ove Office of Evaluation and Oversight

Country Program Evaluation

Costa Rica

2015-2018

IDB | IDB Invest

Office of Evaluation and Oversight
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Washington, D.C. 20577
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RE-535-4
May 2019

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Inter-American Development Bank

IDB Invest

Table of Contents

Preface

As part of its 2018-2019 annual work program, the Office of Evaluation and Oversight (OVE) of the Inter-American Development Bank (IDB) has evaluated the Country Program with Costa Rica 2015-2018. This is OVE's fifth independent evaluation of the Bank's program with Costa Rica. OVE's first Country Program Evaluation (CPE) (RE-277) covered 1990-2001, a period marked by the country's response to the debt crisis of the early 1980s, through an open trade model that resulted in substantial foreign direct investment. The second CPE (RE-325) covered the 2002-2006 period, which began with a slowdown in investment and tourism that was due to exogenous factors, but then continued with a recovery in growth to rates that were high relative to regional averages. The third CPE (RE-377) covered the 2006-2010 period, which was marked by the detrimental effects of the international financial crisis on economic growth and fiscal performance. The fourth CPE (RE-472-3) covered the 2011-2014 period and highlighted Costa Rica's success in increasing per capita income through investments in human capital and an open economy – with strong support by the IDB Group (IDBG).[1] However, that CPE also found that most of the funding was going to civil works, even in areas where sector reform was needed, in part because reaching consensus on such reforms had become more difficult because of political fragmentation and divergent views on the appropriate economic model, such as the affordability of the high level of Costa Rica's social expenditures.

Under the Protocol for CPEs (RE-348-3), the main goal of a CPE is to "provide information on Bank performance at the country level that is credible and useful, and that enables the incorporation of lessons and recommendations that can be used to improve the development effectiveness of the Bank's overall strategy and program of country assistance." This CPE seeks to provide an independent analysis of the relationship of both the IDB and IDB Invest with the country and, in particular, of the relevance and effectiveness of the program, including the financial and nonfinancial products offered by the IDB and IDB Invest during the reporting period.

This evaluation serves as input for the new country strategy (CS) that the IDB and IDB Invest are currently preparing. In 2015, IDB Management developed a new model for country strategy documents (GN-2468-

1 In this document, IDBG refers mainly to the IDB and IDB Invest. IDB Lab (previously the Multilateral Investment Fund – MIF) is addressed as relevant.

9), incorporating changes within the IDBG, such as the private sector merge-out and the update to the Institutional Strategy 2010-2020, with the goal of having results-based programming while ensuring a flexible and programmatic approach to reflect country priorities. In addition to these general principles, the most significant practical effects were to (i) reconsider the formal role and content of the CS to balance the need for strategic selectivity with the inherent nature of the IDBG; (ii) improve strategic selection (areas to be prioritized); (iii) improve synergies between the public and private sector windows of the IDBG; and (iv) simplify the results matrix and strengthen the CS monitoring system. The model also established guidance for the preparation of analytical inputs—including the Country Development Challenges report—to improve dialogue with country governments.

This evaluation follows the methodological guidelines stipulated in the Protocol for CPEs (RE-348-3). It uses diverse sources of information, including interviews with key informants such as current and former government officials, project executing agencies, IDB and IDB Invest sector specialists, international development institutions, and members of academia and civil society who are familiar with the country's development challenges and the different sectors in which the Bank and IDB Invest operate. In addition, the evaluation draws on the Bank's programming and supervision documents, meaning, Progress Monitoring Reports for sovereign-guaranteed (SG) loans and Project Supervision Reports for non-sovereign-guaranteed (NSG) loans. Also used, were its evaluation documents, meaning, Project Completion Reports (PCRs) for SG loans and Expanded Project Supervision Reports (XSRs) for NSG loans. OVE has supplemented the documentary study with analyses of internal and external databases.

The approach paper for this evaluation defined the approach and set out the main evaluation parameters for the CPE. The CPE focuses in particular on the financial and nonfinancial relevance of the CS and country program, the implementation and effectiveness of the program, and its efficiency and sustainability. Because it takes time for results to materialize, the evaluation covers not only operations that were approved during this CPE period, but also a "legacy portfolio" of operations that were approved earlier but were still active during this CPE period and for which the results had not been assessed in the previous CPE period—particularly those that had disbursed in the last two years of the previous CPE period and those for which project evaluations[2] have been completed during the CPE period.[3]

2 Project evaluations also include major external evaluations. OVE also attempted to include projects that should have had PCRs or XSRs during this CPE period.

3 For the Trade Finance Facilitation Program (TFFP), only operations that had activities – approvals, guarantees, or disbursements – during the period were included.

Acknowledgements

This document was prepared by a team consisting of Roland Michelitsch (team leader), Alejandro Soriano, César Bouillon, Horst Wattenbach, Galia Rabchinsky, Nadia Ramirez, Abel Mejia, José Fajgenbaum, María Eugenia Mujica, Claudio Mora-García, Xiomara Rojas-Asqui, and Melanie Putic, under the general supervision of Ivory Yong-Prötzel, OVE Director.

Acronyms and abbreviations

AyA	Costa Rican Water and Sewerage Institute (for its Spanish acronym)
BCCR	Central Bank of Costa Rica (for its Spanish acronym)
BCR	Bank of Costa Rica (for its Spanish acronym)
BNCR	Banco Nacional de Costa Rica (for its Spanish acronym)
BPS	Basis points
CCLIP	Conditional Credit Line for Investment Projects
CID	Central America Country Department
CNE	National Emergency Committee (for its Spanish acronym)
COF	Country Office
CONAVI	National Roads Council (for its Spanish acronym)
CPE	Country Program Evaluation
CS	Country Strategy
E&S	Environmental and social
FI	Financial intermediary
GDP	Gross domestic product
ICE	Costa Rican Electricity Institute (for its Spanish acronym)
IDB(G)	Inter-American Development Bank (Group)
IMF	International Monetary Fund
INA	National Apprenticeship Institute (for its Spanish acronym)
LAC	Latin America and the Caribbean
MIDEPLAN	Ministry of National Planning and Economic Policy (for its Spanish acronym)
NSG	Non-sovereign-guaranteed
OECD	Organisation for Economic Co-operation and Development
OVE	Office of Evaluation and Oversight
PBL	Policy-based loan
PCR	Project Completion Report
PEU	Project-executing unit
PND	National Development Plan (for its Spanish acronym)
PPP	Public-private partnership
SG	Sovereign-guaranteed
SMEs	Small and medium-sized enterprises
SUGEF	Supervisor for Financial Intermediaries (for its Spanish acronym)
TC	Technical cooperation
TFFP	Trade Finance Facilitation Program
XSR	Expanded Supervision Report

Executive Summary

Costa Rica has made notable advances in many areas, but in recent years significant challenges have begun to emerge. Achievements include global environmental leadership, rising per capita incomes and strong human development indicators, and almost universal access to basic services. Challenges include the difficult fiscal situation (which is being addressed through recent reforms), with growing public debt and deteriorating credit ratings, high inequality and a dual economy in which highly productive exporters are insufficiently linked to the local economy, and inefficient provision of public services with high costs and in some areas (e.g., education) weak outcomes. There are also issues related to pollution, waste management, and unplanned urban development.

IDBG's Country Strategy 2015-2018 focused on four areas that were relevant to the country's development needs and priorities: (i) supporting fiscal sustainability and efficient spending; (ii) improving productive infrastructure quality, efficiency, and sustainability (focusing on energy and transport, with water and sanitation as dialogue area); (iii) boosting the competitiveness of small and medium-sized enterprises (SMEs); and (iv) strengthening human capital accumulation.

Approvals during the CS period were less than half those in the previous period and below the approved envelope; they mainly focused on infrastructure (transport and energy). Only four SG loans (US$464 million) were approved, well below the lending envelope (US$736-1031 million) and mostly for transport (US$244 million) and energy (US$200 million). Discussions on a planned policy-based loan (PBL) to strengthen public finances were well advanced, but in the end no PBL was approved, because the needed reforms were only implemented in December 2018. Technical cooperation (TC) operations (32, for US$9.4 million) increased dramatically, resulting in a very high TC/loan ratio (2.7% of total approvals). NSG approvals (US$196.6 million) focused on financial intermediaries (FIs) and support of SMEs.

OVE's analysis included a legacy portfolio – approved earlier but active during this CS-period – that was almost four times the size of approvals in this CS period. IDB focused its attention on improving implementation and increasing disbursements. The SG legacy loans (US$1,737 million) also focused on transport (US$810 million) and energy (US$500 million), but in addition they included about US$300 million for social investment, including health and education. Times for project preparation and implementation in Costa Rica—already extremely long, partly because of the ratification requirement—worsened during this CS period. IDB's country office has worked hard to improve implementation, and despite the lower approval volumes, disbursements remained relatively stable throughout the period and increased in 2018.

Fiscal sustainability and efficient spending were the first priority and IDB's advice was relevant. While the PBL could not proceed, IDB's advice influenced the recently approved reform package. Full implementation of the reform package is essential to address the country's fiscal problems, but additional structural reforms would be needed to address the efficiency of public service provision. As OVE's last CPE already recognized, IDB's overall program should focus more on such reforms.

Infrastructure was the sector with by far the largest volume of IDB's activities. The program was relevant but suffered from many weaknesses and did not sufficiently focus on structural changes for improving competitiveness and efficiency in the provision of services. In general, projects' objectives recognize the need for structural changes and incentives to improve competitiveness and efficiency in the provision of infrastructure services, in line with the IDB strategy, but the progress is modest. Projects suffered from insufficient project preparation, delays, and unit costs higher than the regional average, as well as outdated practices for maintaining public infrastructure, especially in transport. In energy, use of 100% renewable energy was achieved even before the Reventazón project – for which construction cost per installed KW was higher than twice the international average. In transport, the objectives of both the cantonal and national road projects were mostly achieved, but whereas in the former there were promising maintenance pilots, maintenance in the latter is suboptimal. IDBG's CS also included a goal of promoting public-private partnerships (PPPs). While PPPs in airports supported through NSG operations were successful and yielded lessons that could support PPPs in other areas, legal and regulatory reform is needed to improve the enabling environment for PPPs. The projects in environment and natural disaster risk management were small but generally relevant. A legacy loan aimed at enhancing the use of national parks to enhance local economic development could offer valuable lessons. It is too early to fully assess the results of the disaster risk management project, which took relatively long to start disbursing.

Most NSG operations were classified as contributing to **boosting the competitiveness of SMEs**, but IDBG's support did relatively little to create a more level playing field in the financial sector, boost the competitiveness of client companies, and strengthen value chains. In the financial sector, some legacy NSG loans had supported the dominant state-owned banks, but didn't achieve their objectives, whereas loans to other banks and smaller intermediaries had mixed results. Recent changes in regulations that made it more expensive for banks to have foreign exchange loans – along with the depreciation of the colon – led to reduced demand for such loans and increased cancellations. In direct loans to SMEs, the links to improved competitiveness were not always clear, and, lacking a comparative advantage in this area, IDB Invest has appropriately stopped such support to the smallest businesses (Finpyme). While value chain work would conceivably be highly relevant given the dual structure of the economy (with a highly productive export sector that is insufficiently linked to the local sector), this was not a focus of IDBG's strategy; and even where it was a project feature, results were rarely measured. Interviews confirmed that in the past NSG operations had not been fully integrated into the IDBG country strategy and program, but with the increased role of the country representative, efforts were being made to correct this.

In the area of **strengthening human capital accumulation**, operations in the social sector were relevant for the country's needs but suffered from major implementation problems and did not address key structural issues. Legacy loans (related to education and to citizen security and violence prevention) had major implementation difficulties and delays, linked to regulatory, operational, and institutional weaknesses, as well as significantly reduced outputs. Several of the TCs were highly valued by Government counterparts, but a lack of supervision, monitoring, evaluation, and reporting mechanisms hampers the assessment of their effectiveness.

Cross-cutting interventions included institutional strengthening, gender and diversity, environmental issues, and PPPs. Interventions in institutional strengthening were common, usually designed to improve the management of public entities. About a third of projects had gender components, but few addressed diversity. About a quarter of the operations had an explicit environmental component and another 20% some identifiable environmental aspects. While some projects supported PPPs, there was little progress in improving the PPP regulatory framework, as the CS had envisaged.

