Costa Rica – Concluding Statement of the 2014 Article IV mission

This note summarizes preliminary findings and recommendations of the IMF staff mission that visited Costa Rica during October 28 – November 11 to conduct the 2014 Article IV consultation. The mission is grateful for the high quality and openness of the discussions and for the cooperation and hospitality of the Costa Rican authorities.

I. Recent Developments

1. Economic developments since the 2013 Article IV Consultation have been mixed.

- ***Growth decelerated in 2013, though output remains virtually at potential***. Activity rose by 3½ percent in 2013, short of the estimated 4¼ percent trend, largely on account of weaker consumption and net exports. Growth gained some speed in early 2014, as feeble imports and stronger investment offset sluggish exports.

- ***The exchange rate depreciated markedly in 2014, broadly restoring competitiveness.*** The current account deficit declined slightly to 5 percent of GDP in 2013. Nevertheless, in the wake of U.S. monetary policy normalization, the colon depreciated about 7 percent in 2014, largely correcting the REER appreciation from the last decade. Although the Central Bank intervened to smooth exchange rate fluctuations, a government Eurobond issuance helped boost reserves―which remain well within the IMF adequacy metric.

- ***Inflation remained within the target range in 2013, but breached its upper limit in 2014.*** Having ended 2013 at 3.7 percent, inflation persists somewhat above the recently lowered target range of 3-5 percent, owing mainly to the high pass-through to domestic prices from depreciation. To contain second-round effects from depreciation, the authorities appropriately raised monetary policy rates twice since the beginning of the year**.**

- ***The fiscal deficit has continued to increase and public debt is climbing rapidly.*** Transfers and interest costs rose in 2012-13, while revenues stagnated, not least because the 2012 tax reform was nullified by the Constitutional Court on procedural grounds. As a result, the central government deficit increased in 2012-13 to 5½ percent of GDP and debt reached 36 percent of GDP at end-2013.

- ***Domestic financial conditions are broadly neutral.*** Interest rates started rising from mid-2013, as global financial conditions tightened. Nevertheless, according to our estimates, financial conditions in Costa Rica were neither propelling nor dragging GDP growth in early 2014, even before the latest policy rate raise. Credit growth (adjusted for the devaluation's impact on the stock of FX loans) has moderated somewhat, to a level consistent with continued benign financial deepening.

- ***The financial system appears sound, though dollarization remains a source of vulnerability.*** Capital is well above regulatory requirements, liquidity indicators are generally robust, and non-performing loans have remained manageable. Although reliance on foreign funding has increased, banks retain a long FX position. However, in the event of a large depreciation of the colon, credit risk from dollar loans to households and corporations would be sizable

II. OUTLOOK AND RISKS

2. **The economic outlook is subdued amid deteriorating fundamentals.** Growth is expected to remain at about 3½ percent in 2014-15, as the positive impact of U.S. recovery is offset by the closure of Intel manufacturing and weak public investment. The output gap is projected to widen through 2016, closing slowly in the medium term, as growth converges to its estimated trend. The central government deficit is anticipated to stay at about 6 percent of GDP through 2019, reflecting a partial consolidation of around 2 ¼ percent of GDP (¶ 9). Given continued prudent monetary policy, inflation would hover around 4 percent in the medium term after finishing 2014 somewhat above the target range due to the colon depreciation. The current account deficit is to rise slightly to 5¼ percent of GDP by 2019, still largely financed by FDI.

3. **External and domestic risks weigh on the outlook.** The mission views external risks related to the normalization of U.S. monetary policy as balanced. If exit is orderly, the net impact of faster U.S. growth and tighter global financial conditions should be positive in the short term. Nevertheless, extreme bouts of volatility in world financial markets could still inflict serious damage. External risks include also deeper-than-expected slowdowns in advanced and emerging economies and disruptions in commodity markets due to geopolitical tensions. On the other hand, if the recent decline in oil prices were to continue, this could have a limited positive impact on Costa Rica. On the domestic front, persistence of a large fiscal deficit and rising debt ratio could exacerbate vulnerability to sudden changes in financial market sentiment. Large government gross financing requirements could also crowd out private investment and growth. In addition, FDI contraction due to the "signaling effect" from Intel exit could hamper growth.

