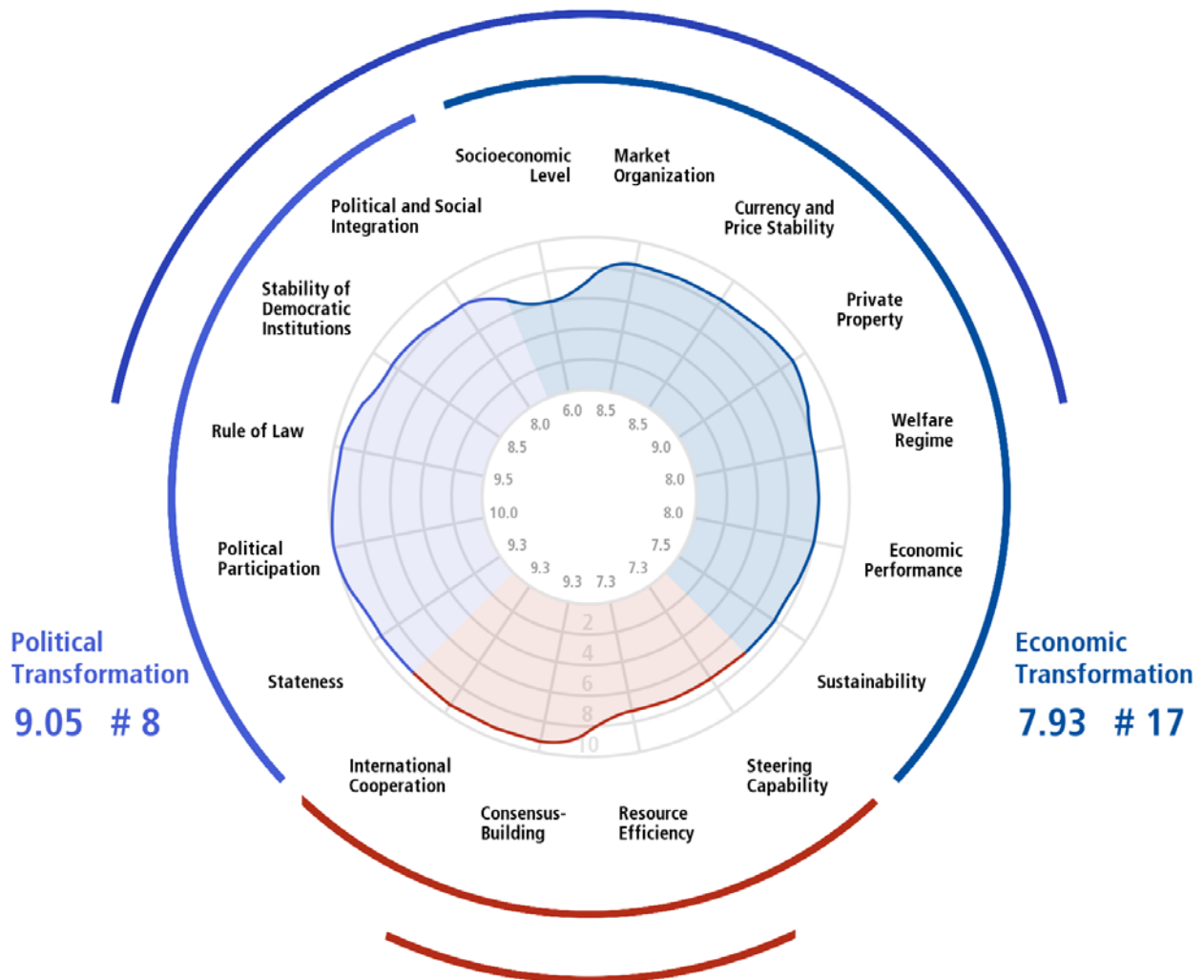


Costa Rica

Status Index

8.49 # 12

on 1-10 scale out of 129



Political Transformation
9.05 # 8

Economic Transformation
7.93 # 17

Governance Index

6.85 # 9

on 1-10 scale out of 129

This report is part of the Bertelsmann Stiftung's Transformation Index (BTI) 2018. It covers the period from February 1, 2015 to January 31, 2017. The BTI assesses the transformation toward democracy and a market economy as well as the quality of political management in 129 countries. More on the BTI at <http://www.bti-project.org>.

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Key Indicators

Population	M	4.9	HDI	0.776	GDP p.c., PPP \$	16614
Pop. growth ¹	% p.a.	1.0	HDI rank of 188	66	Gini Index	48.2
Life expectancy	years	79.6	UN Education Index	0.714	Poverty ³	% 4.2
Urban population	%	77.7	Gender inequality ²	0.308	Aid per capita \$	22.6

Sources (as of October 2017): The World Bank, World Development Indicators 2017 | UNDP, Human Development Report 2016. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$3.20 a day at 2011 international prices.

Executive Summary

During the review period (2015-17), under the administration of Luis Guillermo Solís Rivera, who has been in power since 2014, Costa Rica experienced a strengthening of economic growth and a reduction in poverty, with low, single-digit inflation, stable exchange rates and a significant improvement in tax collections. It saw 98% of its electricity generated from renewable sources, a lower level of perceived corruption, its first direct municipal elections held independently from national elections, and a decision by the International Court of Justice in The Hague that reaffirmed its territorial sovereignty and awarded it payment of an indemnity for environmental damages. These developments reaffirmed the strength of the country's political and economic institutions, evidenced in its high level of human development and its active democratic life. They also evidenced the continuation of a strong commitment to social protection in a competitive market context, with a high level of transformative capacity. At the same time, structural and circumstantial factors limited the country's ability to progress at a faster pace.

Amid some variability, citizen support for democracy continued a long-term downward trend. Trust in, as well as identification with, political parties remained weak, and fragmentation increased in the Legislative Assembly, where the president's party is in the minority. Congressional gridlock has thus far left the government without passage of its most pressing legislative priorities: tax and spending reform bills. Over the last decade, public spending has outpaced revenue by a wide margin, generating a fiscal deficit close to 6% of GDP and a growing public debt burden. This trend is unsustainable and may have serious negative consequences if not corrected in the short term.

Despite the observed reduction in poverty, its level has remained at the 20% threshold for years. Extreme poverty rates have remained stagnant, with a slight increase in the number of households in that state during 2016. Inequality levels continued to rise with the Gini coefficient for 2016 registering its second highest value since 1990. Positive economic growth did not translate into robust employment opportunities and unemployment remained stubbornly high. While the

country's strength in renewable energy was reaffirmed, little changed regarding the substantial carbon emissions emanating from the transportation sector.

The considerable transformations unleashed with the opening of telecommunications and insurance to competition in the aftermath of Central America Free Trade Agreement (CAFTA) have contributed to market growth, lower prices and improvements in quality in those areas. However, legally sanctioned restrictions have created an uneven playing field in banking, electricity and other sectors, limiting potential additional gains from transformation.

The overall pace of economic and political transformation in the country will continue to be challenged by structural factors that remain unchanged since 2013-2014. These include an increasingly complex public administration and a large number of veto players in the political system, including an assertive Constitutional Court and a fragmented party system where minorities are empowered by lax legislative rules of procedure. While a system that fosters consensus and moderation in policy shifts may be desirable to some extent, at the extreme it can create a dangerous inability to adapt to challenging and changing circumstances. Future transformational capacities will therefore depend on the ability to improve upon some of these features.

History and Characteristics of Transformation

Costa Rica is the longest continuous presidential democracy in the Western Hemisphere, second only to the United States. Even among developing nations, the longevity of its democratic regime is second only to India. One of its key transformation moments was the adoption of a new constitution in 1949 after a civil conflict in 1948. This document, and its subsequent reforms, established the bases for the country's political and economic development throughout the second half of the 20th century. It made the state a key player by entrusting it with the fulfillment of key social, economic, and (later) environmental rights, while maintaining important areas of the economy, like banking, electricity and telecommunications as state monopolies. It also entrusted the state with the administration of health, education and housing, and spawned a network of autonomous institutions. The constitution also introduced innovations with the abolition of the army and the creation of an electoral tribunal. This tribunal has the standing of a fourth branch of government and enjoys complete autonomy from the executive, legislative, and judiciary branches. It is charged with organizing elections and holds total jurisdiction over electoral matters, including the settling of disputes.

This constitutional model enabled key accomplishments. It solidified democratic institutions by enabling and assuring widespread participation and robust political party competition. It fostered strong public investments in human and physical capital and the rule of law, which served as backbones to the development of the economy. Finally, it made possible the attainment of high

levels of human development, balancing social and economic priorities, reducing poverty and inequality and protecting the country's environmental patrimony.

In the last 60 years, disagreements between the legislative and executive branches have always been settled through institutional channels, consolidating the democratic system. However, the country has not been exempt from periods of economic instability. At the end of the 1970s, the state-based model came under stress through the combined effects of internal inconsistencies and adverse international conditions sparked by the OPEC shocks and world recession. Rising fiscal and trade imbalances, accompanied by growing debt, climaxed in runaway inflation and massive currency devaluation, leading to a process of structural reform in the early 1980s. Significant liberalization took place during this period mainly within the trading sector, where tariffs and duties were reduced drastically. Privatization was restricted to unprofitable state enterprises while state monopolies in banking, insurance and utilities were left untouched. Only gradually did liberalization advance in these areas, starting with the banking sector in the 1990s. An export-promotion strategy succeeded in attracting foreign direct investment and allowing the country to diversify its production base, first through non-traditional agricultural exports and later through high-tech industries clustered in free-trade zones. International insertion also spawned the development of a vibrant tourist industry, much of it premised on the country's ecological riches. Tourism currently brings in over 2.5 million visitors – over half the country's population – annually.

A key transformation occurred in 2007, when the CAFTA was ratified in the country's first-ever referendum. The agreement encompassed a set of complementary laws that called for the opening of competition in telecommunications and insurance. However, as in banking, no privatization occurred. The state lost its monopoly, but its enterprises must now compete against the private sector. While this has improved the competitiveness of markets, it is not clear that it provided a completely level playing field.

Another key turning point was the establishment of a fourth, constitutional chamber in the Supreme Court in 1989. The court has jurisdiction over the protection of individual rights, the interpretation of the constitution, and the settling of disputes among the branches of government. In order to better protect rights, access to the court was made easy and virtually costless, in fact revolutionizing the exercise of constitutionally guaranteed individual rights and their protection. Access was also facilitated in matters of constitutionality, enabling challenges to laws and statutes, effectively activating a check that had been largely inoperative since 1949. Highly valuable and important, the court has become an assertive arbiter of political disputes, particularly as executive-legislative relations have become more quarrelsome and gridlocked. The court has also entered the realm of administrative decision-making in its enforcement of individual rights. Because lawmakers can submit bills to the court for prospective opinions about their constitutionality, it has become an important veto player in the legislative process.

