

BTI 2010 | Costa Rica Country Report

Status Index	1-10	8.86	# 10 of 128	
Democracy	1-10	9.40	# 6 of 128	➔
Market Economy	1-10	8.32	# 13 of 128	➔
Management Index	1-10	6.63	# 15 of 128	

scale: 1 (lowest) to 10 (highest) score rank trend

This report is part of the Transformation Index (BTI) 2010. The BTI is a global ranking of transition processes in which the state of democracy and market economic systems as well as the quality of political management in 128 transformation and developing countries are evaluated.

The BTI is a joint project of the Bertelsmann Stiftung and the Center for Applied Policy Research (C•A•P) at Munich University.

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Please cite as follows: Bertelsmann Stiftung, *BTI 2010 – Costa Rica Country Report*. Gütersloh: Bertelsmann Stiftung, 2009.

Key Indicators

Population	mn.	4.5	HDI	0.85	GDP p.c.	\$	10842
Pop. growth	% p.a.	1.4	HDI rank of 182	54	Gini Index		47.2
Life expectancy	years	79	UN Education Index	0.88	Poverty ²	%	8.6
Urban population	%	62.7	Gender equality ¹	0.69	Aid per capita	\$	11.8

Sources: UNDP, Human Development Report 2009 | The World Bank, World Development Indicators 2009.

Footnotes: (1) Gender Empowerment Measure (GEM). (2) Percentage of population living on less than \$2 a day.

Executive Summary

The central political and economic event in Costa Rica between February 2007 and January 2009 was the struggle to enact the Central American Free Trade Agreement (CAFTA). The agreement would not only include the country in a region-wide commercial zone with its Central American neighbors, the Dominican Republic and the United States, but would also open up key sectors of the economy, including telecommunications and insurance, to private and foreign investment. CAFTA's opponents believed that the planned reform of 13 domestic laws required in order to implement the treaty's provisions threatened the country's social market economy.

Despite having organized a four-party legislative majority (the "G-38"), the Oscar Arias administration realized by early 2007 that it was unlikely to win legislative approval of both CAFTA and the related laws. In an unexpected turn of events, President Arias ended up backing a referendum – the country's first ever – to decide on CAFTA's fate, and redirected his legislative strategy to secure passage of the accompanying legislation. In October 2007, Costa Rican citizens voted 51.2% to 48.1% (with a turnout of 60% of the electorate) in support of free trade. And, by November 2008, the Legislative Assembly had negotiated passage of the required legal reforms. The opposition Citizens Action Party (Partido Acción Ciudadana, PAC) accepted these results due to the referendum's result, but did little to expedite the negotiations. Thus, after a multi-year, bruising set of political battles, Costa Rica joined CAFTA on January 2, 2009.

Several other important achievements characterize the period under review, and explain why democratic and economic transformation has been notable in Costa Rica. First, economic growth was strong, despite a slowing of the economy in 2008. Second, growth and social programs managed to make the first serious dent in poverty levels in more than a decade. By 2007, households in poverty comprised 16.7% of the population, even though inequality levels rose, and the Gini coefficient increased accordingly from 0.406 (2005) to 0.426 (2007). Third, the government renegotiated the public debt to take advantage of the fall in international interest rates. Along with increasing the effectiveness of tax collection from 12% of GDP in 2001 to

15% in 2008 (despite the absence of fiscal reform), prudent management of new debt obligations in the context of a growing economy helped to reduce the level of public debt to 46.6% of GDP, from slightly more than 60% in 2003.

Nonetheless, the debate on CAFTA illustrated the way that the country's legislative process easily overloads and hampers potential improvements in democratic governance. Though moderate levels of poverty (about 17% of households are poor and 6% extremely poor) and of inequality (the Gini coefficient is 0.426) constrain transformation, the multiple veto players in the Costa Rican political system make it costly to enact publicly endorsed reforms. It is, among other things, the Legislative Assembly's own rules of procedure (which amplify the power of minorities without imposing costs for repeatedly delaying the legislative process) and overlapping jurisdictions (under which a small number of deputies can ask that the Supreme Court's Constitutional Chamber reviews the constitutionality of bills and laws) that make it so difficult to effect the compromise necessary to quicken the pace of political and economic transformation in the country.

History and Characteristics of Transformation

Costa Rica has been a democracy for nearly 50 years. It also has had a competitive political system for more than a century. Before the 1950s, the electorate included virtually the entire male population. Elections were hotly contested and often involved the use of violence and fraud. After decades of election-related conflict, politicians began in 1946 to remove the executive and legislative branches from their roles in election administration. The 1949 Constituent Assembly made an independent court system – the Supreme Tribunal of Elections – responsible for the organization of elections and the tally of the vote. Since the late 1950s (when National Republican Party politicians who lost the 1948 civil war returned from exile and began again to compete for elected offices), Costa Ricans have competed for power in an (almost) “full democracy,” that is, a political system in which all political forces can compete for elected offices and in which the entire adult population is entitled to vote. Since 1958, when the incumbent Party of National Liberation (Partido Liberación Nacional, PLN) reluctantly conceded defeat in the presidential elections, executives and legislators have come to power in quadrennial elections renowned for their openness and fairness. An important exception to this trend was the constitutional prohibition preventing the Costa Rican Communist Party from competing in elections between 1958 and 1966. Weak enforcement of the ban did allow the Communist Party leader to run for office under a different party label in 1970; reform of the constitution eliminated this anti-democratic clause in 1975.

After the United States, Costa Rica has had the longest continuous period of stable presidential democracy. Standoffs between the executive and the legislature have never been translated into a presidential assault on the political system itself. The Costa Rican political system uses an

innovative constitutional design, devolving important policymaking responsibilities to autonomous institutions whose budgets the executive does not propose and the legislature does not approve. Health care, old-age pensions, monetary policy and electoral governance are among the policy areas not under the direct purview of the two elected branches of government. The constitution calls for an independent judiciary that, since the establishment of the Supreme Court's Constitutional Chamber in 1989, has become an assertive interpreter of the powers of and boundaries between the branches of government. The 1949 constitution also proscribes the existence of a standing army, the capstone of a decades-long trend of underfunding the military.