III. POLICY DISCUSSIONS

4. **Costa Rica must reduce existing vulnerabilities and improve long-term sustainability, while boosting potential growth and maintaining financial stability.** In the near term, a tighter fiscal policy stance and vigilance over inflation would buttress macro-economic stability. At the same time, it will be important to begin fiscal consolidation to place public finances on a sustainable path, strengthen the monetary policy framework, and further enhance banking sector supervision and regulation. Reforms to foster competition, increase efficiency, and strengthen competitiveness would help accelerate potential growth.

A. Near-term Policy Mix

5. **The government's proposed fiscal correction for 2015 is suitable, but it is unclear whether the required measures can be implemented in time.** The mission urges the government to take advantage of its political capital to push forward reforms early in its mandate. Fiscal reforms aimed at reducing markedly the deficit are a national priority. Given the absence of a government majority and political fragmentation in Congress, the support of other political parties and civil society is crucial for the success of these much needed fiscal reforms. Budgetary adjustment in 2015 would contribute to mitigate risks of higher inflation, widening external imbalances, and possible adverse financial market reactions associated with U.S. monetary policy normalization. It would also represent a first step to reduce the sustainability gap (¶ 9). The government's fiscal correction target of about 1¼ percent of GDP in 2015 compared to the "passive" budget submitted to Congress is appropriate taking into consideration both fiscal sustainability concerns as well as the cyclical position of the economy. In the mission's view, speedy adoption of the VAT reform would be crucial to achieve this adjustment since improvements to tax administration and expenditure cuts currently under consideration are likely to prove insufficient.

6. **The current monetary policy stance is broadly appropriate, but policy should remain nimble in responding to inflation risks.** With the policy rate at 5.25 percent, the mission considers that the monetary stance allows inflation to re-enter the target band. However, risks of higher inflation prevail due to possible: (i) larger-than-estimated pass-through and second round effects from currency depreciation; (ii) faster U.S. growth; (iii) bigger-than-assumed regulated price hikes, though these are now more unlikely given recent declines in oil prices. Thus the authorities should stand ready to raise rates if inflation does not decline as anticipated, particularly if it persists above the upper limit of the target range.

B. Safeguarding Fiscal Sustainability

7. **Fiscal trends are unsustainable in the long-term.** Under baseline policies, which already incorporate a sizeable adjustment (¶ 11), the consolidated public sector deficit is projected to persist around 6 percent of GDP by 2019, amid a mounting interest bill and the constitutionally mandated increase in education spending. Correspondingly, public sector debt would grow to 51 percent of GDP by 2019, further raising vulnerabilities and eroding macroeconomic stability. External financing costs are expected to rise and its availability may decline if market perceptions continue to deteriorate.

8. **Moreover, the pension system's financial position also needs to be strengthened.** Retirement plans run by the CCSS, the judiciary, and teachers will turn a cash deficit over the long term due to system maturation and population aging. In addition, the pension plans directly supported by the national budget are very costly for government finances and regressive.

9. **Therefore, the mission recommends pursuing ambitious fiscal consolidation.** Excluding the pension system imbalance, a permanent improvement in the primary balance of 3¾ percent of GDP, compared to the level that would prevail in 2015 in the absence of any measures, is required to stabilize the public debt ratio after 2019—which the mission views as an appropriate anchor—and safeguard macroeconomic stability. While the pension system actuarial deficit could be addressed at a later stage through larger contributions, lower replacement rates, and higher retirement age, the mission cautions that the longer the correction is delayed, the larger it will be. The reforms of the pension plans directly supported by the budget undertaken by the government are a step in the right direction but legislative action is needed to deepen the process.

10. **The adjustment should strike a balance between lowering the sustainability gap and limiting the adverse impact on growth.** Cyclical considerations (output is fairly near potential) and the rapid growth of public debt call for some upfront fiscal tightening. In the mission's view, the path that achieves the fiscal consolidation objective with the lowest impact on output would be to undertake about a third of the required budget adjustment in 2015 (1¼ percent of GDP) followed by smaller steps in subsequent 4 years, broadly in line with the authorities' plans (¶ 11). Such a fiscal tightening path would have a modest short-term output cost but a positive impact on output and employment creation over the medium term compared to the baseline scenario. Postponing consolidation would result in larger tightening needs to stabilize debt-to-GDP and increase the probability of disorderly adjustment in the event of an abrupt shift in investor sentiment.

