

Costa Rica

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|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------|------------|----------------------------|--------------|------------|
| Status Index (Democracy: 5.0 / Market economy: 3.9) | | 8.9 | Management Index | | 7.1 |
| System of government | Presidential Democracy | | Population | 4.0 mill. | |
| Voter turnout^a | 68.2 % | | GDP p. c. (\$, PPP) | 9,460 | |
| Women in Parliament | 35.1 % (2003) | | Unemployment rate | 6.8 % (2002) | |
| Population growth^b | 2.6 % | | HDI | 0.832 | |
| Largest ethnic minority | 3 % ^c | | UN Education Index | 0.86 | |
| | | | Gini Index | 45.9 (1997) | |
| Data for 2001 – if not indicated otherwise. ^{a)} Presidential elections 2002, first round. ^{b)} Annual growth between 1975 and 2001. Source: UN Human Development Report 2003. | | | | | |

1. Introduction

Costa Rica has a stable democracy that has been in continuous existence for decades, as well as a social market economy that since the early 1980s has undergone a gradual process of privatization and liberalization. In contrast to many other Latin American states, economic transformation policy in Costa Rica was and is conceived in gradualist and comparatively consensual terms.

This leads on the one hand to a certain backlog of reforms and to delays in necessary modernization processes; on the other hand, it is in keeping with the political culture of the country and is conducive to social harmony. This had been threatened at times by massive and ultimately successful protests in 2000 against privatization efforts in the electricity and telecommunications sector. The period of investigation coincides with the government of Miguel Angel Rodríguez Echeverría (1998–2002) and the first year of the government of Abel Pacheco de la Espriella, in office since May 8, 2002, both of the *Partido Unidad Social Cristiano* (PUSC).

2. History and characteristics of transformation

Democratic transformation: According to the official version, “the hour of democracy’s birth” dates back to 1889, when for the first time power was transferred peacefully from the government to the opposition through an indirect election, in which, however, only a fraction of the adult population participated. Universal, equal and direct male suffrage was finally introduced in 1913; female

suffrage followed in 1948. To be sure, open election fraud did occur in 1944 and 1948 in favor of the ruling coalition.

The annulment of the presidential elections in 1948, which the opposition had won, led to civil war. Its end ushered in the beginning of the Second Republic that same year. On the grounds of the 1948 Constitution, which no longer provides for military forces, Costa Rica has had an uninterrupted tradition of liberal democracy since then. Costa Rica is thus the only country in Latin America that has been under continuous democratic rule over the last five decades and that has been spared government collapses and attempted putsches.

Market-economy transformation: In the 1960s and 1970s, Costa Rica pursued an economic policy oriented toward industrialization and diversification in agricultural exports to reduce its reliance on imports. The state played a major role as manager and entrepreneur. As a result of a severe economic and debt crisis, this development model was abandoned in the early 1980s, and a gradualist policy of structural adjustment and liberalization was introduced. State spending was gradually cut, some state-owned companies were privatized, public subsidies were reduced, the national banking system was opened up, and selective integration into the world market, based on the promotion of non-traditional exports, was pushed forward.

Tourism was increasingly promoted in the 1990s, and efforts were made to attract foreign direct investment in such areas as “outward processing trade” and transnational technology industries. As a result of the gradual, socially cushioned and economically quite successful structural and liberalization policy, the country went through a fundamental process of economic transformation while avoiding radical disruptions in its socioeconomic structure. Social conflicts remained limited and were managed peacefully within the existing political and social structures and institutions.

To this day, however, this consensus-oriented political style stands in the way of far-reaching steps towards liberalization. Thus efforts to partially privatize the state-owned electricity and telecommunications company, the Instituto Costarricense de Electricidad (ICE), and to open up the electricity and telecommunications market in phases—the so-called *Combo del ICE*—in 2000 encountered such massive social opposition that the projects were shelved.

3 Examination of Criteria for Democracy and a Market Economy

3.1 Democracy

Costa Rica has a stable, liberal and representative democracy.

