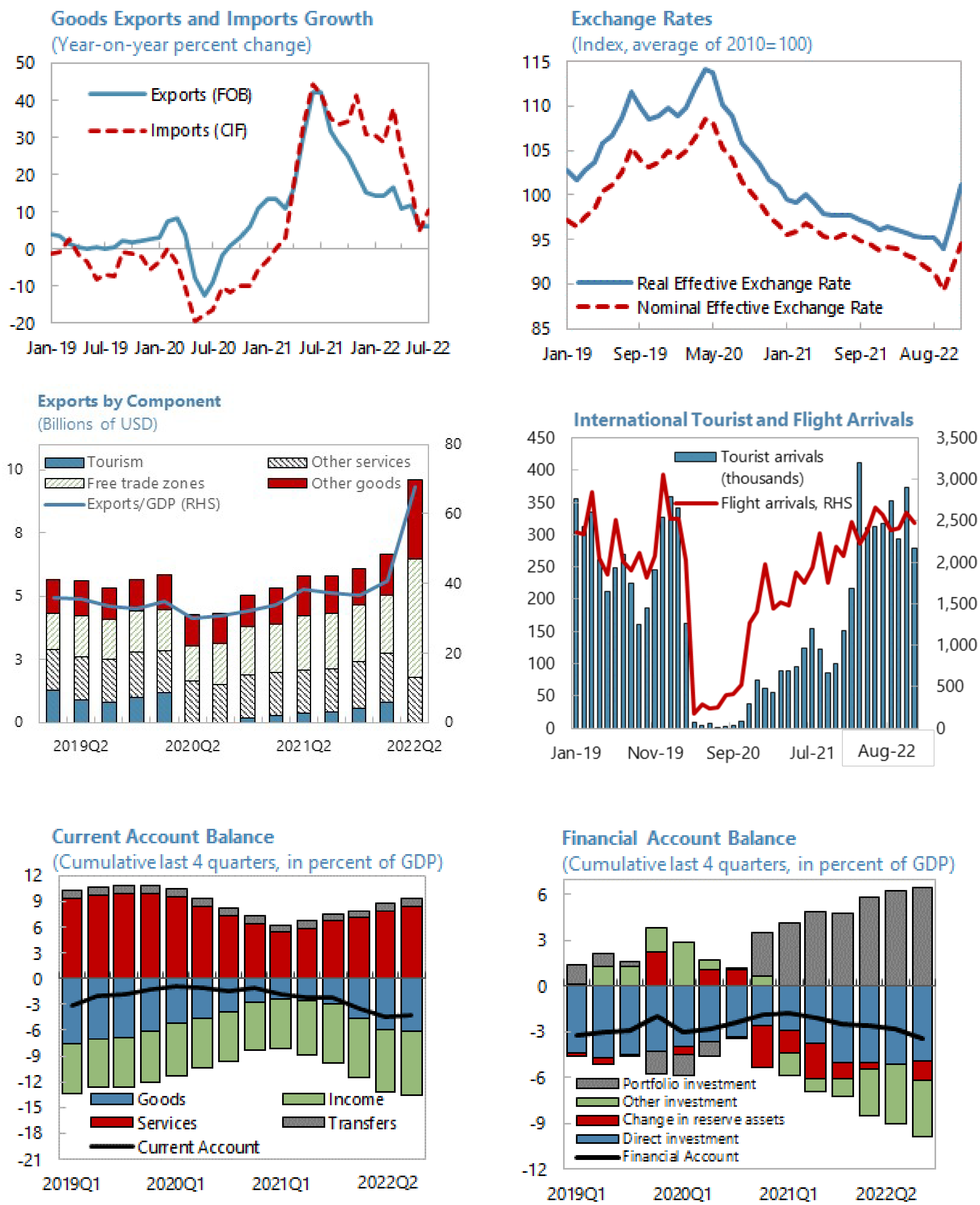
39. Staff supports the authorities' request for an RSF arrangement and recommends completion of the third review under the EFF. The RSF arrangement would support Costa Rica's commendable efforts to assess climate risks, decarbonize its economy, strengthen infrastructure resilience, and green the financial sector. The RSF arrangement is also expected to catalyze further climate financing from official and private sector sources. Given the strong performance to date and the authorities' continued commitment to strong policies and reforms, staff supports completion of the third review under the EFF, completion of the monetary policy consultation, and the request for a waiver of nonobservance of a performance criterion.

Figure 1. Costa Rica: Real Sector Developments



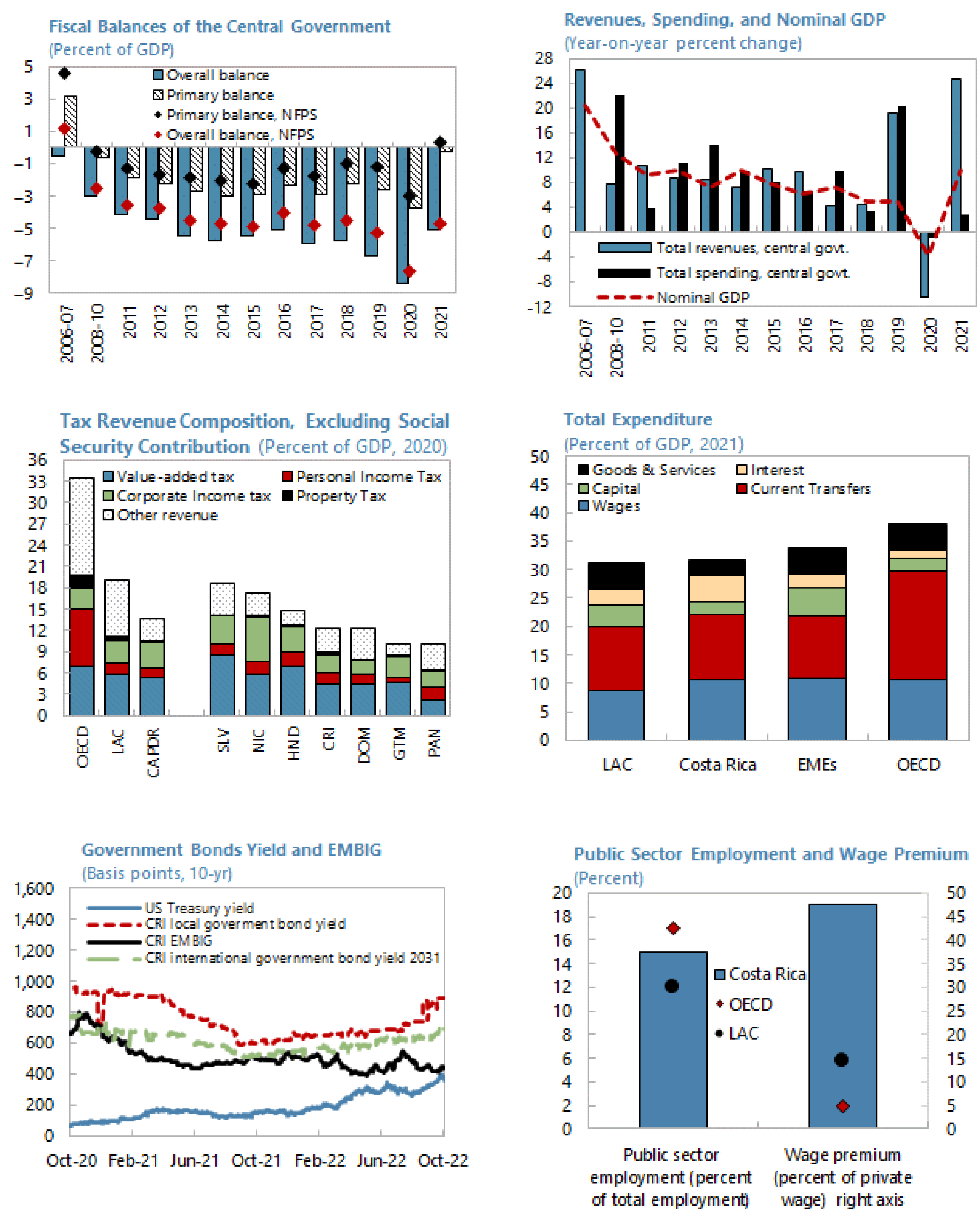
Sources: National authorities and IMF staff estimates.

Figure 2. Costa Rica: External Sector Developments



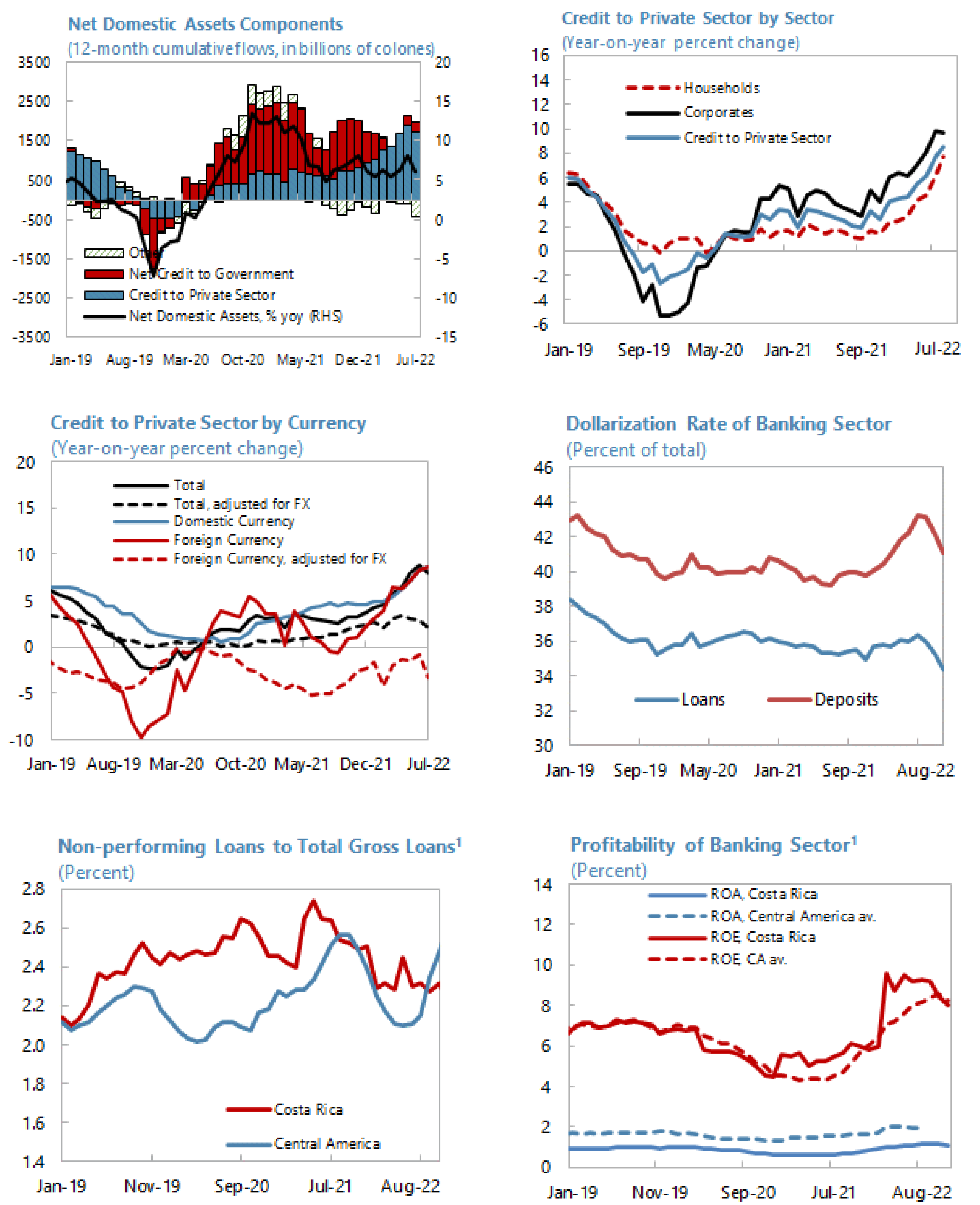
Sources: National authorities; FlightRadar24; and IMF staff estimates.

Figure 3. Costa Rica: Fiscal Sector Developments



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

Figure 4. Costa Rica: Monetary and Financial Sector Developments



Sources: National authorities and IMF staff estimates.

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

Table 1. Costa Rica: Selected Economic and Financial Indicators

				Projections							
	2019	2020	2021	2022	2022	2023	2023	2024	2025	2026	2027
				CR/22/93		CR/22/93					
National Income					(Annual percentage change)						
Real GDP	2.4	-4.1	7.8	3.6	4.3	3.3	2.9	3.0	3.2	3.3	3.2
Domestic demand	0.2	-3.6	7.6	2.4	3.1	2.7	2.4	2.7	2.9	3.2	3.1
Consumption	2.5	-3.8	5.3	2.8	3.6	2.5	2.5	2.6	2.8	2.9	2.8
Private	1.7	-5.0	6.4	3.6	4.0	3.2	2.9	3.0	3.2	3.3	3.2
Public	5.9	0.6	1.4	-0.7	2.4	-0.4	1.3	0.8	1.2	1.3	1.4
Gross fixed capital formation	-8.2	-1.7	8.7	4.3	3.7	5.4	4.2	4.7	5.1	5.2	5.0
Exports of goods and nonfactor services	4.3	-10.9	15.9	9.2	8.3	7.6	5.7	6.1	6.5	6.1	6.0
Imports of goods and nonfactor services	-2.3	-10.2	16.2	6.2	4.8	6.3	4.5	5.4	6.1	6.1	6.1
					(Contributions to real GDP growth)						
Domestic demand	0.2	-3.5	7.4	2.3	3.0	2.5	2.3	2.5	2.8	3.0	3.0
Consumption	2.0	-3.1	4.3	2.2	2.9	1.9	2.0	2.0	2.2	2.3	2.2
Gross domestic investment	-1.8	-0.4	3.1	0.1	0.2	0.6	0.3	0.5	0.6	0.8	0.8
of which: Inventory changes	-0.3	-0.1	1.7	-0.6	-0.5	-0.3	-0.4	-0.2	-0.2	-0.1	-0.1
Net exports	2.2	-0.6	0.3	1.2	1.3	0.7	0.6	0.5	0.4	0.3	0.3
Prices					(Annual percentage change)						
GDP deflator	2.6	0.2	2.1	3.3	5.4	3.4	4.4	3.5	3.1	3.0	3.0
Consumer prices (period average)	2.1	0.7	1.7	4.8	8.6	3.7	6.4	3.8	3.3	3.0	3.0
Consumer prices (end of period)	1.5	0.9	3.3	4.4	9.5	3.4	4.8	3.4	3.1	3.0	3.0
Savings and Investment					(In percent of GDP)						
Savings	16.1	15.8	19.7	19.1	20.5	19.2	20.2	20.0	19.8	19.8	19.7
Domestic savings	14.8	14.8	16.4	16.0	15.9	16.3	15.9	16.4	16.5	16.6	16.8
Private sector	17.5	20.6	19.4	18.1	18.3	17.2	17.4	17.1	16.5	16.4	16.4
Public sector	-2.7	-5.8	-3.0	-2.1	-2.4	-0.9	-1.5	-0.7	-0.1	0.2	0.4
External savings	1.3	1.0	3.3	3.1	4.6	2.9	4.3	3.6	3.4	3.2	2.9
Gross domestic investment	16.1	15.8	19.7	19.1	20.5	19.2	20.2	20.0	19.8	19.8	19.7
Private sector	13.2	13.7	17.9	17.0	18.6	17.0	18.1	17.8	17.6	17.5	17.5
Public sector	2.9	2.1	1.8	2.1	1.9	2.3	2.1	2.2	2.3	2.3	2.3
External Sector											
Current account balance	-1.3	-1.0	-3.3	-3.1	-4.6	-2.9	-4.3	-3.6	-3.4	-3.2	-2.9
Trade balance	-6.0	-2.7	-4.4	-6.6	-7.3	-7.4	-7.4	-7.2	-7.0	-7.0	-6.9
Services	9.8	6.4	6.7	8.9	8.4	9.9	9.0	9.6	9.7	9.7	9.9
Capital account balance	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account balance	-2.0	-1.9	-2.5	-3.1	-4.6	-2.9	-4.3	-3.6	-3.3	-3.1	-2.9
Foreign direct investment, net	-4.2	-2.6	-4.8	-5.1	-5.1	-5.0	-4.9	-4.9	-4.8	-4.8	-4.7
Gross international reserves (millions of U.S. dollars)	8,937	7,232	6,921	8,611	8,241	9,081	8,695	9,359	9,530	10,261	10,891
-as percent of ARA metric	132.5	105.4	94.2	105.5	98.9	107.5	100.2	102.0	100.9	103.1	104.3
-in months of next year's imports	6.1	3.9	3.0	3.7	3.4	3.7	3.4	3.5	3.3	3.4	3.6
External debt	47.8	50.8	51.3	58.0	54.6	58.3	55.5	56.6	56.0	56.2	55.9
Real effective exchange rate, avg. (percent change)	0.6	1.0	-9.2	...	...	...	...	...	...	...	...
Public Finances 1/											
Central government primary balance	-2.6	-3.8	-0.3	0.7	1.1	1.3	1.3	1.7	2.0	2.2	2.3
Central government overall balance	-6.7	-8.4	-5.1	-4.5	-4.3	-3.6	-4.0	-3.2	-2.6	-2.3	-1.9
Central government debt	56.4	67.2	68.2	68.6	67.2	68.3	66.3	65.8	64.8	63.3	61.8
Money and Credit											
Credit to the private sector (percent change)	-2.3	3.4	3.7	3.8	6.2	6.0	5.0	5.8	6.5	6.8	6.8
Monetary base 2/	7.1	8.3	7.9	8.0	7.3	8.2	7.2	7.3	7.3	7.3	7.4
Broad money	44.8	55.0	54.1	53.0	48.9	53.1	48.5	48.6	48.8	48.8	48.9
Memorandum Items											
Nominal GDP (billions of colones) 3/	37,832	36,356	39,993	42,592	43,992	45,464	47,275	50,410	53,662	57,142	60,752
Output gap (as percent of potential GDP)	0.2	-3.4	0.1	-0.1	0.8	0.1	0.3	0.0	-0.1	-0.1	0.0
GDP per capita (US$)	12,691	12,118	12,436	12,663	13,159	13,267	13,868	14,321	14,888	15,526	16,189
Unemployment rate	12.4	20.0	13.7	13.0	12.5	12.0	13.2	13.0	12.0	10.5	9.0

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

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

2/ Includes currency issued and required reserves.

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

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

				Projections							
	2019	2020	2021	2022	2022	2023	2023	2024	2025	2026	2027
				CR/22/93		CR/22/93					
					(In billions of colones)						
Revenue	**5,676**	**5,077**	**6,326**	**6,391**	**6,908**	**6,877**	**7,229**	**7,699**	**8,190**	**8,690**	**9,206**
Tax revenue	4,940	4,385	5,566	5,710	6,006	6,168	6,485	6,916	7,368	7,825	8,300
Nontax revenue[2/]	735	693	760	681	902	709	744	783	823	865	907
Expenditure	**8,223**	**8,147**	**8,379**	**8,326**	**8,806**	**8,510**	**9,141**	**9,312**	**9,590**	**9,976**	**10,389**
Current noninterest	5,803	5,781	5,839	5,349	5,723	5,377	5,757	5,897	6,080	6,311	6,587
Wages	2,613	2,612	2,624	2,664	2,709	2,695	2,737	2,733	2,775	2,841	2,910
Goods and services	327	337	342	303	354	307	350	356	375	400	427
Transfers	2,863	2,832	2,874	2,381	2,659	2,375	2,670	2,808	2,930	3,069	3,251
Interest[3/]	1,553	1,701	1,941	2,221	2,375	2,242	2,521	2,456	2,455	2,538	2,588
Capital	867	665	599	756	708	892	862	958	1,055	1,127	1,213
Primary balance	**-994**	**-1,368**	**-112**	**287**	**478**	**609**	**609**	**844**	**1,055**	**1,252**	**1,406**
Overall Balance	**-2,547**	**-3,069**	**-2,052**	**-1,934**	**-1,897**	**-1,633**	**-1,912**	**-1,612**	**-1,400**	**-1,286**	**-1,182**
Total Financing	2,494	3,388	2,160	1,934	1,897	1,633	1,912	1,612	1,400	1,286	1,182
External (net)	1,119	724	645	2,256	1,340	1,252	2,162	1,369	662	950	936
Domestic (net)	1,376	2,665	1,515	-322	557	381	-250	243	738	336	246
Unidentified financing	0	0	0	0	0	0	0	0	0	0	0
Central government debt	**21,347**	**24,420**	**27,272**	**29,215**	**29,566**	**31,068**	**31,338**	**33,173**	**34,753**	**36,191**	**37,517**
External	4,765	5,898	6,779	9,040	8,044	10,445	10,472	12,014	12,824	13,906	14,972
Domestic	16,582	18,522	20,493	20,174	21,522	20,623	20,866	21,159	21,929	22,285	22,545
Other debt (multilateral financing)	0	0	0	0	0	0	0	0	0	0	0
					(In percent of GDP)						
Revenue	**15.0**	**14.0**	**15.8**	**15.0**	**15.7**	**15.1**	**15.3**	**15.3**	**15.3**	**15.2**	**15.2**
Tax revenue	13.1	12.1	13.9	13.4	13.7	13.6	13.7	13.7	13.7	13.7	13.7
Nontax revenue[2/]	1.9	1.9	1.9	1.6	2.1	1.6	1.6	1.6	1.5	1.5	1.5
Expenditure	**21.7**	**22.4**	**21.0**	**19.5**	**20.0**	**18.7**	**19.3**	**18.5**	**17.9**	**17.5**	**17.1**
Current noninterest	15.3	15.9	14.6	12.6	13.0	11.8	12.2	11.7	11.3	11.0	10.8
Wages	6.9	7.2	6.6	6.3	6.2	5.9	5.8	5.4	5.2	5.0	4.8
Goods and services	0.9	0.9	0.9	0.7	0.8	0.7	0.7	0.7	0.7	0.7	0.7
Transfers	7.6	7.8	7.2	5.6	6.0	5.2	5.6	5.6	5.5	5.4	5.4
Interest[3/]	4.1	4.7	4.9	5.2	5.4	4.9	5.3	4.9	4.6	4.4	4.3
Capital	2.3	1.8	1.5	1.8	1.6	2.0	1.8	1.9	2.0	2.0	2.0
Primary balance	**-2.6**	**-3.8**	**-0.3**	**0.7**	**1.1**	**1.3**	**1.3**	**1.7**	**2.0**	**2.2**	**2.3**
Overall Balance	**-6.7**	**-8.4**	**-5.1**	**-4.5**	**-4.3**	**-3.6**	**-4.0**	**-3.2**	**-2.6**	**-2.3**	**-1.9**
Total Financing	**6.6**	**9.3**	**5.4**	**4.5**	**4.3**	**3.6**	**4.0**	**3.2**	**2.6**	**2.3**	**1.9**
External (net)	3.0	2.0	1.6	5.3	3.0	2.8	4.6	2.7	1.2	1.7	1.5
Domestic (net)	3.6	7.3	3.8	-0.8	1.3	0.8	-0.5	0.5	1.4	0.6	0.4
Unidentified financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Central government debt	**56.4**	**67.2**	**68.2**	**68.6**	**67.2**	**68.3**	**66.3**	**65.8**	**64.8**	**63.3**	**61.8**
External	12.6	16.2	17.0	21.2	18.3	23.0	22.2	23.8	23.9	24.3	24.6
Domestic	43.8	50.9	51.2	47.4	48.9	45.4	44.1	42.0	40.9	39.0	37.1
Other debt (unidentified financing)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:											
Non-interest expenditure growth (percent)											
in nominal terms	19.6	-3.4	-0.1	-5.2	-0.1	2.7	2.9	3.6	4.1	4.2	4.9
in real terms	17.2	-4.1	-1.8	-9.5	-8.0	-1.0	-3.3	-0.2	0.8	1.2	1.8
Nominal GDP (billions of colones)	37,832	36,356	39,993	42,592	43,992	45,464	47,275	50,410	53,662	57,142	60,752

Sources: Ministry of Finance and IMF staff estimates.

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

2/ In 2022, includes a one-off transfer of surpluses from public entities accumulated before their CG consolidation and not used in 2021 as per Law 9524.

