PUBLIC

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

THE BANK'S COUNTRY STRATEGY WITH COSTA RICA 2011-2014

This document was prepared by a team consisting of: Olga Gómez García (CID/CID), Willy Bendix (PDP/CCR), Isabel Marin (PDP/CCR), Andrés Suárez (PDP/CCR), Clarissa Santelmo (CID/CID), Maria Jose Schaffer Cabrera (CID/CGU) and Fazia Pusterla (SPD/SDV), led by Fernando Quevedo (CID/CCR). The sector contributions and comments for other sections were provided by: Anaí Herrera (CID/CID), Laura Alonso (CID/CID), Marcos Camacho (TSP/CCR), Carlos Trujillo (INE/ENE), Jorge Mercado (INE/ENE), Enrique Rodríguez Flores (ENE/CCR), Marcelo Valenzuela (ENE/CCR), Gustavo Béliz (ICF/ICS), Karelia Villa (ICF/ICS), Beatriz Zurita (SCL/SPH), Frederico Guanais de Aguiar (SCL/SPH), Horacio Álvarez (SCL/EDU), Coral Fernández (INE/WSA), Jaime Granados (INT/INT), Gustavo Crespi (SCL/SCT), Jacobo de León (SCF/CCR), Gian Franco Carassale (SCF/INF), Ana María Linares (SPD/SDV), César Rodriguez (SPD/SDV), Bibiana Taboada (SPD/SDV), Alejandra Fleitas (VPC/PDP), and Maria Eugenia Roca (VPC/PDP).

CONTENTS

ANNEXES

ELECTRONIC LINKS

ABBREVIATIONS

AECID	Spanish Agency for International Development Cooperation
ARESEP	Autoridad Reguladora de Servicios Públicos [Public Utilities Regulatory Authority]
BCCR	Central Bank of Costa Rica
CABEI	Central American Bank for Economic Integration
CAF	Andean Development Corporation
CGR	Contraloría General de la República [Office of the Comptroller General of Costa Rica]
CID	Country Department Central America, Mexico, Panama and the Dominican Republic
CONAVI	Consejo Nacional de Vialidad [National Highways Council]
CPS	consolidated public sector
DAC	Development Assistance Committee
EBAIS	Equipos Básicos de Atención Integral de la Salud [basic comprehensive health care teams]
ECD	early childhood development
EHPM	Encuesta de Hogares de Propósitos Mútiples [multipurpose household survey]
EIB	European Investment Bank
EU	European Union
IBRD	International Bank for Reconstruction and Development
ICE	Instituto Costarricense de Electricidad [Costa Rican Electricity Authority]
IFAC	International Federation of Accountants
IKTs	Information and knowledge technologies
IMF	International Monetary Fund
INEC	Instituto Nacional de Estadística [National Statistics Institute]
IPSAS	International Public Sector Accounting Standards
IRI	International Roughness Index
JICA	Japan International Cooperation Agency
KfW Bankengruppe	Kreditanstalt für Wiederaufbau [German Reconstruction and Loan Corporation]
LAC	Latin America and the Caribbean
LGE	Ley General de Electricidad [General Electricity Act]
MBSF	Ministry of Social Welfare and the Family
MICIT	Ministry of Science and Technology
MOPT	Ministry of Public Works and Transportation
MW	Megawatts
NFPS	nonfinancial public sector
NRS	national road system
NSG	nonsovereign guaranteed
OECD	Organization for Economic Cooperation and Development

R&D	research and development
RNCDI	Red Nacional de Cuido y Desarrollo Infantil [national early childhood care and development network]
S&T	science and technology
SCF	Structured and Corporate Financing Department
SIEPAC	Central American Electric Interconnection System
SIGAF	Sistema Integrado de Administración Financiera [Integrated Financial Administration System]
TPDE	Título de Prioridad de Desarrollo Eléctrico [electric development priority title]
UNDP	United Nations Development Programme
UNICRI	United Nations Interregional Crime and Justice Research Institute
USAID	United States Agency for International Development

EXECUTIVE SUMMARY

Growth in Costa Rica	In the period 2003-2007, prior to the international financial crisis, the Costa Rican economy grew at an annual average rate of 6.7%, which was higher than the rate for Latin America and the Caribbean (LAC) thanks to the dynamism of the services and technology sectors. This growth improved social indicators, which were already among the best in the region, and both poverty and extreme poverty were reduced. However, the economy could have grown even more, had it not lost ground compared to other middle-high or high-income economies, such as Singapore or Panama. This lower performance is due to losses in productivity.
Factors related to the loss of productivity	This loss of relative productivity occurred mainly on account of: (i) the quality of infrastructure, which needs modernization and maintenance, particularly roads; (ii) insufficient investment in innovation; (iii) the need to improve the supply of human capital to respond to demand from high-technology sectors, large investors, and drivers of the country's economy; (iv) institutional constraints that delay the approval and implementation of reforms, placing the country's modernization and macroeconomic stability in jeopardy; and (v) deterioration of citizen security and an increase in violence.
Sector priorities	Given the main development challenges identified, the Bank's strategy with the country for the period 2011-2014[1] will focus on the following sectors: (i) transportation; (ii) energy; (iii) citizen security; (iv) early childhood development; (v) health; and (vi) innovation. In addition, the Bank will work to strengthen country systems in financial management and government procurement.
Lending framework	The lending framework for sovereign-guaranteed approvals by the Bank for the period 2011-2014 is an estimated US$1.06 billion. This approvals framework, together with the existing portfolio, will permit sufficient funds to be disbursed to enable the IDB to maintain its position as one of the country's main sources of multilateral financing. The Bank's share of Costa Rica's external public debt would be approximately 12%.
Nonsovereign-guaranteed operations	Work is also being done with private partners to facilitate the development of public infrastructure, and significant growth is therefore expected in the nonsovereign-guaranteed window.

[1] The present country strategy will be in effect from June 2011 to December 2014.

Main risks

The main risks in execution of the Bank's country strategy with Costa Rica are related to the country's slow decision-making processes, the status of public finances, and vulnerability to natural disasters. In the fiscal outlook, the country could decide to scale back its investment plan so as not to worsen the main debt indicators and preserve a stable macroeconomic framework. This situation could affect the expected results of the Bank's strategy, which is based on a given level of approvals and disbursements.

RESULTS MATRIX

Objectives of the government's strategic plan	Sectors for IDB intervention	IDB strategic objectives	Expected outcomes	Indicators	Baseline (Source) (*)	Targets (**)	Measurement frequency for the indicator
To reduce travel costs and times for people and goods, with emphasis on the development of collective public transportation systems, without neglecting the changes and upgrades in road infrastructure necessary to enable those systems to operate adequately	**Transportation**	To rehabilitate and maintain transportation infrastructure and adapt it to growth in demand and strengthen the sector's institutional functioning	National road system upgraded	Improvement in average International Roughness Index (IRI)	2009: 4.5	2014: 2.5	Biannual
				Increase in the percentage of the system whose falling weight deflectometer (FWD)[2] index is considered 'low' (from 0 to 25 mm^2)	2008: 71.5%	2014: 77.5%	Biannual
			Cantonal road system upgraded	Increase in the percentage of the cantonal road system considered to be in "good" condition[3]	2009: 10.7%	2014: 20.2%	Annual
			Port facilities upgraded	Minutes passengers wait when arriving in the country through Juan Santamaría international airport[4]	2009: 31.7	2014: 25.0	Annual
			Institutional capacity strengthened	Percentage of the MOPT-CONAVI budget that is executed	2010: 61.0%	2014: 75.0%	Annual
To achieve an increase in the electric power supply that keeps pace with the increase in the demand for electricity, using clean and renewable sources and reducing the relative importance of energy from hydrocarbons	**Energy**	To strengthen the institutional and regulatory framework of the energy sector, with stress on the electric subsector	Increase in the number of independent electric power producers in the generation matrix	Number of private electric power generation projects	2009: 25	2014: 29	Specific
		To develop installed electric power generation capacity	Increase in installed capacity for electric power generation	Installed capacity of the electric power system	2009: 2412 MW	2014: 2677 MW	Annual

2 The falling weight deflectometer (FWD) measures damage to pavement when certain loads are dropped on it.

3 For more information on the methodology used by the Ministry of Public Works and Transportation to classify the condition of the cantonal road system, see: http://www.mopt.go.cr/planificacion/carreteras/ep_capitulo8.asp

4 Average wait time from when the plane reaches the gate to when passengers leave the airport.

Objectives of the government's strategic plan	Sectors for IDB intervention	IDB strategic objectives	Expected outcomes	Indicators	Baseline (Source) (*)	Targets (**)	Measurement frequency for the indicator
		To consolidate the sustainability of the energy matrix	Increase in the role played by renewable energy in the electric power generation matrix	Percentage of power generated from renewable sources	2009: 94.6% (with 1,787 MW installed)	2014: 95.6% (with 1,972 MW installed)	Annual
			Increase in the participation of new sources of renewable energy in the power generation matrix	Percentage of power generated with new sources of renewable energy: geothermal, solar, wind, and biomass	2009: 16.2% (with 255 MW installed)	2014: 17.5% (with at least 330 MW installed)	Annual
			Increase in power exchanges on the regional electricity market	Percentage of energy sold on the regional electricity market	2009: < 1%	2014: ≥ 4%	Annual
To have a renewed, well-equipped police force; combat impunity, drug trafficking, and organized crime; strengthen crime prevention; and adopt a comprehensive and sustainable citizen security policy	**Citizen security and violence prevention**	To strengthen the capacity of the State to combat organized and common crime	Containment of the rate of growth in violence and crime	National crime index calculated as the average of assaults on houses and individuals per 100,000 population[5]	2009: 133.8 per 100,000 population	2014: 129.8 per 100,000 population (National Violence Observatory)	Annual
				Rate of assaults in program cantons/corresponding rate on the national level[6]	2010: 1.15	2014: 1.00 (National Violence Observatory)	Annual

5 Although the national target at the end of the program for this impact indicator is just 3% lower in absolute terms, the change represents substantial progress given that average annual growth between 2005 and 2008 was 15%.

