



Program Information Document (PID)

Concept Stage | Date Prepared/Updated: 14-Nov-2019 | Report No: PIDC28204

**BASIC INFORMATION****A. Basic Project Data**

Country Costa Rica	Project ID P171912	Project Name First Fiscal and Decarbonization Management DPL (P171912)	Parent Project ID (if any)
Region LATIN AMERICA AND CARIBBEAN	Estimated Board Date Mar 26, 2020	Practice Area (Lead) Macroeconomics, Trade and Investment	Financing Instrument Development Policy Financing
Borrower(s) Ministry of Finance	Implementing Agency Ministry of Finance		

Proposed Development Objective(s)

The Program Development Objective of this DPL is to strengthen Costa Rica's implementation of fiscal and low-carbon development strategies by: (i) adopting reforms to improve fiscal sustainability; and (ii) implement priority climate actions.

Financing (in US\$, Millions)**SUMMARY**

Total Financing	250.00
------------------------	--------

DETAILS

Total World Bank Group Financing	250.00
World Bank Lending	250.00

Decision

The review did authorize the preparation to continue



B. Introduction and Context

Country Context

Costa Rica's success combines political stability, economic openness, good service provision, and sound natural resource management. Democracy has been stable since 1953; one of the oldest in the Latin American and Caribbean region (LCR). Income per capita doubled over the past two decades fueled by openness to trade and foreign investments, diversifying the economy, promoting high value-added exports and demanding a qualified workforce. Strong health care services have contributed to the highest life expectancy at birth in LCR—a rate higher than half of the Organization for Economic Cooperation and Development (OECD) countries. Costa Rica is also recognized worldwide as a leader in environmental management policy and for its commitment to ambitious climate policies. Economic success over the past two decades has also benefited from waves of immigrants that represent 11 percent of the population (the highest percentage in LCR and close to the OECD average); a remarkable occurrence for a region with countries characterized by high levels of emigration.

At the same time, Costa Rica's macroeconomic vulnerabilities are hampering growth and development. A countercyclical fiscal stance helped the economy to bounce back from the 2008 global financial crisis: growth average 4 percent during the 2010-16 period, higher than OECD (1.9 percent) and LCR averages (2.5 percent). However, reliance on current spending led to fiscal deficits of over 5 percent of GDP per year since 2010, which have doubled the central government debt to GDP ratio from less than 25 to 53 percent between 2008 and 2018. As a result of this fiscal situation and other internal and external factors, growth slowed from 4.2 percent in 2016 to a projected 2 percent in 2019. In parallel, national poverty rates increased between 2017 and 2018, both in urban and rural areas, rising from 20 to 21 percent (a level last observed in 2010). Similarly, progress in reducing inequality has halted since 2010, and the unemployment rate rose by 3.3 percentage points year-to-year, reaching 12 percent in the second quarter of 2019.

The Costa Rican authorities have responded by designing and implementing an ambitious package of fiscal, structural and climate-related reforms. In addition to a sluggish economy and growing fiscal issues, the current administration took office in May 2018 facing a challenging political landscape marked by a fragmented legislature. Despite its minority position in Congress, it rapidly reached a historic agreement among divergent political parties on an ambitious reform package. Major structural measures have been legislated to stabilize public finance, accelerate the OECD accession process and decarbonize the economy. Implementation of key reforms have already started in earnest, and bold mid- and long-term targets to reform transport, energy and land use to achieve net zero emissions by 2050 has been set.

Relationship to CPF

The DPF series is fully aligned with the FY16-20 CPF and with IBRD's Graduation Policy. The DPF series is a core instrument to achieve Objective 4 of the CPF (Strengthening fiscal management capacity to enhance efficiency and sustainability) and Objective 6 (Expand capacity to promote climate-smart and environmentally sustainable development). The series also focuses on the two key principles for IBRD graduation policy, by supporting measures to enhance Costa Rica's access to international financial markets and strengthen key economic institutions. Further, the DPF also contributes to a global public good by supporting the implementation of the decarbonization strategy. The series builds on strong policy dialogue and close collaboration with the Government and is part of a joint effort by the international community that includes financing packages from the Development Bank of Latin America (CAF), the Inter-American Development Bank (IDB), the Central American Bank for Economic Integration (BCIE) and the French Development Agency (AFD). The DPF team is also cooperating closely with the IMF on the fiscal and debt sustainability analysis.