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

Table 3. Costa Rica: Balance of Payments

	2019	2020	2021	Projections 2022	2022	2023	2023	2024	2025	2026	2027
				CR/22/93		CR/22/93					
						(In millions of U.S. dollars)					
Current Account	**-826**	**-639**	**-2,136**	**-2,055**	**-3,166**	**-2,048**	**-3,151**	**-2,785**	**-2,694**	**-2,665**	**-2,624**
Goods and services balance	2,424	2,294	1,463	1,515	707	1,739	1,193	1,894	2,151	2,303	2,617
Trade balance	-3,868	-1,708	-2,848	-4,371	-5,052	-5,198	-5,413	-5,480	-5,628	-5,936	-6,179
Export of goods (f.o.b.)	11,831	11,991	14,823	16,076	17,016	17,060	18,076	19,202	20,519	21,819	23,331
Import of goods (f.o.b.)	15,700	13,699	17,671	20,447	22,067	22,259	23,489	24,682	26,147	27,755	29,510
Services balance	6,292	4,003	4,311	5,886	5,758	6,938	6,606	7,375	7,779	8,239	8,797
Of which: Travel balance	2,953	1,085	1,038	2,021	2,034	3,015	2,740	3,249	3,433	3,612	3,808
Exports of services	10,906	8,005	8,938	10,786	10,980	12,467	12,396	13,380	14,086	14,823	15,686
Imports of services	4,614	4,002	4,627	4,901	5,222	5,529	5,789	6,006	6,306	6,584	6,889
Primary Income	-3,832	-3,501	-4,150	-4,202	-4,482	-4,449	-4,970	-5,331	-5,515	-5,673	-5,981
Secondary Income	582	568	551	633	609	662	625	651	670	705	740
Capital Account	**32**	**17**	**19**	**21**	**21**	**23**	**23**	**26**	**28**	**31**	**34**
Financial Account	**-1,268**	**-1,172**	**-1,622**	**-2,035**	**-3,145**	**-2,025**	**-3,129**	**-2,760**	**-2,666**	**-2,634**	**-2,590**
Public sector	-1,002	421	-737	-2,282	-2,794	-913	-2,291	-1,801	-868	-1,215	-1,103
Private sector	-1,658	161	-623	-1,442	-1,670	-1,582	-1,291	-1,624	-1,969	-2,150	-2,117
Foreign direct investment, net	-2,695	-1,644	-3,110	-3,413	-3,526	-3,521	-3,599	-3,738	-3,885	-4,057	-4,214
Other private sector flows	1,037	1,806	2,487	1,971	1,855	1,939	2,308	2,115	1,916	1,907	2,097
Change in International Reserves (increase +)	1,393	-1,754	-263	1,690	1,320	470	454	664	171	731	630
Errors and Omissions	**-473**	**-550**	**495**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
						(In percent of GDP)					
Current Account	**-1.3**	**-1.0**	**-3.3**	**-3.1**	**-4.6**	**-2.9**	**-4.3**	**-3.6**	**-3.4**	**-3.2**	**-2.9**
Goods and services balance	3.8	3.7	2.3	2.3	1.0	2.5	1.6	2.5	2.7	2.7	2.9
Trade balance	-6.0	-2.7	-4.4	-6.6	-7.3	-7.4	-7.4	-7.2	-7.0	-7.0	-6.9
Export of goods (f.o.b.)	18.4	19.3	23.0	24.2	24.7	24.3	24.7	25.1	25.6	25.8	26.2
Import of goods (f.o.b.)	24.4	22.0	27.4	30.8	32.1	31.7	32.0	32.3	32.6	32.8	33.1
Services balance	9.8	6.4	6.7	8.9	8.4	9.9	9.0	9.6	9.7	9.7	9.9
Of which: Travel balance	4.6	1.7	1.6	3.0	3.0	4.3	3.7	4.2	4.3	4.3	4.3
Exports of services	16.9	12.9	13.9	16.3	15.9	17.8	16.9	17.5	17.5	17.5	17.6
Imports of services	7.2	6.4	7.2	7.4	7.6	7.9	7.9	7.9	7.9	7.8	7.7
Primary Income	-5.9	-5.6	-6.4	-6.3	-6.5	-6.3	-6.8	-7.0	-6.9	-6.7	-6.7
Secondary Income	0.9	0.9	0.9	1.0	0.9	0.9	0.9	0.9	0.8	0.8	0.8
Capital Account	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Financial Account	**-2.0**	**-1.9**	**-2.5**	**-3.1**	**-4.6**	**-2.9**	**-4.3**	**-3.6**	**-3.3**	**-3.1**	**-2.9**
Public sector	-1.6	0.7	-1.1	-3.4	-4.1	-1.3	-3.1	-2.4	-1.1	-1.4	-1.2
Private sector	-2.6	0.3	-1.0	-2.2	-2.4	-2.3	-1.8	-2.1	-2.5	-2.5	-2.4
Foreign direct investment, net	-4.2	-2.6	-4.8	-5.1	-5.1	-5.0	-4.9	-4.9	-4.8	-4.8	-4.7
Other private sector flows	1.6	2.9	3.9	3.0	2.7	2.8	3.1	2.8	2.4	2.3	2.4
Change in International Reserves (increase +)	2.2	-2.8	-0.4	2.5	1.9	0.7	0.6	0.9	0.2	0.9	0.7
Errors and Omissions	**-0.7**	**-0.9**	**0.8**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Memorandum Items:											
Non-oil current account (percent of GDP)	1.2	0.3	-0.9	-0.1	-0.7	-0.2	-0.9	-0.7	-0.5	-0.3	-0.2
Terms of trade (annual percentage change)	-0.8	3.5	-2.6	-1.0	-0.9	1.3	1.5	0.8	0.8	0.9	0.8
Gross international reserves (millions of U.S. dollars)	8,937	7,232	6,921	8,611	8,241	9,081	8,695	9,359	9,530	10,261	10,891
Net international reserves, program definition (millions of U.S. dollars)[1/]	6,099	3,712	2,884	3,830	3,639	3,622	2,870	3,605	3,755	4,327	4,892
External debt (percent of GDP)[2/]	47.8	50.8	51.3	58.0	54.6	58.3	55.5	56.6	56.0	56.2	55.9

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

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

2/ Includes public and private sector debt.

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

				Projections							
	2019	2020	2021	2022	2022	2023	2023	2024	2025	2026	2027
				CR/22/93		CR/22/93					
	(In millions of U.S. dollars)										
Gross external financing needs	**-8,164**	**-10,647**	**-11,021**	**-11,910**	**-12,896**	**-11,775**	**-13,910**	**-11,989**	**-11,843**	**-11,943**	**-11,993**
Current account balance	-826	-639	-2,136	-2,055	-3,166	-2,048	-3,151	-2,785	-2,694	-2,665	-2,624
Amortization	-4,777	-4,888	-5,247	-5,094	-6,079	-6,085	-7,605	-6,185	-6,310	-5,912	-5,968
Public sector, of which	-740	-1,145	-771	-356	-357	-1,452	-2,175	-960	-1,059	-613	-491
Central government	-93	-340	-129	-120	-121	-426	-387	-32	-308	-344	-293
Central bank	-377	-627	-2	0	0	0	-275	-550	-275	0	0
Private sector	-4,036	-3,743	-4,476	-4,738	-5,722	-4,633	-5,430	-5,225	-5,251	-5,299	-5,478
of which: short-term	-3,048	-2,709	-3,382	-3,650	-4,577	-3,467	-4,348	-4,131	-4,152	-4,177	-4,322
Other net capital inflows 1/	-2,561	-5,120	-3,638	-4,761	-3,651	-3,642	-3,154	-3,018	-2,838	-3,366	-3,401
Gross external financing sources	**7,669**	**9,267**	**9,867**	**9,623**	**10,955**	**9,904**	**11,068**	**11,283**	**11,112**	**11,268**	**11,389**
Capital transfers	32	17	19	21	21	23	23	26	28	31	34
Direct investment, net	2,695	1,644	3,110	3,413	3,526	3,521	3,599	3,738	3,885	4,057	4,214
Borrowing	6,334	5,852	6,476	7,879	8,729	6,830	7,900	8,183	7,371	7,911	7,771
Public sector, of which	2,262	524	576	2,086	2,467	1,579	2,436	2,867	2,008	1,965	1,800
Central government	1,539	215	-12	1,344	278	1,287	1,696	1,602	1,068	1,075	1,060
of which: Eurobonds	1,467	0	0	1,000	0	1,000	1,500	1,500	1,000	1,000	1,000
Central bank 2/	0	0	0	0	1,100	0	0	0	0	0	0
Private sector	4,072	5,328	5,901	5,793	6,261	5,251	5,464	5,317	5,363	5,946	5,971
Change in International reserves (increase -)	-1,393	1,754	263	-1,690	-1,320	-470	-454	-664	-171	-731	-630
Use of IMF credit	**0**	**522**	**294**	**582**	**555**	**523**	**978**	**276**	**-186**	**-70**	**-164**
Purchases	0	522	294	582	555	589	1,040	523	0	0	0
RFI	0	522	0	0	0	0	0	0	0	0	0
EFF	0	0	294	582	555	589	549	276	0	0	0
RSF	0	0	0	0	0	0	491	247	0	0	0
Repurchases	0	0	0	0	0	-66	-61	-247	-186	-70	-164
Other gross multilateral financing	**495**	**858**	**861**	**1,705**	**1,385**	**1,349**	**1,864**	**430**	**916**	**744**	**769**
World Bank	...	105	313	426	368	369	372	...	...	...	...
Inter-American Development Bank (IDB)	...	282	404	613	693	350	439	...	...	...	...
CAF	...	448	0	50	0	500	500	...	...	...	...
Central American Bank for Economic Integration (CABEI)	...	23	144	617	323	130	553	...	...	...	...
Debt rescheduling or refinancing	0	0	0	0	0	0	0	0	0	0	0
Other exceptional financing	0	0	0	0	0	0	0	0	0	0	0
Unidentified financing	0	0	0	0	0	0	0	0	0	0	0
Memorandum items:											
Gross multilateral support	495	1,380	1,154	2,288	1,940	1,938	2,904	953	916	744	769
In percent of GDP	0.8	2.2	1.8	3.5	2.8	2.8	4.0	1.2	1.1	0.9	0.9
Of which, committed	...	1,380	1,154	2,288	1,940	1,938	2,904	953	916	744	769
Of which, disbursed	...	1,380	1,154	0	0	0	0	0	0	0	0
IMF share of total gross multilateral financing (percent)											
Purchases and disbursements, flow basis	...	38	25	25	29	30	36	...	...	...	...
Purchases and disbursements, cumulative basis	...	38	32	28	31	29	33	...	...	...	...
Current account balance (percent of GDP)	-1.3	-1.0	-3.3	-3.1	-4.6	-2.9	-4.3	-3.6	-3.4	-3.2	-2.9
Gross international reserves	8,937	7,232	6,921	8,611	8,241	9,081	8,695	9,359	9,530	10,261	10,891
In percent of the ARA metric	133	105	94	106	99	107	100	102	101	103	104
In percent of ST debt (remaining maturity)	183	138	114	137	106	175	133	142	157	164	172
In percent of gross external financing requirement	156	123	84	103	75	126	90	100	109	115	415
In months of next year's imports of G&S	6.1	3.9	3.0	3.7	3.4	3.7	3.4	3.5	3.3	3.4	3.6

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

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

2/ Includes FLAR credit line in 2022.

Table 5. Costa Rica: Monetary Survey

	2019	2020	2021	2022	2022	2023	2023	2024
				Projections				
				CR/22/93		CR/22/93		
	(In billions of colones, unless otherwise indicated)							
Central Bank								
Net foreign assets	5,035	4,474	4,007	5,084	4,695	5,492	5,171	5,733
Of which : Gross international reserves								
(In millions of U.S. dollars)	8,937	7,232	6,921	8,611	8,241	9,081	8,695	9,359
Net domestic assets	-2,367	-1,441	-852	-1,680	-1,499	-1,772	-1,774	-2,070
Net domestic credit	-2,166	-1,894	-1,592	-1,901	-1,939	-2,049	-2,103	-2,212
Monetary stabilization instruments (-)	-1,859	-1,564	-1,364	-1,364	-1,364	-1,364	-1,364	-1,364
Other items (net)	-710	-226	-112	-631	-413	-575	-524	-711
Capital account (-)	2,367	2,243	2,216	2,216	2,216	2,216	2,216	2,216
Monetary base[1/]	2,667	3,033	3,155	3,404	3,196	3,720	3,397	3,663
Currency	1,305	1,498	1,529	1,621	1,407	1,718	1,604	1,700
Required reserves	1,362	1,535	1,626	1,783	1,789	2,002	1,793	1,963
Other Depository Institutions								
Net foreign assets	-1,681	-720	-63	-213	748	-227	804	857
Net domestic assets	24,885	27,100	28,912	30,591	29,926	32,595	31,852	33,895
Net domestic credit	28,483	30,630	33,228	33,850	35,557	36,073	36,509	38,583
Credit to nonfinancial public sector (net)	2,674	3,900	5,841	5,255	6,357	5,609	5,843	6,090
Credit to nonfinancial private sector	20,896	21,601	22,405	23,053	23,798	24,443	24,977	26,430
In national currency	13,249	13,583	14,212	14,875	15,417	16,178	16,468	17,785
In foreign currency	7,647	8,019	8,193	8,178	8,380	8,265	8,510	8,645
Credit to financial corporations (net)	4,913	5,129	4,982	5,541	5,402	6,020	5,689	6,063
Other items (net)	1,352	1,602	1,222	2,662	484	2,841	1,915	2,319
Capital account	-4,950	-5,131	-5,538	-5,920	-6,115	-6,319	-6,571	-7,007
Liabilities to nonfinancial private sector	23,204	26,380	28,849	30,378	30,674	32,368	32,656	34,752
In national currency	15,059	16,593	17,466	18,641	17,640	19,898	18,780	20,026
In foreign currency	8,146	9,787	11,383	11,737	13,033	12,470	13,876	14,726
Of which: Deposits (including CDs)	23,025	26,201	28,643	30,141	29,622	32,663	32,087	35,094
Consolidated Financial System								
Net foreign assets	3,354	3,753	3,944	4,871	5,443	5,264	5,975	6,590
Net domestic assets	21,080	23,953	25,727	26,329	25,901	27,910	27,430	28,912
Net domestic credit	23,021	25,465	27,939	28,002	29,729	29,746	30,394	32,094
Other items (net)	643	1,376	1,110	2,031	71	2,267	1,391	1,608
Capital account	-2,583	-2,888	-3,322	-3,704	-3,899	-4,103	-4,355	-4,791
Broad money	16,957	19,990	21,655	22,584	21,491	24,125	22,945	24,518
Memorandum Items	(Annual percentage change)							
Monetary base[1/]	-5.2	13.7	4.0	7.9	1.3	9.3	6.3	7.8
Broad money	4.0	17.9	8.3	5.1	-0.8	6.8	6.8	6.9
Credit to the private sector	-2.3	3.4	3.7	3.8	6.2	6.0	5.0	5.8
In national currency	1.8	2.5	4.6	5.4	8.5	8.8	6.8	8.0
In foreign currency	-8.6	4.9	2.2	1.1	2.3	1.1	1.5	1.6
Credit to the private sector (adjusted by exchange rate changes)	0.1	0.8	2.4	4.0	7.0	5.9	4.3	5.7
	(In percent of GDP)							
Monetary base[1/]	7.1	8.3	7.9	8.0	7.3	8.2	7.2	7.3
Broad money	44.8	55.0	54.1	53.0	48.9	53.1	48.5	48.6
Of which: Deposits denominated in foreign currency	14.2	18.5	20.5	18.8	21.3	18.5	21.1	20.7
Credit to the private sector	55.2	59.4	56.0	54.1	54.1	53.8	52.8	52.4
Of which: In foreign currency	20.2	22.1	20.5	19.2	19.1	18.2	18.0	17.2
Central bank balance	-0.4	0.3	0.1	0.0	0.0	0.0	0.0	0.0

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

1/ Includes currency issued and required reserves.

Table 6. Costa Rica: Financial Soundness Indicators

	2017	2018	2019	2020	2021	2022
	Dec	Dec	Dec	Dec	Dec	August
			(In percent)			
Capitalization						
Risk-adjusted capital ratio	16.8	16.7	17.5	16.8	16.5	16.2
Capital-to-assets ratio	13.9	14.2	15.2	14.4	14.4	14.1
Asset quality						
Nonperforming loans to total loans	2.0	2.1	2.4	2.5	2.3	2.2
Non-income generating assets to total assets	16.2	16.3	15.8	18.3	17.1	17.8
Foreclosed assets to total assets	0.8	1.0	1.1	1.1	1.0	1.0
Loan loss provisions to total loans	2.8	3.3	3.5	4.2	4.3	4.3
Credit in foreign currency to total credit	39.2	39.1	36.6	37.1	36.6	35.1
Management						
Administrative expenses to total assets	3.1	3.1	3.2	3.0	2.9	3.0
Noninterest expenses to gross income	73.7	77.6	83.1	82.0	79.1	86.0
Total expenses to total revenues	94.8	95.6	96.7	97.2	94.6	95.6
Profitability						
Return on assets (ROA)	0.9	0.9	1.0	0.6	0.9	1.1
Return on equity (ROE)	6.5	6.8	6.8	4.6	6.5	8.2
Interest margin to gross income	25.3	21.3	16.4	18.9	26.9	17.4
Liquidity						
Liquid assets to total short-term liabilities	102.7	98.6	96.8	93.9	89.9	94.0
Liquid assets to total assets	29.1	28.0	29.8	33.0	35.7	35.0
Loans to deposits[1/]	112.3	113.1	105.6	99.0	95.6	95.9
Liquid assets to deposits	45.5	43.7	44.6	50.0	52.4	51.2
Sensitivity to market risk						
Net open FX position to capital	22.7	21.1	23.5	25.1	25.6	25.8
Other						
Financial margin[2/]	6.6	7.1	7.1	6.7	7.0	6.9

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

Table 7. Costa Rica: Indicators of Fund Credit

	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	2036	2037	2038	2039	2040	2041	2042	2043	2044
Fund obligations based on existing credit (millions of SDRs)																							
Principal	0.0	46.2	184.7	138.5	51.6	68.8	68.8	68.8	68.8	68.8	17.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Charges and interest 1/	6.3	27.3	23.1	17.0	13.6	11.7	9.6	7.5	5.4	3.2	1.7	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Fund obligations based on existing and prospective credit (millions of SDRs)																							
Principal	0.0	46.2	184.7	138.5	51.6	120.3	189.1	206.3	206.3	206.3	154.7	95.2	63.4	55.4	55.4	55.4	55.4	55.4	55.4	55.4	55.4	46.2	9.2
GRA	0.0	46.2	184.7	138.5	51.6	120.3	189.1	206.3	206.3	206.3	154.7	85.9	17.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
RSF	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	9.2	46.2	55.4	55.4	55.4	55.4	55.4	55.4	55.4	55.4	46.2	9.2
Charges and interest 1/2/	7.8	52.6	77.3	71.9	68.0	67.0	58.3	46.1	36.5	30.2	24.4	20.3	17.8	16.0	14.3	12.6	11.0	9.3	7.6	5.9	4.3	2.6	1.6
Total obligations based on existing and prospective credit																							
Millions of SDRs	7.8	98.8	262.0	210.4	119.6	187.3	247.3	252.4	242.8	236.4	179.1	115.5	81.1	71.4	69.7	68.0	66.4	64.7	63.0	61.3	59.7	48.8	10.8
Percent of exports of goods and services	0.0	0.4	1.1	0.8	0.4	0.7	0.8	0.8	0.7	0.6	0.5	0.3	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0
Percent of gross international reserves	0.1	1.5	3.7	3.0	1.6	2.3	2.9	2.8	2.5	2.3	1.6	1.0	0.7	0.5	0.5	0.5	0.4	0.4	0.4	0.3	0.3	0.2	0.0
Percent of government revenue	0.1	1.2	3.0	2.3	1.3	1.9	2.3	2.3	2.0	1.9	1.3	0.8	0.5	0.4	0.4	0.4	0.3	0.3	0.3	0.3	0.2	0.2	0.0
Percent of public external debt service	0.7	3.6	12.6	9.9	6.9	10.3	12.8	12.3	11.1	10.2	7.2	4.4	2.9	2.4	2.2	2.0	1.9	1.7	1.6	1.4	1.3	1.0	0.2
Percent of GDP	0.0	0.2	0.5	0.4	0.2	0.3	0.4	0.3	0.3	0.3	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Percent of quota	2.1	26.7	70.9	57.0	32.4	50.7	67.0	68.3	65.7	64.0	48.5	31.3	22.0	19.3	18.9	18.4	18.0	17.5	17.1	16.6	16.2	13.2	2.9
Principal	0.0	12.5	50.0	37.5	14.0	32.6	51.2	55.8	55.8	55.8	41.9	25.8	17.2	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	12.5	2.5
GRA	0.0	12.5	50.0	37.5	14.0	32.6	51.2	55.8	55.8	55.8	41.9	23.3	4.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
RSF	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	2.5	12.5	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	12.5	2.5
Outstanding IMF credit based on existing and prospective drawings																							
Millions of SDRs	988.2	1,723.9	1,930.1	1,791.6	1,740.0	1,619.7	1,430.6	1,224.4	1,018.1	811.9	657.2	562.1	498.7	443.3	387.9	332.5	277.1	221.6	166.2	110.8	55.4	9.2	0.0
GRA	988.2	1,354.5	1,376.0	1,237.5	1,185.9	1,065.6	876.5	670.3	464.0	257.8	103.1	17.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
RSF	0.0	369.4	554.1	554.1	554.1	554.1	554.1	554.1	554.1	554.1	554.1	544.9	498.7	443.3	387.9	332.5	277.1	221.6	166.2	110.8	55.4	9.2	0.0
Percent of exports of goods and services	4.7	7.5	7.9	7.0	6.4	5.6	4.7	3.8	3.0	2.2	1.7	1.4	1.1	0.9	0.8	0.6	0.5	0.4	0.3	0.2	0.1	0.0	0.0
Percent of gross international reserves	16.1	26.4	27.6	25.3	22.9	20.2	16.8	13.5	10.6	7.9	6.0	4.9	4.1	3.4	2.8	2.3	1.8	1.3	0.9	0.6	0.3	0.0	0.0
Percent of government revenue	12.3	20.5	22.1	19.7	18.3	16.3	13.6	10.9	8.5	6.4	4.9	3.9	3.3	2.7	2.3	1.8	1.4	1.1	0.8	0.5	0.2	0.0	0.0
Percent of total public external debt	6.9	10.3	10.4	9.2	8.3	7.3	6.1	4.9	3.8	2.9	2.2	1.8	1.5	1.2	1.0	0.8	0.6	0.5	0.3	0.2	0.1	0.0	0.0
Percent of GDP	1.9	3.1	3.4	3.0	2.8	2.5	2.1	1.7	1.3	1.0	0.7	0.6	0.5	0.4	0.3	0.3	0.2	0.2	0.1	0.1	0.0	0.0	0.0
Percent of quota	267.5	466.7	522.5	485.0	471.0	438.5	387.3	331.5	275.6	219.8	177.9	152.2	135.0	120.0	105.0	90.0	75.0	60.0	45.0	30.0	15.0	2.5	0.0
GRA	267.5	366.7	372.5	335.0	321.0	288.5	237.3	181.5	125.6	69.8	27.9	4.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
RSF	0.0	100.0	150.0	150.0	150.0	150.0	150.0	150.0	150.0	150.0	150.0	147.5	135.0	120.0	105.0	90.0	75.0	60.0	45.0	30.0	15.0	2.5	0.0
Net use of IMF credit (millions of SDRs)	412.5	735.7	206.2	-138.5	-51.6	-120.3	-189.1	-206.3	-206.2	-206.3	-154.7	-95.2	-63.4	-55.4	-55.4	-55.4	-55.4	-55.4	-55.4	-55.4	-55.4	-46.2	-9.2
Disbursements	412.5	781.9	390.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayments and repurchases	0.0	46.2	184.7	138.5	51.6	120.3	189.1	206.3	206.3	206.3	154.7	95.2	63.4	55.4	55.4	55.4	55.4	55.4	55.4	55.4	55.4	46.2	9.2
Memorandum items:																							
Exports of goods and services (millions of U.S. dollars)	27,996	30,472	32,582	34,605	36,642	39,017	41,482	44,103	46,890	49,853	53,003	56,352	59,912	63,698	67,723	72,002	76,551	81,388	86,531	91,998	97,811	103,991	110,562
Gross international reserves (millions of U.S. dollars)	8,241	8,695	9,359	9,530	10,261	10,891	11,579	12,311	13,088	13,915	14,795	15,730	16,723	17,780	18,904	20,098	21,368	22,718	24,154	25,680	27,302	29,027	30,861
Quota (millions of SDRs)	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4	369.4

Source: IMF staff estimates and projections.

1/ Based on the GRA rate of charge of 3.155 percent as of October 13, 2022.

2/ Costa Rica belongs to the RST interest Group C. Based on the RST rate of interest of 3.105 percent as of October 13, 2022.

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

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

Source: IMF staff calculations.

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

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

Source: IMF staff calculations.

Annex I. External Sector Assessment

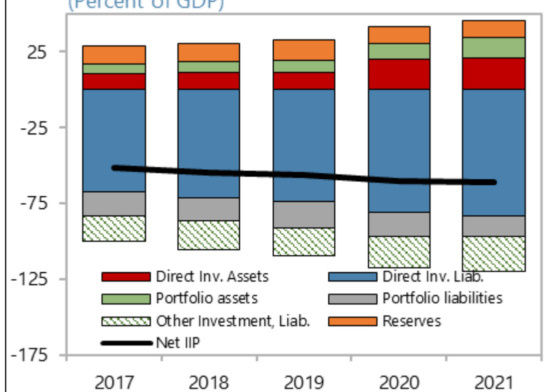
Overall Assessment: *The external position of Costa Rica in 2021 was broadly in line with the level implied by fundamentals and desirable policies. Resilient manufacturing exports were offset by a still-weak tourism sector and stronger imports amid the recovery and rising oil prices, bringing the headline current account (CA) to -3.3 percent of GDP. The assessment takes a medium-term view, with desirable policies set at medium-term levels and temporary factors removed. After adjusting for the temporary nature of the tourism shock and other pandemic-related factors as well as pension outflows diversifying abroad, staff finds a cyclically adjusted CA of -2.3.*

Potential Policy Responses: *The authorities' fiscal consolidation and BCCR's data-dependent monetary policy approach should continue to support external sustainability. At the same time, the structural agenda will help boost business creation and attract investment, rebalancing the external position in the medium-term.*

Foreign Assets and Liabilities: Position and Trajectory

Background. The NIIP has been trending down slowly, reflecting yearly CA deficits, and is projected at -60.8 percent of GDP in 2021. Liabilities mainly include FDI (69 percent of total) with non-portfolio (19 percent) and portfolio (13 percent) external debt comprising most of remainder. External debt was 51 percent of GDP in 2021. It is projected to peak at 57 percent of GDP in 2024, then decline below 56. About 14 percent of external debt is at short-term maturity and nearly all external debt is denominated in foreign currency.

International Investment Position
(Percent of GDP)



Sources: BCCR and IMF staff estimates.

Assessment. The substantial share of FDI in Costa Rica's liabilities mitigate potential risks from its large net debtor position. Declining public sector external debt in the medium-term would also indicate a trend towards sustainability. This is further indicated by the results of the ES model. The positive CA gap indicates the CA is higher than the level required to stabilize the NIIP.

2021 (% GDP)	NIIP: -60.8	Gross Assets: 59.4	Debt Assets: 29.8	Gross Liab.: 120.2	Debt Liab.: 36.2

Current Account

Background. The current account deficit widened to 3.3 percent of GDP in 2021 from 1 percent in 2020 (elevated above the five-year average of 2.6 percent), mainly due to a rise in import prices, and a slow recovery of tourism, which produced only 6.7 percent of exports in 2021 compared to nearly 17.5 percent of exports in 2019. Goods export growth in 2021 was supported primarily by manufacturing. The tourism sector is expected to recover slowly, supporting an improvement in the current account over the medium term.

Assessment. The EBA current account (CA) model suggests a current account gap of 0.5 percent of GDP in 2021, after including adjustors to the current account for the temporary impact of the pandemic and excess pension outflows.[1] In 2020, the gap was 2.3 percent of GDP. The policy gap in 2021—the difference between current and desirable policies—is mostly driven by the relatively

stronger global fiscal expansion in response to the COVID-19 shock. Domestically, higher public savings from the gradual fiscal consolidation under the program should ease crowding out and facilitate higher domestic investment.[2] The EBA external sustainability (ES) model indicates a current account gap of 1.5, meaning the current account deficit is already smaller than the level needed to stabilize net foreign assets at the 2021 level.

