OECD Economic Surveys: Costa Rica 2025

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Foreword

This Economic Survey was prepared by Alberto González Pandiella and Alessandro Maravalle, under the supervision of Aida Caldera Sánchez. Research assistance was provided by Mónica Quinzá Armenta, administrative and editorial support by Gemma Martínez and communication assistance by Laura Fortin.

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Information about this and previous Surveys and more information about how Surveys are prepared is available at https://www.oecd.org/en/topics/economic-surveys.html.

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Basic statistics of Costa Rica, 2023[1]

(Numbers in parentheses refer to the OECD average[2])

LAND, PEOPLE AND ELECTORAL CYCLE					
Population (million)	5.2		Population density per km²	102.1	(39.2)
Under 15 (%)	19.8	(17.0)	Life expectancy at birth (years, OECD: 2023 or latest)	81.0	(81.0)
Over 65 (%)	11.2	(18.3)	Men (OECD: 2023 or latest)	78.4	(78.3)
International migrant stock (% of population, 2020)	10.2	(13.9)	Women (OECD: 2023 or latest)	83.6	(83.6)
Latest 5-year average growth (%)	0.7	(0.4)	Latest general election	Feb. 2022	
ECONOMY					
Gross domestic product (GDP)			Value added shares (%)		
In current prices (billion USD)	86.9		Agriculture, forestry and fishing	4.1	(2.8)
In current prices (billion CRC)	47 059.3		Industry including construction	22.2	(27.2)
Latest 5-year average real growth (%)	3.1	(1.7)	Services	73.7	(70.0)
Per capita (thousand USD PPP)[2]	28.0	(59.0)			
GENERAL GOVERNMENT Per cent of GDP					
Expenditure (2022)	27.6	(43.9)	Gross financial debt (OECD: 2022)	61.1	(109.5)
Revenue (2022)	26.7	(39.0)	Net financial debt (OECD: 2022)	59.3	(67.2)
EXTERNAL ACCOUNTS					
Exchange rate (CRC per USD)	541.35		Main exports (% of total merchandise exports, 2022)		
PPP exchange rate (USA = 1)	323.00		Miscellaneous	39.2	
In per cent of GDP			Vegetable	21.9	
Exports of goods and services	38.9	(31.2)	Food Products	12.2	
Imports of goods and services	33.6	(31.2)	Main imports (% of total merchandise imports, 2022)		
Current account balance	-1.4	(-0.3)	Machinery and electronics	17.3	
Net international investment position	-43.6		Chemicals	14.1	
			Fuels	12.7	
LABOUR MARKET, SKILLS AND INNOVATION					
Employment rate (aged 15 and over, %)	52.1	(58.0)	Unemployment rate, Labour Force Survey (aged 15 and over, %)	8.9	(4.8)
Men	63.1	(65.5)	Youth (aged 15-24, %)	24.8	(10.6)
Women	37.7	(50.8)	Long-term unemployed (1 year and over, %)	1.3	(1.0)
Participation rate (aged 15 and over, %)	55.4	(60.9)	Tertiary educational attainment (aged 25-64, %)	25.3	(41.0)
Average hours worked per year	2 171	(1 742)	Gross domestic expenditure on R&D (% of GDP, 2021)	0.3	(2.9)
ENVIRONMENT					
Total primary energy supply per capita (toe)	0.9	(3.7)	CO_2 emissions from fuel combustion per capita (tonnes)	1.5	(7.6)
Renewables (%)	49.7	(12.5)	Water abstractions per capita (1 000 m³, 2022)	0.6	
Exposure to air pollution (more than 10 µg/m³ of PM 2.5, % of population, 2020)	99.9	(56.5)	Municipal waste per capita (tonnes, 2022)	0.3	(0.5)
SOCIETY					
Income inequality (Gini coefficient, OECD: latest available)	0.470	(0.315)	Education outcomes (PISA 2022 score)		
Relative poverty rate (%, OECD: 2020)	21.2	(11.7)	Reading	415	(476)
Median disposable household income (thousand USD PPP, OECD: 2020)	10.8	(27.5)	Mathematics	385	(472)
Public and private spending (% of GDP)			Science	411	(485)
Health care	7.0	(9.2)	Share of women in parliament (%)	47.4	(32.8)
Pensions (2020, OECD: 2019)	6.2	(9.5)			
Education (public spending, % of GNI, 2021)	6.9	(4.4)			

[1] The year is indicated in parenthesis if it deviates from the year in the main title of this table. Where the OECD aggregate is not provided in the source database, a simple OECD average of latest available data is calculated where data exist for at least 80% of member countries.

[2] OECD aggregate refers to weighted average.

Source: Calculations based on data extracted from databases of the following organisations: OECD, International Energy Agency, International Labour Organisation, International Monetary Fund, United Nations, World Bank; and Ministerio de Hacienda.


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Executive summary

Key messages:

- The fiscal situation has improved but ensuring fiscal sustainability remains a priority. To achieve this, Costa Rica should focus on reducing public debt by sticking to the fiscal rule, introducing spending reviews to improve public spending efficiency and raising more tax revenues by expanding tax bases.
- Facilitating female labour participation and reducing informality will require expanding access to early education and care, along with a comprehensive strategy to reduce informality. This strategy should include lowering the cost of formal employment and reducing the administrative and economic burdens associated with establishing a formal business.
- Achieving decarbonization targets and fostering adaptation to climate change requires expanding and diversifying renewable energy and improving the management of waste and water.
- Nearshoring offers new opportunities for Costa Rica to capitalize on its trade openness and maximise trade benefits, which will require continuing to optimise trade policies, enhancing education, fostering innovation, improving infrastructure, and promoting stronger competition.

Building on successes and seizing new opportunities

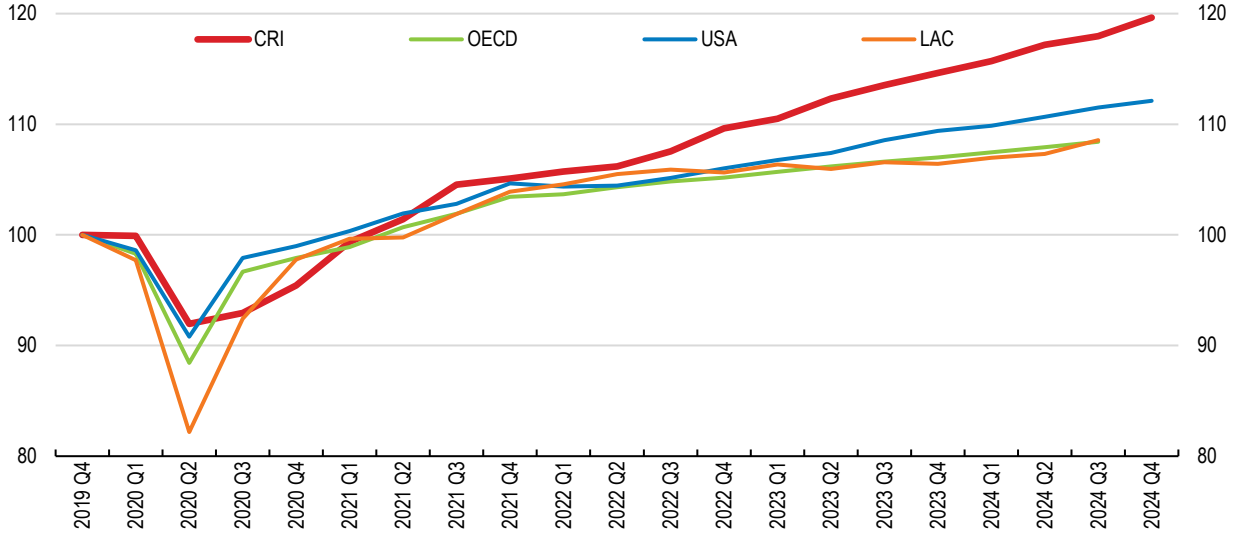
Costa Rica's economy has shown strong growth since the pandemic, with an improved fiscal outlook thanks to contained public spending. To sustain this momentum and support solid medium-term growth, enhance living standards, secure fiscal sustainability and advance the transition to a low-carbon economy, Costa Rica needs to continue and deepen its reform efforts.

Economic performance has improved. Costa Rica's economy is performing well (Figure 1), with growth driven by increasing specialization in high value-added manufacturing and services. Exports are up, and unemployment, income inequality and poverty have recently fallen. The public-debt-to-GDP ratio is also declining. The country is well positioned to seize new trade and investment opportunities, thanks to its commitment to open trade.

Ongoing reforms aim to improve the economy further and should be deepened. Reforms underway include creating a single window for social programmes, overhauling the education system and increasing competition in professional services. However, several of these reforms are still in the early stages of implementation or need legislative approval. Addressing skill mismatches, increasing female labour participation, and reducing informality are crucial for boosting medium-term growth.

Figure 1. Growth has been more resilient and stronger than in peer countries

Real GDP, Index (2019-Q4 = 100), s.a.



Note: LAC is a simple average of Chile, Colombia, Mexico, Argentina, Brazil, and Peru.
Source: *OECD Economic Outlook* (database).

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GDP growth will remain solid and inflation will gradually return to target

Economic activity is set to remain robust, supported by strong exports and improving domestic demand. After receding strongly and becoming negative in 2023, headline inflation will gradually increase towards target.

GDP growth is expected to be 3.8% in 2025. Exports will continue to perform strongly, benefiting from robust global trade. Private consumption will be supported by formal employment growth and improving consumers' confidence. Private

investment will be bolstered by a solid pipeline of foreign direct investment (Table 1).

Unemployment has fallen, below its pre-pandemic level. However, reduced labour force participation, especially among women and youth, partly accounts for this improvement. Formal employment is on the rise, with new jobs increasingly demanding specialized and technical skills. Growth in knowledge-intensive services and high-tech manufacturing is hampered by a mismatch between job vacancies and the skills of job seekers.

Inflation is gradually rising towards target. Headline inflation, which receded sharply and became negative in 2023 due to the reversal of external price shocks and a strong appreciation of the colon, is gradually increasing. Inflation expectations have remained broadly anchored, although they have edged down to the lower limit of the tolerance band.

Monetary policy has responded swiftly to the large external shocks. As inflation began to decline, the Central Bank was the first in the region that started easing. The exchange rate has been allowed to move more flexibly in response to market conditions, acting as a buffer against external shocks. Embedding the Central Bank's independence in the Constitution would further strengthen the institution's credibility.

The financial system has been resilient, but increasing financial dollarization poses risks. Credit and deposit in dollars represent around 35% of the total. Two thirds of the dollarized debt is unhedged. Foreign currency borrowing has recently increased.

A number of distortions fragment financial markets and hinder competition. They affect both state-owned and private banks and include the requirement for public banks to pay contributions to several state funds or for private banks to transfer a share of their deposits to a public fund at below market conditions. Correcting these distortions would have an economy-wide positive impact by facilitating access by firms and households to credit at lower costs.

Table 1. Real GDP growth is set to remain solid

Annual growth rates, %, unless specified

	2023	2024	2025	2026
Real GDP	5.1	4.3	3.8	3.8
Private consumption	5.0	3.6	3.5	4.0
Government consumption	0.1	0.7	0.8	0.7
Gross fixed capital formation	8.6	5.2	7.0	6.7
Exports of goods and services	10.0	5.0	6.2	4.8
Imports of goods and services	5.2	5.8	6.1	5.8
Unemployment rate (% of labour force)	8.9	7.4	7.1	7.3
Consumer price index	0.5	-0.3	2.4	3.2
Central gov. balance (% of GDP)	-3.3	-3.8	-3.2	-2.8
Central gov. debt (% of GDP)	61.1	59.8	59.7	59.2

Source: Updated *OECD Economic Outlook* database.

Maintaining fiscal prudence and enhancing the fiscal framework

The fiscal situation has improved but ensuring fiscal sustainability remains a priority. To achieve this Costa Rica should focus on reducing public debt by sticking to the fiscal rule, introducing spending reviews to improve public spending efficiency and raising more tax revenues by expanding tax bases.

The fiscal situation has improved. After struggling with large deficits in the 2010s, strict adherence to fiscal targets (Figure 2) has helped to start reducing the debt-to-GDP ratio. Primary

spending has decreased due to public sector wage restraint, lower transfers to public entities, and fewer capital projects. With debt interest payments high, at 5% of GDP, and a still high level of public debt, securing fiscal sustainability remains a key priority.

Continuing to fully comply with the fiscal rule is essential. Ongoing fiscal plans appropriately focus on further reducing public debt and interest payments by ensuring a full compliance with the fiscal rule. Declining interest costs will create room to gradually increase social and capital spending. Maintaining a strong fiscal rule remains critical to safeguard progress achieved.

Efforts to improve spending efficiency are underway and should continue. The 2022 public employment law, which standardized salary structures among others, marks a significant step toward enhancing efficiency. Its full implementation will be key to meet the government medium-term fiscal plans. Spending reviews would help prioritize and reallocate funds to improve the quality of public spending. Sharing and using data within the public sector can enhance policy design and allow for better evaluation, helping to ensure that spending is effective and efficient.

Broadening tax bases would support fiscal sustainability and create more fiscal space. Currently, tax expenditures in VAT and personal income tax are large and often benefit wealthier taxpayers. It is critical to avoid legislative changes that erode further the tax base. Personal income tax revenue is significantly lower than in OECD and regional peers.

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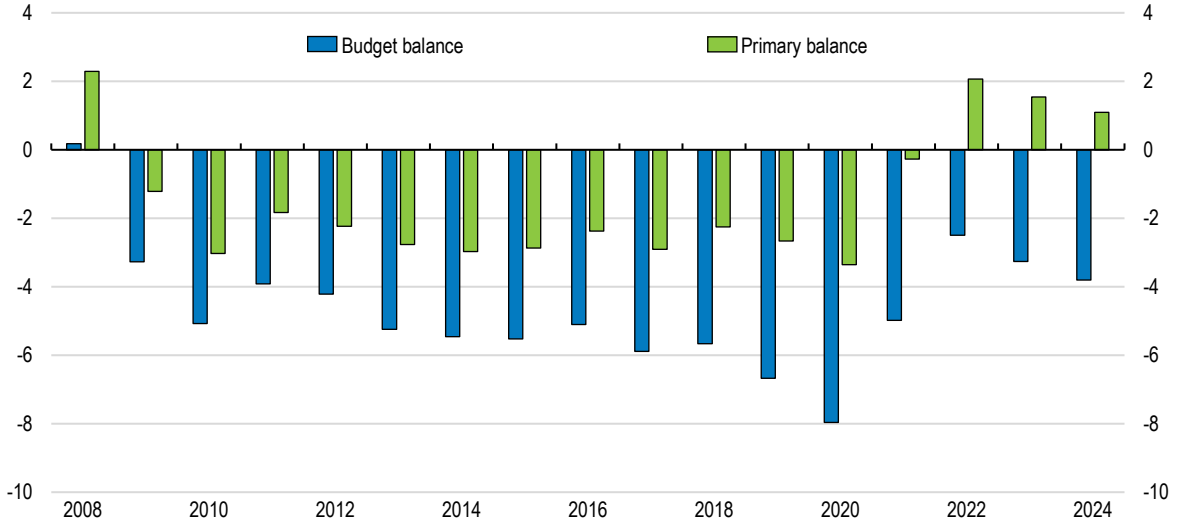
Figure 2. The fiscal deficit has been reduced

Budget balance and primary balance, central government, % of GDP



Source: Ministry of Finance.

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Enhancing equality of opportunities

Facilitating female labour participation and reducing informality will require expanding access to early education and care, along with a comprehensive strategy to reduce informality. This strategy should include lowering the cost of formal employment and reducing the administrative and economic burdens associated with establishing a formal business.

Female labour force participation in Costa Rica is 27 percentage points lower than men's and lags other OECD countries and regional peers (Figure 3). Domestic caregiving responsibilities

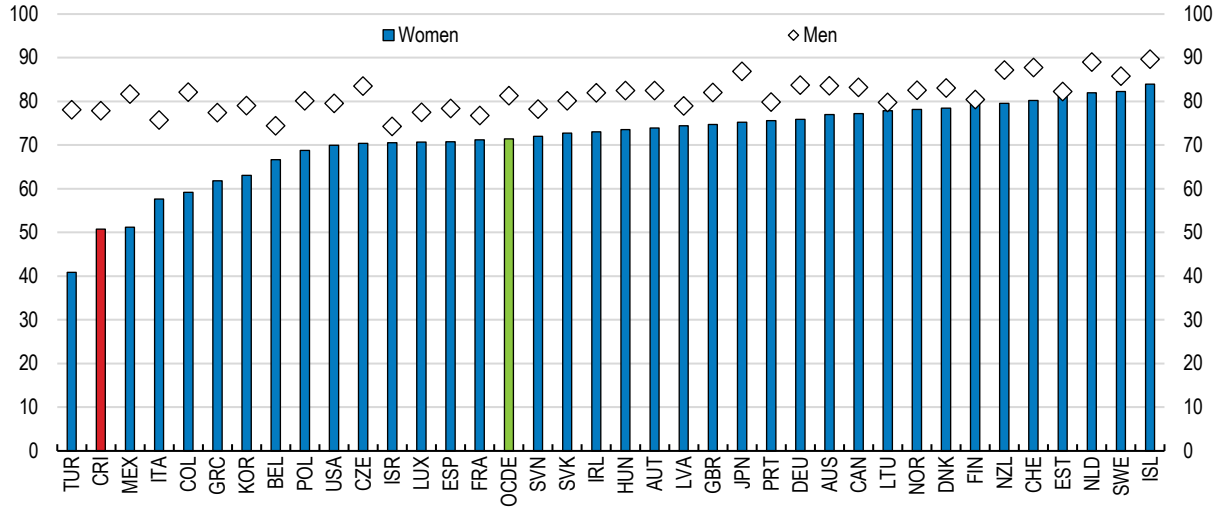
limit women's workforce participation, particularly among low-income women, whose participation rate is below 40%. Additionally, only 7% of children aged 0-2 are enrolled in early education and childcare services.

Expanding access to high-quality affordable early childhood education and care should be a top priority. Currently, the early education network reaches only about 40% of households in poverty. Previous plans fell markedly short of needs. Ensuring access by low-income families should be prioritised. As a next step, access should become available to higher-income households. Co-payment mechanisms for these households can help expand coverage even with limited fiscal resources. The current system is fragmented with unclear roles and responsibilities.

With around 40% of workers in informal jobs, putting in place a comprehensive strategy to tackle informality is also crucial. High employer payroll charges increase the cost of formal employment, hurting particularly low-skilled workers. Not all existing payroll charges are financing the social security system. Bureaucratic and costly regulations complicate setting up formal firms. Low-skilled workers face significant challenges in accessing formal employment opportunities.

Figure 3. Female labour force participation is low

Working-age (15-64) labour force participation rate, %, 2023



Source: *OECD Labour Force Statistics* (database).

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Supporting the green transition

Costa Rica has set ambitious targets to decarbonize its economy. Achieving decarbonization targets and fostering adaptation to climate change requires expanding and diversifying renewable energy and improving the management of waste and water.

Costa Rica aims at decarbonizing its economy and achieve net-zero emissions by 2050, aligning with global efforts to limit global warming to 1.5°C, one of the few among OECD countries. Electrifying the transport sector, which accounts for 54% of carbon emissions, is key to achieve this goal.

Climate change is impacting renewables energy production in Costa Rica. Although nearly all electricity comes from renewables, with hydropower accounting for up to 70%, drier seasons are impacting electricity availability and prices. The planned electrification of transport will increase electricity demand fourfold by 2050. Currently, oil, which is fully imported, and used

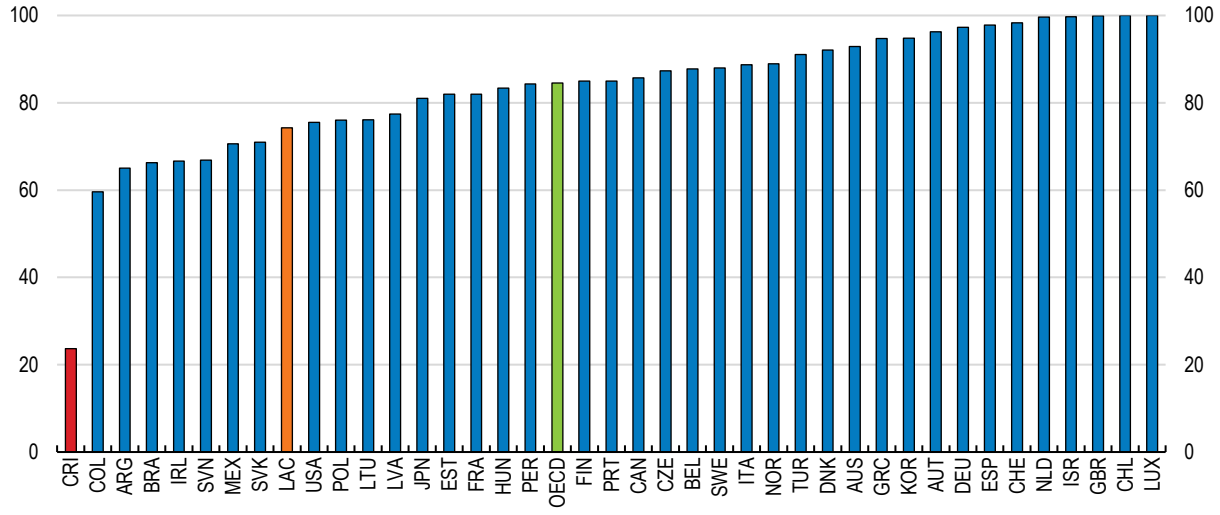
mainly for transport, accounts for 49% of the energy mix. Enhancing the planning of the electricity system would enable a more forward-looking response to medium-term needs and emerging challenges, such as increasing drier seasons.

Regulatory reforms in the electricity sector could boost investment. The state-owned company holds near-total control, with private companies limited to generating 30% of the total electricity at a maximum and mandated to sell their output exclusively to the state company. Barriers also restrict foreign participation in the sector.

Improving waste and water management is vital for adapting to climate change. Waste management, which contributes to 15% of emissions, a larger proportion than in other OECD countries, relies heavily on landfills, impacting ecosystems and public health**.** Water availability is already affected by losses, distribution issues, and a poorly developed sewerage network, with only 25% of the population connected (Figure 4). Climate change and the associated drier seasons are expected to worsen these challenges. Enhancing the planning and execution of water infrastructure projects is essential.

Figure 4. Only a quarter of Costa Rica's population is connected to the sewerage network

Connection to wastewater collection system, % of resident population, 2022 or latest



Source: *OECD Environment Statistics: Water* (database).

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Maximising trade benefits

Openness to trade and foreign direct investment has spurred growth and formal job creation, but many workers, firms and regions have yet to benefit from it. Nearshoring offers new opportunities for Costa Rica to capitalize on its trade openness and maximize trade benefits, which will require continuing to optimize trade policies, enhancing education, fostering innovation, improving infrastructure, and promoting stronger competition.

Costa Rica's commitment to open trade has boosted exports, diversified production and driven economic growth. Medical devices and business services have now surpassed agricultural commodities and tourism as the country's leading exports (Figure 5). Costa Rica's outstanding trade performance and ability to attract FDI are the outcome of a successful trade policy. With Costa Rica's exports remaining concentrated in a few destinations, notably the United States (45% of total exports), the government continued efforts to diversity trade agreements and enhance trade

facilitation, which have regained considerable impetus since 2022, are welcome. They will facilitate stronger integration into global and regional value chains.

Costa Rica's well-educated workforce has been traditionally a key factor to attract FDI and develop value added exports. Education is a priority for Costa Rica, but the education system has struggled to keep pace with the increasing demand for high-tech and advanced skills, leading to large skills shortages that now pose a critical threat to Costa Rica's FDI attractiveness and its ability to maximize trade benefits. A comprehensive education reform is underway, but key timelines and milestones are still unclear. Urgent priorities include accelerating vocational education reforms to boost technical skills, increasing technicians and graduates in STEM areas and ensuring university education is better aligned with labour market demands.

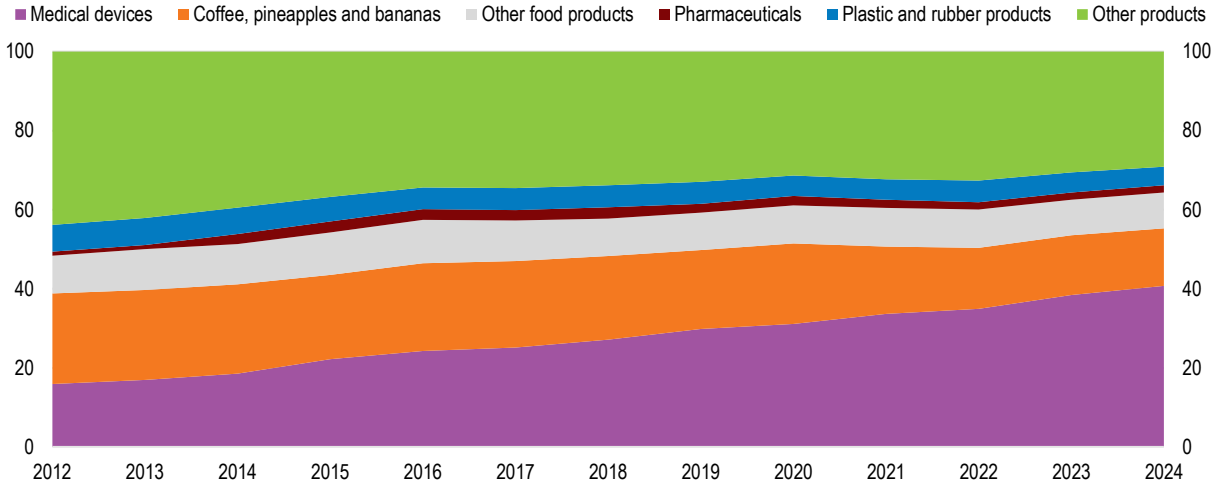
Boosting innovation is crucial for Costa Rican firms to access international markets. However, interactions between public universities and businesses are weak, and most innovation funding goes directly to universities without impact evaluations. Competitive performance-based funding is limited, compared to other OECD countries.

Infrastructure bottlenecks are large, driving up trade costs and limiting the participation of remote regions and SMEs in international trade. Key issues include poor-quality roads and overcrowded ports. The low quality of transport infrastructure can be attributed to underspending, deficient strategic planning and inefficient capital project execution, with only 30% of budgeted capital spending getting executed.

Boosting competition in domestic markets can help Costa Rican firms access better inputs at lower costs. Currently, Costa Rica has some of the strictest regulations in the OECD. Efforts are being made to improve competition in some areas, such as removing anticompetitive practices in professional services and reducing the large and complex stock of regulations. Continuing to increase the Competition Authority's budget is crucial for identifying and addressing anticompetitive practices.

Figure 5. High-tech products are a growing share of Costa Rica's exports

Exports by type of product, % of total good exports



Source: Banco Central de Costa Rica.

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Main findings	Key recommendations
Further buttressing macroeconomic policies	
Headline inflation is gradually increasing but remains below the lower end of the Central Bank's tolerance range. Since March 2023, the Central Bank has lowered its policy interest rate by 500 basis points.	Maintain a data-driven and prudent monetary policy stance and ease further if necessary to ensure that inflation durably returns to the 3% target.
A simple majority in Congress is sufficient to modify key Central Bank legislation, such as the law specifying the mandate of the Bank.	Enshrine the Central Bank operational independence in the Constitution.
The public debt to GDP ratio remains close to 60% and the interest bill has increased to nearly 5% of GDP.	Continue reducing public debt as a share of GDP by adhering to the fiscal rule.
Meeting the fiscal rule requires containing spending and increasing spending efficiency. There remain ample opportunities to improve the quality of spending.	Introduce regular spending reviews to inform the expenditure prioritizations and reallocations and integrate them in the budget process.
Access to relevant data is a key bottleneck to policy making across several policy areas. Current data management practices offer robust safeguards that ensure data confidentiality and security. Increasing the availability and exchange of data is key to undertake spending reviews and sound policy evaluations.	Ensure the availability and exchange of individualized identifiable data across public agencies to support evidence-based policy design, and evaluation, while continuing to ensure data confidentiality and security.
Tax revenues, at 25% of GDP, are hampered by narrow tax bases. The tax system hardly reduces income inequality.	Broaden tax bases by gradually phasing out regressive exemptions on VAT and personal income tax.
Several distortions fragment the financial market and hamper both public and private banks. This undermines competition, restricts access to credit and weakens the transmission of monetary policy.	Correct distortions affecting public and private banks, including the requirement for public banks to pay contributions to several state funds or for private banks to transfer a share of their deposits to a public fund at below market conditions.
Lobbying activities are unregulated, which creates risks of certain groups gaining undue influence, leading to policies not serving the public interest.	Regulate lobbying activities, including by defining which activities and actors are considered lobbyists and by establishing a public lobbying register.
Enhancing the equality of opportunities	
Female labour force participation is lower than for men and that in other OECD and Latin America countries. Previous plans to increase the supply of early education and care have failed. The early education network reaches only about 40% of households in poverty.	Expand early childhood education and care, prioritizing low-income households.
40% of workers are informal, hindering well-being, productivity, and tax revenues. Several factors contribute to informality, including high non-wage costs, complex regulations, and skills mismatches.	Pursue a comprehensive strategy to reduce informality, including lowering the cost of formal job creation, reducing administrative barriers, enhancing skills, strengthening enforcement and simplifying taxes.
Supporting the green transition	
Costa Rica's hydropower sector generates up to 70% of the country's electricity. This reliance on hydropower is increasingly problematic due to dry seasons caused by climate change. The state-owned electricity company operates most of the country's hydroelectric plants and handles the overall electricity planning, which can lead to conflicts of interest. Costa Rica has untapped energy potential in wind, solar and geothermal.	Transfer electricity planning to an independent body and develop a comprehensive medium-term strategy for expanding and diversifying renewable energy sources.
Costa Rica's planned shift to electric transport is set to increase electricity demand fourfold. Meeting this demand will require significant investment in the electricity sector. However, strict regulatory barriers hinder private and foreign investment, including limits on private sector involvement and foreign investment.	Eliminate restrictions and caps on private sector participation in electricity generation and retail supply and remove barriers to foreign investment in the electricity sector.
Despite having abundant water resources, Costa Rica has faced recent water restrictions due to high water losses and aging infrastructure. Climate change and the associated drier seasons are also impacting water availability, Investment in water infrastructure has been hampered by poor planning and execution.	Develop a well-prioritized portfolio of water infrastructure projects, ready for execution as funding becomes available, based on transparent and rigorous cost-benefit analysis.
Maximising trade benefits	
Costa Rica's export markets are concentrated in a few regions, with a growing importance of the United States and Europe as primary destinations.	Continue expanding trade opportunities via trade agreements to open new markets, including by becoming member of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership.
Costa Rica faces challenges with poor educational outcomes and a mismatch between job vacancies and the skills of job seekers. Many Costa Ricans lack the necessary skills to take advantage of new formal job opportunities. While a broad education reform is underway, the specifics of its implementation are not fully defined.	Carry out regular evaluations to monitor progress and impact of reforms to improve educational outcomes and reduce skills mismatches.
Gaps in transport infrastructure are large. Poor planning and design of transport projects lead to delays and cost overruns, with only 30% of the budgeted capital spending being executed effectively.	Strengthen the feasibility assessments for transport projects and enhance budget management, including by establishing detailed implementation plans with clear timelines and milestones.
Outside the free trade zones, innovation outcomes are weak, with limited interactions between universities and the business sector.	Fund public research using competitive and performance-based criteria and establish independent evaluation mechanisms.

1 Sustaining growth and macroeconomic stability

Alberto González Pandiella, OECD

Alessandro Maravalle, OECD

The economy is growing solidly, driven by a strong performance of the export sector and improvements in domestic activity. Inflation turned negative in 2023 due to the reversal of external price shocks and is now gradually rising, although it remains below the Central Bank's tolerance band. The financial sector has shown resilience in the face of recent shocks, but high financial dollarization poses challenges. The fiscal situation has improved significantly, thanks to a strong commitment to spending restraint in line with the fiscal rule. Looking ahead, Costa Rica's key priority is to further reduce public debt by ensuring strict adherence to the fiscal rule, redoubling efforts to enhance public spending efficiency and broadening tax bases. These efforts would reinforce the country's commitment with fiscal prudence and create additional fiscal space to meet spending needs.

1.1. Growth is robust and inflation is gradually increasing

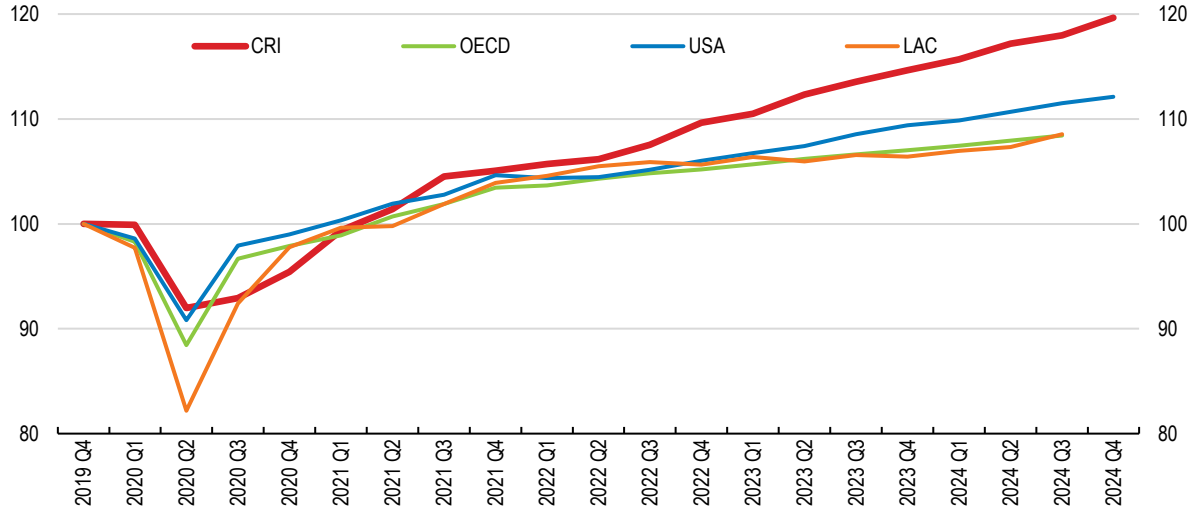
1.1.1. Exports are rising and domestic demand is trending up

Costa Rica has consistently grown more than the OECD and regional peers over the last three years (Figure 1.1). The export sector, after a quick recovery after the pandemic, has performed strongly, with activity in the free trade zones growing steadily (Figure 1.2, panel A) and medical devices representing a growing share of the exports basket. The domestic part of the economy is also improving (Figure 1.2, panel B). Low inflation, which turned negative in 2023 mainly due to the reversal of external price shocks, has boosted real disposable incomes. This, together with improving consumer confidence, has supported private consumption. Private investment is on the rise, as the economy continues to receive a solid pipeline of foreign direct investment. Government consumption remains flat, as fiscal consolidation continues.

The labour market has also improved, albeit more gradually than economic activity. The unemployment rate has fallen and is now below its pre-pandemic level (Figure 1.3, panel A). Private sector wages have increased, both in nominal and real terms, reflecting the robustness in economic activity and low inflation. Conversely, nominal public sector wages have been frozen since 2019 due to fiscal policy constraints. Labour participation decreased significantly after the pandemic shock, particularly among women and youth. It has recently increased slightly, but it remains below its pre-pandemic level, both for men and women (Figure 1.3, panel B). The decrease in men's participation is notable among young (aged 19-25) and older workers (above 60). The fall in women's participation spans across all ages. The proportion of women citing care responsibilities as the reason for being out of the labour force has risen significantly since the pandemic. School closures in Costa Rica were lengthy during the pandemic, leading to an extended period where many women had increased care responsibilities. This prolonged additional care burden may explain the current lower participation of women. Expanding access to early education and childcare services is essential to accelerating women's reintegration into the labour market, as further discussed in Chapter 2 in this Survey.

Figure 1.1. GDP growth has been stronger than in peer countries

Real GDP, Index (2019-Q4=100), s.a.



Note: LAC is a simple average of Chile, Colombia, Mexico, Argentina, Brazil, and Peru.
Source: *OECD Economic Outlook* (database).

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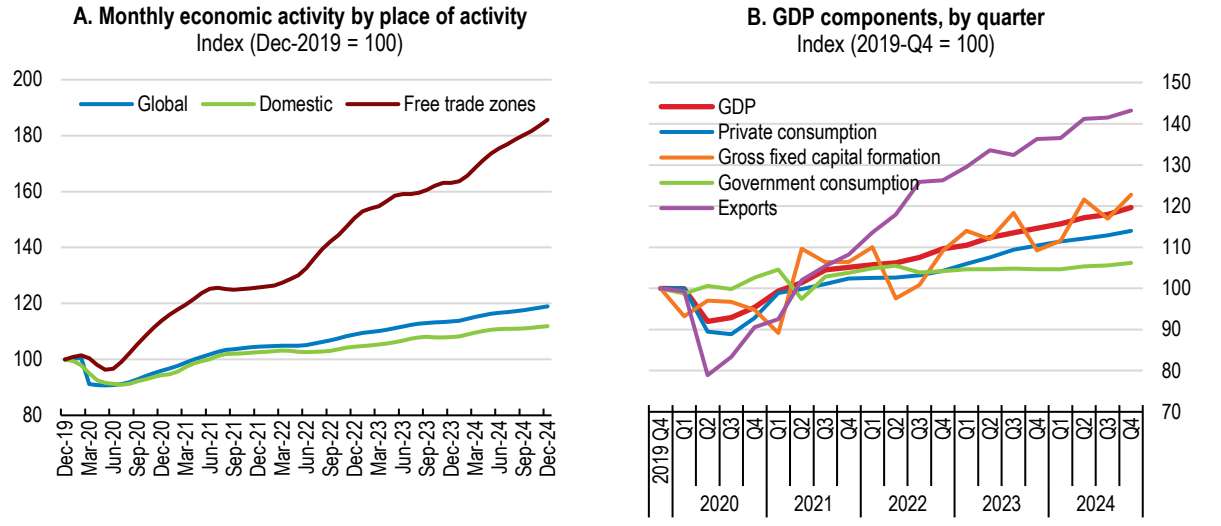
Figure 1.2. The export sector has thrived and the domestic part of the economy is also trending up



Source: Banco Central de Costa Rica.

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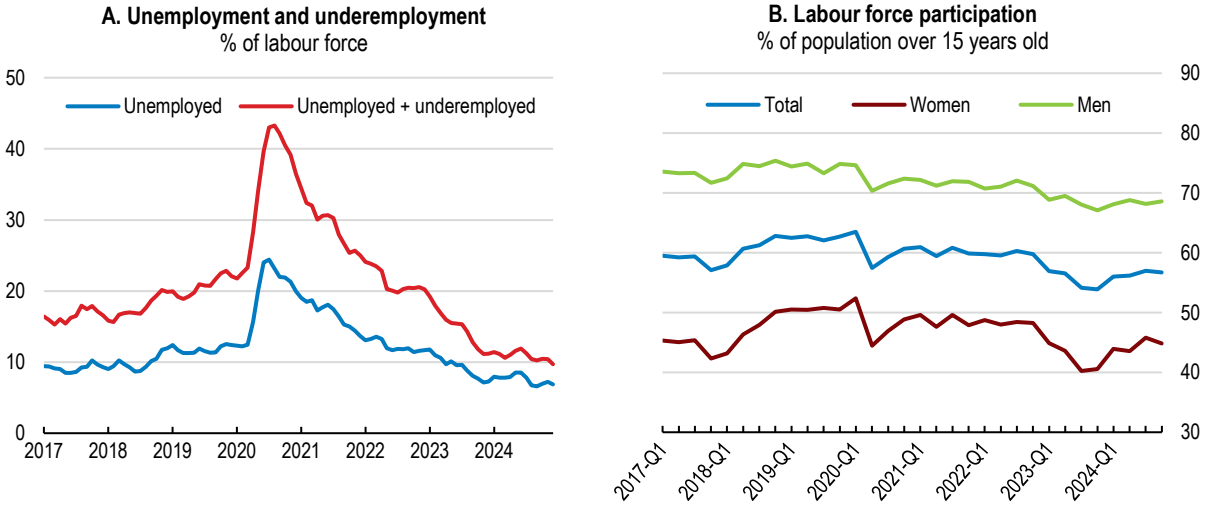
Figure 1.3. The labour market has improved but participation is lower than before the pandemic



Note: In Panel A, the "underemployment" category refers to the share of economically active individuals aged 15 and over who have the ability and desire to work more hours than their current occupation permits.
Source: INEC (2024) Encuesta Continua de Empleo (ECE); and *OECD Labour Force Statistics* (database).

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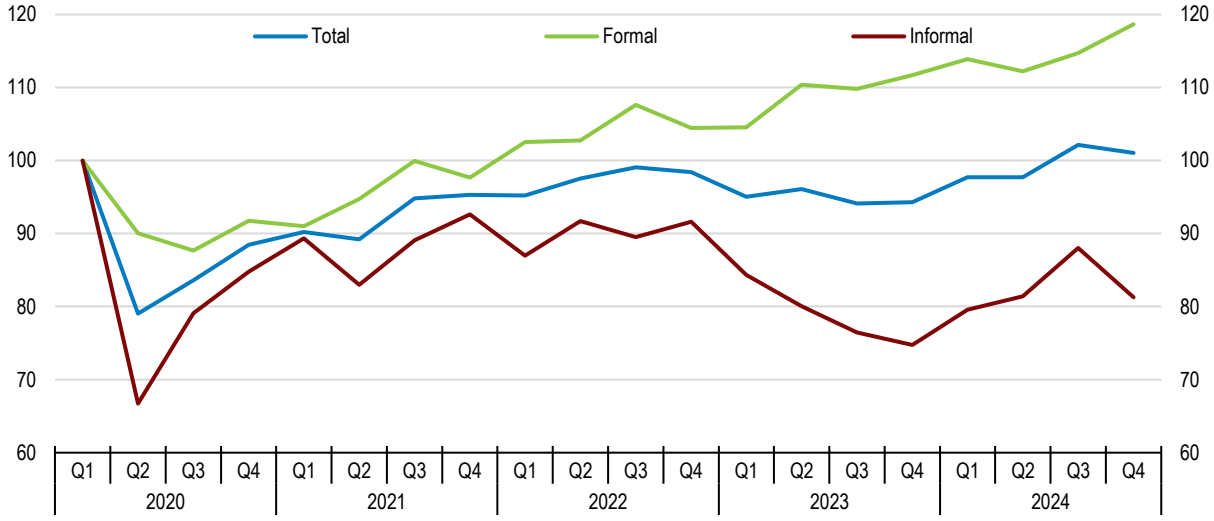
Total employment has returned to its pre-pandemic levels, with employment in the formal sector steadily increasing and informal employment decreasing during 2023 (Figure 1.4). Employment among young workers has particularly fallen, with a 39 percentage points drop in informal employment since the pandemic that was not matched by an equivalent increase in formal employment (Figure 1.5). Sufficiently timely data on enrolment in educational programs is not available to ascertain whether these young individuals not anymore in employment have returned to education. However, the share of youth not in education, employment, or training is relatively high in Costa Rica (Figure 1.5). Formal employment is increasing, but many new jobs demand specialized and technical skills. This contrasts with the fact that many Costa Ricans are leaving the education system before completing secondary education (OECD,

2023[1]). Surveys to Costa Rican employers signal skills mismatches as a growing barrier to boost their operations. Skill mismatches are particularly large in knowledge intensive services and high-tech manufacturing (Box 1.1). Upskilling Costa Rica's workforce is critical to compete in a globalised economy and contribute to keep attracting foreign investment and boosting exports, as further analysed in Chapter 4 of this Survey and in the 2023 Economic Survey.

Figure 1.4. Formal employment has increased

Index (2020-Q1 = 100)



Note: Informality is defined as the percentage of workers in employment meeting one of these conditions: 1) not contributing to the social security system, 2) unpaid workers or 3) self-employed workers and employers who have companies that are not registered in the National Property Registry and do not keep a formal accounting.
Source: INEC (2024), Encuesta Continua de Empleo (ECE).

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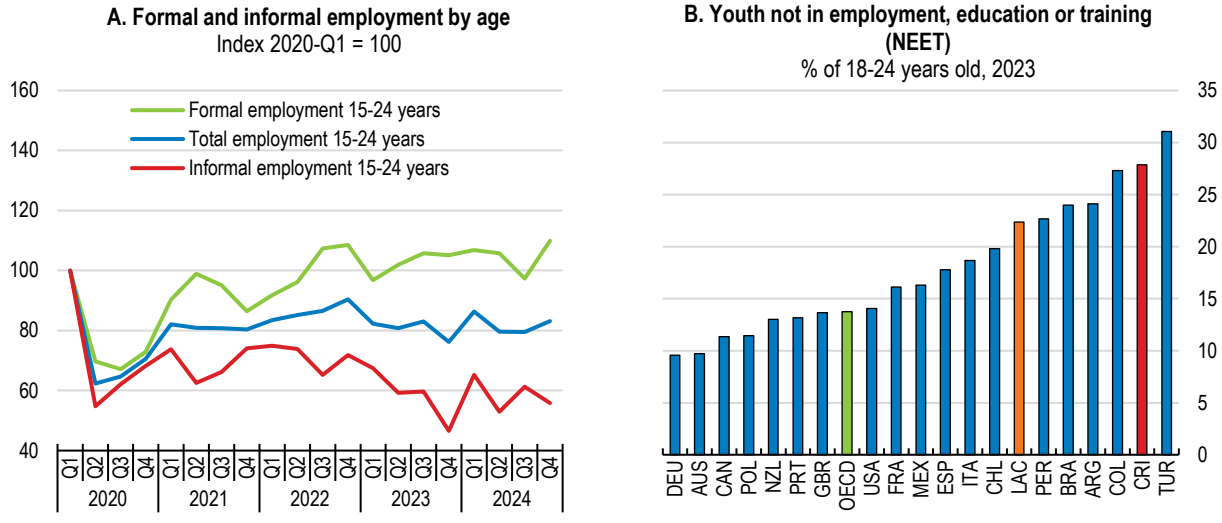
Figure 1.5. Employment among the young has fallen



Note: LAC is a simple average of Chile, Colombia, Mexico, Argentina, Brazil, and Peru.
Source: INEC (2024), Encuesta Continua de Empleo (ECE); and OECD (2024), *Education at a Glance 2024: OECD Indicators*.

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Box 1.1. Skill mismatches in Costa Rica

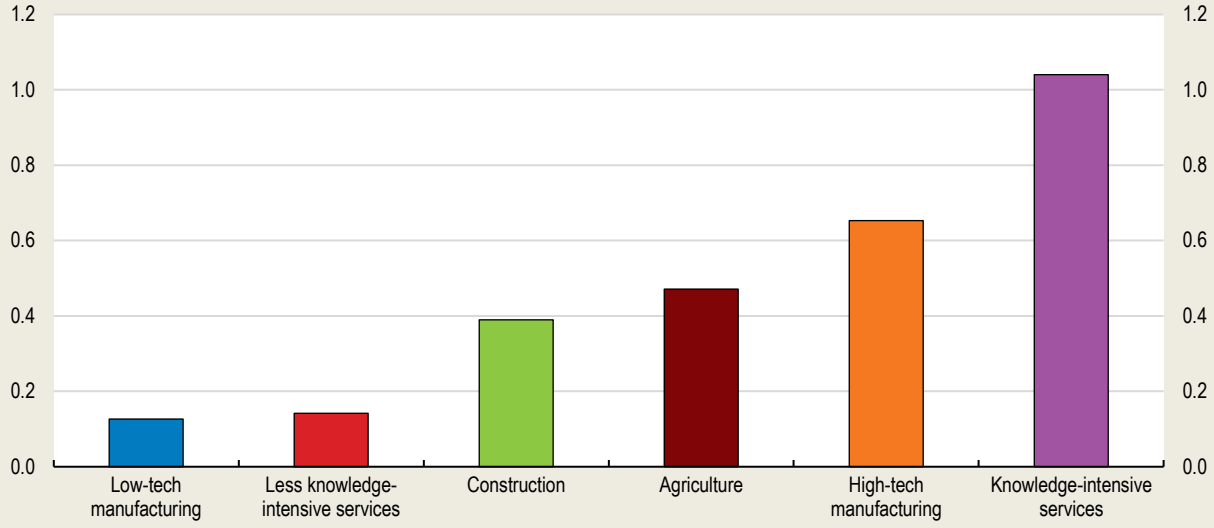
Skill mismatches arise when the skills that employers need do not match the skills of workers and job seekers. Mismatches are costly to firms, workers and governments. Firms may have to retrain under-skilled workers or scale back their activities if unable to find suitable workers. Quantitative indicators about the prevalence of skills mismatches in Costa Rica are scarce. Macroeconomic skills mismatch indicators (MSMI), which compare the skills of the population and the skills required by the labour market, can help to visualize to what extent different economic sectors are affected by skill mismatches ((Quesada and Gonzalez-Pandiella, forthcoming[1]). They are computed as the absolute difference between the share of a skill group in employment and their share in the working age population, i.e.

$$MSMI = \sum_{i=1}^{3} \left| \left(\frac{E_i}{E_T} - \frac{P_i}{P_T} \right) \right|$$

where Ei and Pi are respectively the number of individuals with skill level i in employment and in the population; ET and PT are the total employment and the total population. Skill groups are proxied by educational attainment: low skills are defined as those with below secondary qualification, medium skills as secondary education or incomplete university education, while high skills are defined as tertiary education. The indicator is low if the skill composition of the employed reflects the population's skill composition, while the indicator is high if education profiles of those employed differ significantly from education profiles in the population. Computing these indicators at sector level for Costa Rica reveals significant heterogeneity in skills mismatches across agriculture, manufacturing, construction, and services (Quesada and Gonzalez-Pandiella, forthcoming[1]). It also underscores the need to differentiate manufacturing activities by their technological intensity and services based by their value-added (Figure 1.6) when assessing the extent of skill mismatches in Costa Rica.

Figure 1.6. Skill mismatches vary greatly across sectors

Skills Mismatch Index



Note: The classification of services based on their knowledge intensity adheres to the NACE Rev.2 framework for economic activities. Manufacturing is categorized into low-tech and high-tech sectors, determined by the complexity of the learning processes involved in production and the extent of technological spillovers they generate, following the methodology outlined by Law (2020).
Source: (Quesada and Gonzalez-Pandiella, forthcoming[1]) based on Labour Force Surveys data.

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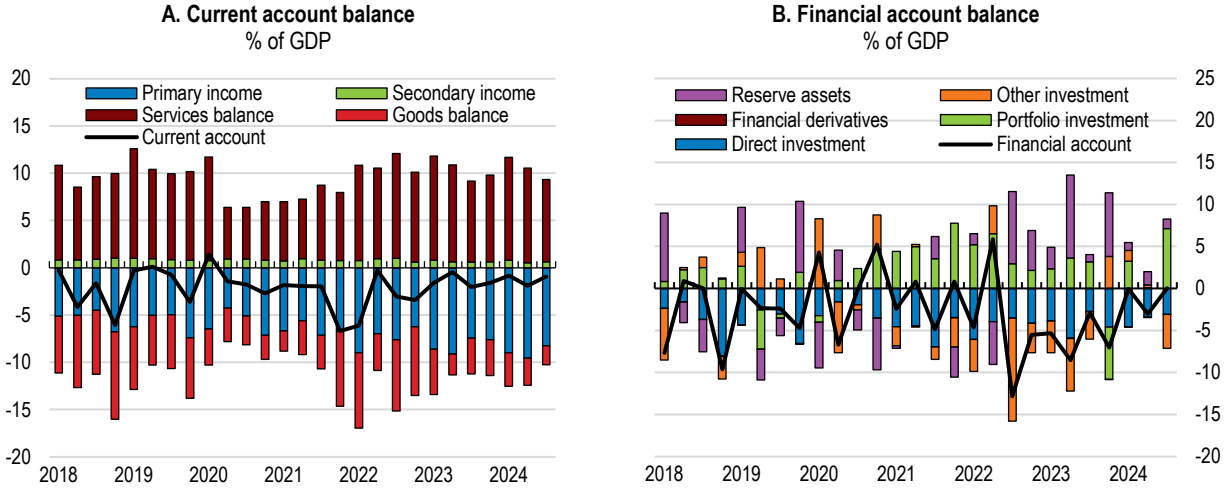
On the external side, the current account deficit has narrowed and continues to be comfortably financed by a stable pipeline of foreign direct investment (Figure 1.7). The services trade balance surplus has increased, representing around 10% of GDP (in comparison with 6% in 2000). This reflects both the recovery in tourism and a larger weight of knowledge-intensive services, such as business services. The deficit in the goods trade balance has shown a decreasing trend over time, with exports of medical devices displaying particularly strong growth (see also Chapter 4). External debt has recently moderated (Figure 1.8), alongside an increase in external reserves, which are currently at a comfortable level aligning with standard metrics.

