Fiscal Reform in Costa Rica:

José Francisco Pacheco
Vice minister of Finance
Recent Performance
<table>
<thead>
<tr>
<th>Year</th>
<th>Interests</th>
<th>Primary Balance</th>
<th>Financial Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>-2.1%</td>
<td>-3.0%</td>
<td>-5.0%</td>
</tr>
<tr>
<td>2011</td>
<td>-2.1%</td>
<td>-1.9%</td>
<td>-4.0%</td>
</tr>
<tr>
<td>2012</td>
<td>-2.0%</td>
<td>-2.3%</td>
<td>-4.3%</td>
</tr>
<tr>
<td>2013</td>
<td>-2.5%</td>
<td>-2.8%</td>
<td>-5.4%</td>
</tr>
<tr>
<td>2014</td>
<td>-2.6%</td>
<td>-3.0%</td>
<td>-5.6%</td>
</tr>
<tr>
<td>2015</td>
<td>-2.7%</td>
<td>-3.0%</td>
<td>-5.7%</td>
</tr>
<tr>
<td>2016</td>
<td>-2.8%</td>
<td>-2.4%</td>
<td>-5.2%</td>
</tr>
</tbody>
</table>

Fiscal deficits over 4% of GDP since 2010

Financial & Primary Balance
Percent of GDP
Reason 1. A constant tax burden

Composition of the Tax burden
Percent of GDP

- VAT
- Income
- Fuel
- Rest
- Tax burden

<table>
<thead>
<tr>
<th>Year</th>
<th>Composition of the Tax burden</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>5.8%</td>
</tr>
<tr>
<td>2009</td>
<td>4.7%</td>
</tr>
<tr>
<td>2010</td>
<td>4.7%</td>
</tr>
<tr>
<td>2011</td>
<td>4.8%</td>
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<tr>
<td>2015</td>
<td>4.6%</td>
</tr>
<tr>
<td>2016</td>
<td>4.5%</td>
</tr>
</tbody>
</table>
**Reason 2. Expenditures continue growing**

### Central Government: Composition of the Total Expenditure

<table>
<thead>
<tr>
<th>Year</th>
<th>Current Expenditure</th>
<th>Capital Expenditure</th>
<th>Total Expenditure</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>16.7%</td>
<td>2.3%</td>
<td>19.0%</td>
</tr>
<tr>
<td>2011</td>
<td>16.7%</td>
<td>1.4%</td>
<td>18.1%</td>
</tr>
<tr>
<td>2012</td>
<td>16.9%</td>
<td>1.4%</td>
<td>18.3%</td>
</tr>
<tr>
<td>2013</td>
<td>18.0%</td>
<td>1.6%</td>
<td>19.6%</td>
</tr>
<tr>
<td>2014</td>
<td>17.8%</td>
<td>1.7%</td>
<td>19.5%</td>
</tr>
<tr>
<td>2015</td>
<td>18.1%</td>
<td>1.8%</td>
<td>19.9%</td>
</tr>
<tr>
<td>2016</td>
<td>18.0%</td>
<td>1.8%</td>
<td>19.8%</td>
</tr>
</tbody>
</table>

*Percent of GDP*
As a result, debt almost doubled since 2008.

The diagram shows the Central Government Debt as a percent of GDP from 2000 to 2016. The debt has increased from 39.0% in 2000 to 44.9% in 2016. The graph distinguishes between Internal Debt, External Debt, and Total Debt.
Financial deficit could exceed 7% in three years without reform
With reforms (approved in 2016), it would be less than 4%

Fiscal Balance

- 1. If the reform was approved between Nov 2016-March 2017
- 2. If the Government's alternative proposal is approved
- 3. If none of the projects is approved


-8.00% -7.00% -6.00% -5.00% -4.00% -3.00% -2.00% -1.00% 0.00%

-7.40% -6.10% -3.90%
The Fiscal Reform: proposal
General considerations

- Fiscal strategy characterized by:
  - Legal and administrative measures
  - Balance between new taxes and expenditure control
  - Legal reform aimed at strengthening MoF capacity to collect taxes more efficiently
- No drastic spending cuts
  - Protection to social expenditures and public investment
- Strong modernization of the IT platforms
The Fiscal Reform Agenda

**Taxes**
- VAT
- Income Tax
- Anti-smuggling *
- Anti-Fraud *
- Tax Legal Entities *
- Tax Exoneration

**Expenses**
- Pension Reform *
  (Budget Regime)
- Single account *
- Fiscal Rule

*Approved
Main contents of the initial tax proposal

• Sales tax:
  • Move from sales to VAT
  • Increase VAT from 13% to 15%
  • Refund VAT to families in the first four income deciles
  • Expected tax collection: 1.3% GDP

• Income tax
  • Expand Tax Base to include all types of capital gains and profitable activity
  • One single and uniform tax rate for those activities: 15%
  • New tax rate for salaries over 2 million colones (US$3,500)
  • Expected tax collection: 0.6% GDP
Economic and political environment of the Reform

- High political fragmentation in Congress: over 12 specific fractions, even inside some political parties
  - Fast track
  - Divergent ideological approaches

- “Broad agenda”: conditionality to discuss reform

- Time is gold

- The sequence of the discussion: taxes first, then expenditures?