In light of these findings, OVE offers the following **recommendations** for the IDBG:

1. Engage with the Government to define the best ways to support the country in its efforts to achieve fiscal sustainability by focusing on the full implementation of the fiscal reform and the structural changes needed to increase revenues and the efficiency of public service provision. To that end, IDB should

emphasize in its country strategy discussion support for the implementation of the reform and agree on specific areas of IDB support (e.g., strengthening institutions, financial support, helping to level the playing field between state-owned and private entities to promote competition). Collaboration with other development banks and the IMF would reinforce IDB's efforts. IDB should also consider adding clear measures of improving efficiency of public service provision in its whole product range.

2. Continue to support the country in seeking to attract private investment through PPPs, particularly in infrastructure, and better integrate IDB Invest's operations into the country program. The recommendation on PPPs of OVE's last CPE remains relevant, particularly in light of the limited fiscal space. IDBG has already analyzed the PPP environment in Costa Rica. Depending on the country's priorities, IDB could provide advice on the necessary legal and regulatory changes to improve that environment, strengthening institutions, or putting in place "model" transactions that could be replicated. IDBG should build on the expanded role of the country representative to better integrate IDB Invest's operations into the country program and ensure that the operations address key development needs in the country – such as strengthening value chains, increasing competition in the financial sector, and providing local currency finance.

3. Continue the focus on improved implementation of IDB projects. IDB will need to ensure improved project preparation. It should engage with the Government on how best to shorten delays from the ratification process, or at the very least take the long delays into account in project timelines and design; and ensure that project-executing units have the appropriate expertise and incentives for efficient project implementation. Particularly given the high incidence of TCs in the country program, it will also be essential to introduce a better monitoring system to assess progress with, and results of, TCs.

4. Continue supporting the country in its environmental leadership, while also helping it to address some challenges and efficiency concerns. IDB could consider partnering with the country on initiatives or projects that build on the experience gained in using natural resource capital for sustainable economic development, address the challenges from "brown" development concerns in the traditional sectors of IDB support (sanitation, transport, urban development), and promote the consideration of environmental efficiency and sustainable development in private sector operations.

01

Country Context[1] and Development Challenges

1.1 Costa Rica has a stable political environment, has enjoyed solid growth and moderate inflation, and aspires to join the group of the world's most developed countries. The democracy index ranks Costa Rica second in Latin America and the Caribbean (LAC). Real gross domestic product (GDP) declined by 1% in 2009 during the global financial crisis, then grew by an average of 4.7% from 2010 to 2012 (in line with the average of IDB client countries). While average growth has decreased to 3.4% since then, this rate was above the LAC average. The service sector has accounted for 74% of the GDP growth between 2015 and 2018.[2] Inflation, after averaging over 10% from 2000 to 2009, fell to 5% from 2010 to 2014 and to very low levels since then. The country is in the process of seeking membership in the Organisation for Economic Co-operation and Development (OECD). Recent governance reviews by the OECD have been very favorable but have also highlighted challenges in public administration.

1.2 Over the last decades, Costa Rica has made significant progress in raising per capita incomes and has achieved strong human development indicators, but there are still challenges. Per capita income has grown by 2.7% annually in real terms since 2000, to US$11,631[3] in 2017, making Costa Rica an upper-middle-income country. Costa Rica's Human Development Index places it 6th in LAC and 1st in Central America in 2018. This strong achievement was accompanied by social expenditures that were high (over 20% of GDP) compared to the LAC average. The population's universal access to the health care system has led to outstanding health outcomes, such as high life expectancy (to 80 years) and low child mortality (9.0 per every 1000 births) (at about half of the LAC region (17.7).[4] Yet, as the perception of quality is declining and wait times are growing, patients are increasingly using private insurance policies. In education, the country has achieved essentially universal access to primary and secondary education for both girls and boys, and also very high levels of tertiary enrollment (over 50%). However, retention is a significant challenge, for example, in 2017 desertion rate was 19.2% and 13.6% for 7th and 8th grade respectively.[5] Despite very high expenditures, education outcomes are poor, and the education system is not catering well to the needs of the private sector.

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1 For more details, including references, see the Approach Paper for this CPE (RE-535).

2 The Economist Intelligence Unit, Annual Data, 2018.

3 All amounts in United States dollars (US$), unless clearly denoted as CRC (Costa Rican colones).

4 World Development Indicators, World Bank, 2017.

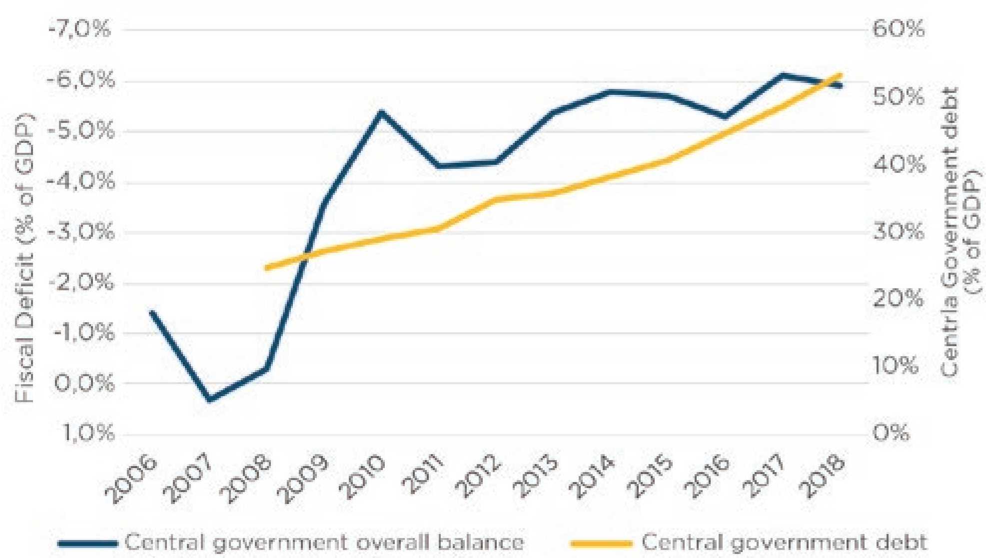
5 Indicators of the Costa Rican Educational System. Ministry of Education of Costa Rica, 2017.

1.3 The fiscal situation has deteriorated significantly in the absence of substantial reforms until 2018. The country had a broadly balanced budget until 2008, but the central Government's overall deficit has increased to an average of over 5% of GDP since 2010 (Figure 1.1), mainly because of an increase in current expenditures. Consequently, the public-debt-to-GDP ratio has more than doubled since 2008, to an estimated 53.5% in 2018. Even after the recently passed fiscal adjustment, the debt ratio will increase further, but peak at 61.5% in 2023.[6] This situation has limited the Government's room to fund much-needed investment.[7] Costa Rica's credit rating has also deteriorated, [8]pecifically because of high debt, the lack of tax reform, and weakening public finances. A more comprehensive reform strategy, including structural reforms, would help improve efficiency of public expenditures.

Figure 1.1

Costa Rica: rising fiscal deficit and debt

Source: International Monetary Fund (IMF) Article IV Staff Consultation Reports and the Central bank of Costa Rica (BCCR).



1.4 Despite improvement, inequality and structural poverty still affect part of the population. The Gini coefficient (0.49 in 2016), shows significant inequality in the country, close to the LAC average (0.48 in 2016). The poverty rate has declined slightly since 2010 but remains at about 20% in 2017 (according to the national definition), and extreme poverty is 5.7%. Poverty particularly affects people in rural areas (24%), as well as women, indigenous people, and people of African descent.

6 IMF, Concluding Statement of a Staff Visit, February 25, 2019.

7 The spread on credit default swaps jumped 63 basis points (bps) in the 4th quarter of 2018, the largest jump for any LAC country. For 2018 as a whole, the spread increased from 155 bps to 400 bps.

8 Standard & Poor's downgraded the long-term ratings from BB to BB- (with negative outlook) in February 2016, and further to B+ (with negative outlook) in December 2018. Moody's downgraded the rating from Ba2 to B1 (with negative outlook) in December 2018. Fitch downgraded the rating from BB to B+ (with negative outlook) in January 2019.

Unemployment, which had been below 5% before the 2008 global financial crisis, has remained high since then, surpassing 10% in 2011 and remaining at 12% in 2018. Female unemployment since the crisis has tended to be about 4 percentage points higher, only 45% of women of working age participate in the labor force compared to 74% of men, and youth unemployment has consistently exceeded 20% since 2010.

1.5 While Costa Rica has assumed a remarkable leadership on green and climate issues, there are challenges in water and air pollution, solid waste management, and urban development. Costa Rica shows a strong track record on many environmental issues such as forest coverage (over 52% of the territory), biodiversity, having 26% of the country under legal protection, and a Government commitment to achieve carbon neutrality (including in the transport sector). At the same time, 25 of the 35 river basins show alarming levels of pollution. The country is also faced with threats from natural disasters inherent to its geographical location, which require disaster preparedness and mitigation efforts. In addition, environmental management challenges must be addressed to prevent negative impacts for residents, ecosystems, and potentially tourism. The challenges with respect to "brown issues" (i.e., related to waste and pollution) include risks to the pollution of surface and groundwater resources, occupation of sensitive environmental areas by the expansion of cities, and agricultural production and waste disposal. For example, Costa Rica has the highest use of pesticides in the world and the 11th highest (and highest in LAC) use of fertilizers.[9]

1.6 Costa Rica's institutions and welfare policy framework have delivered almost universal access to many public services, but quality and efficiency issues need to be addressed. The country has achieved essentially universal access to electricity, even in rural areas, and almost all the electricity is generated from renewable sources – but prices to final consumers are high in comparison to the most efficient markets in LAC and the United States. Costa Rica has also achieved high access to water networks, but coverage with sewerage and wastewater networks is low in comparison to LAC countries at similar income levels: less than a fifth of the population has access to a sewerage system, and only 8% of residential wastewater receives some level of treatment.

9 See Annex VII, Sector Note: Environment and Disaster Risk Management for details.

1.7 Costa Rica has a dense road network but lacks high-capacity highways to improve the productivity of key economic sectors. Costa Rica has one of the densest road networks in LAC, with 83 km of roads for every 100 km2, compared to 45 km for LAC overall. However, Costa Rica's roads are mostly cantonal roads (82% in 2016); the country has only 60 km of high-capacity highways. Transportation time and costs remain an important constraint for Costa Rica's competitiveness, affecting agriculture and tourism, and road quality suffers from low investment in maintenance. There is institutional fragmentation – many agencies are in charge of different parts of the transport sector – also the legal and regulatory framework is complex and inefficient.

1.8 The business environment has been improving, but structural challenges remain. Costa Rica's rank in the Global Competitiveness Index has improved from 54th in 2013/2014 to 47th in 2017/2018 (2nd in LAC, behind only Chile). For Doing Business Costa Rica's rank has improved significantly, from 102nd in 2014 to 61st in 2018. However, a survey conducted for the Global Competitiveness report identified as problematic factors an inefficient Government bureaucracy and an inadequate supply of infrastructure, along with high tax rates, difficulty in accessing financing, and restrictive labor regulations. Areas rated weak in Doing Business include resolving insolvency, enforcing contracts, starting a business, and protecting investors. Another key challenge is Costa Rica's dual economy, with a highly productive export sector operating in free trade zones but not sufficiently integrated, for example through value chains, with the rest of the domestic economy, which continues to suffer from much lower productivity.

1.9 Domestic credit to the private sector has been growing, but publicly owned banks enjoy a commanding share and regulatory preferences. The three largest banks are public, whereas the 12 largest private banks provided less than 33% of credit in 2016. Private banks are required to transfer part of their deposits to public banks, and also are hampered by a lack of deposit insurance, creating an unequal playing field. Several recent changes seek to expand access to credit for SMEs, including the 2015 creation of a second-tier financing mechanism for entrepreneurs and SMEs to which private and public banks have access—the Development Bank System—and the 2016 introduction of a mobile collateral system. However, SMEs still face challenges: credit granting takes up to 20 days, and real interest rates are volatile: -2% in 2007, 13.3% in 2012, and 9.2% in 2017. According to data from the supervisor for financial intermediaries (SUGEF), non-performing loans increased from 1.6% in March 2017 to 2.5% in July 2018 – the highest level since the 2008 crisis.