Figure 1.7. The current account deficit is financed with a stable pipeline of direct investment



Source: Banco Central de Costa Rica.

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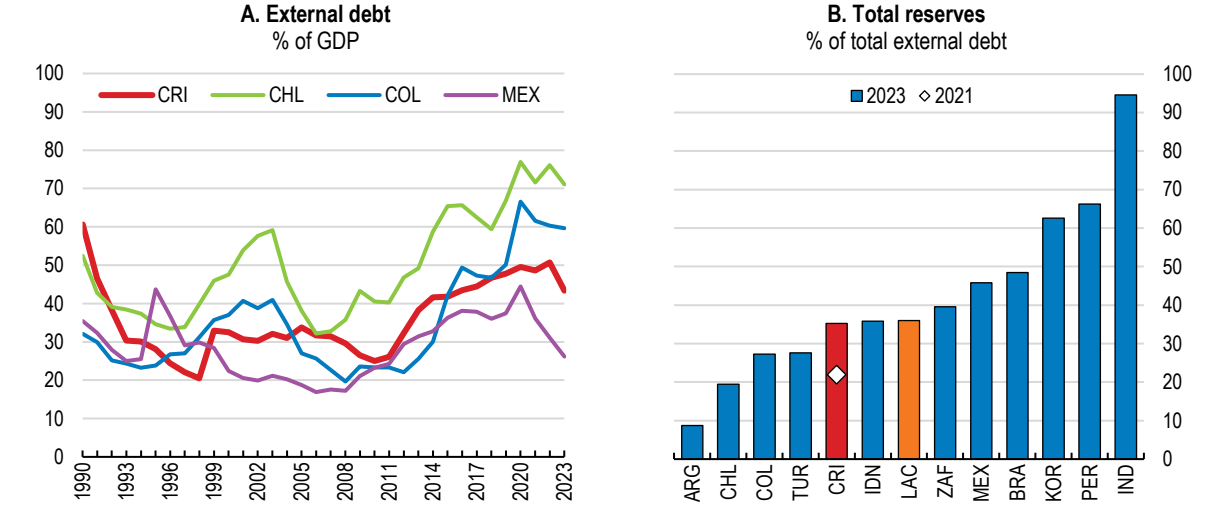
Figure 1.8. External debt has fallen and the level of international reserves has increased



Note: LAC is a simple average of Chile, Colombia, Mexico, Argentina, Brazil, and Peru.
Source: *IMF World Economic Outlook (WEO)* (database); and *IMF International Financial Statistics (IFS)* (database).

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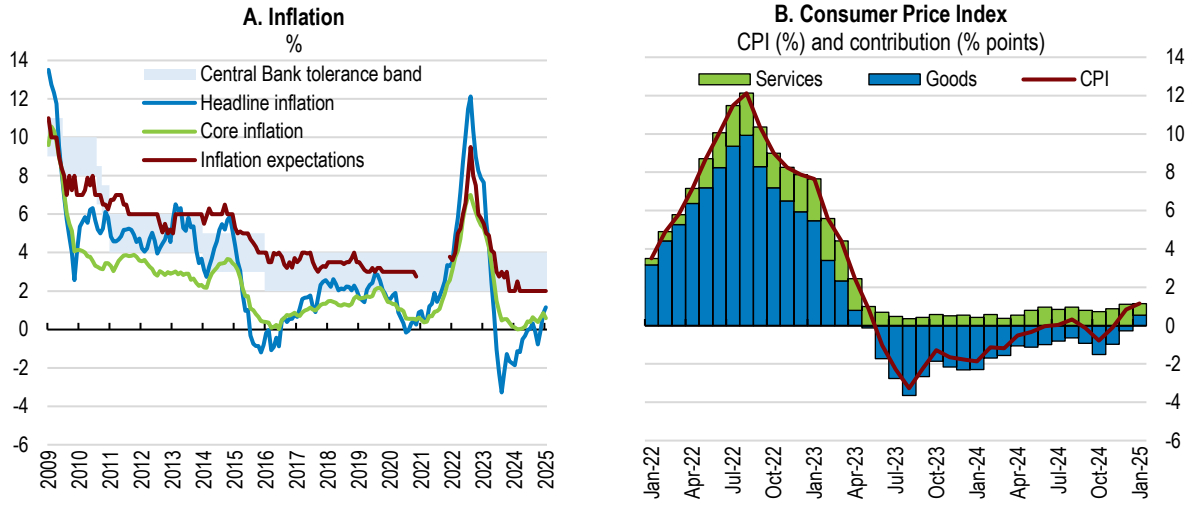
Inflation, which receded sharply and became negative in 2023 mainly due to the reversal of external price shocks, is gradually increasing toward the Central's Bank tolerance band (Figure 1.9). Goods, particularly food, and fuel had the sharpest inflation fall. Both headline and core inflation remain low, at 1.1% and 0.6% respectively in January 2025. Inflation expectations have remained broadly anchored, although they have edged down to the lower limit of the tolerance band.

Figure 1.9. Inflation is gradually strengthening



Note: The shaded area represents the Central Bank's inflation tolerance band. Inflation expectations are the median one-year ahead expectations according to a survey run by the Central Bank. The survey was not conducted between December 2020 and November 2021.
Source: Banco Central de Costa Rica; and *OECD Contribution to year-on-year inflation by COICOP 2018 by country* (database).

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1.1.2. Growth is expected to remain solid

The economy is projected to expand by 3.8% in 2025 and 2026, after growing by 4.3% in 2024 (Table 1.1). Private consumption will be supported by formal job creation and low inflation. Government consumption will remain constrained by ongoing efforts to contain public spending. Private investment is expected continue to be bolstered by foreign direct investment inflows. Export growth is set to accelerate in line with improving global economic conditions. Headline inflation is projected to increase to an average 2.5% in 2025, thanks to ongoing gradual monetary policy easing. The outlook is subject to uncertainties and risks. Increasing foreign currency borrowing could heighten the financial sector's vulnerability. Inflation may turn out lower than expected, necessitating larger cuts in interest rates than anticipated, which could increase risks of abrupt exchange rate fluctuations. An escalation of geopolitical tensions would weigh on foreign demand and could lead to renewed supply chain disruptions. Additional events that could lead to major changes in the outlook include extreme weather events (Table 1.2), which could particularly impact the agriculture sector, and further escalation of crime and violence, which could deter investment and tourism. Like other countries in the region, crime has been on the rise, largely driven by the activities of organized groups. On the upside, nearshoring could boost investment and exports beyond assumed in these projections.

Table 1.1. Growth will remain robust

	2019	2020	2021	2022	2023	2024	2025	2026
GDP at market prices	2.4	-4.3	7.9	4.6	5.1	4.3	3.8	3.8
Private consumption	1.7	-6.9	8.3	2.6	5.0	3.6	3.5	4.0
Government consumption	5.9	0.8	1.7	2.4	0.1	0.7	0.8	0.7
Gross fixed capital formation	-8.2	-3.4	7.8	1.5	8.6	5.2	7.0	6.7
Final domestic demand	0.6	-5.0	7.0	2.4	4.9	3.4	3.7	4.0
Stockbuilding[1]	-0.3	0.2	1.5	-1.5	-1.6	0.7	0.0	0.0
Total domestic demand	0.2	-4.8	8.6	0.8	3.1	4.5	3.6	4.1
Exports of goods and services	4.3	-10.6	15.9	18.5	10.0	5.0	6.2	4.8
Imports of goods and services	-2.3	-12.9	19.2	8.1	5.2	5.8	6.1	5.8
Net exports[1]	2.2	0.4	-0.3	3.9	2.2	0.2	0.6	0.1
Memorandum items								
GDP deflator	2.6	0.8	2.4	6.3	-0.1	0.0	2.6	3.2
Consumer price index	2.1	0.7	1.7	8.3	0.5	-0.3	2.4	3.2
Core inflation index[2]	2.7	1.3	0.9	4.2	1.0	0.1	2.5	3.2
Potential growth	3.2	3.0	3.1	3.2	3.2	3.4	3.5	3.6
Output gap (% of GDP)	-0.5	-7.5	-3.2	-1.9	-0.1	0.7	1.0	1.2
Unemployment rate[3] (% of labour force)	11.8	19.5	16.4	12.2	8.9	7.4	7.1	7.3
Current account balance (% of GDP)	-1.3	-1.2	-3.2	-3.2	-1.4	-1.9	-1.7	-1.7
Central government balance (% of GDP)	-6.7	-8.0	-5.0	-2.5	-3.3	-3.8	-3.2	-2.8
Central government debt (% of GDP)	56.4	66.9	67.6	63.0	61.1	59.8	59.7	59.2

1. Contributions to changes in real GDP, actual amount in the first column. 2. Consumer price index excluding volatile items: agricultural, energy and tariffs approved by various levels of government. 3. Based on national employment survey.
Source: Updated *OECD Economic Outlook* (database).

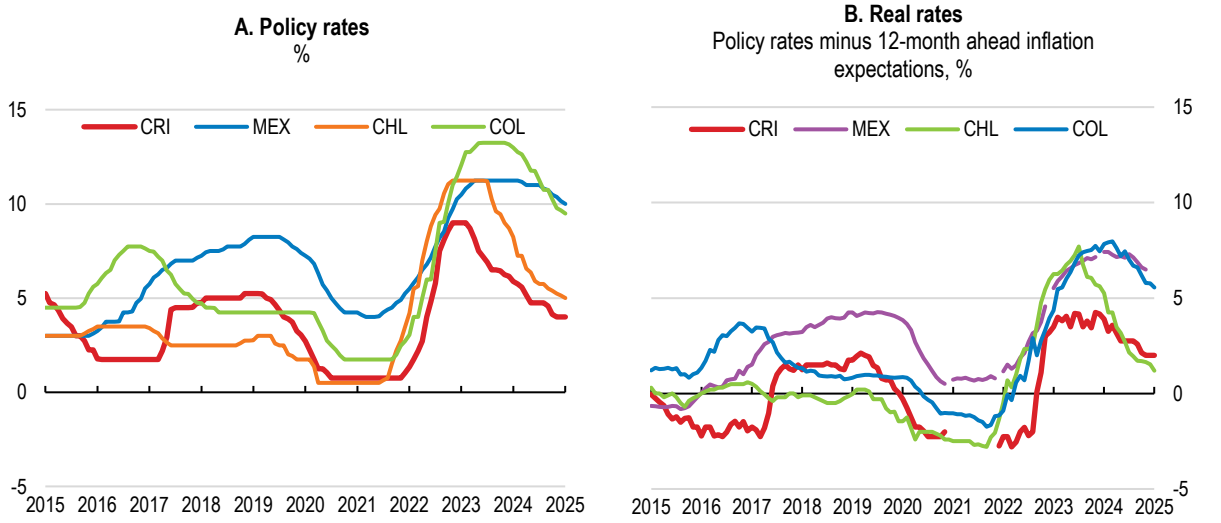
Table 1.2. Events that could lead to major changes in the outlook

Shock	Possible outcome
Extreme weather events, including acute El Niño and La Niña episodes.	A fall in agriculture production and damages in infrastructure. A fall in hydro-based electricity generation. Higher inflation.
An escalation of crime and violence.	Negative impacts on investment and tourism. Loss of citizens trust on government.
An increase in social tensions in neighboring countries.	Increase in migration, adding fiscal pressures.

1.2. Monetary policy has reacted appropriately

As in other OECD countries, Costa Rica experienced a sharp increase in inflation in 2022 and the Central Bank raised interest rates up to 9% (Figure 1.10 and Table 1.3). The inflation rise was mainly caused by external prices increases, as the fiscal package put in place by Costa Rica during the pandemic was modest given that fiscal space was limited. Inflationary pressures receded sharply in 2023 (Figure 1.11), following monetary policy tightening, and in line with the reversal of external price shocks, a strong appreciation of the colon with respect to the dollar (Figure 1.12). The Central Bank reacted again decisively by reducing the restrictiveness of monetary policy. With a first cut in March 2023, the Central Bank has delivered so far a decrease of 500 basis points until reaching the current rate of 4%. Latest estimates indicate that the real neutral rate is around 1.4% (BCCR, 2024[2]), suggesting that the current rate is closed to the neutral rate. The passthrough of policy rates cuts to interest rates faced by firms and households has been visible in deposit rates, while changes in lending rates have been so far small.

Figure 1.10. Monetary policy normalization is underway



Source: Banxico; CEIC; Banco Central de Colombia; and Banco Central de Costa Rica.

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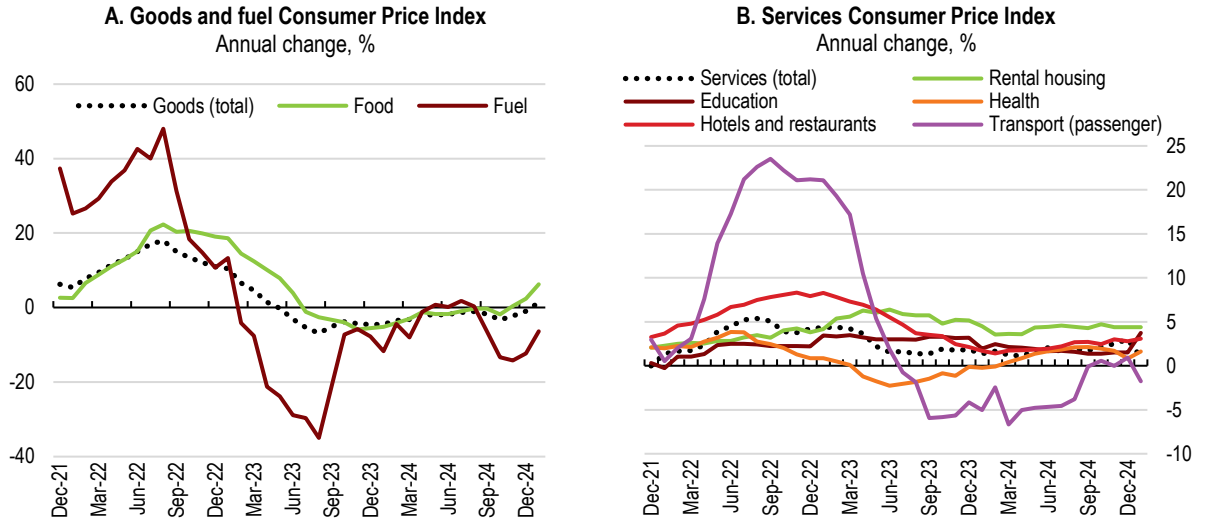
Table 1.3. Past OECD recommendations to improve macroeconomic policies

Past OECD recommendations	Actions taken since the 2023 Economic Survey
Maintain a restrictive monetary policy stance to ensure the return of inflation to the 3% target.	Interest rates were increased to 9% in 2023. Inflation expectations have remained anchored.
Maintain a prudent fiscal policy stance, including by ensuring a full and timely implementation of the fiscal rule. In the medium-term, undertake a review of the fiscal rule to ensure that it continues to secure a prudent fiscal stance and sustainable debt dynamics.	The fiscal balance was reduced from -5% in 2021 to - 3.8% in 2024, thanks to a strict adherence to the fiscal rule.
Based on spending reviews and sound cost-benefit analysis, continue to undertake the necessary expenditures prioritisation and reallocation and create space for capital spending to strengthen.	Current primary spending was reduced to 14.1% in 2024, from 16% in 2021. The Ministry of Finance, with technical assistance from the World Bank, will implement the 'Budget by Results' program, initially focusing on the sectors of Security, Education, and Infrastructure.
Preserve exchange rate flexibility and limit interventions to those necessary to avoid abrupt changes in the exchange rate	The exchange rate has been allowed to move more flexibly in response to market conditions
Fill the current vacancy in the Central Bank board.	The vacancy was filled in June 2023.
Fully implement the public employment framework law across the public sector.	The employment framework was implemented in the central government and progress is underway in other public agencies.
Broaden tax bases by phasing out regressive exemptions, such as the tax exemption on the 13th monthly salary and the one benefiting cooperatives.	The Executive Branch introduced two legislative bills addressing this recommendation, but they have not made progress in Congress
Provide the fiscal council with independent technical support and define its role more explicitly.	While creating technical support positions has been considered, placing these roles within a ministry would compromise the council's independence

Figure 1.11. Inflationary pressures are increasing in food and fuel



Source: Banco Central de Costa Rica; and INEC.

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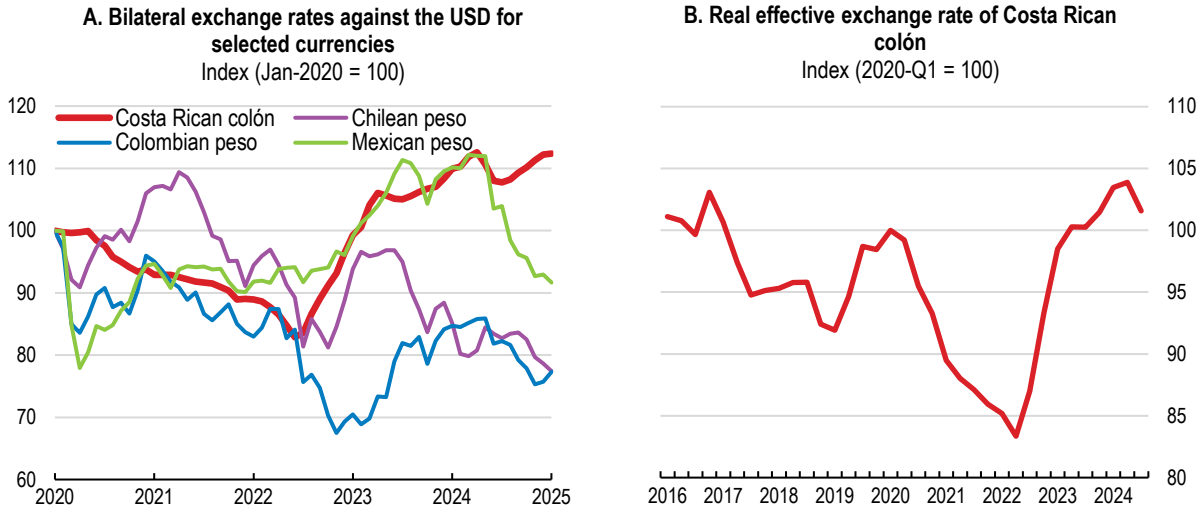
Monetary policy should continue to support the gradual rise of inflation towards target. This requires maintaining a data-driven and prudent monetary policy stance and easing further if necessary to ensure that inflation returns to the 3% target. Headline and core inflation are gradually strengthening but remain low, at 1.1% and 0.6%, respectively, in January 2025 (year-to-year). Gradual and data-driven monetary policy easing would help guide inflation expectations, which have fallen to the lower limit of the tolerance band, get back to the 3% target. Inflation risks include the gap in interest rates between the United States and Costa Rica, which could originate sharp changes in the exchange rate, with significant impacts on inflation. Climate risks are also high, with dry seasons hindering hydro electricity generation (see Chapter 3) and increasing electricity prices. The low passthrough of policy rates cuts to interest rates faced by firms is dampening monetary policy effectiveness.

In line with recommendations in previous OECD Surveys ((OECD, 2018[3]), (OECD, 2016[4])), the exchange rate has been allowed to move more flexibly in response to market conditions. The central bank, as stipulated by its organic law, has limited its interventions in the foreign exchange market to meeting public sector foreign exchange requirements and mitigating volatile fluctuations in the exchange rate. Throughout 2023, the colon significantly appreciated vis a vis the US dollar (Figure 1.12, panel A). The appreciation could be attributed to factors such as interest rates higher than in the United States, improving macroeconomic fundamentals, the solid pipeline of foreign direct investment inflows, a surplus in the services trade balance, and the robust performance in the tourism sector. The colon appreciation took place despite the Central Bank buying international reserves, which are now at a comfortable level and in line with standard metrics (Figure 1.8). The appreciation triggered strong concerns from various groups, pointing to its detrimental impact on competitiveness. In real effective terms, the colon remains at a similar level as in 2017 (Figure 1.12, panel B), suggesting that medium-term competitiveness has remained broadly unchanged after the exchange rate depreciation in 2020-21 and the appreciation in 2023. Flexible exchange rates are particularly advantageous for open economies like Costa Rica's, enabling natural adjustments to economic shifts and promoting macroeconomic stability. They serve as a buffer against external shocks and play a crucial role in inflation control. By promoting macroeconomic stability and a less discretionary and more rule-based economic environment, a flexible exchange rate also enhances attractiveness for foreign direct investment and bolsters competitiveness.

Figure 1.12. The bilateral exchange rate has appreciated



Note: A decrease implies a depreciation of the Costa Rican colón and indicates an improvement in competitiveness. Real effective exchange rates (Panel B) are calculated using constant trade weights.
Source: *OECD Short-term Indicators* (database); and *OECD Economic Outlook* (database).

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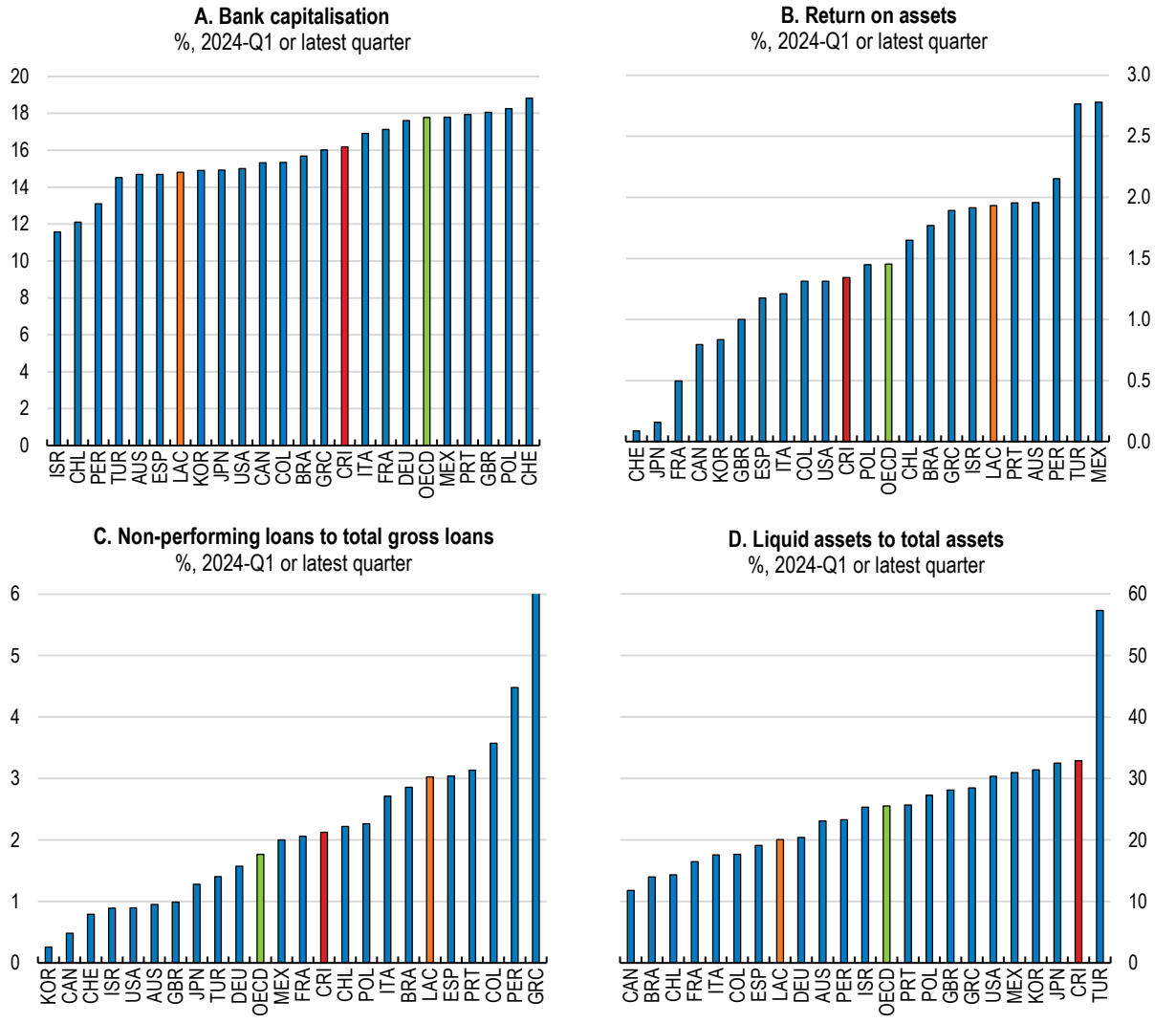
During the OECD accession process, Costa Rica took important measures to strengthen the monetary policy framework (OECD, 2020[5]), such as delinking the designation of the Governor of the Central Bank from the political cycle and clarifying the Governor's dismissal rules. While the Central Bank has been acting independently, further steps to buttress its autonomy are appropriate at this juncture. Now, a simple majority in Congress is sufficient to modify key Central Bank legislation, such as the law specifying its mandate. This could be avoided by enshrining the autonomy and operational independence of the Central Bank in the Constitution, as done in several OECD countries, such as Germany, Switzerland and Portugal, and regional peers, such as Mexico, Colombia and Chile. Constitutional provisions can offer a higher level of legal autonomy, enhancing Central Bank's credibility.

1.3. Financial stability has been maintained

1.3.1. Increasing financial dollarization poses challenges

The financial system has been stable and resilient to recent shocks. It maintains capitalisation levels in line with other OECD countries (Figure 1.13, panel A), liquidity levels above regulatory requirements (Figure 1.13, panel D), and non-performing loans are contained (Figure 1.13, panel C). According to the financial supervisor's latest stress tests, the financial system, including private, state-owned banks and participating credit cooperatives, would be resilient to adverse economic events (SUGEF, 2024[6]).

Figure 1.13. Banks capital and liquidity ratios are high



Note: Bank capitalisation refers to the capital adequacy, regulatory tier 1 capital to risk-weighted assets. LAC is a simple average of Chile, Colombia, Mexico, Brazil, and Peru.
Source: *IMF Financial Soundness Indicators* (database).

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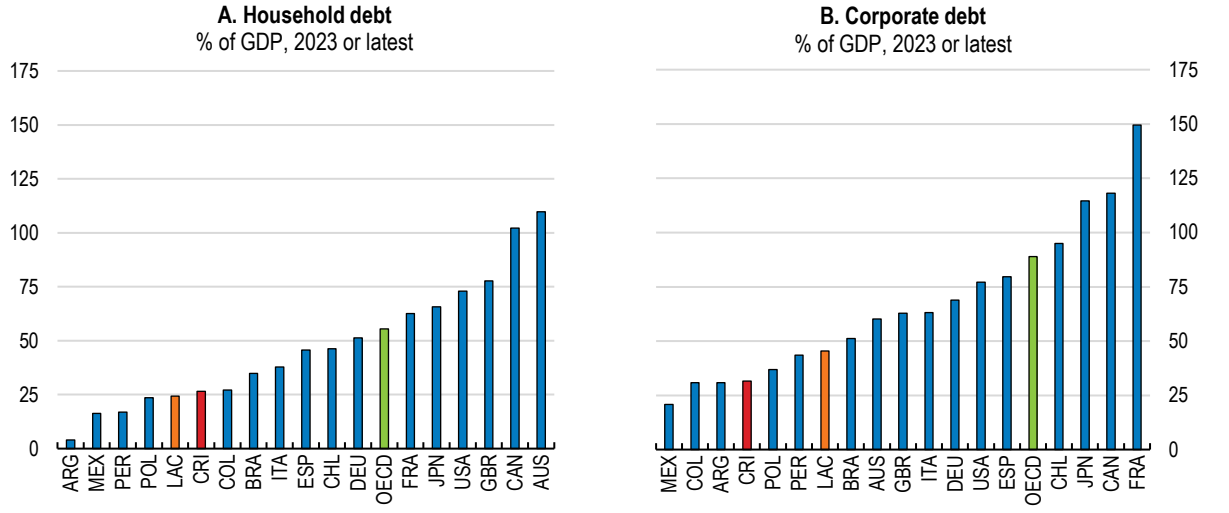
Recent steps such as the publication of stress test results bank by bank in January 2024, a long-standing OECD recommendation (OECD, 2020[5]) have enhanced financial supervision. However, the intervention of two small financial institutions in May 2024 and August 2024, due to mismanagement and improper accounting of non-performing loans, signals that there is a need to foster financial supervision further. This includes evaluating the impact of regulatory reforms undertaken in recent years and buttressing asset valuation practices. Efforts to strengthen governance and enforce existing criteria to ensure that board members in financial institutions, including cooperatives, have the necessary qualifications and experiences, are also warranted. A bill was submitted to the Legislative Assembly in May 2024 to improve the resolution scheme for supervised financial institutions, by expediting their resolution and enabling early intervention and changes in the management of affected entities. The bill also gradually removes the blanket state guarantee to public banks, another long-standing OECD recommendation (OECD, 2020[5]). Implementing the measures foreseen by the bill would buttress financial stability. Plans are also underway to enhance cybersecurity regulations and to stress test the financial sector against climate-change risks.

Private debt is relatively low (Figure 1.14) but high financial dollarization continues to pose challenges. Credit and deposits in dollars represent around 35% of the total (Figure 1.15). Regulators indicate that two thirds of the dollarized debt is unhedged. The recent reduction in foreign exchange market interventions can over time facilitate a better internalisation of exchange rate fluctuations risks by economic agents, reduce moral hazard and contribute to reduce currency mismatches and unhedged positions. In the short term, the interest rate differential between operations in colones and in dollars could foster dollarization, requiring strict monitoring. Credit in dollars has been increasing strongly in recent months (Figure 1.16). The risk weight for foreign exchange credit to unhedged borrowers was increased in January 2024. However, in view of recent large increases in foreign currency lending, recent macroprudential measures should be evaluated and, based on this evaluation additional prudential measures to discourage foreign currency borrowing should be considered.

Figure 1.14. Private debt is low



Note: LAC is a simple average of Chile, Colombia, Mexico, Argentina, Brazil, and Peru.
Source *IMF Global Debt* (database).

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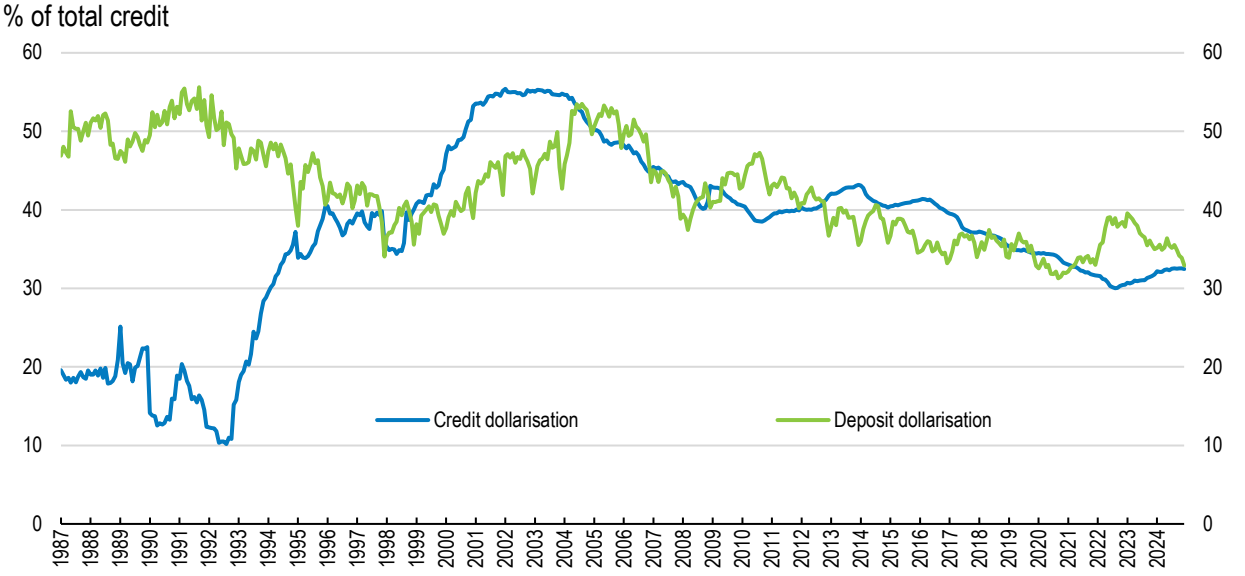
Figure 1.15. Financial dollarization remains high



Source: Banco Central de Costa Rica.

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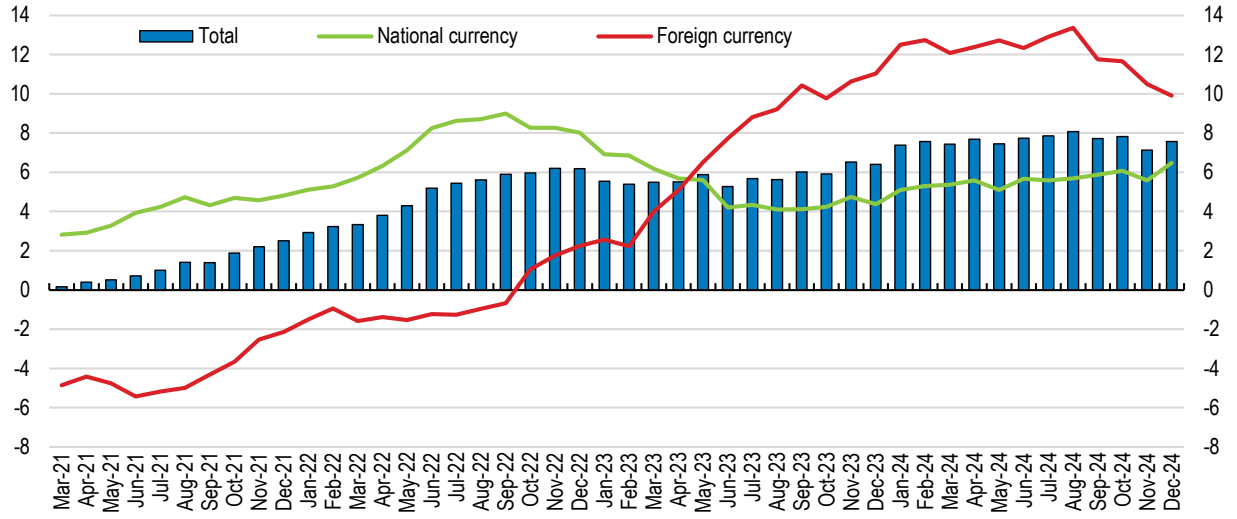
Figure 1.16. Foreign currency credit is increasing strongly

Credit to the private sector by currency, y-o-y growth rate, %



Source: Banco Central de Costa Rica (2024), *Informe de Política Monetaria Enero 2025*.

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1.3.2. Removing distortions in the financial system

Financial stability could also be further buttressed by correcting several distortions, affecting both state-owned and private banks and also state-owned and private insurance companies. These distortions fragment financial markets, hinder competition, and hamper the transmission of monetary policy. They also decrease banks' lending capacity and their ability to innovate and invest in technology. Key distortions include the so-called "banking toll" (*peaje bancario*), by which private banks must make transfers to a fund administered by state-owned banks. The transfers correspond to 17% of their 30-day or shorter-term deposits and are remunerated at an interest rate which is half of the basic deposit rate set by the Central Bank. Conversely, state-owned banks are subject to a number of contributions to several state institutions, such as the National Institute of Cooperative Development (*Instituto Nacional de Fomento Cooperativo*) (10%), the National Commission for Education Loans (*Comisión Nacional de Préstamos para Educación*) (5%), the National Commission of Risk Prevention and Emergency Response (*Comisión Nacional de Prevención de Riesgos y Atención de Emergencias*) (3%) and the Regime for Disability, Old Age and Death (*El régimen de Invalidez, Vejez y Muerte*) (15%). Correcting these distortions, as recommended in previous OECD Economic Surveys, would facilitate that banks increase their efficiency and their capacity to adapt to the changing global financial landscape and improve the transmission of monetary policy changes. It would also have an economy-wide positive impact by facilitating access by firms and households to financial services at lower costs. Institutions currently financed in part by these contributions should transition to full funding through the national budget.

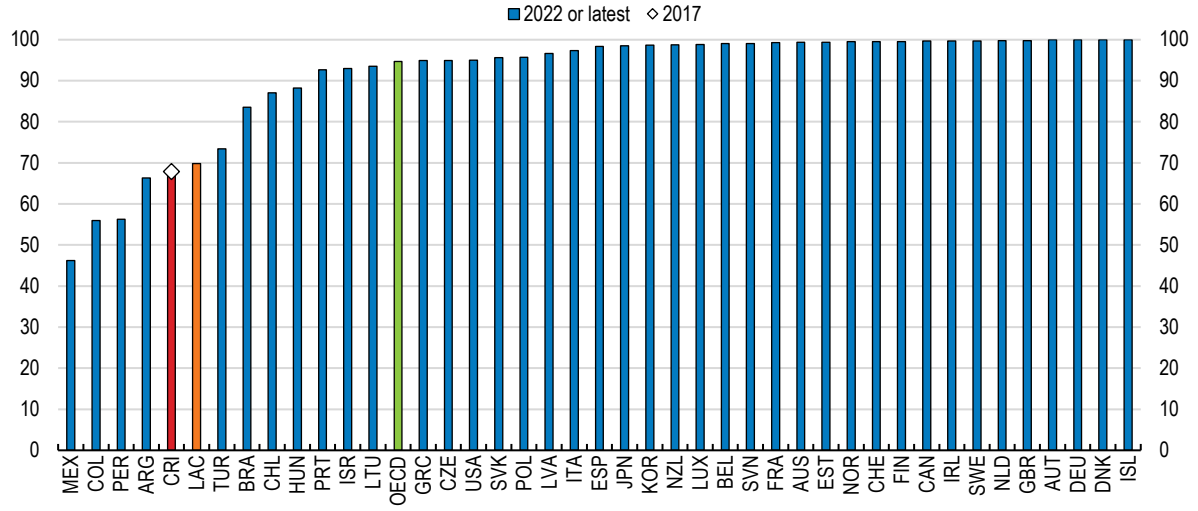
1.3.3. Broadening financial inclusion

Increasing financial inclusion remains a pending challenge (Figure 1.17). Access to bank accounts increased significantly after the pandemic, to 90% of the population in 2023, according to more recent Central Bank information (BCCR, 2023[7]), but there is much room to increase access to credit or other financial instruments. The cap on interest rates is causing financial exclusion. It was introduced in June 2020 to limit the cost of credit, but it is constraining access to credit, particularly for the most vulnerable and high-risk individuals, because financial institutions are less willing to lend to these groups due to the limited potential returns in relation to the higher risks involved. Informal and predatory credit channels,

which often charge exorbitant interest rates and are sometimes connected to criminal groups, have instead recently increased. One possibility to address the challenges posed by the existing cap is to instead apply tiered caps based on the risk profile of the borrower, allowing for higher rates for higher-risk loans. Reducing information asymmetries through a more comprehensive credit registry can also be a more effective way to facilitate access to finance. The credit registry in Costa Rica covers around 35% of the adult population, against 50% in Chile or 80% in Brazil. Expanding the scope of the registry, to incorporate information from non-supervised entities that are performing lending activities, would facilitate creditworthiness assessments by banks. Boosting competition in the financial sector and ensuring sound consumer protection would also contribute to boost financial inclusion and be more effective than the cap. The potential of Fintech to boost financial inclusion remains so far unrealised, as legal barriers remain in place (OECD, 2020[5]).

Figure 1.17. Increasing financial inclusion remains a pending challenge

% aged 15+ with an account at a financial institution



Note: LAC is a simple average of Chile, Colombia, Mexico, Argentina, Brazil, and Peru.
Source: *World Bank Global Findex* (database).

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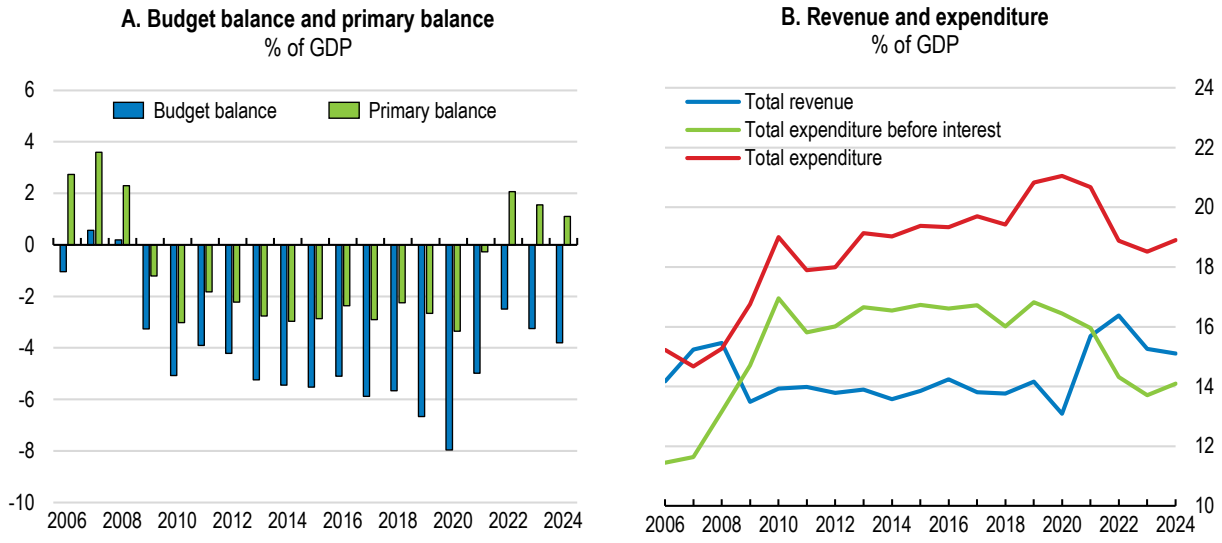
1.4. Securing fiscal sustainability

1.4.1. The fiscal situation has improved

After the widening fiscal deficits in the 2010s, Costa Rica has improved its fiscal situation (Figure 1.18). By adhering to the prudent fiscal targets set by the fiscal rule introduced in the fiscal reform enacted in December 2018 (Box 1.2), the country has set its debt-to-GDP ratio on a declining trajectory. This improvement has led to a notable reduction in sovereign risk premia (Figure 1.19). The government aims to further improve the fiscal situation. The central government fiscal balance is estimated to be at -3.8% in 2024, with the primary balance at 1.1% of GDP. This marks a slight deterioration compared to 2023, attributed to a retroactive public wage increase from 2020 that was not applied then, because of the aggravated fiscal situation created by the pandemic, and that was finally executed in 2024.

Figure 1.18. The fiscal deficit has been reduced



Note: Data refer to central government only. Total revenues do not include social security contributions.
Source: Ministry of Finance.

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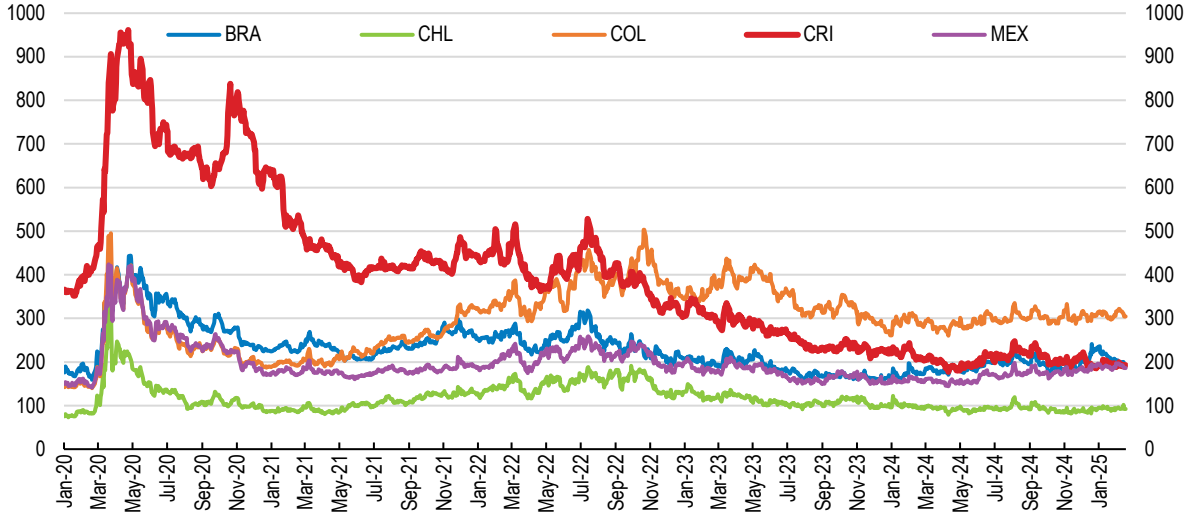
Figure 1.19. Sovereign risk premia have trended down

Emerging-market bond yield spreads, basis points



Note: ICE BofA emerging markets USD-issued sovereign bond option-adjusted spreads are the yield difference over US Treasuries, in basis points. Embedded options are provisions included with some fixed-income securities that allow the investor or the issuer to do specific actions, such as calling back the issue. The OAS helps investors compare a fixed-income security's cash flows to reference rates while also valuing embedded options against general market volatility.
Source: OECD calculations.

Box 1.2. Costa Rica's fiscal rule

The fiscal rule limits the growth of nominal spending depending on the level of public debt, as follows:

- When central government debt at the end of the previous fiscal year is under 30% of GDP or the current expenditure to-GDP ratio is below 17%, the annual growth of current expenditure should not exceed the average nominal GDP growth in the past four years.
- When debt at the end of the previous fiscal year is between 30% and 45% of GDP, the annual growth of current expenditure should not exceed 85% of the average nominal GDP growth in the past four years.
- When debt at the end of the previous fiscal year is between 45% and 60% of GDP, the annual growth of current expenditure should not exceed 75% of the average nominal GDP growth in the past four years.
- When debt at the end of the previous fiscal year is above 60% of GDP, the annual growth of total expenditure should not exceed 65% of the average nominal GDP growth in the past four years.

The fiscal rule law, part of the fiscal reform approved in December 2018, established that the spending of all non-financial entities of the public sector is subject to the rule. This includes the central government, all deconcentrated bodies, the legislature, the judiciary, or non-financial public companies. The fiscal rule law also established different conditions under which institutions can apply for a derogation. Derogations are possible in the case of the declaration of a national emergency or when the country is going through an economic recession (or projections of growth below 1%). As a result of the pandemic shock, several institutions such as Health Ministry, Education Ministry, or the Social Protection Institute (IMAS), were granted derogations.

The government's medium-term fiscal plan appropriately lays out continued gradual reductions in the central government's fiscal deficit, in line with the fiscal rule, with a target of 3.2% of GDP in 2025 (Table 1.4). The reduced deficit would mainly be driven by public sector wage restraint and the containment of transfers to public entities. OECD projections indicate that if the fiscal plan is fully implemented, the debt to GDP ratio will steadily decline (dashed line in Figure 1.21). A key factor in achieving this outcome is reducing the public sector wage bill overtime, which requires strict implementation of the public employment law (see also public spending efficiency section in this Chapter). Interest spending is expected to have peaked at 4.8% of GDP in 2024 (Figure 1.20), and gradually diminish afterwards, in line with the decline in the public debt stock. However, additional spending needs, such as those related to respond to increasingly frequent climate events, buttressing social policies or improving transport and water infrastructure, could strain debt dynamics (red line in Figure 1.21). Enhancing spending efficiency and boosting tax revenues (Table 1.5) are essential to meeting these spending needs while keeping debt on a downward trajectory. Complementing these efforts with an ambitious structural reforms package (Table 1.6) would accelerate the reduction in the debt ratio (blue line in Figure 1.21).

Table 1.4. Evolution of main fiscal aggregates

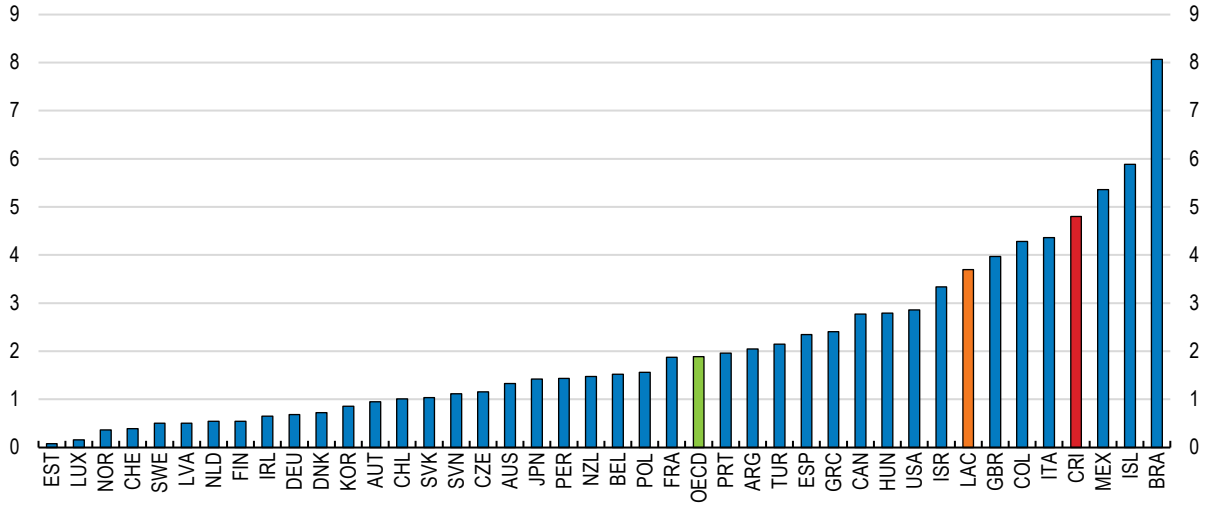
% of GDP

	2018	2019	2020	2021	2022	2023	2024	2025*	2026*	2027*
Total revenues	**13.8**	**14.2**	**13.1**	**15.7**	**16.4**	**15.3**	**15.1**	**14.9**	**14.9**	**14.9**
Tax revenues	12.7	12.9	11.9	13.8	14.1	13.6	13.4	13.3	13.3	13.3
Personal taxes			1.6	1.6	1.6	1.5				
Corporate taxes			2.5	3.1	3.3	3.4				
Value added taxes	4.1	4.3	4.4	5.1	4.9	4.9				
Other			3.4	4.1	4.3	4.0				
Other revenues			1.2	1.9	2.3	1.6				
Total expenditures	**19.4**	**20.8**	**21.0**	**20.7**	**18.9**	**18.5**	**18.9**	**18.1**	**17.7**	**17.2**
Current expenditure	18.1	18.8	19.8	19.2	17.5	17.2	17.3	16.6	16.1	15.5
Wages	6.6	6.5	6.8	6.5	5.9	5.6	5.8	5.3	5.0	4.7
Goods and services	0.6	0.6	0.7	0.8	0.8	0.7	0.7	0.7	0.7	0.7
Interest	3.4	4.0	4.6	4.7	4.6	4.8	4.8	4.8	4.5	4.3
Transfers	7.4	7.7	7.8	7.1	6.3	6.1	6.1	5.9	5.9	5.9
Capital expenditure	1.3	1.9	1.2	1.5	1.4	1.3	1.4	1.4	1.5	1.6
Central government primary balance		**-2.6**	**-3.4**	**-0.3**	**2.1**	**1.6**	**1.1**	**1.6**	**1.8**	**1.9**
Central government overall balance		**-6.7**	**-8.0**	**-5.0**	**-2.5**	**-3.3**	**-3.8**	**-3.2**	**-2.8**	**-2.4**
Non-financial public sector overall balance	-4.4	-5.3	-7.6	-3.8	-0.9	-1.4				
Government financing needs								8.3	8.0	7.0
Central government debt	**51.9**	**56.4**	**66.9**	**67.6**	**63.0**	**61.1**	**59.8**	**60.7**	**59.9**	**58.6**
Non-financial public sector government debt		50.0	59.9	59.0	53.4	49.5				

Note: Central government unless otherwise specified. Data for 2025-2027 are projections and based on Finance Ministry passive scenario. Other revenues include non-tax revenues and transfers. Some rows may not add up due to rounding.
Source: Medium-term fiscal framework (Marco Fiscal de Mediano Plazo) 2024-2029.

