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Report No: PAD3641

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROJECT APPRAISAL DOCUMENT
ON A
PROPOSED LOAN

IN THE AMOUNT OF US$ 156.64 MILLION

TO THE

REPUBLIC OF COSTA RICA

FOR A

FISCAL MANAGEMENT IMPROVEMENT PROJECT

March 5, 2020

Governance Global Practice
Latin America And Caribbean Region

CURRENCY EQUIVALENTS

(Exchange Rate Effective February 19, 2020)

Currency Unit =	CRC
CRC 573,36 =	US$1
US$ 1.38 =	SDR 1

FISCAL YEAR
January 1 - December 31

Regional Vice President:	J. Humberto Lopez (Acting)
Country Director:	Yaye Seynabou Sakho
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ABBREVIATIONS AND ACRONYMS

ATV	Virtual Tax Administration (Administración Tributaria Virtual)
CABEI	Central American Bank for Economic Integration
DAF	Administrative and Financial Directorate *(Dirección Administrativa y Financiera)*
DGA	General Customs Directorate *(Dirección General de Aduanas)*
DGSC	General Directorate of the Civil Service *(Dirección General de Servicio Civil)*
DGT	General Directorate of Taxation *(Dirección General de Tributación)*
DTIC	Directorate of Technologies and Communication *(Dirección de Tecnología y Comunicación)*
EA	Enterprsie Architecture
EA	Environmental Assessment
EHS	Environmental Health and Safety
ESCP	Environmental and Social Commitment Plan
FMA	Financial Management Assessment
GDP	Gross Domestic Product
GRM	Grievance Redress Mechanism
GRS	Grievance Redress Service
ICT	Information and Communication Technology
IPPF	Indigenous People Planning Framework
IADB	Inter-American Development Bank
IFMIS	Integrated Financial Management System
IFR	Interim Financial Report
IMF	International Monetary Fund
IPF	Investment Project Financing
IPSAS	International Public Sector Accounting Standards
IRR	Internal Rate of Return
ISR	Implementation Status Report
IT	Information Technology
LAC	Latin American and the Caribbean
M&E	Monitoring and Evaluation
MICITT	Ministry of Information and Communications Technology
MOF	Ministry of Finance
NDC	Nationally Determined Contributions
NPV	Net Present Value
OECD	Organization for Economic Cooperation and Development
OM	Operations Manual
PDO	Project Development Objective
PCF	Fiscal Control Police *(Policía de Control Fiscal)*
PCU	Project Coordination Unit
PEFA	Public Expenditure and Financial Accountability
PFM	Public Financial Management
SC	Steering Committee
SEP	Stakeholder Engagement Plan
SICOP	Integrated Procurement System (*Sistema Integral de Compras Públicas*)

SIGAF	Integrated Financial Management System *(Sistema Integral de la Gestión de la Administración Financiera)*
SOE	State owned Enterprise
TADAT	Tax Administration Diagnostic Assessment Tool
TD	Digital Taxation (*Tributación Digital*)
TICA	Information Technology for Customs Control *(Tecnología de Información para el Control Aduanero)*
TSA	Treasury Single Account
VAT	Value Added Tax
WB	World Bank

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DATASHEET

BASIC INFORMATION

Country(ies)	Project Name	
Costa Rica	Costa Rica Fiscal Management Improvement Project	
Project ID	**Financing Instrument**	**Environmental and Social Risk Classification**
P172352	Investment Project Financing	Moderate

Financing & Implementation Modalities

[ ] Multiphase Programmatic Approach (MPA)	[ ] Contingent Emergency Response Component (CERC)
[ ] Series of Projects (SOP)	[ ] Fragile State(s)
[ ] Disbursement-linked Indicators (DLIs)	[ ] Small State(s)
[ ] Financial Intermediaries (FI)	[ ] Fragile within a non-fragile Country
[ ] Project-Based Guarantee	[ ] Conflict
[ ] Deferred Drawdown	[ ] Responding to Natural or Man-made Disaster
[ ] Alternate Procurement Arrangements (APA)	

Expected Approval Date	Expected Closing Date
26-Mar-2020	31-Mar-2026
Bank/IFC Collaboration	**Joint Level**
Yes	Complementary or Interdependent project requiring active coordination

Proposed Development Objective(s)

The Project Development Objective (PDO) is to improve efficiency, effectiveness and client orientation of tax and customs administration, and public expenditure management.

Components

Component Name	Cost (US$, millions)
Strengthening public expenditure management	44.44
Enhancing efficiency and client orientation of tax administration	28.46
Enhancing customs controls and services	52.34
Strengthening the technological, institutional and operational environment	23.00
Project Management & Capacity Building	8.40

Organizations

Borrower:	Republic of Costa Rica
Implementing Agency:	Ministry of Finance

PROJECT FINANCING DATA (US$, Millions)

SUMMARY

Total Project Cost	156.64
Total Financing	156.64
of which IBRD/IDA	156.64
Financing Gap	0.00

DETAILS

World Bank Group Financing

International Bank for Reconstruction and Development (IBRD)	156.64

Expected Disbursements (in US$, Millions)

WB Fiscal Year	2020	2021	2022	2023	2024	2025	2026
Annual	0.00	8.48	28.26	65.15	28.93	17.13	8.69
Cumulative	0.00	8.48	36.74	101.89	130.82	147.95	156.64

INSTITUTIONAL DATA

Practice Area (Lead)

Governance

Contributing Practice Areas

Finance, Competitiveness and Innovation, Macroeconomics, Trade and Investment, Poverty and Equity

Climate Change and Disaster Screening

This operation has been screened for short and long-term climate change and disaster risks

SYSTEMATIC OPERATIONS RISK-RATING TOOL (SORT)

Risk Category	Rating
1. Political and Governance	High
2. Macroeconomic	Moderate
3. Sector Strategies and Policies	Moderate
4. Technical Design of Project or Program	High
5. Institutional Capacity for Implementation and Sustainability	High
6. Fiduciary	Moderate
7. Environment and Social	Moderate
8. Stakeholders	High
9. Other	Low
10. Overall	High

COMPLIANCE

Policy

Does the project depart from the CPF in content or in other significant respects?

[ ] Yes [√] No

Does the project require any waivers of Bank policies?

[ ] Yes [✓] No

Environmental and Social Standards Relevance Given its Context at the Time of Appraisal

E & S Standards	Relevance
Assessment and Management of Environmental and Social Risks and Impacts	Relevant
Stakeholder Engagement and Information Disclosure	Relevant
Labor and Working Conditions	Relevant
Resource Efficiency and Pollution Prevention and Management	Relevant
Community Health and Safety	Not Currently Relevant
Land Acquisition, Restrictions on Land Use and Involuntary Resettlement	Not Currently Relevant
Biodiversity Conservation and Sustainable Management of Living Natural Resources	Not Currently Relevant
Indigenous Peoples/Sub-Saharan African Historically Underserved Traditional Local Communities	Relevant
Cultural Heritage	Not Currently Relevant
Financial Intermediaries	Not Currently Relevant

NOTE: For further information regarding the World Bank's due diligence assessment of the Project's potential environmental and social risks and impacts, please refer to the Project's Appraisal Environmental and Social Review Summary (ESRS).

Legal Covenants

Sections and Description
Section I.A.3 of Schedule 2 to the Loan Agreement. No later than three (3) months after the Effective Date, the Borrower, through MoF, shall establish, and thereafter operate and maintain, throughout Project implementation, technical teams, comprised of representatives with functions and responsibilities acceptable to the Bank and defined in the Operational Manual, for purposes of, inter alia, providing technical support for supervising the implementation of the corresponding Project activities, and engage in on-the-job and formal training activities, as required.

Sections and Description

Section I.A.4 of Schedule 2 to the Loan Agreement. The Borrower, through MoF, shall establish, and thereafter operate and maintain, throughout Project implementation, a committee (the "Steering Committee"), chaired by MOF and comprised of representatives with functions and responsibilities acceptable to the Bank and defined in the Operational Manual, including, inter alia: (a) the provision of strategic guidance and overall policy coordination; (b) the oversight of proposed reforms and Project implementation progress; (c) the setting of priorities for the Project; (d) the resolution of conflicts; and (e) inter-ministerial collaboration.

Sections and Description
Section I.A.5 of Schedule 2 to the Loan Agreement. No later than nine (9) months after the Effective Date, the Borrower, through MoF, shall develop a fiscal management strategy, consistent with the objective and Parts of the Project and as part of the Borrower process to define its enterprise architecture strategy, all in a manner acceptable to the Bank and in accordance with the criteria established in the Operational Manual.

Sections and Description
Section I.C.2 of Schedule 2 to the Loan Agreement. The Borrower shall ensure that the Project is implemented in accordance with the ESCP, in a manner acceptable to the Bank.

Sections and Description
Section I.C.3 of Schedule 2 to the Loan Agreement. The Borrower shall (a) take all measures necessary on its part to collect, compile, and furnish to the Bank through regular reports, with the frequency specified in the ESCP, and promptly in a separate report or reports, if so requested by the Bank, information on the status of compliance with the ESCP and the environmental and social instruments referred to therein, all such reports in form and substance acceptable to the Bank, setting out, inter alia: (i) the status of implementation of the ESCP; (ii) conditions, if any, which interfere or threaten to interfere with the implementation of the ESCP; and (iii) corrective and preventive measures taken or required to be taken to address such conditions; and (b) promptly notify the Bank of any incident or accident related to or having an impact on the Project which has, or is likely to have, a significant adverse effect on the environment, the affected communities, the public or workers, in accordance with the ESCP, the instruments referenced therein and the Environmental and Social Standards.

Conditions

Type	Description
Effectiveness	Article IV. Section 4.01 (a) of the Loan Agreement. That the Borrower has prepared and adopted the Operational Manual in a manner acceptable to the Bank.
Type	Description
Effectiveness	Article IV. Section 4.01 (b) of the Loan Agreement. That the PCU has been established and staffed as provided under Sections I.A.1and I.A.2 of Schedule 2 to the Loan Agreement and in a manner satisfactory to the Bank.
Type	Description
Effectiveness	Article IV. Section 4.01 (c) of the Loan Agreement. That the Steering Committee has been established as provided under Section I.A.4 of Schedule 2 to the Loan Agreement and in a manner satisfactory to the Bank.

Type	Description
Disbursement	Section III. B.1 of Schedule 2 to the Loan Agreement. No withdrawal shall be made for payments made prior to the Signature Date, except that withdrawals up to an aggregate amount not to exceed $ 31,328,000 may be made for payments made prior to this date but on or after February 24, 2020 (but in no case more than one year prior to the Signature Date), for Eligible Expenditures.

I. STRATEGIC CONTEXT

A. Country Context

1. **Costa Rica is one of the most politically stable, progressive, and prosperous nations in Latin America and the Caribbean (LAC).** Successive governments have prioritized social welfare and development of the Costa Rican people. Political stability, the social compact, and steady growth have resulted in one of the lowest poverty rates in LAC with strong income growth among the 40 percent of the population with the lowest incomes. Costa Rica's outward-oriented policies have transformed its economy.

2. **Despite these achievements, Costa Rica is showing symptoms of structural problems that could threaten the sustainability of its development.** Growth—which was robust at 4 percent on average between 2010 and 2016—slowed to 2.6 percent in 2018 and 1.4 percent in the first half of 2019. This weakening fiscal situation increased financial costs to the economy and impacted investors' and consumers' confidence, decelerating internal demand. Fiscal pressures threaten to undermine the sustainability of the country's social compact and green trademark and prevent it from undertaking much needed investments in public infrastructure. GDP growth for 2019 was 2.1 percent and is projected to be 2.5 percent in 2020 and 3 percent in 2021. Addressing fiscal constraints and introducing evidence-based policymaking are essential elements of the Government's institutional agenda. Major structural measures have been legislated to stabilize public finance and decarbonize the economy. Costa Rica has already started implementing key reforms and has set bold targets to achieve net zero emissions by 2050.

3. **The Organization of Economic Cooperation and Development (OECD) accession process provides an anchor for Costa Rica's efforts to boost productivity and modernize institutions**. Since 2013, when Costa Rica initiated discussions on the OECD accession process, Costa Rica has approved reforms in the areas of competition, fisheries, central bank independence, the national banking system, securities market regulation, and vocational education and training. The ambitious modernization program also includes public employment reforms, labor market reforms, consolidated supervision for financial sector entities, simplifying business procedures, and harmonizing statistics. The Government expects to complete the accession process in 2020.

4. **Prospects for an improved fiscal outlook are subject to significant domestic risks.** These include a complex political context that could lead to growing public discontent, especially given the rise in the unemployment rate by 3.3 percentage points year-on-year, reaching 12.4 percent in Q4 of 2019.[1] The authorities plan to mitigate these risks by continuing to anchor reforms in the OECD accession process, which commands wide support, and engaging in broad consultations. Urgent efforts are needed to improve public sector management, increase domestic resource mobilization, and optimize public spending. These are key conditions for Costa Rica to resolve its fiscal and growth challenges.

B. Sectoral and Institutional Context

5. **Increases in public spending since 2010, together with weak revenue collections, have led to high and persistent fiscal deficits**. Costa Rica's fiscal performance has deteriorated markedly since the international financial crisis of 2008/2009.[2] The Government adopted a counter-cyclical fiscal stance, which helped the economy bounce back, but its reliance on current spending led to a sharp deterioration in its fiscal position. The

[1] National Institute of Statistics and Census (*Instituto Nacional de Estadística y Censos), 2020.* Increase in unemployment calculated since the second trimester of 2018.
[2] Central Bank and Ministry of Finance data, 2020.

Central Government's budget went from a fiscal surplus of 0.6 percent of GDP in 2007 to a deficit of 6.2 percent of GDP in 2019 and has averaged more than 5 percent of GDP since 2010. The public debt-to-GDP ratio of the Central Government more than doubled from less than 25 to 58 percent between 2008 and 2019.[3]

6. **The Legislative Assembly approved a major fiscal reform in December 2018, the first in more than two decades.** The reform included revenue increases and spending containment measures designed with careful attention to their distributional impacts. It replaced the sales tax with a value-added tax (VAT) while broadening the tax base to include services (limiting the impact of this reform on the poor with exemptions and reduced VAT rates for health services and pharmaceuticals); broadened the income tax base, increasing rates for the upper-income levels; capped bonuses and froze public sector hiring; and introduced fiscal rules constraining current spending growth for the non-financial public sector to the average nominal growth of GDP over the previous four years or less. In parallel, the authorities launched a thorough modernization process for tax collection covering both tax and customs administration.

7. **Costa Rica's tax revenues are low compared to LAC peers and insufficient to finance the country's development needs**. Tax revenue has been below 14 percent of GDP during the 2009–2018 period (about 26 percent of GDP including social security contributions): in 2017, tax to GDP ratio for LAC countries with similar GDP was 22.8 percent.[4] While Costa Rica finances health and education services generously compared to regional OECD peers[5], public investment, at about 4 percent of GDP, is low compared to about 5–6 percent of GDP in Peru and Chile, where public investment is even higher if public-private partnerships are taken into account.

8. **Low tax collection is due, in part, to weaknesses in the structure of the tax system, extensive exemptions, excessive complexity, a narrow base, and low tax productivity**. Since 1953, the Legislative Assembly has approved over 1,259 tax exemptions that amount to more than 5.6 percent of GDP. Consequently, the policy gap between potential and actual General Sales Tax revenue is substantial, averaging about 4 percent of GDP from 2012 to 2016 according to International Monetary Fund (IMF) estimates. The multiplicity of tax exemptions introduces complexity and distortions to the tax system, increases compliance costs, and makes the tax system harder to administer. Exemptions to labor income hamper personal income tax collections. Corporate taxes account for less than one fifth of total revenues (compared to over one-third in OECD countries).