11. **In this connection, the mission welcomes the authorities' medium-term fiscal consolidation plan, but notes that supporting measures still need to be fully specified.**

- The plan to strengthen public finances by about 4 percent of GDP is appropriate, as is the emphasis on revenue enhancement given Costa Rica's low revenue effort compared to other upper-middle-income countries. In particular, we support broadening the VAT base to include services and basic goods, the latter accompanied by actions to mitigate the impact on lower income households, as well as the move to a global income tax. If implemented, the plan will greatly enhance macro stability, thus stimulating growth.

- However, in our view, the proposals at a more advanced stage of elaboration are likely to yield only some 2¼ percent of GDP. Others, notably parts of the income tax and expenditure side reforms, need to be fleshed out to obtain sufficiently refined estimates of their impact, which should amount to 1½ percent of GDP to close the sustainability gap (¶ 9). Moreover, while recent actions to strengthen tax compliance, including the draft anti-tax evasion law submitted to Congress, are appropriate, the mission cautions that yields from such initiatives are generally uncertain and far from immediate.

- Although significant revenue gains may be accrued by reducing tax exemptions and other special treatments, the substantial budget consolidation required will likely demand increases in tax rates in the future. Thus the mission recommends raising the VAT rate from 13 to 15 percent gradually and increasing marginal tax rates on higher brackets as part of the introduction of a global income tax, thereby addressing also distributional concerns. The government has confirmed its willingness to raise VAT rates in steps starting in 2016 consistent with the consolidation recommended by the mission.

- The mission also advises stepping up efforts to contain growth of current expenditure, particularly the wage bill and transfers, notably through modifying indexation to prevent automatic real salary increases and improving efficiency of employment in the public sector. . This is also important to support desirable increases in growth-friendly capital spending, in line with the efforts of the government to improve project execution. At the same time, caution is needed to contain risks of contingent liabilities and additional pressures on domestic financing resulting from new off-budget investment vehicles.

C. Upgrading the Monetary and Exchange Rate Policy Framework

12. **The monetary policy framework still presents important weaknesses.** The mission commends the authorities for their success in maintaining inflation relatively low and reducing the target range to 3-5 percent in 2014. However, inflation expectations are not yet well-anchored and perceived exchange rate stability in the past few years has encouraged dollarization, building up vulnerabilities in balance sheets of banks and private sector.

13. The mission urges the authorities to complete the transition to inflation targeting.

- The mission encourages elimination of the exchange rate band, thereby establishing the inflation target as the undisputed anchor of monetary policy, and further improving communication regarding foreign exchange intervention. This would still allow to smooth out exchange rate volatility and to strengthen the NIR position as long as interventions do not undermine the inflation target. An environment of higher exchange rate flexibility would also help lower the exchange rate pass-through to inflation and force market participants to internalize two-way risks in exchange markets, thus promoting the reduction of foreign currency mismatches on balance sheets. Finally, the authorities should resist pressures to expand the central bank's mandate to include growth, which could generate confusion as to the true target of monetary policy, thereby undermining its credibility.

- The experience of countries that have successfully transitioned to more flexible exchange rate regimes suggests that strong and effective systems for reviewing and managing exposures to exchange rate risk are important. In this regard, the mission welcomes recently adopted stipulations which allow for a more thorough assessment of foreign exchange exposures and associated higher provisioning requirements. Fostering further development of the secondary market for government securities is also desirable.

D. Financial Stability

14. **The mission advises enactment of pending recommendations from the last FSAP.** In particular, greater urgency is required in empowering the Superintendence of Financial Institutions to conduct consolidated supervision, providing adequate protection to bank supervisors, strengthening bank resolution procedures, all of which require passage of new legislation. We welcome progress made towards full implementation of risk-based supervision, but encourage stepped up efforts to bring it up to best practices.

15. **The mission supports gradual adoption of Basel III standards and backs additional improvements in cross-country supervision.** In our view, the regulatory and risk management frameworks would greatly benefit from introducing Basel III definitions of capital, a capital conservation buffer, and a leverage ratio. The mission also recommends enhancing further transnational consolidated supervision, given significant gaps in the definition of a financial group as well as a narrow supervisory and enforcement perimeter.