While Costa Rica is not rich, there is no doubt that, as a country with few natural resources, it has made much of itself in the 20th century. Measured in U.S. dollars at their 1990 value, its GDP per capita grew from \$702 in 1940 to \$3,227 in 2003. In comparative historical terms, the Costa Rican GDP per capita was virtually at the mean of the 15 smallest Latin American countries in 1950. Fifty years later, its GDP per capita was 50% higher than these 15 economies. In PPP terms, the Costa Rican GDP per capita in 2003 was \$9,606.

During the second half of the 20th century, development transformed the Costa Rican economy from an exporter of coffee and bananas – which accounted for three-fourths of exports in 1960 – to one exporting a wide variety of non-traditional agricultural products, light manufactures and even sophisticated computer goods. Between the early 1960s and early 1980s, the government pursued import-substitution industrialization (ISI) policies that encouraged the growth of light manufacturing and gradually turned the domestic terms of trade against agriculture, historically the economy's engine of economic growth. By 1993, coffee and bananas accounted for only a third of all exports, the change amplified by the support of a transnational coalition of exporters, state officials and USAID officials who promoted the development of nontraditional exports in the wake of the 1982 debt default.

The 1982 economic collapse changed everything. In the previous decade, successive governments had taken advantage of low interest on foreign loans to finance public works. The breakdown of commerce among member countries in the Central American Common Market also reduced the size of markets for Costa Rica's protected industries. During the Carazo presidency (1978 – 1982), the public debt soared from 56.2% of GDP in 1980 to 125.2% in 1981, partially as a result of the government's policy of fixed exchange rates despite burgeoning trade and fiscal deficits. Paying off this massive foreign debt required the adoption of export-led development that neutralized the skirmishes between the left-oriented PLN and its right-of-center adversaries.

Costa Rica is now a major tourist destination. Foreign exchange earnings from tourism reached roughly a fifth of total export earnings by 2000. Between 1960 and 1994, exports and imports averaged 66.4% of GDP and this number increased by 10 percentage points by 2005. Even during the heyday of ISI between 1965 and 1982, exports to the Central American Common Market (CACM), all of which erected trade barriers with the rest of the world, constituted less than 18.57% of the country's international trade.

Transformation Status

I. Democracy

Costa Rica's contemporary political system is grounded in the 1949 constitution, which was forged in the aftermath of the 1948 civil war. The president and the Legislative Assembly are elected in separate ballots, but serve concurrent four-year terms. Costa Rica is one of a handful of countries that prevents all elected officials from serving consecutive elected terms. The constitution also calls for an independent judiciary, and since 1989, there has been a Constitutional Chamber ("Sala IV") in the Supreme Court. The state has a large number of autonomous institutes whose budgets do not have to pass through the normal legislative process.

1 | Stateness

The state exercises sovereignty throughout the national territory. There are no violent movements operating in the country, even though Costa Rica is a shipment point for illegal drugs from Colombia to Mexico and the United States. Drug-related violence is not a serious issue in the country.

Monopoly on the use of force

There is a high level of agreement regarding the legitimacy of the nation-state. Citizens complain about the quality of public services and dislike their politicians, but do not support any party or movement seeking to overthrow the state. Though people of Afro-Caribbean descent (mostly in the Caribbean province of Limón) and residents of the two other peripheral provinces (Guanacaste and Puntarenas; there are in total seven provinces) tend to perform relatively poorly on social indicators, there are no movements aimed at secession from the country.

State identity

The political order is secular. Though Article 75 of the constitution asserts that Costa Rica's official religion is Roman Catholic, the constitution also grants religious freedom. Nevertheless, Catholic archbishops frequently offer opinions on matters of public concern (e.g., increases in inequality). They also exercise a de facto veto on sensitive public education issues such as sex education. Until several years ago, the Catholic Church also received a subsidy from the central state. However, neither the Catholic Church nor any protestant church calls for an official role for religion in political life.

No interference of religious dogmas

The Costa Rican state is a complex and differentiated set of political institutions. The system functions around a central state based on a separation of powers. The rule of law, as interpreted by the Constitutional Chamber (since 1989), governs the relations between the branches of government including the Supreme Tribunal of Elections (TSE), which has had the status of an independent branch of government since 1975. The decentralized state includes more than 100 institutions, each of which follows a functionally specific mandate (e.g., social security, water provision, poverty alleviation, health care delivery). These institutions typically account for 60% of all public expenditures.

Basic
administration

2 | Political Participation

There are no constraints on free and fair elections. A free press exists and political authorities and organized groups respect civil rights. Since the 1950s, election management has been exemplary.

Free and fair
elections

The 2006 election was no exception, although close results did generate allegations of misconduct. The PLN candidate, Oscar Arias, won the presidency by a margin of less than 1.12%, or 18,147 votes, winning 40.92% of the valid vote (unless a candidate obtains at least 40% of the valid vote, the elections tribunal convenes a runoff election between the first two runners-up). The TSE initially balked at declaring Arias to be the winner in 2006, given the narrowness of the vote margin separating the PLN and PAC candidates. However, after three weeks of recounting votes in the presence of party observers, the evidence suggested that Arias had indeed won. The TSE subsequently rejected 696 petitions to nullify the electoral results (of which the losing PAC presented 681). Even if the allegations regarding the misplacement of unused ballots and related charges had been ruled acceptable, the number of votes thus impugned would not have reduced Arias' small advantage over PAC candidate Ottón Solís.

The October 2007 vote results were also pristine. Several critics pointed out that the absence of campaign finance regulation meant that the government and the private sector had more funds to publicize their support for CAFTA ratification. A careful analysis of the referendum debate by the Programa del Estado de la Nación (available in their 14th Informe) suggests that the TSE ran an honest vote, even if legislation could be tightened in future referendums.