Costa Rica's political and economic performance has shown some signs of stagnation in recent times. Economic inequality has increased and poverty levels, despite some recent marginal improvements, have remained high. The country's basic infrastructure has not been modernized fast enough to support the needs of a more dynamic economy, and not all participants in the labor

market have benefited equally from economic modernization. Corruption scandals have tarnished the reputation of the traditional parties, contributing to the collapse of the longstanding two-party system and generating widespread disenchantment with politics and politicians. Deficient financial management appears to be undermining the country's welfare system. Thus, transformational change has become increasingly more difficult and Costa Rica's regional lead in basic social and economic indicators has eroded.

The BTI combines text analysis and numerical assessments. The score for each question is provided below its respective title. The scale ranges from 1 (worst) to 10 (best).

Transformation Status

I. Political Transformation

1 | Stateness

The state faces numerous challenges in the arena of citizen security, but its monopoly on the use of force has not been openly challenged. Inroads by drug trafficking organizations have made the Central American region dangerously prone to violent crime. While Costa Rica has not reached the levels of criminal violence of the countries in the Northern Triangle (Honduras, Guatemala and El Salvador), its homicide rates nearly doubled between 2000 and 2010, from 6.1 to 11.5 deaths per hundred thousand inhabitants. Despite some variation, they remained at that level in 2015. Up to 70% of these deaths are attributed to infighting between local drug bands, which in many cases are surrogates for Colombian and Mexican cartels, according to national security officials. The state has responded with a series of policies including social violence prevention, stricter gun control, improved coordination of intelligence, better funding for the police and increased police presence. A new police academy is slated to open its doors in 2017 to enhance the capacities of the force through basic and specialized training.

Territorial disputes along Costa Rica's northern border with Nicaragua continue to be a source of national concern and international attention. A ruling from the International Court of Justice in The Hague required Nicaragua to remove all military personnel from an encampment on a small stretch of Costa Rican soil and to pay an indemnity for environmental damages caused by dredging operations in 2010. According to Costa Rican officials, neither has occurred to date.

The legitimacy of the nation-state is broadly accepted by the population. There are social and political actors who seek to strengthen their influence through collective action, but they do not question the legitimacy of the nation-state. Some of the most militant groups in the public sector unions have on occasion threatened to counter public decisions through "street democracy," but what, if anything, beyond popular mobilization this means has remained ambiguous, and unsubstantiated. The local think tank, Programa Estado de la Nación, reports a significant decrease in social

Question
Score

Monopoly on the
use of force

9



1

State identity

10



1

conflict and citizen protest since the start of the Solís administration, which it attributes to closer links between social sectors and the state. Residents in rural areas tend to fare more poorly on social indicators than their urban counterparts. Nevertheless, this has not led to protest outside the context of institutional mechanisms. All rights, including human rights, are recognized throughout the country.

Although Article 75 of the constitution establishes Roman Catholicism as the state religion, that same article recognizes freedom of religion. This has generated calls from some sectors for the complete secularization of the state. Catholic archbishops and clergy, together with evangelical political parties – which currently control four of the fifty-seven seats in the legislature – are vocal on key political issues, actively opposing same-sex unions, in-vitro fertilization and abortion. Despite this, albeit after much delay, in 2016 the country complied with a ruling from the Inter-American Court of Human Rights ordering the reinstatement of in-vitro fertilization. It is likely that positions from religious leaders influence public opinion, but it is not clear to what degree, if any, they impact lawmaking directly.

At an administrative level the state successfully provides basic services on a national scale, particularly in health, education, potable water, electricity, and telecommunications. In late 2015 the country inaugurated a major solid waste treatment plant that will service over 65% of the population in the San José metropolitan area. This is a significant milestone for its reduction of contamination of water basins, major rivers and the gulf of Nicoya. The central government also increased tax revenues in 2015 and 2016 through improvements in income tax collection. However, the state has evolved into a complex of entities and organizations, which presents increasingly pervasive functional challenges. Executive capacity has been questioned in the area of transportation infrastructure, where the repair of a key bridge on the Pan-American highway – known as “la platina” – has eluded authorities for years at great cost and inconvenience to the population (this bridge will be repaired in March 2017). Execution problems also arose in the construction of a riverine road alongside the border with Nicaragua, which failed after considerable expenditure, and the development of a major highway connecting the city of San Carlos with the capital, which has faced multiple delays and cost overruns. More recently, a crisis has befallen the social security system (CCSS) that has caused its administrative capacity to be seriously questioned. Its operational manifestations have been evident in long health service queues, bloated payrolls, and logistical problems ranging from drug availability to the management of medical facilities. An actuarial evaluation has also revealed that, in the absence of stringent reforms, the reserve fund for the country’s retirement and insurance system may become insufficient in a matter of years. CCSS administrators are considering those reforms, but recently and unilaterally increased the payroll contribution of workers by one percentage point, raising questions about the fairness and soundness of the measure.

No interference of religious dogmas

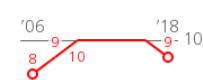
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1

Basic administration

9



1

2 | Political Participation

There are no constraints on free and fair elections. The Supreme Electoral Tribunal has evolved into a worldwide prototype of excellence in the organization and management of elections. Electoral registration is automatic and virtually costless with the acquisition of an identity card required for all citizens. Political parties receive state funding based on their vote shares, and media access for candidates and parties is based largely on this funding. The last national election, held in February 2014, required two voting rounds and there were no major incidents or contestation of the results. The relevance of electoral participation was expanded with the institution of plebiscites and referenda (2006) as well as the direct election of municipal executives and councils (2002). In 2016 elections for the country's 81 municipal governments were held separately from national elections for the first time. Over 30,000 candidates competed for about 6,000 municipal offices, representing 59 political parties, 16 of which were national-level organizations. This number represents an increase of more than 25% over the number registered in the last municipal election, which is consistent with the trend toward multipartism observed at the national level. The last national election (2014) produced nine parties with representation in the legislature, the highest ever in the country's history.

Democratically elected political representatives have effective power to govern, and there is no single group or individual capable of exercising an absolute de facto form of veto power. While there are powerful actors capable of influencing the course of public affairs, notably business groups, public unions, the clergy and the press, among others, none of them can exercise an uncontested veto. No single group can stop the enactment of decrees or legislation without due process and only if the Constitutional Court rules that the legislation or decrees in question are unconstitutional.

Association and assembly rights are unrestricted for individuals and independent political or civic groups and guaranteed by the constitution and the labor code. There are multiple groups in multiple sectors organized at the national, regional and local levels, which regularly exert their influence on government and public opinion, including through mobilization and protests. New groups, such as advocates for sexual diversity, the informal transportation sector and environmentalists have more recently emerged on the social protest scene, experiencing no discrimination from the government. Unionization in the private sector is not extensive, but many workers join solidarist associations, which, aside from providing benefits like low-interest loans, health and recreation services, and savings, may serve as a channel for improved labor relations. Whether these organizations serve as a mechanism that hinders unionization, as labor union leaders allege, is a point of contention.

Free and fair elections

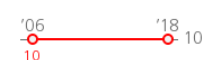
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1

Effective power to govern

10



1

Association / assembly rights

10



1

Freedom of expression is unrestricted for citizens, groups and the press as guaranteed by Articles 26-29 of the constitution. Article 30 guarantees free access to all information from administrative departments that is of “public interest,” except “state secrets.”

A broad array of press outlets, from newspapers to radio, television and the internet, inform citizens and provide varied perspectives on the news and current affairs. The country is ranked sixth in the Reporters Without Borders’ 2016 Press Freedom Index, above all other Latin American and Caribbean countries. This is an improvement over the 2015 index, where the country was ranked 16th worldwide and second in the region.

Recent events reveal these rights have not gone unchallenged, but also that they have been fiercely defended and emerged stronger as a result of those challenges. In 2014 the government was accused of spying on the newspaper *Diario Extra*, monitoring the private and professional phone calls of its journalists over a ten-month period. The Constitutional Court promptly ruled the surveillance, which had been approved by the Prosecutor’s Office, unconstitutional. The judge handling the case expanded the definition of journalist to include any person regularly contributing to reporting or public opinion, including freelancers and bloggers.

In 2015, the government proposed a new law that would have established limits to free expression, effectively punishing the use of certain types of language. This widely decried “gag law” was shuttled, and later that year the legislature derogated three articles of a 1954 law that contained similar provisions, but that had long ceased to be enforced. In 2016, Banco Nacional, which is owned by the state, admitted to withholding advertising contracts from *La Nación* newspaper as punishment for publishing articles criticizing the bank. The Constitutional Court condemned the bank for using public funds as a means of coercion and censure aimed at misdirecting public opinion.

Concerning access to information, Article 30 is (still) not substantiated as a proper freedom of information law. Yet, according to existing Costa Rican law, there are procedures for obtaining information from public institutions, with which the government generally complies.

3 | Rule of Law

There is a clear separation of powers with mutual checks and balances, structured around the constitution of 1949 and subsequent reforms. The system establishes three branches of government (executive, legislative and judiciary), adding a fourth, the electoral branch (the Supreme Electoral Tribunal). From a comparative perspective, the Costa Rican executive is relatively weak. Its decree powers are limited and subject to ratification by the Legislative Assembly, hence rarely used for substantive

Freedom of
expression

10



1

Separation of
powers

10

legislative purposes. Control of the legislative agenda is shared with the Legislative Assembly, passing to the president only during extraordinary sessions. In recent years, the amount of legislation originating from the executive has been decreasing. At the same time, growing party fragmentation and ideological polarization have weakened the decisiveness of the legislature and complicated relations with the executive. This has increased the importance of the judiciary, particularly the Constitutional Court, which is charged with settling jurisdictional disputes between the other powers and interpreting the constitutionality of laws.

An additional component of the separation of powers in the Costa Rican state is the existence of horizontal control mechanisms to oversee and regulate the activities of the executive and its administrative entities. These entities, which are decentralized, largely autonomous and functionally specialized, provide services in the health, financial, energy, telecommunications, insurance and water industries. Their budgets account for as much as two-thirds of public spending and are not subject to legislative approval. They also enjoy considerable autonomy from the executive in terms of their administrative, legal, operational and labor management. Such levels of decentralization and autonomy require horizontal control mechanisms. Principal among these is the Comptroller General's Office, which has a broad and strong mandate to supervise the use of public funds, not only based on legality but also efficiency and outcomes. It has recently been critical, together with the press, of public salaries that far exceed those in the private sector, mostly due to numerous emoluments known as "pluses" that often surpass base salaries.

The judiciary is independent of and free from unconstitutional intervention by other institutions. The second article of the Organic Law of the Judicial Branch establishes that its authority is subject only to the constitution, the law and its own decisions regarding matters within its competence. Norms of independence are entrenched and zealously defended by all sectors, especially the court magistrates themselves. The courts are widely trusted and used by citizens and private corporations as an arena to settle disputes. Even though they are not believed to be corrupt in general terms, cases of corruption do occasionally emerge, but are prosecuted. The independence of the judiciary is guaranteed by a constitutional provision that assigns it 6% of the central state's expected revenues for its operating budget.