6 Some of the indicators are presented as a ratio between the index observed for the program's target population and the index observed for the country's total population. The purpose of specifying the indicators in this way is to compare developments in the program cantons with the rest of the country. This makes it possible to measure the program's impact, controlling for national trends that could affect the results that are of interest.

Objectives of the government's strategic plan	Sectors for IDB intervention	IDB strategic objectives	Expected outcomes	Indicators	Baseline (Source) (*)	Targets (**)	Measurement frequency for the indicator
			Stronger national civil police and local police forces	National Police Quality Index[7]	2010: 30.9	2014: 30.0 (Specific Crime Victim Survey)	Annual
		To develop social protection programs for violence prevention and citizen security	Reduction in juvenile violence	Juvenile delinquency index in the program cantons[8]/corresponding index on the national level	2010: 1.14	2014: 1.0 (Public Ministry)	Annual
			Reduction in recidivism among the prison population	National recidivism index in the program jails/recidivism index in the rest of the jails	2009: 33%[9]	2014: 25% (National Violence Observatory)	Annual
To consolidate social progress and extend protection to vulnerable groups to gradually but systematically reduce poverty and respond by	**Early childhood development**	To consolidate a social safety net from early childhood	Development of the national early childhood care and development system	Percentage of children ages 2 to 6 in quintiles 1 and 2 who attend early childhood care and development services	2009: 19.01% EHPM	2014: 28.3%	Annual
				Employment rate among women ages 18 to 45 with	2009: 25%	2014: 29%	Annual

7 The index is calculated as the weighted average (by number of observations) of positive responses to the following questions in the Specific Crime Victim Survey: (i) If you or a member of your family were the victim of a robbery, assault, or other crime, how confident are you that the police will arrest the perpetrator? (positive: very, somewhat); (ii) Are you satisfied or dissatisfied with police action here in your neighborhood and adjacent areas? (positive: satisfied); (iii) How much do you trust each of the following institutions to resolve or help resolve insecurity and violence? Police (positive: a lot, somewhat); (iv) How often do the police patrol your neighborhood by car or on foot? (positive: frequently); (v) When the police patrol your neighborhood, is their attitude vigilant, do they command respect or not?; (vi) The index is calculated on the basis of average of crime rates among youths under 18, for infractions of the laws on psychotropic drugs, weapons, and explosives, and domestic violence, per 100,000 population.

8 The index will be built to specifically measure the set of situational prevention measures, taking account of the recommendations from the update of the International Crime Victim Survey (UNICRI, 2010).

9 The percentage is considerably higher if it is recalled that the same sentence can involve more than one crime and that many accused persons commit another crime after they have been charged.

Objectives of the government's strategic plan	Sectors for IDB intervention	IDB strategic objectives	Expected outcomes	Indicators	Baseline (Source) (*)	Targets (**)	Measurement frequency for the indicator
differentiating among the specific conditions of each social group by geographic area				children under 6 in quintiles 1 and 2			
To improve health care coverage, quality, and service and place greater emphasis on health promotion (not just curative care)	**Health**	To strengthen and expand the health care system	Enhanced primary health care	Indicator: Percentage of avoidable hospital admissions (admissions for conditions that could be treated in outpatient/primary health care clinics)[10]	2008: 16%	2014: 12%	Annual
			Improvement in the quality and organization of the hospital system	Number of beds per 1,000 population	2010: 1.23 per 1,000 population	2014: 1.27 per 1,000 population[11]	Annual
				Gross death rate per 100 patients age 45 and over during the first 30 days of hospitalization for hemorrhagic stroke[12]	2010: Men 26.5% Women 38.4%	2014: Men 24.9% Women 36.2%	Annual

10 List of avoidable hospital admissions adapted from J. Caminal, B. Starfield, E. Sánchez, C. Casanova, M. Morales. The Role of Primary Care in Preventing Ambulatory Care Sensitive Conditions. European Journal of Public Health 2004; 14: 246–251.

11 Although it may seem small, this increase reverses a trend. The number of beds per 1,000 population has been declining since 1980, when it was 2.99.

12 This indicator is a good proxy for measuring the overall quality of hospital care (OECD, Health at a Glance 2009).

Objectives of the government's strategic plan	Sectors for IDB intervention	IDB strategic objectives	Expected outcomes	Indicators	Baseline (Source) (*)	Targets (**)	Measurement frequency for the indicator
To promote R&D; strengthen the scientific and technology infrastructure; and promote innovation and the transfer of knowledge to the business sector To promote the use of information technologies	Innovation	To increase investment in R&D; increase private investment including investment in R&D; promote the development of technical/scientific human capital	Increase in public investment in R&D	Public investment in R&D	2009: US$81 million (Source: MICIT S&T survey)	2014: 8% increase in public investment in R&D in real terms	Annual
			Increase in private investment, including financing for national investment in R&D	Private financing for national investment in R&D[13]	2009: US$35 million (Source: MICIT S&T survey)	2014: 15% increase in private investment in R&D in real terms	Annual
			Increase in access to and use of information and knowledge technologies (IKTs) in the production sector	Percentage of national companies that invest in IKTs	2008: 32% (Source: MICIT S&T survey)	2014: 50% (Source: MICIT S&T survey)	Annual

[13] Including the adoption of technology.

To constitute a more effective and efficient public sector with greater transparency and better quality public spending	**Financial management and government procurement**	**Financial management system**					
		To strengthen the national government accounting system	Government accounting system implements IFAC International Public Sector Accounting Standards (IPSAS)	Indicator 25 of the PEFA methodology:[14] "Quality and timeliness of annual financial statements"	2010: C+[15]	2014: B+	Annual
		To strengthen the Costa Rican Integrated Financial Administration System (SIGAF)	Integration of budget, treasury, and accounting in the SIGAF for central government financial management	Delays and accounting errors reported by the Office of the Comptroller General on the accounting subsystem.[16]	2010: 1,340 sampling	2014: 0	Annual
		Government procurement					
		To strengthen the institutional capacity and functions of the government procurement information system for its gradual use in IDB operations	Increase in the use of the country's procurement information system	Percentage of the Bank's loan portfolio that uses the information system[17]	2010: 20%	2014: 60%	Annual

(*) The numerical indicators given are currently monitored by different agencies in the country and are updated annually as a minimum.
(**) The indicative targets will be revised or replaced, as necessary, through the programming documents that are prepared during the period the strategy is in effect.

[14] Public Expenditure and Financial Accountability (PEFA) methodology.

[15] Source: Indicator 25 of the 2010 PEFA evaluation.

[16] Source: Report of the Office of the Comptroller General, 2009 (Report DFOE-SAF-06-2009).

[17] The information system used is the publicity module of the country's electronic procurement system (CompraRed).

I. COUNTRY CONTEXT

1.1 In the period 2003-2007, prior to the international financial crisis, the Costa Rican economy grew at an annual average rate of 6.7% thanks to the dynamism of the services and technology sectors and skilled labor that helped to attract innovative companies with high value added. Growth, which was higher than the average in Latin America and the Caribbean (LAC),[18] took place in a context of strong respect for democracy, satisfactory social indicators, and citizen security.

1.2 Investment levels in the period also translated into social gains, contributing to additional progress in poverty reduction.[19] However, the above-mentioned characteristics should have led to every greater dynamism, similar to that observed during the period in other middle-high or high-income economies such as Panama or Singapore. The relative weakness is related to losses in productivity.

1.3 One of the factors affecting Costa Rica's productivity is the poor quality of its infrastructure, particularly in transportation. This is partly due to low public investments in the sector which were around 0.7% of GDP in the 2000s, except for the final two years, affecting the cost of logistics and transportation and influencing company decisions on location, investment, and production.

1.4 Other factors affecting the country's productivity are the shortfall in the supply of skilled labor to respond to needs in high-technology sectors, and low levels of investment in innovation and the development of production, the recent deterioration in citizen security,[20] and slowness to implement policies to correct the lengthy processes entailed in decision-making and passage of reforms.

1.5 For years, the high quality of human capital has been a factor that attracted foreign direct investment. However, its current characteristics and scale are not fully consistent with what the new advanced-technology sectors require. This is aggravated by the fact that job training is not geared to address this. Also, investments in innovation in Costa Rica are about 0.4% of GDP when, according to its per capita income, they should be around 0.9%.

1.6 In parallel, the strength of the country's democracy has been affected in recent years, given that the quest for consensus in the approval of reforms faces significant challenges in a multi-party political context. Ever since the number of political parties represented in the Legislative Assembly has increased, there has been a slowdown in the decision-making process because the rules designed for a two-party system still apply.

---

[18] In 2003-2007, average growth in LAC was close to 4.8% (IMF).