Elected rules have the effective power to govern but do not wield unlimited power. The 1949 proscription of a standing military prevents men in uniform (police and national guards) from exercising veto power. Businessmen, the clergy, and the U.S. Embassy each (and in different ways) affect the course of public affairs, but do not exercise an unwritten or uncontested veto in state affairs. No single group or institution can stop a law promulgated by the executive and legislature, provided

Effective power to
govern

that the measure's constitutionality is upheld by the Constitutional Chamber. A complex society and sophisticated state mean that there is no public institution or private interest that dominates political life.

Costa Rica's political landscape offers freedom of organization and of assembly. Most regions have a multiplicity of groups organized at the local level, each of which are free to approach the government or seek to influence public opinion. National-level groups are also free to organize. They often publish their declarations in the press and on the internet, and are free to shape the political process.

Association /
assembly rights

An important qualification to this claim is that employers successfully impose restrictions on labor unions, as the Programa del Estado de la Nación's Citizen Audit of the Quality of Democracy Report (chapter 10) shows. Less than 3% of the private-sector labor force belongs to a union (about 10% belong to a "solidarity union," or one that includes employers and employees). The International Labor Organization has received numerous complaints about the difficulties associated with forming labor unions in Costa Rica.

There is freedom of the press. There are seven newspapers. The leading paper, *La Nación*, does not dominate the media. It publishes critics of its policies in its opinion sections, giving them regular opportunities to contest its editorials. Its columnists do not simply echo the paper's neoliberal line, and the newspaper does attempt to steer a centrist course in public affairs (in the way *The New York Times* or *The Economist* steer moderate courses from their respective sides of the political spectrum). Other newspapers and television news programs also inform the body politic. The universities and a multiplicity of groups (including the *Academia de Centroamérica* and the Programa del Estado de la Nación, which issues an annual report on the state of the nation, and from which this assessment draws heavily) also contribute facts and opinions that contribute to the intellectual life of what is a fundamentally free society.

Freedom of
expression

3 | Rule of Law

A real separation of powers is in place, with the constitution, the body of law and judicial rulings structuring the political process. The Legislative Assembly, consisting of 57 deputies, is constitutionally the first branch of government, and its consent is required for the passage of laws. The president does have limited decree powers to confront emergency situations, but decrees have to be approved by the Legislative Assembly within 48 hours. The executive can convene the Assembly and ask it to consider bills during extraordinary sessions, which can last as long as six months of the legislative calendar. The Constitutional Court interprets disagreements over the procedures governing lawmaking. Autonomous institutions, including the Central Bank, are formally independent of the central state apparatus.

Separation of
powers

The separation of powers in Costa Rica is akin to what Bruce Ackerman calls the “new separation of powers.” While Costa Rica is presidential, it does not rely upon a checks and balances version of the separation of powers as do the United States or Mexican systems. Each part of government tends rather to concentrate upon carrying out a specialized function. It behaves more like the political system of the Federal Republic of Germany, which fragments powers among a large number of differentiated institutions and agencies.

Costa Rica’s judiciary is independent. Since 1959, the constitution has guaranteed the judiciary no less than 6% of expected central state revenues, which is spent on staffing a large number of courts. In the period under review, there were no reports of other branches of government, state agencies, or informal veto players subordinating the judiciary to their power.

Independent
judiciary

Since the 1980s, reformers have passed and strengthened a variety of laws and agencies designed to fight corruption. As a result, corrupt officeholders do face prosecution. A special report to the 11th edition of the Informe del Estado de la Nación (2004) reveals that, since the late 1990s, approximately 50 persons a year have been condemned for crimes against public service.

Prosecution of
office abuse

Despite these efforts, corrupt officials do get away with violating the public trust, though it is exceedingly hard to measure the extent of corruption evasion. The aforementioned special report, for example, suggests that state institutions purchase many supplies directly (the exact amount is unknown), without going through the normal (and cumbersome) public bidding process. This is an area rife with corruption, as a country with a small population makes it easier for collusion between the public and private sector. Major cases of corruption also seem to take an extraordinarily long time to process. Two former presidents, Rafael Angel Calderón and Miguel Angel Rodríguez (both of the Social Christian Unity Party (Partido Unidad Social Cristiana, PUSC)), were arrested during 2004 – 2005 and at the time of this writing were still awaiting trial (though no longer under house arrest, they face certain restrictions, including traveling outside of the country). Former PLN President José María Figueres defied the Legislative Assembly’s request to return to the country to answer questions about his consulting work for a major international telecommunications firm.

What is clear is that citizens believe their public officials to be corrupt, even if most do not complain about having to grease palms to obtain public services. Surveys conducted in 2006 under the auspices of the Latin American Public Opinion Project (LAPOP) at Vanderbilt University indicate that 77% of Costa Ricans believe that corruption is somewhat or very generalized among public officials, even though only 19.3% of respondents report experiencing at least one act of corruption in 2006.

There are no restrictions on civil rights. Political authorities respect the standard set of individual rights and guarantees. Should citizens have complaints against the state, they can file a complaint with the Ombudsman (Defensoría de los Habitantes) or with the Constitutional Chamber. The Constitutional Chamber accepts writs or complaints from anyone in Costa Rica.

Civil rights

4 | Stability of Democratic Institutions

Democracy continued to perform well during the period of this review, but there is friction between institutions. Legislative productivity is low; the president and the Legislative Assembly have difficulty reaching agreement on major policy issues. In addition, for most of the present decade, legislative activity has been of poor quality. Enacted laws address central economic, political, and social problems to an increasingly minimal respect. Many of them authorize local governments or national institutions to increase service fees or to raise taxes, while others have created new social rights without creating revenues to fund new state commitments. Even, for example, after the first-ever referendum had resulted in CAFTA's approval, the Assembly delayed ratification of a parallel set of laws required for the free trade agreement's implementation until late November 2008. The slowness of the legislative process has been the source of recurring complaints. However, it is important to underscore the fact that both lawmaking and policy implementation follow the rule of law; there are no informal veto players that can block changes in law. Rather, it is the Assembly's own rules of procedure (which amplify the power of minorities without imposing costs for repeatedly delaying the legislative process) and overlapping jurisdictions (under which a small number of deputies can ask the Constitutional Chamber to review the constitutionality of bills and laws) that amplify ideological differences among parties and thus promote friction between the different parts of government.