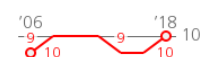
The Costa Rican state has ratified international treaties, approved laws, and supported watchdog organizations against corruption. Citizen awareness and activism against office abuse is high, partly because of a vigilant media that has been quick to denounce it. The evidence suggests that allegations of corruption that are exposed will be prosecuted – including those that involve former presidents, ministers and mayors. Most recently, for example, the Public Prosecutor's Office announced indictments for 26 individuals in the public and private sectors for alleged financial and administrative abuses during construction of a road along the Nicaraguan border under the Chinchilla administration. However, even when prosecution occurs, it takes



1

Independent judiciary

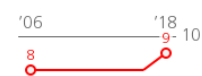
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1

Prosecution of office abuse

9



1

a long time and often fails to result in convictions. In the example just cited, it took six years from the events in 2010 to bring charges against the accused parties. This may have contributed to negative perceptions among the population regarding the prosecution of office abuse. In the eyes of normal people, salary increments of high-level bureaucracy is also corruption (such as salary increases for the general manager and president of the central bank). In the Latin American Opinion Project (LAPOP) 2014 survey, 52.2% of respondents believed the government had done little, very little, or nothing to combat corruption. The Latinobarómetro poll for 2015 found that 63% of respondents consider there was little or no progress in reducing state corruption over the last two years.

Civil rights and non-discrimination are guaranteed by the constitution and enforced through institutions like the Constitutional Court and the ombudsman's office, which provide citizens channels to present grievances against the state in matters concerning their rights. The Constitutional Court allows individuals to seek recourse ("Amparo") for the violation of constitutional rights. Access to the court is extremely open and virtually free of cost. Anyone (including non-citizens) can present a writ without needing a lawyer or using specialized language. Only a description of the grievance is required. The court's decisions carry the weight of law and cannot be appealed. The ombudsman's office (or Defender of the Inhabitants) serves as an advocate of citizen rights and intervenes at the administrative and judicial levels to remediate rights violations, both for individuals and groups. According to the Latin American Public Opinion Project (LAPOP 2014), over 71% of citizens consider that their basic citizenship rights are protected by the state at or above the median level.

A constitutional amendment was passed in 2015 to define Costa Rica as a multiethnic and pluricultural republic, highlighting the historical relevance of racial and ethnic minorities not formerly acknowledged in the country. Together with laws and regulations safeguarding the rights of indigenous peoples, promoting female electoral inclusion and preventing violence against women, these institutional structures evidence a formal intention to protect minority rights. However, real outcomes suggest that inequalities persist in the degree of access to these rights. Freedom House (2016) affirms that indigenous rights have not been a government priority and that indigenous peoples, who make up 3% of the population, face discrimination regarding land rights and access to basic services. It also cites evidence of discriminatory attitudes and practices among law enforcement officers toward the LGBT community. Female labor participation in 2015 was 48% compared to 74% for males. This level of incorporation into the workforce is low by comparison to other emerging economies and the Latin American region, especially given that Costa Rican women outperform men in acquiring education.

Civil rights



4 | Stability of Democratic Institutions

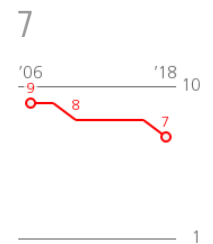
Democratic institutions are the effective means through which political decisions are prepared, made, implemented and reviewed. However, their relative efficiency has been under strain. Fragmentation and ideological polarization have increased in the Legislative Assembly, where the governing party has not held a majority since 1994. The current government of Luis Guillermo Solís does not even hold a plurality, as it controls only 23% of the seats in the legislature. Together with factional divisions within political parties, this has increased the difficulty of coordination between the legislative and executive.

A profusion of veto players within the institutional domain of the state has increased the difficulty of enacting change within the system. At the administrative level, the Comptroller General exercises strict financial and administrative control of the multiple organizations under its purview. While necessary, this greatly reduces the flexibility of the executive. At the citizen level, the Constitutional Court has empowered individuals against administrative action (or inaction) in every aspect of public service covered by the constitution. At the legislative level, procedural rules allow for easy filibustering by minority groups, blocking the passage of substantive reforms. Legislators can also submit bills in process to the Constitutional Court for a review of their constitutionality. These regime characteristics have diluted the effectiveness of democratic institutions while also reducing accountability, by allowing the different players to blame each other for inaction.

Costa Rica has a relatively weak executive, with practically no decree powers and a limited veto. The enactment of its agenda depends on its ability to negotiate with the veto players it must confront and to generate political agreements, if not consensus. The transition from a two-party to a multi-party system has made this increasingly difficult. The *Estado de la Nación* found that during the 2015-16 legislative period only eight bills were approved out of 103 substantive initiatives on the legislative agenda. This gap between legislative demand and supply is the largest of the last 15 years. The reforms that remained pending include key bills to improve the country's fiscal position through new taxes and expenditure reform, as well as long awaited legislation to allow same-sex unions, among others. Costa Rica is a presidential regime where the decision power lies with the Legislative Assembly and the responsibility of action or not belongs to the president of the republic.

While there have been considerable efforts to increase the level of decentralization of the state by transferring greater competencies and resources to municipal governments, as well as allowing the citizenry to elect local representatives directly, the effectiveness and political reach of these governments still appears limited. The Latin American Opinion Project survey (2014) shows that only 10% of those interviewed in a nationally representative sample request assistance from their local

Performance of democratic institutions



government and only 7% attend its meetings. Over half the respondents indicated municipal services were neither good nor bad.

All relevant actors accept the legitimacy of democratic institutions. Democratic norms are well internalized and constitute part of the regular discourse among political actors. This includes respect for due process and the rule of law, the acceptance of rulings handed down by the courts, the peaceful transfer of power, and respect for civic and political rights, as well as the investiture of public officials.

Commitment to democratic institutions

10



5 | Political and Social Integration

While organizationally institutionalized parties exist in Costa Rica, the party system has been relatively fluid since the end of the period of two-party rule in 2002, with a tendency to increase its fragmentation and ideological polarization, and with weak and volatile voter affiliation. This has corresponded with declining levels of electoral participation and a reduction of party loyalty and identification. Party discipline has also diminished, as evidenced by an increase in the number of legislators becoming independent from the party with which they were affiliated when elected. Results from the 2016 municipal elections confirm the trend toward party proliferation and voter apathy. While the increase in the number of parties may enrich representation, both at the national and local levels, it also imposes greater demands on the system to generate consensus and, in its absence, may diminish effectiveness.

Party system

7



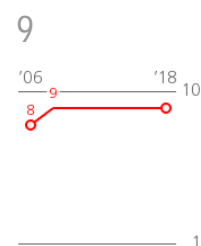
Several studies from Programa Estado de la Nación have highlighted that electoral support for the party system since 2006 has been characterized by its fragility and volatility. Party loyalty tends to be short-lived and linked to the personality of party leaders rather than to programmatic or ideological characteristics of the organization. According to the Latin American Public Opinion Project (LAPOP) 2014 survey, 53% of respondents have little to no trust in political parties, while almost 55% of respondents did not vote for the same party in 2014 as they did in the previous national election in 2010. Voters also tend to divide their votes, supporting different parties for the presidency and Congress in the same election. In the 2014 election, two parties passed to the second round with a combined 60% of the presidential vote: Acción Ciudadana (PAC) and Liberación Nacional (PLN). However, they received 0.8 and 0.9 congressional votes, respectively, for every one of their presidential votes. On the other hand, smaller parties without a viable presidential candidate obtained many times the number of their presidential votes in the congressional election. This increased the number of parties in the legislature to nine (4.92 if weighted by vote share), the highest level since 1953.

Similar phenomena were observable in the 2016 municipal election. According to the Programa Estado de la Nación, only 35% of registered voters showed up to vote, indicating a high level of voter apathy, especially in urban sectors. There was a high level of turnover from the previous municipal election in terms of party control at the executive level. At the legislative level, municipal councils were highly pluralistic in terms of party representation. Only 17.3% of the municipalities had unified party control of the executive and legislative. There were 59 parties competing at the municipal level, 43 of which exist only at the local level.

Ideological polarization has also been on the rise, particularly since 2002. The Project on Latin American Elites, a survey compiled by the University of Salamanca, shows that, according to legislators, the leading parties have been moving in the opposite directions on the ideological spectrum, with the PLN inching to the right and the PAC to the left. The 2014 election featured a strong challenger from the left with a charismatic candidate leading the Frente Amplio (FA). While kept from participating in the second round of the presidential contest, the party won nine seats in the legislature, the highest ever by a leftist party, with representation from every province.

Costa Rica has a broad range of interest groups, ranging from social movements and community organizations to unions and business and professional associations. There are currently several thousand registered civic associations, 291 unions representing almost 290,000 workers, 1,400 solidarist associations representing almost 319,000 workers, 725 cooperatives, and over 3,628 community development associations. The peak employer organization, the Union of Chambers (UCCAEP), has 49 affiliates, which are associations themselves and in turn represent most of the productive sectors of the economy. There have been numerous social movements involving collaboration between a broad spectrum of actors, organized and ad hoc. According to the Programa Estado de la Nación, most mobilizations are staged by organized workers, but they are followed in importance by citizen groups (neighborhood and family associations and others). In 2015 labor mobilized in response to draft bills proposed by the government to streamline and limit employment and benefits in the public sector. The unions grouped themselves into two major blocks, but did not coalesce into a single alliance. Organized collective action episodes reported by the media typically average about 398 per year. They were particularly intense during the Chinchilla administration, but peaked at 587 in 2014, falling to 341 in 2015, after the arrival of the Solís administration. The state is generally respectful of these actions, including social protests that sometimes involve road closures, and abstains from repressing or undermining them. At the same time, there are no organized movements that seek to undermine democracy or civil society. The Latin American Public Opinion Project (LAPOP) surveys show that the percentage of Costa Ricans that engage in protest marches and demonstrations is about 7% (2014).

Interest groups

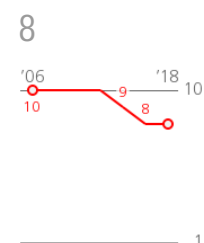


Approval of democracy shows a long-term downward trend which is consistent with the pattern of deterioration identified in the party system, the volatility of electoral preferences, lower political participation, and disenchantment with corruption scandals and the political leaders identified with them. The indicators of support for democracy themselves show a considerable level of variability, which suggests ambiguity on the part of the citizenry. The Latin American Public Opinion Project (LAPOP) measures the levels of diffuse support for democracy through an index of five questions that probe respondents' respect for democratic institutions, norms, and rights. In its 2014 survey, Costa Rica led the Latin American region with the highest score for the system support index, 62.7 (the highest value possible is 100). However, in its previous survey (2012), Costa Rica had scored its lowest value since 1978, 56.8, and in a new study conducted in 2015 and reported by the Programa Estado de la Nación, the index fell by almost four points to a value of 59, its second lowest value, and a loss of about 20 points since 1978. This negative downward trend is confirmed by an alternative measure of democratic approval, expressed support for democracy as preferable to any other form of government. While in the past Costa Rica tended to score considerably higher than the Latin American average and at the highest levels of the ranking with approval rates up to 83%, its more recent scores, as reported by Latinobarómetro, place it scarcely above the regional average with 57% (2015) and 60% (2016).