1.10 Costa Rica faces a challenging environment, both internally and externally. As the last two presidential elections[10] and the country's institutional framework show, political fragmentation adds a layer of complexity for approving and implementing key reforms to address current challenges.[11] Recent labor strikes also illustrate a rising level of confrontation. On the positive side, political forces have manifested their willingness to reach a national agreement. As an important initial step, in December 2018 the legislature passed a fiscal reform package with an estimated yield of 3.5% to 4% of GDP over the medium term. A more comprehensive reform strategy would further strengthen fiscal sustainability,[12] including through a reform of the large number of decentralized and deconcentrated institutions.[13] On the international side, growing trade protectionism among Costa Rica's most important partners, increases in international interest rates, and the massive migration prompted by the conflict in Nicaragua are adding to the economic, social, and fiscal pressures.

10 In 2014, for the first time a third party surprisingly won the elections and had to form a coalition government in the legislative assembly. That party won again in the 2018 elections, again with a minority in the legislative assembly.

11 For example, the 2012 fiscal reform package that was approved by the Legislative Assembly was later invalidated by the Constitutional Court following an injunction filed by a legislator.

12 IMF: Costa Rica: Concluding Statement of a Staff Visit, June 18, 2018.

13 Currently the central Government controls only 40% of the expenditures, as it has little control over the transfers to the deconcentrated (100) and decentralized (35) institutions—a situation that contributes to low spending efficiency. See Macroeconomic and Fiscal Background Note for more detail.

02

Country Development Priorities and the IDBG Program

A. The country's development priorities

2.1 Costa Rica's development priorities for the review period were elaborated in 2014 in the Government's National Development Plan (PND) 2015-2018, "Alberto Cañas Escalante." The plan included a vision of a society that is equitable, based on knowledge, innovation, transparency, and sustainable development. It had three pillars: (i) create the conditions for economic growth, leading to more and better jobs; (ii) reduce inequality and eliminate extreme poverty; and (iii) fight against corruption by strengthening transparency, efficiency, and effectiveness in government. The pillars were underpinned by two cross-cutting themes: promote further citizen participation and ensure local and regional impacts.

2.2 The plan included many thematic priorities and a mandate that it be evaluated in terms of design, processes, and results. The plan identified numerous thematic areas: community development, competitiveness, energy and transport, technological innovation, fishing and tourism, the general well-being of humans and animals, and environmental sustainability. In accordance with the 2000 Political Constitution, the plan was subject to evaluation by the Ministry of Planning and Economic Policy (MIDEPLAN).[14]

2.3 Following elections in 2018, Costa Rica's new Government identified seven priority areas that will influence the next CS: (i) innovation and competitiveness; (ii) infrastructure, mobility, and spatial planning; (iii) security; (iv) health and social security; (v) education for sustainable development and peaceful coexistence; (vi) economic stability and inclusive growth; and (vii) regional development.

2.4 In preparation for the next CS, IDB's recent country dialogue identified some key challenges. During discussions with Government officials in July 2018, IDB identified both significant progress on many fronts and significant challenges. In terms of growth prospects, the challenges included macroeconomic risks (in particular the growing fiscal imbalance), infrastructure and human capital constraints, market failures related to information and coordination, and the high costs of financing. Challenges also included high inequality, high unemployment (especially for youth) and poverty rates, vulnerability to climate change, insufficient investment in innovation, and a deteriorating security situation.[15]

14 National Evaluation Plan (Plan Nacional de Evaluaciones), MIDEPLAN (2016).

15 In conclusion, the challenges were summarized into five areas: (i) improve equity and productivity of human capital; (ii) close productivity gaps and regional differences; (iii) improve infrastructure for improved competitiveness; (iv) strengthen environmental resilience and sustainability; and (v) secure the sustainability of public finances.

B. IDBG's country strategy, 2015-2018

2.5 The CS focused on four broad priorities: (i) supporting fiscal sustainability and efficient spending; (ii) improving productive infrastructure quality, efficiency, and sustainability (focusing on energy and transport, with water and sanitation as a dialogue area); (iii) boosting the competitiveness of SMEs; and (iv) strengthening human capital accumulation. The strategy, approved in late 2015, envisaged two scenarios, with lending envelopes of US$736 and US$1,031 million, respectively. The CS recognized several risks to its implementation: institutional risks, macroeconomic and fiscal risks, and natural disasters.

2.6 The CS objectives were to be supported by cross-cutting interventions and private sector support. The cross-cutting interventions were institutional strengthening, gender equality and diversity, climate change, and environmental sustainability. In addition, the CS recognized the importance of private sector support through its participation in infrastructure. It recognized that this would require improvements in the regulatory framework for PPPs, which the IDBG would support, as well as possible PPPs in social services (education, health, and housing). It also envisaged engaging the private sector in transportation, energy efficiency, green lines, and renewable energy.

2.7 The results matrix included a range of expected outcomes, but no specific targets. Expected outcomes included increased tax revenues and improved efficiency in Government spending, increased coverage and enhanced efficiency of poverty-reduction programs, improved road quality and border crossings, more energy generated from renewable sources, increased revenues to SMEs, increased graduation rates in secondary schools, and improvements in the country's fiduciary and management systems. Some indicators in the results matrix were at such a high level that it was difficult to see how IDBG's country program could affect them; in other cases, the activities and related results indicators arguably did not address some of the key challenges in the sectors.[16]

16 For example, the high cost of energy was also a key issue but was not addressed; and despite the fact that the dominance of state-owned banks is a challenge in the financial sector, the indicator only addressed SME financing by public banks, not by private banks.

C. IDBG's operational portfolio, 2015-2018[17]

2.8 Since January 2015, IDBG has approved a total of US$671.5 million through 63 new operations:[18] four SG loans (US$464 million, most of it for three energy and transport projects); 26 NSG loans and guarantees (US$196.6 million, with 15 operations in financial markets, including 8 in trade finance); and 33 TC operations and grants for US$10.8 million in numerous sectors (reform and modernization of the state, urban sustainability, social investment, environment and natural disasters, science and technology, transport, and others).

2.9 SG approvals from 2015 to 2018 were below the envisaged lending envelope and less than half the amount of those approved from 2011 to 2014. Similarly, NSG approvals during the current CS were about one-third of those approved in the past CS (Table 2.1). SG approvals declined across almost the entire portfolio (in particular, in transport, education, and social investment), in total from US$1,053 to US$475 million. The country's weak fiscal situation contributed to the steep drop, particularly since a PBL being considered in 2016 did not proceed, in part because at that time the country did not implement the required fiscal reforms. Total loan approvals were 37% below the lower end of the envisaged lending envelope. NSG approvals declined from US$461 to US$160 million, mainly because of reduced approvals in FIs and transport. The difficult economic situation also limited demand for NSG operations. However, the decrease was also due in part to new regulations set by SUGEF to reduce systemic risk, which made dollar exposure more expensive for FIs (adding a reserve requirement of 1.5% in 2016) and limited demand for IDB Invest's dollar loans (approvals dropped from US$360 to US$120 million).

17 The strategy period covers also the operations undertaken during the transition period (2014).

18 OVE used September 30, 2018, as the cutoff date for inclusion in the portfolio. After that, two NSG operations were approved (12453-01, US$14 million, and 12274-01, US$12.1 million), as well as two TCs (CR-T1198, US$20,000, and CR-T1159, US$210,000). In addition, IDB Lab approved 13 operations for US$8.5 million during the evaluation period and had a legacy portfolio of 8 operations for US$4.3 million; most of these were for private sector and SME development (11, 52%) and education (3, 14%). See Annex II for more details.

Table 2.1. IDBG approved amount and operations by period

	SG loan		SG grant		SG TC		NSG loan		NSG guarantee		SG+NSG	
	#	Amount (US$M)	#	Amount (US$M)	#	Amount (US$M)	#	Amount (US$M)	#	Amount (US$M)	#	Amount (US$M)
2015-2018	4	464.0	1	1.5	32	9.4	24	193.3	2	3.3	63	671.5
Legacy portfolio	10	1,737.0	1	20.0	12	6.5	26	650.1			49	2,413.5
Total	**14**	**2,201.0**	**2**	**21.5**	**44**	**15.8**	**50**	**843.4**	**2**	**3.3**	**112**	**3,085.0**

Source: OVE's elaboration based on IDBG's databases. Includes the original approved amounts.

2.10 The portfolio under evaluation includes a legacy portfolio of 49 operations for US$2,413.5 million.[19] On the SG side (US$1,763.4 million), this includes mainly loans for infrastructure (transport US$810 million, energy US$500 million, and water and sanitation US$73 million), and social sectors (education US$167.5 million and social investment US$132.4 million), as well as 13 TCs and grants. On the NSG side, it includes 26 loans for US$650 million, again mostly for FIs (US$388.5 million), but also for energy (US$200 million), transport (US$53 million), and corporate loans (US$8.6 million).

2.11 The previous CPE for Costa Rica (RE-472-3) covered the 2011-2014 CS and included three recommendations, which were endorsed by IDB's Board: (i) 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;[20] (ii) support the country in seeking alternatives for attracting private investment through PPPs, particularly in infrastructure; and (iii) help the country strengthen public governance capacities, particularly in areas related to project execution, procurement, and e-government.[21]

19 See Preface for a definition of the legacy portfolio.

20 IDB management partially agreed with this recommendation, citing the importance of also keeping the Bank involved through investment operations.

21 In OVE's latest validation of the implementation of the Action Plan, which, however, is only desk-based, OVE rated the extent to which the action plan addresses recommendations 1 and 2 only "partially" and 3 "substantially", i.e., none was rated "fully" implemented. While the action plan for recommendations 1 and 3 was "on track" in terms of implementation, that for recommendation 2 was not; also, it suffered from a lack of well-defined actions or output targets.

03

Relevance, Implementation, and Sustainability of the Country Program

A. The overall country program

3.1 **Relevance:** Overall, IDBG's CS and the country program were well aligned with the country's own development strategies (as set out in the 2015-2018 PND). IDBG's priorities in the CS (paragraph 2.3 and Table IV.1 in Annex II) were well aligned with the PND, and the older projects with older PNDs (but they remained broadly relevant to date). While naturally the country program did not cover all areas of the PND, it did address a large range of them (the sector notes in Annexes III-X provide additional detail). The CS and country program also addressed the country's main development challenges, as identified by IDB and other institutions.[22] By volume, the IDBG program was particularly aligned with the infrastructure priority, with the competitiveness of SMEs, and – for the legacy portfolio – with strengthening human capital. IDBG's priority to support fiscal sustainability and improved spending efficiency is evidenced by the number of TCs, which provided valuable advice. Other support was not feasible, given that Costa Rica did not implement much-needed reforms until end-2018; as a result, almost no financial resources went to supporting this priority (Table IV.1 in Annex II). The (small) amounts going to operations that were not aligned were mainly concentrated in NSG loans supporting housing finance.[23]

3.2 However, the loan program focused more on addressing specific investment needs than on broader, structural issues. As the previous CPE had already found, IDBG's country program focused relatively more on investment needs than on addressing structural issues. Examples include financing a power plant, rather than addressing the regulatory and competition issues in the sector; financing schools, rather than addressing some of the issues related to high expenditures but weak outcomes; financing banks, including the dominant state-owned banks, rather than addressing the issue of competition and the uneven playing field in the sector. However, several TCs supported strengthening institutions, and TCs in the area of reform and modernization of the state focused on the much-needed reforms to strengthen Government revenue and spending efficiency.

22 For example, in the 2015 Systematic Country Diagnostic (*Costa Rica's Development: From Good to Better*), the World Bank came to similar conclusions on the key challenges, listing – among others – the mounting fiscal pressures; the importance of modernizing the state; growing inequality due in part to the dual economic structure and skills mismatch and high costs (e.g., of labor and electricity and burdensome regulations); an emerging significant infrastructure deficit and the need for greater private participation to fill it; and finally, challenges to sustainability – fiscal, environmental, and social.

23 US$30 million among the 2015-2018 approvals and US$40 million in the legacy portfolio.

3.3 **Instruments:** A shift from loans to TCs, and a focus on implementation. Compared to the previous strategy period, the volume of approvals – mainly in the form of loans – declined significantly. From 2011 to 2014, IDB approved in Costa Rica TCs worth on average 1.7% of the approved loan amounts, approximately in line with the Central America Country Department (CID) (1.9%) and IDB (1.3%). But for 2015-2018, TCs for Costa Rica increased significantly to 2.7% of the approved loan amounts, well above the average in CID (1.0%) and IDB (1.9%). Most TCs approved during the CS period focused on strengthening implementing agencies and improving the implementation of projects.[24] Considering the Government's difficulties to address the strained fiscal situation and implementation problems (discussed below), this appeared to be an appropriate shift on IDB's part, although such a high TC/loan ratio, about 2-3 times the spread on loans (0.8-1.15% during the period), reduces the profitability of the country program for IDB. The one area where instruments are becoming less relevant is NSG credit lines to FIs, given both reduced appetite by FIs to take on foreign exchange loans, and regulatory changes to limit such liabilities.