E. Structural Reforms

16. **Structural reforms should be pursued to boost potential growth and competitiveness.** While Costa Rica has been the regional leader in attracting foreign direct investment, the recent withdrawal of Intel suggests that further steps are needed to maintain the country’s competitive edge. The mission recommends increasing private sector participation in the energy sector and reviewing tariff setting procedures to better reflect changes in costs. Improving the quality of education spending with emphasis on quality child care, early childhood and lower levels of education would help facilitate female return to the labor force, foster productivity improvements, and lower inequality in the long run. Stimulating competition in the banking sector, fostering capital market development, addressing infrastructure bottlenecks, and streamlining business regulations will also help strengthen competitiveness and accelerate potential growth.

Table 1. Costa Rica: Selected Social and Economic Indicators, Baseline Scenario (Partial Fiscal Adjustment)

Population (2011, millions)	4.7	Human Development Index Rank (2011)	70 (out of 187)
Per capita GDP (2013, U.S. dollars)	10,558	Life expectancy (2009, years)	79.1
Unemployment (2011, percent of labor force)	7.7	Literacy rate (2009, percent of people ages > 15)	96.0
Poverty (2010, percent of population)	24.2	Ratio of girls to boys in primary and secondary education (2010, percent)	102.0
Income share held by highest 10 percent of households	39.4		
Income share held by lowest 10 percent of households	1.7	Gini coefficient (2009)	51.0

							Proj.	Proj.
	2008	2009	2010	2011	2012	2013	2014	2015
	(Annual percentage change, unless otherwise indicated)							
Output and Prices								
Real GDP growth	2.7	-1.0	5.0	4.5	5.2	3.5	3.6	3.4
Output gap (percent of potential GDP)	2.8	-1.9	-1.0	-0.3	0.6	0.0	-0.4	-0.9
GDP deflator	12.4	8.4	8.0	4.5	4.1	5.0	5.5	5.6
Consumer prices (end of period)	13.9	4.0	5.8	4.7	4.6	3.7	5.6	4.5
Money and Credit								
Monetary base	11.9	5.1	11.2	11.6	16.9	10.2	9.3	11.0
Broad money	15.8	10.0	-0.2	5.5	10.7	7.7	12.8	9.2
Credit to private sector	31.8	4.5	4.4	13.7	13.4	12.2	14.8	11.4
Monetary policy rate (percent; end of period)	…	…	…	5.0	5.0	4.0	…	…
	(In percent of GDP, unless otherwise indicated)							
Savings and Investment								
Gross domestic investment	27.6	16.3	20.6	21.9	21.7	21.3	21.1	20.4
Gross domestic savings	18.2	14.3	17.1	16.4	16.4	16.2	16.0	15.6
External Sector								
Current account balance	-9.3	-2.0	-3.5	-5.4	-5.3	-5.1	-5.1	-4.8
Of which: Trade balance	-16.8	-6.9	-9.5	-12.5	-11.8	-11.4	-11.6	-11.4
Financial and capital account balance	8.3	1.7	5.5	6.2	9.7	6.8	4.2	5.4
Of which: Foreign direct investment	6.9	4.6	4.0	5.1	4.2	4.9	4.2	4.1
Change in net international reserves (increase -)	348	-51	-561	-132	-2,110	-461	466	-345
Net international reserves (millions of U.S. dollars)	3,799	4,066	4,627	4,756	6,857	7,331	6,865	7,210
Public Finances								
Central government primary balance	2.4	-1.3	-3.0	-1.9	-2.3	-2.8	-3.1	-2.5
Central government overall balance 1/	-0.3	-3.6	-5.4	-4.3	-4.6	-5.6	-6.2	-6.0
Central government debt	24.8	27.2	29.1	30.6	35.1	36.0	39.4	42.3
Consolidated public sector overall balance 2/	0.2	-4.0	-5.4	-4.3	-4.6	-5.4	-6.3	-5.6
Consolidated public sector debt 3/	27.3	29.2	30.5	32.9	38.5	41.9	44.0	45.8
Of which: External public debt	8.6	7.2	7.1	6.4	7.5	8.9	11.0	12.8
Memorandum Item:								
GDP (millions of U.S. dollars)	29,838	29,383	36,298	41,237	45,375	49,621	50,185	54,057

Sources: Central Bank of Costa Rica, Ministry of Finance, and Fund staff estimates.

1/ The inflation adjustment of the principal of TUDES (inflation indexed bonds) was recorded as interest expenditure. In 2014, such inflation adjustment was equivalent to 0.3 percent of GDP.