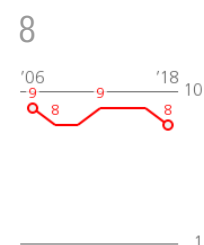
The Programa Estado de la Nación also reports a three-dimensional indicator of democratic approval, the degree to which citizens show dissatisfaction regarding democratic principles, government performance and support for political institutions. It finds that this "triple dissatisfaction" index increased considerably in the last five years, and that it correlates with the degree to which respondents refute the notions that their society is free, peaceful, and green, and that democracy is the most preferable form of government. However, the report also cautions that the proportion of triply dissatisfied respondents remains small, and that it could well serve as a catalyst for transformation in a mature democratic context such as Costa Rica's.

The level of interpersonal trust as measured by opinion surveys is moderate and shows a decreasing trend. In 2010 the Latin American Opinion Project (LAPOP) ranked Costa Rica as having the highest level of interpersonal trust in the Americas, ahead of Canada and the United States. For its 2014 survey, Costa Rica scored right around the mean. There are a considerable number of civic associations, 291 unions, 1,400 solidarist associations, 725 cooperatives and over 3,628 community development associations. The degree to which individuals engage with those organizations does not appear to be great. Of five types of associations evaluated by LAPOP in 2014 – religious, parents', community improvement, political, and women's – only in religious associations did 50% or more of respondents affirm participating at some level. For the other four types of associations, upwards of 74% of respondents said they never engaged with them.

Approval of democracy



Social capital



II. Economic Transformation

6 | Level of Socioeconomic Development

Costa Rica has actively promoted and sustained policies for social inclusion that have resulted in high levels of human development. However, poverty reduction has remained stagnant, inequality has increased, and the country has lost ground in both its world ranking and absolute level of human development, as calculated by the United Nations Development Program (UNDP).

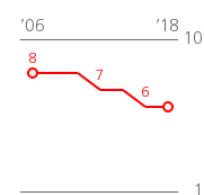
While the country ranked 54th in the world and had a Human Development Index (HDI) score of 0.854 in 2009, the latest report shows it falling in ranking to 69th with an HDI of 0.766 in 2014. This has occurred despite increasing levels of social spending, which suggests there may be problems of effectiveness and efficiency, particularly in the realm of education. The incidence of poverty and extreme poverty has remained above 20% and 6%, respectively, since 1994. There was a notable reduction in poverty between 2014 and 2016, with its incidence falling from 22.4% to 20.5% of households. Extreme poverty increased slightly in 2015, to 7.2%, falling back to 6.3% in 2016, virtually the same level as in 2014 (6.7%). Income inequality has increased significantly over the last decade. The Gini coefficient went from 0.495 in 2006 to 0.521 in 2016. While in 2006 people in the tenth decile had 19.9 times the average income of those in the first decile, in 2015 that ratio increased to 27.2 times. When adjusted for inequality, Costa Rica's HDI 2014 score fell by 20%, dropping the country 11 points in the ranking. Inequality peaked in 2013 with a Gini coefficient of 0.522, falling slightly in 2014 to 0.516 and remaining unchanged in 2015. In 2016 those gains were reversed as the Gini rose to 0.521, almost back to the 2013 level. Real minimum wages grew by 3.8% in 2015, but average household income remained relatively stagnant.

Poverty levels in 2016 suggest a lower household incidence in urban (18.6%) than in rural (25.7%) areas. However, 73% of the population lived in urban settings that year. Inequality is not significantly different across urban and rural sectors, but it is higher in two of the country's six geographical planning regions than it is for the country as a whole: Brunca (south Pacific, bordering Panamá) and Huetar Norte (north-central, bordering Nicaragua). These regions also have higher poverty and extreme poverty rates than the rest of the country. While these are the country's most sparsely populated areas, they still represent 15.4% of its total population. In terms of gender, the incidence of poverty is higher among women, whose average monthly income is about 84% that of their male counterparts. While Costa Rican women have an HDI which is 97.4% that of Costa Rican men, this mainly reflects income differentials,

Question
Score

Socioeconomic
barriers

6



since females have higher life expectancy than men (81.9 vs. 77 years), and higher educational achievement. In the UNDP's 2014 Gender Inequality Index, which measures inequality against men in reproductive health, empowerment and labor markets, Costa Rica ranks 66th and places in the medium to high equality achievement level, better than the Latin American average, but lower than its 2013 rank (63rd).

Economic indicators		2013	2014	2015	2016
GDP	\$ M	49745.1	50656.0	54840.1	57435.5
GDP growth	%	2.3	3.7	4.7	4.3
Inflation (CPI)	%	5.2	4.5	0.8	0.0
Unemployment	%	9.4	9.6	9.6	9.0
Foreign direct investment	% of GDP	6.4	6.5	5.7	5.5
Export growth	%	3.3	5.2	0.0	9.5
Import growth	%	1.7	5.1	4.6	7.7
Current account balance	\$ M	-2431.2	-2488.8	-2383.7	-1879.6
Public debt	% of GDP	35.8	38.3	40.8	44.7
External debt	\$ M	17134.6	19722.1	23588.8	25567.1
Total debt service	\$ M	3287.0	3464.3	2767.2	2829.3
Net lending/borrowing	% of GDP	-4.5	-5.8	-	-
Tax revenue	% of GDP	13.7	13.4	13.6	-
Government consumption	% of GDP	17.6	17.5	17.5	17.3
Public education spending	% of GDP	6.9	6.9	7.2	-
Public health spending	% of GDP	6.9	6.8	-	-
R&D expenditure	% of GDP	0.6	0.6	-	-
Military expenditure	% of GDP	-	-	-	-

Sources (as of October 2017): The World Bank, World Development Indicators | International Monetary Fund (IMF), World Economic Outlook | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database.

7 | Organization of the Market and Competition

Market competition is consistently defined and implemented at macro- and microeconomic levels. Most prices are determined competitively and currency is easily convertible. The freedom to enter contracts in any currency is legally protected, and there are no restraints on making and withdrawing investments. There are state-guaranteed rules for market competition meant to ensure equal opportunities for all market participants (Law 7474). Article 19 of the constitution grants foreigners the same rights and obligations extended to nationals. In fact, foreign direct investment has been a primary factor in economic development in recent years. However, the OECD reports that foreign acquisitions of land and real estate in the coastal and frontier areas are limited, and there is an explicit preference for local suppliers in public procurement processes. Foreign suppliers can only participate in international tenders on the basis of reciprocity. Restrictions also exist in the energy sector, where transmission and distribution of electricity is a state monopoly, and power generation by private parties is limited and subject to bids from the public sector. Foreign investors in this sector must also partner with Costa Rican nationals, granting them a minimum 35% capital stake.

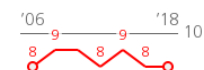
Starting a business in Costa Rica has become much easier in recent years: the World Bank's Doing Business Report 2017 shows it takes 24 days, just a day shy of the global average. The country is ranked 125th out of 190 in the global index in this regard, and 62nd in the overall global index concerning the ease of doing business. While the informal sector is considered small in comparison to other Central American countries, the National Statistics and Census Institute shows it hovers between 40% and 45%. Female informal labor rates are slightly higher than male informal labor rates, although males comprise a larger proportion of the workforce.

Laws to ensure competition are in place, and there is a National Commission for the Promotion of Competition (COPROCOM) charged with investigating and penalizing monopolistic practices or any other obstruction to the free functioning of the market. With the ratification of the CAFTA and the subsequent passage of its complementary laws, the insurance and telecommunication sectors, state monopolies since 1924 and 1963, respectively, were opened to competition starting in 2008. The electricity sector was also opened partially to allow for generation by private entities, but with a cap of 30% of national installed capacity (Law 7200).

While these actions have decidedly increased the competitiveness of the market, there are still considerable legally sanctioned monopolistic limitations. In the energy sector, electricity transmission, distribution and export are state monopolies. While regulated by the Autoridad Reguladora de Servicios Públicos (ARESEP), the state energy company, Instituto Costarricense de Electricidad (ICE), has considerable sway over the strategic direction of the sector and the determination of electricity

Market-based competition

8



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Anti-monopoly policy

8



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prices. A recent report by the state comptroller found that for the past 14 years ICE has overestimated electricity demand, obtaining investment allowances from regulators that have unnecessarily inflated electricity prices. In addition, cost overruns and delays in investment projects have resulted in some of its facilities generating electricity at costs significantly higher than international benchmarks. Private generators also depend on ICE to set contracts out to bid for half the capacity they are entitled to generate. Efforts to further liberalize the sector have encountered resistance and have stalled in the legislature.

The state also retains monopolies in alcohol distillation, the importing, refining and distribution of petroleum and its derivatives, and the operation of railroads, ports and airports. The latter have been offered in concession to private parties with some success – as in the case of the ports of Caldera and Moín, as well as the Juan Santamaría airport – after considerable delays from legal and contractual difficulties. State companies also retain important market shares where they previously held monopolies. The state insurance company holds upwards of 80% of the general insurance market. It is dominant in auto and fire insurance, but is increasingly challenged by private providers in health, where it has been pushed below 50% of the market. State banks are also dominant and engage in oligopolistic practices. They currently enjoy an explicit state deposit guarantee not available to their private competitors, which allows them to control about 70% of the market for demand and savings deposits in local currency. Inroads have been most significant in telecommunications, where the state company lost roughly 40% of its mobile telephony market and 80% of its mobile broadband market between 2010 and 2014. Overall, there has been a considerable broadening of competitive markets, but anti-monopoly policy remains limited by persistent legal reserves that are unlikely to change in the short term.

Costa Rica has continued liberalizing its foreign trade regime, mainly through participation in preferential trade agreements, both bilateral and multilateral, while at the same time maintaining a proactive strategy to attract foreign direct investment. The country can be considered widely liberalized with a trade-to-GDP ratio of 63% (2015) and an average weighted tariff of 4.1% (2014). In its Index of Economic Freedom 2016, the Heritage Foundation ranks Costa Rica as “Free” in Trade Freedom, with a score higher than the South and Central American, as well as the world, averages. Costa Rica joined the General Agreement on Tariffs and Trade in 1990 and became a founding member of the World Trade Organization in 1994. It has been an active participant in the multilateral trade system, including the trade negotiations of the Doha Round. To date, the country has signed free trade agreements with the United States, the Dominican Republic and Central America (CAFTA), the Caribbean Community of Nations (CARICOM), Canada, Chile, Mexico, Panamá, China, Singapore and Colombia. It is also a party to an association agreement signed between the European Union and Central America in 2012. Costa Rica initiated accession to the Organization for Economic Cooperation and

Liberalization of
foreign trade



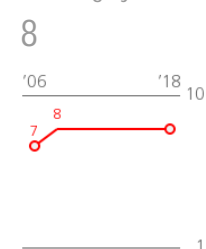
Development (OECD) in April 2015. It also has observer status with the Asia-Pacific Economic Cooperation (APEC) Forum, as well as the Pacific Alliance, and has invested efforts in joining the Trans-Pacific Partnership. The country is dedicated to the pursuit of international trade and is aided in its efforts by two state entities: the Ministry of Foreign Trade (COMEX) and the Promoter of Foreign Trade (PROCOMER), as well as a private export promoting office (CINDE).

