

Costa Rica

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|---|-------|-------------|--------------------------------------|-------------|-------------|
| Status Index (Democracy: 9.40 / Market economy: 8.70) | | 8.70 | Management Index | | 6.66 |
| HDI | 0.838 | | Population | 4.2 mn | |
| GDP per capita (\$, PPP) | 9,606 | | Population growth¹ | 2.5 % | |
| Unemployment rate | N/A | | Women in Parliament | 35.1 % | |
| UN Education Index | 0.87 | | Poverty² | 2.0 % | |
| | | | Gini Index | 46.5 (2000) | |
| Source: UNDP: Human Development Report 2005. Figures for 2003 unless otherwise indicated. ¹ Annual growth between 1975 and 2003. ² Population living below \$ 1 (1990-2003) | | | | | |

A. Executive summary

Costa Ricans were shocked when, in the fall of 2004, the police took two former presidents, Rafael Angel Calderón Fournier (1994-1998) and Miguel Angel Rodríguez (1998-2002), to jail. A crusading General Attorney Francisco Dall'Anese consigned both to preventative detention while his office investigated charges that each received bribes from private contractors. Both cases involve influence peddling among members of the supervisory boards of the Costa Rican Social Security Institute (CCSS) and the Costa Rican Institute for Electricity (ICE), two of the most powerful autonomous institutes in the public sector.

The scandals are the tip of an iceberg of political discontent and institutional failures. They come in the aftermath of the 2002 general elections, when the Party of National Liberation (PLN) and the Party of Social Christian Unity (PUSC) went from obtaining an average of 92% of the vote in the previous five elections to 63% in 2002. In the wake of these watershed elections, the average effective number of legislative parties jumped to 3.7 from 2.5 in the previous five decades.

The administration of PUSC President Pacheco (2002-2006) showed a mixed performance in order to tackle these new problems of Costa Rica's political system. The collapse of the two-party system and the failure of checks and balances (or horizontal accountability) are going to force changes in a political model that lasted from the late 1950s until the late 1990s. Amazingly high voter turnout rates (an average of 80% of the eligible population) will not return until the political class cleans up its act and builds the political consensus to raise low tax rates and/or cut expenditures to deal with a public debt that is now 60% of the annual GDP. The productivity of executive and legislative relations is deteriorating as the party system fragments and differences between legislative factions become more pronounced. While repeated interaction between a relatively small number of parties may have facilitated the agreements necessary to develop long-term development policies, partisan familiarity also led to collusion and the violation of the public interest, as the recent scandals reveal.

In retrospect, the Costa Rican political system had glaring weaknesses as well as notable strengths. Along with typically favorable cross-national comparisons, a dearth of systematic research made it all too easy to focus on the good aspects. If left unattended, current problems could lay the basis for a gradual political implosion. Reasonable levels of economic growth and the resilience of the political system should permit a political recovery, one that is unlikely to be quick or painless. The less than pessimistic scenario might result in politicians and citizens figuring out how to create effective institutional safeguards against corruption and influence-peddling, some of the most serious afflictions affecting political systems in less developed and unequal societies.

B. 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 100 years. Before the 1950s, hotly contested elections often involved the use of violence and fraud and included virtually the entire male population. After decades of election-related conflict and even violence, politicians began, in 1946, to remove the executive and legislative from 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 the losers of the 1948 civil war returned from exile and began to compete for elected offices once again), Costa Ricans have competed for power in a “full democracy”, that is, a political system where all political forces can compete for elected offices and where the entire adult population is entitled to vote. Since 1958, when the incumbent PLN reluctantly conceded defeat in the presidential elections of this year, executives and legislators have come to power in quadrennially scheduled elections, renown for their openness and fairness.

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 the backdrop for a presidential assault on the political system. The Costa Rican political system uses an innovative constitutional design, one that devolves important policymaking responsibilities to autonomous institutions, and one whose budgets the executive does not propose and the legislature does not approve. Health care, 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 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 under-funding the military.

While Costa Rica is not rich, there is no doubt that a country with few natural resources has made much of itself in the 20th century. In 1990 U.S. dollars, 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 that of the other 14 economies. In PPP terms, the Costa Rica GDP per capita in 2002 is \$8,840, the sixth highest of 19 Latin American countries.

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. By 1993, coffee and bananas accounted for only one-third of all exports as a transnational coalition of exporters, state officials, and United States Agency for International Development (USAID) officials promoted the development of non-traditional exports in the wake of the 1982 debt default.

The 1982 economic collapse had a severe impact on Costa Rica's development. During the Carazo presidency (1978-1982), the public debt soared from 56.2% in 1980 to 125.2% in 1981 of the annual GDP as a result, of the government's refusal to unfix the exchange rate in the context of burgeoning trade and fiscal deficits. Paying off a massive foreign debt required adopting export-led development that neutralized the skirmishes between a left-oriented PLN and its right-of-center adversaries. 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.