3.4 The coordination between IDB Invest and the IDB was limited for the evaluation period; however, efforts are being made to create synergies and further integrate IDB Invest operations into the country program. Although in 2016 IDB Invest elaborated a strategic selectivity report, aimed at identifying sectoral gaps and prioritizing areas of intervention where the private sector could be involved in the country program, this document was hardly used as a roadmap for the interventions approved in the country during the period. However, in interviews by OVE, staff from IDB Invest and the Country Office (COF) noted that efforts are being made to create greater synergies between the two arms of the IDBG. For instance, a new version of the strategic selectivity matrix, to be published in 2019, was elaborated with a stronger methodology and is intended to be a guidance document for IDB Invest's future operations. Additionally, IDB Invest is now participating in initial assessments for the CS and in the elaboration of other relevant documents for the country, such as the Country Development Challenges report and Sector Framework Documents.

3.5 Despite the decline in its lending portfolio, IDB was still the main development partner for Costa Rica in terms of loans and TCs. IDB was the international financial institution with the

24 For example, a large share of the funds under the Program for Small and Vulnerable Countries (GN-2616-2), for which Costa Rica is eligible, were used for short-term consulting to improve project preparation or execution (40% of US$1.2 million), followed by project identification and conceptualization studies (28%).

highest amount of approvals for SG loans and for TCs, in both amount and number. From 2015 to 2018, IDB approved a total of four SG loans (for US$464 million) and 35 TCs (for US$11.1 million). During the same period, the World Bank approved only one loan in the health sector, for US$420 million, and one TC. The Central American Bank for Economic Integration approved four loans in agriculture, water and sanitation, and social investment for US$249 million, and JICA approved one loan in the energy sector for US$229 million (Figure II.1, in Annex II).[25] IDB's role was particularly important given the country's low investment in infrastructure and because the Government had not tapped global bond markets since 2015, partly because of the deteriorating credit ratings and increasing spreads.

3.6 Similarly, IDB Invest was the international financial institution with the most NSG approvals during the period (Figure II.2, in Annex II). IDB Invest[26] approved 18 operations for US$160 million, mainly loans to FIs (US$120 million), but also corporate loans and infrastructure projects. The German Investment Corporation approved seven operations (US$148 million), the International Finance Corporation four (US$135 million), the Overseas Private Investment Corporation four (US$110 million), and the Netherlands Development Finance Company three (US$45 million). The loans of other institutions, like IDB Invest's, focus on FIs, often the same entities as IDBG supported, and mainly for the same purposes—support for SMEs and, in some cases, mortgages. There are few international financial institutions providing funds directly to companies in the private sector in Costa Rica or for infrastructure projects.

3.7 Judging from the size and composition of its program and feedback from Government counterparts, IDB was relevant in Costa Rica. Compared to other multilateral development banks, IDB still has a sizable program in Costa Rica—a program that was aligned with the country's development needs and priorities, as expressed in successive PNDs. The feedback from counterparts OVE interviewed was also clearly positive, highlighting especially IDB's technical capacity and its willingness to support the implementing agencies, often with TCs to support project implementation. For instance, counterparts highly praised the IDB's advice in the areas of fiscal sustainability and improving spending efficiency, even if not all of that advice was implemented under the previous Government.

25 The Latin American Development Bank did not approve either SG or NSG operations in Costa Rica during this CS period.

26 IDB Invest in this case refers also to all NSG operations approved by IDB and IIC.

3.8 **Implementation and results:** Compared to the previous CS period, project preparation costs remained stable, but project execution costs increased. The preparation cost per million dollars approved stayed around US$1,450, below the average for Central American countries and the Bank (Table 3.1). The execution costs per million dollars disbursed (about US$11,000) were much higher than for Central American countries and the IDB, but the rate of increase of the costs was much lower (Table 3.2).

Table 3.1. Average cost of preparing investment loans per million dollars approved

Area	2011-2014	2015-2018	% Change
Costa Rica	1,460	1,453	0%
CID	1,959	2,375	21%
IDB	2,954	3,280	11%

Table 3.2. Average cost of executing investment loans per million dollars disbursed

Area	2011-2014	2015-2018	% Change
Costa Rica	10,712	11,339	6%
CID	6,300	9,026	43%
IDB	8,149	9,434	16%

Source: OVE, based on IDB data warehouse. Does not include PBLs and programs.

3.9 The Government's ratification process and weak implementation capacity by executing units led to long delays and low disbursements. Many of the projects with extremely long implementation periods had been approved prior to this CS period, but even projects approved at the beginning of this period still faced similar issues. A Conditional Credit Line for Investment Projects (CCLIP) structure helped to reduce delays for a follow-on project (Cantonal II), since no separate ratification was required.

3.10 Times for project preparation and implementation are very long, in part driven by the ratification requirement (Table 3.3). One of the main challenges in project preparation was the time that investment loans took from identification to approval (427 days) and then from signature to ratification (469 days). These times also increased significantly during this CS period – but this is based on just two operations.[27] Costa Rica is one of the eight countries among IDB's borrowing member countries whose projects financed by multilaterals require legislative ratification, and of the eight, it takes the second-longest time to reach ratification. On average, an investment project takes almost three years from identification to first disbursement (although the number of SG projects in Costa Rica is small). Including legacy operations in OVE's analysis, cumbersome

27 Excluded among Costa Rica's 2015-2018 approvals were one investment grant that does not require ratification and two operations that have not yet been ratified (one of them was approved in 2015, and, if included, it would further increase the average time).

acquisition processes (11/13 projects), weak capacity of the executing agency (7/13), and inadequate project designs (6/13) contributed to the implementation challenges.

Table 3.3. Preparation time: Costa Rica vs. other IDB borrowing member countries that require legislative ratification

Country	Profile to approval (days)		Approval to ratification (days)	
	2011-2014	2015-2018	2011-2014	2015-2018
Costa Rica	**210**	**427**	**308**	**469**
Bolivia	196	286	177	134
Dominican Republic	174	274	319	370
El Salvador	221	142	436	
Haiti	229	391	97	101
Honduras	210	187	151	160
Nicaragua	258	116	126	83
Paraguay	231	255	481	629

Source: OVE, based on IDB Data Warehouse. Number of observations: Costa Rica (2011-2014: 6, 2015-2018: 5, but only 2 ratified projects were included); Bolivia (19, 16); Dominican Republic (12, 6); El Salvador (10, 4); Haiti (32, 13); Honduras (14, 14); Nicaragua (19, 13); Paraguay (15, 13).

3.11 The level of disbursements was higher than in the previous CS, resulting in a positive net flow. Under the base case scenario for the lending envelope,[28] the expected annual approvals and disbursements were set to be US$184 million and US$210 million, respectively. This would have increased the country's debt with the IDB from 1.9% of GDP in 2015 to 2.4% in 2018, and from 14.2% to 14.6% as a proportion of public foreign debt. Annual approvals and disbursements were lower than expected, but disbursed amounts increased compared to the previous CPE.[29] The main factor increasing disbursements was the COF's efforts to strengthen the capacity to implement projects, with measures for each phase of the project cycle and for the institutional environment.[30] Net loan flows[31] to Costa Rica were positive throughout the entire period (Figure 3.1), and the country's debt with IDB increased from 1.4% of GDP in 2015 to 1.7% in 2018.

28 Which assumed no changes in the fiscal path and continuing growth of the central Government's debt.

29 On average, annual disbursements were around US$140 million from 2011 to 2014 and US$192 million from 2015 to 2018, even though loan approvals were well below the expected lending scenario.

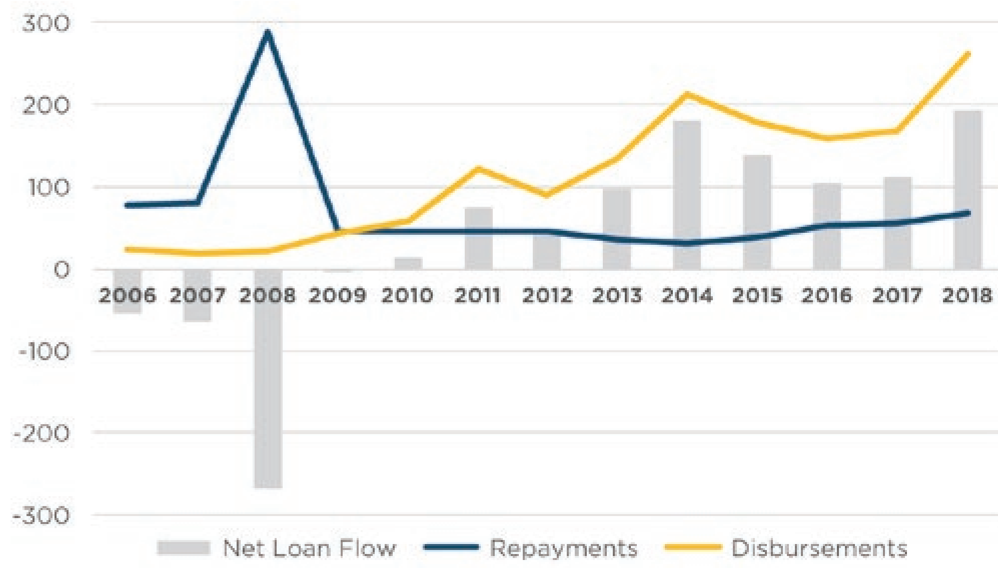
30 IDB (2018). Preparation of a proposal to strengthen the public programs and/or investment projects of public works in Costa Rica (ATN/OC-15916-CR).

31 Disbursements minus repayments.

Figure 3.1

Net SG loan flows, 2006-2018

Source: OVE's elaboration, based on IDBG's databases.



3.12 Sustainability of several projects is in doubt, mainly because of insufficient focus on maintenance and to some extent also shifting government priorities.[32] The most important reason for concerns about sustainability was a lack of focus on maintenance (and sometimes concerns about funding) for several investments in physical infrastructure. Sustainability was also a concern for some TCs that were approved toward the end of the previous Government but were no longer a priority for the new one.

B. Priority 1: supporting fiscal sustainability and efficient spending

3.13 **Relevance:** On the first priority, the IDB provided valuable advice, helping the current Government formulate its fiscal reform, but it did not provide financing. This first strategic objective recognized Costa Rica's most pressing macroeconomic challenge, the fiscal constraints. In this area, IDB supported the Government through four TCs,[33] one legacy operation (strengthening fiscal institutions – CR-T1097) and three operations approved during this CS cycle (Budget for Results – CR-T1127; Technical Support for the Ministry of the Presidency – CR-T1135; and Knowledge Exchange on Electronic Invoicing and Fiscal Risks – CR-T1171). All TCs were aligned with the PND and the country's needs. IDB was also in advanced discussions about a PBL, which would have involved much-needed reforms to strengthen public

32 See sector notes for additional detail.

33 A fifth (legacy) TC under reform of the state, improving the business environment (CR-T1105), was also relevant given the country's needs, but was aligned with improving SME competitiveness.

finances, but this project did not come to fruition as the main fiscal reform was only passed in December 2018. Regarding the expected outcomes, tax revenue increased only slightly from 13.2% to 13.4% of GDP between 2014 and 2017. Lack of information made it impossible for OVE to verify any increase in the efficiency of poverty-reduction programs (Table 3.4).

Table 3.4. Objectives of the CS in supporting fiscal sustainability and spending efficiency

Expected outcomes	Indicators	Baseline	Actual data
Tax revenues increase	Tax revenues over GDP	13.2% of GDP (2014) Ministry of Finance, annual	13.4% of GDP (2017) Ministry of Finance, annual
The efficiency of poverty-reduction programs improves	Fiscal cost of leakage in poverty-reduction programs	0.5% of GDP (2013), Ministry of Finance, annual	N. A.

Source: OVE's elaboration and IDBG's Country Strategy 2015-2018.