Figure 1.20. Interest paid on public debt remains very high

Interest paid on public debt, % of GDP, 2023 or latest



Note: LAC is a simple average of Chile, Colombia, Mexico, Argentina, Brazil and Peru.
Source: Ministerio de Hacienda; and *IMF Public Finances in Modern History* (database).

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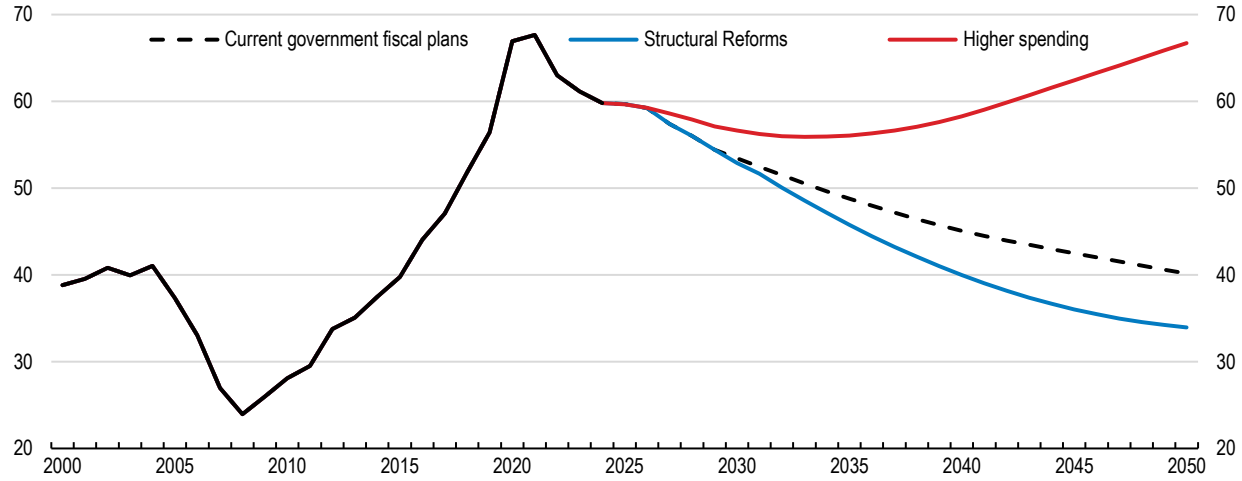
Figure 1.21. Current fiscal policies will keep debt on a declining path

Central government debt, % of GDP



Note: The "Current government fiscal plans" scenario assumes GDP growth as in Table 1.1 until 2026, with a gradual transition to OECD long-term model estimates of potential output thereafter. Inflation is projected as in Table 1.1 until 2026 and a gradual convergence to 3% thereafter. Fiscal assumptions are those outlined in Table 1.4 and in the government fiscal plan until 2029. Thereafter the fiscal primary balance continues to evolve in line with the fiscal rule. The "Structural reforms" scenario assumes the implementation of reforms described in Figure 1.5. Both "Current government fiscal plans" and "Structural reforms" scenarios assume full implementation of the fiscal rule. The scenario "Higher spending" assumes that the fiscal rule is not met and that primary spending is 1.5% of GDP higher than in current government fiscal plans, as an illustration of spending pressures related to climate change and increased spending on social policies and security, and that revenues remain as in current government fiscal plans. In all scenarios the evolution of the interest rate paid on new debt issued is a function of the 10 years US sovereign yield and a risk spread that depends on the ratio of debt-to-GDP. All scenarios include ageing costs in the form of higher pensions and health costs as estimated by (Pessino and Ter-Minassian, 2021).
Source: OECD calculations.

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Table 1.5. Illustrative fiscal impact of some recommendations

Fiscal recommendation	Estimated impact on fiscal balance, % of GDP
Revenue side	
Removing cooperatives' income tax exemption	0.1
Improving immovable property tax collection	0.3
Reducing fragmentation in tax payment and tax collection system	1
Phasing out reduced VAT rates (private education and health)	0.5
Introducing a carbon pricing scheme	0.3
Removing some personal income tax exemptions	0.5
Reducing payroll charges for low-income workers	-0.6
Total revenue side	2.1
Spending side	
Improving liquidity management across the public sector	1
Making greater use of the centralised procurement system	1.5
Full implementation of the public employment law	0.9
Strengthening early childhood education and care	-0.7
Expanding elderly formal care services	-0.3
Increasing spending on adaptation and enhanced infrastructure resilience	-1
Improving water infrastructure	-0.5
Improving transport infrastructure	-1
Improving waste management	-0.5
Total spending side	*-0.6*
Resulting change in primary balance	*1.5*

Note: Numbers in this table are estimates and subject to uncertainty. Implementation would take several years.
Source: OECD calculations.

Table 1.6. Expected gains from ambitious reforms are substantial

Illustrative estimated impact of selected reforms on potential GDP per capita after 10 years

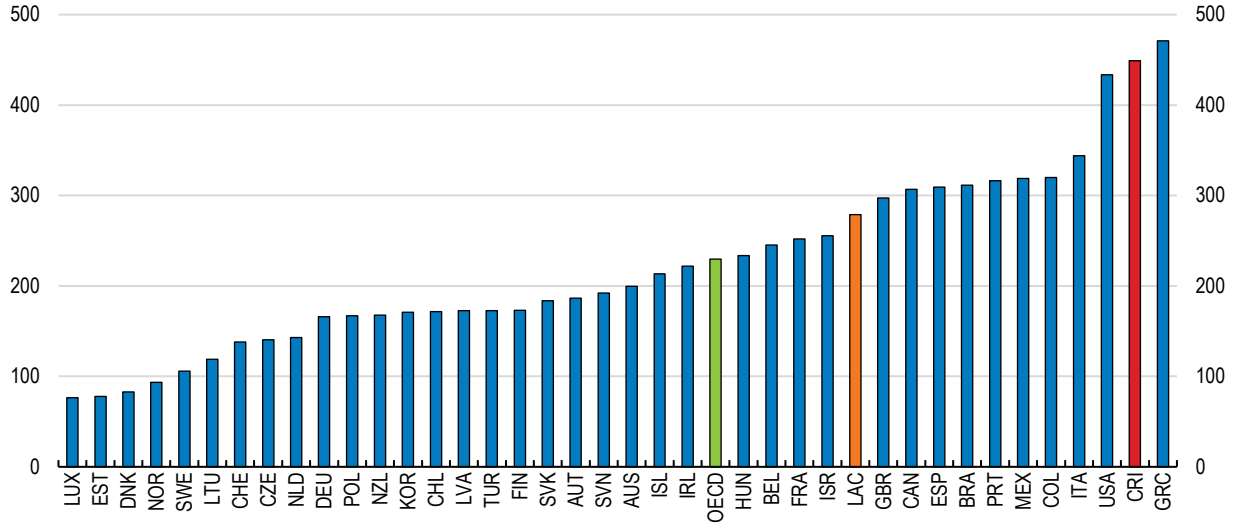
Reform	Impact on real GDP
Facilitate female labour market participation	4.7%
Further reduce regulatory burden	2.9%
Strengthen education outcomes	0.6%
Improving infrastructure	1.9%
Ambitious reform scenario: all the above together	10.3%
Implied average annual growth increase (of ambitious reform scenario):	1.0 percentage points

Note: Simulations based on the OECD long-term growth model (Guillemette and Château, 2023[1]). The scenarios assume that female employment rates, education outcomes or infrastructure quality indexes reach the OECD average by 2050, and that regulatory burden converges to the OECD average by 2030. The individual reform effects do not sum up to the effect of the ambitious reform scenario due to non-linear effects in the model.
Source: Simulations using the OECD long-term model.

Since its approval in December 2018, the perimeter of the rule has been gradually narrowed by exempting certain public agencies. Most recent modifications to the rule coverage were approved by the Legislative Assembly, despite the government's objections. With interest spending amounting to nearly 5% of GDP and debt levels high in relation to tax revenues (Figure 1.22), further legislative changes weakening the rule should be avoided, as they risk undermining the ongoing progress in public debt reduction and the gradual restoration of fiscal space.

Figure 1.22. The level of public debt remains high in relation to tax revenues

Public debt, % of total tax revenue, 2023 and 2022 or latest



Note: Data refer to central government for 2023 for Costa Rica, and to general government for 2022 or latest for all other countries.
Source: Ministerio de Hacienda; *OECD Revenue Statistics* (database); and OECD (2023), *Government at a Glance 2023*.

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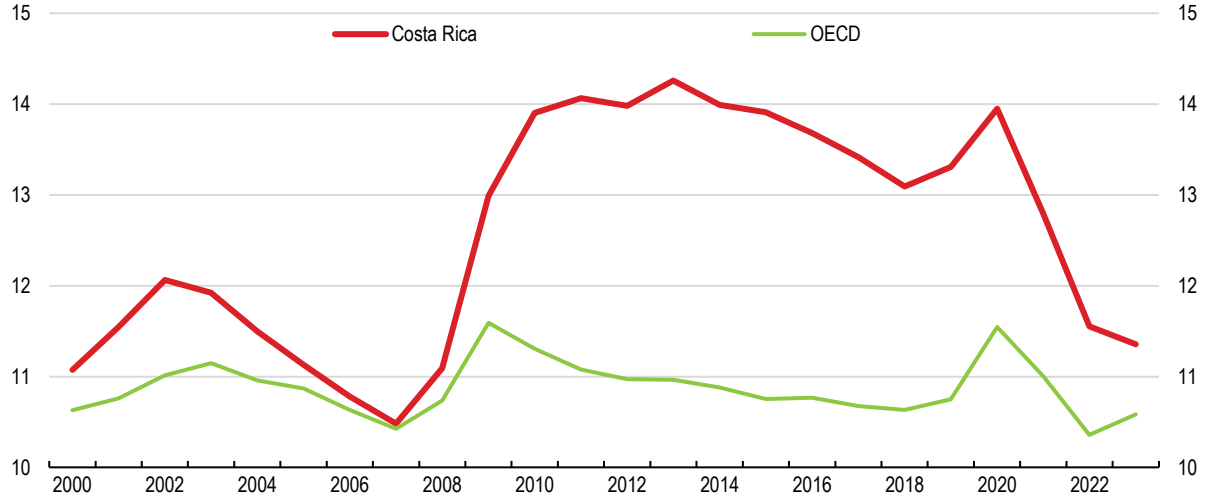
1.4.2. Improving the quality of spending to support growth and equity

Important steps to boost public spending efficiency have been taken, including the 2018 fiscal reform and the ongoing implementation of the public employment law (Figure 1.23). The law has standardized salary structures across the public sector and introduced performance-based incentives. Implementation has begun within the central government, with plans to extend it to additional public sector agencies. Full

implementation of the bill is a critical pillar supporting the government's medium-term fiscal strategy. Substantial opportunities remain to improve the quality of spending to better foster economic growth and equity. Education is a high priority for Costa Rica, devoting around 6.5% of GDP, a larger share of spending than the average OECD economy, yet educations outcomes are relatively weak (Figure 1.24). Improving universities responsiveness to labour market needs and prioritising vocational programmes providing technical skills would improve efficiency in the education sector, as analysed in the thematic Chapter of the 2023 Economic Survey and in Chapter 4 of this Survey. Conversely, Costa Rica also devotes a larger share of spending to health, resulting in good health outcomes, including a life expectancy in line with the OECD average This indicates that there remains significant heterogeneity in public sector spending efficiency across different areas. Regularly carrying out spending reviews, increasingly adopted by many OECD countries (Box 1.3), but not yet implemented in Costa Rica, could help Costa Rica to identify areas in need of improvement and inform the necessary prioritisations and reallocations of spending. Integrating them in the budget process would foster economic growth and equity. Spending prioritisations and reallocations will become increasingly important as population ageing will gradually put further pressure on some categories of social spending, particularly pensions.

Figure 1.23. The public employment wage bill has been reduced

Compensation of employees by general government, % of GDP



Note: OECD is an unweighted average of 31 OECD member countries with available data.
Source: *OECD National Accounts at a Glance* (database).

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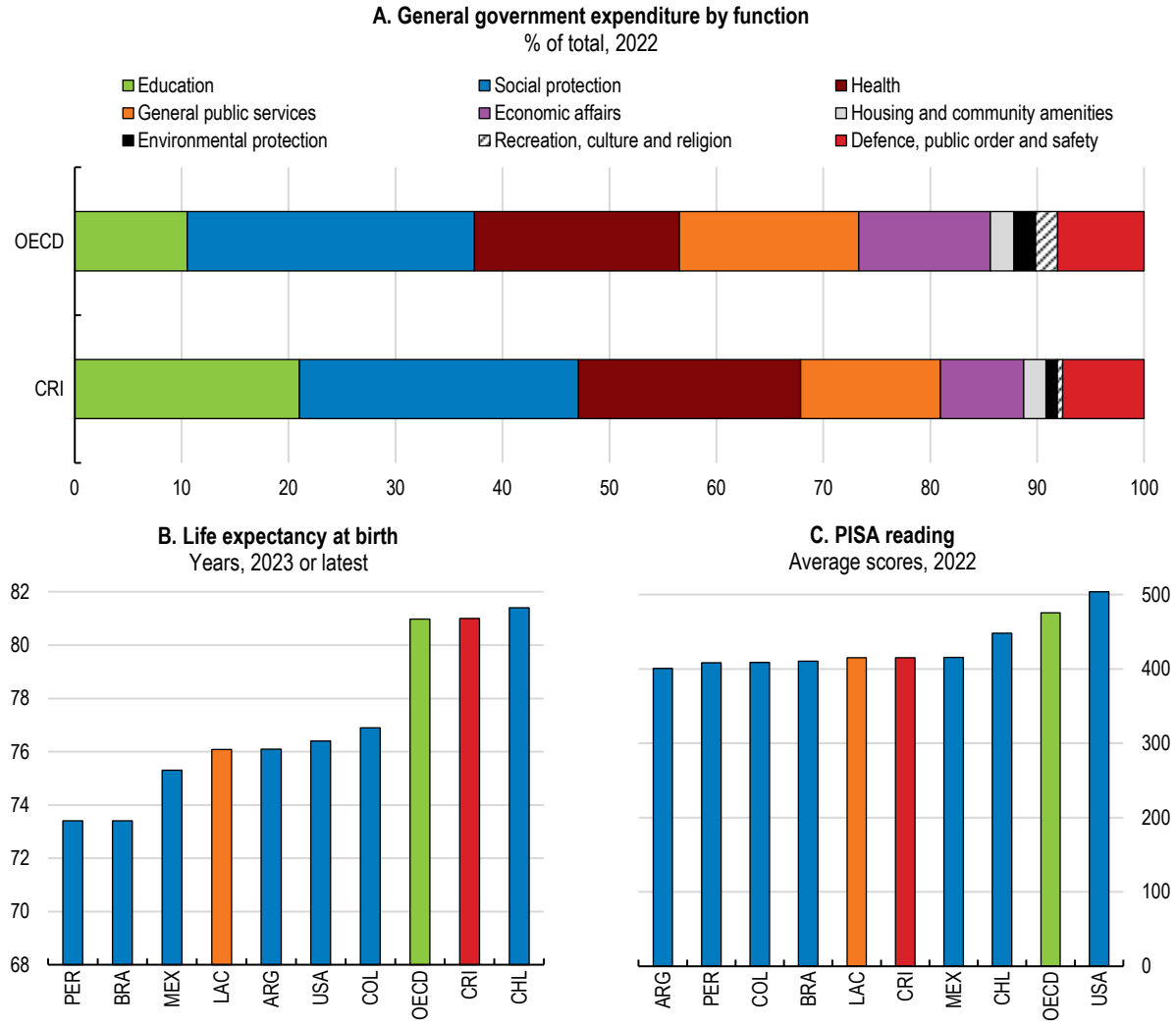
Efforts to boost public sector efficiency, including through spending reviews, require information and evidence to support the reallocation of resources or reformulation of programmes that are not delivering the expected results or may no longer reflect the priorities of citizens. To that end, increasing the availability, sharing and use of data is critical, as illustrated by several OECD countries (Box 1.4), that have used data to improve policy design, while safeguarding data confidentiality and security. Access to relevant and disaggregated data is a key bottleneck to policy making across several policy areas in Costa Rica, as outlined in this Survey. For example, more timely information about enrolment in vocational and university education would allow to better assess latest labour market developments and design policies helping youth get jobs. Ensuring access to individualised and identifiable microdata by the Central Bank would also help to better monitor financial risks. In some cases data are available and efforts should focus on facilitating access and sharing. Legislative changes limiting data access and sharing, including to individualised and identifiable microdata, such as the ones submitted to the Legislative Assembly in April 2024, should be avoided, as it would hamper evidence-based policy decisions.

Figure 1.24. Costa Rica devotes a larger share of spending to education but outcomes are weak



Note: In Panel A, data refer to 2023 for Colombia and Israel, and to 2021 for Costa Rica. OECD average excludes Canada, Mexico, New Zealand, and Türkiye. In Panel B and C, LAC is an unweighted average of Chile, Colombia, Mexico, Argentina, Brazil, and Peru.
Source: *OECD National Accounts* (database); *OECD Health Statistics* (database); and *OECD PISA 2022* (database).

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Social policy is an area in which data availability has increased over the years creating good grounds to improve policy design. A common database on social policy programmes, SINIRUBE, was created in 2013, and has been evolving since then, merging all registries from social programmes. This database has the potential to significantly improve the targeting of social programmes, eliminating existing overlaps and reaching eligible beneficiaries not yet covered by social programmes. Now, public agencies in charge of delivering social programmes freely select beneficiaries. This results in overlaps and poor targeting, with some social programmes having more than 20% of beneficiaries in the two highest income quintiles (OECD, 2023[8]). Making SINIRUBE the tool to select beneficiaries in all social programmes will ensure better targeting and wider reach of social programmes. SINIRUBE could also be used to evaluate the effectiveness of social programmes, to identify which programmes have positive outcomes and should be expanded and which ones should be reformulated or phased out. Plans to further improve SINIRUBE are welcome and include the interoperability of the underlying databases, to ensure that the registry is always based on the most recent available information. Social programmes also suffer from institutional fragmentation, with 21 institutions in charge of providing more than 35 social programmes. Ongoing plans

to concentrate all social programmes in the Social Policy Institute (IMAS) and to grant it ministerial status could reduce fragmentation. There are also promising plans to create a one stop facility, helping individuals to have a unique contact point to access social programme support, which could improve the reach and coverage of social programmes.

Box 1.3. Spending reviews best practices

Spending reviews provide a strategic approach for governments to enhance the sustainability of public finances by systematically analysing existing expenditures. They also provide opportunities to align spending with government priorities and improve its effectiveness While the scope and implementation of spending reviews vary by country, and require customized institutional setups, experiences from OECD countries suggest key best practices, including:

- Formulating clear objectives, including saving targets.
- Gradually covering a significant portion of the budget and government priorities.
- Developing expertise to conduct spending reviews both at finance ministries and within line ministries.
- Establishing clear governance arrangements.
- Ensuring alignment with the budget and the medium-term fiscal framework.
- Concluding reviews with clear recommendations and monitoring their outcomes.

Box 1.4. Data at the centre of policy design: Estonia and Finland

The availability and sharing of data within the public sector are key to enhancing public policies design by enabling better-informed decision-making, reducing duplication, improving resource allocation, and enhancing transparency and accountability. Estonia and Finland are good examples where data are central to policy design.

- Estonia's e-Government system, known as X-Road, is a decentralized data exchange platform that allows secure and efficient communication between various government agencies. Each citizen has a unique digital ID that facilitates secure access to public services and personal data management. This system enhances transparency and reduces administrative burdens, enabling real-time data exchange for personalized services and data-based policymaking.
- Finland employs a national data exchange layer, similar to Estonia's X-Road, which enables secure and interoperable communication between different public sector systems. Legislation supports data sharing while protecting privacy, allowing agencies to use personalized data to design targeted social services, healthcare, and education policies.

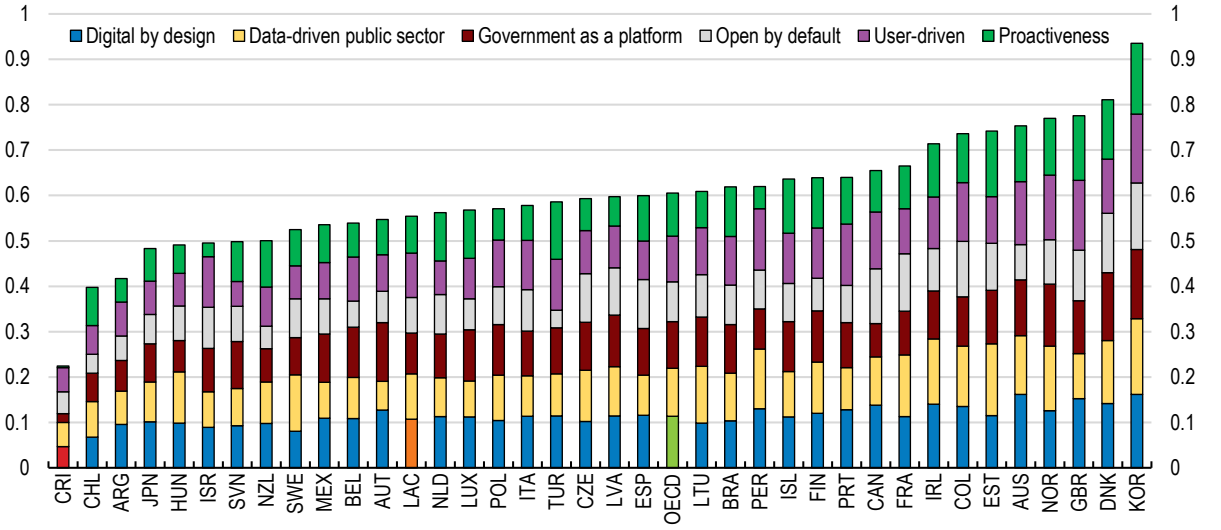
Government's ability to deliver high-quality public services and reduce costs could also increase by accelerating the digitalisation of the public administration. This could improve efficiency in areas like education, health, and legal services while reducing bureaucracy. Costa Rica lags other OECD countries and regional peers in terms of digital government (Figure 1.25). Accelerating the digitalisation of the public administration would require better coordination and harmonisation of IT standards and administrative procedures across government agencies. Improving the adoption by citizens of the digital signature (see Chapter 2) would also be a key building block. Costa Rica has also room to better align the delivery of policies and services to user needs (OECD, 2024[6]). The planned social programmes one-stop facility is a good example of how to deliver public services with the users' needs in mind, rather than being driven by administrative considerations. The use of Artificial Intelligence could also help Costa Rica to enhance

government internal processes. Artificial Intelligence is already being utilized by 66% of the governments in OECD countries (OECD, 2024[9]). Artificial Intelligence can particularly help to automate document processing, helping to extract relevant data and to process it in the appropriates databases, being a useful complement to recommended efforts to increase the use and sharing of data across the public sector. By automating routine tasks, Artificial Intelligence can also free up government employees to focus on more complex issues. Costa Rica has recently established an Artificial Intelligence national strategy to integrate Artificial Intelligence efficiently in the public administration.

Efficiency gains and cost-reductions could also be obtained by centralizing liquidity arrangements across the public sector into a single public entity. Now every public agency has its own liquidity arrangements, which implies higher operational costs, multiplicity of bank fees and higher interest rate payments. A proposal by the General Comptroller to centralize fund management is estimated to generate savings equivalent to 1% of GDP. While this estimate is subject to some uncertainty, improving and centralising liquidity management in the public sector can render several benefits beyond the cost savings. By making use of the electronic payment system, it can foster digitalization across the public sector. By ensuring transparent financial transactions, it can foster oversight and accountability.

Figure 1.25. Costa Rica lags in digital government

Digital Government Index, 0-1 (or "stronger foundations for digital government")



Note: The data collection period for this edition of the DGI is from 1 January 2020 to 31 October 2022. Data for Germany, Greece, the Slovak Republic, Switzerland, and the United States are not included.
Source: OECD (2024), *2023 OECD Digital Government Index: Results and key findings*.

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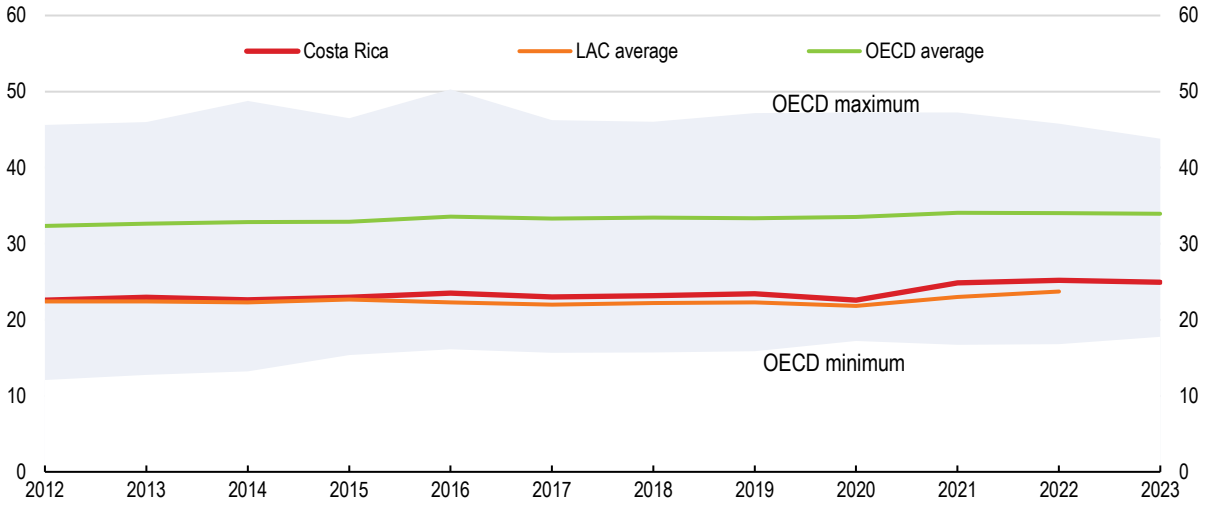
1.4.3. Broadening tax bases and improving the tax mix

Tax revenues increased after 2018's tax reform but remain 8 percentage points lower than the average OECD country (Figure 1.26). The effects of 2018's tax reform have now fully materialized and more recent data show that tax revenues have started to decelerate. There are challenges in advancing another tax reform, as recent government efforts, such as the proposal for a dual personal income tax system, have faced difficulties gaining the necessary political support in the Legislative Assembly. A more viable path for mobilizing more tax revenues could be increasing the revenue-raising capacity of some existing taxes and improving the tax mix (Figure 1.27), relying less on social security contributions and more on other general taxes, such as personal income and immovable property. Such rebalancing of the tax mix would contribute to reduce informality (see also Chapter 2), which would, by increasing formal employment,

broaden tax bases. Given low tax revenues and the limited scope for advancing a tax reform, it will be important not to further erode tax bases, therefore legislative changes granting large tax exemptions must be avoided.

Figure 1.26. Costa Rica tax-to-GDP ratio is low

Tax revenue, % of GDP



Note: LAC is a simple average of Chile, Colombia, Mexico, Argentina, Brazil, and Peru. Data for Australia and Japan refer to 2022. Tax revenues in this chart include social security contributions and therefore differ from the tax revenues shown in Table 1.4, which only reflect central government figures.
Source: *OECD Global Revenue Statistics* (database).

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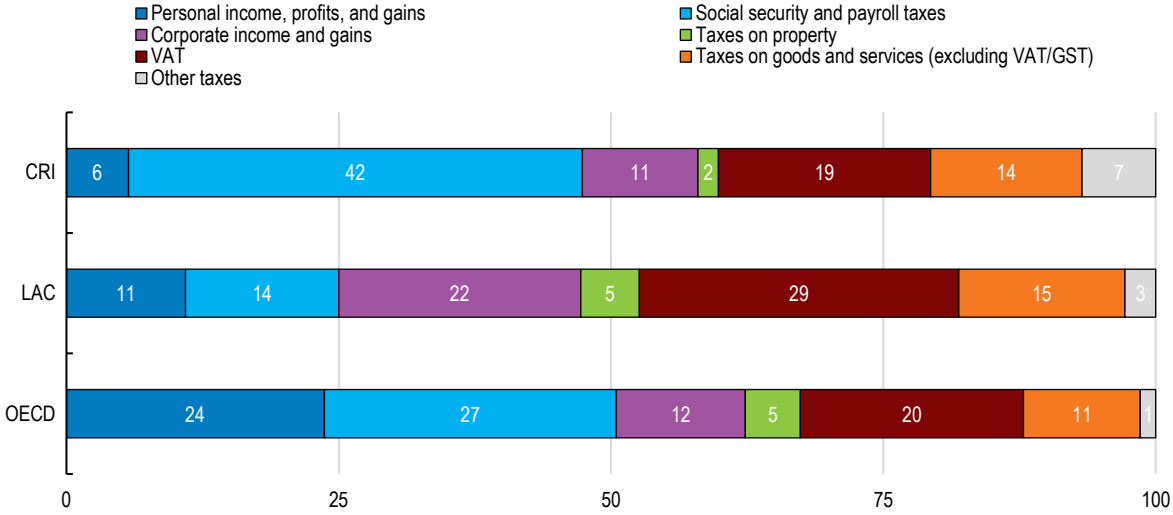
Figure 1.27. Costa Rica derives a high share of its revenues from social security and payroll taxes

% of total tax revenue, 2023



Note: LAC is a simple average of Chile, Colombia, Mexico, Argentina, Brazil, and Peru. OECD and LAC average refer to 2023 or latest. Tax revenues in this chart include social security contributions and therefore differ from the tax revenues shown in Table 1.4, which only reflect central government figures.
Source: *OECD Revenue Statistics in Latin America and the Caribbean* (database); and *OECD Revenue Statistics* (database).

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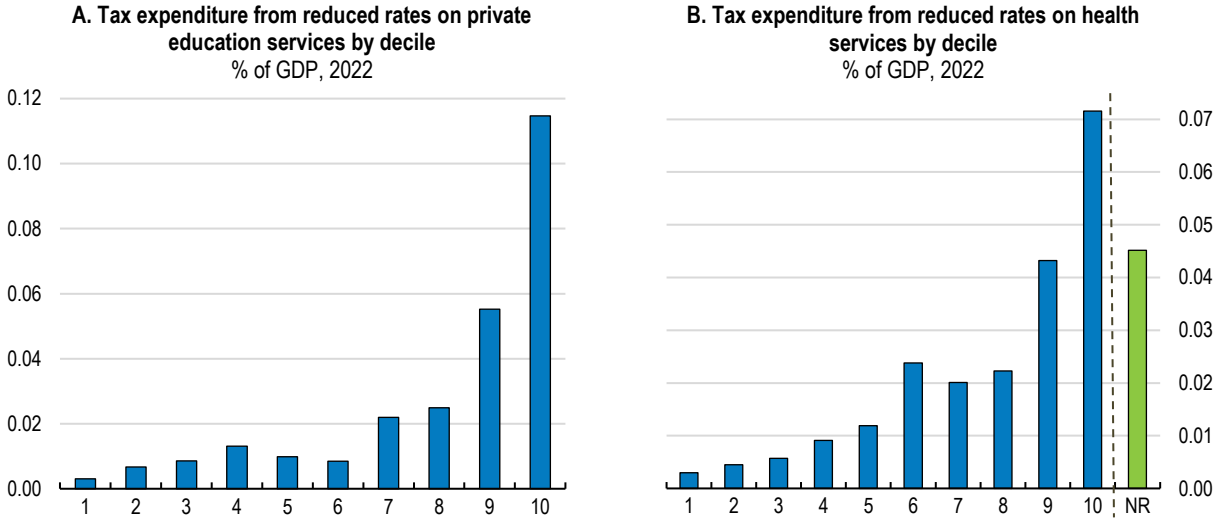
Broadening tax bases by reducing exemptions could increase revenues without raising rates and the ability of the tax system to reduce income inequality, which is currently low. The Ministry of Finance has started publishing an annual report that provides quantitative and detailed information on tax exemptions and can serve as a robust basis for gradually eliminating regressive exemptions. Total tax expenditures account for 4.6% of GDP (MinHac, 2022[10]). Many of them benefit particularly affluent taxpayers, such as certain VAT tax expenditures resulting from taxing some goods and services at reduced rates. Tax expenditures from reduced rates alone amount to 2.2% of GDP. Exemptions for private education and healthcare are particularly regressive, primarily benefiting high-income households (Figure 1.28). Starting to tax the income of cooperatives, which remain exempt despite some of them being large multinational corporations, enjoying trade protection and monopolistic conditions, should also be considered and would yield additional revenues.

There are also opportunities to broaden the personal income tax base, which currently generates a lower share of revenues than in OECD and regional peers (Figure 1.29, panel A). Options to increase revenues in a progressive way include phasing out tax exemptions of the 14th monthly salary for public employees (*Salario escolar*) and of the additional salary or "bonus" paid in December of each year (*Aguinaldo*). Another option to increase revenues is to lower the personal income threshold to start paying taxes. Currently the threshold is set at nearly double the average wage, compared to 0.6 times in Mexico or just 0.3 times the average in OECD countries. The newly taxable income brackets could be subject to a lower entry tax rate. For example, in Mexico the entry tax rate is 1.9%, against a 10% entry tax rate in Costa Rica.

Figure 1.28. Tax revenue forgone from reduced VAT rates benefit high-income households



Note: In Panel B, "NR" refers to non-residents.
Source: Ministerio de Hacienda, Subdirección de Estudios Económicos.

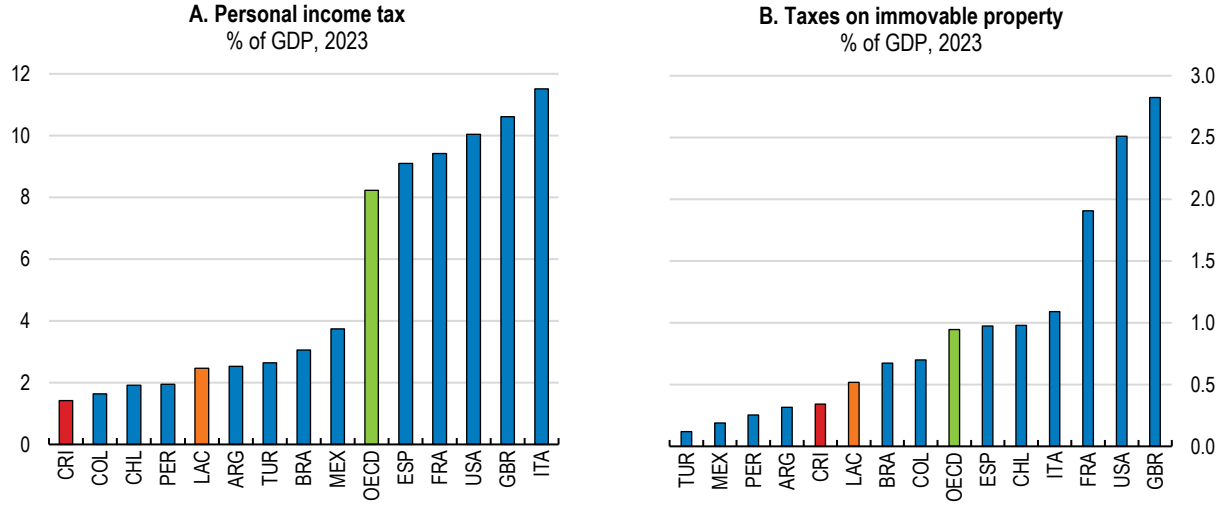
StatLink https://stat.link/8fdmyc

Tax exemptions granted to free trade zones amount to 1.5% of GDP per year. Existing evaluations suggest that free trade zones have brought economic advantages to the country, including an increasingly diversified export basket (Alfaro, 2024[11]), productivity increases (Vega-Monge, 2023[12]) and job creation (Procomer, 2023[13]). The scheme should continue to be regularly evaluated to assess its costs and benefits, in particular how much additional investment, employment and productivity it generates. Costa Rica's free-trade-zone regime is one of the elements in its strategy to attract foreign direct investment. To maintain its competitive edge, updating domestic tax regulations in alignment with evolving international standards is essential. This would ensure maintaining attractiveness for FDI and reinforcing Costa Rica's

reputation for transparency and international cooperation on tax matters. As the global minimum corporate effective tax rate is progressively implemented, other factors in Costa Rica's FDI strategy, such as the availability of a highly skilled workforce (see Chapter 4), will become increasingly important.

Additional revenue collection could also come from recurrent taxes on immovable property (Figure 1.29, panel B), which have a significant redistributive power, are efficient and can deliver significant revenue increases. They deliver 1% of GDP in revenues in the average OECD country against 0.4% in Costa Rica. The central government is responsible for building and maintaining the cadastre while the local governments are responsible for the valuation of property. Valuation rules across local governments are very heterogeneous. Providing support to local governments to ensure that market-valuation rules are applied across all municipalities would prevent unfair competition (OECD, 2017[14]) and increase revenue collection. Exempting low value properties and establishing different tax rates depending on the property value could ensure progressivity.

Figure 1.29. There is room to strengthen personal income and immovable property tax revenues



Note: LAC is an unweighted average of Chile, Colombia, Mexico, Argentina, Brazil, and Peru. OECD and LAC average refer to 2023 or latest.
Source: *OECD Global Revenue Statistics* (database).

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Environmental tax revenues, at 2.3% of GDP, are above the OECD average and regional peers but there is still room to green the tax system further. Diesel is taxed at a rate that is 60% that on gasoline, despite its higher polluting nature. The tax on bunker fuel is also 10% that on regular gasoline. Gradually aligning the rates on diesel and bunker fuel with the gasoline rate would be a first step to use the tax system more forcefully to support the energy transition (see also Chapter 3). Fuel excise taxes are the only way GHG emissions are priced in Costa Rica. An additional step to green the tax system would be to introduce a carbon pricing scheme. This could take the form of a carbon tax element of the fuel excise levy (OECD, 2023[15]), and it would involve adjusting the fuel excise tax to account for the carbon content of the fuel. Its rate could be set at a low level and gradually raised according to a pre-determined schedule. Introducing a carbon tax of EUR 120 tCO2, a mid-range estimate of carbon costs in 2030 for OECD countries, would yield revenue equal to 0.3% of GDP (OECD, 2022[16]). Increasing the carbon price implies political economy challenges, as diesel is largely used in agriculture and public transportation. Phasing in the increase gradually, and temporarily supporting vulnerable households with targeted transfers could facilitate buy-in.

Improving the tax administration and collection efforts could also provide additional revenues (Table 1.5) and reduce tax evasion. There remains room to reduce fragmentation in the collection and administration

of taxes. Numerous public agencies are involved in the collection of taxes. Besides the Finance Ministry, municipalities, the Social Security Institute, the National Insurance Institute, the Central Bank, pensions and insurance operators, several SOEs and professional associations, all are involved in tax collection (CGR, 2021[17]). For the existing 99 taxes, there are 93 different IT platforms used by 143 public institutions. Moving towards a more centralised, digital and less fragmented tax payment and collection system could offer significant efficiency gains and savings that could reach 1% of GDP (CGR, 2021[17]).

Expediting the resolution of tax liabilities would also boost public revenues by ensuring quicker collection and reducing the accumulation of unresolved cases that delay government funding. There is also room to foster tax compliance and reduce tax evasion by ensuring a greater use of electronic invoicing. Electronic invoicing refers to the issuance of an invoice in digital format, documenting commercial transactions electronically. It was introduced in Costa Rica in 2003, and it became compulsory in 2018, except for firms registered under the Simplified Taxation Regime (which tend to be microenterprises in some sectors, such as agriculture or fishery). Compliance has been nevertheless low. Around 43% of those obliged to issue electronic invoices are not complying with this requirement. The successful deployment of e-invoicing in Chile (Box 1.5) suggests that supporting SMEs with free electronic invoicing tools that they could directly use and with training can facilitate a greater use of electronic invoicing. It would also be a valuable step to enable a greater use of pre-filled tax returns, which have been successful to facilitate tax compliance across the OECD, including in Chile.

Box 1.5. Simplifying tax compliance through e-invoicing: the case of Chile

Chile was the first Latin American country to implement an e-invoicing system in 2003, as part of its Digital Agenda. By 2017 more than 80% of firms filling taxes were issuing electronic invoices. This successful take-up was facilitated by the gradual adoption process developed by Chile's tax administration. Initially, e-invoicing was voluntary, but it later became mandatory through a phased four-year process, with requirements and timelines tailored to firms' characteristics, such as size and location (urban versus rural). To support compliance among SMEs, Chile's tax authorities introduced MiPyme, a free electronic invoicing portal designed to ease the transition. Although originally targeted at SMEs, the portal was eventually made available to all businesses. By 2023, more than 90% of firms were using the tax authority's platform. In addition, tax authorities launched extensive information campaigns to promote the benefits of e-invoicing and provided training tools, such as manuals, online videos, and a helpdesk team offering telephone support. E-invoicing has brought numerous benefits to Chile, including simplifying tax compliance and reducing tax evasion. For instance, the data from electronic invoices is used by the tax authorities to prefill VAT returns, a process that benefited 93% of all taxpayers in 2022 (OECD, 2022). This system has significantly reduced compliance costs for taxpayers, cutting the time and expense associated with filing returns. Additionally, the increase in tax revenues from the prefilled returns system has been estimated to be 31 times greater than the budgetary cost of its implementation (IDB, 2023[11]).

1.4.4. Enhancing the fiscal framework

The fiscal rule, enacted in December 2018 and effective since 2020, is the key building block of Costa Rica's fiscal framework. It has provided the necessary spending discipline while allowing flexibility during the pandemic's economic shock. Despite a challenging political environment marked by numerous and continuous requests from public agencies for exceptions, the rule has successfully contained spending, reduced debt, and restored fiscal credibility in Costa Rica. In the medium term, a thorough review of the fiscal rule, drawing from the lessons learned during its implementation in recent years, could help refine its design and ensure it continues to deliver a prudent fiscal stance and sustainable debt dynamics.

Costa Rica has gradually enhanced its fiscal framework. The annual publication of the "Medium-term Fiscal and Budgetary Framework" (*Marco Fiscal Presupuestario de Mediano Plazo*) by the Ministry of Finance has significantly evolved beyond short-term forecasts, now incorporating detailed medium-term projections, scenario analysis and contingent liabilities quantifications. This framework can serve as a robust foundation for adopting a fully-fledged multi-year expenditure system, as done by many OECD countries. This would help to avoid the current focus on next year's spending allocation and would help to align budgetary decisions with long-term policy goals.

Costa Rica's fiscal framework has also started to account for additional expenditures related to contingent liabilities arising from disaster events, including those linked to climate-related events. For the first time, the April 2024 edition of the medium-term fiscal framework included quantitative analyses of climate transition risks. Information systems are being upgraded to enable classification of climate-related expenditures in the budget, facilitating prioritization of investments in adaptation and mitigation (see also Chapter 3). Efforts to operationalize gender budgeting are also underway, including monitoring gender-related spending execution throughout 2024.

Costa Rica's fiscal framework would be further buttressed by setting-up an effective and independent fiscal council, as recommended in previous OECD Economic Surveys. Fiscal councils in other countries in the region, such as Chile and Colombia, have recently been reinforced, yielding significant benefits. These institutions contribute to more informed fiscal policy debates by providing independent and expert analysis that helps to communicate fiscal risks and policy options. Their independent assessments promote greater public trust in government actions by enhancing accountability and transparency. By offering forward-looking assessments of the fiscal situation, fiscal councils can support finance ministries in their communications with both domestic and international stakeholders, including investors and credit rating agencies. This forward-looking approach helps build trust and confidence, which can lead to improved borrowing conditions. The executive decree to establish an independent fiscal council was approved in March 2020, but more than four years later, the council has not started to operate. OECD experience suggests that providing the fiscal council with independent technical support is critical (Caldera et al., 2024[18]). Defining explicitly at which moments in the process of preparation of the medium-term fiscal plan the council is consulted and by when it should issue its assessment would help the council to fulfil its role. Mechanisms to ensure that there is some follow-up of the council assessment and opinions would also be valuable.

Sound management of public debt, by promoting market confidence and medium-term fiscal sustainability, is also essential in a solid fiscal framework. With interest payments nearing 5% of GDP, sustained efforts to enhance debt management are particularly crucial for Costa Rica. Costa Rica has significantly improved debt management over the years, lengthening its maturity and reducing roll-over risks. However, debt management continues to suffer from institutional fragmentation, with different departments overseeing local and external debt, leading to overlaps and inefficiencies. A law approved in August 2024 establishes a unified debt management agency. As analysed in previous OECD Economic Surveys (OECD, 2020[5]) (OECD, 2016[4]), this would help to better take advantage of market funding opportunities and improve risk assessments and management, as evidenced by several OECD countries (Box 1.6). Debt management has also suffered from a complex process to issue debt in foreign currency. Presently, issuing debt in foreign currency requires specific approval by the Legislative Assembly, which causes delays and increases sovereign funding costs, as the timing of issuance depends on when exactly the Assembly approves, rather than on market opportunities. The government has recently proposed a constitutional reform to establishes that the annual approval by the Legislative Assembly of issuing debt in foreign currency would take place at the same time as the approval of the total debt ceiling. This change would facilitate debt management and could reduce sovereign funding costs, as the approval would be obtained earlier, allowing to adapt the precise timing of debt issuance to market conditions.

Box 1.6. Institutional reforms to improve debt management: the case of Portugal

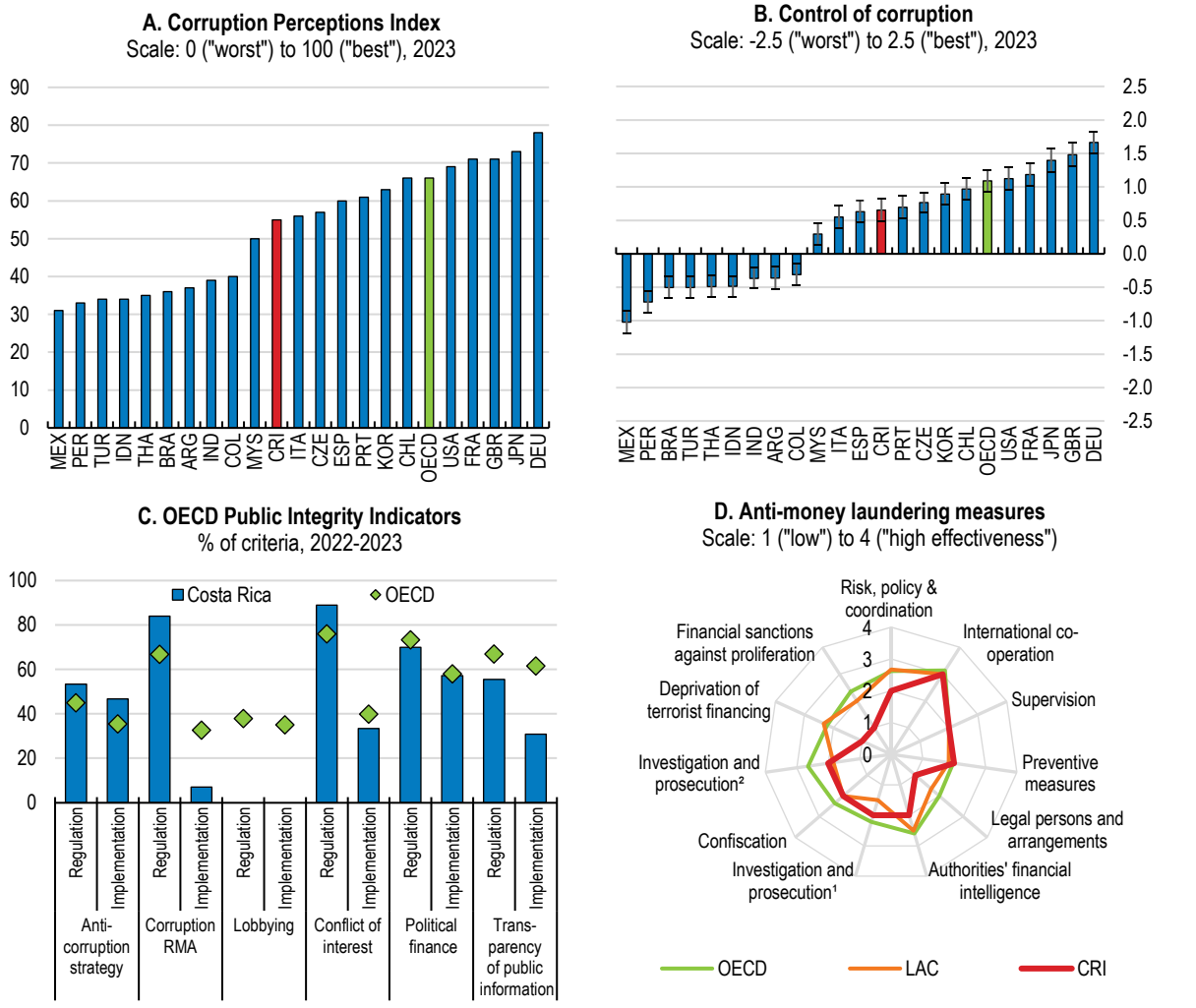
During the 1990s, Portugal implemented significant reforms to enhance public debt management and adapt to evolving European debt markets. Prior to these reforms, the Ministry of Finance had two separate departments managing central government debt: the Treasury Department, responsible for external debt and the issuance of treasury bills, and the Public Credit Department, responsible for domestic debt (excluding treasury bills). Following the reform, all operational activities associated with central government debt management, including debt servicing, were centralized in a newly created debt agency, IGCP (*Agência de Gestão da Tesouraria e da Dívida Pública*). According to its legal framework, IGCP was empowered to negotiate and carry out all financial transactions related to the issuing of central government debt and the active management of the debt portfolio, in compliance with the guidelines approved by the Minister of Finance. IGCP submits a detailed quarterly report to the Minister of Finance, outlining all transactions executed during the period and presenting the cost and risk figures of the debt portfolio. Additionally, an annual report is published, detailing the activities carried out throughout the year and presenting the financial debt accounts.

1.4.5. Reducing and preventing corruption

Continuing the fight against corruption is also essential to enhance fiscal sustainability. Corruption erodes public trust, weakens tax compliance, diverts public resources, and impairs the efficient delivery of public services. Costa Rica has recently made good progress to enhance anti-corruption measures. This includes efforts to strengthen public procurement, an area in which Costa Rica faced the largest corruption scandals in the past. Stricter requirements for awarding direct government contracts have been established, and the Integrated Public Procurement System has become the default procurement tool in the public sector. These improvements can yield significant savings, potentially reaching up to 1.5% of GDP (CGR, 2019[19]). Key pending challenges to reap the benefits of the integrated procurement system are increasing coordinated purchases, to avoid higher costs associated to fragmented purchases, and increasing the pool of bidders, to boost competition and reduce costs (CGR, 2024[20]). In line with previous OECD recommendations, a law establishing specific mechanisms for the protection of whistleblowers and witnesses of acts of corruption was enacted in 2024. Efforts to strengthen the capacities of the Prosecutor Office and the Judicial police to investigate corruption and money laundering crimes are also ongoing.

One important area where Costa Rica has room to reinforce its anticorruption and public integrity framework concerns lobbying activities (Figure 1.30). Such activities are unregulated in Costa Rica, which implies a risk that certain groups can benefit from undue influence, leading to policies that are inefficient and do not serve the public interest. Around half of OECD countries have regulations that define lobbying activities and who qualifies as lobbyists (OECD, 2024[21]). Establishing sanctions, an authority to oversee compliance with lobbying regulations and a public lobbying register are key building blocks of a robust lobbying framework. Introducing stronger regulations that allow citizens to request access to public information, such as adopting an 'open by default' policy for government data, would enhance public information transparency. In this vein, a law approved in October 2024 facilitates access to public information by establishing procedures and making the release of public information compulsory. Continuing the fight against money laundering has become also particularly important, given the rising activities of organized crime groups in Costa Rica.

