Office of Evaluation and Oversight

Country Program Evaluation

Costa Rica

2011-2014

Inter-American Development Bank
January 2015

This document presents the results of the evaluation of the Bank's country program with Costa Rica for the period 2011-2014. This is the fourth time the Office of Evaluation and Oversight (OVE) has provided an independent review of the Bank's program with Costa Rica. The first Country Program Evaluation (CPE) in 2003 covered the period 1990-2001, during which an open trade model was consolidated, leading to substantial foreign direct investment. The second CPE covered the period 2002-2006, in which the country was heavily exposed to external shocks. The third and most recent evaluation, covering 2007-2011, highlighted the difficulty of forging linkages between the most dynamic sectors and the rest of the economy, and drew attention to the State's dwindling capacity to finance investments as a result of its low tax burden and heavy expenditure rigidities.

The evaluation was conducted in accordance with the OVE mandate (document RE-238 corr.) and the Protocol for Country Program Evaluations (document RE-348-2). Its main purposes are to facilitate accountability and identify lessons learned that can enhance the Bank's future program. The evaluation took into account the new country strategy paper models (document GN-2468-6) developed by Management, the most significant practical effects of which were: (i) the de facto separation of the formulation of the country strategy and the programming of operations; (ii) the new emphasis on sector notes; and (iii) the updating of the strategy results matrix and programming documents.

The production of this document involved interviews with some 200 people, including the Bank's main counterpart (the Ministry of Finance); sector-level executing units and the staff responsible for them at the ministerial level; as well as civil society organizations, academics, representatives of international organizations in Costa Rica, and the Bank's Representative and Country Office and headquarters staff. OVE is particularly grateful to the participants in the 22 workshops held in the country, and also to the Regional Manager's Office, the Bank's staff in the Country Office, and the people and authorities of Costa Rica for their generous hospitality.

To fulfill the goal of analyzing the Bank's work during this strategy cycle, OVE reviewed a portfolio of all loans and technical cooperation programs approved between 2011 and 2014, as well as those approved earlier but mostly executed during this period. The lessons learned from this CPE should to serve as a useful input not only when preparing the next country strategy with Costa Rica, but also for the Bank to further enhance its service to similar middle-income countries, where access to alternative sources of financing presents new opportunities and challenges for the Bank.

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Costa Rica 2011-2014

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Abbreviations

BNCR	Banco Nacional de Costa Rica [National Bank of Costa Rica]
CABEI	Central American Bank for Economic Integration
CAF	Corporación Andina de Fomento [Andean Development Corporation]
CAFTA-DR	Dominican Republic-Central America-United States Free Trade Agreement
CCLIP	Conditional credit line for investment projects
CCSS	Caja Costarricense del Seguro Social [Costa Rican Social Security Administration]
CID	Country Department Central America, Mexico, Panama and the Dominican Republic
CONAVI	Consejo Nacional de Vialidad [National Roads Council]
CPD	Country Programming Document
CT/INTRA	Cooperaciones Técnicas Intrarregionales [Intra-regional Technical Cooperation Program]
EAP	Economically active population
FDI	Foreign direct investment
FTA	Free trade agreement
ICE	Instituto Costarricense de Electricidad [Costa Rican Electricity Authority]
IMF	International Monetary Fund
INA	Instituto Nacional de Aprendizaje [National Apprenticeship Institute]
MOPT	Ministry of Public Works and Transportation
NSG	Nonsovereign guaranteed
OECD	Organisation for Economic Co-operation and Development
OVE	Office of Evaluation and Oversight, IDB
PBL	Policy-based loan
PEFA	Public Expenditure and Financial Accountability
PNT	Plan Nacional de Transporte [National Transportation Plan]
PROCOMER	Promoción del Comercio Exterior [Foreign Trade Promotion Agency]
SG	Sovereign guaranteed
SMEs	Small and medium-size enterprises
TC	Technical cooperation operation
UTIF	Unidad Técnica de Infraestructura [Infrastructure Technical Unit]

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Despite major progress that has put Costa Rica in a privileged position on many fronts, the country's future development will depend on its ability to overcome challenges in the fiscal, productive, and infrastructure areas, and also in terms of expenditure quality.

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Executive Summary

Costa Rica has succeeded in joining the middle-income group of countries, thanks to its emphasis on democratic stability, investment in human capital, and an open economy. Despite major progress that has put it in a privileged position on many fronts, the country's future development will depend on its ability to overcome challenges in the fiscal, productive, and infrastructure areas, and also in terms of expenditure quality. These coincided with the government's objectives, which also included social welfare, citizen security, the environment, and competitiveness and innovation.

The Bank took part in most of the government's priorities, approving sovereign guaranteed (SG) loan operations in energy, transportation, citizen security, innovation, and education. With these five investment loans, the Bank met 93% of its SG lending target of US$1.06 billion for the period. In contrast, it did not fully realize the aim of using non-sovereign guaranteed (NSG) funding for infrastructure development.

In practice, the Bank became more selective by targeting most of its financing in three areas, which enabled it to consolidate its relationship with the country. The Bank focused on developing its portfolio in three areas: (i) roads—with strong Bank support for implementation; (ii) energy—trusting in the implementation and borrowing capacity of the Costa Rican Electricity Authority (ICE); and (iii) more opportunistically, via financial intermediaries—without a sovereign guarantee. The Bank was thus able to disburse US$788 million in the period—providing positive net financial inflows to the country for the first time in recent years.

This focus, however, has had the undesired cost of hindering the dissemination of "best practices" beyond Bank projects. Given the difficulty of obtaining parliamentary ratification, over 90% of the funding was for civil works, even in areas that clearly needed sector review. The Bank promoted its own works using its own procedures, instead of country rules, and by forming its own technical units, which conspired against the spread of best practices that would benefit the country, given its weakness in both project execution and the management of public-private projects.

Based on the analysis undertaken, OVE considers that there are opportunities for the Bank to build on its current work, with a view to broadening the development effectiveness and systemic effects of its relationship with the country. Among other things, the analysis suggests three possible areas in which that could be done: (i) the design and implementation of public policies; (ii) the promotion of public-private projects; and (iii) the strengthening of public governance. OVE recognizes that the Bank's work is subject to agreement by the country, and that flexibility will need to be maintained in relation to the use of specific instruments, which will arise from the programming dialogue.

On this basis, OVE puts forward the following recommendations.

- **Recommendation 1: Strive to deepen the Bank's support for the dialogue on the formulation and implementation of public policies, potentially including the fiscal, innovation, and local productive development domains.** The Bank could intensify its current support for the public policy dialogue. Depending on the interest expressed by the country, the Bank could provide support by using tools such as dialogue roundtables, interaction with presidential councils, and technical work with the Legislative Assembly. This should also include exploring with the government the possible use of policy-based loans, while continuing to meet the country's investment needs.

- **Recommendation 2: Support the country in seeking alternatives for attracting private investment through public-private partnerships, particularly in infrastructure.** Although the recent experience of concessions in Costa Rica has been uneven, the IDB Group has played a positive role in putting these processes back on track. OVE believes the IDB Group could draw on its experience to help overcome the poor reputation that concessions currently suffer from. This might involve piloting new private participation arrangements; or using agencies specialized in implementing public-private partnerships that are capable of having a demonstration effect.

- **Recommendation 3: Help the country strengthen public governance capacities, particularly in areas related to project execution, procurement, and e-government.** The Bank could help the country extend successful schemes deriving from the execution of its own projects to the rest of the public administration, including at the subnational level. For example, the use of programmatic schemes could be strengthened by targeting them on the consolidation of best practices. These practices could serve as a model for subsequent phases in which they will be applied to an increasing share of the public investment program. Similarly, support could be provided for the use of technological tools such as an effective public procurement system, or the extension of e-government initiatives to other areas of the public administration.

There are factors that undermine its competitiveness, such as the weakness of the road network and ports, the high level of bureaucracy, and public finance deficits that skew access to credit.

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1 Context of the 2011-2014 Country Program

Costa Rica is noted for its dedication to guaranteeing its citizens' welfare and its open economy. It was the first country in Latin America to set up a universal social welfare system and has one of the longest life expectancies at 79.4 years. Education has also been a priority[1], creating a comparative advantage that helped attract over 200 foreign, mostly technology-based, companies. Costa Rica is also one of the countries with the largest number of trade agreements.

Up to 2008, Costa Rica grew faster than most countries in the region. After the debt crisis of 1982, real per capita gross domestic product (GDP) grew at 2.5% per year between 1983 and 2008, outpacing the Latin American average. This expansion was driven by a reform process that promoted foreign direct investment (FDI) and exports, which rose from average levels of 1.5% and 30% of GDP in the 1980s to 4.7% and 45% of GDP between 2000 and 2008, respectively. Today Costa Rica has a per capita GDP of about US$10,000 at current prices, which ranks it among middle-income countries; but it still faces challenges in the fiscal, public governance, productive, and social areas, as described below.