Costa Rica is now a major tourist destination; foreign exchange from tourism equaled roughly one-fifth of total export earnings by 2000. Between 1960 and 1994, the economy has been open: exports and imports have averaged 66.4% of the GDP. 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 its international trade.

C. Assessment

1. Democracy

Costa Rica has had a stable presidential democracy since the late 1950s. The system is based on the 1949 Constitution, one forged in the aftermath of the 1948 civil war. The president and the legislature are elected in separate ballots, but

serve concurrent four-year terms. Costa Rica is one of three countries that prohibit the consecutive re-election of executives and legislators.

1.1. Stateness

There is no doubt that 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, however, is not an issue in Costa Rica.

There is separation between church and state, and relations between the two are without conflict.

People of Afro-Caribbean descent tend to live in Limón Province and are treated as citizens, even though they are the target of social discrimination.

The national constitution is universally accepted. 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.

1.2. Political participation

From 1949 to 2002, turnout at elections has involved more than 77 % of the adult population. Suffrage rights are universal. Not only have elections been free and fair, but they also have been close and hard-fought. Between 1953 and 1978, the PLN (a quasi-hegemonic party during this period) only lost a presidential election when enough of its rivals organized a coalition and a joint ticket. After debt default during the United Coalition's term (UC, PUSC's predecessor), the government of President Rodrigo Carazo (1978-1982), the PLN, won two elections in a row before losing in elections between 1990 and 2002. His margin of victory averaged less than 3.07 %.

There are no military or other hidden veto players in Costa Rica, although the U.S. Embassy and multilateral institutions do provide some final limits on what the government can do internationally and what it can accomplish. Both Presidents

José Figueres (1953-1958, 1970-1994) and Oscar Arias (1986-1990) had conflicted relations with Washington, D.C., stemming from different conceptions of security threats in Central America.

Subject to checks and balances in the constitution, elected officials can build sufficient political consensus to enact new laws or change old ones. There are no relevant restrictions on the freedom of the press, or on the freedoms of association and assembly.

1.3. Rule of law

Basic rule of law is unproblematic in Costa Rica. Citizens generally obey laws and public officials typically follow them. Though justice is slow, the judiciary is generally respected and there are no credible reports of judges taking money in exchange for favorable rulings on criminal cases. Citizens tend to rank the judiciary (especially the Constitutional Chamber established in 1989) and the Ombudsman highly. There are also no significant restrictions on civil rights and human rights as of this writing.

Compared with some transformation countries, the separation of powers and the system of checks and balances seems to be working. The absence of systematic studies, however, makes it hard to determine how well the political system actually polices itself. Several trends suggest that horizontal accountability is less effective than it might be. Firstly, the formation of a two-party system by the late 1970s meant that two partisan players began to colonize autonomous institutions. Since the 1980s, the erosion of policy differences between the two parties has meant that they had as many reasons to collude as to compete in politics. Secondly, party loyalists' appointments to decentralized agency presidencies and supervisory boards are rarely discussed in public, a topic about which citizens know very little. Interviews suggest that these positions went to a mix of middle-level and upper-level politicians (former deputies, ambassadors, mayors, etcetera), campaign contributors, and members of the president's coterie. Positions as presidents or on boards of directors went to individuals with no relevant experience, no interest in supervising bureaucratically complex agencies, or worse, real conflicts of interest.

Yet, a narrow focus on whether citizens generally follow the laws of the land misses key issues that suggest Costa Rica does not quite rank alongside the law-abiding countries of the world. Though Costa Rica gets high marks for the competitiveness of its elections, it does not receive such a high rating for the openness of its public sector. The 2004 Transparency International Experts Corruption Perception Index places Costa Rica in 41st of 146 countries, below Chile (20th) and Uruguay (28th). Or in other words, though Costa Rica is perceived far better than most of the transformation countries, its score of around 4.5 in the Corruption Perception Index (on a scale from zero to 10) indicates that the country is performing at a mediocre level in absolute terms.

What is clear is that Costa Ricans believe their public officials are corrupt. The 1994 political culture survey indicates that 75% of Costa Ricans believe that corruption is somewhat or very generalized among public officials (the highest rate among five Central American countries and Colombia, Mexico, and Panama), even though only 15% of respondents report experiencing one act of corruption per year, tying with Colombia for the lowest rate among these countries.

The recent scandals of former presidents also involve the boards of two important autonomous institutions. Former ICE president José Antonio Lobo (and confidant of jailed President Rodríguez), a former deputy (on two occasions) and executive minister, received a financial gift from a French telecommunications firm because ICE holds a monopoly on telecommunications and electricity contracts. Even though there has been no criticism of the contract for cell phones that Alcatel won (all of which the Comptroller must endorse), nevertheless observers and citizens wonder how many ICE contracts generated such gifts. Similarly, the stink surrounding the CCSS, which buys a huge amount of pharmaceuticals and medical supplies, and the Calderón clan also raises questions about institutional oversight. Though the CCSS is exempt from Law 4/3 (the law regulating appointments to the supervisory boards of autonomous institutions), its more independent board also did not stop it from betraying the public interest.