Figure 1.30. There is room to improve lobbying and anti-money laundering frameworks



Note: Panel B shows the point estimate and the margin of error. Panel C, Corruption RMA = Corruption risk-management and audit. Panel D shows ratings from the FATF peer reviews of each member to assess levels of implementation of the FATF Recommendations. The ratings reflect the extent to which a country's measures are effective against 11 immediate outcomes. "Investigation and prosecution¹" refers to money laundering. "Investigation and prosecution²" refers to terrorist financing. LAC is a simple average of Chile, Colombia, Mexico, Argentina, Brazil, and Peru.

Source: *Transparency International* (database); *World Bank Worldwide Governance Indicators* (database); *OECD Public Integrity Indicators* (database); and OECD calculations based on OECD Financial Action Task Force (FATF).

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Table 1.7. Policy recommendations to further buttress macroeconomic policies

MAIN FINDINGS	CHAPTER 1 RECOMMENDATIONS (Key recommendations in bold)
Headline inflation remains below the lower end of the Central Bank's tolerance range. Since March 2023, the Central Bank has lowered its policy interest rate by 500 basis points.	**Maintain a data-driven and prudent monetary policy stance and ease further if necessary to ensure that inflation durably returns to the 3% target.**
A simple majority in Congress is sufficient to modify key Central Bank legislation, such as the law specifying the mandate of the Bank.	**Enshrine the Central Bank operational independence in the Constitution.**
The exchange rate has been allowed to move more flexibly. The colon appreciated significantly during 2023, causing strong concerns in some groups about a detrimental impact on competitiveness.	Continue to let the exchange rate move flexibly in response to market conditions and limit interventions to those needed to avoid disorderly fluctuations.
Credit in foreign currency has recently increased strongly. Credit and deposit in dollars represent around 35% of the total. Regulators indicate that two thirds of the dollarized debt is unhedged.	Evaluate the effectiveness of recent macroprudential measures, and based on this evaluation, consider additional measures to discourage foreign currency borrowing and lending.
Several distortions fragment the financial market and hamper both public and private banks. This undermines competition, restricts access to credit and weakens the transmission of monetary policy.	**Correct distortions affecting public and private banks, including the requirement for public banks to pay contributions to several state funds or for private banks to transfer a share of their deposits to a public fund at below market conditions.**
The existing cap on interest rates causes financial exclusion, particularly of most vulnerable and high-risk individuals. Informal and predatory credit channels, who often charge exorbitant interest rates and are often connected to criminal groups, are growing.	Consider reviewing the methodology to set the cap on interest rates and allowing for differentiated caps depending on borrowers' risk profiles. Broaden the scope of the credit registry, to incorporate more lending entities and a higher share of the population.
The intervention of two small financial institutions in May 2024 and August 2024, due to mismanagement and improper accounting of non-performing loans, signals that there is a need to foster financial supervision.	Foster financial supervision, including by evaluating the impact of regulatory reforms undertaken in recent years and by buttressing asset valuation practices.
The public debt to GDP ratio remains close to 60% and the interest bill has increased to nearly 5% of GDP.	**Continue reducing public debt as a share of GDP by adhering to the fiscal rule.**
Meeting the fiscal rule requires containing spending and increasing spending efficiency. There remain ample opportunities to improve the quality of spending.	**Introduce regular spending reviews to inform the expenditure prioritizations and reallocations and integrate them in the budget process.** Improve social policies targeting by using the social registry as the tool to select beneficiaries in all social programmes.
Reducing the public employment wage bill is a key element of government' medium-term fiscal plan. Costa Rica's public employment law passed in 2022, aims to enhance transparency and efficiency.	Ensure a full implementation of the public employment law.
Each public agency has its own liquidity arrangements, which implies higher operational costs, multiplicity of bank fees and higher interest rate payments. A law approved in June 2024 foresees the creation of a centralized system aimed at managing the financial resources in the public sector.	Implement the centralization of liquidity management in the public sector.
Access to relevant data is a key bottleneck to policy making across several policy areas. Current data management practices offer robust safeguards that ensure data confidentiality and security. Increasing the availability and exchange of data is key to undertake spending reviews, sound policy evaluations.	**Ensure the availability and exchange of individualized identifiable data across public agencies to support evidence-based policy design and evaluation, while continuing to ensure data confidentiality and security.**
Tax revenues, at 25% of GDP, are hampered by narrow tax bases. The tax system hardly reduces income inequality.	**Broaden tax bases by gradually phasing out regressive exemptions on VAT and personal income tax.**
The personal income tax yields a significantly lower share of revenues than in OECD and regional peers.	Lower the income threshold to start paying taxes and introduce a lower entry tax rate.
Cooperatives remain exempt from income tax, even though some have grown into large multinational corporations benefiting from trade protection and operating under monopolistic conditions.	Phase out the income tax exemption granted to cooperatives.
Numerous public agencies are involved in the collection of taxes, which increases the cost of paying taxes and contributes to tax evasion. Electronic invoicing is mandatory, but its take-up is low, contributing to tax evasion.	Reduce fragmentation in the collection and administration of taxes, expedite the resolution of tax liabilities and foster e-invoicing adoption.
The local governments are responsible for the valuation of property. Valuation rules across local governments are very heterogeneous.	Support municipalities in applying market-based property valuation across the country.

Most environmental related tax revenues come from an excise duty on fuel. Diesel is taxed at a rate that is 60% that on gasoline. There is no carbon tax in place.	Align the tax rates on diesel and bunker fuel with the gasoline rate and gradually introduce a carbon tax rate, channeling part of the revenues towards low-income households.
The decree to establish an independent fiscal council was approved in 2020 but the council has not yet started to operate.	Set up a fiscal council, provide it with independent technical support and clearly define its role.
Public debt management is hampered by a complex process to issue debt in foreign currency, causing delays and increases in funding costs.	Establish that the Legislative Assembly's annual approval for issuing debt in foreign currency occurs at the same time as the approval of the total debt ceiling.
Lobbying activities are unregulated, which creates risks of certain groups gaining undue influence, leading to policies not serving the public interest.	**Regulate lobbying activities, including by defining which activities and actors are considered lobbyists and by establishing a public lobbying register.**

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2 Enhancing equality of opportunities by increasing female labour participation and reducing informality

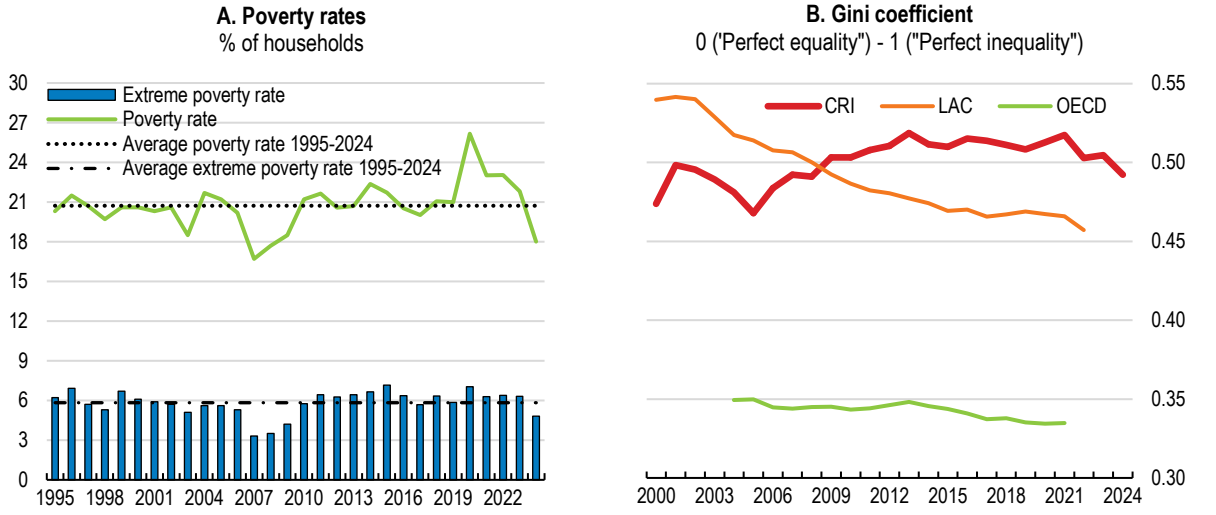
Alberto González Pandiella, OECD

Enhancing women's participation in the labour market and reducing informality are crucial for addressing income inequality and poverty in Costa Rica. Despite notable achievements, including a low pay gender gap and strong political representation, female labour force participation remains significantly lower than that of men and has recently declined. Increasing women's labour force participation would not only strengthen growth but also promote a more equitable distribution of income and opportunities. To achieve this, Costa Rica needs to expand the availability of early education and care and extend school hours or after school programmes. Furthermore, a comprehensive strategy is needed to reduce informality, including reducing the costs of formal employment and reducing the administrative costs of establishing formal businesses.

2.1. Introduction

Reducing income inequality and poverty are pending challenges for Costa Rica. After increasing during the pandemic, both inequality and poverty rates have recently fallen (Figure 2.1). Poverty levels have remained broadly stable at around 20% and extreme poverty at around 6% since the mid-nineties. This Chapter discusses the critical challenges of reducing the gender gap in labour participation and informality, which are key to continue alleviating poverty and inequalities in Costa Rica (Figure 2.2). Enhancing women's access to labour market opportunities would boost households' disposable incomes, reduce poverty risks and expand economic opportunities. Reducing informality is an essential step to provide workers with better wages and high-quality jobs. Since 2020, informality rates among women have aligned more closely with those of men, but historically they have been higher (Figure 2.3). Reducing informality would therefore significantly improve women's access to higher-quality jobs and better employment opportunities. Besides addressing these challenges, improving the delivery of social programmes is another pending challenge, as discussed in Chapter 1 of this Survey and in the 2023 Economic Survey. Reducing the institutional fragmentation of social assistance policies and defining social programmes beneficiaries based on the national registry of social programmes (SINIRUBE), will be key to improve the coverage and reach of social protection and its effectiveness in reducing inequality and poverty (see Chapter 1).

Figure 2.1. Income inequality and poverty have recently fallen



Note: Panel A: Poverty measures are based on national poverty lines. Panel B: Gini index measures the extent to which the distribution of income after taxes and transfers among individuals or households within an economy deviates from a perfectly equal distribution. LAC is a simple average of Chile, Colombia, Mexico, Argentina, Brazil, and Peru. The OECD average refers to 28 OECD member countries with available data.
Source: INEC (2024), Encuesta Nacional de Hogares (ENAHO) and Encuesta de Hogares de Propósitos Múltiples (EHPM); and *World Bank WDI* (database).

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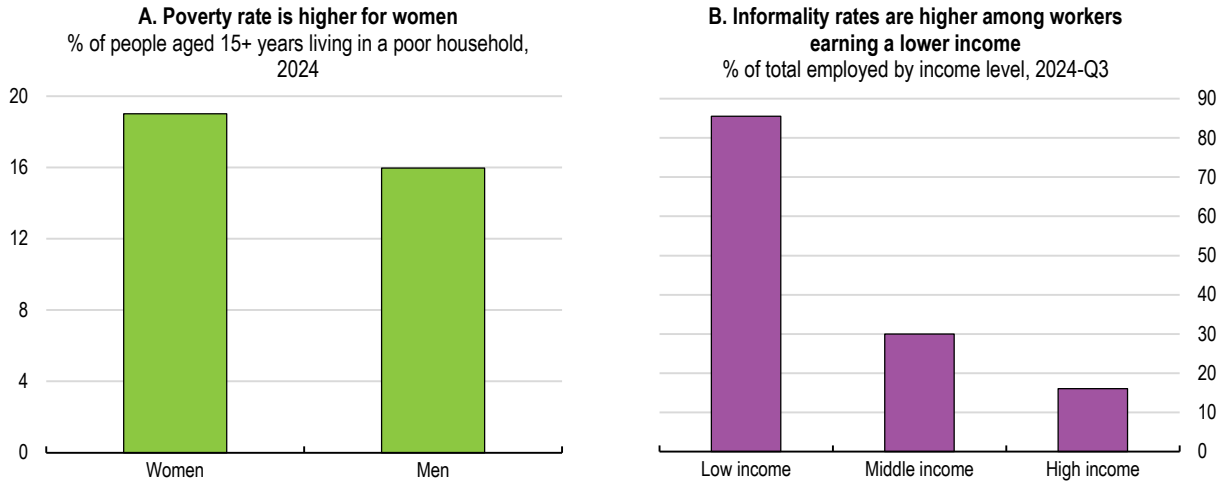
Figure 2.2. Women face higher poverty and informality is widespread among low-income individuals



Note: In Panel A, poverty is defined by the national poverty line. In Panel B, "low income" = 1 minimum salary, "middle income" = 1 to less than 2 minimum salaries, and "high income" = 2 or more minimum salaries.
Source: INEC (2024), Encuesta Nacional de Hogares (ENAHO); and INEC (2024), Encuesta Continua de Empleo (ECE).

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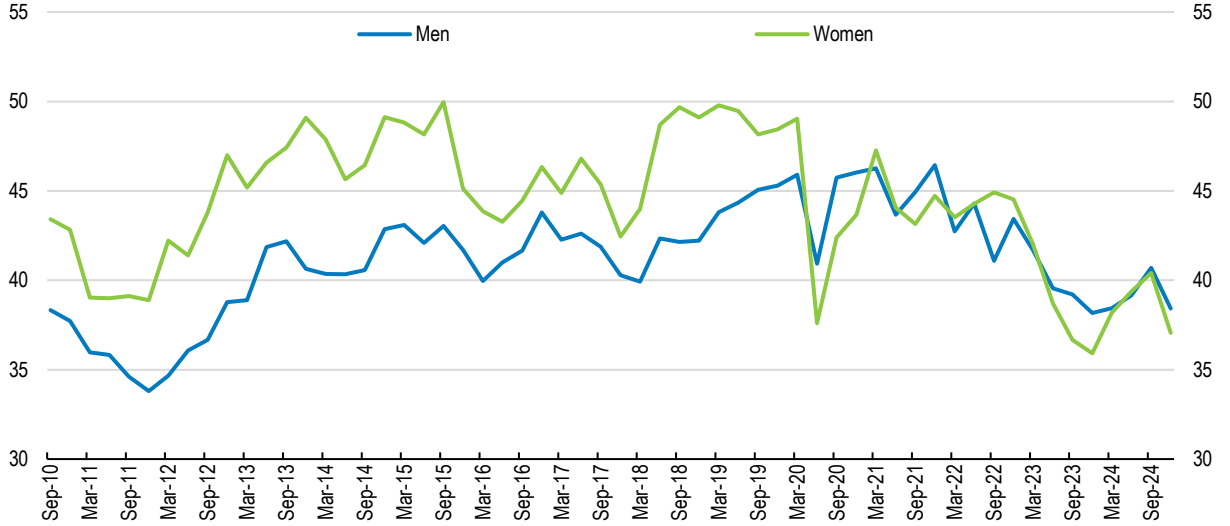
Figure 2.3. Women tend to have higher informality rates

Informality rate, % of total employment by gender



Source: INEC (2024), Encuesta Continua de Empleo (ECE).

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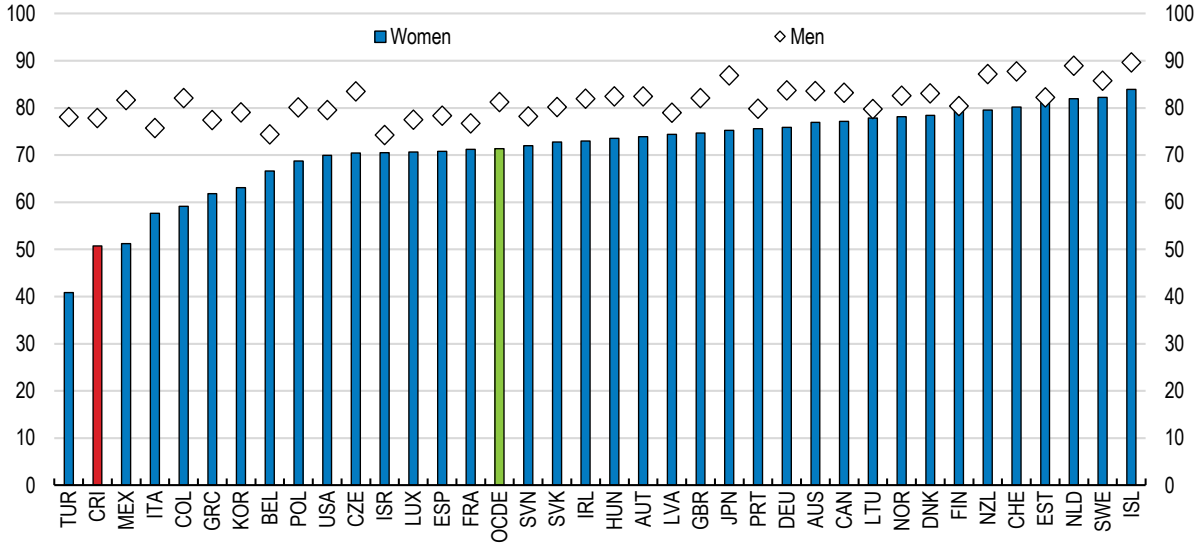
2.2. Supporting female labour market participation

A fundamental human right, equal opportunities for women and men also strengthen economic efficiency through better allocation of talent and bring major economic benefits (OECD, 2024[1]). Costa Rica performs well across several gender equality dimensions in comparison with OECD and Latin American peers. This includes educational attainment, with women achieving equal or higher levels of education than men (OECD, 2024[2]), healthcare access and outcomes, with comprehensive maternal health services (WEF, 2023[3]), political representation, with women holding significant seats in parliament and government positions (OECD, 2023[4]), and the gender pay gap, which is relatively low (Figure 2.6). Costa Rica is also promoting women participation in trade, including by Costa Rica's adhesion to the Global Trade and Gender Arrangement (chapter 4). However, female labour force participation (Figure 2.4) is notably lower than that of men, also compared to other OECD countries, including regional peers such as Chile, Colombia or Peru, and has recently declined (see Figure 1.3 in Chapter 1). The potential gains from increasing Costa Rican women's integration into the labour market are substantial (Figure 2.5). Fully closing gender gaps in labour force participation and hours worked by 2060 would increase Costa Rica's potential GDP per capita by 0.5 percentage points annually, a more substantial improvement than in the average OECD economy. Moreover, boosting female labour force participation could mitigate the fiscal impact of population aging, helping to buttress the sustainability of Costa Rica's pension and healthcare systems.

Figure 2.4. Female labour force participation is low

Working-age (15-64 years) labour force participation rate, %, 2023



Source: *OECD Labour Force Statistics* (database).

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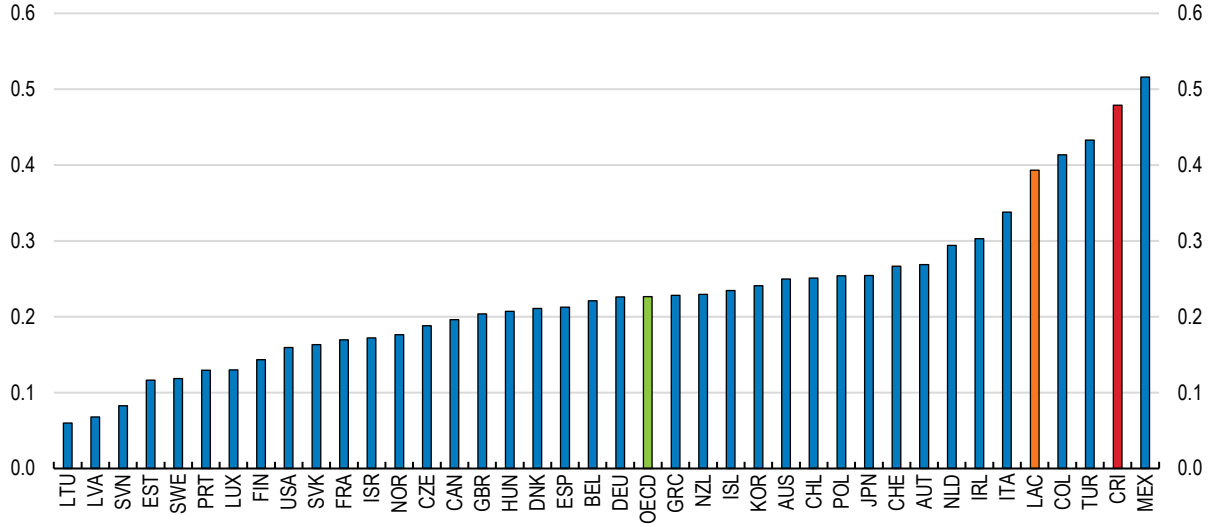
Figure 2.5. Costa Rica has much to gain from closing gender participation gaps

Difference relative to the baseline in projected average annual rate of growth in potential GDP per capita, percentage points



Note: These model-based quantifications are based on the assumption that both gender gaps in labour force participation and hours worked are closed by 2060. Caution should be exercised when interpreting these projections for countries like Costa Rica, where average hours worked are already high, as the assumptions would result in such countries exhibiting significantly higher average hours worked per person by 2060 compared to the OECD average. LAC is a simple average of Chile, Colombia, and Costa Rica.
Source: (OECD, 2023[5]).

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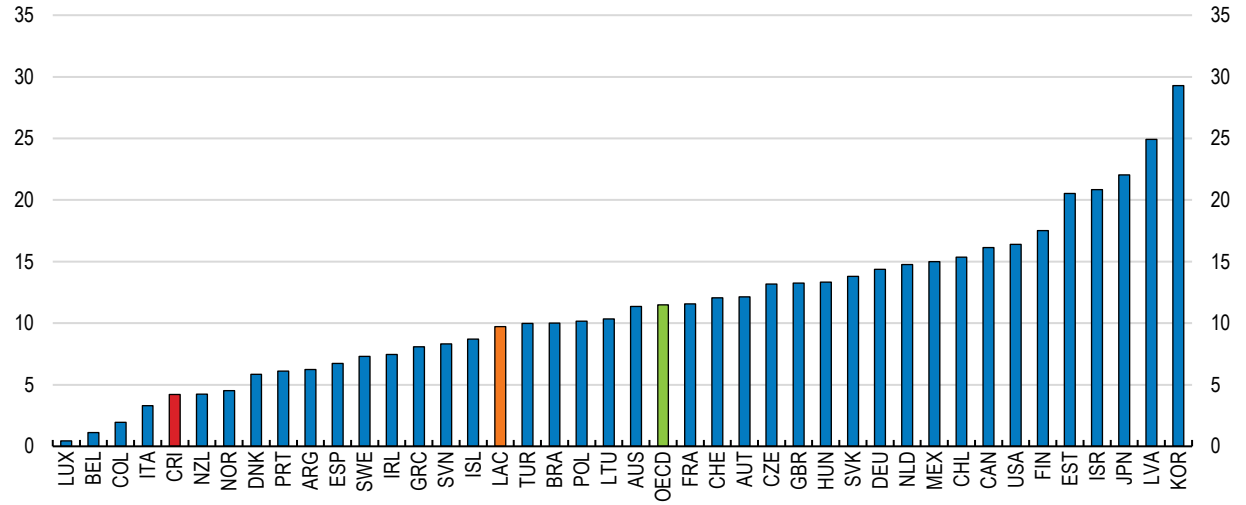
Costa Rica exhibits a relatively small gender gap in median gross earnings for full-time employees, (Figure 2.6). This reflects that women in full-time formal employment earn similar incomes to men. However, overall, women's average income levels are lower due to lower labour force participation and fewer paid working hours. There is a notable disparity in paid work hours, with women working on average eight hours less per week than men. Domestic and care responsibilities disproportionately burden women, who spend almost three times as much time on these activities than men (OECD, 2024[2]). This limits their opportunities to participate in the labour force (Figure 2.7) or to work full-time. This affects women across all income brackets but particularly low-income ones, where 80% cite caregiving responsibilities as a barrier to accessing the labour market. It also particularly impacts mothers, whose employment rate, at 48%, is notably lower than in the OECD (72%).

Expanding access to good quality affordable early childhood education and care should be a top priority, as it offers dual benefits by enhancing women's participation in the labour market and improving educational outcomes and equity (OECD, 2023[6]). Costa Rica needs to increase enrolment rates in early childhood education for both 3-5-year-olds and younger children (Figure 2.8). Currently, the early education network reaches only about 40% of households in poverty (both extreme and moderate poverty). Achieving full coverage for these households would require doubling the current budget, which is approximately 0.23% of GDP. The organization and delivery of early education and care is fragmented, with the Education Ministry responsible for policy design and three other public agencies handling service provision. This institutional arrangement leads to unclear roles and responsibilities among these entities including by the interinstitutional committee established for coordination, (CGR, 2023[7]), hampering service delivery. Plans to expand coverage by 15% from 2018 to 2022 fell short, achieving only a 1.6% increase. Despite significant demand and necessity for care, many centres operate below capacity, offering fewer places than they have the potential to accommodate. The fragmentation also results in difficulties to

achieve homogenous levels of quality. This underscores the need for institutional reforms in the early education and childcare sector.

Figure 2.6. Costa Rica's gender wage gap is smaller than in most OECD countries

Gender wage gap, % of median earnings of men



Note: LAC is a simple average of Chile, Colombia, Mexico, Argentina, and Brazil.
Source: *OECD Gender Wage Gap Statistics* (database).

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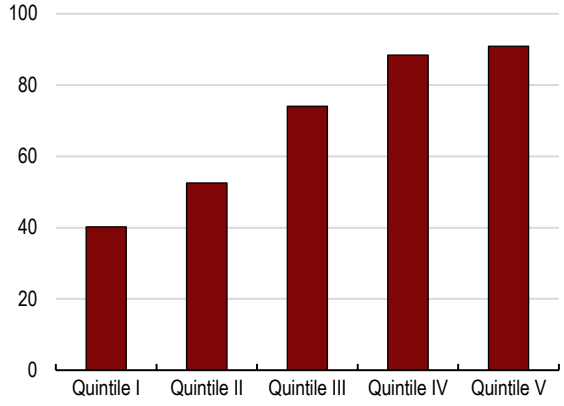
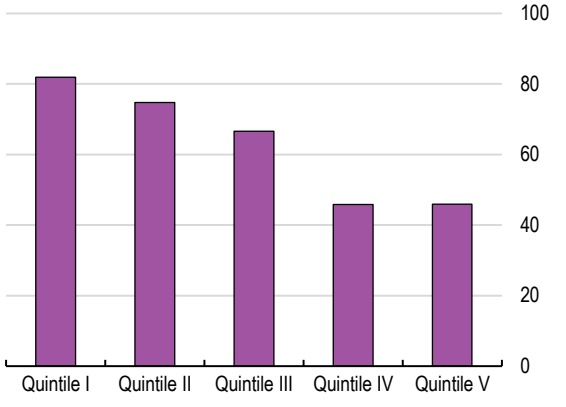
Figure 2.7. Care responsibilities hinder women's labour market participation

A. Female labour market participation rate, by income quintile
25-34-year olds, %, 2024



B. Women out of the labour force due to unpaid care responsibilities, by income quintile
25-34-year olds out of the labour force, %, 2024



Source: INEC (2024), Encuesta Nacional de Hogares (ENAHO).

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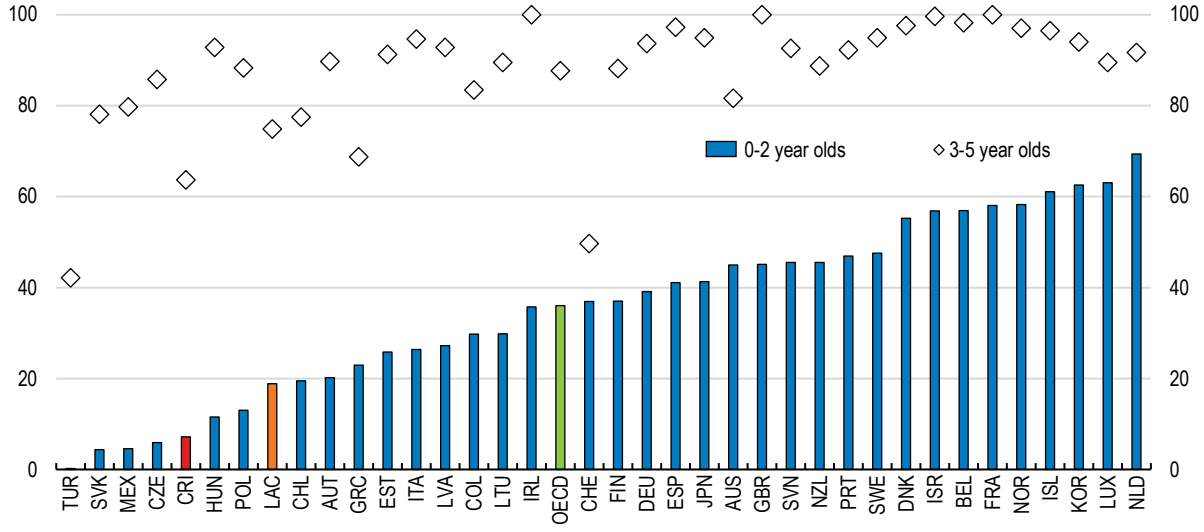
Efforts are currently underway to create a new institutional framework where responsibility and governance would be centralized under a single entity, a new Ministry of Social Affairs (see also Chapter 1 of this Survey). This initiative has the potential to improve governance in the early education sector, reduce fragmentation and expand coverage. It can also help to provide stronger oversight in the early education sector and ensure coordination with other social programmes. Ensuring access for low-income households should be prioritised, as recommended in the 2023 Economic Survey (Table 2.1), with financing coming from the general budget. As a next step, access should become available to higher-income households. Implementing co-payments mechanisms for these households can help expand coverage in a constrained fiscal environment. Moreover, there is a pressing need to establish and enforce quality standards across early education and childcare centres. Recent evaluations have identified gaps in these standards, resulting in varying levels of education and care quality depending on the administering institution (CGR, 2023[7]).

Figure 2.8. Enrolment in early education for the youngest is low

% of children enrolled in education services, 2020 or latest



Note: LAC is a simple average of Chile, Colombia, and Mexico.
Source: (OECD, 2023[5]).

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Table 2.1. Past OECD recommendations on social policies

Past recommendation	Actions taken since the 2023 Survey
Set up a universal cash transfer for poor children.	Efforts have been made to better target the *Avancemos*, scholarship programme towards secondary school students in poverty.
Improve targeting and reduce fragmentation of social programmes.	A reform proposal has been tabled to integrate public agencies in the social sector into a new Social Affairs Ministry.
Set up a universal pension covering all poor seniors.	Consultations between the government, social security system, business sector, trade unions and academia have begun with a view to undertake a pension reform.
Expand the coverage of early education for children below four years, giving priority to low-income families and using co-payment mechanisms.	A reform proposal has been formulated to reduce fragmentation and increase coverage.

Beyond early education, elementary school schedules also have an important bearing on women employment. Reforms in several OECD countries (Box 2.1) attest that extending primary schools' hours can significantly foster mother's labour force participation, leading to increased employment and working hours. Extending Costa Rica's current four-hour school day for children aged three to five years would greatly enhance women's access to the labour market and to work full-time, enabling more flexible work schedules and higher employment rates among mothers. It would also offer the double dividend of improving education outcomes, as analysed in the 2023 OECD Economic Survey of Costa Rica. Only 8.5% of Costa Rican primary schools offer a full-day curriculum, with the remaining schools operating on half-day schedules. This prevents many Costa Rica women from working full-time or be available to work. Increasing the number of primary schools offering full-time schedules would facilitate that more Costa Rica women can take paid jobs and work full-time.

Box 2.1. School schedules and mothers' employment: evidence from Chile and other OECD countries

In 1997, Chile began to implement a national education reform in the public school system that increased weekly hours of instruction without extending the number of school days. For most primary schools, the policy meant changing from a system of half-day shifts to continuous full-day schedules. Impact evaluation of the reform signals an important positive causal effects on mother's labour force participation, employment, weekly hours worked, and months worked during the year (Berthelon, Kruger and Oyarzún, 2023[8]). According to the evaluation, increasing the share of full-time schools by 30 percentage points would boost mothers' employment and participation by around 9% during a one-year period. Lower-educated and married mothers benefit the most from the reform. Other positive experiences include Mexico, with full-day schedules in some elementary schools (Cabrera-Hernández, Padilla-Romo and Peluffo, 2023[9]), and Switzerland, with after-school programmes (Felfe, Lechner and Thiemann, 2016[10]).

Promoting the uptake of paternity leave entitlements for fathers would also be beneficial. In Costa Rica, mothers are entitled to 17 weeks of paid maternity leave following childbirth, which is closed to the OECD average. Public sector employees receive 4 weeks of paternity leave and private sector employees 1.6 weeks. Across OECD countries, there is a trend towards a more balanced distribution of parental leave, gradually approaching a 50/50 split in some countries like Iceland. Gradually expanding fathers' leave entitlements could encourage greater involvement in caregiving and other unpaid work, which could enhance mothers' labour market outcomes both during and after the leave period (OECD, 2024[1]). To increase the take-up of parental leaves by men, Costa Rica could consider gradually introducing reserved leave weeks for fathers, as done by Canada, Denmark, and the Netherlands. The extension of paternity leave entitlements should be financed via the Social Security system, as done for mothers, to facilitate take-up and avoid creating stigmas.

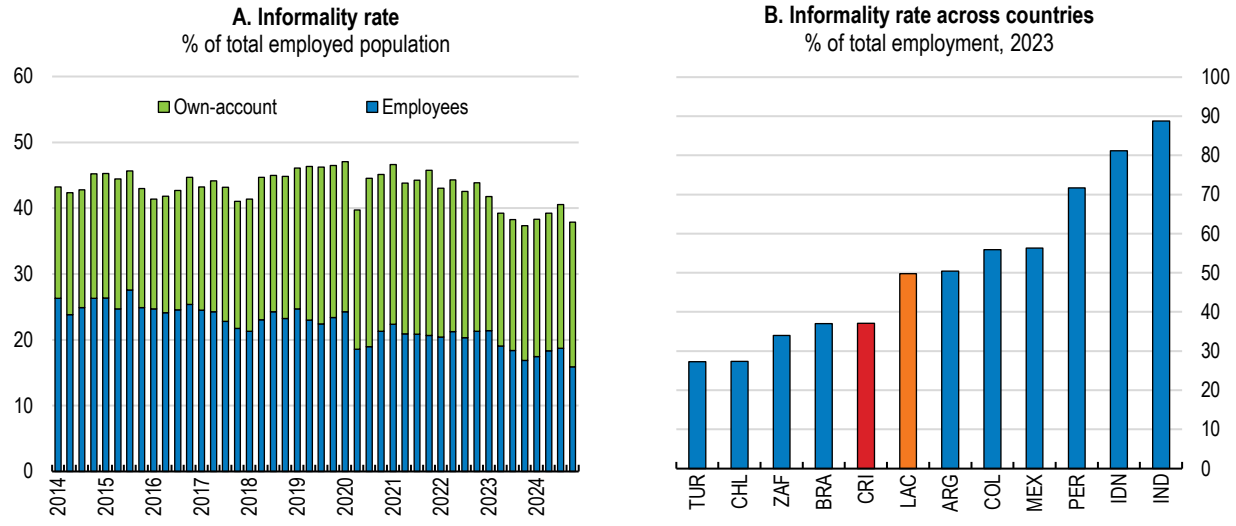
Women also disproportionately bear the responsibility of caring for elderly relatives, highlighting the critical need to expand access to elder care services. The availability of formal elderly care services, where paid workers assist individuals with daily activities, significantly enhances women's participation in the labour force (OECD, 2024[1]). Whether community-based or home-based, these services also contribute to cost savings in healthcare by promoting preventive care and reducing hospitalizations. In Costa Rica, access to elder-care community services is limited, currently serving only about 1600 people nationwide. Initiatives have begun to establish home care services, including a recent pilot programme with the Inter-American Development Bank aimed at supporting caregivers and developing a standardized methodology for assessing the cost of essential care services. Gradually expanding elderly formal care services, including both home-based and community-based care, would also contribute to higher female labour market participation. Prioritizing access for low-income households and implementing co-payment mechanisms for higher-income households holds potential for expanding these services in a fiscally sustainable manner.

In addition to expanding the child and elderly care network, Costa Rican women would benefit from a greater representation in career fields with better job prospects. Although women in Costa Rica are more frequently enrolled in upper secondary education and earn more tertiary degrees than men, they remain underrepresented in science, technology, engineering, and mathematics (STEM) fields. The share of male STEM graduates exceeds female graduates by about 19 percentage points, though this gap is smaller than the OECD average of 25 percentage points. Encouraging young girls and women to pursue STEM studies, including through mentorship programmes as recommended in the 2023 Economic Survey, would improve their chances of gaining quality jobs and support Costa Rica's competitiveness (Chapter 4).

2.3. Reducing informality

Informality, at around 40% of total employment, remains high (Figure 2.9) and is a key driver of inequality and poverty. It is also a cause and a consequence of low productivity. Informality is particularly prevalent among low-income individuals, workers with less than secondary education, the self-employed, and those working in the agriculture sector. Earlier OECD Economic Surveys of Costa Rica ((OECD, 2023[6]), (OECD, 2020[11]), (OECD, 2016[12])), have emphasized that reducing informality requires coordinated actions across multiple policy fronts (Figure 2.10). These include lowering non-wage labour costs, reducing barriers to the creation of formal firms, simplifying the minimum wage system, helping Costa Ricans to acquire the skills needed to access formal jobs (as discussed in Chapter 4 and in the previous Economic Survey), simplifying taxes (as discussed in Chapter 1) and strengthening enforcement of labour and tax regulations. This section reviews recent progress achieved in some of these policy areas and highlights pending challenges.

Figure 2.9. Informality has recently fallen but remains high



Note: In Panel A, informality is defined as the percentage of workers in employment meeting one of these conditions: 1) salaried workers not contributing to the social security system; 2) salaried workers who receive their wage on cash or who only get paid once and who due to the nature of their contract are not deemed eligible for social security registration; 3) unpaid workers; 4) self-employed workers and employers who have companies that are not registered in the National Property Registry and do not keep a formal accounting; and 5) self-employed workers with occasional work (working for less than one month) who due to the nature of the work are not likely to be registered or have formal accounting. Data are quarterly data. Panel B shows the ILO definition of informal employment as self-employment in informal enterprises (small, unregistered enterprises) and wage employment in unprotected jobs, meaning jobs with no social contributions, in both formal and informal enterprises. The ILO definition of informality might differ from that of INEC. LAC is the simple average of Chile, Colombia, Mexico, Argentina, Brazil, and Peru.
Source: INEC (2024) Encuesta Continua de Empleo (ECE); and *ILOSTAT* (database).

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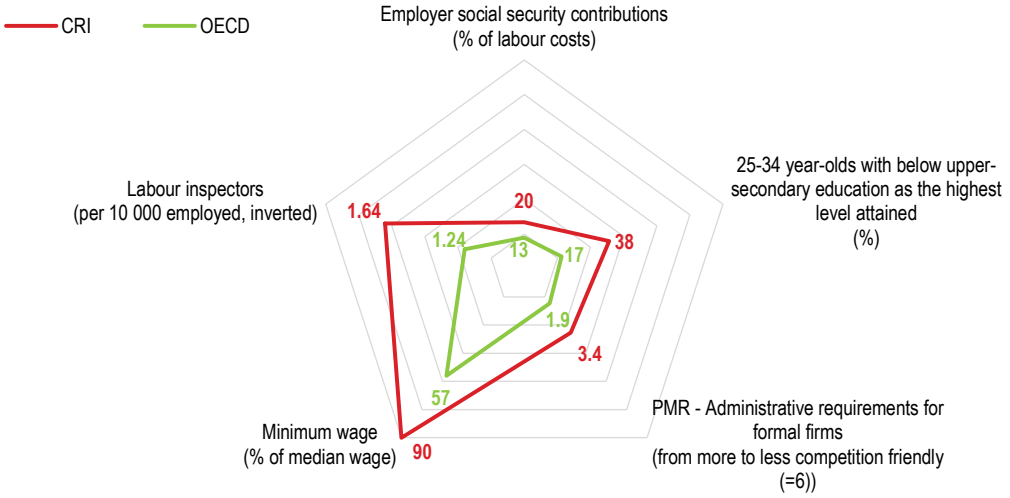
Figure 2.10. Reducing informality requires action across different policy areas

Informality drivers, 2023 or latest



Note: The figure covers some of the policy areas typically related to informality, but its coverage is not comprehensive. OECD refers to an unweighted average of OECD countries with available data. Higher values denote policy settings conducive to higher informality.
Source: *OECD Taxing Wages* (database); *OECD Education at a Glance* (database); *OECD 2023-2024 PMR* (database); *OECD Labour Force Statistics* (database); and OECD calculations based on *ILOSTAT* (database).

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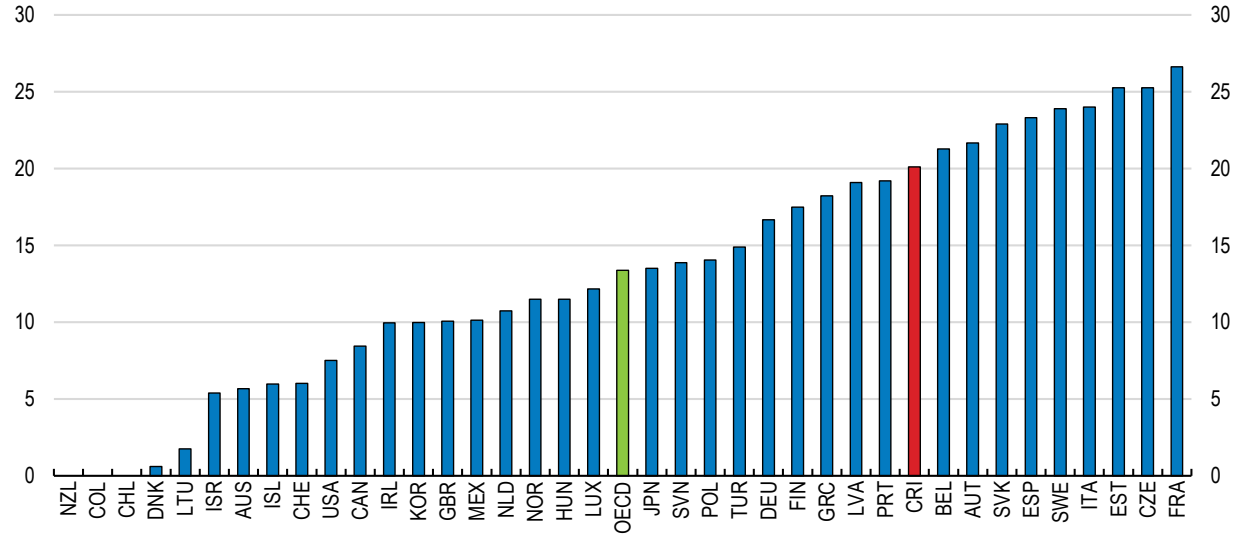
Employer payroll charges are high in comparison with the OECD average (Figure 2.11), which hampers formalisation. Given the low levels of labour productivity, one of the main impediments to formal job creation is this relatively high mandatory social contributions and other payroll taxes (Arnold et al., 2024[13]). Experience in countries like Colombia (OECD, 2024[14]) suggests that reducing these non-wage costs can decrease labour informality.

Currently, payroll charges represent 37% of the wage bill in Costa Rica with employers paying 72% of them. A significant portion of these charges—about 35%—is not financing the Social Security. Instead they are allocated to finance other institutions such as the vocational training unit (INA), a state-owned bank, or the Social Protection Fund (FODESAF). This is a regressive and inefficient way to finance these institutions, as it hinders formalization and erodes tax bases. It particularly hinders low-skilled workers' chances of accessing formal jobs by widening the gap between their productivity and the cost of labour. Financial contributions to the state-owned bank, established in 1969 and now a mature financial institution integrated into financial markets, could be phased out. The vocational training unit and the social fund could be gradually financed through the general budget.

The payroll changes imply that employer charges could be reduced by 7.25 percentage points, without compromising the financing of the social security system. The changes could even be positive for the social security system, as more workers would potentially become formal workers and contributors. Financing the vocational training unit and the social fund fully from the budget would require increasing revenues by broadening the personal income and VAT tax bases or phasing out some tax expenditures, as discussed in Chapter 1 of this Survey. Given the fiscal situation, the change could be implemented gradually and the reduction in employer's payroll charges could be initially targeted at low-income workers.

Figure 2.11. Employers' payroll charges are high in international comparison

Employer social security contributions, % of labour costs, 2023



Source: *OECD Taxing Wages* (database).

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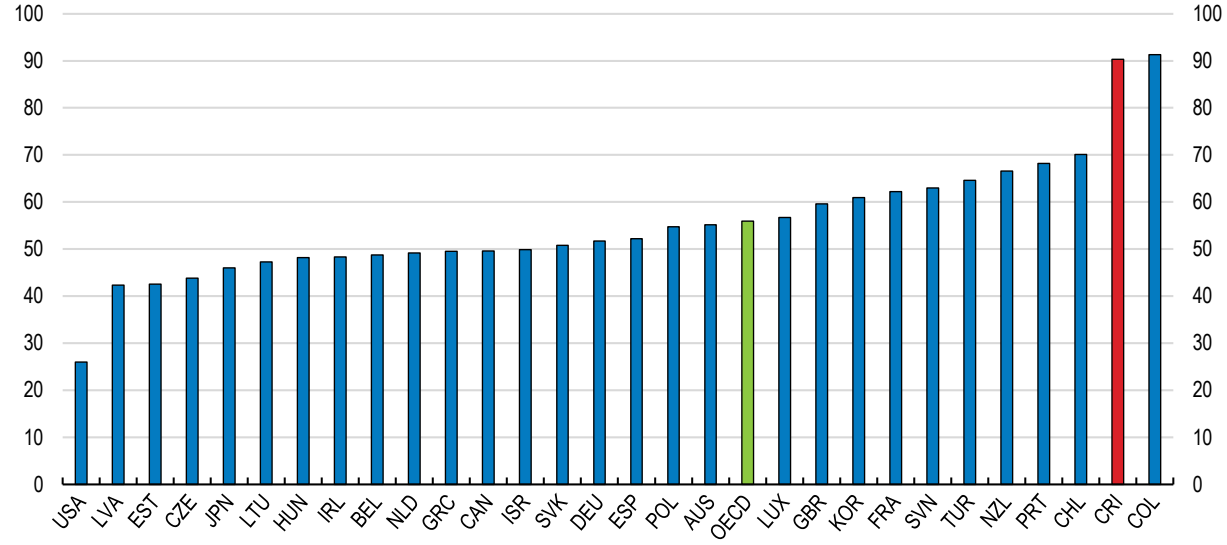
A relatively high minimum wage and a complex minimum wage systems can also foster informality. Costa Rica has simplified its minimum wage system over the last five years, reducing the number of minimum wages from 26 to 16 and plans to further reduce them to 11. In relative terms, Costa Rica's average minimum wage, at nearly 90% of the median mean wage of full-time formal employees, is high in comparison with other OECD countries (Figure 2.12). For emerging economies, often characterised by the co-existence of formal and informal employment, minimum wages that are too high and not effectively enforced may shift workers from formal to informal employment (Del Carpio and Pabon, 2017[15]). Future minimum wage increases should be approached with caution and aligned with labour productivity growth, as they could potentially lower formal employment prospects, especially for low-skilled workers. Undertaking a thorough evaluation of how the level of the minimum wage impacts the likelihood of youth and low-skilled workers accessing formal employment could inform future's discussions and decisions by the committee in charge of advising about the minimum wage. The committee includes representatives from the government, employers, and workers. Its analysis could be strengthened by including labour market experts from academia, bringing in technical expertise and enabling evidence-based recommendations.

Informality is particularly high among part-time workers (Figure 2.13), a situation more common among women. Currently, there is no social contribution regime for part-time workers, who face a minimum contribution base which is fixed regardless of working hours. Consequently, part-time workers often shoulder disproportionately high contribution burdens relative to their income. In addition to high social contribution rates, the fixed minimum contribution base discourages the formalisation of small enterprises, as well as for women and youth, who are more likely to work part time (OECD, 2017[16]). Recognizing these challenges, the Costa Rican Social Security Fund has recently begun implementing a lower minimum contribution base for low-wage and part-time workers. This policy initially applies to workers under 35 years old as of 2023, to workers aged 35 to 50 as of 2024, and will encompass all age groups by 2025. Evaluating the impact of these reductions on formalization rates among low-wage workers will be crucial. The impact of introducing an income threshold should be carefully assessed, particularly regarding potential disincentives for working longer hours and the resulting loss of eligibility for the lower minimum base.

Enabling part-time workers to contribute proportionally to their part-time incomes remains a valuable option to facilitate higher formality among part-time workers.

Figure 2.12. The minimum wage is high relative to the median wage

Minimum wage, % of median wage of full-time workers, 2023



Note: OECD refers to an unweighted average of 30 OECD member countries.
Source: *OECD Labour Force Statistics* (database).

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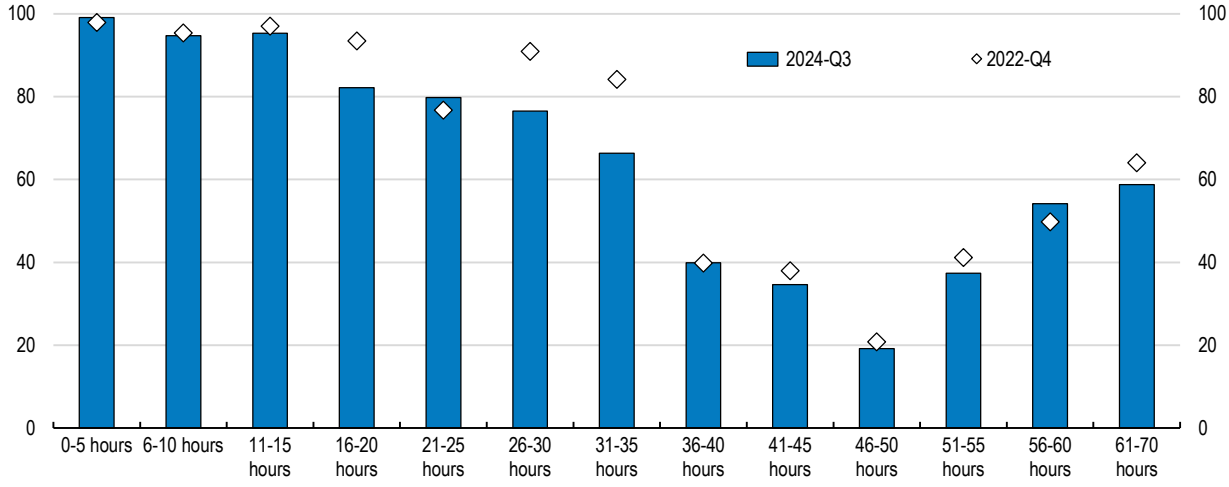
Figure 2.13. Informality is high among part-time workers

Informality rate, % of total employment



Source: OECD calculations based on INEC (2024), Encuesta Continua de Empleo (ECE).