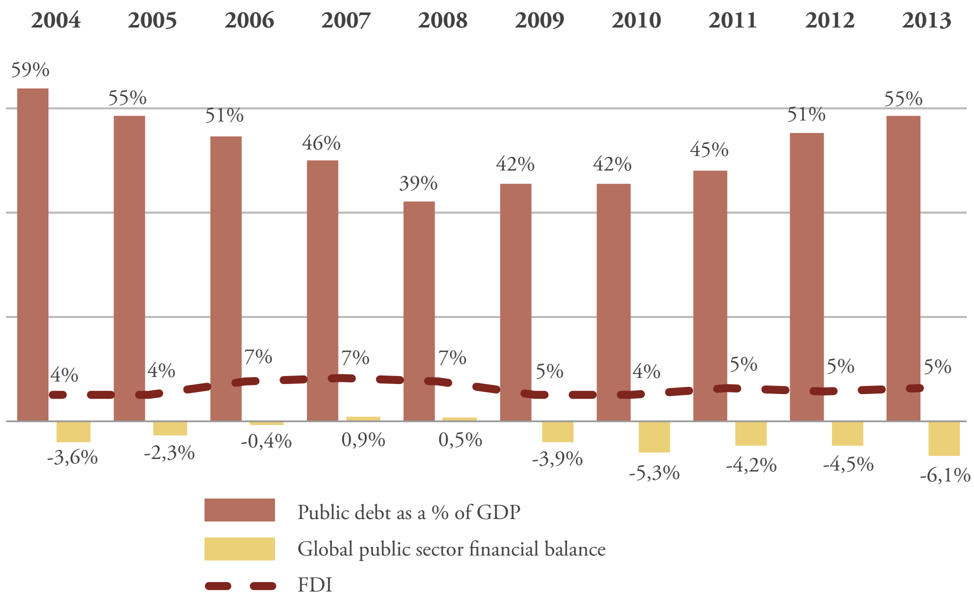
A. Macroeconomic situation

Costa Rica has successfully mitigated the effects of the 2008 global financial crisis. Economic growth averaging 6.7% in the five years leading up to the crisis, together with a significant improvement in public finances, created ample space for the government to adopt countercyclical fiscal measures that cushioned the impact of the crisis.[2] In fact, after a slowdown in 2008-2009, growth rebounded to 4.2% per year between 2010 and 2013. This also helped to curb inflation, which has stayed around 4.5% since 2009 after averaging 13% between 1983 and 2008.

FIGURE 1.1

Public debt. Deficit and FDI as percentage of GDP

Source: National Bank of Costa Rica (BNCR).



Nonetheless, the deficit caused by the countercyclical measures adopted during the crisis is proving hard to reverse and is putting constant pressure on the public debt. The fact that most of the increase in public spending represented current expenditure[3] generated an overall public deficit equivalent to 6% of GDP in 2013, despite cutbacks in public investment. The process of funding the growing deficit of the nonfinancial public sector has rapidly expanded the public debt, which reached a level of 55% of GDP in 2013. Recent tax reform efforts, aimed at raising revenue, were blocked.

The traditional deficit on the external current account has been financed by government borrowing, private capital flows, and FDI—the future availability of which depends heavily on exogenous factors.[4] Costa Rica relies on imports to satisfy its demand for food and fuel. Following a sharp activity slowdown in the wake of the financial crisis, which reduced the current account deficit, the latter has since grown back to 5.4%.[5] Thus far, this deficit has been more than covered by FDI (around 5% of GDP in the last 10 years), capital flows, and loans to the government.

B. PUBLIC GOVERNANCE

The multiplicity of parties represented in the Legislative Assembly makes it hard to reach agreements and formulate policies. Unresolved public policy issues are often referred to the judiciary. In addition, the numerous administrative controls contribute to complex public governance.[6]

Costa Rica's public finances face challenges on both the income and expenditure sides. Although the net public debt (55% of GDP) remains sustainable, potential ongoing public deficits and interest rate hikes accentuate the challenges that exist in the fiscal area. These include both the equity and effectiveness of tax collection and

the need to improve expenditure quality. Studies on a recent reform project identified opportunities in the areas of value added tax (VAT), income tax, customs and results-based budgeting.

Most local governments suffer from even greater shortcomings in management capacity. Local government budgetary execution over the period 1999-2012 averaged below 70%. Local authorities receive less than 2% of their budget in transfers from the central government; and, except for about 10 of the more developed ones, they have little capacity to generate their own resources. This affects service delivery in rural areas, where roughly 35% of the population still lives, and also in periurban areas with levels of poverty, unemployment and housing shortages.

C. Productive sector

The perception of well-established institutions and confidence in the enforcement of the rules foster a generally favorable investment climate. Costa Rica ranks as the region's third most competitive country—after Chile and Panama—measured by the 2013 2014 Global Competitiveness Index (GCI).[7] Nonetheless, there are factors that undermine its competitiveness, such as the weakness of the road network and ports,[8] the high level of bureaucracy, and public finance deficits that skew access to credit. Moreover, electricity rates in Costa Rica have risen in recent years, whereas rates in other countries have fallen as a result of the use of gas. The increased perception of insecurity is another recent problem, which seems to have gained a new focus.

Market opening, in line with the trade treaties to which Costa Rica is a party, has boosted investment. Over the last decade, the opening up of the telecommunications market has attracted most of the FDI entering the country. Liberalization of the financial sector, albeit with preferences for the public sector in guaranteeing deposits, has also been successful; but other areas such as energy are still subject to restrictions. The country has concluded numerous free trade agreements (FTAs), including the Dominican Republic-Central America-United States Free Trade Agreement (CAFTA-DR), which prompted vigorous investment from the United States in cutting-edge technology; the FTA between Central America and the European Union; the FTA with Colombia, and the FTA with China, which has now been ratified. Costa Rica was invited to join the Pacific Alliance (Chile, Colombia, Mexico, and Peru); and it was working on its accession to the OECD.

Costa Rica has a dual productive fabric with weak linkages. Multinational companies located in duty free zones, with tax benefits and strong institutional support,[9] account for over 90% of industrial and service exports, but do not generate significant direct employment.[10] Other firms (mostly small and medium-sized enterprises – SMEs) operate under normal tax regimes. Linkages are weak, not only with enterprises operating under the duty-free-zone regime,[11] but also with the public sector, which controls key aspects of economic activity but lacks effective regulation that would encourage procurement from SMEs.

Table 1.1: The Costa Rican Electricity Sector

Institutional framework	The Costa Rican Electricity Authority (ICE) is the State-owned electric power and telecommunications company, with 80% of the country's installed capacity. The Public Utilities Regulatory Authority (ARESEP) is institutionally and financially much weaker than the ICE.
Coverage	Costa Rica has the highest electricity coverage in the region (99% in 2013), reaching low-income population groups, but generating challenges in terms of recouping the investment.
Demand	Rapid growth (5.4% a year) requires generating capacity to double every 15 years. Households and services account for over 70% of this demand.
Generation	More than 90% is obtained from renewable sources. Public investment constraints have led the country to partially open the sector to private participation—in 1990 up to 15% of total generating capacity, and in 1995 a further 15% under build, operate, and transfer (BOT) schemes. With support from the Bank, the Central American Electric Interconnection System (SIEPAC) is laying the foundations for a regional market.

Although 95% of firms are SMEs, they generally have low productivity. SMEs—74% of which are microenterprises—account for 30% of GDP and 39% of employment. Nonetheless, only 8.6% of private credit goes to SMEs, even though the overall availability of credit in Costa Rica is better than average for the region: 49% of GDP versus a regional average of 41%. Moreover, SMEs account for just 9% of exports from the manufacturing, commerce and services sectors, and 13% in the case of agricultural goods.

Environmental care is a deeply rooted priority in the country, but generates rising costs. Costa Rica is the only country in the region to have extended its forest cover since 2000; and the National Parks System already covers 25% of the country's land area. Costa Rica is now pursuing a zero carbon target by 2021. Despite these achievements, environmental permits are increasingly cited as obstacles to public and private works. Although the country has almost 100% coverage of water supply, 80% of the population still uses septic tanks—in fact just 3% of wastewater connections go to a treatment plant, and this has repercussions for the quality of water bodies.

D. Human capital and the labor market

Education and health levels are among the highest in the region, although there are challenges in terms of quality and sustainability. Costa Rica has achieved universal primary education, but its average of just 9.2 years of schooling reflects a high

secondary-school dropout rate and challenges in terms of educational quality. The number of universities has grown exponentially (from seven in 1983 to about 60 in 2013); but there are doubts as to their quality. Health indicators display high relative levels, but the public delivery system—based on the Costa Rica Social Security Administration (CCSS)—faces operational and sustainability challenges.[12] In addition, Costa Rica provides social services to over 500,000 migrants, mostly from Nicaragua, which raises systemic costs.

Access to employment poses increasing challenges, partly owing to its disconnect with the education system. Unemployment rose in the wake of the 2008 crisis, attaining 8.5% of the EAP in 2013. This mostly affects young people, a large proportion of whom has not completed high school. This group is in addition to the generation of students who interrupted their schooling during the 1980s crisis. The number of science, technology, and engineering graduates is insufficient to meet the demand from companies in the most dynamic sectors of the economy. The National Apprenticeship Institute (INA) has not succeeded in bridging this gap, nor has the shortfall been fully covered by the increasing emphasis of public education toward technical schools offering evening classes.

Table 1.2: Challenges for the development of social programs

Type (% social spending)	Program examples	Key challenges
Universal (55%)	Education and health	Expenditure quality
Selective (10%)	Conditional transfers	Selection/graduation
Restrictive (5%)	Scholarships, INA, *Bono Vivienda* housing subsidy	Equal opportunities
Contributory (30%)	Pensions	System sustainability

Costa Rica is making a major investment in over 30 social programs, but not in a coordinated manner. Social investment represents about 22% of GDP and is channeled through four types of program: universal, selective, restrictive, and contributory. These face challenges of expenditure quality, beneficiary selection and graduation, equal access, and financial sustainability. Strengthening a steering institution that coordinates and systemizes beneficiary data is key.

Poverty has essentially remained stagnant for 20 years, while inequality has worsened. Between 1993 and 2013, non-extreme poverty affected 23.5% of the population (20.5% of households), with extreme poverty afflicting around 6.5%.[13] Meanwhile, the Gini index has increased from 0.470 to 0.518, in contrast to the general trend of declining inequality in Latin America (except in Honduras). This is partly explained by the duality of the Costa Rican economy: inequality increased mainly because the income absorbed by the richest quintile has grown, while people in poverty have failed to integrate into the economy, mostly because of weak jobs.

The Bank's strategy with Costa Rica focused on transportation, energy, citizen security, early childhood development, health and innovation.