[19] Poverty in 2007 affected 16.7% of households, which is 1.8 percentage points lower than the 18.5% reported in 2003. In 2003, 5.1% of the population lived in extreme poverty, compared to 3.3% in 2007 (INEC).

[20] See World Bank Policy Research Working Paper 4041, October 2006, which illustrates the negative impact of insecurity on factor productivity.

1.7 The quality of the country's institutions and a secure socioeconomic environment have made for a comparative advantage. However, in recent years, there has been a rise in violence and downward pressure on citizen security, with an increase in the number of violent crimes. Insecurity has become one of the main concerns of Costa Ricans.[21]

1.8 This is compounded by the fact that since the impact of the international financial crisis began to be felt, there has been some partial reversal of progress in the reduction of poverty and extreme poverty and an increase in unemployment and in inequality indexes.

1.9 In addition, and despite the fact that a recovery has begun,[22] financing for countercyclical fiscal policies to respond to the crisis has left its mark. Public sector financial performance has shifted from a surplus of 0.8% in 2007 to a deficit of 5.2% in 2010, creating greater pressure on the public sector debt which, although it remains at sustainable levels, rose to 43.8% of GDP in 2010. As a result, the authorities have proposed a fiscal reform that will increase fiscal revenues by 2.5% of GDP, making it possible to invest in infrastructure and social sectors without jeopardizing the preexisting move toward debt reduction.

1.10 In this context, the Costa Rican government has prepared a Medium-Term Government Plan.[23] It focuses on four main areas: social welfare and the family, environment, security, and competitiveness and innovation. Within these areas and given the obstacles identified, priority has been placed on investments to improve security, upgrade physical infrastructure, and increase social and productive investments.

II. THE IDB IN COSTA RICA

2.1 The IDB has had a very close relationship with Costa Rica in terms of dialogue and technical assistance in different areas, ranging from fiscal, financial, and macroeconomic policy, to the development of innovative tools for public and private investment in water and sanitation, energy, and education, among others.

2.2 The Bank has helped to develop the energy sector for more than three decades, and is a partner in geothermal and hydroelectric power generation projects and regional transmission projects linked to the SIEPAC line. It has also contributed to investments in the health sector, specifically to improve hospital services, and to developing the country's registration and cadastre system. These interventions are the starting point for this new country strategy.

---

[21] Total crime rates have risen steadily and considerably (177.2%), particularly since 2004. Violations of the Law on Psychotropic Drugs have also risen continuously and significantly (504.3%) since 2000.

[22] After shrinking by 1% in 2009, growth rose to 4.3% in 2010 and is expected to continue at around 4% for the next three years.

[23] The plan has an investment program of US$6.475 billion.

2.3 Also, technical assistance for institutional strengthening plays an important role in the Bank's support for Costa Rica, helping to improve governance which, in turn, makes for greater effectiveness and additionality of Bank interventions as a whole.

2.4 The Bank has been supporting the government's efforts to strengthen management of public finances, and continues to provide technical support for drafting the national fiscal sustainability policy,[24] implementation of which will help to keep public finances sound in the medium term while moving ahead with the investment program for implementing the government's National Development Plan, which includes public investment projects to be financed under the present strategy.

III. BANK PRIORITY AREAS 2011-2014

3.1 The Bank's new country strategy maintains its emphasis on areas that continue to be obstacles to Costa Rica's growth[25] (i.e. transportation, energy, early childhood development, and innovation) and identifies new areas[26] that, as a consequence of the changes in the context in recent years, require immediate attention (i.e. citizen security and health care).[27] The areas identified in the present strategy are aligned with the pillars of the Government Plan and are the result of the diagnostic studies conducted by the Bank[28] and the dialogue with the government, which has been spearheading coordination with all the international cooperation agencies.

3.2 In addition to the areas identified as priorities, there will be more in-depth sector dialogue to evaluate potential support for future measures in education, human capital development, and housing.[29]

3.3 With regard to the lending targets established in the Bank's Results Framework, adopted with the approval of the report on the Ninth General Increase in the Resources of the Bank, the strategy opens up opportunities to attain the target for regional cooperation and integration through interventions in transportation, energy, and innovation, and in climate change and sustainable energy through support for the energy sector. Also, interventions in security, early childhood development, and health will help to attain the target for poverty reduction and increased equity. Lastly, taken together, the interventions approved during the period covered by the

---

[24] The plan establishes measures to contain current expenditures, strengthen investment, and combat tax evasion, as well as a comprehensive tax reform (known as the Tax Solidarity Project) and is expected to yield between 2%-2.5% of GDP.

[25] Agosín, Crespi, Pusterla, and Ulloa (2009), Mesalles (2010), Crespi (2010), Straface (2010).

[26] Beliz and Villa (2010).

[27] Basically, the increase in drug trafficking in Central America, the increase in violence in the country, and the change in Costa Rica's epidemiological profile. See the sector notes on citizen security and health.

[28] Priority sectors were selected based on the analysis in the Diagnostic Assessment of Growth in Costa Rica, prepared by the Bank, and on the government's priorities.

[29] Including potential interventions in low-income housing, through the Opportunities for the Majority NSG window.

Bank's country strategy will contribute to attaining the target for support for small and vulnerable countries (Groups C and D).

A. Transportation

3.4 With 39,000 km of roads, Costa Rica has the largest road system in Central America. However, owing to the lack of maintenance, the country scores near the bottom in world rankings for road quality. Just 40% of the paved national road system and 11% of the cantonal road system are in good condition.[30] The cantonal system accounts for close to 80% of the country's roads and their deterioration has led to increases in vehicle operating costs, holding back development in rural areas.

3.5 The country has seven ports, three of them major ports, whose challenges include:[31] inefficient processes, obsolete infrastructure, and limited capacity. The airport infrastructure also needs to be upgraded to facilitate foreign trade,[32] promote growth in less-developed zones,[33] and serve growing demand from the tourism sector.[34] Investments are needed to renovate, upgrade, and develop existing installed capacity, and future expansion of the system needs to be examined.

3.6 The sector is headed by the Ministry of Public Works and Transportation (MOPT), with the agencies responsible for concessions, roads, ports, civil aviation, and railways, etc., operating under its umbrella. The National Highways Council (CONAVI) is responsible for the maintenance and construction of highways, cross roads, and bridges in the national system. The cantonal system is the responsibility of the municipalities[35] which receive technical assistance and support from the MOPT, given their widespread institutional weaknesses. In this context, one of the main challenges is the lack of funds to build, upgrade, and maintain the system.

3.7 The government is preparing a national transportation plan to address these challenges[36] under which the IDB's interventions will be directed to improving the quality of road infrastructure and management of its maintenance, upgrades to ports and airports, and institutional strengthening for the sector. These objectives will be

---

[30] Good condition defined as an International Roughness Index between 1.0-1.9 m/km.

[31] R. Castro, and J. Porras (2009). Infraestructura y desarrollo económico en Costa Rica.

[32] The World Bank (2009) identifies reliability in air cargo times as one of the problems affecting foreign trade. At present, the value of air exports accounts for 41.1% of the value of all exports (and 0.7% of their volume).

[33] The goal is to replicate the impact that the international airport at Liberia had on the development of Guanacaste on the southern Pacific coast.

[34] In the last five years, international tourist arrivals in Costa Rica have risen by 20% and arrivals by air by 15% (Costa Rican Tourism Institute, 2007-2010). These growth rates are expected to increase even further in the coming years (World Tourism Organization, 2002).

[35] Costa Rica has 81 municipalities and 7 provinces.

[36] Costa Rica ranks 56th out of 139 countries in the World Economic Forum's Global Competitiveness Index (2010-2011). The road subsector ranks 111th; railways 100th; ports 132nd; and airports 80th.

attained through: (i) the adoption of technical standards for road maintenance that will allow for regional integration; (ii) the development of tools for sector planning, activities programming, and works supervision intended to ensure the efficient use of resources and improve road maintenance and conservation; and (iii) an improvement in the quality of both systems. These interventions are also aimed at promoting actions to lessen the impact of transportation activities on climate change. Regional integration is also sought; therefore they will coordinate with similar strategic interventions in neighboring countries. Nonsovereign-guaranteed (NSG) interventions are planned for road, port, and airport infrastructure through the Structured and Corporate Financing Department (SCF).

3.8 The main risks are associated with insufficient planning and execution capacity in the MOPT, CONAVI, and the municipalities. To mitigate them, the Bank plans to provide technical support for the institutional strengthening of those agencies.

B. Energy

3.9 Costa Rica is among the LAC countries with the best electricity coverage (99% in 2009). It is also a leader and pioneer in the use of clean energy sources for electric power generation and has the lowest electricity losses in the region (10.8%). The country has great potential in renewable energy resources, the development of which requires large investments and therefore access to financing. The spending restrictions imposed by the Legislative Assembly, coupled with rate lags[37] during a period when fuel imported for power generation was expensive, held back implementation of the government's investment plan to meet forecast increases in demand.[38] These aspects have caused the generating reserve margin to fall to 7%, the lowest in Central America.[39] Limitations on investments in the transmission system have made it impossible to respond quickly to growth in tourist and industrial zones, which affects the quality of services and jeopardizes competitiveness for the sustained attraction of investments in these sectors. In distribution and marketing, in some highly developed zones, the frequency and length of power outages have increased, adversely affecting service quality.