The banking system is solid and governed according to international standards that include prudential supervision and capital adequacy requirements. All intermediaries must be registered with a superintendence (SUGEF) and unregulated players are now rare. At present there are 52 supervised institutions: 15 banks, of which four are state-owned, three are private domestic banks, and eight are private, foreign banks; 28 savings and loans cooperatives; and nine non-bank financial institutions, including finance companies and mutual funds. State-owned banks are the most sizable and control 53% of the overall market share. There are strict disclosure rules and information on market participants is available to the public. Capital adequacy ratios have normally ranged between 10% to 14%, with a capital to assets ratio of 9.7% in 2015. The rate of non-performing loans is rather low (2015: 1.7%).

In a 2016 analytical note, the International Monetary Fund found the banking sector sound and in a good position to absorb a range of shocks, although it singled out low profitability and high exposure to foreign exchange exposure as vulnerabilities. The Programa Estado de la Nación reports that banking spreads in Costa Rica are twice as large as those prevailing in international markets, and this has kept local currency interest rates stubbornly high. It estimates that the average ratio of operating expenses to net revenues over the last decade has been almost ten percentage points higher for Costa Rican banks than the international benchmark. The IMF associates this low level of operational efficiency to distortions like the explicit guarantee given by the state to all local currency deposits in state banks, which creates an unequal playing field between public and private banks. This allows state banks to engage in oligopolistic practices, capturing up to 70% of the market for local currency deposits, and keeping interest rates higher than they would be in a more competitive context. No reforms have been proposed to date that would correct these inefficiencies.

There is also a development banking system in place aimed at micro-enterprises and small to medium entrepreneurs, established in 2008 and modified in 2014. It aims at providing “development loans” with lower cost and laxer collateral requirements. Funding comes from various sources, including a 17% levy on demand deposits that private banks must transfer to state banks.

Banking system



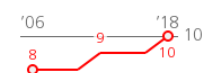
8 | Currency and Price Stability

Monetary policy has been directed toward consolidating the low inflation rates maintained since 2009, while exchange-rate policy has aimed at maintaining stability in a context of market determined exchange rates through a managed band system. Monetary policy was moderately expansive in 2015, but, according to the IMF, this was appropriate given the low levels of inflation and unrealized economic growth potential. Inflation was virtually absent in the past two years, at -0.81% in 2015 and 0.7% in 2016. This was due primarily to low international commodity prices during the period, especially oil, which was down almost 70% from 2014 to 2015. The central bank lowered its nominal monetary interest rate from 5.25% to 1.75% in January 2016. The IMF estimates the country's current neutral monetary interest rate to be around 4.6%, so this policy shift is indeed expansionary, but not so much that it will endanger the price stability observed over the past two years. The central bank has publicly affirmed that its main policy objective, as defined by law, is containing inflation, and that its main policy instrument – the monetary interest rate – will be targeting price stability. The currency was flat in 2015 as the colón devalued by only 0.7%, but that rate grew to about 3% in 2016 as the demand for dollars increased with a rising level of imports. Exporters have complained about an alleged loss of competitiveness due to the relatively stable exchange rates, and have called for higher devaluation. However, the central bank has held firmly to its inflation targets and a policy of intervention in the currency market solely to avoid excessive fluctuations of the colón within its targeted bands.

Costa Rica has not managed to reverse the primary deficit-spending trends it embarked upon to confront the challenges of the 2008 financial crisis. Over the last 10 years, public spending has increased by 3.6% per year on average, while revenues have only grown at an annual average rate of 0.9%. The current administration has increased spending aggressively and, despite some improvements in tax collections, it has not been able to secure the tax increases it sought to reduce the deficit. In 2015 that deficit reached its highest level in 30 years, 5.9% of GDP. Public finances are on an unsustainable path as revenues are insufficient to cover primary expenditures (government spending minus interest on the debt). Structural factors, including generous annuities and salary supplements for public employees that are written into law, and are staunchly defended by powerful unions, make reductions in public spending difficult. New taxes face considerable political opposition in a fragmented congress that the government does not control. Barring a change in either of these circumstances, deficits are likely to continue to grow. As no money is left to pay interest after primary expenditures, it must be borrowed, leading to further increases in the debt burden, which is particularly alarming in a context of rising international interest rates. Central government debt increased from 28% to 42% of GDP from 2010 to 2015 and the IMF estimates that it could reach 69% of GDP by 2021 if current trends continue. A debt level above 50% of GDP is considered unsustainable for

Anti-inflation /
forex policy

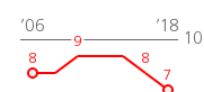
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Macrostability

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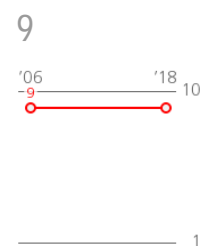
emerging economies. The World Bank reports that external debt stocks to exports increased from 70.55% in 2008 to 138.9% in 2015, highlighting the seriousness of the situation. Ratings for Costa Rican debt have been lowered by international agencies, most recently by Fitch, citing the negative trend of the debt, driven by growing fiscal deficits and an institutional blockage that impedes structural reforms.

9 | Private Property

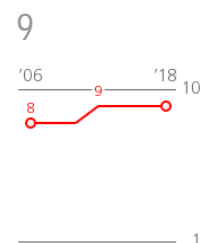
Property rights are secure and contracts are generally upheld. Rights and regulations associated with property acquisition, benefits, use and sale are well defined and enforced. Public interest exceptions may lead to an override of these rights, but always following due process and with adequate compensation. The government maintains appropriate registries and seeks to protect the individual property rights of its citizens and foreign investors. However, foreigners face specific property limitations in that they can only acquire a state concession property by entering a minority partnership with a Costa Rican citizen unless they have resided in Costa Rica for at least five years. While rights are guaranteed by rule of law, the judicial system can be slow in resolving legal disputes, limiting their effectiveness. As far as intellectual property rights, in its 2015 report the International Intellectual Property Alliance (IIPA) finds the Costa Rican music market prone to piracy, with no significant action forthcoming from the government to correct this.

Private companies are viewed as primary engines of economic production and are given appropriate legal safeguards, starting with the constitution. However, there is a long history of state involvement in the economy, which has included the preservation of legal public monopolies in several areas. The ratification of the CAFTA in 2007 and the implementation of its complementary laws opened most of these areas to competition, but not through privatization. State enterprises continue to compete alongside new private companies in telecommunications, electricity generation, insurance and banking, among others. While the playing field is not entirely level and state enterprises enjoy advantages – like an explicit state guarantee for deposits in state banks, or a cap that limits private electricity production – the entrance of private competitors has contributed to market expansion and improvement in quality. The state has also turned to private enterprises to execute and manage large infrastructure projects as concessionaires. Notable examples are the international airport, ports on both coasts, and major highways. Given the state’s budgetary limitations, this is likely to remain an area of continued growth for private investors.

Property rights



Private enterprise

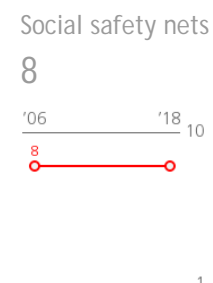


10 | Welfare Regime

There has been a broad and sustained effort to develop social safety nets capable of compensating for social risks and preventing poverty. Social investment by the state encompasses universal programs (health and education), contributive programs (pensions), and selective programs targeted to vulnerable segments of the population (conditional cash transfers and non-contributory pensions). Universal programs represent the largest share of public spending, accounting for a combined 26.3% of GDP in 2015 (6.7% in health, 7.7% in education, 7.1% in social protection, and 2.3% in housing). Health and pensions are managed by the social security organization (CCSS), which is funded mostly through tripartite payroll contributions complemented by government transfers. The coverage of universal services is high, about 78% of the economically active population in health, and 71% in pensions, with most of the remaining population (up to 95%) covered as dependents and/or beneficiaries of selective programs. Health indicators for the population in 2015 are very positive, with life expectancy for women at almost 82 years, and men at 77; under-five mortality rates at 10 deaths per thousand live births (compared to 18 for Latin America and the Caribbean, and six for developed countries); and maternal mortality rates at 25 per hundred thousand live births (compared to 67 for Latin America and the Caribbean, and 14 for the United States).

Despite this, social investment has been unable to reduce poverty below the 20% level or arrest an increase in income inequality. There is no unemployment insurance, although a modification of labor laws established a severance fund that contributes to the capitalization of an individualized account that workers can tap if they lose their jobs. It is also estimated that about 25% of the most vulnerable among the population are not covered by the programs that are designed to target them. There have been efforts at keeping students in school through AVANCEMOS programs and to increase the amount received by the non-contributive pension system.

In recent years, the CCSS has faced serious administrative and financial challenges. Its hospitals have struggled to keep pace with demand for specialized treatments as chronic diseases have displaced infectious diseases and the demographic transition underway increases the number of dependents relative to the working population. More recently, an actuarial study revealed that the reserve fund for the country's retirement and insurance system may become insufficient in a matter of years, if the contributive regime is not reformed. Likely reforms will require an increase in payroll contributions, a reduction in pension benefits, an increase in the minimum retirement age, or a combination of all three of these reforms.



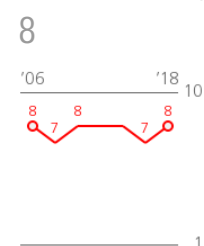
Costa Rican institutions strive to provide equality of opportunity, but with varying levels of success. Access to health care is broad with constant quality of service across different socioeconomic levels and, increasingly, over geographic area. But access to education is still far from universal. While 82% of the population 25 years of age or older had completed primary school in 2014, that percentage dropped to 55% for lower secondary school, and dropped further to 40% for upper secondary school. This means there is considerable desertion from the educational system at the secondary level. Recent results from the OECD's Program for International Student Assessment (PISA) also raise questions about the effectiveness of spending at this level. Its 2015 assessment showed lower scores with respect to 2012 in science, reading and mathematics. Costa Rican students were not the lowest in the Latin American region, but were outperformed by those in Argentina, Chile and Uruguay.

Women and members of ethnic or other minority groups have equal access to education, health and other services, but gaps in outcomes exist. The ratio of female to male enrollment (GPI) slightly advantages women, above all those with higher levels of education. Female labor participation is at 48% and has been rising, but the rate is 74% for men. Female representation in politics is also significant, at 35% of legislative seats in the 2014 election, although that number represents a slight reduction compared to the 2010 election, when it was 39%. This is despite a legal mandate to open a minimum of 40% of available electoral positions to females, which highlights how parity remains elusive, even with the existence of quotas and formal requirements. Only seven of the 22 Supreme Court magistrates are women (32%). Women earn about 18% less than men and fare worse under economic duress. They are especially disadvantaged when they are the sole breadwinners: 44% of households in poverty are female-headed. As for other minorities, higher levels of unemployment and lower human development in the province of Limón compared to other regions of the country suggest that populations of African descent have been disadvantaged in terms of equality of access to opportunity.