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2 The Bank's 2011-2014 Program

This chapter assesses the relevance of the Bank's strategy with Costa Rica and the resulting program. The analysis measures the relative importance to the country of the strategic objectives set, as well as their alignment with the Bank's capacities and their synergy with those of other development actors. It also measures the planned program's degree of alignment with the strategic objectives set out above, and the extent to which the execution of outputs coincided with what was planned, and the reasons for any divergences.

A. Relevance of the strategy

The country based its requirements on the Government Plan, which set priorities for the next four years.[14] In this strategy cycle, the Ministry of Finance decided to hold joint discussions with all multilaterals. The Office of the President of Costa Rica also played a key role in selecting areas for work with the Bank, so the country targeted requests based on a four-pillar Government Plan: (i) Social Welfare; (ii) Citizen Security and Social Peace; (iii) Environment and Land Management; and (iv) Competitiveness and Innovation. Within these pillars, priority was placed on investment to improve security, infrastructure (stressing roads and ports), and the social area (especially in education and preschool care through the *Red de Cuido* care network).

In its 2011-2014 strategy with Costa Rica[15] the Bank identified with most of the pillars of the Government Plan. The Bank's strategy with Costa Rica for 2011-2014 (document GN-2627) was approved in August 2011, and focused on (i) Transportation; (ii) Energy; (iii) Citizen Security; (iv) Early Childhood Development; (v) Health; and (vi) Innovation. The country strategy was aligned directly with three of the four pillars of the Government Plan, while in the fourth pillar, Environment and Land Management, the Bank already had operations with undisbursed balances.

The country strategy seeks to remove the obstacles hindering the country's productivity and growth. In its diagnostic assessment, the country strategy identified five obstacles: *(i) the poor quality of the country's infrastructure, particularly roads; (ii) insufficient investment in innovation; (iii) the need to improve the supply of human capital to meet demand from high-technology sectors, which are the main 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.*[16]

In addition, the country strategy included the areas in which the Bank expected to approve operations in the near future. The areas of energy, early childhood development, and health did not appear as crucial obstacles in the diagnostic assessment; but they were added to the country strategy because, in agreement with the government, future loans were expected to be obtained in those areas. In contrast, "institutional constraints on reforms" (a major obstacle identified by the Bank) was not prioritized as a key area in the strategy.[17]

Table 2.1: Country priorities and country strategy objectives

Challenges identified	Key country strategy obstacles	Govern-ment Plan	Country strategy areas
Infrastructure (roads and ports)	✓	✓	✓
Innovation (and human capital)	✓	✓	✓
Citizen security	✓	✓	✓
Social (schools and the care network)		✓	✓
Infrastructure (energy)			✓
Health			✓
Institutional—reforms	✓		
Environment and land management		✓	

In fact, the presence or otherwise of expected loans seemed to be a decisive factor for specific sectors to be included in the country strategy; so the question arises as to whether the country strategy had an ex ante "guiding" role in the Bank's future work, or whether it served as a justification for a set of anticipated operations. For example, water and sanitation did not form part of the country strategy even though the Bank approved financing in the sector during the months in which the country strategy was being prepared. In contrast, citizen security was included in the strategy. Apart from generating a perception of tighter focus, by avoiding the addition of a new sector to the strategy (water and sanitation); and ensuring support in the country strategy for an anticipated operation (citizen security) which failed only by a few months to gain approval before the country strategy entered into force, OVE did not find any objective justification for why the country strategy treated these two sectors differently, including in the setting of targets.[18]

The country strategy also placed increasing emphasis on areas where the Bank could provide financing for civil works. An analysis of the continuity of objectives of the different country strategies over the last decade reveals the Bank's increasing focus on transportation and energy, as well as some continuity in education, but now also on issues of building-based infrastructure, in line with what has happened in other countries that require legislative ratification.[19] In contrast, public expenditure and macroeconomic management, reform of the State, subnational management, regional integration, reform of the financial sector, tourism, and investment attraction have become less important in the objectives of the successive country strategies. Lastly, the 2011-2014 country strategy introduces new objectives in terms of citizen security, innovation, financial management, and public procurement.

By 2010, the Bank's status as a partner for the country had improved substantially. Between 2002 and 2006 dealings between Costa Rica and the Bank had slowed; but the election of President Arias in 2006 and the change in the Bank's team working on Costa Rica resulted in a steady approximation, in which the Finance Minister took a strong coordinating role in the Bank's activities in the country. By 2010, when President Chinchilla (who had served in the Arias cabinet) took office, the Bank was now perceived as a strong partner that, among other contributions, had supported the country during the 2008 crisis.

Table 2.2: Process of preparing the country strategy with Costa Rica

Start	The process began in late 2009/early 2010. The Regional Manager's Office led a "Diagnostic assessment of bottlenecks for growth" which served as one of the inputs for requesting Policy Notes from the sectors.
Selection of sectors	The Policy Notes fuelled a dialogue with the government. Subsequently, they were evaluated by the Regional Manager based on their potential for resulting in loans, with areas for developing Sector Notes being selected. The Costa Rican government was not actively involved in preparing these notes, but did play an active part in the dialogue.
Inherited portfolio	The guidelines (document GN 2468-6) indicate that this portfolio will be reviewed in the light of the new strategic objectives, but the 2011-2014 country strategy only had a brief annex that did not fully satisfy this requirement.[20]
Costs	In total the country strategy with Costa Rica and its studies involved US$553,148 in wages and US$113,905 in consulting services.

The process of developing the country strategy itself, and the flexibility demonstrated by the Bank in justifying the importance of the areas where approvals were expected, helped revive the Bank's relationship in the country. Table 2.2 shows key points in

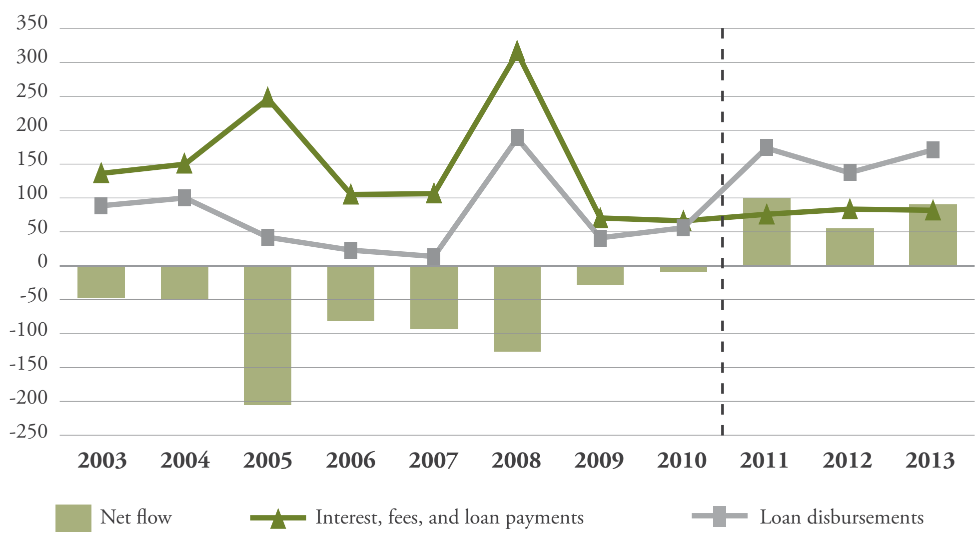
the process of preparing the country strategy in Costa Rica. The dialogue with the country revolved around sector analyses where, according to Bank participants, one of the key incentives was to justify a claim to financial space within the future country strategy. The simultaneous preparation of the technical notes and the possibility of finding spaces for loans helped the Bank to focus on areas with more project potential in the short-term. This, supported by fluid dialogue with the government, enabled the Bank enhance its status as a partner of Costa Rica.

The country strategy estimated an SG lending program of US$1.06 billion for the period—of which 93% has already been taken up by the approval of five loans. The country strategy defined two scenarios: a baseline of US$710 million for the period, triggered if the country could not improve its fiscal situation;[21] and a high scenario of US$1.06 billion.' Although the borrowing level approached the trigger for the baseline scenario, the Bank performed annual debt sustainability analyses and continued operating under the high scenario. One loan absorbing 12% of that scenario was approved in 2011, together with three for 43% in 2012, and another for 38% in 2013.[22] At the time of this evaluation, there were no SG approvals in 2014.

Net cash flow has been positive for the country since 2011, after years of negative flows. Between 2011 and 2014, a total of US$788 million was disbursed to Costa Rica;[23] but, prior to 2010, the country's annual payments had outstripped disbursements, until the situation was reversed in 2011. Disbursements were partly channeled through the inherited portfolio, which accounted for 55% of total funds released in the period. In fact, two inherited loans—the First Electrical Development Program of 2007 and the First Road Infrastructure Program of 2008—jointly accounted for 40% of total disbursements.[24] Apart from transportation and energy, NSG operations in the financial sector also generated a high rate of disbursements; and these three sectors jointly accounted for 90% of funds disbursed.

FIGURE 2.1

Cash flow - Costa Rica 2003-2013 (US$ million)



Nonetheless, programming flexibility led to certain strategic design issues not being formalized, which meant that the country strategy lost the capacity to "guide the decision-making process."[25] For example, the active inherited portfolio was not prioritized in the light of the new objectives; and a varied portfolio, mostly approved during the previous two strategy cycles, continued to be executed, which meant that the programming lost focus and sequencing. Also no targets were set for the mix of instruments,[26] NSG financing, the use of programmatic schemes,[27] or the use of cofinancing. Although the risks were clearly identified, no specific mitigation measures were incorporated.