3.10 The institutional framework for the electric power sector is dominated by a vertically integrated company, the Instituto Costarricense de Electricidad

---

[37] During 2008-2009, rate lags occurred due to a prolonged drought (which made it necessary to generate power using fossil fuels) that coincided with high fuel prices. Although these lags undermined The Costa Rican Electricity Authority's financial results in the short term (making it impossible to automatically recover the costs incurred) and affected its capacity to finance projects in the generating and transmission plan, they had been corrected by the end of 2009 when the Public Utilities Regulatory Authority introduced a gradual adjustment program intended to eliminate them. To improve the enforcement and transparency of the rules, it would be desirable to formalize them in regulations and to establish automatic adjustment mechanisms.

[38] The government's generation expansion plan expects average annual growth in the next five years of 5.3% (starting in 2011).

[39] Period 2008-2009.

[Costa Rican Electricity Authority] (ICE). The Ministry of Environment, Energy, and Telecommunications (MINAET) is the planning agency while the Autoridad Reguladora de Servicios Públicos [Public Utilities Regulatory Authority] (ARESEP), an autonomous technical and administrative institution, regulates all energy rates and prices. Private sector participation in power generation could be higher were it not for the regulatory limitations that restrict private investment to plants not over 50 MW.

3.11 The new General Electricity Act (LGE)[40] will facilitate the development of a wholesale market with private sector participation and will remove some of the barriers to Costa Rica's effective participation in the Regional Energy Market by allowing generators, distributors, and large consumers to participate in it. The changes in the current institutional framework are moderate although under the new act, the Centro Nacional de Control de Energía [National Energy Control Center] (CENCE) is transformed into a decentralized body reporting to the ICE, in charge of administering the wholesale market, load dispatching, technical support for ARESEP in energy auctions, and the issuance of electric development priority titles (TPDEs), among other things.[41]

3.12 Under the LGE, the government plans to take steps to promote generation projects using the ICE's financial and technical capacity to develop strategic projects,[42] while in parallel opening up spaces for the private sector to participate in implementing the strategy to increase power generation from renewable sources (hydraulic, solar, geothermal, biomass, and wind);[43] promote electricity savings and efficient use; and promote the use of biofuels, including bioethanol and biodiesel.

3.13 The Bank will provide technical and financial support for investments to modernize and strengthen the energy sector as a whole, promoting its regional integration and focusing on: (i) technical support for strengthening the regulatory framework with emphasis on the promotion of private sector participation; (ii) development of electric power generating capacity including participation by renewable sources; (iii) support for the necessary investments in transmission and distribution; and (iv) consolidation of Costa Rica's integration into the regional electricity market. These actions will also aim to improve the country's profile as regards its climate

---

40 As this country strategy was being finalized, the new General Electricity Act was being processed in parliament.

41 This new act gives priority to the developers of projects outside the ICE group, to move ahead with preinvestment studies on generation projects based on renewable sources.

42 As the new LGE states, strategic projects mean renewable energy projects with a capacity of over 100 MW that do not have TPDEs issued to third parties, complex projects, geothermal projects, nonrenewable projects, and expansion of its plants.

43 Installed capacity using renewable sources represents just 25% of total real potential. The untapped remainder out of the total potential of each source is: hydroelectric, 77%; geothermal, 36.3%; wind, 64.8%; and biomass, 75.1%. Source ICE 2009.

change impact. NSG interventions are anticipated in this sector through SCF to finance hydroelectric and other renewable energy projects.

3.14 The main sector risks are associated, on the one hand, with the possible environmental and social impacts of building hydroelectric projects, and therefore work will be done to develop environmental and social management plans as mitigation measures. The Bank is currently studying the vulnerability of hydroelectric systems in Central America and adaptation measures; its findings will be relevant for the Costa Rican government for future development of its energy matrix and for mitigating associated risks. Another risk is delays in approving and implementing the regulatory changes necessary to facilitate greater private sector participation in generation, and delays in formalizing the rate adjustment procedure in rules or regulations. This risk will be mitigated through support for reforms to build institutional capacity for sector planning and coordination and differentiation between sector policy roles and regulation of the electricity subsector. Technical support will be facilitated to develop automatic rate adjustment mechanisms.

C. Citizen security and violence prevention

3.15 In Costa Rica, until recently the relatively low crime and violence rates represented progress in terms of social wellbeing and development, and a comparative advantage in LAC.[44] This advantage is being eroded by growth in crime. In the last five years, the number of homicides has risen, turning citizen security into the main concern of Costa Ricans.[45] In addition to its social impact, crime inhibits private investment because it drives up company operating costs on account of the additional expense of private security, raises insurance and risk premiums, and makes it harder to attract and retain human capital.[46]

3.16 The 2010-2014 Government Plan sets out a path for restoring security that revolves around five lines: (i) renewing and equipping police forces; (ii) preventing crime; (iii) adopting a comprehensive, sustainable citizen security policy; (iv) combating impunity; and (v) combating drug trafficking and organized crime.

3.17 Bank intervention will be aimed at bolstering the government's capacity for violence prevention, with the focus on: (i) strengthening of the lead institutions in security and crime prevention to enable them, through multiagency program management, to curb crime and violence levels, addressing the causes and signs of violence from the objective and subjective (perception of fear) standpoints; (ii) professionalization and training[47] of police forces to combat organized crime; (iii) development of social and situational prevention programs for young people

---

44 The homicide rate in 2009 was 11.6 per 100,000 population, while the LAC average was 26.3.

45 Total crime rates have been rising steadily and considerably (177.2%), particularly since 2004; violations of the Law on Psychotropic Drugs have risen continuously and significantly (504.3%) since 2000.

46 United Nations, Office on Drugs and Crime, Crime and Development in Central America. Chapter 3. How Crime is Impeding Development, May 2007.

47 Through the establishment of a police school.

intended to dissuade them from becoming involved in criminal activities; (iv) development of barrio improvement programs intended to prevent violence; and (v) promotion of actions for social rehabilitation of persons in conflict with the law. These interventions will help to promote a regional approach to violence prevention and citizen security.

3.18 The main risks are related to potential flaws in coordination among the many agencies called to act on critical points in criminal activity, by both geographic area and vulnerable group. Another risk is their limited operational capacity. To mitigate these risks, the Bank will support the strengthening of coordination mechanisms and interagency agreements intended to translate these into management agreements with specific commitments on the national and local levels. It will also support the production of statistics broken down by vulnerable and population groups' geographic zones.

D. Early childhood development

3.19 It has been shown[48] that children from poor families lag behind significantly in their physical, emotional, and cognitive development. This is explained both by the scant educational capital in their households and by their limited access to health services, early childhood development (ECD) centers and preschools, and adequate nutrition. Evidence demonstrates that in the future, this will limit their academic performance and reduce the likelihood that they will successfully complete primary and secondary school, affecting their successful passage to adulthood, entry into the workforce, their productivity, and their income. International evidence also indicates that high-quality ECD interventions that focus on very poor children and the early years of life are very beneficial in the short and long terms, even making it possible to break the intergenerational transmission of poverty.

3.20 Costa Rica has made significant progress in human development. It has a broad social safety net (88.8% coverage) and universal access to primary education. However, more than 131,000 children ages 6 and under continue to be poor and their access to education services in early childhood (an essential part of ECD services) is limited. Some 98% of the poorest two-year olds (quintiles 1 and 2) have no access to education services, while the figure for poor three-year-olds is 94% and 75% for poor four-year-olds.

3.21 It has been shown that ECD interventions can make it easier for women to enter the workforce and that they are useful tools for combating poverty in the short term.[49] In the region, childcare has mainly been a woman's responsibility, and Costa Rica is no exception. This responsibility has limited women's access to the labor market, standing in the way of higher income for their families. In Costa Rica, about 144,000 women are unable to work for longer hours because they must tend to

---

48 Shady 2006; Vegas and Santibáñez 2010; Naudeau, et. al 2010; Araujo and López-Boo 2010, among others.

49 Lokshin 2000; Ribar (1992); Kimmel (2006).

young children. Households headed by single mothers or by a male whose spouse stays at home are relatively poorer than households where both parents work: 25% and 23% vs. 10% poverty, respectively.[50] The establishment of ECD as part of the social safety net will improve conditions for children in the short and medium terms and for women and their families by enabling them to join the workforce and boost their incomes.

3.22 Therefore, the government has established the national early childhood care and development network (RNCDI) operated by the Ministry of Social Welfare and the Family (MBSF) to provide early child care and development services for children from the most vulnerable families and offer women the chance to work outside the home.

3.23 The Bank's actions in this sector will be targeted to consolidating the early childhood protection system, focusing on: (i) support for the construction and equipping of the RNCDI for the comprehensive development of the children assisted; (ii) promotion of access to the workforce for beneficiary mothers, which should help to boost family income; and (iii) strengthening the government's institutional capacity to provide early childhood care and development services. NSG interventions are planned in this area through SCF to finance the physical infrastructure of the RNCDI.

3.24 The sector risks are linked to: (i) harmonization of the sector's legal and regulatory framework and the institutional capacity of the new MBSF; (ii) the capacity of the institutions managing and implementing interventions in the sector;[51] and (iii) the government's capacity to allocate funds from the budget[52] to the unit responsible for overall coordination of the RNCDI. To mitigate them, support will be provided for the institutional strengthening of the MBSF, primarily in financial aspects, coordination, and mitigation of construction and equipment risks. The Bank is also planning to provide technical support for the sector on regulatory considerations.