2/ The consolidated public sector balance comprises the central government, decentralized government entities, public enterprises, and the central bank, but excludes the Instituto Costarricense de Electricidad (ICE).

3/ The consolidated public debt nets out central government and central bank debt held by the Caja Costarricense del Seguro Social (social security agency) and other entities of the nonfinancial public sector.

Table 2. Costa Rica: Selected Social and Economic Indicators, Full Fiscal Adjustment Scenario

Population (2011, millions)	4.7	Human Development Index Rank (2011)	70 (out of 187)
Per capita GDP (2013, U.S. dollars)	10,558	Life expectancy (2009, years)	79.1
Unemployment (2011, percent of labor force)	7.7	Literacy rate (2009, percent of people ages > 15)	96.0
Poverty (2010, percent of population)	24.2	Ratio of girls to boys in primary and secondary education (2010, percent)	102.0
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	(Annual percentage change, unless otherwise indicated)							
Output and Prices								
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Output gap (percent of potential GDP)	2.8	-1.9	-1.0	-0.3	0.6	0.0	-0.4	-1.0
GDP deflator	12.4	8.4	8.0	4.5	4.1	5.0	5.5	6.0
Consumer prices (end of period)	13.9	4.0	5.8	4.7	4.6	3.7	5.6	4.4
Money and Credit								
Monetary base	11.9	5.1	11.2	11.6	16.9	10.2	9.3	11.2
Broad money	15.8	10.0	-0.2	5.5	10.7	7.7	12.8	9.5
Credit to private sector	31.8	4.5	4.4	13.7	13.4	12.2	14.6	11.9
Monetary policy rate (percent; end of period)	…	…	…	5.0	5.0	4.0	…	…
	(In percent of GDP, unless otherwise indicated)							
Savings and Investment								
Gross domestic investment	27.6	16.3	20.6	21.9	21.7	21.3	21.1	20.4
Gross domestic savings	18.2	14.3	17.1	16.4	16.4	16.2	16.0	15.7
External Sector								
Current account balance	-9.3	-2.0	-3.5	-5.4	-5.3	-5.1	-5.1	-4.7
Of which: Trade balance	-16.8	-6.9	-9.5	-12.5	-11.8	-11.4	-11.6	-11.3
Financial and capital account balance	8.3	1.7	5.5	6.2	9.7	6.8	4.2	5.4
Of which: Foreign direct investment	6.9	4.6	4.0	5.1	4.2	4.9	4.2	4.1
Change in net international reserves (increase -)	348	-51	-561	-132	-2,110	-461	466	-345
Net international reserves (millions of U.S. dollars)	3,799	4,066	4,627	4,756	6,857	7,331	6,865	7,210
Public Finances								
Central government primary balance	2.4	-1.3	-3.0	-1.9	-2.3	-2.8	-3.1	-2.2
Central government overall balance 1/	-0.3	-3.6	-5.4	-4.3	-4.6	-5.6	-6.2	-5.6
Central government debt	24.8	27.2	29.1	30.6	35.1	36.0	39.4	41.9
Consolidated public sector overall balance 2/	0.2	-4.0	-5.4	-4.3	-4.6	-5.4	-6.3	-5.6
Consolidated public sector debt 3/	27.3	29.2	30.5	32.9	38.5	41.9	44.0	45.6
Of which: External public debt	8.6	7.2	7.1	6.4	7.5	8.9	11.0	12.8
Memorandum Item:								
GDP (millions of U.S. dollars)	29,838	29,383	36,298	41,237	45,375	49,621	50,185	54,189

Sources: Central Bank of Costa Rica, Ministry of Finance, and Fund staff estimates.

1/ The inflation adjustment of the principal of TUDES (inflation indexed bonds) was recorded as interest expenditure. In 2014, such inflation adjustment was equivalent to 0.3 percent of GDP.

2/ The consolidated public sector balance comprises the central government, decentralized government entities, public enterprises, and the central bank, but excludes the Instituto Costarricense de Electricidad (ICE).

3/ The consolidated public debt nets out central government and central bank debt held by the Caja Costarricense del Seguro Social (social security agency) and other entities of the nonfinancial public sector.