The level of programming anticipation, through the annual Country Programming Documents (CPDs), prepared a few months earlier was also relatively low. CPDs were produced each year throughout the period 2011-2014.[28] Although these CPDs were produced in November to estimate loan operations and TCs in Costa Rica for the immediately following calendar year, the CPDs displayed challenges in anticipating the program.[29] In the case of NSG operations, the anticipation rate was 50%, partly owing to the fact that operations anticipated in infrastructure (US$36 million for the Care Network and US$58.8 million for El Chiripa Wind Farm) were not implemented. Moreover, the ICE absorbed more financing than anticipated, whereas the approval of highway projects took two years longer than expected. The rate of anticipation of SG operations was similar (55%), because three operations that had been anticipated were either dropped or postponed.[30] While these divergences from the CPDs demonstrate the Bank's flexibility, they also make its resource planning more difficult.

Table 2.3: Anticipation of operations in the 2011-2014 CPDs

Operations	Total	SG	NSG	TC
Envisaged in CPDs	57	9	12	36
Anticipated and approved	40	5	6	29
Approved but not anticipated	10	2	2	6
% anticipated	70%	55%	50%	81%
% not anticipated	20%	29%	25%	17%

In addition to pursuing the country strategy objectives, the Bank continued to implement a portfolio inherited from previous periods, which enabled it to gain relevance in relation to the country's other needs. The Bank's "strategy" for the period became more relevant in the context of its integration with work that it was already doing (the inherited portfolio), which underscores the importance of a long-term vision. Nonetheless, the 2011-2014 country strategy set 26 goals tailored to the sectors in which approvals were expected (the progress of which is discussed in Chapter III), but lacked mechanisms linking it with the Bank's existing portfolio, through a deliberate quest for continuity. These goals were not reconsidered in the light of the new country strategy, as required by the Country Strategy Guidelines (document GN-2468-6).

As regards other multilaterals, the Central American Bank for Economic Integration (CABEI) operated with a scope similar to that of the IDB, whereas the World Bank focused on higher education and support for natural disaster response. CABEI was the institution with the second broadest scope in Costa Rica, participating in nearly the same sectors as the IDB, in addition to health. The World Bank, seen as more stringent in terms of conditionalities, and which had already suffered setbacks in a major urban development project in the port of Limón and in a health sector reform project, concentrated on higher education, a contingent credit line for natural disaster response, and small-scale interventions in clean energy. Lastly, the Andean Development Corporation (CAF), which is perceived as more expensive but also more flexible, partly owing to its use of country procurement regulations, only participated in a road segment, which was built at a higher per kilometer cost than those of the Bank.

Table 2.4: Multilaterals' activity sectors 2011-2014*

Sector	World Bank	CABEI	CAF	IDB	CR govt.
Transportation		√	√	√	√
Innovation				√	√
Citizen security				√	√
Social investment					√
Energy	√	√		√	
Financial sector		√		√	
Education	√			(√)	
Water and sanitation		√			
Agriculture	√				
Natural disasters	√				
Health		√			
No. of loans	5	24	1	13	-.-
Amounts approved (US$ million)	267	1,499	52	1,448	-.-

Note: (√) Educational infrastructure and the Care Network. * See complement in annex.

B. Program implementation

The portfolio under evaluation consists of 130 operations for US$2.386 billion. This includes both active operations with significant undisbursed balances at 1 January 2011 (inherited portfolio), as well as the operations that were approved during the review period (2011-2014). The country and the Bank continued to

implement 51 operations with large balances which had been approved before 2011; the objectives in these operations mostly corresponded to the two previous strategic planning exercises: the 2003-2005 and 2006-2010 country strategies. At 1 January 2011, these operations had US$900.5 million awaiting disbursement: seven SG loans for US$698.7 million (mainly in transportation and energy), eight NSG loans for US$153 million and 36 TCs for US$48.7 million.[31]

As expected, energy and transportation absorbed two thirds of SG lending in the period 2011-2014, but the other approvals did not fully coincide with the pillars of the country strategy. The two largest approvals during the period were the Transportation Infrastructure Program for US$400 million and the 2012-2016 Electrical Development Program for US$250 million.[32] In addition, three other operations were approved.[33] Of these, the country strategy had envisaged support for citizen security and innovation, but had not anticipated a loan in education, which was only mentioned as a "dialogue area". In contrast, it anticipated support—which did not materialize—in health and early childhood development, where only a few TCs were actually implemented.

The new approvals emphasized the financing of physical works, which faced common problems, irrespective of the sector. Predictably, in the case of transportation and energy loans, the vast majority (94.5% and 93.2%. respectively) of the Bank's financing was allocated to works. But this was also the case in education, in which 92.8% of the funding was used to build schools and sports facilities. Even in the case of citizen security, 60% of Bank funds were spent on the construction of productive units for prison inmates, Civic Centers of Peace, and police stations. All these buildings faced similar problems, including the quality of the feasibility studies, design suitability, environmental management, resettlement, expropriation, procurement, implementation, and technical supervision. Despite being crosscutting challenges, they had not been directly anticipated in the country strategy. For example, the strategy does not make an analysis of the relatively low level of competition between local building contractors.

The high expectations expressed in the country strategy for developing infrastructure with private financing could only be fulfilled in one operation in the energy sector.[34] During the period, US$413.5 million was approved in NSG loans—one in the energy sector and seven to financial entities. This contrasts with the expectation expressed in the country strategy of using private financing to develop the country's infrastructure. During the country strategy period, an innovative operation was approved for US$200 million, combining a loan and guarantee structure, to support the financing of the country's largest hydroelectric project (Reventazón). The remainder (US$213.5 million) was channeled through financial institutions, including Costa Rica's two large public sector banks, to support SME financing and promote foreign trade and mortgage portfolios. These operations with the financial sector were not anticipated in the country strategy, which nonetheless expected

that the private sector would play an important role in filling the infrastructure funding gap in the country, including in the social area, for example by supporting the Care Network.

In addition to the challenges inherent to the execution of physical works, the country strategy identified other key crosscutting challenges in which only limited progress was made. These included the weak "interagency coordination" that persists at the sector level, with overlapping functions and weakness in the "lead institutions."[35] Another unresolved crosscutting challenge identified in the country strategy concerns public procurement. According to the country strategy, the Bank was working to strengthen the institutional capacity of the lead agency for public procurement and the functions of the information system.[36] In practice, two public procurement systems (Mer-Link and Comprared) competed with each other during the period, and no real unification was achieved despite a decree requiring this. The Bank advocated the use of its own procedures for its projects,[37] thereby minimizing its exposure to the problem, but doing little to help resolve it at the country level.

In addition, management capacity challenges affected implementation in most sectors. To address this issue, the Bank designed loans in which about 3% of new SG financing was destined for institutional strengthening, in a context where the Assembly does not favor borrowing in areas unrelated to physical investment. An attempt was made to meet that need with specific TC projects of uncertain continuity. Since 2011, over 60 nonreimbursable TCs have been approved, amounting to US$37.8 million, 9.5% of which were targeted on public governance.[38] In addition, a large proportion of counterpart support took the form of advising and services provided by Country Office staff,[39] but most of these services are not recorded or evaluated. Another way to overcome problems in the design, execution, and supervision is through the funds assigned to Costa Rica in the Action Plan in Group C&D Countries,[40] but these are mostly used to promote projects with the Bank.

In this context, implementation timeframes improved, although they are still long compared to the Bank average. The times taken from approval to the first disbursement improved, from 3.5 years in 2005-2009 to 1.5 years between 2010 to 2014. This was due to the reduction of the time needed for ratification, together with increased concessional support for conditions precedent while the project is still before the Assembly. Nonetheless, the time between approval and parliamentary ratification (15.6 months) remains among the Bank's longest (the average for countries requiring ratification was 6.5 months). The improvement in execution times probably also reflects the greater investment in preparation times, which increased from 16 to 24 months. From the moment of eligibility, Costa Rica remains one of the slowest disbursing countries in the CID region: it takes an estimated 55 months from eligibility to final disbursement (before deadline extensions), compared to a CID average of 43 months.

Furthermore, although several implementation risks were identified in the country strategy, no specific mitigation actions were defined. To address the political risks arising from the delay in parliamentary ratification, the Bank made successful use of dialogue work with the Assembly, although this partly depended on the trust generated by specific Bank staff members.[41] Moreover, while the risk of macroeconomic sustainability was raised as a potential obstacle,[42] no alternatives were defined, apart from promoting the possibility of NSG operations via the ICE. Moreover, specific actions were not defined to mitigate the natural disaster risk identified in the country strategy, particularly their integrated management.[43] Nonetheless, in late 2012, a contingent credit line was obtained to mitigate the ex post effects of natural disasters.[44]

Although not planned in the country strategy, the Bank succeeded in attracting cofinancing. The Bank was able to attract substantial cofinancing from the China Cofinancing Fund (over US$70 million in loans),[45] together with other trust funds administered by the Bank (over US$17.8 million in grants). The country strategy had not anticipated access to certain strategic partners that the Bank could have facilitated through the Office of Outreach and Partnerships. Nonetheless, in practice, this access to key partners did occur on an ad hoc basis and was highly valued by the authorities. In particular, the exchange of officials through the Bank's CT/INTRA program was seen as an attractive option, but not fully utilized.[46]

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The Bank also provided support to the government in setting up a network of nurseries. The consolidation of a Care Network featured prominently in the programs to be implemented by the Chinchilla administration. This was in response to low coverage levels of early childhood education, which forced adults (particularly mothers) to stay at home to look after their children, thereby making it more difficult for them to enter the labor market, which remains a challenge.