9. **Low revenue collection is also due to poor compliance.** The Costa Rican General Directorate of Taxation (*Dirección General de Tributación*, DGT) estimates that tax evasion and avoidance amounted to 8.2 percent of GDP in 2013. The OECD estimates that, in 2014, a quarter of corporations and almost a fifth of self-employed professionals did not file income taxes, while 14.4 percent and 20 percent respectively did not file sales taxes, and 55 percent of persons with profitable professional service activities declared zero income tax. The IMF calculates that the sales tax compliance gap was 31 percent in 2016, equivalent to 1.9 percent of GDP (an increase over the 29 percent gap estimated for 2012).[6] The integrity of the tax system is undermined by a large informal economy and non-compliant practices such as unregistered companies, undeclared income, excessive deductions, abusive tax planning, fraudulent refunds, and other forms of tax fraud.

10. **A recent Tax Administration Diagnostic Assessment Tool (TADAT) assessment highlights weaknesses in tax administration systems and practices.[7]** Costa Rica performed well in the areas of tax filing and tax payment,

[3] Ibid.
[4] *Tax Administration Diagnostic Assessment Tool*, *Costa Rica, Informe de Evaluación del Desempeño*, World Bank, June 2019.
[5] IMF, 2019. Country Report No. 19/101.
[6] *Revenue Administration Gap Analysis Program — Tax Gap Analysis for General Sales Tax and Corporate Income Tax*. International Monetary Fund (IMF), 2016.
[7] WB and IMF TADAT, 2020.

largely owing to the introduction of an on-line payment portal in early 2018 now used by most tax payers. Identified weaknesses include: insufficient effort to identify new taxpayers to broaden the tax base; inadequate controls in DGT's operational and financial activities; limited coverage of tax inspections (9.39 percent of large taxpayers and 0.07 percent of other taxpayers); lack of adequate omission controls with only 19 percent of omitted declarations regularized; and inadequate risk management systems. DGT does not have a comprehensive compliance strategy in place for combating tax evasion and avoidance.

11. **Customs operations in Costa Rica are costly and inefficient**. In 2017, the Legislative Assembly ratified the World Trade Organization Trade Facilitation Agreement and established a National Trade Facilitation Council (*Consejo Nacional de Facilitación del Comercio*) to support its implementation. The General Customs Directorate (*Dirección General de Aduanas*, DGA) has developed a Single Window for Foreign Trade to enable e-payment, implemented a digital signature system, and has made progress on certification processes for authorized economic operators. However, Costa Rica's score on the "*Trading Across Borders*" indicator in *Doing Business 2020* is 77.6, ranking 80 out of 190 economies. Both the time and cost to export from Costa Rica exceed OECD country averages. *Doing Business 2020* reports that it takes 20 hours to complete the clearance process for exports (of which 1.8 hours are spent in customs) and 80 hours to complete the clearance process for imports (of which 72 hours are spent in customs). This performance is due in part to the DGA's complex and redundant procedures and manual controls. Information provided to traders, logistics operators, brokers, and other clients is often insufficient to support compliance. As a result, clearance and inspection processes are slow and expensive compared to those in OECD countries. There is room to improve on trade facilitation, particularly as it relates to cooperation and coordination of all cross border regulatory agencies and logistics operators involved in the clearance process; harmonization and multi-modal access to data; and implementation of a risk management model based on advance information and coordinated single inspection of cargo.

12. **The lack of an effective risk management system undermines operational efficiency in customs.** The current risk management tools do little to strengthen customs controls or ease trade. The DGA and Fiscal Control Police (*Policía de Control Fiscal*, PCF) only partially apply elements of risk analysis to guide control actions. A 2016 study on customs operations published by the General Comptroller Office concluded that it was impossible to find a statistically significant impact of the "red channel" (physical review of cargo) on tax collection. In 2017, according to DGA, the percentage of inspections was 10 percent, and the success level of examinations, or hit rate, was just 3.2 percent.

13. **Earmarking, mandated spending and incremental budgeting limit the Government's ability to allocate resources in line with policy needs and priorities**. In 2018, constitutional and other legal provisions mandated around 44 percent of central government expenditure. The Central Government budget does not include several extrabudgetary central agency funds, such as the Road Fund. There is no overall governance structure or policy guidance for a large state-owned enterprise (SOE) sector. The Ministry of Finance (MOF) has initiated work on a program budget, working with five pilot institutions. However, effective expenditure planning is still limited, and budgeting is largely incremental and annual. It makes limited use of performance information, spending reviews or program evaluations.

14. **There are significant shortcomings in cash and debt management.** Although Costa Rica has implemented a treasury single account (TSA) throughout the Central Government, including the judicial and legislative branches, Treasury does not have oversight of all public resources. As many as 53 decentralized entities and 30 non-business decentralized entities, representing 59 percent of public expenditure, are not included in the TSA. Cash management, treasury and credit functions are not coordinated effectively, resulting in highly dispersed issuances, fragmentation among instruments and maturities, limited price discovery, and a homogeneous investor base dominated by public entities and commercial banks. These issues lead to high funding costs and vulnerability

to exchange rate and refinancing shocks. A debt management strategy that addresses these issues was approved in December 2018. Information systems will now need to be upgraded to consolidate information and facilitate coordination and market access.

15. **Control, accounting and financial reporting systems are fragmented**. Multiple human resource management systems coexist. Unreliable personnel data undermine payroll controls and has allowed increases in public sector wages, amounting to 40 percent of total spending, to outpace growth in revenues. Costa Rica adopted the International Public Sector Accounting Standards (IPSAS) in 2008 and the Law on Strengthening Public Finance of 2011 sets January 1, 2023 as the deadline for their implementation. Considerable work is needed to integrate information systems so that financial information can be consolidated and accessed in real time. Currently, some critical accounting and financial reporting functions are undertaken manually using spreadsheets.

16. **Outdated information technology hinders revenue and expenditure management.** Obsolete products form the backbone of the MOF's current information technology (IT) systems. The Integrated Financial Management System (*Sistema Integral de la Gestión de la Administración Financiera*, SIGAF) has been in place since 2007. It is a hybrid solution based on custom-developed software. SIGAF is no longer fit for purpose and requires modernization to address weaknesses in expenditure control and reporting. DGT runs six tax administration IT applications that are not well integrated. The only modern IT system in use is a taxpayer electronic filing system. Payment data is entered manually for taxpayer accounts. This practice is onerous and prone to data entry errors. Taxpayer registration and tax management systems are poorly integrated, leading to incomplete and inaccurate registries. The bespoke Information Technology for Customs Control (*Tecnología de Información para el Control Aduanero*, TICA) system, developed in the 1990s, does not cover many processes and procedures, hindering control and contributing to delays in border clearance. Audits of the system have revealed serious security concerns. DGA's application portfolio does not include tools—such as apps, websites viewable on mobile devices, and service chats—that are common in many other countries.

17. **IT systems have extremely limited interoperability.** On the revenue side, DGA and DGT manage their information systems independently, and the exchange of information is minimal. This leads to data duplication, fosters under-invoicing and low collection, and makes it difficult to identify tax evasion and monitor exemptions. The customs IT system is not interoperable with the National Trade Single Window or logistics systems for cargo tracking. On the expenditure side, there is no integration across the different public financial management (PFM) systems. This causes serious difficulties during budget preparation and execution and weakens debt management because data on accruing debt are not integrated or maintained. The MOF's IT systems and data infrastructure are highly vulnerable to natural disasters.

18. **MOF's human resource management is poorly equipped to support fiscal reform and technological modernization.** The MOF's Directorate of Technologies and Communication (*Dirección de Tecnología y Comunicación*, DTIC) lacks the staff and resources needed to design and manage IT systems that obtain and utilize information in the quantity and quality necessary. There is limited technical capacity to manage compliance risks, optimize use of resources, or assure sustainability. The General Directorate of the Civil Service (*Dirección General de Servicio Civil*, DGSC), which is responsible for managing all central government staff, operates a rigid HR system that minimizes opportunities for favoritism and nepotism at the cost of quality. Professional-grade staff are recruited through generic examinations and are assigned to government agencies without consideration of technical requirements. Examinations for internal competitions do not assess skills or technical knowledge. There is no credible performance or career management framework in place, nor is there an internal capacity development or knowledge management program for MOF administration staff. Promotions depend on seniority rather than on technical knowledge or performance. The 2018 Law on Strengthening Public Finances requires

implementation of a performance evaluation scheme, which is currently being defined. The Government has presented the Legislative Assembly with a draft Public Employment Law, which aims to modernize the management of public sector, addressing many of the weaknesses outlined above.

Box 1. Climate Change and Public Finance in Costa Rica

Costa Rica ranks second in the world among countries most exposed to multiple hazards[1]. Eighty percent of GDP and 78 percent of the population are located in areas at high risk of multiple hazards, including floods, cyclones, landslides, earthquakes, and volcanic eruptions. Accelerated rise in sea levels could affect over 60 percent of urban areas. Storms have prompted evacuations and caused damage to multiple cities. In 2016, a severe hurricane caused US$21 billion in damages to the country's public infrastructure.

Costa Rica has included a climate change adaptation component in its NDC setting out objectives and goals to reach by 2030. This strategy includes policies on disaster risk management, coastal management, biodiversity, and climate-smart agriculture. A World Bank contingency loan (P111926) has been used to buffer the social and overall fiscal impacts of three natural disasters.

In 2019, Costa Rica unveiled a detailed plan to decarbonize its economy by 2050. The National Decarbonization Plan, which complements Costa Rica's NDC, includes bold mid- and long-term targets to reform transport, energy, waste, and land use, and proposes a green tax reform to decouple tax revenues from the sale of fuels and cars.

There is uncertainty about how much the decarbonization plan will cost and how it will be financed. An initial estimate puts the costs at US$6.5 billion over the next eleven years alone, to be shared between the private and public sectors. The Ministry of Planning has requested the World Bank's help with costing the decarbonization strategy and analyzing how to create (or create incentives for) public, private, and blend mechanisms for its financing.

Costa Rica has endorsed the Helsinki Principles as a member of the Coalition of Finance Ministers for Climate Action and the proposed Project will support their implementation. Costa Rica will incorporate climate change considerations into public investment management, macroeconomic, and fiscal policies in support of its low-carbon and climate-resilient growth strategy. Project activities will support Costa Rica's Adaptation and Decarbonization Plans by including activities: aligning fiscal policies, planning and budgeting with adaptation and decarbonization objectives, implementing disaster resilience standards and protection of physical assets, and enhancing capacity for data protection and systems resilience

[1] Maax Dilley *et al* (2005) Natural Disaster Hotspots: A Global Risk Analysis, Disaster Risk Management Series, 5

C. Relevance to Higher Level Objectives

19. **The MOF has requested the World Bank's support for the design and implementation of reforms to address these revenue and expenditure management challenges.** MOFs strategy builds on the Government's 2019-2024 Transformation Roadmap for MOF, DGT and DGA, and the 2020 Digital Strategy designed through a broad consultative process. The reforms seek to increase revenues through improvements in voluntary compliance and improve the policy alignment and quality of public spending. The reforms encompass changes in regulatory and institutional framework for revenue and expenditure management, significant investments in the modernization and integration of information systems and fundamental changes in organizational culture. The ministry seeks to instill a service culture in tax and customs administration recognizing tax payers as clients.

Strengthened risk management practices and the use of business intelligence systems will help combat tax and customs evasion. Information will be shared across the MOF and with external stakeholders. Planning and budgeting will be aligned with policy that is evidence-based and take a medium-term, results-oriented perspective that supports the Government's sustainable development objectives. This transformation will require substantial investments in information technology and a sustained commitment to change management and capacity building.

20. **The Fiscal Modernization Improvement Project – titled "*Hacienda Digital para el Bicentenario*" by MOF – is aligned with the FY16-20 World Bank Group (WBG) *Country Partnership Framework for Costa Rica* (Report No. 94686-CR), discussed by the Board of Executive Directors on May 26, 2015, and updated in the Performance and Learning Review to the CPF (Report No. 143466-CR) dated December 6, 2019.** The Project supports CPF Pillar 2 (Bolstering Fiscal, Social, and Environmental Sustainability) directly contributing to Objective 4 of promoting fiscal sustainability and strengthening debt management, and Objective 6 of expanding capacity to promote climate-smart and environmentally sustainable development. The proposed Project is aligned with the World Bank's Climate Change Action Plan and climate targets for 2021-2025 and supports Costa Rica's climate change policies (see Box 1). The proposed Project complements a Development Policy Loan (P171912) under preparation which supports fiscal consolidation and decarbonization policies. The proposed Project also adheres to the principles for IBRD engagement in countries above the Graduation Discussion Income (GDI), namely: Costa Rica has access to external capital markets but only on terms that are high for its level of debt and level of development; and Costa Rica is making progress in establishing key institutions for economic and social development.

II. PROJECT DESCRIPTION

A. Project Development Objective

PDO Statement

21. The Project Development Objective (PDO) is to improve efficiency, effectiveness, and client orientation of tax and customs administration, and public expenditure management.

22. The PDO will be achieved through the modernization and digitalization of the Ministry of Finance. This will facilitate tax and customs services and payments, reduce fiscal evasion, improve budget efficiency, strengthen debt management, and transform the Ministry of Finance's institutional culture to place the citizens at the center as clients.

PDO Indicators

23. Achievement of the PDO will be assessed on the basis of the following indicators:

Reduction of operating costs of the tax and customs administration relative to revenue (percentage)

Reduction in the time to produce consolidated financial statements (days)

Reduction in evasion of Value Added Tax as percentage of GDP (percentage)

Reduction in evasion of Corporate Income Tax as percentage of GDP (percentage)

Share of the General Government budget executed directly through the new IFMIS (percentage)

Reduction in the time taken to pay Value Added Tax (hours)

Reduction in the time taken for customs clearance (hours)

B. Project Components

Component 1: Strengthening public expenditure management (US$44.44 million)

24. This component seeks to strengthen the capacity of MOF in the areas of fiscal policy and planning, expenditure management and control. The component will support the reorganization of PFM functions and practices, capacity building and information technology systems, promote evidence-based decision making and mainstream climate change and gender considerations into PFM.

25. ***Subcomponent 1.1: Strengthening expenditure policy and planning.*** This subcomponent seeks to improve the policy alignment and effectiveness of public expenditure across core PFM entities, planning and spending units by financing technical assistance and training in support of, *inter alia*: (a) the development of a fiscal management strategy; (b) the design and application of tools for evidence-based decision making, including periodic spending reviews and program evaluations; (c) the integration of climate change, disaster risk management and gender considerations in expenditure planning; (d) the strengthening of public investment practices in portfolio and asset management and of expenditure planning, including the development of medium-term fiscal, expenditure and budgeting instruments; (e) the systematic application of program and results-informed budgeting; (f) the consolidation of fiscal information and reporting for fiscal management purposes; and (g) the strengthening of the SOE oversight unit's governance and policy functions, including support for engagement with selected SOEs.

26. ***Subcomponent 1.2: Streamlining and control of public expenditure cycle***. This subcomponent seeks to improve the functional integration, reliability and timeliness of PFM information and processes throughout the public expenditure cycle encompassing budget formulation, budget execution, accounting, treasury, public investment, payroll and asset management. The subcomponent will finance technical assistance and training for, *inter alia*: (a) the review and update of the public expenditure cycle institutional, legal and operational framework; (b) the simplification and streamlining of public financial management processes and procedures; (c) the expansion of the single treasury account; (d) the application of accounting and financial reporting international standards; (e) improvements in arrears management and controls; (f) the strengthening of capacity to design and implement a debt management strategy, an issuance program and a price discovery system; (g) the streamlining of income registration for budget and accounting; and (h) the strengthening of payroll controls and asset management procedures.