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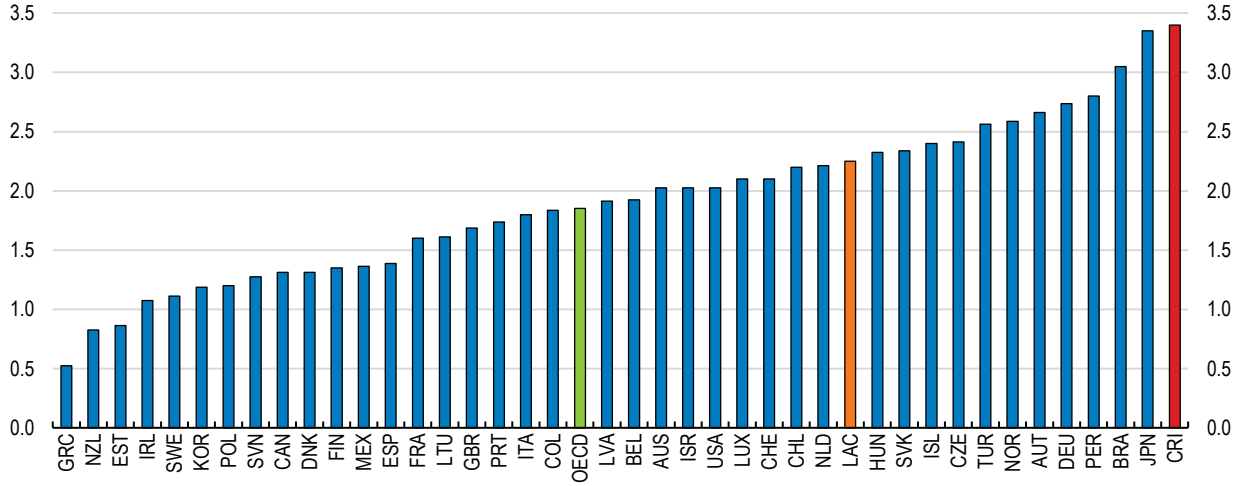
Burdensome regulations and red tape can also act as a barrier to business formalization. The OECD's Product Market Regulation indicator for Costa Rica shows that Costa Rica has one of the most stringent regulations among OECD countries, particularly as concerns regulations related to starting up a formal company (Figure 2.14). There remains ample opportunity to decrease the bureaucratic and economic

costs associated with starting a formal enterprise. Many OECD countries (e.g. Portugal, New Zealand, Estonia or Denmark) have successfully lowered these costs by implementing virtual one-stop shops, where all administrative requirements can be completed at once and online. Costa Rica has taken steps in this direction with the establishment of an Investment Single Window Facility (OECD, 2024[17]). Initially the window was targeted at free trade zones activities and to San Jose metropolitan area but it is now available to all firms. It has the potential to further streamline firm formalization by incorporating more administrative requirements. This is the case of municipal regulations, such as licenses and permits, which are crucial for new firms' creation but are not yet included in the window. There is scope to involve more municipalities in this initiative, as currently, only 30 out of 84 municipalities participate. Environmental and construction requirements could also be added to the platform (OECD, 2024[17]). The low take-up of the digital signature among enterprises and households (see the discussions in the 2020 and 2023 Economic Surveys) is a barrier to broader digitalization of administrative requirements covered by the single window. The cost for business and households of obtaining the digital signature is deemed to be onerous (OECD, 2024[17]). Efforts to reduce these costs would unlock the full potential of the Investment Single Window to simplify administrative procedures and promote formal business creation. The Central Bank's ongoing initiatives to implement a mobile phone-based signature mechanism hold promise for reducing the costs associated with obtaining a digital signature and broadening its adoption.

Costa Rica has started to reduce the stock of regulations that are deemed to be bottlenecks to formal economic activity (Box 2.2). This has been done in cooperation with the private sector, which is an effective way to identify the regulations no longer needed. An important next step would be to conduct comprehensive evaluations of these regulatory changes, as such assessments can provide insights for further reforms. A critical challenge that remains is the absence of an updated and comprehensive centralized catalogue or single registry encompassing all administrative procedures, licenses, and permit requirements for businesses. Currently, this information is scattered across various websites, leading to inconsistencies in some cases (OECD, 2024[17]). Establishing such a registry, and conducting evaluations regularly, would be valuable steps to continue eliminating duplications, harmonizing regulations across different public agencies, and enhancing the functionality of the Investment Single Window.

Figure 2.14. Administrative requirements to set up formal firms are burdensome

PMR Administrative requirements for limited liability companies (LLCs) and personally-owned enterprises (POEs), from 0 ("more competition friendly") to 6 ("less competition friendly")



Note: The majority of the data was collected in 2023. However, in some countries the data collection was completed at a later date. LAC is an unweighted average of Chile, Colombia, Mexico, Brazil, and Peru.
Source: *OECD Product Market Regulation* (database).

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Box 2.2. We let you work

"We Let You Work" (Le Dejamos Trabajar) is a programme by the Ministry of Economy, Industry, and Trade designed to identify and remove bureaucratic hurdles that slow down business operations, hiring, and growth. The Ministry worked with the private sector, chambers of commerce, and 16 public organizations in Costa Rica to pinpoint key obstacles. As a result, they identified 163 bottlenecks, 140 of which were resolved in three phases between August 2022 and September 2023. The remaining 33 will be addressed in 2024.

Most bottlenecks were linked to sector-specific regulations and permit time limits. The second most common issue involved delays in processing permits and licenses. The third issue focused on standardizing application requirements, particularly the technical criteria used by different departments for permit approvals. Other resolved issues included improvements to digital platforms, social insurance enrollment, and service delivery by public institutions.

Multiple ministries, including Environment and Energy, Health, Agriculture and Livestock, Finance, and Public Works and Transportation, helped resolve these challenges. To speed up implementation, the programme prioritized solutions that could be enacted through executive actions, avoiding the need for new laws. Clear deadlines were set for each stage, and specific decrees were published in government reports or in La Gaceta, the official government newspaper.

The second phase of the programme was launched in October 2024 and aims to address barriers that impact citizens when dealing with public institutions, covering issues like water billing or passport processing.

Table 2.2. Policy recommendations to enhance equality of opportunities

MAIN FINDINGS	CHAPTER 2 RECOMMENDATIONS (Key recommendations in bold)
Increasing gender equality	
Female labour force participation is lower than for men and that in other OECD and Latin America countries. Previous plans to increase the supply of early education and care have failed. The early education network reaches only about 40% of households in poverty.	**Expand early childhood education and care, prioritizing low-income households.**
Short school schedules limit women ability to work full-time.	Extend the current four-hour school day for children aged three to five. Accelerate the implementation of full-day schedules in all primary schools.
The delivery of early childhood education and care is highly fragmented, and the quality level is heterogenous.	Improve early education governance by increasing coordination with other social policies and by reducing fragmentation in the delivery of early education. Establish and enforce good quality standards across all early education and care centers.
The duration of paid parental leave is significantly lower for men than women.	Lengthen gradually fathers' paid leave entitlement in the private sector.
Costa Rica ageing process is accelerating rapidly. The current availability of community-based elder care services is low.	Gradually expand elderly formal care services, including home-based and community-based care, prioritizing access by low-income households and establishing co-payment mechanisms for higher income ones.
Reducing informality	
40% of workers are informal, hindering well-being, productivity and tax revenues. Several factors contribute to informality, including high non-wage costs, complex regulations, and skills mismatches. Costa Rica has one of the most stringent regulations among OECD countries, particularly as concerns setting up formal firms.	**Pursue a comprehensive strategy to reduce informality, including lowering the cost of formal job creation, reducing administrative barriers, enhancing skills, strengthening enforcement, and simplifying taxes.** Include all administrative requirements to set up formal firms in the investment single window.
Costa Rica has notably simplified its minimum wage system over the last five years. The level of the minimum wage, at nearly 90% of the median wage of full-time formal employees, is high.	Align future minimum wage increases with labour productivity growth to facilitate youth and low-skilled workers accessing formal employment.
A widespread use of digital signature mechanisms would facilitate the digitalization of administrative requirements required to set-up formal firms. The digital signature mechanism has improved notably but the financial cost to obtain is perceived to be too high. The low take-up of the digital firm limits the digitalization of administrative requirements.	Reduce the financial cost for business and households to obtain the digital signature.
Efforts to reduce the stock of regulations are underway. Measures taken are promising but there are no evaluations about the impact, which limits policy design and planning. Information about the stock of regulations is dispersed across different sources and is sometimes contradictory.	Undertake a thorough evaluation of efforts to reduce administrative requirements acting as bottlenecks to formal economic activity. Build and regularly update a catalogue of all the administrative procedures, licensing and permits requirements that firms must pursue.
Employer payroll charges are high in comparison with the OECD average, which hampers formalisation. Not all the employer payroll charges are allocated to finance the social security system. Around 35% of the charges go to finance other institutions, such as a state-owned bank, the vocational training centre or the fund financing social protection programmes.	Gradually shift the financing of social programmes and vocational training away from payroll charges and into the general budget. Phase out the payroll charge devoted to finance a state-owned bank.
Informality is particularly high among those working part-time. With a minimum contribution base which is fixed and the same regardless of working hours or earnings levels, part-time workers are subject to high contribution burdens relative to their earnings.	Make part-time workers contributions proportional to their part-time income.

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3 Supporting the green transition by diversifying renewables and strengthening water and waste management

Alberto González Pandiella, OECD

Costa Rica has an environmentally friendly economic model but remains vulnerable to climate change. This chapter evaluates the critical role of expanding and diversifying renewable electricity sources to support the electrification of transport, a cornerstone of Costa Rica's decarbonization strategy. Expanding and diversifying renewables would also be crucial for strengthening energy security, by reducing dependency on imported fuels and ensuring a stable and resilient energy supply. With waste accounting for a large share of emissions, there is also a pressing need to improve waste collection systems to ensure efficient and regular collection across the country. Climate change is also impacting water availability, calling for stepping up efforts to renovate water infrastructure and improve wastewater collection and treatment.

Costa Rica has an environmentally friendly economic model and is the first tropical country to have reversed deforestation (OECD, 2023[1]). Its ambitious climate agenda includes a commitment to reach net-zero emissions by 2050 (Figure 3.1, panel A), aligning with global efforts to limit warming to 1.5°C, a goal that few OECD countries are on track to meet. To meet this target, Costa Rica aims to cut emissions by 2030 to 2010 levels, with current policies showing progress in achieving these targets (Climate Action Tracker, 2023[2]). Recent progress includes expanding electric vehicle infrastructure, with electric vehicles fleet quintupling between 2021 and September 2024, and implementing policies to reduce methane emissions in livestock. These are critical steps in addressing emissions in the transport and agriculture sectors, the country's two largest sources of greenhouse gases (Figure 3.1, panel B). However, progress in the waste sector, the third largest emitter, has been slower, underscoring the need for action.

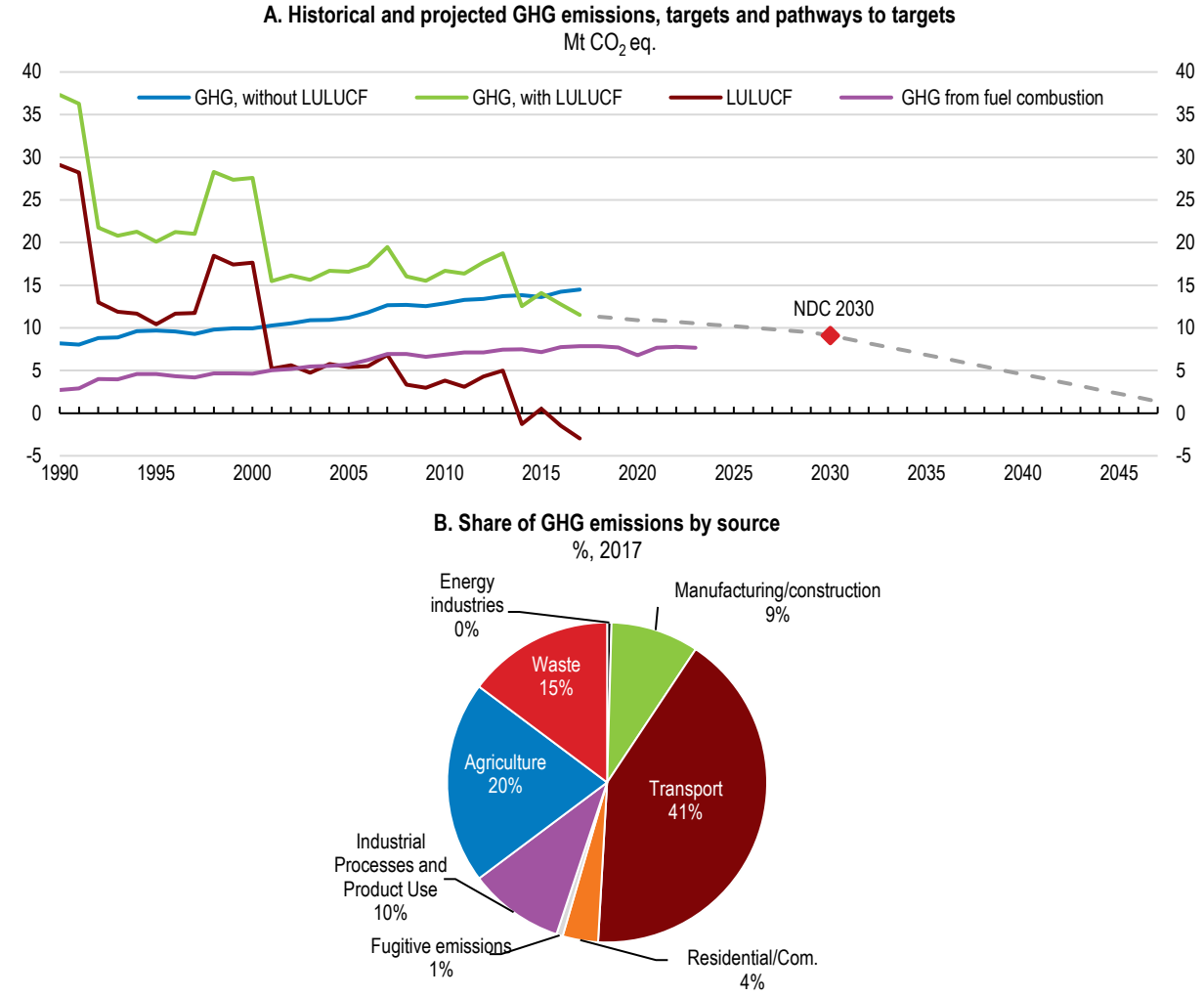
Despite its environmental leadership, Costa Rica is highly vulnerable to climate change, particularly as rising temperatures and sea levels, and altered rainfall patterns intensify. These phenomena threaten to erode coastlines, increase the frequency and severity of floods and droughts, disrupt agricultural production, and degrade vital ecosystems. Such impacts not only endanger Costa Rica's natural resources but also pose serious challenges to its economy and the livelihoods of its population. In 2022, the country launched a National Adaptation Plan, prioritizing disaster risk management system and enhancing infrastructure resilience. Climate risks have also been recently integrated into budget planning and banks risks assessments. Meeting decarbonization and adaptation goals come with significant fiscal demands. Meeting intermediate emission targets and enhancing infrastructure resilience to climate change are projected to require approximately 1% of GDP annually over the next five years. While Costa Rica is attracting new multilateral and private climate financing to support these efforts, improving public spending efficiency and broadening the tax base, as analysed in Chapter 1 of the survey, will be important to create the additional fiscal space needed to fund these investments.

Previous Economic Surveys emphasized reducing emissions in the transport sector, recommending a stronger public transport network and improving tax design (Table 3.1), still pending challenges today. Environmental tax revenues in Costa Rica are relatively high but introducing a carbon tax (see discussion in Chapter 1) is another pending challenge to encourage further carbon reduction emissions. This could take the form of a carbon tax element of the fuel excise levy, and it would involve adjusting the fuel excise tax to account for the carbon content of the fuel (Chapter 1). This chapter focuses on how to expand renewable electricity, critical to support the planned electrification of the transport sector, and how to diversify it, critical to buttress energy security. The chapter also explores the urgent need to improve waste management practices, essential for achieving the country's decarbonization goals. It also provides an overview of adaptation policies, with a focus on water management, as climate change increasingly threatens water availability.

Table 3.1. Past OECD recommendations on green growth

Past recommendation	Actions taken since the 2023 survey
Align the tax rates on diesel and bunker fuel with the gasoline rate and gradually increase the carbon tax rate once high energy prices start falling, and channel part of the revenues towards low-income households.	No action taken.
Broaden the sources of financing of the Payment for Environmental Services scheme.	A draft roadmap has been prepared.
Align taxes on vehicles with their emissions to encourage a shift towards less polluting vehicles.	Efforts are underway to enhance electric vehicle infrastructure, by declaring activities such as energy storage and electric vehicle charging, as "services of general interest", which allows that private players can provide these services, and to expand the fleet of zero-emission public vehicles.
Update toll fees to ensure they reflect the cost of road use and introduce congestion charges.	No action taken.

Figure 3.1. Costa Rica aims at reaching net-zero emissions by 2050



Note: In Panel A, GHG = Greenhouse Gas; LULUCF = Land Use, Land-use Change and Forestry; NDC = Nationally Determined Contribution. Net GHG emissions include those from the LULUCF sector. Data on GHG emissions from fuel combustion are produced by the International Energy Agency (IEA).
Source: OECD (2023), *OECD Environmental Performance Reviews: Costa Rica 2023*.

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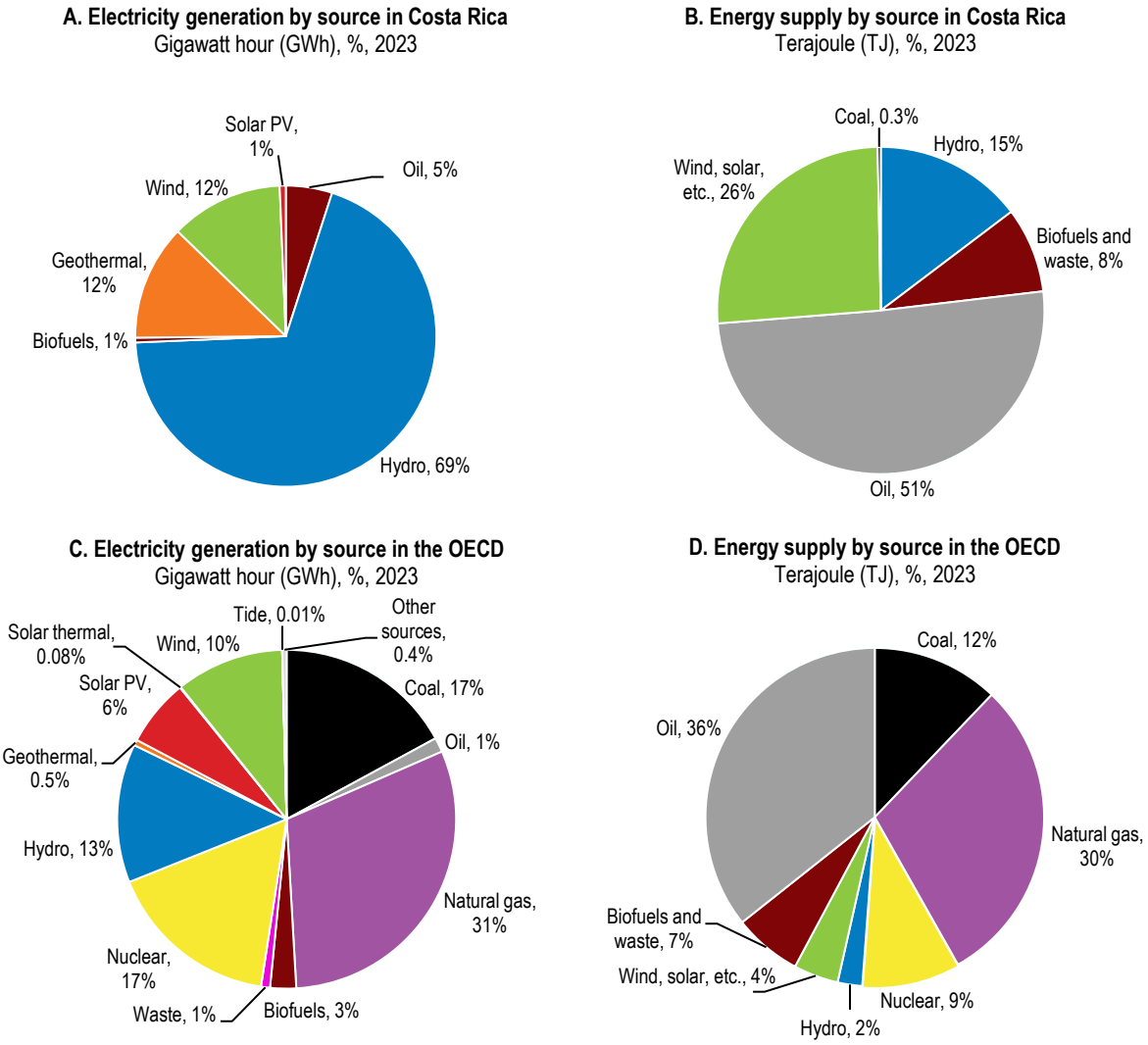
3.1. Expanding and diversifying renewables sources

Costa Rica is a frontrunner in renewables energy use, but it now faces the dual challenge of rapidly increasing electricity demand and the growing impact of climate change on hydropower, its primary renewable source. With the electrification of the transport sector expected to increase electricity demand fourfold by 2050 (OECD, 2023[3]), and potential further increases coming from foreign direct investment and trade integration (discussed in Chapters 1 and 4), the country's electricity needs will increase substantially. However, much of Costa Rica's untapped hydropower is in protected natural areas or indigenous lands, limiting its expansion. At the same time, climate change, particularly prologued dry seasons, is already disrupting hydropower production, causing electricity shortages and a recent increase in oil-based electricity generation. Hence, expanding, and diversifying renewables is also crucial for strengthening energy security, reducing dependency on imported fuels and ensuring a stable and resilient energy supply in the face of growing climate risks.

Since 2015, nearly all electricity generation has come from renewables, with hydropower contributing around 70% of total output, supplemented by wind and geothermal sources (Figure 3.2., panel A). Renewables constitute close to half of the total energy supply, surpassing the OECD average (Figure 3.2, panels B and D). Oil, fully imported, accounts for 51% of Costa Rica's energy mix (Figure 3.2, panel B), predominantly used for transport. Costa Rica's National Decarbonization Plan emphasizes the need to diversify its renewable energy portfolio, recognizing the limitations of relying too heavily on hydropower due to climate change impacts like reduced rainfall. While the overarching goal is to maintain nearly 100% renewable electricity generation, Costa Rica does not currently have explicit targets specifying the contribution of each renewable source in its overall electricity mix.

Figure 3.2. Electricity generation is clean, with a larger share of hydroelectric



Source: *International Energy Agency (IEA) Statistics* (database).

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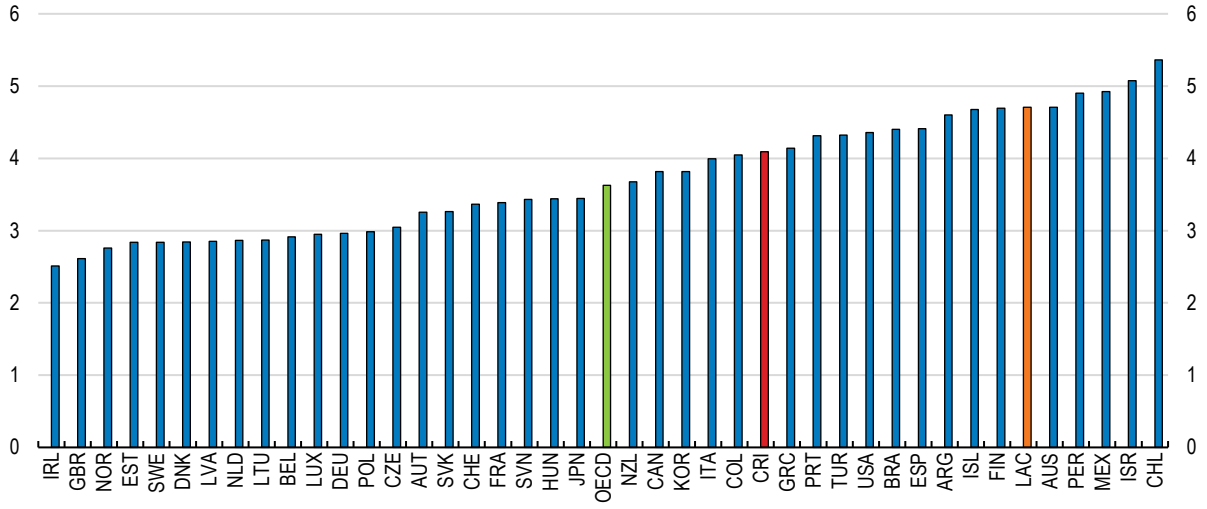
Costa Rica has significant untapped potential in wind, solar (Figure 3.3) and geothermal energy. Its unique geographical features, particularly the strong and consistent winds, grant Costa Rica with substantial wind energy potential. The technical potential for wind energy is estimated at up to 3,800 MW, indicating ample room for expansion from the current 450 MW installed capacity. Several projects to be commissioned in 2025 and 2026 will contribute an additional 412 MW of capacity from solar, wind, and biomass sources.

The country's geological characteristics, marked by numerous volcanoes and geothermal hotspots, make it highly suitable for further harnessing geothermal energy.

Figure 3.3. Costa Rica has untapped potential in solar energy

Average photovoltaic (PV) long-term practical potential, PVOUT level 1, kWh/kWp/day



Source: *World Bank Global Atlas Solar* (database).

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Unlocking Costa Rica's large potential in wind, solar and geothermal sources require improvements in both planning and regulations. An administrative unit within the state-owned electricity company, ICE, is in charge of the overall planning of the electricity system. At the same time, ICE operates most of the country's hydroelectric plants, which can lead to conflict of interest. Transferring the electricity system planning to an independent body would provide a neutral and objective perspective on the system' long-term needs and enable quicker response to emerging challenges. Strengthening planning could involve optimising that energy sources are balanced throughout the year, especially given the seasonal variability in hydropower. Better planning would also involve expanding the grid ability to absorb more solar and wind energy, which can fluctuate and require advanced grid management. This independent body could be tasked with developing a medium-term strategy for expanding and diversifying renewable energy, including setting specific targets for each renewable source. Such a strategy would offer clearer direction to public and private investors, encouraging targeted investments in infrastructure, technology, and innovation to meet these goals.

Regulatory reforms would also be needed to foster investment and innovation. Now, the state-owned company (ICE) has nearly a full monopoly in the electricity sector, with private companies limited to electricity generation and mandated to sell their output exclusively to ICE. Private-sector generators must compete for contracts through ICE's tendering process, which specifies both the quantity and terms of electricity purchases. The share of electricity generation allowed for private companies is capped at 30% and foreign investment restricted to a maximum of 65%. Opening the electricity market, as advised in previous Economic Surveys ((OECD, 2023[1]) and (OECD, 2020[4])), would stimulate investment and contribute to renewables expansion and diversification. Costa Rica could follow the example of many OECD countries which have increasingly introduced some degree of separation between electricity generation, transmission, and retail supply. Effectively separating monopolistic activities (such as the operation of the transmission network) from activities that can be subject to competition (such as generation and retail supply) can bring large benefits in the form of innovation, customer responsiveness and lower prices. Introducing a legal separation would be a good step to boost performance, while

ownership separation would offer the largest benefits. Phasing out restrictions and caps on private sector participation and foreign ownership would be other substantial steps to boost investment. A legislative proposal aimed at reforming the electricity market has been presented to the Legislative Assembly and seems well aligned with some of recommendations from previous OECD Economic Surveys.

There is also space to improve the process for obtaining permits to develop renewable energy projects, as it remains lengthy and complex. Agencies involved in granting permits tend to operate on different timelines, causing significant delays. Some regulatory bodies would benefit from stricter deadlines for processing applications, helping to avoid long waiting periods for developers. Solar panel users also face a high "backup" or "grid access" fee imposed by the state-owned utility company. The fee, designed to cover the costs of maintaining the national electricity grid, can increase electricity costs for solar users by up to 400%, which discourages the adoption of solar power. Reducing the fee would make renewable energy more affordable for consumers and encourage more widespread use of solar energy, including in the agroindustry sector. Local public opposition to the expansion of renewable energy is relatively limited in Costa Rica, compared to other countries, partly because about 80% of the population lives in the Greater Metropolitan Area, which reduces direct local impact from many renewable projects, such as those in rural or remote areas. However, involving affected local communities early in the planning and decision-making process for renewable projects, and ensuring that potential harm to ecosystems and local biodiversity is mitigated, can help build public trust and further reduce opposition.

The substantial increase in electricity demand implies a need to upgrade and expand the electricity grid. To tackle this challenge, the government could prioritize funding for grid infrastructure projects and create incentives for private sector investment in grid upgrades. This includes reinforcing power lines, upgrading substations, and expanding grid capacity to ensure a stable supply as electricity consumption rises. Energy storage technologies will also be crucial for managing Costa Rica's variable renewable energy sources, particularly wind and solar. The government could incentivize research, development, and deployment of energy storage solutions like batteries or pumped hydro. Smart grid solutions will also be essential for efficiently integrating Costa Rica's renewable energy mix. Costa Rica is well positioned to tackle this challenge, as it is gradually deploying smart meters, which would help to put in place real-time monitoring systems, ensuring the grid can dynamically respond to fluctuations in supply and demand.

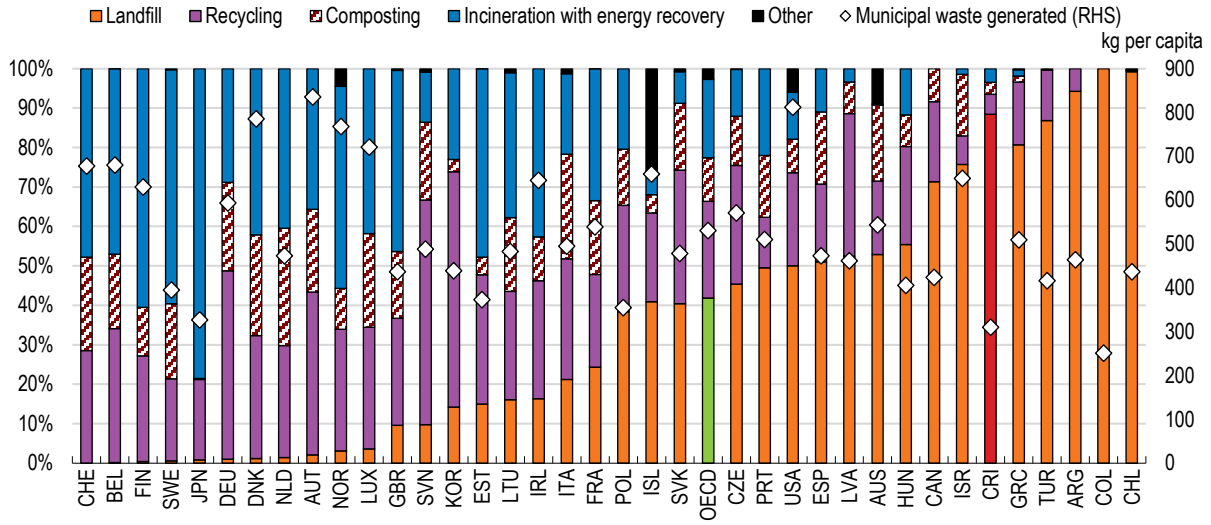
3.2. Improving waste management

Waste management accounts for 14.8% of emissions in Costa Rica, a larger proportion than in other OECD countries. Improving waste management will therefore be crucial to meet decarbonization targets and mitigate climate change. Waste generation is lower than in the OECD average country, reflecting lower-income levels. However, it is on an increasing trend, and the expected increase of population and per capita income, together with resulting changes in consumption patterns, imply accelerating waste generation (OECD, 2023[3]).

More than 80% of waste in Costa Rica is generated by households. Over the past 15 years, Costa Rica has closed 48 illegal dumpsites. However, the country still relies on landfills for waste disposal, which not only contributes to carbon emissions but also exerts pressure on ecosystems and public health. The remaining landfills and dumpsites receive nearly 80% of the total waste generated (Figure 3.4), one of the highest shares among OECD countries.

Figure 3.4. The share of landfilled waste is high

Municipal waste treatment and generation, 2022 or latest



Note: Other recovery includes refuse derived fuel, waste used for backfilling, process loss from mechanical biological treatment (MBT) facilities, incinerator bottom ash sent for recycling, metals from incineration sent for recycling. Other disposal includes waste treated/disposed through other unspecified treatment processes as well as process and moisture loss.
Source: *OECD Municipal Waste: Generation and Treatment* (database).

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Recovery rates have increased since 2016 but remain among the lowest in the OECD. In 2022, only 10.7% of total waste generated was recovered, with recycling, composting and processing representing 4.7%, 2.8% and 3.2%, respectively. This falls short of the 15% waste recovery target established in the 2016-21 National Strategy for Waste Separation, Recovery, and Valorisation. Modernizing waste collection systems to ensure efficient and regular collection in all areas across the country, including rural and underserved regions, remains a significant challenge. Public-private partnerships and stronger cooperation between municipalities, responsible for waste collection, and the central government could help municipalities to strengthen their financial and technical resources to respond to such challenges.

Despite a legal requirement to establish waste management plans, 15 out of 84 local governments in Costa Rica have yet to do so. Additionally, nearly 30% of municipalities lack regulations for waste collection, deposit, and treatment services (CGR, 2021[3]). Waste management practices in those municipalities are often informal or inconsistent, which can lead to inefficiencies, environmental damage, and public health risks. As of the most recent data, **waste collection services for recyclable materials** are now provided in **300 districts** (61%) out of the 486 districts studied, marking good progress in extending coverage for recyclable waste. However, comprehensive **separate waste collection systems, which manage multiple streams,** including recyclables, organic waste, and hazardous materials, are only in place in 24 municipalities, benefiting around 14% of households (CGR, 2021[5]). In 2022, municipalities collected **1.1 million metric tons** of solid waste, of which only **33,165 tons** (3%) were recyclables. This falls short of the **8% target** set in the National Development and Public Investment Plan (CGR, 2023[6]).

OECD experience suggests that encouraging separate waste collection for recycling and composting (Box 3.1), as well as building waste incinerators to deal with residual waste can help to reduce per capita waste generation, and landfilling. To tackle this challenge, current plans include strengthening the central government's role in waste management. Municipalities will have the option to adopt one of three strategies for organic and inorganic waste separation: sending waste to composting, collecting and separating at source, or collecting all waste together for later separation. Additionally, there are plans to implement a

deposit-refund system and introduce a fee on non-recyclable materials. These actions can substantially improve waste collection and recovery.

Box 3.1. OECD Principles concerning a comprehensive waste management policy

The OECD outlines a comprehensive approach to waste management that encompasses all stages of a product's life cycle, from initial design to final disposal. Key principles for comprehensive waste management are:

- **Reduction of waste at its source.** Strategies to avoid or reduce waste generation may include designing and marketing products with extended lifespans or reducing the use of excessive packaging. Encouraging the reuse of products and packaging and promoting the use of alternative materials are also essential elements of source reduction.
- **Reclamation and Recycling.** To support sustainable waste management, countries should adopt measures that promote recycling and reclamation. This includes considering the potential for waste to be used in land reclamation, as a source of raw materials or energy, and to recover the energy value embedded in products.
- **Cost Allocation.** The OECD emphasizes the application of the Polluter-Pays Principle to encourage waste prevention and recycling.
- **Access to Information.** Effective waste management relies on the availability of accurate and comprehensive information. This also applies to waste disposal firms, particularly those that take on waste management responsibilities for third parties. The provision of such information helps to guarantee that waste is managed in the most economically sound and environmentally protective manner.
- **Administrative Arrangements promoting efficient and rational waste management.** This may include creating inventories of waste types and quantities, organizing waste collection systems that facilitate reclamation (e.g., pre-sorting or special collection schemes), and establishing regional disposal centres that operate under cost-effective conditions. Promoting research and development in waste disposal technologies, supporting markets for recycled products, and conducting public information campaigns are also key.

Local governments face high collection operating costs that are not reflected in waste collection tariff models. In 70% of municipalities, waste collection fees are outdated, and 25% are operating at a deficit (CGR, 2021[5]). Municipalities are recommended by the municipal code to periodically review their waste collection models and cost structures, but seldom do it. The government could turn regular tariff updates into a requirement, and could support municipalities in doing so, for example by publishing samples of tariff and cost structures that municipalities could adapt to their local circumstances.

3.3. Adapting to climate change

Costa Rica has a comprehensive approach to climate change adaptation, embedded in national policies and development strategies. Its National Adaptation Plan has already positively impacted over 890000 people through tailored adaptation plans, enhancing resilience in vulnerable communities. The plan prioritizes nature-based solutions, recognizing the critical role of ecosystems in mitigating climate impacts. Efforts include the restoration of wetlands, reforestation projects, and the conservation of mangroves, all of which serve to buffer communities against floods and rising sea levels. To improve the resilience of food systems, Costa Rica is focusing on promoting climate-smart practices in the agriculture sector. This includes improving soil management, implementing water-efficient irrigation systems and encouraging crop diversification to reduce vulnerability to extreme weather events. Efforts to improve adaptation

governance are also ongoing, particularly by enhancing the leadership role of the Ministry of Energy and Environment and of the Ministry of Agriculture and Livestock.

While Costa Rica has made strides in integrating climate adaptation into national policies, it faces challenges at the local level. Municipalities, which are key players in implementing adaptation projects, often lack the necessary financial resources and technical expertise to carry out effective climate measures. To address this, the Ministry of Environment and Energy issued three technical guidelines in 2021 to aid local governments in developing plans to prepare for and adapt to climate change impacts. Strengthening the capacity of local governments, by providing training to local officials, and ensuring better coordination between national and municipal authorities are essential steps to ensure climate adaptation efforts reach all regions. There is also a need to integrate more firmly climate considerations in territorial planning by requiring the inclusion of climate risks in territorial management instruments.

Improving early warning systems is crucial for Costa Rica's ability to respond to climate-related disasters. Some early warning systems are in place but upgrading them to provide-real time data and widening its coverage, particularly in basins where floods and landslides are more recurrent and generate more losses to cover a wider range of climate-related hazards, such as droughts, is a priority. SINIRUBE, the registry of social programmes recipients, can facilitate a stronger coordination between disaster management systems and social programmes, allowing for a quick identification of at-risk populations during extreme weather events.

Robust insurance mechanisms can help to protect communities and industries against climate-related losses. A first step is to ensure that insurers incorporate climate change considerations into their governance and risk management frameworks. Recently published best-practice guidelines for insurance companies (November 2023) and the sustainable finance taxonomy (August 2024) offer valuable support for this integration. Costa Rica's Adaptation Plan aims for 40% insurance companies to integrate climate risk considerations into their governance and risk frameworks by 2026. Costa Rican smallholder farmers, who are most exposed to climate variability, have so far limited access to insurance mechanisms. Initiatives are underway to promote access to insurance schemes against crop loss, including the development of methodologies to measure climate risk and demonstrate how insurance can reduce vulnerability to these risks. Enhancing public awareness campaigns, ensuring citizens are aware of the risks posed by climate change, can promote adoption of insurance mechanisms.

3.3.1. Improving water management

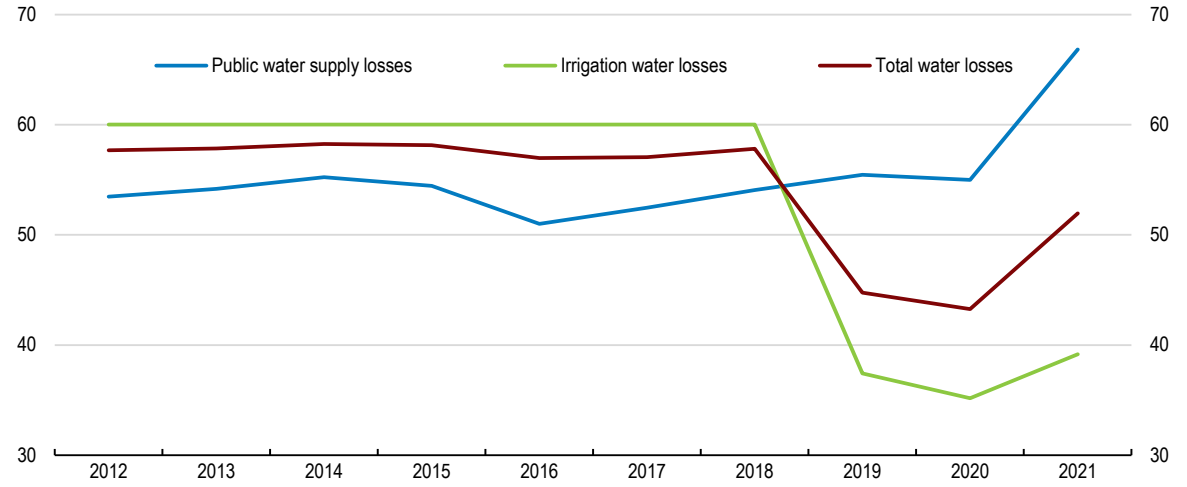
Water management is a key challenge in Costa Rica to adapt to climate change. Costa Rica has abundant water, as measured by renewable freshwater resources per capita. However, access to drinkable water has recently decreased, from 95.7% to 89.9% of the population (PEN, 2024[7]). Water losses are high, particularly in public water supply networks (Figure 3.5), due to aged pipelines, and have lately increased. Recently, water restrictions have been implemented in the Greater Metropolitan Area of San José, as water availability was hampered by losses, the lack of seasonal reservoirs and tanks, storage and distribution problems and illegal connections. Water stress is expected to exacerbate, as climate change intensifies La Niña and El Niño phenomena, making them more unpredictable. Improving water management would therefore be key to foster adaptation to ongoing climate change.

Water availability is also constrained by an underdeveloped sewerage network and a low level of wastewater treatment, which contribute to water pollution and a deterioration of rivers water quality. Only about a quarter of Costa Rica's population is connected to a public sewerage network, a proportion significantly lower than that of OECD and regional peers (Figure 3.6). Most of the population has independent wastewater treatment (septic tanks), and less than 10% are connected to public wastewater treatment plants. Septic tanks usually typically capture only a small share of households' wastewater, with the rest discharged untreated into rivers. Unless carefully managed and monitored, septic tanks leak into

the soil and groundwater, resulting in contamination. In addition only about 15.5% of the sewage collected receives some type of treatment (PEN, 2022[8]).

Figure 3.5. Water losses are high, particularly in the public network system

Freshwater withdrawal losses by activity, % of total withdrawal by activity



Source: OECD (2023), *OECD Environmental Performance Reviews: Costa Rica 2023*.

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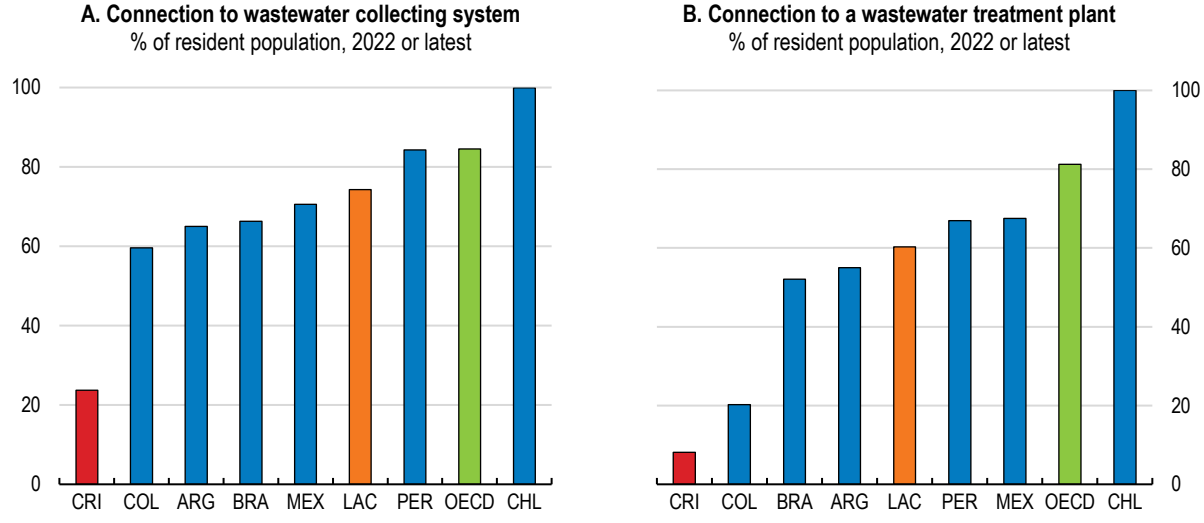
Figure 3.6. Water treatment lags severely behind other countries in the region and the OECD



Note: OECD average refers to a weighted average, and excludes Iceland and Portugal in the right panel, and Iceland and New Zealand in the left panel. LAC average is an average of Chile, Colombia, Mexico, Argentina, Brazil, and Peru.
Source: *OECD Environment Statistics: Water* (database).

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All this underscores that renewing and expanding water infrastructure and scaling up investment in sanitation and wastewater treatment are key to foster Costa Rica's adaptability to climate change and the associated more frequent drier seasons. Only about 15% of the population is projected to be connected to public wastewater treatment systems by 2045, falling short of the 100% target set by the 2026 National Wastewater Sanitation Policy. Weak planning and execution have hampered water and sewage infrastructure, with only half of the 2023 budget allocation for water infrastructure being utilized and

approximately 60% of ongoing projects experiencing delays. Investment in wastewater has been largely neglected for some time. Costa Rica would benefit from long-term strategic financial planning for water and wastewater infrastructure investment. This should include exploring a broad range of options to mobilise the necessary finance, such as public-private partnerships or green bonds. Establishing a portfolio of infrastructure projects, prioritized transparently and based on sound criteria, ready to be executed as financing becomes available, would expedite water infrastructure availability. Comprehensive and realistic project plans, including clear timelines, milestones, and resource allocations, would facilitate efficient project execution. In this vein, Costa Rica has recently established a plan to expedite the execution of 51 priority projects, of which 45 are drinking water projects, five sanitation projects and one project focused on improved management.

Water utilisation levies should in principle, reflect the value of water use and the environmental service provided by the water resources, and provide some of the necessary funding to maintain and expand infrastructure. However, these levies remain very low in Costa Rica (OECD, 2023[3]), limiting their use as an economic incentive for responsible water use and to raise revenue for sustainable water management. Moreover, water supply and sewerage tariffs do not reflect the full economic cost of service provision. There is also room to improve their efficiency as there are significant cross-subsidies among users, with residential users typically paying lower water tariffs than commercial or industrial users. Tariff levels should better reflect the costs of service provision and long-term strategic investment plans. Following the example of other OECD countries, such as France (Box 3.2), Costa Rica is well placed to tackle resulting affordability issues through targeted transfers to low-income households, given the availability of SINIRUBE, the registry including all recipients of social programmes in Costa Rica.

Box 3.2. Updating water tariffs while considering affordability issues: the case of France

Water tariff updates in France are done regularly through a collaborative process between municipal authorities and water service providers (OECD, 2016[9]). These updates consider the costs of service provision, infrastructure maintenance, and environmental factors. Municipalities can set tariffs that reflect local conditions while adhering to national guidelines. These guidelines provide a framework that municipalities must follow when setting and updating water tariffs to that local water pricing systems are fair and financially sustainable. Many municipalities implement a progressive water tariff system, where the cost per cubic meter of water increases with higher levels of consumption (EEA, 2021[10]). This ensures that basic water needs remain affordable, while higher charges are applied to non-essential or excessive water use, encouraging conservation and equitable pricing. To address affordability challenges, France offers financial assistance to vulnerable households through the Water Solidarity Fund (*Fonds de Solidarité pour l'Eau*). This fund provides direct financial aid to help low-income families pay their water bills.

Improving water quality monitoring can also help to improve water management. The information system remains at an early stage, impeding the ability to gain an accurate and comprehensive understanding of the current state and evolution of water quality. Monitoring sites are limited, and data are not collected consistently (OECD, 2023[3]), making it difficult to detect and analyse trends over time. A more comprehensive and robust water quality monitoring framework is essential for better water management, including of external water resources (Box 3.3), which are predominant in Costa Rica. This includes expanding the number of monitoring sites, to cover all critical water bodies, and implementing standardized and frequent data collection protocols.

Box 3.3. Managing external water resources

External water resources refer to natural bodies of water, such as rivers or aquifers, that exist outside of managed or controlled facilities and are relied upon for public, industrial, and agricultural water supply. Pollution control, quality monitoring, and natural methods to filter pollutants are key to manage external water resources. Strict pollution control measures are necessary to prevent harmful discharges from agricultural, industrial, and urban sources. Regular quality monitoring, as recommended in the OECD Water Governance Indicator Framework (OECD, 2018[11]), is essential for tracking water quality, detecting contamination early, and enabling quick action to protect these water resources. Natural solutions, such as planting vegetation along waterways and restoring wetland areas, are effective for filtering pollutants before they reach water sources (OECD, 2020[12]). These approaches help trap sediments, absorb excess nutrients, and enhance water quality in an environmentally sustainable way.

Table 3.2. Policy recommendations to support the green transition

MAIN FINDINGS	CHAPTER 3 RECOMMENDATIONS (Key recommendations in bold)
Expanding and diversifying renewables sources	
Costa Rica's hydropower sector generates up to 70% of the country's electricity. This reliance on hydropower is increasingly problematic due to dry seasons caused by climate change. The state-owned electricity company operates most of the country's hydroelectric plants and handles the overall electricity planning, which can lead to conflicts of interest. Costa Rica has untapped energy potential in wind, solar and geothermal.	**Transfer electricity planning to an independent body and develop a comprehensive medium-term strategy for expanding and diversifying renewable energy sources.**
Costa Rica's planned shift to electric transport is set to increase electricity demand fourfold. Meeting this demand will require significant investment in the electricity sector. However, strict regulatory barriers hinder private and foreign investment, including limits on private sector involvement and foreign investment.	**Eliminate restrictions and caps on private sector participation in electricity generation and retail supply, and remove barriers to foreign investment in the electricity sector.**
The process for obtaining permits to develop renewable energy projects remains lengthy and complex.	Expedite the permitting process for renewable energy projects by establishing stricter deadlines for processing applications.
Solar panel users face a high fee to connect to the grid, which discourages the adoption of solar power. The fee can increase electricity costs for solar users by up to 400%.	Lower the fee paid by solar panel users to connect to the grid.
Costa Rica's decarbonization plan foresees that the demand for electricity will multiply by four by 2050. Demand may increase even more if foreign investment and economic growth are higher than expected. Weather patterns are becoming increasingly difficult to foresee.	Expand grid capacity to cope with the increasing demand for electricity and to handle the integration of multiple intermittent renewable energy sources.
Improving waste management	
Waste management accounts for 15% of GHG because it relies on landfills for waste disposal and waste generation is increasing. Nearly 30% of municipalities do not have a regulation for waste collection, deposit and treatment services.	Strengthen cooperation between the central government and municipalities to enhance municipal technical resources. Gradually increase investment in organic and inorganic waste separation at municipal level,
Municipalities face high operating costs that are not reflected in waste collection tariffs. In 70% of municipalities fees are outdated.	Require municipalities to regularly update their waste collection tariffs to enhance their cost-recovery capacity. Publish samples of tariff and cost structures that municipalities could adapt to their local circumstances,
Adapting to climate change	
Municipalities are crucial to adaptation projects, but their territorial plans are not yet required to consider climate risks.	Integrate climate risks in territorial plans and other land use management instruments.
Early warning systems, key to respond to climate-related disasters, do not cover all basins where floods and landslides are more recurrent or key climate-related hazards, such as droughts.	Upgrade early warning systems to provide-real time data and to cover all areas where floods and landslides are recurrent and a wider range of climate-related hazards, such as droughts.
Insurance mechanisms can help to protect communities and industries against climate-related losses.	Ensure that insurers incorporate climate change considerations into their governance and risk management frameworks.
Strengthening water management	
Despite having abundant water resources, Costa Rica has faced recent water restrictions due to high water losses and aging infrastructure.	Gradually increase investment in water infrastructure and waste management, including through public-private partnerships and green

Climate change and the associated drier seasons are also impacting water availability, Investment in water infrastructure has been hampered by poor planning and execution.	bonds. **Develop a well-prioritized portfolio of water infrastructure projects, ready for execution as funding becomes available, based on transparent and rigorous cost-benefit analysis.** Ensure that all projects have comprehensive and realistic plans, including clear timelines, milestones, and resource allocations.
Most population has independent wastewater treatment (septic tanks). Unless carefully managed and monitored, septic tanks leak into the soil and groundwater, resulting in contamination	Ensure adequate supervision of septic tanks to minimise risks of contamination.
Water utilisation levies and water supply and sewerage tariffs are low limiting their use to incentivise better water use and financing of infrastructure.	Improve the methodology to set water use and sanitation tariffs to enhance their cost-recovery capacity. Target water support to vulnerable households using the social registry (SINIRUBE)
Water quality monitor is hampered by limited monitoring sites are sparse data collection efforts.	Enhance the water information system to ensure it provides accurate and up-to-date data on water availability, use, and quality.