Performance of democratic institutions

There are no undemocratic interests or movements in Costa Rica. The refusal to recognize electoral results only generates negative responses from public opinion. Relevant interest groups accept and work within the existing political framework.

Commitment to democratic institutions

5 | Political and Social Integration

Since 2002, the party system has stabilized; it remains moderate (though less moderate than it was before the mid-1990s) but is decreasingly socially rooted. It is articulating interests, because citizen disenchantment has led to a major restructuring of the political system (e.g., an increase in instability). However, the system seems increasingly unable to aggregate different points of view into a politically accepted set of policies addressing the country's major economic and political challenges.

Party system

The 2006 elections saw the ongoing restructuring of a multiparty system that emerged in the 2002 elections. The previously dominant two parties, the PLN and the PUSC, went from getting more than 90% of the valid vote between 1982 and 1998 to obtaining less than 45% of the vote, with the PLN receiving the lion's share of the 2006 vote. The PUSC appears to be extinct as a political force; it got less than 4% of the presidential vote, largely due to the spectacle of having two of its former presidents, Calderón (1994 – 1998) and Rodríguez (1998 – 2002), jailed in 2004 facing accusations of influence-peddling and corruption (though as of this writing, neither has yet been convicted of these charges). While the PLN got 43.8% (or 25 of 57) of the legislative seats, the PUSC got 7% (4). The PAC, a center-left offshoot of the PLN, is now the major party in opposition to the PLN. The PAC has 29.83% (17) of the legislative seats. In contrast to their behavior during the Pacheco administration (2002 – 2006), parties have remained cohesive and disciplined in the Assembly.

The party system remains moderate (the effective number of parties is 3.3), though not nearly as centripetal as it was before the late 1990s. With the collapse of the PUSC, the PLN has shifted slightly to the right. On the right, the Libertarian Movement (ML) is a tax-cutting, liberal party that both expresses citizen dislike of the old party system and also calls for a dismantling of the Costa Rican welfare state. On the left, the PAC also is an expression of citizen disenchantment with the old party system, mounting a center-left critique of neoliberal economic reforms. As a result, it has been opposed to CAFTA, the central policy initiative at the core of political economic debate in the country.

The party system is no longer socially rooted, if we use voter identification as a proxy for social support (parties in Costa Rica were not really anchored in alternative class positions, as they were in much of Europe). The number of independents has more than doubled, from virtually none in 1993 to nearly 32% of the electorate in January 2006, the month before the 2006 elections (after peaking at 46% in August 2005). Public opinion surveys conducted in March and September 2008 by Unimer and La Nación, respectively found that 32% and 44%, of respondents did not identify with any party. Turnout in 2006 was 65%, confirming a downward trend that started in 1998. Between 1953 and 1994, an average of 80% of adults (18 years or older) turned out to vote in quadrennial elections.

Costa Rica has a network of close-knit interest groups that are fundamentally cooperative. Business associations do not dominate interest group networks. Ownership of the media is not concentrated. Big financial groups do not dominate the economy, though monopolies or quasi-monopolies dominate many parts of the economy. One private firm (Florida Ice and Farm), for example, has a monopoly of breweries. One cooperative (Dos Pinos) dominates dairy products. Whether liberalizing the telecommunications market (as enacted by law in 2008) will end the Costa Rican Institute of Electricity's (ICE) domination of telecommunications and

Interest groups

electricity distribution remains to be seen. Some groups are somewhat more influential than others. The two largest banks, the Bank of Costa Rica (BCR) and the National Bank of Costa Rica (BNCR), hold a large number of central government bonds, and have implicit guarantees against default.

Latinobarómetro surveys indicate that support for democracy has in general been higher than 70% of those surveyed since 1996. The 2008 survey, however, showed that only 67% of Costa Ricans prefer democracy to any other form of government, representing a drop of 16 percentage points since 2007. Recent data from 2008 LAPOP surveys, however, still showed Costa Rica to be in fourth place among Latin American countries, behind Argentina, Uruguay and Venezuela. While ideological differentiation has made lawmaking more difficult, there is absolutely no constituency for hard line, anti-systemic political movements in the country.

Consent to
democratic norms

There is a robust but heterogeneous web of autonomous, self-organized groups, associations and organizations in Costa Rica. Concerning social capital, surveys conducted in 2004 under the auspices of the Latin American Public Opinion Project (LAPOP) at Vanderbilt University indicated that levels of trust in Costa Rica, while not high, were slightly positive (i.e., the percentage of respondents who say they trust others, minus the percentage who say they do not). Using a somewhat different methodology, LAPOP in 2008 ranked Costa Rica in second place, behind Canada and before the United States, and above other Latin American countries. When asked about the confidence they had in the people in their community, almost 38% of those interviewed answered they viewed others as “very trustworthy” – the highest rate in Latin America – and 37% answered they would be “somewhat trustworthy.” Citizen participation in associations in Costa Rica compares favorably with other Latin American countries, both in terms of levels of involvement and types of activity.

Associational
activities

II. Market Economy

6 | Level of Socioeconomic Development

Development indices suggest that disadvantaged minorities exist in Costa Rica, but that they are not ethnically separate or geographically isolated from the rest of the population. Economic development and anti-poverty programs have significantly reduced the number of the poor since the mid-20th century, when half of the population lived in poverty.

Socioeconomic
barriers

The 14th Estado de la Nación en Desarrollo Humano Sostenible reports that the percentage of households in poverty declined from 21.2% in 2005 to 16.7% in 2007. In this case, poverty is defined as a family's inability to buy a necessary basket of goods, as defined by a profile of a family in 1988 and 1989). Nevertheless, the Gini coefficient increased from 0.406 to 0.426 between 2005 and 2007, because the top decile's share of the national income grew ever though the incomes of the bottom decile increased faster (38.5% between 2005 and 2007) than those of the top decile (17.8% in the same period). In 2007, the average number of years of schooling completed by the working age population was 8.7. A study by the University of Costa Rica and UNICEF indicates that 41% of 16- and 17-year-olds did not attend school in 2007.