3 Effectiveness of the 2011-2014 Program

This chapter analyzes the results of the Bank's program of loans and technical cooperation operations. It is organized in terms of the areas defined as strategic priorities in the 2011-2014 country strategy (Section A) and those not defined as strategy priorities (Section B). Overall, between 2011 and 2014, the Bank financed more than 1,000 outputs distributed across 17 areas of action. These contributed to the achievement of 26 development objectives defined in the country strategy, as well as 341 objectives defined in the projects executed during the period, which were largely inherited from the two previous programming cycles.[47]

A. Results in priority areas of the country strategy

1. Transportation

In keeping with national priorities, the Bank defined strategic goals that included *upgrading transportation infrastructure and strengthening the sector's institutions.* The National Transportation Plan (PNT) 2011-2035 proposed investments amounting to US$58.5 billion in strategic corridors and hubs (ports, airports and border crossings). The PNT sought to enhance inter-modality and efficiency in transporting people and cargo.[48] The Bank supported projects to enhance the quality of the national and cantonal road networks, improve passenger flows through the Juan Santamaria International Airport, and increase execution of the Ministry of Public Works and Transportation (MOPT) - National Roads Council (CONAVI) budget.

The road infrastructure program (CR-L1022), approved in 2008, succeeded in committing most of its resources during 2011-2014, thanks to strong technical support from the Bank channeled through an Infrastructure Technical Unit

(UTIF). The UTIF—endowed with specialized consultants initially funded from nonreimbursable resources—was created in response to a request for support throughout the infrastructure area made by the President of the Nation. However, its current focus is on invigorating the Bank- financed portfolio. Among other things, the UTIF has resolved problems with technical designs, rights of way, relocation of public services, bidding processes and appeals, and works supervision.[49]

Table 3.1: Costa Rica program 2011-2014

	Area	Portfolio under evaluation				Emphasis of IDB work	
		Inherited portfolio (US$ million)	Portfolio approved for 2011-2014 (US$ million)	Loans (#)	TCs* (#)	Disbursements in 2011-2014 (US$ million)	Proposed outputs (#)
Priority areas of the country strategy	Transportation	393.00	458.04	4	16	199.15	173
	Energy	239.79	451.94	4	7	310.80	107
	Citizen security	0.47	132.44	1	1	12.30	27
	Early childhood development	0.00	0.96	0	1	0.96	9
	Health	0.00	3.50	0	4	1.05	13
	Innovation	0.44	35.83	1	9	1.01	40
Non-priority areas of the country strategy	Financial markets	107.33	213.98	13	5	205.62	40
	Education and labor market participation	2.79	169.43	1	9	4.51	101
	Public governance	0.47	3.58	0	8	3.01	66
	Decentralization	31.82	3.12	2	7	29.81	115
	Environment and natural disasters	27.00	3.22	1	11	10.75	116
	Water and sanitation	93.00	0.17	1	2	0.02	36
	Other areas**	4.36	10.02	0	22	9.94	175
	TOTAL	**900.47**	**1,486.24**	**28**	**102**	**788.93**	**1,018**

Note: * TCs: Technical cooperation programs. // ** Other areas in which the Bank operates are: the productive sector, social protection, integration and trade, governance and transparency, and civil society.

In addition to supporting the UTIF almost permanently, the Bank took two important tactical decisions. First, the loan was refocused on a single 51 km stretch (Cañas-Liberia), whose design had been supposedly completed through a grant from the CAF but subsequently required major adjustments. Second, its contracting was divided into three parts— road, bridges and connectors—making it possible to award the work for about half of the budgeted amount, although later extensions ultimately absorbed nearly all of the planned amount. The Bank's regulations played a key role by making it possible to select the lowest bid, which under local rules tended to be excluded on "dumping price" grounds —and to avoid unnecessary bidding requirements that tend to restrict competition.[50]

Transportation – Country strategy objectives

Average International Roughness Index (IRI)	Baseline	4.5	2009
	Target	2.5	2014
	Actual	3.6 - 6.4	2012
Proportion of the network with low impact deflectometer	Baseline	71.5%	2008
	Target	77.5%	2014
	Actual	87.4%	2012
Proportion of the cantonal road network in good condition	Baseline	10.7%	2009
	Target	20.2%	2014
	Actual	35.2%	2012
Passenger waiting time (minutes) at the Juan Santamaria International airport	Baseline	31.7	2009
	Target	25	2014
	Actual	30.41	2012
Proportion of total MOPT-CONAVI budget executed	Baseline	61%	2010
	Target	75%	2014
	Actual	89%	2012

The Cantonal Program Road (CR-L1023), approved just months after CR L1022 as part of the same conditional credit line for investment projects (CCLIP), also had design problems.[51] The cantonal program complemented the road infrastructure program, extending small works to the national level—initially to 25 cantons, but later to more than 80 entities across the entire country as part of the ratification process. The operation had several atypical features. One was the fact that the second part of a CCLIP was approved almost simultaneously, and moreover with weak executing agencies.[52] Another was that the Assembly did not accord the MOPT/National Road Council (CONAVI) the same treatment as it had given the ICE (in which the government only acted as guarantor and not a borrower); so, despite being a CCLIP, the details of the works had to be included in the enabling law, which diminished the programmatic nature of the instrument. With loan disbursement levels of 20%, the operation had to cope with the weakness of many of the local executing agencies, and a lack of interest among the largest municipios.[53]

The Bank also provided technical assistance aimed more at supporting its lending than strengthening the country's sector capacities.[54] Costa Rica faces systemic difficulties in executing works to improve the level of the transportation service.[55] These include interagency coordination; the preinvestment deficit; lack of human capital with capabilities and adequate incentives in sector institutions; weak maintenance by CONAVI, which also heads up execution of new works; and lack of competition among local contractors. Apart from isolated support in developing the Logistics Plan, the Bank's focus was on the loans.[56]

It is too soon to assess the results of this portfolio of projects that are still executing, but the Bank's greatest potential achievement is its possible demonstration effect. The Bank financed an NSG operation in the airport sector. This is significant not only because it involved the San José airport, the busiest airport in a country with major international traffic, but because the Bank helped rekindle a concession in which two concession holders had already failed, thus preventing the discrediting of private concession arrangements from being perpetuated in Costa Rica. In this context, it will also be essential to successfully complete the Cañas-Liberia segment (currently 50% completed), to show that superior quality work—using concrete rather than asphalt—can be completed on time and at reasonable cost.

2. Energy

The strategic objectives focused on the development of installed capacity and the sustainability of the energy matrix. The 2012 2024 Electricity Generation Expansion Plan sought to increase the capacity of power generation from renewable sources and expand Costa Rica's electricity grid system. In keeping with the country's goals, the Bank had defined strategic objectives that included increasing the number of independent power producers, and this was achieved. It also sought, unsuccessfully, to increase the share of power generation based on renewable energy and expand regional energy exchanges.

Energy – Country strategy objectives

Number of private power generation projects	Baseline	25	2009
	Target	29	2014
	Actual	31	2013
Installed capacity of the electric power system (MW)	Baseline	2,412	2009
	Target	2,677	2014
	Actual	2,731	2013
Proportion of generation from renewable sources	Baseline	94.6	2009
	Target	95.6	2014
	Actual	87.3	2013
Proportion of generation from geothermal, solar, wind power, and biomass	Baseline	16.2	2009
	Target	17.5	2014
	Actual	14	2012
Proportion of energy produced placed in the regional electricity market	Baseline	< 1%	2009
	Target	≥ 4%	2014
	Actual	0.17%	2013

During the period, the Bank focused on supporting the ICE investment program. Between 2011 and 2014, the Bank implemented two multipurpose operations for the development of the electricity sector, which pursued general objectives in generation, transmission, control, distribution and marketing (CR L1009 approved in 2007 and CR-L1049 approved in 2012, both under a CCLIP).[57] The second program supported the largest investment in power generation during the period, the Reventazón Hydroelectric Project.[58] The financing scheme chosen by the ICE was a trust fund, following previous experiences with smaller-scale works.[59]

Part of the Bank's support took advantage of the ICE's capacity to borrow without a sovereign guarantee. Alongside CR-L1049, the Bank approved an NSG operation (CR-L1056). Use of the A/B loan structure made it possible to involve institutional investors that do not usually participate in this type of operation. As a result, it was possible to extend the maturity of the debt, which is a priority issue for the ICE. Otherwise, the works are amortized at higher rates and over periods that are much shorter than their useful life. The Bank also contributed its experience on safeguards through two TCs for environmental studies and the preparation of an environmental and social strategy.

The execution of the energy portfolio, which accounted for nearly 40% of disbursements during the period, was based on an ongoing relationship with a capable executing agency. The ICE has a high degree of autonomy on planning and investment issues, with its own sources of funds based on telecommunication and electricity rates, which in turn has enabled it to maintain experienced technical staff. These characteristics, which are unusual in the Costa Rican public sector, enable it to operate more effectively than other institutions in the various project phases. The Bank has assisted the ICE, not only through loans but also with technical assistance, partly helping to consolidate these institutional characteristics.[60]

Despite the progress made, Costa Rica still faces challenges that affect its competitiveness and ability to attract investment. Expected electricity demand will require a doubling of installed capacity every 10 to 15 years; and a major effort is needed to prevent this from being met with nonrenewable resources, or through higher rates. The Bank has worked with the country to diversify the energy matrix through technical cooperation operations and the structuring of new projects in the areas of biomass, hydroelectricity and geothermal power; but those efforts require greater coordination and participation by private capital.

3. Citizen security and violence prevention

In 2008 the government sought and received cooperation from the Bank to respond to rising crime rates and prison overcrowding. Although the 2006-2010 country strategy did not include this area as a priority, the Bank started to prepare an operation in 2008. Subsequently, given the chance to approve an operation during the Chinchilla

administration, the area was included among the priorities of the new country strategy. Accordingly, the 2011-2014 country strategy included the strengthening of State capacities to combat organized crime and common delinquency among its objectives, as well as developing social protection programs to prevent violence and insecurity.

In 2011 the Bank approved loan CR L1031, aimed at increasing police efficacy, reducing crime rates among at-risk youth, and reducing recidivism among persons with a criminal record. As the operation had the support of much of the Assembly, the ratification period was relatively short. The operation was also structured to support a variety of topics of interest to the President, including US$1 million to undertake studies of the Care Network. Apart from physical works, such as social centers and police stations, the loan emphasized prevention actions.