3.1.1 Political regime

(1) *Stateness*: The state's monopoly on the use of force is enforced without major impairments. Crime is regarded among the population as a central problem, and the state attempts to counter it with a stronger police presence. All citizens possess equal civil rights. A constitutional reform of 1999 obligates the state to safeguard the existing indigenous languages. Roughly 12,000 of the estimated 40,000 "Indígenas" live on 21 reservations. In everyday life, economic migrants, particularly those of Nicaraguan origin, are subject to resentments and discrimination. The national constitution is universally accepted. There is separation of church and state. The state is present throughout the national territory in the form of a differentiated administrative structure, which is often regarded as overly bureaucratic and inefficient.

(2) *Political participation*: Democratic presidential and parliamentary elections are held every four years. The Supreme Tribunal of Elections (*Tribunal Supremo de Elecciones*, TSE) has organized and monitored the elections in the past decades in a largely independent and professional manner. The power to govern is vested in the elected leaders, who must nevertheless pay heed to a broad spectrum of organized interests to implement and legitimize their policies.

There is no army in Costa Rica that might function as a political veto power. As part of the basic democratic order, there is freedom of association and of assembly, as well as freedom of opinion and of the press, which are also exercised. Death threats against or even the murder of journalists, such as occurred in July 2001, are very atypical of Costa Rica, but legal and financial action are often taken against journalists.

(3) *Rule of law*: Checks and balances and the separation of powers are a given and have been reinforced by a long democratic tradition. The constitutional reality comes very close to a smoothly functioning system of checks and balances. The judiciary is professionally differentiated, safeguards the constitution effectively and operates largely independently. In the everyday world of the justice system, however, the principles of swift, uniform and effective application of the law are not always observed. The problem is intensified by the fact that the judiciary is working very close to full capacity.

Corrupt politicians and officials face prosecution in principle, but in practice appropriate indictments and trials are rare. The new president announced he would take direct action against corruption. Civil rights are guaranteed, although

the International Labour Organization (ILO) has complained about restrictions on the rights of labor unions.

3.1.2 Political patterns of behavior and attitudes

(1) *Institutional stability*: The democratic institutions are, despite shortcomings in some details, capable and stable. Their legitimacy is accepted by all relevant political and social actors.

(2) *Political and social integration*: There is a stable, moderate and socially anchored party system that was characterized in the 1980s and 1990s by competition between two large parties, the *Partido Liberación Nacional* (PLN) and the *Partido Unidad Social Cristiano* (PUSC). The PLN and PUSC differ from one another only negligibly. In the presidential and parliamentary elections of 2002, a third political power, the *Partido de Acción Ciudadana* (PAC), broke the two-party system open and forced a runoff for the presidency for the first time in the country's history, as no candidate achieved the required 40 % support on the first ballot.

There is a relatively dense network of associations and interest groups that articulate and balance out conflicting social interests. In the private sector, however, the level of labor union organization is low. Despite some opposing tendencies, approval of democracy is high, especially by regional standards. According to current surveys, Uruguay and Costa Rica are the countries with the highest approval rates for democracy in Latin America. Political protests do not call the constitutional framework into question. There is a robust but heterogeneous network of autonomous, self-organized groups, societies and organizations.

3.2 Market economy

Costa Rica is the only country in Central America with a social market economy. However, Costa Rica faces the challenge of modernizing its apparatus of state and infrastructures, and of preserving and financing the welfare state components of its development model over the medium and long terms.

3.2.1 Level of socioeconomic development

By regional standards, Costa Rica is above average in its level of development and is now classified by the UNDP as a "high human development" country. The level of poverty and distributive injustice is low by regional standards but is a problem nevertheless. Roughly 23 % of the people are considered poor, according to 2001 data. Extreme poverty is a problem primarily in rural areas. There is

considerable social exclusion in Costa Rica as well, which to some extent is structurally reinforced.

