I. Introduction and Context

A. Country Context

1. Costa Rica is one of the strongest performers in Latin America. Due in large part to its political stability, strong institutions, and open export-driven economy, the country has been successful at attracting high technology firms and developing a sustainable tourism sector. This has contributed to a diversified economy, and robust economic growth. Costa Rica also stands out for its environmental policies and determined mission to achieve carbon neutrality by 2021. Inequality increased somewhat in the second half of the 2000s, but poverty and inequality remain well below most LAC countries, and social indicators are above regional standards.

2. The Chinchilla Administration (2010-14) has put forward an ambitious public investment program to address important bottlenecks to continued strong growth; however, its implementation will require tackling a difficult fiscal situation. In response, the Government has articulated a strategy for medium term fiscal consolidation which includes a comprehensive tax reform. Although this is a step in the right direction, the prospects for approval of the reform are uncertain in an opposition-controlled Congress. While current debt levels can accommodate deficits in the short-term, the situation could become complicated if consolidation does not take place. To spur further growth, Costa Rica also needs to improve the performance of its public Higher Education Institutions (HEIs) in order to increase the stock of advanced human capital, increase investments in technology, and foster research and innovation to enhance competitiveness.
B. Sector and Institutional issues

3. Costa Rica’s higher education system is composed of five public universities: four established universities: Universidad de Costa Rica, Universidad Nacional, Instituto Tecnológico de Costa Rica and Universidad Nacional a Distancia, which account for 47 percent of total enrollment, a relatively new public university, Universidad Técnica Nacional, and approximately 50 self-financed private universities. In addition, there are 60 other higher education non-university institutions, typically of a small scale. The uncontrolled proliferation of private universities has raised concerns at the national level about the qualifications of graduates, and led to the creation in 2002 of the Sistema Nacional de Acreditacion de la Educacion Superior (SINAES), Costa Rica’s national quality assurance agency. SINAES is undertaking evaluation and accreditation of individual programs, a process that has already been initiated in more than 15 institutions (including all five of the public ones).

4. Gross enrolment rates in HEIs remain low compared to other middle income countries such as Brazil, Chile and Colombia, with a large enrolment gap between individuals from the lowest and highest income quintiles. Although the gross enrolment rate has increased, from 22.4 percent in 2002 to 25.8 percent in 2009, this is largely due to the growth of fee-charging private universities since public universities impose access quotas due to limitations in their physical infrastructure and human resources. The limited growth of public universities has constrained access to tertiary education for the poorest students, who are not well positioned to pay for tuition and fees charged by private universities. In addition, even though student financial aid in the form of scholarships reached 42 percent of public university students, the large number of scholarship types -- there are 64 different kinds -- hinders their impact and efficiency. As a result, the contrast between income quintiles is stark, with enrolment rates for the lowest income quintile at around 10 percent, compared to 70 percent for the highest quintile.1

5. The HEI system is not producing sufficient graduates in areas of high economic importance. Most students graduate in the social sciences and education, which accounted for 66 and 72 percent of diplomas awarded by public and private universities in 2009. Basic sciences and engineering represented less than 20 percent of graduates in public universities and less than 10 percent of graduates in private universities. This low proportion of graduates in basic sciences and engineering is not surprising, given that only 11.6 percent of the supply of university programs is concentrated in these areas. The largest deficits in the labor market are in the science and technology fields: basic sciences, computer science, engineering and emerging fields such as nanotechnology, telecommunications, renewable energy and biotechnology. Advanced human capital for research is still notoriously low, with a ratio of less than 0.6 full time equivalent researchers per thousand in the active population, compared to a ratio of 1.3 in Brazil and more than 2 in Chile. The percentage of professors with postgraduate education is low and laboratories and equipment are often out-dated.

6. The financing and governance of the public higher education system have traditionally provided limited incentives to improve the performance of public HEIs. Governance consists of several coordination bodies: (i) A Liaison Commission, which is composed of the public university rectors, and four ministries -- the Ministry of Public Education, the Ministry of Science and Technology, the Ministry of Finance and the Ministry of Planning, negotiates and approves financing for the four established public universities through agreements signed every five years under a Higher Education Financing Agreement (FEES); (ii) the Council on Higher Education (CONESUP), whose main mission is to approve new institutions; (iii) the Council of Public University Rectors (CONARE); (iv) the Unit of Rectors of Private Universities (UNIRE); and (v) SINAES. No single entity coordinates policies related to

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1 CONARE. Tercer informe estado de la educación. Capítulo Educación Superior, Versión Preliminar
the entire higher education system. In addition, there is no single information system on higher education. CONARE has begun improving their system, which has been limited to information on the public system, to provide more comprehensive and timely data and to extend it to include information on the private system.