There are therefore good reasons to wonder how effective horizontal accountability is in Costa Rica. Though no one raises doubts about the professionalism of the Comptroller General, many criticize the agency for taking a narrow, bookkeeping view of its functions. In theory, the Comptroller is the legislature's delegate for overseeing the executive and the decentralized sector. Yet, neither the Assembly nor its auxiliary institution has a reputation for being aggressive watchdogs of the public interest. Recent research by Kevin Casas-Zamora shows how neither the Comptroller General nor the Supreme Tribunal of Elections have really verified the accuracy of the receipts that parties submit for reimbursement. Parties do little more than dump boxes of receipts at the Comptroller, which does not apparently sanction parties for sloppy and incomplete bookkeeping. In addition, while the powerful elite has started to be prosecuted (and the Legislative Assembly enacted a new anti-corruption law in October 2004), few individuals have had to pay a price for questionable or corrupt behavior.

1.4. Stability of democratic institutions

The stability of Costa Rica's democratic institutions has suffered from scandals in recent years, though they still work effectively and efficiently. Despite the implosion of the two-party system, the Costa Rican political system retains the support of its citizens.

There is no support for authoritarian solutions; according to Latinobarometro surveys between 1996 and 2004, less than 9% of respondents believe a dictatorship is preferable to democracy. The political system is not deaf to changes in popular preferences, an institutional asset.

The ultimately failed attempt to democratize the candidate selection process in the PLN and PUSC is part of a broader effort to deepen citizen participation—perhaps the single most important and understudied development in contemporary Costa Rican politics. Both parties have supported municipal decentralization, community participation, and have tinkered with the legislative selection process. Moreover, the laws for electing the Legislative Assembly allow disgruntled citizens to give third parties a chance to rectify political problems.

1.5. Political and social integration

It is doubtful that a stable and socially rooted party system exists in Costa Rica since the 2002 elections, given that the electorate turned decisively against the two-party system. Previously in 1998, non-Marxist third parties obtained 25% of the legislative vote. In 2002, the Citizen Action Party (PAC), a breakaway faction of the PLN led by Ottón Solís, took 25% of the legislative vote. The PAC also forced the PLN candidate Rolando Araya and PUSC candidate Abel Pacheco into a runoff, which Pacheco won. For the first time since 1936, no party met the 40% threshold for winning the presidency (in the end, deputies completed the reform of the constitution in this year to award the presidency to the candidate with the largest number of votes and at least 40% of the valid vote). In total, parties not aligned with the PLN or the PUSC obtained 37% of the congressional vote and an equal share of legislative seats in 2002.

Dissatisfaction with the party establishment initially expressed itself in three ways. First, Mitchell Seligson noted a decline in support levels for their political system—as distinct from support for democracy in the abstract—in Costa Rica. On a scale from one (low) to seven (high), support for the political system peaked at 6.7 in 1983 before falling steadily and reaching 5.5 in 1999. Second, turnout fell to an average of 69% of the adult population in 1998 and 2002, down from an average of 81.12% between 1962 (when PRN leaders returned from exile) and 1994. Third, citizens openly expressed disdain for the two-party system by increasingly identifying themselves as independents since the 1990s. The average percentage of independent voters increased from a low of 17.1% of respondents during Oscar Arias's government (1986-1990) to a high of 30.8% in Rodríguez's government (figures are averages of CID Gallup quarterly polls). After the 2002 elections, the effective number of legislative parties jumped to 3.7 from an average of 2.5 in the previous five decades. In December 2004, only 9% and 5% of survey respondents said they wanted the PLN and PUSC to win the 2006 elections, respectively.

There is a relatively dense network of associations and interest groups that articulate and moderate conflicting social interests. In the private sector, however, the level of labor union organization is low. There is also a robust but heterogeneous network of autonomous, self-organized groups, societies and organizations.

So far, support for democracy has not declined. Latinobarometer surveys indicate that support for democracy oscillates around 75% in Costa Rica between 1996 and 2004. Political polarization also has not accompanied the rise of multi-party politics. There have been no confrontations between President Pacheco and the Assembly, even though cooperation between both branches of government has not been high. Ideological confrontations have been minimal, largely because there is no large, anti-neoliberal rejectionist party in Costa Rica (even if the PAC does have critics of structural adjustment and the Washington consensus). Multiparty politics, however, is associated with a decline in the enactment of laws (see section on governance).

2. Market economy

2.1. Level of socioeconomic development

Development indices suggest that there are disadvantaged minorities, but that they are not ethnically separate or geographically isolated from the rest of the population. Approximately one-fifth of the population lives below the national poverty line (though only one-tenth lives on less than \$2 a day). Yet, economic development and social programs have significantly reduced the number of poor. The Programa del Estado de la Nación points out that the share of households living in poverty has declined from 50% in 1960 to 18% in 2003. The World Bank points out that Gini coefficients remained below 0.45 during the 1990s, one of the lowest rates of inequality in Latin America.