27. ***Subcomponent 1.3: Modernizing PFM Information System.*** This subcomponent seeks to modernize and integrate public financial management information systems through, *inter alia*, enhancements in their functionality, technology and interconnectivity. The system will cover at least the following functions as an integrated software solution: budget preparation; budget authorization; commitment of funds; payments and receipts management; cash management; accounting (automatic and registration); debt and aid management; public investment management; asset and inventory management; payroll calculation and human resource management. The system will integrate with internal and external information systems including procurement and payments systems.

Component 2. Enhancing efficiency and client orientation of tax administration (US$28.46 million)

28. This component seeks to improve the operational capacities of the DGT and DGA to increase tax coverage, facilitate voluntary compliance among taxpayers, and reduce compliance gaps by strengthening the information systems that support management, collection and tax control, and ensuring interoperability among procedures and services of the institutions. The provision of services to taxpayers will be improved to minimize compliance costs, limit tax evasion practices, and ensure service continuity in the events of natural disasters.

29. ***Subcomponent 2.1: Streamlining and automating core tax processes**.* This subcomponent seeks to streamline and automate DGT's and DGA's operational processes including, inter alia: (a) the mapping and reengineering of core tax administration business processes; (b) the development of functional and technical requirements and bidding documents for a new tax administration software; (c) the implementation of an integrated tax information management system to automate refined processes and support the planning, execution, control and monitoring of fiscal management; (d) the development of a robust taxpayer current account and an integrated tax compliance model; (e) the development of a case manager for administration and tracking of internal issues and taxpayers procedures; (f) the improvement of the taxpayer registry and e-invoicing functionality; (g) the development of digital services for tax; and (h) the update of the existing tax administration system regulatory framework to allow for implementation and sustainability of the updated processes, technologies, and systems.

30. ***Subcomponent 2.2: Improving citizen and business taxpayer services***. This subcomponent seeks to improve citizen and business taxpayer services through, *inter alia*, the implementation of client-facing applications. These applications include multi-channel access points and mobile applications for taxpayer registration, e-filing, automated helpdesk, and online access to taxpayer records and profiles.

31. ***Subcomponent 2.3: Design and implementation of a comprehensive compliance strategy.*** This subcomponent seeks to strengthen compliance management Through the design and implementation of a comprehensive, targeted and risk-based compliance strategy to promote more efficient use of data and tax information sources for preventive controls, tax auditing, and enforcement, including, *inter alia*: (a) the design and implementation of an integrated risk management system; (b) the introduction of advance audit techniques and mechanisms to automatically match third-party information and enable a more effective detection of evasion and tax fraud; (c) the reform of DGT's appeal system to reduce contact between tax officials and taxpayers; and (d) the carrying out of risk management activities through the use of an advanced data analytics platform.

Component 3. Enhancing customs controls and services (US$52.34 million)

32. **This component seeks to strengthen DGA and the Fiscal Control Police (PCF)[8] procedures, controls and services to facilitate trade and enhance the business environment and sustain revenue collection.** The component will support the implementation of risk-based streamlined clearance and control procedures to reduce traders' effort and time to comply with import, export and transit formalities and procedures.

33. ***Subcomponent 3.1: Strengthening customs controls and clearance procedures.*** This subcomponent seeks to strengthen customs controls and clearance procedures, including, *inter alia*: (a) the mapping and reengineering of core customs administration business processes; (b) the replacement of the TICA system and the development of the requirements and bidding documents for a new customs management system; (c) the enhancement of cooperation and training across sectors; (d) the update of the Borrower's customs administration regulatory framework, and the implementation of tools and methodologies to improve the efficiency and effectiveness of the customs administration; (e) the acquisition of a modern customs management system and a customer relationship management software; (f) the provision of support to strengthen DGA's and PCF's technical capacities, including the set-up of an operational policy and sustainability strategy for the adoption of modern technologies and better management of data for intelligence and risk management; and (g) the acquisition of laboratory equipment and other tools to improve connectivity, mobility and productivity.

[8] The Fiscal Control Police (PCF) is an unarmed police dependency of the MOF with a mission to protect Costa Rica's tax interests. Support to PCF will be limited to training on procedures and tools related to better management of data for intelligence and risk management.

34. ***Subcomponent 3.2: Improving trade facilitation services.*** This subcomponent seeks to improve trade facilitation services through the provision of financing for, *inter alia*: (a) the provision of technical support to accelerate the release and clearance of goods; (b) the development of digital services and online and mobile applications to ease trade services; (c) the development of a trade information portal; (d) the provision of support for data integration between customs, the trade single window and other border agencies to expedite border clearance and provide accurate information; (e) the provision of training on new procedures for traders; and (f) the carrying out of time release studies and activities to reduce bottlenecks in trade processes.

35. ***Subcomponent 3.3: Implementing a risk-based framework and post-clearance audit.*** This subcomponent seeks to implement a robust risk management framework[9] to improve the performance of DGA and the PCF and promote a more efficient use of information sources for customs auditing, control, and enforcement, including, *inter alia*: (a) the carrying out of an assessment and the provision of support for the implementation of successful and good practice customs initiatives; (b) the acquisition of non-intrusive technologies[10] to support risk management, including the carrying out of an assessment to determine the specific needs for each customs post, the appropriate custom post location, technical specifications and management arrangements for the operation, maintenance and updating of equipment; and (c) the provision of technical assistance to prepare a data integration model for the core customs processes.

Component 4. Strengthening the technological, institutional and operational environment (US$23 million)

36. This component will strengthen the MOF's human resource management function, modernize and integrate its technological infrastructure, and support reform operations and change management.

37. ***Subcomponent 4.1: Strengthening human resource management.*** This subcomponent seeks to strengthen MoF's human resource management functions through, *inter alia*: (a) the development and implementation of an integrated human resources management strategy and HRMIS; (b) the update of staffing plans for revenue and expenditure administrations; (c) the establishment of a robust performance and career management framework; (d) the definition of a rigorous screening process for staff recruitment; (e) the implementation and strengthening of an internal capacity development and knowledge management program for MoF; (f) the development of the requirements and bidding documents for the HRMIS system; (g) the implementation of a web-based HRMIS system to support decentralized operations; (h) the modernization of human resources systems and internal communication models; (i) the improvement of MOF human resources' internal audit function and internal investigation unit; and (j) the design and implementation of a comprehensive transparency strategy.

38. ***Subcomponent 4.2: Modernization and integration of MOF's information technology infrastructure.*** This subcomponent seeks to modernize and integrate MOF's information and communication technology infrastructure and provide support for the implementation of the digital transformation agenda. This envisages an integration tool – an interoperability bus[11] – informed by an Enterprise Architecture (EA) that improves

[9] The risk-based framework will make more efficient use of information from customs, tax, feedback from inspections results, and other information sources to support customs auditing, control, and enforcement. A compliance strategy will differentiate controls for compliant and non-compliant traders and other customs operators and improve planning and management of post clearance audits. Information sharing between customs, tax administration, and other border-agency teams to provide a holistic view of the risk of traders and customs operators. MOF will have a strategy to conduct appropriate post-clearance audits in coordination with the tax administration

[10] Non-intrusive inspection technology comprises technical equipment and machines such as X-ray or gamma-ray imaging equipment (scanners) that allow the inspection of cargo without the need to open the means of transport and unload the cargo.

[11] An interoperability bus is an integration tool responsible for mediating communication and data exchange between systems, such as

interconnectivity and interoperability of government systems, IT governance arrangements, a business continuity plan and the upgrading of network and telecommunication equipment. Annex 3 presents further information on MOF's digital transformation agenda.

39. ***Subcomponent 4.3: Operational Support and Change Management*.** This subcomponent provides operational support and finances change management activities, including, *inter alia*: (a) the provision of technical assistance to manage and provide quality assurance of bidding documents, proposals and deliverables of information and communication technology; (b) the carrying out of capacity building activities to institute envisaged reforms and achieve expected results; (c) the implementation of a change management strategy; and (d) the carrying out of management capacity building activities and a public education campaign. Capacity building will include management training for line officials to support evidence-based decision making, a results orientation in operations, data management and analytics, and the shift to a client service approach in tax and customs.

40. ***Subcomponent 4.4: Flexible Technical Assistance*.** This subcomponent provides financing to address technical and policy issues to support MoF's reform process. Technical assistance will be identified by MOF throughout implementation and subject to World Bank no-objection to ensure consistency with the PDO.

Component 5. Project Management and Capacity Building (US$8.4 million)

41. This component finances support for project coordination and management to ensure successful and timely delivery of Project activities and results, including the provision of support to the PCU for, *inter alia*: (a) Project management and monitoring; (b) the carrying out of fiduciary and safeguards tasks, including compliance with the WB ESF guidelines, and internal controls and audits for the Project; and (c) the carrying out of stakeholder outreach activities for awareness on the Project.

C. Project Beneficiaries

42. **The Project has four categories of beneficiaries.** First, the staff of MOF and its related institutions, DGT, DGA, DTIC, and DGSC, will benefit from more efficient and effective systems for managing public finances, high quality and timely financial information upon which to make decisions, and enhanced technical capacity to manage and utilize that information for decision-making. The Project will strengthen MOF's role in the policy process as coordinator of the PFM system. Second, government agencies will benefit from improvements in PFM practices, greater predictability in funding and information systems for decision-making. This will help agencies manage resources more efficiently and effectively. Third, tax payers,[12] importers and exporters[13] will benefit from improvements in the efficiency of tax and customs administrations, reduced transactions costs and a stronger client orientation in these services. Fourth, civil society organizations and academics undertaking fiscal analysis will benefit from access to better quality and more timely information on public finances that they can use for accountability, advocacy and management purposes. Indirect beneficiaries are firms and households in Costa Rica who will benefit from improved fiscal policy decisions based on more complete, accurate and timely financial information and improved policy analysis.

D. Results Chain

43. **The results chain presented in Figure 1 illustrates the linkage between the Project's key interventions and its targeted intermediate outcomes and development objective**. The results chain rests on a number of key

software applications and databases. It permits systems with disparate technologies to exchange data using data standards regardless of the technology used by the originating system.

[12] TADAT (2019) reports the numbers of taxpayers at end of 2018 as: 168,366 legal persons; 413,128 as physical persons; 25,394 paying retained at source; and 103,120 paying VAT.

[13] MOF estimates that there were 48,646 importers and 3,827 exporters at the end of 2019.

assumptions: the timely acquisition of project inputs, including consultancies, training, goods and IT equipment; successful implementation of training and capacity building programs across the Government of Costa Rica's institutions supporting all project components; timely development and roll-out of software applications for PFM, tax and customs administration and human resource management; successful implementation of change management activities to overcome resistance to reforms, particularly resistance to reforms strengthening internal controls and the automation of manual processes; and continued support for the project and reform agenda, with champions among the Costa Rica's political leadership and at the higher levels of the civil service.

Figure 1: Project Results Chain

Key Challenges		Project Interventions	Intermediate Outcomes	Outcomes	PDO
Unsustainably high public spending, poor policy alignment, short-term planning perspective and inefficiency in spending, weak controls in budget execution	1. Public Financial Management	Develop a fiscal management reform strategy Apply tools for evidence-based decision making Implement expenditure planning, budgeting and public investment management Strengthen SOE oversight unit	Strengthened fiscal policy and planning capacities Increased share of the General Government budget executed directly through the new IFMIS	**Improved efficiency and effectiveness in public expenditure management**	**Improved efficiency, effectiveness and client orientation of tax and customs administration, and public expenditure management**
		Apply accounting and financial reporting Strengthen asset management Develop and implement human resource management and expenditure controls Implement debt management strategy	Financial information standards applied Strenthened expenditure controls Reduced time to produce consolidated financial statements		
		Integrate financial management information Develop and implement human resource management information system	Timely, comprehensive financial information		
Low revenue collection due to poor compliance and operational weaknesses in tax administration systems and practices	2. Tax Administration	Implement client-facing applications	Improved citizen and business taxpayer services	**Improved efficiency, effectiveness, and client orientation of tax administration**	
		Map and re-engineer tax administration Develop and implement tax administration Apply risk-based compliance strategy Enhance tax audit tools and capacities Strengthen the appeals system Increase data analytics capacity Update existing regulatory frameworks	Reduced evasion of VAT and Corporate Income Tax Enhanced compliance with tax requirements Reduced ratio tax administration operating costs to collections Reduced time for taxpayers to pay VAT		
Customs operations are costly and inefficient, thus limiting the country's competitiveness and its capacity to generate income from trade related commerce	3. Customs Administration	Reengineer customs procedures Replace TICA and install customs management Update regulatory frameworks capacities Procure laboratory equipment and other tools	Automated customs controls & Reduced ratio of operating costs of the customs administration Reduced time taken for customs clearance	**Improved efficiency, effectiveness, and client orientation of customs administration**	
		Develop digital services, mobile applications, Integrate customs and single window systems Conduct time release studies and reduce bottlenecks	Improved delivery of trade facilitation services for importers and exporters		
		Develop and implement a risk management Procure non-intrusive technology Increase data analytics capacity	Improved detection and management of customs risks		
4: Strengthen MOF Human Resource Management Function and Integrated Information Technology Solutions					
5: Project Management and Capacity Building					

E. Rationale for Bank Involvement and Role of Partners

44. **The Government of Costa Rica has requested the World Bank's (WB) support in the proposed Project in order to leverage the WB's global experience in PFM, tax and customs and its expertise in the implementation of complex information systems.** The WB has extensive experience working on around 150 projects supporting complex PFM, and revenue administration information systems in more than 80 countries across all regions. Drawing on this experience, the WB can advise on implementation options, ensure that support is well-suited to the country's needs, and help address the policy, technical and change management challenges that arise during implementation. MOF's collaboration with the WB and use of Investment Project Financing (IPF) signals credible commitment and offers greater assurance of continuity across changes in leadership within the administration and across electoral mandates than would be the case if activities are self-financed. The IPF earmarks financing and ensures predictable funds flows throughout the extended time frame needed for implementation of the reforms. Senior officials will be directly responsible for project implementation and the selection and oversight of contractors, while benefiting from World Bank technical advice and support in the process.

45. **The proposed operation has been designed through a broad consultative process and complements support provided by other development partners.** MOF has requested Inter-American Development Bank (IADB) and Central American Bank for Economic Integration (CABEI) financing for critical technical assistance to support activities in the runup to project effectiveness. The WB will coordinate with IADB and CABEI in drafting of terms of reference and the selection of experts. This includes initial work on development of the PFM reform strategy, a functional and legislative review, and preparatory work on the design of the enterprise architecture for key information systems. The project will enhance coordination among development partners such as IMF, IADB, CABEI and the United States Treasury by supporting a regular donor forum.

F. Lessons Learned and Reflected in the Project Design

46. **The World Bank's global experience in the implementation of information technology projects in public finance identifies two major challenges: organizational resistance to change and difficulties in managing information technology contracts.** The lessons learned draw on a study of World Bank financed PFM information systems[14] and the experience of closed and ongoing WB projects[15] supporting PFM, tax and customs administration reforms with integrated information technology solutions.

47. **Addressing resistance to change.** PFM reforms frequently have to overcome resistance to change from internal and external stakeholders who cling to established practices and legacy information systems. An important first step in addressing resistance is for key stakeholders to agree on a strategy that lays out the direction of reforms, the key milestones, the information standards that will be applied, the relationship between information systems, the legacy systems that will be replaced and the process for transition to new working practices. The strategy should provide a framework that guides and benchmarks progress in implementation across changes in administration. A robust governance structure should have the authority to take and enforce decisions during implementation, resolving differences in views between stakeholders. A change management strategy should raise awareness and help management identify and address challenges to the reform process. It should encompass new human resource management practices and strengthen the capacity of managers, policy

[14] Cem, Dener, Joanna Watkins and William Dorotinsky. *Financial Management Information Systems: 25 Years of World Bank Experience on What Works and What Doesn't.* World Bank: Washington, DC. 2011.