Costa Rica continues to pursue an ambitious free trade agenda, having applied in 2022 for membership in the CPTPP and begun negotiations on a free trade agreement with Ecuador. Further trade opening will support diversification of Costa Rica's trading relationships and expand opportunities for trade-based growth.

Costa Rica: EBA Model Estimates, 2021

(in percent of GDP, unless otherwise indicated)

	CA model	REER index model	REER level model	ES model
CA-Actual	**-3.3**			**-3.3**
Cyclical Contributions (from model)	-0.3			-0.3
Temporary factors related to the pandemic 1/	-2.5			-2.5
Excess pension outflows	1.8			1.8
Adjusted CA	**-2.3**			**-2.3**
CA Norm (from model) 2/	**-2.8**			**-3.8**
Adjustments to the norm	0.0			0.0
Adjusted CA Norm	**-2.8**			**-3.8**
CA Gap	**0.5**	**3**	**-2.5**	**1.5**
o/w Policy gap	0.9			
Elasticity	-0.28	-0.28	-0.28	-0.28
REER Gap (in percent)	**-1.8**	**-10.8**	**8.9**	**-2.9**

1/ These include adjustments for travel: 2.2, transport: 0.5, and household consumption composition: -0.2.

2/ Cyclically adjusted, including multilateral consistency adjustments.

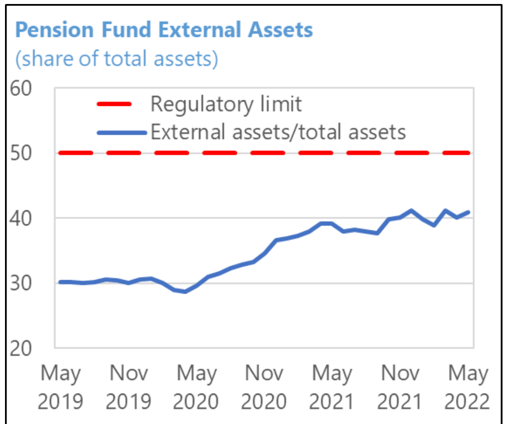
Real Exchange Rate

Background. The REER and NEER have been depreciating over the last five years, with the exception of a sharp appreciation just before the pandemic. The REER and NEER declined by 4.3 percent and 2.6 percent respectively in 2021. In H1 2022 the REER and NEER declined by 2.7 percent and 5.2 percent respectively, but recovered by 7.6 percent and 5.8 percent, respectively in July and August. Exchange rate volatility is partly smoothed by the BCCR's requirement to meet all SOE FX demand outside the FX market.

Assessment. The EBA current account model estimates a REER gap of -1.8 percent using an elasticity of -0.28. The REER index and level models, newly applied to Costa Rica after EBA model revisions in 2022, indicate a gap of -10.8 and 8.9, respectively. The fit of these models is not as good as the CA model, so the assessment is based on the CA model.

Capital and Financial Accounts: Flows and Policy Measures

Background. Costa Rica's capital flows have been dominated by FDI inflows for many years. In 2021, inward FDI rose sharply relative to pre-pandemic levels due to improving competitiveness and near-shoring trends. Inward FDI accounted for 83 percent of net inward capital flows (debits), and net FDI (debit and credit) amounted to 146 percent of the CA. Costa Rica maintains relatively low restrictions on FDI relative to OECD peers.[3] On the other hand, low size and liquidity of the local currency bond market and limited non-resident participation constrain portfolio capital inflows. In normal times, net inward debt portfolio flows represented 20 percent of net inward capital flows on average 2013-17, and total net debt portfolio flows accounted for 33 percent of net capital flows (Table 2 of the main report).



Sources: SUPEN and IMF staff estimates.

Most domestic pension funds are allowed to hold up to half of their assets overseas, but until May 2020 average external asset holdings were only 30 percent of total. Since that time, capital outflows from pension funds have grown dramatically, amounting to US$1.9 billion (2.9 percent of GDP) in 2021 and US$830 million in H1 2022.

Assessment. The external financing structure has been a source of resilience for Costa Rica, with FDI more than covering the current account deficit in normal years. Investments abroad by large pension funds outflows have exerted strong pressure on the exchange rate since May 2020, but outflows have somewhat eased in July and August 2022. The share of external assets in H1 2022 has been suppressed by large negative valuation changes, but headroom remains for about 9 percent more of assets to flow overseas. At the pace at which external assets grew in 2021, the diversification process could continue until roughly end-2024.

FX Intervention and Reserves Level

Background. Gross international reserves (GIR) fell by US$310 million in 2021, reaching US$6.9 billion or 94 percent of the IMF's metric for assessing reserve adequacy (ARA metric) for countries with floating exchange rates.

Until end-September 2022, the BCCR has sold directly about US$270 million on a net basis, in addition to changes in reserves from other sources like external debt disbursements and service. By end-September, GIR stood at US$7.6 billion. A US$1.1 billion loan from the Latin American Reserve Fund (FLAR) in Q3 2022 boosted reserves substantially.

The BCCR operates within a managed floating regime, limiting FX intervention to address episodes of exchange rate volatility. The BCCR also acts as intermediary for SOEs to smooth out their large FX transactions. In 2021, intervention to address volatility amounted to US$36 million in net FX sales and intervention on behalf of SOEs amounted to US$1,304 million in net purchases.

Assessment. Costa Rica's gross FX reserves have fallen somewhat below the 100 percent of ARA adequacy metric at 94 percent in 2021. They are projected to return above the threshold in 2023 and remain there through 2024. A successful return to markets would boost reserves further above the conservative assumptions of the baseline.

Adequacy Metrics
Gross International Reserves, 2021
(percent unless noted otherwise)

Metric	Level	Benchmark
Millions of US dollars	6,921	
ARA metric (floating)	94	100-150
Short-term debt at remaining maturity	114	100
Broad money	21	20
Months of next year's imports	3.2	3

Source: IMF staff estimates

[1] Excess pension flows were calculated by subtracting future "steady state" pension outflows and 2021 BCCR intervention directed at counteracting the outflows from the 2.9 percent of GDP pension outflows in 2021. Pre-pandemic flows of about US$ 400 million per year (0.6 percent of GDP) proxied for steady state flows and all central bank intervention (0.5 percent of GDP in 2021) proxied for pension-directed FX intervention. It is difficult to estimate how many more years the diversification outflows will be sustained because the 50 percent limit on foreign holdings applies to the portfolio, which is affected by large valuation effects as markets swing. Further, outflows had slowed dramatically in July and September 2022. The adjustor is therefore assumed to be a 2-3-year phenomenon and better addressed as a temporary adjustment to the cyclically adjusted current account.

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

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

Annex II. Sovereign Risk and Debt Sustainability Analysis

Annex II. Figure 1. Costa Rica: Sovereign Risk and Debt Sustainability Assessment

Horizon	Mechanical signal	Final assessment	Comments
Overall	…	Moderate	The overall risk reflects a relatvely consistent level of vulnerability over the medium term and long term as well as the use of Fund resources.
Near term 1/	n.a.	n.a.	Not applicable.
Medium term	Moderate	Moderate	The mechanical signal is close to the threshold between a low and moderate risk signal. The final assessmment is informed by the signals as well as the stress scenarios and narrow debt coverage.
Fanchart	Moderate	…	
GFN	Moderate	…	
Stress test	…	…	
Long term	…	Moderate	Climate-related long-term debt risks are limited, partly because investment needs are already within the budget envelope. We assess moderate debt risks from aging, primarily due to a scenario showing pressures to pay pensions (in the absence of further reforms) and to a lesser extent through scenarios of higher healthcare costs and slower GDP growth.
Sustainability assessment 2/		Sustainable	With the implementation of the envisaged policies under the program and Medium-term Fiscal Framework, debt will be on a downward path and financing needs will moderate.
Debt stabilization in the baseline			Yes

DSA summary assessment

Under the baseline scenario, Costa Rica's public debt is assessed to remain sustainable. Public debt is projected to decline to about 67 percent of GDP in 2022, about 62 percent of GDP in 2027, and below 50 percent of GDP by 2035. The main driver of debt dynamics is the fiscal consolidation under the program, which is expected to continue to improve the primary balance. Gross financing needs are estimated at 11.4 percent in 2023 and 8.4 percent in 2027. Financing is expected to come from official external sources, domestic debt, and Eurobonds. The assessment of moderate debt and financing risks over the medium term and long term, together with sensitivity to the exchange rate and the results from the stress scenarios, inform a final assessment of moderate risk. Broader coverage beyond the central government would aid a more comprehensive assessment.

Source: Fund staff.
Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.
1/ The near-term assessment is not applicable in cases where there is a disbursing IMF arrangement. In surveillance-only cases or in cases with precautionary IMF arrangements, the near-term assessment is performed but not published.
2/ A debt sustainability assessment is optional for surveillance-only cases and mandatory in cases where there is a Fund arrangement. The mechanical signal of the debt sustainability assessment is deleted before publication. In surveillance-only cases or cases with IMF arrangements with normal access, the qualifier indicating probability of sustainable debt ("with high probability" or "but not with high probability") is deleted before publication.

Annex II. Figure 2. Costa Rica: Debt Coverage and Disclosures

	CG	GG	NFPS	CPS	Other	Comments
1. Debt coverage in the DSA: 1/	CG	GG	NFPS	CPS	Other	
1a. If central government, are non-central government entities insignificant?					No	

2. Subsectors included in the chosen coverage in (1) above:

		Subsectors captured in the baseline	Inclusion
CPS / NFPS / GG: expected / CG	1	Budgetary central government	Yes
	2	Extra budgetary funds (EBFs)	No
	3	Social security funds (SSFs)	No
	4	State governments	No
	5	Local governments	No
	6	Public nonfinancial corporations	No
	7	Central bank	No
	8	Other public financial corporations	No

3. Instrument coverage:	Currency & deposits	Loans	Debt securities	Oth acct. payable 2/	IPSGSs 3/

4. Accounting principles:	Basis of recording		Valuation of debt stock		
	Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/

5. Debt consolidation across sectors:	Consolidated	Non-consolidated

Color code: chosen coverage; Missing from recommended coverage; Not applicable

Reporting on intra-government debt holdings

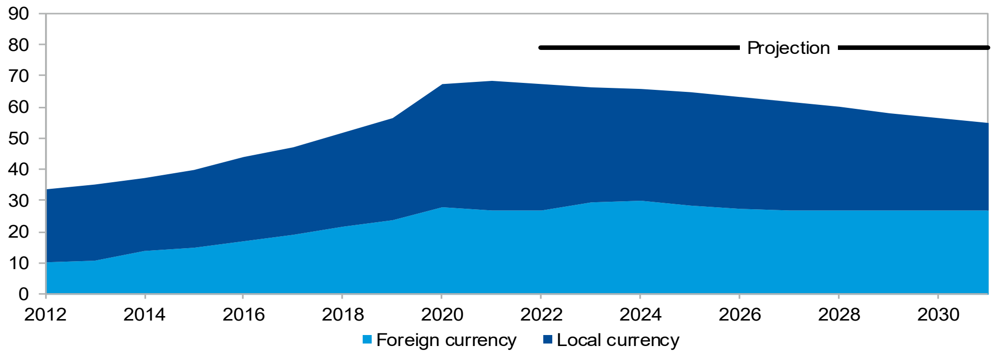
Issuer \ Holder		Budget. central govt	Extra-budget. funds	Social security funds	State govt.	Local govt.	Nonfin. pub. corp.	Central bank	Oth. pub. fin corp	Total
1	Budget. central govt									0
2	Extra-budget. funds									0
3	Social security funds									0
4	State govt.									0
5	Local govt.									0
6	Nonfin pub. corp.									0
7	Central bank									0
8	Oth. pub. fin. corp									0
	Total	0	0	0	0	0	0	0	0	0

1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.
2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.
3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.
4/ Includes accrual recording, commitment basis, due for payment, etc.
5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.
7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.

The coverage in this SRDSA focuses on the central government due to data availability concerns for the broader public sector (including timeliness and quality). Supplementary data suggests unconsolidated domestic debts to other general government entities is about 0.2 percent of GDP and that consolidated debt is low er than for the central government alone in part due to social security fund holdings of government securities. Despite considerable delays due to a cyberattack, the authorities have resumed efforts to improve data timeliness, quality and coverage w ith IMF TA including by expanding GFSM2014 standards to the general government.

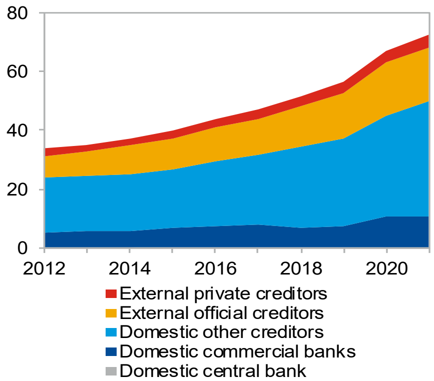
Annex II. Figure 3. Costa Rica: Public Debt Structure Indicators

Debt by currency (percent of GDP)



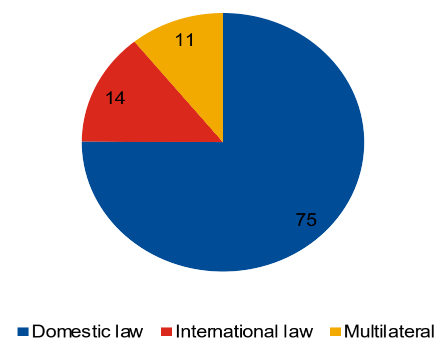
Note: The perimeter shown is central government.

Public debt by holder (percent of GDP)



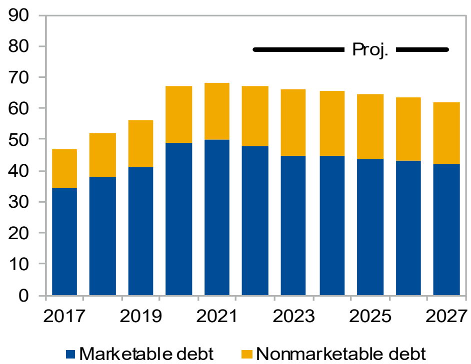
Note: The perimeter shown is central government.

Public debt by governing law, 2021 (percent)



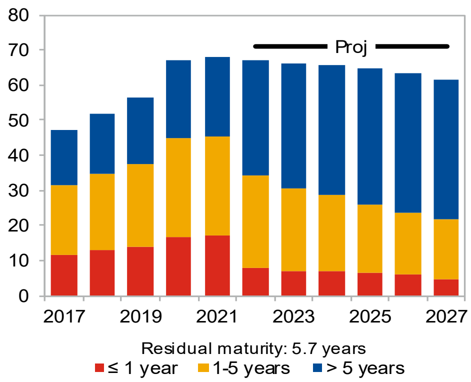
Note: The perimeter shown is central government.

Debt by instruments (percent of GDP)



Note: The perimeter shown is central government.

Public debt by maturity (percent of GDP)



Note: The perimeter shown is central government.

Consistent with the Medium-term Debt Strategy, the share of external debt at longer maturities is expected to rise as the authorities benefit from access to multilateral funding sources and return to the Eurobond market.

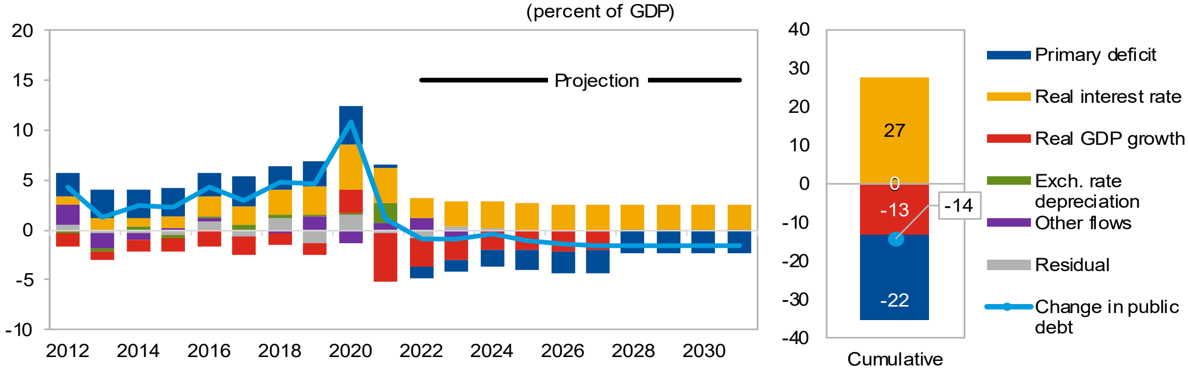
Annex II. Figure 4. Costa Rica: Baseline Scenario

(Percent of GDP unless indicated otherwise)

	Actual	Medium-term projection						Extended projection			
	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Public debt	68.2	67.2	66.3	65.8	64.8	63.3	61.8	60.0	58.2	56.4	54.6
Change in public debt	1.0	-1.0	-0.9	-0.5	-1.0	-1.4	-1.6	-1.7	-1.8	-1.8	-1.8
Contribution of identified flows	1.3	-0.1	-1.2	-0.6	-1.1	-1.4	-1.6	-1.7	-1.8	-1.8	-1.8
Primary deficit	0.3	-1.1	-1.3	-1.7	-2.0	-2.2	-2.3	-2.4	-2.6	-2.6	-2.6
Noninterest revenues	15.8	15.7	15.3	15.3	15.3	15.2	15.2	15.1	15.0	15.0	15.0
Noninterest expenditures	16.1	14.6	14.0	13.6	13.3	13.0	12.8	12.7	12.5	12.5	12.5
Automatic debt dynamics	0.4	-0.2	1.2	1.1	0.8	0.7	0.7	0.7	0.7	0.8	0.8
Int. rate-growth differential	-1.3	-0.8	0.7	0.7	0.6	0.5	0.5	0.5	0.5	0.5	0.5
Real interest rate	3.6	2.0	2.6	2.7	2.6	2.6	2.5	2.4	2.4	2.3	2.2
Real growth rate	-4.8	-2.8	-1.9	-2.0	-2.1	-2.1	-2.0	-1.9	-1.9	-1.8	-1.7
Real exchange rate	2.1	…	…	…	…	…	…	…	…	…	…
Relative inflation	-0.4	0.6	0.5	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.2
Other identified flows	0.6	1.2	-1.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other transactions	0.6	1.2	-1.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Contribution of residual	-0.3	-0.9	0.3	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Gross financing needs	11.2	9.7	11.4	9.6	9.3	9.7	8.4	8.3	8.1	8.1	8.1
of which: debt service	10.9	10.8	12.7	11.3	11.3	11.9	10.7	10.7	10.7	10.7	10.7
Local currency	9.3	7.3	8.5	8.0	7.5	9.3	8.1	8.1	8.1	8.1	8.1
Foreign currency	1.6	3.5	4.2	3.3	3.8	2.6	2.6	2.6	2.6	2.6	2.6
Memo:											
Real GDP growth (percent)	7.8	4.3	2.9	3.0	3.2	3.3	3.2	3.2	3.2	3.1	3.1
Inflation (GDP deflator; percent)	2.1	5.4	4.4	3.5	3.1	3.0	3.0	3.0	3.0	3.0	3.0
Nominal GDP growth (percent)	10.0	10.0	7.5	6.6	6.5	6.5	6.3	6.3	6.3	6.2	6.1
Effective interest rate (percent)	7.9	8.7	8.5	7.8	7.4	7.3	7.2	7.2	7.2	7.2	7.2

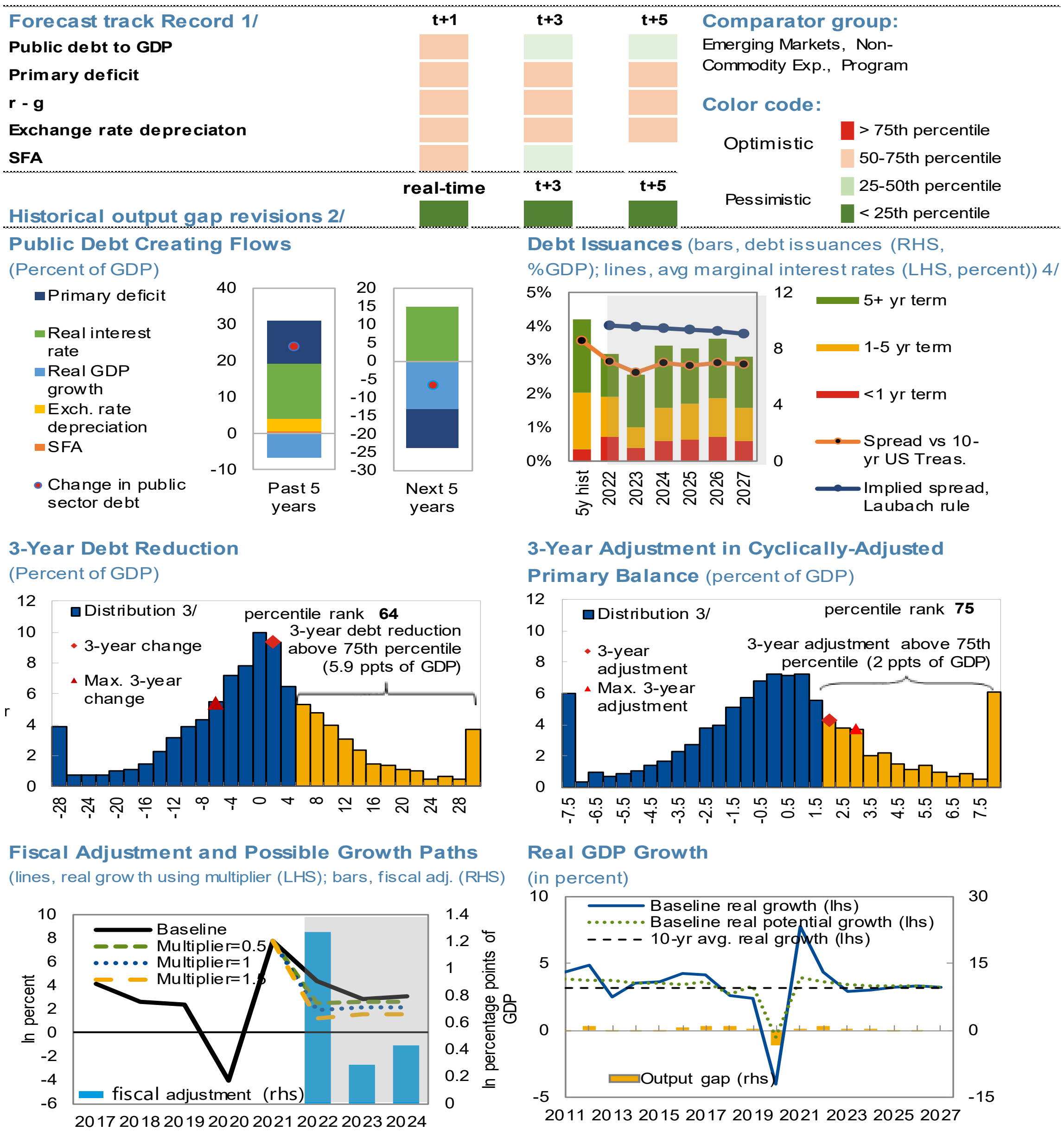
Contribution to change in public debt

(percent of GDP)



A primary surplus is expected to reduce debt in 2022 despite prefinancing to repay a Eurobond due in January 2023. Under the baseline, debt is expected to continue its downward path in 2023 as prefinancing unwinds and primary surpluses increase in line with the program. Forecasts are sensitive to exchange rate valuation effects; for example, a 10 percent variation in the exchange rate can increase or decrease the 2023 debt ratio by almost 3 percent of GDP. In line with the fiscal rule, which limits spending growth as a function of debt levels, fiscal consolidation is expected to continue until about 2030, after which, with debt below 60 percent of GDP, the primary surplus is expected to stabilize until debt falls below 50 percent of GDP before 2035. Gross financing needs are also expected to decline. Financing is expected to come from official external sources, domestic debt, and Eurobond issuances.

Annex II. Figure 5. Costa Rica: Realism of Baseline Assumptions



Realism analysis does not trigger major concerns. The improvement in the primary balance is underpinned by program commitments, which have thus far been exceeded. The baseline does not include yields from recently implemented tax compliance measures or savings from the the public employment bill's implementation. The risk premium is expected to decline due to more favorable multilateral financing sources, especially in 2023, and less pressure on local markets. GDP growth projections are in line with recent averages and those implied with fiscal multipliers, though strong growth in 2022 is based on observed outturns.

Source : IMF Staff.

1/ Projections made in the October and April WEO vintage. Program status not used in creating comparator group due to lack of data.

2/ Percentile rank of the country's output gap revisions (defined as the difference between real time/period ahead estimates and final estimates in the latest October WEO) in the total distribution of revisions across the data sample.

3/ Data cover annual obervations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis.

4/ The Lauback (2009) rule is a linear rule assuming bond spreads increase by about 4 bps in response to a 1 ppt increase in the projected debt-to-GDP ratio.