7. The recently negotiated FEES (2010-15) is expected to bring about a change in the results-orientation of the public higher education system while at the same time producing efficiency gains over time that are necessary to increase enrolment. FEES have normally been distributed among the four established public universities based on historical trends and political negotiations, resulting in a culture that places emphasis on institutional autonomy and limits effective measurement of results. In this context, the Universidad de Costa Rica, the biggest institution, receives traditionally the bulk of public financing. A key new development of the 2010-15 FEES is that it calls for the bulk of non-salary financing for public higher education, US$200 million, to be allocated based on results. It distributes these results-based investment funds evenly between the 4 established public universities in order to enable the three smaller universities to narrow the financing gap with the Universidad de Costa Rica. The 2010-15 FEES also includes provisions to redirect public funding to focus on priority fields, particularly in science and technology.

C. Relationship to CAS

8. The World Bank Group’s Country Partnership Strategy (CPS) for 2012-15 (Report No. 60980-CR) presented to the Board on July 14, 2011 builds on the lessons of the previous CPS and is focused on three clusters which are closely aligned with the Government’s investment program and reflect areas of sustained Bank engagement: (i) developing competitiveness; (ii) improving efficiency and quality in the social sectors; and (iii) supporting the environment and disaster risk management. The proposed Project would contribute to results in the competitiveness cluster through support to improve the quality and access to higher education, especially in priority disciplines.

9. Rationale for World Bank involvement. Multilateral banks such as the Inter-American Development Bank and Banco Centroamericano de Integración Económica (BCIE) have had a long tradition of supporting the Costa Rican higher education sector through loans to specific institutions. However, the proposed operation would be the first multilateral loan supporting systemic change through simultaneously engaging the four established public higher education institutions. In providing this support, the Bank would draw on recent AAA, especially “Central America: Accessing good quality jobs,” which identifies the need for reform in the region’s higher education system, in particular in Central America. It also builds on extensive analytical work on the links between education, employment and competitiveness: “Costa Rica: Competitiveness diagnosis and recommendations,” Report No. AAA34-CR, July 1, 2009. The Bank would also build on its rich history of engagement on system-wide higher education improvements in Latin America (Argentina and Chile).

II. Proposed Development Objective(s)

A. Proposed Project Development Objectives

10. The proposed Project Development Objective (PDO) is to increase equitable access and improve the quality and relevance of the public higher education system by: (i) focusing
resources in key priority disciplines relevant to Costa Rica’s development, and (ii) strengthening public tertiary education institutions’ management capacity and accountability.

B. Key Results.

11. Progress towards meeting these development objectives would be measured by a number of process, output and impact indicators, which would be further identified during Project preparation. Expected impact indicators are shown below:

<table>
<thead>
<tr>
<th>PDO</th>
<th>Key Results</th>
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<tbody>
<tr>
<td>Equitable access</td>
<td>1. Increased access and retention of students from disadvantaged backgrounds</td>
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<tr>
<td>Quality and Relevance</td>
<td>2. Increased enrollment in key disciplines, especially science and technology</td>
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<td></td>
<td>3. Improved faculty qualifications (at Master and PhD levels)</td>
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<td></td>
<td>4. Increased number of accredited programs in key disciplines</td>
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III. Preliminary Description

12. The proposed lending instrument is a Specific Investment Loan with a total Project amount of US$250 million composed of US$200 million from the Bank and US$50 million in counterpart funds from the Government and the four established public universities that would be supported by the Project. The duration of the Project is expected to be 5 years from effectiveness. The Project would achieve its development objective through implementation of two components:

13. **Component 1. Institutional Improvement Agreements** *(Total: US$230 million; Bank: US$200 million; Universities: US$30 million estimated – to be confirmed).* The objective of this component would be to: (a) **help public universities focus resources on key priority disciplines**, by enabling them to undertake strategic investments in areas of high national priority that are critical to respond to the challenge of increasing country competitiveness; and (b) **strengthen public universities’ management capacity and accountability**, by enabling them to develop a culture (i) of strategic long-term planning, including the formulation of an institutional mission, vision and strategy; and (ii) of measurement, target setting, accountability, monitoring and evaluation that would lead to permanent performance-based financing innovations.