[15] The lessons learned draw on the implementation completion reports for the following projects: Kyrgyz Republic PFM Capacity Building Project (P112713); Tajikistan PFM Modernization APL (P099840); Croatia Revenue Modernization Project (P102778); Armenia Tax Administration Modernization Project (P111942). The lessons learned also draw on the experience of the on-going Panama Enhanced Public Sector Efficiency Technical Assistance Loan (P121492).

makers and external stakeholders to use the information generated through the reforms and investments in information systems. These elements are reflected in the project design. The Project will help MOF finalize a fiscal management reform strategy currently under preparation. The governance structure provides for a steering committee (SC), chaired by the Minister of Finance, as the entity that will guide and drive reforms. The Project will finance changes in human resource management practices, change management communications, and management and technical training that promote evidence-based decision-making, use of data analytics, and the shift to a client service culture.

48. **Managing Information Technology.** Information technology projects are particularly challenging where the system design is complex with a wide range of functions, requires the acquisition of IT solutions with heavy customization and entails multiple contracting processes. Projects can mitigate risks by developing a comprehensive, integrated strategy rather than a fragmented implementation of standalone solutions, undertaking extensive business process reengineering and minimizing customization of IT solutions. The Project addresses these challenges by: building on MOF's ICT vision and strategy (see Annex 3); supporting the design and implementation of a new enterprise architecture which will map out the structure and interaction of MOF's information systems; and financing technical assistance to support the design of IT solutions. MOF has committed to the reengineer of business processes to bring them in line with international practice, reducing the need for customization. The procurement strategy will consolidate IT procurement as far as feasible to facilitate contract management and timely implementation

49. **Drawing on its experience of prior technical assistance projects in Costa Rica, the MOF has stressed the importance of having access to adequate technical support during implementation with a combination of full-time advisors and short-term consultants to guide on specific technical issues**. While MOF management will be directly responsible for project implementation, the Project will finance full-time advisors in PFM, tax and custom administration and information technology to support institutional reforms, changes in working practices and the application of information technology. Drawing on the experience of institutional reform projects in LAC, the Project also includes funding for just-in-time consultancy services that cannot be foreseen at the design stage and may need to be mobilized at short-notice.

III. IMPLEMENTATION ARRANGEMENTS

A. Institutional and Implementation Arrangements

50. **The MOF will be the implementing entity for the Project.** A Steering Committee (SC) will be chaired by the Minister of Finance and will include the Vice Minister of Revenues, the Vice Minister of Expenses, the Project Director, and the Director of Technology. The SC will be responsible for the overall policy coordination and policy guidelines for MOF reform, provide strategic guidance, set priorities, resolve conflicts and ensure inter-ministerial collaboration where needed and monitor progress of the Project.

51. **A Project Coordination Unit (PCU) will be established within MOF.** The PCU will be headed by a Project Director. The Project Director will be part of the SC and report directly to the Minister of Finance. The PCU will be responsible for implementing, monitoring and supervising the carrying out of the Project (including its financial, procurement, monitoring and evaluation (M&E) and safeguards aspects). The PCU will be assisted by professional staff (including, *inter alia*, a project coordinator, a financial management specialist, a procurement specialist, and specialists, as needed, on environmental and social aspects) and administrative staff, all in numbers and with terms of reference, and qualifications and experience, acceptable to the World Bank.

52. **Four technical teams, each led by a senior technical advisor reporting to the PCU Director, will support project implementation**. The senior technical advisors will be full-time consultants financed by the Project. The technical teams will advise on reform implementation drawing on international experience, help oversee the work of short-term consultants, and engage in on-the-job and formal training activities as required.

B. Results Monitoring and Evaluation Arrangements

53. **The Project results framework will be used as the basis for project monitoring and evaluation.** The PCU will put in place a project monitoring system to keep records on implementation and generate periodic project progress reports. The monitoring system will draw on administrative data generated by MOF. The PCU will submit periodic monitoring reports to the SC for approval and submission to the World Bank. The PCU will include a M&E team reporting to the Project Director. The M&E team will assist MOF compile information to produce reports on implementation progress and interim results for the MOF's Transformation Roadmap and as required by the WB. The Project will be subject to a midterm review that will recommend adjustments as necessary to the Project's interventions, economic analysis, and or implementation arrangements.

54. **The WB will conduct semi-annual implementation support missions to evaluate the achievement of results and agree on adjustment or corrective measures when necessary**. Implementation progress will be documented in Aide Memoires and Implementation Status and Results (ISR) reports. The results framework will be monitored to ensure indicators' continuing relevance.

55. **External assessments of PFM, tax and customs administrations will provide insights on progress in the implementation of reforms.** The Project will finance a follow-up Public Expenditure Financial Accountability (PEFA) Assessment approximately half way through implementation to monitor progress in the implementation of reforms. The last PEFA was undertaken in 2016 using data from 2014. Third party assessments of tax administration (such as a follow-up TADAT) and Doing Business reports will provide additional inputs to project monitoring.

C. Sustainability

56. **Development of a fiscal management reform strategy through a broad consultative process will help signal credible commitment and sustain continuity of the reform agenda**. The Government and MOF leadership have launched ambitious fiscal management reforms, but their political mandate ends in May 2022. The Project will support the development of a fiscal management strategy that lays out the long-term objectives of reforms, the institutional, regulatory and operational elements of the reform agenda, and arrangements for monitoring and periodic course adjustments. The fiscal management reform strategy will be developed as part MOF's process to define its enterprise architecture strategy and in accordance with the criteria to be established in the Operational Manual (OM).

57. **Project sustainability depends on stakeholder support for the ambitious reform agenda over the medium to long-term.** Development of the fiscal management strategy through a broad consultative process will help mobilize stakeholder support and establish a broad consensus across social and political stakeholders in support of the reform agenda and continuity across electoral mandates. Private sector organizations have expressed support for reforms that reduce transaction costs, ensure information security, and improve the performance of tax and customs administrations. Change management activities and communications will accompany project implementation to ensure that the public and key stakeholder groups are aware of the purpose and impact of reforms. The Project will help enhance MOF's accountability to key stakeholders and develop feedback mechanisms for communication with private sector organizations and other stakeholders. This

will ensure that stakeholders are taken into consideration in the implementation of the reform program, helping sustain support.

58. **Improvement of human resources management and development of technical in-house capacity in MOF will help sustain new management practices, technical skills, and changes in organizational culture.** The Project will strengthen HR management by putting in more effective recruitment practices, introducing performance evaluation methodologies, and providing training for MOF management. A capacity development and knowledge management program for MOF staff will provide continuous learning and skills enhancement and for staff covering technical, managerial and soft skills.

59. **The project will put in place institutional arrangements to ensure maintenance of the technical and functional aspects of systems delivered under the Project**. The Project will develop maintenance routines and practices and provide training as needed to managerial and technical staff.

IV. PROJECT APPRAISAL SUMMARY

A. Technical, Economic and Financial Analysis

60. **Technical Capacity and Change Management.** The proposed Project lays out a challenging set of reforms across PFM, tax and customs administration. MOF has limited reform experience in some of these areas, but the staff and management have high technical capacity. Recent reforms have sought to align PFM practices with international accounting standards, introduce result-oriented budgeting practices, introduce VAT, and implement electronic tax filing and e-invoicing systems. Successful project implementation will require the strengthening of capacity in all functional areas, and training in WBG policies and procedures. The proposed Project provides for significant technical assistance, including full-time technical advisors and consultants, capacity building, communications, and change management activities. Change management is particularly important given that the Project requires changes in organizational culture, promoting use of data and analytics to support evidence-based decision making and a client service orientation in tax and customs administrations. The Project will work with MOF's Human Resources Management Department to embed these skills in the selection, training and promotion of MOF staff.

61. **Information Technology**. MOF has approved an ICT strategy that foresees an innovative government-wide Enterprise Architecture to support the functional integration of its key operating systems. This requires close collaboration and coordination with all government stakeholders involved in the digital government agenda. Annex 3 presents an overview of the information technology problems that MOF seeks to address through the Project and the proposed implementation strategy.

62. **Economic and Financial Analysis.** The economic and financial analysis of the Project assesses benefits for citizens from time savings in dealing with the tax and customs administration and for the MOF from increased revenues as a result of lower tax evasion, tax and customs administrations cost savings and strengthened control of the wage bill spending (see Annex 2). The analysis employed an incremental approach, which, by design, compares the scenario without the Project (counterfactual scenario) and the scenario with the Project. In the economic analysis the time savings accrue to economic actors from lowering the cost of compliance with the tax and customs administrations. Government savings are calculated as both the reduction in administrative costs of collecting taxes and customs for MOF and expenditure savings from greater control over spending as a result of the new Integrated Financial Management Information System (IFMIS) system and particularly the integration with the HRMIS to control the wage bill. Additional benefits accrue to the Government from lower tax evasion raising tax revenues. The results indicate that the Project is economically feasible with an economic Internal Rate

of Return (IRR) of 144 percent, and a real economic Net Present Value (NPV) of US$2,127 million at 10 percent discount rate in real terms. Results of the financial analysis show that the Project is financially feasible, the financial NPV at 5 percent interest rate in real terms is US$2,500 million.

63. **Climate Change Co-Benefits.** Project design addresses climate change vulnerabilities and mitigation opportunities directly affecting the MOF. Installation of new datacenter equipment and improved emergency recovery processes will strengthen the resilience of the MOF's ICT systems and data to climate-related risks and ensure service continuity in the event of natural disasters. Consideration of energy efficiency and low carbon standards in the procurement of goods, services and works, should mitigate emissions. The Project will also support the mainstreaming climate change considerations in PFM practices. This includes the development of tools to: assess fiscal risks arising from short and long-term physical climate change impacts and from the transition to a low to net zero economy; budget and report on public expenditures with adaptation, mitigating and adverse climate impacts; mobilize climate finance; assess and evaluate the alignment of fiscal policy and expenditures with climate change objectives, using spending reviews, expenditure reviews and program evaluations; screen, appraise and evaluate projects to address physical and transition risks; establish guidelines that integrate energy efficiency and greenhouse-gas emissions in investment appraisal, including the use of shadow price of carbon; and establish disaster resilience standards for public infrastructure and management of physical assets.

B. Fiduciary

Financial Management

64. **Financial Management Assessment (FMA) and mitigation measures**. A FMA of MOF was performed and concluded that overall controls and systems in place are adequate; however, it has limited experience implementing Bank-financed projects. The PCU to be established will be responsible for financial management (FM) tasks for the Project and will use country systems for project accounting and supplementary records for reporting. It will also use the single treasury account (*Cuenta Única del Estado,* CUE) to handle project funds. Unaudited semi-annual financial statements, as well as annual financial statements (which will be audited under terms of reference and by an external audit firm, both acceptable to the Bank) will be produced for the Project. The following measures will be implemented to ensure the satisfactory performance of financial management functions for project implementations purposes: hiring qualified FM staff for the PCU; inclusion of internal controls and procedures in the FM section of the OM to ensure adequate contract management and monitoring mechanisms over project funds; and training in FM and disbursement procedures for FM staff. Basic arrangements to ensure control, recording, and reporting are further described in Annex 1.

Procurement

65. **A detailed procurement capacity assessment of MOF as the implementing agency was carried out**. MOF has limited experience in projects financed by the WB and will establish its PCU with procurement qualified staff according to the complexity of the procurement activities. Technical aspects of envisaged procurement activities will require appropriate coordination amongst technical and procurement specialists. The Project Procurement Strategy for Development (PPSD) was prepared and a procurement plan covering the first 18 months of project implementation has been prepared by the Borrower based on PPSD results. The OM will specify appropriate roles and responsibilities of the technical and procurement specialists. PCU staff will be trained in Bank procurement procedures once they are selected.

C. Legal Operational Policies

	Triggered?
Projects on International Waterways OP 7.50	No
Projects in Disputed Areas OP 7.60	No

D. Environmental and Social

66. **Environmental and social safeguards due diligence for this project has been carried out under the World Bank's Environment and Social Framework.** Five Environmental and Social Standards (ESS) are relevant to the Project: ESS1 Assessment and Management of Environmental and Social Risks and Impacts, ESS2 Labor and Working Conditions, ESS3 Resource Efficiency and Pollution Prevention and Management, ESS7 Indigenous Peoples, and ESS10 Stakeholder Engagement and Information Disclosure. The Project does not involve civil works, land acquisition and displacement, or a physical footprint in protected areas or in areas where Indigenous Peoples (IP) are present or have collective attachment. The Project's social risk classification is Moderate and environmental risk classification is Low, as described in the following paragraphs. Consequently, the overall environmental and social risks classification of the project is Moderate.

67. **The Project is expected to generate mainly positive social impacts.** These impacts will be generated through: strengthened capacity to efficiently allocate scarce public resources, therefore leading to improved delivery of essential public services; an improved fiscal position due to better expenditure management and increased tax and customs revenue collected, which is expected to help protect past gains from reductions in poverty and inequality and support the sustainability of the country's future progress; and savings to taxpayers in terms of the reduction of time required to clear customs and pay taxes from more efficient and effective tax administration processes. Improving expenditure efficiency and fiscal sustainability practices will not only lead to more effective use of resources available but will also strengthen public accountability and transparency of public finances. Improvements in taxpayer services are expected to benefit certain types of firms that may currently face a disproportionate tax compliance burden, for example small-businesses and female-led businesses – by addressing and reducing the barriers they face as taxpayers. The main social risks associated with the proposed Project include: resistance to project activities from taxpayers currently not in compliance with the tax code, as well as push back from specific stakeholder groups, such as importers-exporters, auxiliary agents (customs brokers, bonded warehouses, etc.); potential exclusion of taxpayers and groups or individuals who participate cross-border activities and who lack access to internet or technological resources, particularly affecting vulnerable groups and indigenous peoples; the possibility that enhanced tax compliance will imply short-term income impacts that would disproportionately affect poor or vulnerable taxpayers, such as indigenous and female-headed households and/or small and medium enterprises (SMEs); and potential job loss within the MOF as a result of improvement and automation of core processes**.**

68. **Potential environmental risks are related to management and disposal of electronic waste (e-waste) and occupational health and safety issues.** E-waste may be generated due to acquisition of new ICT and security equipment under the project and decommissioning and disposal of old equipment. Occupational health and safety issues are associated with installation as well as ongoing use of equipment including at customs laboratories. The MOF has prepared and disclosed an advanced draft Social Assessment (SA) on February 19, 2020, based on consultations with prioritized stakeholders to assess the potential social risks and impacts associated with the Project. The Borrower has also prepared an advanced draft of the Stakeholder Engagement

Plan (SEP) identifying project stakeholders and outlining strategies for consultation and information disclosure, as well as describing a project-level Grievance Redress Mechanism (GRM). The draft SEP was also disclosed on February 19, 2020. Updated versions of the SA and SEP, incorporating the decisions taken during project appraisal and negotiations will be disclosed no later than three months after project effectiveness. Results from preliminary consultations with IP leaders and representatives have also informed the preparation of a draft Indigenous Peoples Planning Framework (IPPF), which identifies broad potential risks and impacts and provides guidelines for culturally appropriate consultations and will inform the preparation of an Indigenous Peoples Plan (IPP) during project implementation to develop specific activities in a participatory way to ensure the inclusion of IPs as equal project beneficiaries. The draft IPPF was disclosed on MOF's website on February 28, 2020 and an updated version will be disclosed no later than three months after effectiveness. The Borrower will prepare a Labor Management Procedures no later than three months after the Project's effectiveness date. This will include occupational health and safety measures, outline how the Project will manage different kinds of project workers, and describe a GRM accessible to project workers.