Annex II. Figure 6. Costa Rica: Medium-term Risk Analysis

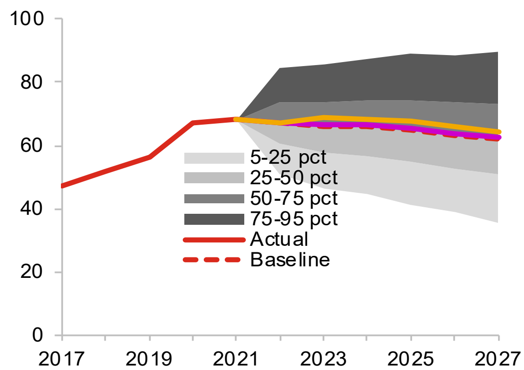
Debt fanchart and GFN financeability indexes

(percent of GDP unless otherwise indicated)

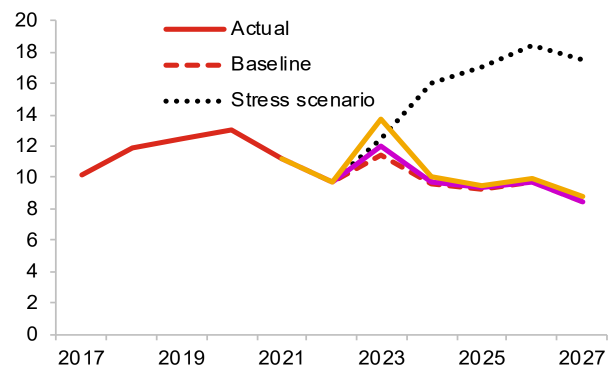
Module	Indicator	Value	Risk index	Risk signal	EMs., Non-Com. Exp, Program (0 – 25 – 50 – 75 – 100)
Debt fanchart module	Fanchart width	54.4	0.8	…	
	Probability of debt not stabilizing (pct)	10.0	0.1	…	
	Terminal debt level x institutions index	30.1	0.7	…	
	Debt fanchart index	**…**	**1.5**	**Moderate**	
GFN finance-ability module	Average GFN in baseline	9.7	3.3	…	
	Bank claims on government (pct bank assets)	12.3	4.0	…	
	Chg. in claims on govt. in stress (pct bank assets)	8.0	2.7	…	
	GFN financeability index	**…**	**10.0**	**Moderate**	

Legend: Interquartile range; Costa Rica

Final fanchart (pct of GDP)



Gross Financing Needs (pct of GDP)

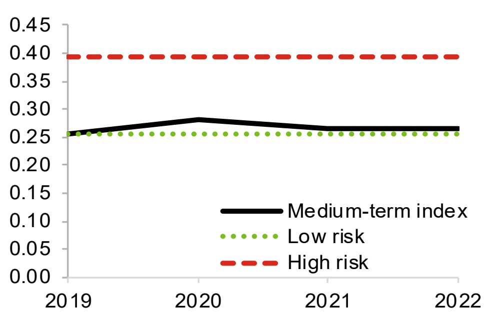


Triggered stress tests (stress tests not activated in gray)

Banking crisis | Commodity prices | Exchange rate | Contingent liab. | Natural disaster

Medium-term index

(index number)



Medium-term risk analysis

	Low risk threshold	High risk threshold	Weight in MTI	Normalized level
Debt fanchart index	1.1	2.1	0.5	0.34
GFN financeability index	7.6	17.9	0.5	0.19
Medium-term index (MTI)	0.26	0.40	…	0.3, Moderate

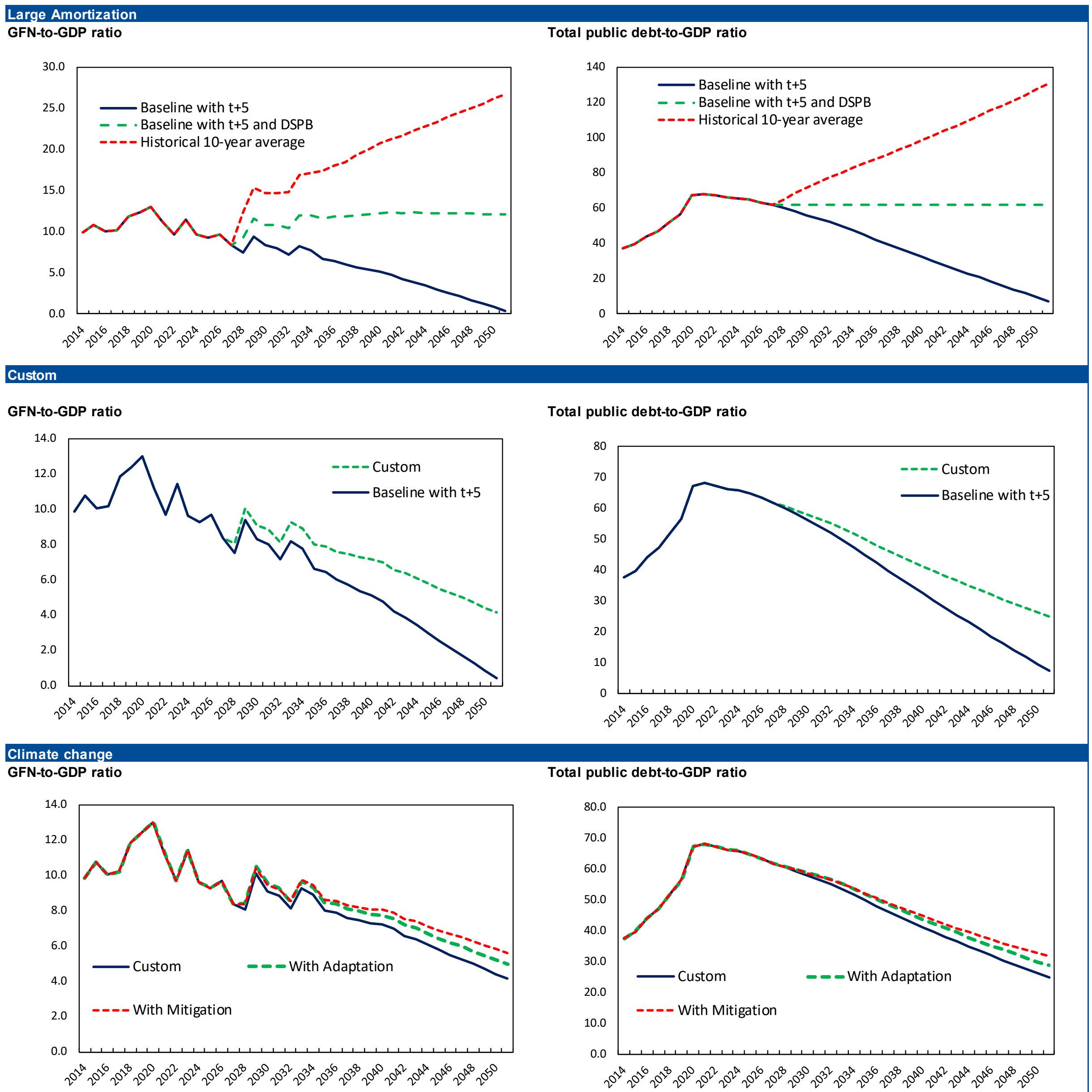
Prob. of missed crisis, 2022-2027 (if stress not predicted): 18.2 pct.

Prob. of false alarm, 2022-2027 (if stress predicted): 38.6 pct.

The fanchart analysis estimates risk to be moderate partly due to a high assessed probability of debt stabilization despite the uncertainty in debt projections.The GFN module indicates lower risks than for comparators. In a standard stress scenario[1] financing needs would rise considerably. The contingent liability test is triggered by narrow debt coverage and includes debts of local government and the social security fund as well as a probabilistic analysis of legal claims. The optional natural disaster shock is customized to a fiscal cost of 2.3 percent of GDP and a reduction in GDP growth of 0.7 percent.

[1] Growth reduced by 1 standard deviation for 2 years, interest rates rise by up to 300 bps, a depreciation equal to the largest of the last 10 years, shorter borrowing maturities, as well as incomplete rollover and no new financing by foreign private creditors.

Annex II. Figure 7. Costa Rica: Long-term Risk Analysis



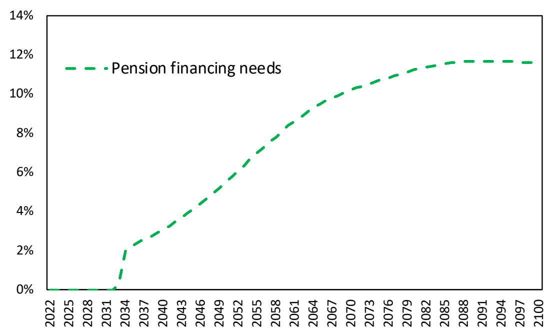
The default large amortization module calculates gross financing needs (GFNs) and debt based on amortization from existing debt under three illustrative scenarios. The custom scenario has a more conservative baseline, which has a primary balance averaging 1.7 percent of GDP over the long term (consistent with the fiscal rule, which allows higher spending as debt falls) and GDP growth slowing, mainly due to a declining labor force, to about 2.3 percent by 2052 (about half the deceleration modelled by the OECD in the absence of any growth-enhancing reforms). Debt is projected to steadily fall to 50 percent of GDP by 2035. GFNs remain somewhat elevated until then but below current levels. The standardized adaptation module adds costs of associated investments of 0.4 percent of GDP in the medium term and declining thereafter. Such costs are consistent with those already envisaged under the macreconomic framework and are estimated to yield long-term fiscal savings, so these results should instead be interpreted as an adverse scenario of unexpected additional net costs. The standardized mitigation module adds costs averaging about 0.3 percent of GDP over the projection period, although these are expected to be frontloaded. The scenarios, which critically assume the investments are sufficient to offset any adverse effects on GDP growth, suggest that a combination of unanticipated additional mitigation and adaptation costs do not pose a large risk to the debt trajectory.

Annex II. Figure 7. Costa Rica: Long-term Risk Analysis (concluded)

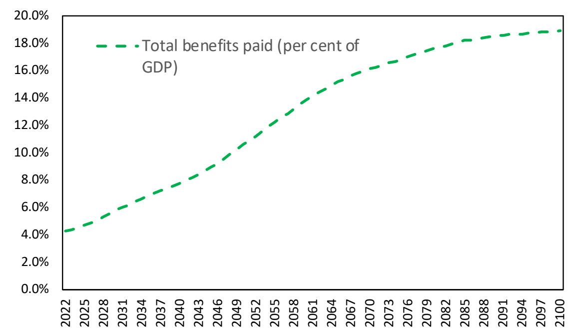
Demographics: Pension

Permanent adjustment needed in the pension system (pp of GDP per year)	To keep pension assets positive for:		
	30 years	50 years	Until 2100
	2.31%	4.97%	7.57%

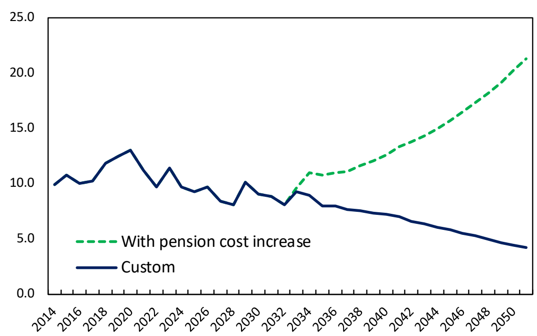
Pension Financing Needs



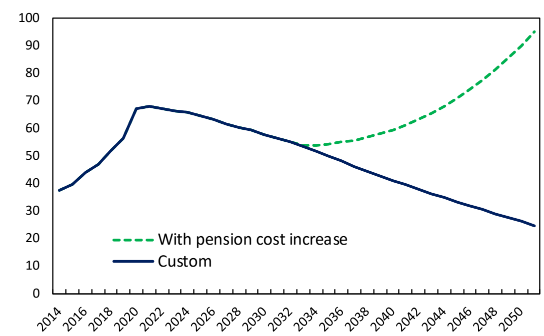
Total benefits paid



GFN-to-GDP ratio

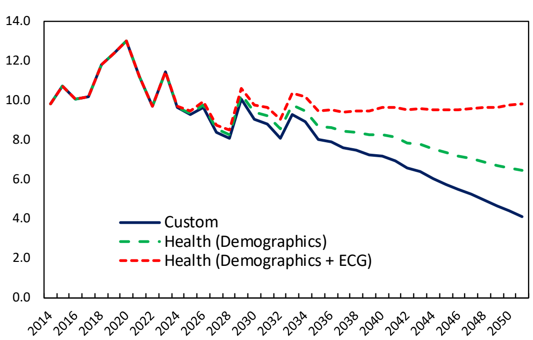


Total public debt-to-GDP ratio

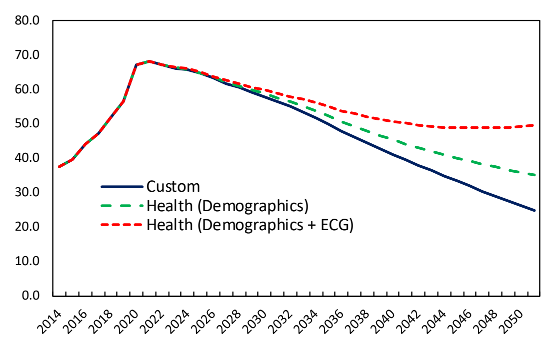


Demographics: Health

GFN-to-GDP ratio



Total public debt-to-GDP ratio



The pensions module considers how aging could increase budgetary pressures. For Costa Rica, the focus is on the old-age, death, and disability pension managed by the social security fund and on judiciary pensions. While both have a small surplus and combined reserves worth 8 percent of GDP, modelled demographic pressures run down assets within about 10 years, generating fiscal pressures and important risks to debt. Since the module does not include recent parametric changes or future reforms, it highlights the importance of addressing potential pensions liabilities rather than the expected evolution of CG debt and financing needs. It excludes the teachers' pension, which represents an actuarial liability to the government of about 1.7 percent of GDP but is closed to new entrants and thus not subject to the same demographic pressures. The healthcare modules estimate how aging can increase pressures on the budget. A scenario of higher spending per capita by 0.6 percent per year, for example due to medical advances, suggests fiscal pressures that would prevent sustained declines in debt or financing needs.

Annex II. Table 1. Costa Rica: External Debt Sustainability Framework, 2017-27

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2017	2018	2019	2020	2021			2022	2023	2024	2025	2026	2027	Debt-stabilizing non-interest current account 6/
Baseline: External debt	44.5	46.7	47.8	50.8	51.3			**54.6**	**55.5**	**56.6**	**56.0**	**56.2**	**55.9**	**-5.5**
Change in external debt	1.0	2.2	1.2	3.0	0.4			3.4	0.8	1.1	-0.6	0.2	-0.3	
Identified external debt-creating flows (4+8+9)	-2.1	-2.4	-4.4	0.0	-3.4			-2.7	-2.2	-3.0	-3.3	-3.5	-3.6	
Current account deficit, excluding interest payments	2.3	1.4	-0.3	-0.5	1.8			3.0	2.3	1.5	1.2	1.1	0.8	
Deficit in balance of goods and services	-0.6	-1.5	-3.8	-3.7	-2.3			-1.0	-1.6	-2.5	-2.7	-2.7	-2.9	
Exports	32.1	34.4	35.3	32.2	36.9			40.7	41.6	42.6	43.1	43.3	43.8	
Imports	31.4	32.9	31.5	28.5	34.6			39.6	39.9	40.1	40.4	40.6	40.9	
Net non-debt creating capital inflows (negative)	-4.5	-4.0	-4.3	-2.7	-5.0			-5.2	-5.0	-5.0	-4.9	-4.9	-4.8	
Automatic debt dynamics 1/	0.2	0.2	0.1	3.2	-0.3			-0.5	0.5	0.6	0.4	0.3	0.4	
Contribution from nominal interest rate	1.4	1.6	1.6	1.5	1.5			1.6	2.0	2.2	2.1	2.0	2.1	
Contribution from real GDP growth	-1.8	-1.1	-1.1	2.0	-3.8			-2.1	-1.5	-1.6	-1.7	-1.8	-1.7	
Contribution from price and exchange rate changes 2/	0.6	-0.2	-0.3	-0.3	2.0			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	3.1	4.5	5.6	3.0	3.9			6.1	3.0	4.1	2.7	3.7	3.4	
External debt-to-exports ratio (in percent)	138.7	135.6	135.5	157.9	139.0			134.4	133.4	132.7	129.8	129.6	127.6	
Gross external financing need (in billions of US dollars) 4/	6.3	5.9	5.6	5.5	7.4			9.2	10.9	9.3	9.3	8.8	8.9	
in percent of GDP	10.4	9.5	8.7	8.9	11.5	10-Year	10-Year	13.4	14.9	12.2	11.6	10.4	10.0	
Scenario with key variables at their historical averages 5/								**54.6**	**56.7**	**58.7**	**59.6**	**61.6**	**63.4**	**-4.9**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	4.2	2.6	2.4	-4.1	7.8	3.2	3.0	4.3	2.9	3.0	3.2	3.3	3.2	
GDP deflator in US dollars (change in percent)	-1.3	0.5	0.8	0.6	-3.8	1.1	3.1	2.4	3.5	1.2	1.7	1.9	2.0	
Nominal external interest rate (in percent)	3.2	3.6	3.4	3.0	3.1	3.2	0.2	3.2	3.9	4.1	4.0	3.8	4.0	
Growth of exports (US dollar terms, in percent)	4.1	10.7	5.9	-12.1	18.8	5.6	7.7	17.8	8.8	6.9	6.2	5.9	6.5	
Growth of imports (US dollar terms, in percent)	5.9	8.1	-1.2	-12.9	26.0	4.3	9.8	22.4	7.3	4.8	5.8	5.8	6.0	
Current account balance, excluding interest payments	-2.3	-1.4	0.3	0.5	-1.8	-2.0	1.7	-3.0	-2.3	-1.5	-1.2	-1.1	-0.8	
Net non-debt creating capital inflows	4.5	4.0	4.3	2.7	5.0	4.3	0.8	5.2	5.0	5.0	4.9	4.9	4.8	

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

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

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

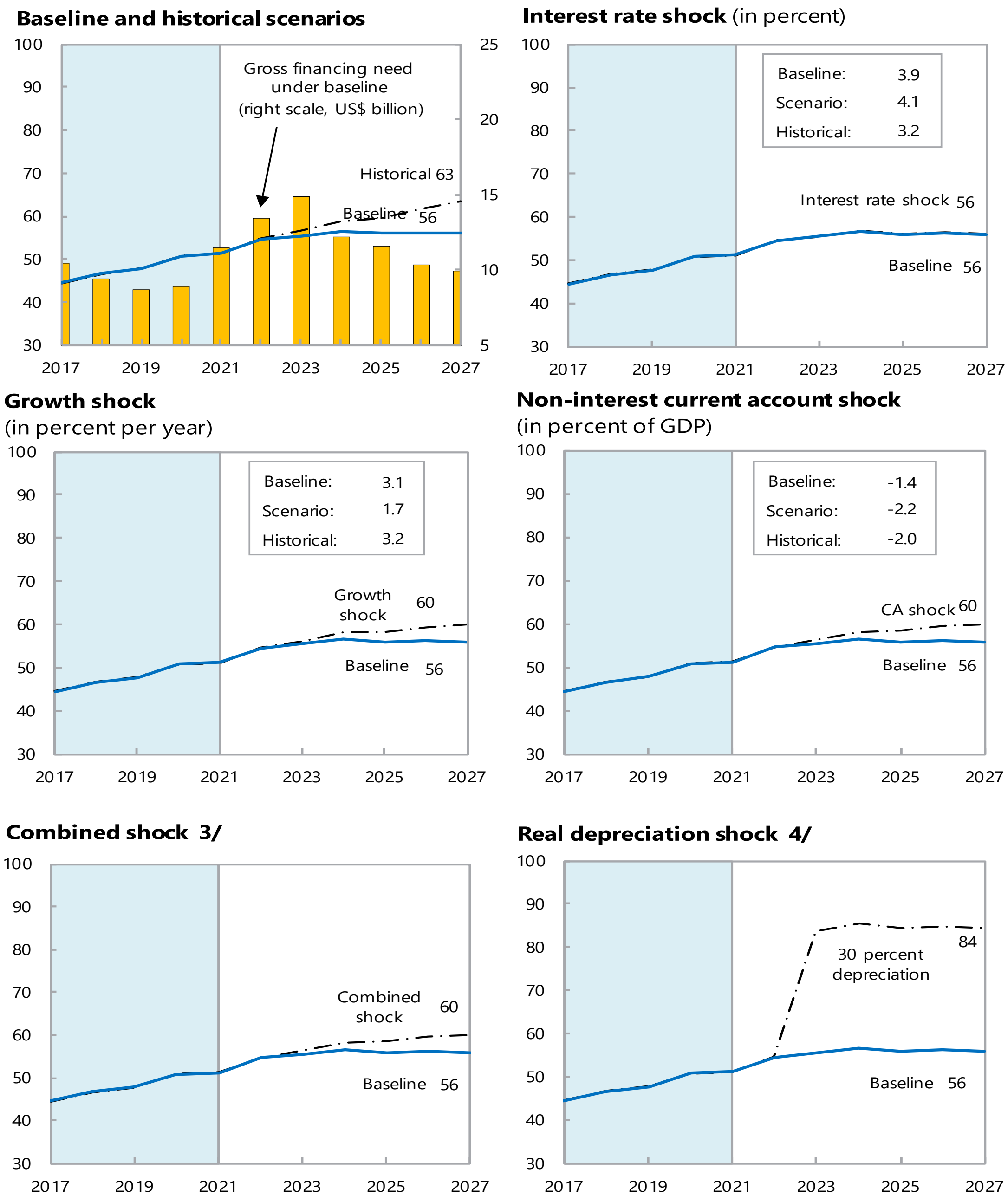
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

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

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

Annex II. Figure 8. Costa Rica: External Debt Sustainability: Bound Tests[1,2]

(External debt In percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2023.

Annex II. Table 2. Costa Rica: Decomposition of Public Debt and Debt Service by Creditor, 2021-23[1]

	Debt Stock (end of period)			Debt Service[3]			
	2021			2021	2022	2023	2021
	(Millions of US$)	*(Percent total debt)*	*(Percent of GDP)*	*(In millions of US$)*			*(Percent of GDP)*
Total	**42,436.1**	**100.0**	**68.1**	**6,790.6**	**6,845.2**	**7,627.7**	**10.9**
External	**10,548.1**	**24.9**	**16.9**	**541.03**	**636.27**	**2,055.0**	**0.9**
Multilateral creditors[2]	4,590.4	10.8	7.4	195.5	279.3	645.1	0.3
IMF	805.8	1.9	1.3				
World Bank	1,291.6	3.0	2.1				
ADB/AfDB/IADB	1,555.0	3.7	2.5				
Other Multilaterals, o/w:	938.1	2.2	1.5				
CAF	526.8	1.2	0.8				
Central American Bank for Economic Integration (CABEI)	411.3	1.0	0.7				
Bilateral Creditors	457.7	1.1	0.7	16.5	27.9	34.6	0.0
Paris Club, o/w:	220.4	0.5	0.4	10.9	13.7	21.37	0.0
French Development Agency (AFD)	144.9	0.3	0.2				
Japan International Cooperation Agency (JICA)	66.9	0.2	0.1				
Non-Paris Club, o/w:	237.3	0.6	0.4	5.6	14.2	13.3	0.0
Exim Bank of China	237.3	0.6	0.4	5.6	14.2	13.3	0.0
Bonds	5,500.0	13.0	8.8	329.1	329.1	1,375.3	0.5
Commercial creditors	0	0.0	0.0	0	0	0	0.0
Other international creditors	0	0.0	0.0	0	0	0	0.0
Domestic	**31,887.98**	**75.1**	**51.2**	**6,249.6**	**6,209.0**	**5,572.8**	**10.0**
Held by residents, total	31,246.7	73.6	50.2				
Held by non-residents, total	641.3	1.5	1.0				
T-Bills	0	0.0	0.0	0	0	0	0.0
Held by: central bank							
local banks							
local non-banks							
non-residents							
Bonds	31,585.4	74.4	50.7	6,234.0	6,121.7	5,546.4	10.0
Loans	302.5	0.7	0.5	15.7	87.3	26.4	0.0
Held by: central bank							
local banks							
local non-banks							
non-residents							
Memo items:							
Collateralized debt[4]	0	0.0	0.0				
Contingent liabilities	5,664.3	13.3	9.1				
o/w: Public guarantees	867.4	2.0	1.4				
o/w: Other explicit contingent liabilities[5]	4,796.9	11.3	7.7				

1/As reported by Country authorities according to their classification of creditors, including by official and commercial. Debt coverage is the same as the DSA.

2/ "Multilateral creditors" are simply institutions with more than one official shareholder and may not necessarily align with creditor classification under other IMF policies (e.g. Lending Into Arrears).

3/ Debt service figures reflect budgetary execution, which is not forecast beyond the current year at the creditor level.

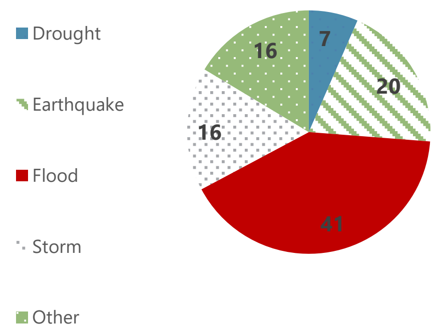
4/ Debt is collateralized when the creditor has rights over an asset or revenue stream that would allow it, if the borrower defaults on its payment obligations, to rely on the asset or revenue stream to secure repayment of the debt. Collateralization entails a borrower granting liens over specific existing assets or future receivables to a lender as security against repayment of the loan. Collateral is "unrelated" when it has no relationship to a project financed by the loan. An example would be borrowing to finance the budget deficit, collateralized by oil revenue receipts. See the joint IMF-World Bank note for the G20 "Collateralized Transactions: Key Considerations for Public Lenders and Borrowers" for a discussion of issues raised by collateral.

5/ Includes other-one off guarantees not included in publicly guaranteed debt (e.g. credit lines) and other explicit contingent liabilities not elsewhere classified (e.g. potential legal claims, payments resulting from PPP arrangements).

Annex III. Costa Rica's Climate Change Challenge[1]

1. Costa Rica is experiencing multiple physical effects from climate change—most acutely through natural disasters. Natural disasters affect Costa Rica's people through death, disease, and displacement. Floods are the most prevalent natural hazard and set to become more common as storms become more frequent and intense. The trend of increasing long droughts is expected to continue and the incidence of extreme temperatures is expected to increase. More gradual physical effects of climate change include higher average temperatures, loss of biodiversity, ocean acidification, and rising sea levels.[2] Efforts to restore ecosystems can help reverse such effects. For example, reforestation can reduce the amount of flooding that results from storms and reduce net carbon emissions by acting as a carbon sink.[3]

Costa Rica: Average Annual Natural Hazard Occurence
(Percent of total incidents,1980-2020)



Sources World Bank; CNE

2. Climate change presents important risks to Costa Rica's economy. Meteorological events harm agricultural output, which represents about 5 percent of GDP and almost one-third of rural employment. Altered rainfall patterns and rising temperatures can alter the areas suitable for crops and livestock.[4] Droughts reduce the amount of water available for drinking, sanitation, and hydroelectric power—which is key to sustaining near-complete use of renewable sources for electricity generation. Flooding from storms or tidal flooding exacerbated by rising sea levels, can make tourist destinations and port cities unattractive or inaccessible by damaging roads and related infrastructure, with a sizable loss of FX receipts. EM-DAT data shows that Costa Rica has suffered a severe storm or flood, which are the most relevant natural disasters for infrastructure damage, every five years (i.e., a probability of around 20 percent per year) on average since 1988. In 1998-2018, damage from rains and droughts averaged 0.7 percent of GDP, of which about half was to transport infrastructure. Although Hurricane Julia did not hit Costa Rica directly, the resulting heavy rains have prompted the authorities to fast-track infrastructure repair. Storms can cause additional damage, with average capital and output costs of about 0.5 percent of GDP over the same period. For

[1] Prepared by Alberto Behar and Pedro Juarros (IMF), with support from IDB and WB staff. Please refer to Annex IX on "Costa Rica's Climate Change Response" in the 2021 Article IV Consultation and EFF Request Staff Report for further analysis.