14. An Institutional Improvement Agreement (IIA) would be entered into between the Government and each of the four established public universities. Each IIA would be established for 5 years and be co-financed by the Bank and university counterpart, with the Bank financing split equally among the four public universities (US$50 million each), consistent with the 2010-15 FEES. The IIAs for each university would be divided in two stages. First, an IIA for $30 million would be signed with each university, while the remaining $20 million would be maintained on hold. Second, after an in-depth mid-term evaluation, each university will gain access to the remaining $20 million or part thereof, depending on their performance/achievement of the results in the first 3 years. The IIAs would include specific indicators and targets, and be signed by the Ministers of Education, Science and Technology, Finance and Planning and the Rector of each of the four public universities. Budgets would be further detailed in an Annual Investment Plan to be approved yearly by the Bank and the Liaison Committee. Before the end of the third year, an in-depth mid-term review would be carried out to assess progress and carry out specific budget reassignments, as needed. This mechanism has been tested in other countries
by the Bank and is seen as adequate in a context where the Government is willing to pilot a new financing approach based on results.

15. The IIA would be based on an Institutional Improvement Plan (IIP) that will cover the totality of the investments to be realized by each university for five years, including activities, indicators, annual targets and budgets. IPPs for each of the four public universities supported by the Project would be organized around three strategic orientations: (i) increasing equitable access and student graduation; (ii) improving the quality and relevance of training programs and human resources and strengthening innovation and scientific and technological development; and (iii) improving institutional management and efficiency. Eligible expenditures to be financed would include: (i) consultant services (i.e. technical assistance for program reform, etc); (ii) goods (i.e. laboratory and computer equipment, furniture); (iii) scholarships and internships (i.e. for enrolling faculty in postgraduate programs); (iv) visiting professors and other faculty and student mobility programs; and (v) infrastructure (i.e. new buildings, laboratories, etc).

16. The IIAs would follow a clear cycle, starting with the preparation of the IIP by a Technical Team, which would be followed by the negotiation of the IIA between the Government (represented by a negotiating team composed of Government representatives, and an international expert) and the universities. Once signed, an ex-post review of the IIA, including monitoring and evaluation, would be carried out by a Supervisory Committee reporting to the Liaison Commission.

17. Component 2. Enhancing the higher education system (Total: US$20 million; Government: US$20 million). The objective of this component would be to promote the development of strategic activities with a system-wide scope to improve quality in HEIs, including: (i) the development of an information system comprising a Labor Observatory and M&E system for the entire higher education system; (ii) improvements in the system of horizontal and vertical academic and institutional coordination, including recognition of credits among institutions; and (iii) enhancements to SINAES financial and technical capacity to improve and implement its development plan, including evaluation and accreditation of programs and universities.

IV. Safeguard Policies that might apply

<table>
<thead>
<tr>
<th>Safeguard Policies Triggered by the Project</th>
<th>Yes</th>
<th>No</th>
<th>TBD</th>
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<tbody>
<tr>
<td>Environmental Assessment (OP/BP 4.01)</td>
<td>X</td>
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<tr>
<td>Natural Habitats (OP/BP 4.04)</td>
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<td>Pest Management (OP 4.09)</td>
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<td>Physical Cultural Resources (OP/BP 4.11)</td>
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<td>Involuntary Resettlement (OP/BP 4.12)</td>
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<td>Indigenous Peoples (OP/BP 4.10)</td>
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<tr>
<td>Forests (OP/BP 4.36)</td>
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<td>Safety of Dams (OP/BP 4.37)</td>
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<td>X</td>
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<td>Projects in Disputed Areas (OP/BP 7.60)*</td>
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<td>Projects on International Waterways (OP/BP 7.50)</td>
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* By supporting the proposed Project, the Bank does not intend to prejudice the final determination of the parties' claims on the disputed areas.
V. Tentative financing
Source: ($m.)
Borrower/Recipient: US$50,000,000.00
IBRD: US$200,000,000.00
IDA
Others (specify)
Total: US$250,000,000.00

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