Citizen security – Country strategy objectives

National rate of assaults	Baseline	133.8	2009
	Target	129.8	2014
	Actual	203	2012
Assault rate in the cantons acted on/national rate	Baseline	1.15	2009
	Target	1	2014
	Actual	1	2012
National index of policing quality	Baseline	30.9	2010
	Target	30	2014
	Actual	Survey not conducted	
Rate of juvenile victims in the cantons acted on/national index	Baseline	1.14	2010
	Target	1	2014
	Actual	Survey not conducted	
Recidivism rate in the prisons acted on/national recidivism rate	Baseline	33%	2009
	Target	25%	2014
	Actual	Survey not conducted	

Although the operation displays a low level of progress, security in the country has improved, at least in terms of the homicide rate.[61] Interagency coordination problems in the prison service and changes in key personnel in the executing agency have delayed implementation and were only resolved in early 2014. Moreover, one of the outputs, the National Police Academy, was removed from the project because the country obtained a grant from the Chinese government to finance it. Instead, the aim is to build police stations. In addition, a constitutional ruling changed the scope of the use of electronic bracelets aimed at reducing prison overcrowding. This was partly due to a design flaw in the operation, which did not publicize its purpose as an alternative punishment for minor crimes rather than for the pre- and post-court phases.

4. Early childhood development

The Bank also provided support to the government in setting up a network of nurseries. The consolidation of a Care Network featured prominently in the programs to be implemented by the Chinchilla administration. This was in response to low coverage levels of early childhood education, which forced adults (particularly mothers) to stay at home to look after their children, thereby making it more difficult for them to enter the labor market, which remains a challenge. The Bank aimed to support that child care network—an area in which the country needs to make further progress.[62]

Early childhood development – Country strategy objectives

Proportion of children ages 2 to 6 in the first and second quintiles attending early childhood care and development services	Baseline	19.01%	2009
	Target	28.30%	2014
	Actual	32.10%	2013
Activity rate among 18 45 year-old women with children under 6 from quintiles 1 and 2	Baseline	0.25	2009
	Target	0.29	2014
	Actual	0.26	2013

The Bank provided support through a TC (CR-T1062), included the Care Centers as part of the citizen security project (CR-L1031), and approved an NSG loan that was never used. Technical cooperation operation CR-T1062 aimed to strengthen the institutions involved and define a strategy and management model. In addition, the CR-L1031 operation[63] expanded the scope of the studies and included a number of spaces forming part of the Care Network in the Civic Centers for Peace. In 2012, the Bank approved US$36 million for an NSG operation that was not used owing to delays in its structuring and the related legal framework. In the end, Law 9220 on Early Childhood Care and Development was passed in April 2014.

5. Health

Although Costa Rica enjoys high levels of health, the Bank reiterated the objective of strengthening and expanding the primary hospital care system—albeit with little success, as was the case in the previous country strategy. The country's main objectives during the period involved adjusting to the new epidemiological profile caused by population aging, and improving the quality of health services. Although not specified as such, this responded to a perception of operational deterioration and worries about the sustainability of the Costa Rican Social Security Administration (CCSS), which is the dominant provider of public health services and pensions. Although the IDB—and the World Bank—had worked previously in the health area (CR0144, Health Sector Development Program 2003-2010), giving institutional support to the ministry and attempting to strengthen the CCSS, in 2011-2014 the Bank only managed to approve one regional technical cooperation program.[64]

Health – Country strategy objectives

Percentage of avoidable hospitalizations	Baseline	0.16%	2008
	Target	0.12%	2014
	Actual	0.14%	2012
No. of beds per 1,000 inhabitants	Baseline	1.23	2010
	Target	1.27	2014
	Actual	1.18	2013
Gross mortality rate among patients over 45 during the first 30 days in hospital following a stroke	Baseline	26.50%	2010
	Target	24.90%	2014
	Actual	Data not available	

6. Innovation

As the government had prioritized innovation as a mechanism to drive growth and productivity, the Bank included increasing investment and related human capital as objectives of the country strategy. Working in coordination with the Presidential Council on Competitiveness and Innovation (CPCI), the Bank made headway on the diagnostic assessment with four technical cooperation programs that aimed to support the innovation program, provide training in the areas of innovation and technology transfer, support the national innovation system, and the State of the Nation Report in the science and technology area. The somewhat unambitious targets in the country strategy have been partly met.

Innovation – Country strategy objectives

Increase in public investment in R&D (US$ million)	Baseline	81	2009
	Target	87.48	2014
	Actual	69.8	2012
Private R&D financing (US$ million)	Baseline	35	2009
	Target	40.25	2014
	Actual	80.6	2012
% of national firms investing in ICTs	Baseline	32%	2009
	Target	50%	2014
	Actual	58%	2012

In 2012 the Bank approved the Innovation and Human Capital for Competitiveness Program (CR-L1043) with US$35 million spread over numerous objectives. The operation, which has recently been ratified, seeks to enhance productivity by forming

adequate human capital and by supporting innovation activities in the productive sector, including through financing and seed capital. Although it currently displays a low level of execution, the multitude of needs that the loan aims to address meant that the numbers of scholarships, subsidies, or loans for firms were reduced to such a small scale, on the order of 100 in each case, that it is unlikely to have a sustainable impact at the country level. Moreover, the design envisages a major role for the public sector, among other things as a seed capital investor, in contrast to the relative absence of major private players.[65]

B. Areas not identified as priorities in the country strategy

Although the *financial sector* was not a priority in the country strategy, the Bank channeled a quarter of the lending program to this sector through its private-sector window. Between 2011 and 2014, the IDB approved 13 loans to banks, amounting to over US$200 million. Their objectives were to increase SME access to financing for eco-friendly projects and mortgages. Although the banks provided customer data, it was impossible to verify whether these would have been funded without the Bank's contribution. Nonetheless, there is ample liquidity in the bank market, so funding would not seem to be a key constraint.

Although the country strategy did not prioritize the *education sector*, including it only as a dialogue area,[66] the Bank approved a loan for education infrastructure. The report on the State of Costa Rican Education in 2013 identified enhancing the quality of educational infrastructure as one of the 11 challenges in the education sector,[67] other major challenges being education quality, retention in high school, and the education-employment nexus. The Bank approved one operation (CR-L1053) for US$167.5 million to build 79 schools and 24 cultural and sporting facilities. This would address some 20% of the estimated educational infrastructure deficit. The operation was structured under a trust fund scheme, operating with IDB regulations and procedures.[68]

While improving public governance was also not a priority in the country strategy, specific topics, such as public procurement, were identified. The Bank worked on these issues through specific TC programs and support provided by its fiduciary and procurement specialists.[69] These included attempts to strengthen the National Public Investment System (SNIP) and working on an investment project bank with the Ministry of National Planning and Economic Policy (MIDEPLAN). In addition, support was provided for advisory activities to lay foundations for a tax reform, improve the quality of public expenditure, and upgrade the capacities of the public procurement information system. To date, all TCs are more than 95% disbursed, but this has not yet resulted in sustainable changes.

The Bank supported projects to enhance the quality of the national and cantonal road networks, improve passenger flows through the Juan Santamaria International Airport, and increase execution of the Ministry of Public Works and Transportation (MOPT) - National Roads Council (CONAVI) budget.

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Public governance – Country strategy objectives

Quality and punctuality of annual financial statements	Baseline	C+	2010
	Target	B+	2014
	Actual	PEFA not updated	
Delays and accounting errors reported by the Office of the Comptroller General	Baseline	1340	2010
	Target	0	2014
	Actual	No data	
Proportion of the Bank's loan portfolio using the information system	Baseline	20%	2010
	Target	60%	2014
	Actual	25%	2013

The Bank also provided support on *decentralization* issues, in which the country faces major budgetary capacity and sustainability challenges. Between 2011 and 2014, the Bank completed execution of a cadastre loan (CR0134), which aimed to improve local revenue collection, but has not yet met expectations even though the project has made significant progress in integrating the register and cadastre, and in terms of regularization.[70] The TCs associated with the Program to Implement the External Pillar of the Medium-term Action Plan for Development Effectiveness (PRODEV) also sought to strengthen the management capacity of relatively developed

municipios in the area around San José. Although these tools proved interesting, they were not fully adopted. Nor were they disseminated to the other municipios, partly because the governing entity that encompasses them suffers from institutional weakness and sustainability challenges. In addition, the Bank proceeded with another earlier operation (CR0150)—Sustainable Development Program for the Sixaola River Binational Basin[71]—promoting a local productive development model.

The *environment* was the only pillar of the government plan that the Bank did not adopt in the country strategy, confining itself to completing execution of an earlier loan and TC programs. Operation CR-L1001, of 2006, sought to consolidate tourism in Costa Rica's State-protected Wilderness Areas, as a tool to strengthen their sustainable management. Slow to execute, the operation only affects small infrastructure works within the areas in question, without addressing issues of budgetary sustainability. The TC programs executed in this sector focused on developing issues related to climate change adaptation and managing biodiversity in protected areas.

Lastly, the area of *water and sanitation*—in which Costa Rica lags behind—was excluded from the country strategy at the last moment, because financing had been approved shortly before to support the investment plan of AyA (the State-owned company in the sector). In this area, in 2010 the Bank approved loans amounting to US$93 million for drinking water and sanitation, and in 2012, a US$170,000 TC for the institutional strengthening of AyA. Thus far, the loan has not been disbursed, owing to delays caused mainly by the complexity of the implementation arrangements, partly reflecting the Assembly's lack of confidence, which led it to impose a structure of cross controls.