E. Health

3.25 Costa Rica has advanced health indicators. Life expectancy at birth is 79 years (5.5 years above the LAC average) and the infant mortality rate is 9.6 per 1,000 live births (almost half of the average for LAC).[53] This is the result of the existing institutional framework, adoption of a system that focuses on preventive care,[54] and

---

50 Román and Morales 2010.

51 The Instituto Mixto de Ayuda Social [Joint Institute for Social Welfare] (IMAS) will manage and implement the Bank's interventions in the sector.

52 The RNCDI is a government priority, but its inclusion in the draft budget does not ensure that the Legislative Assembly will approve the funds.

53 Source: United Nations, Health Statistics Database 2008 (most recent year with regionally comparable data).

54 For example, the coverage of preventive services includes professionally attended childbirths for 98.5% of women (compared to 90.4% on average in LAC).

large investments in the sector[55] that have resulted in the development of an extensive network of integrated services that offer continuity in medical care.

3.26 With regard to institutions, the government has divided up leadership of the system for the delivery of services. The Ministry of Health is the sector regulator and supervisor that ensures the efficient use of resources and focuses on promoting health promotion. The Caja Costarricense del Seguro Social [Costa Rican Social Security Administration] (CCSS) is the main service provider, responsible for programming activities and investment plans, which include construction, upgrading, and maintenance of the service network.

3.27 In recent years, budget constraints have affected the maintenance and expansion of the services network and have led to its deterioration. This, coupled with the sociodemographic changes in the country (concretely the aging of the population[56] which has modified the epidemiological profile), means that it is necessary to continue to strengthen the health infrastructure and maintain innovations in content, and promote improvements in service management to cope with higher demand and the increase in chronic diseases.[57] The quality of the services does not meet public expectations, and the perception of the quality of hospital care has worsened.[58]

3.28 The government's main objectives in this area are to readjust coverage to the new epidemiological profile[59] and improve the quality of the services delivered. The IDB plans to strengthen the health care system through support for the entities therein, including decentralized entities, for: (i) modernization and expansion of primary and tertiary care facilities;[60] (ii) increased access to primary services by the poorest population; (iii) organization and management of the hospital system;[61] and (iv) broadening of the health care model to cover growth in needs caused by the country's changing demographics. NSG operations in this sector, through SCF, are planned in the areas of primary and tertiary health infrastructure.

---

55 The public health investment ratio is 5.9% of GDP (the average for LAC is 3.4%).

56 The percentage of older adults out of the total population has increased (from 5.4% in 1999 to 6.3% in 2009), while the population under 14 has fallen (from 32.4% to 25.9% over the same period).

57 The aging of the population reduces the relative proportion of communicable diseases but increases the relative weight of chronic ones, cardiovascular diseases, and cancer.

58 According to figures from 2009, 63.3% of the population believes that clinics and hospitals provide 'very poor service.' J. Muiser, V. Becerril, R. Saénz, A. Collado, A. Vindas. Mapa del Sistema de Salud de Costa Rica. México, DF: Fundación Mexicana para la Salud, A.C. Public opinion poll conducted in 2009.

59 See the sector note on health.

60 The first level provides services under five comprehensive care programs through basic comprehensive health care teams (EBAIS) and some outlying and deconcentrated clinics. The third level offers hospitalization and highly complex medical and surgical services.

61 See the sector note on health. Improvements should be targeted to more efficient and effective use of resources, which would contribute to the financial sustainability of the system, and an improvement in the quality of care.

3.29 The sector risks identified are constraints on the institutional and financial capacity required to extend access to all population groups. To mitigate them, the Bank will support preparation of a comprehensive medium- and long-term strategy to guide and target actions.

F. Innovation

3.30 Costa Rica's investment in research and development (R&D) as a percentage of GDP is 0.4%, when, according to its per capita income, it should be around 0.9%.[62] This underinvestment is particularly high in the private sector. While countries with similar levels of private sector development finance about 50% of national investment in R&D, the figure for Costa Rica is 30%.

3.31 The main restrictions on higher investments in innovation are: (i) the lack of seed capital; (ii) the small size of the market, which also has high barriers to competition; (iii) insufficient human capital whose profile does not match the needs of industry,[63] particularly in high technology; (iv) the weak linkage between generators and users of knowledge; and (v) the low penetration of information technologies. These last two factors mean that firms have little access to the complementary assets necessary for innovation. Multiple reasons underlie this performance and they must be addressed with a comprehensive vision, which makes it necessary to build up the institutional framework that governs public policies in this area.

3.32 The Costa Rican government's Agenda 2010-2014 prioritizes the need to promote improvements in innovation to raise the country's growth rates and, in particular, to surmount its low productivity. To that end, the government has defined three lines of intervention: (i) human capital and innovation; (ii) infrastructure development; and (iii) improvements in the regulatory framework.

3.33 In this sector, the Bank will provide technical and financial support to increase investments in innovation, particularly by the private sector, through: (i) strengthening and increasing the coverage of financing tools, including early financing for innovation, such as technology development and seed capital funds; (ii) promoting the development of advanced technical and scientific human capital, adapted to the demands of the business sector; (iii) supporting programs to link universities and businesses and for technology transfers; and (iv) increasing access to and use[64] of information and knowledge technologies in production. In this sector, NSG direct interventions are planned for small and medium-sized enterprises and indirect interventions through financial institutions.

---

62 Using conservative estimates for rates of return, if it had invested 0.9 of GDP in R&D, the country's productivity would have grown by nearly 30% more in the last three years than it actually did.

63 R. Jimenez, E. Robles, and G. Arce, "Educación y crecimiento económico en Costa Rica", 2009.

64 Job training interventions will be emphasized.

The main sector risk is related to the difficulty of interagency coordination. To mitigate it, the Bank will support the government in designing a comprehensive medium-term strategy to ensure continuity of policies.

IV. LENDING FRAMEWORK FOR THE BANK'S COUNTRY STRATEGY

4.1 The investment program presented by the government seeks to achieve a suitable combination of sources of financing. Most of the new investments will be carried out with foreign loans so that domestic savings can continue to finance the private sector and a good part of the fiscal deficit. Given the amount and scope of the government's investment program, the Bank is considering a base financial scenario (scenario A) of sovereign-guaranteed loans for US$1.06 billion for the period 2011-2014.

Table 1: Estimated flows of loans and net flows

	Scenario A				Scenario B			
	2011	2012	2013	2014	2011	2012	2013	2014
IDB approvals	132.4	687.5	240.0	0.0	132.4	525.0	52.6	0.0
IDB disbursements	105.7	283.7	291.4	393.3	105.7	190.6	210.3	230.7
Net flow (disbursements-repayments)	58.1	236.9	253.4	357.5	58.1	143.8	172.3	194.9
CPS debt with IDB	575.7	812.6	1066.0	1030.3	575.7	719.5	891.8	856.1
IDB public debt/external debt	14.4	18.7	25.5	25.6	14.4	16.9	21.8	21.4
IDB public debt/multilateral debt	25.1	30.6	42.8	44.2	25.1	28.1	37.0	37.1
IDB public debt/public debt	3.9	5.1	6.4	5.8	3.9	4.5	5.4	4.8
Multilateral public debt/debt	15.8	16.6	14.9	13.2	15.8	16.1	14.5	13.1
CPS debt with IDB/GDP	1.7	2.2	2.7	2.5	1.7	2.0	2.3	2.1
CPS debt/GDP	42.4	43.5	42.8	42.8	42.4	43.3	42.5	42.4

Sources: Approvals, disbursements, and net flows are CID projections based on the preliminary discussions.
IDB debt was calculated based on information from the Ministry of Finance.
Only includes loans to the public sector. External and multilateral debt: Ministry of Finance.

4.2 The base scenario envisions an improvement in the fiscal situation that will permit the debt-to-GDP ratio to be maintained at below 45%.[65] If this cannot be attained, a low lending scenario (scenario B) will be considered[66] for US$710 million. The

---

65 The executive branch presented the national fiscal sustainability plan in January 2011. The plan includes measures to contain current expenditures, strengthen investment, and combat tax evasion, in addition to a sweeping tax reform (Tax Solidarity Project), which has already been presented to Congress.

66 The trigger for scenario B will be if the total public debt/GDP ratio exceeds 53% and there is no program in effect with the International Monetary Fund. This would indicate that the fiscal situation has deteriorated, driven mainly by internal factors that would make it difficult to maintain a program with the IMF.

latter assumes that the country will need to temporarily scale back its investment plan, lengthening the execution period to make it consistent with its financial capacity. Under both scenarios there is a sustainable course for sustainability and debt exposure indicators (see Annexes I, II, and V). As indicated in the estimated flows, the volume of approvals in either scenario is largely frontloaded in the first two years of the country strategy. Programming approvals in the early years will allow legislative ratification to be obtained during the present government's term of office.

4.3 The gross financing needs of Costa Rica's central government are an estimated US$10.78 billion. The Bank will cover about 6.8%-9.9% of those needs (US$1,074.1-US$737.3 million) (See Annex II).