Economic indicators		2004	2005	2006	2007
GDP	\$ mn.	18596.4	19964.9	22526.5	26267.2
Growth of GDP	%	4.3	5.9	8.8	7.8
Inflation (CPI)	%	12.3	13.8	11.5	9.4
Unemployment	%	6.5	6.6	6.0	4.6
Foreign direct investment	% of GDP	4.3	4.3	6.5	7.2
Export growth	%	8.2	12.8	10.3	10.0

		2004	2005	2006	2007
Import growth	%	9.1	12.4	8.1	4.5
Current account balance	\$ mn.	-795.8	-981.0	-1052.7	-1577.8
Public debt	\$ mn.	3555.0	3244.0	3428.5	3749.8
External debt	\$ mn.	5513.6	5996.3	6591.3	7846.3
Total debt service	% of GNI	4.0	3.1	2.7	2.5
Cash surplus or deficit	% of GDP	-1.3	-0.8	1.1	1.7
Tax Revenue	% of GDP	13.4	13.7	14.0	15.2
Government consumption	% of GDP	14.1	13.8	13.5	13.3
Public expnd. on edu.	% of GDP	4.9	-	4.7	4.9
Public expnd. on health	% of GDP	5.1	5.0	5.3	-
R&D expenditure	% of GDP	0.4	-	-	-
Military expenditure	% of GDP	-	-	-	-

Sources: The World Bank, World Development Indicators 2009 | UNESCO Institute for Statistics | International Labour Organization, Key Indicators of the Labour Market Database | Stockholm International Peace Research Institute (SIPRI), Yearbook: Armaments, Disarmament and International Security.

7 | Organization of the Market and Competition

Costa Rica has a competitive market economy. The market sets the price of most goods, the currency is easily convertible at several public or private banks, and there is free use and transfer of profits. While setting up a company is not impossible, Costa Rica falls short of offering ideal conditions for starting a business. The 2009 Doing Business Report (published by the World Bank and the International Finance Corporation) reveals that in 2008 it took 60 days to start a business in Costa Rica (compared to 71 days in the 2006 report). The country ranks 117th out of 181 countries with respect to the ease of doing business (compared to rank 146 out of 171 in the 2006 report).

Market-based competition

Costa Rica's open economy, along with the activity of regulatory agencies, minimizes rent generation by public and private monopolies and oligopolies. In 2007, the Legislative Assembly passed laws to open up the telecommunications and insurance markets, two longstanding public-sector monopolies. Yet the existence of more than 36 regulatory institutions (established between 1990 and 2003), many of which have limited powers and insufficient resources, hinders the state's anti-

Anti-monopoly policy

monopoly stance. The legacy of a telecommunications monopoly and imperfect competition in the banking sector – to take the two most prominent examples of the concentration of market power – indicates that anti-monopoly policy is inconsistent.

There is free trade in Costa Rica, though some observers such as the Heritage Foundation in its Index of Economic Freedom complain about non-tariff barriers, mostly due to slow customs processing procedures. The country has an exceedingly open economy: With the exception of some agricultural products, the average tariff is less than 6%.

Liberalization of
foreign trade

There are institutional foundations supporting a relatively solid banking system and capital market, each of which meet international standards. Until the 1980s, four state banks dominated commercial banking, one of which (the Anglo-Costa Rican Bank) went bankrupt in the mid-1990s. The three remaining state banks held slightly less than half of all deposits during the period under review, and are still the largest domestic banks. While plagued by critical inefficiencies, they enjoy government guarantees against default. Another 12 private banks hold 22% of deposits, and seven offshore banks hold nearly 14% of deposits. The General Superintendent of Financial Services (created in 1985, though predecessors have existed since 1952) supervises banks. The principal complaint against the banking system is that service charges and interest rates on loans are too high, and that interest rates on bank deposits are low. A study on the financial system for the 12th Informe del Estado de la Nación (2005) contends that, while solid, the banking system is subject to a multiplicity of different regulations that undermine its ability to lend money at competitive rates, especially to small borrowers.

Banking system

8 | Currency and Price Stability

Costa Rica has pursued a consistent inflation policy and an appropriate foreign exchange policy. The central bank has done an admirable job of maintaining price stability, particularly given that the central state runs a chronic fiscal deficit (and produces a large, mostly domestically held public debt) and loses money on the bonds it must float to absorb the large amount of foreign exchange that enters the country. While not high or volatile by international standards, the inflation rate has been significant (it was 10.8% in 2007 and the Economist Intelligence Unit estimates that it will be 13.3% in 2008).

Anti-inflation /
forex policy

Beginning in 1982, the central bank developed a crawling peg foreign exchange system as a compromise between a fixed rate and a floating rate. This system worked well enough, because it made monetary action predictable, but it encouraged economic agents to increase prices and thus fueled inflation, as the crawling peg system meant that the prices of tradable goods would be increasing continuously. In October 2006, the central bank opted instead to establish a foreign

exchange rate band regime, which allows the colón to float with upper and lower limits. Since then, the colón has tended to gravitate toward the floor price set by the central bank, which has led to a de facto return to a crawling peg system. Wide swings in currency exchange rates and the overappreciation of the domestic currency (there were large influxes of foreign investment in 2007 and 2008) have prompted widespread criticism of the new foreign exchange regime.

Costa Rican leaders have pursued a consistent stability policy, even showing some improvement between 2007 and 2009. Although not low, inflation has been held in check, in part due to, oddly enough, prudent management of a large fiscal deficit. Between 2007 and 2008, the central state ran a slight surplus. Official figures indicate that the government ran a surplus of 0.6% in 2007 and the Economist Intelligence Unit (EIU) estimates that it will run a surplus of 0.2% in 2008.