69. **Financing for the implementation of measures under the environmental and social (E&S) instruments has been included as part of Project design.** The PCU will be responsible for overall project management, including environmental and social aspects, and will contract relevant experts to guide on ESF related issues by the Project's effectiveness date. On environmental, health and safety (EHS) capacity, given that the Project environmental risk is expected to be low, and considering generally strong national systems, there will only be a need for an intermittent EHS specialist on the Project. With respect to social management capacity, the Project will have a social focal point and contract a specialist as needed to support implementation, conduct consultations, and monitor risk mitigation mechanisms identified under the Project's social instruments. The Borrower will submit to the Bank regular monitoring reports on the environmental, social, health and safety (ESHS) performance of the Project, including but not limited to the implementation of the Environmental and Social Commitment Plan (ESCP), status of preparation and implementation of E&S documents required under the ESCP, stakeholder engagement activities and the functioning of the grievance mechanisms.

70. **Gender.** The Project includes actions to address gaps between men and women in access to opportunities in the labor market and certain services, as described below. Subcomponent 1.1 provides the development and application of gender budgeting methodologies to assess the gender incidence of public spending and identify opportunities to align resources with the Government's gender policies. Subcomponents 2.2. and 3.2. include a gender lens in the management of tax and customs services by collecting and analyzing sex-disaggregated data to monitor and address barriers faced by women and vulnerable groups with the objective of improving their access to quality services. Subcomponent 4.1 incorporates actions to reduce gender gaps in women's access to employment opportunities in MOF and public financial management functions, a key gender gap in Costa Rica,[16] through strengthened human resource management. The Project includes actions to ensure that gender equality principles will be applied throughout career management and the screening process for staff recruitment. The Project will analyze the most recent information provided by the Human Resource Management Assessment of MOF and the central Government, to determine gender gaps in employment among professional-grade staff. In line with this analysis, the Project aims to increase women's representation in staff by conducting targeted outreach to attract female candidates to apply, for example by organizing events at universities, explicitly encouraging women to apply in vacancy postings, and bringing in students as interns to

[16] *Costa Rica Country Gender Scorecard*, World Bank, October 2019.

familiarize them with the organization. MOF will undertake regular staff surveys that include questions on the working environment, the specific challenges affecting women, and areas of improvement.

71. **Citizen Engagement.** The Project incorporates multiple citizen engagement mechanisms in the Results Framework, the ESCP, and the SEP. Implementation and monitoring of citizen engagement activities under the Project, will be based on the SEP and other environmental and social management instruments. MOF conducted broad consultations with key stakeholders including potential beneficiaries and affected parties, parties that could influence Project outcomes, vulnerable groups, and institutional stakeholders (both internal and external) during project preparation. The Project will carry out beneficiary satisfaction surveys at launch, during implementation, and upon completion of key project activities. The results of beneficiary surveys will be reviewed by MOF management and the Project Steering Committee. MOF will publish information on follow-up actions taken in response to the surveys. The SEP provides various opportunities by affected stakeholders and others to voice their opinions and views on the Project. Consultation with national and local level indigenous representative organizations and indigenous community members were held during project preparation. The results are documented in the IPPF prepared by the Borrower. The OM will include a specific section with further details on citizen engagement activities. In addition, two project indicators are collecting and analyzing sex-disaggregated data to monitor, and address barriers faced by women and vulnerable groups with the objective of improving their access to quality services.

V. GRIEVANCE REDRESS SERVICES

72. **Communities and individuals who believe that they are adversely affected by a World Bank (WB) supported project may submit complaints to existing project-level grievance redress mechanisms or the WB's Grievance Redress Service (GRS).** The GRS ensures that complaints received are promptly reviewed in order to address project-related concerns. Project affected communities and individuals may submit their complaint to the WB's independent Inspection Panel which determines whether harm occurred, or could occur, as a result of WB non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank's corporate GRS, please visit http://www.worldbank.org/en/projects-operations/products-and-services/grievance-redress-service. For information on how to submit complaints to the World Bank Inspection Panel, please visit www.inspectionpanel.org.

VI. KEY RISKS

73. **The overall risk is rated High.**

74. **Political and Governance (High).** This risk is high considering the typically long approval process of internationally financed projects in the country. The Government is in proactive and continuous dialogue with stakeholders to secure buy-in for the modernization of the MOF. The Project is critical for macro-fiscal stabilization and therefore critical for Costa Rica's successful accession to the OECD, a policy agenda that enjoys broad consensus. Stakeholder engagement in the preparation and implementation of the medium-term fiscal-management strategy will help mobilize support for the reform agenda and legislative measures as necessary. The Project supports the PCF, which can be perceived as financing activities of a police force. PCF´s mission is to protect the country's tax interests. It is responsible for the prevention and investigation of potential customs and tax crimes, without using force or arms. This Project will only finance information technology tools for the PCF and training on the use of these tools.

75. **Technical design (High).** Technical design risks are high because of the number of IT systems that the Project supports – encompassing PFM, human resources management, tax and customs administration – and the proposed system integration. IT solutions account for 67 percent of the project cost. The operation of these systems requires functional integration with systems managed by other government agencies. MOF will mitigate this risk through the design of a comprehensive Enterprise Architecture that will provide a framework for the design of individual solutions and how they interact. The MOF implementation team will be led by a director of ICT with strong technical skills in systems integration and comprise of technical staff with adequate experience. The Project will complement these staff with ICT advisors to assist in system design, contract management and project implementation.

76. **Stakeholders (High).** Stakeholder risks are high due to the expected resistance to change and close coordination required between MOF departments that have formerly operated in silos. MOF will strengthen coordination across directorates through the Project’s Steering Committee. The Project will finance change management activities that will raise awareness, engage internal and external stakeholders and provide training for managers and technical staff. Reforms in human resource management practices within MOF are expected to help align incentives with the new working practices and instill a stronger client orientation.

77. **Institutional capacity for implementation and sustainability (High).** While the technical capacity and motivation of counterparts is high and MOF leadership has implemented challenging fiscal reforms in recent years, implementing a project of this complexity in terms of the breadth and depth poses a significant challenge. Furthermore, MOF has limited experience managing projects financed by multilateral organizations and the staff are not familiar with Bank procedures and requirements. The Project will require substantial implementation support. Implementation arrangements have been kept simple, with a single implementing agency. A well-staffed Project Coordination Unit will assist with project management. The MOF Directorates responsible for implementation of project activities will be supported by full-time advisors on technical matters to help manage consultancy inputs. The World Bank will also conduct frequent support missions to ensure close monitoring of project implementation and will mobilize the technical skills needed to cover the range of project activities.

VII. RESULTS FRAMEWORK AND MONITORING

Results Framework

COUNTRY: Costa Rica
Costa Rica Fiscal Management Improvement Project

Project Development Objectives(s)

The Project Development Objective (PDO) is to improve efficiency, effectiveness and client orientation of tax and customs administration, and public expenditure management.

Project Development Objective Indicators

Indicator Name	DLI	Baseline	End Target
Improved Efficiency			
Reduction of operating costs of the tax and customs administration relative to revenue (Percentage)		1.77	1.67
Reduction in the time to produce consolidated financial statements (Days)		30.00	7.00
Improved Effectiveness			
Reduction in evasion of Value Added Tax as percent of GDP (Percentage)		2.36	1.50
Reduction in evasion of Corporate Income Tax as a percent of GDP (Percentage)		5.86	3.72
Share of the General Government budget executed directly through the new IFMIS (Percentage)		0.00	100.00
Improved client orientation			

Indicator Name	DLI	Baseline	End Target
Reduction in the time taken to pay Value Added Tax (Hours)		74.00	24.00
Reduction in the time taken for customs clearance (Hours)		72.00	36.00

Intermediate Results Indicators by Components

Indicator Name	DLI	Baseline	End Target
Strengthening public expenditure management			
Proportion of institutions from the national budget that have undertaken evidence-based methodologies for improving expenditure effectiveness (Percentage)		16.00	100.00
Institutions executing budget through IFMIS (Number)		23.00	73.00
Share of institutions using IFMIS to generate consolidated financial statement complying with International Public Sector Accounting Standards (IPSAS) (Percentage)		10.00	100.00
Electronic payments made to beneficiaries through TSA (Percentage)		85.00	100.00
Integrated debt management system (Text)		4 different systems of internal and external debt are operating without integration	Integrated debt management system inter-operable with IFMIS
Reduction in time for generation of debt statistics (Days)		45.00	7.00
Enhancing efficiency and client orientation of tax administration			
Increase in Taxpayers that are satisfied with tax services (Text)		No perception satisfaction measured	Increase baseline by 20%
Share of calls attended by the call center (Percentage)		25.00	90.00
Taxpayer services available on mobile applications (Percentage)		0.00	25.00
Proportion of tax audits that generate tax revenues (Percentage)		66.00	75.00

Indicator Name	DLI	Baseline	End Target
Enhancing customs controls and services			
Traders that are satisfied with customs services (Text)		No perception satisfaction measured	Increase baseline by 20%
Percentage of inspections carried out by Customs (Percentage)		10.00	6.00
Use of advance declarations (Percentage)		13.00	30.00
Proportion of customs audits that generate tax revenues (Percentage)		25.00	70.00
Strengthening the technological, institutional and operational environment			
Interoperability of MOF and other external systems (Number)		0.00	20.00
Availability of Information Management Systems (Percentage)		95.00	99.90
Reduction of staff payments overpaid (Amount(USD))		10,000,000.00	5,000,000.00

Monitoring & Evaluation Plan: PDO Indicators

Indicator Name	Definition/Description	Frequency	Datasource	Methodology for Data Collection	Responsibility for Data Collection
Reduction of operating costs of the tax and customs administration relative to revenue	Current tax and customs budget of MOF (Colones) in period N / total revenues in period N (Colones)	Annual	Budget Law and revenues report	The tax and customs budget will be measured using the following budget programs: Revenue Administration (Administración de Ingresos), Tax and Customs Courts	DGH

				(Tribunales Fiscal y Aduanero), Finance Services (Servicios Hacendarios). This sum will be divided by the total revenues collected in period N. Target costs: Baseline costs – reduction of costs from economic analysis in 2026. Target revenues: baseline revenues + increased revenues from reduced evasion 2026.	
Reduction in the time to produce consolidated financial statements	This indicator measures the time reduction, in number of days, in having internally available consolidated financial statements of the central government, legislative and judicial	Annual	Internal budget reports	Financial statements information of the Central national budget: (24 institutions: 18 ministries, plus Legislative, Judicial, Ombudsman Office, and Comptroller's Office)	DGC (Accounting)
Reduction in evasion of Value Added Tax as percent of GDP	This indicator measures non-compliance with the Value Added Tax (VAT).	Annual	MOF study	The methodology consists in estimating a collection potential, using sources such as the National Household	DGH

				Survey and the National Accounts of the Central Bank of Costa Rica. This potential is contrasted with what is actually collected in accordance with data from the Ministry of Finance. New VAT came into force in July 2019 after the approval of the Law number 9635 and therefore, the team used a proxy calculation related to General Sales Tax.	
Reduction in the time taken to pay Value Added Tax	The indicator measures the time taken to prepare, file and pay value added or sales tax.	Annual	WBG: Doing Business Report (baseline DB 2020)	Preparation time includes the time to collect all information necessary to compute the tax payable and to calculate the amount payable. Filing time includes the time to complete all necessary tax return forms and file the relevant returns at the tax authority. Payment time considers the hours needed to make the payment	MOF

				online or in person. Where taxes and contributions are paid in person, the time includes delays while waiting	
Reduction in evasion of Corporate Income Tax as a percent of GDP	This indicator measures non-compliance with Income Tax (ISR).	Annual	MOF study	The methodology consists in estimating a collection potential, using sources such as the National Household Survey and the National Accounts of the Central Bank of Costa Rica. This potential is contrasted with what is actually collected in accordance with data from the Ministry of Finance.	DGH
Reduction in the time taken for customs clearance	Time for clearance and inspections required by customs authorities	Annual	WBG: Doing Business Report (baseline DB 2020)	Time for clearance and inspections required by customs authorities. This is one of the components included in the Details – Trading across Borders in Costa Rica – Components of Border Compliance	MOF

Share of the General Government budget executed directly through the new IFMIS	Percentage of budget that is directly executed including payment to final beneficiary through the Integrated Financial Management Information System (IFMIS)	Annual	Budget Expenditure Reports	The budget directly executed will be measured as the sum of federal budget executed by the central government, legislative and judicial	DGP

Monitoring & Evaluation Plan: Intermediate Results Indicators

Indicator Name	Definition/Description	Frequency	Datasource	Methodology for Data Collection	Responsibility for Data Collection
Proportion of institutions from the national budget that have undertaken evidence-based methodologies for improving expenditure effectiveness	Proportion of institutions from the national budget (Central government, Legislative, Judicial, Ombudsman Office, and Comptroller's Office) that undertake evidence-based methodologies for improving expenditure effectiveness	Annual	Project reports	Institutions from the national budget undertaking evidence-based methodologies for improving expenditure effectiveness /total number of institutions - national budget: Central government (24 institutions: 18 ministries, plus Legislative, Judicial, Ombudsman Office, and Comptroller's Office)	MOF

Institutions executing budget through IFMIS	Number of institutions that are executing budget through IFMIS	Annual	Project reports	23 institutions: 18 ministries, Legislative, Judicial and Defensoría, target 73%-descentralized	DGP
Share of institutions using IFMIS to generate consolidated financial statement complying with International Public Sector Accounting Standards (IPSAS)	This indicator measures institutions that are generating consolidated financial statements complying with International Public Sector Accounting Standards (IPSAS)	Annual	Project reports	Number of institutions using IFMIS to generate consolidated financial statements complying with IPSAS/Public sector institutions (200 institutions)	DGC
Electronic payments made to beneficiaries through TSA	Percentage of payments (value) registered using TSA	Monthly	Treasury reports	Payments using TSA/total payments	DGT
Integrated debt management system	This indicator measures the integration of the 4 debt management systems inter-operable with IFMIS, so that generate consolidated internal and external debt reports	Semi-annual	Project reports	integration of 4 systems	DGCP
Reduction in time for generation of debt statistics	This indicator measures the time reduction, in number of days, in having consolidated statistics of debt	Semi-annual	Project reports	Baseline-time reduction	DGCP
Increase in Taxpayers that are satisfied with tax services	This indicator measures the perception by taxpayers on the timeliness, effectiveness	Annual	Satisfaction survey to be carried out	A survey will be carried out as part of project activities during the	MOF

	and client orientation of tax services		by MOF	first year of the project where a baseline will be determined. MOF will define the channel to implement the satisfaction survey. The survey should include at least three separate questions on each of the dimensions: timeliness, clarity of procedures, and client orientation. Information will be disaggregated by sex and socio-economic level.	
Share of calls attended by the call center	This indicator measures the level of citizen attention by phone	Semi-annual	Project reports	Numbers of calls attended/total number of calls	DTIC
Taxpayer services available on mobile applications	Number of services made available to taxpayers through mobile apps	Semi-annual	Project reports	The number of services will be calculated directly from the apps	DTIC
Proportion of tax audits that generate tax revenues	This indicator measures the impact of audits on revenue collection	Annual	Reports from DGI	A/Bx100. A= Number of audits that generate revenues/ B= Number of audits.	DGI