V. IMPLEMENTATION OF THE STRATEGY

A. Country systems

5.1 In 2009, the government, with support from the IDB and the World Bank, evaluated its national procurement system by applying the OECD/DAC methodology and identified the following challenges: (i) highly scattered standards because each institution applied its own procurement rules; (ii) lack of integration between budgets and contracts; (iii) lack of a single portal containing all the country's procurement information; (iv) lack of profiles and a system to accredit offices that make procurements and the professionals in charge; and (v) lack of internal control systems apart from those intended to improve the efficiency and effectiveness of management. In addition, the government evaluated the status of the electronic procurement system and, as a result of its studies, launched a strategic procurement modernization plan, which is in the implementation process.[67] As for the use of the procurement system in Bank-financed operations, only the information subsystem is used for publicity purposes (20% of the portfolio). To move ahead in the use of the country procurement system, the Bank will support building the institutional capacity of the body in charge and the functions of the national public procurement information system.

5.2 The most recent diagnostic analyses of Costa Rica's public financial management systems indicate significant progress toward good practices and international standards, chiefly in modernization of the institutional framework, budgeting, treasury management, and adequate monitoring of the public debt. Implementation of the Integrated Financial Administration System (SIGAF) and the Single Treasury Account (CUT) have led to effective financial programming, prudent and disciplined cash flow management, and decentralization of the treasury function. This progress allows for greater use of country financial administration systems to execute Bank operations. Currently, 100% of the portfolio is managed through the budget and treasury subsystems. The Bank will support the government in strengthening its accounting subsystem by implementing the International Public Sector Accounting Standards (IPSAS) and the SIGAF to be used by all central government agencies. As for external control, the Office of the Comptroller General (CGR) is technically capable but the government's preference is for the external audit function to continue being exercised by firms of independent auditors.

B. Coordination with international cooperation agencies

5.3 With the start of the new administration in May 2010, a major effort has been undertaken to improve the government's strategy for international cooperation, defining action priorities and transparent coordination mechanisms that avoid dispersal and duplication in the use of funds. This has been brought about through the active role played by the Ministry of Planning (MIDEPLAN), under the guiding

[67] https://www.hacienda.go.cr/comprared/Plan_Estrategico_Compras_Publicas.pdf.

framework of the National Development Plan 2011-2014. Before that, the government had not used any formal mechanism to coordinate external aid, but instead entered into direct negotiations with bilateral donors.

5.4 In parallel, the Bank and other multilateral institutions have been working to promote complementarity and coordination of their respective supports as well as to simplify and harmonize procedures to reduce transaction costs for the executing agencies. The main areas in which coordinated or joint work has been carried out are: (a) water and sanitation with the Japan International Cooperation Agency (JICA) and the Spanish Agency for International Development Cooperation (AECID); (b) road infrastructure with the Central American Bank for Economic Integration (CABEI); (c) institutional strengthening with the government of the Republic of South Korea and JICA; (d) airport infrastructure with the Overseas Private Investment Corporation (OPIC); and (e) power generation with the European Investment Bank (EIB), CABEI, and JICA.[68]

5.5 In addition, during the period of the country strategy it is expected that the International Bank for Reconstruction and Development (World Bank) will support the government in implementing its competitiveness plan and in tertiary health care (hospitals), tertiary education (universities), and environment and natural disasters. CABEI will also offer support in environment, health, transportation, and energy. The IDB maintains close relations with both institutions as established in the commitments made in the Paris Declaration, which will be reinforced during implementation of the present strategy.

VI. RISKS[69]

6.1 **Macroeconomic risks**.[70] The macroeconomic risks are principally associated with public finances (see Annexes I, II, and V). In the event a tax reform to increase public revenues is not passed, the country may decide to scale back its investment plan or lengthen its execution period to make it consistent with public sector financial capacity and preserve macroeconomic sustainability. This would affect the expected results of the Bank's country strategy with Costa Rica, which have been based on a given level of approvals and disbursements. However, it is not expected that the country's fiscal sustainability will be affected in either of the two scenarios in question (see Annex V).

6.2 **Political risk**. There is a risk that parliamentary ratification of the operations envisaged in this strategy will not be timely. That could jeopardize progress in key

[68] See Annex IV.

[69] The risks and mitigation measures will be monitored throughout the Bank country strategy period.

[70] There are plans mandated within the framework of the Report on the Ninth General Increase in the Resources of the Inter-American Development Bank to produce analyses of the macroeconomic sustainability of the borrowing member countries (including annual reviews), but the corresponding process and implications of this activity have yet to be defined by the Bank's Board of Executive Directors.

areas of the country's development and attainment of the results envisaged in the present country strategy. To mitigate this risk, the government has begun to work together with the different political players from the earliest stages of projects and reforms. In addition support will be provided for the institutional strengthening of Congress to improve its efficiency and facilitate dialogue and consensus-building.

6.3 **Natural disaster risk**. The country is vulnerable to natural disasters, particularly earthquakes. This could pose a risk for macroeconomic stability[71] and the development of infrastructure for production, particularly transportation (a pillar of the country strategy). The Bank will continue discussions with the government on ways of mitigating this risk, such as support for preparation of a national disaster plan, or the analysis of financial tools, such as contingent lines of credit.

[71] The maximum probable loss from a maximum considered event in a period of 500 years is US$6.7 billion for the Costa Rican economy.

SELECTED ECONOMIC AND SOCIAL INDICATORS

	2003	2004	2005	2006	2007	2008	2009	2010
Real sector								
Real GDP growth (%)	6.7	4.5	6.2	9.0	7.4	2.6	-1.0	4.3
GDP in current prices (in US$ billions)	15.9	16.9	18.1	19.9	21.4	26.9	29.7	33.7
Per capita GDP (US$)	3,847.6	4,016.8	4,239.2	4,607.8	4,873.3	6,043.7	6,582.7	7,350.2
Monetary variables, prices, and exchange rate								
Consumer price index (%) end of period	9.9	13.1	14.1	9.4	10.8	13.9	4.0	5.8
Liquidity (annual % var.)	19.1	29.7	24.5	23.6	19.2	22.0	20.5	4.5
Exchange rate (end of period)	398.0	437.0	477.0	520.0	568.0	522.0	514.0	510.0
External sector								
Current account balance (% GDP)	-5.0	-4.3	-4.9	-4.5	-6.3	-9.2	-1.8	-4.2
Foreign direct investment (% GDP)	3.2	4.2	4.3	6.5	7.1	6.7	3.4	4.1
Gross international reserves (US$ millions)	1,838.9	1,921.7	2,312.6	3,114.6	4,113.6	3,799.1	4,066.3	4,627.2
Gross international reserves (% GDP)	11.6	11.4	12.8	15.6	19.2	14.1	13.7	13.7
Public finances								
Financial results, total public sector (% GDP)	-4.8	-3.6	-2.3	-0.4	0.8	-0.4	-3.9	-5.2
Financial results, Central Bank of Costa Rica (% GDP)	-1.5	-1.3	-1.4	-1.1	-0.7	-0.2	-0.8	-0.4
Financial results, NFPS (% GDP)	-2.9	-2.3	-0.9	0.8	1.6	-0.6	-3.1	-4.8
Financial results, central government (% GDP)	-2.8	-2.7	-2.1	-1.1	0.6	0.2	-3.4	-4.9
Primary results, central government (% GDP)	1.2	1.6	2.5	3.1	3.7	2.4	-1.3	-1.3
Public sector debt (% GDP)	60.5	60.5	56.3	52.3	46.3	40.4	43.7	43.8
Public sector external debt (% GDP)	21.3	21.9	18.9	16.2	13.1	12.5	12.0	10.7
Social indicators								
Population (millions)	4.1	4.2	4.3	4.3	4.4	4.5	4.5	4.5
Unemployment rate	6.7	6.5	6.6	6.0	4.6	4.9	8.4	7.3
Percentage of poor population	18.5	21.7	21.2	20.2	16.7	17.7	18.5	21.3
Percentage of population in extreme poverty	5.1	5.6	5.6	5.3	3.3	3.5	4.2	6.0

Sources: For the period 2003-2009 all the data are from the BCCR, except for the social indicators which come from INEC. Data for 2010: BCCR, Ministry of Finance, INEC, CGR, and IMF.

LENDING FRAMEWORK FOR THE BANK'S COUNTRY STRATEGY

1. The investment program presented by the government seeks to have a suitable combination of sources of financing. Most new investment will be carried out with foreign loans, so that domestic savings can continue to finance the private sector and a good part of the fiscal deficit. Given the amount and scope of the government's investment program, the Bank is considering a base financial scenario (scenario A) for sovereign-guaranteed lending for US$1.06 billion for the years 2011-2014.
2. The base scenario envisages an improvement in the fiscal situation that will hold the debt-to-GDP ratio below 45%.
3. Should this improvement not take place, a low financing scenario will be considered (scenario B),[72] for US$710 million. The latter assumes that the country will need to temporarily scale back its investment plan, lengthening the execution period to make it consistent with its financial capacity. There is a sustainable course for sustainability and debt exposure indicators (see Annex I).
4. As indicated in the estimated flows, the volume of approvals in either of the scenarios is largely frontloaded in the first two years of the Bank's country strategy with Costa Rica. Programming approvals in the early years means that legislative ratification can be obtained during the current government's term of office. The volume of annual disbursements will depend on progress in bidding and similar processes linked to investments in infrastructure. In function of this, disbursements are expected to be increasingly distributed throughout the period of the country strategy.