3.2.2 Market structures and competition

There are clear rules of the game for stable free market competition. The extent of government intervention in the economy is still comparatively large. Many state-owned companies are active in the banking, insurance and other financial sectors, as well as in many non-financial sectors, including telecommunications, energy, and the postal service. Some state companies hold a monopoly position. The investment climate is considered good, as foreign companies are not placed at a disadvantage relative to domestic companies. Foreign trade is largely liberalized. There are, however, various import restrictions and prohibitions for reasons of health, safety or environmental protection. Production for export is stimulated through free trade areas. Competition among banks is open in principle, with the exception of the government-controlled insurance market. Banking is dominated by three state-owned banks. Reform initiatives are concerned with, among other things, streamlining the state banking system and improving banking supervision. A bill to privatize the Banco de Costa Rica was decisively rejected by the parliament in 2001.

3.2.3 Stability of currency and prices

Inflation control and an appropriate exchange rate policy are recognized economic policy objectives that are institutionally secured through the central bank. Although the inflation rate remained within the target range of approximately 10 % set by the central bank, it was much higher than the Central American average. The devaluation of the currency proceeded in small, continuous steps, the *sistema de minidevaluaciones*. Despite debates within the country, the “crawling peg” method is being adhered to in order to peg the exchange rate to the US dollar.

3.2.4 Private property

The basic conditions exist for a functioning private sector. Property rights and the regulation of property acquisition are appropriately defined, but there are occasionally problems with exercising these rights in accordance with the law. Illegal occupation of land occasionally occurs in rural areas. Private companies make up the backbone of the economy, despite the many state-owned companies, some of which hold monopoly positions.

The allocation of public contracts and licenses to private companies encounters considerable bureaucratic obstacles. Of numerous projects for which there has

been competitive bidding since 1998, only a few have become operational. Among the successful privatizations are the sale of the state-owned cement works CEMEX in 1999, the modernization and management of the Juan Santamaría International Airport in 2001, and the construction and operation of a high-security prison in Limón Province in 2002. Rail service, which had been largely shut down since 1995, was to be reactivated by a private company, which was also to improve the run-down rail network and take over operations for a period of five to 30 years, but the project failed and has been postponed for an indefinite period. Considerably more important is the failure of privatization efforts in the electricity and telecommunications sector, which had been recommended by the IMF and others. This was a political failure in the face of massive protests.

As a result, even commercial internet access remains in state hands, although the ICE plans to break up the commercial internet monopoly of ICE subsidiary RACSA (Radiográfica Costarricense) by entering the market in the future as a second commercial internet service provider.

3.2.5 Welfare regime

The social systems are well developed by regional standards, but do not cover all risks or all population groups. A considerable portion of the economically active population has no social insurance. The largely comprehensive health system faces the challenge of operating more effectively and efficiently. In view of demographic developments, the financing of health and old age benefits is not guaranteed over the medium or long terms.

The living conditions of the small indigenous population groups are very poor compared with the rest of the nation. The government presented a development plan in 2001 for indigenous peoples. Among the roughly 500,000 Nicaraguan migrants the extent of poverty is above average. The large number of migrants exacerbates local bottlenecks in the provision of health care, education and especially housing.

Women have more or less equal access to higher education, and they account for about 45 % of civil service employees, according to 1999 data. Their share of public management positions is smaller, however, at 33 %. Electoral law and resolutions of the Supreme Tribunal of Elections oblige the political parties to fill at least 40 % of elective and candidate positions with women. Twenty of the 57 members of the parliament elected in 2002 are female.

Various laws and institutions, such as the *Defensoría de la Mujer* and the *Instituto Nacional de las Mujeres*, have since the 1990s aimed to strengthen the rights of women and to protect women from discrimination and violence. A 2001 law on the acknowledgment of paternity makes it easier for single mothers to have fathers registered and obligated to provide child support. The paternity of 30 % of

newborn children has not been acknowledged by their fathers, who are therefore not liable for support.