3.14 **Implementation and results:** TCs faced implementation challenges, an envisaged PBL did not proceed, and operations in other areas did not focus on structural changes. Many TCs faced implementation challenges (mainly due to personnel changes)[34], and the PBL did not proceed[35], since, while some reforms were passed by the previous government (e.g., judicial pensions), the main fiscal reform was only passed by the current government in December 2018. However, it is important to note that the advice IDB provided in this area in the context of both the TCs and the loan preparation was considered highly relevant and useful by the Government counterparts whom OVE interviewed. In fact, the fiscal reforms that were recently approved by the legislature are in line with that advice. Operations in other areas were focused mainly on physical infrastructure but did relatively little to further structural reforms to improve the efficiency of spending (see sections on infrastructure and social sectors).

3.15 **Fiscal sustainability and efficient spending:** Implementation of the recently passed law on strengthening public finances will be an important step in the right direction, but additional efforts could strengthen efficiency of service provision. There is wide agreement among policymakers and the private sector that the reforms envisaged by the new law[36] are important, but that

34 For more detail see Annex III, Sector Note: Macroeconomy and Fiscal Situation.

35 A project profile paper had been prepared and approved.

36 Reforms include replacing the sales tax with a value-added tax and removing most exemptions, broadening the income tax base, increasing the capital gains tax, reforming the remuneration of public employees, and including the National Apprenticeship Institute (INA, for its Spanish acronym) in the mandated 8% of GDP spending on education. The law also introduces fiscal rules that would impose tighter spending and deficit limits as Government debt increases.

additional reforms—in particular, increasing the efficiency of spending and accountability for results in many areas, including reducing the number of deconcentrated and decentralized public institutions— would be desirable.

C. Priority 2: improving productive infrastructure quality, efficiency, and sustainability

3.16 **Relevance:** Most of IDB's funding was for this area and operations were relevant. The goal of attracting more private investments through PPPs was also relevant. During the current CS cycle, this priority area included five investment loans for US$460.8 million (three SG loans for US$444 million and two NSG loans for US$16.8 million), in particular in transport and energy. Given the long project cycle of infrastructure investments, many projects approved in the previous CS cycle (or some even earlier) were still relevant for achieving this goal. On PPPs, the CS envisaged that the IDBG would "support the country in the institutional strengthening necessary to develop PPPs and in promoting the use of this instrument in specific projects." This goal was also relevant, considering the goals of improving efficiency in service delivery and fiscal sustainability. However, no specific goals related to PPPs were included in the results matrix.

3.17 **Implementation and results:** Overall, the program suffered from many weaknesses – insufficient project preparation, delays and increased costs in implementation, and concerns about maintenance. Details are presented by sector in the following paragraphs, but cross-cutting issues include insufficient project preparation and delays due to long ratification periods, both of which imply subsequent significant changes in project design and result in significant delays and cost overruns. Project implementation units were often weak, and they did not necessarily have the appropriate incentives for efficient project implementation (since their work would end at the end of the project).

3.18 **Sustainability** of public infrastructure is compromised because the procurement and implementation of investments are not guided by efficiency objectives and lack accountability mechanisms for results. Across the infrastructure sectors, there is evidence of a lack of efficiency incentives in Government agencies and in the design of project executing units (PEUs), which compromises the achievement of results and long-term sustainability. In **energy**, the high costs, lack of focus on efficiency, and recent losses of the dominant company, Costa

Rican Electricity Institute (ICE), could affect sustainability. To address these issues, profound changes in the institutional arrangements would likely be necessary. In transport, for the national road network investment, costs per km are very high compared to the regional average;[37] in addition, the fact that maintenance contracts specifying service standards could not be implemented could endanger sustainability. In one of the major roads some problems were already visible after only two years. However, in the cantonal road network, promising pilots were conducted using service standards. In water and sanitation, the benefits of the IDB-financed sanitation project in San José can likely be realized only if there are significant additional long-term investments in the sector, in particular to connect the network being built by the IDB to the treatment plant, and to ensure that households actually connect to the network. This will require careful planning, acquisition of the rights-of-way for the main connectors, and significant additional resources. Focusing only on quickly disbursing the components that IDB can finance now would not result in tangible benefits, and the IDB and the Government will need to develop a realistic plan with clear goals – expressed in how many households or people can be effectively connected to proper treatment. In natural resource management, the project to increase the attractiveness of the protected area system for tourism and private sector development should be sustainable, since it also generates income for the implementing institution. It was reported that, on the basis of the experience with the project, external entities had provided additional investment funding for park infrastructure, but fiscal constraints may constrain future funding from Government entities. Establishing a broader acceptance of the importance of managing protected areas with a focus on use by tourists and seeking investments to strengthen the attractiveness of the large protected areas compared to privately managed natural areas, remain challenging, and alternative budget allocation processes could provide better incentives for park managers to increase the attractiveness of their parks.

3.19 **Energy:** The operations were relevant but did little to address the key structural issues of efficiency and sustainability. Most of the volume for energy operations – two SG loans (CR-L1009 in 2007 and CR-L1049 in 2012) for US$500 million and one NSG loan for US$200 million (CR-L1056) were approved before 2015 – supported mainly the Reventazón power project and came to fruition during this CS period. In 2014, IDB also approved two

37 The average cost per km of asphalt paving for two lanes is US$1.4 million in Costa Rica and US$0.8 million in the region, part of this cost is explained by the cost of living in the country.

TCs for renewable energy.[38] These projects were aligned with the objectives of the Government's previous PND (2011-2014), to increase power supply to keep pace with increasing demand for electricity, using clean and renewable sources.[39] However, as OVE's previous CPE (RE-472-3) pointed out, these projects did little to strengthen the institutional and regulatory framework in the sector, improve efficiency, or promote competition in the market, including by increasing the number of independent power producers, which were also strategic objectives under the previous CS (GN-2627).[40] IDBG's operations also did little to address the high cost of electricity to final consumers, which is an important constraint for private enterprises. During this CS period, in 2015 the IDB approved a Program for Renewable Energy, Transmission and Distribution of Electricity (CR-X1014), and within it a US$200 million SG loan (CR-L1070), but it has not yet disbursed. IDB also approved an NSG loan for US$4.8 million for a biomass cogeneration plant (CR-L1071) and a TC to strengthen ICE's environmental and social management capacity.

3.20 In energy, the main goal of increasing the use of renewable energy for electricity production was achieved even before the IDB-supported project started operations. The CS listed a baseline of 88% renewable energy production for 2014 and a goal to increase renewable energy (but without specific targets).[41] By 2015 – that is, before the IDBG-financed Reventazón project came on stream – electricity production from renewable sources had already reached almost 100%. Part of the reason was that electricity demand projections were very optimistic, since demand has been virtually flat since 2008. In retrospect, the relevance of the Reventazón project was diminished by these optimistic demand assumptions.

Table 3.5. Objectives of the CS in energy

Expected outcomes	Indicators	Base (2014)	Actual Data
More energy is generated from conventional and nonconventional renewable sources	Percentage of renewable energy production	88% renewable, 12% thermal (2014) ICE, annual.	99.7% renewable, 0.3% thermal (2017) *ICE's 2017 Annual Report*

Source: OVE's elaboration and IDBG's Country Strategy 2015-2018.

38 An analysis of options to better manage the incorporation of renewable energy (CR-T1113) and support for the project to develop geothermal energy in Guanacaste (CR-T1117).

39 They followed an even earlier project (Conditional Credit Line for Investment Projects, or CCLIP, CR-X1005) in the sector.

40 The Reventazón project was implemented by the dominant state-owned enterprise ICE.

41 ICE's 2017 Annual Report, however, lists 83.4% for 2013, 79.0% for 2014, 98.7% for 2015, 97.1% for 2016, and 99.1% for 2017.

3.21 IDBG was a key financier of the largest hydro project in Central America, but some development objectives – making ICE independent of public financing and making it a more efficient organization – have not been achieved. SG projects with ICE (CR-L1009 and CR-L1049) for a total of US$500 million, approved in 2007 and partially implemented during 2015-2018, have financed strategic investments in power generation, transmission, and distribution, including 5% of the Reventazón hydropower project. Taking into account financing through both SG and NSG loans, IDBG provided about US$395 million, financing a substantial share of this emblematic project. While these investments have been instrumental in guaranteeing coverage levels and service quality, the other key development objectives of making ICE a more efficient institution that is independent of public financing, and fostering Costa Rica's integration into regional electricity markets, have not been achieved. On the contrary, audited financial statements show that ICE's finances have weakened considerably since 2017. The cost of the Reventazón project (US$4,500 per installed kilowatt) was double the international average, and a special audit in 2018 identified significant weaknesses in the cost and risk assessments;[42] it is also observed that electricity prices to industrial consumers in 2016 were 37% higher than the average in Central America; and Costa Rica's participation in the regional electric market has been less important than that of neighboring countries, despite the investments made by the government.

3.22 In hindsight, the Reventazón hydropower project needed a deeper analysis of the financial feasibility and risks by Costa Rican authorities and investors. The decision to build the Reventazón project in 2007 was taken at a time of high economic growth (6.1%), low fiscal deficit (0.5%), and high growth in electricity demand (5.4%).[43] Even though this favorable condition changed in 2008, Government authorities maintained the decision to implement the project under the assumption that electricity demand would pick up again and would be high for the foreseeable future. International lenders, led by the IDBG, structured project finance to support the project through a trust to lease the assets back to ICE for fixed annual payments. International lenders' economic evaluation of the project was too optimistic: they assumed that the project was justified by replacing thermal power plants, using an oil price of US$100 per

42 Office of the Controller of Costa Rica: Informe de Auditoría de Carácter Especial Acerca de la Gestión del Alcance y los Costos del Proyecto Hidroeléctrico Reventazón. September 21, 2018. However, it is important to point out that ICE appealed this report (LaRepublica.net, September 28, 2018).

43 The expectation was 5.4% growth in demand for the 2005-2009 PND, when the Reventazón project was initially approved, compared to 3.05% actual growth between 2006 and 2010, and 2,02 between 2011 and 2014, accordingly to CENCE data.

barrel, and they also assumed high utilization of the generation capacity of the plant. All risks of the project were allocated to ICE, and ultimately to the Government of Costa Rica as its main shareholder. Initially, the plant's generation capacity was reduced for several months in order to repair the access slabs to the spillway, which required lowering the level of the reservoir.

3.23 Despite ICE's capacity to implement large investment programs and its previous lending experience with the IDB, the projects suffered significant delays. The First Electric Sector Development Program (CR-L1009) suffered initial delays totaling 32 months: 17 for the legislature to approve the guarantee law, and 15 for ICE itself to create a specific management unit for the project and for the elaboration of an action plan to improve corporate governance. The closing date was extended by another 24 months because of delays in construction and installation contracts, as well as issues of land acquisition and local permits. The 2012-2016 Electric Development Program: Reventazón Project (CR-L1049) required only two months because did not need to obtain the legislative ratification, and the project was eligible in one year after it was approved by IDB's Board. However, the implementation of the project has been slower than anticipated because of technical delays in individual contracts and due to reallocation of loan resources; therefore, the closing date has already been extended for two years, to October 2019. Nevertheless, the Reventazón project started almost on time (September 2016 vs. mid-2016 in the original plan), which is attributable to ICE's strong technical and project management capabilities.

3.24 The electricity sector needs substantial policy and institutional reforms to be sustainable. The current electricity sector model has delivered a large development impact to Costa Rica, but major policy and institutional reforms are needed to sustain such gains over time and to address the challenges facing the country. The challenges include a demand that is expected to be flat for the next 10 years; ICE's increasing operational and financial costs; optimum utilization of a generation capacity of 3,530 MW, almost 100% renewable, while the maximum power demand was 1,692 MW in March 2017; increasing generation by independent and small-scale wind and solar generators; development of firm power generation (geothermal) in environmentally sensible areas to stabilize the intermittent generation of wind, solar, and run-of-river hydroelectric projects; and the need for continuing investments in transmission and distribution to maintain and improve the quality and stability of electricity services. These issues were raised in 2016 by Costa Rica's Office of the Controller and by the IDB in 2017, which required the Ministry of Environment and Energy, the Regulatory Authority of Public Services, and ICE to take action within a defined time to start reforming the electricity sector by ensuring that all generation projects are subject to a rigorous analysis to select the most efficient for the national electric system, review and adjust the methodology to estimate electricity demand, and review and modify the methodology to set tariffs.