Estimated flows of loans and net flows

	Scenario A				Scenario B			
	2011	2012	2013	2014	2011	2012	2013	2014
IDB approvals	132.4	687.5	240.0	0.0	132.4	525.0	52.6	0.0
IDB disbursements	105.7	283.7	291.4	393.3	105.7	190.6	210.3	230.7
Net flow (disbursements-repayments)	58.1	236.9	253.4	357.5	58.1	143.8	172.3	194.9
CPS debt with the IDB	575.7	812.6	1,066.0	1,030.3	575.7	719.5	891.8	856.1
IDB public sector debt/external public debt	14.4	18.7	25.5	25.6	14.4	16.9	21.8	21.4
IDB public sector debt/multilateral public	25.1	30.6	42.8	44.2	25.1	28.1	37.0	37.1
IDB public sector debt/public sector debt	3.9	5.1	6.4	5.8	3.9	4.5	5.4	4.8
Multilateral public sector debt/public debt	15.8	16.6	14.9	13.2	15.8	16.1	14.5	13.1
CPS debt with IDB/GDP	1.7	2.2	2.7	2.5	1.7	2.0	2.3	2.1
CPS debt/GDP	42.4	43.5	42.8	42.8	42.4	43.3	42.5	42.4

Sources: Approvals, disbursements, and net flows are CID projections based on the preliminary discussions.
IDB debt was calculated based on information from the Ministry of Finance.
Only includes loans to the public sector. External and multilateral debt: Ministry of Finance.

5. Both scenarios indicate an acceptable evolution of debt exposure indicators, which is consistent with the government's borrowing policy. The expected volume of financing means that the IDB's portion of public debt will grow between 2010 and 2014 from 3.9% (3.9%) to

---

[72] The trigger for scenario B will be if the total public debt/total GDP ratio exceeds 53% and there is no program in effect with the International Monetary Fund. This would indicate that the fiscal situation has deteriorated, driven mainly by internal factors that would make it difficult to maintain a program with the IMF.

5.8% (4.8%).[73] Although debt levels with the Bank as a percentage of GDP rise, they continue to be below 6.5% (6.5%). It is also estimated that the country's total debt as a percentage of GDP will remain stable at about 42.9% (42.7%). The behavior of these indicators suggests that Costa Rica will not face debt sustainability problems during the period of the country strategy.

6. The central government's gross financing needs are an estimated US$10.78 billion. The Bank will cover about 6.8% to 9.9% of that figure (US$1,074.1-737.3 million).

Table 1: Central government financing requirements 2011-2014

	2011	2012	2013	2014
Financing (US$ millions)				
Gross financing requirements	2,272.1	2,567.9	2,765.5	3,172.7
Deficit	1,953.6	2,258.0	2,459.0	2,872.0
Repayments	318.5	309.9	306.5	300.7
Gross sources of financing	2,272.1	2,567.9	2,765.5	3,172.7
External	133.1	303.9	317.3	418.9
Internal	2,139.1	2,264.0	2,448.2	2,753.8

Source: Own estimates based on the budget projections of the Ministry of Finance.

[73] The figures in parentheses correspond to the low scenario.

COUNTRY PROGRAM EVALUATION RECOMMENDATIONS (OVE)

Recommendations from the Country Program Evaluation	Incorporation into the Bank strategy with Costa Rica 2011-2014
Recommendation 1: The Bank needs to internalize the constraints imposed by the political economy affecting the legislative ratification process and, consequently, tailor the design of its operations and the timing of their presentation to the Legislative Assembly to minimize delays in the ratification process.	In the new Bank strategy, and in recent semiannual periods and in the dialogue with the authorities, special attention is paid to political economy issues that affect the ratification process, which have been identified as one of the risks that the Bank might encounter. Accordingly, no approvals were proposed for the last year of the government's term and extensive discussions with members of the Legislative Assembly have been incorporated into the design of operations from the outset.
Recommendation 2: The working relationship the Bank establishes with the country through its Executive Branch should lead to operations that are aligned with the priorities of the general public and target areas of major strategic importance for a broad range of political players. Roadblocks in obtaining legislative ratification and the political capital that the Executive must invest in such process are an indication that only those projects identified as relevant and a priority by the State and the country as a whole for periods longer than the strategy cycles will be submitted for ratification. Those problems, combined with the high project cancellation rate in Costa Rica, suggest that ignoring this recommendation would translate into the inefficient use of time and resources without advancing the country's development.	The Bank's support under the new strategy with Costa Rica will be directed to maintaining close relations with the Executive Branch, the Legislative Assembly, and other representative sectors, in order to obtain an excellent alignment of priorities. The Bank is already working with the new government to mitigate the problem of ratification that affects the passage of domestic laws and approval of multilateral loans.
Recommendation 3: Ratification problems also suggest that the Bank should support the Executive in the preparation and detailed technical justification of the programs to be financed by the Bank. The previous evaluation also recommended involving the Legislative Assembly and keeping it apprised of the objectives and progress on the preparation of operations from the outset. The progress made once that recommendation was adopted was clear in the case of the conditional credit line for investment projects (CCLIP) for the *Transportation Infrastructure Program.*	In particular, to mitigate the risk represented by ratification problems, the Bank, under the new strategy with Costa Rica, will continue to support dialogue with the government and the Legislative Assembly to explain the objectives and scope of the IDB's technical and financial support for the country. The road followed in ratification of the CCLIP mentioned in Recommendation 3 and for the energy CCLIP has helped to bring about closer relations between the Bank and the technical experts in the Legislative Assembly, with whom the Bank continues to maintain ongoing dialogue to obtain feedback in the preparation of operations.
Recommendation 4: One way to convince the Legislative Assembly of the merits of Bank-financed projects is to present evidence of the effectiveness of past projects. To that end, the Bank should make an effort to improve project evaluability and ensure that sufficient quality data is gathered to prepare impact evaluations for those projects.	Preparation of projects under the new Bank strategy with Costa Rica envisages building up evaluation capacity (see for example the citizen security project).
Recommendation 5: The Government of Costa Rica asked the Bank to prepare projects (generally with complex designs) for large amounts, in order to lower the transaction costs associated with the legislative ratification process—and the Bank honored that request. Evidence suggests that, even though there is a guaranteed high-level political commitment to ratification within the Executive, this strategy does not guarantee success in terms of	In the design of new operations, special emphasis is being placed on the institutional capacity of the executing agencies. The citizen security operation currently being prepared, for example, proposes conferring legal status on the executing agency to facilitate execution.

Recommendations from the Country Program Evaluation	Incorporation into the Bank strategy with Costa Rica 2011-2014
speeding up the legislative ratification process, as demonstrated by the CCLIP for the *Transportation Infrastructure Program* and the *Pro-Competitiveness Productive Investment Program*. In order for this strategy to be successful, the programs must have executing units with institutional capacity and must be well-justified from a technical standpoint, like the *CCLIP Electric Power Development Project 2008-2014*. In that case, it also helped that it is harder for legislators to influence where the Instituto Costarricense de Electricidad [Costa Rican Electricity Authority] (ICE) will expand its transmission and distribution grid than to influence where transportation infrastructure works are rehabilitated and reconstructed.	
Recommendation 6: To make project execution more efficient, it is recommended that the Bank propose that the government use country systems for procurement of goods and services once the criteria and procedures set forth in the Strategy for Strengthening and Use of Country Systems (document GN-2538) and the Guide for Acceptance of the Use of Country Procurement Systems (document GN-2538-6) are met. The Bank has worked to strengthen these systems and the diagnostic reports (CFAA, CPAR, PEFA, and OECD-DAC) are being completed; however, validation of the systems and the action plan agreed on with the country to authorize Bank use of its systems, if the country deems it prudent, would still be needed.	The new strategy with Costa Rica reinforces the Bank's support to build up country procurement systems.
Recommendation 7: Together with the Executive, the Bank can identify strategic areas where there are opportunities to support the private sector. One of the possible solutions to the legislative ratification problem is to increase the use of private sector projects that do not require ratification. However, the Bank should ensure that those projects have an impact on the welfare of the population. Operations with the private sector cannot be limited solely to financial transactions with no value-added that could be replaced by operations with commercial banks.	The new Bank strategy with Costa Rica is closely aligned with the government's objective of seeking to differentiate sources of financing for investment projects over the next four years. In the infrastructure sector, for example, the Bank is committed to offering technical assistance in public concessions and trusts. The Bank is using innovative financial approaches that permit the private sector to become involved in financing infrastructure works.
Recommendation 8: The Bank needs to make an effort to be more responsive in studying and designing new instruments that enable it to compete with other multilateral organizations in terms of price and flexibility and to overcome the obstacles in the ratification process.	Under the new Bank strategy with Costa Rica, efforts are being made to increase the use of alternative financing arrangements (see the example reported in response to Recommendation 7).
Specific project-related recommendations	
The *Sustainable Development for the Sixaola River Binational Watershed* program is very close to reaching the end of the initial planned effective execution period, but has only disbursed 3.3% of the amount approved. It also presents certain design problems, and the ministry in charge of its execution is considered to be weak. The Bank needs to step up its monitoring efforts since this program presents a novel solution to the problem of poverty in one of the most impoverished regions.	The challenges presented by the *Sustainable Development for the Sixaola River Binational Watershed* program have been identified and the Bank, under the new strategy with Costa Rica, will continue to provide the monitoring needed to make headway in execution. Special support is being provided for this operation, with closer monitoring by Bank specialists.
Although the *Health Sector Development* program has already been completed, the conditions in the Ministry of Health could affect the use of the tools financed by the program. This is a critical time due to the organizational changes within the institution, and it would be wise for the Bank to consider lending the government support so the institution can start to use those	One of the priority areas for action identified in the Bank strategy with Costa Rica is the health sector, with which intensive discussions are being held.