3.2.6 Strength of the economy

There is a high level of openness to foreign trade, and the economy is vulnerable to external influences. After years of growth, the economy is stagnating again. Per capita growth even declined in 2000 and 2001, due in part to the collapse of prices on the global market for coffee, bananas and sugar, Costa Rica's traditional agricultural export products. Also contributing were declines in the country's two most important economic sectors, tourism and the computer industry. The Intel microchip production factory has determined and distorted the nation's economic balance sheet since it opened in 1998, but its production levels have been erratic. Further macroeconomic indicators, such as the inflation rate, the size of the budget deficit and domestic debt, also provide cause for dissatisfaction or alarm.

3.2.7 Sustainability

Ecology is an important topic in Costa Rica, though political discourse was not always followed by adequate policies. Roughly a quarter of the country's territory is under protection, a considerable portion of it in the form of nature parks and nature reserves. It is not only the state that sets store by nature conservation. A portion of the protected areas—approximately 5 % to 8 % of the national territory—is in private hands. Costa Rica is committed to high-quality ecotourism. Ecological concerns occasionally stand in the way of economic resource use. Thus in 2001 plans for offshore oil production were abandoned in the face of massive public pressure. The government banned strip-mining in a 2002 decree.

The planned opening of the electricity and telecommunications markets also met with criticism from environmentalists. The proposed liberalization would have allowed, among other things, private companies with appropriate permits to construct hydroelectric facilities in national parks. Principles of sustainability are increasingly taken into account in the economic use of forests. Marine resources, however, are threatened by over-fishing, especially on the Pacific coast. A new fishing law to replace the existing one dating from 1948 is urgently needed. Water supply and sewage disposal in the capital city, neglected for many years, are in need of modernization and were put up for competitive bidding as a private concession in April 2002.

Traditionally there has been a strong social consensus that crossed party lines on the huge importance of education. The constitution stipulates that 6 % of GDP must go to education. The actual expenditure during the period was less than that, however. The country has a modern, differentiated school system. Pupils become familiar with modern technology at a young age. Despite problems in secondary

education in particular, the educational level is high, and the workforce is considered both motivated and well qualified. Investigations by the US Chamber of Commerce have confirmed that Costa Rica also has the highest labor productivity rate in Latin America. Minimum wages are high by Central American standards, and the work force is expensive. In order to set itself apart from the low-wage countries in the region, the government emphasizes development in high-tech areas.

4. Trend

(1) *Democracy*: State identity, political participation and the rule of law have essentially maintained their existing level of quality. Costa Rica continues to have a stable and functionally capable political democracy. On the negative side, it should be noted that there is a very diffuse but profound mistrust of the political elite. Vilification of politicians is widespread, and a certain amount of political disaffection is detectable. Politicians come under the frequent, though not always unfounded, general suspicion of managing the country's fortunes in their own interests and of lining their own pockets.

The impression that the political elite makes decisions over the heads of the voters was reinforced by the ultimately unsuccessful plan to liberalize the electricity and telecommunications market in phases, which party and factional leaders of the PUSC and PLN parties had negotiated. Government and Parliament had neglected to make the benefits of the reform package clear to Costa Ricans, to address the content of the reform opponents' criticisms, or to adequately win public support for the reforms. The opponents of reform, on the other hand, were able to play upon vague fears of privatization among the population and to mobilize broad segments of the public against the project. The country experienced a wave of protests such as had not occurred in decades.

The mobilization of protesting citizens—even as voter turnout declined—exposed the party-based democracy's "fatigue symptoms" and representational deficiencies, particularly as comprehensive internal democratization of the parties has yet to take place. On the other hand, it is to be taken as a sign of life in Costa Rican democracy that the political establishment gave in to the mostly peaceful protest and has halted its reform plans for the time being. On the positive side, it is also to be noted that opportunities for political participation were increased at the municipal level, via, for example, the *Código Municipal* of 1998.

(2) *Market economy*: The country's developmental status improved during the period as measured by the HDI. The basic institutional conditions for a market economy have not significantly changed. The gradualist course of transformation was retained in principle, but reached its limit, as a result of social opposition. Necessary but unpopular reforms were attempted only sluggishly or not at all.