2.2. Organization of the market and competition

Costa Rica has always had a vibrant, export-oriented economy based on competitive markets. 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.

During the heyday of import substitution industrialization between the early 1960s and early 1980s, trade barriers did lead to the generation of sizable rents for

domestic manufacturers. Created in 1972, CODESA (Costa Rican Development Corporation) played an active role in the economy. They were registered as private corporations whose principal shareholders are the Council of Government. CODESA is exempt from the multitude of constitutional articles and laws promulgated since the late 1960s to gain control of the decentralized state sector (and registered as a private company whose shareholders were the president and his cabinet). CODESA blossomed into an organization that channeled state funds into panoply of infrequently profitable companies like ALCORSA (the Cotton Corporation) and FERTICA (the Costa Rican Fertilizer Corporation). CODESA grew to such inefficient proportions that it consumed about 18% of domestic credit or 50% of all the credit available to the public sector in 1984 and generated millions of colónes' worth of debt by the 1990s.

Since the 1982 debt default, trade has been liberalized. Average tariffs dropped from 53% 1985 to 3.3% by 1999. No government has talked about closing up what is, and has been, an open economy. Though President Pacheco refuses to send the Central American Free Trade Agreement (CAFTA) to the Assembly for approval, there are few doubts that the next government (elections are due to be held in February 2006) will act to ensure approval of the free trade bill.

Since 1995, Costa Rica's autonomous bank regulation agency has been called the General Superintendence of Financial Institutions (SUGEF). Its effectiveness is unclear. In addition, the Bank of Costa Rica and the National Bank of Costa Rica are the two largest banks in the country. Conversations with informed individuals suggest that the banks abuse their market position by granting loans to politically connected clients, many of whom do not pay their loans back.

2.3. Stability of currency and prices

Economic policymaking has become gradually more flexible since 1982. After the government was forced to let the colón float, a relatively independent Central Bank developed a crawling peg system as a compromise between a fixed rate and letting it float. It should be noted that there are no systematic studies of the Central Bank's independence. Well-informed individuals, however, claim that the bank is relatively independent of the elected branches of government. It is also part of the decentralized state sector and therefore is not directly accountable to elected officials.

The state has always run a fiscal deficit. Between 1966 and 1992, the government ran an average fiscal deficit of -2.9%. Most decentralized sector agencies, such as the CCSS and the Water Commission, charge for their services, which lessens the impact of such a low tax take. Altogether, the public sector obtained around 17% of the GDP in taxes and fees between 1980 and 2000; the central government got about 4% less during this period in the form of taxes. Only prudent monetary

policy and positive inflows on the capital account kept the public-debt-to-GDP ratio to an average of 23.6% between 1961 and 1980, substantially below the 60% ceiling recommended for developing economies. Between 1979 and 1991, it ballooned to an average of 96% of the GDP before falling below 60% in 1992.

The central government is unable to collect more than 12% to 13% of the GDP in taxes. Yet, it spends more than 15% of the GDP. In response, the central government has met this shortfall by cutting the size of the state payroll and public investment. It has also contracted a large internal as well as foreign debt, one that by 2003 was close to 60% of the annual GDP. As a share of the GDP, an average of 28.77% of all public debt between 1984 and 2003 has been internal. The cost of not raising taxes and rationalizing expenditures is high: an average of 32.53% of central state expenditures goes to pay the interest on the public debt.

One of the results of chronic fiscal deficits is a long-term inflation rate of 10%. High oil prices in 2004 led to increases in the cost of goods and services. As a result, inflation slightly increased in 2004.

2.4. Private property

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. Privatization has been quite limited. The National Insurance Institute (INS), a state insurance monopoly, is still an autonomous institute. Telecommunications and electricity remain in the hands of another such institute, the Costa Rican Institute for Electricity (ICE). Yet, there are two important changes worth mentioning. First, while two of the largest banks are state-owned (a third was closed in 1995), state banks lost their monopoly on dollar and colón bank deposits with the 1984 Banking Law reform. These, along with other changes, may explain why the financial component of Eduardo Lora's Index of Structural Reform registers an increase from 0.210 in 1985 to 0.727 in 1999. Second, the government did close CODESA, the publicly funded and loss-making development corporation.

2.5. Welfare regime

The Costa Rican welfare state has extensive health care programs and old-age pensions. According to the Programa del Estado de la Nación, an average of 68% of the salaried and unsalaried members of the economically active population and their families had health care coverage between 1990 and 2003. Between 2000 and 2003, the share of salaried personnel with a health care plan has fallen to 62%. During this more recent period, unsalaried workers have rapidly lost health care coverage. It has fallen from 75.33 to 37.76% between 2000 and 2003. Since

1990, an average of 62% of salaried workers have an old-age pension while only an average of 12.66% of unsalaried workers are saving for an old-age pension. There are no provisions for unemployment benefits, the only major welfare state program not available in Costa Rica.