Macrostability

Strong real economic growth (7.3% in 2007, and an EIU estimate of 3% in 2008), better tax collection procedures (in 2007, tax receipts reached 15.5% of GDP) and a renegotiation of the public debt helped to improve what has been a far from ideal fiscal balance sheet. In 2007, public debt fell to 46% of GDP, from an average of 54% between 2005 and 2006.

9 | Private Property

Property rights and regulations are well defined in terms of acquisition, benefits, use and sale. Nevertheless, allegations of fraud against the Public Registry (an agency of the Ministry of Justice and Grace) are frequent.

Property rights

Private and public sector companies are both important to Costa Rica's economy. Until 2008, the state owned the corporations responsible for electricity generation and telecommunications (the ICE) and insurance (the National Institute of Insurance), which together accounted for approximately 8% of GDP. By late 2008, the Assembly approved a collection of laws in support of CAFTA that opened these sectors to competition from new market entrants. State commercial banks still dominate the financial sector, even if they are no longer the only financial institutions operating in Costa Rica.

Private enterprise

10 | Welfare Regime

In 2007, the 14th Informe del Estado de la Nación en Desarrollo Humano Sostenible reported that 53.6% of the economically active population participated in a public pension system. In the same year, 61.9% of the economically active population was offered health care insurance. Both figures have been falling since 2000, when the respective figures were 56.8% and 67.1%. Nevertheless, these rates are sufficient to insure more than 90 percent of the population, because most people

Social safety nets

are related to an economically active person (and because the law requires hospitals and other health care institutions to help any person, whether legally in the country or not, seeking medical assistance). There are no provisions for unemployment benefits, the only major welfare state program not available in Costa Rica. Major anti-poverty programs are run by the Mixed Institute for Social Assistance (IMAS). This institution concentrates on helping Costa Rican families in extreme poverty (approximately 5% of all households). The other 15% of citizens living under the poverty line do not get transfer payments from IMAS, according to 2006 data.

There are several institutions designed to compensate for gross social differences. But the social welfare institutions of Costa Rica do not work as well as many would like. Though the rate of households in poverty decreased to 16.7% in 2007 from 21.2% in 2005, the average number of years of education completed is stuck around eight (it was 8.7 years in 2007). Pre-transfer rates of inequality have increased. Women and/or members of ethnic or religious minorities have near-equal access to societal assets such as education and employment, but women earn less than men on average, and the population of African-Jamaican descent in the province of Limón does worse on social indicators than the population at large.

Equal opportunity

11 | Economic Performance

In the aggregate, it is more accurate to say that growth of GDP per capita has been “relatively high” rather than “low,” thus meriting a better rating than two years earlier. In 2007, growth of GDP per capita was 5.5% (and real growth of GDP was 7.3%). The Economist Intelligence Unit (EIU) estimates that real GDP growth was 3% in 2008, which suggests that GDP per capita growth will be around 1% during this year. Inflation was 10.8% in 2007 and the EIU estimates that, more than likely, inflation will have increased to more than 13% in 2008. While GDP growth declined rapidly between January and December 2008, inflation did as well. The budget balance was in surplus during 2007; official figures indicate that this surplus represented 0.6% of GDP during this year. The EIU estimates that it remains in surplus, but that the amount was probably smaller in 2008. The current account had a deficit of 6% in 2007, which was covered by high levels of foreign investment in the country. The official unemployment rate was 4.6% in 2007.

Output strength

12 | Sustainability

Public policy does take environmental concerns into account. A substantial 26% of the national territory consists of protected areas, public or private. Since 2000, the amount of forest cover has been increasing. By 2005, 42% of the country was forested. International bodies consider Costa Rican environmental legislation to be innovative, but it is bureaucratically cumbersome to implement and follow.

Environmental policy

There is a complex but incomplete set of public and private institutions for basic, secondary and tertiary education. Significant shortcomings exist in the area of research and development. Total spending on education is 8.9% of GDP. Public education spending was 5.9% of GDP in 2005. The 5th Informe del Estado de la Nación indicates that private spending in education is around 3% of GDP. In November 2008, the Legislative Assembly approved the government's 2009 budget, which contained a rise of 15% in education spending compared to 2008, resulting in a share of 6.2% of expected GDP in 2009. That the average completed years of schooling remains at just 8.7 (2007) suggests that the education system is not doing enough to encourage the young to stay in school. Spending on research and development is low: Ministry of Science and Technology (Ministerio de Ciencia y Tecnología, MICIT) figures suggest that it was only 0.38% in 2003 and 2004, the years for which the latest figures are available.

Education policy /
R&D

Transformation Management

I. Level of Difficulty

Structural constraints on governance are moderate, even somewhat higher than expected given the relatively small and (at least historically) homogeneous population. Social structural conditions showed signs of both improvement and deterioration in the period under review. That economic growth and anti-poverty programs reduced the decade-long figure of 20% of households living in poverty to 16.7% in 2007 is the best indicator of social progress. Yet, the Gini coefficient increased from 0.406 to 0.426 between 2005 and 2007. Geographically, Costa Rica is surrounded by weak democracies which have become key transit routes for drug trafficking, and are plagued by organized crime. Along with these other states, it is vulnerable to natural disasters like hurricanes.

Structural
constraints

Another source of constraints stems from the political system itself. It has a relatively large number of veto players. The presidency has limited powers over the legislature. A four-year electoral cycle with bans on consecutive reelection for both the president and deputies relegates the chief executive into a lame duck by the end of his third year in office. An independent judiciary with an activist Constitutional Chamber also increases the transaction costs of negotiating legal and constitutional reforms, especially because opposition deputies can and do ask the Chamber to review the constitutionality of bills as well as of laws. A large set of autonomous institutions, the budgets of which do not need legislative approval and which often have independent sources of funding, adds to the complexity of governance. Moreover, the increasing disrepute of the party system means that politicians have less credibility with the electorate than they once enjoyed. Finally, interest groups can easily mobilize in support of or against the government. Bureaucrats, who represent approximately 15% of the labor force, are organized in unions and go on strike when their interests are impacted.