3.25 **Water and sanitation:** Most projects were legacy operations that are still under implementation. They were aligned with the PND and CS in place at the time and continue to be aligned with the country's development priorities. The 2006-2010 PND prioritized investments in water and sanitation to reduce the country's deficit in treated sewage, which was also repeated in the 2008 National Strategy for Water Resources, which had as one of its main objectives the expansion of the sewage treatment network. IDB's Water and Sanitation Program operation, approved in 2010 (CR-L1024, US$73 million for an investment loan, CR-X1009, US$20 million grant by the Spanish Fund), and two legacy TCs for US$0.4 million were well aligned with that priority, as was a recent TC (CR-T1180) to support the Costa Rican Water and Sewerage Institute (AyA). The low coverage of the sewage network (25.6%), and the even lower percentage with treatment (4.2%), continued to be an issue in the 2015-2018 PND. However, while IDB supported the development of a national water resources management plan, the project itself – expanding the sewage network in San José – was not specifically part of IDB's 2006-2010 CS (GN-2443-1), which was in place when the project was approved, or of subsequent CSs.

3.26 Implementation of the IDB project has been extremely slow, but significant resources are expected to be committed before its close in 2019. At the time of the last monitoring report in March 2018, only 12.6% of the loan and 3.9% of the resources from the Spanish Fund had disbursed. The main reasons for the delays were the complexity of the project (legal, technical, and social), insufficient project preparation, complex organizational structures with two PEUs, and perverse incentives[44] for speedy execution in the PEUs. During the detailed portfolio review in October 2018, IDB and the Government were looking for ways to address implementation issues to speed up the use of funds before the closing date in 2019.

3.27 To date, there are no tangible results from the IDB-financed water and sanitation project, apart from the construction of a small rural system in an indigenous community (Maleku). While

44 Staff in PEUs usually have temporary positions, i.e., they lose their jobs when the project is completed.

significant resources may be used during 2019 because of recent efforts, one concern is that parts of the network being financed by IDB will, at least initially, not be connected to the wastewater treatment plant, since there were problems in obtaining the rights-of-way for the connectors.

3.28 **Transport:** The CS objectives for the transport sector (improving road quality and the efficiency of border posts, Table 3.6) were relevant and supported by a very large investment and TC program. NSG operations supported the use of PPPs in the main country airports. The IDB's financial relevance in the sector has been important,[45] but the CS targets were not attained. This was the sector with the most approvals and disbursements during the period,[46] but projects suffered from delays and maintenance issues. The transport sector portfolio included five investment loans for an amount of over US$1.1 billion (US$865 million legacy and US$257 million approved in this strategy cycle) and six TCs (of which two were legacy operations) for an amount of US$3.3 million (just over US$2 million in legacy operations).[47] The portfolio in execution has three major thrusts: (i) improving the national and cantonal road network, (ii) making border crossings more efficient, and (iii) supporting the airport infrastructure. On improving road quality, several SG legacy operations for a combined US$810 million were still under implementation during this CS cycle.[48] These projects remained aligned with the Government's priorities and with the current CS and were followed up with the Second Cantonal Road Network Program (CR-L1065, 2018, US$144 million). The Border Integration Program (CR-L1066, 2015, US$100 million) was also aligned, but there has been no progress in this area, as no resources have been disbursed. NSG operations supported PPPs in airports, with two legacy operations for the main airports and a follow-on operation during this CS.[49]

45 IDB contributed 13% of the total amount of sectoral financing established in the NDP 2015-2018, remaining the main multilateral financing agency for roads.

46 The analyzed portfolio disbursed US$319 million during the CS period.

47 For more details on the TCs see Annex VI, Sector Note: Transport.

48 First Road Infrastructure Program (CR-L1022, approved in 2008, US$300 million); Transport Infrastructure Program, (CR-L1032, 2013, US$450); and Cantonal Road Network Program (CR-L1023, 2008, US$60 million).

49 The Juan Santamaria International Airport (2009, US$45 million) in San José and Coriport for the Daniel Oduber Quirós Airport in Liberia (2010, US$8 million; with a follow-on operation in 2015, US$12 million).

Table 3.6. Objectives of the CS in transport

Expected outcomes	Indicators	Base (2014)	Actual
Road quality improves	Quality of roads (Global Competitiveness Report)	2.8 rank 119/144	2.7 (2018) rank 124/140
Efficiency of border crossings improves	Maximum freight processing capacity at land border crossings (transportation units/day)	Imports: 362 Exports: 476 Georgia Tech Report (2014): 68	N.A.

Source: OVE's elaboration and IDBG's Country Strategy 2015-2018.

3.29 Most of the disbursements were for the national road network, and – despite implementation delays – the objectives for the first road infrastructure program were mostly achieved. In 2008, IDB approved a CCLIP for the transport infrastructure program (CR-X1007, US$850 million). The first operation under that program was the first road infrastructure program (CR-L1022), mainly to support the widening of the 54-km Cañas-Liberia road, part of the Pacific corridor; this was achieved. In 2013, IDB approved the Infrastructure Transport Program (CR-L1032), to improve road and port infrastructure, which is in its initial stages. The implementation delays were caused mainly by insufficient pre-investment studies and an initially weak implementation unit. There were also concerns about road maintenance, as the Cañas-Liberia road began showing the first signs of deterioration a mere two years after completion, raising concerns about the sustainability. Part of the reason for the maintenance problems was that the envisaged switch to maintenance service contracts was not achieved.

3.30 For the cantonal road network, IDB sought to rehabilitate priority roads and build capacity; after initial slow progress, innovative elements were introduced, and the objectives were broadly achieved. In 2008, the first phase of the cantonal road network program was approved under the CCLIP (US$60 million). The program had significant delays due mainly to the slow ratification process, lack of interest by some municipalities, a lack of project preparation and pipeline, and weak capacities of the municipal PEUs. Nevertheless, the program succeeded in rehabilitating over 430 km of roads and 31 bridge and culvert projects (417 meters). The project also introduced four pilot projects for road maintenance based on service standards with local communities and 41 participative plans for road investments. In 2018, the second phase of the cantonal road network was approved under the CCLIP (US$144 million), but it is not yet ratified; its implementation is expected to take into account the lessons learned under the first phase.

3.31 For the regional integration project, there has been no major progress. Even though the project was approved in 2015, it has not been executed because of two years' delay in ratification, difficulties reaching eligibility related to the trust fund for its operation, legal issues, and lack of dedicated personnel in the PEU. The IDB has supported on fiduciary and socio-environmental issues, on-site visits, facilitating meetings with experts and preparing the implementation proposal.

3.32 Two airports were supported with NSG loans through PPP operations; implementation was successful, yielding potential lessons for PPPs in other sectors. Both projects contributed to significant improvements in service quality and efficiency. Passenger figures increased dramatically,[50] and the Liberia airport appears also to have contributed to improved regional development. In addition, the IDBG successfully supported the implementation of energy efficiency measures in the Liberia airport.

3.33 **Environment and natural disasters:** All four operations (for US$20.6 million) approved during this CS period were relevant in supporting the country's natural disaster response and rehabilitation effort. Between 2015 and 2017, three grant projects[51] responded with a donation of US$200,000 each to agrometeorological events and contributed humanitarian assistance in line with Government requests.[52] In response to the damages to infrastructure caused by tropical storm Nate, in December 2017 IDB approved the first loan to the National Emergency Commission (US$20 million). The funds were to reimburse infrastructure rehabilitation costs covered by implementation partners AyA and the National Roads Council (CONAVI, for its Spanish acronym) in their immediate emergency rehabilitation of roads and water supply systems. All operations were therefore highly relevant for the country and connected well with the cross-cutting environmental issues.

3.34 Two relevant legacy projects (for US$19.2 million), aimed directly at supporting the natural resource sector and addressing disaster risks, were implemented during the CS period. With the loan CR-L1001 (US$19 million, approved in December 2006), IDB financed the development of

50 International passenger arrivals increased between 2014 to 2017 from 1,340,391 to 1,661,897 at the Juan Santa Maria Airport and from 378,485 to 525,661 at the Daniel Oduber Quiros Airport (2017 Statistical Tourism Yearbook).

51 CR-T1137: Tropical Waves; CR-T1161: Hurricane Otto; and CR-T1175: Tropical Storm Nate.

52 They helped provide food, water, and blankets and financed logistical support following the events.

infrastructure in public protected areas and strengthened local and national institutions. The project was aligned to Costa Rica's development needs, in that it supported the protected area administration in strengthening the use of natural resource capital for local economic and private sector development through tourism, and for the generation of additional income for the protected area administration. The loan was highly relevant: it was the first to be implemented with an institution that had traditionally focused almost exclusively on protecting Costa Rica's biodiversity. A small TC (CR-T1103, approved March 2013; US$200,000) was provided through the IDB's financial markets division to support a review of the financial management capacities for natural disaster risks in Costa Rica.

3.35 The legacy loan supporting the protected area system (CR-L1101) was largely implemented during the CS period and reached closure in 2017 with full use of the loan. Implementation of the project was initially very much delayed: it required almost six years to reach eligibility for first disbursement. It initially disbursed slowly, but implementation accelerated after its midterm evaluation and it closed only one year later than the expected implementation period. The project established infrastructure to improve the tourism experience in 11 national parks and by improving park management plans, training staff as well as local counterparts and municipalities. Municipalities received support and priority infrastructure investments, for which the project designed and implemented interventions aligned to priorities at each location. Project activities were coordinated with the Costa Rican Tourism Institute to ensure that the investments would be compatible with their assessment of the use potential and needs for tourism development. The increase in the numbers of registered visitors to the protected area system was in line with expectations at project approval.[53] Implementation of the small TC (CR-T1103, approved March 2013; US$200,000) was considerably delayed, and because of the limited timespan to use the available funds, when the project closed only the first of two components had been implemented, for which a report was provided and discussed with the relevant entities, the Finance Ministry and the National Emergency Committee (CNE). Because of delays in signing the TC agreement and the focus on preparing the implementation of the first component, funds reserved for the second component could eventually not be used.

53 At loan approval (2006), there were 700,000 registered visitors to national parks; when the project reached eligibility (2011) there were 1.1 million; and at project close (2017) there were 2.04 million.

3.36 Loan CR-L1135 has recently disbursed about 90% (work had been carried out earlier), and all three grant projects approved in the CS period were fully disbursed and closed. The small grants (T1137, T1161, and T1175) closed after receiving final reports from the CNE that resources had been used as intended. The fourth project, which was the first loan CNE has ever implemented, had disbursed 90% in December 2018. However, since the IDB loan reimbursed CNE for past works carried out by local implementing partners for rehabilitating damages caused by tropical storm Nate in the roads and water sectors, disbursing later did not hold up the repairs. As reported to the evaluation mission, reviews of the balance of loan funds were ongoing, so that full disbursement of the loan balance was expected during the first quarter of 2019. An exact quantification of results in terms of length of road sections, number of water networks, and estimated final number of beneficiaries will depend on the final list of rehabilitated works being allocated to the IDB loan. In terms of implementation arrangements, it is noteworthy that all rehabilitated road sections are expected to be national roads, as CONAVI is better able to provide the damage assessments, specify works requirements, and issue invoices in line with project requirements, while municipalities usually lack the institutional capacity to meet these requirements.

D. Priority 3: boosting the competitiveness of SMEs

3.37 **Relevance:** Most NSG and some SG operations were classified as contributing to this third priority, which was well aligned with the PND. However, as mentioned in paragraph 3.2, IDBG's support did not enable a more level playing field in the financial sector and did not necessarily help boost the competitiveness of the companies being supported. During the strategy period, of the eight NSG loans going to FIs, seven (US$110 million) had the objective of increasing the share of lending going towards SMEs (as well as loan tenors). Similarly, 16 of the 19 loans from the legacy portfolio (US$293.3 million) included an SME financing component. During the CS period, IDBG supported many types of FIs, including private banks, leasing facilities, and cooperatives. Three of the legacy operations supported the dominant state-owned banks, which already benefit from significant advantages; thus, they were less relevant in terms of supporting greater competition in the financial sector. Additionally, IDBG directly supported SMEs with eight loans for US$13.5 million, most of them part of the Finpyme program and mainly financing working capital; how the loan would help the company to enhance competitiveness was not always clear. Because IDB Invest lacks a comparative advantage in that area, it has since stopped such direct SME support, and is instead focusing on working with intermediaries and bigger companies. Some larger loans highlighted that the clients have linkages to other SMEs, so they could be creating a trickle-down effect, responding to the strategy's objective of incorporating enterprises into value chains, but these results were rarely measured. Other operations—for example, those improving transport and border crossings, or the Program for Innovation and Human Capital for Competitiveness (CR-L1043)—were also relevant for improving SME competitiveness and are covered elsewhere in this CPE.