Table 3. Costa Rica: Central Government Balance, Baseline Scenario (Partial Fiscal Adjustment) 1/

							Projection					
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
						(In billions of colones)						
Revenue	**2,490**	**2,363**	**2,591**	**2,869**	**3,118**	**3,380**	**3,665**	**4,106**	**4,699**	**5,244**	**5,719**	**6,229**
Tax revenue	2,409	2,262	2,492	2,769	3,008	3,292	3,579	4,012	4,597	5,133	5,598	6,097
Nontax revenue 2/	81	101	100	100	110	87	86	94	102	111	121	132
Expenditure	**2,536**	**2,970**	**3,623**	**3,762**	**4,178**	**4,765**	**5,348**	**5,872**	**6,465**	**7,095**	**7,827**	**8,619**
Current noninterest	1,776	2,275	2,723	2,962	3,316	3,684	4,057	4,315	4,727	5,147	5,605	6,096
Wages	857	1,115	1,349	1,514	1,647	1,817	2,006	2,218	2,430	2,647	2,884	3,139
Goods and services	88	106	121	136	143	158	188	221	240	261	284	309
Transfers	832	1,054	1,252	1,313	1,526	1,708	1,863	1,876	2,057	2,238	2,436	2,649
Interest 3/	415	393	452	497	530	681	840	1,036	1,151	1,309	1,527	1,766
Capital	344	302	449	304	332	400	451	521	587	639	695	756
Primary balance	**370**	**-213**	**-580**	**-396**	**-529**	**-704**	**-843**	**-730**	**-614**	**-542**	**-581**	**-624**
Overall Balance	**-46**	**-606**	**-1,032**	**-893**	**-1,059**	**-1,386**	**-1,683**	**-1,766**	**-1,765**	**-1,850**	**-2,108**	**-2,390**
Total Financing	46	606	1,032	893	1,059	1,386	1,683	1,766	1,765	1,850	2,108	2,390
External (net)	0	-186	247	-112	356	401	592	749	348	379	406	417
Domestic (net)	46	793	785	1,005	704	984	1,090	1,017	1,417	1,472	1,702	1,973
Central government debt	**3,891**	**4,587**	**5,562**	**6,382**	**8,015**	**8,932**	**10,677**	**12,518**	**14,330**	**16,260**	**18,464**	**20,966**
External	1,138	976	1,142	1,027	1,383	1,763	2,494	3,288	3,660	4,087	4,554	5,043
Domestic	2,753	3,611	4,420	5,355	6,632	7,169	8,183	9,230	10,670	12,173	13,910	15,924
						(In percent of GDP)						
Revenue	**15.9**	**14.0**	**13.6**	**13.8**	**13.7**	**13.6**	**13.5**	**13.9**	**14.6**	**15.0**	**15.0**	**15.1**
Tax revenue	15.3	13.4	13.1	13.3	13.2	13.3	13.2	13.6	14.3	14.7	14.7	14.7
Nontax revenue 2/	0.5	0.6	0.5	0.5	0.5	0.4	0.3	0.3	0.3	0.3	0.3	0.3
Expenditure	**16.1**	**17.6**	**19.0**	**18.0**	**18.3**	**19.2**	**19.7**	**19.8**	**20.1**	**20.3**	**20.6**	**20.8**
Current noninterest	11.3	13.5	14.3	14.2	14.5	14.9	15.0	14.6	14.7	14.7	14.7	14.7
Wages	5.5	6.6	7.1	7.3	7.2	7.3	7.4	7.5	7.6	7.6	7.6	7.6
Goods and services	0.6	0.6	0.6	0.7	0.6	0.6	0.7	0.7	0.7	0.7	0.7	0.7
Transfers	5.3	6.3	6.6	6.3	6.7	6.9	6.9	6.3	6.4	6.4	6.4	6.4
Interest 3/	2.6	2.3	2.4	2.4	2.3	2.7	3.1	3.5	3.6	3.7	4.0	4.3
Capital	2.2	1.8	2.4	1.5	1.5	1.6	1.7	1.8	1.8	1.8	1.8	1.8
Primary balance	**2.4**	**-1.3**	**-3.0**	**-1.9**	**-2.3**	**-2.8**	**-3.1**	**-2.5**	**-1.9**	**-1.6**	**-1.5**	**-1.5**
Overall Balance	**-0.3**	**-3.6**	**-5.4**	**-4.3**	**-4.6**	**-5.6**	**-6.2**	**-6.0**	**-5.5**	**-5.3**	**-5.5**	**-5.8**
Total Financing	**0.3**	**3.6**	**5.4**	**4.3**	**4.6**	**5.6**	**6.2**	**6.0**	**5.5**	**5.3**	**5.5**	**5.8**
External (net)	0.0	-1.1	1.3	-0.5	1.6	1.6	2.2	2.5	1.1	1.1	1.1	1.0
Domestic (net)	0.3	4.7	4.1	4.8	3.1	4.0	4.0	3.4	4.4	4.2	4.5	4.8
Central government debt	**24.8**	**27.2**	**29.1**	**30.6**	**35.1**	**36.0**	**39.4**	**42.3**	**44.6**	**46.5**	**48.6**	**50.7**
External	7.3	5.8	6.0	4.9	6.1	7.1	9.2	11.1	11.4	11.7	12.0	12.2
Domestic	17.5	21.4	23.2	25.7	29.1	28.9	30.2	31.2	33.2	34.8	36.6	38.5
Memorandum items:												
Non-interest expenditure growth (percent)												
in nominal terms	31.9	21.5	23.1	3.0	11.7	12.0	10.4	7.3	9.9	8.9	8.9	8.8
in real terms	16.3	12.7	16.5	-1.8	6.9	6.4	6.7	2.1	5.4	4.7	4.7	4.6
Nominal GDP	15,702	16,845	19,087	20,852	22,819	24,799	27,100	29,585	32,099	34,934	38,023	41,342
CPI Inflation (period average)	13.4	7.8	5.7	4.9	4.5	5.2	3.4	5.0	4.2	4.0	4.0	4.0