The public sector also has several major anti-poverty programs, including the Children's Hospital, the Mixed Institute of Social Assistance, the National Institute of Housing and Urban Issues, and the National Ward for the Blind. The share of households in poverty dropped from 50% to 21% by the end of the twentieth century. Illiteracy of individuals 12 years or older has gone from 21% to 5% in the same period. The infant mortality rate has fallen from 90 to 10 per 1000 live births in this 50-year period. Family income inequality has fallen from 0.5 in 1961 to 0.43 in 1988. As a result, of these programs and a steady rate of economic growth, the UNDP Human Development Index (HDI) has risen from 0.55 in 1960 to 0.820 in 2002.

2.6. Economic performance

Real GDP grew annually by an average of 4.1% between 1983 and 1998 before stagnating between 1999 and 2001. In 2002, it picked up again, reaching 6.5% in 2003 and 4.2% in 2004. Economists Andrés Rodríguez and Manrique Sáenz suggest that growth has been lower than expected since the debt crisis because of a decline in productivity, which they trace to a fall in public investment since the 1982 debt default. While budget deficits as well as the deficit in the current account balance are still high, the economy as a whole performed quite well, especially concerning foreign debt, investment, and unemployment.

2.7. Sustainability

Environmental concerns are an important issue in Costa Rica, though public policy has not always protected it. Roughly one-quarter of the country's territory is under protection, a considerable portion of it in the form of nature parks and reserves. A portion of the protected areas, approximately 5% to 8% of the national territory, is in private hands. In 2001, public pressure led the abandonment of offshore oil production. Costa Rica is committed to high-quality eco-tourism and, as a result, the government banned strip mining in a 2002 decree.

Environmentalists criticize the planned opening of the electricity and telecommunications markets. 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. Over-fishing threatens marine resources, 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 they were put up for competitive bidding as private concessions in April 2002.

Expenditures on education and health are high, in part because spending on schools has been higher than on guns since the early 20th century (and something that the proscription of the army helped to maintain since 1948). The country has a comprehensive education system, one that includes primary and secondary schools, and universities. The U.S. Chamber of Commerce claims that Costa Rica also has the highest labor productivity rate in Latin America. Minimum wage is high by Central American standards, and the work force is expensive. To set itself apart from the low-wage countries in the region, the government emphasizes development in high-tech areas.

3. Management

3.1. Level of difficulty

The difficulties that PUSC President Pacheco faced between 2003 and late 2004 are not just a product of unfortunately becoming president just as the two-party system fell apart. Policymaking has gradually become more difficult since the 1990s because the political system now includes more veto players. The establishment of the Constitutional Chamber in 1989 brought a new veto player to politics, one that can prevent bills from becoming laws while they proceed through the legislative process. In 1989, the executive lost its long-term ability to legislate by sticking “atypical norms” in the ordinary budget, an unconstitutional action that allowed the executive to overturn constitutional rights and existing laws without formal discussion. The gradual increase in the number of independent voters means that both the executive and the legislature must continuously court an increasingly skeptical public opinion. These developments have compounded the effects of term limits on policymaking; nonconsecutive re-election makes legislators uninterested in supporting the president. The decay of presidential power begins after the middle-point of a term, or by 2004 in the current electoral cycle.

Other factors contribute, to a lesser or greater extent, in making governance difficult. The fact that 20% of households live in poverty leads to anti-poverty initiatives that fight for a share of the public sector’s limited resources. A decrease in public investment - particularly evident in the road network which, according to the Programa del Estado de la Nación, has not really increased since 1993 - lowers economic growth, thereby limits the government’s tax receipts, and thus prevents standards of living from rising more quickly.

Over the last five decades of stable democracy, an autonomous civil society has developed in Costa Rica. However, from time to time civil society organizations also make governance more difficult. Even though the PLN and the PUSC (which jointly held the presidency and an overwhelming majority in the Assembly) had agreed to open up telecommunications to private sector investment in March 2000, massive social protests terminated the government's bipartisan plans to open up telecommunications to private sector investment (the "combo") within one month. Both before and after these protests, governments had to negotiate with relevant sectors of society and listen to public opinion much more carefully than it had been used to doing.

There are no ethnic cleavages interacting with partisan differences to magnify the stakes of political conflict. Nor does the absence of an educated labor force limit economic development and thus complicate governance.