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4 Maximising trade benefits

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Costa Rica's openness to trade and foreign investment has been the main driver behind the country's export-led growth, with sectors like medical devices and business investment now surpassing traditional exports. The current nearshoring trend offers a chance to further capitalise on Costa Rica's strong commitment to open trade and investment and facilitate that more workers, firms and regions reap trade benefits. For that Costa Rica needs to continue optimizing trade policies, improve SMEs participation in international trade, strengthen its innovation system, enhance talent development, address infrastructure gaps, and foster competition in key sectors.

4.1. Introduction

Over the past decades, Costa Rica has achieved notable success in expanding exports, attracting foreign direct investment and increasing its trade network thanks to its strong commitment towards trade and investment openness. Since the 1990s, the country has improved its export performance and effectively diversified its export portfolio beyond traditional agriculture products, like coffee and bananas, and has become a significant exporter of sophisticated goods and services, such as advanced manufacturing products (medical devices) and business services. This shift has been bolstered by the presence of major multinational companies in the country. These successes are closely linked to its stable political environment, strong legal frameworks, free trade agreements, incentives for investors, and commitment to sustainability and human capital. The establishment of free trade zones, together with targeted foreign investment attraction policies, has also been pivotal in attracting foreign investors.

Ongoing nearshoring trends are an opportunity for Costa Rica to further capitalise on its strong commitment to open trade and investment and to tackle the long-standing challenge of enabling the broader reach of trade and investment benefits to workers, firms and regions. For that, the country must address challenges related to workforce skills, infrastructure, innovation, competition and economic diversification. While multinational firms have created jobs and driven innovation, few domestic SMEs participate in global value chains, constraining Costa Rica's ability to access advanced inputs and benefit from knowledge spillovers and competitive pressures that foster productivity growth. Too many Costa Ricans struggle to access jobs in exports-oriented firms due to a persistent mismatch between workers' skills and the needs of exporting industries. Transport and digital infrastructure gaps are a barrier to extend the benefits of trade and investment throughout the country and to continue attracting foreign investment. Low competition in key goods and services markets increases costs for exporting firms and undermines their ability to innovate and expand into global markets.

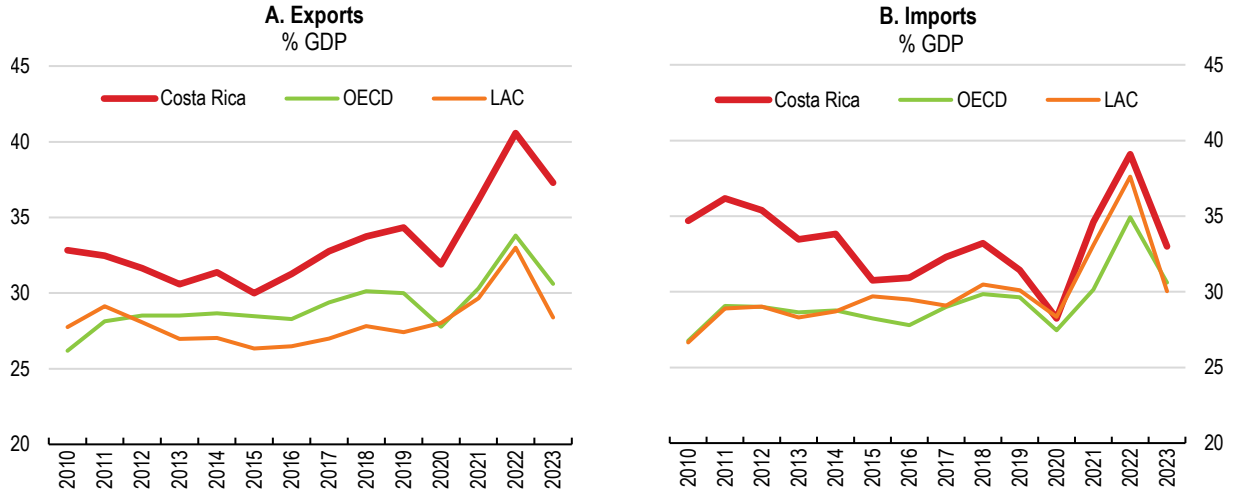
This chapter reviews Costa Rica's achievements in exports and FDI and assesses policy options to seize new opportunities to integrate further into global production networks while also facilitating that more firms, regions and individuals benefit from trade. This includes policies to boost innovation, improve access to credit and strengthen competition in key goods and services markets to support domestic firms' ability to export and increase productivity. Redoubling efforts to promote talent development through education and training would better equip Costa Ricans to access new and quality jobs created by trade and would further enhance Costa Rica's leadership in knowledge-based digital services. Closing infrastructure gaps and improving logistics would help those other areas beyond the Greater Metropolitan Area (GMA) benefit from trade.

4.2. Costa Rica has a remarkable trade and FDI performance

4.2.1. Trade exposure and export performance have strengthened

Costa Rica has had a remarkable trade performance over the last decade in both goods and services. Trade exposure increased in the past decade reaching a peak in 2022 (Figure 4.1, Panel A). This robust trade growth is driven by strong export performance, as Costa Rica has successfully gained market share in global markets (Figure 4.2), and expanded trade opportunities (see 4.3.1).

Figure 4.1. International trade has increased in the past decade



Note: LAC is the simple average of Chile, Colombia, and Mexico.
Source: *OECD Economic Outlook* (database).

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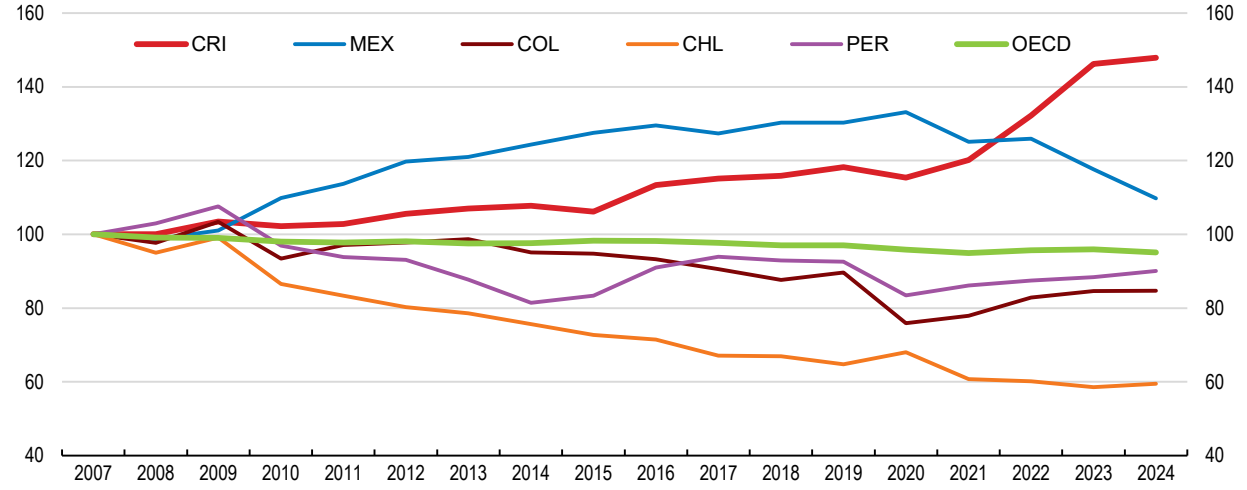
Figure 4.2. Costa Rica's export performance improved since the mid-2010s

Export performance indicator, 2007=100



Note: The export performance indicator compares the growth of export volumes (goods and services) with that of its export markets. It shows whether the country's exports grow faster or slower than its market, i.e. if over time it is experiencing market share gains or losses.
Source: *OECD Economic Outlook* (database).

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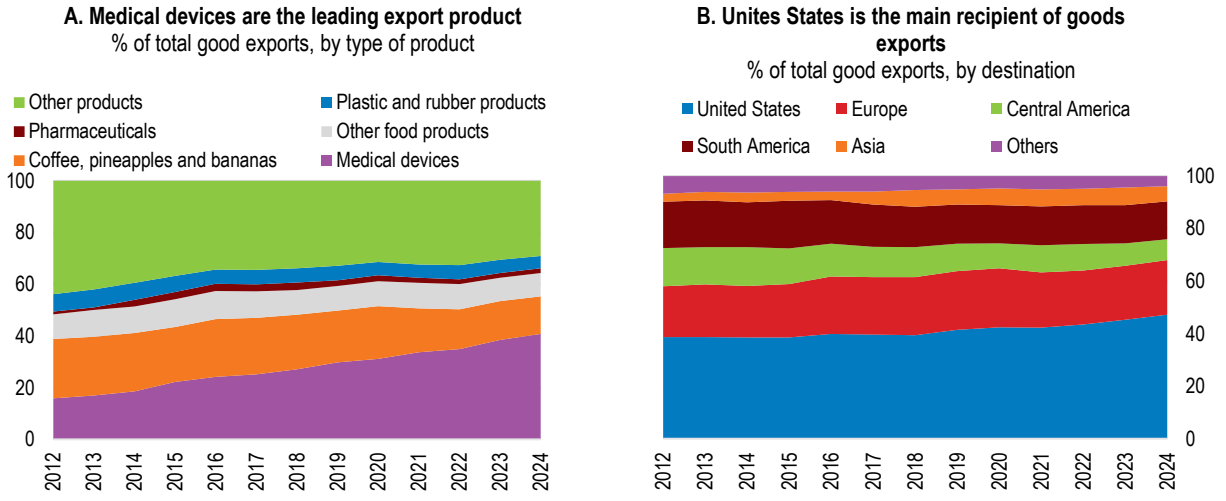
Costa Rica's strong export performance is marked by increasing diversification in goods, with a rising emphasis on medium and high technology goods. Advanced manufacturing products, most notably medical devices, have now surpassed agricultural commodities as the leading export (Figure 4.3, Panel A). Costa Rica's goods export markets are concentrated in a few regions, with the United States, Europe and, to a lesser extent, Central America as primary destinations (Figure 4.3, Panel B), which highlights an opportunity for further diversifying trade partners. Moving up the goods value chain, for instance by helping SMEs to become suppliers or partners with MNEs, as discussed in sections 4.3 and 4.4, will increase the profitability and competitiveness of the country's exports.

Services exports have also grown significantly. Business services, such as accounting, information and communication technology (ICT), back-office operations, and financial services, have significantly increased in value, and have surpassed tourism as the leading services exports (Figure 4.4, Panel A), and are mostly directed towards the United States (Figure 4.4, Panel B). Costa Rica's performance in trade services is associated with relatively low regulatory restrictions compared to most OECD countries (Figure 4.27), especially in sectors such as financial and legal activities. However, there is still room for improvement in sectors like accounting and transport services, where competition remains limited (see section 4.7 on competition).

Figure 4.3. Advanced manufacturing products have surpassed agricultural goods as the leading export



Note: In Panel A, medical devices include electronic equipment for medical treatment.
Source: Banco Central de Costa Rica.

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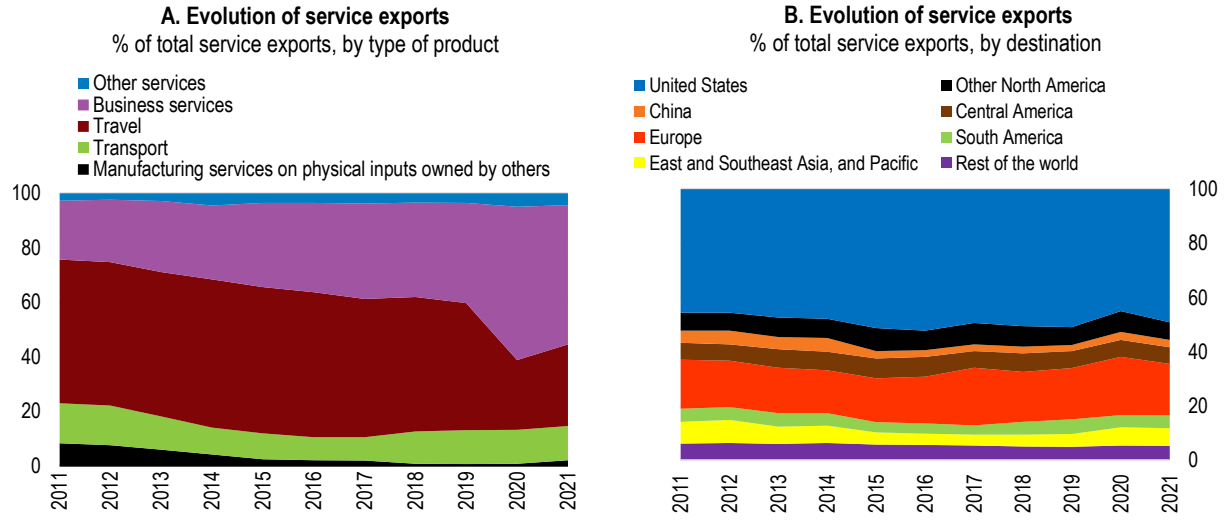
Figure 4.4. Business services have become the largest services exports



Note: In Panel A, "Business services" includes Telecommunications, computer, information services, and other business services.
Source: *OECD-WTO Balanced Trade in Services (BaTIS)* (database).

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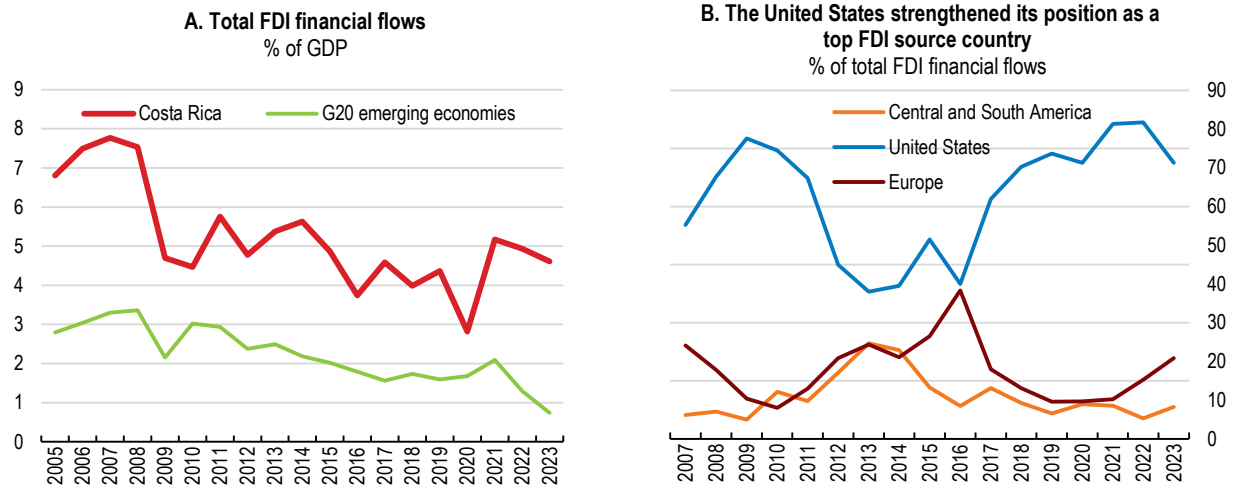
4.2.2. Costa Rica receives large FDI inflows

Costa Rica's ability to attract large inflows of Foreign Direct Investment (FDI) is another cornerstone of its economic success. Annual FDI inflows were on average 4.6% of GDP over the period 2013-23, far above the OECD average (1.9% of GDP over the same period), and above other emerging economies (Figure 4.5, Panel A). FDIs focus on areas such as life sciences, light and advanced manufacturing, food industry and services. The United States is the top FDI investor, distantly followed by European and Central and South American countries (Figure 4.5, Panel B). Costa Rica has benefited from the shift in United States FDI outflows driven by the reconfiguration of global supply chains, resulting in a significant increase in U.S. investment over the past decade. Its geographical proximity to the U.S. offers the possibility of enhancing supply chain resilience through risk diversification —mitigating logistic, climate, and geopolitical disruptions—compared to Asia, while also reducing shipping distances. Although the substantial FDI inflows from the United States offer significant development opportunities, they also pose the risk of over-reliance on a single source. Greater diversification could help mitigate this risk for Costa Rica, as recognised by the Costa Rica Foreign Trade and Investment Promotion agency (PROCOMER) in its 2023 FDI attraction strategy.

Figure 4.5. Costa Rica attracts large FDI inflows



Note: In Panel A, G20 non-OECD economies include 8 countries: Argentina, Brazil, China, India, Indonesia, Russian Federation, Saudi Arabia, South Africa. In Panel B, data for 2022 and 2023 are preliminary.
Source: *OECD FDI Flows Main Aggregates, BMD4* (database); and OECD calculations based on COMEX.

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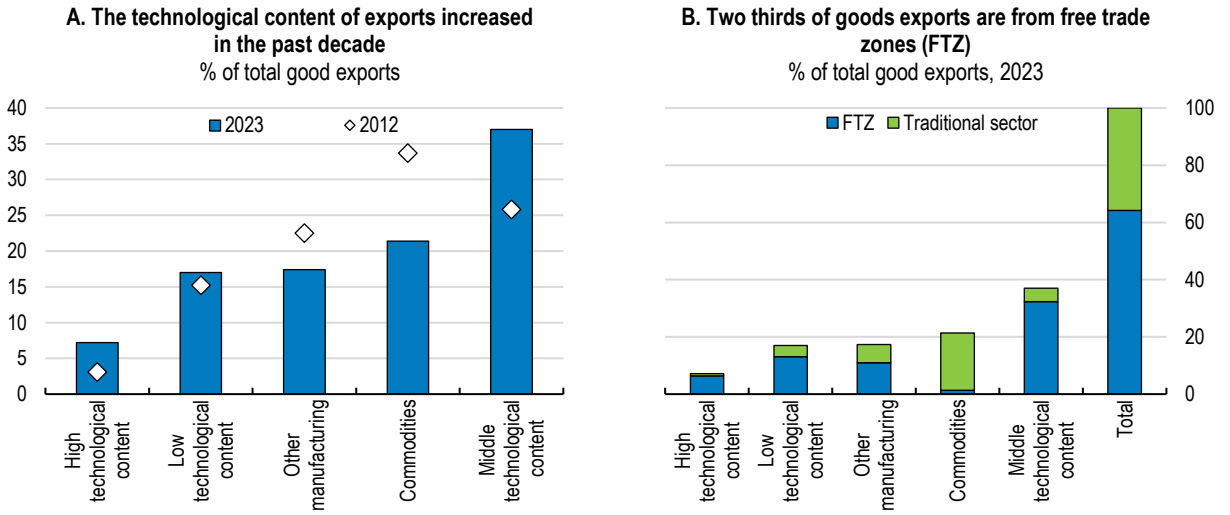
Costa Rica's Free Trade Zones (FTZs) have been key to promote higher value-added exports. FTZs are a key element of the country's export and investment promotion strategy. FTZs have boosted the technological content of exports (Figure 4.6, Panel A) and concentrate most exports and FDI, especially within the Great Metropolitan area (GMA), with two thirds of all exports coming from firms in FTZs (Figure 4.6, Panel B). Acknowledging this challenge, a 2023 law established new incentives aimed to attract FDI outside the GMA targeting companies in export activities as well as in areas such as health, agriculture and sustainable parks. Costa Rica has been able to attract 59 new FDI projects since then, 13 of them outside the metropolitan area, compared to an average of 6 per year.

Costa Rica's FDI regulatory environment is also very favorable (Figure 4.7) and export services and manufacturing companies, export trade companies (not producers) and companies engaged in R&D that establish in Costa Rica's FTZs benefit from various tax incentives, custom duty exemptions, and other advantages.

Figure 4.6. Costa Rica's free trade zones have been key to promote higher value-added exports



Source: PROCOMER.

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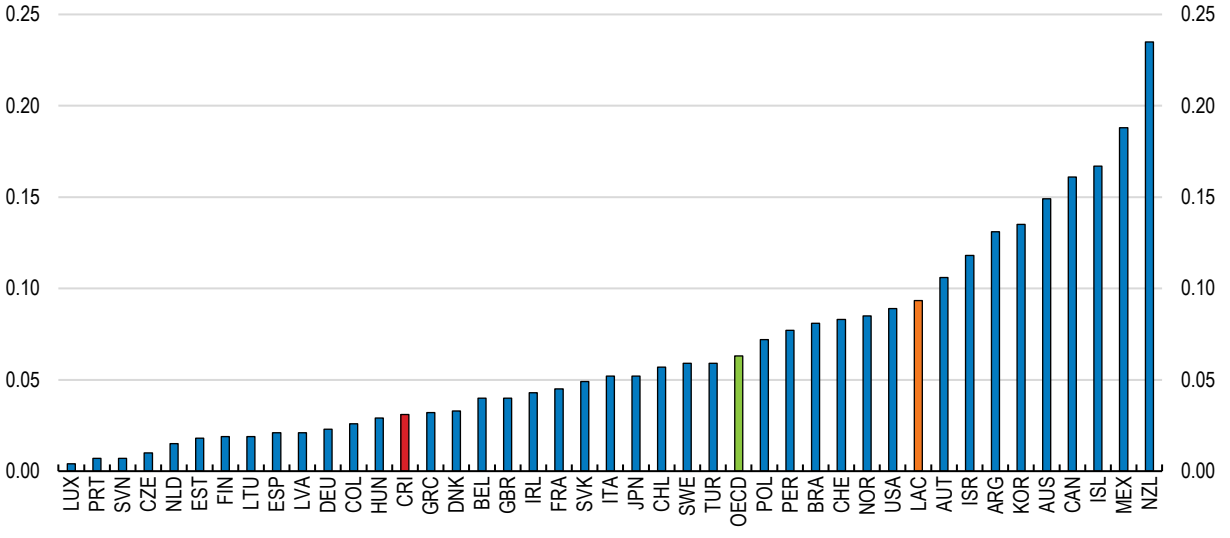
Figure 4.7. Lenient regulation makes Costa Rica an attractive environment for FDI

OECD FDI Restrictiveness Index, from 0 ("least restrictive) to 1 ("most restrictive"), 2020



Note: LAC is a simple average of Chile, Colombia, Mexico, Argentina, Brazil and Peru.
Source: *OECD FDI Restrictiveness Index* (database).

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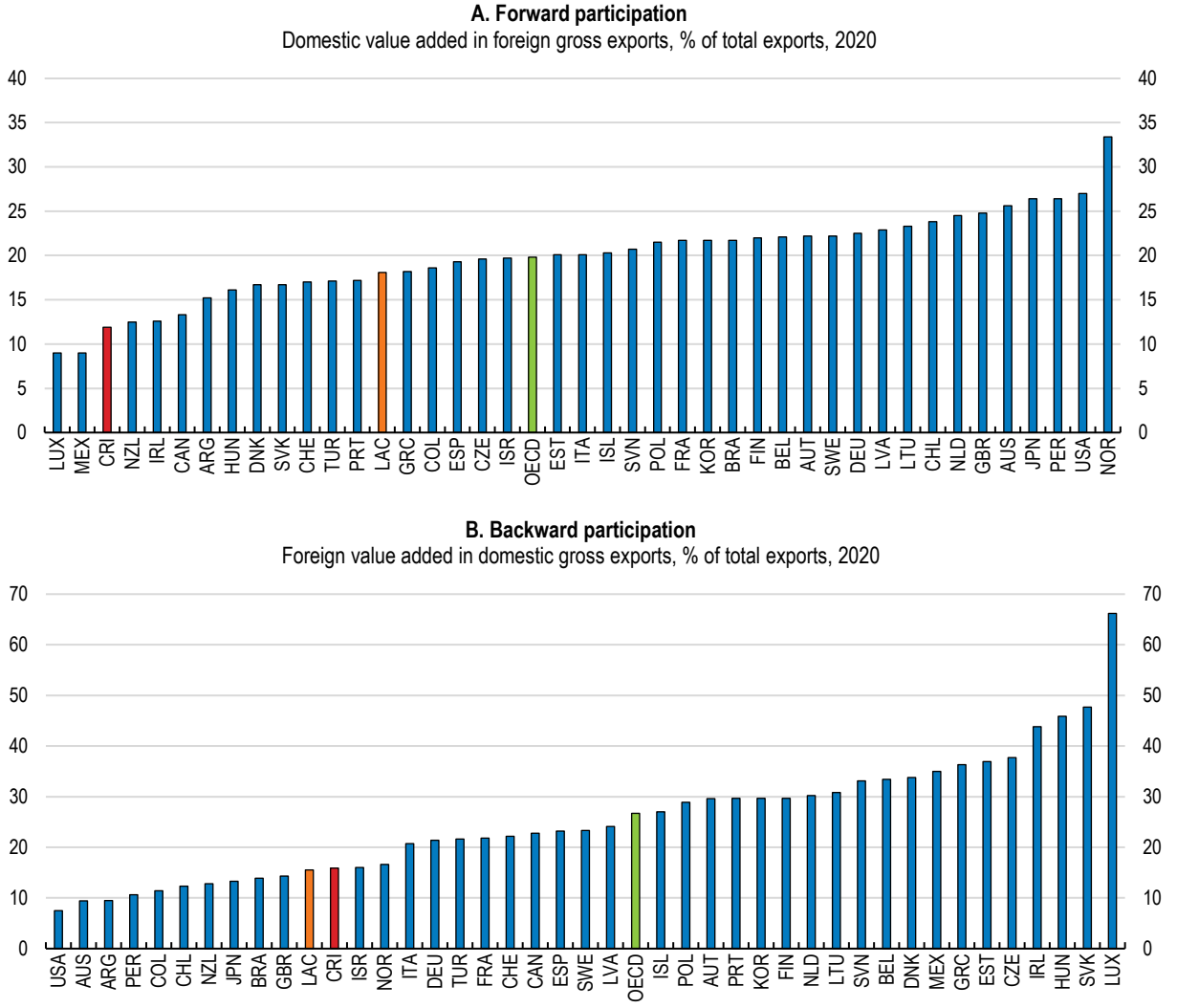
Despite its success in attracting FDI and good export performance, Costa Rica is less embedded in global value chains than other more manufacture intensive or trade focused economies (Box 4.1). This reflects that exports are primarily composed of final goods rather than intermediate goods that are part of global production networks. Thus, the country's industries rely more on domestically produced inputs rather than importing advanced components or technologies from abroad (low backward linkages) (Figure 4.8, Panel A) and exports are mostly final products rather than intermediate goods that are further processed or assembled elsewhere (low forward linkages) (Figure 4.8, Panel B). Increasing participation into global value chains would help Costa Rica to further increase trade benefits. Imported inputs are often technologically superior or more cost-effective, enabling companies to innovate and improve efficiency. Integration into GVCs offers opportunities to specialise in highly productive niches. Additionally, GVC participation can foster knowledge transfer between countries and firms, while driving firms to improve competitiveness and innovation.

Figure 4.8. Costa Rica's forward and backward participation in GVCs remains low



Note: Backward participation is the foreign value added embodied in a country's exports as a share of this country's total exports. Forward participation is the domestic value added of a country embodied in the exports of third countries as a share of this country's total exports. LAC is the simple average of Chile, Colombia, Mexico, Argentina, Brazil, and Peru.
Source: *OECD Trade in Value Added (TiVA) 2023 edition* (database).

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Box 4.1. Costa Rica's participation in Global Value Chains (GVCs)

Costa Rica's participation in GVCs showed limited progress over the last ten years and remains below the average OECD country. Participation in GVCs is defined the sum of backward linkages (Figure 4.8, Panel A), the share of foreign value added in Costa Rica's total exports, and forward linkages (Figure 4.8, Panel B), the share of Costa Rican value added embodied in foreign countries' exports.

In Costa Rica, participation in GVCs stands at around 28% against an OECD average of almost 47%. Manufacturing industries (basic metals, rubber and plastics, transport equipment, machinery, and electronics) score the highest values in backward participation, which points to Costa Rica specialising in assembling activities that require relatively more imported intermediate goods to produce exports.

Costa Rica's forward participation is larger than in regional peers as Mexico, but the gap with respect to other OECD economies that are also large recipients of FDI remains large. If overall the forward participation rate has stagnated around a low level in the past decade, in services sectors (business services, wholesale and retail trade and repair of motor vehicles and motorcycles) it increased remarkably, far above the average of Latina American countries. This suggests that Costa Rica moved rapidly up the services GVC by shifting the composition of its exports towards more sophisticated services through competitiveness gains. Conversely, forward linkages in manufacturing of computer, electronic and optical products remain low.

4.3. Optimizing trade policies

Costa Rica's outstanding trade performance and ability to attract FDI are the outcome of a successful trade policy, which underpins its export-led growth strategy. Key elements include a strong commitment to trade openness with continuous efforts to open new markets through trade agreements, reduction in trade tariffs, effective trade facilities and a favourable business environment for FDI. Moreover, Costa Rica's attractiveness is bolstered by its robust institutional framework, with the Ministry of Foreign Trade (COMEX) and the Costa Rica Foreign Trade and Investment Promotion Agency (PROCOMER) playing proactive roles in trade policy-making and in promoting exports and investment flows, respectively.

This section presents the features of Costa Rica's trade policy and proposes how it can be further enhanced by continuing to improve trade facilitation, deepen trade diversification and favour SMEs participation in international trade.

4.3.1. Keep expanding trade opportunities via trade agreements

Costa Rica's existing trade agreements are wide (Figure 4.9). It has signed 18 trade agreements (bilateral, or multilateral), of which 17 already in force, providing preferential access to markets representing around 60% of the world GDP (PPP based), resulting in an increasing number of trade partners.

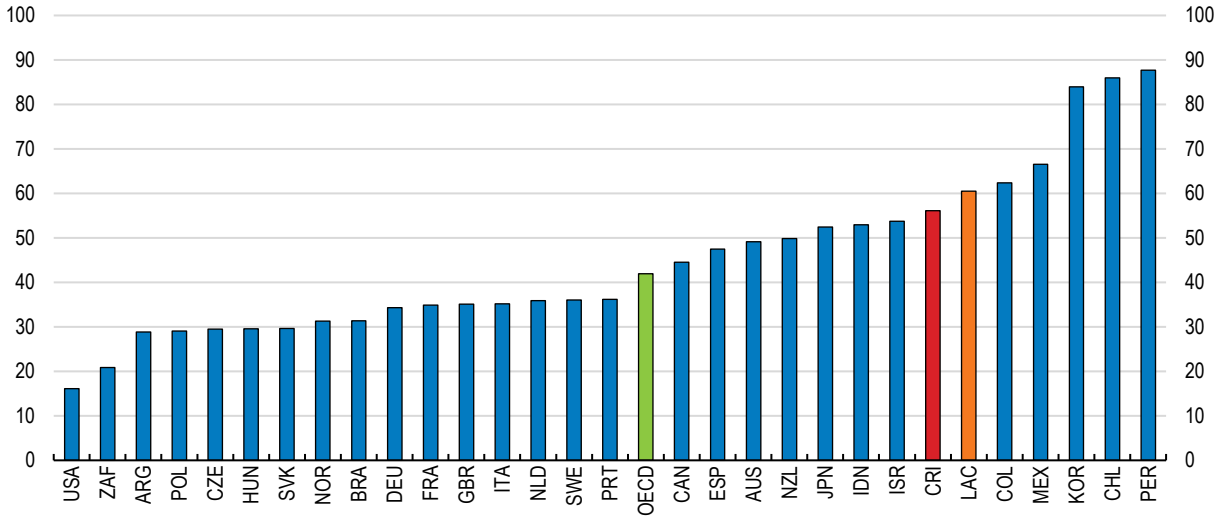
With Costa Rica's exports remaining concentrated in a few destinations, notably the US, (Figure 4.3, Figure 4.4), efforts are underway to further diversify trade partners (Table 4.1). In 2023 Costa Rica negotiated trade agreements with the United Arab Emirates, the first one with a Middle East country, and with Ecuador, the latest entered into force on October 1 2024, that are expected to increase exports and production. Costa Rica also signed in 2024 the Agreement on Climate Change, Trade and Sustainability (ACCTS) with New Zealand, Switzerland and Iceland, through which tariffs on some environmental goods will be eliminated, among other measures. Costa Rica is seeking to join the Pacific Alliance, formed by Chile, Colombia, Mexico and Peru to foster regional integration, which accounts for 60% of Latin America's imports. If Costa Rica became a member, it would benefit from its geographical location in between the Pacific Alliance members, enhancing access to a large market and improving its prospects to attract further direct investment. It would also strengthen value chains in the region and offer a valuable platform to

increase trade integration with Asia, given Costa Rica's bilateral free-trade agreements (FTAs) with China, Singapore and South Korea. Valuable efforts are also underway, and should continue, to strengthen trade relationships with rapidly growing economies in the Asian-Pacific region by becoming member of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). Furthermore, Costa Rica is working to join the Digital Economy Partnership Agreement (DEPA).

Signing international treaties that avoid double taxation could help further diversify trade partners in services. Currently, Costa Rica entered into four such treaties with Germany, Mexico, Spain and the United Arab Emirates. Finally, Costa Rica progressed in promoting inclusive trade by joining the Inclusive Trade Action Group in 2023, focusing two of the chapters in the trade agreement with Ecuador on SMEs and gender, and including provisions to support women and youth in the chapter on SME in the agreement with the United Arab Emirates.

Figure 4.9. Costa Rica's trade agreements are wide

Trade agreements, % of world GDP, 2023



Note: Data for GDP refer to 2023 or latest, and for trade agreements to 2020. LAC refers to the unweighted average of Chile, Colombia, Mexico, Argentina, Brazil, and Peru. Trade agreements are weighted by partner countries' GDP in PPP US dollars. The computations exclude the domestic country GDP.
Source: OECD calculations based on Dür et al. (2014).

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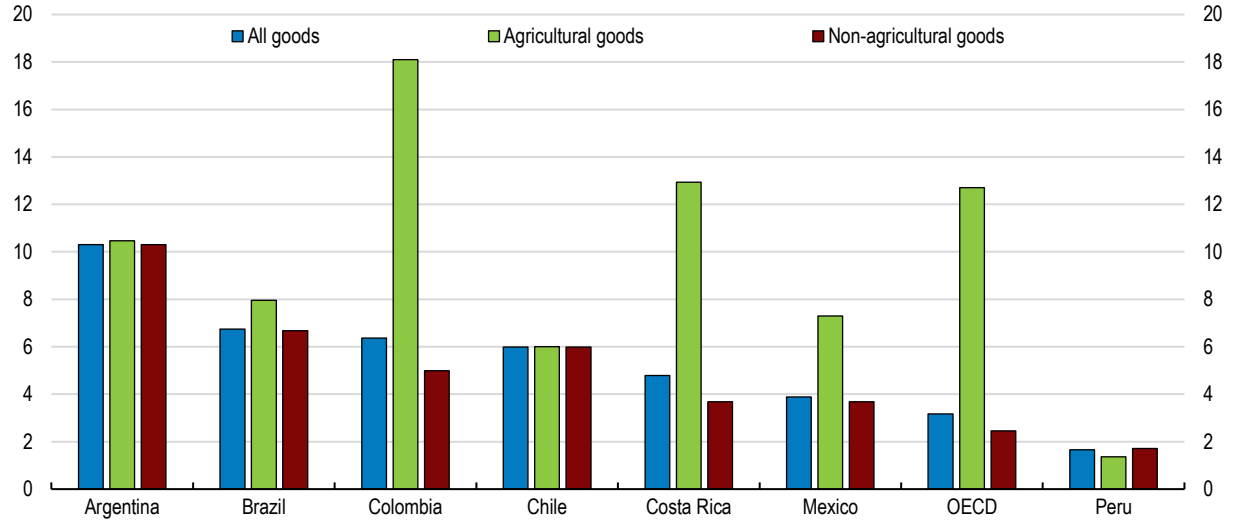
4.3.2. Continuing to reduce trade tariffs in agriculture and enhancing trade facilitation

Costa Rica is a member of the World Trade Organisation since 1995, and its trade tariffs are overall in line with the average OECD country, though there is room to reduce tariffs in agricultural goods (Figure 4.10). Moreover, while around 70% of non-agriculture good imports are duty free the share is only 33% for agriculture imports. The top tariffs apply to products such as poultry meat, dairy products, sugar and rice. Reducing import tariffs on raw agricultural products would enhance competitiveness in sectors that rely on them as inputs by lowering their production costs and enabling more efficient supply chains. Following recommendations in previous OECD Economic Surveys (e.g., OECD 2020), rice import tariffs have been recently decreased significantly (from 36% to 5%). Similar steps should be taken in the sugar sector. The intended integration into the Pacific Alliance would also imply lowering tariffs in the agriculture sector. Model-based simulations about the impact of these tariff reductions in the context of an integration with the Pacific Alliance suggest that they would increase Costa Rica's GDP growth by 0.3% (CEPAL, 2021[1]).

Figure 4.10. There is room to decrease tariffs in agricultural products

Applied Most Favoured Nation tariff, trade weighted average duty, %, 2023



Note: The Most Favoured Nation tariff is the tariff that countries impose on imports from other members of the World Trade Organisation, unless the country is part of a preferential trade agreement.
Source: *WTO Statistics* (database).

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Costa Rica has progressed in the modernization of land customs infrastructure. Since June 2024 a joint custom infrastructure (the Integrated Control Centre) is operating at the border with Panama with authorities from both countries working together in the same infrastructure. A new custom infrastructure is also at an advanced state (complete at 56% as of September 2024) at the border with Nicaragua. These efforts will expedite firms' exports thus facilitating trade via land. Costa Rica also streamlined and simplified customs procedures for imports and exports and ranks high in the OECD trade facilitation performance. The National Council on Trade Facilitation (CONAFAC), created in 2017 to help the implementation of WTO Trade Facility Agreement and composed by representatives of the government and businesses, plays a relevant role in enhancing trade facilitation. CONAFAC's main achievements include investing more than US$110 million in the modernisation of the main land border posts, improving cross-institutional coordination at customs borders, promoting Costa Rica's accession to the Kyoto Convention, modernising customs legislation and carrying out standardisation and automation of foreign trade formalities. However, further improvements could be achieved in custom clearance documents and procedures.. According to OECD Trade Facilitation Indicators, the time required to prepare custom clearance documents could also be lowered. Currently it takes more than twenty hours to prepare all documentation in Costa Rica, against only one hour in the best performing countries (e.g., Singapore).

Further streamlining export processes could make it easier for SMEs to engage in trade. Costa Rica has a single window trade facility (*Ventanilla Única de Comercio exterior*, VUCE) allowing exporting firms to submit standardised information and documents through a single point of entry. Currently around 56% of procedures in VUCE are automated, and the single window has reduced the time and costs related to trade processes and procedures by around 80% (Thorrens, 2019[2]) and has been recently digitalised (VUCE 2.0) allowing firms to access trade facilities on a digital platform 24 hours a day, 7 days a week.

Costa Rica could further improve its single window trade facility to provide specific services tailored to the needs of SMEs following the examples of countries such as South Korea, Peru and Uruguay (Box 4.2). SMEs typically face additional specific barriers both internal (e.g., such as lack of information about foreign markets) and external (lengthy and costly regulations). Providing digital platforms that make easier for SMEs to connect with MNEs and foreign companies, also through information on trade fairs, could provide

SMEs with the network required to export that they often lack. To better understand the barriers SMEs face for their internationalization, the government could launch a consultation with SMEs associations. The ongoing development of the VUCE 3.0, to be completed by 2027, provides an opportunity to integrate improvements targeting exporting SMEs. More broadly, streamlining bureaucracy, which is burdensome in Costa Rica as analysed in Chapter 2 and in previous OECD Economic Surveys, would benefit SMEs internationalisation as their competitiveness in global markets is highly affected by domestic regulation.

Box 4.2. Tailoring trade support facilities to SMEs needs

Peru integrated into its single window for foreign trade (Ventanilla Unica de Comercio Exterior, VUCE) two specific tools aimed to strengthen international trade participation of small and medium sized enterprises (SMEs): E-PYMEX and VUCE B2B.

- E-PYMEX is an Enterprise Resource Planning (ERP), a free digital platform specifically designed for SMEs engaged in international trade to help them manage and integrate all their business activities (e.g., sales, purchasing inventory, marketing or finance).
- VUCE B2B is a digital marketplace that helps Peruvian SMEs to easily search for foreign buyers and offers information for tendering processes, fairs, and other business events. The platform is connected to E-PYMEX and allows SMEs to streamline all business-to-business ("B2B") and business-to-government ("B2G") trade-related payments.

Uruguay's single window for foreign trade incorporates since 2019 the tool "TU EXPORTA" ("You Export") to boost the internationalisation of SMEs, increase their formalization, and reduce costs for small shipments. The project allows small and medium businesses to export shipments of up to 2,000 USD in value and benefit from exclusive exemptions. These exemptions include a simplified and expedited customs process, a complete waiver of taxes and duties, and a special process for returned goods. All these processes are managed and centralised in Uruguay's VUCE, simplifying the interactions between exporting SMEs and customs agents.

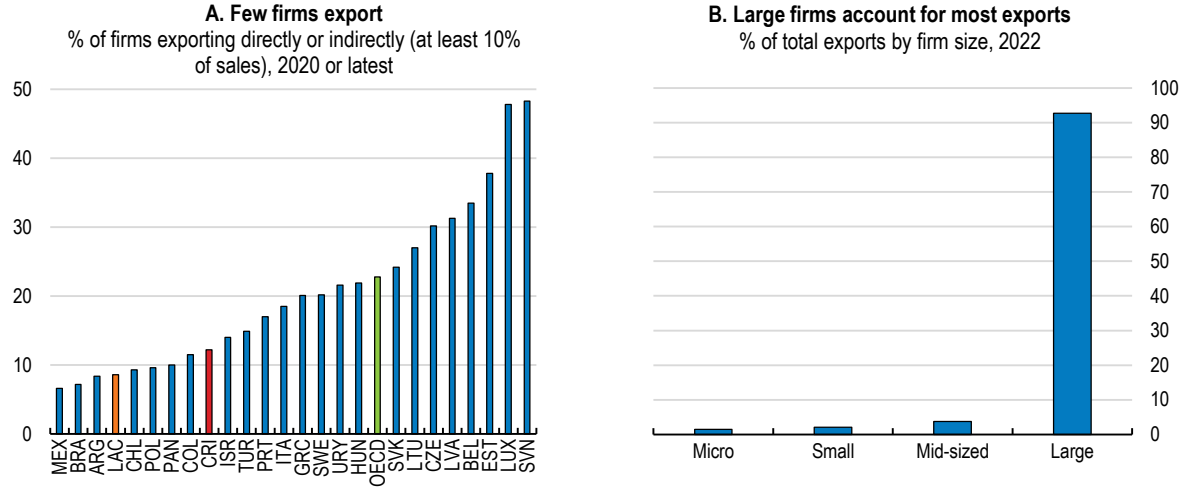
South Korea's platforms uTradeHub and UniPass are a global benchmark for single windows for foreign trade since their launch in 2006 and 2007. The two platforms provide a series of services including providing support for finding foreign buyers, obtaining international standards and certifications, automatising custom procedures, and assisting in corporate functions like finance, human resources, and logistics. The platforms integrate specific services tailored to the needs of SMEs to help them start and develop international SME eCommerce. These initiatives contributed to reduce exporting costs for SMEs, mainly via reduced services charges from custom brokers, improved transparency in foreign trade procedures, and contributed to increase Korean SMEs participation in international trade.

Source: (Thorrens, 2019[2]; Lee, 2020[3]; Yang, 2009[4])

4.3.3. Further facilitating SMEs internationalisation

Costa Rica remains a dual economy with a small number of large and relatively productive multinational firms, largely focused on external markets, coexisting with a majority of local SMEs exclusively focused on domestic markets that struggle to grow and to export (Figure 4.11), as described in previous OECD Economic Surveys (OECD, 2016[5]; OECD, 2018[6]; OECD, 2020[7]; OECD, 2023[8]). This duality is a key factor behind Costa Rica's low level of labour productivity (Figure 4.12, Panel A), which is only slowly converging towards the OECD average (Figure 4.12, Panel B).

Figure 4.11. Few firms export, especially among SMEs, and large firms account for most exports



Note: Panel A: OECD is the simple average of 20 OECD countries. LAC is the simple average of Argentina, Brazil, Chile, Colombia, and Mexico.
Source: *World Bank Enterprise Survey* (database); and Banco Central de Costa Rica.

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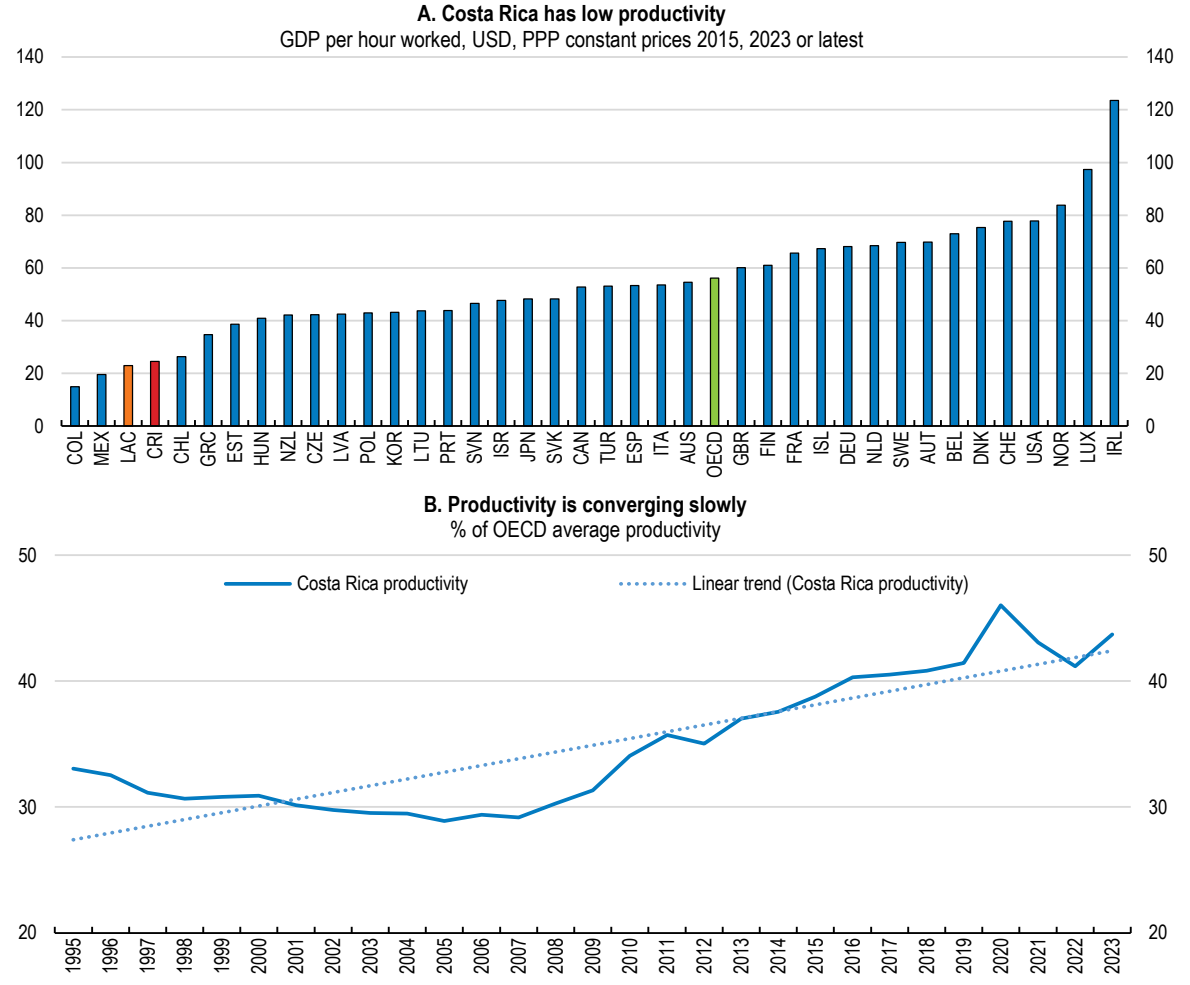
Figure 4.12. Labour productivity is relatively low and only slowly converging to the OECD average



Note: In Panel B, the dotted line is the linear trend in productivity expressed as a share of OECD average level.
Source: *OECD Productivity* (database).

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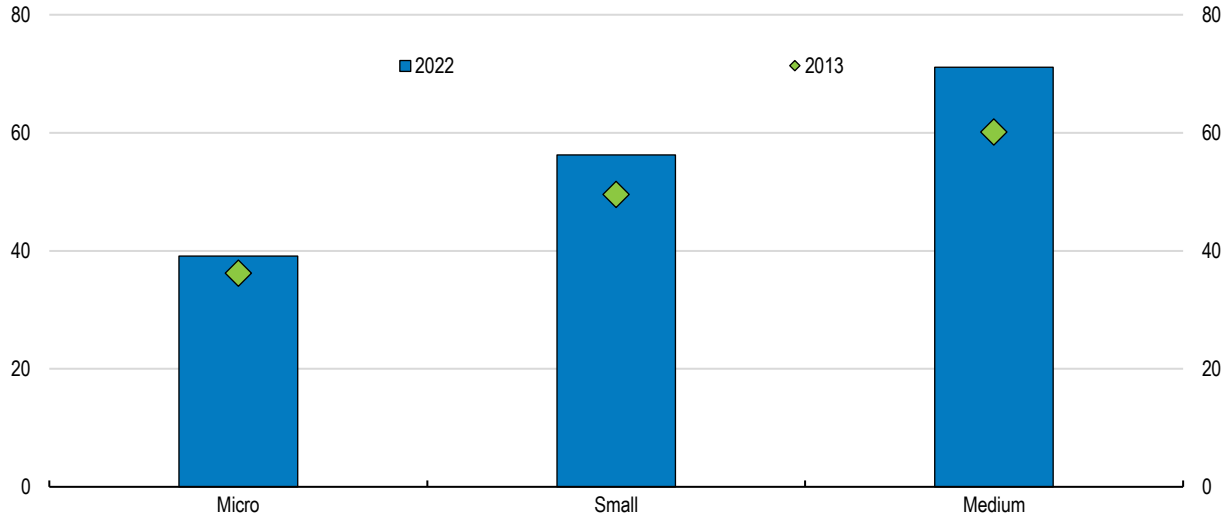
Acknowledging the relevance of strengthening linkages between Costa Rican SMEs and multinational enterprises (MNEs), Costa Rica, as part of its trade policy, actively promotes partnerships between local suppliers and multinationals. Costa Rica Foreign Trade and Investment Promotion agency (PROCOMER) recruits and evaluates local potential suppliers and assess whether they are suited to become providers of foreign firms. They assess suppliers' infrastructure, production capacity and upscaling, marketing or human capital and recommend them how to further improve. Despite limited resources (12 people and an annual budget of 745 thousand USD in 2019 (Monge-Gonzalez, Crespi and Beverinotti, 2020[9]), PROCOMER has established more than 5000 linkages between local suppliers and exporting firms, for example in the medical device sector, since 2020. Linkages of higher value usually occur when the local supplier operates in high-technology sectors (e.g. QR technology, solar battery, automation and robotics development or nanotechnology solutions for agriculture) and can innovate to adapt production to the specific needs of the MNEs. The integration of local firms into the GVC of semiconductor is also actively promoted by the Ministry of Foreign Trade (COMEX). PROCOMER, together with the Ministries of Agriculture and Livestock and COMEX, also operates the programme Descubre to link farmers to export markets by providing technical support for small producers to become providers of larger exporting companies in selected agro-food value chains (OECD, 2023[10]). The programme has a reduced budget and staff and its impact is yet to be evaluated.

Becoming a supplier or partner of MNEs can also be a stepping-stone to export, facilitate firm growth and creation of higher-wage formal jobs (Figure 4.13). Evidence shows that firms that have become suppliers of MNEs are indeed more likely to start exporting. Costa Rican firms that supply foreign-owned firms have, four years after the first sale, 33% higher sales, 26% more employees, 22% more net assets, and 23% higher total input costs (OECD, 2018[11]; Rodriguez-Alvarez and Monge-Gonzalez, 2013[12]; Alfaro Urena, Manelici and Vasquez, 2021[13]). Total Factor Productivity increases range from 4% to 9% (Alfaro-Urena et al., 2022[14]). These benefits originate from technology spillovers (special equipment, inputs or technology), better administrative or production practices, or human capital spillovers (learning by doing and specific training). Over time, further spillovers originate via labour mobility (Monge-González, Hewitt and Torres-Carballo, 2015[15]), as workers trained in high productive exporting firms may spread knowledge to local suppliers or create new firms, through imitation (reverse engineering, management practice), or by promoting competition among domestic firms trying to supply MNEs. Given the positive impact that these linkages have, Costa Rica should continue and expand its efforts to promote partnerships between local firms and multinationals, also by taking advantage of a MNEs post-pandemic strategy of strengthening links with local suppliers to reduce supply chain disruption risks.