Table: Development of socioeconomic indicators of modernization

| | HDI | GDI | GDP Index | Gini Index | UN Education Index | GDP per capita (\$, PPP) |
|------|-------|-------|-----------|-------------|--------------------|--------------------------|
| 1998 | 0.797 | 0.789 | 0.68 | 45.9 (1997) | 0.85 | 5,987 |
| 2000 | 0.820 | 0.814 | 0.74 | - | 0.86 | 8,650 |

Sources: UNDP, Report on Human Development, 2000, 2002.

Table: Macroeconomic indices (1998–2002)

| | 1998 | 1999 | 2000 | 2001 | 2002 |
|----------------------------------|------|------|------|------|------|
| Growth of GDP in % | 8.3 | 8.0 | 2.2 | 1.0 | 2.8 |
| Growth of GDP per capita in % | 5.6 | 5.4 | -0.1 | -1.2 | 0.7 |
| Inflation rate in % | 12.4 | 10.1 | 10.2 | 11.0 | 10.0 |
| Reported urban unemployment in % | 5.4 | 6.2 | 5.3 | 5.8 | 6.8 |
| Budget deficit in % of GDP | -2.5 | -2.3 | -3.0 | -2.9 | -4.3 |
| Balance of payments in % of GDP | - | - | -5.1 | -5.0 | -5.4 |

Source: CEPAL, *Balance preliminar de las economías de América Latina y el Caribe*, December 2002.

5. Transformation management

5.1 Level of difficulty

Costa Rica belongs to the “middle income countries.” Yet the economy is vulnerable to external influences, and per capita growth is stagnating at present. The educational level, by regional standards in particular, is high, measured at 0.86 in the UN Education Index. In this quite homogeneous society, political, social and ethnic conflicts are not very pronounced, and they are settled for the most part peacefully. There is a developed civil society and a civic culture. The rule of law and institutional stability are well established.

5.2 Reliable pursuit of goals

The government is pursuing, apart from the management of current problems, longer-range objectives. Accordingly, it attaches great importance to education, new technologies and, with reservations, the environment. It recognizes in principle the need to modernize state-owned enterprises and infrastructure and to

bring fresh capital from private investors into the country for major projects. However, it is politically and socially difficult for the government to approve and implement the appropriate reforms. Despite these difficulties, government policy ensures a basic confidence with respect to life, the law and the economy. The arrival of important multinational companies in recent years indicates a relatively favorable investment climate that owes much to, not least of all, the country's political stability and social harmony.

5.3 Effective use of resources

The government makes efficient use of almost all of its available resources. The state apparatus is large, bureaucratically over-regulated and in great need of modernization. On the income side, tax revenues increased during the period of study, partly as a result of reforms and simplification of the tax laws. Yet the government was not able to gain control of the budget deficit, especially as the budget is heavily burdened by debt service. Budget cuts affected, among other things, the state's share of the costs of presidential election campaigns in 2002, which was statutorily lowered from 0.19 % to 0.10 % of GDP.

Attempts to rehabilitate the state budget in the short term through privatizations had little success during the period, as the government had set its hopes on large proceeds from the failed privatization of the electricity and telecommunications sector. Larger debt-restructuring programs were in part blocked by the parliament. The new government has announced further taxes and budget cuts.

The gradualism of economic transformation in Costa Rica has been a political goal since the 1980s, but it has also meant that reform plans and legislative projects, though they may be proposed and approved, are only partially implemented, if at all, or are postponed. The most recent example is the failed partial privatization of the electricity and telecommunications market, which the parliament had passed on first reading. In response to massive social protests, the project was at first halted. The constitutional court later declared the passage of the law to be unconstitutional.

Though the gradualist, socially cushioned course of reform is conducive to legitimizing government policy and building social consensus, it infringes upon the effectiveness and efficiency of government action. There is a danger that necessary steps toward modernization and reform will be delayed. Although public services enable progress in development, the infrastructure is in urgent need of modernization, as are the transportation and communications sectors. Bureaucratic obstacles to companies must also be removed. In particular, the period of time from competitive bidding to the awarding of public contracts and private concessions is too long. Public administration has also not developed an understanding of its role as a provider of services, and it treats socially disadvantaged citizens in particular in a manner that is not always appropriate.