Recommendations from the Country Program Evaluation	Incorporation into the Bank strategy with Costa Rica 2011-2014
tools and update them when necessary.	

SUMMARY OF COORDINATION WITH INTERNATIONAL COOPERATION AGENCIES

1. In recent years, the Bank has consolidated its position as the main multilateral agency that provides financing for Costa Rica, accounting for almost 15% of the central government's external debt at the end of 2009 (compared to 3.2% for the World Bank or 6.2% for total bilateral external debt). In this context, the Bank has endorsed implementation of the Paris Declaration, trying to promote complementarity between its actions and bilateral and multilateral aid on the ground, and to bring about greater harmonization and simplification of operating and fiduciary procedures with a view to minimizing administrative and transaction costs for the executing agencies and the Bank itself.
2. For its part, the new administration that took office in May 2010 has considerably strengthened the government's strategy for coordinating international cooperation, setting action priorities and establishing transparent coordination mechanisms to avoid dispersal and unnecessary duplication in the use of funds,[74] and to promote synergies and economies of scale among the different multilateral and bilateral players.
3. In the case of the development banks (IDB, World Bank, CAF, CABEI) and multilateral and bilateral development agencies (UNDP, USAID, AECID, JICA), operational and day-to-day cooperation is carried out through periodic meetings to exchange information and coordinate activities (joint missions, technical meetings, etc.) that have allowed for the efficient coordination of responsibilities among the different institutions.
4. The IDB's main coordination activities take place in the field of transportation infrastructure in close cooperation with the World Bank CAF, and CABEI. In the area of environment, climate change, and natural disasters, the IDB also cooperates with institutions such as the UNDP, the World Bank, CABEI, and KfW Bankengruppe, and in the area of energy it cooperates with JICA, the UNDP, CABEI, and KfW Bankengruppe.
5. During the period the country strategy is in effect, the International Bank for Reconstruction and Development (IBRD or World Bank) is expected to support the government in implementing its competitiveness plan, improving the business climate, and in the areas of tertiary health care (hospitals), tertiary education (universities), and the environment and natural disasters. CABEI will also provide support in the fields of environment, health, transportation, and energy. The IDB maintains close relations with both institutions to coordinate and complement interventions, as was established in the commitments made in the Paris Declaration, which will be reinforced during implementation of the present strategy.

[74] The new government presented a public investment program for the period 2010-2014 for US$6.475 billion, to be financed by international financial institutions.

AREA	IBRD	CABEI	UNDP	USAID	AECID	JICA	EU & EIB	CAF	KfW
Transportation									
Energy									
Citizen security									
Judicial system									
Violence prevention									
Food security									
Education									
Health									
Poverty and inequality									
Gender									
Science and technology									
Telecommunications									
Water and sanitation									
Trade and integration									
Environment and climate change									
Natural disasters									
Institutional strengthening									
Local development and decentralization									
Micro, small, and medium-sized enterprises									
Agriculture									
Business climate									
Culture									
Competitiveness									

MACROECONOMIC RISK ANALYSIS

1. **In 2011 growth is expected to be on the order of 4%, similar to the rate of 4.3% seen in 2010.** After the economy contracted by 1.0% in 2009—which was slightly higher than the regional average (0.9%)—growth forecasts for the Costa Rican economy for the period 2011-2014 concur that the economy will grow by about 4% a year, for a recovery that is better than the regional average. However, given the new international context, Costa Rica can be expected to grow in the coming years at rates below the average of 6.7% that it achieved in the period 2003-2007. Forecasts for lower growth in the United States and Costa Rica's heavy reliance on demand from that country for its exports constitute a constraint on growth. The recent rise in the prices of various commodities imported by Costa Rica and the consequent negative income effect that it has on the country are another factor that will hold back strong economic growth.

2. **Another risk facing the Costa Rican economy is linked to the status of public finances.** Lower levels of growth than those preceding the crisis will require prudent management of the fiscal accounts. **In 2010, the central government's accounts posted growth in total current income of 15.7%** over 2009. However, tax income in 2010 increased by just 9.7% compared to the same period the previous year. Also, total spending has grown over the same period by 26.8%. One particularly relevant point is that the increase in spending to carry out an expansionary policy to counteract the impact of the crisis largely occurred through increases in payroll, which are difficult to reverse after the crisis ends (spending on wages grew from 7.1% of GDP in 2007 to 9.4% of GDP en 2010). This will pose a challenge that will have to be met through tax increases and/or spending cuts in areas that are more flexible than personnel.

3. With technical assistance from the Bank, the government is promoting a **tax reform** that will increase public revenue while helping to improve tax equity and simplify the tax system. **The tax reform presented to the Legislative Assembly could bring in an additional US$1.2 billion in revenue (about 3% of GDP taking projected GDP for 2011 as the base)**. However, this amount is expected to be reduced during parliamentary processing of the reform to about US$800 million (equivalent to 2% of GDP). **With regard to spending**, the document on national fiscal sustainability policy published by the government plans to cap growth by freezing new hiring and not filling vacancies, in addition to making smaller cuts in spending on per diems, travel, transportation, training, and protocol. Given the scant capacity to adjust aggregate spending, **it will be fundamental to lower it as a percentage of GDP through strong government resistance to pressure for higher spending as the economy grows.**

4. The markets appear to have confidence in the government's ability to take steps to guarantee fiscal sustainability. **Last 4 March, the Fitch rating agency raised the rating of Costa Rican government bonds from BB a BB+**[75] with a stable outlook. Apart from apparent confidence in the capacity to undertake those measures, this reflects Costa Rica's resistance

[75] The level preceding investment grade.

to the financial waves during the global crisis, consolidation of single-digit inflation, strengthening of international reserves, and low-risk external debt which is at modest levels.

5. **In the event there is no improvement in the fiscal situation, aside from possible deterioration in macroeconomic stability, it may become necessary to scale back the investment program presented by the government in July 2010**.

DEM

STRATEGIC ALIGNMENT. This measures two dimensions: (i) the extent to which the objectives of the strategy are consistent with the country's development challenges and with the government's priorities and plans; and (ii) use of a mix of products (financial, knowledge, technical assistance) to attain the objectives, and identification of other cooperation agencies and their areas of action.

Consistency of strategic objectives: The strategy identifies the following areas of work: (i) transportation; (ii) energy; (iii) citizen security and violence prevention; (iv) early childhood development; (v) health; (vi) innovation; and (vii) financial management and government procurement. All of the areas selected face major development challenges identified in the "Growth Analysis" and in the respective sector notes. They are consistent with the government's priorities and result from the dialogue between the country and the Bank.

Mix of products and participation by other donors: The strategy proposes to use different Bank instruments such as sovereign-guaranteed operations, NSG operations, and technical-cooperation projects. The strategy takes into account coordination with and interventions by other multilateral donors such as the World Bank, AECID, JICA, CABEI, and other bilateral agencies.

EFFECTIVENESS. This measures whether the country strategy is likely to achieve its intended objectives, through an examination of four dimensions: (i) the quality of the diagnostics on which Bank action is based in each area of work; (ii) the quality of the results matrix for the strategy; (iii) the use and build up of country systems; and (iv) the analysis of the lending framework.

Effectiveness dimensions	%
I. Sector diagnostics	
- Sector diagnostics (includes an analysis of the entire sector) - Diagnostic targeting the proposed areas of intervention	43 57
- Identifies the main problems based on empirical evidence	71
- Identifies the main beneficiaries	100
- Identifies and measures the factors that contribute to the problems identified	71
- Presents the policy framework and a sequence for Bank intervention	71
- The diagnostic corresponds to the objectives presented in the strategy	100
II. Results matrix	
- The expected outcomes are clearly defined	100
- The indicators are outcome indicators and are SMART	92
- The indicators have baselines	92

Seven sector notes were presented as support for the strategy: 57% of them focus on the areas where Bank action is planned; 43% contain an analysis of the sector as a whole and include the most relevant subsectors, which are used to define the Bank's interventions.

- 71% of the notes clearly identify the main sector problems based on empirical evidence.

- 100% of the notes identify the potential beneficiaries in each area of intervention.
- 71% of the notes identify or measure the factors that contribute to the problems identified.
- 71% of the notes identify the policy framework and a sequence for Bank actions.
- In 100% of the notes, the subjects dealt with are consistent with the Bank's strategic objectives.

Results matrix: The results matrix contains 13 strategic objectives for Bank action and 26 indicators to measure progress toward the proposed objectives.

- 100% of the strategic objectives clearly identify the expected outcomes.
- 92% of the indicators used are outcome indicators and are SMART.
- 92% of the indicators have baselines.

Country systems: With regard to fiduciary systems (financial management and procurement) diagnostics have been performed for all the financial management subsystems and for the procurement information system. Work will be done to build up the budget and accounting/reporting systems and the procurement information system. Partial use will be made of the financial management (budget and treasury) and procurement (information system) subsystems.

Lending framework: The strategy contains an analysis of the country's financing requirements and provides an estimate of the amount required from the Bank in base and alternative scenarios.

RISKS. This measures three dimensions: (i) identification of factors that actually do or might affect attainment of the proposed objectives; (ii) definition of mitigation measures; and (iii) monitoring mechanisms.

The strategy identifies the risks associated with Bank participation in each of the strategic sectors and identifies mitigation measures. It also discusses more general risks (macroeconomic, political, natural disasters) that will be monitored during the period the strategy remains in effect.