Profile of the Political System

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|--|-------------------------------------|--------------------------------------|---------------|
| Regime type: | <i>Democracy</i> | Constraints to executive authority: | 2 |
| System of government: | <i>Presidential</i> | Electoral system disproportionality: | 11.15 |
| | | Latest parliamentary election: | 03.02.2002 |
| | | Effective number of parties: | 3.7 |
| 1. Head of State: | <i>Abel Pacheco de la Espriella</i> | Cabinet duration: | 05/02-present |
| Type of government: | <i>unified government</i> | Parties in government: | 1 |
| | | Number of ministries: | 14 |
| | | Number of ministers: | 14 |
| <p>Source: BTI team, based upon information by country analysts, situation in July 2005. Constraints to executive authority (1-6 max.) measures the institutional constraints posed by a federal or decentralized state, a second parliamentary chamber, referenda, constitutional and judicial review and the rigidity of the constitution. Electoral disproportionality (Gallagher index) reflects the extent to which electoral rules are majoritarian (high values) or proportional: $\sqrt{\frac{1}{2} \sum (v_i - p_i)^2}$; v_i is the share of votes gained by party i; p_i is the share of parliamentary mandates controlled by party i. For presidential/semi-presidential systems, the geometric mean of presidential election and parliamentary election disproportionality is calculated. Effective number of parties reflects the political weight of parties (Laakso/Taagepera index) = $1 / (\sum p_i^2)$; p_i is the share of parliamentary mandates controlled by party i. Number of ministries/ ministers denotes the situation on 1 January 2005.</p> | | | |

3.2. Steering capability

The PUSC President Pacheco's administration (2002-2006) does seem to hold a set of policy priorities that are consistent with a social market economy. There is, in fact, little disagreement among key policy and partisan actors that the state should invest in human and physical capital to promote market-based development and to minimize social inequality. Both are long-term concerns of Costa Rican state and society.

Despite consensus on ultimate goals, the Pacheco administration has been unable to solve the chronic fiscal deficit. Nor has it been able to obtain legislative approval for CAFTA, a free-trade agreement important for obtaining continued

access to the U.S. market. Pacheco has also done little to advance the broader agenda of institutional reform that political renewal requires.

In part, the inability to make progress on these goals is a product of a decline in steering capability. One of the sources of decline is institutional. Unfortunately for Pacheco and for the country, the steering capability of the state has reached a 10-year low because of the increase in the number of veto players. Pacheco is the first president in more than 40 years to have a legislative contingent below 45% of all Assembly seats. The government only began its four-year term with the support of 33% of all legislative seats in 2002.

The Pacheco administration's political management strategy is another source of steering capability decline, with effects on the implementation of needed reforms. To its critics, the Pacheco administration has also proven not to be an adroit manager of political conflicts. In the face of public sector work stoppages in the middle of 2004, the president agreed to raise public sector salaries above the rate wanted by his minister of finance. As a result, Finance Minister Alberto Dent resigned on September 1, 2004, which provoked several more cabinet resignations. As the government's fiscal reform law became bogged down in the Assembly, the government would not submit CAFTA to the legislature until deputies approved the government's fiscal reform package. This political ploy did not produce the desired results between 2003 and 2004 (and, as of April 2005, it has still not succeeded to date). The president's handling of these key bills with a divided legislature generates speculation about the administration's capacity to set priorities and to develop effective political strategies to turn bills into laws.

The ability to learn, for instance to develop innovative policies in case of failed measures, which had been an advantage of Costa Rica's political system for years, also seems to have suffered from the recent turbulences. Yet, the agenda of necessary political reforms, necessary to restore confidence in the political system, are long and complex. Without political renewal, elected officials will find it impossible to build the consensus to raise taxes and therefore to obtain more funds for investments in human and physical capital. An innovative political architecture, one that delegates central state functions to institutions largely independent of the executive and legislative branches of government, appears to have succumbed to bipartisan nepotism and bureaucratic inertia.

While the Comptroller General is constitutionally empowered to review the budgets of all public agencies, a concentration on narrow book balancing inhibits horizontal accountability. That the Comptroller's governing body, the Legislative Assembly, has not encouraged the Comptroller to oversee the behavior of the executive or of the decentralized sector impairs accountability and transparency.

Appointment of directors and board of directors of autonomous institutions remains shrouded in mystery. Though parties choose presidential candidates in

primaries (a process that started in the 1970s), presidential candidates and factional leaders fill closed-list PR lists for the Legislative Assembly, without consulting very much with the regular members. The half-hearted efforts to reform the legislative candidate selection process, which started in the 1990s, have not produced legislative contingents more responsive to citizen demands. While Assembly deliberations often have gotten front-page billing in newspapers, the virtual absence of roll-call votes limits accountability and transparency. Committee hearings do not get much media attention and budget committee hearings are not constitutionally required to make their deliberations public.

3.3. Resource efficiency

It is hard to judge the resource efficiency of the political system during the review period. It is clear that something like a bureaucratic apparatus continues to exist in Costa Rica, one that has many of the tools and some of the resources necessary for policymaking success.