[2] See Ministerio de Ambiente y Energía (2022), *Plan Nacional de Adaptación al Cambio Climático 2022-2026.*

[3] FONAFIFO (2020), *Greenhouse Gas Emissions Offset Projects under the Payment for Environmental Services Program Reforestation Activity.*

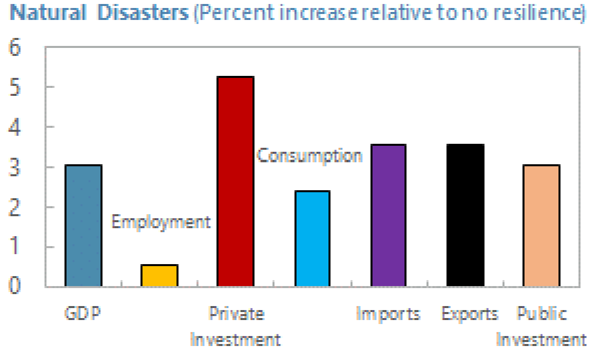
[4] World Bank (2021), *Climate Risk Country Profile: Costa Rica.*

example, estimated damage from Tropical Storm Nate in 2017 was equivalent to 1 percent of GDP.[5] In a high-risk scenario, damage could rise to 1.6 to 2.5 percent per year over the medium term.[6] These physical risks would also impact the financial sector. The authorities are refining stress tests to capture physical-risks and establishing exposures based not on where loans were granted but where the activity they support is located. Climate change interacts with other shocks. For example, the COVID-19 pandemic, by severely impacting tourism, also curtailed funding sources available to national parks for conservation or reforestation. Also, the combination over time of negative effects from climate change and other shocks erodes the coping capacity of the poorest.

3. Investment in resilient public infrastructure can deliver important long-run output as well as fiscal gains to Costa Rica. Building resilient public infrastructure (such as durable roads, bridges, and sea walls) can reduce future expected losses from climate events. This is one of the priority actions in the authorities' National Adaptation Plan launched in April 2022. Costa Rica's net benefits of investing in resilient infrastructure are assessed through a small open economy DSGE model tailored to address adaptation investment and climate events that destroy a share of public capital.[7] Expert estimates suggest resilient public investment is 25 percent more expensive than non-resilient public investment.[8] Staff analysis, calibrated for Costa Rica assuming that the share of resilient public capital stock rises from 0 to 80 percent in the long run, indicates that public investment in resilience infrastructure (of about 1.6 percent of GDP, at an additional fiscal cost of 0.4

Costa Rica: Benefits of Investing in Resilient Infrastructure Model

Long-Term Return of Public Investment in Resilience to Natural Disasters (Percent increase relative to no resilience)



Average Annual Fiscal Gains of Investment in Resilience (In percent of steady state GDP)

Total Gains	**0.49**
Stock saving Decrease in reconstruction spending after NDs	0.01
Flow saving Moderation of output and tax revenue decline after NDs	0.02
Steady State Increase in tax revenues due to higher output	0.46
Cost of resilience Increase of public investment spending due to resilience cos	**0.40**
Net annual saving	**0.09**

Sources: Model-based IMF staff estimates.
Note: It assumes the government increases investment in resilient infrastructure to reduce damages by climate-related natural disasters to 20 percent, while maintaining historical investment rates.

[5] Ministerio de Ambiente y Energía (ibid.).

[6] Controloría General de la Republica, cited by Ministerio de Ambiente y Energia (ibid.).

[7] The results are based on the model developed by Fernandez-Corugedo, Gonzalez-Gomes, and Guerson (2022).

[8] IMF Regional Economic Outlook, October 2021: "Climate Change Challenges in Latin America and the Caribbean", based on estimates of Ex-Post Damage Assessments from the World Bank.

percent of GDP)[9] yields a long-term increase in the level of GDP of 3 percent. The results integrate the direct effect of lower public capital destruction, which reduces the output loss after a climate event as well as an indirect effect of the higher expected returns to private investment from higher public capital and GDP. In turn, higher private capital increase employment, labor productivity, and real wages. The simulation also suggests that, over the long run, investment in resilience infrastructure would yield gross fiscal gains of about 0.5 percent of GDP per year (text table), leading to long-run steady state net gains of about 0.1 percent of GDP.[10]

4. **Costa Rica's decarbonization and conservation agenda is also integral to the country's development strategy.** Among the 11 highest-priority projects in Costa Rica's National Strategic Plan 2050 (PEN 50), launched in April 2022, decarbonization projects represent the largest share of the portfolio, with costs estimated at almost 5 percent of GDP. Nevertheless, full implementation of the National Decarbonization Plan is expected to yield benefits in the order of $41 billion, after netting out upfront costs of $37 billion.[11] Economic gains are estimated to be positive in almost any scenario. Livestock, forestry, and agriculture would have the largest decarbonization and economic gains, followed closely by private and public transport. For freight, industry, and waste management, the economic gains would be negligible but the decarbonization gains would be significant. Nevertheless, decarbonization efforts will need to be carefully implemented to maximize its environmental and economic gains, while mitigating the transition costs through offsetting measures. For example, increasingly lower reliance on fuel for transport could cause revenue losses from fuel taxes of 0.4 percent of GDP per year between 2023 and 2050.[12] Lower incidence of vehicle ownership and exemptions on electric cars would reduce registration revenues, although VAT collection from electricity sales would increase as well as the import tax gains associated with the capital costs of electrifying the fleet (assuming a phasing out of existing import duty exemptions on electric vehicles). To offset expected revenue losses and support mitigation, other taxes, for example other green taxes, would be required.

Costa Rica: Net Present Value of Decarbonization Plan (US$ billions, to 2050)

Agriculture, ranching, and nature-based solutions	21.9
Public and Private Transport	17.3
Other	1.7
Total	**40.9**

Source: IADB; Rand Corporation; and others, 2020.

5. **A just transition to a decarbonized economy includes proactive efforts to minimize disproportionally negative effects on some segments of the population.** While the transition to net-zero has the potential to be job creating, the gains would be modest at around one-quarter of

[9] This value is broadly consistent with the costing included in the infrastructure resilience roadmap and National Adaptation Plan (¶28).

[10] The gains from investing ex-ante in resilient public infrastructure have three additive components: i) lowering reconstruction spending after each event (stock saving); ii) limiting the decline in output and employment after a shock and therefore reducing tax revenues losses (flow saving), and finally iii) generating a higher steady-state level of output, consumption, and employment and therefore of tax revenues.

[11] IDB, DCC, Rand Corporation, and UCR (2020), *The Benefits and Costs of Decarbonizing Costa Rica's Economy*.

[12] IDB (2021), *Impacto Fiscal de la Descarbonización del Transporte en Costa Rica y Opciones de Política para manejarlo.*

one percent of the labor force by 2035.[13] Moreover, agriculture and fishing as well as mining and quarrying would have slower job growth because of the transition and these sectors tend to have poorer workers with fewer skills. Regarding transition risks from global mitigation, Costa Rica does not have significant investments in hydrocarbons, but higher international jet fuel costs or less favorable attitudes to flying could reduce tourism to the country, which would reduce incomes disproportionately for women and in the poorer coastal regions. To mitigate these effects, it is crucial to address skills mismatches, increase mobility, generate alternative employment opportunities, and ensure the social safety net can support the transition. Some forms of social assistance could be tied to conservation or other mitigation efforts. For example, preservation of forests and other ecosystems can be tied to transfers and generate pro-poor jobs.[14] At the same time, the poor are more exposed to the effects of climate change and ecosystem damage through higher food prices, lower agricultural output, and lower tourism, and so stand to benefit disproportionally from the climate agenda.

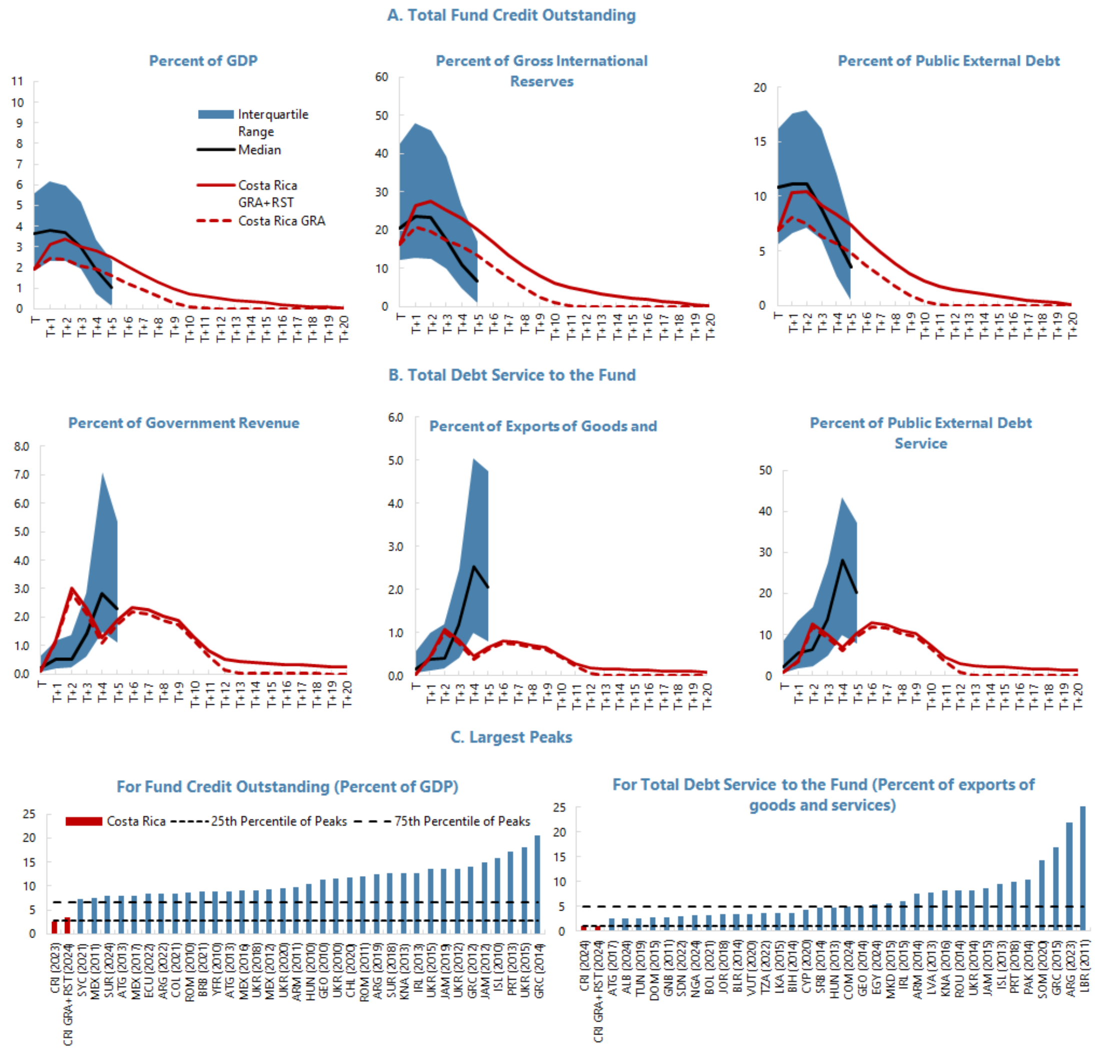
6. **Costa Rica's efforts to fight climate change and restore ecosystems have earned it international recognition.** Costa Rica's climate change vulnerability and readiness is ranked as 61st out of 182 countries by the ND-GAIN index. Costa Rica's ambition to reach net-zero emissions by 2050 earned it the United Nations' "Champion of the Earth" award in 2019 and its "fair share target" and "policies and actions" are among the few assessed by the Climate Action Tracker to be consistent with limiting global warming to 1.5°C. The Nationally Determined Contribution aims to bring 2030 emissions (9 million tons of carbons dioxide equivalent) back to around 2010 levels. Following confirmed emissions reductions from improved tree cover, it started receiving disbursements from the Carbon Partnership Facility under the Emission Reductions Purchase Agreement (ERPA) in August 2022. Costa Rica is the first tropical country to have reversed the decline in its forests, which have since doubled in size and helped flora and fauna thrive. In recognition of this protection for environmental services, Costa Rica was an inaugural winner of the "Earthshot Prize" in 2021. Moreover, in recognition of its track record and to support continued reforestation and ecosystem conservation, Costa Rica received a first disbursement from the Green Climate Fund in January 2022. These grants and prizes amount to over US$115 million and complement ongoing financial support from development partners, including US$1.1 billion by the World Bank for 2022-2024 and a Policy Based Loan of US$400 million provided by the IDB, French Development Agency, and Korean Infrastructure Funding Facility. The authorities also plan to develop public-private partnerships to finance most of the portfolio of priority investments identified for the PEN 50 and to gain Environmental, Social, and Governance (ESG) status to generate greater private financing opportunities.

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

[14] World Bank (2022), Opportunities for Reducing Poverty and Inequality in Costa Rica: World Bank Poverty and Inequality Assessment.

Annex IV. Capacity to Repay

Annex IV. Figure 1. Costa Rica: Capacity to Repay Indicators



Sources: IMF Finance Department, World Economic Outlook.

Notes:
1) T = date of GRA arrangement approval.
2) Red lines/bars indicate the CtR indicator for the arrangement of interest.
3) The median, interquartile range, and comparator bars reflect all RFIs and UCT arrangements approved under the GRA (excluding blending arrangements) between 2008 and 2022.
4) Countries in the control group with multiple RFIs and/or GRA arrangements are entered as separate events in the database.
5) Comparator series is for GRA arrangements only and runs up to T+5.
6) Total Debt Service to the Fund consists of GRA, RST and SDR-related obligations.
7) All charts use data at the time of program approval with the exception of the chart on the right-hand side of section C, which uses ex-post data due to data limitations.
8) In section C charts, Costa Rica is not among the 35 largest peaks and is illustrated for the purposes of comparison only.
9) Indicators compared to GRA only borrowing countris,all programs.

Appendix I. Letter of Intent

San José, October 27, 2022

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

Dear Ms. Georgieva:

Amid ongoing external pressures and lingering challenges posed by the COVID-19 pandemic, our economic program, supported by the Extended Arrangement under the Extended Fund Facility (EFF), is playing a critical role in securing macroeconomic stability, supporting a continued economic recovery, and promoting a stronger, greener, and more inclusive growth over the medium term.

Notwithstanding a challenging global environment, we have managed to make important progress under the Fund-supported program. For the third review, we met the end-June fiscal targets by a comfortable margin. The end-June target on Net International Reserves (NIR) was missed due to rising external pressures. Nevertheless, we were able to proactively purchase FX from the market in the second half of the year, significantly narrowing the breach of the end-September indicative target, and we are committed to be back on track by end-December. Moreover, as a result of the global commodity shock, the inflation outer target band under the program's Monetary Policy Consultation Clause (MPCC) was breached in June and September, triggering a Board consultation as part of this review cycle. We continue to comply with the continuous performance criteria.

We are also advancing our ambitious structural reform agenda. We met the two end-April structural benchmarks by publishing a Medium-Term Fiscal Framework for the entire Non-Financial Public Sector (NFPS) and an updated Medium-Term Debt Strategy. We also met the end-September structural benchmark to develop a roadmap to enhance infrastructure resilience to climate change. While the structural benchmark to adjust the minimum contribution base for part-time workers was not met by end-June 2022 as originally envisaged, the plan was formulated on time and approved in September.

In view of the macroeconomic policies implemented to achieve the main program objectives, our proactive response to recent economic challenges and ongoing corrective actions to rebuild reserve buffers, as well as the progress on the structural reforms under the program, we request completion of the Third Review of the Extended Arrangement under the EFF and the purchase of SDR 206.23 million. We also request a waiver on the nonobservance of the end-June 2022 NIR quantitative performance criterion.

Our fiscal consolidation efforts have delivered a strong overperformance and we are on track to achieve a primary surplus of about 1.3 percent of GDP by end-2023 and a debt-to-GDP ratio of 50 percent of GDP by end-2035, in line with our program objectives. Nevertheless, given the still high level of public debt and risks to the outlook, we plan to implement additional progressive income and expenditure measures during the program period to deliver a faster decline in debt to secure macroeconomic stability and foster inclusive and sustainable growth, in line with international best practices. Monetary policy will continue to proactively respond to the shocks facing the economy, under its data-dependent and forward-looking approach, to bring inflation back within the Central Bank of Costa Rica (BCCR)'s tolerance band and anchor expectations, in line with the BCCR's inflation targeting and flexible exchange rate regime. We remain committed to advance our ambitious reform agenda to support a dynamic and inclusive economy, tackling the structural challenges posed by still high inequality and informality and fostering greater economic empowerment of women.

We are also resolved to advance our pioneering efforts to adapt to climate change, given our country's important exposure to natural disasters, and transition to a low carbon and resilient economy, generating growth and new job opportunities. To support our climate change efforts and catalyze additional financing by other official and private partners, we are requesting access under the Resilience and Sustainability Facility (RSF) from the IMF totaling SDR 554.1 million (150 percent of quota) for the remaining duration of the Extended Arrangement, to be provided for direct budget support.

This Letter of Intent and the attached Memorandum of Economic and Financial Policies (MEFP) and Technical Memorandum of Understanding (TMU) update the versions dated March 9, 2022 and set out the economic policies and reform measures that we intend to implement to achieve the objectives of our Fund-supported program under the EFF and requested RSF arrangement. We have also finalized a Memorandum of Understanding (MOU) between the BCCR and Ministry of Finance that clarifies the responsibilities for timely servicing of the financial obligations to the IMF under the RSF arrangement, complementing the existing MOU under the EFF.

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

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

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

Sincerely yours,

/S/

Róger Madrigal-López
President, Central Bank of Costa Rica
Governor of the IMF

/S/

Nogui Acosta Jaén
Minister of Finance

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

Attachment I. Memorandum of Economic and Financial Policies

1. **The government of Costa Rica remains fully committed to the economic reform program supported by the extended arrangement under the EFF as well as the reform measures under the requested RSF arrangement.** The extended arrangement was approved by the IMF Executive Board on March 1, 2021, and ratified by the country's Legislative Assembly on July 19, 2021. This memorandum outlines in detail the progress toward meeting the objectives of the Fund-supported program and our policy plans to advance these objectives as well as our policy commitments under the requested RSF arrangement. Tables 1, 2, and 3 summarize performance to date and how we plan to update the quantitative targets going forward, as well as progress made with structural benchmarks, including new structural conditionality under the EFF and requested RSF arrangement going forward.

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

I. MACROECONOMIC DEVELOPMENTS AND OUTLOOK

3. **After a strong recovery in 2021, external headwinds are weighing on the Costa Rican economy.** The pandemic hit the Costa Rican economy hard in 2020, severely impacting the already weak fiscal accounts and generating sizable balance-of-payments needs. Despite global supply chain bottlenecks, a deterioration in the terms of trade, and ongoing fiscal consolidation efforts, real GDP recovered vigorously in 2021 by 7.8 percent. However, domestic activity has softened in recent months, largely due to heightened external pressures. Real GDP growth is forecast to be 4.3 percent in 2022 and 2.9 percent in 2023. Over the medium term, economic growth is expected to return to its potential of around 3 percent. Higher global commodity prices and a weak recovery in tourism are negatively weighing on the current account and international reserves, in the context of capital outflows from local pension funds. External pressures have also fed through to inflation, which stood at 10.4 percent y/y in September, well above the BCCR's 2-4 percent tolerance band. The outlook remains subject to downside risks, including from further supply shocks from commodity prices, a deeper-than-expected global slowdown, a further tightening of financial conditions, the ongoing pandemic, and possible natural disasters.

II. PROGRAM PERFORMANCE

4. **Since taking office, we have made important progress on our reform agenda.** The end-June Quantitative Performance Criterion (QPC) on the central government (CG) primary balance and debt stock were met by a comfortable margin, reflecting continued robust revenue performance and

our prudent approach to spending. While final data are being delayed, we are confident to have also met the end-September indicative fiscal targets by a good margin. The end-June QPC and the end-September IT on net international reserves were both missed, largely due to the commodity price shock, but we are on track to meet the end-December QPC. The Monetary Policy Consultation Clause (MPCC) outer band— set in early 2022 under a more benign outlook for global food and energy prices—was breached by 2.6 and 5.3 percentage points in June and September, respectively. Attached is a letter from the central bank explaining the deviation in accordance with the required Board consultation. We continue to observe the continuous PCs on non-accumulation of new external arrears, non-imposition/intensification of restrictions on the making of payments and transfers for current international transactions, non-imposition/modification of multiple currency practices (MCPs), non-introduction/intensification of import restrictions for BOP reasons, and no conclusion of bilateral payments agreements that are inconsistent with Article VIII obligations. There has also been important progress with our structural reform agenda. The two end-April structural benchmarks—for the Cabinet to approve and publish a Medium-Term Fiscal Framework for the entire Non-Financial Public Sector (NFPS) and to approve and publish a Medium-Term Debt Strategy (MTDS)—were both met, as was the end-September structural benchmark to develop a roadmap to enhance infrastructure resilience to climate change. The structural benchmark to approve a plan to adjust the minimum contribution base for part-time workers was not met by end-June 2022 but the plan was approved in September. We are making steady progress towards submitting amendments to the BCCR Law to the Legislative Assembly, as planned by end-December 2022.

III. FISCAL POLICY

Fiscal Stance

5. **The main priorities of fiscal policy are to meet the critical social and health needs of the population, support the recovery, and secure debt sustainability.** Costa Rica's fiscal balance deteriorated sharply over the past decade, due to a permanent increase in current spending following the global financial crisis. Recognizing the pressing fiscal and financing challenges facing our country, a comprehensive fiscal reform bill was approved by the Legislative Assembly in December 2018 to rein in spending and strengthen revenue. This reform put public debt on a declining trajectory over the medium term, mostly by requiring a significant decline in spending as a share of GDP. The economic contraction caused by the pandemic made an additional fiscal adjustment necessary to keep debt at manageable levels. Building on a strong revenue overperformance in 2021, we are committed to pressing ahead with the required fiscal consolidation, while continuing to protect the vulnerable and supporting a sustainable economic recovery. Our efforts to date have contributed to an improved fiscal outlook and we are on track to achieve a primary balance of about 1.3 percent of GDP by end-2023 and reach a debt-to-GDP ratio of 50 percent by 2035. Nevertheless, given the still high level of public debt and risks to the outlook, we

plan to implement additional progressive income and expenditure measures during the program period to foster more inclusive and sustainable growth and deliver a faster decline in debt.

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

- ***Fiscal rule.*** The reform introduced a fiscal rule tying down nominal spending growth and included tight restraints on public sector remunerations. The reform also enabled reallocation of earmarked revenues and legally mandated spending (except those mandated by the Constitution) if debt exceeds 50 percent of GDP. The rule has played a pivotal role in anchoring debt sustainability. However, recent experience through the pandemic and the Russian invasion of Ukraine have identified opportunities to improve the rule. Following a change to the implementing regulation of the fiscal rule in June 2022, the spending ceilings for execution will no longer be based on the previous year's execution but exclusively on the previous year's original budget. The change addressed a structural shortcoming in the regulation that penalized under-execution by ministries and other agencies and reduced the flexibility to reallocate resources within the budget envelope to meet evolving or unanticipated needs. We are considering further options to improve the fiscal rule, notably to clarify its regulatory perimeter and allow for a more flexible reallocation of resources within the spending ceilings while maintaining its essential role in containing spending and reducing debt. A first legislative proposal was submitted to the Legislative Assembly in early September. We are now discussing this draft with different parties and, with the support of IMF Technical Assistance (TA), in line with best international practices, we plan to submit amendments through motions at the legislative committee level by end-November 2022. We are also analyzing complementary reforms to the budget process and Medium-term fiscal framework to improve credibility, control, and flexibility in our fiscal management. The prudent fiscal targets under our Medium-term Fiscal Framework will continue to guide our fiscal strategy, consistent with the fiscal rule and program targets.

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

7. In 2022, we are entrenching further improvement in the fiscal accounts, in line with the program targets. Despite the challenges posed by a cyberattack that targeted several government systems and the rising external pressures on the economy, we comfortably met the end-June CG primary balance and debt targets under the program. In particular, the end-June primary balance was CRC 577 billion, compared to a program target of CRC144 billion and we are confident to have also met the end-September indicative fiscal targets by a good margin. Accordingly, we are on track

to achieve a primary surplus of CRC478 billion by end-December 2022 (or about 1.1 percent of GDP), comfortably above the CRC287 billion target. We have been implementing the following measures:

- ***Revenue measures***. Despite being forced to shut down our main tax collection systems in late April due to a breach into our information systems, tax revenue performance remained strong in the first semester of 2022, especially for income tax, thanks to the prompt deployment of contingency plans to ensure the continuity of basic services to large taxpayers. Moreover, the implementation of the 2018 tax reform continues to generate durable and incremental yields through the scheduled rate increases of VAT on construction-related services and tourism as well as the capital income tax. To mitigate the impact of the global commodity price shock, we delayed the scheduled inflation adjustment to the fuel tax for six months until December 2022. We remain committed to further strengthen revenue and deliver a more balanced, inclusive fiscal adjustment by advancing a cohesive set of progressive and growth-friendly tax bills (MEFP¶8). We will use one-off revenues—from the transfer of surpluses accumulated by decentralized entities before incorporation into the central government—to accelerate debt reduction.

- ***Spending measures***. Because the debt ratio exceeded 60 percent of GDP in 2020 and 2021, our fiscal rule envisages tighter spending constraints for 2022-2025 to accelerate debt reduction. Accordingly, total spending is set to grow by around 2 percent in 2022 (after excluding emergency spending). Primary spending is estimated to fall by around 1.5 percent of GDP in 2022. The spending restraint is based on continued wage constraints imposed by the 2018 fiscal reform (freeze in base salaries, annuities, and new hiring; and elimination of all vacancies). Moreover, until September 2022, we also implemented (i) annual nominal reductions of temporary wage components (such as overtime) by 8.5 percent; (ii) freezes in pensions of public sector retirees and current transfers to the public sector excluding transfers to the Social Security Fund (CCSS); (iii) cuts in non-pension private transfers, non-CCSS public transfers, and transfers with external resources; and (iv) annual nominal reduction in spending on goods and services. While the regulation related to these constraints was abrogated in September 2022 to provide more flexibility to the budget process, the Ministry of Finance's (MOF) circular issued in November 2021 as envisaged by law 8131 continues to ensure tight spending controls remain in place in line with the budget and fiscal rule. Moreover, we continue to closely monitor spending execution and adjust appropriations to line ministries monthly. Delays and reprioritization of capital projects as well as unused resources from a guarantee fund have led to an under execution of capital spending. Moreover, despite the rigidities imposed by the fiscal rule on some agencies, we issued supplementary budgets, excluded *Fondo de Desarrollo Social y Asignaciones Familiares* (FODESAF) resources from the fiscal rule, identified operational efficiencies, and deployed higher-than-anticipated revenues from the Joint Institute for Social Welfare's (IMAS) commercial activities to reallocate additional resources to mitigate the effects of higher prices on the most vulnerable. We are providing an additional 0.1 percent of GDP including CRC 20 billion (of which CRC 8 billion will accrue in 2022) for temporary food support (mostly to new beneficiaries), CRC 13 billion to assist minors, and CRC 11 billion for conditional cash transfers under existing programs. In the face of considerable social and political pressure, a temporary scheme to limit the increase in gasoline prices is also under consideration by the

Legislative Assembly. However, the measure has become less urgent amid reduced external pressures from energy prices and might not advance further through the legislative process. Nonetheless, if such pressures were to reemerge, we are committed to amending the measure before it is sent for debate to ensure its duration does not exceed 9 months, the fiscal cost is capped at CRC 3 billion (or less than 0.01 percent of GDP), and it is covered by the fiscal rule spending ceiling.