Sources: Ministry of Finance and Fund staff estimates.

1/ Includes expenditure cuts equivalent to 0.3 percent of GDP, other cuts in transfers, a partial hiring freeze, broadening of the VAT base, a move towards global income tax, miscellaneous cuts in exemptions, and moderate gains from improvements in tax evasion.

2/ Transfers to the Social development and Family Transfers Fund (FODESAF) are recorded in net terms.

3/ The inflation adjustment of the principal of TUDES (inflation indexed bonds) was recorded as interest expenditure. In 2014, such inflation adjustment was equivalent to 0.3 percent of GDP.

Table 4. Costa Rica: Central Government Balance, Full Fiscal Adjustment Scenario 1/

							Projection					
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
						(In billions of colones)						
Revenue	**2,490**	**2,363**	**2,591**	**2,869**	**3,118**	**3,380**	**3,665**	**4,121**	**4,742**	**5,516**	**6,264**	**6,892**
Tax revenue	2,409	2,262	2,492	2,769	3,008	3,292	3,579	4,027	4,639	5,403	6,141	6,758
Nontax revenue 2/	81	101	100	100	110	87	86	95	103	113	123	134
Expenditure	**2,536**	**2,970**	**3,623**	**3,762**	**4,178**	**4,765**	**5,348**	**5,788**	**6,326**	**7,019**	**7,688**	**8,358**
Current noninterest	1,776	2,275	2,723	2,962	3,316	3,684	4,057	4,265	4,660	5,076	5,527	6,008
Wages	857	1,115	1,349	1,514	1,647	1,817	2,006	2,191	2,382	2,583	2,801	3,032
Goods and services	88	106	121	136	143	158	188	221	241	263	288	314
Transfers	832	1,054	1,252	1,313	1,526	1,708	1,863	1,852	2,038	2,230	2,438	2,661
Interest 3/	415	393	452	497	530	681	840	1,000	1,075	1,297	1,453	1,578
Capital	344	302	449	304	332	400	451	523	591	647	707	772
Primary balance	**370**	**-213**	**-580**	**-396**	**-529**	**-704**	**-843**	**-667**	**-510**	**-207**	**30**	**113**
Overall Balance	**-46**	**-606**	**-1,032**	**-893**	**-1,059**	**-1,386**	**-1,683**	**-1,667**	**-1,585**	**-1,504**	**-1,423**	**-1,465**
Total Financing	46	606	1,032	893	1,059	1,386	1,683	1,667	1,585	1,504	1,423	1,465
External (net)	0	-186	247	-112	356	401	592	749	349	382	412	426
Domestic (net)	46	793	785	1,005	704	984	1,090	917	1,235	1,122	1,011	1,039
Central government debt	**3,891**	**4,587**	**5,562**	**6,382**	**8,015**	**8,932**	**10,677**	**12,426**	**14,071**	**15,691**	**17,254**	**18,856**
External	1,138	976	1,142	1,027	1,383	1,763	2,494	3,294	3,677	4,135	4,643	5,163
Domestic	2,753	3,611	4,420	5,355	6,632	7,169	8,183	9,132	10,393	11,555	12,611	13,693
						(In percent of GDP)						