C. Proposed Development Objective(s)

The Program Development Objective of this DPL is to strengthen Costa Rica's implementation of fiscal and low-carbon development strategies by: (i) adopting reforms to improve fiscal sustainability; and (ii) and implement priority climate actions. As such, support will be provided to key elements of the Government's fiscal policy reform and climate change mitigation agenda. The two pillars supported by the DPL series are mutually reinforcing: fiscal sustainability is essential to enable the Government to create the necessary headroom to overtime increase investment in the infrastructure, natural and human capital necessary for the country's development and decarbonization plan. In parallel, Costa Rica's long-term fiscal and economic prosperity will continue to depend on the sustainable use of its vast natural resources.

Key Results

By 2022, the key results are expected to be achieved: (1) Revenues from VAT as a share of total revenues increasing from 18 to 20 percent; (2) Revenues from direct taxes as a share of total revenues increasing from 19.7 to 21 percent; (3) annual government budgets in compliance with the fiscal rule; (4) Average nominal growth rate of public wage bill of the Central Government and Non-Financial Public Sector growing by only 3.2 and 4.2 percent, respectively on average for the 2018-22 period (down from 8.5 and 6.9 percent during the 2013-17 period, respectively); (5) Average maturity of Central Government debt increasing to 7.5 years in 2022; (6) Three environmental sectoral policies updated; (7) Three tools (computerized) prepared for the calculation of Life Cycle Assessment (LCA) for selected products under implementation, including user guides for selected products (coffee). Additionally, a comprehensive monitoring framework established for the National Decarbonization Plan and about 1,773 livestock farms applying NAMA model by 2021.

D. Concept Description

Fiscal and environmental sustainability are the main priorities of the current administration, together with accelerating the OECD accession process. These priorities are also aligned with the administration's program and focused on reducing state bureaucracy and increasing public spending efficiency. The program also calls for low carbon development, via medium and long-term reforms, in basic infrastructure and economic sectors such as public and private transport, energy, industry, agriculture, waste management, and land and forest management.

Implementation of these priority reforms has already begun in earnest. The Government passed the fiscal reform package in 2018, "*Ley de Sustentabilidad de las Finanzas Publicas*." The Government also enacted in early 2019 a *National Decarbonization Plan*, which aims to make the country one of the first decarbonized countries by 2050. The Plan includes concrete medium- and long-term goals in strategic sectors such as transport, which is currently one of the country's major sources of greenhouse gas emissions.

The proposed DPF would support important reforms along two pillars. The first one, on Fiscal Sustainability, support the adoption of a VAT reform, an income tax reform, the introduction of a fiscal responsibility framework, the containment of the public sector wage bill, and the strategy to improve public debt management. The second one, on decarbonization, support climate measurement and monitoring, municipal-level voluntary emission reductions, reforms conducive to sustainable, low carbon, transport and the mainstreaming of climate in the agricultural sector.

E. Poverty and Social Impacts, and Environmental, Forests, and Other Natural Resource Aspects

Poverty and Social Impacts



The reforms supported by this operation are not expected to have adverse consequences on poverty and inclusion, while some moderate gains are expected over the medium to long term. The introduction of the VAT could have only a minor negative impact on the poor, but is expected to be limited by several exemptions and three additional reduced rates: 4 percent for private health services provided by authorized health centers or health science professionals; 2 percent for pharmaceuticals, supplies, machinery, equipment and reactive agents used for industrial production; and 1 percent for the basket of basic goods. Overall, the tax reform should improve tax progressivity as the bulk of the extra collection will come from the two top income deciles. The reform to the income tax law should not have an impact on the poorest segments of the population, either as the new taxation regime for capital income and capital gains will only affect high income households. Also, the changes to the salary tax rate only affect households earning more than 2,103,000 Costa Rican colones—more than seven times the minimum wage. A full PSIA is expected to be completed prior to the Review by the Regional Operational Committee.

Environmental, Forests, and Other Natural Resource Aspects

The policies supported by the DPL are not likely to cause any negative effect on the environment, forests, or other natural resources. The policies supported under the first pillar of this DPL on fiscal management are unlikely to have significant effects on the environment. The policies under the second pillar are designed to improve low-carbon development and environmental management and thus, will have significant positive effects.

CONTACT POINT

World Bank

Pedro L. Rodriguez
Program Leader

Borrower/Client/Recipient

Ministry of Finance
Melvin Quiros-Romero
General Director, Debt Department
quirosrme@hacienda.go.cr

Implementing Agencies

Ministry of Finance
Leticia Chavez-Barboza
Coordinator
chavesbl@hacienda.go.cr



FOR MORE INFORMATION CONTACT

The World Bank
1818 H Street, NW
Washington, D.C. 20433
Telephone: (202) 473-1000
Web: <http://www.worldbank.org/projects>

APPROVAL

Task Team Leader(s):	Pedro L. Rodriguez
----------------------	--------------------

Approved By

Country Director:	Andrea C. Guedes	02-Dec-2019
-------------------	------------------	-------------