Promoting certification among SMEs can also facilitate SMEs becoming suppliers to larger firms. By obtaining internationally recognised certifications in areas such as product safety and quality or environment sustainability (e.g., ISO 9001, ISO 14001, Marca Pais, Carbono Neutral), SMEs can demonstrate their commitment to meeting high standards and ensuring product or service reliability. However, Costa Rica's SMEs often struggle to obtain international quality certification also because the process to obtain certification is costly and lengthy. Developing funding schemes to support SMEs in obtaining internationally recognised certifications, including by repurposing some of the existing business innovation schemes, could increase SMEs chances of obtaining certification. Other public policies can indirectly foster stronger linkages, including encouraging SMEs to invest in innovation, technology and processes that make them more attractive to MNEs, improving their access to finance and increasing the availability of high-skilled workers, as analysed in the following sections of this chapter.

Figure 4.13. Wages and productivity increase with the firm's size

Wage gap by firm size, % of large firms' median wage



Source: OECD calculations based on Banco Central de Costa Rica.

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To promote further integration into global value chains Costa Rica needs to continue attracting FDIs and better integrate MNEs with the local economy. To achieve it, trade policy should be complemented with policy interventions addressing structural bottlenecks in areas such as infrastructure, innovation and access to finance, education and skills and competition. SMEs may be less attractive as partners for foreign firms because they lack high-skilled workers, or access to finance to support investment for obtaining certification or scale needed to meet MNEs' requirements, or have low innovation capacity. There is large room to better support business innovation, entrepreneurship and investment in research and development (R&D) to support SME's internationalisation, as discussed in section 4.4. Similarly, adequate education and training are key policies to avoid that talent shortage reduced the capacity to attract FDI or prevent existing MNEs from further expanding, as analysed in section 4.5. Firms' ability to participate in GVCs, especially in more remote regions, is limited by inadequate infrastructure development, especially in terms of transports and logistics, as discussed in section 4.6. Low competition, by increasing trade and firms' input costs and reducing incentives to innovate, makes harder for SMEs to start exporting and integrate into global value chain, as discussed in section 4.7.

Table 4.1. Past OECD recommendations on trade integration

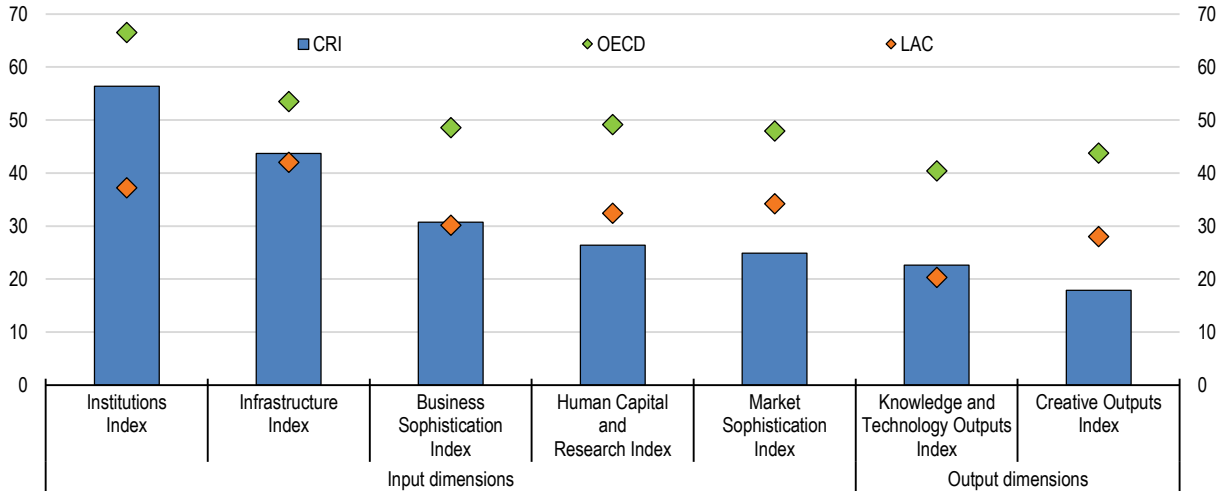
Past OECD Recommendations	Actions Taken Since the 2023 Survey
Pursue ongoing renewed efforts to increase trade integration further, including becoming a member of the Pacific Alliance.	Costa Rica sent a formal request in July of 2022 to the Pro-Tempore Presidency of the Pacific Alliance to join the bloc. Currently, the government is waiting for the request to be positively evaluated and for the formation of the Working Group on Costa Rica's Accession Process to be convened. Costa Rica signed trade agreements with the Republic of Ecuador in March of 2023 and the United Arab Emirates in April of 2024. Costa Rica formalised its request to join the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) in August 2022.

4.4. Boosting innovation and access to finance for SMEs

Despite its shift into more knowledge-intensive goods and services, Costa Rica underperforms the average OECD country and regional peers in key innovation performance indicators (Figure 4.14). The gap is especially large in innovation outputs, which capture Costa Rica's limited ability to produce and diffuse new knowledge (e.g. new patents, production of scientific articles, receipts from intellectual properties) and the reduced impact of new knowledge on the economy (e.g., gain in aggregate labour productivity, creation of domestic high technology companies). The gap in innovation outputs is also due to the National Plan for Science and Technology (NPST) not focusing on innovation outputs, an aspect that could be considered in the assessment review of the NPST launched in June 2024. Overall spending in R&D is low (Figure 4.15, Panel A), far below that of most OECD countries (0.4% of GDP against 1.9% of GDP for the average OECD countries) or what it would be expected for its level of development (0.75% of GDP) (Monge-Gonzalez, Crespi and Beverinotti, 2020[9]). Moreover, Costa Rica has few researchers (Figure 4.15, Panel B) and the number of patents or industry design is low relative to Costa Rica's level of investment (WIPO, 2023[16]).

Figure 4.14. Costa Rica underperforms in key innovation indicators

Global Innovation Index, 0-100 (or "best"), 2023 or latest



Notes: The Global Innovation Index measures countries' capacity for, and success in, innovation. It is composed of two sub-indices, the Innovation Input Index and Innovation Output Index, which are composed of five and two pillars, respectively. LAC is the simple average of Chile, Colombia, Mexico, Argentina, Brazil, and Peru.
Source: World Intellectual Property Organization (WIPO).

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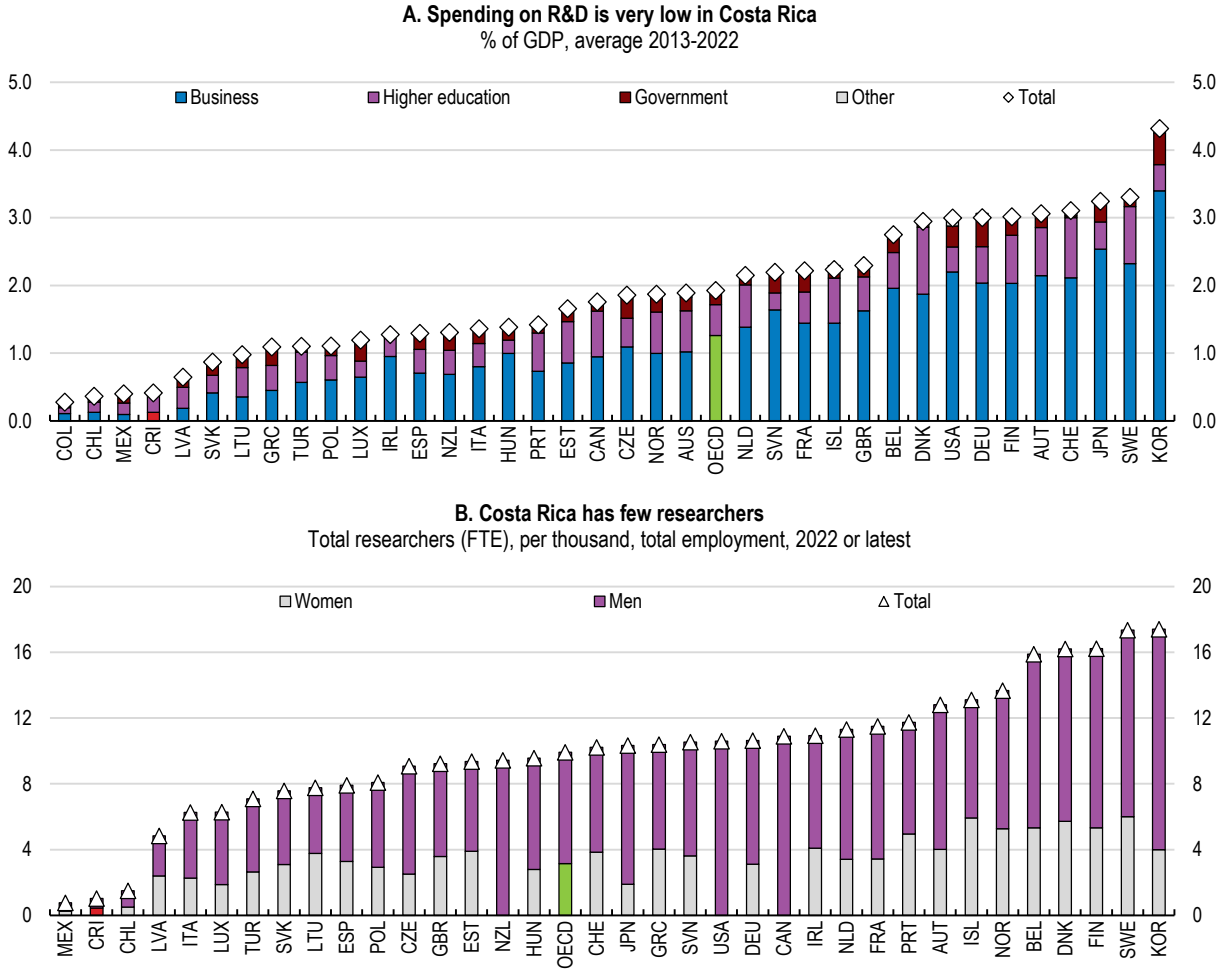
Investment in R&D is performed primarily by the higher education sector (public universities) and the business sector (Figure 4.15, Panel A). Public universities are funded by the education budget and by Constitution are fully autonomous on how to allocate their research budget, which is not subject to external assessments. Funding for public research then tends to be dispersed across multiple areas without clear priorities. Costa Rica could follow the example of many OECD countries (e.g., Finland or the United Kingdom) that have a competitive and research performance-based system as the main mechanism for orienting public funding in science, technology and innovation.

Investment in R&D by the business sector is also low. It is mostly performed by large, mainly foreign owned enterprises firms operating in the free trade zones, and in a few dynamic sectors in the agroindustry and in advanced manufacturing industries (medical devices, aerospace, renewable energy, software and

design services) (OECD, 2017[17]). Several MNEs perform R&D abroad, while local firms rarely engage into R&D nor demand R&D or services based on R&D by local universities or research centres.

Figure 4.15. Spending on R&D is low and researchers are few



Note: In Panel B, there are no data for the number of researchers for Australia, Colombia, and Israel, and for the number of women researchers for Australia, Canada, Colombia, Israel, New Zealand, and the United States.
Source: *OECD MSTI* (database).

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The low level of business R&D investment is also due to the limited support provided by public innovation policies through grants and credits. Two programmes (PROPYME, and Linkages), run by the Costa Rican Promoter for Research and innovation (Promotora Costarricense de Innovacion e Investigacion), an agency under the Ministry of Science, Technology,Innovation and Telecommunications, provide grants for capability upgrading of SME and business linking to global value chains, but have little funding, restrictive requirements and burdensome operations, and few SMEs benefit from these programmes (OECD, 2017[17]). The Development Banking System (*Sistema de Banca para el Desarrollo*) is the main source of credit for business innovation, but while it increased its credit portfolio and number of beneficiaries since 2022, its ability to support funding for innovation has room for improvement, as analysed in section 4.4.2.

Strengthening support for innovation and R&D would encourage companies to develop more sophisticated products and processes to be more competitive on a global scale and help them integrate more fully into global value chains. By strengthening its public innovation policies, promoting the transfer of knowledge

between universities and the business sector, and improving access to finance for innovation, Costa Rica can create a robust innovation ecosystem that drives export growth and attracts FDI.

4.4.1. Enhancing the public innovation system

Strengthening governance and streamlining programmes

Costa Rica's public innovation policy is underdeveloped and uncoordinated, with highly independent institutions that struggle to cooperate to implement a consistent innovation policy. Weak coordination and limited funding lead to poor implementation of the National Plan for Science. The Ministry of Science, Technology, Innovation and Telecommunications (MICITT), the leading ministry in charge of coordination and implementation of innovation policies, has recently increased its staff (from 150 to 193) and budget, though still remains underfunded. The budget for Science, Technology and Innovation (STI) at 0.015% of GDP in 2023 is low and is traditionally scattered across a large number of programmes so that each programme ends up with limited resources and often overlaps with others, producing duplicity and high management costs (OECD, 2017[17]). The budget is set annually adding uncertainty over continuity in the funding for innovation. Programmes are designed and managed by different institutions hampering coordination and policy alignment.

Designing a long-term national innovation strategy would help identify technologies and sectors with strategic importance in terms of growth and employment opportunities, and in which Costa Rica has clear potential to achieve excellence. Involving in the design of this strategy all relevant stakeholders (representatives of the government, academia and business sector) and making it subject to the Parliamentary approval, the innovation roadmap could result resilient to the political cycle thus ensuring continuity in the pursuit of its long-term goals. A reform of the governance of the National Innovation System aimed to ensure high degree of coordination among public institutions would ease its implementation.

Strengthening the role of the innovation ministry could improve coordination, monitoring, implementation and assessment of innovation policies. The recent reorganization of the MICITT structure aimed to achieve better coordination across all the actors of the National STI system, also through the formulation of policies and guidelines, may help avoid duplication and optimise the use of resources. As a further line of action the number of programmes could be consolidated around key areas identified as national priorities and a single window for business innovation programmes could be established to streamline document submission and processes in the delivery of business innovation programmes. The steering power of the MICITT could benefit from counterbalancing the operational autonomy of autonomous agencies operating in sciences, technology and innovation that are responsible for funding allocation. This could be achieved via strong accountability requirements set by the MICITT. Costa Rica could follow the example of several OECD countries that adopted successful institutional frameworks for the design of innovation road mapping and to achieve stakeholder coordination (Box 4.3).

Box 4.3. Institutional frameworks for setting long-term National Innovation Strategies

The Netherlands' Advisory Council for Science and Technology Policy (AWT), created in 1990, is an independent strategic advisory body that advises the Dutch government and parliament on STI policy aiming to achieve excellence in selected areas and technologies selected for their strategic importance in terms of growth opportunities or relevance to societal challenges. The AWT is composed by a maximum of twelve members from research institutes and business-sector organisations who participate as individuals rather than as representatives of their organisation of affiliation, and is supported by an administrative and secretariat staff to help prepare meetings and draft reports and background studies. The AWT can be solicited to provide advice on innovation policy or specific policy

issues by the Ministry of Education, Culture and Science, the Ministry of Economic Affairs, other government departments or the Parliament. Its multi-annual work programme is defined in consultation with The Netherlands Ministry of Education, Culture and Science and Ministry of Economic Affairs. The AWT produces an annual report and publicises its findings through reports, advisory letters and background papers. The AWT is evaluated every four years by an external independent commission, according to the guidelines of the Advisory Bodies Framework Act.

The Finnish institutional framework for science, technology and innovation (STI) policy has been considered a reference since the 1990s. Within the Finnish innovation system the Research and Innovation Council (RIC, earlier the Science and technology Policy Council) plays a key role. The main duties of the RIC include assisting the government in its responsibilities for the master plan, coordination and fund-assignment in national technology policies. Joint with a strong commitment to public investment in R&D and education, innovation policy led by the RIC and large, well-funded agencies such as Tekes (Finnish funding agency for innovation) helped transform Finland from one of the lowest-technology economies in the OECD into a global leader in information and communication technologies industries.

In Korea the Science, Technology and Innovation Office (STIO) supports the Presidential Advisory Council on Science and Technology (PACST) and the Ministry of Science and ICT (MSIT) in the cross-governmental co-ordination of the STI system. This STI governance structure provide strategic directions, align plans and budgets and articulate and monitor interventions across the whole of government. The STIO plays a dominant role in developing the five-year Basic Plan and aligning sectoral ministries' midterm and annual plans with it, as well as in the annual budgeting review of research and development (R&D) programmes and their monitoring and evaluation. This governance has been instrumental in ensuring strategic coherence during a period of rapid expansion of the Korean STI system and the shift from a position of fast follower to that of scientific and technological leader in some key high-growth areas.

Source: (OECD, 2014[18]; OECD, 2023[19])

Innovation policy has had limited success in promoting business innovation, especially in SMEs, or boosting entrepreneurship. In recent years several positive initiatives have been undertaken to improve consistency and efficiency of innovation policy. Recent efforts led to a rapid increase in the implementation of programmes aimed at promoting entrepreneurship benefiting four times more firms in 2023 (120) than what had been the average in previous years. This progress is welcome and should continue. In 2021, most innovation programmes (financial support for SMEs, grants for STEM researchers, support for the creation of clusters) were consolidated within an agency to promote innovation and research (Promotora Costarricense de Innovacion y Investigacion, PCII), under the Ministry of Science, Innovation, Technology and Telecommunication, thus increasing coordination across ministries and the business sector. Increasing limited resources could help amplify the impact of innovation policies, but this should go along with establishing mechanisms to ensure that innovation programmes are assessed and that findings from evaluations feed back into policy making. A more impactful innovation policy could be achieved by setting clear and measurable goals for innovation programmes and regularly assessing their impact, for example via an external independent commission.

Improving the linkages between higher education institutions and the business sector

Promoting collaboration between universities, research centres and firms can drive innovation and technology transfer. However, cooperation between the business sector and private or public educational or research centres in Costa Rica is scarce and mostly for training purposes. To support SMEs to create new products, improve processes and access funding, Costa Rica could develop upgrading programmes targeting SMEs. Several successful country examples could inspire Costa Rica's efforts. For instance, the

EU Innovation Voucher programmes grants SMEs vouchers to receive assistance to explore business opportunities, identify production improvements or develop new products from registered knowledge providers (universities and research centres). Germany successfully supports technology transfers in technologically advanced industries (e.g. Exist, Signo).

Incentives for building links between the higher education and the business sector could be strengthened, also building on the experience of the Hélice programme, funded by the Korean International Cooperation Agency, that promotes the creation of spin-offs based on research developed at the University of Costa Rica. Spin-offs are important vehicles to commercialise new products resulting from scientific research. Universities could take equity investments in spin-off companies. Additionally, the model used to allocate funding for research in universities could be changed towards a performance-based model to promote applied research. To strengthen the links between research and businesses, and to promote local value added and innovation, one criteria to assess performance could be the number of applied research projects a university develops in cooperation or in response to demands from local industries.

Promoting innovation hubs

Establishing innovation clusters or hubs where startups, SMEs and multinational companies can collaborate, share resources and benefit from common infrastructure could support innovation, as evidence from several OECD countries shows (Box 4.4). Costa Rica has a National Cluster Programme since 2020 to facilitate innovation and the integration of domestic firms into GVCs. This initiative if adequately supported and strengthened can promote specialization, support firms moving toward higher value-added activities, and reduce regional gaps. The creation of a cluster coordination unit could strengthen the governance of the cluster development policy. It could collaborate with other agencies (such as PROCOMER) and foster links between cluster firms and public institutions to better align public policies (education, access to finance, competition, regulation, innovation) with the needs of clusters.

Box 4.4. The experience of Cluster Development Policies (CDP) in Latin American countries and the Basque country

Cluster development policy in Latin American countries

Most LAC countries developed cluster policies in the 2000s. Overall, the creation of clusters had a positive impact on firms innovation capacity, development indicators (innovation capacity, employment) and growth (production, exports), though not on aggregate productivity. Among the main lessons of these experiences, divergences in views among public institutions (vision, mandate, short-term political consideration) is found to reduce the capacity to support clusters, whereas a lengthy process to create a cluster (up to three years, with the exception of Chile) reduced trust in cluster potentiality.

The case of the Basque country

The Basque Country, an autonomous community in Northern Spain, adopted a successful cluster policy in the 1990s. Between 1992 and 2010 the CDP supported the creation of 21 clusters, with cluster firms displaying better productivity and export performance than firms in the same sector outside the cluster. Overall, given the large size of the clusters, this policy contributed to boost growth.

The policy supported firms in several ways. It provided support for obtaining international quality certification, made information on international markets more accessible, helped identify education and training institutions to align workforce skills with labour demand, and facilitated the access to incentives for innovation investment. The policy also produced positive externalities for the whole business sectors via the creation or improvement of technology and training centres.

Source: (Monge Fonzalez and Salazar, 2016[20]).

4.4.2. Improving SMEs' access to finance for innovation

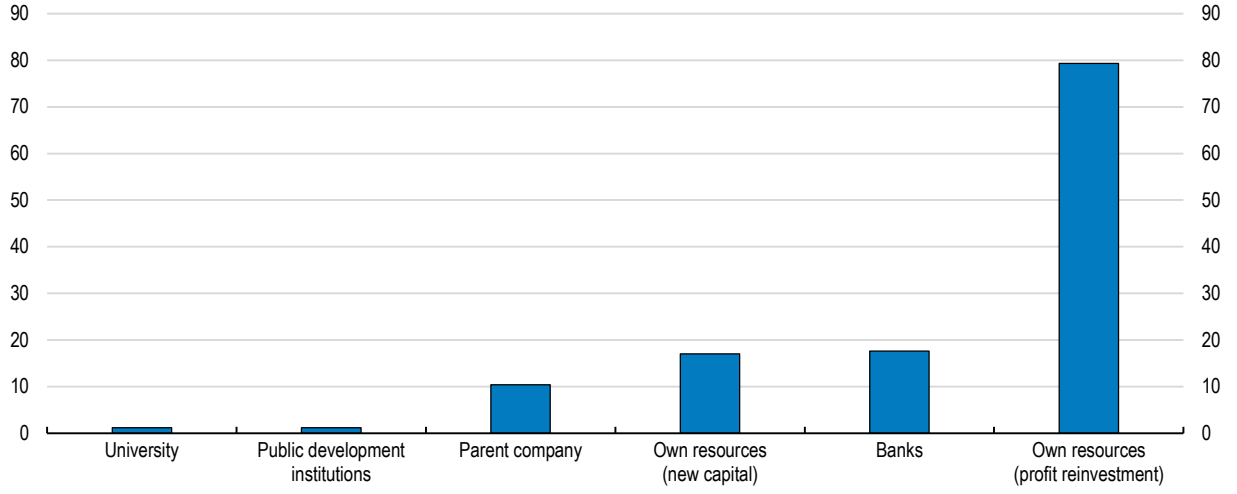
Businesses in Costa Rica fund their innovation investment mostly from own resources (Figure 4.16), with a marginal support from public development funds. Banks grant most business credit to large firms (Figure 4.17, Panel A) and SMEs receive relatively less credit also in international comparison (Figure 4.17, Panel B). Banks are reluctant to lend to SMEs for innovation projects that entail considerable risk, in the absence of collaterals that most SMEs lack. Similarly, they prefer lending for business innovation projects when they are at an advanced stage, thus reducing opportunities for startups (Campos Gallo, Saenz leon and Carvajal Vega, 2022[21]).

Alternative funding options for SMEs remain underdeveloped in Costa Rica. Seed capital, which covers the cost of creating an idea for a new business or a new product, amounted to around 3.3 million colones (around 6,600 USD) in 2023 (Ching Vindas, 2024[22]). The few investment angels operating in Costa Rica are isolated and lack an organization that could help match potential start-ups with seed-stage investors or create connections with other support institutions such as incubators or universities. The capital risk industry, which in many countries is an important option for securing technical and financial support for scaling up innovative fast-growing companies, is also limited. As of 2024 there were no private venture capital risk funds operating in Costa Rica and just two public venture capital funds still at the raising fund stage (Ching Vindas, 2024[22]).

The Development Banking System (*Sistema de Banca para el Desarrollo*, SDB) is the main source of funding for micro and SMEs in Costa Rica and one of its goals is to provide technical and financial support for SMEs to promote innovation, scaling ups, technology transfer and integration into GVCs. SDB's resources are targeted in priority to specific vulnerable groups (e.g., women and young entrepreneurs or micro firms), and beneficiaries located in low-development areas. As a result of these priorities, micro firms and, to a lesser extent, small firms, receive most of the SDB credit (Figure 4.18, Panel A), especially in the in the services (trade, other services and tourism) and agriculture sector (Figure 4.18, Panel B).

Figure 4.16. Businesses finance innovation mainly via own resources

Composition of funding for innovation, by source, %



Note: The sum does not add up to 100%, as firms can use other sources of funding not included in the figure.
Source: Atlas de Innovacion 2023.

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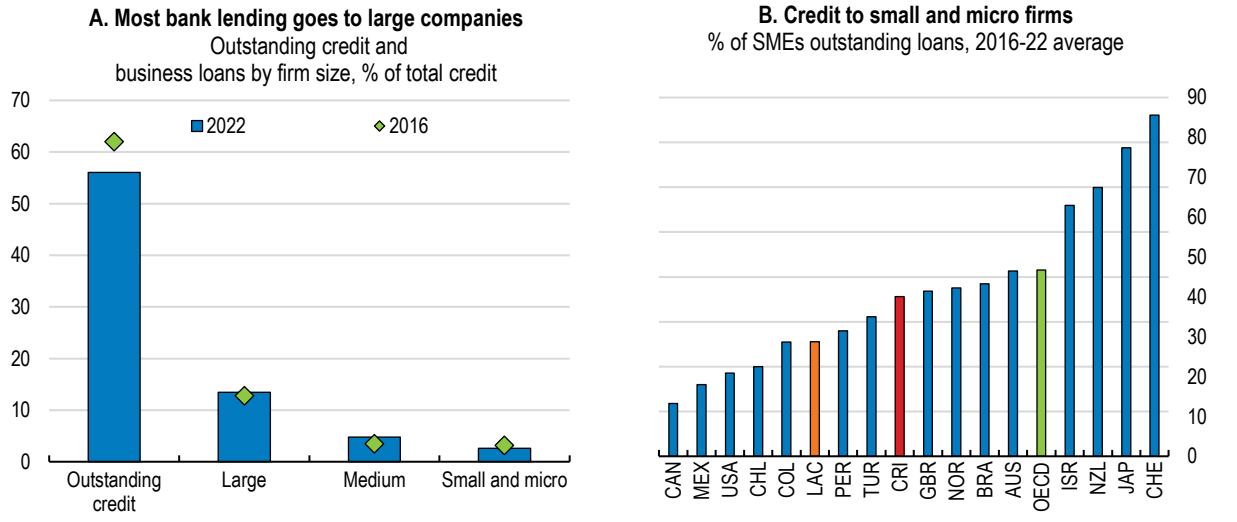
Figure 4.17. Most banking credit goes to large firms



Note: In Panel B, LAC is a simple average of Chile, Colombia, Mexico, and Brazil.
Source: (BCCR, 2023[23]); and OECD (2024), *Financing SMEs and Entrepreneurs 2024: An OECD Scoreboard*.

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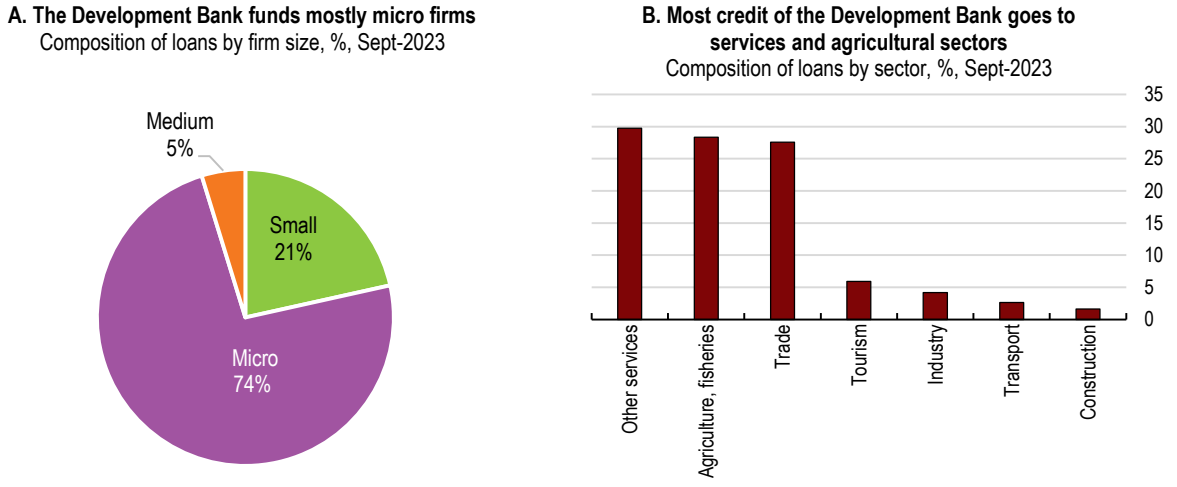
Figure 4.18. The Development Bank finances mostly micro firms in agriculture and services



Source: Sistema de Banca para el Desarrollo (SDB).

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Reforms in 2014 and 2021, together with the issuance of new regulation in 2023, attempted to enhance the role of the SDB in supporting SMEs innovation, technological transfers and integration into GVCs by strengthening credit, guarantees, cooperation with other institutions and the development of new tools such as seed capital and capital risk instruments. While these changes have overall led to a rapid increase in the credit portfolio (+61.4% between May 2022 and August 2023) and in the number of beneficiaries (+80.4% between May 2022 and August 2023) of the SDB, most initiatives related to promoting funding for innovation remain at an early stage and need scaling up. The SDB cooperation with the National Vocational Training Agency (*Instituto Nacional the Aprendizaje*, INA), could be strengthened to support entrepreneurship training (SDB, 2022[24]). The promotion of seed capital has been more successful, and the SDB has started distributing seed capital via ten agencies each targeting different activities (prototypes,

rural entrepreneurship, sustainable production or internationalisation), though the amount of resources involved remains limited. On capital risk, there is limited progress though.

The SDB should continue promoting alternative sources of funding for innovation via seed capital for early-stage startups (e.g., market research or prototyping), and via capital risk tools for late-stage startup (e.g., scaling-up or marketing). The SDB needs to set clear priorities in funding allocation to avoid dispersing its limited resources among too many areas, reducing effectiveness. Priority areas could include support for innovation, entrepreneurship, transfer technology and scaling ups of SMEs, that bear the highest potential for boosting SMEs business innovation. More resources could be also obtained by increasing interest rates on loans to firms that could afford to pay the higher rates applied by commercial banks.

Shortage of human talent and limited financial education among entrepreneurs are general factors hindering the development of capital risk tools in Costa Rica, and accordingly also the SDB capacity to promote them. It is necessary to increase the number of professionals in the management of capital risk funds and to provide sufficient incentives to avoid the high-risk of brain drain once the talent is trained. This process can take several years and incentives to attract talent from abroad could be adopted in the short term. The proposals set in the Institutional Strategy Plan 2024-2028 of the SDB aiming to fund training in risk capital and establish a 5 USD million capital risk fund are positive initiatives. Standardizing the cooperation framework adopted for the accreditation of seed capital agencies would help streamline the process.

To boost business innovation the SDB could address more resources to middle-sized firms, especially in the manufacturing sector, that tend to have a larger potential for innovation. Past assessments of the SDB impact find that most credit for micro firms is provided for necessity rather than for exploiting business opportunities (SDB, 2022[24]). Redefining the size of micro and SMEs according to the OECD definition would allow to increase the size of firms that benefit priority access to SDB funding. A medium-sized firm in Costa Rica has between 31 and 100 employees against between 50 and 249 in the OECD definition. The Ministry of Economy, Industry and Commerce could easily implement this redefinition via a change in regulation.

4.5. Promoting talent development through education and training

Costa Rica has made significant investments in education over the years, and its well-educated workforce has traditionally been a key factor to attract FDI in high-value sectors. However, the education system has struggled to keep pace with the increasing demand for high-tech and advanced skills, leading to large skills shortages that now pose a critical threat to Costa Rica's FDI attractiveness and its ability to maximise trade benefits. More broadly, the education and training system faces structural challenges preventing many Costa Ricans from getting broadly-based competencies to support lifelong learning, as reported in the last Survey (OECD, 2023[8]). In response, several reforms (Box 4.5) have been initiated or are forthcoming, though the full scope and timeliness of these reforms has yet to be disclosed. The effectiveness of these initiatives will have to be closely monitored to ensure they achieve the desired impact Overall, Costa Rica needs to pursue additional reforms efforts to improve educational efforts and reduce skills mismatches, including by establishing regular evaluations to monitor progress and impact.

A main challenge is the mismatch between exporting industry needs and available skills, especially in advanced manufacturing and business services. Businesses and foreign investors report difficulties in finding the right skills and there is a lack of technicians and graduates in STEM areas (INEC, 2018[25]) (see also Chapter 1). Conservative estimates put the shortage of STEM graduates at between eight to thirty-five thousand people over 2017-23 (Santa Cruz, Delgado and B., 2024[26]) for firms operating in the free trade zones, but the shortage for the whole economy is likely to be far larger. It is key to increase the number of technicians and graduates in STEM areas and expand digital and English proficiency to create

a skilled workforce capable of driving the country's integration into global value chains while attracting investment from high value-added high-tech industries.

Box 4.5. Recent policy initiatives in education

Costa Rica elaborated a series of reforms of the education system. The full strategy is yet under preparation but several initiatives have already been implemented or are about to be, including:

- The Employability and Human Talent Strategy (Estrategia Nacional de Empleabilidad y Talento Humano, ENETH or Estrategia Brete), led by the Ministry of Labour and Social Affairs and including the participation of several public institutions. ENETH aims to increase students' employability skills by a better alignment of school curriculum with industrial needs, promoting dual education and reinforcing bilingualism, attracting more specialised talent from abroad as well as initiatives aimed to promote the development of talent in innovation;
- Increasing the coverage of support programmes for adults with incomplete secondary studies (more than six hundred thousands) by eliminating age eligibility criteria and including in-person and distance educational support, with around 16 thousand adults completing secondary studies by end 2024;
- The National Programme in Technological Training introducing new courses in technology and promoting the use of technology as a learning source in 40% of the schools in 2024;
- Introduction in 2023 of a standardised test to assess reading and listening skills in a foreign language (English or French) for students in the final year of secondary school and provision of digital support to disadvantaged students (eight thousand in 2023);
- Introduction of interactive programmes based on artificial intelligence (learning accelerator tools) to support skills in Mathematics and English language;
- Re-introduction of end-of-cycle national standardised tests at primary and secondary schools to assess students' skills and knowledge and to identify areas for improvement;
- Public universities increased grants to facilitate access to tertiary education to disadvantaged students and increase the supply of places of degrees in-demand in the job market;
- The Regulation of private higher education was modified to reduce from four years to four months the time required for the National Council of Private Higher Education to approve the creation of a new course or degree;
- A legislative initiative aims to streamline higher education academic equivalence to improve international attractiveness of talent;
- In collaboration with the Ministry of Labour, MEP awarded 3,000 scholarships to enhance secondary school students' English language skills, targeting primarily vocational high schools;
- To enhance STEM skills of students in vocational education a new specialisation in Artificial Intelligence has been created and two other STEM specialisations (Cloud Computing and Data Management and Visualization) are in the final stage of the approval process;
- Three Scientific High Schools have been created in rural areas aimed at graduating 90 students equipped with strong STEM skills.
- Increase in school connectivity (broadband) currently covering around 44.5% of all educational centres.

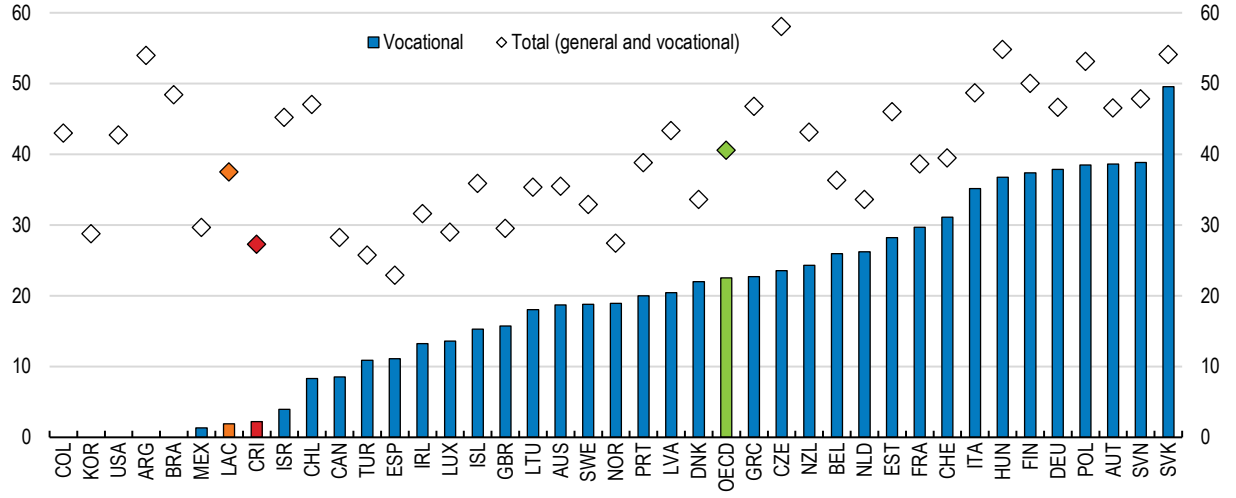
4.5.1. Increasing capacity and quality of vocational education and training

There is room for improving vocational and technical training programmes (VET) to support more workers acquiring skills required to fill jobs in expanding exporting industries. There are few VET graduates (Figure 4.19) and, despite both students and firms high demand, no secondary vocational school has been

created since 2016. Many VET graduates also have low qualifications (OECD, 2023[8]) and lack the skills demanded by the private sector, reducing their employability. Only around a third of VET graduates has a specialisation required by firms in the most dynamic sectors (Duran Monge, Santos and Salas-Gutierez, 2023[27]). Not all VET specialisations provide training in highly demanded soft skills (e.g. critical thinking, problem solving, team working), and only a few of them (9 out of 53) have curricula that have been aligned with the private sector to better match their needs (CGR, 2022[28]). Expanding VET programmes in areas in high demand, such as the semiconductor sector (Box 4.6), could enhance competitiveness in more sectors.

Figure 4.19. VET graduates are few

% of 25- to 34-year-olds with a general or vocational level of education as the highest level attained, 2022



Source: OECD (2023), *Education at a Glance 2023*.

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The 2021 reform of the National Apprenticeship Institute (INA), which aimed to align training supply to labour market needs and support entrepreneurship, has been challenged in court and stalled. The reform allowed INA to hire externally specialised staff not available internally to strengthen the supply of training in high demand skills, or even outsource this training. To fully reap the benefits of this reform, new legislation has been presented in Congress to amend INA's legal framework and fully implement the reform.

Costa Rica introduced dual education programmes in 2019 to improve the outcomes of the VET system. However, by 2024 only 300 students are enrolled in dual education programmes, mostly in the tourism sector. The outbreak of the pandemic has probably slowed the roll out. The involvement of firms is crucial for a successful development of a dual education system and social partners (professional and employers' organisations) must have real responsibilities in defining the overall vocational profile and the standards of the programmes, monitoring and evaluating students' progress, and grading and granting credits and diplomas. A further barrier to the diffusion of dual education programmes is the cost as the budget for VET has been cut by around 11% between 2015 and 2022 (CONARE, 2023[29]).

A close monitoring of the implementation of the dual education system would help identify weaknesses and thus adjust legislation or regulation to overcome them (EFTP, 2023[30]). A positive progress in this direction is the draft bill presented in the Congress in April 2024, which aims at modifying legislation to increase the number of mentors, scarcity is found to limit the diffusion of dual education programmes. The draft bill includes further measures that reduce the cost of firms in participating in dual education programmes.

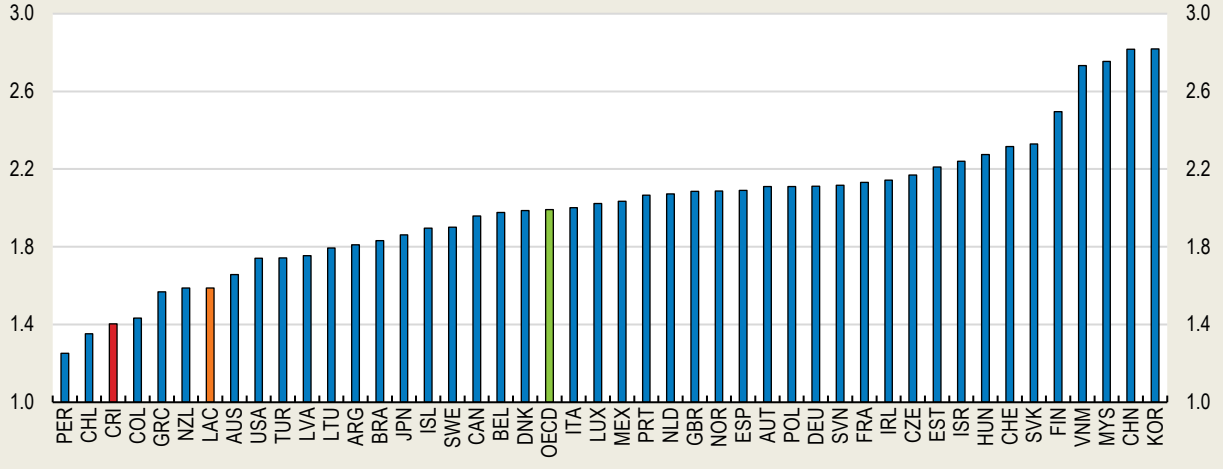
Two recent policy initiatives have the potential to improve the supply of VET education in Costa Rica. Firstly, the creation of the National System of Technical Vocational Education and Training (SINEFOTEP) in April 2024 could improve monitoring the quality and effectiveness of VET programmes. Its absence was considered a major obstacle to increase the supply of professional towards STEM areas (CGR, 2017[31]). Secondly, the establishment of a new national strategic framework, the National Policy for Technical Education and Training (PNEFTP) for 2023-2033, if well implemented could improve the supply of VET education by focusing on three axes: ensuring high quality of VET programmes and their relevance to the needs of the labour market via continuous updating and improvement of VET programmes; promoting the development of VET research to better understand the needs of the labour markets and assess the impact of VET programmes; and facilitating the access to VET education of vulnerable population.

Box 4.6. Moving up the electronics GVC: the impact on exports and salaries

In Costa Rica the semiconductor sector employs around five thousand workers, with most firms in the sector operating in the segment of assembling, testing and packaging (ATP) and, to a lesser extent, in that of electronic design (R&D). The use of upstreamness indicators, which measures the position of a sector within a GVC by measuring the average distance of the production stages of an industry from final use (Antràs et al., 2012[32]), confirms that Costa Rica specialises in stages of production close to the final consumption, such as ATP, rather than in upstream activities (e.g. R&D) (Figure 4.20). However, ATP is a low value-added stage of the production chain of semiconductor (around 4 %) and also allows for weak technology transfers (Monge, 2017[33]). An important recent policy initiative, the Semiconductor Roadmap Strategy (SRS), might help Costa Rica move towards higher value-added activities such as the areas of design. The SRS is a cross-institutional scheme aimed at increasing attractiveness for FDI in the semiconductor through a series of policy initiatives in the areas of human talent, R&D and FDI incentives, regulatory improvement and investment facilitation. Preliminary results from empirical work for this Survey (Vidal and Maravalle (forthcoming) suggest that Costa Rica's exports and real wages in the semiconductor sector would increase by at least 4% if it moved upstream the GVC towards higher value-added activities.

Figure 4.20. Costa Rica specialised in low upstream stage of productions in the semiconductor GVC

Upstreamness indicators in electronics



Note: Upstreamness takes up values equal or above 1, the higher the value the more production is concentrated in upstream stages that are more distant to the final consumer. LAC is a simple average of Chile, Colombia, Mexico, Argentina, Brazil, and Peru.
Source: (Borchert et al., 2021[34]; Mancini et al., 2024[35]); and Vidal and Maravalle (forthcoming).

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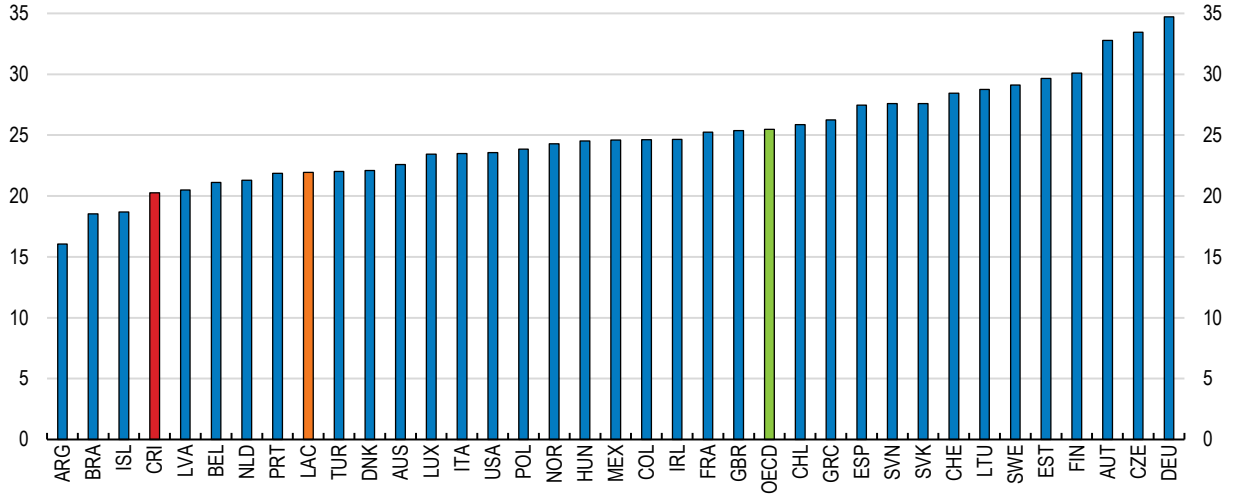
4.5.2. Promoting STEM skills

Increasing the share of graduates in STEM, especially in areas such as information and telecommunications (IT) and engineering, would support the expansion of the most dynamic high value-added sectors. Since 2019, the number of tertiary degrees awarded has increased in all STEM areas, but health sciences. However, both the proportion of young adults with higher education (31% against the OECD average of 47%) and the share of graduates in STEM areas remains low in Costa Rica (Figure 4.21). Improving the quality of primary and secondary education, in line with the analysis of the last OECD Economic Survey (OECD, 2023[8]), especially in scientific subjects, is a critical pre-requisite for increasing demand for higher education in STEM areas, and thus the number of graduates. Almost 95% of the students failed the diagnostic test in mathematics of the University of Costa Rica in 2023, and the performance of 15-year-old Costa Rican secondary students in the 2022 Programme for International Student Assessment (PISA) was poor in sciences (36th out of 37th) and mathematics (36th out of 37th).

Figure 4.21. Costa Rica has relatively few graduates in STEM

Tertiary graduates in STEM, % of all graduates, 2021 or latest year



Note: The distribution of graduates by field of study is calculated as the share of graduates from each field over the total of graduates. STEM includes all graduates (short-cycle tertiary, bachelor's, master's, and doctoral degrees) with a degree in natural sciences, mathematics and statistics; information and communication technologies; and engineering, manufacturing and construction. LAC is the simple average of Chile, Colombia, Mexico, Argentina, and Brazil.
Source: OECD (2022*), Education at a Glance 2022*.

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Increasing the number of postgraduates (Masters and PhDs) in STEM fields is especially relevant to support innovation processes that would facilitate the integration of domestic firms into GVCs (Duran-Monge, Santos and Aragon, 2023[36]). Strengthening human talent in STEM areas related to agriculture would promote innovation in regions outside the Great Metropolitan Area where agricultural activities represent a large share of production and a shortage of graduates and technicians specialised in the agroindustry is a barrier to bridge the rural-urban development gap. This would allow Costa Rica to scale up initiatives such as the one promoted by the Ministry of Innovation, Science and Technology, the Rural Development Institute and the National Apprenticeship Institute that support the adoption of technologies (e.g., bioproducts, AI, Internet of things) by around 1,200 local producers in rural areas close to the capital (Dota, Tarrazù and Leon Cortes) to increase their competitiveness through innovation.

Attracting talent from abroad could help increase the supply of talent in high demand sectors in the short-medium term. However, Costa Rica has ample room for improving its capacity to attract highly skilled talents according to the OECD 2023 talent attractiveness index. Despite providing a relatively attractive

tax framework and competitive wages (10th out of 38th), Costa Rica performance is poor in quality of labour market opportunities (38th out of 38th), long-term integration and access to citizenship (33th out of 38th) family environment, (opportunities for family members in terms of entry laws, 33rd out of 38th) and skills environment (34th out of 38th). Few Costa Rican STEM specialists live abroad, around 765 students or workers (Santos and Rojas-Godinez, 2023[37]), which is insufficient to fill in the gap, but strengthening networks with them may help attract FDI, favour technology transfer or help establish international research collaboration networks. The pool of talent could be increased by increasing the number of women employed or studying STEM (see Chapter 2).

4.5.3. Strengthening proficiency in digital skills and English

There is room for improvement in digital skills, such as software development, cybersecurity, data science and AI that are becoming increasingly important for firms, as many companies, when deciding where to invest, prioritise countries with a strong pipeline of tech-savy workers.

Costa Rica needs to improve digital literacy from an early age. Educational institutions play a limited role in fostering digital skills, with minimal use of the internet for pedagogical purposes and insufficient teacher guidance (Global kids online survey, 2024[38]). This calls for further efforts in integrating digital literacy into the education system through comprehensive training and a cohesive digital strategy. More attention should be devoted to low-skilled workers that will increasingly face pressures to upskill and reskill because of the digital revolution. Costa Rica currently provides free training to bridge the digital gap through its smart community centres, around 244 throughout the country. Costa Rica could further strengthen basic digital skills across the population by drawing on OECD country experience, such as the system of vouchers that individuals may use in training centres of their choice (as in Vienna in Austria) (OECD, 2017[39]).

Initiatives aimed to strengthen the supply of specialised courses in high-demand advanced digital skills areas include a public-private cooperation among the National Apprenticeship Institute (INA) and the private sector, aimed to create a training facility to train professionals for the semiconductor industry focusing on semiconductor, cybersecurity, 4G and 5G networks, AI, and cloud computing with an initial capacity of 700 students yearly. INA is also strengthening the supply of virtual courses on digital areas in cooperation with large IT firms present in Costa Rica. These initiatives are commendable but it is necessary to overcome difficulties in the recruitment of adequate teaching staff to implement them and scale them up. To this purpose, it is key to amend via new legislation the reform of INA to make it possible to hire externally teaching staff with the adequate specialization that is currently unavailable within INA.

Good knowledge of a foreign language, together with having completed secondary education, are becoming essential requirements for a formal job. MNEs in the services sector often require at least an upper intermediate knowledge of English (level B2) and most firms in manufacturing require the knowledge of English for qualified roles (graduates or technician, managers) (INEC, 2023[40]). The 2023 standardised national test of foreign language competences shows an improvement in the average level of English proficiency achieved by students at the last year of upper secondary studies. However, there are still too many students with a basic (level A1 or A2) or an intermediate level (level B1), especially among young adults. The knowledge of English should be strengthened at any level of education, but especially at an early age as the coverage of English in preschool and primary schools is incomplete because teachers are scarce (OECD, 2023[8]). The lack of English teachers is mostly due to the imbalance between the supply of graduates in education programmes and the needs of the education system. To reduce this imbalance, Costa Rica could consider increase the quota of university programmes in English education or try to attract English teachers with high-quality teaching qualification from abroad.