The *Contraloría General de la República* audits public expenditures in an effective and largely independent manner. Yet its capacity to expose corrupt practices in public administration is limited. According to surveys, many Costa Ricans are of the opinion that corruption is widespread. Certainly corresponding complaints are rather infrequent. Recommendations by the *Comisión sobre Corrupción del Foro de Concertación Nacional* in 1998 for the prevention and punishment of corruption were taken up only in part by the Rodríguez government and the parliament. The Pacheco government has announced that it will proceed against corruption and put a stop to the waste and misuse of public funds. In future, public servants, including members of the governing cabinet, will be required to economize in travel abroad, in the use of government vehicles and in their expenses.

5.4 Governance capability

The leading politicians reacted to failure by becoming very cautious about further privatization plans. It had become all too clear that the government had only limited authority to implement unpopular reforms. Since 2000, the social and political necessity of finding a consensus has been increased by the fact that the new government no longer holds a parliamentary majority. Prolonged negotiations and a struggle for compromises will precede steps towards further reform in the future. Partly for the sake of social harmony, economic misallocations arising from the continued existence of antiquated governmental structures will be tolerated. The leading politicians, after underestimating public opposition to the *Combo del ICE*, are now hesitant to make full use of what scope for action they have. In the medium term, it will be important, in order to finance necessary modernizations and investments, to bring fresh capital into the country by taking sensibly organized steps toward liberalization.

5.5 Consensus-building

Democracy and the social market economy are firmly anchored in politics and society. In view of the massive protests against the Rodríguez government's privatization plans, all political parties have endeavored to maintain social equilibrium, which is also in keeping with the Costa Ricans' understanding of democracy and a social market economy. Traditionally, the legitimacy of the welfare state has played a central role in the politics of the country. Protests during the period were directed not only against privatization plans, but against the removal of protectionist agricultural tariffs as well. Historical injustices do not play a role in politics. Political lessons have long since been learned from the civil war of 1948, some of which have led to the abolition of the army.

5.6 International cooperation

Costa Rica is making efforts to place its products on international markets, and has further expanded its trade relationships in recent years. Free trade agreements were signed during the period with Chile, the Dominican Republic and Canada; negotiations were held with Panama and Trinidad & Tobago; and preparations were made to negotiate a free trade agreement with the United States. In addition, investment protection agreements were ratified with, among others, the Czech Republic, Argentina, Paraguay, the Netherlands and Venezuela. Costa Rica, which traditionally has approached the Central American integration process guardedly, supports, in common with its neighboring states, efforts toward a free trade agreement with the United States. A border dispute with Nicaragua, which had revived during the period, has been settled.

6. Overall evaluation

In view of the originating conditions, current status and evolution achieved, as well as the political managerial achievements, this assessment comes to the following conclusions:

Before the period, Costa Rica already had a stable democracy and a market economy that stands out as fairly socially oriented by regional standards. In the wake of an economic and fiscal crisis, the government has pursued since the 1980s a gradualist, socially cushioned and economically relatively successful structural and liberalization policy.

However, the attempt in 2000 to open up the electricity and telecommunications market encountered massive public opposition and failed. The great wave of protests against the project exposed, apart from privatization fears, the party-based democracy's representational deficiencies, which are fed by the broad mistrust that portions of the population harbor towards the political elite. This does not threaten the continued existence and capabilities of the democracy, however. The organizational capability of the elected representatives to introduce further steps towards economic privatization and liberalization has been and remains limited.

7. Outlook

Modernizing the state and infrastructure, removing bureaucratic obstacles and elaborate licensing procedures and opening up certain economic sectors, including the large telecommunications market, are important elements of a reform agenda. It is the task of the government to seek political and social support for necessary reforms and to organize these in such a way that social harmony is preserved. The consensual political style is in keeping with the country's political culture and with the Costa Ricans' understanding of democracy and a social market economy.