There are noteworthy traditions of civil society in existence. There is a plenitude of organizations at both the local and national levels. The national registry lists almost 19,000 civic associations and there are more than 2,800 community associations, according to 2006 data. In addition, informal associations may be three times as numerous as registered civic associations.

Civil society
traditions

There are no irreconcilable ethnic, religious or social cleavages. The most important recent debate in contemporary society and politics was on ratification of CAFTA and a collection of related laws to open up protected sectors of the economy to competition. Though a referendum in October 2007 – the first ever in the country’s history – led to the popular ratification of CAFTA, the delay in the approval of the related laws demonstrated how polarizing the struggle over free trade and neoliberal reform remains in Costa Rica.

Conflict intensity

II. Management Performance

14 | Steering Capability

The political leadership is committed to constitutional democracy and a socially responsible market economy, but the complexity of the policy-making process reduces its ability to address a variety of problems necessary to advance these goals. Halfway through its four-year term in office, the Arias administration succeeded in ratifying CAFTA and opening up strategic sectors of the economy to private sector competition, a goal that previous administrations had also pursued and failed to achieve.

Prioritization

Costa Rican governments have had limited success in completing structural reforms since the mid-1990s. Progress on reforming tax laws to increase the central state’s share of GDP has stalled. Midway through its term in office, the Arias administration announced that it would not pursue comprehensive tax reform, concentrating instead on ratification of CAFTA and related legislation. Although the Legislative Assembly approved the final bits of the free-trade agreement’s accompanying legislation by late November 2008, it would be inaccurate to credit the Arias administration with too much responsibility for the package’s enactment. Left to its own devices, it is unlikely that the Arias administration would have been able to negotiate legislative approval of these bills. It was the referendum (which supported CAFTA approval by a popular vote of 51.2% to 48.1%, with a turnout of 60% of the electorate), initially opposed by the administration, that ultimately led to the agreement’s passage. An inordinately complex legislative process that empowers minorities, strategic and legal mistakes, and the inability of the Arias administration to negotiate effectively with its critics prolonged approval of the accompanying legislation until November 2008. As a result, the government was forced to request repeated extensions of deadlines for approval of CAFTA and its accompanying legislation.

Implementation

The political leadership does correct mistakes and change failed policies, but frequently remains stuck in the same routines. Evidence for this claim stems from the way the Arias administration failed to assemble a broad legislative coalition to enact several important structural reforms, including tax reform and CAFTA. It relied rather upon deploying its four-party coalition known as the G-38 to obtain legislative approval of CAFTA in 2006 and the beginning of 2007, despite the fact that the complexity of the legislative process allowed treaty opponents to mire the government in agonizingly slow Assembly debates. When a dissident member of the governing PLN party, José Miguel Corrales, sought in early 2007 to organize a citizen referendum to block CAFTA approval, the Arias administration initially opposed the effort to let citizens vote on what had become the central issue of national politics. Once the Arias administration realized that it was unlikely to obtain legislative backing of both CAFTA and the 13 sets of related legal reforms, it decided to hedge its bets by backing a public vote on CAFTA and to redirect its efforts in the Assembly toward seeking approval of the accompanying legislation.

Policy learning

15 | Resource Efficiency

The government can make relatively efficient use of available economic and human resources. At the bureaucratic level, the 1951 civil service law is a source both of strength and rigidity. Approximately 56% of public sector workers belong to one of Latin America's oldest civil services, established in 1954 (the remaining public sector employees labor under special rules in the legislature, judiciary, or autonomous institutions). The Inter-American Development Bank's (IADB) Network on Public Policy Management and Transparency gives the Costa Rican civil service 58 points out of a potential 100 points on its Bureaucratic Merit Index, the third-best ranking in the region after Brazil (88 points) and Chile (61 points). Yet, it is almost impossible to discipline non-performing bureaucrats. The central state also runs a chronic budget deficit, though it is small and managed adroitly.

Efficient use of assets

The government has limited success in coordinating conflicting objectives and interests. The election of Arias in February 2006 helped to increase coordination between the government and its legislative delegation. However, programmatic differences between government and opposition, the Assembly's own rules of procedure that amplify the power of minorities without imposing costs on them for repeatedly delaying the legislative process, and overlapping jurisdictions (which allow a small number of deputies to ask the Constitutional Chamber to review the constitutionality of bills as well of laws) impair the ability of the executive to coordinate policy-making.

Policy coordination

Most integrity mechanisms function, though with limited efficacy. The Comptroller General of the Republic (CGR) audits the accounts of central and decentralized state agencies. An increasing share of public sector purchases are made without

Anti-corruption policy

going through the public bidding process, raising troubling questions as to whether public and private sector actors are colluding to violate the public trust. The fact that no one knows the extent of such purchases – not even the CGR – is a cause for concern. Parties must provide reports of their campaign expenditures in order to receive their share of public campaign funds. However, regulation of private campaign expenditures remains lax because parties typically use satellite organizations that can circumvent campaign finance regulations. In late 2004, the Legislative Assembly passed a new Law Against Public Sector Corruption and Illicit Enrichment.

16 | Consensus-Building

All major (and minor) political actors agree on the goal of building and maintaining market-based democracy. However, there is disagreement over certain political and economic reforms. Although all parties support free trade, the PAC (which received a third of the legislative vote and 40% of the presidential vote in the most recent elections) was against CAFTA, because they believed the country could negotiate a better free trade agreement with the United States. The PAC is also wary of liberalizing the telecommunications monopoly, because the ICE has been a relatively successful state corporation, despite widely recognized limitations in its provision of telephone service. The governing PLN backs all of these reforms.

Consensus on goals

There are no relevant anti-democratic actors, such as military or powerful private sector groups. Public sector labor unions are perhaps the only extra-institutional veto player with some influence. They declared their opposition to CAFTA and to telecommunications reform. However, once a majority of citizens had ratified CAFTA, labor unions accepted the results, and by late 2008 acquiesced to the government's success in obtaining legislative approval for the accompanying legislation.