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Costa Rica has made significant progress that has put it in a privileged position on many fronts. Nonetheless, it faces new challenges stemming from its increasingly dual economy, with an export sector that has few linkages to the rest of the country..

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4 Conclusions and Recommendations

This chapter draws conclusions on the results of the 2011-2014 cycle and makes recommendations to inform the Bank's new strategy with Costa Rica. Despite major accomplishments, Costa Rica has clearly reached a turning point. The country's further development will depend on its ability to address public policy challenges, particularly in the fiscal area; spur its production structure; reduce economic duality; attract sufficient investment, especially in infrastructure; and continue building institutional capacity at all levels of public administration.

A. Conclusions

In the period 2011-2014, the Bank became more selective, which enabled it to consolidate its relationship with the country. The Bank focused on developing its portfolio in three areas: (i) roads—with strong Bank support for implementation; (ii) energy—trusting in the implementation and borrowing capacity of the Costa Rican Electricity Authority (ICE); and (iii) more opportunistically, via financial intermediaries—without a sovereign guarantee. As a result, it more than doubled its financial contribution to Costa Rica, providing it with active support in executing Bank projects. It also played the role of trusted adviser, particularly on infrastructure issues.

This focus, however, has had the undesired cost of hindering the dissemination of "best practices" beyond Bank projects. Even in areas that clearly needed sector review, the Bank financed infrastructure such as school buildings. Similarly, in the road sector, the Bank insisted on promoting the financed works using its own procedures and creating a specific technical unit (UTIF), which, despite its goodwill, faced a workload that prevented greater dissemination of capacities and best practices to the rest of the sector. This focus contrasted with' the work done in previous decades, with more deliberate sector reform efforts.

The dual profile of the Bank's portfolio was accentuated, with investment projects targeting civil works and multiple relatively disperse technical cooperation programs. Given the difficulty of obtaining parliamentary ratification for external borrowing to finance consulting services, over 90% of the Bank's financing was for civil works. These in turn were distributed across the country, apart from the power plants that benefit the entire network, irrespective of their location. The Bank was also successful in attracting over US$30 million in nonreimbursable technical cooperation financing. Nonetheless, most of the TCs in question did little to sustainably improve the country's capacities.

The Bank only played an ad hoc supporting role on policy issues, even though the country still faces major challenges. Costa Rica has made significant progress that has put it in a privileged position on many fronts. Nonetheless, it faces new challenges stemming from its increasingly dual economy, with an export sector that has few linkages to the rest of the country. Tax revenue collection, which is relatively small and suffers from high evasion and exemptions, is not sufficient to finance growing demands for service provision. The corporatist nature of the public sector apparatus conspires against expenditure efficiency, leaving little room for the increasing investment that is needed—which the public sector, given its chronic deficits and rising debt level, can no longer sustain on its own.

This is compounded by clear implementation weakness. Costa Rica lacks an effective public preinvestment system, apart from the investment undertaken by the larger-capacity public enterprises such as the ICE. Project implementation is then hindered by the application of ex ante controls and a shallow pool of suppliers for large-scale public works. Moreover, private participation schemes that included foreign suppliers have lost credibility owing to several recent failures, caused by weak planning, negotiation, and supervision. This weakness is most clearly evident at the local level, where most institutions lack the capacity to articulate local productive development.

B. Recomendations

Based on the analysis undertaken, OVE considers that there are opportunities for the Bank to build on its current work, with a view to broadening the development effectiveness and systemic effects of its relationship with the country. Among other things, the analysis suggests three possible areas in which that could be done: (i) the design and implementation of public policies; (ii) the promotion of public-private projects; and (iii) the strengthening of public governance. OVE recognizes that the Bank's work is subject to agreement by the country, and that flexibility will need to be maintained in relation to the use of specific instruments, which will arise from the programming dialogue. On this basis, OVE puts forward the following recommendations.

- **Recommendation 1:** Strive to deepen the Bank's support for the dialogue on the formulation and implementation of public policies, potentially including the fiscal, innovation, and local productive development domains. The Bank could intensify its current support for the public policy dialogue. Depending on the interest expressed by the country, the Bank could provide support by using tools such as dialogue roundtables, interaction with presidential councils, and technical work with the Legislative Assembly. This should also include exploring with the government the possible use of policy-based loans, while continuing to meet the country's investment needs.

- **Recommendation 2:** Support the country in seeking alternatives for attracting private investment through public-private partnerships, particularly in infrastructure. Although the recent experience of concessions in Costa Rica has been uneven, the IDB Group has played a positive role in putting these processes back on track. OVE believes the IDB Group could draw on its experience to help overcome the poor reputation that concessions currently suffer from. This might involve piloting new private participation arrangements; or using agencies specialized in implementing public-private partnerships that are capable of having a demonstration effect.

- **Recommendation 3:** Help the country strengthen public governance capacities, particularly in areas related to project execution, procurement, and e-government. The Bank could help the country extend successful schemes deriving from the execution of its own projects to the rest of the public administration, including at the subnational level. For example, the use of programmatic schemes could be strengthened by targeting them on the consolidation of best practices. These practices could serve as a model for subsequent phases in which they will be applied to an increasing share of the public investment program. Similarly, support could be provided for the use of technological tools such as an effective public procurement system, or the extension of e-government initiatives to other areas of the public administration.

[1] The Constitution requires the State to spend 8% of GDP per year on education as from 2014.

[2] The primary balance strengthened from close to zero in 2002 to an average surplus in excess of 3% of GDP in 2006-2008.

[3] This stemmed mainly from wage hikes and an increase in the number of public posts. The measures were supported by the IMF as part of the Standby Arrangement.

[4] In September 2014 citing "institutional weakness, as evidenced by continued political obstacles to comprehensive fiscal reform," Moody's downgraded Costa Rica's government bond rating to Ba1 from Baa3, which means that the country loses investment grade status.

[5] This reflects a large trade deficit (averaging an estimated 11.7% of GDP in 2012-2013), partially offset by a substantial surplus on the services account.

[6] The Office of the Comptroller General of the Republic performs ex ante and ex post controls on most procedures. Adapted from the 2011 study conducted by the University of Costa Rica and the Ministry of National Planning and Economic Policy (MIDEPLAN).

[7] Costa Rica was ranked 54th out of 148 countries in the Global Competitiveness Index (GCI).

[8] According to the World Bank's Enterprise Survey (2010), 54% of entrepreneurs interviewed identified transportation as a serious constraint—well above the regional average of 24%.

[9] For example, support from entities of public interest and mixed financing such as the Costa Rican Coalition for Development Initiatives (CINDE) and the Foreign Trade Promotion Agency (PROCOMER).

[10] The Census of Exporters (PROCOMER, 2012) indicates that the export sector employs about 28% of the economically active population (EAP), while activities in duty free zones only occupy around 3% of the workforce.

[11] The global supply policies of multinationals, lack of scale, and the need for certification of local businesses make linkages weak (Economic Commission for Latin America and the Caribbean 2014).

[12] Costa Rica ranked 68th out of 186 countries in the 2014 Human Development Index, dropping six places from 2013, and is below Argentina, Chile, The Bahamas, Panama, Uruguay, and Venezuela.

[13] Poverty, measured by unmet basic needs, did indeed improve. The proportion of households with at least one unmet basic need dropped from 36.1% in 2000 to 24.6% in 2011 (see United Nations Development Programme, 2014).

[14] The country strategy refers to a National Development Plan for 2011-2014. Despite being short-term (four years) this is the longest-term formal planning document currently in force in Costa Rica. In contrast, there is longer-term planning in public enterprises, such as the ICE in the energy and telecommunications sectors.

[15] The Bank's strategy with Costa Rica for 2011-2014 (document GN-2627) was approved in August 2011, effective retroactively as from January 2011.

[16] IDB Country Strategy 2011-2014. Costa Rica. p. 3.

[17] In practice, the Bank provided technical assistance to help Costa Rica overcome specific institutional constraints—e.g. in the fiscal area and improving its "Doing Business" ranking.

[18] Incidentally, while Costa Rica faces major challenges in the sanitation sector, it compares favorably with other countries of the region in the area of citizen security.

[19] The CPE for Paraguay (2009-2013) found that countries that needed legislative approval/ratification tended to have a larger share of their portfolios in infrastructure than the Bank average during the period 2009-2013 (57% vs. 41%). This could be due to a parliamentary bias in favor of infrastructure projects. The need for ratification entails lengthy paperwork and modifications to the projects. In general, parliaments are reluctant to approve borrowing that is unrelated to specific physical works (e.g. to pay for consulting services).

Notes

[20] According to document GN-2468-6, the country strategy "would identify in general terms the need and scope for adjusting the active portfolio towards achievement of the country development objectives set forth in the country strategy. The execution of the portfolio would be assessed from a strategic standpoint [...] seeking to ensure and maximize the development impact of ongoing projects—which [owing to their degree of progress] represent the Bank's major contribution to country development [during the evaluation period].

[21] The baseline trigger was a Public debt/GDP ratio above 53% and that the country did not have a current IMF program.

[22] In 2011, US$132 million was approved in the area of coexistence and citizen security. In 2012, US$250 million was approved in the energy sector, US$167 million in educational infrastructure, and US$35 million for innovation. In 2013, US$400 million was approved for a road transportation operation.

[23] Encompassing the period January to August 2014.

[24] Transportation and energy in general accounted for 62.5% of the total amount disbursed in the period.

[25] This is precisely the key objective of the country strategy, according to Country Strategy Guidelines (document GN-2468-6). Moreover, the design parameters mentioned in this and later paragraphs are considered a requirement of country strategies, according to the same current guidelines (document GN 2468-6).

[26] Although it did not specify a mix of instruments, the country strategy did suggest a preference for investment loans and technical assistance to support them. Although the amount of TC available for the period is not specified ex ante in the country strategy, Costa Rica absorbed more than US$30 million between 2011 and 2014, including regional TCs. Uncertainty about the availability of this support contrasts with the need for them.