8. We remain committed to further advancing our fiscal consolidation efforts in 2023. Specifically, we will target a primary surplus of at least CRC 609 billion by end-December 2023 (or about 1.3 percent of GDP). To deliver the needed structural adjustment, net of one-offs, and support a balanced and progressive fiscal consolidation going forward, we are committed to implementing the following revenue and expenditure measures, consistent with the 2023 budget submitted to the Legislative Assembly for approval on September 1, 2022:

- ***Revenue measures***. We remain committed to improving revenue mobilization through a more equitable and efficient tax system (MEFP ¶10). In September 2022, we conducted a detailed review of our personal income tax (PIT), with support from IMF TA. Based on the findings of the analysis, we will submit by end-December 2022 to the Legislative Assembly a tax bill to reform the PIT to increase horizonal and vertical equity by taxing income of employed, pensioners, and self-employed individuals under a single recalibrated schedule, thereby equalizing their tax burden. The reform will also fully harmonize the PIT rate on capital income and gains, broaden the tax base by, among others, including dividends distributed by firms in free zones and removing the progressive schedule within the CIT, while maintaining the existing regime for small and medium enterprises. Moreover, we will broaden the tax base by including capital income earned abroad by Costa Rican residents. The bill is expected to be approved by end-September 2023. The annual yield of the reform is estimated to be at least 0.1 percent of GDP. In September 2022, we adopted a legal framework to periodically appraise tax expenditures and remove those no longer serving their intended purpose, aiding our efforts to broaden the tax base and improve its fairness. Accordingly, we will further broaden the tax base by removing the lenient VAT treatment of airfares and tax exemption on car rentals through legislation expected to be submitted to the legislative assembly by end-November 2022. In this context, we will also remove tax expenditure provisions with a larger social cost than their benefit. We will continue with the scheduled phase-out of reduced VAT rates to the tourism sector and construction services. This, together with the additional income tax yields that were not realized earlier due to the enforcement of thin capitalization rules between related parties, are expected to generate a yield of 0.1 percent of GDP. Finally, as part of our commitment to foster green growth, we will introduce a revenue neutral scheme of feebates to strengthen incentives to replace high-polluting private vehicles and further our decarbonization plans (MEFP ¶41). The overall net yields on the revenue side on an annual net basis is estimated at about 0.2 percent of GDP.

- ***Spending measures.*** Within the limits of the fiscal rule, the 2023 budget presented to the Legislative Assembly envisages total spending growth of 2.6 percent in 2023 (after accounting for emergency spending). Given projected increases in the interest bill, this implies zero growth in

budgeted primary spending. Moreover, we will continue to prudently manage budget execution to fully meet the program primary surplus target, adjusting appropriations to line ministries monthly as warranted. Despite the constraints on spending, the proposed 2023 budget represents an increase in social spending of more than CRC 60 billion (9 percent) compared to the 2022 budget. By reallocating unexecuted resources through subsequent budgets, as we did in 2022, we are committed to adding another CRC 60 billion to maintain social spending as a share of GDP relative to 2022, channeling these resources to the main cash transfer and childcare programs. As approved under the 2018 fiscal reform, we are also effectively reallocating spending away from legally mandated uses (with the exemption of those mandated by the Constitution) when the debt-to-GDP ratio is above 50 percent of GDP. We remain committed to staying current on all our payment obligations and not accumulating any spending arrears. Approval by the Legislative Assembly of external loans by our multilateral partners and planned multi-year Eurobond issuance, together with continued improvement in market conditions and ongoing debt management efforts, are also critical to help contain interest expenditure, which will reduce the headline deficit and create additional space for priority spending.

9. Given the still high degree of uncertainty related to the COVID-19 crisis and economic recovery, our program builds in flexibility to deal with unforeseen shocks. Ongoing improvements in tax and customs administration continue supporting revenue yields. Further progress in strengthening our tax system, with the approval of tax bills in the Legislative Assembly, would also secure our public finances on a firmer footing. Nevertheless, were revenues to underperform, we will propose to the Legislative Assembly temporary tax measures and we will reprioritize non-critical spending as needed to ensure that the primary target goal remains within reach. In the event of additional COVID-19 needs, due to a more protracted pandemic, the program targets will continue to allow for an adjustor to accommodate increased COVID-19 emergency spending, up to a cumulative 0.2 percent of GDP in the remainder of 2022 and 2023, that might emerge from increased transfers to support health services, stronger targeted support to households and businesses heavily affected by the pandemic, or further enhanced social assistance programs to support the most vulnerable groups. We are, however, committed to saving any revenue over-performance in 2022 and outer years to accelerate our debt reduction plans.

10. We will further advance our fiscal consolidation efforts in 2024 and over the medium term to secure debt sustainability, while making space for critical infrastructure and social needs. Additional measures will be underpinned by a planned income tax reform and additional efforts to rationalize tax expenditure (MEFP ¶11). In addition, the implementation of our ambitious reform of public-sector employment (MEFP ¶13) will further support our commitment to keeping nominal spending growth low. In line with the fiscal rule and the Public Employment Bill (PEB), the freeze in the basic wage and accrual of annuities will be extended beyond 2025. We will do these while we continue to modernize and strengthen our social safety net. Expected efficiency gains through consolidation of ministries and other institutions as part of our broader public sector reform; our planned asset sale program; and greater revenue mobilization from the modernization of the tax and custom administration (MEFP ¶12) and PFM reforms (MEFP ¶15) provide important upsides to

our ability to tackle our current debt and financing challenges faster than expected under the program, thereby supporting macroeconomic stability and growth.

Structural Fiscal and Debt Management Reforms

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

12. We are strengthening revenue administration to support our fiscal consolidation plans and medium-term revenue strategy. The Tax Compliance Improvement Plan, approved in December 2021 (structural benchmark) with IMF TA support, aims at strengthening compliance strategies through a more robust large-scale automated cross-matching of information to detect inaccurate reporting and revamped audit programs focused on VAT on services and erosion of CIT bases. While the rollout of the compliance plan was delayed due to the hacking of the tax and custom administration's main collection systems, we resumed the implementation of different compliance risk mitigation strategies in August 2022, with quarterly monitoring based on both quantitative and qualitative indicators. By end-December 2022 we will strengthen the integrity of the taxpayers' registry, with IMF TA, and produce risk assessments of VAT, international taxation, and large taxpayers. We will also develop a guideline (*ficha*) to undertake risk assessments of large net-wealth taxpayers by end-November 2022. We will further enhance our information-driven enforcement capabilities by end-March 2023 through the deployment of the National Integrated Risk Management Systems, a tax and customs coordinated risk management approach, which will use administrative and third-party information to enhance compliance, including automatic exchange of information on financial accounts (CRS), Country-by-Country (CbC) reports and an effective use of corporation shareholders and beneficial owners' registers when warranted. We also plan to formulate a complete impact evaluation assessment framework to identify compliance improvement gains by end-December 2023. On the customs side, the approval of the new Customs

Law in May 2022, with IMF TA support, will further promote trade facilitation to help increase productivity growth in trade-related sectors and improve revenue collection through more effective risk-based enforcement. The implementing regulation is expected to be finalized and enter into force by end-November 2022. Additional revenue administration efficiencies are expected from the MOF's digital transformation plan, *Hacienda Digital para el Bicentenario*, supported by the World Bank (WB), which will upgrade tax and customs procedures and information systems, including a heightened security and mitigation plans to deal with cyber security risks.

13. We are committed to rationalizing and improving the efficiency and quality of government spending through the implementation of the public employment reform. Beyond what was already mandated by the December 2018 reform, there is significant scope to further rationalize the public wage bill, bringing it back on a sustainable path after its excessive expansion over the last 15 years. The implementation of the landmark Public Employment Bill, approved in March 2022 (the related structural benchmark was not met by end-May 2021 as initially envisaged due to legislative delays), is underway. The Ministry of Planning and Economic Policy (MIDEPLAN), through the creation of a Public Employment Unit and in coordination with the Civil Service and with support from the Inter-American Development Bank (IDB), is finalizing the methodology to create a single pay spine with eight job families, consolidating within the single salary other wage supplements such as annuities, bonuses, incentives, and others. The oversight over the design of the single wage spine is being shared between MIDEPLAN and autonomous institutions for their employees (Judiciary and Legislative Branches, Supreme Electoral Tribunal, public universities, municipalities, and CCSS), following the criteria and ceilings approved by the Bill. The Bill, including the introduction of a single pay spine, will be implemented by end-March 2023 (**structural benchmark**), within 12 months since its approval. To circumvent potential legal obstacles to its implementation, since July 2022, we have been undertaking public consultations to hear different sectors' perspectives. We will submit the implementing regulation for formal public consultation in January 2023 to be able to incorporate any further feedback ahead of its final approval and publication when the law enters into force in March 2023. The reform will enhance fairness and productivity by replacing the current salary system, which indiscriminately rewards seniority and civil-service exclusivity, generating perverse incentives for public servants. Its implementation will modernize and streamline the public administration, bringing the public wage bill on a sustainable path, in line with OECD recommendations. It applies to all public sector institutions except for non-state public entities that operate in the public interest and state-owned companies and institutions that operate under competitive markets. Due to the large wage premium in the public sector, the salaries of the many existing workers that fall above the spine will be frozen until they are reached by the single pay scheme. This, along with the gradual transition to the single wage spine for existing workers whose salaries fall below the reference wage for their occupation (Transitory Disposition XI), will imply that savings can be immediately rendered from the effectiveness of the reform. Based on the new reference salaries, we estimate, with support from the IDB, that savings from the reform will range between 0.4 and 0.6 percent of GDP during the first five years for the entire public sector including savings of 0.3 to 0.5 percent of GDP for the central government. The Public Employment Bill foresees that new hiring under the new rules will start no later than twelve months after its entry into force. The Bill also introduces rules for recruitment and selection, professional development, and

performance assessment, including of top-ranked officials; and new employee benefits including one-month parental leave, two-month extension of maternity leave (for special cases), and sick leave to take care of a family member.

14. We are committed to enhance the targeting accuracy and delivery of our social protection programs, leveraging on digitalization. Costa Rica devotes important resources in its budget (1.9 percent of GDP in 2021) to fighting poverty and reducing inequality. There are opportunities to build on recent improvements and further enhance the effectiveness of some of its social assistance programs through improved coverage, targeting, and delivery. The delivery system is also highly fragmented with different entities engaging in social assistance activities, with scope for improvement in institutional arrangements, transparency, and payments delivery.

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

- ***Targeting and coverage of social programs.*** To continue enhancing the targeting accuracy of our social programs, with the support of the WB, we continue strengthening the role of SINIRUBE (*Sistema Nacional de Información y Registro Único de Beneficiarios del Estado*) as the main instrument to target social protection benefits and services, which will also contribute to a more harmonized framework for inter-institutional coordination. In August 2022, a study by *Programa Estado de la Nación* confirmed the robustness of the SINIRUBE algorithm for targeting beneficiaries. Major social assistance programs have already adopted SINIRUBE and IMAS is helping adoption by remaining institutions including the judiciary and higher education. The government is encouraging municipalities to learn and adopt SINIRUBE as their targeting instrument. In addition to boosting inclusiveness, these efforts will improve spending efficiency by using the new interoperable data to rationalize existing programs. In this context, building on IMAS Directive 0122-2022, we are increasing the capabilities of SINIRUBE to have a better and up-to-date socio-economic profile of individuals and households to inform benefit allocation decisions. To support effective compliance with Directive 060-MTSS-MDHIS, IMAS is beginning to remove ineligible duplicate benefits, identified by SINURIBE, outside of municipalities, starting

in early 2023. In 2023, we will also start a new bridge program to facilitate transition to employment and entrepreneurship. With technical support from the WB, IMAS is in the process of designing and developing a single window that; (i) serves as a one-stop-shop for potential beneficiaries to access social programs; (ii) consolidates information about the existing benefits that individuals and families are receiving and provides information of potential eligibility for new benefits; (iii) and facilitates coordination between social protection institutions. The government expects to have the first stage of this single window by end-2023.

15. We are taking further actions to improve public financial management (PFM) to ensure proper implementation of our fiscal rule.

- ***Medium-Term Fiscal Framework***. With support from IMF TA, the MOF published in April 2022 a Medium-Term Fiscal Framework (MTFF) covering the NFPS including the period 2022-2027, meeting the relevant structural benchmark. The revised MTFF, which improves the credibility of the budget process and presents a coherent fiscal strategy in line with the fiscal rule, includes an analysis and reporting of fiscal risks with contingent liabilities, debt guarantees, and explicit fiscal contingency reserve schemes, and integrate into the fiscal strategy a medium-term public investment plan/framework. The MTFF was updated in September 2022, as part of the submission of the 2023 budget, ensuring continuity in the analysis of macroeconomic shocks and further analysis of debt management. We plan to further strengthen the MTFF by end-March 2023 by better aligning our fiscal policy with long-term national plans through improved spending projections, well within the limits of the fiscal rule. In line with IMF TA recommendations, we plan to formalize a unit at the MOF permanently in charge of macro fiscal issues by end-February 2023.

- ***Public Investment Management Assessment***. To improve the planning, allocation, and implementation of public investment among the numerous entities currently responsible for infrastructure development, the MOF and MIDEPLAN undertook a Public Investment Management Assessment (PIMA), including a new Climate Change Module, in November-December 2021, with support from the IMF, WB, and IDB. Based on the assessment, we have defined a plan aimed at strengthening public investment efficiency while making fiscal space for our climate change-related and other critical infrastructure needs (MEFP ¶40). As part of this plan, we submitted a bill to extend the process and procedures of the national public investment management system (*Sistema Nacional de Inversion Publica (SNIP)*) to a broader set of NFPS entities to the Legislative Assembly. We expect the bill to be approved by the Legislative Assembly by end-June 2023. We plan to complement our work on project appraisal by including in the appraisal process the climate impact of the project through the social cost of carbon by end-September 2023 (MEFP ¶40). To give continuity to the work initiated with the support of IDB and private consultants, we will publish by end-December 2023 a set of clear and transparent project selection criteria including climate change criteria (MEFP ¶40). We already issue quarterly and half year reports on the physical and financial progress of externally funded projects. To streamline capital project portfolio monitoring, with the adoption of *Hacienda Digital* in 2025, we plan to extend the process to the domestically funded projects. We also plan to develop a

comprehensive asset register including information on the stock of public assets and their condition as a necessary precondition to inform investment planning, selection, and maintenance.

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

- ***Fiscal Council.*** We are also working on fully operationalizing the Fiscal Council, with the goal of the Council publishing its first public assessment of the government's fiscal strategy in 2023. We will support the Fiscal Council in developing proper communication tools as well as a memorandum of collaboration with the MOF to clarify the separation of functions and information sharing.

- ***Other key PFM institutional reforms.*** The MOF and the Comptroller's Office will continue working together along the entire budget cycle to ensure compliance with the fiscal rule. We have recently resumed our efforts to reduce budget fragmentation. Following the consolidation under the CG budget from 2021 of all public entities, as required by Law 9524 of April 2018, we plan to consolidate public services within fewer public institutions, as part of our planned public sector reform. Specifically, we submitted legislation to consolidate responsibilities of multiple entities within the Ministry of Public Works and Transportation (MOPT), a new Ministry of Housing, and a new Social Ministry to abate redundancies within the public sector. We are also restructuring several ministries to strengthen their oversight of other decentralized entities and eliminating the Ministry of Governance, reallocating some of its directorates under other public institutions. In addition, with IMF TA support, we will continue improving management of public sector liquidity by extending the Treasury Single Account (TSA) to decentralized and autonomous entities. Specifically, we are drafting legislation that requires the phased transfer of all cash held by decentralized and autonomous entities in commercial bank accounts to the TSA, which will reduce idle cash in the financial system and reduce the central government's borrowing costs. Additional expenditure administration efficiencies are expected from the MOF's digital transformation plan, *Hacienda Digital para el Bicentenario*, supported by the WB, which will

modernize and integrate our PFM information systems to better align expenditure policies across core PFM entities, planning, and spending units.

16. We are modernizing our public procurement processes. In line with the Social Dialogue's agreements, we enforced the use by all procuring entities of the electronic platform *Sistema Integrado de Compras Públicas* (SICOP) to lower transaction costs and improve capacity and expertise. The Public Procurement Law (No. 9986) approved in May 2021 introduced a sound regulatory and institutional framework for managing and implementing umbrella contracts for goods and services, eliminating past exceptions to public bidding processes and increasing competition for government contracts. This new procurement legal framework will enter into force in December 2022 and requires bidders' registration in the e-procurement system, 'Electronic Registry of Official Suppliers and Subcontractors of the Unified Digital System', to be incorporated into the *Sistema Integrado de Compras Públicas* (SICOP). After a public consultation period in August 2022, the MOF continues to review the regulation to implement law 9986, in coordination with the President's office. The regulation will be published by end-November 2022. The regulation will require all competing bidders to submit accurate and current beneficial ownership information through affidavits as part of the bidding process. The required information includes information to identify the beneficial owner, including their full name and type and number of official identification document(s) for legal persons. Although SICOP is accessible to the public, beneficial ownership information will be held within MOF's supplier registry for consultation by the Comptroller General of the Republic, Office of the Attorney General of the Republic or other judicial authority upon request. It will also allow the authorities to cross-check information with the Transparency and Final Beneficiary Registry, administered by the BCCR to combat tax fraud and money laundering (MEFP¶34). Moreover, the enforcement of the Public Procurement Law will update, streamline, and modernize the public procurement processes ensuring greater efficiency, savings through bulk purchases of certain goods and it will allow differentiating by public works, goods and services and set different thresholds and processes for each, doing away with a great deal of complexity in the public procurement process.

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

18. We are committed to improving governance and increasing transparency in SOEs. Although SOEs play a dominant role in many key sectors of the economy, such as electricity,

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

19. We are strongly committed to boost productivity through greater efficiency and competitiveness in the electricity sector and the modernization of electricity tariffs. Costa Rica's energy companies impose a high cost of energy for consumers and the productive sector. Since 2021, the Costa Rican Institute of Electricity has been implementing an efficiency strategy to reduce electricity prices in the context of its strategic plan for 2019-23 (Strategy 4.0). This strategy includes actions such as reducing operational costs, restructuring debt, and implementing the IFRS. These efforts were reflected in cumulative tariff reductions in 2021 of 15.98 percent, 12.73 percent, and 13.44 percent in generation, distribution, and transmission, respectively, compared to December 2020. The Government is committed to advancing this efficiency strategy through further debt restructuring and cost reduction in order to achieve lower and more competitive tariffs. ICE will continue the execution of its Financial Sustainability Roadmap to reduce fixed costs and renegotiate debt conditions in its financial statements and the regulatory accounting used for tariff setting by reclassifying operating leases as finance leases. With WB support, ICE will assess its cost structure in each segment of the electricity supply chain (generation, transmission, distribution) to identify efficiency opportunities and launch a roadmap with detailed actions to increase the efficiency of the state-owned company by end-March 2023. ICE will not renew or will renegotiate at affordable terms the private generator contracts as they expire, as a stop of future liabilities. To support these efforts and optimize the use of installed infrastructure, a bill (No. 22.561) on authorizing private energy generators, public companies, and cooperatives to sell their surplus energy (after supplying local demand) to the regional market was submitted to the Legislative Assembly in June 2021 and is expected to be approved by end-June 2023. In addition, to remove barriers to foreign participation in the sector, a bill (No. 22.601) to eliminate the minimum national capital requirement of 35 percent for private companies to sell electricity to ICE, in line with OECD recommendations, has been submitted to the Legislative Assembly and is expected to be approved by end-June 2023. *Autoridad Reguladora de Servicios Públicos* (ARESEP) will expand its efforts to reduce electricity prices charged by other generators beyond ICE, applying new tariff methodologies to other distribution and transmission companies, vis-à-vis with the adoption of new benchmark tariffs for generation,

distribution, and transmission, with IDB support. To achieve this, under ARESEP's leadership, three companies (ICE, ESPH and COOPELESCA) started to implement the first part of the tariff modernization program in 2021 and, building on this pilot, the remaining five companies have started implementation in 2022. As the next step, all eight companies are expected to develop their roadmaps for the introduction of international reference tariffs by end-April 2023. ARESEP will continue monitoring distribution companies' financial costs to ensure their investment projects' financing terms fit with the underlying assets' useful lifespan. Efforts are also ongoing to increase competition in the energy sector. The implementing regulation for Law No. 10086 to simplify the administrative procedures for private participation in power generation from renewable sources for self-consumption, approved in October 2021, will be approved by end-December 2022 (MEFP¶41).

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

- ***Institutional debt management reforms.*** We plan to submit an amendment to law 8131 to the Legislative Assembly to centralize all debt-related functions of the government, in line with best international practices, to improve transparency and reporting of public debt, within the purview of a new standalone Public Debt Management Office reporting directly to the Minister of Finance, by end-June 2023 (**proposed structural benchmark**). The established Assets and Liabilities Committee, comprising the Treasury, the Public Credit Department (DCP), the soon-to-be-established Macroeconomic Analysis Unit of the MOF, and the BCCR, will continue to provide strategic guidance and inter-agency coordination of high-level policy decisions related to government debt. Finally, as the individual approval of external loans creates additional burden on debt management, we will continue to liaise with the Legislative Assembly to seek a general authorization for external borrowing consistent with the approved annual budgetary and borrowing limits and debt management strategy (see below). As in the case of Laws 7970 and 9070 of 1999 and 2012, respectively, the general authorization will provide the government with greater flexibility for international issuances or loans from bilateral and multilateral lenders.

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

- ***Domestic market development.*** We are taking steps to improve the functioning of the debt markets by focusing our issuance on standard fixed-rate bullet bonds of select maturities. Open

bond windows and bilateral bond sales are being gradually phased out. We will reform the auction mechanism for Treasury to become a price-taker in bond auctions (which will improve the price discovery process) and we will form a technical pricing committee to develop guidelines for pricing methodologies. We will further encourage non-resident participation in our debt market by easing regulatory barriers and harmonizing the tax regime for non-resident investors, subject to macroprudential considerations. We submitted a proposal to the Legislative Assembly to promote and open the Costa Rican public debt market to foreign participants, which we expect to be approved by end-December 2022. We are also in consultations with different international platforms to allow clearing and settlement of our debt securities in accordance with international standards. We will continue to make active use of liability management operations to reduce the rollover risks associated with debt maturing in the next 12-24 months and to smooth the impact of maturing benchmark bonds, in line with our MTDS. Finally, in December 2022, with support from the BCCR and IDB, we will roll out a pilot market-making/primary dealer program with a small group of participants with well-defined rights and responsibilities.

21. We are advancing our efforts to improve data quality and transparency in fiscal reporting. We are committed to improving the timeliness, quality, and comprehensiveness of the fiscal, financial and debt accounting for the public sector, with support from IMF's TA. Despite some delays due to the hacking attacks to several government systems, we resumed efforts to adopt the GFSM 2014 accrual accounting standards for fiscal and debt information. We are on track to finalize the compilation of monthly revenue and expenditure (above-the-line) data excluding accrued interest for 2019-2022 for the Consolidated Central Government (CCG), including for extrabudgetary units (*unidades descentralizadas*) representing at least 80 percent of extrabudgetary units' spending by end-March 2023. We intend to compile BCG quarterly debt stocks from the first quarter of 2022 to the third quarter of 2023 including loans and debt securities at nominal value (including accrued interest) according to the GFSM 2014 framework, by end-December 2023. We will progressively extend this effort to expand institutional coverage of GFS and PSDS to the general government (GG) and its subsectors (consolidated GG, including the CCSS and local governments). This will allow the compilation and publication of quarterly GG fiscal and debt data for 2022 and 2023 consistent with 2014 GFSM accrual accounting standards by end-March 2024. We will expand institutional coverage to include nonfinancial public corporations' GFS and PSDS above-the-line quarterly data by end-March 2025. In this context, we initiated the compilation, consolidation, and dissemination of 2022, 2023 and 2024 data on assets and liabilities for all subsectors of CCG, local governments, the social security fund, and the nonfinancial public corporations, and developed the reporting of fiscal risks (in the context of the MTFF), to include contingent liabilities, guarantees, concession contracts, and the indebtedness of municipal governments and nonfinancial public corporations by end-March 2025. These improvements include the comprehensive collection and reconciliation of financing (below-the-line) data, the harmonization of both methodology and data coverage among national accounts, government finance and public sector debt statistics, as well as coordinated improvements on public sector accounting to guarantee stock-flow consistency, allow balance sheet enhanced analysis and provide improved data for decision making. We will update the program coverage and definitions in line with progress in these areas in subsequent reviews and reflect them in the attached TMU.

IV. MONETARY AND EXCHANGE RATE POLICY

22. Monetary policy continues to be underpinned by our firm commitment to low inflation within an inflation targeting framework. Maintaining low and stable inflation, under a flexible exchange rate, is critical to secure domestic and external stability, consistent with the BCCR's mandate. In response to the COVID-19 shock, the strong credibility afforded by the inflation targeting framework allowed the BCCR to run a strongly countercyclical policy stance, reducing the policy rate to a record low of 0.75 percent by June 2020 and supporting liquidity and bank credit. Given rising inflationary pressures and upside risks to the inflation forecast, the BCCR began to raise the policy rate in December 2021. As a result of the protracted commodity shock from Russia's invasion of Ukraine, inflationary pressures became more entrenched and started to impact inflation expectations. In response, the BCCR accelerated its tightening pace, bringing the policy rate to 9 percent by October 2022. In addition, the minimum legal reserve requirement rate for deposits and obligations in national currency was raised from 12 percent to 15 percent in July 2022. Notwithstanding these tightening measures, the outer MPCC band was breached by 2.6 and 5.3 percentage points in June and September 2022, respectively. The attached letter explains the factors behind this overshoot of the target as part of the consultation with the IMF Executive Board (Attachment III).