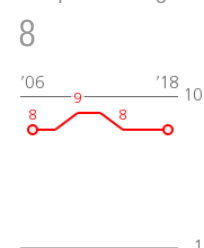
11 | Economic Performance

In 2015, Costa Rica had moderate GDP growth (3.78%) but relatively high unemployment (9.6%) and sluggish earnings growth (0.3%). GDP growth will increase to an estimated 4.3% in 2016, but no significant reduction in unemployment is expected (it was at 9.7% in the third quarter). One of the largest challenges faced by the country has been the inability to generate dynamic job opportunities in the domestic sector. The emphasis placed on foreign direct investment as a source of economic dynamism privileges exports with high technological content, which are skill-, not labor-intensive. However, most of the workforce is employed in low productivity sectors. The IMF has observed that the country has an abnormally high level of reliance on the service sector and that there is a lack of backward linkages in its export sector. This limits the extent to which larger portions of the workforce can

Equal opportunity



Output strength



be incorporated into the more modern sectors, and contributes to wage inequalities by keeping skill premiums high. The dependence on export markets also adds volatility to GDP growth.

The largest economic challenge the country faces going forward is closing the gap between government revenues and expenditures. The current level of its fiscal deficit, at almost 6% of GDP, is both destabilizing and unsustainable. It is already contributing to an acceleration of the public debt, which could become difficult to manage in a few years, if not corrected, and has garnered downgrades from international rating agencies. The central bank and the treasury estimate that, barring the passage of tax and spending reforms, the deficit will remain close to 6% in 2017. Given constitutional mandates, the rigidity of public spending and strong union opposition to spending reform, most of the adjustment will have to come on the revenue side. The IMF estimates that to place public debt levels back on a sustainable course and maintain public investment at levels that can support economic growth, the government needs new taxes in the range of 2.5%-3% of GDP. However, its proposed bills are mired in Congress and their prospects are uncertain, especially with the 2018 presidential campaign already starting to take shape.

Despite these challenges, most estimates suggest the pace of economic growth will be maintained close to the 4% level in 2017. All economic sectors are expected to grow, but services more strongly than agriculture and construction, with exports growing at 7%. Since this will maintain the pattern of economic activity followed to date, it is unlikely to significantly reduce unemployment. Given the partial recovery of oil prices and a slightly higher devaluation of the currency, inflation is expected to rise in 2017, but not above 2% (the central bank's target is 3% plus or minus one percentage point).

12 | Sustainability

Costa Rica has been recognized as a leader in environmental protection and conservation. The right to a healthy and ecologically balanced environment is constitutionally established (Article 50) and hence subject to enforcement through special environmental courts as well as the Constitutional Court. More than 25% of the territory is under protected status and the country recovered more than 30% of its forest cover over the last three decades. However, the country's record is more nuanced when analyzed from the perspective of its ecological footprint, waste management and the sustainability of its economic practices.

While the country generated 98% of its electricity from renewable sources in 2015, electricity only accounts for a quarter of the energy resources consumed. Of the remaining energy needs, 73% are filled mostly through highly contaminating hydrocarbons. As a result, greenhouse gas emissions outpace the country's absorption capacity, despite its goal of becoming carbon-neutral by 2021. Most residual water

Environmental
policy

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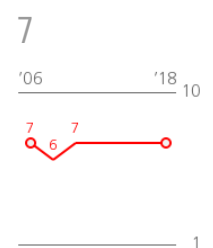
from homes and industries flows into rivers without treatment, impacting the country's Pacific basin with high levels of contamination. The Programa Estado de la Nación notes that there are legal and organizational resources in place designed to regulate and control these issues, and that their persistence is due to governmental inertia. In 2015 this was partly countered by the opening of Los Tajos, a solid waste treatment plant expected to cover over a million people in the San José metropolitan area. Yet, at the same time, most buildings (77%) rely on septic tanks to treat their water, which creates risks of seepage into subterranean water sources, and only 16% of the treatment plants installed by industries are actively monitored by the government. In the transportation sector, which accounted for 54% of energy consumption in 2015 and is the main source of carbon emissions, there are no public policy proposals to redirect the country toward a greater reliance on public transportation and clean fuels. As far as the sustainability of economic practices, the expansion of export-based agriculture has driven intensive use of fertilizers and pesticides and placed new pressure on water sources.

Costa Rica ranked fifth worldwide in the 2012 Environmental Performance Index (EPI), but 54th in 2015. The Programa Estado de la Nación explains that this precipitous drop was due to the expansion of the index to include new variables covering residual water and emissions management, two areas in which (as mentioned above) Costa Rica is particularly weak. In the 2016 EPI, Costa Rica ranked 42nd among 180 countries, a significant improvement relative to 2015, but not quite at the level of 2012. The 2016 ranking does place Costa Rica as first in the Latin American and Caribbean region.

Education is a key component of social policy, with preschool and general basic education (until the ninth grade) obligatory, universal, and free, and the public budget for education at all levels constitutionally mandated at a minimum of 8% of GDP (Article 78). As a result, literacy rates exceed 97% of the population aged 15 and over, and there is a complex institutional network devoted to education at the primary, secondary, and tertiary levels. While universal coverage has been achieved at primary level, only 88% of the eligible population (ages 13 to 17) is enrolled at the secondary level, and dropout rates are close to 9% (2015). The average number of years of education among economically active members of population over 15 years of age was 9.5 in 2014. Recent administrations have increased spending in education, which reached 7.7% of GDP in 2015, approaching the 8% constitutionally mandated level.

However, some indicators suggest this spending may not be entirely effective: only 55% and 40% of the population 25 or older had completed secondary school at the lower and upper levels, respectively; international testing results in 2015 showed scores for fifteen-year-olds had fallen relative to 2012 in science, reading and math; and 14% of young people (15 to 24) in 2015 were neither working nor studying. The percentage of those 18 or older able to complete secondary education in 2015 was 40% for women and 36.8% for men. Investment in research and development remains

Education policy /
R&D



low, at around 0.56% of GDP (2013), barely a quarter of the target level in developed economies.

The country is host to high-tech companies, many of which have invested considerably in research facilities, most notably INTEL Corporation and AD-ASTRA Rocket Company, among others. Public and private universities also engage in considerable research activities. The extent to which this can be increased to scale and produce greater linkages and spillovers for the economy remains unclear. This is one of the stated goals of the country's Ministry of Science, Technology, and Telecommunications. In its National Plan for Science, Technology, and Innovation 2015-2021, it recognizes the need to foster interaction between private and public research centers to transfer technology toward productive sectors and improve competitiveness.

Governance

I. Level of Difficulty

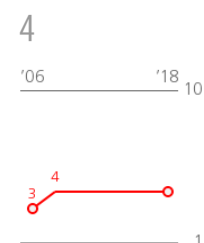
Stagnant poverty rates, rising inequality, fiscal rigidities, a fragmented and fluid party system, and a byzantine network of public institutions and regulations are the main structural constraints on governance capacity. While poverty fell by two percentage points between 2014 and 2016, permanently breaching the 20% threshold has not been possible. At the same time, inequality levels relinquished gains made in 2014 and 2015 to almost return to their highest level in the past 30 years. That this has occurred despite rising social spending and sustained social safety net policies, suggests a high level of difficulty is constraining the governance capacity of political leaders in these areas.

A rigid spending structure beset by constitutional mandates, automatic salary increases, generous pensions and recalcitrant public unions limits the containment of expenses. Revenues have increased through better tax collection, but one administration after another has been denied tax increases to balance the budget. The result has been a public debt burden that is growing at unsustainable rates and could become destabilizing.

This inability to pass reforms is itself the result of a party system that has become increasingly fragmented and polarized. Executives arrive in power without legislative majorities and the system lacks appropriate incentives to foster governing coalitions capable of generating a consensus. This seeps down into other critical areas of governance, especially the development and execution of key infrastructure projects necessary to sustain economic growth, which suffer chronic delays and cost overruns. High school desertion rates and low test scores could limit the opportunities of a significant number of young Costa Ricans, becoming structural constraints in the future. High unemployment rates and the inability to broaden job opportunities across the skill base may have a similar effect.

An intricate and overgrown network of state institutions with multiple veto points makes transformation challenging and slow. Infrastructure projects, for example, are slowed down for years or even stopped by permitting needs, bureaucratic requirements and legal challenges. Mechanisms established to ensure horizontal accountability, like the comptroller's and ombudsman's offices, while necessary to

Structural
constraints



avoid corruption and ensure individual rights, can make the government inefficient. The country has been unable to find a balance between effectiveness and probity in the public sector.

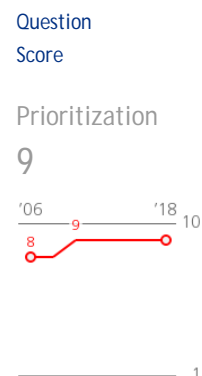
Traditions of civil society are strong. There are about 19,500 civic associations, 291 unions, 725 cooperatives, close to 1,400 solidarist associations, and more than 3,600 community development associations registered in the country. However, opinion polls suggest that the degree to which individuals engage with those organizations is not high. The level of self-declared interpersonal trust among citizens, an indicator of social capital, is about average when compared to other countries in the Latin American Opinion Project. There is a considerable level of citizen participation that occurs outside of formal organizations, as evidenced by levels of collective actions – public declarations, meetings and assemblies, public manifestation – reported by the media. In 2015, 28% of these were undertaken by unaffiliated citizen groups.

There are no violent incidents based on social, ethnic or religious differences. Some contentious social and economic policy issues have generated conflict, but these have typically been resolved through institutional channels, without greater incident. There are significant levels of popular mobilization to protest policies and exert pressure for political and socioeconomic goals, although they have diminished since the beginning of the Solís Rivera administration. Recent mobilizations include marches for post-material objectives, notably gender equality, animal rights and environmental issues. The environmental category accounts for almost 15% of all collective actions and involves diverse issues including water usage, coastal and marine resources and industrial agricultural practices. While most protests target the state and often involve street blockages, police violence and repression are rare.

II. Governance Performance

14 | Steering Capability

The executive is required by law to specify its strategic priorities in a national development plan (Plan Nacional de Desarrollo), with detailed goals and objectives for all government institutions, divided by sectors and regions. The Ministry of Economy and Planning (MIDEPLAN) is tasked with development, execution and coordination of the plan, which articulates the executive’s agenda for the four-year duration of the presidential term. There is a national evaluation system that follows the plan through its execution and the comptroller general also evaluates it periodically. The 2015-2018 development plan emphasizes three main goals: promoting economic growth and generating quality jobs; combating poverty and



reducing inequality; and fighting corruption through open government, transparency and efficiency.

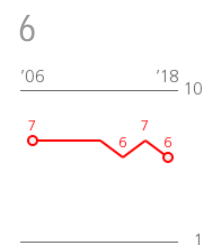
The government also vowed to streamline the implementation of long-delayed infrastructure projects that have become a drag on the country's economic growth. In the fiscal realm, the Solís administration declared it would gain the public's trust during the first half of its term by increasing public efficiency – particularly in tax collection and government spending – and the accountability of public officials. In its estimation, this would lay the groundwork for the pursuit of fiscal reforms in the second half of the administration. While it tried to make tax increases more palatable by combining them with reforms that would restrict and rationalize public spending, both sets of reforms have for the most part failed to advance in the legislature.