Traders that are satisfied with customs services	This indicator measures the perception by traders on the timeliness, effectiveness and client orientation	Annual	Satisfaction survey to be carried out by MOF	A survey will be deployed as part of project activities during the first year of the project where a baseline will be determined. MOF will define the channel to implement the satisfaction survey. The survey should include at least three separate questions on each of the dimensions: timeliness, clarity of procedures, and client orientation. Informatio n will be disaggregated by sex and socio-economic level.	MOF
Percentage of inspections carried out by Customs	This indicator measures the level of control that Customs exerts on the entry of goods through the physical review of import declarations	Semi-annual	Reports from DGA	A / Bx100.A = Number of import declarations assigned to the red channel; B = total import declarations (in the period).	DGA
Use of advance declarations	This indicator measures the level of facility granted by Customs and the willingness of operators to comply with	Semi-annual	Reports from DGA	A / Bx100. A = Number of advance import declarations processed in the period; B = total	DGA

	the requirements required for the application of the advance declaration			number of import declarations processed in the period.	
Proportion of customs audits that generate tax revenues	This indicator measures the impact of audits on revenue collection	Annual	Reports from DGA	A/Bx100. A= Number of audits that generate revenues/ B= Number of audits.	DGA
Interoperability of MOF and other external systems	This indicator measures the number of systems in the MOF that are connected via the interoperability bus using web services or other similar and appropriate mechanisms that permit these systems to share data within the MOF and potentially externally.	Annual	Project reports	Number of systems that have a documented external programming interface, e.g. web services, that are connected to the interoperability bus and are actively sending and receiving information with other systems within the MOF or externally.	DTIC
Availability of Information Management Systems	This indicator measures the level of stability of PFM, Tax and Customs information systems, as the lowest daily information systems' up-time measured during the last month.	Daily	Project reports	Uptime is a metric that represents the percentage of time that hardware and IT system together are successfully operational. It refers to when an information system is working, versus downtime,	DTIC

				which refers to when an information system is not working.	
Reduction of staff payments overpaid	This indicator measures the amount of payments paid by mistake on payroll incurred as a result of delay of information regarding changes on employee´s appointments (e.g. layoffs)	Semi-annual	Internal HR reports	Annual amount overpaid to personnel	DRH

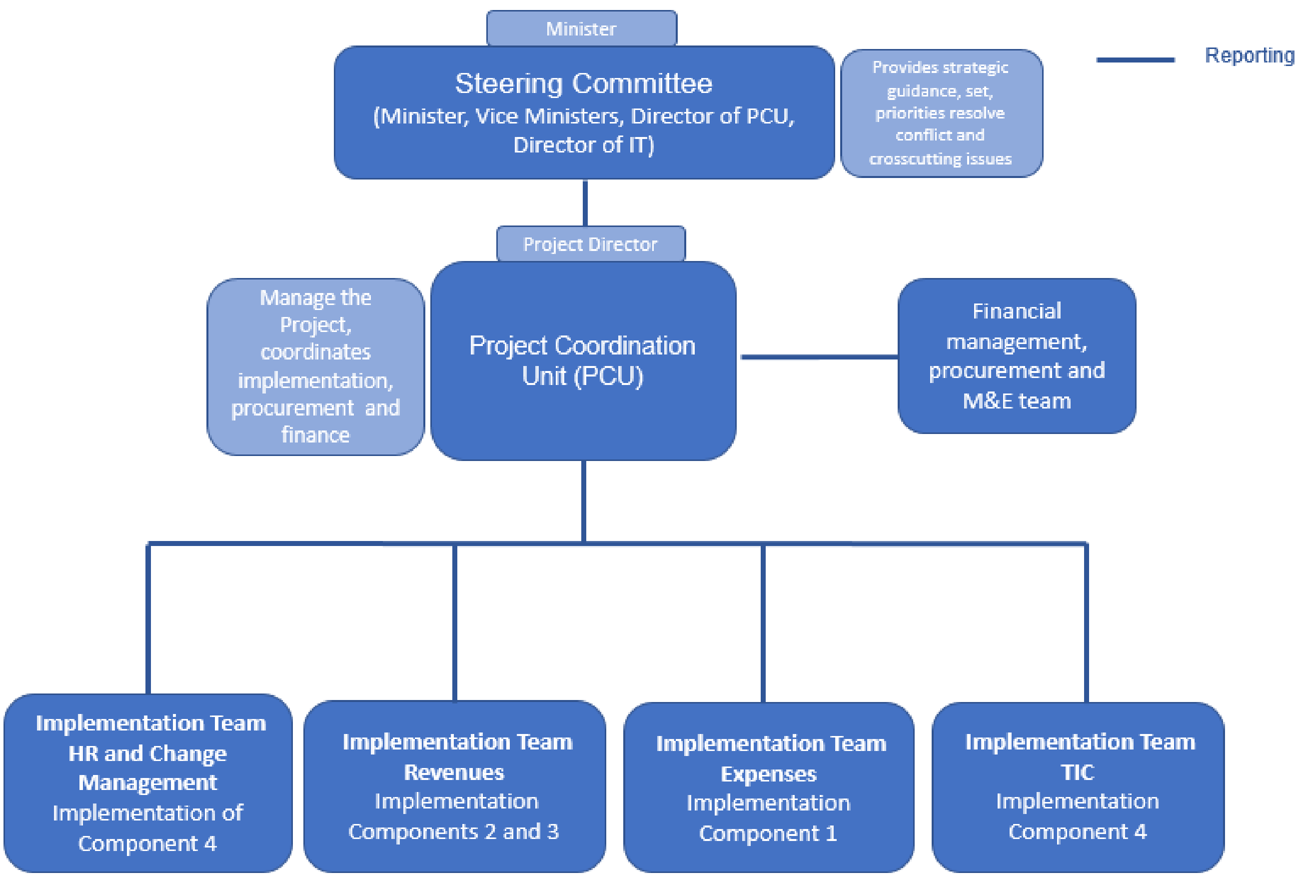
ANNEX 1: Implementation Arrangements and Support Plan

Republic of Costa Rica
Fiscal Management Improvement Project

Implementation Arrangements

1. **The MOF will be the implementing entity for the Project**. The organizational structure of the Project is presented in Figure 1.1,

Figure 1.1: Project Implementation Arrangements



2. **Details on the institutional and implementation arrangements for the proposed Project, including roles and responsibilities, will be included in the Operations Manual (OM).** The OM will include: a detailed description of the project activities and institutional arrangements for the Project; the Project's administrative, financial management (accounting, auditing, reporting), procurement and disbursement procedures; monitoring indicators for the Project; institutional and administrative mechanisms established to ensure institutional coordination; and the functions, responsibilities and composition of the Steering Committee. The OM will be adopted by MOF prior to Loan effectiveness.

3. **The Government will prepare a Fiscal Management Strategy for the period covered by the project.** As part of the MOF process to define its enterprise architecture strategy and in accordance with the criteria established in the Operational Manual, the Fiscal Management Strategy will encompass reforms in public financial management, tax administration and customs administration and the development of supporting information systems. The Fiscal Management Strategy will lay out: reform objectives, expected outcomes, outputs and activities; an implementation plan with key milestones; intended alignment with international standards; measures to strengthen the use of data-informed, evidence-based decision-making; measures to ensure a timely, smooth transition between current and future business practices and information systems; roles and contributions of external partners; and decision-making, governance and reporting arrangements for the reform program. The Fiscal Management Strategy will be prepared through a process that engages the key internal and external stakeholders.

4. **A Steering Committee (SC) will set the Project's strategic direction.** The SC will be chaired by the Minister of Finance and will include the Vice Minister of Revenues, the Vice Minister of Expenses, the Project Director, and the Director of Technology. The SC, to be established before effectiveness, will be responsible for the overall policy coordination and policy guidelines for MOF reform, provide strategic guidance, set priorities, resolve conflicts and ensure inter-ministerial collaboration where needed and monitor progress of the Project. The SC will consider proposed adjustments to the Project's activities, results framework or implementation arrangements and clear any associated requests to be submitted to the World Bank's approval.

5. **A Project Coordination Unit (PCU) will be established within the MOF.** The PCU will be headed by a Project Director. The Project Director will report directly to the Minister of Finance and serve as a member of the SC. The PCU will be responsible for: implementing, monitoring and supervising the carrying out of the Project (including its financial, procurement and safeguards aspects). It will be responsible for the day-to-day management of the project; management of the project's human and financial resources; and coordination with line directorates and with the World Bank. The PCU will be staffed with specialists on procurement, contract management, financial management, monitoring and evaluation, communications, environmental and social aspects, and administrative staff, all in numbers and with terms of reference, and qualifications and experience, acceptable to the Bank. The remuneration of externally hired specialists will be based on the Government-approved pay scales for contractual staff to allow the MOF to take them on board with its own budget resources, subject to satisfactory performance.

6. **Four teams led by the PCU director will lead project implementation.** Each team will have the support of a full-time senior technical advisor, who will provide technical advice and help oversee the work of short-term consultants and engage in on-the-job and formal training activities as required. Each team will coordinate with existing revenues and financial administration committees composed of the different directors from MOF.[17]

Financial Management

7. **The PCU will be responsible for financial management tasks.** The PCU will be staffed with a seasoned Financial Management Specialist, an Accountant, and a Treasury Analyst for carrying out financial management tasks under the Project which include: (a) budget formulation, execution, and monitoring; (b) cash flow management (including processing payments and submitting loan withdrawal applications to the WB); (c) maintenance of accounting records (including the administration and maintenance of an inventory of project

[17] *Comisión de Coordinación de la Administración Financiera (CCAF),* Commission for Coordination of Financial Administration established by decree *34.534; Comisión de Coordinación del Área de Ingresos (CCAI),* Commission for Coordination in the Area of Revenues, established 39.696.

assets); (d) preparation of semi-annual reports and annual financial statements; (e) administration of underlying information systems; and (f) arranging for execution of external audit.

8. **Planning and budgeting.** The PCU will be responsible for preparing and monitoring the annual operating plan and budget. The Project's annual operational plan will be the main input for budget formulation. The project's budget will be integrated into the MOF's annual budget. Budget formulation and execution will follow MOF procedures and requirements. Its monitoring procedures will be established in the OM.

9. **Accounting.** Project accounting will be managed through the integrated financial management system (country system). The integrated system includes budgeting, procurement, treasury, and accounting modules. Project accounting is on accrual basis, in accordance with the Government's accounting policies. However, the Project's financial statements required by the WB will be prepared on cash basis. Supplementary records will be maintained in EXCEL to be used to prepare the project financial statements.

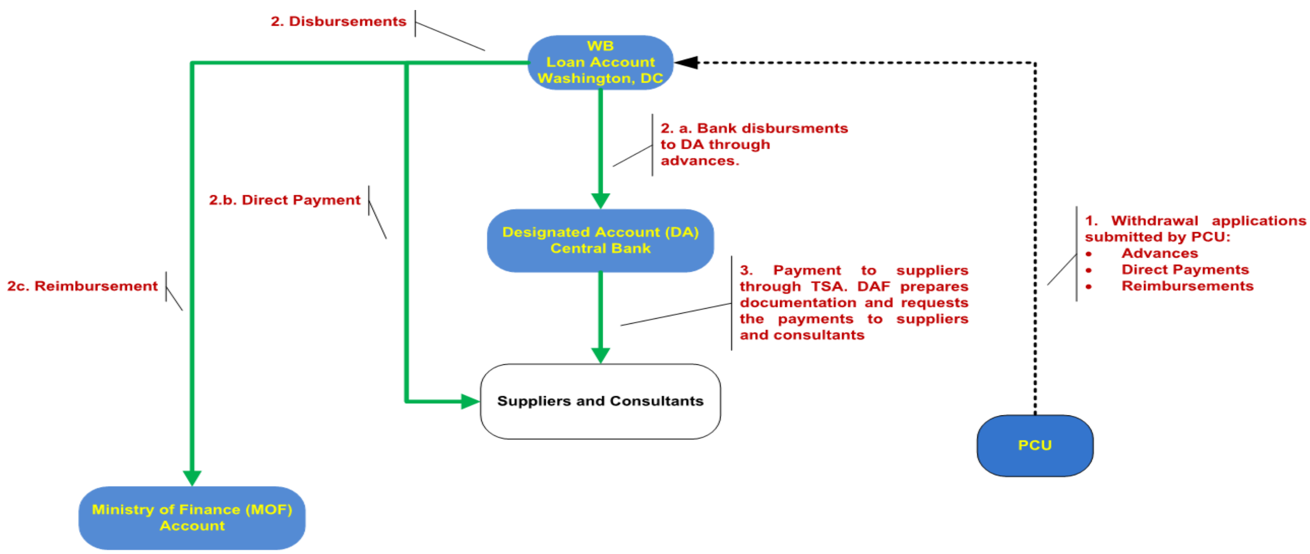
10. **Internal Controls.** MOF has adequate internal control and procedures. The main FM normative regulatory framework consists of the country's Financial Management Law (Law 8131) and Internal Control Law (Law 8292) and other regulations issued by the General Comptroller of the Republic which establish sound FM policies and procedures applicable to project transactions. FM arrangements specific to the Project that are not contemplated in the cited regulations will be documented in the OM. The OM will include a FM section detailing: governance, roles and responsibilities of the FM staff at the PCU; internal controls for the Project; and content and formats of the Interim Financial Report (IFRs), annual financial reports; and auditing arrangements. The PCU will request that MOF's Internal Audit Unit and the General Comptroller of the Republic include the Project in their annual work plans whenever possible

11. **Financial reporting.** The PCU's Financial Management Specialist will prepare and submit semi-annual IFRs within the 45 days after the end of each semester. The IFRs will contain at least: a statement of sources and uses of funds (with expenditures classified by category of expenditures) and cash balance; a statement of budget execution per component and subcomponent; and a reconciliation of the Designated Account.

12. **External Audit.** The PCU's financial management specialist will prepare project special purpose financial statements on an annual basis. The Project's annual financial statements will be audited by a private firm under the terms and conditions acceptable to the WB. The Project's annual audit reports will be submitted to the WB not later than six months after the end of each audited period. Audit costs will be financed by the Project. Audited financial statements will be disclosed on the MOF website and the WB will make them available to the public in accordance with the WB Policy on Access to Information.

13. **Designated Account.** The Designated Account (DA) will be opened at the Central Bank of Costa Rica in United States Dollars. For this Project, "the Treasury Single Account" will apply using the Digital Treasury System, whereby MOF will have its sub-account in US Dollars. The following disbursement methods may be used to withdraw funds from the loan: reimbursement; advance; and direct payment. Under the advance method and to facilitate implementation, the project will have access to the DA to be used exclusively for deposits and withdrawals of loan proceeds for eligible expenditures. As needed, the MOF will make payments of accrued expenditures out from this account in both US Dollars or in local currency. Funds deposited into the DA as advances, will follow Bank's disbursement policies and procedures as described in the Disbursement and Financial Information Letter (DFIL) and Disbursement Guidelines. The flow of funds is illustrated in Figure 1.2. The Designated Account (request of advances; direct payment, reimbursement, and documentation of expenditures) will be managed by the PCU.

Figure 1.2: Flow of Funds



14. **Payment process.** Payments for the Project will be made to suppliers/contractors through the Digital Treasury System, following standard procedures established in the OM for the approval of applications to be submitted to the National Treasury. Payments to suppliers and consultants are expected to be made in less than 30 days once the supported documentation is approved by the treasure analyst. This procedure will be included in the OM.

15. **Project Documentation.** MOF will retain all records (contracts, orders, invoices, bills, receipts and other documents) evidencing expenditures under the Project until at least the later of: one year after the WB has accepted the audited Financial Statements covering the period during which the last withdrawal from the Loan Account was made; and two years after the Closing Date. The MOF will provide access to the WB to examine such records.

16. **Financial Management Implementation Support Plan**. Project supervision will review the implementation of FM arrangements and performance, identify corrective actions as necessary, and monitor fiduciary risks. Supervision missions will take place on an annual basis and will include: desk review of project IFRs and audit reports, following-up on any issues raised by auditors, as appropriate; participation in project supervisions at least once a year, to look into the operation of the control systems and arrangements described in this assessment; and updating the FM rating in the Financial Management Implementation Support and Supervision Report, as needed. In addition, during the first year of execution, the Project will be closely monitored (biannually) to verify that the FM arrangements are working as intended and to make changes if needed.