3.38 **Implementation and results:** The results of NSG operations supporting FIs were mixed: results were generally unsatisfactory for operations with state-owned banks, while operations with private banks and other small FIs had varied results. IDB's loan operations with state-owned banks, part of the legacy portfolio and aimed at increasing their SME portfolios, have not delivered the expected results. Banco de Costa Rica's (BCR) had two operations, one in 2012 and another in 2014, totaling US$32.5 million. From 2012 BCR's SME portfolio contracted from $510 million (12% of their loan portfolio) to US$217.9 (2.7%) in 2016, implying that BCR's priority mainly focused on its capitalization and not on reaching SME beneficiaries. Similarly, an operation with Banco Nacional de Costa Rica (BNCR), another state-owned bank, did not meet its expected objectives, their MSME and women-led MSME portfolios both declined throughout the program. This could be partly explained by changes in the lending priorities of state-owned banks, which actively focused on reducing their risk-weighted lending exposure. However, in 2017 both banks showed growth in their loan portfolios to SMEs, these being the only indicators used by the CS to measure the credit increase for SMEs in the country (Table 3.7). By contrast, the results for operations with private banks and other small FIs that closed during this CS period have been mixed and strongly connected to market conditions and the specialization of each entity; some FIs have managed to increase their SME and/or mortgage portfolios, and at the same time increase the tenor of sub-loans, but part of this may have been attributable to market conditions. As to TFFP lines, their use has been uneven over the years. During 2018 they were not used, in part because of the high market liquidity and the difficulty in meeting certain IDBG requirements for using them (i.e., letters of credit for all sub-loans when many trade operations now operate without them), and their higher rates compared to some competitors.

Table 3.7. Objectives of the CS in boosting the competitiveness of SMEs

Expected outcomes	Indicators	Base (2014)	Actual (2017)
Credit to SMEs rises steadily	Annual growth (Dec.-Dec.) in the portfolio of bank loans to SMEs	BNCR: 1,8% BCR: 6% Bancredito 9,7%; (2014)[a]	BNCR: 9,1% BCR: 8% (2017)[b]

Source: IDB Country Strategy with Costa Rica (2015-2018).
a. In 2017, the Government of Costa Rica closed Bancredito's commercial operations due to its poor financial performance..
b. Only includes 2017 figures. Previous SME portfolio growth for state-owned banks is detailed in p. 3.38

3.39 Operations with corporate clients went mainly to SMEs. Some larger operations had positive development outcomes. Most operations had positive financial results for IDB Invest. In some cases, objectives included improving competitiveness for other SMEs and the creation of value chains, but indicators measuring such objectives were rare, especially for Finpyme operations. Operations approved before 2015 went to relatively larger clients and were able to report somewhat more encouraging development outcomes like savings in utilities (because of LEED certification), job creation, foreign exchange generation, and strengthened value chains.[54] However, intended outcomes such as domestic purchases, export sales, and expenditures in social investments were poorly reported and often not monitored. The nonfinancial additionality provided by IDB Invest during the period, in the form of TCs and seminars on corporate governance, was positive; and in some cases, additional requirements from IDB induced the borrowers to take more measures to ensure the sustainability of the projects and to engage in cross-cutting environmental and gender themes.

3.40 Political challenges and institutional capacity affected the design and execution of loan and TC operations related to innovation. Two TCs approved during the evaluation period[55] were designed are experiencing implementation problems because they were designed according to the priorities of the previous Government, so many of their objectives are no longer a priority and are having to be rethought. Also experiencing implementation problems is the Innovation and Human Capital for Competitiveness Program (CR-L1043), approved for US$35 million in 2012, but not ratified until 17 months later—so that it has been implemented by a Government that was not involved in its design and did not

54 Through the Korea-IIC SME Development Trust Fund, the IIC created the "Programa de Mejora Artesanal 2011-12," tied to the Café Britt operation. The program offered technical assistance to 30 artisans who were potential suppliers of crafts to Café Britt stores. The artisans received training in design methodology, helping them understand the importance of design as a tool to improve the products and to provide innovation.

55 Strengthening of the Presidential Council for Competitiveness and Innovation (CR-T1136) and Support for Digital Transformation Policies for Productivity and Equity (CR-T1184).

consider it a priority. Some of the difficulties encountered during the program's execution have been the low capacity of the PEU, which was understaffed and did not have the proper resources to manage the program (e.g., IT systems, monitoring capacity), and the scant support provided by the Ministry. Most program outputs are well under target; the program is set to expire in 2019 and has disbursed only 38% of its funds;[56] and while there has been high demand for some components, especially scholarships, others are having difficulties attracting applicants that meet the criteria set by the program—for example, the component involving innovation for micro, small, and medium-sized enterprises. Recently, following the change in Government, the program has become a priority for the Ministry of Science, Technology and Telecommunications of Costa Rica, which is talking with the IDB about potentially extending it.

3.41 **Sustainability:** IDB Invest's requirements are seen as a comparative advantage by some, but as a burden by others. IDB Invest typically requires clients to improve their environmental and social (E&S) standards. Some clients appreciated IDB Invest's assistance in these areas and commented that they had incorporated the requirements into their processes. Others, however, considered the reporting requirements a burden and a disadvantage of working with IDB Invest. Limited reporting and follow-up make it difficult to assess achievements in terms of actual E&S improvements. Direct support to SMEs by IDB Invest was not considered sustainable and has been discontinued and replaced by work through intermediaries, following an OVE evaluation.[57] For FI operations, E&S sustainability was in most cases satisfactory, with small E&S risks associated with SME and mortgage financing. However, financial sustainability may be at risk, given BCCR's new regulations on foreign exchange exposure for FIs, requiring additional reserves for dollar loans; these regulations have already been a partial cause for the cancellation of three loans to FIs.

E. Priority 4: strengthening human capital accumulation

3.42 **Relevance:** The program supporting the fourth priority was also aligned with the country's PND and development needs. IDB's TCs in social investment were expected to contribute both to this goal and to the first (fiscal sustainability) through improved efficiency of the programs. Operations in the social sector included nine TCs (US$3.7 million) and one grant (US$1.5

56 Data as of November 2018. For more details see Annex IX, Sector Note: Private Sector and Innovation.

57 *Evaluation of Direct Support to SMEs by the IIC* (CII/RE-23-3), which found that IIC did not have a comparative advantage in directly supporting SMEs versus local FIs.

million) approved during the CS period, and two loans, one for education infrastructure (US$167.5 million) and one for violence prevention and social inclusion (US$132.4 million), and two TCs (US$1.1 million), approved before the CS period. The priority expressed in the PND was to reduce poverty, in particular extreme poverty, by reducing social and regional inequality. IDB's strategic priority of strengthening human capital accumulation is directly associated with poverty reduction in the medium to long term, with a particular focus on increasing the rate of graduation from secondary education and increasing the coverage and efficiency of poverty reduction programs (which also contributes to priority one, fiscal sustainability) (Table 3.8).

Table 3.8. Objectives of the CS in strengthening human capital accumulation

Expected outcomes	Indicators	Base (2014)	Actual
Gross secondary-school graduation rate increases	Gross grade 9 graduation rate	54.2%71; State of the Nation Report (2012), annual	55.8%; State of Education (2017)
The coverage and efficiency of poverty-reduction programs increases	Percentage of extremely poor households that received a monetary transfer from the Government	40%, Government estimate; Regional Policy Dialogue, Presentation (2014), annual	41.6%, Own calculations based on ENAHO 2017-INEC

Source: IDB Country Strategy with Costa Rica (2015-2018).

3.43 The Bank's operations in education and social protection were directly aligned with the current CS, and its operations in health and citizen security were aligned with the prior CS. They contribute to the goal of human capital accumulation and are clearly relevant to the country's overall development priorities.

3.44 The social investment portfolio included 6 TCs (all approved in the current CS period) aimed at contributing to social policy design and potential scaling up of pilot interventions, and a legacy loan on citizen security and violence prevention. Most of the TCs – together amounting to US$1.6 million – focused on strengthening the earning capacity of poor and vulnerable households, and some also sought to improve the efficiency and effectiveness of expenditures. The loan (CR-L1031, US$132 million), approved during the previous CS period but mainly implemented during this one, was focused on reducing crime rates among at-risk youth and reducing recidivism, by building infrastructure that was expected to foster prevention and improve police efficacy.[58]

58 The PND's objective was "to have a renewed, well-equipped police force; combat impunity, drug trafficking and organizing crime; strengthen crime prevention; and adopt a comprehensive and sustainable citizen security policy"; IDB's strategic objective was "to strengthen the capacity of the State to combat organized and common crime." See IDB CS 2011-2014 (GN-2627).

3.45 In education, a loan approved during the previous CS period was focused on improving school infrastructure, and two TCs in this CS period focused on improving the management, monitoring, and evaluation associated with the loan and improving early-year learning. While relevant, these operations did not address structural issues in the education sector. The loan (CR-L1053, US$167.5 million) was approved under the 2011-2014 CS, which had included education as a dialogue area but did not envisage a loan; it was designed to close about 20% of the deficit of access to education that was due to a lack of infrastructure, by constructing various education facilities. It was accompanied by a TC (CR-T1092), approved in 2015, to support its implementation (management, monitoring and evaluation). Another TC (CR-T1134) was a pilot project to enhance mathematical/ logical thinking in preschool. While the projects were relevant in light of the 2015-2018 PND, which emphasized the importance of quality infrastructure for education, they did not address the more structural issues in the education sector – high expenditures, but weak outcomes. One of the structural issues was also the fact that the education system did not cater well for the needs of the labor market, but activities to address this issue were limited.[59]

3.46 Three small operations for about US$2 million were active in the health sector during this CS period. A grant (CR-G1004) under the Meso-American Health Facility, approved in this CS period and following up on a previous grant (CR-G1001), supported reducing teen pregnancies. One TC (CR-T1111) supported the implementation (management, monitoring, and evaluation) of the grants. Another TC (CR-T1129) aimed at improving public spending (priority 1) by institutionalizing the evaluation of technologies in the health sector. The three operations were aligned with various national plans (see Social Sectors note for details) and the CS. In particular, the operations to reduce teen pregnancies were relevant for the goal of increasing graduation rates in secondary schools.

3.47 **Implementation and results:** The implementation of social sector loan projects experienced significant delays. The extension of the violence prevention project (CR-L1031) amounted to 20 months, and that of the education project (CR-L1053) to four years, almost doubling the original timeline. The output targets of that project (CR-L1053) also diminished substantially during implementation, with the expected number of finished education infrastructures dropping from 103 to 55. Significant adjustments

59 Three TCs somewhat addressed this issue (CR-T1115, CR-T1154 and CR-T1157), but the most directly relevant component - strengthening INA - was not implemented yet.

at the output level also occurred in CR-L1031, as funds were reoriented to build police stations and comprehensive attention units in prisons.

3.48 In both loans, the major bottlenecks affecting implementation were (i) regulatory, especially related to red tape and to the ratification requirement;[60] (ii) operational, in particular, the absence of sufficient pre-investment analysis in loan documents; and (iii) institutional, linked to weak managerial, technical, and supervisory/monitoring capacities of PEUs, at least in the initial phases of implementation. For the TCs, the principal bottlenecks to effective implementation were related to the lack of supervision, monitoring, evaluation, and reporting mechanisms.

3.49 The available information is not sufficient to assess the achievement of outcomes in the social sector area of the CS, since loan and grant operations are still under implementation and neither PCRs nor final evaluations are available. TCs, which have been the predominant mode of operation during this CS period, do not have project monitoring reports or standard forms assessing their outcomes. However, TCs were highly valued by Government counterparts and seem to have contributed to the design of policies aimed at poverty reduction (CR-T1126; see Social Sector note for details).

3.50 The participation of the private sector in the social sector operations was minor and limited to the role of implementing partners of components of three TCs in the social investments subsector (CR-T1115, CR-T1154, and CR-T1157, together with a total budget of about US$1.8 million). In all three, not-for-profit private sector development entities (Fundación Ciudadanía Activa and Asociación Horizonte Positivo) were engaged as implementing partners. The education project (CR-L1053) was implemented through a trust fund managed by Government-owned National Bank. Lessons learned from this intervention may contribute to the consideration of future PPPs involving trust funds.