[27] The country strategy only opened up the possibility of programmatic schemes to mitigate ratification difficulties but did not set targets. The Bank attempted multistage schemes such as conditional credit lines for investment projects (CCLIPs), but with uneven experience. In energy, the State only served as guarantor of the ICE, so the credit line could be approved simultaneously. In contrast, in transportation, the State acted as borrower, thereby foregoing part of the advantages of a program, because the Assembly had to approve each individual operation.

[28] The CPDs were completed in November 2011 (for the retroactive period Jan-Dec 2011), January 2012 (for 2012), November 2012 (for 2013), and November 2013 (for 2014).

[29] Total operations approved compared to those programmed in the CPDs differs from year to year and according to the type of operation. The TCs generally achieved a higher degree of anticipation. Anticipation for 2011 was 100%, because the CPD for that year was retroactive.

[30] Border Crossings, Geothermal Generation, and Cantonal Network II.

[31] In early 2011 the portfolio contained the following: two operations in the transportation sector dating from 2008, with a balance of US$341 million; one in energy from 2007, with a balance of US$234 million; two operations in water and sanitation from 2004 and 2010, with a balance of US$81 million; one for cadastre modernization from 2000, with US$21 million outstanding; and one in the environment sector from 2006, with US$19 million undisbursed.

[32] The Transportation Infrastructure Program (PIT) (CR-L1032) was approved in 2013 and the Power Sector Development Program (CR-L1049), which includes funding for Reventazón, was approved in 2012.

[33] Construction and equipping of educational infrastructure for US$167 million; Prevention of violence and promotion of social inclusion (CR-L1031) for US$132.4 million; Innovation and human capital for competitiveness (CR-L1043) for US$35 million.

34 The country strategy expected to "facilitate, with private partners, the development of public infrastructure, [leading to] significant growth […] in the non-sovereign guaranteed window." The expectation was that the Bank would be able to provide technical assistance to the country "in using financial approaches that permit the private sector to become involved in financing infrastructure works." In practice, the unexpected failure of several government-promoted concessions made it impossible to accomplish this goal. The country strategy does not mention the Multilateral Investment Fund (MIF) or the Inter-American Investment Corporation (IIC).

35 For example, the 2010 water and sanitation loan has yet to resolve its inefficient institutional arrangement which combines multiple executing agencies with overlapping responsibilities.

36 According to the country strategy, a joint evaluation by the IDB and World Bank identified highly scattered standards, a lack of integration between budgets and contracts, the lack of a single portal containing procurement data, the lack of an accreditation system, and the lack of control systems apart from those designed to optimize costs.

37 The Office of the Comptroller acts as verification body for the projects ex ante, during, and ex post. The Bank uses its own standards thanks to the special laws that authorize its loans, but this arrangement is not always applied exclusively as officials tend also to refer to national regulations.

38 A third of these are regional TCs administered by the Bank. The most important were for integration and trade (20%), followed by transportation (18%), environment and natural disasters (12.3%), public administration (11.9%), and social protection (10.3%). OVE selected for analysis only those regional TCs in which the Country Office played an important role, or those over US$1 million.

39 Including meetings, emails, discussion sessions, missions, or events.

40 Roughly US$200,000 annually in nonreimbursable technical cooperation.

41 Support for strengthening Congress to improve efficiency and facilitate dialogue and consensus-building had been anticipated, but ultimately this did not materialize.

42 According to the country strategy, "[i]n 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."

43 According to the country strategy, "[t]he country is vulnerable to natural disasters, particularly earthquakes. This could pose a risk for macroeconomic stability 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."

44 The Bank interacted with the National Emergency Commission in responding to the effects of an earthquake and a tropical storm that did not cause significant macroeconomic damage. However, that institution was ineligible to receive more support in comprehensive disaster management because of its role in building a border crossing with Nicaragua (not financed by the Bank) which gave rise to public allegations of irregularities.

45 The Transportation Infrastructure Program (CR-L1032) received an additional US$50 million from the China Fund; and a further US$25 million was used from the same fund to support another NSG operation with Banco Nacional.

46 CT/INTRA allocates US$30,000 per year to Costa Rica for travel by staff to and from the country, whereas actual spending on this item has averaged US$42,000 a year.

47 The annex reports the trend of most of these objectives, using data collected by OVE.

48 The PNT, which was developed in 2011 by the Ministry of Public Works and Transportation (MOPT), envisaged an investment rate of about US$1 billion per year until 2018 and about US$3 billion as from 2019. The budget was expected to cover just over 60% of this amount, with the remainder coming from other sources, including external funding.

[49] During the bidding phase, several appeals were made to the bidding documents for the bridges of the Cañas-Liberia segment, which were upheld by the Office of the Comptroller General of the Republic, resulting in an extension of the deadline for receiving bids. In addition, there was no external supervisory structure to review and approve the designs prepared by the contractor.

[50] In fact, at the same time CONAVI awarded a similar segment (Bajos Chilamate-Vuelta de Kooper) under local rules with CAF funding, which resulted in the fourth most expensive bidder gaining the contract, in which the amount bid closely matched the total available budget.

[51] Both linked to the CCLIP (CR-X1007) for US$850 million approved in 2008.

[52] In fact the executing agencies of the two phases were different: CONAVI and MOTP, respectively.

[53] This operation had multiple works designed to improve roads in 25 targeted cantons; but its geographic scope was extended to the whole country during the legislative negotiations for its ratification. As a result, in many cases the amounts reallocated only sufficed for small-scale works that are not of interest to the local authorities. Moreover, the enabling law set restrictions, such as a ban on paving, that are unsuited to urban cantons.

[54] The availability of funds does not seem to be the bottleneck, in view of a new transport infrastructure program approved in 2013 (US$400 million) and the remainder of the CCLIP (about US$490 million, including US$140 million for a second cantonal phase).

[55] The service level of the transportation network is very low, with slow traffic flows, congestion, high vehicle operating costs, and a lack of traffic safety.

[56] For example, a US$100,000 TC programmed for 2012, which in the end was not approved, aimed to support the government in designing a preinvestment fund for technical, economic, and regulatory studies for structuring infrastructure projects (see the 2012 CPD).

[57] The first program is progressing well, with 100% of amounts committed and 74% disbursed.

[58] The Reventazón hydroelectric plant will have a capacity of 305.5 MW, representing about 10% of Costa Rica's total installed capacity. The hydroelectric plant is at an advanced stage of progress (more than 65% complete) and is expected to come on stream in 2016.

[59] One of the main financing objectives of the ICE and the government is to move towards less reliance on SG loans. The ICE has an incentive to seek greater autonomy from the availability of central government fiscal funding, and from possible amendments during the process of legislative approval needed for the SG financing to pass. The government also has incentives to free up fiscal space. The Bank has supported that objective (e.g. through an earlier loan to refinance the ICE's debt and through the institutional strengthening components of previous operations).

[60] Since 1962, when the Bank made its first loan for the Electricity Expansion Program, the ICE has executed about 20 Bank operations. These include Electrical Development II (loan 572/OC-CR, US$82.8 million), which ended in 1999 with resources allocated to investments in geothermal (Miravalles II), hydroelectric (Toro I & II), and transmission and distribution projects; and Electric Power Development III (loan 796/OC CR, US$320 million), which ended in 2006, the main components of which were also projects in hydro (Angostura), wind (Tejona), and geothermal power (Miravalles V), the modernization of Cachi hydroelectric plant, and other transmission and distribution works. While the ICE has worked with other institutions such as the European Investment Bank, the Japan Bank for International Cooperation, and CABEI on specific issues, the IDB has provided continued support.

[61] Thus far, with a level of disbursement of 9%, the only outputs are the construction of a music school in Parque La Libertad and a Civic Center for Peace in Garabito.

[62] Some 144,000 women cannot fully enter the labor market owing to their childcare obligations. In addition 131,000 children ages 6 and under remain poor, with limited access to early childhood education services: only 37% of 3-to-5-year-olds have access to educational services in Costa Rica, compared to 58% regionwide.

[63] Social prevention component targeting at-risk children and youth in critical areas.

64 The US$2 million Mesoamerican Health Initiative 2015 (CR-G1001) sought to strengthen comprehensive sexual and reproductive health services, and improve methods of intervention and coordination of the network of services for adolescents. With disbursements at around 25%, it is too early to assess its results, but this development problem is significant.

65 In fact, the Development Initiatives Coalition of Costa Rica (CINDE), which works with multinational companies based in Costa Rica, currently has a much smaller staff (around 30) than the more than 200 people it originally had. This has impacted its ability to maximize the mutual benefits of working with established companies.

66 "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." Country strategy 2011-2014 (paragraph 3.2).

67 Estimates show that the deficit would be around US$1 billion.

68 The trust, administered by the National Bank of Costa Rica (BNCR), is governed by the Bank's regulations, and only has to follow national administrative procurement principles. Since ratification, the trustee has been working on forming the executing unit and meeting the conditions precedent—a process that has been delayed partly by the BNCR's lack of experience in executing civil works trust funds and also in using the Bank's systems and procedures.

69 These include support for the implementation of International Public Sector Accounting Standards, and support for the Office of the Comptroller General in financial planning and auditing. There has also been slippage recently in the use of the national public procurement information system.

70 In the future, the project can be expected to allow for better land management in three of the four functions (tenure, planning and development) as a result of the integration of the registry, cadastre and geographical institute into a single entity. The planning and development functions (land management) will be also enhanced by the cadastral updating and digital mapping (including the demarcation of areas under special regimes (ABREs). The tenure function (land registration processes) would be streamlined once the SIRI Real Estate Registry Information System is up and running.

71 Its aim is to improve living conditions for the population of the Sixaola river basin (Talamanca canton), through actions in the economic, social, environmental and local management areas that help implement a sustainable development model for it.