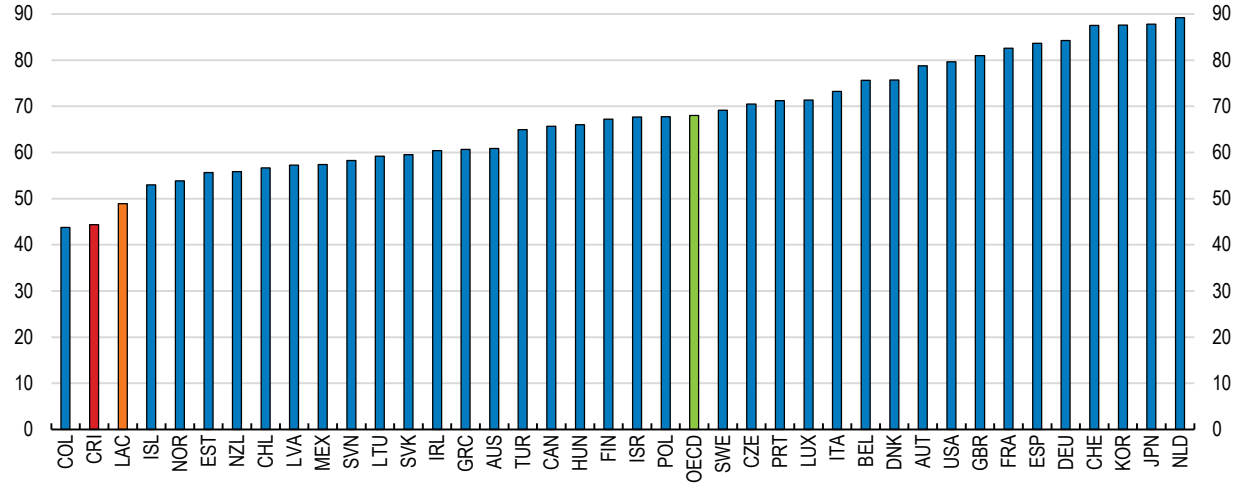
4.6. Closing transport and digital infrastructure gaps

4.6.1. Transport infrastructure needs are high

Infrastructure gaps result in higher costs to export and import, hindering participation of firms from remote regions, especially SMEs, in international trade. Costa Rica suffers from infrastructure bottlenecks in nearly all transport areas (Figure 4.22). The road network is of low quality, Pacific coast port infrastructure has insufficient capacity, the rail system is underdeveloped (Figure 4.23, Panel A) and intermodal connections are weak. Large investments are needed to improve the quality of transport infrastructure, which is essential to connect regions and firms to international markets. The low quality of transport infrastructure negatively affects Costa Rica's logistic performance (Figure 4.23, Panel B) and poor logistics hampers supply chain resilience and deeper integration into global value chains.

Figure 4.22. The quality of transport infrastructure is low

Transport Infrastructure Index, 0-100 ("best")



Note: Transport infrastructure include road, rail, sea and air.
Source: *World Economic Forum (WEF) Global Competitiveness Index 4.0* (database).

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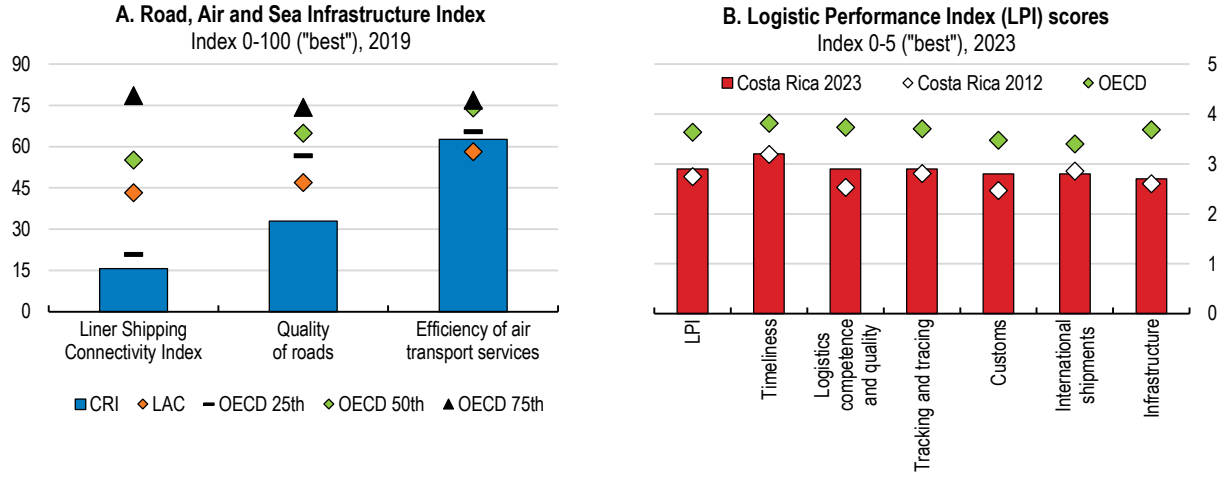
Improving ports is essential as they are the main portal for shipping imports and exports. Accessibility to global trade through the shipping network, proxied by the liner shipping connectivity index, points to a low level of integration (Figure 4.23, Panel A). The main port on the Pacific coast, the port of Caldera, is operating above its maximum capacity provoking delays and higher transport costs and reducing the potential for exporting to Asia (e.g., agriculture products). With a railway network almost inexistent, the Costa Rican freight transport system is essentially based on roads, whose low quality (Figure 4.23, Panel A) is the cause of frequent traffic congestions, slow speed and long trip times. Costa Rica performs better in efficiency of airport services, above regional peers though still below the OECD average. The Juan Santa Maria Airport, one of the two international airports, is expected to reach its maximum capacity by 2025. The current concession is expiring in 2036 and it is unclear if the airport will be able to absorb the expected increase in the number of passengers and freight, and no new airport is expected to be built.

The low quality of Costa Rica's transport infrastructure can be attributed to underspending (Figure 4.24) and deficient strategic planning (OECD, 2016[5]). Even during the 2008-19 public spending surge that led to Costa Rica's critical fiscal situation, capital investment was largely neglected at the advantage of current primary spending (OECD, 2023[8]). Progressing towards the 2030 Agenda for Sustainable Developments goals in transport, energy and telecommunication infrastructure would require investment amounting

to 3-4% of GDP (Brichetti et al., 2021[41]). While reducing the fiscal deficit would gradually open space for increasing capital investment (see Chapter 1), private investment will also be needed to fill infrastructure gaps.

Figure 4.23. The low quality of transport infrastructure negatively affects logistics performance



Source: *World Economic Forum (WEF) Global Competitiveness Index 4.0* (database); and *World Bank Logistic Performance Index* (database).

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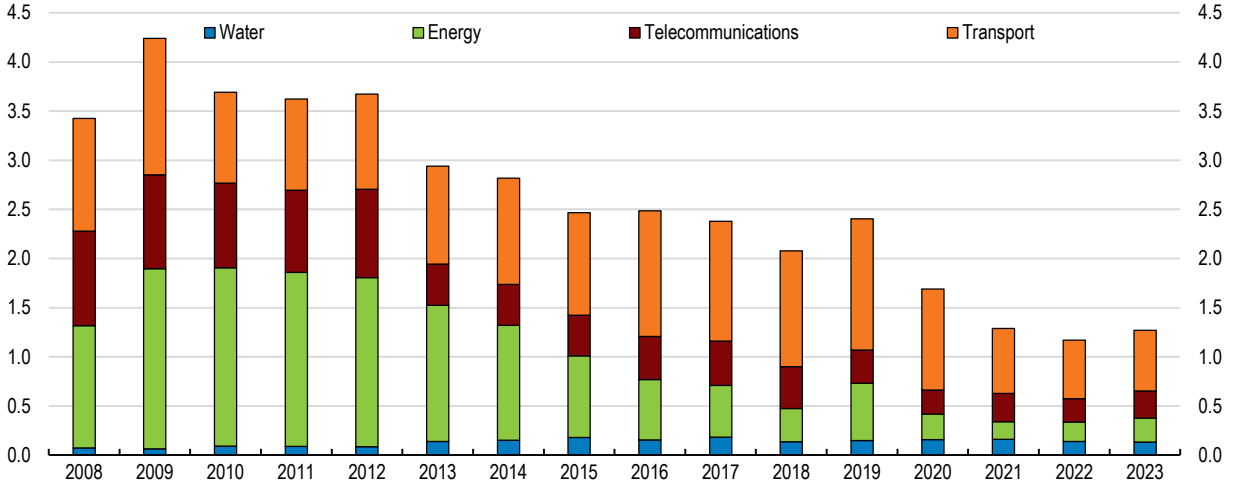
Figure 4.24. Infrastructure investment is low and has significantly fallen over time

Public investment in infrastructure, % of GDP



Source: INFRALATAM.

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4.6.2. Enhancing transport infrastructure governance

The National Transport Plan 2011-2035 was not agreed with all relevant stakeholders (private sector, citizens) and its implementation is hindered by administrative fragmentation, weak governance and lack of institutional capacity, which in turn cause inefficient planning, selection, prioritization and implementation of transport infrastructure (CGR, 2020[42]). Ten different transport agencies may sponsor infrastructure projects. However, projects lack a proper feasibility and affordability analysis assessing the risk of cost

overruns, despite passing a pre-investment assessment phase and a cross-institutional validation process. Weak planning results in higher cost and delays in the implementation phase (e.g., unprogrammed expropriation, use of materials requiring higher maintenance costs). The time required from planning to implementing infrastructure is also extremely long (between 8 and 11 years) (PEN, 2018[43]), despite there have been improvements in reducing delays in the implementation phase since 2017. For example, the project for the construction of a new road connecting the cities of San Carlos and San Ramón was approved in 1969, began in 2005 and is expected to be completed in 2026 (Madrigal, 2023[44]). These delays undermine the ability to execute capital investment projects, and usually only 30% of the capital spending that is budgeted is executed.

Infrastructure project selection is also subject to the political cycle. Project prioritization, as well as procurement modality (standard or Public-Private Partnership), can change during the life of a project when the deciding administration changes, preventing project continuity. Moreover, directors of infrastructure agencies have a quick turnover hindering long-term planning. Between 2005 and 2014 the project for an electric train aimed to improve the public transport system in the Great Metropolitan Area was changed six times by different directors of the Costa Rican Railway Institute (INCOFER) and has not yet been implemented.

Strengthening transport infrastructure governance to ensure continuity in the implementation of a long-term vision for infrastructure, including by making it less dependent on the political cycle, and improving institutional capacity is a priority. Costa Rica could establish a shared long-term strategy to be elaborated by experts and approved by central government, after consultation with local government, the private sector and citizens. Its implementation could be compulsory and regularly updated. The selection of the projects to be included in the budget could be based on clear criteria consistently applied to all projects in the portfolio. Giving priority to ongoing project and infrastructure maintenance investment needs may be an option for ensuring continuity.

Ongoing reforms aim at streamlining the transport institutional framework by eliminating redundant agencies and transferring their functions to the Ministry of Public Works and Transport (MOPT). These reforms attempts are welcome as they would foster MOPT's stewardship and improve coordination, help reduce fragmentation in public investment processes and foster the ability to deliver capital investment projects in a more effective and efficient manner. Furthermore, the assessment of infrastructure projects should be strengthened to ensure adequate analysis of feasibility and affordability. In the short term, when institutional capacity is not available, resorting to the private sector for evaluating infrastructure projects using standardised contracts could be a possibility. In the long run, to strengthen technical capacity and reduce the impact of the political cycle, Costa Rica could opt for transferring the assessment and management of all infrastructure projects to a single independent infrastructure public agency with permanent technical staff and a director appointed through a competitive procedure, as is the case in several OECD countries (Box 4.7). Given the limited fiscal space, the agency could be funded through savings from eliminating or downsizing existing agencies and could be also tasked with elaborating a long-term infrastructure strategy in coordination with all relevant stakeholders.

Box 4.7. Independent infrastructure agencies: the cases of Australia, Chile, and Korea

Australia: Infrastructure Australia is an independent infrastructure agency created in 2008 to assess that infrastructure investments meet national needs, to advice on reforms to infrastructure legislation and to ensure that planned infrastructure is effectively prioritised in the national budget. The agency maintains the Infrastructure Priority List, a public list of unfunded pipeline infrastructure projects of national significance. The agency collaborates with policy leaders, industry experts, government stakeholders, and academia, to guarantee that infrastructure policy and projects deliver meaningful outcomes.

Chile: The Chilean National Investment System (SNI) ensures independent analysis and assessment throughout planning, execution, and evaluation of infrastructure projects. The assessment process consists of four stages: ex-ante review for social impact, coordination of budget formulation, supervision of budget execution, and ex-post review for efficiency and effectiveness.

Korea: Large infrastructure projects in Korea are evaluated by the Public and Private Infrastructure Investment Management Centre (PIMAC), an independent unit of the Korea Development Institute. The agency reviews central or regional government projects whose cost is above a minimum threshold (approximately USD 50 million in 2022). All infrastructure projects must undergo a Preliminary Feasibility Study by PIMAC to assess their economic efficiency and development significance. The agency assesses the risk of overestimating demand. Projects whose cost increased undergo a Re-assessment Study of Feasibility.

Source: (Australia, 2021[45]; IMF, 2022[46]; Jay-Hyung, 2012[47])

4.6.3. Improving road and port infrastructure

Costa Rica has an extensive road network but its overall quality is low (Figure 4.23, Panel A). Around one third of the National Road network has insufficient functional capacity, a share up to 50% in the province of the capital San Jose, and driving conditions become dangerous on most roads when wet (80%) (LANNAME, 2023[48]), and rain is common in Costa Rica even during the dry season.

Resources for road infrastructure and maintenance are low. The budget of the institution charged with road infrastructure (National Council for Mobility, CONAVI) was cut by 40% between 2017 and 2022. Only 61% of road maintenance interventions in 2021 were associated with improvement in road conditions, which points to spending inefficiencies. Lack of road maintenance risks increasing rehabilitation costs and reducing the expected life of the infrastructure. Estimates find that each dollar not spent in maintenance requires at least seven dollars in the future.

Lack of competition in the road infrastructure market reduces quality and increases the risk of corruption. In Costa Rica two firms used to win most contracts for road maintenance (41 out of 44 in 2022/23) and there have been corruption scandals leading to the suspension of maintenance contracts in recent years (e.g., the Cochinilla bribery scandal in 2021). Attracting international firms to participate in public procurement for infrastructure projects could increase competition. This could be facilitated by increasing the value of projects for procurement, for example by binding multiple slots, as well as removing regulation that may advantage local firms (e.g., use of local materials).

Adopting maintenance contracts based on results could reduce costs and increase quality and life expectancy of road infrastructure. In a maintenance contract based on results, the government would pay a fixed periodic fee, independent of the frequency and type of work required for maintenance, if the quality of the road infrastructure remains above some minimum standards. Maintaining an updated database of national roads and their status would help identify needs and priorities, following the example of the Road Administration in Estonia. An electronic database storing information on all investments in new road infrastructure and maintenance would increase transparency. The National Council for Mobility (CONAVI) should be able to shift resources to face unexpected events or needs, but currently that is difficult as it requires a legislative decree.

Maritime transport is the backbone of trade in Costa Rica, with around 60% of all goods exports passing through ports, but port infrastructure needs improving. Costa Rica's main ports are the Caldera Port, the main freight port in the Pacific side of the country, and a seaport (Port Terminal of Limón) and a container port (Moín Container Terminal) in the Caribbean coast of the country. The ports in the Caribbean coast, however, have a far higher capacity than the Caldera Port and handle most (83%) of the cargos, thus accounting for most of goods export movement. The Pacific Caldera port is currently operating at maximum capacity, which increases trade processing times and produces inefficiencies leading to costlier imports

and exports. Improving port infrastructure and increasing capacity in the Pacific side would support trade growth, facilitate expansion of exports towards Asia and help diversify trade, as also supported by a cost benefit analysis performed the International Finance Corporation (INCOP, 2024[49]). Currently, works on Caldera port are expected to start in August 2026, when the current concession expires, but optimisation works to maintain its operational capacity are expected to be completed by 2025.

Transport intramodality needs to be considered when planning the improvement of port infrastructure, so that road or train infrastructure is also developed to consider the increase in traffic due to the port activity. To reduce transport times for imports and export movements and traffic congestion, Costa Rica should intensify its efforts to develop freight railway connecting the main ports on the Pacific and Caribbean coast with the Great Metropolitan Area, such as the project of a freight train connecting the Caribbean and Northern regions (TELCA) that since 2019 remains at the planning stage. Transport costs are high also because of lack of competition in water freight transport, as discussed in section 4.7.

4.6.4. Leveraging external financing for infrastructure

Costa Rica could promote the participation of international firms in public procurement for infrastructure projects by increasing the scale of tenders, also via bundling together slots of lesser value, to increase competition among bidders to reduce costs and increase the quality of infrastructure. However, Costa Rica's limited fiscal space for public spending in infrastructure makes leveraging external financing to fund public infrastructure an attractive alternative to bridge its infrastructure gap. Costa Rica can enhance access to external financing for infrastructure through a broad strategy that includes leveraging private investment, including PPPs, alongside other pillars. By fostering PPPs, the government can attract private sector investment in infrastructure projects, transferring some financial risks and reducing public expenditure. This can be complemented by concessional loans from multilateral institutions, offering favourable terms like lower interest rates and longer repayment periods. Additionally, Costa Rica could opt for issuing green or sustainable linked bonds to attract capitals for investment focused on environmental projects capitalizing on its strong environmental policies.

Costa Rica could use private public partnerships (PPPs) to leverage private sector investment in infrastructure. Since the adoption of the Concession Law in 1998 only five projects have been developed as PPPs in Costa Rica. Several regional peers have been able to use PPPs to improve infrastructure capacity such as Chile, or Colombia, which developed 4900 km of roads in 13 years through PPPs, and recently applied PPPs to cover non-transport infrastructure such as water treatment plants and hospitals (OECD, 2024[50]).

The limited use of PPPs is due to regulatory asymmetry between PPPs and standard procurement and lack of institutional capacity in the National Concessions Council (CNC), the body under the Ministry of Public Works and Transport tasked with administering procurement contracts. The process for implementing PPPs is more complex than standard procurement and most staff lack the specific knowledge required to apply it. The PPPs methodology to perform cost-benefit analysis is also more onerous, as it requires comparing initial savings in capital spending against the stream of future annual payments or relinquishing revenues from user fees. PPPs also tend to have higher transaction costs to structure deals and monitor performance and imply contingent liability risks (payment to be made if certain events occur, such as minimum traffic guarantee, compensation for early termination) that are complex to estimate. The use of PPPs should also be accompanied by proper fiscal accounting in the budget of these contingent liabilities.

To expand the use of PPPs the technical capacity of the staff of the National Concession Council should be increased, and subcontracting technical analysis allowed, as in Panama. The council should also focus its activity on the design and assessment of PPP projects, while delegating supervision tasks to the entity sponsoring the project. Streamlining PPPs' procedures to reduce their cost and execution time and could further boost their use and make PPPs more attractive to the private sector.

Despite the potential of PPPs to deliver much-needed infrastructure investment under limited fiscal space, they require carefully designed frameworks to mitigate some of the inherent risks, which include demand risk, operating risk, investment risk and land acquisition risk (Box 4.8). While a PPP project may be feasible and economically viable, and value for money analysis show that the PPP is the best option to procure it, fiscal risks must be carefully assessed to define its affordability. This is a challenging task because the cost of contingent liabilities is difficult to assess, since the need for, timing, and value of payments are uncertain. Colombia, Peru and Chile all have published accounting and budgeting methodology for valuing the financial implications of contingent liabilities under PPPs.

A prerequisite to expand the use of PPPs in Costa Rica is the adoption since the beginning of an adequate dispute resolution mechanism through cheap, rapid and independent resolution protocols. Disputes between the government and the private concessionaire over a PPPs deal may lead to lengthy legal proceeding that delay construction or disrupt facility operation as happened for example for the first generation of PPP road concessions in the mid-1990s in Mexico, Argentina and Colombia (Engles et al., 2003[51]). Procurement information systems could be adopted to learn from past procurement outcomes as well as identify signs of bid rigging, such as the Construction Quality Assessment System of Singapore, which provides independent evaluations by inspecting firm's performance.

Box 4.8. Best practices in transport PPP projects

Demand risk, operating risk, investment risk and land acquisition risk are the main risks that need to be carefully assessed and managed in transport PPP projects. A transport demand lower than projected may cause revenues to be insufficient to cover costs. Increases in operational costs (wages, energy) that cannot be shifted onto transport fees would reduce profitability. Transport infrastructure require large land acquisition that may be opposed by residents causing delays.

An adequate management of these risks should be considered along all the phases of the project:

- Set a legal and institutional framework that ensures transparency and fairness in the process of PPP projects to help the private sector to adequately evaluate the risks involved;
- Project development: careful planning and management and allocation of risks, by implementing feasibility studies in drafting PPP projects that include risk allocation, assess economic feasibility and expected outcome (e.g. reduction in traffic congestion);
- Project planning: Clarify the risk allocation between the public and the private sector also by defining the form of PPP (e.g., Build, Operate and Transfers, where the private after building the infrastructure transfers it to the public sector and leases it; or Build, Own and Operate, where the private sector builds and operates the infrastructure with ownership);
- Project Procurement: In selecting the private sector partner invite many candidates to increase competition and provide appropriate specifications in the procurement to ensure that the selected company has the required capability, experience and reliability. In the evaluation process, consider the quality of transport infrastructure (user utility, safety and environmental impacts) as well as the costs; launch market sounding nationally and internationally where the public sector explains the transport PPP projects under consideration to the private sector to increase participation;
- Project Implementation and Monitoring: Supervise the work, the costs and the schedule of building and operation; resort to support from international cooperation organizations that might provide expertise.

Chile avoided demand risk in its concession for the construction and operation of a 141 kilometre road (Interconexion vial Santiago Valparaiso Vina del Mar) by setting a variable term for the operation phase, which would extend the concession beyond the initially planned 22 years if a longer time was necessary

for the tendered company to recover the investment. The construction phase took three years and the project improved connectivity in the area reducing travelling time and improved safety. Thailand used PPP to build and operate an inland container deposit and to build the road connecting it to the Laem Chabang Port. The projected increase in activity of the port was assessed as a factor heavily reducing demand risk.

Source: (APEC, 2015[52])

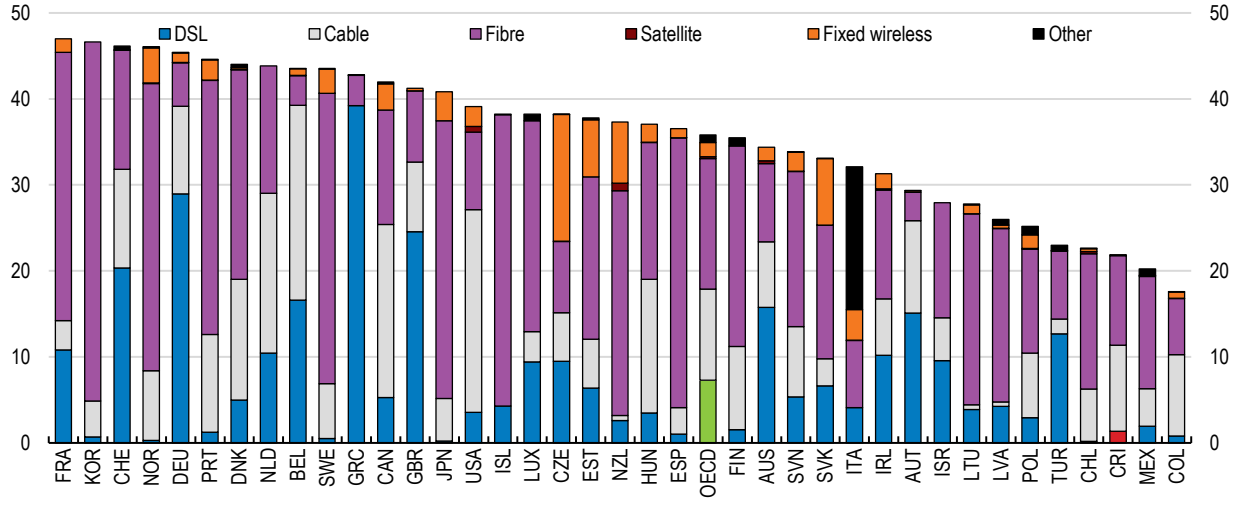
Finally, building credibility and trust among stakeholders (private sector, government and citizens) is crucial to increase the use of PPP contracts, which imply long time relationships (up to 90 years). Costa Rica could start building credibility by adopting PPPs in future procurement contracts, estimated at around 2 USD billion in the next two years. A further stimulus to the use of PPPs could come from the Public-Private Partnership Project Preparation Facility (PPF), which aims to leverage public and private sector resources (up to USD 1.2 billion) to develop sustainable and efficient infrastructure projects by 2030. A further area to start using PPPs is provided by a 2019 reform that introduce the possibility of using PPPs for running underused public infrastructures (infrastructure asset recycling).

4.6.5. Upgrading and expanding digital infrastructure

Digital infrastructure is expanding but challenges exist to further increase the coverage and performance of the fixed broadband network and to start deploying 5G mobile networks. Around 95% of the population and 79% of the territory is covered by 4G mobile network technology and access to mobile broadband has increased, though it remains below the OECD average (around 96 subscriptions per 100 inhabitants in Costa Rica against 115 for the average OECD country). Fiber optic infrastructure has remained stable between 2019 and 2023 and fixed broadband penetration remains low (Figure 4.25).

Figure 4.25. Fixed broadband penetration is low

Fixed broadband subscriptions per 100 inhabitants, by technology, December 2023



Note: Data for 2023 for Australia, Canada, Mexico, Switzerland, and United States, are preliminary estimates. For Canada, fixed wireless includes Satellite. For France, cable data includes VDSL2. For Italy, terrestrial fixed wireless data includes WiMax lines, and other data includes vDSL services. For Mexico, data for 2023 corresponds to Q3 2023. DSL stands for digital subscriber line technology.
Source: *OECD Broadband Statistics* (database).

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The deployment of 5G infrastructure is currently limited in Costa Rica, contrary to several countries in Latin America where 5G networks are already in place. The deployment of 5G networks would provide Costa

Rica with faster and more reliable connectivity to support development. Costa Rica started in the summer of 2024 an open tendering to assign the 5G spectrum frequencies to telecommunication operators, which is expected to be completed by the first quarter of 2025. The auction process is designed to provide strong incentives for the deployment of 5G networks throughout the country. Following the approach used in Brazil in 2021, most of the value of the bid (90%) would be returned to the operator in exchange for building connectivity infrastructure in low-density priority areas outside the Great Metropolitan Area, which otherwise would not be covered for not being financially viable.

Heterogeneous infrastructure regulation at the municipality level remains a barrier to a rapid deployment of telecommunication infrastructure. Municipalities should adapt regulation to guidelines to improve standardization issued in January 2024. As of now, 18 municipalities out of 84 have adopted it, but many municipalities lack technical knowledge to apply them. The creation of a one-stop digital shop related to the deployment of (digital) infrastructure (ventanilla unica digital para el despliegue de infraestructura), as done in Peru and as proposed by the Telecommunication Infrastructure Action Plan 2024-2025, could help streamline the administrative burden. However, the need for resources to frequently update the platform following changes in municipal regulation is a challenge to its implementation.

There is room for improving regulations affecting the deployment of digital infrastructure. Passive infrastructure sharing of duct infrastructure for optic fiber is compulsory but unregulated. Despite existing regulation for access poles and ducts the incumbent owner of the infrastructure sets high prices for sharing it and delays in answering requests from other operators (SUTEL, 2024[53]), thus limiting de facto competition for fixed telephony and high-volume data transmission. Tariff and procedures for sharing ducts infrastructures for the deployment of optic fibre by new operators should be regulated. In addition, the resolution of conflicts on access to essential infrastructure is very lengthy and can take more time than established (up to three years), thus causing further delay in the deployment of fiber optic. The Telecommunications Superintendence (SUTEL), which oversees the conflict resolution mechanism, should speed up conflict resolution by devoting more resources to it. Installing new ducts is also subject to a complex authorization process by the Ministry of Public Works and Transport that could be streamlined. Promoting the development of municipal regulation to allow for using new and less invasive techniques for installing optic fiber (micro trenches), and making information on all existing duct infrastructure public and available on-line, would help spread digital infrastructure more rapidly.

Table 4.2. Past OECD recommendations on infrastructure

Past OECD Recommendations	Actions Taken Since the 2023 Survey
Introduce separation between generation, transmission and retail supply of electricity and relax restrictions and caps on private sector participation.	There is a law project currently sitting in the National Assembly to open the wholesale energy market, as well as remove the power of the National Electricity Institute (Instituto Costarricense de Electricidad – ICE) to grant permits to build new electricity generation plants.
Streamline the institutional structure of the public works sector and eliminate ineffective agencies. Publish online project information and evaluations on large infrastructure projects and expand the use of evaluations and cost-benefit analysis.	No action taken.
Facilitate entry and higher competition in the fixed broadband market. Streamline and harmonise e-communications regulations. Licence the 5G spectrum through a transparent concession process.	An open tendering to assign the 5G spectrum frequencies to private telecommunication operators started in mid-2024 and is expected to be completed by the second half of2025. The Telecommunication Superintendence carried out two market studies to identify barriers to the deployment of telecommunication infrastructure. Regulation for the deployment of telecommunication infrastructure was harmonised by a new regulation issued in January 2024.

4.7. Strengthening competition

Fostering competition in key goods and services markets, a pending challenge for Costa Rica as analysed in previous OECD Economic Surveys (OECD, 2016[5]; OECD, 2020[7]; OECD, 2023[8]), would improve trade performance. Costa Rica's weak competitive environment increases firms' trade and input costs, thus reducing their competitiveness and capacity to export, while also reducing FDI attractiveness. Weak competition also discourages domestic firms from investing in innovation to compete by differentiating their products and improving efficiency rather than on low wages.

Complex regulations and the presence of dominant state-owned enterprises often acts as a barrier to entry in key sectors such as the transport services (road and water freight, cargo handling), thus leading to high costs to import and export. The quality and the deployment of core infrastructure services, such as electricity and fixed-broadband telecommunications, is also negatively affected by weak competition in network sectors. This has repercussion on the attractiveness of FDI in electricity intensive sectors (e.g., semiconductor) or business services in ICT. Finally, the presence of high tariffs in several agriculture products limits competition and reduces trade opportunities in an important sector of Costa Rican economy, as discussed above. Costa Rica's successful experience with the opening of the mobile telecommunications sector, which led to higher employment and greater access to mobile services at lower costs (OECD, 2020[7]), highlights the numerous benefits of fostering competition.

Other than regulatory barriers and distortions induced by high public ownership, Costa Rica has room to improve the effective enforcement power of the Commission to Promote Competition, one of the two competition authorities. Fully functional competitition authorities disposing of the capacity of sanctioning anticompetitive practices, such as cartels and abuses of dominant position, are essential to effectively reduce market concentration, encourage firms efficiency, create a wider choice for customers (firms and households) and reduce prices and improve quality.

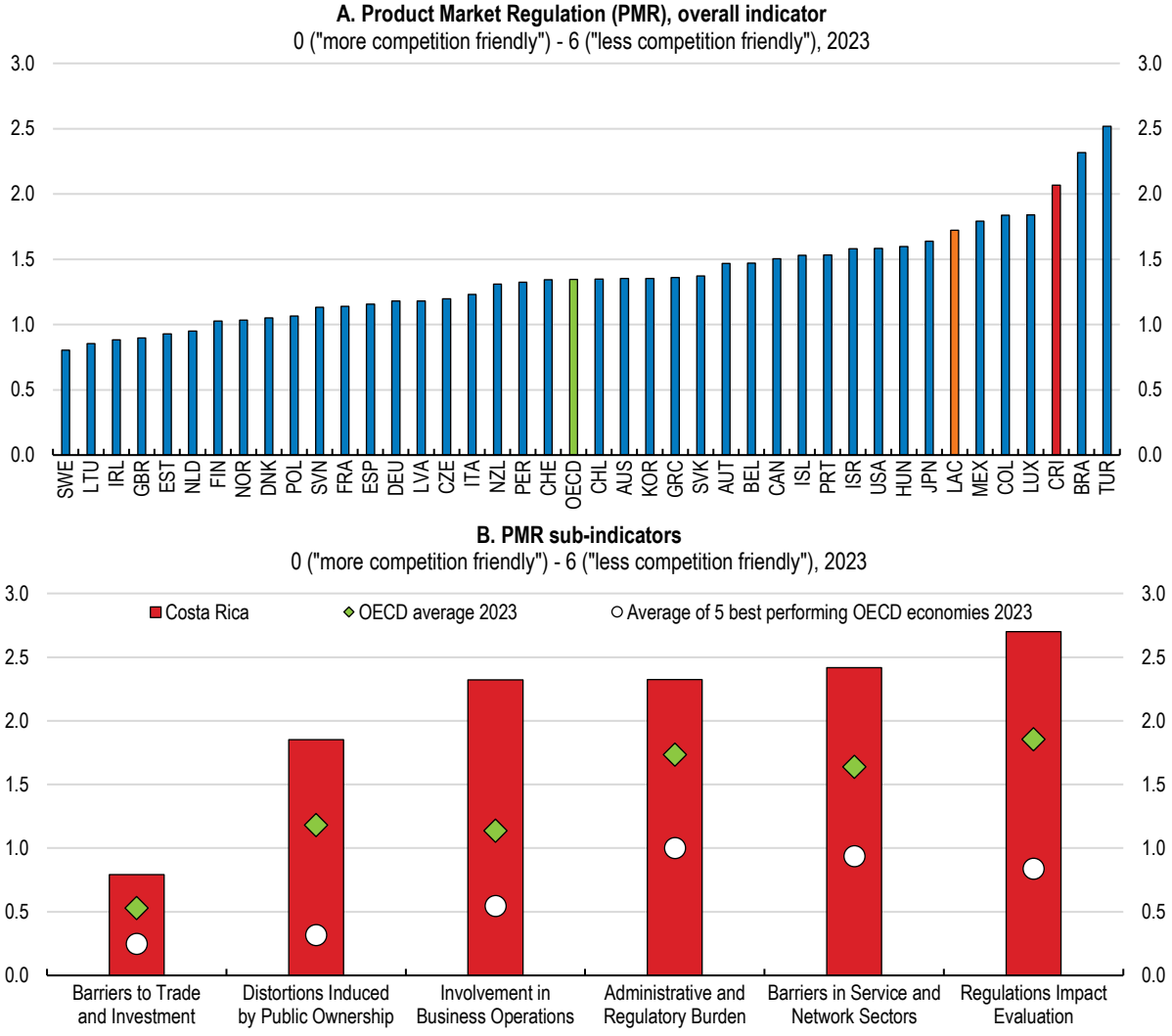
Costa Rica has one of the most stringent product market regulations among OECD countries (Figure 4.26, Panel A), resulting from complex regulations, barriers in services and network sectors and distortions induced by high public ownership (Figure 4.26, Panel B). Streamlining regulatory bottlenecks would support the semiconductor roadmap strategy (Box 4.6), which is a key element of the current Costa Rican trade development policy. For example, the use and trade of chemicals widely used in the semiconductor sector currently requires an authorization by the Ministry of Health that takes more time to be processed than the 15-day delay prescribed by a Decree.

Costa Rica has ample opportunities to boost competition in its goods and services markets by streamlining the high regulatory burden acting as a barrier to entry, as analysed in Chapter 2. Despite having taken recent positive initiatives in this direction, such as the establishment of the Investment Single Window Facility and the programme "Le Dejamos Trabajar", there is not yet a virtual one-stop shop where firms can complete all administrative requirements at once and online. Continuing to extend one-stop windows for business creation around the country to facilitate that all administrative requirements to set up formal firms can be met at once (see Chapter 2) would help business creation. Also, regulatory restrictions of trade in services, which are overall low in Costa Rica in comparison with most OECD countries (Figure 4.27), have room for improvement in sectors like accounting, bookkeeping and tax consultancy and transport services (water, freight transport by road, cargo handling). For example, limits to foreign equity shares and the obligation for freight carriers to file tariffs with the regulator are major factors behind the high level of restrictiveness in freight transport by road.

Export business environment is negatively affected by high prices of key input sectors (electricity, transport, banking, insurance and petroleum-derived fuels), some of which subject to tariffs and price controls, remain state monopolies or are dominated by state-owned enterprises (SOEs). Costa Rican exporting firms have to pay higher costs for energy, water, transport and telecommunication services than their regional peers, thus suffering a competitiveness loss. The cost per kWh for business in Costa Rica (0.24 USD in

Marchborder 2024) is higher than in the United States (0.145 USD in March 2024) and other countries in the region (GlobalPetrolPrices.com, 2024[54]) and the average monthly cost of fixed-line broadband in Costa Rica (46 USD) is above the average across OECD countries (37 USD) and more than twice as much as expensive than in Chile, Brazil Peru and Colombia (cable.co.uk, 2024[55]). High energy prices, for example, seriously hamper the global competitiveness of Costa Rican exporting companies. A reform of the electricity sector recently tabled in the Legislative Assembly (see also Chapter 3) has the potential to open the electricity sector to competition, which could reduce electricity prices. Removing regulatory distortions in the banking sector (see Chapter 1) would also increase competition, facilitating access to credit by Costa Rican firms at better terms.

Figure 4.26. Product market regulations are stringent



Source: *OECD Product Market Regulation* (database).

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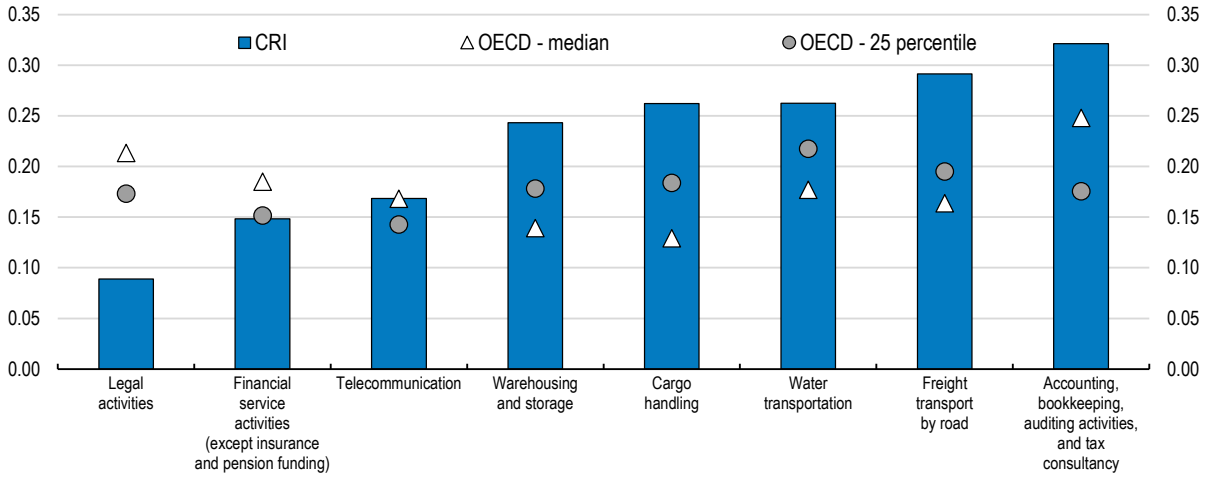
Figure 4.27. Services trade restrictions are relatively low in legal and financial activities but high in accounting and transport services

Services Trade Restrictiveness Index by services sector, from 0 ("best") to 1 ("worst"), 2023



Note: The OECD STRI collects information on services trade restrictions across 22 services sectors. The project has two distinct but complementary instruments: a services trade regulatory database and a services trade restrictiveness.
Source: *OECD Services Trade Restrictiveness Index (STRI)* (database).

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The Regulatory Authority for Public Services (ARESEP) sets tariffs in the energy, water and transport sectors, while the Telecommunication Supervisor (SUTEL) regulates telecommunication services and is in charge of setting tariffs for the services that are not subject to market competition. The way tariffs are set reduces competition among regulated companies that have no incentive to achieve productivity gains and increase efficiency, charging high prices for key business inputs such as freight transport, energy and telecommunication services (OECD, 2020[7]). Adopting alternative tariff methodologies, such as price- and revenue cap regulations, would create incentives for regulated firms to improve productivity and contribute to reduce business operational costs.

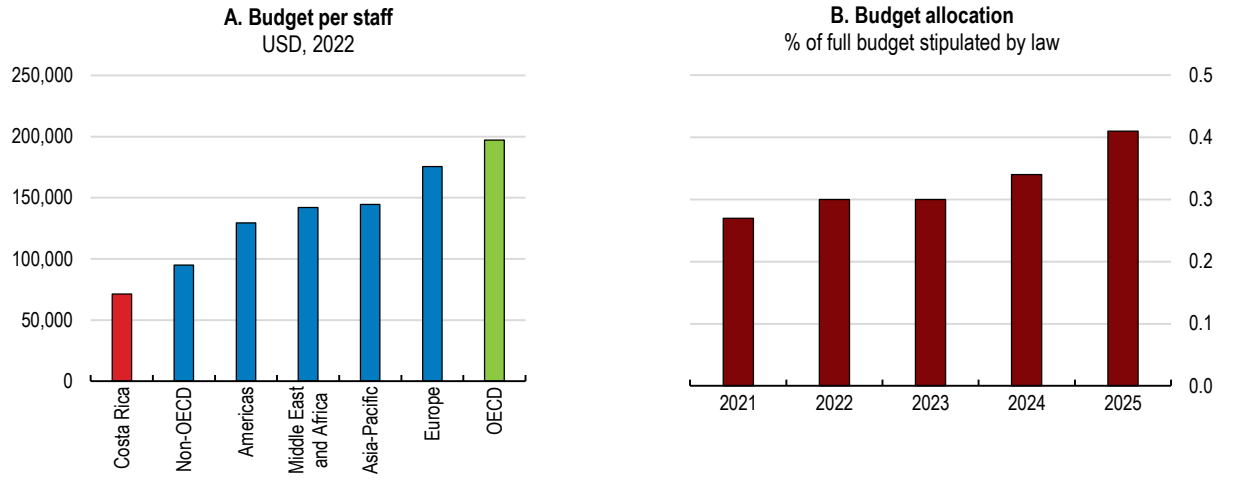
Regulation in digital markets is weak (OECD-WBG, 2024[56]) and could be strengthened to improve fair trade, contestability and guarantee use and access to data. SUTEL has recently launched a study on the Digital Mobile Ecosystem. The competition authorities should continue assessing the degree of competition in digital markets. Digital platforms in Costa Rica could be explicitly prohibited from grating preferential treatment on their own products over those offered by third party providers in ranking or search functionality.

Costa Rica has recently taken bold actions to eliminate anticompetitive regulations in professional services and in the rice industry. These actions followed findings from the competition authority and are in line with analysis and recommendations of previous OECD Economic Surveys. Some of the Presidential decrees eliminating compulsory minimum tariffs in fifteen professional services have already been implemented, but others have been challenged in court and either are pending a final decision or have been annulled. For four professional services authorities have filed a bill to eliminate compulsory minimum tariffs. This would help to boost competition and reduce costs of key professional services for firms, especially SMEs, as larger firms tend to internalise these services. Positive steps have also been taken to open the rice sector, where import tariffs were reduced (from 36% to 5%) and inefficient price-setting regulation was eliminated. Since their adoption the volume of rice imports increased at the expense of less productive domestic production and counterfactual simulation estimates that the measures had a beneficial impact on the retail price of rice, which otherwise would have been higher (between 10% to 25%) (BCCR, 2024[57]).

Following recommendations from the competition authority to increase competition in the passenger and freight transport market could help Costa Rica improve mobility and reduce trade transport costs. Reforming the concession system for the provision of public transport services by eliminating the monopoly power of current incumbents, which de facto enjoy a limitless automatic renewal of concessions (Vargas Irola and Velazquez Gonzalez, 2021[58]), and replacing it by competitive public tenders, would help improve mobility and reduce traffic congestions as well as pollution. Reforming the water freight market through a change in legislation that eliminates the possibility of price and market distribution agreement (COPROCOM, 2021[59]) would reduce logistic costs and better support Costa Rica's export-led development strategy.

An independent and well-resourced competition authority is a key pillar of a solid competition framework. The Superintendence of Telecommunication (SUTEL), which also operates as regulatory authority, has sufficient resources to fulfil its functions, and already issued most of the secondary regulation required to ensure its operational, technical and administrative autonomy. However, despite regular increases, the Commission to Promote Competition (COPROCOM) continues to have a budget per staff below that of both OECD and non-OECD countries (Figure 4.28, Panel A). The budget situation has impeded adding new employees and acquiring new equipment (OECD, 2024[60]). COPROCOM also must rely on international support to carry out market studies, which joint with opinions are essential for implementing pro-competitive reforms, as recent initiatives in professional services, originated by the authority investigations, show. Around 40% of the budget set out in the competition law has been allocated by 2025 (Figure 4.28, Panel B), representing a 20% rise from 2024. A fully functional competitive authority can help to reduce the cost of key goods and services, which would support firms' competitiveness. It would be particularly beneficial at the current juncture when authorities are taking bold steps to improve regulations and open key sectors of the economy to competition (e.g., professional services, electricity market, rice sector).

Figure 4.28. The competition authority continues to be underfunded



Note: The OECD CompStats database covers data from competition agencies in 77 jurisdictions, of which 38 jurisdictions are OECD jurisdictions (including the European Commission). Data are divided into four geographic regions: Americas (18 jurisdictions), Asia-Pacific (15 jurisdictions), Europe (34 jurisdictions) and Middle East and Africa (10 jurisdictions). In Panel B, the budget for 2025 corresponds to the one the Ministry of Finance committed to provide in the 2025 budget.
Source: *OECD CompStats* (database); and OECD calculations based on COPROCOM.

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Table 4.3. Past OECD recommendations on competition

Past OECD Recommendations	Actions Taken Since the 2023 Survey
Reduce the stock of regulations and conduct regulatory impact assessments.	The programme "We Let You Work" (Le Dejamos Trabajar) identified and removed around 163 bureaucratic hurdles between 2022 and 2024.
Provide the national competition authority with the financing set in the law.	The national competition authority budget has increased overtime.
Reduce red tape and the number of agencies in the agriculture public sector.	A draft bill to streamline the agriculture public sector was proposed in Congress in October 2022.
Introduce online one-stop mechanisms covering all licences and permits.	No action taken.

Table 4.4. Recommendations to maximise trade benefits

Main Findings	Recommendations (Key recommendations in bold)
Optimizing trade policies	
Costa Rica's export markets are concentrated in a few regions, with a growing importance of the United States and Europe as primary destinations.	**Continue expanding trade opportunities via trade agreements to open new markets, including by becoming member of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership.**
There is room to strengthen linkages between domestic SMEs and multinational firms (MNEs) located in Costa Rica. Evidence suggests that local firms becoming suppliers of foreign-owned firms significantly increase their sales, employment and productivity.	Foster partnerships between MNCs and SMEs by strengthening matchmaking programmes, providing training and advisory services to build local SMEs capacity.
Obtaining international certifications can facilitate SMEs exports and SMEs becoming suppliers to foreign firms, but the process to obtain certification is costly and lengthy.	Support SMEs in obtaining certifications, including by providing funding by repurposing some of the existing business innovation support schemes.
Boosting Innovation and access to finance for SMEs	
Resources for innovation policy remain limited and there are no mechanisms to ensure that innovation programmes are assessed and that findings from evaluations feed back into policy making.	Reduce the number of innovation programmes, set clear and measurable goals and establish evaluation mechanisms for innovation programmes.
Outside the free trade zones, innovation outcomes are weak, with limited interactions between universities and the business sector.	**Fund public research using competitive and performance-based criteria and establish independent evaluation mechanisms.**
Weak business innovation prevents SMEs from scaling up and integrate into global value chains.	Strengthen upgrading programmes targeting SMEs and create a cluster coordination unit to better align public policies with clusters' needs.
SMEs lack access to credit for innovation investment and support for entrepreneurship. The Development Banking System (SDB) provides most credit to micro firms and only marginally to medium-sized firms that are more likely to innovate. The SDB lacks capacity on seed capital and venture capital funding.	Shift SDB resources and priorities towards supporting SMEs innovation and entrepreneurship, and strengthen funding for training in risk capital.
Promoting talent development through education and training	
Costa Rica faces challenges with poor educational outcomes and a mismatch between job vacancies and the skills of job seekers. Many Costa Ricans lack the necessary skills to take advantage of new formal job opportunities. While a broad education reform is underway, the specifics of its implementation are not fully defined.	**Carry out regular evaluations to monitor progress and impact of reforms to improve educational outcomes and reduce skills mismatches.**
Graduates from the National Vocational Training Institute are mostly low-qualified technicians with low employability. The National apprenticeship Institute (INA) struggles to recruit specialised teachers for courses providing skills in high demand from the labour market.	Reorientate vocational training towards high demanded skills (digital and technical). Introduce legislative change to allow INA to hire externally specialised staff not available internally.
The number of STEM graduates does not meet the labour market demand.	Modify university funding mechanisms by linking funding to system-wide performance goals such as increasing STEM programmes and the number of graduates.
Too many students end secondary studies with basic or intermediate level of knowledge of English, also for scarcity of teachers in preschool and primary schools.	Strengthen the knowledge of English at any level of education, especially in preschool and primary schools.

Closing transport and digital infrastructure gaps	
Gaps in transport infrastructure are large. Poor planning and design of transport projects lead to delays and cost overruns, with only 30% of the budgeted capital spending being executed effectively.	**Strengthen the feasibility assessments for transport projects and enhance budget management, including by establishing detailed implementation plans with clear timelines and milestones.**
International tenders for infrastructure projects and Private-Public Partnerships (PPPs) are rarely used in Costa Rica. The large infrastructure gap increases costs to trade and hinders participation of firms from remote regions, especially SMEs, in international trade.	Promote greater participation of international firms in public procurement for infrastructure projects and consider private investment, including PPPs. Strengthen the institutional capacity of the National Concessions Council (CNC).
The penetration of fixed broadband is hindered by heterogeneity in local infrastructure regulation. Delays in responses from the incumbent to requirements for passive infrastructure sharing, hinder the timely deployment of digital infrastructure.	Create a one-stop digital shop for the deployment of digital infrastructure and strengthen regulations to expedite the resolution of infrastructure sharing disputes.
Strengthening competition	
Stronger competition in Costa Rica could significantly improve firms' competitiveness and capacity to export. There is room to strengthen the enforcement power of the competition authority. Its budget has gradually increased, while remaining below the level set out by law.	Continue to increase the competition authority budget to provide it with the necessary resources to fulfill its mandate.
The concession system for the provision of public transport services gives to the incumbent excessive market power via a de facto limitless automatic renewal of concessions. The use of price and market distribution agreement in the water freight market increases logistic costs.	Reform the concession system for the provision of public transport services by replacing automatic renewal of concessions by competitive public tenders. Reform the water freight market to eliminate the possibility of price and market distribution agreements.
Following OECD recommendations to boost competition in professional services, steps are being taken to remove mandatory minimum tariffs.	Accelerate ongoing efforts to phase out compulsory minimum tariffs in professional services.

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Costa Rica's economy is performing well, with growth driven by increasing specialization in high value-added manufacturing and services. While the fiscal situation has improved, ensuring long-term fiscal sustainability remains a priority. To achieve this Costa Rica should focus on reducing public debt by sticking to the fiscal rule, introducing spending reviews to improve public spending efficiency and raising more tax revenues by expanding tax bases. Facilitating women's labour market participation and reducing informality are crucial for reducing income inequality and poverty. This will require expanding access to early education and care and a comprehensive strategy to reduce informality. This strategy should include reducing the administrative and economic burdens associated with establishing formal business. Costa Rica has set ambitious targets to decarbonize its economy. Achieving these targets and adapting to climate change will require expanding and diversifying renewable energy and improving the management of waste and water. Openness to trade has spurred growth, but many workers, firms and regions have yet to benefit from it. This would require addressing skills shortages, a critical challenge to Costa Rica's attractiveness for foreign direct investment. Further optimizing trade policies, fostering innovation and improving infrastructure are also vital to maximize trade benefits.

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