Revenue	**15.9**	**14.0**	**13.6**	**13.8**	**13.7**	**13.6**	**13.5**	**13.9**	**14.7**	**15.6**	**16.2**	**16.3**
Tax revenue	15.3	13.4	13.1	13.3	13.2	13.3	13.2	13.6	14.4	15.3	15.9	16.0
Nontax revenue 2/	0.5	0.6	0.5	0.5	0.5	0.4	0.3	0.3	0.3	0.3	0.3	0.3
Expenditure	**16.1**	**17.6**	**19.0**	**18.0**	**18.3**	**19.2**	**19.7**	**19.5**	**19.6**	**19.9**	**19.9**	**19.8**
Current noninterest	11.3	13.5	14.3	14.2	14.5	14.9	15.0	14.4	14.4	14.4	14.3	14.2
Wages	5.5	6.6	7.1	7.3	7.2	7.3	7.4	7.4	7.4	7.3	7.2	7.2
Goods and services	0.6	0.6	0.6	0.7	0.6	0.6	0.7	0.7	0.7	0.7	0.7	0.7
Transfers	5.3	6.3	6.6	6.3	6.7	6.9	6.9	6.2	6.3	6.3	6.3	6.3
Interest 3/	2.6	2.3	2.4	2.4	2.3	2.7	3.1	3.4	3.3	3.7	3.8	3.7
Capital	2.2	1.8	2.4	1.5	1.5	1.6	1.7	1.8	1.8	1.8	1.8	1.8
Primary balance	**2.4**	**-1.3**	**-3.0**	**-1.9**	**-2.3**	**-2.8**	**-3.1**	**-2.2**	**-1.6**	**-0.6**	**0.1**	**0.3**
Overall Balance	**-0.3**	**-3.6**	**-5.4**	**-4.3**	**-4.6**	**-5.6**	**-6.2**	**-5.6**	**-4.9**	**-4.3**	**-3.7**	**-3.5**
Total Financing	**0.3**	**3.6**	**5.4**	**4.3**	**4.6**	**5.6**	**6.2**	**5.6**	**4.9**	**4.3**	**3.7**	**3.5**
External (net)	0.0	-1.1	1.3	-0.5	1.6	1.6	2.2	2.5	1.1	1.1	1.1	1.0
Domestic (net)	0.3	4.7	4.1	4.8	3.1	4.0	4.0	3.1	3.8	3.2	2.6	2.5
Central government debt	**24.8**	**27.2**	**29.1**	**30.6**	**35.1**	**36.0**	**39.4**	**41.9**	**43.6**	**44.4**	**44.6**	**44.7**
External	7.3	5.8	6.0	4.9	6.1	7.1	9.2	11.1	11.4	11.7	12.0	12.2
Domestic	17.5	21.4	23.2	25.7	29.1	28.9	30.2	30.8	32.2	32.7	32.6	32.5
Memorandum items:												
Non-interest expenditure growth (percent)												
in nominal terms	31.9	21.5	23.1	3.0	11.7	12.0	10.4	6.2	9.7	9.0	8.9	8.7
in real terms	16.3	12.7	16.5	-1.8	6.9	6.4	6.7	1.2	5.3	4.8	4.8	4.6
Nominal GDP	15,702	16,845	19,087	20,852	22,819	24,799	27,100	29,687	32,308	35,353	38,662	42,193
CPI Inflation (period average)	13.4	7.8	5.7	4.9	4.5	5.2	3.4	5.0	4.1	4.0	4.0	4.0

Sources: Ministry of Finance and Fund staff estimates.

1/ Includes measures as in the baseline partial adjustment scenario (table 3) as well as measures to contain growth in the wage bill, and increases in the VAT rate and marginal income tax rates in outer years.

2/ Transfers to the Social development and Family Transfers Fund (FODESAF) are recorded in net terms.

3/ The inflation adjustment of the principal of TUDES (inflation indexed bonds) was recorded as interest expenditure. In 2014, such inflation adjustment was equivalent to 0.3 percent of GDP.