Procurement Arrangements

17. **Procurement will be carried out in accordance with "World Bank Procurement Regulations for IPF Borrowers" (July 2016, revised November 2017 and August 2018) ("Procurement Regulations").** MOF has prepared a Project Procurement Strategy for Development (PPSD) describing how procurement in this operation will support the PDO and deliver value for money following a risk-based approach. The PPSD provides adequate market analysis for the selection methods detailed in the Procurement Plan. Mandatory Procurement Prior Review

Thresholds detailed in Annex I of the WB's Procurement Regulations are observed. All procurement procedures, including roles and responsibilities of different units, will be defined in the Project Operation Manual.

18. **Procurement Plan.** In accordance with paragraph 5.9 of the Procurement Regulations, the WB's Systematic Tracking and Exchanges in Procurement (STEP) system will be used to prepare, clear and update Procurement Plans and conduct all procurement transactions for the Project. The Procurement Plan has been prepared by the Borrower in accordance with the results provided by the PPSD and agreed with the WB. The summary of the PPSD includes the recommended procurement approach for higher risk/value contracts.

19. **Civil Works.** No works are foreseen to be funded under the Project.

20. **Goods.** Goods to be financed under the Project will include equipment and telecom infrastructure, shared digital platforms, laboratory and camera equipment, equipment for cybersecurity, non-intrusive customs inspections equipment, among others.

Table 1.1: Summary of PPSD Recommended Procurement Approach for Higher Value Contracts

Description	Estimated cost	Review	Market approach	Procurement method
Goods				
Customs Equipment	$2 500 000	Prior	International	Request for Bids
Scanners	$25 000 000	Prior	International	Request for Bids
Data Center Equipment and Telecom	$2 500 000	Prior	International	Request for Bids
CyberSecurity Office Equipment	$1 100 000	Prior	International	Request for Bids
Non-Consulting Services				
IFMIS development	$19 000 000	Prior	International	Request for Bids
eProcurement Improvements	$1 640 000	Prior	International	Request for Bids
Tax Administration System	$16 500 000	Prior	International	Request for Bids
Customs Administration System	$18 000 000	Prior	International	Request for Bids
Cloud Services	$3 000 000	Prior	International	Request for Bids
HRMIS/Payroll System	$3 000 000	Prior	International	Request for Bids
Develop Shared Digital Platforms	$2 500 000	Prior	International	Request for Bids
Digital Document Management System	$3 000 000	Prior	International	Request for Bids
Consulting Services				
Trade Facilitation	$2 120 000	Prior	International	QCBS
Improving Performance Management	$1 520 000	Prior	International	QCBS
Change Management	$3 120 000	Prior	International	QCBS
Communications	$1 620 000	Prior	International	QCBS

21. **Non-consulting services.** The Project will finance services such as such as financial management, human resource management, tax and custom administration information systems, cloud services, among others.

22. **Selection of consulting services.** Consulting services to be financed under the Project will include technical advisory services for PFM, tax and customs administration reform, change management, training, information technology project management, among others.

23. **Procurement Bidding Documents.** Standard Procurement Documents (SPDs) shall be used for all contracts subject to international competitive procurement and those contracts as specified in the Procurement Plan tables in STEP. For bidding processes with national market approach, procedures for bidding and request of quotations documents were agreed with the WB at negotiation.

24. **Operating Costs.** Operating costs means the incremental expenses incurred by the Borrower on account of Project implementation, supervision, monitoring and evaluation, which may include office supplies, rental expenses, reasonable commercial banking charges and fees, communication and insurance costs, operation and maintenance of office equipment, office maintenance, utilities, document duplication/printing, travel cost and per diem of staff assigned to carry out responsibilities under the Project (but excluding consulting services), none of which would have been incurred in the absence of the Project.

25. **Capacity assessment.** The WB performed a capacity assessment to evaluate the adequacy of procurement arrangements of MOF. The assessment focused on how MOF will be organized to procure using the loan's funds, in terms of staffing structure, procurement record system, internal controls, roles and responsibilities. The key issues and procurement risks for project implementation are: limited experience of MOF staff in the implementation of Bank-financed projects; lack of personnel in the current structure of MOF to implement the project scope; and poor coordination between technical units and procurement.

26. **Procurement mitigation measures.** MOF will establish a PCU with appropriate staff in terms of qualifications and quantity. The OM will define appropriate roles and responsibilities of the technical and procurement specialists. MOF will ensure that the Project has the appropriate knowledge and skills from a technical and procurement perspective to procure and manage all processes planned as part of the project scope.

27. **Use of national e-procurement system.** The Project will advertise through the Integrated System for Public Purchases (*Sistema Integrado de Compras Publicas,* SICOP) system all procurement processes using the module developed for projects funded by international organization. These advertisements will be additional to those in the United Nations Development Business (UNDB) through STEP and any other media as considered appropriate by the Project and in accordance to the PPSD. The WB will assess the SICOP to determine its use in WB-funded operations with all its functionalities.

28. **Frequency of Procurement Supervision.** In addition to prior review supervisions to be carried out by the WB, the WB will implement annual supervision missions reviewing 20 percent of the post review processes.

Implementation Support Plan

29. **Given the depth and breadth of the reform program and the complexity of the information technology solutions foreseen, the Project will require enhanced implementation support**. The WB's task team will includes technical expertise in the areas of public policy, PFM, tax administration, customs administration and trade facilitation, information technology, and communications. The team will maintain continuous communication with the MOF and will conduct implementation support missions at least three times a year during the first two years of implementation. The implementation support team will include social and environmental specialists to assist MOF in the implementation of environmental and social safeguards, including periodic review of the safeguards instruments to ensure that they continue to serve their intended purpose. Additional specialists – WB staff or external consultants--will mobilized as needed to support work on specific technical issues.

Table 1.2: Annual Implementation Support Requirement (First Two Years)

Skills required	Team members	# staff weeks	# of trips
Task management	Sr. Public Sector Specialist (TTL)	15	6
Planning and Policy Analysis	Sr. Public Sector Specialist	8	3
Public Financial Management	Sr. Public Sector Specialist	8	3
Tax Administration	STC Consultant	8	3
Customs and Trade Facilitation	Sr. Private Sector Specialist (Co-TTL)	10	3
Information Technology	Sr. Public Sector Specialist	6	3
Information Technology	STC Consultant	6	3
Financial management	FM Specialist	2	1
Procurement	Sr. Procurement Specialist	4	2
ESF, environment	Sr. Environmental Specialist	1	1
ESF, social	Social Specialist	2	2
Monitoring & evaluation	Operations Analyst	6	2
Communications	Sr. Communications Specialist	2	2

ANNEX 2: Economic and Financial Analysis

Republic of Costa Rica
Fiscal Management Improvement Project

1. **Economic Benefits.** The economic benefits from the Project arise from addressing three main problems: first, unsustainable, poor quality spending, owing to shortcomings in expenditure management, control of payroll and debt service systems that limit the ability to align resources with policy goals and create inefficiencies in spending; second, difficulties in raising tax revenues due to poor voluntary compliance and high rates of tax evasion; and third inefficiencies in the business environment, owing to high transaction costs for importers and exporters and time-consuming procedures for voluntary tax compliance, especially for VAT. The cost benefit analysis is based on estimations of six quantifiable benefit streams.

2. **Savings from strengthened expenditure controls**. Savings from greater expenditure controls leading to annual government expenditure efficiency improvements are estimated to be 1 percent of spending annually from year five. The spending savings are expected to arise in particular from the greater controls in payroll. At over 20 percent of GDP, the Government of Costa Rica's payroll expenditures as a share of GDP are among the highest in the LAC region, and account for approximately 40 percent of public expenditures. Costa Rica's public-sector wage bill as a share of GDP is higher than that of most OECD countries, even though its public employment share is among the lowest. Savings arise from efficiency gains through spending reviews, greater expenditure control across all categories of expenditure, additional investments in the HRMIS and payroll components under the Project and ICT infrastructure and maintenance savings from investing in modern ICT infrastructure.

3. **Reduced tax evasion**. Increases in revenues from reduced tax evasion are estimated to be 0.5 percent of GDP from year five of the project. The DGT estimated the cost of tax evasion and avoidance at 8.22 percent of GDP in 2013. The OECD estimated that, in 2014, one-quarter of corporations and almost one-fifth of self-employed professionals did not fill out their income taxes, and 14.4 percent and one-fifth did not file sales taxes. The OECD estimated that over 55 percent of persons who have profitable professional service activities declared zero income tax. The IMF estimated the sales tax compliance gap was 31 percent in 2016, equivalent to 1.9 percent of GDP. A conservative assumption is that the IMF's compliance cost gap can be reduced by 25 percent. The compliance gap will be reduced by the use of risk-based analysis of non-compliant tax payers, more effective tax payer audits and increased voluntary compliance.

4. **Reduced tax administration costs**. Savings are assumed to be a 5 percent reduction in year three and a further 5 percent reduction in years four and five. Tax administration savings assume a 5 percent reduction in administrative costs in the first year, and 5 percent in the next two years, after which administrative costs grow as per the base case. A 2007 estimate of the benefits of a revenue reform project suggests administrative costs could fall by 30 percent over the course of this project.[18]

5. **Reduced compliance costs for taxpayers.** Economic benefits are estimated at 1 percent of tax revenues from year five of the project. A 2007 WB analysis suggests compliance costs can be as high as 2-10 percent of tax revenues up to 2.5 percent of GDP.[19] However, Costa Rica already has a good system of online tax payments, and the country is ranked 57 out of 188 countries in terms of "Paying Taxes" in Doing Business 2019. The number of payments per year (10) is below the average for OECD high income countries (11.2) as is the time (hours per year) spent: 151 days in Costa Rica compared to 159 in OECD high income countries. Consequently, a conservative

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[18] PREM Notes *Estimating Economic Benefits for Revenue Administration Reform Projects*. PREM. World Bank, 2007
[19] Ibid

assumption is made for time savings for tax payers. The greatest potential benefits will be in reducing the time to pay VAT and to encourage greater use of simplified on-line transactions.

6. **Reduced customs compliance costs for exporters**. Economic benefits are estimated as 0.1 percent of the value of exports from year five. Estimated economic benefits from improved customs administration and lowering the clearance time for exports and imports could be between 0.1 and 0.5 percent of the value of the cargo per day.[20] A 2003 OECD study estimated that the costs of preparing clearance documentation could vary from 3.5 to 15 percent of the value of the import cargo, while Hummel (2001) estimated a day saved in shipping time is worth 0.8 percent of the value of the shipment of manufactured goods. Doing Business 2020 reports that it takes 20 hours to complete the clearance process for exports (of which 1.8 hours are spent in customs). Costa Rica is ranked 73 of 188 countries on the Doing Business 2019 for "Trading Across Borders." Both time and costs of export for exceed OECD country averages (but are below LAC averages). Overall border compliance is estimated at 20 hours and US$375 per exporter; documentary compliance is estimated at 24 hours and US$80 to export. Time savings will be generated through the streamlining and further automation of customs procedures, reductions in the number and better targeting of inspections and use of non-intrusive technologies.

7. **Reduced customs compliance costs for importers.** Economic benefits are estimated at 0.1 percent of the value of imports from year five. Doing Business 2020 reports that it takes 80 hours to complete the clearance process for imports (of which 72 hours are spent in customs); and import border compliance costs 80 hours and US$420, and documentary compliance 26 hours and US$75 to import. As for exports, time savings will be generated through the streamlining and further automation of customs procedures, reductions in the number and better targeting of inspections and use of non-intrusive technologies.

8. **Cost-Benefit Analysis**. The cost benefit analysis has been calculated over a Project life of 10 years, with a 10 percent social discount rate. The total cost of the Project is estimated to be US$156,640,000 fully financed by the loan. These costs have not been modified to remove any tax component. The economic net present value of the Project is positive at a 10 percent discount rate, with an IRR of 144 percent. Sensitivity analysis at -15 percent of benefits and +15 percent of costs does not materially affect project viability.

9. **Unquantified Benefits.** The Project will benefit all economic actors as a result of more effective PFM (expenditure and revenue) systems which can be expected to lead to improved fiscal outcomes, more efficient and effective public spending, ultimately leading to improvements in public infrastructure and services. While not directly quantifiable, the higher level economic benefits are likely to arise in terms of the greater economic growth as a result of a more stable macroeconomic outlook and reduced risk from fiscal management and management of the medium term debt sustainability and macro outlook. Other benefits which have not been quantified could include those accruing to the MOF, tax administration, and customs officials who are expected to benefit as a result of the training received and skills generated under the Project.

10. **Financial Appraisal.** There is a significant overlap in the quantifiable financial and economic benefits of the project. The Project is expected to generate additional financial revenues to the MOF in the form of increased tax revenues from a reduction in tax evasion and an increase in compliance and savings to the from tighter control over expenditures, especially payroll. Given the lower reliance on customs receipts, any additional increase in customs duties arising from the Project is assumed to be negligible. Using the financial flows based on the assumptions some the economic analysis the Project generates a positive financial rate of return of 134 percent, and a positive net present value (based on a compound interest rate of 5 percent) of US$2,538 million.

[20] Ibid

ANNEX 3: Technical Annex

Republic of Costa Rica
Fiscal Management Improvement Project

1. **This is a challenging Project owing to the number and complexity of IT systems that the Project supports, encompassing systems for PFM, human resources management, tax and customs administration, system integration and improvements in ICT infrastructure and shared digital solutions**. IT solutions account for 67 percent of project cost. This annex outlines the IT strategy behind the Project, briefly examines the state of each system, and outlines options for system development.

Information Technology Vision and Governance

2. **The National Plan for Science and Technology (2015-2021) requires public sector institutions to develop strategies for the use of ICT to facilitate interaction with citizens and move to towards a service orientation**. National Decree No. 41248 (2018) establishes a high-level commission for digital government with an advisory body for the development of public policy for digital government. The National Plan has five elements: pure digital life is the delivery of digital public services, integrated and secure and of high quality to improve the well-being of citizens; Intelligent Costa Rica is the transformation of public institutions to facilitate collaborative work, efficiency and the application of new technologies for intelligent decision-making; Business transformation 4.0 facilitates the necessary mechanisms to increase productivity and competitiveness of businesses in the context of the technology revolution social innovation through the use of new technologies to empower societal actors; and development of telecommunications infrastructure for connectivity with a focus on inclusivity and solidarity.

3. **The MOF has developed a Strategy and Vision for the reforms through a consultative process.**[21] The DTIC has led the development of the strategy based on industry best practices. It embraces the concept commonly known as service-oriented architecture similar to the Roads implementation in Estonia and the Canada Service-Oriented Architecture Strategy[22]. Each functional directorate with MOF has detailed its own strategic plan aligned with the broader MOF strategic plan and vision. The MOF Strategy identifies the following action items:

a. Increase tax compliance using technological tools and efficient work processes to combat evasion, effective implementation of VAT and comprehensive management of tax compliance risks.

b. Improve efficiency and intelligence in public spending by applying management for development results through: implementation of fiscal rules; management by results; implementing a unique public procurement system; implementing international accounting standards in companies of the Non-Financial Public Sector by 2020; and implementing and adopting of IPSAS with transients in the Public Sector 2022.

c. Reach a sustainable level of Central Government Debt and control its risks through: an appropriate management strategy for the consolidation of finances; strengthened debt management in the local stock market; implementation of a medium and long-term debt strategy of the Central Government; and diversification of the debt base of investors.

d. Modernize institutional management, by applying a process-focused model, to: improve results; foster a culture of innovation and continuous improvement of the processes oriented to the service of the

[21] *Institutional Strategic Plan 2019-2023 (Plan estratégico institucional 2019-2023)*, Ministry of Finance of Costa Rica.
[22] *Overview of Enterprise Architecture Work in 15 Countries*. Jukka Heikkiläand Katja Penttinen. Finnish Enterprise Architecture Research Project, 2016.

population; establish a culture of risk management and business continuity; and propose and implement a new organizational management model.

e. Improve technology management using innovative technologies that allow the integration and security of information for decision making, by supporting a digital transformation through modernization of technological services.