The use of the available economic and human resources by the government has not been optimal. The efficient use of economic resources suffered from the inability to manage the budget deficit, the failed tax reform, and the salary rise for public employees. At the bureaucratic level, a civil service law dating from 1951 is a source of rigidity. Interviews with policymakers reveal that it is virtually impossible to dismiss state personnel for lack of performance or for corruption. They allege that salaries for lower-level administrative staff are higher than in the private sector while salaries for professional workers are lower. There are concerns about more qualified staff leaving the state sector. The not-high 2004 Transparency International index for Costa Rica (ranked 41st of 146 countries) supports the claim that many observers make that cumbersome bureaucratic procedures permit public servants to extract “bribes” from citizens before performing basic public services. While no one claims that bribery is widespread in Costa Rica, inefficiency does create possibilities for rent seeking. It also contributes to low public regard for the political system, even though few citizens report being the victims of corrupt acts.

During the last two years, the Pacheco government often failed to successfully coordinate conflicting interests and objectives; presidential leadership and capability for integration were sometimes too weak. For example, in the face of the public sector work stoppages in 2004, the President agreed to the salary rise, which in the end led to the resignation of the Finance Minister and several other cabinet members.

Renewing a bankrupt party system and improving the effectiveness of checks and balances are tasks complex enough to keep public officials busy for years. Though most of the integrity mechanisms are in place in Costa Rica, the Pacheco

administration has done little to combat corruption other than allocating additional funds for the General Attorney and approving the anti-corruption legislation the Assembly approved in late 2004.

Unfortunately, the current administration must also repair the ship of state as it is becoming dangerously low on fuel. Though the public sector no longer has a huge external debt with which to contend, it is running short of funds just when it needs them to rebuild itself. The dramatic rise in the public debt is an outcome that severely restricts the government's ability to deploy resources in order to confront political and economic challenges.

3.4. Consensus-building

Between 2003 and late 2004, the well-established consensus in favor of the country's social market economy, and its export-oriented growth model, continues to exist. However, debate in Costa Rica does revolve around ways to increase state revenues, clean up its political system, and deepen democracy.

Deep-seated conflicts do not exist. Elected officials and citizens therefore do not have to worry about thwarting political polarization. Indeed, the political system is a product of numerous negotiations over past conflicts, mostly about the distribution of state power. The political system promotes stability and compromise, even if the disintegration of the two-party system and other structural changes is slowing down policymaking.

Critics of the consensus, however, do exist. On the left, factions within the Party of Citizen Action (PAC), which holds 25% of Assembly seats, raise questions about neo-liberalism. Public sector labor unions express opposition to CAFTA. On the right, only one party, the Party of the Libertarian Movement (PLM), openly questions the "social" side of this project.

Building consensus around raising taxes (or cutting public expenditures) and political renewal is not easy. For example, President Pacheco asked a committee of distinguished economists to produce a report on fiscal reform, one that initially welcomed the participation of civil society, but later dropped many of their proposals. Issued in 2003, the fiscal reform bill remains frozen in the Assembly. Until the government and the citizenry agree to increase tax collection rates and pay for public services, increasingly voters will have their policy demands unfulfilled and yet another set of reasons to punish parties at the polls.

Strengthening social capital is not a priority for elected officials, even though they do not try to hinder its development. For the reasons presented previously, elected officials cannot exclude relevant social organizations from policymakers. It is true

that the highly centralized parties probably never went out of their way to work with unions, community groups or NGOs before the 1980s.

Reconciling perpetrators and victims of human rights abuses is not an issue in Costa Rica.

3.5. International cooperation

The political leadership does work with its international counterparts and organizations. Especially since 1982, governments have signed agreements with the Agency for International Development (USAID), the Inter-American Development Bank (IADB) and the World Bank. In economic affairs, Costa Rican administrations have been willing to work with, and borrow ideas from, international institutions. Though international counterparts express frustration with the slowness of lawmaking (a complaint no doubt likely to increase as a result of the collapse of the two-party system), the Costa Rican government has fulfilled international agreements and is therefore credible and reliable.

However there seems to be less interest in borrowing ideas for political renewal. The judiciary has signed agreements with both the Inter-American Development Bank and the World Bank for modernization. Yet, there are not a lot of policy specialists or researchers familiar with international debates and academic findings on transparency and accountability. This lack will make political change that much more difficult to enact.

Costa Rican governments have always been reluctant to get too involved in Central American affairs. The instability of the other countries on the isthmus makes Costa Ricans leery of too many entanglements with their neighbors. Costa Rica, nevertheless, is engaged in several bilateral agreements and has been actively involved in CAFTA.

4. Trend of development

4.1. Democratic development

The disintegration of the two-party system indicates that political participation and social and political integration more generally, have declined between 2001 and 2005. While the 70% voter turnout rate in the 1998 general elections is still quite good comparatively speaking, it marks a sudden 10% drop in the country's long-term rate. It stayed at this level in the 2002 elections, when the two dominant parties saw a dramatic drop in their share of the popular vote. Both the PLN and the PUSC went from obtaining 92% of the vote in the previous five elections to 63% in 2002.