Anti-democratic veto actors

The political leadership has prevented cleavage-based conflicts from escalating. Unlike in the past, the government managed to keep opposition to CAFTA and neoliberal reforms from spiraling into a major confrontation with its opponents.

Cleavage / conflict management

The political leadership listens to, but does not always take into account the views and interests of civil society actors. However, these groups do have opportunities to voice opinions on policy concerns (e.g., the constitution provides for popular initiative in pushing for new laws, and environmental regulations provide for local input on the implementation of new laws). The Arias administration met with a diversity of groups during its first year in office, seeking to build support for its reform agenda. However, left-leaning groups remained wary of the administration, due to their opposition to CAFTA and to the liberalization of telecommunications and insurance monopolies.

Civil society participation

Not applicable.

Reconciliation

17 | International Cooperation

The political leadership makes use of well-focused international aid for the purpose of political and economic transformation. It has learned from multilateral institutions like the World Bank and the Inter-American Development Bank. As an upper-middle income country, it is becoming harder for Costa Rica to attract the attention of international donors.

Effective use of support

The international community sees Costa Rica's government as credible and reliable. The central bank's ability to effect a smooth transition away from the crawling peg system speaks well of the country's financial credibility. Delay in the approval of CAFTA and its accompanying legislation doubtlessly impaired credibility with respect to the United States and Costa Rica's neighbors, and raised questions about the country's commitment to enact major structural reforms. However, some foreign observers may simply have seen this for what it was: a major policy initiative that a supremely democratic country (with a large number of veto players) was discussing at length.

Credibility

Costa Ricans have always thought of themselves – and, for better and for worse, with a great deal of justification – as an island of stability and development in an isthmus that has experienced a great deal of dictatorship, instability and poverty. This makes many Costa Ricans reluctant to become actively involved in their neighbors' affairs. Some opposition to CAFTA may, in fact, have stemmed from an unwillingness to sign a trade agreement that the rest of Central America has already approved. Nevertheless, Costa Rica is an important commercial partner in the region; after El Salvador and Guatemala, it is the third-largest exporter of goods and services to Central America. It is a member of some relevant regional associations, including the Organization of American States. Indeed, the prior Secretary General of this group was former President Rodríguez, who was forced to resign soon after taking the post because of involvement in a major corruption scandal. However, Costa Rica is not a member of the Central American Court of Justice or the Central American Parliament, which has generated resentment in the rest of Central America.

Regional cooperation

Strategic Outlook

Costa Rica is a country with impressive achievements during the period of this review, as its high rating from the Bertelsmann Transformation Index (BTI) and other international agencies suggest. Its economy grew. Social indicators improved. Sound management led to an important reduction in the public debt. Citizens and their representatives held their first-ever referendum, and passed a package of economic reforms that promotes free trade and liberalizes state-dominated sectors of the economy.

Yet, the country could progress even faster on key economic, political and social dimensions. Most indicators do show improvement, but at a pace insufficient for the country to become a developed society.

The economic and social problems are evident. Slightly less than a fifth of households live in poverty. Inequality is on the rise (from a Gini coefficient of 0.406 to 0.426 between 2005 and 2007); although the lowest decile of the population witnessed the highest income growth rate between 2005 and 2007 (38.6%), most income gains accrued to upper income groups that had the wealth, education and connections to improve their standard of living. That the working population has an average of 8.7 years of schooling (as of 2007) indicates that many Costa Ricans are unable to compete for the best-paying jobs. In the aggregate, these weaknesses undermine the country's ability to attract investment in technological and other high-end sectors that generate well-paying jobs. These limitations help explain why the economy is unable to achieve high growth rates over sustained periods of time. Moreover, unless agreements on improving human capital are reached, the rapidly aging society will not be able to fund the welfare entitlements of the estimated 25% of the population that will soon be 60 or older.

It would be misleading to claim that approval of the CAFTA package means the political system has overcome its weaknesses in advancing important and relevant democratic and economic transformations. In the first place, without popular approval in a referendum, it is doubtful whether the Legislative Assembly would have approved CAFTA and its accompanying legislation. Political actors have difficulty forging encompassing agreements in the Assembly, in part because even small numbers of deputies can derail passage of laws for which majority support exists. Even though the electorate's backing of CAFTA effectively ended the debate over free trade and liberalization (because it made opponents of reform legislation into opponents of democratic majorities), opposition deputies still used legislative approval to retard passage of these reforms. In the second place, it took more than a decade to open up the telecommunications and insurance sectors to private sector competition, and approximately five years to review and vote on CAFTA. That the Arias administration gave up its work on other key reform areas (including revamping tax laws, transforming education and improving anti-poverty programs) to enact a free-trade agreement also suggests that the political system does not promote comprehensive solutions to policy problems or even permit the concurrent analysis of

related policy problems. These reforms simply took up too much of the political system's time. As a result, debate about fiscal policy, educational reform and other pressing issues were once again postponed.

Perhaps the historic October 2007 referendum suggests that the political system will improve its capacity to settle political disputes, because direct democracy will remind legislators to focus on the voters' will. It is an open question whether referendums will overcome the limitations of an easily overloaded legislative process. Enacting law will become even more difficult because, as their terms progress, the ability of presidents to fashion legislative agreements weakens. By the third year of their terms in office, Costa Rican executives increasingly become hostage to congressional and political alignments that are focused on picking candidates for the next general election cycle.

The slow pace of legislative change suggests that it will not be easy to reform a political system with multiple veto players. Areas ripe for reform include, first, the Legislative Assembly's own rules of procedure, which amplify the power of minorities without imposing costs for repeatedly frustrating the will of the majority. Second, that fact that small numbers of deputies can ask the Constitutional Chamber to review the constitutionality of bills and laws is used by minorities to delay and ultimately stymie policy change. More ambitious reform proposals would even dismantle legislative term limits, and prevent voters from rewarding or punishing legislators for frustrating the will of the majority. Without these changes, executives will have to deploy their limited resources to strike agreements in important policy areas that can be implemented with a relatively high degree of consensus.