23. Monetary policy will remain data dependent and forward looking to meet the inflation target of 3 percent, with a tolerance band of ±1 percentage point, over the medium term. The BCCR will continue to monitor inflation developments closely and communicate clearly and transparently on the drivers of inflation, inflation outlook, and the implications for monetary policy. The BCCR stands ready to continue with a gradual and orderly increase in the policy rate, as needed, to bring inflation back within the BCCR's tolerance band and anchor inflation expectations. Progress in meeting the inflation target under the program will continue to be monitored through a MPCC around quarterly targets (Table 1), as described in the attached TMU.

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

25. A calibrated series of operational reforms are underway to deepen the FX market. The BCCR is taking steps to strengthen the predictability and transparency of its FX transactions and create incentives for greater reliance on market-based transactions. To improve visibility on large

orders and better manage FX demands from the NFPS, since April 2022, NFPS entities must give an advance notice of at least one month to the BCCR for FX requests. Moreover, the BCCR is conducting a broader review of the way in which the foreign exchange needs of the NFPS are managed, with a view to strengthening the efficiency of these transactions and minimizing unnecessary buildup of FX deposits of NFPS. Recommendations to the BCCR Board will be submitted by end-December 2022. To further improve transparency and market function, we are considering separating the BCCR's FX operations intervention between i) transactions for reserve accumulation and replenishment from NFPS sales, which will occur via a preannounced schedule of daily FX auctions; and ii) intervention to address market dysfunction, which will occur via Monex as needed. Moreover, the BCCR will seek to improve the functioning of the spot foreign exchange market in order to favor better price formation and liquidity, including the possible introduction of market makers that will enhance liquidity in the market. Specifically, we will seek market makers who will have an obligation to regularly quote prices based on minimum trading lots and a maximum bid/ask spread. We will also revisit Monex operating parameters by end-December 2022 to re-extend trading hours. To improve transparency, the BCCR will set minimum and maximum thresholds to order sizes, which will also help to define the roles of participants in Monex, by end-December 2022. In addition, with regards to the spot market, we will promote initiatives to favor ethical, responsible and transparent behavior of market participants, through the implementation among its main participants of the FX Global Code by end-December 2023. Developing an auction system will need to be carefully sequenced with efforts to deepen the market and to help FX intermediaries manage large orders. We also plan to revise the FX intermediaries' net open FX position requirements in line with international best practices. Once we have improved liquidity in the spot market, we will work to develop the FX derivative market, which would improve FX liquidity, hedging potential and price formation. A master agreement will be developed (in coordination with foreign exchange intermediaries) for the negotiation of FX derivatives in the country by end-April 2024 and FX swaps will be introduced as an instrument for the BCCR's participation in this market by end-June 2024. All the envisaged reforms will be conducted in a manner consistent with our Article VIII commitments and the IMF's Institutional View on Liberalization and Management Capital Flows. All these actions to deepen the FX market and allow for greater flexibility of the exchange rate would complement other measures being taken to reduce financial dollarization (MEFP ¶29), which in turn should reduce financial vulnerabilities and strengthen monetary policy transmission.

26. We stand ready to further strengthen the BCCR's independence, transparency, and accountability in the implementation of the flexible inflation targeting regime. The amendments to the BCCR Law in 2019—to tighten the dismissal rules for the BCCR Governor, delink the Governor's term from the political cycle, and remove the Minister of Finance's voting rights in the BCCR Board—have improved the personal autonomy provisions in the law. To further strengthen the BCCR's operational autonomy and governance, and in line with the recommendations of the IMF's 2020 Safeguards Assessment, we submitted to the MOF draft amendments to the BCCR law, prepared in consultation with IMF staff, by end-August 2021, meeting the relevant structural benchmark. The final amendments, once approved by the MOF and the President of the Republic, in line with program understandings, will be submitted to the Legislative Assembly by end-December 2022 (**structural benchmark**). The Executive Branch will take the necessary steps in order to fill the

current vacancy in the BCCR Board. In addition, we will develop a long-term roadmap to continue to strengthen the BCCR´s equity position.

V. FINANCIAL SECTOR POLICIES

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

28. The banking sector remains stable after the expiration of most of the extraordinary regulatory measures introduced in response to the COVID-19 crisis. Pre-pandemic settings have been restored on the regulatory treatment of restructured loans as of January 1, 2022. At the same time, the use of already accumulated countercyclical provisions and the softer regulatory capital thresholds that define banks' "irregularity" was extended until December 2022. In parallel, we have strengthened reporting and monitoring efforts, as laid out in the attached TMU, and we will continue to monitor the situation closely, including through the Financial Stability Committee's (FSC) Monitoring and Coordination Group (MCG) comprising senior representatives of the BCCR, CONASSIF, the Superintendencies, and the MOF. With the unwinding of the extraordinary COVID-19 measures, the technical group supporting the MCG will continue to meet frequently to follow up on key systemic developments and financial risks and seeking to detect and anticipate sources of stress. Over the years, we have also made significant progress in systemic risk assessment by strengthening our credit, market and liquidity risks' stress test models and contagion risk tools. We will continue updating our bottom-up and top-down stress test results and publishing them in our annual Financial Stability Report. In line with the BCCR's roadmap to integrate climate considerations into monetary and financial policies, we have been working to enhance our capabilities on climate risk management, including through an integrated climate and economic model, and developing stress testing methodologies (MEFP ¶44).

29. We plan to take further actions to reduce the risks from financial dollarization. Since 2018, the BCCR has allowed for greater exchange rate flexibility, helping agents internalize exchange rate risks (MEFP ¶24-25). To complement these efforts, the FSC is closely monitoring the risks from dollarization, and SUGEF and CONASSIF have taken further measures to discourage dollarization, including (i) establishing a higher general provision requirement for loans to non-FX generators, (ii) calculating liquidity coverage requirements by currency, (iii) requiring additional capital requirements for foreign currency mortgages to unhedged borrowers, based on LTV thresholds; and (iv) requiring banks to assess the sensitivity of debtors' payment capacity to exchange rate changes. SUGEF and CONASSIF have (i) revised the definition of an unhedged borrower, which will take effect from January 1, 2023; and (ii) issued a new regulation imposing additional capital requirements on foreign currency loans to unhedged borrowers. The regulation establishes a gradual increase in the

risk weight for credits to unhedged borrowers, starting on January 1, 2024, and ending on January 1, 2031. The risk weight will apply gradually to both the loan balance by end-December 2023 and to the marginal loans from the corresponding effective date. To increase transparency, SUGEF will also begin to regularly publish data on unhedged FX borrowing starting in December 2022.

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

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

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

- ***Strengthening supervisors' legal powers and protection.*** Drawing on the Basel Core Principles assessment from a recent FSAP developmental module, we intend to pursue critical legislative reforms to strengthen supervisors' legal powers and protection. Specifically, we intend to grant to CONASSIF, SUGEF and the other Superintendencies the legal powers to (i) dismiss members of the Board and senior management of banks for engaging in unsafe and unsound practices, (ii) to

impose additional capital requirements under Pillar II on individual banks; (iii) to ease the legal conditions for the exercise of supervisory powers (giving more discretion to the supervisor) and to establish a separate appeal procedure for (at least) the most serious supervisory measures and intervention or resolution decisions in which the annulment of the decision can only result in a monetary indemnification of damages, but never in the reversal of its legal effects. Moreover, we are working to recalibrate the sanctioning framework to provide the proper incentives. In addition, we intend to strengthen the legal protection for supervisors with respect to coverage of legal costs, and protection against good faith errors. We aim at finalizing by end-June 2023 a road map on the necessary steps to take these reforms forward.

- ***Responding to cyber risks***. In addition, with support from IMF TA, we are preparing draft regulations to address governance and risk management of cyber risk, including with respect to information sharing, incident reporting and testing frameworks, as well as how to address third party risks and response to and recovery from cyber incidents. We plan to complete the draft and initiate consultations with the industry by end-February 2023, with the regulations expected to be approved by end-June 2023.

31. We will continue to strengthen our financial safety net by enhancing our banking resolution and deposit guarantee framework in line with best practices. We have advanced our crisis preparedness framework considerably, with the approval by the Legislative Assembly in February 2020 of the law on banking resolution and the creation of a deposit guarantee fund (DGF) (law no. 9816). Implementing regulations have been in effect since May 2021, and quarterly payments into the DGF started in October 2021. With support from IMF TA, we are further strengthening the legal framework on bank resolution and deposit insurance, including adequate institutional arrangements for the DGF and the resolution authority, sufficient resolution powers, and clear resolution triggers. This will include strengthening the legal regime for resolution and recovery plans. Accordingly, we are finalizing draft amendments to Law 9816 and other relevant laws, in coordination with CONASSIF and the BCCR. We plan to submit them for consultation with the industry and other stakeholders by end-April 2023. We will submit the final legal amendments, once approved by the MOF and the President of the Republic, in line with program understandings, to the Legislative Assembly by end-December 2023 **(proposed structural benchmark)**. The financial safety net and the crisis preparedness framework have also been strengthened by the continuous monitoring of macro-financial risks by the MCG (MEFP ¶28), including through an updated early warnings system; an updated contingency plan for episodes of financial stress, with the inclusion of a communications protocol; and the BCCR´s recent enhancement of its Lender of Last Resort mechanism.

32. The Executive Branch is committed to level the playing field between public and private banks to foster competition. Several distortions and regulatory asymmetries hamper both private- and state-owned banks, and hence their ability to support growth and job creation in Costa Rica. To remove these asymmetries, we plan to submit a proposal to the Legislative Assembly to (i) convert parafiscal contributions by state-owned banks into a single commensurate transfer to the CG budget, adjusting the fiscal rule spending accordingly; (ii) remove the requirement on state-

owned financial institutions to comply with public procurement requirements; (iii) gradually phase out the requirement for private banks, which have not opened agencies or branches in certain areas listed in the law, to transfer a part of their short-term deposits as a loan to state-owned banks (the *peaje*). In parallel, we will identify alternative ways to channel resources to underserved sectors, limiting any fiscal contingent liabilities. We will develop a first legislative draft by end-October 2023. The asymmetry generated by the existing legal requirement for NFPS to do their banking with state-owned banks will be also corrected with the approval of the legislation on the Single Treasury Account (MEFP ¶15). As the deposit guarantee covering the entire banking sector becomes fully effective, we will explore options to gradually phase out the existing blanket guarantee for state-owned banks. The BCCR and MEIC have also recently launched a database that compares credit products across the financial system, to enhance information for financial consumers and foster bank competition.

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

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

- ***Complying with FATF standards***. Costa Rica continues to strengthen its technical compliance with the FATF standards on AML/CFT to help the fight against money laundering and terrorist financing. In May 2022, we submitted an application to the Financial Action Task Force of Latin America (GAFILAT) for the re-rating of four FATF recommendations (8, 17, 22, and 28), whose discussion will take place at the GAFILAT Plenary Meeting in December 2022. In addition, six other recommendations will also be re-evaluated due to changes in the FATF standard. We also

provided a progress update on effectiveness and technical compliance to the GAFILAT Plenary in July 2022. An improved Enhanced Follow-Up Report is expected in 2023.

- ***Strengthening the AML/CFT framework and disclosure of beneficial ownership***. CONASSIF has approved regulations to make our sanctioning framework more effective, proportionate and dissuasive, incorporate new regulated subjects, and adopt a new regulatory and legal framework related to beneficial ownership, including in revised SUGEF Regulation 12-21 of September 2020. CONASSIF has also updated regulations (in force as of January 1, 2022) to strengthen the due diligence measures that financial entities are required to apply to politically exposed persons, the financing of political parties, and the receipt of cash especially in foreign currency. In January 2021 CONASSIF approved SUGEF regulation 35-21 that established the *Centro de Información Conozca a su Cliente* (CICAC) as a centralized repository of customer information that will promote transparency, efficiency, and cost reduction concerning Know-Your-Customer (KYC) monitoring and supervision. This regulation became effective in January 2022. All regulated entities in the financial system are required to ask for the customer's authorization to record their information in CICAC as of July 2022. With respect to DNFBPs, close to 5,000 legal entities and individuals are registered in SUGEF, and as of December 2022 they will be required to upload information to CICAC in order to register. We are developing technology to enable financial institutions' clients to share the beneficial ownership information provided for the centralized registry with the CICAC repository. Furthermore, the regulation also allows SUGEF to "suspend" the registration of legal entities and individuals that do not comply with regulatory requirements, which prevents regulated financial intermediaries to provide services to them. As of June 2022, 1040 registered legal persons and natural persons have been suspended. Moreover, in accordance with Law 9416 and Decree no. 41040-H, to strengthen information and transparency on beneficial ownership, the BCCR also created in 2019 a centralized registry (Transparency and Beneficial Ownership Registry) and started collecting shareholder and beneficial ownership information for all legal entities except trusts, third-party resource managers and non-profit organizations. The registry is accessible to the MOF and the Costa Rican Institute on Drugs. As of October 2021, trusts have been included, and we intend to include the rest of the entities by end-December 2023. CONASSIF and the Financial Intelligence Unit will continue to dedicate resources to AML/CFT supervision and collaboration between competent authorities and carry out inspections with the required frequency.

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

35. We are resolved to further advancing our growth-enhancing reform agenda, supporting a resilient recovery from the COVID-19 crisis. In May 2021, Costa Rica officially became an OECD member, following a successful accession process, which saw the introduction of 14 landmark legal reforms and many administrative reforms. Going forward, we remain fully committed to further advancing our reform agenda. Specifically, our strategy hinges on three key objectives: (i) protecting the most vulnerable from the impact of the crisis and supporting inclusion,

including by promoting greater female labor force participation; (ii) boosting productivity growth, including by eliminating barriers to business formalization, investment, and job creation; and (iii) promoting a green recovery, anchored by our National Decarbonization Plan and the goal of becoming a zero net emission economy by 2050.

A. Protecting the Most Vulnerable and Boosting Productivity Growth

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

- ***Formalization.*** To incentivize formalization, since 2017, the CCSS has adopted plans to reduce social security contributions, targeting populations where informality is prevalent. To encourage formal part-time or flexible employment, the CCSS Board of Directors formulated in June 2022 a plan to adjust the minimum contribution base for part-time workers and submitted it for public consultation. While the related structural benchmark was not met by end-June as originally envisaged, the CCSS approved the final plan in September 2022. The reduced minimum contribution base is expected to be implemented in three phases to minimize the shortfall of contributions, starting in January 2023 for workers below the age of 35; January 2024 for workers below the age of 50; and January 2025 for all workers. Furthermore, the CCSS is developing incentives for independent workers to contribute to the SS system, by allowing differentiation in contributions by age/years in the job market and for seasonal employment. The PIT reform also considers increasing incentives to contribute to CCSS by allowing the deductibility of CCSS contributions from the PIT's taxable income (MEFP ¶11). To reduce the administrative burden for firms, over the last four years we reduced the number of minimum wages from 26 to 16 and plan to further reduce it to 11 by end-December 2022, in line with OECD recommendations. We will further support these efforts by implementing our national strategy for transitioning to the formal economy, with technical assistance from the ILO.

- ***Education.*** We have taken measures to improve the quality of the education system to address skill mismatches with the labor market and increase human capital. In this context, we are undertaking an extensive review of school curricula by competencies, strengthening synergies with the local communities and the private sector. We aim at finalizing and introducing the updated curricula by end-February 2024. We will proceed in parallel to offer training opportunities to teachers based on the new student and curricula targeted competencies. We will develop a preliminary proposal for a new performance-based evaluation model, by early 2024, and we will finalize it following formal consultations. On the basis of the new student and teacher competencies being defined, the Ministry of Education is also developing a new proposal to evaluate students' performance, which will replace the former student performance tests (FARO). To help address the impact of the pandemic on educational outcomes, training courses were offered to improve teaching performance in the use of digital technologies, in collaboration with universities and other entities. Going forward, we will continue to reduce the digital gap by providing infrastructure, improving teachers' digital capacity, and providing teachers and

students, especially from low-income families, access to the necessary equipment. In February 2021, a Bilingualism Education Policy was introduced, with an Action Plan to improve proficiency in a second language, including students in rural areas, by 2040. To foster entrepreneurship and to develop an entrepreneurial education strategy, we are integrating in the curricula courses in business management in 17 schools. We are also revising our existing vocational curricula in the context of Industry 4.0, to be implemented by end-December 2023, with support from the IDB. We are already offering 24 new study programs, and we aim to implement 8 more programs by 2023. The INA (*Instituto Nacional de Aprendizaje*)'s Organic Law has been amended to provide this vocational institution with greater autonomy and agility for administration and hiring, with employability as its key objective, in line with ILO recommendations. We will also continue linking public universities' funding to labor market needs and enhancing their connections to the business world through integration in the National Science and Technology Information System to promote innovation and allow firms to benefit from access to state-of-the art knowledge and skills, in line with recommendations from IDB and OECD.

- ***Investment climate.*** To attract investment, we are making efforts to identify spending priorities and promote PPPs, with support from CABEI and IDB, to reduce existing physical and digital infrastructure gaps, consistent with our fiscal consolidation plans under the program. With IDB support, we recently launched the Program of Road Infrastructure and Promotion of PPP and will provide critical training on PPP development across central and local governments during 2022-2024. Another critical step in promoting investment is our ongoing effort to reduce electricity tariffs (MEFP ¶19). To further reduce the digital divide in the country, especially increasing access for the most vulnerable, we launched in November 2022—with support of the IDB—a new National Telecommunications Plan 2022-2027, with a focus on increasing competition among 5G technology operators (at least 3) by end-December 2023. To reduce red tape, we are developing a new legislative reform updating the Law 8220 to simplify administrative procedures with sanctions to government officials for non-compliance. In collaboration with the private sector, we have launched the program *Le Dejamos Trabajar* to eliminate 163 obstacles for businesses by end-February 2023. As part of our smart deregulation strategy, we are implementing *Costa Rica Fluye* commitments with 11 public institutions to enact 21 regulatory enhancements. We also implemented a single-window system (VUI), where businesses can apply for licenses and permits. To further cut red tape, the VUI is being implemented in 37 local governments, while efforts are ongoing to simplify 125 procedures across the public sector to start a business, integrate environmental permits, and centralize procedures at the national level to provide for a single point of contact, in line with OECD recommendations, by end-September 2023. In September 2022, we also eliminated minimum fees to increase competition in 11 professional associations. In addition, we are expediting the implementation of the new bankruptcy law (Ley 9957), with the approval of the necessary regulation. The law simplifies the bankruptcy process to reduce the duration and cost of liquidation proceedings and promote restructuring of affected firms. To foster FDI attraction, already one of Costa Rica´s strengths, we will promote innovation clusters to

remove information barriers and facilitate the integration of domestic firms in global value chains.

37. As part of our efforts to promote inclusive growth, we continue to focus on increasing female labor force participation. Costa Rica's long-standing provision of universal healthcare, pensions, and general education has supported greater inclusiveness and equality of opportunities. We aim at further promoting inclusive growth by strengthening female labor force participation, which is considerably lower than for men, despite women's better education outcomes. In this context, we launched in September 2020 the Gender Parity Initiative (IPG), with support from the IDB, WEF, and AFD, to reduce women's care burden—the top obstacle to female labor force participation—and promote their participation in the labor market and leadership positions. Under the IPG, we plan to implement, over a minimum period of three years, an action plan with measures ranging from regulatory changes to awareness-raising initiatives that involve public and private sectors. In this context, we appointed inspectors from the Ministry of Labor in each region to monitor and sanction gender discrimination, including pay gaps, in private companies. In addition, we will expand from around 11,000 to more than 20,000 women the coverage under the program *Avanzamos Mujeres* by end-December 2023, which provides education and technical training, subject to the availability of fiscal resources. We are also advancing our gender budgeting agenda to support the implementation of IPG and other initiatives to reduce the gender economic gap (MEFP ¶15). Moreover, we are launching a strategy to combat sexual harassment, providing emotional and legal support to victims, increasing resources for first-response centers, developing early warning devices to prevent harassment in public transportation, and increasing awareness through a broad communication campaign. As a first step we launched a pilot strategy in October 2022.

- ***Childcare.*** The 2018 fiscal reform expanded the definition of public education to include early education centers, with a view to helping reallocate funds to increase the supply of public childcare services. In 2021, childcare services were increased by 15,000 additional children (relative to 2017), with a focus on children up to 5 years old, improving access for low-income households. Before further expanding coverage, we are working on a plan to strengthen the quality of the supply of existing childcare services standardizing the costing framework and the basic certification for supply of services. To further expand offer and access to private childcare services, we are working to implement a co-payment scheme based on family income, above the poverty line and below the sixth decile, building on the current private-sector pilots in the free-trade zone. Stronger childcare facilities can in turn support educational outcomes and female labor force participation. The Public Employment Bill has also introduced for public sector workers one month of paternity leave, a two-month extension of maternity leave (in specific cases), and paid leave to take care of a family member.

- ***Long-term care.*** In March 2021 a National Care Policy 2021-2031 was launched to establish a long-term care system and reduce women's family care requirements (Decree 42878-MP-MDHIS). In March 2022, the SINCA (*Sistema Nacional de Cuidados y Apoyos para personas adultas y personas adultas mayores en situación de dependencia*) was created to improve the quality and access to long-term care. The plan will be progressively implemented along five pillars:

governance, data intelligence, strengthening of care supply and benefits, generation of conditions for closing gender gaps in labor markets, and quality assurance. In addition to strengthening the coverage of day centers and long-term residences, the system will also establish home care and assistance services for dependent people. The Mixed Institute of Social Help (IMAS), the National Institute of Women (INAMU) and the Ministry of Labor and Social Security (MTSS) are working, with support from UN Women, on a mechanism to prioritize provision of care services in households where there is potential for women to enter (or remain in) formal employment, and to ensure money transfers to caregivers living in extreme poverty where the prospect for paid employment is low. We plan to complete the protocols for eligibility by end-March 2023, building on a pilot with support from UN Women. We will start to implement the new Policy for all eligible women by end-December 2023. We are also making progress on three pilots of care services to test its feasibility and cost/efficiency, financed by the IDB. In an effort to unify access to services and extend coverage, we will implement a single dependency scale and a co-payment scheme based on family income by end-December 2023. To further increase the supply of care services, we are developing a pilot to connect care services providers with those in demand of such services through a mobile application, with IDB support.

- ***Education and entrepreneurship.*** The ongoing efforts to strengthen our education system and vocational training as well as to deepen financial inclusion (MEFP ¶33) will be critical to support women's economic empowerment. We have developed a plan to boost at regional level the program FOMUJERES, which finance women-owned business and provide support to formalize them, and we plan to start its implementation in January 2023. Additionally, there are ongoing financial inclusion pilot programs financed by CAF to design financial products based on women's specific needs. In 2022, we completed the incorporation of all regions in the country into the STEAM education strategy to continue to foster the participation of women in these fields in collaboration with the IDB. 56 new public institutions are expected to be added in 2022 to the 160 public educational institutions already implementing the STEAM education strategy. We will also continue to implement our national action plan for gender equality in scientific and technological fields, which will strengthen female labor force participation and productivity growth.

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

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

comprehensive climate strategy. This instrument will be critical to our efforts, together with the additional climate finance resources it is expected to catalyze.

39. To support our strategy, we are enhancing our institutional readiness to respond to the climate change challenge. The Ministry for Energy and the Environment (MINAE) has overall responsibility for climate change issues. To mainstream and consolidate governance of the ecosystems, we submitted a bill (23.213) in June 2022 to integrate relevant decentralized bodies into MINAE that is expected to be approved by end-December 2022. MINAE produced our National Adaptation Plan with the support of MIDEPLAN and our National Decarbonization Plan with the support of other ministries. The National Commission of Risk Prevention and Emergencies (CNE) coordinates actions and articulates the overall disaster management framework. MINAE's National Directorate of Climate Change oversees our Carbon Neutrality Country Program (PPCN 2.0), which supports the country's mitigation efforts by providing a mechanism for the voluntary adequate management of greenhouse gas emissions for public and private organizations. Moreover, we will establish a data-driven, highly inclusive process to update NDCs and long-term climate action plans including the new National Development Plan for the environmental sector, which was launched in October 2022. MINAE, through the Secretariat of Planning's Environmental Sector (*Secretaria de Planificacion del Sector Ambiente* (SEPLASA)) is coordinating with MIDEPLAN and ministries and entities that are part of the environmental sector to ensure the sustainability of the modelling and analysis capabilities that have been developed over the last six years. The BCCR is part of the Network of Central Banks and Supervisors for Greening the Financial System (NGFS) and established the Group for Strategic Analysis of Climate Change (GAECC), which is instrumental in coordinating national efforts to green the monetary and financial sector (MEFP¶47).

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

- ***Disaster Risk Management***. With support from the WB, we are strengthening our National System for Disaster Risk Management—which has been in force since 2006—in line with the Institutional Strategic Plan 2018-2022 of the National Commission for Risk Prevention and Emergency Care. We will have business continuity policies in all providers of public services by June 2023. We have already developed climate risk maps for extreme hydrometeorological events for 23 cantons of the country and expect to cover all remaining cantons by end-June 2023. We also plan to address the significant gaps in the integration of climate-related risks into spatial planning and regulations. Currently only about 50 percent of Costa Rica's land area is regulated by land-use/spatial plans, and the Regulatory Plans (urban and coastal) and Regional Development Plans do not take into account climate change considerations. Considering the importance of spatial planning for resilient infrastructure, the Ministry of Housing and Human Settlements (MIVAH) in collaboration with the Ministry of Environment and Energy (MINAE) will develop and publish guidelines for including climate change considerations in Regulatory Plans by end-February 2024 (**proposed RSF reform measure**). We will start to implement the new

guidelines into all the new regulatory plans and gradually adjust the existing ones. In complementary work, the National Commission for Risk Prevention and Emergency Care is providing information to the municipalities on climate related risks. To support the most vulnerable productive sectors, we also introduced a new insurance scheme in 2019, which allows agricultural producers to insure their harvest against climate change risks and offers lower premia for producers implementing adaptation measures. The NAP aims to introduce 75 percent of small and medium size farmers to crop insurance providers over the period 2022-2026.