Corruption scandals and, more importantly, weaknesses in horizontal accountability have negatively affected the rule of law. While any serious look at contemporary Costa Rica reveals continued strengths - fair elections and comprehensive health care coverage for its population, to name but two - it also reveals several glaring weaknesses, which observers have ignored given the overall strength of democracy in the country. While there is no effort to roll back democratic and social achievements, elected officials between 2001 and 2005 have done little to promote transparency and accountability.

The single-most important achievement during this period has been the General Attorney and La Nación's (the country's newspaper of record) aggressive investigation of acts of corruption. Neither President Pacheco nor the Legislative Assembly has opposed these efforts. Indeed, given the popularity of the anti-corruption struggle, both allocated additional monies for the General Attorney's office in late 2004. In late October of this year, the legislature issued the first ever anti-corruption law. Later this year, the Assembly also sacked Alex Solís as Comptroller General for having forged (with their consent) family member's signatures on checks.

4.2. Market economy development

The market economy continues to flourish. Attempts to open up state monopolies in electricity, telecommunications and insurance have stopped. The 2001 "combo" protests killed interest in dismantling state monopolies. Until a new party system comes into existence, it will be very difficult indeed to forge the political consensus to advance these structural reforms.

Table: Development of macroeconomic fundamentals (2000-2004)

| | 2000 | 2001 | 2002 | 2003 | 2004 |
|--|-------|-------|-------|-------|-------|
| Real Growth of GDP in % | 1.8 | 1.1 | 2.9 | 6.5 | 4.2 |
| Export growth in %* | -12.2 | -14.2 | 4.6 | 16.2 | 2.4 |
| Import growth in % | 0.4 | -1.0 | -5.3 | 11.6 | 7.4 |
| Inflation in % (CPI) | 10.2 | 11.0 | 9.7 | 9.9 | 13.1 |
| Investment in % of GDP | 17.8 | 18.0 | 18.6 | 18.9 | 17.5 |
| Tax Revenue in % of GDP* | 11.9 | 13 | 13 | 13.2 | n.a. |
| Unemployment in % | 5.3 | 5.8 | 6.8 | 6.7 | 6.7 |
| Budget balance in % of GDP | -3.0 | -2.9 | -4.3 | -2.9 | -2.8 |
| Current account balance in billion \$* | -0.75 | -0.74 | -0.92 | -0.93 | -0.89 |

Sources: CEPAL, Estudio Económico 2004-05, Santiago de Chile 2005; * Programa del Estado de la Nación, *Estado de la Nación en Desarrollo Humano Sostenible: X Aniversario* (San José: Programa del Estado de la Nación, 2004).

D. Strategic perspective

One scenario for the future is bleak. The two-party system will completely disappear with the 2006 elections. The assembly will become more fragmented and be filled with political novices incapable of repairing the ship of state. Disagreement between the executive and the legislature will paralyze policymaking. There will be no political consensus to raise tax rates and improve tax collection and/or to cut expenditures. Public sector strikes will further impair the quality of public services. Economic growth will fall and so will investment in the economy. In different ways, this route led to the collapse of democracy in Uruguay in 1973 and to its implosion in contemporary Venezuela.

An alternative scenario is that the stress and even crisis will be the backdrop for political renewal. Though establishing new ways of selecting presidents of autonomous institutions and their boards will be harder, changing the blatantly partisan manner in which they are chosen is far from impossible. Perhaps the assembly will even agree to hold roll call votes, something that deputies have resisted for years, but that transparency and political accountability require. Moreover, the Costa Rican economy is also growing, unlike in Uruguay between the 1950s and early 1970s and contemporary Venezuela.

Serious political renewal will have to wait until 2006, at the earliest. As of this writing, it is already beyond the halfway mark in President Pacheco's term, the date by which presidential powers swiftly decay. Term limits quickly make presidents into lame ducks, a process accelerated because Pacheco only had the support of 33% of the assembly at the beginning of their terms. Pacheco has also proven uninterested in doing little more than observing political events and trends, especially once his ratings in the polls began to slide in 2003. Political observers criticize him for doing little to advance fiscal reform and for linking its approval with enactment of CAFTA. At an unfortunate time, the country is saddled with an executive unwilling to advance the multifaceted and long-term agenda that democratic stability requires.

In the near and medium term, international supporters should encourage elected officials to promote transparency and accountability. The international community should condition aid on the promulgation of a "small" reforms so that, in the medium and long term, citizens recover their faith in the political systems. It should work with groups like the Academia de Centroamerica, the Programa del Estado de la Nación and other groups that are a goldmine of information about politics, policymaking and political economy in the country. In addition to encouraging legislators to hold roll call votes, they could encourage the assembly to issue regular bulletins about committee work and deliberations. Autonomous institutions should be required to make their executive deliberations public. Before considering an administrative rule change, bureaucrats should regularly solicit the opinions of interested parties and the public at large. Costa Rica should

also adopt a freedom of information law to make information of public policymaking much more accessible. It remains unclear how informed key policymakers are about the international transparency agenda; the international community can play a vital role by disseminating information about the diversity of ways in which political systems can open up and promote accountability.