The current executive depends on a legislature controlled by its political opponents to pass reforms and this has limited its ability to advance its priorities. It has the lowest rate of success for legislature approval of bills submitted by the executive since 1990. Two notable reforms that did get through the legislature were bills that had been under discussion for several years, reflecting priorities carried over from previous administrations. These were the revamping of the civil and labor procedural codes, which are expected to increase judicial efficiency and to reduce the duration of trials by introducing oral procedures.

In its National Development Plan, the Solís administration defined concrete goals for each of its three main objectives. For its first objective, generating faster economic growth with greater and better employment, it projected real GDP growth of 4% in 2015 and 5% in 2016, and a reduction of the unemployment rate to 8.35% in 2015 and 8.05% in 2016. While economic growth has been positive, actual results have fallen short of these goals, with real GDP growth reaching 3.78% in 2015, and a likely 4.3% in 2016. Unemployment was not far from the goal when measured at the mid-year point, as the plan does, where the rate reached 8.5% in 2015 and 7.8% in 2016. However, it remained close to 9.6% toward the end of the year in both 2015 and 2016.

For its second objective, reducing general and extreme poverty while reducing inequality, the government set goals of obtaining Gini coefficients of 0.5099 and 0.5094 in 2015 and 2016, respectively, and reducing the total number of households in extreme poverty to 47,405 in 2015 and 42,000 in 2016. While the government was able to reduce overall poverty by two percentage points in this period, the percentage of households in extreme poverty in 2016 was virtually unchanged from 2014. Results fell short of the specified goals as the number of households in extreme poverty actually rose in 2015, to 104,702, and then fell to 95,004 in 2016, more than twice the goal and slightly higher than its 2014 level (94,810). Goals for inequality were also unmet as the actual Gini coefficients were considerably higher: 0.516 for 2015 and 0.521 for 2016.

Implementation

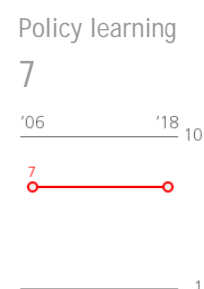


For its third objective, fighting against corruption and strengthening transparency and efficiency, the government's goal is to score 62 and 63.6 in Transparency International's Corruption Perception Index for 2015 and 2016, respectively, and 0.65 and 0.77 in the World Bank's government effectiveness index for 2015 and 2016, also respectively. While Costa Rica's ranking in the Corruption Perception Index did improve for the two years under study, the scores fell significantly short of their goals, registering 55 for 2015 and 58 for 2016. For the government effectiveness index, the latest data showed the country's score in 2015 (0.38) fell relative to its 2014 level, distancing it substantially from the established goal.

In more general terms, the government was unable to pass any of the reforms it considered essential for managing the fiscal crisis besetting the country. On the revenue side these reforms include the conversion of the sales taxes into a value-added tax, a revamping of income taxes, and the reinstatement of a levy on corporations passed during the previous administration but declared unconstitutional on procedural grounds. However, the government had some success increasing revenues through administrative measures. Revenues increased by 5.8% in 2015, the equivalent of 0.5% of GDP, an unprecedented amount for the country in recent periods, mostly as a result of improvements in the collection of income tax. On the expenditure side, the principal reforms seek to limit emoluments in the public sector and cap general spending through the introduction of a fiscal responsibility rule. The government completed some important infrastructure projects, but not to the extent that it could claim a substantive reversal of the backlog besetting the country in this area.

In developing policy responses, the government usually relies on best practices, international cooperation and expert advice. An example of policy learning is the shift away from unfunded mandates in the bills approved by the legislature over the past two years. According to the Programa Estado de la Nación, between 1990 and 2016, Congress passed 879 bills creating or extending individual rights, but did not specify sources of revenue to fulfill those mandates in 51% of the cases. This trend was averted in 2015 and 2016. Among new or extended mandates, 47% had a specified source of funding compared to 41% that did not. Estado de la Nación suggests that the intense discussion generated by the country's fiscal crisis may have resulted in a heightened consciousness about the responsibility entailed by enactments that increase public spending, a clear indication of policy learning.

There are sufficient institutional mechanisms in place to allow the government to replace failed policies with innovative ones, including the constant monitoring and evaluation of policies through the comptroller's office and various other supervisory agencies. However, the time lag between policy enactments and evaluations is sometimes considerable, blunting the effectiveness of those mechanisms. Over time the state has developed a highly sophisticated apparatus for generating and tracking statistical information that includes the National Institute for Statistics and the Census



(INEC), the central bank, and others. The prompt and highly reliable statistics generated by these entities provide the feedback necessary for policy learning and adjustment throughout the various parts of the state. The government also relies on the scientific output and academic expertise provided by labs and research centers at public universities. A vital source of analysis for policy learning and innovation is the Programa Estado de la Nación, a research center funded by the rectors of the country's public universities (CONARE). However, instances abound where policy failure is compounded by the inability of the state to innovate and adapt quickly. For example, rail transportation was abandoned hastily in the 1990s, and its infrastructure was left to deteriorate at great cost. It was reintroduced some years ago as an alternative for interurban transportation. However, rail crossings were not equipped with necessary rail guards or warning systems. Despite the predictable collisions – and loss of life and property – that have occurred over the years since, this situation has yet to be corrected.

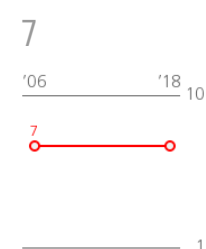
15 | Resource Efficiency

Highly complex administrative structures stand in the way of efficient government use of human and financial resources. The public sector is composed of over 300 entities of diverse juridical and functional nature. The 19 ministries of the executive are subdivided into 80 subunits with different degrees of financial and administrative autonomy. This poses great challenges for coordination, management and control. Politicians and opinion leaders have repeatedly pinpointed the need for state reform, but it has been elusive.

While the country has a long-established civil service (1951), it does not encompass all public-sector employees and its relative effectiveness varies across areas. In some cases, it guarantees merit-based professionalism while in others it is a source of rigidity and constraint. Given the practical impossibility of firing a civil service employee, many entities have devised ways to hire around it, creating enclaves of variant dynamism within the state. Strong public sector unions have obtained concessions over the years that have raised average levels of compensation in the public sector well above those in the private sector. These benefits include seniority clauses and other statutory recognitions – for continued education, or exclusivity, for example – as well as special severance packages. They are compounded by defined benefit pension regimes for different public employees where costs far exceed individual contributions and must be paid out of the state budget. Altogether, this has had a snowball effect on public spending that has seriously limited resource efficiency. The World Bank placed Costa Rica around the 67th percentile in its government effectiveness index for 2015.

The state budget has been rising at unsustainable rates due mostly to increases in the debt service and public salaries. Debt service has grown as a result of persistent fiscal

Efficient use of assets

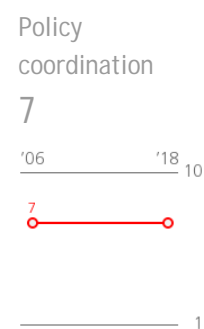


deficits, which have increased the debt stock from 28% (2010) to 42% (2015) of GDP. Salaries have also increased at fast rates due to indexing built into public sector labor contracts. The state's ability to control expenditures is limited by these forces, but also by constitutional and legal mandates that require it to channel close to 10% of GDP to specific uses like funding the Judiciary and public education, among others. As a result, over 87% of the budget is consumed by transfers, salaries and debt service. If these trends continue, the IMF estimates that the public debt could approximate 70% of GDP by 2021.

At the level of the executive the government has the necessary tools to coordinate conflicting objectives into a coherent scheme, but the state apparatus is too unwieldy to allow for simple policy implementation. Since the president names ministers without being subject to ratification, he commands the direct loyalty of his cabinet and is at liberty to organize and coordinate it as he deems necessary.

Among the mechanisms employed to ensure coordination are regular cabinet meetings (Consejo de Gobierno) where government priorities are set and discussed, the designation of special ministers to coordinate policy across sectors, and the ability to create inter-ministerial councils. But the complexity of the public sector and its fragmentation into multiple organizations and agencies pose difficult coordination challenges that sometimes threaten the coherence of policies. A salient example is the environmental sector where, despite an increase in regulatory statutes, enforcement often lags due to institutional weakness and confusion among multiple organizations with overlapping jurisdictions and redundant functions. Institutional coordination has also been lacking in the areas of foreign policy, territorial planning and rural development.

While there are institutional mechanisms, like the Ministry of the Presidency, designed to facilitate coordination with the legislature, loose party discipline and the emergence of competing factions within the main parties, including that of the executive, have made harmonization of objectives challenging. The executive's main tool for advancing the discussion of its policy priorities is its prerogative to set the legislative agenda twice yearly during so-called extraordinary sessions. The Programa Estado de la Nación interprets the frequency with which the executive includes, and then removes, a given bill from the agenda within the same extraordinary session as a measure of relative stability. Frequent alterations of the docket indicate an unstable agenda, with bills subject to constant strategic retraction and political negotiations. This instability has increased with the level of party fragmentation in the legislature, and reached its apex under the current administration. It may partially explain why the current government has the lowest rate of approval for bills submitted by the executive since 1990.



Costa Rica has laws and regulations against corruption and has ratified international treaties like the Inter-American Convention Against Corruption and the U.N. Convention Against Corruption that commit the country to combat corruption. Criminal prosecution of corruption is spearheaded by the Attorney General (Fiscal General) and a special criminal investigative police force (OIJ). A special state office (Procuraduría de la Ética) functions as an anti-corruption watchdog for the public sector, and the Comptroller General exercises strict financial and administrative oversight over all public entities, approving or rejecting contracts and public bids, performing audits and detecting instances of corruption. Most public entities also have internal auditors who closely monitor their spending. These regulators ensure the transparency of the procurement process, although they also make it cumbersome and slow, one of the factors that has encumbered the public sector's managerial capacity in areas like infrastructure.

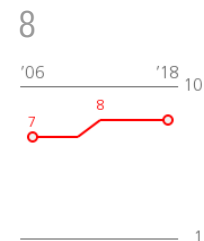
The constitution (Article 30) guarantees public access to all information pertaining to the state and its entities, and most public entities provide the media and citizenry access to their information. However, state entities have alleged state secrecy, an exception allowed by law, to deny public access to sensitive information. State-owned enterprises have also withheld information claiming the need to secrecy in order to remain competitive against the private sector. The final arbiter on the matter is the Constitutional Court. For example, in 1993 it ruled that the salaries of public officials could not be treated secretly, and upheld that criterion in several challenges to the ruling. In 2016 it ruled that the state electricity and telecommunications company (ICE) could treat some of its financial information with secrecy, but only where expressly permitted by law, and for a limited and reasonable period of time.

The criminal code establishes prison sentences of up to 10 years for public officials convicted of receiving bribes. A strict anti-corruption law was passed in 2004 in response to corruption scandals involving high-ranking officials, including three ex-presidents. It established stricter reporting requirements for public officials, including the disclosure of personal assets and conflicts of interest. The exposure of such cases evidences the willingness of officials to investigate, denounce and pursue corruption, along with a vigilant and assertive media. However, prosecutions are lengthy and often result in failed convictions or suspended sentences. Opinion surveys reflect a generalized perception that government efforts to combat corruption are insufficient, with up to a fifth of respondents in the 2014 Latin American Public Opinion Project identifying corruption as the most important problem confronting the country.