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

41. We are strongly committed to promoting environmentally sustainable growth by implementing the mitigation strategies in our ambitious National Decarbonization Plan. Recognizing the need for prompt and bold action to mitigate climate change, in 2019, we launched a

National Decarbonization Plan, pledging to reduce greenhouse gas emissions to a net absolute maximum of 9.11 million tons of carbon dioxide equivalent (CO_2e) by 2030 and achieve zero net emissions by 2050. The Plan is among the few assessed to be consistent with limiting global warming to 1.5°C, in line with the Paris Agreement. With almost 100 percent of the electricity matrix currently sourced from renewables, we start off from a strong position.

- ***Electrification of transport.*** To support the electrification of private vehicles, the Legislative Assembly approved a bill to extend tax incentives for electric vehicles to 2034. Moreover, we are developing a feebate scheme to promote the transition to low-emission vehicles (MEFP ¶8). The scheme comprises a sliding scale of fees to vehicles with above average emission rates and a sliding scale of rebates to light-duty private passenger vehicles with below average emission rates levied at the time of purchase or import of new or used vehicles that are up to 5 years old. The design will aim to be revenue-neutral, with safeguards to reduce risks of revenue loss. With support from IMF TA, we will complete the technical design of the feebate scheme. We will submit to the Legislative Assembly the bill on the introduction of the feebate scheme to strengthen incentives for low-pollution private vehicles by end-September 2023 (**proposed RSF reform measure**). As part of our systematic cost-benefit analysis of tax exemptions (MEFP ¶11), we will also appraise and publish a review of existing tax incentives with a negative effect on the environment to support decarbonization efforts by end-February 2024 (**proposed RSF reform measure**), with a view to streamlining them over time. In parallel, we will continue to encourage fleet electrification processes in the transport sector—the largest contributor to greenhouse gas emissions. For public transport, we will develop new promotional electric tariffs, building on the experience of existing pilots and assuming a 15-year life span, by end-June 2023, for the use and the supply of electricity associated with charging centers for electric buses and incorporate the tariff into the current tariff schedules of electricity distribution companies. With support from the IDB, we have installed 40 fast charging centers nationwide and are on track to reach 70 by end-December 2022. We are conducting a review of the existing operators' concessions contracts and transport routes with a view to include incentives to unit (fleet) electrification.

- ***Renewable energy.*** Our efforts to increase competition in the energy sector and reduce electricity prices from renewable sources will support decarbonization. We will approve the implementing regulation of Law No. 10086, as approved by the Legislative Assembly in October 2021, to simplify the administrative procedures for private participation in power generation from renewable sources for self-consumption by end-December 2022 (**proposed RSF reform measure**). This will complement ongoing efforts (i) by the Costa Rican Institute of Electricity to enact tariff reductions by reducing operational costs, restructuring debt, and implementing IFRS; (ii) by the *Autoridad Reguladora de Servicios Públicos* (ARESEP) to reduce electricity prices charged by other generators beyond ICE, applying new tariff methodologies; (iii) and to introduce measures to remove barriers to foreign participation in the energy sector through legislation currently under consideration by the legislative assembly (MEFP ¶19). We are also developing the legal framework to allow the private sector to use geothermal energy in industrial processes, agriculture, and tourism. Currently only ICE is allowed to use low-enthalpy geothermal

energy, and we plan is to submit to the Legislative Assembly a bill to facilitate expanded use of this renewable energy by end-April 2023.

- ***Agriculture, forestry, and marine ecosystems.*** The agriculture and forestry sector play a major role in carbon sequestration and are therefore key to reaching our zero net emission target. With support from the German Development Agency (GIZ), we will further support farmers in adopting low-carbon technologies and practices by providing technical assistance, promoting agricultural research on low-carbon solutions, and further developing financing instruments. We are also scaling up nationally appropriate mitigation actions (NAMAs) for coffee, rice, sugarcane, and bananas, with support from the IDB and AFD. We plan to have an assessment of the costs of such a scaling up and to identify suitable financing options, starting with priority sectors, by end-March 2023. We will refine our payment for ecosystems schemes to cover the entire landscape including agriculture, livestock, and forestry, with support from the WB and the Global Environmental Facility. We are also establishing initiatives to promote job creation through such schemes, including in the wood industry. We are also seeking opportunities to extend the payment for environmental services model to the marine sectors, starting with the fisheries, with WB support. We are also committed to supporting the "blue" economy through sustainable and innovative approaches to the use of coastal areas while ensuring their conservation. We have already exceeded our goal to protect 30 percent of our marine territory under conservation schemes by end-December 2022. To this end, in December 2021, we signed the decree 43368-MINAE to expand the protection of Coco Island National Park and Montes Submarinos Marine Area to consolidate the protection of important marine ecosystems as well as endangered species and high commercial value ones and promote sustainable tourism and other economic activities while preserving the health and resilience of the ocean. This is part of a broader regional conservation and management strategy in the Eastern Tropical Pacific, which aims to establish a transboundary biosphere reserve to consolidate swim-ways or underwater biological corridors that will connect Cocos Island (Costa Rica), Galapagos (Ecuador), Malpelo (Colombia) and Coiba (Panama), with the relevant application expected to be filed by end-March 2023.

- ***Environmental trade.*** We are making progress in negotiating an Agreement on Climate Change, Trade and Sustainability (ACCTS) with five other countries (Fiji, Iceland, New Zealand, Norway, Switzerland) to ensure that our trade policy supports the goals set forth by the National Decarbonization Plan. We and other ACCTS members have agreed to work towards eliminating tariffs on environmental goods trade, barriers to environmental services trade, and environment-damaging subsidies and commitments. By end-December 2022, we will publish our sustainable agro-landscapes strategy, which will help position our agro products as sustainable and carbon neutral on global markets under a unified brand (Essential Costa Rica), and MINAE is supporting the Ministry of Foreign Trade in negotiations with trading partners.

42. We are further developing our strategy for transition mitigation. In March 2021, we released the Territorial Economic Strategy for an Inclusive and Decarbonized Economy 2020-2050, with support from the IDB. The Strategy aims to make a gradual transition to an inclusive and decarbonized economy by 2050, with 12 development poles, six corridors—that will facilitate the

interaction between these poles—and 12,750 km^2 of territorial management areas. The strategy involves policy measures on economic growth, social inclusion, human capital, gender, infrastructure and connectivity, and natural capital. Among the fifty priority actions, key just transition actions include expanding coverage of early English education and implementing training programs on the green and blue economy. Our modeling work, with support from the IDB and UN, has estimated that our National Decarbonization Plan has economic benefits of $41 billion in net present value terms and a net positive effect on jobs by 2050. We are conducting additional analytical work to study the technical profiles for new green and blue jobs by end-November 2022 and identify transition pathways for different industries to move towards decarbonization by end-March 2023.

43. To proactively assess the macro-fiscal implications of our climate change strategy, we are integrating climate risks into our budget planning. In May 2022 we approved the functional budget classification system in line with the 2014 IMF Government Finance Statistics Manual and the international concepts and definitions of climate change and disaster risk expenditure. With the support of the IDB and the AFD we are developing a methodology for tagging climate-related expenditure in budget and financial reporting. As a next step, the MOF will publish guidelines for climate budget tagging by end-February 2023 (**proposed RSF reform measure**). We will enhance the capacities of ministries and agencies on green budget tagging and modify the financial management information systems to operationalize the new climate change expenditure classification. In September 2022, we published a National Strategy for Financial Management of Disaster Risks, which quantifies financial losses and identifies possible financial instruments that could be mobilized *ex ante* (e.g., budget provisions, the National Emergency Fund, and insurance) or *ex post* (e.g., budget reallocations, new loans) to respond to such losses. The MOF, in collaboration with the National Commission for Risk Prevention and Emergency Care, will develop and publish an implementation plan of the strategy to select an optimal combination of instruments by end-June 2023. While the natural disaster risks are well integrated into the fiscal risks analysis, with the support of the IMF, we will expand the quantitative climate fiscal risk analysis in the Medium-Term Fiscal Framework to include transition risks associated to the implementation of the National Decarbonation Strategy by end-September 2023 **(proposed RSF reform measure)**.

44. The BCCR and the supervisory authorities are pressing ahead with efforts to address climate change effects on the financial sector. In 2019, the BCCR joined the Network of Central Banks and Supervisors for Greening the Financial System (NGFS). The BCCR also established within the central bank the Group for Strategic Analysis of Climate Change (GAECC), comprising representatives of different departments, to address the impacts and risks related to climate change on the central bank's main objectives. With support from GAECC, the BCCR developed a roadmap to integrate climate change considerations into the design of monetary, financial, and macro-prudential policies. The roadmap is centered around four blocks: establishing reliable and comparable data with identification of systematic data gaps, strengthening modeling and analytical capacity for scenario analysis, promoting climate change risk management in the financial system, and greening international reserves. Over the past few years, the CONASSIF and the Superintendencies have also worked to raise awareness and train the industry on the risks and opportunities associated with climate change, efforts that create strong synergies with the BCCR road map. They have aligned their

agendas with the National Strategic Plan 2050. The GAECC now regularly coordinates with the CONASSIF and the Superintendencies and serves the purpose of coordinating efforts on climate change issues. The BCCR has taken the decision to dedicate permanent staff resources to the GAECC, which will ensure continuity and allow further strengthening and broadening of its coordination function.

- ***Data and modeling to assess financial sector climate risks.*** The BCCR is taking stock of the required data to adequately analyze the impact of climate change and, with support of the WB, aims to identify suitable indicators that can serve as a reference to measure and monitor climate-related risks. An important part of monitoring such risks is to document the main climate risks faced by Costa Rica at a more granular level, combining information from various sources, and identifying systemic data gaps. Supervisory agencies will coordinate efforts to obtain firm-level disclosures of climate-related risks to inform the design of regulatory and supervisory approaches to manage these risks, within their respective mandates. Complementary to these efforts, the BCCR has recently compiled and made public two new environmental accounts—Material Flow Accounts for 2014-2019 and Environmental Protection Expenditure Accounts—for the private sector for 2018-2020. However, an integrated database, with more granular information, is needed to systematically capture risks at the national level. To this end, the BCCR will create a data repository, as a first step covering at least 35 percent of the credit portfolio, including indicators of (i) main climate hazards, notably hydro-meteorological ones; (ii) degree of vulnerability to climate-related events at sectoral and geographical levels; (iii) exposure of banks´ credit portfolios to vulnerable industries and regions by end-February 2023 (**proposed RSF reform measure**). With support from the IDB, the BCCR has developed an integrated economic and environmental model to conduct impact analysis of climate policies. The BCCR aims at being fully operational in the analysis of different climate scenarios combined with various mitigation and adaptation policies by end-December 2024.

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

repository is fully developed, we will also seek to incorporate climate risks into the bottom-up stress testing.

- ***Greening international reserves.*** The BCCR aims at leading the search of an investment portfolio for its international reserves that is environmentally friendly and increases exposures to issuers with the best environmental performance, using a "best in class strategy". To this end, the BCCR plans to publish a final selection of indicators of the "greenness" of its reserve holdings in its 2022 Annual Report by end-February 2023 (**proposed RSF reform measure**).

- ***Regulation of socioenvironmental risks.*** To lay the foundations for ensuring that the regulated financial sector entities adequately take into account climate change risks and consistent with interim guidance from the Financial Stability Board's Task Force on Climate-related Financial Disclosures, CONASSIF will approve a regulation on management of socioenvironmental risks and climate change risks in the credit portfolio by end-September 2023 (**proposed RSF reform measure**). This regulation aims to strengthen risk management by requiring banks to put in place processes to approve policies to manage such risks and incorporating them into decision-making processes, including specifying roles for the Board and senior management, the main risk areas to be covered (including physical and transition risks), and disclosure requirements. We will also strengthen internal training for supervisors and processes to determine that banks are in compliance with the expectations above. As we improve information collection and taxonomies, we will be better able to customize financial regulations for the Costa Rican context, to update capital and liquidity requirements and requirements for market risk, operational risk, and other material climate-related risks.

45. We are taking initial steps for the development of green financing. The Legislative Assembly approved in October 2021, Law 10051 to Promote Financing and Investment for Sustainable Development, through the use of Thematic Public Offering Securities, to promote such financing for investment in activities aimed at achieving the national goals for a sustainable development and a green economy. Further to this, the CONASSIF approved updates to a series of associated regulations in May 2022: (i) supervised entities must incorporate the sustainable or responsible component in their investment policies; (ii) they must incorporate ESG risk management into their risk management framework; (iii) they are now allowed to issue ESG bonds; and (iv) they are recommended to include voluntary disclosures on their ESG actions in their annual reports. The first two of these measures were approved with a transitional period that ends in December 2023. To further support the development of green financing, the GAECC, the CONASSIF, and the Superintendencies have formed a working group, supported by technical assistance from the WB, with the objective of developing a single green taxonomy for the financial sector. In the meantime, we are also exploring Costa Rica's ability to be recognized as an ESG sovereign to catalyze further financing from private investor leveraging on our ambitious climate actions. We are also considering the issuance of thematic sovereign bonds to foreign investors with key performance indicators related to forestry coverage, ecological integrity, and biodiversity.

VII. RISKS AND CONTINGENCIES

46. The largest risks to the program come from an array of external factors. Further impacts of Russia's war in Ukraine on commodity markets, a greater-than-expected global downturn and/or further spillovers from advanced economy monetary policy all carry the potential to adversely impact Costa Rica's economy. These shocks and the required policy response to rising inflationary and external pressures would likely entail a further slowdown in domestic activity. This could in turn lead to weaker-than-expected revenue performance, impacting our fiscal consolidation strategy. Our exposure to natural disasters continues to pose important risks which are likely to increase over time. These downside risks could challenge and renew concerns about debt sustainability. Should any of these risks materialize, the government of Costa Rica stands ready to adjust promptly its policies, in close consultation with IMF staff. On the upside, were domestic or external developments to support a stronger economic performance, we stand ready to accelerate the adjustment and reform process, strengthening the resilience of our economy to future shocks.

VIII. PROGRAM MONITORING

47. Progress in the implementation of our policies, which are supported by the IMF, is monitored through semi-annual reviews, performance criteria (PCs), indicative targets (ITs), structural benchmarks (SBs), and Reform Measures (RMs). These are detailed in Tables 1 and 2, with definitions and data requirements provided in the attached TMU. Purchases under the EFF and RSF will be used for direct budget support during the program period. The BCCR and the MOF have finalized a new Memorandum of Understanding on the responsibilities for servicing financial obligations to the IMF under the RSF, complementing the existing one under the EFF.

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

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

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

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

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

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

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

5/ Excluding IMF financing.

Table 2. Costa Rica: Structural Benchmarks

Structural Benchmarks	Target Date	Status	Comment
Efficiency of government spending			
Legislative Assembly to approve Public Employment Bill.	End-May 2021	**Not Met**	Approved on March 7, 2022.
Implementation of Public Employment Bill, including introduction of a single pay spine.	End-March 2023		Ongoing
Revenue mobilization			
The Tax Commissioner to approve a new Tax Compliance Improvement Plan, in line with IMF staff recommendations.	End-December 2021	**Met**	
Fiscal governance and transparency			
Publication of financial statement under IFRS standards for fiscal year 2020 for three SOEs (ICE, AyA, CNP).	End-December 2021	**Not met**	Pending for a small firm under CNP.
Cabinet to approve and publish a Medium-Term Fiscal Framework for the entire Non-Financial Public Sector for 2023-2026.	End-April 2022	**Met**	
Cabinet to approve and publish a Medium-Term Debt Strategy (MTDS) for 2023-2026.	End-April 2022	**Met**	
Government to submit law amendments to the Legislative Assembly to centralize all debt-related functions of the government within the purview of a standalone Public Debt Management Office, reporting to the Minister of Finance.	End-June 2023		**Proposed SB**
Social safety nets			
MOF's National Treasury to centralize and digitalize the payment system for all the cash transfer social assistance programs, in coordination with social assistance units.	End-December 2021	**Met**	

Table 2. Costa Rica: Structural Benchmarks (concluded)			
Monetary and financial sector reforms			
The BCCR to submit to the Ministry of Finance draft amendments to the BCCR Law, prepared in consultation with IMF staff, to strengthen the central bank's operational autonomy and governance framework.	End-August 2021	**Met**	
The government to submit amendments to the BCCR Law to the Legislative Assembly, prepared in consultation with IMF staff, to strengthen the central bank's operational autonomy and governance framework.	End-December 2022		Ongoing
Government to submit amendments to the bank resolution and deposit insurance law and related legislation, in line with program understandings, to the Legislative Assembly, to strengthen the crisis management framework.	End-December 2023		**Proposed new SB**
Macro-structural reforms			
CCSS to formulate and approve a plan to adjust the minimum contribution base for part-time workers.	End-June 2022	**Not met**	Approved on September 1, 2022.
Authorities to develop a roadmap to enhance infrastructure resilience to climate change, including cost assessment and financing options.	End-September 2022	**Met**	

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

Reform Measures (RMs)	Indicative Date	Expected Corresponding Review under the EFF Arrangement
I. Integrating Climate Risks into Fiscal Planning		
RM1. Ministry of Finance to develop and publish guidelines for climate budget tagging.	End-February 2023	**Fourth EFF Review**
RM5. Ministry of Finance to expand the quantitative climate fiscal risk analysis in the Medium-Term Fiscal Framework to include climate transition risks.	End-September 2023	**Fifth EFF Review**
II. Strengthening Public Investment and Infrastructure Resilience		
RM6. MIDEPLAN to develop and publish guidelines to expand the project appraisal process to assess the impact of the project on climate change through the social cost of carbon.	End-September 2023	**Fifth EFF Review**
RM9. MIDEPLAN to publish guidelines on project selection criteria including a range of climate change criteria for SNIP entities.	End-December 2023	**Sixth EFF Review**
RM10. MIVAH, in collaboration with MINAE, to develop and publish guidelines for including climate change analysis in Regulatory Plans.	End-February 2024	**Sixth EFF Review**
III. Supporting Decarbonization		
RM2. Government to approve implementing regulation to simplify the administrative procedures for private participation in power generation from renewable sources for self-consumption.	End-December 2022	**Fourth EFF Review**
RM7. Government to submit to the Legislative Assembly a bill to introduce feebate scheme to strengthen incentives for low-pollution private vehicles.	End-September 2023	**Fifth EFF Review**

Table 3. Costa Rica: Proposed Reform Measures Under the Proposed Resilience and Sustainability Facility Arrangement (concluded)		
RM11. Government to appraise and publish a review of existing tax incentives with a negative effect on the environment to support decarbonization efforts.	End-February 2024	**Sixth EFF Review**
IV. Greening Reserves and Strengthening Financial Sector Resilience		
RM3. BCCR to create a repository with data on climate hazards; industrial and geographical vulnerability to climate events; banks' lending exposure to vulnerable industries and regions.	End-February 2023	**Fourth EFF Review**
RM4. BCCR to publish indicators of the "greenness" of its reserve holdings in its 2022 Annual Report.	End-February 2023	**Fourth EFF Review**
RM8. CONASSIF to approve regulation on management of socioenvironmental risks and climate change risks in the credit portfolio.	End-September 2023	**Fifth EFF Review**
RM12. BCCR to incorporate climate effects on the banking sector in its top-down stress testing, based on aggregated data and capturing those new risks on credit risk parameters.	End-February, 2024	**Sixth EFF Review**

Attachment II. Technical Memorandum of Understanding

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

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

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

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

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

d) a monetary policy consultation clause;

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

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

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

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

c) no introduction or modification of multiple currency practices;

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

- These four performance criteria will be monitored continuously.

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

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

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

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

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

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

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

I. PERFORMANCE CRITERIA

A. Performance Criterion on Central Government Primary Balance

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

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

B. Performance Criterion on Net Official International Reserves

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

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

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

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

- The following adjustment will apply:

9. If (i) the amount of foreign program financing by the central government and the BCCR net of IMF purchases (GRA and RST resources) and all debt service; (ii) the amount of external commercial borrowing (including international sovereign bonds and syndicated loans) by the central

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

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

II. CONTINUOUS PERFORMANCE CRITERIA

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

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

III. MONETARY POLICY CONSULTATION CLAUSE

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

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

where

t = the month within which the test date is included

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

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

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

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

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

IV. INDICATIVE TARGETS

A. Indicative Target on Debt Stock of the Central Government

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

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

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

V. DATA REPORTING REQUIREMENTS

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(In billions of colones)

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

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

Table 4. Costa Rica: Central Government Debt[1/]

(In billions of colones)

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

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

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

(In millions of U.S. dollars)

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

1/ As agreed for the purpose of monitoring the program. 2/ As defined in TMU ¶8.

Table 6. Costa Rica: Gross Official Reserve Position[1/]
(In millions of U.S. dollars)

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

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

Table 7. Costa Rica: Priority Social Spending[1/]
(In billions of Colons)

	FODESAF	Central Govt transfers	Other sources of financing	Total public sector spending	Number of beneficiaries
1. Non-contributory pensions and healthcare					
1.1. Non contributory pensiones regime (RNC)					
2. Targeted social assistance programs					
2.1. Conditional cash transfer *Crecemos* [2/]					
2.2. Conditional cash transfer *Avancemos*		-			
2.3. Poverty reduction and income support					
2.3.1. Basic needs (Atención a Familias)					
2.3.2. Family allowance (Asignación Familiar)					
2.3.3. Emergencies					
2.3.4. Fishing subsidies (Veda)					
2.4. Childcare					
2.4.1. Childcare transfer					
2.4.2. Childcare transfer CIDAI					
2.4.3. Childcare services (API intramuros)					
2.5. School programs					
2.5.1. School lunch program					
2.5.2. School transportation					
2.5.3 Social scholarship program [3/]					
2.6. Housing subsidies					
2.6.1. Housing improvement					
2.6.2. Housing grants					
2.7. Food security and nutrition programs					
2.7.1. Prestación alimentaria					
2.8. Active labor market programs					
2.8.1. Employment National Program (PRONAE)					
2.8.2. Small enterprises' support program (PRONAMYPE)					
2.8.3. Productive ideas					
2.8.4. Training aid					
2.8.5. Training voucher program [4/]					
2.9. Other targeted programs					
2.9.1. Subsidies for elderly persons					
2.9.2. Subsidies for persons with disabilities					
2.9.3. Subsidies for violence female victims					
2.9.3. Subsidies for teenage mothers					
3. Capital transfers to social assistance programs					
3.1. Community infrastructure and socio-productive projects					
TOTAL					

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

Attachment III. BCCR Consultation with the IMF Executive Board on the Missed Inflation Target Under the MPCC

In June and September 2022, inflation stood at 10.1 and 10.4 percent, respectively, which is the equivalent of a 2.6 and a 5.3 percentage points (p.p.) breach, respectively, of the upper outer band limit agreed in the Monetary Policy Consultation Clause.

A. Inflation Trajectory

The increase in inflation began in the second half of 2021, but manifested itself more strongly in 2022, especially since the second quarter, reaching 10.4 percent in September, compared to 3.3 percent in December 2021. Since February, inflation has been above the BCCR target and with a growing trend, and since last May, inflation has been above the upper outer band limit established in the MPCC.

The acceleration of inflation responds to external shocks but also to domestic factors. Externally, inflationary pressures have been more persistent than expected at the beginning of the year, as they were exacerbated by the effects of the war in Ukraine and the new confinement measures due to the outbreak of the COVID-19 virus in some world regions, which led to significant increases in the international prices of food supplies and oil derivatives.

Costa Rica, as a small economy, open and highly integrated with the rest of the world in its trade and financial transactions, has faced these inflationary pressures manifested in a worsening of imported inflation. This shock has been transferred to local inflation, especially to the prices of food and fuels, which in September showed annual growth rates of 20.3 percent and 31.3 percent, respectively. Those products explained 42.4 percent and 15.9 percent of the annual rate of the inflation for that month, respectively.

Although inflation has primarily been driven by a supply shock and, therefore, it is out of the control of monetary policy, some internal factors have also boosted the increase in local prices:

a) The base effect associated with the low inflation in the first nine months of 2021 (average of 1.3 percent), still a consequence of the effects of the pandemic.

b) Inflationary expectations have increased. According to the survey in September, the median of expectations was 8.0 percent and 5.0 percent at 12 and 24 months, respectively, values that exceeded by 4.4 and 1.4 p.p. those registered in January 2022.

c) The depreciation of the colón during the first semester of the current year, a partial consequence of a greater demand for foreign currency to meet the oil bill and the requirements of pension funds.

d) The rebound of domestic demand, in line with the gradual dissipation of some disinflationary forces in the Costa Rican economy since 2019 (accentuated in 2020 due to the pandemic).

B. Policy Response

The Central Bank of Costa Rica (BCCR) had an expansionary monetary policy which has been coherent with the disinflationary pressures. From mid-2020 and during most of 2021, the Monetary Policy Rate stood at 0.75 percent, its historical minimum. However, given prospective signs of inflationary pressures, in December 2021 the BCCR began a gradual process of increases in its Monetary Policy Rate, with eight adjustments totaling 825 basis points, up to 9 percent rate in October.

The upward adjustments to the reference rate have been complemented by other measures aiming to reduce excess liquidity in the money market. For instance, the BCCR increased in July 2022 the reserve requirement for local currency (from 12 percent to 15 percent) and has had an active participation in the debt market, through the placement of medium-term bonds.

The BCCR has communicated its commitment to inflation control and that the monetary policy is forward-looking. Therefore, in order to achieve the long-term inflation goal (3 percent ± 1 p.p.), the monetary policy stance will continue to be data-dependent and forward-looking, in line with the inflation targeting framework.

C. Inflation Projections

With the available information, inflation is expected to have reached its year-on-year maximum last August (12.1 percent). BCCR models project that, conditional on an active monetary policy, inflation would slow down to 9.7 percent at the fourth quarter of 2022.

As external shocks dissipate, FX pressures moderates, inflation expectations continue the convergence towards the BCCR´s target (started in September), and the monetary policy rate transmission mechanism is completed, the deceleration of the inflation rate is expected to continue during 2023, for a gradual return towards the BCCR's target by late 2024.

Nevertheless, inflation will likely remain above the upper limit of the outer band agreed in the MPCC in December 2022 and possibly June 2023. Therefore, BCCR will continue to consult with the IMF Executive Board as warranted.

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

As all forecasts, inflation projections are conditional on risk factors. Among the upward risks, the inertia in inflation expectations stands out, even though they recently registered a downward correction. Other upward risks are higher prices of raw materials in international markets, new lockdowns due to COVID-19 that limit the flow of trade and increase the cost of transportation, and upward pressures on the exchange rate motivated by faster than expected increases in external interest rates, which may encourage capital outflows and the demand for foreign currency by residents. Downside risks include slow growth in our main trading partners and international food and oil prices lower than the ones expected in our base scenario.