4. **At the center of MOF's vision is a mechanism that facilitates data exchange, an interoperability bus[23], that has capacity to provide content-based routing, security, protocol agnosticism, web service orchestration, workflow management, and a business rules engine to assist with workflows**. This would permit the MOF to integrate a wide variety of sources of data and systems regardless of the proprietary technologies those systems use. As Figure 3.1 illustrates, the MOF envisions not only integrating systems within its own directorates, but also being able to integrate the digital identity, the national registry, social security, elections tribunal, and the trade single window. This has potential to form a truly government-wide interoperability bus that facilities data flows and breaks down siloes. The interoperability bus handles cross-cutting concerns such as business continuity, governance, security, and high availability. It is envisioned to be run on the cloud. An enterprise architecture will be completed to thoroughly evaluate the business process architecture, the data architecture, the application architecture, and the technology architectures, to properly assess the current systems and sub-systems and what should reside where.

5. **The concepts of data exchange and digital government have been around for many years in Costa Rica, starting in 2000 in the Presidency (*Casa Presidencial)* and known as *Gobierno Digital* (Digital Government)**. *Gobierno Digital* has since been absorbed into the Ministry of ICT (MICITT). Part of the successful work of the MICITT was the creation of an interoperability bus. It is still in existence and currently being run under the auspices of the electric company. However, this bus, which is built on Oracle technologies, is starting to show its age, is costly to operate and use, and does not facilitate the use of emergent technology. Currently, the MOF pays US$900,000 a month to its provider for these services. The new Vision represents an opportunity to cut costs, increase the use of open-source software, apply newer techniques of integration, scale more easily given exponential growth in data volumes, and make data interoperability and MOF more agile.

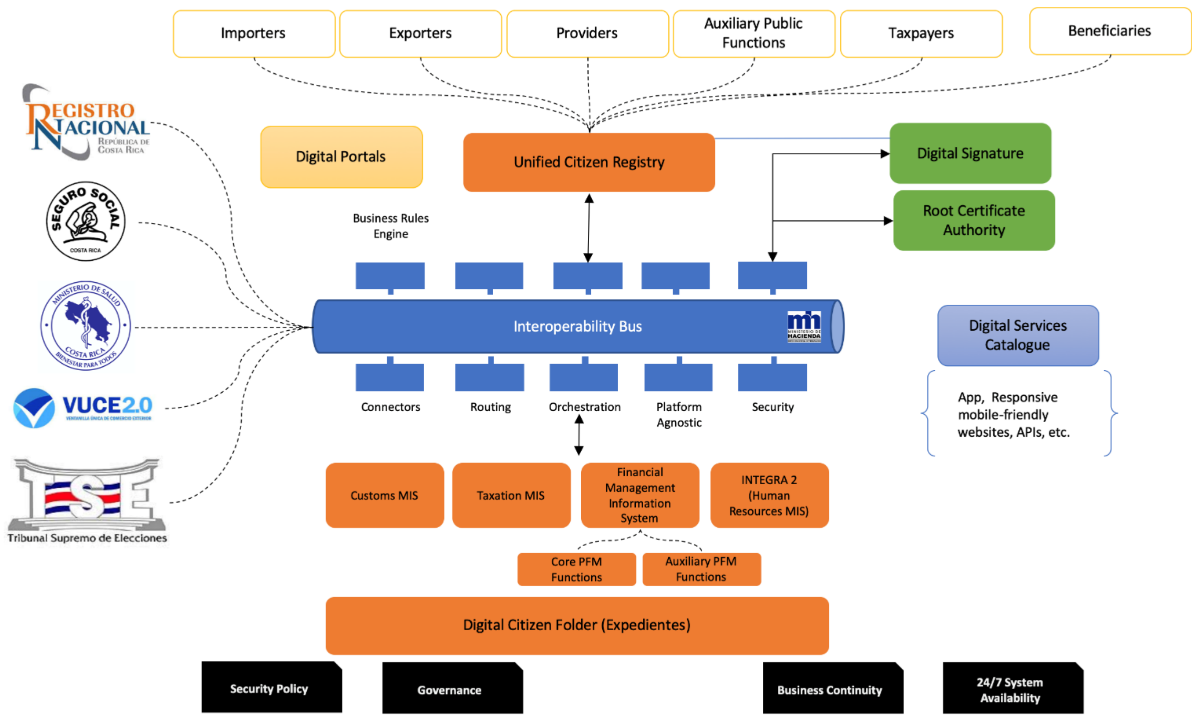
6. **DTIC has engaged the services of a consultant to develop terms of reference for the development of an Enterprise Architecture (EA) with financing from the IADB**. Given the organizational structure of the MOF and its directorate, and the fact that each directorate and its ICT systems work in siloes, it is prudent to undertake a MOF-wide look at the technology, applications, the data and the business processes that flow both within and across all MOF directorates. DTIC has expressed the need for the proposed Project to assist with the implementation of the EA and the various governance mechanisms that an EA requires. EA implementation generally includes the development of a repository and an organizational structure that will sustain the EA and ensure that all future projects are in strategic alignment.

7. **The DTIC also requires strengthening of more general ICT governance, cybersecurity implementation, compliance and policy, and project planning**. The Project seeks to: develop an IT project planning model; assist with the definition of and implementation of a software management model; establish a formal Chief Information

[23] An interoperability bus is an integration tool responsible for mediating communication and data exchange between systems, such as software applications and databases. It permits systems with disparate technologies to exchange data using data standards regardless of the technology used by the originating system.

Officer (CIO) office oriented to provide strategic information technology vision and ensure information integrity; and setup various EA-related governance mechanisms plus the EA Repository.

Figure 3.1 Digital Transformation & Modernization Based on a Service-oriented Architecture



Cybersecurity

8. **Current assessments of the state of cybersecurity within the MOF paint a bleak picture identifying security issues at the level of the technology stack, network, applications, policies and procedures, and staff practices**. DTIC has documented the number of attacks it sees on its networks and applications and is attempting to mitigate them. The Project will support the development of a Cybersecurity Office within the broader ICT governance structure that will: develop and enforce cybersecurity policy; work with the EA architecture committees to ensure that security is an integral component in the procurement/development of new systems from inception; perform security audits; and perform remediation of security issues with existing systems. Where needed, software and hardware, such as firewall devices, intrusion detection software, monitoring and alerting software, will be added or upgraded.

Tax Systems

9. **An inventory of the current systems related to tax reveals a patchwork landscape of systems that have grown organically over time to meet the needs of the DGT**. These include: the Integrated Tax Administration Information System (*Sistema Integrado de Información de la Administración Tributaria,* SIIAT), Virtual Tax Administration (*Administración Tributaria Virtual*, ATV), and Digital Taxation (*Tributación Digital,* TD). SIIAT was put into production in 1994 and has 1,308 users, ATV in 2015 and has 1,034 internal users and 1,053,405 external

users, and TD in 2008 and has 500 users. SIIAT is a legacy system running on UNIX with ADABAS as its database engine.

10. **MOF's Directorate of Taxation runs a unique taxpayer registry system (RUT)**. This is the registry for natural persons and legal entities and representatives that is used for tax administration and other purposes. It allows the tax and customs administrations to grant tax identification numbers and keep records of the identity, commercial activity and location of taxpayers, as well as the commercial networks. Strategically and conceptually this has been seen as a separate and distinct registry. This registry could be integrated with a new taxation system but only an EA will confirm this.

11. **MOF needs to develop a single tax management system that facilitates the flow of information, supports the effective and timely collection of taxes, and provides tools to facilitate the taxpayers' returns**. An evaluation of the tax and customs systems reveal a number of shortcomings from an ICT perspective. A large part of DGT an DGA processes have a low level of digitization or none at all. Systems lack data interoperability: components of service to taxpayers, electronic notifications, as well as the management of documents, cases, and files, which should be cross-sectional and parameterizable but are not. There is no information governance scheme to allow interested parties access the data they require in a timely manner. There is a lack of technologies for taxpayer services such as apps, websites for mobile devices, avatars and service chats. These tools could reduce the intervention of officials by up to 70 percent of enquiries. DTIC does not have a technology research unit that can explore new technologies such as machine learning, use of logistic regression, data mining, etc.

12. **DTIC reports that SIIAT will lose its support contract from the manufacturer as of March 2020.** The system is becoming obsolete. There are tentative plans to migrate data to the DT system and link to the ATV system as a stop gap measure. This makes replacement of the taxation system a high priority. The EA will be key to determining the final form of taxation systems. It will provide a crosscutting look at taxation across the MOF and the Government and may recommend replacement of existing systems and significant business process reform.

Customs Systems

13. **The DGA has developed a strategy and plan that meets the broader MOF strategy and plan**[24]. This plan calls for the DGA to "increase control actions in all phases of the customs process: prior control, permanent control and subsequent control with the intensive use of technology, in order to achieve a fair and efficient collection." This will require improving processes, tools and technology to strengthen customs control and increase tax collection. The plan focuses on service, control and security as pillars.

14. **The current Customs System, TICA, was donated by Uruguay in the early 2000s**. It has 1,414 internal and 17,214 external users. TICA was developed on a proprietary platform called Genexus. Studies by a Korean team[25] and the IMF[26] conclude that the system cannot meet the strategic needs of the Directorate and should be replaced. Some of the issues identified are: difficulty in responding to the trade volume growth; difficulty in responding to changes in customs administration procedures; limited acceptance of global customs administration frameworks; inability to provide real-time information and satisfy various customer demands such as the mobile access; lack of an integrated risk model; difficulties in integrating with taxation systems. Given the

[24] Strategic customs administration plan (*Plan Estratégico del Servicio Nacional de Aduanas) 2019-2023*, Ministry of Finance of Costa Rica, December, 2018.

[25] Master plan for the modernization of customs management (*Plan Maestro para la Modernización de la Gestión Aduanera*), Korea Customs Service, 2017.

[26] Guiding principles for strengthening revenue administrations *(Ejes Rectores para el Fortalecimiento de las Administraciones de Ingresos), IMF, 2018.*

legacy technology that TICA is based on, it is difficult to find human resources to work on the system that are cost effective.

Integrated Financial Management Systems (IFMIS)

15. **The IFMIS consists of a patchwork of largely custom developed systems that are difficult to integrate and maintain and often built using tools that are no longer supported**. The budget formulation application was built using Visual Basic 2005 in 2011 and supports 464 users. It has a web application component along with a traditional desktop application. The tools used to build the program are no longer supported which hampers modifications needed to support the current budget formulation process. Budget execution is done via SIGAF, which was built in 2003 on SAP (ABAP) by Price Waterhouse Cooper, supporting 729 users. Accounting, treasury, budget and procurement functions are executed by SIGAF. Asset and inventory management is handled via a system first put in production in 2002, Integrated System for the Goods and Inventory (*Sistema Integrado para la Administración de Bienes e Inventarios*, SIBINET). It has been updated repeatedly. Transfer of electronic funds is handled by the *Tesoreria Digital* application, a custom-built software supported by Software PROSOFT S.A. in 2009. The debt management system (*Sistema de Gestión de la Deuda,* SIGADE) is a Java application based on Oracle database from the United Nations Conference on Trade and Development put into production in 2016. Accounting is handled by a 2016 system developed by Price Waterhouse Cooper. Consolidation is done via the Costa Rican Public Sector Consolidation System (*Sistema de Consolidación de Cifras del Sector Publico Costarricense,* SICCNET) produced in 2003 and supported by the vendor S-COM using Visual Basic.

16. **One of the main drivers for consolidating and replacing current systems is the move of the MOF toward IPSAS.** Current systems hamper the adoption of IPSAS because they do not handle all core and auxiliary PFM functions and are not integrated. Some of the current systems are built using tools that no longer have official support hampering modification and making it more costly. Production of financial reports is a challenge as there are 12 “satellite” systems that must feed data into SIGAF.

17. **There is no public investment management system**. All pre and post investment activities PIM-related activities are done manually with spreadsheets.

Human Resource Management

18. **MOF must have a single system that has the processes for calculating the payroll, payroll payment and all processes related to the management of human resources such as: performance evaluation, professional career, training and training of the collaborator, among others.** This single system must have the capacity to support the entire executive branch and the decentralized organs of the Central Government. The current HRM system, Integra-1, was custom built in 2003 on PowerBuilder and Visual Basic and has 4,038 MOF users and 9,097 external users. Integra-2 was completed in 2014 on more modern technologies and converted to a web application. After internal studies and evaluation, the MOF has determined it needs to stabilize, improve and update the Integra-2 solution so that it becomes the common platform that supports the management of human resources, payroll and payments of all ministries and their attached institutions. The current system does not meet needs. The enterprise architecture work proposed may allow the Ministry to consider integrating human resource functions under a broader IFMIS umbrella.

Data Analytics Platform

19. **The DGT has established a Risk Management Directorate (*Dirección de Gestión de Riesgo*), responsible for determining and planning the strategies, provisions and risk criteria, based on a risk management and customs intelligence model, which allows for permanent control actions, immediate and subsequent profiles of subjects, merchandise and customs operations**. The DGA uses elements of risk analysis to guide its control actions

and inspections of customs declarations. However, DGA lacks a robust system for collection and analysis of the results or engagement of operational units, intelligence, or investigations. An IMF analysis of customs systems and operation in 2017[27] revealed numerous shortcomings in the area of risk management. For example, the Directorate did manual risk analysis for arriving maritime cargo, there were no processes for evaluation and management of risk in manifests for cargo arriving via air or land. Numerous interviews with MOF staff highlight the need for dashboards, KPIs and other business intelligence tools. EXCEL currently is used as a business intelligence tool in most cases.

20. **An IMF[3] study concluded that there is a need to strengthen the business intelligence layer within the MOF**. Specifically, implement an institutional risk analysis tool that permits the use of Discrete Multicriteria Decision Theory (TDMCD) with various methods of calculating and standardizing scores; and inferential tools and data mining that allow the use of techniques such as logistic regression, the grouping of behaviors or the discovery of patterns and recognition of trends for the selection of taxpayers and the creation of real-time models. Given the widespread business intelligence needs across MOF, the Ministry is considering a broader data analytics platform that will not only support basic data warehouse style operations, but also permit ad-hoc querying of data via user-friendly tools, the generation of standardized reports, data mining, the application of machine learning models and real-time monitoring and analytics.

Digital Document Management Systems (*Expediente*)

21. **DGT does not have a 360-degree view of the taxpayer, especially as it relates to a taxpayer's history and obligations.** This also implies that taxpayers will find it difficult to obtain a comprehensive view of their obligations from a single source. Information resides within the Directorate and also in various external sources (ICE, CCSS, municipalities). The Directorate has developed a conceptual model[28] of how it would remedy this situation through the creation of an electronic folder (*expediente electrónico*) that is secured with restricted access that would permit both the DGT and the taxpayer to have that comprehensive view. The Project aims to support the development of a document management system that would assist the DGT in developing and managing all information and documents associated with a taxpayer.

Telecommunications and Infrastructure

22. **The Government is promoting use of the cloud as an alternative to constructing new data centers**. The Government has its email in the cloud and has been migrating data to the cloud. There are some systems that already reside in the cloud, such as for the Comptroller. The new interoperability bus is also being considered as a candidate for the cloud. Given a move in this direction, it will be necessary to strengthen the telecommunications and infrastructure in order to guarantee availability of system and user/citizen

[27] Guiding principles for strengthening revenue administrations *(Ejes Rectores para el Fortalecimiento de las Administraciones de Ingresos),* IMF, 2018.
[28] Conceptual Tax Model (*Modelo Conceptual Tributario)*, Ministry of Finance, 2014.