Party financing is strictly regulated by the Supreme Electoral Tribunal and an electoral code that was revamped in 2009 to strengthen applicable restrictions and improve transparency.

Currently the Legislative Assembly is discussing an initiative (dealt with under File 20,246) which would reform Article 62 of the Law against Corruption and Illicit Enrichment in Public Service in order to declare crimes of corruption exempt from the statute of limitations.

Anti-corruption policy



16 | Consensus-Building

All major actors agree on the goal of consolidating democracy. The country has a longstanding democratic tradition that is a source of national pride. In recent years, the level of public approval for democracy has fallen due to popular discontent with public corruption, economic performance and political dysfunction. The Latinobarómetro Survey (2015) finds that almost 70% of respondents believe the country is governed in the interest of powerful groups, rather than the people, and 75% consider the distribution of income to be unfair or very unfair. However, studies have shown that those dissatisfied with democracy at levels that could challenge its stability are relatively few. These citizens tend to question the country's exceptionalism as a peaceful, green and prosperous republic, but do not necessarily challenge these as desirable ideals. In a more general sense, dissatisfaction has taken shape in a fluid and fragmented party system that is seeking to, but has yet been unable to, reconstitute itself. This may be viewed as a healthy questioning of specific policies and administrative failures, rather than a broader questioning of democracy, that could serve as a catalyst for transformation in a mature democratic context.

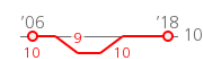
All major actors agree on the goal of consolidating a market economy, although there is some disagreement regarding the extent of state involvement in economic activity. Public sector unions have traditionally contested market-based competition in certain sectors, and continue to support state monopolies where they exist, as in the electricity sector. Together with political parties on the left, they question the motives of multinational capital and the value of global insertion. However, political consensus has resulted in a general transformation trend toward an increase in market-based competition. All major actors do share a consensus that extended social protection should exist as an integral component of the market economy.

There are no anti-democratic veto actors with anti-democratic interests, such as the military or influential economic actors. Some social movements oppose reform through extra-parliamentary and sometimes contentious means, but not with anti-democratic intent.

The political leadership has prevented cleavage-based conflict from escalating by promoting dialog and respect for the country's democratic traditions. The dominant emergent cleavage is between those who benefit from the socioeconomic order and those who feel excluded, as well as those who do not consider themselves adequately represented by or are disillusioned with the existent political institutions. Political parties are no longer the sole channel for interest aggregation and political

Consensus on goals

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Anti-democratic actors

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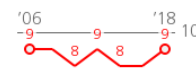


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Cleavage / conflict management

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representation. They have been joined by social movements as citizens mobilize and engage in various forms of political expression to pursue specific causes and protest injustices. While contestation may in certain instances have become more conflictual, it has always remained within institutional boundaries. The state, often the object of protest itself, has been respectful of democratic rights and has generally refrained from repression.



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The political leadership enables civil society participation in many areas and assigns an important role to civic leaders in policy discussions, but also shows a tendency to engage in top-down agenda setting and policy formulation. Various spaces have been created to enable the participation of civil society. When new laws are enacted or existing laws reformed, it is typical for the organized representatives of sectors affected by the laws to voice their concerns before legislative committees. Some government policies, like those governing minimum wages and salary increases, are defined in consultation with the organized representatives of workers and employers. There are also examples of participatory policy-making at the local level, such as the formulation of county plans for local human development, the constitution of citizen audits, and some level of participatory budgeting. Social movements are another form of civil society participation, and they take part in hundreds of marches and protests each year. Yet, low levels of citizen engagement with formal organizations, at least according to opinion polls and regional comparisons, seem to suggest that more could be done to enable civil society participation. For example, civic groups could be engaged in the assessment of the social and environmental impacts of projects in the planning and development of zoning regulations, as well as other activities at the local level.

Civil society participation

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The country has not experienced major historical injustices of the type covered by this question.

Reconciliation

n/a



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17 | International Cooperation

The political leadership makes well focused use of international assistance to implement its long-term development strategy. In its National Development Plan the government recognizes the importance of international cooperation and highlights the possibility of joining new international forums, such as the OECD and Pacific Alliance, as a potential source of new opportunities in this area. The current administration has emphasized a South-South cooperation model, centered on exchanges of information, technology, and general knowledge between countries

Effective use of support

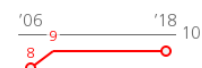
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with comparable development levels. Costa Rica has established such cooperative agreements with Mexico, Argentina, Chile, Uruguay, Perú and Colombia. As a middle-income country, Costa Rica has seen a considerable reduction in direct flows of international assistance, with the emphasis shifting away from concessionary aid to international loans. Traditionally, most cooperation has come from multilateral organizations, primarily the Inter-American Development Bank, the Central American Bank for Economic Integration and the World Bank. More recent flows have seen an increase in bilateral cooperation, mainly from China, but also Japan, Germany, South Korea, the United States, the Netherlands and Spain. Most of the funding from these sources has been destined for four sectors: energy and environment, public works and transportation, economic and financial development, and health and social development.

However, the political leadership has so far not managed to fruitfully adapt international advice to confront its precarious macrostability problems, which are seen as the main obstacle for socioeconomic advance, as the IMF has repeatedly warned.

Costa Rica has traditionally exerted an outsized international influence relative to its physical and economic power. It has represented Latin America as a temporary member of the United Nations Security Council on three occasions. It has also promoted international treaties and conventions in the areas of arms control, disarmament, international cooperation and environmental protection. The government pursues the promotion of human rights, peace and democracy as a matter of foreign policy. Together with trade and sustainable development, these issues dominate the agendas of its diplomatic missions abroad and in international forums. The country is in good standing with international financial institutions, although its debt ratings have been downgraded in recent months by international rating agencies due to its deteriorating fiscal position. The country is also now in compliance with a ruling from the Inter-American Court on Human Rights ordering the restoration of in-vitro fertilization procedures.

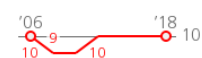
The political leadership actively and successfully builds and expands cooperative neighborly and international relations, although it has faced some challenges in recent years with its northern neighbor, Nicaragua. The country is part of the Central American Integration System (SICA) and has traditionally been an active participant, although in 2015 President Solís pulled the country out of the political mechanisms of the organization for six months, while remaining in the economic and integration system. This was to protest the unwillingness of partner members to assist with a humanitarian crisis produced when Cuban migrants en route to the United States were stranded on Costa Rican soil after Nicaragua denied them overland passage. The country is also engaged in different initiatives to build and expand cooperation with regional neighbors. It is a member of the CAFTA and belongs to the Community of Latin American and Caribbean States (CELAC), in which it served as president pro



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Credibility

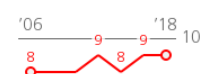
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Regional cooperation

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tempore in 2015, hosting the organization's summit in San José. The country has also signed a Cross Border Cooperation Agreement with Panamá to facilitate binational cooperation in multiple fields. While there is no similar agreement with Nicaragua, there are a series of bilateral commissions to promote cross-border development and coordination. Regional coordination has also been advanced through the Central American Rural and Territorial Development Strategy (ECADERT), an initiative under SICA of which Costa Rica is part. The strategy establishes transborder territories to facilitate rural development and capitalize on joint opportunities. Costa Rica does not participate in the Central American Parliament or the Central American Court.

Efforts to strengthen ties with the rest of Central America have been obstructed by the incursion of Nicaraguan troops into Costa Rican territory starting in 2010, as this has hindered the level of harmony within regional integration institutions. This led to disputes before the International Court of Justice in The Hague which eventually confirmed the violation of Costa Rica's sovereign territory and ordered Nicaragua to pay an indemnity for the environmental damages caused by its dredging activities on Costa Rican soil. However, tensions continue as Nicaragua has questioned the amount of the indemnity and refused to tender payment, and new incursions by Nicaraguan soldiers into Costa Rican soil have occurred as recently as January 2017.

Strategic Outlook

For Costa Rica to maintain its significant accomplishments in the economic, social and political realms, and further deepen them in the future, it must tackle the structural limitations that increasingly threaten progress. This will require a set of administrative reforms to enhance the state's execution and implementation capabilities and a set of political reforms to improve representation, strengthen the accountability of legislators and encourage better coordination between the executive and the legislative branches.

The Costa Rican state continues to expand in scope, adding layers of organization, producing a vast institutional structure that is difficult to coordinate and control. Correcting this should not mean gutting the state of key functions but rather strengthening capabilities so that it may operate more rationally and expeditiously, particularly in key currently weak areas such as infrastructure, citizen security, secondary education, solid waste disposal and transportation. Budgetary controls must be implemented to ensure the rationality and efficiency of all expenditures. But adequate, perhaps even greater resources are also necessary. Strengthening the state while balancing fiscal revenues and expenditures is the greatest challenge the country faces going forward, as the current deficit becomes increasingly unsustainable. So far, the political barriers to tax and spending reform have seemed insurmountable. Yet, inaction may prove the worst choice as public indebtedness continues to rise, leading to economic instability and possibly crisis and contraction, at significant social cost.

Political reforms are also necessary in order to improve the quality and responsiveness of representation. Costa Rican society has grown and become more plural, urban and educated. This richer social context must find representation in the country's political institutions if trust in the political system is to be restored. While there are many options in terms of institutional design, there are some general objectives that should be targeted. For one, representation should be proportional to the size of the population. In Costa Rica, the number of deputies has not changed since 1961, despite a trebling of the population. For another, representatives should have incentives to build political careers in the legislature, developing a record and demonstrating their accountability to the electorate. This is currently inhibited by a ban on continuous reelection that precludes specialization and hampers learning from experience, negatively impacting the quality of representation and legislation. Finally, institutional mechanisms should foster the strengthening of political parties and facilitate the creation of legislative majorities, something the current political system does not do well.

There could also be gains from fine-tuning parliamentary procedures. Cross-national comparisons show that the Costa Rican legislature is unduly permissive in several procedures, including the use of the floor and the submission of amendments. Together with the ability to consult the constitutionality of bills, this often leads to unduly obstructionist tactics. Reforms should aim to provide an institutional environment that, while inclusive, also fosters negotiation and consensus, thereby lessening the relevance of obstructive tactics. A more coherent legislature with improved

mechanisms for coordination with the executive would likely foster a rebalancing of power among the branches, lessening the need for judicial adjudication.

Increased avenues for direct citizen participation should complement these reforms. While the plebiscite, referendum and popular initiative have been added to the Costa Rican political system, increasing the venues for citizen participation might well contribute to the accountability and responsiveness of elected representatives. Examples include the use of participatory budgeting, health and education councils, other forms of participative innovation at the local level and more effective decentralization, coupled with the development of stronger capabilities at the municipal level.

It is also important to pay attention to the international context and Costa Rica's strategy for trade liberalization. Costa Rica has been successful in signing trade agreements but not so much in managing those agreements. Improvements in the capabilities of managing agreements must take place.