3.51 **Sustainability:** It is too early to assess sustainability, but certain conditions will be essential to achieve it. The sustainability of these programs can only be assessed once PCRs and final evaluations are available. But the main conditions for the sustainability of the expected outputs and outcomes in the social sector are (i) attainment of national ownership of interventions and thus appropriate inclusion in Government budgets; and

60 The time elapsed between the signature of loan documents and congressional ratification was 14 and 10 months for loans CR-L1053 and CR-L1031, respectively.

(ii) predictability of funding for scaling up relevant outputs and outcomes. In the current fiscal context, meeting these conditions will require major efforts to significantly improve the efficiency and quality of social public expenditures. In addition, for loan operations with strong infrastructure components (CR-L1031 and CR-L1053), a further condition for sustainability is the inclusion of adequate infrastructure maintenance functions in standard operating procedures and budgets.

F. Cross-cutting interventions

3.52 Cross-cutting interventions[61] on institutional strengthening were common. One of the cross-cutting CS objectives was to provide support for institutional strengthening, since the limited technical and institutional capacity of most executing agencies affected the operations' execution and effectiveness. IDB continuously included institutional strengthening components to address this issue. Three of the four SG loans approved during the CS and 50% of the TCs (10 of 20) included a specific institutional strengthening component, while another 25% of the TCs (5 of 20) included some type of institutional strengthening aspect, though not a specific component. Similarly, in the legacy portfolio, 70% of the loans (7 of 10) and 75% of the TCs (9 of 12) included a specific institutional strengthening component. Institutional strengthening components were particularly prevalent in infrastructure (70%, or 19 of 27 operations). Examples of institutional strengthening components include advice on enhancing revenue and improving spending, support for management capacity, training activities for officials to enhance staff capacity, strengthening entities in socio-environmental issues, and elaborating action plans to improve and strengthen processes to plan, formulate, program, execute, supervise, and control public works investment projects.

3.53 Cross-cutting interventions on gender equality and diversity: The country made important progress, and a quarter of IDB's CS program addressed gender, but few interventions addressed diversity issues. In 2018, the country ranked third in LAC in closing gender gaps, with high rankings especially in education and political empowerment.[62] The Government had established

61 For all projects implemented during the CS period, OVE reviewed the extent to which cross-cutting issues were addressed as a direct objective or as a relevant aspect (without being a formal objective). Little information was available on the degree to which these outcomes were achieved.

62 World Economic Forum (2018), The Global Gender Gap Report 2018. Overall, Costa Rica ranked 22nd of 149 countries in the Global Gender Gap index, with a score of 0.75. The index is a framework for capturing the magnitude of gender-based disparities on a scale from 0 (disparity) to 1 (parity) across four thematic dimensions, the sub-

a gender equality plan, the National Policy on Gender Equality and Equity 2007-2017. Also, the 2015-2018 PND included gender equality and equity as an underlying principle of development, with gender issues present across all 16 sectoral objectives.[63] The IDBG's CS included gender and diversity as a cross-cutting action area. A gender component was integrated into about a quarter (26%) of the operations approved in the CS period and 8% of the legacy portfolio, mostly by including results for gender aspects, but usually not as a main component. Including the legacy portfolio, support for gender aspects was focused on social sector operations (6), with some activities in other sectors.[64] For example, in the financial sector there was an operation with emphasis on increasing credit for women; in a transport operation, IDB encouraged women's participation in the maintenance microenterprise pilots. Support for diversity aspects was limited. Diversity was mainstreamed in 5% of the operations approved in this CS period and 4% of the legacy portfolio, by including results for diversity aspects (but not as a main component).[65]

3.54 Cross-cutting findings on environmental issues: A quarter of the operations (10 of 39) approved in the CS period included an environmental component and 20% (8) contained identifiable environmental aspects. Half of the projects with an explicit environmental component focused on disaster risk response, and the other half included brown environmental dimensions in infrastructure projects.[66] All four approved projects in the environment area and one TC formally classified as FI operations focused on disaster risk response, but no project approved in the CS period focused on natural resource management. The eight projects that contained environmental aspects included two infrastructure projects (one TC supporting public-private instruments for the urban regeneration of San José, and a loan for renewable energy transmission and distribution), two TCs in the social sector, and three corporate projects (two were to

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indices Economic Participation and Opportunity, Educational Attainment, Health and Survival, and Political Empowerment. In LAC, only Nicaragua and Barbados ranked higher. The country moved up 19 places compared to 2017, largely by significantly increasing women in parliament, moving the country into the global top 10 on this indicator, and closing its educational attainment gender gap.

63 ECLAC and AECID (2017). Gender equality plans in LAC: Road maps for development.

64 There were also operations in the financial sector (3), infrastructure (2), corporate (2), and innovation (1).

65 Including the legacy portfolio, support for diversity aspects was in the social sector (3) and environment (1).

66 Of these, one TC supported the E&S management capacity building for ICE's electricity business line and two TCs and two loans concerned the transport sector, including one NSG loan to an airport (which had invested explicitly to obtain an energy efficiency certification and operates an autonomous sewage treatment facility).

prepare an environmental and social action plan and the third included the adoption of an E&S management system as a development outcome).[67]

3.55 A similar share (22 of 49) of the legacy portfolio addressed environmental challenges (8 had environmental components and 14 had environmental aspects). In the legacy portfolio, one project explicitly focused on natural resource management, one TC on disaster risk management, and the remainder on brown environmental issues. Several TCs aimed to support improved urban mobility in San José by developing options to increase the efficiency of transport in the city (developing guidelines for a travel demand policy, studies into the feasibility of clean fuel technologies, public transport options to reduce energy intensity in transport). One FI operation in the NSG portfolio aimed to support the development of a green credit line.

3.56 PPPs: during the CS period IDBG supported various PPP projects, mostly infrastructure operations, but did not address problems regarding the PPP regulatory framework, an important aspect envisaged in the CS. PPPs were one of the priorities during this CS period. IDBG financed infrastructure in an airport that works under concession (US$12 million), and through TCs gave support for the formulation of urban infrastructure projects in San José under a PPP modality (US$500,000), provided training on PPPs to the San José Urban Planning Directorate (US$228,000), and enhanced public and private sector dialogue by financing a PPP Americas workshop in Costa Rica, which presented success cases from LAC. The legacy portfolio included PPP operations that financed infrastructure in airports (two NSG loans for US$53 million) and in energy (an NSG loan for US$200 million), and also supported an agreement between the public and private sectors to implement a pilot project on land use and transport integration in San José (US$1.78 million). However, there was no support for the improvement of the regulatory framework for PPPs and concessions, or for the institutions supporting them, both of which have been bottlenecks to the wide application of PPPs.[68]

67 OVE was unable to verify within the scope of the CPE whether companies being covered by the credit lines may have contributed to addressing specific environmental challenges (e.g., focusing on low-pesticide agricultural production or low-carbon-emission production and processing, for which Costa Rica established standards in the coffee and livestock sectors).

68 Infrascope 2018, a publication and ranking by the Economist Intelligence Unit that the IDBG supports, ranks Costa Rica 17th (of 40), and only 10th in LAC as an "emerging" PPP environment. While the investment and business climate are rated highly (2nd), regulations (28th) and institutions (30th) are particularly weak.

04

Conclusions and Recommendations

4.1 IDBG's program was relevant and aligned with country priorities, and IDB continues to be seen as very important development partner. While the program during this CS period was significantly smaller than in the last period, it was still the largest among international financial institutions and was focused on key development priorities. Most of the funding was directed to important infrastructure priorities (transport and energy – and from the legacy portfolio also water and sanitation, education, and citizen security), but some smaller operations – for example, TCs in the areas of fiscal sustainability and poverty reduction – were also important and well-received. Reforms adopted at the end of the CS period were aligned with IDB's advice.

4.2 The key issue for the country at this point is the area of fiscal sustainability, and past investment loans did not focus sufficiently on the structural changes needed to increase the efficiency of expenditures. With the passage of the fiscal reform package, the Government of Costa Rica has taken an important step in the right direction, and implementation of the package will be critical. Further reform will be needed to increase the efficiency of providing public services. This is an area IDB tried to address in several TCs,[69] but did not sufficiently focus on loans (which mainly, but not exclusively, supported physical infrastructure). In addition, in many areas the efficiency and effectiveness of the operations and the system in which they operate could be improved: transport, for which there is insufficient focus on maintenance; energy, with the very high costs of electricity; water and sanitation, with the need to ensure that the IDB-financed project effectively connects households in San José to proper sewage treatment; or education, in which projects focused more on physical infrastructure than on weak outcomes, despite high expenditures in the sector. IDBG could build on some of the positive experiences, such as the innovative pilots for maintenance in the cantonal road network.

4.3 A greater focus on public-private synergies will likely be needed. Little progress has been made on the last CS's objective of increasing the use of PPPs, which could potentially contribute to greater efficiency while helping to improve infrastructure and provide public services in the context of fiscal constraints. IDBG could help the country build on the positive experiences with PPPs in some areas (such as the airports it helped finance) to increase their use in other areas, including by helping to improve the regulatory framework for PPPs, even though the strained fiscal situation also creates challenges for PPPs. It will also be

69 For example, in several TCs on reform of the state and also on poverty reduction (to increase the efficiency of social expenditure).

important to ensure that the education system appropriately caters to the skills needed in the labor market, and that IDB Invest focuses its operations more on some of the country's key development needs—for example, addressing the problems arising from the dual economy through a greater focus on strengthening value chains, or better catering to the needs of the financial sector by offering local currency products and focusing on increasing competition.

4.4 IDB will also need to continue its focus on strengthening design and implementation. While IDB has made some progress with its greater focus on implementation, projects were still affected by weak feasibility studies, significant delays, lower achievements than expected, and higher costs. Much more can be done across all areas of the project cycle. For TCs, little information was available on the outputs they achieved, and even less on what their results were.

4.5 IDB needs to continue its support on green and brown environmental challenges. Costa Rica has built a strong international reputation, based on its high endowment with natural resource capital and biodiversity, combined with ambitious visions for use of renewable energy and carbon neutrality. IDBG has supported these developments both directly and indirectly during the CS period—for example, by financing the largest hydro dam (even though with lower demand there is now excess generation capacity), implementing operations supporting the use of the protected areas system, and trying to connect more people to sewage treatment. Going forward, Costa Rica's goal to achieve carbon neutrality will require addressing the transport sector and urban mobility, which IDB has also started to support (through TCs). For the country to preserve its reputation as a tourist destination, it will also need to address environmental challenges, such as sanitation. Implementing these ambitions with cost-efficient interventions will be challenging and will offer IDB opportunities to add value.

4.6 In light of these findings, OVE offers the following **recommendations** for the IDB Group:

1. Engage with the Government to define the best ways to support the country in its efforts to achieve fiscal sustainability by focusing on the full implementation of the fiscal reform and the structural changes needed to increase revenues and the efficiency of public service provision. To that end, IDB should emphasize in its country strategy discussion support for the implementation of the reform and agree on specific areas of IDB support (e.g., strengthening

institutions, financial support, helping to level the playing field between state-owned and private entities to promote competition). Collaboration with other development banks and the IMF would reinforce IDB's efforts. IDB should also consider adding clear measures of improving efficiency of public service provision in its whole product range.

2. Continue to support the country in seeking to attract private investment through PPPs, particularly in infrastructure, and better integrate IDB Invest's operations into the country program. The recommendation on PPPs of OVE's last CPE remains relevant, particularly in light of the limited fiscal space. IDBG has already analyzed the PPP environment in Costa Rica. Depending on the country's priorities, IDB could provide advice on the necessary legal and regulatory changes to improve that environment, strengthening institutions, or putting in place "model" transactions that could be replicated. IDBG should build on the expanded role of the country representative to better integrate IDB Invest's operations into the country program and ensure that the operations address key development needs in the country – such as strengthening value chains, increasing competition in the financial sector, and providing local currency finance.

3. Continue the focus on improved implementation of IDB projects. IDB will need to ensure improved project preparation. It should engage with the Government on how best to shorten delays from the ratification process, or at the very least take the long delays into account in project timelines and design; and ensure that project-executing units have the appropriate expertise and incentives for efficient project implementation. Particularly given the high incidence of TCs in the country program, it will also be essential to introduce a better monitoring system to assess progress with, and results of, TCs.

4. Continue supporting the country in its environmental leadership, while also helping it to address some challenges and efficiency concerns. IDB could consider partnering with the country on initiatives or projects that build on the experience gained in using natural resource capital for sustainable economic development, address the challenges from "brown" development concerns in the traditional sectors of IDB support (sanitation, transport, urban development), and promote the consideration of environmental efficiency and sustainable development in private sector operations.

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