

The contents of this document are preliminary and subject to change.

GRAY/21/572

February 25, 2021

**Statement by Ms. Robitaille and Ms. Senich on Costa Rica  
(Preliminary)  
Executive Board Meeting  
March 1, 2021**

We thank staff for their informative report and Mr. Moreno and Mr. Cartagena Guardado for their very helpful Buff statement. The pandemic has taken a large toll on the economy, and the loss of tourism income has been brutal given the sector's importance as a source of employment for lower income groups. Furthermore, the pandemic struck just as the authorities were in the midst of a multi-year effort to address the country's fiscal imbalances and stabilize the path of public debt. **We welcome the Costa Rican authorities' engagement with the Fund, and we support the request for a three-year Extended Fund Arrangement (EFF).** The EFF builds upon the Rapid Financing Instrument approved last April and should unlock financing from other IFIs and further the goals of promoting economic recovery, strengthening public finances, and fostering inclusive and green growth.

**Promoting economic recovery and protecting the most vulnerable remain the most pressing objectives.** Costa Rica's universal health care system and widespread access to clean water and sanitation have been instrumental in enabling the health response to the pandemic, but we agree with staff that the authorities need to develop a broader policy response to address the root causes of high unemployment among vulnerable populations. Staff note that COVID-related spending in 2020 was only 1.3 percent of GDP, which seems low for a middle-income emerging market, although that figure does not include lost revenues from the COVID-19-related tax breaks. *How has Costa Rica's discretionary fiscal response to the pandemic compared with those of other emerging markets (EMs), particularly with respect to support for the most vulnerable?*

**We welcome that the authorities are pressing on with fiscal reforms that aim to stabilize the path of public debt and reduce the high level of inequality.** The expansion in the public sector wage bill over the past decade has undermined fiscal stability but also contributed to a worsening in income distribution because most public workers are in higher income groups. Further, taxes and transfers play a limited redistributive role in Costa Rica. We therefore welcome the authorities' plans to rein in the public sector wage bill. The tax reform

of 2018 will institute a progressive tax regime and contribute to an improvement in income distribution. We believe spending to support the vulnerable could have been more ambitious, however, as the authorities' planned increase of social spending for the most vulnerable by 0.1 percent of GDP would lift only 12,000 people out of poverty. *Staff comments would be welcome.*

**Strengthening public finances will require a medium-term fiscal framework as well as broader coverage of the public sector.** Costa Rica's public debt is judged to be sustainable, but the level is high, at over 65 percent of GDP, and importantly does not include State-owned Enterprises (SOEs). We therefore welcome the inclusion of a structural benchmark on a medium-term fiscal framework and welcome that the program requires SOEs to adopt International Financial Reporting Standards so that the authorities have a complete understanding of the fiscal position.

**The monetary policy response to the crisis has been appropriate.** Costa Rica's move in recent years to a more flexible exchange rate regime under an inflation targeting (IT) framework enabled the central bank (BCCR) to use monetary policy to attenuate the economic weakness, but, as is the case for several EM central banks, the policy rate has reached the effective lower bound. The BCCR's response to being at the effective lower bound strikes us as having been appropriately cautious through their introduction of a repo arrangement that aims to improve credit availability and with BCCR purchases of government and other liquid bonds to improve market functioning used very selectively. The program appropriately includes a Monetary Policy Consultation Clause, given Costa Rica's inflation targeting framework. We strongly support the program's plan to strengthen the BCCR's governance structure, bolstering the institution's operational independence.

**We are encouraged by the finding that the staff's high level bank stress test found the banking system to be adequately capitalized.** We urge the authorities to continue to monitor banks carefully so that bank credit will be available as the recovery takes hold. We also support the authorities' efforts to reduce the high degree of dollarization in Costa Rica which requires the central bank to remain committed to promoting low inflation, so that people do not feel a need to protect themselves from exchange rate risk by moving to dollar-denominated assets. *Can staff please comment on the likely effectiveness of the authorities' prudential measures to reduce dollarization?*

**Finally, we welcome staff's coverage of climate risk in the proposed program.** Costa Rica has been proactive in addressing climate risk and has a well-earned reputation for its attention to the environment, especially in tourism. We were also pleased to see the inclusion of a structural benchmark on devising a road map for strengthening infrastructure resilience to climate.